1st Farm Credit Services, ACA

Quarterly Report
September 30, 2016

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the consolidated financial condition and consolidated results of operations of 1st Farm Credit Services, ACA (the parent) and 1st Farm Credit Services, FLCA and 1st Farm Credit Services, 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, 2015 (2015 Annual Report).

AgriBank, FCB's (AgriBank) financial condition and results of operations materially impact members' investment in 1st Farm Credit Services, 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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MERGER ACTIVITY

We are committed to the success of agriculture, rural communities and most importantly, our client-owners. Every day, we partner with our clients to deliver the insights and expert guidance they have come to expect and count on from their financial services provider. To be that trusted advisor, we are consistently looking for ways to better serve our clients and return value to our stockholders. It's a business objective we've been committed to for the long haul and one we believe matches the strides of our clients – constantly evolving and growing to better our operation.

In August, the Boards of Directors of 1st Farm Credit Services, ACA, AgStar Financial Services, ACA, and Badgerland Financial, ACA unanimously voted in favor of recommending a merger to our client-owners. With the decision to recommend a merger, a number of additional regulatory and procedural steps still need to be completed before our client-owners have the opportunity to vote on the proposal in early 2017. We filed a merger application with our regulator, the Farm Credit Administration, in the third quarter.

1st Farm Credit Services, ACA serves the northern 42 counties of Illinois. Badgerland Financial, ACA serves the southern 33 Wisconsin counties; and AgStar Financial Services, ACA serves 69 counties across Minnesota and Wisconsin. While our markets differ in some ways, our philosophies and focus on client relationships and commitment to rural communities and agriculture are closely aligned.

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 2015 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

According to the October 3, 2016 USDA Crop Progress and Condition Report, the Illinois corn harvest was 43% complete, compared to 44% last year. Corn condition was rated at 82% good to excellent. The percentage of corn that was mature reached 97%, compared to 93% last year.

Soybean harvest was 16% complete, compared to 42% last year. Soybean condition was rated at 80% good to excellent. Soybeans turning color reached 94%, the same as 94% last year.

Temperature averaged 61.5 degrees, 0.4 degrees below normal at the end of the quarter. Topsoil moisture was 97% adequate or better and subsoil moisture was 96% adequate or better.

According to the USDA Illinois Crop Production Report, the forecasted corn yield per acre for Illinois is 200 bushels, up 14 bushels from 2015. Harvested area of corn is forecast at 11.5 million acres, unchanged from 2015. Production is forecast at 2.3 billion bushels, up 14% from last year. If realized, this would tie the 2014 record corn yield and be the second highest production on record behind 2014.

The harvested area of soybeans, forecast at 9.84 million acres, is up 1% from the previous year. The Illinois soybean yield is forecast at 61 bushels per acre, up 5 bushels from 2015. Production is forecast at a record setting 600 million bushels, a 10% increase from last year.

Corn prices in Central Illinois at September 30, 2016 were $3.09 per bushel, down $0.36 per bushel from last quarter and down $0.86 per bushel compared to one year ago. Soybean prices for the same period were $9.24 per bushel, down $2.34 per bushel from last quarter, yet up $0.56 per bushel compared to one year ago.

According to the September 1, 2016 Hogs and Pigs Report, in the United States the inventory of all hogs and pigs was 70.9 million head, up 4% from June 1 and up 2% from one year ago. The average pigs saved per litter was a record high 10.58 for the June-August period, compared to 10.39 last year. Farrowing intentions were 2.9 million sows during the September-November quarter, down slightly from the actual farrowings during the same period in 2015.

LOAN PORTFOLIO

Loan Portfolio

Total loans were $5.3 billion at September 30, 2016, an increase of $98.0 million from December 31, 2015. The increase was primarily due to real estate loan growth offset by increased repayments on commercial loan balances.

Portfolio Credit Quality

The credit quality of our portfolio remained stable from December 31, 2015. Adversely classified loans increased to 1.6% of the portfolio at September 30, 2016, from 1.5% of the portfolio at December 31, 2015. Adversely classified loans are loans with well-defined credit weakness. 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, 2016, $473.1 million of our loans were, to some level, guaranteed under these government programs.

Risk Assets

Risk assets are comprised of nonaccrual loans, accruing restructured loans, accruing loans 90 days or more past due, and other property owned.

Components of Risk Assets

(dollars in thousands) As of:	**September 30 2016**	December 31 2015
Loans:		
Nonaccrual	**$34,985**	$27,704
Accruing restructured	**1,050**	1,658
Accruing loans 90 days or more past due	**786**	5,542
Total risk loans	**36,821**	34,904
Other property owned	**323**	--
Total risk assets	**$37,144**	$34,904
Total risk loans as a percentage of total loans	**0.7%**	0.7%
Nonaccrual loans as a percentage of total loans	**0.6%**	0.5%
Current nonaccrual loans as a percentage of total nonaccrual loans	**28.7%**	43.8%
Total delinquencies as a percentage of total loans	**0.6%**	0.5%

Note: Accruing loans include accrued interest receivable.

Our risk assets have not changed significantly from December 31, 2015 and remained at acceptable levels. Total risk loans as a percentage of total loans were well within our established risk management guidelines.

The increase in nonaccrual loans was primarily due to the downgrade of a commercial loan relationship and a real estate loan relationship offset by a payoff of a commercial loan relationship. Nonaccrual loans remained at an acceptable level at September 30, 2016.

Our accounting policy requires accruing loans past due 90 days to be transferred into nonaccrual status unless adequately secured and in the process of collection. Based on our analysis, all accruing loans 90 days or more past due were eligible to remain in accruing status.

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 2016**	December 31 2015
Allowance as a percentage of:		
Loans	**0.3%**	0.3%
Nonaccrual loans	**51.9%**	65.0%
Total risk loans	**49.3%**	51.6%

In our opinion, the allowance for loan losses was reasonable in relation to the risk in our loan portfolio at September 30, 2016.

RESULTS OF OPERATIONS

Profitability Information

(dollars in thousands) For the nine months ended September 30	**2016**	2015
Net income	**$71,333**	$67,301
Return on average assets	**1.7%**	1.8%
Return on average members' equity	**9.4%**	9.5%

Changes in the chart above 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.

Changes in Significant Components of Net Income

(in thousands) For the nine months ended September 30	**2016**	2015	**Increase (decrease) in net income**
Net interest income	**$94,232**	$89,693	**$4,539**
Provision for loan losses	**764**	2,321	**1,557**
Patronage income	**14,219**	14,619	**(400)**
Other income, net	**12,411**	12,060	**351**
Operating expenses	**48,497**	45,106	**(3,391)**
Provision for income taxes	**268**	1,644	**1,376**
Net income	**$71,333**	$67,301	**$4,032**

Changes in Net Interest Income

(in thousands) For the nine months ended September 30	**2016 vs 2015**
Changes in volume	**$9,804**
Changes in interest rates	**(7,085)**
Changes in nonaccrual income and other	**1,820**
Net change	**$4,539**

The change in the provision for loan losses was primarily related to a decrease in exposure due to historically high farm land values partially offset by an increase in allowance for loan loss related to impaired loans.

The change in patronage income was primarily related to a decrease in patronage income received on loans in the AgriBank Asset Pool Program due to lower patronage rates and a lower average balance of our portfolio in the AgriBank Asset Pool Program compared to the prior year. In addition, patronage received from AgriBank decreased due to a lower patronage rate compared to the prior year. These decreases were partially offset by the patronage accrued related to an increase in the wholesale spread on our note payable.

The change in other income was primarily related to an increase in financially related services income.

The change in operating expenses was primarily related to Farm Credit System Insurance Corporation (FCSIC) expense which increased in 2016 primarily due to an increase in the premium rate charged by FCSIC on accrual loans from 13 basis points in 2015 to 16 basis points for the first half and 18 basis points for the second half of 2016.The FCSIC Board meets periodically throughout the year to review premium rates and has the ability to change these rates at any time.

FUNDING, LIQUIDITY, AND CAPITAL

We borrow from AgriBank, under a note payable, in the form of a line of credit. Our note payable matures on November 30, 2016, at which time the note will be renegotiated. 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.

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, 2016 or December 31, 2015.

Total members' equity increased $57.3 million from December 31, 2015 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 2015 Annual Report for a more complete description of these ratios.

Select Capital Ratios

As of	Regulatory Minimums	**September 30 2016**	December 31 2015
Permanent capital ratio	7.0%	**16.5%**	16.4%
Total surplus ratio	7.0%	**16.3%**	16.2%
Core surplus ratio	3.5%	**16.3%**	16.2%

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. As discussed in Note 4 of the accompanying Consolidated Financial Statements we will be subject to new regulations and capital requirements effective January 1, 2017.

REGULATORY MATTERS

Regulatory Capital Requirements

On March 10, 2016, the FCA Board approved a final rule to modify the regulatory capital requirements for System Banks and Associations. The stated objectives of the 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 final rule replaces existing core surplus and total surplus ratios with common equity tier 1, tier 1, and total capital risk-based capital ratios. The final rule also adds a tier 1 leverage ratio. The permanent capital ratio continues to remain in effect with the final rule. Refer to Note 4 of the accompanying Consolidated Financial Statements for additional information regarding these ratios.

The effective date of the new capital requirements is January 1, 2017. We are currently evaluating the impact of the recently announced changes.

Investment Securities Eligibility

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. FCA has not issued any further information regarding this proposed rule.

CERTIFICATION

The undersigned have reviewed the September 30, 2016 Quarterly Report of 1st Farm Credit Services 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.

Jeffrey Austman
Chairperson of the Board
1st Farm Credit Services, ACA

Gary J. Ash
President and Chief Executive Officer
1st Farm Credit Services, ACA

James F. Garvin
Chief Financial Officer
1st Farm Credit Services, ACA

November 4, 2016

CONSOLIDATED STATEMENTS OF CONDITION

1st Farm Credit Services, ACA
(in thousands)
(Unaudited)

As of:	**September 30 2016**	December 31 2015
ASSETS		
Loans	**$5,342,979**	$5,244,991
Allowance for loan losses	**18,141**	17,998
Net loans	**5,324,838**	5,226,993
Investment in AgriBank, FCB	**128,203**	125,702
Investment securities	**188,838**	134,351
Accrued interest receivable	**60,474**	45,167
Other property owned	**323**	--
Other assets	**45,530**	43,139
Total assets	**$5,748,206**	$5,575,352
LIABILITIES		
Note payable to AgriBank, FCB	**$4,655,066**	$4,535,834
Accrued interest payable	**18,323**	15,683
Patronage distribution payable	**13,874**	18,000
Other liabilities	**15,907**	18,123
Total liabilities	**4,703,170**	4,587,640
Contingencies and commitments (Note 5)		
MEMBERS' EQUITY		
Protected members' equity	**--**	8
Capital stock and participation certificates	**9,904**	10,025
Allocated surplus	**52,412**	--
Unallocated surplus	**982,720**	977,679
Total members' equity	**1,045,036**	987,712
Total liabilities and members' equity	**$5,748,206**	$5,575,352

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

CONSOLIDATED STATEMENTS OF INCOME

1st Farm Credit Services, ACA
(in thousands)
(Unaudited)

	Three Months Ended		Nine Months Ended	
For the period ended September 30	**2016**	2015	**2016**	2015
Interest income	**$51,120**	$45,103	**$148,049**	$132,956
Interest expense	**18,323**	14,986	**53,817**	43,263
Net interest income	**32,797**	30,117	**94,232**	89,693
(Reversal of) provision for loan losses	**(1,038)**	338	**764**	2,321
Net interest income after (reversal of) provision for loan losses	**33,835**	29,779	**93,468**	87,372
Other income				
Patronage income	**4,869**	4,774	**14,219**	14,619
Financially related services income	**7,477**	5,955	**8,779**	7,021
Fee income	**139**	1,607	**3,357**	4,596
Miscellaneous (loss) income, net	**(18)**	115	**275**	443
Total other income	**12,467**	12,451	**26,630**	26,679
Operating expenses				
Salaries and employee benefits	**10,768**	9,962	**31,608**	29,849
Other operating expenses	**5,983**	5,171	**16,889**	15,257
Total operating expenses	**16,751**	15,133	**48,497**	45,106
Income before income taxes	**29,551**	27,097	**71,601**	68,945
(Benefit from) provision for income taxes	**(554)**	530	**268**	1,644
Net income	**$30,105**	$26,567	**$71,333**	$67,301

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

CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

1st Farm Credit Services, ACA

(in thousands)

(Unaudited)

	Protected Members' Equity	Capital Stock and Participation Certificates	Allocated Surplus	Unallocated Surplus	Total Members' Equity
Balance at December 31, 2014	$9	$9,953	$--	$904,496	$914,458
Net income	--	--	--	67,301	67,301
Unallocated surplus designated for patronage distributions	--	--	--	(6,913)	(6,913)
Capital stock and participation certificates issued	--	517	--	--	517
Capital stock and participation certificates retired	--	(455)	--	--	(455)
Balance at September 30, 2015	$9	$10,015	$--	$964,884	$974,908
Balance at December 31, 2015	$8	$10,025	$--	$977,679	$987,712
Net income	**--**	**--**	**--**	**71,333**	**71,333**
Net surplus allocated under nonqualified patronage program	**--**	**--**	**52,412**	**(52,412)**	**--**
Unallocated surplus designated for patronage distributions	**--**	**--**	**--**	**(13,880)**	**(13,880)**
Capital stock and participation certificates issued	**--**	**498**	**--**	**--**	**498**
Capital stock and participation certificates retired	**(8)**	**(619)**	**--**	**--**	**(627)**
Balance at September 30, 2016	**$--**	**$9,904**	**$52,412**	**$982,720**	**$1,045,036**

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. 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, 2016 are not necessarily indicative of the results to be expected for the year ending December 31, 2016. 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, 2015 (2015 Annual Report).

The Consolidated Financial Statements present the consolidated financial results of 1st Farm Credit Services, ACA (the parent) and 1st Farm Credit Services, FLCA and 1st Farm Credit Services, PCA (the subsidiaries). All material intercompany transactions and balances have been eliminated in consolidation.

Recently Issued or Adopted Accounting Pronouncements

The following accounting standards have been issued since the issuance of our 2015 Annual Report, but are not yet effective.

In June 2016, the Financial Accounting Standards Board (FASB) issued guidance entitled "Measurement of Credit Losses on Financial Instruments." The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses. The guidance is effective for nonpublic entities for annual reporting periods beginning after December 15, 2020 and interim periods within annual periods beginning after December 15, 2021. Early adoption is permitted as of annual reporting periods beginning after December 15, 2018, including interim periods within those annual periods. We are currently evaluating the impact of the guidance on our financial condition, results of operations, cash flows, and financial statement disclosures.

Refer to Note 2 in our 2015 Annual Report for additional information on other accounting standards that have been issued, but are not yet effective. We are currently evaluating the impact of the guidance on our Consolidated Financial Statements. No accounting pronouncements were adopted during the nine months ended September 30, 2016.

NOTE 2: LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans by Type

(dollars in thousands)

As of:	**September 30, 2016**		December 31, 2015	
	Amount	%	Amount	%
Real estate	**$2,838,248**	**53.1%**	$2,711,006	51.7%
Commercial	**1,966,820**	**36.8%**	2,081,360	39.7%
Other	**537,911**	**10.1%**	452,625	8.6%
Total	**$5,342,979**	**100.0%**	$5,244,991	100.0%

The Other category is primarily comprised of communication, energy, and international related loans and purchased government guaranteed loans and bonds originated under the Mission Related Investment authority.

Delinquency

Aging Analysis of Loans

(in thousands) **As of September 30, 2016**	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less than 30 Days Past Due	Total	90 Days or More Past Due and Accruing
Real estate	**$2,427**	**$5,664**	**$8,091**	**$2,864,984**	**$2,873,075**	**$--**
Commercial	**4,340**	**18,789**	**23,129**	**1,967,125**	**1,990,254**	**786**
Other	**288**	**--**	**288**	**538,878**	**539,166**	**--**
Total	**$7,055**	**$24,453**	**$31,508**	**$5,370,987**	**$5,402,495**	**$786**

As of December 31, 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	$1,993	$3,661	$5,654	$2,728,017	$2,733,671	$309
Commercial	2,757	11,589	14,346	2,087,935	2,102,281	244
Other	3,549	4,989	8,538	445,175	453,713	4,989
Total	$8,299	$20,239	$28,538	$5,261,127	$5,289,665	$5,542

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) As of:	**September 30 2016**	December 31 2015
Volume with specific reserves	**$7,980**	$9,506
Volume without specific reserves	**28,841**	25,398
Total risk loans	**$36,821**	$34,904
Total specific reserves	**$4,470**	$4,758
For the nine months ended September 30	**2016**	2015
Income on accrual risk loans	**$97**	$148
Income on nonaccrual loans	**2,431**	611
Total income on risk loans	**$2,528**	$759
Average risk loans	**$34,964**	$30,508

We did not have any material commitments to lend additional money to borrowers whose loans were at risk at September 30, 2016.

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.

We completed TDRs of certain commercial loans during the nine months ended September 30, 2016 and 2015. Our recorded investment in these loans just prior to restructuring was $113 thousand and $356 thousand during the nine months ended September 30, 2016 and 2015, respectively. Our recorded investment in these loans immediately following the restructuring was $115 thousand and $356 thousand during the nine months ended September 30, 2016 and 2015, respectively. 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 included deferral of principal and extension of maturity.

We had no TDRs that defaulted during the nine months ended September 30, 2016 and $14 thousand in the commercial loan category that defaulted during the nine months ended September 30, 2015, in which the modifications were within twelve months of the respective reporting period.

TDRs Outstanding

(in thousands) As of:	**September 30** **2016**	December 31 2015
Accrual status:		
Real estate	**$1,042**	$1,652
Commercial	**8**	6
Total TDRs in accrual status	**$1,050**	$1,658
Nonaccrual status:		
Real estate	**$2,321**	$2,734
Commercial	**5,393**	9,716
Total TDRs in nonaccrual status	**$7,714**	$12,450
Total TDRs status:		
Real estate mortgage	**$3,363**	$4,386
Commercial	**5,401**	9,722
Total TDRs	**$8,764**	$14,108

Additional commitments to lend to borrowers whose loans have been modified in a TDR were $46 thousand at September 30, 2016.

Allowance for Loan Losses

Changes for Allowance for Loan Losses

(in thousands) Nine months ended September 30	**2016**	2015
Balance at beginning of period	**$17,998**	$15,847
Provision for loan losses	**764**	2,321
Loan recoveries	**141**	429
Loan charge-offs	**(762)**	(612)
Balance at end of period	**$18,141**	$17,985

The increase in allowance for loan losses from December 31, 2015 was primarily related to identification of specific reserves related to loans transferred to nonaccrual.

NOTE 3: INVESTMENT SECURITIES

We held investment securities of $188.8 million at September 30, 2016 and $134.4 million at December 31, 2015. Our investment securities primarily consisted of securities containing loans fully guaranteed by the Small Business Administration (SBA) and mortgage-backed securities issued by the Federal Agricultural Mortgage Corporation (Farmer Mac).

The investment securities have been classified as held-to-maturity. The investment portfolio is evaluated for other-than-temporary impairment. To date, we have not recognized any impairment on our investment portfolio.

Our investments are either mortgage-backed securities (MBS), which are generally longer-term investments, or asset-backed securities (ABS), which are generally shorter-term investments. Farmer Mac guaranteed investments are typically MBS while SBA, FSA, Agricultural and Rural Community bonds, and USDA guaranteed investments may be comprised of either MBS or ABS.

Additional Investment Securities Information

(dollars in thousands) **As of September 30, 2016**	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Weighted Average Yield
MBS	**$80,495**	**$467**	**($139)**	**$80,823**	**3.6%**
ABS	**108,343**	**2,375**	**(217)**	**110,501**	**2.1%**
Total	**$188,838**	**$2,842**	**($356)**	**$191,324**	**2.7%**

As of December 31, 2015	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Weighted Average Yield
MBS	$--	$--	$--	$--	--
ABS	134,351	3,385	(261)	137,475	1.7%
Total	$134,351	$3,385	($261)	$137,475	1.7%

Investment income is recorded in "Interest income" in the Consolidated Statements of Income and totaled $2.6 million and $2.1 million for the nine months ended September 30, 2016 and 2015, respectively.

NOTE 4: MEMBERS' EQUITY

Regulatory Capitalization Requirements

On March 10, 2016, the FCA Board approved a final rule to modify the regulatory capital requirements for System Banks and Associations. The final rule replaces existing core surplus and total surplus ratios with common equity tier 1, tier 1, and total capital risk-based capital ratios. The final rule also adds a tier 1 leverage ratio. The permanent capital ratio continues to remain in effect with the final rule. The effective date of the new capital requirements is January 1, 2017.

FCA Revised Capital Requirements

	Regulatory Minimums	Capital Conservation Buffer	Total
Risk adjusted:			
Common equity Tier 1 ratio	4.5%	2.5%	7.0%
Tier 1 capital ratio	6.0%	2.5%	8.5%
Total capital ratio	8.0%	2.5%	10.5%
Non-risk adjusted:			
Tier 1 leverage ratio	4.0%	1.0%	5.0%

If the capital ratios fall below the total requirements, including the buffer amounts, capital distributions (equity redemptions, dividends, and patronage) and discretionary senior executive bonuses are restricted or prohibited without prior FCA approval.

We made nonqualified patronage allocations of $52.4 million during the period ended September 30, 2016. Our nonqualified patronage allocation is based on a determination by the Board of Directors that surplus from 2015 patronage-sourced earnings can be allocated to eligible borrowers while still maintaining the Association's sound capital position. The timing and amounts of all future allocated surplus redemptions is at the discretion of the Board of Directors, subject to compliance with applicable regulatory requirements. These patronage equities have no voting rights and are only transferable if specifically authorized by the Board of Directors.

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 levels of inputs that may be used to measure fair value. Refer to Note 2 in our 2015 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, 2016 or December 31, 2015.

Non-Recurring

We may be required, from time to time, to measure certain assets at fair value on a non-recurring basis.

Assets Measured at Fair Value on a Non-recurring Basis

(in thousands)	**As of September 30, 2016**				**Nine months ended September 30, 2016**
	Fair Value Measurement Using			Total Fair	Total (Losses)
	Level 1	Level 2	Level 3	Value	Gains
Impaired loans	**$--**	**$183**	**$3,503**	**$3,686**	**($474)**
Other property owned	**--**	**--**	**336**	**336**	**7**
	As of December 31, 2015				Nine months ended September 30, 2015
	Fair Value Measurement Using			Total Fair	Total (Losses)
	Level 1	Level 2	Level 3	Value	Gains
Impaired loans	$--	$340	$4,645	$4,985	($1,125)
Other property owned	--	--	--	--	6

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 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 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.

NOTE 7: SUBSEQUENT EVENTS

We have evaluated subsequent events through November 4, 2016, 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.