Farm Credit Midsouth, ACA

Quarterly Report
September 30, 2018

MANAGEMENT'S DISCUSSION AND ANALYSIS

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

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

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Jonesboro, AR 72404
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FORWARD-LOOKING INFORMATION

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

AGRICULTURAL AND ECONOMIC CONDITIONS

The majority of our customers are in the middle of harvest as of quarter-end. According to the October 1, 2018, United States Department of Agriculture's (USDA) Crop Progress and Condition Report, 86% of the corn was harvested compared to 95% for the 5 year average. Cotton harvested was 23% compared to the 5 year average of 11% with 78% being in good to excellent condition. Rice was 77% harvested compared to the 5 year average of 75% and Soybeans were 20% harvested compared to the 5 year average of 37% with 90% being considered in fair or better condition. Price loss coverage (PLC) payments as well as tariff relief funds are expected to help offset the decline in crop prices.

LOAN PORTFOLIO

Loan Portfolio

Total loans were $987.9 million at September 30, 2018, an increase of $129.7 million from December 31, 2017. The increase was primarily due to our short-term portfolio, which increased $107.9 million due to normal operating disbursements. Our mortgage portfolio increased $21.8 million due to real estate sales and refinances.

Portfolio Credit Quality

The credit quality of our portfolio declined from December 31, 2017. Adversely classified loans increased to 3.2% of the portfolio at September 30, 2018, from 2.8% of the portfolio at December 31, 2017. Adversely classified loans are loans we have identified as showing some credit weakness outside our credit standards. We have considered portfolio credit quality in assessing the reasonableness of our allowance for loan losses.

In certain circumstances, government guarantee programs are used to reduce the risk of loss. At September 30, 2018, $10.9 million of our loans were, to some level, guaranteed under these government programs.

Risk Assets

Components of Risk Assets

(dollars in thousands) As of:	**September 30 2018**	December 31 2017
Loans:		
Nonaccrual	**$ 7,992**	$ 9,677
Accruing restructured	**504**	12
Accruing loans 90 days or more past due	**--**	--
Total risk loans	**8,496**	9,689
Other property owned	**--**	40
Total risk assets	**$ 8,496**	$ 9,729
Total risk loans as a percentage of total loans	**0.8%**	1.1%
Nonaccrual loans as a percentage of total loans	**0.8%**	1.1%
Current nonaccrual loans as a percentage of total nonaccrual loans	**3.0%**	82.1%
Total delinquencies as a percentage of total loans	**0.8%**	0.3%

Note: Accruing loans include accrued interest receivable.

Our risk assets have decreased from December 31, 2017, and have remained at acceptable levels. Total risk loans as a percentage of total loans were well within our established risk management guidelines.

The decrease in nonaccrual loans was primarily due to reinstatements to accrual status and normal repayments**.** Nonaccrual loans remained at an acceptable level at September 30, 2018, and December 31, 2017.

The increase in accruing restructured loans was primarily due to a reclassification from nonaccrual to accrual of a previously restructured loan.

The increase in total delinquencies as a percentage of total loans was primarily due to an increase in nonaccrual volume.

Allowance for Loan Losses

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

Allowance Coverage Ratios

As of:	**September 30 2018**	December 31 2017
Allowance as a percentage of:		
Loans	**0.4%**	0.3%
Nonaccrual loans	**44.6%**	26.8%
Total risk loans	**41.9%**	26.8%

In our opinion, the allowance for loan losses was reasonable in relation to the risk in our loan portfolio at September 30, 2018.

RESULTS OF OPERATIONS

Profitability Information

(dollars in thousands) For the nine months ended September 30	**2018**	2017
Net income	**$ 12,805**	$ 11,445
Return on average assets	**1.9%**	1.7%
Return on average members' equity	**8.0%**	7.6%

Changes in the chart above relate directly to:

- Changes in income discussed below
- Changes in assets discussed in the Loan Portfolio section
- Changes in capital discussed in the Funding, Liquidity, and Capital section

Changes in Significant Components of Net Income

(in thousands) For the nine months ended September 30	2018	2017	Increase (decrease) in net income
Net interest income	**$ 19,222**	$ 19,512	**$ (290)**
Provision for loan losses	**945**	1,349	**404**
Patronage income	**2,114**	2,489	**(375)**
Other income, net	**3,304**	591	**2,713**
Operating expenses	**10,602**	9,727	**(875)**
Provision for income taxes	**288**	71	**(217)**
Net income	**$ 12,805**	$ 11,445	**$ 1,360**

Changes in Net Interest Income

(in thousands) For the nine months ended September 30	2018 vs 2017
Changes in volume	**$ 323**
Changes in interest rates	**(385)**
Changes in nonaccrual income and other	**(228)**
Net change	**$ (290)**

The change in the provision for loan losses was related to the excellent yields generated from the 2017 crop which allowed some borrowers to increase their working capital.

The change in other income was primarily due to a $2.0 million reversal of a lawsuit liability. See Note 3 below for detailed information. We also had distributions from Allocated Insurance Reserve Accounts (AIRA) of $519 thousand. The AIRA was recently established by the Farm Credit System Insurance Corporation (FCSIC) when premiums collected increased the level of the Insurance Fund beyond the required 2% of insured debt. There was no distribution in 2017. Refer to the 2017 Annual Report for additional information about the FCSIC.

The change in operating expenses was primarily related to an increase in employee costs due to succession planning as well as purchased services. This was partially offset by FCSIC expense, which decreased in 2018 primarily due to a lower premium rate charged by FCSIC on accrual loans from 15 basis points in 2017 to 9 basis points in 2018. The FCSIC Board meets periodically throughout the year to review premium rates and has the ability to change these rates at any time.

The change in provision for income taxes was primarily related to increased revenue as a result of the lawsuit liability reversal mentioned above.

FUNDING, LIQUIDITY, AND CAPITAL

We borrow from AgriBank, under a note payable, in the form of a line of credit. Our note payable matures on April 30, 2020 at which time the note will be renegotiated. The repricing attributes of our line of credit generally correspond to the repricing attributes of our loan portfolio, which significantly reduces our market interest rate risk. Due to the cooperative structure of the Farm Credit System and as we are a stockholder of AgriBank, we expect this borrowing relationship to continue into the foreseeable future. Our other source of lendable funds is from unallocated surplus.

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

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

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

Total members' equity increased $8.6 million from December 31, 2017, primarily due to net income for the period partially offset by patronage distribution accruals**.** Accumulated other comprehensive loss is the impact of prior service cost and unamortized actuarial gain/loss related to the Pension Restoration Plan. Refer to Note 8 in our 2017 Annual Report for more information on the Pension Restoration Plan.

The Farm Credit Administration (FCA) Regulations require us to maintain minimums for our common equity tier 1, tier 1 capital, total capital, and permanent capital risk-based capital ratios. In addition, the FCA requires us to maintain minimums for our non-risk-adjusted ratios of tier 1 leverage and unallocated retained earnings and equivalents. Refer to Note 6 in our 2017 Annual Report for a more complete description of these ratios.

Regulatory Capital Requirements and Ratios

As of:	**September 30 2018**	December 31 2017	Regulatory Minimums	Capital Conservation Buffer	Total
Risk-adjusted:					
Common equity tier 1 ratio	**19.2%**	19.6%	4.5%	2.5%*	7.0%
Tier 1 capital ratio	**19.2%**	19.6%	6.0%	2.5%*	8.5%
Total capital ratio	**19.5%**	19.9%	8.0%	2.5%*	10.5%
Permanent capital ratio	**19.3%**	19.7%	7.0%	N/A	7.0%
Non-risk-adjusted:					
Tier 1 leverage ratio	**20.3%**	21.0%	4.0%	1.0%	5.0%
Unallocated retained earnings and equivalents leverage ratio	**20.5%**	21.2%	1.5%	N/A	1.5%

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

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

RELATIONSHIP WITH AGRIBANK

Purchased Services

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

REGULATORY MATTERS

Investment Securities Eligibility

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

CERTIFICATION

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

Chris Roberts
Chairman of the Board
Farm Credit Midsouth, ACA

James McJunkins
President and Chief Executive Officer
Farm Credit Midsouth, ACA

Shari J. Wilson
Executive Vice President of Finance, Chief Financial Officer
Farm Credit Midsouth, ACA

November 9, 2018

CONSOLIDATED STATEMENTS OF CONDITION

Farm Credit Midsouth, ACA

(in thousands)
(Unaudited)

As of:		September 30 2018		December 31 2017
ASSETS				
Loans	**$**	**987,927**	$	858,247
Allowance for loan losses		**3,562**		2,593
Net loans		**984,365**		855,654
Investment in AgriBank, FCB		**18,794**		18,794
Accrued interest receivable		**23,958**		16,975
Other property owned		**--**		40
Deferred tax assets, net		**337**		620
Other assets		**9,157**		8,684
Total assets	**$**	**1,036,611**	$	900,767
LIABILITIES				
Note payable to AgriBank, FCB	**$**	**807,083**	$	677,222
Accrued interest payable		**5,075**		3,883
Patronage distribution payable		**4,200**		5,400
Other liabilities		**3,291**		5,927
Total liabilities		**819,649**		692,432
Contingencies and commitments (Note 3)				
MEMBERS' EQUITY				
Protected members' equity		**--**		2
Capital stock and participation certificates		**1,895**		1,904
Unallocated surplus		**215,321**		206,715
Accumulated other comprehensive loss		**(254)**		(286)
Total members' equity		**216,962**		208,335
Total liabilities and members' equity	**$**	**1,036,611**	$	900,767

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Farm Credit Midsouth, ACA

(in thousands)
(Unaudited)

	Three Months Ended		Nine Months Ended	
For the period ended September 30	**2018**	2017	**2018**	2017
Interest income	**$ 12,304**	$ 11,365	**$ 32,190**	$ 30,209
Interest expense	**5,075**	4,076	**12,968**	10,697
Net interest income	**7,229**	7,289	**19,222**	19,512
Provision for loan losses	**797**	620	**945**	1,349
Net interest income after provision for loan losses	**6,432**	6,669	**18,277**	18,163
Other income				
Patronage income	**768**	1,225	**2,114**	2,489
Financially related services income	**270**	206	**320**	258
Fee income	**48**	144	**365**	412
Allocated Insurance Reserve Accounts distribution	**--**	--	**519**	--
Miscellaneous income (loss), net	**24**	22	**2,100**	(79)
Total other income	**1,110**	1,597	**5,418**	3,080
Operating expenses				
Salaries and employee benefits	**2,293**	2,118	**6,913**	6,404
Other operating expenses	**1,244**	1,100	**3,689**	3,323
Total operating expenses	**3,537**	3,218	**10,602**	9,727
Income before income taxes	**4,005**	5,048	**13,093**	11,516
(Benefit from) provision for income taxes	**(170)**	(165)	**288**	71
Net income	**$ 4,175**	$ 5,213	**$ 12,805**	$ 11,445
Other comprehensive income				
Employee benefit plans activity	**$ 11**	$ --	**$ 32**	$ --
Total other comprehensive income	**11**	--	**32**	--
Comprehensive income	**$ 4,186**	$ 5,213	**$ 12,837**	$ 11,445

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

CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

Farm Credit Midsouth, ACA

(in thousands)
(Unaudited)

	Protected Members' Equity	Capital Stock and Participation Certificates	Unallocated Surplus	Accumulated Other Comprehensive Income	Total Members' Equity
Balance at December 31, 2016	$ 2	$ 1,994	$ 195,941	$ --	$ 197,937
Net income	--	--	11,445	--	11,445
Unallocated surplus designated for patronage distributions	--	--	(3,225)	--	(3,225)
Capital stock and participation certificates issued	--	93	--	--	93
Capital stock and participation certificates retired	--	(149)	--	--	(149)
Balance at September 30, 2017	$ 2	$ 1,938	$ 204,161	$ --	$ 206,101
Balance at December 31, 2017	$ 2	$ 1,904	$ 206,715	$ (286)	$ 208,335
Net income	**--**	**--**	**12,805**	**--**	**12,805**
Other comprehensive income	**--**	**--**	**--**	**32**	**32**
Unallocated surplus designated for patronage distributions	**--**	**--**	**(4,199)**	**--**	**(4,199)**
Capital stock and participation certificates issued	**--**	**106**	**--**	**--**	**106**
Capital stock and participation certificates retired	**(2)**	**(115)**	**--**	**--**	**(117)**
Balance at September 30, 2018	**$ --**	**$ 1,895**	**$ 215,321**	**$ (254)**	**$ 216,962**

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

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

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

Recently Issued or Adopted Accounting Pronouncements

We have assessed the potential impact of accounting standards that have been issued by the Financial Accounting Standards Board (FASB) and have determined the following standards to be applicable to our business. While we are a nonpublic entity, we generally adopt on the public entity required date to align with other Farm Credit System institutions. For recently issued and adopted accounting pronouncements disclosed, we plan to adopt on the public entity effective date.

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

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

NOTE 2: LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans by Type

(dollars in thousands)

As of:	**September 30, 2018**		December 31, 2017	
	Amount	%	Amount	%
Real estate mortgage	**$ 497,848**	**50.5%**	$ 476,739	55.5%
Production and intermediate-term	**435,034**	**44.0%**	323,535	37.7%
Agribusiness	**53,669**	**5.4%**	56,803	6.6%
Other	**1,376**	**0.1%**	1,170	0.2%
Total	**$ 987,927**	**100.0%**	$ 858,247	100.0%

The other category is primarily comprised of rural residential real estate loans and certain assets originated under the mission related investment authority.

Delinquency

Aging Analysis of Loans

(in thousands) **As of September 30, 2018**	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less than 30 Days Past Due	Total
Real estate mortgage	**$ 1,830**	**$ --**	**$ 1,830**	**$ 508,431**	**$ 510,261**
Production and intermediate-term	**1,330**	**3,598**	**4,928**	**440,526**	**445,454**
Agribusiness	**--**	**1,306**	**1,306**	**53,482**	**54,788**
Other	**--**	**--**	**--**	**1,382**	**1,382**
Total	**$ 3,160**	**$ 4,904**	**$ 8,064**	**$ 1,003,821**	**$ 1,011,885**

As of December 31, 2017	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less than 30 Days Past Due	Total
Real estate mortgage	$ --	$ --	$ --	$ 486,439	$ 486,439
Production and intermediate-term	1,250	129	1,379	328,596	329,975
Agribusiness	--	1,606	1,606	56,028	57,634
Other	--	--	--	1,174	1,174
Total	$ 1,250	$ 1,735	$ 2,985	$ 872,237	$ 875,222

Note: Accruing loans include accrued interest receivable.

There were no loans 90 days or more past due and still accruing interest at September 30, 2018, and December 31, 2017.

Risk Loans

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

Risk Loan Information

(in thousands) As of:	**September 30 2018**	December 31 2017
Volume with specific allowance	**$ 4,685**	$ 5,674
Volume without specific allowance	**3,811**	4,015
Total risk loans	**$ 8,496**	$ 9,689
Total specific allowance	**$ 1,014**	$ 786
For the nine months ended September 30	**2018**	2017
Income on accrual risk loans	**$ 18**	$ 4
Income on nonaccrual loans	**185**	413
Total income on risk loans	**$ 203**	$ 417
Average risk loans	**$ 9,157**	$ 6,652

Note: Accruing loans include accrued interest receivable.

We had no commitments to lend additional money to borrowers whose loans were classified as risk loans at September 30, 2018.

Troubled Debt Restructurings (TDRs)

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

There were no TDRs that occurred during the nine months ended September 30, 2018, or 2017.

There were no TDRs that defaulted during the nine months ended September 30, 2018, or 2017 in which the modification was within twelve months of the respective reporting period.

TDRs Outstanding in the Production and Intermediate-Term Loan Category

(in thousands) As of:	**September 30 2018**	December 31 2017
TDRs in accrual status	**$ 504**	$ 12
TDRs in nonaccrual status	**402**	1,296
Total TDRs	**$ 906**	$ 1,308

There were no commitments to lend to borrowers whose loans have been modified in a TDR at September 30, 2018.

Allowance for Loan Losses

Changes in Allowance for Loan Losses

(in thousands)

Nine months ended September 30	2018	2017
Balance at beginning of period	**$ 2,593**	$ 1,634
Provision for loan losses	**945**	1,349
Loan recoveries	**24**	46
Loan charge-offs	**--**	(764)
Balance at end of period	**$ 3,562**	$ 2,265

NOTE 3: CONTINGENCIES AND COMMITMENTS

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

We may be named as a defendant in certain lawsuits or legal actions in the normal course of business. In 2009, we were named as a counter-defendant based on various lender liability type of theories in an on-going foreclosure lawsuit. On October 26, 2015, the case was heard by a jury, and on November 3, 2015, a verdict was rendered against the Association. We appealed the verdict, and on April 4, 2018, the Arkansas Court of Appeals substantially reversed all of the verdict. The decision of the Arkansas Court of Appeals was subsequently upheld by the Arkansas Supreme Court on June 21, 2018, when the Court denied the defendants' Petition for Review. This decision effectively ends the lender liability portion of the litigation. We had previously recorded a $2.3 million liability for this lawsuit, which $2.0 million has been overturned and therefore reversed. This amount is included in "Other liabilities" in the Consolidated Statements of Condition. At the date of these Consolidated Financial Statements, our management team was not aware of any other material actions. However, management cannot ensure that such actions or other contingencies will not arise in the future.

NOTE 4: FAIR VALUE MEASUREMENTS

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

We did not have any assets or liabilities measured at fair value on a recurring basis at September 30, 2018, or December 31, 2017.

Non-Recurring

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

Assets Measured at Fair Value on a Non-recurring Basis

(in thousands)

	As of September 30, 2018			
	Fair Value Measurement Using			Total Fair
	Level 1	Level 2	Level 3	Value
Impaired loans	**$ --**	**$ --**	**$ 3,855**	**$ 3,855**
Other property owned	**--**	**--**	**--**	**--**
	As of December 31, 2017			
	Fair Value Measurement Using			Total Fair
	Level 1	Level 2	Level 3	Value
Impaired loans	$ --	$ --	$ 5,132	$ 5,132
Other property owned	--	--	42	42

Valuation Techniques

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

Other property owned: Represents the fair value and related losses of foreclosed assets that were measured at fair value based on the collateral value, which is generally determined using appraisals, or other indications based on sales of similar properties. Costs to sell represent transaction costs and are not

included as a component of the asset's fair value. If the process uses independent appraisals and other market-based information, they are classified as Level 2. If the process requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the property and other matters, they are classified as Level 3.

NOTE 5: SUBSEQUENT EVENTS

We have evaluated subsequent events through November 9, 2018, which is the date the Consolidated Financial Statements were available to be issued. There have been no material subsequent events that would require recognition in our Quarterly Report or disclosure in the Notes to Consolidated Financial Statements.