2016 Annual Report

POSITIONED FOR TOMORROW.

AgStar
Financial Services, ACA

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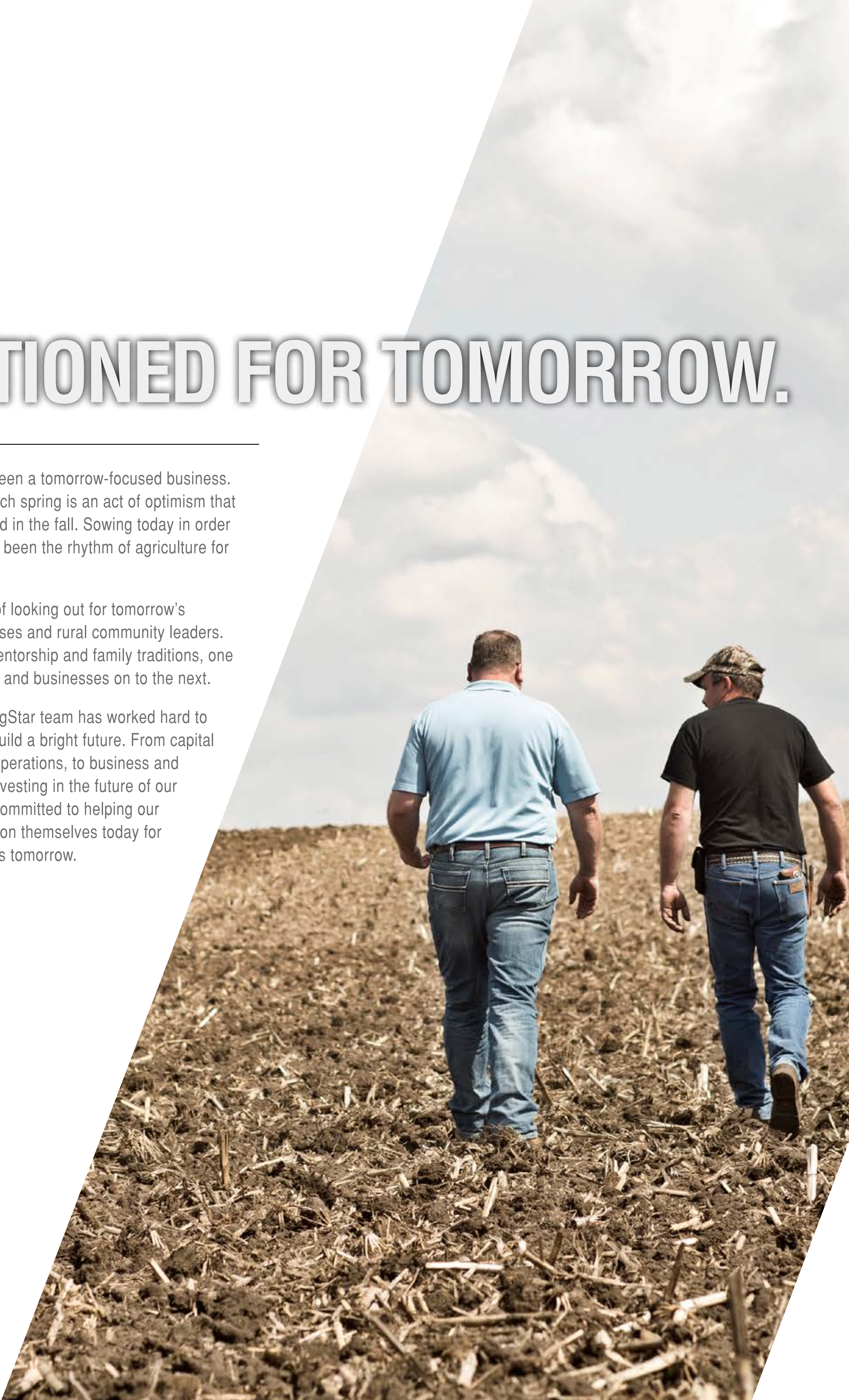


Agriculture has always been a tomorrow-focused business. The planting of seeds each spring is an act of optimism that the effort will be rewarded in the fall. Sowing today in order to reap tomorrow—that's been the rhythm of agriculture for thousands of years.

Farming has a tradition of looking out for tomorrow's generations, agribusinesses and rural community leaders. Through stewardship, mentorship and family traditions, one generation passes farms and businesses on to the next.

For over a century, the AgStar team has worked hard to partner with farmers to build a bright future. From capital that powers day-to-day operations, to business and consulting services, to investing in the future of our communities; AgStar is committed to helping our client-stockholders position themselves today for more growth and success tomorrow.

AgStar's Mission: Enhancing Life in Agriculture and Rural America

CELEBRATING A CENTURY OF LOOKING FORWARD

Commemorating the 100th Anniversary of Farm Credit

A centennial anniversary for a business is a rare thing, especially in the sometimes turbulent agriculture and financial industries. The uniqueness of the anniversary milestone made AgStar all the more excited to help commemorate Farm Credit's 100th year of providing reliable, consistent financing and service to farmers and rural America.

As an association that is part of the Farm Credit System, AgStar observed this important milestone at our client picnics and in our flagship offices. We also provided $100 stipends to help 100 youth attend 4-H or FFA leadership camps in Washington, D.C.

In June, AgStar joined our fellow associations at Farm Credit's official centennial celebration in Washington, D.C. The event included visits with lawmakers, during which AgStar leaders discussed important, timely issues that affect our clients in agriculture. We also had an opportunity to hear from former U.S. Department of Agriculture Secretary Tom Vilsack.

Among the many highlights of this year of celebration was the naming and recognition of Farm Credit's Fresh Perspectives—100 individuals from throughout the nation who are making a positive difference in agriculture, two of which are AgStar clients.

Fresh Perspectives honoree and AgStar client Pakou Hang attended the Farm Credit 100 celebration in Washington, D.C. While there, she visited with AgStar board members, elected officials and other attendees.

Farm Credit honored AgStar's Joe Deufel, left, for his 45 years of service in the system.

AgStar board members and other representatives spent considerable time talking with U.S. Senators and Representatives about issues affecting our clients.

HONORING THOSE WHO IMPROVE RURAL AMERICA

AgStar Clients Are Among 100 Farm Credit Fresh Perspectives Leaders

To people outside agriculture, it may seem like the cycle is the same—plant, cultivate, harvest, repeat. But those inside farming and agribusiness know the means to those familiar ends constantly change and evolve, as do the challenges facing rural America.

The Farm Credit 100 Fresh Perspectives program—the cornerstone of Farm Credit's 100th anniversary of supporting rural communities and agriculture—was designed to honor those who help position agriculture and rural communities to capitalize on the changes and opportunities tomorrow brings. The 100 honorees were selected from more than 1,000 nominations from all 50 states.

The Farm Credit 100 Fresh Perspectives selection panelists evaluated nominations of individuals and groups who demonstrate influence, leadership and innovation in 10 categories. Two AgStar clients were among those honored. Erin Brenneman of Washington, Iowa, was recognized in the Agriculture Education and Community Impact category, while Pakou Hang of St. Paul, Minnesota, was honored for Mentoring and Volunteerism. (See article below.)

In addition, several of the top 100 honorees reside in Minnesota and Wisconsin—states served by AgStar. They include:

- Jacob Chisholm of Gary, Minnesota
- CHS in Inver Grove Heights, Minnesota
- Joe Tomandl III of Medford, Wisconsin
- Anthony Schultz and Katrina Becker of Athens, Wisconsin
- Diane and Roger King of Holmen, Wisconsin

AgStar Clients Honored for Advocacy, Mentoring and Volunteerism

Erin Brenneman of Washington, Iowa, is the farrowing manager for her family's pork operation and a dedicated advocate for the agriculture industry. In addition to promoting agriculture through social media and providing tours of her farm to local community groups, she travels throughout the country to educate students and others about modern production methods and technology. Brenneman was raised in Chicago. Her passion for agriculture and above-and-beyond effort to promote the industry, combined with her city upbringing, form a unique combination that helps her reach a range of demographics with the message that agriculture matters.

Photo by Christopher Smith

Pakou Hang and her family fled political persecution in Laos when she was just 15 days old. Hang, who now lives in St. Paul, Minnesota, grew up helping on the vegetable farm her parents started after immigrating to the U.S. The farm helped pay for her and her siblings' Catholic school education, leading to college degrees for all. With a master's in political science, Hang is working to advance the prosperity of Hmong farmers and their families as executive director of the Hmong American Farmers Association (HAFA) in St. Paul. She has received many awards and fellowships and is currently working with other organizations to explore barriers to land access for immigrant, beginning and landless farmers.

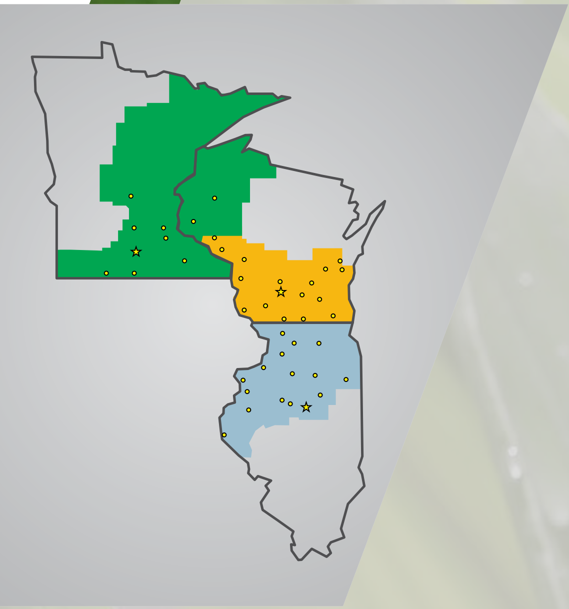
DEVELOPING TOMORROW'S LEADERS

AgStar Contributes $10,600 to Minnesota and Wisconsin 4-H and FFA for Youth Leadership Initiatives

Preparing new generations of leaders is critical to the success of any business, especially farming and other agribusiness. That's why the AgStar Fund for Rural America, the corporate giving program of AgStar Financial Services, proudly donated $10,600 toward Minnesota and Wisconsin FFA and 4-H foundations in 2016.

This grant helped support youth attending either the Washington Leadership Conference or the Citizenship Washington Focus event that summer. AgStar recognizes FFA and 4-H as important programs that help bring young people into farming and other agribusiness as well as develop future industry leaders. Conferences like the two in Washington help the next generation of agriculture create relationships with each other and learn from current industry experts and leaders.

EXPLORING NEW OPPORTUNITIES FOR GROWTH AND EFFICIENCY



AgStar, Badgerland and 1st Farm Credit Discuss Potential Merger

Positioning for tomorrow requires planning today. In that spirit, AgStar began discussions with Badgerland Financial and 1st Farm Credit Services in 2016 to determine if a merger would enhance our collective ability to deliver the insights and expert guidance, innovative products and services, and superior return on investment that member-owners deserve from their financial services provider.

Many of our discussions revolved around fulfilling our mission of supporting rural communities and agriculture with reliable, consistent credit and financial services. Through this process, our three associations' Boards of Directors remain committed to making sure our members are positioned for success, not only today but in the years ahead.

Badgerland Financial, based in Prairie du Sac, Wisconsin, serves 33 southern Wisconsin counties. 1st Farm Credit, based in Normal, Illinois, serves 42 counties in northern Illinois.

The Boards of Directors from each of the three companies unanimously approved recommending that the proposed merger go to stockholders for a vote in early 2017. FCA recently provided preliminary approval of the merger, and stockholders will get a chance to vote soon. If approved, the merger will be effective later in 2017.

FIGHTING HUNGER IN THE HEARTLAND

Continuing Our Commitment to Leading by Example

Even in the agriculture heartland that helps feed the entire nation, one in ten people experience hunger. In keeping with our mission to enhance rural communities, in 2016 AgStar team members again made a positive impact on the fight against hunger through several efforts.

Kids Against Hunger Food Pack

In partnership with AgStar's Diversity and Inclusion Council, AgStar team members and guests spent time during the organization's annual conference packing a total of 9,801 pounds of food for Kids Against Hunger. The attendees worked in two groups on an assembly line to package ingredients for a nutritious, vitamin-fortified soy-rice casserole. Each package contained enough for six meals. The packs were distributed to families through food banks in Minnesota and northwest Wisconsin.

Kids Against Hunger is an international, non-profit organization with 100 food packaging satellites across the U.S. and Canada. Three Rotary Clubs from the Menomonie and Chippewa Valley areas in Wisconsin organized the service project for AgStar.

Let's Kick Hunger Day

In January 2016, AgStar partnered with WCCO, Taste of the NFL, Land O'Lakes and General Mills for the seventh annual Let's Kick Hunger Day Radiothon at the Mall of America. The radiothon raised more than $260,000 to support Second Harvest Heartland. Each dollar donated provides enough for about three meals.

This year, the AgStar Fund for Rural America also matched general donations made during a portion of the Let's Kick Hunger drive as well as all donations by AgStar team members made throughout the day. One hundred percent of the funds raised stay local and help kick hunger across Minnesota and western Wisconsin through Second Harvest Heartland.

AgStar team members also volunteered their time for the effort by answering phones and taking donations during the radiothon. Since its inception, Let's Kick Hunger Day has raised more than $1.4 million to provide 4.2 million meals for hungry families.

AgStar's 7th Annual Food Drive

The AgStar Fund for Rural America partnered with AgStar team members to raise $23,528 for local food shelves in 2016, a year in which more families than ever depended upon those services.

Cash donations made by team members during the month of March were matched by the AgStar Fund for Rural America. AgStar team members at each flagship office served as Community Coordinators to organize events and deliver all cash and checks directly to a total of 62 food shelves, ensuring that 100 percent of donations helped those in need.

AgStar team members and the AgStar Fund for Rural America have had formal food drives to benefit food shelves across our service area and in Iowa since 2010.

Client Farmers Give Generously

Some of AgStar's client farmers are also helping to reduce the area's hunger pains. Edling Farms in Clear Lake, Riverside Farms in Elk River and Pahl's in Apple Valley were among the 46 farms in Minnesota and Wisconsin that donated much needed fresh produce to Second Harvest Heartland through its Share Fresh program.

Second Harvest Heartland's warehouses received and distributed three semi-trucks full of donated produce every day last August, boosting the amount of goods delivered to partner food shelves.

Farmers have been donating produce to Second Harvest Heartland since 2002, having found it to be an attractive option for fruits and vegetables that are too small or too blemished to sell to retail grocers.

Clients' involvement in Share Fresh and their partnership with Second Harvest Heartland is a testament to their passion for agriculture and the well-being of others. AgStar is proud to work with them and Second Harvest Heartland to improve the quality of life in rural America by helping to provide one of the most basic human needs to those struggling in our service area.

Diversity & Inclusion Council Members Volunteer

The Diversity & Inclusion Council donated time, effort and money to fight hunger in 2016. As a service project, council members took a shift at the Second Harvest Heartland food bank where they prepared more than 7,000 pounds of potatoes to be distributed to hungry families.

Along with the volunteerism, the Diversity & Inclusion Council contributed $500 in matching funds, which is equivalent to a truckload of food.

STANDING BY OUR COMMUNITIES

Donations Help Bring Relief to Madelia and Melrose

When separate fires hit two small communities in Minnesota in 2016, AgStar was quick to provide the initial funds for a recovery drive and encouraged others to match.

Flames decimated Madelia's downtown in early February, leaving uninsured losses to public and private property exceeding $1 million, according to an article in the Minneapolis *Star Tribune*. AgStar responded with a $15,000 donation to help the community of 2,200 recover. The money was donated to the Southern Minnesota Initiative Foundation (SMIF).

In September, a fire in Melrose—a town of about 3,600 people located 35 miles west of St. Cloud—caused an estimated $600,000 in damage to 11 businesses and eight apartments. The fire also displaced about two dozen people who were living in the apartments. AgStar donated $25,000 to the Initiative Foundation, based in Little Falls, to help Melrose recover.

In both communities, AgStar partnered with other groups to make early donations that kickstarted giving and challenged other corporations and organizations to support the effort as well.

PARTNERING TO EXPAND HEALTHCARE IN AUGUSTA, WISCONSIN

AgStar Plays a Key Role in $11 Million Project

When Augusta Area Homes, Inc., cut the ribbon on its new 52,000-square-foot healthcare facility in June, AgStar was on hand to help celebrate the addition to the community.

The $11 million nursing home replaced a building that dated back to 1960. In addition to providing the community with modern-day nursing home services, the building also offers 12 assisted living units—an option not previously available in Augusta. The project included investments from AgStar, financing from USDA (United States Department of Agriculture) Rural Development and a land donation from Bush Brothers and Company.

CONTRIBUTING TO THE FIGHT AGAINST CANCER

AgStar Helps Hormel Institute Celebrate Building Expansion

An unassuming research center in Austin, Minnesota, dramatically ramped up its war on cancer in 2016, and AgStar was proud to support its efforts.

The Hormel Institute has used science to help overcome rural America's challenges since its founding by Jay C. Hormel in 1942. Lately, the Hormel Institute has made cancer its main focus. To that end, this year the institute doubled its facility's size with a 75,000-square-foot addition. The expansion creates room for 120 more cancer researchers, bringing the total employee count to 250.

The AgStar Fund for Rural America has been the Hormel Institute's ally in the battle against cancer since 2011. In 2016, AgStar contributed another $12,500 to the Hormel Institute to support its work and recent expansion project. The donation represented the Fund for Rural America's annual $10,000 matching grant commitment designed to inspire others to support the Institute and its work to fight cancer, plus an extra $2,500 to celebrate the center's expansion. To date, AgStar has donated $62,500 to benefit the institute's work.

AgStar also supports the center's focus on using food and agriculture as key factors in preventing or curing cancer, raising general awareness of the critical factor food choices play in good health and the creation of jobs and broad economic benefit in southern Minnesota.

Doing $6 Million Worth of Good

Since its founding in 2001, the Fund for Rural America has invested more than $6 million in the future of agriculture and rural America. Besides the Hormel Institute, the Fund's donations have supported:

- Emergency services to provide equipment like fire helmets, automated external defibrillators (AEDs), portable radios, turnout gear, fire hoses and grain bin rescue kits.
- Ag education in the form of welding equipment, technology, surveying tools and more.
- County fair building repairs and maintenance.
- Scholarships for high school seniors, plus tuition for beginning farmers.
- Rural Feasibility Studies to promote economic development.

President and CEO Rod Hebrink, left, talks live with Linder Farm Network's Lynn Ketelsen about the Hormel Institute's importance to agriculture and AgStar's commitment to the research center.

MAINTAINING A CULTURE OF INCLUSION AND EXCELLENCE

Team Focus Leads to Top Workplace Recognition

AgStar understands that the only way to deliver the exceptional products and services to customers that generate business growth and success is by attracting and retaining the best employees.

In addition to carefully selecting employees for our high-performing team, AgStar offers above-and-beyond benefits including team outings, wellness and recognition programs, a learning and development focus, and flexible work schedules to bring team members closer and keep motivation high.

In 2016, employees reacted to the positive work environment by ranking AgStar among the *Star Tribune's* 150 Top Workplaces in Minnesota for the sixth consecutive year. The rankings were tabulated by Workplace Dynamics, an independent survey organization specializing in employee engagement and retention, which gathered and analyzed responses from employees at Minnesota public, private and nonprofit organizations.

DELIVERING RETURN ON INVESTMENT FOR STOCKHOLDERS

2016 Patronage Allocation Retirement Brings Payments to Nearly $198 Million

In November, nearly 12,000 AgStar investors received payments from their 2007 patronage allocations.

The AgStar Board of Directors voted to retire 2007 patronage allocations, totaling $35 million, by the end of 2016. When allocations are retired, stockholders receive checks for their share of the patronage allocations. Since 1998, AgStar has allocated $643 million in patronage and retired nearly $198 million of those allocations to eligible stockholders.

Patronage allocations create additional value for stockholders and provide additional disciplines for the organization to effectively utilize stockholders' capital.

Each year, AgStar's Board of Directors determines if the organization is in the position to retire (and issue payments to members for) any outstanding patronage allocations. AgStar's patronage program was designed with a targeted 7- to 10-year retirement time frame.

Using the Power of the Internet to Serve Customers

Launched at the end of 2015, Client Access evolved with new capabilities in 2016. Today, hundreds of clients are experiencing the convenience, flexibility and reduced paper shuffling that result from securely managing their finances via AgStar's Client Access.

Key benefits of Client Access:

- **Provide documents to AgStar**—Clients can upload their year-end financial information and most documents required for bank business, such as closing or servicing a loan.
- **Access to statements and bills**—Client Access makes things like monthly statements, annual statements, patronage statements, bills and other tax documents accessible online any time.
- **View account information**—Clients can access account summary and detailed information, including balances, payment dates and interest paid; plus loan and crop insurance documents.

AGSTAR BUSINESS UNITS

Home Mortgage Services offers home financing options for clients in rural areas or communities. The focal point of this segment is mortgages to buy, build or refinance residences or acreages. We also serve eligible clients wishing to purchase rural real estate for recreational use, such as hunting and sporting.

Capital Markets builds relationships with commercial banks, Farm Credit Institutions and other lending partners in buying loan participations and syndications. This specialized team provides a national marketing vehicle to gain improved access to the agribusiness and commercial producer loan market and provides portfolio diversity, earnings and market intelligence to the organization.

Agri-Access® (www.Agri-Access.com) operates as a unit of AgStar Financial Services, ACA, and is a correspondent lender primarily focused on purchasing participations in agricultural real estate loans and leases across the U.S. Agri-Access brings diversification to AgStar's portfolio. Agri-Access also services agricultural loans for institutional investors. The main Agri-Access contact office is located in Des Moines, Iowa. We also have a contact office in Meridian, Idaho.

Rural Capital Network supports community and economic development, infrastructure needs, revitalization projects and emerging markets in rural America. AgStar Rural Capital Network invests in projects through the purchase of bonds issued by local communities, organizations or businesses. In addition, this team partners with other Farm Credit associations and local community banks focusing on investing in critical access hospitals, assisted-living facilities, rural multi-family rental housing, business expansions, etc.

AgStar's **Client Solutions Team** delivers guidance, insight and counseling to support our array of services including loans and leases, crop insurance and consulting to nearly 13,900 clients and producers.

Our team collaborates within the organization to bring specialized knowledge and expertise to meet each client's unique needs. Our team possesses extensive knowledge in their areas of expertise—from grain to livestock to renewable fuels and emerging markets—and provides financial services and counseling to commercial producers, agribusinesses and processors.

Services are provided across many commodities with particular expertise in the swine, dairy and cash grain industry segments. Other areas include beef, bio energy, equine, logging and recreational land.

PRODUCTS & SERVICES

Loans

Operating Loans • Equipment Loans • Real Estate Loans • Starter Loans for young, beginning and emerging market farmers

Leasing

Equipment and Machinery Leases • Truck and Trailer Leases • Vehicle Leases • Building and Facility Leases

Insurance

Crop Hail Insurance • Multi-Peril Crop Insurance • Specialty Crop Insurance • Crop Revenue Insurance • Life Insurance

Home Mortgages

Home Loans • Construction Loans • Hobby Farm Loans • Manufactured Housing Loans • Home Site Loans • Recreational Land Loans • Home Renovation Loans

Business Services

Fleet Services • Appraisal Services • Cash Management Services • AgStar Edge • Margin Manager • Internet Banking • Remote Deposit Capture

Consulting Services

Financial Management • Benchmarking

TO OUR STOCKHOLDERS

Last year gave us more evidence of what we already know: farming is a cyclical business. While high yields offset pressures for some, low prices in several commodities made 2016 a challenging year for many of our clients. Within those challenging times, AgStar found opportunities to nourish partnerships that have endured for a century by focusing on the success of our clients, stockholders and communities.

A Strong Partner for Farmers and Rural America

Our emphasis on managing expenses relative to growth remains an important part of AgStar's success. In 2016, AgStar reported net income of $129.2 million and a 7.7 percent increase in loan volume. In addition, our credit quality and capital ratios remained relatively stable. In 2016, we saw returns from commercial loans and fee income exceed expectations. This positive performance, along with our continued discipline on controllable expenses, has helped to offset increased provision for loan losses and Farm Credit Insurance fund costs.

Along with maintaining our financial stability, AgStar serves client-stockholders by sharing financial expertise, something that's especially critical during tougher economic conditions.

Merging Resources to Help Clients Succeed

In August, the Boards of Directors for AgStar, 1st Farm Credit Services and Badgerland Financial unanimously voted to move forward with a proposal to merge the three organizations into one.

AgriBank approved the merger proposal in the fall, and the Farm Credit Administration (FCA) was reviewing the proposed merger as this report went to press. The FCA recently granted preliminary approval and soon stockholders of the three associations will receive disclosure documents outlining the details of the proposed merger, as well as a ballot to use to cast their vote regarding the proposal. Client meetings to review the disclosure documents and answer questions will be scheduled before ballots are due.

If ultimately approved, the merged organization—which will be known as Compeer Financial—will use each association's strengths to move toward our goal of helping clients and team members thrive. Compeer Financial will be headquartered in Sun Prairie, Wisconsin, and function as a Farm Credit Association, just as the three associations do currently. No local offices will close due to the merger. Clients can expect to maintain relationships with their current financial representatives.

The Boards of Directors of all three associations intend for the merged organization to offer patronage in some form and to retire allocated equities in an equitable manner assuming the merged associations' capital position supports such payments. The future retirement of allocated equities will be discussed in the disclosure document stockholders will receive before the merger vote and, like today, is subject to future board action and regulatory limitations.

2016 Patronage Allocation and Retirement

AgStar has been alongside farmers for 100 years, guiding clients' financial strategy as they tend to their fields and raise their livestock. This long-standing relationship and our investment in one another allowed AgStar to retire our 2007 patronage allocations and share $35 million in earnings with nearly 12,000 stockholders in 2016. We also allocated $67 million in patronage, based on business conducted in 2016.

One thing we know about tomorrow for sure is it will bring new opportunities for AgStar to serve our client-stockholders. We're grateful for that fact and pledge to make decisions today that keep our company and client-stockholders Positioned for Tomorrow.

Kaye Compart
Chairperson of the Board
AgStar Financial Services, ACA

Rodney Hebrink
President and CEO
AgStar Financial Services, ACA

LEADERSHIP

Over the centuries, American farmers have evolved an instinct for positioning their businesses for tomorrow. The fact that most of AgStar's board members are producers who represent grower client-stockholders bodes well for AgStar's ability to continue to make tomorrow-focused decisions. Guided by the board's wisdom and faithful representation of client-stockholders, AgStar will remain positioned to capitalize on whatever opportunities tomorrow brings.

Board of Directors

Front left to right: Gregory Nelson, Kaye Compart, Eunice (Eunie) Biel

Middle left to right: Dale Holmgren, Theresa (Ann) Broome, Larry Fischer, Terry Ebeling, Joyce Fernando

Back left to right: David Bollman, Rick Sommers, Wesley Beck, Kevin Koppendrayer, Spencer Enninga, David Kretzschmar

Executive Committee

Front left to right: Jodie Hermer, Jase Wagner, Rodney Hebrink, Mark Greenwood

Back left to right: Joseph Deufel, Tim Tracy, John Hemstock, Paul Kohls, John Monson, Wick Manley

2016 FINANCIAL HIGHLIGHTS

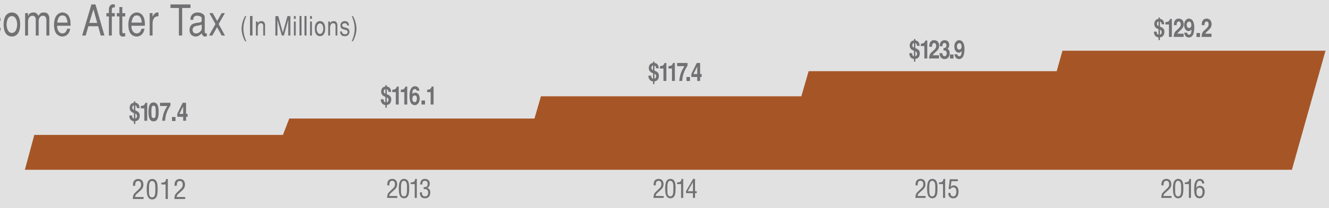
8.62%

Compound Annual Growth Rate for the Last Five Years

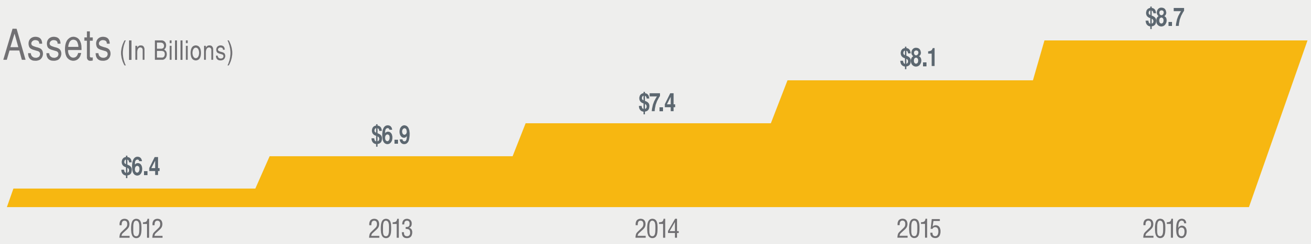
$1,315 MILLION

Equity (Total Capital)

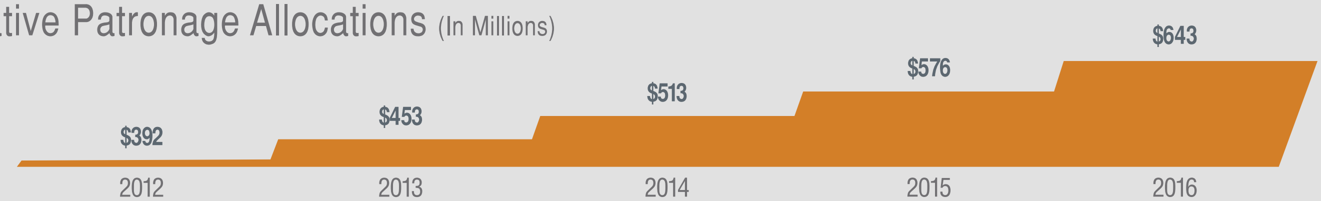
Net Income After Tax (In Millions)



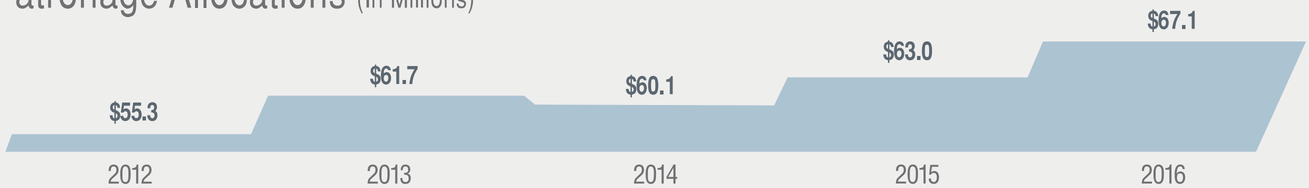
Earning Assets (In Billions)



Cumulative Patronage Allocations (In Millions)



Annual Patronage Allocations (In Millions)



571

Full-Time Equivalent Team Members

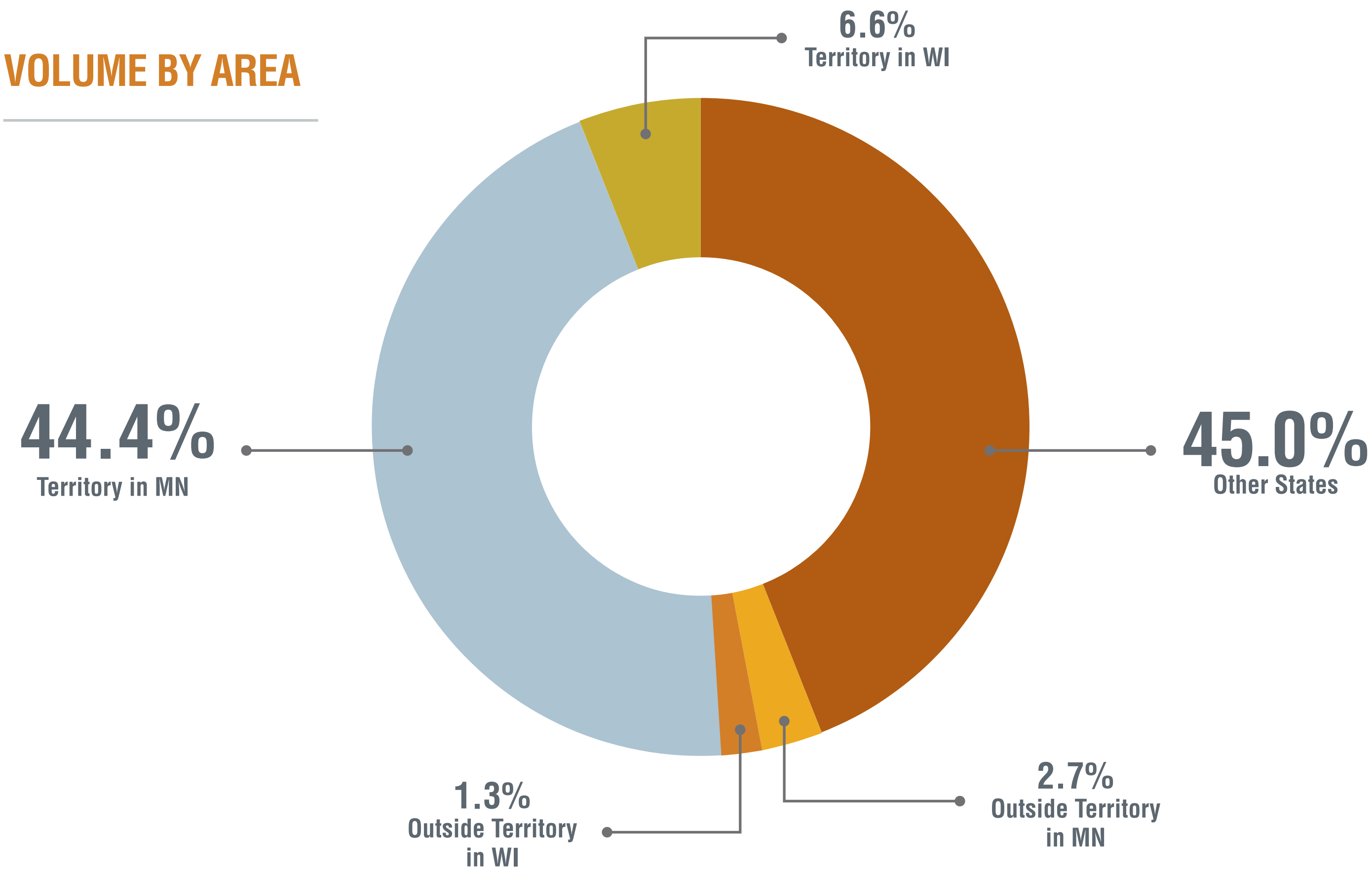
14,900

Number of Voting Stockholders

20,400

AgStar Clients

VOLUME BY AREA



VOLUME BY ENTERPRISE

- **33.3%** Grain/Cash Crops
- **18.2%** Agribusiness
- **11.0%** Swine
- **9.0%** Dairy
- **7.3%** Home Mortgages
- **6.5%** Other
- **4.5%** Cattle
- **4.5%** Forest Products
- **3.0%** Landlords
- **2.7%** Renewable Energy

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CONSOLIDATED FIVE-YEAR SUMMARY OF SELECTED FINANCIAL DATA

AgStar Financial Services, ACA

(dollars in thousands)

	2016	2015	2014	2013	2012
Statement of Condition Data					
Loans held to maturity	**$ 8,152,435**	$ 7,572,042	$ 6,899,646	$ 6,363,512	$ 5,913,336
Allowance for loan losses	**36,018**	27,071	23,655	24,725	26,814
Net loans held to maturity	**8,116,417**	7,544,971	6,875,991	6,338,787	5,886,522
Loans held for sale	**27,370**	35,380	7,899	4,470	--
Net loans	**8,143,787**	7,580,351	6,883,890	6,343,257	5,886,522
Unrestricted cash	**2,200**	1,900	--	--	--
Investment securities	**473,248**	442,972	481,936	462,424	484,092
Investment in AgriBank, FCB	**180,812**	171,395	142,098	150,016	141,137
Other property owned	**840**	1,060	3,140	3,315	10,137
Other assets	**179,780**	164,032	161,176	146,591	141,609
Total assets	**$ 8,980,667**	$ 8,361,710	$ 7,672,240	$ 7,105,603	$ 6,663,497
Obligations with maturities of one year or less	**$ 7,665,199**	$ 7,035,085	$ 6,434,693	$ 5,950,196	$ 5,692,651
Obligations with maturities greater than one year	**--**	99,491	99,369	99,247	99,125
Total liabilities	**7,665,199**	7,134,576	6,534,062	6,049,443	5,791,776
Preferred stock	**100,000**	100,000	100,000	100,000	--
Capital stock and participation certificates	**15,934**	16,085	16,177	15,912	15,655
Allocated surplus	**441,122**	406,758	371,004	339,360	302,789
Unallocated surplus	**758,412**	704,291	650,915	600,888	553,277
Accumulated other comprehensive income	**--**	--	82	--	--
Total equity	**1,315,468**	1,227,134	1,138,178	1,056,160	871,721
Total liabilities and equity	**$ 8,980,667**	$ 8,361,710	$ 7,672,240	$ 7,105,603	$ 6,663,497
Statement of Income Data					
Net interest income	**$ 206,793**	$ 197,568	$ 187,480	$ 175,272	$ 158,151
Provision for (reversal of) loan losses	**10,082**	5,939	1,084	(3,078)	7,182
Other expenses, net	**67,474**	67,727	69,007	62,220	43,588
Net income	**$ 129,237**	$ 123,902	$ 117,389	$ 116,130	$ 107,381
Key Financial Ratios					
Return on average assets	**1.5%**	1.6%	1.6%	1.7%	1.8%
Return on average equity	**10.1%**	10.4%	10.7%	11.9%	12.9%
Net interest income as a percentage of average earning assets	**2.5%**	2.7%	2.7%	2.7%	2.7%
Equity as a percentage of total assets	**14.6%**	14.7%	14.8%	14.9%	13.1%
Net charge-offs as a percentage of average loans	**0.0%**	0.0%	0.0%	0.0%	0.1%
Allowance for loan losses as a percentage of loans	**0.4%**	0.4%	0.3%	0.4%	0.5%
Permanent capital ratio	**14.1%**	14.8%	15.7%	15.4%	13.9%
Total surplus ratio	**14.0%**	14.5%	15.4%	15.2%	13.7%
Core surplus ratio	**12.1%**	12.3%	12.9%	12.5%	10.9%
Net Income Distributed					
Patronage distributions:					
Allocated surplus	**$ 67,070**	$ 62,908	$ 60,004	$ 61,598	$ 54,966
Preferred stock dividends	**6,750**	6,750	6,749	3,132	--
Other					
Asset Pool Loans serviced for AgriBank, FCB	**$ 221,582**	$ 256,550	$ 74,040	$ 82,850	$ 102,794

MANAGEMENT'S DISCUSSION AND ANALYSIS

AgStar Financial Services, ACA

The following commentary reviews the consolidated financial condition and consolidated results of operations of AgStar Financial Services, ACA (the Association) and its subsidiaries, AgStar Financial Services, FLCA and AgStar Financial Services, PCA (subsidiaries) and provides additional specific information. The accompanying Consolidated Financial Statements and Notes to the Consolidated Financial Statements also contain important information about our financial condition and results of operations.

The Farm Credit System (System) is a nationwide system of cooperatively owned banks and associations established by Congress to meet the credit needs of American agriculture. As of January 1, 2017, the System consisted of three Farm Credit Banks, one Agricultural Credit Bank, and 73 customer-owned cooperative lending institutions (associations). The System serves all 50 states, Washington D.C., and Puerto Rico. This network of financial cooperatives is owned and governed by the rural customers the System serves.

AgriBank, FCB (AgriBank), a System bank, and its affiliated Associations are collectively referred to as the AgriBank Farm Credit District (AgriBank District or the District). We are an affiliated Association in the District.

The Farm Credit Administration (FCA) is authorized by Congress to regulate the System. The Farm Credit System Insurance Corporation (FCSIC) ensures the timely payment of principal and interest on Systemwide debt obligations and the retirement of protected borrower capital at par or stated value.

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

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Our Annual Report is available on our website no later than 75 days after the end of the calendar year and stockholders are provided a copy of such report no later than 90 days after the end of the calendar year. The Quarterly Reports are available on our website no later than 40 days after the end of each calendar quarter. To request free copies of our Annual or Quarterly Reports, contact us as stated above.

MERGER ACTIVITY

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

In August, the Boards of Directors of 1st Farm Credit Services, ACA, AgStar Financial Services, ACA, and Badgerland Financial, ACA unanimously voted in favor of recommending a merger to our client-owners. With the decision to recommend a merger, a number of additional regulatory and procedural steps still need to be completed. A merger application was filed with our regulator, the FCA, in the third quarter of 2016. The FCA recently granted preliminary approval, and our client-owners will have an opportunity to vote on the proposed merger in early 2017. The expected merger effective date would be July 1, 2017.

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

FORWARD-LOOKING INFORMATION

This Annual Report includes 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 "anticipate", "believe", "estimate", "may", "expect", "intend", "outlook", and similar expressions are used to identify such forward-looking statements. These statements reflect our current views with respect to future events. However, actual results may differ materially from our expectations due to a number of risks and uncertainties which may be beyond our control. These risks and uncertainties include, but are not limited to:

- Political, legal, regulatory, financial markets, international, and economic conditions and developments in the United States (U.S.) and abroad
- Economic fluctuations in the agricultural and farm-related business sectors
- Unfavorable weather, disease, and other adverse climatic or biological conditions that periodically occur and impact agricultural productivity and income
- Changes in U.S. government support of the agricultural industry and the System as a government-sponsored enterprise, as well as investor and rating agency actions relating to events involving the U.S. government, other government-sponsored enterprises, and other financial institutions
- Actions taken by the Federal Reserve System in implementing monetary policy
- Credit, interest rate, and liquidity risks inherent in our lending activities
- Changes in our assumptions for determining the allowance for loan losses, other-than-temporary impairment, and fair value measurements

AGRICULTURAL AND ECONOMIC CONDITIONS

We are chartered to serve territories in Minnesota and Wisconsin and serve many sectors in agriculture including our primary agricultural industries of grain, swine, and dairy. We also serve the housing, energy, and food processing and distribution segments. Credit quality, delinquencies, and nonaccrual levels modestly weakened during 2016, but remain better than historical averages. The United States Department of Agriculture (USDA) World Agriculture Supply and Demand Estimates (WASDE) report released on January 12, 2017 estimates the 2016 corn crop yield at 174.6 bushels per acre and total production of 15.1 billion bushels. The same report estimated a U.S. soybean yield of 52.1 bushels per acre and total production of 4.3 billion bushels. Both Minnesota and Wisconsin are projected to have record yields for both corn and soybeans – each surpassing records set merely a year ago.

The forecast for corn prices in 2016 were consistent with 2015. In the January 12, 2017 WASDE report, the USDA projects 2016/17 average corn prices of $3.10 to $3.70 per bushel compared to $3.61 estimated for 2015/16 despite both U.S. and global production increases. Growth in domestic consumption, increased exports and further usage to produce ethanol mitigated the rise in production, but not enough to prevent a building of U.S. ending stocks.

While global soybean production also increased over last season, prices are forecasted to end the season marginally higher for 2016/17. The U.S. exporters were able to take advantage of lingering effects from adverse weather conditions during the Brazilian growing season and favorable dollar move against the Real. U.S. exports were particularly strong in the summer and early fall – typically a seasonally slow period for U.S. farmers. The 2016/17 U.S. season-average farm price forecast for soybeans is $9.00 to $10.00 per bushel compared to the 2015/16 level of $8.95 per bushel.

Profits realized for the primary segments of our portfolio were less favorable during 2016. Favorable growing conditions within our territory coupled with generally favorable conditions in the broader Corn Belt, led to strong production and tight margins for grain producers. Margins for grain producers will likely remain narrow in 2017 based on current expectations and futures prices, and many clients will potentially face a third consecutive year of operating losses. As we receive updated client financial information in 2017, we are expecting some stress in the grain portfolio likely to occur as a result of low average on-farm commodity prices compared to input expenses.

The low feed prices remained a positive for input costs for livestock producers; however, production increases for those same livestock producers led to lower market prices and decreased margins. According to the USDA, U.S. inventory of all hogs and pigs on December 1, 2016 was 71.5 million head, up 4% from a year previous and a new record high. The USDA 2016 estimate for barrows and gilts is $46.16 per hundredweight, which is down 8.1% from 2015. Similarly, milk production continues its multi-year increase. The USDA estimates U.S. milk production at 212.5 billion pounds in 2016, up 1.9% from 2015. Combined with the effect of an increase in imports, the all-milk price is estimated to average $16.20 for 2016 – down 5.4% compared to 2015.

According to the USDA Economic Research Service, farm sector profitability is forecast to decline for the third straight year. Net cash farm income for 2016 is forecast at $90.1 billion, down 14.6% from the 2015 estimate. Net farm income, a more comprehensive measure of profitability, is forecast to be $66.9 billion in 2016, down 17.2% from prior year. Cash receipts are estimated to fall $23.4 billion (6.2%) in 2016 due primarily to a drop in animal/animal product receipts; crop receipts are essentially unchanged from 2015. Nearly all major animal specialties—including dairy, meat animals, and poultry/eggs— are forecast to have lower receipts. Ultimately, the estimate for 2016 is notably higher than the projections USDA expected at the beginning of the year. While receipts were as low as expected or lower, production costs declined more than expectations. After reaching record highs in 2014, farm production expenses are estimated to have dipped for the second consecutive year in 2016. Farmers experienced a 2.6% drop in overall production expenses forecasted on top of an 8.1% decline in 2015. The declines in overall expenses occurred despite rises in property taxes and labor costs. Net rent expense—the amount paid to rent land, adjusted for any payouts of the landlord's share of government payments and/or insurance indemnities and for any expenses paid by the landlords—is forecast to decrease by 1.6%.

Often not directly tied to commodity prices, overall conditions have been favorable for agribusinesses in recent years. Profit margins and credit quality for our agribusiness segment remained stable in 2016, and our current credit quality expectations for 2017 remain favorable. Agricultural related businesses have generally been profitable and fared better during the past several years than companies not closely tied to agriculture. Overall, this portfolio, mainly consisting of processing/packaging, power, telecom, and renewable energy has been performing satisfactorily.

Over the past few years, our rural home mortgage portfolio credit quality has remained strong. The economy continues to generate a number of positive economic signals for the housing market. According to the CoreLogic Home Price Index, home prices nationwide increased by 7.1% in November 2016 compared with November 2015; and 1.1% compared with the previous month. While rates moved upward in the latter portion of 2016, mortgage interest rates remain near historic lows. Additionally, the U.S. Bureau of Labor Statistics reported that the national unemployment rate declined to 4.7% as of December 2016, a steady decline from over 10% in 2009. Both Minnesota and Wisconsin have state unemployment rates below the national average.

Farm real estate values in our territory were generally below 2014 levels though demand for farm real estate remained steady. Values for transitional and recreational property remain low compared to the peak values previously reached.

We do extensive monitoring of land values in our territory, conducted by licensed real estate appraisers, of a sample of benchmark farms selected to represent our lending footprint. Our most recent internal benchmarking real estate market survey, as of June 30, 2016, indicated that regional agricultural land values in our territory had decreased on average by 3.9% in the previous 12 months. Qualitative surveys of lending officers compiled by the Federal Reserve Banks of Chicago and Minneapolis indicated that farmland values fell 3% from a year ago across their districts. However, Federal Reserve Banks of Chicago also noted a 2% year-over-year increase in farmland values for the state of Wisconsin which is consistent with our benchmarking study.

Declining land values following sustained periods of land value increases have historically created conditions of considerable risk for collateral-based lenders. Nominal and real (inflation-adjusted) agricultural land values have increased in proportions similar to other asset classes during the last decade, but agricultural land values escaped the valuation declines that other assets suffered during the recession. This is largely because grain farming remained profitable throughout the economic crisis period. As profit margins in grain tighten and rents compress, it is likely that farmland values will follow the same path. We have maintained a disciplined approach to our real estate underwriting standards.

Our credit risk policies emphasize loan repayment capacity in addition to conservative assessments of collateral values that secure loans. Although the FCA Regulations allow real estate mortgage loans of up to 85% of appraised value, our underwriting standards generally limit lending to no more than 65% of sustainable value (based on crop production history) at origination for agricultural production land. While underwriting exceptions on loan-to-appraised-value are sometimes granted, in such cases offsetting strengths are generally present in other areas.

Some of our core credit objectives include working with clients to promote risk management, ensure high quality financial statements and production reports, encourage disciplined marketing plans, and provide individualized servicing plans and strategies. We continue to be involved and support positive legislative changes for agriculture and rural America.

LOANS HELD TO MATURITY

Loan Portfolio

Total loans held to maturity and finance and conditional sales leases (hereinafter collectively referred to as loans) were $8.2 billion at December 31, 2016, an increase of $580.4 million from December 31, 2015.

Components of Loans

(in thousands)

As of December 31	2016	2015	2014
Accrual loans:			
Real estate mortgage	**$ 4,027,084**	$ 3,652,435	$ 3,445,430
Production and intermediate term	**1,993,049**	2,006,728	1,914,878
Agribusiness	**1,198,963**	919,991	598,236
Other	**872,478**	943,991	889,763
Nonaccrual loans	**60,861**	48,897	51,339
Total loans	**$ 8,152,435**	$ 7,572,042	$ 6,899,646

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

The increase in total loans from December 31, 2015 was primarily due to continued focus on capitalizing on growth opportunities in our real estate mortgage and agribusiness portfolios.

We offer variable, fixed, capped, indexed, and adjustable interest rate loan programs and variable and fixed interest rate lease programs to our clients. We determine interest margins charged on each lending program based on cost of funds, credit risk, market conditions, and the need to generate sufficient earnings.

As part of the AgriBank Asset Pool program, we have sold participation interests in real estate loans to AgriBank. The total participation interests in this program were $221.6 million, $256.6 million, and $74.0 million at December 31, 2016, 2015, and 2014, respectively.

Portfolio Distribution

We are chartered to serve certain counties in Minnesota and Wisconsin. At December 31, 2016, approximately 44.4% of our loan portfolio was within our territory in Minnesota, 6.6% was within our territory in Wisconsin, 2.7% was in Minnesota outside our territory, and 1.3% was in Wisconsin outside our territory. The remainder of our portfolio outside of Minnesota and Wisconsin helps support rural America and to diversify our portfolio risk.

Agricultural Concentrations

As of December 31	2016	2015	2014
Cash grains	**33.3%**	34.4%	37.3%
Agribusiness	**18.2%**	16.3%	14.3%
Swine	**11.0%**	10.0%	10.2%
Dairy	**9.0%**	8.7%	8.9%
Home mortgages	**7.3%**	7.8%	8.6%
Cattle	**4.5%**	5.1%	4.4%
Forest products	**4.5%**	4.3%	3.0%
Landlords	**3.0%**	3.1%	3.4%
Renewable energy	**2.7%**	2.8%	2.8%
Other	**6.5%**	7.5%	7.1%
Total	**100.0%**	100.0%	100.0%

Commodities are based on the borrower's primary intended commodity at the time of loan origination and may change due to borrower business decisions as a result of changes in weather, prices, input costs, and other circumstances.

Our production and intermediate term loan portfolio shows some seasonality. Borrowings increase throughout the planting and growing seasons to meet farmers' operating and capital needs. These loans are normally at their lowest levels following the harvest and then increase in the spring and throughout the rest of the year as clients fund operating needs. In addition, the loan portfolio increased temporarily in December, followed by significant repayments in January, as clients increased their operating lines to purchase 2017 production inputs, primarily as part of tax-planning strategies.

Portfolio Credit Quality

The credit quality of our portfolio declined from December 31, 2015. Adversely classified loans increased to 2.9% of the portfolio at December 31, 2016, from 1.8% of the portfolio at December 31, 2015. 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.

Most dairy producers experienced reduced margins during 2016 compared to break-even levels in 2015 due to stabilizing feed costs and lower milk prices. For the year, most operations will be at or below break-even depending upon marketing and production. Dairy margins have improved somewhat recently, and the outlook for 2017 is to be above break-even levels for most producers.

Pork production was similar to dairy in 2016 as profitability will hinge upon individual producer margin management. Weaker export markets pressured margins as persistent weak margins limited the positive impact of contracting and hedging for risk management. Volatility will continue to be the norm and margin management is key to ongoing viability. There have been recent opportunities for clients to lock in positive margins for 2017, and clients' margins should improve in 2017.

The volatility of corn and soybean prices creates an added risk for producers to manage, particularly for the protein sectors of our portfolio.

Crop producers have now experienced several years of strong production that is outstripping demand. Credit quality in this segment is less favorable than in 2015 as non-adverse declined from 98.1% to 96.0% in 2016. With generally favorable conditions for U.S. corn and soybean production again in 2016, prices remained low. As such, we expect grain producer incomes to be around break-even to moderate losses. Strong equity positions should be maintained, but we continue to expect to see tightening margins pose challenges for some producers during the next 12 to 24 months. Domestic stocks of corn and soybeans remain at high levels. Grain producers in Minnesota and Wisconsin generally experienced a strong production year in 2016.

Conditions the past two to three years have been favorable overall resulting in positive performance generally for agribusinesses. Ethanol assets are part of the agribusiness segment, and credit quality in this segment remained at sound levels as margins remained stable due to lower corn prices. Most ethanol producers were near break-even in 2016.

In addition, significant steps to manage risk in the portfolio have been taken through enhancement of risk management and continuing efforts to promote financial counseling.

In certain circumstances, government guarantee programs are used to reduce the risk of loss. At December 31, 2016, $203.5 million of our loans were, to some level, guaranteed under these government programs. In addition, at December 31, 2016, $474.4 million of our loans were to some level guaranteed through the Federal Agricultural Mortgage Corporation (Farmer Mac) Standby Commitment Program.

Excluded in the ratios and volumes as discussed in this section are our investment securities held-to-maturity. At December 31, 2016, these investment securities totaled $473.2 million, consisting of $431.6 million in mortgage-backed securities (MBS) issued by Farmer Mac or guaranteed by the Small Business Administration (SBA) or by the USDA, $34.8 million in asset-backed securities (ABS), issued and guaranteed by SBA or USDA, and $6.9 million in bonds, which are currently not guaranteed. Had this volume been included, the adversely classified asset ratio would be 2.7% at December 31, 2016, compared to 1.7% at December 31, 2015. Additional investment securities information is included in Notes 5 and 17 to the accompanying Consolidated Financial Statements.

Risk Assets

Components of Risk Assets

(dollars in thousands)

As of December 31	**2016**	2015	2014
Loans:			
Nonaccrual	**$ 60,861**	$ 48,897	$ 51,339
Accruing restructured	**24,417**	21,072	22,892
Accruing loans 90 days or more past due	**738**	124	304
Total risk loans	**86,016**	70,093	74,535
Other property owned	**840**	1,060	3,140
Total risk assets	**$ 86,856**	$ 71,153	$ 77,675
Total risk loans as a percentage of total loans	**1.0%**	0.9%	1.1%
Nonaccrual loans as a percentage of total loans	**0.7%**	0.6%	0.7%
Current nonaccrual loans as a percentage of total nonaccrual loans	**54.4%**	69.1%	72.4%
Total delinquencies as a percentage of total loans	**0.6%**	0.4%	0.5%

Note: Accruing loans include accrued interest receivable.

Our risk assets have increased from December 31, 2015, but remained at acceptable levels. Despite the increase in risk assets, total risk loans as a percentage of total loans were well within our established risk management guidelines.

The increase in nonaccrual loans was primarily due to the downgrading of certain accounts in our grain, dairy, and cattle portfolios; partially offset by the upgrading of a communications account. Nonaccrual loans remained at an acceptable level at December 31, 2016, 2015, and 2014.

The increase in accruing restructured loans was primarily the result of upgrading a nonaccrual communications account to accrual status; partially offset by refinancing the loans of a certain dairy account.

The increase in accruing loans 90 days or more past due was largely due to production and intermediate term loans in our grain and landlords portfolios. Our accounting policy requires accruing loans past due 90 days to be transferred into nonaccrual status unless adequately secured and in the process of collection. Based on our analysis, all accruing loans 90 days or more past due were eligible to remain in accruing status.

The increase in total delinquencies as a percentage of total loans was the result of financial stress in the grain industry. Delinquencies may continue to increase if lower grain prices persist.

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 the periodic evaluation of factors such as loan loss history, estimated probability of default, estimated loss severity, portfolio quality, stress testing, and current economic and environmental conditions.

Allowance Coverage Ratios

As of December 31	**2016**	2015	2014
Allowance as a percentage of:			
Loans	**0.4%**	0.4%	0.3%
Nonaccrual loans	**59.2%**	55.4%	46.1%
Total risk loans	**41.9%**	38.6%	31.7%
Net charge-offs as a percentage of average loans	**0.0%**	0.0%	0.0%
Adverse assets to risk funds	**20.6%**	11.8%	11.2%

The increase in allowance for loan losses from December 31, 2015, which resulted in additional provision for loan losses, was due to continued deterioration in our grain portfolio. In our opinion, the allowance for loan losses was reasonable in relation to the risk in our loan portfolio at December 31, 2016.

Additional loans held to maturity information is included in Notes 3, 14, 15, and 17 to the accompanying Consolidated Financial Statements.

LOANS HELD FOR SALE

We originate loans held for sale under our RuraLiving® program, a rural residential mortgage program, designed to provide qualified borrowers with additional options for competitive rate financing of rural homes in small towns or that are part of a hobby farm, pastureland, or tillable acreage. Loans closed under this program will be sold to and securitized by a third party investor. The volume in this program was $27.4 million, $35.4 million, and $7.9 million at December 31, 2016, 2015, and 2014, respectively. We typically purchase the resulting securities, a portion of which we actively market and sell within 30 days of purchase. Refer to the Investment Securities section for additional information regarding these transactions. Additional loans held for sale information is included in Notes 4 and 17 to the accompanying Consolidated Financial Statements.

INVESTMENT SECURITIES

In addition to loans and leases, we held investment securities. We had held-to-maturity investment securities of $473.2 million, $443.0 million, and $460.9 million at December 31, 2016, 2015, and 2014, respectively. Our investments primarily include MBS issued by Farmer Mac or guaranteed by SBA or USDA, ABS issued and guaranteed by SBA and USDA, and bonds.

We purchase MBS investments, a significant portion of which are the resulting securities from our RuraLiving® program. These investments may be held-to-maturity or available-for-sale and are included in “Investment securities” on the Consolidated Statements of Condition. Included within our held-to-maturity investment securities portfolio are Farmer Mac MBS of $329.8 million, $276.2 million, and $267.4 million as of December 31, 2016, 2015, and 2014, respectively. We sold available-for-sale investment securities with total sales proceeds of $102.8 million and $53.7 million during 2016 and 2015, respectively. These sales resulted in a gain of $659 thousand and $355 thousand during 2016 and 2015, respectively, which was recognized in “Fee and miscellaneous income, net” in the Consolidated Statements of Comprehensive Income. We had no outstanding available-for-sale investment securities at December 31, 2016 or 2015. Our investments available-for-sale totaled $21.0 million at December 31, 2014.

The investment portfolio is evaluated for other-than-temporary impairment. To date, we have not recognized any impairment on our investment portfolio.

Additional investment securities information is included in Notes 5 and 17 to the accompanying Consolidated Financial Statements.

OTHER INVESTMENT

We and other Farm Credit Institutions are among the limited partners for a $154.5 million Rural Business Investment Company (RBIC) established on October 3, 2014. The RBIC facilitates equity and debt investments in agriculture-related businesses that create growth and job opportunities in rural America. Our total commitment is $20.0 million through October 2019. Our investment in the RBIC totaled $7.5 million, $4.2 million, and $0.8 million at December 31, 2016, 2015, and 2014, respectively.

The investment was evaluated for impairment. No impairments were recognized on this investment during 2016, 2015, or 2014. During the year ended December 31, 2016, we received a distribution of $250 thousand as the RBIC sold an investment. The distribution was a return of contributed capital and, therefore, reduced our recorded investment. To date, no income has been distributed from the RBIC. We received no distributions during the years ended December 31, 2015 or 2014.

Additional other investment information is included in Notes 6 and 17 to the accompanying Consolidated Financial Statements.

RESULTS OF OPERATIONS

Profitability Information

(dollars in thousands)

For the year ended December 31	2016	2015	2014
Net income	$ 129,237	$ 123,902	$ 117,389
Return on average assets	1.5%	1.6%	1.6%
Return on average equity	10.1%	10.4%	10.7%

Changes in the chart above relate directly to:

- Changes in income discussed below
- Changes in assets discussed in the Loan Portfolio, Investment Securities, and Other Investment sections
- Changes in capital discussed in the Capital Adequacy section

Changes in Significant Components of Net Income

	For the year ended December 31			Increase (decrease) in net income	
(in thousands)	2016	2015	2014	2016 vs 2015	2015 vs 2014
Net interest income	$ 206,793	$ 197,568	$ 187,480	$ 9,225	$ 10,088
Provision for loan losses	10,082	5,939	1,084	(4,143)	(4,855)
Patronage income	27,519	18,146	21,684	9,373	(3,538)
Other income, net	45,113	41,169	35,778	3,944	5,391
Operating expenses	135,001	126,344	123,009	(8,657)	(3,335)
Provision for income taxes	5,105	698	3,460	(4,407)	2,762
Net income	$ 129,237	$ 123,902	$ 117,389	$ 5,335	$ 6,513

Net Interest Income

Changes in Net Interest Income

(in thousands)

For the year ended December 31	2016 vs 2015	2015 vs 2014
Changes in volume	$ 19,886	$ 17,264
Changes in interest rates	(11,140)	(8,725)
Changes in asset securitization	212	229
Changes in nonaccrual income and other	267	1,320
Net change	$ 9,225	$ 10,088

Net interest income included income on nonaccrual loans that totaled $7.1 million, $7.2 million, and $5.7 million in 2016, 2015, and 2014, respectively. Nonaccrual income is recognized when received in cash, collection of the recorded investment is fully expected, and prior charge-offs have been recovered.

Net interest margin (net interest income as a percentage of average earning assets) was 2.5%, 2.7%, and 2.7% in 2016, 2015, and 2014, respectively. The drop in 2016 was due to rising rates, an increase in the cost of funds from AgriBank as they implemented a new pricing framework, and mix change in our business. The increase in cost of funds from the additional margin required by the new AgriBank pricing framework was returned back to us in the form of patronage. We expect margins to further compress due to this increase in cost of funds and may also be impacted if interest rates continue to rise, competition increases, and growth in our correspondent lending programs continues. We expect our loan and lease products to remain competitive in the market place in 2017.

Provision for Loan Losses

The fluctuation in the provision for loan losses was related to deterioration of loans in our grain portfolio and our estimate of losses in our portfolio for the applicable years. Additional discussion is included in Note 3 to the accompanying Consolidated Financial Statements.

Patronage Income

We received patronage income based on the average balance of our note payable to AgriBank. The patronage rates were 25.6 basis points, 26.0 basis points, and 33.5 basis points in 2016, 2015, and 2014, respectively. We recorded patronage income of $18.2 million, $16.6 million, and $19.7 million in 2016, 2015, and 2014, respectively.

Since 2008, we have participated in the AgriBank Asset Pool program in which we sell participation interests in certain real estate loans to AgriBank. As part of this program, we received patronage income in an amount that approximated the net earnings of the loans. Net earnings represents the net interest income associated with these loans adjusted for certain fees and costs specific to the related loans as well as adjustments deemed appropriate by AgriBank related to the credit performance of the loans, as applicable. In addition, we received patronage income in an amount that approximated the wholesale patronage had we retained the volume. We recorded asset pool patronage income of $5.7 million, $1.6 million, and $1.9 million in 2016, 2015, and 2014, respectively.

Beginning in 2016, we also received patronage of $3.6 million related to the increase in the wholesale spread on our note payable from the additional margin required by the new AgriBank pricing framework.

Patronage distributions for the programs discussed above are declared solely at the discretion of AgriBank's Board of Directors.

Other Income, Net

The change in other income, net was primarily due to an increase in fee and miscellaneous income, net, partially offset by a decrease in financially related services income.

Fee and miscellaneous income, net increased primarily due to origination and prepayment fees, net fair value gains on loans held for sale, and net gain on sales of investments. We originated rural home loans for resale in the secondary market. We sold loans in the secondary market totaling $58.0 million, $57.9 million, and $37.2 million in 2016, 2015, and 2014, respectively. The fee income from this activity totaled $1.4 million, $1.3 million, and $0.8 million in 2016, 2015, and 2014, respectively. These amounts are included in "Fee and miscellaneous income, net" in the accompanying Consolidated Statements of Comprehensive Income.

Financially related services income decreased largely due to a reduction in commissions earned on hail and multi-peril crop insurance.

Operating Expenses

The following presents a comparison of operating expenses by major category and the net pre-tax operating rate (total on-going expenses less financially related services income and fees earned, divided by average earning assets).

Components of Operating Expenses

(dollars in thousands)

For the year ended December 31	**2016**	2015	2014
Salaries and employee benefits	**$ 90,022**	$ 87,157	$ 83,776
Purchased and vendor services	**5,822**	5,477	5,688
Communications	**1,271**	1,297	1,381
Occupancy and equipment	**13,173**	11,781	11,282
Advertising and promotion	**6,318**	6,179	6,375
Examination	**1,911**	1,612	1,523
Farm Credit System insurance	**12,241**	8,408	7,158
Other	**4,243**	4,433	5,826
Total operating expenses	**$ 135,001**	$ 126,344	$ 123,009
Net pre-tax operating rate	**0.9%**	1.0%	1.1%

Salaries and employee benefits expense increased primarily related to normal salary and benefit increases, an increase in variable compensation expense resulting from favorable business results, and higher pension related expenses. We expect pension expense to decrease in 2017 primarily driven by a plan amendment during 2016 and increased return on assets as a result of increased funding, partially offset by decreases in discount rate and expected return on plan assets assumptions.

Occupancy and equipment expense increased due to higher computer software licenses, support, and maintenance as well as an increase in the threshold for capitalizing fixed assets.

We have been notified by our regulator, the FCA, that our examination fees are expected to substantially increase in 2017.

FCSIC insurance expense increased in 2016 primarily due to an increase in the premium rate charged by FCSIC on accrual loans from 13 basis points in 2015 to 16 basis points for the first half and 18 basis points for the second half of 2016. The FCSIC has announced premiums will decrease to 15 basis points for 2017. The FCSIC Board meets periodically throughout the year to review premium rates and has the ability to change these rates at any time.

Provision for Income Taxes

The variance in provision for income taxes was related to our estimate of taxes based on taxable income. Patronage distributions reduced our tax liability in 2016, 2015, and 2014. Additional discussion is included in Note 12 to the accompanying Consolidated Financial Statements.

FUNDING AND LIQUIDITY

We borrow from AgriBank, under a note payable, in the form of a line of credit, as described in Note 9 to the accompanying Consolidated Financial Statements. This line of credit is our primary source of liquidity and is used to fund operations and meet current obligations. At December 31, 2016, we had $876.2 million available under our line of credit. We generally apply excess cash to this line of credit.

Note Payable Information

(dollars in thousands) For the year ended December 31	**2016**	2015	2014
Average balance	**$ 7,114,270**	$ 6,368,928	$ 5,890,395
Average interest rate	**1.7%**	1.6%	1.6%

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.

On May 30, 2013, we issued $100 million of Series A-1 non-cumulative perpetual preferred stock. We used the net proceeds from the Series A-1 preferred stock issuance to increase our regulatory capital pursuant to FCA Regulations in effect at December 31, 2016, for the continued development of our business, and for general corporate purposes. For regulatory capital purposes, our Series A-1 preferred stock is included in permanent capital, total surplus, and core surplus, subject to certain limitations. Dividends on Series A-1 preferred stock, if declared by the Board of Directors in its sole discretion, are non-cumulative and are payable quarterly. This issuance of Series A-1 preferred stock is discussed further in Note 11 to the accompanying Consolidated Financial Statements.

In March 2010, we issued $100 million of aggregate principal amount of Series A Subordinated Notes (Notes) due in 2025. The Notes bear a fixed interest rate of 9.0% per annum, payable semi-annually. Our Board of Directors has authorized up to a maximum of $200.0 million for subordinated debt issuance. The Notes are unsecured and subordinate to all other categories of creditors, including general creditors, and senior to all classes of shareholders. At our option, we may redeem all or some of the Notes on any interest payment date on or after a date 10 years from the closing date. On December 15, 2016, we redeemed all $100 million of outstanding subordinated notes at par value, which were redeemable on any interest payment date at any time following FCA notification of certain changes to our regulatory capital requirements.

We have entered into a Standby Commitment to Purchase Agreement with Farmer Mac, a System institution, to help manage credit risk. If a loan covered by the agreement goes into default, subject to certain conditions, we have the right to sell the loan to Farmer Mac. This agreement remains in place until the loan is paid in full. We had $474.4 million, $470.2 million, and $469.7 million of our loans in this program at December 31, 2016, 2015, and 2014, respectively. We paid Farmer Mac commitment fees totaling $2.1 million, $2.0 million, and $2.0 million in 2016, 2015, and 2014, respectively. These amounts are included in “Other operating expenses” in the Consolidated Statements of Comprehensive Income. There were no sales of loans to Farmer Mac under this agreement in 2016, 2015, or 2014.

CAPITAL ADEQUACY

Total equity increased $88.3 million from December 31, 2015, primarily due to net income for the year partially offset by patronage distribution accruals and preferred stock dividends.

Equity Position Information

(dollars in thousands) As of December 31	**2016**	2015	2014	Regulatory Minimums
Equity	**$ 1,315,468**	$ 1,227,134	$ 1,138,178	
Surplus as a percentage of equity	**91.2%**	90.5%	89.8%	
Permanent capital ratio	**14.1%**	14.8%	15.7%	7.0%
Total surplus ratio	**14.0%**	14.5%	15.4%	7.0%
Core surplus ratio	**12.1%**	12.3%	12.9%	3.5%

Our capital plan is designed to maintain an adequate amount of surplus and allowance for loan losses which represents our reserve for adversity prior to impairment of stock. We manage our capital to allow us to meet stockholder needs and protect stockholder interests, both now and in the future.

Refer to the Funding and Liquidity section for further discussion related to our non-cumulative perpetual preferred stock and subordinated notes. Additional information is included in Notes 10 and 11 to the accompanying Consolidated Financial Statements.

Additional discussion of these regulatory ratios, along with discussion of new regulations and capital requirements which became effective January 1, 2017 are included in the Regulatory Matters section and in Note 11 to the accompanying Consolidated Financial Statements.

In addition to these regulatory requirements, we establish an optimum total capital target. This target allows us to maintain a capital base adequate for future growth and investment in new products and services. The target is subject to revision as circumstances change. As of December 31, 2016, our optimum total capital target was 13.0%, as defined in our 2017 capital plan. We anticipate that we will exceed all regulatory requirements, including the capital conservation buffer. Further, we expect we will be within a reasonable range of our optimum target for capital adequacy.

We have a nonqualified patronage program that targets payment to borrowers within 7-10 years after the year of declaration, subject to Board approval. The Board of Directors authorized the retirement of the remainder of the nonqualified patronage allocations of $35.0 million, $28.2 million, and $28.9 million in 2016, 2015, and 2014, respectively. In addition, the Board of Directors authorized the payment of $1.3 million, $868 thousand, and $609 thousand of dividends on approved transactions in 2016, 2015, and 2014, respectively. The timing and amounts of all future patronage redemptions and dividend payments remains at the discretion of the Board of Directors based on a combination of factors including the risk in our portfolio, earnings, and our current capital position. Further information regarding our patronage distributions is included in Notes 11 and 12 to the accompanying Consolidated Financial Statements.

The changes in our capital ratios reflect changes in capital and assets. Refer to the Loan Portfolio, Investment Securities, and Other Investment sections for further discussion of the changes in assets. Additional equity information is included in Note 11 to the accompanying Consolidated Financial Statements.

ACCUMULATED OTHER COMPREHENSIVE INCOME

Our investment portfolio includes available-for-sale securities that are carried at fair value. Unrealized gains and losses on the available-for-sale investment securities that are not other-than-temporarily impaired are reported as a separate component of equity. During 2014, the change in net unrealized gains on all investment securities totaled $82 thousand of other comprehensive income, reflecting unrealized gains from changes in interest rates. During 2016 and 2015, these unrealized gains were reclassified to income due to the sale of securities.

RELATIONSHIP WITH AGRIBANK

Borrowing

We borrow from AgriBank to fund our lending operations in accordance with the Farm Credit Act. Approval from AgriBank is required for us to borrow elsewhere. A General Financing Agreement (GFA), as discussed in Note 9 to the accompanying Consolidated Financial Statements, governs this lending relationship.

The components of cost of funds under the GFA 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

In the periods presented, we were not subject to the risk premium component. Certain factors may impact our cost of funds, which primarily includes market interest rate changes impacting marginal cost of debt as well as changes to pricing methodologies impacting the spread components described above.

The marginal cost of debt approach simulates matching the cost of underlying debt with similar terms as the anticipated terms of our loans to borrowers. This approach substantially protects us from market interest rate risk. We may occasionally engage in funding strategies that result in limited interest rate risk with approval by AgriBank's Asset Liability Committee.

Investment

We are required to invest in AgriBank capital stock as a condition of borrowing. This investment may be in the form of purchased stock or stock representing distributed AgriBank surplus. As of December 31, 2016, we were required by AgriBank to maintain an investment equal to 2.25% of the average quarterly balance of our note payable to AgriBank plus an additional 1.0% on growth that exceeded a targeted rate. AgriBank's current bylaws allow AgriBank to increase the required investment to 4.0%. In December 2016, AgriBank's Board approved the 2017 capital plan, which amended the required stock investments for affiliated Associations, effective January 1, 2017. The new required investment will be the lesser of 4.0% or a multiple component calculation based on a percentage of our average quarterly balance of our note payable to AgriBank with a higher percentage on balances above a sustainable growth rate and includes a component for additional investments under the asset pool program. The 2017 component requirements are currently 2.25% on average note payable, with an additional 4.5% on growth in excess of a 5.5% sustainable growth rate and an 8.0% investment under the asset pool program.

As of December 31, 2016, we are required by AgriBank to maintain and investment equal to 8.0% of the quarter end balance of the participation interests in real estate loans sold to AgriBank under the AgriBank Asset Pool program.

At December 31, 2016, $111.3 million of our investment in AgriBank consisted of stock representing distributed AgriBank surplus and $69.5 million consisted of purchased investment. For the periods presented in this report, we have received no dividend income on this stock investment and we do not anticipate any in future years.

As an AgDirect, LLP partnering association, we are required to purchase stock in AgDirect, which purchases an equivalent amount of stock in AgriBank. Specifically, the AgDirect trade credit financing program is required to own stock in AgriBank in the amount of 6.0% of the AgDirect program's outstanding participation loan balance at quarter end plus 6.0% of the expected balance to be originated during the following quarter.

Patronage

We receive different types of discretionary patronage from AgriBank, which is paid in cash. AgriBank's Board of Directors sets the level of:

- Patronage on our note payable with AgriBank
- Patronage based on the balance and net earnings of loans in the AgriBank Asset Pool program

Purchased Services

We purchase various services from AgriBank including certain financial and retail systems, financial reporting services, tax reporting services, technology services, insurance services, and internal audit services.

The total cost of services we purchased from AgriBank was $2.2 million, $1.9 million, and $1.9 million in 2016, 2015, and 2014, respectively. Costs of services purchased from AgriBank are partially dependent on the number of clients, if the number of clients decreases, the cost of services may increase.

Impact on Stockholders' Investment

Due to the nature of our financial relationship with AgriBank, the financial condition and results of operations of AgriBank materially impact our stockholders' investment.

OTHER RELATIONSHIPS AND PROGRAMS

Relationships with Other Farm Credit Institutions

ProPartners Financial: We participate in ProPartners Financial (ProPartners) alliance with certain other associations in the Farm Credit System to provide producer financing through agribusinesses that sell crop inputs. ProPartners is directed by representatives from participating associations. The income, expense, and credit risks are allocated based on each association's participation interest of the ProPartners volume. Each association's allocation is established based on mutual agreement of the owners. We had $158.2 million, $163.3 million, and $149.6 million of ProPartners volume at December 31, 2016, 2015, and 2014, respectively. We also had $195.5 million of available commitment on ProPartners loans at December 31, 2016.

As the facilitating association for ProPartners, we provide, and are compensated for, various support functions. This includes human resources, accounting, payroll, reporting, and other finance functions. We also serve as the primary originating association for ProPartners participations and sales.

Federal Agricultural Mortgage Corporation: We have a financial relationship with Farmer Mac to provide a standby commitment program for the repayment of principal and interest on certain loans. Refer to the Funding and Liquidity section for further discussion.

We also purchase mortgage-backed security investments from Farmer Mac. Refer to the Investment Securities section for further discussion.

Additionally, we are an approved mortgage loan central servicer for Farmer Mac. Total loan volume being serviced was $381.2 million, $244.3 million, and $177.2 million as of December 31, 2016, 2015, and 2014, respectively. Income from this servicing was $436 thousand, $383 thousand, and $370 thousand for the years ended December 31, 2016, 2015, and 2014, respectively.

CoBank, ACB: We have a relationship with CoBank, ACB (CoBank), a System bank, which involves purchasing and selling participation interests in loans. CoBank provides direct loan funds to associations in its chartered territory and makes loans to cooperatives and other eligible borrowers. CoBank also provides certain cash management services to some of our clients. To support these cash management services, we have a cash management agreement with CoBank that includes a $9.25 million back-up cash management settlement facility. As part of this relationship, our equity investment in CoBank was $985 thousand, $919 thousand, and $796 thousand at December 31, 2016, 2015, and 2014, respectively.

Farm Credit Foundations: We have a relationship with Farm Credit Foundations (Foundations) which involves purchasing human resource information systems, and benefit, payroll, and workforce management services. As of December 31, 2016, 2015, and 2014, our investment in Foundations was $83 thousand. The total cost of services we purchased from Foundations was $486 thousand, $422 thousand, and $391 thousand in 2016, 2015, and 2014, respectively.

Rural Business Investment Company: We and other Farm Credit Institutions are among the limited partners for a $154.5 million RBIC established on October 3, 2014. Refer to the Other Investment section for further discussion.

Unincorporated Business Entities (UBEs)

In certain circumstances we may establish separate entities to acquire and manage complex collateral, primarily for legal liability purposes.

4 Rivers, LLP: We participated with certain other AgriBank District associations in 4 Rivers, LLP (4 Rivers), which functioned as a negotiating and administrative arm for crop insurance. 4 Rivers negotiated commission and profit share terms with the Approved Insurance Providers (AIP). The value proposition was 4 Rivers covered a larger geographical area, had more premium volume and offered the AIP potential for a more stable and profitable return. Each participating association continues to conduct crop insurance business independently within its chartered territory, whereas 4 Rivers was utilized for negotiating contract terms and facilitating the pooling of crop insurance business in a manner which optimized the value received by the participating associations. As a part of this relationship, our investment in 4 Rivers, LLP was $13 thousand at December 31, 2015 and 2014. The participating associations voted to dissolve 4 Rivers, LLP in December 2016.

Rural Funding, LLC: We have a limited liability company established for the purpose of facilitating bond transactions with other financial institutions called Rural Funding, LLC. We do not receive any management fees from the limited liability company.

AgDirect, LLP: We participate in the AgDirect trade credit financing program, which includes origination and refinancing of agriculture equipment loans through independent equipment dealers. The program is facilitated by another AgriBank District association through a limited liability partnership in which we are a partial owner. Our investment in AgDirect, LLP, was $3.8 million and $1.9 million at December 31, 2016 and 2015, respectively. We had no investment at December 31, 2014.

Programs

We are involved in a number of programs designed to improve our credit delivery, related services, and marketplace presence.

AgStar Fund for Rural America: Created in 2001, the AgStar Fund for Rural America (Fund) helps create stability and strength by investing in quality of life programs that enhance life in agriculture and rural America for rural residents and their communities. In 2016, the Fund awarded $979 thousand through scholarships, grants, and sponsorships to support ag-related programs. The Fund is managed by an internal committee.

Highlights of the 2016 Fund activities include:

- $88 thousand in grants to support local organizations that benefit agriculture and rural residents, supporting education, the environment, technology, and quality of life.
- $150 thousand to the Emergency Response Departments providing rural communities with response equipment, technology, and turnout gear.
- $51 thousand to high school agriculture classrooms, funding the technology and equipment needs in agricultural education.

RuraLiving®: RuraLiving is a rural residential mortgage program designed to provide qualified borrowers with additional options for competitive rate financing of rural homes in small towns or that are part of a hobby farm, pastureland, or tillable acreage. Loans closed under this program will be sold to and securitized by a third party investor.

Equipment Financing: We have entered into agreements with certain dealer networks to provide alternative service delivery channels to clients. These trade credit opportunities create more flexible and accessible financing options to clients through dealer point-of-purchase financing programs.

We also participate in the AgDirect trade credit financing program. Refer to the UBE section for further discussion on this program.

Farm Cash Management: We offer Farm Cash Management to our clients. Farm Cash Management links clients' revolving lines of credit with an AgriBank investment bond to optimize clients' use of funds.

FCC Services: We have an agreement with FCC Services to provide various risk and insurance management, vehicle purchases, and training services. Additionally, we have a strategic support agreement with FCC Services to enable FCC Services to provide reinsurance to crop insurance companies that includes a loss/gain sharing agreement. Included in "Other assets" in the Consolidated Statements of Condition is $4.9 million, net, to help support our total relationship. In net, we paid $1.3 million, $1.3 million, and $3.1 million in 2016, 2015, and 2014, respectively, to FCC Services for insurances, memberships, training, and losses under the loss/gain sharing agreement.

Mission Related Investments: The public mission of the System has always been to provide financing to agriculture and rural areas. Our primary focus has always been and will remain financing production agriculture. Because of the changing needs of rural America, we have placed additional emphasis on investing in rural communities and businesses by creating the Rural Capital Network. We had outstanding bonds of $122.3 million, $192.6 million, and $168.8 million at December 31, 2016, 2015, and 2014, respectively. This business unit makes investments in rural America through the purchase of bonds, focusing on rural businesses, health care, and housing facilities.

We continue to have minority investments in a few small-scale local economic development corporations and have outstanding investments $44 thousand, $72 thousand, and $75 thousand in local economic development corporations at December 31, 2016, 2015, and 2014, respectively.

Patronage: Since 1998, our Board of Directors has allocated $643.4 million of nonqualified patronage dividends to our member stockholders. Our nonqualified patronage allocation is based on a Board of Directors resolution requiring an allocation of annual net patronage-eligible earnings. For 2016, this amounted to $67.1 million, spread between our member stockholders. Allocated patronage equities have no voting rights and are redeemed at the sole discretion of the Board of Directors.

Fleet Management: We offer fleet management services to small and mid-sized agribusinesses. Depending on the program selected, services range from customized vehicle ordering, combined with lease financing, to full service program options of providing fuel cards, maintenance management, 24/7 emergency roadside assistance, license renewal services, fleet reporting, and vehicle disposal service. Additionally, we make available customized vehicle ordering and leasing options to Farm Credit Institutions. At the end of 2016, we have ordered vehicles for 27 System entities. We have manufacturer's fleet codes for the following brands: Ford, General Motors, Chrysler, Toyota, Nissan, Mazda, Volvo, and Subaru.

Business Units

Agri-Access®: We have entered into agreements with certain financial institutions to provide correspondent lending programs under the trade name Agri-Access, which operates as a unit of AgStar Financial Services, ACA. Agri-Access focuses primarily on purchasing participations in agricultural real estate loans and leases. Agri-Access also services loan portfolios for other institutional investors. These financial services firms are dispersed throughout the United States. The main Agri-Access contact office is located in Des Moines, Iowa. We also have a contact office in Meridian, Idaho. Further information can be obtained at www.agri-access.com.

Client Solutions Team: We provide operating, term, and real estate loans, leases, crop insurance, life insurance, and consulting services to nearly 13,900 core market clients and producers who are typically in the grain, dairy, and swine industries. This structure enables our team to collaborate with other professionals with specialized knowledge, depending on the client's specific goals and unique needs.

Our industry specialists possess broad, extensive knowledge and experience in their areas of expertise, providing financing to commercial producers, agribusinesses, and processors, primarily focused in swine, dairy, and bio-energy.

Our home mortgage services team provides home financing options for rural residents living in the country or in communities with populations of 2,500 or less. The focal points of this segment are mortgages to buy, build, or refinance residences or acreages. Title insurance, appraisal services, and home equity loans are also offered.

Our consulting team provides business management and professional services such as financial reporting and management, project and business analysis, and family transition consulting. Services are provided across all commodities with particular expertise in the dairy, swine, and cash grain industry segments.

Capital Markets: The Capital Markets team focuses on relationships with commercial banks, Farm Credit Institutions, and other lending partners to buy loan participations and partner in syndicated loan transactions. This specialized team provides a national marketing vehicle to gain improved access to the agribusiness and commercial producer loan market, and provides portfolio diversity, earnings, and market intelligence to the organization.

Rural Capital Network: The Rural Capital Network team is devoted to supporting community and economic development, infrastructure needs, revitalization projects, and emerging agribusinesses in rural America. Rural Capital Network invests in projects through the purchase of bonds issued by local communities, organizations, or businesses, focusing on investing in critical access hospitals, assisted-living facilities, rural rental multi-family housing, business expansions, and other similar enterprises. In December 2014, an alliance was formed with CoBank to fund rural facilities across the United States. This alliance will help promote jobs, economic benefits and enhance the quality of life in rural communities. This alliance will partner with other Farm Credit Institutions and local community banks to provide attractive and reliable short and long term financing options to fully fund projects of significant size.

REGULATORY MATTERS

Regulatory Capital Requirements

Effective January 1, 2017, the regulatory capital requirements for System banks and associations were modified. The stated objectives of the revised requirements are to:

- Modernize capital requirements while ensuring that institutions continue to hold sufficient regulatory capital to fulfill their mission as a government-sponsored enterprise
- Ensure that the System's capital requirements are comparable to the Basel III framework and the standardized approach that the federal banking regulatory agencies have adopted, but also to ensure that the rules recognize the cooperative structure and the organization of the System
- Make System regulatory capital requirements more transparent
- Meet the requirements of section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act

The final rule replaced existing core surplus and total surplus ratios with common equity tier 1, tier 1 capital, and total capital risk-based capital ratios. The final rule also added a tier 1 leverage ratio and an unallocated retained earnings equivalents leverage ratio. The permanent capital ratio continues to remain in effect with the final rule. Refer to Note 11 to the accompanying Consolidated Financial Statements for additional information regarding these ratios.

The final rule to modify regulatory capital requirements qualifies as a regulatory event under the terms of our subordinated note purchase agreement which allows for the redemption of the outstanding subordinated notes in whole at par on any interest payment date. On December 15, 2016, we redeemed all $100 million of outstanding subordinated notes at par value.

Investment Securities Eligibility

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

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

The public comment period ended on October 23, 2014. The FCA has not issued any further information regarding this proposed rule.

REPORT OF MANAGEMENT

We prepare the Consolidated Financial Statements of AgStar Financial Services, ACA (the Association) and are responsible for their integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The Consolidated Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States of America. The Consolidated Financial Statements, in our opinion, fairly present the financial condition of the Association. Other financial information included in the Annual Report is consistent with that in the Consolidated Financial Statements.

To meet our responsibility for reliable financial information, we depend on accounting and internal control systems designed to provide reasonable, but not absolute assurance that assets are safeguarded and transactions are properly authorized and recorded. Costs must be reasonable in relation to the benefits derived when designing accounting and internal control systems. Financial operations audits are performed to monitor compliance. PricewaterhouseCoopers LLP, our independent auditors, audit the Consolidated Financial Statements. They also conduct a review of internal controls to the extent necessary to comply with auditing standards generally accepted in the United States of America. The Farm Credit Administration also performs examinations for safety and soundness as well as compliance with applicable laws and regulations.

The Board of Directors has overall responsibility for our system of internal control and financial reporting. The Board of Directors and its Audit Committee consults regularly with us and meets periodically with the independent auditors and other auditors to review the scope and results of their work. The independent auditors have direct access to the Board of Directors, which is composed solely of directors who are not officers or employees of the Association.

The undersigned certify we have reviewed the Association's Annual Report, which has been prepared 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.

Kaye Compart
Chairperson of the Board
AgStar Financial Services, ACA

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

Jase L. Wagner
Senior Vice President and Chief Financial Officer
AgStar Financial Services, ACA

March 9, 2017

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The AgStar Financial Services, ACA (the 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 2013 framework in Internal Control — Integrated Framework, 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.

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

Jase L. Wagner
Senior Vice President and Chief Financial Officer
AgStar Financial Services, ACA

March 9, 2017

REPORT OF AUDIT COMMITTEE

AgStar
Financial Services, ACA

The Consolidated Financial Statements were prepared under the oversight of the Audit Committee. The Audit Committee is composed of a subset of the Board of Directors of AgStar Financial Services, ACA (the Association). The Audit Committee oversees the scope of the Association's internal audit program, the approval, and independence of PricewaterhouseCoopers LLP (PwC) as independent auditors, the adequacy of the Association's system of internal controls and procedures, and the adequacy of management's actions with respect to recommendations arising from those auditing activities. The Audit Committee's responsibilities are described more fully in the Internal Control Policy and the Audit Committee Charter.

Management is responsible for 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 Consolidated Financial Statements in accordance with auditing standards generally accepted in the United States of America and to issue their report based on their audit. The Audit Committee's responsibilities include monitoring and overseeing these processes.

In this context, the Audit Committee reviewed and discussed the audited Consolidated Financial Statements for the year ended December 31, 2016, with management. The Audit Committee also reviewed with PwC the matters required to be discussed by Statement on Auditing Standards AU-C 260, *The Auditor's Communication with Those Charged with Governance*, and both PwC and the internal auditors directly provided reports on any significant matters to the Audit Committee.

The Audit Committee had discussions with and received written disclosures from PwC confirming its independence. The Audit Committee also reviewed the non-audit services provided by PwC, if any, and concluded these services were not incompatible with maintaining PwC's independence. The Audit Committee discussed with management and PwC any other matters and received any assurances from them as the Audit Committee deemed appropriate.

Based on the foregoing review and discussions, and relying thereon, the Audit Committee recommended that the Board of Directors include the audited Consolidated Financial Statements in the Annual Report for the year ended December 31, 2016.

Wesley Beck
Chairperson of the Audit Committee
AgStar Financial Services, ACA

Terry Ebeling
Joyce Fernando
Larry Fischer
Kevin Koppendrayer

March 9, 2017

pwc

Report of Independent Auditors

To the Board of Directors of AgStar Financial Services, ACA,

We have audited the accompanying Consolidated Financial Statements of AgStar Financial Services, ACA (the Association) 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, changes in equity and 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 Association'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 Association'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 AgStar Financial Services, ACA and its subsidiaries as of December 31, 2016, 2015 and 2014, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

March 9, 2017

PricewaterhouseCoopers LLP, 45 South Seventh Street, Suite 3400, Minneapolis, MN 55402
T: (612) 596 6000, www.pwc.com/us

CONSOLIDATED STATEMENTS OF CONDITION

AgStar Financial Services, ACA

(in thousands)

As of December 31	2016	2015	2014
ASSETS			
Loans held to maturity	**$ 8,152,435**	$ 7,572,042	$ 6,899,646
Allowance for loan losses	**36,018**	27,071	23,655
Net loans held to maturity	**8,116,417**	7,544,971	6,875,991
Loans held for sale	**27,370**	35,380	7,899
Net loans	**8,143,787**	7,580,351	6,883,890
Unrestricted cash	**2,200**	1,900	--
Investment securities (including $0, $0, and $20,997 at fair value)	**473,248**	442,972	481,936
Assets held for lease, net	**36,598**	38,396	41,566
Accrued interest receivable	**64,904**	58,734	54,899
Investment in AgriBank, FCB	**180,812**	171,395	142,098
Premises and equipment, net	**17,633**	18,072	17,388
Other property owned	**840**	1,060	3,140
Other assets	**60,645**	48,830	47,323
Total assets	**$ 8,980,667**	$ 8,361,710	$ 7,672,240
LIABILITIES			
Note payable to AgriBank, FCB	**$ 7,590,254**	$ 6,949,764	$ 6,340,682
Subordinated debt	**--**	99,491	99,369
Accrued interest payable	**31,954**	26,805	24,367
Deferred tax liabilities, net	**125**	3,614	6,730
Other liabilities	**42,866**	54,902	62,914
Total liabilities	**7,665,199**	7,134,576	6,534,062
Contingencies and commitments (Note 15)			
EQUITY			
Preferred stock	**100,000**	100,000	100,000
Capital stock and participation certificates	**15,934**	16,085	16,177
Allocated surplus	**441,122**	406,758	371,004
Unallocated surplus	**758,412**	704,291	650,915
Accumulated other comprehensive income	**--**	--	82
Total equity	**1,315,468**	1,227,134	1,138,178
Total liabilities and equity	**$ 8,980,667**	$ 8,361,710	$ 7,672,240

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

AgStar Financial Services, ACA

(in thousands)

For the year ended December 31		2016		2015		2014
Interest income	**$**	**338,266**	$	306,898	$	288,597
Interest expense		**131,473**		109,330		101,117
Net interest income		**206,793**		197,568		187,480
Provision for loan losses		**10,082**		5,939		1,084
Net interest income after provision for loan losses		**196,711**		191,629		186,396
Other income						
Patronage income		**27,519**		18,146		21,684
Net operating lease income		**1,352**		1,760		1,646
Financially related services income		**18,742**		19,746		17,721
Fee and miscellaneous income, net		**25,019**		19,663		16,411
Total other income		**72,632**		59,315		57,462
Operating expenses						
Salaries and employee benefits		**90,022**		87,157		83,776
Farm Credit System insurance		**12,241**		8,408		7,158
Other operating expenses		**32,738**		30,779		32,075
Total operating expenses		**135,001**		126,344		123,009
Income before income taxes		**134,342**		124,600		120,849
Provision for income taxes		**5,105**		698		3,460
Net income	**$**	**129,237**	$	123,902	$	117,389
Other comprehensive income						
Investment securities available for sale:						
Not-other-than-temporarily-impaired investments	**$**	**--**	$	(82)	$	82
Total other comprehensive income	**$**	**--**	$	(82)	$	82
Comprehensive income	**$**	**129,237**	$	123,820	$	117,471

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

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

AgStar Financial Services, ACA

(in thousands)

	Preferred Stock	Capital Stock and Participation Certificates	Allocated Surplus	Unallocated Surplus	Accumulated Other Comprehensive Income	Total Equity
Balance as of December 31, 2013	$ 100,000	$ 15,912	$ 339,360	$ 600,888	$ --	$ 1,056,160
Net income	--	--	--	117,389	--	117,389
Other comprehensive income	--	--	--	--	82	82
Net surplus allocated under nonqualified patronage program	--	--	60,004	(60,004)	--	--
Redemption of prior year allocated patronage	--	--	(28,360)	--	--	(28,360)
Preferred stock dividend	--	--	--	(6,749)	--	(6,749)
Other distribution	--	--	--	(609)	--	(609)
Capital stock and participation certificates issued	--	1,522	--	--	--	1,522
Capital stock and participation certificates retired	--	(1,257)	--	--	--	(1,257)
Balance as of December 31, 2014	100,000	16,177	371,004	650,915	82	1,138,178
Net income	--	--	--	123,902	--	123,902
Other comprehensive income	--	--	--	--	(82)	(82)
Net surplus allocated under nonqualified patronage program	--	--	62,908	(62,908)	--	--
Redemption of prior year allocated patronage	--	--	(27,154)	--	--	(27,154)
Preferred stock dividend	--	--	--	(6,750)	--	(6,750)
Other distribution	--	--	--	(868)	--	(868)
Capital stock and participation certificates issued	--	1,337	--	--	--	1,337
Capital stock and participation certificates retired	--	(1,429)	--	--	--	(1,429)
Balance as of December 31, 2015	100,000	16,085	406,758	704,291	--	1,227,134
Net income	**--**	**--**	**--**	**129,237**	**--**	**129,237**
Net surplus allocated under nonqualified patronage program	**--**	**--**	**67,070**	**(67,070)**	**--**	**--**
Redemption of prior year allocated patronage	**--**	**--**	**(32,706)**	**--**	**--**	**(32,706)**
Preferred stock dividend	**--**	**--**	**--**	**(6,750)**	**--**	**(6,750)**
Other distribution	**--**	**--**	**--**	**(1,296)**	**--**	**(1,296)**
Capital stock and participation certificates issued	**--**	**1,357**	**--**	**--**	**--**	**1,357**
Capital stock and participation certificates retired	**--**	**(1,508)**	**--**	**--**	**--**	**(1,508)**
Balance as of December 31, 2016	**$ 100,000**	**$ 15,934**	**$ 441,122**	**$ 758,412**	**$ --**	**$ 1,315,468**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

AgStar Financial Services, ACA

(in thousands)

For the year ended December 31	2016	2015	2014
Cash flows from operating activities			
Net income	**$ 129,237**	$ 123,902	$ 117,389
Depreciation on premises and equipment	**4,377**	4,245	4,358
Gain on sale of premises and equipment, net	**(391)**	(537)	(607)
Depreciation on assets held for lease	**8,983**	9,127	8,882
Loss (gain) on disposal of assets held for lease, net	**28**	(153)	(59)
Decrease (increase) in loans held for sale	**8,010**	(27,481)	(3,429)
Amortization of premiums on loans and investment securities	**2,217**	2,862	2,215
Amortization of debt issuance costs	**509**	122	122
Provision for loan losses	**10,082**	5,939	1,084
Stock patronage received from Farm Credit Institutions	**(66)**	(123)	(4,258)
Gain on other property owned, net	**(255)**	(484)	(567)
Loss on derivative activities	**226**	709	558
Gain on sale of investments	**(659)**	(355)	--
Changes in operating assets and liabilities:			
Increase in accrued interest receivable	**(6,626)**	(4,268)	(6,386)
(Increase) decrease in other assets	**(9,846)**	485	(4,009)
Increase in accrued interest payable	**5,149**	2,438	1,580
(Decrease) increase in other liabilities	**(17,606)**	(9,169)	5,896
Net cash provided by operating activities	**133,369**	107,259	122,769
Cash flows from investing activities			
Increase in loans, net	**(581,765)**	(675,063)	(540,067)
(Purchases) redemptions of investment in AgriBank, FCB, net	**(9,417)**	(29,296)	12,145
(Purchases) redemptions of investment in other Farm Credit Institutions, net	**(1,866)**	(1,907)	49
Increase in investment securities, net	**(134,863)**	(17,608)	(21,820)
Proceeds from the sale of available for sale investment securities	**102,822**	53,670	--
Purchases of derivatives, net	**(406)**	(741)	--
Purchases of assets held for lease, net	**(7,213)**	(5,804)	(13,937)
Proceeds from sales of other property owned	**1,697**	3,835	4,050
Purchases of premises and equipment, net	**(3,547)**	(4,392)	(4,346)
Decrease (increase) in restricted cash	**2,126**	(1,927)	(1,228)
Net cash used in investing activities	**(632,432)**	(679,233)	(565,154)
Cash flows from financing activities			
Increase in note payable to AgriBank, FCB, net	**640,490**	609,082	478,249
Subordinated notes retired	**(100,000)**	--	--
Patronage distributions paid	**(34,002)**	(28,022)	(28,969)
Preferred stock dividends paid	**(6,750)**	(6,750)	(6,749)
Capital stock and participation certificates retired, net	**(375)**	(436)	(146)
Net cash provided by financing activities	**499,363**	573,874	442,385
Net change in cash	**300**	1,900	--
Cash at beginning of year	**1,900**	--	--
Cash at end of year	**$ 2,200**	$ 1,900	$ --
Supplemental schedule of non-cash activities			
Stock financed by loan activities	**$ 646**	$ 820	$ 884
Stock applied against loan principal	**412**	464	465
Stock applied against interest	**10**	12	8
Interest transferred to loans	**446**	421	935
(Decrease) increase in equity from investment securities	**--**	(82)	82
Loans transferred to other property owned	**1,580**	1,557	3,500
Financed sales of other property owned	**358**	286	192
Decrease (increase) in payable to Farmer Mac not yet settled	**2,126**	(1,927)	(1,228)
Supplemental information			
Interest paid	**$ 126,324**	$ 106,892	$ 99,537
Taxes paid (refunded), net	**6,020**	3,433	(284)

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AgStar Financial Services, ACA

NOTE 1: ORGANIZATION AND OPERATIONS

Association

AgStar Financial Services, ACA (the Association) and its subsidiaries, AgStar Financial Services, FLCA and AgStar Financial Services, PCA (subsidiaries) are lending institutions of the System. We are a customer-owned cooperative providing credit and credit-related services to, or for the benefit of, eligible member stockholders for qualified agricultural purposes in the counties of Aitkin, Anoka, Benton, Blue Earth, Brown, Carlton, Carver, Cass, Chisago, Cook, Cottonwood, Crow Wing, Dakota, Dodge, Faribault, Fillmore, Freeborn, Goodhue, Hennepin, Houston, Isanti, Itasca, Jackson, Kanabec, Lake, LeSueur, McLeod, Martin, Mille Lacs, Morrison, Mower, Murray, Nicollet, Nobles, Olmsted, Pine, Pipestone, Ramsey, Rice, Rock, St. Louis, Scott, Sibley, Sherburne, Stearns, Steele, southern Todd, Wabasha, Waseca, Washington, Watonwan, Winona, and Wright counties in the state of Minnesota and Ashland, Barron, Bayfield, Burnett, Chippewa, Douglas, Dunn, Eau Claire, Iron, Pepin, Pierce, Polk, Rusk, St. Croix, Sawyer, and Washburn counties in the state of Wisconsin.

We borrow from AgriBank, FCB (AgriBank) and provide financing and related services to our clients. Our ACA holds all the stock of the FLCA and PCA subsidiaries and provides lease financing options for agricultural production or operating purposes. The FLCA makes secured long-term agricultural real estate, rural home, and part-time farmer mortgage loans and holds certain types of investments. The PCA makes short-term and intermediate-term loans and holds certain types of investments. We also service certain loans.

We offer various risk management services, including credit life, term life, credit disability, title, crop hail, and multi-peril crop insurance for clients and those eligible to borrow. We also offer services, such as fee appraisals, cash management, farm business consulting, producer education, auction clerking, title search, and fleet management services to our clients.

Farm Credit System and District

The Farm Credit System (System) is a nationwide system of cooperatively owned banks and associations established by Congress to meet the credit needs of American agriculture. As of January 1, 2017, the System consisted of three Farm Credit Banks (FCB), one Agricultural Credit Bank (ACB), and 73 customer-owned cooperative lending institutions (associations). AgriBank, a System bank, and its affiliated Associations are collectively referred to as the AgriBank Farm Credit District (AgriBank District or the District). At January 1, 2017, the District consisted of 17 Agricultural Credit Associations (ACA) that each have wholly-owned Federal Land Credit Association (FLCA) and Production Credit Association (PCA) subsidiaries.

FLCAs are authorized to originate long-term real estate mortgage loans. PCAs are authorized to originate short-term and intermediate-term loans. ACAs are authorized to originate long-term real estate mortgage loans and short-term and intermediate-term loans either directly or through their subsidiaries. Associations are authorized to provide lease financing options for agricultural purposes and are also authorized to purchase and hold certain types of investments. AgriBank provides funding to all associations chartered within the District.

Associations are authorized to provide, either directly or in participation with other lenders, credit and related services to eligible borrowers. Eligible borrowers may include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related service businesses. In addition, associations can participate with other lenders in loans to similar entities. Similar entities are parties that are not eligible for a loan from a System lending institution, but have operations that are functionally similar to the activities of eligible borrowers.

The Farm Credit Administration (FCA) is authorized by Congress to regulate the System banks and associations. We are examined by the FCA and certain association actions are subject to the prior approval of the FCA and/or AgriBank.

The Farm Credit Act established the Farm Credit System Insurance Corporation (FCSIC) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is used to ensure the timely payment of principal and interest on Farm Credit Systemwide debt obligations, to ensure the retirement of protected borrower capital at par or stated value, and for other specified purposes.

At the discretion of the FCSIC, the Insurance Fund is also available to provide assistance to certain troubled System institutions and for the operating expenses of the FCSIC. Each System bank is required to pay premiums into the Insurance Fund until the assets in the Insurance Fund equal 2.0% of the aggregated insured obligations adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments. This percentage of aggregate obligations can be changed by the FCSIC, at its sole discretion, to a percentage it determines to be actuarially sound. The basis for assessing premiums is debt outstanding with adjustments made for nonaccrual loans and impaired investment securities which are assessed a surcharge while guaranteed loans and investment securities are deductions from the premium base. AgriBank, in turn, assesses premiums to District associations each year based on similar factors.

Merger Activity

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

In August, the Boards of Directors of 1st Farm Credit Services, ACA, AgStar Financial Services, ACA, and Badgerland Financial, ACA unanimously voted in favor of recommending a merger to our client-owners. With the decision to recommend a merger, a number of additional regulatory and procedural steps still need to be completed. A merger application was filed with our regulator, the FCA, in the third quarter of 2016. The FCA recently granted preliminary approval, and our client-owners will have an opportunity to vote on the proposed merger in early 2017. The expected merger effective date would be July 1, 2017.

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

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Accounting Principles and Reporting Policies

Our accounting and reporting policies conform to accounting principles generally accepted in the United States of America (GAAP) and the prevailing practices within the financial services industry. Preparing financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

Principles of Consolidation

The Consolidated Financial Statements present the consolidated financial results of AgStar Financial Services, ACA and its subsidiaries. All material intercompany transactions and balances have been eliminated in consolidation.

Significant Accounting Policies

Loans Held to Maturity: Loans are carried at their principal amount outstanding net of any unearned income, cumulative charge-offs, unamortized deferred fees and costs on originated loans, and unamortized premiums or discounts on purchased loans. Loan interest is accrued and credited to interest income based upon the daily principal amount outstanding. Origination fees, net of related costs, are deferred and recognized over the life of the loan as an adjustment to net interest income. The net amount of loan fees and related origination costs are not material to the Consolidated Financial Statements taken as a whole.

Generally we place loans in nonaccrual status when principal or interest is delinquent for 90 days or more (unless the loan is well secured and in the process of collection) or circumstances indicate that full collection is not expected.

When a loan is placed in nonaccrual status, we reverse current year accrued interest to the extent principal plus accrued interest before the transfer exceeds the net realizable value of the collateral. Any unpaid interest accrued in a prior year is capitalized to the recorded investment of the loan, unless the net realizable value is less than the recorded investment in the loan, then it is charged-off against the allowance for loan losses. Any cash received on nonaccrual loans is applied to reduce the recorded investment in the loan, except in those cases where the collection of the recorded investment is fully expected and the loan does not have any unrecovered prior charge-offs. In these circumstances interest is credited to income when cash is received. Loans are charged-off at the time they are determined to be uncollectible. Nonaccrual loans may be returned to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected, the borrower has demonstrated payment performance, and the loan is not classified as doubtful or loss.

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 formally restructured loan for regulatory purposes. 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 troubled debt restructurings are considered risk loans (as defined below).

Loans that are sold as participations are transferred as entire financial assets, groups of entire financial assets, or participating interests in the loans. The transfers of such assets or participating interests are structured such that control over the transferred assets, or participating interests have been surrendered and that all of the conditions have been met to be accounted for as a sale.

Loans Held for Sale: Loans held for sale include rural residential mortgages originated for sale. We elected the fair value option for all loans held for sale. Loans are valued on an individual basis and gains or losses are recorded in “Fee and miscellaneous income, net” in the Consolidated Statements of Comprehensive Income. Direct loan origination costs and fees for loans held for sale are recognized in income at origination. Interest income on loans held for sale is calculated based upon the note rate of the loan and is recorded in “Interest income” in the Consolidated Statements of Comprehensive Income.

Allowance for Loan Losses: The allowance for loan losses is an estimate of losses in our loan 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, stress testing, and current economic and environmental conditions.

Loans in our portfolio that are considered impaired are analyzed individually to establish a specific allowance. A loan is impaired when it is probable that all amounts due will not be collected according to the contractual terms of the loan agreement. We generally measure impairment based on the net realizable value of the collateral. Risk loans include nonaccrual loans, accruing restructured loans, and accruing loans 90 days or more past due. All risk loans are considered to be impaired loans.

We record a specific allowance to reduce the carrying amount of the risk loan by the amount the recorded investment exceeds the net realizable value of collateral. When we deem a loan to be uncollectible, we charge the loan principal and prior year(s) accrued interest against the allowance for loan losses. Subsequent recoveries, if any, are added to the allowance for loan losses.

An allowance is recorded for probable and estimable credit losses as of the financial statement date for loans that are not individually assessed as impaired. We use a two-dimensional loan risk rating model that incorporates a 14-point rating scale to identify and track the probability of borrower default and a separate 6-point scale addressing the loss severity. The combination of estimated default probability and loss severity is the primary basis for recognition and measurement of loan collectability of these pools of loans. These estimated losses may be adjusted for relevant current environmental factors.

Changes in the allowance for loan losses consist of provision activity, recorded in “Provision for loan losses” in the Consolidated Statements of Comprehensive Income, recoveries, and charge-offs.

Investment Securities: We are authorized to purchase and hold certain types of investments. Those investments for which we have the positive intent and ability to hold to maturity have been classified as held-to-maturity and are carried at cost adjusted for the amortization of premiums and accretion of discounts. If an investment is determined to be other-than-temporarily impaired, the carrying value of the security is written down to fair value. The impairment loss is separated into credit related and non-credit related components. The credit related component is expensed through “Fee and miscellaneous income, net” in the Consolidated Statements of Comprehensive Income in the period of impairment. The non-credit related component is recognized in other comprehensive income and amortized over the remaining life of the security as an increase in the security’s carrying amount.

Other investment securities may not necessarily be held-to-maturity and, accordingly, have been classified as available-for-sale. These investments are reported at fair value, and unrealized holding gains and losses on investments that are not other-than-temporarily impaired are netted and reported as a separate component of equity in “Accumulated Other Comprehensive Income” in the Consolidated Statements of Condition. Changes in the fair value of investment securities are reflected as direct charges or credits to other comprehensive income, unless the security is deemed to be other-than-temporarily impaired. When other-than-temporary impairment exists and we do not intend to sell the impaired debt security, nor are we more likely than not to be required to sell the security before recovery, we separate the loss into credit-related and non-credit-related components. If a security is deemed to be other-than-temporarily impaired, the security is written down to fair value, the credit-related component is recognized through earnings and the non-credit-related component is recognized in other comprehensive income.

Purchased premiums and discounts are amortized over the terms of the respective securities. Realized gains and losses are determined using specific identification method and are recognized in current operations.

Other Investment: The carrying amount of the investment in the Rural Business Investment Company, in which we are a limited partner and hold a non-controlling interest, is accounted for under the equity method. The investment is included in “Other assets” in the Consolidated Statements of Condition. The investment is assessed for impairment. If impairment exists, losses are included in “Fee and miscellaneous income, net” in the Consolidated Statements of Comprehensive Income in the year of impairment.

Leases: We have finance, conditional sales, and operating leases. Under finance and conditional sales leases, unearned income from lease contracts represents the excess of gross lease receivables plus residual receivables over the cost of leased equipment. We amortize net unearned finance income to earnings using the interest method. The carrying amount of finance and conditional sales leases is included in “Loans held to maturity” in the Consolidated Statements of Condition and represents lease rent and residual receivables net of the unearned income. Under operating leases, property is recorded at cost and depreciated on a straight-line basis over the lease term to an estimated residual value. We recognize operating lease revenue evenly over the term of the lease in “Net operating lease income” in Consolidated Statements of Comprehensive Income. We charge depreciation and other expenses against revenue as incurred. The amortized cost of operating leases is included in “Assets held for lease, net” in the Consolidated Statements of Condition and represents the asset cost net of accumulated depreciation.

Investment in AgriBank: Our stock investment in AgriBank is on a cost plus allocated equities basis.

Premises and Equipment: The carrying amount of premises and equipment is at cost, less accumulated depreciation Calculation of depreciation is generally on the straight-line method over the estimated useful lives of the assets. Gains or losses on disposition are included in “Fee and miscellaneous income, net” in the Consolidated Statements of Comprehensive Income. Depreciation and maintenance and repair expenses are included in “Other operating expenses” in the Consolidated Statements of Comprehensive Income and improvements are capitalized.

Other Property Owned: Other property owned, consisting of real and personal property acquired through foreclosure or deed in lieu of foreclosure, is recorded at the fair value less estimated selling costs upon acquisition. Any initial reduction in the carrying amount of a loan to the fair value of the collateral received is charged to the allowance for loan losses. Revised estimates to the fair value less costs to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Related income, expenses, and gains or losses from operations and carrying value adjustments are included in “Fee and miscellaneous income, net” in the Consolidated Statements of Comprehensive Income.

Post-Employment Benefit Plans: The District has various post-employment benefit plans in which our employees participate. Expenses related to these plans are included in “Salaries and employee benefits” in the Consolidated Statements of Comprehensive Income.

Certain employees participate in the AgriBank District Retirement Plan. The plan is comprised of two benefit formulas. At their option, employees hired prior to October 1, 2001 are on the cash balance formula or on the final average pay formula. Benefits eligible employees hired between October 1, 2001 and December 31, 2006 are on the cash balance formula. Effective January 1, 2007, the AgriBank District Retirement Plan was closed to new employees. The AgriBank District Retirement Plan utilizes the "Projected Unit Credit" actuarial method for financial reporting and funding purposes.

Certain employees also participate in the AgriBank District nonqualified defined benefit Pension Restoration Plan. This plan restores retirement benefits to certain highly compensated eligible employees that would have been provided under the qualified plan if such benefits were not above certain Internal Revenue Code limits.

We also provide certain health insurance benefits to eligible retired employees according to the terms of those benefit plans. The anticipated cost of these benefits is accrued during the employees' active service period.

The defined contribution plan allows eligible employees to save for their retirement either pre-tax, post-tax, or both, with an employer match on a percentage of the employee's contributions. We provide benefits under this plan for those employees that do not participate in the AgriBank District Retirement Plan in the form of a fixed percentage of salary contribution in addition to the employer match. Employer contributions are expensed when incurred.

Income Taxes: The ACA and PCA accrue federal and certain state income taxes. The ACA and PCA are exempt from Minnesota state income tax. Deferred tax assets and liabilities are recognized for future tax consequences of temporary differences between the carrying amounts and tax basis of assets and liabilities. Deferred tax assets are recorded if the deferred tax asset is more likely than not to be realized. If the realization test cannot be met, the deferred tax asset is reduced by a valuation allowance. The expected future tax consequences of uncertain income tax positions are accrued.

The FLCA is exempt from federal and other taxes to the extent provided in the Farm Credit Act.

Patronage Program: We have a nonqualified patronage program that requires the allocation of earnings for each fiscal year provided all statutory and regulatory capital requirements have been met. Nonqualified patronage distributions do not qualify as a deduction from our taxable income, and the client receiving it does not record it as taxable income, until it is redeemed at some future date. The redemption of nonqualified patronage distributions is at the discretion of the Board of Directors.

Commitments to Extend Credit: Unfunded commitments for residential mortgages intended to be held for sale are considered derivatives and recorded in the Consolidated Statements of Condition at fair value with changes in fair value recorded in "Fee and miscellaneous income, net" in the Consolidated Statements of Comprehensive Income. All other unfunded loan commitments are not considered derivatives. Reserves for credit exposure on all other unfunded credit commitments are recorded in "Other liabilities" in the Consolidated Statements of Condition.

Derivatives: We are party to derivative financial instruments called "to be announced" securities (TBAs) to manage exposure to interest rate risk and changes in the fair value of investments available for sale, loans held for sale, and the interest rate lock commitments that are determined prior to funding. TBAs are measured in terms of notional amounts. The notional amount is not exchanged and is used as a basis on which interest payments are determined.

In accordance with Financial Accounting Standards Board (FASB) guidance on "Accounting for Derivative Instruments and Hedging Activities", derivatives are recorded on the Consolidated Statements of Condition as Other assets or Other liabilities on a net basis, measured at fair value. These derivatives are designed as hedging instruments and, accordingly, changes in fair value are accounted for as gains or losses through earnings in "Fee and miscellaneous income, net" in the Consolidated Statements of Comprehensive Income. Losses resulting from counterparty risk are accounted for as a component of other comprehensive income, in the equity section of the Consolidated Statements of Condition.

Off-Balance Sheet Credit Exposures: Commitments to extend credit are agreements to lend to customers, generally having fixed expiration dates or other termination clauses. Standby letters of credit are agreements to pay a beneficiary if there is a default on a contractual arrangement. Any reserve for unfunded lending commitments and unexercised letters of credit is based on management's best estimate of losses inherent in these instruments, but the commitments have not yet disbursed. Factors such as likelihood of disbursal and likelihood of losses given disbursement are utilized in determining a reserve, if needed. Based on our assessment, any reserve is recorded in "Other liabilities" in the Consolidated Statements of Condition and a corresponding loss is recorded in "Provision for credit losses" in the Consolidated Statements of Comprehensive Income. However, no such reserve was necessary as of December 31, 2016, 2015, or 2014.

Cash: For purposes of reporting cash flow, cash includes cash on hand and deposits in banks.

Fair Value Measurement: The accounting guidance describes three levels of inputs that may be used to measure fair value.

Level 1 — Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

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:

- Quoted prices for similar assets or liabilities in active markets
- 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, quoted prices that are not current, or principal market information that is not released publicly
- Inputs that are observable such as interest rates and yield curves, prepayment speeds, credit risks, and default rates
- Inputs derived principally from or corroborated by observable market data by correlation or other means

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. These unobservable inputs reflect the reporting entity's own judgments about assumptions that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include financial instruments whose value is 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.

Recently Issued or Adopted Accounting Pronouncements

We have assessed the potential impact of accounting standards that have been issued by the FASB and have determined the following standards to be applicable to our business:

Standard	Description	Effective date and financial statement impact
In June 2016, the FASB issued ASU 2016-13 “Financial Instruments – Credit Losses.”	The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses.	The guidance is effective for non-U.S. Securities Exchange Commission filers for annual reporting periods beginning after December 15, 2020 including interim periods within those annual periods. Early adoption is permitted as of annual reporting periods beginning after December 15, 2018, including interim periods within those annual periods. We are currently evaluating the impact of the guidance on our financial condition, results of operations, cash flows, and financial statement disclosures.
In February 2016, the FASB issued ASU 2016-02 “Leases.”	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.	The guidance is effective for public entities for annual reporting periods beginning after December 15, 2018 including interim periods within that year. Early adoption is permitted and modified retrospective adoption is required. We are currently evaluating the impact of the guidance on our financial condition, results of operations, cash flows, and financial statement disclosures.
In January 2016, the FASB issued ASU 2016-01 “Recognition and Measurement of Financial Assets and Financial Liabilities.”	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.	The guidance is effective for public entities for annual reporting periods beginning after December 15, 2017 including interim periods within that year. Early adoption is permitted for only a portion of the guidance, but that guidance does not apply to the Financial Statements. We are currently evaluating the impact of the remaining guidance on our financial condition, results of operations, cash flows, and financial statement disclosures.
In February 2015, the FASB issued ASU 2015-02 “Consolidation-Amendments to the Consolidation Analysis.”	The guidance modifies the assessment of Variable Interest Entity (VIE) characteristics as well as the assessment of related parties. Additional clarifying guidance was issued in October 2016 under ASU 2016-17 “Consolidation-Interests Held through Related Parties That are under Common Control.”	The guidance is effective for public entities for annual reporting periods beginning after December 15, 2015. Early adoption is allowed, including in any interim period. The adoption of this guidance did not have a material impact on our financial condition, results of operations, cash flows, and financial statement disclosures.
In August 2014, the FASB issued ASU 2014-15 “Presentation of Financial Statements-Going Concern.”	The 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 to continue as a going concern exists if it is probable that the entity will be unable to meet its obligations for the assessed period.	This guidance became effective for all entities for interim and annual periods ending after December 15, 2016. The adoption of this guidance did not have a material impact on our financial condition, results of operations, cash flows, or financial statement disclosures.
In May 2014, the FASB issued ASU 2014-09 “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 our contracts would be excluded from the scope of this new guidance.	The guidance is effective for public entities for first interim reporting period within the annual reporting periods beginning after December 15, 2017. In March 2016, the FASB issued ASUs 2016-08 and 2016-10 which provided further clarifying guidance on the previously issued standard. We are in the process of reviewing contracts to determine the effect, if any, on our financial condition and results of operations.

NOTE 3: LOANS HELD TO MATURITY AND ALLOWANCE FOR LOAN LOSSES

Loans by Type

(dollars in thousands)	**2016**		2015		2014	
As of December 31	Amount	%	Amount	%	Amount	%
Real estate mortgage	**$ 4,054,633**	**49.7%**	$ 3,675,008	48.5%	$ 3,471,082	50.3%
Production and intermediate term	**2,019,030**	**24.8%**	2,020,921	26.7%	1,928,522	28.0%
Agribusiness	**1,200,684**	**14.7%**	920,347	12.2%	598,254	8.7%
Other	**878,088**	**10.8%**	955,766	12.6%	901,788	13.0%
Total	**$ 8,152,435**	**100.0%**	$ 7,572,042	100.0%	$ 6,899,646	100.0%

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

Portfolio Concentrations

Concentrations exist when there are amounts loaned to multiple borrowers engaged in similar activities, which could cause them to be similarly impacted by economic conditions. We lend primarily within agricultural industries.

As of December 31, 2016, volume plus commitments to our ten largest borrowers totaled an amount equal to 4.6% of total loans and commitments.

While these concentrations represent our maximum potential credit risk, as it relates to recorded loan principal, a substantial portion of our lending activities are collateralized. In addition, a certain portion of our loans are guaranteed by the Federal Agricultural Mortgage Corporation (Farmer Mac) or U.S. government agencies. This reduces our exposure to credit loss associated with our lending activities. 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. Long-term real estate loans are secured by the first liens on the underlying real property. FCA Regulations state that long-term real estate loans are not to exceed 85% (97% if guaranteed by a government agency) of the property's appraised value at origination and our underwriting standards generally limit lending to no more than 65% at origination. 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 lender in the collateral, may result in loan-to-value ratios in excess of the regulatory maximum. The District has an internally maintained database which uses market data to estimate market values of collateral for a significant portion of the real estate mortgage portfolio. We consider credit risk exposure in establishing the allowance for loan losses.

Participations

We may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume, or comply with the FCA Regulations or General Financing Agreement (GFA) limitations.

Participations Purchased and Sold

	AgriBank		Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
(in thousands)	Participations		Participations		Participations		Participations	
As of December 31, 2016	Purchased	Sold	Purchased	Sold	Purchased	Sold	Purchased	Sold
Real estate mortgage	**$ --**	**$ (288,589)**	**$ 261,029**	**$ (87,784)**	**$ 1,193,258**	**$ (17,110)**	**$ 1,454,287**	**$ (393,483)**
Production and intermediate term	**--**	**(86,216)**	**10,169**	**(881,077)**	**1,113,255**	**(118)**	**1,123,424**	**(967,411)**
Agribusiness	**--**	**(44,162)**	**477,587**	**(38,441)**	**364,507**	**(6,878)**	**842,094**	**(89,481)**
Other	**--**	**(917)**	**540,000**	**--**	**14,207**	**--**	**554,207**	**(917)**
Total	**$ --**	**$ (419,884)**	**$ 1,288,785**	**$ (1,007,302)**	**$ 2,685,227**	**$ (24,106)**	**$ 3,974,012**	**$ (1,451,292)**

	AgriBank		Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations		Participations		Participations		Participations	
As of December 31, 2015	Purchased	Sold	Purchased	Sold	Purchased	Sold	Purchased	Sold
Real estate mortgage	$ --	$ (326,933)	$ 255,474	$ (64,847)	$ 1,039,332	$ (13,409)	$ 1,294,806	$ (405,189)
Production and intermediate term	--	(53,650)	15,620	(891,700)	1,184,955	--	1,200,575	(945,350)
Agribusiness	--	(20,790)	356,847	(29,447)	291,986	(22,767)	648,833	(73,004)
Other	--	(7,556)	542,550	(41,777)	15,998	(25,391)	558,548	(74,724)
Total	$ --	$ (408,929)	$ 1,170,491	$ (1,027,771)	$ 2,532,271	$ (61,567)	$ 3,702,762	$ (1,498,267)

As of December 31, 2014	AgriBank Participations Purchased	AgriBank Participations Sold	Other Farm Credit Institutions Participations Purchased	Other Farm Credit Institutions Participations Sold	Non-Farm Credit Institutions Participations Purchased	Non-Farm Credit Institutions Participations Sold	Total Participations Purchased	Total Participations Sold
Real estate mortgage	$ --	$ (176,904)	$ 247,144	$ (86,245)	$ 913,204	$ (14,096)	$ 1,160,348	$ (277,245)
Production and intermediate term	--	(65,838)	28,600	(980,300)	1,241,226	(782)	1,269,826	(1,046,920)
Agribusiness	--	(31,821)	250,354	(24,737)	157,898	(29,685)	408,252	(86,243)
Other	--	(18,597)	506,935	(19,765)	18,404	(15,175)	525,339	(53,537)
Total	$ --	$ (293,160)	$ 1,033,033	$ (1,111,047)	$ 2,330,732	$ (59,738)	$ 3,363,765	$ (1,463,945)

Credit Quality and Delinquency

We utilize the FCA Uniform Classification System to categorize loans into five credit quality categories. The categories are:

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

We had no loans categorized as loss at December 31, 2016, 2015, or 2014.

Credit Quality of Loans

(dollars in thousands) **As of December 31, 2016**	Acceptable Amount	%	Special Mention Amount	%	Substandard/ Doubtful Amount	%	Total Amount	%
Real estate mortgage	**$ 3,844,164**	**94.0%**	**$ 116,011**	**2.8%**	**$ 131,021**	**3.2%**	**$ 4,091,196**	**100.0%**
Production and intermediate term	**1,867,608**	**91.7%**	**88,035**	**4.3%**	**81,030**	**4.0%**	**2,036,673**	**100.0%**
Agribusiness	**1,189,413**	**98.8%**	**4,621**	**0.4%**	**9,598**	**0.8%**	**1,203,632**	**100.0%**
Other	**828,007**	**94.1%**	**36,453**	**4.1%**	**15,898**	**1.8%**	**880,358**	**100.0%**
Total	**$ 7,729,192**	**94.1%**	**$ 245,120**	**3.0%**	**$ 237,547**	**2.9%**	**$ 8,211,859**	**100.0%**

As of December 31, 2015	Acceptable Amount	%	Special Mention Amount	%	Substandard/ Doubtful Amount	%	Total Amount	%
Real estate mortgage	$ 3,564,761	96.2%	$ 85,808	2.3%	$ 56,311	1.5%	$ 3,706,880	100.0%
Production and intermediate term	1,962,292	96.3%	33,079	1.6%	43,275	2.1%	2,038,646	100.0%
Agribusiness	891,229	96.6%	14,207	1.5%	17,267	1.9%	922,703	100.0%
Other	916,462	95.7%	20,813	2.2%	20,517	2.1%	957,792	100.0%
Total	$ 7,334,744	96.2%	$ 153,907	2.0%	$ 137,370	1.8%	$ 7,626,021	100.0%

As of December 31, 2014	Acceptable Amount	%	Special Mention Amount	%	Substandard/ Doubtful Amount	%	Total Amount	%
Real estate mortgage	$ 3,355,586	95.8%	$ 72,751	2.1%	$ 72,453	2.1%	$ 3,500,790	100.0%
Production and intermediate term	1,886,643	97.0%	30,987	1.6%	27,295	1.4%	1,944,925	100.0%
Agribusiness	588,941	98.1%	1,570	0.3%	9,851	1.6%	600,362	100.0%
Other	871,458	96.5%	18,994	2.1%	13,036	1.4%	903,488	100.0%
Total	$ 6,702,628	96.4%	$ 124,302	1.8%	$ 122,635	1.8%	$ 6,949,565	100.0%

Note: Accruing loans include accrued interest receivable.

Aging Analysis of Loans

(in thousands) **As of 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	Total	90 Days Past Due and Accruing
Real estate mortgage	**$ 11,554**	**$ 10,614**	**$ 22,168**	**$ 4,069,028**	**$ 4,091,196**	**$ 97**
Production and intermediate term	**8,608**	**10,844**	**19,452**	**2,017,221**	**2,036,673**	**577**
Agribusiness	**1,359**	**55**	**1,414**	**1,202,218**	**1,203,632**	**--**
Other	**2,920**	**2,117**	**5,037**	**875,321**	**880,358**	**64**
Total	**$ 24,441**	**$ 23,630**	**$ 48,071**	**$ 8,163,788**	**$ 8,211,859**	**$ 738**

As of December 31, 2015	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less than 30 Days Past Due	Total	90 Days Past Due and Accruing
Real estate mortgage	$ 12,952	$ 4,039	$ 16,991	$ 3,689,889	$ 3,706,880	$ 27
Production and intermediate term	3,409	6,890	10,299	2,028,347	2,038,646	28
Agribusiness	98	--	98	922,605	922,703	--
Other	3,366	1,549	4,915	952,877	957,792	69
Total	$ 19,825	$ 12,478	$ 32,303	$ 7,593,718	$ 7,626,021	$ 124

As of December 31, 2014	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less than 30 Days Past Due	Total	90 Days Past Due and Accruing
Real estate mortgage	$ 14,289	$ 7,035	$ 21,324	$ 3,479,466	$ 3,500,790	$ 282
Production and intermediate term	3,181	2,599	5,780	1,939,145	1,944,925	7
Agribusiness	1,984	--	1,984	598,378	600,362	--
Other	2,666	1,091	3,757	899,731	903,488	15
Total	$ 22,120	$ 10,725	$ 32,845	$ 6,916,720	$ 6,949,565	$ 304

Note: Accruing loans include accrued interest receivable.

All loans 90 days or more past due and still accruing interest were adequately secured and in the process of collection and, as such, were eligible to remain in accruing status.

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. Interest income recognized and cash payments received on nonaccrual risk loans are applied as described in Note 2.

Risk Loan Information

(in thousands)

As of December 31	2016	2015	2014
Nonaccrual loans:			
Current as to principal and interest	**$ 33,128**	$ 33,773	$ 37,174
Past due	**27,733**	15,124	14,165
Total nonaccrual loans	**60,861**	48,897	51,339
Accruing restructured loans	**24,417**	21,072	22,892
Accruing loans 90 days or more past due	**738**	124	304
Total risk loans	**$ 86,016**	$ 70,093	$ 74,535
Volume with specific reserves	**$ 8,731**	$ 4,785	$ 8,779
Volume without specific reserves	**77,285**	65,308	65,756
Total risk loans	**$ 86,016**	$ 70,093	$ 74,535
Total specific reserves	**$ 3,218**	$ 2,230	$ 3,098
For the year ended December 31	**2016**	2015	2014
Income on accrual risk loans	**$ 1,278**	$ 1,321	$ 690
Income on nonaccrual loans	**7,101**	7,198	5,735
Total income on risk loans	**$ 8,379**	$ 8,519	$ 6,425
Average recorded risk loans	**$ 85,864**	$ 76,997	$ 104,172

Note: Accruing loans include accrued interest receivable.

To mitigate credit risk, we have entered into a Standby Commitment to Purchase Agreement with Farmer Mac. In the event of default, subject to certain conditions, we have the right to sell the loans identified in the agreement to Farmer Mac. This agreement remains in place until the loan is paid in full. We had $474.4 million, $470.2 million, and $469.7 million of our loans in this program at December 31, 2016, 2015, and 2014, respectively. Fees paid to Farmer Mac for these commitments totaled $2.1 million, $2.0 million, and $2.0 million in 2016, 2015, and 2014, respectively. These amounts are included in “Other operating expenses” in the Consolidated Statements of Comprehensive Income. There were no sales of loans to Farmer Mac under this agreement in 2016, 2015, or 2014.

Nonaccrual Loans by Loan Type

(in thousands)

As of December 31	2016	2015	2014
Real estate mortgage	**$ 27,551**	$ 22,573	$ 25,652
Production and intermediate term	**25,980**	14,193	13,644
Agribusiness	**1,721**	356	19
Other	**5,609**	11,775	12,024
Total	**$ 60,861**	$ 48,897	$ 51,339

Additional Impaired Loan Information by Loan Type

(in thousands)	As of December 31, 2016 Recorded Investment	Unpaid Principal Balance	Related Allowance	For the year ended December 31, 2016 Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for loan losses:					
Real estate mortgage	**$ 2,676**	**$ 2,714**	**$ 260**	**$ 2,830**	**$ --**
Production and intermediate term	**3,855**	**4,250**	**2,036**	**3,852**	**--**
Agribusiness	**76**	**76**	**40**	**31**	**--**
Other	**2,124**	**2,157**	**882**	**1,305**	**--**
Total	**$ 8,731**	**$ 9,197**	**$ 3,218**	**$ 8,018**	**$ --**
Impaired loans with no related allowance for loan losses:					
Real estate mortgage	**$ 39,738**	**$ 63,026**	**$ --**	**$ 42,027**	**$ 5,244**
Production and intermediate term	**24,023**	**45,829**	**--**	**24,000**	**2,024**
Agribusiness	**1,645**	**2,039**	**--**	**679**	**12**
Other	**11,879**	**14,119**	**--**	**11,140**	**1,099**
Total	**$ 77,285**	**$ 125,013**	**$ --**	**$ 77,846**	**$ 8,379**
Total impaired loans:					
Real estate mortgage	**$ 42,414**	**$ 65,740**	**$ 260**	**$ 44,857**	**$ 5,244**
Production and intermediate term	**27,878**	**50,079**	**2,036**	**27,852**	**2,024**
Agribusiness	**1,721**	**2,115**	**40**	**710**	**12**
Other	**14,003**	**16,276**	**882**	**12,445**	**1,099**
Total	**$ 86,016**	**$ 134,210**	**$ 3,218**	**$ 85,864**	**$ 8,379**

	As of December 31, 2015 Recorded Investment	Unpaid Principal Balance	Related Allowance	For the year ended December 31, 2015 Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for loan losses:					
Real estate mortgage	$ 1,423	$ 1,513	$ 370	$ 1,548	$ --
Production and intermediate term	2,297	2,458	1,459	2,580	--
Agribusiness	--	--	--	980	--
Other	1,065	1,092	401	955	--
Total	$ 4,785	$ 5,063	$ 2,230	$ 6,063	$ --
Impaired loans with no related allowance for loan losses:					
Real estate mortgage	$ 38,357	$ 61,954	$ --	$ 41,704	$ 6,291
Production and intermediate term	15,811	38,058	--	17,760	1,771
Agribusiness	356	586	--	437	12
Other	10,784	13,554	--	11,033	445
Total	$ 65,308	$ 114,152	$ --	$ 70,934	$ 8,519
Total impaired loans:					
Real estate mortgage	$ 39,780	$ 63,467	$ 370	$ 43,252	$ 6,291
Production and intermediate term	18,108	40,516	1,459	20,340	1,771
Agribusiness	356	586	--	1,417	12
Other	11,849	14,646	401	11,988	445
Total	$ 70,093	$ 119,215	$ 2,230	$ 76,997	$ 8,519

	As of December 31, 2014			For the year ended December 31, 2014	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for loan losses:					
Real estate mortgage	$ 4,845	$ 5,583	$ 1,482	$ 5,165	$ --
Production and intermediate term	3,190	3,314	1,331	4,028	--
Agribusiness	--	--	--	--	--
Other	744	803	285	555	--
Total	$ 8,779	$ 9,700	$ 3,098	$ 9,748	$ --
Impaired loans with no related allowance for loan losses:					
Real estate mortgage	$ 39,586	$ 66,137	$ --	$ 54,923	$ 5,035
Production and intermediate term	14,857	37,282	--	21,209	1,330
Agribusiness	19	64	--	10	7
Other	11,294	13,573	--	18,282	53
Total	$ 65,756	$ 117,056	$ --	$ 94,424	$ 6,425
Total impaired loans:					
Real estate mortgage	$ 44,431	$ 71,720	$ 1,482	$ 60,088	$ 5,035
Production and intermediate term	18,047	40,596	1,331	25,237	1,330
Agribusiness	19	64	--	10	7
Other	12,038	14,376	285	18,837	53
Total	$ 74,535	$ 126,756	$ 3,098	$ 104,172	$ 6,425

The recorded investment in the loan is the unpaid principal amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, and acquisition costs and may also reflect a previous direct charge-off of the investment.

Unpaid principal balance represents the contractual principal balance of the loan.

We did not have any material commitments to lend additional money to borrowers whose loans were at risk at December 31, 2016.

Troubled Debt Restructurings (TDRs)

Included within our loans are troubled debt restructurings (TDRs). These loans have been modified by granting a concession in order to maximize the collection of amounts due when a borrower is experiencing financial difficulties. All risk loans, including TDRs, are analyzed within our allowance for loan losses.

TDR Activity

(in thousands)

For the year ended December 31	**2016**		2015		2014	
	Pre-modification	Post-modification	Pre-modification	Post-modification	Pre-modification	Post-modification
Real estate mortgage	**$ --**	**$ --**	$ 766	$ 535	$ 736	$ 594
Production and intermediate term	**806**	**827**	1,072	1,074	499	500
Agribusiness	**69**	**69**	--	--	--	--
Other	**--**	**--**	--	--	190	190
Total	**$ 875**	**$ 896**	$ 1,838	$ 1,609	$ 1,425	$ 1,284

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

The primary types of modification included deferral of principal and extension of maturity.

We had TDRs in the production and intermediate term loan category of $163 thousand and $32 thousand that defaulted during the years ended December 31, 2016 and 2015, respectively in which the modifications were within twelve months of the respective reporting period. There were no TDRs that defaulted during the year ended December 31, 2014 in which the modification was within twelve months of the respective reporting period.

TDRs Outstanding

(in thousands) As of December 31	2016	2015	2014
Accrual status:			
Real estate mortgage	**$ 14,765**	$ 17,193	$ 18,494
Production and intermediate term	**1,322**	3,879	4,398
Agribusiness	**--**	--	--
Other	**8,330**	--	--
Total TDRs in accrual status	**$ 24,417**	$ 21,072	$ 22,892
Nonaccrual status:			
Real estate mortgage	**$ 1,399**	$ 4,929	$ 6,835
Production and intermediate term	**3,004**	5,582	5,709
Agribusiness	**67**	--	--
Other	**84**	8,407	8,788
Total TDRs in nonaccrual status	**$ 4,554**	$ 18,918	$ 21,332
Total TDRs:			
Real estate mortgage	**$ 16,164**	$ 22,122	$ 25,329
Production and intermediate term	**4,326**	9,461	10,107
Agribusiness	**67**	--	--
Other	**8,414**	8,407	8,788
Total TDRs	**$ 28,971**	$ 39,990	$ 44,224

The decrease in outstanding TDR volume from December 31, 2015 was primarily due to a borrower in our dairy portfolio refinancing their notes at market rates.

Additional commitments to lend to borrowers whose loans have been modified in a TDR were $2.6 million at December 31, 2016.

Allowance for Loan Losses

Changes in Allowance for Loan Losses

(in thousands) For the year ended December 31	2016	2015	2014
Balance at beginning of year	**$ 27,071**	$ 23,655	$ 24,725
Provision for loan losses	**10,082**	5,939	1,084
Loan recoveries	**1,355**	870	2,298
Loan charge-offs	**(2,490)**	(3,393)	(4,452)
Balance at end of year	**$ 36,018**	$ 27,071	$ 23,655

The increase in allowance for loan losses, which resulted in additional provision for loan losses, was due to continued deterioration in our grain portfolio.

Changes in Allowance for Loan Losses and Year End Recorded Investments by Loan Type

(in thousands)	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Other	Total
Allowance for loan losses:					
Balance as of December 31, 2015	**$ 10,622**	**$ 10,549**	**$ 2,323**	**$ 3,577**	**$ 27,071**
Provision for loan losses	**4,974**	**4,406**	**260**	**442**	**10,082**
Loan recoveries	**370**	**786**	**66**	**133**	**1,355**
Loan charge-offs	**(156)**	**(2,109)**	**--**	**(225)**	**(2,490)**
Balance as of December 31, 2016	**$ 15,810**	**$ 13,632**	**$ 2,649**	**$ 3,927**	**$ 36,018**
Ending balance: individually evaluated for impairment	**$ 260**	**$ 2,036**	**$ 40**	**$ 882**	**$ 3,218**
Ending balance: collectively evaluated for impairment	**$ 15,550**	**$ 11,596**	**$ 2,609**	**$ 3,045**	**$ 32,800**
Recorded investment in loans outstanding:					
Ending balance as of December 31, 2016	**$ 4,091,196**	**$ 2,036,673**	**$ 1,203,632**	**$ 880,358**	**$ 8,211,859**
Ending balance: individually evaluated for impairment	**$ 42,414**	**$ 27,878**	**$ 1,721**	**$ 14,003**	**$ 86,016**
Ending balance: collectively evaluated for impairment	**$ 4,048,782**	**$ 2,008,795**	**$ 1,201,911**	**$ 866,355**	**$ 8,125,843**

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Other	Total
Allowance for loan losses:					
Balance as of December 31, 2014	$ 10,662	$ 8,605	$ 1,498	$ 2,890	$ 23,655
Provision for loan losses	613	3,574	1,041	711	5,939
Loan recoveries	355	434	--	81	870
Loan charge-offs	(1,008)	(2,064)	(216)	(105)	(3,393)
Balance as of December 31, 2015	$ 10,622	$ 10,549	$ 2,323	$ 3,577	$ 27,071
Ending balance: individually evaluated for impairment	$ 370	$ 1,459	$ --	$ 401	$ 2,230
Ending balance: collectively evaluated for impairment	$ 10,252	$ 9,090	$ 2,323	$ 3,176	$ 24,841
Recorded investment in loans outstanding:					
Ending balance as of December 31, 2015	$ 3,706,880	$ 2,038,646	$ 922,703	$ 957,792	$ 7,626,021
Ending balance: individually evaluated for impairment	$ 39,780	$ 18,108	$ 356	$ 11,849	$ 70,093
Ending balance: collectively evaluated for impairment	$ 3,667,100	$ 2,020,538	$ 922,347	$ 945,943	$ 7,555,928

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Other	Total
Allowance for loan losses:					
Balance as of December 31, 2013	$ 10,418	$ 7,345	$ 2,592	$ 4,370	$ 24,725
Provision for (reversal of) loan losses	1,040	1,581	(1,094)	(443)	1,084
Loan recoveries	958	1,037	--	303	2,298
Loan charge-offs	(1,754)	(1,358)	--	(1,340)	(4,452)
Balance as of December 31, 2014	$ 10,662	$ 8,605	$ 1,498	$ 2,890	$ 23,655
Ending balance: individually evaluated for impairment	$ 1,482	$ 1,331	$ --	$ 285	$ 3,098
Ending balance: collectively evaluated for impairment	$ 9,180	$ 7,274	$ 1,498	$ 2,605	$ 20,557
Recorded investment in loans outstanding:					
Ending balance as of December 31, 2014	$ 3,500,790	$ 1,944,925	$ 600,362	$ 903,488	$ 6,949,565
Ending balance: individually evaluated for impairment	$ 44,431	$ 18,047	$ 19	$ 12,038	$ 74,535
Ending balance: collectively evaluated for impairment	$ 3,456,359	$ 1,926,878	$ 600,343	$ 891,450	$ 6,875,030

The recorded investment in the loan is the unpaid principal amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, and acquisition costs and may also reflect a previous direct charge-off of the investment.

NOTE 4: LOANS HELD FOR SALE

Loans Held for Sale Activity, at Fair Value

(in thousands)

For the year ended December 31	**2016**	2015	2014
Balance at beginning of year	**$ 35,380**	$ 7,899	$ 4,470
Originations	**96,798**	66,349	27,529
Proceeds	**(104,185)**	(38,938)	(24,171)
Fair value adjustments	**(623)**	70	71
Balance at end of year	**$ 27,370**	$ 35,380	$ 7,899

"Loans held for sale" are on our Consolidated Statements of Condition. These represent mortgage loans whereby the interest rate is set prior to funding. We are subject to the effects of changes in mortgage interest rates from the date of the interest rate lock commitment through the sale of the loan to a third party investor. As a result, we are exposed to interest rate risk and related price risk during the period from the date of the interest rate lock commitment through the interest rate lock commitment cancellation or expiration date or through the date of sale to a third party investor. To minimize risk we use forward commitments to sell TBAs at specified prices to economically hedge the interest rate risk.

NOTE 5: INVESTMENT SECURITIES

We have held to maturity investment securities of $473.2 million, $443.0 million, and $460.9 million at December 31, 2016, 2015, and 2014, respectively. Our investment securities consisted of:

- Mortgage-backed securities (MBS) issued by Farmer Mac or guaranteed by the Small Business Administration (SBA) or by the United States Department of Agriculture (USDA)

- Asset-backed securities (ABS) guaranteed by SBA or USDA
- Municipal revenue bonds and a corporate debt security (Bonds)

The investment securities have been classified as held-to-maturity. MBS are generally longer-term investments and ABS are generally shorter-term investments. Farmer Mac guaranteed investments are typically MBS while SBA and USDA guaranteed investments may be comprised of either MBS or ABS. All of our held-to-maturity investment securities, except $6.9 million and $4.9 million, were fully guaranteed by Farmer Mac, SBA, or USDA at December 31, 2016 and 2015, respectively. All of our investment securities were fully guaranteed as of December 31, 2014.

Additional Held-to-Maturity Investment Securities Information

(dollars in thousands) **As of December 31, 2016**	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Weighted Average Yield
MBS	**$ 431,592**	**$ 951**	**$ (12,223)**	**$ 420,320**	**3.8%**
ABS	**34,784**	**--**	**(2,105)**	**32,679**	**1.7%**
Bonds	**6,872**	**2**	**(255)**	**6,619**	**6.3%**
Total	**$ 473,248**	**$ 953**	**$ (14,583)**	**$ 459,618**	**3.6%**

As of December 31, 2015	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Weighted Average Yield
MBS	$ 396,433	$ 1,542	$ (9,213)	$ 388,762	3.6%
ABS	41,603	1	(2,376)	39,228	1.9%
Bonds	4,936	--	(251)	4,685	6.4%
Total	$ 442,972	$ 1,543	$ (11,840)	$ 432,675	3.5%

As of December 31, 2014	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Weighted Average Yield
MBS	$ 414,902	$ 2,704	$ (9,435)	$ 408,171	3.8%
ABS	46,037	17	(2,299)	43,755	2.2%
Total	$ 460,939	$ 2,721	$ (11,734)	$ 451,926	3.7%

Investment income is recorded in “Interest income” in the Consolidated Statements of Comprehensive Income and totaled $15.7 million, $14.6 million, and $15.9 million in 2016, 2015, and 2014, respectively.

Contractual Maturities of Held-to-Maturity Investment Securities

(in thousands) **As of December 31, 2016**	Amortized Cost
Less than one year	**$ 885**
One to five years	**28,239**
Five to ten years	**63,268**
More than ten years	**380,856**
Total	**$ 473,248**

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

(in thousands)	Less than 12 months		Greater than 12 months	
As of December 31, 2016	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
MBS	**$ 121,060**	**$ 3,912**	**$ 206,792**	**$ 8,311**
ABS	**4,492**	**342**	**27,650**	**1,763**
Bonds	**--**	**--**	**4,661**	**255**
Total	**$ 125,552**	**$ 4,254**	**$ 239,103**	**$ 10,329**

	Less than 12 months		Greater than 12 months	
As of December 31, 2015	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
MBS	$ 100,500	$ 2,221	$ 152,190	$ 6,992
ABS	10,221	538	27,360	1,838
Bonds	4,665	251	--	--
Total	$ 115,386	$ 3,010	$ 179,550	$ 8,830

	Less than 12 months		Greater than 12 months	
As of December 31, 2014	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
MBS	$ 54,047	$ 3,257	$ 157,552	$ 6,178
ABS	19,232	1,196	19,444	1,103
Total	$ 73,279	$ 4,453	$ 176,996	$ 7,281

Unrealized losses greater than 12 months associated with held-to-maturity investment securities are not considered to be other-than-temporary due to the 100% guarantee of the principal by Farmer Mac, SBA, or USDA. However, the premiums paid to purchase the investment are not guaranteed and are amortized over the maturity of each loan on a straight-line basis as a reduction of interest income. Repayment of principal is assessed at least quarterly, and any remaining unamortized premium is taken as a reduction to interest income if principal repayment is unlikely, or when a demand for payment is made for the guarantee. At December 31, 2016, the majority of the $10.3 million unrealized loss greater than 12 months represents unamortized premium.

We had investment securities available-for-sale, consisting of MBS, with a fair value of $21.0 million at December 31, 2014. The contractual maturities were all more than 10 years at December 31, 2014. We had no outstanding investment securities available-for-sale at December 31, 2016 or 2015.

Additional Available-for-Sale Investment Securities Information

(in thousands) For the year ended December 31	**2016**	2015	2014
Proceeds from sales	**$ 102,822**	$ 53,670	$ --
Realized gains on sales, net	**659**	355	--
Unrealized gains (losses)	**--**	--	82

The investment portfolio is evaluated for other-than-temporary impairment. To date, we have not recognized any impairment on our investment portfolio.

NOTE 6: OTHER INVESTMENT

We and other Farm Credit Institutions are among the limited partners for a $154.5 million Rural Business Investment Company (RBIC) established on October 3, 2014. The RBIC facilitates equity and debt investments in agriculture-related businesses that create growth and job opportunities in rural America. Our total commitment is $20.0 million through October 2019. Our investment in the RBIC totaled $7.5 million, $4.2 million, and $0.8 million at December 31, 2016, 2015, and 2014, respectively.

The investment was evaluated for impairment. No impairments were recognized on this investment during 2016, 2015, or 2014. During the year ended December 31, 2016, we received a distribution of $250 thousand as the RBIC sold an investment. The distribution was a return of contributed capital and, therefore, reduced our recorded investment. To date, no income has been distributed from the RBIC. We received no distributions during the years ended December 31, 2015 or 2014.

NOTE 7: INVESTMENT IN AGRIBANK

As of December 31, 2016, we were required by AgriBank to maintain an investment equal to 2.25% of the average quarterly balance of our note payable to AgriBank plus an additional 1.0% on growth that exceeded a targeted rate. In December 2016, AgriBank's Board approved the 2017 capital plan, which amended the required stock investments for affiliated Associations, effective January 1, 2017. The new required investment will be the lesser of 4.0% or a multiple component calculation based on a percentage of our average quarterly balance of our note payable to AgriBank with a higher percentage on balances above a sustainable growth rate and includes a component for additional investments under the asset pool program. The 2017 component requirements are currently 2.25% on average note payable, with an additional 4.5% on growth in excess of a 5.5% sustainable growth rate and an 8.0% investment under the asset pool program.

As of December 31, 2016, we were also required by AgriBank to maintain an investment equal to 8.0% of the quarter end balance of the participation interests in real estate loans sold to AgriBank under the AgriBank Asset Pool program.

The balance of our investment in AgriBank, all required stock, was $180.8 million, $171.4 million, and $142.1 million at December 31, 2016, 2015, and 2014, respectively.

NOTE 8: ASSETS HELD FOR LEASE, NET

We hold property for agricultural leasing, primarily farm equipment and facilities.

Net Operating Lease Income and Property Held for Lease by Major Category

(in thousands)	**2016**	2015	2014
For the year ended December 31:			
Net operating lease income	**$ 1,352**	$ 1,760	$ 1,646
As of December 31:			
Farm/vehicle equipment	**$ 33,332**	$ 39,946	$ 41,402
Facilities	**23,702**	20,018	20,662
Subtotal	**57,034**	59,964	62,064
Less: accumulated depreciation	**20,436**	21,568	20,498
Assets held for lease, net	**$ 36,598**	$ 38,396	$ 41,566

Expected Future Minimum Rentals

(in thousands)	Operating Leases
2017	$ 8,163
2018	6,248
2019	4,170
2020	2,884
2021	1,968
Thereafter	2,291
Total minimum future rentals	$ 25,724

NOTE 9: NOTE PAYABLE TO AGRIBANK

Our note payable to AgriBank represents borrowings, in the form of a line of credit, to fund our loan portfolio. The line of credit is governed by a GFA and our assets serve as collateral.

Note Payable Information

(dollars in thousands) As of December 31	**2016**	2015	2014
Line of credit	**$ 8,500,000**	$ 7,400,000	$ 6,900,000
Outstanding principal under the line of credit	**7,590,254**	6,949,764	6,340,682
Interest rate	**1.8%**	1.6%	1.6%

Our note payable matures March 31, 2017, at which time the note will be renegotiated.

The GFA provides for limitations on our ability to borrow funds based on specified factors or formulas relating primarily to outstanding balances, credit quality, and financial condition. At December 31, 2016, and throughout the year, we materially complied with the GFA terms and were not declared in default under any GFA covenants or provisions.

NOTE 10: SUBORDINATED DEBT

In March 2010, we issued $100.0 million of aggregate principal amount of Series A Subordinated Notes (Notes), due in 2025. The Notes bear a fixed interest rate of 9.0% per annum, payable semi-annually. Our Board of Directors has authorized up to a maximum of $200.0 million for subordinated debt issuance. At our option, we may redeem all or some of the Notes, on any interest payment date on or after a date 10 years from the closing date (March 2010). This debt is subordinate to all other creditor debt, including general creditors, and senior to all classes of stock. Our subordinated debt is not considered System debt and is not an obligation of, nor guaranteed by any System entity. Further, payments on the subordinated Notes are not insured by the FCSIC. On December

15, 2016, we redeemed all $100 million of outstanding subordinated notes at par value, which were redeemable on any interest payment date at any time following FCA notification of certain changes to our regulatory capital requirements.

NOTE 11: EQUITY

Capitalization Requirements

In accordance with the Farm Credit Act, each client is required to invest in us as a condition of obtaining a loan. As authorized by the Agricultural Credit Act and our capital bylaws, the Board of Directors has adopted a capital plan that establishes a stock purchase requirement for obtaining a loan of 2.0% of the client's total loan(s) or one thousand dollars, whichever is less. The purchase of one participation certificate is required of all clients to whom a lease is issued and of all non-stockholder clients who purchase financial services. The Board of Directors may increase the amount of required investment to the extent authorized in the capital bylaws. The client acquires ownership of the capital stock at the time the loan or lease is made. The aggregate par value of the stock is added to the principal amount of the related obligation. We retain a first lien on the stock or participation certificates owned by clients.

Regulatory Capitalization Requirements

Select Capital Ratios

As of December 31	**2016**	2015	2014	Regulatory Minimums
Permanent capital ratio	**14.1%**	14.8%	15.7%	7.0%
Total surplus ratio	**14.0%**	14.5%	15.4%	7.0%
Core surplus ratio	**12.1%**	12.3%	12.9%	3.5%

These ratios are calculated in accordance with FCA Regulations and are discussed below:

- The permanent capital ratio is average at-risk capital plus any allocated excess stock divided by average risk-adjusted assets.
- The total surplus ratio is average unallocated surplus less any deductions made in the computation of permanent capital divided by average risk-adjusted assets.
- The core surplus ratio is average unallocated surplus less any deductions made in the computation of total surplus and less any allocated excess stock investment in AgriBank divided by average risk-adjusted assets.

Risk-adjusted assets have been defined by FCA Regulations as the Statement of Condition assets and off-balance-sheet commitments adjusted by various percentages, depending on the level of risk inherent in the various types of assets.

Effective January 1, 2017, the regulatory capital requirements for System Banks and Associations were modified. The final rule replaced existing core surplus and total surplus ratios with common equity tier 1, tier 1 capital, and total capital risk-based capital ratios. The final rule also added a tier 1 leverage ratio and an unallocated retained earnings equivalents (UREE) leverage ratio. The permanent capital ratio continues to remain in effect with the final rule.

FCA Revised Capital Requirements

	Regulatory Minimums	Capital Conservation Buffer	Total
Risk-adjusted:			
Common equity tier 1 ratio	4.5%	2.5%	7.0%
Tier 1 capital ratio	6.0%	2.5%	8.5%
Total capital ratio	8.0%	2.5%	10.5%
Non-risk-adjusted:			
Tier 1 leverage ratio	4.0%	1.0%	5.0%
UREE leverage ratio	1.5%	0.0%	1.5%

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

Regulatory capital included any allocated investment in AgriBank that is in excess of the required investment under an allotment agreement with AgriBank. We had no allocated excess stock at December 31, 2016, 2015, or 2014. Effective January 1, 2017, the regulatory capital requirements allow for allotment agreements for only the permanent capital ratio and, as such, any stock in excess of our AgriBank required investment will not be included in the common equity tier 1, tier 1 capital, total capital, or leverage ratios.

Description of Equities

The following represents information regarding classes and number of shares of stock and participation certificates outstanding. All shares and participation certificates are stated at a $5.00 par value, except the Series A-1 preferred stock, which is $1,000 par value.

	Number of Shares		
As of December 31	**2016**	2015	2014
Class B common stock (at-risk)	**2,954,404**	2,970,136	2,979,694
Class E participation certificates (at-risk)	**232,327**	246,831	255,752
Series A-1 preferred stock	**100,000**	100,000	100,000

Under our bylaws, we are also authorized to issue Class C and Class D common stock. Each of these classes of stock is at-risk and nonvoting with a $5.00 par value per share. We also are authorized to issue Class H preferred stock, an at-risk nonvoting stock with a $1.00 par value per share. Currently, no stock of these classes has been issued.

On May 30, 2013, we issued $100 million of Series A-1 non-cumulative perpetual preferred stock. This series may be held or transferred in blocks having an aggregate par value of not less than $250,000 and an investor must hold at least 250 shares. We used the net proceeds from the Series A-1 preferred stock issuance to increase our regulatory capital pursuant to FCA Regulations in effect at December 31, 2016, for the continued development of our business, and for general corporate purposes.

Dividends on the Series A-1 preferred stock, if declared by the Board of Directors in its sole discretion, are non-cumulative and are payable quarterly in arrears on the 15th day of February, May, August, and November, beginning on August 15, 2013. Dividends accrue at a fixed annual rate of 6.75% from the date of issuance through August 14, 2023, and beginning on August 15, 2023 will accrue at an annual rate equal to the 3-month USD LIBOR rate, reset quarterly, plus 4.58%. The Series A-1 preferred stock is not mandatorily redeemable at any time. However, the Series A-1 preferred stock will be redeemable at par value, in whole or in part, at our option, quarterly beginning on August 15, 2023. In addition, the Series A-1 preferred stock will be redeemable in whole, at our option, at any time upon the occurrence of certain defined regulatory events. Series A-1 preferred stockholders do not have any voting rights, but may appoint two board observers after six unpaid dividend payments.

The Series A-1 preferred stock is junior to any subordinated debt, existing and future debt obligations, and to any series of preferred stock we may issue in the future with priority rights. Series A-1 preferred stock is senior to outstanding Class B, C, or D common stock, Class E participation certificates, Class H preferred stock, and patronage equities. The Series A-1 preferred stock has a preference as to dividends and on liquidation or dissolution over all other classes of equities.

Only holders of Class B common stock have voting rights. Our bylaws allow us to pay dividends on any classes of stock. However, no stock dividends have been declared to date other than the Series A-1 preferred stock dividends.

Our bylaws generally permit stock and participation certificates to be retired at the discretion of our Board of Directors and in accordance with our capitalization plans, provided prescribed capital standards have been met. At December 31, 2016, we exceeded the prescribed standards. We do not anticipate any significant changes in capital that would affect the normal retirement of stock.

In the event of our liquidation or dissolution, according to our bylaws, any remaining assets after payment or retirement of all liabilities will be distributed in the following order of priority:

- first, to holders of Series A-1 preferred stock,
- second, to holders of Class H preferred stock,
- third, to holders of Class B, C, and D common stock and Class E participation certificates pro rata to all such stock,
- fourth, to member stockholders who have received capital through patronage transactions pro rata to all such capital, and
- lastly, any remaining assets shall be distributed to current and former member stockholders based on relative patronage transactions.

In the event of impairment, losses will be absorbed by unallocated capital reserves, patronage equities, or the concurrent impairment of all classes of stock, in a manner deemed to be fair and equitable by the Board of Directors, provided that no shares of Class H preferred stock may be impaired until all other classes of stock and participation certificates are fully impaired, and provided further that no shares of Series A-1 preferred stock will be impaired until all classes of junior stock have been impaired in their entirety.

All classes of stock and participation certificates, other than Series A-1 preferred stock, are transferable to other clients who are eligible to hold such class of stock or participation certificates. Transfers of Class B common stock are subject to the approval of the Board of Directors. Transfers of Class C or D common stock or Class E participation certificates are only allowed if we meet the regulatory minimum capital requirements. Series A-1 preferred stock may only be transferred to qualified institutional buyers and institutional accredited investors, as those terms are defined by the Securities Act of 1933, as amended, and only in accordance with the terms and limitations of the Series A-1 preferred stock offering documents.

Patronage Distributions

We made net nonqualified patronage allocations of $67.1 million, $62.9 million, and $60.0 million at December 31, 2016, 2015, and 2014, respectively. Our nonqualified patronage allocation is based on a Board of Directors resolution requiring an allocation of annual net patronage-eligible earnings for each fiscal year. Patronage equities have no voting rights, are redeemed at the sole discretion of the Board of Directors and are transferable only if specifically authorized by the Board of Directors.

We have a nonqualified patronage program that targets payment to borrowers within 7-10 years after the year of declaration, subject to Board approval. The Board of Directors authorized the retirement of the remainder of the nonqualified patronage allocations of $35.0 million, $28.2 million, and $28.9 million in 2016, 2015, and 2014, respectively. In addition, the Board of Directors authorized the payment of $1.3 million, $868 thousand, and $609 thousand of dividends on approved transactions in 2016, 2015, and 2014, respectively. The timing and amounts of all future patronage redemptions and dividend payments remains at the discretion of the Board of Directors based on a combination of factors including the risk in our portfolio, earnings, and our current capital position. Further information regarding the tax impact of our patronage distributions is included in Note 12.

We received a special stock patronage refund of $4.6 million from AgriBank on December 31, 2002. This stock received would be subject to tax only upon conversion to cash. Effective in 2002, our Board of Directors passed a resolution stating that, should we realize additional taxable income from the conversion of this stock, we will declare a patronage distribution to our member stockholders at such time in an amount equivalent to the amount of such additional taxable income realized.

The FCA Regulations prohibit patronage distributions to the extent they would reduce our permanent capital ratio below the minimum permanent capital adequacy standards. Additionally, effective January 1, 2017, patronage distributions may be restricted or prohibited without prior FCA approval if capital ratios fall below the total requirements, including the buffer amounts. We do not foresee any events that would result in this prohibition in 2017.

NOTE 12: INCOME TAXES

Provision for Income Taxes

Provision for Income Taxes

(dollars in thousands)

For the year ended December 31	**2016**	2015	2014
Current:			
Federal	**$ 8,273**	$ 3,624	$ 3,552
State	**322**	190	239
Total current	**$ 8,595**	$ 3,814	$ 3,791
Deferred:			
Federal	**$ (3,409)**	$ (2,978)	$ (360)
State	**(81)**	(138)	29
Total deferred	**(3,490)**	(3,116)	(331)
Provision for income taxes	**$ 5,105**	$ 698	$ 3,460
Effective tax rate	**3.8%**	0.6%	2.9%

Reconciliation of Taxes at Federal Statutory Rate to Provision for Income Taxes

(in thousands)

For the year ended December 31	**2016**	2015	2014
Federal tax at statutory rates	**$ 47,020**	$ 43,610	$ 42,297
State tax, net	**95**	57	111
Patronage distributions	**(8,525)**	(8,538)	(7,508)
Effect of non-taxable entity	**(34,387)**	(32,706)	(30,690)
Other	**902**	(1,725)	(750)
Provision for income taxes	**$ 5,105**	$ 698	$ 3,460

Tax Related Matters

Tax reductions were recorded reflecting the 2007, 2006, and 2005 nonqualified patronage retired in the fourth quarters of 2016, 2015, and 2014, respectively. These reductions are reflected in the above table in the “Patronage distributions” adjustments.

Deferred Income Taxes

Tax laws require certain items to be included in our tax returns at different times than the items are reflected on our Consolidated Statements of Comprehensive Income. Some of these items are temporary differences that will reverse over time. We record the tax effect of temporary differences as deferred tax assets and liabilities netted on our Consolidated Statements of Condition.

Deferred Tax Assets and Liabilities

(in thousands) As of December 31	2016	2015	2014
Allowance for loan losses	**$ 7,239**	$ 5,193	$ 4,306
Postretirement benefit accrual	**536**	510	485
Deferred fee income, net	**1,168**	897	695
Accrued incentive	**1,366**	1,654	1,378
Leasing related, net	**(8,400)**	(11,396)	(12,511)
Accrued patronage income not received	**(906)**	(481)	(702)
Accrued pension asset	**(779)**	--	--
Depreciation	**(177)**	(190)	(212)
Other assets	**81**	451	409
Other liabilities	**(253)**	(252)	(578)
Deferred tax liabilities, net	**$ (125)**	$ (3,614)	$ (6,730)
Gross deferred tax assets	**$ 10,390**	$ 8,705	$ 7,273
Gross deferred tax liabilities	**$ (10,515)**	$ (12,319)	$ (14,003)

A valuation allowance for the deferred tax assets was not necessary at December 31, 2016, 2015, or 2014.

We have not provided for deferred income taxes on approximately $59.8 million of patronage allocations received from AgriBank prior to 1993. Such allocations, distributed in the form of stock, are subject to tax only upon conversion to cash. Our intent is to permanently maintain this investment in AgriBank. Also, we have not provided deferred income taxes on $4.6 million of patronage allocations in the form of AgriBank stock distributed in 2002 to the ACA and PCA. The Board of Directors has passed a resolution that, should this stock ever be converted to cash, creating a tax liability, an equal amount will be distributed to patrons at that time under our patronage program. Additionally, we have not provided deferred income taxes on accumulated FLCA earnings of $843.7 million as it is our intent to permanently maintain this equity in the FLCA or to distribute the earnings to stockholders in a manner that results in no additional tax liability to us.

Our income tax returns are subject to review by various United States taxing authorities. We record accruals for items that we believe may be challenged by these taxing authorities. However, we had no uncertain income tax positions at December 31, 2016. In addition, we believe we are no longer subject to income tax examinations for years prior to 2013.

NOTE 13: EMPLOYEE BENEFIT PLANS

Pension and Post-Employment Benefit Plans

Complete financial information for the pension and post-employment benefit plans may be found in the Combined AgriBank and affiliated Associations 2016 Annual Report (District financial statements).

The Farm Credit Foundations Plan Sponsor and Trust Committees provide oversight of the benefit plans. These governance committees are comprised of elected or appointed representatives (senior leadership and/or Board of Director members) from participating organizations. The Coordinating Committee (a subset of the Plan Sponsor Committee comprised of AgriBank District representatives) is responsible for decisions regarding retirement benefits at the direction of AgriBank District participating employers. The Trust Committee is responsible for fiduciary and plan administrative functions.

Pension Plan: Certain employees participate in the AgriBank District Retirement Plan, a District-wide multi-employer defined benefit retirement plan. The plan is comprised of two benefit formulas. At their option, employees hired prior to October 1, 2001 are on the cash balance formula or the final average pay formula. New benefits-eligible employees hired between October 1, 2001 and December 31, 2006 are on the cash balance formula. Effective January 1, 2007, the defined benefit retirement plan was closed to new employees. 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 certain eligible District 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 we choose to stop participating in the plan, we may be required to pay an amount based on the underfunded status of the plan. Because of the nature of the plan, any individual employer is not able to unilaterally change the provisions of the plan. If an employee transfers to another employer within the same plan, 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.

AgriBank District Retirement Plan Information

(in thousands) As of December 31		2016		2015		2014
Unfunded liability	**$**	**374,305**	$	453,825	$	423,881
Projected benefit obligation		**1,269,625**		1,255,259		1,234,960
Fair value of plan assets		**895,320**		801,434		811,079
Accumulated benefit obligation		**1,096,913**		1,064,133		1,051,801

For the year ended December 31		2016		2015		2014
Total plan expense	**$**	**53,139**	$	63,800	$	45,827
Our allocated share of plan expenses		**7,056**		8,759		6,449
Contributions by participating employers		**90,000**		62,722		52,032
Our allocated share of contributions		**11,808**		8,619		7,263

The unfunded liability 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 accumulated benefit obligation is the actuarial present value of the benefits attributed to employee service rendered before the measurement date and based on current employee service and compensation. The 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 their current employees as well as an allocation of the remaining costs based proportionately on the estimated projected liability of the employer under this plan. We recognize our proportional share of expense and contribute a proportional share of funding. Our allocated share of plan expenses is included in “Salaries and employee benefits” in the Consolidated Statements of Comprehensive Income.

Benefits paid to participants in the District were $56.4 million in 2016. While the plan is a governmental plan and is not subject to minimum funding requirements, 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 total District employer contributions expected to be paid into the pension plan during 2017 is $90.0 million. Our allocated share of these pension contributions is expected to be $11.8 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 amounts reflected in the District financial statements.

Nonqualified Retirement Plan: We also participate in the District-wide nonqualified defined benefit Pension Restoration Plan. This plan restores retirement benefits to certain highly compensated eligible employees that would have been provided under the qualified plan if such benefits were not above certain Internal Revenue Code limits.

Pension Restoration Plan Information

(in thousands) As of December 31		2016		2015		2014
Unfunded liability	**$**	**28,514**	$	31,650	$	27,695
Projected benefit obligation		**28,514**		31,650		27,695
Accumulated benefit obligation		**22,778**		26,323		22,959

For the year ended December 31		2016		2015		2014
Total plan expense	**$**	**5,767**	$	3,776	$	3,652
Our allocated share of plan expenses		**3,004**		595		1,231
Our cash contributions		**5,200**		216		158

The nonqualified plan is funded as the benefits are paid; therefore, there are no assets in the plan and the unfunded liability is equal to the projected benefit obligation. The amount of the pension benefits funding status is subject to many variables including 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 their participants in the plan. Our allocated share of plan expenses is included in “Salaries and employee benefits” in the Consolidated Statements of Comprehensive Income. The Pension Restoration Plan is unfunded and we make annual contributions to fund benefits paid to our retirees covered by the plan.

Retiree Medical Plans: District employers also provide certain health insurance benefits to eligible retired employees according to the terms of the benefit plans. The anticipated costs of these benefits are accrued during the period of the employee’s active status.

Retiree Medical Plan Information

(in thousands) For the year ended December 31		2016		2015		2014
Postretirement benefit expense	$	**157**	$	275	$	166
Our cash contributions		**144**		139		128

Postretirement benefit costs are included in "Salaries and employee benefits" in the Consolidated Statements of Comprehensive Income. Our cash contributions are equal to the benefits paid.

Defined Contribution Plans

We participate in a District-wide defined contribution plan. For employees hired before January 1, 2007, employee contributions are matched dollar for dollar up to 2.0% and 50 cents on the dollar on the next 4.0% on both pre-tax and post-tax contributions. The maximum employer match is 4.0%. For employees hired after December 31, 2006, we contribute 3.0% of the employee's compensation and will match employee contributions dollar for dollar up to a maximum of 6.0% on both pre-tax and post-tax contributions. The maximum employer contribution is 9.0%.

We also participate in a District-wide Nonqualified Deferred Compensation Plan. Eligible participants must meet one of the following criteria: certain salary thresholds as determined by the IRS, are either a Chief Executive Officer or President of a participating employer, or have previously elected pre-tax deferrals in 2006 under predecessor nonqualified deferred compensation plans. Under this plan the employee may defer a portion of his/her salary, bonus, and other compensation. Additionally, the plan provides for supplemental employer matching contributions related to any compensation deferred by the employee that would have been eligible for a matching contribution under the defined contribution plan if it were not for certain IRS limitations.

Employer contribution expenses for the defined contribution plan, included in "Salaries and employee benefits" in the Consolidated Statements of Comprehensive Income, were $3.8 million, $3.6 million, and $3.4 million in 2016, 2015, and 2014, respectively. These expenses were equal to our cash contributions for each year.

Additionally, we participate in a District-wide Pre-409A Frozen Nonqualified Deferred Compensation Plan. This plan serves the same purpose as the Nonqualified Deferred Compensation Plan. However, the plan was frozen effective January 1, 2007. As such, no additional participants are eligible to enter the plan and no additional employer contributions will be made to the plan.

NOTE 14: RELATED PARTY TRANSACTIONS

In the ordinary course of business, we may enter into loan transactions with our officers, directors, their immediate family members, and other organizations with which such persons may be associated. Such transactions may be 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 other persons. In our opinion, none of these loans outstanding at December 31, 2016 involved more than a normal risk of collectability.

Related Party Loans and Leases Information

(in thousands)		2016		2015		2014
As of December 31:						
Total related party loans and leases	$	**13,194**	$	22,510	$	26,119
For the year ended December 31:						
Advances to related parties	$	**8,804**	$	18,787	$	21,571
Repayments by related parties		**8,605**		18,063		19,325

The related parties can be different each year end primarily due to changes in the composition of the Board of Directors and the mix of organizations with which such persons may be associated. Advances and repayments on loans and leases in the preceding chart are related to those considered related parties at year end.

Additional transactions other than loans in the ordinary course of business involving directors and senior officers include purchasing meat gift boxes from Compart Family Farms, Inc. at advertised prices. Director, Kaye Compart, is affiliated with Compart Family Farms, Inc.

As discussed in Note 9, we borrow from AgriBank, in the form of a line of credit, to fund our loan portfolio.

We purchase various services from AgriBank including certain financial and retail systems, financial reporting services, tax reporting services, technology services, insurance services, and internal audit services. The total cost of services we purchased from AgriBank was $2.2 million, $1.9 million, and $1.9 million in 2016, 2015, and 2014, respectively.

We also purchase human resource information systems, and benefit, payroll, and workforce management services from Farm Credit Foundations (Foundations). As of December 31, 2016, 2015, and 2014, our investment in Foundations was $83 thousand. The total cost of services purchased from Foundations was $486 thousand, $422 thousand, and $391 thousand in 2016, 2015, and 2014, respectively.

We have an agreement with CoBank to provide certain cash management services to some of our clients. To support these cash management services, we have a cash management agreement with CoBank that includes a $9.25 million back-up cash management settlement facility.

NOTE 15: CONTINGENCIES AND COMMITMENTS

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

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

We have commitments to extend credit and letters of credit to satisfy the financing needs of our borrowers. These financial instruments involve, to varying degrees, elements of credit risk that may be recognized in the 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 loan contract. Standby letters of credit are agreements to pay a beneficiary if there is a default on a contractual arrangement. At December 31, 2016, we had commitments to extend credit and unexercised commitments related to standby letters of credit of $2.4 billion. Additionally, we had $44.8 million of issued standby letters of credit and $11.2 million of other commitments as of December 31, 2016. Refer to Note 17 for additional discussion regarding standby letters of credit.

Commitments to extend credit and letters of credit generally have fixed expiration dates or other termination clauses and we may require payment of a fee. If commitments to extend credit and letters of credit remain unfulfilled or have not expired, they may have credit risk not recognized in the financial statements. Many of the commitments to extend credit and letters of credit will expire without being fully drawn upon. Therefore, the total commitments do not necessarily represent future cash requirements. Certain letters of credit may have recourse provisions that would enable us to recover from third parties amounts paid under guarantees, thereby limiting our maximum potential exposure. The credit risk involved in issuing these financial instruments is essentially the same as that involved in extending loans to borrowers and we apply the same credit policies. The amount of collateral obtained, if deemed necessary by us upon extension of credit, is based on management's credit evaluation of the borrower.

We are among the limited partners in a RBIC. Refer to Note 6 for additional discussion regarding this commitment.

NOTE 16: DERIVATIVES

We use forward commitments to sell TBAs at specified prices to economically hedge the interest rate risk on investments available-for-sale, loans held for sale, and interest rate lock commitments. Changes in fair value subsequent to inception are based on changes in the fair value of the underlying loan and for commitments to originate loans and changes in the probability that the loan will fund within the terms of the commitment. Changes in the probability that the loan will fund within the terms of the commitment are affected primarily by changes in interest rates and the passage of time.

As of December 31, 2016, we had $34.5 million of forward commitments to sell, hedging $27.4 million of mortgage loans held for sale and $13.0 million of unfunded mortgage loan commitments. We began hedging available-for-sale investments during 2015, however there were no available-for-sale investments outstanding at December 31, 2016 or 2015. As of December 31, 2015, we had $42.7 million of forward commitments to sell, hedging $35.4 million of mortgage loans held for sale and $8.9 million of unfunded mortgage loan commitments. As of December 31, 2014, we had $8.9 million of forward commitments to sell, hedging $7.9 million of mortgage loans held for sale and $3.4 million of unfunded mortgage loan commitments. The forward commitments to sell and the unfunded mortgage loan commitments on loans intended to be sold are considered derivatives and are recognized at fair value. On the TBAs, we had gains of $1.3 million, $315 thousand, and $21 thousand and losses of $1.5 million, $1.0 million, and $579 thousand relating to net fair value adjustments and sales in 2016, 2015, and 2014, respectively. These amounts were included in "Fee and miscellaneous income, net" in the Consolidated Statements of Comprehensive Income.

NOTE 17: 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 for a more complete description of the three input levels.

Recurring

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

Loans held for sale: The loans held for sale portfolio is held at fair value. Fair value is based on quoted market prices, where available, or the prices for other similar mortgage loans with similar characteristics. As necessary, these prices are adjusted for typical securitization activities, including servicing value, portfolio composition, market conditions, and liquidity. We had loans held for sale of $27.4 million, $35.4 million, and $7.9 million as of December 31, 2016, 2015, and 2014, respectively, which were valued using Level 3 inputs. Total fair value losses related to these loans of $468 thousand in 2016 and fair value gains of $155 thousand and $85 thousand in 2015 and 2014, respectively, were recognized in "Fee and miscellaneous income, net" in the Consolidated Statements of Comprehensive Income.

Investment securities available-for-sale: Investment securities available-for-sale are held at fair value. Fair value is based on quoted market prices, where available, or the prices for other similar securities with similar characteristics. As necessary, these prices are adjusted for typical securitization activities, including servicing value, portfolio composition, market conditions, and liquidity. Investment securities available-for-sale totaled $21.0 million at December 31, 2014, which were valued using Level 3 inputs. Gains related to these investments totaling $82 thousand in 2014, were recognized in "Other comprehensive income" in the Consolidated Statements of Comprehensive Income. During the year ended December 31, 2016 and 2015 we sold available-for-sale investment securities with total sales proceeds of $102.8 million and $53.7 million, resulting in a gain of $659 thousand and $355 thousand, respectively, which was recognized in "Fee and miscellaneous income, net" in the Consolidated Statements of Comprehensive Income. We had no outstanding available-for-sale securities at December 31, 2016 or 2015.

Derivatives: If an active market exists, the fair value of our derivative financial instruments called TBAs is based on currently quoted market prices. We had TBAs with a notional value of $34.5 million, $42.7 million, and $8.9 million as of December 31, 2016, 2015, and 2014, respectively, which were used to manage exposure to interest rate risk and changes in the fair value of loans held for sale and the interest rate lock commitments that are determined prior to funding. Beginning in 2015, we also used these instruments to hedge the changes in fair value related to investment securities available-for-sale. These derivatives were recorded on a net basis using Level 1 fair value inputs. Net losses related to TBAs sold, combined with fair value gains on the TBAs, resulted in a net loss of $225 thousand, $709 thousand, and $558 thousand in 2016, 2015, and 2014, respectively. These were included in “Fee and miscellaneous income, net” in the Consolidated Statements of Comprehensive Income.

Non-Recurring

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

Impaired loans: Represents the carrying amount and related write-downs of loans which were evaluated for individual impairment based on the appraised value of the underlying collateral. When the value of the collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established. Costs to sell represent transaction costs and are not included as a component of the asset’s fair value. If the process uses independent appraisals and other 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.

Assets Measured at Fair Value on a Non-recurring Basis

(in thousands)

As of December 31, 2016	Fair Value Measurement Using				Total (Losses)
	Level 1	Level 2	Level 3	Total Fair Value	Gains
Impaired loans	**$ --**	**$ 821**	**$ 4,969**	**$ 5,790**	**$ (2,030)**
Other property owned	**--**	**--**	**1,022**	**1,022**	**255**

As of December 31, 2015	Fair Value Measurement Using				
	Level 1	Level 2	Level 3	Total Fair Value	Total Gains
Impaired loans	$ --	$ 1,493	$ 1,190	$ 2,683	$ 119
Other property owned	--	--	1,473	1,473	484

As of December 31, 2014	Fair Value Measurement Using				
	Level 1	Level 2	Level 3	Total Fair Value	Total Gains
Impaired loans	$ --	$ 1,174	$ 4,792	$ 5,966	$ 1,272
Other property owned	--	--	4,322	4,322	567

Other Financial Instrument Measurements

Estimating the fair value of our investment in AgriBank is not practical because the stock is not traded. As discussed in Note 7, the investment is a requirement of borrowing from AgriBank.

A description of the methods and assumptions used to estimate the fair value of each class of our financial instruments, measured at carrying amounts and not measured at fair value on the Consolidated Statements of Condition, for which it is practical to estimate that value, follows:

Net non-impaired loans held to maturity: Because no active market exists for our loans, the fair value of loans that are not individually specifically impaired is estimated by discounting the expected future cash flows using current interest rates at which similar loans would be made or repriced to borrowers with similar credit risk. In addition, loans are valued using the Farm Credit interest rate yield curve, prepayment rates, contractual loan information, credit classification, and collateral values. As the discount rates are based upon internal pricing mechanisms and other management estimates, management has no basis to determine whether the fair values presented would be indicative of the exit price negotiated in an actual sale. Furthermore, certain statutory or regulatory factors not considered in the valuation, such as the unique statutory rights of System borrowers, could render our portfolio less marketable outside the System.

Investment securities held to maturity: If an active market exists, the fair value is based on currently quoted market prices. For those securities for which an active market does not exist, we estimate the fair value of these investments by discounting the expected future cash flows using current interest rates adjusted for credit risk.

Rural business investment company: Given the limited information available related to the expected return of our non-controlling interest in the RBIC and current earnings do not indicate impairment or projected losses, fair value was estimated at cost. The RBIC is included in “Other assets” in the Consolidated Statements of Conditions.

Note payable to AgriBank, FCB: Estimating the fair value of the note payable to AgriBank is determined by segregating the note into pricing pools according to the types and terms of the underlying loans funded. We discount the estimated cash flows from these pools using the current rate charged by AgriBank for additional borrowings with similar characteristics.

Subordinated debt: We estimate the fair value of the subordinated debt by discounting the expected future cash requirements using current interest rates.

Commitments to extend credit and letters of credit: Estimating the fair value of commitments and letters of credit is determined by the inherent credit loss in such instruments.

Financial Instruments Not Measured at Fair Value on the Consolidated Statements of Condition

(in thousands)

As of December 31	**2016**		2015		2014	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:						
Net non-impaired loans held to maturity	**$ 8,110,904**	**$ 8,090,387**	$ 7,542,416	$ 7,567,903	$ 6,870,310	$ 6,923,936
Investment securities held to maturity	**473,248**	**459,618**	442,972	432,675	460,939	451,926
Rural business investment company	**7,455**	**7,455**	4,216	4,216	757	757
Financial liabilities:						
Note payable to AgriBank, FCB	**$ 7,590,254**	**$ 7,567,186**	$ 6,949,764	$ 6,959,752	$ 6,340,682	$ 6,367,951
Subordinated debt	**--**	**--**	99,491	108,900	99,369	110,793
Unrecognized financial instruments:						
Commitments to extend credit and letters of credit		**$ (3,086)**		$ (3,273)		$ (2,869)

NOTE 18: SUBSEQUENT EVENTS

We have evaluated subsequent events through March 9, 2017, 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 2016 Consolidated Financial Statements or disclosures in the Notes to Consolidated Financial Statements.

DISCLOSURE INFORMATION REQUIRED BY REGULATIONS

AgStar Financial Services, ACA
(Unaudited)

Description of Business

General information regarding the business is incorporated herein by reference from Note 1 to the accompanying Consolidated Financial Statements.

The description of significant business developments, if any, is incorporated herein by reference from the “Management's Discussion and Analysis" section of the accompanying Consolidated Financial Statements.

Description of Property

Property Information

Location	Description	Usage
Apple Valley, MN	Leased	Branch
Baldwin, WI	Owned	Branch
Bloomington, IL	Leased	Commercial Unit
Blue Earth, MN	Leased	Branch
Des Moines, IA	Leased	Contact Office
Duluth, MN	Leased	Contact Office
Glencoe, MN	Owned	Branch
Lake Elmo, MN	Leased	Commercial Unit
Mankato, MN	Owned / Leased	Branch/Headquarters
Meridian, ID	Leased	Contact Office
Northfield, MN	Leased	Branch
Rice Lake, WI	Owned	Branch
Rochester, MN	Leased	Branch
St. Cloud, MN	Owned	Branch
Sauk Centre, MN	Leased	Contact Office
Spokane, WA	Leased	Commercial Unit
Worthington, MN	Leased	Branch/Contact Office

Legal Proceedings

Information regarding legal proceedings is discussed in Note 15 to the accompanying Consolidated Financial Statements. We were not subject to any enforcement actions as of December 31, 2016.

Description of Capital Structure

Information regarding our capital structure is discussed in Note 11 to the accompanying Consolidated Financial Statements.

Description of Liabilities

Information regarding liabilities is discussed in Notes 9, 10, 11, 12, 13, 15, and 17 to the accompanying Consolidated Financial Statements.

Selected Financial Data

The "Consolidated Five-Year Summary of Selected Financial Data” is presented at the beginning of the accompanying Consolidated Financial Statements.

Management’s Discussion and Analysis

Information regarding any material aspects of our financial condition, changes in financial condition, and results of operations are discussed in the "Management's Discussion and Analysis” section of the accompanying Consolidated Financial Statements.

Board of Directors

Our Board of Directors is organized into the following committees to carry out Board responsibilities:

- The **Audit Committee** oversees financial reporting, the adequacy of our internal control systems, the scope of our internal audit program, the independence of the outside auditors, the processes for monitoring compliance with laws and regulations and the code of ethics. The Audit Committee also oversees the adequacy of management’s action with respect to recommendations arising from auditing activities.

- The **Credit Committee** oversees the integration of risk management activities throughout our organization. Committee members review ongoing risk assessments of current and emerging risks to ensure adequate planning and resources are directed at managing the identified risks. The Credit Committee also establishes and promotes an effective risk culture throughout our organization.
- The **Human Resources Committee** oversees and provides overall direction and/or recommendations for compensation, benefits and human resource performance management programs.

Board of Directors as of December 31, 2016, including business experience during the last five years

Name	Term	Principal occupation and other business interests
Kaye Compart Chairperson	October 2015 - 2018	**Principal occupation:** Self-employed swine and seedstock producer **Other affiliations:** Director: Nicollet Area Community Foundation, Nicollet, MN, a fundraising organization
Dale Holmgren Vice Chairperson	October 2016 - 2020	**Principal occupation:** Self-employed grain and livestock farmer **Other affiliations:** President: Svin Hus, Inc., a swine operation
Wesley Beck	October 2014 - 2017	**Principal occupation:** Self-employed grain and livestock farmer **Other affiliations:** Director: St. James Medical Center Foundation, St. James, MN, a volunteer fundraising committee
Eunice Biel	October 2014 - 2017	**Principal occupation:** Self-employed dairy and grain famer Employed through 2014 at Mayo Clinic, Rochester, MN, as a Graphic Designer **Other affiliations:** Executive Board: Minnesota Farmers Union, a general farm policy organization Board Member: Center for Rural Policy and Development, Mankato, MN, a nonprofit organization focused on rural issues Board Member: Minnesota Dairy Research/Education and Consumer Outreach Authority, St. Paul, MN, an agency of the Minnesota Department of Agriculture focused on partnerships between higher education and the dairy industry Board Member: Associated Milk Producer's Inc., a dairy marketing cooperative owned by Midwest dairy farm families Bristol Township Clerk
David Bollman	October 2016 - 2018	**Principal occupation:** Self-employed grain and vegetable farmer
Theresa Ann Broome Outside Director	October 2015 - 2019	**Principal occupation:** Self-employed Human Resources Consultant Chief People Officer: Lower Colorado River Authority, Austin, TX, a power plant and park management company (August 2010 - March 2012) **Other affiliations:** President: Sienna Group, HR Consulting Director: Farm Credit Foundations, a pension and benefits service provider
Terry Ebeling	October 2016 - 2019	**Principal occupation:** Self-employed grain farmer
Spencer Enninga	October 2014 - 2017	**Principal occupation:** Self-employed grain and livestock farmer and seed sales representative **Other affiliations:** President: Enninga Farms, Inc., Fulda, MN, a grain and livestock operation
Joyce Fernando Outside Director	April 2015 - October 2017	**Principal occupation:** Finance Lead for ConAgra Foods, Park Rapids, MN (2016 - Present) Plant Controller for ConAgra Foods, Park Rapids, MN (2013 - 2016) International Accounting Manager for The Walt Disney Company (2007 - 2013)
Larry Fischer	October 2015 - 2017	**Principal occupation:** Self-employed grain and livestock farmer **Other affiliations:** President/Treasurer: Fischer Dairy, Inc., Sleepy Eye, MN, a dairy operation Member: Fischer Ridge, LLC, Sleepy Eye, MN, an entity created to own and manage recreational land
Kevin Koppendrayer	October 2015 - 2019	**Principal occupation:** Self-employed grain farmer and a seed sales representative Owner: Koppendrayer Trucking, Princeton, MN

Name	Term	Principal Occupation and Other Affiliations
David Kretzschmar	October 2014 - 2017	**Principal occupation:** Self-employed dairy and grain farmer **Other affiliations:** President: Kretzschmar Holsteins, Inc., Mellen, WI, a dairy operation
Gregory Nelson	October 2014 - 2017	**Principal occupation:** Self-employed grain and livestock farmer
Rick Sommers	October 2015 - 2018	**Principal occupation:** Self-employed dairy farmer. He ran a dairy operation until late 2014. Williams & Associates, appraisal trainee

In 2015, the Board of Directors approved to reduce the number of regions from five to three and reduced the number of stockholder-elected Directors from 15 to 12 following the 2016 Director election. The term for Directors has been increased from three years to four years. In order to accomplish a goal of one stockholder-elected Director on the ballot each year from each of AgStar's three regions, Director terms will vary over the next several years ranging from two to four years.

Pursuant to our bylaws, Directors are paid a reasonable amount for attendance at board meetings, committee meetings, or other special assignments. Directors are also reimbursed for reasonable expenses incurred in connection with such meetings or assignments. In 2016, the Board of Directors' per diem rate was $400 per day plus travel time compensation for each meeting attended. The Board of Directors regular monthly meetings are normally two days in length. In addition, they hold two, three-day planning sessions annually. In 2016, each Director received a $1,200 per month retainer fee, with the exception of the chairperson who received a $1,700 per month retainer fee. The Board committee chairperson for the Audit Committee, Human Resources Committee, and Credit Committee each received an additional retainer of $100 per month. Each Director is eligible for a variable retainer fee based on companywide financial and business objectives. The award is calculated as a percentage of the Director's annual per diem compensation. The performance criteria include return on equity, operating revenue growth, adverse assets to risk funds ratio, net operating rate, client satisfaction, and client loyalty. Under the terms of the plan, no payments are made in the event our return on equity or adverse assets to risk funds ratio fall outside specified threshold levels. The percentage used in the award calculation depends on the actual results for each performance criteria.

Information regarding compensation paid to each director who served during 2016 follows:

	Number of Days Served				
Name	Board Meetings	Other Official Activities	Compensation Paid for Service on a Board Committee	Name of Committee	Total Compensation Paid in 2016[1]
Wesley Beck	19.0	26.0	$ 2,133	Audit	$ 38,284
Eunice Biel	19.0	23.0	1,788	Human Resources	35,941
David Bollman	19.0	19.0	1,763	Human Resources	34,582
Theresa Ann Broome	19.0	42.0	2,400	Human Resources	50,356
Kaye Compart	19.0	38.0	1,694	Human Resources	49,475
Terry Ebeling	18.0	20.0	2,134	Audit	34,210
Spencer Enninga	19.0	23.0	1,777	Credit	36,761
Joyce Fernando	15.0	12.0	2,178	Audit	30,765
Larry Fischer	19.0	18.0	2,181	Audit	34,019
Dale Holmgren	19.0	36.0	1,707	Credit	41,587
Steven Johnson[2]	16.0	17.0	1,386	Human Resources	30,399
Kevin Koppendrayer	19.0	23.0	2,107	Audit	35,927
David Kretzschmar	19.0	31.0	1,829	Credit	41,629
William McCue[2]	16.0	12.0	1,275	Credit	26,937
Gregory Nelson	19.0	25.0	1,706	Credit	36,705
Lawrence Romuald[3]	0.0	0.0			2,682
Lowell Schafer[3]	0.0	0.0			1,860
Rick Sommers	19.0	10.0	1,685	Human Resources	29,770
					$ 591,889

[1] Compensation in 2016 includes taxable fringe benefits, if applicable and variable retainer earned during 2015 and paid in 2016.

[2] No longer on the Board at December 31, 2016.

[3] No longer on the Board, compensation represents variable retainer earned during 2015 and paid in 2016.

Senior Officers

Senior Officers as of December 31, 2016, including business experience during the last five years

Name and Position	Business experience and other business interests
Rodney W. Hebrink President and Chief Executive Officer	**Business experience:** President and Chief Executive Officer from July 2014 to present Executive Vice President and Chief Financial Officer from October 2011 - July 2014 **Other business affiliations:** Board Member of Farm Credit Foundations, a pension and benefits service provider Board Member of MN AgriGrowth Council President of Rural Funding, LLC
Joseph R. Deufel Executive Vice President, Chief Credit Officer and Assistant Secretary	**Business experience:** Executive Vice President, Chief Credit Officer and Assistant Secretary from July 1991 to present
Jase L. Wagner Senior Vice President and Chief Financial Officer	**Business experience:** Senior Vice President and Chief Financial Officer from October 2014 to present Vice President and Managing Director, Agri-Access from January 2014 to October 2014 Vice President of Capital Management from April 2010 to January 2014
Wick Manley Executive Vice President and Chief Relationship Management Officer	**Business experience:** Executive Vice President and Chief Relationship Management Officer from September 2001 to present
Paul B. Kohls Senior Vice President, General Counsel and Secretary	**Business experience:** Senior Vice President, General Counsel and Secretary from January 2012 to present **Other business affiliations:** Board Member of Better Futures Minnesota, a non-profit

Information related to compensation paid to senior officers is provided in our Annual Meeting Information Statement (AMIS). The AMIS is available for public inspection at our office.

Transactions with Senior Officers and Directors

Information regarding related party transactions is discussed in Note 14 to the accompanying Consolidated Financial Statements.

Travel, Subsistence, and Other Related Expenses

Directors and senior officers are reimbursed for reasonable travel, subsistence, and other related expenses associated with business functions. A copy of our policy for reimbursing these costs is available by contacting us at:

P.O. Box 4249
Mankato, MN 56002
(866) 577-1831
www.agstar.com
AgStarEteam@agstar.com

The total directors' travel, subsistence, and other related expenses were $197 thousand, $196 thousand, and $350 thousand in 2016, 2015, and 2014, respectively.

Involvement in Certain Legal Proceedings

No events occurred during the past five years that are material to evaluating the ability or integrity of any person who served as a director or senior officer on January 1, 2017 or at any time during 2016.

Client Privacy

The FCA Regulations protect clients' nonpublic personal financial information. Our directors and employees are restricted from disclosing information about our association or our clients not normally contained in published reports or press releases.

Relationship with Qualified Public Accountant

There were no changes in independent auditors since the last Annual Report to stockholders and we are in agreement with the opinion expressed by the independent auditors. The total fees paid during 2016 for audit services were $126 thousand and $2 thousand was paid for accounting research software. Our audit committee has approved non-audit services for merger related preclearance services. As of December 31, 2016, we have paid no fees associated with these non-audit services.

Financial Statements

The "Report of Management", "Report on Internal Control Over Financial Reporting", "Report of Audit Committee", "Report of Independent Auditors", "Consolidated Financial Statements", and "Notes to Consolidated Financial Statements" are presented prior to this portion of the accompanying Consolidated Financial Statements.

Young, Beginning, and Small Farmers and Ranchers

Information regarding credit and services to young, beginning, and small farmers and ranchers, and producers or harvesters of aquatic products is discussed in an addendum to this Annual Report.

Equal Employment Opportunity

We are an equal opportunity employer. It is our policy to provide equal employment opportunity to all persons regardless of race, color, sex, creed, religion, national origin, age, disability, marital status, familial status, sexual orientation, public assistance status, veteran status, genetic information, pregnancy or any other status protected by law. We comply with all federal, state, and local equal opportunity employment regulations. All personnel decisions and processes relating to our employees and job applicants are conducted in an environment free of discrimination and harassment. We are committed to recruiting, hiring, providing standard benefits, training, and promoting without regard to the above listed factors.

YOUNG, BEGINNING, AND SMALL FARMERS AND RANCHERS

AgStar Financial Services, ACA

(Unaudited)

We have specific programs in place to serve the credit related needs of young, beginning and small farmers and ranchers (YBS) in our territory. The definitions of YBS as developed by the Farm Credit Administration (FCA) follow:

- Young: A farmer, rancher, or producer or harvester of aquatic products who is age 35 or younger as of the loan transaction date.
- Beginning: A farmer, rancher, or producer or harvester of aquatic products who has 10 years or less farming or ranching experience as of the loan transaction date.
- Small: A farmer, rancher, or producer or harvester of aquatic products who normally generates less than $250 thousand in annual gross sales of agricultural or aquatic products.

Mission Statement

Mission Statement: We will provide ongoing access to credit, related services and outreach programs to qualified YBS farmers.

Policy to complete Mission Statement: We will actively develop and execute an annual business plan to qualified YBS farmers. This plan will target and serve YBS farmers through a variety of credit and outreach programs in an effort to help the next generation of farmers succeed. We are further committed to supporting educational and developmental opportunities to this segment of farmers.

2016 Business Environment

The number of young farmers within our territory has increased during the last several years. The 2007 United States Department of Agriculture (USDA) census data showed the young farmer population within our territory at 6%. Data from the 2012 USDA census revealed the young farmer population is now 12%. In comparison, 18% of our total loans are to young farmers. (The USDA census information and FCA definition of young farmers varies slightly. USDA information is reported for farmers 34 years of age and younger, versus the FCA's definition of 35 years of age and younger.)

The number of beginning farmers has increased slightly over the past years. According to the USDA census, beginning farmers within our territory increased from 20% in 2007 to 21% in 2012. Using the FCA definition, 22% of our total loans are made to beginning farmers. (The USDA census information and FCA definition of beginning farmers varies slightly. While FCA defines a beginning farmer as an individual with 10 years or less experience, the USDA reports those who have been farming the same farm for 9 years or less.)

In the small farmer area there has been a widening disparity in gross farm income between the large and small farmers. Of farmers surveyed in the 2007 census, 87% had less than $250 thousand in total value of sales. In the 2012 USDA census, this decreased to 81%. Forty-one percent of our total loans are to small farmers. (The FCA definition of a small farm [less than $250 thousand in annual gross sales] varies some from the USDA census information, which is reported as total value of sales.)

In 2016, we targeted $4.5 billion of aggregate YBS lending. Total aggregate YBS lending at year end 2016 was $4.5 billion, putting us at our targeted level. Our YBS goals and results for 2016 were:

Total number of loans to Young, Beginning and Small Farmers

	Goal	Actual	% of Goal
Young	11,000	10,626	97%
Beginning	13,500	12,932	96%
Small	25,600	24,466	96%

New loans made in 2016 to Young, Beginning and Small Farmers

	Number of loans		TLO* (in millions)	
	Goal	Actual	Goal	Actual
Young	4,200	4,422	$420	$413
Beginning	5,200	5,030	$470	$525
Small	10,900	10,502	$460	$495

* TLO - Total Legal Obligation

The number of new loans to young farmers and the new loan TLO for both beginning and small farmers exceeded all targeted levels. Of the loans that utilized government agency guarantees in 2016, 56% were to YBS farmers.

2016 Highlights

Each of our Financial Service Officers was charged with establishing relationships and writing new loans with six new, young or beginning farmer prospects in 2016. The average number of new, young, or beginning clients per Financial Service Officer achieved was 6.6, surpassing the targeted level. Ongoing informal mentoring and financial counseling is provided as a normal course of business to young and beginning farmers. Closely linked to the mentoring program is the offering of related services. Financial Service Officers, through their normal course of business, also discuss the advantages and availability of other products and services, including crop insurance, cash management, and online banking services which are also available to YBS farmers.

As part of our YBS educational and outreach initiatives, we offered the "GroundBreakers Educational Conference" in February 2016. The two-day conference featured sessions around management characteristics of successful agricultural producers as well as industry and legislative breakout sessions. The conference was attended by over 300 clients and prospects. Additionally, the AgStar Scholars program (supported by the AgStar Fund for Rural America) continues to offer financial assistance and internship opportunities to students studying agriculture at the University of Minnesota, South Dakota State University, Iowa State University, University of Wisconsin – Madison, and the University of Wisconsin – River Falls. Ten college students were awarded scholarships in 2016. The Fund also awarded 42 scholarships totaling $42,000 to graduating high school seniors who are moving on to study agriculture at the university or technical college level. We continue to provide young and beginning farmers with tuition assistance for state Farm Business Management programs. The program provided partial tuition assistance to 10 clients and non-clients throughout our territory in 2016. We continue to be a financial sponsor of many innovative programs and conferences, the MN FFA Star awards, and the "Ag in the Classroom" program, just to name a few.

Programs for YBS farmers include standards and guidelines to provide for extension of sound and constructive credit, consistent with our business objectives. We review the YBS lending programs and underwriting standards on an ongoing basis. To minimize credit and profit risk exposure, maximum portfolio concentration and program graduation criteria were included in the program. Additionally, a risk pool of $50 million is available annually for YBS farmer loans and leases. In 2016, almost $17 million of the risk pool was utilized.

FUNDS HELD PROGRAM

AgStar Financial Services, ACA

(Unaudited)

Purpose

This policy provides direction to management for administering uninsured voluntary and involuntary accounts in compliance with FCA Regulation 614.4175.

Objective

FCA Regulation 614.4175 provides that the association may provide funds to borrowers from voluntary advance conditional payment accounts in lieu of increasing the borrower's loan. The association also may establish involuntary payment accounts for purposes identified in the regulation and this policy. The direction in this policy provides for regulatory compliance in the administration of such voluntary and involuntary accounts and their management to avoid liquidity risk.

Voluntary Advance Conditional Payment Accounts

Voluntary advance conditional payments are available for the benefit and convenience of clients who desire to make conditional payments. The voluntary account balance may not exceed the outstanding balance on the related loan(s). Loans having a prepayment penalty or variable interest rate cap should not have a funds held balance greater than 10% of the principal balance.

The association will generally pay interest for the time voluntary funds are held unapplied at the Effective Federal Funds Rate calculated by the Federal Reserve Bank of New York to the nearest eighth of one percent following a change in the Target Range by the members of the Federal Reserve's Federal Open Market Committee or a loan's current bill rate minus 50 basis points.

Rate changes will be effective within 60 days of a change by the Federal Reserve's Federal Open Market Committee. Our Asset Liability Committee (ALCO) shall have the authority to adjust the rate paid on funds held. Any change by ALCO in the method of determining the funds held rate shall be reported to the Board within 60 days.

Withdrawal of Funds

Funds in a funds held account may be available to be returned to clients, upon request, for an eligible loan purpose in lieu of increasing the client's loan. Withdrawals from funds held in general should be limited and in general should not be less than $100. Upon the death of a client who has funds held balances, the association does not set up death beneficiaries or "payable on death" designations to distribute funds held balances.

Involuntary Payment Accounts

The association may establish involuntary payment accounts including, but not limited to, funds held for borrowers, such as loan proceeds to be disbursed for which the borrower is obligated; the unapplied insurance proceeds arising from any insured loss; any insurance premiums and applicable taxes collected in advance in connection with any loan.

Amounts in involuntary payments accounts must be reasonable for the purpose for which the account is intended, for example, equal to annual payments of insurance and taxes plus a reasonable contingency, funds for construction projects, or insurance proceeds to rebuild.

The association may pay a different rate of interest on funds held that are required to be maintained either as a condition of the loan or which have other restricted purposes such as insurance and tax escrows or insurance proceeds. If the interest rate on the involuntary payment account is above the association's standard funds held rate, the funds held balance should be limited to 20% of the principal balance.

ALCO shall have authority to adjust the rate paid on funds held if the Federal Funds Rate target no longer provides a reasonable correlation to the Association's variable cost of funds. Any change by ALCO in the method of determining the funds held rate shall be reported to the Board within 60 days.

Withdrawal of Funds on Involuntary Payment Accounts

Involuntary payment accounts may be used only for their specifically designated purpose. Withdrawal of escrow funds may be permitted if the funds are needed to protect the loan collateral or it is not adverse to the association's best interest to release the funds.

Agreement/Disclosures

The association shall require written agreements with borrowers and adequate disclosures regarding:

- The uninsured status of voluntary advance conditional payment funds or involuntary payment account funds and an explanation of the risk in the event of the association's liquidation;
- Limits on amounts that can be paid into voluntary advance conditional payment accounts or involuntary payment accounts;
- Interest rates that will be paid, including the terms of variable interest rates; and
- Withdrawal guidelines.

Liquidation

In the event of association liquidation, all borrowers having funds in voluntary or involuntary uninsured accounts shall be notified in accordance with FCA Regulation 627.2735. The notice shall advise that the funds ceased earning interest when the receivership was instituted, and the funds will be applied against the outstanding indebtedness of any loans of such borrower unless, within 15 days of such notice, the borrower directs the receiver to otherwise apply such funds in the manner provided for in existing loan documents.

The CEO, or other officer designated by the CEO, shall be responsible for developing and maintaining procedures to ensure administration of this policy.

The Board of Directors shall review the ongoing adequacy of this policy at least annually.

Delegated and Retained Authorities

All authorities included in the operating parameters are delegated as specified and to the extent not delegated are retained by the Board of Directors.

Exceptions

Any exceptions to this policy shall require approval of the Board of Directors and, at the option of the Board, may receive post approval.

Reporting

Material issues regarding this policy shall be reported to the Board of Directors by the CEO, or other association officer designated by the CEO, at such times and in such format as the CEO determines appropriate.

Revision Approval Date: 2/26/03; 2/22/07; 12/17/09; 11/18/10; 2/19/14; 12/16/15

Initial Board Approval Date: 12/16/98

Related Documents

FCA Regulations 614.4175 and 627.2735; FCA BL-030

AgStar
Financial Services, ACA

1921 Premier Drive
Mankato, MN 56001