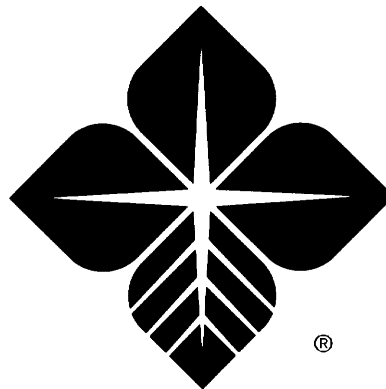
HERITAGE LAND BANK, ACA

2018
Quarterly Report
First Quarter



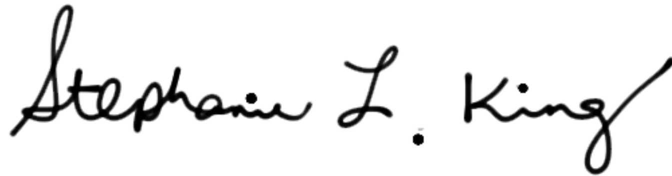
For the Quarter Ended March 31, 2018

REPORT OF MANAGEMENT

The undersigned certify that we have reviewed this report, that it has been 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.

Bill Tandy, Chief Executive Officer
May 4, 2018

Roger Claxton, Chairman, Board of Directors
May 4, 2018



Stephanie L. King, Interim Chief Financial Officer
May 4, 2018

HERITAGE LAND BANK, ACA
MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the financial performance of the Heritage Land Bank, ACA (Agricultural Credit Association), referred to as the Association, for the quarter ended March 31, 2018. These comments should be read in conjunction with the accompanying consolidated financial statements and the December 31, 2017 Annual Report to Stockholders.

The Association is a member of the Farm Credit System (System), a nationwide network of cooperatively owned financial institutions established by and subject to the provisions of the Farm Credit Act of 1971, as amended, and the regulations of the Farm Credit Administration (FCA) promulgated thereunder.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The consolidated financial statements were prepared under the oversight of the Association's audit committee.

Significant Events:

The Association's Board of Directors is committed to returning earnings in the form of a patronage distribution. In December 2017, the Board of Directors declared a cash patronage distribution of approximately $3.1 million from 2017 profits to be paid by March 31, 2018. The patronage distribution equated to 65 basis points (.65 percent). Including the patronage paid in 2018, the aggregate amount paid and allocated to its stockholders for the past 20 years will exceed $44.4 million.

Loan Portfolio:

Total loans outstanding at March 31, 2018, including nonaccrual loans and sales contracts, were $476,010,146 compared to $482,939,554 at December 31, 2017, reflecting a decrease of 1.4 percent. Nonaccrual loans as a percentage of total loans outstanding were 0.1 percent at March 31, 2018, and December 31, 2017.

The Association recorded $20,406 in recoveries and no charge-offs for the quarter ended March 31, 2018, and $26,697 in recoveries and no charge-offs for the same period in 2017. The Association's allowance for loan losses was 1.0 percent of total loans outstanding as of March 31, 2018, and December 31, 2017.

Risk Exposure:

High-risk assets include nonaccrual loans, loans that are past due 90 days or more and still accruing interest, formally restructured loans and other property owned. The following table illustrates the Association's components and trends of high-risk assets.

	March 31, 2018		December 31, 2017	
	Amount	**%**	Amount	%
Nonaccrual	**$ 488,077**	**17.6%**	$ 495,754	17.8%
Formally restructured	**425,985**	**15.3%**	427,893	15.3%
Other property owned, net	**1,867,347**	**67.1%**	1,867,347	66.9%
Total	**$ 2,781,409**	**100.0%**	$ 2,790,994	100.0%

Investments:

During the first quarter of 2018, the Association did not exchange any mortgage loans that previously were covered under a long-term standby commitment to purchase agreement with Federal Agricultural Mortgage Corporation (Farmer Mac) for a Farmer Mac guaranteed agricultural mortgage-backed security. The Association continues to service the loans included in this transaction. These investments in guaranteed securities are included in this report's Consolidated Balance Sheet as investments.

Results of Operations:

The Association had net income of $1,903,337 for the three months ended March 31, 2018, as compared to net income of $1,293,917 for the same period in 2017, reflecting an increase of 47.1 percent. Net interest income was $3,376,814 for the three months ended March 31, 2018, compared to $2,926,933 for the same period in 2017.

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	Three months ended:			
	March 31, 2018		March 31, 2017	
	Average Balance	**Interest**	Average Balance	Interest
Loans	**$ 477,538,218**	**$ 5,938,573**	$ 427,754,550	$ 4,962,317
Investments	**290,749**	**4,019**	404,352	4,846
Total interest-earning assets	**477,828,967**	**5,942,592**	428,158,902	4,967,163
Interest-bearing liabilities	**403,131,624**	**2,565,778**	357,299,786	2,040,230
Impact of capital	**$ 74,697,343**		$ 70,859,116	
Net interest income		**$ 3,376,814**		$ 2,926,933

	2018 Average Yield	2017 Average Yield
Yield on loans	**5.04%**	4.70%
Yield on investments	**5.61%**	4.86%
Total yield on interest-earning assets	**5.04%**	4.70%
Cost of interest-bearing liabilities	**2.58%**	2.32%
Interest rate spread	**2.46%**	2.38%
Net interest income as a percentage of average earning assets	**2.87%**	2.77%

	Three months ended: March 31, 2018 vs March 31, 2017		
	Increase (decrease) due to		
	Volume	**Rate**	**Total**
Interest income - loans	**$ 577,534**	**$ 398,722**	**$ 976,256**
Interest income - investments	**(1,361)**	**534**	**(827)**
Total interest income	**576,173**	**399,256**	**975,429**
Interest expense	**261,709**	**263,839**	**525,548**
Net interest income	**$ 314,464**	**$ 135,417**	**$ 449,881**

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nterest income for the three months ended March 31, 2018, increased by $975,429, or 19.6 percent, from the same period of 2017, primarily due to increases in yields on earning assets and an increase in average loan volume. Interest expense for the three months ended March 31, 2018, increased by $525,548, or 25.8 percent, from the same period of 2017 due to an increase in interest rates and an increase in average debt volume. Average loan volume for the first quarter of 2018 was $477,538,218, compared to $427,754,550 in the first quarter of 2017. The average net interest rate spread on the loan portfolio for the first quarter of 2018 was 2.46 percent, compared to 2.38 percent in the first quarter of 2017.

The Association's return on average assets for the three months ended March 31, 2018, was 1.58 percent compared to 1.20 percent for the same period in 2017. The Association's return on average equity for the three months ended March 31, 2018, was 9.74 percent, compared to 6.93 percent for the same period in 2017.

Liquidity and Funding Sources:

The Association secures the majority of its lendable funds from the Farm Credit Bank of Texas (Bank), which obtains its funds through the issuance of System-wide obligations and with lendable equity. The following schedule summarizes the Association's borrowings.

	March 31, 2018	December 31, 2017
Note payable to the Bank	**$ 400,414,072**	$ 409,033,718
Accrued interest on note payable	**890,131**	866,381
Total	**$ 401,304,203**	$ 409,900,099

The Association operates under a general financing agreement (GFA) with the Bank. The current GFA is effective through September 30, 2020. The primary source of liquidity and funding for the Association is a direct loan from the Bank. The outstanding balance of $400,414,072 as of March 31, 2018, is recorded as a liability on the Association's balance sheet. The note carried a weighted average interest rate of 2.47 percent at March 31, 2018. The indebtedness is collateralized by a pledge of substantially all of the Association's assets to the Bank and is governed by the GFA. The decrease in note payable to the Bank and related accrued interest payable since December 31, 2017, is due to the Association's decrease in loan volume. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were $74,860,785 at March 31, 2018. The maximum amount the Association may borrow from the Bank as of March 31, 2018, was $475,106,401 as defined by the GFA. The indebtedness continues in effect until the expiration date of the GFA, which is September 30, 2020, unless sooner terminated by the Bank upon the occurrence of an event of default, or by the Association, in the event of a breach of this agreement by the Bank, upon giving the Bank 30 calendar days' prior written notice, or in all other circumstances, upon giving the Bank 120 days' prior written notice.

Capital Resources:

The Association's capital position increased by $1,084,678 at March 31, 2018, compared to December 31, 2017. The Association's debt as a percentage of members' equity was 5.14:1 as of March 31, 2018, compared to 5.32:1 as of December 31, 2017.

Farm Credit Administration regulations require us to maintain minimums for various regulatory capital ratios. New regulations became effective January 1, 2017, which replaced the previously required core surplus and total surplus ratios with common equity tier 1, tier 1 capital, and total capital risk-based capital ratios. The new regulations also added tier 1 leverage and unallocated retained earnings and equivalents (UREE) ratios. The permanent capital ratio continues to remain in effect, with some modifications to align with the new regulations. As of March 31, 2018, the Association exceeded all regulatory capital requirements.

Significant Recent Accounting Pronouncements:

In February 2018, the Financial Accounting Standards Board (FASB) issued guidance entitled "Income Statement — Reporting Comprehensive Income — Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." This guidance allows for the reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the recently issued tax legislation, Tax Cuts and Jobs Act (TCJA) that lowered the federal corporate tax rate from 35% to 21%. The amount of the reclassification shall include the effect of the change in the tax rate on gross deferred tax amounts and related valuation allowances at the date of enactment of the TCJA related to items remaining in accumulated other comprehensive income. The guidance becomes effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The Association is evaluating the impact of adoption on the Association's financial condition and its results of operations.

In August 2017, the FASB issued guidance entitled "Targeted Improvements to Accounting for Hedging Activities." The guidance better aligns an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. The amendments in this guidance require an entity to present the earnings effect of the hedging instrument in the same income statement line item in which the earnings effect of the hedged item is reported. This guidance also addresses the timing of effectiveness testing, qualitative and quantitative effectiveness testing, and components that can be excluded from effectiveness testing. This guidance becomes effective for interim and annual periods beginning after December 15, 2018. The Association is evaluating the impact of adoption on the Association's financial condition and its results of operations.

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 becomes effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not impact the Association's financial condition but did change the classification of certain items in the results of operations.

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

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

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

In January 2016, the FASB issued guidance entitled "Recognition and Measurement of Financial Assets and Liabilities." The guidance affects, among other things, the presentation and disclosure requirements for financial instruments. For public entities, the guidance eliminates the requirement to disclose the methods and significant assumptions used to estimate the fair value of financial instruments carried at amortized cost. This guidance becomes effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not impact the Association's financial condition or its results of operations 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. In this regard, a majority of our contracts would be excluded from the scope of this new guidance. In August 2015, the FASB issued an update that defers this guidance by one year, which results in the new revenue standard becoming effective for interim and annual reporting periods beginning after December 15, 2017. The Association has determined that the effect of the adoption is not material to its financial condition or results of operations and will not change its current recognition practices.

Relationship with the Farm Credit Bank of Texas:

The Association's financial condition may be impacted by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect the stockholder's investment in the Association. The Management's Discussion and Analysis and Notes to Financial Statements contained in the 2017 Annual Report of Heritage Land Bank, ACA more fully describe the Association's relationship with the Bank.

The Texas Farm Credit District's (District) annual and quarterly stockholder reports, as well as those of the Bank, are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, The Ag Agency, P.O. Box 202590, Austin, Texas 78720, or by calling (512) 483-9204. Copies of the District's quarterly and annual stockholder reports also can be requested by e-mail at *fcb@farmcreditbank.com*. The annual and quarterly stockholder reports for the Bank and the District are also available on its website at *www.farmcreditBank.com.*

The Association's quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Heritage Land Bank, ACA, 4608 Kinsey Drive, Tyler, Texas 75703 or calling (903) 534-9204. The annual and quarterly stockholder reports for the Association are also available on its website at *heritagelandbank.com.* Copies of the Association's quarterly stockholder reports can also be requested by e-mailing *stephanie.king@heritagelandbank.com.*

HERITAGE LAND BANK, ACA

CONSOLIDATED BALANCE SHEET

	March 31, 2018 (unaudited)	December 31, 2017
ASSETS		
Cash	$ 65,853	$ 1,026,770
Investments	283,339	307,296
Loans	476,010,146	482,939,554
Less: allowance for loan losses	4,921,270	4,900,864
Net loans	471,088,876	478,038,690
Accrued interest receivable	2,511,047	2,254,169
Investment in and receivable from the Farm Credit Bank of Texas:		
Capital stock	7,529,080	7,529,080
Other	495,000	458,666
Other property owned, net	1,867,347	1,867,347
Premises and equipment, net	3,186,634	3,039,363
Other assets	336,317	258,594
Total assets	$ 487,363,493	$ 494,779,975
LIABILITIES		
Note payable to the Farm Credit Bank of Texas	$ 400,414,072	$ 409,033,718
Accrued interest payable	890,131	866,381
Drafts outstanding	129,494	119,775
Dividends payable	917,339	3,112,377
Other liabilities	5,604,484	3,324,429
Total liabilities	407,955,520	416,456,680
MEMBERS' EQUITY		
Capital stock and participation certificates	2,326,080	2,317,035
Unallocated retained earnings	77,234,409	76,156,072
Accumulated other comprehensive loss	(152,516)	(149,812)
Total members' equity	79,407,973	78,323,295
Total liabilities and members' equity	$ 487,363,493	$ 494,779,975

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

HERITAGE LAND BANK, ACA

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

	Quarter Ended March 31,	
	2018	2017
INTEREST INCOME		
Loans	**$ 5,938,573**	$ 4,962,317
Investments	**4,019**	4,846
Total interest income	**5,942,592**	4,967,163
INTEREST EXPENSE		
Note payable to the Farm Credit Bank of Texas	**2,565,778**	2,040,230
Net interest income	**3,376,814**	2,926,933
PROVISION FOR LOAN LOSSES	**-**	-
Net interest income after provision for loan losses	**3,376,814**	2,926,933
NONINTEREST INCOME		
Income from the Farm Credit Bank of Texas:		
Patronage income	**541,671**	662,783
Loan fees	**(27,029)**	13,539
Refunds from Farm Credit System Insurance Corporation	**299,740**	-
Financially related services income	**433**	525
Other noninterest income	**21,562**	29,578
Total noninterest income	**836,377**	706,425
NONINTEREST EXPENSES		
Salaries and employee benefits	**1,463,835**	1,252,511
Directors' expense	**57,615**	84,655
Purchased services	**90,697**	76,757
Travel	**56,062**	62,596
Occupancy and equipment	**169,998**	190,654
Communications	**44,184**	38,056
Advertising	**143,955**	172,517
Public and member relations	**76,872**	118,162
Supervisory and exam expense	**42,565**	38,500
Insurance Fund premiums	**98,405**	121,376
Loss on other property owned, net	**3,117**	133,224
Other noninterest expense	**62,549**	50,433
Total noninterest expenses	**2,309,854**	2,339,441
NET INCOME	**1,903,337**	1,293,917
Other comprehensive income:		
Change in postretirement benefit plans	**(2,704)**	(4,519)
COMPREHENSIVE INCOME	**$ 1,900,633**	$ 1,289,398

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

HERITAGE LAND BANK, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

(unaudited)

	Capital Stock/ Participation Certificates	Retained Earnings Unallocated	Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
Balance at December 31, 2016	$ 2,110,740	$ 72,941,069	$ 76,116	$ 75,127,925
Comprehensive income	-	1,293,917	(4,519)	1,289,398
Capital stock/participation certificates and allocated retained earnings issued	119,035	-	-	119,035
Capital stock/participation certificates and allocated retained earnings retired	(79,905)	-	-	(79,905)
Patronage distributions declared	-	(746,125)	-	(746,125)
Balance at March 31, 2017	$ 2,149,870	$ 73,488,861	$ 71,597	$ 75,710,328
Balance at December 31, 2017	$ 2,317,035	$ 76,156,072	$ (149,812)	$ 78,323,295
Comprehensive income	-	1,903,337	(2,704)	1,900,633
Capital stock/participation certificates and allocated retained earnings issued	101,145	-	-	101,145
Capital stock/participation certificates and allocated retained earnings retired	(92,100)	-	-	(92,100)
Patronage distributions declared	-	(825,000)	-	(825,000)
Balance at March 31, 2018	**$ 2,326,080**	**$ 77,234,409**	**$ (152,516)**	**$ 79,407,973**

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

HERITAGE LAND BANK, ACA
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

The Heritage Land Bank, ACA (Agricultural Credit Association), referred to as the Association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves the Anderson, Angelina, Cherokee, Collin, Dallas, Henderson, Hunt, Nacogdoches, Panola, Rockwall, Rusk, Sabine, San Augustine, Shelby, Smith and Tarrant in the state of Texas. The Association is a lending institution of the Farm Credit System (System), which was established by Acts of Congress to meet the needs of American agriculture.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. (GAAP) for interim financial information. Accordingly, they do not include all of the disclosures required by GAAP for annual financial statements and should be read in conjunction with the audited financial statements as of and for the year ended December 31, 2017, as contained in the 2017 Annual Report to Stockholders.

In the opinion of management, the accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles (GAAP), except for the inclusion of a statement of cash flows. GAAP require a business enterprise that provides a set of financial statements reporting both financial position and results of operations to also provide a statement of cash flows for each period for which results of operations are provided. In regulations issued by FCA, Associations have the option to exclude statements of cash flows in interim financial statements. Therefore, the Association has elected not to include a statement of cash flows in these consolidated financial statements. These interim financial statements should be read in conjunction with the audited financial statements as of and for the year ended December 31, 2017, as contained in the 2017 Annual Report to Stockholders. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year ending December 31, 2017. Descriptions of the significant accounting policies are included in the 2017 Annual Report to Stockholders. In the opinion of management, these policies and the presentation of the interim financial condition and results of operations conform with GAAP and prevailing practices within the banking industry.

In February 2018, the Financial Accounting Standards Board (FASB) issued guidance entitled "Income Statement — Reporting Comprehensive Income — Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." This guidance allows for the reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the recently issued tax legislation, Tax Cuts and Jobs Act (TCJA) that lowered the federal corporate tax rate from 35% to 21%. The amount of the reclassification shall include the effect of the change in the tax rate on gross deferred tax amounts and related valuation allowances at the date of enactment of the TCJA related to items remaining in accumulated other comprehensive income. The guidance becomes effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The Association is evaluating the impact of adoption on the Association's financial condition and its results of operations.

In August 2017, the FASB issued guidance entitled "Targeted Improvements to Accounting for Hedging Activities." The guidance better aligns an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. The amendments in this guidance require an entity to present the earnings effect of the hedging instrument in the same income statement line item in which the earnings effect of the hedged item is reported. This guidance also addresses the timing of effectiveness testing, qualitative and quantitative effectiveness testing, and components that can be excluded from effectiveness testing. This guidance becomes effective for interim and annual periods beginning after December 15, 2018. The Association is evaluating the impact of adoption on the Association's financial condition and its results of operations.

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 becomes effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not impact the Association's financial condition but did change the classification of certain items in the results of operations.

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

In June 2016, 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 results of operations.

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

In January 2016, the FASB issued guidance entitled "Recognition and Measurement of Financial Assets and Liabilities." This guidance affects, among other things, the presentation and disclosure requirements for financial instruments. For public entities, the guidance eliminates the requirement to disclose the methods and significant assumptions used to estimate the fair value of financial instruments carried at amortized cost. This guidance becomes effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not impact the Association's financial condition or its results of operations 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. In this regard, a majority of our contracts would be excluded from the scope of this new guidance. In August 2015, the FASB issued an update that defers this guidance by one year, which results in the new revenue standard becoming effective for interim and annual reporting periods beginning after December 15, 2017. The Association has determined that the effect of the adoption is not material to its financial condition or results of operations and will not change its current recognition practices.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The preparation of these consolidated financial statements requires the use of management's estimates. The results for the quarter ended March 31, 2018, are not necessarily indicative of the results to be expected for the year ended December 31, 2017. Certain amounts in the prior period's financial statements have been reclassified to conform to current financial statement presentation.

NOTE 2 — INVESTMENTS:

The following is a summary of Farmer Mac agricultural mortgage-backed securities:

	March 31, 2018				
	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**	**Weighted Average Yield**
Agricultural mortgage-backed securities	**$ 283,339**	**$ -**	**$ (2,161)**	**$ 281,178**	**5.09 %**

	December 31, 2017				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	$ 307,296	$ -	$ (643)	$ 306,653	5.09 %

NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES:

A summary of loans follows:

Loan Type	**March 31, 2018 Amount**	December 31, 2017 Amount
Production agriculture:		
Real estate mortgage	**$ 417,873,781**	$ 421,346,572
Production and intermediate term	**14,544,797**	15,759,254
Rural residential real estate	**33,975,837**	35,614,588
Agribusiness:		
Processing and marketing	**8,272,589**	8,802,964
Farm-related business	**1,141,400**	647,988
Loans to cooperatives	**2,635**	102,469
Mission-related investments	**155,691**	358,881
Lease receivables	**43,416**	44,668
Communication	**-**	262,170
Total	**$ 476,010,146**	$ 482,939,554

The Association purchases or sells participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration regulations. The following table presents information regarding the balances of participations purchased and sold at March 31, 2018:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Agribusiness	$ 4,674,152	$ 1,284,670	$ -	$ -	$ 4,674,152	$ 1,284,670
Real estate mortgage	294,111	75,057,788	-	-	294,111	75,057,788
Total	$ 4,968,263	$76,342,458	$ -	$ -	$ 4,968,263	$76,342,458

The Association is authorized under the Farm Credit Act to accept "advance conditional payments" (ACPs) from borrowers. To the extent the borrower's access to such ACPs is restricted and the legal right of setoff exists, the ACPs are netted against the borrower's related loan balance. Unrestricted advance conditional payments are included in other liabilities. ACPs are not insured, and interest is generally paid by the Association on such balances. There were no ACPs at March 31, 2018, and December 31, 2017.

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

	March 31, 2018	December 31, 2017
Nonaccrual loans:		
Real estate mortgage	**$ 429,070**	$ 439,536
Rural residential real estate	**53,876**	56,034
Production and intermediate term	**5,131**	184
Total nonaccrual loans	**488,077**	495,754
Accruing restructured loans:		
Real estate mortgage	**425,985**	425,680
Rural residential real estate	**-**	-
Production and intermediate term	**-**	2,213
Total accruing restructured loans	**425,985**	427,893
Total nonperforming loans	**914,062**	923,647
Other property owned	**1,867,347**	1,867,347
Total nonperforming assets	**$ 2,781,409**	$ 2,790,994

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

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

The following table shows loans and related accrued interest as a percentage of total loans and related accrued interest receivable by loan type as of:

	March 31, 2018	December 31, 2017
Real estate mortgage		
Acceptable	**97.1** %	97.6 %
OAEM	**0.8**	0.3
Substandard/doubtful	**2.1**	2.1
	100.0	100.0
Production and intermediate term		
Acceptable	**98.5**	98.5
OAEM	**0.5**	0.5
Substandard/doubtful	**1.0**	1.0
	100.0	100.0
Agribusiness		
Acceptable	**100.0**	100.0
OAEM	**-**	-
Substandard/doubtful	**-**	-
	100.0	100.0
Communication		
Acceptable	**-**	100.0
OAEM	**-**	-
Substandard/doubtful	**-**	-
	-	100.0
Rural residential real estate		
Acceptable	**99.7**	99.7
OAEM	**-**	-
Substandard/doubtful	**0.3**	0.3
	100.0	100.0
Lease receivables		
Acceptable	**100.0**	100.0
OAEM	**-**	-
Substandard/doubtful	**-**	-
	100.0	100.0
Mission-related investments		
Acceptable	**100.0**	100.0
OAEM	**-**	-
Substandard/doubtful	**-**	-
	100.0	100.0
Total loans		
Acceptable	**97.4**	97.8
OAEM	**0.7**	0.3
Substandard/doubtful	**1.9**	1.9
	100.0 %	100.0 %

The following tables provide an age analysis of past due loans (including accrued interest) as of:

March 31, 2018	**30-89 Days Past Due**	**90 Days or More Past Due**	**Total Past Due**	**Not Past Due or Less Than 30 Days Past Due**	**Total Loans**	**Recorded Investment >90 Days and Accruing**
Real estate mortgage	**$ 1,586,064**	**$ 188,654**	**$1,774,718**	**$ 418,161,693**	**$ 419,936,411**	**$ -**
Rural residential real estate	**54,331**	**-**	**54,331**	**34,004,365**	**34,058,696**	**-**
Production and intermediate term	**-**	**5,131**	**5,131**	**14,857,249**	**14,862,380**	**-**
Processing and marketing	**-**	**-**	**-**	**8,311,352**	**8,311,352**	**-**
Farm-related business	**18,396**	**-**	**18,396**	**1,131,489**	**1,149,885**	**-**
Mission-related investments	**-**	**-**	**-**	**156,420**	**156,420**	**-**
Lease receivables	**-**	**-**	**-**	**43,415**	**43,415**	**-**
Loans to cooperatives	**-**	**-**	**-**	**2,634**	**2,634**	**-**
Communication	**-**	**-**	**-**	**-**	**-**	**-**
Total	**$ 1,658,791**	**$ 193,785**	**$1,852,576**	**$ 476,668,617**	**$ 478,521,193**	**$ -**

December 31, 2017	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans	Recorded Investment >90 Days and Accruing
Real estate mortgage	$ 6,826,071	$ 54,793	$6,880,864	$ 416,377,348	$ 423,258,212	$ -
Rural residential real estate	12,924	-	12,924	35,678,475	35,691,399	-
Production and intermediate term	169,566	184	169,750	15,830,277	16,000,027	-
Processing and marketing	-	-	-	8,823,040	8,823,040	-
Farm-related business	-	-	-	650,451	650,451	-
Mission-related investments	-	-	-	359,910	359,910	-
Communication	-	-	-	263,651	263,651	-
Loans to cooperatives	-	-	-	102,365	102,365	-
Lease receivables	-	-	-	44,668	44,668	-
Total	$ 7,008,561	$ 54,977	$7,063,538	$ 478,130,185	$ 485,193,723	$ -

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

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

As of March 31, 2018, the total recorded investment of troubled debt restructured loans was $575,523, including $149,538 classified as nonaccrual and $425,985 classified as accrual, with no specific allowance for loan loss. As of March 31, 2018, commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring were $2,259 at period end and $34,841 at December 31, 2017.

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

The predominant form of concession granted for troubled debt restructuring includes extensions and/or rearranging of terms. Other types of modifications include extension of the term, principal or accrued interest reductions, interest rate decreases and delayed payments, among others. At times, these terms might be offset with incremental payments, collateral or new borrower guarantees, in which case we assess all of the modified terms to determine if the overall modification qualifies as a troubled debt restructuring.

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

	Loans Modified as TDRs		TDRs in Nonaccrual Status*	
	March 31, 2018	December 31, 2017	March 31, 2018	December 31, 2017
Real estate mortgage	$ 575,523	$ 574,986	$ 149,538	$ 149,306
Production and intermediate term	-	2,397	-	184
Total	$ 575,523	$ 577,383	$ 149,538	$ 149,490

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

Additional impaired loan information is as follows:

	March 31, 2018			December 31, 2017		
	Recorded Investment	**Unpaid Principal Balance[a]**	**Related Allowance**	Recorded Investment	Unpaid Principal Balance[a]	Related Allowance
Impaired loans with a related allowance for credit losses:						
Real estate mortgage	**$ -**	**$ -**	**$ -**	$ -	$ -	$ -
Production and intermediate term	**-**	**-**	**-**	-	-	-
Processing and marketing	**-**	**-**	**-**	-	-	-
Rural residential real estate	**37,596**	**37,596**	**4,669**	38,721	38,721	4,669
Total	**$ 37,596**	**$ 37,596**	**$ 4,669**	$ 38,721	$ 38,721	$ 4,669
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	**$ 851,401**	**$ 852,710**	**$ -**	$ 862,870	$ 864,179	$ -
Production and intermediate term	**5,131**	**757,019**	**-**	2,385	775,055	-
Processing and marketing	**-**	**5,115,441**	**-**	-	-	-
Rural residential real estate	**16,279**	**16,279**	**-**	17,313	17,313	-
Total	**$ 872,811**	**$6,741,449**	**$ -**	$ 882,568	$1,656,547	$ -
Total impaired loans:						
Real estate mortgage	**$ 851,401**	**$ 852,710**	**$ -**	$ 862,870	$ 864,179	$ -
Production and intermediate term	**5,131**	**757,019**	**-**	2,385	775,055	-
Processing and marketing	**-**	**5,115,441**	**-**	-	-	-
Rural residential real estate	**53,875**	**53,875**	**4,669**	56,034	56,034	4,669
Total	**$ 910,407**	**$6,779,045**	**$ 4,669**	$ 921,289	$1,695,268	$ 4,669

[a] Unpaid principal balance represents the recorded principal balance of the loan.

	For the Three Months Ended:			
	March 31, 2018		March 31, 2017	
	Average Impaired Loans	**Interest Income Recognized**	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:				
Real estate mortgage	**$ -**	**$ -**	$ -	$ -
Production and intermediate term	**-**	**-**	-	-
Processing and marketing	**-**	**-**	-	-
Rural residential real estate	**38,040**	**-**	-	-
Total	**$ 38,040**	**$ -**	$ -	$ -
Impaired loans with no related allowance for credit losses:				
Real estate mortgage	**$ 857,180**	**$ 7,445**	$ 3,367,912	$ 36,166
Production and intermediate term	**1,829**	**1,500**	16,266	231
Processing and marketing	**-**	**-**	-	-
Rural residential real estate	**16,739**	**-**	8,261	148
Total	**$ 875,748**	**$ 8,945**	$ 3,392,439	$ 36,545
Total impaired loans:				
Real estate mortgage	**$ 857,180**	**$ 7,445**	$ 3,367,912	$ 36,166
Production and intermediate term	**1,829**	**1,500**	16,266	231
Processing and marketing	**-**	**-**	-	-
Rural residential real estate	**54,779**	**-**	8,261	148
Total	**$ 913,788**	**$ 8,945**	$ 3,392,439	$ 36,545

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

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communications	Water and Waste Water	Rural Residential Real Estate	Lease Receivables	Mission-Related Investments	Total
Allowance for Credit Losses:									
Balance at December 31, 2017	$ 2,429,067	$ 826,461	$1,619,584	$ 4,840	$ -	$ 18,168	$ -	$ 2,744	$ 4,900,864
Charge-offs	-	-	-	-	-	-	-	-	-
Recoveries	-	20,406	-	-	-	-	-		20,406
Provision for loan losses	-	-	-	-	-	-	-	-	-
Other	-	-	-	-	-	-	-	-	-
Balance at March 31, 2018	$ 2,429,067	$ 846,867	$1,619,584	$ 4,840	$ -	$ 18,168	$ -	$ 2,744	$ 4,921,270
Ending Balance:									
Individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ 4,669	$ -	$ -	$ 4,669
Collectively evaluated for impairment	2,429,067	846,867	1,619,584	4,840	-	13,499	-	2,744	4,916,601
Balance at March 31, 2018	$ 2,429,067	$ 846,867	$1,619,584	$ 4,840	$ -	$ 18,168	$ -	$ 2,744	$ 4,921,270
Balance at December 31, 2016	$ 2,328,403	$ 684,237	$1,619,584	$ 4,840	$ -	$ 18,168	$ -	$ -	$ 4,655,232
Charge-offs	-	-	-	-	-	-	-	-	-
Recoveries	2,000	24,697	-	-	-	-	-	-	26,697
Provision for loan losses	-	-	-	-	-	-	-	-	-
Other	-	-	-	-	-	-	-	-	-
Balance at March 31, 2017	$ 2,330,403	$ 708,934	$1,619,584	$ 4,840	$ -	$ 18,168	$ -	$ -	$ 4,681,929
Ending Balance:									
Individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Collectively evaluated for impairment	2,330,403	708,934	1,619,584	4,840	-	18,168	-	-	4,681,929
Balance at March 31, 2017	$ 2,330,403	$ 708,934	$1,619,584	$ 4,840	$ -	$ 18,168	$ -	$ -	$ 4,681,929

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communications	Water and Waste Water	Rural Residential Real Estate	Lease Receivables	Mission-Related Investments	Total
Recorded Investments in Loans Outstanding:									
Ending Balance at March 31, 2018	$419,936,411	$ 14,862,380	$9,463,871	$ -	$ -	$34,058,696	$43,415	$ 156,420	$ 478,521,193
Individually evaluated for impairment	$ 851,401	$ 5,131	$ -	$ -	$ -	$ 16,279	$ -	$ -	$ 872,811
Collectively evaluated for impairment	$419,085,010	$ 14,857,249	$9,463,871	$ -	$ -	$34,042,417	$43,415	$ 156,420	$ 477,648,382
Ending Balance at March 31, 2017	$370,678,894	$ 38,255,468	$3,335,155	$ 289,633	$ 20,682	$28,891,377	$ -	$ -	$ 441,471,209
Individually evaluated for impairment	$ 3,413,688	$ 14,864	$ -	$ -	$ -	$ 22,531	$ -	$ -	$ 3,451,083
Collectively evaluated for impairment	$367,265,206	$ 38,240,604	$3,335,155	$ 289,633	$ 20,682	$28,868,846	$ -	$ -	$ 438,020,126

NOTE 4 — CAPITAL:

The Association's board of directors has established a Capital Adequacy Plan (Plan) that includes the capital targets that are necessary to achieve the institution's capital adequacy goals as well as the minimum permanent capital standards. The Plan monitors projected dividends, equity retirements and other actions that may decrease the Association's permanent capital. In addition to factors that must be considered in meeting the minimum standards, the board of directors also monitors the following factors: capability of management; quality of operating policies, procedures and internal controls; quality and quantity of earnings; asset quality and the adequacy of the allowance for losses to absorb potential loss within the loan and lease portfolios; sufficiency of liquid funds; needs of an institution's customer base; and any other risk-oriented activities, such as funding and interest rate risk, potential obligations under joint and several liability, contingent and off-balance-sheet liabilities, or other conditions warranting additional capital. At least quarterly, management reviews the Association's goals and objectives with the board.

Regulatory Capitalization Requirements

Risk-adjusted:	**Regulatory Minimums**	**Conservation Buffer**	**Total**	**As of March 31, 2018**	**As of December 31, 2017**
Common equity tier 1 ratio	4.50%	2.50%	7.00%	**15.65%**	15.70%
Tier 1 capital ratio	6.00%	2.50%	8.50%	**15.65%**	15.70%
Total capital ratio	8.00%	2.50%	10.50%	**16.75%**	16.79%
Permanent capital ratio	7.00%	0.00%	7.00%	**15.82%**	15.87%
Non-risk-adjusted:					
Tier 1 leverage ratio	4.00%	1.00%	5.00%	**14.89%**	14.92%
UREE leverage ratio	1.50%	0.00%	1.50%	**15.96%**	15.77%

The components of the Association's risk-adjusted capital, based on 90-day average balances, were as follows at March 31, 2018 and December 31, 2017, respectively:

March 31, 2018	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
Numerator:				
Unallocated retained earnings	**$ 76,782,632**	**$ 76,782,632**	**$ 76,782,632**	**$ 76,782,632**
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	**2,323,367**	**2,323,367**	**2,323,367**	**2,323,367**
Allowance for loan losses and reserve for credit losses subject to certain limitations			**5,009,875**	
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	**(7,478,743)**	**(7,478,743)**	**(7,478,743)**	**(7,478,743)**
	$ 71,627,256	**$ 71,627,256**	**$ 76,637,131**	**$ 71,627,256**
Denominator:				
Risk-adjusted assets excluding allowance	**$ 465,120,305**	**$ 465,120,305**	**$ 465,120,305**	**$ 465,120,305**
Regulatory Adjustments and Deductions:				
Regulatory deductions included in total capital	**(7,478,743)**	**(7,478,743)**	**(7,478,743)**	**(7,478,743)**
Allowance for loan losses				**(4,909,875)**
	$ 457,641,562	**$ 457,641,562**	**$ 457,641,562**	**$ 452,731,687**

December 31, 2017	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
Numerator:				
Unallocated retained earnings	$ 76,194,302	$ 76,194,302	$ 76,194,302	$ 76,194,302
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	2,298,379	2,298,379	2,298,379	2,298,379
Allowance for loan losses and reserve for credit losses subject to certain limitations	-	-	5,009,166	-
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	(6,409,089)	(6,409,089)	(6,409,089)	(6,409,089)
	$ 72,083,592	$ 72,083,592	$ 77,092,758	$ 72,083,592
Denominator:				
Risk-adjusted assets excluding allowance	$ 465,625,839	$ 465,625,839	$ 465,625,839	$ 465,625,839
Regulatory Adjustments and Deductions:				
Regulatory deductions included in total capital	(6,409,089)	(6,409,089)	(6,409,089)	(6,409,089)
Allowance for loan losses	-	-	-	(4,890,344)
	$ 459,216,750	$ 459,216,750	$ 459,216,750	$ 454,326,406

*Capped at 1.25% of risk-adjusted assets

The components of the Association's non-risk-adjusted capital, based on 90-day average balances, were as follows at March 31, 2018 and December 31, 2017, respectively:

	March 31, 2018		December 31, 2017	
	Tier 1 leverage ratio	**UREE leverage ratio**	Tier 1 leverage ratio	UREE leverage ratio
Numerator:				
Unallocated retained earnings	**$ 76,782,632**	**$ 76,782,632**	$ 76,194,302	$ 76,194,302
Common Cooperative Equities:				
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	**(7,478,743)**	**-**	(6,409,089)	-
	$ 71,627,256	**$ 76,782,632**	$ 72,083,592	$ 76,194,302
Denominator:				
Total Assets	**$ 488,820,072**	**$ 488,820,072**	$ 489,823,769	$ 489,823,769
Regulatory Adjustments and Deductions:				
Regulatory deductions included in tier 1 capital	**(7,671,218)**	**(7,671,218)**	(6,742,030)	(6,742,030)
	$ 481,148,854	**$ 481,148,854**	$ 483,081,739	$ 483,081,739

An additional component of equity is accumulated other comprehensive income, which is reported as follows:

	March 31, 2018
Nonpension postretirement benefits	**$ (152,516)**
Total	**$ (152,516)**

	March 31, 2017
Nonpension postretirement benefits	$ 71,597
Total	$ 71,597

The Association's accumulated other comprehensive (loss) income relates entirely to its nonpension other postretirement benefits. Amortization of prior service credits and of actuarial (gain) loss are reflected in “Salaries and employee benefits” in the Consolidated Statement of Comprehensive Income. The following table summarizes the changes in accumulated other comprehensive income for the three months ended March 31:

	2018	**2017**
Accumulated other comprehensive (loss) income at January 1	**$(149,812)**	$ 76,116
Amortization of prior service credits included in salaries and employee benefits	**(2,704)**	(4,519)
Other comprehensive loss, net of tax	**(2,704)**	(4,519)
Accumulated other comprehensive (loss) income at March 31	**$(152,516)**	$ 71,597

NOTE 5 — INCOME TAXES:

Heritage Land Bank, ACA conducts its business activities through two wholly-owned subsidiaries. Long-term mortgage lending activities are conducted through a wholly-owned FLCA subsidiary which is exempt from federal and state income tax. Short- and intermediate-term lending activities are conducted through a wholly-owned PCA subsidiary. The PCA subsidiary and the ACA holding company are subject to income tax. Heritage Land Bank, ACA operates as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, Heritage Land Bank, ACA can exclude from taxable income amounts distributed as qualified patronage dividends in the form of cash, stock or allocated retained earnings. Provisions for income taxes are made only on those taxable earnings that will not be distributed as qualified patronage dividends. Deferred taxes are recorded as the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution 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 (more than 50 percent probability), based on management’s estimate, that they will not be realized. As of March 31, 2018 and 2017, the Association carried a deferred tax asset of $9,451,734 and $9,312,650, respectively, with a full valuation allowance recorded against the asset every year.

NOTE 6 — FAIR VALUE MEASUREMENTS:

FASB guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 14 to the 2017 Annual Report to Stockholders for a more complete description.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

March 31, 2018	**Fair Value Measurement Using**			**Total Fair**
	Level 1	**Level 2**	**Level 3**	**Value**
Assets:				
Assets held in nonqualified benefit trusts	**$ 24,916**	**$ -**	**$ -**	**$ 24,916**
Total assets	**$ 24,916**	**$ -**	**$ -**	**$ 24,916**

December 31, 2017	Fair Value Measurement Using			Total Fair
	Level 1	Level 2	Level 3	Value
Assets:				
Assets held in nonqualified benefit trusts	$ -	$ -	$ -	$ -
Total assets	$ -	$ -	$ -	$ -

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

March 31, 2018	**Fair Value Measurement Using**			**Total Fair Value**
	Level 1	**Level 2**	**Level 3**	
Assets:				
Loans*	**$ -**	**$ -**	**$ 35,705**	**$ 35,705**
Other property owned	**-**	**-**	**1,867,347**	**1,867,347**

December 31, 2017	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Loans*	$ -	$ -	$ 34,052	$ 34,052
Other property owned	-	-	1,867,347	1,867,347

*Represents the fair value of certain loans that were evaluated for impairment under authoritative guidance "Accounting by Creditors for Impairment of a Loan." The fair value was based upon the underlying collateral since these were collateral-dependent loans for which real estate is the collateral.

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

Sensitivity to Changes in Significant Unobservable Inputs

For recurring fair value measurements categorized within Level 3 of the fair value hierarchy, the significant unobservable inputs used in the fair value measurement of the mortgage-backed securities are prepayment rates, probability of default, and loss severity in the event of default. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement.

Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for the loss severity and a directionally opposite change in the assumption used for prepayment rates.

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

Valuation Techniques

As more fully discussed in Note 14 to the 2017 Annual Report to Stockholders, authoritative 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. The following represent a brief summary of the valuation techniques used for the Association's assets and liabilities. For a more complete description, see Notes to the 2017 Annual Report to Stockholders.

Investment Securities

Where quoted prices are available in an active market, available-for-sale securities are classified as Level 1. If quoted prices are not available in an active market, the fair value of securities is estimated using quoted prices for similar securities received from pricing services, pricing models that utilize observable inputs, or discounted cash. Generally, these securities are classified as Level 2. This would include U.S. Treasury, U.S. agency, and certain mortgage-backed securities. Where there is limited activity or less transparency around inputs to the valuation, the securities are classified as Level 3. Securities classified within

Level 3 include asset-backed securities and certain mortgage-backed securities, including private label-FHA/VA securities and those issued by Farmer Mac.

Assets Held in Nonqualified Benefits Trusts

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

Loans Evaluated for Impairment

For certain loans evaluated for impairment under FASB impairment guidance, the fair value is based upon the underlying real estate collateral since the loans were collateral-dependent. 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, a majority of these loans have fair value measurements that fall within Level 3 of the fair value 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 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 the other property owned involves the use of independent appraisals and other market-based information. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. As a result, these fair value measurements fall within Level 3 of the hierarchy.

Loans

Fair value is estimated by discounting the expected future cash flows using the Associations' current interest rates at which similar loans would be made to borrowers with similar credit risk. The discount rates are based on the Associations' current loan origination rates as well as management's estimates of credit risk. Management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale and could be less.

For purposes of estimating fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics. Expected future cash flows, primarily based on contractual terms, and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

The fair value of loans in nonaccrual status that are current as to principal and interest is estimated as described above, with appropriately higher interest rates which reflect the uncertainty of continued cash flows. For collateral-dependent impaired loans, it is assumed that collection will result only from the disposition of the underlying collateral.

NOTE 7 — EMPLOYEE BENEFIT PLANS:

The following table summarizes the components of net periodic benefit costs of nonpension other postretirement employee benefits for the three months ended March 31:

	Other Benefits	
	2018	2017
Service cost	**$ 5,394**	$ 5,022
Interest cost	**13,272**	12,573
Expected return on plan assets	**-**	-
Amortization of prior service credits	**(3,388)**	(4,519)
Amortization of net actuarial loss	**684**	-
Net periodic benefit cost	**$ 15,962**	$ 13,076

The Association's liability for the unfunded accumulated obligation for these benefits at March 31, 2018, was $1,356,054 and is included in "Other Liabilities" in the balance sheet.

The structure of the District's defined benefit pension plan is characterized as multiemployer since the assets, liabilities, and cost of the plan are not segregated or separately accounted for by participating employers (banks and associations). The Association recognizes its amortized annual contributions to the plan as an expense. The Association previously disclosed in its financial statements for the year ended December 31, 2017, that it expected to contribute $52,305 to the District's defined benefit pension plan in 2017. As of March 31, 2018, $15,962 contributions have been made. The Association presently anticipates contributing an additional $47,884 to fund the defined benefit pension plan in 2017 for a total of $63,846.

NOTE 8 — COMMITMENTS AND CONTINGENT LIABILITIES:

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

NOTE 9 — SUBSEQUENT EVENTS:

The Association has evaluated subsequent events through May 4, 2018, which is the date the financial statements were issued. There are no other significant events requiring disclosure as of May 4, 2018.