Northwest
FARM CREDIT SERVICES

2022 Quarterly Report

June 30, 2022

Quarterly Report
June 30, 2022
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, an Agricultural Credit Association (ACA) and its wholly-owned subsidiaries (collectively referred to as Northwest FCS) for the three and six months ended June 30, 2022. These comments should be read in conjunction with the unaudited consolidated financial statements and related notes included in this report, as well as the 2021 Annual Report to Stockholders. Dollar amounts are in thousands unless otherwise noted.

Northwest FCS quarterly and annual reports to stockholders may be obtained 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, by telephone at (509) 340-5300, or toll free at (800) 743-2125. 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 FCS.

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;
- Global health pandemics;
- Global conflicts;
- 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 London Inter-bank Offered Rate (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;

- Disruptive technologies impacting the banking and financial services industries or implemented by competitors which negatively impact the ability to compete in the marketplace;
- Nonperformance by counterparties to derivative positions;
- The resolution of legal proceedings and related matters; and
- Industry outlook for agricultural conditions and land values.

Merger Activity

During the first quarter of 2022, the Boards of Directors of Northwest FCS and Farm Credit West, ACA, made a strategic decision to enter into a non-binding Letter of Intent to pursue a merger of the two organizations. The consolidated association would be headquartered in Spokane, Washington. Upon completion of the merger, the association would serve over 23,000 customers in Alaska, Arizona, California, Idaho, Montana, Nevada, Oregon and Washington with expected total assets over $28 billion. If the outcome of due diligence is satisfactory and related approvals are received from CoBank and the Farm Credit Administration, customer-owners would vote on the merger in late 2022. If approved, the merger would be effective no earlier than January 1, 2023.

Results of Operations

Net income for the three months ended June 30, 2022, was $85.8 million compared to $109.1 million for the same period of the prior year. Net income for the six months ended June 30, 2022, was $170.3 million compared to $188.6 million for the same period of the prior year. The decrease for the three month comparative periods was primarily due to a smaller credit loss reversal in the current period, an increase in noninterest expenses, and an increase in net interest income. 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 in noninterest expenses, and an increase in net interest income. The increase in noninterest expenses for the three and six months ended June 30, 2022, was primarily related to an increase in the insurance fund premium assessment rate on Systemwide adjusted insured debt to 20 basis points compared to 16 basis points for three and six months ended June 30, 2021. In June 2022, the Farm Credit System Insurance Corporation (Insurance Corporation) retroactively applied the rate to the beginning of the year. The increase to the insurance fund premium assessment rate was necessary in order to target the Farm Credit Insurance Fund (Insurance Fund) balance to the statutory secure base amount of 2.0 percent. See Note 1 of the 2021 Annual Report to Stockholders for additional information.

Net interest income was $102.2 million for the three months ended June 30, 2022, compared to $95.9 million for the same period of the prior year. Net interest income was $201.7 million for the six months ended June 30, 2022, compared to $188.8 million 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, 2022 and 2021	*Change in income/expense*	*Change in rate*	*Change in volume*
Interest income on total loans	$ 13,459	$ 222	$ 13,237
Interest income on investment securities	685	506	179
Total interest income	**$ 14,144**	**$ 728**	**$ 13,416**
Total interest expense	(7,885)	(3,791)	(4,094)
Net interest income	**$ 6,259**	**$ (3,063)**	**$ 9,322**

Change between the six months ended June 30, 2022 and 2021	*Change in income/expense*	*Change in rate*	*Change in volume*
Interest income on total loans	$ 19,354	$ (5,148)	$ 24,502
Interest income on investment securities	1,070	720	350
Total interest income	**$ 20,424**	**$ (4,428)**	**$ 24,852**
Total interest expense	(7,562)	129	(7,691)
Net interest income	**$ 12,862**	**$ (4,299)**	**$ 17,161**

Information regarding the average daily balances and average rates earned and paid which impact net interest margin are presented in the following table:

For the three months ended June 30,	*2022*	*2021*
Net interest income	$ 102,197	$ 95,938
Average balances:		
Total loans	$ 14,051,130	$ 12,736,047
Investment securities	457,449	294,682
Average interest earning assets	**$ 14,508,579**	**$ 13,030,729**
Average interest bearing liabilities	**$ 11,985,002**	**$ 10,647,108**
Net interest margin	2.83%	2.95%

For the six months ended June 30,	*2022*	*2021*
Net interest income	$ 201,701	$ 188,839
Average balances:		
Total loans	$ 13,947,801	$ 12,718,791
Investment securities	441,227	285,808
Average interest earning assets	**$ 14,389,028**	**$ 13,004,599**
Average interest bearing liabilities	**$ 11,888,029**	**$ 10,636,567**
Net interest margin	2.83%	2.93%

During the three and six months ended June 30, 2022, there was a credit loss reversal of $1.5 million and a provision for credit losses of $2.5 million, respectively. These are compared to credit loss reversals of $22.5 million and $22.0 million for the three and six months ended June 30, 2021, respectively. Refer to the Loan Portfolio section below for additional discussion on credit quality.

Noninterest income for the three months ended June 30, 2022, was $33.9 million compared to $33.7 million for the same period of the prior year, an increase of $0.2 million or 0.5 percent. Noninterest income for the six months ended June 30, 2022, was $70.4 million compared to $63.0 million for the same period of the prior year, an increase of $7.5 million or 11.9 percent, primarily due to an increase in patronage income, other noninterest income, and financially related services.

Noninterest expense for the three months ended June 30, 2022, and 2021, was $51.6 million and $42.7 million, respectively, an increase of $8.9 million or 20.8 percent. Noninterest expense for the six months ended June 30, 2022, and 2021, was $98.9 million and $84.5 million, respectively, an increase of $14.4 million or 17.0 percent. The increase in noninterest expense for the three and six month comparative periods was primarily due to increases in other noninterest expense, salaries and employee benefits, and an increase in the insurance fund premiums previously discussed.

Outlook

Macroeconomic and geopolitical uncertainties present Northwest FCS and its customers a number of unique opportunities and challenges. While Northwest FCS cannot fully determine the longer-term impact of these on its customers and business, it continues to monitor the situation and potential impacts.

For additional 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, 2022	*December 31, 2021*	*Change*
Production agriculture:			
Real estate mortgage	$ 7,190,976	$ 7,003,397	$ 187,579
Production and intermediate-term	3,305,007	3,331,925	(26,918)
Agribusiness:			
Processing and marketing	1,661,819	1,572,896	88,923
Loans to cooperatives	649,188	522,960	126,228
Farm related business	379,872	315,425	64,447
Rural infrastructure:			
Energy	285,296	298,893	(13,597)
Communications	178,699	158,523	20,176
Water and waste disposal	111,140	88,933	22,207
Rural residential real estate	306,744	339,364	(32,620)
Other:			
Leases	60,365	72,263	(11,898)
Other	3,998	8,218	(4,220)
Total	**$ 14,133,104**	**$ 13,712,797**	**$ 420,307**

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

	June 30, 2022	*December 31, 2021*
Fruit and tree nuts	11.0%	11.1%
Dairy	10.5%	11.5%
Cattle and livestock	10.0%	10.0%
Forest products	8.5%	8.7%
Agricultural services	6.7%	5.4%
Potatoes	6.6%	6.7%
Grains	6.1%	6.1%
Ag processing	5.7%	6.2%
Other concentrations in aggregate	34.9%	34.3%
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, 2022		*December 31, 2021*
Nonperforming assets:				
Nonaccrual loans	$	42,749	$	49,526
Restructured accrual loans		4,964		4,964
Accrual loans 90 days or more past due		606		2,782
Total impaired loans and interest	**$**	**48,319**	**$**	**57,272**
Other property owned, net		—		—
Total nonperforming assets	**$**	**48,319**	**$**	**57,272**
Nonaccrual loans to total loans and accrued interest		0.3%		0.4%
Impaired loans to total loans and accrued interest		0.3%		0.4%
Nonperforming assets to total loans and accrued interest		0.3%		0.4%

Nonperforming assets at June 30, 2022, decreased by $9.0 million compared to December 31, 2021. Nonaccrual loans decreased by $6.8 million from December 31, 2021, and consist primarily of dairy and energy commodities. Accrual loans 90 days or more past due decreased by $2.2 million from December 31, 2021, and were adequately secured and in the process of collection. Accruing restructured loan volume did not change compared to December 31, 2021.

The allowance for credit losses at June 30, 2022, was $79.0 million compared to $76.5 million at December 31, 2021. Net recoveries for the three months ended June 30, 2022 and 2021, were $20 thousand and $29 thousand, respectively. Net charge offs for the six months ended June 30, 2022 and 2021 were $10 thousand for both periods.

At June 30, 2022, patronage receivable decreased by $48.8 million compared to December 31, 2021, from the receipt of patronage, partially offset by amounts recorded related to the estimate of patronage receivable for 2022.

At June 30, 2022, patronage payable decreased by $80.3 million compared to December 31, 2021, as a result of the disbursement of patronage, partially offset by accruals recorded related to the estimate of patronage payable for 2022.

Liquidity, Investment Securities and Funding Source

The primary source of Northwest FCS liquidity and funding is a direct loan from CoBank that is reported as a note payable to CoBank, ACB in the Consolidated Balance Sheets. The funding arrangement is governed by a general financing agreement. Northwest FCS is currently in compliance with this agreement, including repayment pursuant to the terms and conditions of each debt obligation to CoBank and does not foresee issues with obtaining funding or maintaining liquidity and sensitivity requirements.

Northwest FCS has two secondary sources of liquidity and funding, with the first being a Liquidity Investments Portfolio managed by Northwest FCS. The Liquidity Investments Portfolio holds investment securities primarily to maintain a liquidity reserve and to assist with interest rate risk management. In accordance with Board-approved policies, Northwest FCS purchases high credit quality investment securities to ensure the investment portfolio is readily marketable and available to serve as a source of liquidity in the event of disruption to Northwest FCS' normal funding sources. Additional investment securities information is in Note 2.

Northwest FCS' other secondary source of liquidity and funding is through an uncommitted Federal Funds line of credit with Wells Fargo Bank, N.A. The amount available through this line is $75.0 million and is intended to provide liquidity for disaster recovery or other emergency situations. At June 30, 2022, no balance was outstanding on this line of credit.

Capital Regulations

The Farm Credit Administration (FCA) sets minimum regulatory capital requirements. Northwest FCS exceeded the regulatory minimums and capital conservation buffer amounts, where applicable, for all ratios. The following table sets forth the regulatory capital ratio requirements and ratios:

	June 30, 2022	*December 31, 2021*	*Regulatory minimums*	*Total regulatory minimums with buffer*
Risk-adjusted:				
Common equity tier 1 ratio	17.0%	17.4%	4.5%	7.0%
Tier 1 capital ratio	17.0%	17.4%	6.0%	8.5%
Total capital ratio	17.5%	17.9%	8.0%	10.5%
Permanent capital ratio	17.1%	17.5%	7.0%	7.0%
Non-risk-adjusted:				
Tier 1 leverage ratio*	18.1%	18.5%	4.0%	5.0%
UREE leverage ratio	18.1%	19.9%	1.5%	1.5%

**Must include the regulatory minimum requirement of at least 1.5 percent of UREE.*

See Note 8 of the 2021 Annual Report to Stockholders for a complete description of these ratios.

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 and six months ended June 30, 2022.

Phil DiPofi	**Tom Nakano**	**Nathan Riggers**
President and CEO	EVP-Chief Administrative and Financial Officer	Chair of the Board
August 9, 2022	August 9, 2022	August 9, 2022

NORTHWEST FARM CREDIT SERVICES, ACA

Consolidated Balance Sheets

(dollars in thousands) (unaudited)

	June 30, 2022	December 31, 2021
ASSETS		
Cash	$ 17,776	$ 55,287
Investment securities	479,740	422,301
Loans	14,026,200	13,610,719
Less: allowance for loan losses	62,000	60,000
Net loans	13,964,200	13,550,719
Accrued interest receivable	108,554	103,704
Investment in CoBank, ACB	419,844	444,046
Patronage receivable	46,201	94,986
Investment in Farm Credit System Entities	77,845	73,983
Premises and equipment, net	51,688	48,194
Other assets	32,764	33,897
Total assets	$ 15,198,612	$ 14,827,117
LIABILITIES		
Note payable to CoBank, ACB	$ 11,380,708	$ 11,040,740
Advance conditional payments and other interest bearing liabilities	586,763	526,948
Accrued interest payable	30,216	24,138
Patronage payable	84,719	165,030
Other liabilities	62,728	80,830
Total liabilities	12,145,134	11,837,686
MEMBERS' EQUITY		
Capital stock and participation certificates	13,546	13,480
Less: capital stock and participation certificates receivable (Note 4)	(13,546)	(13,480)
Accumulated other comprehensive loss, net of tax	(51,735)	(30,191)
Unallocated retained earnings	3,105,213	3,019,622
Total members' equity	3,053,478	2,989,431
Total liabilities and members' equity	$ 15,198,612	$ 14,827,117

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,	
	2022	2021	2022	2021
NET INTEREST INCOME				
Interest income	$ 142,667	$ 128,523	$ 274,631	$ 254,207
Interest expense	40,470	32,585	72,930	65,368
Net interest income	102,197	95,938	201,701	188,839
(Credit loss reversal) provision for credit losses	(1,520)	(22,529)	2,510	(21,990)
Net interest income after (credit loss reversal) provision for credit losses	103,717	118,467	199,191	210,829
NONINTEREST INCOME				
Patronage	23,951	22,813	48,213	42,970
Financially related services	3,141	4,844	8,599	7,739
Loan and other fees	3,550	3,518	7,130	7,411
Other noninterest income	3,242	2,544	6,506	4,839
Total noninterest income	33,884	33,719	70,448	62,959
NONINTEREST EXPENSE				
Salaries and employee benefits	26,494	23,754	52,086	47,920
Purchased services	8,371	7,738	15,640	14,466
Insurance fund premiums	6,297	3,728	10,381	7,484
Occupancy and equipment	2,614	2,669	6,533	5,155
Other noninterest expenses	7,791	4,789	14,216	9,465
Total noninterest expense	51,567	42,678	98,856	84,490
Income before income taxes	86,034	109,508	170,783	189,298
Provision for income taxes	211	394	482	661
Net income	$ 85,823	$ 109,114	$ 170,301	$ 188,637

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,	***2022***	***2021***
Net income	$ 170,301	$ 188,637
Amortization of costs included in net periodic pension cost, net of deferred income tax	750	793
Net change in unrealized loss on investment securities	(22,294)	(1,246)
Other comprehensive loss, net of tax	(21,544)	(453)
Comprehensive income	$ 148,757	$ 188,184

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,	***2022***	***2021***
Balance at beginning of period	$ 2,989,431	$ 2,804,908
Comprehensive income	148,757	188,184
Issuance of stock in exchange for customer stock receivable	944	1,054
Release of customer stock receivable associated with retired stock	(878)	(898)
Less: capital stock and participation certificates receivable (Note 4)	(66)	(156)
Patronage	(84,710)	(80,899)
Balance at end of period	$ 3,053,478	$ 2,912,193

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

NORTHWEST FARM CREDIT SERVICES, ACA

Notes to Financial Statements (unaudited)

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, 2021, are contained in the 2021 Annual Report to Stockholders. These unaudited results for the three and six months ended June 30, 2022, should be read in conjunction with the 2021 Annual Report to Stockholders.

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the financial services industry 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, 2021, as contained in the 2021 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, 2022. Descriptions of the significant accounting policies are included in the 2021 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 financial services industry.

Recently Issued or Adopted Accounting Pronouncements

In March 2022, the Financial Accounting Standards Board (FASB) issued updated guidance, "Financial Instruments - Credit Losses: Troubled Debt Restructurings and Vintage Disclosures." The guidance eliminates the accounting guidance for troubled debt restructurings (TDRs) by creditors while enhancing disclosure requirements for certain loan refinancings and restructurings when a borrower is experiencing financial difficulty. The creditor will have to apply the guidance to determine whether a modification results in a new loan or a continuation of an existing loan. In addition to the TDR guidance, the update requires public business entities to disclose current period gross write-offs by year of origination for financing receivables and net investments in leases within the scope of the credit losses standard. These amendments will be effective for Northwest FCS at the time of adoption of the measurement of credit losses on financial instruments standard on January 1, 2023.

In June 2016, the FASB issued guidance, Measurement of Credit Losses on Financial Instruments. The guidance, commonly referred to as CECL, 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, as updated and amended in November 2019, becomes effective for interim and annual reporting periods beginning after December 15, 2022, with early adoption permitted. Northwest FCS continues to evaluate the impact this guidance will have on its financial statements upon adoption, which will be partially dependent on the composition of its portfolio and asset quality at the adoption date, as well as economic conditions and forecasts at the time of adoption. Implementation efforts are underway and include the development and testing of Northwest FCS' systems, data requirements, guidance interpretation and related accounting policy decisions and consideration of relevant internal processes and controls.

In January 2021, the FASB issued an update to Reference Rate Reform whereby certain derivative instruments may be modified to change the rate used for margining, discounting or contract price alignment. An entity may elect to apply the new amendments on a full retrospective basis as of any date from the beginning of an interim period that includes or is subsequent to March 12, 2020, or on a prospective basis to new modifications from any date within an interim period that includes or is subsequent to the date of the update, up to the date that financial statements are available to be issued. These amendments do not apply to contract modifications made or new hedging relationships entered into after December 31, 2022, and existing hedging relationships evaluated for effectiveness in periods after December 31, 2022. Northwest FCS is evaluating the impact of adoption and expects minimal impact to its consolidated financial condition and results of operations.

NOTE 2 – Investment Securities

The following is a summary of investments held for maintaining a liquidity reserve and managing interest rate risk and are classified as available-for-sale:

June 30, 2022	*Amortized cost*	*Gross unrealized gains*	*Gross unrealized losses*	*Fair value*
U.S. Treasury debt securities	$ 505,744	$ 435	$ (26,439)	$ 479,740
Total	**$ 505,744**	**$ 435**	**$ (26,439)**	**$ 479,740**

December 31, 2021	*Amortized cost*	*Gross unrealized gains*	*Gross unrealized losses*	*Fair value*
U.S. Treasury debt securities	$ 426,012	$ 591	$ (4,302)	$ 422,301
Total	**$ 426,012**	**$ 591**	**$ (4,302)**	**$ 422,301**

The following table is a summary of the contractual maturity, fair value, amortized cost and weighted average yield of investments available-for-sale as of June 30, 2022:

	Contractual maturity			
June 30, 2022	*In one year or less*	*One to five years*	*Five to ten years*	*Total*
U.S. Treasury debt securities				
Amortized cost	$ 50,215	$ 352,967	$ 102,562	**$ 505,744**
Fair value	$ 49,211	$ 337,295	$ 93,234	**$ 479,740**
Weighted average yield	0.16%	1.23%	1.33%	**1.15%**

The following table shows investment securities by gross unrealized losses and fair value, aggregated by investment category and length of time that the securities have been in a continuous unrealized loss position at June 30, 2022. The continuous loss position is based on the date the unrealized loss was first identified.

	Less than 12 months		*Greater than 12 Months*	
June 30, 2022	*Fair value*	*Unrealized losses*	*Fair value*	*Unrealized losses*
U.S. Treasury debt securities	$ 360,100	$ (21,061)	$ 96,740	$ (5,378)
Total	**$ 360,100**	**$ (21,061)**	**$ 96,740**	**$ (5,378)**

As of June 30, 2022, Northwest FCS expects to collect all principal and interest on its investment securities. Northwest FCS does not intend to sell the securities in unrealized loss positions, nor is it likely that Northwest FCS will be required to sell such securities, for regulatory, liquidity or other purposes, before an anticipated recovery of its cost basis occurs.

NOTE 3 – Loans and Allowance for Credit Losses

A summary of loans follows:

	June 30, 2022	December 31, 2021
Real estate mortgage	$ 7,115,002	$ 6,926,476
Production and intermediate-term	3,285,725	3,316,291
Agribusiness	2,681,563	2,404,311
Rural infrastructure	574,042	545,149
Rural residential real estate	305,810	338,374
Other	64,058	80,118
Total loans	**$ 14,026,200**	**$ 13,610,719**

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, 2022	Participations purchased	Participations sold	Participations purchased	Participations sold	Participations purchased	Participations sold
Real estate mortgage	$ 629,494	$ 663,905	$ —	$ —	$ 629,494	$ 663,905
Production and intermediate-term	728,702	3,493,587	3	—	728,705	3,493,587
Agribusiness	1,315,072	1,148,453	2,418	2,500	1,317,490	1,150,953
Rural infrastructure	574,042	—	—	—	574,042	—
Other	60,082	—	—	—	60,082	—
Total	**$ 3,307,392**	**$ 5,305,945**	**$ 2,421**	**$ 2,500**	**$ 3,309,813**	**$ 5,308,445**

	Farm Credit institutions		Non- Farm Credit institutions		Total	
December 31, 2021	Participations purchased	Participations sold	Participations purchased	Participations sold	Participations purchased	Participations sold
Real estate mortgage	$ 628,320	$ 694,485	$ —	$ —	$ 628,320	$ 694,485
Production and intermediate-term	688,383	3,480,621	10	—	688,393	3,480,621
Agribusiness	1,101,912	1,015,247	2,462	5,000	1,104,374	1,020,247
Rural infrastructure	545,149	—	—	—	545,149	—
Other	71,937	—	—	—	71,937	—
Total	**$ 3,035,701**	**$ 5,190,353**	**$ 2,472**	**$ 5,000**	**$ 3,038,173**	**$ 5,195,353**

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

		June 30, 2022		December 31, 2021
Nonaccrual loans:				
Real estate mortgage	$	20,642	$	20,787
Production and intermediate-term		12,957		18,837
Agribusiness		303		333
Rural infrastructure		7,999		7,999
Rural residential real estate		848		1,482
Other		—		88
Total nonaccrual loans	**$**	**42,749**	**$**	**49,526**
Restructured accrual loans:				
Real estate mortgage	$	1,027	$	1,133
Production and intermediate-term		3,181		2,992
Rural residential real estate		756		839
Total restructured accrual loans	**$**	**4,964**	**$**	**4,964**
Accrual loans 90 days or more past due:				
Real estate mortgage	$	362	$	—
Production and intermediate-term		244		2,782
Total accrual loans 90 days or more past due	**$**	**606**	**$**	**2,782**
Total impaired loans	**$**	**48,319**	**$**	**57,272**
Other property owned		—		—
Total nonperforming assets	**$**	**48,319**	**$**	**57,272**

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, 2022	*Acceptable*	*OAEM*	*Substandard/ doubtful*	*Total*
Real estate mortgage	97.0%	1.6%	1.4%	**100.0%**
Production and intermediate-term	95.4%	2.0%	2.6%	**100.0%**
Agribusiness	95.1%	4.8%	0.1%	**100.0%**
Rural infrastructure	98.6%	0.0%	1.4%	**100.0%**
Rural residential real estate	97.4%	0.7%	1.9%	**100.0%**
Other	96.1%	0.0%	3.9%	**100.0%**
Total	**96.4%**	**2.2%**	**1.4%**	**100.0%**

December 31, 2021	Acceptable	OAEM	Substandard/ doubtful	Total
Real estate mortgage	96.7%	1.8%	1.5%	**100.0%**
Production and intermediate-term	94.0%	2.7%	3.3%	**100.0%**
Agribusiness	97.4%	2.4%	0.2%	**100.0%**
Rural infrastructure	98.5%	0.0%	1.5%	**100.0%**
Rural residential real estate	96.8%	0.9%	2.3%	**100.0%**
Other	95.8%	0.5%	3.7%	**100.0%**
Total	**96.3%**	**2.0%**	**1.7%**	**100.0%**

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

June 30, 2022	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	$ 7,174,181	$ 12,553	$ 4,242	$ 16,795	$ 7,190,976	$ 362
Production and intermediate-term	3,282,286	20,429	2,292	22,721	3,305,007	244
Agribusiness	2,690,397	314	168	482	2,690,879	—
Rural infrastructure	567,136	—	7,999	7,999	575,135	—
Rural residential real estate	305,691	956	97	1,053	306,744	—
Other	64,142	221	—	221	64,363	—
Total	**$14,083,833**	**$ 34,473**	**$ 14,798**	**$ 49,271**	**$14,133,104**	**$ 606**

**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.*

December 31, 2021	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	$ 6,953,326	$ 44,080	$ 5,991	$ 50,071	$ 7,003,397	$ —
Production and intermediate-term	3,300,701	21,649	9,575	31,224	3,331,925	2,782
Agribusiness	2,407,490	3,791	—	3,791	2,411,281	—
Rural infrastructure	538,350	—	7,999	7,999	546,349	—
Rural residential real estate	338,884	480	—	480	339,364	—
Other	80,393	88	—	88	80,481	—
Total	**$13,619,144**	**$ 70,088**	**$ 23,565**	**$ 93,653**	**$13,712,797**	**$ 2,782**

**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, 2022	*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	$ —	$ —	$ —	$ 68	$ —
Production and intermediate-term	2,256	2,476	309	2,736	—
Agribusiness	135	146	8	157	—
Rural infrastructure	7,999	7,999	2,000	7,999	—
Rural residential real estate	—	—	—	—	—
Other	—	—	—	—	—
Total impaired loans with a related allowance	**$ 10,390**	**$ 10,621**	**$ 2,317**	**$ 10,960**	**$ —**
Impaired loans with no related allowance for loan losses:					
Real estate mortgage	$ 22,031	$ 23,555	$ —	$ 22,234	$ 152
Production and intermediate-term	14,126	17,871	—	16,498	696
Agribusiness	168	166	—	172	47
Rural infrastructure	—	—	—	—	—
Rural residential real estate	1,604	1,612	—	2,088	163
Other	—	—	—	43	5
Total impaired loans with no related allowance	**$ 37,929**	**$ 43,204**	**$ —**	**$ 41,035**	**$ 1,063**
Total impaired loans:					
Real estate mortgage	$ 22,031	$ 23,555	$ —	$ 22,302	$ 152
Production and intermediate-term	16,382	20,347	309	19,234	696
Agribusiness	303	312	8	329	47
Rural infrastructure	7,999	7,999	2,000	7,999	—
Rural residential real estate	1,604	1,612	—	2,088	163
Other	—	—	—	43	5
Total impaired loans	**$ 48,319**	**$ 53,825**	**$ 2,317**	**$ 51,995**	**$ 1,063**

**The recorded investment in the receivable is the face amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges and acquisition costs and may also reflect a previous direct write-down on the investment. The recorded investment may be less than the unpaid principal balance as payments on non-cash basis nonaccrual loans reduce the recorded investment.*

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

December 31, 2021	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	$ 398	$ 405	$ 2	$ 2,197	$ —
Production and intermediate-term	3,039	3,000	537	2,531	—
Agribusiness	160	160	8	130	—
Rural infrastructure	7,999	7,999	2,000	4,695	—
Rural residential real estate	—	—	—	213	—
Other	—	—	—	8	—
Total impaired loans with a related allowance	**$ 11,596**	**$ 11,564**	**$ 2,547**	**$ 9,774**	**$ —**
Impaired loans with no related allowance for loan losses:					
Real estate mortgage	$ 21,522	$ 22,541	$ —	$ 24,199	$ 1,163
Production and intermediate-term	21,572	25,747	—	24,200	1,069
Agribusiness	173	179	—	1,068	186
Rural infrastructure	—	—	—	667	—
Rural residential real estate	2,321	2,404	—	2,605	241
Other	88	87	—	475	36
Total impaired loans with no related allowance	**$ 45,676**	**$ 50,958**	**$ —**	**$ 53,214**	**$ 2,695**
Total impaired loans:					
Real estate mortgage	$ 21,920	$ 22,946	$ 2	$ 26,396	$ 1,163
Production and intermediate-term	24,611	28,747	537	26,731	1,069
Agribusiness	333	339	8	1,198	186
Rural infrastructure	7,999	7,999	2,000	5,362	—
Rural residential real estate	2,321	2,404	—	2,818	241
Other	88	87	—	483	36
Total impaired loans	**$ 57,272**	**$ 62,522**	**$ 2,547**	**$ 62,988**	**$ 2,695**

**The recorded investment in the receivable is the face amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges and acquisition costs and may also reflect a previous direct write-down on the investment. The recorded investment may be less than the unpaid principal balance as payments on non-cash basis nonaccrual loans reduce the recorded investment.*

***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 infrastructure*	*Rural residential real estate*	*Other*	*Total*
Allowance for loan losses:							
Balance at March 31, 2022	$ 20,014	$ 20,841	$ 16,070	$ 4,361	$ 1,282	$ 1,932	$ 64,500
Charge-offs	—	—	—	—	—	—	—
Recoveries	2	18	—	—	—	—	20
(Loan loss reversal) provision for loan losses	(473)	(1,566)	(441)	385	(141)	(284)	(2,520)
Balance at June 30, 2022	**$ 19,543**	**$ 19,293**	**$ 15,629**	**$ 4,746**	**$ 1,141**	**$ 1,648**	**$ 62,000**
Allowance for loan losses:							
Balance at December 31, 2021	$ 18,566	$ 22,065	$ 11,987	$ 4,107	$ 1,333	$ 1,942	$ 60,000
Charge-offs	(1)	(71)	—	—	—	—	(72)
Recoveries	4	58	—	—	—	—	62
Provision for loan losses (loan loss reversal)	974	(2,759)	3,642	639	(192)	(294)	2,010
Balance at June 30, 2022	**$ 19,543**	**$ 19,293**	**$ 15,629**	**$ 4,746**	**$ 1,141**	**$ 1,648**	**$ 62,000**
Ending balance: Allowance individually evaluated for impairment	$ —	$ 309	$ 8	$ 2,000	$ —	$ —	$ 2,317
Ending balance: Allowance collectively evaluated for impairment *	19,543	18,984	15,621	2,746	1,141	1,648	59,683
Balance at June 30, 2022	**$ 19,543**	**$ 19,293**	**$ 15,629**	**$ 4,746**	**$ 1,141**	**$ 1,648**	**$ 62,000**

**Balances include amounts related to accrual loans 90 days or more past due.*

	Real estate mortgage	Production and intermediate-term	Agribusiness	Rural infrastructure	Rural residential real estate	Other	Total
Allowance for loan losses:							
Balance at March 31, 2021	$ 13,391	$ 35,455	$ 16,112	$ 5,205	$ 1,545	$ 2,292	$ 74,000
Charge-offs	(2)	(1)	(2)	(2)	—	—	(7)
Recoveries	3	26	—	7	—	—	36
Provision for loan losses (loan loss reversal)	3,585	(12,538)	(3,696)	(1,196)	112	(296)	(14,029)
Balance at June 30, 2021	**$ 16,977**	**$ 22,942**	**$ 12,414**	**$ 4,014**	**$ 1,657**	**$ 1,996**	**$ 60,000**
Allowance for loan losses:							
Balance at December 31, 2020	$ 20,934	$ 29,865	$ 17,404	$ 2,992	$ 2,038	$ 2,267	$ 75,500
Charge-offs	(2)	(59)	(2)	(2)	—	—	(65)
Recoveries	3	45	—	7	—	—	55
(Loan loss reversal) provision for loan losses	(3,958)	(6,909)	(4,988)	1,017	(381)	(271)	(15,490)
Balance at June 30, 2021	**$ 16,977**	**$ 22,942**	**$ 12,414**	**$ 4,014**	**$ 1,657**	**$ 1,996**	**$ 60,000**
Ending balance: Allowance individually evaluated for impairment	$ —	$ 238	$ 15	$ 2,000	$ —	$ —	$ 2,253
Ending balance: Allowance collectively evaluated for impairment *	16,977	22,704	12,399	2,014	1,657	1,996	57,747
Balance at June 30, 2021	**$ 16,977**	**$ 22,942**	**$ 12,414**	**$ 4,014**	**$ 1,657**	**$ 1,996**	**$ 60,000**

***Balances include amounts related to accrual loans 90 days or more past due.*

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

	Real estate mortgage	Production and intermediate-term	Agribusiness	Rural infrastructure	Rural residential real estate	Other	Total
Recorded investment in loans outstanding:							
Ending balance: Loans individually evaluated for impairment	$ 21,669	$ 16,138	$ 303	$ 7,999	$ 1,604	$ —	$ 47,713
Ending balance: Loans collectively evaluated for impairment *	7,169,307	3,288,869	2,690,576	567,136	305,140	64,363	14,085,391
Balance at June 30, 2022	**$ 7,190,976**	**$ 3,305,007**	**$ 2,690,879**	**$ 575,135**	**$ 306,744**	**$ 64,363**	**$ 14,133,104**

***Balances include amounts related to accrual loans 90 days or more past due.*

	Real estate mortgage	Production and intermediate-term	Agribusiness	Rural infrastructure	Rural residential real estate	Other	Total
Recorded investment in loans outstanding:							
Ending balance: Loans individually evaluated for impairment	$ 21,920	$ 21,829	$ 333	$ 7,999	$ 2,321	$ 88	$ 54,490
Ending balance: Loans collectively evaluated for impairment *	6,981,477	3,310,096	2,410,948	538,350	337,043	80,393	13,658,307
Balance at December 31, 2021	**$ 7,003,397**	**$ 3,331,925**	**$ 2,411,281**	**$ 546,349**	**$ 339,364**	**$ 80,481**	**$ 13,712,797**

**Balances include amounts related to accrual loans 90 days or more past due*

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 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,	*2022*	*2021*
Balance at March 31,	$ 16,000	$ 25,500
Provision (reversal) for unfunded lending commitments	1,000	(8,500)
Balance at June 30,	**$ 17,000**	**$ 17,000**

Six months ended June 30,	*2022*	*2021*
Balance at January 1,	$ 16,500	$ 23,500
Provision (reversal) for unfunded lending commitments	500	(6,500)
Balance at June 30,	**$ 17,000**	**$ 17,000**

For the three and six months ended June 30, 2022 and 2021, there were no pre-modification or post-modification outstanding recorded investments for TDRs. 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, 2022	*June 30, 2021*
Trouble debt restructurings that subsequently defaulted:		
Production and intermediate-term	$ 2,564	$ —
Total	**$ 2,564**	**$ —**

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, 2022	*Loans modified as TDRs*	*TDRs in nonaccrual status*
Real estate mortgage	$ 11,951	$ 10,924
Production and intermediate-term	11,958	8,777
Rural residential real estate	756	—
Total	**$ 24,665**	**$ 19,701**

December 31, 2021		Loans modified as TDRs		TDRs in nonaccrual status
Real estate mortgage	$	12,364	$	11,230
Production and intermediate-term		17,454		14,462
Rural residential real estate		839		—
Total	**$**	**30,657**	**$**	**25,692**

NOTE 4 – Capital

Capital Stock and Participation Certificates

In accordance with the Farm Credit Act and Northwest FCS' capitalization bylaws, each borrower is required to acquire capital stock or participation certificates in Northwest FCS as a condition of borrowing. Borrowers acquire ownership of capital stock or participation certificates at the time the loan is made. Borrowers are not currently required to make a cash investment to acquire capital stock or participation certificates; however, their obligation to pay for the capital stock or participation certificates is maintained as an interest free obligation with Northwest FCS. The capital stock and participation certificates are at-risk investments as described in the Northwest FCS capitalization bylaws. Northwest FCS retains a first lien on common stock or participation certificates owned by its borrowers. Stock is retired in accordance with Northwest FCS bylaws and only if Northwest FCS is in compliance with its capital adequacy requirements. Borrowers are responsible for payment of the cash investment upon demand by Northwest FCS. Capital stock and participation certificates receivable are included within members' equity in the Consolidated Balance Sheets under a contra account titled 'Less: capital stock and participation certificates receivable (Note 4)'. This has no impact on the capital stock or participation certificates owned by Northwest FCS's borrowers, as borrowers retain all rights afforded to them by the Farm Credit Act.

Accumulated Other Comprehensive (Loss) Income

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

		Pension and other benefit plans, net of tax		Unrealized losses on investment securities		Accumulated other comprehensive (loss) income, net of tax
Balance at March 31, 2022	$	(26,103)	$	(20,192)	$	(46,295)
Other comprehensive loss before reclassifications		—		(5,812)		(5,812)
Amounts reclassified from accumulated other comprehensive loss		372		—		372
Net current period other comprehensive income (loss)	**$**	**372**	**$**	**(5,812)**	**$**	**(5,440)**
Balance at June 30, 2022	**$**	**(25,731)**	**$**	**(26,004)**	**$**	**(51,735)**

		Pension and other benefit plans, net of tax		Unrealized gains/(losses) on investment securities		Accumulated other comprehensive (loss) income, net of tax
Balance at December 31, 2021	$	(26,481)	$	(3,710)	$	(30,191)
Other comprehensive income (loss) before reclassifications		3		(22,294)		(22,291)
Amounts reclassified from accumulated other comprehensive loss		747		—		747
Net current period other comprehensive income (loss)	**$**	**750**	**$**	**(22,294)**	**$**	**(21,544)**
Balance at June 30, 2022	**$**	**(25,731)**	**$**	**(26,004)**	**$**	**(51,735)**

	Pension and other benefit plans, net of tax		Unrealized (losses)/gains on investment securities		Accumulated other comprehensive (loss) income, net of tax	
Balance at March 31, 2021	$	(28,556)	$	(248)	$	(28,804)
Other comprehensive income before reclassifications		—		154		154
Amounts reclassified from accumulated other comprehensive loss		396		—		396
Net current period other comprehensive income	**$**	**396**	**$**	**154**	**$**	**550**
Balance at June 30, 2021	**$**	**(28,160)**	**$**	**(94)**	**$**	**(28,254)**

	Pension and other benefit plans, net of tax		Unrealized gains/(losses) on investment securities		Accumulated other comprehensive (loss) income, net of tax	
Balance at December 31, 2020	$	(28,953)	$	1,152	$	(27,801)
Other comprehensive loss before reclassifications		—		(1,246)		(1,246)
Amounts reclassified from accumulated other comprehensive loss		793		—		793
Net current period other comprehensive income (loss)	**$**	**793**	**$**	**(1,246)**	**$**	**(453)**
Balance at June 30, 2021	**$**	**(28,160)**	**$**	**(94)**	**$**	**(28,254)**

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

	Location of (losses) gains recognized in Consolidated Statements of Income	Amount reclassified from accumulated other comprehensive (loss) income			
For the three months ended June 30,			*2022*		*2021*
Pension and other benefit plans:					
Amortization of net actuarial loss	Salaries and employee benefits	$	(378)	$	(401)
Deferred tax	Provision for income taxes		6		5
Total reclassifications		**$**	**(372)**	**$**	**(396)**

	Location of losses (gains) recognized in Consolidated Statements of Income	Amount reclassified from accumulated other comprehensive (loss) income			
For the six months ended June 30,			*2022*		*2021*
Pension and other benefit plans:					
Amortization of net actuarial loss	Salaries and employee benefits	$	(756)	$	(802)
Deferred tax	Provision for income taxes		9		9
Total reclassifications		**$**	**(747)**	**$**	**(793)**

NOTE 5– 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 2021 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:

June 30, 2022	*Classification in the Consolidated Balance Sheets*	*Fair value measurement using* *Level 1*	*Level 2*	*Level 3*	*Total fair value*
Assets:					
Investment securities	Investment securities	$ —	$ 479,740	$ —	$ 479,740
Derivative assets	Other assets	—	—	—	—
Rural Business Investment Companies (RBICs)	Other assets	—	—	8,328	8,328
Total assets		**$ —**	**$ 479,740**	**$ 8,328**	**$ 488,068**
Liabilities:					
Derivative liabilities	Other liabilities	$ —	$ 1,104	$ —	$ 1,104
Total liabilities		**$ —**	**$ 1,104**	**$ —**	**$ 1,104**

December 31, 2021	*Classification in the Consolidated Balance Sheets*	*Fair value measurement using* *Level 1*	*Level 2*	*Level 3*	*Total fair value*
Assets:					
Investment securities	Investment securities	$ —	$ 422,301	$ —	$ 422,301
Derivative assets	Other assets	—	4,040	—	4,040
Rural Business Investment Companies (RBICs)	Other assets	—	—	5,877	5,877
Total assets		**$ —**	**$ 426,341**	**$ 5,877**	**$ 432,218**

There were no liabilities as of December 31, 2021.

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, 2022	$ —	$ —	$ 8,281	$ 8,281
December 31, 2021	$ —	$ —	$ 9,374	$ 9,374

Valuation Techniques

As more fully discussed in Note 2 of the 2021 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.

Investment Securities

Where quoted prices are available in an active market, available-for-sale securities would be classified as level 1. If quoted prices are not available in an active market, the fair value of securities is estimated using quoted prices for similar securities received from pricing services or discounted cash flows. Generally, these securities would be classified as Level 2. This would include U.S. Treasury, U.S. agency and certain mortgage-backed-securities. Where there is limited activity or less transparency around inputs to the valuation, the securities are classified as Level 3. The estimated fair values of investment securities also appear in Note 2.

Derivative Assets and Liabilities

Exchange-traded derivatives valued using quoted prices would be classified within the fair value Level 1 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 the fair value Level

2 of the valuation hierarchy. Such derivatives include interest rate swaps. 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 curves and volatility assumptions about future interest rate movements.

RBICs

The RBICs facilitate equity and debt investments in agriculture-related businesses that create growth and job opportunities in rural America. These investments are not publicly traded and book value approximates their fair value. As a result, RBICs are classified within fair value Level 3 hierarchy and are included in other assets in the Consolidated Balance Sheets.

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 and are included in loans in the Consolidated Balance Sheets.

NOTE 6 – 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 volatility. See Note 15 of the 2021 Annual Report to Stockholders for additional information.

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 receive-fixed, pay-floating interest rate swaps 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 receive-fixed swap derivative financial instruments
December 31, 2021	$ 140,000
Additions	—
Maturities	(2,000)
June 30, 2022	**$ 138,000**

	Activity in the notional amounts of receive-fixed swap derivative financial instruments
December 31, 2020	$ 390,000
Additions	—
Maturities	(100,000)
June 30, 2021	**$ 290,000**

Accounting for Derivative Instruments and Hedging Activities

Northwest FCS records derivatives as assets or liabilities at fair value in the Consolidated Balance Sheets. Northwest FCS records changes in the fair value of a derivative in current period earnings. 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 notional amount of the fair value hedging activity relates to receive-fixed, pay-floating swaps to align Northwest FCS 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.

The following amounts were recorded in the balance sheet related to fair value hedges:

	Carrying amount of the hedged item	
	June 30, 2022	*December 31, 2021*
Note payable to CoBank, ACB	$ 136,904	$ 144,066

	Cumulative amount of fair value hedging adjustment included in the carrying amount of the hedged item	
	June 30, 2022	*December 31, 2021*
Note payable to CoBank, ACB	$ (1,096)	$ 4,066

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, 2022	*Derivative assets (1)*	*Derivative liabilities (2)*
Receive-fixed swaps	$ —	$ 1,104
Total derivatives designated as hedging instruments	**$ —**	**$ 1,104**

(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.

	Fair value of derivative financial instruments	
December 31, 2021	*Derivative assets (1)*	*Derivative liabilities (2)*
Receive-fixed swaps	$ 4,040	$ —
Total derivatives designated as hedging instruments	**$ 4,040**	**$ —**

(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 in the Consolidated Statement of Income	
For the six months ended June 30, 2022	Interest income	Interest expense
Total amount of line items presented in Consolidated Statement of income	$ 274,631	$ (72,930)
Gain (loss) on fair value hedge relationships:		
Receive-fixed swaps:		
Recognized on derivatives	$ —	$ (5,144)
Recognized on hedged items	—	5,162
Net income recognized on fair value hedges	**$ —**	**$ 18**

For the six months ended June 30, 2021	Effect of fair value hedge accounting in the Consolidated Statement of Income	
	Interest income	Interest expense
Total amount of line items presented in Consolidated Statement of income	$ 254,207	$ (65,368)
Gain (loss) on fair value hedge relationships:		
Receive-fixed swaps:		
Recognized on derivatives	$ —	$ (4,276)
Recognized on hedged items	—	4,279
Net income recognized on fair value hedges	**$ —**	**$ 3**

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 Swaps and Derivatives Association, Inc. 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 7 – Subsequent Events

Northwest FCS has evaluated subsequent events through August 9, 2022, the date the financial statements were issued or available to be issued, and determined there are no other items to disclose.

Northwest Farm Credit Services, ACA

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