

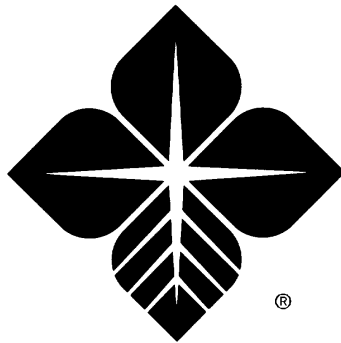
**HERITAGE LAND BANK, ACA**

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**2017  
Quarterly Report  
First Quarter**



**For the Quarter Ended March 31, 2017**



## 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 8, 2017



Roger Claxton, Chairman, Board of Directors  
May 8, 2017



Adena K. Nichols, Chief Financial Officer  
May 8, 2017

**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, 2017. These comments should be read in conjunction with the accompanying financial statements and the 2016 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 is celebrating its 100th anniversary in 2017. There are no other significant events to disclose.

**Loan Portfolio:**

Total loans outstanding at March 31, 2017, including nonaccrual loans, were \$439.1 million compared to \$416.1 million at December 31, 2016, reflecting increase of 5.5 percent. Nonaccrual loans as a percentage of total loans outstanding were 0.2 percent at March 31, 2017, compared to 0.2 percent at December 31, 2016.

The Association recorded \$25 thousand in recoveries and no charge-offs for the quarter ended March 31, 2017, and \$177 thousand in recoveries and no charge-offs for the same period in 2016. The Association's allowance for loan losses was 1.1 percent and 1.1 percent of total loans outstanding as of March 31, 2017, and December 31, 2016, respectively.

**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, 2017		December 31, 2016	
	Amount	%	Amount	%
Nonaccrual	\$ 1,097,563	20.5%	\$ 1,164,302	29.2%
90 days past due and still accruing interest	1,815,661	33.9%	-	0.0%
Formally restructured	564,541	10.5%	582,007	14.6%
Other property owned, net	1,885,472	35.1%	2,235,472	56.2%
Total	\$ 5,363,237	100.0%	\$ 3,981,781	100.0%

## Results of Operations:

The Association had net income of \$1.3 million for the three months ended March 31, 2017, as compared to net income of \$1.4 million for the same period in 2016 due to loss on sale of acquired property in March 2017. Net interest income was \$2.9 million for the three months ended March 31, 2017, compared to \$2.9 million for the same period in 2016.

	Three months ended:			
	March 31, 2017		December 31, 2016	
	Average Balance	Interest	Average Balance	Interest
Loans	\$ 427,754,550	\$ 4,962,317	\$ 376,899,535	\$ 4,533,088
Investments	404,352	4,846	601,794	6,486
Total interest-earning assets	428,158,902	4,967,163	377,501,329	4,539,574
Interest-bearing liabilities	357,299,786	2,040,230	308,120,967	1,681,785
Impact of capital	\$ 70,859,116		\$ 69,380,362	
Net interest income		<u>\$ 2,926,933</u>		<u>\$ 2,857,789</u>
	2017		2016	
	<u>Average Yield</u>		<u>Average Yield</u>	
Yield on loans	4.70%		4.84%	
Yield on investments	4.86%		4.33%	
Total yield on interest-earning assets	4.70%		4.84%	
Cost of interest-bearing liabilities	2.32%		2.20%	
Interest rate spread	2.39%		2.64%	
Net interest income as a percentage of average earning assets	2.77%		3.04%	

	Three months ended: March 31, 2017 vs. March 31, 2016		
	Increase (decrease) due to		
	Volume	Rate	Total
Interest income - loans	\$ 606,590	\$ (177,361)	\$ 429,229
Interest income - investments	(2,110)	470	(1,640)
Total interest income	604,480	(176,891)	427,589
Interest expense	266,208	92,237	358,445
Net interest income	<u>\$ 338,272</u>	<u>\$ (269,128)</u>	<u>\$ 69,144</u>

Interest income for the three and three months ended March 31, 2017, increased by \$427 thousand, or 9.5 percent, from the same period of 2016, primarily due to increases in average loan volume. Interest expense for the three months ended March 31, 2017, increased by \$358 thousand, or 21.3 percent, from the same period of 2016 due to an increase in interest rates and average debt volume. Average loan volume for the first quarter of 2017 was \$427.8 million compared to \$376.9 million in the first quarter of 2016. The average net interest rate spread on the loan portfolio for the first quarter of 2017 was 2.39 percent, compared to 2.64 percent in the first quarter of 2016.

The Association's return on average assets for the three months ended March 31, 2017, was 1.20 percent compared to 1.46 percent for the same period in 2016. The Association's return on average equity for the three months ended March 31, 2017, was 6.93 percent, compared to 7.74 percent for the same period in 2016.

## Liquidity and Funding Sources:

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

	<b>March 31, 2017</b>	<b>December 31, 2016</b>
Note payable to the bank	\$ <b>370,417,966</b>	\$ 345,169,821
Accrued interest on note payable	<b>720,856</b>	663,466
Total	<b>\$ 371,138,822</b>	<b>\$ 345,833,287</b>

## Capital Resources:

The Association's capital position increased by \$582 thousand at March 31, 2017, compared to December 31, 2016. The Association's debt as a percentage of members' equity was 4.98:1 as of March 31, 2017, compared to 4.68:1 as of December 31, 2016. 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 remains in effect, with some modifications to align with the new regulations.

## Significant Recent Accounting Pronouncements:

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

In June 2016, the FASB issued guidance entitled "Measurement of Credit Losses on Financial Instruments." The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses. For public business entities that are not U.S. Securities and Exchange Commission filers this guidance becomes effective for interim and annual periods beginning after December 15, 2020, with early application permitted. The Association is currently 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 currently 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 becomes effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance is not expected to impact the Association's financial condition or its results of operations.

In August 2014, the FASB issued guidance entitled "Presentation of Financial Statements — Going Concern." The guidance governs management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. This guidance requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year after the date the financial statements are issued or within one year after the financial statements are available to be issued, when applicable. Substantial doubt exists if it is probable that the entity will be unable to meet its obligations for the assessed period. This guidance becomes effective for interim and annual periods ending after December 15, 2016, and early application is permitted. Management will be required to make its initial assessment as of December 31, 2016. The Association is currently evaluating a potential disclosure for this recent accounting pronouncement.

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 is in the process of reviewing contracts to determine the effect, if any, on their financial condition or results of operations.

**Regulatory Matters:**

On March 10, 2016, the Farm Credit Administration approved a final rule to modify the regulatory capital requirements for System Banks and Associations. The stated objectives of the proposed rule are as follows:

- To modernize capital requirements while ensuring that the institutions continue to hold sufficient regulatory capital to fulfill their 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 the requirements of section 939A of the Dodd-Frank Act.

The final rule is effective on January 1, 2017. The association is in compliance with the required minimum capital standards as of March 31, 2017. [

**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 2016 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 [fcf@farmcreditBank.com](mailto:fcf@farmcreditBank.com). The annual and quarterly stockholder reports for the Bank and the District are also available on its website at [www.farmcreditBank.com](http://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, TX 75703 or calling (903) 534-4975. The annual and quarterly stockholder reports for the Association are also available on its website at [www.heritagelandbank.com](http://www.heritagelandbank.com).

**HERITAGELAND BANK, ACA**

**CONSOLIDATED BALANCE SHEET**

	<b>March 31, 2017 (unaudited)</b>	<b>December 31, 2016</b>
<b><u>ASSETS</u></b>		
Cash	\$ 3,285,545	\$ 256,735
Investments	398,161	423,564
Loans	439,140,209	416,165,557
Less: allowance for loan losses	4,679,928	4,655,232
Net loans	<u>434,460,281</u>	<u>411,510,325</u>
Accrued interest receivable	2,331,000	2,022,783
Investment in and receivable from the Farm Credit Bank of Texas:		
Capital stock	6,396,505	6,396,505
Other	566,248	491,673
Deferred taxes, net	-	-
Other property owned, net	1,885,472	2,235,472
Premises and equipment, net	3,129,486	3,166,643
Other assets	331,281	295,679
Total assets	<u><u>\$ 452,783,979</u></u>	<u><u>\$ 426,799,379</u></u>
<b><u>LIABILITIES</u></b>		
Note payable to the Farm Credit Bank of Texas	\$ 370,417,966	\$ 345,169,821
Advance conditional payments	-	-
Accrued interest payable	720,856	663,466
Drafts outstanding	128,391	13,888
Dividends payable	738,700	2,749,838
Patronage distributions payable	-	-
Deferred taxes, net	-	-
Other liabilities	5,067,738	3,074,441
Total liabilities	<u><u>377,073,651</u></u>	<u><u>351,671,454</u></u>
<b><u>MEMBERS' EQUITY</u></b>		
Capital stock and participation certificates	2,149,870	2,110,740
Preferred Stock Issued	-	-
Additional paid-in capital	-	-
Allocated retained earnings	-	-
Unallocated retained earnings	73,488,861	72,941,069
Accumulated other comprehensive income (loss)	71,597	76,116
Total members' equity	<u><u>75,710,328</u></u>	<u><u>75,127,925</u></u>
Total liabilities and members' equity	<u><u>\$ 452,783,979</u></u>	<u><u>\$ 426,799,379</u></u>

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

HERITAGELAND BANK, ACA

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

	Quarter and Year Ended	
	March 31,	
	2017	2016
<b><u>INTEREST INCOME</u></b>		
Loans	\$ 4,962,317	\$ 4,533,088
Investments	4,846	6,486
Other	-	-
Total interest income	<u>4,967,163</u>	<u>4,539,574</u>
<b><u>INTEREST EXPENSE</u></b>		
Note payable to the Farm Credit Bank of Texas	2,040,230	1,681,785
Advance conditional payments	-	-
Total interest expense	<u>2,040,230</u>	<u>1,681,785</u>
Net interest income	<u>2,926,933</u>	<u>2,857,789</u>
<b><u>PROVISION FOR LOAN LOSSES</u></b>		
	-	-
Net interest income after provision for loan losses	<u>2,926,933</u>	<u>2,857,789</u>
<b><u>NONINTEREST INCOME</u></b>		
Income from the Farm Credit Bank of Texas:		
Patronage income	662,783	472,495
Loan fees	13,539	16,510
Refunds from Farm Credit System		
Insurance Corporation	-	-
Financially related services income	525	569
Gain (loss) on other property owned, net	(133,224)	31,307
Gain (loss) on sale of premises and equipment, net	-	-
Other noninterest income	29,578	22,973
Impairment losses on investments		
Total other-than-temporary impairment losses	-	-
Less: portion of loss recognized in other comprehensive income	-	-
Net impairment loss recognized in earnings	-	-
Total noninterest income	<u>573,201</u>	<u>543,854</u>
<b><u>NONINTEREST EXPENSES</u></b>		
Salaries and employee benefits	1,252,511	1,048,161
Directors' expense	84,655	64,386
Purchased services	76,757	160,367
Travel	62,596	60,285
Occupancy and equipment	190,654	150,879
Communications	38,056	33,233
Advertising	172,517	151,737
Public and member relations	118,162	133,546
Supervisory and exam expense	38,500	31,804
Insurance Fund premiums	121,376	113,235
Merger-implementation and restructuring costs	-	-
Other noninterest expense	50,433	56,414
Total noninterest expenses	<u>2,206,217</u>	<u>2,004,047</u>
Income before income taxes	<u>1,293,917</u>	<u>1,397,596</u>
Provision for (benefit from) income taxes	-	-
<b>NET INCOME</b>	<u>1,293,917</u>	<u>1,397,596</u>
Other comprehensive income:		
Change in postretirement benefit plans	(4,519)	(4,519)
Income tax expense related to items of other comprehensive income	-	-
Other comprehensive income, net of tax	<u>(4,519)</u>	<u>(4,519)</u>
<b>COMPREHENSIVE INCOME</b>	<u>\$ 1,289,398</u>	<u>\$ 1,393,077</u>



HERITAGE LAND BANK, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY  
(unaudited)

	<u>Capital Stock/ Participation Certificates</u>	<u>Retained Earnings Unallocated</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Members' Equity</u>
Balance at December 31, 2015	\$ 1,946,435	\$ 70,088,120	\$ 71,511	\$ 72,106,066
Comprehensive income	-	1,397,588	(4,519)	1,393,069
Preferred Stock Issued				
Capital stock/participation certificates and allocated retained earnings issued	74,985	-	-	74,985
Preferred Stock retired				
Capital stock/participation certificates and allocated retained earnings retired	(58,925)	-	-	(58,925)
Patronage Distributions Declared	-	(643,000)	-	(643,000)
Balance at March 31, 2016	<u>\$ 1,962,495</u>	<u>\$ 70,842,708</u>	<u>\$ 66,992</u>	<u>\$ 72,872,195</u>
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
Preferred Stock Issued				
Capital stock/participation certificates and allocated retained earnings issued	119,035	-	-	119,035
Preferred Stock retired				
Capital stock/participation certificates and allocated retained earnings retired	(79,905)	-	-	(79,905)
Patronage Distributions Declared	-	(746,125)	-	(746,125)
<b>Balance at March 31, 2017</b>	<b><u>\$ 2,149,870</u></b>	<b><u>\$ 73,488,861</u></b>	<b><u>\$ 71,597</u></b>	<b><u>\$ 75,710,328</u></b>

The accompanying notes are an integral part of these combined 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 counties of 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 (the System), which was established by Acts of Congress to meet the needs of American agriculture.

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

In June 2016, 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 currently 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 currently 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 is not expected to impact the Association’s financial condition or its results of operations.

In May 2014, the FASB issued guidance entitled, “Revenue from Contracts with Customers.” The guidance governs revenue recognition from contracts with customers and requires an entity to recognize revenue to depict the transfer of promised goods or

services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Financial instruments and other contractual rights within the scope of other guidance issued by the FASB are excluded from the scope of this new revenue recognition guidance. In this regard, a majority of our contracts would be excluded from the scope of this new guidance. In August 2015, the FASB issued an update that defers this guidance by one year, which results in the new revenue standard becoming effective for interim and annual reporting periods beginning after December 15, 2017. The Association is in the process of reviewing contracts to determine the effect, if any, on their financial condition or results of operations.

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, 2017, 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:

	<b>March 31, 2017</b>					
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>		<b>Weighted Average Yield</b>
Agricultural mortgage-backed securities	\$ 398	\$ 2	\$ -	\$ 400		4.80 %

	<b>December 31, 2016</b>					
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>		<b>Weighted Average Yield</b>
Agricultural mortgage-backed securities	\$ 424	\$ 2	\$ -	\$ 426		4.27 %

### NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES:

A summary of loans follows:

Loan Type	March 31, 2017 Amount	December 31, 2016 Amount
Production agriculture:		
Real estate mortgage	\$ 387,724	\$ 368,565
Production and intermediate term	18,966	18,247
Agribusiness:		
Loans to cooperatives	2	2
Processing and marketing	2,368	-
Farm-related business	896	920
Communication	288	297
Energy	-	-
Water and waste water	21	21
Rural residential real estate	28,829	28,054
Agricultural export finance	-	-
Lease receivables	-	-
Mission-related investments	60	60
Total	\$ 439,154	\$ 416,166

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, 2017:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	\$ 424	\$ 75,353	\$ -	\$ -	\$ 424	\$ 75,353
Agribusiness	-	1,285	-	-	-	1,285
Communication	288	-	-	-	288	-
Total	\$ 712	\$ 76,638	\$ -	\$ -	\$ 712	\$ 76,638

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

	<b>March 31, 2017</b>	December 31, 2016
<b>Nonaccrual loans:</b>		
Real estate mortgage	\$ 1,075	\$ 1,164
Rural residential real estate	<u>23</u>	<u>-</u>
Total nonaccrual loans	<b>1,098</b>	1,164
<b>Accruing restructured loans:</b>		
Real estate mortgage	550	552
Production and intermediate term	15	30
Total accruing restructured loans	<b>565</b>	582
<b>Accruing loans 90 days or more past due:</b>		
Real estate mortgage	<u>1,816</u>	<u>-</u>
Total accruing loans 90 days or more past due	<b>1,816</b>	-
Total nonperforming loans	<b>3,479</b>	1,746
Other property owned	<u>1,885</u>	<u>2,235</u>
Total nonperforming assets	<b>\$ 5,364</b>	<b>\$ 3,981</b>

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:

	<b>March 31, 2017</b>	December 31, 2016
Real estate mortgage		
Acceptable	97.5 %	97.4 %
OAEM	0.2	0.6
Substandard/doubtful	2.3	2.0
	<b>100.0</b>	100.0
Production and intermediate term		
Acceptable	99.1	99.1
OAEM	-	-
Substandard/doubtful	0.9	0.9
	<b>100.0</b>	100.0
Agribusiness		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	<b>100.0</b>	100.0
Energy and water/waste water		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	<b>100.0</b>	100.0
Communication		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	<b>100.0</b>	100.0
Rural residential real estate - nonfarmer		
Acceptable	99.8	99.3
OAEM	-	-
Substandard/doubtful	0.2	0.7
	<b>100.0</b>	100.0
Mission-related investments		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	<b>100.0</b>	100.0
Total loans		
Acceptable	97.7	97.6
OAEM	0.1	0.5
Substandard/doubtful	2.2	1.9
	<b>100.0 %</b>	<b>100.0 %</b>

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

March 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	\$ 1,756	\$ 2,433	\$ 4,189	\$ 383,691	\$ 387,880	\$ -
Production and intermediate term	18	-	18	19,267	19,285	-
Loans to cooperatives	-	-	-	2	2	-
Processing and marketing	-	-	-	2,374	2,374	-
Farm-related business	-	-	-	899	899	-
Communication	-	-	-	290	290	-
Energy	-	-	-	-	-	-
Water and waste water	-	-	-	21	21	-
Rural residential real estate	40	23	63	28,829	28,892	-
Mission-related investments	-	-	-	60	60	-
Total	\$ 1,814	\$ 2,456	\$ 4,270	\$ 435,433	\$ 439,703	\$ -
December 31, 2016	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans	Recorded Investment >90 Days and Accruing
Real estate mortgage	\$ 1,428	\$ 402	\$ 1,830	\$ 367,354	\$ 369,184	\$ -
Production and intermediate term	19	-	19	18,477	18,496	-
Loans to cooperatives	-	-	-	4	4	-
Processing and marketing	-	-	-	-	-	-
Farm-related business	-	-	-	934	934	-
Communication	-	-	-	298	298	-
Water and waste water	-	-	-	21	21	-
Rural residential real estate	77	-	77	28,038	28,115	-
Mission-related investments	-	-	-	60	60	-
Total	\$ 1,524	\$ 402	\$ 1,926	\$ 415,186	\$ 417,112	\$ -

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, 2017, the total recorded investment of troubled debt restructured loans was \$629 thousand, including \$64 thousand classified as nonaccrual and \$565 thousand classified as accrual. There was no specific allowance for loan losses recorded for troubled debt restructured loans. As of March 31, 2017, there were no commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring.

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). Charge-offs recorded at the modification date were \$0 for the quarter ending March 31, 2017.

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, 2017	December 31, 2016	March 31, 2017	December 31, 2016
Real estate mortgage	\$ 614	\$ 617	\$ -	\$ -
Production and intermediate term	15	30	-	-
Total	\$ 629	\$ 647	\$ -	\$ -

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

Additional impaired loan information is as follows:

	March 31, 2017			December 31, 2016		
	Recorded Investment	Unpaid Principal Balance <sup>a</sup>	Related Allowance	Recorded Investment	Unpaid Principal Balance <sup>a</sup>	Related Allowance
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	\$ 3,441	\$ 3,511	\$ -	\$ 1,715	\$ 1,812	\$ -
Production and intermediate term	15	857	-	29	894	-
Processing and marketing	-	-	-	-	5,115	-
Rural residential real estate	23	23	-	-	-	-
Total	\$ 3,479	\$ 4,391	\$ -	\$ 1,744	\$ 7,821	\$ -
Total impaired loans:						
Real estate mortgage	\$ 3,441	\$ 3,511	\$ -	\$ 1,715	\$ 1,812	\$ -
Production and intermediate term	15	857	-	29	894	-
Processing and marketing	-	-	-	-	5,115	-
Rural residential real estate	23	23	-	-	-	-
Total	\$ 3,479	\$ 4,391	\$ -	\$ 1,744	\$ 7,821	\$ -

<sup>a</sup> Unpaid principal balance represents the recorded principal balance of the loan.

	For the Quarter & Year Ended March 31, 2017		For the Quarter & Year Ended March 31, 2016	
	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized
Impaired loans with no related allowance for credit losses:				
Real estate mortgage	\$ 3,368	\$ 37	\$ 3,070	\$ 15
Production and intermediate term	16	-	71	1
Rural residential real estate	8	-	4	-
Total	\$ 3,392	\$ 37	\$ 3,145	\$ 16
Total impaired loans:				
Real estate mortgage	\$ -	\$ -	\$ 3,070	\$ 15
Production and intermediate term	-	-	71	1
Agricultural export finance	-	-	4	-
Total	\$ -	\$ -	\$ 3,145	\$ 16



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	Energy and Water/Waste Water	Rural Residential Real Estate	Mission- Related Investments	Total
<b>Allowance for Credit Losses:</b>								
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	-	-	-	-	-	-	-	-
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
Balance at								
December 31, 2015	\$ 2,255,947	\$ 630,071	\$ 1,153,673	\$ 4,840	\$ -	\$ 18,168	\$ -	\$ 4,062,699
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-	-
Other Reserve/Unfunded Com	-	-	-	-	-	-	-	-
Provision for loan losses	-	-	-	-	-	-	-	-
Balance at								
March 31, 2016	\$ 2,255,947	\$ 630,071	\$ 1,153,673	\$ 4,840	\$ -	\$ 18,168	\$ -	\$ 4,062,699
Ending Balance:								
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	2,255,947	630,071	1,153,673	4,840	-	18,168	-	4,062,699
Balance at								
March 31, 2016	\$ 2,255,947	\$ 630,071	\$ 1,153,673	\$ 4,840	\$ -	\$ 18,168	\$ -	\$ 4,062,699
<b>Recorded Investments in Loans Outstanding:</b>								
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
Ending Balance at								
March 31, 2016	\$ 316,634,573	\$ 25,113,553	\$ 937,528	\$ 319,540	\$ -	\$ 35,674,675	\$ -	\$ 378,679,869
Individually evaluated for impairment	\$ 3,616,029	\$ 69,920	\$ -	\$ -	\$ -	\$ 3,236	\$ -	\$ 3,689,185
Collectively evaluated for impairment	\$ 313,018,543	\$ 25,043,633	\$ 937,528	\$ 319,540	\$ -	\$ 35,671,440	\$ -	\$ 374,990,684

## 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

Effective January 1, 2017, the regulatory capital requirements for System Banks and Associations were modified. The new regulations replaced existing 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 a tier 1 leverage ratio and an unallocated retained earnings equivalents (UREE) leverage ratio. The permanent capital ratio continues to remain in effect.

		Select Capital Ratios			
		A	B	C	D
		Regulatory	Capital		As of
		Minimums	Conservation	Total	31-Mar-17
			Buffer		
01	Risk-adjusted:				
01[a]	Common equity tier 1 ratio	4.50%	2.50%	7.00%	16.78%
01[b]	Tier 1 capital ratio	6.00%	2.50%	8.50%	16.78%
01[c]	Total capital ratio	8.00%	2.50%	10.50%	16.84%
01[d]	Permanent capital ratio	7.00%	0.00%	7.00%	16.97%
02	Non-risk-adjusted:				
02[a]	Tier 1 leverage ratio	4.00%	1.00%	5.00%	16.01%
02[b]	UREE leverage ratio	1.50%	0.00%	1.50%	17.00%

\*The 2.5% capital conservation buffer for the risk-adjusted ratios will be phased in over a three year period ending on December 31, 2019.

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

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

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

The ratios are based on a three-month average daily balance in accordance with FCA regulations and are calculated as follows:

Common equity tier 1 ratio is statutory minimum purchased borrower stock, other required borrower stock held for a minimum of 7 years, allocated equities held for a minimum of 7 years or not subject to revolvment, unallocated retained earnings, paid-in capital, less certain regulatory required deductions including the amount of allocated investments in other System institutions, and the amount of purchased investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.

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

If the capital ratios fall below the minimum regulatory requirements, including the capital conservation and leverage buffer amounts, capital distributions (equity redemptions, dividends, and patronage) and discretionary bonus payments to senior offices are restricted or prohibited without prior FCA approval.

	Risk-adjusted Capital Ratios			
	A Common Equity Tier 1 ratio	B Tier 1 Capital Ratio	C Total Capital Ratio	D Permanent Capital Ratio
<b>Numerator:</b>				
Unallocated retained earnings	73,558,490	73,558,490	73,558,490	73,558,490
Paid-in capital	-	-	-	-
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	2,125,830	2,125,830	2,125,830	2,125,830
Other required member purchased stock held <5 years				
Other required member purchased stock held ≥ 5 years but < 7 years				
Other required member purchased stock held ≥7 years				
Allocated equities:				
Allocated equities held <5 years				
Allocated equities held ≥5 years but < 7 years				
Allocated equities held ≥7	-	-	-	-
Nonqualified allocated equities not subject to retirement	-	-	-	-
Non-cumulative perpetual preferred stock		-	-	-
Other preferred stock subject to certain limitations				
Subordinated debt subject to certain limitation				
Allowance for loan losses and reserve for credit losses subject to certain limitations			225,010	
<b>Regulatory Adjustments and Deductions:</b>				
Amount of allocated investments in other System institutions	(6,396,505)	(6,396,505)	(6,396,505)	(6,396,505)
Other regulatory required deductions	-	-	-	-
<b>Denominator:</b>				
Risk-adjusted assets excluding allowance	427,954,211	421,557,706	421,557,706	414,612,040
<b>Regulatory Adjustments and Deductions:</b>				
Regulatory deductions included in total capital	(6,396,505)	-	-	(6,396,505)
Allowance for loan losses				103,987

	Capital Ratio - no risk adjustment	
	A Tier 1 leverage ratio	B UREE leverage ratio
Numerator:		
Unallocated retained earnings	73,558,490	73,558,490
Paid-in capital	-	-
Common Cooperative Equities:		
Statutory minimum purchased borrower stock	2,125,830	-
Other required member purchased stock held <5 years		
Other required member purchased stock held ≥ 5 years but < 7 years		
Other required member purchased stock held ≥7 years		
Allocated equities:		
Allocated equities held ≥7	-	-
Nonqualified allocated equities not subject to retirement	-	-
Non-cumulative perpetual preferred stock	-	-
Other preferred stock subject to certain limitations		
Subordinated debt subject to certain limitation		
Allowance for loan losses and reserve for credit losses subject to certain limitations		
Regulatory Adjustments and Deductions:		
Amount of allocated investments in other System institutions	(6,396,505)	-
Other regulatory required deductions	-	-
Denominator:		
Total Assets	438,784,340	438,784,340
Regulatory Adjustments and Deductions:		
Regulatory deductions included in tier 1 capital	(6,396,505)	-

There were no significant changes to capital nor any significant capitalization bylaw changes during the quarter ended March 31, 2017. Heritage Land Bank is not aware of any noncompliance with FCA capital regulations.

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

<b>Accum Other Comp Income (Loss)</b>	
<b>March 31, 2017</b>	<b>Before Tax</b>
<b>Nonpension postretirement benefits</b>	<b>\$ 71</b>
<b>Total</b>	<b>\$ 71</b>
March 31, 2016	Before Tax
Nonpension postretirement benefits	\$ 67
Total	\$ 67

The Association's accumulated other comprehensive income (loss) relates entirely to its nonpension other postretirement benefits. Amortization of prior service (credits) cost 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 (loss) for the three months ended March 31:

	<u>2017</u>	<u>2016</u>
Accumulated other comprehensive income (loss) at January 1	\$ 76	\$ 72
Amortization of prior service (credit) costs included		
in salaries and employee benefits	(5)	(5)
Other comprehensive income (loss), net of tax	<u>(5)</u>	<u>(5)</u>
Accumulated other comprehensive income at March 31	<u>\$ 71</u>	<u>\$ 67</u>

#### 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 at 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, 2017 and 2016, the Association carried a deferred tax asset of \$9.3 million and \$8.6 million, respectively, with a full valuation allowance recorded against the asset each 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 2 to the 2016 Annual Report to Stockholders for a more complete description.

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

<u>March 31, 2017</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Assets held in nonqualified benefit trusts	17	-	-	17
Total assets	<u>17</u>	<u>-</u>	<u>-</u>	<u>17</u>

<u>December 31, 2016</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Assets held in nonqualified benefit trusts	\$ 16	-	-	16
Total assets	<u>16</u>	<u>-</u>	<u>-</u>	<u>16</u>

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

<u>March 31, 2017</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Loans*	\$ -	\$ -	\$ -	\$ -
Other property owned	-	-	1,885	1,885
<u>December 31, 2016</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Loans*	\$ -	\$ -	\$ -	\$ -
Other property owned	-	-	2,235	2,235

\*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.

### **Valuation Techniques**

As more fully discussed in Note 2 to the 2016 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 2016 Annual Report to Stockholders.

#### *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.

**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:

Three months ended March 31 :

	Other Benefits	
	2017	2016
Service cost	\$ 5	\$ 7
Interest cost	13	13
Expected return on plan assets	-	-
Amortization of prior service (credits) costs	(5)	(5)
Net periodic benefit cost	<u>\$ 13</u>	<u>\$ 15</u>

The Association’s liability for the unfunded accumulated obligation for these benefits at March 31, 2017, was \$1.1 million 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 (Bank and Associations). The Association recognizes its amortized annual contributions to the plan as an expense. As of March 31, 2017, \$10 thousand of contributions have been made. The Association presently anticipates contributing an additional \$40 thousand to fund the defined benefit pension plan in 2017 for a total of \$50 thousand.

**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 8, 2017, which is the date the financial statements were issued. There are no other significant events requiring disclosure as of May 8, 2017