# GSFC 2017 ANNUAL REPORT

## YOUR VENTURE AGRICULTURE

Golden State Farm Credit


GOLDEN STATE
FARM CREDIT

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**DEAR**
# STOCKHOLDERS,

We are pleased to report that 2017 was another profitable year at Golden State Farm Credit. On behalf of the Board of Directors and our dedicated staff, we would like to thank you for the contributions you have made to our success. As an owner of the Association, we are pleased to inform you that we increased our overall loan volume (7.4%) in 2017. Positive operating results, solid capital levels, and strong credit quality enabled your Association to return $11,400,000 of patronage to its Members. These results are due to the overall agricultural economy and our staff's commitment to provide quality service to the growers and producers within the communities we serve. The Annual Report highlights our excellent financial performance this past year.

As 2018 begins, the Board and Staff are aware of the challenges facing those working in agriculture – the uncertainty of drought, the impact of the freeze, labor concerns, volatile commodity prices, as well as a multitude of other potential issues not mentioned. We are honored to be a part of an organization that has deep roots in California Agriculture and works to find solutions to the problems you face.

Our philosophy goes to the heart of the matter; we only accomplish our goals when yours come to fruition. Simply said - **"Your Venture – Agriculture. Our Venture – Your Success."** Successful organizations are built by teams of individuals that commit to working together towards achieving a common goal. Thanks to the leadership the Board of Directors provides, the guidance the Association's Management team gives, the knowledge our dedicated Staff offers, and the on-going loyalty we receive from you, Golden State Farm Credit is a successful organization.

The Association values its strong commitment to meeting the needs of our members and local agribusinesses through efficient services that go beyond expectations. We are especially proud of our pledge to assist the young, beginning, and small farmers in our area. Our focus on the next generation is not new; it's why Farm Credit recently celebrated 100 years of service to the multiple generations in agriculture. We are the lender of choice and our promise to you is to stand by your side, through the peaks and valleys that are inherent to agriculture, as you follow your passion and succeed in reaching your dreams.

This report contains the results of the Association's 2017 financial performance. As you'll see, we have the capacity to serve you and your needs, whatever they may be. As a member and owner of the Association, you can take comfort in knowing that its earnings and capital base offers every member access to a competitive, dependable, and responsible source of credit.

We invite you to read this year's Annual Report for a look inside your organization. We trust you will be as pleased with the Association's performance as we are. Thank you for the privilege of serving your business needs and for the support you have given to Golden State Farm Credit over the past year. We wish you the best of success in 2018 and beyond.

MICHAEL FRY
**Chairman of the Board**

J. FLETCHER MONROE
**President & Chief Executive Officer**

***MARCH 16, 2018***

# BOARD OF
# DIRECTORS

### MICHAEL FRY
**Chairman of the Board**
*Term of Office: 2016-2021*

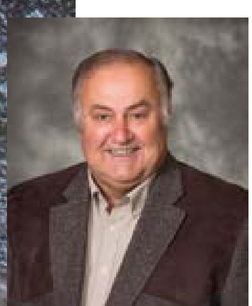
*Mr. Fry is Vice President of Ag Operations for Olam Spices and Vegetables Ingredients. Mr. Fry also farms tree fruit and walnuts in a partnership with his brother. Prior to joining the Golden State Farm Credit, ACA Board, he had served on the Federal Land Bank Association of Kingsburg, FLCA Board since 2006.*

### GREGORY W. LONG
**Vice Chairman of the Board**
*Term of Office: 2014-2019*

*Mr. Long grows almonds and does custom farm management of almonds, walnuts and prunes. He is involved as a member of the Farm Bureau and Red Bluff High School AG Advisory Committee. Prior to joining the Golden State Farm Credit, ACA Board, he had served on the Northern California Farm Credit, ACA Board since 2005.*

### STEPHEN BROWN
**Compensation Committee Chairman**
*Term of Office: 2015-2020*

*Mr. Brown is a dairyman and farmer. He also serves on the California Dairies, Inc. Board of Directors. Prior to joining the Golden State Farm Credit, ACA Board, Mr. Brown had served on the Federal Land Bank Association of Kingsburg, FLCA Board since 2009.*



### MICHAEL R. CHAMBERS
**Director**
*Term of Office: 2014-2018*

*Mr. Chambers grows walnuts, prunes, and pears in the Gridley area. He is involved with Butte County Farm Bureau and Sunsweet Growers, Inc. Prior to joining the Golden State Farm Credit, ACA Board, he had served on the Northern California Farm Credit, ACA Board since 1987.*

## CASEY JONES

**Director**

*Term of Office: 2017-2022*

*Mr. Jones and his family farm peaches, plums, pluots, nectarines, apricots and almonds in the Kingsburg area. Mr. Jones is the Managing Partner with Sun Valley Packing in Reedley. He also serves on the California Fresh Fruit Association Board. He was elected to the Golden State Farm Credit, ACA Board in 2017.*

## SANDRA MANSFIELD

**Appointed Director & Audit Committee Chairwoman**

*Term of Office: 2015-2020*

*Ms. Mansfield is a certified public accountant. She has been self-employed as a consultant in agribusiness since 2008. She has been a member of the Board Nominating Committee for CoBank since 2016. Ms. Mansfield also served from 2014-2016 as a member of the Board of Directors of AgVantis, our technology services provider. Prior to joining the Golden State Farm Credit, ACA Board, Ms. Mansfield had served on the Federal Land Bank Association of Kingsburg, FLCA Board since 2012.*

## GEORGE R. NICOLAUS

**Director**

*Term of Office: 2015-2020*

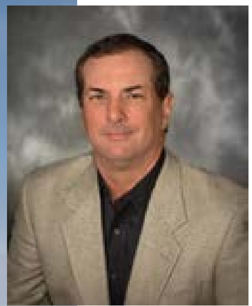
*Mr. Nicolaus grows almonds, walnuts and seed crops in Butte County. His family owned business, Nicolaus Nut Company, provides custom farming, planting and harvest operations. He is a general partner in two farming and land development partnerships in the Chico area. Mr. Nicolaus is chairman of the Zimmerman Scholarship Committee, chairman of the North State Hulling Co-op and a Butte County Farm Bureau member. Prior to joining the Golden State Farm Credit, ACA Board, he had served on the Northern California Farm Credit, ACA Board since 2006.*

## VERNON PETERSON

**Director**

*Term of Office: 2016-2021*

*Mr. Peterson along with his family, grows organic stone fruit and chickens in Kingsburg. Additionally, the family packs stone fruit, pomegranates and citrus for a few dozen of their neighbors and distributes a weekly box of organic produce to several thousand families though a CSA they founded called Abundant Harvest Organics. He was elected to the Golden State Farm Credit, ACA Board in 2016.*

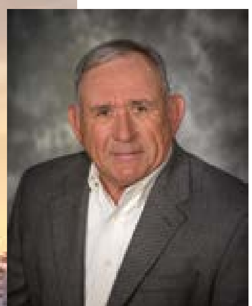


## ROBERT REIMER

**Director**

*Term of Office: 2014-2018*

*Mr. Reimer farms tree fruit and table grapes. He is also the owner and president of Reimer Transport Inc., Weldon Trucking, Inc., and 50% owner of Reimer Farms Inc. Prior to joining the Golden State Farm Credit, ACA Board, he had served on the Federal Land Bank Association of Kingsburg, FLCA Board since 2008.*



## GEORGE SWANER

**Director**

*Term of Office: 2014-2019*

*Mr. Swaner grows rice, hay and has a rice drying operation. He also does custom farming and has a cow-calf operation with his son in the Glenn area. He is involved with the Bayliss Fire Department and California Rice Research Board. Prior to joining the Golden State Farm Credit, ACA Board, he had served on the Northern California Farm Credit, ACA Board since 1996.*

## TERRI WEST

**Appointed Director**

*Term of Office: 2017-2018*

*Ms. West serves as the Chief Financial Officer at Actagro, LLC. Prior to joining Actagro in 2009, she served as Finance and Credit Manager for a California-based manufacturer, and as Senior Accountant at two public accounting firms. She received a MBA in Finance from California State University at Fresno and a Bachelor of Business Administration in Marketing from Pacific Lutheran University. She was appointed to the Golden State Farm Credit, ACA Board in 2017.*

## JOHN DE JONG

**Director**

*Term of Office: 2014-2017*

*Mr. de Jong is owner and operator of Dover Dairy Farms, Summerhill Goat Dairy, Standard Feeding Company, and 1/3 owner of Fair Oaks Dairy Farms. He was elected to the Golden State Farm Credit, ACA Board in 2014. Mr. de Jong's term expired in July 2017 and he did not seek re-election.*

## HARRY L. "RICK" CINQUINI

**Director**

*Term of Office: 2015-2017*

*Mr. Cinquini passed away in 2017. The Board deferred filling his seat until the 2018 election.*

## SENIOR
# OFFICERS

### J. FLETCHER MONROE
**President & Chief Executive Officer**

*Mr. Monroe has served as President and Chief Executive Officer from February 2015 to present. Previously he served as Regional Vice President of another Farm Credit organization from 2012 through 2015. Mr. Monroe also serves as a member of the Board of Directors of AgVantis, our technology services provider, since January 2017. He began his career with the Farm Credit System in 1987. His career has included credit and management experience and he has been an active part of two Farm Credit Association mergers.*

### DANIEL S. STEVENSON
**Executive Vice President & Chief Operating Officer**

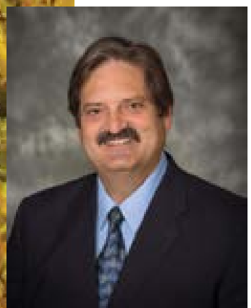
*Mr. Stevenson has served as Executive Vice President and Chief Operating Officer since February 2015. Previously he served as Executive Vice President and acting Co-CEO from June 2014 through January 2015. He also served as Senior Vice President for Northern California Farm Credit, ACA from January 1991 through 2013 and has been employed by the Farm Credit system since 1975.*
*Mr. Stevenson retired in February 2018.*

### WALTER LOHSE
**Senior Vice President & Chief Credit Officer**

*Mr. Lohse has served as Senior Vice President and Chief Credit Officer since August 2017. He previously served as VP Credit Management for Golden State Farm Credit from March 2015 through August 2017. Mr. Lohse has served previously as a Loan Officer with Northern California Farm Credit, ACA. Mr. Lohse has been employed in the Farm Credit System since 1986.*

### REANETTE FILLMER
**Senior Vice President & Chief Human Capital Officer**

*Ms. Fillmer has served as Senior Vice President and Chief Administrative Officer since January 2018. She previously served as Senior Vice President and Chief Human Capital Officer since February 2016. She is currently serving as the Vice Mayor of Chico, her term started December 2014 and ends December 2018. She has also served as a Human Resources Consultant, Human Resources Director for Tehama County, Human Resources Manager for the Sacramento Superior Court, and Human Resources Generalist for Butte Community Bank. She holds her PHR and CLRM certifications.*



LARRY GRAGER

**Executive Vice President & Chief Financial Officer**

*Mr. Grager was hired in February 2016 as Senior Vice President and Chief Financial Officer. He was promoted to Executive Vice President and Chief Financial Officer in September 2017. He has previously served as Chief Financial Officer at First Mountain Bank, Big Bear Lake, CA; Seattle Metropolitan Credit Union, Seattle, WA; First National Bank of Southern California, Riverside, CA and Gilmore Bank, Los Angeles, CA. He is a CPA licensed by the state of Washington and has his MBA from the University of Puget Sound in Tacoma, WA.*

CRAIG MEYER

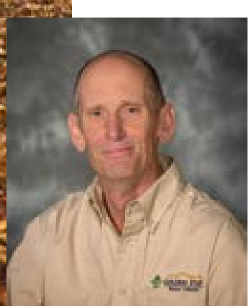
**Senior Vice President & Chief Risk Officer**

*Mr. Meyer has served as Senior Vice President and Chief Risk Officer since February 2015. Previously he served as VP Customer Service and Risk Manager from January 2014 through February 2015, and he served as Vice President-Support Services & Credit Services for AgVantis, Inc. from January 2001 through December 2013. Mr. Meyer has been employed by the Farm Credit system since 1976.*

DAVE LEHRMAN

**Senior Vice President & Chief Appraisal Officer**

*Mr. Lehrman has served as Chief Appraisal Officer since January 2017. He was appointed Senior Vice President effective January 2018. Prior to that, he served as Appraisal Manager from January 2014 through December 2016. Previously he served as Appraisal Manager for Federal Land Bank Association of Kingsburg, FLCA since 2007. Mr. Lehrman has been employed in the Farm Credit System since 1986.*



RANDY TOS

**Executive Vice President & Chief Credit Officer**

*Mr. Tos has served as Executive Vice President and Chief Credit Officer since February 2015. Previously he served as Regional Chief Credit Officer and acting Co-CEO from June 2014 through January 2015. He also served as Senior Vice President and Chief Credit Officer of the Federal Land Bank Association of Kingsburg, FLCA from 2004 through 2013 and has been employed by the Farm Credit System since 1982. Mr. Tos retired in August 2017.*

# GSFC

A BORROWER-OWNED COOPERATIVE

**PAID $68.4 MILLION**

OVER SIX YEARS

**BACK TO OUR MEMBERS**

## 2017

**$11.4 MILLION**

**IN PATRONAGE**

# 2017

**IN REVIEW**

## MARK MCKEAN

**the 2017 Far West High Cotton Award Winner**

Mark McKean, a third-generation California cotton grower is passionate about his farm and has enormous respect for the land, the environment, and water conservation. This led to his family being awarded the Farm Press/Cotton Foundation High Cotton Award for 2017.

The Farm Press and the National Cotton Council began the High Cotton Awards back in 1994 and have recognized nearly 100 U.S. cotton producers. The award was developed to illustrate how cotton growers and their families care about the environment and are true stewards of the land, air, and water. Upon hearing that they received the High Cotton award, McKean said, "It's a true honor to receive this award. I've known many people who have received it, and they are the icons of the industry who I respect in many different ways."

Mark and his wife, Megan, and their sons, Wyatt and Connor, operate McKean Farms at Riverdale, an operation located in Fresno County. The 3,700 acres farm produces Pima cotton (540 acres last year), almonds, wine grapes, processing tomatoes, and alfalfa. Mark is a forward-looking grower. He likes growing cotton and knows that every crop has its share of challenges. "If you are a cotton farmer and you don't enjoy it, you probably shouldn't be growing it," he says. He goes on to say, "It's not easy because of the many steps during the growing cycle. For me, cotton is really rewarding at harvest time. You travel across a nice field and see the fruits of your labor. It's a rewarding day when you end up with a really good crop of cotton."

The McKean family places great emphasis on environmental stewardship, using inputs sparingly. "We once had crop uniformity issues at defoliation time, and we've counteracted much of it with variable rate Pix applications," Mark says. "It's really helped at picking time. The benefits include better defoliation and a more uniform crop at picking." The McKean family's pro-environment philosophy includes the limited use of crop protection materials and the adoption of natural predators. Mark states, "Anytime you start applying a chemical, you are in a cycle of doing it again and again. The longer you can put it off, the better."

*The McKean Family*

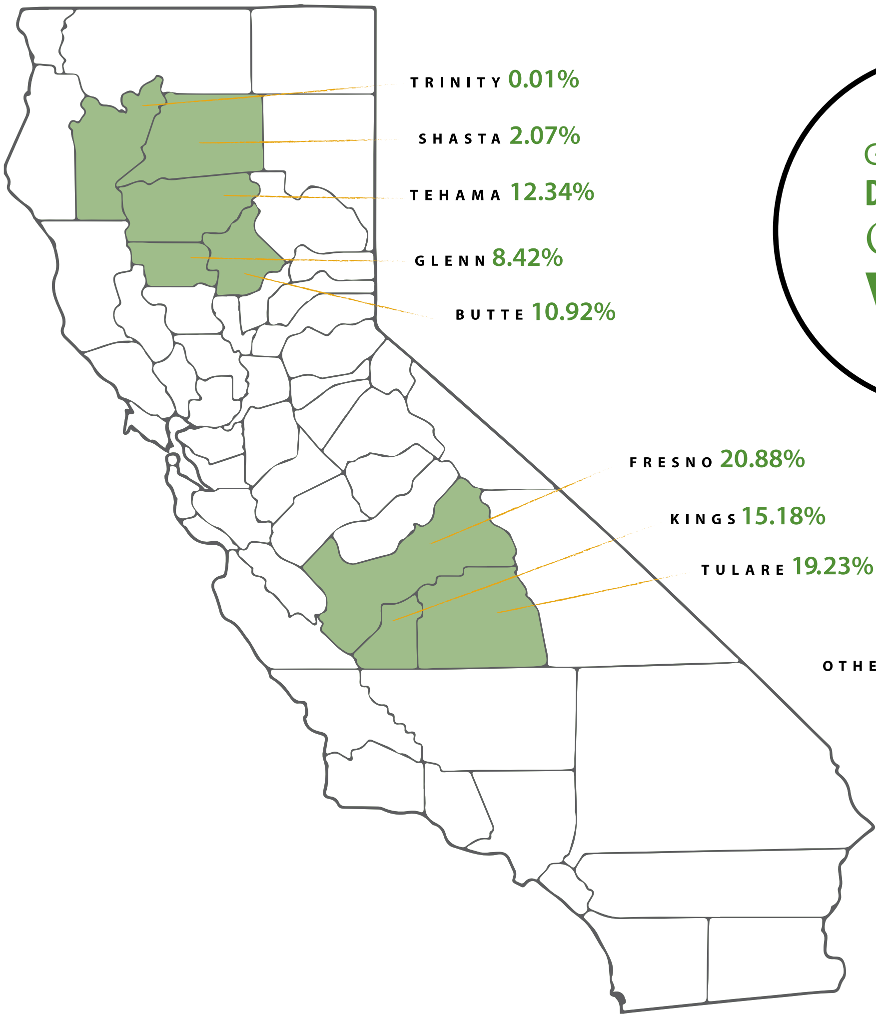
Water is an ongoing issue in California agriculture. McKean Farms takes part in the University of California Cooperative agricultural research trials with cotton experts, Dan Munk and Bob Hutmacher. "Mark has demonstrated leadership by supporting UC work in the areas of irrigation management, variety development, tillage, and soil building," Munk says. "He has provided testimony at public hearings by the Regional Water Quality Control Board about essential farming methods, including environmentally sound nitrogen management practices used to produce high-yielding crops." McKean's leadership positions include multiple water associations. He has also served as the chairman, and is a current board member on the California Cotton Growers Association (CCGA).

Both of the McKean's sons, Wyatt and Connor, graduated from college and returned to the family farm. Megan says, "Like Mark, I am very blessed the boys came back to the business." The two young men remain positive about agriculture, but understand the ongoing challenges the industry faces. Mark and Megan have also dedicated time to guiding local youth to become successful leaders.

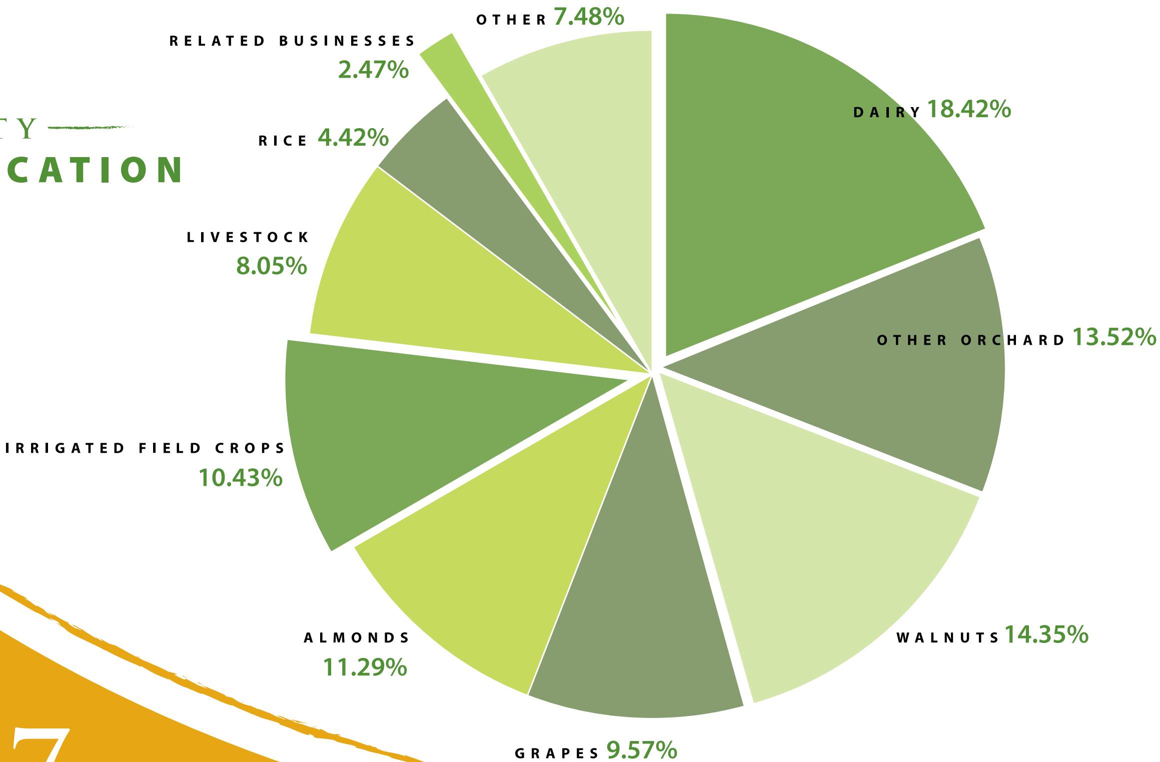
McKean has said there are three things he finds most rewarding when farming, "The reward of providing a safe supply of food and fiber; the reward of having our employees become successful in life; and the reward that I receive from friends and family related to that success."

***The McKean family places great emphasis on environmental stewardship.***

# GEOGRAPHIC DISTRIBUTION OF LOAN VOLUME




# COMMODITY DIVERSIFICATION




2017
IN REVIEW

# RAW MILK

## A Time for Change

*Courtesy of The AG Mag magazine*

The Duivenvoorden Farm began when Marc Duivenvoorden's parents emigrated from Holland and started a dairy in Cottonwood, CA. It was a conventional dairy for 30 years. After the elder Duivenvoorden passed away Marc kept the dairy going. In 2004 Marc and his brother Seth were milking 60–80 cows a day and selling their milk to a creamery, but after the 2008 economic downturn they made the decision to do something different.

Seth, who majored in animal science at Chico State and worked at the university's organic dairy, puts it this way, "Friends were asking us about raw milk. We were looking for new ideas, how we could survive in a different way. We researched herd share programs and used the help of the Farmer to Consumer Legal Defense Fund to establish a Herd Share Program. That's when we started making changes. We grew our business by word of mouth."

The Duivenvoordens sold herd shares. Every herd share owner owns a 1/10th of 1% leasehold interest in the herd. For a set price, a milk consumer is guaranteed a gallon of raw milk a week. Seth again, "After two years of doing herd shares, we were making more on our milk than we were when we took it to the creamery." The creamery wanted all the Duivenvoorden's milk. So, the family dropped the creamery. "They made the decision for us," says Marc. "We were well on our way with our herd shares, within two years we had between 200 and 300 families getting raw milk from us."

They milk their cows once day. "It's about quality not quantity," says Seth. "When we milked twice a day, we noticed that in the mornings, when cows had rested all night, the milk was much richer, there was more butter fat. On the second milking it was less creamy; there were less solids in the milk. Most dairymen are scared of milking only once a day, thinking if you don't milk twice a day the cows will get sick. But if you take out the stress of standing on concrete six to eight hours a day, and instead replace it with once a day two hours max, with the rest of the time on pasture there's less stress. Our cows are on pasture year round. In the winter, when the pasture is in its dormancy stage, we feed grass hay and our own hydroponically grown barley sprouts."

*Left to right: Marc, Kaden, and Seth*

Seth describes their herd share owners as "local, dedicated raw milk consumers who value sustainable farming and knowing their farmers. The herd share owners come to the Duivenvoorden Farm once a week to pick up their milk. They bring their kids and make it an experience for the whole family. They see where their milk comes from and also see the cows, goats, pigs, cats and dogs. A lot of young families have educated themselves about where their food is coming from. These people are creating a relationship between their food and the farmer."

In 2015 Duivenvoorden Farms saw a plateau starting to form with the growth of the herd share, and coincidentally the state was pushing them to build a milk plant due to the amount of cows they were milking for the herd share. The milk plant solved both issues by complying with the state and expanding their business. So the family business plan shifted once again, to building a milk plant and selling their milk in retail locations, now up to eight.

Seth and Marc were ready. "We were already set up to be a Grade A dairy and we built the milk plant so we could sell our milk in retail outlets, as Grade A certified." Sounds simple, but it took two years of research and planning, including learning what's acceptable to the state. They installed solar and built a commercial kitchen. "We're at the beginning of what I hope will be a raw milk business."

Was the move to build their own creamery a good one? Seth answers, "Yes, a good move. We cut out the middleman; we're doing it on our own, which means we get to control our product, down to the finished bottle of milk – the benefits outweigh the headaches. We might be the smallest milk plant in California and the largest herd share." Duivenvoorden Farms www.rawmilkdairy.com.

**Photos provided courtesy of Edible Shasta Butte Magazine.*

***We cut out the middleman; we're doing it on our own, which means we get to control our product…***

GSFC

# Supporting Agriculture and Rural America

## AWARDING $824,419

IN SPONSORSHIPS & DONATIONS

**OVER THE PAST FOUR YEARS**

## 2017

## GIVING $241,724

IN SPONSORSHIPS & DONATIONS

### NORTH STATE FOOD BANK

**The Community Food Bank Receives $5,000 from Golden State Farm Credit and CoBank.**

*Golden State Farm Credit presenting their donation to the North State Food Bank. Pictured left to right: Ray Block (Golden State Farm Credit's Regional Vice President) and Timothy J Hawkins (Community Action Agency's Chief Programs Officer).*

### COMMUNITY FOOD BANK

**Community Action Agency's North State Food Bank Receives $5,000 from Golden State Farm Credit and CoBank.**

*Golden State Farm Credit presenting their donation to the Community Food Bank. Pictured left to right: Andrew Souza (Community Food Bank's President & CEO), Mike Rico (Golden State Farm Credit's Regional Vice President).*

## BAILEY BROWNFIELD

**Agriculture Business**

*Written by Taylor Lacey, Public Information Intern for the College of Agriculture.*

Although she may not have been raised on a family farm or ranch, Bailey Brownfield quickly found her foothold in agriculture. You could always find her outside getting the show animals ready and getting her hands dirty. Today, the senior agriculture business major's passion for the industry continues to grow since attending Shasta Community College and transferring to CSU, Chico.

Brownfield's first exposure to the industry came from visiting her aunt and uncle's registered Hereford operation in Bonanza, Oregon. She grew up in Red Bluff CA, where she became heavily involved in 4-H and Future Farmers of America (FFA). While attending Red Bluff High School, Brownfield also had the opportunity to represent Tehama County as both junior and senior Beef Ambassador.

Brownfield's dedication to the industry in the business sector was not always transparent. It wasn't until she began working alongside mentor Shelley Macdonald, with Golden State Farm Credit, on event collaborations with the Tehama County Farm Bureau; that she began to envision her future occupation. Brownfield's path was also guided through an internship with the Tehama County Farm Bureau office. This provided her with countless networking opportunities as well as opportunities to help plan and coordinate events. Brownfield says the most rewarding part was seeing events she took a part in coordinating play out in the end. "Being in the Golden State Farm Credit office with Shelley showed me that agriculture business is more than being in an office. It is also going out and working directly in the industry with farmers and ranchers. I just loved the atmosphere. Shelley is an outstanding individual and has been an influential role model for me," Brownfield said.

She also credits Chico State professor Dave Daley for exposing her to new realms within agriculture that she would have otherwise not known. "Dr. Dave Daley's ag seminar class opened up my eyes to all the different pathways in agriculture. There are so many amazing opportunities out there that most people just don't know about," she said.

*Bailey Brownfield*

Since coming to Chico, Brownfield has also become immensely involved and became a member of the Sigma Alpha Sorority, Tri County Young Farmers and Ranchers, and Young Cattlemen's Association. Bailey also serves as the co-coordinator and founder of the Relay For Life-style event based on horseback. Since its establishment in 2009, the Nor-Cal Hero Ride for Life raised a grand total of $209,000 for the American Cancer Society.

Brownfield has been awarded numerous scholarship awards in agriculture. A few of her awards include the Rod Knight Memorial Scholarship, California Women of Agriculture Scholarship, Tehama County Farm Bureau Scholarship, and Tehama County Cattlewomen's Scholarship. "In the future, I can definitely see myself living in the Redmond-Bend (Oregon) area with a job directly related to agriculture business, possibly with Farm Credit or as a pharmaceutical representative." Brownfield says.

Brownfield's favorite thing about the CSU, Chico College of Agriculture is the small family feel. In her transfer from Shasta College, Bailey credits Chico's warm friendly atmosphere with making for a smooth transition. When asked what advice she would have for incoming students to the College of Agriculture, "Don't be afraid to branch out and try different things," she said. "Get involved, that's how you get the opportunity to meet new people and find your pathway."

***Agriculture business is more than being in an office. It is also going out and working directly in industry with farmers and ranchers.***

# FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA

*dollars in thousands*

| | December 31 | | | | |
|---|---|---|---|---|---|
| | **2017** | 2016 | 2015 | 2014 | 2013 |
| **Statement of Condition Data** | | | | | |
| Loans | **$ 1,476,850** | $ 1,375,591 | $ 1,216,296 | $ 1,152,326 | $ 465,879 |
| Less allowance for loan losses | **4,603** | 4,229 | 3,321 | 2,524 | 2,502 |
| Net loans | **1,472,247** | 1,371,362 | 1,212,975 | 1,149,802 | 463,377 |
| Investment in CoBank, ACB | **47,453** | 41,357 | 39,592 | 39,489 | 18,032 |
| Other property owned | **-** | - | - | 57 | - |
| Other assets | **45,395** | 38,934 | 34,308 | 29,260 | 11,927 |
| **Total assets** | **$ 1,565,095** | $ 1,451,653 | $ 1,286,875 | $ 1,218,608 | $ 493,336 |
| Obligations with maturities of one year or less | **$ 1,273,264** | $ 1,176,285 | $ 1,025,763 | $ 968,059 | $ 395,589 |
| Reserve for unfunded commitments | **153** | 190 | 64 | - | - |
| **Total liabilities** | **1,273,417** | 1,176,475 | 1,025,827 | 968,059 | 395,589 |
| Capital stock and participation certificates | **1,555** | 1,600 | 1,582 | 1,612 | 983 |
| Additional paid-in capital | **141,442** | 141,442 | 141,442 | 141,442 | - |
| Unallocated retained earnings | **148,925** | 132,320 | 118,333 | 107,833 | 96,764 |
| Accumulated other comprehensive (loss)/income | **(244)** | (184) | (309) | (338) | - |
| **Total shareholders' equity** | **291,678** | 275,178 | 261,048 | 250,549 | 97,747 |
| **Total liabilities and shareholders' equity** | **$ 1,565,095** | $ 1,451,653 | $ 1,286,875 | $ 1,218,608 | $ 493,336 |

| | For the Year Ended December 31 | | | | |
|---|---|---|---|---|---|
| | **2017** | 2016 | 2015 | 2014 | 2013 |
| **Statement of Income Data** | | | | | |
| Net interest income | **$ 40,087** | $ 34,804 | $ 31,681 | $ 29,702 | $ 12,703 |
| Patronage distribution from Farm Credit institutions | **5,731** | 5,207 | 4,577 | 4,625 | 1,633 |
| Provision for credit losses | **337** | 1,034 | 863 | 61 | - |
| Noninterest expense, net | **17,474** | 14,888 | 13,093 | 11,998 | 6,559 |
| Provision for/(Benefit from) income taxes | **2** | 2 | 2 | (301) | 3 |
| **Net income** | **$ 28,005** | $ 24,087 | $ 22,300 | $ 22,569 | $ 7,774 |
| **Comprehensive income** | **$ 27,945** | $ 24,212 | $ 22,329 | $ 22,231 | $ 7,774 |
| **Key Financial Ratios** | | | | | |
| **For the Year** | | | | | |
| Return on average assets | **1.87%** | 1.80% | 1.82% | 1.88% | 1.68% |
| Return on average shareholders' equity | **9.75%** | 8.90% | 8.57% | 9.07% | 8.02% |
| Net interest income as a percentage of average earning assets | **2.80%** | 2.72% | 2.72% | 2.61% | 2.91% |
| Net charge-offs/(recoveries) as a percentage of average net loans | - | - | <0.01% | <0.01% | - |
| **At Year End** | | | | | |
| Shareholders' equity as a percentage of total assets | **18.64%** | 18.96% | 20.29% | 20.56% | 19.81% |
| Debt as a ratio to shareholders' equity | **4.37:1** | 4.28:1 | 3.93:1 | 3.86:1 | 4.05:1 |
| Allowance for loan losses as a percentage of loans | **0.31%** | 0.31% | 0.27% | 0.22% | 0.54% |
| Common equity tier 1 (CET1) capital ratio | **15.60%** | N/A | N/A | N/A | N/A |
| Tier 1 capital ratio | **15.60%** | N/A | N/A | N/A | N/A |
| Total regulatory capital ratio | **15.90%** | N/A | N/A | N/A | N/A |
| Tier 1 leverage ratio | **16.39%** | N/A | N/A | N/A | N/A |
| Unallocated retained earnings and URE equivalents (UREE) leverage ratio | **17.58%** | N/A | N/A | N/A | N/A |
| Permanent capital ratio | **15.65%** | 16.36% | 18.04% | 18.13% | 17.17% |
| Total surplus ratio | **N/A** | 16.25% | 17.91% | 18.00% | 16.97% |
| Core surplus ratio | **N/A** | 16.09% | 17.65% | 17.70% | 15.95% |
| **Net Income Distribution** | | | | | |
| Cash patronage distribution paid | **$ 10,600** | $ 11,500 | $ 11,600 | $ 11,400 | $ 4,100 |
| Cash patronage declared | **$ 11,400** | $ 10,100 | $ 11,800 | $ 11,500 | $ 4,100 |

# DISCUSSION AND ANALYSIS

### Introduction

The following discussion summarizes the financial position and results of operations of Golden State Farm Credit, ACA (Association) for the year ended December 31, 2017. Comparisons with prior years are included. We have emphasized material known trends, commitments, events, or uncertainties that have impacted, or are reasonably likely to impact our financial condition and results of operations. The discussion and analysis should be read in conjunction with the accompanying consolidated financial statements, footnotes and other sections of this report. The accompanying consolidated financial statements were prepared under the oversight of our Audit Committee. The Management's Discussion and Analysis includes the following sections:

- Business Overview
- Economic Overview
- Loan Portfolio
- Credit Risk Management
- Results of Operations
- Liquidity
- Capital Resources
- Regulatory Matters
- Governance
- Forward-Looking Information
- Critical Accounting Policies and Estimates
- Customer Privacy

Our quarterly reports to shareholders are available approximately 40 days after the calendar quarter end and annual reports are available approximately 75 days after the calendar year end. The reports may be obtained free of charge on our website, www.gsfarmcredit.com, or upon request. We are located at 1359 East Lassen Avenue, Chico, California 95973, or may be called at (530) 571-4160.

## BUSINESS OVERVIEW

### Farm Credit System Structure and Mission

We are one of 69 associations in the Farm Credit System (System), which was created by Congress in 1916 and has served agricultural producers for over 100 years. The System mission is to provide sound and dependable credit to American farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses through a member-owned cooperative system. This is done by making loans and providing financial services. Through its commitment and dedication to agriculture, the System continues to have the largest portfolio of agricultural loans of any lender in the United States. The Farm Credit Administration (FCA) is the System's independent safety and soundness federal regulator and was established to supervise, examine and regulate System institutions.

### Our Structure and Focus

As a cooperative, we are owned by the members we serve. Our territory served extends across a diverse agricultural region of Butte, Fresno, Glenn, Kings, Shasta, Tehama, Trinity and Tulare counties in California. We make long-term real estate mortgage loans to farmers, ranchers, rural residents and agribusinesses and production and intermediate-term loans for agricultural production or operating purposes. Additionally, we provide other related services to our borrowers, such as credit life insurance, multi-peril crop and crop hail insurance, advance conditional payment accounts, leasing, and fee appraisals. Our success begins with our extensive agricultural experience and knowledge of the market and is dependent on the level of satisfaction we provide to our borrowers.

As part of the System, we obtain the funding for our lending and operations from a Farm Credit Bank. Our funding bank, CoBank, ACB (CoBank), is a cooperative of which we are a member. CoBank, its related associations, and AgVantis, Inc. (AgVantis) are referred to as the District.

We, along with the borrower's investment in our Association, are materially affected by CoBank's financial condition and results of operations. The CoBank quarterly and annual reports are available free of charge by accessing CoBank's website, www.cobank.com, or may be obtained at no charge by contacting us at 1359 East Lassen Avenue, Chico, California 95973, or by calling (530) 571-4160. Annual reports are available within 75 days after year end and quarterly reports are available within 40 days after the calendar quarter end.

We purchase technology and other operational services from AgVantis, which is a technology service corporation. Our current service agreement expires on December 31, 2018. We are a shareholder in AgVantis, along with other AgVantis customers. Farm Credit Foundations, a human resource shared service provider for a number of Farm Credit institutions, provides administration for our payroll and benefits and may provide related human resource offerings.

## ECONOMIC OVERVIEW

During 2017, economic conditions in our region continued to experience favorable conditions. While interest rates have risen slightly, they remain relatively low and real estate collateral values remain strong. The primary commodities reflected in our portfolio have prices that allow for profitable production. There was a weakening in prices of dairy products. Pricing of tree nut products has stabilized at a lower level than several years ago. Many of our agricultural products are dependent on global markets and international trade. Weakening economies, particularly in the Pacific Rim area, and the high value of our currency may contribute to lower demand and prices of some commodities. An aggressive position by the federal government toward foreign trade agreements could have an unknown but significant impact on agricultural export markets. Generally, favorable economic conditions are expected to continue into 2018.

The drought conditions, water availability and the long term effects on agriculture continue to be the major considerations in looking at growth and profitability for the future. Following a very strong rainfall and snow pack season in 2016 and 2017, recent rain and snow pack measurements have been less than normal through December 2017. It is still unknown how another drought year may affect surface and groundwater rights in the future. State and local water laws and regulation could have a significant impact on agriculture in our territory. Given the high commodity prices of the last several years, there has been a significant increased investment in some commodities. As the increased supply comes online in future years, it may have a negative impact on prices. Political and environmental issues add to the uncertainty of the future prosperity of agriculture in our region.

The Agricultural Act of 2014 (Farm Bill) was signed into law on February 7, 2014. This Farm Bill governs an array of federal farm and food programs, including commodity price and support payments, farm credit, agricultural conservation, research, rural development, and foreign and domestic food programs for five years. The Farm Bill eliminates $23 billion in mandatory federal spending over a 10-year period, representing a reduction in the U.S. government farm policy support. The Farm Bill repeals direct payments and limits producers to risk management tools that offer protection when they suffer significant losses. The Farm Bill provides continued support for crop insurance programs, strengthens livestock disaster assistance and provides dairy producers with a voluntary margin protection program without imposing government-mandated supply controls. The next Farm Bill is scheduled for 2018.

During August 2017, CoBank management announced changes to their capital plans and patronage programs for eligible customer-owners designed to address a number of marketplace challenges. The changes are intended to strengthen CoBank's long-term capacity to serve customers' borrowing needs, enhance CoBank's ability to capitalize future customer growth, and ensure equitability among different customer segments. For cooperatives and other eligible direct borrowers as well as for loans purchased from other Farm Credit institutions, the new target patronage levels take effect in 2018 calendar year and will be reflected in patronage distributions made in March 2019. Affiliated Associations and non-affiliated Farm Credit and other financing institutions will transition to their new target patronage levels over a multi-year period ending in 2020.

New U.S. tax laws resulting from legislation commonly known as the Tax Cuts and Jobs Acts of 2017 (TCJA) were enacted in late 2017. Among other things, the TCJA changed the federal corporate tax rate from 35 percent to 21 percent. While the Association realized a net expense from the decrease in the federal corporate tax rate in its 2017 financial results, the full impact due to the revaluation of the net deferred tax asset impact of the TCJA is difficult to predict and may not be fully known for several years. Changes that could affect our business and customers include, but are not limited to, modifications to deductions surrounding interest expense and equipment purchases and the overall changes in the competitive environment impacting financial institutions.

## LOAN PORTFOLIO

Total loans outstanding were $1.48 billion at December 31, 2017, an increase of $101.3 million, or 7.4%, from loans at December 31, 2016 of $1.38 billion, and an increase of $260.6 million, or 21.4%, from loans at December 31, 2015 of $1.22 billion. The increase in loans was due to customer demand, the improved real estate market, an increase in agricultural activity within our territory and increased participations purchased for diversification purposes. The types of loans outstanding at December 31 are reflected in the following table.

| | 2017 | | 2016 | | 2015 | |
|---|---|---|---|---|---|---|
| *(dollars in thousands)* | Volume | Percent | Volume | Percent | Volume | Percent |
| Real estate mortgage loans | $ 1,231,055 | 83.4% | $ 1,168,141 | 85.0% | $ 1,061,681 | 87.3% |
| Production and intermediate-term loans | 119,902 | 8.1% | 95,640 | 7.0% | 72,100 | 5.9% |
| Agribusiness loans | 60,660 | 4.1% | 54,554 | 3.9% | 47,307 | 3.9% |
| Rural infrastructure loans | 14,906 | 1.0% | 7,031 | 0.5% | – | – |
| Rural residential real estate loans | 247 | – | 258 | – | 269 | – |
| Lease receivables | 50,080 | 3.4% | 49,967 | 3.6% | 34,939 | 2.9% |
| Total | $ 1,476,850 | 100.0% | $ 1,375,591 | 100.0% | $ 1,216,296 | 100.0% |

*Having family members directly involved in farming has enabled me to understand how our members' success expands beyond the loan. When our members succeed, their families and the surrounding communities prosper as well. More importantly, I feel that being an added support system that helps our members withstand adversities, is when our efforts make the biggest impact. These are the success stories I remember most.*

**Tod Kimmelshue,** *Chico*
*Serving Our Members Since 1983*

OUR VENTURE–
**YOUR SUCCESS**

Real estate mortgage loans outstanding increased to $1.23 billion, compared with $1.17 billion at year-end 2016, primarily due to regular organic growth. Long-term mortgage loans are primarily used to purchase, refinance or improve real estate. These loans have maturities ranging from 5 to 40 years. By federal regulation, a real estate mortgage loan must be secured by a first lien and may only be made in an amount up to 85% of the original appraised value of the property, or up to 97% of the appraised value, if the loan is guaranteed by certain state, federal, or other governmental agencies. Under our current underwriting standards, we loan less than the regulatory limit of 85% of the appraised value of the property.

The production and intermediate-term loans increased 25.4% to $119.9 million compared with 2016 loans of $95.6 million, primarily due to the addition of several large loans and an increased focus on marketing production loans to former land bank customers. Production loans are used to finance the ongoing operating needs of agricultural producers and generally match the borrower's normal production and marketing cycle, which is typically 12 months. Intermediate-term loans are generally used to finance depreciable capital assets of a farm or ranch and are written for a specific term, 1 to 15 years, with most loans being less than 10 years. Our production and intermediate-term loan portfolio shows some seasonality. Borrowings increase throughout the planting and growing seasons to meet farmers' operating and capital needs. 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 Diversification

While we make loans and provide financially related services to qualified borrowers in agricultural and rural sectors and to certain related entities, our loan portfolio is diversified by loan participations purchased and sold, geographic locations served, commodities financed and loan size as illustrated in the following four tables.

We purchase loan and lease participations from other System entities to generate additional earnings and diversify risk related to existing commodities financed and our geographic area served. In addition, we sell a portion of certain large loans to other System entities to reduce risk and comply with lending limits we have established.

Our volume of participations purchased and sold as of December 31 follows.

| *(dollars in thousands)* | 2017 | 2016 | 2015 |
|---|---|---|---|
| Participations purchased | $ 72,712 | $ 57,348 | $ 29,555 |
| Participations sold | $ 105,946 | $ 108,605 | $ 105,818 |

We have no loans sold with recourse, retained subordinated participation interests in loans sold, or interests in pools of subordinated participation interests that are held in lieu of retaining a subordinated participation interest in the loans sold.

The geographic distribution of loans by county at December 31 follows. As previously mentioned we purchase loan participations outside our territory, which are included in Other in the following table.

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Fresno | 20.88% | 23.69% | 27.20% |
| Tulare | 19.23% | 18.35% | 14.62% |
| Kings | 15.18% | 16.23% | 18.64% |
| Tehama | 12.34% | 10.76% | 10.37% |
| Butte | 10.92% | 10.30% | 10.37% |
| Glenn | 8.42% | 8.79% | 9.66% |
| Shasta | 2.07% | 2.26% | 2.30% |
| Trinity | 0.01% | 0.01% | 0.02% |
| Other | 10.95% | 9.61% | 6.82% |
| Total | 100.00% | 100.00% | 100.00% |

We are a party to an Agreement Providing Territorial Concurrence (Agreement) with Farm Credit West. This Agreement eliminates territorial restrictions and allows either party to make loans through its dealer network in the other's territory for a fee.

The following table shows the primary agricultural commodities produced by our borrowers based on the Standard Industrial Classification System (SIC) published by the federal government. This system is used to assign commodity or industry categories based on the primary business of the customer. A primary business category is assigned when the commodity or industry accounts for 50% or more of the total value of sales for a business; however, a large percentage of agricultural operations typically includes more than one commodity.

| | **December 31** | | |
|---|---|---|---|
| SIC Category | 2017 | 2016 | 2015 |
| Dairy | 18.42% | 19.04% | 16.93% |
| Walnuts | 14.35% | 11.97% | 11.94% |
| Other orchards | 13.52% | 14.72% | 15.21% |
| Almonds | 11.29% | 10.86% | 11.14% |
| Irrigated field crops | 10.43% | 10.21% | 11.08% |
| Grapes | 9.57% | 10.05% | 11.40% |
| Livestock | 8.05% | 8.30% | 8.61% |
| Rice | 4.42% | 4.71% | 4.69% |
| Related business | 2.47% | 1.67% | 1.85% |
| Other | 7.48% | 8.47% | 7.15% |
| Total | 100.00% | 100.00% | 100.00% |

Our loan portfolio contains a diverse mix of commodities. Dairy, other orchards, walnuts, almonds, irrigated field crops and grapes are the largest concentrations. These six commodities represent 77% of our loan volume, the same level as 2016. This concentration is spread over a large number of borrowers. Repayment ability of our borrowers is closely related to the production and profitability of the commodities they raise. If a loan fails to perform, restructuring and/or other servicing alternatives are influenced by the underlying value of the collateral, which is impacted by industry economics. Our future performance would be negatively impacted by adverse agricultural conditions. The degree of the adverse impact would be correlated to the commodities negatively affected and the magnitude and duration of the adverse agricultural conditions to our borrowers.

In addition to commodity diversification noted in the previous table, further diversification is also achieved from loans to rural residents and part-time farmers, which typically derive most of their earnings from non-agricultural sources. These borrowers are less subject to agricultural cycles and would likely be more affected by weaknesses in the general economy.

The principal balance outstanding at December 31, 2017 for loans $250 thousand or less accounted for 12.0% of loan volume and 72.8% of the number of loans. Credit risk on small loans, in many instances, may be reduced by non-farm income sources. The following table details loan principal by dollar size at December 31 for the last three years.

| | **2017** | | 2016 | | 2015 | |
|---|---|---|---|---|---|---|
| *(dollars in thousands)* | **Amount outstanding** | **Number of loans** | Amount outstanding | Number of loans | Amount outstanding | Number of loans |
| $1 - $250 | **$ 177,845** | **2,942** | $ 197,777 | 2,895 | $ 190,180 | 2,726 |
| $251 - $500 | **170,774** | **486** | 175,366 | 492 | 179,080 | 510 |
| $501 - $1,000 | **205,200** | **290** | 206,172 | 292 | 198,447 | 277 |
| $1,001 - $5,000 | **616,025** | **285** | 570,475 | 259 | 494,623 | 225 |
| $5,001 - $25,000 | **307,006** | **39** | 225,801 | 31 | 153,966 | 23 |
| Total | **$ 1,476,850** | **4,042** | $ 1,375,591 | 3,969 | $ 1,216,296 | 3,761 |

Approximately 14% of our outstanding loan volume is attributable to our ten largest borrower relationships. Due to their size, the loss of any of these loans or the failure of any of these loans to perform would adversely affect the portfolio and our future operating results.

The credit risk of some long-term real estate loans has been reduced by entering into agreements that provide long-term standby commitments by Federal Agricultural Mortgage Corporation (Farmer Mac) to purchase the loans in the event of default. The amount of loans subject to these Farmer Mac credit enhancements was $104.2 million at December 31, 2017, $98.3 million at December 31, 2016 and $100.1 million at December 31, 2015. Included in other operating expenses were fees paid for these Farmer Mac commitments totaling $322 thousand in 2017, $355 thousand in 2016 and $360 thousand in 2015. Under the Farmer Mac long-term standby commitment to purchase agreements, we continue to hold the loans in our portfolio, and we pay commitment fees to Farmer Mac for the right to put a loan designated in these agreements to Farmer Mac at par in the event the loan becomes significantly delinquent (typically four months past due). If the borrower cures the default, we must repurchase the loan and the commitment remains in place. Farmer Mac long-term standby commitments to purchase agreements are further described in Note 3. Other than the contractual obligations arising from these business transactions with Farmer Mac, Farmer Mac is not liable for any debt or obligation of ours and we are not liable for any debt or obligation of Farmer Mac. For more information on Farmer Mac, refer to their website at www.farmermac.com.

Credit guarantees with government agencies of $2.1 million at year-end 2017, $2.4 million at year-end 2016 and $2.2 million at year-end 2015 were outstanding.

## Credit Commitments

We may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of our borrowers. These financial instruments include commitments to extend credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in our consolidated financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee by the borrower. We may also participate in standby letters of credit to satisfy the financing needs of our borrowers. These standby letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. The following table summarizes the maturity distribution of unfunded credit commitments on loans at December 31, 2017.

| *(dollars in thousands)* | **Less than 1 year** | **1 - 3 years** | **3 - 5 years** | **Over 5 years** | **Total** |
|---|---|---|---|---|---|
| Commitments | $ 78,790 | $ 59,728 | $ 14,473 | $ 223,316 | $ 376,307 |
| Standby letters of credit | 362 | – | 1 | – | 363 |
| Total commitments | $ 79,152 | $ 59,728 | $ 14,474 | $ 223,316 | $ 376,670 |

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the Consolidated Statement of Condition until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and we apply the same credit policies to these commitments. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on our credit evaluation of the borrower. We consider potential losses related to unfunded commitments, and a reserve for unfunded commitments is included in the liabilities section of the Consolidated Statement of Condition. The related provision for the reserve for unfunded commitment is included as part of the provision for credit losses on the Consolidated Statement of Comprehensive Income.

## High Risk Assets

Nonperforming loan volume is comprised of nonaccrual loans, restructured loans, and loans 90 days past due still accruing interest and are referred to as impaired loans. High risk assets consist of impaired loans and other property owned. Comparative information regarding high risk assets in the portfolio, including accrued interest, follows:

| *(dollars in thousands)* | 2017 | 2016 | 2015 |
|---|---|---|---|
| Nonaccrual loans: | | | |
| Real estate mortgage | $ 3,493 | $ 498 | $ 283 |
| Lease receivables | 223 | 276 | 1 |
| Total nonaccrual loans | 3,716 | 774 | 284 |
| Total high risk assets | $ 3,716 | $ 774 | $ 284 |
| Nonaccrual loans to total loans | 0.25% | 0.06% | 0.02% |
| High risk assets to total loans | 0.25% | 0.06% | 0.02% |
| High risk assets to total shareholders' equity | 1.27% | 0.28% | 0.11% |

We had no loans classified as restructured or 90 days past due still accruing interest, and no other property owned for the years presented.

*Unaudited*

Total high risk assets increased $2.9 million, to $3.7 million at December 31, 2017 compared with year-end 2016. Contributing to the increase in our high risk assets were loans to borrowers adversely impacted by commodity price volatility and higher farm input costs in the current agricultural environment. Even with this increase, the amount of high risk assets is considered low.

Nonaccrual loans represent all loans where there is a reasonable doubt as to collection of all principal and/or interest. Nonaccrual volume increased $2.9 million compared with December 31, 2016 due to the transfer of loans to nonaccrual status. One customer comprises approximately 89% of the total nonaccrual volume.

The following table provides additional information on nonaccrual loans as of December 31 for the last three fiscal years.

| *(dollars in thousands)* | 2017 | 2016 | 2015 |
|---|---|---|---|
| Nonaccrual loans current as to principal and interest | $ 621 | $ 487 | $ 284 |

For the years presented, we had no cash basis nonaccrual loans and no restructured loans in nonaccrual status.

High risk asset volume is currently very low. Management has projected modest increases in future years.

## Credit Quality

We review the credit quality of the loan portfolio on an on-going basis as part of our risk management practices. Each loan is classified according to the Uniform Classification System (UCS), which is used by all System institutions. Following are the classification definitions.

- **Acceptable** – Assets are expected to be fully collectible and represent the highest quality.
- **Other Assets Especially Mentioned (OAEM)** – Assets are currently collectible but exhibit some potential weakness.
- **Substandard** – Assets exhibit some serious weakness in repayment capacity, equity, and/or collateral pledged on the loan.
- **Doubtful** – Assets exhibit similar weaknesses as substandard assets. However, doubtful assets have additional weaknesses in existing facts that make collection in full highly questionable.
- **Loss** – Assets are not considered collectible.



*Unaudited*

The following table presents statistics based on UCS related to the credit quality of the loan portfolio, including accrued interest at December 31 for the last three fiscal years.

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Acceptable | 98.54% | 98.91% | 99.79% |
| OAEM | 0.67% | 0.83% | 0.12% |
| Substandard | 0.79% | 0.26% | 0.09% |
| Total | 100.00% | 100.00% | 100.00% |

During 2017, overall credit quality remained very high. Loans classified as Acceptable and OAEM were 99.21% at December 31, 2017, 99.74% at December 31, 2016 and 99.91% at December 31, 2015. We had no loans classified as Doubtful or Loss for any of the three years presented. The financial position of most agricultural producers strengthened during the past decade, and most of our borrowers have maintained generally strong financial positions. As such, our credit quality is anticipated to remain sound in the near term. However, agriculture remains a cyclical business that is heavily influenced by weather, production, operating costs and commodity prices. Each of these can be significantly impacted by uncontrollable events. If less favorable economic conditions continue, it will likely lead to weakening in the loan portfolio. Loan delinquencies (accruing loans 30 days or more past due) as a percentage of accruing loans decreased to a low level of 0.11% at December 31, 2017, compared with 0.21% at December 31, 2016 and 0.02% at December 31, 2015.

## Allowance for Loan Losses

We maintain an allowance for loan losses at a level consistent with the probable and estimable losses inherent in the loan portfolio identified by management. The allowance for loan losses at each period end was considered to be adequate to absorb probable losses existing in the loan portfolio. Because the allowance for loan losses considers factors such as current agricultural and economic conditions, adverse weather, loan loss experience, portfolio quality and loan portfolio composition, there will be a direct impact to the allowance for loan losses and our income statement when there is a change in any of those factors. The following table provides relevant information regarding the allowance for loan losses as of December 31 for the last three fiscal years.

| *(dollars in thousands)* | 2017 | 2016 | 2015 |
|---|---|---|---|
| Balance at beginning of year | $ 4,229 | $ 3,321 | $ 2,524 |
| Charge-offs: | | | |
| Lease receivables | – | – | 2 |
| Net charge-offs | – | – | 2 |
| Provision for loan losses | 374 | 908 | 799 |
| Balance at December 31 | $ 4,603 | $ 4,229 | $ 3,321 |
| Net charge-offs as a percentage of average net loans | – | – | <0.01% |

The following table presents the allowance for loan losses by loan type as of December 31 for the last three fiscal years.

| *(dollars in thousands)* | 2017 | 2016 | 2015 |
|---|---|---|---|
| Real estate mortgage | $ 949 | $ 667 | $ 773 |
| Production and intermediate-term | 1,980 | 1,932 | 1,464 |
| Agribusiness | 999 | 998 | 311 |
| Rural infrastructure | 98 | 50 | – |
| Rural residential real estate | 1 | 1 | 2 |
| Lease receivables | 576 | 581 | 771 |
| Total | $ 4,603 | $ 4,229 | $ 3,321 |

The allowance for loan losses increased $374 thousand from December 31, 2016, to $4.6 million at December 31, 2017. The increase in allowance for loan losses was due to the provision for loan losses totaling $374 thousand that was recorded due to growth in the loan portfolio. There were no charge-offs or recoveries recorded during 2017. Charge-offs have been zero for the last two years. During 2016, our allowance for loan losses increased $908 thousand from 2015 primarily due to growth in the loan portfolio. Comparative allowance for loan losses coverage as a percentage of loans and certain other credit quality indicators as of December 31 are presented in the following table.

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Allowance as a percentage of: | | | |
| Loans | 0.31% | 0.31% | 0.27% |
| Impaired loans | 123.87% | 546.38% | 1,169.37% |

We maintain a separate reserve for unfunded commitment, which is included in Liabilities on our Consolidated Statement of Condition. The related provision for the reserve for unfunded commitments is included as part of the provision for credit losses on the Consolidated Statement of Comprehensive Income, along with the provision for loan losses.

A summary of changes in the reserve for unfunded commitment follows.

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Balance at beginning of year | $ 190 | $ 64 | $ – |
| (Reversal of)/Provision for reserve of unfunded commitments | (37) | 126 | 64 |
| Total | $ 153 | $ 190 | $ 64 |

## Young, Beginning and Small Farmers and Ranchers Program

As part of the Farm Credit System, we are committed to providing sound and dependable credit and related services to young, beginning and small (YBS) farmers and ranchers. Our mission statement for this program is:

***To Serve Young, Beginning and Small Farmers by***
***Providing Dependable Credit and Financial Services***

This policy is intended to provide for both the mortgage and commercial credit, and other Association related service needs of a group of borrowers who may not be eligible for financing under our existing policies.

Following are FCA regulatory definitions for YBS farmers and ranchers.

- **Young Farmer:** A farmer, rancher, or producer or harvester of aquatic products who was age 35 or younger as of the date the loan was originally made.
- **Beginning Farmer:** A farmer, rancher, or producer or harvester of aquatic products who had 10 years or less farming or ranching experience as of the date the loan was originally made.
- **Small Farmer:** A farmer, rancher, or producer or harvester of aquatic products who normally generated less than $250 thousand in annual gross sales of agricultural or aquatic products at the date the loan was originally made.

The following table outlines our percentage of YBS loans as a percentage of the number of loans in our loan portfolio while the USDA column represents the percent of farmers and ranchers classified as YBS within our territory per the 2012 USDA Agricultural Census, which is the most current data available. Due to FCA regulatory definitions, a farmer/rancher may be included in multiple categories as they would be included in each category in which the definition was met.

| | | December 31 | | |
|---|---|---|---|---|
| | USDA | 2017 | 2016 | 2015 |
| Young | 10% | 12% | 13% | 14% |
| Beginning | 29% | 20% | 24% | 24% |
| Small | 78% | 27% | 32% | 32% |



Unaudited

Note that several differences exist in definitions between USDA statistics and our data due to our use of FCA definitions. Young farmers are defined as 34 years old and younger by the USDA, while FCA definitions include farmers 35 years old and younger. Beginning farmers are defined by FCA as those with 10 years or less farming experience; however, the USDA identifies beginning farmers as on their current farm less than 10 years. This may include both beginning farmers and experienced farmers who have recently changed farmsteads. Our percentages are based on the number of loans in our portfolio, while the USDA percentages are based on the number of farmers and ranchers. While these definition differences do exist, the information is the best comparative information available.

We establish annual marketing goals to increase market share of loans to YBS farmers and ranchers. Our goals are as follows:

- Offer related services either directly or in coordination with others that are responsive to the needs of YBS farmers and ranchers in our territory;
- Take full advantage of opportunities for coordinating credit and services offered with other System institutions in the territory and other governmental and private sources of credit who offer credit and services to those who qualify as YBS farmers and ranchers in our territory; and,
- Implement effective outreach programs to attract YBS farmers and ranchers.

Quarterly reports are provided to our Board of Directors detailing the number, volume and credit quality of our YBS customers. We have developed quantitative targets to monitor our progress as follows:

- Loan volume and loan number goals for YBS farmers and ranchers in our territory;
- Percentage goals representative of the demographics of YBS farmers and ranchers in our territory;
- Percentage goals for loans made to new borrowers qualifying as YBS farmers and ranchers in our territory; and,
- Goals for capital committed to loans made to YBS farmers and ranchers in our territory.

| | Volume (change) | | Number of loans (change) | |
|---|---|---|---|---|
| | Goal | Actual | Goal | Actual |
| Young | 3% | 11% | 3% | 0% |
| Beginning | 3% | 1% | 1% | (2%) |
| Small | 3% | (1%) | 3% | 0% |

To ensure that credit and services offered to our YBS farmers and ranchers are provided in a safe and sound manner and within our risk-bearing capacity, we utilize customized loan underwriting standards, loan guarantee programs, fee waiver programs, or other credit enhancement programs. Additionally, we are actively involved in developing and sponsoring educational opportunities, leadership training, business financial training and insurance services for YBS farmers and ranchers.

*"A lot of us are from farms, have family involved in farming, or live in an agricultural community. We know how much time and effort it takes to be successful in agriculture. We know how much risk is involved. I have shared the excitement of a customer's first harvest and I have stood by them when they have struggled. The connections I make with our members is how I measure success."*

**Jonathan van Tol,** *Willows*
*Serving Our Members Since 2007*

OUR VENTURE–
**YOUR SUCCESS**

## CREDIT RISK MANAGEMENT

Credit risk arises from the potential failure of a borrower to meet repayment obligations that result in a financial loss to the lender. Credit risk exists in our loan portfolio and in our unfunded loan commitments and standby letters of credit. Credit risk is actively managed on an individual and portfolio basis through application of sound lending and underwriting standards, policies and procedures and stress test analysis of the portfolio.

Underwriting standards are utilized to determine an applicant's operational, financial, and managerial resources available for repaying debt within the terms of the note and loan agreement. Underwriting standards include among other things, an evaluation of:

- **character** – borrower integrity and credit history;
- **capacity** – repayment capacity of the borrower based on cash flows from operations or other sources of income;
- **collateral** – to protect the lender in the event of default and also serve as a secondary source of loan repayment;
- **capital** – ability of the operation to survive unanticipated risks; and,
- **conditions** – intended use of the loan funds, terms, restrictions, etc.

Processes for information gathering, balance sheet and income statement verification, loan analysis, credit approvals, disbursements of proceeds and subsequent loan servicing actions are established and followed. Underwriting standards vary by industry and are updated periodically to reflect market and industry conditions.

By regulation, we cannot have loan commitments to one borrower for more than 15% of our lending and lease limit base. The lending and lease limit base is defined as permanent capital with any applicable adjustments related to preferred stock and any investment held in connection with the sale of loan participation interest. Additionally, we set our own lending limits to manage loan concentration risk. Internal lending limits have been established for individual loan size and risk level. We have adopted an internal lending limit maximum of 12% of permanent capital for our highest quality borrowers.

We have established internal lending delegations to properly control the loan approval process. Delegations to staff are based on our risk-bearing ability, loan size, complexity, type and risk, as well as the expertise and position of the credit staff member. Larger and more complex loans or loans perceived to have higher risk are typically approved by our loan committee with the most experienced and knowledgeable credit staff serving as members.

The majority of our lending is first mortgage real estate loans which must be secured by a first lien on real estate. Production and intermediate-term lending accounts for most of the remaining volume and is typically secured by livestock, crops and equipment. Collateral evaluations are completed in compliance with FCA and Uniform Standards of Professional Appraisal Practices requirements. All property is appraised at market value. All collateral evaluations must be performed by a qualified appraiser. Certain appraisals must be performed by individuals with a state certification or license.

We use a two-dimensional risk rating model (Model) based on the Farm Credit System's Combined System Risk Rating Guidance. The Model estimates each loan's probability of default (PD) and loss given default (LGD). PD estimates the probability that a borrower will experience a default within twelve months from the date of determination. LGD provides an estimation of the anticipated loss with respect to a specific financial obligation of a borrower assuming a default has occurred or will occur within the next twelve months. The Model uses objective and subjective criteria to identify inherent strengths, weaknesses, and risks in each loan. PDs and LGDs are utilized in loan and portfolio management processes and are utilized for the allowance for loan losses estimate.

The Model's 14-point probability of default scale provides for nine acceptable categories, one OAEM category, two substandard categories, one doubtful category and one loss category; each carrying a distinct percentage of default probability. The Model's LGD scale provides 6 categories, A through F, that have the following anticipated principal loss and range of economic loss expectations:

- **A** 0% anticipated principal loss; 0% to 5% range of economic loss
- **B** 0% to 3% anticipated principal loss; >5% to 15% range of economic loss
- **C** > 3% to 7% anticipated principal loss; >15% to 20% range of economic loss
- **D** > 7% to 15% anticipated principal loss; >20% to 25% range of economic loss
- **E** > 15% to 40% anticipated principal loss; >25% to 50% range of economic loss
- **F** above 40% anticipated loss; above 50% range of economic loss

## RESULTS OF OPERATIONS

### Earnings Summary

In 2017, we recorded net income of $28.0 million, compared with $24.1 million in 2016, and $22.3 million in 2015. The increase in 2017 was primarily due to higher net interest income resulting from the strong growth in loan volume and the improvement in net interest margin. The increase in 2016 was primarily due to higher net interest income resulting from the strong growth in loan volume, offset by higher noninterest expense. The following table presents the changes in the significant components of net income from the previous year.

| *(dollars in thousands)* | 2017 vs. 2016 | 2016 vs. 2015 |
|---|---|---|
| Net income, prior year | $ 24,087 | $ 22,300 |
| Increase/(Decrease) from changes in: | | |
| Interest income | 12,163 | 4,520 |
| Interest expense | (6,880) | (1,397) |
| Net interest income | 5,283 | 3,123 |
| Provision for credit losses | 697 | (171) |
| Noninterest income | 589 | 743 |
| Noninterest expense | (2,651) | (1,908) |
| Total increase in net income | 3,918 | 1,787 |
| Net income, current year | $ 28,005 | $ 24,087 |

Return on average assets increased to 1.87% from 1.80% in 2016, and return on average shareholders' equity increased to 9.75% from 8.90% in 2016, primarily due to the strength of earnings. The return on average equity increased due to increasing leverage as loan volume increased.

### Net Interest Income

Net interest income for 2017 was $40.1 million compared with $34.8 million for 2016 and $31.7 million for 2015. Net interest income is our principal source of earnings and was impacted by interest earning asset volume, yields on assets and cost of debt. The increase in net interest income was largely due to growth in the volume of interest earning assets. The increase in general interest rates affected both interest income and interest expense. Net interest margin improved slightly in 2017, but made a smaller contribution to total net interest income. The following table provides an analysis of the individual components of the change in net interest income during 2017 and 2016.

| *(dollars in thousands)* | 2017 vs. 2016 | 2016 vs. 2015 |
|---|---|---|
| Net interest income, prior year | $ 34,804 | $ 31,681 |
| Increase/(Decrease) in net interest income from changes in: | | |
| Interest rates earned | 5,903 | 339 |
| Interest rates paid | (4,615) | (190) |
| Volume of interest-bearing assets and liabilities | 3,997 | 2,979 |
| Interest income on nonaccrual loans | (2) | (5) |
| Increase in net interest income | 5,283 | 3,123 |
| Net interest income, current year | $ 40,087 | $ 34,804 |

The following table illustrates net interest margin and the average interest rates on loans and debt cost and interest rate spread.

| | For the Year Ended December 31 | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| Net interest margin | 2.80% | 2.72% | 2.72% |
| Interest rate on: | | | |
| Average loan volume | 4.16% | 3.70% | 3.67% |
| Average debt | 1.61% | 1.18% | 1.16% |
| Interest rate spread | 2.55% | 2.52% | 2.51% |

The change in interest rate spread was modest. Matched funding of loan activity reduces the volatility in the interest rate spread. Interest rates have increased, with the federal funds rate increasing 100 basis points since 2016. The increase in net interest margin in addition to the change in spread was due to higher earnings on our own capital and participation in the fixed term investment program.

## Provision for Credit Losses

We monitor our loan portfolio and unfunded commitments on a regular basis to determine if an adjustment in our allowance for loan losses or reserve for unfunded commitment is warranted. This determination is based on our assessment of the probable and estimable losses inherent in our loan portfolio and unfunded commitments. The increase to the loss reserves is affected through an increase in provision for credit losses or a reduction through a credit loss reversal. We recorded provision for credit losses of $337 thousand in 2017, compared with $1.0 million in 2016 and $863 thousand in 2015. The provision for loan losses of $374 thousand recorded during 2017 was primarily due to growth in the loan portfolio. The reversal of reserve for unfunded commitments of $37 thousand was recorded during 2017 due to a reduction the amount of unfunded commitments. The provision for loan losses recorded in 2016 and 2015 were primarily due to increasing loan volume. The provision for reserve for unfunded commitments recorded in 2016 and 2015 was due to growth in the loan portfolio.

## Noninterest Income

During 2017, we recorded noninterest income of $6.3 million, compared with $5.7 million in 2016 and $5.0 million in 2015. Patronage distributions from CoBank are our primary source of noninterest income. Patronage is accrued in the year earned and then received from CoBank in the following year. CoBank patronage is distributed in cash and stock. Patronage earned from CoBank was $5.7 million in 2017, $4.9 million in 2016 and $4.5 million in 2015.

During August 2017, CoBank management announced changes to their patronage program. The new plan includes a reduction to our patronage income in 2018 on participation loans with CoBank from 100 basis points to 95 basis points. Patronage related to our direct note with CoBank for all other loans will be reduced from 45 basis points to 40 basis points in 2019 with a further reduction to 36 basis points in 2020.

In 2016 and 2015, we received a patronage distribution from AgVantis, based on our services purchased from AgVantis during the respective fiscal year. During 2017, no patronage distribution was issued. We received a Notice of Allocation with our total patronage of $235 thousand in 2016 and $39 thousand in 2015, which includes cash patronage of $47 thousand for 2016 and $8 thousand for 2015. The balance of the allocation is recorded in other assets. Additionally, we recorded a cash patronage of $10 thousand from Farm Credit Foundations, the organization that provides our payroll and human resource services. This compares with $6 thousand recorded in 2016 and $10 thousand in 2015. Patronage is also received from other Associations. Patronage from all System entities is included in patronage distribution from Farm Credit institutions on the Consolidated Statement of Comprehensive Income.

We received mineral income of $14 thousand during 2017, which is distributed to us quarterly by CoBank. Mineral income increased from $10 thousand in 2016.

### Noninterest Expense

Noninterest expense for 2017 increased $2.7 million, or 17.23%, to $18.0 million compared with 2016 and $4.6 million, or 33.8% compared with 2015. Noninterest expense for each of the three years ended December 31 is summarized as follows:

| | | | | Percent of Change | |
|---|---|---|---|---|---|
| *(dollars in thousands)* | 2017 | 2016 | 2015 | 2017/2016 | 2016/2015 |
| Salaries & employee benefits | $ 10,865 | $ 8,568 | $ 7,802 | 26.81% | 9.82% |
| Occupancy & equipment | 756 | 680 | 500 | 11.18% | 36.00% |
| Purchased services from AgVantis | 1,381 | 1,425 | 1,029 | (3.09%) | 38.48% |
| Supervisory & examination costs | 444 | 395 | 347 | 12.41% | 13.83% |
| Other | 2,903 | 2,661 | 2,658 | 9.09% | 0.11% |
| Total operating expense | 16,349 | 13,729 | 12,336 | 19.08% | 11.29% |
| Losses on other property owned, net | – | – | 13 | – | (100.00%) |
| Farm Credit Insurance Fund premium | 1,688 | 1,657 | 1,129 | 1.87% | 46.77% |
| Total noninterest expense | $ 18,037 | $ 15,386 | $ 13,478 | 17.23% | 14.16% |

For the year ended December 31, 2017, total operating expense increased $2.6 million, or 19.1%, compared with the year ended December 31, 2016, primarily due to increased salary and benefits, occupancy and equipment, professional services and training. The investment in additional staff, facilities and training was made to accommodate growth in volume and complexity of the Association.

### Provision for Income Taxes

We recorded $2 thousand in provision for income taxes during 2017, compared with provision for income taxes of $2 thousand in 2016 and $2 thousand in 2015. Tax expense of $375 thousand was recorded resulting from the enactment of federal tax legislation in late December 2017 which, among other things, lowered the federal corporate tax rate from 35 percent to 21 percent beginning in 2018. In accordance with accounting principles generally accepted in the United State (GAAP), the change to the lower corporate tax rate led to a revaluation of our deferred tax assets and deferred tax liabilities in the period of enactment (2017). Tax expense was also impacted by our patronage refund program. We operate as a Subchapter T cooperative for tax purposes and thus may deduct from taxable income certain amounts that are distributed from net earnings to borrowers. See Note 10 for additional details.

## LIQUIDITY

Liquidity is needed to pay our note with CoBank, fund loans and other commitments, and fund business operations in a cost-effective manner. Our liquidity policy directs how we manage short-term cash flow, maximize debt reduction and liquidate nonearning assets. Our direct loan with CoBank, cash on hand and borrower loan repayments provide adequate liquidity to fund our on-going operations and other commitments.

### Funding Sources

Our primary source of liquidity is the ability to obtain funds for our operations through a borrowing relationship with CoBank. Our note payable to CoBank is collateralized by a pledge to CoBank of substantially all of our assets. Substantially all cash received is applied to the note payable and all cash disbursements are drawn on the note payable. The indebtedness is governed by a General Financing Agreement (GFA) with CoBank. The GFA in effect at December 31, 2017 was scheduled to mature on May 31, 2018; however, a new GFA entered into on January 1, 2018 will mature on December 31, 2022. The annual average principal balance of the note payable to CoBank was $1.18 billion in 2017, $1.03 billion in 2016 and $925.0 million in 2015.

We plan to continue to fund lending operations through the utilization of our funding arrangement with CoBank, retained earnings from current and prior years and from borrower stock investments. CoBank's primary source of funds is the ability to issue Systemwide Debt Securities to investors through the Federal Farm Credit Bank Funding Corporation. This access has traditionally provided a dependable source of competitively priced debt that is critical for supporting our mission of providing credit to agriculture and rural America. Although financial markets experienced significant volatility in the last few years, we were able to obtain sufficient funding to meet the needs of our customers.

### Interest Rate Risk

The interest rate risk inherent in our loan portfolio is substantially mitigated through our funding relationship with CoBank which allows for loans to be match-funded. Borrowings from CoBank match the pricing, maturity, and option characteristics of our loans to borrowers. CoBank manages interest rate risk through the direct loan pricing and its asset/liability management processes. Although CoBank incurs and manages the primary sources of interest rate risk, we may still be exposed to interest rate risk through the impact of interest rate changes on earnings generated from our loanable funds. To stabilize earnings from loanable funds, we have committed excess loanable funds with CoBank in a laddered maturity portfolio at fixed rates as a part of CoBank's Association Equity Positioning Program (AEPP). This enables us to reduce our overall cost of funds with CoBank without significantly increasing our overall interest rate risk position.

### Funds Management

We offer variable, fixed, adjustable prime-based and LIBOR-based rate loans to borrowers. Our Asset and Liability Committee determines the interest rate charged based on the following factors: 1) the credit strength of the borrower; 2) the interest rate charged by CoBank; 3) our existing rates and spreads; 4) the competitive rate environment; and 5) our profitability objectives.

> *"Success isn't always measured by the growth of an operation or in dollars and cents. It can also be measured by the growth a family experiences when they come together for the good of the operation. Being involved with a member's family and witnessing their success is extremely gratifying."*
>
> **John Lehrman,** *Kingsburg*
> *Serving Our Members Since 1980*

> *"At Golden State Farm Credit your customers quickly become your family. Like our families at home, we are meant to not only share in their successes, but we are also meant to help them persevere through the difficult times that can arise. California agriculture is quickly changing and it is important to have a lender and a partner that is devoted to your long-term success and to help you get through any bumps along the way."*
>
> **Tanner Swanson,** *Hanford*
> *Serving Our Members Since 2013*

OUR VENTURE–
**YOUR SUCCESS**

## CAPITAL RESOURCES

Capital supports asset growth and provides protection for unexpected credit and operating losses. Capital is also needed for investments in new products and services. We believe a sound capital position is critical to our long-term financial success due to the volatility and cycles in agriculture. Over the past several years, we have been able to build capital primarily through net income retained after patronage. Shareholders' equity at December 31, 2017 totaled $291.7 million, compared with $275.2 million at December 31, 2016 and $261.0 million at December 31, 2015. The increase of $16.5 million in shareholders' equity reflects net income, partially offset by net stock retirements, patronage refunds, and an increase in accumulated other comprehensive loss. Our capital position is reflected in the following ratio comparisons.

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Debt to shareholders' equity | 4.37:1 | 4.28:1 | 3.93:1 |
| Shareholders' equity as a percent of net loans | 19.81% | 20.07% | 21.52% |
| Shareholders' equity as a percent of total assets | 18.64% | 18.96% | 20.29% |

Debt to shareholders' equity increased and shareholders' equity as a percent of net loans and of total assets decreased from 2016 primarily due to the increase in loan volume. Loans increased more than 7% in 2017 after double-digit growth in 2016. This has increased leverage; however, capital remains strong and capital ratios continue to exceed regulatory requirements by a large margin.

### Retained Earnings

Our retained earnings increased $16.6 million to $148.9 million at December 31, 2017 from $132.3 million at December 31, 2016 and increased $30.6 million from $118.3 million at December 31, 2015. The increase in 2017 was a result of net income of $28.0 million, partially offset by $11.4 million of patronage distributions declared.

### Patronage Program

We have a Patronage Program that allows us to distribute our available net earnings to our shareholders. This program provides for the application of net earnings in the manner described in our Bylaws. In addition to determining the amount and method of patronage to be distributed, the Bylaws address increasing surplus to meet capital adequacy standards established by Regulations; increasing surplus to a level necessary to support competitive pricing at targeted earnings levels; and increasing surplus for reasonable reserves. Patronage distributions are based on business done with us during the year. We paid cash patronage of $10.6 million in 2017, $11.5 million in 2016 and $11.6 million in 2015. During 2017, we declared patronage distributions of $11.4 million, with $5.5 million paid in September 2017 and remainder to be paid in March 2018.

### Stock

Our total stock and participation certificates decreased $45 thousand in 2017. The balance of $1.6 million has remained relatively flat since 2015. We require a stock investment for each borrower. We have a Borrower Level Stock Program which allows stock to be assigned to each borrower instead of each loan. This reduces the stock requirements for borrowers with multiple loans. The current stock requirement for each borrower is the lesser of one thousand dollars or 2.00% of the collective total balance of each borrower's loan(s).

### Accumulated Other Comprehensive Income or Loss

Accumulated other comprehensive loss totaled $244 thousand at December 31, 2017, an increase of $60 thousand compared with year-end 2016 and a decrease of $65 thousand compared with year-end 2015. Certain employees participate in a non-qualified Defined Benefit Pension Restoration Plan (Plan). Accounting guidance requires recognition of the Plan's underfunded status and unamortized actuarial gains and losses and prior service costs or credits as a liability with an offsetting adjustment to accumulated other comprehensive loss.

## Capital Plan and Regulatory Requirements

Our Board of Directors establishes a formal capital adequacy plan that addresses capital goals in relation to risks. The capital adequacy plan assesses the capital level necessary for financial viability and to provide for growth. Our plan is updated annually and approved by our Board of Directors. FCA regulations require the plan consider the following factors in determining optimal capital levels, including:

- Regulatory capital requirements;
- Asset quality;
- Needs of our customer base; and,
- Other risk-oriented activities, such as funding and interest rate risks, contingent and off-balance sheet liabilities and other conditions warranting additional capital.

In 2016, the FCA adopted final rules (the New Capital Regulations) relating to regulatory capital requirements for System banks and Associations. The New Capital Regulations took effect January 1, 2017. The stated objectives of the New Capital Regulations are as follows:

- To modernize capital requirements while ensuring that System institutions continue to hold sufficient regulatory capital to fulfill the System's mission as a government-sponsored enterprise;
- To ensure that the System's capital requirements are comparable to the Basel III framework and the standardized approach that the federal banking regulatory agencies have adopted, but also to ensure that the rules recognize the cooperative structure and the organization of the System;
- To make System regulatory capital requirements more transparent; and
- To meet certain requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act).

The New Capital Regulations, among other things, replaced existing core surplus and total surplus requirements with common equity tier 1 (CET1), tier 1 and total capital (tier 1 plus tier 2) risk-based capital ratio requirements. The New Capital Regulations also added a tier 1 leverage ratio for all System institutions, which replaced the existing net collateral ratio for System banks. In addition, the New Capital Regulations established a capital conservation buffer and a leverage buffer and enhanced the sensitivity of risk weightings. The revisions to the risk-weightings included alternatives to the use of credit ratings, as required by the Dodd-Frank Act.

The New Capital Regulations set the following minimum risk-based requirements:

- A CET1 capital ratio of 4.5 percent;
- A tier 1 capital ratio (CET1 capital plus additional tier 1 capital) of 6 percent; and
- A total capital ratio (tier 1 capital plus tier 2) of 8 percent.

The New Capital Regulations also set a minimum tier 1 leverage ratio (tier 1 capital divided by total assets) of 4 percent, of which at least 1.5 percent must consist of unallocated retained earnings (URE) and URE equivalents, which are nonqualified allocated equities with certain characteristics of URE.

The New Capital Regulations established a capital cushion (capital conservation buffer) of 2.5 percent above the risk-based CET1, tier 1 and total capital requirements. In addition, the New Capital Regulations established a leverage capital cushion (leverage buffer) of 1 percent above the tier 1 leverage ratio requirement. If capital ratios fall below the regulatory minimum plus buffer amounts, capital distributions (equity redemptions, cash dividend payments, and cash patronage payments) and discretionary senior executive bonuses are restricted or prohibited without prior FCA approval. The New Capital Regulations established a three-year phase-in of the capital conservation buffer beginning January 1, 2017. There is no phase-in of the leverage buffer.

As shown in the following table, at December 31, 2017, our capital and leverage ratios exceeded regulatory minimums. If these capital standards are not met, the FCA can impose restrictions, including limiting our ability to pay patronage distributions, retire equities and pay preferred stock dividends.

| | 2017 | Minimum Requirement with Buffer |
|---|---|---|
| Common Equity Tier 1 Capital ratio | **15.60%** | 7.00% |
| Tier 1 Capital ratio | **15.60%** | 8.50% |
| Total Capital ratio | **15.90%** | 10.50% |
| Tier 1 Leverage ratio | **16.39%** | 5.00% |
| Unallocated Retained Earnings and URE Equivalents (UREE) Leverage | **17.58%** | 1.50% |
| Permanent capital ratio | **15.65%** | 7.00% |

The minimum capital ratio requirements were not meant to be adopted as the optimum capital level, so the Association has established goals in excess of the regulatory minimum. As of December 31, 2017, we have met or exceeded our goals. Due to our strong capital position, we will continue to be able to retire at-risk stock.

As displayed in the following table, we exceeded the minimum regulatory capital requirements in effect through December 31, 2016.

| | 2016 | 2015 | 2014 | 2013 | 2012 | Regulatory Minimum |
|---|---|---|---|---|---|---|
| Permanent capital ratio | 16.36% | 18.04% | 18.13% | 17.17% | 17.56% | 7.00% |
| Total surplus ratio | 16.25% | 17.91% | 18.00% | 16.97% | 17.35% | 7.00% |
| Core surplus ratio | 16.09% | 17.65% | 17.70% | 15.95% | 16.29% | 3.50% |

Refer to Note 8, Shareholders' Equity, in this report for additional information on our capital and related requirements and restrictions.

## REGULATORY MATTERS

As of December 31, 2017, we had no enforcement actions in effect and FCA took no enforcement actions on us during the year.

On March 10, 2016, the FCA adopted final rules (the New Capital Regulations) relating to regulatory capital requirements for System banks, including CoBank, and Associations. The New Capital Regulations took effect January 1, 2017. We are in compliance with the New Capital Regulations.

## GOVERNANCE

We are governed by a twelve-member board that provides direction and oversees our management. Of these directors, ten are elected by the shareholders and two are appointed by the elected directors. Our Board of Directors represents the interests of our shareholders. The Board of Directors meets regularly to perform the following functions, among others:

- selects, evaluates and compensates the chief executive officer;
- approves the strategic plan, capital plan, financial plan and the annual operating budget;
- oversees the lending operations;
- directs management on significant issues; and,
- oversees the financial reporting process, communications with shareholders and our legal and regulatory compliance.

### Director Independence

All directors must exercise sound judgment in deciding matters in our interest. All our directors are independent from the perspective that none of our management or staff serves as Board members. However, we are a financial services cooperative, and the Farm Credit Act and FCA Regulations require our elected directors to have a loan relationship with us.

The elected directors, as borrowers, have a stake in ensuring our Association remains strong and successful. However, our borrowing relationship could be viewed as having the potential to compromise the independence of an elected director. For this reason, the Board has established independence criteria to ensure that a loan relationship does not compromise the independence of our Board. Annually, in conjunction with our independence analysis and reporting on our loans to directors, each director provides financial information and any other documentation and/or assertions needed for the Board to determine the independence of each Board member.

### Audit Committee

The Audit Committee reports to the Board of Directors. The Audit Committee is composed of five members of the Board of Directors. During 2017, nine meetings were held. The Audit Committee responsibilities generally include, but are not limited to:

- oversight of the financial reporting risk and the accuracy of the quarterly and annual shareholder reports;
- the oversight of the system of internal controls related to the preparation of quarterly and annual shareholder reports;
- the review and assessment of the impact of accounting and auditing developments on the consolidated financial statements; and,
- the establishment and maintenance of procedures for the receipt, retention and treatment of confidential and anonymous submission of concerns, regarding accounting, internal accounting controls or auditing matters.

### Compensation Committee

The Compensation Committee reports to the Board of Directors. The Compensation Committee is composed of five members of the Board of Directors. The Compensation Committee is responsible for the oversight of employee and director compensation. The Committee annually reviews, evaluates and approves the compensation policies, programs and plans for senior officers and employees including benefits programs.

### Other Governance

The Board has monitored the requirements of public companies under the Sarbanes-Oxley Act. While we are not subject to the requirements of this law, we are striving to implement steps to strengthen governance and financial reporting. We strive to maintain strong governance and financial reporting through the following actions:

- a system for the receipt and treatment of whistleblower complaints;
- a code of ethics for our President/CEO, Chief Financial Officer and Chief Credit Officer;
- open lines of communication between the independent auditors, management, and the Audit Committee;
- "plain English" disclosures;
- officer certification of accuracy and completeness of the consolidated financial statements; and,
- information disclosure through our website.

### Code of Ethics

Our directors and employees are responsible for maintaining the highest of standards in conducting our business. In that regard, we established a Code of Ethics for the Board of Directors and a Code of Ethics for the Chief Executive Officer, Chief Financial Officer, Chief Credit Officer, and other senior financial professionals who are involved, directly or indirectly, with the preparation of our financial statements and the maintenance of financial records supporting the financial statements. These Codes of Ethics supplement our Standards of Conduct Policies for Directors and Employees. Annually, each employee and director files a written and signed disclosure statement as required under the Standards of Conduct Policies. Likewise, all employees certify compliance with our Code of Ethics on an annual basis.

### Whistleblower Program

We maintain a program for employee complaints related to accounting, financial reporting, internal accounting controls, or auditing matters. This program allows employees to submit confidential, anonymous concerns regarding accounting, financial reporting, internal accounting controls, fraud or auditing matters without the fear of reprisal, retaliation or adverse action being taken against any employee who, in good faith, reports or assists in the investigation of a violation or suspected violation, or who makes an inquiry about the appropriateness of an anticipated or actual course of action.

## FORWARD-LOOKING INFORMATION

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

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international, and farm-related business sectors;
- weather, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry and/or the Farm Credit System; and,
- actions taken by the Federal Reserve System in implementing monetary policy.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our consolidated financial statements are based on accounting principles generally accepted in the United States of America. Our significant accounting policies are critical to the understanding of our results of operations and financial position because some accounting policies require us to make complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. We consider these policies critical because we have to make judgments about matters that are inherently uncertain. For a complete discussion of significant accounting policies, see Note 2 of the accompanying consolidated financial statements. The development and selection of critical accounting policies, and the related disclosures, have been reviewed by our Audit Committee. A summary of critical policies relating to the determination of the allowance for loan losses follows.

### Allowance for Loan Losses/Reserve for Unfunded Commitment

The allowance for loan losses is our best estimate of the amount of probable loan losses existing in and inherent in our loan portfolio as of the balance sheet date. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through loan loss reversals and loan charge-offs. Additionally, we provide line of credit financing to our customers. We have established a reserve for unfunded commitment to cover probable losses. This reserve is reported as a liability in our consolidated balance sheet. The reserve for unfunded commitment is increased through provision for the reserve for unfunded commitments and is decreased through reversals of the reserve for unfunded commitments. Provision for loan losses and provision for reserve for unfunded commitments are referred to as a provision for credit losses on the Consolidated Statement of Comprehensive Income. We determine the allowance for loan losses and the reserve for unfunded commitment based on a regular evaluation of the loan and commitment portfolios, which generally considers recent historical charge-off experience adjusted for relevant factors.

Loans are evaluated based on the borrower's overall financial condition, resources, and payment record; the prospects for support from any financially responsible guarantor; and, if appropriate, the estimated net realizable value of any collateral. The allowance for loan losses attributable to these loans is established by a process that estimates the probable loss inherent in the loans, taking into account various historical factors, internal risk ratings, regulatory oversight, and geographic, industry and other factors.

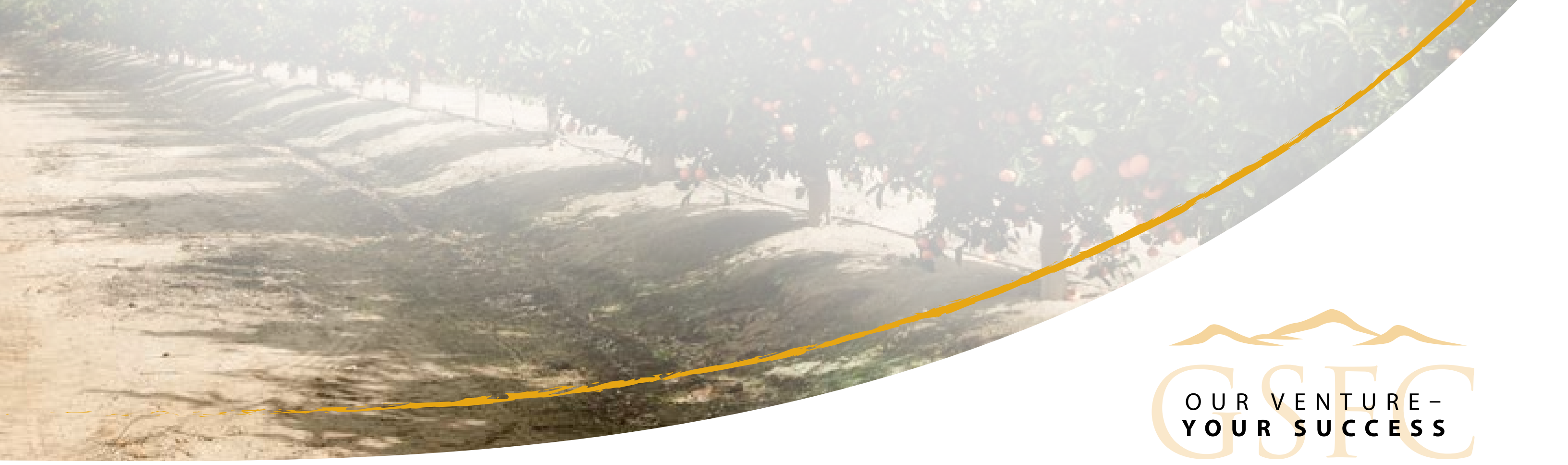
Changes in the factors we consider in the evaluation of losses in the loan portfolio could occur for various credit related reasons and could result in a change in the allowance for loan losses, which would have a direct impact on the provision for loan losses and results of operations.  See Notes 2 and 3 to the accompanying consolidated financial statements for detailed information regarding the allowance for loan losses.

## CUSTOMER PRIVACY

FCA regulations require that borrower information be held in confidence by Farm Credit institutions, their directors, officers and employees.  FCA regulations and our Standards of Conduct Policies specifically restrict Farm Credit institution directors and employees from disclosing information not normally contained in published reports or press releases about the institution or its borrowers or members.  These regulations also provide Farm Credit institutions clear guidelines for protecting their borrowers' nonpublic information.

*"It's important to me that our members succeed because I grew up in this community and I truly believe agriculture and our members are the lifeblood of the Central Valley.  My parents were teachers in Hanford, my mom elementary and my father an Ag Advisor for the high school.  Many of the families I work with today were students of theirs or their children were.  I take such pride knowing that I am doing my part to help those important members of our community continue to thrive.  To me this job is very personal because I see how agriculture reaches out and affects every aspect of the local community. I believe our Association protects and empowers our members to be able to continue their support of small towns across the valley.  To be honest, the only customer survey that matters to me is when my clients see my mom in the grocery store and say,  "Travis sure took great care of us.""*

**Travis Mann,** *Kingsburg*
*Serving Our Members Since 2017*



OUR VENTURE–
**YOUR SUCCESS**

# REPORT OF MANAGEMENT

The consolidated financial statements of Golden State Farm Credit, ACA (Association) are prepared by management, who is 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 generally accepted accounting principles appropriate in the circumstances, and in the opinion of management, fairly present the financial condition of the Association. Other financial information included in the 2017 annual report is consistent with that in the financial statements.

To meet its responsibility for reliable financial information, management depends on the Association's accounting and internal control systems, which have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded and transactions are properly authorized and recorded. Third party auditors are engaged to perform audits of the accounting records, review accounting systems and internal controls, and recommend improvements as appropriate. The Association is also examined by the Farm Credit Administration.

The Audit Committee of the Board of Directors has overall responsibility for the Association's system of internal control and financial reporting. The Audit Committee consults regularly with management and reviews the results of the examinations by the various entities named above. The independent auditors have direct access to the Audit Committee.

The undersigned certify the Golden State Farm Credit, ACA Annual Report has been reviewed and prepared in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

MICHAEL FRY
**Chairman of the Board**

J. FLETCHER MONROE
**President & Chief Executive Officer**

LARRY GRAGER
**Chief Financial Officer**

***MARCH 16, 2018***

# REPORT OF
# INTERNAL CONTROL OVER FINANCIAL REPORTING

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

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of December 31, 2017. In making the assessment, management used the framework in Internal Control — Integrated Framework (2013), promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association concluded that as of December 31, 2017, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of December 31, 2017.

J. Fletcher Monroe

J. FLETCHER MONROE
**President & Chief Executive Officer**

Larry Grager

LARRY GRAGER
**Chief Financial Officer**

***MARCH 16, 2018***

# AUDIT COMMITTEE REPORT

The Audit Committee (Committee) includes five members from the Board of Directors of Golden State Farm Credit, ACA (Association). In 2017, nine Committee meetings were held. The Committee oversees the scope of the Association's internal audit program, the independence of the outside auditors, the adequacy of the Association's system of internal controls and procedures, and the adequacy of management's action with respect to recommendations arising from those auditing activities. The Committee's responsibilities are described more fully in the Internal Control Policy and the Audit Committee Charter. The Committee approved the appointment of PricewaterhouseCoopers, LLP (PwC) as the Association's independent auditors for 2017.

The fees for professional services rendered for the Association by its independent auditor, PwC, during 2017 were $49,200 for audit services.

Management is responsible for the Association's 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 Association's consolidated financial statements in accordance with auditing standards generally accepted in the United States of America and to issue a report thereon. The Committee's responsibilities include monitoring and overseeing these processes.

In this context, the Committee reviewed and discussed the Association's Quarterly Reports and the Association's audited financial statements for the year ended December 31, 2017 (the "Financial Statements") with management. The Committee also reviews with PwC the matters required to be discussed by Statements on Auditing Standards. Both PwC and the Association's internal auditors directly provide reports on significant matters to the Committee.

Based on the foregoing review and discussions and relying thereon, the Committee recommended that the Board of Directors include the Financial Statements in the Association's Annual Report to Shareholders for the year ended December 31, 2017 and for filing with the Farm Credit Administration.

SANDRA MANSFIELD
**Chairman of Audit Committee**

**Audit Committee Members**
TERRI WEST, VICE CHAIRMAN
MICHAEL CHAMBERS
ROBERT REIMER
VERNON PETERSON

***MARCH 16, 2018***

| *(Dollars in Thousands)* | December 31 | | |
|---|---|---|---|
| | **2017** | 2016 | 2015 |
| **ASSETS** | | | |
| Loans | **$ 1,476,850** | $1,375,591 | $ 1,216,296 |
| Less allowance for loan losses | **4,603** | 4,229 | 3,321 |
| Net loans | **1,472,247** | 1,371,362 | 1,212,975 |
| Cash | **16,608** | 16,672 | 18,555 |
| Accrued interest receivable | **14,399** | 10,453 | 6,274 |
| Investment in CoBank, ACB | **47,453** | 41,357 | 39,592 |
| Premises and equipment, net | **3,976** | 3,371 | 3,182 |
| Prepaid benefit expense | **3,377** | 2,199 | 863 |
| Other assets | **7,035** | 6,239 | 5,434 |
| **Total assets** | **$ 1,565,095** | $1,451,653 | $ 1,286,875 |
| | | | |
| **LIABILITIES** | | | |
| Note payable to CoBank, ACB | **$ 1,246,472** | $1,141,754 | $ 991,675 |
| Advance conditional payments | **11,990** | 21,263 | 20,696 |
| Accrued interest payable | **1,832** | 1,225 | 1,084 |
| Patronage distributions payable | **5,900** | 5,100 | 6,500 |
| Accrued benefits liability | **1,489** | 634 | 723 |
| Reserve for unfunded commitments | **153** | 190 | 64 |
| Other liabilities | **5,581** | 6,309 | 5,085 |
| **Total liabilities** | **1,273,417** | 1,176,475 | 1,025,827 |
| | | | |
| **Commitments and Contingencies (See Note 14)** | | | |
| | | | |
| **SHAREHOLDERS' EQUITY** | | | |
| Capital stock and participation certificates | **1,555** | 1,600 | 1,582 |
| Additional paid-in capital | **141,442** | 141,442 | 141,442 |
| Unallocated retained earnings | **148,925** | 132,320 | 118,333 |
| Accumulated other comprehensive (loss)/income | **(244)** | (184) | (309) |
| **Total shareholders' equity** | **291,678** | 275,178 | 261,048 |
| **Total liabilities and shareholders' equity** | **$ 1,565,095** | $1,451,653 | $ 1,286,875 |

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

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

| *(Dollars in Thousands)* | For the Year Ended December 31 | | |
|---|---|---|---|
| | **2017** | 2016 | 2015 |
| **INTEREST INCOME** | | | |
| Loans | **$ 59,513** | $ 47,350 | $ 42,830 |
| **Total interest income** | **59,513** | 47,350 | 42,830 |
| **INTEREST EXPENSE** | | | |
| Note payable to CoBank, ACB | **19,281** | 12,408 | 11,004 |
| Other | **145** | 138 | 145 |
| **Total interest expense** | **19,426** | 12,546 | 11,149 |
| Net interest income | **40,087** | 34,804 | 31,681 |
| Provision for credit losses | **337** | 1,034 | 863 |
| Net interest income after provision for credit losses | **39,750** | 33,770 | 30,818 |
| **NONINTEREST INCOME** | | | |
| Financially related services income | **160** | 168 | 161 |
| Loan fees | **222** | 245 | 130 |
| Patronage distribution from Farm Credit institutions | **5,731** | 5,207 | 4,577 |
| Mineral income | **14** | 10 | 12 |
| Other noninterest income | **167** | 75 | 82 |
| **Total noninterest income** | **6,294** | 5,705 | 4,962 |
| **NONINTEREST EXPENSE** | | | |
| Salaries and employee benefits | **10,865** | 8,568 | 7,802 |
| Occupancy and equipment | **756** | 680 | 500 |
| Purchased services from AgVantis, Inc. | **1,381** | 1,425 | 1,029 |
| Losses on other property owned, net | **-** | - | 13 |
| Farm Credit Insurance Fund premium | **1,688** | 1,657 | 1,129 |
| Supervisory and examination costs | **444** | 395 | 347 |
| Other noninterest expense | **2,903** | 2,661 | 2,658 |
| **Total noninterest expense** | **18,037** | 15,386 | 13,478 |
| Income before income taxes | **28,007** | 24,089 | 22,302 |
| Provision for/(Benefit from) income taxes | **2** | 2 | 2 |
| **Net income** | **28,005** | 24,087 | 22,300 |
| **COMPREHENSIVE INCOME** | | | |
| Amortization of retirement costs | **128** | 128 | 107 |
| Actuarial loss on retirement obligation | **(188)** | (3) | (78) |
| **Total comprehensive income** | **$ 27,945** | $ 24,212 | $ 22,329 |

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

# CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

| *(Dollars in Thousands)* | Capital Stock and Participation Certificates | Additional Paid-In Capital | Unallocated Retained Earnings | Accumulated Other Comprehensive Income/(Loss) | Total Shareholders' Equity |
|---|---|---|---|---|---|
| **Balance at December 31, 2014** | $ 1,612 | $ 141,442 | $ 107,833 | $ (338) | $ 250,549 |
| Comprehensive income | | | 22,300 | 29 | 22,329 |
| Stock and participation certificates issued | 326 | | | | 326 |
| Stock and participation certificates retired | (356) | | | | (356) |
| Patronage Distributions: Cash | | | (11,800) | | (11,800) |
| **Balance at December 31, 2015** | 1,582 | 141,442 | 118,333 | (309) | 261,048 |
| Comprehensive income | | | 24,087 | 125 | 24,212 |
| Stock and participation certificates issued | 163 | | | | 163 |
| Stock and participation certificates retired | (145) | | | | (145) |
| Patronage Distributions: Cash | | | (10,100) | | (10,100) |
| **Balance at December 31, 2016** | 1,600 | 141,442 | 132,320 | (184) | 275,178 |
| Comprehensive income | | | 28,005 | (60) | 27,945 |
| Stock and participation certificates issued | 117 | | | | 117 |
| Stock and participation certificates retired | (162) | | | | (162) |
| Patronage Distributions: Cash | | | (11,400) | | (11,400) |
| **Balance at December 31, 2017** | **$ 1,555** | **$ 141,442** | **$ 148,925** | **$ (244)** | **$ 291,678** |

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

# CONSOLIDATED STATEMENT OF CASH FLOWS

*(Dollars in Thousands)*

| | For the Year Ended December 31 | | |
|---|---|---|---|
| | **2017** | 2016 | 2015 |
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | | |
| Net income | **$ 28,005** | $ 24,087 | $ 22,300 |
| Adjustments to reconcile net income to net cash provided by/(used in) operating activities: | | | |
| Depreciation | **468** | 410 | 351 |
| Provision for credit losses | **337** | 1,034 | 863 |
| Patronage stock from CoBank, ACB | **(106)** | (84) | (93) |
| Allocated patronage from AgVantis | **-** | (189) | (31) |
| Carrying value adjustment for other property owned | **-** | - | (20) |
| (Gains)/Losses on sales of premises and equipment | **(90)** | (29) | 13 |
| Net accretion of yield related to loans and notes payable acquired in merger | **295** | 438 | 582 |
| Change in assets and liabilities: | | | |
| (Increase)/Decrease in accrued interest receivable | **(3,946)** | (4,179) | (130) |
| Increase in prepaid benefit expense | **(1,178)** | (1,336) | (136) |
| (Increase)/Decrease in other assets | **(690)** | (532) | 122 |
| Increase/(Decrease) in accrued interest payable | **607** | 141 | (3,433) |
| Increase in accrued benefits liability | **795** | 36 | 12 |
| (Decrease)/Increase in other liabilities | **(728)** | 1,224 | (3,268) |
| Total adjustments | **(4,236)** | (3,066) | (5,168) |
| Net cash provided by operating activities | **23,769** | 21,021 | 17,132 |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | | |
| (Increase) in loans, net | **(102,739)** | (161,190) | (65,757) |
| Increase in investment in CoBank, ACB | **(6,096)** | (1,765) | (103) |
| Expenditures for premises and equipment, net | **(983)** | (570) | (410) |
| Proceeds from sales of other property owned | **-** | - | 44 |
| Net cash used in investing activities | **(109,818)** | (163,525) | (66,226) |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | | |
| Net draw on note payable to CoBank, ACB | **105,903** | 151,536 | 68,944 |
| (Decrease)/Increase in advance conditional payments | **(9,273)** | 567 | (3,519) |
| Capital stock retired | **(162)** | (145) | (356) |
| Capital stock issued | **117** | 163 | 326 |
| Cash patronage distributions paid | **(10,600)** | (11,500) | (11,600) |
| Net cash provided by financing activities | **85,985** | 140,621 | 53,795 |
| Net (decrease)/increase in cash | **(64)** | (1,883) | 4,701 |
| Cash at beginning of year | **16,672** | 18,555 | 13,854 |
| Cash at end of year | **$ 16,608** | $ 16,672 | $ 18,555 |
| **SUPPLEMENTAL CASH INFORMATION:** | | | |
| Cash paid during the year for: | | | |
| Interest | **$ 18,819** | $ 12,405 | $ 14,582 |
| Income taxes | **$ 2** | $ 2 | $ 2 |
| **SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:** | | | |
| Patronage stock from CoBank, ACB | **$ 106** | $ 84 | $ 93 |
| Allocated patronage from AgVantis | **$ -** | $ 189 | $ 31 |
| Net charge-offs | **$ -** | $ - | $ 2 |
| Patronage distributions payable | **$ 5,900** | $ 5,100 | $ 6,500 |
| Change in accumulated other comprehensive (loss)/income | **$ (60)** | $ 125 | $ 29 |

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

# NOTES OF CONSOLIDATED FINANCIAL STATEMENTS

*(Dollars in Thousands, Except as Noted)*

## NOTE 1 – ORGANIZATION AND OPERATIONS

**A. Organization:** Golden State Farm Credit, ACA and its subsidiaries, Golden State Farm Credit, FLCA, (Federal Land Credit Association (FLCA)) and Golden State Farm Credit, PCA, (Production Credit Association (PCA)), (collectively called "the Association") are member-owned cooperatives which provide credit and credit-related services to or for the benefit of eligible borrowers/shareholders for qualified agricultural purposes in the counties of Butte, Fresno, Glenn, Kings, Shasta, Tehama, Trinity and Tulare in the state of California.

The Association is a lending institution of the Farm Credit System (System), a nationwide system of cooperatively owned banks and associations, which was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (the Farm Credit Act). The System is comprised of three Farm Credit Banks, one Agricultural Credit Bank and 69 associations.

CoBank, ACB (funding bank or the "Bank") its related associations and AgVantis, Inc. (AgVantis) are collectively referred to as the District. CoBank provides the funding to associations within the District and is responsible for supervising certain activities of the District Associations. AgVantis, which is owned by the entities it serves, provides technology and other operational services to certain associations and to CoBank. The CoBank District consists of CoBank, 22 Agricultural Credit Associations (ACA), which each have two wholly owned subsidiaries, (a FLCA and a PCA) and AgVantis.

ACA parent companies provide financing and related services through their FLCA and PCA subsidiaries. Generally, the FLCA makes secured long-term agricultural real estate and rural home mortgage loans and the PCA makes short- and intermediate-term loans for agricultural production or operating purposes.

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

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). By law, the Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on System wide debt obligations (Insured Debt), (2) to ensure the retirement of protected stock at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary use by the Insurance Corporation in providing assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System Bank is required to pay premiums, which may be passed on to the Associations, into the Insurance Fund based on its annual average outstanding insured debt adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments until the assets in the Insurance Fund reach the "secure base amount," which is defined in the Farm Credit Act as 2.0 percent of the aggregate Insured Debt or such other percentage of the Insured Debt as the Insurance Corporation, in its sole discretion, determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums, as necessary to maintain the Insurance Fund at the 2.0 percent level. As required by the Farm Credit Act, as amended, the Insurance Corporation may return excess funds above the secure base amount to System institutions. The Bank passes this premium expense and the return of excess funds as applicable through to each Association based on the Association's average adjusted note payable with the Bank.

**B. Operations:** The Farm Credit Act sets forth the types of authorized lending activity, persons eligible to borrow, and financial services which can be provided by the Association. The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, their cooperatives, rural residents and farm-related businesses.

The Association also offers credit life insurance, multi-peril crop and crop hail insurance, advance conditional payment accounts and leasing (vehicle, equipment and direct financing leases) and fee appraisals.

The Association's financial condition may be impacted by factors affecting CoBank. The CoBank Annual Report is available free of charge on CoBank's website, www.cobank.com; or may be obtained at no charge by contacting the Association at 1359 East Lassen Avenue, Chico, California 95973 or by calling (530) 571-4160. Upon request, Association shareholders will be provided with a copy of the CoBank Annual Report. The CoBank Annual Report discusses the material aspects of CoBank's and District's financial condition, changes in financial condition, and results of operations.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the Association conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of financial statements in conformity with GAAP requires Association management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results may differ from these estimates. Significant estimates are discussed in these footnotes as applicable. Certain amounts in prior years' consolidated financial statements have been reclassified to conform to the current year's financial statement presentation.

The consolidated financial statements include the accounts of Golden State Farm Credit, FLCA and Golden State Farm Credit, PCA. All significant inter-company transactions have been eliminated in consolidation. Recently issued accounting pronouncements follow.

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

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

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

In February 2016, the FASB issued guidance entitled "Leases." The guidance requires the recognition by lessees of lease assets and lease liabilities on the balance sheet for the rights and obligations created by those leases. Leases with lease terms of more than 12 months are impacted by this guidance. This guidance becomes effective for interim and annual periods beginning after December 15, 2018, with early application permitted. The Association is evaluating the impact of adoption on its financial condition and results of operations.

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

In May 2014, the FASB issued guidance entitled, "Revenue from Contracts with Customers." The guidance governs revenue recognition from contracts with customers and requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Financial instruments and other contractual rights within the scope of other guidance issued by the FASB are excluded from the scope of this new revenue recognition guidance. In this regard, a majority of our contracts would be excluded from the scope of this new guidance. In August 2015, the FASB issued an update that defers this guidance by one year, which results in the new revenue standard becoming effective for interim and annual reporting periods beginning after December 15, 2017. The Association determined the effect was not material to its financial condition or results of operations.

Below is a summary of our significant accounting policies.

A. **Loans and Allowance for Loan Losses:** Long-term real estate mortgage loans generally have original maturities ranging from five to 40 years. Substantially all short- and intermediate-term loans made for agricultural production or operating purposes have maturities of ten years or less. Loans are carried at their principal amount outstanding adjusted for charge-offs and deferred loan fees or costs. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. Loan origination fees and direct loan origination costs are capitalized and the net fee or cost is amortized over the life of the related loan as an adjustment to yield.

   Loans acquired in a business combination are initially recognized at fair value based on current interest rates and taking into account the borrowers' credit quality, and therefore acquired loans have no related allowance for loan losses at acquisition date. Those loans with evidence of credit quality deterioration at purchase are required to be recorded in accordance with the authoritative accounting guidance on "Accounting for Certain Loans or Debt Securities Acquired in a Transfer." This guidance addresses accounting for differences between contractual cash flows and cash flows expected to be collected from the initial investment in loans if those differences are attributable, at least in part, to credit quality. The initial fair values for these types of loans are determined by discounting both principal and interest cash flows expected to be collected using an observable discount rate for similar instruments with adjustments that management believes a market participant would consider in determining fair value. Subsequent decreases to expected principal cash flows will result in a charge to the provision for loan losses and a corresponding increase to allowance for loan losses. Subsequent increases in expected principal cash flows will result in recovery of any previously recorded allowance for loan losses, to the extent applicable, and a reclassification from nonaccretable difference to accretable yield for any remaining increase. For variable rate loans, expected future cash flows were initially based on the rate in effect at acquisition; expected future cash flows are recalculated as rates change over the lives of the loans.

   Impaired loans are loans for which it is probable that principal and interest will not be collected according to the contractual terms of the loan and are generally considered substandard or doubtful, which is in accordance with the loan rating model, as described below. Impaired loans include nonaccrual loans, restructured loans and loans past due

90 days or more and still accruing interest. A loan is considered contractually past due when any principal repayment or interest payment required by the loan contract is not received on or before the due date. A loan shall remain contractually past due until it is formally restructured or until the entire amount past due, including principal, accrued interest, and penalty interest incurred is collected in full or otherwise discharged.

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

When loans are in nonaccrual status, loan payments are generally applied against the recorded nonaccrual balance. A nonaccrual loan may, at times, be maintained on a cash basis. As a cash basis nonaccrual loan, the recognition of interest income from cash payments received is allowed when the collectability of the recorded investment in the loan is no longer in doubt and the loan does not have a remaining unrecovered charge-off associated with it. Nonaccrual loans may be returned to accrual status when all contractual principal and interest is current, the borrower has demonstrated payment performance, there are no unrecovered prior charge-offs and collection of future payments is no longer in doubt. If previously unrecognized interest income exists at the time the loan is transferred to accrual status, cash received at the time of or subsequent to the transfer is first recorded as interest income until such time as the recorded balance equals the contractual indebtedness of the borrower.

The Association purchases loan and lease participations from other System entities to generate additional earnings and diversify risk. Additionally, the Association sells a portion of certain large loans to other System entities to reduce risk and comply with established lending limits. Loans are accounted for following the accounting requirements for sale treatment.

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

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

The credit risk rating methodology is a key component of the Association's allowance for loan losses evaluation, and is generally incorporated into its loan underwriting standards and internal lending limit. The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance is increased through provision for loan losses and loan recoveries and is decreased through loan loss reversals and loan charge-offs. The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, environmental conditions, loan portfolio composition, collateral value, portfolio quality, current production conditions and prior loan loss experience. The allowance for loan losses encompasses various judgments, evaluations and appraisals with respect to the loans and their underlying collateral that, by their nature, contain elements of uncertainty, imprecision and variability. Changes in the agricultural economy and environment and their impact on borrower repayment capacity will cause various judgments, evaluations and appraisals to change over time. Accordingly, actual circumstances could vary significantly from the Association's expectations and predictions of those circumstances. Management considers the following macro-economic factors in determining and supporting the level of allowance for loan losses: the concentration of lending in agriculture, combined with uncertainties associated with farmland values, commodity prices, exports, government assistance programs, regional economic effects and weather-related influences.

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

**B.** **Cash:** Cash, as included in the consolidated financial statements, represents cash on hand and on deposit at financial institutions. At times, cash deposits may be in excess of federally insured limits.

**C.** **Investment in CoBank:** The Association's required investment in CoBank is in the form of Class A Stock. The minimum required investment is 4.00 percent of the prior year's average direct loan volume. The investment in CoBank is comprised of patronage based stock and purchased stock. The requirement for capitalizing patronage-based participation loans sold to CoBank is 8.00 percent of the prior ten-year average of such participations sold to CoBank.

**D.** **Premises and Equipment:** Land is carried at cost. Premises and equipment are carried at cost less accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Estimated useful life for the building ranges from 25 to 30 years and ranges from 5 to 10 years for furniture and equipment and 5 years for automobiles. Gains and losses on dispositions are reflected in current operating results. Maintenance and repairs are expensed and improvements above certain thresholds are capitalized.

**E.** **Other Property Owned:** Other property owned, consisting of real and personal property acquired through foreclosure or deed in lieu of foreclosure, is recorded at fair value less estimated selling costs upon acquisition. Any initial reduction in the carrying amount of a loan to the fair value of the collateral received is charged to the allowance for loan losses. On at least an annual basis, revised estimates to the fair value are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income and expenses from operations and carrying value adjustments are included in net gains/(losses) on other property owned in the Consolidated Statement of Comprehensive Income.

**F.** **Other Assets and Other Liabilities:** Other assets are comprised primarily of accounts receivable, prepaid expenses, and investment in Farm Credit institutions. Significant components of other liabilities primarily include accounts payable and employee benefits.

**G.** **Advance Conditional Payments:** The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, the advance conditional payments are netted against the borrower's related loan balance. Unrestricted advance conditional payments are included in liabilities. Restricted advance conditional payments are primarily associated with mortgage loans, while non-restricted are primarily related to production and intermediate-term loans and insurance proceeds on mortgage loans. Advance conditional payments are not insured. Interest is generally paid by the Association on advance conditional payments.

**H. Employee Benefit Plans:** Substantially all employees of the Association participate in the Eleventh District Defined Benefit Retirement Plan (Pension) and/or the Farm Credit Foundations Defined Contribution/401(k) Plan (401 (k)). The Defined Benefit Plan is a noncontributory plan. Benefits are based on compensation and years of service. The Association recognizes its proportional share of expense and contributes its proportional share of funding. The Defined Benefit Plan was closed to employees hired after December 31, 1997.

The 401 (k) Plan has two components. Employees who do not participate in the Pension Plan may receive benefits through the Employer Contribution portion of the Defined Contribution Plan. In this plan, the Association provides a monthly contribution based on a defined percentage of the employee's salary. Employees may also participate in a Salary Deferral Plan governed by Section 401(k) of the Internal Revenue Code. The Association matches a certain percentage of employee contributions. Employees hired on or after January 1, 1998 are eligible to participate only in the Defined Contribution Plan and Salary Deferral Plan. All defined contribution costs are expensed in the same period that participants earn employer contributions.

The Association also provides certain health and life insurance benefits to eligible current and retired employees through the Farm Credit Foundations Retiree Medical and Retiree Life Plans. Substantially all employees may become eligible for those benefits if they reach normal retirement age while working for the Association. The anticipated costs of these benefits are accrued during the period of the employee's active service. The authoritative accounting guidance requires the accrual of the expected cost of providing postretirement benefits during the years that the employee renders service necessary to become eligible for these benefits.

The Association also participates in the Eleventh District nonqualified defined benefit Pension Restoration Plan. This plan provides retirement benefits above the Internal Revenue Code compensation limit to certain highly compensated eligible employees. Benefits payable under this plan are offset by the benefits payable from the pension plan.

Certain eligible employees may also participate in a nonqualified deferred compensation plan where they are able to defer a portion of their compensation. The Association matches a certain percentage of employee contributions to the plan.

**I. Patronage Distribution from CoBank:** Patronage distributions from CoBank are accrued by the Association in the year earned.

**J. Income Taxes:** As previously described, the ACA holding company conducts its business activities through two wholly owned subsidiaries. Long-term mortgage lending activities are operated through a wholly owned FLCA subsidiary which is exempt from federal and state income tax. Short- and intermediate-term lending activities are operated through a wholly owned PCA subsidiary. Operating expenses are allocated to each subsidiary based on estimated relative service. All significant transactions between the subsidiaries and the parent company have been eliminated in consolidation. The ACA, along with the PCA subsidiary, is subject to income taxes. The Association accounts for income taxes under the liability method. Accordingly, deferred taxes are recognized for estimated taxes ultimately payable or recoverable based on federal, state or local laws.

The Association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the Association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated retained earnings. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage distributions. Deferred taxes are recorded on the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the Association and will therefore impact future tax payments. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (over 50 percent probability), based on management's estimate, the deferred tax assets will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of the Association's expected patronage program, which reduces taxable earnings.

The Association has not provided deferred income taxes on amounts allocated to the Association which relate to the Bank's post-1992 earnings to the extent that such earnings will be passed through to Association borrowers through qualified patronage allocations. Additionally, deferred income taxes have not been provided on the Bank's post-1992 unallocated earnings.

For California tax purposes, the Association can exclude from taxable income all patronage sourced income. Therefore, the provision for state income taxes is made only on non-patronage sourced earnings.

K. **Other Comprehensive Income/Loss:** Other comprehensive income refers to revenue, expenses, gains and losses that under GAAP are recorded as an element of shareholders' equity and comprehensive income but are excluded from net income. Accumulated other comprehensive income/loss refers to the balance of these transactions. The Association records other comprehensive income/loss associated with the liability under the Pension Restoration Plan.

L. **Fair Value Measurement:** Accounting guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. It describes three levels of inputs that may be used to measure fair value:

**LEVEL 1** — Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets include assets held in trust funds which relate to the Association's deferred compensation plan and supplemental retirement plan. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace.

**LEVEL 2** — Observable inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly or indirectly. Level 2 inputs include the following: (a) quoted prices for similar assets or liabilities in active markets; (b) quoted prices for identical or similar assets or liabilities in markets that are not active so that they are traded less frequently than exchange-traded instruments, the prices are not current or principal market information is not released publicly; (c) inputs other than quoted prices that are observable such as interest rates and yield curves, prepayment speeds, credit risks and default rates; and, (d) inputs derived principally from or corroborated by observable market data by correlation or other means.

**LEVEL 3** — Unobservable inputs are those that are supported by little or no market activity and that are significant to the determination of the fair value of the assets or liabilities. These unobservable inputs reflect the reporting entity's own assumptions about factors that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include financial instruments whose values are 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. Level 3 assets include other property owned.

The fair value disclosures are presented in Note 15.

**M. Off-balance-sheet credit exposures:** Commitments to extend credit are agreements to lend to customers, generally having fixed expiration dates or other termination clauses that may require payment of a fee. Commercial letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. These letters of credit are issued to facilitate commerce and typically result in the commitment being funded when the underlying transaction is consummated between the customer and third party. The credit risk associated with commitments to extend credit and commercial letters of credit is essentially the same as that involved with extending loans to customers and is subject to normal credit policies. Collateral may be obtained based on management's assessment of the customer's creditworthiness.

## NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES

A summary of loans follows.

| | December 31 | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| Real estate mortgage | $ 1,231,055 | $ 1,168,141 | $ 1,061,681 |
| Production and intermediate-term | 119,902 | 95,640 | 72,100 |
| Agribusiness | 60,660 | 54,554 | 47,307 |
| Rural infrastructure | 14,906 | 7,031 | – |
| Rural residential real estate | 247 | 258 | 269 |
| Lease receivables | 50,080 | 49,967 | 34,939 |
| Total loans | $ 1,476,850 | $ 1,375,591 | $ 1,216,296 |

The Association purchases or sells loan participations with other parties in order to diversify risk, manage loan volume and comply with FCA regulations. The following table presents information regarding participations purchased and sold as of December 31, 2017:

| | Purchased | Sold |
|---|---|---|
| Real estate mortgage | $ 11,737 | $ 96,391 |
| Agribusiness | 28,313 | – |
| Rural infrastructure | 14,906 | – |
| Lease receivables | 17,756 | 9,555 |
| Total | $ 72,712 | $ 105,946 |

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

The Association has obtained credit enhancements by entering into Standby Commitment to Purchase Agreements (Agreements) with Federal Agricultural Mortgage Corporation (Farmer Mac), covering loans with principal balance outstanding of $104.2 million, $98.3 million and $100.1 million at December 31, 2017, 2016 and 2015, respectively. Under the Agreements, Farmer Mac agrees to purchase loans from the Association in the event of default (typically four months past due), subject to certain conditions, thereby mitigating the risk of loss from covered loans. In return, the Association pays Farmer Mac commitment fees based on the outstanding balance of loans covered by the Agreements. Such fees, totaling $322 for 2017, $355 in 2016 and $360 in 2015 are reflected in noninterest expense.

In addition to Farmer Mac, credit enhancements with federal government agencies of $2.1 million at year-end 2017, $2.4 million at year-end 2016 and $2.2 million at year-end 2015 were outstanding.

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

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

The following table shows loans and related accrued interest classified under the FCA Uniform Loan Classification system as a percentage of total loans and related accrued interest receivable by loan type as of December 31.

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Real estate mortgage | | | |
| Acceptable | 98.30% | 98.81% | 99.77% |
| OAEM | 0.77% | 0.96% | 0.13% |
| Substandard | 0.93% | 0.23% | 0.10% |
| Total | 100.00% | 100.00% | 100.00% |
| Production and intermediate-term | | | |
| Acceptable | 99.59% | 99.25% | 99.99% |
| OAEM | 0.30% | 0.08% | 0.01% |
| Substandard | 0.11% | 0.67% | – |
| Total | 100.00% | 100.00% | 100.00% |
| Agribusiness | | | |
| Acceptable | 100.00% | 100.00% | 100.00% |
| Total | 100.00% | 100.00% | 100.00% |
| Rural infrastructure | | | |
| Acceptable | 100.00% | 100.00% | – |
| Total | 100.00% | 100.00% | – |
| Rural residential real estate | | | |
| Acceptable | 80.56% | 80.03% | 79.54% |
| OAEM | 19.44% | 19.58% | 20.09% |
| Substandard | – | 0.39% | 0.37% |
| Total | 100.00% | 100.00% | 100.00% |
| Lease receivables | | | |
| Acceptable | 100.00% | 99.45% | 100.00% |
| Substandard | – | 0.55% | – |
| Total | 100.00% | 100.00% | 100.00% |
| Total Loans | | | |
| Acceptable | 98.54% | 98.91% | 99.79% |
| OAEM | 0.67% | 0.83% | 0.12% |
| Substandard | 0.79% | 0.26% | 0.09% |
| Total | 100.00% | 100.00% | 100.00% |

Impaired loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms. The following presents information relating to impaired loans including accrued interest.

| | December 31 | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| Nonaccrual loans: | | | |
| Current as to principal and interest | $ 621 | $ 487 | $ 284 |
| Past due | 3,095 | 287 | – |
| Total impaired loans | $ 3,716 | $ 774 | $ 284 |

There were no loans classified as accruing restructured or accruing loans 90 days or more past due for the years presented. There were no material commitments to lend additional funds to debtors whose loans were classified impaired for the years presented.

High risk assets consist of impaired loans and other property owned. The following table presents these in a more detailed manner than the previous table. These nonperforming assets (including related accrued interest) are as follows:

| | December 31 | | |
|---|---|---|---|
| *(dollars in thousands)* | 2017 | 2016 | 2015 |
| Nonaccrual loans | | | |
| Real estate mortgage | $ 3,493 | $ 498 | $ 283 |
| Lease receivables | 223 | 276 | 1 |
| Total impaired loans | 3,716 | 774 | 284 |
| Total high risk assets | $ 3,716 | $ 774 | $ 284 |

Additional impaired loan information is as follows:

| | Recorded Investment at 12/31/17 | Unpaid Principal Balance* | Average Impaired Loans | Interest Income Recognized |
|---|---|---|---|---|
| Impaired loans with no related allowance for credit losses: | | | | |
| Real estate mortgage | $ 3,493 | $ 3,564 | $ 1,115 | $ 44 |
| Production and intermediate term | – | – | 11 | 1 |
| Lease receivables | 223 | 223 | 247 | – |
| Total | $ 3,716 | $ 3,787 | $ 1,373 | $ 45 |

| | Recorded Investment at 12/31/16 | Unpaid Principal Balance* | Average Impaired Loans | Interest Income Recognized |
|---|---|---|---|---|
| Impaired loans with no related allowance for credit losses: | | | | |
| Real estate mortgage | $ 498 | $ 598 | $ 570 | $ 27 |
| Production and intermediate term | – | – | 12 | 1 |
| Agribusiness | – | – | 17 | 1 |
| Lease receivables | 276 | 276 | 24 | – |
| Total | $ 774 | $ 874 | $ 623 | $ 29 |

| | Recorded Investment at 12/31/15 | Unpaid Principal Balance* | Average Impaired Loans | Interest Income Recognized |
|---|---|---|---|---|
| Impaired loans with no related allowance for credit losses: | | | | |
| Real estate mortgage | $ 283 | $ 346 | $ 280 | $ 25 |
| Production and intermediate term | – | – | 59 | – |
| Lease receivables | 1 | 1 | 9 | – |
| Total | $ 284 | $ 347 | $ 348 | $ 25 |

**Unpaid principal balance represents the recorded principal balance of the loan*

There were no impaired loans with a related allowance for any of the years presented.

Interest income is recognized and cash payments are applied on nonaccrual impaired loans as described in Note 2. The following table presents interest income recognized on impaired loans.

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| Interest income recognized on: | | | |
| Nonaccrual loans | $ 18 | $ 20 | $ 25 |
| Accrual loans 90 days or more past due | 27 | 9 | – |
| Interest income recognized on impaired loans | $ 45 | $ 29 | $ 25 |

Interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans follows.

| | For the Year Ended December 31 | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| Interest income which would have been recognized under the original loan terms | $ 145 | $ 34 | $ 27 |
| Less: interest income recognized | 18 | 20 | 25 |
| Interest income not recognized | $ 127 | $ 14 | $ 2 |

The following table provides an age analysis of past due loans (including accrued interest).

| 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 | Recorded Investment in Loans Outstanding | Recorded Investment > 90 Days and Accruing |
|---|---|---|---|---|---|---|
| Real estate mortgage | $ 1,669 | $ 3,092 | $ 4,761 | $ 1,239,079 | $ 1,243,840 | $ – |
| Production and intermediate-term | 20 | – | 20 | 121,119 | 121,139 | – |
| Agribusiness | – | – | – | 60,894 | 60,894 | – |
| Rural infrastructure | – | – | – | 14,978 | 14,978 | – |
| Rural residential real estate | – | – | – | 248 | 248 | – |
| Lease receivables | – | – | – | 50,150 | 50,150 | – |
| Total | $ 1,689 | $ 3,092 | $ 4,781 | $ 1,486,468 | $ 1,491,249 | $ – |

| 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 | Recorded Investment in Loans Outstanding | Recorded Investment > 90 Days and Accruing |
|---|---|---|---|---|---|---|
| Real estate mortgage | $ 2,247 | $ – | $ 2,247 | $ 1,175,096 | $ 1,177,343 | $ – |
| Production and intermediate-term | 644 | 1 | 645 | 95,880 | 96,525 | – |
| Agribusiness | – | – | – | 54,893 | 54,893 | – |
| Rural infrastructure | – | – | – | 7,033 | 7,033 | – |
| Rural residential real estate | – | – | – | 259 | 259 | – |
| Lease receivables | – | 276 | 276 | 49,715 | 49,991 | – |
| Total | $ 2,891 | $ 277 | $ 3,168 | $ 1,382,876 | $ 1,386,044 | $ – |

| December 31, 2015 | 30-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or less than 30 Days Past Due | Recorded Investment in Loans Outstanding | Recorded Investment > 90 Days and Accruing |
|---|---|---|---|---|---|---|
| Real estate mortgage | $ 208 | $ – | $ 208 | $ 1,066,848 | $ 1,067,056 | $ – |
| Production and intermediate-term | – | – | – | 72,682 | 72,682 | – |
| Agribusiness | – | – | – | 47,620 | 47,620 | – |
| Rural residential real estate | – | – | – | 270 | 270 | – |
| Lease receivables | – | – | – | 34,942 | 34,942 | – |
| Total | $ 208 | $ – | $ 208 | $ 1,222,362 | $ 1,222,570 | $ – |

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

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. The Association recorded no troubled debt restructuring during the years presented.

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

| | Balance at December 31, 2016 | Charge-offs | Recoveries | Provision for Loan Losses/(Loan Loss Reversals) | Balance at December 31, 2017 |
|---|---|---|---|---|---|
| Real estate mortgage | $ 667 | $ – | $ – | $ 282 | $ 949 |
| Production and intermediate-term | 1,932 | – | – | 48 | 1,980 |
| Agribusiness | 998 | – | – | 1 | 999 |
| Rural infrastructure | 50 | – | – | 48 | 98 |
| Rural residential real estate | 1 | – | – | – | 1 |
| Lease receivables | 581 | – | – | (5) | 576 |
| Total | $ 4,229 | $ – | $ – | $ 374 | $ 4,603 |

| | Balance at December 31, 2015 | Charge-offs | Recoveries | Provision for Loan Losses/(Loan Loss Reversals) | Balance at December 31, 2016 |
|---|---|---|---|---|---|
| Real estate mortgage | $ 773 | $ – | $ – | $ (106) | $ 667 |
| Production and intermediate-term | 1,464 | – | – | 468 | 1,932 |
| Agribusiness | 311 | – | – | 687 | 998 |
| Rural infrastructure | – | – | – | 50 | 50 |
| Rural residential real estate | 2 | – | – | (1) | 1 |
| Lease receivables | 771 | – | – | (190) | 581 |
| Total | $ 3,321 | $ – | $ – | $ 908 | $ 4,229 |

| | Balance at December 31, 2014 | Charge-offs | Recoveries | Provision for Loan Losses/(Loan Loss Reversals) | Balance at December 31, 2015 |
|---|---|---|---|---|---|
| Real estate mortgage | $ 422 | $ – | $ – | $ 351 | $ 773 |
| Production and intermediate-term | 1,310 | – | – | 154 | 1,464 |
| Agribusiness | 156 | – | – | 155 | 311 |
| Rural residential real estate | 3 | – | – | (1) | 2 |
| Lease receivables | 633 | 2 | – | 140 | 771 |
| Total | $ 2,524 | $ 2 | $ – | $ 799 | $ 3,321 |

The Association maintains a separate reserve for unfunded commitments, which is included in Liabilities on our Consolidated Statement of Condition. The related provision for the reserve for unfunded commitments is included as part of the provision for credit losses on the Consolidated Statement of Comprehensive Income, along with the provision for loan losses.

A summary of changes in the reserve for unfunded commitments follows:

| | For the Year Ended December 31 | | |
|---|---|---|---|
| | **2017** | 2016 | 2015 |
| Balance at beginning of period | $ 190 | $ 64 | $ – |
| Provision for unfunded commitments | (37) | 126 | 64 |
| Total | $ 153 | $ 190 | $ 64 |

Additional information on the allowance for loan losses follows.

| | Allowance for Credit Losses Ending Balance at December 31, 2017 | | Recorded Investment in Loans Outstanding Ending Balance at December 31, 2017 | |
|---|---|---|---|---|
| | Individually evaluated for impairment | Collectively evaluated for impairment | Individually evaluated for impairment | Collectively evaluated for impairment |
| Real estate mortgage | $ – | $ 949 | $ 3,493 | $ 1,240,347 |
| Production and intermediate-term | – | 1,980 | – | 121,139 |
| Agribusiness | – | 999 | – | 60,894 |
| Rural infrastructure | – | 98 | – | 14,978 |
| Rural residential real estate | – | 1 | – | 248 |
| Lease receivables | – | 576 | 223 | 49,927 |
| Total | $ – | $ 4,603 | $ 3,716 | $ 1,487,533 |

| | Allowance for Credit Losses Ending Balance at December 31, 2016 | | Recorded Investment in Loans Outstanding Ending Balance at December 31, 2016 | |
|---|---|---|---|---|
| | Individually evaluated for impairment | Collectively evaluated for impairment | Individually evaluated for impairment | Collectively evaluated for impairment |
| Real estate mortgage | $ | $ 667 | $ 498 | $ 1,176,845 |
| Production and intermediate-term | – | 1,932 | 1 | 96,524 |
| Agribusiness | – | 998 | – | 54,893 |
| Rural infrastructure | – | 50 | – | 7,033 |
| Rural residential real estate | – | 1 | – | 259 |
| Lease receivables | – | 581 | – | 49,991 |
| Total | $ – | $ 4,229 | $ 499 | $ 1,385,545 |

| | Allowance for Credit Losses Ending Balance at December 31, 2015 | | Recorded Investment in Loans Outstanding Ending Balance at December 31, 2015 | |
|---|---|---|---|---|
| | Individually evaluated for impairment | Collectively evaluated for impairment | Individually evaluated for impairment | Collectively evaluated for impairment |
| Real estate mortgage | $ – | $ 773 | $ 283 | $ 1,066,773 |
| Production and intermediate-term | – | 1,464 | – | 72,682 |
| Agribusiness | – | 311 | – | 47,620 |
| Rural residential real estate | – | 2 | – | 270 |
| Lease receivables | – | 771 | 1 | 34,941 |
| Total | $ – | $ 3,321 | $ 284 | $ 1,222,286 |

A summary of the components of the Association's net investment in direct financing leases is as follows.

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Net investment in Direct Financing Leases: | | | |
| Minimum Lease Payments to be Received, Net of Participation Interests | $ 32,380 | $ 41,660 | $ 33,066 |
| Estimated Residual Values of Leased Property (Unguaranteed) | 2,832 | 3,227 | 2,916 |
| Less: Unearned Finance Income | (2,888) | (3,498) | (2,690) |
| Net Investment in Direct Financing Leases | $ 32,324 | $ 41,389 | $ 33,292 |

At December 31, 2017, gross minimum lease payments and minimum future revenue to be received for direct financing leases are as follows:

| Year | Minimum Lease Payments | Minimum Future Revenue |
|---|---|---|
| 2018 | $ 10,501 | $ 708 |
| 2019 | $ 8,943 | $ 660 |
| 2020 | $ 5,910 | $ 526 |
| 2021 | $ 3,113 | $ 350 |
| 2022 | $ 1,244 | $ 182 |
| Subsequent Years | $ 2,668 | $ 461 |

## NOTE 4 – INVESTMENT IN COBANK

At December 31, 2017, the Association's investment in CoBank is in the form of Class A stock with a par value of $100.00 per share. The Association is required to own stock in CoBank to capitalize its direct loan balance and participation loans sold to CoBank. The current requirement for capitalizing its direct loan from CoBank is 4.00 percent of the Association's prior year average direct loan balance. The current requirement for capitalizing patronage-based participation loans sold to CoBank is 8.00 percent of the Association's prior ten-year average balance of such participations sold to CoBank. Under the current CoBank capital plan applicable to such participations sold, patronage from CoBank related to these participations sold is paid 75 percent cash and 25 percent Class A stock. The capital plan is evaluated annually by CoBank's board of directors and management and is subject to change.

CoBank may require the holders of its equities to subscribe for such additional capital as may be needed to meet its capital requirements for its joint and several liability under the Farm Credit Act and regulations. In making such a capital call, CoBank shall take into account the financial condition of each such holder and such other considerations, as it deems appropriate.

The Association owned approximately 1.47 percent of the outstanding common stock of CoBank at December 31, 2017.

## NOTE 5 – PREMISES AND EQUIPMENT

Premises and equipment consisted of the following.

| | December 31 | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| Land | $ 508 | $ 508 | $ 508 |
| Buildings and leasehold improvements | 3,598 | 3,212 | 3,074 |
| Furniture, equipment and automobiles | 2,455 | 1,941 | 1,516 |
| | 6,561 | 5,661 | 5,098 |
| Less: accumulated depreciation | 2,585 | 2,290 | 1,916 |
| Total | $ 3,976 | $ 3,371 | $ 3,182 |

## NOTE 6 – OTHER PROPERTY OWNED

Losses on other property owned, net as reflected on the Consolidated Statement of Comprehensive Income consisted of the following.

| | December 31 | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| Losses on sale, net | $ – | $ – | $ 13 |
| Losses on other property owned, net | $ – | $ – | $ 13 |

## NOTE 7 – NOTE PAYABLE TO COBANK

The Association's indebtedness to CoBank represents borrowings by the Association to fund its loan portfolio. This indebtedness is collateralized by a pledge of substantially all of the Association's assets and is governed by a General Financing Agreement (GFA). According to the agreement, the aggregate outstanding amount of principal and accrued interest shall not at any time exceed the line of credit. The GFA is subject to periodic renewals in the normal course of business. The GFA in effect at December 31, 2017 was scheduled to mature on May 31, 2018; however, a new GFA entered into effective January 1, 2018 will mature on December 31, 2022. The Association was in compliance with the terms and conditions of the GFA as of December 31, 2017. Substantially all borrower loans are match-funded with CoBank. Payments and disbursements are made on the note payable to CoBank on the same basis the Association collects payments from and disburses on borrower loans. The interest rate may periodically be adjusted by CoBank based on the terms and conditions of the borrowing.

| | December 31 | | |
|---|---|---|---|
| | **2017** | 2016 | 2015 |
| Line of credit | **$ 1,300,000** | $ 1,342,767 | $ 1,189,259 |
| Outstanding principal and accrued interest balance | **$ 1,248,284** | $ 1,142,958 | $ 992,741 |
| Average outstanding principal balance under the line of credit | **$ 1,177,898** | $ 1,028,977 | $ 925,013 |
| Weighted average interest rate | **1.64%** | 1.21% | 1.19% |

Under the Farm Credit Act, the Association is obligated to borrow only from CoBank, unless CoBank gives approval to borrow elsewhere. Other than our funding relationship with the Bank, and our advanced conditional payments, we have no other uninsured or insured debt. See Note 2 for additional information. CoBank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2017, the Association's notes payable was within the specified limitations.

The Association has the opportunity to commit loanable funds with CoBank under a variety of programs at either fixed or variable rates for specified timeframes. Participants in the program receive a credit on the committed loanable funds balance classified as a reduction of interest expense. These committed funds are netted against the note payable to the Bank. The average committed funds as of December 31 are as follows:

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Average committed funds | $ 219,543 | $ 218,043 | $ 219,917 |
| Average rates | 1.13% | 0.47% | 0.14% |

## NOTE 8 – SHAREHOLDERS' EQUITY

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

**A. Capital Stock and Participation Certificates**

In accordance with the Farm Credit Act, each borrower is required to invest in the Association as a condition of borrowing. The borrower normally acquires ownership of the stock or participation certificates at the time the loan is made, but usually does not make a cash investment. Generally, the aggregate par value of the stock is added to the principal amount of the related loan obligation. The Association has a first lien on the stock or participation certificates owned by its borrowers. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding stock or participation certificates. Our bylaws generally permit stock and participation certificates to be retired at the discretion of the Board of Directors and in compliance with our capitalization plans, provided prescribed capital standards have been met. At December 31, 2017, we exceeded the prescribed standards. We do not anticipate any significant changes in capital that would affect the normal retirement of stock.

Capitalization bylaws allow stock requirements to range from the lesser of one thousand dollars or 2.00 percent of the amount of the loan to 10.00 percent of the loan. The Board of Directors has the authority to change the minimum required stock level of a shareholder as long as the change is within this range. Currently, the Association has a stock requirement of the lesser of one thousand dollars or 2.00 percent of the amount of the borrower's combined loan volume.

**B. Regulatory Capitalization Requirements and Restrictions**

The Farm Credit Administration sets minimum regulatory capital requirements for Banks and Associations. Effective January 1, 2017, new regulatory capital surplus requirements for Banks and Associations were adopted. These new requirements replaced the core surplus and total surplus requirements with Common Equity Tier 1, Tier 1 Capital and Total Capital risk-based capital ratio requirements. The new requirements also replaced the existing net collateral ratio for System Banks with a Tier 1 Leverage ratio and an Unallocated Retained Earnings (URE) and URE Equivalents Leverage ratio that are applicable to both the Banks and Associations. The Permanent Capital Ratio continues to remain in effect; however, the risk-adjusted assets are calculated differently than in the past.

The following sets forth the regulatory capital ratio requirements and ratios at December 31, 2017:

| Ratio | Primary Components of Numerator | Denominator | Ratios as of December 31, 2017 | Minimum with Buffer* | Minimum Requirement |
|---|---|---|---|---|---|
| Common Equity Tier 1 (CET1) Capital | Unallocated retained earnings (URE), common cooperative equities (qualifying capital stock and allocated equity)[1] | Risk-adjusted assets | 15.60% | 7.0% | 4.5% |
| Tier 1 Capital | CET1 Capital, non-cumulative perpetual preferred stock | Risk-adjusted assets | 15.60% | 8.5% | 6.0% |
| Total Capital | Tier 1 Capital, allowance for loan losses[2], common cooperative equities[3], and term preferred stock and subordinated debt[4] | Risk-adjusted assets | 15.90% | 10.5% | 8.0% |
| Tier 1 Leverage** | Tier 1 Capital | Total assets | 16.39% | 5.0% | 4.0% |
| Unallocated Retained Earnings and URE Equivalents (UREE) Leverage | URE and URE Equivalents | Total assets | 17.58% | — | 1.5% |
| Permanent Capital | Retained earnings, common stock, non-cumulative perpetual preferred stock and subordinated debt, subject to certain limits | Risk-adjusted assets | 15.65% | — | 7.0% |

**The new capital requirements have a three-year phase-in of the capital conservation buffer applied to the risk-adjusted capital ratios. There is no phase-in of the leverage buffer. Amounts shown reflect the full capital conservation buffer.*

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

*1 Equities outstanding 7 or more years*

*2 Capped at 1.25% of risk-adjusted assets*

*3 Outstanding 5 or more years, but less than 7 years*

*4 Outstanding 5 or more years*

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

The Association Board and management fully recognize the need to take appropriate actions to generate adequate earnings, maintain adequate capital levels, and to manage risk. Should significant capital, risk management, or earnings stresses emerge, management would give consideration to various capital and earnings enhancement strategies as outlined in the Association's capital contingency plan.

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

### C. Description of Equities

Each owner of class C capital stock is entitled to a single vote. Other classes of borrower equities do not provide voting rights to their owners. All classes of stock are transferable to other customers who are eligible to hold such class of stock.

At December 31, 2017, the Association had 305,928 shares of common stock and 5,000 shares of participation certificates outstanding, all at a par value of $5 per share/unit.

The Association has the authority to issue other classes of stock, no shares of which are outstanding. The voting rights, duties and liabilities of such classes of stock are similar to the classes of stock discussed above.

Any net losses, to the extent that they exceed any contingency reserve and unallocated surplus shall, except as otherwise provided in the Farm Credit Act, be treated as impairing; first, unallocated surplus evidenced by nonqualified written notices of allocation; second, allocated surplus evidenced by qualified written notices of allocation in the reverse order of issuance until all such allocated surplus has been impaired; third, to all classes of common stock and participation certificates until fully impaired; and fourth, to preferred stock (if any) until fully impaired.

In the event of liquidation or dissolution of the Association, any assets remaining after payment or retirement of all liabilities shall be distributed in the following order of priority. First, to the holders, pro rata, of all classes of preferred stock (if any) until an amount equal to the aggregate par value of all such shares then issued and outstanding has been distributed to such holders. Second, to the holders, pro rata, of all classes of common stock and participation certificates, until an amount equal to the aggregate par value of all such shares then issued and outstanding has been distributed to such holders. Third, to the holders of allocated surplus evidenced by qualified written notices of allocation. Fourth, to the holders of unallocated surplus evidenced by non-qualified written notices of allocation. Fifth, any remaining assets after such distributions shall be distributed to present and former patrons on a patronage basis, to the extent practicable.

The changes in the number of shares of capital stock outstanding during 2017 are summarized in the following table.

| *Shares in whole numbers* | Capital |
|---|---|
| Balance outstanding at January 1, 2017 | 320,030 |
| Issuances | 23,425 |
| Retirements | (32,527) |
| Balance outstanding at December 31, 2017 | 310,928 |

### D. Patronage and/or Dividends

The Association's bylaws provide for the payment of patronage distributions. All patronage distributions to a borrower shall be on such proportionate patronage basis as may be approved by the Association's Board of Directors, consistent with the requirement of Subchapter T of the Internal Revenue Code.

At each year end, the Board of Directors evaluates whether to retain the Association's net income to strengthen its capital position or to distribute a portion of the net income to customers by declaring a qualified/cash patronage refund. For 2017, the Association allocated 40.71 percent of its patronage-sourced net income to its patrons.

That portion of patronage-sourced net income not distributed in cash is also allocated to patrons. In accordance with Internal Revenue Service requirements, each customer is sent a nonqualified written notice of allocation. Allocated, but not distributed patronage refunds, are added to the unallocated retained earnings account. Such allocations may provide a future basis for a distribution of capital. The Board of Directors considers these unallocated retained earnings to be permanently invested in the Association. As such, there is no current plan to revolve or redeem these amounts. No express or implied right to have such capital retired or revolved at any time is granted.

For 2017, the Board approved patronage distributions to borrowers of the ACA of $11.4 million of 2017 income. Of this amount, $5.5 million was disbursed in 2017 and the remaining $5.9 million will be disbursed in 2018.

For 2016, the Board approved patronage distributions to borrowers of the ACA of $10.1 million of 2016 income. Of this amount, $5.0 million was disbursed in 2016 and the remaining $5.1 million was disbursed in 2017.

For 2015, the Board approved patronage distributions to borrowers of the ACA of $11.8 million of 2015 income. Of this amount, $5.3 million was disbursed in 2015 and the remaining $6.5 million was disbursed in 2016.

**E. Accumulated Other Comprehensive Income/Loss**

The Association reports accumulated other comprehensive income/loss in its Consolidated Statement of Changes in Shareholders' Equity. As more fully described in Note 2, accumulated other comprehensive income/loss results from the recognition of the Pension Restoration Plan's net unamortized gains and losses and prior service costs or credits. The Association has accumulated other comprehensive loss of $244 in 2017, $184 in 2016 and $309 in 2015.

The following table presents activity in the accumulated other comprehensive income/(loss), net of tax by component:

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Pension and other benefit plans: | | | |
| Beginning balance | $ (184) | $ (309) | $ (338) |
| Other comprehensive (loss)/income before reclassifications | (188) | (3) | (78) |
| Amounts reclassified from accumulated other comprehensive loss | 128 | 128 | 107 |
| Net current period other comprehensive income | (60) | 125 | 29 |
| Year-end balance | $ (244) | $ (184) | $ (309) |

The following table represents reclassifications out of accumulated other comprehensive (loss)/income.

| | Amount Reclassified from Accumulated Other Comprehensive (Loss)/Income | | | Location of Gain/Loss Recognized in Statement of Income |
|---|---|---|---|---|
| | December 31 | | | |
| | 2017 | 2016 | 2015 | |
| Pension and other benefit plans: | | | | |
| Net actuarial loss | $ 128 | $ 128 | $ 107 | Salaries and |
| Total reclassifications | $ 128 | $ 128 | $ 107 | employee benefits |

## NOTE 9 – PATRONAGE DISTRIBUTION FROM FARM CREDIT INSTITUTIONS

Patronage income recognized from Farm Credit institutions to the Association follows.

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| CoBank | $ 5,708 | $ 4,947 | $ 4,509 |
| AgVantis | – | 235 | 39 |
| Farm Credit Foundations | 10 | 6 | 10 |
| Other | 13 | 19 | 19 |
| Total | $ 5,731 | $ 5,207 | $ 4,577 |

Patronage distributed from CoBank was in cash and stock. The amount earned in 2017 was accrued and will be paid by CoBank in March 2018. The amount earned and accrued in 2016 and 2015 was paid by CoBank in March of the following year.

Patronage distribution from AgVantis was in the form of a Notice of Allocation; 20 percent was distributed in cash with the balance of the allocation recorded as an investment in AgVantis which is recorded in other assets in the year received.

Patronage distributed by Farm Credit Foundations was accrued at the end of the year and will be paid in March 2018. Farm Credit Foundations, a human resource service provider for a number of Farm Credit institutions, provides our payroll and human resource services.

## NOTE 10 – INCOME TAXES

The provision for income taxes includes current state provision of $2 for each of the years ending December 31, 2017, 2016 and 2015. There was no current Federal provision for these years. Additionally, there was no deferred Federal or state provision for the years presented.

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

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| Federal tax at statutory rate | $ 9,522 | $ 8,190 | $ 7,583 |
| State tax, net | 1 | 1 | 1 |
| Effect of non-taxable FLCA subsidiary | (9,325) | (7,953) | (7,748) |
| Change in valuation allowance | (148) | 66 | 407 |
| Patronage distributions | (340) | (306) | – |
| Non-Patronage Source Income | 1 | – | – |
| Non-deductible meals and entertainment | 3 | 3 | 3 |
| Change in tax rates | 375 | – | – |
| Other | (87) | 1 | (244) |
| Provision for income taxes | $ 2 | $ 2 | $ 2 |

Deferred tax assets and liabilities are comprised of the following.

| | December 31 | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| Deferred income tax assets: | | | |
| Allowance for loan losses | $ 616 | $ 990 | $ 881 |
| Accrued annual leave | 36 | 58 | 44 |
| Organization costs | 9 | 6 | 9 |
| Net operating loss carryforwards (NOL) | 356 | 291 | – |
| NOL classified as provision to return adjustment | – | – | 324 |
| Gross deferred tax assets | 1,017 | 1,345 | 1,258 |
| Deferred tax asset valuation allowance | (606) | (755) | (689) |
| Deferred income tax liabilities: | | | |
| Cumulative stock patronage | (270) | (437) | (437) |
| Patronage refunds from Bank | (141) | (153) | (132) |
| Gross deferred tax liabilities | (411) | (590) | (569) |
| Net deferred tax asset | $ – | $ – | $ – |

The calculation of deferred tax assets and liabilities involves various management estimates and assumptions as to future taxable earnings, including the amount of non-patronage income and patronage income retained. The expected future tax rates are based upon enacted tax laws.

In 2017, tax expense of $375 resulted from the enactment of federal tax legislation in late December 2017 which, among other things, lowered the federal corporate tax rate from 35 percent to 21 percent beginning in 2018. In accordance with GAAP, the change to the lower corporate tax rate led to a revaluation of the Association's deferred tax assets and deferred tax liabilities in the period of enactment (2017).

The Association recorded a valuation allowance of $606 in 2017, $755 in 2016 and $689 in 2015. The Association will continue to evaluate the realizability of the deferred tax assets and adjust the valuation allowance accordingly. At December 31, 2017, the Association had federal and state net operating loss carryforwards of $356 that expire from 2026 to 2037.

The Association has no uncertain tax positions as of December 31, 2017, 2016 or 2015. The Association recognizes interest and penalties related to unrecognized tax positions as an adjustment to income tax expense. The tax years that remain open for federal and major state income tax jurisdictions are 2014 and forward.

## NOTE 11 – EMPLOYEE BENEFIT PLANS

Certain employees participate in the Ninth and Eleventh Retirement Plan, multi-employer defined benefit retirement plans. 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 eligible 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 the Association chooses to stop participating in the plan, the Association may be required to pay an amount based on the underfunded status of the plan, referred to as a withdrawal liability. Because of the multi-employer nature of the plan, any individual employer is not able to unilaterally change the provisions of the plan. If an employee moves 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.

The defined benefit pension plan reflects an unfunded liability totaling $84.6 million for the Ninth Retirement Plan (Ninth Plan) and $70.4 million for the Eleventh Retirement Plan (Eleventh Plan) at December 31, 2017. The pension benefits funding status 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 projected benefit obligation and the fair value of the multi-employer plan assets at December 31, follows:

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| **Projected benefit obligation ($ Millions)** | | | |
| Ninth Plan | $ 292.6 | $ 270.6 | $ 244.3 |
| Eleventh Plan | $ 271.1 | $ 257.9 | $ 244.5 |
| **Fair value of plan assets ($ Millions)** | | | |
| Ninth Plan | $ 208.0 | $ 175.6 | $ 155.1 |
| Eleventh Plan | $ 200.7 | $ 172.2 | $ 154.5 |

The amount of the pension benefits 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 its current employees as well as an allocation of the remaining costs based proportionately on the estimated projected liability of the employer under this plan. The Association recognizes its proportional share of expense and contributes a proportional share of funding.

Costs and contributions for the multi-employer plans at December 31 follow:

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| **Plan expenses for all participating employers ($ Millions)** | | | |
| Ninth Plan | $ 12.7 | $ 11.3 | $ 16.1 |
| Eleventh Plan | $ 3.6 | $ 5.9 | $ 4.8 |
| **Association's allocated share of plan expenses included in salaries and benefits** | | | |
| Ninth Plan | $ 109 | $ 78 | $ 106 |
| Eleventh Plan | $ 329 | $ 431 | $ 518 |
| **Plan contributions for all participating employers ($ Millions)** | | | |
| Ninth Plan | $ 20.0 | $ 20.4 | $ 13.6 |
| Eleventh Plan | $ 16.0 | $ 17.5 | $ 7.5 |
| **Association's allocated share of plan contributions** | | | |
| Ninth Plan | $ 171 | $ 141 | $ 89 |
| Eleventh Plan | $ 1,445 | $ 1,705 | $ 805 |

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 employer contributions expected to be paid into the pension plans during 2018 is $20.0 million for the Ninth Plan and $16.0 million for the Eleventh Plan. The Association's allocated share of these pension contributions is expected to be $205 thousand for the Ninth Plan and $2.0 million for the Eleventh Plan. 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 anticipated.

Postretirement benefits other than pensions are also provided through the Farm Credit Foundations Retiree Medical and Retiree Life Plans to eligible current and retired employees of the Association. Benefits provided are determined on a graduated scale, based on years of service. The anticipated costs of these benefits are accrued during the period of the employee's active service. Postretirement benefits (primarily health care benefits and life insurance) included in salaries and employee benefits were $35 in 2017, $23 in 2016 and $43 in 2015. The Association made cash contributions of $13 in 2017, $23 in 2016 and $17 in 2015.

The Association participates in two non-qualified defined benefit Pension Restoration Plans that are unfunded. The plans provide retirement benefits above the Internal Revenue Code compensation limit to certain highly compensated eligible employees. Benefits payable under the Pension Restoration Plan are offset by the benefits payable from the Pension Plan. Pension Restoration Plan expenses included in salaries and employee benefits were $893 in 2017, $146 in 2016 and $121 in 2015.

The funding status and the amounts recognized in the Consolidated Statement of Condition for the Association's Pension Restoration Plan follows:

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| **Change in benefit obligation:** | | | |
| Benefit obligation at the beginning of the period | $ 330 | $ 430 | $ 338 |
| Service cost | – | 7 | – |
| Interest cost | 9 | 11 | 14 |
| Actuarial loss | 945 | 3 | 199 |
| Benefits paid | (121) | (121) | (121) |
| Benefit obligation at the end of the period | $ 1,163 | $ 330 | $ 430 |
| **Change in plan assets:** | | | |
| Company contributions | $ 121 | $ 121 | $ 121 |
| Benefits paid | (121) | (121) | (121) |
| Fair value of plan assets at the end of the period | $ – | $ – | $ – |
| Funded status of the plan | $ (1,163) | $ (330) | $ (430) |
| **Amounts recognized in the Consolidated Statement of Condition consist of:** | | | |
| Liabilities | $ 1,163 | $ 330 | $ 430 |
| Net amount recognized | $ 1,163 | $ 330 | $ 430 |

The following table represents the amounts included in accumulated other comprehensive income/loss for the Pension Restoration Plan at December 31:

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Net actuarial loss | $ 244 | $ 184 | $ 309 |
| Total amount recognized in AOCI/loss | $ 244 | $ 184 | $ 309 |

An estimated net actuarial loss of $51 for the Pension Restoration Plan will be amortized into income over the next year.

The projected and accumulated benefit obligation for the Pension Restoration Plan at December 31 was:

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Projected benefit obligation | $ 1,163 | $ 330 | $ 430 |
| Accumulated benefit obligation | $ 1,067 | $ 330 | $ 357 |

The net periodic pension expense for the Pension Restoration Plan included in the Consolidated Statement of Comprehensive Income is comprised of the following at December 31.

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| **Components of net periodic benefit cost** | | | |
| Service cost | $ 756 | $ 7 | $ – |
| Interest cost | 9 | 11 | 14 |
| Expected return on plan assets | – | – | n/a |
| Net amortization and deferral | 128 | 128 | 107 |
| Net periodic benefit cost | $ 893 | $ 146 | $ 121 |

Changes in benefit obligation recognized in accumulated other comprehensive income are included in the following table.

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Current year net actuarial loss | $ (188) | $ (3) | $ (78) |
| Amortization of net actuarial loss | 128 | 128 | 107 |
| Total recognized in other comprehensive loss | $ (60) | $ 125 | $ 29 |

Weighted average assumptions used to determine benefit obligation at December 31:

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Ninth Plan | | | |
| Discount rate | 3.35% | 3.51% | 3.60% |
| Rate of compensation increase | 5.00% | 5.00% | 5.00% |
| Eleventh Plan | | | |
| Discount rate | 2.99% | 3.20% | 3.17% |
| Rate of compensation increase | 5.50% | 5.50% | 5.50% |

Weighted average assumptions used to determine net periodic benefit cost for the years ended December 31:

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Ninth Plan | | | |
| Discount rate | | | 4.10% |
| Projected benefit obligation | 3.51% | 3.60% | |
| Service cost | 3.58% | 3.77% | |
| Interest cost | 3.04% | 2.86% | |
| Rate of compensation increase | 5.00% | 5.00% | 5.00% |
| Eleventh Plan | | | |
| Discount rate | | | 4.10% |
| Projected benefit obligation | 3.20% | 3.17% | |
| Service cost | 3.65% | 3.55% | |
| Interest cost | 2.71% | 2.55% | |
| Rate of compensation increase | 5.50% | 5.50% | 4.50% |

The Association expects to contribute $139 to the Pension Restoration Plan in 2018.

### Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

| | Pension Restoration Benefits |
|---|---|
| 2018 | $ 139 |
| 2019 | $ 264 |
| 2020 | $ 405 |
| 2021 | $ 265 |
| 2022 | $ 152 |
| 2023 – 2027 | $ – |

The Association also participates in the Farm Credit Foundations Defined Contribution/401(k) Plan. The Contribution Plan has two components. Employees who do not participate in the Pension Plan may receive benefits through the Employer Contribution portion of the Contribution Plan. In this plan, the Association provides a monthly contribution based on a defined percentage of the employee's salary. Employees may also participate in a Salary Deferral Plan governed by Section 401(k) of the Internal Revenue Code. The Association matches a certain percentage of employee contributions. Employer contributions to the Contribution Plan were $564 in 2017, $484 in 2016 and $421 in 2015.

## NOTE 12 – RELATED PARTY TRANSACTIONS

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

The Association has a policy that loans to directors and senior officers must be maintained at an Acceptable or Other Assets Especially Mentioned (OAEM) credit classification. If the loan falls below the OAEM credit classification, corrective action must be taken and the loan brought back to either Acceptable or OAEM within a year. If not, the director or senior officer must resign from the Board of Directors or employment.

Loan information to related parties for the years ended December 31 is shown below.

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Beginning balance | $ 25,788 | $ 18,510 | $ 12,037 |
| New loans | 22,916 | 11,762 | 4,944 |
| Repayments | (12,997) | (5,688) | (4,330) |
| Reclassifications* | 17,379 | 1,204 | 5,859 |
| Ending balance | $ 53,086 | $ 25,788 | $ 18,510 |

**Represents loans that were once considered related party, but are no longer considered related party, or loans that were not related party that subsequently became related party loans.*

In the opinion of management, none of the loans outstanding to officers and directors at December 31, 2017 involved more than a normal risk of collectibility.

The Association also has business relationships with certain other System entities. The Association paid $1.4 million in 2017, $1.4 million in 2016 and $1.0 million in 2015 to AgVantis for technology services. One Association officer, elected by AgVantis' owners, serves as an AgVantis' director. The Association paid $138 in 2017 and 2016, and $120 in 2015 to Foundations for human resource services.

## NOTE 13 – REGULATORY ENFORCEMENT MATTERS

There are no regulatory enforcement actions in effect for the Association.

## NOTE 14 – COMMITMENTS AND CONTINGENCIES

The Association has various commitments outstanding and contingent liabilities. With regard to contingent liabilities, there are no actions pending against the Association in which claims for monetary damages are asserted.

The Association may participate in financial instruments with off-balance sheet risk to satisfy the financing needs of its borrowers and to manage their exposure to interest-rate risk. These financial instruments include commitments to extend credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee by the borrower. At December 31, 2017, $376.3 million of commitments to extend credit were outstanding.

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the Consolidated Statement of Condition until funded or drawn upon. The credit risk associated with issuing commitments is substantially the same as that involved in extending loans to borrowers and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

The Association also participates in standby letters of credits to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. At December 31, 2017, $363 thousand of standby letters of credit were outstanding with a nominal fair value. Outstanding standby letters of credit have expiration dates ranging from 2018 to 2022. The maximum potential amount of future payments the Association is required to make under the guarantees is $363 thousand.

## NOTE 15 – FAIR VALUE MEASUREMENTS

Accounting guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. The fair value measurement is not an indication of liquidity. See Note 2 for additional information.

The Association has no assets or liabilities measured at fair value on a recurring basis for the periods presented. During the three years presented, the Association recorded no transfers in or out of Levels 1, 2 or 3. The Association has no assets or liabilities measured at fair value on a non-recurring basis for any of the periods presented.

### Valuation Techniques

As more fully discussed in Note 2, accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Fair values of financial instruments represent the estimated amount to be received to sell an asset or paid to transfer or extinguish a liability in active markets among willing participants at the reporting date. Due to the uncertainty of expected cash flows resulting from financial instruments, the use of different assumptions and valuation methodologies could significantly affect the estimated fair value amounts. Accordingly, certain of the estimated fair values may not be indicative of the amounts for which the financial instruments could be exchanged in a current or future market transaction. The following presents a brief summary of the valuation techniques used by the Association for assets and liabilities subject to fair value measurement:

### Loans

For impaired loans measured on a non-recurring basis, the fair value is based upon the underlying collateral since the loans are collateral-dependent loans for which real estate is the collateral. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the real estate, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established and the net loan is reported at its fair value.

## NOTE 16 – QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Quarterly results of operations for the years ended December 31, 2017, 2016 and 2015, follow.

| | 2017 | | | | |
|---|---|---|---|---|---|
| | First | Second | Third | Fourth | Total |
| Net interest income | $ 9,244 | $ 10,065 | $ 10,402 | $ 10,376 | $ 40,087 |
| Provision for credit losses | – | 174 | 163 | – | 337 |
| Noninterest expense, net | 2,943 | 2,538 | 2,721 | 3,543 | 11,745 |
| Net income | $ 6,301 | $ 7,353 | $ 7,518 | $ 6,833 | $ 28,005 |

| | 2016 | | | | |
|---|---|---|---|---|---|
| | First | Second | Third | Fourth | Total |
| Net interest income | $ 8,280 | $ 8,579 | $ 8,887 | $ 9,058 | $ 34,804 |
| Provision for credit losses | 226 | 322 | 230 | 256 | 1,034 |
| Noninterest expense, net | 2,395 | 2,491 | 2,463 | 2,334 | 9,683 |
| Net income | $ 5,659 | $ 5,766 | $ 6,194 | $ 6,468 | $ 24,087 |

| | 2015 | | | | |
|---|---|---|---|---|---|
| | First | Second | Third | Fourth | Total |
| Net interest income | $ 7,649 | $ 7,893 | $ 8,029 | $ 8,110 | $ 31,681 |
| Provision for credit losses | 40 | – | 148 | 675 | 863 |
| Noninterest expense, net | 2,014 | 1,702 | 2,094 | 2,708 | 8,518 |
| Net income | $ 5,595 | $ 6,191 | $ 5,787 | $ 4,727 | $ 22,300 |

## NOTE 17 – SUBSEQUENT EVENTS

The Association has evaluated subsequent events through March 16, 2018 which is the date the financial statements were issued, and no material subsequent events were identified.

## Report of Independent Auditors

To the Board of Directors of
Golden State Farm Credit, ACA

We have audited the accompanying consolidated financial statements of Golden State Farm Credit, ACA and its subsidiaries (the Association), which comprise the consolidated statements of condition as of December 31, 2017, 2016 and 2015, and the related consolidated statements of comprehensive income, of changes in shareholders' equity, and of 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 Golden State Farm Credit, ACA and its subsidiaries as of December 31, 2017, 2016, and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

March 16, 2018

*PricewaterhouseCoopers LLP, 1100 Walnut St. Kansas City, MO 64106*
T: (816) 472 7921, F: (816) 218 1890, *www.pwc.com/us*

# DISCLOSURE INFORMATION REQUIRED BY FARM CREDIT ADMINISTRATION REGULATIONS

## DESCRIPTION OF BUSINESS

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

The description of significant developments that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, and concentrations of assets, if any, required to be disclosed in this section, is incorporated herein by reference from "Management's Discussion and Analysis" (MD&A) included in this annual report to shareholders.

## DESCRIPTION OF PROPERTY

The following table sets forth certain information regarding the properties of the Association:

## LOCATIONS

**Main Office**
1580 Ellis Street
Kingsburg, California 93631
559-897-5814

**Chico Branch**
3435 Silverbell Road
Chico, California 95973
530-895-8698

**Hanford Branch**
1001 E. Third Street
Hanford, California 93230
559-584-5401

**Red Bluff Branch**
255 Sale Lane
Red Bluff, California 96080
530-527-1941

**Willows Branch**
201-A North Tehama Street
Willows, California 95988
530-934-7071

**Administrative Office - *Leased***
1359 East Lassen Avenue
Chico, California 95973
530-571-4160

**Appraisal Office – *Leased***
1530 Marion Street
Kingsburg, California 93631
559-897-7490

Unless otherwise noted, branches and offices are owned.

## LEGAL PROCEEDINGS AND ENFORCEMENT ACTIONS

Information required to be disclosed in this section is incorporated herein by reference from Note 13 to the financial statements, "Regulatory Enforcement Matters," and Note 14 to the financial statements, "Commitments and Contingencies," included in this annual report to shareholders.

## DESCRIPTION OF CAPITAL STRUCTURE

Information required to be disclosed in this section is incorporated herein by reference from Note 8 to the financial statements, "Shareholders' Equity," included in this annual report to shareholders.

## DESCRIPTION OF LIABILITIES

The description of debt outstanding required to be disclosed in this section is incorporated herein by reference from Note 7 to the financial statements, "Note Payable to CoBank," included in this annual report to shareholders.

The description of advance conditional payments is incorporated herein by reference to Note 2 to the financial statements, "Summary of Significant Accounting Policies," included in this annual report to shareholders.

The description of contingent liabilities required to be disclosed in this section is incorporated herein by reference from Note 14 included in this annual report to shareholders.

## SELECTED FINANCIAL DATA

The selected financial data for the five years ended December 31, 2017, required to be disclosed in this section is incorporated herein by reference from the "Five-Year Summary of Selected Consolidated Financial Data," included in this annual report to shareholders.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

"Management's Discussion and Analysis," which appears within this annual report to shareholders and is required to be disclosed in this section, is incorporated herein by reference.

## DIRECTORS AND SENIOR OFFICERS

The following represents certain information regarding the directors and senior officers of the Association. Effective January 1, 2014, all directors of Federal Land Bank Association of Kingsburg, FLCA and Northern California Farm Credit, ACA became directors of Golden State Farm Credit, ACA and will serve the remainder of their original elected/appointed terms.

**Directors (see page 5)**
**Senior Officers (See page 8)**

## COMPENSATION OF DIRECTORS AND SENIOR OFFICERS

Directors are compensated for their services based on daily honorarium of $600 and a $100 preparation fee for members. The Board Chairman and Vice Chairman are paid a daily honorarium of $1,000 and $750, respectively, with the Board Chairman receiving a $250 preparation fee. The Audit Committee Chairman and Compensation Committee Chairman are paid a daily honorarium of $750. Directors are also reimbursed for mileage at the current IRS rate, as well as documented business expenses while serving in an official capacity.

Additional information for each director follows.

| | Number of Days Served at | | | | Compensation for | | | |
|---|---|---|---|---|---|---|---|---|
| Name | Board Meetings | Audit Meetings | Compen-sation Meetings | Other Official Activities | Board Meetings And Official Duties | Audit Committee | Compensation Committee | Total Compensation Paid During 2017 |
| Michael Fry | 11 | 1 | 2 | 9 | $ 20,750 | $ 250 | $ – | $ 21,000 |
| Gregory W. Long | 9 | – | 2 | 7 | 11,550 | – | – | 11,550 |
| Stephen Brown | 10 | – | 9 | 3 | 8,800 | – | 750 | 9,550 |
| Michael R. Chambers | 7 | 9 | 1 | – | 4,200 | 2,500 | – | 6,700 |
| Casey Jones | 5 | – | 5 | 5 | 5,900 | – | 500 | 6,400 |
| Sandra Mansfield | 10 | 9 | 2 | 13 | 14,650 | 3,750 | 250 | 18,650 |
| George R. Nicolaus | 7 | – | 8 | 4 | 6,950 | – | 750 | 7,700 |
| Vernon Peterson | 11 | 8 | 1 | 5 | 10,250 | 2,250 | – | 12,500 |
| Robert Reimer | 9 | 8 | 1 | 7 | 9,700 | 2,000 | – | 11,700 |
| George Swaner | 9 | – | 8 | 7 | 10,050 | – | 500 | 10,550 |
| Terry West | 4 | 4 | 1 | 3 | 4,250 | 1,000 | 250 | 5,500 |
| John de Jong | 4 | – | 1 | 1 | 2,600 | – | 250 | 2,850 |
| Total Compensation | | | | | $ 109,650 | $ 11,750 | $ 3,250 | $ 124,650 |

Directors, officers, and employees of the Association are reimbursed for travel, subsistence, and other related expenses which are incurred in the performance of their duties. Each traveler is required to submit travel expenses on forms provided by the Association. They are then reviewed for appropriateness and reimbursed upon approval. A copy of the Association's travel and expense reimbursement policy is available to shareholders upon request. Aggregate reimbursements to directors for travel, subsistence and other related expenses were $28,533 in 2017, $25,111 in 2016 and $37,844 in 2015. There was no noncash compensation paid to directors in 2017.

The Annual Meeting Information Statement is available for public inspection at the Association office. Required senior officer compensation information is included in the Association's Annual Meeting Information Statement mailed to all stockholders. Disclosure of information on the total compensation paid during the last fiscal year to any senior officer, or to any other officer included, is available and will be disclosed to shareholders upon request.

## TRANSACTIONS WITH SENIOR OFFICERS AND DIRECTORS

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

## INVOLVEMENT OF SENIOR OFFICERS AND DIRECTORS IN CERTAIN LEGAL PROCEEDINGS

There were no matters which came to the attention of management or the Board of Directors regarding involvement of senior officers or current directors in specified legal proceedings which are required to be disclosed in this section.

## BORROWER PRIVACY STATEMENT

Since 1972, Farm Credit Administration (FCA) regulations have forbidden the directors and employees of Farm Credit institutions from disclosing personal borrower information to others without borrower consent. The Association does not sell or trade customers' personal information to marketing companies or information brokers. Additional information regarding FCA rules governing the disclosure of customer information can be obtained by contacting the Association.

## RELATIONSHIP WITH INDEPENDENT AUDITORS

There were no changes in independent auditors since the prior annual report to shareholders and there were no material disagreements with our independent auditors on any matter of accounting principles or financial statement disclosure during this period.

## RELATIONSHIP WITH COBANK, ACB (COBANK)

The Association is materially affected by CoBank's financial condition and results of operations.

The Association's statutory obligation to borrow from CoBank is discussed in Note 7. Financial assistance agreements between the Association and CoBank are discussed in Note 8. Association requirement to invest in CoBank and CoBank's ability to access capital of the Association is discussed in Note 4 to the financial statements, "Investment in CoBank," included in this annual report to shareholders. CoBank's role in mitigating the Association's exposure to interest rate risk is discussed in the MD&A section – Liquidity.

CoBank is required to distribute its Annual Report to shareholders of the Association if the bank experiences a significant event that has a material effect on the Association as defined by FCA regulations.

## FINANCIAL STATEMENTS

The financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 16, 2018, and the Report of Management, appearing as part of this annual report to shareholders, are incorporated herein by reference.

## COBANK ANNUAL AND QUARTERLY REPORTS TO SHAREHOLDERS

The shareholders' investment in the Association is materially affected by the financial condition and results of operations of CoBank. Consequently, the Association's annual and quarterly reports should be read in conjunction with CoBank's 2017 Annual and Quarterly Reports to Shareholders. Quarterly reports are available approximately 40 days after the calendar quarter end and annual reports are available approximately 75 days after the calendar year end. A copy of these reports may be obtained free upon request from the Association. The Association is located at 1359 East Lassen Avenue, Chico, California 95973, or may be contacted by calling (530) 571-4160. The reports may also be obtained free of charge by visiting CoBank's website at www.cobank.com.

## AFFIRMATIVE ACTION PLAN AND EQUAL EMPLOYMENT OPPORTUNITY POLICY

The Association has adopted an Affirmative Action Plan and Equal Employment Opportunity Policy.

Golden State Farm Credit

Our members become part of our family. They open up to us so we can understand what they need and how we can best help them. We become connected and celebrate their victories and mourn their tragedies. Our loan officers gather as much information as possible so they can educate and better help our members. Our members also educate us with their own personal endeavors and this enables us to stay connected and help each other succeed.

**Mary Ann Haley,** *Hanford*
*Serving Our Members Since 2000*

I take pride in being able to offer our members the tools and advice they need reach their goals. More importantly I am filled with a sense of satisfaction when I see a how our members, their families, and the surrounding communities grow when they succeed.

**Ray Block,** *Chico*
*Serving Our Members Since 2017*

All of life depends on a healthy natural environment, water, air, sunlight, soil, and diversity of living species. Because of this, farmers are the hardest working and most dedicated individuals. Without them we would not have food. The quality of human life depends on farmers succeeding.

**Kori Dusina,** *Chico*
*Serving Our Members Since 2004*

Our member's success is important because it means they've achieved their desired vision and goals, which is rewarding to them as well as me as their account officer. We share in our customer's success by providing positive feedback and ongoing support. The success of our community is also important and I believe in giving back to the community that provides me and my family a wonderful place to live.

**Shelley Macdonald,** *Red Bluff*
*Serving Our Members Since 1994*

I see Golden State Farm Credit members as part of our extended "family" in which we give our best efforts to help each member of the family to become successful in all of their endeavors, not only in their professional pursuits, but also in their personal pursuits. While the lender to borrower relationship may start out as a business transaction, the personal relationship is the one that endures through good times as well as challenging times. Members are not just borrowers or customers, but valued friends and members of the Golden State Farm Credit family. Their success is our success.

**Gary Davis,** *Kingsburg*
*Serving Our Members Since 2005*

OUR VENTURE–
**YOUR SUCCESS**

FOR **AMERICA'S** AGRICULTURALIST

# THANK YOU!

**Our success is because of you and your ongoing loyalty.**
**Thank you for being a part of the Golden State Farm Credit Family.**

## OUR MISSION

TO ENHANCE THE ABILITY OF THE AGRICULTURAL COMMUNITY TO ACHIEVE BUSINESS AND PERSONAL GOALS BY CONTINUING TO PROVIDE NEEDED AND COMPETITIVE CREDIT AND FINANCIAL SERVICES


GOLDEN STATE
FARM CREDIT