# 2014

# ANNUAL REPORT

# PREMIER FARM CREDIT, ACA

# MESSAGE TO STOCKHOLDERS

Dear Members:

On behalf of the Board of Directors and staff, I am pleased to present to you the 2014 Annual Report on the financial condition of Premier Farm Credit, ACA. This Annual Report represents the consolidated results of operations for Premier Farm Credit, PCA and Premier Farm Credit, FLCA, the wholly owned subsidiaries of Premier Farm Credit, ACA.

As a stock holding member of this Association, your ownership stake provides you with a right to know how your Association is faring financially. Ownership further offers you a say in how your Association is being managed. This can be done through the election of a Board that will represent you and your interests; or through personal contact with Association personnel. In either regard, the enduring tenets of the cooperative model are that your rights as a stockholder give you a voice in the operations of your Association.

In 2014, we were again blessed with solid loan growth. Over the past several years, we have been fortunate to have had strong growth in our loan portfolio, while also maintaining excellent credit quality. Our earnings continue to be sound and have enabled us to continue to build capital, while still allowing for the declaration of a strong patronage dividend.

In the true cooperative spirit, your Board is committed to maintaining a meaningful patronage program. They understand the value it adds to the lending relationship and have expressed this commitment through strong annual declarations.

The Board declared a patronage of $3.5 million for 2014. This brings the total patronage returned to our members since 1996 to $43.7 million.

The Board and staff of Premier would like to extend our sincere appreciation for your ongoing commitment to the Association. It is your loyalty and commitment to this Association that enables it to enjoy the successful business results you will find evidenced in this report.

As you review the contents of this report, please feel free to contact us should you have questions about the state of your Association.

We again thank you and look forward to continuing to serve you, as we work together to ensure a bright future for agriculture and Rural America.

Sincerely,

Rick Sanger
President and Chief Executive Officer

PREMIER FARM CREDIT MISSION STATEMENT

Premier Farm Credit shall professionally promote and provide sound, profitable and competitively priced credit and credit related services to enhance the economic well being of farmers, ranchers and ag businesses in rural America

## Five-Year Summary of Selected Consolidated Financial Data

(Dollars in Thousands)

| | December 31 | | | | |
|---|---|---|---|---|---|
| | **2014** | 2013 | 2012 | 2011 | 2010 |
| **Statement of Condition Data** | | | | | |
| Loans | **$ 595,554** | $ 564,620 | $ 523,238 | $ 469,009 | $ 428,058 |
| Less allowance for loan losses | **1,882** | 1,720 | 1,874 | 2,249 | 2,417 |
| Net loans | **593,672** | 562,900 | 521,364 | 466,760 | 425,641 |
| Investment in CoBank, ACB | **17,884** | 17,444 | 17,444 | 1 | 1 |
| Investment in U.S. AgBank, FCB | **NA** | NA | NA | 17,443 | 12,586 |
| Other property owned | **-** | - | - | 636 | - |
| Other assets | **24,854** | 22,469 | 19,168 | 20,599 | 15,607 |
| **Total assets** | **$ 636,410** | $ 602,813 | $ 557,976 | $ 505,439 | $ 453,835 |
| Obligations with maturities of one year or less | **$ 20,412** | $ 19,715 | $ 22,000 | $ 18,979 | $ 13,014 |
| Obligations with maturities longer than one year | **488,513** | 462,810 | 422,808 | 378,197 | 342,777 |
| **Total liabilities** | **508,925** | 482,525 | 444,808 | 397,176 | 355,791 |
| Protected borrower stock | **-** | - | - | - | 1 |
| Capital stock | **960** | 985 | 1,006 | 1,035 | 1,026 |
| Unallocated retained earnings | **126,593** | 119,343 | 112,238 | 107,299 | 97,108 |
| Accumulated other comprehensive loss | **(68)** | (40) | (76) | (71) | (91) |
| **Total shareholders' equity** | **127,485** | 120,288 | 113,168 | 108,263 | 98,044 |
| **Total liabilities and shareholders' equity** | **$ 636,410** | $ 602,813 | $ 557,976 | $ 505,439 | $ 453,835 |

| | For the Year Ended December 31 | | | | |
|---|---|---|---|---|---|
| | **2014** | 2013 | 2012 | 2011 | 2010 |
| **Statement of Income Data** | | | | | |
| Net interest income | **$ 15,123** | $ 14,091 | $ 12,260 | $ 11,122 | $ 9,915 |
| Patronage distribution from Farm Credit institutions | **2,311** | 2,008 | 1,747 | 4,547 | 657 |
| Tax-free recapitalization distribution due to AgBank merger | **-** | - | - | 4,856 | - |
| Provision for loan losses/(Loan loss reversal) | **155** | (171) | (382) | 36 | (514) |
| Noninterest expense, net | **6,451** | 6,048 | 4,964 | 5,348 | 4,767 |
| Provision for income taxes | **78** | 117 | 236 | 450 | 334 |
| **Net income** | **$ 10,750** | $ 10,105 | $ 9,189 | $ 14,691 | $ 5,985 |
| **Comprehensive income** | **$ 10,722** | $ 10,141 | $ 9,184 | $ 14,711 | $ 5,935 |
| **Key Financial Ratios** | | | | | |
| **For the Year** | | | | | |
| Return on average assets | **1.80%** | 1.82% | 1.86% | 3.18% | 1.43% |
| Return on average shareholders' equity | **8.54%** | 8.57% | 8.15% | 14.26% | 6.08% |
| Net interest income as a percentage of average earning assets | **2.67%** | 2.68% | 2.64% | 2.55% | 2.50% |
| Net (recoveries)/charge-offs as a percentage of average net loans | **<(0.01%)** | <(0.01%) | <(0.01%) | 0.05% | 0.04% |
| **At Year End** | | | | | |
| Shareholders' equity as a percentage of total assets | **20.03%** | 19.95% | 20.28% | 21.42% | 21.60% |
| Debt as a ratio to shareholders' equity | **3.99:1** | 4.01:1 | 3.93:1 | 3.67:1 | 3.63:1 |
| Allowance for loan losses as a percentage of loans | **0.32%** | 0.30% | 0.36% | 0.48% | 0.56% |
| Permanent capital ratio | **17.42%** | 17.19% | 18.56% | 18.52% | 19.70% |
| Total surplus ratio | **17.27%** | 17.03% | 18.38% | 18.32% | 19.47% |
| Core surplus ratio | **17.10%** | 16.56% | 17.70% | 18.09% | 18.92% |
| **Net Income Distribution** | | | | | |
| Cash patronage distribution paid | **$ 3,000** | $ 4,250 | $ 4,500 | $ 3,000 | $ 1,000 |
| Cash patronage declared | **$ 3,500** | $ 3,000 | $ 4,250 | $ 4,500 | $ 3,000 |

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## INTRODUCTION

The following discussion summarizes the financial position and results of operations of Premier Farm Credit, ACA for the year ended December 31, 2014. Comparisons with prior years are included. We have emphasized material known trends, commitments, events, or uncertainties that have impacted, or are reasonably likely to impact our financial condition and results of operations. You should read these comments along with the accompanying consolidated financial statements, footnotes and other sections of this report. The accompanying consolidated financial statements were prepared under the oversight of our Audit Committee. The Management's Discussion and Analysis includes the following sections:

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

Our quarterly reports to shareholders are available approximately 40 days after the calendar quarter end and annual reports are available approximately 75 days after the calendar year end. The reports may be obtained free of charge on our website, www.premieraca.com, or upon request. We are located at 202 Poplar Street, Sterling, Colorado 80751, or may be contacted by calling (970) 522-5295.

## BUSINESS OVERVIEW

### *Farm Credit System Structure and Mission*

As of December 31, 2014, we are one of 77 associations in the Farm Credit System (System), which was created by Congress in 1916 and has served agricultural producers for over 90 years. The System mission is to provide sound and dependable credit to American farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses through a member-owned cooperative system. This is done by making loans and providing financial services. Through its commitment and dedication to agriculture, the System continues to have the largest portfolio of agricultural loans of any lender in the United States. The Farm Credit Administration (FCA) is the System's independent safety and soundness federal regulator and was established to supervise, examine and regulate System institutions.

### *Our Structure and Focus*

As a cooperative, we are owned by the members we serve. Our territory served extends across a diverse agricultural region of northeastern Colorado. The counties in our territory are listed in Note 1 of the accompanying consolidated financial statements. We make long-term real estate mortgage loans to farmers, ranchers, rural residents and agribusinesses and production and intermediate-term loans for agricultural production or operating purposes. Additionally, we provide other related services to our borrowers, such as credit life insurance, multi-peril crop and crop hail insurance, advance conditional payment accounts and provides additional services to borrowers such as leasing and fee appraisals. Our success begins with our extensive agricultural experience and knowledge of the market and is dependent on the level of satisfaction we provide to our borrowers.

As part of the System, we obtain the funding for our lending and operations from a Farm Credit Bank. Our funding bank, CoBank, ACB (CoBank), is a cooperative of which we are a member. CoBank, its related associations, and AgVantis, Inc. (AgVantis) are referred to as the District.

We, along with the borrower's investment in our Association, are materially affected by CoBank's financial condition and results of operations. The CoBank quarterly and annual reports are available free of charge by accessing CoBank's website, www.cobank.com, or may be obtained at no charge by contacting us at 202 Poplar Street,

Sterling, Colorado 80751, or by calling (970) 522-5295. Annual reports are available within 75 days after year end and quarterly reports are available within 40 days after the calendar quarter end.

We purchase technology and other operational services from AgVantis, which is a technology service corporation. Our Services Agreement with AgVantis expired on December 31, 2014. Upon expiration, a new services agreement was effective which expires on December 31, 2016. We are a shareholder in AgVantis, along with all other AgVantis customers. Farm Credit Foundations, a human resource service provider for a number of Farm Credit institutions, provides our payroll and human resource services.

## ECONOMIC OVERVIEW

Our six county trade area continues to reflect favorable general economic conditions. Agriculture producers continue to maintain sound financial stability and credit strength resulting from strong prior earnings and rising asset values. During 2014, commodity prices reflected volatility with cash grain prices remaining depressed relative to previous historic values while livestock prices rose to record levels. In addition, during the latter part of the year energy prices began to decrease significantly. Local weather conditions for the most part were favorable in 2014. The territory benefited from general abundant and timely moisture; however, there were some adverse localized weather events that impacted production. Livestock producers, in some instances, were affected by unseasonably cold weather during spring calving season.

Cash grain operations have seen profit levels significantly reduced over the past two years. This segment of the loan portfolio has begun to show some stress as certain producers have experienced losses. The stress has been somewhat limited as yields were generally very good across the territory which is helping to offset some of the price decline. In 2014, irrigated corn production reflected well above average yields while dryland corn and wheat production reflected in some cases record yields. Most borrowers are expected to maintain sound net worth with some deterioration in working capital. The past five years have been very profitable for most cash grain operations enabling these producers the ability to endure a limited period of financial stress. Most impacted will be the younger more leveraged producers and those operations that are smaller in size and/or highly dependent on rented acreage. Cow calf, feedlot and stocker operations had a strong year due to historically high prices combined with lower feed costs and improved range conditions. At this time, the production outlook for 2015 looks promising as soil moisture conditions remain favorable and reservoirs have filled or are near full for the coming year.

General economic conditions outside of agriculture continue to shown signs of improvement. The national unemployment rate has dropped to 5.6%, down 1.1% from December 2013 with the Colorado unemployment rate at 4.1%, down 2.1% from December 2013. The general economy has benefited from job growth, strengthening wages, increases in consumer spending, and lower fuel prices. Businesses are also expected to increase fixed asset investment as the improving consumer outlook encourages companies to make longer term investments which have been delayed. Locally, the economy has been stable with low unemployment and strong housing prices. The local energy sector has provided an economic boost with significant regional activity in both the oil and wind industries.

Going forward the economy will likely be impacted by the recent sharp decline in oil prices which will temper investments in the energy sector. The anticipation of rising interest rates may also limit new housing starts and home sales. The Federal Reserve remains cautious in transitioning from its highly accommodative monetary policy. Closely tied to agriculture is the rising value of the U.S. dollar, encouraging imports from abroad and discouraging exports of U.S. produced goods and services.

The credit quality of the purchased loan portfolio continues to reflect improvement over the past several years. Segments previously reporting stress have shown material strengthening. This improvement is related to the strengthening of the general economy and lower raw commodity prices. The only exception may be beef processors due to higher live cattle prices and limited vertical integration. While the purchased loan portfolio has areas that may be impacted by risk, the portfolio is not expected to experience material stress in 2015.

New loan growth has slowed in the direct portfolio. While land prices within our territory have not experienced deterioration, the rate of growth has slowed or leveled off. Producers have become more conservative given the possibility of prolonged reduced commodity prices. We recognize that real estate prices have seen sharp increases as a result of the liquidity in agriculture. We will continue to monitor real estate price trends and have taken a position of obtaining increased real estate margins on new loans being financed. Overall, credit quality is expected to remain strong in 2015; however, slight deterioration is possible as a result of continued lower grain commodity prices.

The Agricultural Act of 2014 (Farm Bill) was signed into law on February 7, 2014. This Farm Bill will govern an array of federal farm and food programs, including commodity price and support payments, farm credit, agricultural conservation, research, rural development, and foreign and domestic food programs for five years. The Farm Bill eliminates $23 billion in mandatory federal spending over a 10-year period, representing a reduction in the U.S.

government farm policy support. The Farm Bill repeals direct payments and limits producers to risk management tools that offer protection when they suffer significant losses. The Farm Bill provides continued support for crop insurance programs, strengthens livestock disaster assistance and provides dairy producers with a voluntary margin protection program without imposing government-mandated supply controls.

## LOAN PORTFOLIO

Total loans outstanding were $595.6 million at December 31, 2014, an increase of $31.0 million, or 5.5%, from loans at December 31, 2013 of $564.6 million, and an increase of $72.4 million, or 13.8%, from loans at December 31, 2012 of $523.2 million. Loan volume increased in both the direct and participations purchased portfolio. Internal volume growth was attributed to new real estate loans and increased borrowing on operating lines of credit combined with a reduction in the level of prepayments of term loans. Purchased loan volume increased primarily due to new loans purchased through our arrangements with both Commercial Finance Group (CFG) and CoBank. The types of loans outstanding at December 31 are reflected in the following table.

| | **2014** | | 2013 | | 2012 | |
|---|---|---|---|---|---|---|
| *(dollars in thousands)* | **Volume** | **Percent** | Volume | Percent | Volume | Percent |
| Real estate mortgage loans | **$ 340,185** | **57.12%** | $ 330,156 | 58.48% | $ 294,258 | 56.24% |
| Production and intermediate-term loans | **141,933** | **23.83%** | 125,966 | 22.31% | 136,650 | 26.12% |
| Agribusiness loans to: | | | | | | |
| Cooperatives | **13,073** | **2.20%** | 12,034 | 2.13% | 10,879 | 2.08% |
| Process and marketing | **62,964** | **10.57%** | 55,419 | 9.82% | 42,891 | 8.20% |
| Farm related business | **4,849** | **0.81%** | 5,446 | 0.96% | 4,205 | 0.80% |
| Communication loans | **10,359** | **1.74%** | 11,100 | 1.97% | 10,889 | 2.08% |
| Energy loans | **18,761** | **3.15%** | 20,966 | 3.71% | 17,038 | 3.26% |
| Water/waste water loans | **1,064** | **0.18%** | 1,093 | 0.19% | 1,150 | 0.22% |
| Agricultural export finance loans | **2,000** | **0.34%** | 2,000 | 0.35% | 4,615 | 0.88% |
| Rural residential real estate loans | **366** | **0.06%** | 440 | 0.08% | 663 | 0.12% |
| Total | **$ 595,554** | **100.00%** | $ 564,620 | 100.00% | $ 523,238 | 100.00% |

Real estate mortgage loans outstanding increased to $340.2 million, compared with $330.2 million at year-end 2013, primarily due to stable new loan demand combined with reduced prepayments of principal. Long-term mortgage loans are primarily used to purchase, refinance or improve real estate. These loans have maturities ranging from 5 to 40 years. Real estate mortgage loans are also made to rural homeowners. By federal regulation, a real estate mortgage loan must be secured by a first lien and may only be made in an amount up to 85% of the original appraised value of the property, or up to 97% of the appraised value, if the loan is guaranteed by certain state, federal, or other governmental agencies. Under our current underwriting standards, we loan less than the regulatory limit of 85% of the appraised value of the property.

The production and intermediate-term loans increased 12.7% to $141.9 million compared with 2013 loans of $126.0 million, primarily due to a combination of increased borrowing on operating lines of credit and new participations purchased within this portfolio segment. Production loans are used to finance the ongoing operating needs of agricultural producers. Production loans generally match the borrower's normal production and marketing cycle, which is typically 12 months. Intermediate-term loans are generally used to finance depreciable capital assets of a farm or ranch. Intermediate-term loans are written for a specific term, 1 to 15 years, with most loans being less than 10 years.

The agribusiness loans increased 11.0% to $80.9 million compared with 2013 loans of $72.9 million due to new participations purchased within this portfolio segment. In addition, slight decreases were noted in communication, energy, and water / waste water loan volume primarily due to principal repayments on loan participations. Additionally, at December 31, 2014 approximately 98.7% of agribusiness, and 100% of communication, energy, water and waste water and agricultural export finance volume were a result of loan participations.

### *Portfolio Diversification*

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

We purchase loan participations from other System entities to generate additional earnings and diversify risk related to existing commodities financed and our geographic area served. In addition, we sell a portion of certain large loans to other System entities to reduce risk and comply with lending limits we have established.

To increase our market share of broadly syndicated participation loans, we are a party to a shared lending operation known as the Commercial Finance Group (CFG). The agreement includes our Association together with Farm Credit of East Central Oklahoma, ACA; Farm Credit of Southern Colorado, ACA; and several associations in the AgriBank District. Along with these associations, we pool our resources to coordinate and enhance the marketing, originating and servicing of large, complex commercial and mortgage loans, as well as diversify risk. This agreement was consummated December 2010 and essentially replaced the Agribusiness Finance Group (AFG), which was a similar agreement that terminated on September 1, 2011. The AFG agreement included our Association and three other District Associations. The remaining participations through AFG will terminate at maturity or renewal.

Our volume of participations purchased and sold as of December 31 follows.

| *(dollars in thousands)* | **2014** | 2013 | 2012 |
|---|---|---|---|
| Participations purchased – AFG | **$ 22,047** | $ 23,456 | $ 39,693 |
| Participations purchased – CFG | **104,445** | 92,067 | 66,612 |
| Participations purchased – other | **15,368** | 13,710 | 11,166 |
| Total participations purchased | **$ 141,860** | $ 129,233 | $ 117,471 |
| Total participations sold | **$ 15,619** | $ 16,710 | $ - |

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

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

| | **2014** | 2013 | 2012 |
|---|---|---|---|
| Logan | **11.70%** | 12.47% | 13.57% |
| Morgan | **9.15%** | 10.05% | 10.06% |
| Phillips | **9.19%** | 9.18% | 9.10% |
| Sedgwick | **1.31%** | 1.39% | 1.68% |
| Washington | **7.42%** | 8.10% | 8.16% |
| Yuma | **21.98%** | 21.13% | 22.72% |
| Other | **39.25%** | 37.68% | 34.71% |
| Total | **100.00%** | 100.00% | 100.00% |

Our largest volume concentration is in Yuma County due to the physical size of the county and the scale of operations relative to other counties. The Other category represents 39.25% of the portfolio, a 1.57% increase from 2013 and a 4.54% increase from 2012. The increase in Other is related to increased direct loan volume in Nebraska which comprises 4.43% of the total and increased participation volume in various states.

We are party to a Territorial Approval Agreement (Agreement) with other associations in the states of Oklahoma, Colorado, Kansas and New Mexico. The Agreement eliminates territorial restrictions and allows associations that are a party to the Agreement to make loans in any other association's territory regardless of a borrower's place of residence, location of operations, location of loan security or location of headquarters. This Agreement can be terminated upon the earlier to occur of:

1) the time when all but one association has withdrawn as a party to the Agreement; or
2) December 31, 2025, or
3) when requested by FCA.

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

| SIC Category | December 31 2014 | 2013 | 2012 |
|---|---|---|---|
| Corn | **37.68%** | 39.04% | 36.59% |
| Beef | **16.12%** | 14.84% | 16.46% |
| Wheat | **11.49%** | 11.78% | 11.07% |
| Landlords | **5.70%** | 5.63% | 6.89% |
| Hay | **1.97%** | 1.91% | 2.03% |
| Other | **27.04%** | 26.80% | 26.96% |
| Total | **100.00%** | 100.00% | 100.00% |

Our loan portfolio contains a concentration of corn, beef and wheat producers. The Other category reflects 27.04% of the volume and is comprised of 79 separate commodity groups, the largest representing 1.61% of the total. Repayment ability of our borrowers is closely related to the production and profitability of the commodities they raise. If a loan fails to perform, restructuring and/or other servicing alternatives are influenced by the underlying value of the collateral which is impacted by industry economics. Our future performance would be negatively impacted by adverse agricultural conditions. The degree of the adverse impact would be correlated to the commodities negatively affected and the magnitude and duration of the adverse agricultural conditions to our borrowers.

In addition to commodity diversification noted in the previous table, further diversification is also achieved from loans to rural residents and part-time farmers which typically derive most of their earnings from non-agricultural sources. These borrowers are less subject to agricultural cycles and would likely be more affected by weaknesses in the general economy. Of our loan volume at December 31, 2014, approximately 33% consists of borrowers with income not solely from agricultural sources, a slight decrease from 34% for 2013, and the same as 33% for 2012.

The principal balance outstanding at December 31, 2014 for loans $250 thousand or less accounted for 25.3% of loan volume and 77.5% of the number of loans. Credit risk on small loans, in many instances, may be reduced by non-farm income sources. The following table details loan principal by dollar size at December 31.

| | 2014 | | 2013 | | 2012 | |
|---|---|---|---|---|---|---|
| *(dollars in thousands)* | **Amount outstanding** | **Number of loans** | Amount outstanding | Number of loans | Amount outstanding | Number of loans |
| $1 - $250 | **$ 150,495** | **1,963** | $ 151,877 | 2,021 | $ 150,647 | 2,028 |
| $251 - $500 | **106,053** | **296** | 100,709 | 280 | 102,117 | 290 |
| $501 - $1,000 | **115,168** | **160** | 110,529 | 153 | 101,793 | 146 |
| $1,001 - $5,000 | **196,316** | **111** | 173,511 | 101 | 150,462 | 89 |
| $5,001 – 25,000 | **27,522** | **3** | 27,994 | 3 | 18,219 | 2 |
| Total | **$ 595,554** | **2,533** | $ 564,620 | 2,558 | $ 523,238 | 2,555 |

Approximately 15% of our loans outstanding are attributable to 10 borrowers. Due to their size, the loss of any of these loans or the failure of any of these loans to perform would adversely affect the portfolio and our future operating results.

Credit guarantees with government agencies of $11.0 million at year-end 2014, $10.5 million at year-end 2013 and $12.2 million at year-end 2012 were outstanding.

***Credit Commitments***

We may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of our borrowers. These financial instruments include commitments to extend credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in our consolidated financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee by the borrower. We may also participate in standby letters of credit to satisfy the financing needs of our borrowers. These standby letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. The following table summarizes the maturity distribution of unfunded credit commitments on loans at December 31, 2014.

| *(dollars in thousands)* | **Less than 1 year** | **1 – 3 years** | **3 – 5 years** | **Over 5 years** | **Total** |
|---|---|---|---|---|---|
| Commitments to extend credit | $ 70,587 | $ 59,762 | $ 43,414 | $ 7,867 | $ 181,630 |
| Standby letters of credit | 1,255 | 955 | 210 | – | 2,420 |
| Total commitments | $ 71,842 | $ 60,717 | $ 43,624 | $ 7,867 | $ 184,050 |

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

***High Risk Assets***

Nonperforming loan volume is comprised of nonaccrual loans, restructured loans, and loans 90 days past due still accruing interest and are referred to as impaired loans. High risk assets consist of impaired loans and other property owned. Comparative information regarding high risk assets in the portfolio, including accrued interest, follows:

| *(dollars in thousands)* | **2014** | 2013 | 2012 |
|---|---|---|---|
| Nonaccrual loans: | | | |
| Real estate mortgage | **$ –** | $ 45 | $ 83 |
| Communication | **945** | 999 | 465 |
| Total nonaccrual loans | **945** | 1,044 | 548 |
| Total high risk assets | **$ 945** | $ 1,044 | $ 548 |
| Nonaccrual loans to total loans | **0.16%** | 0.18% | 0.10% |
| Impaired loans to total loans | **0.16%** | 0.18% | 0.10% |
| High risk assets to total loans | **0.16%** | 0.18% | 0.10% |
| High risk assets to total shareholders' equity | **0.74%** | 0.87% | 0.48% |

We had no loans classified as restructured or 90 days past due still accruing interest, and no other property owned for the years presented.

Total high risk assets decreased $99 thousand, or 9.5%, to $945 thousand at December 31, 2014 compared with year-end 2013.

Nonaccrual loans represent all loans where there is a reasonable doubt as to collection of all principal and/or interest. Nonaccrual volume decreased $99 thousand compared with December 31, 2013 due to the payoff of one nonaccrual real estate mortgage and repayments received on the communication nonaccrual loans. Nonaccrual loans increased $496 thousand when comparing December 31, 2013 to December 31, 2012 primarily due to a communication loan being reclassified as nonaccrual. As of December 31, 2014, two loans to one borrower in the communication industry comprised the entire nonaccrual loan volume. The following table provides additional information on nonaccrual loans as of December 31.

| *(dollars in thousands)* | **2014** | 2013 | 2012 |
|---|---|---|---|
| Nonaccrual loans current as to principal and interest | **$ 945** | $ 1,044 | $ 548 |
| Restructured loans in nonaccrual status | **$ 945** | $ 999 | $ – |

For the years presented, we had no cash basis nonaccrual loans.

High risk asset volume is anticipated to increase in the future. Adverse economic conditions, weather conditions, uncertainty in consumer confidence, lower commodity prices and stressed asset values may be contributors to the increase.

***Credit Quality***

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

- Acceptable – Assets are expected to be fully collectible and represent the highest quality.

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

The following table presents statistics based on UCS related to the credit quality of the loan portfolio, including accrued interest at December 31.

| | **2014** | 2013 | 2012 |
|---|---|---|---|
| Acceptable | **97.01%** | 97.66% | 96.16% |
| OAEM | **2.60%** | 1.36% | 2.85% |
| Substandard | **0.39%** | 0.98% | 0.99% |
| Total | **100.00%** | 100.00% | 100.00% |

During 2014, overall credit quality improved. Loans classified as Acceptable and OAEM were 99.61% at December 31, 2014, 99.02% at December 31, 2013 and 99.01% at December 31, 2012. We had no loans classified as Doubtful or Loss for any of the three years presented. The financial position of most agricultural producers strengthened during the past decade, and most of our borrowers have maintained generally strong financial positions. As such, our credit quality is anticipated to remain sound in the near term. However, agriculture remains a cyclical business that is heavily influenced by production, operating costs and commodity prices. Each of these can be significantly impacted by uncontrollable events. If less favorable economic conditions continue, it will likely lead to weakening in the loan portfolio. We had no loan delinquencies (accruing loans 30 days or more past due) as a percentage of accruing loans at December 31, 2014, compared with 0.06% at December 31, 2013 and none at December 31, 2012.

***Allowance for Loan Losses***

We maintain an allowance for loan losses at a level consistent with the probable and estimable losses inherent in the loan portfolio identified by management. The allowance for loan losses at each period end was considered to be adequate to absorb probable losses existing in the loan portfolio. Because the allowance for loan losses considers factors such as current agricultural and economic conditions, loan loss experience, portfolio quality and loan portfolio composition, there will be a direct impact to the allowance for loan losses and our income statement when there is a change in any of those factors. The following table provides relevant information regarding the allowance for loan losses as of December 31.

| *(dollars in thousands)* | **2014** | 2013 | 2012 |
|---|---|---|---|
| Balance at beginning of year | **$ 1,720** | $ 1,874 | $ 2,249 |
| Charge-offs: | | | |
| Production and intermediate-term | **2** | 1 | – |
| Total charge-offs | **2** | 1 | – |
| Recoveries: | | | |
| Production and intermediate-term | **9** | 8 | 7 |
| Agribusiness | **–** | 10 | – |
| Total recoveries | **9** | 18 | 7 |
| Net recoveries | **(7)** | (17) | (7) |
| Provision for loan losses/(Loan loss reversal) | **155** | (171) | (382) |
| Balance at December 31 | **$ 1,882** | $ 1,720 | $ 1,874 |
| Net recoveries to average net loans | **<(0.01%)** | <(0.01%) | <(0.01%) |

The following table presents the allowance for loan losses by loan type as of December 31.

| *(dollars in thousands)* | **2014** | 2013 | 2012 |
|---|---|---|---|
| Real estate mortgage | **$ 717** | $ 660 | $ 662 |
| Production and intermediate-term | **322** | 282 | 388 |
| Agribusiness | **599** | 522 | 735 |
| Communication | **66** | 188 | 23 |
| Energy | **161** | 65 | 64 |
| Water/waste water | **6** | 2 | 2 |
| Agricultural export finance | **11** | 1 | – |
| Total | **$ 1,882** | $ 1,720 | $ 1,874 |

The allowance for loan losses increased $162 thousand from December 31, 2013, to $1.9 million at December 31, 2014. The increase in allowance for loan losses was primarily due to the provision for loan losses totaling $155 thousand that was recorded due to a $700 thousand management reserve on participations purchased being established. This reserve was partially offset by the elimination of $520 thousand of specific reserves related to communications and poultry and $25 thousand of general reserves both due to improved credit quality. Net recoveries of $7 thousand were recorded during 2014. Overall, charge-off activity remains low relative to the size of our loan portfolio. During 2013, our allowance for loan losses decreased $154 thousand from 2012. The decrease in allowance for loan losses was primarily due to loan loss reversals totaling $171 thousand that were recorded due to a $350 thousand reduction of a poultry specific reserve offset by a $170 thousand communications specific reserve and $9 thousand of general reserves. Net recoveries of $17 were recorded during 2013. Comparative allowance for loan losses coverage as a percentage of loans and certain other credit quality indicators as of December 31 are presented in the following table.

| | **2014** | 2013 | 2012 |
|---|---|---|---|
| Allowance as a percentage of: | | | |
| Loans | **0.32%** | 0.30% | 0.36% |
| Impaired loans | **199.15%** | 164.75% | 341.97% |
| Nonaccrual loans | **199.15%** | 164.75% | 341.97% |

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

As part of the Farm Credit System, we are committed to providing sound and dependable credit and related services to young, beginning and small (YBS) farmers and ranchers. Our YBS mission statement is as follows:

PREMIER FARM CREDIT, ACA WILL ENCOURAGE THE FINANCING OF YOUNG, BEGINNING, AND SMALL FARMERS, RANCHERS AND PRODUCERS OR HARVESTERS OF AQUATIC PRODUCTS BY IMPLEMENTING A PROGRAM DESIGNED TO MEET THE NEEDS OF THESE APPLICANTS TO THE FULLEST EXTENT OF THEIR CREDITWORTHINESS. THE ASSOCIATION WILL SUPPORT GOVERNMENT EFFORTS TO PROVIDE YBS PRODUCERS ASSISTANCE THROUGH SPECIAL PROGRAMS.

Following are FCA regulatory definitions for YBS farmers and ranchers.

- Young Farmer: A farmer, rancher, or producer or harvester of aquatic products who was age 35 or younger as of the date the loan was originally made.
- Beginning Farmer: A farmer, rancher, or producer or harvester of aquatic products who had 10 years or less farming or ranching experience as of the date the loan was originally made.
- Small Farmer: A farmer, rancher, or producer or harvester of aquatic products who normally generated less than $250 thousand in annual gross sales of agricultural or aquatic products at the date the loan was originally made.

The following table outlines our percentage of YBS loans as a percentage of the number of loans in our loan portfolio while the USDA column represents the percent of farmers and ranchers classified as YBS within our territory per the 2012 USDA Agricultural Census, which is the most current data available. Due to FCA regulatory definitions, a farmer/rancher may be included in multiple categories as they would be included in each category in which the definition was met.

| | USDA | 2014 | 2013 | 2012 |
|---|---|---|---|---|
| Young | 7.67% | 12.82% | 13.01% | 13.57% |
| Beginning | 11.07% | 12.95% | 13.16% | 13.41% |
| Small | 32.15% | 23.65% | 24.95% | 27.84% |

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

We offer related services either directly or in coordination with others that are responsive to the needs of YBS farmers and ranchers in our territory. Such services include crop insurance, credit life insurance, fee appraisals and equipment/vehicle leasing programs. We increase opportunities for YBS farmers by coordinating credit and credit services in the territory utilizing governmental and private sources. We utilize the Farm Service Agency (FSA) programs such as down payment assistance programs and loan guarantees to assist us in meeting the needs of YBS borrowers. We have implemented effective outreach programs to attract YBS farmers and ranchers through sponsorships in area YBS organizations. In addition, we strongly support the local community colleges, Northeastern Junior College and Morgan Community College, as well as Colorado State University by sponsoring scholarships. We have established a Premier Farm Credit Student Board at Colorado State University. A team of employees has developed FFA Course Curriculums with staff presenting the materials at various High Schools in our territory. These curriculums have several modules designed for a variety of ages and learning stages. We also provide monetary donations to area high school events and organizations such as 4-H and FFA. Our qualitative efforts are strongly successful as all personnel are actively involved in furthering the opportunities for YBS producers within our territory.

During 2014, we have donated to 57 different YBS groups or organizations. Also, 48% of the members of the Stockholder's Advisory Committee and the Nominating Committee are reflected as young, beginning and/or small in the database.

Quarterly reports are provided to our Board of Directors detailing the number, volume and credit quality of our YBS customers. We have developed quantitative targets to monitor our progress. Quantitative goals established in the 2015 Business Plan reflect an annual growth rate of 4.5% for Young, Beginning and Small Farmers within loan numbers and classified loan volume. The three year goals we have established to increase market share of loans to YBS farmers and ranchers are as follows:

| Young Farmer / Rancher | | | Beginning Farmer / Rancher | | | Small Farmer / Rancher | | |
|---|---|---|---|---|---|---|---|---|
| Year | Number | Volume | Year | Number | Volume | Year | Number | Volume |
| 12/31/2015 | 429 | $80,144,083 | 12/31/2015 | 435 | $67,850,645 | 12/31/2015 | 794 | $72,262,663 |
| 12/31/2016 | 449 | $83,750,566 | 12/31/2016 | 454 | $70,903,924 | 12/31/2016 | 830 | $75,514,482 |
| 12/31/2017 | 469 | $87,519,342 | 12/31/2017 | 475 | $74,094,601 | 12/31/2017 | 867 | $78,912,634 |

As reflected in the following chart, during 2014, we experienced both volume and loan number reductions across all measured segments. Asset prices continue to remain high, which requires more capital, therefore making it difficult for the young and beginning farmers to begin farming operations. Cash grain commodity prices have slightly deteriorated, while input costs and living expenses continue to increase. Many farmers have diversified their operations in order to recognize profits in other commodity areas. This is more difficult for young and beginning farmers due to the amount of capital required for equipment or livestock. In addition, prices have remained high enough to cause the gross farm sales result to exceed the Small Farmer measurement in some cases.

| | Young | Beginning | Small |
|---|---|---|---|
| 2014 Goal | 434 | 440 | 832 |
| | $85,086,771 | $73,153,224 | $75,809,658 |
| | | | |
| 2014 Actual | 411 | 416 | 760 |
| | $76,692,902 | $64,928,847 | $69,150,873 |
| | | | |
| 2013 Actual | 417 | 423 | 800 |
| | $81,814,203 | $70,339,638 | $72,893,902 |

To ensure that credit and services offered to our YBS farmers and ranchers are provided in a safe and sound manner and within our risk-bearing capacity, we have developed specific lending products directed at serving the YBS

producers in our territory. These products include YBS specific loan programs, including the YBS Stocker Cattle Program, YBS Breeding Cattle Program and YBS Crop Farming Program. In addition, we utilize loan guarantee programs, fee waivers and interest rate concessions to qualified YBS farmers. Additionally, we are actively involved in developing and sponsoring educational opportunities, leadership training, business financial training and insurance services for YBS farmers and ranchers.

## CREDIT RISK MANAGEMENT

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

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

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

Processes for information gathering, balance sheet and income statement verification, loan analysis, credit approvals, disbursements of proceeds and subsequent loan servicing actions are established and followed. Underwriting standards vary by industry and are updated periodically to reflect market and industry conditions.

By regulation, we cannot have loan commitments to one borrower for more than 15% of our permanent capital. Additionally, we set our own lending limits to manage loan concentration risk. Lending limits have been established for loans originated by our Association, loans originated outside our Association, and special lending programs. We have adopted an individual lending limit maximum of 15% of permanent capital for our highest quality borrowers.

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

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

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

The Model's 14-point probability of default scale provides for nine acceptable categories, one OAEM category, two substandard categories, one doubtful category and one loss category; each carrying a distinct percentage of default probability. The Model's LGD scale provides 6 categories, A through F, that have the following anticipated principal loss and range of economic loss expectations:

- A 0% anticipated principal loss; 0% to 5% range of economic loss
- B 0% to 3% anticipated principal loss; >5% to 15% range of economic loss
- C > 3% to 7% anticipated principal loss; >15% to 20% range of economic loss

- D > 7% to 15% anticipated principal loss; >20% to 25% range of economic loss
- E > 15% to 40% anticipated principal loss; >25% to 50% range of economic loss
- F above 40% anticipated loss; above 50% range of economic loss

## RESULTS OF OPERATIONS

### *Earnings Summary*

In 2014, we recorded net income of $10.8 million, compared with $10.1 million in 2013, and $9.2 million in 2012. The increase in 2014 was primarily due to increased net interest income and noninterest income partially offset by increased noninterest expense and provision for loan losses. The increase in 2013 was due to increased net interest income partially offset by increased noninterest expense. The following table presents the changes in the significant components of net income from the previous year.

| *(dollars in thousands)* | **2014 vs. 2013** | 2013 vs. 2012 |
|---|---|---|
| Net income, prior year | **$ 10,105** | $ 9,189 |
| Increase/(Decrease) from changes in: | | |
| Interest income | **1,259** | 958 |
| Interest expense | **(227)** | 873 |
| Net interest income | **1,032** | 1,831 |
| Provision for loan losses | **(326)** | (211) |
| Noninterest income | **256** | (106) |
| Noninterest expense | **(356)** | (717) |
| Provision for income taxes | **39** | 119 |
| Total increase in net income | **645** | 916 |
| Net income, current year | **$ 10,750** | $ 10,105 |

Return on average assets decreased to 1.80% from 1.82% in 2013, and return on average shareholders' equity decreased to 8.54% from 8.57% in 2013. These slight decreases were primarily the result of increases in average assets in the amount of $40.7 million and average shareholders' equity in the amount of $7.9 million.

### *Net Interest Income*

Net interest income for 2014 was $15.1 million compared with $14.1 million for 2013 and $12.3 million for 2012. Net interest income is our principal source of earnings and is impacted by interest earning asset volume, yields on assets and cost of debt. The increase in net interest income was largely due to increased loan volume along with interest income realized on nonaccrual loans and decreased funding costs. These increases were partially offset by lower interest rates earned on loans. The following table provides an analysis of the individual components of the change in net interest income during 2014 and 2013.

| *(dollars in thousands)* | **2014 vs. 2013** | 2013 vs. 2012 |
|---|---|---|
| Net interest income, prior year | **$ 14,091** | $ 12,260 |
| Increase/(Decrease) in net interest income from changes in: | | |
| Interest rates earned | **(553)** | (1,732) |
| Interest rates paid | **431** | 2,045 |
| Volume of interest-bearing assets and liabilities | **1,043** | 1,512 |
| Interest income on nonaccrual loans | **111** | 6 |
| Increase in net interest income | **1,032** | 1,831 |
| Net interest income, current year | **$ 15,123** | $ 14,091 |

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

| | **For the Year Ended December 31** | | |
|---|---|---|---|
| | **2014** | 2013 | 2012 |
| Net interest margin | **2.67%** | 2.68% | 2.64% |
| Interest rate on: | | | |
| Average loan volume | **4.30%** | 4.38% | 4.75% |
| Average debt | **1.97%** | 2.07% | 2.62% |
| Interest rate spread | **2.33%** | 2.31% | 2.13% |

The increase in interest rate spread resulted from an 8 basis point decrease in interest rates on average loan volume and a 10 basis point decrease in interest rates on average debt. Despite a slight increase in interest rate spread, net interest margin decreased slightly primarily due to a $39.6 million increase in average loan balances. In 2014 interest rates remained relatively flat resulting in minimal change in rates and spreads.

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

We monitor our loan portfolio on a regular basis to determine if any increase through provision for loan losses or decrease through a loan loss reversal in our allowance for loan losses is warranted based on our assessment of the probable and estimable losses inherent in our loan portfolio. We recorded net provision for loan losses of $155 thousand in 2014, compared with net loan loss reversals of $171 thousand in 2013 and $382 thousand in 2012. The provision for loan losses recorded during 2014 was primarily due to a $700 thousand management reserve established on participations purchased. This reserve was partially offset by the elimination of $520 thousand of specific reserves related to communications and poultry and $25 thousand of general reserves both due to improved credit quality. The $700 thousand purchased loan reserve established in 2014 takes into consideration additional risk exposure that may be present in purchased loans due to the nature of these credits where we are reliant on third parties for direct loan servicing along with other factors. The loan loss reversals recorded in 2013 and 2012 were primarily due to the elimination of specific reserves related to certain portfolio segments and improved credit quality.

***Noninterest Income***

During 2014, we recorded noninterest income of $4.2 million, compared with $3.9 million in 2013 and $4.0 million in 2012. Patronage distributions from our funding Bank are our primary source of noninterest income. Beginning in 2012, patronage is accrued in the year earned and then received from CoBank in the following year. CoBank patronage is distributed in cash and stock. Patronage earned from CoBank was $2.2 million in 2014, $1.8 million in 2013 and $1.6 million in 2012.

We received a patronage distribution from AgVantis, based on our services purchased from AgVantis during 2014. We received a Notice of Allocation with our total patronage of $157 thousand, which includes cash patronage of $31 thousand compared with $33 thousand for 2013 and $26 thousand for 2012. The balance of the allocation is recorded in other assets. Additionally, we received a cash patronage of $3 thousand from Farm Credit Foundations, the organization that provides our payroll and human resource services. This compares with $6 thousand recorded in 2013 and 2012. Patronage from these two entities and CoBank is included in patronage distribution from Farm Credit institutions on the Consolidated Statement of Comprehensive Income.

We received mineral income of $976 thousand during 2014, which is distributed to us quarterly by CoBank. During 2012, we received a distribution of $400 thousand from Farm Credit System Insurance Corporation (FCSIC) representing our allocated portion of the excess amount in the System's insurance fund above the 2.0% secure base amount. No such distribution was received in 2014 or 2013.

Noninterest income also includes loan fees, financially related services income and other noninterest income. Loan fees in 2014 were $341 thousand, a decrease of $72 thousand from 2013, primarily due to fewer new loan originations and loan conversions in 2014. In addition, loan fees received from the participation loan portfolio decreased due to competitive factors. Financially related services income in 2014 was $399 thousand, a decrease of $46 thousand, from 2013, primarily due to lower collected commissions on crop and credit life policies along with a reduction in the number of new policies written. In addition, fee appraisal income was reduced in 2014.

***Noninterest Expense***

Noninterest expense for 2014 increased $356 thousand, or 4.5%, to $8.3 million compared with 2013 and $1.1 million, or 14.8% compared with 2012. Noninterest expense for each of the three years ended December 31 is summarized as follows.

| *(dollars in thousands)* | **2014** | 2013 | 2012 | **Percent of Change 2014/2013** | 2013/2012 |
|---|---|---|---|---|---|
| Salaries & employee benefits | **$ 4,822** | $ 4,862 | $ 4,611 | **(0.82%)** | 5.44% |
| Occupancy & equipment | **540** | 471 | 436 | **14.65%** | 8.03% |
| Purchased services from AgVantis | **803** | 756 | 749 | **6.22%** | 0.93% |
| Supervisory & examination costs | **194** | 183 | 180 | **6.01%** | 1.67% |
| Other | **1,457** | 1,316 | 1,089 | **10.71%** | 20.84% |
| Total operating expense | **7,816** | 7,588 | 7,065 | **3.00%** | 7.40% |
| Losses on other property owned, net | – | – | 11 | – | (100.00%) |
| Farm Credit Insurance Fund premium | **502** | 374 | 169 | **34.22%** | 121.30% |
| Total noninterest expense | **$ 8,318** | $ 7,962 | $ 7,245 | **4.47%** | 9.90% |

For the year ended December 31, 2014, total operating expense increased $228 thousand, or 3.00%, compared with the year ended December 31, 2013. Salary and employee benefits decreased in 2014 primarily due to a reduction in pension expense which was greater than annual salary increases and other employee benefit increases. Salary and employee benefits increased in 2013 due to annual salary increases and increased pension expenses compared to 2012. Occupancy and equipment increased in 2014 and 2013 primarily due to building remodel and improvement expenses along with the associated increase in depreciation expense. Purchased services from AgVantis increased in 2014 and 2013 due to increased loan volume which is a factor in the service charge. In addition, 2014 also reflects a rate increase charged by AgVantis. Other expense increased in 2014 and 2013 mainly due to increased CFG loan servicing fees related to participation loans due to growth in loan volume. CFG servicing fees increased $101 thousand in 2014 and $117 thousand in 2013. In addition, expenses related to training and marketing have strategically increased. Insurance Fund premium increased $128 thousand to $502 thousand due to an increase in the premium rate and an increase in volume. Premium rates were 12 basis points during 2014 compared with 10 basis points in 2013 and 5 basis points in 2012.

***Provision for income taxes/Benefit from income taxes***

We recorded $78 thousand in provision for income taxes during 2014, compared with $117 thousand in 2013 and $236 thousand in 2012. The decrease was primarily due to a reduction of taxable income related to Production Credit Association (PCA) earnings, which are not tax exempt. See Note 1 for more information. Tax expense was also impacted by our patronage refund program. We operate as a Subchapter T cooperative for tax purposes and thus may deduct from taxable income certain amounts that are distributed from net earnings to borrowers. See Note 2 for additional details.

## LIQUIDITY

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

***Funding Sources***

Our primary source of liquidity is the ability to obtain funds for our operations through a borrowing relationship with CoBank. Our note payable to CoBank is collateralized by a pledge to CoBank of substantially all of our assets. Substantially all cash received is applied to the note payable and all cash disbursements are drawn on the note payable. The indebtedness is governed by a General Financing Agreement (GFA) with CoBank which matures on May 31, 2018. The annual average principal balance of the note payable to CoBank was $447.1 million in 2014, $408.5 million in 2013 and $358.1 million in 2012.

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

### *Interest Rate Risk*

The interest rate risk inherent in our loan portfolio is substantially mitigated through our funding relationship with CoBank which allows for loans to be match-funded. Borrowings from CoBank match the pricing, maturity, and option characteristics of our loans to borrowers. CoBank manages interest rate risk through the direct loan pricing and its asset/liability management processes. Although CoBank incurs and manages the primary sources of interest rate risk, we may still be exposed to interest rate risk through the impact of interest rate changes on earnings generated from our loanable funds. To stabilize earnings from loanable funds, we have committed excess loanable funds with CoBank at fixed rates for specified terms as a part of CoBank's Association Equity Positioning Program (AEPP). This enables us to reduce our overall cost of funds with CoBank without significantly increasing our overall interest rate risk position.

### *Funds Management*

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

We have a relationship with CoBank, and First Tennessee Bank to offer a purchase card program to commercial customers. The purchase cards are similar to credit cards and allow customers to make agricultural-related purchases which are then automatically posted to the customer's loan on a monthly basis. We remit payment to First Tennessee Bank on behalf of the borrowers each month for purchases made with the card.

## CAPITAL RESOURCES

Capital supports asset growth and provides protection for unexpected credit and operating losses. Capital is also needed for investments in new products and services. We believe a sound capital position is critical to our long-term financial success due to the volatility and cycles in agriculture. Over the past several years, we have been able to build capital primarily through net income retained after patronage. Shareholders' equity at December 31, 2014 totaled $127.5 million, compared with $120.3 million at December 31, 2013 and $113.2 million at December 31, 2012. The increase from 2013 of $7.2 million in shareholders' equity reflects net income partially offset by patronage refunds, net stock retirements and an increase in accumulated other comprehensive loss. Our capital position is reflected in the following ratio comparisons.

| | **2014** | 2013 | 2012 |
|---|---|---|---|
| Debt to shareholders' equity | **3.99:1** | 4.01:1 | 3.93:1 |
| Shareholders' equity as a percent of net loans | **21.47%** | 21.37% | 21.71% |
| Shareholders' equity as a percent of total assets | **20.03%** | 19.95% | 20.28% |

Debt to shareholders' equity decreased and shareholders' equity as a percent of net loans and of total assets increased from 2013 primarily due to the net increase in shareholders' equity relative to debt, net loans and total assets.

### *Retained Earnings*

Our retained earnings increased $7.3 million to $126.6 million at December 31, 2014 from $119.3 million at December 31, 2013 and increased $14.4 million from $112.2 million at December 31, 2012. The increase was a result of net income of $10.8 million, partially offset by $3.5 million of patronage distributions declared.

### *Patronage Program*

We have a Patronage Program that allows us to distribute our available net earnings to our shareholders. This program provides for the application of net earnings in the manner described in our Bylaws. In addition to determining the amount and method of patronage to be distributed, the Bylaws address increasing surplus to meet capital adequacy standards established by Regulations; increasing surplus to a level necessary to support competitive pricing at targeted earnings levels; and increasing surplus for reasonable reserves. Patronage distributions are based on business done with us during the year. We paid cash patronage of $3.0 million in 2014, $4.3 million in 2013 and $4.5 million in 2012. During 2014, we declared patronage distributions of $3.5 million to be paid in March 2015.

### *Stock*

Our total stock decreased $25 thousand to $960 thousand at December 31, 2014, from $985 thousand at December 31, 2013 and decreased from $1.0 million at December 31, 2012. The decrease was due to $71 thousand of stock retirements, partially offset by $46 thousand of stock issuances. We require a stock investment for each borrower.

The Borrower Level Stock Program allows stock to be assigned to each borrower instead of each loan. This reduces the stock requirements for borrowers with multiple loans. The current stock requirement for each borrower is the lesser of one thousand dollars or 2.00% of the collective total balance of each borrower's loan(s).

***Accumulated Other Comprehensive Income or Loss***

Accumulated other comprehensive loss totaled $68 thousand at December 31, 2014, an increase of $28 thousand compared with year-end 2013 and a decrease of $8 thousand compared with year-end 2012. Certain employees participate in a non-qualified Defined Benefit Pension Restoration Plan (Plan). Accounting guidance requires recognition of the Plan's underfunded status and unamortized actuarial gains and losses and prior service costs or credits as a liability with an offsetting adjustment to accumulated other comprehensive income/loss.

***Capital Plan and Regulatory Requirements***

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

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

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

| | Regulatory Minimum | **2014** | 2013 | 2012 |
|---|---|---|---|---|
| Permanent capital ratio | 7.00% | **17.42%** | 17.19% | 18.56% |
| Total surplus ratio | 7.00% | **17.27%** | 17.03% | 18.38% |
| Core surplus ratio | 3.50% | **17.10%** | 16.56% | 17.70% |

As of December 31, 2014, we exceeded the regulatory minimum capital ratios and are expected to do so throughout 2015. However, the minimum ratios established were not meant to be adopted as the optimum capital level, so we have established goals in excess of the regulatory minimum. As of December 31, 2014, we have met our goals. Due to our strong capital position, we will continue to be able to retire at-risk stock.

***Building Projects***

During 2013 and 2014, a building remodel project was completed on the administrative office building located at 202 Poplar Street in Sterling, Colorado. Expenditures for the remodel were $104 thousand in 2013 and $90 thousand in 2014. The remodel was funded with our capital.

## REGULATORY MATTERS

As of December 31, 2014, we had no enforcement actions in effect and FCA took no enforcement actions on us during the year.

On May 8, 2014, the Farm Credit Administration approved a proposed rule to modify the regulatory capital requirements for System Associations. The stated objectives of the proposed rule are as follows:

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

As currently drafted, the proposed rule would, among other things, eliminate the core surplus and total surplus requirements and introduce common equity tier 1, tier 1 and total capital (tier 1 + tier 2) risk-based capital ratio

requirements. The proposal would add a minimum tier 1 leverage ratio for all System institutions. In addition, the proposal would establish a capital conservation buffer, and modify and expand risk weightings. The revisions to the risk weightings of exposures would include alternatives to the use of credit ratings, as required by the Dodd-Frank Act. The proposed effective date is January 1, 2016.

The public comment period ended on February 16, 2015. While uncertainty exists as to the final form of the proposed rule, based on our preliminary assessment, we do not believe the new rule will impose any significant constraints on our business strategies or growth prospects.

## GOVERNANCE

### *Board of Directors*

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

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

### *Director Independence*

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

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

### *Audit Committee*

The Audit Committee reports to the Board of Directors. The Audit Committee is composed of four members of the Board of Directors. During 2014, four meetings were held. The Audit Committee responsibilities generally include, but are not limited to:

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

### *Compensation Committee*

The Compensation Committee is responsible for the oversight of employee and director compensation. The Compensation Committee is composed of nine members of the Board of Directors, all deemed to be independent of any relationship that, in the opinion of the Board, would interfere with the exercise of independent judgment as Committee members. The Committee annually reviews, evaluates and approves the compensation policies, programs and plans for senior officers and employees including benefits programs.

### *Policy Review Committee*

The Policy Review Committee reports to the Board of Directors. The Policy Review Committee is composed of four members of the Board of Directors. During 2014, two meetings were held. The Committee semi-annually reviews, evaluates and recommends for approval to the Board of Directors various policies and procedures utilized by the Association.

***Other Governance***

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

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

## FORWARD-LOOKING INFORMATION

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

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

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

***Allowance for Loan Losses***

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

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

Changes in the factors we consider in the evaluation of losses in the loan portfolio could occur for various credit related reasons and could result in a change in the allowance for loan losses, which would have a direct impact on the provision for loan losses and results of operations. See Notes 2 and 3 to the accompanying consolidated financial statements for detailed information regarding the allowance for loan losses.

## CUSTOMER PRIVACY

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

Premier Farm Credit
The Gold Standard in Ag Lending

**Premier Farm Credit, ACA**
**Sterling Administrative Office**
202 Poplar Street | P.O. Box 1785
Sterling, CO 80751
www.premieraca.com

**Telephone:** 970.522.5295
**Facsimile:** 970.522.6584
**Toll Free:** 877.650.8240

# REPORT OF MANAGEMENT

The consolidated financial statements of Premier Farm Credit, ACA (Association) are prepared by management, who is 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 generally accepted accounting principles appropriate in the circumstances, and in the opinion of management, fairly present the financial condition of the Association. Other financial information included in the 2014 annual report is consistent with that in the financial statements.

To meet its responsibility for reliable financial information, management depends on the Association's accounting and internal control systems, which have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded and transactions are properly authorized and recorded. To monitor compliance, Ann C. Wagner, an independent 3rd party, performed audits of the accounting records, reviewed accounting systems and internal controls, and recommended improvements as appropriate. The Association is also examined by the Farm Credit Administration.

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

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

Eldon Heermann
Chairman of the Board

Rick Sanger
President and Chief Executive Officer

Michael Grauberger
Chief Financial Officer

March 16, 2015

Premier Farm Credit
The Gold Standard in Ag Lending

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# AUDIT COMMITTEE REPORT

The Audit Committee (Committee) includes four members from the Board of Directors of Premier Farm Credit, ACA (Association). In 2014, four Committee meetings were held. The Committee oversees the scope of the Association's internal audit program, the independence of the outside auditors, the adequacy of the Association's system of internal controls and procedures, and the adequacy of management's action with respect to recommendations arising from those auditing activities. The Committee's responsibilities are described more fully in the Internal Control Policy and the Audit Committee Charter. The Committee approved the appointment of PricewaterhouseCoopers, LLP (PwC) as the Association's independent auditors for 2014.

The fees for professional services rendered for the Association by its independent auditor, PwC, during 2014 were $32,500 for audit services and $7,200 for tax services.

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

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

In this context, the Committee reviewed and discussed the Association's Quarterly Reports and the Association's audited financial statements for the year ended December 31, 2014 (the "Financial Statements") with management. The Committee also reviews with PwC the matters required to be discussed by Statements on Auditing Standards. Both PwC and the Association's internal auditors directly provide reports on significant matters to the Committee.

Based on the foregoing review and discussions and relying thereon, the Committee recommended that the Board of Directors include the Financial Statements in the Association's Annual Report to Shareholders for the year ended December 31, 2014 and for filing with the Farm Credit Association.

Gary K. Lancaster

Gary K. Lancaster, Chairman of the Audit Committee

Audit Committee Members
Gary K. Lancaster
Jason R. Pachner
Lyndsey D. Bishop
Rebecca K.W. Lenz

March 16, 2015

## Independent Auditor's Report

To the Board of Directors of
Premier Farm Credit, ACA

We have audited the accompanying consolidated financial statements of Premier Farm Credit, ACA, and its subsidiaries (the Association), which comprise the consolidated statement of condition as of December 31, 2014, 2013 and 2012, and the related consolidated statements of comprehensive income, of changes in shareholders' equity, and of cash flows for the years then ended.

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

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

### *Auditor's Responsibility*

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 Premier Farm Credit, ACA, and its subsidiaries at December 31, 2014, 2013 and 2012, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

March 16, 2015

*PricewaterhouseCoopers LLP, 1100 Walnut, Suite 1300, Kansas City, MO 64106*
*T: (816) 472 7921, F: (816) 218 1890, www.pwc.com/us*

## Consolidated Statement of Condition

(Dollars in Thousands)

| | December 31 | | |
|---|---|---|---|
| | **2014** | 2013 | 2012 |
| **ASSETS** | | | |
| Loans | **$ 595,554** | $ 564,620 | $ 523,238 |
| Less allowance for loan losses | **1,882** | 1,720 | 1,874 |
| Net loans | **593,672** | 562,900 | 521,364 |
| Cash | **11,620** | 10,822 | 9,036 |
| Accrued interest receivable | **6,644** | 6,370 | 5,611 |
| Investment in CoBank, ACB | **17,884** | 17,444 | 17,444 |
| Premises and equipment, net | **1,360** | 1,318 | 1,208 |
| Prepaid benefit expense | **498** | 525 | 587 |
| Deferred tax asset | **15** | 88 | 201 |
| Other assets | **4,717** | 3,346 | 2,525 |
| **Total assets** | **$ 636,410** | $ 602,813 | $ 557,976 |
| **LIABILITIES** | | | |
| Note payable to CoBank, ACB | **$ 484,622** | $ 457,405 | $ 417,517 |
| Advance conditional payments | **13,397** | 13,313 | 15,023 |
| Accrued interest payable | **3,891** | 5,405 | 5,291 |
| Patronage distributions payable | **3,500** | 3,000 | 4,250 |
| Accrued benefits liability | **352** | 318 | 340 |
| Other liabilities | **3,163** | 3,084 | 2,387 |
| **Total liabilities** | **508,925** | 482,525 | 444,808 |
| **Commitments and Contingencies (See Note 14)** | | | |
| **SHAREHOLDERS' EQUITY** | | | |
| Capital stock | **960** | 985 | 1,006 |
| Unallocated retained earnings | **126,593** | 119,343 | 112,238 |
| Accumulated other comprehensive loss | **(68)** | (40) | (76) |
| **Total shareholders' equity** | **127,485** | 120,288 | 113,168 |
| **Total liabilities and shareholders' equity** | **$ 636,410** | $ 602,813 | $ 557,976 |

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

## Consolidated Statement of Comprehensive Income

(Dollars in Thousands)

| | For the Year Ended December 31 | | |
|---|---|---|---|
| | **2014** | 2013 | 2012 |
| **INTEREST INCOME** | | | |
| Loans | **$ 24,299** | $ 23,040 | $ 22,082 |
| **Total interest income** | **24,299** | 23,040 | 22,082 |
| **INTEREST EXPENSE** | | | |
| Note payable to CoBank, ACB | **9,131** | 8,887 | 9,757 |
| Other | **45** | 62 | 65 |
| **Total interest expense** | **9,176** | 8,949 | 9,822 |
| Net interest income | **15,123** | 14,091 | 12,260 |
| Provision for loan losses/(Loan loss reversal) | **155** | (171) | (382) |
| Net interest income after provision for loan losses/(loan loss reversal) | **14,968** | 14,262 | 12,642 |
| **NONINTEREST INCOME** | | | |
| Financially related services income | **399** | 445 | 505 |
| Loan fees | **341** | 413 | 458 |
| Patronage distribution from Farm Credit institutions | **2,311** | 2,008 | 1,747 |
| Farm Credit Insurance Fund distribution | **-** | - | 400 |
| Mineral income | **976** | 889 | 759 |
| Other noninterest income | **151** | 167 | 159 |
| **Total noninterest income** | **4,178** | 3,922 | 4,028 |
| **NONINTEREST EXPENSE** | | | |
| Salaries and employee benefits | **4,822** | 4,862 | 4,611 |
| Occupancy and equipment | **540** | 471 | 436 |
| Purchased services from AgVantis, Inc. | **803** | 756 | 749 |
| Losses on other property owned, net | **-** | - | 11 |
| Farm Credit Insurance Fund premium | **502** | 374 | 169 |
| Supervisory and examination costs | **194** | 183 | 180 |
| Other noninterest expense | **1,457** | 1,316 | 1,089 |
| **Total noninterest expense** | **8,318** | 7,962 | 7,245 |
| Income before income taxes | **10,828** | 10,222 | 9,425 |
| Provision for income taxes | **78** | 117 | 236 |
| **Net income** | **10,750** | 10,105 | 9,189 |
| **COMPREHENSIVE INCOME** | | | |
| Amortization of retirement costs | **5** | 14 | 14 |
| Actuarial (loss)/gain in retirement obligation | **(33)** | 22 | (19) |
| **Total comprehensive income** | **$ 10,722** | $ 10,141 | $ 9,184 |

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

## Consolidated Statement of Changes in Shareholders' Equity

(Dollars in Thousands)

| | Capital Stock | Unallocated Retained Earnings | Accumulated Other Comprehensive Income/(Loss) | Total Shareholders' Equity |
|---|---|---|---|---|
| **Balance at December 31, 2011** | $ 1,035 | $ 107,299 | $ (71) | $ 108,263 |
| Comprehensive income | | 9,189 | (5) | 9,184 |
| Stock issued | 89 | | | 89 |
| Stock retired | (118) | | | (118) |
| Patronage Distributions: Cash | | (4,250) | | (4,250) |
| **Balance at December 31, 2012** | 1,006 | 112,238 | (76) | 113,168 |
| Comprehensive income | | 10,105 | 36 | 10,141 |
| Stock issued | 66 | | | 66 |
| Stock retired | (87) | | | (87) |
| Patronage Distributions: Cash | | (3,000) | | (3,000) |
| **Balance at December 31, 2013** | 985 | 119,343 | (40) | 120,288 |
| Comprehensive income | | 10,750 | (28) | 10,722 |
| Stock issued | 46 | | | 46 |
| Stock retired | (71) | | | (71) |
| Patronage Distributions: Cash | | (3,500) | | (3,500) |
| **Balance at December 31, 2014** | **$ 960** | **$ 126,593** | **$ (68)** | **$ 127,485** |

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

## Consolidated Statement of Cash Flows

(Dollars in Thousands)

| | For the Year Ended December 31 | | |
|---|---|---|---|
| | **2014** | 2013 | 2012 |
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | | |
| Net income | **$ 10,750** | $ 10,105 | $ 9,189 |
| Adjustments to reconcile net income to net cash provided by/(used in) operating activities: | | | |
| Depreciation | **219** | 168 | 163 |
| Provision for loan losses/(Loan loss reversal) | **155** | (171) | (382) |
| Stock patronage from CoBank | **(35)** | - | - |
| Allocated patronage from AgVantis | **(125)** | (131) | (104) |
| Gains on sales of premises and equipment | **(20)** | (16) | (12) |
| Losses on sales of other property owned | **-** | - | 10 |
| Change in assets and liabilities: | | | |
| Decrease in deferred tax asset | **73** | 113 | 216 |
| (Increase)/Decrease in accrued interest receivable | **(274)** | (759) | 490 |
| Decrease in prepaid benefit expense | **27** | 62 | 11 |
| (Increase)/Decrease in other assets | **(1,211)** | (690) | 484 |
| (Decrease)/Increase in accrued interest payable | **(1,514)** | 114 | (785) |
| Increase in accrued benefits liability | **6** | 14 | 13 |
| Increase in other liabilities | **79** | 697 | 218 |
| Total adjustments | **(2,620)** | (599) | 322 |
| Net cash provided by operating activities | **8,130** | 9,506 | 9,511 |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | | |
| Increase in loans, net | **(30,927)** | (41,365) | (54,222) |
| Increase in investment in CoBank | **(440)** | - | - |
| Expenditures for premises and equipment, net | **(241)** | (262) | (131) |
| Proceeds from sales of other property owned | **-** | - | 626 |
| Net cash used in investing activities | **(31,608)** | (41,627) | (53,727) |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | | |
| Net draw on note payable to CoBank | **27,217** | 39,888 | 45,396 |
| Increase/(Decrease) in advance conditional payments | **84** | (1,710) | 3,035 |
| Capital stock retired | **(71)** | (87) | (118) |
| Capital stock issued | **46** | 66 | 89 |
| Cash patronage distributions paid | **(3,000)** | (4,250) | (4,500) |
| Net cash provided by financing activities | **24,276** | 33,907 | 43,902 |
| Net increase/(decrease) in cash | **798** | 1,786 | (314) |
| Cash at beginning of year | **10,822** | 9,036 | 9,350 |
| Cash at end of year | **$ 11,620** | $ 10,822 | $ 9,036 |
| **SUPPLEMENTAL CASH INFORMATION:** | | | |
| Cash paid during the year for: | | | |
| Interest | **$ 10,690** | $ 8,835 | $ 10,607 |
| Income taxes | **$ -** | $ 11 | $ 20 |
| **SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:** | | | |
| Stock patronage from CoBank | **$ 35** | $ - | $ - |
| Allocated patronage from AgVantis | **$ 125** | $ 131 | $ 104 |
| Net recoveries | **$ (7)** | $ (17) | $ (7) |
| Patronage distributions payable | **$ 3,500** | $ 3,000 | $ 4,250 |
| Change in accumulated other comprehensive loss | **$ (28)** | $ 36 | $ (5) |

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

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in Thousands, Except as Noted)

## NOTE 1 – ORGANIZATION AND OPERATIONS

A. Organization: Premier Farm Credit, ACA and its subsidiaries, Premier Farm Credit, FLCA, (Federal Land Credit Association (FLCA)) and Premier Farm Credit, PCA, (Production Credit Association (PCA)), (collectively called "the Association") are member-owned cooperatives which provide credit and credit-related services to or for the benefit of eligible borrowers/shareholders for qualified agricultural purposes in the counties of Logan, Morgan, Phillips, Sedgwick, Yuma and Washington in the state of Colorado.

The Association is a lending institution of the Farm Credit System (System), a nationwide system of cooperatively owned banks and associations, which was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (the Farm Credit Act). At December 31, 2014, the System was comprised of three Farm Credit Banks, one Agricultural Credit Bank and 77 associations.

Effective January 1, 2012, U.S. AgBank, FCB (AgBank) merged with and into CoBank, FCB, a wholly owned subsidiary of CoBank, ACB (CoBank). As a result of the merger, CoBank became the funding bank of the Association beginning January 1, 2012.

CoBank, its related associations and AgVantis, Inc. (AgVantis) are collectively referred to as the District. CoBank provides the funding to associations within the District and is responsible for supervising certain activities of the District Associations. AgVantis, which is owned by the entities it serves, provides technology and other operational services to certain associations and to CoBank. As of December 31, 2014, the CoBank District consisted of CoBank, 25 Agricultural Credit Associations (ACA), which each have two wholly owned subsidiaries, (a FLCA and a PCA), one FLCA and AgVantis.

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

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

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

B. Operations: The Farm Credit Act sets forth the types of authorized lending activity, persons eligible to borrow, and financial services which can be provided by the Association. The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, their cooperatives, rural residents and farm-related businesses.

The Association also offers credit life insurance, multi-peril crop and crop hail insurance, advance conditional payment accounts and provides additional services to borrowers such as leasing and fee appraisals.

The Association's financial condition may be impacted by factors affecting CoBank. The CoBank Annual Report is available free of charge on CoBank's website, www.cobank.com; or may be obtained at no charge by contacting the Association at 202 Poplar Street, Sterling, Colorado 80751, or by calling (970) 522-5295. Upon request, Association shareholders will be provided with a copy of the CoBank Annual Report. The CoBank Annual Report discusses the material aspects of CoBank's and District's financial condition, changes in financial condition, and results of operations.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

The consolidated financial statements include the accounts of Premier Farm Credit, FLCA and Premier Farm Credit, PCA. All significant inter-company transactions have been eliminated in consolidation. Recently issued or adopted accounting pronouncements follow.

In May 2014, the Financial Accounting Standards Board (FASB) issued guidance entitled, "Revenue from Contracts with Customers." The guidance governs revenue recognition from contracts with customers and requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Financial instruments and other contractual rights within the scope of other guidance issued by the FASB are excluded from the scope of this new revenue recognition guidance. In this regard, a majority of our contracts would be excluded from the scope of this new guidance. The guidance becomes effective for the first interim reporting period within the annual reporting periods after December 15, 2016. The Association is in the process of reviewing contracts to determine the effect, if any, on the Association's financial condition or its results of operations.

Below is a summary of our significant accounting policies.

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

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

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

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

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

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

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

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

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

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

B. Cash: Cash, as included in the consolidated financial statements, represents cash on hand and on deposit at financial institutions.

C. Investment in CoBank: The Association's required investment in CoBank is in the form of Class A Stock. The minimum required investment is 4.00 percent of the prior year's average direct loan volume. The investment in CoBank is comprised of patronage based stock and purchased stock. The requirement for capitalizing its patronage-based participation loans sold to CoBank is 8.00 percent of the prior ten-year average of such participations sold to CoBank.

   Prior to the bank merger on January 1, 2012, the Association's investment in AgBank was in the form of Class A Stock. The minimum required investment in AgBank was 5.00 percent of average direct loan volume, net of excess investment. The required investment was adjusted on a quarterly basis to reflect changes in direct loan volume. The required investment was comprised of AgBank surplus attributed to the Association, patronage based stock and purchased stock. On the date of the merger, AgBank stock was converted to CoBank stock.

D. Premises and Equipment: Land is carried at cost. Premises and equipment are carried at cost less accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Estimated useful life for the buildings range from 24 to 40 years and ranges from 1 to 13 years for furniture, equipment and automobiles. Gains and losses on dispositions are reflected in current operating results. Maintenance and repairs are expensed and improvements above certain thresholds are capitalized.

E. Other Property Owned: Other property owned, consisting of real and personal property acquired through foreclosure or deed in lieu of foreclosure, is recorded at 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. On at least an annual basis, revised estimates to the fair value less cost 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. Income and expenses from operations and carrying value adjustments are included in net gains/(losses) on other property owned in the Consolidated Statement of Comprehensive Income.

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

G. Advance Conditional Payments: The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, the advance conditional payments are netted against the borrower's related loan balance. Unrestricted advance conditional payments are included in liabilities. Restricted advance conditional payments are primarily associated with mortgage loans, while non-restricted are primarily related to production and intermediate-term loans and insurance proceeds on mortgage loans. Advance conditional payments are not insured. Interest is generally paid by the Association on advance conditional payments.

H. Employee Benefit Plans: Substantially all employees of the Association participate in the Ninth Farm Credit District Pension Plan (Pension Plan) and/or the Farm Credit Foundations Defined Contribution/401(k) Plan (401(k) Plan). The Pension Plan is a non-contributory defined benefit plan. Benefits are based on compensation and years of service. The Association recognizes its proportional share of expense and contributes its proportional share of funding. The Pension Plan was closed to employees beginning January 1, 2007.

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

   The Association also participates in the Farm Credit Foundations Retiree Medical Plan. These postretirement benefits (other than pensions) are provided to eligible retired employees of the Association. The anticipated costs of these benefits were accrued during the period of the employee's active service. The authoritative accounting guidance requires the accrual of the expected cost of providing postretirement benefits during the years that the employee renders service necessary to become eligible for these benefits.

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

Certain eligible employees may also participate in a nonqualified deferred compensation plan where they are able to defer a portion of their compensation. The Association matches a certain percentage of employee contributions to the plan.

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

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

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

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

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

On December 31, 2011, AgBank, in anticipation of its January 1, 2012 merger with CoBank, recapitalized and distributed stock to its Association members. Deferred taxes have not been recorded by the Association on that distribution as management's intent, if that stock is ever converted to cash, is to pass through any related earnings to Association borrowers through qualified patronage allocations.

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

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

Level 1 — Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets include assets held in trust funds which relate to the Association's deferred compensation plan and supplemental retirement plan. The trust

funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace.

Level 2 — Observable inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly or indirectly. Level 2 inputs include the following: (a) quoted prices for similar assets or liabilities in active markets; (b) quoted prices for identical or similar assets or liabilities in markets that are not active so that they are traded less frequently than exchange-traded instruments, the prices are not current or principal market information is not released publicly; (c) inputs other than quoted prices that are observable such as interest rates and yield curves, prepayment speeds, credit risks and default rates; and, (d) inputs derived principally from or corroborated by observable market data by correlation or other means.

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

The fair value disclosures are presented in Note 15.

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

## NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES

A summary of loans follows.

| | December 31 | | |
|---|---|---|---|
| | **2014** | 2013 | 2012 |
| Real estate mortgage | **$ 340,185** | $ 330,156 | $ 294,258 |
| Production and intermediate-term | **141,933** | 125,966 | 136,650 |
| Agribusiness: | | | |
| Loans to cooperatives | **13,073** | 12,034 | 10,879 |
| Process and marketing | **62,964** | 55,419 | 42,891 |
| Farm related business | **4,849** | 5,446 | 4,205 |
| Communication | **10,359** | 11,100 | 10,889 |
| Energy | **18,761** | 20,966 | 17,038 |
| Water/waste water | **1,064** | 1,093 | 1,150 |
| Agricultural export finance | **2,000** | 2,000 | 4,615 |
| Rural residential real estate | **366** | 440 | 663 |
| Total loans | **$ 595,554** | $ 564,620 | $ 523,238 |

The Association purchases or sells loan participations with Farm Credit institutions in order to diversify risk, manage loan volume and comply with FCA regulations. The following table presents information regarding participations purchased and sold as of December 31, 2014:

| | Purchased | Sold |
|---|---|---|
| Real estate mortgage | $ 15,359 | $ 11,494 |
| Production and intermediate-term | 14,580 | 4,125 |
| Agribusiness | 79,737 | – |
| Communication | 10,359 | – |
| Energy | 18,761 | – |
| Water/waste water | 1,064 | – |
| Agricultural export finance | 2,000 | – |
| Total | $ 141,860 | $ 15,619 |

The Association's concentration of credit risk in various agricultural commodities is shown in the following table.

| | **December 31** | | | | | |
|---|---|---|---|---|---|---|
| | **2014** | | 2013 | | 2012 | |
| SIC Category | **Amount** | **Percent** | Amount | Percent | Amount | Percent |
| Corn | **$ 224,405** | **37.68%** | $ 220,428 | 39.04% | $ 191,453 | 36.59% |
| Beef | **96,003** | **16.12%** | 83,790 | 14.84% | 86,125 | 16.46% |
| Wheat | **68,429** | **11.49%** | 66,512 | 11.78% | 57,923 | 11.07% |
| Landlords | **33,947** | **5.70%** | 31,788 | 5.63% | 36,051 | 6.89% |
| Hay | **11,732** | **1.97%** | 10,784 | 1.91% | 10,622 | 2.03% |
| Other | **161,038** | **27.04%** | 151,318 | 26.80% | 141,064 | 26.96% |
| Total | **$ 595,554** | **100.00%** | $ 564,620 | 100.00% | $ 523,238 | 100.00% |

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

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

Credit enhancements with federal government agencies of $11,001 at year-end 2014, $10,539 at year-end 2013 and $12,237 at year-end 2012 were outstanding. The Association utilizes Farm Service Agency (FSA) 90% guarantees. The United States Government guarantees to pay 90% of any loss incurred on the FSA guaranteed loans.

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

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

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

| | **2014** | 2013 | 2012 |
|---|---|---|---|
| Real estate mortgage | | | |
| Acceptable | **97.43%** | 98.15% | 95.76% |
| OAEM | **2.44%** | 1.62% | 3.44% |
| Substandard | **0.13%** | 0.23% | 0.80% |
| Total | **100.00%** | 100.00% | 100.00% |
| Production and intermediate-term | | | |
| Acceptable | **95.55%** | 98.13% | 96.33% |
| OAEM | **4.45%** | 0.15% | 2.27% |
| Substandard | **–** | 1.72% | 1.40% |
| Total | **100.00%** | 100.00% | 100.00% |
| Agribusiness | | | |
| Acceptable | **98.40%** | 95.01% | 96.55% |
| OAEM | **0.43%** | 2.76% | 2.68% |
| Substandard | **1.17%** | 2.23% | 0.77% |
| Total | **100.00%** | 100.00% | 100.00% |
| Energy | | | |
| Acceptable | **97.82%** | 100.00% | 95.73% |
| Substandard | **2.18%** | – | 4.27% |
| Total | **100.00%** | 100.00% | 100.00% |
| Water/waste water | | | |
| Acceptable | **100.00%** | 100.00% | 100.00% |
| Total | **100.00%** | 100.00% | 100.00% |
| Communication | | | |
| Acceptable | **90.88%** | 91.01% | 100.00% |
| Substandard | **9.12%** | 8.99% | – |
| Total | **100.00%** | 100.00% | 100.00% |
| Rural residential real estate | | | |
| Acceptable | **73.47%** | 73.47% | 81.80% |
| OAEM | **26.53%** | 26.53% | 18.20% |
| Total | **100.00%** | 100.00% | 100.00% |
| Agricultural export finance | | | |
| Acceptable | **100.00%** | 100.00% | 100.00% |
| Total | **100.00%** | 100.00% | 100.00% |
| Total Loans | | | |
| Acceptable | **97.01%** | 97.66% | 96.16% |
| OAEM | **2.60%** | 1.36% | 2.85% |
| Substandard | **0.39%** | 0.98% | 0.99% |
| Total | **100.00%** | 100.00% | 100.00% |

Impaired loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms. The following presents information relating to impaired loans including accrued interest.

| | **December 31** | | |
|---|---|---|---|
| | **2014** | 2013 | 2012 |
| Nonaccrual loans: | | | |
| Current as to principal and interest | **$ 945** | $ 1,044 | $ 548 |
| Total impaired loans | **$ 945** | $ 1,044 | $ 548 |

There were no loans classified as accruing restructured or accruing loans 90 days or more past due for the years presented.

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

High risk assets consist of impaired loans and other property owned. The following table presents these in a more detailed manner than the previous table. The Association had no other property owned for the years presented. These nonperforming assets (including related accrued interest) are as follows:

| | December 31 | | |
|---|---|---|---|
| *(dollars in thousands)* | **2014** | 2013 | 2012 |
| Nonaccrual loans | | | |
| Real estate mortgage | **$ –** | $ 45 | $ 83 |
| Communication | **945** | 999 | 465 |
| Total nonaccrual loans | **945** | 1,044 | 548 |
| Total high risk assets | **$ 945** | $ 1,044 | $ 548 |

Additional impaired loan information is as follows:

| | Recorded Investment at 12/31/14 | Unpaid Principal Balance* | Related Allowance | Average Impaired Loans | Interest Income Recognized |
|---|---|---|---|---|---|
| Impaired loans with a related allowance for credit losses: | | | | | |
| Communication | $ – | $ – | $ – | $ 286 | $ – |
| Total | $ – | $ – | $ – | $ 286 | $ – |
| Impaired loans with no related allowance for credit losses: | | | | | |
| Real estate mortgage | $ – | $ – | | $ 14 | $ 141 |
| Communication | 945 | 1,076 | | 790 | 1 |
| Total | $ 945 | $ 1,076 | | $ 804 | $ 142 |
| Total impaired loans: | | | | | |
| Real estate mortgage | $ – | $ – | $ – | $ 14 | $ 141 |
| Communication | 945 | 1,076 | – | 1,076 | 1 |
| Total | $ 945 | $ 1,076 | $ – | $ 1,090 | $ 142 |

| | Recorded Investment at 12/31/13 | Unpaid Principal Balance* | Related Allowance | Average Impaired Loans | Interest Income Recognized |
|---|---|---|---|---|---|
| Impaired loans with a related allowance for credit losses: | | | | | |
| Communication | $ 999 | $ 1,000 | $ 170 | $ 828 | $ – |
| Total | $ 999 | $ 1,000 | $ 170 | $ 828 | $ – |
| Impaired loans with no related allowance for credit losses: | | | | | |
| Real estate mortgage | $ 45 | $ 177 | | $ 106 | $ 21 |
| Production and intermediate-term | – | – | | 60 | 10 |
| Agribusiness: | | | | | |
| Processing and marketing | – | – | | 24 | 1 |
| Communication | – | – | | 96 | – |
| Total | $ 45 | $ 177 | | $ 286 | $ 32 |
| Total impaired loans: | | | | | |
| Real estate mortgage | $ 45 | $ 177 | $ – | $ 106 | $ 21 |
| Production and intermediate-term | – | – | – | 60 | 10 |
| Agribusiness: | | | | | |
| Processing and marketing | – | – | – | 24 | 1 |
| Communication | 999 | 1,000 | 170 | 924 | – |
| Total | $ 1,044 | $ 1,177 | $ 170 | $ 1,114 | $ 32 |

| | Recorded Investment at 12/31/12 | Unpaid Principal Balance* | Related Allowance | Average Impaired Loans | Interest Income Recognized |
|---|---|---|---|---|---|
| Impaired loans with a related allowance for credit losses: | | | | | |
| Communication | $ – | $ – | $ – | $ 473 | $ – |
| Total | $ – | $ – | $ – | $ 473 | $ – |
| Impaired loans with no related allowance for credit losses: | | | | | |
| Real estate mortgage | $ 83 | $ 257 | | $ 321 | $ 26 |
| Production and intermediate-term | – | – | | 39 | 3 |
| Agribusiness: | | | | | |
| Processing and marketing | – | – | | – | 1 |
| Communication | 465 | 526 | | 40 | – |
| Total | $ 548 | $ 783 | | $ 400 | $ 30 |
| Total impaired loans: | | | | | |
| Real estate mortgage | $ 83 | $ 257 | $ – | $ 321 | $ 26 |
| Production and intermediate-term | – | – | – | 39 | 3 |
| Agribusiness: | | | | | |
| Processing and marketing | – | – | – | – | 1 |
| Communication | 465 | 526 | – | 513 | – |
| Total | $ 548 | $ 783 | $ – | $ 873 | $ 30 |

* Unpaid principal balance represents the recorded principal balance of the loan

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

| | Year Ended December 31 | | |
|---|---|---|---|
| | **2014** | 2013 | 2012 |
| Interest income recognized on: | | | |
| Nonaccrual loans | **$ 142** | $ 31 | $ 26 |
| Accrual loans 90 days or more past due | **–** | 1 | 4 |
| Interest income recognized on impaired loans | **$ 142** | $ 32 | $ 30 |

Interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans follows.

| | Year Ended December 31 | | |
|---|---|---|---|
| | **2014** | 2013 | 2012 |
| Interest income which would have been recognized under the original loan terms | **$ 138** | $ 79 | $ 59 |
| Less: interest income recognized | **142** | 31 | 26 |
| Interest income (recognized)/not recognized | **$ (4)** | $ 48 | $ 33 |

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

| **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 Loans | Recorded Investment > 90 Days and Accruing |
|---|---|---|---|---|---|---|
| Real estate mortgage | $ – | $ – | $ – | $344,950 | $ 344,950 | $ – |
| Production and intermediate-term | – | – | – | 143,396 | 143,396 | – |
| Agribusiness | – | – | – | 81,249 | 81,249 | – |
| Communication | – | – | – | 10,365 | 10,365 | – |
| Energy | – | – | – | 18,801 | 18,801 | – |
| Water/waste water | – | – | – | 1,069 | 1,069 | – |
| Rural residential real estate | – | – | – | 368 | 368 | – |
| Agricultural export finance | – | – | – | 2,000 | 2,000 | – |
| Total | $ – | $ – | $ – | $602,198 | $ 602,198 | $ – |

| December 31, 2013 | 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 Loans | Recorded Investment > 90 Days and Accruing |
|---|---|---|---|---|---|---|
| Real estate mortgage | $ – | $ – | $ – | $334,792 | $ 334,792 | $ – |
| Production and intermediate-term | 367 | – | 367 | 126,943 | 127,310 | – |
| Agribusiness | – | – | – | 73,224 | 73,224 | – |
| Communication | – | – | – | 11,106 | 11,106 | – |
| Energy | – | – | – | 21,019 | 21,019 | – |
| Water/waste water | – | – | – | 1,098 | 1,098 | – |
| Rural residential real estate | – | – | – | 441 | 441 | – |
| Agricultural export finance | – | – | – | 2,000 | 2,000 | – |
| Total | $ 367 | $ – | $ 367 | $570,623 | $ 570,990 | $ – |

| December 31, 2012 | 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 Loans | Recorded Investment > 90 Days and Accruing |
|---|---|---|---|---|---|---|
| Real estate mortgage | $ – | $ – | $ – | $298,152 | $ 298,152 | $ – |
| Production and intermediate-term | – | – | – | 138,100 | 138,100 | – |
| Agribusiness | – | – | – | 58,198 | 58,198 | – |
| Communication | – | – | – | 10,894 | 10,894 | – |
| Energy | – | – | – | 17,060 | 17,060 | – |
| Water/waste water | – | – | – | 1,155 | 1,155 | – |
| Rural residential real estate | – | – | – | 675 | 675 | – |
| Agricultural export finance | – | – | – | 4,615 | 4,615 | – |
| Total | $ – | $ – | $ – | $528,849 | $ 528,849 | $ – |

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

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider.

During 2013, the Association recorded TDRs in communication loans with a pre-modification and post-modification outstanding recorded investment of $1,011. The Association recorded no TDRs during 2014 and 2012. Pre-modification represents the recorded investment in the loan receivable just prior to restructuring and post-modification

represents the recorded investment in the loan receivable immediately following the restructuring. The recorded investment is the face amount of the loan receivable increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, or acquisition costs and may also reflect a previous direct write-down of the loan receivable. There were no TDRs that occurred within the previous 12 months of that year and for which there was a payment default during the period for any of the periods presented.

The loan modified as TDR had a balance of $945 at year-end 2014 and $999 at year-end 2013 and was recorded as a nonaccrual loan. The TDRs are classified as nonaccrual loans for allowance for loss purposes. Additional commitments to lend to borrowers whose loans have been modified in TDRs were $19 at December 31, 2014. There were no additional commitments to lend to borrowers whose loans have been modified in TDRs for year-end 2013 and 2012.

A summary of changes in the allowance for loan losses and period end recorded investment in loans is as follows:

| | Balance at December 31, 2013 | Charge-offs | Recoveries | Provision for Loan Losses/(Loan Loss Reversals) | Balance at December 31, 2014 |
|---|---|---|---|---|---|
| Real estate mortgage | $ 660 | $ – | $ – | $ 57 | $ 717 |
| Production and intermediate-term | 282 | 2 | 9 | 33 | 322 |
| Agribusiness | 522 | – | – | 77 | 599 |
| Communication | 188 | – | – | (122) | 66 |
| Energy | 65 | – | – | 96 | 161 |
| Water/waste water | 2 | – | – | 4 | 6 |
| Agricultural export finance | 1 | – | – | 10 | 11 |
| Total | $ 1,720 | $ 2 | $ 9 | $ 155 | $ 1,882 |

| | Balance at December 31, 2012 | Charge-offs | Recoveries | Provision for Loan Losses/(Loan Loss Reversals) | Balance at December 31, 2013 |
|---|---|---|---|---|---|
| Real estate mortgage | $ 662 | $ – | $ – | $ (2) | $ 660 |
| Production and intermediate-term | 388 | 1 | 8 | (113) | 282 |
| Agribusiness | 735 | – | 10 | (223) | 522 |
| Communication | 23 | – | – | 165 | 188 |
| Energy | 64 | – | – | 1 | 65 |
| Water/waste water | 2 | – | – | – | 2 |
| Agricultural export finance | – | – | – | 1 | 1 |
| Total | $ 1,874 | $ 1 | $ 18 | $ (171) | $ 1,720 |

| | Balance at December 31, 2011 | Charge-offs | Recoveries | Provision for Loan Losses/(Loan Loss Reversals) | Balance at December 31, 2012 |
|---|---|---|---|---|---|
| Real estate mortgage | $ 708 | $ – | $ – | $ (46) | $ 662 |
| Production and intermediate-term | 374 | – | 7 | 7 | 388 |
| Agribusiness | 847 | – | – | (112) | 735 |
| Communication | 270 | – | – | (247) | 23 |
| Energy | 44 | – | – | 20 | 64 |
| Water/waste water | 2 | – | – | – | 2 |
| Rural residential real estate | 1 | – | – | (1) | – |
| Agricultural export finance | 3 | – | – | (3) | – |
| Total | $ 2,249 | $ – | $ 7 | $ (382) | $ 1,874 |

| | Allowance for Credit Losses Ending Balance at December 31, 2014 | | Recorded Investment in Loans Outstanding Ending Balance at December 31, 2014 | |
|---|---|---|---|---|
| | Individually evaluated for impairment | Collectively evaluated for impairment | Individually evaluated for impairment | Collectively evaluated for impairment |
| Real estate mortgage | $ – | $ 717 | $ – | $ 344,950 |
| Production and intermediate-term | – | 322 | – | 143,396 |
| Agribusiness | – | 599 | – | 81,249 |
| Communication | – | 66 | 945 | 9,420 |
| Energy | – | 161 | – | 18,801 |
| Water/waste water | – | 6 | – | 1,069 |
| Rural residential real estate | – | – | – | 368 |
| Agricultural export finance | – | 11 | – | 2,000 |
| Total | $ – | $ 1,882 | $ 945 | $ 601,253 |

| | Allowance for Credit Losses Ending Balance at December 31, 2013 | | Recorded Investment in Loans Outstanding Ending Balance at December 31, 2013 | |
|---|---|---|---|---|
| | Individually evaluated for impairment | Collectively evaluated for impairment | Individually evaluated for impairment | Collectively evaluated for impairment |
| Real estate mortgage | $ – | $ 660 | $ 45 | $ 334,747 |
| Production and intermediate-term | – | 282 | – | 127,310 |
| Agribusiness | – | 522 | – | 73,223 |
| Communication | 170 | 18 | 999 | 10,108 |
| Energy | – | 65 | – | 21,019 |
| Water/waste water | – | 2 | – | 1,098 |
| Rural residential real estate | – | – | – | 441 |
| International | – | 1 | – | 2,000 |
| Total | $ 170 | $ 1,550 | $ 1,044 | $ 569,946 |

| | Allowance for Credit Losses Ending Balance at December 31, 2012 | | Recorded Investment in Loans Outstanding Ending Balance at December 31, 2012 | |
|---|---|---|---|---|
| | Individually evaluated for impairment | Collectively evaluated for impairment | Individually evaluated for impairment | Collectively evaluated for impairment |
| Real estate mortgage | $ – | $ 662 | $ 83 | $ 298,069 |
| Production and intermediate-term | – | 388 | – | 138,100 |
| Agribusiness | – | 735 | – | 58,198 |
| Communication | – | 23 | 465 | 10,429 |
| Energy | – | 64 | – | 17,060 |
| Water/waste water | – | 2 | – | 1,155 |
| Rural residential real estate | – | – | – | 675 |
| Agricultural export finance | – | – | – | 4,615 |
| Total | $ – | $ 1,874 | $ 548 | $ 528,301 |

## NOTE 4 – INVESTMENT IN COBANK

At December 31, 2014, the Association's investment in CoBank is in the form of Class A stock with a par value of $100.00 per share. The Association is required to own stock in CoBank to capitalize its direct loan balance and participation loans sold to CoBank. The current requirement for capitalizing its direct loan from CoBank is 4.00 percent of the Association's prior year average direct loan balance. The 2014 requirement for capitalizing its patronage-based participation loans sold to CoBank is 8.00 percent of the Association's prior ten-year average balance of such participation sold to CoBank. Under the current CoBank capital plan applicable to such participation sold, patronage from CoBank related to these participation sold is paid 75 percent cash and 25 percent Class A stock. The capital plan is evaluated annually by CoBank's board of directors and management and is subject to change.

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

The Association owned approximately 0.78 percent of the outstanding common stock of CoBank at December 31, 2014.

## NOTE 5 – PREMISES AND EQUIPMENT

Premises and equipment consisted of the following.

| | December 31 | | |
|---|---|---|---|
| | **2014** | 2013 | 2012 |
| Land | **$ 290** | $ 290 | $ 290 |
| Buildings and leasehold improvements | **2,331** | 2,117 | 2,086 |
| Furniture, equipment and automobiles | **1,309** | 1,230 | 1,235 |
| Construction in progress | **–** | 104 | – |
| | **3,930** | 3,741 | 3,611 |
| Less: accumulated depreciation | **2,570** | 2,423 | 2,403 |
| Total | **$ 1,360** | $ 1,318 | $ 1,208 |

## NOTE 6 – OTHER PROPERTY OWNED

During 2012, the Association recorded losses on other property owned as reflected on the Consolidated Statement of Comprehensive Income. The losses consisted of $10 on the sale and net operating expenses of $1. No gains or losses were recorded in 2014 or 2013.

## NOTE 7 – NOTE PAYABLE TO COBANK

The Association's indebtedness to CoBank represents borrowings by the Association to fund its loan portfolio. This indebtedness is collateralized by a pledge of substantially all of the Association's assets and is governed by a General Financing Agreement (GFA) which provides for an open-ended revolving line of credit. The GFA and promissory note are subject to periodic renewals in the normal course of business. The GFA matures on May 31, 2018. Management expects renewal of the GFA at that time. The Association was in compliance with the terms and conditions of the GFA as of December 31, 2014. Substantially all borrower loans are match-funded with CoBank. Payments and disbursements are made on the note payable to CoBank on the same basis the Association collects payments from and disburses on borrower loans. The interest rate may periodically be adjusted by CoBank based on the terms and conditions of the borrowing. The weighted average interest rate was 2.04 percent for the year ended December 31, 2014, compared with 2.18 percent at December 31, 2013, and 2.72 percent at December 31, 2012.

The Association has the opportunity to commit loanable funds with CoBank under a variety of programs at either fixed or variable rates for specified timeframes. Participants in the program receive a credit on the committed loanable funds balance classified as a reduction of interest expense. These committed funds are netted against the note payable to the Bank. The average committed funds as of December 31 are as follows:

| | **2014** | 2013 | 2012 |
|---|---|---|---|
| Average committed funds | **$ 125,595** | $ 126,840 | $ 113,429 |
| Average rates | **0.99%** | 0.79% | 0.56% |

Under the Farm Credit Act, the Association is obligated to borrow only from CoBank, unless CoBank gives approval to borrow elsewhere. CoBank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2014, the Association's notes payable was within the specified limitations.

## NOTE 8 – SHAREHOLDERS' EQUITY

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

A. Protected Borrower Stock

Protection of certain stock is provided under the Farm Credit Act which requires the Association, when retiring protected stock, to retire it at par or stated value regardless of its book value. Protected stock includes stock and allocated equities which were outstanding as of January 6, 1988, or were issued or allocated prior to October 6, 1988.

B. Capital Stock

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

Capitalization bylaws allow stock requirements to range from the lesser of one thousand dollars or 2.00 percent of the amount of the loan to 10.00 percent of the loan. The Board of Directors has the authority to change the minimum required stock level of a shareholder as long as the change is within this range. Currently, the Association has a stock requirement of the lesser of one thousand dollars or 2.00 percent of the amount of the borrower's combined loan volume.

C. Regulatory Capitalization Requirements and Restrictions

The FCA's capital adequacy regulations require the Association to maintain permanent capital of 7.00 percent of average risk-adjusted assets. Failure to meet the requirement can initiate certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Association's consolidated financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless the prescribed capital standard is met. The FCA regulations also require other additional minimum standards for capital be maintained. These standards require all System institutions to achieve and maintain ratios of total surplus as a percentage of average risk-adjusted assets of 7.00 percent and of core surplus (generally unallocated surplus) as a percentage of average risk-adjusted assets of 3.50 percent. At December 31, 2014, the Association's permanent capital ratio was 17.42 percent, total surplus ratio was 17.27 percent and core surplus ratio was 17.10 percent.

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

D. Description of Equities

The following paragraphs describe the attributes of each class of stock authorized by the Association bylaws and indicate the number of shares outstanding at December 31, 2014. Unless otherwise indicated all classes of stock have a par value of $5.00.

Class A Preferred Stock (Nonvoting, at-risk, no shares outstanding) - Represents Association retained earnings, dividends or patronage distributions allocated on or after October 6, 1988. This stock may also represent Class B or Class C Common Stock of a borrower which automatically converts to Class A two years after repayment of the loan in full. Retirement is at the sole discretion of the Board of Directors provided that the Association will continue to meet minimum capital adequacy requirements as established under Regulations.

Class B Common Stock (Voting, at-risk, 191,176 shares outstanding) - Issued on or after October 6, 1988, for farm and ranch loans. Retirement is at the sole discretion of the Board of Directors provided that the Association will continue to meet minimum capital adequacy requirements as established under Regulations. If the Association is unable to retire Class B Common Stock,

or if the borrower elects to keep his/her investment in the Association after repayment of the loan in full, the stock must be converted to Class A Preferred Stock within two years.

Class C Common Stock (Nonvoting, at-risk, 800 shares outstanding) - Issued on or after October 6, 1988, for farm-related and rural home loans and to other persons or organizations who are eligible to borrow but are not eligible to hold voting stock. Retirement is at the sole discretion of the Board of Directors provided that the Association will continue to meet minimum capital adequacy requirements as established under Regulations. If the Association is unable to retire Class C Common Stock, or if the borrower elects to keep his/her investment in the Association after repayment of the loan in full, the stock must be converted to Class A Preferred Stock within two years.

Class D Investor Stock (Nonvoting, at-risk, no shares outstanding, par value of 1,000 dollars) – Shall be issued only to CoBank. Retirement is at the sole discretion of the Board of Directors provided that the Association will continue to meet minimum capital adequacy requirements as established under Regulations.

Class E Preferred Stock (Nonvoting, at-risk, no shares outstanding, par value as may be determined by any agreement of financial assistance between the Association and CoBank) - Issued only to CoBank in consideration of financial assistance to the Association from CoBank. Retirement is at the sole discretion of the Board of Directors. Class E Preferred Stock shall be retired in accordance with the provisions of any agreement entered into between the Association and CoBank in consideration of CoBank providing financial assistance to the Association.

Class F Common Stock (Voting, protected, no shares outstanding) - Issued prior to October 6, 1988, to borrowers entitled to vote. It must be retired at par value upon repayment of the loan unless the borrower elects to retain his/her investment in the Association. If so, the stock must be converted to Class G Common Stock within two years after loan repayment in full. Retirement is at the sole discretion of the Board of Directors provided that the Association will continue to meet minimum capital adequacy requirements as established under Regulations.

Class G Common Stock (Nonvoting, protected, no shares outstanding) - Formerly participation certificates, this represents stock issued prior to October 6, 1988, to rural residence borrowers and others not eligible to vote. This stock may also represent Class F Common Stock of a borrower which automatically converts to Class G Common Stock two years after repayment of the loan in full. It must be retired at par value upon repayment of the loan unless the borrower elects to retain his/her investment in the Association. Retirement is at the sole discretion of the Board of Directors provided that the Association will continue to meet minimum capital adequacy requirements as established under Regulations.

If at any time the Association does not meet the minimum capital adequacy standards established by FCA, all stock required to be purchased as a condition of obtaining a loan shall be purchased from the Association and may not be purchased from persons other than the Association.

The changes in the number of shares of capital stock outstanding during 2014 are summarized in the following table.

| *Shares in whole numbers* | Capital |
|---|---|
| Balance outstanding at January 1, 2014 | 197,036 |
| Issuances | 9,119 |
| Retirements | (14,179) |
| Balance outstanding at December 31, 2014 | 191,976 |

E. Patronage and/or Dividends

Dividends may be declared or patronage distributions allocated to holders of Class B, C, F and G Stock, System institutions and non-System institutions with or for whom the Association conducts certain business transactions out of the whole or any part of net earnings which remain at the end of the fiscal year, as the Board of Directors may determine, in accordance with the regulations for banks and associations of the System. However, distributions and retirements are precluded by regulation until the minimum capital adequacy standards have been attained. Amounts not distributed are retained as unallocated retained

earnings. The Association made a cash patronage distribution of $3,000 in 2014, $4,250 in 2013 and $4,500 in 2012. The Association declared a patronage distribution of $3,500 in 2014 to be paid in 2015.

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities shall be distributed to retire stock in the following order of priority: First, pro rata to all classes of preferred stock; second, pro rata to all classes of common stock; third, to the holders of allocated surplus evidenced by qualified written notices of allocation, in the order of year of issuance and pro rata by year of issuance; fourth, to the holders of allocated surplus evidenced by non-qualified written notices of allocation, in the order of year of issuance and pro rata by year of issuance. Any remaining assets of the Association after such distributions shall be distributed to present and former Patrons on a patronage basis, to the extent practicable.

At each year end, the Board of Directors evaluates whether to retain the Association's net income to strengthen its capital position or to distribute a portion of the net income to customers by declaring a qualified/cash patronage refund. For 2014, the Association allocated 32.40 percent of its patronage-sourced net income to its patrons.

F. Accumulated Other Comprehensive Income/Loss

The Association reports accumulated other comprehensive income/loss in its Consolidated Statement of Changes in Shareholders' Equity. As more fully described in Note 2, accumulated other comprehensive income/loss results from the recognition of the Pension Restoration Plan's net unamortized gains and losses and prior service costs or credits. The Association has accumulated other comprehensive loss of $68 in 2014, $40 in 2013 and $76 in 2012. There were no other items affecting comprehensive income or loss.

The following table presents activity in the accumulated other comprehensive loss, net of tax by component:

| | **2014** | 2013 |
|---|---|---|
| Pension benefit plan: | | |
| Beginning balance | **$ (40)** | $ (76) |
| Other comprehensive (loss)/income before reclassifications | **(33)** | 22 |
| Amounts reclassified from accumulated other comprehensive loss | **5** | 14 |
| Net current period other comprehensive (loss)/income | **(28)** | 36 |
| Year-end balance | **$ (68)** | $ (40) |

The following table represents reclassifications out of accumulated other comprehensive income (loss).

| | Amount Reclassified from Accumulated Other Comprehensive Income (Loss) December 31 | | Location of Gain/Loss Recognized in Statement of Income |
|---|---|---|---|
| | **2014** | 2013 | |
| Pension benefit plan: | | | |
| Net actuarial loss | **$ 5** | $ 14 | Salaries and employee benefits |
| Total reclassifications | **$ 5** | $ 14 | |

## NOTE 9 – PATRONAGE DISTRIBUTION FROM FARM CREDIT INSTITUTIONS

Patronage income recognized from Farm Credit institutions to the Association follows.

| | **2014** | 2013 | 2012 |
|---|---|---|---|
| CoBank | **$ 2,151** | $ 1,838 | $ 1,611 |
| AgVantis | **157** | 164 | 130 |
| Farm Credit Foundations | **3** | 6 | 6 |
| Total | **$ 2,311** | $ 2,008 | $ 1,747 |

Patronage distributed from CoBank was in cash and stock. The amount earned in 2014 was accrued and will be paid by CoBank in March 2015. The amount earned and accrued in 2013 was paid by CoBank in March 2014. The amount declared in December 2012 by CoBank was accrued in 2012 and was paid in March 2013.

Patronage distribution from AgVantis was in the form of a Notice of Allocation; 20 percent was distributed in cash with the balance of the allocation recorded as an investment in AgVantis which is recorded in other assets in the year received.

Patronage distributed by Farm Credit Foundations was in cash and was recorded in the year received. Farm Credit Foundations, a human resource service provider for a number of Farm Credit institutions, provides our payroll and human resource services.

## NOTE 10 – INCOME TAXES

The provision for income taxes follows.

| | Year Ended December 31 | | |
|---|---|---|---|
| | **2014** | 2013 | 2012 |
| Current: | | | |
| Federal | **$ 4** | $ 5 | $ 17 |
| State | **–** | – | 3 |
| Deferred: | | | |
| Federal | **7** | 98 | 189 |
| State | **67** | 14 | 27 |
| Provision for income taxes | **$ 78** | $ 117 | $ 236 |

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

| | Year Ended December 31 | | |
|---|---|---|---|
| | **2014** | 2013 | 2012 |
| Federal tax at statutory rate | **$ 3,681** | $ 3,475 | $ 3,205 |
| State tax, net | **44** | 9 | 19 |
| Effect of non-taxable entity | **(3,509)** | (3,366) | (2,980) |
| Patronage refunds | **(155)** | – | – |
| Other | **17** | (1) | (8) |
| Provision for income taxes | **$ 78** | $ 117 | $ 236 |

Deferred tax assets and liabilities are comprised of the following.

| | December 31 | | |
|---|---|---|---|
| | **2014** | 2013 | 2012 |
| Deferred income tax assets: | | | |
| Allowance for loan losses | **$ 96** | $ 94 | $ 79 |
| Depreciation | **59** | 51 | 47 |
| Net operating loss carryforward | **1** | 66 | 215 |
| Gross deferred tax assets | **156** | 211 | 341 |
| Deferred tax asset valuation allowance | **–** | – | – |
| Deferred income tax liabilities: | | | |
| Sale of fixed assets | **(5)** | (5) | (5) |
| Bank patronage allocation | **(127)** | (109) | (127) |
| Investment in partnership | **(9)** | (9) | (8) |
| Gross deferred tax liability | **(141)** | (123) | (140) |
| Net deferred tax asset | **$ 15** | $ 88 | $ 201 |

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

The Association recorded no valuation allowance in 2014, 2013 or 2012. The Association will continue to evaluate the realizability of the deferred tax assets and adjust the valuation allowance accordingly. At December 31, 2014, the Association had federal net operating loss carryforwards of $1 that expire from 2024 to 2027.

The Association has no uncertain tax positions as of December 31, 2014, 2013 or 2012. The Association recognizes interest and penalties related to unrecognized tax positions as an adjustment to income tax expense. The Association accounts for income taxes in accordance with Accounting Standards Codification (ASC) 740, which provides guidance for how uncertain tax positions should be recognized, measured, presented and disclosed in the consolidated financial statements. ASC 740 requires the evaluation of tax positions taken or expected to be taken in the course of preparing the Association's tax returns to determine whether the tax positions are more-likely-than-not of being sustained upon examination by the applicable tax authority, based on the technical merits of the tax position, and then measuring the tax benefit that is more-likely-than-not to be realized. Tax positions not deemed to meet the more-likely-than-not threshold would be recorded as a tax expense in the current reporting period. The tax years that remain open for federal and major state income tax jurisdictions are 2011 and forward.

## NOTE 11 – EMPLOYEE BENEFIT PLANS

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

The defined benefit pension plan reflects an unfunded liability totaling $89.8 million at December 31, 2014. The pension benefits funding status reflects the net of the fair value of the plan assets and the projected benefit obligation at the date of these consolidated financial statements. The projected benefit obligation is the actuarial present value of all benefits attributed by the pension benefit formula to employee service rendered prior to the measurement date based on assumed future compensation levels. The projected benefit obligation of the plan was $242.1 million at December 31, 2014, $203.2 million at December 31, 2013 and $210.1 million at December 31, 2012. The fair value of the plan assets was $152.3 million at December 31, 2014, $144.7 million at December 31, 2013 and $116.2 million at December 31, 2012. The amount of the pension benefits funding status is subject to many variables including performance of plan assets and interest rate levels. Therefore, changes in assumptions could significantly affect these estimates.

Costs are determined for each individual employer based on costs directly related to its current employees as well as an allocation of the remaining costs based proportionately on the estimated projected liability of the employer under this plan. The Association recognizes its proportional share of expense and contributes a proportional share of funding. Total plan expense for participating employers was $12.9 million in 2014, $15.8 million in 2013 and $25.4 million in 2012. The Association's allocated share of plan expenses included in salaries and employee benefits was $606 in 2014, $805 in 2013, and $646 in 2012. Participating employers contributed $11.1 million in 2014, $14.6 million in 2013 and $12.8 million in 2012 to the plan. The Association's allocated share of these pension contributions was $579 in 2014, $742 in 2013, and $636 in 2012. While the plan is a governmental plan and is not subject to minimum funding requirements, the employers contribute amounts necessary on an actuarial basis to provide the plan with sufficient assets to meet the benefits to be paid to participants. The amount of the total employer contributions expected to be paid into the pension plans during 2015 is $13.0 million. The Association's allocated share of these pension contributions is expected to be $691. The amount ultimately to be contributed and the amount ultimately recognized as expense as well as the timing of those contributions and expenses, are subject to many variables including performance of plan assets and interest rate levels. These variables could result in actual contributions and expenses being greater than or less than anticipated.

Postretirement benefits other than pensions are provided through the Farm Credit Foundations Retiree Medical Plan to retired employees of the Association. Benefits provided are determined on a graduated scale based on years of service. The anticipated costs of these benefits were accrued during the period of the employee's active service.

Postretirement benefits expense (primarily health care benefits) included in salaries and employee benefits were $4 in 2014, $7 in 2013 and $7 in 2012. These expenses are equal to the Association's cash contributions for each year.

The Association participates in a non-qualified defined benefit Pension Restoration Plan that is unfunded. The plan provides retirement benefits above the Internal Revenue Code compensation limit to certain highly compensated eligible employees. Benefits payable under the Pension Restoration Plan are offset by the benefits payable from the Pension Plan. Pension Restoration Plan expenses included in salaries and employee benefits were $22 in 2014, $29 in 2013 and $28 in 2012.

The funding status and the amounts recognized in the Consolidated Statement of Condition for the Association's Pension Restoration Plan follows:

| | **Nonqualified Pension Benefits** | | |
|---|---|---|---|
| | **2014** | 2013 | 2012 |
| **Change in projected benefit obligation:** | | | |
| Benefit obligation at the beginning of the period | **$ 192** | $ 199 | $ 165 |
| Service cost | **7** | 7 | 7 |
| Interest cost | **10** | 8 | 8 |
| Actuarial loss/(gain) | **33** | (22) | 19 |
| Benefit obligation at the end of the period | **$ 242** | $ 192 | $ 199 |
| Fair value of plan assets at the end of the period | **–** | – | – |
| Funded status of the plan | **$ (242)** | $ (192) | $ (199) |
| **Amounts recognized in the Consolidated Statement of Condition consist of:** | | | |
| Liabilities | **$ 242** | $ 192 | $ 199 |
| Net amount recognized | **$ 242** | $ 192 | $ 199 |

The following table represents the amounts included in accumulated other comprehensive income/loss for the Pension Restoration Plan at December 31:

| | **2014** | 2013 | 2012 |
|---|---|---|---|
| Net actuarial loss | **$ (68)** | $ (40) | $ (76) |
| Total amount recognized in AOCI/(loss) | **$ (68)** | $ (40) | $ (76) |

An estimated net actuarial loss of $11 for the Pension Restoration Plan will be amortized into income over the next year.

The projected and accumulated benefit obligation for the Pension Restoration Plan at December 31 was:

| | **2014** | 2013 | 2012 |
|---|---|---|---|
| Projected benefit obligation | **$ 242** | $ 192 | $ 199 |
| Accumulated benefit obligation | **$ 212** | $ 172 | $ 154 |

The net periodic pension expense for the Pension Restoration Plan included in the Consolidated Statement of Comprehensive Income is comprised of the following at December 31.

| | **Pension Benefits** | | |
|---|---|---|---|
| | **2014** | 2013 | 2012 |
| **Components of net periodic benefit cost** | | | |
| Service cost | **$ 7** | $ 7 | $ 7 |
| Interest cost | **10** | 8 | 8 |
| Net amortization and deferral | **5** | 14 | 13 |
| Net periodic benefit cost | **$ 22** | $ 29 | $ 28 |

Changes in benefit obligation recognized in accumulated other comprehensive income are included in the following table.

| | **2014** | 2013 | 2012 |
|---|---|---|---|
| Current year net actuarial (loss)/gain | **$ (33)** | $ 22 | $ (19) |
| Amortization of net actuarial loss | **5** | 14 | 14 |
| Total recognized in other comprehensive income/(loss) | **$ (28)** | $ 36 | $ (5) |

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

| | **2014** | 2013 | 2012 |
|---|---|---|---|
| Discount rate | **4.10%** | 4.90% | 4.15% |
| Rate of compensation increase | **5.00%** | 5.00% | 5.00% |

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

| | **2014** | 2013 | 2012 |
|---|---|---|---|
| Discount rate | **4.90%** | 4.15% | 5.10% |
| Rate of compensation increase | **5.00%** | 5.00% | 5.00% |

The Association does not expect to contribute to the Pension Restoration Plan in 2015.

**Estimated Future Benefit Payments**

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

| | Pension Restoration Benefits |
|---|---|
| 2015 | $ – |
| 2016 | $ – |
| 2017 | $ – |
| 2018 | $ 293 |
| 2019 | $ – |
| 2020 – 2024 | $ – |

The Association also participates in the Farm Credit Foundations Defined Contribution/401(k) Plan. Employees who do not participate in the Pension Plan may receive benefits through the Employer Contribution portion of the Contribution Plan. In this plan, the Association provides a monthly contribution based on a defined percentage of the employee's salary. Employees may also participate in a Salary Deferral Plan governed by Section 401(k) of the Internal Revenue Code. The Association matches a certain percentage of employee contributions to the plan. Employer contributions to the Contribution Plan were $232 in 2014, $232 in 2013 and $224 in 2012.

## NOTE 12 – RELATED PARTY TRANSACTIONS

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

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

Loan information to related parties for the years ended December 31 is shown below.

| | **2014** | 2013 | 2012 |
|---|---|---|---|
| New loans | **$ 49,994** | $ 56,114 | $ 57,963 |
| Repayments | **$ 52,784** | $ 55,199 | $ 44,035 |
| Ending balance | **$ 16,457** | $ 17,381 | $ 29,950 |

In the opinion of management, none of the loans outstanding to officers and directors at December 31, 2014 involved more than a normal risk of collectibility.

The Association also has business relationships with certain other System entities. The Association paid $803 in 2014, $756 in 2013 and $749 in 2012 to AgVantis for technology services and $51 in 2014, $62 in 2013 and $60 in 2012 to CoBank for operational services. The Association paid $82 in 2014, $78 in 2013 and $73 in 2012 to Foundations for human resource services.

## NOTE 13 – REGULATORY ENFORCEMENT MATTERS

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

## NOTE 14 – COMMITMENTS AND CONTINGENCIES

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

The Association may participate in financial instruments with off-balance sheet risk to satisfy the financing needs of its borrowers and to manage their exposure to interest-rate risk. These financial instruments include commitments to extend credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee by the borrower. At December 31, 2014, $181,630 of commitments to extend credit were outstanding.

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

The Association also participates in standby letters of credits to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. At December 31, 2014, $2,420 of standby letters of credit were outstanding with a nominal fair value. Outstanding standby letters of credit have expiration dates ranging from 2015 to 2019. The maximum potential amount of future payments the Association is required to make under the guarantees is $2,420.

## NOTE 15 – FAIR VALUE MEASUREMENTS

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

Assets measured at fair value on a recurring basis at December 31 for each of the fair value hierarchy values are summarized as follows:

| | Fair Value Measurement Using | | | Total Fair Value |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | |
| Assets held in nonqualified benefits trusts | | | | |
| **2014** | **$ 568** | **$ –** | **$ –** | **$ 568** |
| 2013 | $ 444 | $ – | $ – | $ 444 |
| 2012 | $ 319 | $ – | $ – | $ 319 |

The Association has no liabilities measured at fair value on a recurring basis for the periods presented. During the three years presented, the Association recorded no transfers in or out of Levels 1, 2, or 3. Assets measured at fair value on a non-recurring basis at December 31 for each of the fair value hierarchy values are summarized as follows:

| | Fair Value Measurement Using | | | Total Fair | Total |
|---|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Value** | **Losses** |
| Loan Assets | | | | | |
| **2014** | **$ –** | **$ –** | **$ 945** | **$ 945** | **$ (170)** |
| 2013 | $ – | $ – | $ 829 | $ 829 | $ (170) |
| 2012 | $ – | $ – | $ 465 | $ 465 | $ (254) |

The Association has no liabilities measured at fair value on a non-recurring basis for any of the periods presented.

The estimated fair values of the Association's financial instruments recorded at carrying amount on the Consolidated Statement of Condition follow.

| | December 31 | | | | | |
|---|---|---|---|---|---|---|
| | **2014** | | 2013 | | 2012 | |
| | **Carrying Amount** | **Fair Value** | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Financial assets: | | | | | | |
| Loans, net | **$ 593,672** | **$ 594,199** | $ 562,900 | $ 557,184 | $ 521,364 | $ 527,488 |
| Cash | **$ 11,620** | **$ 11,620** | $ 10,822 | $ 10,822 | $ 9,036 | $ 9,036 |
| Assets held in nonqualified benefits trust | **$ 568** | **$ 568** | $ 444 | $ 444 | $ 319 | $ 319 |
| Financial liabilities: | | | | | | |
| Note payable to CoBank | **$ 484,622** | **$ 485,321** | $ 457,405 | $ 454,082 | $ 417,517 | $ 426,439 |
| Advance conditional payments | **$ 13,397** | **$ 13,397** | $ 13,313 | $ 13,313 | $ 15,023 | $ 15,023 |

***Valuation Techniques***

As more fully discussed in Note 2, accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Fair values of financial instruments represent the estimated amount to be received to sell an asset or paid to transfer or extinguish a liability in active markets among willing participants at the reporting date. Due to the uncertainty of expected clash flows resulting from financial instruments, the use of different assumptions and valuation methodologies could significantly affect the estimated fair value amounts. Accordingly, certain of the estimated fair values may not be indicative of the amounts for which the financial instruments could be exchanged in a current or future market transaction. The following presents a brief summary of the valuation techniques used by the Association for assets and liabilities subject to fair value measurement:

*Loans*

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

For purposes of determining the fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

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

With regards to impaired loans, it is not practicable to provide specific information on inputs as each collateral property is unique. For certain loans evaluated for impairment under accounting impairment guidance, the fair value is based upon the underlying collateral since the loans are collateral-dependent loans for which real estate is the collateral. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the real estate, less estimated costs to sell, is

less than the principal balance of the loan, a specific reserve is established and the net loan is reported at its fair value.

*Cash*

The carrying value is a reasonable estimate of fair value.

*Assets Held in Non-Qualified Benefits Trusts*

Assets held in trust funds related to deferred compensation and supplemental retirement plans are classified within Level 1. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace.

*Note Payable to CoBank*

The notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets), which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current interest rate that would be charged for borrowings. For purposes of this estimate, it is assumed the cash flow on the notes payable is equal to the principal payments on the Association's loan receivables plus accrued interest on the notes payable.

*Advance Conditional Payments*

The carrying value is a reasonable estimate of fair value as these funds are held in cash.

*Commitments to Extend Credit and Standby Letters of Credit*

The fair value of commitments is estimated using the fees currently charged for similar agreements, taking into account the remaining terms of the agreements and the creditworthiness of the counterparties. For fixed-rate loan commitments, estimated fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of standby letters of credit approximate the fees currently charged for similar agreements or the estimated cost to terminate or otherwise settle similar obligations. These are generally classified as Level 3 and are valued by using discounted cash flows with unobservable inputs of rate of funding and risk-adjusted spread. As of December 31, 2014, 2013 and 2012, the fair value was considered nominal.

## NOTE 16 – QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Quarterly results of operations for the years ended December 31, 2014, 2013 and 2012, follow.

| | **2014** | | | | |
|---|---|---|---|---|---|
| | **First** | **Second** | **Third** | **Fourth** | **Total** |
| **Net interest income** | **$ 3,724** | **$ 3,730** | **$ 3,765** | **$ 3,904** | **$ 15,123** |
| **(Loan loss reversal)/Provision for loan losses** | **(24)** | **(201)** | **(360)** | **740** | **155** |
| **Noninterest expense, net** | **1,038** | **1,039** | **1,057** | **1,084** | **4,218** |
| **Net income** | **$ 2,710** | **$ 2,892** | **$ 3,068** | **$ 2,080** | **$ 10,750** |

| | 2013 | | | | |
|---|---|---|---|---|---|
| | First | Second | Third | Fourth | Total |
| Net interest income | $ 3,380 | $ 3,377 | $ 3,631 | $ 3,703 | $ 14,091 |
| Provision for loan losses/(Loan loss reversal) | 116 | 73 | (458) | 98 | (171) |
| Noninterest expense, net | 1,010 | 1,057 | 927 | 1,163 | 4,157 |
| Net income | $ 2,254 | $ 2,247 | $ 3,162 | $ 2,442 | $ 10,105 |

| | 2012 | | | | |
|---|---|---|---|---|---|
| | First | Second | Third | Fourth | Total |
| Net interest income | $ 2,886 | $ 2,921 | $ 3,101 | $ 3,352 | $ 12,260 |
| Loan loss reversal | (126) | (20) | (3) | (233) | (382) |
| Noninterest expense, net | 882 | 407 | 966 | 1,198 | 3,453 |
| Net income | $ 2,130 | $ 2,534 | $ 2,138 | $ 2,387 | $ 9,189 |

## NOTE 17 – SUBSEQUENT EVENTS

The Association has evaluated subsequent events through March 16, 2015 which is the date the financial statements were issued, and no material subsequent events were identified.

# Disclosure Information Required By Farm Credit Administration Regulations

(Amounts in Whole Dollars)

## Description of Business

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

The description of significant developments that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, and concentrations of assets, if any, required to be disclosed in this section, is incorporated herein by reference from "Management's Discussion and Analysis" (MD&A) included in this annual report to shareholders.

## Description of Property

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

| Location | Description | Form of Ownership |
|---|---|---|
| 202 Poplar Street<br>Sterling, Colorado 80751 | Office Building<br>(Administrative Office) | Owned |
| 229 South Third Street<br>Sterling, Colorado 80751 | Office Building | Owned |
| 225 East Railroad Avenue<br>Ft. Morgan, Colorado 80701 | Office Building | Owned |
| 700 West Eighth Avenue<br>Yuma, Colorado 80759 | Office Building | Owned |
| 143 South Campbell, Suite 100<br>Holyoke, Colorado 80734 | Office Building | Leased* |
| 210 North 2nd Street<br>Sterling, Colorado 80751 | Vacant | Owned |

** Automatically renewable month-to-month lease, currently leased for $500.00 per month.*

## Legal Proceedings and Enforcement Actions

Information required to be disclosed in this section is incorporated herein by reference from Note 13 to the financial statements, "Regulatory Enforcement Matters," and Note 14 to the financial statements, "Commitments and Contingencies," included in this annual report to shareholders.

## Description of Capital Structure

Information required to be disclosed in this section is incorporated herein by reference from Note 8 to the financial statements, "Shareholders' Equity," included in this annual report to shareholders.

## Description of Liabilities

The description of debt outstanding required to be disclosed in this section is incorporated herein by reference from Note 7 to the financial statements, "Note Payable to CoBank," included in this annual report to shareholders.

The description of advance conditional payments is incorporated herein by reference to Note 2 to the financial statements, "Summary of Significant Accounting Policies," included in this annual report to shareholders.

The description of contingent liabilities required to be disclosed in this section is incorporated herein by reference from Note 14 included in this annual report to shareholders.

## SELECTED FINANCIAL DATA

The selected financial data for the five years ended December 31, 2014, required to be disclosed in this section is incorporated herein by reference from the "Five-Year Summary of Selected Consolidated Financial Data," included in this annual report to shareholders.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

"Management's Discussion and Analysis," which appears within this annual report to shareholders and is required to be disclosed in this section, is incorporated herein by reference.

## *DIRECTORS AND SENIOR OFFICERS*

The following represents certain information regarding the directors and senior officers of the Association.

### DIRECTORS

| | |
|---|---|
| Eldon Heermann | Chairman - Mr. Heermann represents the Northeast Region – Seat 1, serving a three-year term which expires in 2017. Business Experience: Owner/operator of a small grain farm. Mr. Heermann operates as Eldon L. Heermann and is a partner in the family partnership, Heermann Productions Partnership. He is a diversified dryland and irrigated farmer raising both wheat and corn. Mr. Heermann has been a member of the Farm Credit System for 34 years. Mr. Heermann serves on the Compensation Committee and represents Premier Farm Credit, ACA as a member of the District Farm Credit Council Board. |
| Wayne Midcap | Vice Chairman - Mr. Midcap represents the Northwest Region – Seat 1, serving a three-year term which expires in 2017. Business Experience: Farming and selling seed wheat. Mr. Midcap is a shareholder in four family farm operations, Midcap Seed & Grain, LLC, Midcap Farms, Longview Farms, LLC, and Rock Creek Farms, Inc. which are diversified dryland farming operations that raise certified seed wheat and millet. He is a director and past president of Colorado Seed Growers Association. He has been a member of the Farm Credit System for 26 years. Mr. Midcap serves as Chairman of the Compensation Committee. |
| Lyndsey D. Bishop | Appointed Director and Financial Expert – Ms. Bishop is from the Wray area, serving a three-year term which was to expire in 2015. The Board has taken action to reappoint her for an additional three-year term which will expire in 2018. She has served as a Director since 2012. Lyndsey's business experience during the past five years, including principal occupation and employment includes being an Auditor for BKD, serving as a Loan Officer for First Pioneer National Bank, being a partner and CPA at Bohall Neubauer, and currently being the owner and CPA of Just Numbers, LLC. Ms. Bishop provides tax and consulting services to clients throughout Northeast Colorado. Lyndsey graduated Summa Cum Laude from the University of Northern Colorado, Monfort College of Business with a Bachelor of Science in Business Administration with an emphasis in accounting. Lyndsey has experience in auditing financial statements and assessing risk and internal control structures, as well as lending and agricultural accounting. Lyndsey is a member of the Wray United Methodist Church where she previously served as Finance Chair. Ms. Bishop serves as the chairperson for the Wray High School Business Advisory Council and volunteers for student interviews at Rural AmeriTowne in Wray, CO. Ms. Bishop serves on the Association's Audit Committee and Compensation Committee. |
| Martin Christensen | Director - Mr. Christensen represents the Northwest Region – Seat 3, serving a three-year term which expires in 2016. Business Experience: Livestock and farming operation. Mr. Christensen is the owner, operator, and manager of two family corporations, M & C Farms, Inc. and Four X Ranch, Inc. The entities raise irrigated crops and maintain a Holstein Springer program. He is a member of the Morgan County Cattleman's Association and a Life Member of the Fort Morgan Chapter of Young Farmers. Mr. Christensen has been a member of the Farm Credit System for 33 years. |
| Bruce Kokes | Director - Mr. Kokes represents the Northeast Region – Seat 2, serving a three-year term which expires in 2015. Business Experience: Farming and ranching. Mr. Kokes operates Bruce Kokes Farm and is a partner in the MMB Partnership. Mr. Kokes raises wheat, millet, and hay and runs a cow/calf operation. Mr. Kokes serves as a Director and Treasurer for the Crook Fire District. He is also a member of the Crook |

| | |
|---|---|
| | Fire Department and NJC Young Farmers. Mr. Kokes has been a member of the Farm Credit System for 18 years. Mr. Kokes serves as Chairman of the Policy Review Committee. |
| Gary K. Lancaster | Appointed Director - Mr. Lancaster is from Julesburg, Colorado, serving a three-year term which expires in 2016. Business Experience: Retired CSU Extension Agent and owns and operates 100 acres of grass. Mr. Lancaster is a member and past President of the Rotary Club of Sedgwick County. He is also a member of the Fort Sedgwick Park Committee where he has served as Chairman for the past nine years. Mr. Lancaster is Chairman of the Audit Committee and also serves on the Compensation Committee. |
| Rebecca K.W. Lenz | Director – Mrs. Lenz represents the South Region – Seat 3, serving a three-year term which expires in 2016. Business Experience: Farming and secretary/controller for family companies. Mrs. Lenz has been involved in farming with her husband, George, and their family partnership, Six by Two Land Company, LLP. She is also involved in Lenz Farms, LLC; Lenz Family Farms, LLC; Full House Holdings, LLC; LFE, Inc.; Sand Creek Charolais, LLC; Five Aces, LLC; Royal Flush Farms, Inc.; ProGrain Farms; and Ag Legacy, LLC. They produce corn, potatoes, dry edible beans and wheat as well as operate a cow/calf operation, background calves and raise a registered Charolais herd. Mrs. Lenz serves on the Wray Community District Hospital Board of Directors, is the Club Leader for Wauneta 4-H Club in Yuma County, member of St. Andrew's Catholic Church and Rocky Mountain Farmers Union. She has been a member of the Farm Credit System for 26 years. Mrs. Lenz served as Secretary of the Policy Review Committee until May 2014 and currently serves on the Compensation Committee and Audit Committee. |
| William D. McConnell | Director – Mr. McConnell represents the Northwest Region – Seat 2, serving a three-year term which expires in 2015. Business Experience: Farming, ranching, and operating a custom grass seeding business. He is a partner in the William D. McConnell family farm, Sagebrush Outfitters, LLC, and operates McConnell Custom Grass Seeding. He is a member of the Colorado Wheat Growers Association. Mr. McConnell has been a member of the Farm Credit System for 38 years. Mr. McConnell serves on the Policy Review Committee and Compensation Committee. |
| Jason R. Pachner | Director – Mr. Pachner represents the South Region – Seat 2, serving a three-year term which expires in 2015. Business Experience: Farming and ranching. Mr. Pachner is an officer of Pachner Diversified, and the managing partner for all Pachner entities, including Pachner Farms & Livestock; Pachner Agri-Enterprises; and Pachner Properties. He raises wheat, corn, proso millet, hay millet, and certified seed wheat in addition to operating a cow/calf and yearling operation. He has served on the Board of Directors for the Washington County Cattleman's Association and the Colorado Conservation Tillage Association. Mr. Pachner serves as an elder in his church where he is also the worship leader. He has been a member of the Farm Credit System for 21 years. Mr. Pachner served on the Policy Review Committee from the beginning of this director tenure until May 1, 2014, and currently serves on the Compensation Committee and as Vice Chairman of the Audit Committee. |
| Richard P. Starkebaum | Director – Mr. Starkebaum represents the Northeast Region – Seat 3, serving a three year term which expires in 2016. Business Experience: Farming and ranching. Mr. Starkebaum is President of Starkebaum Farms, Inc., Manager of C-Star Farms, LLC, and Partner in L&P Starkebaum LLC. He raises wheat, corn, millet and hay as well as running a cow/calf operation. He is currently Vice-President of the Haxtun School Board and is a member of the school building committee. He also serves as Chairman of the Phillips County Planning Commission, Chairman of Region One Translator Association and Chairman of the Phillips County Recreation District. Mr. Starkebaum has been a member of the Farm Credit System for 34 years. He serves as Secretary of the Policy Review Committee and also serves on the Compensation Committee. |
| Timothy Trim | Director - Mr. Trim represents the South Region – Seat 1, serving a three-year term which expires in 2017. Business Experience: Farming and ranching. He is the President of Trim Ranch Inc., a family corporation, managing commercial cows and raising wheat, millet and feed. Mr. Trim is a member R-Calf and serves as President of the Glenn Cemetery Association. He has been a member of the Farm Credit System for 30 years. Mr. Trim serves on the Policy Review Committee and Compensation Committee. |

| | |
|---|---|
| Martin D. Brophy | Retired Director - Mr. Brophy represented the South Region – Seat 1, and retired following a three-year term which expired in February 2014. Mr. Brophy served as a Director for 13 years. |

**SENIOR OFFICERS**

| | |
|---|---|
| Richard Sanger | President - Chief Executive Officer<br>Mr. Sanger has been a Farm Credit System employee since June 3, 1985. All of his years of service have been with associations that formed Premier Farm Credit, ACA, except for five years in which he was employed by the Eighth Farm Credit District. During his tenure, Mr. Sanger has served in various capacities and was appointed President and Chief Executive Officer on April 27, 2006. |
| Michael Grauberger | Chief Financial Officer<br>Mr. Grauberger has been a Farm Credit System employee since June 9, 1986. All of his years of service have been with associations that formed Premier Farm Credit, ACA, except for three years in which he was employed by the FLBA of Colorado Springs. During his tenure, Mr. Grauberger has served in various capacities and was appointed Chief Financial Officer on March 1, 2014. Prior to Chief Financial Officer, he was Vice President - Lending (Branch Manager of the Sterling Lending Office) for 8 years. |
| Douglas D. Keil | Chief Credit Officer<br>Mr. Keil has been a Farm Credit System employee since August 19, 1986. All of his years of service have been with associations that formed Premier Farm Credit, ACA, except for two years in which he was employed by the Eighth Farm Credit District and Farm Credit Services of the Mountain Plains, ACA. During his tenure, Mr. Keil has served in various capacities and was appointed Chief Credit Officer in May 2000. |
| Phyllis P. Luft | Vice President - Administration<br>Mrs. Luft has been a Farm Credit System employee since October 10, 1983. All of her years of service have been with associations that formed Premier Farm Credit, ACA, except for three and a half years in which she was employed by Farm Credit Services of the Mountain Plains, ACA. During her tenure, Mrs. Luft has served in various capacities and was appointed Vice President - Administration in April 2000. |
| Cathy G. Castillega | Former Chief Financial Officer<br>Ms. Castillega had over 26 years of experience within the Farm Credit System and served as Chief Financial Officer of Premier Farm Credit, ACA from October 29, 2007 until her retirement on February 28, 2014. |

## COMPENSATION OF DIRECTORS AND SENIOR OFFICERS

Directors of the Association were compensated for services on a per diem basis at the rate of $500 per day. The chairman was compensated for services on a per diem basis at the rate of $600 per day. During 2014, mileage was reimbursed at a rate of $0.56 per mile while on official business.

The Compensation Committee meetings were held in conjunction with the regular board meetings, so no additional compensation was paid to the directors for these meetings.

Additional information for each director is provided as follows.

| Name | Number of Days Served at | | Compensation for | | | Total Compensation Paid During 2014 |
|---|---|---|---|---|---|---|
| | Board Meetings | Other Official Activities | Board Meetings | Policy Review | Audit | |
| Eldon Heermann | 8 | 2 | $ 6,000 | $ - | $ - | $ 6,000 |
| Wayne Midcap | 9 | 6 | 7,500 | - | - | 7,500 |
| Lyndsey D. Bishop | 10 | 8 | 8,000 | - | 1,000 | 9,000 |
| Martin Christensen | 8 | 6 | 7,000 | - | - | 7,000 |
| Bruce Kokes | 6 | 4 | 4,000 | 1,000 | - | 5,000 |
| Gary K. Lancaster | 10 | 6 | 7,000 | - | 1,000 | 8,000 |
| Rebecca K.W. Lenz | 10 | 4 | 6,000 | - | 1,000 | 7,000 |
| William D. McConnell | 8 | 11 | 8,500 | 1,000 | - | 9,500 |
| Jason R. Pachner | 8 | 8 | 7,000 | - | 1,000 | 8,000 |
| Richard Starkebaum | 7 | 11 | 8,000 | 1,000 | - | 9,000 |
| Timothy Trim | 7 | 9 | 7,000 | 1,000 | - | 8,000 |
| Martin D. Brophy | 1 | - | 500 | - | - | 500 |
| Total Compensation | | | $ 76,500 | $ 4,000 | $ 4,000 | $ 84,500 |

Directors are reimbursed for travel, subsistence and other expenses related to Association business according to Association policy. A copy of this policy is available to shareholders upon request. Aggregate reimbursements to directors for travel, subsistence and other related expenses were $67,493 in 2014, $65,841 in 2013 and $66,895 in 2012. There was no non-cash compensation paid to directors in 2014.

| President and CEO[2] | Year | Annual | | | | Total |
|---|---|---|---|---|---|---|
| | | Salary | Incentive compensation[3] | Deferred/ Perquisites[4] | Other[5] | |
| Richard Sanger | 2014 | $ 214,496 | $ 60,000 | $ 306,510 | $ 2,067 | $ 583,073 |
| Richard Sanger | 2013 | $ 200,518 | $ 65,000 | $ 100,238 | $ 1,923 | $ 367,679 |
| Richard Sanger | 2012 | $ 181,462 | $ 70,000 | – | $ 1,731 | $ 253,193 |

| Aggregate Number of Officers/Highly Compensated Individuals (excluding CEO)[2] | Year | Annual | | | | Total |
|---|---|---|---|---|---|---|
| | | Salary | Incentive compensation[3] | Deferred/ Perquisites[4] | Other[5] | |
| 6 | 2014 | $ 612,083 | $ 105,760 | $ 649,130 | $ 19,354 | $1,386,327 |
| 5 | 2013 | $ 567,584 | $ 114,360 | $ 118,595 | $ 3,395 | $ 803,934 |
| 6 | 2012 | $ 624,074 | $ 169,688 | – | $ 4,090 | $ 797,852 |

1. Disclosure of the total compensation paid during 2014 to any designated senior officer or highly compensated employee is available to our shareholders upon request. The Salary and Incentive Compensation columns of the Summary Compensation Table include all amounts earned during 2014 regardless of whether a portion of such compensation has been deferred by the CEO or other Senior Officers' elections pursuant to the Farm Credit Foundations Defined Contribution/401(k) Plan (401(k) Plan) and the Farm Credit Foundations Nonqualified Deferred Compensation Plan (NQDC Plan).
2. The senior officers and highly compensated employees included above are those officers defined by FCA regulations Section 619.9310 and Section 620.6. The 2014 senior officer data includes partial year totals paid to the prior CFO during the period.
3. Incentive compensation amounts represent amounts earned in the reported fiscal year, which are paid in February of the subsequent year. The annual incentive compensation amounts are calculated based on relevant performance factors for the reported fiscal year.
4. The Change in Pension Value increased in 2014 primarily due to the increase in years of service and age and changes in actuarial assumptions such as the discount rate. The change in value of the pension benefits is defined as the vested portion of the present value of the accumulated benefit obligation from December 31 of the prior year, disclosed in Note 11 of the Financial Statements. This value is not reflected for 2012. Also represents company contributions to retirement plans for all employees and any changes in value of pension benefits. In 2014, the Association's employer matching contribution to the CEO's account in the 401(k) Plan was $9,262 and its contribution to the CEO's account in the NQDC Plan to restore the employer match that was limited due to restrictions in the Internal Revenue Code and compensation deferred was $1,940. For 2014, the Association's employer matching and non-elective contributions for the other Senior Officers' accounts in the 401(k) Plan were $29,468 and there were no contributions to their accounts in the NQDC Plan. No tax reimbursements are made to senior officers/highly compensated individuals.
5. Includes the payout of unused annual leave.

**COMPENSATION PHILOSOPHY**

The Association endeavors to provide compensation packages that are competitive in the marketplace to attract and retain a quality, tenured staff. In addition to base salary, all staff, including the CEO and senior officers, can earn additional compensation under annual incentive and bonus plans which are tied to the overall business performance of the Association. The plans are based on a fiscal year and are designed to motivate employees to exceed financial, marketing and credit quality performance targets approved by the Board of Directors. These targets typically include return on assets, cost per hundred, credit quality, credit administration, growth in loan volume and new loan volume booked. The program links pay to performance with appropriate controls in place to ensure sound credit quality and administration is maintained, while focusing on the long-term financial goals of the Association. The plans are short-term in nature and do not create a long-term financial obligation for the Association and they can be amended annually. The plans are reviewed each year by the Compensation Committee and are approved by the Board of Directors.

The Compensation Committee annually reviews market information related to the administration of compensation at all levels of the Association, including the CEO and senior officers. The information consists of surveys for market-based merit increases, peer comparisons, salary levels and incentive plans. The Compensation Committee also has access to a compensation consultant.

Expense Reimbursement – All employees are reimbursed for travel and subsistence expenses incurred when traveling on Association business. A copy of the travel policy is available to shareholders upon written request.

Information on pension benefits attributable to the CEO, senior officers and other highly compensated individuals follows.

| As of December 31, 2014<br>President and CEO[1] | Plan | Years of Credited Service | Present Value of Accumulated Benefits[2] | Payments Made During the Reporting Period[3] |
|---|---|---|---|---|
| Richard Sanger | Ninth Pension Plan | 31.03 | $ 1,354,716 | $ – |
| | Nonqualified Pension Restoration Plan | 31.03 | $ 228,433 | $ – |

| Aggregate Number of Senior Officers/ Highly Compensated Individuals[1] | Plan | Average Years of Credited Service | Present Value of Accumulated Benefits[2] | Payments Made During the Reporting Period[3] |
|---|---|---|---|---|
| 6 | Ninth Pension Plan | 28.9 | $ 3,581,908 | $ 474,738 |

1 The senior officers and the highly compensated employees included in the pension benefits disclosure are those defined by FCA regulations Section 619.9310 and Section 620.6.
2 For the Pension or Retirement Plan and the Former 9th District Pension Restoration Plan, this represents the total for the aggregate senior officer and highly compensated employee group.
3 Represents post-retirement benefit payments made during the last fiscal year.

Retirement Plan Overview – The CEO and certain Senior Officers participate in the Ninth Farm Credit District Pension Plan (the Pension Plan) which is a qualified defined benefit plan and the Ninth District Pension Restoration Plan, which is a nonqualified retirement plan. Additionally, substantially all employees participate in the 401 (k) Plan, which has an employee matching contribution. Certain eligible employees participate in the Non-qualified Deferred Compensation Plan, which allows individuals to defer compensation and which restores the benefits limited in the 401 (k) Plan by restrictions in the Internal Revenue Code.

Qualified Pension Plan – In general, the Pension Plan provides participants with a 50% joint-and-survivor annuity benefit at normal retirement that is equal to 1.50% of average monthly compensation during the 60 consecutive months in which an individual receives his highest compensation (High 60) multiplied by his years of benefit service, plus 0.25% of the amount by which the High 60 exceeds covered compensation multiplied by years of benefit service. The benefit is actuarially adjusted if the individual chooses a different form of distribution than a 50% joint-and-survivor annuity, such as a lump sum distribution. The pension valuation was determined using a blended approach assuming half of the benefits would be paid as a lump sum and half as an annuity at the participants earliest unreduced retirement age. The Pension Plan pays benefits up to the applicable limits under the Internal Revenue Code.

Nonqualified Pension Restoration Plan – The Pension Restoration Plan is unfunded and not qualified for tax purposes. Benefits payable under this plan are equal to the excess of the amount that would be payable under the

terms of the Qualified Pension Plan disregarding the limitations imposed under Internal Revenue Code Sections 401(a)(17) and 415, over the pension actually payable under the Qualified Pension Plan. The plan also restores any benefits attributable to nonqualified deferred compensation excluded from the benefit determined under the Qualified Pension Plan. The nonqualified pension restoration valuation was determined using an assumption that benefits would be paid as a lump sum at the participants earliest unreduced retirement age.

## TRANSACTIONS WITH SENIOR OFFICERS AND DIRECTORS

The Association's policies on loans to and transactions with its officers and directors, required to be disclosed in this section are incorporated herein by reference from Note 12 to the financial statements, "Related Party Transactions," included in this annual report to shareholders.

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

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

## BORROWER PRIVACY STATEMENT

Since 1972, Farm Credit Administration (FCA) regulations have forbidden the directors and employees of Farm Credit institutions from disclosing personal borrower information to others without borrower consent. The Association does not sell or trade customers' personal information to marketing companies or information brokers. Additional information regarding FCA rules governing the disclosure of customer information can be obtained by contacting the Association.

## FINANCIAL EXPERT

In October 2012, the Board appointed Lyndsey Bishop, a CPA, to fill the role of financial expert on the Board. Ms. Bishop is an owner of an accounting firm and has experience in corporate auditing and banking.

## RELATIONSHIP WITH COBANK, ACB (COBANK)

The Association is materially affected by CoBank's financial condition and results of operations.

The Association's statutory obligation to borrow from CoBank is discussed in Note 7. Financial assistance agreements between the Association and CoBank are discussed in Note 8. Association requirement to invest in CoBank and CoBank's ability to access capital of the Association is discussed in Note 4 to the financial statements, "Investment in CoBank," included in this annual report to shareholders. CoBank's role in mitigating the Association's exposure to interest rate risk is discussed in the MD&A section – Liquidity.

CoBank is required to distribute its Annual Report to shareholders of the Association if the bank experiences a significant event that has a material effect on the Association as defined by FCA regulations.

## RELATIONSHIP WITH INDEPENDENT AUDITORS

There were no changes in independent auditors since the prior annual report to shareholders and there were no material disagreements with our independent auditors on any matter of accounting principles or financial statement disclosure during this period.

## FINANCIAL STATEMENTS

The financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 16, 2015, and the Report of Management, appearing as part of this annual report to shareholders, are incorporated herein by reference.

## COBANK ANNUAL AND QUARTERLY REPORTS TO SHAREHOLDERS

The shareholders' investment in the Association is materially affected by the financial condition and results of operations of CoBank. Consequently, the Association's annual and quarterly reports should be read in conjunction with CoBank's 2014 Annual and Quarterly Reports to Shareholders. Quarterly reports are available approximately 40 days after the calendar quarter end and annual reports are available approximately 75 days after the calendar year end. A copy of these reports may be obtained free upon request from the Association. The Association is located at 202 Poplar Street, Sterling, Colorado 80751, or may be contacted by calling (970) 522-5295. The reports may also be obtained free of charge by visiting CoBank's website at www.cobank.com.