# 2018 Quarterly Report

**MARCH 31, 2018**

Dear CoBank Customer-Owner:

We're pleased to report that CoBank recorded another period of solid financial performance in the first quarter of 2018. Lending increased in all three of our operating segments, and earnings, credit quality and capital remained strong. Despite ongoing marketplace challenges impacting many of the industries we finance, the bank remains well-positioned to meet the financial needs of its customers and fulfill its mission of service to rural America.

Average loan volume rose 4 percent to $101.7 billion in the first quarter of 2018, from $97.9 billion in the same period last year. The increase resulted primarily from growth in lending to grain and farm supply cooperatives and to affiliated Farm Credit associations.

Net interest income increased 4 percent to $371.0 million, from $356.1 million in the same period last year. The increase resulted primarily from higher average loan volume as well as higher returns on invested capital. Noninterest income increased 48 percent to $81.4 million, primarily due to a return of excess insurance funds from the Farm Credit System Insurance Corporation.

Net income for the quarter rose 8 percent to $284.4 million, compared to $262.8 million in the first quarter last year, primarily due to the increases in noninterest income and net interest income as well as a decrease in operating expenses and lower income tax expense, offset by a higher provision for loan losses. CoBank recorded a $50 million provision for loan losses for the first quarter of 2018, compared to $15 million in the prior-year period, due to specific reserves for a small number of agribusiness and rural infrastructure customers, overall credit quality deterioration and growth in average loan volume. Operating expenses declined by $8.1 million primarily due to a reduction in Farm Credit insurance premiums. Income tax expense declined by $7.2 million due to the positive impact of federal tax legislation enacted in December 2017.

Net interest margin rose to 1.15 percent in the first quarter of 2018 from 1.14 percent a year ago. The improvement in margin primarily reflected an increased level of seasonal lending to grain and farm supply customers as well as increased earnings on invested capital.

Although credit quality in our loan portfolio is generally favorable, we experienced some deterioration as a result of continuing low commodity prices and other challenges impacting our customers. Nonaccrual loans increased to $325.8 million at March 31, 2018, from $246.8 million at December 31, 2017. At quarter-end, 1.0 percent of the bank's loans were classified as adverse assets, unchanged from the end of last year. The bank's allowance for credit losses totaled $721.0 million at quarter-end, or 1.32 percent of non-guaranteed loans when loans to Farm Credit associations are excluded.

CoBank's capital levels remained well in excess of regulatory minimums. As of March 31, 2018, shareholders' equity totaled $9.0 billion, and the bank's total capital ratio was 14.55 percent, compared with the 8.0 percent (10.5 percent inclusive of the fully phased-in capital conservation buffer) minimum established by the Farm Credit Administration, the bank's independent regulator. At quarter-end, the bank held approximately $30.4 billion in cash, investments and overnight funds and had 176 days of liquidity, which was in excess of regulatory liquidity requirements.

Under the guidance of our board, we remain focused on building the financial strength and stability of the bank, which is essential to our long-term ability to provide customers with dependable credit and the other financial services they need to meet the demands of a rapidly evolving marketplace. In addition, we continue to invest in our operating platform and in the people, processes and systems we need to deliver an exceptional experience to our borrowers. Our commitment to our customers and to rural America as a whole remains essential to who we are; our board and management team, along with our more than 1,000 associates, value greatly the trust you place in us and deeply appreciate the opportunity to serve as your trusted financial partner.

Kevin Riel

Kevin G. Riel
Chair of the Board

Tom Halverson

Thomas E. Halverson
President and Chief Executive Officer

May 10, 2018

# Financial Highlights
**CoBank, ACB**

($ in Thousands)

| | March 31, 2018 (Unaudited) | December 31, 2017 |
|---|---|---|
| Total Loans | **$ 102,285,364** | $ 99,265,505 |
| Less: Allowance for Loan Losses | **645,317** | 576,927 |
| Net Loans | **101,640,047** | 98,688,578 |
| Total Assets | **133,401,573** | 129,210,813 |
| Total Shareholders' Equity | **8,976,021** | 9,060,077 |

| **For the Three Months Ended March 31, (Unaudited)** | **2018** | **2017** |
|---|---|---|
| Net Interest Income | **$ 371,041** | $ 356,114 |
| Provision for Loan Losses | **50,000** | 15,000 |
| Net Fee Income | **20,969** | 23,542 |
| Net Income | **284,412** | 262,808 |
| Net Interest Margin | **1.15 %** | 1.14 % |
| Return on Average Assets | **0.87** | 0.83 |
| Return on Average Common Shareholders' Equity | **14.27** | 13.72 |
| Return on Average Total Shareholders' Equity | **12.86** | 12.33 |
| Average Total Loans | **$ 101,657,100** | $ 97,946,747 |
| Average Earning Assets | **130,729,539** | 126,679,649 |
| Average Total Assets | **132,064,944** | 128,150,517 |

# Management's Discussion and Analysis of Financial Condition and Results of Operations

**CoBank, ACB**

## Business Overview

CoBank, ACB (CoBank or the Bank) is one of the four banks of the Farm Credit System (System) and provides loans, leases and other financial services to vital industries across the rural communities of America. The System is a federally chartered network of borrower-owned cooperative lending institutions and related service organizations. The System was established in 1916 by the U.S. Congress, and is a government-sponsored enterprise. CoBank is federally chartered under the Farm Credit Act of 1971, as amended (the Farm Credit Act), and is subject to supervision, examination, and safety and soundness regulation by an independent federal agency, the Farm Credit Administration (FCA).

Our customers consist of agricultural cooperatives; other food and agribusiness companies; rural power, communications and water cooperatives and companies; rural community facilities; Agricultural Credit Associations (Associations), which are regulated, farmer-owned financial institutions and members of the System; and other businesses that serve agriculture and rural communities. We provide a broad range of loans and other financial services through three operating segments: Agribusiness, Strategic Relationships and Rural Infrastructure.

The following discussion and analysis should be read in conjunction with the accompanying condensed consolidated quarterly financial statements and related notes, the accompanying regulatory capital disclosures and our 2017 Annual Report to Shareholders.

## Consolidated Results of Operations

Average loan volume was $101.7 billion during the first three months of 2018 compared to $97.9 billion in the same prior-year period. The 4 percent increase in average loan volume resulted primarily from growth in lending to grain and farm supply cooperatives in our Agribusiness operating segment and Associations in our Strategic Relationships operating segment.

Net income increased $21.6 million to $284.4 million for the three-month period ended March 31, 2018, compared to $262.8 million during the same period in 2017. The 8 percent increase in earnings primarily resulted from increases in noninterest income and net interest income as well as a decrease in operating expenses and a lower provision for income taxes. The increase in noninterest income was largely due to a return of excess insurance funds from the Farm Credit System Insurance Corporation (Insurance Corporation). These items were somewhat offset by a higher provision for loan losses in the 2018 period.

Net interest income increased $14.9 million to $371.0 million for the three months ended March 31, 2018, compared to $356.1 million for the same prior-year period. The 4 percent increase in net interest income was primarily driven by higher average loan volume, including an increase in seasonal lending in our Agribusiness operating segment, and an increase in earnings from our invested capital.

Net interest margin increased to 1.15 percent for the first quarter of 2018 from 1.14 percent for the same period in 2017. The increase in our net interest margin primarily reflected the impact of increased seasonal lending and higher earnings on our invested capital.

We recorded a $50.0 million provision for loan losses in the three-month period ended March 31, 2018 compared to $15.0 million in the same period in 2017. The 2018 provision largely reflects increases in specific reserves associated with a small number of customers in our Agribusiness and Rural Infrastructure operating segments as well as increased exposure in the Agribusiness operating segment resulting from deterioration in credit quality and growth in average loan volume. The 2017 provision primarily reflected increased lending activity and slight deterioration in credit quality in our Agribusiness operating segment. Adversely classified loans and accrued interest were 1.00 percent of total loans and accrued interest at March 31, 2018 and December 31, 2017. Nonaccrual loans increased to $325.8 million at March 31, 2018 from $246.8 million at December 31, 2017 primarily resulting from credit quality deterioration impacting a small number of customers in our Agribusiness and Rural Infrastructure operating segments. Loan recoveries, net of charge-offs, totaled $0.2 million in the first three months of 2018 compared to loan charge-offs, net of recoveries, of $0.4 million during the same period in 2017.

Noninterest income increased $26.4 million to $81.4 million for the first quarter of 2018 from $55.0 million for the same prior-year period. Noninterest income is primarily composed of fee income, patronage income, loan prepayment income and miscellaneous gains and losses, offset by losses on early extinguishments of debt. The increase in noninterest income resulted largely from the return of $35.0 million in excess insurance funds from the Insurance Corporation related to the Farm Credit Insurance Fund (Insurance Fund). The returned insurance funds are included in 'Other, Net' within the 'Noninterest Income/(Expense)' section of the accompanying condensed consolidated statement of income for the three months ended March 31, 2018. As more fully explained in our 2017 Annual Report, when the Insurance Fund exceeds the statutory 2 percent secure base amount (SBA), the Insurance Corporation is required to reduce premiums and may return excess amounts. The Insurance Fund began 2018 above the SBA. In the first quarter of 2018, the Insurance Corporation approved the distribution of the excess amounts and such amounts were distributed to System entities in March. This item was partially offset by a decrease of $6.7 million in gains recognized on sales of investment securities. In the first quarter of 2018, we sold investment securities with a combined book value of $8.0 million for gains totaling $2.7 million. During the three-month period ended March 31, 2017, sales of investment securities with a combined book value of $1.6 billion resulted in gains totaling $9.4 million. Sales of investment securities are discussed further beginning on page 11. Losses on early extinguishments of debt, net of prepayment income, increased by $5.0 million during the three months ended March 31, 2018, compared to the same prior-year period. We extinguish debt to offset the current and prospective impact of prepayments in our loan and investment portfolios and to maintain a desired mix of interest-earning assets and interest-bearing liabilities. In the 2018 period, we took advantage of market opportunities to buy back higher-cost debt, which will reduce interest expense and benefit earnings in future periods. As a result, losses on early extinguishments of debt exceeded prepayment income. Net fee income decreased $2.6 million in the first three months of 2018, compared to the same period in 2017, primarily due to a lower level of fee income in our Rural Infrastructure operating segment.

Total operating expenses for the three-month period ended March 31, 2018 decreased $8.1 million to $84.6 million from $92.7 million for the same period in 2017. The lower level of operating expenses was driven by a decrease in Insurance Fund premium expense of $8.0 million in the first three months of 2018 compared to the 2017 period. The decrease is due to the impact of lower premium rates partially offset by growth in loan volume. Insurance Fund premium rates are set by the Insurance Corporation and were 9 basis points of adjusted insured debt obligations in the first quarter of 2018 compared to 15 basis points during the first quarter of 2017. General and administrative expenses decreased $1.7 million primarily due to the timing of corporate contributions. These items were somewhat offset by an increase in employee compensation expense of $1.3 million to $41.8 million for the first three months of 2018 primarily due to an increase in the number of employees to support new business initiatives and maintain high levels of customer service. As of March 31, 2018 and 2017, we had 1,005 and 982 employees, respectively.

Our income tax expense decreased to $33.4 million for the first quarter of 2018, compared to $40.6 million for the same prior-year period. Our effective tax rates were 10.5 percent and 13.4 percent for the three-month periods ended March 31, 2018 and 2017, respectively. The decreases in our income tax expense and the effective tax rate were primarily due to the enactment of federal tax legislation in late 2017 which, among other things, lowered the federal corporate tax rate from 35 percent to 21 percent beginning in 2018.

As a result of the higher level of earnings in the first three months of 2018, our annualized return on average common shareholders' equity increased to 14.27 percent for the three months ended March 31, 2018 from 13.72 percent for the same period in 2017. Our annualized return on average assets increased to 0.87 percent for the three-month period ended March 31, 2018, compared to 0.83 percent for the same prior-year period.

## Operating Segment Financial Review

We provide financial services to agricultural cooperatives; other food and agribusiness companies; rural power, communications and water cooperatives and companies; rural community facilities; farmer-owned financial institutions and other businesses that serve agriculture and rural communities. We conduct lending operations through three operating segments: Agribusiness, Strategic Relationships and Rural Infrastructure.

Loans outstanding and the allowance for loan losses by operating segment at March 31, 2018 and 2017 are reported in Notes 3 and 10 to the accompanying condensed consolidated financial statements. All customer activity, including loans and leases and related income, is specifically assigned to the business units that comprise the operating segments. Investment securities and federal funds sold and other overnight funds, which are primarily held as a liquidity reserve to support our banking operations, are not specifically assigned to operating segments; however, the income from investment securities and federal funds sold and other overnight funds is allocated to the operating segments. Net income by operating segment is summarized in the following table and is more fully detailed in Note 10 to the accompanying condensed consolidated financial statements.

**Net Income by Operating Segment** ($ in Thousands)

| For the Three Months Ended March 31, | 2018 | 2017 |
|---|---|---|
| **Operating Segment:** | | |
| Agribusiness | $ 131,512 | $ 122,567 |
| Strategic Relationships | 61,319 | 67,438 |
| Rural Infrastructure | 89,024 | 75,063 |
| Total Operating Segments | 281,855 | 265,068 |
| Corporate/Other | 2,557 | (2,260) |
| **Total** | $ 284,412 | $ 262,808 |

### *Agribusiness*

The Agribusiness operating segment includes loans and other financial services provided to a diverse market of cooperatives and other businesses in various agricultural sectors including grain handling and marketing, farm supply, fruits, nuts, vegetables, forest products, dairy, livestock, biofuels and food processing. Agribusiness loans outstanding totaled $34.4 billion at March 31, 2018, compared to $30.3 billion at December 31, 2017. The $4.1 billion increase in loans outstanding was primarily driven by seasonal financing requirements at many grain and farm supply cooperatives. The Agribusiness segment includes our Agricultural Export Finance Division, which provides trade finance to support U.S. exporters of agricultural products. The Agricultural Export Finance Division had $4.9 billion and $5.0 billion in loans outstanding as of March 31, 2018 and December 31, 2017, respectively. At March 31, 2018 and December 31, 2017, 19 percent and 20 percent, respectively, of the loans in the Agricultural Export Finance Division were guaranteed by the U.S. government. Our Agribusiness segment also includes Farm Credit Leasing Services Corporation (FCL), a wholly-owned subsidiary, which provides lease products and related services to Association partners, agribusinesses, agricultural producers and rural infrastructure companies. As of March 31, 2018 and December 31, 2017, FCL had $3.3 billion and $3.4 billion, respectively, in leases outstanding.

Agribusiness average loan volume increased 6 percent to $33.6 billion for the first quarter of 2018 from $31.8 billion for the same period of 2017. Growth in Agribusiness average loan volume resulted primarily from higher levels of seasonal financing at many grain and farm supply cooperatives resulting from greater levels of grain ownership and somewhat higher grain commodity prices in the 2018 period.

Agribusiness net income increased $8.9 million in the first three months of 2018 to $131.5 million from $122.6 million for the same period in 2017 due to increases in net interest income and noninterest income as well as a lower provision for income taxes and a decrease in operating expenses. These items were somewhat offset by a higher provision for loan losses.

Net interest income increased by $15.9 million to $199.0 million for the three-month period ended March 31, 2018 from $183.1 million for the 2017 period primarily due to growth in average loan volume including a higher level of seasonal financing to grain and farm supply cooperatives.

Agribusiness recorded a $47.0 million provision for loan losses during the first three months of 2018 compared to $13.0 million in the same prior-year period. The 2018 provision resulted primarily from increases in specific reserves associated with a small number of customers as well as an increase in exposure due to deterioration in overall credit quality and growth in loan volume. The 2017 provision reflected a higher level of lending activity and slight deterioration in overall credit quality. Nonaccrual loans in Agribusiness increased to $271.0 million at March 31, 2018, as compared to $213.0 million at December 31, 2017, due to credit quality deterioration impacting a small number of food and agribusiness customers, somewhat offset by a previously-restructured loan which was paid off during the quarter. Loan recoveries, net of charge-offs, totaled $0.2 million for the three months ended March 31, 2018, compared to loan charge-offs, net of recoveries, of $0.4 million for the same prior-year period.

Noninterest income increased $15.6 million to $44.6 million in the first quarter of 2018, largely due to the return of excess insurance funds from the Insurance Corporation. This increase was somewhat offset by higher losses on early extinguishments of debt, net of prepayment income.

Agribusiness operating expenses decreased to $49.2 million for the first three months of 2018 from $53.5 million in the same prior-year period primarily due to the decrease in Insurance Fund premiums, as described on page 5. Agribusiness income tax expense decreased $7.2 million to $15.9 million for the first quarter of 2018, as compared to the 2017 period. The decrease primarily resulted from the change in the federal corporate tax rate, as discussed on page 5.

### *Strategic Relationships*

The Strategic Relationships operating segment includes wholesale loans from the direct funding relationships we have with our affiliated Association customer-owners and our wholesale funding relationships with other System institutions. Our affiliates include Associations operating in 23 states serving the Northwest, West, Southwest, Rocky Mountains, Mid-Plains, and Northeast regions of the United States. As of March 31, 2018, the Strategic Relationships portfolio totaled $46.8 billion, compared to $47.9 billion at December 31, 2017. The decrease in outstanding loan volume primarily resulted from a typical seasonal decline in Association lending to agricultural producers. At March 31, 2018 and December 31, 2017, loans outstanding included $41.9 billion and $43.0 billion, respectively, in wholesale loans to our affiliated Associations and $4.9 billion of participations in wholesale loans made by other System banks to certain of their affiliated Associations. These participations included $3.9 billion as of both March 31, 2018 and December 31, 2017 in wholesale loans made by the Farm Credit Bank of Texas (FCBT). The balance of participations of $1.0 billion as of March 31, 2018 and December 31, 2017 represent wholesale loans made by AgFirst Farm Credit Bank.

Strategic Relationships average loan volume increased 3 percent to $47.0 billion for the three-month period ended March 31, 2018, compared to $45.6 billion for the same prior-year period. The increase resulted from greater overall lending to agricultural producers at our affiliated Associations and, to a lesser extent, an increase in participations in wholesale loans made by other System banks to certain of our affiliated Associations in the first quarter of 2018 as compared to the 2017 period.

Strategic Relationships net income decreased $6.1 million to $61.3 million for the first three months of 2018, as compared to $67.4 million for the same prior-year period. The decrease primarily resulted from lower levels of noninterest income. Strategic Relationships current period operating results did not benefit from the previously mentioned return of excess insurance funds from the Insurance Corporation because these amounts were passed on directly to our Association customers since premium assessments are also directly passed on to them. Net interest income decreased to $69.6 million in the first quarter of 2018, compared to $70.5 million for the same period in 2017, primarily due to a slight decrease in overall loan spread, somewhat offset by the impact of growth in average loan volume.

As a wholesale lender to Associations, we benefit from the diversification of the Association loan portfolios and a strong collateral position. In addition, the earnings, capital and loan loss reserves of the Associations provide an additional layer of protection against losses in their respective loan portfolios. Lower spreads in the Strategic Relationships operating segment are commensurate with the lower risk profile and lower regulatory capital requirements. Notwithstanding the downgraded credit quality classification of an affiliated Association wholesale loan and a participation in a wholesale loan made by FCBT to one of its affiliated Associations as discussed on page 9, loan quality in Strategic Relationships remains strong. No provision for loan losses or allowance for credit losses have been recorded related to any of our Association wholesale loans.

Strategic Relationships noninterest income decreased to $2.6 million in the first three months of 2018 from $7.2 million in the 2017 period resulting from a lower level of gains on the sale of investment securities in the first quarter of 2018, as compared to the 2017 period, which are allocated to the operating segments.

Operating expenses increased to $10.9 million for the first quarter of 2018, compared to $10.3 million recorded in the same period in 2017 primarily due to the increase in employee compensation expenses described on page 5.

### *Rural Infrastructure*

The Rural Infrastructure operating segment includes loans and other financial services provided to cooperatives and other companies in the power and energy, communications, water and waste water industries as well as to community facilities in rural America. Power and energy industry customers include rural electric generation and transmission cooperatives, electric distribution cooperatives, renewable energy providers, independent power producers, regulated utilities and investor-owned utilities. Communications industry customers include rural local exchange carriers, wireless providers, data transport networks, cable television systems, tower companies, telecommunication services and data centers. In addition, the Bank has customers in the water industry, including rural water and waste water companies, as well as rural health care and other community facilities. The Rural Infrastructure loan portfolio totaled $21.0 billion at both March 31, 2018 and December 31, 2017.

Rural Infrastructure average loan volume increased 2 percent to $21.0 billion for the first three months of 2018, compared to $20.6 billion for the same prior-year period. Growth in Rural Infrastructure average loan volume resulted primarily from increased lending to communications, energy and water customers.

Rural Infrastructure net income increased by $13.9 million to $89.0 million for the first quarter of 2018, compared to $75.1 million for the same prior-year period. The increase was primarily driven by higher noninterest income and a decrease in operating expenses.

Net interest income totaled $105.4 million for the three-month period ended March 31, 2018, generally consistent as compared to $105.3 million in the 2017 period. This slight increase was primarily due to the increase in average loan volume, somewhat offset by slight spread compression resulting from continued strong competition for our customers' business from other financial service providers in the marketplace.

Rural Infrastructure recorded a provision for loan losses of $3.0 million during the first three months of 2018 compared to $2.0 million for the same period in 2017. The 2018 provision primarily reflected increases in specific reserves associated with a small number of customers, somewhat offset by lower reserves in the balance of the portfolio. The 2017 provision primarily reflected growth in average loan volume. Nonaccrual loans in Rural Infrastructure increased to $54.8 million at March 31, 2018 compared to $33.9 million at December 31, 2017 due to a project finance loan which was transferred to nonaccrual status in 2018. There were no significant loan charge-offs or recoveries during the first quarter of 2018 or 2017 in Rural Infrastructure.

Noninterest income increased by $10.9 million to $28.5 million for the first quarter of 2018 compared to $17.6 million for the same period in 2017 primarily resulting from the return of excess insurance funds from the Insurance Corporation. This increase was somewhat offset by higher losses on early extinguishments of debt, net of prepayment income and a decrease in fee income during the 2018 period.

Rural Infrastructure operating expenses decreased by $3.8 million to $24.9 million for the first three months of 2018 compared to $28.7 million for the same prior-year period primarily due to a decrease in Insurance Fund premiums, as described on page 5.

# Credit Quality, Liquidity, Capital Resources and Other

### *Loan Quality*

The following table presents loans and accrued interest receivable, classified by management pursuant to our regulator's Uniform Loan Classification System, as a percent of total loans and accrued interest.

**Loan Quality Ratios**

| | March 31, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| | Wholesale Loans [1] | Commercial Loans [2] | Total Bank | Wholesale Loans [1] | Commercial Loans [2] | Total Bank |
| Acceptable | **98.87 %** | **95.32 %** | **96.95 %** | 99.02 % | 95.54 % | 97.22 % |
| Special Mention | **1.13** | **2.83** | **2.05** | 0.98 | 2.52 | 1.78 |
| Substandard | **-** | **1.83** | **0.99** | - | 1.93 | 1.00 |
| Doubtful | **-** | **0.02** | **0.01** | - | 0.01 | - [3] |
| Loss | **-** | **-** | **-** | - | - | - |
| **Total** | **100.00 %** | **100.00 %** | **100.00 %** | 100.00 % | 100.00 % | 100.00 % |

[1] Represents loans in our Strategic Relationships operating segment
[2] Represents loans in our Agribusiness and Rural Infrastructure operating segments
[3] Represents less than 0.01 percent of total bank loans and accrued interest

While our overall loan quality measures remain strong at March 31, 2018, we experienced deterioration in the first quarter of 2018. The level of Acceptable loans and accrued interest as a percent of total loans and accrued interest was 96.95 percent at March 31, 2018 compared to 97.22 percent at December 31, 2017.

At March 31, 2018, Special Mention loans included a $470.9 million participation in a wholesale loan made by FCBT to one of its affiliated Associations and a $57.9 million wholesale loan to one of our affiliated Associations. Pursuant to our regulatory requirements, we classify our wholesale loans using the same credit rating methodology as is used with our commercial loans. Our loans to Associations are collateralized by substantially all of the Association assets. In addition, the earnings, capital and loan loss reserves of the Associations provide additional layers of protection against losses in their retail loan portfolios. While the Special Mention classifications primarily reflect internal control weaknesses at these Associations, some of which were material weaknesses, as a result of the collateralization and other mitigants described above, we do not anticipate any losses related to these wholesale loans. As of March 31, 2018, CoBank has not made any provision for loan loss or recorded any allowance for credit loss related to any of our wholesale loans.

We recorded a $50.0 million provision for loan losses in the first quarter of 2018 compared to $15.0 million during the 2017 period. The 2018 provision largely reflects increases in specific reserves associated with a small number of customers in our Agribusiness and Rural Infrastructure operating segments as well as increased exposure in the Agribusiness operating segment resulting from deterioration in credit quality and growth in average loan volume. The 2017 provision primarily reflected increased lending activity and slight deterioration in credit quality in our Agribusiness operating segment. Total loan recoveries, net of charge-offs, were $0.2 million for the first three months of 2018 compared to loan charge-offs, net of recoveries, of $0.4 million in the 2017 period. Nonaccrual loans increased to $325.8 million at March 31, 2018 from $246.8 million at December 31, 2017. The increase primarily resulted from credit quality deterioration impacting a small number of customers in our Agribusiness and Rural Infrastructure operating segments. Our total allowance for credit losses (ACL), which includes the allowance for loan losses and the reserve for unfunded commitments, was $721.0 million at March 31, 2018 compared to $670.8 million at December 31, 2017. Our ACL as a percent of total loans was 0.70 percent at March 31, 2018 and 0.68 percent at December 31, 2017. As a percent of non-guaranteed loans outstanding and excluding loans to Associations, our ACL was 1.32 percent at March 31, 2018 compared to 1.33 percent at December 31, 2017.

While the overall credit quality of our loan portfolio remains strong and has been favorable in recent years, we expect some continued deterioration due to an ongoing low agricultural commodity price environment and other factors impacting our customers. In addition, concentrations within our loan portfolio can cause the level of our loan quality, nonaccrual loans, charge-offs and provisions for loan losses or loan loss reversals to vary significantly from period to period.

### *Liquidity and Investments*

Our liquidity management objectives are to provide a reliable source of funding to borrowers, meet maturing debt obligations, provide additional liquidity if market conditions deteriorate and fund operations on a cost effective basis. While we believe that sufficient resources are available to meet liquidity management objectives through our debt maturity structure, holdings of liquid assets and access to the capital markets, the volatility of our loan volume and the cash flow requirements from our cash management program causes our liquidity needs to vary significantly from day to day.

One of the ways in which we measure and monitor our liquidity position is by assuming no ability to issue debt and calculating the number of days into the future we could meet maturing debt obligations by using available cash and eligible investments. System banks are required by regulation to maintain a minimum of 90 days of liquidity (cash and readily marketable investments generally discounted by 5 to 10 percent of market value) on a continuous basis and to establish an incremental liquidity reserve. At March 31, 2018 and December 31, 2017, our liquidity was 176 days.

We hold cash, investment securities, federal funds sold and other overnight funds primarily to maintain a liquidity reserve and manage short-term surplus funds. Cash, federal funds sold and other overnight funds totaled $1.0 billion and $2.3 billion as of March 31, 2018 and December 31, 2017, respectively. Our investment securities increased $2.5 billion to $29.4 billion at March 31, 2018 compared to $26.9 billion at December 31, 2017.

The table below summarizes our investment securities and related unrealized gains/(losses) by asset class.

**Investment Securities** ($ in Millions)

| | March 31, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| | Amortized Cost | Fair Value | Unrealized Gains/ (Losses) | Amortized Cost | Fair Value | Unrealized Gains/ (Losses) |
| Certificates of Deposit | $ 1,090 | $ 1,090 | $ - | $ 775 | $ 775 | $ - |
| U.S. Treasury Debt | 13,101 | 12,874 | (227) | 11,137 | 11,029 | (108) |
| U.S. Agency Debt | 3,199 | 3,173 | (26) | 3,369 | 3,356 | (13) |
| Residential Mortgage-Backed: | | | | | | |
| Ginnie Mae | 3,029 | 2,983 | (46) | 1,876 | 1,856 | (20) |
| U.S. Agency | 6,446 | 6,335 | (111) | 6,758 | 6,718 | (40) |
| FHA/VA Non-Wrapped Reperformer | 231 | 254 | 23 | 235 | 257 | 22 |
| Non-Agency | 17 | 17 | - | 26 | 29 | 3 |
| Commercial Mortgage-Backed: | | | | | | |
| U.S. Agency | 2,407 | 2,398 | (9) | 2,504 | 2,499 | (5) |
| Agricultural Mortgage-Backed: | | | | | | |
| Farmer Mac | 73 | 71 | (2) | 79 | 78 | (1) |
| Corporate Bonds | 40 | 40 | - | 40 | 40 | - |
| Asset-Backed and Other | 150 | 158 | 8 | 225 | 233 | 8 |
| **Total** | $ 29,783 | $ 29,393 | $ (390) | $ 27,024 | $ 26,870 | $ (154) |

Credit risk in our investment portfolio primarily exists in investment securities that are not guaranteed by the U.S. government or a government-sponsored enterprise (U.S. Agency), which include our certificates of deposit, FHA/VA non-wrapped reperformer mortgage-backed securities (i.e., investment securities where residential mortgage loans serving as collateral were cured after a default), non-agency mortgage-backed securities (MBS), corporate bonds and asset-backed securities (ABS). Excluding certificates of deposit, with which the counterparties carry the highest short-term credit rating, these securities collectively total $468.1 million (fair value) or 2 percent of our total investment securities as of March 31, 2018. Credit risk in our investment portfolio also arises from the inability of guarantors and third-party providers of other credit enhancements to meet their contractual obligations to us.

Pursuant to FCA regulations, certain securities must be excluded from our liquidity reserve, which would include certificates of deposit that no longer carry one of the two highest short-term credit ratings; non-agency MBS and ABS, which include our FHA/VA non-wrapped reperformer MBS that are no longer rated triple-A by at least one major rating agency; corporate bonds that no longer carry one of the two highest ratings by at least one major rating agency; and any investment whose market value is less than 80 percent of book value. As a result, as of March 31, 2018, $418.1 million of securities were not included in our liquidity reserve. Another $166.4 million of investment securities, including Federal Agricultural Mortgage Corporation (Farmer Mac) MBS, were not included in our liquidity reserve as of March 31, 2018, pursuant to regulation.

We recorded no impairment losses on investment securities during the first three months of 2018 and 2017. However, an increase in the level of defaults, foreclosures or modifications on residential mortgages, a decline in home prices or weak economic conditions may result in additional downward adjustments to the fair value of certain investment securities and the need to record future impairment losses against earnings.

During the three-month period ended March 31, 2018, we sold five non-agency debt securities with a combined book value of $8.0 million for total proceeds of $10.7 million. One of the non-agency MBS had been previously impaired and excluded from our liquidity reserve. These securities were sold to manage credit exposure and take advantage of favorable market conditions. The resulting gains from these sales of $2.7 million are recorded in Noninterest Income in the accompanying condensed consolidated statement of income for the three months ended March 31, 2018.

In the first quarter of 2017, we sold nine U.S. Agency debt securities with a combined book value of $1.6 billion as well as six non-agency MBS with a combined book value of $26.4 million. The U.S. Agency debt securities were sold to better position our overall investment portfolio. The non-agency MBS had been previously impaired and were excluded from our liquidity reserve, and were sold due to favorable market conditions. The resulting gains from these sales of $9.4 million are recorded in Noninterest Income in the accompanying condensed consolidated statement of income for the three months ended March 31, 2017.

As all of our investment securities are classified as "available for sale", we recognize changes in the fair value of our investment securities in accumulated other comprehensive income/(loss), a component of shareholders' equity, unless losses are credit-related and considered other-than-temporary, in which case that portion of the loss is recorded in earnings. We recorded unrealized losses of $235.5 million for the first three months of 2018, compared to unrealized gains of $24.2 million for the same prior-year period. The unrealized gains and losses recorded in both periods primarily reflect the impact of market interest rate changes on the fair value of fixed rate securities.

An additional source of liquidity is cash provided by our operating activities (primarily generated from net interest income in excess of operating expenses), which totaled $342.4 million and $214.1 million for the first three months of 2018 and 2017, respectively.

Notwithstanding the various sources of liquidity discussed above, if no other sources existed to repay maturing Federal Farm Credit Banks Consolidated Systemwide bonds, medium term notes and discount notes (collectively referred to as Systemwide Debt Securities), the assets of the Insurance Fund would be used to repay such debt.

The Insurance Corporation has an agreement with the Federal Financing Bank, a federal instrumentality subject to the supervision and direction of the U.S. Treasury, pursuant to which the Federal Financing Bank would advance funds to the Insurance Corporation. Under its existing statutory authority, the Insurance Corporation may use these funds to provide assistance to the System banks in exigent market circumstances that threaten the banks' ability to pay maturing debt obligations. The agreement provides for advances of up to $10 billion and terminates on September 30, 2018 unless otherwise renewed. The decision whether to seek funds from the Federal Financing Bank is at the discretion of the Insurance Corporation, and each funding obligation of the Federal Financing Bank is subject to various terms and conditions and, as a result, there can be no assurance that funding would be available if needed by the System.

### *Capital Resources*

We believe that a sound capital position is critical to our long-term financial success and future growth. Our shareholders' equity is composed of preferred and common stock, retained earnings and other comprehensive income/(loss), and totaled $9.0 billion at March 31, 2018, as compared to $9.1 billion at December 31, 2017. The decrease in stockholders' equity resulted from an increase in accumulated other comprehensive loss during the first three months of 2018 primarily resulting from changes in unrealized losses on investment securities driven by market interest rate changes.

At March 31, 2018 and December 31, 2017, our capital and leverage ratios exceeded regulatory minimums, as shown in the following table.

**Regulatory Capital Requirements and Ratios**

| | | March 31, 2018 | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| | Regulatory Minimums | Actual | Actual Buffer | Actual | Actual Buffer | Required Buffer |
| Common Equity Tier 1 Capital Ratio | 4.5 % | 11.37 % | 6.87 % | 11.67 % | 7.17 % | 2.5 % [1] |
| Tier 1 Capital Ratio | 6.0 | 13.54 | 7.54 | 13.97 | 7.97 | 2.5 [1] |
| Total Capital Ratio | 8.0 | 14.55 | 6.55 | 15.24 | 7.24 | 2.5 [1] |
| Tier 1 Leverage Ratio | 4.0 | 7.08 | 3.08 | 7.26 | 3.26 | 1.0 |
| Unallocated Retained Earnings (URE) and URE Equivalents Leverage Ratio | 1.5 | 2.80 | n/a | 2.96 | n/a | n/a |
| Permanent Capital Ratio | 7.0 | 13.68 | n/a | 14.29 | n/a | n/a |

[1] The capital conservation buffer is being phased in over three years, reaching its full value of 2.5 percent in 2020.

See pages 52 through 60 for more information on required regulatory capital disclosures, including the components of the ratios displayed above.

In April 2016, we redeemed all of our outstanding 7.875 percent subordinated notes due in 2018 totaling $404.7 million. The redemption price was 100 percent of the principal amount, together with accrued and unpaid interest up to, but excluding, the date of redemption. For information relating to a complaint filed by a number of investors who had held the 7.875 percent subordinated notes alleging CoBank impermissibly redeemed the subordinated notes, see Note 9 to the accompanying condensed consolidated financial statements.

We may from time to time seek to retire our outstanding debt or equity securities through calls, tender offers and/or exchanges, open market purchases, privately negotiated transactions or otherwise. We may also issue new debt or equity securities. Such calls, tender offers, exchanges, open market purchases or new issuances, if any, will depend on prevailing market conditions, the Bank's capital position and liquidity requirements, contractual restrictions, changes to capital regulations and other factors.

# Business Outlook

We operate in an environment that poses a number of challenges for the Bank and its customers. Although interest rates have increased recently, they remain low by historical standards and continue to limit returns on capital and investment securities. Monetary policy as established by the Federal Reserve and the policies of other central banks around the world could create further uncertainty regarding interest rates and asset valuations. The direction of the U.S. economic, trade and foreign policies remains uncertain. In particular, the imposition of tariffs and related reactions by governments around the world could lead to significant disruption in markets for agricultural products. Negotiations are underway to rewrite the North American Free Trade Agreement, the outcome of which could impact the U.S. economy and our customers. Competition for the business of our customers across most of the industries we serve continues to be intense. Agricultural commodity prices have remained relatively low due to strong global supplies and are subject to volatility driven by weather conditions, trade policies and other factors. Customers in many of the industries we serve are impacted by commodity prices and agricultural yields, fluctuations in the value of the U.S. dollar, weather, and ongoing political and regulatory uncertainty. Although the Farm Bill will remain in effect through fiscal year 2018, there is considerable uncertainty as to the content and timing of the next farm bill. Many of our power customers continue to be impacted by energy efficiency initiatives, price volatility of various fuel sources including coal and natural gas, changing regulation of carbon dioxide emissions, renewable energy standards and customer demand for distributed generation. Rapidly changing technology and customer demands create uncertainty in the communications industry. Although these challenges could reduce the credit quality and impact the level of loan demand in certain sectors of our loan portfolio, CoBank remains well-positioned to continue to serve as a dependable financial partner for our customers.

The enactment of the Tax Cuts and Jobs Act of 2017 (TCJA) in late December 2017 generated a one-time earnings benefit in 2017 and will lower our ongoing effective tax rate, which includes federal and state income taxes, in 2018 and beyond. Management and the Board of Directors are analyzing these significant changes to determine how best to maximize the value of realized and anticipated benefits for our customer-owners and other stakeholders.

We continue to focus on delivering the credit and financial services our customers need to compete, grow and achieve business success, enhancing our enterprise risk management capabilities and maintaining our financial strength. In addition, we continue to collaborate with our affiliated Associations to enhance our business models to further our collective mission. We believe that our strong liquidity and capital will continue to provide the capacity to support customers in all market conditions. We also believe that paying patronage is an important part of our value proposition as it effectively lowers the net cost of borrowing for our customer-owners. We continue our disciplined approach to managing risk and monitoring asset quality. We also continue to make prudent investments in our people, processes, data infrastructure and technology, including enhancing our digital banking capabilities, to strengthen the value and improve the experience we provide to our customers.

Under the guidance of our Board of Directors and through the focus of an experienced executive management team, we expect to achieve continued success through execution of our business strategies. This includes, among other objectives, creating mutually beneficial partnerships with other System institutions, maintaining effective access to the agency debt capital markets, educating policy makers and other key stakeholders of the critical mission of CoBank and the System, prudently optimizing current lending authorities and maintaining compliance with laws and regulations. We continue to explore strategic alliances and other opportunities with our customers, other System institutions, financial service providers and other public and private entities as we strive to better fulfill our mission in rural America in a safe and sound manner.

## Forward-Looking Statements

Certain of the statements contained in this quarterly report that are not historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Our actual results may differ materially from those included in the forward-looking statements that relate to our plans, projections, expectations and intentions. Forward-looking statements are typically identified by words such as “believe,” “expect,” “anticipate,” “intend,” “estimate,” “plan,” “project,” “may,” “will,” “should,” “would,” “could” or similar expressions. Although we believe that the information expressed or implied in such forward-looking statements is reasonable, we can give no assurance that such projections and expectations will be realized or the extent to which a particular plan, projection or expectation may be realized. These forward-looking statements are based on current knowledge and are subject to various risks and uncertainties, including, but not limited to:

- Changes in economic, marketplace or regulatory environments that negatively impact the agricultural, power, communications, water and leasing industries;
- The level of interest rates and relationships between various interest rate indices and actions taken by the Federal Reserve to manage the monetary policy of the United States;
- Currency fluctuations that impact the value of the U.S. dollar in global markets;
- Adverse food safety and weather events, disease, and other unfavorable conditions that periodically occur and impact agricultural productivity and income;
- Changes in levels of global crop production, exports, usage and inventories;
- Credit performance of the loan portfolio;
- Performance of underlying collateral, including farmland values and specialized property that secures rural infrastructure credits;

- Loan portfolio growth and seasonal factors;
- Weak U.S. economic conditions;
- Weaknesses in other developed and emerging economies;
- Government policies and political developments in the United States and other countries in which we do business;
- Geopolitical uncertainties throughout the world that may impact the industries we lend to, or, economic, fiscal or monetary conditions;
- Changes in the U.S. government's support of the System, the agricultural industry, agricultural exports, rural infrastructure and rural economies;
- Legislative or regulatory actions that affect current and ongoing operations of the System or the banking, financial services, agricultural, power, communications, water and leasing industries;
- Legislative or regulatory actions that affect our relationships with our employees;
- Actions taken by the U.S. Congress relative to other government-sponsored enterprises, including the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), the Federal Home Loan Banks and Farmer Mac;
- Actions taken by the U.S. government to manage U.S. immigration or fiscal policies;
- Government trade policies in the United States and other countries, including tariffs and other restrictions that impact markets for agricultural and other products;
- Changes impacting the Bank or its customers as a result of the implementation of the TCJA;
- A decrease in the credit outlook or ratings of U.S. government debt and agency debt, including Systemwide Debt Securities;
- Cybersecurity risks, including a failure or breach of our operational or security systems or infrastructure, that could adversely affect our business, financial performance and reputation;
- Disruptive technologies impacting the banking and financial services industries or implemented by our competitors which negatively impact our ability to compete in the marketplace;
- Changes in assumptions underlying the valuations of financial instruments;
- Changes in the bases for our estimates underlying the allowance for credit losses;
- Failure of our investment portfolio to perform as expected or deterioration in the credit quality of such investments;
- The resolution of legal proceedings and related matters;
- Environmental-related conditions or laws impacting our lending activities;
- Nonperformance by counterparties under our derivative and vendor contracts;
- Reform and regulation which impacts LIBOR and other benchmark interest rates; and
- Our ability to continue to partner with various System and other entities in light of ongoing consolidation within the System and the industries we serve.

We expressly disclaim any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

# Condensed Consolidated Balance Sheets

**CoBank, ACB**

($ in Thousands)

| | March 31, 2018 (Unaudited) | December 31, 2017 |
|---|---|---|
| **Assets** | | |
| Total Loans | **$ 102,285,364** | $ 99,265,505 |
| Less: Allowance for Loan Losses | **645,317** | 576,927 |
| Net Loans | **101,640,047** | 98,688,578 |
| Cash and Cash Equivalents | **128,049** | 1,313,620 |
| Federal Funds Sold and Other Overnight Funds | **895,000** | 1,035,000 |
| Investment Securities | **29,393,485** | 26,870,378 |
| Interest Rate Swaps and Other Financial Instruments | **234,321** | 180,845 |
| Accrued Interest Receivable and Other Assets | **1,110,671** | 1,122,392 |
| **Total Assets** | **$ 133,401,573** | $ 129,210,813 |
| **Liabilities** | | |
| Bonds and Notes | **$ 123,158,405** | $ 118,406,283 |
| Interest Rate Swaps and Other Financial Instruments | **149,608** | 86,732 |
| Reserve for Unfunded Commitments | **75,722** | 93,865 |
| Accrued Interest Payable and Other Liabilities | **1,041,817** | 1,563,856 |
| **Total Liabilities** | **$ 124,425,552** | $ 120,150,736 |
| Commitments and Contingent Liabilities (Note 9) | | |
| **Shareholders' Equity** | | |
| Preferred Stock | **1,500,000** | 1,500,000 |
| Common Stock | **3,240,291** | 3,240,445 |
| Unallocated Retained Earnings | **4,696,005** | 4,551,600 |
| Accumulated Other Comprehensive Loss | **(460,275)** | (231,968) |
| **Total Shareholders' Equity** | **$ 8,976,021** | $ 9,060,077 |
| **Total Liabilities and Shareholders' Equity** | **$ 133,401,573** | $ 129,210,813 |

*The accompanying notes are an integral part of the condensed consolidated financial statements.*

# Condensed Consolidated Statements of Income
**CoBank, ACB**

($ in Thousands) (Unaudited)

| | For the Three Months Ended March 31, | |
|---|---|---|
| | **2018** | **2017** |
| **Interest Income** | | |
| Loans | **$ 773,870** | $ 614,340 |
| Investment Securities, Federal Funds Sold and Other Overnight Funds | **154,859** | 123,780 |
| Total Interest Income | **928,729** | 738,120 |
| **Interest Expense** | **557,688** | 382,006 |
| Net Interest Income | **371,041** | 356,114 |
| Provision for Loan Losses | **50,000** | 15,000 |
| Net Interest Income After Provision for Loan Losses | **321,041** | 341,114 |
| **Noninterest Income/(Expense)** | | |
| Net Fee Income | **20,969** | 23,542 |
| Patronage Income | **16,253** | 16,101 |
| Prepayment Income | **1,394** | 2,832 |
| Losses on Early Extinguishments of Debt | **(5,554)** | (2,007) |
| Gains on Sale of Investment Securities | **2,710** | 9,387 |
| Other, Net | **45,650** | 5,183 |
| Total Noninterest Income | **81,422** | 55,038 |
| **Operating Expenses** | | |
| Employee Compensation | **41,822** | 40,537 |
| Insurance Fund Premium | **13,529** | 21,505 |
| Information Services | **8,715** | 8,659 |
| General and Administrative | **5,367** | 7,047 |
| Occupancy and Equipment | **3,645** | 3,477 |
| Farm Credit System Related | **4,401** | 4,166 |
| Purchased Services | **2,068** | 2,070 |
| Other | **5,081** | 5,262 |
| Total Operating Expenses | **84,628** | 92,723 |
| Income Before Income Taxes | **317,835** | 303,429 |
| Provision for Income Taxes | **33,423** | 40,621 |
| **Net Income** | **$ 284,412** | $ 262,808 |

*The accompanying notes are an integral part of the condensed consolidated financial statements.*

# Condensed Consolidated Statements of Comprehensive Income
**CoBank, ACB**

($ in Thousands) (Unaudited)

| | For the Three Months Ended March 31, | |
|---|---|---|
| | **2018** | **2017** |
| **Net Income** | **$ 284,412** | $ 262,808 |
| **Other Comprehensive (Loss)/Income, Net of Tax**: | | |
| Net Change in Unrealized (Losses)/Gains on Investment Securities Not Other-Than-Temporarily Impaired | **(214,049)** | 25,270 |
| Net Change in Unrealized Gains/(Losses) on Other-Than-Temporarily Impaired Investment Securities | **45** | (3,426) |
| Net Change in Unrealized Gains/(Losses) on Interest Rate Swaps and Other Financial Instruments | **10,846** | (1,924) |
| Net Pension Adjustment | **1,465** | 820 |
| **Other Comprehensive (Loss)/Income** | **(201,693)** | 20,740 |
| **Comprehensive Income** | **$ 82,719** | $ 283,548 |

*The accompanying notes are an integral part of the condensed consolidated financial statements.*

# Condensed Consolidated Statements of Changes in Shareholders' Equity
**CoBank, ACB**

($ in Thousands) (Unaudited)

| For the Three Months Ended March 31, | 2018 | 2017 |
|---|---|---|
| **Balance at Beginning of Period** | **$ 9,060,077** | $ 8,573,758 |
| Comprehensive Income | **82,719** | 283,548 |
| Preferred Stock: | | |
| Dividends | **(21,426)** | (21,046) |
| Common Stock: | | |
| Issuances | **9** | 20 |
| Retirements | **(31,084)** | (25,819) |
| Cash Patronage Accrued | **(114,274)** | (122,527) |
| **Balance at End of Period** | **$ 8,976,021** | $ 8,687,934 |

*The accompanying notes are an integral part of the condensed consolidated financial statements.*

# Condensed Consolidated Statements of Cash Flows
**CoBank, ACB**

($ in Thousands) (Unaudited)

| For the Three Months Ended March 31, | 2018 | 2017 |
|---|---|---|
| **Cash Flows Provided by Operating Activities** | | |
| Net Income | $ 284,412 | $ 262,808 |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: | | |
| Provision for Loan Losses | 50,000 | 15,000 |
| Deferred Income Taxes | (25,441) | (32,037) |
| Depreciation and Amortization/Accretion, Net | 2,639 | 7,267 |
| Losses on Early Extinguishments of Debt | 5,554 | 2,007 |
| Net Gains on Sales of Investment Securities | (2,710) | (9,387) |
| Decrease in Accrued Interest Receivable and Other Assets | 106,686 | 138,211 |
| Decrease in Accrued Interest Payable and Other Liabilities | (57,890) | (162,491) |
| Net Gains on Interest Rate Swaps and Other Financial Instruments | (20,396) | (6,419) |
| Payments for Termination of Interest Rate Swaps | - | (395) |
| Other | (420) | (474) |
| Net Cash Provided by Operating Activities | 342,434 | 214,090 |
| **Cash Flows Used in Investing Activities** | | |
| Net Increase in Loans | (3,029,548) | (1,669,946) |
| Net Increase in Investment Securities | (2,889,157) | (1,474,270) |
| Net Decrease/(Increase) in Federal Funds Sold and Other Overnight Funds | 140,000 | (270,000) |
| Net Cash Used in Investing Activities | (5,778,705) | (3,414,216) |
| **Cash Flows Provided by Financing Activities** | | |
| Net Issuances of Bonds and Notes | 4,796,966 | 2,260,827 |
| Payments on Early Extinguishments of Debt | (5,554) | (2,007) |
| Net Retirements of Common Stock | (31,075) | (25,799) |
| Cash Patronage Distribution Paid | (494,220) | (471,623) |
| Preferred Stock Dividends Paid | (15,417) | (15,142) |
| Net Cash Provided by Financing Activities | 4,250,700 | 1,746,256 |
| Net Decrease in Cash | (1,185,571) | (1,453,870) |
| Cash at Beginning of Period | 1,313,620 | 1,660,517 |
| Cash at End of Period | $ 128,049 | $ 206,647 |
| **Supplemental Disclosures:** | | |
| **Schedule of Noncash Investing and Financing Activities** | | |
| Net Change in Accrued Securities Purchases | $ 39,615 | $ 99,247 |
| Net Change in Receivables from Sale of Investment Securities | 99,816 | (16,290) |
| Net Change in Unrealized (Losses)/Gains on Investment Securities, Before Taxes | (235,517) | 24,166 |
| Net Change in Unrealized Gains/(Losses) on Interest Rate Swaps, Other Financial Instruments and Hedged Items, Before Taxes | 10,893 | (2,375) |
| Patronage in Common Stock | 30,921 | 29,574 |
| Reclassification of Stranded Tax Effects from Accumulated Other Comprehensive Income to Retained Earnings (Refer to Note 2) | 26,614 | - |
| Reclassification of Collateral Assets to an Offset of the Fair Value of Interest Rate Swaps and Other Financial Instruments | - | 70,415 |

*The accompanying notes are an integral part of the condensed consolidated financial statements.*

# Notes to Condensed Consolidated Financial Statements

**CoBank, ACB**

*(Unaudited) ($ in Thousands, Except Share and Per Share Amounts and as Noted)*

## Note 1 – Organization, Lending Authority and Significant Accounting Policies

The accompanying condensed consolidated financial statements include the accounts of CoBank, ACB and its wholly-owned subsidiaries, CoBank, FCB and Farm Credit Leasing Services Corporation (FCL), collectively hereinafter referred to as CoBank or the Bank. All material inter-company accounts and transactions have been eliminated. In our opinion, all adjustments considered necessary for a fair presentation of the interim financial condition, results of operations and cash flows have been made. These adjustments are of a normal recurring nature, unless otherwise disclosed. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted.

CoBank is a member of the Farm Credit System (System). We provide loans, leases and other financial services to support agriculture, rural infrastructure and rural communities across the United States. We are cooperatively owned by our eligible U.S. customers. Our customers consist of agricultural cooperatives; other food and agribusiness companies; rural power, communications and water cooperatives and companies; rural community facilities; Agricultural Credit Associations (Associations), which are regulated, farmer-owned financial institutions and members of the System; and other businesses that serve agriculture and rural communities.

These unaudited quarterly condensed consolidated financial statements should be read in conjunction with the 2017 Annual Report, which includes a description of our organization and lending authority. Also included in the 2017 Annual Report is a summary of significant accounting policies. These quarterly condensed consolidated financial statements have been prepared in accordance with these same accounting policies. Certain reclassifications have been made to amounts reported in previous periods to conform to the 2018 presentation.

CoBank is the funding bank for certain System Associations, which are collectively referred to as our “affiliated Associations.” The accompanying condensed consolidated financial statements exclude financial information of our affiliated Associations. CoBank and our affiliated Associations are collectively referred to as the “District.” We separately publish certain unaudited combined financial information of the District, including a condensed statement of condition and statement of income, which can be found on our website at www.cobank.com. Such information is not incorporated by reference into, and should not be considered part of, this quarterly report. Additional information about our affiliated Associations and District financial information is contained in Note 11 to these condensed consolidated financial statements.

Copies of CoBank’s financial reports are available on request by calling or visiting one of our banking center locations and through our website at www.cobank.com. Copies of financial reports of our affiliated Associations and the System are available on their respective websites.

We have evaluated subsequent events through May 10, 2018, which is the date the financial statements were issued.

## Note 2 – Recently Issued or Adopted Accounting Pronouncements

New U.S. tax laws resulting from legislation commonly known as the Tax Cuts and Jobs Act of 2017 (TCJA) were enacted in late 2017. Among other things, the TCJA reduced the federal corporate tax rate from 35 percent to 21 percent. In accordance with accounting principles generally accepted in the United States of America (GAAP), the change to a lower corporate tax rate led to a remeasurement of our deferred tax liabilities and deferred tax assets in the period of enactment (2017). For deferred tax amounts originally recorded in accumulated other comprehensive income/(loss), this remeasurement resulted in a disproportionate effect of $26.6 million which remained "stranded" in accumulated other comprehensive loss as of December 31, 2017. In February 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU), "Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." The new guidance provides entities the option to reclassify the stranded tax effects of the TCJA from accumulated other comprehensive income/(loss) to retained earnings. For all entities, this guidance becomes effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. We elected to early adopt this guidance, as permitted by the standard. As a result, the stranded tax effect was reclassified at the beginning of the first quarter of 2018 resulting in increases to accumulated other comprehensive loss and retained earnings of $26.6 million. The Bank utilizes the item-by-item approach for releasing income tax effects from accumulated other comprehensive income. The reclassification by component of accumulated other comprehensive loss is presented in Note 5.

In August 2017, the FASB issued ASU, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities." The new guidance will make more financial and non-financial hedging strategies eligible for hedge accounting. It also amends the presentation and disclosure requirements and changes how companies assess effectiveness. It is intended to more closely align hedge accounting with companies' risk management strategies, simplify the application of hedge accounting, and increase transparency as to the scope and results of hedging programs. For public business entities, the ASU becomes effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The new guidance may be adopted immediately, provided that all of the amendments are adopted as of the beginning of the year. We are reviewing the guidance to determine the effect on our financial position and results of operations.

In August 2016, the FASB issued ASU, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments." The ASU is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. The guidance addresses, among other issues, the presentation of debt prepayment or extinguishment costs and settlement of zero-coupon debt instruments in the statement of cash flows. We adopted this standard in the first quarter of 2018. While the adoption did not have a significant impact on our statement of cash flows as a whole, the classification of certain transactions changed as a result of this guidance. Specifically, payments on early extinguishments of debt are now presented within financing activities whereas such cash outflows were previously captured within operating activities. In addition, upon settlement of our discount notes, which are zero-coupon debt instruments, the portion of the cash payment attributed to the accreted interest related to the debt discount has been classified as a cash outflow within operating activities whereas previously this outflow was classified as a financing activity. The adoption of this standard resulted in a decrease in net cash provided by operating activities of $46.4 million and $19.7 million during the three months ended March 31, 2018 and 2017, respectively. This impact is fully offset by the corresponding increase in net cash provided by financing activities resulting from the changes in classification. The adoption of this guidance did not impact our financial condition or results of operations.

In June 2016, the FASB issued ASU, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The ASU introduces a new model for recognizing credit losses on financial instruments based on an estimate of current expected credit losses. The new model will apply to: (1) loans, accounts receivable, trade receivables, and other financial assets measured at amortized cost; (2) loan commitments and certain other off-balance sheet credit exposures; (3) debt securities and other financial assets measured at fair value through other comprehensive income/(loss); and (4) beneficial interests in securitized financial assets. For public business entities that are not U.S. Securities and Exchange Commission filers the ASU becomes effective in fiscal years beginning after December 15, 2020, including interim periods within those fiscal years, and early application is permitted. We are reviewing the guidance to determine the effect on our consolidated financial position and results of operations.

In February 2016, the FASB issued ASU, “Leases.” This guidance is intended to improve financial reporting about leasing transactions and affects all organizations that lease assets. The ASU will require organizations that lease assets, referred to as lessees, to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. The accounting for organizations that own the assets leased by the lessee, also known as lessor accounting, will remain largely unchanged from current GAAP. This guidance becomes effective for interim and annual periods beginning after December 15, 2018, and early application is permitted. Based on our preliminary review and analysis, the new lease accounting guidance will have an insignificant impact on our consolidated financial condition and results of operations, and will have no impact on our cash flows.

In January 2016, the FASB issued ASU, “Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities.” The guidance affects, among other things, the presentation and disclosure requirements for financial instruments. For public entities, the ASU eliminates the requirement to disclose the methods and significant assumptions used to estimate the fair value of financial instruments carried at amortized cost. The guidance becomes effective for the first interim reporting period within the annual reporting periods after December 15, 2017. We adopted this guidance in the first quarter of 2018 and therefore certain previous disclosures have been eliminated from Note 7. The adoption of this guidance did not have a material effect on our consolidated financial position, results of operations or cash flows.

In May 2014, the FASB issued guidance entitled “Revenue from Contracts with Customers.” The guidance governs revenue recognition from contracts with customers and requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Financial instruments and other contractual rights within the scope of other guidance issued by the FASB are excluded from the scope of this new revenue recognition guidance. As such, the substantial majority of our contracts are excluded from the scope of this new guidance. The guidance became effective for the first interim reporting period within the annual reporting periods after December 15, 2017. We adopted this standard in the first quarter of 2018. The adoption of this guidance did not have a material impact on our consolidated financial position, results of operations or cash flows.

# Note 3 – Loans, Loan Quality and Allowance for Credit Losses

### *Loans Outstanding*

Loans outstanding by operating segment are shown below.

($ in Millions)

| | March 31, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| Agribusiness | $ | **34,409** | $ | 30,304 |
| Strategic Relationships | | **46,848** | | 47,948 |
| Rural Infrastructure | | **21,028** | | 21,014 |
| **Total** | $ | **102,285** | $ | 99,266 |

### *Allowance for Credit Losses*

The following tables present the changes in the components of our allowance for credit losses and details of ending balances. The allowance for credit losses includes the allowance for loan losses and the reserve for unfunded commitments. The elements of our allowance for credit losses are presented by operating segment.

| | Agribusiness | Strategic Relationships[1] | Rural Infrastructure | Total |
|---|---|---|---|---|
| **March 31, 2018** | | | | |
| **Allowance for Loan Losses** | | | | |
| Beginning Balance at January 1, 2018 | $ 411,078 | $ - | $ 165,849 | $ 576,927 |
| Charge-offs | (640) | - | (11) | (651) |
| Recoveries | 868 | - | 30 | 898 |
| Provision for Loan Losses | 47,000 | - | 3,000 | 50,000 |
| Transfers from Reserve for Unfunded Commitments[2] | 15,347 | - | 2,796 | 18,143 |
| Ending Balance at March 31, 2018 | 473,653 | - | 171,664 | 645,317 |
| **Reserve for Unfunded Commitments** | | | | |
| Beginning Balance at January 1, 2018 | 68,826 | - | 25,039 | 93,865 |
| Transfers to Allowance for Loan Losses[2] | (15,347) | - | (2,796) | (18,143) |
| Ending Balance at March 31, 2018 | 53,479 | - | 22,243 | 75,722 |
| **Allowance for Credit Losses** | $ 527,132 | $ - | $ 193,907 | $ 721,039 |
| **Allowance for Credit Losses** | | | | |
| Ending Balance, Allowance for Credit Losses Related to Loans: | | | | |
| Individually Evaluated for Impairment | $ 73,715 | $ - | $ 21,233 | $ 94,948 |
| Collectively Evaluated for Impairment | 453,417 | - | 172,674 | 626,091 |
| **Total** | $ 527,132 | $ - | $ 193,907 | $ 721,039 |
| **Loans** | | | | |
| Ending Balance for Loans and Related Accrued Interest: | | | | |
| Individually Evaluated for Impairment | $ 270,965 | $ 46,951,099 | $ 54,832 | $ 47,276,896 |
| Collectively Evaluated for Impairment | 34,270,166 | - | 21,059,699 | 55,329,865 |
| **Total** | $ 34,541,131 | $ 46,951,099 | $ 21,114,531 | $ 102,606,761 |

(1) As a result of a strong collateral position with respect to loans to Associations, along with the earnings, capital and loss reserves of Associations that serve as an additional layer of protection against losses, no allowance for credit losses is recorded in our Strategic Relationships operating segment.

(2) These transfers generally occur as a result of advances on or repayments of seasonal lines of credit or other loans.

| | Agribusiness | Strategic Relationships[1] | Rural Infrastructure | Total |
|---|---|---|---|---|
| **March 31, 2017** | | | | |
| **Allowance for Loan Losses** | | | | |
| Beginning Balance at January 1, 2017 | $ 393,548 | $ - | $ 165,426 | $ 558,974 |
| Charge-offs | (746) | - | - | (746) |
| Recoveries | 344 | - | - | 344 |
| Provision for Loan Losses | 13,000 | - | 2,000 | 15,000 |
| Transfers from (to) Reserve for Unfunded Commitments[2] | 9,380 | - | (2,212) | 7,168 |
| Ending Balance at March 31, 2017 | 415,526 | - | 165,214 | 580,740 |
| **Reserve for Unfunded Commitments** | | | | |
| Beginning Balance at January 1, 2017 | 76,737 | - | 26,759 | 103,496 |
| Transfers (to) from Allowance for Loan Losses[2] | (9,380) | - | 2,212 | (7,168) |
| Ending Balance at March 31, 2017 | 67,357 | - | 28,971 | 96,328 |
| **Allowance for Credit Losses** | $ 482,883 | $ - | $ 194,185 | $ 677,068 |
| **Allowance for Credit Losses** | | | | |
| Ending Balance, Allowance for Credit Losses Related to Loans: | | | | |
| Individually Evaluated for Impairment | $ 26,313 | $ - | $ - | $ 26,313 |
| Collectively Evaluated for Impairment | 456,570 | - | 194,185 | 650,755 |
| **Total** | $ 482,883 | $ - | $ 194,185 | $ 677,068 |
| **Loans** | | | | |
| Ending Balance for Loans and Related Accrued Interest: | | | | |
| Individually Evaluated for Impairment | $ 188,253 | $ 45,544,334 | $ - | $ 45,732,587 |
| Collectively Evaluated for Impairment | 30,875,514 | - | 20,561,141 | 51,436,655 |
| **Total** | $ 31,063,767 | $ 45,544,334 | $ 20,561,141 | $ 97,169,242 |

[1] As a result of a strong collateral position with respect to loans to Associations, along with the earnings, capital and loss reserves of Associations that serve as an additional layer of protection against losses, no allowance for credit losses is recorded in our Strategic Relationships operating segment.

[2] These transfers generally occur as a result of advances on or repayments of seasonal lines of credit or other loans.

The information in the tables under the Credit Quality, Aging Analysis and Impaired Loans captions is presented by operating segment, with guaranteed and non-guaranteed loans in our Agribusiness segment separately identified.

### *Credit Quality*

The following table presents our loans and accrued interest, classified by management pursuant to our regulator's Uniform Loan Classification System.

| March 31, 2018 | Agribusiness Non-Guaranteed | Agribusiness Guaranteed | Strategic Relationships | Rural Infrastructure | Total |
|---|---|---|---|---|---|
| Acceptable | **$ 31,491,524** | **$ 930,361** | **$ 46,422,272** | **$ 20,629,316** | **$ 99,473,473** |
| Special Mention | **1,204,169** | **-** | **528,827** | **370,882** | **2,103,878** |
| Substandard | **901,563** | **-** | **-** | **114,333** | **1,015,896** |
| Doubtful | **13,514** | **-** | **-** | **-** | **13,514** |
| Loss | **-** | **-** | **-** | **-** | **-** |
| **Total** | **$ 33,610,770** | **$ 930,361** | **$ 46,951,099** | **$ 21,114,531** | **$ 102,606,761** |
| **December 31, 2017** | | | | | |
| Acceptable | $ 27,452,294 | $ 998,215 | $ 47,581,031 | $ 20,765,915 | $ 96,797,455 |
| Special Mention | 1,076,344 | - | 470,780 | 222,166 | 1,769,290 |
| Substandard | 878,047 | - | - | 116,082 | 994,129 |
| Doubtful | 4,240 | - | - | - | 4,240 |
| Loss | - | - | - | - | - |
| **Total** | $ 29,410,925 | $ 998,215 | $ 48,051,811 | $ 21,104,163 | $ 99,565,114 |

### *Aging Analysis*

The following table presents an aging of past due loans and accrued interest.

| March 31, 2018 | Agribusiness Non-Guaranteed | Agribusiness Guaranteed | Strategic Relationships | Rural Infrastructure | Total |
|---|---|---|---|---|---|
| 30-89 Days Past Due | **$ 40,940** | **$ -** | **$ -** | **$ -** | **$ 40,940** |
| 90 Days Past Due | **9,296** | **-** | **-** | **-** | **9,296** |
| **Total Past Due** | **$ 50,236** | **$ -** | **$ -** | **$ -** | **$ 50,236** |
| Current | **33,560,534** | **930,361** | **46,951,099** | **21,114,531** | **102,556,525** |
| **Total** | **$ 33,610,770** | **$ 930,361** | **$ 46,951,099** | **$ 21,114,531** | **$ 102,606,761** |
| **Accruing Loans 90 Days or More Past Due** | **$ 427** | **$ -** | **$ -** | **$ -** | **$ 427** |
| **December 31, 2017** | | | | | |
| 30-89 Days Past Due | $ 33,503 | $ - | $ - | $ - | $ 33,503 |
| 90 Days Past Due | 14,190 | - | - | - | 14,190 |
| **Total Past Due** | $ 47,693 | $ - | $ - | $ - | $ 47,693 |
| Current | 29,363,232 | 998,215 | 48,051,811 | 21,104,163 | 99,517,421 |
| **Total** | $ 29,410,925 | $ 998,215 | $ 48,051,811 | $ 21,104,163 | $ 99,565,114 |
| **Accruing Loans 90 Days or More Past Due** | $ 670 | $ - | $ - | $ - | $ 670 |

### *Impaired Loans*

Impaired loan information is shown in the following table. Loans past due 90 days or more and still accruing interest are adequately secured and in the process of collection.

| March 31, 2018 | Agribusiness Non-Guaranteed | Agribusiness Guaranteed[1] | Strategic Relationships[1] | Rural Infrastructure | Total |
|---|---|---|---|---|---|
| Nonaccrual Loans[2] | **$ 270,965** | **$ -** | **$ -** | **$ 54,832** | **$ 325,797** |
| Accruing Loans 90 Days or More Past Due | **427** | **-** | **-** | **-** | **427** |
| Accruing Restructured Loans | **-** | **-** | **-** | **-** | **-** |
| **Total Impaired Loans** | **$ 271,392** | **$ -** | **$ -** | **$ 54,832** | **$ 326,224** |
| **December 31, 2017** | | | | | |
| Nonaccrual Loans[2] | $ 212,980 | $ - | $ - | $ 33,857 | $ 246,837 |
| Accruing Loans 90 Days or More Past Due | 670 | - | - | - | 670 |
| Accruing Restructured Loans | - | - | - | - | - |
| **Total Impaired Loans** | $ 213,650 | $ - | $ - | $ 33,857 | $ 247,507 |

[1] There were no impaired loans in our Agribusiness Guaranteed or Strategic Relationships portfolios for any of the periods presented.

[2] At March 31, 2018, none of our nonaccrual loans qualified as Troubled Debt Restructurings. Included in nonaccrual loans at December 31, 2017 were $17.3 million of loans that qualified as troubled debt restructurings.

The following tables present information on impaired loans and related amounts in the allowance for loan losses.

| March 31, 2018 | Agribusiness Non-Guaranteed | Agribusiness Guaranteed[1] | Strategic Relationships[1] | Rural Infrastructure | Total |
|---|---|---|---|---|---|
| **Impaired Loans With No Related Allowance for Loan Losses** | | | | | |
| Carrying Amount | **$ 96,202** | **$ -** | **$ -** | **$ -** | **$ 96,202** |
| Unpaid Principal | **107,022** | **-** | **-** | **-** | **107,022** |
| Average Balance | **90,887** | **-** | **-** | **-** | **90,887** |
| Interest Income Recognized | **1,736** | **-** | **-** | **908** | **2,644** |
| **Impaired Loans With Related Allowance for Loan Losses** | | | | | |
| Carrying Amount | **175,190** | **-** | **-** | **54,832** | **230,022** |
| Unpaid Principal | **183,735** | **-** | **-** | **56,911** | **240,646** |
| Allowance for Loan Losses | **73,715** | **-** | **-** | **21,233** | **94,948** |
| Average Balance | **122,898** | **-** | **-** | **34,843** | **157,741** |
| Interest Income Recognized | **1,784** | **-** | **-** | **-** | **1,784** |
| **Total Impaired Loans** | | | | | |
| Carrying Amount | **271,392** | **-** | **-** | **54,832** | **326,224** |
| Unpaid Principal | **290,757** | **-** | **-** | **56,911** | **347,668** |
| Allowance for Loan Losses | **73,715** | **-** | **-** | **21,233** | **94,948** |
| Average Balance | **213,785** | **-** | **-** | **34,843** | **248,628** |
| Interest Income Recognized | **3,520** | **-** | **-** | **908** | **4,428** |

[1] There were no impaired loans in our Agribusiness Guaranteed or Strategic Relationships portfolios for any of the periods presented.

| December 31, 2017 | Agribusiness Non-Guaranteed | Agribusiness Guaranteed[(1)] | Strategic Relationships[(1)] | Rural Infrastructure | Total |
|---|---|---|---|---|---|
| **Impaired Loans With No Related Allowance for Loan Losses** | | | | | |
| Carrying Amount | $ 99,838 | $ - | $ - | $ - | $ 99,838 |
| Unpaid Principal | 141,715 | - | - | - | 141,715 |
| Average Balance | 102,234 | - | - | 9,277 | 111,511 |
| Interest Income Recognized | 2,487 | - | - | 4,118 | 6,605 |
| **Impaired Loans With Related Allowance for Loan Losses** | | | | | |
| Carrying Amount | 113,812 | - | - | 33,857 | 147,669 |
| Unpaid Principal | 122,027 | - | - | 34,841 | 156,868 |
| Allowance for Loan Losses | 36,556 | - | - | 8,300 | 44,856 |
| Average Balance | 111,929 | - | - | 7,206 | 119,135 |
| Interest Income Recognized | 49 | - | - | - | 49 |
| **Total Impaired Loans** | | | | | |
| Carrying Amount | 213,650 | - | - | 33,857 | 247,507 |
| Unpaid Principal | 263,742 | - | - | 34,841 | 298,583 |
| Allowance for Loan Losses | 36,556 | - | - | 8,300 | 44,856 |
| Average Balance | 214,163 | - | - | 16,483 | 230,646 |
| Interest Income Recognized | 2,536 | - | - | 4,118 | 6,654 |

(1) There were no impaired loans in our Agribusiness Guaranteed or Strategic Relationships portfolios for any of the periods presented.

***Commitments on Impaired Loans***

There were $29.4 million in commitments available to be drawn by borrowers whose loans were classified as impaired at March 31, 2018.

***Troubled Debt Restructurings***

Troubled debt restructurings (TDRs) are loans in which we have granted a concession because the borrower is experiencing financial difficulty. Concessions may include payment deferrals, term extensions and/or interest rate reductions. TDRs classified as nonaccrual loans, along with other impaired loans, may be returned to accruing status upon meeting specific criteria, as more fully described in our 2017 Annual Report. During the three months ended March 31, 2018 and 2017, there were no modifications that qualified as TDRs. At March 31, 2018, none of our nonaccrual loans qualified as TDRs. Included in nonaccrual loans at December 31, 2017 were $17.3 million of loans that qualified as TDRs.

## Note 4 – Investment Securities

A summary of the amortized cost and fair value of investment securities available-for-sale is as follows:

($ in Millions)

| March 31, 2018 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Certificates of Deposit | $ 1,090 | $ - | $ - | $ 1,090 |
| U.S. Treasury Debt | 13,101 | - | (227) | 12,874 |
| U.S. Agency Debt | 3,199 | 2 | (28) | 3,173 |
| Residential Mortgage-Backed Securities (MBS): | | | | |
| Ginnie Mae | 3,029 | 2 | (48) | 2,983 |
| U.S. Agency | 6,446 | 5 | (116) | 6,335 |
| FHA/VA Non-Wrapped Reperformer | 231 | 23 | - | 254 |
| Non-Agency | 17 | - | - | 17 |
| Commercial MBS: | | | | |
| U.S. Agency | 2,407 | 4 | (13) | 2,398 |
| Agricultural MBS: | | | | |
| Farmer Mac | 73 | - | (2) | 71 |
| Corporate Bonds | 40 | - | - | 40 |
| Asset-Backed and Other | 150 | 8 | - | 158 |
| **Total** | $ 29,783 | $ 44 | $ (434) | $ 29,393 |

($ in Millions)

| December 31, 2017 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Certificates of Deposit | $ 775 | $ - | $ - | $ 775 |
| U.S. Treasury Debt | 11,137 | 8 | (116) | 11,029 |
| U.S. Agency Debt | 3,369 | 7 | (20) | 3,356 |
| Residential MBS: | | | | |
| Ginnie Mae | 1,876 | 1 | (21) | 1,856 |
| U.S. Agency | 6,758 | 24 | (64) | 6,718 |
| FHA/VA Non-Wrapped Reperformer | 235 | 22 | - | 257 |
| Non-Agency | 26 | 3 | - | 29 |
| Commercial MBS: | | | | |
| U.S. Agency | 2,504 | 3 | (8) | 2,499 |
| Agricultural MBS: | | | | |
| Farmer Mac | 79 | - | (1) | 78 |
| Corporate Bonds | 40 | - | - | 40 |
| Asset-Backed and Other | 225 | 8 | - | 233 |
| **Total** | $ 27,024 | $ 76 | $ (230) | $ 26,870 |

A summary of the contractual maturity, amortized cost, fair value and weighted average yield of investment securities by type at March 31, 2018 is as follows:

($ in Millions)

| | Contractual Maturity | | | | |
|---|---|---|---|---|---|
| March 31, 2018 | In One Year or Less | One to Five Years | Five to Ten Years | After Ten Years | Total |
| **Certificates of Deposit** | | | | | |
| Amortized Cost | $ 1,090 | $ - | $ - | $ - | $ 1,090 |
| Fair Value | 1,090 | - | - | - | 1,090 |
| Weighted Average Yield | 1.79 % | - % | - % | - % | 1.79 % |
| **U.S. Treasury Debt Securities** | | | | | |
| Amortized Cost | $ 2,797 | $ 7,351 | $ 2,953 | $ - | $ 13,101 |
| Fair Value | 2,793 | 7,227 | 2,854 | - | 12,874 |
| Weighted Average Yield | 1.46 % | 1.77 % | 1.99 % | - % | 1.76 % |
| **U.S. Agency Debt Securities** | | | | | |
| Amortized Cost | $ 1,028 | $ 1,107 | $ 1,064 | $ - | $ 3,199 |
| Fair Value | 1,028 | 1,093 | 1,052 | - | 3,173 |
| Weighted Average Yield | 2.65 % | 2.01 % | 2.02 % | - % | 2.22 % |
| **Ginnie Mae Residential MBS** | | | | | |
| Amortized Cost | $ - | $ 3 | $ 6 | $ 3,020 | $ 3,029 |
| Fair Value | - | 3 | 6 | 2,974 | 2,983 |
| Weighted Average Yield | - % | 2.86 % | 2.69 % | 2.71 % | 2.71 % |
| **U.S. Agency Residential MBS** | | | | | |
| Amortized Cost | $ - | $ 15 | $ 22 | $ 6,409 | $ 6,446 |
| Fair Value | - | 15 | 22 | 6,298 | 6,335 |
| Weighted Average Yield | - % | 2.40 % | 2.18 % | 2.45 % | 2.45 % |
| **FHA/VA Non-Wrapped Reperformer Residential MBS** | | | | | |
| Amortized Cost | $ - | $ - | $ - | $ 231 | $ 231 |
| Fair Value | - | - | - | 254 | 254 |
| Weighted Average Yield | - % | - % | - % | 6.62 % | 6.62 % |
| **Non-Agency Residential MBS** | | | | | |
| Amortized Cost | $ - | $ - | $ - | $ 17 | $ 17 |
| Fair Value | - | - | - | 17 | 17 |
| Weighted Average Yield | - % | - % | - % | 4.60 % | 4.60 % |
| **U.S. Agency Commercial MBS** | | | | | |
| Amortized Cost | $ - | $ 1,429 | $ 978 | $ - | $ 2,407 |
| Fair Value | - | 1,425 | 973 | - | 2,398 |
| Weighted Average Yield | - % | 2.13 % | 2.08 % | - % | 2.11 % |
| **Farmer Mac Agricultural MBS** | | | | | |
| Amortized Cost | $ - | $ - | $ - | $ 73 | $ 73 |
| Fair Value | - | - | - | 71 | 71 |
| Weighted Average Yield | - % | - % | - % | 3.02 % | 3.02 % |
| **Corporate Bonds** | | | | | |
| Amortized Cost | $ 40 | $ - | $ - | $ - | $ 40 |
| Fair Value | 40 | - | - | - | 40 |
| Weighted Average Yield | 2.12 % | - % | - % | - % | 2.12 % |
| **Asset-Backed and Other** | | | | | |
| Amortized Cost | $ - | $ 126 | $ - | $ 24 | $ 150 |
| Fair Value | - | 126 | - | 32 | 158 |
| Weighted Average Yield | - % | 1.31 % | - % | 13.80 % | 3.33 % |
| **Total** | | | | | |
| Amortized Cost | $ 4,955 | $ 10,031 | $ 5,023 | $ 9,774 | $ 29,783 |
| Fair Value | 4,951 | 9,889 | 4,907 | 9,646 | 29,393 |
| Weighted Average Yield | 1.78 % | 1.83 % | 2.02 % | 2.69 % | 2.13 % |

While the substantial majority of our residential mortgage-backed securities (MBS) and a portion of our asset-backed securities (ABS) have contractual maturities in excess of 10 years, expected maturities for these securities are shorter than contractual maturities because borrowers have the right to call or prepay obligations with or without penalties.

The following table shows the fair value and gross unrealized losses for investments in a loss position aggregated by investment category, and the length of time the securities have been in a continuous unrealized loss position at March 31, 2018 and December 31, 2017. The continuous loss position is based on the date the impairment first occurred.

| | Less Than 12 Months | | Greater Than 12 Months | |
|---|---|---|---|---|
| ($ in Millions) | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| **March 31, 2018** | | | | |
| Certificates of Deposit | **$ 680** | **$ -** | **$ -** | **$ -** |
| U.S. Treasury Debt | **8,063** | **(131)** | **2,919** | **(96)** |
| U.S. Agency Debt | **1,339** | **(13)** | **768** | **(15)** |
| Residential MBS: | | | | |
| Ginnie Mae | **2,281** | **(48)** | **44** | **-** |
| U.S. Agency | **4,464** | **(66)** | **1,333** | **(50)** |
| FHA/VA Non-Wrapped Reperformer | **21** | **-** | **-** | **-** |
| Non-Agency | **1** | **-** | **6** | **-** |
| Commercial MBS: | | | | |
| U.S. Agency | **744** | **(6)** | **311** | **(7)** |
| Agricultural MBS: | | | | |
| Farmer Mac | **-** | **-** | **71** | **(2)** |
| Corporate Bonds | **10** | **-** | **-** | **-** |
| Asset-Backed and Other | **63** | **-** | **72** | **-** |
| **Total** | **$ 17,666** | **$ (264)** | **$ 5,524** | **$ (170)** |
| **December 31, 2017** | | | | |
| Certificates of Deposit | $ 280 | $ - | $ - | $ - |
| U.S. Treasury Debt | 6,048 | (46) | 2,953 | (70) |
| U.S. Agency Debt | 977 | (5) | 1,039 | (15) |
| Residential MBS: | | | | |
| Ginnie Mae | 1,540 | (21) | 53 | - |
| U.S. Agency | 2,109 | (21) | 1,406 | (43) |
| FHA/VA Non-Wrapped Reperformer | 21 | - | - | - |
| Non-Agency | 1 | - | 7 | - |
| Commercial MBS: | | | | |
| U.S. Agency | 814 | (4) | 356 | (4) |
| Agricultural MBS: | | | | |
| Farmer Mac | - | - | 78 | (1) |
| Corporate Bonds | 10 | - | - | - |
| Asset-Backed and Other | 77 | - | 127 | - |
| **Total** | $ 11,877 | $ (97) $ - | $ 6,019 | $ (133) |

We do not intend to sell the securities in unrealized loss positions, nor is it likely that we will be required to sell such securities, for regulatory, liquidity or other purposes, before an anticipated recovery of our cost basis occurs.

## Note 5 – Changes in Accumulated Other Comprehensive Income/(Loss)

Changes in accumulated other comprehensive income/(loss) for the three months ended March 31, 2018 and 2017 are presented in the following table.

**Changes in Accumulated Other Comprehensive Income/(Loss) by Component[1]**

| | Unrealized (Losses)/Gains On Investment Securities | | Unrealized (Losses)/Gains on Interest Rate Swaps and Other Financial Instruments | Net Pension Adjustment | Total |
|---|---|---|---|---|---|
| | Non-OTTI | OTTI | | | |
| **Balance at January 1, 2018** | **$ (125,198)** | **$ 3,236** | **$ (49,981)** | **$ (60,025)** | **$ (231,968)** |
| Balance sheet reclassification of stranded tax effects from accumulated other comprehensive income/(loss) to retained earnings (Refer to Note 2) | **(9,953)** | **270** | **(4,474)** | **(12,457)** | **(26,614)** |
| **Balance at January 1, 2018, as adjusted** | **$ (135,151)** | **$ 3,506** | **$ (54,455)** | **$ (72,482)** | **$ (258,582)** |
| Other comprehensive income/(loss) before reclassifications | **(213,822)** | **2,528** | **11,474** | **-** | **(199,820)** |
| Amounts reclassified from accumulated other comprehensive (loss)/income to net income | **(227)** | **(2,483)** | **(628)** | **1,465** | **(1,873)** |
| Net current-period other comprehensive income/(loss) | **(214,049)** | **45** | **10,846** | **1,465** | **(201,693)** |
| **Balance at March 31, 2018** | **$ (349,200)** | **$ 3,551** | **$ (43,609)** | **$ (71,017)** | **$ (460,275)** |
| **Balance at January 1, 2017** | $ (19,627) | $ 4,969 | $ (37,707) | $ (67,518) | $ (119,883) |
| Other comprehensive income/(loss) before reclassifications | 30,589 | 246 | (4,888) | - | 25,947 |
| Amounts reclassified from accumulated other comprehensive (loss)/income to net income | (5,319) | (3,672) | 2,964 | 820 | (5,207) |
| Net current-period other comprehensive income/(loss) | 25,270 | (3,426) | (1,924) | 820 | 20,740 |
| **Balance at March 31, 2017** | $ 5,643 | $ 1,543 | $ (39,631) | $ (66,698) | $ (99,143) |

[1] Amounts are presented net of tax. Amounts reclassified shown in parentheses indicate a decrease in accumulated other comprehensive income or an increase in accumulated other comprehensive loss.

The following table presents the effect of reclassifications from accumulated other comprehensive income/(loss) to net income for the three-month periods ended March 31, 2018 and 2017.

**Reclassifications from Accumulated Other Comprehensive Income/(Loss) to Net Income**

| For the Three Months Ended March 31, 2018 | Amount Reclassified from Accumulated Other Comprehensive Income/(Loss) | | Location of Gain/(Loss) Recognized in Income Statement |
|---|---|---|---|
| **Unrealized gains/(losses) on available-for-sale investment securities:** | | | |
| Sales gains and losses | **$** | **227** | Noninterest Income - Other, Net |
| **Unrealized gains/(losses) on OTTI investment securities:** | | | |
| Sales gains and losses | | **2,483** | Noninterest Income - Other, Net |
| **Unrealized (losses)/gains on interest rate swaps and other financial instruments:** | | | |
| Interest rate contracts | | **(1,967)** | Interest Expense |
| Foreign exchange contracts | | **3,427** | Interest Income |
| Tax effect | | **(832)** | Provision for Income Taxes |
| **Pension and other benefit plans:** | | | |
| Net actuarial (loss)/gain | | **(1,687)** | Operating Expenses - Employee Compensation |
| Prior service (cost)/credit | | **(256)** | Operating Expenses - Employee Compensation |
| Tax effect | | **478** | Provision for Income Taxes |
| **Total reclassifications** | **$** | **1,873** | |
| **For the Three Months Ended March 31, 2017** | | | |
| **Unrealized gains/(losses) on available-for-sale investment securities:** | | | |
| Sales gains and losses | $ | 5,691 | Noninterest Income - Other, Net |
| Tax effect | | (372) | Provision for Income Taxes |
| **Unrealized gains/(losses) on OTTI investment securities:** | | | |
| Sales gains and losses | | 3,695 | Noninterest Income - Other, Net |
| Tax effect | | (23) | Provision for Income Taxes |
| **Unrealized (losses)/gains on interest rate swaps and other financial instruments:** | | | |
| Interest rate contracts | | (1,901) | Interest Expense |
| Foreign exchange contracts | | (1,939) | Interest Income |
| Tax effect | | 876 | Provision for Income Taxes |
| **Pension and other benefit plans:** | | | |
| Net actuarial loss | | (1,066) | Operating Expenses - Employee Compensation |
| Prior service cost | | (257) | Operating Expenses - Employee Compensation |
| Tax effect | | 503 | Provision for Income Taxes |
| **Total reclassifications** | $ | 5,207 | |

## Note 6 – Derivative Financial Instruments and Hedging Activities

***Risk Management Objectives and Strategies***

We maintain an overall interest rate risk management strategy that incorporates the use of derivative financial instruments to manage liquidity and to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. Our goal is to manage interest rate sensitivity by modifying the repricing frequency or effective maturity of certain balance sheet assets and liabilities. We also maintain a foreign exchange risk management strategy to reduce the impact of currency fluctuations on our relatively nominal amount of foreign currency-denominated loans. As a result of interest rate and foreign exchange rate fluctuations, fixed-rate assets and liabilities will appreciate or depreciate in market value. The effect of this unrealized appreciation or depreciation is expected to be substantially offset by gains and losses on the derivative instruments that are linked to these assets and liabilities. Interest rate and foreign exchange fluctuations also cause interest income and interest expense of variable-rate assets and liabilities to increase or decrease. The effect of this variability in earnings is expected to be substantially offset by gains and losses on the derivative instruments that are linked to these assets and liabilities.

***Uses of Derivatives***

To achieve risk management objectives and satisfy the financing needs of our borrowers, we execute various derivative transactions with other financial institutions. Derivatives (primarily interest rate swaps) are used to manage liquidity and the interest rate risk arising from maturity and repricing mismatches between assets and liabilities. Under interest rate swap arrangements, we agree with a counterparty to exchange, at specified intervals, payment streams calculated on a specified notional amount, with at least one payment stream based on a specified floating-rate index. We use a variety of interest rate swaps including the exchange of floating-rate for fixed-rate swaps and fixed-rate for floating-rate swaps with payment obligations tied to specific indices. In addition, we execute foreign exchange spot and forward contracts to manage currency risk on loans denominated in foreign currencies. We also enter into derivatives for our customers as a service to enable them to transfer, modify or reduce their interest rate risk and foreign exchange risk. We substantially offset this risk transference by concurrently entering into offsetting agreements with counterparties.

The notional amounts of derivatives at March 31, 2018 and related activity for the first three months of 2018 are shown in the following table.

**Activity in the Notional Amounts of Derivative Financial Instruments**

| ($ in Millions) | Swaps | Caps / Floors | Spots / Forwards | Total |
|---|---|---|---|---|
| **December 31, 2017** | **$ 26,355** | **$ 5,123** | **$ 183** | **$ 31,661** |
| Additions /Accretion | **2,956** | **100** | **1,062** | **4,118** |
| Maturities /Amortization | **(1,628)** | **(55)** | **(996)** | **(2,679)** |
| Terminations | **(360)** | **-** | **-** | **(360)** |
| **March 31, 2018** | **$ 27,323** | **$ 5,168** | **$ 249** | **$ 32,740** |

The notional amounts of derivatives at March 31, 2017 and related activity for the first three months of 2017 are shown in the following table.

**Activity in the Notional Amounts of Derivative Financial Instruments**

| ($ in Millions) | Swaps | Caps / Floors | Spots / Forwards | Total |
|---|---|---|---|---|
| **December 31, 2016** | $ 23,931 | $ 3,100 | $ 227 | $ 27,258 |
| Additions /Accretion | 1,692 | - | 1,065 | 2,757 |
| Maturities /Amortization | (1,549) | (85) | (1,067) | (2,701) |
| Terminations | (382) | - | - | (382) |
| **March 31, 2017** | $ 23,692 | $ 3,015 | $ 225 | $ 26,932 |

### *Accounting for Derivative Instruments and Hedging Activities*

We record derivatives as assets or liabilities at their fair value on the consolidated balance sheets. We record changes in the fair value of a derivative in current period earnings or accumulated other comprehensive income/(loss), depending on the use of the derivative and whether it qualifies for hedge accounting. For fair value hedge transactions that hedge changes in the fair value of assets or liabilities, changes in the fair value of the derivative will generally be offset in the statement of comprehensive income by changes in the hedged item's fair value attributable to the risk being hedged. For cash flow hedge transactions, in which we hedge the variability of future cash flows related to a variable-rate asset or liability, changes in the fair value of the derivative are reported in accumulated other comprehensive income/(loss). The gains and losses on the derivatives that we report in accumulated other comprehensive income/(loss) will be reclassified as earnings in the period in which earnings are affected by the variability of the cash flows of the hedged item. We record the ineffective portion of all hedges in current period earnings.

For our customer transactions, which are not designated as hedging instruments, we record the related changes in fair value in current period earnings. We substantially offset this risk transference by concurrently entering into offsetting agreements with counterparties, with the changes in fair value of these transactions also recorded in current period earnings.

### *Fair Value Hedges*

The majority of the fair value hedging activity relates to entering into interest rate swaps primarily to convert our non-prepayable fixed-rate debt to floating-rate debt to achieve our liquidity management strategy. The amount converted depends on contractual interest rates and maturities. For the remaining fair value hedges, we enter into receive-fixed, pay-floating swaps to align our equity positioning strategy with our risk management strategy. For fair value hedges, the amount of hedge ineffectiveness is recognized as net interest income in current period earnings.

### *Cash Flow Hedges*

We purchase interest rate caps and floors to hedge cap and floor risk embedded within a portion of our floating-rate investment securities and loans. The interest rate caps hedge floating-rate debt cash flows that fund the cash flows from floating-rate investment securities. If the strike rates in the purchased interest rate caps are exceeded, we receive cash flows on the derivative to hedge our floating-rate funding exposure above such strike levels. The interest rate floors hedge cash flows from floating-rate loans. If market index rates underlying our floating rate loans decline below strike levels, we receive cash flows on the derivative. We also enter into foreign exchange spot and forward contracts to manage currency risk on loans denominated in foreign currencies. Typically, foreign currency contracts are purchased to fund the principal cash flows of the loan and simultaneously sold to lock in the principal and interest cash flows upon repricing or maturity date of the loan. For cash flow hedges, the amount of hedge ineffectiveness, the amount excluded from effectiveness assessment, and the amounts reclassified from accumulated other comprehensive income/(loss) into current period earnings are all reflected in net interest income. At March 31, 2018, we expect that $9.4 million of expense will be reclassified from other comprehensive income into earnings in the next 12 months, based on the anticipated cash flows of existing financial instruments. The maximum term over which we are hedging our exposure to the variability of future cash flows for all forecasted transactions is approximately 18 years.

***Derivatives Not Designated as Hedges***

Derivative agreements with our customers and the related offsetting derivative agreements with counterparties are not designated as hedging instruments and do not receive hedge accounting treatment. Accordingly, any changes in the fair value of these customer related derivatives are recognized immediately as noninterest income/expense in current period earnings.

***Counterparty Credit Risk***

The use of derivatives for risk management introduces credit risk related to customers and counterparties. Generally, when the fair value of a derivative contract is positive, we are exposed to credit risk.

Derivative transactions with our customers are typically secured through our loan agreements. As of March 31, 2018 and December 31, 2017, the notional amount of derivatives with our customers totaled $8.3 billion and $8.0 billion, respectively.

The majority of our non-customer derivatives are transacted with derivative counterparties and governed by master swap agreements, which include bilateral collateral arrangements, requiring the Bank or our counterparties to post collateral on a daily basis with thresholds set at zero for all active counterparties. The master swap agreements also include netting agreements requiring the net settlement of covered contracts with the same counterparty in the event of default by the other party. The "net" mark-to-market exposure represents the netting of the positive and negative exposures with that counterparty. Notwithstanding these protections, we are exposed to credit risk with these counterparties due to the timing of daily margining activities. As of March 31, 2018 and December 31, 2017, the notional amount of derivatives with our non-customer counterparties totaled $12.9 billion and $13.3 billion, respectively, which excludes the $11.5 billion and $10.4 billion, respectively, of cleared derivatives discussed below.

We record derivative exposures and related cash collateral balances at gross amounts in our consolidated balance sheets. Pursuant to our master swap agreements, as of March 31, 2018, our non-customer counterparties had posted $128.0 million in cash as collateral with us. We estimate that the amount of losses related to derivatives we could be exposed to in the event of nonperformance by dealer counterparties to our derivative positions, net of collateral held by us, was $1.0 million and $0.7 million at March 31, 2018 and December 31, 2017, respectively.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) requires certain derivative transactions to be cleared through a central clearinghouse and traded on regulated swap execution facilities. The U.S. Commodity Futures Trading Commission has exempted certain qualifying swaps entered into by end-users and financial cooperatives from these new requirements. The exemptions do not cover all swaps executed by CoBank and are generally limited to swaps entered into in connection with loans and derivatives for customer-owners. CoBank has also voluntarily chosen to clear some swap transactions for economic and risk management purposes. As a result, certain of our derivative transactions are cleared through a futures commission merchant (FCM) with a clearinghouse or central counterparty (CCP). When these swaps are cleared, a single bilateral swap is divided into two separate swaps with the CCP becoming the counterparty to both of the initial parties to the swap. CCPs have several layers of protection against default including initial margin and variation margin or settlement payments that are required to be posted by participants. FCMs prequalify counterparties to all cleared swaps, set exposure limits for each counterparty and collect initial margin and variation margin or settlement payments daily for changes in the value of cleared derivatives. The margin and settlement payments collected from both parties to the swap protect against credit risk in the event of a counterparty default. As of March 31, 2018 and December 31, 2017, the notional amount of our cleared derivatives was $11.5 billion and $10.4 billion, respectively. Initial margin and settlement payments totaling $42.4 million and $125.0 million, respectively, as of March 31, 2018 and $32.0 million and $104.6 million, respectively, as of December 31, 2017 were held by our CCP for our cleared derivatives.

In 2015, the FCA and various other federal agencies, known as the Prudential Regulators under the Dodd-Frank Act, jointly adopted final rules which will subject many non-cleared swaps to minimum initial and variation margin requirements. Such requirements become effective over the next several years. The Prudential Regulators also issued an interim final rule excluding swaps that qualify for certain exemptions from the scope of the final margin rules. CoBank is eligible for certain regulatory exemptions related to, among other things, transactions with end users and with customer-owners. Accordingly, we do not currently anticipate that adoption of these rules will have a material impact on our use of derivatives or our overall financial position.

***Hedge Terminations***

In the first quarter of 2017, we terminated approximately $318.2 million in notional value of interest rate swaps for asset-liability management purposes. These swaps were accounted for as fair value hedges. During the three months ended March 31, 2018 we did not terminate any interest rate swaps for asset-liability management purposes.

We terminated interest rate swaps with customers and offsetting dealer counterparties totaling notional value of $359.5 million and $64.0 million during the first three months of 2018 and 2017, respectively. Proceeds from the customer terminations were offset by payments for the offsetting dealer terminations.

A summary of the impact of derivative financial instruments on our condensed consolidated balance sheets as of March 31, 2018 and December 31, 2017 is shown in the following tables.

**Fair Value of Derivative Financial Instruments**

| As of March 31, 2018 | | Fair Value of Derivative Assets[1] | | Fair Value of Derivative Liabilities[2] |
|---|---|---|---|---|
| **Derivatives Designated as Hedging Instruments** | | | | |
| Interest Rate Contracts | $ | 47,573 | $ | 133,244 |
| Foreign Exchange Contracts | | 1,138 | | 679 |
| Total Derivatives Designated as Hedging Instruments | $ | 48,711 | $ | 133,923 |
| **Derivatives Not Designated as Hedging Instruments** | | | | |
| Interest Rate Contracts | $ | 185,344 | $ | 140,386 |
| Foreign Exchange Contracts | | 266 | | 255 |
| Total Derivatives Not Designated as Hedging Instruments | $ | 185,610 | $ | 140,641 |
| Settlement Payments | | - | | (124,956) |
| **Total Derivatives** | $ | 234,321 | $ | 149,608 |

[1] These assets make up the "Interest Rate Swaps and Other Financial Instruments" assets in the condensed consolidated balance sheet as of March 31, 2018.
[2] These liabilities make up the "Interest Rate Swaps and Other Financial Instruments" liabilities in the condensed consolidated balance sheet as of March 31, 2018.

**Fair Value of Derivative Financial Instruments**

| As of December 31, 2017 | | Fair Value of Derivative Assets[1] | | Fair Value of Derivative Liabilities[2] |
|---|---|---|---|---|
| **Derivatives Designated as Hedging Instruments** | | | | |
| Interest Rate Contracts | $ | 37,479 | $ | 88,382 |
| Foreign Exchange Contracts | | 113 | | 3,109 |
| Total Derivatives Designated as Hedging Instruments | $ | 37,592 | $ | 91,491 |
| **Derivatives Not Designated as Hedging Instruments** | | | | |
| Interest Rate Contracts | $ | 142,801 | $ | 99,378 |
| Foreign Exchange Contracts | | 452 | | 427 |
| Total Derivatives Not Designated as Hedging Instruments | $ | 143,253 | $ | 99,805 |
| Settlement Payments | | - | | (104,564) |
| **Total Derivatives** | $ | 180,845 | $ | 86,732 |

[1] These assets make up the "Interest Rate Swaps and Other Financial Instruments" assets in the condensed consolidated balance sheet as of December 31, 2017.
[2] These liabilities make up the "Interest Rate Swaps and Other Financial Instruments" liabilities in the condensed consolidated balance sheet as of December 31, 2017.

A summary of the impact of derivative financial instruments on our condensed consolidated statements of income and comprehensive income for the three months ended March 31, 2018 and 2017 is shown below.

**Derivative Financial Instruments in Fair Value Hedging Relationships**

| | Net Amount of Gain or (Loss) Recognized in Income on Derivatives and Hedged Items[1] | |
|---|---|---|
| **Three Months Ended March 31,** | **2018** | **2017** |
| Interest Rate Contracts | **$ 450** | $ 346 |
| **Total** | **$ 450** | $ 346 |

[1] Located in Interest Expense in the condensed consolidated statements of income for the three months ended March 31, 2018 and 2017.

**Derivative Financial Instruments in Cash Flow Hedging Relationships**

| **Three Months Ended March 31, 2018** | **Amount of Gain or (Loss) Recognized in Accumulated Other Comprehensive Income (Loss) on Derivatives[1]** | **Amount of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Income (Loss) to Income on Derivatives[1]** | **Amount of Gain or (Loss) Recognized in Income on Derivatives[2]** |
|---|---|---|---|
| Interest Rate Contracts | **$ 8,899** | **$ (2,100)** [3] | **$ 134** |
| Foreign Exchange Contracts | **3,455** | **3,428** [4] [5] | **592** [4] |
| **Total** | **$ 12,354** | **$ 1,328** | **$ 726** |

[1] Effective portion

[2] Ineffective portion and amount excluded from effectiveness assessment.

[3] Located in Interest Expense in the condensed consolidated statement of income for the three months ended March 31, 2018.

[4] Located in Interest Income – Loans in the condensed consolidated statement of income for the three months ended March 31, 2018.

[5] Fully offset by a $3,428 loss on foreign currency denominated loans (hedged items) which is also located in Interest Income – Loans in the condensed consolidated statement of income for the three months ended March 31, 2018.

| Derivative Financial Instruments in Cash Flow Hedging Relationships | | | | | | |
|---|---|---|---|---|---|---|
| **Three Months Ended March 31, 2017** | **Amount of Gain or (Loss) Recognized in Accumulated Other Comprehensive Income (Loss) on Derivatives[1]** | | **Amount of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Income (Loss) to Income on Derivatives[1]** | | **Amount of Gain or (Loss) Recognized in Income on Derivatives[2]** | |
| Interest Rate Contracts | $ | (3,935) | $ | (1,901) [3] | $ | - |
| Foreign Exchange Contracts | | (2,280) | | (1,939) [4] [5] | | 245 [4] |
| **Total** | $ | (6,215) | $ | (3,840) | $ | 245 |

[1] Effective portion

[2] Ineffective portion and amount excluded from effectiveness assessment.

[3] Located in Interest Expense in the condensed consolidated statement of income for the three months ended March 31, 2017.

[4] Located in Interest Income – Loans in the condensed consolidated statement of income for the three months ended March 31, 2017.

[5] Fully offset by a $1,939 gain on foreign currency denominated loans (hedged items) which is also located in Interest Income – Loans in the condensed consolidated statement of income for the three months ended March 31, 2017.

| Derivative Financial Instruments Not Designated as Hedging Relationships[1] | | | | |
|---|---|---|---|---|
| | **Net Amount of Gain or (Loss) Recognized in Income On Derivatives[2]** | | | |
| **Three Months Ended March 31,** | | **2018** | | **2017** |
| Interest Rate Contracts | **$** | **1,534** | $ | (438) |
| Foreign Exchange Contracts | | **(14)** | | 4 |
| **Total** | **$** | **1,520** | $ | (434) |

[1] Primarily represents our derivative agreements with customers and related offsetting derivative agreements with counterparties.

[2] Located in Other Noninterest Income/(Expense) in the condensed consolidated statements of income for the three months ended March 31, 2018 and 2017.

### *Asset/Liability Offsetting*

As noted previously, derivative transactions with swap dealers include bilateral collateral and netting agreements that require the net settlement of covered contracts. Derivative transactions with customers are collateralized through loan agreements. Notwithstanding collateral and netting provisions, our derivative assets and liabilities are not offset in the accompanying condensed consolidated balance sheets. The amount of collateral received or pledged is calculated on a net basis, by counterparty.

The following table summarizes derivative assets and liabilities, related accrued interest and amounts of collateral exchanged pursuant to our agreements.

**Offsetting of Financial and Derivative Instruments**

| | Gross Amounts of Assets/Liabilities Presented in the Condensed Consolidated Balance Sheets | Amounts Not Offset In the Condensed Consolidated Balance Sheets | | |
|---|---|---|---|---|
| | | Cash Collateral Received/ Pledged[1] | Investment Securities Received/Pledged as Collateral | Net Amount |
| **As of March 31, 2018** | | | | |
| Assets: | | | | |
| Interest Rate Swaps and Other Financial Instruments: | | | | |
| Dealer | **$ 153,624** | **$ (127,960)** | **$ -** | **$ 25,664** |
| Customer | **54,013** | **-** | **-** | **54,013** |
| Clearinghouse | **26,684** | **-** | **-** | **26,684** |
| Accrued Interest Receivable on Derivative Contracts | **8,054** | **-** | **-** | **8,054** |
| Liabilities: | | | | |
| Interest Rate Swaps and Other Financial Instruments: | | | | |
| Dealer | **27,078** | **(2,100)** | **-** | **24,978** |
| Customer | **99,093** | **-** | **-** | **99,093** |
| Clearinghouse | **23,437** | **-** | **(42,364)** | **-** [2] |
| Accrued Interest Payable on Derivative Contracts | **12,250** | **-** | **-** | **12,250** |
| **As of December 31, 2017** | | | | |
| Assets: | | | | |
| Interest Rate Swaps and Other Financial Instruments: | | | | |
| Dealer | $ 84,969 | $ (50,910) | $ - | $ 34,059 |
| Customer | 83,351 | - | - | 83,351 |
| Clearinghouse | 12,525 | - | - | 12,525 |
| Accrued Interest Receivable on Derivative Contracts | 8,616 | - | - | 8,616 |
| Liabilities: | | | | |
| Interest Rate Swaps and Other Financial Instruments: | | | | |
| Dealer | 37,784 | (3,050) | - | 34,734 |
| Customer | 41,189 | - | - | 41,189 |
| Clearinghouse | 7,759 | - | (31,999) | - [2] |
| Accrued Interest Payable on Derivative Contracts | 7,415 | - | - | 7,415 |

(1) Cash collateral received is recognized in the condensed consolidated balance sheets.

(2) Cash and investment securities pledged as collateral fully offset the related gross liability in the condensed consolidated balance sheets.

## Note 7 – Fair Value Measurements

The fair value of financial instruments represents the estimated amount to be received to sell an asset or paid to transfer or extinguish a liability (an exit price) in active markets among willing participants at the reporting date. The FASB has established a three-level fair value hierarchy aimed at maximizing the use of observable inputs – that is, inputs that reflect the assumptions market participants would use in pricing an asset or liability.

A description of the methods, assumptions and inputs to the valuation process used to determine or estimate the fair value of each class of financial instruments within the three-level hierarchy follows.

***Level 1***

Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Our Level 1 assets at March 31, 2018 consist of assets held in a trust fund related to deferred compensation and nonqualified retirement plans. The trust fund includes investments in securities that are actively traded and have quoted net asset value prices that are directly observable in the marketplace.

***Level 2***

Level 2 inputs include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability. Our Level 2 assets and liabilities at March 31, 2018 include our derivative contracts, collateral balances related to derivative contracts, certificates of deposit, federal funds sold and other overnight funds, U.S. Treasury and agency debt investment securities, Ginnie Mae MBS, non-agency MBS, corporate bonds, the substantial majority of agency MBS and the majority of ABS.

The fair value of federal funds sold and other overnight funds is generally their face value, plus accrued interest, as these instruments are readily convertible to cash and are short-term in nature.

The fair value of our investment securities classified as Level 2 is determined by a third-party pricing service that uses valuation models to estimate current market prices. Inputs and assumptions related to these models are typically observable in the marketplace. Such models incorporate prepayment assumptions and underlying collateral information to generate cash flows that are discounted using appropriate benchmark interest rate curves and volatilities. These third-party valuation models also incorporate information regarding non-binding broker/dealer quotes, available trade information, historical cash flows, credit ratings, and other market information. The estimated fair values of investment securities also appear in Note 4.

The fair value of our derivative financial instruments is the estimated amount to be received to sell a derivative asset or paid to transfer or extinguish a derivative liability in active markets among willing participants at the reporting date. Estimated fair value is determined through internal market valuation models. These models use an income approach and incorporate benchmark interest rate curves (primarily the Overnight Index Swap rate for collateralized derivative contracts and the USD LIBOR/swap curve for non-collateralized derivative contracts), volatilities, counterparty credit quality and other inputs that are observable directly or indirectly in the marketplace. We compare internally calculated derivative valuations to broker/dealer quotes to substantiate the results. The fair value of collateral assets and liabilities related to derivative contracts is their face value, plus accrued interest, as these instruments are cash balances; therefore, fair value approximates face value.

The following table presents information about valuation techniques and inputs to Level 2 fair value measurements.

| Information About Valuation Techniques and Inputs to Level 2 Fair Value Measurements | | |
|---|---|---|
| | Valuation Technique | Inputs |
| Federal Funds Sold and Other Overnight Funds | Carrying Value | Par/Principal Plus Accrued Interest |
| Certificates of Deposit | Third-Party Pricing Service | Benchmark Yield Curve<br>Quoted Prices |
| Investment Securities | Third-Party Pricing Service | Prepayment Rate<br>Lifetime Default Rate<br>Loss Severity<br>Benchmark Yield Curve<br>Quoted Prices |
| Interest Rate Swaps and Other Financial Instruments | Discounted Cash Flow | Benchmark Yield Curve<br>Counterparty Credit Risk<br>Volatility |
| Collateral Assets and Collateral Liabilities | Carrying Value | Par/Principal Plus Accrued Interest |

### *Level 3*

Level 3 inputs are unobservable and supported by limited or no market activity. Our Level 3 assets at March 31, 2018 include our Federal Agricultural Mortgage Corporation (Farmer Mac) MBS, FHA/VA non-wrapped reperformer MBS and a small portion of agency MBS and ABS. Based on the lack of active trading volume and an orderly market for these securities, we classified these securities as Level 3. Fair value for all Farmer Mac MBS and a small portion of our Level 3 ABS is calculated internally using third-party models. Fair value for FHA/VA non-wrapped reperformer MBS, Level 3 agency MBS and the substantial majority of our Level 3 ABS is estimated through a third-party pricing service that uses valuation models to estimate current market prices. Inputs into all of these valuation models include underlying collateral data and projected losses as well as information for prepayment speeds and discounting spreads. Due to the lack of marketplace information, the inputs into these valuation models primarily represent management assumptions, with some corroboration to market inputs where information is available.

Level 3 assets at March 31, 2018 also include $137.5 million of loans originally measured at cost, which were written down to fair value as a result of impairment. The valuation of these assets is based on either the fair value of the underlying collateral, if the loan is collateral dependent, or the present value of expected future cash flows. Such valuations may include the use of independent appraisals or other market-based information to develop a management estimate of fair value. As a result, these fair value measurements fall under Level 3 in the fair value hierarchy; however, they are excluded from the 'Assets and Liabilities Measured at Fair Value on a Recurring Basis' tables on pages 45 and 46 because they are not measured on a recurring basis.

Our Level 3 liabilities at March 31, 2018 include standby letters of credit whose market value is internally calculated based on information that is not observable either directly or indirectly in the marketplace.

No transfers into or out of the three levels of assets occurred during the three months ended March 31, 2018 and 2017.

The following table presents quantitative information about Level 3 fair value measurements as of March 31, 2018.

**Quantitative Information About Valuation Techniques and Unobservable Inputs to Level 3 Fair Value Measurements**

| ($ in Millions) | Fair Value | Valuation Technique | Unobservable Inputs | Range |
|---|---|---|---|---|
| **Assets** | | | | |
| Investment Securities: | | | | |
| U.S. Agency MBS | $ 123 | Third-Party Pricing Service | Prepayment Rate | * |
| | | | Lifetime Default Rate | * |
| | | | Loss Severity | * |
| FHA/VA Non-Wrapped Reperformer MBS | 254 | Third-Party Pricing Service | Prepayment Rate | * |
| | | | Lifetime Default Rate | * |
| | | | Loss Severity | * |
| Farmer Mac MBS | 71 | Discounted Cash Flow | Prepayment Rate | 6-8 percent |
| | | | Mark-to-Market Spread | 1 percent |
| Asset-Backed | 26 | Third-Party Pricing Service | Prepayment Rate | * |
| | | | Lifetime Default Rate | * |
| | | | Loss Severity | * |
| Other (included in Asset-Backed) | 7 | Discounted Cash Flow | Prepayment Rate | 0 percent |
| Impaired Loans | 138 | Appraisal / | Income/Expense Data | ** |
| | | Discounted Cash Flow | Comparable Sales | ** |
| | | | Replacement Cost | ** |
| **Liabilities** | | | | |
| Standby Letters of Credit | $ 10 | Discounted Cash Flow | Mark-to-Market Spread | 0.1-1 percent |

* Excludes ranges which are determined by a third-party pricing service.

** Range of inputs are unique to each collateral property.

### *Assets and Liabilities Measured at Fair Value on a Recurring Basis*

The following tables present the assets and liabilities that are measured at fair value on a recurring basis at March 31, 2018 and December 31, 2017 for each of the fair value hierarchy levels.

**Assets and Liabilities Measured at Fair Value on a Recurring Basis**

**March 31, 2018**

| ($ in Millions) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Federal Funds Sold and Other Overnight Funds | $ - | $ 895 | $ - | $ 895 |
| Investment Securities: | | | | |
| Certificates of Deposit | - | 1,090 | - | 1,090 |
| U.S. Treasury Debt | - | 12,874 | - | 12,874 |
| U.S. Agency Debt | - | 3,173 | - | 3,173 |
| Residential MBS: | | | | |
| Ginnie Mae | - | 2,983 | - | 2,983 |
| U.S. Agency | - | 6,212 | 123 | 6,335 |
| FHA/VA Non-Wrapped Reperformer | - | - | 254 | 254 |
| Non-Agency | - | 17 | - | 17 |
| Commercial MBS: | | | | |
| U.S. Agency | - | 2,398 | - | 2,398 |
| Agricultural MBS: | | | | |
| Farmer Mac | - | - | 71 | 71 |
| Corporate Bonds | - | 40 | - | 40 |
| Asset-Backed and Other | - | 125 | 33 | 158 |
| Interest Rate Swaps and Other Financial Instruments | - | 234 | - | 234 |
| Assets Held in Trust (included in Other Assets) | 82 | - | - | 82 |
| Collateral Assets (included in Other Assets) | - | 2 | - | 2 |
| **Total Assets** | **$ 82** | **$ 30,043** | **$ 481** | **$ 30,607** |
| **Liabilities** | | | | |
| Interest Rate Swaps and Other Financial Instruments | $ - | $ 150 | $ - | $ 150 |
| Collateral Liabilities (included in Bonds and Notes) | - | 128 | - | 128 |
| Standby Letters of Credit (included in Other Liabilities) | - | - | 10 | 10 |
| **Total Liabilities** | **$ -** | **$ 278** | **$ 10** | **$ 288** |

| Assets and Liabilities Measured at Fair Value on a Recurring Basis | | | | |
|---|---|---|---|---|
| **December 31, 2017** | | | | |
| ($ in Millions) | **Level 1** | **Level 2** | **Level 3** | **Total** |
| **Assets** | | | | |
| Federal Funds Sold and Other Overnight Funds | $ - | $ 1,035 | $ - | $ 1,035 |
| Investment Securities: | | | | |
| Certificates of Deposit | - | 775 | - | 775 |
| U.S. Treasury Debt | - | 11,029 | - | 11,029 |
| U.S. Agency Debt | - | 3,356 | - | 3,356 |
| Residential MBS: | | | | |
| Ginnie Mae | - | 1,856 | - | 1,856 |
| U.S. Agency | - | 6,593 | 125 | 6,718 |
| FHA/VA Non-Wrapped Reperformer | - | - | 257 | 257 |
| Non-Agency | - | 29 | - | 29 |
| Commercial MBS: | | | | |
| U.S. Agency | - | 2,499 | - | 2,499 |
| Agricultural MBS: | | | | |
| Farmer Mac | - | - | 78 | 78 |
| Corporate Bonds | - | 40 | - | 40 |
| Asset-Backed and Other | - | 194 | 39 | 233 |
| Interest Rate Swaps and Other Financial Instruments | - | 181 | - | 181 |
| Assets Held in Trust (included in Other Assets) | 81 | - | - | 81 |
| Collateral Assets (included in Other Assets) | - | 3 | - | 3 |
| **Total Assets** | $ 81 | $ 27,590 | $ 499 | $ 28,170 |
| **Liabilities** | | | | |
| Interest Rate Swaps and Other Financial Instruments | $ - | $ 87 | $ - | $ 87 |
| Collateral Liabilities (included in Bonds and Notes) | - | 51 | - | 51 |
| Standby Letters of Credit (included in Other Liabilities) | - | - | 10 | 10 |
| **Total Liabilities** | $ - | $ 138 | $ 10 | $ 148 |

The following table presents the changes in Level 3 assets and liabilities measured at fair value on a recurring basis.

**Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis**

| ($ in Millions) | U.S. Agency Residential MBS | Farmer Mac Agricultural MBS | FHA/VA Non-Wrapped Reperformer Residential MBS | Asset-Backed Securities and Other | Standby Letters of Credit |
|---|---|---|---|---|---|
| **Balance at December 31, 2017** | **$ 125** | **$ 78** | **$ 257** | **$ 39** | **$ 10** |
| Total Gains or Losses (Realized/Unrealized): | | | | | |
| Included in Other Comprehensive Income | **1** | **-** | **-** | **(1)** | **-** |
| Issuances | **-** | **-** | **-** | **1** | **2** |
| Settlements | **(4)** | **(7)** | **(6)** | **(7)** | **(2)** |
| Accretion | **1** | **-** | **3** | **1** | **-** |
| **Balance at March 31, 2018** | **$ 123** | **$ 71** | **$ 254** | **$ 33** | **$ 10** |
| **Balance at December 31, 2016** | $ 147 | $ 97 | $ 275 | $ 39 | $ 10 |
| Issuances | - | - | - | 1 | 2 |
| Settlements | (8) | (8) | (11) | (2) | (2) |
| Accretion | 1 | - | 2 | 1 | - |
| **Balance at March 31, 2017** | $ 140 | $ 89 | $ 266 | $ 39 | $ 10 |

### *Estimated Fair Value of Certain Other Financial Instruments*

The following table presents the estimated fair value of financial instruments that are recorded in the condensed consolidated balance sheets at cost, as well as certain off-balance sheet financial instruments, as of March 31, 2018 and December 31, 2017.

($ in Millions)

| | March 31, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| | Carrying Amount | Estimated Fair Value | Fair Value Hierarchy | Carrying Amount | Estimated Fair Value | Fair Value Hierarchy |
| **Financial Assets:** | | | | | | |
| Net Loans | **$ 101,640** | **$ 101,879** | **Level 3** | $ 98,689 | $ 99,742 | Level 3 |
| **Financial Liabilities:** | | | | | | |
| Bonds and Notes | **$ 123,158** (1) | **$ 123,027** (1) | **Level 3** | $ 118,406 (2) | $ 118,859 (2) | Level 3 |
| **Off-Balance Sheet Financial Instruments:** | | | | | | |
| Commitments to Extend Credit | **$ -** | **$ (83)** | **Level 3** | $ - | $ (92) | Level 3 |

(1) Includes $128 million in Level 2 collateral liabilities carried at fair value as of March 31, 2018.

(2) Includes $51 million in Level 2 collateral liabilities carried at fair value as of December 31, 2017.

### *Commitments to Extend Credit*

The fair value of commitments to extend credit is estimated by applying a risk-adjusted spread percentage to these obligations.

## Note 8 – Employee Benefit Plans

We have employer-funded, qualified defined benefit pension plans, which are noncontributory and cover employees hired prior to January 1, 2007. We also have noncontributory, unfunded nonqualified supplemental executive retirement plans covering certain senior officers and specified other senior managers, as well as a noncontributory, unfunded nonqualified executive retirement plan covering certain former senior officers. We have a 401(k) retirement savings plan pursuant to which we match a certain percentage of employees' elective contributions. In addition, under this plan, employees hired on or after January 1, 2007 receive additional, non-elective employer defined contributions. For eligible senior managers, including our senior officers, we also have a nonqualified deferred compensation plan, which includes benefits not provided under the employee savings plan due to certain Internal Revenue Code limitations.

All retirement-eligible employees are also currently eligible for other postretirement benefits, which primarily include access to health care benefits. Substantially all participants pay the full premiums associated with these other postretirement health care benefits. Participant contributions are adjusted annually.

We contributed $0.7 million to our funded qualified defined benefit pension plans during the three months ended March 31, 2018, and anticipate that we will contribute approximately $3.0 million more to such plans during the remainder of 2018. We expect to contribute a total of $0.3 million, net of collected retiree premiums, to our other postretirement benefit plans in 2018. No contributions to our trust funds related to our nonqualified retirement plans were made during the three months ended March 31, 2018, nor do we anticipate making contributions to such plans during the remainder of 2018. Our actual contributions could differ from the estimates noted above.

## Note 9 – Commitments and Contingent Liabilities

Due to the often volatile seasonal borrowing requirements of our Agribusiness customers, which are impacted by changing commodity prices, farmer delivery patterns, weather and other factors, we provide a significant amount of revolving loan commitments. We also provide revolving loan commitments to other customers including those in the electric distribution and power supply industries. At March 31, 2018, commitments to extend credit and commercial letters of credit were $26.9 billion and $334.9 million, respectively.

Under the Farm Credit Act, we are primarily liable for the portion of outstanding Federal Farm Credit Banks Consolidated Systemwide bonds, medium term notes and discount notes (collectively referred to as Systemwide Debt Securities) issued by CoBank. Additionally, we are contingently liable by statute for the outstanding Systemwide Debt Securities issued by the other System banks. Total Systemwide Debt Securities of the System were $269.4 billion at March 31, 2018.

There are several mechanisms in place affecting exposure to statutory joint and several liabilities. System banks are statutorily required to maintain eligible unencumbered assets at a level at least equal in value to the total amount of debt for which such System bank is primarily liable. In addition, in the event of a default by a System bank, the Insurance Fund would be required to make timely payment of principal and interest on Systemwide Debt Securities, to the extent that net assets are available in the Insurance Fund, before the joint and several liability of the System banks would be triggered. At March 31, 2018, the aggregated assets of the Insurance Fund totaled $4.7 billion. Finally, System banks must maintain certain financial criteria in order to participate in Systemwide debt issuances. If these criteria are not met, a troubled System bank's access to and participation in Systemwide debt issuances could be limited or denied.

On at least a quarterly basis, we assess our liabilities and contingencies in connection with outstanding legal proceedings utilizing the latest information available. For those matters where it is probable that we will incur a loss and the amount of the loss can be reasonably estimated, we record a liability in our consolidated financial statements. For other matters, where a loss is not probable or the amount of the loss is not estimable, we will not accrue legal reserves.

In June 2016, a lawsuit was commenced by the filing of a complaint in the United States District Court Southern District of New York against CoBank by a number of investors (the “Plaintiffs”) who had held CoBank’s 7.875 percent Subordinated Notes due in 2018 (the “Notes”). The Notes were redeemed at par plus accrued interest by CoBank in April 2016 due to the occurrence of a “Regulatory Event” (as defined under the terms of the Notes). The Plaintiffs have asserted a breach of contract claim and a breach of implied covenant of good faith and fair dealing claim alleging that CoBank impermissibly redeemed the Notes. The Plaintiffs have requested damages in an amount to be determined at trial, reasonable attorneys’ fees and any other such relief as the court may deem just and proper. CoBank filed its answer in September 2016 and discovery concluded in January 2018. CoBank intends to vigorously defend against these allegations. The likelihood of any outcome of this proceeding cannot be determined at this time.

While the outcome of legal proceedings is inherently uncertain, based on information currently available, advice of legal counsel and available insurance coverage, we believe that the liabilities, if any, arising from our legal proceedings will not have a material adverse effect on the consolidated financial position, consolidated results of operations or consolidated cash flows of the Bank. However, in the event of unexpected future developments, it is possible that the ultimate resolution of these matters, if unfavorable, may be material to the Bank’s consolidated financial position, consolidated results of operations or consolidated cash flows.

## Note 10 – Segment Financial Information

We conduct our lending operations through three operating segments: Agribusiness, Strategic Relationships and Rural Infrastructure.

The accompanying tables present condensed disaggregated information for the segments. Allocations of resources and corporate items, as well as measurement of financial performance, are made at these operating segment levels. All customer activity, including loans and leases and related income, is specifically assigned to the business units that make up the operating segments. Investment securities and federal funds sold and other overnight funds, which are primarily held as a liquidity reserve to support our banking operations, are not specifically assigned to operating segments; however, the income from investment securities and federal funds sold and other overnight funds is allocated to the operating segments. Information to reconcile the total reportable segments to the total CoBank financial statements is shown as “Corporate/Other.” Intersegment transactions are insignificant.

We do not hold significant assets in any foreign country. Substantially all of our agricultural export finance loans are U.S. dollar-denominated and 19 percent of these loans are guaranteed by the U.S. government.

For the three-month periods ended March 31, 2018 and 2017, no customer made up 10 percent or more of our gross or net interest income.

## Segment Financial Information

### For the Three Months Ended March 31, 2018

| | Agribusiness | Strategic Relationships | Rural Infrastructure | Subtotal | Corporate/ Other | Total CoBank |
|---|---|---|---|---|---|---|
| **Results of Operations** ($ in Thousands): | | | | | | |
| Net Interest Income | $ 199,030 | $ 69,624 | $ 105,399 | $ 374,053 | $ (3,012) | $ 371,041 |
| Provision for Loan Losses | 47,000 | - | 3,000 | 50,000 | - | 50,000 |
| Noninterest Income | 44,596 | 2,570 | 28,494 | 75,660 | 5,762 | 81,422 |
| Operating Expenses | 49,240 | 10,875 | 24,876 | 84,991 | (363) | 84,628 |
| Provision for Income Taxes | 15,874 | - | 16,993 | 32,867 | 556 | 33,423 |
| **Net Income** | $ 131,512 | $ 61,319 | $ 89,024 | $ 281,855 | $ 2,557 | $ 284,412 |
| **Selected Financial Information at March 31, 2018 ($ in Millions):** | | | | | | |
| Loans | $ 34,409 | $ 46,848 | $ 21,028 | $ 102,285 | $ - | $ 102,285 |
| Less: Allowance for Loan Losses | (474) | - | (171) | (645) | - | (645) |
| **Net Loans** | $ 33,935 | $ 46,848 | $ 20,857 | $ 101,640 | $ - | $ 101,640 |
| **Total Assets** | $ 34,271 | $ 46,980 | $ 20,953 | $ 102,204 | $ 31,198 (1) | $ 133,402 |
| (1) Other assets are comprised of: | | | | | | |
| Federal Funds Sold and Other Overnight Funds | | | | | | $ 895 |
| Investment Securities | | | | | | 29,393 |
| Other Assets | | | | | | 910 |

### For the Three Months Ended March 31, 2017

| | Agribusiness | Strategic Relationships | Rural Infrastructure | Subtotal | Corporate/ Other | Total CoBank |
|---|---|---|---|---|---|---|
| **Results of Operations** ($ in Thousands): | | | | | | |
| Net Interest Income | $ 183,084 | $ 70,543 | $ 105,264 | $ 358,891 | $ (2,777) | $ 356,114 |
| Provision for Loan Losses/(Loan Loss Reversal) | 13,000 | - | 2,000 | 15,000 | - | 15,000 |
| Noninterest Income | 29,005 | 7,169 | 17,633 | 53,807 | 1,231 | 55,038 |
| Operating Expenses | 53,480 | 10,274 | 28,707 | 92,461 | 262 | 92,723 |
| Provision for Income Taxes | 23,042 | - | 17,127 | 40,169 | 452 | 40,621 |
| **Net Income** | $ 122,567 | $ 67,438 | $ 75,063 | $ 265,068 | $ (2,260) | $ 262,808 |
| **Selected Financial Information at March 31, 2017 ($ in Millions):** | | | | | | |
| Loans | $ 30,967 | $ 45,473 | $ 20,481 | $ 96,921 | $ - | $ 96,921 |
| Less: Allowance for Loan Losses | (415) | - | (166) | (581) | - | (581) |
| **Net Loans** | $ 30,552 | $ 45,473 | $ 20,315 | $ 96,340 | $ - | $ 96,340 |
| **Total Assets** | $ 30,927 | $ 45,564 | $ 20,405 | $ 96,896 | $ 30,871 (1) | $ 127,767 |
| (1) Other assets are comprised of: | | | | | | |
| Federal Funds Sold and Other Overnight Funds | | | | | | $ 1,020 |
| Investment Securities | | | | | | 29,191 |
| Other Assets | | | | | | 660 |

## Note 11 – Affiliated Associations

CoBank is chartered by the FCA to serve the Associations that provide credit and related financial services to or for the benefit of eligible borrowers/shareholders for qualified purposes in specific geographic areas in the United States. The Associations are not authorized by the Farm Credit Act to participate in the issuance of Systemwide Debt Securities. Therefore, we are the primary funding source for our affiliated Associations. As of March 31, 2018, we have 22 affiliated Associations serving 23 states across the Northwest, West, Southwest, Rocky Mountains, Mid-Plains, and Northeast regions of the United States.

The Associations originate and service long-term real estate mortgage loans as well as short- and intermediate-term loans for agricultural and other purposes to full and part-time farmers. Associations may also make loans to, among others, processing and marketing entities, farm-related businesses, and rural residents for home purchase and improvements. The Associations may also purchase eligible loan participations from System entities and other lending institutions. Additionally, the Associations may serve as an intermediary in offering multi-peril crop insurance and credit life insurance, and providing additional financial services to borrowers.

The Farm Credit Act and FCA regulations require us to monitor and approve certain activities of our affiliated Associations. CoBank and our affiliated Associations operate under a creditor/debtor relationship evidenced by a General Financing Agreement (GFA) entered into separately with each Association. The GFA sets forth the creditor/debtor relationship between us and each Association and also references certain requirements contained in the Farm Credit Act and FCA regulations. The Associations' respective boards of directors are expected to establish and monitor the necessary policies and procedures to comply with all FCA regulations. In all other respects, the lending relationship with the Associations is substantially similar to that with our other borrowers.

Our affiliated Associations are considered customers and thus operate independently and maintain an arms-length relationship with us, except to the extent that the Farm Credit Act requires us, as the funding bank, to monitor and approve certain activities of these Associations. Accordingly, the financial information of affiliated Associations is not included in our condensed consolidated financial statements.

# Regulatory Capital Disclosures

**CoBank, ACB**

*(Unaudited) ($ in Thousands, Except as Noted)*

### *Overview*

These quarterly regulatory capital disclosures (set forth in Title 12 of the Code of Federal Regulations parts 628.61 through 628.63) should be read in conjunction with our 2017 Annual Report to Shareholders, which includes additional qualitative disclosures. Unless otherwise noted, there have been no material changes to the qualitative disclosures contained in our 2017 Annual Report.

The following table summarizes the interim disclosure requirements and indicates where each matter is disclosed in this quarterly report.

| Disclosure Requirement | Description | Q1 2018 Quarterly Report Reference |
|---|---|---|
| Scope of Application | Corporate entity and consolidated subsidiaries | Page 52 |
| Capital Structure | Regulatory capital components | Pages 52 through 53 |
| Capital Adequacy | Risk-weighted assets | Page 54 |
| | Regulatory capital ratios | Page 13 |
| Capital Buffers | Quantitative disclosures | Pages 13, 54 |
| Credit Risk | Summary of exposures | Page 55 |
| | Geographic distribution | Page 56 |
| | Industry distribution | Page 57 |
| | Contractual maturity | Page 57 |
| | Impaired loans and allowance for credit losses | Note 3 |
| Counterparty Credit Risk-Related Exposures | Counterparty exposures | Note 6, Page 57 |
| Credit Risk Mitigation | Exposures with reduced capital requirements | Pages 6, 9, 58 through 59 |
| Securitization | Securitization exposures | Notes 4 and 7, Pages 11, 59 |
| Equities | General description | Page 60 |
| Interest Rate Risk for Non-Trading Activities | Interest rate sensitivity | Note 6, Page 60 |

### *Scope of Application*

The disclosures contained herein relate to CoBank, ACB and its wholly-owned subsidiaries, CoBank, FCB and Farm Credit Leasing Services Corporation (FCL), collectively hereinafter referred to as CoBank or the Bank. These entities are also consolidated in our financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). FCL is required to comply with the New Capital Regulations on a standalone basis, but it is not required to make the disclosures contained herein for CoBank as a whole. FCL's capital ratios exceeded the minimum regulatory requirements at March 31, 2018.

### *Capital Structure*

Common equity tier 1, which includes common stock and retained earnings, is the largest component of the Bank's capital structure. Preferred stock is also included in tier 1 regulatory capital, subject to certain limitations. In addition, our allowance for credit losses is included in tier 2 regulatory capital, subject to certain limitations.

The following table provides a summary of the Bank's regulatory capital components.

| Regulatory Capital Components | | |
|---|---|---|
| **Three Months Ended March 31, 2018** | | **Average Balance** |
| **Common Equity Tier 1 Capital (CET1)** | | |
| Common Cooperative Equities: | | |
| Statutory Minimum Purchased Borrower Stock | $ | 2,487 |
| Other Required Member Purchased Stock | | 716,764 |
| Allocated Equities: | | |
| Qualified Allocated Equities Subject to Retirement | | 2,492,386 |
| Nonqualified Allocated Equities Subject to Retirement | | - |
| Nonqualified Allocated Equities Not Subject to Retirement | | 2,691,580 |
| Unallocated Retained Earnings | | 2,007,138 |
| Paid-In Capital | | - |
| Regulatory Adjustments and Deductions Made to CET1 | | (62,192) |
| **Total CET1** | $ | 7,848,163 |
| **Tier 1 Capital** | | |
| Non-Cumulative Perpetual Preferred Stock | $ | 1,500,000 |
| Regulatory Adjustments and Deductions Made to Tier 1 Capital | | - |
| **Total Additional Tier 1 Capital** | | 1,500,000 |
| **Total Tier 1 Capital** | $ | 9,348,163 |
| **Tier 2 Capital** | | |
| Common Cooperative Equities Not Included in CET1 | $ | 22,979 |
| Tier 2 Capital Elements: | | |
| Allowance for Credit Losses | | 676,437 |
| Regulatory Adjustments and Deductions Made to Tier 2 Capital | | - |
| **Total Tier 2 Capital** | $ | 699,416 |
| **Total Capital** | $ | 10,047,579 |

### *Capital Adequacy and Capital Buffers*

Our risk-adjusted regulatory capital ratios are calculated by dividing the relevant total capital elements (e.g. Total CET1) by risk-weighted assets. The following table presents information on the components of risk-weighted assets included in the calculation of regulatory capital ratios.

**Risk-Weighted Assets**

| Three Months Ended March 31, 2018 | | Average Balance |
|---|---|---|
| **On-Balance Sheet Assets:** | | |
| Exposures to Sovereign Entities | $ | - |
| Exposures to Supranational Entities and Multilateral Development Banks | | 180,612 |
| Exposures to Government-Sponsored Enterprises(1) | | 11,697,956 |
| Exposures to Depository Institutions, Foreign Banks, and Credit Unions(2) | | 3,057,739 |
| Exposures to Public Sector Entities | | 27,974 |
| Corporate Exposures, including Borrower Loans and Leases | | 43,952,669 |
| Residential Mortgage Exposures | | - |
| Past Due and Nonaccrual Exposures | | 356,495 |
| Securitization Exposures | | 239,737 |
| Equity Investment Exposures | | 17,260 |
| Other Assets | | 685,812 |
| **Off-Balance Sheet:** | | |
| Commitments | | 7,508,343 |
| Over-the-Counter Derivatives | | 143,406 |
| Cleared Transactions | | 434 |
| Letters of Credit | | 1,163,392 |
| Unsettled Transactions | | - |
| **Total Risk-Weighted Assets Before Additions/(Deductions)** | $ | 69,031,829 |
| **Additions:** | | |
| Intra-System Equity Investments | $ | 62,192 |
| **Deductions:** | | |
| Regulatory Adjustments and Deductions Made to CET1 | | (62,192) |
| Regulatory Adjustments and Deductions Made to Additional Tier 1 Capital | | - |
| Regulatory Adjustments and Deductions Made to Tier 2 Capital | | - |
| **Total Risk-Weighted Assets(3)** | $ | 69,031,829 |

(1) Includes exposures to Farm Credit System entities.

(2) Also includes exposures to other financial institutions that are risk weighted as exposures to U.S. depository institutions and credit unions.

(3) For purposes of calculating the permanent capital ratio, average risk-weighted assets for the three months ended March 31, 2018 was $68.4 billion.

As shown on page 13 of this quarterly report, the Bank exceeded all capital requirements as of March 31, 2018 to which it was subject, including applicable capital buffers. Because capital exceeded the buffer requirements, the Bank currently has no limitations on its distributions and discretionary bonus payments. The aggregate amount of eligible retained income was $612.0 million as of March 31, 2018.

### *Credit Risk*

The following table summarizes credit exposures related to loans, unfunded loan commitments, investment securities and letters of credit. The contractual amount of a commitment to extend credit represents our maximum exposure to credit loss in the event of default by the borrower, if the borrower were to fully draw against the commitment.

**Major Credit Exposures - Lending and Investments**

| Three Months Ended and As of March 31, 2018 | Average Balance | End of Period |
|---|---|---|
| Loans Outstanding | $ 101,657,100 | $ 102,285,364 |
| Unfunded Loan Commitments | 29,126,406 | 26,857,822 |
| Investment Securities | 28,226,070 | 29,393,485 |
| Letters of Credit | 1,438,865 | 1,511,701 |

The table below shows derivatives by underlying exposure type, segregated between contracts traded in over-the-counter markets and those cleared through a central clearinghouse. Gross positive fair value represents the credit exposure attributed to derivatives before the mitigating effects of counterparty collateral.

**Major Credit Exposures - Derivatives**

| Three Months Ended and As of March 31, 2018 | Average Balance | | End of Period | |
|---|---|---|---|---|
| | Notional Amount | Gross Positive Fair Value | Notional Amount | Gross Positive Fair Value |
| Over-the-Counter Derivatives: | | | | |
| Interest Rate Contracts | $ 21,257,297 | $ 204,860 | $ 21,025,160 | $ 206,233 |
| Foreign Exchange Contracts | 262,967 | 1,133 | 248,441 | 1,404 |
| Total Over-the-Counter Derivatives | $ 21,520,264 | $ 205,993 | $ 21,273,601 | $ 207,637 |
| Cleared Derivatives: | | | | |
| Interest Rate Contracts | 10,932,299 | 23,396 | 11,466,038 | 26,684 |
| **Total Derivatives** | $ 32,452,563 | $ 229,389 | $ 32,739,639 | $ 234,321 |

The following table illustrates the geographic distribution of our outstanding loans as of March 31, 2018.

**Total Lending Portfolio - Geographic Distribution**

| As of March 31, 2018 | Wholesale Loans[1] | Commercial Loans |
|---|---|---|
| California | 41 % | 7 % |
| Washington | 18 | 2 |
| Texas | 7 [2] | 6 |
| Connecticut | 12 | 1 |
| Kansas | 6 | 5 |
| Illinois | - | 6 |
| Iowa | - | 6 |
| Oklahoma | 4 | 2 |
| Colorado | 3 | 3 |
| Minnesota | - | 5 |
| Asia | - | 5 |
| Nebraska | - | 3 |
| Florida | - | 3 |
| Latin America | - | 3 |
| Ohio | - | 3 |
| New Mexico | 3 | 1 |
| Pennsylvania | 2 [2] | 1 |
| North Dakota | - | 3 |
| Missouri | - | 3 |
| Georgia | - | 2 |
| New York | - | 2 |
| Wisconsin | - | 2 |
| Mississippi | 1 [2] | 1 |
| Indiana | - | 2 |
| Utah | 2 | - |
| North Carolina | - | 2 |
| South Dakota | - | 2 |
| Arkansas | - | 2 |
| Virginia | - | 1 |
| South Carolina | - | 1 |
| New Jersey | - | 1 |
| Massachusetts | - | 1 |
| Europe, Middle East and Africa | - | 1 |
| Louisiana | - | 1 |
| Tennessee | - | 1 |
| Michigan | - | 1 |
| Other | 1 [2] | 9 |
| **Total** | 100 % | 100 % |

[1] The distribution of wholesale loans to Associations is based on the state in which the Association is headquartered and may not be representative of their underlying loan portfolio.

[2] Includes participation interests in loans to nonaffiliated Associations.

The following table illustrates the primary business/commodity distribution of our outstanding loans as of March 31, 2018.

**Total Lending Portfolio - Distribution by Primary Business/Commodity**

| As of March 31, 2018 | Share |
|---|---|
| Affiliated Associations | 41 % |
| Farm Supply and Grain Marketing | 12 |
| Electric Distribution | 9 |
| Agricultural Export Finance | 5 |
| Nonaffiliated Entities | 5 |
| Generation and Transmission | 3 |
| Lease Financing (through FCL) | 3 |
| Fruits, Nuts and Vegetables | 3 |
| Forest Products | 3 |
| Fish, Livestock and Poultry | 2 |
| Dairy | 2 |
| Independent Power Producers | 2 |
| Local Exchange Carriers | 1 |
| Water and Wastewater | 1 |
| Regulated Utility | 1 |
| Competitive Local Telephone Exchange Carriers | 1 |
| Sugar and Related Products | 1 |
| Other | 5 |
| **Total** | 100 % |

A summary of the remaining contractual maturity of our loans, unfunded commitments, investment securities, letters of credit and derivatives at March 31, 2018 follows.

($ in Millions)

**Contractual Maturity**

| As of March 31, 2018 | In One Year or Less | One to Five Years | After Five Years | Total |
|---|---|---|---|---|
| Loans Outstanding | $ 61,846 | $ 16,755 | $ 23,684 | $ 102,285 |
| Unfunded Loan Commitments | 13,052 | 8,131 | 5,675 | 26,858 |
| Investment Securities | 4,951 | 9,889 | 14,553 | 29,393 |
| Letters of Credit | 511 | 488 | 513 | 1,512 |
| Derivatives (Notional Amounts) | 5,694 | 15,888 | 11,158 | 32,740 |

Refer to Note 3 in the condensed consolidated financial statements in this quarterly report for amounts of impaired loans (with or without related allowance for credit loss), loans in nonaccrual status and greater than 90 days past due, loans past due greater than 90 days and still accruing interest, the allowance for credit losses, charge-offs, and changes in components of our allowance for credit losses.

### *Counterparty Credit Risk*

Refer to Note 6 in the condensed consolidated financial statements in this quarterly report for information related to derivative financial instruments utilized by CoBank including a summary of the fair value of derivative assets and liabilities, collateral held and net unsecured exposure.

### *Credit Risk Mitigation*

CoBank uses various strategies to mitigate credit risk in its lending, leasing, investing and derivatives activities. The disclosures in this section relate solely to credit risk mitigation instruments and activities that reduce regulatory capital requirements, which include certain guarantees in our lending and investment portfolios, and collateral or settlement payments in our derivatives portfolio.

#### Loans

Our Agricultural Export Finance Division (AEFD) utilizes the U.S. government-sponsored export loan guarantee General Sales Manager (GSM) program for a portion of its export financing. Refer to the Operating Segment Financial Review section on page 6 of this quarterly report for additional discussion related to our AEFD.

As discussed on page 9 of this quarterly report, our loans to affiliated Associations are collateralized by substantially all of the Association assets. In addition, the earnings, capital and loan loss reserves of the Associations provide additional layers of protection against losses in their respective retail loan portfolios. Lower regulatory capital requirements are commensurate with the lower risk profile associated with our loans to affiliated Associations.

#### Investments

Credit risk in our investment portfolio is mitigated by investing primarily in securities issued or guaranteed by the U.S. government or a government-sponsored enterprise (U.S. Agency). At March 31, 2018, 60 percent of our $29.4 billion investment portfolio consisted of securities that carry a full faith and credit guarantee of the U.S. government. Such securities include mortgage-backed securities (MBS) issued by the Government National Mortgage Association (Ginnie Mae), Export-Import Bank of the United States securities and U.S. Treasury and other debt securities, including loans backed by the Small Business Administration. Approximately 34 percent of our investment portfolio consisted of securities issued by a U.S. Agency, including MBS issued by the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac) and Federal Agricultural Mortgage Corporation (Farmer Mac).

An additional 4 percent of our investment portfolio consists of short-term certificates of deposit with highly-rated financial institutions. The remaining 2 percent of our investments primarily relates to a portfolio composed of FHA/VA non-wrapped reperformer MBS, non-agency MBS, asset-backed securities (ABS) and corporate bonds. With the exception of corporate bonds, which are risk-weighted based on the corporate counterparty, these exposures are captured in the Securitization section below.

The following table summarizes the loan and investment exposures whose capital requirements are reduced as a result of credit risk mitigants.

**Loan and Investment Exposures**

| Three Months Ended March 31, 2018 | Average Exposure Amount | Risk Weighted Exposures |
|---|---|---|
| Guaranteed Loans under the GSM program | $ 975,367 | $ - |
| Loans to Farm Credit System entities | 46,852,994 | 9,370,599 |
| Investment Securities Issued or Guaranteed by U.S. Government | 16,769,537 | - |
| Investment Securities Issued or Guaranteed by a U.S. Agency | 11,636,787 | 2,327,357 |
| **Total** | $ 76,234,685 | $ 11,697,956 |

## Derivatives

As described in Note 6 in the condensed consolidated financial statements in this quarterly report, transactions with dealers in our over-the-counter derivative portfolio as well as those cleared through a clearinghouse are collateralized or otherwise secured through settlement payments. As a result, at March 31, 2018, we held financial collateral totaling $128.0 million that offset derivative exposure for purposes of calculating risk-weighted assets.

### *Securitization*

The Bank participates in securitizations as investors through the purchase of MBS and ABS, which are included in our investment portfolio. As of March 31, 2018, CoBank did not retain any resecuritization exposures. The following disclosures relate only to MBS and ABS not guaranteed by the U.S. government or a U.S. Agency. The average balance of these unguaranteed securities was $214.1 million for the three-month period ended March 31, 2018.

Below is a summary of our securitization exposures held during the three months ended March 31, 2018 by exposure type and categorized by risk-weight band.

**Securitization Exposures**

| Three Months Ended March 31, 2018 | | Average Exposure Amount | | Risk Weighted Asset (Under Gross Up Approach) |
|---|---|---|---|---|
| Residential Mortgage-Backed Securities (MBS): | | | | |
| FHA/VA Non-Wrapped Reperformer | $ | 17,032 | $ | 18,799 |
| Non-Agency | | 19,093 | | 34,548 |
| Asset-Backed Securities (ABS) | | 177,924 | | 186,390 |
| **Total** | $ | 214,049 | $ | 239,737 |

**Securitization Risk-Weight Bands**

| Three Months Ended March 31, 2018 | | Average Exposure Amount | | Risk Weighted Asset |
|---|---|---|---|---|
| Gross-Up Risk-Weight Bands: | | | | |
| 100% - 125% | $ | 212,608 | $ | 222,796 |
| >125% and <1,250% | | 126 | | 504 |
| 1,250% | | 1,315 | | 16,437 |
| **Total** | $ | 214,049 | $ | 239,737 |

For the three-month period ended March 31, 2018, we did not hold any off-balance sheet securitization exposures nor were any securitization exposures deducted from capital.

Refer to Note 4 in the condensed consolidated financial statements in this quarterly report for additional information related to purchases and sales of securitization exposures as well as the amortized cost, unrealized gains/(losses) and fair value of MBS and ABS held in our investment portfolio. Refer to page 11 for additional information related to sales of securitization exposures during the first quarter of 2018. In addition, Note 7 of the quarterly report describes the methods and assumptions, including any changes as applicable, applied in valuing our MBS and ABS.

### *Equities*

The Bank does not have significant exposure to equity investments. We are a limited partner in certain Rural Business Investment Companies (RBICs). These RBICs facilitate investments in agriculture-related businesses that create growth and job opportunities in rural America. These investments are not publicly traded. There have been no sales or liquidations of these investments during the three months ended March 31, 2018.

### *Interest Rate Risk*

Interest rate risk, also referred to as market risk, is the risk that changes in interest rates may adversely affect operating results and financial condition. We use asset/liability models to evaluate the dynamics of our balance sheet and to estimate earnings volatility under different interest rate scenarios. Our analysis includes calculating the impact of significant increases or decreases in interest rates on net interest income, over a 12 month period, and the estimated market value of equity.

This analysis estimates the effect of immediate and sustained parallel shifts in the yield curve (called "shocks") of 100, 200 and 300 basis points. Pursuant to regulation and our Board policy, when the three-month Treasury rate is below 4 percent, as it was for the period presented, we perform a shock equal to one-half the three-month Treasury rate.

The following tables summarize the impact of interest rate changes on net interest income and the market value of equity.

| **Net Interest Income at Risk** | |
|---|---|
| **March 31, 2018** | |
| **Scenario:** | |
| - 300 bp shock | n/a |
| - 200 bp shock | n/a |
| - 100 bp shock | n/a |
| - 86 bp shock | (0.4) % |
| + 100 bp shock | 0.0 |
| + 200 bp shock | (0.3) |
| + 300 bp shock | (0.5) |

| **Market Value of Equity at Risk** | |
|---|---|
| **March 31, 2018** | |
| **Scenario:** | |
| - 300 bp shock | n/a |
| - 200 bp shock | n/a |
| - 100 bp shock | n/a |
| - 86 bp shock | 3.3 % |
| + 100 bp shock | (4.8) |
| + 200 bp shock | (9.8) |
| + 300 bp shock | (14.4) |

# Controls and Procedures

**CoBank, ACB**

We maintain a system of disclosure controls and procedures. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information disclosed by us in our quarterly and annual reports is accumulated and communicated to our management, including our chief executive officer and our chief financial officer, as appropriate, to allow timely decisions to be made regarding disclosure. The chief executive officer and the chief financial officer have evaluated our disclosure controls and procedures as of the end of the period covered by this quarterly report and have concluded that our disclosure controls and procedures are effective as of that date.

We also maintain a system of internal controls. The term “internal controls,” as defined by the American Institute of Certified Public Accountants’ Codification of Statement on Auditing Standards, AU-C Section 315, means a process - effected by the board of directors, management and other personnel - designed to provide reasonable assurance regarding the achievement of objectives in reliability of financial reporting, the effectiveness and efficiency of operations and compliance with applicable laws and regulations. We continually assess the adequacy of our internal control over financial reporting and enhance our controls in response to internal control assessments and internal and external audit and regulatory requirements and recommendations. There have been no significant changes in our internal controls or in other factors that could significantly affect such controls subsequent to the date we carried out our evaluations. In accordance with our internal control procedures, these financial statements were prepared under the oversight of the Audit Committee of our Board of Directors.

# Certification Required by Farm Credit Administration Regulations

The undersigned have reviewed this quarterly report which has been prepared in accordance with all applicable statutory or regulatory requirements and certify that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Signed this 10th day of May, 2018.

/s/ KEVIN G. RIEL

Kevin G. Riel
*Chair of the Board*

/s/ THOMAS E. HALVERSON

Thomas E. Halverson
*President and Chief Executive Officer*

/s/ DAVID P. BURLAGE

David P. Burlage
*Chief Financial Officer*

CERTIFICATION

I, Thomas E. Halverson, President and Chief Executive Officer of CoBank, ACB (CoBank or the Bank), a federally chartered instrumentality under the Farm Credit Act of 1971, as amended, certify that:

(1) I have reviewed this quarterly report of CoBank;

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of CoBank as of, and for, the periods presented in this report;

(4) CoBank's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for CoBank and have:

a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Bank, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
c. evaluated the effectiveness of the Bank's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
d. disclosed in this report any change in the Bank's internal control over financial reporting that occurred during the Bank's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting; and

(5) CoBank's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Bank's auditors and the audit committee of the Bank's board of directors (or persons performing the equivalent functions):

a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize, and report financial information; and
b. any fraud, whether or not material, that involves management or other employees who have a significant role in the Bank's internal control over financial reporting.

/s/ THOMAS E. HALVERSON

Thomas E. Halverson
*President and Chief Executive Officer*

Dated: May 10, 2018

CERTIFICATION

I, David P. Burlage, Chief Financial Officer of CoBank, ACB (CoBank or the Bank), a federally chartered instrumentality under the Farm Credit Act of 1971, as amended, certify that:

(1) I have reviewed this quarterly report of CoBank;

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of CoBank as of, and for, the periods presented in this report;

(4) CoBank's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for CoBank and have:

   a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Bank, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c. evaluated the effectiveness of the Bank's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d. disclosed in this report any change in the Bank's internal control over financial reporting that occurred during the Bank's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting; and

(5) CoBank's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Bank's auditors and the audit committee of the Bank's board of directors (or persons performing the equivalent functions):

   a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize, and report financial information; and
   b. any fraud, whether or not material, that involves management or other employees who have a significant role in the Bank's internal control over financial reporting.

/s/ DAVID P. BURLAGE

David P. Burlage
*Chief Financial Officer*

Dated: May 10, 2018

# Office Locations

**CoBank, ACB**

***CoBank National Office***
6340 S. Fiddlers Green Circle
Greenwood Village, CO 80111
P. O. Box 5110
Denver, CO 80217
(303) 740-4000
(800) 542-8072

***Farm Credit Leasing Services Corporation***
600 Highway 169 South, Suite 300
Minneapolis, MN 55426
(952) 417-7800
(800) 444-2929

***Washington, DC Office***
50 F Street, N.W., Suite 900
Washington, DC 20001
(202) 650-5860

## U.S. Regional Offices

***Ames Banking Center***
2515 University Boulevard, Suite 104
Ames, IA 50010
(515) 292-8828

***Atlanta Banking Center *****
2300 Windy Ridge Parkway, Suite 370S
Atlanta, GA 30339
(770) 618-3200
(800) 255-7429
FCL: (770) 618-3226

***Austin Banking Center *****
4801 Plaza on the Lake Drive
Austin, TX 78746
(855) 738-6606

***Enfield Banking Center *****
240B South Road
Enfield, CT 06082-4451
(860) 814-4043
(800) 876-3227
FCL: (860) 814-4049

***Fargo Banking Center***
4143 26th Avenue South, Suite 101
Fargo, ND 58104
(701) 277-5007
(866) 280-2892

***Florida Farm Credit Leasing Office ****
3594 Maribella Dr.
New Smyrna Beach, FL 32168
(678) 592-5394

***Kentucky Farm Credit Leasing Office ****
1601 Providence Place Parkway
Lexington, KY 40511
(859) 254-2741

***Louisville Banking Center***
1601 UPS Drive, Suite 102
Louisville, KY 40223
(502) 423-5650
(800) 262-6599

***Lubbock Banking Center***
5715 West 50th
Lubbock, TX 79414
(806) 788-3700

***Minneapolis Banking Center *****
600 Highway 169 South, Suite 300
Minneapolis, MN 55426
(952) 417-7900
(800) 282-4150
FCL: (800) 444-2929

***Ohio Farm Credit Leasing Office ****
1225 Irmscher Boulevard
Celina, OH 45822
(855) 838-9961 Ext. 23969

***Omaha Banking Center *****
13810 FNB Parkway, Suite 301
Omaha, NE 68154
(402) 492-2000
(800) 346-5717

***Sacramento Banking Center *****
3755 Atherton Road
Rocklin, CA 95765
(916) 380-3524
(800) 457-0942
FCL: (800) 289-7080

***Spokane Banking Center***
2001 South Flint Road, Suite 102
Spokane, WA 99224
(509) 363-8700
(800) 378-5577

***Sterling Banking Center***
229 South 3rd Street
Sterling, CO 80751
(970) 521-2774

***St. Louis Banking Center *****
635 Maryville Centre Drive, Suite 130
St. Louis, MO 63141
(314) 835-4200
(800) 806-4144
FCL: (800) 853-5480

***Wichita Banking Center *****
245 North Waco, Suite 130
Wichita, KS 67202
(316) 290-2000
(800) 322-3654
FCL: (800) 322-6558

## International

***Singapore Representative Office***
10 Hoe Chiang Road
#05-01 Keppel Towers
Singapore 089315
(65) 6534-5261

* *Farm Credit Leasing office only*
** *Farm Credit Leasing office within this CoBank location*

*CoBank's 2018 Quarterly and Annual Reports to Shareholders are available free of charge on request by calling or visiting one of our banking center locations and through our website at www.cobank.com on approximately May 10, 2018, August 9, 2018, November 9, 2018, and March 7, 2019 (Annual Report).*