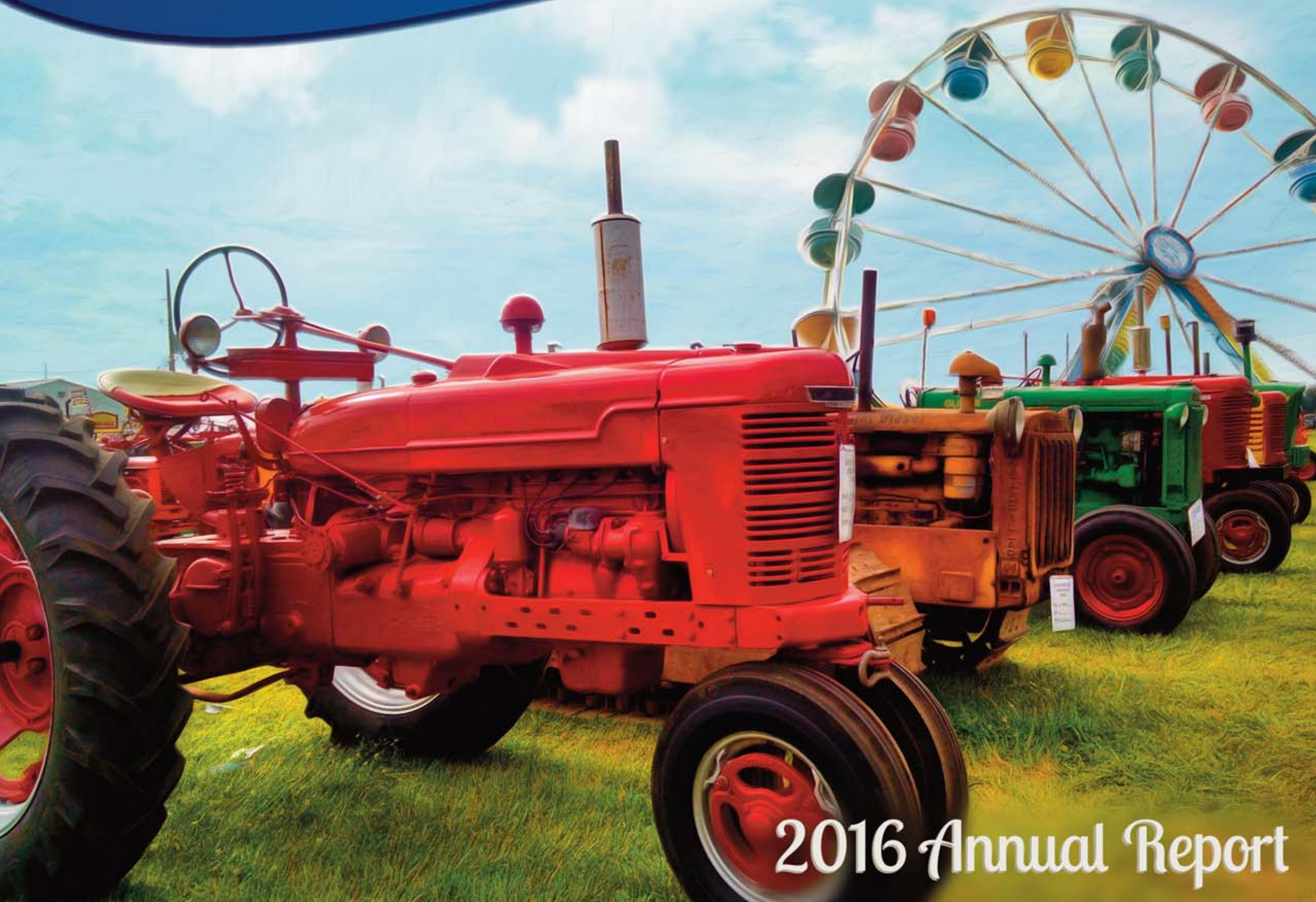
# Agriculture:

## A Blue Ribbon Business



2016 Annual Report

**YOSEMITE FARM CREDIT, ACA**

**2016 ANNUAL REPORT**

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## A MESSAGE TO OUR MEMBERS

We are pleased to present this 2016 Annual Report of Yosemite Farm Credit, ACA to you, our Members.

***Financial Results***

Your Association continues to thrive. Net earnings of $43 million remain strong as a result of growing loan volume and controlling expenses. The Association's capital remains strong, building a foundation for future growth and insulating against economic volatility.

***Growth and Loan Quality***

The amount of loans outstanding at year-end increased 12.6% exceeding $2.5 billion. Credit quality remains high due to profitability in 2016 for most commodities and continued strong land values. There were no loan charge-offs and delinquent loans at 0.2% continue at very low levels.

***Member Success***

We appreciate being able to serve the outstanding group of agricultural business people in our area. Your business success and your ability to meet your loan obligations drive the success of your Association.

***Patronage***

We remain committed to returning earnings that are not necessary for the operation of your Association. The strong earnings enabled the Association to declare a patronage dividend of $11.5 million while continuing to provide competitive rates. We are ensuring that your Association remains a long term, reliable source of funds for agriculture while also providing competitive rates.

***Service***

Your Association is guided by a local Board of Directors that is focused on your financing needs. Yosemite Farm Credit delivers local service with an experienced staff that understands agriculture.

We appreciate the opportunity to serve our Members' financing needs and look forward to "Helping our Members Prosper" in 2017.

Rick J. Scheuber
Board Chair

Leonard Van Elderen
President & Chief Executive Officer

# YOSEMITE FARM CREDIT, ACA
## FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA
(Dollars in Thousands)

| | December 31 | | | | |
|---|---|---|---|---|---|
| | **2016** | 2015 | 2014 | 2013 | 2012 |
| **Consolidated Statements of Condition Data** | | | | | |
| Loans | **$ 2,512,101** | $ 2,231,075 | $ 2,014,073 | $ 1,849,639 | $ 1,736,630 |
| Less allowance for loan losses | **6,584** | 5,034 | 4,601 | 4,865 | 4,921 |
| Net loans | **2,505,517** | 2,226,041 | 2,009,472 | 1,844,774 | 1,731,709 |
| Investment securities | **23,462** | 29,044 | 41,325 | 49,068 | 57,728 |
| Investment in CoBank, ACB | **78,205** | 69,218 | 64,010 | 61,029 | 56,413 |
| Other assets | **53,999** | 44,078 | 39,471 | 38,915 | 33,177 |
| **Total assets** | **$ 2,661,183** | $ 2,368,381 | $ 2,154,278 | $ 1,993,786 | $ 1,879,027 |
| | | | | | |
| Obligations with maturities of one year or less | **$ 2,227,798** | $ 1,966,953 | $ 1,782,474 | $ 1,652,382 | $ 1,565,736 |
| Obligations with maturities longer than one year | **91** | 132 | 1,614 | 218 | 275 |
| **Total liabilities** | **2,227,889** | 1,967,085 | 1,784,088 | 1,652,600 | 1,566,011 |
| Stock and participation certificates | **1,845** | 1,794 | 1,767 | 1,738 | 1,692 |
| Unallocated retained earnings | **431,540** | 399,634 | 368,586 | 339,666 | 311,599 |
| Accumulated other comprehensive loss | **(91)** | (132) | (163) | (218) | (275) |
| **Total shareholders' equity** | **433,294** | 401,296 | 370,190 | 341,186 | 313,016 |
| **Total liabilities and shareholders' equity** | **$ 2,661,183** | $ 2,368,381 | $ 2,154,278 | $ 1,993,786 | $ 1,879,027 |

| | For the Year Ended December 31 | | | | |
|---|---|---|---|---|---|
| | **2016** | 2015 | 2014 | 2013 | 2012 |
| **Consolidated Statements of Comprehensive Income Data** | | | | | |
| Net interest income | **$ 61,344** | $ 55,997 | $ 51,178 | $ 48,365 | $ 45,073 |
| Provision for credit losses/(credit loss reversals)[1] | **2,182** | 858 | (266) | (60) | 74 |
| Non-interest income | **10,332** | 9,293 | 8,592 | 8,343 | 9,239 |
| Non-interest expense and tax expense | **26,109** | 23,078 | 21,502 | 19,476 | 16,685 |
| **Net income** | **$ 43,385** | $ 41,354 | $ 38,534 | $ 37,292 | $ 37,553 |
| Amortization of retirement credits | **41** | 31 | 55 | 57 | 59 |
| **Total Comprehensive Income** | **$ 43,426** | $ 41,385 | $ 38,589 | $ 37,349 | $ 37,612 |
| | | | | | |
| **Consolidated Key Financial Ratios** | | | | | |
| **For the Year** | | | | | |
| Return on average assets | **1.79%** | 1.90% | 1.92% | 1.97% | 2.17% |
| Return on average shareholders' equity | **10.24%** | 10.60% | 10.70% | 11.25% | 12.43% |
| Net interest income as a percentage of average earning assets | **2.66%** | 2.71% | 2.70% | 2.69% | 2.75% |
| Net charge-offs as a percentage of average loans | **0.00%** | 0.00% | 0.00% | 0.00% | 0.00% |
| **At Year-End** | | | | | |
| Shareholders' equity as a percentage of assets | **16.28%** | 16.94% | 17.18% | 17.11% | 16.66% |
| Debt as a ratio to shareholders' equity | **5.14:1** | 4.90:1 | 4.82:1 | 4.84:1 | 5.00:1 |
| Allowance for credit losses as a percentage of loans[1] | **0.30%** | 0.24% | 0.23% | 0.26% | 0.28% |
| Permanent capital ratio | **14.26%** | 14.72% | 14.88% | 15.07% | 14.46% |
| Total surplus ratio | **14.18%** | 14.64% | 14.80% | 14.98% | 14.37% |
| Core surplus ratio | **14.18%** | 14.64% | 14.80% | 14.98% | 14.31% |
| **Net Income Distribution** | | | | | |
| Cash patronage distributions | **$ 10,354** | $ 9,555 | $ 9,234 | $ 8,223 | $ 7,619 |
| Cash patronage declared | **$ 11,479** | $ 10,354 | $ 9,603 | $ 9,223 | $ 8,221 |

(1) Includes the allowance for loan losses and the reserve for unfunded commitments.

# REPORT OF MANAGEMENT

The consolidated financial statements of Yosemite Farm Credit, ACA (Association) are prepared by management, who is responsible for their integrity and objectivity, including amounts that must necessarily be based upon judgments and estimates. The consolidated financial statements have been prepared in conformity with generally accepted accounting principles appropriate in the circumstances, and in the opinion of management, fairly present the financial condition of the Association. Other financial information included in the 2016 Annual Report is consistent with that in the financial statements.

To meet its responsibility for reliable financial information, management depends upon the Association's accounting and internal control systems, which have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded and transactions are properly authorized and recorded. To monitor compliance, management engaged CoBank, ACB's Internal Audit staff to perform audits of the accounting records, review accounting systems and internal controls, and recommend improvements as appropriate. The Association is also examined by the Farm Credit Administration.

The Audit Committee of the Board of Directors has overall responsibility for the Association's system of internal control and financial reporting. The Audit Committee consults regularly with management and reviews the results of the examinations by the various entities named above. The independent auditors have direct access to the Audit Committee.

The undersigned certify that the Yosemite Farm Credit, ACA Annual Report has been reviewed and prepared in accordance with all applicable statutory and regulatory requirements, and that the information contained here is true, accurate, and complete to the best of our knowledge and belief.

Rick J. Scheuber
Board Chair

Leonard Van Elderen
President & Chief Executive Officer

Tracy V. Sparks
Executive Vice President &
Chief Financial Officer

March 2, 2017

## REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Yosemite Farm Credit, ACA (Association) principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association's consolidated financial statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by, or under the supervision of the Association's principal executives and principal financial officers, or persons performing similar functions, and effected by its Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting information and the preparation of the consolidated financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America and includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Association's assets that could have a material effect on its consolidated financial statements.

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of December 31, 2016. In making the assessment, management used the framework in *Internal Control — Integrated Framework (2013)*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association concluded that as of December 31, 2016, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of December 31, 2016.

Leonard Van Elderen
President & Chief Executive Officer

Tracy V. Sparks
Executive Vice President & Chief Financial Officer

March 2, 2017

# AUDIT COMMITTEE REPORT

The Audit Committee (Committee) includes six members from the Board of Directors of Yosemite Farm Credit, ACA (Association). In 2016, eleven Committee meetings were held. The Committee oversees the scope of the Association's internal audit program, the independence of the outside auditors, the adequacy of the Association's system of internal controls and procedures, and the adequacy of management's action with respect to recommendations arising from those auditing activities. The Committee's responsibilities are described more fully in the Internal Control Policy and the Audit Committee Charter. The Committee approved the appointment of PricewaterhouseCoopers LLP (PwC) as the Association's independent auditor for 2016.

The fees paid for professional services rendered for the Association by its independent auditor, PwC, during 2016 were $106,284 for audit services and $10,700 for tax services.

The Committee reviewed the non-audit services provided by PwC and concluded these services were not incompatible with maintaining the independent auditor's independence.

Management is responsible for the Association's internal controls and the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. PwC is responsible for performing an independent audit of the Association's consolidated financial statements in accordance with auditing standards generally accepted in the United States of America and to issue a report thereon. The Committee's responsibilities include monitoring and overseeing these processes.

In this context, the Committee reviewed and discussed the Association's audited financial statements for the year ended December 31, 2016 (the "Financial Statements") with management. The Committee also reviews with PwC the matters required to be discussed by Statements on Auditing Standards. Both PwC and the Association's internal auditors directly provide reports on significant matters to the Committee.

Based on the foregoing review and discussions and relying thereon, the Committee recommended that the Board of Directors include the Financial Statements in the Association's Annual Report to Shareholders for the year ended December 31, 2016 and for filing with the FCA.

Nancy Sill
Audit Committee Chair

Audit Committee Members:
Wayne Christian
John B. Fiscalini
Alicia Madsen
Dino Migliazzo
Rick Scheuber

March 2, 2017

**YOSEMITE FARM CREDIT, ACA**
# MANAGEMENT'S DISCUSSION AND ANALYSIS

## INTRODUCTION

The following discussion summarizes the financial position and results of operations of Yosemite Farm Credit, ACA for the year ended December 31, 2016. Comparisons with prior years are included. We have emphasized material known trends, commitments, events, or uncertainties that have impacted, or are reasonably likely to impact the financial condition and results of operations. You should read these comments along with the accompanying consolidated financial statements, footnotes and other sections of this report. The accompanying consolidated financial statements were prepared under oversight of the Audit Committee. The Management's Discussion and Analysis includes the following sections:

- Business Overview
- Economic Overview
- Loan Portfolio
- Credit Risk Management
- Results of Operations
- Liquidity
- Capital Resources
- Regulatory Matters
- Governance
- Forward-Looking Information
- Critical Accounting Policies and Estimates
- Customer Privacy

Our quarterly reports to shareholders are available approximately 40 days after the calendar quarter end and annual reports are available approximately 75 days after the calendar year end. The reports may be obtained free of charge on our website, www.yosemitefarmcredit.com, or upon request. We are located at 806 W. Monte Vista Ave., Turlock, CA or may be contacted by calling (209) 667-2366 during business hours Monday – Friday, 8 a.m. – 5 p.m. PST.

## BUSINESS OVERVIEW

### *Farm Credit System Structure and Mission*

We are one of 73 associations in the Farm Credit System (System), which was created by Congress in 1916 and has served agricultural producers for over 100 years. The System mission is to provide sound and dependable credit to American farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses through a member-owned cooperative system. This is done by making loans and providing financial services. Through its commitment and dedication to agriculture, the System continues to have the largest portfolio of agricultural loans of any lender in the United States. The Farm Credit Administration (FCA) is the System's independent safety and soundness federal regulator and was established to supervise, examine and regulate System institutions.

### *Our Structure and Focus*

As a cooperative, we are owned by the members we serve. The territory served extends across a diverse agricultural region of California's Central Valley. The counties in our territory are listed in Note 1, "Organization and Operations," of the accompanying consolidated financial statements. We make long-term real estate mortgage loans to farmers, ranchers, rural residents and agribusinesses, and production and intermediate-term loans for agricultural production or operating purposes. The Association also serves as an intermediary in offering credit life insurance and multi-peril crop insurance and provides other related services such as cash management and lease financing. Our success begins with extensive agricultural experience and knowledge of the market and is dependent on the level of satisfaction we provide to our borrowers.

As part of the System, we obtain the funding for our lending and operations from a Farm Credit Bank. Our funding bank, CoBank, ACB (CoBank), is a cooperative of which we are a member.

We, along with the borrower's investment in our Association, are materially affected by CoBank's financial condition and results of operations. The CoBank quarterly and annual reports are available free of charge by accessing CoBank's website, www.cobank.com, or may be obtained at no charge by contacting us at 806 W. Monte Vista Avenue, Turlock CA 95382 or calling us at (209) 667-2366 during business hours Monday - Friday, 8:00 a.m. - 5:00 p.m. PST. Annual reports are available within 75 days after year-end and quarterly reports are available within 40 days after the calendar quarter end.

We purchased online banking technology from AgVantis, which is a technology service corporation, in 2016. Our services Agreement with AgVantis expired in April 2016, and was not renewed. Our online banking technology is now provided by CoBank. Farm Credit Foundations, a human resource service provider for a number of Farm Credit institutions, provides our payroll and human resource services. We are a shareholder in Farm Credit Foundations along with other Foundations customers.

## ECONOMIC OVERVIEW

For the past couple of years, many of our farmer borrowers have experienced favorable economic conditions due to strong commodity prices. This prosperity is reflected in the Association's financial strength. We recognize that agriculture is a cyclical business that can experience volatility in commodities.

In 2015 and 2016, net dairy income was substantially less than net dairy income in 2014. With net milk prices close to or below the accrual based cost of production, many dairy farmers operated at breakeven and used operational dairy profits from 2014. Strong beef prices and decreased feed costs provided some relief in 2015 and 2016. California dairy farmers are expected to again be challenged by moderately low milk prices through the first half of 2017, with an increase in milk prices in the latter half of the year. Water availability will affect the quality and availability of roughage influencing the profitability of dairy producers. Despite decreases in prices from the 2014 records, tree nut price levels remain profitable for the majority of our Association's growers. Almonds are the leading agricultural crop in the San Joaquin Valley and the highest grossing export crop from the State of California. Indications are for continued profitability in 2017.

The fundamental advantages in the Association's territory are good soils, a climate well suited to the crops grown, and relatively inexpensive irrigation water. While a second year of above average rainfall has helped the availability and price of water, much of the region we serve remains in severe or extreme drought conditions. Pumping from wells, water transfers within and between districts and neighbors, and fallowing ground are some of the strategies available to members to mitigate drought conditions. The Association will continue to make credit decisions based on the needs and requests of each Member. Each situation is evaluated on its own merits. Surface and ground water regulations and availability will continue to cause uncertainty within our territory.

The Agricultural Act of 2014 (Farm Bill) was signed into law on February 7, 2014. This Farm Bill governs an array of federal farm and food programs, including commodity price and support payments, farm credit, agricultural conservation, research, rural development, and foreign and domestic food programs for five years. The Farm Bill eliminated $23 billion in mandatory federal spending over a 10-year period, representing a reduction in the U.S. government farm policy support. The Farm Bill repeals direct payments and limits producers to risk management tools that offer protection when they suffer significant losses. The Farm Bill provides continued support for crop insurance programs, strengthens livestock disaster assistance and provides dairy producers with a voluntary margin protection program without imposing government-mandated supply controls.

## LOAN PORTFOLIO

Total loans outstanding were $2.512 billion at December 31, 2016, an increase of $281.0 million, or 12.6% from loans at December 31, 2015 of $2.231 billion, which was an increase of $217.0 million, or 10.8% increase from loans at December 31, 2014 of $2.014 billion. The increase in loan volume is a result of new loan requests for real estate mortgage and production and intermediate-term loans. The types of loans outstanding at December 31 are reflected in the following table ($ millions).

| | **2016** | | 2015 | | 2014 | |
|---|---|---|---|---|---|---|
| | **Outstanding** | **Percent** | Outstanding | Percent | Outstanding | Percent |
| Real estate mortgage | **$ 1,898.9** | **75.6%** | $ 1,744.1 | 78.2% | $ 1,546.7 | 76.8% |
| Production and intermediate-term | **401.9** | **16.0%** | 313.9 | 14.1% | 298.6 | 14.8% |
| Agribusiness loans to: | | | | | | |
| Cooperatives | **32.6** | **1.3%** | 34.0 | 1.5% | 28.0 | 1.4% |
| Processing and marketing | **120.1** | **4.8%** | 86.6 | 3.9% | 88.6 | 4.4% |
| Farm related business | **43.1** | **1.7%** | 35.5 | 1.6% | 33.1 | 1.6% |
| Rural residential real estate | **2.8** | **0.1%** | 2.8 | 0.1% | 5.0 | 0.3% |
| Lease receivables | **12.7** | **0.5%** | 14.2 | 0.6% | 14.1 | 0.7% |
| Total | **$ 2,512.1** | **100.0%** | $ 2,231.1 | 100.0% | $ 2,014.1 | 100.0% |

Real estate mortgage loans outstanding increased to $1.899 billion, compared with $1.744 billion at year-end 2015, primarily due to loan requests from existing members not specific to any commodity, net of loan payoffs. Long-term mortgage loans are primarily used to purchase, refinance or improve real estate. These loans have maturities ranging from 5 to 40 years. Real estate mortgage loans are also made to rural homeowners. By federal regulation, a real estate mortgage loan must be secured by a first lien and may only be made in an amount up to 85% of the original appraised value of the property, or up to 97% of the appraised value, if the loan is guaranteed by certain state, federal, or other governmental agencies. Under our current underwriting standards, we originate loans less than the regulatory limit of 85% of the appraised value of the property.

The production and intermediate-term loans increased $88.0 million to $401.9 million compared with 2015 loans of $313.9 million, primarily due to loan requests from existing members not specific to any commodity, net of loan payoffs. Production loans are used to finance the ongoing operating needs of agricultural producers. Production loans generally match the borrower's normal production and marketing cycle, which is typically 12 months. Intermediate-term loans are generally used to finance depreciable capital assets of a farm or ranch. Intermediate-term loans are written for a specific term, 1 to 15 years, with most loans being less than 10 years.

Total Agribusiness loans increased $39.7 million to $195.8 million compared with $156.1 million at year-end 2015, primarily due to loan requests from new and existing members in the processing and marketing loan portfolio as well as growth in the Association's Capital Markets lending group. Agribusiness loans are made to benefit the throughput of agricultural goods to the marketplace. These loans consist of long-term mortgages on the facilities and equipment of a processor as well as short- and intermediate-operating lines of credit.

***Portfolio Diversification***

While we make loans and provide financially related services to qualified borrowers in agricultural and rural sectors and to certain related entities, our loan portfolio is diversified by loan and lease participations purchased and sold, geographic locations served, commodities financed, and loan size as illustrated in the following four tables.

We purchase loan participations and lease participations from other System and non-System entities to generate additional earnings and, in some cases, diversify risk related to existing commodities financed and our geographic area served. In addition, we sell a portion of certain large loans to other System and non-System entities to reduce risk and comply with lending limits we have established. These participations (both purchased and sold) provide a means to reduce the risk associated with large loans along with an opportunity to further diversify the risk associated with individual commodities.

The balance of participations purchased and sold as of December 31 is included in the following table ($ millions).

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Participations purchased | **$ 187.8** | $ 164.1 | $ 131.3 |
| Participations sold | **$ 103.9** | $ 70.3 | $ 60.1 |

We have no retained subordinated participation interests in loans sold, or interests in pools of subordinated participation interests that are held in lieu of retaining a subordinated participation interest in the loans sold.

The geographic distribution of loans by county at December 31 is included in the following table. As previously mentioned, we purchase loan participations outside our territory, which are included in "Other" in the following table.

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Stanislaus | **46.9%** | 45.9% | 47.0% |
| Merced | **33.7** | 34.1 | 33.4 |
| San Joaquin | **5.0** | 4.7 | 5.1 |
| Madera | **4.8** | 4.6 | 3.8 |
| Fresno | **1.8** | 2.2 | 2.5 |
| Tuolumne | **0.5** | 0.6 | 0.7 |
| Other | **7.3** | 7.9 | 7.5 |
| Total | **100.0%** | 100.0% | 100.0% |

The following table shows the primary agricultural commodities produced by our borrowers based on the Standard Industrial Classification System (SIC) published by the federal government. This system is used to assign commodity or industry categories based on the primary business of the customer. A primary business category is assigned when the commodity or industry accounts for 50% or more of the total value of sales for a business; however, a large percentage of agricultural operations typically includes more than one commodity. Commodities included in the portfolio as of December 31 are set forth in the following table.

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Dairy | **35.2%** | 36.6% | 38.2% |
| Almonds | **26.2** | 25.0 | 23.0 |
| Fruit & Tree Nuts | **6.6** | 7.2 | 7.3 |
| Field Crops | **5.4** | 5.4 | 4.6 |
| Other | **26.6** | 25.8 | 26.9 |
| Total | **100%** | 100% | 100% |

The "Other" category represents 56 loan commodities that individually do not represent a concentration of more than 5% of the loan portfolio.

We have a relatively diverse loan portfolio; however, our loan portfolio contains a concentration of dairy and almond producers as a reflection of the commodity concentration in our chartered territory. Repayment ability of our borrowers is closely related to the profitability of the commodities they produce or raise. If a loan fails to perform, restructuring and or other servicing alternatives are available. Our future performance would be negatively impacted by adverse agricultural conditions. The degree of the adverse impact would be correlated to the commodities negatively affected and the magnitude and duration of the adverse agricultural conditions to our borrowers.

In addition to commodity diversification noted in the previous table, further diversification is also achieved from loans to rural residents and part-time farmers, which typically derive most of their earnings from non-agricultural sources. These borrowers are less subject to agricultural cycles and would likely be more affected by weaknesses in the general economy.

Loans originated for less than $250 thousand accounted for 3.7% of loan volume and 54.4% of the number of loans at December 31, 2016. Credit risk on small loans, in many instances, may be reduced by non-farm income sources. The table below details loan principal by dollar size at December 31 ($ millions).

| | **2016** | | 2015 | | 2014 | |
|---|---|---|---|---|---|---|
| | **Amount outstanding** | **Number of loans** | Amount outstanding | Number of loans | Amount outstanding | Number of loans |
| ($ in thousands) | | | | | | |
| $1 - $250 | **$ 92.6** | **2,529** | $ 119.5 | 2,468 | $ 117.4 | 2,349 |
| $251 - $500 | **289.9** | **781** | 270.3 | 731 | 271.1 | 739 |
| $501 - $1,000 | **467.0** | **662** | 450.0 | 635 | 430.6 | 607 |
| $1,001 - $5,000 | **1,277.5** | **635** | 1,144.8 | 573 | 1,050.3 | 519 |
| $5,001 - $25,000 | **385.1** | **46** | 246.5 | 32 | 144.7 | 19 |
| Total | **$ 2,512.1** | **4,653** | $ 2,231.1 | 4,439 | $ 2,014.1 | 4,233 |

We are not dependent on a single borrower or a group of large liability borrowers. The loss of any of these loans or the failure of any of these loans to perform would not adversely affect the portfolio and our future operating results given the portfolio asset quality, commodity diversity and collateral values underlying the portfolio. The top ten borrowers account for 8.0% of loan volume.

The credit risk of some long-term real estate loans has been reduced by entering into agreements that provide long-term standby commitments by Federal Agricultural Mortgage Corporation (Farmer Mac) to purchase the loans in the event of default. The amount of loans subject to these Farmer Mac credit enhancements was $195.0 million at December 31, 2016, $168.5 million at December 31, 2015, and $144.6 million at December 31, 2014. Fees paid to Farmer Mac totaled $721.0 thousand for 2016, $606.1 thousand for 2015 and $629.1 thousand for 2014 and are recorded in the Consolidated Statements of Comprehensive Income as a reduction of interest income.

Under the Farmer Mac long-term standby commitment to purchase agreements, we continue to hold the loans in our portfolio, and we pay commitment fees to Farmer Mac for the right to put a loan designated in these agreements to Farmer Mac at par in the event the loan becomes significantly delinquent (typically four months past due). If the borrower cures the default, we must repurchase the loan from Farmer Mac and the commitment remains in place. Farmer Mac long-term standby commitments to purchase agreements are further described in Note 4, "Loans and Allowance for Loan Losses," of the accompanying consolidated financial statements. Other than the contractual obligations arising from these business transactions with Farmer Mac, Farmer Mac is not liable for any debt or obligation of ours and we are not liable for any debt or obligation of Farmer Mac. For more information on Farmer Mac, refer to their website at www.farmermac.com.

Additionally, the Association has credit guarantees of approximately $3.8 million with Farm Service Agency (FSA) at year-end 2016, $3.6 million at year-end 2015 and $4.6 million at year-end 2014. We use FSA guarantees to make loans to young, beginning, and small farmers, to reduce our risk on large loans, and to assist borrowers experiencing financial difficulties.

### *Credit Commitments*

We may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of our borrowers. These financial instruments include commitments to extend credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in our consolidated financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee by the borrower. The following table summarizes the maturity distribution of unfunded credit commitments on letters of credit and loans at December 31, 2016 ($ millions).

| | Less than 1 year | 1 – 3 years | 3 – 5 years | Over 5 years | Total |
|---|---|---|---|---|---|
| Commitments to Extend Credit | $ 154.1 | $ 212.2 | $ 15.1 | $ 287.8 | $ 669.2 |
| Standby Letters of Credit | $ 1.0 | $ 3.4 | $ - | $ - | $ 4.4 |

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the Consolidated Statements of Condition until funded or drawn upon. The credit risk associated with issuing commitments is substantially the same as that involved in extending loans to borrowers and we apply the same credit policies to these commitments. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on our credit evaluation of the borrower. No material losses are anticipated as a result of these credit commitments. We maintain a separate reserve for unfunded commitments, which is included in Other Liabilities on the Consolidated Statements of Condition. The related provision for the reserve for unfunded commitments is included as part of the provision for credit losses on the Consolidated Statements of Comprehensive Income, along with the provision for loan losses.

### *High Risk Assets*

Non-performing loan volume is comprised of nonaccrual loans, restructured loans, and loans 90 days past due still accruing interest, and are referred to as impaired loans. High risk assets consist of impaired loans and other property owned. Prudent credit administration coupled with customer commitment to timely loan payments has resulted in a low level of high risk assets including nonaccrual loans.

Comparative information regarding high risk assets in the portfolio, including any interest on accruing loans, is provided in the following table as of December 31 ($ thousands).

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Nonaccrual loans and leases: | | | |
| Real estate mortgage loans | **$ 4,099** | $ 4,241 | $ 10,525 |
| Production and intermediate-term loans | **1,439** | 54 | 65 |
| Lease receivables | **-** | 2 | 2 |
| Total nonaccrual loans | **$ 5,538** | **$ 4,297** | **$ 10,592** |
| Total accruing loans 90 days past due | - | - | - |
| Restructured loans | - | - | - |
| Other property owned | - | - | - |
| Total high risk assets | **$ 5,538** | $ 4,297 | $ 10,592 |
| Nonaccrual loans to total loans | **.22%** | .19% | .53% |
| High risk assets to total loans | **.22%** | .19% | .53% |
| High risk assets to shareholders' equity | **1.28%** | 1.07% | 2.86% |

Nonaccrual loans represent all loans where there is a reasonable doubt as to collection of all principal and/or interest. Of the 20 loans in the nonaccrual portfolio, 18 loans remain well secured and are considered fully collectible. Two nonaccrual loans have additional weaknesses in existing facts that make collection in full questionable. Six nonaccrual loans were past due 90 days or more at December 31, 2016. Nonaccrual loans increased $1.2 million at December 31, 2016 compared with the year-end 2015 due to the transfers of additional loans to nonaccrual partially offset by pay-offs. One customer comprises approximately 53% of the total nonaccrual volume.

The following table provides additional information on nonaccrual loans at December 31 ($ thousands).

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Nonaccrual loans current as to principal and interest | **$ 3,121** | $ 4,246 | $ 10,462 |

For the years presented, we had no loans restructured or cash basis nonaccrual loans or leases. Other property owned is real or personal property that has been acquired through foreclosure, deed in lieu of foreclosure or other means. We had no other property owned for any of the periods presented.

High risk asset volume is anticipated to remain static. We expect profitability in our primary commodities.

### *Credit Quality*

We review the credit quality of the loan portfolio on an on-going basis as part of our risk management practices. Each loan is classified according to the Uniform Classification System (UCS), which is used by all System institutions. Below are the classification definitions.

- Acceptable – assets are expected to be fully collectible and represent the highest quality;
- Other Assets Especially Mentioned (OAEM) – assets are currently collectible but exhibit some potential weakness;
- Substandard – assets exhibit some serious weakness in repayment capacity, equity, and/or collateral pledged on the loan;
- Doubtful – assets exhibit similar weaknesses as substandard assets. However, doubtful assets have additional weaknesses in existing facts, conditions and values that make collection in full highly questionable; and
- Loss – assets are not considered collectible.

The following table shows credit quality of loans and leases including accrued interest classified under the UCS as a percentage of total loans including accrued interest at December 31.

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Acceptable | **96.0%** | 98.1% | 97.1% |
| OAEM | **2.4** | 1.0 | 1.0 |
| Substandard | **1.6** | 0.9 | 1.9 |
| Doubtful | - | - | - |
| Total | **100.0%** | 100.0% | 100.0% |

During 2016, recent economic conditions have created challenges for some borrowers and our credit quality has declined. Loans classified as “Acceptable” or “OAEM” were 98.4% at December 31, 2016, 99.1% at December 31, 2015, and 98.1% at December 31, 2014. We had no loans classified as doubtful or loss for any of the periods presented. The financial position of most agricultural producers strengthened during the past decade, and most of our borrowers have maintained generally strong financial positions. As such, our credit quality is anticipated to remain sound in the near term. However, agriculture remains a cyclical business that is heavily influenced by production, operating costs and commodity prices. Each of these can be significantly impacted by uncontrollable events. If less favorable economic conditions continue, it will likely lead to weakening in the loan portfolio. Loan delinquencies (accruing loans 30 days or more past due) as a percentage of accruing loans increased but remained at a low level of 0.17% at December 31, 2016, compared with 0.07% at December 31, 2015 and 0.08% at December 31, 2014.

### *Allowance for Credit Losses*

We maintain an allowance for credit losses at a level consistent with the probable losses identified by management. The allowance for credit losses at each period end was considered to be adequate to absorb probable losses existing in the loan portfolio as well as potential losses from unfunded commitments. Because the allowance for credit losses considers factors such as current agricultural and economic conditions, loan loss experience, portfolio quality and loan portfolio composition, there will be a direct impact to the allowance for credit losses and our Consolidated Statements of Comprehensive Income when there is a change in any of those factors.

In 2015, the Association revised its classification for the allowance for credit losses. The provision for loan losses and the reserve for unfunded commitments are included together as part of the provision for credit losses on the Consolidated Statements of Comprehensive Income. The allowance for loan losses is presented as an adjustment to the value of our loan portfolio for inherent credit losses related to the portfolio risk. The reserve for unfunded commitments takes into consideration potential losses related to unfunded commitments. We have reclassified these balances to a separate reserve for unfunded commitments, which is included in Other Liabilities on the Association's Consolidated Statements of Condition. The reserve for unfunded commitments was $1,057 thousand as of December 31, 2016 and $425 thousand as of December 31, 2015.

The following table provides relevant information regarding the allowance for loan losses as of December 31 ($ thousands).

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Balance at beginning of year | **$ 5,034** | $ 4,601 | $ 4,865 |
| Charge-offs – production and intermediate-term | **-** | - | - |
| Recoveries – production and intermediate-term | **-** | - | 2 |
| Transfers (to) from reserve for unfunded commitments | **(632)** | - | - |
| Reclassification to reserve for unfunded commitments | - | (425) | - |
| Provision for loan losses/(loan loss reversals) | **2,182** | 858 | (266) |
| Balance at December 31 | **$ 6,584** | $ 5,034 | $ 4,601 |

The following table provides the allowance for loan losses by loan type as of December 31 ($ thousands).

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Real estate mortgage | **$ 3,649** | $ 3,568 | $ 3,141 |
| Production and intermediate-term | **2,686** | 1,297 | 1,136 |
| Agribusiness | **218** | 144 | 315 |
| Rural residential real estate | **3** | 2 | 2 |
| Lease receivables | **28** | 23 | 7 |
| Total | **$ 6,584** | $ 5,034 | $ 4,601 |

The allowance for loan losses increased $1.6 million from December 31, 2015 to $6.6 million at December 31, 2016. The increase in allowance for loan losses was primarily due to the increases in the allowance of credit losses totaling $2.2 million that was recorded due to the increased risk in the loan portfolio partially offset by the transfers to the reserve for unfunded commitments of $632 thousand. Transfers between the allowance for loan losses and the reserve for unfunded commitments can occur in conjunction with funding a seasonal line of credit or other loan and decreasing a related unfunded commitment or, conversely, receiving a loan payment and increasing a related unfunded commitment. Newly-executed loan commitments will also increase this liability. There were no charge-offs or net recoveries recorded during 2016. During 2015, our allowance for loan losses increased $433 thousand primarily due to the increase in the allowance of credit losses totaling $858 thousand that was recorded due to increased risk in the loan portfolio partially offset by the reclassification of the reserve for unfunded commitments of $425 thousand as explained above. Comparative allowance for credit losses coverage as a percentage of loans and certain other credit quality indicators as of December 31 are presented in the following table.

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Allowance for credit losses as a percentage of: | | | |
| Loans | **.30%** | .24% | .23% |
| Impaired loans | **137.96%** | 127.04% | 43.44% |
| Nonaccrual loans | **137.96%** | 127.04% | 43.44% |

For additional information, refer to Note 4, "Loans and Allowance for Credit Losses," of the accompanying consolidated financial statements.

***Young, Beginning and Small Farmers and Ranchers Program***

As part of the Farm Credit System, we are committed to providing sound and dependable credit and related services to young, beginning and small (YBS) farmers and ranchers. Our YBS mission statement is "To serve Young, Beginning, and Small farmers and ranchers in order to facilitate their entrance into agriculture and improve the income and well-being of both existing and prospective members by making available an adequate and dependable supply of credit along with providing closely related services necessary for their success." YBS farmers and ranchers are:

- Young Farmer: A farmer or rancher who is age 35 or younger as of the date the loan is originally made.
- Beginning Farmer: A farmer or rancher who has ten years or less farming or ranching experience as of the date the loan is originally made.
- Small Farmer: A farmer or rancher who normally generates less than $250 thousand in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

The following table outlines our percentage of YBS loans as a percentage of the number of loans in our loan portfolio while the USDA column represents the percent of farmers and ranchers classified as YBS within our territory per the 2007 USDA Agricultural Census, which is the most current data available. Due to FCA regulatory definitions, a farmer/rancher may be included in multiple categories as they would be included in each category in which the definition was met.

| | **2016** | 2015 | 2014 | USDA |
|---|---|---|---|---|
| Young | **15.2%** | 15.1% | 15.1% | 6.5% |
| Beginning | **22.2%** | 21.9% | 22.3% | 28.9% |
| Small | **20.8%** | 22.0% | 23.0% | 79.9% |

Note that several differences exist in definitions between USDA statistics and our data due to our use of FCA definitions. Young farmers are defined as 34 years old and younger by the USDA, while FCA definitions include farmers 35 years old and younger. Beginning farmers are defined by FCA as those with 10 years or less farming experience; however, the USDA identifies beginning farmers as on their current farm less than 10 years. This may include both beginning farmers and experienced farmers who have recently changed farmsteads. Our percentages are based on the number of loans in our portfolio, while the USDA percentages are based on the number of farmers and ranchers. While these definition differences do exist, the information will be utilized as it is the best comparative information available.

We establish annual quantitative targets to measure our mission to serve YBS farmers and ranchers in our territory. The targets are quantified by the number of new YBS loans as a percentage of total new loans. The targets for 2017 through 2019 are as follows:

| | 2017 Number of New Loans | 2018 Number of New Loans | 2019 Number of New Loans |
|---|---|---|---|
| Young | 16% | 16% | 16% |
| Beginning | 24% | 24% | 24% |
| Small | | | |
| $0-$50,000 | 35% | 35% | 35% |
| $50,001-$100,000 | 55% | 55% | 55% |
| $100,001-$250,000 | 42% | 42% | 42% |
| >$250,001 | 13% | 13% | 13% |

Annual marketing goals established to increase market share of loans to YBS farmers and ranchers are as follows:

- Offer related services directly, or in coordination, with other organizations that are responsive to the needs of YBS farmers and ranchers in our territory;
- Take full advantage of opportunities to coordinate credit and services offered by other system institutions, governmental and private sources, to those who qualify as YBS farmers and ranchers in our territory; and,
- Implement effective outreach programs to attract YBS farmers and ranchers.

The Association financially supports and is involved in outreach activities within our lending territory in a continuing effort to achieve qualitative goals. Our staff actively participates in the Los Banos, Merced and Stanislaus county fairs. We support and promote the Merced and Stanislaus FFA project competition as well as other community educational training activities. Yosemite Farm Credit coordinates and donates to a territory wide scholarship program for students graduating from high school who plan to continue their education in the agricultural field. In 2016 the Board continued the practice of inviting a small group of members representing young, beginning and small borrowers to Board meetings which provides visibility into governance matters of the Association.

To ensure that credit and services offered to our YBS farmers and ranchers are provided in a safe, sound manner, and within our risk-bearing capacity, we utilize customized underwriting standards, loan guarantee programs, and coordinated lending. YBS loans that do not meet the traditional underwriting standard require Loan Committee approval.

Management provides quarterly reports to our Board of Directors detailing the number, volume and credit quality of our YBS customers.

## CREDIT RISK MANAGEMENT

Credit risk arises from the potential failure of a borrower to meet repayment obligations that result in a financial loss to the lender. Credit risk exists in our loan portfolio, in our unfunded loan commitments, and also in our standby letters of credit. Credit risk is actively managed on an individual and portfolio basis through application of sound lending and underwriting standards, policies and procedures.

Underwriting standards are utilized to determine an applicant's operational, financial, and managerial resources available for repaying debt within the term of the note and loan agreement. Underwriting standards include among other things, an evaluation of:

- character – borrower integrity and credit history;
- capacity – repayment capacity of the borrower based on cash flows from operations or other sources of income;
- collateral – to protect the lender in the event of default and also serve as a secondary source of loan repayment;
- capital – ability of the operation to survive unanticipated risks; and
- conditions – intended use of the loan funds, terms, restrictions, etc.

Processes for information gathering, balance sheet and income statement verification, loan analysis, credit approvals, disbursements of proceeds and subsequent loan servicing actions are established and followed.

By regulation, we cannot have loan commitments to one borrower for more than 15% of our permanent capital. Additionally, we set our own lending limits to manage loan concentration risk. We have adopted an individual lending limit maximum of 10% of permanent capital.

We have established internal lending delegations to properly control the loan approval process. Delegations to staff are based on our risk-bearing ability, loan size, complexity, type and risk, as well as the expertise and position of the credit staff member. Larger and more complex loans or loans perceived to have higher risk are typically approved by our loan committee with the most experienced and knowledgeable credit staff serving as members.

The majority of our lending is mortgage real estate loans which must be secured by a first lien on real estate. Production and intermediate-term lending accounts for most of the remaining volume and is typically secured by livestock, crops and equipment. Collateral evaluations are completed in compliance with FCA and Uniform Standards of Professional Appraisal Practices requirements. All property is appraised at market value. All collateral evaluations must be performed by a qualified appraiser. Certain appraisals must be performed by individuals with a state certification or license.

We use a two-dimensional risk rating model (Model) based on the Farm Credit System's Combined System Risk Rating Guidance. The Model estimates each loan's probability of default (PD) and loss given default (LGD). PD estimates the probability that a borrower will experience a default within twelve months from the date of determination. LGD provides an estimation of the anticipated loss with respect to a specific financial obligation of a borrower assuming a default has occurred or will occur within the next twelve months. The Model uses objective and subjective criteria to identify inherent strengths, weaknesses, and risks in each loan. PDs and LGDs are utilized in loan and portfolio management processes and are utilized for the allowance for credit losses estimate. This Model also serves as the basis for economic capital modeling.

The Model's 14-point probability of default scale provides for nine acceptable categories, one OAEM category, two substandard categories, one doubtful category and one loss category; each carrying a distinct percentage of default probability. The Model's LGD scale provides six categories, A through F, that have the following anticipated principal loss and range of economic loss expectations:

A. 0% anticipated principal loss; 0% to 5% range of economic loss
B. 0% to 3% anticipated principal loss; ≥5% to 15% range of economic loss
C. >3% to 7% anticipated principal loss; ≥15% to 20% range of economic loss
D. >7% to 15% anticipated principal loss; ≥20% to 25% range of economic loss
E. >15% to 40% anticipated principal loss; ≥25% to 50% range of economic loss
F. above 40% anticipated loss; above 50% range of economic loss

## RESULTS OF OPERATIONS

### *Earnings Summary*

In 2016, we recorded net income of $43.4 million, compared with $41.4 million in 2015 and $38.5 million in 2014. The increase in net income in 2016 and 2015 were primarily due to increased net interest income.

The following table presents the changes in the significant components of net income from the previous year ($ thousands).

| | **2016 vs. 2015** | 2015 vs. 2014 |
|---|---|---|
| Net income, prior year | **$ 41,354** | $ 38,534 |
| Increase (decrease) from changes in: | | |
| Interest income | **9,237** | 4,943 |
| Interest expense | **(3,890)** | (124) |
| Increase in net interest income | **5,347** | 4,819 |
| Provision for credit losses | **(1,324)** | (1,124) |
| Non-interest income | **1,039** | 701 |
| Non-interest expense, including tax expense | **(3,031)** | (1,576) |
| Total increase in net income | **2,031** | 2,820 |
| Net income, current year | **$ 43,385** | $ 41,354 |

Return on average assets decreased to 1.79% from 1.90% in 2015, and return on average shareholders' equity decreased to 10.24% from 10.60% in 2015. The decreases were primarily a result of increased operating costs with significant loan growth.

***Net Interest Income***

Net interest income for 2016 was $61.3 million compared with $56.0 million for 2015 and $51.2 million for 2014. Net interest income is our principal source of earnings and is impacted by interest earning asset volume, yields on assets and cost of debt. The change in net interest income was largely due to loan growth. The table below provides an analysis of the individual components of the change in net interest income during 2016 and 2015 ($ thousands).

| | **2016 vs. 2015** | 2015 vs. 2014 |
|---|---|---|
| Net interest income, prior year | **$ 55,997** | $ 51,178 |
| Increase (decrease) from changes in: | | |
| Interest rates earned | **682** | (2,426) |
| Average interest-earning assets | **9,295** | 6,633 |
| Loans in nonaccrual status | **(740)** | 736 |
| Increase in interest income | **9,237** | 4,943 |
| Interest rates paid | **(1,072)** | 1,845 |
| Average interest-bearing liabilities | **(2,818)** | (1,969) |
| Increase in interest expense | **(3,890)** | (124) |
| Increase in net interest income | **5,347** | 4,819 |
| Net interest income, current year | **$ 61,344** | $ 55,997 |

The following table illustrates net interest margin and the average interest rates on loans and debt cost, as well as interest rate spread.

| | For the Year Ended December 31 | | |
|---|---|---|---|
| | **2016** | 2015 | 2014 |
| Net interest margin | **2.66%** | 2.71% | 2.70% |
| Interest rate on: | | | |
| Average loan volume | **3.90%** | 3.86% | 4.04% |
| Average debt | **1.50%** | 1.32% | 1.35% |
| Interest rate spread | **2.40%** | 2.54% | 2.69% |

The interest rate spread in 2016 decreased by 0.14% from 2015 due to efforts to maintain a competitive rate structure in the market and increases in funding costs not passed on to members.

***Provision for Credit Losses/(Credit Loss Reversals)***

We monitor our loan portfolio on a regular basis to determine if any increase through provision for credit losses or decrease through a credit loss reversal in our allowance for credit losses is warranted based on our assessment of the probable losses in our loan portfolio and potential losses from unfunded commitments. We recorded provision for credit losses of $2.2 million for the year ended December 31, 2016 compared with provision for credit losses of $858 thousand for the year ended December 31, 2015 and net reversal for credit losses of $266 thousand for the year ended December 31, 2014. The increase in provision for credit losses during 2016 was primarily due to loan growth as well as large loan risk management. The increase in provision for credit losses during 2015 was due to loan growth and increased risk exposure due to water quantity and quality. Reversals of credit losses recorded during 2014 were primarily due to decreased risk exposure from improving borrower profitability. Based upon the year-end 2016 analysis, management believes the allowance for credit losses is adequate to provide for the current risk inherent in the Association's loan portfolio and potential losses from unfunded commitments. A specific reserve was recorded on two loans at December 31, 2016.

### *Non-Interest Income*

During 2016, we recorded non-interest income of $10.3 million, compared with $9.3 million in 2015 and $8.6 million in 2014. Patronage distributions from CoBank are our primary source of non-interest income. Patronage is accrued in the year earned and then received from CoBank in the following year. CoBank patronage is distributed in cash and stock. Patronage earned from CoBank was $8.7 million in 2016, $7.7 million in 2015, and $7.2 million in 2014.

### *Non-interest Expense*

For the year ended December 31, 2016, total non-interest expenses increased $3.0 million, or 13.1%, compared with the year ended December 31, 2015. Non-interest expense includes salaries & benefits, occupancy and equipment, insurance fund premiums and other operating expenses. Salaries and benefits increased $1.5 million, or 9.9% due to annual increases and the addition of several new employees. These additions are in response to Association growth and planning for succession of retiring employees. Insurance fund premium increased $0.4 million or 10.4% due to an increase in the premium rate and an increase in volume. Premium rates were 16 basis points for the first half of 2016 and 18 basis points for the second half of 2016 compared to 13 basis points in 2015 and 12 basis points in 2014. Other non-interest expense consists of accounts which are each less than 5% of total non-interest expense.

## LIQUIDITY

Liquidity is necessary to meet our financial obligations. Liquidity is needed to pay our note with CoBank, fund loans and other commitments, and fund business operations in a cost-effective manner. Our liquidity policy is intended to maximize debt reduction, liquidate non-earning assets, and manage short-term cash flow. Our direct loan with CoBank, cash on hand and borrower loan repayments provide adequate liquidity to fund our on-going operations and other commitments.

### *Funding Sources*

Our primary source of liquidity is the ability to obtain funds for our operations through a borrowing relationship with CoBank. Our note payable to CoBank is collateralized by a pledge to CoBank of substantially all of our assets. Substantially all cash received is applied to the note payable and all cash disbursements are drawn on the note payable. The indebtedness is governed by a General Financing Agreement (GFA) with CoBank which matures on May 31, 2018. We expect renewal of the GFA at that time. The annual average principal balance of the note payable to CoBank was $1.940 billion in 2016, $1.718 billion in 2015 and $1.592 billion in 2014.

We plan to continue to fund lending operations through the utilization of our funding agreement with CoBank, retained earnings from current and prior years and from borrower stock investments. CoBank's primary source of funds is the ability to issue System-wide Debt Securities to investors through the Federal Farm Credit Bank Funding Corporation. This access has traditionally provided a dependable source of competitively priced debt that is critical for supporting our mission of providing credit to agriculture and rural America. Although financial markets experienced significant volatility in the last few years, we were able to obtain sufficient funding to meet the needs of our customers.

### *Interest Rate Risk*

The interest rate risk inherent in our loan portfolio is substantially mitigated through our funding relationship with CoBank which allows for loans to be match-funded. Borrowings from CoBank match the pricing, maturity, and option characteristics of our loans to borrowers. CoBank manages interest rate risk through the direct loan pricing and its asset/liability management processes. Although CoBank incurs and manages the primary sources of interest rate risk, we may still be exposed to interest rate risk through the impact of interest rate changes on earnings generated from our loanable funds.

### *Funds Management*

We offer variable, fixed, adjustable prime-based and LIBOR-based rate loans to borrowers. Our Asset Liability Committee establishes interest rates based on the following factors: 1) the interest rate charged by CoBank; 2) our existing rates and spreads; 3) the competitive rate environment; and 4) our profitability objectives.

## CAPITAL RESOURCES

Capital supports asset growth and provides protection for unexpected credit and operating losses. Capital is also needed for future growth and for investments in new products and services. We believe a sound capital position is critical to our long-term financial success due to the volatility and cycles in agriculture. Over the past several years, we have been able to build capital primarily through net income retained after patronage. Shareholders' equity at December 31, 2016 totaled $433.3 million, compared with $401.3 million at December 31, 2015 and $370.2 million at December 31, 2014. The increase of $32.0 million in shareholders' equity reflects net income, net stock issuances and a decrease in comprehensive loss, offset by patronage refunds. Our capital position is reflected in the following ratio comparisons at December 31.

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Debt to shareholders' equity | **5.14:1** | 4.90:1 | 4.82:1 |
| Shareholders' equity as a percent of net loans | **17.29%** | 18.03% | 18.42% |
| Shareholders' equity as a percent of total assets | **16.28%** | 16.94% | 17.18% |

Debt to shareholders' equity increased and shareholders' equity as a percent of net loans decreased from 2015 primarily due to an increase in retained earnings of $31.9 million and a $281.0 million increase in loans outstanding from 2015.

### *Retained Earnings*

Our retained earnings increased $31.9 million to $431.5 million at December 31, 2016 from $399.6 million at December 31, 2015 and increased $31.0 from $368.6 million at December 31, 2014. The increase was a result of net income of $43.4 million partially offset by $11.5 million of patronage distributions declared.

### *Patronage Program*

We have a Patronage Program that allows us to distribute our available net earnings to our shareholders. This program provides for the application of net earnings in the manner described in our Bylaws. In addition to determining the amount and method of patronage to be distributed, the Bylaws require increasing surplus to meet capital adequacy standards established by Regulations; increasing surplus to a level necessary to support competitive pricing at targeted earnings levels; and increasing surplus for reasonable reserves. Patronage distributions are based on business done with us during the year. We paid cash patronage of $10.4 million in 2016, compared to $9.6 million in 2015, and $9.2 million in 2014. During 2016, we declared patronage distributions of $11.5 million to be paid in 2017.

***Stock***

Our total stock and participation certificates increased $51 thousand and remains at $1.8 million at December 31, 2016, at December 31, 2015, and at December 31, 2014. In accordance with the Association's capitalization bylaws, the Association has a borrower purchased capital requirement of $1,000 per customer.

***Accumulated Other Comprehensive Income and Losses***

Accumulated other comprehensive loss totaled $91 thousand at December 31, 2016, as compared to $132 thousand at year-end 2015 and $163 thousand at year-end 2014. Certain employees participate in a non-qualified Defined Benefit Pension Restoration Plan (Plan). Accounting guidance requires recognition of the Plan's underfunded status and unamortized actuarial gains and losses and prior service costs or credits as a liability with an offsetting adjustment to accumulated other comprehensive loss.

***Capital Plan and Regulatory Requirements***

Our Board of Directors establishes a formal capital adequacy plan that addresses capital goals in relation to risks. The capital adequacy plan assesses the capital level necessary for financial viability and to provide for growth. Our plan is updated annually and approved by our Board of Directors. FCA regulations require the plan to consider the following factors in determining optimal capital levels, including:

- Regulatory capital requirements;
- Asset quality;
- Needs of our customer base; and
- Other risk-oriented activities, such as funding and interest rate risks, contingent and off-balance sheet liabilities and other conditions warranting additional capital.

FCA regulations establish minimum capital standards expressed as a ratio of capital to assets, taking into account relative risk factors for all System institutions. In general, the regulations provide for a relative risk weighting of assets and establish a minimum ratio of permanent capital, total surplus and core surplus to risk-weighted assets. Our capital ratios as of December 31 and the FCA minimum requirements follow.

| | **2016** | 2015 | 2014 | Regulatory Minimum |
|---|---|---|---|---|
| Permanent capital ratio | **14.26%** | 14.72% | 14.88% | 7.00% |
| Total surplus ratio | **14.18%** | 14.64% | 14.80% | 7.00% |
| Core surplus ratio | **14.18%** | 14.64% | 14.80% | 3.50% |

As of December 31, 2016, we exceeded the regulatory minimum capital ratios. However, the minimum ratios established were not meant to be adopted as the optimum capital level, so we have established goals in excess of the regulatory minimum. As of December 31, 2016, we have met our goals. Due to our strong capital position, we will continue to be able to retire at-risk stock.

## REGULATORY MATTERS

As of December 31, 2016, we had no enforcement actions in effect and FCA took no enforcement actions on us during the year.

On March 10, 2016, the FCA adopted final rules (the New Capital Regulations) relating to regulatory capital requirements for System banks, including CoBank, and Associations. The New Capital Regulations take effect January 1, 2017. The stated objectives of the New Capital Regulations are as follows:

- To modernize capital requirements while ensuring that System institutions continue to hold sufficient regulatory capital to fulfill the System's mission as a government-sponsored enterprise;
- To ensure that the System's capital requirements are comparable to the Basel III framework and the standardized approach that the federal banking regulatory agencies have adopted, but also to ensure that the rules recognize the cooperative structure and the organization of the System;
- To make System regulatory capital requirements more transparent; and
- To meet certain requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act).

The New Capital Regulations, among other things, replace existing core surplus and total surplus requirements with common equity tier 1 (CET1), tier 1 and total capital (tier 1 plus tier 2) risk-based capital ratio requirements. The New Capital Regulations also add a tier 1 leverage ratio for all System institutions, which replaces the existing net collateral ratio for System banks. In addition, the New Capital Regulations establish a capital conservation buffer and a leverage buffer; enhance the sensitivity of risk weightings; and, for System banks only, require additional public disclosures. The revisions to the risk weightings include alternatives to the use of credit ratings, as required by the Dodd-Frank Act.

The New Capital Regulations set the following minimum risk-based requirements:

- A CET1 capital ratio of 4.5 percent;
- A tier 1 capital ratio (CET1 capital plus additional tier 1 capital) of 6 percent; and
- A total capital ratio (tier 1 plus tier 2) of 8 percent.

The New Capital Regulations also set a minimum tier 1 leverage ratio (tier 1 capital divided by total assets) of 4 percent, of which at least 1.5 percent must consist of unallocated retained earnings (URE) and URE equivalents, which are nonqualified allocated equities with certain characteristics of URE.

The New Capital Regulations establish a capital cushion (capital conservation buffer) of 2.5 percent above the risk-based CET1, tier 1 and total capital requirements. In addition, the New Capital Regulations establish a leverage capital cushion (leverage buffer) of 1 percent above the tier 1 leverage ratio requirement. If capital ratios fall below the regulatory minimum plus buffer amounts, capital distributions (equity redemptions, cash dividend payments, and cash patronage payments) and discretionary senior executive bonuses are restricted or prohibited without prior FCA approval. The New Capital Regulations establish a three-year phase-in of the capital conservation buffer beginning January 1, 2017. There will be no phase-in of the leverage buffer.

We are in compliance with the New Capital Regulations as of January 1, 2017.

## GOVERNANCE

### *Board of Directors*

We are governed by an eleven-member board that provides direction and oversees our management. Of these directors, eight are elected by the shareholders and three are appointed by the elected directors. Our Board of Directors represents the interests of our shareholders. The Board of Directors meets regularly to perform the following functions, among others:

- selects, evaluates and compensates the chief executive officer;
- approves the strategic plan, capital plan, financial plan and the annual operating budget;
- oversees the lending operations;
- directs management on significant issues; and
- oversees the financial reporting process, communications with shareholders and our legal and regulatory compliance.

### *Director Independence*

All directors must exercise sound judgment in deciding matters in the Association's interest. All Association directors are independent from the perspective that none of the management or staff serve as Board members. However, we are a financial services cooperative, and the Farm Credit Act and FCA Regulations require our elected directors to have a loan relationship with us.

The elected directors, as borrowers, have a vested interest in ensuring our Association remains strong and viable. The Board has established independence criteria to ensure that a loan relationship does not compromise the independence of our Board. Annually, in conjunction with our independence analysis and reporting on our loans to directors, each director provides financial information and any other documentation and/or assertions needed for the Board to determine the independence of each Board member.

### *Audit Committee*

The Audit Committee reports to the Board of Directors. The Audit Committee is composed of six members. During 2016, eleven meetings were held. The Audit Committee responsibilities generally include, but are not limited to:

- oversight of the financial reporting risk and the accuracy of the quarterly and annual shareholder reports;
- oversight of the system of internal controls related to the preparation of quarterly and annual shareholder reports;
- review and assessment of the impact of accounting and auditing developments on the consolidated financial statements; and
- establishment and maintenance of procedures for the receipt, retention and treatment of confidential and anonymous submission of concerns regarding accounting, internal accounting controls or auditing matters.

### *Compensation Committee*

The Compensation Committee (Committee) is responsible for the oversight of employee and director compensation. The Committee is composed of the full Board of Directors. The Committee annually reviews, evaluates and approves the compensation policies, programs and plans for senior officers and employees including benefits programs.

### *Other Governance*

The Board has monitored the requirements of public companies under the Sarbanes-Oxley Act. While we are not subject to the requirements of this law, we continually implement steps to strengthen governance and financial reporting. We strive to maintain strong governance and financial reporting through the following actions:

- a system for the receipt and treatment of whistleblower complaints;
- a code of ethics for the President/CEO, Chief Financial Officer, Chief Credit Officer, Assistant Chief Financial Officer, and Financial Accounting Manager;
- open lines of communication between the independent auditors, management, and the Audit Committee;
- "plain English" disclosures;
- officer certification of accuracy and completeness of the consolidated financial statements; and
- information disclosure through our website.

## FORWARD-LOOKING INFORMATION

Our discussion contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Words such as "anticipates," "believes," "could," "estimates," "may," "should," and "will," or other variations of these terms are intended to identify forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions, and expected future developments. However, actual results and developments may differ materially from our expectations and predictions due to a number of risks and uncertainties, many of which are beyond our control. These risks and uncertainties include, but are not limited to:

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international, and farm-related business sectors;
- weather, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry and/or the Farm Credit System; and
- actions taken by the Federal Reserve System in implementing monetary policy.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our consolidated financial statements are based on accounting principles generally accepted in the United States of America. Our significant accounting policies are critical to the understanding of the Association results of operations and financial position because some accounting policies require us to make complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. We consider these policies critical because we have to make judgments about matters that are inherently uncertain. For a complete discussion of significant accounting policies, see Note 2, "Summary of Significant Accounting Policies," and Note 4, "Loans and Allowance for Credit Losses," of the accompanying consolidated financial statements. The development and selection of critical accounting policies, and the related disclosures, have been reviewed by our Audit Committee. A summary of critical policies relating to determination of the allowance for credit losses follows.

***Allowance for Credit Losses***

The allowance for credit losses is a combination of our allowance for loan losses and the reserve for unfunded liabilities. It is our best estimate of the amount of probable loan losses existing in and inherent in our loan portfolio as well as potential losses from unfunded commitments as of the balance sheet date. The allowance for credit losses is increased through provisions for credit losses and loan recoveries and is decreased through credit loss reversals and loan charge-offs. We determine the allowance for credit losses based on a regular evaluation of the loan portfolio and unfunded commitments, which generally considers recent historical charge-off experience adjusted for relevant factors.

Loans and unfunded commitments are evaluated based on the borrower's overall financial condition, resources, and payment record, the prospects for support from any financially responsible guarantor and, if appropriate, the estimated net realizable value of any collateral. The allowance for credit losses attributable to these loans and unfunded commitments are established by a process that estimates the probable loss inherent in the loans and unfunded commitments, taking into account various historical and projected factors, internal risk ratings, regulatory oversight, and geographic, industry and other factors.

Changes in the factors we consider in the evaluation of losses in the loan portfolio and unfunded commitments could occur for various credit related reasons and could result in a change in the allowance for credit losses, which would have a direct impact on the provision for credit losses and results of operations. See Note 2, "Summary of Significant Accounting Policies," and Note 4, "Loans and Allowance for Credit Losses," of the accompanying consolidated financial statements for detailed information regarding the allowance for credit losses.

## CUSTOMER PRIVACY

FCA regulations require that borrower information be held in confidence by Farm Credit institutions, their directors, officers and employees. FCA regulations and our Standards of Conduct Policies specifically restrict Farm Credit institution directors and employees from disclosing information not normally contained in published reports or press releases about the institution or its borrowers or members. These regulations also provide Farm Credit institutions clear guidelines for protecting their borrowers' nonpublic information.

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## Report of Independent Auditors

To the Board of Directors of Yosemite Farm Credit, ACA and Subsidiaries:

We have audited the accompanying consolidated financial statements of Yosemite Farm Credit, ACA and its subsidiaries, which comprise the consolidated statements of condition as of December 31, 2016, 2015 and 2014, and the related consolidated statements of comprehensive income, of changes in shareholders' equity, and of cash flows for the years then ended.

### *Management's Responsibility for the Consolidated Financial Statements*

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Yosemite Farm Credit, ACA and its subsidiaries as of December 31, 2016, 2015 and 2014, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

March 2, 2017

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## YOSEMITE FARM CREDIT, ACA
## CONSOLIDATED STATEMENTS OF CONDITION
(Dollars in Thousands)

| | December 31 | | |
|---|---|---|---|
| | **2016** | 2015 | 2014 |
| **ASSETS** | | | |
| Loans | **$ 2,512,101** | $ 2,231,075 | $ 2,014,073 |
| Less allowance for loan losses | **6,584** | 5,034 | 4,601 |
| Net loans | **2,505,517** | 2,226,041 | 2,009,472 |
| Cash | **4,650** | 2,634 | - |
| Investment securities - held-to-maturity | **23,462** | 29,044 | 41,325 |
| Accrued interest receivable | **22,675** | 15,776 | 14,182 |
| Investment in CoBank, ACB | **78,205** | 69,218 | 64,010 |
| Premises and equipment, net | **16,162** | 16,269 | 16,633 |
| Other assets | **10,512** | 9,399 | 8,656 |
| **Total assets** | **$ 2,661,183** | $ 2,368,381 | $ 2,154,278 |
| **LIABILITIES** | | | |
| Note payable to CoBank, ACB | **$ 2,154,744** | $ 1,900,093 | $ 1,710,120 |
| Cash management accounts | **51,772** | 48,610 | 55,745 |
| Accrued interest payable | **2,620** | 2,103 | 1,942 |
| Patronage distributions payable | **11,479** | 10,354 | 9,603 |
| Other liabilities | **7,274** | 5,925 | 6,678 |
| **Total liabilities** | **2,227,889** | 1,967,085 | 1,784,088 |
| **Commitments and Contingencies:** (See Note 14) | | | |
| **SHAREHOLDERS' EQUITY** | | | |
| Capital stock and participation certificates | **1,845** | 1,794 | 1,767 |
| Unallocated retained earnings | **431,540** | 399,634 | 368,586 |
| Accumulated other comprehensive loss | **(91)** | (132) | (163) |
| **Total shareholders' equity** | **433,294** | 401,296 | 370,190 |
| **Total liabilities and shareholders' equity** | **$ 2,661,183** | $ 2,368,381 | $ 2,154,278 |

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

# YOSEMITE FARM CREDIT, ACA
# CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Dollars in Thousands)

| | For the Year Ended December 31 | | |
|---|---|---|---|
| | **2016** | 2015 | 2014 |
| **INTEREST INCOME** | | | |
| Loans | **$ 87,216** | $ 77,453 | $ 72,031 |
| Investment securities | **1,247** | 1,773 | 2,252 |
| **Total interest income** | **88,463** | 79,226 | 74,283 |
| **INTEREST EXPENSE** | | | |
| Note payable to CoBank, ACB | **26,909** | 22,997 | 22,923 |
| Cash management accounts | **210** | 232 | 182 |
| **Total interest expense** | **27,119** | 23,229 | 23,105 |
| Net interest income | **61,344** | 55,997 | 51,178 |
| Provision for credit losses/(credit loss reversals) | **2,182** | 858 | (266) |
| **Net interest income after provision for credit losses/(credit loss reversals)** | **59,162** | 55,139 | 51,444 |
| **NON-INTEREST INCOME** | | | |
| Patronage distribution from Farm Credit Institutions | **9,404** | 8,363 | 7,776 |
| Financially related services income | **307** | 224 | 190 |
| Other non-interest income | **621** | 706 | 626 |
| **Total non-interest income** | **10,332** | 9,293 | 8,592 |
| **NON-INTEREST EXPENSE** | | | |
| Salaries and employee benefits | **16,811** | 15,292 | 14,379 |
| Occupancy and equipment | **1,385** | 1,337 | 1,146 |
| Farm Credit Insurance Fund premium | **3,145** | 2,128 | 1,821 |
| Other non-interest expense | **4,766** | 4,319 | 4,154 |
| **Total non-interest expense** | **26,107** | 23,076 | 21,500 |
| Income before income taxes | **43,387** | 41,356 | 38,536 |
| Provision for income taxes | **2** | 2 | 2 |
| **Net income** | **$ 43,385** | $ 41,354 | $ 38,534 |
| **COMPREHENSIVE INCOME** | | | |
| Amortization of retirement costs | **41** | 31 | 55 |
| **Total comprehensive Income** | **$ 43,426** | $ 41,385 | $ 38,589 |

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

## YOSEMITE FARM CREDIT, ACA
## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Dollars in Thousands)

| | Capital Stock and Participation Certificates | Retained Earnings | Accumulated Other Comprehensive Income/(Loss) | Total Shareholders' Equity |
|---|---|---|---|---|
| **Balance at December 31, 2013** | $ 1,738 | $ 339,666 | $ (218) | $ 341,186 |
| Comprehensive Income | | 38,534 | 55 | 38,589 |
| Stock and participation certificates issued | 193 | | | 193 |
| Stock and participation certificates retired | (164) | | | (164) |
| Net patronage distributions | | (9,614) | | (9,614) |
| **Balance at December 31, 2014** | $ 1,767 | $ 368,586 | $ (163) | $ 370,190 |
| Comprehensive Income | | 41,354 | 31 | 41,385 |
| Stock and participation certificates issued | 160 | | | 160 |
| Stock and participation certificates retired | (133) | | | (133) |
| Net patronage distributions | | (10,306) | | (10,306) |
| **Balance at December 31, 2015** | $ 1,794 | $ 399,634 | $ (132) | $ 401,296 |
| Comprehensive Income | | **43,385** | **41** | **43,426** |
| Stock and participation certificates issued | **196** | | | **196** |
| Stock and participation certificates retired | **(145)** | | | **(145)** |
| Net patronage distributions | | **(11,479)** | | **(11,479)** |
| **Balance at December 31, 2016** | **$ 1,845** | **$ 431,540** | **$ (91)** | **$ 433,294** |

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

**YOSEMITE FARM CREDIT, ACA**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**
(Dollars in Thousands)

| | For the Year Ended December 31 | | |
|---|---|---|---|
| | **2016** | 2015 | 2014 |
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | | |
| Net income | **$ 43,385** | $ 41,354 | $ 38,534 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Provision for credit losses/(credit loss reversals) | **2,182** | 858 | (266) |
| Depreciation and amortization | **1,011** | 931 | 788 |
| Gain on sales of premises and equipment | **(68)** | (85) | (25) |
| Stock patronage received from CoBank | **(158)** | (145) | (135) |
| Changes in assets and liabilities: | | | |
| Increase in accrued interest receivable | **(6,899)** | (1,594) | (1,998) |
| Increase in other assets and receivable from CoBank | **(1,100)** | (743) | (289) |
| Increase (decrease) in accrued interest payable | **517** | 161 | (68) |
| Increase (decrease) in other liabilities | **758** | (1,147) | 1,822 |
| Net cash provided by operating activities | **39,628** | 39,590 | 38,363 |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | | |
| Disbursements on loans, net | **(281,026)** | (217,002) | (164,434) |
| Payments received on investment securities | **5,582** | 12,281 | 7,743 |
| Purchase of stock in CoBank | **(8,842)** | (5,063) | (2,627) |
| Recoveries of loans charged off | **-** | - | 2 |
| Purchase of premises and equipment, net | **(836)** | (482) | (4,087) |
| Net cash used in investing activities | **(285,122)** | (210,266) | (163,403) |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | | |
| Net draws on note payable to CoBank | **254,651** | 189,973 | 120,284 |
| Increase (decrease) in cash management account | **3,162** | (7,135) | 9,125 |
| Patronage distributions | **(10,354)** | (9,555) | (9,234) |
| Issuances of capital stock and participation certificates, net | **51** | 27 | 29 |
| Net cash provided by financing activities | **247,510** | 173,310 | 120,204 |
| Net increase (decrease) in cash | **2,016** | 2,634 | (4,836) |
| Cash at beginning of year | **2,634** | - | 4,836 |
| Cash at end of year | **$ 4,650** | $ 2,634 | $ - |

**SUPPLEMENTAL CASH FLOW INFORMATION:**

| | | | |
|---|---|---|---|
| Cash paid for interest | **$ 26,602** | $ 23,068 | $ 23,173 |
| Cash paid for income taxes | **$ 2** | $ 2 | $ 2 |

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

# YOSEMITE FARM CREDIT, ACA
# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 1 – ORGANIZATION AND OPERATIONS

A. **Organization:** Yosemite Farm Credit, ACA and its subsidiaries, Yosemite Land Bank, FLCA and Yosemite Production Credit, PCA, (collectively called the Association) are member-owned cooperatives which provide credit and credit-related services to or for the benefit of eligible borrowers/shareholders for qualified agricultural purposes in the counties of Stanislaus, Merced, Tuolumne, Mariposa and Fresno, in the state of California.

The Association is a lending institution of the Farm Credit System (System), a nationwide system of cooperatively owned banks and associations, which was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (the Farm Credit Act). The System is comprised of three Farm Credit Banks, one Agricultural Credit Bank and 73 associations.

CoBank, ACB (funding bank or the "Bank"), its related associations and AgVantis, Inc. (AgVantis) are collectively referred to as the District. CoBank provides the funding to associations within the District and is responsible for supervising certain activities of the District Associations. AgVantis, which is owned by the entities it serves, provides technology and other operational services to certain associations and to CoBank. The CoBank District consists of CoBank, 23 Agricultural Credit Associations (ACA), which each have two wholly owned subsidiaries, (a FLCA and a PCA), one FLCA and AgVantis.

ACA parent companies provide financing and related services through their FLCA and PCA subsidiaries. Generally, the FLCA makes secured long-term agricultural real estate and rural home mortgage loans and the PCA makes short and intermediate-term loans for agricultural production or operating purposes.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System Banks and Associations. The FCA examines the activities of System institutions to ensure their compliance with the Farm Credit Act, FCA regulations and safe and sound banking practices.

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). By law, the Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on System-wide debt obligations (Insured Debt), (2) to ensure the retirement of protected stock at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary use by the Insurance Corporation in providing assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System Bank is required to pay premiums, which may be passed on to the Associations, into the Insurance Fund based on its annual average outstanding insured debt adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments until the assets in the Insurance Fund reach the "secure base amount," which is defined in the Farm Credit Act as 2.0% of the aggregate Insured Debt or such other percentage of the Insured Debt as the Insurance Corporation, in its sole discretion, determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums, as necessary to maintain the Insurance Fund at the 2.0% level. As required by the Farm Credit Act, as amended, the Insurance Corporation may return excess funds above the secure base amount to System institutions. The Bank passes this premium expense and the return of excess funds as applicable through to each Association based on the Association's average adjusted note payable with the Bank.

B. **Operations:** The Farm Credit Act sets forth the types of authorized lending activity, persons eligible to borrow, and financial services which can be provided by the Association. The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, their cooperatives, rural residents and farm-related businesses. The Association also serves as an intermediary in offering credit life insurance and multi-peril crop insurance and provides other related services such as cash management and lease financing.

The Association's financial condition may be impacted by factors affecting CoBank. The CoBank Annual Report is available free of charge on CoBank's website, www.cobank.com, or may be obtained at no charge by contacting Yosemite Farm Credit, 806 W. Monte Vista Ave., Turlock CA 95382 or calling (209) 667-2366. Upon request, Association shareholders will be provided with a copy of the CoBank Annual Report, which includes the combined balance sheet and income statements of CoBank and its related Associations, and AgVantis. The CoBank Annual Report discusses the material aspects of the Bank's and the District's financial condition, changes in financial condition, and results of operations.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The accounting and reporting policies of the Association conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of financial statements in conformity with GAAP requires Association management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results may differ from these estimates. Significant estimates are discussed in these footnotes as applicable.

The consolidated financial statements include the accounts of Yosemite Land Bank, FLCA and Yosemite Production Credit, PCA. All significant inter-company transactions have been eliminated in consolidation. Recently issued accounting pronouncements follow.

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

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. For public business entities that are not U.S. Securities and Exchange Commission filers this guidance becomes effective for interim and annual periods beginning after December 15, 2020, with early application permitted. The Association will evaluate the impact of adoption on the its financial condition and its results of operations.

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

In January 2016, the FASB issued guidance entitled "Recognition and Measurement of Financial Assets and Liabilities." The guidance affects, among other things, the presentation and disclosure requirements for financial instruments. For disclosure purposes, entities that are not public business entities will no longer be required to disclose the fair value of financial instruments carried at amortized cost. Entities that are not public business entities can early adopt the provision permitting the omission of fair value disclosure for financial instruments at amortized cost. The Association elected to early adopt this guidance in 2015.

In May 2014, the FASB issued guidance entitled, "Revenue from Contracts with Customers." The guidance governs revenue recognition from contracts with customers and requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Financial instruments and other contractual rights within the scope of other guidance issued by the FASB are excluded from the scope of this new revenue recognition guidance. In this regard, a majority of the Association's contracts would be excluded from the scope of this new guidance. In August 2015, the FASB issued an update that defers this guidance by one year, which results in the new revenue standard becoming effective for interim and annual reporting periods beginning after December 15, 2017. The Association is in the process of reviewing contracts to determine the effect, if any, on its financial condition or results of operations.

Following is a summary of significant accounting policies.

**A. Loans and Allowance for Credit Losses:** Long-term real estate mortgage loans generally have original maturities ranging from 5 to 40 years. Substantially all short and intermediate-term loans made for agricultural production or operating purposes have maturities of ten years or less. Loans are carried at their principal amount outstanding adjusted for charge-offs and deferred loan fees or costs. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. Loan origination fees and direct loan origination costs are capitalized and the net fee or cost is amortized over the life of the related loan as an adjustment to the yield.

Impaired loans are loans for which it is probable that principal and interest will not be collected according to the contractual terms of the loan and are generally considered substandard or doubtful, which is in accordance with the loan rating model, as described below. Impaired loans include nonaccrual loans, restructured loans and loans past due 90 days or more and still accruing interest. A loan is considered contractually past due when any principal repayment or interest payment required by the loan contract is not received on or before the due date. A loan shall remain contractually past due until it is formally restructured or until the entire amount past due, including principal, accrued interest, and penalty interest incurred is collected in full or otherwise discharged.

Impaired loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days or more (unless adequately collateralized and in the process of collection) or when circumstances indicate that collection of principal and/or interest is in doubt. Additionally, all loans over 180 days past due are placed in nonaccrual status. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is reversed (if accrued in the current year) and/or included in the recorded nonaccrual balance (if accrued in prior years). Loans are charged-off at the time they are determined to be uncollectible.

A restructured loan constitutes a troubled debt restructuring if for economic or legal reasons related to the debtor's financial difficulties the Association grants a concession to the debtor that it would not otherwise consider.

When loans are in nonaccrual status, loan payments are generally applied against the recorded nonaccrual balance. A nonaccrual loan may, at times, be maintained on a cash basis. As a cash basis nonaccrual loan, the recognition of interest income from cash payments received is allowed when the collectability of the recorded investment in the loan is no longer in doubt and the loan does not have a remaining unrecovered charge-off associated with it. Nonaccrual loans may be returned to accrual status when all contractual principal and interest is current, the borrower has demonstrated payment performance, there are no unrecovered prior charge-offs and collection of future payments is no longer in doubt. If previously unrecognized interest income exists at the time the loan is transferred to accrual status, cash received at the time of or subsequent to the transfer is first recorded as interest income until such time as the recorded balance equals the contractual indebtedness of the borrower.

The Association purchases loan and lease participations from other System and non-System entities to generate additional earnings and diversify risk related to existing commodities financed and the geographic area served. Additionally, the Association sells a portion of certain large loans to other System and non-System entities to reduce risk and comply with established lending limits. Loans are accounted for following the accounting requirements for sale treatment.

The Association uses a two-dimensional loan rating model based on internally generated combined System risk rating guidance that incorporates a 14-point risk-rating scale to identify and track the probability of borrower default and a separate scale addressing loss given default over a period of time. Probability of default is the probability that a borrower will experience a default within 12 months from the date of the determination of the risk rating. A default is considered to have occurred if the lender believes the borrower will not be able to pay its obligation in full or the borrower is past due more than 90 days. The loss given default is management's estimate as to the anticipated economic loss on a specific loan assuming default has occurred or is expected to occur within the next 12 months.

Each of the probability of default categories carries a distinct percentage of default probability. The 14-point risk rating scale provides for granularity of the probability of default, especially in the acceptable ratings. There are nine acceptable categories that range from a borrower of the highest quality to a borrower of minimally acceptable quality. The probability of default between 1 and 9 is very narrow and would reflect almost no default to a minimal default percentage. The probability of default grows more rapidly as a loan moves from a "9" to other assets especially mentioned and grows significantly as a loan moves to a substandard (viable) level. A substandard (non-viable) rating indicates that the probability of default is almost certain.

In 2015, the Association revised its classification for the allowance for credit losses. The allowance for credit losses is presented as an adjustment to the value of our loan portfolio for inherent credit losses related to the portfolio risk. The reserve for unfunded commitments takes into consideration potential losses related to unfunded commitments. We have reclassified these balances to a separate reserve for unfunded commitments, which is included in Other Liabilities on the Association's Consolidated Statements of Condition. Transfers between the allowance for loan losses and the reserve for unfunded commitments can occur in conjunction with funding a seasonal line of credit or other loan and decreasing a related unfunded commitment or, conversely, receiving a loan payment and increasing a related unfunded commitment. Newly-executed loan commitments will also increase this liability. The provision for loan losses and the reserve for unfunded commitments are included together as part of the provision for credit losses on the Consolidated Statements of Comprehensive Income.

The credit risk rating methodology is a key component of the Association's allowance for credit losses evaluation, and is generally incorporated into its loan underwriting standards and internal lending limit. The allowance for credit losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance is increased through provision for credit losses and loan recoveries and is decreased through credit loss reversals and loan charge-offs. The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, environmental conditions, loan portfolio composition, collateral value, portfolio quality, current production conditions and prior loan loss experience. The allowance for credit losses encompasses various judgments, evaluations and appraisals with respect to the loans and their underlying collateral that, by their nature, contain elements of uncertainty, imprecision and variability. Changes in the agricultural economy and environment and their impact on borrower repayment capacity will cause various judgments, evaluations and appraisals to change over time. Accordingly, actual circumstances could vary significantly from the Association's expectations and predictions of those circumstances. Management considers the following macro-economic factors in determining and supporting the level of allowance for credit losses: the concentration of lending in agriculture, combined with uncertainties associated with farmland values, commodity prices, exports, government assistance programs, regional economic effects and weather-related influences.

The allowance for credit losses includes components for loans individually evaluated for impairment and loans collectively evaluated for impairment. Generally, for loans individually evaluated, the allowance for credit losses represents the difference between the recorded investment in the loan and the present value of the cash flows expected to be collected discounted at the loan's effective interest rate, or at the fair value of the collateral, if the loan is collateral dependent. For those loans collectively evaluated for impairment, the allowance for credit losses is determined using the risk-rating model as previously discussed.

B. **Cash:** Cash, as included in the consolidated financial statements, represents cash on hand and on deposit at financial institutions. At times, cash deposits may be in excess of federally insured limits.

C. **Investment Securities:** The Association may hold investments in accordance with investment programs approved by FCA. Mortgage-backed securities issued by Farmer Mac are investments for which the Association has the intent and ability to hold to maturity and are classified as held-to-maturity and carried at cost.

Impairment is considered to be other-than-temporary if the present value of cash flows expected to be collected from the debt securities is less than the amortized cost basis of the security (any such shortfall is referred to as a "credit loss"). If an entity intends to sell an impaired debt security or is more likely than not to be required to sell the security before recovery of its amortized cost basis, the impairment is other-than-temporary and should be recognized currently in earnings in an amount equal to the entire difference between fair value and amortized cost. If a credit loss exists, but an entity does not intend to sell the impaired debt security and is not more likely than not to be required to sell before recovery, the impairment is other-than-temporary and should be separated into (i) the estimated amount relating to credit loss, and (ii) the amount relating to all other factors. Only the estimated credit loss amount is recognized currently in earnings, with the remainder of the loss amount recognized in other comprehensive income.

**D.** **Investment in CoBank:** The Association's required investment in CoBank is in the form of Class A Stock. The minimum required investment is 4.0% of the prior year's average direct loan volume. The investment in CoBank is comprised of patronage based stock and purchased stock.

**E.** **Premises and Equipment:** Land is carried at cost. For construction in progress, direct project costs are capitalized and the asset is not depreciated until the project is complete and placed into service. Premises and equipment are carried at cost less accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Useful lives for buildings is 30 years and ranges from 3 to 15 years for furniture, equipment and automobiles. Gains and losses on dispositions are reflected in current operating results. Maintenance and repairs are expensed and improvements above certain thresholds are capitalized.

**F.** **Other Assets and Other Liabilities:** Other assets are comprised primarily of accounts receivable, prepaid expenses, and investment in Farm Credit institutions. Significant components of other liabilities primarily include accounts payable, employee benefits, and the reserve for unfunded commitments.

**G.** **Cash Management Accounts:** The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. Such payments are presented as liabilities in the Consolidated Statements of Condition. Cash Management Accounts are not insured. Interest is paid by the Association on such accounts. The Association offers conditional trust fund accounts for its borrowers. Access to such funds is restricted and as such, these funds are netted against the borrower's related loan balance.

**H.** **Employee Benefit Plans:** Substantially all employees of the Association participate in the Eleventh District Defined Benefit Retirement Plan (Defined Benefit Plan) and/or the Farm Credit Foundations Defined Contribution/401(k) Plan (Defined Contribution Plan). The Defined Benefit Plan is a noncontributory plan. Benefits are based on compensation and years of service. The Association recognizes its proportional share of expense and contributes its proportional share of funding. The Defined Benefit Plan was closed to employees hired after December 31, 1997.

The Defined Contribution Plan has two components. Employees who do not participate in the Defined Benefit Plan may receive benefits through the Employer Contribution portion of the Defined Contribution Plan. In this plan, the Association provides a monthly contribution based on a defined percentage of the employee's salary. Employees may also participate in a Salary Deferral Plan governed by Section 401(k) of the Internal Revenue Code. The Association matches a certain percentage of employee contributions. Employees hired on or after January 1, 1998 are eligible to participate only in the Defined Contribution Plan and Salary Deferral Plan. All defined contribution costs are expensed in the same period that participants earn employer contributions.

The Association also provides certain health and life insurance benefits to eligible current and retired employees through the Farm Credit Foundation Retiree Medical and Retiree Life Plans. Substantially all employees may become eligible for those benefits if they reach normal retirement age while working for the Association. The anticipated costs of these benefits are accrued during the period of the employee's active service. The authoritative accounting guidance requires the accrual of the expected cost of providing postretirement benefits during the years that the employee renders service necessary to become eligible for these benefits.

The Association also participates in the Eleventh District nonqualified defined benefit Pension Restoration Plan. This plan provides retirement benefits above the Internal Revenue Code compensation limit to certain highly compensated eligible employees. Benefits payable under this plan are offset by the benefits payable from the pension plan.

I. **Patronage Distributions:** Patronage distributions from CoBank are accrued by the Association in the year earned.

J. **Income Taxes:** As previously described, the ACA holding company conducts its business activities through two wholly owned subsidiaries. Long-term mortgage lending activities are operated through a wholly owned FLCA subsidiary which is exempt from federal and state income tax. Short- and intermediate-term lending activities are operated through a wholly owned PCA subsidiary. Operating expenses are allocated to each subsidiary based on estimated relative service. All significant transactions between the subsidiaries and the parent company have been eliminated in consolidation. The ACA, along with the PCA subsidiary, are subject to income taxes. The Association accounts for income taxes under the liability method. Accordingly, deferred taxes are recognized for estimated taxes ultimately payable or recoverable based on federal, state or local laws.

The Association elected to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the Association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated retained earnings. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage distributions. Deferred taxes are recorded on the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the Association and will therefore impact future tax payments. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (over 50% probability), based on management's estimate, the deferred tax assets will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of the Association's expected patronage program, which reduces taxable earnings.

Deferred income taxes have not been recorded by the Association on stock patronage distributions received from the Bank prior to January 1, 1993, the adoption date of accounting guidance on income taxes. Association management's intent is to permanently invest these and other undistributed earnings in the Bank, or if converted to cash, to pass through any such earnings to Association borrowers through qualified patronage allocations.

The Association has provided deferred income taxes on amounts allocated to the Association which relate to the Bank's post-1992 earnings. Deferred income taxes have not been provided on the Bank's post-1992 unallocated earnings to the extent that such earnings will be passed through to Association borrowers through qualified patronage allocations.

For California tax purposes, the Association can exclude from taxable income all patronage sourced income. Therefore, the provision for state income taxes is made only on non-patronage sourced taxable earnings.

K. **Other Comprehensive Income/(Loss):** Other comprehensive income refers to revenue, expenses, gains and losses that under GAAP are recorded as an element of shareholders' equity and comprehensive income but are excluded from net income. Accumulated other comprehensive income/(loss) refers to the balance of these transactions. The Association records other comprehensive income/loss associated with the liability under the Pension Restoration Plan (see Note 11).

L. **Fair Value Measurement:** Accounting guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. It describes three levels of inputs that may be used to measure fair value:

Level 1 — Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets include investments that are actively traded and have quoted net asset values that are observable in the marketplace. The Association holds no Level 1 investments.

Level 2 — Observable inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly or indirectly. Level 2 inputs include the following: (a) quoted prices for similar assets or liabilities in active markets; (b) quoted prices for identical or similar assets or liabilities in markets that are not active so that they are traded less frequently than exchange-traded instruments, the prices are not current or principal market information is not released publicly; (c) inputs other than quoted prices that are observable such as interest rates and yield curves, prepayment speeds, credit risks and default rates; and, (d) inputs derived principally from or corroborated by observable market data by correlation or other means. The Association holds no Level 2 investments.

Level 3 — Unobservable inputs are those that are supported by little or no market activity and that are significant to the determination of the fair value of the assets or liabilities. These unobservable inputs reflect the reporting entity's own assumptions about factors that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include financial instruments whose values are determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. Level 3 assets include impaired loans and other property owned.

The fair value disclosures are presented in Note 15.

M. **Off-balance-sheet Credit Exposures:** Commitments to extend credit are agreements to lend to customers generally having fixed expiration dates or other termination clauses that may require payment of a fee. Commercial letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. These letters of credit are issued to facilitate commerce and typically result in the commitment being funded when the underlying transaction is consummated between the customer and third party. The credit risk associated with commitments to extend credit and commercial letters of credit is essentially the same as that involved with extending loans to customers and is subject to normal credit policies. Collateral may be obtained based on management's assessment of the customer's creditworthiness.

## NOTE 3 – INVESTMENT SECURITIES:

The Association may hold FCA approved investments. The following table is a summary of investments, which are held-to-maturity and have contractual maturities in excess of 10 years ($ thousands).

| | **December 31, 2016** | | | | |
|---|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Weighted Average Yield |
| Mortgage-backed securities | **$ 23,462** | **$ 356** | **$ -** | **$23,818** | **5.33%** |
| Total | **$ 23,462** | **$ 356** | **$ -** | **$23,818** | **5.33%** |

| | December 31, 2015 | | | | |
|---|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Weighted Average Yield |
| Mortgage-backed securities | $ 29,044 | $ 705 | $ - | $29,749 | 5.41% |
| Total | $ 29,044 | $ 705 | $ - | $29,749 | 5.41% |

| | December 31, 2014 | | | | |
|---|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Weighted Average Yield |
| Mortgage-backed securities | $ 41,325 | $ 1,409 | $ - | $42,734 | 5.39% |
| Total | $ 41,325 | $ 1,409 | $ - | $42,734 | 5.39% |

The Association's mortgage-backed securities are all Farmer Mac. Farmer Mac securities are Agricultural Mortgage-Backed Securities which are pools of agriculture loans that have been securitized and guaranteed by Farmer Mac. Substantially all Farmer Mac securities have contractual maturities in excess of ten years. However, expected maturities for mortgage-backed securities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

## NOTE 4 - LOANS AND ALLOWANCE FOR CREDIT LOSSES:

A summary of loans is provided in the following table as of December 31 ($ thousands).

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Real estate mortgage | **$ 1,898,901** | $ 1,744,186 | $ 1,546,679 |
| Production & intermediate term | **401,879** | 313,861 | 298,573 |
| Agribusiness | **195,775** | 156,034 | 149,746 |
| Rural residential real estate | **2,792** | 2,773 | 5,009 |
| Lease receivables | **12,754** | 14,221 | 14,066 |
| Total | **$ 2,512,101** | $ 2,231,075 | $ 2,014,073 |

The Association purchases or sells loan participations with other parties in order to diversify risk, manage loan volume and comply with FCA regulations. The following table presents information regarding participations purchased and sold as of December 31, 2016 ($ thousands).

| | Other Farm Credit Institutions | | Non-Farm Credit Institutions | | Total | |
|---|---|---|---|---|---|---|
| | Purchased | Sold | Purchased | Sold | Purchased | Sold |
| Real estate mortgage | **$ 64,447** | **$ 62,224** | **$ 375** | **$ -** | **$ 64,822** | **$ 62,224** |
| Production & intermediate-term | **22,561** | **2,640** | **5,181** | **-** | **27,742** | **2,640** |
| Agribusiness | **92,301** | **39,062** | **2,916** | | **95,217** | **39,062** |
| Total | **$ 179,309** | **$103,926** | **$ 8,472** | **$ -** | **$187,781** | **$103,926** |

While the volumes shown in the previous tables represent the relative amounts of the Association's potential credit risk as it relates to recorded loan principal, a substantial portion of the Association's loans are collateralized. Accordingly, the Association's exposure to credit loss associated with lending activities is considerably less than the recorded loan balances. An estimate of the Association's current loss exposure is indicated in the Consolidated Statements of Condition in the allowance for loan losses.

The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but typically includes farmland and income-producing property, such as crops and livestock, as well as receivables. Long-term real estate loans are secured by first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85% (97% if guaranteed or enhanced by a government agency) of the property's appraised value. However, a decline in a property's market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the Association in the collateral, may result in loan to value ratios in excess of the regulatory maximum.

The Association has obtained credit enhancements by entering into Standby Commitment to Purchase Agreements (Agreements) with Farmer Mac covering loans with principal balances outstanding of $195.0 million, $168.5 million and $144.6 million at December 31, 2016, 2015 and 2014, respectively. Under the Agreements, Farmer Mac agrees to purchase loans from the Association in the event of default (typically four months past due), subject to certain conditions, thereby mitigating the risk of loss from covered loans. In return, the Association pays Farmer Mac commitment fees based on the outstanding balance of loans covered by the Agreements. Such fees, totaling $721.0 thousand in 2016, $606.1 thousand in 2015, and $629.1 thousand in 2014 are reflected as a reduction to interest income.
In addition to Farmer Mac, the Association has credit guarantees from Farm Service Agency for $3.8 million, $3.6 million and $4.6 million for the years ending 2016, 2015 and 2014, respectively.

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

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

The following table shows loans and related accrued interest classified under the FCA Uniform Loan Classification system as a percentage of total loans and related accrued interest receivable by loan type as of December 31.

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Real estate mortgage | | | |
| Acceptable | **96.5%** | 97.8% | 97.1% |
| OAEM | **2.3** | 1.2 | 0.9 |
| Substandard | **1.2** | 1.0 | 2.0 |
| Total | **100.0%** | 100.0% | 100.0% |
| Production & intermediate-term | | | |
| Acceptable | **92.1%** | 98.2% | 95.7% |
| OAEM | **4.3** | 1.0 | 1.9 |
| Substandard | **3.6** | 0.8 | 2.4 |
| Total | **100.0%** | 100.0% | 100.0% |
| Agribusiness | | | |
| Acceptable | **98.5%** | 99.8% | 100.0% |
| OAEM | **-** | - | - |
| Substandard | **1.5** | 0.2 | - |
| Total | **100.0%** | 100.0% | 100.0% |
| Rural residential real estate | | | |
| Acceptable | **100.0%** | 100.0% | 100.0% |
| OAEM | **-** | - | - |
| Substandard | **-** | - | - |
| Total | **100.0%** | 100.0% | 100.0% |
| Leases | | | |
| Acceptable | **99.9%** | 99.8% | 99.7% |
| OAEM | **0.1** | 0.2 | 0.3 |
| Substandard | **-** | - | - |
| Total | **100.0%** | 100.0% | 100.0% |
| All Loans | | | |
| Acceptable | **96.0%** | 98.1% | 97.2% |
| OAEM | **2.4** | 1.0 | 1.0 |
| Substandard | **1.6** | 0.9 | 1.8 |
| Total | **100.0%** | 100.0% | 100.0% |

Impaired loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms. The following presents information relating to impaired loans including accrued interest, if any, as of December 31 ($ thousands).

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Nonaccrual loans: | | | |
| Current as to principal and interest | **$ 3,121** | $ 4,246 | $ 10,462 |
| Past due | **2,417** | 51 | 130 |
| Total nonaccrual loans | **5,538** | 4,297 | 10,592 |
| Total impaired accrual loans | **-** | - | - |
| Total impaired loans | **$ 5,538** | $ 4,297 | $ 10,592 |

There were no material commitments to lend additional funds to debtors whose loans were classified impaired for the years presented.

High risk assets consist of impaired loans and other property owned. These nonperforming assets (including related accrued interest) are as follows as of December 31 ($ thousands).

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Nonaccrual loans: | | | |
| Real estate mortgage | **$ 4,099** | $ 4,241 | $ 10,525 |
| Production & intermediate-term | **1,439** | 54 | 65 |
| Leases | **-** | 2 | 2 |
| Total nonaccrual loans | **5,538** | 4,297 | 10,592 |
| Total impaired loans | **5,538** | 4,297 | 10,592 |
| Other property owned | **-** | - | - |
| Total high risk assets | **$ 5,538** | $ 4,297 | $ 10,592 |

Additional impaired loan information is as follows ($ thousands).

| **December 31, 2016** | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Impaired Loans | Interest Income Recognized |
|---|---|---|---|---|---|
| Impaired loans with a related allowance for credit losses: | | | | | |
| Production & intermediate-term | **$ 787** | **$ 787** | **$ 291** | **$ 262** | **$ -** |
| Total | **$ 787** | **$ 787** | **$ 291** | **$ 262** | **$ -** |
| Impaired loans with no related allowance for credit losses: | | | | | |
| Real estate mortgage | **$ 4,099** | **$ 4,099** | **$ -** | **$ 4,588** | **$ 79** |
| Production & intermediate-term | **652** | **652** | **-** | **288** | **7** |
| Lease receivables | **-** | **-** | **-** | **-** | **2** |
| Total | **$ 4,751** | **$ 4,751** | **$ -** | **$ 4,876** | **$ 88** |
| Total impaired loans: | | | | | |
| Real estate mortgage | **$ 4,099** | **$ 4,099** | **$ -** | **$ 4,588** | **$ 79** |
| Production & intermediate-term | **1,439** | **1,439** | **291** | **550** | **7** |
| Lease receivables | **-** | **-** | **-** | **-** | **2** |
| Total | **$ 5,538** | **$ 5,538** | **$ 291** | **$ 5,138** | **$ 88** |

| December 31, 2015 | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Impaired Loans | Interest Income Recognized |
|---|---|---|---|---|---|
| Impaired loans with a related allowance for credit losses: | | | | | |
| Production & intermediate-term | $ 54 | $ 54 | $ 53 | $ 59 | $ - |
| Total | $ 54 | $ 54 | $ 53 | $ 59 | $ - |
| Impaired loans with no related allowance for credit losses: | | | | | |
| Real estate mortgage | $ 4,241 | $ 4,241 | $ - | $ 8,129 | $ 822 |
| Production & intermediate-term | - | - | - | 1 | 1 |
| Lease receivables | 2 | 2 | - | 2 | - |
| Total | $ 4,243 | $ 4,243 | $ - | $ 8,132 | $ 823 |
| Total impaired loans: | | | | | |
| Real estate mortgage | $ 4,241 | $ 4,241 | $ - | $ 8,129 | $ 822 |
| Production & intermediate-term | 54 | 54 | 53 | 60 | 1 |
| Lease receivables | 2 | 2 | - | 2 | - |
| Total | $ 4,297 | $ 4,297 | $ 53 | $ 8,191 | $ 823 |

| December 31, 2014 | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Impaired Loans | Interest Income Recognized |
|---|---|---|---|---|---|
| Impaired loans with a related allowance for credit losses: | | | | | |
| Production & intermediate-term | $ 65 | $ 65 | $ 64 | $ 68 | $ - |
| Total | $ 65 | $ 65 | $ 64 | $ 68 | $ - |
| Impaired loans with no related allowance for credit losses: | | | | | |
| Real estate mortgage | $ 10,525 | $ 10,525 | $ - | $ 13,167 | $ 88 |
| Production & intermediate-term | - | - | - | 6 | - |
| Agribusiness | - | - | - | - | 1 |
| Lease receivables | 2 | 2 | - | 9 | - |
| Total | $ 10,527 | $ 10,527 | $ - | $ 13,182 | $ 89 |
| Total impaired loans: | | | | | |
| Real estate mortgage | $ 10,525 | $ 10,525 | $ - | $ 13,167 | $ 88 |
| Production & intermediate-term | 65 | 65 | 64 | 74 | - |
| Agribusiness | - | - | - | - | 1 |
| Lease receivables | 2 | 2 | - | 9 | - |
| Total | $ 10,592 | $ 10,592 | $ 64 | $ 13,250 | $ 89 |

Interest income is recognized and cash payments are applied on nonaccrual impaired loans as described in Note 2. The following table presents interest income recognized on impaired loans ($ thousands).

| | **For the Year Ended December 31** | | |
|---|---|---|---|
| | **2016** | 2015 | 2014 |
| Interest income recognized on: | | | |
| Nonaccrual loans | **$ 83** | $ 823 | $ 87 |
| Restructured accrual | **-** | - | - |
| Accrual loans 90 days or more past due | **5** | - | 2 |
| Interest income recognized on impaired loans | **$ 88** | $ 823 | $ 89 |

Interest income on nonaccrual loans that would have been recognized under the original terms of the loans follows ($ thousands).

| | For the Year Ended December 31 | | |
|---|---|---|---|
| | **2016** | 2015 | 2014 |
| Interest income which would have been recognized under the original loan terms | **$ 341** | $ 432 | $ 640 |
| Less: interest income recognized | **83** | 823 | 87 |
| Foregone (recognized) interest income | **$ 258** | $ (391) | $ 553 |

The following table provides an age analysis of past due loans, including accrued interest ($ thousands).

| **December 31, 2016** | 30-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or less than 30 Days Past Due | Recorded Investment in Loans Outstanding | Recorded Investment >90 Days and Accruing |
|---|---|---|---|---|---|---|
| Real estate mortgage | **$ 128** | **$1,730** | **$ 1,858** | **$ 1,915,842** | **$ 1,917,700** | **$ -** |
| Production & intermediate-term | **4,112** | **652** | **4,764** | **399,432** | **404,196** | **-** |
| Agribusiness | **-** | **-** | **-** | **197,096** | **197,096** | **-** |
| Rural residential real estate | **-** | **-** | **-** | **2,797** | **2,797** | **-** |
| Lease receivables | **-** | **-** | **-** | **12,754** | **12,754** | **-** |
| Total | **$ 4,240** | **$2,382** | **$ 6,622** | **$ 2,527,921** | **$2,534,543** | **$ -** |

| 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 | Recorded Investment in Loans Outstanding | Recorded Investment >90 Days and Accruing |
|---|---|---|---|---|---|---|
| Real estate mortgage | $ 547 | $ - | $ 547 | $ 1,756,557 | $ 1,757,104 | $ - |
| Production & intermediate-term | 785 | - | 785 | 314,670 | 315,455 | - |
| Agribusiness | 243 | - | 243 | 156,791 | 157,034 | - |
| Rural residential real estate | - | - | - | 2,779 | 2,779 | - |
| Lease receivables | - | - | - | 14,221 | 14,221 | - |
| Total | $ 1,575 | $ - | $ 1,575 | $ 2,245,018 | $2,246,593 | $ - |

| 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 | Recorded Investment in Loans Outstanding | Recorded Invest-ment >90 Days and Accruing |
|---|---|---|---|---|---|---|
| Real estate mortgage | $ 371 | $ - | $ 371 | $ 1,557,646 | $ 1,558,017 | $ - |
| Production & intermediate-term | 1,050 | - | 1,050 | 298,785 | 299,835 | - |
| Agribusiness | 250 | - | 250 | 150,726 | 150,976 | - |
| Rural residential real estate | - | - | - | 5,018 | 5,018 | - |
| Lease receivables | - | - | - | 14,065 | 14,065 | - |
| Total | $ 1,671 | $ - | $ 1,671 | $ 2,026,240 | $2,027,911 | $ - |

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

A restructuring of a debt constitutes a troubled debt restructuring if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. There were no restructurings of debt in any of the years presented.

In 2015, the Association revised its classification for the allowance for credit losses. The provision for loan losses and the reserve for unfunded commitments are included together as part of the provision for credit losses on the Consolidated Statements of Comprehensive Income. The allowance for loan losses is presented as an adjustment to the value of our loan portfolio for inherent credit losses related to portfolio risk. The reserve for unfunded commitments takes into consideration potential losses related to unfunded commitments. These balances have been reclassified to a separate reserve for unfunded commitments, which is included in Other Liabilities on the Association's Consolidated Statements of Condition.

A summary of changes in the allowance for loan losses and period end recorded investment in loans is as follows ($ thousands).

| | Balance at December 31, 2015 | Charge-offs | Recoveries | Transfers (to) from Reserve for Unfunded Commitments | Provision for Credit Losses/ (Credit Loss Reversals) | Balance at December 31, 2016 |
|---|---|---|---|---|---|---|
| Real estate mortgage | **$ 3,568** | **$ -** | **$ -** | **$ (53)** | **$ 134** | **$ 3,649** |
| Production & intermediate-term | **1,297** | **-** | **-** | **(332)** | **1,721** | **2,686** |
| Agribusiness | **144** | **-** | **-** | **(247)** | **321** | **218** |
| Rural residential real estate | **2** | **-** | **-** | **-** | **1** | **3** |
| Lease receivables | **23** | **-** | **-** | **-** | **5** | **28** |
| Total | **$ 5,034** | **$ -** | **$ -** | **$ (632)** | **$ 2,182** | **$ 6,584** |

| | Balance at December 31, 2014 | Charge-offs | Recoveries | Reclassification to Reserve for Unfunded Commitments | Provision for Credit Losses/ (Credit Loss Reversals) | Balance at December 31, 2015 |
|---|---|---|---|---|---|---|
| Real estate mortgage | $ 3,141 | $ - | $ - | $ (72) | $ 499 | $ 3,568 |
| Production & intermediate-term | 1,136 | - | - | (217) | 378 | 1,297 |
| Agribusiness | 315 | - | - | (136) | (35) | 144 |
| Rural residential real estate | 2 | - | - | - | - | 2 |
| Lease receivables | 7 | - | - | - | 16 | 23 |
| Total | $ 4,601 | $ - | $ - | $(425) | $ 858 | $ 5,034 |

| | Balance at December 31, 2013 | Charge-offs | Recoveries | Provision for Credit Losses/ (Credit Loss Reversals) | Balance at December 31, 2014 |
|---|---|---|---|---|---|
| Real estate mortgage | $ 3,476 | $ - | $ - | $ (335) | $ 3,141 |
| Production & intermediate-term | 1,099 | - | 2 | 35 | 1,136 |
| Agribusiness | 279 | - | - | 36 | 315 |
| Rural residential real estate | 3 | - | - | (1) | 2 |
| Lease receivables | 8 | - | - | (1) | 7 |
| Total | $ 4,865 | $ - | $ 2 | $ (266) | $ 4,601 |

| | Allowance for Loan Losses Ending Balance at December 31, 2016 | | Recorded Investments in Loans Outstanding Ending Balance at December 31, 2016 | |
|---|---|---|---|---|
| | Individually evaluated for impairment | Collectively evaluated for impairment | Individually evaluated for impairment | Collectively evaluated for impairment |
| Real estate mortgage | **$ -** | **$ 3,649** | **$ 4,099** | **$ 1,894,802** |
| Production & intermediate-term | **291** | **2,395** | **1,439** | **400,440** |
| Agribusiness | **-** | **218** | **-** | **195,775** |
| Rural residential real estate | **-** | **3** | **-** | **2,792** |
| Lease receivables | **-** | **28** | **-** | **12,754** |
| Total | **$ 291** | **$ 6,293** | **$ 5,538** | **$ 2,506,563** |

| | Allowance for Loan Losses Ending Balance at December 31, 2015 | | Recorded Investments in Loans Outstanding Ending Balance at December 31, 2015 | |
|---|---|---|---|---|
| | Individually evaluated for impairment | Collectively evaluated for impairment | Individually evaluated for impairment | Collectively evaluated for impairment |
| Real estate mortgage | $ - | $ 3,568 | $ 4,241 | $ 1,739,946 |
| Production & intermediate-term | 53 | 1,244 | 54 | 313,806 |
| Agribusiness | - | 144 | - | 156,034 |
| Rural residential real estate | - | 2 | - | 2,773 |
| Lease receivables | - | 23 | 2 | 14,219 |
| Total | $ 53 | $ 4,981 | $ 4,297 | $ 2,226,778 |

| | Allowance for Loan Losses Ending Balance at December 31, 2014 | | Recorded Investments in Loans Outstanding Ending Balance at December 31, 2014 | |
|---|---|---|---|---|
| | Individually evaluated for impairment | Collectively evaluated for impairment | Individually evaluated for impairment | Collectively evaluated for impairment |
| Real estate mortgage | $ - | $ 3,141 | $ 10,525 | $ 1,536,154 |
| Production & intermediate-term | 64 | 1,072 | 65 | 298,508 |
| Agribusiness | - | 315 | - | 149,746 |
| Rural residential real estate | - | 2 | - | 5,009 |
| Lease receivables | - | 7 | 2 | 14,064 |
| Total | $ 64 | $ 4,537 | $ 10,592 | $ 2,003,481 |

A summary of changes in the reserve for unfunded commitments is as follows ($ thousands).

| | Balance at December 31, 2015 | Transfers from (to) Allowance for Loan Losses | Balance at December 31, 2016 |
|---|---|---|---|
| Real estate mortgage | **$ 72** | **$ 53** | **$ 125** |
| Production & intermediate-term | **217** | **332** | **549** |
| Agribusiness | **136** | **247** | **383** |
| Total | **$ 425** | **$ 632** | **$ 1,057** |

| | Balance at December 31, 2014 | Reclassification from Allowance for Loan Losses | Balance at December 31, 2015 |
|---|---|---|---|
| Real estate mortgage | $ - | $ 72 | $ 72 |
| Production & intermediate-term | - | 217 | 217 |
| Agribusiness | - | 136 | 136 |
| Total | $ - | $ 425 | $ 425 |

## NOTE 5 - INVESTMENT IN COBANK:

At December 31, 2016, the Association's investment in CoBank is in the form of Class A stock with a par value of $100 per share. The Association is required to own stock in CoBank to capitalize its direct loan balance and participation loans sold to CoBank. The current requirement for capitalizing its direct loan from CoBank is 4.00 percent of the Association's prior year average direct loan balance. The 2016 requirement for capitalizing patronage-based participation loans sold to CoBank was 8.00 percent of the Association's prior ten-year average balance of such participations sold to CoBank. Under the current CoBank capital plan applicable to such participations sold, patronage from CoBank related to these participations sold is paid 75 percent cash and 25 percent Class A stock. The capital plan is evaluated annually by CoBank's board of directors and management and is subject to change.

CoBank may require the holders of its equities to subscribe for such additional capital as may be needed to meet its capital requirements for its joint and several liability under the Farm Credit Act and regulations. In making such a capital call, CoBank shall take into account the financial condition of each such holder and such other considerations, as it deems appropriate.

The Association owned approximately 2.55 percent of outstanding common stock of CoBank at December 31, 2016.

## NOTE 6 - PREMISES AND EQUIPMENT:

Premises and equipment consisted of the following as of December 31 ($ thousands).

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Land | **$ 2,784** | $ 2,784 | $ 2,488 |
| Buildings and leasehold improvements | **13,202** | 13,149 | 13,116 |
| Furniture, equipment and automobiles | **5,473** | 4,977 | 5,585 |
| Construction in progress | **240** | 34 | 317 |
| Less: accumulated depreciation | **5,537** | 4,675 | 4,873 |
| Total | **$ 16,162** | $ 16,269 | $ 16,633 |

The Association is obligated under various noncancelable operating leases for office space. At December 31, 2016, future minimum lease payments for all noncancelable leases are as follows ($ thousands):

| | |
|---|---|
| 2017 | $69.8 |
| 2018 | 59.6 |
| Total minimum lease payments | $129.4 |

## NOTE 7 - NOTES PAYABLE TO COBANK:

The Association's indebtedness to CoBank represents borrowings by the Association to fund its loan portfolio. This indebtedness is collateralized by a pledge of substantially all of the Association's assets and is governed by a General Financing Agreement (GFA). The GFA and promissory note are subject to periodic renewals in the normal course of business. The GFA matures on May 31, 2018. Management expects renewal of the GFA at that time. The Association was in compliance with the terms and conditions of the GFA as of December 31, 2016. Substantially all borrower loans are match-funded with CoBank. Payments and disbursements are made on the note payable to CoBank on the same basis the Association collects payments from and disburses on borrower loans. The interest rate may periodically be adjusted by CoBank based on the terms and conditions of the borrowing. The weighted average interest rate was 1.52% for the year ended December 31, 2016, compared with 1.34% at December 31, 2015, and 1.38% at December 31, 2014.

Under the Farm Credit Act, the Association is obligated to borrow only from CoBank, unless CoBank gives approval to borrow elsewhere. CoBank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2016, the Association's notes payable was within the specified limitations.

## NOTE 8 – SHAREHOLDERS' EQUITY:

A description of the Association's capitalization, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below.

A. **Capital Stock and Participation Certificates:** In accordance with the Farm Credit Act, and association bylaws, each borrower is required to invest in the Association as a condition of borrowing. Currently the Association has a stock requirement of $1,000 per customer.

   The borrower normally acquires ownership of the stock at the time the loan is made, but usually does not make a cash investment. Generally, the aggregate par value of the stock is added to the principal amount of the related loan obligation. The Association has a first lien on the stock owned by its borrowers. At the discretion of the Board of Directors, retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding stock certificate.

B. **Regulatory Capitalization Requirements and Restrictions:** The FCA's capital adequacy regulations require the Association to maintain permanent capital of 7.00% of average risk-adjusted assets. Failure to meet the requirement can initiate certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Association's consolidated financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless the prescribed capital standard is met. The FCA regulations also require other additional minimum standards for capital to be maintained. These standards require all System institutions to achieve and maintain ratios of total surplus as a percentage of risk-adjusted assets of 7.00% and of core surplus (generally unallocated surplus) as a percentage of average risk-adjusted assets of 3.50%. At December 31, 2016, the Association's permanent capital, core surplus and total surplus ratios were 14.26%, 14.18% and 14.18%, respectively.

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 requirements with common equity tier 1, tier 1 and total capital risk-based capital ratio requirements. The final rule also replaces the existing net collateral ratio with 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.

An existing regulation empowers FCA to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. This regulation has not been utilized to date. The Association has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

C. **Description of Equities:** Each owner of class C capital stock is entitled to a single vote. Other classes of borrower equities do not provide voting rights to their owners. Voting stock may not be transferred to another person unless such person is eligible to hold voting stock.

At December 31, 2016, the Association had 369,090 shares of class C common stock certificates outstanding, all at a par value of $5.00 per share/unit.

The Association has the authority to issue other classes of stock, no shares of which are outstanding. The voting rights, duties and liabilities of such classes of stock are similar to those discussed above.

Losses that result in impairment of capital stock and participation certificates will be allocated to the classes of equity described above on a pro-rata basis. Upon liquidation of the Association, any assets remaining after the settlement of all liabilities will be distributed first to redeem the par value of equities. After these retirements, remaining assets will be distributed to holders of allocated surplus, on an equitable basis as determined by the Board. Any remaining assets after such distribution will be distributed to current and former Members and other Patrons in proportion to the volume or value of patronage business done with or for each such party.

D. **Patronage:** At each year end, the Board of Directors evaluates whether to retain the Association's net income to strengthen its capital position or to distribute a portion of the net income to customers by declaring a qualified/cash patronage refund. For 2016, the Association allocated 28% of its patronage-sourced net income to its patrons. The portion of patronage-sourced net income not distributed in cash is also allocated to patrons. In accordance with Internal Revenue Service requirements, each customer is sent a nonqualified written notice of allocation. Allocated, but not distributed patronage refunds, are included in the unallocated retained earnings account. The Board of Directors considers these unallocated retained earnings to be permanently invested in the Association. As such, there is no current plan to revolve or redeem these amounts. No express or implied right to have such capital retired or revolved at any time is granted.

E. **Accumulated Other Comprehensive Income/(Loss):** The Association reports accumulated other comprehensive income/(loss) in its Consolidated Statements of Comprehensive Income, and its Consolidated Statements of Changes in Shareholders' Equity. As more fully described in Note 2, other comprehensive income/(loss) results from the recognition of the Pension Restoration Plan's net unamortized gains and losses and prior service costs or credits. The Association has accumulated other comprehensive loss of $91 thousand in 2016, $132 thousand in 2015 and $163 thousand in 2014. There were no other items affecting comprehensive income or loss.

## NOTE 9 – PATRONAGE DISTRIBUTION FROM FARM CREDIT INSTITUTIONS:

Patronage income recognized from Farm Credit Institutions to the Association follows ($ thousands).

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| CoBank | | | |
| Direct note | **$ 8,728** | $ 7,742 | $ 7,153 |
| Participations | **632** | 580 | 580 |
| Other | **44** | 41 | 43 |
| Total | **$ 9,404** | $ 8,363 | $ 7,776 |

Patronage distributed from CoBank was in cash and stock. The amount earned in 2016 was accrued and will be paid by CoBank in March 2017. The amount earned and accrued in 2015 was paid by CoBank in March 2016. The amount earned and accrued in 2014 was paid by CoBank in March 2015.

## NOTE 10 – INCOME TAXES:

The provision for income taxes follows ($ thousands).

| | **For the Year Ended December 31** | | |
|---|---|---|---|
| | **2016** | 2015 | 2014 |
| Current | | | |
| Federal | **$ -** | $ - | $ - |
| State | **2** | 2 | 2 |
| Deferred: | **-** | - | - |
| Federal | **-** | - | - |
| State | **-** | - | - |
| Provision for income taxes | **$ 2** | $ 2 | $ 2 |

The provision for income tax differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as follows ($ thousands).

| | **For the Year Ended December 31** | | |
|---|---|---|---|
| | **2016** | 2015 | 2014 |
| Federal tax at statutory rate | **$ 14,751** | $ 14,060 | $ 13,102 |
| State Tax, net | **2** | 2 | 2 |
| Tax exempt income | **(14,852)** | (13,870) | (13,209) |
| Adjustments to deferred tax asset valuation allowance | **501** | 84 | 107 |
| Prior year tax adjustment | **-** | 13 | - |
| Patronage distributions | **(400)** | (287) | - |
| Provision for income taxes | **$ 2** | $ 2 | $ 2 |

Deferred tax assets and liabilities are comprised of the following as of December 31 ($ thousands).

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| Gross deferred tax assets: | | | |
| Allowance for credit losses | **$ 1,175** | $ 566 | $ 434 |
| Loss carry-forwards | **644** | 644 | 657 |
| Gross deferred tax assets | **1,819** | 1,210 | 1,091 |
| Less: valuation allowance | **918** | 417 | 333 |
| Gross deferred tax assets, net of valuation allowance | **901** | 793 | 758 |
| Gross deferred tax liabilities: | | | |
| Patronage distributions from CoBank | **(521)** | (413) | (378) |
| Patronage refunds from CoBank | **(380)** | (380) | (380) |
| Gross deferred tax liabilities | **(901)** | (793) | (758) |
| Net deferred tax asset/(liability) | **$ -** | $ - | $ - |

The calculation of deferred tax assets and liabilities involves various management estimates and assumptions as to future taxable earnings including the amount of non-patronage income and patronage income retained. The expected future tax rates are based upon enacted tax laws.

The Association has a valuation allowance of $918.4 thousand in 2016, $417.4 thousand in 2015 and $333.5 thousand in 2014. The Association will continue to evaluate the realizability of the deferred tax assets and adjust the valuation allowance accordingly. At December 31, 2016, the Association had federal and state net operating loss carry forwards that expire from 2026 to 2031.

The Association accounts for income taxes in accordance with ASC 740, which provides guidance for how uncertain tax positions should be recognized, measured, presented and disclosed in the financial statements. ASC 740 requires the evaluation of tax positions taken or expected to be taken in the course of preparing the Association's tax returns to determine whether the tax positions are more-likely-than-not of being sustained upon examination by the applicable tax authority, based on the technical merits of the tax position, and then measuring the tax benefit that is more-likely-than-not to be realized. Tax positions not deemed to meet the more-likely-than-not threshold would be recorded as a tax expense in the current reporting period. The Association did not have any positions for which it is reasonably possible that the total amounts of unrecognized tax positions will significantly increase or decrease within the next 12 months. The Association recognizes interest and penalties related to unrecognized tax positions as an adjustment to income tax expense. The Association has no uncertain tax positions to be recognized as of December 2016, 2015 or 2014. The tax years that remain open for federal and major state income tax jurisdictions are 2013 and forward.

## NOTE 11 - EMPLOYEE BENEFIT PLANS:

Certain employees participate in the Eleventh District Retirement Plan, a multi-employer defined benefit retirement plan. The Department of Labor has determined the plan to be a governmental plan; therefore, the plan is not subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended (ERISA). As the plan is not subject to ERISA, the plan's benefits are not insured by the Pension Benefit Guaranty Corporation. Accordingly, the amount of accumulated benefits that participants would receive in the event of the plan's termination is contingent on the sufficiency of the plan's net assets to provide benefits at that time. This Plan is noncontributory and covers eligible employees. The assets, liabilities, and costs of the plan are not segregated by participating entities. As such, plan assets are available for any of the participating employers' retirees at any point in time. Additionally, if a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers. Further, if the Association chooses to stop participating in the plan, it may be required to pay an amount based on the underfunded status of the plan, referred to as a withdrawal liability. Because of the multi-employer nature of the plan, any individual employer is not able to unilaterally change the provisions of the plan. If an employee moves to another employer within the same plan, the employee benefits under the plan transfer. Benefits are based on salary and years of service. There is no collective bargaining agreement in place as part of this plan.

The defined benefit pension plan reflects a total unfunded liability of $85.6 million at December 31, 2016. The pension benefits funding status reflects the net of the fair value of the plan assets and the projected benefit obligation at the date of these consolidated financial statements. The projected benefit obligation is the actuarial present value of all benefits attributed by the pension benefit formula to employee service rendered prior to the measurement date based on assumed future compensation levels. The projected benefit obligation of the plan was $257.9 million at December 31, 2016, $244.5 million at December 31, 2015 and $247.2 million at December 31, 2014. The fair value of the plan assets was $172.2 million at December 31, 2016, $154.5 million at December 31, 2015 and $162.0 million at December 31, 2014. The amount of the pension benefits funding status is subject to many variables including performance of plan assets and interest rate levels. Therefore, changes in assumptions could significantly affect these estimates.

Costs are determined for each individual employer based on costs directly related to its current employees as well as an allocation of the remaining costs based proportionately on the estimated projected liability of the employer under this plan. The Association recognizes its proportional share of expense and contributes a proportional share of funding. Total plan expense for participating employers was $5.9 million in 2016, $4.8 million in 2015, and $2.5 million in 2014. The Association's allocated share of plan expenses included in salaries and employee benefits was $0.2 million in 2016, $0.2 million 2015, and $0.1 million in 2014. Participating employers contributed $17.5 million in 2016, $7.5 million in 2015, and $5.1 million in 2014 to the plan. The Association's allocated share of these pension contributions was $0.9 million in 2016, $0.3 million in 2015, and $0.2 million in 2014. While the plan is a governmental plan and is not subject to minimum funding requirements, the employers contribute amounts necessary on an actuarial basis to provide the plan with sufficient assets to meet the benefits to be paid to participants. The amount of the total employer contributions expected to be paid into the pension plans during 2017 is $16.0 million. The Association's allocated share of these pension contributions is expected to be $0.6 million. The amount ultimately to be contributed and the amount ultimately recognized as expense as well as the timing of those contributions and expenses, are subject to many variables including performance of plan assets and interest rate levels. These variables could result in actual contributions and expenses being greater than or less than anticipated.

Postretirement benefits other than pensions are also provided through the Farm Credit Foundations Retiree Medical and Retiree Life Plans to eligible current and retired employees of the Association. Benefits provided are determined on a graduated scale, based on years of service. The anticipated costs of these benefits are accrued during the period of the employee's active service. Postretirement benefits expense (primarily health care benefits and life insurance) included in salaries and employee benefits were $39 thousand in 2016, $68 thousand in 2015, and $51 thousand in 2014. These expenses are equal to the Association's cash contributions for each year.

The Association participates in a non-qualified defined benefit Pension Restoration Plan that is unfunded. The plan provides retirement benefits above the Internal Revenue Code compensation limit to certain highly compensated eligible employees. Benefits payable under the Pension Restoration Plan are offset by the benefits payable from the Pension Plan. Pension Restoration Plan expenses included in salaries and employee benefits were $46 thousand in 2016, $43 thousand in 2015, and $68 thousand in 2014.

The funding status and the amounts recognized in the Consolidated Statements of Condition for the Association's Pension Restoration Plan follows ($ thousands).

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Change in benefit obligation | | | |
| Benefit obligation at the beginning of year | **$ 181** | $ 233 | $ 279 |
| Interest cost | **4** | 9 | 13 |
| Actuarial loss | **1** | 1 | 2 |
| Benefits paid | **(60)** | (62) | (61) |
| Benefit obligation at the end of the period | **$ 126** | $ 181 | $ 233 |
| Funded status | **$ (126)** | $ (181) | $ (233) |
| Net amount recognized – December 31 | **$ (126)** | $ (181) | $ (233) |

Amounts recognized in the Consolidated Statements of Condition follows ($ thousands).

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Accrued benefit liability | **$ (126)** | $ (181) | $ (233) |
| Net amount recognized | **$ (126)** | $ (181) | $ (233) |

The following table represents the amounts included in accumulated other comprehensive income/(loss) for the Pension Restoration Plan at December 31 ($ thousands).

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Unrecognized net actuarial loss | **$ 91** | $ 132 | $ 163 |
| Total amount recognized in AOCI/loss | **$ 91** | $ 132 | $ 163 |

An estimated net actuarial loss of $41 thousand for the Pension Restoration Plan will be amortized into income over the next year.

The projected and accumulated benefit obligation for the Pension Restoration Plan at December 31 was as follows ($ thousands).

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Projected benefit obligation | **$ 126** | $ 181 | $ 233 |
| Accumulated benefit obligation | **$ 126** | $ 181 | $ 233 |
| Fair value of plan assets | **N/A** | N/A | N/A |

The net periodic pension expense for the Pension Restoration Plan included in the Consolidated Statements of Comprehensive Income is comprised of the following at December 31 ($ thousands).

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Components of net periodic benefit cost: | | | |
| Interest cost | **$ 4** | $ 9 | $ 13 |
| Amortized unrecognized net actuarial loss | **42** | 34 | 55 |
| Net periodic cost | **$ 46** | $ 43 | $ 68 |

Changes in benefit obligation recognized in accumulated other comprehensive income are included in the following table ($ thousands).

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Current year actuarial loss | **$ 1** | $ 3 | $ - |
| Amortization of net actuarial gain | **(42)** | (34) | (55) |
| Total recognized in other comprehensive income | **$ 41** | $ 31 | $ 55 |

Weighted average assumptions used to determine benefit obligation at December 31:

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Discount rate | **3.20%** | 3.17% | 4.10% |
| Rate of compensation increase | **5.50%** | 5.50% | 4.50% |

Weighted average assumptions used to determine net periodic benefit cost for years ended December 31:

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Discount rate | **3.17%** | 4.10% | 4.85% |
| Rate of compensation increase | **5.50%** | 4.50% | 4.50% |

The Association expects to contribute $61 thousand to the pension restoration plan in 2017.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid ($ thousands).

| Year | Pension Restoration Benefits |
|---|---|
| 2017 | $ 61 |
| 2018 | $ 61 |
| 2019 | $ - |
| 2020 | $ - |
| 2021 | $ - |
| 2022 – 2026 | $ 2 |

The Association also participates in the Farm Credit Foundations Defined Contribution/401(k) Plan (Contribution Plan). The Contribution Plan has two components. Employees who do not participate in the Pension Plan may receive benefits through the Employer Contribution portion of the Contribution Plan. In this plan, the Association provides a monthly contribution based on a defined percentage of the employee's salary. Employees may also participate in a Salary Deferral Plan governed by Section 401(k) of the Internal Revenue Code. The Association matches a certain percentage of employee contributions. Employer contributions to the Contribution Plans were $1.3 million, $1.2 million and $1.1 million for the years ended December 31, 2016, 2015 and 2014.

## NOTE 12 - RELATED PARTY TRANSACTIONS:

In the ordinary course of business, the Association enters into loan transactions with officers and directors of the Association, their immediate families and other organizations with which such persons may be associated. Such loans are subject to special approval requirements contained in the FCA regulations and are made on the same terms, including interest rates, amortization schedules and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

The Association has a policy that loans to directors and senior officers must be maintained at an Acceptable or Other Assets Especially Mentioned (OAEM) credit classification. If the loan falls below the OAEM credit classification, corrective action must be taken and the loan brought back to either Acceptable or OAEM within eighteen months. If not, the director or senior officer must resign from the Board or employment.

Loan information to related parties for the years ended December 31 is shown below ($ millions).

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| New loans/advances | **$ 27.2** | $ 36.7 | $ 54.4 |
| Repayments | **$ 22.0** | $ 31.0 | $ 57.1 |
| Ending balance | **$ 57.6** | $ 52.4 | $ 46.7 |

In the opinion of management, none of the loans outstanding to officers and directors at December 31, 2016 involved more than a normal risk of collectability.

## NOTE 13 – REGULATORY ENFORCEMENT MATTERS:

There are no regulatory enforcement actions in effect for the Association.

## NOTE 14 - COMMITMENTS AND CONTINGENCIES:

The Association has various commitments outstanding and contingent liabilities. With regard to contingent liabilities, there are no actions pending against the Association in which claims for monetary damages are asserted.

The Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers and to manage their exposure to interest rate risk. These financial instruments include commitments to extend credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee by the borrower. At December 31, 2016, $673.6 million of commitments to extend credit were outstanding, including $4.4 million of letters of credit.

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the Consolidated Statements of Condition until funded or drawn upon. The credit risk associated with issuing commitments is substantially the same as that involved in extending loans to borrowers and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

## NOTE 15 – FAIR VALUE MEASUREMENTS:

Accounting guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. The fair value measurement is not an indication of liquidity. See Note 2 for additional information.

The Association has no assets or liabilities measured at fair value on a recurring basis for the periods presented. During the three years presented, the Association recorded no transfers in or out of Levels 1, 2, or 3.

Assets measured at fair value on a non-recurring basis at December 31 for the fair value hierarchy Level 3 values are summarized below ($ thousands).

| | Total Fair Value Level 3 | Total (Losses)/Gains |
|---|---|---|
| **Assets:** | | |
| **2016** | | |
| **Loans** | **$ 496** | **$ (291)** |
| 2015 | | |
| Loans | $ - | $ (53) |
| 2014 | | |
| Loans | $ - | $ (64) |

### Valuation Techniques

As more fully discussed in Note 2, accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following presents a brief summary of the valuation techniques used by the Association for assets and liabilities subject to fair value measurement:

**Loans:** Fair value is estimated by discounting the expected future cash flows using the Association's current interest rates at which similar loans would be made to borrowers with similar credit risk. The discount rates are based on the District's current loan origination rates as well as management estimates of credit risk. Management has no basis to determine whether the estimated fair values presented would be indicative of the assumptions and adjustments that a purchaser of the Association's loans would seek in an actual sale.

Fair value of loans in a nonaccrual status is estimated as described above, with appropriately higher interest rates, which reflect the uncertainty of continued cash flows. For noncurrent nonaccrual loans, it is assumed that collection will result only from the disposition of the underlying collateral, discounted at an interest rate, which appropriately reflects the uncertainty of the expected future cash flows over the average disposal period. Where the net realizable value of the collateral exceeds the legal obligation for a particular loan, the legal obligation is generally used in place of the net realizable value.

With regards to impaired loans, it is not practicable to provide specific information on inputs as each collateral property is unique. For certain loans evaluated for impairment under accounting impairment guidance, the fair value is based upon the underlying collateral since the loans are collateral-dependent loans for which real estate is the collateral. The fair value measurement process uses independent appraisals and other market-based information, market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the real estate, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established and the net loan is reported at its fair value.

## NOTE 16 – QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Quarterly results of operations for the years ended December 31, 2016, 2015 and 2014, follow ($ millions).

| | 2016 | | | | |
|---|---|---|---|---|---|
| | **First** | **Second** | **Third** | **Fourth** | **Total** |
| **Net interest income** | **$ 15.0** | **$ 15.2** | **$ 15.4** | **$ 15.7** | **$ 61.3** |
| **Provision for credit losses/(Credit loss reversal)** | **$ (0.5)** | **$ 0.6** | **$ 0.8** | **$ 1.3** | **$ 2.2** |
| **Non-interest expense, net** | **$ 4.3** | **$ 3.8** | **$ 3.9** | **$ 3.7** | **$ 15.7** |
| **Net income** | **$ 11.2** | **$ 10.8** | **$ 10.7** | **$ 10.7** | **$ 43.4** |

| | 2015 | | | | |
|---|---|---|---|---|---|
| | First | Second | Third | Fourth | Total |
| Net interest income | $ 13.4 | $ 13.5 | $ 14.8 | $ 14.3 | $ 56.0 |
| Provision for credit losses/(Credit loss reversal) | $ 0.3 | $ 0.5 | $ 0.0 | $ 0.1 | $ 0.9 |
| Non-interest expense, net | $ 3.6 | $ 3.5 | $ 3.4 | $ 3.2 | $ 13.7 |
| Net income | $ 9.5 | $ 9.5 | $ 11.4 | $ 11.0 | $ 41.4 |

| | 2014 | | | | |
|---|---|---|---|---|---|
| | First | Second | Third | Fourth | Total |
| Net interest income | $ 12.5 | $ 12.5 | $ 12.9 | $ 13.3 | $ 51.2 |
| Provision for credit losses/(Credit loss reversal) | $ (0.3) | $ (0.2) | $ (0.1) | $ 0.3 | $ (0.3) |
| Non-interest expense, net | $ 3.5 | $ 3.3 | $ 3.2 | $ 3.0 | $ 13.0 |
| Net income | $ 9.3 | $ 9.4 | $ 9.8 | $ 10.0 | $ 38.5 |

## NOTE 17 – SUBSEQUENT EVENTS:

The Association has evaluated subsequent events through March 2, 2017 which is the date the financial statements were issued, and no material subsequent events were identified.

# YOSEMITE FARM CREDIT, ACA
# DISCLOSURE INFORMATION

## DESCRIPTION OF BUSINESS

The description of the territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered, and related Farm Credit organizations required to be disclosed in this section is incorporated herein by reference to Note 1 of the consolidated financial statements, "Organization and Operations," included in this Annual Report to Shareholders.

The description of significant developments that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conduct of the business, seasonal characteristics, and concentrations of assets, if any, required to be disclosed in this section, is incorporated herein by reference to, "Management's Discussion and Analysis," included in this Annual Report to Shareholders.

## SELECTED FINANCIAL DATA

The selected financial data for the five years ended December 31, 2016, required to be disclosed in this section is incorporated herein by reference to the, "Five-Year Summary of Selected Consolidated Financial Data," included in this Annual Report to Shareholders.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

"Management's Discussion and Analysis," which appears on pages six through twenty-six of this Annual Report to Shareholders, and is required to be disclosed in this section, is incorporated herein by reference.

## FINANCIAL STATEMENTS

The financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 2, 2017, appearing on page twenty-seven, and the Report of Management appearing on page three of this Annual Report to Shareholders, are incorporated herein by reference. The Board has been active in meeting its responsibility for the success of the Association. In meeting its responsibility for reliable financial information, the Board depends upon the representation of management, CoBank, ACB (the Bank) and the Association's system of internal audits and controls, as well as the results of independent audits. In 2016, the Association's financial statements were audited by PricewaterhouseCoopers LLP and the Association's operations and credit functions were reviewed by its own internal auditors and CoBank. The results of these audits were presented to the Audit Committee. In the opinion of management, the financial statements contained in this report fairly present the Association's year-end financial position, results of operations, and cash flows.

## RELATIONSHIP WITH THE BANK

- The Association's statutory obligation to borrow from the Bank is discussed in Note 7 to the consolidated financial statements, "Notes Payable to CoBank," included in this Annual Report to Shareholders.

- The Bank's ability to access capital of the Association is discussed in Note 5 to the consolidated financial statements, "Investment in CoBank," included in this Annual Report to Shareholders.

- The Bank's role in mitigating the Association's exposure to interest rate risk is described in the Liquidity section of the Management's Discussion and Analysis on page twenty.

**DESCRIPTION OF PROPERTY**

The following table sets forth certain information regarding properties of the Association.

| Location: | Description: |
|---|---|
| 800 W. Monte Vista Avenue<br>Turlock, California | Administrative Branch<br>Office Building and Land<br>Ownership: 100% FLCA |
| 806 W. Monte Vista Avenue<br>Turlock, California | Administrative Branch<br>Office Building and Land<br>Ownership: 100% FLCA |
| 810 W. Monte Vista Avenue<br>Turlock, California | Turlock Branch<br>Office Building and Land<br>Ownership: 100% FLCA |
| 345 W. Las Palmas<br>Patterson, California | Patterson Branch<br>Office Building and Land<br>Ownership: 100% FLCA |
| 1213 13th Street<br>Modesto, California | Modesto Branch<br>Office Building and Land<br>Ownership: 100% FLCA |
| 178 South Maag Avenue<br>Oakdale, California | Oakdale Branch<br>Office Building<br>Lessor: John Simvoulakis |
| G Street & Live Oak<br>Oakdale, California | Oakdale Lot<br>Land<br>Ownership: 100% FLCA |
| 530 Washington<br>Los Banos, California | Los Banos Branch<br>Office Building and Land<br>Ownership: 100% FLCA |
| 1732 O Street<br>Merced, California | Merced Lot<br>Land<br>Ownership: 100% FLCA |
| 760 W. 18th Street<br>Merced, California | Merced Branch<br>Office Building and Land<br>Ownership: 100% FLCA |

## DESCRIPTION OF LIABILITIES

The description of rights and obligations, and contingent liabilities required to be disclosed in this section is incorporated herein by reference to Notes 7 and 14 to the consolidated financial statements, "Notes Payable to CoBank," and "Commitments and Contingencies," included in this Annual Report to Shareholders.

## DESCRIPTION OF CAPITAL STRUCTURE

Information required in this section is incorporated herein by reference to Note 8 to the consolidated financial statements, "Shareholders' Equity," included in this Annual Report to Shareholders.

## LEGAL PROCEEDINGS AND ENFORCEMENT ACTIONS

Information required in this section is incorporated herein by reference to Note 14 to the consolidated financial statements, "Commitments and Contingencies," included in the Annual Report to Shareholders.

## DIRECTORS

Farm Credit Administration (FCA) regulations require the disclosure of Directors' business experience for the last five years, other business interests on whose board the Director serves or where the Director serves as a senior officer, the name of the position held and the principal business in which the business is engaged, compensation and reimbursement received as an Association Director and certain other information. The following represents these disclosures for the Directors of Yosemite Farm Credit, ACA.

**Rick Scheuber**, Director and Board Chair
Term of Office: 2015-2018
For the past five years Rick has been a self-employed farmer in the Patterson area. Rick is also a trustee of the Alfred J. Scheuber and Betty J. Scheuber Revocable Trust and a managing member of Scheuber Farms, LLC. The business is principally involved in diversified field and row crop farming.

**Dino Migliazzo**, Director and Board Vice-Chair
Term of Office: 2015-2018
For the past five years Dino has been an owner/operator for Migliazzo & Sons Dairy in the Atwater area. The business is principally involved in milk production. Dino is an Audit Committee Member for the National Holstein Association and a District Farm Credit Council Board Member.

**Bruce Burroughs,** Director
Term of Office: 2014-2017
For the past five years Bruce has been a dairyman and almond grower in the Denair area. Bruce is a director and holds an officer position for the California Livestock Producers (Self-Insured Group) and Burroughs Management Inc. Bruce is also a general partner/voting member with Sierra Vista Dairy, LP: B&B Burroughs Ranches, LP, and BruBar Properties, LLC. Bruce is also a trustee of the B&B Burroughs Revocable Trust. The businesses are principally involved in milk production, tree nuts and commercial property ownership.

**Wayne Christian,** Appointed Director and Audit Committee Vice-Chair
Term of Office: 2014-2017
Wayne, an outside director, was first appointed to the Board in 1988. Prior to his appointment to the Board, he had a long successful career with Bank of America and is now retired.

**Mark Jensen,** Director
Term of Office: 2014–2017
For the past five years Mark's principal occupation has been a practicing attorney with Jensen & Jensen Attorneys in Modesto. His principal occupation also includes involvement with the following farming entities. Mark's a director and holds an officer position in Patterson Nut Co., Inc., Patterson Nut Marketing Co., Inc., and J. Wilmar Jensen, Inc. Mark is a general partner in Jensen Bros, Co., Draper Road Ranch, and Jensen & Jensen Investments. Mark is also a managing member of the Jensen Ranch Trucking, LLC, CJ Farming Co, LLC and DTOM, LLC. These businesses are principally involved in farming. Mark is a limited partner in the J. Wilmar Jensen Family Partnerships, LP and a general partner in Jensen Family Fund and Hoyer Road Ranch. Mark is also a member of the Newman Rotary Club, Stanislaus County Estate Planning Council, the McHenry Mansion Foundation, and a director/CFO for Ride for Mom, Inc.

**Alicia Madsen,** Appointed Director
Term of Office: 2015-2017
Alicia, an outside director was first appointed to the Board in November 2015. From 2002 to 2013 she was in the commercial banking industry. Alicia now works for a construction and design company and manages an almond orchard in the LaGrange area.

**Brian Genzoli**, Director
Term of Office: 2015-2018
For the past five years Brian has been a self-employed almond grower in the Turlock area. Brian is also a trustee of the Brian and Linda Genzoli Revocable Trust. The business is principally involved in the farming of almonds. Brian is a Board Member of the Turlock Rural Fire District, and the Kiwanis Club of the Greater Turlock. Brian is also a member of the Blue Diamond Growers, and the Stanislaus County Farm Bureau.

**Arnold Barcellos**, Director
Term of Office: 2016-2019
For the past five years Arnold has been a self-employed farmer principally involved in diversified field and row crop farming in the Los Banos area. Arnold is a partner in A-Bar Ag Enterprises and Barcellos, Et Al. Arnold is a trustee of the Arnold Barcellos and Teresina Barcellos Living Trust. The businesses are principally involved in row crop farming. Arnold also serves as the Board Chairman of the Charleston Drainage District.

**Ken Bays,** Director
Term of Office 2016-2019
For the past five years Ken has been a self-employed farmer in the Patterson area. Ken is a director and Vice-President with Bays Ranch Inc. He also owns/operates Bays Ranch Shredding Co. Ken is a trustee of the Kenneth and Michele Bays Revocable Trust. Ken is also a partner in Bays and Ielmini, M & B Farming, M & B Rentals, the Ivan E & Eleanor D Bays Real Property Partnership and a beneficiary of the Ivan E. and Eleanor D. Bays Family Trust. These businesses are principally involved in diversified field and row crop farming. Ken also serves as the Board Member of the West Stanislaus Irrigation District, the Board Secretary for Westside Hulling Association, and a Board Member of the Apricot Producers of California. Ken serves on the Patterson High School and Modesto Junior College Ag Advisory Committees and also as the Chief for the Westley - Elsolyo Volunteer Fire Department.

**John Fiscalini,** Director
Term of Office: 2016-2019
For the past five years, John has owned and operated Fiscalini Cheese Company in Modesto. John also owns and operates the following entities in his capacity as trustee of the John Fiscalini Revocable Trust: Fiscalini Farms, LP; John Fiscalini Management Company, LLC; Fiscalini Farms Management, LLC; Fiscalini Properties, LP; Mathew B. Fiscalini Trust, and the Marie Fiscalini Family, LP. The businesses are principally involved in cheese making, farming, milk production, and electric generation. John is also an alumni of the California Ag Leadership.

**Nancy Sill**, Appointed Director and Audit Committee Chair
Term of Office: 2016-2019
Nancy, an outside director, was first appointed to the Board in 2007. She is an instructor at Yosemite Community College District – Modesto Junior College, a Certified Public Accountant and a member of the Resource Allocation Council at Modesto Junior College. Nancy is also a member of the Finance Council for Sacred Heart Catholic Church in Patterson and the Patterson High School Ag Advisory Committee. Nancy owns and farms walnuts in the Patterson area.

## SENIOR OFFICERS

FCA regulations also require the following disclosure of the business experience for the last five years for each senior officer, other business interests on whose board the senior officer serves or where the senior officer serves as another senior officer, the name of the position held and the principal business in which the business is engaged.

**Leonard Van Elderen**, President and Chief Executive Officer
Leonard has served as the Chief Executive Officer and President for the past eight years and prior to the appointment as President, he served as the Chief Credit Officer for the previous seven years. Leonard has a total of thirty-five years of Farm Credit experience.

**Tracy V. Sparks,** Executive Vice-President, Chief Operating and Financial Officer, and Treasurer
Tracy is a CPA and has served as the Chief Financial Officer for the past twenty-two years as well as the Chief Operating Officer for the past eight years and has a total of twenty-three years of Farm Credit experience.

**Leslie C. Crutcher,** Executive Vice-President and Chief Credit Officer
Leslie (Les) has served as the Chief Credit Officer for the past eight years and prior to being selected as Chief Credit Officer he served as a Corporate Lending Executive and Loan Officer for the Association. Les has a total of eighteen years of Farm Credit experience.

**James C. Connelly,** Executive Vice-President and General Counsel
James (Jim) has served as the General Counsel for the past eleven years and has a total of thirty years of Farm Credit experience.

## COMPENSATION OF DIRECTORS AND SENIOR OFFICERS

Directors are compensated for their services as follows: An honorarium of $600 per month, except the Board Chair who receives $1,000 per month, in addition to compensation for committee meetings of $400 per day or $200 per half day. The Appointed Directors receive honorariums of $1,100 per month except the Audit Chair who receives $1,500 per month in addition to compensation for committee meetings of $800 per day or $400 per half day. The total compensation paid to Directors in 2016 amounted to $173,400. Directors are also reimbursed for mileage, and documented business expenses while serving in an official capacity. No individual director received more than $5,000 in non-cash compensation during the reporting period.

| Name | Years of Service | Number of Days Served at Board Meetings | Number of Days Served in Other Official Activities | Total Compensation Paid During 2016 |
|---|---|---|---|---|
| Arnold Barcellos | 40 | 11 | 1.5 | $11,300 |
| Ken Bays | 3 | 11 | 7.5 | $13,100 |
| Bruce Burroughs | 2 | 10 | 4 | $12,100 |
| Wayne Christian | 28 | 11 | 1.5 | $21,400 |
| John Fiscalini | 12 | 10 | 2 | $11,200 |
| Brian Genzoli | 10 | 10 | 1.5 | $11,000 |
| Mark Jensen | 2 | 9 | 4 | $11,600 |
| Alicia Madsen | 1 | 10 | 6.5 | $24,600 |
| Dino Migliazzo | 22 | 11 | 7 | $13,500 |
| Rick Scheuber | 22 | 11 | 14.5 | $18,600 |
| Nancy Sill | 9 | 11 | 2.5 | $25,000 |

The Association has a travel policy that provides for reimbursement of reasonable travel, subsistence and related expenses of directors and employees when on official Association business. A copy of the Association's travel policy is available to stockholders upon request. The following amounts of total director reimbursement for travel, subsistence and related expenses was $18,937, $14,407, and $26,975, for 2016, 2015 and 2014, respectively.

CEO and other senior officer compensation disclosures have been included in the Association Annual Meeting Information Statement (AMIS) mailed to all voting shareholders. Any noncash compensation with an annual aggregate value of $5,000 or more is included in total compensation paid to the CEO and other senior officers. Disclosure of total compensation paid during the last fiscal year to any senior officer or any other officer included in the aggregate disclosures contained in the AMIS will be disclosed to Association shareholders upon request. The AMIS is available for public inspection at the Association's offices upon request.

## TRANSACTIONS WITH SENIOR OFFICERS AND DIRECTORS

The Association's policies on loans to and transactions with its senior officers and Directors, required to be disclosed in this section, are incorporated herein by reference from Note 12 to the consolidated financial statements, "Related Party Transactions," included in the Annual Report to Shareholders. No loans to Directors or senior officers, their immediate families and affiliated organizations involved more than a normal risk of collectability during 2016. The Association did not conduct any other type of transactions with Senior Officers or Directors.

## INVOLVEMENT OF DIRECTORS AND SENIOR OFFICERS IN CERTAIN LEGAL PROCEEDINGS

There were no matters which came to the attention of management or the Board of Directors regarding involvement of current Directors or senior officers in specified legal proceedings, which are required to be disclosed in this section.

## RELATIONSHIP WITH INDEPENDENT AUDITOR

There were no changes in independent auditor since the prior Annual Report to Shareholders and there were no material disagreements with our independent auditor on any matter of accounting principles or financial statement disclosures during this period.

## BORROWER PRIVACY

Your privacy is important to us. We want you to know that we hold your financial and other personal information in strict confidence. Since 1972, the Farm Credit Administration regulations have forbidden the directors and employees of Farm Credit institutions from disclosing personal borrower information to others without your consent. We do not sell or trade our customers' personal information to marketing companies or information brokers.

FCA rules allow us to disclose customer information to others only in these situations:

- We may give it to another Farm Credit institution that you do business with.
- We can be a credit reference for you with other lenders and provide information to a credit bureau or other consumer reporting agency.
- We can provide information in certain types of legal or law enforcement proceedings.
- We may provide information to auditors for the purpose of confirming loan balances and terms.
- FCA and other third–party examiners may review loan files during regular examination of our Association.
- If one of our employees applies to become a licensed real estate appraiser, we may give your copies of real estate appraisal reports to the State agency that licenses appraisers when required. We will first remove as much personal information from the appraisal report as possible.

As a member of this institution, your privacy and security of your personal information are vital to our continued ability to serve your ongoing credit needs.

EQUAL HOUSING LENDER

YOSEMITE FARM CREDIT

P.O. Box 3278
Turlock, CA 95381



Helping Our Members Prosper!