# Badgerland Financial, ACA

**Quarterly Report**
**September 30, 2015**

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the consolidated financial condition and consolidated results of operations of Badgerland Financial, ACA (the parent) and Badgerland Financial, FLCA and Badgerland Financial, PCA (the subsidiaries). 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, 2014 (2014 Annual Report).

AgriBank, FCB's (AgriBank) financial condition and results of operations materially impact members' investment in Badgerland Financial, ACA. To request free copies of the AgriBank and combined AgriBank and affiliated Associations' financial reports or additional copies of our report, contact us at:


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## 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 2014 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

Overall, growing conditions for the year were favorable. There was an extended period of time during the late summer with little moisture which may impact soybean yields in particular. Feed supplies for livestock producers are good. Harvest is underway and weather conditions have been good so far for getting the crops out of the fields. Yields are average to good for soybeans. Corn yields are expected to be above average throughout most of the association's territory. Cash prices for corn and soybeans have declined as harvest time approached. Cash corn prices are about $3.35/bushel (bu) to $3.40/bu with soybeans about $8.05/bu to $8.15/bu. Futures prices for new crop corn are approximately $3.67/bu with soybeans at approximately $8.75/bu. More grain is expected to go into storage this fall with producers looking to take advantage of any price increases after the fall harvest. Much tighter margins are expected by grain producers over the next couple of years. Although operating expenses, including cash rent, may eventually adjust downward to reflect the lower commodity prices, there will likely be a period of time where margins will be negative for many producers.

Class III milk price for the third quarter averaged $16.14/Hundred weight (cwt). This price reflects a ten cent reduction from the previous quarter and compares negatively to a price of $22.02 for the third quarter of 2014. Calendar year 2014 averaged $22.34/cwt. 2015 is expected to average about $16.00/cwt. Milk futures for the balance of 2015 (Oct-Dec) currently average $15.46/cwt. (all milk prices are before premiums). Many dairy producers had done considerable prepaying of expenses for 2014 tax planning purposes. The pre-pays plus some reduction in feed costs have helped producers deal with lower margins in 2015. However, the outlook for milk prices over the next few months is expected to result in very tight margins for many dairy producers. Overall land prices have remained stable to increasing throughout the association's territory year-to-date, however, the much tighter margins being experienced by both grain and dairy operations is expected to result in a softening of land prices over the next year.

## LOAN PORTFOLIO

### Loan Portfolio

Total loans were $3.6 billion at September 30, 2015, an increase of $178.3 million from December 31, 2014. The change was primarily due to an increase in accrual mortgage loan volume in the amount of $157.2 million or 5.9%, from December 31, 2014. Year-to-date growth has been modest so far; however, we have seen an increase in new loan activity the past couple of months. In part, this is a result of a successful new business marketing campaign which recently concluded. The loan participations portfolio showed some pay downs early in the year; however, increased activity in this portfolio has resulted in the outstanding principal balance increasing to a level similar to its 2015 peak. Much of the loan participation portfolio is booked as mortgage loans.

On July 1, 2015 we added an additional $49.9 million of loan assets to the 2008 pool in the AgriBank Asset Pool Program. Additionally, we were required to purchase additional AgriBank stock as a result of this transaction in order to maintain the required investment equal to 8.0% of the loans we have sold under this program.

## Portfolio Credit Quality

The credit quality of our portfolio remained stable from December 31, 2014. Adversely classified loans increased to 2.4% of the portfolio at September 30, 2015, from 2.2% of the portfolio at December 31, 2014. 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, government guarantee programs are used to reduce the risk of loss. At September 30, 2015, $102.0 million of our loans were, to some level, guaranteed under these government programs.

## Risk Assets

The following table summarizes risk information (accruing loans include accrued interest receivable) (dollars in thousands):

| As of: | **September 30 2015** | December 31 2014 |
|---|---|---|
| Loans: | | |
| Nonaccrual | **$ 19,938** | $ 11,532 |
| Accruing restructured | **684** | 56 |
| Accruing loans 90 days or more past due | **2,658** | 249 |
| Total risk loans | **23,280** | 11,837 |
| Other property owned | **307** | 782 |
| Total risk assets | **$ 23,587** | $ 12,619 |
| Total risk loans as a percentage of total loans | **0.6%** | 0.3% |
| Nonaccrual loans as a percentage of total loans | **0.6%** | 0.3% |
| Total delinquencies as a percentage of total loans | **0.6%** | 0.5% |

Our risk assets have increased from December 31, 2014, but remain at acceptable levels. Despite the increase in risk assets, total risk loans as a percentage of total loans remains well within our established risk management guidelines.

The increase in nonaccrual loans was due primarily to several loans within our portion of the ProPartners Financial alliance portfolio moving to nonaccrual as well as the transfer of a large participation loan to nonaccrual. Nonaccrual loans remained at an acceptable level at September 30, 2015 and 41.2% of our nonaccrual loans were current.

The increase in accruing restructured loans was primarily due to a transfer of a production and intermediate term loan in the amount of $410 thousand to accruing restructured status during the first quarter of 2015 and a transfer of a real estate mortgage loan of $249 thousand to accruing restructured status during the second quarter of 2015.

The increase in accruing loans 90 days or more past due was primarily due to an increase in delinquent loans in the production and intermediate term category and due to several loans within our portion of the ProPartners Financial alliance portfolio becoming past due for 90 days or more. Based on our analysis, all loans 90 days or more past due and still accruing interest were adequately secured and in the process of collection and, as such, were eligible to remain in accruing status.

The decrease in other property owned was primarily due to disposals during the nine months ended September 30, 2015.

## 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.

The following table presents comparative allowance coverage of various loan categories:

| As of: | **September 30 2015** | December 31 2014 |
|---|---|---|
| Allowance as a percentage of: | | |
| Loans | **0.3%** | 0.3% |
| Nonaccrual loans | **61.5%** | 81.3% |
| Total risk loans | **52.7%** | 79.2% |

In our opinion, the allowance for loan losses was reasonable in relation to the risk in our loan portfolio at September 30, 2015. The change in ratios is due to the increase in nonaccrual loans as noted in Risk Assets discussed above whereas the allowance has remained stable.

## RESULTS OF OPERATIONS

The following table presents profitability information (dollars in thousands):

| For the nine months ended September 30 | 2015 | 2014 |
|---|---|---|
| Net income | **$ 55,487** | $ 58,010 |
| Return on average assets | **2.0%** | 2.3% |
| Return on average members' equity | **9.6%** | 10.9% |

Changes in these ratios are directly related to the changes in income discussed in this section, changes in assets discussed in the Loan Portfolio section, and changes in capital discussed in the Funding, Liquidity, and Capital section.

The following table summarizes the changes in components of net income (in thousands):

| For the nine months ended September 30 | 2015 | 2014 | Increase (decrease) in net income |
|---|---|---|---|
| Net interest income | **$ 70,773** | $ 70,073 | **$ 700** |
| Provision for loan losses | **2,210** | 1,936 | **(274)** |
| Patronage income | **14,869** | 15,986 | **(1,117)** |
| Other income, net | **13,748** | 13,723 | **25** |
| Operating expenses | **42,059** | 40,352 | **(1,707)** |
| Benefit from income taxes | **(366)** | (516) | **(150)** |
| Net income | **$ 55,487** | $ 58,010 | **$ (2,523)** |

The following table quantifies changes in net interest income for the nine months ended September 30, 2015 compared to the same period in 2014 (in thousands):

| | 2015 vs 2014 |
|---|---|
| Changes in volume | **$ 4,238** |
| Changes in interest rates | **(3,418)** |
| Changes in nonaccrual income and other | **(120)** |
| Net change | **$ 700** |

The change in the provision for loan losses was primarily related to changes in loan volume and loss estimates in the portfolio.

The change in patronage income was primarily related to decreased patronage received from AgriBank due to a lower patronage rate compared to the prior year and a decrease in patronage income received from the AgDirect trade credit financing program as a result of lower than anticipated loan volume.

The change in operating expenses was primarily related to increased salaries and benefits expenses resulting from new staff positions and the Farm Credit System Insurance Corporation (FCSIC) expense increasing in 2015 primarily due to an increase in the premium rate charged on accrual loans by FCSIC from 12 basis points in 2014 to 13 basis points in 2015.

## 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 August 30, 2015 and was renewed for $3.6 billion with a maturity date of August 30, 2016. The note payable will be renegotiated at that time. 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 the Association is a stockholder of AgriBank, we expect this borrowing relationship to continue into the foreseeable future.

Cost of funds associated with our note payable includes a marginal cost of debt component, a spread component, which includes cost of servicing, cost of liquidity, bank profit, and, if applicable, a risk premium component. However, we were not subject to a risk premium at September 30, 2015 or December 31, 2014.

Total members’ equity increased $45.5 million from December 31, 2014 primarily due to net income for the period, which was partially offset by patronage distribution accruals.

Farm Credit Administration regulations require us to maintain a certain level for our permanent capital ratio, total surplus ratio, and core surplus ratio. Refer to Note 7 in our 2014 Annual Report for a more complete description of these ratios. The following table summarizes the regulatory minimums and our actual results for the regulatory ratios:

| As of | Regulatory Minimums | **September 30 2015** | December 31 2014 |
|---|---|---|---|
| Permanent capital ratio | 7.0% | **16.9%** | **16.5%** |
| Total surplus ratio | 7.0% | **16.6%** | **16.3%** |
| Core surplus ratio | 3.5% | **16.6%** | **16.3%** |

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.

## REGULATORY MATTERS

On May 8, 2014, the FCA Board approved a proposed rule to modify the regulatory capital requirements for System Banks and Associations. The stated objectives of the proposed rule are to:

- Modernize capital requirements while ensuring that institutions continue to hold sufficient regulatory capital to fulfill their mission as a government-sponsored enterprise
- 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
- Make System regulatory capital requirements more transparent
- Meet the requirements of section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act

The most recent comment period closed July 10, 2015. The initial comment period on the proposed rule, after extension, closed February 16, 2015.

On June 12, 2014, the FCA Board approved a proposed rule to revise the requirements governing the eligibility of investments for System Banks and Associations. The stated objectives of the proposed rule are to:

- Strengthen the safety and soundness of System Banks and Associations
- Ensure that System Banks hold sufficient liquidity to continue operations and pay maturing obligations in the event of market disruption
- Enhance the ability of the System Banks to supply credit to agricultural and aquatic producers
- Comply with the requirements of section 939A of the Dodd-Frank Act
- Modernize the investment eligibility criteria for System Banks
- Revise the investment regulation for System Associations to improve their investment management practices so they are more resilient to risk

The public comment period ended on October 23, 2014.

## CERTIFICATION

The undersigned have reviewed the September 30, 2015 Quarterly Report of Badgerland 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 W. Cade
Chairperson of the Board
Badgerland Financial, ACA

Diane M. Cole

Diane M. Cole
Chief Executive Officer
Badgerland Financial, ACA

Gregory Rufsvold

Gregory S. Rufsvold
Chief Financial Officer
Badgerland Financial, ACA

November 9, 2015

# CONSOLIDATED STATEMENTS OF CONDITION

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

| As of: | | **September 30 2015** | | December 31 2014 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Loans | **$** | **3,593,242** | $ | 3,414,943 |
| Allowance for loan losses | | **12,262** | | 9,378 |
| Net loans | | **3,580,980** | | 3,405,565 |
| Investment in AgriBank, FCB | | **99,812** | | 96,807 |
| Accrued interest receivable | | **27,216** | | 18,636 |
| Other property owned | | **307** | | 782 |
| Other investments | | **7,275** | | 6,725 |
| Other assets | | **45,148** | | 45,961 |
| Total assets | **$** | **3,760,738** | $ | 3,574,476 |
| **LIABILITIES** | | | | |
| Note payable to AgriBank, FCB | **$** | **2,916,542** | $ | 2,787,000 |
| Accrued interest payable | | **10,654** | | 9,480 |
| Deferred tax liabilities, net | | **687** | | 1,053 |
| Patronage distribution payable | | **10,125** | | 13,000 |
| Other liabilities | | **30,260** | | 16,983 |
| Total liabilities | | **2,968,268** | | 2,827,516 |
| Contingencies and commitments | | **--** | | -- |
| **MEMBERS' EQUITY** | | | | |
| Capital stock and participation certificates | | **8,489** | | 8,345 |
| Unallocated surplus | | **783,981** | | 738,615 |
| Total members' equity | | **792,470** | | 746,960 |
| Total liabilities and members' equity | **$** | **3,760,738** | $ | 3,574,476 |

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

# CONSOLIDATED STATEMENTS OF INCOME

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

| | *Three Months Ended* | | *Nine Months Ended* | |
|---|---|---|---|---|
| *For the period ended September 30* | **2015** | 2014 | **2015** | 2014 |
| **Interest income** | **$ 34,738** | $ 32,729 | **$ 101,386** | $ 96,949 |
| **Interest expense** | **10,656** | 9,097 | **30,613** | 26,876 |
| Net interest income | **24,082** | 23,632 | **70,773** | 70,073 |
| **Provision for loan losses** | **903** | 1,026 | **2,210** | 1,936 |
| Net interest income after provision for loan losses | **23,179** | 22,606 | **68,563** | 68,137 |
| **Other income** | | | | |
| Patronage income | **4,942** | 5,215 | **14,869** | 15,986 |
| Financially related services income | **5,386** | 5,384 | **10,399** | 9,763 |
| Fee income | **1,210** | 849 | **3,454** | 3,103 |
| Miscellaneous (loss) income, net | **(146)** | 790 | **(105)** | 857 |
| Total other income | **11,392** | 12,238 | **28,617** | 29,709 |
| **Operating expenses** | | | | |
| Salaries and employee benefits | **8,867** | 8,646 | **26,363** | 25,852 |
| Other operating expenses | **4,867** | 4,760 | **15,696** | 14,500 |
| Total operating expenses | **13,734** | 13,406 | **42,059** | 40,352 |
| Income before income taxes | **20,837** | 21,438 | **55,121** | 57,494 |
| **Benefit from income taxes** | **172** | (259) | **(366)** | (516) |
| Net income | **$ 20,665** | $ 21,697 | **$ 55,487** | $ 58,010 |

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

# CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

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

| | Capital Stock and Participation Certificates | Unallocated Surplus | Total Members' Equity |
|---|---|---|---|
| Balance at December 31, 2013 | $ 8,151 | $ 677,398 | $ 685,549 |
| Net income | -- | 58,010 | 58,010 |
| Unallocated surplus designated for patronage distributions | -- | (7,496) | (7,496) |
| Capital stock and participation certificates issued | 561 | -- | 561 |
| Capital stock and participation certificates retired | (399) | -- | (399) |
| Balance at September 30, 2014 | $ 8,313 | $ 727,912 | $ 736,225 |
| Balance at December 31, 2014 | $ 8,345 | $ 738,615 | $ 746,960 |
| Net income | **--** | **55,487** | **55,487** |
| Unallocated surplus designated for patronage distributions | **--** | **(10,121)** | **(10,121)** |
| Capital stock and participation certificates issued | **585** | **--** | **585** |
| Capital stock and participation certificates retired | **(441)** | **--** | **(441)** |
| **Balance at September 30, 2015** | **$ 8,489** | **$ 783,981** | **$ 792,470** |

*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 accompanying Consolidated Financial Statements contain all adjustments necessary for a fair presentation of the interim consolidated financial condition and consolidated results of operations. While our accounting policies conform to accounting principles generally accepted in the United States of America (U.S. GAAP) and the prevailing practices within the financial services industry, this interim Quarterly Report is prepared based upon statutory and regulatory requirements and, accordingly, does not include all disclosures required by U.S. GAAP. The results of the nine months ended September 30, 2015 are not necessarily indicative of the results to be expected for the year ending December 31, 2015. 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, 2014 (2014 Annual Report).

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

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

#### Recently Issued or Adopted Accounting Pronouncements

We have assessed the potential impact of accounting standards that have been issued, but are not yet effective, and have determined that no such standards are expected to have a material impact to our Consolidated Financial Statements.

### NOTE 2: LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans consisted of the following (dollars in thousands):

| As of: | **September 30, 2015** | | December 31, 2014 | |
|---|---|---|---|---|
| | Amount | % | Amount | % |
| Real estate mortgage | **$ 2,187,254** | **60.9%** | $ 2,054,506 | 60.2% |
| Production and intermediate term | **894,410** | **24.9%** | 864,969 | 25.3% |
| Agribusiness | **324,459** | **9.0%** | 307,623 | 9.0% |
| Other | **187,119** | **5.2%** | 187,845 | 5.5% |
| Total | **$ 3,593,242** | **100.0%** | $ 3,414,943 | 100.0% |

The other category is primarily comprised of communication, rural residence, and energy related loans as well as certain assets originated under our mission related investment authority.

#### Delinquency

The following table provides an aging analysis of past due loans and related accrued interest receivable by loan type (in thousands):

| **As of September 30, 2015** | 30-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or Less than 30 Days Past Due | Total | 90 Days or More Past Due and Accruing |
|---|---|---|---|---|---|---|
| Real estate mortgage | **$ 7,424** | **$ 4,330** | **$ 11,754** | **$ 2,192,779** | **$ 2,204,533** | **$ 1,308** |
| Production and intermediate term | **2,263** | **5,090** | **7,353** | **895,809** | **903,162** | **896** |
| Agribusiness | **156** | **3,526** | **3,682** | **321,234** | **324,916** | **25** |
| Other | **77** | **430** | **507** | **187,340** | **187,847** | **429** |
| Total | **$ 9,920** | **$ 13,376** | **$ 23,296** | **$ 3,597,162** | **$ 3,620,458** | **$ 2,658** |

| As of December 31, 2014 | 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 | 90 Days or More Past Due and Accruing |
|---|---|---|---|---|---|---|
| Real estate mortgage | $ 9,835 | $ 2,155 | $ 11,990 | $ 2,053,421 | $ 2,065,411 | $ 142 |
| Production and intermediate term | 4,757 | 590 | 5,347 | 866,156 | 871,503 | 107 |
| Agribusiness | -- | -- | -- | 308,271 | 308,271 | -- |
| Other | 151 | 655 | 806 | 187,588 | 188,394 | -- |
| Total | $ 14,743 | $ 3,400 | $ 18,143 | $ 3,415,436 | $ 3,433,579 | $ 249 |

## Risk Loans

The following table presents risk loan information (accruing loans include accrued interest receivable) (in thousands):

| As of: | September 30 2015 | December 31 2014 |
|---|---|---|
| Volume with specific reserves | **$ 7,841** | $ 2,519 |
| Volume without specific reserves | **15,439** | 9,318 |
| Total risk loans | **$ 23,280** | $ 11,837 |
| Total specific reserves | **$ 3,156** | $ 874 |
| For the nine months ended September 30 | **2015** | 2014 |
| Income on accrual risk loans | **$ 90** | $ 61 |
| Income on nonaccrual loans | **399** | 519 |
| Total income on risk loans | **$ 489** | $ 580 |
| Average risk loans | **$ 17,655** | $ 12,787 |

The increase in risk loans is due primarily to the increase in nonaccrual loans, increase in accruing restructured loans, and increase in accruing loans 90 days or more past due. The increase in nonaccrual loans was primarily due to several loans within our portion of the ProPartners Financial alliance portfolio moving to nonaccrual as well as the transfer of a large participation loan to nonaccrual. The increase in accruing restructured loans was primarily due to a transfer of a production and intermediate term loan in the amount of $410 thousand to accruing restructured status during the first quarter of 2015 and a transfer of a Real Estate Mortgage loan of $249 thousand to accruing restructured status during the second quarter of 2015. The increase in accruing loans 90 days or more past due was primarily due to an increase in delinquent loans in the production and intermediate term category and due to several loans within our portion of the ProPartners Financial alliance portfolio becoming past due for 90 days or more.

We did not have any material commitments to lend additional money to borrowers whose loans were at risk at September 30, 2015.

## 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.

The following table presents information regarding TDRs that occurred during the nine months ended September 30 (in thousands):

| | **2015** | | 2014 | |
|---|---|---|---|---|
| | Pre-modification | Post-modification | Pre-modification | Post-modification |
| Real estate mortgage | **$ 436** | **$ 250** | $ 176 | $ 176 |
| Production and intermediate term | **582** | **508** | 7 | 7 |
| Agribusiness | **4,505** | **4,505** | -- | -- |
| Total | **$ 5,523** | **$ 5,263** | $ 183 | $ 183 |

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 of the loan is the face amount of the receivable increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, and acquisition costs and may also reflect a previous direct charge-off.

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

The following table presents TDRs that defaulted during the nine months ended September 30 in which the modification date was within twelve months of the respective reporting period (in thousands):

| | **2015** | 2014 |
|---|---|---|
| Production and intermediate term | **$ 12** | $ -- |
| Agribusiness | **3,501** | -- |
| Total | **$ 3,513** | $ -- |

The following table presents information regarding TDRs outstanding (in thousands):

| As of: | | September 30 2015 | | December 31 2014 |
|---|---|---|---|---|
| Accrual status: | | | | |
| Real estate mortgage | $ | **248** | $ | -- |
| Production and intermediate term | | **436** | | 56 |
| Total TDRs in accrual status | $ | **684** | $ | 56 |
| Nonaccrual status: | | | | |
| Real estate mortgage | $ | **287** | $ | 313 |
| Production and intermediate term | | **226** | | 191 |
| Agribusiness | | **4,501** | | -- |
| Total TDRs in nonaccrual status | $ | **5,014** | $ | 504 |
| Total TDRs | $ | **5,698** | $ | 560 |

The increase in nonaccrual status TDRs was primarily due to a non-accrual large participation loan which was restructured during the 9 months ending September 30, 2015. The increase in accrual status TDRs was primarily due to the restructure of an accrual production and intermediate term loan in the amount of $410 thousand during the first quarter of 2015 and a restructure of an accrual real estate mortgage loan of $249 thousand during the second quarter of 2015.

Additional commitments to lend to borrowers whose loans have been modified in a TDR were $1 thousand at September 30, 2015.

### Allowance for Loan Losses

A summary of changes in the allowance for loan losses follows (in thousands):

| Nine months ended September 30 | | 2015 | | 2014 |
|---|---|---|---|---|
| Balance at beginning of period | $ | **9,378** | $ | 2,740 |
| Provision for loan losses | | **2,210** | | 1,936 |
| Loan recoveries | | **719** | | 88 |
| Loan charge-offs | | **(45)** | | (413) |
| Balance at end of period | $ | **12,262** | $ | 4,351 |

The increase in allowance for loan losses was related to $2.2 million provision for loan losses recorded in the nine months ended September 30, 2015 primarily related to changes in loss estimates and specific reserves in the portfolio.

## NOTE 3: OTHER INVESTMENTS

We hold non-controlling investments in venture capital equity funds of $7.3 million at September 30, 2015 and $6.7 million at December 31, 2014. These investments represent our stake in venture capital equity funds focused on the needs of rural start-up companies. Our $5.0 million commitment to these venture capital equity funds began in 2008 and was initially over a period of ten years. In 2013, we committed an additional $5.0 million over a period of ten additional years. We are a limited partner in the funds and these investments are valued at cost. Our remaining commitment to the funds at September 30, 2015 was $2.5 million over the next nine years.

The investments were evaluated for impairment. No impairments have been recognized on these investments during the nine months ended September 30, 2015 or 2014. To date, we have not received any distributions from the funds. A dividend distribution of $237 thousand was received from the funds on October 6, 2015.

## NOTE 4: CONTINGENCIES AND COMMITMENTS

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

We may be named as a defendant in lawsuits or legal actions in the normal course of business. At the date of these Consolidated Financial Statements, we were not aware of any such actions that would have a material impact on our financial condition. However, such actions could arise in the future.

We hold non-controlling investments in venture capital equity funds. Refer to Note 3 for additional discussion regarding this commitment.

## NOTE 5: 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 levels of inputs that may be used to measure fair value. Refer to Note 2 in our 2014 Annual Report for a more complete description of the three input levels.

We did not have any assets or liabilities measured at fair value on a recurring basis at September 30, 2015 or December 31, 2014.

### Non-Recurring Basis

We may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. Information on assets measured at fair value on a non-recurring basis follows (in thousands):

| | **As of September 30, 2015** | | | | **Nine months ended September 30, 2015** |
|---|---|---|---|---|---|
| | Fair Value Measurement Using | | | Total Fair | Total |
| | Level 1 | Level 2 | Level 3 | Value | Losses |
| Impaired loans | **$ --** | **$ 4,801** | **$ 118** | **$ 4,919** | **$ (2,327)** |
| Other property owned | **--** | **--** | **319** | **319** | **(92)** |

| | As of December 31, 2014 | | | | Nine months ended September 30, 2014 |
|---|---|---|---|---|---|
| | Fair Value Measurement Using | | | Total Fair | Total |
| | Level 1 | Level 2 | Level 3 | Value | Losses |
| Impaired loans | $ -- | $ 1,703 | $ 24 | $ 1,727 | $ (1,315) |
| Other property owned | -- | -- | 813 | 813 | 165 |

### Valuation Techniques

**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 market-based information, they fall under 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 fall under 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.

## NOTE 6: SUBSEQUENT EVENTS

We have evaluated subsequent events through November 6, 2015, 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.