2018 ANNUAL REPORT

FARM CREDIT OF SOUTHERN COLORADO

Our Pride. Our Purpose. Our Passion.
Financing & promoting the success of agriculture.

CEO MESSAGE TO ASSOCIATION

PRESIDENT & CEO

JEREMY ANDERSON

It is a pleasure to present our 2018 Farm Credit of Southern Colorado Annual Report of Financial Condition. Farm Credit of Southern Colorado experienced strong financial performance in 2018, building upon the positive trends that your farmer/rancher owned cooperative has achieved over the years. These positive trends of sound operations are crucial in allowing us to fulfill our broader mission of serving farmers, ranchers, agriculture, and rural communities. We are committed to investing in your association and maintaining the capital necessary to allow us to grow with you and your operation's needs. The Association had very strong operating results in 2018. Net earnings were in excess of $16.0 million which allows the Association to return $4.5 million in cash patronage in March 2019, to you our stockholders.

Additional Association highlights for 2018 included:

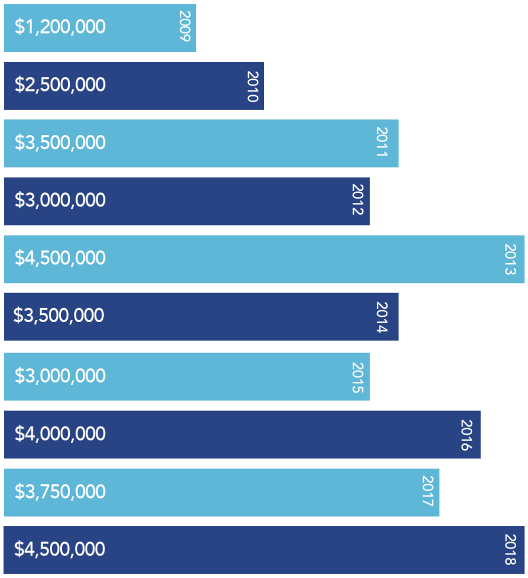
1. Originated 50 new loans for $5.2 million to new young, beginning, or small farmers or ranchers customers
2. Provided an interest rate discount program for recently discharged military veterans
3. Sponsored educational meetings within our lending territory
4. Hosted our first Annie's Project workshop - education for farm and ranch women
5. Continued to grow rural home loans and leasing in our loan portfolio

At Farm Credit of Southern Colorado, we believe it is our duty to provide a relevant and dependable source of credit and financial services that contribute to the long term success of our members and rural communities. We understand that as customers you expect competitively priced products and services, exceptional customer service, convenient credit delivery, knowledgeable staff, and a dedicated management team. As a member and owner of this cooperative, you also have the added benefit of playing a role in Association governance, earning back patronage, and building an organization to benefit current and future generations of farm and ranch families, all while working with a team of professionals devoted to your success.

The annual report provides detailed documentation supporting the financial results of the Association. We encourage you to read it carefully, and if you have concerns or questions, please feel free to contact us. Thank you for your continued support and for your business.

PATRONAGE

For over 100 years, Farm Credit has been passionately serving Rural America and Agriculture. We are proud to partner with the hard-working people who dedicate themselves to bettering America.

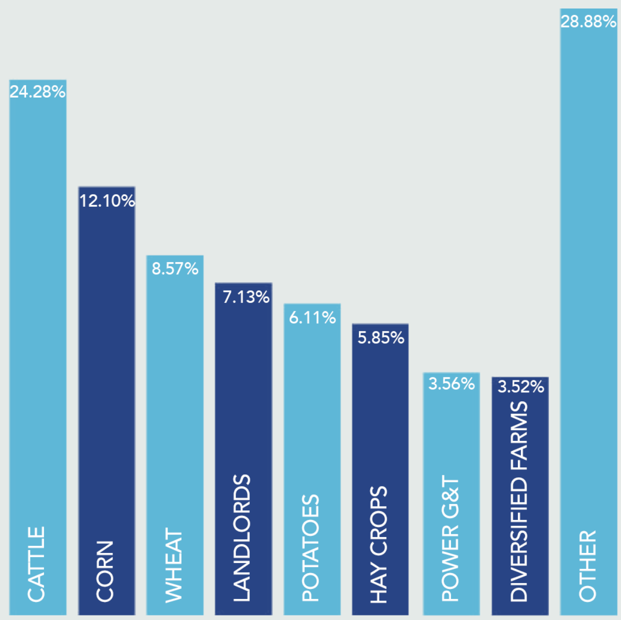


In the last 10 years, our cooperative has returned over $33,450,000 of profits to our eligible member-owners in patronage.

Our mission is to be a growing and successful cooperative that empowers employees to be a financial partner to our members while promoting the success of agriculture and our communities.

PORTFOLIO BREAKDOWN

Our association loan volume by borrower primary commodity as of December 31, 2018.



KEY NUMBERS

$1,102,797
TOTAL ASSETS
In thousands

$16,017
NET INCOME
In thousands

$253,337
TOTAL SHAREHOLDER'S EQUITY
In thousands

$4,500
TOTAL 2018 PATRONAGE DECLARED
In thousands

OUR BOARD OF DIRECTORS

MARK PETERSON
BOARD CHAIRMAN

Chairman of the Board currently serving a three-year term which expires in 2019. Mr. Peterson is a partner in a family run farm, Peterson Farms, LLC, farming potatoes and malting barley for Coors.

Mr. Peterson is currently serving as Chairman of the Colorado Potato Administrative Committee. He is a Director on the National Potato Council, which is the governmental oversight committee for the potato industry in the US. He serves on the Trade Affairs committee, the US-Mexico Trade affairs sub-committee, and the Legislative and Governmental Affairs Committee.

KENT PRICE
BOARD VICE CHAIRMAN

Vice Chairman of the Board currently serving a three-year term which expires in 2020 and Chairman of the Association's Compensation Committee. Mr. Price is a partner in Price Farms LLC, Price Farms Certified Seed Company LLC, Price Heritage LLC and Expo LLC. He is also part owner in San Acio Seed and San Acio Lands LLC. His operations include seed and market potatoes, and produce malt barley for Coors. He graduated from Adams State University and has been farming for over 36 years. He is currently secretary/treasurer for the Colorado Certified Potato Growers Association, serves on the San Luis Valley Colorado State University Research Committee, and secretary/treasurer of the San Luis Valley Well Owner's Association. He is an alternate on the Colorado Potato Administration Committee (CPAC) for Saguache County.

STEVE BETTS
APPOINTED DIRECTOR

Appointed Director currently serving a three-year term which expires in 2021 and Vice Chairman of the Association's Audit - Risk Committee. Mr. Betts is Chief Financial Officer of Merrick & Company, a global design engineering firm, and is also on the Board of Advisors for Phiston Technologies, Inc. Mr. Betts is a Certified Public Accountant licensed in Colorado.

JIM CROWDER
BOARD MEMBER

Director currently serving a three-year term which expires in 2021 and member of the Compensation Committee. Mr. Crowder has been ranching for the past five years. His operation consists of cow/calf, calf backgrounding, and some farming. He owns approximately 2,000 acres and leases about 9,000 acres. Previously, he was a Colorado Brand Inspector from 1979 to 2015. Mr. Crowder received a Bachelor of Science degree from Panhandle State University.

COLIN DURHAM
BOARD MEMBER

Director currently serving a three-year term which expires in 2019 and a member of the Association's Audit-Risk Committee. Dr. Durham is a 2013 graduate of Colorado State University's College of Veterinary Medicine.

Dr. Durham is a partner at Colorado Veterinary Clinic, P.C. in La Junta, Colorado. He is also a veterinarian at La Junta Livestock Commission, Inc. He and his brother run a commercial cow-calf and stocker operation. Additionally, they take in cattle on a custom grazing/partnership basis. They lease pasture in Crowley, El Paso, Lincoln and Otero counties.

CARL KEITH JAMES
BOARD MEMBER

Director currently serving a three-year term which expires in 2019 and a member of the Association's Audit - Risk Committee. He is the Association representative to the CoBank, ACB District Farm Credit Council. Mr. James has been farming since 1973. He has a cow/calf, stocker and wheat operation. Mr. James is Chairman of the Eastern Slope Rural Telephone Association Board and a Director on the Lincoln Community Hospital Board.

Scott Maranville: Director served a three-year term which expired in 2018.
Rosalie Martinez: Director, served a three-year term which expired in 2018.
Ronald Rehfeld: Director served a three-year term which expired in 2018.

Director currently serving a three-year term which expires in 2021 and a member of the Audit - Risk Committee. Mr. Livingston resides in Stratton, Colorado and has operated a farm and ranch with his wife Julie since 1984. Their primary enterprise is a cow/calf operation that spans across Kit Carson and Yuma counties. Mr. Livingston is also a member of Livingston Farms, LLC, which he and his son operate together to raise corn, milo, and wheat.

MIKE LIVINGSTON
BOARD MEMBER

Director currently serving a three-year term which expires in 2020 and a member of the Association's Compensation Committee. Mr. Negley has farmed and ranched since 1970. He is a partner in J & L Farms, a family partnership conducting a wheat and cow/calf operation. He serves as Secretary on the Board of Directors for the Kiowa Soil Conservation Board and Director for the Eads Hospital Board.

JOHN NEGLEY
BOARD MEMBER

Director serving a three-year term which expires in 2020 and a member of the Association's Compensation Committee and Chairman of the Scholarship Committee. Mr. Pautler has been farming since 1967. He is a partner in Pautler Brothers, a family owned irrigated and dryland corn and wheat operation. Mr. Pautler serves as Chairman on the Kit Carson County Planning Commission and is Treasurer of the Stratton Fire Protection District.

GARY PAUTLER
BOARD MEMBER

Appointed Director currently serving a three-year term which expires in 2020 and Chairman of the Association's Audit - Risk Committee. Dr. Prentice is the founder, President and Chief Economist of Farm Sector Economics, Inc., a consulting firm specializing in macroeconomic linkages to agriculture. After a 30-year run, Dr. Prentice closed Farm Sector Economics to focus on his teaching and Board work. He serves on the Board of Advisors for Bio-Economic Research Associates and also the Board of Advisors for the Bastiat Society of Colorado Springs. Dr. Prentice teaches as a Professor of Economics and Business at Colorado Technical University. He is an Adjunct Scholar at the Ludwig von Mises Institute, a Senior Fellow at the Independence Institute, and a Fellow of the Centennial Institute at Colorado Christian University.

PAUL PRENTICE
APPOINTED DIRECTOR

Director currently serving a three-year term which expires in 2021 and Vice Chairman of the Association's Compensation Committee and member of the Scholarship Committee. Mr. Uhland is a partner with his brothers in Tri-County Farms GP, which has a dryland crop operation raising wheat, milo, corn, sunflowers and millet. He is also partner in U-Land LLC which owns and leases land. He is a partner in Colorado Mills LLC, a sunflower oil and feed processing plant in Lamar, Colorado. He is partner in JAG, Inc. a farming corporation and partner in Kiowa County Investment Group, LLC. He serves on the Kiowa County Weed Board and is an alternate on the Sunflower Administrative Committee.

JEFF UHLAND
BOARD MEMBER

Director currently serving a three-year term which expires in 2021 and member of the Compensation Committee and Scholarship Committee. Mr. Yoder resides in Karval, Colorado in Lincoln County. Ranch manager has been his principal occupation for the past five years; his agricultural operation consists of cow/calf. Mr. Yoder is employed by Diamond Hitch Cattle Company, LLC as a ranch manager and is a member of that limited liability company. Mr. Yoder serves on the Colorado Cattlemen's Association Ag Policy Committee as its Chair. Mr. Yoder received a degree in Agricultural Business/Agricultural Economics from Oklahoma Panhandle State University.

SID YODER
BOARD MEMBER

OUR SENIOR OFFICERS

JEREMY ANDERSON
PRESIDENT & CEO

President and Chief Executive Officer (CEO) since November 2017. Previously, he served as Regional President, Board Member and part owner of a community bank in south central Nebraska. Mr. Anderson has over 17 years of commercial banking experience with National and Regional commercial banks. He has also been an active farmer. He and his wife have operated a working row-crop farming operation with his grandparents and parents near Clay Center, Nebraska for 25 years.

DEBORAH ANDERSON
VP OF HUMAN RESOURCES

Vice President of Human Resources since June 2017. Previously, she served as HR Generalist from 2010 to June 2017. Ms. Anderson started with the Association as an Administrative Assistant then moved to an HR – Administrative Assistant, and has been with Farm Credit of Southern Colorado for 17 years. She holds the Society of Human Resource Management's SHRM-CP Certification in Human Resources.

SHERRI BANDY
VP OF OPERATIONS

Vice President of Operations since June 2018. Previously, she served as Help Desk Manager from June 2017 to June 2018. Ms. Bandy started as an Operations Coordinator in 2000, and has been employed with the Farm Credit System for 19 years.

WILLIAM A. BARNES
CHIEF APPRAISAL OFFICER

Chief Appraisal Officer since January 2015. He was Senior Vice President – Appraisal Services January 2011 to December 2014. Prior to that he was the Vice President – Appraisals for 17 years. Mr. Barnes is a Colorado Certified General Appraiser and holds the Accredited Rural Appraiser, (ARA), designation which is awarded by the American Society of Farm Managers and Rural Appraisers, (ASFMRA), to those members who have had years of experience, are technically trained, have passed a rigid examination and subscribe to a high code of ethics. He has held this designation since 1989. He has been with the Farm Credit System for 39 years.

CHUCK BLASI
CHIEF CREDIT OFFICER

Chief Credit Officer beginning in March 2018. Previously served as Senior Vice President-Lending from February 2016 to March 2018 and Senior Credit Officer September 2013 to February 2016. Mr. Blasi served in various Loan Officer roles in the La Junta and Burlington Branches for 27 years from 1986 to 2013. Mr. Blasi has been employed within Farm Credit of Southern Colorado for over 32 years.

David L. Self: Chief Credit Officer beginning in December 2014 to February 2018. He was previously Executive Vice President Lending from July 2014 to December 2014; Senior Vice President Lending from November 2009 to July 2014. Mr. Self served as the Vice President – Credit from July 2000 to November 2009. Mr. Self started as a field representative in 1981 and has worked for five different Associations, one Farm Credit Bank and three different Farm Credit Districts. Mr. Self was employed within the Farm Credit System for 38 years and retired in January 2019.

Senior Vice President of Credit since January 2017. Previously, he served as Vice President of Credit from October 2013 to January 2017. Mr Broeckelman has worked in retail credit and lending capacities with Farm Credit of Ness City and the Burlington Branch of Farm Credit of Southern Colorado, and has been employed with the Farm Credit System for 33 years.

MARK BROECKELMAN
SVP OF CREDIT

Chief Information Officer (CIO) since November 2018. Previously served as Vice President of Information Services at Farm Credit of New Mexico and has 15 years of experience in the Farm Credit System. Mr. Hunt has several IT certifications including MCSA, A+, and Security+ along with being a Lean certified expert. He actively serves on the AgVantis Technology Committee.

KODE HUNT
CHIEF INFORMATION OFFICER

Chief Risk Officer since March 2018. Previously Ms. Lange served as VP – Risk management from March 2017 to February 2018, VP – Capital Markets from March 2016 to February 2017, and AVP-Credit/Risk Management Specialist from July 2007 to February 2016. She has been with Farm Credit of Southern Colorado for 11 years serving in various roles within credit, operations, and risk management. Prior to coming to Farm Credit, Ms. Lange worked at a commercial bank in California in both the credit and risk management departments.

KATRINA LANGE
CHIEF RISK OFFICER

Chief Financial Officer since February 2007. Ms. Neppl served as Interim CEO from June 2017 to November 2017. She also served as Vice President/Branch Manager of the Colorado Springs Branch from February 2001 to February 2007 and as Assistant Vice President – Risk Management from January 2000 to February 2001. She has been with the Farm Credit System for 26 years.

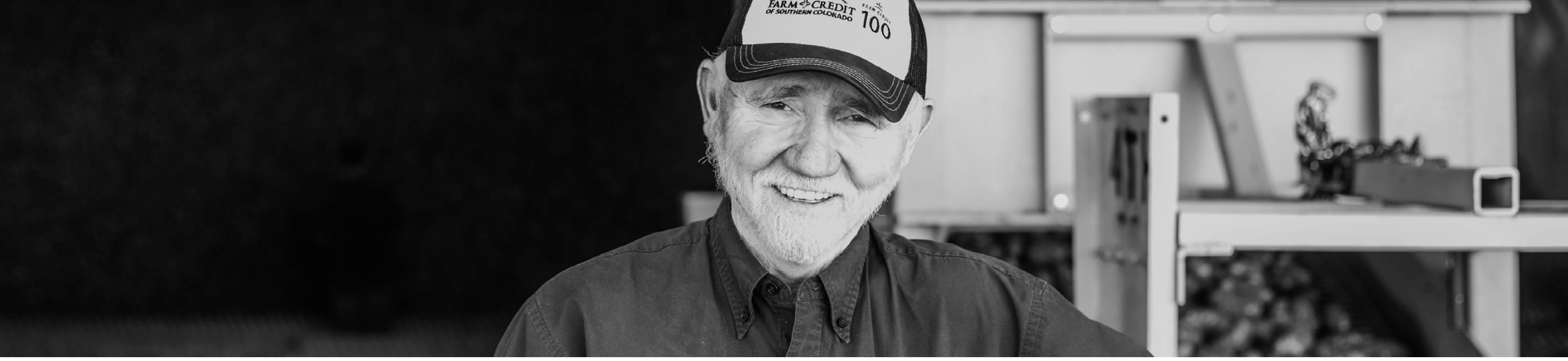
SHAWNA R. NEPPL
CHIEF FINANCIAL OFFICER

Chief Banking Officer since March 2016. Previously, Mr. West served as Vice President – Capital Markets from May 2015 to March 2016. Mr. West began his career with CoBank as a credit analyst, then moved to Farm Credit of Southern Colorado from 2004 to 2007 reaching the position of Vice President – Credit. He then served at American AgCredit as Vice President – Relationship Manager for eight years, returning to Farm Credit of Southern Colorado in 2015. Mr. West has been with the Farm Credit System for 17 years and in the banking industry 26 years.

KENNETH P. WEST
CHIEF BANKING OFFICER

Ricky Sellers: Interim Chief Operating Officer from July 2017 through May 2018, Standards of Conduct Official from July 2017 to March 2018, and Compliance Officer from January 2011 through May 2018.

Nick Wedel: Chief Information Security Officer from February 2018 to July 2018.



ASPEN POTATOES

Jed, Rick, and Jake
Monte Vista, Colorado

Surrounded by the mountains in the San Luis Valley sits a potato operation that has been financed by Farm Credit of Southern Colorado for three generations. From its early roots of packaging potatoes for the military to growing into a fully integrated operation, Aspen Potatoes LLC has become a staple of our Farm Credit association.

While some operations define success as the amount of money they make in a year, the Ellithorpe's have a different definition. "My success is to have something that can continue on and pass on to the next generation and they can enjoy the fruits of that. It's not my own accomplishments, because the accomplishments that you see around here, they're not mine, they're everybody's. Everybody put something in," said Rick Ellithorpe, second generation.

Rick's son, Jed, grew up on the operation. After college, he wanted to do something that mattered. "I know a lot of kids that were my age and in my class that were sons and daughters of farmers that didn't come back to farming. And I got to thinking what compelled me to come back to farming, and mostly it was family," Jed said.

"You know there was a lot of other opportunities out there, but when it really came down to it, I wanted to do something that mattered. Something that was important. And the important thing for me was to come back out of school and be able to assist my dad with some of the things I had learned in college and just help him out with what he had built thus far."

As a cooperative, FCSC is dedicated to helping our partners create operations with long, sustainable futures. The relationships we build often last multiple generations and depend on meaningful interactions.

"You find other partners in business and you stick with them. They'll take care of you and you can take care of them. We cannot go through this business alone. You have to develop loyalties… over the years we have developed some very strategic partners that I don't think we could even be in business without," Jed said.

"You're not in this alone- it takes a whole bunch of people inside and outside your business to make it work."

BOWMAN RURAL HOME

Rick and Jennifer
Victor, Colorado

After two major mortgage lenders and countless local banks told the Bowman's they would finance their rural home and backed out, Rick and Jennifer began to wonder if anyone would be able to help them finance their home. With just one call, Rick was working with FCSC, getting his 6,000 square foot home and 80-acre property financed in one product.

"After a few tries with a few traditional lenders, I tried to work with local banks and hit roadblocks halfway through the process," Rick said. "Working through the whole process [with Farm Credit of Southern Colorado] was very easy. Through phone calls and emails, we had a couple small hurdles to get over in the process, but even those went smoothly."

Because of the size of the house, with the added 80 acres, many local banks would start the Bowman's down the loan process, but backed out. With FCSC, they were able to finance the house and the 80 acres in one product.

"From the time we contacted Farm Credit through closing, it was pretty smooth," Rick said.

Financing a property on a mountain in Victor, Colorado sounds like an impossible feat. But with the dedicated team at FCSC, the Bowman's were able to finalize their financing in under four weeks.

"We are extremely grateful that you were there," Jennifer said.

Five-Year Summary of Selected Consolidated Financial Data

(Dollars in Thousands)

	December 31				
	2018	2017	2016	2015	2014
Statement of Condition Data					
Loans	**$ 1,028,163**	$ 981,997	$ 943,326	$ 930,505	$ 899,667
Less allowance for loan losses	**2,863**	2,261	1,535	1,474	1,413
Net loans	**1,025,300**	979,736	941,791	929,031	898,254
Investment in CoBank, ACB	**32,435**	31,487	30,876	29,954	29,423
Other property owned	**-**	2,378	2,575	1,752	5,398
Other assets	**45,062**	41,236	37,807	36,985	37,133
Total assets	**$ 1,102,797**	$ 1,054,837	$ 1,013,049	$ 997,722	$ 970,208
Obligations with maturities of one year or less	**$ 19,075**	$ 14,943	$ 14,538	$ 13,571	$ 13,737
Obligations with maturities longer than one year	**829,974**	798,183	766,778	762,847	744,959
Reserve for unfunded commitments	**411**	382	270	457	-
Total liabilities	**849,460**	813,508	781,586	776,875	758,696
Protected borrower stock	**-**	-	-	-	2
Preferred stock	**2,826**	2,619	1,879	1,761	2,863
Capital stock	**1,454**	1,410	1,407	1,375	1,328
Unallocated retained earnings	**249,624**	238,141	228,177	217,711	207,319
Accumulated other comprehensive loss	**(567)**	(841)	-	-	-
Total shareholders' equity	**253,337**	241,329	231,463	220,847	211,512
Total liabilities and shareholders' equity	**$ 1,102,797**	$ 1,054,837	$ 1,013,049	$ 997,722	$ 970,208

	For the Year Ended December 31				
	2018	2017	2016	2015	2014
Statement of Income/(Expense) Data					
Net interest income	**$ 27,805**	$ 26,678	$ 25,648	$ 24,508	$ 23,769
Patronage distribution from Farm Credit institutions	**4,105**	3,541	3,760	3,418	3,520
Provision for credit losses	**(494)**	(822)	(368)	(747)	(17)
Noninterest expense, net	**(15,393)**	(15,662)	(14,560)	(13,773)	(11,819)
Provision for income taxes	**(6)**	(5)	(5)	(5)	(5)
Net income	**$ 16,017**	$ 13,730	$ 14,475	$ 13,401	$ 15,448
Comprehensive income	**$ 16,291**	$ 12,889	$ 14,475	$ 13,401	$ 15,448

Key Financial Ratios					
For the Year					
Return on average assets	**1.50%**	1.33%	1.44%	1.38%	1.61%
Return on average shareholders' equity	**6.41%**	5.74%	6.35%	6.19%	7.21%
Net interest income as a percentage of average earning assets	**2.78%**	2.77%	2.72%	2.70%	2.64%
Net (recoveries)/charge-offs as a percentage of average net loans	**(0.01%)**	<(0.01)%	0.05%	0.03%	0.02%
At Year End					
Shareholders' equity as a percentage of total assets	**22.97%**	22.88%	22.85%	22.14%	21.80%
Debt as a ratio to shareholders' equity	**3.35:1**	3.37:1	3.38:1	3.52:1	3.59:1
Allowance for loan losses as a percentage of loans	**0.28%**	0.23%	0.16%	0.16%	0.16%
Common equity tier 1 (CET1) capital ratio	**19.68%**	19.52%	N/A	N/A	N/A
Tier 1 capital ratio	**19.68%**	19.52%	N/A	N/A	N/A
Total regulatory capital ratio	**19.94%**	19.74%	N/A	N/A	N/A
Tier 1 leverage ratio	**20.78%**	20.35%	N/A	N/A	N/A
Unallocated retained earnings and URE equivalents (UREE) leverage ratio	**21.41%**	20.94%	N/A	N/A	N/A
Permanent capital ratio	**19.98%**	19.81%	20.17%	19.16%	18.97%
Total surplus ratio	**N/A**	N/A	19.85%	18.85%	18.54%
Core surplus ratio	**N/A**	N/A	19.85%	18.85%	18.54%
Net Income Distribution					
Cash patronage distributions paid	**$ 3,750**	$ 4,000	$ 3,000	$ 3,500	$ 4,500
Cash patronage declared	**$ 4,500**	$ 3,750	$ 4,000	$ 3,000	$ 3,500
Stock dividends paid	**$ 28**	$ 14	$ 9	$ 10	$ 49
Stock dividends declared	**$ 34**	$ 16	$ 9	$ 9	$ 34

Unaudited

MANAGEMENT'S DISCUSSION AND ANALYSIS

INTRODUCTION

The following discussion summarizes the financial position and results of operations of Farm Credit of Southern Colorado, ACA (Association) for the year ended December 31, 2018. 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
- Patron's Consent to Take Patronage Distribution into Income

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.aglending.com, or upon request. We are located at 5110 Edison Avenue, Colorado Springs, Colorado 80915 or may be contacted by calling (800) 815-8559 or (719) 570-1087.

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 southern Colorado. The counties in our territory are listed in Note 1 of the accompanying consolidated financial statements. 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, leasing, fee appraisals, advanced conditional payment accounts and an investment stock program. 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 5110 Edison Avenue, Colorado Springs, Colorado 80915 or by calling (800) 815-8559 or (719) 570-1087. 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 prior service agreement expired on December 31, 2018. A new agreement was entered into and will expire on December 31, 2021. 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

The Federal Reserve raised the Fed Funds Rate 100 basis points in 2018 with a target range for the Fed Funds rate of 2.25% – 2.50%. Fed officials indicate that two more rate hikes in 2019 are likely. These planned moves are in reaction to the expectation of faster economic growth, higher inflation, and lower unemployment in coming years.

National unemployment remains low at 3.7%, monthly job creation remains strong, and inflation is considered to be under control at approximately 2.0% for 2018. U.S. economic growth continues to be steady with a 3.0% growth rate projected for 2018. The biggest reason is an increase in U.S. consumer spending. Consumer confidence and the unemployment rate are at their best levels since 2000. This is primarily a result of last year's multi-trillion dollar gain in household net worth from stock market gains and double-digit increases in home prices. These events have caused a feeling of increased wealth among U.S. consumers.

Our lending territory spans over a very diverse region of Southern Colorado, including the San Luis Valley. The various commodities range from corn, wheat, cattle and potatoes, which represent the top four commodity concentrations in our association. Cattle is our largest commodity concentration made up primarily of cow/calf, fed cattle and stockers. Fortunately, grass conditions remain adequate to allow for maintenance of the cow herds so we don't anticipate herd reduction, despite drought conditions in our territory. Due to positive market conditions, stocker operations posted profits in 2018.

Corn and wheat prices remained low in 2018 due to large global surpluses and tariffs, resulting in continued economic stress for the eastern region of our territory. The south region, which has a high concentration of wheat, battled drought conditions which impacted yields. The Seasonal Drought Outlook map shows drought conditions persisting in our territory through the end of the first quarter 2019. With increased protein levels in wheat, fairly good premium was paid at the elevators and flour millers, allowing wheat farmers to stay above break even.

The most significant improvement was for the potato farmers in the San Luis Valley, the second largest producer of fresh potatoes in the United States. All the potatoes are packaged locally and sent to grocery stores in surrounding states. The mountain region provides ideal growing conditions for potatoes. Potato prices improved in 2018 due to consumer demand and other regions in the country were hit with poor weather conditions resulting in reduced production.

Over the past two years, the aging farmer has become more prevalent in our eastern region. The association has seen increased farms being farmed under various leasing arrangements, resulting in landlords being in the top 5 of our commodity concentrations.

Real estate values in our territory have remained stable to increasing. Large mountain ranch properties held stable values. Real estate transactions over $100 thousand have been primarily cash deals resulting in limited loan volume. The hemp and marijuana industry has begun to impact the price of irrigation farm ground, with increasing prices from higher demand.

The Agricultural Improvement Act of 2018 (Farm Bill) was signed into law on December 20, 2018. This new Farm Bill will govern an array of federal farm and food programs, including commodity price support payments, farm credit, conservation programs, research, rural development and foreign and domestic food programs for five years through 2023. The new Farm Bill continues to provide support for crop insurance programs and commodity support programs, strengthen livestock disaster programs, and provides dairy producers with an updated voluntary margin protection program that will provide more flexibility to dairy operations. The Farm Bill also authorizes the production and marketing of industrial hemp in accordance with state or federal regulations.

Many provisions of the Farm Bill will require the United States Department of Agriculture to develop rules and procedures to fully implement these authorities. The timing for the issuance of those rules is uncertain and has been impacted by the ongoing shutdown of portions of the Federal government.

LOAN PORTFOLIO

Total loans outstanding were $1.03 billion at December 31, 2018, an increase of $46.2 million, or 4.7%, from loans at December 31, 2017 of $982.0 million, and an increase of $84.8 million, or 9.0%, from loans at December 31, 2016 of $943.3 million. The increase in loans was due to growth in both our core loan portfolio and participations purchased portfolio. The types of loans outstanding at December 31 are reflected in the following table.

	2018		2017		2016	
(dollars in thousands)	**Volume**	**Percent**	Volume	Percent	Volume	Percent
Real estate mortgage loans	**$609,071**	**59.2%**	$573,590	58.4%	$539,889	57.3%
Production and intermediate-term loans	**178,320**	**17.4%**	180,294	18.4%	182,932	19.4%
Agribusiness loans	**151,480**	**14.8%**	147,501	15.0%	148,944	15.8%
Rural infrastructure loans	**79,620**	**7.7%**	70,877	7.2%	61,716	6.5%
Agricultural export finance loans	**8,512**	**0.8%**	8,506	0.9%	8,513	0.9%
Rural residential real estate loans	**44**	**–**	57	–	107	–
Mission-related loans	**1,116**	**0.1%**	1,172	0.1%	1,225	0.1%
Total	**$1,028,163**	**100.0%**	$981,997	100.0%	$943,326	100.0%

Real estate mortgage loans outstanding increased 6.2% to $609.1 million compared with $573.6 million at year-end 2017, primarily due to a few large loans that were recorded in our core portfolio during 2018. Long-term mortgage loans are primarily used to purchase, refinance or improve real estate. These loans have maturities ranging from 5 to 40 years. Real estate mortgage loans are also made to rural homeowners. 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.

Production and intermediate-term loans decreased 1.1% to $178.3 million compared with 2017 loans of $180.3 million, primarily due to a large payoff in our core portfolio, partially offset by a new large loan in our participations purchased portfolio. 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. Intermediate-term loans 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.

Agribusiness loans were $151.5 million or 14.8% of the loan portfolio at the end of 2018, compared to $147.5 million or 15.0% of the portfolio at the end of 2017. Agribusiness loans consist of loans to farm related businesses, cooperatives, and process and marketing businesses.

Increases were also noted in rural infrastructure loans where 100% of the loan volume was due to loan participations in communication, energy and water/waste water. Additionally, at December 31, 2018, 100% of agricultural export finance volume was a result of loan participations.

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 participations from other System and non-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.

To increase our market share of broadly syndicated participation loans, we are a party to a shared lending operation known as the Commercial Finance Group (CFG). The agreement includes our Association together with Premier Farm Credit, ACA; Oklahoma AgCredit, ACA; and several associations in the AgriBank District. Along with these associations, we pool our resources to coordinate and enhance the marketing, originating and servicing of large, complex commercial and mortgage loans, as well as diversify risk. This agreement essentially replaced the Agribusiness Finance Group (AFG), which was a similar agreement that terminated in 2011. The AFG agreement included our Association and three other District Associations. The remaining participations through AFG will terminate at maturity or renewal.

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

(dollars in thousands)	**2018**	2017	2016
Participations purchased with AFG	**13,144**	17,583	18,381
Participations purchased with CFG	**230,572**	210,172	189,360
Participations purchased with other Farm Credit institutions	**53,527**	39,069	47,376
Participations purchased with non-Farm Credit institutions	**2,700**	4,105	2,132
Total participations purchased	**$ 299,943**	$ 270,929	$ 257,249
Participations sold to other Farm Credit institutions	**26,204**	$ 20,133	$ 17,127
Total participations sold	**$ 26,204**	$ 20,133	$ 17,127

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 – Colorado and Other in the following table.

	2018	2017	2016
Alamosa	**2.29%**	2.94%	2.91%
Arapahoe	**3.44%**	3.61%	3.07%
Baca	**2.93%**	2.91%	3.16%
Bent	**1.11%**	1.06%	1.14%
Cheyenne	**4.29%**	4.33%	4.18%
Conejos	**1.16%**	1.03%	0.65%
Douglas	**1.68%**	1.81%	1.99%
El Paso	**1.14%**	1.09%	1.13%
Elbert	**2.98%**	3.51%	3.69%
Jefferson	**0.85%**	1.30%	1.18%
Kiowa	**1.48%**	1.68%	1.74%
Kit Carson	**17.88%**	17.16%	18.44%
Las Animas	**0.86%**	0.90%	0.97%
Lincoln	**3.10%**	3.44%	3.68%
Otero	**1.95%**	2.00%	1.92%
Prowers	**2.14%**	2.17%	2.35%
Pueblo	**0.90%**	0.94%	1.02%
Rio Grande	**3.89%**	3.80%	3.33%
Saguache	**1.63%**	1.89%	2.29%
Other – Colorado	**12.58%**	12.72%	10.98%
Other	**31.72%**	29.71%	30.18%
Total	**100.00%**	100.00%	100.00%

We are party to a Territorial Approval Agreement (Agreement) with two other associations in the states of Colorado and Kansas. The Agreement eliminates territorial restrictions and allows associations that are a party to the Agreement to make loans in any other association's territory regardless of a borrower's place of residence, location of operations, location of loan security or location of headquarters. This Agreement can be terminated upon the earlier to occur of:

1) the time when all but one association has withdrawn as a party to the Agreement; or
2) when requested by FCA.

We are a party to an Agreement Providing Territorial Concurrence (Agreement) with Farm Credit Services of America. 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.

SIC Category	December 31 **2018**	2017	2016
Cattle	**24.28%**	22.05%	22.10%
Corn	**12.10%**	13.99%	14.71%
Wheat	**8.57%**	12.69%	15.31%
Landlords	**7.13%**	6.05%	3.82%
Potatoes	**6.11%**	6.59%	6.47%
Hay	**5.85%**	6.15%	5.12%
Power	**3.56%**	3.83%	4.30%
Diversified Farms	**3.52%**	2.57%	2.26%
Other	**28.88%**	26.08%	25.91%
Total	**100.00%**	100.00%	100.00%

Our loan portfolio contains a concentration of cattle, corn and wheat producers. The majority of our cattle producers fall into one of three categories: cow/calf producers, grazing stockers and fed cattle. Each has a distinct risk profile which provides for diversity. As of December 31, 2018, borrowers with cow/calf producers as their primary product comprised 14.74% of the portfolio, fed cattle were 5.83% and stockers were 2.60%. Cattle producers that did not fall into one of these sub categories comprised 1.11% of the portfolio. Our concentration of corn producers decreased to 12.10%. Our concentration of wheat producers declined to 8.57%. Our concentration of landlords increased to 7.13%. The other category reflects 28.88% of the volume and is comprised of more than 75 separate categories, the largest of these representing 2.87% of the total.

The increase in diversified farms in 2018 is due to re-evaluating the primary product codes for each customer. During 2018, we updated the code to most appropriately reflect the borrower's overall operations. Due to changes in some borrower's overall operations over time, there were shifts in the enterprise concentrations. The update also impacted corn, wheat and landlords, as well as other categories in 2018.

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. Of our outstanding loan volume at December 31, 2018, 8.1% consists of borrowers that are non-farm income dependent, a decrease from 9.2% for 2017, and 9.8% for 2016.

The loans outstanding at December 31, 2018 for loans $250 thousand or less accounted for 18.8% of loan volume and 72.3% 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 loans outstanding by dollar size at December 31 for the last three years.

	2018		2017		2016	
(dollars in thousands)	**Amount outstanding**	**Number of loans**	Amount outstanding	Number of loans	Amount outstanding	Number of loans
$1 - $250	**$ 193,767**	**2,399**	$ 185,249	2,325	$ 185,462	2,391
$251 - $500	**152,275**	**423**	158,070	448	159,697	452
$501 - $1,000	**202,256**	**284**	193,837	273	193,629	272
$1,001 - $5,000	**394,212**	**204**	369,880	193	348,698	179
$5,001 - $25,000	**85,653**	**10**	74,961	11	55,840	8
Total	**$1,028,163**	**3,320**	$ 981,997	3,250	$ 943,326	3,302

Approximately 13% of our loans outstanding is attributable to ten borrowers. 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.

Credit guarantees with government agencies of $17.0 million at year-end 2018, $18.0 million at year-end 2017 and $18.3 million at year-end 2016 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 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, 2018.

(dollars in thousands)	**Less than 1 year**	**1 – 3 years**	**3 – 5 years**	**Over 5 years**	**Total**
Commitments to extend credit	$110,110	$ 85,254	$ 80,959	$34,075	$310,398
Standby letters of credit	2,471	264	157	21	2,913
Total commitments	$112,581	$ 85,518	$ 81,116	$34,096	$313,311

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)	**2018**	2017	2016
Nonaccrual loans:			
Real estate mortgage	**$ 10,049**	$ 10,723	$ 4,391
Production and intermediate-term	**129**	1,586	1,420
Agribusiness	**337**	–	–
Total nonaccrual loans	**10,515**	12,309	5,811
Accruing restructured loans:			
Real estate mortgage	**495**	519	97
Production and intermediate-term	**789**	717	727
Rural infrastructure	**–**	–	1,279
Total accruing restructured loans	**1,284**	1,236	2,103
Accruing loans 90 days past due:			
Production and intermediate-term	**75**	–	–
Total accruing loans 90 days past due	**75**	–	–
Total impaired loans	**11,874**	13,545	7,914
Other property owned	**–**	2,378	2,575
Total high risk assets	**$ 11,874**	$ 15,923	$ 10,489
Nonaccrual loans to total loans	**1.02%**	1.25%	0.62%
Impaired loans to total loans	**1.15%**	1.38%	0.84%
High risk assets to total loans	**1.15%**	1.62%	1.11%
High risk assets to total shareholders' equity	**4.69%**	6.60%	4.53%

Total high risk assets decreased $4.0 million, or 25.4%, to $11.9 million at December 31, 2018 compared with year-end 2017. The reduction in high risk assets was largely due to a decrease in nonaccrual loans and the sale of all our other property owned.

Nonaccrual loans represent all loans where there is a reasonable doubt as to collection of all principal and/or interest. Nonaccrual volume decreased $1.8 million compared with December 31, 2017 due to large pay downs by one loan complex, offset by a transfer in of two large loan complexes and various smaller increases. At year-end 2018, four loan complexes made up 93.09% of the nonaccrual loan volume. We have 95.95% of the nonaccrual loan volume secured by real estate. The following table provides additional information on nonaccrual loans as of December 31 for the last three fiscal years.

(dollars in thousands)	**2018**	2017	2016
Nonaccrual loans current as to principal and interest	**$ 10,136**	$ 11,213	$ 1,421
Restructured loans in nonaccrual status	**$ –**	$ –	$ 443

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

Accruing restructured loans including related accrued interest increased $48 thousand during 2018 primarily as a result of loan advances, as no new restructured loans were added in 2018. The accruing restructured loans include only the year-end balances of loans and related accrued interest on which monetary concessions have been granted to borrowers and that are in accrual status. Accruing restructured loans do not include loans on which monetary concessions have been granted but which remain in nonaccrual status.

At the end of 2018, we had one loan that was 90 days past due and still accruing interest. This loan has an FSA guarantee.

Other property owned is real or personal property that has been acquired through foreclosure, deed in lieu of foreclosure or other means. We had no other property owned at December 31, 2018, compared with $2.4 million at December 31, 2017 and $2.6 million at December 31, 2016. We held three acquired properties at the end of 2017, all of which were sold during 2018 for a gain, resulting in a total gain on sales of $173 thousand.

High risk asset volume is anticipated to increase through 2019 as we continue to see distress in our borrowers' operations due to on-going stress in the cash grains and livestock sectors. We will continue to work with borrowers who are experiencing distress in their operations and will fully provide borrower rights to these borrowers. Our first direction is to restructure a borrower's loan(s) in an attempt to return them back to viability. We will explore and apply all feasible alternatives available to help these distressed borrowers shore up their operations without creating undue risk on the Association. On a positive note, the portfolio associated with the potato industry continues to improve.

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.

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.

	2018	2017	2016
Acceptable	**91.64%**	93.46%	92.10%
OAEM	**3.67%**	2.34%	3.64%
Substandard	**4.68%**	4.20%	4.26%
Doubtful	**0.01%**	–	–
Total	**100.00%**	100.00%	100.00%

Recent economic conditions have created challenges for some borrowers and our credit quality has declined. Loans classified as Acceptable and OAEM were 95.31% at December 31, 2018, 95.80% at December 31, 2017 and 95.74% at December 31, 2016. Substandard volume increased to 4.68% at December 31, 2018 compared to 4.20% at December 31, 2017 and 4.26% at December 31, 2016. Twelve loan complexes comprise approximately 88% of the substandard loan volume at December 31, 2018. We had one loan classified as Doubtful at December 31, 2018; it is also in nonaccrual status. We had no loans classified as Loss for any of the three years presented.

Agriculture remains a cyclical business that is heavily influenced by production, operating costs and commodity prices. The outlook for the agricultural economy in 2019 is decisively bleaker than one year ago. Global trade related issues and abundant supplies will continue to suppress agriculture. We expect our cash grains and livestock loan portfolios to weaken but remain sound. Many of our borrowers maintained a strong financial position during the last decade and that is helping them weather the storm. Loan delinquencies (accruing loans 30 days or more past due) as a percentage of accruing loans increased, however remained at a low level of 0.24% at December 31, 2018, compared with 0.17% at December 31, 2017 and 0.54% at December 31, 2016.

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, 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)	**2018**	2017	2016
Balance at beginning of year	**$ 2,261**	$ 1,535	$ 1,474
Charge-offs:			
Production and intermediate-term	**45**	22	684
Total charge-offs	**45**	22	684
Recoveries:			
Real estate mortgage	**–**	–	50
Production and intermediate-term	**173**	38	140
Agribusiness	**9**	–	–
Total recoveries	**182**	38	190
Net (recoveries)/charge-offs	**(137)**	(16)	494
Provision for loan losses	**465**	710	555
Balance at December 31	**$ 2,863**	$ 2,261	$ 1,535
Net (recoveries)/charge-offs to average net loans	**(0.01%)**	<(0.01%)	0.05%

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)	**2018**	2017	2016
Real estate mortgage	**$ 710**	$ 675	$ 429
Production and intermediate-term	**668**	557	388
Agribusiness	**932**	693	443
Rural infrastructure	**330**	317	265
Agricultural export finance	**7**	6	6
Mission-related	**216**	13	4
Total	**$ 2,863**	$ 2,261	$ 1,535

The allowance for loan losses increased $602 thousand from December 31, 2017, to $2.9 million at December 31, 2018. The increase in allowance for loan losses was primarily due to the provision for loan losses totaling $465 thousand that was recorded due to increases in all three reserve categories. General reserves increased $177 thousand due to increased volume and deterioration of credit quality. Specific reserves increased $176 thousand due to a loan with potential collateral shortfall and the management reserves increased $249 thousand due to an increase in identified risk in the portfolio. Net recoveries of $137 thousand were recorded during 2018. Overall, charge-off activity remains low relative to the size of our loan portfolio. During 2017, our allowance for loan losses increased $726 thousand from 2016 primarily due to the provision for loan losses totaling $710 thousand that was recorded due to new (higher) PD factors utilized in the calculations based on the updated Combined System Risk Rating Guidance and the newly implemented 18-month default horizon. 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.

	2018	2017	2016
Allowance as a percentage of:			
Loans	**0.28%**	0.23%	0.16%
Impaired loans	**24.11%**	16.69%	19.39%
Nonaccrual loans	**27.23%**	18.37%	26.41%

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.

	Year Ended December 31		
(dollars in thousands)	**2018**	2017	2016
Balance at beginning of year	**$ 382**	$ 270	$ 457
Provision for/(Reversal of) reserve for unfunded commitments	**29**	112	(187)
Total	**$ 411**	$ 382	$ 270

Young, Beginning and Small Farmers and Ranchers Program

As part of the Farm Credit System, we are committed to providing a program for young, beginning and small (YBS) farmers and ranchers that provides access to credit to help get them started, along with access to education to help keep them going. Farm Credit of Southern Colorado's YBS program is in pursuit of empowering our young, beginning and small producers to succeed as our next generation of agricultural producers and customers.

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.

	USDA	**2018**	2017	2016
Young	8.51%	**17.79%**	17.40%	16.93%
Beginning	37.32%	**21.67%**	20.88%	20.34%
Small	92.85%	**32.03%**	32.52%	31.22%

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 those 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.

Quarterly reports are provided to our Board of Directors detailing the number and volume of our YBS customers relative to the business plan goals. We have developed quantitative targets to monitor our progress.

For 2018, the goal was to originate 42 or more new YBS loans to new customers for $6.0 million or greater. Actual results were 50 new loans, for a total of $5.2 million, to new customers meeting at least one of the three YBS criteria. Additionally, we set portfolio goals with the following results:

New Loans	Number Goal	Number Results	Volume Goal	Volume Results
Young	171	141	$ 40,000	$ 22,080
Beginning	226	192	$ 56,200	$ 43,380
Small	265	238	$ 43,200	$ 36,473
Existing Loans				
Young	722	656	$ 145,000	$ 149,333
Beginning	870	799	$ 200,000	$ 217,917
Small	1,310	1,181	$ 181,500	$ 185,796

During 2019, we are focusing more on outreach efforts to ensure that we are reaching the YBS farmers and ranchers in our territory. As such, this year's goals focus more on new loans made to YBS customers as a whole, rather than on the number of young, beginning, or small farmer and rancher loans in the portfolio. The reason for this is that, as noted above, one customer may meet all three definitions, and therefore be counted three times in the total portfolio numbers that were used in the past. Going forward, we will be focusing more on how many YBS farmers and ranchers we reach without double or triple counting. Therefore, for 2019, we have set the following quantitative objectives for loans that meet the definition of lending to a young, beginning, and/or small farmer or rancher (YBS customers) as follows:

	2019	2020	2021
# of New Loans	250	275	300
Volume of New Loans	$15 million	$16.5 million	$18 million

Over the planning period, the goal is to have total loans in each category of YBS customers as follows:

	2019		2020		2021	
	# of Loan	Volume	# of Loan	Volume	# of Loan	Volume
Young	730	$ 154,000	810	$ 159,000	900	$ 164,000
Beginning	870	$ 221,000	950	$ 226,000	1,040	$ 231,000
Small	1,260	$ 190,000	1,340	$ 195,000	1,430	$ 199,000

To ensure that credit and services offered to 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, and 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 farmer and ranchers.

We established annual marketing goals to increase market share of loans to YBS farmers and ranchers. In an effort to better serve our 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.

As part of our marketing strategy, we utilize FSA and other loan guarantee programs whenever it is advantageous to a YBS customer. Additionally, we host outreach functions targeted at the YBS customers in our territory. In 2018, we hosted several functions that were educational and beneficial to YBS customers, which included hosting and sponsoring Annie's Project events, working with future agricultural leaders at state and local FFA career fairs, offering market workshops, and sponsoring workshops hosted by Colorado State University (CSU) Extension throughout our territory.

We are expanding our YBS program, which will be done in two phases. In 2019, Phase One will be launched, where we will implement a comprehensive education program focused on YBS farmers and ranchers. Planning will take place throughout 2019 for Phase Two, a more robust financing program with options and benefits for YBS producers, with plans to implement in 2020. Phase One includes the following qualitative goals:

Educating Future Producers and Employees

- Interact with local FFA Chapters at our various locations by participating in educational events where we can showcase Farm Credit careers and how we support farmers, ranchers and rural America.

Educating Young Producers

- Create fact sheets and infographics to share via social media and our website,
- Offer educational workshops at our various locations; and,
- Invite YBS producers and/or prospects to participate in Farm Credit University's Ag Biz Basics

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 also 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.

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 within the portfolio. Lending limits have been established on a loan by loan basis for all customer complexes that exceed 5% of our lending limit base. We utilize a tool that considers factors such as financial position, enterprise concentrations and collateral.

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 which includes our most experienced and knowledgeable credit staff.

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. We adjust the PD factors in the Combined System Risk Rating Guidance to account for our loss emergence period which has been determined to be 18 months. 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

In regards to our purchased participation loans, there are a few differences in the credit risk management practices of this segment of our portfolio. Like core credit, underwriting standards are utilized to determine an applicant's operational, financial, and managerial resources available for repayment of debt; however, due to the unique industries financed in the capital markets arena, this segment of our portfolio has a different set of underwriting standards that apply to the specific industries in which we lend. Also, like core credit, we cannot have commitments to one borrower for more than 15% of our lending limit base. Within the purchased participations portfolio, specific hold limits have been established based on PD and industry. Additionally, the participations purchased portfolio contains loans to borrowers that are considered similar entities, and by regulation must be in compliance with specific limits outlined in our Association policy.

RESULTS OF OPERATIONS

Earnings Summary

In 2018, we recorded net income of $16.0 million, compared with $13.7 million in 2017, and $14.5 million in 2016. The increase in 2018 was primarily due to a higher noninterest income and net interest income, and decreased provision for credit losses, partially offset by higher noninterest expense. The decrease in 2017 was due to higher noninterest expense and increased provision for credit losses, partially offset by higher net interest income. The following table presents the changes in the significant components of net income from the previous year.

(dollars in thousands)	**2018 vs. 2017**	2017 vs. 2016
Net income, prior year	**$ 13,730**	$ 14,475
Increase/(Decrease) from changes in:		
Interest income	**5,708**	2,923
Interest expense	**(4,581)**	(1,893)
Net interest income	**1,127**	1,030
Provision for credit losses	**328**	(454)
Noninterest income	**1,785**	(304)
Noninterest expense	**(952)**	(1,017)
Provision for income tax	**(1)**	–
Total increase/(decrease) in net income	**2,287**	(745)
Net income, current year	**$ 16,017**	$ 13,730

Return on average assets increased to 1.50% from 1.33% in 2017, and return on average shareholders' equity increased to 6.41% from 5.74% in 2017, primarily as a result of an increase in net income.

Net Interest Income

Net interest income for 2018 was $27.8 million compared with $26.7 million for 2017 and $25.6 million for 2016. Net interest income is our principal source of earnings and is impacted by interest earning asset volume, yields on assets and cost of debt. The increase in net interest income was largely due to an increase in our average accrual loan volume offset by a decrease in spread. The following table provides an analysis of the individual components of the change in net interest income during 2018 and 2017.

(dollars in thousands)	**2018 vs. 2017**	2017 vs. 2016
Net interest income, prior year	**$ 26,678**	$ 25,648
Increase/(Decrease) in net interest income from changes in:		
Interest rates earned	**3,802**	1,894
Interest rates paid	**(3,890)**	(1,580)
Volume of interest-bearing assets and liabilities	**1,130**	704
Interest income on nonaccrual loans	**85**	12
Increase in net interest income	**1,127**	1,030
Net interest income, current year	**$ 27,805**	$ 26,678

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

	Year Ended December 31		
	2018	2017	2016
Net interest margin	**2.78%**	2.77%	2.72%
Interest rate on:			
Average loan volume	**4.97%**	4.57%	4.36%
Average debt	**2.70%**	2.21%	2.00%
Interest rate spread	**2.27%**	2.36%	2.36%

The decrease in interest rate spread resulted from a 49 basis point increase in interest rates on average debt offset by a 40 basis point increase in interest rates on average loan volume. The increase in net interest margin was due to higher earnings on our own capital.

Provision for Credit Losses

We monitor our loan portfolio and unfunded commitments on a regular basis to determine if any increase through provision for credit losses or decrease through a credit loss reversal in our allowance for loan losses or reserve for unfunded commitment is warranted based on our assessment of the probable and estimable losses inherent in our loan portfolio and unfunded commitments. We recorded net provision for credit losses of $494 thousand in 2018, compared with $822 thousand in 2017 and $368 thousand in 2016. The provision for loan losses of $465 thousand recorded during 2018 was primarily due to increases in reserves related to increased loan volume, deteriorating credit quality and increased risk exposure on certain loans. The provision for loan losses in 2017 was primarily due to the benchmark data that we use for determining our PD factors indicating increased defaults over the prior year. The provision for loan losses in 2016 was primarily due to an increase in our general reserves stemming from an increase in loan volume, an increase in the risk profile of our portfolio and an increase in the PD factors used due to our benchmark data indicating increased defaults over the prior year.

The provision for reserve for unfunded commitments of $29 thousand was recorded during 2018 due to an increase in overall exposure at default of the entire portfolio and an increase in loss percentage factors due to downgrades during the year. The provision for reserve for unfunded commitments of $112 thousand recorded in 2017 was due to the change in PD factors utilized in the calculation of the reserve for unfunded commitments as a result of the newly implemented 18-month default horizon. The reversal of provision for unfunded commitments of $187 thousand in 2016 was due to the elimination of management reserves on unfunded commitments.

Noninterest Income

During 2018, we recorded noninterest income of $6.6 million, compared with $4.8 million in 2017 and $5.1 million in 2016. 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. The total patronage from CoBank is comprised of two sources: patronage based on our borrowing balance (direct note patronage) and patronage based on loans we originate and then sell a portion to them as a participant (sold volume patronage). Patronage earned from CoBank was $4.1 million in 2018 which includes a one-time cash patronage distribution of $474 thousand relating to tax reform changes, $3.5 million in 2017 and $3.5 million in 2016.

During August 2017, CoBank management announced changes to their capital plans and patronage programs for eligible customer-owners designed to address a number of market place challenges. The changes were 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. The plan included a reduction to our patronage income in 2018 of 5 basis points on participation loans with CoBank. Additionally, there was a reduction in patronage related to our direct note with CoBank of 5 basis points in 2019 and a further reduction of 4 basis points in 2020. In 2018, we received 95 basis points on participation loans and 45 basis points on our direct note with CoBank.

In 2016, we received a patronage distribution from AgVantis, based on our services purchased from AgVantis during the respective fiscal year. During 2018 and 2017, no patronage distribution was issued. We received a Notice of Allocation with total patronage of $283 thousand in 2016, which includes cash patronage of $57 thousand. The balance of the allocation is recorded in other assets. Additionally, we recorded a cash patronage of $9 thousand from Farm Credit Foundations, the organization that provides our payroll and human resource services, which will be paid in the following year. This compares with $12 thousand recorded in 2017 and $11 thousand in 2016. Patronage from these two entities and CoBank is included in patronage distribution from Farm Credit institutions on the Consolidated Statement of Comprehensive Income.

We received a refund of $678 thousand from Farm Credit System Insurance Corporation (FCSIC). The FCSIC refund is our portion of excess funds above the secure base amount in the FCSIC Allocated Insurance Reserve Accounts.

We received mineral income of $733 thousand during 2018, which is distributed to us quarterly by CoBank. Mineral income increased from $657 thousand in 2017 and $642 thousand in 2016. The increase is attributed to an increase in production revenue due to higher crude oil commodity prices and an increase in oil and gas drilling activity resulting in additional wells being brought online.

Noninterest income also includes loan fees, financially related services income and other noninterest income. Loan fees in 2018 were $507 thousand, an increase of $120 thousand from 2017, primarily due to more fee based loan activity in our participations purchased portfolio.

Noninterest Expense

Noninterest expense for 2018 increased $952 thousand, or 5.6%, to $17.9 million compared with 2017 and $2.0 million or 12.4% compared with 2016. Noninterest expense for each of the three years ended December 31 is summarized as follows:

				Percent of Change	
(dollars in thousands)	**2018**	2017	2016	**2018/2017**	2017/2016
Salaries & employee benefits	**$ 10,136**	$ 9,577	$ 8,754	**5.84%**	9.40%
Occupancy & equipment	**1,424**	1,313	1,219	**8.45%**	7.71%
Purchased services from AgVantis	**1,912**	1,593	1,710	**20.03%**	(6.84%)
Supervisory & examination costs	**399**	362	349	**10.22%**	3.72%
Other	**3,503**	2,753	2,574	**27.24%**	6.95%
Total operating expense	**17,374**	15,598	14,606	**11.39%**	6.79%
(Gains)/Losses on other property owned	**(154)**	265	109	**(158.11%)**	143.12%
Farm Credit Insurance Fund premium	**684**	1,089	1,220	**(37.19%)**	(10.74%)
Total noninterest expense	**$ 17,904**	$ 16,952	$ 15,935	**5.62%**	6.38%

For the year ended December 31, 2018, total operating expense increased $1.8 million, or 11.4%, compared with the year ended December 31, 2017, primarily due to increases in salaries and employee benefits, purchased services from AgVantis and other. Salaries and employee benefits costs are higher due to annual raises and bonuses, along with higher pension expenses. Occupancy and equipment is higher due to increased maintenance and software licenses. Other expenses are higher primarily due to increased attorney fees, purchased services for technology support, participation purchased servicing fees, and training costs. Gains on other property owned is a result of the gain on the sales of three properties previously owned. Insurance Fund premium decreased $405 thousand to $684 thousand at December 31, 2018 due to a decrease in the premium rate offset by an increase in average net loan payable to CoBank.

Provision for income taxes

We recorded $6 thousand in provision for income taxes during 2018, compared with $5 thousand in 2017 and $5 thousand in 2016. During 2017, tax expense was impacted by $1.1 million in expense 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 States (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). 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 necessary to meet our financial obligations. 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 is intended to 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 which matures on December 31, 2022. The annual average principal balance of the note payable to CoBank was $804.5 million in 2018, $781.0 million in 2017 and $766.3 million in 2016.

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 at a fixed rate for a specified term 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 Liability Committee with the oversight from our Board of Directors determines the interest rate charged based on the following factors: 1) the interest rate charged by CoBank; 2) our existing rates and spreads; 3) the competitive rate environment; and 4) our profitability objectives.

We have a relationship with CoBank, and First Tennessee Bank to offer a purchase card program to commercial customers. The purchase cards are similar to credit cards and allow customers to make agricultural-related purchases which are then automatically posted to the customer's loan on a monthly basis. We remit payment to First Tennessee Bank on behalf of the borrowers each month for purchases made with the card.

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, 2018 totaled $253.3 million, compared with $241.3 million at December 31, 2017 and $231.5 million at December 31, 2016. The increase of $12.0 million in shareholders' equity reflects net income, net stock issuances and a decrease in accumulated other comprehensive loss, partially offset by patronage refunds and dividends paid. Our capital position is reflected in the following ratio comparisons.

	2018	2017	2016
Debt to shareholders' equity	**3.35:1**	3.37:1	3.38:1
Shareholders' equity as a percent of net loans	**24.71%**	24.63%	24.58%
Shareholders' equity as a percent of total assets	**22.97%**	22.88%	22.85%

Debt to shareholders' equity decreased and shareholders' equity as a percent of net loans and of total assets increased from 2017 primarily due to an increase in unallocated retained earnings.

Retained Earnings

Our retained earnings increased $11.5 million to $249.6 million at December 31, 2018 from $238.1 million at December 31, 2017 and increased $21.4 million from $228.2 million at December 31, 2016. The increase in 2018 was a result of net income of $16.0 million, partially offset by $4.5 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 levels of earnings and increasing surplus for reasonable reserves. Patronage distributions are based on business done with us during the year. We paid cash patronage of $3.8 million in 2018, $4.0 million in 2017 and $3.0 million in 2016. During 2018, we declared patronage distributions of $4.5 million to be paid in March 2019.

Stock

Our total stock increased $251 thousand to $4.3 million at December 31, 2018, from $4.0 million at December 31, 2017 and increased from $3.3 million at December 31, 2016. The increase during 2018 was due to $477 thousand of stock issuances and $28 thousand preferred stock dividends paid, partially offset by $254 thousand of stock retirements. We have a Borrower Level Stock Program which allows stock to be assigned to each borrower instead of each loan. This reduces the stock requirement for borrowers of multiple loans. The current stock requirement for each borrower is the lesser of one thousand dollars or 2.00% of the collective loan balance of each borrower's loan(s).

Preferred stock is a one cent, at risk, investment stock that can only be purchased by owners of any class of common stock. Dividends are declared and paid at the discretion of the Board of Directors. Dividends accrue daily at a set investment rate and are declared and paid quarterly by purchase of additional preferred stock in the owner's name.

Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss totaled $567 thousand at December 31, 2018, a decrease of $274 thousand compared with year-end 2017 and an increase of $567 thousand compared with year-end 2016. 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, 2018, 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.

	2018	2017	Minimum Requirement with Buffer
Common Equity Tier 1 Capital ratio	**19.68%**	19.52%	7.00%
Tier 1 Capital ratio	**19.68%**	19.52%	8.50%
Total Capital ratio	**19.94%**	19.74%	10.50%
Tier 1 Leverage ratio	**20.78%**	20.35%	5.00%
Unallocated Retained Earnings and URE Equivalents (UREE) Leverage ratio	**21.41%**	20.94%	1.50%
Permanent capital ratio	**19.98%**	19.81%	7.00%

The minimum ratios established were not meant to be adopted as the optimum capital level, so we have established goals in excess of the regulatory minimum. As of December 31, 2018, we have 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	20.17%	19.16%	18.97%	20.00%	21.38%	7.00%
Total surplus ratio	19.85%	18.85%	18.54%	17.86%	19.01%	7.00%
Core surplus ratio	19.85%	18.85%	18.54%	17.57%	18.53%	3.50%

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

Building Projects

In 2018, we entered into contract to purchase land in Lamar, Colorado for the purpose of building a new office. The purchase is scheduled to be completed in the first quarter of 2019. It is anticipated it will take twelve months to build the new office. The funding source for the new building will be from our capital. We are under negotiations with a prospective buyer to sell the current facility in Lamar.

REGULATORY MATTERS

As of December 31, 2018, we had no enforcement actions in effect and FCA took no enforcement actions on us during the year.

GOVERNANCE

Board of Directors

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 vested interest 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-Risk Committee

The Audit-Risk Committee reports to the Board of Directors. The Audit-Risk Committee is composed of six members of the Board of Directors. During 2018, ten meetings were held. The Audit-Risk 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.

The Audit-Risk Committee is responsible for the oversight of credit risk, including lending and underwriting standards, and assesses the conditions that may materially impact the loan portfolio.

Compensation Committee

The Compensation Committee is responsible for the oversight of employee and director compensation. The Compensation Committee is composed of seven member of the Board of Directors. 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 that applies to all of our employees and directors;
- 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 all employees, including those 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 our Standards of Conduct Policies and also certifies compliance with our Code of Ethics.

Whistleblower Program

We maintain a program for anyone to report complaints related to accounting, financial reporting, internal accounting controls, or auditing matters and all other incidents of misconduct such as theft, harassment, discrimination or collusion. This program allows for the submission of confidential, anonymous concerns regarding accounting, financial reporting, internal accounting controls, fraud or auditing matters and all other incidents of misconduct such as theft, harassment, discrimination, or collusion 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.

PATRON'S CONSENT TO TAKE PATRONAGE DISTRIBUTION INTO INCOME

Our Bylaws under Section 735.6 states that each holder of our stock consent to take into account, as income, at its stated dollar amount as provided in 26 U.S.C. Section 1385, the amount of his or her respective distribution paid as qualified written notice of allocation, which may include stock, allocated surplus, and/or the amount of any distribution that has been applied to the patron's indebtedness as provided in Section 735.4 and 735.5 of our Bylaws.

Consent under this section shall be continuing in effect, provided that consent pursuant to the first paragraph of this section shall cease to be effective with respect to patronage of a distributee occurring after the distributee has ceased to hold stock in us. Consent obtained under this section may be revoked in writing, provided that such revocation shall become effective only with respect to patronage occurring on or after the first day of our first fiscal year beginning after the revocation is filed with us.

FARM CREDIT
OF SOUTHERN COLORADO

The Peak of AgLending

5110 Edison Avenue
Colorado Springs, CO 80915
(719) 570-1087
www.aglending.com

REPORT OF MANAGEMENT

The consolidated financial statements of Farm Credit of Southern Colorado, 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 2018 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. To monitor compliance, management engaged Ann Wagner 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 Farm Credit of Southern Colorado's 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.

Mark Peterson
Chairman of the Board

Jeremy M. Anderson
President and Chief Executive Officer

Shawna R. Neppl
Chief Financial Officer

March 15, 2019

FARM CREDIT
OF SOUTHERN COLORADO
The Peak of AgLending

5110 Edison Avenue
Colorado Springs, CO 80915
(719) 570-1087
www.aglending.com

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Farm Credit of Southern Colorado, 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, 2018. In making the assessment, management used the framework in *Internal Control — Integrated Framework (2013)*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

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

Jeremy M. Anderson
President and Chief Executive Officer

Shawna R. Neppl
Chief Financial Officer

March 15, 2019

FARM CREDIT
OF SOUTHERN COLORADO
The Peak of AgLending

5110 Edison Avenue
Colorado Springs, CO 80915
(719) 570-1087
www.aglending.com

AUDIT COMMITTEE REPORT

The Audit-Risk Committee (Committee) includes six (6) members from the Board of Directors of Farm Credit of Southern Colorado, ACA (Association). In 2018, ten (10) 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-Risk Committee Charter. The Committee approved the appointment of PricewaterhouseCoopers, LLP (PwC) as the Association's independent auditors for 2018.

The fees for professional services rendered for the Association by its independent auditor, PwC, during 2018 were $51,400 for audit services and $8,100 for tax services.

The Committee reviewed the non-audit services provided by PwC and concluded these services were not incompatible with maintaining the independent auditor's independence.

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, 2018 (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, 2018 and for filing with the Farm Credit Administration.

Paul Prentice

Paul Prentice, Chairman of the Audit-Risk Committee

Audit-Risk Committee Members

Steve Betts Colin Durham Keith James

Michael Livingston Mark Peterson Paul Prentice

March 15, 2019

pwc

Report of Independent Auditors

To the Board of Directors of
Farm Credit of Southern Colorado, ACA

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

PricewaterhouseCoopers LLP

March 15, 2019

PricewaterhouseCoopers LLP, 909 Poydras Street, Suite 3100, New Orleans, LA 70112
T: (504) 558 8200, F: (504) 558 8960, www.pwc.com/us

Consolidated Statement of Condition

(Dollars in Thousands)

	December 31		
	2018	2017	2016
ASSETS			
Loans	**$ 1,028,163**	$ 981,997	$ 943,326
Less allowance for loan losses	**2,863**	2,261	1,535
Net loans	**1,025,300**	979,736	941,791
Cash	**9,015**	6,886	5,035
Accrued interest receivable	**16,531**	15,796	14,337
Investment in CoBank, ACB	**32,435**	31,487	30,876
Investment in AgDirect	**137**	-	-
Premises and equipment, net	**11,939**	12,172	12,642
Other property owned	**-**	2,378	2,575
Prepaid benefit expense	**2,409**	1,645	1,105
Other assets	**5,031**	4,737	4,688
Total assets	**$ 1,102,797**	$ 1,054,837	$ 1,013,049
LIABILITIES			
Note payable to CoBank, ACB	**$ 828,090**	$ 796,825	$ 765,542
Advance conditional payments	**10,647**	5,923	7,248
Accrued interest payable	**1,884**	1,358	1,236
Patronage distributions payable	**4,500**	3,750	4,000
Accrued benefits liability	**735**	1,018	189
Reserve for unfunded commitments	**411**	382	270
Other liabilities	**3,193**	4,252	3,101
Total liabilities	**849,460**	813,508	781,586
Commitments and Contingencies (See Note 14)			
SHAREHOLDERS' EQUITY			
Preferred stock	**2,826**	2,619	1,879
Capital stock	**1,454**	1,410	1,407
Unallocated retained earnings	**249,624**	238,141	228,177
Accumulated other comprehensive loss	**(567)**	(841)	-
Total shareholders' equity	**253,337**	241,329	231,463
Total liabilities and shareholders' equity	**$ 1,102,797**	$ 1,054,837	$ 1,013,049

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		
	2018	2017	2016
INTEREST INCOME			
Loans	**$ 49,739**	$ 44,031	$ 41,108
Total interest income	**49,739**	44,031	41,108
INTEREST EXPENSE			
Note payable to CoBank, ACB	**21,866**	17,338	15,453
Other	**68**	15	7
Total interest expense	**21,934**	17,353	15,460
Net interest income	**27,805**	26,678	25,648
Provision for credit losses	**494**	822	368
Net interest income after provision for credit losses	**27,311**	25,856	25,280
NONINTEREST INCOME			
Financially related services income	**160**	179	122
Loan fees	**507**	387	524
Patronage distribution from Farm Credit institutions	**4,105**	3,541	3,760
Farm Credit Insurance Fund distribution	**678**	-	-
Mineral income	**733**	657	642
Other noninterest income	**433**	67	87
Total noninterest income	**6,616**	4,831	5,135
NONINTEREST EXPENSE			
Salaries and employee benefits	**10,136**	9,577	8,754
Occupancy and equipment	**1,424**	1,313	1,219
Purchased services from AgVantis, Inc.	**1,912**	1,593	1,710
(Gains)/Losses on other property owned, net	**(154)**	265	109
Farm Credit Insurance Fund premium	**684**	1,089	1,220
Supervisory and examination costs	**399**	362	349
Other noninterest expense	**3,503**	2,753	2,574
Total noninterest expense	**17,904**	16,952	15,935
Income before income taxes	**16,023**	13,735	14,480
Provision for income taxes	**6**	5	5
Net income	**16,017**	13,730	14,475
COMPREHENSIVE INCOME			
Amortization of retirement costs	**265**	-	-
Actuarial gain/(loss) in retirement obligation	**9**	(841)	-
Comprehensive income	**$ 16,291**	$ 12,889	$ 14,475

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

Consolidated Statement of Changes in Shareholders' Equity

(Dollars in Thousands)

	Preferred Stock	Capital Stock	Unallocated Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total Shareholders' Equity
Balance at December 31, 2015	$ 1,761	$ 1,375	$ 217,711	$ -	$ 220,847
Comprehensive income			14,475	-	14,475
Stock issued	225	168			393
Stock retired	(116)	(136)			(252)
Preferred stock dividends	9		(9)		-
Patronage distributions: Cash			(4,000)		(4,000)
Balance at December 31, 2016	1,879	1,407	228,177	-	231,463
Comprehensive income			13,730	(841)	12,889
Stock issued	842	134			976
Stock retired	(116)	(131)			(247)
Preferred stock dividends	14		(16)		(2)
Patronage distributions: Cash			(3,750)		(3,750)
Balance at December 31, 2017	2,619	1,410	238,141	(841)	241,329
Comprehensive income			16,017	274	16,291
Stock issued	300	177			477
Stock retired	(121)	(133)			(254)
Preferred stock dividends	28		(34)		(6)
Patronage distributions: Cash			(4,500)		(4,500)
Balance at December 31, 2018	**$ 2,826**	**$ 1,454**	**$ 249,624**	**$ (567)**	**$ 253,337**

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

Consolidated Statement of Cash Flows

(Dollars in Thousands)

	2018	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	**$ 16,017**	$ 13,730	$ 14,475
Adjustments to reconcile net income to net cash provided by/(used in) operating activities:			
Depreciation	**720**	712	708
Provision for credit losses	**494**	822	368
Patronage stock from CoBank, ACB	**-**	(13)	(18)
Allocated patronage from AgVantis	**-**	-	(226)
(Gains)/Losses on sales of premises and equipment	**(45)**	19	5
Gains on sale of other property owned	**(173)**	-	-
Carrying value adjustment for other property owned	**-**	172	109
Change in assets and liabilities:			
Increase in accrued interest receivable	**(735)**	(1,459)	(1,028)
Increase in prepaid benefit expense	**(764)**	(540)	(672)
Increase in other assets	**(294)**	(36)	(146)
Increase in accrued interest payable	**526**	122	54
Decrease in accrued benefits liability	**(9)**	(12)	(13)
(Decrease)/Increase in other liabilities	**(1,065)**	1,149	(160)
Total adjustments	**(1,345)**	936	(1,019)
Net cash provided by operating activities	**14,672**	14,666	13,456
CASH FLOWS FROM INVESTING ACTIVITIES:			
Increase in loans, net	**(46,029)**	(38,655)	(14,247)
Increase in investment in CoBank, ACB	**(948)**	(611)	(922)
Increase in investment in AgDirect	**(137)**	-	-
Expenditures for premises and equipment	**(487)**	(264)	(102)
Proceeds from sales of premises and equipment	**45**	3	1
Proceeds from sales of other property owned	**2,551**	25	-
Net cash used in investing activities	**(45,005)**	(39,502)	(15,270)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net draw on note payable to CoBank, ACB	**31,265**	31,283	3,877
Increase/(Decrease) in advance conditional payments	**4,724**	(1,325)	140
Preferred stock retired	**(121)**	(116)	(116)
Preferred stock issued	**300**	842	225
Capital stock retired	**(133)**	(131)	(136)
Capital stock issued	**177**	134	168
Cash patronage distributions paid	**(3,750)**	(4,000)	(3,000)
Net cash provided by financing activities	**32,462**	26,687	1,158
Net increase/(decrease) in cash	**2,129**	1,851	(656)
Cash at beginning of year	**6,886**	5,035	5,691
Cash at end of year	**$ 9,015**	$ 6,886	$ 5,035
SUPPLEMENTAL CASH INFORMATION:			
Cash paid during the year for:			
Interest	**$ 21,408**	$ 17,231	$ 15,406
Income taxes	**$ 5**	$ 5	$ 7
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:			
Patronage stock from CoBank, ACB	**$ -**	$ 13	$ 18
Allocated patronage from AgVantis	**$ -**	$ -	$ 226
Loans transferred to other property owned	**$ -**	$ -	$ 932
Net (recoveries)/charge-offs	**$ (137)**	$ (16)	$ 494
Patronage distributions payable	**$ 4,500**	$ 3,750	$ 4,000
Stock dividends paid	**$ 28**	$ 14	$ 9
Stock dividends declared	**$ 34**	$ 16	$ 9
Change in accumulated other comprehensive income	**$ 274**	$ (841)	$ -

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in Thousands, Except as Noted)

NOTE 1 – ORGANIZATION AND OPERATIONS

A. Organization: Farm Credit of Southern Colorado, ACA and its subsidiaries, Farm Credit of Southern Colorado, FLCA, (Federal Land Credit Association (FLCA)) and Farm Credit of Southern Colorado, 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 Alamosa, Arapahoe, Archuleta, Baca, Bent, Chaffee, Cheyenne, Conejos, Costilla, Crowley, Custer, Douglas, El Paso, Elbert, Fremont, Hinsdale, Huerfano, Kiowa, Kit Carson, Lake, Las Animas, Lincoln, Mineral, Otero, Park, Prowers, Pueblo, Rio Grande, Saguache, Teller, and the southern half of Jefferson in the state of Colorado.

   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 Systemwide 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, leasing and provides additional services to borrowers such as fee appraisals and an investment stock program.

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 5110 Edison Avenue, Colorado Springs, Colorado 80915, or at PO Box 75640, Colorado Springs, Colorado 80970-5640 or by calling (800) 815-8559 or (719) 570-1087. 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

Basis of Presentation and Consolidation

The consolidated financial statements (the "financial statements") of the Association have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). In consolidation, all significant intercompany accounts and transactions are eliminated and all material wholly-owned and majority-owned subsidiaries are consolidated unless GAAP requires otherwise. The consolidated financial statements include the accounts of Farm Credit of Southern Colorado, PCA and Farm Credit of Southern Colorado, FLCA.

Reclassifications

Certain amounts in prior year's financial statements have been reclassified to conform to current year's financial statement presentation. The accounting and reporting policies of the Association conform to GAAP and prevailing practices within the banking industry.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements. Actual results could differ from these estimates.

Recently issued accounting pronouncements

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

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

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

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

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

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. In July 2018, the FASB issued an update entitled "Leases – Targeted Improvements," which provides entities with an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. An entity that elects this additional transition method must provide the required disclosures of the now current standard for all prior periods presented. The guidance and related amendments in this update become effective for interim and annual periods beginning after December 15, 2018, with early application permitted. The Association has evaluated the impact of adoption on its financial condition and results of operations and determined the impact of adoption on its financial condition and results of operations is immaterial.

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

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

Summary of the Association's 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.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms of the loan and are generally considered substandard or doubtful, which is in accordance with the loan rating model, as described below. Impaired loans include nonaccrual loans, restructured loans and loans past due 90 days or more and still accruing interest. A loan is considered contractually past due when any principal repayment or interest payment required by the loan 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.

A restructured loan constitutes a troubled debt restructuring if for economic or legal reasons related to the debtor's financial difficulties the Association grants a concession to the debtor that it would not otherwise consider.

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 and non-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 sold and the sale terms comply with requirements under Accounting Standards Codification (ASC) 860 "Transfers and Servicing."

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 Association adjusts the PD factors in the combined System risk rating guidance to account for the loss emergence period which has been determined to be 18 months. 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. 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 and loans collectively evaluated for impairment. Generally, for loans individually evaluated, the allowance for loan losses represents the difference between the recorded investment in the loan and the present value of the cash flows expected to be collected discounted at the loan's effective interest rate, or at the fair value of the collateral, 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 ranges from 20 to 40 years for buildings, 1 to 10 years for furniture and equipment and 1 to 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 other than CoBank. 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 unrestricted 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 Ninth Farm Credit District Pension Plan (Pension Plan) and/or the Farm Credit Foundations Defined Contribution/401(k) Plan (401(k) Plan). The Pension Plan is a non-contributory defined benefit 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 Pension Plan was closed to employees beginning January 1, 2007.

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. All defined contribution costs are expensed in the same period that participants earn employer contributions.

The Association also participates in the Farm Credit Foundations Retiree Medical Plan. These postretirement benefits (other than pensions) are provided to eligible retired employees of the Association. The anticipated costs of these benefits were 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 Ninth 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.

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 elected 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.

Deferred income taxes have not been recorded by the Association on stock patronage distributions received from the Bank prior to January 1, 1993, the adoption date of accounting guidance on income taxes. Association management's intent is to permanently invest these and other undistributed earnings in CoBank, or if converted to cash, to pass through any such earnings to Association borrowers through qualified patronage allocations.

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.

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. See Note 8 for further information.

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		
	2018	2017	2016
Real estate mortgage	**$ 609,071**	$ 573,590	$ 539,889
Production and intermediate-term	**178,320**	180,294	182,932
Agribusiness	**151,480**	147,501	148,944
Rural infrastructure	**79,620**	70,877	61,716
Agricultural export finance	**8,512**	8,506	8,513
Rural residential real estate	**44**	57	107
Mission-related	**1,116**	1,172	1,225
Total loans	**$ 1,028,163**	$ 981,997	$ 943,326

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, 2018.

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Purchased	Sold	Purchased	Sold	Purchased	Sold
Real estate mortgage	$ 41,301	$ 26,204	$ 2,700	$ –	$ 44,001	$ 26,204
Production and intermediate-term	23,123	–	–	–	23,123	–
Agribusiness	144,687	–	–	–	144,687	–
Rural infrastructure	79,620	–	–	–	79,620	–
Agricultural export finance	8,512	–	–	–	8,512	–
Total	$ 297,243	$ 26,204	$ 2,700	$ –	$ 299,943	$ 26,204

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.

Credit enhancements with federal government agencies of $17.0 million at year-end 2018, $18.0 million at year-end 2017 and $18.3 million at year-end 2016 were outstanding. These credit enhancements consist primarily of loans in the USDA FSA Guaranteed Loan Program. To incent the Association to make certain loans we could not normally underwrite, the USDA typically will guarantee 90% of the loss on the debt. This program is a valuable tool used to manage credit to young/beginning/small borrowers, as well as high risk credit groups. Using the program creates constructive credit for both the borrower and the lender.

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.
- 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.

	2018	2017	2016
Real estate mortgage			
Acceptable	**90.50%**	91.90%	91.83%
OAEM	**4.17%**	2.55%	3.17%
Substandard	**5.33%**	5.55%	5.00%
Total	**100.00%**	100.00%	100.00%
Production and intermediate-term			
Acceptable	**87.83%**	91.01%	86.42%
OAEM	**5.25%**	4.31%	7.29%
Substandard	**6.88%**	4.68%	6.29%
Doubtful	**0.04%**	–	–
Total	**100.00%**	100.00%	100.00%
Agribusiness			
Acceptable	**97.08%**	99.10%	97.81%
OAEM	**1.54%**	0.32%	1.14%
Substandard	**1.38%**	0.58%	1.05%
Total	**100.00%**	100.00%	100.00%
Rural infrastructure			
Acceptable	**99.28%**	100.00%	96.56%
OAEM	**0.72%**	–	3.44%
Total	**100.00%**	100.00%	100.00%
Agricultural export finance			
Acceptable	**100.00%**	100.00%	100.00%
Total	**100.00%**	100.00%	100.00%
Rural residential real estate			
Acceptable	**100.00%**	100.00%	100.00%
Total	**100.00%**	100.00%	100.00%
Mission related			
Acceptable	**–**	100.00%	100.00%
Substandard	**100.00%**	–	–
Total	**100.00%**	100.00%	100.00%
Total Loans			
Acceptable	**91.64%**	93.46%	92.10%
OAEM	**3.67%**	2.34%	3.64%
Substandard	**4.68%**	4.20%	4.26%
Doubtful	**0.01%**	–	–
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		
	2018	2017	2016
Nonaccrual loans:			
Current as to principal and interest	**$ 10,136**	$ 11,213	$ 1,420
Past due	**379**	1,096	4,391
Total nonaccrual loans	**10,515**	12,309	5,811
Impaired accrual loans:			
Restructured	**1,284**	1,236	2,103
Accrual loans 90 days or more past due	**75**	–	–
Total impaired accrual loans	**1,359**	1,236	2,103
Total impaired loans	**$ 11,874**	$ 13,545	$ 7,914

Commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2018 totaled $750. These commitments were considered when establishing the reserve for unfunded commitments which is recorded in liabilities.

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		
	2018	2017	2016
Nonaccrual loans			
Real estate mortgage	**$ 10,049**	$ 10,723	$ 4,391
Production and intermediate-term	**129**	1,586	1,420
Agribusiness	**337**	–	–
Total nonaccrual loans	**10,515**	12,309	5,811
Accruing restructured loans			
Real estate mortgage	**495**	519	97
Production and intermediate-term	**789**	717	727
Rural infrastructure	**–**	–	1,279
Total accruing restructured loans	**1,284**	1,236	2,103
Accruing loans 90 days past due			
Production and intermediate-term	**75**	–	–
Total Accruing loans 90 days past due	**75**	–	–
Total impaired loans	**11,874**	13,545	7,914
Other property owned	**–**	2,378	2,575
Total high risk assets	**$ 11,874**	$ 15,923	$ 10,489

Additional impaired loan information is as follows:

	Recorded Investment at 12/31/18	Unpaid Principal Balance*	Related Allowance	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:					
Real estate mortgage	$ 651	$ 626	$ 5	$ 301	$ –
Production and intermediate-term	80	92	31	49	–
Agribusiness	337	343	106	50	–
Total	$ 1,068	$ 1,061	$ 142	$ 400	$ –
Impaired loans with no related allowance for credit losses:					
Real estate mortgage	$ 9,893	$ 11,200		$ 13,627	$ 101
Production and intermediate-term	913	1,387		1,554	221
Agribusiness	–	–		3	–
Total	$ 10,806	$ 12,587		$ 15,184	$ 322
Total impaired loans:					
Real estate mortgage	$ 10,544	$ 11,826	$ 5	$ 13,928	$ 101
Production and intermediate-term	993	1,479	31	1,603	221
Agribusiness	337	343	106	53	–
Total	$ 11,874	$ 13,648	$ 142	$ 15,584	$ 322

	Recorded Investment at 12/31/17	Unpaid Principal Balance*	Related Allowance	Average Impaired Loans	Interest Income Recognized
Impaired loans with no related allowance for credit losses:					
Real estate mortgage	$ 11,242	$ 15,274		$ 5,433	$ 147
Production and intermediate-term	2,303	6,894		1,712	76
Total	$ 13,545	$ 22,168	$ –	$ 7,145	$ 223

The Association had no impaired loans with a related allowance at December 31, 2017.

	Recorded Investment at 12/31/16	Unpaid Principal Balance*	Related Allowance	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:					
Real estate mortgage	$ –	$ –	$ –	$ 168	$ –
Production and intermediate-term	–	–	–	1,435	–
Total	$ –	$ –	$ –	$ 1,603	$ –
Impaired loans with no related allowance for credit losses:					
Real estate mortgage	$ 4,488	$ 4,525		$ 9,458	$ 176
Production and intermediate-term	2,147	6,518		1,730	23
Agribusiness	–	–		96	–
Rural infrastructure	1,279	1,601		1,390	67
Total	$ 7,914	$ 12,644		$ 12,674	$ 266
Total impaired loans:					
Real estate mortgage	$ 4,488	$ 4,525	$ –	$ 9,626	$ 176
Production and intermediate-term	2,147	6,518	–	3,165	23
Agribusiness	–	–	–	96	–
Rural infrastructure	1,279	1,601	–	1,390	67
Total	$ 7,914	$ 12,644	$ –	$ 14,277	$ 266

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

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		
	2018	2017	2016
Interest income recognized on:			
Nonaccrual loans	**$ 197**	$ 112	$ 101
Restructured accrual loans	**64**	55	83
Accrual loans 90 days or more past due	**61**	56	82
Interest income recognized on impaired loans	**$ 322**	$ 223	$ 266

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

	Year Ended December 31		
	2018	2017	2016
Interest income which would have been recognized under the original loan terms	**$ 1,415**	$ 1,225	$ 1,001
Less: interest income recognized	**261**	167	184
Interest income not recognized	**$ 1,154**	$ 1,058	$ 817

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

December 31, 2018	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or less than 30 Days Past Due	Recorded Investment in Loans Outstanding	Recorded Investment > 90 Days and Accruing
Real estate mortgage	$ –	$ 260	$ 260	$ 620,316	$ 620,576	$ –
Production and intermediate-term	2,520	113	2,633	179,802	182,435	75
Agribusiness	–	–	–	152,073	152,073	–
Rural infrastructure	–	–	–	79,908	79,908	–
Agricultural export finance	–	–	–	8,539	8,539	–
Rural residential real estate	–	–	–	45	45	–
Mission-related	–	–	–	1,118	1,118	–
Total	$ 2,520	$ 373	$ 2,893	$1,041,801	$1,044,694	$ 75

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	$ 778	$ –	$ 778	$ 583,492	$ 584,270	$ –
Production and intermediate-term	1,815	212	2,027	182,285	184,312	–
Agribusiness	–	–	–	148,278	148,278	–
Rural infrastructure	1	–	1	71,173	71,174	–
Agricultural export finance	–	–	–	8,527	8,527	–
Rural residential real estate	–	–	–	58	58	–
Mission-related	–	–	–	1,174	1,174	–
Total	$ 2,594	$ 212	$ 2,806	$ 994,987	$ 997,793	$ –

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	$ 1,301	$ 3,423	$ 4,724	$ 544,757	$ 549,481	$ –
Production and intermediate-term	4,732	118	4,850	181,759	186,609	–
Agribusiness	–	–	–	149,673	149,673	–
Rural infrastructure	–	–	–	62,005	62,005	–
Agricultural export finance	–	–	–	8,558	8,558	–
Rural residential real estate	–	–	–	109	109	–
Mission-related	–	–	–	1,228	1,228	–
Total	$ 6,033	$ 3,541	$ 9,574	$ 948,089	$ 957,663	$ –

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 following table presents additional information regarding troubled debt restructurings (whether accrual or nonaccrual) that occurred during the year.

	Year Ended December 31					
	2018		2017		2016	
	Outstanding Recorded Investment					
	Pre-modification	Post-modification	Pre-modification	Post-modification	Pre-modification	Post-modification
Real estate mortgage	$ –	$ –	$ –	$ –	$ 443	$ 443
Production and intermediate-term	–	–	891	891	716	716
Total	$ –	$ –	$ 891	$ 891	$ 1,159	$ 1,159

Note: Pre-modification represents the recorded investment in the loan receivable just prior to restructuring and post-modification represents the recorded investment in the loan receivable immediately following the restructuring. The recorded investment is the face amount of the loan receivable 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.

Additional commitments to lend to borrowers whose loans have been modified in TDRs were $545 at December 31, 2018, $463 at December 31, 2017, and $76 at December 31, 2016. There were no TDRs that occurred within the previous 12 months of the year for which there was a payment default during the period.

The following table provides information on outstanding loans restructured in troubled debt restructurings at period end. These loans are included as impaired loans in the impaired loan table at December 31.

	Loans modified as TDRs			TDRs in Nonaccrual Status*		
	2018	2017	2016	**2018**	2017	2016
Real estate mortgage	**$ 495**	$ –	$ 540	**$ –**	$ –	$ 443
Production and intermediate-term	**789**	519	727	**–**	–	–
Rural infrastructure	**–**	717	1,279	**–**	–	–
Total	**$ 1,284**	$ 1,236	$ 2,546	**$ –**	$ –	$ 443

*Represents the portion of loans modified as TDRs that are in nonaccrual status.

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

	Balance at December 31, 2017	Charge-offs	Recoveries	Provision for Loan Losses/(Loan Loss Reversals)	Balance at December 31, 2018
Real estate mortgage	$ 675	$ –	$ –	$ 35	$ 710
Production and intermediate-term	557	45	173	(17)	668
Agribusiness	693	–	9	230	932
Rural infrastructure	317	–	–	13	330
Agricultural export finance	6	–	–	1	7
Mission-related	13	–	–	203	216
Total	$ 2,261	$ 45	$ 182	$ 465	$ 2,863

	Balance at December 31, 2016	Charge-offs	Recoveries	Provision for Loan Losses/(Loan Loss Reversals)	Balance at December 31, 2017
Real estate mortgage	$ 429	$ –	$ –	$ 246	$ 675
Production and intermediate-term	388	22	38	153	557
Agribusiness	443	–	–	250	693
Rural infrastructure	265	–	–	52	317
Agricultural export finance	6	–	–	–	6
Mission-related	4	–	–	9	13
Total	$ 1,535	$ 22	$ 38	$ 710	$ 2,261

	Balance at December 31, 2015	Charge-offs	Recoveries	Provision for Loan Losses/(Loan Loss Reversals)	Balance at December 31, 2016
Real estate mortgage	$ 446	$ –	$ 50	$ (67)	$ 429
Production and intermediate-term	335	684	140	597	388
Agribusiness	381	–	–	62	443
Rural infrastructure	301	–	–	(36)	265
Agricultural export finance	7	–	–	(1)	6
Mission-related	4	–	–	–	4
Total	$ 1,474	$ 684	$ 190	$ 555	$ 1,535

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:

	Year Ended December 31		
	2018	2017	2016
Balance at beginning of period	**$ 382**	$ 270	$ 457
Provision for unfunded commitments	**29**	112	(187)
Total	**$ 411**	$ 382	$ 270

Additional information on the allowance for loan losses follows:

	Allowance for Credit Losses Ending Balance at December 31, 2018		Recorded Investment in Loans Outstanding Ending Balance at December 31, 2018	
	Individually evaluated for impairment	Collectively evaluated for impairment	Individually evaluated for impairment	Collectively evaluated for impairment
Real estate mortgage	$ 5	$ 705	$ 10,544	$ 610,032
Production and intermediate-term	31	637	993	181,442
Agribusiness	106	826	337	151,736
Rural infrastructure	–	330	–	79,908
Agricultural export finance	–	7	–	8,539
Rural residential real estate	–	–	–	45
Mission-related	–	216	–	1,118
Total	$ 142	$ 2,721	$ 11,874	$ 1,032,820

	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	$ –	$ 675	$ 11,242	$ 573,028
Production and intermediate-term	–	557	2,303	182,009
Agribusiness	–	693	–	148,278
Rural infrastructure	–	317	–	71,174
Agricultural export finance	–	6	–	8,527
Rural residential real estate	–	–	–	58
Mission-related	–	13	–	1,174
Total	$ –	$ 2,261	$ 13,545	$ 984,248

	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	$ –	$ 429	$ 4,754	$ 544,727
Production and intermediate-term	–	388	2,147	184,462
Agribusiness	–	443	–	149,673
Rural infrastructure	–	265	–	62,005
Agricultural export finance	–	6	–	8,558
Rural residential real estate	–	–	–	109
Mission-related	–	4	–	1,228
Total	$ –	$ 1,535	$ 6,901	$ 950,762

NOTE 4 – INVESTMENT IN COBANK

At December 31, 2018, 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, patronage from CoBank related to these participations sold is paid 75 percent cash and 25 percent Class A stock on participations for agricultural cooperatives and communications customers and 80 percent cash and 20 percent Class A stock on participations for electric distribution and generation cooperatives and rural water customers. 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 0.95 percent of the outstanding common stock of CoBank at December 31, 2018, compared with 0.97 percent at December 31, 2017 and 1.01 percent at December 31, 2016. As of those dates, the Bank's assets totaled $139.02 billion, $129.21 billion, and $126.13 billion and members' equity totaled $9.53 billion, $9.06 billion and $8.57 billion. The Bank's earnings were $1.19 billion in 2018, $1.13 billion in 2017 and $945.68 million in 2016.

NOTE 5 – PREMISES AND EQUIPMENT

Premises and equipment consisted of the following.

	December 31		
	2018	2017	2016
Land	**$ 916**	$ 916	$ 916
Buildings and leasehold improvements	**12,410**	12,402	12,371
Furniture, equipment and automobiles	**3,383**	3,058	2,988
Construction in progress	**17**	–	9
	16,726	16,376	16,284
Less: accumulated depreciation	**4,787**	4,204	3,642
Total	**$ 11,939**	$ 12,172	$ 12,642

NOTE 6 – OTHER PROPERTY OWNED

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

	December 31		
	2018	2017	2016
Gains on sale, net	**$ (173)**	$ –	$ –
Carrying value adjustments	**–**	172	109
Operating expense, net	**19**	93	–
(Gains)/Losses on other property owned, net	**$ (154)**	$ 265	$ 109

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 will mature on December 31, 2022. The Association was in compliance with the terms and conditions of the GFA as of December 31, 2018. 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		
	2018	2017	2016
Line of credit	**$ 925,000**	$ 925,000	$ 908,749
Outstanding principal and accrued interest balance	**$ 829,967**	$ 798,183	$ 766,777
Average outstanding principal balance under the line of credit	**$ 804,471**	$ 781,017	$ 766,282
Weighted average interest rate	**2.72%**	2.22%	2.02%

Under the Farm Credit Act, the Association is obligated to borrow only from CoBank, unless CoBank gives approval to borrow elsewhere. Other than the funding relationship with the Bank, and our advanced conditional payments, the Association has 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, 2018, 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:

	2018	2017	2016
Average committed funds	**$ 202,820**	$ 190,094	$ 183,301
Average rates	**1.68%**	0.99%	0.55%

NOTE 8 – SHAREHOLDERS' EQUITY

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

A. Protected Borrower Stock

Protection of certain stock is provided under the Farm Credit Act which requires the Association, when retiring protected stock, to retire it at par or stated value regardless of its book value. Protected stock includes stock and allocated equities which were outstanding as of January 6, 1988, or were issued or allocated prior to October 6, 1988.

B. Capital Stock

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 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 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. Our bylaws generally permit stock 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, 2018, 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.

C. 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, 2018.

Ratio	**Primary Components of Numerator**	**Denominator**	**Ratios as of December 31, 2018**	**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	19.68%	7.0%	4.5%
Tier 1 Capital	CET1 Capital, non-cumulative perpetual preferred stock	Risk-adjusted assets	19.68%	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	19.94%	10.5%	8.0%
Tier 1 Leverage**	Tier 1 Capital	Total assets	20.78%	5.0%	4.0%

Ratio	Primary Components of Numerator	Denominator	Ratios as of December 31, 2018	Minimum with Buffer*	Minimum Requirement
Unallocated Retained Earnings and URE Equivalents (UREE) Leverage	URE and URE Equivalents	Total assets	21.41%	—	1.5%
Permanent Capital	Retained earnings, common stock, non-cumulative perpetual preferred stock and subordinated debt, subject to certain limits	Risk-adjusted assets	19.98%	—	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 Board of Directors has established, adopted and will maintain formal written Capital Adequacy Plan to ensure the Association maintains compliance with capital adequacy regulations. The objectives in the plan are:

- Maintain Association capital at a level sufficient to meet all regulatory and System requirements;
- Provide protection against risk inherent in the Association's operation;
- Provide protection against unknown or unexpected risk;
- Provide sufficient capital for future asset growth;
- Allow the Association to operate profitably over the long-term;
- Maintain a competitive market positon; and,
- Increase Association surplus, thereby reducing reliance on borrower stock for capitalization needs.

Additionally, the Capital Adequacy Plan includes the capital targets necessary to achieve the Association's capital adequacy goals, as well as the minimum regulatory capital requirements.

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.

D. Description of Equities

The following paragraphs describe the attributes of each class of stock authorized by the Association bylaws and indicates the number of shares outstanding at December 31, 2018. Unless otherwise indicated all classes of stock have a par value of $5.00. All classes of stock are transferrable to other customers who are eligible to hold such class of stock. Transfers of stock are only allowed as long as the Association meets the regulatory minimum capital requirements.

Class A Common Stock (Nonvoting, at-risk, no shares outstanding) – Issued in exchange for Class B Common Stock or Class C Common Stock; as a patronage refund; as a dividend; or in exchange for allocated surplus. Retirement is at the sole discretion of the Board of Directors.

Class B Common Stock (Voting, at-risk, 288,126 shares outstanding) – Issued solely to, and shall be acquired by, borrowers and other applicants who are farmers, ranchers, or producers or harvesters of aquatic products and who are eligible to vote. Class B Common Stock may also be held by those borrowers who exchanged one share of Class F Common Stock for one share of Class B Common Stock. Each Class B Common shareholder shall hold at least one share as long as the holder continues business with the Association. Within two years after the holder terminates its relationship with the Association, any outstanding Class B Common Stock shall be converted to Class A Common Stock. Retirement is at the sole discretion of the Board of Directors.

Class C Common Stock (Nonvoting, at-risk, 2,620 shares outstanding) – Class C Common Stock may be issued to borrowers or applicants who are: (a) rural residents, including persons eligible to hold voting stock, to capitalize rural housing loans; (b) persons or organizations furnishing farm-related services; (c) other persons or organizations who are eligible to borrow from or participate with the Association but who are not eligible to hold voting stock. Class C Common Stock may be issued to any person who is not a shareholder but who is eligible to borrow from the Association for the purpose of qualifying such person for technical assistance, financially related services and leasing services offered by the Association. Within two years after the holder terminates its relationship with the Association, any outstanding Class C Common Stock shall be converted to Class A Common Stock. Retirement is at the sole discretion of the Board of Directors.

Class D Common Stock (Nonvoting, at-risk, no shares outstanding, par value of one thousand dollars) – Issued to CoBank or to any person through direct sale.

Class E Preferred Stock (Nonvoting, at-risk, no shares outstanding, par value as may be determined by any agreement of financial assistance between the Association and CoBank) - Issued only to CoBank in consideration of financial assistance to the Association from CoBank. Retirement is at the sole discretion of the Board of Directors.

Class F Common Stock (Voting, protected, no shares outstanding) – Shall be issued to those individuals and entities who held the same class of stock in a predecessor to the Association. The Association shall not issue any additional Class F Common Stock. Each Class F Common shareholder shall hold at least one share as long as the holder continues business with the Association. Within two years after the holder terminates its relationship with the Association, any outstanding Class F Common Stock shall be converted to Class G Common Stock. Retirement is at the sole discretion of the Board of Directors.

Class G Common Stock (Nonvoting, protected, no shares outstanding) – Issued only to those individuals and entities who held the same class of stock in a predecessor to the Association and as necessary for conversions from Class F Common Stock. No further shares of Class G Common Stock will be issued. It must be retired upon repayment of the loan.

Class H Preferred Stock (Nonvoting, at-risk, 282,650,733 shares outstanding, par value of one cent) – Issued to and may be acquired only by owners of any class of Common Stock and who have an outstanding loan with the Association.

The changes in the number of shares of protected and capital stock outstanding during 2018 are summarized in the following table.

Shares in whole numbers	Preferred	Capital
Balance outstanding at January 1, 2018	261,880,195	281,948
Issuances	32,810,812	35,416
Retirements	(12,040,274)	(26,618)
Balance outstanding at December 31, 2018	282,650,733	290,746

E. Patronage and/or Dividends

Dividends may be declared and paid to holders of Class H Stock on a quarterly basis based on a dividend rate determined by the Board of Directors. Dividends paid on the stock will be applied towards the purchase of additional shares of the stock at par value.

Dividends may be declared or patronage distributions allocated to holders of Class B, C, F and G Stock out of the whole or any part of net earnings which remain at the end of the fiscal year, as the Board of Directors may determine, in accordance with the regulations for banks and associations of the System. Additionally, patronage distributions may be allocated to System institutions, with or for whom the Association conducts specified business transactions. However, distributions and retirements are precluded by regulation until the minimum capital adequacy standards have been attained. Amounts not distributed are retained as unallocated retained earnings. The Association made a cash patronage distribution of $3,750 in 2018, $4,000 in 2017 and $3,000 in 2016. The Association declared a $4,500 cash patronage to be distributed in 2019.

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities shall be distributed to retire stock in the following order of priority: First, to the holders of all classes of Class E 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 of all classes of Class H Preferred Stock 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, pro rata, of all classes of common stock, until an amount equal to the aggregate par value of all such shares then issued and outstanding has been distributed to such holders; fourth, any remaining assets of the Association after such distributions shall be distributed to present and former members and other patrons on a patronage basis, to the extent practicable.

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 2018, the Association allocated 28.13 percent of its patronage-sourced net income to its patrons.

F. 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 $567 in 2018 and $841 in 2017. There were no other items affecting comprehensive income or loss.

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

	2018	2017	2016
Pension and other benefit plans:			
Beginning balance	**$ (841)**	$ –	$ –
Other comprehensive loss before reclassifications	**9**	(841)	–
Amounts reclassified from accumulated other comprehensive loss	**265**	–	–
Net current period other comprehensive income/(loss)	**274**	(841)	–
Year-end balance	**$ (567)**	$ (841)	$ –

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

	Amount Reclassified from Accumulated Other Comprehensive Loss			Location of Loss Recognized in Statement of Income
	December 31			
	2018	2017	2016	
Pension and other benefit plans:				
Net actuarial loss	**$ 265**	$ –	$ –	Salaries and employee benefits
Total reclassifications	**$ 265**	$ –	$ –	

NOTE 9 – PATRONAGE DISTRIBUTION FROM FARM CREDIT INSTITUTIONS

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

	2018	2017	2016
CoBank	**$ 4,096**	$ 3,529	$ 3,466
AgVantis	**–**	–	283
Farm Credit Foundations	**9**	12	11
Total	**$ 4,105**	$ 3,541	$ 3,760

Patronage distributed from CoBank was in cash. The amount earned in 2018 was accrued and will be paid by CoBank in March 2019. The amount earned and accrued in 2017 and 2016 was paid by CoBank in March of the following year. In 2018, we received a one-time cash patronage distribution from CoBank of $474 relating to tax reform changes.

In 2016, 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 2019. 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 follows.

	Year Ended December 31		
	2018	2017	2016
Current:			
Federal	**$ 5**	$ 4	$ 4
State	**1**	1	1
Provision for income taxes	**$ 6**	$ 5	$ 5

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		
	2018	2017	2016
Federal tax at statutory rate	**$ 3,365**	$ 4,670	$ 4,923
State tax, net	**1**	1	1
Effect of non-taxable FLCA subsidiary	**(3,743)**	(5,212)	(5,090)
Change in valuation allowance	**398**	(601)	159
Change in tax rates	**–**	1,143	–
Other	**(15)**	4	12
Provision for income taxes	**$ 6**	$ 5	$ 5

Deferred tax assets and liabilities are comprised of the following.

	December 31		
	2018	2017	2016
Deferred income tax assets:			
Allowance for loan losses	**$ 184**	$ 156	$ 160
Nonaccrual loan interest	**89**	634	799
Gain on other property owned	**–**	221	269
Net operating loss carryforward	**2,476**	1,451	1,890
Charitable contribution carryover	**2**	2	4
Gross deferred tax assets	**2,751**	2,464	3,122
Deferred tax asset valuation allowance	**(2,739)**	(2,272)	(2,824)
Deferred income tax liabilities:			
Depreciation	**(9)**	(10)	(18)
Bank patronage allocation	**–**	(180)	(277)
Sale of fixed assets	**(1)**	(1)	(1)
Gain on installment sales	**(1)**	(1)	(2)
Gross deferred tax liability	**(11)**	(192)	(298)
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.

The Association recorded a valuation allowance of $2.7 million in 2018, $2.3 million in 2017 and $2.8 million in 2016. The Association will continue to evaluate the realizability of the deferred tax assets and adjust the valuation allowance accordingly. Due to tax reform, the federal and state net operating loss of $1.0 million recorded in 2018 has an indefinite carryforward period. At December 31, 2017, the Association had federal and state net operating loss carryforwards of $1.5 million that expire from 2032 to 2037.

Tax expense in 2017 was impacted by 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 has no uncertain tax positions as of December 31, 2018, 2017 or 2016. 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 2015 and forward.

NOTE 11 – EMPLOYEE BENEFIT PLANS

Certain employees participate in the Ninth Retirement Plan, a multi-employer defined benefit retirement plan. The Department of Labor has determined the plan to be a governmental plan; therefore, the plan is not subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended (ERISA). As the plan is not subject to ERISA, the plan's benefits are not insured by the Pension Benefit Guaranty Corporation. Accordingly, the amount of accumulated benefits that participants would receive in the event of the plan's termination is contingent on the sufficiency of the plan's net assets to provide benefits at that time. This Plan is noncontributory and covers 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 $69.5 million at December 31, 2018. 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 of the plan was $274.4 million at December 31, 2018, $292.6 million at December 31, 2017 and $270.6 million at December 31, 2016. The fair value of the plan assets was $204.9 million at December 31, 2018, $208.0 million at December 31, 2017 and $175.6 million at December 31, 2016. 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. Total plan expense for participating employers was $10.8 million in 2018, $12.7 million in 2017 and $11.3 million in 2016. The Association's allocated share of plan expenses included in salaries and employee benefits was $893 in 2018, $946 in 2017, and $832 in 2016. Participating employers contributed $20.0 million in 2018, $20.0 million in 2017 and $20.4 million in 2016 to the plan. The Association's allocated share of these pension contributions was $1.7 million in 2018, $1.5 million in 2017 and 1.5 million in 2016. 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 2019 is $20.0 million. The Association's allocated share of these pension contributions is expected to be $1.8 million. The amount ultimately to be contributed and the amount ultimately recognized as expense as well as the timing of those contributions and expenses, are subject to many variables including performance of plan assets and interest rate levels. These variables could result in actual contributions and expenses being greater than or less than anticipated.

Postretirement benefits other than pensions are provided through the Farm Credit Foundations Retiree Medical Plan to retired employees of the Association. Benefits provided are determined on a graduated scale based on years of service. The anticipated costs of these benefits were accrued during the period of the employee's active service. Postretirement benefits (primarily health care benefits) included in salaries and employee benefits were income of $2 in 2018, $3 in 2017 and $1 in 2016. The Association made cash contributions of $7 in 2018, $9 in 2017 and $12 in 2016.

Beginning in 2017, the Association participates in a non-qualified defined benefit Pension Restoration Plan that is unfunded. The plan provides 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 $290 in 2018 and none in 2017.

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

	2018	2017
Change in benefit obligation:		
Benefit obligation at the beginning of the period	**$ 841**	$ –
Interest cost	**25**	–
Actuarial (gain)/loss	**(9)**	841
Benefits Paid	**(290)**	–
Benefit obligation at the end of the period	**$ 567**	$ 841
Change in plan assets:		
Company contributions	**$ 290**	$ –
Benefits paid	**(290)**	–
Fair value of plan assets at the end of the period	**$ –**	$ –
Funded status of the plan	**$ (567)**	$ (841)
Amounts recognized in the Consolidated Statement of Condition consist of:		
Liabilities	**$ 567**	$ 841
Net amount recognized	**$ 567**	$ 841

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

	2018	2017
Net actuarial loss	**$ (567)**	$ (841)
Total amount recognized in AOCI/(loss)	**$ (567)**	$ (841)

An estimated net actuarial loss of $269 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:

	2018	2017
Projected benefit obligation	**$ 567**	$ 841
Accumulated benefit obligation	**$ 567**	$ 841

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.

	Nonqualified Pension Restoration Benefits	
	2018	2017
Components of net periodic benefit cost/(income)		
Interest cost	**$ 25**	$ –
Net amortization and deferral	**265**	–
Net periodic benefit cost	**$ 290**	$ –

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

	2018	2017
Current year net actuarial gain/(loss)	**$ 9**	$ (841)
Amortization of net actuarial loss	**265**	–
Total recognized in other comprehensive income	**$ 274**	$ (841)

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

	2018	2017
Discount rate	**4.06%**	3.35%
Rate of compensation increase	**5.00%**	5.00%

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

	Nonqualified Pension Restoration Benefits	
	2018	2017
Discount rate		
Projected benefit obligation	**3.35%**	3.51%
Service Cost	**3.39%**	3.58%
Interest Cost	**3.13%**	3.04%
Rate of compensation increase	**5.00%**	5.00%

The Association expects to contribute $290 to the Pension Restoration Plan in 2019.

Estimated Future Benefit Payments

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

	Pension Restoration Benefits
2019	$ 290
2020	$ 290
2021	$ –
2022	$ –
2023	$ –
2024 – 2028	$ –

The Association also participates in the Farm Credit Foundations Defined Contribution/401(k) Plan. 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 to the plan. Employer contributions to the Contribution Plan were $552 in 2018, $486 in 2017 and $432 in 2016.

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.

Association loans made, endorsed, or guaranteed by directors, director candidates, and employees of the Association are required to be maintained at an acceptable or OAEM classification at all times. Additionally, scheduled repayment should be made on or before the installment or maturity dates identified in the note. If any loan made by the Association to a director, director candidate, or employee of the Association at any time becomes classified below the OAEM credit classification or if any such loan becomes delinquent for more than 30 days, then the Association will terminate the director's, director candidate's, or employee's service, candidacy, or employment with the Association unless an exception is requested and granted.

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

	2018	2017	2016
Beginning balance	**$ 17,995**	$ 16,450	$ 15,448
New loans and advances	**17,133**	11,226	11,733
Repayments	**(17,090)**	(10,041)	(10,881)
Reclassifications*	**(1,091)**	360	150
Ending balance	**$ 16,947**	$ 17,995	$ 16,450

* 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, 2018 involved more than a normal risk of collectibility.

The Association also has business relationships with certain other System entities. The Association paid $1.9 million in 2018, $1.6 million in 2017 and $1.7 million in 2016 to AgVantis for technology services and $2 in 2018 and 2017 and none in 2016 to CoBank for operational services. The Association paid $145 in 2018, $167 in 2017, and $145 in 2016 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, 2018, $310.4 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 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, 2018, $2.9 million of standby letters of credit were outstanding with a nominal fair value. Outstanding standby letters of credit have expiration dates ranging from 2019 to 2025. The maximum potential amount of future payments the Association is required to make under the guarantees is $2.9 million.

The credit risk association with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers. Management applies the same credit policies to these instruments. Upon fully funding an instrument, the credit risk amounts are equal to the contract amounts and the potential for loss from such transactions is subject to borrower repayment or the value of collateral securing the loan (if any). The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. The Association maintains a contingency reserve for unfunded commitments, which reflect management's best estimate of losses inherent in lending commitments made to customers but not yet disbursed upon.

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 assets held in nonqualified benefit trusts measured at fair value on a recurring basis that are determined to be Level 1 of $8 at December 31, 2018 and none at December 31, 2017 and 2016. The Association has no liabilities measured at fair value on a recurring basis for the periods presented.

Assets measured at fair value on a non-recurring basis at December 31 for each of the fair value hierarchy values are summarized as follows:

	Fair Value Measurement Using			Total Fair
	Level 1	Level 2	Level 3	Value
Assets:				
2018				
Loans	**$ –**	**$ –**	**$ 281**	**$ 281**
Other property owned	**$ –**	**$ –**	**$ –**	**$ –**
2017				
Loans	$ –	$ –	$ –	$ –
Other property owned	$ –	$ –	$ 2,565	$ 2,565
2016				
Loans	$ –	$ –	$ 356	$ 356
Other property owned	$ –	$ –	$ 2,870	$ 2,870

The Association has no 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.

Assets Held in Non-Qualified Benefits Trusts

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

Loans

For 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. The fair value of these loans would fall under Level 2 of the hierarchy if the process only uses independent appraisals and other market-based information.

Other Property Owned

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

NOTE 16 – QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Quarterly results of operations for the years ended December 31, 2018, 2017, and 2016, follow.

	2018				
	First	**Second**	**Third**	**Fourth**	**Total**
Net interest income	**$ 6,753**	**$ 6,885**	**$ 7,054**	**$ 7,113**	**$ 27,805**
Provision for credit losses/(Credit loss reversal)	**(183)**	**391**	**(111)**	**397**	**494**
Noninterest expense, net	**2,559**	**2,918**	**2,576**	**3,241**	**11,294**
Net income	**$ 4,377**	**$ 3,576**	**$ 4,589**	**$ 3,475**	**$ 16,017**

	2017				
	First	Second	Third	Fourth	Total
Net interest income	$ 6,494	$ 6,711	$ 6,803	$ 6,670	$ 26,678
Provision for credit losses/(Credit loss reversal)	613	(178)	71	316	822
Noninterest expense, net	3,079	2,910	3,029	3,108	12,126
Net income	$ 2,802	$ 3,979	$ 3,703	$ 3,246	$ 13,730

	2016				
	First	Second	Third	Fourth	Total
Net interest income	$ 6,219	$ 6,300	$ 6,495	$ 6,634	$ 25,648
Provision for credit losses/(Credit loss reversal)	234	323	236	(425)	368
Noninterest expense, net	2,733	2,651	2,520	2,901	10,805
Net income	$ 3,252	$ 3,326	$ 3,739	$ 4,158	$ 14,475

NOTE 17 – SUBSEQUENT EVENTS

The Association has evaluated subsequent events through March 15, 2019 which is the date the financial statements were issued, and no material subsequent events were identified.

Disclosure Information Required By Farm Credit Administration Regulations

(Amounts in Whole Dollars)

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:

Location	Description	Form of Ownership
5110 Edison Avenue Colorado Springs, Colorado	Administrative Office and Lending Office	Owned
549 South Lincoln Burlington, Colorado	Lending Office	Owned
1302 East Third Street La Junta, Colorado	Lending Office	Owned
201 South Fifth Street Lamar, Colorado	Lending Office	Owned
100 East Main Street Limon, Colorado	Lending Office	Owned
159 Washington Street Monte Vista, Colorado	Lending Office	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.

Other than ordinary routine litigation incidental to the business, there are no material legal proceedings pending to which the Association is a party of which any of its property is subject to, or which involve claims that the Association may be required to satisfy.

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," to the financial statements, 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, 2018, 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.

DIRECTORS

Mark Peterson: Chairman of the Board currently serving a three-year term which expires in 2019. Mr. Peterson is a partner in a family run farm, Peterson Farms, LLC, farming potatoes and malting barley for Coors. Mr. Peterson is currently serving as Chairman of the Colorado Potato Administrative Committee. He is a Director on the National Potato Council, which is the governmental oversight committee for the potato industry in the US. He serves on the Trade Affairs committee, the US-Mexico Trade affairs sub-committee, and the Legislative and Governmental Affairs Committee.

Kent Price: Vice Chairman of the Board currently serving a three-year term which expires in 2020 and Chairman of the Association's Compensation Committee. Mr. Price is a partner in Price Farms LLC, Price Farms Certified Seed Company LLC, Price Heritage LLC and Expo LLC. He is also part owner in San Acio Seed and San Acio Lands LLC. His operations include seed and market potatoes, and produce malt barley for Coors. He graduated from Adams State University and has been farming for over 36 years. He is currently secretary/treasurer for the Colorado Certified Potato Growers Association, serves on the San Luis Valley Colorado State University Research Committee, and secretary/treasurer of the San Luis Valley Well Owner's Association. He is an alternate on the Colorado Potato Administration Committee (CPAC) for Saguache County.

Steve Betts: Appointed Director currently serving a three-year term which expires in 2021 and Vice Chairman of the Association's Audit-Risk Committee. Mr. Betts is Chief Financial Officer of Merrick & Company, a global design engineering firm, and is also on the Board of Advisors for Phiston Technologies, Inc. Mr. Betts is a Certified Public Accountant licensed in Colorado.

Jim Crowder: Director currently serving a three-year term which expires in 2021 and member of the Compensation Committee. Mr. Crowder has been ranching for the past five years. His operation consists of cow/calf, calf backgrounding, and some farming. He owns approximately 2,000 acres and leases about 9,000 acres. Previously, he was a Colorado Brand Inspector from 1979 to 2015. Mr. Crowder received a Bachelor of Science degree from Panhandle State University.

Colin Durham: Director currently serving a three-year term which expires in 2019 and a member of the Association's Audit-Risk Committee. Dr. Durham is a 2013 graduate of Colorado State University's College of Veterinary Medicine. Dr. Durham is a partner at Colorado Veterinary Clinic, P.C. in La Junta, Colorado. He is also a veterinarian at La Junta Livestock Commission, Inc. He and his brother run a commercial cow-calf and stocker operation. Additionally, they take in cattle on a custom grazing/partnership basis. They lease pasture in Crowley, El Paso, Lincoln and Otero counties.

Carl Keith James: Director currently serving a three-year term which expires in 2019 and a member of the Association's Audit-Risk Committee. He is the Association representative to the CoBank, ACB District Farm Credit Council. Mr. James has been farming since 1973. He has a cow/calf, stocker and wheat operation. Mr. James is Chairman of the Eastern Slope Rural Telephone Association Board and a Director on the Lincoln Community Hospital Board.

Michael Livingston: Director currently serving a three-year term which expires in 2021 and a member of the Audit-Risk Committee. Mr. Livingston resides in Stratton, Colorado and has operated a farm and ranch with his wife Julie since 1984. Their primary enterprise is a cow/calf operation that spans across Kit Carson and Yuma counties. Mr. Livingston is also a member of Livingston Farms, LLC, which he and his son operate together to raise corn, milo, and wheat.

John Negley: Director currently serving a three-year term which expires in 2020 and a member of the Association's Compensation Committee. Mr. Negley has farmed and ranched since 1970. He is a partner in J & L Farms, a family partnership conducting a wheat and cow/calf operation. He serves as Secretary on the Board of Directors for the Kiowa Soil Conservation Board and Director for the Eads Hospital Board.

Gary Pautler: Director serving a three-year term which expires in 2020 and a member of the Association's Compensation Committee and Chairman of the Scholarship Committee. Mr. Pautler has been farming since 1967. He is a partner in Pautler Brothers, a family owned irrigated and dryland corn and wheat operation. Mr. Pautler serves as Chairman on the Kit Carson County Planning Commission and is Treasurer of the Stratton Fire Protection District.

Paul Prentice: Appointed Director currently serving a three-year term which expires in 2020 and Chairman of the Association's Audit-Risk Committee. Dr. Prentice is the founder, President and Chief Economist of Farm Sector Economics, Inc., a consulting firm specializing in macroeconomic linkages to agriculture. After a 30-year run, Dr. Prentice closed Farm Sector Economics to focus on his teaching and Board work. He serves on the Board of Advisors for Bio-Economic Research Associates and also the Board of Advisors for the Bastiat Society of Colorado Springs. Dr. Prentice teaches as a Professor of Economics and Business at Colorado Technical University. He is an Adjunct Scholar at the Ludwig von Mises Institute, a Senior Fellow at the Independence Institute, and a Fellow of the Centennial Institute at Colorado Christian University.

Jeffrey Uhland: Director currently serving a three-year term which expires in 2021 and Vice Chairman of the Association's Compensation Committee and member of the Scholarship Committee. Mr. Uhland is a partner with his brothers in Tri-County Farms GP, which has a dryland crop operation raising wheat, milo, corn, sunflowers and millet. He is also partner in U-Land LLC which owns and leases land. He is a partner in Colorado Mills LLC, a sunflower oil and feed processing plant in Lamar, Colorado. He is partner in JAG, Inc. a farming corporation and partner in Kiowa County Investment Group, LLC. He serves on the Kiowa County Weed Board and is an alternate on the Sunflower Administrative Committee.

Sid Yoder: Director currently serving a three-year term which expires in 2021 and member of the Compensation Committee and Scholarship Committee. Mr. Yoder resides in Karval, Colorado in Lincoln County. Ranch manager has been his principal occupation for the past five years; his agricultural operation consists of cow/calf. Mr. Yoder is employed by Diamond Hitch Cattle Company, LLC as a ranch manager and is a member of that limited liability company. Mr. Yoder serves on the Colorado Cattlemen's Association Ag Policy Committee as its Chair. Mr. Yoder received a degree in Agricultural Business/Agricultural Economics from Oklahoma Panhandle State University.

Scott Maranville: Director served a three-year term which expired in 2018.

Rosalie Martinez: Director, served a three-year term which expired in 2018.

Ronald Rehfeld: Director served a three-year term which expired in 2018.

SENIOR OFFICERS

Jeremy Anderson: President and Chief Executive Officer (CEO) since November 2017. Previously, he served as Regional President, Board Member and part owner of a community bank in south central Nebraska. Mr. Anderson has over 17 years of commercial banking experience with National and Regional commercial banks. He has also been an active farmer. He and his wife have operated a working row-crop farming operation with his grandparents and parents near Clay Center, Nebraska for 25 years.

Deborah Anderson: Vice President of Human Resources since June 2017. Previously, she served as HR Generalist from 2010 to June 2017. Ms. Anderson started with the Association as an Administrative Assistant then moved to an HR – Administrative Assistant, and has been with Farm Credit of Southern Colorado for 17 years. She holds the Society of Human Resource Management's SHRM-CP Certification in Human Resources.

Sherri Bandy: Vice President of Operations since June 2018. Previously, she served as Help Desk Manager from June 2017 to June 2018. Ms. Bandy started as an Operations Coordinator in 2000, and has been employed with the Farm Credit System for 19 years.

William A. Barnes: Chief Appraisal Officer since January 2015. He was Senior Vice President – Appraisal Services January 2011 to December 2014. Prior to that he was the Vice President – Appraisals for 17 years. Mr. Barnes is a Colorado Certified General Appraiser and holds the Accredited Rural Appraiser, (ARA), designation which is awarded by the American Society of Farm Managers and Rural Appraisers, (ASFMRA), to those members who have had years of experience, are technically trained, have passed a rigid examination and subscribe to a high code of ethics. He has held this designation since 1989. He has been with the Farm Credit System for 39 years.

Chuck Blasi: Chief Credit Officer beginning in March 2018. Previously served as Senior Vice President-Lending from February 2016 to March 2018 and Senior Credit Officer September 2013 to February 2016. Mr. Blasi served in various Loan Officer roles in the La Junta and Burlington Branches for 27 years from 1986 to 2013. Mr. Blasi has been employed within Farm Credit of Southern Colorado for over 32 years.

Mark Broeckelman: Senior Vice President of Credit since January 2017. Previously, he served as Vice President of Credit from October 2013 to January 2017. Mr Broeckelman has worked in retail credit and lending capacities with Farm Credit of Ness City and the Burlington Branch of Farm Credit of Southern Colorado, and has been employed with the Farm Credit System for 33 years.

Kode Hunt: Chief Information Officer (CIO) since November 2018. Previously served as Vice President of Information Services at Farm Credit of New Mexico and has 15 years of experience in the Farm Credit System. Mr. Hunt has several IT certifications including MCSA, A+, and Security+ along with being a Lean certified expert. He actively serves on the AgVantis Technology Committee.

Katrina Lange: Chief Risk Officer since March 2018. Previously Ms. Lange served as VP – Risk management from March 2017 to February 2018, VP – Capital Markets from March 2016 to February 2017, and AVP-Credit/Risk Management Specialist from July 2007 to February 2016. She has been with Farm Credit of Southern Colorado for 11 years serving in various roles within credit, operations, and risk management. Prior to coming to Farm Credit, Ms. Lange worked at a commercial bank in California in both the credit and risk management departments.

Shawna R. Neppl: Chief Financial Officer since February 2007. Ms. Neppl served as Interim CEO from June 2017 to November 2017. She also served as Vice President/Branch Manager of the Colorado Springs Branch from February 2001 to February 2007 and as Assistant Vice President – Risk Management from January 2000 to February 2001. She has been with the Farm Credit System for 26 years.

Kenneth P. West: Chief Banking Officer since March 2016. Previously, Mr. West served as Vice President – Capital Markets from May 2015 to March 2016. Mr. West began his career with CoBank as a credit analyst, then moved to Farm Credit of Southern Colorado from 2004 to 2007 reaching the position of Vice President – Credit. He then served at American AgCredit as Vice President – Relationship Manager for eight years, returning to Farm Credit of Southern Colorado in 2015. Mr. West has been with the Farm Credit System for 17 years and in the banking industry 26 years.

David L. Self: Chief Credit Officer beginning in December 2014 to February 2018. He was previously Executive Vice President Lending from July 2014 to December 2014; Senior Vice President Lending from November 2009 to July 2014. Mr. Self served as the Vice President – Credit from July 2000 to November 2009. Mr. Self started as a field representative in 1981 and has worked for five different Associations, one Farm Credit Bank and three different Farm Credit Districts. Mr. Self was employed within the Farm Credit System for 38 years and retired in January 2019.

Ricky Sellers: Interim Chief Operating Officer from July 2017 through May 2018, Standards of Conduct Official from July 2017 to March 2018, and Compliance Officer from January 2011 through May 2018.

Nick Wedel: Chief Information Security Officer from February 2018 to July 2018.

COMPENSATION OF DIRECTORS AND SENIOR OFFICERS

Directors of the Association were compensated for services on a per diem basis at the rate of $500 per day and an additional $250 preparation time for each Board Meeting (excluding conferences, tours, etc.). The Chairman of the Board and Committee Chairs received an additional $100 per official meeting. When the Compensation Committee and Audit-Risk Committee meetings were held in conjunction with the regular board meetings, no additional compensation was paid to the directors for these meetings. The two Board appointed financial experts received an additional $100 per official meeting. The Directors were compensated at the rate of $100 per hour for conference calls. Mileage was compensated at the rate of $0.545 per mile while on official business.

Additional information for each director is provided below:

Name	Number of Days Served at: Board Meetings	Number of Days Served at: Other Official Activities	Compensation for: Board Meetings And Official Duties	Compensation for: Audit-Risk Committee	Compensation for: Compensation Committee	Compensation Paid During 2018
Mark Peterson	11.0	18.5	$ 18,650	$ 2,200	$ 300	$ 21,150
Kent Price	11.0	16.5	18,350	–	1,200	19,550
Steve Betts	10.0	4.0	10,000	700	–	10,700
James Crowder	5.0	1.5	4,100	–	250	4,350
Colin Durham	11.0	7.0	11,650	700	–	12,350
Carl Keith James	12.0	10.0	13,850	–	250	14,100
Michael Livingston	6.0	1.0	4,750	–	–	4,750
John Negley	12.0	12.0	14,600	–	500	15,100
Gary Pautler	12.0	23.0	21,450	900	800	23,150
Paul Prentice	11.0	10.0	15,250	700	–	15,950
Jeffrey Uhland	9.0	7.5	10,250	–	250	10,500
Sid Yoder	6.0	2.0	5,100	–	250	5,350
Scott Maranville	4.0	3.0	4,250	–	250	4,500
Rosalie Martinez	6.0	6.5	8,400	700	–	9,100
Ronald Rehfeld	6.0	9.0	8,750	–	250	9,000
Total Compensation			$169,400	$ 5,900	$ 4,300	$ 179,600

Directors and senior officers are reimbursed for travel, subsistence and other expenses related to Association business according to Association policy. A copy of this policy is available to shareholders upon request. Aggregate reimbursements to directors for travel, subsistence and other related expenses were $85,692 in 2018, $104,287 in 2017 and $102,995 in 2016. Noncash compensation paid to directors as a group was $1,697 during 2018.

Information on senior officers and directors who hold Preferred H-Stock follows. The average dividend rate during 2018 on all balances was 1.25%.

Name of the Account	Director or Officer	December 31, 2018 Balance	Purchases during 2018	Retirements during 2018
James Crowder	Director	$ 302,731	$ 202,282	$ –
Gary Pautler	Director	$ 51,316	$ 522	$ –

Information on Chief Executive Officer (CEO), senior officers and other highly compensated individuals follows.

CEO Name[(1)]	Year	Salary	Incentive Compensation[(2)]	Bonus[(3)]	Deferred/Perq	Other[(4)]	Total
Jeremy Anderson	2018	$350,000	$ 102,312	$128,000	$ 34,306	$ –	$614,618
Jeremy Anderson	2017	$ 47,788	$ 6,539	$ –	$ 188,342	$ –	$242,669
Shawna Neppl	2017	$117,303	$ 16,326	$ –	$ 5,128	$ –	$138,757
Alan Woodard	2017	$124,205	$ –	$ –	$ 13,692	$ 10,932	$148,829
Alan Woodard	2016[(3)]	$ 70,000	$ 10,466	$ –	$ 13,010	$ 210	$ 93,686
Russell Tomky	2016[(3)]	$260,560	$ 39,121	$ –	$ 13,540	$194,221	$507,442

(1) CEO Compensation for 2017 includes Alan Woodard from January 1 through June 9, 2017, Shawna Neppl as Interim CEO from June 12 through November 10, 2017, and Jeremy Anderson from November 13 through December 31, 2017. CEO compensation for 2016 includes Russell Tomky from January 1 through September 30, 2016, and Alan Woodard from October 1 through December 31, 2016.

Aggregate Number Of Officers/Highly Compensated Individuals (excluding CEO)	Year	Salary	Incentive Compensation(2)	Bonus(3)	Deferred/ Perq	Other(4)	Total
11	2018(1)	$ 1,334,015	$ 224,388	$67,647	$ 136,615	$ 268,011	$ 2,030,676
6	2017(1)	$ 1,056,476	$ 96,122	$ –	$ 72,464	$ 2,073,936	$ 3,298,998
5	2016(5)	$ 813,291	$ 121,374	$ –	$ 56,630	$ 438,973	$ 1,430,268

Disclosure of information on the total compensation paid during the last fiscal year to any senior officer, or to any other officer included in the aggregate, is available to shareholders upon request. The senior officers and highly compensated employees included above are those defined by FCA regulations section 619.9310 and section 620.6.

(1) Aggregate number includes 11 senior officers for 2018. Aggregate number includes 5 senior officers and 1 highly compensated employee for 2017. CFO served as Interim CEO for the period June 12, 2017 through November 10, 2017. Compensation earned during this time period is included in CEO information; remaining time is included in senior officer information.
(2) Incentive Plan amounts represent performance bonuses earned in the reported fiscal year.
(3) Bonus amounts represent discretionary bonuses and retention bonuses earned in the reported fiscal year.
(4) "Other" includes changes in the value of pension benefits, vacation payouts, separation pay and service awards. The change in value of the pension benefits is defined as the vested portion of the present value of the accumulated benefit obligation from December 31 of the prior year, disclosed in Note 11 of the Financial Statements. In 2018, we had a negative change in pension value of $8,242 due to a variety of factors including, but not limited to, interest/discount rates, length of service, age, starting values, etc.
(5) For 2016, we reclassified employer match on the deferred contribution plan available to all employees from "Other" to "Deferred/Perq". We also reclassified vacation pay from "Deferred/Perq" to "Other".

We believe the design and governance of our compensation program is consistent with the highest standards of risk management and provides total compensation that promotes our mission to ensure a safe, sound, and dependable source of credit and related services for agriculture and rural America. Our compensation philosophy aims to provide a competitive total rewards package that will enable us to attract and retain highly qualified officers with the requisite expertise and skills while achieving desired business results aligned with the best interest of our shareholders. The design of our senior officer compensation program supports our risk management goals and includes (1) a balanced mix of base and variable pay, (2) a balanced use of performance measures that are risk-adjusted where appropriate, (3) a pay-for-performance process that allocates individual awards based on both results and how those results were achieved.

Senior officers are compensated with a mix of direct cash as well as retirement plans generally available to all employees. Our Board of Directors determines the appropriate balance of short-term compensation while keeping in mind their responsibilities to our shareholders. Base salary and short-term incentive are intended to be competitive with annual compensation for comparable positions at peer organizations. The Association has one Incentive Plan. The Pay for Performance Incentive Program is available to all employees and payable once a year. This Pay for Performance Incentive Program is designed and intended to promote and reward positive business results in several key performance areas. These typically include credit quality, loan volume growth, return on assets and other key ratios. It is also intended to build and enhance teamwork among all employees and groups of employees for the ultimate benefit of our customers and their Association. Annual Incentive Compensation reflects the amount in the year earned.

Senior officer base salaries reflect the officer's experience and level of responsibility. Base salaries are subject to review and approval by the Human Resource Committee of our Board of Directors and are subject to adjustment based on changes in responsibilities or competitive market conditions.

Retirement Plan Overview – Certain Senior Officers participate in two defined benefit retirement plans: (a) the Ninth Farm Credit District Pension Plan (Pension Plan), which is a qualified defined benefit plan and (b) the Former Ninth and Eleventh District Employers Pension Restoration Plan (Pension Restoration Plan), which is a nonqualified retirement plan. As of December 31, 2018, the CEO did not participate in the Pension Plan or the Pension Restoration Plan. Additionally, substantially all employees participate in the 401(k) Plan, which has an employer matching contribution. Information on pension benefits attributable to senior officers and other highly compensated individuals follows.

Aggregate Number of Senior Officers/ Highly Compensated Individuals Participating in Plan	Plan	Average Years of Credited Service	Present Value of Accumulated Benefits	Payments Made During the Reporting Period
5	Pension Plan	34.96	$ 6,490,563	$ 103,815
	Restoration Plan		$ -	$ 3,895

For the Pension Plan and the Pension Restoration Plan, the average years of service represents an average for the aggregate senior officers and highly compensated employee group included in the Plan.

Pension Plan – In general, the Pension Plan is a qualified plan and provides participants with a 50% joint-and-survivor annuity benefit at normal retirement that is equal to 1.50% of average monthly compensation during the 60 consecutive months in which an individual receives his highest compensation (High 60) multiplied by his years of benefit service, plus 0.25% of the amount by which the High 60 exceeds covered compensation multiplied by years of benefit service. The benefit is actuarially adjusted if the individual chooses a different form of distribution than a 50% joint-and-survivor annuity, such as a lump sum distribution. The pension valuation was determined using a blended approach assuming half of the benefits would be paid as a lump sum and half as an annuity at the participants earliest unreduced retirement age. The Pension Plan pays benefits up to the applicable limits under the Internal Revenue Code.

Pension Restoration Plan – The Pension Restoration Plan is unfunded and not qualified for tax purposes. Benefits payable under this plan are equal to the excess of the amount that would be payable under the terms of the Pension Plan disregarding the limitations imposed under Internal Revenue Code Sections 401(a)(17) and 415, over the pension actually payable under the Pension Plan. The plan also restores any benefits attributable to nonqualified deferred compensation excluded from the benefit determined under the Pension Plan. The nonqualified pension restoration valuation was determined using an assumption that benefits would be paid as a lump sum at the participants earliest unreduced retirement age.

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 15, 2019, 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 2018 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 5110 Edison Avenue, Colorado Springs, Colorado 80915, or may be contacted at PO Box 75640, Colorado Springs, Colorado 80970-5640 or by calling (800) 815-8559 or (719) 570-1087. The reports may also be obtained free of charge by visiting CoBank's website at www.cobank.com.