Northwest
FARM CREDIT SERVICES

2019 Quarterly Report

March 31, 2019

Here to Help You Grow®

Quarterly Report
March 31, 2019
Northwest Farm Credit Services, ACA

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

The following commentary is a review of the consolidated financial condition and results of operations of Northwest Farm Credit Services, ACA and subsidiaries (Northwest FCS) for the three months ended March 31, 2019. These comments should be read in conjunction with the unaudited consolidated financial statements and related notes included in this report, as well as the 2018 Annual Report to Stockholders. Dollar amounts are in thousands unless otherwise noted. Stockholders may obtain copies of the 2018 Annual Report to Stockholders free of charge on Northwest FCS' website, www.northwestfcs.com, or upon request at Northwest Farm Credit Services, ACA, P.O. Box 2515, Spokane, Washington 99220-2515, or by telephone at (509) 340-5300 or toll free at (800) 743-2125.

The financial condition and results of operations of CoBank, ACB (CoBank), materially affect the risk associated with stockholder investments in Northwest FCS. Stockholders of Northwest FCS may obtain copies of CoBank's financial statements free of charge by accessing CoBank's website at www.cobank.com or upon request at Northwest Farm Credit Services, ACA, P.O. Box 2515, Spokane, Washington 99220-2515 or by telephone at (509) 340-5300 or toll free at (800) 743-2125.

The Consolidated Financial Statements were prepared under the oversight of the Audit Committee.

Forward-Looking Statements

Certain statements contained in this report that are not historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act. Actual results may differ materially from those included in the forward-looking statements that relate to 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 it is believed that information expressed or implied in such forward-looking statements is reasonable, no assurance can be given 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:

- Political (including trade policies), legal, regulatory, financial markets and economic conditions and developments in the United States and abroad;
- Economic fluctuations in the agricultural, rural infrastructure and farm-related business sectors;
- Weather-related, disease and other adverse climatic or biological conditions that impact agricultural productivity and income;
- Changes in U.S. government support of the agricultural industry and the Farm Credit System as a government-sponsored enterprise, as well as investor and rating agency reactions to events involving the U.S. government, other government-sponsored enterprises and other financial institutions;
- Actions taken by the Federal Reserve System in implementing monetary policy;
- Actions taken by the U.S. government to manage U.S. fiscal policy, including tax reform;
- Credit, interest rate and liquidity risk inherent in lending activities;
- Transition from LIBOR to an alternative index or indexes;
- Changes in assumptions for determining the allowance for credit losses and fair value measurements;
- Cybersecurity risks, including a failure or breach of operational or security systems or infrastructure, that could adversely affect business, financial performance and reputation;
- Nonperformance by counterparties to derivative positions;
- The resolution of legal proceedings and related matters; and
- Industry outlooks for agricultural conditions and land values.

Critical Accounting Policies

The financial statements are reported in conformity with accounting principles generally accepted in the United States of America. Northwest FCS considers significant accounting policies to be critical to the understanding of its financial condition and results of operations because some accounting policies require making complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. For a complete discussion of significant accounting policies, see Note 2 of the 2018 Annual Report to Stockholders. The following is a summary of certain critical policies.

Allowance for Credit Losses

The allowance for credit losses is comprised of the allowance for loan losses and the reserve for unfunded lending commitments (reflected in other liabilities in the Consolidated Balance Sheets). The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance for loan losses encompasses various judgments, evaluations and appraisals with respect to the loans and their underlying security that, by their nature, contain elements of uncertainty, imprecision and variability. Changes in the agricultural economy and environment, and their impact on borrower repayment capacity, will cause various judgments, evaluations and appraisals to change over time. Accordingly, actual circumstances could vary significantly from Northwest FCS' expectations and estimates. In determining and supporting the level of allowance for loan losses, management considers factors such as: the loan portfolio composition and concentrations, collateral values, commodity prices, import/export levels, government assistance programs, regional and global economic effects and weather-related influences.

The allowance for loan losses includes components for loans individually evaluated for impairment and loans collectively evaluated for impairment. Generally, loans individually evaluated in the allowance for loan losses represent the difference between the recorded investment in the loan and the present value of the cash flows expected to be collected, discounted at the loan's effective interest rate, or at the fair value of the collateral, if the loan is collateral dependent. For those loans collectively evaluated for impairment, the allowance for loan losses is determined using an estimate of expected losses based on historical experience for similar loans.

The reserve for unfunded lending commitments is based on management's best estimate of losses inherent in lending commitments made to customers but not yet disbursed. Factors such as likelihood of disbursal and likelihood of losses given disbursement are utilized in determining this contingency.

Valuation Methodologies

Various valuation methodologies are applied to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets for which an observable liquid market exists, such as assets held in trust funds. Significant estimates and assumptions are also utilized to value items for which an observable liquid market does not exist. Examples of these items include nonaccrual loans, other property owned and standby letters of credit. These valuations require the use of various assumptions, including, but not limited to, discount rates, rates of return on assets, repayment rates, cash flows, default rates, liquidation values and realization of deferred tax assets in future years.

Results of Operations

Net income for the three months ended March 31, 2019, was $66,078 compared to $74,769 for the same period of the prior year. The decrease was primarily due to a $2,649 refund received from the Farm Credit System Insurance Corporation (Insurance Corporation) of excess amounts in the Farm Credit Insurance Fund (Insurance Fund) in the current year compared to a $7,124 refund received in the prior year. As more fully explained in Note 1 of the 2018 Annual Report to Stockholders, when the Insurance Fund exceeds the statutory 2 percent secure base amount, the Insurance Corporation is required to reduce premiums and may refund excess amounts. The Insurance Fund ended 2018 and 2017 above the secure base amount, and consequently in the first quarter of 2019 and 2018, the Insurance Corporation voted to return excess amounts to Farm Credit System entities. A provision for credit losses compared to a credit loss reversal for the same period in the prior year also contributed to the decline in net income.

Net interest income was $81,653 for the three months ended March 31, 2019, compared to $79,547 for the same period of the prior year. Influences on net interest income from changes in effective rates on, and volume of, interest earning assets and interest bearing liabilities are presented in the following table:

Change between the three months ended March 31, 2019 and 2018	*Change in income/expense*	*Change in rate*	*Change in volume*
Total interest income	$ 18,977	$ 12,939	$ 6,038
Total interest expense	(16,871)	(14,813)	(2,058)
Net interest income	$ 2,106	$ (1,874)	$ 3,980

Information regarding the average daily balances and average rates earned and paid are presented in the following table:

For the three months ended March 31,	*2019*	*2018*
Net interest income	$ 81,653	$ 79,547
Average balances:		
Average interest earning assets	$ 11,318,382	$ 10,797,387
Average interest bearing liabilities	$ 9,136,869	$ 8,741,305
Net interest margin	2.93%	2.99%

During the three months ended March 31, 2019 and 2018, there was a provision for credit losses of $3,455 and a credit loss reversal of $19, respectively. Refer to the Consolidated Balance Sheets section for an additional discussion on credit quality.

Noninterest income for the three months ended March 31, 2019, was $27,835 compared to $32,727 for the same period for the prior year, a decrease of $4,892 or 15.0 percent, primarily due to a decline in the Insurance Corporation refund previously discussed.

Noninterest expense for the three months ended March 31, 2019 and 2018, was $39,683 and $37,292, respectively, an increase of $2,391 or 6.4 percent. The increase in noninterest expense for the three month comparative periods was primarily related to salaries and employee benefits.

The effective income tax rate during the three months ended March 31, 2019, and 2018, was 0.4 percent and 0.3 percent, respectively. Tax rate estimates are based on the income from the taxable lending portfolio and include the effect of anticipated patronage distributions.

Outlook

The following highlights the general health of agricultural commodities with the greatest concentrations in the portfolio.

Dairy: Northwest FCS anticipates break-even returns for dairy in 2019. Futures markets suggest unprofitable prices through the first half of the year. Higher prices in the latter half are expected to offset first-half losses.

Forest Products: Log and lumber prices are expected to increase slightly and remain stable throughout 2019. Northwest FCS anticipates profitable returns for timberland owners and slightly weaker, yet profitable, margins for processors over the next 12 months.

Fruit and Tree Nuts: The principal commodity financed by Northwest FCS in this sector is apples. Northwest FCS expects slightly profitable returns over the next 12 months for apple producers. Lackluster apple prices driven by trade strife continue to weigh on producer profitability.

Cattle and Livestock: The principal commodity financed by Northwest FCS in this sector is cattle and calves. Northwest FCS' outlook suggests slightly profitable returns throughout the beef industry, bolstered by strong domestic and foreign demand. Stagnant growth in the national cow herd favors higher prices. Additional winter feed costs will hinder profitability.

Potatoes: Northwest FCS anticipates lower production and inventory, leading to higher prices. Contracted potatoes will likely be profitable, and uncontracted potatoes are projected to be slightly profitable. Delayed planting foreshadows a smaller crop in 2019.

Grains: USDA projects the 2018-19 all-wheat price will be between $5.10 and $5.20 per bushel. Northwest FCS predicts this price should allow slightly profitable returns for producers. Unprofitable rotation crops, like peas, lentils and garbanzo beans, will weigh on producer profitability as trade strife continues.

For more information on the industries served by Northwest FCS, visit Industry Insights in the Resources section of www.northwestfcs.com.

Financial Condition

Loan Portfolio

Loans and accrued interest by type are presented in the following table:

	March 31, 2019	*December 31, 2018*	*Change*
Production agriculture:			
Real estate mortgage	$ 5,319,004	$ 5,347,044	$ (28,040)
Production and intermediate-term	2,845,597	2,984,821	(139,224)
Agribusiness:			
Processing and marketing	1,523,093	1,479,904	43,189
Loans to cooperatives	428,274	420,126	8,148
Farm related business	231,030	226,309	4,721
Rural infrastructure:			
Energy	206,912	191,370	15,542
Communications	55,357	61,418	(6,061)
Water and waste disposal	63,155	49,350	13,805
Rural residential real estate	593,533	609,700	(16,167)
Other:			
Leases	60,850	62,694	(1,844)
Other	12,612	15,649	(3,037)
Total	$ 11,339,417	$ 11,448,385	$ (108,968)

The loan portfolio is comprised of a wide array of commodities, which are summarized by concentration in the following table:

	March 31, 2019	*December 31, 2018*
Dairy	11.9%	12.2%
Forest products	10.9%	10.4%
Fruit and tree nuts	10.5%	10.5%
Cattle and livestock	9.1%	9.0%
Potatoes	6.9%	7.0%
Agricultural services	6.2%	5.8%
Grains	6.1%	6.3%
Ag processing	5.8%	6.0%
Other concentrations in aggregate	32.6%	32.8%
Total	100.0%	100.0%

Impaired loan volume is comprised of nonaccrual loans, restructured loans, and loans past due 90 days or more and still accruing interest. Nonperforming assets consist of impaired loans and other property owned. Comparative information regarding nonperforming assets in the portfolio, including accrued interest where appropriate, are presented in the following table:

	March 31, 2019	*December 31, 2018*
Nonperforming assets:		
Nonaccrual loans	$ 70,390	$ 73,452
Restructured accrual loans	12,884	14,441
Accrual loans 90 days or more past due	20,115	4,182
Total impaired loans and interest	$ 103,389	$ 92,075
Other property owned, net	297	373
Total nonperforming assets	$ 103,686	$ 92,448
Nonaccrual loans to total loans and accrued interest	0.6%	0.6%
Impaired loans to total loans and accrued interest	0.9%	0.8%
Nonperforming assets to total loans and accrued interest	0.9%	0.8%

Assets classified as impaired at March 31, 2019, increased by $11,238 compared to December 31, 2018. Loans 90 days or more past due and still accruing interest increased by $15,933 from December 31, 2018, and were adequately secured and in the process of collection. Nonaccrual loans decreased by $3,062 at March 31, 2019, compared to December 31, 2018 and consists primarily of Dairy, Ag Processing, Sugar Beets and Potato commodities. Accruing restructured loan volume decreased by $1,557 compared to December 31, 2018.

The allowance for credit losses at March 31, 2019, was $98,500 compared to $95,000 at December 31, 2018. For the three months ended March 31, 2019, there were net recoveries of $45 compared to $19 for the same period of the prior year.

At March 31, 2019, other assets decreased by $25,357 compared to December 31, 2018, including a reduction in patronage receivable from the receipt of patronage, partially offset by amounts recorded related to the estimate of patronage receivable for 2019 and the addition of right-of-use lease assets related to the implementation of the new lease accounting standard (for additional information, refer to Note 3 to the Consolidated Financial Statements).

At March 31, 2019, other liabilities decreased by $110,854 compared to December 31, 2018, primarily due to a reduction in patronage payable from the disbursement of patronage, partially offset by accruals recorded related to the estimate of patronage payable for 2019 and the addition of lease liabilities related to the implementation of the new lease accounting standard (for additional information, refer to Note 3 to the Consolidated Financial Statements).

Liquidity and Funding Source

Northwest FCS' primary source of liquidity and funding is CoBank. The funding arrangement is governed by a general financing agreement. Northwest FCS is currently in compliance with this agreement, including repayment pursuant to the individual terms and conditions of each debt obligation to CoBank. Management does not foresee significant concerns with obtaining funding or maintaining liquidity.

Capital Regulations

Farm Credit Administration (FCA) regulations require Northwest FCS to maintain minimums for common equity tier 1, tier 1 capital, total capital, and permanent capital risk-based capital ratios. In addition, the FCA requires Northwest FCS to maintain minimums for non-risk-adjusted ratios of tier 1 leverage and unallocated retained earnings and equivalents (UREE) leverage. At March 31, 2019 and December 31, 2018, the capital and leverage ratios exceeded regulatory minimums, as shown in the following table. See Note 8 of the 2018 Annual Report to Stockholders for a more complete description of these ratios.

	March 31, 2019	*December 31, 2018*	*Regulatory minimums*	*Capital conservation buffer*	*Total regulatory minimums with buffer*
Risk-adjusted:					
Common equity tier 1 ratio	17.5%	17.6%	4.5%	2.5%*	7.0%
Tier 1 capital ratio	17.5%	17.6%	6.0%	2.5%*	8.5%
Total capital ratio	18.3%	18.5%	8.0%	2.5%*	10.5%
Permanent capital ratio	17.7%	17.8%	7.0%	N/A	7.0%
Non-risk-adjusted:					
Tier 1 leverage ratio	19.0%	19.2%	4.0%	1.0%	5.0%
UREE leverage ratio	20.1%	20.1%	1.5%	N/A	1.5%

** The 2.5 percent capital conservation buffer over risk-adjusted ratio minimums will be phased in over three years under the FCA capital requirements.*

Certification

The undersigned certify that they have reviewed this report and it has been prepared in accordance with all applicable statutory or regulatory requirements and that the information contained herein is true, accurate and complete to the best of their knowledge and belief. There were no material changes in the internal control over financial reporting during the three months ended March 31, 2019.

Phil DiPofi
President and CEO
May 10, 2019

Tom Nakano
EVP-Chief Administrative and Financial Officer
May 10, 2019

Greg Hirai
Chair of the Board
May 10, 2019

NORTHWEST FARM CREDIT SERVICES, ACA

Consolidated Balance Sheets

(dollars in thousands) (unaudited)

	March 31, 2019	December 31, 2018
ASSETS		
Cash	$ 10,371	$ 64,170
Loans	11,241,908	11,345,642
Less: allowance for loan losses	78,500	78,000
Net loans	11,163,408	11,267,642
Accrued interest receivable	97,601	102,828
Investment in CoBank, ACB	387,217	384,764
Premises and equipment, net	34,940	32,731
Other assets	109,339	134,696
Total assets	$ 11,802,876	$ 11,986,831
LIABILITIES		
Note payable to CoBank, ACB	$ 8,870,627	$ 8,969,333
Advance conditional payments and other interest bearing liabilities	232,987	242,872
Accrued interest payable	39,442	36,433
Other liabilities	98,026	208,880
Total liabilities	9,241,082	9,457,518
MEMBERS' EQUITY		
Capital stock and participation certificates	12,632	12,672
Accumulated other comprehensive loss, net of tax	(30,824)	(31,297)
Unallocated retained earnings	2,579,986	2,547,938
Total members' equity	2,561,794	2,529,313
Total liabilities and members' equity	$ 11,802,876	$ 11,986,831

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

NORTHWEST FARM CREDIT SERVICES, ACA

Consolidated Statements of Income

(dollars in thousands) (unaudited)

	For the three months ended March 31, 2019	2018
NET INTEREST INCOME		
Interest income	$ 144,057	$ 125,080
Interest expense	62,404	45,533
Net interest income	81,653	79,547
Provision for credit losses (credit loss reversal)	3,455	(19)
Net interest income after provision for credit losses (credit loss reversal)	78,198	79,566
NONINTEREST INCOME		
Patronage income	16,147	15,518
Financially related services	4,484	5,338
Loan and other fees	2,366	2,790
Other noninterest income	4,838	9,081
Total noninterest income	27,835	32,727
NONINTEREST EXPENSE		
Salaries and employee benefits	22,761	20,590
Purchased services	6,336	6,277
Occupancy and equipment expense	2,732	2,875
Insurance fund premium	1,897	1,789
Other noninterest expenses	5,957	5,761
Total noninterest expense	39,683	37,292
Income before income taxes	66,350	75,001
Provision for income taxes	272	232
Net income	$ 66,078	$ 74,769

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

NORTHWEST FARM CREDIT SERVICES, ACA

Consolidated Statements of Comprehensive Income

(dollars in thousands) (unaudited)

For the three months ended March 31,		***2019***		***2018***
Net income	$	66,078	$	74,769
Amortization of costs included in net periodic pension cost, net of deferred income tax		473		412
Other comprehensive income, net of tax		473		412
Comprehensive income	$	66,551	$	75,181

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

NORTHWEST FARM CREDIT SERVICES, ACA

Consolidated Statements of Changes in Members' Equity

(dollars in thousands) (unaudited)

For the three months ended March 31,		***2019***		***2018***
Balance at beginning of period	$	2,529,313	$	2,367,211
Comprehensive income		66,551		75,181
Capital stock and participation certificates issued		343		331
Capital stock and participation certificates retired		(383)		(403)
Patronage distribution accrued		(34,030)		(27,135)
Balance at end of period	$	2,561,794	$	2,415,185

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

NORTHWEST FARM CREDIT SERVICES, ACA

Consolidated Statements of Cash Flows

(dollars in thousands) (unaudited)

For the three months ended March 31,	***2019***	***2018***
Cash flows from operating activities:		
Net income	$ 66,078	$ 74,769
Adjustments to reconcile net income to net cash from operating activities:		
Provision for credit losses (credit loss reversal)	3,455	(19)
Depreciation and amortization	1,119	953
Net losses on early extinguishment of notes payable	976	103
Net losses (gains) on sales and valuation adjustments of other property owned	20	(86)
Net gains on receive fixed swaps	(47)	(2)
Accretion of zero-interest discount notes interest	(1,001)	(33)
Changes in:		
Accrued interest receivable	5,227	7,120
Other assets	40,360	39,130
Accrued interest payable	3,009	4,003
Other liabilities	(23,203)	(23,975)
Net cash provided by operating activities	95,993	101,963
Cash flows from investing activities:		
Decrease in loans, net	103,779	93,441
Decrease in CoBank, ACB and other investments	670	572
Purchases of premises and equipment	(1,334)	(1,453)
Proceeds from sales of premises and equipment and other property owned	61	414
Acquisition of insurance customer lists	(402)	-
Net cash provided by investing activities	102,774	92,974
Cash flows from financing activities:		
Decrease in notes payable, net	(101,465)	(146,916)
Payments on early extinguishment of notes payable	(976)	(103)
(Decrease) increase in advanced conditional payments	(11,820)	39,147
Capital stock and participation certificates issued	343	331
Capital stock and participation certificates retired	(383)	(403)
Distribution of patronage	(138,265)	(108,116)
Net cash used in financing activities	(252,566)	(216,060)
Net decrease in cash	(53,799)	(21,123)
Cash at beginning of period	64,170	29,904
Cash at end of period	$ 10,371	$ 8,781
Supplemental schedule of non-cash investing and financing activities:		
Loans transferred to other property owned	$ -	$ 90
Net loan recoveries	(45)	(19)
Stock patronage income received from CoBank	(2,453)	(2,585)
Patronage distribution accrued	34,030	27,135
Reclassification of stranded tax effects from accumulated other comprehensive loss to unallocated retained earnings	-	(192)
Supplemental cash information:		
Interest paid	$ 59,395	$ 41,530
Taxes paid (net of refunds)	183	2

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

NOTE 1 – Organization and Significant Accounting Policies

Organization

A description of the organization and operations of Northwest FCS, the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2018, are contained in the 2018 Annual Report to Stockholders. These unaudited results for the three months ended March 31, 2019, should be read in conjunction with the 2018 Annual Report to Stockholders. Amounts are in thousands unless otherwise noted.

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information. Accordingly, they do not include all of the disclosures required by GAAP for annual financial statements and should be read in conjunction with the audited financial statements as of and for the year ended December 31, 2018, as contained in the 2018 Annual Report to Stockholders.

In the opinion of management, the unaudited financial information is complete and reflects all adjustments, consisting of normal recurring adjustments, necessary for the fair statement of results for the interim period. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The Consolidated Income Statements for interim periods are not necessarily indicative of the results to be expected for the full year ending December 31, 2019. Descriptions of the significant accounting policies are included in the 2018 Annual Report to Stockholders. In the opinion of management, these policies and the presentation of the interim financial condition and results of operations conform with GAAP and prevailing practices within the banking industry.

Recently Issued or Adopted Accounting Pronouncements

In August 2018, the Financial Accounting Standards Board (FASB) issued guidance, Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Cost. The guidance aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by this guidance. This guidance becomes effective for interim and annual periods beginning after December 15, 2019. The guidance also requires an entity (customer) to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. It further specifies where to present expense and payments in the financial statements. Early adoption is permitted. The guidance is to be applied on a retrospective or prospective basis to all implementation costs incurred after the date of adoption. Northwest FCS is evaluating the impact of adoption on its financial condition, results of operations and financial statement disclosures.

In August 2018, the FASB issued guidance, Disclosure Framework — Changes to the Disclosure Requirements for Defined Benefit Plans. The guidance modifies the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. This guidance becomes effective for fiscal years ending after December 15, 2020. Early adoption is permitted. The guidance is to be applied on a retrospective basis for all periods. The adoption of this guidance will not impact Northwest FCS' financial condition or its results of operations but will impact the employee benefit plan disclosures.

In August 2018, the FASB issued guidance, Disclosure Framework — Changes to the Disclosure Requirements for Fair Value Measurement. The guidance modifies the requirements on fair value measurements by removing, modifying or adding to the disclosures. This guidance becomes effective for interim and annual periods beginning after December 15, 2019. Early adoption is permitted and an entity is permitted to early adopt any removal or modified disclosures and delay adoption of the additional disclosures until their effective date. The adoption of this guidance will not impact Northwest FCS' financial condition or its results of operations, but will impact the fair value measurements disclosures.

In August 2017, the FASB issued guidance, Targeted Improvements to Accounting for Hedging Activities. The guidance better aligns an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. The amendments in this guidance require an entity to present the earnings effect of the hedging instrument in the same income statement line item in which the earnings effect of the hedged item is reported. This guidance also addresses the timing of effectiveness testing, qualitative and quantitative effectiveness testing and components that can be excluded from effectiveness testing. This guidance became effective for interim and annual periods beginning after December 15, 2018. The adoption of this guidance did not have a material impact on Northwest FCS' financial condition or results of operations, but did impact the derivative disclosures.

In June 2016, the FASB issued guidance, Measurement of Credit Losses on Financial Instruments. The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. For public business entities that are not U.S. Securities and Exchange Commission filers this guidance becomes effective for interim and annual periods beginning after December 15, 2020, with early application permitted. Northwest FCS is currently evaluating the impact of adoption on its financial condition, results of operations and financial statement disclosures.

In February 2016, the FASB issued guidance, Leases. The guidance requires the recognition by lessees of lease assets and lease liabilities on the balance sheet for the rights and obligations created by those leases. Leases with lease terms of more than 12 months are impacted by this guidance. This guidance became effective for interim and annual periods beginning after December 15, 2018. The adoption of this guidance did not materially impact Northwest FCS' financial condition or its results of operations but did impact lease disclosures. Northwest FCS adopted this guidance on January 1, 2019 and upon adoption, recorded $13,712 of right-of-use lease assets, $14,201 of lease liabilities and no adjustment to retained earnings. For additional information, refer to Note 3.

NOTE 2 – Loans and Allowance for Credit Losses

A summary of loans follows:

	March 31, 2019	*December 31, 2018*
Real estate mortgage	$ 5,258,448	$ 5,276,940
Production and intermediate-term	2,822,740	2,964,171
Agribusiness	2,171,684	2,117,212
Rural residential real estate	591,643	607,835
Rural infrastructure	324,363	301,544
Other	73,030	77,940
Total loans	$ 11,241,908	$ 11,345,642

Northwest FCS may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume and comply with FCA regulations. The following tables present information regarding participations purchased and sold. Participations purchased volume in the tables exclude syndications and purchases of other interests in loans:

	Farm Credit institutions		*Non-Farm Credit institutions*		*Total*	
March 31, 2019	*Participations purchased*	*Participations sold*	*Participations purchased*	*Participations sold*	*Participations purchased*	*Participations sold*
Real estate mortgage	$ 412,654	$ 581,367	$ 30	$ 10	$ 412,684	$ 581,377
Production and intermediate-term	467,805	2,933,492	1,019	-	468,824	2,933,492
Agribusiness	850,570	883,294	1,201	13,553	851,771	896,847
Rural infrastructure	324,363	-	-	-	324,363	-
Other	60,463	-	-	-	60,463	-
Total	$ 2,115,855	$ 4,398,153	$ 2,250	$ 13,563	$ 2,118,105	$ 4,411,716

	Farm Credit institutions		*Non-Farm Credit institutions*		*Total*	
December 31, 2018	*Participations purchased*	*Participations sold*	*Participations purchased*	*Participations sold*	*Participations purchased*	*Participations sold*
Real estate mortgage	$ 421,870	$ 564,831	$ 46	$ 11	$ 421,916	$ 564,842
Production and intermediate-term	517,569	2,875,582	1,220	-	518,789	2,875,582
Agribusiness	827,709	855,863	408	12,681	828,117	868,544
Rural infrastructure	301,544	-	-	-	301,544	-
Other	62,356	-	-	-	62,356	-
Total	$ 2,131,048	$ 4,296,276	$ 1,674	$ 12,692	$ 2,132,722	$ 4,308,968

Nonperforming assets consist of impaired loans and other property owned. The nonperforming assets, including related accrued interest where applicable, are as follows:

	March 31, 2019	December 31, 2018
Nonaccrual loans:		
Real estate mortgage	$ 25,684	$ 26,802
Production and intermediate-term	15,708	16,096
Agribusiness	21,390	22,753
Rural residential real estate	3,735	3,740
Other	3,873	4,061
Total nonaccrual loans	$ 70,390	$ 73,452
Accruing restructured loans:		
Real estate mortgage	$ 3,224	$ 3,998
Production and intermediate-term	8,422	8,670
Agribusiness	-	-
Rural residential real estate	1,238	1,773
Total accruing restructured loans	$ 12,884	$ 14,441
Accruing loans 90 days or more past due:		
Real estate mortgage	$ 10,826	$ 1,274
Production and intermediate-term	8,941	2,908
Agribusiness	294	-
Rural residential real estate	54	-
Total accruing loans 90 days or more past due	$ 20,115	$ 4,182
Total impaired loans	$ 103,389	$ 92,075
Other property owned, net	297	373
Total nonperforming assets	$ 103,686	$ 92,448

One credit quality indicator utilized by Northwest FCS is the FCA Uniform Loan Classification System that categorizes loans into five categories. The categories are defined as follows:

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

The following tables show loans and related accrued interest classified under the FCA Uniform Loan Classification System as a percentage of total loans and related accrued interest by loan type:

March 31, 2019	*Acceptable*	*OAEM*	*Substandard/ doubtful*	*Total*
Real estate mortgage	92.2%	3.1%	4.7%	100.0%
Production and intermediate-term	90.0%	3.3%	6.7%	100.0%
Agribusiness	93.3%	4.3%	2.4%	100.0%
Rural residential real estate	96.1%	1.4%	2.5%	100.0%
Rural infrastructure	94.5%	0.0%	5.5%	100.0%
Other	92.9%	1.8%	5.3%	100.0%
Total	92.1%	3.2%	4.7%	100.0%

December 31, 2018	*Acceptable*	*OAEM*	*Substandard/ doubtful*	*Total*
Real estate mortgage	91.8%	3.5%	4.7%	100.0%
Production and intermediate-term	89.9%	3.5%	6.6%	100.0%
Agribusiness	94.6%	2.7%	2.7%	100.0%
Rural residential real estate	96.4%	1.3%	2.3%	100.0%
Rural infrastructure	98.0%	2.0%	0.0%	100.0%
Other	93.0%	1.8%	5.2%	100.0%
Total	92.2%	3.2%	4.6%	100.0%

The following tables provide an aging analysis of past due loans and accrued interest:

March 31, 2019	*Current loans*	*30-89 days past due*	*90+ days past due*	*Total past due*	*Total*	*Recorded investment 90+ days and accruing interest*
Real estate mortgage	$ 5,277,040	$ 15,451	$ 26,513	$ 41,964	$ 5,319,004	$ 10,826
Production and intermediate-term	2,797,581	31,003	17,013	48,016	2,845,597	8,941
Agribusiness	2,181,745	-	652	652	2,182,397	294
Rural residential real estate	589,167	2,913	1,453	4,366	593,533	54
Rural infrastructure	325,424	-	-	-	325,424	-
Other	72,662	800	-	800	73,462	-
Total	$ 11,243,619	$ 50,167	$ 45,631	$ 95,798	$ 11,339,417	$ 20,115

December 31, 2018	*Current loans*	*30-89 days past due*	*90+ days past due*	*Total past due*	*Total*	*Recorded investment 90+ days and accruing interest*
Real estate mortgage	$ 5,304,210	$ 24,832	$ 18,002	$ 42,834	$ 5,347,044	$ 1,274
Production and intermediate-term	2,950,152	23,296	11,373	34,669	2,984,821	2,908
Agribusiness	2,124,928	1,201	210	1,411	2,126,339	-
Rural residential real estate	604,004	3,796	1,900	5,696	609,700	-
Rural infrastructure	302,138	-	-	-	302,138	-
Other	77,372	971	-	971	78,343	-
Total	$ 11,362,804	$ 54,096	$ 31,485	$ 85,581	$ 11,448,385	$ 4,182

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

Additional impaired loan information, including related accrued interest where applicable, is as follows:

March 31, 2019	Recorded investment	Unpaid principal balance *	Related allowance	Average impaired loans	Interest income recognized on impaired loans
Impaired loans with a related allowance for loan losses:					
Real estate mortgage	$ -	$ -	$ -	$ -	$ -
Production and intermediate-term	724	956	230	751	-
Agribusiness	7,259	8,012	3,222	7,378	-
Rural residential real estate	346	327	12	345	-
Other	-	-	-	-	-
Total impaired loans with a related allowance	$ 8,329	$ 9,295	$ 3,464	$ 8,474	$ -
Impaired loans with no related allowance for loan losses:					
Real estate mortgage	$ 39,734	$ 39,329	$ -	$ 33,788	$ 365
Production and intermediate-term	32,347	35,779	-	27,670	232
Agribusiness	14,425	15,243	-	15,025	2
Rural residential real estate	4,681	4,859	-	4,832	62
Other	3,873	3,911	-	3,900	35
Total impaired loans with no related allowance	$ 95,060	$ 99,121	$ -	$ 85,215	$ 696
Total impaired loans:					
Real estate mortgage	$ 39,734	$ 39,329	$ -	$ 33,788	$ 365
Production and intermediate-term	33,071	36,735	230	28,421	232
Agribusiness	21,684	23,255	3,222	22,403	2
Rural residential real estate	5,027	5,186	12	5,177	62
Other	3,873	3,911	-	3,900	35
Total impaired loans	$ 103,389	$ 108,416	$ 3,464	$ 93,689	$ 696

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

December 31, 2018	Recorded investment	Unpaid principal balance *	Related allowance	Average impaired loans	Interest income recognized on impaired loans
Impaired loans with a related allowance for loan losses:					
Real estate mortgage	$ -	$ -	$ -	$ 10,936	$ -
Production and intermediate-term	768	1,003	174	4,080	-
Agribusiness	7,719	8,010	3,371	7,119	-
Rural residential real estate	341	326	8	462	-
Other	-	-	-	344	-
Total impaired loans with a related allowance	$ 8,828	$ 9,339	$ 3,553	$ 22,941	$ -
Impaired loans with no related allowance for loan losses:					
Real estate mortgage	$ 32,074	$ 32,073	$ -	$ 22,973	$ 705
Production and intermediate-term	26,906	30,456	-	23,813	1,351
Agribusiness	15,034	15,591	-	10,084	114
Rural residential real estate	5,172	5,355	-	3,668	271
Other	4,061	4,100	-	2,176	148
Total impaired loans with no related allowance	$ 83,247	$ 87,575	$ -	$ 62,714	$ 2,589
Total impaired loans:					
Real estate mortgage	$ 32,074	$ 32,073	$ -	$ 33,909	$ 705
Production and intermediate-term	27,674	31,459	174	27,893	1,351
Agribusiness	22,753	23,601	3,371	17,203	114
Rural residential real estate	5,513	5,681	8	4,130	271
Other	4,061	4,100	-	2,520	148
Total impaired loans	$ 92,075	$ 96,914	$ 3,553	$ 85,655	$ 2,589

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

A summary of changes in the allowance for loan losses is as follows:

	Real estate mortgage	Production and intermediate-term	Agribusiness	Rural residential real estate	Rural infrastructure	Other	Total
Allowance for loan losses:							
Balance at December 31, 2018	$ 20,955	$ 30,871	$ 20,715	$ 2,693	$ 1,751	$ 1,015	$ 78,000
Charge-offs	-	(2)	(9)	-	-	-	(11)
Recoveries	9	31	-	16	-	-	56
(Loan loss reversals) provision for loan losses	(900)	(1,232)	1,446	(2)	1,146	(3)	455
Balance at March 31, 2019	$ 20,064	$ 29,668	$ 22,152	$ 2,707	$ 2,897	$ 1,012	$ 78,500
Ending balance: Allowance individually evaluated for impairment	$ -	$ 230	$ 3,222	$ 12	$ -	$ -	$ 3,464
Ending balance: Allowance collectively evaluated for impairment	20,064	29,438	18,930	2,695	2,897	1,012	75,036
Balance at March 31, 2019	$ 20,064	$ 29,668	$ 22,152	$ 2,707	$ 2,897	$ 1,012	$ 78,500

	Real estate mortgage	Production and intermediate-term	Agribusiness	Rural residential real estate	Rural infrastructure	Other	Total
Allowance for loan losses:							
Balance at December 31, 2017	$ 21,823	$ 30,920	$ 20,725	$ 3,114	$ 3,032	$ 2,386	$ 82,000
Charge-offs	(72)	(15)	(9)	-	-	-	(96)
Recoveries	13	82	20	-	-	-	115
Provision for loan losses (loan loss reversals)	121	(2,887)	2,789	(132)	(118)	(292)	(519)
Balance at March 31, 2018	$ 21,885	$ 28,100	$ 23,525	$ 2,982	$ 2,914	$ 2,094	$ 81,500
Ending balance: Allowance individually evaluated for impairment	$ 1,635	$ 972	$ 2,918	$ -	$ -	$ -	$ 5,525
Ending balance: Allowance collectively evaluated for impairment	20,250	27,128	20,607	2,982	2,914	2,094	75,975
Balance at March 31, 2018	$ 21,885	$ 28,100	$ 23,525	$ 2,982	$ 2,914	$ 2,094	$ 81,500

The recorded investment in loans, including accrued interest, is as follows:

	Real estate mortgage	Production and intermediate-term	Agribusiness	Rural residential real estate	Rural infrastructure	Other	Total
Recorded investment in loans outstanding:							
Ending balance: Loans individually evaluated for impairment	$ 28,908	$ 24,130	$ 21,390	$ 4,973	$ -	$ 3,873	$ 83,274
Ending balance: Loans collectively evaluated for impairment	5,290,096	2,821,467	2,161,007	588,560	325,424	69,589	11,256,143
Balance at March 31, 2019	$ 5,319,004	$ 2,845,597	$2,182,397	$ 593,533	$ 325,424	$ 73,462	$ 11,339,417
Recorded investment in loans outstanding:							
Ending balance: Loans individually evaluated for impairment	$ 30,800	$ 24,766	$ 22,753	$ 5,513	$ -	$ 4,061	$ 87,893
Ending balance: Loans collectively evaluated for impairment	5,316,244	2,960,055	2,103,586	604,187	302,138	74,282	11,360,492
Balance at December 31, 2018	$ 5,347,044	$ 2,984,821	$2,126,339	$ 609,700	$ 302,138	$ 78,343	$ 11,448,385

Northwest FCS maintains a contingency reserve for unfunded lending commitments, which reflects its best estimate of losses inherent in lending commitments made to customers but not yet disbursed. The reserve for unfunded lending commitments is a component of the allowance for credit losses and is included in other liabilities in the Consolidated Balance Sheets. The provision or reversal for unfunded lending commitments is included within the provision for credit losses or credit loss reversals in the Consolidated Statements of Income. A summary of changes in the reserve for unfunded lending commitments is as follows:

Three months ended March 31,	*2019*	*2018*
Balance at January 1,	$ 17,000	$ 22,500
Provision for unfunded lending commitments	3,000	500
Balance at March 31,	$ 20,000	$ 23,000

The following table presents information regarding troubled debt restructurings (TDRs), including accrued interest:

Three months ended March 31,	*2019*		*2018*	
	Pre-modification outstanding recorded investment	*Post-modification outstanding recorded investment*	*Pre-modification outstanding recorded investment*	*Post-modification outstanding recorded investment*
Troubled debt restructurings:				
Production and intermediate-term	-	-	31	31
Total	$ -	$ -	$ 31	$ 31

Note: Pre-modification represents the recorded investment prior to restructuring and post-modification represents the recorded investment immediately following the restructuring. The recorded investment is the face amount of the receivable increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, or acquisition costs and may also reflect a previous direct write-down of the investment.

The following table presents information regarding TDRs that occurred within the previous 12 months and for which there was a subsequent payment default during the period:

	March 31, 2019	*March 31, 2018*
Troubled debt restructurings that subsequently defaulted:		
Production and intermediate-term	$ -	$ 194
Total	$ -	$ 194

The following tables provide information on outstanding TDRs, including accrued interest. These loans are included as impaired loans in the impaired loans tables.

March 31, 2019	*Loans modified as TDRs*	*TDRs in nonaccrual status*
TDRs:		
Real estate mortgage	$ 4,268	$ 1,044
Production and intermediate-term	15,983	7,561
Agribusiness	6,893	6,893
Rural residential real estate	1,238	-
Total	$ 28,382	$ 15,498

December 31, 2018	*Loans modified as TDRs*	*TDRs in nonaccrual status*
TDRs:		
Real estate mortgage	$ 5,042	$ 1,044
Production and intermediate-term	16,263	7,593
Agribusiness	7,680	7,680
Rural residential real estate	1,773	-
Total	$ 30,758	$ 16,317

NOTE 3 – Leases

Adoption of the leasing standard impacted results as follows:

	As of March 31, 2019	As of December 31, 2018	Lease standard adjustment	As of January 1, 2019	Classification in Consolidated Balance Sheets
Operating leases	$ 15,271	$ -	$ 13,712	$ 13,712	Other assets
Finance leases	4,829	2,920	-	2,920	Premises and equipment, net
Total lease assets	$ 20,100	$ 2,920	$ 13,712	$ 16,632	
Operating leases	$ 16,079	$ -	$ 14,201	$ 14,201	Other liabilities
Financing leases	5,099	3,164	-	3,164	Advance conditional payments and other interest bearing liabilities
Total lease liabilities	$ 21,178	$ 3,164	$ 14,201	$ 17,365	

The components of lease expense were as follows:

For the three months ended March 31,	*2019*	*Classification in Consolidated Statements of Income*
Operating leases cost	$ 1,247	Occupancy and equipment expense
Short-term lease cost	3	Occupancy and equipment expense
Finance lease cost:		
Amortization of right-of-use assets	158	Occupancy and equipment expense
Interest on lease liabilities	83	Interest expense
Variable lease cost (costs excluded from lease payments)	176	Occupancy and equipment expense
Sublease income	(2)	Other noninterest income
Net lease cost	$ 1,665	

Other supplemental cash and non-cash information related to leases was as follows:

For the three months ended March 31,	*2019*
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows for operating leases	$ 1,270
Operating cash flows for finance leases	105
Financing cash flows for finance leases	134
Right-of-use assets obtained in exchange for lease obligations:	
Operating leases	$ 16,414
Finance leases	2,066

Lease term and discount rate are as follows:

	March 31, 2019
Weighted average remaining lease term in years:	
Operating leases	4.84
Finance leases	9.78
Weighted average discount rate:	
Operating leases	2.66%
Finance leases	7.65%

Future minimum lease payments under non-cancellable leases as of March 31, 2019 were as follows:

	Operating leases	Finance leases	Total
2019	$ 3,624	$ 680	$ 4,304
2020	3,929	896	4,825
2021	3,482	813	4,295
2022	2,699	671	3,370
2023	1,206	630	1,836
Thereafter total lease payments	2,218	3,052	5,270
Less: interest	(1,079)	(1,643)	(2,722)
Total	$ 16,079	$ 5,099	$ 21,178

NOTE 4 – Capital

Other Accumulated Comprehensive Loss

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

	Pension and other benefit plans, net of tax	Accumulated other comprehensive (loss) income, net of tax
Balance at December 31, 2018	$ (31,297)	$ (31,297)
Other comprehensive income before reclassifications	5	5
Amounts reclassified from accumulated other comprehensive loss	468	468
Net current period other comprehensive income	$ 473	$ 473
Balance at March 31, 2019	$ (30,824)	$ (30,824)

	Pension and other benefit plans, net of tax	Accumulated other comprehensive (loss) income, net of tax
Balance at December 31, 2017	$ (29,645)	$ (29,645)
Other comprehensive income before reclassifications	-	-
Amounts reclassified from accumulated other comprehensive loss	412	412
Consolidated Balance Sheets reclassification of stranded tax effects from accumulated other comprehensive loss to unallocated retained earnings	(192)	(192)
Net current period other comprehensive income	$ 220	$ 220
Balance at March 31, 2018	$ (29,425)	$ (29,425)

The following table represents amounts reclassified from accumulated other comprehensive loss, net of tax to the Consolidated Statements of Income:

	Amount reclassified from accumulated other comprehensive loss		Location of (losses) gains recognized in Consolidated Statements of Income
For the three months ended March 31,	*2019*	*2018*	
Pension and other benefit plans:			
Amortization of net actuarial loss	$ (469)	$ (431)	Salaries and employee benefits
Deferred tax	1	19	Provision for income taxes
Total reclassifications	$ (468)	$ (412)	

NOTE 5 – Income Taxes

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

For the three months ended March 31,		*2019*		*2018*
Federal tax at statutory rate	$	13,933	$	15,750
State tax, net		31		(20)
Effect of nontaxable activities		(9,664)		(11,906)
Effect of estimated patronage distribution		(3,138)		(5,699)
Adjustment to deferred tax asset valuation allowance		(987)		2,220
Other		97		(113)
Provision for income taxes	$	272	$	232

Deferred tax assets and liabilities were comprised of the following:

		March 31, 2019		*December 31, 2018*
Allowance for credit losses	$	11,481	$	11,120
Employee benefits, net		3,434		5,121
Interest on nonaccrual loans		758		684
Deferred loan fees and costs, net		211		216
Other		78		395
Gross deferred tax assets	$	15,962	$	17,536
Valuation allowance		(14,714)		(16,074)
Net deferred tax asset	$	1,248	$	1,462

Northwest FCS operates its long-term mortgage lending activities through a Federal Land Credit Association (FLCA) subsidiary and its short and intermediate-term lending activities through a Production Credit Association (PCA) subsidiary. Income earned by the FLCA subsidiary is exempt from federal and state income taxes.

NOTE 6 – Fair Value Measurements

Accounting guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. See Note 2 of the 2018 Annual Report to Stockholders for a more complete description.

Assets and liabilities measured at fair value on a recurring basis for each of the fair value hierarchy values are summarized in the following tables:

	Fair value measurement using							
March 31, 2019		*Level 1*		*Level 2*		*Level 3*		*Total fair value*
Assets:								
Assets held in trust	$	93	$	-	$	-	$	93
Derivative assets		-		2,211		-		2,211
Total assets	$	93	$	2,211	$	-	$	2,304
Liabilities:								
Derivative liabilities	$	-	$	3,162	$	-	$	3,162
Standby letters of credit		-		-		386		386
Total liabilities	$	-	$	3,162	$	386	$	3,548

December 31, 2018	Fair value measurement using Level 1	Level 2	Level 3	Total fair value
Assets:				
Assets held in trust	$ 93	$ -	$ -	$ 93
Derivative assets	-	764	-	764
Total assets	$ 93	$ 764	$ -	$ 857
Liabilities:				
Derivative liabilities	$ -	$ 5,522	$ -	$ 5,522
Standby letters of credit	-	-	443	443
Total liabilities	$ -	$ 5,522	$ 443	$ 5,965

The tables below represent a reconciliation of all Level 3 liabilities measured at fair value on a recurring basis using significant unobservable inputs:

	Standby letters of credit
Balance at December 31, 2018	$ 443
Issuances	67
Settlements	(124)
Balance at March 31, 2019	$ 386

	Standby letters of credit
Balance at December 31, 2017	$ 554
Issuances	59
Settlements	(187)
Balance at March 31, 2018	$ 426

Assets measured at fair value on a non-recurring basis for each of the fair value hierarchy values are summarized in the following table:

	Fair value measurement using Level 1	Level 2	Level 3	Total fair value
Assets:				
Nonaccrual loans				
March 31, 2019	$ -	$ -	$ 4,896	$ 4,896
December 31, 2018	$ -	$ -	$ 5,478	$ 5,478
Other property owned				
March 31, 2019	$ -	$ -	$ 325	$ 325
December 31, 2018	$ -	$ -	$ 425	$ 425

Valuation Techniques

As more fully discussed in Note 2 of the 2018 Annual Report to Stockholders, accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following represents a brief summary of the valuation techniques used for Northwest FCS' assets and liabilities.

Assets Held in Trusts

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

Nonaccrual Loans

For nonaccrual loans, it is assumed that collection will result from the disposition of the underlying collateral. Fair value of these loans is estimated to equal the aggregate net realizable value of the underlying collateral. When the net realizable value of collateral exceeds the legal obligation for a particular loan, the legal obligation was used for evaluating fair values of the respective loans. The carrying value of accrued interest receivable was assumed to approximate its fair value. As a result, nonaccrual loans are classified within the fair value Level 3 hierarchy.

Other Property Owned

The process for measuring the fair value of other property owned involves the use of appraisals or other market-based information. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. As a result, other property owned is classified within the fair value Level 3 hierarchy.

Derivative Assets and Liabilities

Exchange-traded derivatives valued using quoted prices would be classified within Level 1 of the valuation hierarchy. However, few classes of derivative contracts are listed on an exchange; thus, the derivative positions are valued using internally developed models that use as their basis readily observable market parameters and are classified within Level 2 of the valuation hierarchy. Such derivatives include interest rate swaps and foreign currency forward contracts.

The models used to determine the fair value of derivative assets and liabilities use an income approach based on observable market inputs, including the LIBOR and Overnight Index Swap curves and volatility assumptions about future interest rate movements.

Standby Letters of Credit

The fair value of standby letters of credit was based on fees currently charged for similar agreements or the estimated cost to terminate or otherwise settle similar obligations. The standby letters of credit are classified within the fair value Level 3 hierarchy.

NOTE 7 – Derivative Instruments and Hedging Activities

Risk Management Objectives and Strategies

Northwest FCS maintains an overall risk management strategy that incorporates the use of derivative financial instruments to minimize significant unplanned fluctuations in earnings that are caused by interest rate and foreign exchange rate volatility. The goal is to manage interest rate sensitivity and foreign exchange risk by modifying the repricing or maturity characteristics of certain balance sheet assets and liabilities and foreign currency exchange contracts. 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. Northwest FCS considers the strategic use of derivatives to be a prudent method of managing risk, as it prevents earnings from being exposed to undue risk posed by changes in interest rates or foreign exchange rates.

By using derivative instruments, Northwest FCS exposes itself to credit risk and market risk. Generally, when the fair value of a derivative contract is positive, this indicates that the counterparty owes Northwest FCS, thus creating a performance risk for Northwest FCS. When the fair value of the derivative contract is negative, Northwest FCS owes the counterparty and, therefore assumes no performance risk. Northwest FCS' derivative activities are monitored by its asset/liability committee (ALCO) as part of its oversight of the asset/liability and treasury functions. The ALCO is responsible for approving hedging strategies that are developed within parameters established by the Northwest FCS' Board of Directors. The resulting hedging strategies are then incorporated into Northwest FCS' overall risk-management strategies.

Uses of Derivatives

To achieve risk management objectives and satisfy the financing needs of its borrowers, Northwest FCS executes derivative transactions with CoBank. Derivatives (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, Northwest FCS agrees to exchange with CoBank, at specified intervals, interest payment streams calculated on a specified notional amount, with at least one interest payment stream based on a specified floating-rate index. Northwest FCS uses interest rate swaps where fixed-rate interest is received and floating-rate interest is paid with payment obligations tied to specific indices.

The notional amounts of derivatives and related activity of derivatives are shown in the following tables:

	Activity in the notional amounts of derivative financial instruments	
	Receive fixed swaps	Total
December 31, 2018	$ 556,000	$ 556,000
Additions	44,000	44,000
Maturities	-	-
Terminations	-	-
March 31, 2019	$ 600,000	$ 600,000

	Activity in the notional amounts of derivative financial instruments	
	Receive fixed swaps	Total
December 31, 2017	$ 395,000	$ 395,000
Additions	108,000	108,000
Maturities	-	-
Terminations	-	-
March 31, 2018	$ 503,000	$ 503,000

Accounting for Derivative Instruments and Hedging Activities

Northwest FCS records derivatives as assets or liabilities at their fair value in the Consolidated Balance Sheets. Northwest FCS records 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 Consolidated Statements of Income by changes in the hedged item’s fair value attributable to the risk being hedged. Northwest FCS records the ineffective portion of all hedges in current period earnings.

Fair-Value Hedges

The majority of the notional amount of the fair value hedging activity relates to entering into receive-fixed, pay-floating interest rate swaps primarily to synthetically convert non-callable fixed-rate debt to floating-rate debt for liquidity management purposes. For the remaining fair value hedges, Northwest FCS enters into receive-fixed, pay-floating swaps to align its equity positioning with its overall risk management strategy. Northwest FCS includes the gain or loss on the hedged items in the same line item (interest expense) as the offsetting loss or gain on the related interest rate swaps. As of March 31, 2019, and December 31, 2018 the following amounts were recorded on the balance sheet related to the cumulative basis adjustments for fair value hedges:

	Carrying amount of the hedged item		Cumulative amount of fair value hedging adjustment included in the carrying amount of the hedged item	
	March 31, 2019	December 31, 2018	March 31, 2019	December 31, 2018
Note payable to CoBank, ACB	$ 599,029	$ 551,268	$ (971)	$ (4,731)

Summary of Derivative Instruments and Hedging Activities

A summary of the impact of derivative financial instruments in the Consolidated Balance Sheets is shown in the following tables:

	Fair value of derivative financial instruments	
March 31, 2019	*Derivative assets (1)*	*Derivative liabilities (2)*
Receive fixed swaps	$ 2,211	$ 3,162
Total derivatives designated as hedging instruments	$ 2,211	$ 3,162

	Fair value of derivative financial instruments	
December 31, 2018	*Derivative assets (1)*	*Derivative liabilities (2)*
Receive fixed swaps	$ 764	$ 5,522
Total derivatives designated as hedging instruments	$ 764	$ 5,522

(1) Derivative assets are included in other assets in the Consolidated Balance Sheets.

(2) Derivative liabilities are included in other liabilities in the Consolidated Balance Sheets.

A summary of the impact of derivative financial instruments in the Consolidated Statements of Income and Consolidated Statements of Comprehensive Income is shown in the following tables:

	Derivative financial instruments in fair value hedging relationships	
	Net amount of gain or (loss) recognized in income on derivative and hedged item (1)	
For the three months ended March 31,	*2019*	*2018*
Receive fixed swaps	$ 47	$ 2
Total	$ 47	$ 2

(1) Located in interest expense in the Consolidated Statements of Income for each of the respective periods presented.

Counterparty Credit Risk

The use of derivatives for risk management introduces counterparty credit risk. Generally, when the fair value of a derivative contract is positive, Northwest FCS is exposed to credit risk. Northwest FCS has an International Securities Dealer Association agreement with CoBank, which meets the definition of a Qualifying Master Netting Agreement per FCA Regulations and requires the net settlement of covered contracts. Collateral is not exchanged between Northwest FCS and CoBank. Notwithstanding netting provisions, derivative assets and liabilities are not offset in the accompanying Consolidated Balance Sheets.

NOTE 8 –Employee Benefit Plans

The components of net periodic pension cost (income) are as follows:

For the three months ended March 31,	*2019*	*2018*
Components of net periodic benefit cost (income):		
Service cost	$ 11	$ 19
Interest cost	729	662
Expected return on plan assets	(967)	(1,246)
Amortization of net loss	469	431
Net periodic benefit cost (income)	$ 242	$ (134)

Northwest FCS previously disclosed in the 2018 Annual Report to Stockholders that it expects to make a contribution of approximately $1,000 to its Pension Plan during 2019. As of March 31, 2019, no contributions have been made. See Note 10 of the 2018 Annual Report to Stockholders for a more complete description of Employee Benefit Plans.

NOTE 9 – Subsequent Events

Northwest FCS has evaluated subsequent events through May 10, 2019, the date the financial statements were issued or available to be issued, and determined there are no other items to disclose.

Board of Directors

Greg Hirai, Chair	Wendell, Idaho
Nate Riggers, Vice Chair	Nezperce, Idaho
Christy Burmeister-Smith	Newman Lake, Washington
Nels DeBruycker	Choteau, Montana
Susan Doverspike	Burns, Oregon
Jim Farmer	Nyssa, Oregon
Duane (Skip) Gray	Albany, Oregon
David Hedlin	Mt. Vernon, Washington
John Helle	Dillon, Montana
Dave Nisbet	Bay Center, Washington
Derek Schafer	Ritzville, Washington
Karen Schott	Broadview, Montana
Julie Shiflett	Spokane, Washington
Shawn Walters	Newdale, Idaho

Management Executive Committee

Phil DiPofi	President and Chief Executive Officer
Tom Nakano	Executive Vice President-Chief Administrative and Financial Officer
Mark Nonnenmacher	Executive Vice President-Special Industry Lending & Services
Bill Perry	Executive Vice President-Lending & Insurance
John Phelan	Executive Vice President-Chief Risk and Credit Officer*
Linda Hendricksen*	Senior Vice President-Marketing and Public Affairs
Brent Fetsch	Oregon President
Mandy Minick	Washington President
Doug Robison	Idaho President
Megan Shroyer	Montana President

**Effective April 1, 2019*

Office Locations

Headquarters

2001 S Flint Road
Spokane, WA 99224*
(509) 340-5300

Idaho

73 Fort Hall Avenue, Suite A
American Falls, Idaho 83211
(208) 226-1340

370 N Meridian Street, Suite A
Blackfoot, Idaho 83221
(208) 782-3800

1408 Pomerelle Avenue, Suite B
Burley, Idaho 83318
(208) 678-6650

417 Main Street
Cottonwood, Idaho 83522
(208) 962-2280

1215 Pier View Drive
Idaho Falls, Idaho 83402*
(208) 552-2300

2631 Nez Perce Drive, Suite 201
Lewiston, Idaho 83501
(208) 799-4800

16034 Equine Drive
Nampa, Idaho 83687
(208) 468-1600

102 N State Street, Suite 2
Preston, Idaho 83263
(208) 852-2145

1036 Erikson Drive
Rexburg, Idaho 83440
(208) 656-2100

815 N College Road
Twin Falls, Idaho 83301
(208) 732-1000

139 River Vista Place, Suite 201
Twin Falls, ID 83301
(208) 732-1000

Montana

3490 Gabel Road, Suite 300
Billings, Montana 59102
(406) 651-1670

1001 W Oak Street, Suite 200
Bozeman, Montana 59715
(406) 556-7300

519 S Main Street
Conrad, Montana 59425
(406) 278-4600

134 E Reeder Street
Dillon, Montana 59725
(406) 683-1200

54147 US Highway 2, Suite A
Glasgow, Montana 59230
(406) 228-3900

700 River Drive S
Great Falls, Montana 59405
(406) 268-2200

1705 US Highway 2 NW, Suite A
Havre, Montana 59501
(406) 265-7878

120 Wunderlin Street, Suite 6
Lewistown, Montana 59457
(406) 538-7737

502 S Haynes Avenue
Miles City, Montana 59301
(406) 233-3100

3021 Palmer Street, Suite B
Missoula, Montana 59808
(406) 532-4900

123 N Central Avenue
Sidney, Montana 59270
(406) 433-3920

Oregon

3370 10th Street, Suite B
Baker City, Oregon 97814
(541) 524-2920

650 E Pine Street, Suite 106A
Central Point, Oregon 97502
(541) 665-6100

2345 NE Overlook Drive, Suite 100
Hillsboro, Oregon 97006
(503) 844-7920

94482 Highway 99 E
Junction City, Oregon 97448
(541) 685-6140

300 Klamath Avenue, Suite 200
Klamath Falls, Oregon 97601
(541) 850-7500

308 SE 10th Street
Ontario, Oregon 97914
(541) 823-2660

12 SW Nye Avenue
Pendleton, Oregon 97801
(541) 278-3300

3113 S Highway 97, Suite 100
Redmond, Oregon 97756
(541) 504-3500

2222 NW Kline Street
Roseburg, Oregon 97471
(541) 464-6700

650 Hawthorne Avenue SE,
Suite 210
Salem, Oregon 97301
(503) 373-3000

3591 Klindt Drive, Suite 110
The Dalles, Oregon 97058
(541) 298-3400

Washington

265 E George Hopper Road
Burlington, Washington 98233
(360) 707-2353

629 S Market Boulevard
Chehalis, Washington 98532
(360) 767-1100

224 N Main Street
Colfax, Washington 99111
(509) 397-2840

1501 E Yonezawa Boulevard
Moses Lake, Washington 98837
(509) 764-2700

9915 St. Thomas Drive
Pasco, Washington 99301*
(509) 542-3720

201 W Broadway Avenue, Suite B
Ritzville, Washington 99169
(509) 659-1105

2157 N Northlake Way, Suite 120
Seattle, WA 98103
(206) 691-2000

2001 S Flint Road, Suite 101
Spokane, WA 99224*
(509) 340-5600

2735 Allen Road
Sunnyside, Washington 98944
(509) 836-3080

1 W Pine Street
Walla Walla, Washington 99362
(509) 525-2400

2580 Chester Kimm Road
Wenatchee, Washington 98801
(509) 665-2160

1360 N 16th Avenue
Yakima, Washington 98902
(509) 225-3200

** Northwest FCS Owned*