# 2018 ANNUAL REPORT

# Farm Credit

SOUTHEAST MISSOURI

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## Farm Credit Southeast Missouri, ACA

# MESSAGE FROM THE CHIEF EXECUTIVE OFFICER

Dear Farm Credit Customer-Owners,

Enclosed you will find the report of our financial results for 2018. More importantly, though, I want to convey our gratitude for the opportunity to work for you. As employees we are all helping each other do the best we can to bring you value based on our agricultural lending expertise and dedication to helping you be successful.

Over the past 4 years, we've methodically increased our association-wide staffing to build in more backup strength in critical positions, provide for more specialization, and plan for smooth succession for retirements occurring in 2019. We are very fortunate to have a significant number of employees with mid to long range tenure, who are providing training and guidance to our newer employees.

In Poplar Bluff, we are excited to announce that we are in the process of designing a new branch office building to serve that market more efficiently. We are looking forward to relocating to a more safely accessible, visible location in the southwest part of Poplar Bluff, at the intersection of U.S. Highway 67 and State Route M highway.

On the business development front, we have engaged a marketing firm this year to help us with our branding and marketplace effectiveness, particularly on the various social media platforms. Hopefully you will notice these efforts as this year unfolds.

We are making a significant change this year in our annual meeting process. In the past, our annual meeting was always in August. Starting this year, we are moving the annual meeting date up to April. Also, we are doing away with proxy voting before the annual meeting. Instead, we will have a more customary mail ballot process following the April annual meeting. Communication will be sent to all stockholders with information on this new process. We believe this process will be easier for our voting stockholders to understand and will be more straightforward to administer.

Turning our attention to the association's 2018 financial performance – we had another very good year. We grew our average earning assets by 1.7%, our pretax income totaled nearly $16.0 million, we had a very strong 2.3% pretax rate of return on assets, and our credit quality remains very high at over 99% rated fully Acceptable and OAEM (Other Assets Especially Mentioned).

Due to these strong financial results, the board was pleased to announce a $7.1 million patronage refund of 2018 earnings, which was distributed in February, 2019. This distribution of earnings to our loan customers is by far the largest ever, and it brings the total amount paid in patronage since 1994 up over $79.0 million. This represents a significant contribution to our owners' financial well-being and to our local community economies.

All of you benefit from growth that we derive from building our business. Your help telling our story to neighbors and farm property owners who are not already Farm Credit Southeast Missouri customer-owners goes a long way in helping us build this cooperative.

We love working for you – for farmers, rural homeowners, landowners, and owners of other rural businesses. It is challenging and rewarding work.

Please let us know how we are doing, and what we can do to serve you better.

We thank you for your business and support, and look forward to seeing you whenever possible.

Best wishes for a healthy and prosperous 2019.

Bob Smith
President / Chief Executive Officer
Farm Credit Southeast Missouri, ACA

March 8, 2019

# CONSOLIDATED FIVE-YEAR SUMMARY OF SELECTED FINANCIAL DATA

*Farm Credit Southeast Missouri, ACA*

*(dollars in thousands)*

| As of December 31 | **2018** | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|
| **Statement of Condition Data** | | | | | |
| Loans | **$ 670,743** | $ 629,942 | $ 614,216 | $ 582,111 | $ 573,994 |
| Allowance for loan losses | **526** | 534 | 482 | 452 | 457 |
| Net loans | **670,217** | 629,408 | 613,734 | 581,659 | 573,537 |
| Investment in AgriBank, FCB | **13,106** | 12,865 | 11,709 | 11,090 | 11,409 |
| Investment securities | **801** | 1,509 | 2,483 | 3,326 | 4,272 |
| Other assets | **21,349** | 16,666 | 14,767 | 13,384 | 13,175 |
| Total assets | **$ 705,473** | $ 660,448 | $ 642,693 | $ 609,459 | $ 602,393 |
| Obligations with maturities of one year or less | **$ 13,071** | $ 12,195 | $ 507,112 | $ 481,791 | $ 482,244 |
| Obligations with maturities greater than one year | **540,118** | 504,826 | -- | -- | -- |
| Total liabilities | **553,189** | 517,021 | 507,112 | 481,791 | 482,244 |
| Capital stock and participation certificates | **1,733** | 1,713 | 1,715 | 1,742 | 1,756 |
| Unallocated surplus | **150,551** | 141,714 | 133,866 | 125,926 | 118,392 |
| Total members' equity | **152,284** | 143,427 | 135,581 | 127,668 | 120,149 |
| Total liabilities and members' equity | **$ 705,473** | $ 660,448 | $ 642,693 | $ 609,459 | $ 602,393 |
| For the year ended December 31 | **2018** | 2017 | 2016 | 2015 | 2014 |
| **Statement of Income Data** | | | | | |
| Net interest income | **$ 20,744** | $ 20,055 | $ 18,583 | $ 18,224 | $ 17,891 |
| Provision for (reversal of) credit losses | **10** | 434 | 24 | (9) | 83 |
| Other expenses, net | **4,800** | 4,772 | 5,119 | 5,449 | 4,059 |
| Net income | **$ 15,934** | $ 14,849 | $ 13,440 | $ 12,784 | $ 13,749 |
| **Key Financial Ratios** | | | | | |
| **For the Year** | | | | | |
| Return on average assets | **2.3%** | 2.2% | 2.1% | 2.1% | 2.3% |
| Return on average members' equity | **10.8%** | 10.6% | 10.2% | 10.3% | 11.9% |
| Net interest income as a percentage of average earning assets | **3.2%** | 3.1% | 3.0% | 3.2% | 3.2% |
| Net (recoveries) charge-offs as a percentage of average loans | **(0.0%)** | 0.1% | (0.0%) | 0.0% | 0.0% |
| **At Year End** | | | | | |
| Members' equity as a percentage of total assets | **21.6%** | 21.7% | 21.1% | 20.9% | 19.9% |
| Allowance for loan losses as a percentage of loans | **0.1%** | 0.1% | 0.1% | 0.1% | 0.1% |
| Capital ratios effective beginning January 1, 2017: | | | | | |
| Common equity tier 1 ratio | **20.1%** | 20.2% | N/A | N/A | N/A |
| Tier 1 capital ratio | **20.1%** | 20.2% | N/A | N/A | N/A |
| Total capital ratio | **20.1%** | 20.3% | N/A | N/A | N/A |
| Permanent capital ratio | **20.1%** | 20.2% | N/A | N/A | N/A |
| Tier 1 leverage ratio | **19.7%** | 19.6% | N/A | N/A | N/A |
| Capital ratios effective prior to 2017: | | | | | |
| Permanent capital ratio | **N/A** | N/A | 19.6% | 19.5% | 17.8% |
| Total surplus ratio | **N/A** | N/A | 19.4% | 19.2% | 17.5% |
| Core surplus ratio | **N/A** | N/A | 19.4% | 19.2% | 17.5% |
| **Net Income Distributed** | | | | | |
| **For the Year** | | | | | |
| Patronage distributions: | | | | | |
| Cash | **$ 6,997** | $ 5,501 | $ 5,250 | $ 5,100 | $ 4,100 |

# MANAGEMENT'S DISCUSSION AND ANALYSIS

*Farm Credit Southeast Missouri*, ACA

The following commentary reviews the consolidated financial condition and consolidated results of operations of Farm Credit Southeast Missouri, ACA (the Association) and its subsidiaries, Farm Credit Southeast Missouri, FLCA and Farm Credit Southeast Missouri, PCA and provides additional specific information. The accompanying Consolidated Financial Statements and Notes to the Consolidated Financial Statements also contain important information about our financial condition and results of operations.

The Farm Credit System (System) is a nationwide system of cooperatively owned banks and associations established by Congress to meet the credit needs of American agriculture. As of January 1, 2019, the System consisted of three Farm Credit Banks, one Agricultural Credit Bank, and 69 customer-owned cooperative lending institutions (associations). The System serves all 50 states, Washington D.C., and Puerto Rico. This network of financial cooperatives is owned and governed by the rural customers the System serves.

AgriBank, FCB (AgriBank), a System Farm Credit Bank, and its District associations are collectively referred to as the AgriBank Farm Credit District (AgriBank District or the District). We are an association in the District.

The Farm Credit Administration (FCA) is authorized by Congress to regulate the System. The Farm Credit System Insurance Corporation (FCSIC) ensures the timely payment of principal and interest on Systemwide debt obligations and the retirement of protected borrower capital at par or stated value.

Due to the nature of our financial relationship with AgriBank, the financial condition and results of operations of AgriBank materially impact our members' investment. To request free copies of AgriBank financial reports, contact us at:

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Our Annual Report is available on our website no later than 75 days after the end of the calendar year and members are provided a copy of such report no later than 90 days after the end of the calendar year. The Quarterly Reports are available on our website no later than 40 days after the end of each calendar quarter. To request free copies of our Annual or Quarterly Reports, contact us as stated above.

## FORWARD-LOOKING INFORMATION

This Annual Report includes 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 "anticipate", "believe", "estimate", "may", "expect", "intend", "outlook", and similar expressions are used to identify such forward-looking statements. These statements reflect our current views with respect to future events. However, actual results may differ materially from our expectations due to a number of risks and uncertainties which may be beyond our control. These risks and uncertainties include, but are not limited to:

- Political, legal, regulatory, financial markets, international, and economic conditions and developments in the United States (U.S.) and abroad
- Economic fluctuations in the agricultural and farm-related business sectors
- Unfavorable weather, disease, and other adverse climatic or biological conditions that periodically occur and impact agricultural productivity and income
- Changes in U.S. government support of the agricultural industry and the System as a government-sponsored enterprise, as well as investor and rating agency actions relating to events involving the U.S. government, other government-sponsored enterprises, and other financial institutions
- Actions taken by the Federal Reserve System in implementing monetary policy
- Credit, interest rate, and liquidity risks inherent in our lending activities
- Changes in our assumptions for determining the allowance for loan losses, other-than-temporary impairment, and fair value measurements

## AGRICULTURAL AND ECONOMIC CONDITIONS

**Land Values:** The average benchmark farm land value change in 2018 was 1.6%, compared to 0.2% and 2.1% in 2017 and 2016, respectively. The more moderate land value changes the past three years are indicative of lower commodity prices to more historical levels.

**Crop Conditions:** With above average rainfall in the fourth quarter, harvest was delayed across much of the area primarily affecting soybean and cotton, but does not appear to have had a negative impact on yields. Wheat planning also fell slightly behind schedule with the wet fall, but impact to total acres planted should be minimal. Overall, a good harvest with yields that were "average" to "above average" for 2018.

**Commodity Prices:** The U.S. government recently announced the approval of a second and final round of the Market Facilitation Program payments for 2018 crop production which will further assist farmers impacted by lower crop prices related to the retaliatory tariffs imposed by China earlier this year, particularly for soybeans.

## LOAN PORTFOLIO

### Loan Portfolio

Total loans were $670.7 million at December 31, 2018, an increase of $40.8 million from December 31, 2017.

**Components of Loans**

| (in thousands)<br>As of December 31 | **2018** | 2017 | 2016 |
|---|---|---|---|
| Accrual loans: | | | |
| Real estate mortgage | **$ 376,267** | $ 351,197 | $ 331,402 |
| Production and intermediate-term | **239,861** | 217,861 | 225,283 |
| Agribusiness | **7,136** | 7,444 | 4,935 |
| Other | **47,093** | 50,452 | 49,616 |
| Nonaccrual loans | **386** | 2,988 | 2,980 |
| Total loans | **$ 670,743** | $ 629,942 | $ 614,216 |

The other category is comprised of certain assets originated under our mission related investment authority as well as rural residential real estate loans.

The increase in total loans from December 31, 2017, was primarily due to strong loan originations of real estate mortgage and intermediate-term loans as well as a fewer repayments received on production loans in the fourth quarter. This was partially offset by a decrease in agribusiness, mission related investments, and nonaccrual loans.

We offer variable, fixed, indexed, and adjustable interest rate loan programs to our borrowers. We determine interest margins charged on each lending program based on cost of funds, credit risk, market conditions, and the need to generate sufficient earnings.

### Portfolio Distribution

We are chartered to serve certain counties in Missouri and purchase the remainder of our portfolio outside of Missouri to support rural America and to diversify our portfolio risk. Approximately 81.2% of our total loan portfolio was in Butler, Stoddard, Dunklin, Scott, New Madrid, Cape Girardeau, and Mississippi counties at December 31, 2018.

**Agricultural Concentrations**

| As of December 31 | **2018** | 2017 | 2016 |
|---|---|---|---|
| Cotton | **20.3%** | 20.1% | 21.3% |
| Soybeans | **18.0%** | 18.4% | 18.4% |
| Corn | **17.9%** | 17.9% | 18.9% |
| Rice | **17.2%** | 17.1% | 15.9% |
| Livestock | **7.1%** | 6.4% | 5.6% |
| Landlords | **4.5%** | 4.7% | 4.6% |
| Processing and marketing | **1.8%** | 2.3% | 2.5% |
| Other | **13.2%** | 13.1% | 12.8% |
| Total | **100.0%** | 100.0% | 100.0% |

Commodities are based on the borrower's primary intended commodity at the time of loan origination and may change due to borrower business decisions as a result of changes in weather, prices, input costs, and other circumstances.

Our production and intermediate-term loan portfolio exhibits some seasonality relating to patterns of operating loans made to crop producers. These loans are normally at their lowest levels following the harvest and then increase in the spring and throughout the rest of the year as borrowers fund operating needs.

### Portfolio Credit Quality

The credit quality of our portfolio improved from December 31, 2017. Adversely classified loans decreased to 0.7% of the portfolio at December 31, 2018, from 1.0% of the portfolio at December 31, 2017. Adversely classified loans are loans we have identified as showing some credit weakness outside our credit standards. We have considered portfolio credit quality in assessing the reasonableness of our allowance for loan losses.

In certain circumstances, Federal Agricultural Mortgage Corporation (Farmer Mac) and government agency guarantee programs are used to reduce the risk of loss. At December 31, 2018, $68.5 million of our loans were, to some level, guaranteed under these government programs.

## Risk Assets

**Components of Risk Assets**

(dollars in thousands)

| As of December 31 | | **2018** | | 2017 | | 2016 |
|---|---|---|---|---|---|---|
| Loans: | | | | | | |
| Nonaccrual | **$** | **386** | $ | 2,988 | $ | 2,980 |
| Accruing restructured | | **415** | | 482 | | -- |
| Accruing loans 90 days or more past due | | **1,358** | | 1,368 | | 143 |
| Total risk loans | | **2,159** | | 4,838 | | 3,123 |
| Other property owned | | **--** | | -- | | -- |
| Total risk assets | **$** | **2,159** | $ | 4,838 | $ | 3,123 |
| Total risk loans as a percentage of total loans | | **0.3%** | | 0.8% | | 0.5% |
| Nonaccrual loans as a percentage of total loans | | **0.1%** | | 0.5% | | 0.5% |
| Current nonaccrual loans as a percentage of total nonaccrual loans | | **96.9%** | | 69.5% | | 95.8% |
| Total delinquencies as a percentage of total loans | | **0.6%** | | 0.9% | | 1.2% |

Note: Accruing loans include accrued interest receivable.

Our risk assets have decreased from December 31, 2017, and have remained at acceptable levels. Total risk loans as a percentage of total loans were well within our established risk management guidelines.

The decrease in nonaccrual loans was primarily due to the reinstatement of accrual status of one customer's line of credit and the payoff of seven nonaccrual local credits to four customers. Nonaccrual loans remained at an acceptable level at December 31, 2018, 2017, and 2016.

The decrease in accruing restructured loans was primarily due to continued performance for our single restructured loan.

## Allowance for Loan Losses

The allowance for loan losses is an estimate of losses on loans inherent in our portfolio as of the financial statement date. We determine the appropriate level of allowance for loan losses based on the periodic evaluation of factors such as loan loss history, estimated probability of default, estimated loss severity, portfolio quality, and current economic and environmental conditions.

**Allowance Coverage Ratios**

| As of December 31 | **2018** | 2017 | 2016 |
|---|---|---|---|
| Allowance as a percentage of: | | | |
| Loans | **0.1%** | 0.1% | 0.1% |
| Nonaccrual loans | **136.3%** | 17.9% | 16.2% |
| Total risk loans | **24.4%** | 11.0% | 15.4% |
| Net (recoveries) charge-offs as a percentage of average loans | **(0.0%)** | 0.1% | (0.0%) |
| Adverse assets to risk funds | **3.3%** | 5.0% | 5.3% |

Note: Risk funds includes permanent capital and allowance for loan losses.

In our opinion, the allowance for loan losses was reasonable in relation to the risk in our loan portfolio at December 31, 2018.

Additional loan information is included in Notes 3, 10, 11, and 12 to the accompanying Consolidated Financial Statements.

## INVESTMENT SECURITIES

In addition to loans, we held investment securities. Investment securities totaled $801 thousand, $1.5 million, and $2.5 million at December 31, 2018, 2017, and 2016, respectively. Our investment securities consisted of securities containing loans guaranteed by the Small Business Administration.

The investment portfolio is evaluated for other-than-temporary impairment. For the years ended December 31, 2018, 2017, and 2016, we have not recognized any impairment on our investment portfolio.

Additional investment securities information is included in Note 5 to the accompanying Consolidated Financial Statements.

## RESULTS OF OPERATIONS

**Profitability Information**

| (dollars in thousands)<br>For the year ended December 31 | 2018 | 2017 | 2016 |
|---|---|---|---|
| Net income | **$ 15,934** | $ 14,849 | $ 13,440 |
| Return on average assets | **2.3%** | 2.2% | 2.1% |
| Return on average members' equity | **10.8%** | 10.6% | 10.2% |

Changes in the chart above relate directly to:

- Changes in income discussed below
- Changes in assets discussed in the Loan Portfolio and Investment Securities sections
- Changes in capital discussed in the Capital Adequacy section

**Changes in Significant Components of Net Income**

| | For the year ended December 31 | | | Increase (decrease) in net income | |
|---|---|---|---|---|---|
| (in thousands) | **2018** | 2017 | 2016 | **2018 vs 2017** | 2017 vs 2016 |
| Net interest income | **$ 20,744** | $ 20,055 | $ 18,583 | **$ 689** | $ 1,472 |
| Provision for credit losses | **10** | 434 | 24 | **424** | (410) |
| Patronage income | **2,856** | 2,719 | 2,105 | **137** | 614 |
| Other income, net | **1,556** | 1,100 | 1,135 | **456** | (35) |
| Operating expenses | **9,167** | 8,457 | 8,293 | **(710)** | (164) |
| Provision for income taxes | **45** | 134 | 66 | **89** | (68) |
| Net income | **$ 15,934** | $ 14,849 | $ 13,440 | **$ 1,085** | $ 1,409 |

### Net Interest Income

**Changes in Net Interest Income**

| (in thousands)<br>For the year ended December 31 | 2018 vs 2017 | 2017 vs 2016 |
|---|---|---|
| Changes in volume | **$ 531** | $ 906 |
| Changes in interest rates | **(25)** | 472 |
| Changes in nonaccrual income and other | **183** | 94 |
| Net change | **$ 689** | $ 1,472 |

Net interest income included income on nonaccrual loans that totaled $307 thousand, $123 thousand, and $30 thousand in 2018, 2017, and 2016, respectively. Nonaccrual income is recognized when received in cash, collection of the recorded investment is fully expected, and prior charge-offs have been recovered.

Net interest margin (net interest income as a percentage of average earning assets) was 3.2%, 3.1%, and 3.0% in 2018, 2017, and 2016, respectively. Our net interest margin is sensitive to interest rate changes and competition.

### Provision for Credit Losses

The fluctuation in the provision for credit losses was related to our estimate of losses in our portfolio for the applicable years. Additional discussion is included in Note 3 to the accompanying Consolidated Financial Statements.

### Patronage Income

We may receive patronage from AgriBank and other Farm Credit Institutions. Patronage distributions from AgriBank and other Farm Credit Institutions are declared solely at the discretion of each institution’s Board of Directors.

**Patronage Income**

| (in thousands)<br>For the year ended December 31 | 2018 | 2017 | 2016 |
|---|---|---|---|
| Wholesale patronage | **$ 2,849** | $ 2,711 | $ 2,098 |
| Other Farm Credit Institutions | **7** | 8 | 7 |
| Total patronage income | **$ 2,856** | $ 2,719 | $ 2,105 |

Wholesale patronage income is based on the average balance of our note payable to AgriBank. The patronage rates were 54.1 basis points, 52.1 basis points, and 25.6 basis points in 2018, 2017, and 2016, respectively. The increase in the patronage rate in 2017 was primarily due to a change in AgriBank's capital plan effective July 1, 2017. The capital plan was modified to pay out 100% of net earnings beginning in 2017. Previously, 50% of net earnings was paid. See the Relationship with AgriBank section for further discussion on patronage income.

In addition, the wholesale patronage balance includes equalization. Equalization is determined based on the quarterly average balance of stock in excess of our AgriBank required investment. The equalization rate is targeted at the average cost of funds for all District associations as a group.

### Other Income, Net

The change in other income, net was primarily due to the Allocated Insurance Reserve Accounts (AIRA) distribution.

The increase in AIRA was due to our share of distributions from AIRA of $352 thousand in 2018. The AIRA was established by the FCSIC when premiums collected increased the level of the Insurance Fund beyond the required secured base amount of 2.0% of insured debt. There were no AIRA distributions in 2017 or 2016.

### Operating Expenses

**Components of Operating Expenses**

(dollars in thousands)

| For the year ended December 31 | **2018** | 2017 | 2016 |
|---|---|---|---|
| Salaries and employee benefits | **$ 5,571** | $ 5,284 | $ 5,227 |
| Purchased and vendor services | **1,456** | 984 | 881 |
| Communications | **70** | 72 | 62 |
| Occupancy and equipment | **494** | 436 | 424 |
| Advertising and promotion | **341** | 244 | 230 |
| Examination | **241** | 232 | 215 |
| Farm Credit System insurance | **448** | 735 | 809 |
| Other | **546** | 470 | 445 |
| Total operating expenses | **$ 9,167** | $ 8,457 | $ 8,293 |
| Operating rate | **1.4%** | 1.3% | 1.4% |

Salaries and employee benefits expense increased primarily due to an increase in head count as well as annual merit increases.

Purchased and vendor services expense increased primarily due to higher technology collaboration expenses as well as an increase in purchased technology application services (loan accounting, general ledger, online banking). Additionally, audit expenses increased.

The Farm Credit System insurance expense decreased in 2018 primarily due to a lower premium rate charged by FCSIC on accrual loans from 15 basis points in 2017 to 9 basis points in 2018. The FCSIC has announced premiums will remain unchanged at 9 basis points for 2019. The FCSIC Board meets periodically throughout the year to review premium rates and has the ability to change these rates at any time.

### Provision for Income Taxes

The variance in provision for income taxes was related to our estimate of taxes based on taxable income. Patronage distributions to members reduced our tax liability in 2018, 2017, and 2016. Additional discussion is included in Note 8 to the accompanying Consolidated Financial Statements.

## FUNDING AND LIQUIDITY

We borrow from AgriBank, under a note payable, in the form of a line of credit, as described in Note 6 to the accompanying Consolidated Financial Statements. This line of credit is our primary source of liquidity and is used to fund operations and meet current obligations. At December 31, 2018, we had $157.0 million available under our line of credit. We generally apply excess cash to this line of credit.

**Note Payable Information**

(dollars in thousands)

| For the year ended December 31 | **2018** | 2017 | 2016 |
|---|---|---|---|
| Average balance | **$ 526,851** | $ 521,614 | $ 496,418 |
| Average interest rate | **2.6%** | 2.0% | 1.8% |

The repricing attributes of our line of credit generally correspond to the repricing attributes of our loan portfolio, which significantly reduces our market interest rate risk. Due to the cooperative structure of the Farm Credit System and as we are a stockholder of AgriBank, we expect this borrowing relationship to continue into the foreseeable future. Our other source of lendable funds is from unallocated surplus.

We have entered into a Standby Commitment to Purchase Agreement with Farmer Mac, a System institution, to help manage credit risk. If a loan covered by the agreement goes into default, subject to certain conditions, we have the right to sell the loan to Farmer Mac. This agreement remains in place until the loan is paid in full. The guaranteed volume of loans subject to the purchase agreement was $15.0 million, $16.0 million, and $16.5 million at December 31, 2018, 2017, and 2016, respectively. We paid Farmer Mac commitment fees totaling $71 thousand, $74 thousand, and $76 thousand in 2018, 2017, and 2016, respectively. These amounts are included in "Other operating expenses" in the Consolidated Statements of Income. As of December 31, 2018, no loans have been sold to Farmer Mac under this agreement.

## CAPITAL ADEQUACY

Total members' equity was $152.3 million, $143.4 million, and $135.6 million at December 31, 2018, 2017, and 2016, respectively. Total members' equity increased $8.9 million from December 31, 2017, primarily due to net income for the year partially offset by patronage distribution accruals.

Effective January 1, 2017, the FCA Regulations require us to maintain minimums for our common equity tier 1, tier 1 capital, total capital, and permanent capital risk-based capital ratios. In addition, the FCA requires us to maintain minimums for our non-risk-adjusted ratios of tier 1 leverage and unallocated retained earnings and equivalents leverage.

**Regulatory Capital Requirements and Ratios**

| As of December 31 | **2018** | 2017 | Regulatory Minimums | Capital Conservation Buffer | Total |
|---|---|---|---|---|---|
| Risk-adjusted: | | | | | |
| Common equity tier 1 ratio | **20.1%** | 20.2% | 4.5% | 2.5%* | 7.0% |
| Tier 1 capital ratio | **20.1%** | 20.2% | 6.0% | 2.5%* | 8.5% |
| Total capital ratio | **20.1%** | 20.3% | 8.0% | 2.5%* | 10.5% |
| Permanent capital ratio | **20.1%** | 20.2% | 7.0% | N/A | 7.0% |
| Non-risk-adjusted: | | | | | |
| Tier 1 leverage ratio | **19.7%** | 19.6% | 4.0% | 1.0% | 5.0% |
| Unallocated retained earnings and equivalents leverage ratio | **19.7%** | 19.6% | 1.5% | N/A | 1.5% |

*The 2.5% capital conservation buffer over risk-adjusted ratio minimums is being phased in over three years under the FCA capital requirements. The phase in period ends on December 31, 2019.

Our capital plan is designed to maintain an adequate amount of surplus and allowance for loan losses which represents our reserve for adversity prior to impairment of stock. We manage our capital to allow us to meet member needs and protect member interests, both now and in the future.

Additional discussion of these regulatory ratios is included in Note 7 to the accompanying Consolidated Financial Statements.

Capital ratios are directly impacted by changes in capital, assets, and off-balance sheet commitments. Refer to the Loan Portfolio and the Investment Securities sections for further discussion of the changes in assets. Additional members' equity information is included in Note 7 to the accompanying Consolidated Financial Statements. Refer to Note 7 in our Annual Report for the year ended December 31, 2016, for a more complete description of the ratios effective as of December 31, 2016. We were in compliance with the minimum required capital ratios as of December 31, 2016.

If the capital ratios fall below the total requirements, including the buffer amounts, capital distributions (equity redemptions, dividends, and patronage) and discretionary senior executive bonuses are restricted or prohibited without prior FCA approval. We do not foresee any events that would result in this prohibition in 2019.

## RELATIONSHIP WITH AGRIBANK

### Borrowing

We borrow from AgriBank to fund our lending operations in accordance with the Farm Credit Act. Approval from AgriBank is required for us to borrow elsewhere. A General Financing Agreement (GFA), as discussed in Note 6 to the accompanying Consolidated Financial Statements, governs this lending relationship.

The components of cost of funds under the GFA include:

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

In the periods presented, we were not subject to the risk premium component. Certain factors may impact our cost of funds, which primarily include market interest rate changes impacting marginal cost of debt as well as changes to pricing methodologies impacting the spread components described above.

The marginal cost of debt approach simulates matching the cost of underlying debt with similar terms as the anticipated terms of our loans to borrowers. This approach substantially protects us from market interest rate risk. We may occasionally engage in funding strategies that result in limited interest rate risk with approval by AgriBank's Asset/Liability Committee.

### Investment

We are required to invest in AgriBank capital stock as a condition of borrowing. This investment may be in the form of purchased stock or stock representing distributed AgriBank surplus. As of December 31, 2018, we were required by AgriBank to maintain an investment equal to 2.25% of the average quarterly balance of our note payable, with an additional amount required on association growth in excess of a targeted growth rate, if the District is also growing above a targeted growth rate.

### Patronage

AgriBank's 2018 capital plan is intended to provide for adequate capital at AgriBank under capital regulations as well as to create a path to long-term capital optimization within the AgriBank District. The plan optimizes capital at AgriBank; distributing available AgriBank earnings in the form of patronage, either cash or stock. The plan is designed to maintain capital adequacy such that sufficient earnings will be retained in the form of unallocated retained earnings and allocated stock to meet the leverage ratio target and other regulatory or policy constraints prior to any cash patronage distributions.

We receive the following types of discretionary patronage from AgriBank:

- Wholesale patronage which includes:
    - Patronage on our note payable with AgriBank
    - Equalization patronage based on our excess stock in AgriBank

Beginning in 2017, wholesale patronage income earned may be paid in cash and AgriBank stock. Wholesale patronage income for 2018, 2017, and 2016 was paid in cash.

### Purchased Services

We purchase various services from AgriBank, including SunStream Business Services, a division of AgriBank. The services include certain financial and retail systems, financial reporting services, tax reporting services, technology services, and insurance services.

The total cost of services we purchased from AgriBank was $673 thousand, $526 thousand, and $486 thousand in 2018, 2017, and 2016, respectively.

### Impact on Members' Investment

Due to the nature of our financial relationship with AgriBank, the financial condition and results of operations of AgriBank materially impact our members' investment.

## OTHER RELATIONSHIPS AND PROGRAMS

### Relationships with Other Farm Credit Institutions

**Federal Agricultural Mortgage Corporation:** We have entered into a Standby Commitment to Purchase Agreement with Farmer Mac. This agreement allows us to sell loans identified under the agreement to Farmer Mac. Refer to the Funding and Liquidity section for further discussion of this agreement.

**CentRic Technology Collaboration:** We participate in CentRic Technology Collaboration (CTC) with certain other AgriBank District associations. The CTC facilitates the development and maintenance of certain retail technology systems essential to providing credit and other services to our members. The CTC operations are governed by representatives of each participating association. The expenses of CTC are allocated to each of the participating associations based on an agreed upon formula. The systems developed are owned by each of the participating associations.

**Farm Credit Foundations:** We have a relationship with Farm Credit Foundations (Foundations), a System service corporation, which involves purchasing human resource information systems, and benefit, payroll, and workforce management services. As of December 31, 2018, 2017, and 2016, our investment in Foundations was $11 thousand. The total cost of services we purchased from Foundations was $111 thousand, $89 thousand, and $76 thousand in 2018, 2017, and 2016, respectively.

### Programs

We are involved in a number of programs designed to improve our credit delivery, related services, and marketplace presence.

**Farm Cash Management:** We offer Farm Cash Management to our members. Farm Cash Management links members' revolving lines of credit with an AgriBank investment bond to optimize members' use of funds.

## REGULATORY MATTERS

### Investment Securities Eligibility

In May 2018, the FCA Board approved a final rule to revise the requirements governing the eligibility of investment securities for System banks and associations. The new regulation revises the eligibility purpose, type, and amount of investments that a System association may hold. The regulation was effective January 1, 2019. We have updated our policies, procedures, and other documentation to ensure compliance with the new regulation. The impact of the regulation has not been material to our financial statements.

# REPORT OF MANAGEMENT

*Farm Credit Southeast Missouri, ACA*

We prepare the Consolidated Financial Statements of Farm Credit Southeast Missouri, ACA (the Association) and are responsible for their integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The Consolidated Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States of America. The Consolidated Financial Statements, in our opinion, fairly present the financial condition of the Association. Other financial information included in the Annual Report is consistent with that in the Consolidated Financial Statements.

To meet our responsibility for reliable financial information, we depend on accounting and internal control systems designed to provide reasonable, but not absolute assurance that assets are safeguarded and transactions are properly authorized and recorded. Costs must be reasonable in relation to the benefits derived when designing accounting and internal control systems. Financial operations audits are performed to monitor compliance. PricewaterhouseCoopers LLP, our independent auditors, audit the Consolidated Financial Statements. They also consider internal controls to the extent necessary to design audit procedures that comply with auditing standards generally accepted in the United States of America. The Farm Credit Administration also performs examinations for safety and soundness as well as compliance with applicable laws and regulations.

The Board of Directors has overall responsibility for our system of internal control and financial reporting. The Board of Directors and its Audit Committee consults regularly with us and meets periodically with the independent auditors and other auditors to review the scope and results of their work. The independent auditors have direct access to the Board of Directors, which is composed solely of directors who are not officers or employees of the Association.

The undersigned certify we have reviewed the Association's Annual Report, which has been prepared in accordance with all applicable statutory or regulatory requirements. The information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Markel D. Yarbro
Chairperson of the Board
Farm Credit Southeast Missouri, ACA

Robert E. Smith
President / Chief Executive Officer
Farm Credit Southeast Missouri, ACA

Vernon D. Griffith
Executive Vice President / Chief Financial Officer
Farm Credit Southeast Missouri, ACA

March 8, 2019

# REPORT OF AUDIT COMMITTEE

*Farm Credit Southeast Missouri, ACA*

The Consolidated Financial Statements were prepared under the oversight of the Audit Committee. The Audit Committee is composed of a subset of the Board of Directors of Farm Credit Southeast Missouri, ACA (the Association). The Audit Committee oversees the scope of the Association's internal audit program, the approval, and independence of PricewaterhouseCoopers LLP (PwC) as independent auditors, the adequacy of the Association's system of internal controls and procedures, and the adequacy of management's actions with respect to recommendations arising from those auditing activities. The Audit Committee's responsibilities are described more fully in the Internal Control Policy and the Audit Committee Charter.

Management is responsible for internal controls and the preparation of the Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States of America. PwC is responsible for performing an independent audit of the Consolidated Financial Statements in accordance with auditing standards generally accepted in the United States of America and to issue their report based on their audit. The Audit Committee's responsibilities include monitoring and overseeing these processes.

In this context, the Audit Committee reviewed and discussed the audited Consolidated Financial Statements for the year ended December 31, 2018, with management. The Audit Committee also reviewed with PwC the matters required to be discussed by Statement on Auditing Standards AU-C 260, *The Auditor's Communication with Those Charged with Governance*, and both PwC and the internal auditors directly provided reports on any significant matters to the Audit Committee.

The Audit Committee had discussions with and received written disclosures from PwC confirming its independence. The Audit Committee also reviewed the non-audit services provided by PwC, if any, and concluded these services were not incompatible with maintaining PwC's independence. The Audit Committee discussed with management and PwC any other matters and received any assurances from them as the Audit Committee deemed appropriate.

Based on the foregoing review and discussions, and relying thereon, the Audit Committee recommended that the Board of Directors include the audited Consolidated Financial Statements in the Annual Report for the year ended December 31, 2018.

Phillip M. Showmaker
Chairperson of the Audit Committee
Farm Credit Southeast Missouri, ACA

**Audit Committee Members:**
Jennifer Hendrickson
Ed C. Marshall III
Markel D. Yarbro

March 8, 2019

**Report of Independent Auditors**

To the Board of Directors of Farm Credit Southeast Missouri, ACA,

We have audited the accompanying Consolidated Financial Statements of Farm Credit Southeast Missouri, ACA and its subsidiaries (the Association), which comprise the consolidated statements of condition as of December 31, 2018, 2017, and 2016, and the related consolidated statements of 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 Farm Credit Southeast Missouri, ACA and its subsidiaries as of December 31, 2018, 2017, and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

March 8, 2019

*PricewaterhouseCoopers LLP, 45 South Seventh Street, Suite 3400, Minneapolis, MN 55402*
*T: (612) 596 6000, www.pwc.com/us*

# CONSOLIDATED STATEMENTS OF CONDITION

*Farm Credit Southeast Missouri, ACA*

*(in thousands)*

| As of December 31 | **2018** | 2017 | 2016 |
|---|---|---|---|
| **ASSETS** | | | |
| Loans | **$ 670,743** | $ 629,942 | $ 614,216 |
| Allowance for loan losses | **526** | 534 | 482 |
| Net loans | **670,217** | 629,408 | 613,734 |
| Investment in AgriBank, FCB | **13,106** | 12,865 | 11,709 |
| Investment securities | **801** | 1,509 | 2,483 |
| Accrued interest receivable | **14,438** | 11,142 | 10,083 |
| Deferred tax assets, net | **54** | 100 | 233 |
| Other assets | **6,857** | 5,424 | 4,451 |
| Total assets | **$ 705,473** | $ 660,448 | $ 642,693 |
| **LIABILITIES** | | | |
| Note payable to AgriBank, FCB | **$ 540,118** | $ 504,826 | $ 496,650 |
| Accrued interest payable | **3,957** | 2,890 | 2,289 |
| Patronage distribution payable | **7,100** | 7,000 | 5,500 |
| Other liabilities | **2,014** | 2,305 | 2,673 |
| Total liabilities | **553,189** | 517,021 | 507,112 |
| Contingencies and commitments (Note 11) | | | |
| **MEMBERS' EQUITY** | | | |
| Capital stock and participation certificates | **1,733** | 1,713 | 1,715 |
| Unallocated surplus | **150,551** | 141,714 | 133,866 |
| Total members' equity | **152,284** | 143,427 | 135,581 |
| Total liabilities and members' equity | **$ 705,473** | $ 660,448 | $ 642,693 |

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

# CONSOLIDATED STATEMENTS OF INCOME

*Farm Credit Southeast Missouri, ACA*

*(in thousands)*

| For the year ended December 31 | **2018** | 2017 | 2016 |
|---|---|---|---|
| **Interest income** | **$ 34,226** | $ 30,618 | $ 27,319 |
| **Interest expense** | **13,482** | 10,563 | 8,736 |
| Net interest income | **20,744** | 20,055 | 18,583 |
| **Provision for credit losses** | **10** | 434 | 24 |
| Net interest income after provision for credit losses | **20,734** | 19,621 | 18,559 |
| **Other income** | | | |
| Patronage income | **2,856** | 2,719 | 2,105 |
| Financially related services income | **1,142** | 1,115 | 1,131 |
| Fee (expense) income, net | **(62)** | (67) | (78) |
| Allocated Insurance Reserve Accounts distribution | **352** | -- | -- |
| Miscellaneous income, net | **124** | 52 | 82 |
| Total other income | **4,412** | 3,819 | 3,240 |
| **Operating expenses** | | | |
| Salaries and employee benefits | **5,571** | 5,284 | 5,227 |
| Other operating expenses | **3,596** | 3,173 | 3,066 |
| Total operating expenses | **9,167** | 8,457 | 8,293 |
| Income before income taxes | **15,979** | 14,983 | 13,506 |
| **Provision for income taxes** | **45** | 134 | 66 |
| Net income | **$ 15,934** | $ 14,849 | $ 13,440 |

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

# CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

*Farm Credit Southeast Missouri, ACA*

*(in thousands)*

| | Capital Stock and Participation Certificates | Unallocated Surplus | Total Members' Equity |
|---|---|---|---|
| Balance as of December 31, 2015 | $ 1,742 | $ 125,926 | $ 127,668 |
| Net income | -- | 13,440 | 13,440 |
| Unallocated surplus designated for patronage distributions | -- | (5,500) | (5,500) |
| Capital stock and participation certificates issued | 99 | -- | 99 |
| Capital stock and participation certificates retired | (126) | -- | (126) |
| Balance as of December 31, 2016 | 1,715 | 133,866 | 135,581 |
| Net income | -- | 14,849 | 14,849 |
| Unallocated surplus designated for patronage distributions | -- | (7,001) | (7,001) |
| Capital stock and participation certificates issued | 105 | -- | 105 |
| Capital stock and participation certificates retired | (107) | -- | (107) |
| Balance as of December 31, 2017 | 1,713 | 141,714 | 143,427 |
| Net income | **--** | **15,934** | **15,934** |
| Unallocated surplus designated for patronage distributions | **--** | **(7,097)** | **(7,097)** |
| Capital stock and participation certificates issued | **121** | **--** | **121** |
| Capital stock and participation certificates retired | **(101)** | **--** | **(101)** |
| **Balance as of December 31, 2018** | **$ 1,733** | **$ 150,551** | **$ 152,284** |

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

# CONSOLIDATED STATEMENTS OF CASH FLOWS

*Farm Credit Southeast Missouri, ACA*

*(in thousands)*

| For the year ended December 31 | 2018 | 2017 | 2016 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Net income | **$ 15,934** | $ 14,849 | $ 13,440 |
| Depreciation on premises and equipment | **171** | 148 | 165 |
| Loss (gain) on sale of premises and equipment, net | **1** | 6 | (41) |
| Amortization of premiums on loans | **1,193** | 1,514 | 1,071 |
| Provision for credit losses | **10** | 434 | 24 |
| Changes in operating assets and liabilities: | | | |
| Increase in accrued interest receivable | **(3,328)** | (1,135) | (770) |
| Increase in other assets | **(840)** | (837) | (765) |
| Increase in accrued interest payable | **1,067** | 601 | 494 |
| Decrease in other liabilities | **(291)** | (368) | (2,309) |
| Net cash provided by operating activities | **13,917** | 15,212 | 11,309 |
| **Cash flows from investing activities** | | | |
| Increase in loans, net | **(41,924)** | (17,495) | (33,140) |
| Purchases of investment in AgriBank, FCB, net | **(242)** | (1,156) | (618) |
| Decrease in investment securities, net | **708** | 974 | 843 |
| (Purchases) sales of premises and equipment, net | **(718)** | (157) | 14 |
| Net cash used in investing activities | **(42,176)** | (17,834) | (32,901) |
| **Cash flows from financing activities** | | | |
| Increase in note payable to AgriBank, FCB, net | **35,292** | 8,176 | 26,886 |
| Patronage distributions paid | **(6,997)** | (5,501) | (5,250) |
| Capital stock and participation certificates retired, net | **(36)** | (53) | (44) |
| Net cash provided by financing activities | **28,259** | 2,622 | 21,592 |
| Net change in cash | **--** | -- | -- |
| Cash at beginning of year | **--** | -- | -- |
| Cash at end of year | **$ --** | $ -- | $ -- |
| **Supplemental schedule of non-cash activities** | | | |
| Stock financed by loan activities | **$ 88** | $ 81 | $ 67 |
| Stock applied against loan principal | **32** | 30 | 50 |
| Interest transferred to loans | **32** | 76 | 13 |
| Patronage distributions payable to members | **7,100** | 7,000 | 5,500 |
| **Supplemental information** | | | |
| Interest paid | **$ 12,415** | $ 9,962 | $ 8,242 |
| Taxes paid, net | **2** | 5 | 5 |

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

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*Farm Credit Southeast Missouri, ACA*

## NOTE 1: ORGANIZATION AND OPERATIONS

### Farm Credit System and District

The Farm Credit System (System) is a nationwide system of cooperatively owned banks and associations established by Congress to meet the credit needs of American agriculture. As of January 1, 2019, the System consisted of three Farm Credit Banks, one Agricultural Credit Bank, and 69 customer-owned cooperative lending institutions (associations). AgriBank, FCB (AgriBank), a System Farm Credit Bank, and its District associations are collectively referred to as the AgriBank Farm Credit District (AgriBank District or the District). At January 1, 2019, the District consisted of 14 Agricultural Credit Associations (ACA) that each have wholly-owned Federal Land Credit Association (FLCA) and Production Credit Association (PCA) subsidiaries.

FLCAs are authorized to originate long-term real estate mortgage loans. PCAs are authorized to originate short-term and intermediate-term loans. ACAs are authorized to originate long-term real estate mortgage loans and short-term and intermediate-term loans either directly or through their subsidiaries. Associations are authorized to provide lease financing options for agricultural purposes and are also authorized to purchase and hold certain types of investments. AgriBank provides funding to all associations chartered within the District.

Associations are authorized to provide, either directly or in participation with other lenders, credit and related services to eligible borrowers. Eligible borrowers may include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related service businesses. In addition, associations can participate with other lenders in loans to similar entities. Similar entities are parties that are not eligible for a loan from a System lending institution, but have operations that are functionally similar to the activities of eligible borrowers.

The Farm Credit Administration (FCA) is authorized by Congress to regulate the System banks and associations. We are examined by the FCA and certain association actions are subject to the prior approval of the FCA and/or AgriBank.

The Farm Credit Act established the Farm Credit System Insurance Corporation (FCSIC) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is used to ensure the timely payment of principal and interest on Farm Credit Systemwide debt obligations, to ensure the retirement of protected borrower capital at par or stated value, and for other specified purposes.

At the discretion of the FCSIC, the Insurance Fund is also available to provide assistance to certain troubled System institutions and for the operating expenses of the FCSIC. Each System bank is required to pay premiums into the Insurance Fund until the assets in the Insurance Fund equal 2.0% of the aggregated insured obligations adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments. This percentage of aggregate obligations can be changed by the FCSIC, at its sole discretion, to a percentage it determines to be actuarially sound. The basis for assessing premiums is debt outstanding with adjustments made for nonaccrual loans and impaired investment securities which are assessed a surcharge while guaranteed loans and investment securities are deductions from the premium base. AgriBank, in turn, assesses premiums to District associations each year based on similar factors.

### Association

Farm Credit Southeast Missouri, ACA (the Association) and its subsidiaries, Farm Credit Southeast Missouri, FLCA and Farm Credit Southeast Missouri, PCA (subsidiaries) are lending institutions of the System. We are a customer-owned cooperative providing credit and credit-related services to, or for the benefit of, eligible members for qualified agricultural purposes in the counties of Bolinger, Butler, Cape Girardeau, Carter, Dunklin, Mississippi, New Madrid, Pemiscot, Ripley, Scott, Stoddard, and Wayne in the state of Missouri.

We borrow from AgriBank and provide financing and related services to our members. Our ACA holds all the stock of the FLCA and PCA subsidiaries.

We offer credit life, term life, crop hail, and multi-peril crop insurance to borrowers and those eligible to borrow.

## NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Accounting Principles and Reporting Policies

Our accounting and reporting policies conform to accounting principles generally accepted in the United States of America (GAAP) and the prevailing practices within the financial services industry. Preparing financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

### Principles of Consolidation

The Consolidated Financial Statements present the consolidated financial results of Farm Credit Southeast Missouri, ACA and its subsidiaries. All material intercompany transactions and balances have been eliminated in consolidation.

## Significant Accounting Policies

**Loans:** Loans are carried at their principal amount outstanding net of any unearned income, cumulative charge-offs, unamortized deferred fees and costs on originated loans, and unamortized premiums or discounts on purchased loans**.** Loan interest is accrued and credited to interest income based upon the daily principal amount outstanding. Origination fees, net of related costs, are deferred and recognized over the life of the loan as an adjustment to net interest income. The net amount of loan fees and related origination costs are not material to the Consolidated Financial Statements taken as a whole.

Generally we place loans in nonaccrual status when principal or interest is delinquent for 90 days or more (unless the loan is well secured and in the process of collection) or circumstances indicate that full collection is not expected.

When a loan is placed in nonaccrual status, we reverse current year accrued interest to the extent principal plus accrued interest before the transfer exceeds the net realizable value of the collateral. Any unpaid interest accrued in a prior year is capitalized to the recorded investment of the loan, unless the net realizable value is less than the recorded investment in the loan, then it is charged-off against the allowance for loan losses. Any cash received on nonaccrual loans is applied to reduce the recorded investment in the loan, except in those cases where the collection of the recorded investment is fully expected and the loan does not have any unrecovered prior charge-offs. In these circumstances interest is credited to income when cash is received. Loans are charged-off at the time they are determined to be uncollectible. 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, the borrower has demonstrated payment performance, and the loan is not classified as doubtful or loss.

In situations where, for economic or legal reasons related to the borrower's financial difficulties, we grant a concession for other than an insignificant period of time to the borrower that we would not otherwise consider, the related loan is classified as a troubled debt restructuring, also known as a formally restructured loan for regulatory purposes. A concession is generally granted in order to minimize economic loss and avoid foreclosure. Concessions vary by program and borrower and may include interest rate reductions, term extensions, payment deferrals, or an acceptance of additional collateral in lieu of payments. In limited circumstances, principal may be forgiven. Loans classified as troubled debt restructurings are considered risk loans (as defined below).

Loans that are sold as participations are transferred as entire financial assets, groups of entire financial assets, or participating interests in the loans. The transfers of such assets or participating interests are structured such that control over the transferred assets, or participating interests have been surrendered and that all of the conditions have been met to be accounted for as a sale.

Evidence of credit quality deterioration as of the purchase date may include statistics such as past due and nonaccrual status. Acquired loans that meet our definition of risk loans are generally considered to be credit-impaired and are accounted for as individual loans. Accounting for PCI loans involves estimating fair value at acquisition using the cash flows expected to be collected. As we generally are unable to estimate the timing and amount of future cash flows, measurement is based on the net realizable value of the collateral underlying these loans.

**Allowance for Loan Losses:** The allowance for loan losses is our best estimate of the amount of losses on loans inherent in our portfolio as of the date of the financial statements. We determine the appropriate level of allowance for loan losses based on periodic evaluation of factors such as loan loss history, estimated probability of default, estimated loss severity, portfolio quality, and current economic and environmental conditions.

Loans in our portfolio that are considered impaired are analyzed individually to establish a specific allowance. A loan is impaired when it is probable that all amounts due will not be collected according to the contractual terms of the loan agreement. We generally measure impairment based on the net realizable value of the collateral. Risk loans include nonaccrual loans, accruing restructured loans, and accruing loans 90 days or more past due. All risk loans are considered to be impaired loans.

We record a specific allowance to reduce the carrying amount of the risk loan by the amount the recorded investment exceeds the net realizable value of collateral. When we deem a loan to be uncollectible, we charge the loan principal and prior year(s) accrued interest against the allowance for loan losses. Subsequent recoveries, if any, are added to the allowance for loan losses.

An allowance is recorded for probable and estimable credit losses as of the financial statement date for loans that are not individually assessed as impaired. We use a two-dimensional loan risk rating model that incorporates a 14-point rating scale to identify and track the probability of borrower default and a separate 6-point scale addressing the loss severity. The combination of estimated default probability and loss severity is the primary basis for recognition and measurement of loan collectability of these pools of loans. These estimated losses may be adjusted for relevant current environmental factors.

Changes in the allowance for loan losses consist of provision activity, recorded in "Provision for credit losses" in the Consolidated Statements of Income, recoveries, and charge-offs.

**Investment in AgriBank:** Our stock investment in AgriBank is on a cost plus allocated equities basis.

**Investment Securities:** We are authorized to purchase and hold certain types of investments. If we have the positive intent and ability to hold these investments to maturity, they have been classified as held-to-maturity and are carried at cost adjusted for the amortization of premiums and accretion of discounts. If an investment is determined to be other-than-temporarily impaired, the carrying value of the security is written down to fair value. The impairment loss is separated into credit related and non-credit related components. The credit related component is expensed through "Miscellaneous income, net" in the Consolidated Statements of Income in the period of impairment. The non-credit related component is recognized in other comprehensive income. Purchased premiums and discounts are amortized or accreted using the straight-line method, which approximates the interest method, over the terms of the respective securities. Realized gains and losses are determined using specific identification method and are recognized in current operations.

**Premises and Equipment:** The carrying amount of premises and equipment is at cost, less accumulated depreciation and is included in "Other assets" in the Consolidated Statements of Condition. Calculation of depreciation is generally on the straight-line method over the estimated useful lives of the assets. Gains or losses on disposition are included in "Miscellaneous income, net" in the Consolidated Statements of Income. Depreciation and maintenance and repair expenses are included in "Other operating expenses" in the Consolidated Statements of Income and improvements are capitalized.

**Post-Employment Benefit Plans:** The District has various post-employment benefit plans in which our employees participate. Expenses related to these plans are included in “Salaries and employee benefits” in the Consolidated Statements of Income.

Certain employees participate in the AgriBank District Retirement Plan. The plan is comprised of two benefit formulas. At their option, employees hired prior to October 1, 2001, are on the cash balance formula or on the final average pay formula. Benefits eligible employees hired between October 1, 2001, and December 31, 2006, are on the cash balance formula. Effective January 1, 2007, the AgriBank District Retirement Plan was closed to new employees. The AgriBank District Retirement Plan utilizes the "Projected Unit Credit" actuarial method for financial reporting and funding purposes.

We also provide certain health insurance benefits to eligible retired employees according to the terms of those benefit plans. The anticipated cost of these benefits is accrued during the employees’ active service period.

The defined contribution plan allows eligible employees to save for their retirement either pre-tax, post-tax, or both, with an employer match on a percentage of the employee’s contributions. We provide benefits under this plan for those employees that do not participate in the AgriBank District Retirement Plan in the form of a fixed percentage of salary contribution in addition to the employer match. Employer contributions are expensed when incurred.

**Income Taxes:** The ACA and PCA accrue federal and state income taxes. Deferred tax assets and liabilities are recognized for future tax consequences of temporary differences between the carrying amounts and tax basis of assets and liabilities. Deferred tax assets are recorded if the deferred tax asset is more likely than not to be realized. If the realization test cannot be met, the deferred tax asset is reduced by a valuation allowance. The expected future tax consequences of uncertain income tax positions are accrued.

The FLCA is exempt from federal and other taxes to the extent provided in the Farm Credit Act.

**Patronage Program:** We accrue patronage distributions according to a prescribed formula approved by the Board of Directors. Generally, we pay the accrued patronage during the first quarter after year end.

**Off-Balance Sheet Credit Exposures:** Commitments to extend credit are agreements to lend to customers, generally having fixed expiration dates or other termination clauses. Any reserve for unfunded lending commitments is based on management’s best estimate of losses inherent in these instruments, but the commitments have not yet disbursed. Factors such as likelihood of disbursal and likelihood of losses given disbursement are utilized in determining a reserve, if needed. Based on our assessment, any reserve is recorded in “Other liabilities” in the Consolidated Statements of Condition and a corresponding loss is recorded in “Provision for credit losses” in the Consolidated Statements of Income.

**Cash:** For purposes of reporting cash flow, cash includes cash on hand.

**Fair Value Measurement:** The accounting guidance describes three levels of inputs that may be used to measure fair value.

Level 1 — Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 — Observable inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly or indirectly. Level 2 inputs include:

- Quoted prices for similar assets or liabilities in active markets
- Quoted prices for identical or similar assets or liabilities in markets that are not active so that they are traded less frequently than exchange-traded instruments, quoted prices that are not current, or principal market information that is not released publicly
- Inputs that are observable such as interest rates and yield curves, prepayment speeds, credit risks, and default rates
- Inputs derived principally from or corroborated by observable market data by correlation or other means

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. These unobservable inputs reflect the reporting entity’s own judgments about assumptions that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

**Recently Issued or Adopted Accounting Pronouncements**

We have assessed the potential impact of accounting standards that have been issued by the Financial Accounting Standards Board (FASB) and have determined the following standards to be applicable to our business. While we are a nonpublic entity, our financial results are closely related to the performance of the combined Farm Credit System. Therefore, we typically adopt accounting pronouncements on the public business entities effective date or aligned with other System institutions, whichever is earlier.

| Standard and effective date | Description | Adoption status and financial statement impact |
|---|---|---|
| In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09 "Revenue from Contracts with Customers." This guidance was effective for public business entities on January 1, 2018. | The guidance governs revenue recognition from contracts with customers and requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Financial instruments and other contractual rights within the scope of other guidance issued by the FASB are excluded from the scope of this guidance. The guidance sets forth the requirement for new and enhanced disclosures. | We adopted this guidance on January 1, 2018, using the modified retrospective approach, as the majority of our revenues are not subject to the new guidance. The adoption of the guidance did not have a material impact on the financial condition, results of operations, or cash flows. |
| In March 2017, the FASB issued ASU 2017-07 "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Cost." This guidance was effective for public business entities on January 1, 2018. | This guidance requires that an employer disaggregate the service cost component from the other components of net benefit cost. Specifically, the guidance requires non-service cost components of net benefit cost to be recognized in a non-operating income line item of the income statement and allow only the service cost component of net benefit cost to be eligible for capitalization. | The adoption of the guidance did not impact the Association's financial condition, results of operations, cash flows, or financial statement disclosures. |
| In January 2016, the FASB issued ASU 2016-01 "Recognition and Measurement of Financial Assets and Financial Liabilities." This guidance was effective for public business entities on January 1, 2018. | The guidance is intended to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. The amendments address certain aspects of recognition, measurement, presentation, and disclosure of financial statements. | We adopted this guidance on January 1, 2018. The adoption of this guidance did not impact our financial condition, results of operations, or cash flows, but did impact our fair value disclosures. |
| In February 2016, the FASB issued ASU 2016-02 "Leases." In July 2018, the FASB issued ASU 2018-11 "Leases (Topic 842): Targeted Improvements." The guidance is effective for public business entities in its first quarter of 2019 and early adoption is permitted. | The guidance modifies the recognition and accounting for lessees and lessors and requires expanded disclosures regarding assumptions used to recognize revenue and expenses related to leases. When this guidance is adopted, a liability for lease obligations and a corresponding right-of-use asset will be recognized on the Consolidated Statements of Condition for all lease arrangements spanning more than 12 months. The guidance includes an optional transition method where an entity is permitted to apply the guidance as of the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings. | We adopted this guidance on January 1, 2019. The adoption of this guidance did not have a material impact on our financial condition, results of operations, and financial statement disclosures, and had no impact on cash flows. |
| In August 2018, the FASB issued ASU 2018-15 "Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract." The guidance is effective for our first quarter of 2020 and early adoption is permitted. | The guidance clarifies that implementation costs incurred in a hosting arrangement that is a service contract should be accounted for in the same manner as implementation costs incurred to develop or obtain internal-use software. | We are in the process of reviewing the accounting standard. Based on our preliminary review and analysis, this new guidance is not expected to have a material impact on our financial condition, results of operations, cash flows, and financial statement disclosures. |
| In June 2016, the FASB issued ASU 2016-13 "Financial Instruments – Credit Losses." This guidance is effective for public business entities for non-U.S. Securities Exchange Commission filers for the first quarter of 2021 and early adoption is permitted. | The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses. | We have no plans to early adopt this guidance. We are in the process of reviewing the standard. Significant implementation matters yet to be addressed include system selection, drafting of accounting policies and disclosures, and designing processes and controls. We are currently unable to estimate the impact on the financial statements. |

## NOTE 3: LOANS AND ALLOWANCE FOR LOAN LOSSES

**Loans by Type**

| (dollars in thousands) | **2018** | | | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|---|---|---|
| As of December 31 | | Amount | % | | Amount | % | | Amount | % |
| Real estate mortgage | **$** | **376,639** | **56.1%** | $ | 353,371 | 56.1% | $ | 333,770 | 54.3% |
| Production and intermediate-term | | **239,875** | **35.8%** | | 218,676 | 34.7% | | 225,894 | 36.8% |
| Agribusiness | | **7,136** | **1.1%** | | 7,444 | 1.2% | | 4,935 | 0.8% |
| Other | | **47,093** | **7.0%** | | 50,451 | 8.0% | | 49,617 | 8.1% |
| Total | **$** | **670,743** | **100.0%** | $ | 629,942 | 100.0% | $ | 614,216 | 100.0% |

The other category is comprised of certain assets originated under our mission related investment authority as well as rural residential real estate loans.

### Portfolio Concentrations

Concentrations exist when there are amounts loaned to multiple borrowers engaged in similar activities, which could cause them to be similarly impacted by economic conditions. We lend primarily within agricultural industries.

As of December 31, 2018, volume plus commitments to our ten largest borrowers totaled an amount equal to 10.9% of total loans and commitments.

Total loans plus any unfunded commitments represent a proportionate maximum potential credit risk. However, substantial portions of our lending activities are collateralized. Accordingly, the credit risk associated with lending activities is less than the recorded loan principal. 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. Long-term real estate loans are secured by the first liens on the underlying real property.

### Credit Quality and Delinquency

We utilize the FCA Uniform Classification System to categorize loans into five credit quality categories. The categories are:

- Acceptable – loans are non-criticized loans representing the highest quality. They are expected to be fully collectible. This category is further differentiated into various probabilities of default.
- Other assets especially mentioned (Special Mention) – loans are currently collectible but exhibit some potential weakness. These loans involve increased credit risk, but not to the point of justifying a substandard classification.
- Substandard – loans exhibit some serious weakness in repayment capacity, equity, and/or collateral pledged on the loan.
- Doubtful – loans exhibit similar weaknesses as substandard loans. Doubtful loans have additional weaknesses in existing factors, conditions, and values that make collection in full highly questionable.
- Loss – loans are considered uncollectible.

We had no loans categorized as loss at December 31, 2018, 2017, or 2016.

**Credit Quality of Loans**

| (dollars in thousands) | Acceptable | | | Special Mention | | | Substandard/ Doubtful | | | Total | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **As of December 31, 2018** | | Amount | % | | Amount | % | | Amount | % | | Amount | % |
| Real estate mortgage | **$** | **363,500** | **94.6%** | **$** | **18,252** | **4.7%** | **$** | **2,536** | **0.7%** | **$** | **384,288** | **100.0%** |
| Production and intermediate-term | | **232,390** | **94.4%** | | **11,851** | **4.8%** | | **2,030** | **0.8%** | | **246,271** | **100.0%** |
| Agribusiness | | **4,405** | **61.1%** | | **2,801** | **38.9%** | | **--** | **0.0%** | | **7,206** | **100.0%** |
| Other | | **47,106** | **99.4%** | | **199** | **0.4%** | | **105** | **0.2%** | | **47,410** | **100.0%** |
| Total | **$** | **647,401** | **94.5%** | **$** | **33,103** | **4.8%** | **$** | **4,671** | **0.7%** | **$** | **685,175** | **100.0%** |

| | Acceptable | | | Special Mention | | | Substandard/ Doubtful | | | Total | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| As of December 31, 2017 | | Amount | % | | Amount | % | | Amount | % | | Amount | % |
| Real estate mortgage | $ | 338,086 | 94.1% | $ | 16,995 | 4.7% | $ | 4,349 | 1.2% | $ | 359,430 | 100.0% |
| Production and intermediate-term | | 209,791 | 93.9% | | 11,402 | 5.1% | | 2,132 | 1.0% | | 223,325 | 100.0% |
| Agribusiness | | 5,894 | 78.4% | | 1,626 | 21.6% | | -- | 0.0% | | 7,520 | 100.0% |
| Other | | 50,656 | 99.7% | | 31 | 0.1% | | 111 | 0.2% | | 50,798 | 100.0% |
| Total | $ | 604,427 | 94.3% | $ | 30,054 | 4.7% | $ | 6,592 | 1.0% | $ | 641,073 | 100.0% |

| As of December 31, 2016 | Acceptable Amount | % | Special Mention Amount | % | Substandard/ Doubtful Amount | % | Total Amount | % |
|---|---|---|---|---|---|---|---|---|
| Real estate mortgage | $ 326,823 | 96.5% | $ 7,239 | 2.1% | $ 4,869 | 1.4% | $ 338,931 | 100.0% |
| Production and intermediate-term | 217,313 | 94.2% | 11,473 | 5.0% | 1,743 | 0.8% | 230,529 | 100.0% |
| Agribusiness | 4,297 | 85.7% | 716 | 14.3% | -- | 0.0% | 5,013 | 100.0% |
| Other | 49,811 | 100.0% | -- | 0.0% | -- | 0.0% | 49,811 | 100.0% |
| Total | $ 598,244 | 95.8% | $ 19,428 | 3.1% | $ 6,612 | 1.1% | $ 624,284 | 100.0% |

Note: Accruing loans include accrued interest receivable.

**Aging Analysis of Loans**

| (in thousands) **As of December 31, 2018** | 30-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or Less Than 30 Days Past Due | Total | Accruing Loans 90 Days or More Past Due |
|---|---|---|---|---|---|---|
| Real estate mortgage | **$ 499** | **$ 12** | **$ 511** | **$ 383,777** | **$ 384,288** | **$ --** |
| Production and intermediate-term | **128** | **--** | **128** | **246,143** | **246,271** | **--** |
| Agribusiness | **--** | **--** | **--** | **7,206** | **7,206** | **--** |
| Other | **2,097** | **1,358** | **3,455** | **43,955** | **47,410** | **1,358** |
| Total | **$ 2,724** | **$ 1,370** | **$ 4,094** | **$ 681,081** | **$ 685,175** | **$ 1,358** |

| As of December 31, 2017 | 30-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or Less Than 30 Days Past Due | Total | Accruing Loans 90 Days or More Past Due |
|---|---|---|---|---|---|---|
| Real estate mortgage | $ 183 | $ 499 | $ 682 | $ 358,748 | $ 359,430 | $ -- |
| Production and intermediate-term | 59 | 396 | 455 | 222,870 | 223,325 | -- |
| Agribusiness | -- | -- | -- | 7,520 | 7,520 | -- |
| Other | 2,988 | 1,369 | 4,357 | 46,441 | 50,798 | 1,368 |
| Total | $ 3,230 | $ 2,264 | $ 5,494 | $ 635,579 | $ 641,073 | $ 1,368 |

| As of December 31, 2016 | 30-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or Less Than 30 Days Past Due | Total | Accruing Loans 90 Days or More Past Due |
|---|---|---|---|---|---|---|
| Real estate mortgage | $ 922 | $ 268 | $ 1,190 | $ 337,741 | $ 338,931 | $ 143 |
| Production and intermediate-term | 790 | -- | 790 | 229,739 | 230,529 | -- |
| Agribusiness | -- | -- | -- | 5,013 | 5,013 | -- |
| Other | 5,407 | -- | 5,407 | 44,404 | 49,811 | -- |
| Total | $ 7,119 | $ 268 | $ 7,387 | $ 616,897 | $ 624,284 | $ 143 |

Note: Accruing loans include accrued interest receivable.

## Risk Loans

Risk loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms. Interest income recognized and cash payments received on nonaccrual risk loans are applied as described in Note 2.

**Risk Loan Information**

(in thousands)

| As of December 31 | 2018 | 2017 | 2016 |
|---|---|---|---|
| Nonaccrual loans: | | | |
| Current as to principal and interest | **$ 374** | $ 2,078 | $ 2,855 |
| Past due | **12** | 910 | 125 |
| Total nonaccrual loans | **386** | 2,988 | 2,980 |
| Accruing restructured loans | **415** | 482 | -- |
| Accruing loans 90 days or more past due | **1,358** | 1,368 | 143 |
| Total risk loans | **$ 2,159** | $ 4,838 | $ 3,123 |
| Volume with specific allowance | **$ --** | $ 391 | $ 473 |
| Volume without specific allowance | **2,159** | 4,447 | 2,650 |
| Total risk loans | **$ 2,159** | $ 4,838 | $ 3,123 |
| Total specific allowance | **$ --** | $ 42 | $ 35 |
| For the year ended December 31 | **2018** | 2017 | 2016 |
| Income on accrual risk loans | **$ 186** | $ 60 | $ 8 |
| Income on nonaccrual loans | **307** | 123 | 30 |
| Total income on risk loans | **$ 493** | $ 183 | $ 38 |
| Average risk loans | **$ 4,060** | $ 4,912 | $ 2,040 |

Note: Accruing loans include accrued interest receivable.

**Nonaccrual Loans by Loan Type**

(in thousands)

| As of December 31 | 2018 | 2017 | 2016 |
|---|---|---|---|
| Real estate mortgage | **$ 372** | $ 2,173 | $ 2,369 |
| Production and intermediate-term | **14** | 815 | 611 |
| Total | **$ 386** | $ 2,988 | $ 2,980 |

**Additional Impaired Loan Information by Loan Type**

| (in thousands) | As of December 31, 2018 Recorded Investment | Unpaid Principal Balance | Related Allowance | For the year ended December 31, 2018 Average Impaired Loans | Interest Income Recognized |
|---|---|---|---|---|---|
| Impaired loans with a related allowance for loan losses: | | | | | |
| Real estate mortgage | $ -- | $ -- | $ -- | $ -- | $ -- |
| Production and intermediate-term | -- | -- | -- | -- | -- |
| Agribusiness | -- | -- | -- | -- | -- |
| Other | -- | -- | -- | -- | -- |
| Total | $ -- | $ -- | $ -- | $ -- | $ -- |
| Impaired loans with no related allowance for loan losses: | | | | | |
| Real estate mortgage | $ 787 | $ 896 | $ -- | $ 1,277 | $ 224 |
| Production and intermediate-term | 14 | 911 | -- | 140 | 103 |
| Agribusiness | -- | -- | -- | -- | -- |
| Other | 1,358 | 1,314 | -- | 2,643 | 166 |
| Total | $ 2,159 | $ 3,121 | $ -- | $ 4,060 | $ 493 |
| Total impaired loans: | | | | | |
| Real estate mortgage | $ 787 | $ 896 | $ -- | $ 1,277 | $ 224 |
| Production and intermediate-term | 14 | 911 | -- | 140 | 103 |
| Agribusiness | -- | -- | -- | -- | -- |
| Other | 1,358 | 1,314 | -- | 2,643 | 166 |
| Total | $ 2,159 | $ 3,121 | $ -- | $ 4,060 | $ 493 |

| | As of December 31, 2017 Recorded Investment | Unpaid Principal Balance | Related Allowance | For the year ended December 31, 2017 Average Impaired Loans | Interest Income Recognized |
|---|---|---|---|---|---|
| Impaired loans with a related allowance for loan losses: | | | | | |
| Real estate mortgage | $ -- | $ -- | $ -- | $ -- | $ -- |
| Production and intermediate-term | 391 | 775 | 42 | 756 | -- |
| Agribusiness | -- | -- | -- | -- | -- |
| Other | -- | -- | -- | -- | -- |
| Total | $ 391 | $ 775 | $ 42 | $ 756 | $ -- |
| Impaired loans with no related allowance for loan losses: | | | | | |
| Real estate mortgage | $ 2,655 | $ 2,743 | $ -- | $ 2,664 | $ 65 |
| Production and intermediate-term | 424 | 1,000 | -- | 817 | 81 |
| Agribusiness | -- | -- | -- | -- | -- |
| Other | 1,368 | 1,331 | -- | 675 | 37 |
| Total | $ 4,447 | $ 5,074 | $ -- | $ 4,156 | $ 183 |
| Total impaired loans: | | | | | |
| Real estate mortgage | $ 2,655 | $ 2,743 | $ -- | $ 2,664 | $ 65 |
| Production and intermediate-term | 815 | 1,775 | 42 | 1,573 | 81 |
| Agribusiness | -- | -- | -- | -- | -- |
| Other | 1,368 | 1,331 | -- | 675 | 37 |
| Total | $ 4,838 | $ 5,849 | $ 42 | $ 4,912 | $ 183 |

| | As of December 31, 2016 | | | For the year ended December 31, 2016 | |
|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Impaired Loans | Interest Income Recognized |
| Impaired loans with a related allowance for loan losses: | | | | | |
| Real estate mortgage | $ 473 | $ 564 | $ 35 | $ 295 | $ -- |
| Production and intermediate-term | -- | -- | -- | -- | -- |
| Agribusiness | -- | -- | -- | -- | -- |
| Other | -- | -- | -- | -- | -- |
| Total | $ 473 | $ 564 | $ 35 | $ 295 | $ -- |
| Impaired loans with no related allowance for loan losses: | | | | | |
| Real estate mortgage | $ 2,039 | $ 2,040 | $ -- | $ 1,270 | $ 15 |
| Production and intermediate-term | 611 | 1,164 | -- | 356 | 17 |
| Agribusiness | -- | -- | -- | 10 | -- |
| Other | -- | -- | -- | 109 | 6 |
| Total | $ 2,650 | $ 3,204 | $ -- | $ 1,745 | $ 38 |
| Total impaired loans: | | | | | |
| Real estate mortgage | $ 2,512 | $ 2,604 | $ 35 | $ 1,565 | $ 15 |
| Production and intermediate-term | 611 | 1,164 | -- | 356 | 17 |
| Agribusiness | -- | -- | -- | 10 | -- |
| Other | -- | -- | -- | 109 | 6 |
| Total | $ 3,123 | $ 3,768 | $ 35 | $ 2,040 | $ 38 |

The recorded investment in the loan is the unpaid principal amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, and acquisition costs and may also reflect a previous direct charge-off of the investment.

Unpaid principal balance represents the contractual principal balance of the loan.

We did not have any material commitments to lend additional money to borrowers whose loans were classified as risk loans at December 31, 2018.

## Troubled Debt Restructurings (TDRs)

Included within our loans are TDRs. These loans have been modified by granting a concession in order to maximize the collection of amounts due when a borrower is experiencing financial difficulties. All risk loans, including TDRs, are analyzed within our allowance for loan losses.

There were no TDRs that defaulted during the years ended December 31, 2018, 2017, or 2016 in which the modification was within twelve months of the respective reporting period.

**TDRs Outstanding in the Real Estate Mortgatge Loan Category**

(in thousands)

| As of December 31 | **2018** | 2017 | 2016 |
|---|---|---|---|
| TDRs in accrual status | **$ 415** | $ 482 | $ -- |
| TDRs in nonaccrual status | **--** | -- | 473 |
| Total TDRs | **$ 415** | $ 482 | $ 473 |

There were no commitments to lend to borrowers whose loans have been modified in a TDR at December 31, 2018.

## Allowance for Loan Losses

**Changes in Allowance for Loan Losses**

(in thousands)

| For the year ended December 31 | **2018** | 2017 | 2016 |
|---|---|---|---|
| Balance at beginning of year | **$ 534** | $ 482 | $ 452 |
| (Reversal of) provision for loan losses | **(80)** | 434 | 24 |
| Loan recoveries | **97** | 5 | 6 |
| Loan charge-offs | **(25)** | (387) | -- |
| Balance at end of year | **$ 526** | $ 534 | $ 482 |

The “Provision for credit losses” in the Consolidated Statements of Income includes a (reversal of) provision for loan losses as presented in the previous chart, as well as a provision for credit loss reserve on unfunded commitments. The accrued credit loss reserve on unfunded commitments are recorded in “Other liabilities” in the Consolidated Statements of Condition.

**Credit Loss Information on Unfunded Commitments**

| (in thousands)<br>For the year ended December 31 | **2018** | 2017 | 2016 |
|---|---|---|---|
| Provision for credit losses | **$ 90** | $ -- | $ -- |
| **As of December 31** | **2018** | 2017 | 2016 |
| Accrued credit loss reserve | **$ 90** | $ -- | $ -- |

**Changes in Allowance for Loan Losses and Year End Recorded Investments by Loan Type**

| (in thousands) | Real Estate Mortgage | Production and Intermediate-Term | Agribusiness | Other | Total |
|---|---|---|---|---|---|
| Allowance for loan losses: | | | | | |
| Balance as of December 31, 2017 | **$ 132** | **$ 389** | **$ 10** | **$ 3** | **$ 534** |
| Provision for (reversal of) loan losses | **34** | **(111)** | **(2)** | **(1)** | **(80)** |
| Loan recoveries | **5** | **92** | **--** | **--** | **97** |
| Loan charge-offs | **--** | **(25)** | **--** | **--** | **(25)** |
| Balance as of December 31, 2018 | **$ 171** | **$ 345** | **$ 8** | **$ 2** | **$ 526** |
| Ending balance: individually evaluated for impairment | **$ --** | **$ --** | **$ --** | **$ --** | **$ --** |
| Ending balance: collectively evaluated for impairment | **$ 171** | **$ 345** | **$ 8** | **$ 2** | **$ 526** |
| Recorded investment in loans outstanding: | | | | | |
| Ending balance as of December 31, 2018 | **$ 384,288** | **$ 246,271** | **$ 7,206** | **$ 47,410** | **$ 685,175** |
| Ending balance: individually evaluated for impairment | **$ 787** | **$ 14** | **$ --** | **$ 1,358** | **$ 2,159** |
| Ending balance: collectively evaluated for impairment | **$ 383,501** | **$ 246,257** | **$ 7,206** | **$ 46,052** | **$ 683,016** |

| | Real Estate Mortgage | Production and Intermediate-Term | Agribusiness | Other | Total |
|---|---|---|---|---|---|
| Allowance for loan losses: | | | | | |
| Balance as of December 31, 2016 | $ 120 | $ 356 | $ 6 | $ -- | $ 482 |
| Provision for loan losses | 7 | 420 | 4 | 3 | 434 |
| Loan recoveries | 5 | -- | -- | -- | 5 |
| Loan charge-offs | -- | (387) | -- | -- | (387) |
| Balance as of December 31, 2017 | $ 132 | $ 389 | $ 10 | $ 3 | $ 534 |
| Ending balance: individually evaluated for impairment | $ -- | $ 42 | $ -- | $ -- | $ 42 |
| Ending balance: collectively evaluated for impairment | $ 132 | $ 347 | $ 10 | $ 3 | $ 492 |
| Recorded investment in loans outstanding: | | | | | |
| Ending balance as of December 31, 2017 | $ 359,430 | $ 223,325 | $ 7,520 | $ 50,798 | $ 641,073 |
| Ending balance: individually evaluated for impairment | $ 2,655 | $ 815 | $ -- | $ 1,368 | $ 4,838 |
| Ending balance: collectively evaluated for impairment | $ 356,775 | $ 222,510 | $ 7,520 | $ 49,430 | $ 636,235 |

| | Real Estate Mortgage | Production and Intermediate-Term | Agribusiness | Other | Total |
|---|---|---|---|---|---|
| Allowance for loan losses: | | | | | |
| Balance as of December 31, 2015 | $ 139 | $ 306 | $ 7 | $ -- | $ 452 |
| (Reversal of) provision for loan losses | (25) | 50 | (1) | -- | 24 |
| Loan recoveries | 6 | -- | -- | -- | 6 |
| Loan charge-offs | -- | -- | -- | -- | -- |
| Balance as of December 31, 2016 | $ 120 | $ 356 | $ 6 | $ -- | $ 482 |
| Ending balance: individually evaluated for impairment | $ 35 | $ -- | $ -- | $ -- | $ 35 |
| Ending balance: collectively evaluated for impairment | $ 85 | $ 356 | $ 6 | $ -- | $ 447 |
| Recorded investment in loans outstanding: | | | | | |
| Ending balance as of December 31, 2016 | $ 338,931 | $ 230,529 | $ 5,013 | $ 49,811 | $ 624,284 |
| Ending balance: individually evaluated for impairment | $ 2,512 | $ 611 | $ -- | $ -- | $ 3,123 |
| Ending balance: collectively evaluated for impairment | $ 336,419 | $ 229,918 | $ 5,013 | $ 49,811 | $ 621,161 |

The recorded investment in the loan is the unpaid principal amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, and acquisition costs and may also reflect a previous direct charge-off of the investment.

## NOTE 4: INVESTMENT IN AGRIBANK

As of December 31, 2018, we were required by AgriBank to maintain an investment equal to 2.25% of the average quarterly balance of our note payable, with an additional amount required on association growth in excess of a targeted growth rate, if the District is also growing above a targeted growth rate.

**Investment in AgriBank**

| (in thousands)<br>As of December 31 | **2018** | 2017 | 2016 |
|---|---|---|---|
| Required stock investment | **$ 13,066** | $ 12,332 | $ 11,709 |
| Purchased excess stock investment | **40** | 533 | -- |
| Total investment | **$ 13,106** | $ 12,865 | $ 11,709 |

Excess stock investment is recorded when the required investment in AgriBank is lower than our total investment.

## NOTE 5: INVESTMENT SECURITIES

We held investment securities of $801 thousand, $1.5 million, and $2.5 million at December 31, 2018, 2017, and 2016, respectively. Our investment securities consisted of securities containing loans fully guaranteed by the Small Business Administration (SBA).

The investment securities have been classified as held-to-maturity. The investment portfolio is evaluated for other-than-temporary impairment. For the years ended December 31, 2018, 2017, and 2016, we have not recognized any impairment on our investment portfolio.

**Additional Investment Securities Information**

| (dollars in thousands)<br>As of December 31 | **2018** | 2017 | 2016 |
|---|---|---|---|
| Amortized cost | **$ 801** | $ 1,509 | $ 2,483 |
| Unrealized gains | **21** | 48 | 92 |
| Unrealized losses | **--** | -- | (25) |
| Fair value | **$ 822** | $ 1,557 | $ 2,550 |
| Weighted average yield | **4.3%** | 3.8% | 3.4% |

Investment income is recorded in "Interest income" in the Consolidated Statements of Income and totaled $47 thousand, $77 thousand, and $100 thousand in 2018, 2017, and 2016, respectively.

## NOTE 6: NOTE PAYABLE TO AGRIBANK

Our note payable to AgriBank represents borrowings, in the form of a line of credit, to fund our loan portfolio. The line of credit is governed by a GFA and our assets serve as collateral.

**Note Payable Information**

(dollars in thousands)

| As of December 31 | 2018 | 2017 | 2016 |
|---|---|---|---|
| Line of credit | **$ 700,000** | $ 700,000 | $ 635,000 |
| Outstanding principal under the line of credit | **540,118** | 504,826 | 496,650 |
| Interest rate | **2.8%** | 2.2% | 1.8% |

Our note payable matures June 30, 2020, at which time the note will be renegotiated.

The GFA provides for limitations on our ability to borrow funds based on specified factors or formulas relating primarily to outstanding balances, credit quality, and financial condition. Additionally, we have requirements to maintain an effective program of internal controls over financial reporting. At December 31, 2018, and throughout the year, we were not declared in default under any GFA covenants or provisions.

## NOTE 7: MEMBERS' EQUITY

### Capitalization Requirements

In accordance with the Farm Credit Act, each borrower is required to invest in us as a condition of obtaining a loan. As authorized by the Agricultural Credit Act and our capital bylaws, the Board of Directors has adopted a capital plan that establishes a stock purchase requirement for obtaining a loan of 2.0% of the customer's total loan(s) or one thousand dollars, whichever is less. The purchase of one participation certificate is required of all non-stockholder customers who purchase financial services. The Board of Directors may increase the amount of required investment to the extent authorized in the capital bylaws. The borrower acquires ownership of the capital stock at the time the loan or lease is made. The aggregate par value of the stock is added to the principal amount of the related obligation. We retain a first lien on the stock or participation certificates owned by customers.

### Regulatory Capitalization Requirements

**Regulatory Capital Requirements and Ratios**

| As of December 31 | 2018 | 2017 | Regulatory Minimums | Capital Conservation Buffer | Total |
|---|---|---|---|---|---|
| Risk-adjusted: | | | | | |
| Common equity tier 1 ratio | **20.1%** | 20.2% | 4.5% | 2.5%* | 7.0% |
| Tier 1 capital ratio | **20.1%** | 20.2% | 6.0% | 2.5%* | 8.5% |
| Total capital ratio | **20.1%** | 20.3% | 8.0% | 2.5%* | 10.5% |
| Permanent capital ratio | **20.1%** | 20.2% | 7.0% | N/A | 7.0% |
| Non-risk-adjusted: | | | | | |
| Tier 1 leverage ratio | **19.7%** | 19.6% | 4.0% | 1.0% | 5.0% |
| Unallocated retained earnings and equivalents leverage ratio | **19.7%** | 19.6% | 1.5% | N/A | 1.5% |

*The 2.5% capital conservation buffer over risk-adjusted ratio minimums is being phased in over three years under the FCA capital requirements. The phase in period ends on December 31, 2019.

Effective January 1, 2017, the regulatory capital requirements for Farm Credit System banks and associations were modified. These regulations replaced existing core surplus and total surplus ratios with common equity tier 1, tier 1 capital, and total capital risk-based capital ratios. These regulations also added a tier 1 leverage ratio and an unallocated retained earnings and equivalents (UREE) leverage ratio. The permanent capital ratio continues to remain in effect, with some modifications, to align with these regulations.

Risk-adjusted assets have been defined by the FCA Regulations as the Statement of Condition assets and off-balance-sheet commitments adjusted by various percentages, depending on the level of risk inherent in the various types of assets. The primary changes effective January 1, 2017, which generally have the impact of increasing risk-adjusted assets (decreasing risk-based regulatory capital ratios) were as follows:

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

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

These ratios are based on a three-month average daily balance in accordance with FCA Regulations and are calculated as follows (not all items below may be applicable to our Association):

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

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

Effective January 1, 2017, the regulatory capital requirements allow for allotment agreements for only the permanent capital ratio and, as such, any stock in excess of our AgriBank required investment was not included in the common equity tier 1, tier 1 capital, total capital, or leverage ratios. We had no allocated excess stock at December 31, 2018, or 2017.

Refer to Note 7 in our 2016 Annual Report for a more complete description of the ratios effective as of December 31, 2016. We were in compliance with the minimum required capital ratios as of December 31, 2016.

**Description of Equities**

The following represents information regarding classes and number of shares of stock and participation certificates outstanding. All shares and participation certificates are stated at a $5.00 par value.

| | Number of Shares | | |
|---|---|---|---|
| As of December 31 | **2018** | 2017 | 2016 |
| Class B common stock (at-risk) | **8,852** | 8,306 | 8,128 |
| Class C common stock (at-risk) | **334,666** | 330,917 | 331,552 |
| Series 2 participation certificates | **3,114** | 3,314 | 3,314 |

Under our bylaws, we are also authorized to issue Class D common stock, Class E common stock, and Class F preferred stock. Each of these classes of common stock is at-risk and nonvoting with a $5.00 par value per share. Currently, no stock of these classes has been issued.

Only holders of Class C common stock have voting rights. Our bylaws do not prohibit us from paying dividends on any classes of stock. However, no dividends have been declared to date.

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

In the event of our liquidation or dissolution, according to our bylaws, any remaining assets after payment or retirement of all liabilities will be distributed first, to holders of preferred stock, and second, pro rata to holders of all classes of common stock and participation certificates.

In the event of impairment, losses will be absorbed first by concurrent impairment of all classes of common stock and participation certificates, then by holders of preferred stock.

All classes of stock are transferable to other customers who are eligible to hold such class as long as we meet the regulatory minimum capital requirements.

**Patronage Distributions**

We accrued patronage distributions of $7.1 million, $7.0 million, and $5.5 million at December 31, 2018, 2017, and 2016, respectively. Generally, the patronage distributions are paid in cash during the first quarter after year end. The Board of Directors may authorize a distribution of earnings provided we meet all statutory and regulatory requirements.

The FCA Regulations prohibit patronage distributions to the extent they would reduce our permanent capital ratio below the minimum permanent capital adequacy standards. Additionally, effective January 1, 2017, patronage distributions may be restricted or prohibited without prior FCA approval if capital ratios fall below the total requirements, including the buffer amounts.

## NOTE 8: INCOME TAXES

The Tax Cuts and Jobs Act (the Act) was enacted in December of 2017. This Act contained various tax law changes, including a federal statutory tax rate change to 21% from 34%, effective January 1, 2018. Because deferred tax assets and liabilities are expected to be recognized in the Association's tax return in a future year, when the new statutory tax rate would be applicable, the deferred tax assets and liabilities as of December 31, 2017, were valued using a blended federal/state effective tax rate based on the new federal statutory tax rate. The effect of this revaluation was recognized in our provision for (benefit from) income taxes for the year ended December 31, 2017.

### Provision for Income Taxes

**Provision for Income Taxes**

(dollars in thousands)

| For the year ended December 31 | **2018** | 2017 | 2016 |
|---|---|---|---|
| Current: | | | |
| Federal | **$ (1)** | $ 1 | $ 1 |
| Total current | **$ (1)** | $ 1 | $ 1 |
| Deferred: | | | |
| Federal | **$ 46** | $ 133 | $ 65 |
| Total deferred | **46** | 133 | 65 |
| Provision for income taxes | **$ 45** | $ 134 | $ 66 |
| Effective tax rate | **0.3%** | 0.9% | 0.5% |

**Reconciliation of Taxes at Federal Statutory Rate to Provision for Income Taxes**

(in thousands)

| For the year ended December 31 | **2018** | 2017 | 2016 |
|---|---|---|---|
| Federal tax at statutory rates | **$ 3,356** | $ 5,094 | $ 4,592 |
| Patronage distributions | **(1,099)** | (1,729) | (1,631) |
| Effect of non-taxable entity | **(2,211)** | (3,293) | (2,354) |
| Change in statutory tax rates due to the Tax Cuts and Jobs Act | **--** | 62 | -- |
| Other | **(1)** | -- | (541) |
| Provision for income taxes | **$ 45** | $ 134 | $ 66 |

### Deferred Income Taxes

Tax laws require certain items to be included in our tax returns at different times than the items are reflected on our Consolidated Statements of Income. Some of these items are temporary differences that will reverse over time. We record the tax effect of temporary differences as deferred tax assets and liabilities netted on our Consolidated Statements of Condition.

**Deferred Tax Assets and Liabilities**

(in thousands)

| As of December 31 | **2018** | 2017 | 2016 |
|---|---|---|---|
| Allowance for loan losses | **$ 99** | $ 88 | $ 113 |
| Postretirement benefit accrual | **139** | 144 | 238 |
| Accrued incentive | **64** | 72 | 118 |
| Accrued pension asset | **(278)** | (234) | (280) |
| Other assets | **31** | 31 | 50 |
| Other liabilities | **(1)** | (1) | (6) |
| Deferred tax assets, net | **$ 54** | $ 100 | $ 233 |
| Gross deferred tax assets | **$ 333** | $ 335 | $ 519 |
| Gross deferred tax liabilities | **$ (279)** | $ (235) | $ (286) |

A valuation allowance for the deferred tax assets was not necessary at December 31, 2018, 2017, or 2016.

We have not provided for deferred income taxes on patronage allocations received from AgriBank prior to 1993. Such allocations, distributed in the form of stock, are subject to tax only upon conversion to cash. Our intent is to permanently maintain this investment in AgriBank. Our total permanent investment in

AgriBank is $10 million. Additionally, we have not provided deferred income taxes on accumulated FLCA earnings of $108.0 million as it is our intent to permanently maintain this equity in the FLCA or to distribute the earnings to members in a manner that results in no additional tax liability to us.

Our income tax returns are subject to review by various United States taxing authorities. We record accruals for items that we believe may be challenged by these taxing authorities. However, we had no uncertain income tax positions at December 31, 2018. In addition, we believe we are no longer subject to income tax examinations for years prior to 2015.

## NOTE 9: EMPLOYEE BENEFIT PLANS

### Pension and Post-Employment Benefit Plans

Complete financial information for the pension and post-employment benefit plans may be found in the AgriBank 2018 Annual Report.

The Farm Credit Foundations Plan Sponsor and Trust Committees provide oversight of the benefit plans. These governance committees are comprised of elected or appointed representatives (senior leadership and/or Board of Director members) from the participating organizations. The Plan Sponsor Committee is responsible for employer decisions regarding all benefit plans including retirement benefits. These decisions could include plan design changes, vendor changes, determination of employer subsidies (if any), and termination of specific benefit plans. Any action to change or terminate the retirement plan can only occur at the direction of the AgriBank District participating employers. The Trust Committee is responsible for fiduciary and plan administrative functions.

**Pension Plan:** Certain employees participate in the AgriBank District Retirement Plan, a District-wide multi-employer defined benefit retirement plan. The Department of Labor has determined the plan to be a governmental plan; therefore, the plan is not subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended (ERISA). As the plan is not subject to ERISA, the plan's benefits are not insured by the Pension Benefit Guaranty Corporation. Accordingly, the amount of accumulated benefits that participants would receive in the event of the plan's termination is contingent on the sufficiency of the plan's net assets to provide benefits at that time. This plan is noncontributory and covers certain eligible District employees. The assets, liabilities, and costs of the plan are not segregated by participating entities. As such, plan assets are available for any of the participating employers' retirees at any point in time. Additionally, if a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers. Further, if we choose to stop participating in the plan, we may be required to pay an amount based on the underfunded status of the plan. Because of the nature of the plan, any individual employer is not able to unilaterally change the provisions of the plan. If an employee transfers to another employer within the same plan, the employee benefits under the plan transfer. Benefits are based on salary and years of service. There is no collective bargaining agreement in place as part of this plan.

**AgriBank District Retirement Plan Information**

(in thousands)

| As of December 31 | 2018 | 2017 | 2016 |
|---|---|---|---|
| Unfunded liability | **$ 274,450** | $ 352,516 | $ 374,305 |
| Projected benefit obligation | **1,272,063** | 1,371,013 | 1,269,625 |
| Fair value of plan assets | **997,613** | 1,018,497 | 895,320 |
| Accumulated benefit obligation | **1,125,682** | 1,184,550 | 1,096,913 |

| For the year ended December 31 | 2018 | 2017 | 2016 |
|---|---|---|---|
| Total plan expense | **$ 51,900** | $ 44,730 | $ 53,139 |
| Our allocated share of plan expenses | **607** | 526 | 639 |
| Contributions by participating employers | **90,000** | 90,000 | 90,000 |
| Our allocated share of contributions | **1,045** | 1,102 | 1,070 |

The unfunded liability reflects the net of the fair value of the plan assets and the projected benefit obligation at the date of these Consolidated Financial Statements. The projected benefit obligation is the actuarial present value of all benefits attributed by the pension benefit formula to employee service rendered prior to the measurement date based on assumed future compensation levels. The accumulated benefit obligation is the actuarial present value of the benefits attributed to employee service rendered before the measurement date and based on current employee service and compensation. The funding status is subject to many variables including performance of plan assets and interest rate levels. Therefore, changes in assumptions could significantly affect these estimates.

Costs are determined for each individual employer based on costs directly related to their current employees as well as an allocation of the remaining costs based proportionately on the estimated projected liability of the employer under this plan. We recognize our proportional share of expense and contribute a proportional share of funding. Our allocated share of plan expenses is included in "Salaries and employee benefits" in the Consolidated Statements of Income.

Benefits paid to participants in the District were $68.6 million in 2018. While the plan is a governmental plan and is not subject to minimum funding requirements, the employers contribute amounts necessary on an actuarial basis to provide the plan with sufficient assets to meet the benefits to be paid to participants. The amount of the total District employer contributions expected to be paid into the pension plan during 2019 is $90.0 million. Our allocated share of these pension contributions is expected to be $1.2 million. The amount ultimately to be contributed and the amount ultimately recognized as expense as well as the timing of those contributions and expenses, are subject to many variables including performance of plan assets and interest rate levels. These variables could result in actual contributions and expenses being greater than or less than the amounts reflected in the District financial statements.

**Retiree Medical Plans:** District employers also provide certain health insurance benefits to eligible retired employees according to the terms of the benefit plans. The anticipated costs of these benefits are accrued during the period of the employee's active status.

**Retiree Medical Plan Information**

| (in thousands)<br>For the year ended December 31 | **2018** | 2017 | 2016 |
|---|---|---|---|
| Postretirement benefit (income) expense | **$ (15)** | $ 6 | $ 4 |
| Our cash contributions | **38** | 36 | 41 |

The 2018 postretirement benefit income is due to an actuarial gain. Postretirement benefit (income) expense is included in "Salaries and employee benefits" in the Consolidated Statements of Income. Our cash contributions are equal to the benefits paid.

### Defined Contribution Plans

We participate in a District-wide defined contribution plan. For employees hired before January 1, 2007, employee contributions are matched dollar for dollar up to 2.0% and 50 cents on the dollar on the next 4.0% on both pre-tax and post-tax contributions. The maximum employer match is 4.0%. For employees hired after December 31, 2006, we contribute 3.0% of the employee's compensation and will match employee contributions dollar for dollar up to a maximum of 6.0% on both pre-tax and post-tax contributions. The maximum employer contribution is 9.0%.

Employer contribution expenses for the defined contribution plan, included in "Salaries and employee benefits" in the Consolidated Statements of Income, were $196 thousand, $156 thousand, and $202 thousand in 2018, 2017, and 2016, respectively. These expenses were equal to our cash contributions for each year.

## NOTE 10: RELATED PARTY TRANSACTIONS

In the ordinary course of business, we may enter into loan transactions with our officers, directors, their immediate family members, and other organizations with which such persons may be associated. Such transactions may be subject to special approval requirements contained in the FCA Regulations and are made on the same terms, including interest rates, amortization schedules, and collateral, as those prevailing at the time for comparable transactions with other persons. In our opinion, none of these loans outstanding at December 31, 2018, involved more than a normal risk of collectability.

**Related Party Loans Information**

| (in thousands)<br>As of December 31 | **2018** | 2017 | 2016 |
|---|---|---|---|
| Total related party loans | **$ 6,952** | $ 5,396 | $ 6,525 |
| For the year ended December 31 | **2018** | 2017 | 2016 |
| Advances to related parties | **$ 11,007** | $ 4,846 | $ 5,841 |
| Repayments by related parties | **7,569** | 5,740 | 7,523 |

The related parties can be different each year end primarily due to changes in the composition of the Board of Directors and the mix of organizations with which such persons may be associated. Advances and repayments on loans in the preceding chart are related to those considered related parties at year end.

As discussed in Note 6, we borrow from AgriBank, in the form of a line of credit, to fund our loan portfolio. All interest expense as shown on the Consolidated Statements of Income was paid to AgriBank. Total patronage received from AgriBank was $2.8 million, $2.7 million, and $2.1 million in 2018, 2017, and 2016, respectively. Refer to Note 4 for stock investment in AgriBank information.

We purchase various services from AgriBank, including SunStream Business Services, a division of AgriBank FCB. The services include certain financial and retail systems, financial reporting services, tax reporting services, technology services, and insurance services. The total cost of services we purchased from AgriBank was $673 thousand, $526 thousand, and $486 thousand in 2018, 2017, and 2016, respectively.

We also purchase human resource information systems, and benefit, payroll, and workforce management services from Farm Credit Foundations (Foundations). As of December 31, 2018, 2017, and 2016, our investment in Foundations was $11 thousand. The total cost of services purchased from Foundations was $111 thousand, $89 thousand, and $76 thousand in 2018, 2017, and 2016, respectively.

## NOTE 11: CONTINGENCIES AND COMMITMENTS

In the normal course of business, we have various contingent liabilities and commitments outstanding, which may not be reflected in the Consolidated Financial Statements. We do not anticipate any material losses because of these contingencies or commitments.

We may be named as a defendant in certain lawsuits or legal actions in the normal course of business. At the date of these Consolidated Financial Statements, our management team was not aware of any material actions. However, management cannot ensure that such actions or other contingencies will not arise in the future.

We have commitments to extend credit to satisfy the financing needs of our borrowers. These financial instruments involve, to varying degrees, elements of credit risk that may be recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the loan contract. At December 31, 2018, we had commitments to extend credit of $163.9 million.

Commitments to extend credit generally have fixed expiration dates or other termination clauses and we may require payment of a fee. If commitments to extend credit remain unfulfilled or have not expired, they may have credit risk not recognized in the financial statements. Many of the commitments to extend credit will expire without being fully drawn upon. Therefore, the total commitments do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by us upon extension of credit, is based on management's credit evaluation of the borrower.

## NOTE 12: FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or most advantageous market for the asset or liability. Accounting guidance also establishes a fair value hierarchy, with three input levels that may be used to measure fair value. Refer to Note 2 for a more complete description of the three input levels.

We did not have any assets or liabilities measured at fair value on a recurring basis at December 31, 2018, 2017, or 2016.

### Non-Recurring

**Assets Measured at Fair Value on a Non-recurring Basis**

(in thousands)

| **As of December 31, 2018** | Fair Value Measurement Using | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total Fair Value |
| Impaired loans | **$ --** | **$ --** | **$ --** | **$ --** |

| As of December 31, 2017 | Fair Value Measurement Using | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total Fair Value |
| Impaired loans | $ -- | $ -- | $ 367 | $ 367 |

| As of December 31, 2016 | Fair Value Measurement Using | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total Fair Value |
| Impaired loans | $ -- | $ -- | $ 460 | $ 460 |

### Valuation Techniques

**Impaired loans:** Represents the carrying amount and related write-downs of loans which were evaluated for individual impairment based on the appraised value of the underlying collateral. When the value of the collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. If the process uses observable market-based information, they are classified as Level 2. If the process requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters, they are classified as Level 3.

## NOTE 13: SUBSEQUENT EVENTS

We have evaluated subsequent events through March 8, 2019, which is the date the Consolidated Financial Statements were available to be issued. There have been no material subsequent events that would require recognition in our 2018 Consolidated Financial Statements or disclosure in the Notes to Consolidated Financial Statements.

# DISCLOSURE INFORMATION REQUIRED BY REGULATIONS

*Farm Credit Southeast Missouri, ACA*
*(Unaudited)*

### Description of Business

General information regarding the business is incorporated herein by reference from Note 1 to the Consolidated Financial Statements in this Annual Report.

The description of significant business developments, if any, is incorporated herein by reference from the Management's Discussion and Analysis section of this Annual Report.

### Description of Property

**Property Information**

| Location | Description | Usage |
|---|---|---|
| Sikeston, MO | Owned | Headquarters |
| Sikeston, MO | Owned | Branch |
| Mississippi County, MO | Owned | Branch |
| Dexter, MO | Owned | Branch |
| Jackson, MO | Owned | Branch |
| Kennett, MO | Owned | Branch |
| Portageville, MO | Owned | Branch |
| Poplar Bluff, MO | Owned | Branch |

### Legal Proceedings

Information regarding legal proceedings is discussed in Note 11 to the Consolidated Financial Statements in this Annual Report. We were not subject to any enforcement actions as of December 31, 2018.

### Additional Regulatory Capital Disclosure

**Regulatory Capital Ratios Pursuant to FCA Regulation 620.5**

| As of December 31 | 2013 | 2012 |
|---|---|---|
| Permanent capital ratio | 17.2% | 16.3% |
| Total surplus ratio | 16.9% | 16.0% |
| Core surplus ratio | 16.9% | 16.0% |

Refer to the Consolidated Five-Year Summary of Selected Financial Data at the beginning of this Annual Report for capital ratio calculations for the past five years.

### Description of Capital Structure

Information regarding our capital structure is discussed in Note 7 to the Consolidated Financial Statements in this Annual Report.

### Description of Liabilities

Information regarding liabilities is discussed in Notes 6, 7, 8, 9, and 11 to the Consolidated Financial Statements in this Annual Report. All debt and other liabilities in the financial statements are uninsured.

### Selected Financial Data

The Consolidated Five-Year Summary of Selected Financial Data is presented at the beginning of this Annual Report.

### Management’s Discussion and Analysis

Information regarding any material aspects of our financial condition, changes in financial condition, and results of operations are discussed in the Management's Discussion and Analysis section of this Annual Report.

## Board of Directors

**Board of Directors as of December 31, 2018, including business experience during the last five years**

| Name | Term | Principal Occupation and Other Affiliations |
|---|---|---|
| **Markel D. Yarbro**<br>Chairperson<br>Service Began: 1998 | 2016 - 2019 | **Principal Occupation:**<br>Self-employed grain farmer<br>**Other Affiliations:**<br>Board Member (Secretary): Ozark Border Electric Coop (rural electric cooperative)<br>Board Chairman: M&A Electric Coop Board (rural electric cooperative) |
| **Jennifer Hendrickson**<br>Vice-Chairperson<br>Service Began: 2013 | 2018 - 2021 | **Principal Occupation:**<br>Owner and President of Hendrickson Business Advisors, LLC, a business consulting firm<br>Owner and President of Hendrickson Business Brokers, LLC, a brokerage company<br>Owner of Hendrickson Holdings - a commercial real estate company |
| **Michael Aufdenberg**<br>Service Began: 2012 | 2018- 2021 | **Principal Occupation:**<br>Self-employed grain and livestock farmer |
| **Ed C. Marshall III**<br>Service Began: 2005 | 2017 - 2020 | **Principal Occupation:**<br>Self-employed grain farmer<br>**Other Affiliations:**<br>President: Levee District #3, a special levee maintenance taxing entity located in Mississippi County |
| **Darrell Nichols**<br>Service Began: 1996 | 2017 - 2020 | **Principal Occupation:**<br>Self-employed grain and rice farmer |
| **James Priggel**<br>Service Began: 2010 | 2016 - 2019 | **Principal Occupation:**<br>Self-employed grain and cotton farmer |
| **John Robinson**<br>Service Began: 1998 | 2017 - 2020 | **Principal Occupation:**<br>Self-employed grain and cotton farmer<br>**Other Affiliations:**<br>Board member (Treasurer): Drainage District Ditch #37, a special drainage ditch taxing entity located in Dexter, Missouri |
| **Phillip M. Showmaker**<br>Outside Director<br>Audit Committee Chairperson<br>Service Began: 2011 | 2017 - 2020 | **Principal Occupation:**<br>Partner of Clay, Showmaker & Clay, LLP, a CPA firm located in Sikeston, Missouri<br>Owner of Clay & Showmaker, a financial services company |
| **Marty Vancil**<br>Service Began: 2012 | 2018 - 2021 | **Principal Occupation:**<br>Self-employed grain and cotton farmer |

Pursuant to our bylaws, directors are paid a reasonable amount for attendance at board meetings, committee meetings, or other special assignments. Directors are also reimbursed for reasonable expenses incurred in connection with such meetings or assignments. Our Board of Directors has adopted a rate of $500 per day and a rate of $175 per conference call. In addition, the Chairman and Audit Committee Chairman receive a $500 monthly stipend.

Information regarding compensation paid to each director who served during 2018 follows:

| | Number of Days Served | | | | |
|---|---|---|---|---|---|
| Name | Board Meetings | Other Official Activities | Compensation Paid for Service on a Board Committee | Name of Committee | Total Compensation Paid in 2018 |
| Michael Aufdenberg | 11.0 | 10.0 | $ -- | -- | $ 9,143 |
| Jennifer Hendrickson | 11.0 | 28.0 | 500 | Audit | 17,818 |
| Ed C. Marshall III | 8.0 | 2.0 | 500 | Audit | 4,693 |
| Darrell Nichols | 11.0 | 6.0 | -- | -- | 7,143 |
| James Priggel | 11.0 | 4.0 | -- | -- | 6,793 |
| John Robinson | 8.0 | 2.0 | -- | -- | 4,293 |
| Phillip M. Showmaker | 9.0 | 23.0 | 6,500 | Audit | 15,693 |
| Marty Vancil | 9.0 | 1.0 | -- | -- | 4,693 |
| Markel D. Yarbro | 10.0 | 24.0 | 500 | Audit | 15,318 |
| | | | | | $ 85,587 |

## Senior Officers

**Senior Officers as of December 31, 2018, including business experience during the last five years**

| Name and Position | Business experience and other business affiliations |
|---|---|
| **Robert E. Smith**<br>President / Chief Executive Officer | **Business experience:**<br>President/Chief Executive Officer since January 2016. Prior to that, Smith served as SVP/Chief Credit Officer for 33 years.<br>**Other business affiliations:**<br>Board Member (Secretary): Sikeston Board of Municipal Utilities (public utility providing water, sewer, and electricity) |
| **Vernon D. Griffith**<br>Executive Vice President / Chief Financial Officer | **Business experience:**<br>Executive Vice President/Chief Financial Officer from November 1991 to present. |
| **Michael Alan Hicks**<br>Executive Vice President / Chief Credit Officer | **Business experience:**<br>EVP/Chief Credit Officer since September 2017. Prior to that, Hicks served as SVP/Senior Relationship Officer since January 2017 and VP/Branch Manager for the previous 23 years. |

Information related to compensation paid to senior officers is provided in our Annual Meeting Information Statement (AMIS). The AMIS is available for public inspection at our office.

## Transactions with Senior Officers and Directors

Information regarding related party transactions is discussed in Note 10 to the Consolidated Financial Statements in this Annual Report.

## Travel, Subsistence, and Other Related Expenses

Directors and senior officers are reimbursed for reasonable travel, subsistence, and other related expenses associated with business functions. A copy of our policy for reimbursing these costs is available by contacting us at:

1116 N. Main Street
Sikeston, MO 63801
(573) 471-0342
www.farmcreditsemo.com
info@farmcreditsemo.com

The total directors' travel, subsistence, and other related expenses were $38 thousand, $27 thousand, and $24 thousand in 2018, 2017, and 2016, respectively.

## Involvement in Certain Legal Proceedings

No events occurred during the past five years that are material to evaluating the ability or integrity of any person who served as a director or senior officer on January 1, 2019, or at any time during 2018.

## Member Privacy

The FCA Regulations protect members' nonpublic personal financial information. Our directors and employees are restricted from disclosing information about our Association or our members not normally contained in published reports or press releases.

## Relationship with Qualified Public Accountant

There were no changes in independent auditors since the last Annual Report to members and we are in agreement with the opinion expressed by the independent auditors. The total financial statement audit fees paid during 2018 were $67 thousand. Our engagement letter commits to reimbursing the external auditor for reasonable out-of-pocket expenses as incurred for travel.

## Financial Statements

The Report of Management, Report of Audit Committee, Report of Independent Auditors, Consolidated Financial Statements, and Notes to Consolidated Financial Statements are presented prior to this portion of the Consolidated Financial Statements in this Annual Report.

## Young, Beginning, and Small Farmers and Ranchers

Information regarding credit and services to young, beginning, and small farmers and ranchers, and producers or harvesters of aquatic products is discussed in an addendum to this Annual Report.

# YOUNG, BEGINNING, AND SMALL FARMERS AND RANCHERS

*Farm Credit Southeast Missouri, ACA*

*(Unaudited)*

We have specific programs in place to serve the credit and related needs of young, beginning and small farmers and ranchers (YBS) in our territory. The definitions of young, beginning and small farmers and ranchers follow:

- Young: A farmer, rancher, or producer or harvester of aquatic products who is age 35 or younger as of the loan transaction date.
- Beginning: A farmer, rancher, or producer or harvester of aquatic products who has 10 years or less farming or ranching experience as of the loan transaction date.
    - A loan to a "young" or "beginning" borrower qualifies if the young or beginning borrower is obligated on the note or is an owner of the closely held entity financed. A loan to a publicly held entity or other entity that is not closely held does not qualify.
- Small: A farmer, rancher, or producer or harvester of aquatic products who normally generates less than $250 thousand in annual gross sales of agricultural or aquatic products.

### Demographics

Based on the United States Department of Agriculture (USDA) 2012 Census of Agriculture, 6.2% of the farmers in our 12 county territory are young farmers (up to age 34); 16.5% of the farmers in the territory are beginning farmers (up to 9 years 'on the present farm'); and 76.7% of the farms are small farms ($1,000 to $249,000 gross farm income).

The USDA Census definitions are in parentheses above. Please note that the USDA Census definitions do not exactly match the accepted YBS definitions widely used in the Farm Credit System as listed in the previous section and therefore the Census percentages are not necessarily comparable to the associations' percentages.

### Mission Statement

Young, beginning and small farmers, ranchers and producers or harvesters of aquatic products are valued customers of our Association. It is our mission to provide sound and constructive credit and services to young, beginning and small farmers, ranchers and producers or harvesters of aquatic products to the maximum extent possible consistent with safe and sound business practices and within our risk-bearing capacity.

We have protected the name AgSunrise which is the program we have established to serve the young/beginning farmers in our territory.

We have and continue to network with other Farm Credit Service associations to share information about what programs have worked in their areas.
We attended a nationwide workshop that brought together several association representative to discuss options and ways we can continue to promote our YBS programs and maintain the credit standards recommended by AgriBank as well as FCA.

### Quantitative Goals and Results

Below are the 2018 targets and actual results for our young, beginning and small farmers and ranchers program:

| 2018 Target | 2018 Actual Results |
|---|---|
| 15% by Number | 20.0% Young Farmers (all existing) |
| 15% by Number | 23.8% Young Farmers (new loans in 2018) |
| 10% by Volume | 18.8% Young Farmers (all existing) |
| 10% by Volume | 28.3% Young Farmers (new loans in 2018) |
| 15% by Number | 22.1% Beginning Farmers (all existing) |
| 15% by Number | 27.4% Beginning Farmers (new loans in 2018) |
| 10% by Volume | 18.8% Beginning Farmers (all existing) |
| 10% by Volume | 26.6% Beginning Farmers (new loans in 2018) |
| 15% by Number | 39.4% Small Farmers (all existing) |
| 15% by Number | 35.9% Small Farmers (new loans in 2018) |
| 10% by Volume | 13.4% Small Farmers (all existing) |
| 10% by Volume | 8.3% Small Farmers (new loans in 2018) |

The following tables detail the level of new business generated in 2018 plus the level of business outstanding as of December 31, 2018, both by number of loans and by volume for young and beginning farmers and ranchers:

| Young and Beginning Farmers and Ranchers – Gross New Business During 2018 | | | | |
|---|---|---|---|---|
| Category | Number of Loans | Percent of Total | Volume Outstanding (in thousands) | Percent of Total |
| Total gross new loans and commitments made during the year | 1,064 | 100.0% | $332,173 | 100.0% |
| Total loans and commitments made to young farmers and ranchers | 253 | 23.8% | $93,932 | 28.3% |
| Total loans and commitments made to beginning farmers and ranchers | 292 | 27.4% | $88,243 | 26.6% |

| Young and Beginning Farmers and Ranchers – Number/Volume of Loans Outstanding at December 31, 2018 | | | | |
|---|---|---|---|---|
| Category | Number of Loans | Percent of Total | Volume Outstanding (in thousands) | Percent of Total |
| Total loans and commitments outstanding at year end | 3,822 | 100.0% | $832,018 | 100.0% |
| Young farmers and ranchers | 764 | 20.0% | $155,962 | 18.8% |
| Beginning farmers and ranchers | 843 | 22.1% | $156,667 | 18.8% |

The following tables detail the level of new business generated in 2018 plus the level of business outstanding as of December 31, 2018, both by number of loans and by volume for small farmers and ranchers:

| Small Farmers and Ranchers - Gross New Business by Loan Size During 2018 | | | | |
|---|---|---|---|---|
| Number/Volume | $0 - $50,000 | $50,001 - $100,000 | $100,001 - $250,000 | $250,001 and greater |
| Total number of new loans and commitments made during the year | 376 | 152 | 209 | 327 |
| Total number of loans made to small farmers and ranchers during the year | 239 | 63 | 67 | 13 |
| Number of loans to small farmers and ranchers as a % of total number of loans | 63.4% | 41.5% | 32.1% | 4.0% |
| | | | | |
| Total gross loan volume of all new loans and commitments made during the year (in thousands) | $9,153 | $11,461 | $35,657 | $275,902 |
| Total gross loan volume to small farmers and ranchers (in thousands) | $5,241 | $4,524 | $10,968 | $6,953 |
| Loan volume to small farmers and ranchers as a % of total gross new loan volume | 57.3% | 39.5% | 30.8% | 2.5% |

| Small Farmers and Ranchers - Number/Volume of Loans Outstanding by Loan Size at December 31, 2018 | | | | |
|---|---|---|---|---|
| Number/Volume Outstanding | $0 - $50,000 | $50,001 - $100,000 | $100,001 - $250,000 | $250,001 and greater |
| Total loans and commitments outstanding at year end | 1,519 | 635 | 806 | 862 |
| Total number of loans to small farmers and ranchers | 916 | 266 | 249 | 76 |
| Number of loans to small farmers and ranchers as a % of total number of loans | 60.3% | 41.9% | 30.9% | 8.8% |
| | | | | |
| Total loan volume outstanding at year end (in thousands) | $31,988 | $46,280 | $130,923 | $622,827 |
| Total loan volume to small farmers and ranchers (in thousands) | $17,307 | $19,152 | $39,280 | $35,681 |
| Loan volume to small farmers and ranchers as a % of total loan volume | 54.1% | 41.4% | 30.0% | 5.7% |

**Qualitative Goals and Outreach Programs**

We have set the following seven qualitative goals for 2019:

- Offer credit and related services in coordination with Farm Service Agency (FSA) and State programs
- Offer differential loan underwriting standards
- Make use of loan guarantees, subordinations and co-signers
- Offer business and financial skills training
- Offer insurance products
- Promote use of Missouri Linked Deposit Program funding with lower customer interest rates
- Continue to promote a 2018 strategic initiative, called AgSunrise, which is a subset of YBS, but with special focus on Young and Beginning Farmers and Ranchers

Based on our 2018 goals for the young, beginning and small farmers and ranchers program, the results were as follows:

- Sponsored meetings to educate YBS farmers on crop marketing techniques including futures and options
- Sponsored meetings to educate YBS farmers on crop insurance services
- Sponsored meetings tailored to educate YBS farmers on how to join marketing techniques with crop insurance services
- Offered crop protection insurance and life insurance to YBS farmers and discussed the benefits with them individually, in meetings and via radio advertising
- Met with YBS farmers to show them the support that could be made by using FSA 90/10 guarantees
- Shared Farm Financial Checkup results with borrowers
- Met with FSA to obtain information to provide to young farmers on programs that would benefit them, including guarantee and subordination programs
- Counseled YBS farmers in the office on good financial practices
- Ran ads on radio stations pertaining to YBS programs
- Attended semi-annual meetings on the Three Rivers Junior College Ag Committee to discuss educational needs of Ag students
- Offered a streamlined scorecard approval service for small farmers to significantly reduce paperwork
- Encouraged YBS farmers to use marketing consultants, scouting services and financial guidance counselors
- Encouraged YBS farmers to keep adequate financial records and for their accountant to prepare full disclosure year-end financial statements including a Statement of Cash Flows to better analyze and manage their finances
- Member of Kennett Chamber of Commerce Agriculture committee
- Met with FSA officials to identify YBS farmers that may be able to graduate from FSA and qualify for loans from our association
- Made FSA guaranteed loans with YBS farmers
- Made FSA subordinated loans to YBS farmers and continued to work with the FSA loan officer on possible new loans for them
- Invited and recognized Future Farmers of America (FFA) sponsor and officers at annual dinner
- Met goal of developing and launching the AgSunrise program within the association which:
    - Supports and builds relationships with FFA program directors
    - Builds relationship with FSA
    - Adapted credit presentation model to address the target segment
    - Provided interest rate discounts, fee waivers, and financial support for the target segment

- Provide financial support for educational programs for target segment
- AgSunrise meeting held in Sikeston in January 2019 with 47 young, beginning farmers attending

**Participated in Various Sponsorships:**

- MO Rice Research Field Day
- MO Delta Center Field Day
- Missouri Farm Bureau Foundation for YBS farmers
- Farmers Recognition Banquet for the Charleston and Kelly High School Districts
- Meal for Southeastern Missouri (SEMO) District Ag Teachers meeting
- Missouri Farm Bureau Foundation golf tournament
- Several high school athletic teams and events
- SEMO district fair 4H and FFA livestock show
- Local FFA Chapters for awards
- Hurley Women's Ag Tour
- FFA Events
- University of MO corn production meeting
- Stoddard County 4H livestock auction
- Butler County 4H auction
- Missouri Young Farmer/Young Farmer Wives Tour
- Farmers Recognition Banquet at Sikeston
- Farmers Recognition Luncheon at Poplar Bluff
- Sponsored Multi County Women's Health Fair

**Safety and Soundness of the Program**

In order to provide for extension of sound and constructive credit to young, beginning, and small farmers and ranchers, consistent with our mission statement and business objectives, we set standards and guidelines related to character, capacity, capital and collateral.

The following standards and guidelines applied to our young, beginning and small farmers and ranchers:

| YBS Standards and Guidelines | | |
|---|---|---|
| Character: | Must be satisfactory | (same as regular standard) |
| Capacity: | 115% Capital debt repayment capacity | (same as regular standard) |
| Capital: | Liquidity: 0% adjusted working capital divided by average gross income | (vs 15% regular standard) |
| | Solvency: 40% owners' equity | (vs 50% regular standard) |
| Collateral: | 85% Loan to appraised value (PCA) | (vs 75% regular standard) |
| | 75% Loan to appraised value (FLCA) | (vs 65% regular standard) |

As indicated by these standards, primary emphasis will be on the character and capacity standards. Exceptions may be granted if there are offsetting strengths. All terms of repayment or advances will be consistent with our existing lending standards and policy. Obtaining co-signers or guarantors will be encouraged where applicable in order to maintain credit standards, but is not necessarily a requirement. Whenever possible, maximum coordination will occur between us and with governmental and other private sources of credit to provide the best credit package for the customer. Applicants are expected to have the capability to manage and perform at or above average enterprise standards of earnings.

To minimize credit and profit risk exposure when less restrictive minimum credit criteria are required than for other customers, supplemental services or incentives not offered to other customers are available, or qualifying farmers receive preferred interest rates, we have set a maximum portfolio concentration not to exceed 200% of our risk funds. This maximum portfolio concentration is the total outstanding principal balances of loans to young, beginning and small farmers and ranchers which have one or more exceptions to the core underwriting standards for regular loans (i.e., 50% owners' equity, 15% working capital divided by average gross income, 115% capital debt repayment capacity, and 75% loan to appraised value for the PCA or 65% loan to appraised value for the FLCA – as traditionally analyzed, or loans scoring less than 200 if scorecard processed).

Management will ensure that loans made under these programs are identified and reported to the Board quarterly and to AgriBank, FCB annually, or more frequently as required. Such reports will provide a summary of actual results compared to the quantitative and qualitative program targets and goals as set forth in our operational and strategic business plan. Reports on these programs will also be provided to regulatory agencies, as required.

Randy Caldwell (Senior Relationship Officer) is the coordinator for our AgSunrise programs. He will be reaching out to the branches to help coordinate events and programs.

We have also recently contracted with Smart Marketing to assist in promoting all our programs. We feel they will be very effective in giving us additional contact with the Young, Beginning farmers in our trade area especially using social media.

# FUNDS HELD PROGRAM

*Farm Credit Southeast Missouri, ACA*

*(Unaudited)*

The Association offers a Funds Held Program ("Funds Held") that provides for customers to make advance payments on designated real estate loans and intermediate term loans. The following terms and conditions apply to all Funds Held unless the loan agreement, or related documents, between the Association and customer provide for other limitations.

**Payment Application**

Loan payments received by the Association before the loan has been billed will normally be placed into Funds Held and applied against the next installment due. Loan payments received after the loan has been billed will be directly applied to the installment due on the loan and related charges, if any. Funds received in excess of the billed amount will be placed into Funds Held unless the customer has specified the funds to be applied as a special or early prepayment of principal.

When a loan installment becomes due, monies in Funds Held for the loan will be automatically applied toward the installment on the due date. Any accrued interest on Funds Held will be applied first. If the balance in Funds Held does not fully satisfy the entire installment, the customer must pay the difference by the installment due date.

**Account Maximum**

The amount in Funds Held may not exceed 50% of the unpaid principal balance of the loan.

**Interest Rate**

Interest will accrue on Funds Held at a simple rate of interest determined by the Association, but may never exceed the interest rate charged on the related loan. The Association may change the interest rate from time to time, and may provide for different rates for different categories of loans.

Interest rates are currently reported on each customer's year end loan statement.

**Withdrawals**

The Association may permit borrowers to withdraw funds from a voluntary Funds Held account, on an exception basis, up to four times per year. The minimum amount that may be withdrawn at any one time is limited to the lesser of $500 or the balance remaining in the Funds Held account.

All requests for withdrawal of funds are subject to Association approval.

**Association Options**

In the event of default on any loan, or if Funds Held exceeds the maximum limit as established above, or if the Association discontinues its Funds Held Program, the Association may apply funds in the account to the unpaid loan balance and other amounts due, and shall return any excess funds to the customer.

**Uninsured Account**

Funds Held is not a depository account and is not insured. In the event of Association liquidation, customers having balances in Funds Held shall be notified according to FCA Regulations.

**Questions**

Please direct any questions regarding Funds Held to your local branch representative.

FARM CREDIT
SOUTHEAST MISSOURI

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Cape Girardeau, MO
63701

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