



**Alabama**  
*Farm Credit*

2018 ANNUAL REPORT



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## REPORT OF MANAGEMENT

The consolidated financial statements of Alabama Farm Credit, ACA (the Association) are prepared by management, who is responsible for the statements' integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. Other financial information included in the annual report is consistent with that in the consolidated financial statements.

To meet its responsibility for reliable financial information, management depends on the Farm Credit Bank of Texas' and the Association's accounting and internal control systems, which have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded and transactions are properly authorized and recorded. The systems have been designed to recognize that the cost of controls must be related to the benefits derived. The consolidated financial statements are audited by PricewaterhouseCoopers LLP, independent accountants, who also conduct a review of internal controls to the extent necessary to comply with auditing standards solely for the purpose of establishing a basis for reliance thereon in determining the nature, extent and timing of audit tests applied in the audit of the consolidated financial statements in accordance with auditing standards generally accepted in the United States of America. The Association is also examined by the Farm Credit Administration.

The board of directors has overall responsibility for the Association's systems of internal control and financial reporting. The board consults regularly with management and reviews the results of the audits and examinations referred to previously.

The undersigned certify that we have reviewed this annual report, that it has been prepared in accordance with all applicable statutory and regulatory requirements, and that the information contained herein is true, accurate and complete to the best of our knowledge or belief.



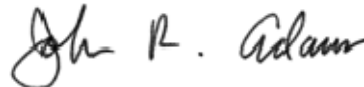
Mel Koller, Chief Executive Officer/President  
*March 13, 2019*



Matthew Christjohn, DVM, Chairman, Board of Directors  
*March 13, 2019*



Karri H. Sumrall, Chief Financial Officer/Ex. Vice President  
*March 13, 2019*



John R. Adams, CPA, Chairman, Audit Committee  
*March 13, 2019*

## REPORT OF AUDIT COMMITTEE

The Audit Committee (committee) is composed of John R. Adams, CPA, Larry Don McGee and Matthew J. Christjohn, DVM, who are directors of Alabama Farm Credit, ACA. In 2018, ten committee meetings were held. The committee oversees the scope of Alabama Farm Credit, ACA's system of internal controls and procedures, and the adequacy of management's action with respect to recommendations arising from those auditing activities. The committee's approved responsibilities are described more fully in the Audit Committee Charter, which is available on request or on Alabama Farm Credit, ACA's website. The committee approved the appointment of PricewaterhouseCoopers LLP for 2018.

Management is responsible for Alabama Farm Credit, ACA's internal controls and the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. The consolidated financial statements are prepared under the oversight of the committee. PricewaterhouseCoopers LLP is responsible for performing an independent audit of Alabama Farm Credit, ACA's consolidated financial statements in accordance with auditing standards generally accepted in the United States of America and for issuing a report thereon. The committee's responsibilities include monitoring and overseeing these processes.

In this context, the committee reviewed and discussed Alabama Farm Credit, ACA's audited consolidated financial statements for the year ended December 31, 2018 (audited consolidated financial statements) with management and PricewaterhouseCoopers LLP. The committee also reviews with PricewaterhouseCoopers LLP the matters required to be discussed by authoritative guidance, "The Auditor's Communication with Those Charged with Governance," and both PricewaterhouseCoopers LLP's and Alabama Farm Credit, ACA's internal auditors directly provide reports on significant matters to the committee.

The committee discussed with PricewaterhouseCoopers LLP its independence from Alabama Farm Credit, ACA. The committee also reviewed the nonaudit services provided by PricewaterhouseCoopers LLP and concluded that these services were not incompatible with maintaining the independent accountant's independence. The committee has discussed with management and PricewaterhouseCoopers LLP such other matters and received such assurances from them as the committee deemed appropriate.

Based on the foregoing review and discussions and relying thereon, the committee recommended that the board of directors include the audited consolidated financial statements in Alabama Farm Credit, ACA's Annual Report to Stockholders for the year ended December 31, 2018.



John R. Adams, CPA, Chairman  
March 13, 2019



Larry Don McGee, Member  
March 13, 2019



Matthew Christjohn, DVM, Member  
March 13, 2019

**ALABAMA FARM CREDIT, ACA**

**FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA**

(unaudited)

(dollars in thousands)

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
<b>Balance Sheet Data</b>					
Assets					
Cash	\$ 49	\$ 339	\$ 11	\$ 42	\$ 85
Loans	794,416	729,419	672,097	624,847	560,348
Less: allowance for loan losses	4,010	3,778	3,698	3,782	3,775
Net loans	790,406	725,641	668,399	621,065	556,573
Investment in and receivable from the Farm Credit Bank of Texas	14,315	12,519	11,733	10,275	8,982
Other property owned, net	1,025	2,492	2,064	1,454	1,503
Other assets	14,448	12,570	11,647	10,676	9,736
Total assets	<u>\$ 820,243</u>	<u>\$ 753,561</u>	<u>\$ 693,854</u>	<u>\$ 643,512</u>	<u>\$ 576,879</u>
Liabilities					
Obligations with maturities of one year or less	\$ 14,854	\$ 14,784	\$ 14,187	\$ 12,050	\$ 11,195
Obligations with maturities greater than one year	688,446	628,639	575,404	533,625	475,760
Total liabilities	<u>703,300</u>	<u>643,423</u>	<u>589,591</u>	<u>545,675</u>	<u>486,955</u>
Members' Equity					
Capital stock and participation certificates	2,798	2,687	2,518	2,416	2,263
Unallocated retained earnings	114,166	107,957	101,909	95,672	88,200
Accumulated other comprehensive loss	(21)	(506)	(164)	(251)	(539)
Total members' equity	<u>116,943</u>	<u>110,138</u>	<u>104,263</u>	<u>97,837</u>	<u>89,924</u>
Total liabilities and members' equity	<u>\$ 820,243</u>	<u>\$ 753,561</u>	<u>\$ 693,854</u>	<u>\$ 643,512</u>	<u>\$ 576,879</u>
<b>Statement of Income Data</b>					
Net interest income	\$ 21,809	\$ 21,321	\$ 20,609	\$ 19,204	\$ 17,540
(Provision for loan losses) or loan loss reversal	(242)	(100)	11	(198)	(1,533)
Income from the Farm Credit Bank of Texas	3,159	2,602	2,496	2,277	2,050
Other noninterest income	762	384	370	335	1,021
Noninterest expense	(9,897)	(9,159)	(8,799)	(7,967)	(7,003)
Net income	<u>\$ 15,591</u>	<u>\$ 15,048</u>	<u>\$ 14,687</u>	<u>\$ 13,651</u>	<u>\$ 12,075</u>
<b>Key Financial Ratios for the Year</b>					
Return on average assets	2.0%	2.0%	2.2%	2.2%	2.2%
Return on average members' equity	13.2%	13.5%	14.0%	14.0%	13.3%
Net interest income as a percentage of average earning assets	2.9%	3.1%	3.2%	3.3%	3.4%
Net charge-offs as a percentage of average loans	0.0%	0.0%	0.0%	0.0%	0.1%

**ALABAMA FARM CREDIT, ACA**

**FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA  
(unaudited)  
(dollars in thousands)**

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
<b>Key Financial Ratios at Year End*</b>					
Members' equity as a percentage of total assets	<b>14.3%</b>	14.6%	15.0%	15.2%	15.6%
Debt as a percentage of members' equity	<b>601.4%</b>	584.2%	565.5%	557.7%	541.5%
Allowance for loan losses as a percentage of loans	<b>0.5%</b>	0.5%	0.6%	0.6%	0.7%
Common equity tier 1 ratio	<b>15.7%</b>	16.0%	n/a	n/a	n/a
Tier 1 capital ratio	<b>15.7%</b>	16.0%	n/a	n/a	n/a
Total capital ratio	<b>16.2%</b>	16.6%	n/a	n/a	n/a
Permanent capital ratio	<b>15.7%</b>	16.1%	16.8%	16.8%	17.5%
Tier 1 leverage ratio	<b>13.8%</b>	14.2%	n/a	n/a	n/a
UREE leverage ratio	<b>15.0%</b>	15.4%	n/a	n/a	n/a
<b>Net Income Distribution</b>					
Patronage dividends:					
Cash	<b>8,999</b>	8,450	6,179	6,455	6,275

\*Effective January 1, 2017, the new regulatory capital ratios were implemented by the Association. Regulatory ratios remained well above regulatory minimums, including the conservation and leverage buffers at December 31, 2018.

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS  
(Unaudited)**

The following commentary explains management's assessment of the principal aspects of the consolidated financial condition and results of operations of Alabama Farm Credit, ACA, including its wholly-owned subsidiaries, Alabama Farm Credit, PCA and Alabama Farm Credit, FLCA (Association) for the years ended December 31, 2018, 2017 and 2016, and should be read in conjunction with the accompanying consolidated financial statements. The accompanying financial statements were prepared under the oversight of the Association's audit committee.

**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-related 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;
- actions taken by the Federal Reserve System in implementing monetary policy;
- disruptions to information technology systems and services; and
- cyber-security risks such as unauthorized access to sensitive information or disruption of business operations.

**Significant Events:**

In January 2018, the Association approved a patronage distribution to its stockholders. The Association was able to distribute \$9,000,701 to its members due to strong earnings during 2017. The distribution was paid in March 2018. Also in December 2018, the Association accrued a \$9,380,495 patronage distribution to its stockholders. The payment resolution was approved in January 2019 and will be disbursed in March 2019. The Association was able to return these funds to its members due to strong earnings over the past three years.

In December 2018, the Association received a direct loan patronage of \$2,770,845 from the Farm Credit Bank of Texas ("Bank"), representing 41.8 basis points on the average daily balance of the Association's direct loan with the Bank. Additionally, the Association received a special patronage from the Bank in September 2018 in the amount of \$64,526. During 2018, the Association also received \$323,981 in patronage payments from the Bank, based on the Association's stock investment in the Bank.

During 2018, the Association required charge-offs of \$12,924 and received \$3,833 in recoveries. Also during 2018, the Association acquired two properties from various counties in north Alabama. The Association sold six properties during 2018, resulting in a net decrease of \$1,467,217, including a gain of \$181,390. At December 31, 2018, the Association held five properties with a carrying value of \$1,024,659, net of allowance, in Other Property Owned, net, on the balance sheet.

For more than 29 years, the Association has continued to provide its members with quality financial services. The board of directors and management remain committed to maintaining the financial integrity of the Association while offering competitive loan products that meet the financial needs of agricultural producers.

## **Loan Portfolio:**

The Association makes and services loans to farmers, ranchers, rural homeowners and certain farm-related businesses. The Association's loan volume consists of long-term farm mortgage loans, production and intermediate-term loans, and farm-related business loans. These loans are available to eligible borrowers with competitive fixed, adjustable, and index-based interest rates with loan maturities up to 30 years. Loans serviced by the Association offer several installment payment cycles, the timing of which usually coincides with the seasonal cash-flow capabilities of the borrower.

The composition of the Association's loan portfolio, including principal less funds held of \$794,416,124, \$729,419,322 and \$672,097,379 as of December 31, 2018, 2017 and 2016, respectively, is described more fully in detailed tables in Note 3 to the consolidated financial statements, "Loans and Allowance for Loan Losses," included in this annual report. The Association increased total loan volume by \$64,996,802 or 8.9 percent compared to 2017. These increases are the result of an increase in capital markets activity, an overall improvement of economic and financial markets and increased demand for loans within the Association's territory.

The Association's largest commodity concentration in its loan portfolio continues to be poultry, which is approximately 46.2 percent or \$367,403,162. The industry is presently stable with market prices for poultry showing some positive signs of increased demand for poultry products. Production in 2018 remained steady to increasing as markets both in the States and overseas continue to show signs of increased demand for poultry meat supplies. Some integrators are offering new grower contracts in order to meet their market demands, with egg and chick placements in Alabama increasing slightly each week. The Association has 32.7 percent of its poultry portfolio guaranteed, which helps to reduce loss exposure in this commodity. Projections for 2019 indicate that markets will remain stable or improve. The Association continues to experience some isolated concerns in this segment of its portfolio, as evidenced by some due date changes to better match the individual growers' batch sales. Management feels that this loan servicing is due primarily to changes in poultry markets where integrators are adjusting their bird size/placements as the market dictates. Management anticipates these concerns will correct themselves with the increased demand for poultry.

Avian Influenza, or bird flu, continues to be of concern to the Association; however, there were no known Avian Influenza cases in 2018 within the Association's territory, or thus far in 2019. The State Department of Agriculture and Industries, as well as all poultry integrators, have mandatory strict biosecurity requirements for all farms. The Association also has bio security guidelines for poultry farm inspections during high risk conditions. The Association will continue to monitor any changes regarding outbreaks and any impact to the loan portfolio on an ongoing basis during the upcoming winter months.

Agricultural income has been stable to improving over the past few years, with fairly good growing conditions and commodity prices. Weather conditions for 2018 had average moisture over most of the Association's territory. Cow-calf profitability has declined slightly, compared to 2017. In 2018, inventories in the growing yards and feedlots were high, causing some decline in market prices. Calf prices, however, are expected to slightly improve or hold steady in 2019, which should also be beneficial to cow-calf operators in the Association's lending territory.

Prices for utilities, gas, electricity and water continue to put downward pressure on the growers' net income. This is somewhat offset by previous and projected increases in grower contracts paid by all the major integrators within the Association's territory. Poultry farm sales for 2019 are projected to remain stable. Feed costs to the integrators remained at a more normal or reasonable level in 2018, due to lower costs for corn and soybeans.

Timber markets for 2018 have improved with industry leaders projecting increasing demand for wood products as compared to 2017. A new pine lumber mill announced for Demopolis, Alabama has commenced production, along with the announcement of Georgia-Pacific to build a new lumber production facility in Talladega, Alabama. These projects have increased demand and have helped prices for pine saw timber within Central and West Central Alabama, along with an increase in demand from overseas markets.

Overall land values have seen a slight improvement or remained stable in most all areas of the Association's territory based on the current economic climate. The agricultural economy, in general for the area, remained stable in 2018. The Association's credit quality experienced a slight decline to 99.0 percent non-adverse loan volume at 2018 year end, compared to 99.4 and 99.6 percent non-adverse loan volume at year-end 2017 and 2016, respectively.

With a favorable lending package, we are prepared to experience steady growth in the years ahead. We will continue to work with our borrowers as all market segments make corrections with minimal restructuring. We will also continue to work within our policies and procedures to mitigate any risk that may arise. The Association's 2019 goal will be to increase its presence in the agricultural and rural credit market, and uphold its position as the premier agricultural lender for the area. The Association intends



to maintain the same emphasis on providing sound, constructive, short-, intermediate- and long-term credit to the agricultural and rural sector within its territory.

### Purchase and Sales of Loans:

During 2018, 2017 and 2016, the Association was participating in loans with other lenders. As of December 31, 2018, 2017 and 2016, these participations totaled \$39,973,017, \$31,529,243 and \$26,033,629, or 5.0 percent, 4.3 percent and 3.9 percent of loans, respectively. There were no participations purchased from entities outside the district during the years ended December 2018, 2017 and 2016. The increase in volume in 2018 was the result of the Association purchasing new participation loans in addition to refinancing of or draws on existing lines of credit during the year. The Association has not sold any participations as of December 31, 2018, 2017 and 2016.

### Risk Exposure:

High-risk assets include nonaccrual loans, loans that are past due 90 days or more and still accruing interest, formally restructured loans and other property owned, net.

The following table illustrates the Association's components and trends of high-risk assets serviced for the prior three years as of December 31:

	2018		2017		2016	
	Amount	%	Amount	%	Amount	%
Nonaccrual	\$ 4,983,487	71.4%	\$ 2,707,313	43.7%	\$ 1,354,126	25.4%
90 days past due and still accruing interest	-	0.0%	-	0.0%	679,933	12.7%
Formally restructured	967,847	13.9%	1,007,403	16.2%	1,243,130	23.3%
Other property owned, net	1,024,659	14.7%	2,491,876	40.1%	2,064,392	38.6%
Total	\$ 6,975,993	100.0%	\$ 6,206,592	100.0%	\$ 5,341,581	100.0%

High-risk assets increased in 2018 by \$769,401, or 12.4 percent, as compared to 2017. During 2018, 29 loans to 15 borrowers totaling \$4,299,272 were moved to nonaccrual status while three loans totaling \$259,297 were moved from nonaccrual to other property owned and no loans were reinstated to accrual status. Nonaccrual loans decreased by an additional \$1,763,801 from repayments and charge-offs.

At December 31, 2018, 2017 and 2016, loans that were considered impaired were \$5,951,334, \$3,714,716 and \$3,277,189, representing 0.7 percent, 0.5 percent and 0.4 percent of loan volume, respectively. Impaired loans consist of all high-risk assets except other property owned, net.

The Association had nine properties in other property owned at the beginning of 2018. During 2018, the Association acquired two additional properties from various counties in north Alabama. The Association sold six properties during 2018, resulting in a net decrease of \$1,467,217, including a gain of \$181,390. At December 31, 2018, the Association held five properties with a carrying value of \$1,024,659, net of allowance, which consisted of 197.2 acres of land.

Counterparty risk is continually monitored by management of the Association. The Association's primary counterparty risk comes from poultry integrators with which its borrowers are associated and participation loans. Because the Association has approximately 46.2 percent of its portfolio concentrated in poultry, it mitigates inherent risks in the poultry markets and the integrators by heavy utilization of government guarantees. At December 31, 2018, approximately 32.7 percent, or \$122.1 million, of the Association's poultry loans were government guaranteed. Also, the Association's lending territory has multiple integrators, which would minimize the risk of counterparty failure or lack of performance. Management analyzes the financial position and performance of these integrators by regularly gathering updated financials and other reports that are made available to the public. The Association, in the normal course of business, has participation loans with other Farm Credit associations and Farm Credit banks.

Except for the relationship between installment due date and seasonal cash-flow capabilities of the borrower, the Association is not affected by any seasonal characteristics. The factors affecting the operations of the Association are the same factors that would affect any agricultural real estate lender.

To help mitigate and diversify credit risk, the Association has employed practices including credit guarantees and engaging in loan participations. At December 31, 2018, the Association had approximately \$146.3 million, or 18.4 percent, of its portfolio that had guarantees with the Farm Service Agency (FSA) or the Small Business Administration (SBA).

## Allowance for Loan Losses:

The following table provides relevant information regarding the allowance for loan losses as of, or for the year ended, December 31:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Allowance for loan losses	\$ <b>4,010,000</b>	\$ 3,778,000	\$ 3,698,400
Allowance for loan losses to total loans	<b>0.5%</b>	0.5%	0.6%
Allowance for loan losses to nonaccrual loans	<b>80.5%</b>	139.5%	273.1%
Allowance for loan losses to impaired loans	<b>67.4%</b>	101.7%	112.9%
Net charge-offs to average loans	<b>0.0%</b>	0.0%	0.0%

The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition, collateral value, portfolio quality, current production conditions and economic conditions, and prior loan loss experience. Management may consider other qualitative factors in determining and supporting the level of allowance for loan losses including but not limited to: the concentration of lending in agriculture, combined with uncertainties associated with farmland values, commodity prices, exports, government assistance programs, regional economic effects, borrower repayment capacity, depth of lender staff, and/or past trends, and weather-related influences.

Based upon ongoing risk assessment and the allowance for loan losses procedures outlined above, the allowance for loan losses of \$4,010,000, \$3,778,000 and \$3,698,400 at December 31, 2018, 2017 and 2016, respectively, is considered adequate by management to compensate for inherent losses in the loan portfolio at such dates. The \$232,000 increase compared to 2017 is primarily due to an increase in loan volume and an increase in the poultry and row crop impairment pools, and specific allowances on impaired loans. It is management's assertion that the allowance coverage is adequate based on historical losses, portfolio stress testing, risk analysis, mitigation of losses due to having first lien real estate with minimal to no price appreciation and, as mentioned above, having approximately \$146.3 million, or 18.4 percent, of its portfolio that had guarantees with the FSA or the SBA.

## Results of Operations:

The Association's net income for the year ended December 31, 2018, was \$15,591,380 as compared to \$15,048,411 for the year ended December 31, 2017, reflecting an increase of \$542,969, or 3.6 percent. The Association's net income for the year ended December 31, 2016 was \$14,687,198. Net income increased \$361,213, or 2.5 percent, in 2017 versus 2016.

Net interest income for 2018, 2017 and 2016 was \$21,809,331, \$21,321,396 and \$20,608,949, respectively, reflecting increases of \$487,935, or 2.3 percent, for 2018 versus 2017 and \$712,447, or 3.5 percent, for 2017 versus 2016. 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 tables:

	<u>2018</u>		<u>2017</u>		<u>2016</u>	
	<u>Average Balance</u>	<u>Interest</u>	<u>Average Balance</u>	<u>Interest</u>	<u>Average Balance</u>	<u>Interest</u>
Loans	\$ <b>762,226,287</b>	\$ <b>40,035,598</b>	\$ 697,982,969	\$ 35,255,632	\$ 651,308,150	\$ 32,192,750
Interest-bearing liabilities	<b>662,413,401</b>	<b>18,226,267</b>	603,303,802	13,934,238	560,655,754	11,583,801
Impact of capital	<b>\$ 99,812,886</b>		<b>\$ 94,679,167</b>		<b>\$ 90,652,396</b>	
Net interest income		<b>\$ 21,809,331</b>		<b>\$ 21,321,394</b>		<b>\$ 20,608,949</b>

	<u>2018</u>	<u>2017</u>	<u>2016</u>
	<u>Average Yield</u>	<u>Average Yield</u>	<u>Average Yield</u>
Yield on loans	<b>5.3%</b>	5.1%	4.9%
Cost of interest-bearing liabilities	<b>2.8%</b>	2.4%	2.1%
Interest rate spread	<b>2.5%</b>	2.7%	2.8%

	2018 vs. 2017			2017 vs. 2016		
	Increase (decrease) due to			Increase (decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
Interest income - loans	\$ 3,244,994	\$ 1,534,972	\$ 4,779,966	\$ 2,307,098	\$ 755,784	\$ 3,062,882
Interest expense	1,365,254	2,926,775	4,292,029	881,151	1,469,286	2,350,437
Net interest income	\$ 1,879,740	\$ (1,391,803)	\$ 487,937	\$ 1,425,947	\$ (713,502)	\$ 712,445

Interest income for 2018 increased by \$4,779,966, or 13.6 percent, compared to 2017, primarily due to an increase in average loan volume as a result of the active lending environment during 2018, 2017 and 2016. This increase was offset by a slight decrease in loan yields. Interest expense for 2018 increased by \$4,292,029, or 30.8 percent, compared to 2017 again due to the increase in average loan volume and an increase in interest rates on the Association's direct note with the Bank. The interest rate spread decreased by 24 basis points to 2.5 percent in 2018 from 2.7 percent in 2017, primarily due to the increase in interest rates on the Association's direct note and competitive market for loans within the Association territory. The interest rate spread decreased by 14 basis points to 2.7 percent in 2017 from 2.8 percent in 2016, primarily due to a competitive market for loans within the Association territory.

Noninterest income for 2018 increased by \$935,068, or 31.3 percent, compared to 2017, due primarily to an increase in patronage income from the Bank in the amount of \$557,085, or 21.4 percent, as compared to 2017. Additionally, the Association received an allocation of excess insurance fund balances in the allocated insurance reserve accounts (AIRAs) in the amount of \$333,007 from the Farm Credit Services Insurance Corporation that was not received in 2017.

Noninterest income for 2017 increased by \$119,947, or 4.2 percent, compared to 2016, due primarily to an increase in patronage income from the Bank in the amount of \$106,738, or 4.3 percent, as compared to 2016.

Provisions for loan losses increased by \$142,135, or 142.2 percent, compared to 2017, due primarily to an increase in loan volume and an increase in the specific allowance on impaired loans. The Association's risk factors used in the calculation of the allowance were based on a conservative review of high-risk assets, actual loss history, delinquencies and an estimate of expected and inherent losses over the next 12 to 18 months.

Operating expenses consist primarily of salaries, employee benefits and purchased services. Expenses for purchased services may include administrative services, marketing, information systems, accounting and loan processing, among others. The increase in operating expenses of \$737,901, or 8.1 percent, in 2018 as compared to 2017 was due primarily to an increase in salaries and benefits, occupancy and equipment and other expenses, offset by a decrease in purchased services and insurance fund premiums. Additionally, the Association recognized a gain on other property owned in 2018 as compared to a loss in 2017. The increase in salaries and benefits is due to additional personnel that were hired in 2018 due to the change in the lending business process in early 2018. The increase in occupancy and equipment is due to the renovations of one office and increased equipment and other expenses to accommodate increased staffing. The increase in other expenses was due primarily to an increase in the FCA examination fee and other miscellaneous expenses. The decrease in purchased services was due primarily to a decrease in legal costs and the timing of billings from service providers. The decrease in insurance fund premiums was due to a decrease in basis points from 16 in 2017 to 13 basis points in 2018.

The increase in operating expenses of \$360,214, or 4.1 percent, in 2017 as compared to 2016 was due primarily to an increase in directors' expense, purchased services, travel, communications, and advertising, offset by a significant decline in losses on property owned. The increase in directors' expense is due to additional meetings and training required. Increases in purchased services is a result of a significant emphasis on internal controls over financial reporting during 2017, as well as legal fees related to a specific legal action. Travel costs increased in 2017 due to training of new staff and additional staff meetings related to the new business model. The Association switched communication carriers during the 2017 year, which resulted in additional startup costs. In addition, communication costs increased due to expiration of certain credits from the previous carrier. Advertising costs increased based on an increase in the budget. The increased operational costs were offset by significantly lower disposal losses and write-downs on other property owned.

Authoritative accounting guidance requiring the capitalization and amortization of loan origination fees and costs resulted in the capitalization of \$1,364,326, \$1,285,121 and \$1,183,184 for 2018, 2017 and 2016, respectively, in origination fees, which will be amortized over the life of the loans as an adjustment to yield in net interest income. The capitalized costs consisted of salaries and benefits totaling \$1,381,137 related to the origination of loans.

For the year ended December 31, 2018, the Association's return on average assets was 2.0 percent, as compared to 2.0 percent and 2.2 percent for the years ended December 31, 2017 and 2016, respectively. For the year ended December

31, 2018, the Association's return on average members' equity was 13.2 percent, as compared to 13.5 percent and 14.0 percent for the years ended December 31, 2017 and 2016, respectively. The decline is primarily due to tighter net interest margins on an increased loan volume.

Because the Association depends on the Bank for funding, any significant positive or negative factors affecting the operations of the Bank may have an effect on the operations of the Association.

### **Liquidity and Funding Sources:**

The interest rate risk inherent in the association's loan portfolio is substantially mitigated through the funding relationship with the Bank. The Bank manages interest rate risk through its direct loan pricing and asset/liability management process.

The primary source of liquidity and funding for the Association is a direct loan from the Bank. The outstanding balance of \$686,711,154, \$627,339,627 and \$574,372,777 as of December 31, 2018, 2017 and 2016, respectively, is recorded as a liability on the Association's balance sheet. The note carried a weighted average interest rate of 2.9 percent, 2.4 percent and 2.1 percent at December 31, 2018, 2017 and 2016, respectively. The indebtedness is collateralized by a pledge of substantially all of the Association's assets to the Bank and is governed by a general financing agreement. The increase in note payable to the Bank and related accrued interest payable since December 31, 2017, is due to the Association's loan portfolio growth. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were \$108,505,559, \$102,749,906 and \$98,287,775 at December 31, 2018, 2017 and 2016, respectively. The maximum amount the Association may borrow from the Bank as of December 31, 2018, was \$800,880,864 as defined by the general financing agreement. The indebtedness continues in effect until the expiration date of the general financing agreement, which is September 30, 2020, unless sooner terminated by the Bank upon the occurrence of an event of default, or by the Association, in the event of a breach of this agreement by the Bank, upon giving the Bank 30 calendar days' prior written notice, or in all other circumstances, upon giving the Bank 120 days' prior written notice.

The liquidity policy of the Association is to manage cash balances, to maximize debt reduction and to increase accrual loan volume. This policy will continue to be pursued during 2019. As borrower payments are received, they are applied to the Association's note payable to the Bank.

The Association will continue to fund its operations through direct borrowings from the Bank, capital surplus from prior years and borrower stock. It is management's opinion that funds available to the Association are sufficient to fund its operations for the coming year.

### **Capital Resources:**

The Association's capital position remains strong, with total members' equity of \$116,943,338, \$110,137,666 and \$104,263,100 at December 31, 2018, 2017 and 2016, respectively. Under regulations governing minimum permanent capital adequacy and other capitalization issues, the Association is required to maintain a minimum adjusted permanent capital of 7.0 percent of risk-adjusted assets as defined by the FCA. The permanent capital ratio measures available at-risk capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the institution's financial capacity to absorb potential losses beyond that provided in the allowance for loss accounts. The Association's permanent capital ratio at December 31, 2018, 2017 and 2016 was 15.7 percent, 16.1 percent and 16.8 percent, respectively.

Under the new regulations, the Association is required to maintain a minimum Common Equity Tier 1 (CET1), Tier 1 Capital and Total Capital ratios of 4.5 percent, 6.0 percent and 8.0 percent, along with a capital conservation buffer of 2.5 percent applicable to each ratio, respectively. The 2.5 percent capital conservation buffer will be phased in over a three year period ending on December 31, 2019. The Association's Common Equity Tier 1 ratio was 15.7 percent and Tier 1 Capital ratio was 15.7 percent, and total capital ratio was 16.2 percent at December 31, 2018. Under the new regulations, the Association is required to maintain a minimum Tier 1 Leverage ratio of 4.0 percent, along with a leverage buffer of 1.0 percent, and a minimum Unallocated Retained Earnings Equivalents (UREE) leverage ratio of 1.5 percent. The Association's Tier 1 Leverage ratio was 13.8 percent and UREE Leverage ratio was 15.0 percent at December 31, 2018. The CET1 capital ratio is an indicator of the institution's highest quality of capital and consists of unallocated retained earnings, qualifying common cooperative equities (CCEs) that meet the required holding periods and paid-in capital. The Tier 1 Capital ratio is a measure of the institution's quality of capital and financial strength. The Total Capital Ratio is supplementary to the Tier 1 Capital ratio, the components of which include qualifying CCEs subject to certain holding periods, third-party capital subject to certain holding periods and limitations, and allowance and reserve for credit losses subject to certain limitations. The Tier 1 leverage ratio is used to measure the amount of leverage an institution has incurred against its capital base, of which at least 1.5 percent must be Unallocated Retained Earnings (URE) and URE equivalents. This is the UREE Leverage ratio.

Prior to January 1, 2017, the core surplus ratio measured available core surplus capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio was an indicator of the quality of capital that exists to maintain stable earnings and financial strength. The Association's core surplus ratio at December 31, 2016 was 16.4 percent, which was in compliance with the FCA's minimum ratio requirement of 3.5 percent. The total surplus ratio measured available surplus capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio was an indicator of the reserves existing to protect borrowers' investments in the Association. The Association's total surplus ratio at December 31, 2016 was 16.4 percent, which was in compliance with the FCA's minimum ratio requirement of 7.0 percent.

The following table represents the Association's capital ratios for the years at December 31:

Risk-adjusted:	Regulatory Minimums	Conservation Buffer*	Total	As of December 31, 2018
Common equity tier 1 ratio	4.5%	2.5%	7.0%	15.7%
Tier 1 capital ratio	6.0%	2.5%	8.5%	15.7%
Total capital ratio	8.0%	2.5%	10.5%	16.2%
Permanent capital ratio	7.0%	0.0%	7.0%	15.7%

Non-risk-adjusted:	Regulatory Minimums	Conservation Buffer	Total	As of December 31, 2017
Tier 1 leverage ratio**	4.0%	1.0%	5.0%	13.8%
UREE leverage ratio	1.5%	0.0%	1.5%	15.0%

Risk-adjusted:	Regulatory Minimums	Conservation Buffer	Total	As of December 31, 2017
Common equity tier 1 ratio	4.5%	2.5%	7.0%	16.0%
Tier 1 capital ratio	6.0%	2.5%	8.5%	16.0%
Total capital ratio	8.0%	2.5%	10.5%	16.6%
Permanent capital ratio	7.0%	0.0%	7.0%	16.1%

Non-risk-adjusted:	Regulatory Minimums	Conservation Buffer	Total	As of December 31, 2017
Tier 1 leverage ratio	4.0%	1.0%	5.0%	14.2%
UREE leverage ratio	1.5%	0.0%	1.5%	15.4%

	2016	2015	2014
Core Surplus	16.4%	16.4%	17.0%
Total Surplus	16.4%	16.4%	17.0%

A summary of the new capital ratio requirements and comparative results for the Association as of December 31, 2018, are presented in Note 9 to the consolidated financial statements, "Members' Equity," included in this annual report.

#### Significant Recent Accounting Pronouncements:

In August 2018, the Financial Accounting Standards Board (FASB) issued guidance entitled "Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Cost." The guidance aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by this guidance. This guidance becomes effective for interim and annual periods beginning after December 15, 2019. The guidance also requires an entity (customer) to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. It further specifies where to present expense and payments in the financial statements. Early adoption is permitted. The guidance is to be applied on a retrospective or prospective basis to all implementation costs incurred after the date of adoption. The adoption of this guidance is not expected to impact the Association's financial condition or its results of operations.

In August 2018, the FASB issued guidance entitled “Disclosure Framework — Changes to the Disclosure Requirements for Defined Benefit Plans.” The guidance modifies the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. This guidance becomes effective for fiscal years ending after December 15, 2020. Early adoption is permitted. The guidance is to be applied on a retrospective basis for all periods. The adoption of this guidance will not impact the Association’s financial condition or its results of operations, but will impact the employee benefit plan disclosures.

In August 2018, the FASB issued guidance entitled “Disclosure Framework — Changes to the Disclosure Requirements for Fair Value Measurement.” The guidance modifies the requirements on fair value measurements by removing, modifying or adding to the disclosures. This guidance becomes effective for interim and annual periods beginning after December 15, 2019. Early adoption is permitted and an entity is permitted to early adopt any removal or modified disclosures and delay adoption of the additional disclosures until their effective date. The adoption of this guidance will not impact the Association’s financial condition or its results of operations, but will impact the fair value measurements disclosures. The Association early adopted the removal and modified disclosures during the fourth quarter of 2018.

In February 2018, the Financial Accounting Standards Board (FASB) issued guidance entitled “Income Statement — Reporting Comprehensive Income — Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.” This guidance allows for the reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the recently issued tax legislation, Tax Cuts and Jobs Act (TCJA), that lowered the federal corporate tax rate from 35 percent to 21 percent. The amount of the reclassification shall include the effect of the change in the tax rate on gross deferred tax amounts and related valuation allowances at the date of enactment of the TCJA related to items remaining in accumulated other comprehensive income. The guidance becomes effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The Association early adopted the guidance during the first quarter of 2018. The adoption of this guidance did not materially impact the Association’s financial condition or its results of operations.

In August 2017, the FASB issued guidance entitled “Targeted Improvements to Accounting for Hedging Activities.” The guidance better aligns an entity’s risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. The amendments in this guidance require an entity to present the earnings effect of the hedging instrument in the same income statement line item in which the earnings effect of the hedged item is reported. This guidance also addresses the timing of effectiveness testing, qualitative and quantitative effectiveness testing and components that can be excluded from effectiveness testing. This guidance becomes effective for interim and annual periods beginning after December 15, 2018. The Association does not currently participate in hedging activities; therefore there is no impact of adoption on the Association’s financial condition.

In March 2017, the FASB issued guidance entitled “Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Cost.” The guidance requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. Other components are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. This guidance became effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not materially impact the Association’s financial condition but did change the classification of certain items in the results of operations.

In August 2016, the FASB issued guidance entitled “Classification of Certain Cash Receipts and Cash Payments.” The guidance addresses specific cash flow issues with the objective of reducing the diversity in the classification of these cash flows. Included in the cash flow issues are debt prepayment or debt extinguishment costs and settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing. This guidance became effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not materially impact the Association’s financial condition or its results of operations but did change the classification of certain items in the statement of cash flows.

In June 2016, the FASB issued guidance entitled “Measurement of Credit Losses on Financial Instruments.” The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses. For public business entities that are not U.S. Securities and Exchange Commission filers, this guidance becomes effective for interim and annual periods beginning after December 15, 2020, with early application permitted. The Association is evaluating the impact of adoption on the Association’s financial condition and its results of operations.

In February 2016, the FASB issued guidance entitled “Leases.” The guidance requires the recognition by lessees of lease assets and lease liabilities on the balance sheet for the rights and obligations created by those leases. Leases with lease terms of more than 12 months are impacted by this guidance. In July 2018, the FASB issued an update entitled “Leases – Targeted Improvements,” which provides entities with an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. An entity that elects this additional transition method must provide the required disclosures of the now current standard for all prior periods presented. The guidance and related amendments in this updated disclosure become effective for interim and annual periods beginning after December 15, 2018, with early application permitted. The adoption of this guidance is not expected to impact the Association’s financial condition or its results of operations.

In January 2016, the FASB issued guidance entitled “Recognition and Measurement of Financial Assets and Liabilities.” The guidance affects, among other things, the presentation and disclosure requirements for financial instruments. For public entities, the guidance eliminates the requirement to disclose the methods and significant assumptions used to estimate the fair value of financial instruments carried at amortized cost. This guidance became effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not impact the Association’s financial condition or its results of operations but did impact the Association’s fair value disclosures.

In May 2014, the FASB issued guidance entitled “Revenue from Contracts with Customers.” The guidance governs revenue recognition from contracts with customers and requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Financial instruments and other contractual rights within the scope of other guidance issued by the FASB are excluded from the scope of this new revenue recognition guidance. The guidance sets forth the requirement for new and enhanced disclosures. The Association adopted the new standard effective January 1, 2018, using the modified retrospective approach. As the majority of the Association’s revenues are not subject to the new guidance, the adoption of the guidance did not have a material impact on the financial position, results of operations, equity or cash flows.

### **Regulatory Matters:**

At December 31, 2018, the Association was not under written agreements with the Farm Credit Administration.

On July 28, 2016, the Farm Credit Administration published a final regulation to modify the regulatory capital requirements for System banks and associations. The stated objectives of the proposed rule were as follows:

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

The final rule replaces existing core surplus and total surplus requirements with common equity tier 1, tier 1 and total capital risk-based capital ratio requirements. The final rule also replaces the existing net collateral ratio with a tier 1 leverage ratio and is applicable to all banks and associations. The permanent capital ratio will continue to remain in effect with the final rule.

The new capital requirements became effective January 1, 2017, with a three-year phase-in of the capital conservation buffer applied to the risk-adjusted capital ratios. The Bank is in compliance with the required minimum capital standards and met the conservation buffers as of December 31, 2017.

On June 12, 2014, the Farm Credit Administration approved a proposed rule to revise the requirements governing the eligibility of investments for System banks and associations. 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.

This regulation becomes effective January 1, 2019.

### **Relationship With the Bank:**

The Association's statutory obligation to borrow only from the Bank is discussed in Note 8 to the consolidated financial statements, "Note Payable to the Bank," included in this annual report.

The Bank's ability to access capital of the Association is discussed in Note 2 to the consolidated financial statements, "Summary of Significant Accounting Policies," included in this annual report, within the section "Capital Stock Investment in the Bank."

The Bank's role in mitigating the Association's exposure to interest rate risk is described in the section "Liquidity and Funding Sources" of Management's Discussion and Analysis and in Note 9 to the consolidated financial statements, "Note Payable to the Bank," included in this annual report.

The Bank provides computer systems to support the critical operations of all district associations. In addition, each association has operating systems and facility-based systems that are not supported by the Bank. As disclosed in Note 13 to the consolidated financial statements, "Related Party Transactions," included in this annual report, the Bank provides many services that the Association can utilize, such as administrative, marketing, information systems and accounting services. Additionally, the Bank bills district expenses to the associations, such as the Farm Credit System Insurance Corporation insurance premiums.

### **Summary:**

Over the past 29 years, regardless of the state of the agricultural economy, your Association's board of directors and management, as well as the board of directors and management of the Bank, have been committed to offering their borrowers a ready source of financing at a competitive price. Your continued support will be critical to the success of this Association.





## Report of Independent Auditors

To the Board of Directors of Alabama Farm Credit, ACA

We have audited the accompanying consolidated financial statements of Alabama Farm Credit, ACA and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2018, December 31, 2017 and December 31, 2016, and the related consolidated statements of 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.

### ***Auditors' 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 Company'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 Company'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 Alabama Farm Credit, ACA and its subsidiaries as of December 31, 2018, December 31, 2017 and December 31, 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*PricewaterhouseCoopers LLP*

March 13, 2019

**ALABAMA FARM CREDIT, ACA**

**CONSOLIDATED BALANCE SHEET**

	December 31,		
	2018	2017	2016
<b><u>Assets</u></b>			
Cash	\$ 48,700	\$ 339,393	\$ 11,349
Loans	794,416,124	729,419,322	672,097,379
Less: allowance for loan losses	4,010,000	3,778,000	3,698,400
Net loans	790,406,124	725,641,322	668,398,979
Accrued interest receivable	8,701,345	7,538,556	7,175,856
Investment in and receivable from the Farm			
Credit Bank of Texas:			
Capital stock	13,155,480	11,970,985	11,149,925
Other	1,159,553	547,617	582,639
Other property owned, net	1,024,659	2,491,876	2,064,392
Premises and equipment	4,460,346	4,081,885	3,764,148
Other assets	1,286,394	949,182	706,638
Total assets	<u>\$ 820,242,601</u>	<u>\$ 753,560,816</u>	<u>\$ 693,853,926</u>
<b><u>Liabilities</u></b>			
Note payable to the Farm Credit Bank of Texas	\$ 686,711,154	\$ 627,339,627	\$ 574,372,777
Accrued interest payable	1,735,047	1,299,309	1,031,551
Drafts outstanding	1,303,900	1,145,124	1,706,377
Patronage distributions payable	9,383,761	9,001,174	8,449,985
Other liabilities	4,165,401	4,637,916	4,030,136
Total liabilities	<u>703,299,263</u>	<u>643,423,150</u>	<u>589,590,826</u>
<b><u>Members' Equity</u></b>			
Capital stock and participation certificates	2,798,455	2,687,255	2,518,190
Unallocated retained earnings	114,166,208	107,956,718	101,909,008
Accumulated other comprehensive loss	(21,325)	(506,307)	(164,098)
Total members' equity	<u>116,943,338</u>	<u>110,137,666</u>	<u>104,263,100</u>
Total liabilities and members' equity	<u>\$ 820,242,601</u>	<u>\$ 753,560,816</u>	<u>\$ 693,853,926</u>

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

**ALABAMA FARM CREDIT, ACA**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	Year Ended December 31,		
	2018	2017	2016
<b><u>Interest Income</u></b>			
Loans	\$ 40,035,598	\$ 35,255,632	\$ 32,192,750
<b><u>Interest Expense</u></b>			
Note payable to the Farm Credit Bank of Texas	18,226,267	13,934,238	11,583,801
Net interest income	21,809,331	21,321,394	20,608,949
Provision for (reversal of) Loan Losses	242,091	99,956	(11,009)
Net interest income after provision for losses	21,567,240	21,221,438	20,619,958
<b><u>Noninterest Income</u></b>			
Income from the Farm Credit Bank of Texas:			
Patronage income	3,159,352	2,602,267	2,495,529
Loan fees	292,362	245,234	235,314
Financially related services income	17,390	17,641	19,884
Gain on other property owned, net	35,583	-	-
Gain on sale of premises and equipment, net	77,368	40,347	44,680
Other noninterest income	339,050	80,548	70,683
Total noninterest income	3,921,105	2,986,037	2,866,090
<b><u>Noninterest Expenses</u></b>			
Salaries and employee benefits	5,893,474	5,049,172	4,776,519
Directors' expense	347,862	346,184	298,882
Purchased services	426,577	512,017	246,821
Travel	608,035	560,437	497,047
Occupancy and equipment	529,049	463,594	473,136
Communications	245,544	197,322	143,456
Advertising	371,254	344,971	305,676
Public and member relations	266,031	273,949	261,542
Supervisory and exam expense	239,311	224,609	205,470
Insurance Fund premiums	462,296	692,260	730,706
Business insurance premiums	105,773	97,626	89,376
Other components of net periodic postretirement benefit cost	96,434	59,251	72,780
Loss on other property owned, net	-	94,907	428,078
Other noninterest expense	305,325	242,765	269,361
Total noninterest expenses	9,896,965	9,159,064	8,798,850
<b>NET INCOME</b>	<b>15,591,380</b>	<b>15,048,411</b>	<b>14,687,198</b>
Other comprehensive income:			
Change in postretirement benefit plans	484,982	(342,209)	87,080
<b>COMPREHENSIVE INCOME</b>	<b>\$ 16,076,362</b>	<b>\$ 14,706,202</b>	<b>\$ 14,774,278</b>

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

ALABAMA FARM CREDIT, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

	Capital Stock/ Participation Certificates	Retained Earnings Unallocated	Accumulated Other Comprehensive Loss	Total Members' Equity
Balance at December 31, 2015	\$ 2,415,825	\$ 95,672,059	\$ (251,178)	\$ 97,836,706
Comprehensive income	-	14,687,198	87,080	14,774,278
Capital stock/participation certificates issued	350,565	-	-	350,565
Capital stock/participation certificates retired	(248,200)	-	-	(248,200)
Patronage paid	-	(712)	-	(712)
Patronage dividends declared:				
Cash	-	(8,449,537)	-	(8,449,537)
Balance at December 31, 2016	2,518,190	101,909,008	(164,098)	104,263,100
Comprehensive income	-	15,048,411	(342,209)	14,706,202
Capital stock/participation certificates issued	432,215	-	-	432,215
Capital stock/participation certificates retired	(263,150)	-	-	(263,150)
Patronage dividends declared:				
Cash	-	(9,000,701)	-	(9,000,701)
Balance at December 31, 2017	2,687,255	107,956,718	(506,307)	110,137,666
Comprehensive income	-	15,591,380	484,982	16,076,362
Capital stock/participation certificates issued	418,695	-	-	418,695
Capital stock/participation certificates retired	(307,495)	-	-	(307,495)
Patronage paid	-	(1,395)	-	(1,395)
Patronage dividends declared:				
Cash	-	(9,380,495)	-	(9,380,495)
<b>Balance at December 31, 2018</b>	<b>\$ 2,798,455</b>	<b>\$ 114,166,208</b>	<b>\$ (21,325)</b>	<b>\$ 116,943,338</b>

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

**ALABAMA FARM CREDIT, ACA**

**CONSOLIDATED STATEMENT OF CASH FLOWS**

	Year Ended December 31,		
	2018	2017	2016
<b>Cash flows from operating activities:</b>			
Net income	\$ 15,591,380	\$ 15,048,411	\$ 14,687,198
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses or (loan loss reversal)	242,091	99,955	(11,009)
Provision for acquired property	85,317	108,117	374,954
Gain on sale of other property owned, net	(181,390)	(61,874)	(26,642)
Depreciation	349,399	304,143	306,641
Amortization (accretion) of net (premiums) discounts in investments	(238,653)	(195,271)	(136,108)
Gain on sale of premises and equipment, net	(76,843)	(40,347)	(44,680)
Increase in accrued interest receivable	(1,162,789)	(362,700)	(764,605)
(Increase) decrease in other receivables from the Farm Credit Bank of Texas	(611,936)	35,022	(283,172)
Decrease (increase) in other assets	5,645	(57,814)	(26,207)
Increase in accrued interest payable	435,738	267,758	138,707
Increase in other liabilities	11,467	243,571	74,003
Net cash provided by operating activities	14,449,426	15,388,971	14,289,080
<b>Cash flows from investing activities:</b>			
Increase in loans, net	(63,843,090)	(58,158,733)	(49,138,047)
Cash recoveries of loans previously charged off	3,833	3,830	29,426
Proceeds from purchase of investment in the Farm Credit Bank of Texas	(1,184,495)	(821,060)	(1,175,215)
Purchases of premises and equipment	(808,502)	(656,301)	(293,844)
Proceeds from sales of premises and equipment	157,485	74,769	71,560
Proceeds from sales of other property owned	292,450	371,418	750,900
Net cash used in investing activities	(65,382,319)	(59,186,077)	(49,755,220)

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

**ALABAMA FARM CREDIT, ACA**

**CONSOLIDATED STATEMENT OF CASH FLOWS**

	Year Ended December 31,		
	2018	2017	2016
<b>Cash flows from financing activities:</b>			
Net draws on note payable to the Farm Credit Bank of Texas	\$ 59,371,527	\$ 52,966,850	\$ 41,640,952
Increase (decrease) in drafts outstanding	158,776	(561,253)	(128,871)
Issuance of capital stock and participation certificates	418,695	424,505	350,565
Retirement of capital stock and participation certificates	(307,495)	(255,440)	(248,200)
Patronage distributions paid	(8,999,303)	(8,449,512)	(6,179,113)
Net cash provided by financing activities	50,642,200	44,125,150	35,435,333
Net (decrease) increase in cash	(290,693)	328,044	(30,807)
Cash at the beginning of the year	339,393	11,349	42,156
Cash at the end of the year	\$ 48,700	\$ 339,393	\$ 11,349
 <b>Supplemental schedule of noncash investing and financing activities:</b>			
Net decrease (increase) in unrealized (gains) losses in investment securities	\$ 142,329	\$ (4,454)	\$ 4,979
Financed sales of other property owned	1,125,155	196,331	522,950
Loans transferred to other property owned	259,297	1,210,985	2,412,755
Loans charged off	12,924	2,186	94,358
Accumulated other comprehensive income (loss)	484,982	(342,209)	87,080
Patronage distributions declared	9,380,495	9,000,701	8,449,537
Net increase (decrease) in FSA receivable	(80,204)	19,675	167,856
Increase in reserve for unfunded commitments	1,000	(22,000)	(7,143)
 <b>Supplemental cash information:</b>			
Cash paid during the year for:			
Interest	\$ 17,790,529	\$ 13,934,237	\$ 11,445,177

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

**ALABAMA FARM CREDIT, ACA**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 — ORGANIZATION AND OPERATIONS:**

- A. Organization: Alabama Farm Credit, ACA (Agricultural Credit Association), and its wholly-owned subsidiaries, Alabama Farm Credit, PCA and Alabama Farm Credit, FLCA (collectively called “the Association”), is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves the counties of Blount, Calhoun, Cherokee, Clay, Cleburne, Colbert, Cullman, DeKalb, Etowah, Fayette, Franklin, Jackson, Jefferson, Lamar, Lauderdale, Lawrence, Limestone, Madison, Marion, Marshall, Morgan, Randolph, Shelby, St. Clair, Talladega, Walker and Winston in the state of Alabama.

The Association is a lending institution of the Farm Credit System (System), a nationwide system of cooperatively owned banks and associations that was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (Act). At December 31, 2018, the System consisted of three Farm Credit Banks (FCBs) and their affiliated associations, one Agricultural Credit Bank (ACB) and its affiliated associations, the Federal Farm Credit Banks Funding Corporation (Funding Corporation) and various service and other organizations.

The Farm Credit Bank of Texas (Bank) and its related associations are collectively referred to as the “District.” The Bank provides funding to all associations within the district and is responsible for supervising certain activities of the district associations. At December 31, 2018, the district consisted of the Bank, one FLCA and 13 ACA parent companies, which have two wholly-owned subsidiaries, an FLCA and a PCA, operating in or servicing the states of Alabama, Louisiana, Mississippi, New Mexico and Texas. ACA parent companies provide financing and related services through their FLCA and PCA subsidiaries. The FLCA makes secured long-term agricultural real estate and rural home mortgage loans. The PCA makes short- and intermediate-term loans for agricultural production or operating purposes.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System banks and associations. The FCA examines the activities of System associations to ensure their compliance with the Farm Credit Act, FCA regulations, and safe and sound banking practices.

The Act established the Farm Credit System Insurance Corporation (FCSIC) 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, (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 the discretionary uses by the FCSIC of providing assistance to certain troubled System institutions and to cover the operating expenses of the FCSIC. 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 monies in the Insurance Fund reach the “secure base amount,” which 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 other such percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the FCSIC is required to reduce premiums as necessary to maintain the Insurance Fund at the 2 percent level. As required by the Farm Credit Act, as amended, the FCSIC may return excess funds above the secure base amount to System institutions.

FCA regulations require borrower information to be held in strict confidence by Farm Credit institutions, their directors, officers and employees. Directors and employees of the Farm Credit institutions are prohibited, except under specified circumstances, from disclosing nonpublic personal information about members.

- B. Operations: The Act sets forth the types of authorized lending activity, persons eligible to borrow and financial services that can be offered by the Association. 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 makes and services short- and intermediate-term loans for agricultural production or operating purposes, and secured long-term real estate mortgage loans, with funding from the Bank.

The Association also serves as an intermediary in offering credit life insurance and multi-peril crop insurance.

## **NOTE 1 — ORGANIZATION AND OPERATIONS (continued):**

The Association's financial condition may be affected by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect stockholders' investments in the Association. Upon request, stockholders of the Association will be provided with the Farm Credit Bank of Texas Annual Report to Stockholders.

## **NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:**

The accounting and reporting policies of the Association conform to accounting principles generally accepted in the United States of America ("GAAP") and prevailing practices within the banking industry.

### Basis of Presentation and Consolidation

The consolidated financial statements (the "financial statements") of the Association have been prepared in conformity with GAAP. In consolidation, all significant intercompany accounts and transactions are eliminated and all material wholly-owned and majority-owned subsidiaries are consolidated unless GAAP requires otherwise.

### Reclassifications

Certain amounts in prior years' financial statements have been reclassified to conform to current financial statement presentation. The consolidated financial statements include the accounts of the Association.

### Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses; the valuation of deferred tax assets; the determination of fair value of financial instruments and subsequent impairment analysis. Actual results could differ from those estimates.

#### **A. Recently Issued or Adopted Accounting Pronouncements:**

In August 2018, the Financial Accounting Standards Board (FASB) issued guidance entitled "Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Cost." The guidance aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by this guidance. This guidance becomes effective for interim and annual periods beginning after December 15, 2019. The guidance also requires an entity (customer) to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. It further specifies where to present expense and payments in the financial statements. Early adoption is permitted. The guidance is to be applied on a retrospective or prospective basis to all implementation costs incurred after the date of adoption. The adoption of this guidance is not expected to impact the Association's financial condition or its results of operations.

In August 2018, the FASB issued guidance entitled "Disclosure Framework — Changes to the Disclosure Requirements for Defined Benefit Plans." The guidance modifies the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. This guidance becomes effective for fiscal years ending after December 15, 2020. Early adoption is permitted. The guidance is to be applied on a retrospective basis for all periods. The adoption of this guidance will not impact the Association's financial condition or its results of operations, but will impact the employee benefit plan disclosures.

In August 2018, the FASB issued guidance entitled "Disclosure Framework — Changes to the Disclosure Requirements for Fair Value Measurement." The guidance modifies the requirements on fair value measurements by removing, modifying or adding to the disclosures. This guidance becomes effective for interim and annual periods beginning after December 15, 2019. Early adoption is permitted and an entity is permitted to early adopt any removal or modified disclosures and delay adoption of the additional disclosures until their effective date. The adoption of this guidance will not impact the Association's financial condition or its results of operations, but will impact the fair value measurements disclosures. The Association early adopted the removal and modified disclosures during the fourth quarter of 2018.



## **NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):**

In February 2018, the Financial Accounting Standards Board (FASB) issued guidance entitled “Income Statement — Reporting Comprehensive Income — Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.” This guidance allows for the reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the recently issued tax legislation, Tax Cuts and Jobs Act (TCJA), that lowered the federal corporate tax rate from 35 percent to 21 percent. The amount of the reclassification shall include the effect of the change in the tax rate on gross deferred tax amounts and related valuation allowances at the date of enactment of the TCJA related to items remaining in accumulated other comprehensive income. The guidance becomes effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The Association early adopted the guidance during the first quarter of 2018. The adoption of this guidance did not materially impact the Association’s financial condition or its results of operations.

In August 2017, the FASB issued guidance entitled “Targeted Improvements to Accounting for Hedging Activities.” The guidance better aligns an entity’s risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. The amendments in this guidance require an entity to present the earnings effect of the hedging instrument in the same income statement line item in which the earnings effect of the hedged item is reported. This guidance also addresses the timing of effectiveness testing, qualitative and quantitative effectiveness testing and components that can be excluded from effectiveness testing. This guidance becomes effective for interim and annual periods beginning after December 15, 2018. The Association does not currently participate in hedging activities; therefore there is no impact of adoption on the Association’s financial condition.

In March 2017, the FASB issued guidance entitled “Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Cost.” The guidance requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. Other components are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. This guidance became effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not materially impact the Association’s financial condition but did change the classification of certain items in the results of operations.

In August 2016, the FASB issued guidance entitled “Classification of Certain Cash Receipts and Cash Payments.” The guidance addresses specific cash flow issues with the objective of reducing the diversity in the classification of these cash flows. Included in the cash flow issues are debt prepayment or debt extinguishment costs and settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing. This guidance became effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not materially impact the Association’s financial condition or its results of operations but did change the classification of certain items in the statement of cash flows.

In June 2016, the FASB issued guidance entitled “Measurement of Credit Losses on Financial Instruments.” The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses. For public business entities that are not U.S. Securities and Exchange Commission filers this guidance becomes effective for interim and annual periods beginning after December 15, 2020, with early application permitted. The Association is evaluating the impact of adoption on the Association’s financial condition and its results of operations.

In February 2016, the FASB issued guidance entitled “Leases.” The guidance requires the recognition by lessees of lease assets and lease liabilities on the balance sheet for the rights and obligations created by those leases. Leases with lease terms of more than 12 months are impacted by this guidance. In July 2018, the FASB issued an update entitled “Leases – Targeted Improvements,” which provides entities with an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. An entity that elects this additional transition method must provide the required disclosures of the now current standard for all prior periods presented. The guidance and related amendments in this updated disclosure become effective for interim and annual periods beginning after December 15, 2018, with early application permitted. The adoption of this guidance is not expected to impact the Association’s financial condition or its results of operations.

## NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

In January 2016, the FASB issued guidance entitled “Recognition and Measurement of Financial Assets and Liabilities.” The guidance affects, among other things, the presentation and disclosure requirements for financial instruments. For public entities, the guidance eliminates the requirement to disclose the methods and significant assumptions used to estimate the fair value of financial instruments carried at amortized cost. This guidance became effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not impact the Association’s financial condition or its results of operations but did impact the Association’s fair value disclosures.

In May 2014, the FASB issued guidance entitled, “Revenue from Contracts with Customers.” The guidance governs revenue recognition from contracts with customers and requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Financial instruments and other contractual rights within the scope of other guidance issued by the FASB are excluded from the scope of this new revenue recognition guidance. The guidance sets forth the requirement for new and enhanced disclosures. The Association adopted the new standard effective January 1, 2018, using the modified retrospective approach. As the majority of the Association’s revenues are not subject to the new guidance, the adoption of the guidance did not have a material impact on the financial position, results of operations, equity or cash flows.

- B. Cash: Cash, as included in the statement of cash flows, represents cash on hand and on deposit at local banks.
- C. Loans and Allowance for Loan Losses: Long-term real estate mortgage loans generally have original maturities ranging from five to 30 years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less. Loans are carried at their principal amount outstanding adjusted for charge-offs and net deferred loan fees or costs. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. Authoritative accounting guidance requires loan origination fees and direct loan origination costs, if material, to be capitalized and the net fee or cost to be amortized over the life of the related loan as an adjustment to yield.

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 and are generally considered substandard or doubtful, which is in accordance with the loan rating model, as described below. Impaired loans include nonaccrual loans, restructured loans, and 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 a result of past-due status, is collected or otherwise discharged in full.

Impaired loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days (unless adequately secured and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. Additionally, all loans over 180 days past due are placed in nonaccrual status. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is either reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in prior years). Loans are charged off at the time they are determined to be uncollectible.

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. A concession is generally granted in order to minimize the Association’s economic loss and avoid foreclosure. Concessions vary by program and are borrower-specific and may include interest rate reductions, term extensions, payment deferrals or the acceptance of additional collateral in lieu of payments. In limited circumstances, principal may be forgiven. A loan restructured in a troubled debt restructuring is an impaired loan.

Payments received on nonaccrual loans are generally applied to the recorded investment in the loan asset. 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, the interest portion of payments is recognized as current interest income. Nonaccrual loans may be returned to accrual status when principal and interest are current, the borrower has demonstrated payment performance, there are no unrecovered prior charge-offs and collection of future payments is no longer in doubt. If previously unrecognized interest income exists at the time the loan is transferred to accrual status, cash received at the time of or subsequent to the transfer is first recorded as interest income until such time as the recorded balance equals the contractual indebtedness of the borrower.

The Bank and related associations use a two-dimensional loan rating model based on an 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

## NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

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 probability of default 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 (OAEM) and grows significantly as a loan moves to a substandard (viable) level. A substandard (nonviable) rating indicates that the probability of default is almost certain.

The credit risk-rating methodology is a key component of the Association's allowance for loan losses evaluation, and is generally incorporated into its loan underwriting standards and internal lending limit. The allowance for loan losses is maintained at a level considered adequate by management to provide for probable losses inherent in the loan portfolio. The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition, collateral value, portfolio quality, current production conditions and economic conditions, and prior loan loss experience. Management may consider other qualitative factors in determining and supporting the level of allowance for loan losses including but not limited to: the concentration of lending in agriculture, combined with uncertainties associated with farmland values, commodity prices, exports, government assistance programs, regional economic effects, borrower repayment capacity, depth of lender staff, and/or past trends, and weather-related influences. The allowance for loan losses encompasses various judgments, evaluations and appraisals with respect to the loans and their underlying security that, by their nature, contain elements of uncertainty and imprecision. Changes in the agricultural economy and their impact on borrower repayment capacity will cause these various judgments, evaluations and appraisals to change over time. Accordingly, actual circumstances could vary significantly from the institutions' expectations and predictions of those circumstances.

The allowance for loan losses includes components for loans individually evaluated for impairment and loans collectively evaluated for impairment. Generally, for loans individually evaluated the allowance for loan losses represents the difference between the recorded investment in the loan and the present value of the cash flows expected to be collected, discounted at the loan's effective interest rate, or at the fair value of the collateral, less estimated costs to sell, if the loan is collateral-dependent. For those loans collectively evaluated for impairment, the allowance for loan losses is determined using the risk-rating model.

The Association purchases loan participations from other System entities to generate additional earnings and diversify risk related to existing commodities financed and the geographic area served. Currently, the Association does not sell portions of certain large loans to other System entities with established lending limits.

- D. Capital Stock Investment in the Farm Credit Bank of Texas: The Association's investment in the Bank is in the form of Class A voting capital stock and allocated retained earnings. This investment is adjusted periodically based on the Association's proportional utilization of the Bank compared to other district associations. The Bank requires a minimum stock investment of 2.0 percent of the Association's average borrowing from the Bank. This investment is carried at cost plus allocated equities in the accompanying consolidated balance sheet.

If needed to meet regulatory capital adequacy requirements, the board of directors of the Bank may increase the percentage of stock held by an association from 2.0 percent of the average outstanding balance of borrowings from the Bank to a maximum of 5.0 percent of the average outstanding balance of borrowings from the Bank.

- E. Other Property Owned, Net: Other property owned, net, consists of real and personal property acquired through foreclosure or deed in lieu of foreclosure, and is recorded at fair value less estimated selling costs upon acquisition and is included in other assets in the consolidated balance sheet. 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. On at least an annual basis, 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 and expenses from operations and carrying value adjustments are included in net gains (losses) on other property owned in the statements of comprehensive income.

**NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):**

- F. Premises and Equipment: Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. Depreciation is provided on the straight-line method using estimated useful lives of the assets. Gains and losses on dispositions are reflected in current operations. Maintenance and repairs are charged to operating expense, and improvements are capitalized.
- G. Advance Conditional Payments: The Association is authorized under the Act to accept advance payments from borrowers. To the extent that the borrower's access to such funds is restricted, the advance 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 liabilities in the accompanying consolidated balance sheet. Advance conditional payments are not insured. Interest is generally paid by the Association on such accounts at rates established by the board of directors.
- H. Employee Benefit Plans: Employees of the Association participate in either the district defined benefit retirement plan (DB plan) or the defined contribution plan (DC plan). All eligible employees may participate in the Farm Credit Benefits Alliance 401(k) Plan. Also, the Association sponsors a nonqualified defined contribution 401(k) plan. The DB plan is closed to new participants. Participants generally include employees hired prior to January 1, 1996. The DB plan is noncontributory and provides benefits based on salary and years of service. The "projected unit credit" actuarial method is used for financial reporting and funding purposes for the DB plan.

Participants in the DC plan generally include employees who elected to transfer from the DB plan prior to January 1, 1996, and employees hired on or after January 1, 1996. Participants in the DC plan direct the placement of their employers' contributions, 5.0 percent of eligible pay for the year ended December 31, 2018, made on their behalf into various investment alternatives. The Association recognized pension costs for the DC plan of \$232,047, \$197,991 and \$174,974 for the years ended December 31, 2018, 2017 and 2016, respectively.

The structure of the district's DB plan is characterized as multiemployer, since neither the assets, liabilities nor costs of the plan are segregated or separately accounted for by the associations. No portion of any surplus assets is available to the associations, nor are the associations required to pay for plan liabilities upon withdrawal from the plans. As a result, the associations recognize as pension cost the required contribution to the plans for the year. Contributions due and unpaid are recognized as a liability. For the DB plan, the Association recognized pension costs of \$381,833, \$439,953 and \$277,099 for the years ended December 31, 2018, 2017 and 2016, respectively.

The Association also participates in the Farm Credit Benefits Alliance 401(k) Plan, which requires the associations to match 100 percent of employee contributions up to 3.0 percent of eligible earnings and to match 50 percent of employee contributions for the next 2.0 percent of employee contributions, up to a maximum employer contribution of 4.0 percent of eligible earnings. Association 401(k) plan costs are expensed as incurred. The Association's contributions to the 401(k) plan were \$188,897, \$162,842 and \$147,001 for the years ended December 31, 2018, 2017 and 2016, respectively.

The CEO and certain executive or highly compensated employees in the Association are eligible to participate in a separate nonqualified supplemental 401(k) plan, named the Farm Credit Benefits Alliance Nonqualified Supplemental 401(k) Plan (supplemental 401(k) plan). This plan allows district employers to elect to participate in any or all of the following benefits:

- Restored Employer Contributions – to allow "make-up" contributions for eligible employees whose benefits to the qualified 401(k) plan were limited by the Internal Revenue Code during the year
- Elective Deferrals – to allow eligible employees to make pre-tax deferrals of compensation above and beyond any deferrals into the qualified 401(k) plan
- Discretionary Contributions – to allow participating employers to make a discretionary contribution to an eligible employee's account in the plan, and to designate a vesting schedule

The Association made no contributions to this plan for the years ended December 31, 2018, 2017 and 2016. There were no payments made from the supplemental 401(k) plan to active employees during 2018, 2017 or 2016.

In addition to pension benefits, the Association provides certain health care and life insurance benefits to qualifying retired employees (other postretirement benefits). These benefits are not characterized as multiemployer and, consequently, the liability for these benefits is included in other liabilities on the consolidated balance sheet.

Employees hired prior to January 1, 2004 and who are at least 55 years of age (or at least age 50 with 30 years of service) may retire and have their medical premium paid on a percentage of cost sharing basis predicated on length of employment service.

## NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

Employees hired before this date that have reached the age requirement and have 25 years of service will receive 100 percent of their medical premium paid. Employees hired after January 1, 2004 will be eligible for access only to retiree medical benefits for themselves, but will be responsible for 100 percent of the premium. For further information on the Association's employee benefit plans, see Note 11, "Employee Benefit Plans."

- I. **Income Taxes:** The ACA holding company conducts its business activities through two wholly-owned subsidiaries. Long-term mortgage lending activities are operated through the wholly-owned FLCA subsidiary, which is exempt from federal and state income tax. Short- and intermediate-term lending activities are operated through the wholly-owned PCA subsidiary. Operating expenses are allocated to each subsidiary based on estimated relative service. All significant transactions between the subsidiaries and the parent company have been eliminated in consolidation. The ACA, along with the PCA subsidiary, is subject to income tax. 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 retained earnings. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage refunds. Deferred taxes are provided on the Association's taxable income on the basis of a proportionate share of the tax effect of temporary differences not allocated in patronage form. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (over 50 percent probability), based on management's estimate, that they will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of the Association's expected patronage program, which reduces taxable earnings.
- J. **Patronage Refunds From the Farm Credit Bank of Texas:** The Association records patronage refunds from the Bank on an accrual basis.
- K. **Fair Value Measurement:** The FASB guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. It describes three levels of inputs that may be used to measure fair value:

Level 1 — Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury, other U.S. government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets. Also included in Level 1 are assets held in trust funds, which relate to deferred compensation and the supplemental retirement plan. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace. Pension plan assets that are invested in equity securities, including mutual funds and fixed-income securities that are actively traded, are also included in Level 1.

Level 2 — Observable inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly or indirectly. Level 2 inputs include the following: (a) quoted prices for similar assets or liabilities in active markets; (b) quoted prices for identical or similar assets or liabilities in markets that are not active so that they are traded less frequently than exchange-traded instruments, the prices are not current or principal market information is not released publicly; (c) inputs other than quoted prices that are observable, such as interest rates and yield curves, prepayment speeds, credit risks and default rates; and (d) inputs derived principally from or corroborated by observable market data by correlation or other means. This category generally includes certain U.S. government and agency mortgage-backed debt securities, corporate debt securities and derivative contracts. Pension plan assets that are derived from observable inputs, including corporate bonds and mortgage-backed securities, are reported in Level 2.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities are considered Level 3. These unobservable inputs reflect the reporting entity's own assumptions about assumptions that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain private equity investments, retained residual interests in securitizations, asset-backed securities, highly structured or long-term derivative contracts, certain loans and other property owned. Pension plan assets such as certain mortgage-backed securities that are supported by little or no market data in determining the fair value are included in Level 3.

The fair value disclosures are presented in Note 14, "Fair Value Measurements."

**NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):**

L. Off-balance-sheet credit exposures: 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. Commercial letters of credit are conditional 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. The credit risk associated with commitments to extend credit and commercial 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.

**NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES:**

A summary of loans as of December 31 follows:

Loan Type	2018		2017		2016	
	Amount	%	Amount	%	Amount	%
Real estate mortgage	\$ 650,500,490	81.9%	\$ 619,995,606	85.0%	\$ 590,832,751	87.9%
Production and intermediate term	89,442,720	11.2%	70,227,903	9.6%	49,357,303	7.3%
Agribusiness:						
Processing and marketing	32,667,110	4.1%	25,616,273	3.5%	17,260,248	2.6%
Farm-related business	2,161,726	0.3%	949,469	0.2%	928,968	0.1%
Rural residential real estate	17,551,701	2.2%	12,630,071	1.7%	11,584,572	1.7%
Communication	2,061,951	0.3%	-	0.0%	1,991,970	0.3%
Energy	30,426	0.0%	-	0.0%	141,567	0.1%
Total	\$ 794,416,124	100.0%	\$ 729,419,322	100.0%	\$ 672,097,379	100.0%

The Association may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration regulations. The following table presents information regarding participations purchased and sold as of December 31, 2018:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
	Agribusiness	\$ 33,261,298	\$ -	\$ -	\$ -	\$ 33,261,298
Production and intermediate term	4,619,342	-	-	-	4,619,342	-
Communication	2,061,951	-	-	-	2,061,951	-
Energy	30,426	-	-	-	30,426	-
	\$ 39,973,017	\$ -	\$ -	\$ -	\$ 39,973,017	\$ -

A Geographic Distribution of loans as of December 31, 2018 is as follows:

County	2018	2017	2016
De Kalb	18.6%	19.1%	19.5%
Marshall	9.3%	9.7%	9.4%
Lawrence	7.6%	7.7%	7.2%
Cullman	5.0%	5.6%	5.5%
Jackson	4.8%	5.1%	4.9%
Blount	4.5%	4.0%	4.4%
Madison	4.2%	4.1%	4.0%
Randolph	4.1%	3.8%	3.7%
Etowah	4.1%	4.3%	4.3%
Franklin	4.0%	4.4%	4.0%
Other counties with less than 4%	31.0%	29.4%	26.7%
Other states	2.8%	2.8%	6.4%
	100.0%	100.0%	100.0%

**NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES (continued):**

The Association's concentration of credit risk in various agricultural commodities is shown in the following table. While the amounts represent the Association's maximum potential credit risk as it relates to recorded loan principal, 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. An estimate of the Association's credit risk exposure is considered in the determination of the allowance for loan losses.

Operation/Commodity	2018		2017		2016	
	Amount	%	Amount	%	Amount	%
Poultry and eggs	\$ 367,403,162	46.2%	\$ 334,040,092	45.8%	\$ 319,339,325	47.5%
Livestock, except dairy and poultry	132,877,075	16.7%	120,437,892	16.5%	110,168,472	16.4%
Timber	83,484,297	10.5%	67,752,888	9.3%	63,208,034	9.4%
Field crops, except cash grains	69,559,969	8.8%	56,846,501	7.8%	48,263,537	7.2%
Cash grains	59,529,810	7.5%	52,060,618	7.1%	47,494,406	7.1%
Rural home loans	17,551,701	2.2%	41,865,717	5.7%	36,143,635	5.4%
Other	64,010,110	8.1%	56,415,614	7.8%	47,479,970	7.0%
Total	<u>\$ 794,416,124</u>	<u>100.0%</u>	<u>\$ 729,419,322</u>	<u>100.0%</u>	<u>\$ 672,097,379</u>	<u>100.0%</u>

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 secured by the first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (or 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 the loan-to-value ratios in excess of the regulatory maximum.

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

	December 31, 2018	December 31, 2017	December 31, 2016
<b>Nonaccrual loans:</b>			
Real estate mortgage	\$ 4,751,770	\$ 2,675,292	\$ 1,349,979
Production and intermediate term	231,717	32,021	4,147
Total nonaccrual loans	<u>4,983,487</u>	<u>2,707,313</u>	<u>1,354,126</u>
<b>Accruing restructured loans:</b>			
Real estate mortgage	967,847	1,007,403	1,243,130
<b>Accruing loans 90 days or more past due:</b>			
Production and intermediate term	-	-	679,933
Total nonperforming loans	<u>5,951,334</u>	<u>3,714,716</u>	<u>3,277,189</u>
Other property owned	<u>1,024,659</u>	<u>2,491,876</u>	<u>2,064,392</u>
Total nonperforming assets	<u>\$ 6,975,993</u>	<u>\$ 6,206,592</u>	<u>\$ 5,341,581</u>

One credit quality indicator utilized by the Bank and the Association is the Farm Credit Administration's Uniform Loan Classification System, which categorizes loans into five categories. The categories are defined as follows:

- Acceptable – assets are expected to be fully collectible and represent the highest quality,
- Other assets especially mentioned (OAEM) – assets are currently collectible but exhibit some potential weakness,
- Substandard – assets exhibit some serious weakness in repayment capacity, equity and/or collateral pledged on the loan,
- Doubtful – assets exhibit similar weaknesses to substandard assets; however, doubtful assets have additional weaknesses in existing factors, conditions and values that make collection in full highly questionable, and
- Loss – assets are considered uncollectible.

**NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES (continued):**

The following table shows loans and related accrued interest classified under the Farm Credit Administration’s Uniform Loan Classification System as a percentage of total loans and related accrued interest receivable by loan type as of December 31:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Real estate mortgage			
Acceptable	<b>98.4</b> %	98.3 %	97.8 %
OAEM	<b>0.6</b>	1.0	1.7
Substandard/doubtful	<b>1.0</b>	0.7	0.5
	<u><b>100.0</b></u>	<u>100.0</u>	<u>100.0</u>
Production and intermediate term			
Acceptable	<b>98.1</b>	99.1	98.0
OAEM	<b>0.4</b>	0.8	1.9
Substandard/doubtful	<b>1.5</b>	0.1	0.1
	<u><b>100.0</b></u>	<u>100.0</u>	<u>100.0</u>
Processing and marketing			
Acceptable	<b>100.0</b>	100.0	100.0
OAEM	-	-	-
Substandard/doubtful	-	-	-
	<u><b>100.0</b></u>	<u>100.0</u>	<u>100.0</u>
Farm-related business			
Acceptable	<b>100.0</b>	100.0	100.0
OAEM	-	-	-
Substandard/doubtful	-	-	-
	<u><b>100.0</b></u>	<u>100.0</u>	<u>100.0</u>
Communication			
Acceptable	<b>100.0</b>	-	100.0
OAEM	-	-	-
Substandard/doubtful	-	-	-
	<u><b>100.0</b></u>	<u>-</u>	<u>100.0</u>
Energy			
Acceptable	<b>100.0</b>	-	100.0
OAEM	-	-	-
Substandard/doubtful	-	-	-
	<u><b>100.0</b></u>	<u>-</u>	<u>100.0</u>
Rural residential real estate			
Acceptable	<b>98.8</b>	100.0	100.0
OAEM	-	-	-
Substandard/doubtful	<b>1.2</b>	-	-
	<u><b>100.0</b></u>	<u>100.0</u>	<u>100.0</u>
Total Loans			
Acceptable	<b>98.4</b>	<b>98.4</b>	<b>98.0</b>
OAEM	<b>0.6</b>	<b>1.0</b>	<b>1.6</b>
Substandard/doubtful	<b>1.0</b>	<b>0.6</b>	<b>0.4</b>
	<u><b>100.0</b></u> %	<u><b>100.0</b></u> %	<u><b>100.0</b></u> %



**NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES (continued):**

The following tables provide an age analysis of past due loans (including accrued interest) as of December 31, 2018, 2017 and 2016:

December 31, 2018:	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or less than 30 Days Past Due	Total Loans	Recorded Investment >90 Days and Accruing
Real estate mortgage	\$ 8,336,375	\$ 698,974	\$ 9,035,349	\$ 648,635,359	\$ 657,670,708	\$ -
Production and intermediate term	1,186,262	177,726	1,363,988	89,504,549	90,868,537	-
Agribusiness:						
Processing and marketing	-	-	-	32,707,317	32,707,317	-
Farm-related business	-	-	-	2,167,163	2,167,163	-
Rural residential real estate	589,387	-	589,387	17,021,674	17,611,061	-
Communication	-	-	-	2,062,210	2,062,210	-
Energy	-	-	-	30,473	30,473	-
<b>Total</b>	<b>\$ 10,112,024</b>	<b>\$ 876,700</b>	<b>\$ 10,988,724</b>	<b>\$ 792,128,745</b>	<b>\$ 803,117,469</b>	<b>\$ -</b>
December 31, 2017:	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or less than 30 Days Past Due	Total Loans	Recorded Investment >90 Days and Accruing
Real estate mortgage	\$ 5,314,383	\$ 842,421	\$ 6,156,804	\$ 620,417,696	\$ 626,574,500	\$ -
Production and intermediate term	154,573	4,147	158,720	70,966,247	71,124,967	-
Agribusiness:						
Processing and marketing	-	-	-	25,640,420	25,640,420	-
Farm-related business	-	-	-	950,911	950,911	-
Rural residential real estate	-	-	-	12,667,080	12,667,080	-
<b>Total</b>	<b>\$ 5,468,956</b>	<b>\$ 846,568</b>	<b>\$ 6,315,524</b>	<b>\$ 730,642,354</b>	<b>\$ 736,957,878</b>	<b>\$ -</b>
December 31, 2016:	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or less than 30 Days Past Due	Total Loans	Recorded Investment >90 Days and Accruing
Real estate mortgage	\$ 4,930,125	\$ 466,251	\$ 5,396,376	\$ 591,753,387	\$ 597,149,763	\$ -
Production and intermediate term	180,525	679,933	860,458	49,294,713	50,155,171	679,933
Agribusiness:						
Processing and marketing	-	-	-	17,282,180	17,282,180	-
Farm-related business	-	-	-	930,738	930,738	-
Rural residential real estate	-	-	-	11,619,886	11,619,886	-
Communication	-	-	-	1,993,338	1,993,338	-
Energy	-	-	-	142,159	142,159	-
<b>Total</b>	<b>\$ 5,110,650</b>	<b>\$ 1,146,184</b>	<b>\$ 6,256,834</b>	<b>\$ 673,016,401</b>	<b>\$ 679,273,235</b>	<b>\$ 679,933</b>

Note: The recorded investment in the receivable is the face amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges or acquisition costs, and may also reflect a previous direct write-down of the investment.

A restructuring of a debt constitutes a troubled debt restructuring if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Troubled debt restructurings are undertaken in order to improve the likelihood of recovery on the loan and may include, but are not limited to, forgiveness of principal or interest, interest rate reductions that are lower than the current market rate for new debt with similar risk, or significant term or payment extensions.

As of December 31, 2018, the total recorded investment of troubled debt restructured loans was \$967,847, all of which were classified as accrual. Troubled debt restructurings are analyzed for allowance for loan losses using the specific analysis method. No specific allowance for loan losses was recorded for troubled debt restructurings as of December 31, 2018. Also, there were no commitments to lend funds to borrowers whose loans have been modified in a troubled debt restructuring at December 31, 2018.

There were no loans formally restructured during the year ending December 31, 2018; however, the following table presents additional information regarding troubled debt restructurings that occurred during the years ended December 31, 2017 and 2016. The pre-modification outstanding recorded investment represents the recorded investment of the loans as of the quarter end prior to the restructuring. The post-modification outstanding recorded investment represents the recorded investment of the loans as of the quarter end the restructuring occurred.

**NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES (continued):**

December 31, 2017:	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	\$ 118,192	\$ 118,192
Total	\$ 118,192	\$ 118,192
December 31, 2016:	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	\$ 307,536	\$ 308,869
Total	\$ 307,536	\$ 308,869

In restructurings where principal is forgiven, the amount of the forgiveness is immediately charged off. In restructurings where accrued interest is forgiven, the interest is reversed (if current year interest) or charged off (if prior year interest). There were no charge offs at the modification date for the year ended December 31, 2018.

The predominant form of concession granted for troubled debt restructuring includes the extension of terms due to cash flow constrictions enabling the borrower to fund the original payment amount. At times these terms might be offset with incremental payments, collateral or new borrower guarantees, in which case the Association assesses all of the modified terms to determine if the overall modification qualifies as a troubled debt restructuring.

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

	Loans Modified as TDRs		
	December 31, 2018	December 31, 2017	December 31, 2016
Troubled debt restructurings:			
Real estate mortgage	\$ 967,847	\$ 1,007,403	\$ 1,243,130
Total	\$ 967,847	\$ 1,007,403	\$ 1,243,130

**NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES (continued):**

Additional impaired loan information is as follows:

	Recorded Investment at 12/31/2018	Unpaid Principal Balance <sup>a</sup>	Related Allowance	Average Impaired Loans	Interest Income Recognized
<b>Impaired loans with a related allowance for credit losses:</b>					
Real estate mortgage	\$ 1,654,533	\$ 1,655,783	\$ 147,132	\$ 659,717	\$ -
Production and intermediate term	225,678	225,678	92,606	62,854	-
Total	<u>\$ 1,880,211</u>	<u>\$ 1,881,461</u>	<u>\$ 239,738</u>	<u>\$ 722,571</u>	<u>\$ -</u>
<b>Impaired loans with no related allowance for credit losses:</b>					
Real estate mortgage	\$ 4,057,640	\$ 4,059,559	\$ -	\$ 3,778,009	\$ 109,944
Production and intermediate term	6,039	6,039	-	132,169	6,024
Total	<u>\$ 4,063,679</u>	<u>\$ 4,065,598</u>	<u>\$ -</u>	<u>\$ 3,910,178</u>	<u>\$ 115,968</u>
<b>Total impaired loans:</b>					
Real estate mortgage	\$ 5,712,173	\$ 5,715,342	\$ 147,132	\$ 4,437,726	\$ 109,944
Production and intermediate term	231,717	231,717	92,606	195,023	6,024
Total	<u><u>\$ 5,943,890</u></u>	<u><u>\$ 5,947,059</u></u>	<u><u>\$ 239,738</u></u>	<u><u>\$ 4,632,749</u></u>	<u><u>\$ 115,968</u></u>

<sup>a</sup> Unpaid principal balance represents the recorded principal legal balance of the loan.

	Recorded Investment at 12/31/2017	Unpaid Principal Balance <sup>a</sup>	Related Allowance	Average Impaired Loans	Interest Income Recognized
<b>Impaired loans with a related allowance for credit losses:</b>					
Real estate mortgage	\$ 506,268	\$ 506,268	\$ 18,903	\$ 160,616	\$ -
Production and intermediate term	32,021	32,136	31,037	9,025	-
Total	<u>\$ 538,289</u>	<u>\$ 538,404</u>	<u>\$ 49,940</u>	<u>\$ 169,641</u>	<u>\$ -</u>
<b>Impaired loans with no related allowance for credit losses:</b>					
Real estate mortgage	\$ 3,168,044	\$ 3,178,177	\$ -	\$ 3,135,213	\$ 62,436
Production and intermediate term	-	-	-	131,196	-
Rural residential real estate	-	-	-	295	-
Total	<u>\$ 3,168,044</u>	<u>\$ 3,178,177</u>	<u>\$ -</u>	<u>\$ 3,266,704</u>	<u>\$ 62,436</u>
<b>Total impaired loans:</b>					
Real estate mortgage	\$ 3,674,312	\$ 3,684,445	\$ 18,903	\$ 3,295,829	\$ 62,436
Production and intermediate term	32,021	32,136	31,037	140,221	-
Rural residential real estate	-	-	-	295	-
Total	<u><u>\$ 3,706,333</u></u>	<u><u>\$ 3,716,581</u></u>	<u><u>\$ 49,940</u></u>	<u><u>\$ 3,436,345</u></u>	<u><u>\$ 62,436</u></u>

<sup>a</sup> Unpaid principal balance represents the recorded principal legal balance of the loan.

**NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES (continued):**

	Recorded Investment at 12/31/2016	Unpaid Principal Balance <sup>a</sup>	Related Allowance	Average Impaired Loans	Interest Income Recognized
<b>Impaired loans with a related allowance for credit losses:</b>					
Real estate mortgage	\$ -	\$ -	\$ -	\$ -	\$ -
Production and intermediate term	4,147	4,147	4,147	204	169
Total	<u>\$ 4,147</u>	<u>\$ 4,147</u>	<u>\$ 4,147</u>	<u>\$ 204</u>	<u>\$ 169</u>
<b>Impaired loans with no related allowance for credit losses:</b>					
Real estate mortgage	\$ 2,593,109	\$ 2,586,767	\$ -	\$ 2,139,188	\$ 96,710
Production and intermediate term	679,933	652,239	-	642,498	37,393
Total	<u>\$ 3,273,042</u>	<u>\$ 3,239,006</u>	<u>\$ -</u>	<u>\$ 2,781,686</u>	<u>\$ 134,103</u>
<b>Total impaired loans:</b>					
Real estate mortgage	\$ 2,593,109	\$ 2,586,767	\$ -	\$ 2,139,188	\$ 96,710
Production and intermediate term	684,080	656,386	4,147	642,702	37,562
Total	<u><u>\$ 3,277,189</u></u>	<u><u>\$ 3,243,153</u></u>	<u><u>\$ 4,147</u></u>	<u><u>\$ 2,781,890</u></u>	<u><u>\$ 134,272</u></u>

<sup>a</sup> Unpaid principal balance represents the recorded principal legal balance of the loan.

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2018, 2017 and 2016.

Interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans at December 31:

	2018	2017	2016
Interest income which would have been recognized under the original terms	\$ 403,730	\$ 181,026	\$ 54,510
Less: interest income recognized	(115,968)	(62,436)	(6,195)
Foregone interest income	<u><u>\$ 287,762</u></u>	<u><u>\$ 118,590</u></u>	<u><u>\$ 48,315</u></u>

**NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES (continued):**

A summary of the changes in the allowance for credit losses and the ending balance of loans outstanding are as follows:

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communication	Energy/ Water and Waste Water	Rural Residential Real Estate	Total
<b>Allowance for Credit Losses:</b>							
Balance at							
December 31, 2017	\$ 3,583,400	\$ 145,526	\$ 37,427	\$ -	\$ -	\$ 11,647	\$ 3,778,000
Charge-offs	(8,912)	(4,012)	-	-	-	-	(12,924)
Recoveries	3,833	-	-	-	-	-	3,833
Provision for loan losses	130,592	111,553	(4,901)	1,819	(275)	3,303	242,091
Other	(246)	(9,431)	8,369	-	275	33	(1,000)
Balance at							
December 31, 2018	<u>\$ 3,708,667</u>	<u>\$ 243,636</u>	<u>\$ 40,895</u>	<u>\$ 1,819</u>	<u>\$ -</u>	<u>\$ 14,983</u>	<u>\$ 4,010,000</u>
Ending Balance: individually evaluated for impairment	\$ 147,132	\$ 92,606	\$ -	\$ -	\$ -	\$ -	\$ 239,738
Ending Balance: collectively evaluated for impairment	\$ 3,561,535	\$ 151,030	\$ 40,895	\$ 1,819	\$ -	\$ 14,983	\$ 3,770,262
<b>Recorded Investment in Loans Outstanding:</b>							
Ending Balance at							
December 31, 2018	\$ 657,670,708	\$ 90,868,537	\$ 34,874,480	\$ 2,062,210	\$ 30,473	\$ 17,611,061	\$ 803,117,469
Ending balance for loans individually evaluated for impairment	\$ 5,719,617	\$ 231,717	\$ -	\$ -	\$ -	\$ -	\$ 5,951,334
Ending balance for loans collectively evaluated for impairment	\$ 651,951,091	\$ 90,636,820	\$ 34,874,480	\$ 2,062,210	\$ 30,473	\$ 17,611,061	\$ 797,166,135
	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communication	Energy	Rural Residential Real Estate	Total
<b>Allowance for Credit Losses:</b>							
Balance at							
December 31, 2016	\$ 3,601,697	\$ 56,604	\$ 27,089	\$ 2,450	\$ 313	\$ 10,247	\$ 3,698,400
Charge-offs	(2,186)	-	-	-	-	-	(2,186)
Recoveries	3,830	-	-	-	-	-	3,830
Provision for loan losses	(15,965)	104,255	14,929	(2,450)	(1,976)	1,163	99,956
Other	(3,976)	(15,333)	(4,591)	-	1,663	237	(22,000)
Balance at							
December 31, 2017	<u>\$ 3,583,400</u>	<u>\$ 145,526</u>	<u>\$ 37,427</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 11,647</u>	<u>\$ 3,778,000</u>
Ending Balance: individually evaluated for impairment	\$ 18,902	\$ 31,037	\$ -	\$ -	\$ -	\$ -	\$ 49,939
Ending Balance: collectively evaluated for impairment	\$ 3,564,498	\$ 114,489	\$ 37,427	\$ -	\$ -	\$ 11,647	\$ 3,728,061
<b>Recorded Investment in Loans Outstanding:</b>							
Ending Balance at							
December 31, 2017	\$ 626,574,500	\$ 71,124,967	\$ 26,591,331	\$ -	\$ -	\$ 12,667,080	\$ 736,957,878
Ending balance for loans individually evaluated for impairment	\$ 3,682,695	\$ 32,021	\$ -	\$ -	\$ -	\$ -	\$ 3,714,716
Ending balance for loans collectively evaluated for impairment	\$ 622,891,805	\$ 71,092,946	\$ 26,591,331	\$ -	\$ -	\$ 12,667,080	\$ 733,243,162

**NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES (continued):**

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communication	Energy	Rural Residential Real Estate	Total
<b>Allowance for Credit Losses:</b>							
Balance at							
December 31, 2015	\$ 3,683,029	\$ 63,667	\$ 20,193	\$ 2,550	\$ 681	\$ 11,364	\$ 3,781,484
Charge-offs	(34,047)	(60,311)	-	-	-	-	(94,358)
Recoveries	3,689	25,737	-	-	-	-	29,426
Provision for loan losses	(53,565)	32,361	12,153	(100)	(1,011)	(847)	(11,009)
Other	2,591	(4,850)	(5,257)	-	643	(270)	(7,143)
Balance at							
December 31, 2016	<u>\$ 3,601,697</u>	<u>\$ 56,604</u>	<u>\$ 27,089</u>	<u>\$ 2,450</u>	<u>\$ 313</u>	<u>\$ 10,247</u>	<u>\$ 3,698,400</u>
Ending Balance:							
individually evaluated for impairment	\$ -	\$ 4,147	\$ -	\$ -	\$ -	\$ -	\$ 4,147
Ending Balance:							
collectively evaluated for impairment	<u>\$ 3,601,697</u>	<u>\$ 52,457</u>	<u>\$ 27,089</u>	<u>\$ 2,450</u>	<u>\$ 313</u>	<u>\$ 10,247</u>	<u>\$ 3,694,253</u>
Ending Balance: loans acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
<b>Recorded Investment in Loans Outstanding:</b>							
Ending Balance at							
December 31, 2016	<u>\$ 597,149,763</u>	<u>\$ 50,155,171</u>	<u>\$ 18,212,918</u>	<u>\$ 1,993,338</u>	<u>\$ 142,159</u>	<u>\$ 11,619,886</u>	<u>\$ 679,273,235</u>
Ending balance for loans individually evaluated for impairment	<u>\$ 5,396,376</u>	<u>\$ 860,458</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 6,256,834</u>
Ending balance for loans collectively evaluated for impairment	<u>\$ 591,753,387</u>	<u>\$ 49,294,713</u>	<u>\$ 18,212,918</u>	<u>\$ 1,993,338</u>	<u>\$ 142,159</u>	<u>\$ 11,619,886</u>	<u>\$ 673,016,401</u>

**NOTE 4 — INVESTMENT IN THE FARM CREDIT BANK OF TEXAS**

The investment in the Farm Credit Bank of Texas is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying consolidated balance sheet. Estimating the fair value of the Association's investment in the Farm Credit Bank of Texas is not practicable because the stock is not traded. The Association owned 4.2 percent, 4.0 percent and 3.9 percent of the issued stock of the Bank as of December 31, 2018, 2017 and 2016. As of those dates, the Bank's assets totaled \$24.5 billion, \$22.8 billion and \$21.2 billion and members' equity totaled \$1.8 billion, \$1.7 billion and \$1.6 billion. The Bank's earnings were \$190.5 million, \$196.0 million and \$192.4 million during 2018, 2017 and 2016.

**NOTE 5 — PREMISES AND EQUIPMENT:**

Premises and equipment consisted of the following at December 31:

	2018	2017	2016
Land and improvements	\$ 818,080	\$ 746,869	\$ 746,869
Building and improvements	3,527,384	3,186,422	3,176,177
Furniture and equipment	608,764	585,758	570,650
Computer equipment and software	217,488	220,898	250,891
Automobiles	853,111	858,084	699,628
Construction in progress	350,309	300,944	-
	<u>6,375,136</u>	<u>5,898,975</u>	<u>5,444,215</u>
Accumulated depreciation	<u>(1,914,790)</u>	<u>(1,817,090)</u>	<u>(1,680,067)</u>
Total	<u>\$ 4,460,346</u>	<u>\$ 4,081,885</u>	<u>\$ 3,764,148</u>

**NOTE 5 — PREMISES AND EQUIPMENT (continued):**

The Association leases office space in Moulton, Alabama on a month-to-month basis. The Association does not have a binding contract and the lease can be terminated by the Association at any time without prejudice. Lease expense was \$600 for each of the three years ended December 31, 2018, 2017 and 2016. There are no minimum annual lease payments for the next five years.

The Association also enters into operating leases for office equipment for all branch offices. Lease expense was \$39,618, \$58,677 and \$49,163 for the years ended December 31, 2018, 2017 and 2016, respectively. Minimum annual lease payments for the next five years are as follows:

	Operating
2019	\$ 9,969
2020	9,969
2021	3,198
Total	<u>\$ 23,136</u>

**NOTE 6 — OTHER PROPERTY OWNED, NET:**

Net gain (loss) on other property owned, net, consists of the following for the years ended December 31:

	2018	2017	2016
Gain on sale, net	\$ 181,390	\$ 66,791	\$ 26,642
Carrying value adjustments	(85,317)	(108,117)	(374,954)
Operating expense, net	(60,490)	(53,581)	(79,766)
Net gain (loss) on other property owned	<u>\$ 35,583</u>	<u>\$ (94,907)</u>	<u>\$ (428,078)</u>

The Association had nine properties in other property owned at the beginning of 2018. During 2018, the Association acquired two additional properties from various counties in north Alabama. The Association sold six properties during 2018, resulting in a net decrease of \$1,467,217, including a gain of \$181,390. At December 31, 2017, the Association held five properties with a carrying value of \$1,024,659, net of allowance, which consisted of 197.2 acres of land.

**NOTE 7 — OTHER ASSETS AND OTHER LIABILITIES:**

Other assets comprised the following at December 31:

	2018	2017	2016
Guaranteed loan receivables	\$ 826,906	\$ 452,412	\$ 265,897
Investment in FCS Association captive insurance	342,704	376,337	335,180
Other	116,784	120,433	105,561
Total	<u>\$ 1,286,394</u>	<u>\$ 949,182</u>	<u>\$ 706,638</u>

Other liabilities comprised the following at December 31:

	2018	2017	2016
Accumulated postretirement benefit obligation	\$ 1,773,138	\$ 2,170,598	\$ 1,790,034
Accounts payable, other	1,126,114	1,229,050	1,204,062
FCS insurance premium	462,296	692,260	730,706
Accrued annual leave	302,904	271,968	245,206
Other	500,949	274,040	60,128
Total	<u>\$ 4,165,401</u>	<u>\$ 4,637,916</u>	<u>\$ 4,030,136</u>

## **NOTE 8 — NOTE PAYABLE TO THE BANK:**

The interest rate risk inherent in the Association's loan portfolio is substantially mitigated through the funding relationship with the Bank. The Bank manages interest rate risk through its direct loan pricing and asset/liability management process. The Association's indebtedness to the Bank represents borrowings by the Association to fund the majority of its loan portfolio. The indebtedness is collateralized by a pledge of substantially all of the Association's assets, and is governed by a general financing agreement. The interest rate on the direct loan is based upon the Bank's cost of funding the loans the Association has outstanding to its borrowers. The indebtedness continues in effect until the expiration date of the general financing agreement, which is September 30, 2020, unless sooner terminated by the Bank upon the occurrence of an event of default, or by the Association, in the event of a breach of this agreement by the Bank, upon giving the Bank 30 calendar days' prior written notice, or in all other circumstances, upon giving the Bank 120 days' prior written notice.

The total amount and the weighted average interest rate of the Association's direct loan from the Bank at December 31, 2018, 2017 and 2016 was \$686,711,154 at 2.9 percent, \$627,339,627 at 2.4 percent and \$574,372,777 at 2.1 percent, respectively.

Under the Act, the Association is obligated to borrow only from the Bank unless the Bank approves borrowing from other funding sources. The Bank and FCA regulations have 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, 2018, 2017 and 2016, the Association's note payable was within the specified limitations. The maximum amount the Association may borrow from the Bank as of December 31, 2018, was \$800,880,864, as defined by the general financing agreement.

In addition to borrowing limits, the financing agreement establishes certain covenants, including limits on leases, investments, other debt and dividend and patronage distributions; minimum standards for return on assets and for liquidity; and provisions for conducting business, maintaining records, reporting financial information, and establishing policies and procedures. Remedies specified in the general financing agreement associated with the covenants include additional reporting requirements, development of action plans, increases in interest rates on indebtedness, reduction of lending limits or repayment of indebtedness. As of and for the years ended December 31, 2018, 2017 and 2016, the Association was not subject to remedies associated with the covenants in the general financing agreement.

## **NOTE 9 — MEMBERS' EQUITY:**

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

Protection of certain borrower equity is provided under the Act that requires the Association, when retiring protected borrower equity, to retire such equity at par or stated value regardless of its book value. Protected borrower equity includes capital stock, participation certificates and allocated equities that were outstanding as of January 6, 1988, or were issued or allocated prior to October 6, 1988. If an association is unable to retire protected borrower equity at par value or stated value, amounts required to retire this equity would be obtained from the Insurance Fund.

In accordance with the Act and the Association's capitalization bylaws, each borrower is required to invest in the Association as a condition of borrowing. The investment in Class A capital stock (for farm loans) and participation certificates (for rural home and farm-related business loans) is equal to 2.0 percent of the loan amount, prior to 2004. In March 2004, on new loans only, the Association changed its stock investment requirement to the lesser of 2.0 percent of the loan amount, or \$1,000. In November 2005, the board of directors approved a stock reduction to equalize the stock of all borrowers to 2.0 percent or \$1,000, whichever is less.

The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, usually by adding the aggregate par value of the capital stock or participation certificates to the principal amount of the related loan obligation. The capital stock or participation certificates are subject to a first lien by the Association. 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 capital stock or participation certificates.

If needed to meet regulatory capital adequacy requirements, the board of directors of the Association may increase the percentage of stock requirement of each borrower up to a maximum of 10 percent of the loan amount.

Each owner of Class A capital stock is entitled to a single vote, while participation certificates provide no voting rights to their owners.



**NOTE 9 — MEMBERS' EQUITY (continued):**

Our bylaws generally permit stock and participation certificates to be retired at the discretion of our board of directors and in accordance with our capitalization plans, provided prescribed capital standards have been met. At December 31, 2018, we exceeded the prescribed standards. We do not anticipate any significant changes in capital that would affect the normal retirement of stock.

Within two years of repayment of a loan, the Association bylaws require the conversion of any borrower's outstanding Class A to Class C stock. Class C stock has no voting rights except in a case where a new issuance of preferred stock has been submitted to stockholders affected by the preference. Redemption of Class C shares is made solely at the discretion of the Association's board of directors. At December 31, 2017, 2016 and 2015, the Association had no Class C stock.

All borrower stock is at risk. As such, losses that result in impairment of capital stock or participation certificates shall be borne on a pro rata basis by all holders of Class A capital stock and participation certificates. In the event of liquidation of the Association, capital stock and participation certificates would be utilized as necessary to satisfy any remaining obligations in excess of the amounts realized on the sale or liquidation of assets. Any excess of the amounts realized on the sale of liquidation of assets over the Association's obligations to external parties and to the Bank would be distributed to the Association's stockholders.

Dividends and patronage distributions may be paid on the capital stock and participation certificates of the Association, as the board of directors may determine by resolution, subject to capitalization requirements as defined by the FCA. Amounts not distributed are retained as unallocated retained earnings. The following dividends and patronage distributions were declared and paid in 2018, 2017 and 2016, respectively:

<u>Date Declared</u>	<u>Date Paid</u>	<u>Patronage</u>
<b>December 31, 2018</b>	<b>March 2019</b>	<b>\$ 9,380,495</b>
December 31, 2017	March 2018	\$ 9,000,701
December 31, 2016	March 2017	\$ 8,449,537

The Farm Credit Administration sets minimum regulatory capital requirements for banks and associations. Effective January 1, 2017, new regulatory capital requirements for banks and associations were adopted. These new requirements replaced the core surplus and total surplus requirements with Common Equity Tier 1, Tier 1 Capital and Total Capital risk-based capital ratio requirements. The new requirements also replaced the existing net collateral ratio for System Banks with a Tier 1 Leverage ratio and an Unallocated Retained Earnings (URE) and URE Equivalents Leverage ratio that are applicable to both the banks and associations. The Permanent Capital Ratio continues to remain in effect; however, the risk-adjusted assets are calculated differently than in the past. As of December 31, 2018, the Association is not prohibited from retiring stock or distributing earnings

The following sets forth the regulatory capital ratio requirements and ratios at December 31, 2018:

<u>Risk-adjusted:</u>	<u>Regulatory Minimums</u>	<u>Conservation Buffer*</u>	<u>Total</u>	<u>As of December 31, 2018</u>
Common equity tier 1 ratio	4.50%	2.50%	7.00%	15.65%
Tier 1 capital ratio	6.00%	2.50%	8.50%	15.65%
Total capital ratio	8.00%	2.50%	10.50%	16.19%
Permanent capital ratio	7.00%	0.00%	7.00%	15.73%
<u>Non-risk-adjusted:</u>				
Tier 1 leverage ratio**	4.00%	1.00%	5.00%	13.83%
UREE leverage ratio	1.50%	0.00%	1.50%	14.98%

\*The 2.5% capital conservation buffer for the risk-adjusted ratios will be phased in over a three year period ending on December 31, 2019. There is no phase-in of the leverage buffer.

\*\*Must include the regulatory minimum requirement for the URE and UREE Leverage ratio

**NOTE 9 — MEMBERS' EQUITY (continued):**

Risk-adjusted assets have been defined by FCA Regulations as the Statement of Condition assets and off-balance-sheet commitments adjusted by various percentages, depending on the level of risk inherent in the various types of assets. The primary changes which generally have the impact of increasing risk-adjusted assets (decreasing risk-based regulatory capital ratios) were as follows:

- Inclusion of off-balance-sheet commitments less than 14 months
- Increased risk-weighting of most loans 90 days past due or in nonaccrual status

Risk-adjusted assets are calculated differently for the permanent capital ratio (referred herein as PCR risk-adjusted assets) compared to the other risk-based capital ratios. The primary difference is the deduction of the allowance for loan losses from risk-adjusted assets for the permanent capital ratio.

The ratios are based on a three-month average daily balance in accordance with FCA regulations and are calculated as follows:

- Common equity tier 1 ratio is statutory minimum purchased borrower stock, other required borrower stock held for a minimum of 7 years, allocated equities held for a minimum of 7 years or not subject to revolvement, unallocated retained earnings, paid-in capital, less certain regulatory required deductions including the amount of allocated investments in other System institutions, and the amount of purchased investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.
- Tier 1 capital ratio is common equity tier 1 plus non-cumulative perpetual preferred stock, divided by average risk-adjusted assets.
- Total capital is tier 1 capital plus other required borrower stock held for a minimum of 5 years, allocated equities held for a minimum of 5 years, subordinated debt and limited-life preferred stock greater than 5 years to maturity at issuance subject to certain limitations, allowance and reserve for credit losses under certain limitations less certain investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.
- Permanent capital ratio (PCR) is all at-risk borrower stock, any allocated excess stock, unallocated retained earnings, paid-in capital, subordinated debt and preferred subject to certain limitations, less certain allocated and purchased investments in other System institutions, divided by PCR risk-adjusted assets.
- Tier 1 leverage ratio is tier 1 capital, including regulatory deductions, divided by average assets less regulatory deductions subject to tier 1 capital.
- UREE leverage ratio is unallocated retained earnings, paid-in capital, allocated surplus not subject to revolvement less certain regulatory required deductions including the amount of allocated investments in other System institutions divided by average assets less regulatory deductions subject to tier 1 capital.

If the capital ratios fall below the total requirements, including the buffer amounts, capital distributions (equity redemptions, dividends and patronage) and discretionary senior executive bonuses are restricted or prohibited without prior FCA approval.

The components of the Association's risk-adjusted capital, based on 90 average balances, were as follows at December 31, 2018:

(dollars in thousands)	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
<b>Numerator:</b>				
Unallocated retained earnings	\$ 119,946	\$ 119,946	\$ 119,946	\$ 119,946
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	2,791	2,791	2,791	2,791
Allowance for loan losses and reserve for credit losses subject to certain limitations*			3,864	
<b>Regulatory Adjustments and Deductions:</b>				
Amount of allocated investments in other System institutions	(11,984)	(11,984)	(11,984)	(11,984)
	<u>\$ 110,753</u>	<u>\$ 110,753</u>	<u>\$ 114,617</u>	<u>\$ 110,753</u>
<b>Denominator:</b>				
Risk-adjusted assets excluding allowance	719,778	719,778	719,778	719,778
<b>Regulatory Adjustments and Deductions:</b>				
Regulatory deductions included in total capital	(11,984)	(11,984)	(11,984)	(11,984)
Allowance for loan losses				(3,816)
	<u>\$ 707,794</u>	<u>\$ 707,794</u>	<u>\$ 707,794</u>	<u>\$ 703,978</u>

\*Capped at 1.25% of risk-adjusted assets

**NOTE 9 — MEMBERS' EQUITY (continued):**

The components of the Association's non-risk-adjusted capital, based on 90 average balances, were as follows at December 31, 2018:

(dollars in thousands)	Tier 1 leverage ratio	UREE leverage ratio
<b>Numerator:</b>		
Unallocated retained earnings	<b>119,946</b>	<b>119,946</b>
Common Cooperative Equities:		
Statutory minimum purchased borrower stock	<b>2,791</b>	-
Regulatory Adjustments and Deductions:		
Amount of allocated investments in other System institutions	<b>(11,984)</b>	-
	<b>110,753</b>	<b>119,946</b>
<b>Denominator:</b>		
Total Assets	<b>816,743</b>	<b>816,743</b>
Regulatory Adjustments and Deductions:		
Regulatory deductions included in tier 1 capital	<b>(16,168)</b>	<b>(16,168)</b>
	<b>800,575</b>	<b>800,575</b>

The FCA's capital adequacy regulations require the Association to achieve permanent capital and common equity tier 1 capital of at least 7.0 percent of risk-adjusted assets and off-balance-sheet commitments (less than fourteen months). Failure to meet the ratio requirements can initiate certain mandatory and possibly additional discretionary actions by the 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 stockholders unless prescribed capital standards are met.

As described in Note 2, "Summary of Significant Accounting Policies," included in this annual report, the Bank may increase the percentage of stock held by an association from 2.0 percent of the average outstanding balance of borrowings from the Bank to a maximum of 5.0 percent of the average outstanding balance of borrowings from the Bank. Currently, the required stock investment in the Bank is 2.0 percent of the average borrowings from the previous twelve months. This stock investment reduces the amount of Association capital available for inclusion in the Association's capital adequacy calculations.

An FCA regulation empowers the FCA 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.

At December 31, the Association had the following shares of Class A capital stock and participation certificates outstanding at a par value of \$5 per share:

	2018	2017	2016
Class A stock	<b>531,887</b>	510,344	479,750
Participation certificates	<b>27,804</b>	27,107	23,888
Total	<b>559,691</b>	537,451	503,638

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

**Accumulated Other Comprehensive Loss**

<b>December 31, 2018</b>	<b>Before Tax</b>	<b>Deferred Tax</b>	<b>Net of Tax</b>
<b>Nonpension postretirement benefits</b>	<b>\$ (21,325)</b>	<b>\$ -</b>	<b>\$ (21,325)</b>
December 31, 2017	Before Tax	Deferred Tax	Net of Tax
Nonpension postretirement benefits	\$ (506,307)	\$ -	\$ (506,307)
December 31, 2016	Before Tax	Deferred Tax	Net of Tax
Nonpension postretirement benefits	\$ (164,098)	\$ -	\$ (164,098)

**NOTE 9 — MEMBERS' EQUITY (continued):**

The Association's accumulated other comprehensive income (loss) relates entirely to its nonpension other postretirement benefits. The following table summarizes the changes in accumulated other comprehensive loss and the location on the income statement for the year ended December 31:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Accumulated other comprehensive loss at January 1	\$ (506,307)	\$ (164,098)	\$ (251,178)
Amortization of prior service cost (credit) included in salaries and employee benefits	<b>484,982</b>	(342,209)	87,080
Accumulated other comprehensive loss at December 31	<u>\$ (21,325)</u>	<u>\$ (506,307)</u>	<u>\$ (164,098)</u>

**NOTE 10 — INCOME TAXES:**

The provision for (benefit from) income taxes follows for the years ended December 31:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Federal tax at statutory rate	\$ 3,274,190	\$ 5,266,944	\$ 5,140,519
State tax, net	1,013,440	978,147	954,668
Effect of nontaxable FLCA subsidiary	(4,609,468)	(6,525,747)	(6,372,332)
Change due to tax rate change	-	573,450	-
Change in valuation allowance	321,838	(292,794)	277,145
Provision for income taxes	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Deferred tax assets and liabilities in accordance with accounting guidance, "Accounting for Income Taxes," are comprised of the following at December 31:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
<u>Deferred Tax Assets</u>			
Allowance for loan losses	\$ 75,899	\$ 38,575	\$ 29,939
Loss carryforwards	1,654,714	1,375,393	1,733,835
Deferred origination fees	(282,355)	(287,550)	(344,562)
Net deferred tax assets	<u>1,448,258</u>	<u>1,126,418</u>	<u>1,419,212</u>
Deferred tax asset valuation allowance	(1,448,258)	(1,126,418)	(1,419,212)
Net deferred tax asset (liability)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

At December 31, 2018, the Association has a net operating loss carryover of \$6,017,142 available to offset against future taxable income that will begin to expire in 2030. Due to the changes in tax law in 2018, \$1,015,713 of the net operating loss carryover can be carried forward indefinitely, while the remaining \$5,001,429 will expire 20 years from the time it was originally incurred.

The Association recorded valuation allowances of \$1,448,258, \$1,126,418 and \$1,419,212 during 2018, 2017 and 2016, respectively. The Association will continue to evaluate the realizability of the deferred tax assets and adjust the valuation allowance accordingly.

The Association adopted FASB guidance on accounting for uncertainty in income taxes when the Association became an ACA in 2010. Upon adoption, the Association did not need to recognize a tax liability for any uncertain tax positions and, at December 31, 2018, 2017 and 2016, the Association did not recognize a tax liability for any uncertain tax positions.

The enactment of federal tax legislation in late December 2017 lowered the federal corporate tax from 35% to 21% beginning January 1, 2018. In accordance with GAAP, the change to lower corporate tax rate led to a remeasurement of the deferred tax liabilities and deferred tax assets in 2017, the period of enactment.

## NOTE 11 — EMPLOYEE BENEFIT PLANS:

**Employee Retirement Plans:** Employees of the Association participate in either the defined benefit retirement plan (DB plan) or the defined contributions plan (DC plan) and are eligible to participate in the Farm Credit Benefits Alliance 401(k) Plan. These plans are described more fully in section H of Note 2, “Summary of Significant Accounting Policies.” The structure of the district’s DB plan is characterized as multiemployer, since neither the assets, liabilities nor cost of any plan is segregated or separately accounted for by participating employers (Bank and associations). No portion of any surplus assets is available to any participating employer. As a result, participating employers of the plan only recognize as cost the required contributions for the period and a liability for any unpaid contributions required for the period of their financial statements. Plan obligations, assets and the components of annual benefit expenses are recorded and reported upon district combination only. The Association records current contributions to the DB plan as an expense in the current year.

The CEO and certain executive or highly compensated employees in the Association are eligible to participate in a separate nonqualified supplemental 401(k) plan, named the Farm Credit Benefits Alliance Nonqualified Supplemental 401(k) Plan (supplemental 401(k) plan). This plan allows district employers to elect to participate in any or all of the following benefits:

- Restored Employer Contributions – to allow “make-up” contributions for eligible employees whose benefits to the qualified 401(k) plan were limited by the Internal Revenue Code during the year
- Elective Deferrals – to allow eligible employees to make pre-tax deferrals of compensation above and beyond any deferrals into the qualified 401(k) plan
- Discretionary Contributions – to allow participating employers to make a discretionary contribution to an eligible employee’s account in the plan, and to designate a vesting schedule

The Association made no contributions to this plan for the years ended December 31, 2018, 2017 and 2016. There were no payments made from the supplemental 401(k) plan to active employees during 2018, 2017 or 2016.

The DB plan is noncontributory and benefits are based on salary and years of service. The legal name of the plan is Farm Credit Bank of Texas Pension Plan; its employer identification number is 74-1110170. The DB plan is not subject to any contractual expiration dates. The DB plan’s funding policy is to fund current year benefits expected to be earned by covered employees plus an amount to improve the accumulated benefit obligation funded status by a percentage approved by the plan sponsor. The plan sponsor is the board of the Farm Credit Bank of Texas. The “projected unit credit” actuarial method is used for both financial reporting and funding purposes. District employers have the option of providing enhanced retirement benefits, under certain conditions, within the DB plan, to facilitate reorganization and/or restructuring. The actuarial present value of vested and nonvested accumulated benefit obligation exceeded the net assets of the DB plan as of December 31, 2018.

The risks of participating in these multiemployer plans are different from single-employer plans in the following aspects:

- a. Assets contributed to the multi-employer plan by one employer may be used to provide benefits to employees of other participating employers.
- b. If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.
- c. If the Association chooses to stop participating in some of its multi-employer plans, it may be required to pay the plan an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

The following table includes additional information regarding the funded status of the plan, the Association’s contributions and the percentage of Association contribution to total plan contributions for the years ended December 31, 2018, 2017 and 2016:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Funded status of plan	<b>68.0</b> %	69.7 %	66.4 %
Association's contribution	<b>\$ 381,833</b>	\$ 439,953	\$ 277,099
Percentage of Association's contribution to total contributions	<b>3.9</b> %	3.8 %	2.4 %

The funded status presented above is based on the percentage of plan assets to projected benefit obligations. DB plan funding is based on the percentage of plan assets to the accumulated benefit obligation, which was 70.1 percent, 73.4 percent and 70.6 percent at December 31, 2018, 2017 and 2016, respectively.

**NOTE 11 — EMPLOYEE BENEFIT PLANS (continued):**

**Other Postretirement Benefits:** In addition to pension benefits, the Association provides certain health care benefits to qualifying retired employees (other postretirement benefits). These benefits are not characterized as multi-employer and, consequently, the liability for these benefits is included in other liabilities. Employees hired prior to January 1, 2004 and who are at least 55 years of age (or at least age 50 with 30 years of service) may retire and have their medical premium paid on a percentage of cost sharing basis predicated on length of employment service. Employees hired before this date, that have reached the age requirement and have 25 years of service, will receive 100 percent of their medical premium paid. Employees hired after January 1, 2004, will be eligible for access only to retiree medical benefits for themselves, but will be responsible for 100 percent of the premium.

**Retiree Welfare Benefit Plans**

<b>Disclosure Information Related to Retirement Benefits</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>
<b>Change in Accumulated Postretirement Benefit Obligation</b>			
Accumulated postretirement benefit obligation, beginning of year	\$ 2,170,598	\$ 1,790,034	\$ 1,820,840
Service cost	40,636	28,068	27,867
Interest cost	85,656	81,262	84,465
Plan amendments	(84,822)	-	-
Plan participants' contributions	2,587	2,759	2,558
Actuarial (gain) loss	(389,382)	320,198	(98,765)
Benefits paid	(52,135)	(51,723)	(46,931)
Accumulated postretirement benefit obligation, end of year	\$ 1,773,138	\$ 2,170,598	\$ 1,790,034
<b>Change in Plan Assets</b>			
Plan assets at fair value, beginning of year	\$ -	\$ -	\$ -
Employer contributions	49,548	48,964	44,373
Plan participants' contributions	2,587	2,759	2,558
Benefits paid	(52,135)	(51,723)	(46,931)
Plan assets at fair value, end of year	\$ -	\$ -	\$ -
Funded status of the plan	\$ (1,773,138)	\$ (2,170,598)	\$ (1,790,034)
<b>Amounts Recognized in Statement of Financial Position</b>			
Current liabilities	\$ (63,057)	\$ (69,147)	\$ (55,427)
Noncurrent liabilities	\$ (1,710,081)	\$ (2,101,451)	\$ (1,734,607)
	\$ (1,773,138)	\$ (2,170,598)	\$ (1,790,034)
<b>Amounts Recognized in Accumulated Other Comprehensive Income</b>			
Net actuarial loss	\$ 106,147	\$ 524,918	\$ 207,520
Prior service credit	(84,822)	(18,611)	(43,422)
Total	\$ 21,325	\$ 506,307	\$ 164,098
<b>Weighted-Average Assumptions Used to Determine Obligations at Year End</b>			
Measurement date	12/31/2018	12/31/2017	12/31/2016
Discount rate	4.75%	4.00%	4.55%
Health care cost trend rate assumed for next year (pre-/post-65) - medical	7.30%/6.90%	7.70%/6.90%	6.75%/6.50%
Ultimate health care cost trend rate	4.50%	4.50%	4.50%
Year that the rate reaches the ultimate trend rate	2026/2027	2026	2025

**NOTE 11 — EMPLOYEE BENEFIT PLANS (continued):**

The following table reflects the benefit obligation, cost and actuarial assumptions for the Association's other postretirement benefits:

<b>Total Cost</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>
Service cost	\$ 40,636	\$ 28,068	\$ 27,867
Interest cost	85,656	81,262	84,465
Amortization of:			
Unrecognized prior service credit	(18,611)	(24,811)	(24,811)
Unrecognized net loss	29,389	2,800	13,126
Net postretirement benefit cost	\$ 137,070	\$ 87,319	\$ 100,647
Accounting for settlements/curtailments/special termination benefits	\$ -	\$ -	\$ -
<b>Other Changes in Plan Assets and Projected Benefit Obligation Recognized in Other Comprehensive Income</b>			
Net actuarial loss (gain)	\$ (389,382)	\$ 320,198	\$ (98,765)
Amortization of net actuarial loss (gain)	(29,389)	24,811	(13,126)
Prior service cost (credit)	(84,822)	(2,800)	24,811
Amortization of prior service credit	18,611	-	-
Total recognized in other comprehensive income	\$ (484,982)	\$ 342,209	\$ (87,080)
<b>AOCI Amounts Expected to be Amortized Into Expense in 2019</b>			
Unrecognized prior service credit	\$ (8,682)	\$ (18,611)	\$ (24,811)
Unrecognized net loss	-	29,389	2,800
Total	\$ (8,682)	\$ 10,778	\$ (22,011)
<b>Weighted-Average Assumptions Used to Determine Benefit Cost</b>			
Measurement date	12/31/2017	12/31/2016	12/31/2015
Discount rate	4.00%	4.60%	4.70%
Health care cost trend rate assumed for next year (pre-/post-65) - medical	7.70%/6.90%	6.75%/6.50%	7.00%/6.50%
Ultimate health care cost trend rate	4.50%	4.50%	4.50%
Year that the rate reaches the ultimate trend rate	2026/2026	2025	2025
<b>Expected Future Cash Flows</b>			
<b>Expected Benefit Payments (net of employee contributions)</b>			
Fiscal 2019	\$ 63,057		
Fiscal 2020	65,120		
Fiscal 2021	59,091		
Fiscal 2022	67,083		
Fiscal 2023	66,218		
Fiscal 2024–2028	399,803		
<b>Expected Contributions</b>			
Fiscal 2019	\$ 63,057		

## **NOTE 12 — RELATED PARTY TRANSACTIONS:**

Directors of the Association, except for any director-elected directors, are required to be borrowers/stockholders of the Association. Also, in the ordinary course of business, the Association may enter into loan origination or servicing transactions with its officers, relatives of officers and directors, or with organizations with which such persons are associated. Such loans are subject to special approval requirements contained in FCA regulations and are made on the same terms, including interest rates, amortization schedule and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

Total loans to such persons at December 31, 2018, 2017 and 2016 for the Association amounted to \$20,239,488, \$19,033,009 and \$16,740,970. During 2018, 2017 and 2016, \$7,939,814, \$6,067,172 and \$4,959,457 of new loans were made, and repayments totaled \$8,360,532, \$4,327,098 and \$2,341,207, respectively. In the opinion of management, no such loans outstanding at December 31, 2018, 2017 and 2016 involved more than a normal risk of collectability.

Expenses included in purchased services may include purchased services such as administrative services, marketing, information systems and accounting services and allocations of expenses incurred by the Bank and passed through to the associations, such as FCSIC expenses. The Bank charges the individual associations directly for these services based on each association's proportionate usage. These expenses totaled \$524,975, \$745,804 and \$246,821 in 2018, 2017 and 2016, respectively.

The Association entered into a transaction for the hosting of the Athens' Branch customer appreciation dinner in 2018, 2017 and 2016 with Tate Farms, of which director Stewart McGill is a partner. Mr. McGill had no interest in the transaction. Total amount paid to Tate Farms for the catering, rental and customer giveaways totaled \$13,300, \$9,450 and \$8,413, respectively. The Association has utilized the Tate Farms venue for this annual event since 2013, which was prior to Mr. McGill becoming a board member in 2016.

The Association received patronage payments from the Bank totaling \$3,159,352, \$2,602,267 and \$2,495,529 during 2018, 2017 and 2016, respectively.

## **NOTE 13 — FAIR VALUE MEASUREMENTS:**

Accounting 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. See Note 2, "Summary of Significant Accounting Policies," for additional information.

### **Valuation Techniques**

As more fully discussed in Note 2, "Summary of Significant Accounting Policies," accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Due to the uncertainty of expected cash flows resulting from financial instruments, the use of different assumptions and valuation methodologies could significantly affect the estimated fair value amounts. Accordingly, certain of the estimated fair values may not be indicative of the amounts for which the financial instruments could be exchanged in a current or future market transition. The following represent a brief summary of the valuation techniques used by the Bank and associations for assets and liabilities:

#### *Assets Held in Nonqualified Benefits Trusts*

Assets held in trust funds related to deferred compensation and supplemental retirement plans are classified within Level 1. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace.

#### *Loans*

For certain loans evaluated for impairment under impairment guidance, the fair value is based upon the underlying collateral since loans are collateral-dependent loans for which real estate is collateral. 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. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the real estate, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established.



**NOTE 13 — FAIR VALUE MEASUREMENTS (continued):**

With regard to impaired loans, it is not practicable to provide specific information on inputs as each collateral property is unique. System institutions utilize appraisals to value these loans and take into account unobservable inputs such as income and expense, comparable sales, replacement cost and comparability adjustments.

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

With regard to other property owned, it is not practicable to provide specific information on inputs as each collateral property is unique. System institutions utilize appraisals to value these loans and take into account unobservable inputs such as income and expense, comparable sales, replacement cost and comparability adjustments.

Information about other financial instruments fair value measurements:

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

Assets and liabilities measured at fair value on a recurring basis at December 31, 2018, 2017 and 2016 for each of the fair value hierarchy values are summarized below:

<b>December 31, 2018</b>	<b>Fair Value Measurement Using</b>			<b>Total Fair Value</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	
Assets:				
Assets held in nonqualified benefit trusts	<b>\$ 76,804</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 76,804</b>
Total assets	<b>\$ 76,804</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 76,804</b>
<b>December 31, 2017</b>	<b>Fair Value Measurement Using</b>			<b>Total Fair Value</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	
Assets:				
Assets held in nonqualified benefit trusts	<b>\$ 64,142</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 64,142</b>
Total assets	<b>\$ 64,142</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 64,142</b>
<b>December 31, 2016</b>	<b>Fair Value Measurement Using</b>			<b>Total Fair Value</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	
Assets:				
Assets held in nonqualified benefit trusts	<b>\$ 33,673</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 33,673</b>
Total assets	<b>\$ 33,673</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 33,673</b>

**NOTE 13 — FAIR VALUE MEASUREMENTS (continued):**

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

December 31, 2018	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Loans	\$ -	\$ -	\$ 1,640,473	\$ 1,640,473
Other property owned	-	-	1,060,801	1,060,801
December 31, 2017	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Loans	\$ -	\$ -	\$ 488,350	\$ 488,350
Other property owned	-	-	2,573,808	2,573,808
December 31, 2016	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Loans	\$ -	\$ -	\$ -	\$ -
Other property owned	-	-	2,123,843	2,123,843

Financial assets and financial liabilities measured at carrying amounts and not measured at fair value on the consolidated balance sheets for each of the fair value hierarchy values are summarized as follows:

**December 31, 2018**  
**Fair Value Measurement Using**

	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
Assets:					
Cash	\$ 48,700	\$ 48,700	\$ -	\$ -	\$ 48,700
Net loans	788,765,651	-	-	774,464,019	774,464,019
Total Assets	<u>\$788,814,351</u>	<u>\$ 48,700</u>	<u>\$ -</u>	<u>\$774,464,019</u>	<u>\$774,512,719</u>
Liabilities:					
Note payable to Bank	\$686,711,154	\$ -	\$ -	\$674,319,173	\$674,319,173
Total Liabilities	<u>\$686,711,154</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$674,319,173</u>	<u>\$674,319,173</u>

December 31, 2017  
Fair Value Measurement Using

	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
Assets:					
Cash	\$ 339,393	\$ 339,393	\$ -	\$ -	\$ 339,393
Net loans	725,641,322	-	-	715,202,710	715,202,710
Total Assets	<u>\$725,980,715</u>	<u>\$ 339,393</u>	<u>\$ -</u>	<u>\$715,202,710</u>	<u>\$715,542,103</u>
Liabilities:					
Note payable to Bank	\$627,339,627	\$ -	\$ -	\$618,361,862	\$618,361,862
Total Liabilities	<u>\$627,339,627</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$618,361,862</u>	<u>\$618,361,862</u>

**NOTE 13 — FAIR VALUE MEASUREMENTS (continued):**

	December 31, 2016				Total Fair Value
	Total Carrying Amount	Fair Value Measurement Using			
		Level 1	Level 2	Level 3	
<b>Assets:</b>					
Cash	\$ 11,349	\$ 11,349	\$ -	\$ -	\$ 11,349
Net loans	668,398,979	-	-	666,550,036	666,550,036
Total Assets	<u>\$668,410,328</u>	<u>\$ 11,349</u>	<u>\$ -</u>	<u>\$666,550,036</u>	<u>\$666,561,385</u>
<b>Liabilities:</b>					
Note payable to Bank	\$574,372,777	\$ -	\$ -	\$572,816,083	\$572,816,083
Total Liabilities	<u>\$574,372,777</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$572,816,083</u>	<u>\$572,816,083</u>

**NOTE 14 — COMMITMENTS AND CONTINGENCIES**

In addition to those commitments and contingencies discussed in Note 2, “Summary of Significant Accounting Policies,” the Association is involved in various legal proceedings in the ordinary course of business. In the opinion of legal counsel and management, there are no legal proceedings at this time that are likely to materially affect the Association.

The Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers in the form of commitments to extend credit and commercial letters of credit. These financial 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. At December 31, 2018, \$59,240,258 of commitments and no commercial letters of credit outstanding.

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.

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 financing obligations. At December 31, 2018, \$586,536 of standby letters of credit were issued primarily in conjunction with participation loans. The fair value of these obligations at December 31, 2017 is based on fees for the unexpired period remaining, which are negligible.

**NOTE 15 — REGULATORY ENFORCEMENT MATTERS**

The Association has not received notice for any cease and desist orders, temporary cease and desist orders, supervisory or other written agreements, notices of charges, prohibitions and removals of officers and directors, civil money penalties and other enforcement matters which have or could have a significant impact on the financial statements as of December 31, 2018.

**NOTE 16 — QUARTERLY FINANCIAL INFORMATION (UNAUDITED):**

Quarterly results of operations for the years ended December 31 (in thousands) follow:

	2018				
	First	Second	Third	Fourth	Total
Net interest income	\$ 5,468	\$ 5,410	\$ 5,463	\$ 5,468	\$ 21,809
(Provision for) reversal of loan losses	33	31	(98)	(208)	(242)
Noninterest expense, net	(1,309)	(1,525)	(1,731)	(1,411)	(5,976)
Net income	\$ 4,192	\$ 3,916	\$ 3,634	\$ 3,849	\$ 15,591

	2017				
	First	Second	Third	Fourth	Total
Net interest income	\$ 5,280	\$ 5,240	\$ 5,359	\$ 5,442	\$ 21,321
(Provision for) reversal of loan losses	(13)	(107)	(29)	49	(100)
Noninterest expense, net	(1,561)	(1,673)	(1,570)	(1,369)	(6,173)
Net income	\$ 3,706	\$ 3,460	\$ 3,760	\$ 4,122	\$ 15,048

	2016				
	First	Second	Third	Fourth	Total
Net interest income	\$ 5,084	\$ 5,155	\$ 5,119	\$ 5,251	\$ 20,609
(Provision for) reversal of loan losses	(24)	157	11	(133)	11
Noninterest expense, net	(1,525)	(1,615)	(1,693)	(1,100)	(5,933)
Net income	\$ 3,535	\$ 3,697	\$ 3,437	\$ 4,018	\$ 14,687

**NOTE 17 — SUBSEQUENT EVENTS:**

The Association has evaluated subsequent events through March 13, 2019 which is the date the financial statements were issued or available to be issued and has determined that there were no other events requiring disclosure.

## **DISCLOSURE INFORMATION AND INDEX**

(Unaudited)

*Disclosures Required by Farm Credit Administration Regulations*

### **DESCRIPTION OF BUSINESS**

The description of the territory served, the persons eligible to borrow, the types of lending activities engaged in and the financial services offered, and related Farm Credit organizations required to be disclosed in this section is incorporated herein by reference from Note 1 to the consolidated financial statements, "Organization and Operations," included in this annual report.

The descriptions of significant developments that had or could have a material impact on earnings, interest rates to borrowers, patronage, or dividends and acquisitions or dispositions of material assets, changes in the reporting entity, changes in patronage policies or practices and financial assistance provided by or to the Association through loss sharing or capital preservation agreements or from any other source, if any, required to be disclosed in this section are incorporated herein by reference from "Management's Discussion and Analysis of Financial Condition and Results of Operations," included in this annual report.

### **DESCRIPTION OF PROPERTY**

The Alabama Farm Credit, ACA (Association) serves its 27-county territory through its main administrative and lending office at 1740 Eva Road NE, Cullman, Alabama 35055. Additionally, there are five branch lending offices located throughout the territory. The Association owns the office buildings in Albertville, Athens, Cullman, Talladega and Tusculumbia, free of debt. The Association leases an outpost in Moulton.

### **LEGAL PROCEEDINGS**

In the ordinary course of business, the Association is involved in various legal proceedings. In the opinion of legal counsel and management, there are no legal proceedings at this time that are likely to materially affect the consolidated financial statements of the Association.

### **DESCRIPTION OF CAPITAL STRUCTURE**

The information required to be disclosed in this section is incorporated herein by reference from Note 9 to the consolidated financial statements, "Members' Equity," included in this annual report.

### **DESCRIPTION OF LIABILITIES**

The description of liabilities required to be disclosed in this section is incorporated herein by reference from Note 8, "Note Payable to the Bank," Note 11, "Employee Benefit Plans" and in "Management's Discussion and Analysis of Financial Condition and Results of Operations," included in this annual report.

The description of contingent liabilities required to be disclosed in this section is incorporated herein by reference from Notes 2 and 14 to the consolidated financial statements, "Summary of Significant Accounting Policies" and "Commitments and Contingencies," respectively, included in this annual report.

### **RELATIONSHIP WITH THE FARM CREDIT BANK OF TEXAS**

The Association's financial condition may be impacted by factors that affect the Farm Credit Bank of Texas (Bank), as discussed in Note 1 to the consolidated financial statements, "Organization and Operations," included in this annual report. The financial condition and results of operations of the Bank may materially affect the stockholders' investment in the Association.

The annual and quarterly stockholder reports of the Farm Credit Bank of Texas (Bank) are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, The Ag Agency, P.O. Box 202590, Austin, Texas 78720-2590 or calling (512) 483-9204. Copies of the Bank annual and quarterly stockholder reports can also be requested by e-mailing [fcb@farmcreditbank.com](mailto:fcb@farmcreditbank.com). The annual and quarterly stockholder reports are also available on its website at [www.farmcreditbank.com](http://www.farmcreditbank.com).

The Association's quarterly stockholder reports are also available free of charge, upon request. These reports will be available approximately 40 days after quarter end and can be obtained by writing to Alabama Farm Credit, ACA, P.O. Box 639, Cullman, Alabama 35056 or calling (256) 737-7128. Copies of the Association's quarterly stockholder reports can also be requested by e-

mailing [karri.sumrall@alabamafarmcredit.com](mailto:karri.sumrall@alabamafarmcredit.com). The Association’s annual stockholder report is available on its website at [www.alabamafarmcredit.com](http://www.alabamafarmcredit.com) 75 days after the fiscal year end. Copies of the Association’s annual stockholder report can also be requested 90 days after the fiscal year end.

## SELECTED FINANCIAL DATA

The selected financial data for the five years ended December 31, 2018, required to be disclosed, is incorporated herein by reference to the “Five-Year Summary of Selected Consolidated Financial Data” included in this annual report to stockholders.

## MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

“Management’s Discussion and Analysis,” which precedes the consolidated financial statements in this annual report, is incorporated herein by reference.

## DIRECTORS AND SENIOR OFFICERS

The Association’s member-elected and director-elected board of directors and senior officers are as follows:

NAME	POSITION	DATE ELECTED/ EMPLOYED	Term Expires	Years in Current Position
Matthew J. Christjohn, DVM	Chairman (Member-elected)	2005	2020	
Larry Don McGee	Vice-Chairman (Member-elected)	1997	2021	
Loyd Rutherford	Member-Elected	1990	2019	
Stewart McGill	Member-Elected	2016	2019	
Danny R. Baugh	Member-Elected	2015	2021	
Rickey Cornutt	Member-Elected	2017	2020	
John R. Adams, CPA	Director-Elected Member	2006	2021	
Hugh C. Harris	Director-Elected Member	2014	2020	
Melvin “Mel” K. Koller	President /Chief Executive Officer	2018		0.3 years
K. Ben Gore*	President /Chief Executive Officer	1989		10.0 years
Ralph D. Stewart	Executive Vice President/Chief Credit Officer	2009		9.5 years
Karri H. Sumrall, CPA	Executive Vice President/Chief Financial Officer	2003		15.5 years
C. Greg Copeland	Senior Vice President	1989		4.3 years

\*On September 4, 2018, the board of directors appointed Melvin “Mel” K. Koller as president and chief executive officer of the Association. K. Ben Gore retired from his position as president and chief executive officer on August 31, 2018 with an official retirement date of September 30, 2018.

A brief statement of the business and employment background of each director and senior officer is provided for informational purposes.

**Matthew J. Christjohn, DVM**, age 48. Dr. Christjohn is the owner and operator of Large Animal Veterinary Services, LLC, a practice concentrating livestock; mainly cattle. The business covers territory in Alabama, Georgia, Florida and Oklahoma. Dr. Christjohn received his Animal & Dairy Science degree from Auburn University in 1992, Doctor of Veterinary Medicine degree from Auburn University in 1995 and Master of Business Administration from the University of Phoenix in January 2008. In addition to his business, he presently owns and operates a 360-acre cattle farm in Wedowee, Alabama, operating as Sandy Creek Ranch, LLC. Dr. Christjohn is a member of the American and Alabama Veterinary Medical Associations, Society for Theriogenology, American Association of Bovine Practitioners, Academy of Veterinary Consultants, National Cattleman’s Beef Association, Alabama Cattlemen’s Association, and the Florida Cattlemen’s Association. Dr. Christjohn was elected chairman of the board in 2017 and is also a member of the Association’s audit committee.

**Larry Don McGee**, age 67. Mr. McGee is a full-time poultry and cattle farmer from Jackson County. He owns and operates 500 acres in Jackson and DeKalb counties. He has approximately 200 head of brood cows along with three pullet houses with a capacity of 21,000. He has been the owner/operator of L&D Farms for the past 31 years. He is a member of DeKalb County Cattlemen’s Association and the Alabama Poultry and Egg Association. Mr. McGee is also a member of the Association’s audit committee.

**Loyd Rutherford**, age 77. Mr. Rutherford is semi-retired, living in Lawrence County. Before retiring he worked for 32 years with a local cooperative along with raising cotton, soybeans, cattle and broilers. He has been on the Association board since 1990 and has served as chairman from 1995 until April 2017. Mr. Rutherford served on the district benefits administrative committee for the Farm Credit Bank of Texas and was a member of the Farm Credit Benefit Alliance plan sponsor committee, which services both AgFirst Bank and the Farm Credit Bank of Texas during 2017. He also served on the Tenth District Farm Credit Council board and was a board member for the National Farm Credit Council headquartered in Washington, D.C. Mr. Rutherford operates JRL, Inc., a construction and development company in Moulton, Alabama. Mr. Rutherford is also a member of the Association's compensation committee.

**Stewart McGill**, age 37. Mr. McGill is one of four managing partners and operators of Tate Farms General Partnership (Tate Farms). Tate Farms is located in Madison County, farming approximately 5,500 acres of cotton, corn, soybeans, wheat and pumpkins, as well as an Agritourism business that hosts approximately 60,000 guests each fall. Additionally, Mr. McGill is also a crop insurance agent with State Tate Crop Insurance. He is a member of the Alabama Farmers Federation and is also a member of the Association's compensation committee.

**Danny Ray Baugh**, age 62. Mr. Baugh is a full-time cattle and poultry farmer from Marshall County. He owns and operates a 285-acre farm in Marshall County. Mr. Baugh runs an approximately 160-head cow-calf operation, along with a 200-acre hay operation on rented lands. He currently grows for Wayne Farms, operating eight broiler houses with a farm capacity of 176,000. Mr. Baugh retired from Albertville Municipal Utilities Board in 2005 as their water plant manager after 30 years of service. He is a member of the Alabama Poultry and Egg Association, Alabama Cattlemen's Association, Marshall County Farmers Cooperative and Marshall/Dekalb Electric Cooperative. Mr. Baugh is also a member of the Association's compensation committee.

**Rickey Cornutt**, age 56. Mr. Cornutt is a full time row-crop and cattle farmer. He and his brother own Cornutt Farms, LLC in Marshall County, Alabama. Cornutt Farms, LLC consists of approximately 2,000 acres of owned and leased land of corn, soybeans, wheat and pastureland, and also operates a 300-head cow-calf operation. Additionally, Mr. Cornutt is a director of Marshall County Farmers Federation, Dekalb Farmers' Cooperative, Marshall County TVA Discretionary Fund Committee, State Board Committee of Soil and Water, and the Marshall County Conservation District. Mr. Cornutt is a member of the Association's compensation committee.

**John R. Adams, CPA**, age 59. Mr. Adams is a certified public accountant with over 37 years of experience in public accounting. He is a partner in a local accounting firm in Decatur, Alabama. Mr. Adams received his Bachelor of Science degree with a major in Accounting from the University of Alabama. He is a member of the American Institute of Certified Public Accountants, Alabama Society of Certified Public Accountants and National Society of Accountants for Cooperatives. Mr. Adams is also the chairman of the Association's audit committee.

**Hugh C. Harris**, age 67. Mr. Harris is a practicing attorney with over 42 years in the legal profession. Mr. Harris received both his Undergraduate and Juris Doctorate degrees from the University of Alabama. He spent his first 11 years as deputy district attorney for McClellan, in Cullman, Alabama, and is a member of the Cullman County Bar Association, Alabama State Bar and the Alabama Defense Lawyers Association. He serves as a director of the East Cullman Water Board and is an active member of the Alabama and Cullman Cattlemen's Association. Mr. Harris operates a small part-time cow-calf farm in Cullman County. Mr. Harris is also the chairman of the Association's compensation committee.

**Melvin "Mel" K. Koller**, age 37, President/Chief Executive Officer. Mr. Koller has been CEO since September 4, 2018, and has over 16 years' experience within Agriculture Finance, over 12 of those with the Farm Credit System.

**K. Ben Gore**, age 66, President/Chief Executive Officer. Mr. Gore was hired as CEO on January 1, 2009, and had over 43 years of experience with the Farm Credit System. On September 30, 2018, K. Ben Gore retired from his position as president and chief executive officer of the Association.

**Ralph D. Stewart**, age 46, Executive Vice President/Chief Credit Officer. Mr. Stewart was employed by the Association in September 2009. Mr. Stewart has over 20 years' experience with the Farm Credit System.

**Karri H. Sumrall, CPA**, age 47, Executive Vice President/Chief Financial Officer. Ms. Sumrall is a certified public accountant with over eight years of experience in public accounting with an emphasis in financial institutions and has over 14 years of experience with the Farm Credit System. Additionally, Ms. Sumrall is a director/member of Sumrall Holdings, LLC, an insurance agency operated solely by Ms. Sumrall's spouse, and she has no direct part in its operation.

**C. Greg Copeland**, age 58, Senior Vice President/Branch Manager. Mr. Copeland has been the branch manager of the Albertville branch since January 1, 2009 and has a total of 34 years' experience with the Farm Credit System.

## COMPENSATION OF DIRECTORS

With the exception of the chairman, who receives \$1,000 per month, directors were compensated for their service to the Association in the form of an honorarium at the rate of \$800 per month and \$600 per day for regular, special and committee meetings. Directors receive an additional \$300 for special and committee meetings held on the same day as the regular meetings. Additionally, the directors receive \$150 for each conference call meeting. Certain expenses incurred by directors while representing the Association in an official capacity were reimbursed. Mileage for attending official meetings during 2018 was paid at the IRS-approved rate of 54.5 cents per mile. A copy of the travel policy is available to stockholders of the Association upon request.

<u>Director</u>	<u>Board Meetings</u>	<u>Other Official Activities</u>	<u>2018 Total Compensation</u>
Matthew J. Christjohn, DVM	12	21	\$ 30,500
Larry Don McGee	12	23	29,750
Loyd Rutherford	12	13	31,650
J. Stewart McGill	12	12	25,800
Danny Baugh	12	12	27,450
Rickey Cornutt	11	9	22,050
John R. Adams, CPA	12	24	28,700
Hugh C. Harris	12	20	29,700
			<u><u>\$ 225,600</u></u>

The aggregate compensation paid to directors in 2018, 2017 and 2016 was \$225,600, \$223,450 and \$204,450, respectively. Additionally, no director received noncash compensation exceeding \$5,000 in 2018, 2017 and 2016.

The primary function of the audit committee is to assist the board of directors in fulfilling its oversight responsibilities relating to the quality of financial reporting, the system of internal controls, the audit process, and the Association's process for monitoring compliance with laws and regulations and the code of conduct.

The primary function of the compensation committee is to provide assistance to the board of directors in fulfilling the board's responsibilities on matters relating to compensating the board and the Association's CEO, reviewing the compensation policies and plans for senior officers and employees, including incentive compensation plans and benefits, overseeing the Association's management succession planning and engaging in such other matters as may from time to time be specifically delegated to the committee by the board.

Additional detail regarding director compensation paid for committee service (which is included in the table above) is as follows for 2018:

<u>Director</u>	<u>Committee</u>	
	<u>Audit</u>	<u>Compensation</u>
Matthew J. Christjohn, DVM	\$ 4,500	\$ -
Larry Don McGee	4,500	-
Loyd Rutherford	-	1,350
J. Stewart McGill	-	1,350
Danny Baugh	-	1,350
Rickey Cornutt	-	1,350
John R. Adams, CPA	4,500	-
Hugh C. Harris	-	1,350
	<u><u>\$ 13,500</u></u>	<u><u>\$ 6,750</u></u>

The aggregate amount of reimbursement for travel, subsistence and other related expenses paid to directors and on their behalf was \$122,262, \$122,734 and \$94,582 in 2018, 2017 and 2016, respectively.



## COMPENSATION OF SENIOR OFFICERS

### Compensation Discussion and Analysis – Chief Executive Officer (CEO) and Senior Officers

#### Overview

A critical factor to the Association's success is its ability to attract, develop and retain staff that is knowledgeable and efficient in their ability to support the Association in the execution of its strategic objectives and delivery of Association results that maximize the value to the stockholders. This objective holds particularly true for the Association's chief executive officer (CEO) and senior officer group. The Association operates utilizing a compensation program which focuses on the performance and contributions of its employees in achieving the Association's financial and operational objectives, all for the ultimate benefit of its stockholders/members. The Association's board of directors, through its compensation committee, establishes salary and incentive programs utilizing data derived from independent third-party compensation specialists in the financial services sector to ensure that salary and incentive structures are in line with market-comparable positions. Studies provided by third-party compensation specialists form the foundation for the Association's evaluation and establishment of salary and incentive plans used by the Association.

Association employees, including senior officers, can earn compensation above base salary through an annual success-sharing incentive plan. The term of the plan is each calendar year beginning January 1 through December 31. The plan is based upon the achievement of predetermined Association performance goals for return on assets, net loan growth, credit quality and delinquency volume. The plan places more emphasis on earnings (return on assets) than any other factor in the plan and is approved by the board of directors annually. All full-time employees that have been employed at least three months are eligible to earn an individual incentive up to 30 percent of their annual salary based upon their performance evaluation, including individual performance objectives. The following criteria is also used for determining eligibility for the incentive pay: (1) the Association must not be in default of the General Financing Agreement with the Farm Credit Bank of Texas; (2) the Association cannot receive an annually combined overall rating of "unsatisfactory" on credit administration by the Internal Credit Review and/or FCA examinations; (3) the employee's branch office cannot receive an annually combined overall rating of "unsatisfactory" on credit administration; (4) there must be material income from operations beyond what is needed to fund the incentive plan; and (5) eligible employees must receive an annual performance rating of "meets" on his/her individual performance review.

Association employees have the opportunity to earn commissions on revenue generated from sales of credit life and term life insurance. The Association participates in a program with outside insurance companies to provide borrowers the opportunity to purchase the insurance. Employees who generate the insurance sales receive a portion of the commissions received by the Association. Amounts paid under these plans are paid no later than January following the close of the plan term and are included in "Other" in the table on the following page.

The Association provides certain employees use of Association automobiles. The employees' personal use of these automobiles is governed by the Association's board-approved travel and vehicle policy as well as IRS rules. Employees assigned a vehicle are required to maintain a business mileage log. Personal use of these vehicles is calculated and reported in compliance with current IRS regulations. Amounts for personal use of an Association vehicle are included in "Deferred/Perquisite" in the table below.

Employees who use their personal automobiles for business purposes were reimbursed during 2018 at the IRS-approved rate of 54.5 cents per mile. The Association's travel policy allows spousal travel in some instances. Travel expenses reimbursed for spousal travel are considered to be paid to the employee or director under a non-accountable plan and are therefore included in their gross income or IRS Form 1099 in accordance with IRS guidelines. Amounts relating to reimbursed travel expenses are included in "Deferred/Perquisite" in the table on the following page. As discussed in Note 2, "Summary of Significant Accounting Policies," and Note 11, "Employee Benefit Plans," the Association participates in the Farm Credit Benefits Alliance 401(k) Plan and the Defined Contribution (DC) Plan. Amounts contributed by the Association to the 401(k) and DC plans on behalf of the CEO and senior officers are included in the "Deferred/Perquisite" column in the compensation table on the following page.

Association policy allows for reimbursement of tuition and related education expenses incurred in connection with approved undergraduate and/or graduate level coursework. The program is available to all full-time, permanent employees. The Association also provides group term life insurance to all employees in an amount equal to double the employees' respective salaries. To the extent that the value of this life insurance exceeds \$50,000, an amount is added to each respective employee's taxable earnings using the IRS-approved calculations. These payments are included in "Other" in the table on the following page.

Additionally, the Association employs a program for the health and well-being of its employees. All full-time, permanent employees are eligible to participate in the program, which allows for reimbursement of physical fitness related expenses up to \$400 per year, per employee. These payments are included in "Other" in the table on the following page. Retirement gifts and any

payout of unused annual leave at retirement are included in “Other” in the table on the following page. Neither the CEO nor any other senior officer received noncash compensation exceeding \$5,000 in 2018, 2017 or 2016. Senior officers, including the CEO, are reimbursed for reasonable travel, subsistence and other related expenses while conducting Association business. A copy of the Association’s travel policy is available to shareholders upon request.

### Summary Compensation Table

The following table summarizes the compensation paid to the CEO and all senior officers of the Association during 2018, 2017 and 2016. This may include other non-senior officers if their total compensation is within the top five highest paid employees. Amounts reflected in the table are presented in the year the compensation was earned.

<u>Name of Individual or number in group (a)</u>	<u>Year</u>	<u>Salary (b)</u>	<u>Bonus (c)</u>	<u>Change in Pension Value (d)</u>	<u>Deferred/Perquisite (e)</u>	<u>Other (f)</u>	<u>Total</u>
Mel Koller, CEO	2018	\$ 90,524	\$ 23,675	\$ -	\$ 11,337	\$ 25,151	\$ 150,687
K. Ben Gore, CEO*		240,009	57,729	-	22,213	62,905	382,856
	2017	300,012	90,000	337,149	25,377	6,248	758,786
	2016	285,010	82,935	24,155	27,658	4,118	423,876

\*Retired September 30, 2018

Aggregate Number of Senior Officers (& other highly compensated employees, if applicable)

(5)	2018	\$ 774,589	\$ 179,991	\$ 13,941	\$ 125,623	\$ 4,225	\$ 1,098,369
(5)	2017	754,528	215,803	276,631	112,442	4,737	1,364,141
(5)	2016	727,728	194,377	178,991	104,198	2,259	1,207,553

(a) Aggregate number of senior officers/highly compensated individuals, excluding CEO.

(b) Gross salary, including retention plan compensation for certain senior officers.

(c) Bonuses paid within the first 30 days of the subsequent calendar year.

(d) Change in pension value represents the change in the actuarial present value of the accumulated benefit under the defined benefit pension plan, the Farm Credit Bank of Texas Pension Plan, from the prior fiscal year to the current fiscal year.

(e) Deferred/Perquisites include contributions to 401(k) and defined contribution plans, supplemental 401(k) discretionary contributions, automobile benefits and spousal travel reimbursements in accordance with IRS guidelines.

(f) Amounts in the “Other” column include group term life insurance, service awards, health and wellness reimbursements, moving allowance, insurance commission and annual leave paid out upon retirement or termination.

Disclosure of information on the total compensation paid and the arrangements of the compensation plans during the last fiscal year to any senior officer or to any other officer included in the aggregate are available and will be disclosed to shareholders of the Association upon request.

The Association’s voting shareholders have the authority to cast a vote in an advisory vote on the Association’s CEO and/or senior officer compensation if 5 percent of the total voting stockholders submit a petition to do so. The petition and the advisory vote will be conducted in accordance with the Association’s policies and procedures. If a vote were to occur in the future, the results would be shared with the shareholders. The results of any advisory vote are nonbinding on the Association’s compensation committee and the Association’s board of directors. Also, if the compensation for either the CEO or the aggregate senior officer group increased 15 percent or more from the previous reporting period, the Association must hold an advisory vote. To date, no advisory votes on the Association’s CEO and senior officer compensation have occurred.

## Pension Benefits Table

The following table presents the total annual benefit provided from the defined benefit pension plan applicable to the CEO for the year ended December 31, 2018:

Name	Plan Name	Number of Years Credited Service	Present Value of Accumulated Benefit	Payments During 2018
K. Ben Gore, CEO (retired)	Farm Credit Bank of Texas Pension Plan	N/A	\$ -	\$ 2,757,641
Aggregate Number of Senior Officers (& other highly compensated employees, if applicable)				
(1)		36.475	\$ 1,695,581	\$ -

## Pension Benefits Table Narrative Disclosure

The former CEO and one of the other top paid employees or senior officers of the Association participate in the Farm Credit Bank of Texas Pension Plan (the “Pension Plan”), which is a qualified defined benefit retirement plan. Compensation, as defined in the Pension Plan, includes wages, incentive compensation, deferrals to the 401(k) and flexible spending account plans, but excludes annual leave or sick leave that may be paid in cash at the time of termination, retirement or transfer of employment, severance payments, retention bonuses, taxable fringe benefits and any other payments. Pension Plan benefits are based on the average of monthly eligible compensation over the 60 consecutive months that produce the highest average after 1996 (“FAC60”). The Pension Plan’s benefit formula for a Normal Retirement Pension is the sum of (a) 1.65 percent of FAC60 times “Years of Benefit Service” and (b) 0.5 percent of (i) FAC60 in excess of Social Security covered compensation items and (ii) “Years of Benefit Service” (not to exceed 35). The present value of the senior officers’ accumulated Pension Plan is calculated assuming retirement had occurred at the measurement date used for financial reporting purposes with the retirement at age 65. The Pension Plan’s benefit formula for the Normal Retirement Pension assumes that the senior is married on the date the annuity begins, that the spouse is exactly two years younger than the senior officer and that the benefit is payable in the form of a 50 percent joint and survivor annuity. If any of those assumptions are incorrect, the benefit is recalculated to be the actuarial equivalent benefit.

## Other Supplemental Retirement Plans Funded by the Association on Behalf of Senior Officers and Employees

The Association sponsors a defined contribution supplemental retirement plan eligible to employees whose compensation exceeds the IRS threshold of \$120,000 in the preceding year. This plan would allow for an employee to restore their contributions restricted by IRS limits to salary, elective deferrals made by employees to defer compensation out to a future date, discretionary contributions made by the Association to a select group of employees and a retention feature using vesting schedules for discretionary contributions. This plan is a nonqualified 401(k) plan. The Association has made no contributions to the plan to date. Employees assigned Association automobiles reimburse the Association for personal miles at a board-established rate. Employees who use their personal automobiles for business purposes were reimbursed during 2018 at the IRS-approved rate of 54.5 cents per mile.

## **TRANSACTIONS WITH DIRECTORS AND SENIOR OFFICERS**

The Association's policies on loans to and transactions with its officers and directors, required to be disclosed in this section, are incorporated herein by reference from Note 12 to the consolidated financial statements, "Related Party Transactions," included in this annual report.

### **DIRECTORS' AND SENIOR OFFICERS' INVOLVEMENT IN CERTAIN LEGAL PROCEEDINGS**

During the past five years, none of the Association's officers or directors have been involved in legal proceedings that are material to an evaluation of the ability or integrity of any person who served as a director or senior officer.

### **RELATIONSHIP WITH INDEPENDENT AUDITOR**

The Association's audit committee engaged the independent accounting firm of PricewaterhouseCoopers, LLC (PwC) to perform the annual audit of the Association's financial statements included in this annual report. The total fees paid per the 2018 audit engagement letter for professional services rendered for the Association by PwC were \$56,902.

### **RELATIONSHIP WITH UNINCORPORATED BUSINESS ENTITIES**

The Association had no relationships with unincorporated business entities at December 31, 2018.

## **FINANCIAL STATEMENTS**

The financial statements, together with the report thereon of PricewaterhouseCoopers, LLC dated March 13, 2019, and the report of management in this annual report to stockholders, are incorporated herein by reference.

## **MEMBER/SHAREHOLDER PRIVACY**

Members' nonpublic personal financial information is protected by Farm Credit Administration regulation. Our directors and employees are restricted from disclosing information not normally contained in published reports or press releases about the Association or its members.

## **CREDIT AND SERVICES TO YOUNG, BEGINNING AND SMALL FARMERS AND RANCHERS, AND PRODUCERS OR HARVESTERS OF AQUATIC PRODUCTS**

The Association is committed to meeting the needs of Young, Beginning and Small (YBS) farmers and ranchers and recognizes the need to support these operators to ensure a strong agricultural community for the future. Support of YBS lending activities is a priority in the Association. Additional employee time and other resources are combined with the most liberal application of the Association's underwriting standards possible to meet the credit needs of YBS farmers and ranchers. In addition, the Association actively supports other programs, events, scholarships and educational activities that benefit young people who will become the agricultural providers of tomorrow.

The Association sets minimum standards and monitors its YBS performance on a regular basis. These results are also compared to the demographics of the territory it serves as reflected in the USDA Census of Agriculture (Census).

Definitions for "young," "beginning" and "small" farmers and ranchers used by the Association are:

- Young: Age 35 or younger as of the loan date
- Beginning: 10 years or less of farming, ranching or aquatic experience as of the loan date
- Small: Less than \$250,000 in annual gross sales of agricultural products

Slight differences noted between the Census and our YBS information is as follows:

- The Census shows young farmers in a group up to age 34, whereas the Association's YBS information shows young farmers up to age 35.
- The Census shows years on present farm up to 9 years, whereas the Association's YBS information shows 10 years or less for a beginning farmer.
- The Census data is based on number of farms, whereas the Association's YBS information is based on number of loans.

The 2012 USDA Census of Agriculture for Alabama indicates that 4.7 percent of farm operators are “young,” 19.2 percent are “beginning” and 91.0 percent of the farms are “small.” The Association’s YBS lending goals per its 2018 business plan were as follows:

<b>YBS Class</b>	<b>Percentage of Total Loans</b>	<b>Percentage of Loan Volume</b>
Young	> 25%	> 25%
Beginning	> 45%	> 45%
Small	> 70%	> 55%

The Associations YBS loans, as a percentage of total loans outstanding as of December 31, are reflected in the table below for the past three years:

	<b>2016</b>		<b>2017</b>		<b>2018</b>	
	Loans	Volume	Percent of Total Loans	Percent of Loan Volume	Percent of Total Loans	Percent of Loan Volume
<b>Young</b>	26.6%	28.0%	26.6%	28.0%	26.8%	29.1%
<b>Beginning</b>	49.6%	49.5%	50.0%	48.5%	50.4%	50.3%
<b>Small</b>	74.8%	58.9%	74.8%	56.8%	73.6%	55.4%

The Association’s YBS loans, as a percentage of all loans closed each year, are reflected in the table below for the past three years:

	<b>2016</b>		<b>2017</b>		<b>2018</b>	
	Loans	Loan Volume	Percent of New Loans	Percent of New Loan Volume	Percent of New Loans	Percent of New Loan Volume
<b>Young</b>	24.3%	13.2%	25.4%	26.0%	28.8%	31.9%
<b>Beginning</b>	47.6%	38.5%	47.1%	45.5%	51.2%	53.8%
<b>Small</b>	68.0%	57.0%	71.2%	55.4%	68.6%	49.4%

For purposes of the above tables, a loan could be classified in more than one category depending upon the characteristics of the underlying borrower. The number and volume of loans in many cases falls into more than one category. For example, a 32-year-old farmer with farm income of \$150,000 would be counted in the statistics for both “young” and “small” categories.

The Association continues to provide credit to YBS farmers and ranchers at high levels as reflected by the above comparative data. Emphasis on this area of the Association’s lending business will continue to be a priority.