2019 Quarterly Report

June 30, 2019

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Quarterly Report
June 30, 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 and six months ended June 30, 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. Additionally, the financial condition and results of operations of CoBank, ACB (CoBank), may 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, www.cobank.com, or upon request at Northwest Farm Credit Services, ACA. Requests can be made 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 June 30, 2019, was $67,194 compared to $69,743 for the same period of the prior year. The decrease for the three month comparative periods was primarily due to an increase in noninterest expense and a smaller credit loss reversal in the current period, partially offset by an increase to noninterest income in the current period. Net income for the six months ended June 30, 2019, was $133,272 compared to net income of $144,512 for the same period of the prior year. The decrease for the six month comparative periods was primarily due to a provision for credit losses compared to a credit loss reversal for the same period in the prior year, an increase to noninterest expense in the current year and 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.

Net interest income was $82,183 for the three months ended June 30, 2019, compared to $80,779 for the same period of the prior year. Net interest income was $163,836 for the six months ended June 30, 2019, compared to $160,326 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 June 30, 2019 and 2018	*Change in income/expense*	*Change in rate*	*Change in volume*
Total interest income	$ 14,060	$ 8,691	$ 5,369
Total interest expense	(12,656)	(10,654)	(2,002)
Net interest income	$ 1,404	$ (1,963)	$ 3,367

Change between the six months ended June 30, 2019 and 2018	*Change in income/expense*	*Change in rate*	*Change in volume*
Total interest income	$ 33,037	$ 21,629	$ 11,408
Total interest expense	(29,527)	(25,682)	(3,845)
Net interest income	$ 3,510	$ (4,053)	$ 7,563

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

For the three months ended June 30,	*2019*	*2018*
Net interest income	$ 82,183	$ 80,779
Average balances:		
Average interest earning assets	$ 11,305,354	$ 10,861,369
Average interest bearing liabilities	$ 9,130,482	$ 8,782,850
Net interest margin	2.92%	2.98%

For the six months ended June 30,	*2019*	*2018*
Net interest income	$ 163,836	$ 160,326
Average balances:		
Average interest earning assets	$ 11,311,832	$ 10,829,555
Average interest bearing liabilities	$ 9,133,658	$ 8,762,192
Net interest margin	2.92%	2.99%

During the three months ended June 30, 2019, there was a credit loss reversal of $61 and for the six months ended June 30, 2019 there was a provision for credit losses of $3,394. These are compared to credit loss reversals of $3,844 and 3,863 for the three and six months ended June 30, 2018. Refer to the Consolidated Balance Sheets section for an additional discussion on credit quality.

Noninterest income for the three months ended June 30, 2019, was $25,644 compared to $22,708 for the same period for the prior year, an increase of $2,936 or 12.9 percent, primarily due to an increase in financially related services, other noninterest income, and patronage income. Noninterest income for the six months ended June 30, 2019, was $53,479, which was a decrease of $1,956 or 3.5 percent compared to $55,435 for the same period of the prior year, primarily due to the Insurance Corporation refund previously discussed, offset by an increase to patronage income and financially related services.

Noninterest expense for the three months ended June 30, 2019, and 2018, was $40,354 and $37,175, respectively, an increase of $3,179 or 8.6 percent. Noninterest expense for the six months ended June 30, 2019, and 2018 was $80,037 and $74,467, respectively, an increase of

$5,570 or 7.5 percent. The increase in noninterest expense for the three and six month comparative periods was primarily related to an increases in salaries and employee benefits.

The effective income tax rate during the three months ended June 30, 2019, and 2018, was 0.5 percent and 0.6 percent, respectively. The effective income tax rate during the six months ended June 30, 2019, and 2018, was 0.5 percent and 0.4 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.

Forest Products: Northwest FCS' 12-month outlook projects profitable margins for timberland owners and slightly profitable margins for forest products manufacturers. Despite early 2019 log price declines, timberland owners are expected to be profitable through the year. Processors are expected to be slightly profitable as they work through higher priced contracted log inventory with lower lumber pricing.

Dairy: Northwest FCS' 12-month dairy outlook anticipates slightly profitable returns in 2019. Futures markets suggest increasing Class III and Class IV milk prices for the remainder of 2019. This comes following slightly unprofitable to break-even returns through the first half of 2019.

Fruit and Tree Nuts: The principal commodity financed by Northwest FCS in this sector is apples. Northwest FCS' 12-month profitability outlook projects slight profitability for the apple industry. Downward price pressure from diminishing exports due to tariffs along with rising production and labor costs are expected to weigh on profitability.

Cattle and Livestock: The principal commodity financed by Northwest FCS in this sector is cattle and calves. Northwest FCS' 12-month outlook suggests slightly profitable returns throughout the beef industry. Trade negotiations and feed costs continue to fuel uncertainty in the market. Increasing feed costs are expected to shrink margins and ripple through fall calf prices.

Potatoes: Northwest FCS' 12-month outlook is for profitable contracted potatoes and slightly profitable uncontracted potatoes. Following a late spring, growing conditions have been ideal in Washington but challenging in Eastern Idaho. Producers with larger potatoes still in storage have the opportunity to capture higher prices as supplies decrease.

Grains: Northwest FCS' 12-month outlook is for slightly profitable returns. The United States Department of Agriculture's (USDA) projections suggest the 2018-19 season-average farm price for all-wheat will be $5.10 per bushel. Prices can vary depending on local basis prices.

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:

	June 30, 2019	December 31, 2018	Change
Production agriculture:			
Real estate mortgage	$ 5,506,976	$ 5,347,044	$ 159,932
Production and intermediate-term	2,981,991	2,984,821	(2,830)
Agribusiness:			
Processing and marketing	1,471,929	1,479,904	(7,975)
Loans to cooperatives	391,393	420,126	(28,733)
Farm related business	264,471	226,309	38,162
Rural infrastructure:			
Energy	228,063	191,370	36,693
Communications	62,857	61,418	1,439
Water and waste disposal	63,085	49,350	13,735
Rural residential real estate	573,788	609,700	(35,912)
Other:			
Leases	60,101	62,694	(2,593)
Other	12,253	15,649	(3,396)
Total	$ 11,616,907	$ 11,448,385	$ 168,522

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

	June 30, 2019	December 31, 2018
Forest products	11.3%	10.4%
Dairy	11.3%	12.2%
Fruit and tree nuts	11.3%	10.5%
Cattle and livestock	9.2%	9.0%
Potatoes	7.2%	7.0%
Grains	6.5%	6.3%
Ag processing	5.9%	6.0%
Agricultural services	5.6%	5.8%
Other concentrations in aggregate	31.7%	32.8%
Total	100.0%	100.0%

Impaired loan volume is comprised of nonaccrual loans, restructured loans, and accrual loans 90 days or more past due. 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:

		June 30, 2019		*December 31, 2018*
Nonperforming assets:				
Nonaccrual loans	$	77,172	$	73,452
Restructured accrual loans		12,759		14,441
Accrual loans 90 days or more past due		1,992		4,182
Total impaired loans and interest	$	91,923	$	92,075
Other property owned, net		28		373
Total nonperforming assets	$	91,951	$	92,448
Nonaccrual loans to total loans and accrued interest		0.7%		0.6%
Impaired loans to total loans and accrued interest		0.8%		0.8%
Nonperforming assets to total loans and accrued interest		0.8%		0.8%

Assets classified as impaired at June 30, 2019, decreased by $152 compared to December 31, 2018. Nonaccrual loans increased by $3,720 from December 31, 2018 and consists primarily of Dairy, Ag Processing, and Potato commodities. Accrual loans 90 days or more past due decreased by $2,190 from December 31, 2018, and were adequately secured and in the process of collection. Accruing restructured loan volume decreased by $1,682 compared to December 31, 2018.

The allowance for credit losses at June 30, 2019, was $98,500 compared to $95,000 at December 31, 2018. Net recoveries for the three and six months ended June 30, 2019, were $61 and $106, respectively. Net recoveries for the three and six months ended June 30, 2018, were $344 and $363, respectively.

At June 30, 2019, other assets decreased by $8,823 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 June 30, 2019, other liabilities decreased by $74,160 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 June 30, 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.

	June 30, 2019	*December 31, 2018*	*Regulatory minimums*	*Capital conservation buffer*	*Total regulatory minimums with buffer*
Risk-adjusted:					
Common equity tier 1 ratio	17.9%	17.6%	4.5%	2.5%*	7.0%
Tier 1 capital ratio	17.9%	17.6%	6.0%	2.5%*	8.5%
Total capital ratio	18.7%	18.5%	8.0%	2.5%*	10.5%
Permanent capital ratio	18.0%	17.8%	7.0%	N/A	7.0%
Non-risk-adjusted:					
Tier 1 leverage ratio	19.5%	19.2%	4.0%	1.0%	5.0%
UREE leverage ratio	20.6%	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 six months ended June 30, 2019.

Phil DiPofi
President and CEO
August 9, 2019

Tom Nakano
EVP-Chief Administrative and Financial Officer
August 9, 2019

Greg Hirai
Chair of the Board
August 9, 2019

NORTHWEST FARM CREDIT SERVICES, ACA

Consolidated Balance Sheets

(dollars in thousands) (unaudited)

		June 30, 2019		December 31, 2018
ASSETS				
Loans	$	11,506,655	$	11,345,642
Less: allowance for loan losses		78,000		78,000
Net loans		11,428,655		11,267,642
Cash		8,684		64,170
Accrued interest receivable		110,296		102,828
Investment in CoBank, ACB		387,217		384,764
Premises and equipment, net		34,225		32,731
Other assets		125,873		134,696
Total assets	$	12,094,950	$	11,986,831
LIABILITIES				
Note payable to CoBank, ACB	$	9,081,271	$	8,969,333
Advance conditional payments and other interest bearing liabilities		246,916		242,872
Accrued interest payable		36,897		36,433
Other liabilities		134,720		208,880
Total liabilities		9,499,804		9,457,518
MEMBERS' EQUITY				
Capital stock and participation certificates		12,682		12,672
Accumulated other comprehensive loss, net of tax		(30,363)		(31,297)
Unallocated retained earnings		2,612,827		2,547,938
Total members' equity		2,595,146		2,529,313
Total liabilities and members' equity	$	12,094,950	$	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 June 30,		For the six months ended June 30,	
	2019	2018	2019	2018
NET INTEREST INCOME				
Interest income	$ 145,393	$ 131,333	$ 289,450	$ 256,413
Interest expense	63,210	50,554	125,614	96,087
Net interest income	82,183	80,779	163,836	160,326
(Credit loss reversal) provision for credit losses	(61)	(3,844)	3,394	(3,863)
Net interest income after (credit loss reversal) provision for credit losses	82,244	84,623	160,442	164,189
NONINTEREST INCOME				
Patronage income	16,459	15,792	32,606	31,310
Financially related services	3,688	2,356	8,172	7,694
Loan and other fees	2,547	2,457	4,913	5,247
Other noninterest income	2,950	2,103	7,788	11,184
Total noninterest income	25,644	22,708	53,479	55,435
NONINTEREST EXPENSE				
Salaries and employee benefits	22,972	20,413	45,733	41,003
Purchased services	6,551	6,937	12,887	13,214
Occupancy and equipment expense	2,519	2,524	5,251	5,399
Insurance fund premium	1,882	1,791	3,779	3,580
Other noninterest expenses	6,430	5,510	12,387	11,271
Total noninterest expense	40,354	37,175	80,037	74,467
Income before income taxes	67,534	70,156	133,884	145,157
Provision for income taxes	340	413	612	645
Net income	$ 67,194	$ 69,743	$ 133,272	$ 144,512

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 six months ended June 30,		***2019***		***2018***
Net income	$	133,272	$	144,512
Amortization of costs included in net periodic pension cost, net of deferred income tax		934		836
Other comprehensive income, net of tax		934		836
Comprehensive income	$	134,206	$	145,348

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 six months ended June 30,		***2019***		***2018***
Balance at beginning of period	$	2,529,313	$	2,367,211
Comprehensive income		134,206		145,348
Capital stock and participation certificates issued		719		743
Capital stock and participation certificates retired		(709)		(762)
Patronage distribution accrued		(68,383)		(54,274)
Balance at end of period	$	2,595,146	$	2,458,266

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 six months ended June 30,	***2019***	***2018***
Cash flows from operating activities:		
Net income	$ 133,272	$ 144,512
Adjustments to reconcile net income to net cash from operating activities:		
Provision for credit losses (credit loss reversal)	3,394	(3,863)
Depreciation and amortization	2,217	2,026
Net losses on early extinguishment of notes payable	1,801	183
Net losses (gains) on sales and valuation adjustments of other property owned	119	(65)
Net gains on receive fixed swaps	(44)	-
Accretion of zero-interest discount notes interest	(2,369)	(154)
Changes in:		
Accrued interest receivable	(7,468)	(3,061)
Other assets	29,374	26,986
Accrued interest payable	464	3,988
Other liabilities	(18,534)	(15,175)
Net cash provided by operating activities	142,226	155,377
Cash flows from investing activities:		
Increase in loans, net	(160,937)	(40,235)
Decrease (increase) in CoBank, ACB and other investments	374	(285)
Purchases of premises and equipment	(1,649)	(1,631)
Proceeds from sales of premises and equipment and other property owned	263	1,588
Acquisition of insurance customer lists	(402)	-
Net cash used in investing activities	(162,351)	(40,563)
Cash flows from financing activities:		
Increase (decrease) in notes payable, net	102,635	(116,317)
Payments on early extinguishment of notes payable	(1,801)	(183)
Increase in advanced conditional payments	2,248	87,730
Capital stock and participation certificates issued	719	743
Capital stock and participation certificates retired	(709)	(762)
Distribution of patronage	(138,453)	(108,132)
Net cash used in financing activities	(35,361)	(136,921)
Net decrease in cash	(55,486)	(22,107)
Cash at beginning of period	64,170	29,904
Cash at end of period	$ 8,684	$ 7,797
Supplemental schedule of non-cash investing and financing activities:		
Loans transferred to other property owned	$ 30	$ 143
Net loan recoveries	(106)	(363)
Acquisition of premises and equipment	-	(486)
Stock patronage income received from CoBank	(2,453)	(2,585)
Patronage distribution accrued	68,383	54,274
Reclassification of stranded tax effects from accumulated other comprehensive loss to unallocated retained earnings	-	(192)
Supplemental cash information:		
Interest paid	$ 125,150	$ 92,099
Taxes paid, net of refunds	366	127

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 and six months ended June 30, 2019, should be read in conjunction with the 2018 Annual Report to Stockholders. Certain amounts in prior years' financial statement disclosure Note 5 – Income Taxes have been reclassified to conform to current financial statement presentation. 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:

	June 30, 2019	*December 31, 2018*
Real estate mortgage	$ 5,433,761	$ 5,276,940
Production and intermediate-term	2,959,035	2,964,171
Agribusiness	2,117,169	2,117,212
Rural residential real estate	571,851	607,835
Rural infrastructure	352,927	301,544
Other	71,912	77,940
Total loans	$ 11,506,655	$ 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*	
June 30, 2019	*Participations purchased*	*Participations sold*	*Participations purchased*	*Participations sold*	*Participations purchased*	*Participations sold*
Real estate mortgage	$ 451,025	$ 590,245	$ 29	$ 8	$ 451,054	$ 590,253
Production and intermediate-term	515,420	3,095,373	828	-	516,248	3,095,373
Agribusiness	886,602	799,954	2,239	7,500	888,841	807,454
Rural infrastructure	352,927	-	-	-	352,927	-
Other	59,705	-	-	-	59,705	-
Total	$ 2,265,679	$ 4,485,572	$ 3,096	$ 7,508	$ 2,268,775	$ 4,493,080

	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:

	June 30, 2019	*December 31, 2018*
Nonaccrual loans:		
Real estate mortgage	$ 27,582	$ 26,802
Production and intermediate-term	22,233	16,096
Agribusiness	20,246	22,753
Rural residential real estate	3,538	3,740
Other	3,573	4,061
Total nonaccrual loans	$ 77,172	$ 73,452
Accruing restructured loans:		
Real estate mortgage	$ 3,190	$ 3,998
Production and intermediate-term	8,346	8,670
Rural residential real estate	1,223	1,773
Total accruing restructured loans	$ 12,759	$ 14,441
Accruing loans 90 days or more past due:		
Real estate mortgage	$ 970	$ 1,274
Production and intermediate-term	1,022	2,908
Total accruing loans 90 days or more past due	$ 1,992	$ 4,182
Total impaired loans	$ 91,923	$ 92,075
Other property owned, net	28	373
Total nonperforming assets	$ 91,951	$ 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:

June 30, 2019	*Acceptable*	*OAEM*	*Substandard/ doubtful*	*Total*
Real estate mortgage	92.5%	3.0%	4.5%	100.0%
Production and intermediate-term	89.8%	4.0%	6.2%	100.0%
Agribusiness	92.7%	5.9%	1.4%	100.0%
Rural residential real estate	95.9%	1.6%	2.5%	100.0%
Rural infrastructure	95.0%	0.0%	5.0%	100.0%
Other	93.6%	1.4%	5.0%	100.0%
Total	92.1%	3.6%	4.3%	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:

June 30, 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	$ 5,481,328	$ 8,664	$ 16,984	$ 25,648	$ 5,506,976	$ 970
Production and intermediate-term	2,957,316	9,607	15,068	24,675	2,981,991	1,022
Agribusiness	2,123,430	4,011	352	4,363	2,127,793	-
Rural residential real estate	568,254	3,724	1,810	5,534	573,788	-
Rural infrastructure	354,005	-	-	-	354,005	-
Other	70,174	2,180	-	2,180	72,354	-
Total	$ 11,554,507	$ 28,186	$ 34,214	$ 62,400	$ 11,616,907	$ 1,992

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:

June 30, 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		6,224		7,071		448		2,618		-
Agribusiness		7,575		8,295		3,275		7,393		-
Rural residential real estate		355		331		7		349		-
Other		-		-		-		-		-
Total impaired loans with a related allowance	$	14,154	$	15,697	$	3,730	$	10,360	$	-
Impaired loans with no related allowance for loan losses:										
Real estate mortgage	$	31,742	$	31,675	$	-	$	33,124	$	589
Production and intermediate-term		25,377		28,026		-		27,267		456
Agribusiness		12,671		13,613		-		13,879		2
Rural residential real estate		4,406		4,561		-		4,641		120
Other		3,573		3,623		-		3,814		191
Total impaired loans with no related allowance	$	77,769	$	81,498	$	-	$	82,725	$	1,358
Total impaired loans:										
Real estate mortgage	$	31,742	$	31,675	$	-	$	33,124	$	589
Production and intermediate-term		31,601		35,097		448		29,885		456
Agribusiness		20,246		21,908		3,275		21,272		2
Rural residential real estate		4,761		4,892		7		4,990		120
Other		3,573		3,623		-		3,814		191
Total impaired loans	$	91,923	$	97,195	$	3,730	$	93,085	$	1,358

**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 March 31, 2019	$ 20,064	$ 29,668	$ 22,152	$ 2,707	$ 2,897	$ 1,012	$ 78,500
Charge-offs	(11)	(121)	-	-	-	-	(132)
Recoveries	40	152	-	-	-	-	192
Provision for loan losses (loan loss reversals)	1,779	(1,247)	(1,090)	(176)	147	27	(560)
Balance at June 30, 2019	$ 21,872	$ 28,452	$ 21,062	$ 2,531	$ 3,044	$ 1,039	$ 78,000
Balance at December 31, 2018	$ 20,955	$ 30,871	$ 20,715	$ 2,693	$ 1,751	$ 1,015	$ 78,000
Charge-offs	(11)	(122)	(9)	-	-	-	(142)
Recoveries	49	183	-	16	-	-	248
Provision for loan losses (loan loss reversals)	879	(2,480)	356	(178)	1,293	24	(106)
Balance at June 30, 2019	$ 21,872	$ 28,452	$ 21,062	$ 2,531	$ 3,044	$ 1,039	$ 78,000
Ending balance: Allowance individually evaluated for impairment	$ -	$ 448	$ 3,275	$ 7	$ -	$ -	$ 3,730
Ending balance: Allowance collectively evaluated for impairment	21,872	28,004	17,787	2,524	3,044	1,039	74,270
Balance at June 30, 2019	$ 21,872	$ 28,452	$ 21,062	$ 2,531	$ 3,044	$ 1,039	$ 78,000

	Real estate mortgage	Production and intermediate-term	Agribusiness	Rural residential real estate	Rural infrastructure	Other	Total
Allowance for loan losses:							
Balance at March 31, 2018	$ 21,885	$ 28,100	$ 23,525	$ 2,982	$ 2,914	$ 2,094	$ 81,500
Charge-offs	(8)	(113)	(5)	-	-	-	(126)
Recoveries	87	345	38	-	-	-	470
(Loan loss reversals) provision for loan losses	(1,070)	1,053	(2,096)	(241)	(302)	(188)	(2,844)
Balance at June 30, 2018	$ 20,894	$ 29,385	$ 21,462	$ 2,741	$ 2,612	$ 1,906	$ 79,000
Balance at December 31, 2017	$ 21,823	$ 30,920	$ 20,725	$ 3,114	$ 3,032	$ 2,386	$ 82,000
Charge-offs	(80)	(128)	(14)	-	-	-	(222)
Recoveries	100	427	58	-	-	-	585
(Loan loss reversals) provision for loan losses	(949)	(1,834)	693	(373)	(420)	(480)	(3,363)
Balance at June 30, 2018	$ 20,894	$ 29,385	$ 21,462	$ 2,741	$ 2,612	$ 1,906	$ 79,000
Ending balance: Allowance individually evaluated for impairment	$ 1,640	$ 1,351	$ 1,520	$ -	$ -	$ -	$ 4,511
Ending balance: Allowance collectively evaluated for impairment	19,254	28,034	19,942	2,741	2,612	1,906	74,489
Balance at June 30, 2018	$ 20,894	$ 29,385	$ 21,462	$ 2,741	$ 2,612	$ 1,906	$ 79,000

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	$ 30,772	$ 30,579	$ 20,246	$ 4,761	$ -	$ 3,573	$ 89,931
Ending balance: Loans collectively evaluated for impairment	5,476,204	2,951,412	2,107,547	569,027	354,005	68,781	11,526,976
Balance at June 30, 2019	$ 5,506,976	$ 2,981,991	$2,127,793	$ 573,788	$ 354,005	$ 72,354	$ 11,616,907
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 June 30,	*2019*	*2018*
Balance at March 31,	$ 20,000	$ 23,000
Provision (reversal) for unfunded lending commitments	500	(1,000)
Balance at June 30,	$ 20,500	$ 22,000

Six months ended June 30,	*2019*	*2018*
Balance at January 1,	$ 17,000	$ 22,500
Provision (reversal) for unfunded lending commitments	3,500	(500)
Balance at June 30,	$ 20,500	$ 22,000

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

Three months ended June 30,	*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	$ -	$ -	$ -	$ -
Agribusiness	-	-	7,858	7,858
Total	$ -	$ -	$ 7,858	$ 7,858

Six months ended June 30,	*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
Agribusiness	-	-	7,858	7,858
Total	$ -	$ -	$ 7,889	$ 7,889

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:

	June 30, 2019	*June 30, 2018*
Troubled debt restructurings that subsequently defaulted:		
Production and intermediate-term	$ -	$ 159
Total	$ -	$ 159

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

June 30, 2019	*Loans modified as TDRs*	*TDRs in nonaccrual status*
Real estate mortgage	$ 4,234	$ 1,044
Production and intermediate-term	15,249	6,903
Agribusiness	7,340	7,340
Rural residential real estate	1,223	-
Total	$ 28,046	$ 15,287

December 31, 2018	*Loans modified as TDRs*	*TDRs in nonaccrual status*
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:

	Classification in Consolidated Balance Sheets	As of June 30, 2019	As of December 31, 2018	Lease standard adjustment	As of January 1, 2019
Operating leases	Other assets	$ 14,777	$ -	$ 13,712	$ 13,712
Finance leases	Premises and equipment, net	4,664	2,920	-	2,920
Total lease assets		$ 19,441	$ 2,920	$ 13,712	$ 16,632
Operating leases	Other liabilities	$ 15,559	$ -	$ 14,201	$ 14,201
Financing leases	Advance conditional payments and other interest bearing liabilities	4,959	3,164	-	3,164
Total lease liabilities		$ 20,518	$ 3,164	$ 14,201	$ 17,365

The components of lease expense were as follows:

	Classification in Consolidated Statements of Income	For the six months ended June 30, 2019
Operating leases cost	Occupancy and equipment expense	$ 2,482
Short-term lease cost	Occupancy and equipment expense	7
Finance lease cost:		
Amortization of right-of-use assets	Occupancy and equipment expense	323
Interest on lease liabilities	Interest expense	170
Variable lease cost (costs excluded from lease payments)	Occupancy and equipment expense	303
Sublease income	Other noninterest income	(5)
Net lease cost		$ 3,280

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

	For the six months ended June 30, 2019
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows for operating leases	$ 213
Operating cash flows for finance leases	2,517
Financing cash flows for finance leases	273
Right-of-use assets obtained in exchange for lease obligations:	
Operating leases	$ 17,056
Finance leases	2,066

Lease term and discount rate are as follows:

	As of June 30, 2019
Weighted average remaining lease term in years:	
Operating leases	4.57
Finance leases	9.89
Weighted average discount rate:	
Operating leases	2.61%
Finance leases	7.62%

Future minimum lease payments under non-cancellable leases as of June 30, 2019 were as follows:

	Operating leases	Finance leases	Total
Remaining in 2019	$ 2,442	$ 454	$ 2,896
2020	4,060	896	4,956
2021	3,614	813	4,427
2022	2,832	670	3,502
2023	1,339	630	1,969
Thereafter total lease payments	2,268	3,052	5,320
Less: interest	(996)	(1,556)	(2,552)
Total	$ 15,559	$ 4,959	$ 20,518

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 March 31, 2019	$ (30,824)	$ (30,824)
Other comprehensive income before reclassifications	-	-
Amounts reclassified from accumulated other comprehensive loss	461	461
Net current period other comprehensive income	$ 461	$ 461
Balance at June 30, 2019	$ (30,363)	$ (30,363)

	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	929	929
Net current period other comprehensive income	$ 934	$ 934
Balance at June 30, 2019	$ (30,363)	$ (30,363)

	Pension and other benefit plans, net of tax	Accumulated other comprehensive (loss) income, net of tax
Balance at March 31, 2018	$ (29,425)	$ (29,425)
Other comprehensive income before reclassifications	-	-
Amounts reclassified from accumulated other comprehensive loss	424	424
Consolidated Balance Sheets reclassification of stranded tax effects from accumulated other comprehensive loss to unallocated retained earnings	-	-
Net current period other comprehensive income	$ 424	$ 424
Balance at June 30, 2018	$ (29,001)	$ (29,001)

		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		836		836
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	$	644	$	644
Balance at June 30, 2018	$	(29,001)	$	(29,001)

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

For the three months ended June 30,	*Location of (losses) gains recognized in Consolidated Statements of Income*		*Amount reclassified from accumulated other comprehensive loss* 2019		2018
Pension and other benefit plans:					
Amortization of net actuarial loss	Salaries and employee benefits	$	(469)	$	(432)
Deferred tax	Provision for income taxes		8		8
Total reclassifications		$	(461)	$	(424)

For the six months ended June 30,	*Location of losses (gains) recognized in Consolidated Statements of Income*		*Amount reclassified from accumulated other comprehensive loss* 2019		2018
Pension and other benefit plans:					
Amortization of net actuarial loss	Salaries and employee benefits	$	(938)	$	(863)
Deferred tax	Provision for income taxes		9		27
Total reclassifications		$	(929)	$	(836)

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 six months ended June 30,		*2019*		*2018*
Federal tax at statutory rate	$	28,116	$	30,483
State tax, net		523		178
Effect of nontaxable activities		(19,276)		(22,443)
Effect of estimated patronage distribution		(4,558)		(8,641)
(Decrease) increase in deferred tax asset valuation allowance		(4,344)		943
Other		151		125
Provision for income taxes	$	612	$	645

Deferred tax assets and liabilities were comprised of the following:

	June 30, 2019	December 31, 2018
Allowance for credit losses	$ 10,747	$ 11,120
Employee benefits, net	3,998	5,121
Interest on nonaccrual loans	884	684
Deferred loan fees and costs, net	211	216
Other	161	1,133
Gross deferred tax assets	$ 16,001	$ 18,274
Patronage income	(3,797)	(7,414)
Gross deferred tax liabilities	$ (3,797)	$ (7,414)
Valuation allowance	(11,283)	(9,398)
Net deferred tax asset	$ 921	$ 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. In the table above, certain amounts for December 31, 2018 have been reclassified to conform to the current presentation.

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			
June 30, 2019	Level 1	Level 2	Level 3	Total fair value
Assets:				
Assets held in trust	$ 94	$ -	$ -	$ 94
Derivative assets	-	7,154	-	7,154
Total assets	$ 94	$ 7,154	$ -	$ 7,248
Liabilities:				
Derivative liabilities	$ -	$ 196	$ -	$ 196
Standby letters of credit	-	-	355	355
Total liabilities	$ -	$ 196	$ 355	$ 551

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	148
Settlements	(236)
Balance at June 30, 2019	$ 355

	Standby letters of credit
Balance at December 31, 2017	$ 554
Issuances	218
Settlements	(308)
Balance at June 30, 2018	$ 464

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				
June 30, 2019	$ -	$ -	$ 10,947	$ 10,947
December 31, 2018	$ -	$ -	$ 5,478	$ 5,478
Other property owned				
June 30, 2019	$ -	$ -	$ 28	$ 28
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 repayment risk for Northwest FCS. When the fair value of the derivative contract is negative, Northwest FCS owes the counterparty and, therefore assumes no repayment 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		59,000		59,000
Maturities		-		-
Terminations		-		-
June 30, 2019	$	615,000	$	615,000

	Activity in the notional amounts of derivative financial instruments			
		Receive fixed swaps		*Total*
December 31, 2017	$	395,000	$	395,000
Additions		131,000		131,000
Maturities		-		-
Terminations		-		-
June 30, 2018	$	526,000	$	526,000

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.

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.

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	
June 30, 2019	*Derivative assets (1)*	*Derivative liabilities (2)*
Receive fixed swaps	$ 7,154	$ 196
Total derivatives designated as hedging instruments	$ 7,154	$ 196

	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 Statement of Income is shown in the following tables:

	Effect of fair value hedge accounting on the Consolidated Statement of Income		
For the six months ended June 30, 2019	*Interest income*	*Interest expense*	*Net interest income*
Total amount of line items presented in Consolidated Statement of Income	$ 289,450	$ (125,614)	$ 163,836
Gain (loss) on fair value hedge relationships:			
Receive fixed swaps:			
Recognized on derivatives	$ -	$ 11,716	$ 11,716
Recognized on hedged items	-	(11,672)	(11,672)
Net income recognized on fair value hedges	$ -	$ 44	$ 44

	Effect of fair value hedge accounting on the Consolidated Statement of Income		
For the six months ended June 30, 2018	*Interest income*	*Interest expense*	*Net interest income*
Total amount of line items presented in Consolidated Statement of Income	$ 256,413	$ (96,087)	$ 160,326
Gain (loss) on fair value hedge relationships:			
Receive fixed swaps:			
Recognized on derivatives	$ -	$ (6,918)	$ (6,918)
Recognized on hedged items	-	6,918	6,918
Net income recognized on fair value hedges	$ -	$ -	$ -

Derivative Financial Instruments in Fair Value Hedging Relationships

As of June 30, 2019, and December 31, 2018, the following amounts were recorded in the Consolidated Balance Sheets 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	
	June 30, 2019	*December 31, 2018*	*June 30, 2019*	*December 31, 2018*
Note payable to CoBank, ACB	$ 621,940	$ 551,268	$ 6,940	$ (4,732)

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 June 30,		*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		432
Net periodic benefit cost (income)	$	242	$	(133)

For the six months ended June 30,		*2019*		*2018*
Components of net periodic benefit cost (income):				
Service cost	$	22	$	38
Interest cost		1,459		1,324
Expected return on plan assets		(1,934)		(2,492)
Amortization of net loss		938		863
Net periodic benefit cost (income)	$	485	$	(267)

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 June 30, 2019, $330 in 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 August 9, 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
Dave 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
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