**Quarterly Report**
**September 30, 2018**

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the consolidated financial condition and consolidated results of operations of Compeer Financial, ACA and its subsidiaries Compeer Financial, FLCA and Compeer Financial, PCA. This discussion should be read in conjunction with both the unaudited consolidated financial information and related notes included in this Quarterly Report as well as Management's Discussion and Analysis included in our Annual Report for the year ended December 31, 2017 (2017 Annual Report).

Due to the nature of our financial relationship with AgriBank, FCB (AgriBank), the financial condition and results of operations of AgriBank materially impact our stockholders' investment. To request free copies of the AgriBank or the AgriBank District financial reports or additional copies of our report, contact us at:


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## MERGER ACTIVITY

The merger between 1st Farm Credit Services, ACA (1st FCS), AgStar Financial Services, ACA (AgStar), and Badgerland Financial, ACA (Badgerland) – and each of the entities' production credit and federal land credit affiliates – was effective July 1, 2017. 1st FCS and Badgerland were merged into AgStar. The merged entity was renamed Compeer Financial, ACA and is headquartered in Sun Prairie, Wisconsin. The effects of the merger are included in our financial position at September 30, 2018, and December 31, 2017. Results of operations and equity reflect the results of AgStar prior to July 1, 2017, and the merged Association after July 1, 2017.

## FORWARD-LOOKING INFORMATION

Any forward-looking statements in this Quarterly Report are based on current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from expectations due to a number of risks and uncertainties. More information about these risks and uncertainties is contained in our 2017 Annual Report. We undertake no duty to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

## AGRICULTURAL AND ECONOMIC CONDITIONS

Economic and agricultural conditions evolved through the third quarter of 2018, and markets continue to adjust to international trade developments. The credit portfolio includes several diverse sectors in production agriculture with primary industries of grain, dairy, and swine production. Additionally, rural housing, energy, and food processing and distribution comprise significant portfolio segments. Profitability prospects among clients remain challenging in many segments, particularly within production agriculture. Production agriculture profitability varied widely, depending upon commodity produced and impact of geopolitical factors. However, overall Compeer credit quality remained stable.

The United States Department of Agriculture (USDA) projects net farm income for 2018 at $65.7 billion, a $9.8 billion, or 13% decrease from 2017. If realized, the forecasted decrease for 2018 would be below the 10-year average net farm income of $85.0 billion. The 10-year average includes a notably robust period during 2011 through 2014 when prices for many major commodities attained record or near-record highs. While below the levels in 2017, the 2018 forecast remains above the 2016 level in inflation adjusted dollars, and does not include any payments under the trade aid package announced by the USDA in July 2018. Net cash income is also projected down for 2018, but at a significantly higher level, $91.5 billion, which supports loan repayment. In spite of the lower farm income outlook, farm wealth is projected up 1.2% from 2017 to $3.0 trillion. Farm asset values reflect farm investors' and lenders' expectations about long-term profitability of farm sector investments.

Trade issues continue to weigh on many agriculture sectors. Since 2008, U.S. agricultural exports have accounted for a 20% share of U.S. farm and manufactured or processed agricultural sales. In 2018, agricultural exports are forecast to be flat at $144.5 billion, due largely to abundant supplies in international markets and strong competition from major foreign competitors. The ongoing U.S.-China trade dispute is expected to shift trade patterns, but the aggregate value of U.S. exports is expected to hold steady.

Within the October 11, 2018, World Agricultural Supply and Demand Estimates (WASDE), the USDA projects 2018/19 U.S. corn production at 14.8 billion bushels, 1.2% above the estimated 2017/18 production. Projected average yield estimate is above trend-line, at 180.7 bushels per acre with projected ending stocks at 1.8 billion bushels. Estimate for 2018/19 season-average corn price received by producers is between $3.00 and $4.00 per bushel, compared to an estimated $3.36 for the previous crop year. The USDA projection for 2018/19 soybean production is 4.7 billion bushels, 6.3% above the estimated 2017/18 production, with yield per harvested acre above trend-line at 53.1 bushels. The 2018/19 season-average soybean price projection is between $7.35 and $9.85 per bushel, compared to an estimated $9.33 per bushel for the previous crop year. Changes in U.S.-China trade relations have the greatest impact on the market price of soybeans. Absent change in trade relations with China, the impact to soybean prices is likely to continue into 2019.

National milk production in 2018 is up 1.1% over 2017 production, though the average number of milk cows declined 27,000 head from the same quarter last year. Tight Upper Midwest processor capacity continues to result in lower basis payments in some areas. The USDA forecasts an average price received by farmers for all milk of $16.35 to $16.45 per cwt in 2018, significantly below the $17.65 received during 2017. The USDA's Farm Service Agency announced an August 2018 Margin Protection Program-Dairy Margin of about $7.43 per cwt, down from $9.87 at year-end 2017. At a potential dairy margin of $8 or less, government insurance payments are possible depending on the level of coverage chosen by the dairy producer. We expect many dairy operators will be at or below break-even throughout 2018.

Hog margins appear to be below break-even through the remainder of 2018, in large part due to expanding production and geopolitical influence particularly surrounding U.S.-Mexico relations as it relates to the North American Free Trade Agreement (NAFTA). As of September 2018, there were 75.5 million hogs and pigs on U.S. farms, up 3% from a year ago, according to the Quarterly Hogs and Pigs report published by USDA's National Agricultural Statistics Service. Hog producers intended to farrow 3.2 million sows during the September to November 2018 quarter, up 2% from the same period a year ago. The potential elimination of NAFTA and the resulting tariffs created significant profitability headwinds for producers across several commodity groups in the first half of 2018. Completed renegotiation of the new U.S.-Mexico-Canada (USMCA) trade agreement are expected to ease these headwinds, if ratified.

Much of the Compeer service area experienced moderation in land values over the past several years. Lower commodity margins coupled with increasing interest rates fueled a modest correction in value. The USDA released its annual land survey in August, which indicated a slight improvement in value for Wisconsin (2.3%) and Illinois (2.1%), coupled with a slight decline in Minnesota (-1.1%). Internal valuations return similar results. Overall, Compeer continues to believe that U.S. agriculture can withstand a further moderation in land values without enduring significant financial stress and hardship.

Economic and secular conditions remain favorable to the housing market, despite the headwind of rising interest rates and a slowdown in home sales. Increasing home values and rising mortgage rates have made it more difficult for potential buyers to afford a home. According to the CoreLogic Home Price Index, home prices nationwide increased 5.5% year over year (August 2018). CoreLogic expects appreciation to slow over the coming year. They expect home prices decreased by 0.4% from August to September 2018. Additionally, sales of new U.S. single-family homes fell to a near two-year low in September and data for the prior three months were revised lower. Nevertheless, the national unemployment rate remains near historic lows at 3.7% per the U.S. Bureau of Labor Statistics, and U.S. home ownership remains low at 64.3%, slightly above the 50-year low. Coupled with the millennial generation approaching home-formation age, many indicate a pent-up demand for homes.

Compeer continues to see low delinquencies and adversity across its portfolio. All the same, some of our core credit objectives include working with clients to promote risk management, ensure high quality financial statements and production reports, encourage disciplined marketing plans, and provide individualized servicing plans and strategies. We continue to be involved and support positive legislative changes for agriculture and rural America.

## LOANS HELD TO MATURITY

### Loans Held to Maturity

Loans held to maturity were $18.4 billion at September 30, 2018, an increase of $630.6 million from December 31, 2017. The increase was primarily driven by growth in real estate mortgage and agribusiness loans, particularly within the Capital Markets and AgriAccess sectors.

### Portfolio Credit Quality

The credit quality of our portfolio remained relatively stable from December 31, 2017. Adversely classified loans increased slightly to 3.1% of the portfolio at September 30, 2018, from 2.4% of the portfolio at December 31, 2017. The increase was due to a continued overall downturn in the agricultural economy, led by stress in the grain and dairy sectors. Adversely classified loans are loans we have identified as showing some credit weakness outside our credit standards. We have considered portfolio credit quality in assessing the reasonableness of our allowance for loan losses.

In certain circumstances, Federal Agricultural Mortgage Corporation and government agency guarantee programs are used to reduce the risk of loss. At September 30, 2018, $1.4 billion of our loans were, to some level, guaranteed under these government programs.

## Risk Assets

**Components of Risk Assets**

| (dollars in thousands) As of: | | **September 30 2018** | | December 31 2017 |
|---|---|---|---|---|
| Loans: | | | | |
| Nonaccrual | **$** | **116,650** | $ | 90,464 |
| Accruing restructured | | **11,406** | | 12,121 |
| Accruing loans 90 days or more past due | | **9,488** | | 133 |
| Total risk loans | | **137,544** | | 102,718 |
| Other property owned | | **1,045** | | 954 |
| Total risk assets | **$** | **138,589** | $ | 103,672 |
| Total risk loans as a percentage of total loans | | **0.7%** | | 0.6% |
| Nonaccrual loans as a percentage of total loans | | **0.6%** | | 0.5% |
| Current nonaccrual loans as a percentage of total nonaccrual loans | | **31.3%** | | 38.0% |
| Total delinquencies as a percentage of total loans | | **1.0%** | | 0.7% |

Note: Accruing loans include accrued interest receivable.

Our risk assets have increased from December 31, 2017, but have remained at acceptable levels. Despite the increase in risk assets, total risk loans as a percentage of total loans were well within our established risk management guidelines.

Overall, nonaccrual loans remained at an acceptable level at September 30, 2018, and December 31, 2017, even with slight nonaccrual increases within the grain, dairy, and real estate sectors.

The increase in accruing loans 90 days or more past due was primarily driven by activity within the real estate portfolio, along with production agriculture loans. Our accounting policy requires loans past due 90 days or more to be transferred into nonaccrual status unless adequately secured and in the process of collection. Based on our analysis, accruing loans 90 days or more past due were eligible to remain in accruing status.

The increase in total delinquencies as a percentage of total loans was also primarily driven by activity within the same portions of the portfolio mentioned above, including the real estate and production agriculture loans.

## Allowance for Loan Losses

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

**Allowance Coverage Ratios**

| As of: | **September 30 2018** | December 31 2017 |
|---|---|---|
| Allowance as a percentage of: | | |
| Loans | **0.3%** | 0.3% |
| Nonaccrual loans | **53.3%** | 54.0% |
| Total risk loans | **45.2%** | 47.6% |

The increase in our allowance for loan losses from December 31, 2017, was due to provision expense recorded primarily to reflect the increase in risk assets noted above. In our opinion, the allowance for loan losses was reasonable in relation to the risk in our loan portfolio at September 30, 2018.

## LOANS HELD FOR SALE

We originate loans held for sale under our secondary market program, which is a rural residential mortgage program designed to provide qualified borrowers with options for competitive rate financing of rural homes in small towns or homes that are part of a hobby farm, pastureland, or tillable acreage. Loans closed under this program will be sold to and securitized by third party investors. At September 30, 2018, the volume in this program was $31.5 million, a $1.5 million increase from December 31, 2017. The increase was the result of our originations of new loans held for sale.

## RESULTS OF OPERATIONS

**Profitability Information**

| (dollars in thousands)<br>For the nine months ended September 30 | | 2018 | | 2017 |
|---|---|---|---|---|
| Net income | $ | **281,446** | $ | 161,953 |
| Return on average assets | | **1.9%** | | 1.8% |
| Return on average equity | | **10.8%** | | 10.6% |

Changes in the chart above relate directly to:

- Merger of 1st FCS, AgStar, and Badgerland into Compeer Financial
- Changes in income discussed below
- Changes in assets discussed in the Loan Portfolio section
- Changes in capital discussed in the Funding, Liquidity, and Capital section

**Changes in Significant Components of Net Income**

| (in thousands)<br>For the nine months ended September 30 | | 2018 | | 2017 | | Increase (decrease) in net income |
|---|---|---|---|---|---|---|
| Net interest income | $ | **353,749** | $ | 228,591 | $ | **125,158** |
| Provision for loan losses | | **16,200** | | 8,409 | | **(7,791)** |
| Patronage income | | **72,897** | | 46,586 | | **26,311** |
| Other income, net | | **70,308** | | 38,558 | | **31,750** |
| Operating expenses | | **196,087** | | 135,313 | | **(60,774)** |
| Provision for income taxes | | **3,221** | | 8,060 | | **4,839** |
| Net income | $ | **281,446** | $ | 161,953 | $ | **119,493** |

**Changes in Net Interest Income**

| (in thousands)<br>For the nine months ended September 30 | | 2018 vs 2017 |
|---|---|---|
| Changes in volume | $ | **136,092** |
| Changes in interest rates | | **(9,195)** |
| Changes in asset securitizations | | **98** |
| Changes in nonaccrual income and other | | **(1,837)** |
| Net change | $ | **125,158** |

The increase in the provision for loan losses was primarily driven by the merger and resulting size of the portfolio. Additional provisions were booked during 2018 to also reflect the deterioration in the grain and dairy sectors of the portfolio.

The change in patronage income was primarily due to the following:

- An increase in patronage income received on loans in the AgriBank Asset Pool Program due to a higher average balance on our portfolio in the AgriBank Asset Pool Program compared to the prior year. In addition, the earnings on loans in the AgriBank Asset Pool Program increased due to the share of distributions from Allocated Insurance Reserve Accounts (AIRA) totaling $979 thousand in 2018 related to the participations sold to AgriBank. The AIRA was established by the Farm Credit System Insurance Corporation (FCSIC) when premiums collected increased the level of the Insurance Fund beyond the required 2% of insured debt. There was no distribution in 2017. Refer to the 2017 Annual Report for additional information about the FCSIC.
- An increase in patronage received from AgriBank due to a higher average balance on our note payable, which was partially offset by a lower patronage rate compared to the prior year. This was primarily driven by the merger into Compeer Financial.
- An increase in the wholesale spread on our note payable, which is returned as patronage.

The change in other income was primarily due to our share of the AIRA distribution received from the FCSIC of $10.9 million in 2018. The AIRA was established by FCSIC when premiums collected increased the level of the Insurance Fund beyond the required 2% of insured debt. There was no distribution in 2017. Refer to the 2017 Annual Report for additional information about the FCSIC. In addition, we saw increases in other income related to the merger in 2017 with other income as of September 30, 2018, reflecting those of the merged organization. The most significant increases were in crop insurance income and retail loan fee income. We originated rural home loans for resale in the secondary market. We sold loans in the secondary market totaling $89.0 million through September 30, 2018, compared to $104.8 million for the same period in 2017. The fee income from this activity totaled $444 thousand for the nine months ended September 30, 2018, compared to $635 thousand for the same period of 2017.

The change in operating expenses was primarily related to the merger in 2017 with the operating expenses as of September 30, 2018, reflecting those of the merged organization. The primary driver in the overall operating expenses increase was an increase in salaries and employee benefits expense due to an overall larger organization.

The decrease in provision for income taxes was related to multiple factors. While we did have more overall taxable income due to the merger, we were able to offset that with benefits from the recent tax reform and deductions from our patronage program.

## FUNDING, LIQUIDITY, AND CAPITAL

We borrow from AgriBank, under a note payable, in the form of a line of credit. Our note payable matured on September 30, 2018, and was renewed for $22.0 billion with a maturity date of September 30, 2021. The note payable will be renegotiated no later than the maturity date. The repricing attributes of our line of credit generally correspond to the repricing attributes of our loan portfolio, which significantly reduces our market interest rate risk. Due to the cooperative structure of the Farm Credit System and as we are a stockholder of AgriBank, we expect this borrowing relationship to continue into the foreseeable future. Our other source of lendable funds is from unallocated surplus.

The components of cost of funds associated with our note payable include:

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

We were not subject to a risk premium at September 30, 2018, or December 31, 2017.

Total equity increased $176.0 million from December 31, 2017, primarily due to net income for the period partially offset by patronage distribution accruals, the redemption of allocated patronage, and preferred stock dividend accruals. Accumulated other comprehensive (loss) income is the impact of prior service cost and unamortized actuarial gain/loss related to the Pension Restoration Plan. Refer to Note 13 in our 2017 Annual Report for more information on the Pension Restoration Plan.

The Farm Credit Administration (FCA) Regulations require us to maintain minimums for our common equity tier 1, tier 1 capital, total capital, and permanent capital risk-based capital ratios. In addition, the FCA requires us to maintain minimums for our non-risk-adjusted ratios of tier 1 leverage and unallocated retained earnings and equivalents. Refer to Note 11 in our 2017 Annual Report for a more complete description of these ratios.

**Regulatory Capital Requirements and Ratios**

| As of: | **September 30 2018** | December 31 2017 | Regulatory Minimums | Capital Conservation Buffer | Total |
|---|---|---|---|---|---|
| Risk-adjusted: | | | | | |
| Common equity tier 1 ratio | **14.8%** | 14.2% | 4.5% | 2.5%* | 7.0% |
| Tier 1 capital ratio | **15.3%** | 14.7% | 6.0% | 2.5%* | 8.5% |
| Total capital ratio | **15.7%** | 15.1% | 8.0% | 2.5%* | 10.5% |
| Permanent capital ratio | **15.7%** | 15.7% | 7.0% | N/A | 7.0% |
| Non-risk-adjusted: | | | | | |
| Tier 1 leverage ratio | **15.5%** | 15.0% | 4.0% | 1.0% | 5.0% |
| Unallocated retained earnings and equivalents leverage ratio | **14.2%** | 13.8% | 1.5% | N/A | 1.5% |

*The 2.5% capital conservation buffer over risk-adjusted ratio minimums is being phased in through 2020 under the FCA capital requirements.

The capital adequacy ratios are directly impacted by the changes in capital as more fully explained in this section and the changes in assets as discussed in the Loan Portfolio section.

## RELATIONSHIP WITH AGRIBANK

### Purchased Services

During 2016, District associations and AgriBank conducted research related to repositioning many business services offered by AgriBank into a separate entity jointly owned by AgriBank and participating associations. The long-term strategic objective of this initiative is to increase scale, improve operating efficiency, and enhance technology and business services. The proposed service entity will be named SunStream Business Services. An application to form the service entity was submitted to the FCA for approval in May 2017, and the FCA continues its due diligence on the charter request.

## REGULATORY MATTERS

### Investment Securities Eligibility

In May 2018, the FCA Board approved a final rule to revise the requirements governing the eligibility of investment securities for System Banks and associations. The new regulation revises the eligibility purpose, type, and amount of investments that a System association may hold. The regulation is effective January 1, 2019. We are currently working to update policies, procedures, and other documentation to ensure compliance by the effective date. We do not expect the regulation to have a material impact on our financial statements.

## CERTIFICATION

The undersigned have reviewed the September 30, 2018, Quarterly Report of Compeer Financial, ACA, which has been prepared under the oversight of the Audit Committee and in accordance with all applicable statutory or regulatory requirements. The information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Mark W. Cade

Mark Cade
Chairperson of the Board
Compeer Financial, ACA

Rodney W. Hebrink
President and Chief Executive Officer
Compeer Financial, ACA

Jase L. Wagner
Chief Financial Officer
Compeer Financial, ACA

November 6, 2018

# CONSOLIDATED STATEMENTS OF CONDITION

*Compeer Financial, ACA*

*(in thousands)*

*(Unaudited)*

| As of: | | **September 30 2018** | | December 31 2017 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Loans held to maturity | **$** | **18,379,668** | $ | 17,749,021 |
| Allowance for loan losses | | **62,197** | | 48,849 |
| Net loans held to maturity | | **18,317,471** | | 17,700,172 |
| Loans held for sale | | **31,537** | | 30,062 |
| Net loans | | **18,349,008** | | 17,730,234 |
| Unrestricted cash | | **2,200** | | 2,200 |
| Investment securities | | **967,248** | | 879,258 |
| Assets held for lease, net | | **41,936** | | 41,368 |
| Accrued interest receivable | | **205,389** | | 151,801 |
| Investment in AgriBank, FCB | | **514,712** | | 514,712 |
| Premises and equipment, net | | **68,205** | | 65,148 |
| Other property owned | | **1,045** | | 954 |
| Deferred tax assets, net | | **3,189** | | 1,139 |
| Other assets | | **155,342** | | 158,537 |
| Total assets | **$** | **20,308,274** | $ | 19,545,351 |
| **LIABILITIES** | | | | |
| Note payable to AgriBank, FCB | **$** | **16,479,273** | $ | 15,847,060 |
| Accrued interest payable | | **101,914** | | 78,959 |
| Patronage distribution payable | | **57,359** | | 122,000 |
| Other liabilities | | **82,066** | | 85,695 |
| Total liabilities | | **16,720,612** | | 16,133,714 |
| Contingencies and commitments (Note 5) | | | | |
| **EQUITY** | | | | |
| Preferred stock | | **100,000** | | 100,000 |
| Capital stock and participation certificates | | **33,972** | | 34,213 |
| Additional paid-in capital | | **1,780,603** | | 1,780,603 |
| Allocated surplus | | **479,444** | | 523,252 |
| Unallocated surplus | | **1,200,180** | | 980,818 |
| Accumulated other comprehensive loss | | **(6,537)** | | (7,249) |
| Total equity | | **3,587,662** | | 3,411,637 |
| Total liabilities and equity | **$** | **20,308,274** | $ | 19,545,351 |

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

# CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

*Compeer Financial, ACA*
*(in thousands)*
*(Unaudited)*

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| *For the period ended September 30* | **2018** | 2017 | **2018** | 2017 |
| **Interest income** | **$ 221,948** | $ 197,443 | **$ 639,966** | $ 379,901 |
| **Interest expense** | **101,610** | 78,759 | **286,217** | 151,310 |
| Net interest income | **120,338** | 118,684 | **353,749** | 228,591 |
| **Provision for loan losses** | **7,077** | 4,811 | **16,200** | 8,409 |
| Net interest income after provision for loan losses | **113,261** | 113,873 | **337,549** | 220,182 |
| **Other income** | | | | |
| Patronage income | **24,487** | 31,595 | **72,897** | 46,586 |
| Net operating lease income | **599** | 444 | **1,558** | 1,238 |
| Financially related services income | **8,931** | 8,902 | **31,400** | 18,274 |
| Allocated Insurance Reserve Accounts distribution | **--** | -- | **10,938** | -- |
| Fee and miscellaneous income, net | **8,755** | 9,701 | **26,412** | 19,046 |
| Total other income | **42,772** | 50,642 | **143,205** | 85,144 |
| **Operating expenses** | | | | |
| Salaries and employee benefits | **44,134** | 46,156 | **130,564** | 88,861 |
| Farm Credit System insurance | **3,547** | 5,683 | **10,548** | 11,346 |
| Other operating expenses | **20,245** | 19,113 | **54,975** | 35,106 |
| Total operating expenses | **67,926** | 70,952 | **196,087** | 135,313 |
| Income before income taxes | **88,107** | 93,563 | **284,667** | 170,013 |
| **(Benefit from) provision for income taxes** | **(1,963)** | 4,970 | **3,221** | 8,060 |
| Net income | **$ 90,070** | $ 88,593 | **$ 281,446** | $ 161,953 |
| **Other comprehensive income** | | | | |
| Employee benefit plans activity | **$ 237** | $ -- | **$ 712** | $ -- |
| Total other comprehensive income | **237** | -- | **712** | -- |
| Comprehensive income | **$ 90,307** | $ 88,593 | **$ 282,158** | $ 161,953 |

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

# CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

*Compeer Financial, ACA*
*(in thousands)*
*(Unaudited)*

| | Preferred Stock | Capital Stock and Participation Certificates | Additional Paid-in Capital | Allocated Surplus | Unallocated Surplus | Accumulated Other Comprehensive (Loss) Income | Total Equity |
|---|---|---|---|---|---|---|---|
| Balance at December 31, 2016 | $ 100,000 | $ 15,934 | $ -- | $ 441,122 | $ 758,412 | $ -- | $ 1,315,468 |
| Net income | -- | -- | -- | -- | 161,953 | -- | 161,953 |
| Other comprehensive income | -- | -- | -- | -- | -- | -- | -- |
| Transfer of allocated surplus to unallocated surplus | -- | -- | -- | (41,286) | 41,286 | -- | -- |
| Redemption of allocated patronage | -- | -- | -- | (26,317) | 78 | -- | (26,239) |
| Preferred stock dividend | -- | -- | -- | -- | (6,750) | -- | (6,750) |
| Unallocated surplus designated for patronage distributions | -- | -- | -- | -- | (32,364) | -- | (32,364) |
| Allocated surplus acquired in connection with merger | -- | -- | -- | 196,430 | -- | -- | 196,430 |
| Equity issued in connection with merger | -- | 18,555 | 1,780,603 | -- | -- | -- | 1,799,158 |
| Capital stock and participation certificates issued | -- | 1,255 | -- | -- | -- | -- | 1,255 |
| Capital stock and participation certificates retired | -- | (1,416) | -- | -- | -- | -- | (1,416) |
| Balance at September 30, 2017 | $ 100,000 | $ 34,328 | $ 1,780,603 | $ 569,949 | $ 922,615 | $ -- | $ 3,407,495 |
| Balance at December 31, 2017 | $ 100,000 | $ 34,213 | $ 1,780,603 | $ 523,252 | $ 980,818 | $ (7,249) | $ 3,411,637 |
| Net income | **--** | **--** | **--** | **--** | **281,446** | **--** | **281,446** |
| Other comprehensive income | **--** | **--** | **--** | **--** | **--** | **712** | **712** |
| Transfer of allocated surplus to unallocated surplus | **--** | **--** | **--** | **--** | **--** | **--** | **--** |
| Redemption of allocated patronage | **--** | **--** | **--** | **(43,808)** | **41** | **--** | **(43,767)** |
| Preferred stock dividend | **--** | **--** | **--** | **--** | **(6,750)** | **--** | **(6,750)** |
| Unallocated surplus designated for patronage distributions | **--** | **--** | **--** | **--** | **(55,375)** | **--** | **(55,375)** |
| Allocated surplus acquired in connection with merger | **--** | **--** | **--** | **--** | **--** | **--** | **--** |
| Equity issued in connection with merger | **--** | **--** | **--** | **--** | **--** | **--** | **--** |
| Capital stock and participation certificates issued | **--** | **1,796** | **--** | **--** | **--** | **--** | **1,796** |
| Capital stock and participation certificates retired | **--** | **(2,037)** | **--** | **--** | **--** | **--** | **(2,037)** |
| **Balance at September 30, 2018** | **$ 100,000** | **$ 33,972** | **$ 1,780,603** | **$ 479,444** | **$ 1,200,180** | **$ (6,537)** | **$ 3,587,662** |

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1: ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

The Consolidated Financial Statements contain all adjustments necessary for a fair presentation of the interim consolidated financial condition and consolidated results of operations. Our accounting policies conform to accounting principles generally accepted in the United States of America (GAAP) and the prevailing practices within the financial services industry. This interim Quarterly Report is prepared based upon statutory and regulatory requirements and in accordance with GAAP. However, certain disclosures required by GAAP are omitted. The results of the nine months ended September 30, 2018, are not necessarily indicative of the results to be expected for the year ending December 31, 2018. The interim financial statements and the related notes in this Quarterly Report should be read in conjunction with the Consolidated Financial Statements and related notes included in our Annual Report for the year ended December 31, 2017 (2017 Annual Report).

The merger between 1st Farm Credit Services, ACA (1st FCS), AgStar Financial Services, ACA (AgStar), and Badgerland Financial, ACA (Badgerland) was effective July 1, 2017. The merged entity, Compeer Financial, ACA, is headquartered in Sun Prairie, Wisconsin. The effects of the merger with 1st FCS and Badgerland are included in our financial position at September 30, 2018, and December 31, 2017. Results of operations and equity reflect the results of AgStar prior to July 1, 2017, and the merged Association after July 1, 2017.

Certain amounts in prior periods' financial statements have been reclassified to conform to the current period's presentation.

The Consolidated Financial Statements present the consolidated financial results of Compeer Financial, ACA (the Association) and its subsidiaries Compeer Financial, FLCA and Compeer Financial, PCA (the subsidiaries). All material intercompany transactions and balances have been eliminated in consolidation.

#### Recently Issued or Adopted Accounting Pronouncements

We have assessed the potential impact of accounting standards that have been issued by the Financial Accounting Standards Board (FASB) and have determined the following standards to be applicable to our business.

| Standard and effective date | Description | Adoption status and financial statement impact |
|---|---|---|
| In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09 "Revenue from Contracts with Customers." This guidance was effective for public entities on January 1, 2018. | The guidance governs revenue recognition from contracts with customers and requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Financial instruments and other contractual rights within the scope of other guidance issued by the FASB are excluded from the scope of this guidance. The guidance sets forth the requirement for new and enhanced disclosures. | We adopted this guidance on January 1, 2018, using the modified retrospective approach, as the majority of our revenues are not subject to the new guidance. The adoption of the guidance did not have a material impact on the financial condition, results of operations, or cash flows. |
| In March 2017, the FASB issued ASU 2017-07 "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Cost." This guidance was effective for public entities on January 1, 2018. | This guidance requires that an employer disaggregate the service cost component from the other components of net benefit cost. Specifically, the guidance requires non-service cost components of net benefit cost to be recognized in a non-operating income line item of the income statement and allow only the service cost component of net benefit cost to be eligible for capitalization. | We adopted this guidance on January 1, 2018. Non-service cost components of net benefit cost were reclassified from salaries and employee benefits to other operating expenses on the Statements of Comprehensive Income. The change in classification was not material. There were no changes to the Association's financial condition, cash flows, or financial statement disclosures. |
| In January 2016, the FASB issued ASU 2016-01 "Recognition and Measurement of Financial Assets and Financial Liabilities." This guidance was effective for public business entities on January 1, 2018. | The guidance is intended to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. The amendments address certain aspects of recognition, measurement, presentation, and disclosure of financial statements. | We adopted this guidance on January 1, 2018. The adoption of this guidance did not impact our financial condition, results of operations, or cash flows, but did impact our fair value disclosures. |

| Standard and effective date | Description | Adoption status and financial statement impact |
|---|---|---|
| In November 2016, the FASB issued ASU 2016-18 "Statement of Cash Flows." This guidance was effective for public business entities on January 1, 2018. | The guidance modifies how restricted cash is presented in the statement of cash flows by requiring amounts generally described as restricted cash to be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. | We adopted this guidance on January 1, 2018, which has been retrospectively applied to all periods presented. There were no changes to the Association's financial condition, results of operations, equity, or financial statement disclosures. The impact to the cash flows was to include restricted cash balances in the beginning and end of period balances of cash and restricted cash. Restricted cash was previously disclosed in investing activities in the cash flows. |
| In February 2016, the FASB issued ASU 2016-02 "Leases." In July 2018, the FASB issued ASU 2018-11 "Leases (Topic 842): Targeted Improvements." The guidance is effective for public entities in its first quarter of 2019 and early adoption is permitted. | The guidance modifies the recognition and accounting for lessees and lessors and requires expanded disclosures regarding assumptions used to recognize revenue and expenses related to leases. When this guidance is adopted, a liability for lease obligations and a corresponding right-of-use asset will be recognized on the Consolidated Statements of Condition for all lease arrangements spanning more than 12 months. The guidance includes an optional transition method where an entity is permitted to apply the guidance as of the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings. | We have no plans to early adopt this guidance. We are in the process of implementing leasing software, drafting accounting policies, and designing processes and controls to implement this standard. The necessary disclosures will be determined during 2018. We have determined after preliminary review, this guidance will impact the financial condition, results of operations, and financial statement disclosures, and will have no impact on cash flows. |
| In August 2018, the FASB issued ASU 2018-15 "Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract." The guidance is effective for our first quarter of 2020 and early adoption is permitted. | The guidance clarifies that implementation costs incurred in a hosting arrangement that is a service contract should be accounted for in the same manner as implementation costs incurred to develop or obtain internal-use software. | We are in the process of reviewing the accounting standard. Based on our preliminary review and analysis, this new guidance will not have a material impact on our financial condition, results of operations, cash flows, and financial statement disclosures. |
| In June 2016, the FASB issued ASU 2016-13 "Financial Instruments – Credit Losses." This guidance is effective for public business entities for non-U.S. Securities Exchange Commission filers for the first quarter of 2021 and early adoption is permitted. | The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses. | We have no plans to early adopt this guidance. We are in the process of reviewing the standard. Significant implementation matters yet to be addressed include system selection, drafting of accounting policies and disclosures, and designing processes and controls. We are currently unable to estimate the impact on the financial statements. |

## NOTE 2: LOANS HELD TO MATURITY AND ALLOWANCE FOR LOAN LOSSES

**Loans by Type**

(dollars in thousands)

| As of: | **September 30, 2018** | | December 31, 2017 | |
|---|---|---|---|---|
| | Amount | % | Amount | % |
| Real estate mortgage | **$ 8,983,009** | **48.9%** | $ 8,668,049 | 48.9% |
| Production and intermediate-term | **4,033,311** | **21.9%** | 4,389,478 | 24.7% |
| Agribusiness | **3,442,431** | **18.7%** | 2,953,661 | 16.6% |
| Other | **1,920,917** | **10.5%** | 1,737,833 | 9.8% |
| Total | **$ 18,379,668** | **100.0%** | $ 17,749,021 | 100.0% |

The other category is primarily comprised of communication, energy, agricultural export finance, rural residential real estate, and water and waste water related loans as well as finance and conditional sales leases and bonds originated under our mission related investment authority.

### Credit Quality

We utilize the Farm Credit Administration (FCA) Uniform Classification System to categorize loans into five credit quality categories. The categories are:

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

We had no loans categorized as loss at September 30, 2018, or December 31, 2017.

**Credit Quality of Loans**

| (dollars in thousands) | Acceptable | | Special Mention | | Substandard/ Doubtful | | Total | |
|---|---|---|---|---|---|---|---|---|
| **As of September 30, 2018** | Amount | % | Amount | % | Amount | % | Amount | % |
| Real estate mortgage | **$ 8,477,402** | **93.3%** | **$ 311,923** | **3.4%** | **$ 303,916** | **3.3%** | **$ 9,093,241** | **100.0%** |
| Production and intermediate-term | **3,725,536** | **91.0%** | **188,594** | **4.6%** | **180,885** | **4.4%** | **4,095,015** | **100.0%** |
| Agribusiness | **3,363,189** | **97.3%** | **23,408** | **0.7%** | **69,832** | **2.0%** | **3,456,429** | **100.0%** |
| Other | **1,877,231** | **97.4%** | **30,320** | **1.6%** | **19,732** | **1.0%** | **1,927,283** | **100.0%** |
| Total | **$ 17,443,358** | **93.9%** | **$ 554,245** | **3.0%** | **$ 574,365** | **3.1%** | **$ 18,571,968** | **100.0%** |

| | Acceptable | | Special Mention | | Substandard/ Doubtful | | Total | |
|---|---|---|---|---|---|---|---|---|
| As of December 31, 2017 | Amount | % | Amount | % | Amount | % | Amount | % |
| Real estate mortgage | $ 8,200,416 | 93.8% | $ 307,700 | 3.5% | $ 234,407 | 2.7% | $ 8,742,523 | 100.0% |
| Production and intermediate-term | 4,065,241 | 91.6% | 224,080 | 5.0% | 149,225 | 3.4% | 4,438,546 | 100.0% |
| Agribusiness | 2,910,257 | 98.2% | 27,844 | 0.9% | 26,263 | 0.9% | 2,964,364 | 100.0% |
| Other | 1,709,360 | 98.0% | 6,249 | 0.4% | 27,680 | 1.6% | 1,743,289 | 100.0% |
| Total | $ 16,885,274 | 94.4% | $ 565,873 | 3.2% | $ 437,575 | 2.4% | $ 17,888,722 | 100.0% |

Note: Accruing loans include accrued interest receivable.

### Delinquency

**Aging Analysis of Loans**

| (in thousands) **As of September 30, 2018** | 30-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or Less than 30 Days Past Due | Total | Accruing Loans 90 Days or More Past Due |
|---|---|---|---|---|---|---|
| Real estate mortgage | **$ 40,521** | **$ 41,240** | **$ 81,761** | **$ 9,011,480** | **$ 9,093,241** | **$ 2,781** |
| Production and intermediate-term | **31,114** | **34,807** | **65,921** | **4,029,094** | **4,095,015** | **4,617** |
| Agribusiness | **19,811** | **919** | **20,730** | **3,435,699** | **3,456,429** | **--** |
| Other | **13,544** | **3,555** | **17,099** | **1,910,184** | **1,927,283** | **2,090** |
| Total | **$ 104,990** | **$ 80,521** | **$ 185,511** | **$ 18,386,457** | **$ 18,571,968** | **$ 9,488** |

| As of December 31, 2017 | 30-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or Less than 30 Days Past Due | Total | Accruing Loans 90 Days or More Past Due |
|---|---|---|---|---|---|---|
| Real estate mortgage | $ 38,159 | $ 13,367 | $ 51,526 | $ 8,690,997 | $ 8,742,523 | $ -- |
| Production and intermediate-term | 30,306 | 26,566 | 56,872 | 4,381,674 | 4,438,546 | 133 |
| Agribusiness | 56 | 3,182 | 3,238 | 2,961,126 | 2,964,364 | -- |
| Other | 4,563 | 1,538 | 6,101 | 1,737,188 | 1,743,289 | -- |
| Total | $ 73,084 | $ 44,653 | $ 117,737 | $ 17,770,985 | $ 17,888,722 | $ 133 |

Note: Accruing loans include accrued interest receivable.

## Risk Loans

Risk loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms.

**Risk Loan Information**

| (in thousands)<br>As of: | **September 30<br>2018** | December 31<br>2017 |
|---|---|---|
| Volume with specific allowance | **$ 38,273** | $ 21,481 |
| Volume without specific allowance | **99,271** | 81,237 |
| Total risk loans | **$ 137,544** | $ 102,718 |
| Total specific allowance | **$ 12,113** | $ 8,811 |
| For the nine months ended September 30 | **2018** | 2017 |
| Income on accrual risk loans | **$ 860** | $ 845 |
| Income on nonaccrual loans | **6,523** | 7,260 |
| Total income on risk loans | **$ 7,383** | $ 8,105 |
| Average risk loans | **$ 130,409** | $ 89,604 |

Note: Accruing loans include accrued interest receivable. In addition, risk loans include purchased credit-impaired loans.

We did not have any material commitments to lend additional money to borrowers whose loans were classified as risk loans at September 30, 2018.

## Troubled Debt Restructurings (TDRs)

In situations where, for economic or legal reasons related to the borrower's financial difficulties, we grant a concession for other than an insignificant period of time to the borrower that we would not otherwise consider, the related loan is classified as a troubled debt restructuring, also known as a restructured loan. A concession is generally granted in order to minimize economic loss and avoid foreclosure. Concessions vary by program and borrower and may include interest rate reductions, term extensions, payment deferrals, or an acceptance of additional collateral in lieu of payments. In limited circumstances, principal may be forgiven. Loans classified as TDRs are considered risk loans. All risk loans are analyzed within our allowance for loan losses. We record a specific allowance to reduce the carrying amount of the restructured loan to the lower of book value or net realizable value of collateral.

**TDR Activity**

| (in thousands)<br>Nine months ended September 30 | **2018** | | 2017 | |
|---|---|---|---|---|
| | Pre-modification | Post-modification | Pre-modification | Post-modification |
| Real estate mortgage | **$ 309** | **$ 309** | $ -- | $ -- |
| Production and intermediate-term | **1,618** | **1,617** | 657 | 656 |
| Agribusiness | **6,857** | **6,857** | -- | -- |
| Total | **$ 8,784** | **$ 8,783** | $ 657 | $ 656 |

Pre-modification represents the outstanding recorded investment of the loan just prior to restructuring and post-modification represents the outstanding recorded investment of the loan immediately following the restructuring. The recorded investment in the loan is the unpaid principal amount of the receivable increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, acquisition costs, and unamortized adjustments to fair value on loans acquired through the merger and may also reflect a previous direct charge-off of the investment.

The primary types of modification included interest rate reduction below market, forgiveness of principal, and extension of maturity.

**TDRs that Occurred Within the Previous 12 Months that Subsequently Defaulted During the Nine Months Ended September 30**

| (in thousands) | **2018** | 2017 |
|---|---|---|
| Production and intermediate-term | **$ 20** | $ 86 |
| Agribusiness | **4,242** | -- |
| Total | **$ 4,262** | $ 86 |

**TDRs Outstanding**

| (in thousands)<br>As of: | | September 30<br>2018 | | December 31<br>2017 |
|---|---|---|---|---|
| Accrual status: | | | | |
| Real estate mortgage | $ | **10,426** | $ | 11,598 |
| Production and intermediate-term | | **980** | | 523 |
| Agribusiness | | **--** | | -- |
| Other | | **--** | | -- |
| Total TDRs in accrual status | $ | **11,406** | $ | 12,121 |
| Nonaccrual status: | | | | |
| Real estate mortgage | $ | **1,222** | $ | 1,335 |
| Production and intermediate-term | | **1,177** | | 1,751 |
| Agribusiness | | **4,524** | | 91 |
| Other | | **64** | | 69 |
| Total TDRs in nonaccrual status | $ | **6,987** | $ | 3,246 |
| Total TDRs: | | | | |
| Real estate mortgage | $ | **11,648** | $ | 12,933 |
| Production and intermediate-term | | **2,157** | | 2,274 |
| Agribusiness | | **4,524** | | 91 |
| Other | | **64** | | 69 |
| Total TDRs | $ | **18,393** | $ | 15,367 |

Additional commitments to lend to borrowers whose loans have been modified in a TDR were $1.5 million at September 30, 2018.

### Allowance for Loan Losses

**Changes in Allowance for Loan Losses**

| (in thousands)<br>Nine months ended September 30 | | 2018 | | 2017 |
|---|---|---|---|---|
| Balance at beginning of period | $ | **48,849** | $ | 36,018 |
| Provision for loan losses | | **16,200** | | 8,409 |
| Loan recoveries | | **1,092** | | 1,050 |
| Loan charge-offs | | **(3,944)** | | (671) |
| Balance at end of period | $ | **62,197** | $ | 44,806 |

## NOTE 3: INVESTMENT SECURITIES

We had held-to-maturity investment securities of $967.2 million at September 30, 2018, and $879.3 million at December 31, 2017. Our investment securities consisted of:

- Mortgage-backed securities (MBS) issued by the Federal Agricultural Mortgage Corporation (Farmer Mac) or guaranteed by the Small Business Administration (SBA) or by the United States Department of Agriculture (USDA)
- Asset-backed securities (ABS) guaranteed by SBA or USDA
- Municipal revenue bonds and corporate debt security (Bonds)

The investment securities have been classified as held-to-maturity. MBS are generally longer-term investments and ABS are generally shorter-term investments. Farmer Mac guaranteed investments are typically MBS while SBA and USDA guaranteed investments may be comprised of either MBS or ABS. All our held-to-maturity investments, except $9.2 million as of September 30, 2018, and $12.2 million as of December 31, 2017, were fully guaranteed by Farmer Mac, SBA, or USDA.

**Additional Held-to-Maturity Investment Securities Information**

| (dollars in thousands)<br>**As of September 30, 2018** | | Amortized Cost | | Unrealized Gains | | Unrealized Losses | | Fair Value | Weighted Average Yield |
|---|---|---|---|---|---|---|---|---|---|
| MBS | **$** | **887,389** | **$** | **1,541** | **$** | **(23,773)** | **$** | **865,157** | **4.2%** |
| ABS | | **66,179** | | **380** | | **(1,328)** | | **65,231** | **4.0%** |
| Bonds | | **13,680** | | **20** | | **(155)** | | **13,545** | **5.1%** |
| Total | **$** | **967,248** | **$** | **1,941** | **$** | **(25,256)** | **$** | **943,933** | **4.2%** |
| As of December 31, 2017 | | Amortized Cost | | Unrealized Gains | | Unrealized Losses | | Fair Value | Weighted Average Yield |
| MBS | $ | 775,599 | $ | 695 | $ | (10,906) | $ | 765,388 | 3.8% |
| ABS | | 91,490 | | 17 | | (1,538) | | 89,969 | 2.3% |
| Bonds | | 12,169 | | -- | | (49) | | 12,120 | 5.5% |
| Total | $ | 879,258 | $ | 712 | $ | (12,493) | $ | 867,477 | 3.6% |

Investment income is recorded in “Interest income” in the Consolidated Statements of Comprehensive Income and totaled $26.3 million and $15.6 million for the nine months ended September 30, 2018, and 2017, respectively.

**Contractual Maturities of Held-to-Maturity Investment Securities**

| (in thousands)<br>**As of September 30, 2018** | | Amortized Cost |
|---|---|---|
| Less than one year | **$** | **3,436** |
| One to five years | | **31,198** |
| Five to ten years | | **38,851** |
| More than ten years | | **893,763** |
| Total | **$** | **967,248** |

A summary of investments in an unrealized loss position presented by the length of time the investments have been in continuous unrealized loss position follows:

| (in thousands) | Less than 12 months | | | | Greater than 12 months | | | |
|---|---|---|---|---|---|---|---|---|
| **As of September 30, 2018** | | Fair Value | | Unrealized Losses | | Fair Value | | Unrealized Losses |
| MBS | **$** | **482,495** | **$** | **(12,166)** | **$** | **230,679** | **$** | **(11,607)** |
| ABS | | **27,656** | | **(461)** | | **9,855** | | **(867)** |
| Bonds | | **--** | | **--** | | **10,175** | | **(155)** |
| Total | **$** | **510,151** | **$** | **(12,627)** | **$** | **250,709** | **$** | **(12,629)** |
| | Less than 12 months | | | | Greater than 12 months | | | |
| As of December 31, 2017 | | Fair Value | | Unrealized Losses | | Fair Value | | Unrealized Losses |
| MBS | $ | 438,480 | $ | (3,416) | $ | 256,692 | $ | (7,490) |
| ABS | | 61,565 | | (515) | | 15,493 | | (1,023) |
| Bonds | | 7,233 | | (33) | | 4,887 | | (16) |
| Total | $ | 507,278 | $ | (3,964) | $ | 277,072 | $ | (8,529) |

Unrealized losses greater than 12 months associated with held-to-maturity investment securities are not considered to be other-than-temporary due to the 100% guarantee of the principal by Farmer Mac, SBA, or USDA. However, the premiums paid to purchase the investment are not guaranteed and are amortized over the maturity of each loan on a straight-line basis as a reduction of interest income. Repayment of principal is assessed at least quarterly, and any remaining unamortized premium is taken as a reduction to interest income if principal repayment is unlikely, or when a demand for payment is made for the guarantee. At September 30, 2018, the majority of the $12.6 million unrealized loss greater than 12 months represents unamortized premium.

We had no outstanding available-for-sale investment securities at September 30, 2018, or December 31, 2017.

**Additional Available-for-Sale Investment Securities Information**

| Nine months ended September 30 | **2018** | 2017 |
|---|---|---|
| Proceeds from sales | **$ 57,600** | $ 51,296 |
| Realized (losses) on sales, net | **(455)** | (343) |

The investment portfolio is evaluated for other-than-temporary impairment. No investments within the portfolio were impaired as of September 30, 2018, and December 31, 2017.

## NOTE 4: OTHER INVESTMENTS

We held non-controlling investments in venture capital equity funds in “Other assets” of $10.0 million at September 30, 2018, and December 31, 2017. These investments represent our stake in venture capital equity funds focused on the needs of rural start-up companies. We had no remaining commitment at September 30, 2018, or December 31, 2017. To date, no income has been distributed from the funds. We received no distributions from the funds during the nine months ended September 30, 2018 and 2017. We acquired this non-controlling investment in venture capital equity funds as a result of the merger with Badgerland.

We and other Farm Credit Institutions are among the limited partners for Rural Business Investment Companies (RBICs). Our total commitment is $29.5 million with varying commitment end dates through September 2021. Certain commitments may have an option to extend under certain circumstances. Our investment in the RBICs are recorded in “Other assets” in the Consolidated Statements of Condition, and totaled $13.2 million at September 30, 2018, and $11.8 million at December 31, 2017.

The investments were evaluated for impairment. No investments were impaired as of September 30, 2018, and December 31, 2017.

## NOTE 5: CONTINGENCIES AND COMMITMENTS

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

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

## NOTE 6: FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or most advantageous market for the asset or liability. Accounting guidance also establishes a fair value hierarchy, with three input levels that may be used to measure fair value. Refer to Note 2 in our 2017 Annual Report for a more complete description of the three input levels.

### Recurring

The following represents a summary of the assets, valuation techniques, and inputs used to measure fair value on a recurring basis:

**Loans held for sale:** The loans held for sale portfolio is held at fair value. Fair value is based on quoted market prices, where available, or the prices for other similar mortgage loans with similar characteristics. As necessary, these prices are adjusted for typical securitization activities, including servicing value, portfolio composition, market conditions, and liquidity. We had loans held for sale of $31.5 million and $30.1 million as of September 30, 2018, and December 31, 2017, respectively, which were valued using Level 3 inputs. Total fair value losses related to these loans were $20 thousand for the nine months ended September 30, 2018, compared to a gain of $149 thousand for the same period of 2017, which were recognized in “Fee and miscellaneous income, net” in the Consolidated Statements of Comprehensive Income.

**Investment securities available-for-sale:** Investment securities available-for-sale are held at fair value. Fair value is based on quoted market prices, where available, or the prices for other similar securities with similar characteristics. As necessary, these prices are adjusted for typical securitization activities, including servicing value, portfolio composition, market conditions, and liquidity. We had no outstanding available-for-sale investment securities at September 30, 2018, or December 31, 2017. During the nine months ended September 30, 2018, and 2017 we sold available-for-sale investment securities with total sales proceeds of $57.6 million and $51.3 million, resulting in a loss of $455 thousand and $343 thousand, respectively, which was recognized in “Fee and miscellaneous income, net” in the Consolidated Statements of Comprehensive Income.

**Derivatives:** If an active market exists, the fair value of our derivative financial instruments called TBAs is based on currently quoted market prices. We had TBAs with a notional value of $34.8 million and $44.8 million as of September 30, 2018, and December 31, 2017, respectively, which were used to manage exposure to interest rate risk and changes in the fair value of loans held for sale and the interest rate lock commitments that are determined prior to funding. We also used these instruments to hedge the changes in fair value related to investment securities available-for-sale. These derivatives were recorded on a net basis using Level 1 fair value inputs. Net losses related to TBAs sold, combined with fair value gains on the TBAs, resulted in a net gain of $866 thousand for the nine months ended September 30, 2018, compared to a net loss of $817 thousand for the same period of 2017. These were included in “Fee and miscellaneous income, net” in the Consolidated Statements of Comprehensive Income.

**Non-Recurring**

We may also be required, from time to time, to measure certain assets at fair value on a non-recurring basis. The following represents a summary of the assets, valuation techniques, and inputs used to measure fair value on a non-recurring basis:

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

**Other property owned:** Represents the fair value and related losses of foreclosed assets that were measured at fair value based on the collateral value, which is generally determined using appraisals, or other indications based on sales of similar properties. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. If the process uses independent appraisals and other observable market-based information, they are classified as Level 2. If the process requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the property and other matters, they are classified as Level 3.

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

(in thousands)

| | **As of September 30, 2018** | | | |
|---|---|---|---|---|
| | Fair Value Measurement Using | | | Total Fair |
| | Level 1 | Level 2 | Level 3 | Value |
| Impaired loans | **$ --** | **$ --** | **$ 27,468** | **$ 27,468** |
| Other property owned | **--** | **--** | **1,636** | **1,636** |
| | As of December 31, 2017 | | | |
| | Fair Value Measurement Using | | | Total Fair |
| | Level 1 | Level 2 | Level 3 | Value |
| Impaired loans | $ -- | $ -- | $ 13,304 | $ 13,304 |
| Other property owned | -- | -- | 1,130 | 1,130 |

**NOTE 7: SUBSEQUENT EVENTS**

We have evaluated subsequent events through November 6, 2018, which is the date the Consolidated Financial Statements were available to be issued. There have been no material subsequent events that would require recognition in our Quarterly Report or disclosure in the Notes to Consolidated Financial Statements.