Farm Credit Illinois, ACA

Quarterly Report
June 30, 2018

MANAGEMENT'S DISCUSSION AND ANALYSIS

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

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

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FORWARD-LOOKING INFORMATION

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

AGRICULTURAL AND ECONOMIC CONDITIONS

The 2018 Illinois planting season started slowly in April as conditions were unseasonably cool and wet. Patchy snow was seen in all areas of the state into mid-April, and planting progress was behind average until late in the month. Into May, temperatures climbed above normal and drier weather allowed planting progress to accelerate. The trend of above normal temperatures has continued through the growing season. Heavy rains were seen in late June, especially in the southern part of our territory. The July 2, 2018, United States Department of Agriculture's (USDA) Illinois Crop Progress and Condition report shows Growing Degree Days ahead of normal as corn silking was at 40% compared to the five-year average of 11%. Soybeans were at 44% blooming compared to 11% over the past five years. The Illinois corn crop was rated 84% good-excellent while soybeans with the same ratings total 78%.

The June 12, 2018, USDA World Agricultural Supply and Demand Estimates left projected 2018/19 corn production unchanged at 14.040 billion bushels, down 3.8% from estimated 2017/18 production. Corn exports for the 2017/18 marketing year could be at a 10-year high – ending stocks are projected lower and the season-average corn price was raised $0.10 to $3.90 per bushel at the mid-point. Both beginning stocks and ending stocks were lowered for soybeans this month with 2018/19 production unchanged at 4.28 billion bushels. Positive news is offset by a small projected increase in global production. The season-average soybean price estimate of $10.00 at the mid-point was unchanged from May.

Uncertainty surrounding global trade has undermined commodity prices since mid-June when China announced 25% tariffs on $50 billion of U.S. goods, including soybeans. Escalating trade tensions with other key foreign buyers, including Mexico, have further increased pessimism for the U.S. agricultural economy. President Trump and U.S. Secretary of Agriculture Sonny Perdue have given assurances that American farmers will not bear the brunt of trade negotiations, and the ultimate goal is to level the playing field for American producers in global trade. Agricultural economists from the University of Illinois have submitted that a prolonged trade fight would have long-term effects on consumption, but in the short-term, commodities may be oversold on trade fears and positive crop prospects early in the growing season.

The House version of the 2018 Farm Bill passed on June 21, 2018, with the Senate version passing a week later. The House and Senate bills differ substantially in areas including farm subsidy payments, crop insurance provisions, conservation programs, and work requirements for those using the Supplemental Nutrition Assistance Program. The differences will present challenges when lawmakers meet to reconcile the two versions of the bill. If the discrepancies cannot be resolved, a new farm bill may not be passed before the current law expires on September 30, 2018, which would cause disruptions in some programs.

LOAN PORTFOLIO

Loan Portfolio

Total loans were $4.0 billion at June 30, 2018, a decrease of $24.2 million from December 31, 2017. The decrease was primarily due to the seasonality of our commercial portfolio.

Portfolio Credit Quality

The credit quality of our portfolio declined from December 31, 2017. Adversely classified loans increased to 2.9% of the portfolio at June 30, 2018, from 2.5% of the portfolio at December 31, 2017. Adversely classified loans are loans we have identified as showing some credit weakness outside our credit standards. We have considered portfolio credit quality in assessing the reasonableness of our allowance for loan losses.

In certain circumstances, government guarantee programs are used to reduce the risk of loss. At June 30, 2018, $103.9 million of our loans were, to some level, guaranteed under these government programs.

Risk Assets

Components of Risk Assets

(dollars in thousands) As of:	**June 30 2018**	December 31 2017
Loans:		
Nonaccrual	**$ 6,615**	$ 5,540
Accruing restructured	**68**	110
Accruing loans 90 days or more past due	**1,524**	--
Total risk loans	**8,207**	5,650
Other property owned	**--**	--
Total risk assets	**$ 8,207**	$ 5,650
Total risk loans as a percentage of total loans	**0.2%**	0.1%
Nonaccrual loans as a percentage of total loans	**0.2%**	0.1%
Current nonaccrual loans as a percentage of total nonaccrual loans	**36.6%**	45.1%
Total delinquencies as a percentage of total loans	**0.3%**	0.2%

Note: Accruing loans include accrued interest receivable.

As of June 30, 2018, risk assets and related ratios are within established risk management guidelines.

The increase in nonaccrual loans and accruing loans 90 days or more past due was primarily a reflection of the stress in the agricultural economy. Nonaccrual loans remained at an acceptable level at June 30, 2018, and December 31, 2017. Our accounting policy requires loans past due 90 days or more to be transferred into nonaccrual status unless adequately secured and in the process of collection. Based on our analysis, accruing loans 90 days or more past due were eligible to remain in accruing status.

Allowance for Loan Losses

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

Allowance Coverage Ratios

As of:	**June 30 2018**	December 31 2017
Allowance as a percentage of:		
Loans	**0.3%**	0.2%
Nonaccrual loans	**159.0%**	128.4%
Total risk loans	**128.2%**	125.9%

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

RESULTS OF OPERATIONS

Profitability Information

(dollars in thousands) For the six months ended June 30		2018		2017
Net income	**$**	**34,778**	$	34,465
Return on average assets		**1.7%**		1.7%
Return on average members' equity		**7.4%**		8.0%

Changes in the chart above relate directly to:

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

Changes in Significant Components of Net Income

(in thousands) For the six months ended June 30		2018		2017		Increase (decrease) in net income
Net interest income	**$**	**48,305**	$	48,224	**$**	**81**
Provision for loan losses		**3,242**		1,202		**(2,040)**
Patronage income		**8,978**		8,436		**542**
Other income, net		**6,959**		4,021		**2,938**
Operating expenses		**27,285**		24,731		**(2,554)**
(Benefit from) provision for income taxes		**(1,063)**		283		**1,346**
Net income	**$**	**34,778**	$	34,465	**$**	**313**

Changes in Net Interest Income

(in thousands) For the six months ended June 30		2018 vs 2017
Changes in volume	**$**	**2,584**
Changes in interest rates		**(2,404)**
Changes in nonaccrual income and other		**(99)**
Net change	**$**	**81**

The change in the provision for loan losses was related to a production and intermediate-term loan that moved from substandard viable to substandard non-viable during the first quarter of 2018.

The change in other income, net was primarily due to our share of distributions from Allocated Insurance Reserve Accounts (AIRA) of $2.3 million. The AIRA was recently established by the Farm Credit System Insurance Corporation (FCSIC) when premiums collected increased the level of the Insurance Fund beyond the required 2% of insured debt. There were no distributions in 2017. Refer to the 2017 Annual Report for additional information about the FCSIC.

The change in operating expenses was primarily due to the change in technology platforms that we are currently undergoing in 2018.

FUNDING, LIQUIDITY, AND CAPITAL

We borrow from AgriBank, under a note payable, in the form of a line of credit. Our note payable matures on July 31, 2020, at which time the note will be renegotiated. The repricing attributes of our line of credit generally correspond to the repricing attributes of our loan portfolio, which significantly reduces our market interest rate risk. Due to the cooperative structure of the Farm Credit System and as we are a stockholder of AgriBank, we expect this borrowing relationship to continue into the foreseeable future. Our other source of lendable funds is from unallocated surplus. At June 30, 2018, our loan portfolio was funded 80.2% by the direct note and 19.8% by unallocated surplus.

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

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

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

Total members' equity increased $34.5 million from December 31, 2017, primarily due to net income for the period. Accumulated other comprehensive loss is the impact of prior service cost and unamortized actuarial gain/loss related to the Pension Restoration Plan. Refer to Note 8 in our 2017 Annual Report for more information on the Pension Restoration Plan.

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

Select Capital Ratios

As of:	**June 30 2018**	December 31 2017	Regulatory Minimums	Capital Conservation Buffer	Total
Risk-adjusted:					
Common equity tier 1 ratio	**19.0%**	18.2%	4.5%	2.5%*	7.0%
Tier 1 capital ratio	**19.0%**	18.2%	6.0%	2.5%*	8.5%
Total capital ratio	**19.2%**	18.3%	8.0%	2.5%*	10.5%
Permanent capital ratio	**19.0%**	18.2%	7.0%	N/A	7.0%
Non-risk-adjusted:					
Tier 1 leverage ratio	**20.8%**	20.0%	4.0%	1.0%	5.0%
Unallocated retained earnings and equivalents leverage ratio	**22.1%**	21.1%	1.5%	N/A	1.5%

*The capital conservation buffer over risk-adjusted ratio minimums continues to be phased in under the Farm Credit Administration capital requirements, up to 2.5% beginning in 2020.

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

REGULATORY MATTERS

Investment Securities Eligibility

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

CERTIFICATION

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

Mark Miller
Chairperson of the Board
Farm Credit Illinois, ACA

Thomas H. Tracy
President & Chief Executive Officer
Farm Credit Illinois, ACA

Kelly D. Loschen
Chief Financial Officer
Farm Credit Illinois, ACA

August 9, 2018

CONSOLIDATED STATEMENTS OF CONDITION

Farm Credit Illinois, ACA
(in thousands)
(Unaudited)

As of:		June 30 2018		December 31 2017
ASSETS				
Loans	**$**	**4,049,626**	$	4,073,787
Allowance for loan losses		**10,519**		7,111
Net loans		**4,039,107**		4,066,676
Investment in AgriBank, FCB		**93,452**		95,206
Accrued interest receivable		**43,547**		49,442
Deferred tax assets, net		**434**		--
Other assets		**51,387**		52,850
Total assets	**$**	**4,227,927**	$	4,264,174
LIABILITIES				
Note payable to AgriBank, FCB	**$**	**3,246,741**	$	3,314,191
Accrued interest payable		**19,467**		16,341
Deferred tax liabilities, net		**--**		145
Other liabilities		**8,116**		14,386
Total liabilities		**3,274,324**		3,345,063
Contingencies and commitments (Note 3)				
MEMBERS' EQUITY				
Protected members' equity		**2**		4
Capital stock and participation certificates		**7,558**		7,922
Unallocated surplus		**947,048**		912,270
Accumulated other comprehensive loss		**(1,005)**		(1,085)
Total members' equity		**953,603**		919,111
Total liabilities and members' equity	**$**	**4,227,927**	$	4,264,174

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Farm Credit Illinois, ACA
(in thousands)
(Unaudited)

	Three Months Ended		Six Months Ended	
For the period ended June 30	**2018**	2017	**2018**	2017
Interest income	**$ 43,421**	$ 38,466	**$ 85,441**	$ 75,633
Interest expense	**19,467**	14,273	**37,136**	27,409
Net interest income	**23,954**	24,193	**48,305**	48,224
Provision for loan losses	**1,628**	1,205	**3,242**	1,202
Net interest income after provision for loan losses	**22,326**	22,988	**45,063**	47,022
Other income				
Patronage income	**4,420**	4,270	**8,978**	8,436
Financially related services income	**1,830**	1,515	**3,573**	2,984
Fee income	**441**	584	**978**	916
Allocated insurance reserve accounts distribution	**--**	--	**2,318**	--
Miscellaneous income (loss), net	**1**	(9)	**90**	121
Total other income	**6,692**	6,360	**15,937**	12,457
Operating expenses				
Salaries and employee benefits	**7,580**	7,406	**15,124**	14,978
Other operating expenses	**6,677**	4,741	**12,161**	9,753
Total operating expenses	**14,257**	12,147	**27,285**	24,731
Income before income taxes	**14,761**	17,201	**33,715**	34,748
(Benefit from) provision for income taxes	**(484)**	196	**(1,063)**	283
Net income	**$ 15,245**	$ 17,005	**$ 34,778**	$ 34,465
Other comprehensive income				
Employee benefit plans activity	**$ 40**	$ --	**$ 80**	$ --
Total other comprehensive income	**40**	--	**80**	--
Comprehensive income	**$ 15,285**	$ 17,005	**$ 34,858**	$ 34,465

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

CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

Farm Credit Illinois, ACA
(in thousands)
(Unaudited)

	Protected Members' Equity	Capital Stock and Participation Certificates	Unallocated Surplus	Accumulated Other Comprehensive Loss	Total Members' Equity
Balance at December 31, 2016	$ 5	$ 8,035	$ 838,924	$ --	$ 846,964
Net income	--	--	34,465	--	34,465
Capital stock and participation certificates issued	--	276	--	--	276
Capital stock and participation certificates retired	(2)	(382)	--	--	(384)
Balance at June 30, 2017	$ 3	$ 7,929	$ 873,389	$ --	$ 881,321
Balance at December 31, 2017	$ 4	$ 7,922	$ 912,270	$ (1,085)	$ 919,111
Net income	**--**	**--**	**34,778**	**--**	**34,778**
Other comprehensive income	**--**	**--**	**--**	**80**	**80**
Capital stock and participation certificates issued	**--**	**286**	**--**	**--**	**286**
Capital stock and participation certificates retired	**(2)**	**(650)**	**--**	**--**	**(652)**
Balance at June 30, 2018	**$ 2**	**$ 7,558**	**$ 947,048**	**$ (1,005)**	**$ 953,603**

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

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

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

Recently Issued or Adopted Accounting Pronouncements

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

Standard and effective date	Description	Adoption status and financial statement impact
In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09 “Revenue from Contracts with Customers." This guidance was effective for public entities on January 1, 2018.	The guidance governs revenue recognition from contracts with customers and requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Financial instruments and other contractual rights within the scope of other guidance issued by the FASB are excluded from the scope of this guidance. The guidance sets forth the requirement for new and enhanced disclosures.	We adopted this guidance on January 1, 2018, using the modified retrospective approach, as the majority of the Association’s revenues are not subject to the new guidance, the adoption of the guidance did not have a material impact on the financial condition, results of operations, equity, or cash flows.
In March 2017, the FASB issued ASU 2017-07 “Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Cost.” This guidance was effective for public entities on January 1, 2018.	This guidance requires that an employer disaggregate the service cost component from the other components of net benefit cost. Specifically, the guidance requires non-service cost components of net benefit cost to be recognized in a non-operating income line item of the income statement and allow only the service cost component of net benefit cost to be eligible for capitalization.	We adopted this guidance on January 1, 2018. The adoption of the guidance did not impact the Association’s financial condition or cash flows, but did change the classification of certain items in the results of operations. The change in classification was not material and did not result in a reclassification on the Statement of Comprehensive Income. There were no changes to the financial statement disclosures.
In January 2016, the FASB issued ASU 2016-01 “Recognition and Measurement of Financial Assets and Financial Liabilities.” This guidance was effective for public business entities on January 1, 2018.	The guidance is intended to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. The amendments address certain aspects of recognition, measurement, presentation, and disclosure of financial statements.	We adopted this guidance on January 1, 2018. The adoption of this guidance did not impact our financial condition, results of operations or cash flows, but did impact the Association’s fair value disclosures.
In February 2016, the FASB issued ASU 2016-02 “Leases.” The guidance is effective for public entities in its first quarter of 2019 and early adoption is permitted.	The guidance modifies the recognition and accounting for lessees and lessors and requires expanded disclosures regarding assumptions used to recognize revenue and expenses related to leases. When this guidance is adopted, a liability for lease obligations and a corresponding right-of-use asset will be recognized on the Consolidated Statements of Condition for all lease arrangements spanning more than 12 months.	We have no plans to early adopt this guidance. We are in the process of system selection, drafting accounting policies, and designing processes and controls to implement this standard. The necessary disclosures will be determined during 2018. We have determined after preliminary review, this guidance will not have a material impact on our financial condition, results of operations, and financial statement disclosures, and will have no impact on cash flows.

Standard and effective date	Description	Adoption status and financial statement impact
In June 2016, the FASB issued ASU 2016-13 “Financial Instruments – Credit Losses.” This guidance is effective for public business entities for non-U.S. Securities Exchange Commission filers for the first quarter of 2021 and early adoption is permitted.	The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses.	We have no plans to early adopt this guidance. We are in the process of reviewing the standard. Significant implementation matters yet to be addressed include system selection, drafting of accounting policies and disclosures, designing processes and controls. We are currently unable to estimate the impact on the financial statements.

NOTE 2: LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans by Type

(dollars in thousands) As of:	**June 30, 2018**			December 31, 2017		
		Amount	%		Amount	%
Real estate mortgage	**$**	**2,308,367**	**57.0%**	$	2,278,901	55.9%
Production and intermediate-term		**742,063**	**18.3%**		864,617	21.2%
Agribusiness		**781,259**	**19.3%**		742,575	18.2%
Other		**217,937**	**5.4%**		187,694	4.7%
Total	**$**	**4,049,626**	**100.0%**	$	4,073,787	100.0%

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

Delinquency

Aging Analysis of Loans

(in thousands) **As of June 30, 2018**	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less than 30 Days Past Due	Total	Accruing Loans 90 Days or More Past Due
Real estate mortgage	**$ 2,870**	**$ 1,756**	**$ 4,626**	**$ 2,334,436**	**$ 2,339,062**	**$ --**
Production and intermediate-term	**2,168**	**3,862**	**6,030**	**745,252**	**751,282**	**1,524**
Agribusiness	**--**	**--**	**--**	**784,424**	**784,424**	**--**
Other	**--**	**--**	**--**	**218,405**	**218,405**	**--**
Total	**$ 5,038**	**$ 5,618**	**$ 10,656**	**$ 4,082,517**	**$ 4,093,173**	**$ 1,524**

As of December 31, 2017	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less than 30 Days Past Due	Total	Accruing Loans 90 Days or More Past Due
Real estate mortgage	$ 1,953	$ 1,677	$ 3,630	$ 2,306,877	$ 2,310,507	$ --
Production and intermediate-term	1,842	1,284	3,126	875,742	878,868	--
Agribusiness	293	--	293	745,287	745,580	--
Other	--	--	--	188,274	188,274	--
Total	$ 4,088	$ 2,961	$ 7,049	$ 4,116,180	$ 4,123,229	$ --

Note: Accruing loans include accrued interest receivable.

Risk Loans

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

Risk Loan Information

(in thousands) As of:	**June 30 2018**	December 31 2017
Volume with specific allowance	**$ 1,136**	$ 679
Volume without specific allowance	**7,071**	4,971
Total risk loans	**$ 8,207**	$ 5,650
Total specific allowance	**$ 876**	$ 529
For the six months ended June 30	**2018**	2017
Income on accrual risk loans	**$ 33**	$ 17
Income on nonaccrual loans	**168**	268
Total income on risk loans	**$ 201**	$ 285
Average risk loans	**$ 7,049**	$ 5,559

Note: Accruing loans include accrued interest receivable.

We did not have any material commitments to lend additional money to borrowers whose loans were classified as risk loans at June 30, 2018.

Troubled Debt Restructurings (TDRs)

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

We completed TDRs of certain production and intermediate-term loans during the six months ended June 30, 2018, and 2017. Our recorded investment in these loans just prior to restructuring was $52 thousand and $127 thousand during the six months ended June 30, 2018, and 2017, respectively. Our recorded investment in these loans immediately following the restructuring was $52 thousand and $126 thousand during the six months ended June 30, 2018, and 2017, respectively. The recorded investment of the loan is the unpaid principal amount of the receivable increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, and acquisition costs and may also reflect a previous direct charge-off. The primary types of modification included extension of maturity and forgiveness of principal of interest.

We had TDRs in the production and intermediate-term loan category of $75 thousand and $6 thousand that defaulted during the six months ended June 30, 2018, and 2017, respectively in which the modifications were within twelve months of the respective reporting period.

TDRs Outstanding in the Production and Intermediate-Term Loan Category

(in thousands) As of:	**June 30 2018**	December 31 2017
TDRs in accrual status	**$ 68**	$ 110
TDRs in nonaccrual status	**261**	254
Total TDRs	**$ 329**	$ 364

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

Allowance for Loan Losses

Changes in Allowance for Loan Losses

(in thousands) Six months ended June 30	**2018**	2017
Balance at beginning of period	**$ 7,111**	$ 6,420
Provision for loan losses	**3,242**	1,202
Loan recoveries	**373**	300
Loan charge-offs	**(207)**	(160)
Balance at end of period	**$ 10,519**	$ 7,762

NOTE 3: CONTINGENCIES AND COMMITMENTS

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

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

NOTE 4: FAIR VALUE MEASUREMENTS

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

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

Non-Recurring

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

Assets Measured at Fair Value on a Non-recurring Basis

(in thousands)

	As of June 30, 2018			
	Fair Value Measurement Using			Total Fair
	Level 1	Level 2	Level 3	Value
Impaired loans	**$ --**	**$ --**	**$ 273**	**$ 273**
	As of December 31, 2017			
	Fair Value Measurement Using			Total Fair
	Level 1	Level 2	Level 3	Value
Impaired loans	$ --	$ --	$ 157	$ 157

Valuation Techniques

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

NOTE 5: SUBSEQUENT EVENTS

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