2018 ANNUAL REPORT

Cape Fear Farm Credit

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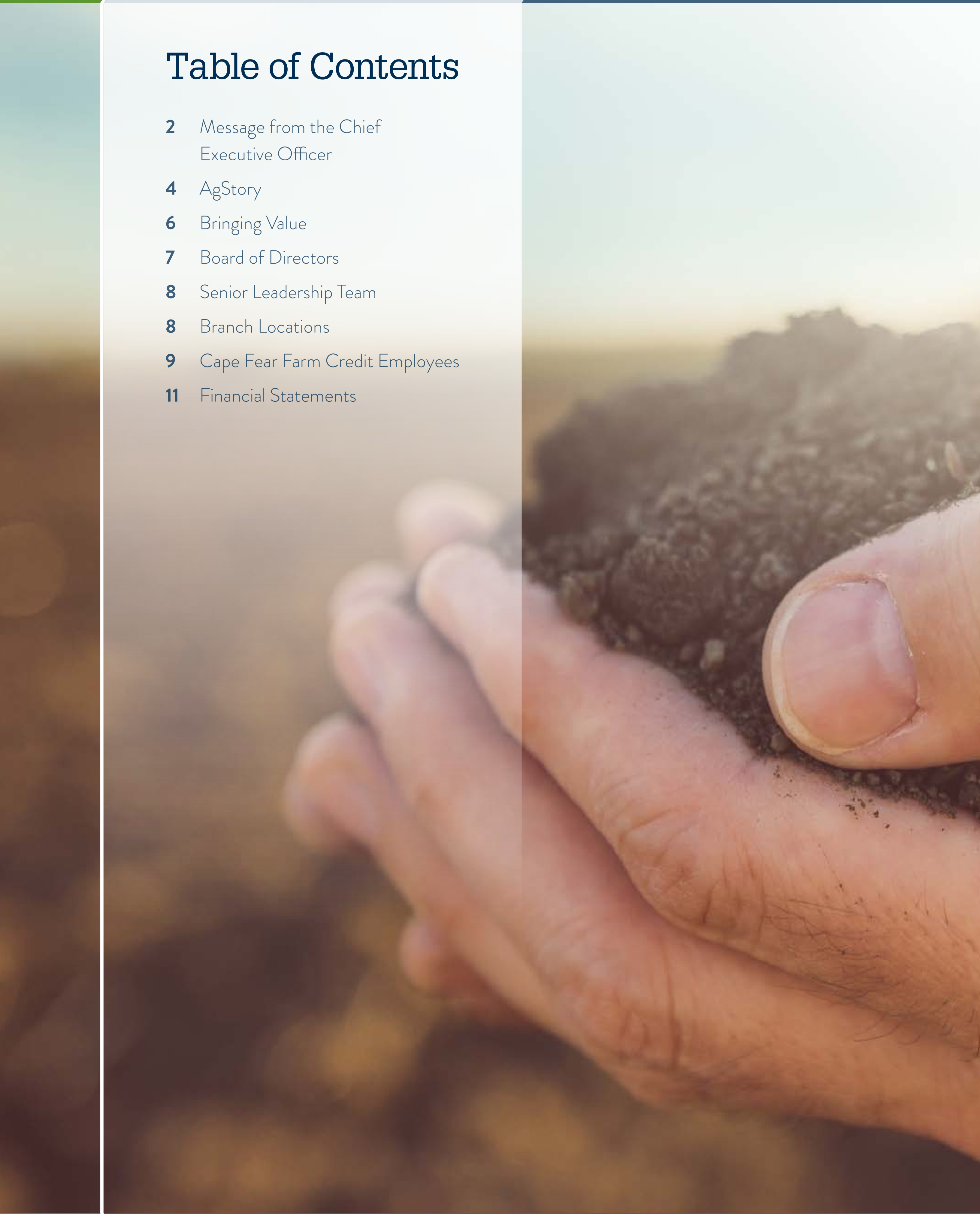


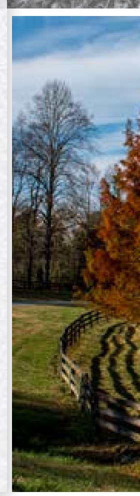
Message from the Chief Executive Officer

As a young boy, I remember sitting on my granddad's front porch, as he would tell stories of his childhood… growing up in a big farm family in South Georgia, the great depression and other historical events that we recall today. The art of storytelling has been around for generations and just the word "story" is simply intriguing with anticipation to hear the conclusion.

In years to come, I believe the year of 2018 will become a story; a story of hardship and challenges, but also one of persistence and commitment. Perhaps, just perhaps, it would go something like this…

With farming, there are many variables out of the farmers control… weather, changing consumer views, and legislation, just to name a few. You name it; a farmer has probably endured it. The year 2018 was no different as it was a year of significant adversity for many North Carolina Farmers, from a wet spring to Hurricane Florence in September. Due to those unforeseen and uncontrollable weather conditions, farmers had small yields, lost crops, and endured millions of dollars in damage throughout the Cape Fear Farm Credit territory. Nuisance lawsuits created a stronger rural and urban divide that sparked hardship on farmers, controversy and new legislation.

However, although that year was tough, I saw neighbors helping neighbors get their crops out of the field or their livestock to higher ground. I witnessed communities come together to support, love and care for each other and their operations. I was able to be a part of thousands of individuals, with a like passion of rural communities and agriculture, who rallied together in Raleigh, NC to show support of the NC Farm Bill. Although it was a rough year, the lessons learned and stories told will last for generations to come.



Now, I understand the story may not go exactly how I portrayed it, but let us be honest, 2018 was challenging. Although as I reflect, it is our honor to stand beside you as your financial partner during 2018. Many customer-owners endured hardship yet are continuing to move forward. These stories of resilience are the stories that need to be told to others.

Even with all of the challenges the agriculture sector conquered in 2018, Cape Fear Farm Credit continues to be a strong partner, both within the communities we serve and as your financial cooperative.

- ✓ Cape Fear Farm Credit donated $50,000 to North Carolina Baptists on Mission for N.C. disaster relief
- ✓ In November 2018, as a part of "Farm Credit Cares," approximately 205 Farm Credit employees across six states spent more than 1,700 volunteer hours in eastern North Carolina and northeastern South Carolina assisting impacted families get back into their homes.
- ✓ $16 million dollar in patronage distribution. $10.6 million was distributed as an early patronage in October 2018 to assist with Hurricane Florence recovery
- ✓ Return on Assets (ROA) over 2.1%
- ✓ Strong credit quality at nearly 94% acceptable
- ✓ Permanent capital level continues to be strong at over 20%

I personally thank you for allowing us to serve the needs of you, our customer-owners and communities within Southeastern North Carolina. It is through your loyalty and relationship that Cape Fear Farm Credit is able to thrive within our communities and to those we serve. We look forward to continuing to be your partner in 2019 and beyond, as we continue to carry out our mission, "To be the lender of choice to all of agriculture and our rural communities".

Brad Cornelius

Brad Cornelius, Chief Executive Officer

AgStory: The Story of Agriculture

As humans, we are natural born storytellers.

We do it every day and have done it since the beginning of time. Through spoken words and written pages, we tell stories.

Although there is one story that may seem mundane and boring to those living it, but it is a story that is profound and necessary to tell—the story of agriculture.

Few things impact every single person in this world, but agriculture does. And yet, despite its far reach, agriculture and those working in the agriculture industry are misunderstood. Why? It is largely in part because those that tell the story of agriculture aren't the ones living it. In short, we should not let someone else tell our story.

There is a gap between the farm and the public that is filled with misunderstandings, doubts, falsities, and skewed perspectives. This gap was created when people moved away from the farm and now has expanded as much of our population has never experienced life on a farm.

As people are becoming further removed from farms, media coverage of agriculture has changed. New technologies and advancements within agriculture are not being relayed properly to the public and now much of the population is concerned and curious.

According to a US Farmers and Ranchers Alliance Study, only 20% of people rate the agriculture industry as 8, 9, or 10 on a 10 point scale where 10 is complete trust. The same study also says that more than half of people are concerned if their food is safe. Let that sink in. People don't trust agriculture. Where does this mistrust come from? For a while it came from silence. No one was telling the story of agriculture, but then a story began to unfold. It was a story told, not by agriculturalists, but by others. They answered the questions and filled the gap with their version of agriculture. It wasn't all wrong, but it wasn't true either.

Today, the story that is being told has changed the views of agriculture. Those of us in agriculture found our characters have been altered and the plotlines have shifted. No longer are we experts in the field; we are perceived as uneducated. No longer are we stewards of the land and nurturers of animals; we are thought to be polluters and abusers.

Because of this narrative, the gap between farm and public is being filled with many false pictures. It is being filled with laws, policies, regulations, lawsuits, negative media, and labels.

Why tell the story of agriculture? Because if we don't, someone else will. It is so important to tell your agricultural story. You don't have to be a farmer. Maybe you're a mom who trusts farmers to produce food that is healthy for your children. Tell that. Maybe you are an accountant who has many agricultural clients that you love. Maybe you are a farmer. Just because it is your daily routine, doesn't mean it is mundane to others. Tell that story.

It doesn't take a lot to tell the story of agriculture. You don't have to start a blog or become a public speaker. You just have to be you. The more who tell the story, the stronger the story will be. Your voice matters.

Tips for Telling Your AgStory:

1. **Start a Conversation**—don't be afraid to talk to people whether that's online or in person. Don't be confrontational, just choose to engage.
2. **Educate**—educate yourself and others. It is important to stay up to date on current events and facts so that when an opportunity or question does arise, you are ready.
3. **Share personal stories**—remember, humans are natural born storytellers. Telling stories, especially personal ones is the easiest and most impactful tool you have.
4. **Show don't just tell**—pictures speak a thousand words…just take more photos. Even better than photos, invite people to your farm.
5. **Focus on the future and continuous improvement**—brag about how good agriculture has gotten and continues to be.
6. **Be natural and be YOU**—develop credibility by being genuine. That is sure to help the public trust agriculture more.
7. **Let your passion shine**—for many of us, working in agriculture is more than a profession, it is a passion. Let that shine!
8. **Resist being defensive**—it can be hard, but it is important not to get defensive or in a heated argument. Sometimes, all you can do is offer a person an updated version of the story of agriculture, but they may not always accept it.
9. **Keep it simple**—for those involved in agriculture, terms like farrow or no-till may seem common, but others listening to the story may not understand. Don't use industry jargon but just keep it simple.
10. **Explore mediums**—there are so many different ways that you can tell your ag story these days, the options are endless. It doesn't have to be complicated. For example, if you have Facebook, snap a picture of harvest and put a quick fact with the photo or share how many hours you've spent in the combine. Short, simple, sweet. Challenge yourself to try something new, whether that is a new platform, or a new way to use your platform.

You have a story to tell, and now, more than ever, it is important to tell it. How will you tell your AgStory?

Bringing Value

Loans for Your Farm

- Equipment and vehicles
- Operating expenses
- Poultry and livestock facilities
- Farm improvements
- Barns, stables, sheds

Loans for Your Agribusiness

- Nurseries and greenhouses
- Poultry and livestock operations
- Gins and processing facilities
- Timber and sawmill operations
- Farm-related businesses

Loans for Your Home & Place in the Country

- Lots
- Homes
  - Home construction
  - Purchases and refinancing
  - Remodeling and improvements
  - Refinances
- Horses, cattle and other livestock
- Livestock and utility trailers

More than just loans...

Cape Fear Farm Credit wants to help you be successful. We offer the following services and conveniences:

E-Commerce

AccountAccess
Conveniently manage your account information 24/7 from your computer or mobile device

Money Management Tools

FastCash
Quick and easy fund transfers from your line of credit loan into your personal or business checking account at no cost to you

AutoDraft
Hassle-free, automatic drafting of your loan payments saves you time and money

AutoBorrow
A cash management tool that links your Cape Fear Farm Credit loan to your business checking account

Other Services

Farm Credit *EXPRESS*
Offered at most local equipment dealers

Leases
Trucks, equipment, buildings and more

Educational Programs
Offered throughout the year to our members

Industry News
Market news, data analysis, and other tools to keep ahead of the curve

Board of Directors

Gary Hendrix
(Chairman)
Raeford, NC

Jon Pope
(Vice-Chairman)
Coats, NC

Al Bain
Outside Director
Lillington, NC

David Gooden
Elizabethtown, NC

Tony Grant
Outside Director
Columbia, SC

Nash Johnson II
Clinton, NC

Adrian Locklear
Maxton, NC

Paul Maguire
Roseboro, NC

Morris Murphy
Albertson, NC

Gary Rouse
Outside Director
Clinton, NC

Michael T. (Bo) Stone
Rowland, NC

* Alfred Wooten completed his elected term as a director on February 19, 2019.

Senior Leadership Team

From the left:

Mark Cochran
Director of IT

Randy Pope
Commercial & Capital Markets Manager

Sarah Temple
Sr. Human Resources Administrator

John Patterson
Regional Manager

Brad Cornelius
Chief Executive Officer

Evan Kleinhans
Chief Financial Officer

Brook Gillis
Regional Manager

Geoff Manderewicz
Chief Credit Officer

Branch Locations

Burgaw
811 South Walker Street
910-259-5481

Clinton
1780 Southeast Boulevard
910-592-8121

Harnett County
400 W Broad Street
910-892-4065

Elizabethtown
108 North Poplar Street
910-862-4536

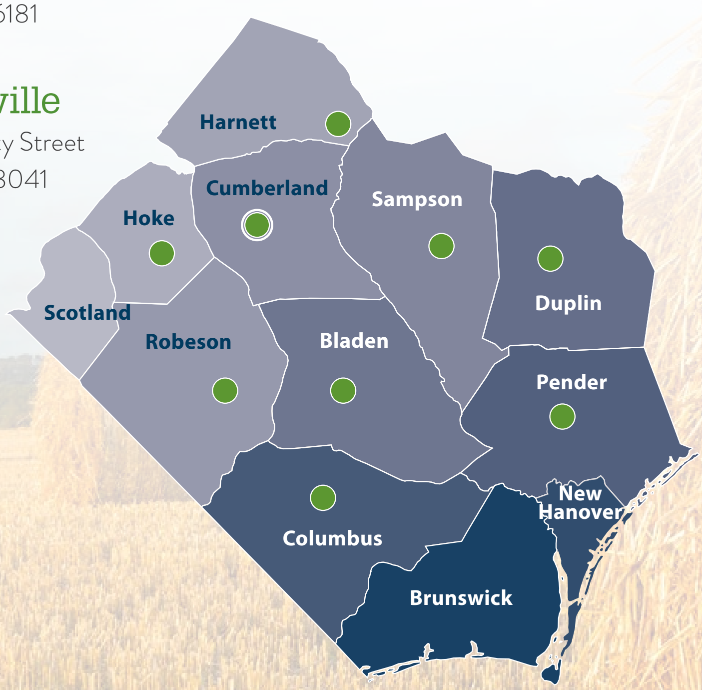
Fayetteville
333 East Russell Street
910-483-1404

Kenansville
127 Beasley Street
910-296-1776

Lumberton
1902 North Cedar Street
910-738-8181

Raeford
331 South Main Street
910-875-6181

Whiteville
300 Liberty Street
910-642-8041



Cape Fear Farm Credit Employees
(as of December 31, 2018)

Administrative
Brad Cornelius
Janna Bass
Melissa Boney
Kim Bunce
Nancy Byrd
Mark Cochran
Dana Desien
Elise DeVegter
Mendy Grella
Brook Gillis
Chuck Hester
Elizabeth Hester
Ronda Hoffman
Cathy Keane
Brentley King
Evan Kleinhans
Geoff Manderewicz
Will Maxwell
Tina Melvin-Ford
Christy Moore
Katie Neal
John Patterson
Kristina Quinn
Janet Smith
Jill Smith
Sharon Smith
Courtney Stewart
Sarah Temple
Michael Thomas

Burgaw Branch
Betty Kay Williams
Kelly Foy

Clinton Branch
Mike Carter
Patrick Abrams
Sylvia Fryar
Tonya Hobbs
Dennis Honrine
Martin Jackson
Gena Tew

Elizabethtown Branch
Jake Suggs
Jeanne Fields
Paula Roberts
Kaleb Sargent
Linda Wilson

Fayetteville Branch
Brian Johnson
Summer Howard
Ashley Such

Harnett County Branch
Stuart Betts
Tracy Armstrong
Deneice Core
Karen Powell
Denise Stancil
Glenda Tew

Kenansville Branch
Gerald Wilson
Shannon Bell
Kim Hunter
Daniel Outlaw
Debbie Raynor
Shannon Scott

Lumberton Branch
Kevin Kinlaw
Suzanne Malloy
Vickie Edwards
Carmin Russ

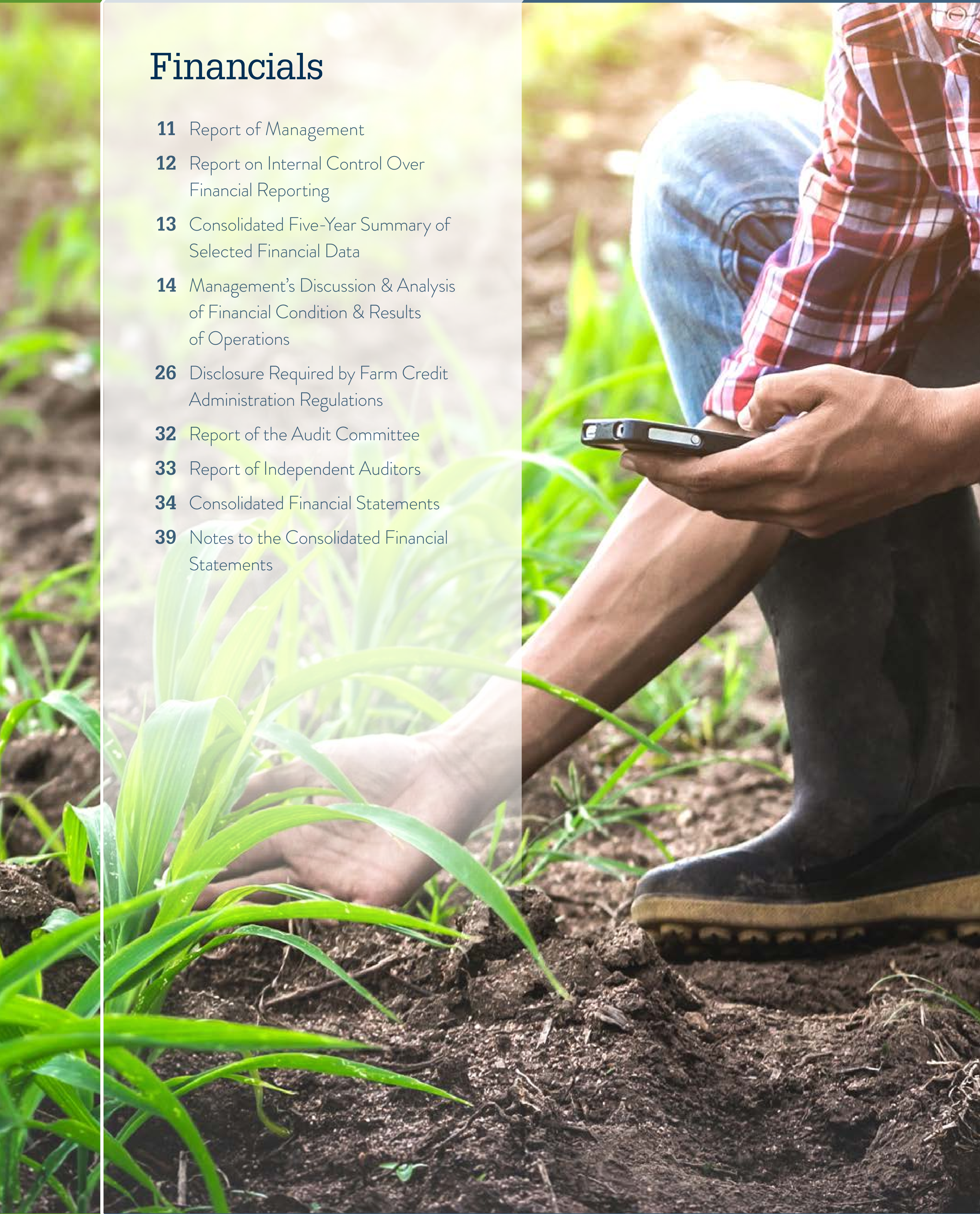
Raeford Branch
Brian Johnson
Benjamin Ellmers
Sharon Nichols
Josie Russell

Whiteville Branch
Kevin Kinlaw
Andy Coates
Noele Hester
Candy Ward
Joshua West

Capital Markets Department
Randy Pope
Cliff Kilpatrick
Amy Tyndall

Appraisal Department
John Hales
Ismael Avila
Amy Capra
Jared Johnson
Graham Smith

Financials



Report of Management

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

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

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

The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that we have reviewed the 2018 Annual Report of Cape Fear Farm Credit, ACA, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Gary Hendrix
Chairman of the Board

Brad Cornelius
Chief Executive Officer

Evan J. Kleinhans
Chief Financial Officer

March 13, 2019

Report on Internal Control Over Financial Reporting

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

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of December 31, 2018. In making the assessment, management used the framework in *Internal Control — Integrated Framework (2013)*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association's management concluded that as of December 31, 2018, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of December 31, 2018.

Brad Cornelius
Chief Executive Officer

Evan J. Kleinhans
Chief Financial Officer

March 13, 2019

Consolidated Five-Year Summary Of Selected Financial Data

(dollars in thousands)	2018	2017	December 31, 2016	2015	2014
Balance Sheet Data					
Cash	**$ 2,543**	$ 2,606	$ 3,063	$ 3,882	$ 3,107
Investments in debt securities	**3,738**	3,978	4,209	7,366	4,647
Loans	**928,304**	933,424	859,557	830,254	789,693
Allowance for loan losses	**(13,528)**	(7,911)	(7,738)	(7,117)	(5,378)
Net loans	**914,776**	925,513	851,819	823,137	784,315
Equity investments in other Farm Credit institutions	**10,673**	10,257	9,951	9,592	9,360
Other property owned	**366**	1,167	1,876	1,356	4,976
Other assets	**26,447**	25,506	24,605	25,090	27,180
Total assets	**$ 958,543**	$ 969,027	$ 895,523	$ 870,423	$ 833,585
Notes payable to AgFirst Farm Credit Bank*	**$ 742,744**	$ 746,548	$ 683,642	$ 667,938	$ 636,579
Accrued interest payable and other liabilities with maturities of less than one year	**12,280**	23,145	24,214	25,062	27,222
Total liabilities	**755,024**	769,693	707,856	693,000	663,801
Protected borrower stock	**3**	3	3	3	3
Capital stock and participation certificates	**2,464**	2,507	2,454	2,411	2,406
Retained earnings					
Allocated	**103,116**	100,298	90,846	83,467	77,931
Unallocated	**98,205**	96,833	94,664	91,849	89,784
Accumulated other comprehensive income (loss)	**(269)**	(307)	(300)	(307)	(340)
Total members' equity	**203,519**	199,334	187,667	177,423	169,784
Total liabilities and members' equity	**$ 958,543**	$ 969,027	$ 895,523	$ 870,423	$ 833,585
Statement of Income Data					
Net interest income	**$ 26,816**	$ 25,786	$ 24,604	$ 24,693	$ 24,336
Provision for loan losses	**6,022**	787	892	622	174
Noninterest income (expense), net	**(603)**	1,624	(3,516)	(4,469)	(75)
Net income	**$ 20,191**	$ 26,623	$ 20,196	$ 19,602	$ 24,087
Key Financial Ratios					
Rate of return on average:					
Total assets	**2.15%**	2.91%	2.31%	2.30%	2.95%
Total members' equity	**9.79%**	13.55%	10.83%	10.96%	14.16%
Net interest income as a percentage of average earning assets	**2.92%**	2.89%	2.89%	3.00%	3.09%
Net (chargeoffs) recoveries to average loans	**(0.044)%**	(0.069)%	(0.032)%	0.136%	(0.109)%
Total members' equity to total assets	**21.23%**	20.57%	20.96%	20.38%	20.37%
Debt to members' equity (:1)	**3.71**	3.86	3.77	3.91	3.91
Allowance for loan losses to loans	**1.46%**	0.85%	0.90%	0.86%	0.68%
Permanent capital ratio	**20.35%**	20.53%	22.23%	22.23%	23.30%
Total surplus ratio	**	**	21.93%	21.91%	22.96%
Core surplus ratio	**	**	21.93%	21.91%	22.96%
Common equity tier 1 capital ratio	**20.07%**	20.35%	**	**	**
Tier 1 capital ratio	**20.07%**	20.35%	**	**	**
Total regulatory capital ratio	**21.15%**	21.22%	**	**	**
Tier 1 leverage ratio	**20.56%**	20.45%	**	**	**
Unallocated retained earnings (URE) and URE equivalents leverage ratio	**20.80%**	20.66%	**	**	**
Net Income Distribution					
Estimated patronage refunds:					
Cash	**$ 16,000**	$ 15,000	$ 10,000	$ 12,000	$ 14,000
Nonqualified retained earnings	**2,187**	9,473	7,807	5,944	8,890

** General financing agreement is renewable on a one-year cycle. The next renewal date is December 31, 2019.*
*** Not applicable due to changes in regulatory capital requirements effective January 1, 2017.*

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

(dollars in thousands, except as noted)

GENERAL OVERVIEW

The following commentary summarizes the financial condition and results of operations of Cape Fear Farm Credit, ACA, (Association) for the year ended December 31, 2018 with comparisons to the years ended December 31, 2017 and December 31, 2016. This information should be read in conjunction with the Consolidated Financial Statements, Notes to the Consolidated Financial Statements and other sections in this Annual Report. The accompanying Consolidated Financial Statements were prepared under the oversight of the Audit Committee of the Board of Directors. For a list of the Audit Committee members, refer to the "Report of the Audit Committee" reflected in this Annual Report. Information in any part of this Annual Report may be incorporated by reference in answer or partial answer to any other item of the Annual Report.

The Association is an institution of the Farm Credit System (System), which was created by Congress in 1916 and has served agricultural producers for 102 years. The System's mission is to maintain and improve the income and well-being of American farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses. The System is the largest agricultural lending organization in the United States. The System is regulated by the Farm Credit Administration, (FCA), which is an independent safety and soundness regulator.

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

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

Copies of the Association's Annual and Quarterly reports are also available upon request free of charge on the Association's website, ***www.capefearfarmcredit.com***, or by calling 1-800-368-5819, extension 3243, or writing Evan J. Kleinhans, Cape Fear Farm Credit, P.O. Box 2405, Fayetteville, NC, 28302. The Association prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly Report, which is available on the internet, within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Association.

FORWARD LOOKING INFORMATION

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

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

AGRICULTURAL OUTLOOK

The following United States Department of Agriculture (USDA) analysis provides a general understanding of the U.S. agricultural economic outlook. However, this outlook does not take into account all aspects of the Association's business. References to USDA information in this section refer to the U.S. agricultural market data and are not limited to information/data in the Association's territory.

Production agriculture is a cyclical business that is heavily influenced by commodity prices, weather, tax and trade policies, interest rates and various other factors. From 2010 through 2014, the U.S. farm sector generally experienced favorable economic conditions driven by high commodity and livestock prices and increasing farmland values. This generally fostered improved financial strength across the farm sector, with farmer working capital peaking in 2012. Working capital is defined as the amount of cash and cash convertible assets minus liabilities due to creditors within 12 months. However, since 2014, the agricultural environment has been more challenging. Currency fluctuations, large inventories and current U.S. trade policies, including the retaliatory action by other countries, have begun to adversely impact demand and prices for agricultural exports, which have reduced net farm income (a broad measure of profits) and eroded farmer working capital. Higher interest rates could exacerbate the reduction in net farm income by increasing interest expense for farmers with floating-rate loans or other liabilities that reprice periodically to current market interest rates. The following table illustrates USDA data on net farm income and farmer working capital:

	Year Ended December 31,			
(dollars in billions)	2018*	2017	2016	2015
Net Farm Income	$66.295	$75.381	$61.542	$81.053
Farmer Working Capital	$49.879	$72.279	$65.197	$82.657

**Forecasted*

The substantial risk-bearing capacity, gained prior to 2015, has afforded U.S. crop producers time to transition their operations to the new environment of lower commodity prices, compressed margins and higher interest rates. Optimal input usage, adoption of cost-saving technologies, negotiation of adjustments to various business arrangements, such as rental cost of agriculture real estate, and effective use of hedging and other price risk management strategies are all critical in yielding positive net farm income for producers. Producers who are able to realize cost of production efficiencies and market their farm products effectively are most likely to adapt to the current price environment. However, if these current market conditions persist, farm sector financial strength will continue to weaken, challenging a greater number of producers who may not be able to sufficiently adjust their operations to avoid loan repayment challenges.

The February 2019 USDA forecast estimates 2018 farmers' net cash income, which is a measure of the cash income after payment of business expenses, at $95.0 billion, down $9.0 billion from 2017. The forecasted decrease in farmers' net cash income for 2018 is primarily due to an expected increase in cash expenses of $11.9 billion, led by increases in fuels/oil, interest, feed, and hired labor.

The February 2019 USDA outlook for the farm economy, as a whole, projects 2019 farmers' net cash income to increase to $97.7 billion, a $2.7 billion increase from 2018. The forecasted increase in farmers' net cash income for 2019 is primarily due to an expected decrease in cash expenses of $4.4 billion and increase in cash receipts for crops of $2.2 billion, partially offset by a decrease in direct government payments of $2.8 billion.

As estimated by the USDA in November 2018, the System's market share of farm business debt (defined as debt incurred by those involved in on-farm agricultural production) decreased slightly to 40.4 percent at December 31, 2017 (the latest available data), as compared with 40.9 percent at December 31, 2016.

While 2018 net farm income and working capital have declined, a healthy U.S. economy is expected to support domestic demand for most agricultural commodities in the foreseeable future. The primary area of risk will remain the export component of the demand for U.S. agricultural commodities, with a stronger dollar and ongoing uncertainty surrounding the future of U.S. trade policy. Major cash crops in the U.S. are projected to remain at elevated supply levels resulting from a combination of factors, including overall excellent crop conditions, tariffs and strong harvests in recent years. In addition to cash crops, pork and dairy are heavily dependent upon exports and most susceptible to foreign trade-related disruptions. The risk in the export component of the demand for U.S. agricultural commodities has been minimally mitigated by Market Facilitation Program assistance to producers impacted by retaliatory tariffs. Additionally, the revised Dairy Margin Protection Program in the 2018 Farm Bill and the new Dairy Revenue Protection Program will provide some support for dairy farmers. Mid-sized dairies, especially operations that are more highly leveraged or have high relative costs, will continue to face financial challenges at least into mid-2019.

The following table sets forth the commodity prices per bushel for certain crops, by hundredweight for hogs, milk, and beef cattle, and by pound for broilers and turkeys from December 31, 2015 to December 31, 2018:

Commodity	12/31/18	12/31/17	12/31/16	12/31/15
Hogs	$43.40	$48.60	$43.10	$42.80
Milk	$16.40	$17.20	$18.90	$17.30
Broilers	$0.51	$0.50	$0.48	$0.47
Turkeys	$0.50	$0.53	$0.74	$0.89
Corn	$3.54	$3.23	$3.32	$3.65
Soybeans	$8.57	$9.30	$9.64	$8.76
Wheat	$5.28	$4.50	$3.90	$4.75
Beef Cattle	$117.00	$118.00	$111.00	$122.00

In a prolonged period of less favorable conditions in agriculture, the Association's financial performance and credit quality measures would likely be negatively impacted. Any negative impact from these less favorable conditions should be lessened by geographic and commodity diversification and the influence of off-farm income sources supporting agricultural-related debt. However, agricultural borrowers who are more reliant on off-farm income sources may be more adversely impacted by a weakened general economy.

CRITICAL ACCOUNTING POLICIES

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

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

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

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

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

ECONOMIC CONDITIONS

North Carolina's economy continues to improve as labor markets have strengthened, household conditions have improved, and housing market indicators have moved in a positive direction. The Cape Fear region continues to have slower economic growth in comparison to other parts of the state and country. North Carolina's unemployment rate decreased from 4.5% in December 2017 to 3.6% in December 2018 and is below the national rate of 3.9%. The unemployment rate in Southeastern North Carolina is higher than the state average. Of the 12 counties in Southeastern North Carolina that the Association serves, 66.67% are ranked by the North Carolina Department of Commerce as Tier 1, or most distressed in terms of economic wellbeing, 8.33% are ranked as Tier 2, or moderately distressed, and 25.0% are ranked as Tier 3, or least distressed.

Overall, the farm sector profitability is expected to decline in 2019 caused by modest commodity prices, weather conditions, and farm expenses falling more slowly than commodity prices. The region was adversely impacted by Hurricane Florence in 2018 and is still dealing with the adverse impact of the storm. Liquidity in the balance sheet has eroded for many farmers and has created the need for debt restructuring and additional borrowing by some.

The swine and poultry segments, the largest commodity exposures in our portfolio, are profitable due to lower feed costs, but face headwinds due to disputes with trading partners. The swine industry also faces uncertainty caused by on-going nuisance lawsuits. Significant poultry sector expansion is occurring in the Cape Fear region. Disease outbreaks have slowed for livestock farmers and are being managed by proper biosecurity; however, continued diligence is needed. Production levels have created large supplies of hogs and poultry. A strong US dollar and trade policy pose as potential threats as the export market plays a significant role in maintaining current price levels.

Crop production, the third largest portion of the loan portfolio, has suffered from adverse weather conditions, modest commodity prices, and farm expenses falling slower than commodity prices during 2018. Input costs remain high for most crops. Commodity prices are forecast to remain near current levels in 2019 with peanuts being an exception. Tobacco production contracts are expected to be cut again in 2019.

Farm real estate values increased slightly during 2018; however, farm asset values have the potential to decrease in 2019 with more farm equipment and real estate offered for sale.

Credit quality reflects the challenging lending environment with 93.79% rated acceptable, which is a slight decline from last year. Loans classified as other assets especially mentioned, currently collectible but exhibiting some potential weakness, decreased slightly from last year to 3.83%, while loans classified as substandard, those exhibiting serious weaknesses in repayment capacity, equity and/or loan performance, increased slightly from last year to 2.38%. Although management expects credit quality to remain stressed in certain segments during 2019, Cape Fear Farm Credit's financial performance continues to be strong.

Our Association's loan officers, with the support and direction of our senior leadership team, have successfully navigated the challenges of operating in difficult economic conditions. We continue to adhere to our mission to be the lender of choice to all of agriculture and our rural communities. Our expertise in agricultural and rural lending allows us to help our customer-owners through the fluctuations and uncertainties that are prevalent in the agricultural industry today.

LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners, and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans through numerous product types.

The diversification of the Association loan volume by type for each of the past three years is shown below.

	December 31,					
Loan Type	2018		2017		2016	
	(dollars in thousands)					
Real estate mortgage	$ 609,465	65.65 %	$ 591,310	63.35 %	$ 527,783	61.40 %
Production and intermediate-term	265,477	28.60	287,559	30.81	287,275	33.42
Processing and marketing	22,697	2.45	21,734	2.33	21,776	2.53
Farm related business	10,553	1.14	7,311	0.78	4,023	0.47
Loans to Cooperatives	5,976	0.64	8,539	0.91	6,376	0.74
Rural residential real estate	4,658	0.50	4,844	0.52	4,877	0.57
International	3,260	0.35	3,259	0.35	3,257	0.38
Lease Receivable	2,988	0.32	3,142	0.34	2,962	0.35
Power and water/waste disposal	1,934	0.21	1,983	0.21	276	0.03
Communication	1,296	0.14	3,743	0.40	952	0.11
	$ 928,304	100.00 %	$ 933,424	100.00 %	$ 859,557	100.00 %

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

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

	December 31,		
Branch/State	2018	2017	2016
Burgaw	6.02%	6.45%	6.36%
Clinton	14.64	15.11	14.48
Dunn*	–	–	6.09
Elizabethtown	8.24	8.22	9.91
Fayetteville	3.32	3.27	3.04
Harnett County	8.98	9.21	–
Kenansville	24.37	22.60	21.24
Lillington*	–	–	3.77
Lumberton	5.34	6.56	8.36
Raeford	5.60	5.22	5.78
Whiteville	4.14	4.73	5.20
Capital Markets	5.83	6.40	6.48
Commercial	11.45	11.08	6.70
Bonds & Investments	–	.01	0.03
Special Asset Management	2.07	1.14	2.56
	100.00%	100.00%	100.00%

**The Dunn and Lillington branches were consolidated into one branch, Harnett County, in 2017.*

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

The major commodities in the Association's loan portfolio are shown below. The predominant commodities are Swine, Chickens, and Field & Row Crops, which constitute 64 percent of the entire portfolio.

	December 31,					
Commodity Group	2018		2017		2016	
	(dollars in thousands)					
Chickens	$ 253,109	27%	$ 245,525	26%	$ 194,295	23%
Swine	244,890	26	245,680	26	255,024	30
Field & Row Crops	98,269	11	102,958	11	110,968	13
Timber, Sawmills, & Paper	58,612	6	60,156	7	46,928	5
Turkeys	50,359	5	41,223	4	24,623	3
Landlords	48,762	5	53,696	6	51,474	6
Tobacco	45,640	5	49,584	5	46,672	5
Fruits, Vegetables, & Nuts	43,779	5	41,578	5	42,554	5
Other	30,159	3	39,831	4	34,459	4
Livestock	26,178	3	23,105	2	21,367	2
Cotton	13,526	2	15,817	2	19,356	2
Non-Farm & Miscellaneous	9,246	1	8,531	1	5,226	1
Rural Home	5,775	1	5,740	1	6,611	1
Total	$ 928,304	100%	$ 933,424	100%	$ 859,557	100%

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The Association's loan portfolio contains a concentration of swine, chicken, and field & row crop producers. Although a large percentage of the loan portfolio is concentrated in these enterprises, many of these operations are diversified within their enterprise and/or with crop production that reduces overall risk exposure. Demand for pork and chicken, prices of field grains, and international trade are some of the factors affecting the price of these commodities. Even though the concentration of large loans has increased over the past several years, the agricultural enterprise mix of these loans is diversified and similar to that of the overall portfolio. The risk in the portfolio associated with commodity concentration and large loans is reduced by the range of diversity of enterprises in the Association's territory.

The Association had a 7.71% increase in gross loan volume for the twelve months ended December 31, 2018, in comparison with the same period of 2017. Purchased accruing loans decreased by $11,227 or 17.16% in 2018 from 2017. The Association had a $106,610 increase in sold volume, which equated to a 1.51% decrease in net accruing volume in 2018 in comparison with 2017.

During 2018, the Association continued activity in the selling of loan participations within the System. Selling participation loans provides a means for the Association to spread credit concentration risk and realize interest and fee income which may strengthen our capital position. The Association continued strict guidelines for purchases in 2018.

	December 31,		
Loan Participations:	**2018**	**2017**	**2016**
	(dollars in thousands)		
Participations Purchased – FCS Institutions	$ 50,984	$ 62,002	$ 51,673
Participations Purchased – Non-FCS Institutions	3,614	3,500	5,849
Participations Sold	(387,575)	(281,707)	(213,714)
Total	$ (332,977)	$ (216,205)	$ (156,192)

The Association did not have any loans sold with recourse, retained subordinated participation interests in loans sold, or interests in pools of subordinated participation interests for the period ended December 31, 2018.

The Association continued to sell qualified long-term mortgage loans into the secondary market in 2018. For the period ended December 31, 2018, the Association originated loans for resale totaling $796 which is a decrease of $649 or 44.91% from the 2017 amount of $1,445 originated. Of the $796 originated in 2018, $705 was sold into the secondary market and, $91 in loans were held for sale at year end waiting processing and funding. The Association originated $1,445 loans for resale in 2017, $1,314 was sold into the secondary market and $131 in loans were held for sale at year end waiting processing and funding. The Association originated $1,861 loans for resale in 2016, $1,861 was sold into the secondary market, and no loans were held for sale at year end waiting processing and funding.

MISSION RELATED INVESTMENTS

During 2005, the FCA initiated an investment program to stimulate economic growth and development in rural areas. The FCA outlined a program to allow System institutions to hold such investments, subject to approval by the FCA on a case-by-case basis. FCA approved the Rural America Bonds pilot program and the Tobacco Buyout Program under the Mission Related Investments umbrella, as described in the following.

Effective December 31, 2016, the FCA concluded each pilot program approved as part of the Investment in Rural America program. Each institution participating in such programs may continue to hold its investment through the maturity dates for the investments, provided the institution continues to meet all approval conditions. Although the pilot programs have concluded, the FCA can consider future requests on a case-by-case basis.

In October 2005, the FCA authorized AgFirst and the Associations to make investments in Rural America Bonds under a three-year pilot period. Rural America Bonds may include debt obligations issued by public and private enterprises, corporations, cooperatives, other financing institutions, or rural lenders where the proceeds would be used to support agriculture, agribusiness, rural housing, or economic development, infrastructure, or community development and revitalization projects in rural areas. Examples include investments that fund value-added food and fiber processors and marketers, agribusinesses, commercial enterprises that create and maintain employment opportunities in rural areas, community services, such as schools, hospitals, and government facilities, and other activities that sustain or revitalize rural communities and their economies. The objective of this pilot program was to help meet the growing and diverse financing needs of agricultural enterprises, agribusinesses, and rural communities by providing a flexible flow of money to rural areas through bond financing. These bonds are classified as Loans or Investments on the Consolidated Balance Sheets depending on the nature of the investment. As of December 31, 2018, the Association had $3,738 in Rural America Bonds of which all were classified as Investment Securities. As of December 31, 2017, the Association had $4,055 in Rural America Bonds of which $77 of these instruments were classified as Loans and the other $3,978 were classified as Investment Securities. As of December 31, 2016, the Association had $4,444 in Rural America Bonds of which $235 of these instruments were classified as Loans and the other $4,209 were classified as Investment Securities.

CREDIT RISK MANAGEMENT

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

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

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

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

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

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

Credit Quality	2018	2017	2016
Acceptable & OAEM	97.62%	97.81%	96.50%
Substandard	2.38%	2.17%	3.50%
Doubtful	–%	0.02%	–%
Loss	–%	–%	–%
Total	100.00%	100.00%	100.00%

The Association monitors and manages risk concentrations to safeguard the investment of its stockholders. Risk concentrations can arise from:

- the collective exposure of loan(s) to a single obligor or group of obligors;
- a group of loans in which the primary repayment source is dependent upon a common affiliated party such as a livestock integrator, a marketing cooperative, a specialized buying station, etc.;
- a group of loans whose primary repayment source is dependent upon a specific commodity or industry;
- financial entities failing to meet their contractual obligations to the Association, referred to as financial counterparty risk.

The tools for managing these risks include financial monitoring of the risk source, proper reserve and capital levels, loan participations and cooperative lending, government guarantees, standby loan guarantees issued by other financial institutions, and periodic stress testing of the Association's portfolio.

The Association maintains a standby loan guarantee agreement with Farmer Mac, a separate entity of the Farm Credit System, to guarantee a pool of loans. Under the terms of the agreement, Farmer Mac is obligated to purchase loans that default and limit the Association's maximum loss potential to $4,000. This standby guarantee agreement reduced the Association's risk caused by concentrations in certain industries and certain affiliated parties. As of December 31, 2018, the balance of loans guaranteed in this pool was $22,004. The balance of loans guaranteed in this pool for years ended in 2017 and 2016 was $39,379 and $58,123, respectively. The Association added additional loans to the pool during 2017. No losses have been recognized on the Farmer Mac pool in 2018, 2017 or 2016.

The Association also utilizes government guarantees to help reduce risk on individual loan relationships and to help manage concentration risk. As of the year ended December 31, 2018, the balance of loans secured by a government guarantee was $49,342. The balance of loans secured by a government guarantee for the years ended in 2017 and 2016 was $57,558 and $64,498, respectively.

Nonperforming Assets

The Association's loan portfolio is divided into performing and high-risk categories. A Special Assets Management Department is responsible for servicing loans classified as high-risk. The high-risk assets, including accrued interest, are detailed below:

	December 31,		
High-risk Assets	2018	2017	2016
	(dollars in thousands)		
Nonaccrual loans	$ 18,820	$ 10,020	$ 19,662
Accruing restructured loans	2,076	2,733	3,546
Accruing bankruptcy loans	198	80	258
Accruing loans 90 days past due	188	–	–
Total high-risk loans	21,282	12,833	23,466
Other property owned	366	1,167	1,876
Total high-risk assets	$ 21,648	$ 14,000	$ 25,342
Ratios			
Nonaccrual loans to total loans	2.03%	1.07%	2.29%
High-risk assets to total assets	2.26%	1.44%	2.83%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or future interest accruals, under the contractual terms of the loan. In substance, nonaccrual loans reflect loans where the accrual of interest has been suspended. Nonaccrual loans increased $8,800 or 87.82% percent in 2018 in comparison with 2017. The increase in nonaccrual volume is primarily attributed to the transfer of a large relationship to nonaccrual status in the fourth quarter of 2018. Of the $18,820 in nonaccrual volume at December 31, 2018, $7,283 or 38.70%, compared to $2,756 or 27.50% and $2,124 or 10.80% at December 31, 2017 and 2016, respectively, was current as to scheduled principal and interest payments but did not meet all regulatory requirements to be transferred into accrual status.

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

Allowance for Loan Losses

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

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

Allowance for Loan Losses Activity:	Year Ended December 31, 2018	2017	2016
	(dollars in thousands)		
Balance at beginning of year	$ 7,911	$ 7,738	$ 7,117
Charge-offs:			
Real estate mortgage	(115)	(21)	(551)
Production and intermediate-term	(536)	(866)	(136)
Energy	–	–	–
Agribusiness	–	–	–
Rural Residential Real Estate	–	–	–
Total charge-offs	(651)	(887)	(687)
Recoveries:			
Real estate mortgage	72	1	250
Production and intermediate-term	174	258	166
Energy	–	14	–
Agribusiness	–	–	–
Rural Residential Real Estate	–	–	–
Total recoveries	246	273	416
Net (charge-offs) recoveries	(405)	(614)	(271)
Provision for (reversal of allowance for) loan losses	6,022	787	892
Balance at end of year	$ 13,528	$ 7,911	$ 7,738
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	(.044)%	(.069)%	(0.032)%

The allowance for loan losses increased by $5,617 in 2018 compared to 2017. The increase in allowance is attributable to additional reserves to address risk in the row crop sector associated with the effects of Hurricane Florence as well as additional reserves to address inherent risk in the swine industry. In addition, there was an increase in specific reserves driven by the increase in nonaccrual volume.

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

Allowance for Loan Losses by Type	December 31, 2018	2017	2016
	(dollars in thousands)		
Production and intermediate-term	$ 6,660	$ 3,026	$ 3,386
Real estate mortgage	6,332	4,535	4,048
Agribusiness	284	233	217
Energy	3	2	2
Rural residential real estate	47	38	34
Communication	32	26	18
International	31	25	24
Lease Receivable	139	26	9
Total allowance	$ 13,528	$ 7,911	$ 7,738

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

Allowance for Loan Losses as a Percentage of:	December 31, 2018	2017	2016
Total loans	1.46%	0.85%	0.90%
Nonperforming loans	64.17%	62.03%	33.34%
Nonaccrual loans	71.88%	78.95%	39.36%

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

RESULTS OF OPERATIONS

Net Interest Income

Net interest income was $26.8 million, $25.8 million, and $24.6 million in 2018, 2017 and 2016, respectively. Net interest income is the difference between interest income and interest expense. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets and cost of debt. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following table:

Change in Net Interest Income:	Volume*	Rate	Nonaccrual Income	Total
	(dollars in thousands)			
12/31/18 - 12/31/17				
Interest income	$ (15)	$ 4,324	$ (33)	$ 4,276
Interest expense	181	(3,427)	–	(3,246)
Change in net interest income	$ 166	$ 897	$ (33)	$ 1,030
12/31/17 - 12/31/16				
Interest income	$ 2,624	$ 1,093	$ (222)	$ 3,495
Interest expense	(1,079)	(1,234)	–	(2,313)
Change in net interest income	$ 1,545	$ (141)	$ (222)	$ 1,182

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

Noninterest Income

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

Noninterest Income	For the Year Ended December 31, 2018	2017	2016	Percentage Increase/(Decrease) 2018/2017	2017/2016
	(dollars in thousands)				
Loan fees	$ 1,918	$ 2,042	$ 2,415	(6.07)%	(15.45) %
Fees for financially related services	31	112	124	(72.32)	(9.68)
Patronage refund from other Farm Credit Institutions	12,283	12,823	9,898	(4.32)	29.55
Other noninterest income	531	244	89	117.62	174.16
Total noninterest income	$ 14,763	$ 15,221	$ 12,526	(3.01)%	21.52 %

Noninterest income decreased $458 or 3.01% when comparing 2018 to 2017 and increased $2,695 or 21.52% when comparing 2017 to 2016. The decrease from 2017 to 2018 is primarily attributed to a decrease in special patronage distribution from $6,775 in 2017 to $5,949 in 2018. This special patronage is nonrecurring and was declared by the AgFirst Board of Directors in 2016, 2017 and 2018 due to their very strong earnings and high capital levels. The increase from 2016 to 2017 is primarily attributed to an increase in special patronage from $4,203 in 2016 to $6,775 in 2017. The Association had a $124 decrease in loan fees from 2017 to 2018. The Association had an $81 decrease in fees for financially related services from 2017 to 2018. Other noninterest income increased to $531 in 2018 from $244 in 2017.

Noninterest Expense

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

Noninterest Expense	For the Year Ended December 31, 2018	2017	2016	Percentage Increase/(Decrease) 2018/2017	2017/2016
	(dollars in thousands)				
Salaries and employee benefits	$ 10,035	$ 9,861	$ 10,354	1.76%	(4.76)%
Occupancy and equipment	837	728	683	14.97	6.59
Insurance Fund premiums	622	998	1,074	(37.68)	(7.08)
(Gains) losses on other property owned, net	83	981	222	(91.54)	341.89
Other operating expenses	3,681	916	3,566	301.86	(74.31)
Total noninterest expense	$ 15,258	$ 13,484	$ 15,899	13.16%	(15.19)%

Salaries and employee benefits increased by $174 or 1.76% in 2018 as compared with 2017. Insurance Fund premiums decreased 37.68% percent for the twelve months ended December 31, 2018 compared to the same period of 2017. The FCSIC set premiums at 9 basis points on adjusted insured debt outstanding for 2018. In addition, there was a 10 basis point premium on the average principal outstanding of nonaccrual loans and any other-than-temporarily impaired investments. The Association recognized losses on Other Property Owned of $83 in 2018 compared to $981 for 2017 and $222 for 2016. Please refer to Note 5, *Other Property Owned*, of the Notes to the Consolidated Financial Statements, for more information concerning Association Other Property Owned. Other Operating Expenses increased by 301.86% in 2018 from 2017. The total increase in noninterest expense in 2018 in comparision with 2017 is primarily a result of the pension and OPEB accounting estimate change made in the fourth quarter of 2018. Total noninterest expense increased $1,774 or 13.16% when comparing 2018 to 2017 and decreased $2,415 or 15.19% when comparing 2017 to 2016.

Income Taxes

The Association recorded a provision for income taxes of $108 for the year ended December 31, 2018 as compared to a provision of $113 for 2017 and a provision of $143 for 2016. Refer to Note 2, *Summary of Significant Accounting Policies, Income Taxes*, and Note 12, *Income Taxes* of the Notes to the Consolidated Financial Statements, for more information concerning Association income taxes.

Key Results of Operations Comparisons

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

Key Results of Operations Comparisons	For the 12 Months Ended 12/31/18	12/31/17	12/31/16
Return on average assets	2.15%	2.91%	2.31%
Return on average members' equity	9.79%	13.55%	10.83%
Net interest income as a percentage of average earning assets	2.92%	2.89%	2.89%
Net (charge-offs) recoveries to average loans	(.044)%	(.069)%	(.032)%

Cape Fear Farm Credit has enjoyed robust earnings in recent years with strong interest income as well as noninterest income. The Association has experienced moderate loan volume growth over the last three years. Net charge-offs as a percentage of average loans have remained less than (1.0)% over the last three years, and the Association's net interest margin, while contracting slightly, has remained strong.

Our goal is to generate earnings sufficient to fund operations, adequately capitalize the Association, and achieve an adequate rate of return for our members. We also seek to attract and maintain high quality loan volume priced at competitive rates and to manage credit risk in our entire portfolio, while efficiently meeting the credit needs of our members.

LIQUIDITY AND FUNDING SOURCES

Liquidity and Funding

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement (GFA). The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association, creating notes payable (or direct loans) to the Bank. The Bank manages interest rate risk through direct loan pricing and asset/liability management. The notes payable are segmented into variable rate and fixed rate components. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. Association capital levels effectively create a borrowing margin between the amount of loans outstanding and the amount of notes payable outstanding. This margin is commonly referred to as "Loanable Funds."

Total notes payable to the Bank at December 31, 2018, was $742,744 as compared to $746,548 at December 31, 2017 and $683,642 at December 31, 2016. The decrease of .051% compared to December 31, 2017 is attributed to an increase in capital and a decrease in loan volume year over year. The increase of 9.20% as of December 31, 2017 compared to December 31, 2016 is attributable to an increase in loan volume year over year. The average volume of outstanding notes payable to the Bank was $719,469 for the year ended December 31, 2018. For the year ended December 31, 2017 and 2016, the average volume outstanding notes payable to the Bank was $704,381 and $674,591, respectively. Refer to Note 6, *Notes Payable to AgFirst Farm Credit Bank*, of the Notes to the Consolidated Financial Statements, for weighted average interest rates and maturities, and additional information concerning the Association's notes payable.

Management's Discussion & Analysis of Financial Condition & Results of Operations (dollars in thousands, except as noted)

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

The Association had no lines of credit available from third party financial institutions as of December 31, 2018.

Funds Management

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

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers fixed, adjustable and variable rate loan products that are marginally priced according to financial market rates. Variable rate loans may be indexed to market indices such as the Prime Rate or the 30 or 90-day London Interbank Offered Rate (LIBOR). Adjustable rate mortgages are indexed to U.S. Treasury Rates. Fixed rate loans are priced based on the current cost of System debt of similar terms to maturity.

The majority of the interest rate risk in the Association's Consolidated Balance Sheets is transferred to the Bank through the notes payable structure. The Bank, in turn, actively utilizes funds management techniques to identify, quantify and control risk associated with the loan portfolio.

Relationship with the Bank

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

The Bank's ability to access capital of the Association is discussed in Note 7, *Members' Equity*, of the Notes to the Consolidated Financial Statements.

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

CAPITAL RESOURCES

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

The Association Board of Directors establishes, adopts, and maintains a formal written capital adequacy plan to ensure that adequate capital is maintained for continued financial viability, to provide for growth necessary to meet the needs of members/borrowers, and to ensure that all stockholders are treated equitably. There were no material changes to the capital plan for 2018 that would affect minimum stock purchases or would have an effect on the Association's ability to retire stock and distribute earnings.

Total members' equity at December 31, 2018, increased 2.10% percent to $203,519 from the December 31, 2017 total of $199,334. At December 31, 2017, total members' equity increased 6.22% from the December 31, 2016 total of $187,667. The increase was primarily attributed to the increase in retained surplus due to the amount of net income being greater than any surplus amounts revolved or redeemed in 2018.

Total capital stock and participation certificates were $2,467 on December 31, 2018, compared to $2,510 on December 31, 2017, and $2,457 on December 31, 2016.

FCA sets minimum regulatory capital requirements for System banks and associations. Capital adequacy is evaluated using a number of regulatory ratios. For all periods represented, the Association exceeded minimum regulatory standards for all ratios.

The following sets forth the regulatory capital ratios which were effective January 1, 2017:

Ratio	Minimum Requirement	Capital Conservation Buffer*	Minimum Requirement with Capital Conservation Buffer	Capital Ratios as of December 31, 2018	Capital Ratios as of December 31, 2017
Risk-adjusted ratios:					
CET1 Capital Ratio	4.5%	1.25%	5.75%	20.07%	20.35%
Tier 1 Capital Ratio	6.0%	1.25%	7.25%	20.07%	20.35%
Total Capital Ratio	8.0%	1.25%	9.25%	21.15%	21.22%
Permanent Capital Ratio	7.0%	0.0%	7.0%	20.35%	20.53%
Non-risk-adjusted:					
Tier 1 Leverage Ratio	4.0%	1.0%	5.0%	20.56%	20.45%
UREE Leverage Ratio	1.5%	0.0%	1.5%	20.80%	20.66%

* *The capital conservation buffers have a 3 year phase-in period and will become fully effective January 1, 2020. Risk-adjusted ratio minimums will increase 0.625% each year until fully phased in. There is no phase-in period for the tier 1 leverage ratio.*

If the capital ratios fall below the minimum regulatory 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 following sets forth regulatory Capital ratios as previously reported:

	Regulatory Minimum	2016	2015	2014	2013	2012
Permanent Capital Ratio	7.00%	22.23%	22.23%	23.30%	22.25%	20.66%
Total Surplus Ration	7.00%	21.93%	21.91%	22.96%	21.88%	20.41%
Core Surplus Ratio	3.50%	21.93%	21.91%	22.96%	21.88%	20.41%

There are no trends, commitments, contingencies, or events that are likely to affect the Association's ability to meet regulatory minimum capital standards and capital adequacy requirements.

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

PATRONAGE PROGRAM

Prior to the beginning of any fiscal year, the Association's Board of Directors, by adoption of a resolution, may establish a Patronage Allocation Program to distribute its available consolidated net earnings. This resolution provides for the application of net earnings in the manner described in the Association's Bylaws. This program includes the setting aside of funds to increase surplus to meet minimum capital adequacy standards established by FCA Regulations, to increase surplus to meet Association capital adequacy standards to a level necessary to support competitive pricing at targeted earnings levels, and for reasonable reserves for necessary purposes of the Association. After excluding net earnings attributable to (a) the portion of loans participated to another institution, and (b) participation loans purchased, remaining consolidated net earnings are eligible for allocation to borrowers. Refer to Note 7, *Members' Equity*, of the Notes to the Consolidated Financial Statements, for more information concerning the patronage distributions. The Association declared patronage distributions of $16,000 in 2018, $15,000 in 2017, and $10,000 in 2016.

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

The Association's mission is to be the lender of choice to agriculture and our rural communities, which includes providing credit to Young*, Beginning** and Small*** farmers. We recognize these farmers are vital to the future growth of the Association, its ability to succeed at its mission, and the economic health of southeastern North Carolina. Demographic data indicates that the average age of a farmer is increasing, making it even more important for the Association to be committed to attracting, growing and retaining young, beginning and small farmer/ranchers.

For these reasons, the Association has established annual business goals to ensure we meet the financial needs of these farmers and increase our market share of loans to these farmers. Our business goals include both specific marketing plans to target these groups and designated resources to help ensure YBS borrowers have access to a stable source of credit. The Association will continue to strive to build its YBS portfolio.

The following table outlines the loan volume and number of YBS loans originated by the Association in 2018.

	As of December 31, 2018	
	Number of Loans	Amount of Loans
Young	201	$51,108
Beginning	228	$58,440
Small	489	$31,016

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

The 2012 USDA Ag census data has been used as a benchmark to measure the Association's market share to this group of farmers. The census indicated there were 6,348 farmers within the Association's chartered territory (counties). Of these reported farmers, the following were classified as Young, Beginning or Small Farmers:

- 378 or 6.0% of the total – Young;
- 1,265 or 19.90% of the total – Beginning; and
- 4,724 or 74.40% of the total – Small.

The Ag census does not collect data on how many of these farmers borrow money thus a fair comparison of market percentage is not possible; however, as of December 31, 2018, the demographics of the Association's agricultural portfolio contained 5,246 loans to farmers. Of that total, the following were classified as Young, Beginning or Small Farmers:

- 809 or 15.42% of the total were Young Farmers;
- 1,110 or 21.16% of the total were Beginning Farmers; and
- 2,040 or 38.89% of the total were to Small Farmers.

The Association recognizes that these farmers have unique credit and business needs to be successful. Through marketing, outreach and financial support programs, we maintain a multi-pronged program to help young, beginning and small farmers. These initiatives and outreach programs included:

- Support of 4-H, FFA, and young farmer organizations through sponsorships, donations and fundraisers.
- Involvement of at least one Young, Beginning, or Small (YBS) Farmer on each Branch Advisory Committee.
- Implementation of streamlined loans with reduced cost.
- Sponsorship of a program called Ag Biz Planner – an e-learning course focused on helping young, beginning, small, minority or veteran farmers develop a business plan and learn to be successful

business owners. At the conclusion of the online portion, all participants come together for a day and a half conference to hear expert speakers and engage in network activities to put in practice the principles learned in the course.
- Sponsorship of an Emerging Entrepreneurs' Conference – a three day conference focused on young, beginning, small, minority and veteran farmers. Topics include farm transition, farm management, issues facing agriculture, and strategic planning all delivered by expert speaker(s). The conference is designed to create an interactive environment for emerging entrepreneurs to network and share ideas.
- Advertising, including social media and use of the Association's internet site, to reach YBS Farmers.

The Chief Credit Officer coordinates the Association's YBS efforts. The Association includes YBS goals in the annual strategic plan, and reports on those goals and achievements to the Board of Directors on a quarterly basis.

The Association is committed to the future success of Young, Beginning and Small farmers.

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

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

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

REGULATORY MATTERS

On May 10, 2018, the Farm Credit Administration adopted a final rule that amends the regulations governing investments of System banks and associations. The final rule strengthens eligibility criteria for the investments the banks may purchase and hold. It also implements Section 939A of the Dodd-Frank Act by removing references to and requirements for credit ratings and substitutes the eligibility requirement with other appropriate standards of credit worthiness. In addition, it grants associations greater flexibility regarding the risk management purposes for investments and limits the type and amount of investments that an association may hold. Only securities that are issued by, or are unconditionally guaranteed or insured as to the timely payment of principal and interest by, the U.S. government or its agencies are eligible for association risk management purposes. An association may purchase and hold investments not to exceed 10 percent of its 90-day average daily balance of outstanding loans on the last business day of the quarter. The final rule became effective January 1, 2019.

Farm Bill

The Agricultural Improvement Act of 2018 (Farm Bill) was signed into law on December 20, 2018. This new Farm Bill will govern an array of federal farm and food programs, including commodity price support payments, farm credit, conservation programs, research, rural development and foreign and domestic food programs for five years through 2023. The new Farm Bill continues to provide support for crop insurance and commodity support programs, strengthen livestock disaster programs, and provides dairy producers with an updated voluntary margin protection program that will provide additional risk management options to dairy operations.

The Farm Bill also clarifies and updates the Insurance Corporation's authorities to act as conservator or receiver of a System institution. The Congressional Conference Committee report states that Congress intends "for the authorities of the Corporation to be functionally equivalent to the parallel authorities of the Federal Deposit Insurance Corporation." In addition, the Farm Bill provides, among other authorities, the Insurance Corporation with the authority to organize, and the Farm Credit Administration to charter, a System bridge bank, which has all the powers of a System bank with a maximum life span of five years.

Many provisions of the Farm Bill will require the United States Department of Agriculture to develop rules and procedures to fully implement these authorities. The timing for the issuance of those rules is uncertain.

LIBOR TRANSITION

On July 27, 2017, the United Kingdom Financial Conduct Authority (the Conduct Authority) announced that it will no longer persuade or compel such banks to submit rates for the calculation of the LIBOR rates after 2021. The Conduct Authority regulates the panel banks that submit quotes for the purpose of calculating LIBOR to the Intercontinental Exchange (ICE) Benchmark Administration (the entity that is responsible for calculating LIBOR). Accordingly, it is uncertain whether the ICE Benchmark Administration will continue to quote LIBOR after 2021. Furthermore, in the United States, efforts to identify a set of alternative U.S. dollar reference interest rates include proposals by the Alternative Reference Rates Committee (ARRC) of the Federal Reserve Board and the Federal Reserve Bank of New York. Specifically, the ARRC has proposed the Secured Overnight Financing Rate (SOFR) as the recommended alternative to LIBOR and the Federal Reserve Bank of New York began publishing SOFR in April of 2018. SOFR is based on a broad segment of the overnight Treasury repurchase market and is a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities.

At this time, it is not possible to predict, among other uncertainties, whether (i) LIBOR will be discontinued, (ii) the effect of any changes to the methodology for calculating LIBOR, or (iii) any establishment of alternative reference rates or any other reforms to LIBOR that may be enacted in the United Kingdom, in the United States or elsewhere. Uncertainty as to the nature of such potential changes, alternative reference rates or other reforms may adversely affect the trading market for LIBOR based instruments, including certain of the Systemwide Debt Securities, System borrowings, loans, investments, derivatives, other System assets and liabilities and preferred stock that are indexed to LIBOR. Accordingly, reform of, or the replacement or disappearance of, LIBOR and the proposed regulation of LIBOR and other "benchmarks" may adversely affect the rates of interest the System pays on its Systemwide Debt Securities (including changes to their value and liquidity, return, and usefulness for intended purpose), on other borrowings and preferred stock, as well as the value of and return on loans and investments and the value and effectiveness of derivatives. This could adversely affect the System's cash flows. Moreover, if LIBOR is replaced, System institutions will need to take steps to restructure their debt and derivatives, which could adversely affect operations.

The System institutions are currently evaluating the potential impact of the eventual replacement of the LIBOR benchmark interest rate, including the possibility of using SOFR as the alternative to LIBOR. While each system institution is required by the regulator to have a transition plan, the transition from LIBOR to SOFR is expected to be complex and to include the development of term and credit adjustments to minimize, to the extent possible, discrepancies between LIBOR and SOFR. Accordingly, the transition may introduce additional basis risk for market participants, including when an alternative index, e.g., SOFR, exists in conjunction with LIBOR. There can be no guarantee that SOFR will become the dominant alternative to U.S. dollar LIBOR or that SOFR will be widely used. In addition, other alternatives may or may not be developed with additional complications.

Changes in LIBOR may result in interest rates and/or payments that are higher or lower than, or that do not otherwise correlate over time with, the interest rates and/or payments that would have been associated with LIBOR-based Systemwide Debt Securities, or loans or investments that are based on LIBOR, which may increase or decrease the payments to be made on such LIBOR-based Systemwide Debt Securities, or loans or investments that are based on LIBOR.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

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

The following Accounting Standards Updates (ASUs) were issued by the Financial Accounting Standards Board (FASB) but have not yet been adopted:

Summary of Guidance	Adoption and Potential Financial Statement Impact
ASU 2016-13 – Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments	
• Replaces multiple existing impairment standards by establishing a single framework for financial assets to reflect management's estimate of current expected credit losses (CECL) over the complete remaining life of the financial assets. • Changes the present incurred loss impairment guidance for loans to a CECL model. • The Update also modifies the other-than-temporary impairment model for debt securities to require an allowance for credit impairment instead of a direct write-down, which allows for reversal of credit impairments in future periods based on improvements in credit. • Eliminates existing guidance for purchased credit impaired (PCI) loans, and requires recognition of an allowance for expected credit losses on these financial assets. • Requires a cumulative-effect adjustment to retained earnings as of the beginning of the reporting period of adoption. • Effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early application will be permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018.	• The Association has begun implementation efforts by establishing a cross-discipline governance structure and will implement a third-party model. The Association is currently identifying key interpretive issues and assessing processes against the new guidance to determine what modifications may be required. • The Association expects that the new guidance will result in an increase in its allowance for credit losses due to several factors, including: 1. The allowance related to loans and commitments will most likely increase to cover credit losses over the full remaining expected life of the portfolio, and will consider expected future changes in macroeconomic conditions, 2. An allowance will be established for estimated credit losses on any debt securities, 3. The nonaccretable difference on any PCI loans will be recognized as an allowance, offset by an increase in the carrying value of the related loans. • The extent of the increase is under evaluation, but will depend upon the nature and characteristics of the Association's portfolio at the adoption date, and the macroeconomic conditions and forecasts at that date. • The Association expects to adopt the guidance in first quarter 2021.
ASU 2016-02 – Leases (Topic 842)	
• Requires lessees to recognize leases on the balance sheet with lease liabilities and corresponding right-of-use assets based on the present value of lease payments. • Lessor accounting activities are largely unchanged from existing lease accounting. • The Update also eliminates leveraged lease accounting but allows existing leveraged leases to continue their current accounting until maturity, termination or modification. • Also, expands qualitative and quantitative disclosures of leasing arrangements. • Requires adoption using a modified cumulative-effect approach wherein the guidance is applied to all periods presented. A recent amendment provides 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. • Effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted.	• The practical expedients allow entities to largely account for existing leases consistent with current guidance, except for the incremental balance sheet recognition for lessees. • The Association completed its evaluation of leasing contracts and activities and developed its methodology to estimate the right-of-use assets and lease liabilities, which is based on the present value of lease payments. There will not be a material change to the timing of expense recognition. • Given the limited changes to lessor accounting, there were no material changes to recognition or measurement for the Association. • The Association will need to provide additional disclosure information as a result of adopting the Update. • The Association will adopt the guidance in first quarter 2019 using the optional modified retrospective method and practical expedients for transition. • Upon adoption, the Association will record a cumulative-effect adjustment to equity of approximately $1. In addition, a Right of Use Asset in the amount of $120 and Lease Liability in the amount of $119 will be recorded.

Disclosure Required by Farm Credit Administration Regulations

Description of Business

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

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

Unincorporated Business Entities

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

Entity Name	Entity Type	Entity Purpose
Cape Fear Acquisitions	LLC	Manage Acquired Property
Ethanol Holding Company	LLC	Manage Acquired Property
A1 Ledges Wilder	LLC	Manage Acquired Property
A1 Sequatchie Point	LLC	Manage Acquired Property

Description of Property

The following table sets forth certain information regarding the properties of the reporting entity as of 12/31/18, all of which are located in North Carolina:

Location	Description	Form of Ownership
333 East Russell Street Fayetteville	Administrative/ Branch	Owned
105 East Front Street Lillington	Branch	Owned
400 West Broad Street Dunn	Branch	Owned
1780 Southeast Boulevard Clinton	Branch	Owned
127 Beasley Street Kenansville	Branch	Owned
811 South Walker Street Burgaw	Branch	Owned
108 North Poplar Street Elizabethtown	Branch	Owned
331 South Main Street Raeford	Branch	Owned
1902 North Cedar Street Lumberton	Branch	Owned
300 Liberty Street Whiteville	Branch	Owned

Legal Proceedings

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

Description of Capital Structure

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

Description of Liabilities

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

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

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

Senior Officers

The following represents certain information regarding the senior officers of the Association and their business experience for the past five years:

Senior Officer	Position & Other Business Interests
Bradford (Brad) Cornelius	*President and Chief Executive Officer* since January 2016. He previously served as Chief Credit Officer at AgChoice Farm Credit for five years. Prior, he spent eighteen years in various lending and credit roles at AgGeorgia Farm Credit.
Mark A. Cochran	*Director of Information Technology* since June 2018. He previously served as an Executive Director of Business Technology Operations for 15 years at Healthways, Inc.
Brook H. Gillis	*Senior Vice President / Regional Manager* since September 2017. She previously served as a Relationship Manager in the Capital Markets Department for one year and Branch Manager in the Elizabethtown Branch for five years.
Evan J. Kleinhans	*Senior Vice President / Chief Financial Officer* since November 2011. He previously served as Vice President of Finance and Accounting for Information Science Consulting, Inc.
Geoffrey Manderewicz	*Senior Vice President / Chief Credit Officer* since February 2017. He previously served as Credit Analysis Manager for four years and Credit Analyst for two years at AgChoice Farm Credit. Prior, he served as a Loan Officer and Branch Manager for Northwest Savings Bank.
Johnathan O. Patterson	*Senior Vice President / Regional Manager* since September 2017. He previously served as Credit Portfolio Manager for three years and Special Assets Manager for three years. Prior, he served as a Loan Officer and Branch Manager at Cape Fear Farm Credit and Carolina Farm Credit.
Randy T. Pope	*Senior Vice President / Commercial and Capital Markets Manager* since 2001. Prior to that, he served as a Loan Officer and Branch Manager in the Lillington branch office.
Sarah B. Temple	*Senior Human Resources Administrator* since April 2017. She previously served as a Credit Analyst for five years.

The total amount of compensation earned by the Chief Executive Officer (CEO) and the senior officers and other highly compensated employees as a group during the years ended December 31, 2018, 2017 and 2016, is as follows:

Name of Individual or Number in Group	Year	Salary	Bonus	Deferred Comp.	Change in Pension Value*	Perq/ Other**	Total
Bradford Cornelius	2018	$ 316,262	$ 68,391	$ –	$ 154,494	$ 22,299	$ 561,446
Bradford Cornelius	2017	$ 275,427	$ 55,085	$ –	$ 432,140	$ 19,263	$ 781,915
Bradford Cornelius	2016	$ 250,010	$ 45,627	$ –	$ 366,196	$ 15,987	$ 677,819
William L. Melton	2016	$ 26,251	$ –	$ –	$ 1,376	$ –	$ 27,627
7	2018	$ 817,766	$ 160,293	$ –	$ (68,527)	$ 57,300	$ 966,832
11	2017	$ 1,061,185	$ 161,727	$ –	$ 462,555	$ 97,858	$ 1,783,325
8	2016	$ 879,649	$ 114,340	$ –	$ 293,388	$ 72,239	$ 1,359,617

All amounts are in actual dollars

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

*** The Perquisites/Other amount disclosed in the above chart includes club memberships, automobile allowance, deferred compensation, life insurance, and relocation reimbursement.*

The disclosure of information on the total compensation paid during 2018 to any senior officer or to any other employee included in the aggregate group total as reported in the table above is available and will be disclosed to the shareholders of the institution upon request.

Amounts in the above table classified as Perquisites include travel incentives, group life insurance, automobile compensation, purchased automobile, spousal travel, relocation and tuition reimbursement. Amounts in the above table classified as Other include amounts contributed by the Association on behalf of the senior officer to a defined contribution plan unless the plan is made available to all employees on the same basis.

In addition to a base salary, senior officers earn additional compensation under a profit sharing plan. The Association profit sharing plan is designed to motivate employees to maximize the return to Association stockholders. The profit sharing plan has positive and negative adjustments for loan volume growth, earnings, efficiencies, and credit quality factors. All Association employees are covered by the plan. Bonuses shown in previous years are shown in the year earned which may be different than the year of payment.

Additionally, all employees are reimbursed for all direct travel expenses incurred when traveling on Association business. A copy of the travel policy is available to shareholders upon written request.

Pension Benefits Table
As of December 31, 2018

Name of Individual or Number in Group	Year	Plan Name	Number of Years Credited Service	Actuarial Present Value of Accumulated Benefits	Payments During 2018
CEO:					
Bradford Cornelius (1)	2018	AgFirst Retirement Plan	27.92	$ 2,034,255	$ –
				$ 2,034,255	$ –
Senior Officers and Highly Compensated Employees:					
2 Officers, excluding the CEO	2018	AgFirst Retirement Plan	30.08*	$ 1,887,683	$ –
				$ 1,887,683	$ –

All amounts are in actual dollars
** Represents the average years of credited service for the group*

Retirement and Deferred Compensation Plans

The Association's compensation programs include retirement and deferred compensation plans designed to provide income following an employee's retirement. Although retirement benefits are paid following an employee's retirement, the benefits are earned while employed. The objective of the Association is to offer benefit plans that are market competitive and aligned with the Association's strategic objectives. The plans are designed to enable the Association to proactively attract, retain, recognize and reward a highly skilled, motivated and diverse staff that supports the Association's mission and that allows the Association to align the human capital needs with the Association's overall strategic plan.

Employees hired prior to January 1, 2003 participate in the AgFirst Farm Credit Retirement Plan. Employees are eligible to retire and begin drawing unreduced pension benefits at age 65 or when years of credited service plus age equal "85." Upon retirement, annual payout is equal to 2 percent of the highest three years average compensation times years of credited service, subject to the Internal Revenue Code limitations. For purposes of determining the payout, "average compensation" is defined as regular salary (i.e., does not include incentive awards compensation). At the election of the retiree, benefits are paid based upon various annuity terms or on a lump sum basis. Benefits under the plan are not subject to an offset for Social Security.

Employees hired on or after January 1, 2003 participated in the AgFirst Farm Credit Cash Balance Retirement Plan (CB Plan). The CB Plan was closed to new participants effective as of December 31, 2014, which affected employees hired on or after November 4, 2014, and employer contributions were discontinued effective as of January 1, 2015. All participants who were not already fully vested in the CB Plan became fully vested as of December 31, 2014. The CB Plan was terminated effective as of December 31, 2016, and as a result of the termination, vested benefits were distributed to participants in 2017. Beginning on January 1, 2015, for participants in the CB Plan and eligible employees hired on or after November 4, 2014, additional employer contributions are made to the 401(k) Plan equal to 3.00 percent of the participants' eligible compensation.

Employees participate in the Farm Credit Benefits Alliance 401(k) Plan, a qualified 401(k) defined contribution plan which has an employer matching contribution determined by the employee's date of hire. Employees hired prior to January 1, 2003 receive a maximum employer matching contribution equal to $0.50 for each $1.00 of employee compensation contributed up to 6 percent, subject to the Internal Revenue Code limitation on compensation. Employees hired on or after January 1, 2003 receive a maximum employer matching contribution equal to $1.00 for each $1.00 of employee compensation contributed up to 6 percent, subject to the Internal Revenue Code limitation on compensation.

Senior officers and other highly compensated employees may participate in the Farm Credit Benefits Alliance Nonqualified Supplemental 401(k) Plan, a nonqualified deferred compensation plan that allows certain key employees to defer compensation and which restores the benefits limited in the qualified 401(k) plan as a result of restrictions in the Internal Revenue Code. The plan also includes a provision for discretionary contributions to be made by the Association.

Chief Executive Officer

Mr. Cornelius participates in the AgFirst Farm Credit Retirement Plan. Mr. Melton participated in the AgFirst Farm Credit Cash Balance Retirement Plan.

Mr. Cornelius participates in the Farm Credit Benefits Alliance 401(k) Plan. Mr. Melton did not participate in the Farm Credit Benefits Alliance 401(k) Plan.

Mr. Cornelius does not participate in the Farm Credit Benefits Alliance Nonqualified Supplemental 401(k) Plan. Mr. Melton did not participate in the Farm Credit Benefits Alliance Nonqualified Supplemental 401(k) Plan.

Directors

The following chart details the year the director began serving on the board, the current term of expiration, and total cash compensation paid:

DIRECTOR & TITLE*	ORIGINAL YEAR OF ELECTION OR APPOINTMENT	CURRENT TERM EXPIRATION**	TOTAL COMP. PAID DURING 2018
Gary A. Hendrix, *Chairman*	2007	2022	$ 30,000
Jonathan A. Pope, *Vice Chairman*	2009	2021	25,000
Alton D. Bain, *Outside Director*	2014	2021	30,000
David R. Gooden (1)	2014	2022	25,000
Anthony T. Grant, *Outside Director*	2013	2023	32,500
Nash Johnson II	2017	2021	25,000
Adrian B. Locklear	2016	2020	25,000
Paul M. Maguire	2014	2022	25,000
T. Morris Murphy	2016	2020	25,000
Gary L. Rouse, *Outside Director*	2014	2021	30,000
Michael T. (Bo) Stone (2)	2015	2019	27,500
Alfred K. Wooten	2004	2019	27,500
Total			$ 327,500

All amounts are in actual dollars

** Position Title as of 12/31/2018*
*** Term expires on the Annual Meeting Date of corresponding year unless otherwise noted*

(1)Mr. David R. Gooden previously served from 2005-2008
(2)Mr. Michael T. Stone previously served from 2007-2014.

The following represents certain information regarding the directors of the Association, including their principal occupation and employment for the past five years.

Mr. Gary A. Hendrix, *Chairman***,** is a row crop, cotton, and peanut farmer. His principal occupation and employment for the past five years was self-employed farming. Mr. Hendrix also serves on the boards of FCI (agricultural services), the North Carolina Soybean Growers Association (crop promotion) and the Hoke County Soil & Water Conservation District (conservation).

Mr. Jonathan (Jon) A. Pope*, Vice Chairman*, is a row crop, cattle, contract poultry and hay farmer. His principal occupation and employment for the past five years was self-employed farming. Mr. Pope also serves on the board of the Harnett County Farm Bureau (insurance).

Mr. Alton D. Bain, was appointed as an Association outside director in 2014. He is a Partner in Bain & McRae, LLP, a law firm. His principal occupation and employment for the past five years was practicing law with Bain & McRae, LLP. Mr. Bain also serves as president of the Harnett County Historical Society (historic preservation), and also as an elder at Lillington Presbyterian Church, a religious organization.

Mr. David R. Gooden is a row crop, hay, strawberry, cattle, timber, swine, poultry and sweet corn farmer. His principal occupation and employment for the past five years was self-employed farming. Mr. Gooden serves on the Bladen County Board of Commissioners (political), and also as President of the Bladen County Livestock Association (livestock promotion).

Mr. Anthony T. Grant was appointed as an Association outside director in 2013. He is the CEO and owner of Grant Business Advisors, a financial advisory and business strategies firm. His principal occupation and employment for the past five years was as a business consultant with Grant Business Advisors and Grant Business Strategies. Mr. Grant also serves as Chairman, USDA Farm Service Agency, State Committee for South Carolina, and on the board of the Columbia Urban League (multi-service non-profit agency).

Mr. Nash Johnson II is a swine, poultry, timber, row crop, cattle and hay farmer. His principal occupation and employment for the past five years was self-employed farming. Mr. Johnson serves as an advisory committee member for the Clinton-Sampson Airport Authority (aviation).

Mr. Adrian Locklear is a row crop, rapeseed, sweet corn and yellow field pea farmer. His principal occupation the past five years was self-employed farming.

Mr. Paul M. Maguire is a cattle, poultry, hay and timber farmer. His principal occupation and employment for the past five years was self-employed farming. Mr. Maguire also serves as on the Cumberland County Extension Advisory Board (agricultural advisory board), and as an officer of the Cumberland County Livestock Association (livestock promotion).

Mr. T. Morris Murphy is a tobacco, corn, soybeans, cotton, sweet potatoes, cucumbers, hay, swine and poultry farmer. His principal occupation for the past five years was self-employed farming. Mr. Murphy also serves on the board of the North Carolina Pork Council (livestock promotion), the Albertson Volunteer Fire Department, and as assistant treasurer at Friendship F.W.B. Church, a religious organization.

Mr. Gary L. Rouse was appointed as an Association outside director in 2014. He is the President, Stockholder and Firm Manager of Rouse & Peterson, P.A a public accounting firm. His principal occupation and employment for the last five years was practicing as a Certified Public Accountant at Rouse & Peterson, P.A.

Mr. Michael T. (Bo) Stone is a row crop, hay, cattle, contract swine, produce and strawberry farmer. His principal occupation and employment for the past five years was self-employed farming. Mr. Stone also serves on the board of Southeastern Regional Medical Center (hospital), Dillon Christian School (private school), The Farm Credit Council (trade association), and AgFirst Farm Credit Bank (financial institution).

Mr. Alfred K. Wooten is a turf grass, blueberry and row crop farmer. His principal occupation and employment for the past five years was self-employed farming. Mr. Wooten also serves on the board of the North Carolina Sod Producers Association (crop promotion association) the Pender County Farm Bureau (insurance). *Mr. Wooten completed his elected term as director February 19, 2019.*

Subject to approval by the board, the Association may allow the outside Directors a quarterly retainer of $7,500, elected Directors a quarterly retainer of $6,250, Board Chairman a $1,250 quarterly stipend, and other Committee Chairs a $625 quarterly stipend. Total compensation paid to directors as a group during 2018 was $327,500.

The following chart details the number of meetings and other activities as well as committee assignments during 2018 for each director:

Name of Director	Days Served: Regular Board Meetings	Days Served: Other Official Activities*	Committee Assignments**
Gary A. Hendrix *Chairman (1)*	9	21	Compensation, Governance
Alton D. Bain, *Outside Director*	9	10	Compensation
David R. Gooden	9	9	Audit
Anthony T. Grant, *Outside Director (2)*	9	22	Governance, Risk Management
Nash Johnson II	9	15	Audit
Adrian B. Locklear	7	15	Compensation
Paul M. Maguire	9	13	Risk Management
T. Morris Murphy	8	12	Risk Management
Jonathan A. Pope	8	15	Governance, Risk Management
Gary L. Rouse, *Outside Director*	9	15	Audit
Michael T. (Bo) Stone *(3)*	7	19	Audit, Governance
Alfred K. Wooten *(4)*	6	18	Compensation, Governance

* *Includes board committee meetings and other board activities other than regular board meetings including training.*
** *Committee Assignments as of 12/31/2018*

(1) Chairman of the Governance Committee
(2) Chairman of the Risk Committee
(3) Chairman of the Audit Committee
(4) Chairman of the Compensation Committee

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

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was $130,899 for 2018, $106,470 for 2017, and $87,465 for 2016.

Transactions with Senior Officers and Directors

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

Involvement in Certain Legal Proceedings

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

Relationship with Independent Auditors

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

Aggregate fees paid by the Association for services rendered by its independent auditors for the year ended December 31, 2018 were as follows:

	2018
Independent Auditors	
Pricewaterhouse Coopers LLP	
Audit services	$ 73,150
Total	$ 73,150

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

Consolidated Financial Statements

The Consolidated Financial Statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 13, 2019 and the report of management, which appear in this Annual Report, are incorporated herein by reference.

Copies of the Association's Annual and unaudited Quarterly reports are available upon request free of charge by calling 1-800-368-5819, extension 3243 or writing Evan J. Kleinhans, Chief Financial Officer, Cape Fear Farm Credit, PO Box 2405, Fayetteville, NC, 28302 or by accessing the web site, ***www.capefearfarmcredit.com***. The Association prepares an electronic version of the Annual Report which is available on the Association's web site within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

Borrower Information Regulations

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

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

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

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

Shareholder Investment

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

Report of the Audit Committee

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

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

PricewaterhouseCoopers LLP (PwC), the Association's independent auditors for 2018, is responsible for expressing an opinion on the conformity of the Association's audited consolidated financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 114 *(The Auditor's Communication With Those Charged With Governance)*. The Committee discussed with PwC its independence from Cape Fear Farm Credit. The Committee also reviewed the non-audit services provided by PwC and concluded that these services were not incompatible with maintaining PwC's independence.

The Committee has also concluded that PwC's provision of non-audit services, if any, to the Association is compatible with PwC's independence.

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited consolidated financial statements be included in the Association's Annual Report for 2018. The foregoing report is provided by the following independent directors, who constitute the Committee:

Bo Stone
Chairman of the Audit Committee

Members of Audit Committee

David R. Gooden
Nash Johnson II
Gary L. Rouse

March 13, 2019

Report of Independent Auditors

To the Board of Directors and Management of
Cape Fear Farm Credit, ACA

We have audited the accompanying consolidated financial statements of Cape Fear Farm Credit, ACA and its subsidiaries (the "Association"), which comprise the consolidated balance sheets as of December 31, 2018, 2017 and 2016, and the related consolidated statements of income, comprehensive income, changes in members' equity and cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

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

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 Association's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Cape Fear Farm Credit, ACA and its subsidiaries as of December 31, 2018, 2017 and 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

Miami, Florida

March 13, 2019

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

Consolidated Balance Sheets

(dollars in thousands)	December 31, 2018	2017	2016
Assets			
Cash	**$ 2,543**	$ 2,606	$ 3,063
Investments in debt securities:			
Held to maturity (fair value of $3,627, $3,815, and $3,961, respectively)	**3,738**	3,978	4,209
Loans	**928,304**	933,424	859,557
Allowance for loan losses	**(13,528)**	(7,911)	(7,738)
Net loans	**914,776**	925,513	851,819
Loans held for sale	**91**	131	—
Accrued interest receivable	**9,588**	9,060	7,938
Equity investments in other Farm Credit institutions	**10,673**	10,257	9,951
Premises and equipment, net	**3,277**	3,114	3,191
Other property owned	**366**	1,167	1,876
Accounts receivable	**13,261**	12,904	10,307
Other assets	**230**	297	3,169
Total assets	**$ 958,543**	$ 969,027	$ 895,523
Liabilities			
Notes payable to AgFirst Farm Credit Bank	**$ 742,744**	$ 746,548	$ 683,642
Accrued interest payable	**1,972**	1,703	1,394
Patronage refunds payable	**5,385**	15,024	10,026
Accounts payable	**1,323**	1,447	2,541
Other liabilities	**3,600**	4,971	10,253
Total liabilities	**755,024**	769,693	707,856
Commitments and contingencies (Note 11)			
Members' Equity			
Protected borrower stock	**3**	3	3
Capital stock and participation certificates	**2,464**	2,507	2,454
Retained earnings			
Allocated	**103,116**	100,298	90,846
Unallocated	**98,205**	96,833	94,664
Accumulated other comprehensive income (loss)	**(269)**	(307)	(300)
Total members' equity	**203,519**	199,334	187,667
Total liabilities and members' equity	**$ 958,543**	$ 969,027	$ 895,523

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

Consolidated Statements of Income

(dollars in thousands)	For the year ended December 31, 2018	2017	2016
Interest Income			
Loans	**$ 48,357**	$ 44,073	$ 40,511
Investments	**188**	197	263
Total interest income	**48,545**	44,270	40,774
Interest Expense			
Notes payable to AgFirst Farm Credit Bank	**21,729**	18,484	16,170
Net interest income	**26,816**	25,786	24,604
Provision for loan losses	**6,022**	787	892
Net interest income after provision for loan losses	**20,794**	24,999	23,712
Noninterest Income			
Loan fees	**1,918**	2,042	2,415
Fees for financially related services	**31**	112	124
Patronage refunds from other Farm Credit institutions	**12,283**	12,823	9,898
Gains (losses) on sales of rural home loans, net	**29**	25	42
Gains (losses) on sales of premises and equipment, net	**49**	205	14
Gains (losses) on other transactions	**(23)**	11	2
Insurance Fund refunds	**476**	—	—
Other noninterest income	**—**	3	31
Total noninterest income	**14,763**	15,221	12,526
Noninterest Expense			
Salaries and employee benefits	**10,035**	9,861	10,354
Occupancy and equipment	**837**	728	683
Insurance Fund premiums	**622**	998	1,074
(Gains) losses on other property owned, net	**83**	981	222
Other operating expenses	**3,681**	916	3,566
Total noninterest expense	**15,258**	13,484	15,899
Income before income taxes	**20,299**	26,736	20,339
Provision for income taxes	**108**	113	143
Net income	**$ 20,191**	$ 26,623	$ 20,196

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

Consolidated Statements of Comprehensive Income

(dollars in thousands)	For the year ended December 31, **2018**	**2017**	**2016**
Net income	**$ 20,191**	$ 26,623	$ 20,196
Other comprehensive income net of tax			
Employee benefit plans adjustments	**38**	(7)	7
Comprehensive income	**$ 20,229**	$ 26,616	$ 20,203

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

Consolidated Statements of Changes in Members' Equity

(dollars in thousands)	Protected Borrower Stock	Capital Stock and Participation Certificates	Retained Earnings Allocated	Retained Earnings Unallocated	Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
Balance at December 31, 2015	$ 3	$ 2,411	$ 83,467	$ 91,849	$ (307)	$ 177,423
Comprehensive income				20,196	7	20,203
Capital stock/participation certificates issued/(retired), net		43				43
Patronage distribution						
Cash				(10,000)		(10,000)
Nonqualified retained earnings			7,807	(7,807)		—
Patronage distribution adjustment			(428)	426		(2)
Balance at December 31, 2016	$ 3	$ 2,454	$ 90,846	$ 94,664	$ (300)	$ 187,667
Comprehensive income				26,623	(7)	26,616
Capital stock/participation certificates issued/(retired), net		53				53
Patronage distribution						
Cash				(15,000)		(15,000)
Nonqualified retained earnings			9,473	(9,473)		—
Patronage distribution adjustment			(21)	19		(2)
Balance at December 31, 2017	$ 3	$ 2,507	$ 100,298	$ 96,833	$ (307)	$ 199,334
Comprehensive income				**20,191**	**38**	**20,229**
Capital stock/participation certificates issued/(retired), net		**(43)**				**(43)**
Patronage distribution						
Cash				**(16,000)**		**(16,000)**
Nonqualified retained earnings			**2,187**	**(2,187)**		**—**
Patronage distribution adjustment			**631**	**(632)**		**(1)**
Balance at December 31, 2018	**$ 3**	**$ 2,464**	**$ 103,116**	**$ 98,205**	**$ (269)**	**$ 203,519**

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

Consolidated Statements of Cash Flows

(dollars in thousands)	For the year ended December 31, 2018	2017	2016
Cash flows from operating activities:			
Net income	**$ 20,191**	$ 26,623	$ 20,196
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	**467**	$ 505	$ 486
Amortization (accretion) of net deferred loan costs (fees)	**(86)**	(47)	(39)
Provision for loan losses	**6,022**	787	892
(Gains) losses on other property owned	**—**	863	64
(Gains) losses on sales of premises and equipment, net	**(49)**	(205)	(14)
(Gains) losses on sales of rural home loans, net	**(29)**	(25)	(42)
(Gains) losses on other transactions	**23**	(11)	(2)
Changes in operating assets and liabilities:			
Origination of loans held for sale	**(796)**	(1,445)	(1,861)
Proceeds from sales of loans held for sale, net	**865**	1,339	1,903
(Increase) decrease in accrued interest receivable	**(528)**	(1,122)	(611)
(Increase) decrease in accounts receivable	**(357)**	(2,597)	33
(Increase) decrease in other assets	**67**	2,872	900
Increase (decrease) in accrued interest payable	**269**	309	84
Increase (decrease) in accounts payable	**(124)**	(1,094)	1,471
Increase (decrease) in other liabilities	**(1,356)**	(5,278)	(321)
Total adjustments	**4,388**	(5,149)	2,943
Net cash provided by (used in) operating activities	**24,579**	21,474	23,139
Cash flows from investing activities:			
Purchases of investments in debt securities, held to maturity	**—**	—	(163)
Proceeds from maturities of or principal payments received on investments in debt securities, held to maturity	**240**	231	3,320
Net (increase) decrease in loans	**4,953**	(74,809)	(31,147)
(Increase) decrease in equity investments in other Farm Credit institutions	**(416)**	(306)	(359)
Purchases of premises and equipment	**(660)**	(489)	(350)
Proceeds from sales of premises and equipment	**79**	266	41
Proceeds from sales of other property owned	**649**	221	937
Net cash provided by (used in) investing activities	**4,845**	(74,886)	(27,721)
Cash flows from financing activities:			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	**(3,804)**	62,906	15,704
Capital stock and participation certificates issued/(retired), net	**(43)**	53	43
Patronage refunds and dividends paid	**(25,640)**	(10,004)	(11,984)
Net cash provided by (used in) financing activities	**(29,487)**	52,955	3,763
Net increase (decrease) in cash	**(63)**	(457)	(819)
Cash, beginning of period	**2,606**	3,063	3,882
Cash, end of period	**$ 2,543**	$ 2,606	$ 3,063
Supplemental schedule of non-cash activities:			
Financed sales of other property owned	**$ 152**	$ 64	$ 85
Receipt of property in settlement of loans	**—**	439	1,697
Estimated cash dividends or patronage distributions declared or payable	**16,000**	15,000	10,000
Employee benefit plans adjustments (Note 9)	**(38)**	7	(7)
Supplemental information:			
Interest paid	**21,460**	18,175	16,086
Taxes (refunded) paid, net	**75**	67	25

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

Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

Note 1 — Organization and Operations

A. **Organization:** Cape Fear Farm Credit, ACA (Association) is a member-owned cooperative that provides credit and credit-related services to qualified borrowers in the counties of Bladen, Brunswick, Columbus, Cumberland, Duplin, Harnett, Hoke, New Hanover, Pender, Robeson, Sampson, and Scotland in the state of North Carolina.

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

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

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

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

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

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

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

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

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

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

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

Note 2 — Summary of Significant Accounting Policies

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

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

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

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

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

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

Impaired loans are loans for which it is probable that all principal and interest will not 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 remains contractually past due until the entire amount past due, including principal, accrued interest, and penalty interest incurred as the result of past due status, is collected or otherwise discharged in full. A formal restructuring may also cure a past due status.

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

When loans are in nonaccrual status, payments are applied against 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 received in cash may be recognized as interest income. Nonaccrual loans may be returned to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected, and the loan is not classified "doubtful" or "loss." Loans are charged off at the time they are determined to be uncollectible.

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

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

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

- Changes in credit risk classifications
- Changes in collateral values
- Changes in risk concentrations
- Changes in weather-related conditions
- Changes in economic conditions

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

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

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

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

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

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

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

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

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

Equity Investments in Other Farm Credit System Institutions
Investments in other Farm Credit System institutions are generally nonmarketable investments consisting of stock and participation certificates, allocated surplus, and reciprocal investments in other institutions regulated by the FCA. These investments are carried at cost and evaluated for impairment based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value.

Investment in Debt Securities
The Association holds certain investment securities, as permitted under the FCA regulations. These investments are classified based on management's intention on the date of purchase and are generally recorded in the Consolidated Balance Sheets as securities on the trade date.

Securities for which the Association has the intent and ability to hold to maturity are classified as held-to-maturity (HTM) and carried at amortized cost. Investment securities classified as available-for-sale (AFS) are carried at fair value with net unrealized gains and losses included as a component of Other Comprehensive Income (OCI). Purchase premiums and discounts are amortized or accreted ratably over the term of the respective security using the interest method. The amortization of premiums on certain purchased callable debt securities that have explicit, noncontingent call features and that are callable at fixed prices on preset dates are amortized to the earliest call date.

Impairment
The Association reviews all investments that are in a loss position in order to determine whether the unrealized loss, which is considered an impairment, is temporary or other-than-temporary. As mentioned above, changes in the fair value of AFS investments are reflected in OCI, unless the investment is deemed to be other-than-temporarily impaired (OTTI). Impairment is considered to be other-than-temporary if the present value of cash flows expected to be

collected from the debt security is less than the amortized cost basis of the security (any such shortfall is referred to as a "credit loss"). If the Association intends to sell an impaired debt security or is more likely than not to be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the impairment is other-than-temporary and recognized currently in earnings in an amount equal to the entire difference between fair value and amortized cost. If a credit loss exists, but the Association does not intend to sell the impaired debt security and is not more likely than not to be required to sell before recovery, the impairment is other-than-temporary and is separated into (i) the estimated amount relating to credit loss, and (ii) the amount relating to all other factors. Only the estimated credit loss amount is charged to current earnings, with the remainder of the loss amount recognized in OCI.

In subsequent periods, if the present value of cash flows expected to be collected is less than the amortized cost basis, the Association will record additional OTTI and adjust the yield of the security prospectively. The amount of total OTTI for an AFS security that previously was impaired is determined as the difference between its carrying amount prior to the determination of OTTI and its fair value.

Investment Income
Interest on investment securities, including amortization of premiums and accretion of discounts, is included in Interest Income. Realized gains and losses from the sales of investment securities are recognized in current earnings using the specific identification method.

Dividends from Investments in Other Farm Credit Institutions are generally recorded as patronage income and included in Noninterest Income.

Other Investments
As discussed in Note 8, certain investments, consisting primarily of mutual funds, are held in trust and investment accounts and are reported at fair value. Holding period gains and losses are included within Noninterest Income on the Consolidated Statements of Income and the balance of these investments, totaling $70, is included in Other Assets on the accompanying Consolidated Balance Sheets as of December 31, 2018.

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

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

Defined Contribution Plans
Substantially all employees are eligible to participate in the defined contribution Farm Credit Benefit Alliance (FCBA) 401(k) Plan, subsequently referred to as the 401(k) Plan, which qualifies as a 401(k) plan as defined by the Internal Revenue Code. Employee deferrals are not to exceed the maximum deferral as determined and adjusted by the Internal Revenue Service. Company contributions to the 401(k) Plan are expensed as funded.

Additional information may be found in Note 9.

Multi-Employer Defined Benefit Plans
Substantially all employees hired before January 1, 2003 may participate in the AgFirst Farm Credit Retirement Plan (Plan), which is a defined benefit plan and considered multi-employer under FASB accounting guidance. The Plan is noncontributory and includes eligible Association and District employees. The "Projected Unit Credit" actuarial method is used for financial reporting purposes.

In addition to pension benefits, the Association provides certain health care and life insurance benefits for retired employees (other postretirement benefits) through a multi-District sponsored retiree healthcare plan. Substantially all employees are eligible for those benefits when they reach early retirement age while working for the Association. Authoritative accounting guidance requires the accrual of the expected cost of providing these benefits to an employee, their beneficiaries and covered dependents during the years the employee renders service necessary to become eligible for benefits.

Since the foregoing plans are multiemployer, the Association does not apply the provisions of FASB guidance on employers' accounting for defined benefit pension and other postretirement plans in its stand-alone financial statements. Rather, the effects of this guidance are reflected in the Annual Information Statement of the Farm Credit System.

Additional information may be found in Note 9 and in the Notes to the Annual Information Statement of the Farm Credit System.

Single Employer Defined Benefit Plans
The Association also sponsors a single employer defined benefit supplemental retirement plan and offers a FCBA supplemental 401(k) plan for certain key employees. These plans are nonqualified; therefore, the associated liabilities are included in the Association's Consolidated Balance Sheets in Other Liabilities.

The foregoing defined benefit plan is considered single employer, therefore the Association applies the provisions of FASB guidance on employers' accounting for defined benefit pension and other postretirement plans in its stand-alone financial statements. See Note 9 for additional information.

I. **Income Taxes:** The Association evaluates tax positions taken in previous and current years according to FASB guidance. A tax position can result in a permanent reduction of income taxes payable, a deferral of income taxes otherwise currently payable to future years, or a change in the expected realizability of deferred tax assets.

The term tax position also encompasses, but is not limited to, an entity's status, including its status as a pass-through entity or tax-exempt entity.

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

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

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

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

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

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

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

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

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

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

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

Additional information may be found in Note 8.

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

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

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

M. **Revenue Recognition:** The Association generates income from multiple sources.

Financial Instruments
The largest source of revenue for the Association is Interest Income. Interest income is recognized on an accrual basis driven by nondiscretionary formulas based on written contracts, such as loan agreements or securities contracts. Credit-related fees, including letter of credit fees, finance charges and other fees are recognized in Noninterest Income when earned. Other types of noninterest revenues,

such as service charges, professional services and broker fees, are accrued and recognized into income as services are provided and the amount of fees earned is reasonably determinable.

Contracts with Customers
In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers (Topic 606). This guidance, which became effective January 1, 2018, changed the recognition of revenue from contracts with customers. The core principle of the guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance also included expanded disclosure requirements that result in an entity providing users of financial statements with comprehensive information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from the entity's contracts with customers. Based on input received from stakeholders, the FASB issued several additional Updates that generally provided clarifying guidance where there was the potential for diversity in practice, or address the cost and complexity of applying Topic 606.

The Association maintains contracts with customers to provide support services in various areas such as accounting, lending transactions, consulting, insurance, and information technology. The Association does not generally incur costs to obtain contracts. As most of the contracts are to provide access to expertise or system capacity that the Association maintains, there are no material incremental costs to fulfill these contracts that should be capitalized.

Transition Information

- The Association identified ancillary revenues affected by this Update and adopted the guidance on January 1, 2018.
- The amendments were applied using the modified retrospective approach.
- The Association elected to only apply the guidance to contracts that were not completed at the date of initial application.
- Subtopics 610-20 on gains and losses from the derecognition of nonfinancial assets, and 340-40 on other assets and deferred costs-contracts with customers were adopted using the same transition options.
- Adoption did not have an impact on the Association's financial condition or results of operations.

Gains and Losses from Nonfinancial Assets
Any gains or losses on sales of Premises and Equipment and OPO are included as part of Noninterest Income. These gains and losses are recognized, and the nonfinancial asset is derecognized, when the Association has entered into a valid contract with a noncustomer and transferred control of the asset. If the criteria to meet the definition of a contract have not been met, the Association does not derecognize the nonfinancial asset and any consideration received is recognized as a liability. If the criteria for a contract are subsequently met, or if the consideration received is or becomes nonrefundable, a gain or loss may be recognized at that time.

N. **Accounting Standards Updates (ASUs):** In August 2018, the FASB issued ASU 2018-15 Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract. The amendments align 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 the amendments in this Update. The guidance is effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted, including adoption in any interim period, for all entities. The amendments should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. Adoption of the guidance will have no impact on the statements of financial condition and results of operations.

In August 2018, the FASB issued ASU 2018-13 Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement. The amendments are part of the FASB's disclosure framework project. The project's objective and primary focus are to improve the effectiveness of disclosures in the notes to financial statements by facilitating clear communication of the information required by GAAP that is most important to users of each entity's financial statements. The amendments remove, modify or add certain disclosures contained in the financial statement footnotes related to fair value. Additionally, the guidance is intended to promote the appropriate exercise of discretion by entities when considering fair value measurement disclosures and to clarify that materiality is an appropriate consideration of entities and their auditors when evaluating disclosure requirements. The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Certain amendments should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. Entities may early adopt the provisions in whole upon issuance or may early adopt any removed or modified disclosures upon issuance and delay adoption of the additional disclosures until their effective date. The Association has adopted the removed disclosures effective with the 2018 Annual Report.

In July 2018, the FASB issued ASU 2018-09 Codification Improvements. The amendments affect a wide variety of Topics in the Codification. They apply to all reporting entities within the scope of the affected accounting guidance. The Board has an ongoing project on its agenda about improvements to clarify the Codification or to correct unintended application of guidance. Those items generally are not expected to have a significant effect on current accounting practice. The transition and effective date guidance is based on the facts and circumstances of each amendment.

In February 2018, the FASB issued ASU 2018-02 Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The guidance allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The amendments eliminate the stranded tax effects resulting from the Tax Cuts and Jobs Act and are intended to improve the usefulness of information reported to financial statement users. However, because the amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The Update also requires certain disclosures about stranded tax effects. The guidance is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The Association is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.

In March 2017, the FASB issued ASU 2017-08 Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. The guidance relates to certain callable debt securities and shortens the amortization period for any premium to the earliest call date. The Update will be effective for interim and annual periods beginning after December 15, 2018 for public business entities. The Association is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.

In March 2017, the FASB issued ASU 2017-07 Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost related to the income statement presentation of the components of net periodic benefit cost for an entity's sponsored defined benefit pension and other postretirement plans. The amendments were effective January 1, 2018 for the Association. Adoption in 2018 did not have a material effect on the Association's financial statements, but did require reclassification of certain periodic pension costs to Other Operating Expenses.

In January 2017, the FASB issued ASU 2017-01 Business Combinations (Topic 805): Clarifying the Definition of a Business. The amendments provide a more robust framework to use in determining when a set of assets and activities is a business. They also support more consistency in applying the guidance, reduce the costs of application, and make the definition of a business more operable. The ASU was effective January 1, 2018 for the Association. The amendments were applied prospectively. Adoption of the guidance in 2018 had no impact on the statements of financial condition and results of operations of the Association.

In June 2016, the FASB issued ASU 2016-13 Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. This Update, and subsequent clarifying guidance issued, is intended to improve financial reporting by requiring timelier recording of credit losses on financial instruments. It requires an organization to measure all expected credit losses for financial assets held at the reporting date. Financial institutions and other organizations will use forward-looking information to better estimate their credit losses. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public companies that are not SEC filers, it will take effect for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Association is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.

In February 2016, the FASB issued ASU 2016-02 Leases (Topic 842). This Update, and subsequent clarifying guidance issued, requires organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Leases will be classified as either finance leases or operating leases. This distinction will be relevant for the pattern of expense recognition in the income statement. The amendments will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years for public business entities. The Association will implement the guidance in first quarter 2019 using the practical expedients and does not expect a material impact to the financial statements.

In January 2016, the FASB issued ASU 2016-01 Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The Update, and subsequent clarifying guidance issued, was intended to improve the recognition and measurement of financial instruments. The new guidance makes targeted improvements to existing GAAP.

Transition Information

- The Association identified investment securities affected by this Update and adopted the guidance on January 1, 2018.
- The amendments related to equity securities without readily determinable fair values were applied prospectively to equity investments that existed as of the date of adoption.
- Application of the amendments did not require a cumulative effect adjustment.
- Adoption did not have an impact on the Association's financial condition or results of operations.
- The new standard did result in changes to certain disclosures.

Note 3 — Loans and Allowance for Loan Losses

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

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

Notes to the Consolidated Financial Statements (dollars in thousands, except as noted)

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

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

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

- Real estate mortgage loans — loans made to full-time or part-time farmers secured by first lien real estate mortgages with maturities from five to thirty years. These loans may be made only in amounts up to 85 percent of the appraised value of the property taken as security or up to 97 percent of the appraised value if guaranteed by a federal, state, or other governmental agency. The actual percentage of loan-to-appraised value when loans are made is generally lower than the statutory required percentage.
- Production and intermediate-term loans — loans to full-time or part-time farmers that are not real estate mortgage loans. These loans fund eligible financing needs including operating inputs (such as labor, feed, fertilizer, and repairs), livestock, living expenses, income taxes, machinery or equipment, farm buildings, and other business-related expenses. Production loans may be made on a secured or unsecured basis and are most often made for a period of time that matches the borrower's normal production and marketing cycle, which is typically one year or less. Intermediate-term loans are made for a specific term, generally greater than one year and less than or equal to ten years.
- Loans to cooperatives — loans for any cooperative purpose other than for communication, power, and water and waste disposal.
- Processing and marketing loans — loans for operations to process or market the products produced by a farmer, rancher, or producer or harvester of aquatic products, or by a cooperative.
- Farm-related business loans — loans to eligible borrowers that furnish certain farm-related business services to farmers or ranchers that are directly related to their agricultural production.
- Rural residential real estate loans — loans made to individuals, who are not farmers, to purchase a single-family dwelling that will be the primary residence in open country, which may include a town or village that has a population of not more than 2,500 persons. In addition, the loan may be to remodel, improve, or repair a rural home, or to refinance existing debt. These loans are generally secured by a first lien on the property.
- Communication loans — loans primarily to finance rural communication providers.
- Power loans — loans primarily to finance electric generation, transmission and distribution systems serving rural areas.
- Water and waste disposal loans — loans primarily to finance water and waste disposal systems serving rural areas.
- International loans — primarily loans or credit enhancements to other banks to support the export of U.S. agricultural commodities or supplies. The federal government guarantees a substantial portion of these loans.
- Lease receivables — the net investment for all finance leases such as direct financing leases, leveraged leases, and sales-type leases.
- Other (including Mission Related) — additional investments in rural America approved by the FCA on a program or a case-by-case basis. Examples of such investments include partnerships with agricultural and rural community lenders, investments in rural economic development and infrastructure, and investments in obligations and mortgage securities that increase the availability of affordable housing in rural America.

A summary of loans outstanding at period end follows:

	December 31, 2018	2017	2016
Real estate mortgage	$ 609,465	$ 591,311	$ 527,783
Production and intermediate-term	265,477	287,559	287,275
Loans to cooperatives	5,976	8,539	6,376
Processing and marketing	22,697	21,734	21,776
Farm-related business	10,553	7,311	4,023
Communication	1,296	3,743	952
Power and water/waste disposal	1,934	1,983	276
Rural residential real estate	4,658	4,844	4,877
International	3,260	3,258	3,257
Lease receivables	2,988	3,142	2,962
Total loans	$ 928,304	$ 933,424	$ 859,557

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

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

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

	December 31, 2018							
	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	$ 10,946	$ 65,285	$ –	$ –	$ 1,802	$ 2,619	$ 12,748	$ 67,904
Production and intermediate-term	12,553	261,938	–	–	1,812	–	14,365	261,938
Loans to cooperatives	3,293	–	2,693	–	–	–	5,986	–
Processing and marketing	12,008	39,824	–	–	–	–	12,008	39,824
Farm-related business	–	3,358	–	14,551	–	–	–	17,909
Communication	1,299	–	–	–	–	–	1,299	–
Power and water/waste disposal	1,939	–	–	–	–	–	1,939	–
Lease receivables	–	–	2,990	–	–	–	2,990	–
International	3,263	–	–	–	–	–	3,263	–
Total	$ 45,301	$ 370,405	$ 5,683	$ 14,551	$ 3,614	$ 2,619	$ 54,598	$ 387,575

	December 31, 2017							
	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	$ 6,404	$ 65,599	$ –	$ –	$ –	$ 4,048	$ 6,404	$ 69,647
Production and intermediate-term	21,856	194,247	–	–	3,500	–	25,356	194,247
Loans to cooperatives	5,824	–	2,720	–	–	–	8,544	–
Processing and marketing	11,862	17,813	–	–	–	–	11,862	17,813
Farm-related business	1,191	–	–	–	–	–	1,191	–
Communication	3,752	–	–	–	–	–	3,752	–
Power and water/waste disposal	1,988	–	–	–	–	–	1,988	–
Lease receivables	–	–	3,142	–	–	–	3,142	–
International	3,263	–	–	–	–	–	3,263	–
Total	$ 56,140	$ 277,659	$ 5,862	$ –	$ 3,500	$ 4,048	$ 65,502	$ 281,707

	December 31, 2016							
	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	$ 2,170	$ 59,066	$ –	$ –	$ –	$ 7,083	$ 2,170	$ 66,149
Production and intermediate-term	23,977	131,621	–	–	5,849	–	29,826	131,621
Loans to cooperatives	6,383	–	–	–	–	–	6,383	–
Processing and marketing	10,436	15,944	–	–	–	–	10,436	15,944
Farm-related business	1,253	–	–	–	–	–	1,253	–
Communication	953	–	–	–	–	–	953	–
Power and water/waste disposal	276	–	–	–	–	–	276	–
Lease receivables	–	–	2,962	–	–	–	2,962	–
International	3,263	–	–	–	–	–	3,263	–
Total	$ 48,711	$ 206,631	$ 2,962	$ –	$ 5,849	$ 7,083	$ 57,522	$ 213,714

Notes to the Consolidated Financial Statements (dollars in thousands, except as noted)

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

	December 31, 2018			
	Due less than 1 year	Due 1 Through 5 years	Due after 5 years	Total
Real estate mortgage	$ 9,968	$ 96,946	$ 502,551	$ 609,465
Production and intermediate-term	110,006	85,678	69,793	265,477
Loans to cooperatives	2,693	2,524	759	5,976
Processing and marketing	6,488	7,692	8,517	22,697
Farm-related business	3,431	4,123	2,999	10,553
Communication	–	1,296	–	1,296
Power and water/waste disposal	–	–	1,934	1,934
Rural residential real estate	51	789	3,818	4,658
International	1,999	1,011	250	3,260
Lease receivables	–	571	2,417	2,988
Total loans	$ 134,636	$ 200,630	$ 593,038	$ 928,304
Percentage	14.50%	21.61%	63.89%	100.00%

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

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

	December 31,		
	2018	2017	2016
Real estate mortgage:			
Acceptable	94.93%	94.68%	92.30%
OAEM	3.73	3.64	4.76
Substandard/doubtful/loss	1.34	1.68	2.94
	100.00%	100.00%	100.00%
Production and intermediate-term:			
Acceptable	91.28%	92.53%	89.47%
OAEM	4.75	4.55	7.04
Substandard/doubtful/loss	3.97	2.92	3.49
	100.00%	100.00%	100.00%
Loans to cooperatives:			
Acceptable	100.00%	100.00%	100.00%
OAEM	–	–	–
Substandard/doubtful/loss	–	–	–
	100.00%	100.00%	100.00%
Processing and marketing:			
Acceptable	87.43%	86.34%	79.37%
OAEM	–	4.63	–
Substandard/doubtful/loss	12.57	9.03	20.63
	100.00%	100.00%	100.00%
Farm-related business:			
Acceptable	100.00%	100.00%	100.00%
OAEM	–	–	–
Substandard/doubtful/loss	–	–	–
	100.00%	100.00%	100.00%

	December 31,		
	2018	2017	2016
Communication:			
Acceptable	100.00%	100.00%	100.00%
OAEM	–	–	–
Substandard/doubtful/loss	–	–	–
	100.00%	100.00%	100.00%
Power and water/waste disposal:			
Acceptable	100.00%	100.00%	100.00%
OAEM	–	–	–
Substandard/doubtful/loss	–	–	–
	100.00%	100.00%	100.00%
Rural residential real estate:			
Acceptable	90.75%	92.33%	92.59%
OAEM	4.34	5.23	5.63
Substandard/doubtful/loss	4.91	2.44	1.78
	100.00%	100.00%	100.00%
International:			
Acceptable	100.00%	100.00%	100.00%
OAEM	–	–	–
Substandard/doubtful/loss	–	–	–
	100.00%	100.00%	100.00%
Lease receivables:			
Acceptable	89.33%	99.58%	99.46%
OAEM	0.33	0.42	0.54
Substandard/doubtful/loss	10.34	–	–
	100.00%	100.00%	100.00%
Total loans:			
Acceptable	93.78%	93.96%	91.18%
OAEM	3.83	3.85	5.32
Substandard/doubtful/loss	2.39	2.19	3.50
	100.00%	100.00%	100.00%

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

	December 31, 2018				
	30 Through 89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans
Real estate mortgage	$ 1,708	$ 1,862	$ 3,570	$ 611,490	$ 615,060
Production and intermediate-term	3,805	5,546	9,351	259,882	269,233
Loans to cooperatives	–	–	–	5,980	5,980
Processing and marketing	–	1,936	1,936	20,893	22,829
Farm-related business	–	–	–	10,598	10,598
Communication	–	–	–	1,296	1,296
Power and water/waste disposal	–	–	–	1,936	1,936
Rural residential real estate	55	73	128	4,545	4,673
International	–	–	–	3,274	3,274
Lease receivables	213	188	401	2,597	2,998
Total	$ 5,781	$ 9,605	$ 15,386	$ 922,491	$ 937,877

	December 31, 2017				
	30 Through 89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans
Real estate mortgage	$ 1,949	$ 2,165	$ 4,114	$ 592,281	$ 596,395
Production and intermediate-term	919	2,723	3,642	287,692	291,334
Loans to cooperatives	–	–	–	8,544	8,544
Processing and marketing	–	1,969	1,969	19,836	21,805
Farm-related business	1	–	1	7,346	7,347
Communication	–	–	–	3,771	3,771
Power and water/waste disposal	–	–	–	1,984	1,984
Rural residential real estate	57	9	66	4,793	4,859
International	–	–	–	3,269	3,269
Lease receivables	–	–	–	3,154	3,154
Total	$ 2,926	$ 6,866	$ 9,792	$ 932,670	$ 942,462

	December 31, 2016				
	30 Through 89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans
Real estate mortgage	$ 2,441	$ 6,050	$ 8,491	$ 523,831	$ 532,322
Production and intermediate-term	1,671	6,177	7,848	282,685	290,533
Loans to cooperatives	–	–	–	6,381	6,381
Processing and marketing	–	4,502	4,502	17,317	21,819
Farm-related business	–	–	–	4,033	4,033
Communication	–	–	–	952	952
Power and water/waste disposal	–	–	–	276	276
Rural residential real estate	–	9	9	4,882	4,891
International	–	–	–	3,288	3,288
Lease receivables	–	–	–	2,973	2,973
Total	$ 4,112	$ 16,738	$ 20,850	$ 846,618	$ 867,468

Notes to the Consolidated Financial Statements (dollars in thousands, except as noted)

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

	December 31, 2018	2017	2016
Nonaccrual loans:			
Real estate mortgage	$ 6,044	$ 3,265	$ 7,714
Production and intermediate-term	10,421	4,740	7,391
Processing and marketing	1,936	1,969	4,502
Rural residential real estate	109	46	55
Lease receivables	310	–	–
Total	$ 18,820	$ 10,020	$ 19,662
Accruing restructured loans:			
Real estate mortgage	$ 575	$ 941	$ 1,170
Production and intermediate-term	941	1,792	2,376
Processing and marketing	560	–	–
Total	$ 2,076	$ 2,733	$ 3,546
Accruing loans 90 days or more past due:			
Lease receivables	$ 188	$ –	$ –
Total	$ 188	$ –	$ –
Total nonperforming loans	$ 21,084	$ 12,753	$ 23,208
Other property owned	366	1,167	1,876
Total nonperforming assets	$ 21,450	$ 13,920	$ 25,084
Nonaccrual loans as a percentage of total loans	2.03%	1.07%	2.29%
Nonperforming assets as a percentage of total loans and other property owned	2.31%	1.49%	2.91%
Nonperforming assets as a percentage of capital	10.54%	6.98%	13.37%

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

	December 31, 2018	2017	2016
Impaired nonaccrual loans:			
Current as to principal and interest	$ 7,283	$ 2,755	$ 2,124
Past due	11,537	7,265	17,538
Total	$ 18,820	$ 10,020	$ 19,662
Impaired accrual loans:			
Restructured	$ 2,076	$ 2,733	$ 3,546
90 days or more past due	188	–	–
Total	$ 2,264	$ 2,733	$ 3,546
Total impaired loans	$ 21,084	$ 12,753	$ 23,208
Additional commitments to lend	$ 276	$ 1	$ 3

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

	December 31, 2018			Year Ended December 31, 2018	
Impaired loans:	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**	**Average Impaired Loans**	**Interest Income Recognized on Impaired Loans**
With a related allowance for credit losses:					
Real estate mortgage	$ 3,828	$ 3,924	$ 1,102	$ 2,712	$ 106
Production and intermediate-term	8,316	8,484	3,798	5,892	232
Processing and marketing	–	–	–	–	–
Rural residential real estate	–	–	–	–	–
Lease receivables	185	186	108	131	5
Total	$ 12,329	$ 12,594	$ 5,008	$ 8,735	$ 343
With no related allowance for credit losses:					
Real estate mortgage	$ 2,791	$ 3,841	$ –	$ 1,978	$ 78
Production and intermediate-term	3,046	3,879	–	2,158	84
Processing and marketing	2,496	2,886	–	1,769	69
Rural residential real estate	109	181	–	77	3
Lease receivables	313	313	–	221	9
Total	$ 8,755	$ 11,100	$ –	$ 6,203	$ 243
Total impaired loans:					
Real estate mortgage	$ 6,619	$ 7,765	$ 1,102	$ 4,690	$ 184
Production and intermediate-term	11,362	12,363	3,798	8,050	316
Processing and marketing	2,496	2,886	–	1,769	69
Rural residential real estate	109	181	–	77	3
Lease receivables	498	499	108	352	14
Total	$ 21,084	$ 23,694	$ 5,008	$ 14,938	$ 586

Impaired loans:	December 31, 2017 Recorded Investment	Unpaid Principal Balance	Related Allowance	Year Ended December 31, 2017 Average Impaired Loans	Interest Income Recognized on Impaired Loans
With a related allowance for credit losses:					
Real estate mortgage	$ 1,739	$ 1,701	$ 245	$ 2,285	$ 88
Production and intermediate-term	1,260	1,263	680	1,656	63
Processing and marketing	–	–	–	–	–
Rural residential real estate	–	–	–	–	–
Total	$ 2,999	$ 2,964	$ 925	$ 3,941	$ 151
With no related allowance for credit losses:					
Real estate mortgage	$ 2,467	$ 3,569	$ –	$ 3,243	$ 124
Production and intermediate-term	5,272	6,070	–	6,928	265
Processing and marketing	1,969	2,316	–	2,588	99
Rural residential real estate	46	109	–	60	2
Total	$ 9,754	$ 12,064	$ –	$ 12,819	$ 490
Total impaired loans:					
Real estate mortgage	$ 4,206	$ 5,270	$ 245	$ 5,528	$ 212
Production and intermediate-term	6,532	7,333	680	8,584	328
Processing and marketing	1,969	2,316	–	2,588	99
Rural residential real estate	46	109	–	60	2
Total	$ 12,753	$ 15,028	$ 925	$ 16,760	$ 641

Impaired loans:	December 31, 2016 Recorded Investment	Unpaid Principal Balance	Related Allowance	Year Ended December 31, 2016 Average Impaired Loans	Interest Income Recognized on Impaired Loans
With a related allowance for credit losses:					
Real estate mortgage	$ 1,622	$ 1,549	$ 233	$ 1,622	$ 61
Production and intermediate-term	3,805	3,885	1,380	3,805	143
Processing and marketing	–	–	–	–	–
Rural residential real estate	–	–	–	–	–
Total	$ 5,427	$ 5,434	$ 1,613	$ 5,427	$ 204
With no related allowance for credit losses:					
Real estate mortgage	$ 7,262	$ 7,687	$ –	$ 7,260	$ 273
Production and intermediate-term	5,962	6,480	–	5,961	225
Processing and marketing	4,502	4,679	–	4,501	169
Rural residential real estate	55	112	–	55	2
Total	$ 17,781	$ 18,958	$ –	$ 17,777	$ 669
Total impaired loans:					
Real estate mortgage	$ 8,884	$ 9,236	$ 233	$ 8,882	$ 334
Production and intermediate-term	9,767	10,365	1,380	9,766	368
Processing and marketing	4,502	4,679	–	4,501	169
Rural residential real estate	55	112	–	55	2
Total	$ 23,208	$ 24,392	$ 1,613	$ 23,204	$ 873

Notes to the Consolidated Financial Statements (dollars in thousands, except as noted)

A summary of changes in the allowance for loan losses and period end recorded investment in loans for each reporting period follows:

	Real Estate Mortgage	Production and Intermediate-term	Agribusiness*	Communication	Power and Water/Waste Disposal	Rural Residential Real Estate	International	Lease receivables	Total
Activity related to the allowance for credit losses:									
Balance at December 31, 2017	$ 4,534	$ 3,026	$ 233	$ 26	$ 2	$ 38	$ 26	$ 26	$ 7,911
Charge-offs	(115)	(536)	–	–	–	–	–	–	(651)
Recoveries	72	174	–	–	–	–	–	–	246
Provision for loan losses	1,841	3,996	51	6	1	9	5	113	6,022
Balance at December 31, 2018	$ 6,332	$ 6,660	$ 284	$ 32	$ 3	$ 47	$ 31	$ 139	$ 13,528
Balance at December 31, 2016	$ 4,048	$ 3,386	$ 217	$ 18	$ 2	$ 34	$ 24	$ 9	$ 7,738
Charge-offs	(21)	(866)	–	–	–	–	–	–	(887)
Recoveries	1	258	–	–	14	–	–	–	273
Provision for loan losses	506	248	16	8	(14)	4	2	17	787
Balance at December 31, 2017	$ 4,534	$ 3,026	$ 233	$ 26	$ 2	$ 38	$ 26	$ 26	$ 7,911
Balance at December 31, 2015	$ 4,202	$ 2,600	$ 227	$ 18	$ 2	$ 68	$ –	$ –	$ 7,117
Charge-offs	(551)	(136)	–	–	–	–	–	–	(687)
Recoveries	250	166	–	–	–	–	–	–	416
Provision for loan losses	147	756	(10)	–	–	(34)	24	9	892
Balance at December 31, 2016	$ 4,048	$ 3,386	$ 217	$ 18	$ 2	$ 34	$ 24	$ 9	$ 7,738
Allowance on loans evaluated for impairment:									
Individually	$ 1,102	$ 3,798	$ –	$ –	$ –	$ –	$ –	$ 108	$ 5,008
Collectively	5,230	2,862	284	32	3	47	31	31	8,520
Balance at December 31, 2018	$ 6,332	$ 6,660	$ 284	$ 32	$ 3	$ 47	$ 31	$ 139	$ 13,528
Individually	$ 245	$ 680	$ –	$ –	$ –	$ –	$ –	$ –	$ 925
Collectively	4,289	2,346	233	26	2	38	26	26	6,986
Balance at December 31, 2017	$ 4,534	$ 3,026	$ 233	$ 26	$ 2	$ 38	$ 26	$ 26	$ 7,911
Individually	$ 233	$ 1,380	$ –	$ –	$ –	$ –	$ –	$ –	$ 1,613
Collectively	3,815	2,006	217	18	2	34	24	9	6,125
Balance at December 31, 2016	$ 4,048	$ 3,386	$ 217	$ 18	$ 2	$ 34	$ 24	$ 9	$ 7,738
Recorded investment in loans evaluated for impairment:									
Individually	$ 6,661	$ 11,782	$ –	$ –	$ –	$ 109	$ –	$ 499	$ 19,051
Collectively	608,399	257,451	39,407	1,296	1,936	4,564	3,274	2,499	918,826
Balance at December 31, 2018	$ 615,060	$ 269,233	$ 39,407	$ 1,296	$ 1,936	$ 4,673	$ 3,274	$ 2,998	$ 937,877
Individually	$ 4,251	$ 6,737	$ 1,998	$ –	$ –	$ 47	$ –	$ –	$ 13,033
Collectively	592,144	284,597	35,698	3,771	1,984	4,812	3,269	3,154	929,429
Balance at December 31, 2017	$ 596,395	$ 291,334	$ 37,696	$ 3,771	$ 1,984	$ 4,859	$ 3,269	$ 3,154	$ 942,462
Individually	$ 8,883	$ 9,767	$ 4,502	$ –	$ –	$ 55	$ –	$ –	$ 23,207
Collectively	523,439	280,766	27,731	952	276	4,836	3,288	2,973	844,261
Balance at December 31, 2016	$ 532,322	$ 290,533	$ 32,233	$ 952	$ 276	$ 4,891	$ 3,288	$ 2,973	$ 867,468

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

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. The following tables present additional information about pre-modification and post-modification outstanding recorded investment and the effects of the modifications that occurred during the periods presented.

	Year Ended December 31, 2018				
Outstanding Recorded Investment	**Interest Concessions**	**Principal Concessions**	**Other Concessions**	**Total**	**Charge-offs**
Pre-modification:					
Real estate mortgage	$ –	$ 535	$ 12	$ 547	
Production and intermediate-term	–	1,189	89	1,278	
Processing and marketing	–	663	–	663	
Rural residential real estate	–	9	–	9	
Total	$ –	$ 2,396	$ 101	$ 2,497	
Post-modification:					
Real estate mortgage	$ –	$ 534	$ 12	$ 546	$ –
Production and intermediate-term	–	1,172	89	1,261	–
Processing and marketing	–	663	–	663	–
Rural residential real estate	–	9	–	9	–
Total	$ –	$ 2,378	$ 101	$ 2,479	$ –

Outstanding Recorded Investment	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
	Year Ended December 31, 2017				
Pre-modification:					
Real estate mortgage	$ –	$ 1,357	$ –	$ 1,357	
Production and intermediate-term	–	1,750	–	1,750	
Rural residential real estate	–	1,172	–	1,172	
Total	$ –	$ 4,279	$ –	$ 4,279	
Post-modification:					
Real estate mortgage	$ –	$ 1,357	$ –	$ 1,357	$ –
Production and intermediate-term	–	1,749	–	1,749	–
Rural residential real estate	–	1,172	–	1,172	–
Total	$ –	$ 4,278	$ –	$ 4,278	$ –

Outstanding Recorded Investment	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
	Year Ended December 31, 2016				
Pre-modification:					
Real estate mortgage	$ –	$ 74	$ –	$ 74	
Production and intermediate-term	–	866	–	866	
Rural residential real estate	–	103	–	103	
Total	$ –	$ 1,043	$ –	$ 1,043	
Post-modification:					
Real estate mortgage	$ –	$ 74	$ –	$ 74	$ –
Production and intermediate-term	–	871	–	871	–
Rural residential real estate	–	103	–	103	–
Total	$ –	$ 1,048	$ –	$ 1,048	$ –

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

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

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

	Total TDRs			Nonaccrual TDRs		
	December 31,			December 31,		
	2018	2017	2016	2018	2017	2016
Real estate mortgage	$ 1,804	$ 1,353	$ 1,351	$ 1,229	$ 412	$ 181
Production and intermediate-term	1,903	2,971	3,183	962	1,179	807
Processing and marketing	1,283	763	–	723	763	–
Rural residential real estate	35	37	46	35	37	46
Total loans	$ 5,025	$ 5,124	$ 4,580	$ 2,949	$ 2,391	$ 1,034
Additional commitments to lend	$ –	$ 1	$ –			

The following table presents information as of period end:

	December 31, 2018
Carrying amount of foreclosed residential real estate properties held as a result of obtaining physical possession	$ –
Recorded investment of consumer mortgage loans secured by residential real estate for which formal foreclosure proceedings are in process	$ –

Note 4 — Investments

Investments in Debt Securities

The Association's investments consist primarily of Rural America Bonds (RABs), which are private placement securities purchased under the Mission Related Investment (MRI) program approved by the FCA. In its Conditions of Approval for the program, the FCA generally considers a RAB ineligible if its investment rating, based on the internal 14-point risk rating scale used to also grade loans, falls below 9 and requires System institutions to provide notification to FCA when a security becomes ineligible. Any other bonds purchased under the MRI program, approved on a case-by-case basis by FCA, may have different eligibility requirements. At December 31, 2018, the Association held no RABs whose credit quality had deteriorated beyond the program limits.

Notes to the Consolidated Financial Statements (dollars in thousands, except as noted)

A summary of the amortized cost and fair value of investment securities held-to-maturity follows:

	December 31, 2018				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
RABs	$ 3,738	$ –	$ (111)	$ 3,627	5.09%

	December 31, 2017				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
RABs	$ 3,978	$ –	$ (163)	$ 3,815	4.99%

	December 31, 2016				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
RABs	$ 4,209	$ –	$ (248)	$ 3,961	4.91%

A summary of the contractual maturity, amortized cost and estimated fair value of investment securities held-to-maturity follows:

	December 31, 2018		
	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	$ –	$ –	– %
After one year through five years	–	–	–
After five years through ten years	929	896	2.49
After ten years	2,809	2,731	5.95
Total	$ 3,738	$ 3,627	5.09%

A portion of these investments has contractual maturities in excess of ten years. However, expected maturities for these types of securities can differ from contractual maturities because borrowers may have the right to prepay obligations with or without prepayment penalties.

An investment is considered impaired if its fair value is less than its cost. The following tables show the fair value and gross unrealized losses for investments that were in a continuous unrealized loss position aggregated by investment category at each reporting period. A continuous unrealized loss position for an investment is measured from the date the impairment was first identified.

	December 31, 2018			
	Less than 12 Months		12 Months or Greater	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
RABs	$ –	$ –	$ 3,627	$ (111)

	December 31, 2017			
	Less than 12 Months		12 Months or Greater	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
RABs	$ –	$ –	$ 3,815	$ (163)

	December 31, 2016			
	Less than 12 Months		12 Months or Greater	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
RABs	$ –	$ –	$ 3,961	$ (248)

The recording of an impairment loss is predicated on: (1) whether or not management intends to sell the security, (2) whether it is more likely than not that management would be required to sell the security before recovering its costs, and (3) whether management expects to recover the security's entire amortized cost basis (even if there is no intention to sell). If the Association intends to sell the security or it is more likely than not that it would be required to sell the security, the impairment loss equals the full difference between amortized cost and fair value of the security. When the Association does not intend to sell securities in an unrealized loss position and it is not more likely than not that it would be required to sell the securities, other-than-temporary impairment loss is separated into credit loss and non-credit loss. Credit loss is defined as the shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis.

The Association performs periodic credit reviews, including other-than-temporary impairment analyses, on its investment securities portfolio. The objective is to quantify future possible loss of principal or interest due on securities in the portfolio. Factors considered in determining whether an impairment is other-than-temporary include among others: (1) the length of time and the extent to which the fair value is less than cost, (2) adverse conditions specifically related to the industry, (3) geographic area and the condition of the underlying collateral, (4) payment structure of the security, (5) ratings by rating agencies, (6) the credit worthiness of bond insurers, and (7) volatility of the fair value changes.

The Association uses the present value of cash flows expected to be collected from each debt security to determine the amount of credit loss. This technique requires assumptions related to the underlying collateral, including default rates, amount and timing of prepayments, and loss severity. Assumptions can vary widely from security to security and are influenced by such factors as loan interest rate, geographical location of the borrower, borrower characteristics, and collateral type.

Significant inputs used to estimate the amount of credit loss include, but are not limited to, performance indicators of the underlying assets in the security (including default rates, delinquency rates, and percentage of nonperforming assets), loan-to-collateral value ratios, third-party guarantees, current levels of subordination, vintage, geographic concentration, and credit ratings. The Association may obtain assumptions for the default rate, prepayment rate, and loss severity rate from an independent third party, or generate the assumptions internally.

The Association has not recognized any credit losses in 2018 or prior years as any impairments were deemed temporary and resulted from non-credit related factors. The Association has the ability and intent to hold these temporarily impaired investments until a recovery of unrealized losses occurs, which may be at maturity, and at this time expects to collect the full principal amount and interest due on these securities, especially after considering credit enhancements.

Equity Investments in Other Farm Credit Institutions
Equity investments in other Farm Credit System institutions are generally nonmarketable investments consisting of stock and participation certificates, allocated surplus, and reciprocal investments in other institutions regulated by the FCA. These investments are carried at cost and evaluated for impairment based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value.

The Association is required to maintain ownership in the Bank in the form of Class B or Class C stock as determined by the Bank. The Bank may require additional capital contributions to maintain its capital requirements. The Association's investment in the Bank totaled $10,128 for 2018, $9,697 for 2017 and $9,416 for 2016. The Association owns 3.70 percent of the issued stock of the Bank as of December 31, 2018 net of any reciprocal investment. As of that date, the Bank's assets totaled $33.1 billion and shareholders' equity totaled $2.2 billion. The Bank's earnings were $306 million for 2018. In addition, the Association had an investment of $545 related to other Farm Credit institutions at December 31, 2018.

Note 5 — Real Estate and Other Property

Premises and Equipment
Premises and equipment consists of the following:

	December 31,		
	2018	2017	2016
Land	$ 1,003	$ 1,003	$ 1,032
Buildings and improvements	4,298	3,888	3,872
Furniture and equipment	3,001	3,136	2,991
	8,302	8,027	7,895
Less: accumulated depreciation	5,025	4,913	4,704
Total	$ 3,277	$ 3,114	$ 3,191

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

	December 31,		
	2018	2017	2016
(Gains) losses on sale, net	$ 20	$ 39	$ (91)
Carrying value unrealized (gains) losses	(20)	824	155
Operating (income) expense, net	83	118	158
(Gains) losses on other property owned, net	$ 83	$ 981	$ 222

OPO consisted of 2, 7, and 7 properties with book values of $366, $1,167 and $1,876 at December 31, 2018, 2017 and 2016, respectively. Both OPO properties held at December 31, 2018 were added to the portfolio before 2018. During 2018, 8 properties (including parcels) were sold, representing a book value of $792.

Gains on sales of other property owned were deferred if the sales involved financing from the Association and did not meet the criteria for immediate recognition. The Association had no deferred gains at December 31, 2018, 2017, and 2016.

Note 6 — Debt

Notes Payable to AgFirst Farm Credit Bank
Under the Farm Credit Act, the Association is obligated to borrow only from the Bank, unless the Bank approves borrowing from other funding sources. The borrowing relationship is established with the Bank through a General Financing Agreement (GFA). The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The GFA has a one year term which expires on December 31 and is renewable each year. The Association has no reason to believe the GFA will not be renewed upon expiration. The Bank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2018, the Association's notes payable were within the specified limitations.

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

The weighted average interest rates on the variable rate advances were 3.43 percent for LIBOR-based loans and 3.47 percent for Prime-based loans, and the weighted average remaining maturities were 2.5 years and 1.4 years, respectively, at December 31, 2018. The weighted-average interest rate on the fixed rate and adjustable rate mortgage (ARM) loans which are match funded by the Bank was 3.19 percent, and the weighted average remaining maturity was 9.0 years at December 31, 2018. The weighted-average interest rate on all interest-bearing notes payable was 3.24 percent and the weighted-average remaining maturity was 7.8 years at December 31, 2018. Gross notes payable consist of approximately 18.74 percent variable rate and 81.26 percent fixed rate portions, representing a match-funding of the Association's loan volume at December 31, 2018. Notes payable to AgFirst Farm Credit Bank, as reflected on the Consolidated Balance Sheets, also include a credit which reduces the notes payable balance and corresponding interest expense. The weighted average maturities described above are related to matched-funded loans. The direct note itself has an annual maturity as prescribed in the GFA.

Note 7 — Members' Equity

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

A. **Protected Borrower Stock:** Protection of certain borrower stock is provided under the Farm Credit Act which requires the Association, when retiring protected borrower stock, to retire such stock at par or stated value regardless of its book value. Protected borrower stock includes capital stock and participation certificates which 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 stock at par value or stated value, amounts required to retire this equity would be obtained from the Insurance Fund.

Notes to the Consolidated Financial Statements (dollars in thousands, except as noted)

B. **Capital Stock and Participation Certificates:** In accordance with the Farm Credit Act and the Association's capitalization bylaws, each borrower is required to invest in Class C stock for agricultural loans, or participation certificates in the case of rural home and farm-related business loans, as a condition of borrowing. The initial borrower investment, through either purchase or transfer, must be in an amount equal to 200 shares ($1,000.00) or one (1) share for each $250.00 (or fraction thereof) of the amount of the loan. The Board of Directors may increase the amount of investment if necessary to meet the Association's capital needs. Loans designated for sale or sold into the Secondary Market on or after April 16, 1996 will have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation.

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

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

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

Effective January 1, 2017, the regulatory capital requirements for System Banks and associations were modified. The new regulations 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. New regulations replaced core surplus and total surplus ratios with common equity tier 1 (CET1) capital, tier 1 capital, and total capital risk-based ratios. The new regulations also include a tier 1 leverage ratio and an unallocated retained earnings (URE) and URE equivalents (UREE) leverage ratio. The permanent capital ratio (PCR) remains in effect.

The ratios are calculated using three-month average daily balances, in accordance with FCA regulations, as follows:

- The CET1 capital ratio is the sum of 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 investments in other System institutions, divided by average risk-adjusted assets.
- The tier 1 capital ratio is CET1 capital plus non-cumulative perpetual preferred stock, divided by average risk-adjusted assets.
- The total capital ratio is tier 1 capital plus other required borrower stock held for a minimum of 5 years, subordinated debt and limited-life preferred stock greater than 5 years to maturity at issuance subject to certain limitations, allowance for loan losses and reserve for unfunded commitments under certain limitations less certain investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.
- The permanent capital ratio is all at-risk borrower stock, any allocated excess stock, unallocated retained earnings, paid-in capital, subordinated debt and preferred stock subject to certain limitations, less certain investments in other System institutions, divided by PCR risk-adjusted assets.
- The tier 1 leverage ratio is tier 1 capital, divided by average assets less regulatory deductions to tier 1 capital.
- The URE and UREE leverage ratio is unallocated retained earnings, paid-in capital, and 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 to tier 1 capital.

The following sets forth the regulatory capital ratios which were effective January 1, 2017:

Ratio	Minimum Requirement	Capital Conservation Buffer*	Minimum Requirement with Capital Conservation Buffer	Capital Ratios as of December 31, 2018	2017
Risk-adjusted ratios:					
CET1 Capital	4.5%	1.25%	5.75%	20.07%	20.35%
Tier 1 Capital	6.0%	1.25%	7.25%	20.07%	20.35%
Total Capital	8.0%	1.25%	9.25%	21.15%	21.22%
Permanent Capital	7.0%	0.0%	7.0%	20.35%	20.53%
Non-risk-adjusted ratios:					
Tier 1 Leverage	4.0%	1.0%	5.0%	20.56%	20.45%
URE and UREE Leverage	1.5%	0.0%	1.5%	20.80%	20.66%

** The capital conservation buffers have a 3 year phase-in period and will become fully effective January 1, 2020. Risk-adjusted ratio minimums will increase 0.625% each year until fully phased in. There is no phase-in period for the tier 1 leverage ratio.*

If the capital ratios fall below the minimum regulatory 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.

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

The Association had the following shares outstanding at December 31, 2018:

		Shares Outstanding		
Class	**Protected**	**Number**		**Aggregate Par Value**
B Common/Nonvoting	Yes	576	$	3
C Common/Voting	No	473,538		2,368
C Participation Certificates/Nonvoting	No	19,240		96
Total Capital Stock and Participation Certificates		493,354	$	2,467

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

Retained Earnings

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

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

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

Allocated equities shall be retired solely at the discretion of the Board, provided that minimum capital standards established by the FCA and the Board are met. All nonqualified distributions are tax deductible only when redeemed.

At December 31, 2018, allocated members' equity consisted of $103,116 of nonqualified retained surplus.

Dividends

The Association may declare noncumulative dividends on its capital stock and participation certificates provided the dividend rate does not exceed 20 percent of the par value of the respective capital stock and participation certificates. Such dividends may be paid solely on Classes D Preferred Stock or on all classes of stock and participation certificates.

The rate of dividends paid on Class D Preferred Stock for any fiscal year may not be less than the rate of dividends paid on Classes A, B or C Common Stock or participation certificates for such year. The rate of dividends on Classes A, B and C Common Stock and participation certificates shall be at the same rate per share.

Dividends may not be declared if, after recording the liability, the Association would not meet its capital adequacy standards. No dividends were declared by the Association for any of the periods included in these Consolidated Financial Statements.

Patronage Distributions

Prior to the beginning of any fiscal year, the Board, by adoption of a resolution, may obligate the Association to distribute to borrowers on a patronage basis all or any portion of available net earnings for such fiscal year or for that and subsequent fiscal years. Patronage distributions are based on the proportion of the borrower's interest to the amount of interest earned on patronage loans by the Association on its total loans unless another proportionate patronage basis is approved by the Board.

If the Association meets its capital adequacy standards after making the patronage distributions, the patronage distributions may be in cash, authorized stock of the Association, allocations of earnings retained in an allocated members' equity account, or any one or more of such forms of distribution. Patronage distributions of the Association's earnings may be paid on either a qualified or nonqualified basis, or a combination of both, as determined by the Board. A minimum of 20 percent of the total qualified patronage distribution to any borrower for any fiscal year shall always be paid in cash.

Transfer

Class D Preferred, Classes A, B and C Common Stocks, and Classes B and C Participation Certificates may be transferred to persons or entities eligible to purchase or hold such equities.

Notes to the Consolidated Financial Statements (dollars in thousands, except as noted)

Impairment

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

(a) ***First,*** allocated surplus evidenced by nonqualified written notices of allocation, in its entirety, with application to most recent allocation first and then in reverse order until all such allocated surplus has been exhausted;
(b) ***Second,*** allocated surplus evidenced by qualified written notices of allocation, in its entirety, with application to most recent allocation first and then in reverse order until all such allocated surplus has been exhausted;
(c) ***Third,*** Class A Common Stock, Class B Common Stock, Class C Common Stock and Class C Participation Certificates issued and outstanding, pro rata until such stock is fully impaired; and
(d) ***Fourth,*** Class D Preferred Stock issued and outstanding, if any.

Impairments shall be considered as being applied pro rata to each share and/or unit outstanding in the class.

Liquidation

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

(a) ***First,*** to the holders of Class D Preferred Stock until an amount equal to the aggregate par value of all shares of said stock then issued and outstanding has been distributed to such holders;
(b) ***Second,*** to the holders of Class A Common, Class B Common, Class C Common, Class B Participation Certificates and Class C Participation Certificates, pro rata in proportion to the number of shares or units of each such class of stock or participation certificates then issued and outstanding, until an amount equal to the aggregate par value or face amount of all such shares or units has been distributed to such holders;
(c) ***Third,*** to the holders of allocated surplus evidenced by qualified written notices of allocation, in the order of year of issuance and pro rata by year of issuance, until the total amount of such allocated surplus has been distributed;
(d) ***Fourth,*** to the holders of allocated surplus evidenced by nonqualified written notices of allocation, in the order of year of issuance and pro rata by year of issuance, until the total amount of such allocated surplus has been distributed; and
(e) ***Fifth,*** any remaining assets of the Association after such distributions shall be distributed to past and present Patrons on a patronage basis, to the extent practicable.

E. **Accumulated Other Comprehensive Income (AOCI):**

Changes in Accumulated Other Comprehensive income by Component *(a)*

	For the Years Ended December 31,		
	2018	**2017**	**2016**
Employee Benefit Plans:			
Balance at beginning of period	$ (307)	$ (300)	$ (307)
Other comprehensive income before reclassifications	21	(23)	(8)
Amounts reclassified from AOCI	17	16	15
Net current period OCI	38	(7)	7
Balance at end of period	$ (269)	$ (307)	$ (300)

Reclassifications Out of Accumulated Other Comprehensive Income *(b)*

	2018	**2017**	**2016**	**Income Statement Line Item**
Defined Benefit Pension Plans:				
Periodic pension costs	$ (17)	$ (16)	$ (15)	See Note 9.
Amounts reclassified	$ (17)	$ (16)	$ (15)	

(a) Amounts in parentheses indicate debits to AOCI.
(b) Amounts in parentheses indicate debits to profit/loss.

Note 8 — Fair Value Measurement

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

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

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

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

Level 1
Assets held in trust funds, related to deferred compensation plans, and assets held in mutual funds, related to the Association's Corporate Giving Fund, are classified as Level 1. The trust funds include investments in securities that are actively traded and have quoted net asset value prices that are directly observable in the marketplace.

For cash, the carrying value is primarily utilized as a reasonable estimate of fair value.

Level 2
The Association had no Level 2 assets and liabilities measured at fair value on a recurring basis.

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

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

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

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

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

For investments in debt securities held to maturity, which consists of RABs, fair value is determined by discounting the expected future cash flows using prevailing rates for similar assets.

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

Notes to the Consolidated Financial Statements (dollars in thousands, except as noted)

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

	December 31, 2018				
	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
Recurring Measurements					
Assets:					
Assets held in trust funds	$ 70	$ 70	$ –	$ –	$ 70
Recurring Assets	$ 70	$ 70	$ –	$ –	$ 70
Liabilities:					
Recurring Liabilities	$ –	$ –	$ –	$ –	$ –
Nonrecurring Measurements					
Assets:					
Impaired loans	$ 7,321	$ –	$ –	$ 7,321	$ 7,321
Other property owned	366	–	–	429	429
Nonrecurring Assets	$ 7,687	$ –	$ –	$ 7,750	$ 7,750
Other Financial Instruments					
Assets:					
Cash	$ 2,543	$ 2,543	$ –	$ –	$ 2,543
Investments in debt securities, held-to-maturity	3,738	–	–	3,627	3,627
Loans	907,546	–	–	890,256	890,256
Other Financial Assets	$ 913,827	$ 2,543	$ –	$ 893,883	$ 896,426
Liabilities:					
Notes payable to AgFirst Farm Credit Bank	$ 742,744	$ –	$ –	$ 730,917	$ 730,917
Other Financial Liabilities	$ 742,744	$ –	$ –	$ 730,917	$ 730,917

	December 31, 2017				
	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
Recurring Measurements					
Assets:					
Assets held in trust funds	$ 98	$ 98	$ –	$ –	$ 98
Recurring Assets	$ 98	$ 98	$ –	$ –	$ 98
Liabilities:					
Recurring Liabilities	$ –	$ –	$ –	$ –	$ –
Nonrecurring Measurements					
Assets:					
Impaired loans	$ 2,074	$ –	$ –	$ 2,074	$ 2,074
Other property owned	1,167	–	–	1,294	1,294
Nonrecurring Assets	$ 3,241	$ –	$ –	$ 3,368	$ 3,368
Other Financial Instruments					
Assets:					
Cash	$ 2,606	$ 2,606	$ –	$ –	$ 2,606
Investments in debt securities, held-to-maturity	3,978	–	–	3,815	3,815
Loans	923,570	–	–	912,031	912,031
Other Financial Assets	$ 930,154	$ 2,606	$ –	$ 915,846	$ 918,452
Liabilities:					
Notes payable to AgFirst Farm Credit Bank	$ 746,548	$ –	$ –	$ 736,855	$ 736,855
Other Financial Liabilities	$ 746,548	$ –	$ –	$ 736,855	$ 736,855

	December 31, 2016				
	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
<u>Recurring Measurements</u>					
Assets:					
Assets held in trust funds	$ 66	$ 66	$ –	$ –	$ 66
Recurring Assets	$ 66	$ 66	$ –	$ –	$ 66
Liabilities:					
Recurring Liabilities	$ –	$ –	$ –	$ –	$ –
<u>Nonrecurring Measurements</u>					
Assets:					
Impaired loans	$ 3,814	$ –	$ –	$ 3,814	$ 3,814
Other property owned	1,876	–	–	2,119	2,119
Nonrecurring Assets	$ 5,690	$ –	$ –	$ 5,933	$ 5,933
<u>Other Financial Instruments</u>					
Assets:					
Cash	$ 3,063	$ 3,063	$ –	$ –	$ 3,063
Investments in debt securities, held-to-maturity	4,209	–	–	3,961	3,961
Loans	838,005	–	–	837,239	837,239
Other Financial Assets	$ 845,277	$ 3,063	$ –	$ 841,200	$ 844,263
Liabilities:					
Notes payable to AgFirst Farm Credit Bank	$ 683,642	$ –	$ –	$ 674,231	$ 674,231
Other Financial Liabilities	$ 683,642	$ –	$ –	$ 674,231	$ 674,231

SENSITIVITY TO CHANGES IN SIGNIFICANT UNOBSERVABLE INPUTS

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

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

Investments in Debt Securities

The fair values of predominantly all Level 3 investments in debt securities have consistent inputs, valuation techniques and correlation to changes in underlying inputs. The models used to determine fair value for these instruments use certain significant unobservable inputs within a discounted cash flow or market comparable pricing valuation technique. Such inputs generally include discount rate components including risk premiums, prepayment estimates, default estimates and loss severities.

These Level 3 assets would decrease (increase) in value based upon an increase (decrease) in discount rates, defaults, or loss severities. Conversely, the fair value of these assets would generally increase (decrease) in value if the repayment input were to increase (decrease).

Generally, a change in the assumption used for defaults is accompanied by a directionally similar change in the risk premium component of the discount rate (specifically, the portion related to credit risk) and a directionally opposite change in the assumption used for prepayments. Unobservable inputs for loss severities do not normally increase or decrease based on movements in the other significant unobservable inputs for these Level 3 assets.

Inputs to Valuation Techniques

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

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

Notes to the Consolidated Financial Statements (dollars in thousands, except as noted)

Quantitative Information about Recurring and Nonrecurring Level 3 Fair Value Measurements

	Fair Value	Valuation Technique(s)	Unobservable Input	Range
Impaired loans and other property owned	$ 7,750	Appraisal	Income and expense	*
			Comparable sales	*
			Replacement costs	*
			Comparability adjustments	*

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

Information about Other Financial Instrument Fair Value Measurements

	Valuation Technique(s)	Input
Cash	Carrying Value	Par/Principal and appropriate interest yield
Loans	Discounted cash flow	Prepayment forecasts Probability of default Loss severity
Investments in debt securities, held-to-maturity	Discounted cash flow	Prepayment rates Risk adjusted discount rate
Notes payable to AgFirst Farm Credit Bank	Discounted cash flow	Prepayment forecasts Probability of default Loss severity

Note 9 — Employee Benefit Plans

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

1. Assets contributed to multi-employer plans by one employer may be used to provide benefits to employees of other participating employers.
2. If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.
3. If the Association chooses to stop participating in some of its multi-employer plans, the Association may be required to contribute to eliminate the underfunded status of the plan.

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

1. The Employee Identification Number (EIN) and three-digit Pension Plan Number
2. The most recent Pension Protection Act (PPA) zone status. Among other factors, plans in the red zone are generally less than 65 percent funded, plans in the yellow zone are less than 80 percent funded, and plans in the green zone are at least 80 percent funded.
3. The "FIP/RP Status" indicating whether a financial improvement plan (FIP) or a rehabilitation plan (RP) is either pending or has been implemented.
4. The expiration date(s) of collective-bargaining agreement(s).

The FAP Plan covers employees hired prior to January 1, 2003 and includes other District employees that are not employees of the Association. It is accounted for as a multiemployer plan. The related net benefit plan obligations are not included in the Association's Balance Sheets but are included in the Combined Balance Sheets for the AgFirst District. FAP Plan expenses included in employee benefit costs on the Association's Statements of Income were $1,730 for 2018, $1,615 for 2017, and $2,207 for 2016. At December 31, 2018, 2017, and 2016, the total liability balance for the FAP Plan presented in the District Combined Balance Sheets is $94,491, $139,104, and $119,000, respectively. The FAP Plan is 89.56 percent, 86.41 percent, and 86.96 percent funded to the projected benefit obligation as of December 31, 2018, 2017, and 2016, respectively.

In addition to providing pension benefits, the Association provides certain medical and dental benefits for eligible retired employees through the OPEB Plan. Substantially all of the Association employees may become eligible for the benefits if they reach early retirement age while working for the Association. Early retirement age is defined as a minimum of age 55 and 10 years of service. Employees hired after December 31, 2002, and employees who separate from service between age 50 and age 55, are required to pay the full cost of their retiree health insurance coverage. Employees who retire subsequent to December 1, 2007 are no longer provided retiree life insurance benefits. The OPEB Plan includes other Farm Credit System employees that are not employees of the Association or District and is accounted for as a multiemployer plan. The related net benefit plan obligations are not included in the Association's Balance Sheets but are included in the Combined Statement of Condition for the Farm Credit System. The OPEB Plan is unfunded with expenses paid as incurred. Postretirement benefits other than pensions included in employee benefit costs on the Association's Statements of Income were $278 for 2018, $256 for 2017, and $473 for 2016. At December 31, 2018, the total AgFirst District liability balance for the OPEB Plan presented in the Farm Credit System Combined Statement of Condition is $181,820.

During 2017, the method of recording expenses at participating District entities for the FAP and OPEB Plans was modified. Prior to 2017, expense was recorded based on allocations of actuarially-determined costs and any differences between recorded expense and actual contributions were recorded in Other Assets or Other Liabilities on the Consolidated Balance Sheets. For 2017 and future years, participating entities will record employee benefit costs based on the actual contributions to the Plans. This change caused the Association to modify its accounting estimates recorded in Other Assets and Other

Liabilities since the assets and liabilities do not impact future contributions to the Plans. The change in estimate resulted in the reduction of Other Assets by $2,802 and the reduction of Other Liabilities by $5,552 on the Association's Balance Sheets, and a total reduction of noninterest expenses on the Association's Statements of Income of $2,750 during 2017.

The Association also participates in a defined contribution Farm Credit Benefits Alliance (FCBA) 401(k) Plan (401(k) Plan), which qualifies as a 401(k) plan as defined by the Internal Revenue Code. For employees hired on or prior to December 31, 2002, the Association contributes $0.50 for each $1.00 of the employee's first 6.00 percent of contribution (based on total compensation) up to the maximum employer contribution of 3.00 percent of total compensation. For employees hired on or after January 1, 2003, the Association contributes $1.00 for each $1.00 of the employee's first 6.00 percent of contribution up to the maximum employer contribution of 6.00 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as determined and adjusted by the Internal Revenue Service. The 401(k) Plan costs are expensed as funded. Employer contributions to this plan included in salaries and employee benefit costs were $379, $363, and $333 for the years ended December 31, 2018, 2017, and 2016, respectively. Beginning in 2015, contributions include an additional 3.00 percent of eligible compensation for employees hired after December 31, 2002.

FASB guidance further requires the determination of the fair value of plan assets and recognition of actuarial gains and losses, prior service costs or credits, and transition assets or obligations as a component of AOCI. Under the guidance, these amounts are subsequently recognized as components of net periodic benefit costs over time. For 2018, 2017, and 2016, $38, $(7) and $7, respectively, has been recognized as a net credit, a net debit, and a net credit to AOCI to reflect these elements.

The supplemental retirement plan is unfunded and had a projected benefit obligation of $374 and a net under-funded status of $374 at December 31, 2018. Expenses of the nonqualified plan included in noninterest expenses were $32, $32, and $33 for 2018, 2017, and 2016, respectively. Assumptions used to determine the projected benefit obligation as of December 31, 2018 included a discount rate of 4.40 percent.

Additional information for the above may be found in the Notes to the Annual Information Statement of the Farm Credit System.

Note 10 — Related Party Transactions

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

Total loans to such persons at December 31, 2018 amounted to $10,539. During 2018, $2,801 of new loans were made and repayments totaled $4,272. In the opinion of management, none of these loans outstanding at December 31, 2018 involved more than a normal risk of collectability.

Note 11 — Commitments and Contingencies

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

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

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

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the Consolidated Balance Sheets until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. At December 31, 2018, $141,334 of commitments to extend credit and no commercial letters of credit were outstanding. There was no reserve for unfunded commitments included in Other Liabilities in the Consolidated Balance Sheets at December 31, 2018.

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. At December 31, 2018, standby letters of credit outstanding totaled $180 with expiration dates ranging from January 1, 2019 to May 1, 2022. The maximum potential amount of future payments that may be required under these guarantees was $180.

Notes to the Consolidated Financial Statements (dollars in thousands, except as noted)

Note 12 — Income Taxes

The provision (benefit) for income taxes follows:

	Year Ended December 31, 2018	2017	2016
Current:			
Federal	$ 108	$ 113	$ 143
State	–	–	–
Total provision (benefit) for income taxes	$ 108	$ 113	$ 143

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

	December 31, 2018	2017	2016
Federal tax at statutory rate	$ 4,262	$ 9,358	$ 7,119
State tax, net	(30)	(33)	–
Non-pat tax	19	190	–
Patronage distributions	(3,360)	(5,250)	(3,500)
Tax-exempt FLCA earnings	(1,781)	(4,108)	(3,810)
Change in valuation allowance	875	(1,682)	259
Adjustment to deferred-prior period	–	–	–
Adjustment for lower statutory rate	–	1,623	–
Other	123	15	75
Provision (benefit) for income taxes	$ 108	$ 113	$ 143

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

	December 31, 2018	2017	2016
Deferred income tax assets:			
Allowance for loan losses	$ 2,212	$ 1,153	$ 1,987
Net operating loss – carryforward	1,196	1,204	1,996
Nonaccrual loan interest	416	353	670
Gross deferred tax assets	3,824	2,710	4,653
Less: valuation allowance	(3,824)	(2,710)	(4,653)
Gross deferred tax assets, net of valuation allowance	–	–	–
Deferred income tax liabilities:			
Future Bank equity redemption	–	–	–
Loan fees	–	–	–
Gross deferred tax liability	–	–	–
Net deferred tax asset (liability)	$ –	$ –	$ –

At December 31, 2018, deferred income taxes have not been provided by the Association on approximately $3.6 million of patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

The Association recorded a valuation allowance of $3,824, $2,710, and $4,653 as of December 31, 2018, 2017 and 2016, respectively. The Association will continue to evaluate the realizability of these deferred tax assets and adjust the valuation allowance accordingly.

There were no uncertain tax positions identified related to the current year and the Association has no unrecognized tax benefits at December 31, 2018 for which liabilities have been established. The Association recognizes interest and penalties, if any, related to unrecognized tax benefits as a component of income tax expense.

The tax years that remain open for federal and major state income tax jurisdictions are 2015 and forward.

Note 13 — Additional Financial Information

Quarterly Financial Information (Unaudited)

2018	First	Second	Third	Fourth	Total
Net interest income	$ 6,682	$ 6,724	$ 6,681	$ 6,729	$ 26,816
Provision for (reversal of allowance for) loan losses	147	758	1,388	3,729	6,022
Noninterest income (expense), net	(1,288)	(1,767)	(1,857)	4,309	(603)
Net income	$ 5,247	$ 4,199	$ 3,436	$ 7,309	$ 20,191

2017	First	Second	Third	Fourth	Total
Net interest income	$ 6,297	$ 6,243	$ 6,620	$ 6,626	$ 25,786
Provision for (reversal of allowance for) loan losses	104	(35)	433	285	787
Noninterest income (expense), net	(1,914)	(1,870)	(2,353)	7,761	1,624
Net income	$ 4,279	$ 4,408	$ 3,834	$ 14,102	$ 26,623

	2016				
	First	Second	Third	Fourth	Total
Net interest income	$ 6,135	$ 6,176	$ 6,136	$ 6,157	$ 24,604
Provision for (reversal of allowance for) loan losses	225	702	242	(277)	892
Noninterest income (expense), net	(1,559)	(1,895)	(2,140)	2,078	(3,516)
Net income	$ 4,351	$ 3,579	$ 3,754	$ 8,512	$ 20,196

Note 14 — Subsequent Events

The Association evaluated subsequent events and determined that there were none requiring disclosure through March 13, 2019, which was the date the financial statements were issued.

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Cape Fear Farm Credit
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