

LONE STAR, ACA

2020 Quarterly Report Second Quarter



For the Quarter Ended June 30, 2020

REPORT OF MANAGEMENT

The undersigned certify that we have reviewed this report, that 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 our knowledge and belief.



Joe H. Hayman, Chief Executive Officer

August 7, 2020



David Harris, Chairman, Board of Directors

August 7, 2020



Nicholas Acosta, Chief Financial Officer

August 7, 2020



David Conrad, Chairman, Audit Committee

August 7, 2020

Second Quarter 2020 Financial Report

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LONE STAR, ACA
MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis reviews the consolidated financial performance of the Lone Star, ACA, (ACA) including its wholly-owned subsidiaries Lone Star, FLCA and Lone Star, PCA, (collectively referred to herein as the Association) for the three and six months ended June 30, 2020. The discussion should be read in conjunction with the Association's Annual Report to Stockholders, and notes thereto, for the year ended December 31, 2019.

The Association is a member of the Farm Credit System (System), a nationwide network of cooperatively owned financial institutions established by and subject to the provisions of the Farm Credit Act of 1971, as amended, and the regulations of the Farm Credit Administration (FCA) promulgated thereunder.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The consolidated financial statements were prepared under the oversight of the Association's audit committee.

Significant Events:

In December 2019, the Board of Directors (Board) of Lone Star, ACA declared a cash patronage in the amount of \$19,423,559 paid in March of 2020 based on 2019 earnings. The 2019 cash patronage represents on average a 1.5 percent reduction in borrowers loan interest rate. The patronage was paid to eligible borrowers based on their average outstanding loan balance for the year ending December 31, 2019. The Association's total capital position remains strong after the declaration and payment of patronage at 18.47 percent for the period ending June 30, 2020.

The following table provides information on the patronage received from the Farm Credit Bank of Texas (Bank) for the year ended December 31, 2019:

	<u>2019</u>
Direct loan patronage	\$ 5,742,455
Stock investment in the Bank	772,220
AMBS investment patronage	<u>145,426</u>
Total Patronage Received	<u>\$ 6,660,101</u>

The direct loan patronage received represents 46 basis points on average daily balance of the Association's direct loan with the Bank.

During the first quarter of 2020, the Board appointed Joe Hayman as President and Chief Executive Officer. Mr. Hayman has served Farm Credit for more than 25 years, most recently as Chief Executive Officer at Southern AgCredit for the previous 12 years.

Since 1917, the Association and its predecessors have provided its members with quality financial services. The Board and management remain committed to maintaining the financial integrity of the Association while offering competitive loan products that meet the financial needs of agricultural producers.

Loan Portfolio:

The Association makes and services loans to farmers, ranchers, rural homeowners and certain farm-related businesses. The Association's loan volume consists of long-term farm mortgage loans, production and intermediate-term loans and farm-related business loans. These loan products are available to eligible borrowers with competitive variable, fixed, adjustable, LIBOR-based and prime-based interest rates. Commercial loans primarily consist of operating loans and short-term loans for working capital, equipment and livestock. Mortgage loans primarily consist of 20- to 40- year maturities. Loans serviced by the Association offer several installment payment cycles, the timing of which usually coincides with the seasonal cash-flow capabilities of the borrower.

Total loans outstanding at June 30, 2020, including nonaccrual loans and sales contracts, were \$1,784,832,795 compared to \$1,631,671,416 at December 31, 2019, reflecting an increase of 9.4 percent. Nonaccrual loans as a percentage of total loans outstanding were 0.3 percent at June 30, 2020, compared to 0.2 percent at December 31, 2019. Impaired loans as a percentage of total loans outstanding were 0.4 percent at June 30, 2020, compared to 0.3 percent at December 31, 2019.

The Association recorded \$58,348 in recoveries and \$3,782 in charge-offs for the quarter ended June 30, 2020, and \$224,027 in recoveries and \$4,601 in charge-offs for the same period in 2019. The Association's allowance for loan losses was 0.4 percent and 0.4 percent of total loans outstanding as of June 30, 2020, and December 31, 2019, respectively.

Risk Exposure:

High-risk assets include nonaccrual loans, loans that are past due 90 days or more and still accruing interest, formally restructured loans and other property owned. The following table illustrates the Association's components and trends of high-risk assets.

	June 30, 2020		December 31, 2019	
	Amount	%	Amount	%
Nonaccrual	\$ 5,386,437	82.4%	\$ 3,333,895	74.4%
Formally restructured	1,152,503	17.6%	1,149,573	25.6%
Total	<u>\$ 6,538,940</u>	<u>100.0%</u>	<u>\$ 4,483,468</u>	<u>100.0%</u>

At June 30, 2020 and December 31, 2019, the Association held no property classified as other property owned.

Results of Operations:

The Association had net income of \$8,215,430 and \$15,597,697 for the three and six months ended June 30, 2020, as compared to net income of \$8,117,013 and \$14,535,126 for the same period in 2019, reflecting an increase of 1.2 percent and 7.3 percent, respectively. Net interest income was \$11,978,354 and \$23,711,183 for the three and six months ended June 30, 2020, compared to \$11,478,880 and \$23,134,825 for the same period in 2019, respectively.

	Six Months Ended			
	June 30, 2020		June 30, 2019	
	Average Balance	Interest	Average Balance	Interest
Loans	\$ 1,700,999,022	\$ 41,751,354	\$ 1,564,723,727	\$ 41,346,871
Total interest-earning assets	1,700,999,022	41,751,354	1,564,723,727	41,346,871
Interest-bearing liabilities	1,354,509,236	18,040,171	1,227,017,572	18,212,046
Impact of capital	<u>\$ 346,489,786</u>		<u>\$ 337,706,155</u>	
Net interest income		<u>\$ 23,711,183</u>		<u>\$ 23,134,825</u>

	2020	2019
	Average Yield	Average Yield
Yield on loans	4.94%	5.33%
Total yield on interest-earning assets	4.94%	5.33%
Cost of interest-bearing liabilities	2.68%	2.99%
Interest rate spread	2.26%	2.34%
Net interest income as a percentage of average earning assets	2.80%	2.98%

	Six months ended: June 30, 2020 vs. June 30, 2019		
	Increase (decrease) due to		
	Volume	Rate	Total
Interest income - loans	\$ 3,611,010	\$ (3,206,527)	\$ 404,483
Total interest income	3,611,010	(3,206,527)	404,483
Interest expense	1,897,550	(2,069,425)	(171,875)
Net interest income	<u>\$ 1,713,460</u>	<u>\$ (1,137,102)</u>	<u>\$ 576,358</u>

Interest income for the three and six months ended June 30, 2020, decreased by \$60,757 and increased by \$404,483, or 0.3 percent and 1.0 percent, respectively, from the same period of 2019, primarily due to an increase in average interest-earning assets offset by a decrease in yield on interest-earning assets. Interest expense for the three and six months ended June 30, 2020, decreased by \$560,231 and \$171,875, or 6.0 percent and 0.9 percent, from the same period of 2019 due to an increase in interest-bearing liabilities offset by a decrease in the cost of interest-bearing liabilities. Average loan volume for the second quarter of 2020 was \$1,741,537,004, compared

to \$1,568,173,842 in the second quarter of 2019. The average net interest rate spread on the loan portfolio for the second quarter of 2020 was 2.28 percent, compared to 2.30 percent in the second quarter of 2019.

The Association's return on average assets for the six months ended June 30, 2020, was 1.81 percent compared to 1.83 percent for the same period in 2019. The Association's return on average equity for the six months ended June 30, 2020, was 8.74 percent, compared to 8.39 percent for the same period in 2019.

Noninterest income for the three and six months ended June 30, 2020, increased by \$242,695 and \$449,086, or 13.5 percent and 11.3 percent, respectively, from the same period of 2019, primarily due to an increase in patronage income from the Bank and an increase in loan fees resulting from growth in Association loan assets. Noninterest expenses for the three and six months ended June 30, 2020, decreased by \$1,365,509 and \$2,504,520, or 19.7 percent and 17.6 percent, respectively, from the same period of 2019, primarily due to a decrease in salaries and employee benefits due to internal staffing changes and reallocation of resources in 2020. The decrease is also attributed to a decrease in purchased services as a result of a reduction in consulting, legal, and audit expenses.

Provisions for loan losses for the three and six months ended June 30, 2020, increased by \$2,000,186 and \$2,438,914, or 113.6 percent and 149.6 percent, respectively, from the same period of 2019, primarily due to an increase in Association loan assets compared to 2019. Additionally, the provision reversal in 2019, was primarily due to a reduction of outstanding debt and updated collateral analysis in the Association's special asset portfolio.

Liquidity and Funding Sources:

The Association secures the majority of its lendable funds from the Bank, which obtains its funds through the issuance of System-wide obligations and with lendable equity. The following schedule summarizes the Association's borrowings.

	June 30, 2020	December 31, 2019
Note payable to the Bank	\$ 1,440,854,675	\$ 1,278,483,867
Accrued interest on note payable	2,742,901	3,092,379
Total	\$ 1,443,597,576	\$ 1,281,576,246

The outstanding balance of the note payable to the Bank was \$1,440,854,675 as of June 30, 2020, and is recorded as a liability on the Association's balance sheet. The note carried a weighted average interest rate of 2.29 percent as of June 30, 2020. The indebtedness is collateralized by a pledge of substantially all of the Association's assets to the Bank and is governed by the general financing agreement. The increase in note payable to the Bank and decrease in accrued interest payable since December 31, 2019, correlates directly with the overall increase in the Association accrual loan volume and reduction in average cost for the period. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were \$344,719,250 as of June 30, 2020. The maximum amount the Association may borrow from the Bank as of June 30, 2020, was \$1,786,924,983 as defined by the general financing agreement. The indebtedness continues in effect until the expiration date of the general financing agreement, which is September 30, 2020, unless sooner terminated by the Bank upon the occurrence of an event of default, or by the Association, in the event of a breach of this agreement by the Bank, upon giving the Bank 30 calendar days' prior written notice, or in all other circumstances, upon giving the Bank 120 days' prior written notice.

Capital Resources:

The Association's capital position increased by \$15,399,953 as of June 30, 2020, compared to December 31, 2019. The Association's debt as a percentage of members' equity was 3.96:1 as of June 30, 2020, compared to 3.74:1 as of December 31, 2019.

FCA regulations require the Association to maintain minimums for various regulatory capital ratios. New regulations became effective January 1, 2017, which replaced the previously required core surplus and total surplus ratios with common equity tier 1, tier 1 capital, and total capital risk-based capital ratios. The new regulations also added tier 1 leverage and unallocated retained earnings and equivalents (UREE) ratios. The permanent capital ratio continues to remain in effect, with some modifications to align with the new regulations. As of June 30, 2020, the Association exceeded all regulatory capital requirements.

Economic Conditions:

The United States has been operating under a presidentially declared emergency since March 13, 2020 due to the Coronavirus Disease 2019 (also referred to as COVID-19). The Association continues during these unprecedented times to fulfill its mission to support agriculture and rural communities by providing access to reliable and consistent credit. The Association is closely monitoring its loan portfolio overall and is particularly focused on sectors that may be pressured by COVID-19 and its related economic impacts, such as oil and gas, food processing, timber and beef cattle. The Association has adjusted its portfolio monitoring and servicing practices and, if appropriate, will evaluate its allowance for loan losses as changes in outlook occur. Capital levels remained strong to support any adversity or continuing loan demand.

Operationally, the Association continues to function as normal during these challenging times. The Association has witnessed the benefits of past and current technology initiatives which allow personnel to work remotely and support both their families and their customer base. As it relates to the Association's internal controls over financial reporting and disclosure controls and procedures, the controls and procedures continue to operate effectively and no material changes to the controls or financial systems have occurred or are contemplated.

The potential impact of COVID-19 on the global, U.S. and regional economies creates a high degree of economic uncertainty; however, it is too early to assess the potential impact as conditions continue to unfold. The Association will closely monitor the situation in the coming quarters.

On July 2, the U.S. Bureau of Labor Statistics (BLS) reported that total nonfarm payroll employment rose month-over-month by 4.8 million in June, and the U.S. unemployment rate declined to 11.1 percent. Job gains observed in recent weeks have generally been attributable to the partial resumption of economic activity following the initial impact of the COVID-19 pandemic. Although unemployment fell in May and June, the jobless rate and the number of unemployed are up by 7.6 percentage points and 12.0 million, respectively, since February. Per the third estimate released by the U.S. Bureau of Economic Analysis, U.S. real gross domestic product (GDP) declined by 5.0 percent in the first quarter of 2020, with Texas reporting a 2.5 percent decrease in activity. Official estimates of second quarter GDP growth are not yet available, but many economists expect U.S. real GDP to decline at an annualized rate of more than 30 percent. Uncertainty regarding the future trajectory of the U.S. and global economies is historically high due to COVID-19.

According to the U.S. Energy Information Administration (EIA), the spot price of West Texas Intermediate crude oil averaged \$38 per barrel during June, a notable increase compared to March (\$29 per barrel), April (\$17 per barrel) and May (\$29 per barrel). Although oil prices have increased in recent weeks, they remain significantly lower year-over-year due primarily to reductions in global demand associated with COVID-19. According to EIA's June 2020 Short Term Energy Outlook, West Texas Intermediate oil prices are projected to average about \$35 per barrel in 2020.

The U.S.-Mexico-Canada Agreement (USMCA) became effective on July 1, replacing the North American Free Trade Agreement (NAFTA). The implementation of USMCA provides much-needed certainty for exporters and importers operating across North America, including agricultural producers and agribusinesses. According to the USDA, about 29 percent of all U.S. farm and food exports were shipped to Mexico or Canada in 2019. USMCA includes provisions improving market access for U.S. dairy and poultry products, among other items, per USDA.

In the June 2020 World Agricultural Supply and Demand Estimate (WASDE) report, USDA projected lower season-average prices in the 2020/2021 marketing year for several crops, including corn, soybeans and cotton. In late June, however, USDA's Acreage report indicated significantly lower-than-anticipated planted area for corn and cotton. This publication led to volatility in futures markets for affected commodities, and it may compel USDA to revise its price expectations in future publications.

COVID-19 impacted many agricultural operations during the quarter. Factors included food processing facility closures and a significant decline in foodservice demand. These issues led to significant short-term declines in livestock and dairy component prices. By the end of June, beef, hog and poultry slaughter were back to pre-COVID-19 levels, but carcass prices remained lower year-over-year. Meanwhile, Class III milk prices were historically volatile this quarter, falling from \$16.25 per hundredweight in March to \$12.14 in May before rising to \$21.04 in June. According to USDA projections released in June, livestock and milk prices will generally average lower in 2020 compared to 2019.

Many producers utilize risk management tools, such as Federally-sponsored crop insurance programs and forward, futures and options contracts, to mitigate risk and enhance margins. The Association's portfolio continues to be supported by strong credit quality, high levels of capital, low advance rates and diversification.

Significant Recent Accounting Pronouncements:

Refer to Note 1 – "Organization and Significant Accounting Policies" in this quarterly report for disclosures of recent accounting pronouncements which may impact the Association's consolidated financial position and results of operations and for critical accounting policies.

Relationship With the Farm Credit Bank of Texas:

The Association's financial condition may be impacted by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect the stockholder's investment in the Association. The Management's Discussion and Analysis and Notes to Financial Statements contained in the 2019 Annual Report of the Association more fully describe the Association's relationship with the Bank.

The annual and quarterly stockholder reports of the Bank are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, Corporate Communications, P.O. Box 202590, Austin, Texas 78720-2590 or calling (512) 465-1881. Copies of the Bank annual and quarterly stockholder reports can also be requested by e-mailing fcb@farmcreditbank.com. The annual and quarterly stockholder reports are also available on its website at www.farmcreditbank.com.

The Association's annual and quarterly stockholder reports are available free of charge, upon request. The annual and quarterly stockholder reports are available approximately 75 days after year end and 40 days after quarter end, respectively, and can be obtained by writing to Lone Star, ACA, 1612 Summit Avenue, Suite 300, Fort Worth, Texas 76102 or calling (817) 332-6565. The annual and quarterly stockholder reports for the Association are also available on its website at www.lonestaragcredit.com. Copies of the Association's annual and quarterly stockholder reports can be requested by e-mailing ShareHolderRelations@lonestaragcredit.com.

LONESTAR, ACA

CONSOLIDATED BALANCE SHEET

	June 30, 2020 (unaudited)	December 31, 2019
<u>ASSETS</u>		
Cash	\$ 238,729	\$ 66,150
Loans	1,784,832,795	1,631,671,416
Less: allowance for loan losses	<u>(8,003,298)</u>	<u>(7,129,083)</u>
Net loans	1,776,829,497	1,624,542,333
Accrued interest receivable	11,123,889	9,223,030
Investment in and receivable from the Bank:		
Capital stock	25,008,575	25,036,060
Other	3,642,963	1,046,155
Premises and equipment, net	3,111,012	3,098,799
Other assets	<u>3,075,673</u>	<u>3,416,805</u>
Total assets	<u><u>\$ 1,823,030,338</u></u>	<u><u>\$ 1,666,429,332</u></u>
<u>LIABILITIES</u>		
Note payable to the Bank	\$ 1,440,854,675	\$ 1,278,483,867
Accrued interest payable	2,742,901	3,092,379
Drafts outstanding	27,311	44,338
Patronage distributions payable	-	19,423,559
Other liabilities	<u>12,227,014</u>	<u>13,606,705</u>
Total liabilities	<u><u>1,455,851,901</u></u>	<u><u>1,314,650,848</u></u>
<u>MEMBERS' EQUITY</u>		
Capital stock and participation certificates	5,585,705	5,737,095
Additional paid-in capital	91,343,553	91,343,553
Unallocated retained earnings	271,124,964	255,587,367
Accumulated other comprehensive income (loss)	<u>(875,785)</u>	<u>(889,531)</u>
Total members' equity	<u>367,178,437</u>	<u>351,778,484</u>
Total liabilities and members' equity	<u><u>\$ 1,823,030,338</u></u>	<u><u>\$ 1,666,429,332</u></u>

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

LONESTAR, ACA

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2020	2019	2020	2019
<u>INTEREST INCOME</u>				
Loans	\$ 20,706,635	\$ 20,767,392	\$ 41,751,354	\$ 41,346,871
Total interest income	20,706,635	20,767,392	41,751,354	41,346,871
<u>INTEREST EXPENSE</u>				
Note payable to the Bank	8,728,266	9,287,692	18,040,040	18,211,176
Advance conditional payments	15	820	131	870
Total interest expense	8,728,281	9,288,512	18,040,171	18,212,046
Net interest income	11,978,354	11,478,880	23,711,183	23,134,825
<u>PROVISION FOR LOAN LOSSES</u>				
	240,095	(1,760,091)	808,097	(1,630,817)
Net interest income after provision for loan losses	11,738,259	13,238,971	22,903,086	24,765,642
<u>NONINTEREST INCOME</u>				
Income from the Bank:				
Patronage income	1,758,822	1,627,432	3,435,758	3,231,357
Loan fees	218,615	68,605	416,948	146,919
Refunds from Farm Credit System Insurance Corporation	-	-	293,816	340,601
Financially related services income	2,050	1,339	3,280	3,702
Loss on other property owned, net	-	(19,218)	-	(25,135)
Gain on sale of premises and equipment, net	29,839	54,722	86,480	151,856
Other noninterest income	28,079	61,830	194,641	132,537
Total noninterest income	2,037,405	1,794,710	4,430,923	3,981,837
<u>NONINTEREST EXPENSES</u>				
Salaries and employee benefits	3,438,360	4,163,097	7,165,229	8,733,119
Directors' expense	81,721	172,153	187,122	285,270
Purchased services	544,351	605,959	1,053,546	1,311,010
Travel	156,642	308,499	375,605	553,220
Occupancy and equipment	365,413	405,362	757,566	794,358
Communications	127,843	98,114	234,753	189,365
Advertising	112,535	171,213	206,433	315,678
Public and member relations	107,927	298,494	450,791	645,866
Supervisory and exam expense	156,721	163,970	313,442	327,940
Insurance Fund premiums	252,138	252,649	490,639	505,118
Other components of net periodic postretirement benefit cost	51,908	68,611	103,816	137,222
Other noninterest expense	171,568	224,515	403,078	448,374
Total noninterest expenses	5,567,127	6,932,636	11,742,020	14,246,540
Income before income taxes	8,208,537	8,101,045	15,591,989	14,500,939
Benefit from income taxes	(6,893)	(15,968)	(5,708)	(34,187)
NET INCOME	8,215,430	8,117,013	15,597,697	14,535,126
Other comprehensive income:				
Change in postretirement benefit plans	6,873	(2,646)	13,746	(5,292)
Other comprehensive income, net of tax	6,873	(2,646)	13,746	(5,292)
COMPREHENSIVE INCOME	\$ 8,222,303	\$ 8,114,367	\$ 15,611,443	\$ 14,529,834

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

LONESTAR, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

(unaudited)

	Capital Stock/ Participation Certificates	Additional Paid-in-Capital	Retained Earnings		Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2018	\$ 5,911,140	\$ 91,343,553	\$ -	\$ 246,571,786	\$ (399,101)	\$ 343,427,378
Comprehensive income	-	-	-	14,535,126	(5,292)	14,529,834
Capital stock/participation certificates and allocated retained earnings issued	309,215	-	-	-	-	309,215
Capital stock/participation certificates and allocated retained earnings retired	(418,550)	-	-	-	-	(418,550)
Dividends declared	-	-	-	(98,153)	-	(98,153)
Balance at June 30, 2019	<u>\$ 5,801,805</u>	<u>\$ 91,343,553</u>	<u>\$ -</u>	<u>\$ 261,008,759</u>	<u>\$ (404,393)</u>	<u>\$ 357,749,724</u>
Balance at December 31, 2019	\$ 5,737,095	\$ 91,343,553	\$ -	\$ 255,587,367	\$ (889,531)	\$ 351,778,484
Comprehensive income	-	-	-	15,597,697	13,746	15,611,443
Capital stock/participation certificates and allocated retained earnings issued	518,010	-	-	-	-	518,010
Capital stock/participation certificates and allocated retained earnings retired	(669,400)	-	-	-	-	(669,400)
Dividends declared	-	-	-	(60,100)	-	(60,100)
Balance at June 30, 2020	<u>\$ 5,585,705</u>	<u>\$ 91,343,553</u>	<u>\$ -</u>	<u>\$ 271,124,964</u>	<u>\$ (875,785)</u>	<u>\$ 367,178,437</u>

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

LONE STAR, ACA
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

Lone Star, ACA, including its wholly-owned subsidiaries, Lone Star, PCA and Lone Star, FLCA (collectively referred to as “the Association”), is a member-owned cooperative which provides credit and credit-related services to, or for the benefit of, eligible borrowers/stockholders for qualified agricultural purposes in the counties of Bell, Borden, Bosque, Bowie, Burnet, Camp, Cass, Cooke, Coryell, Dallas, Delta, Denton, Eastland, Ellis, Erath, Falls, Fannin, Fisher, Freestone, Grayson, Hamilton, Hill, Hood, Johnson, Kent, Lamar, Lampasas, Limestone, McLennan, Milam, Mitchell, Morris, Navarro, Nolan, Palo Pinto, Parker, Red River, Scurry, Shackelford, Somervell, Stephens, Tarrant, Taylor, Throckmorton, Titus, Williamson, Wise and Young in the state of Texas. The Association is a lending institution of the Farm Credit System (the System), which was established by Acts of Congress to meet the needs of American agriculture.

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. (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, 2019, as contained in the 2019 Annual Report to Stockholders.

In the opinion of management, the accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles (GAAP), except for the inclusion of a statement of cash flows. GAAP require a business enterprise that provides a set of financial statements reporting both financial position and results of operations to also provide a statement of cash flows for each period for which results of operations are provided. In regulations issued by FCA, associations have the option to exclude statements of cash flows in interim financial statements. Therefore, the Association has elected not to include a statement of cash flows in these consolidated financial statements. These interim financial statements should be read in conjunction with the audited financial statements as of and for the year ended December 31, 2019, as contained in the 2019 Annual Report to Stockholders. 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 results of operations for interim periods are not necessarily indicative of the results to be expected for the full year ending December 31, 2020. Descriptions of the significant accounting policies are included in the 2019 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.

Effective June 24, 2020, the Association was released from a Special Supervision letter dated January 30, 2019, issued by the Farm Credit Administration (FCA). This action returned the Association to Normal Supervision status and terminated all remaining supervisory requirements. The Association complied with all requirements of the Special Supervision letter and as a result was not assessed any monetary penalties by the FCA during Special Supervision.

In March 2020, the Financial Accounting Standards Board (FASB) issued guidance entitled “Facilitation of the Effects of Reference Rate Reform on Financial Reporting.” The guidance provides optional expedients and exceptions for applying GAAP to contracts, hedging relationships and other transactions affected by reference rate reform. The guidance simplifies the accounting evaluation of contract modifications that replace a reference rate affected by reference rate reform and contemporaneous modifications of other contracts related to the replacement of the reference rate. With respect to hedge accounting, the guidance allows amendment of formal designation and documentation of hedging relationships in certain circumstances as a result of reference rate reform and provides additional expedients for different types of hedges, if certain criteria are met. The optional amendments are effective as of March 12, 2020, through December 31, 2022. The adoption of this guidance will not impact the Association’s financial condition or its results of operations.

In December 2019, the FASB issued guidance entitled “Simplifying the Accounting for Income Taxes.” This guidance eliminates certain intra period tax allocations, foreign deferred tax recognition and interim period tax calculations. In addition, the guidance simplifies disclosure regarding capital and franchise taxes, the allocation of goodwill in business combinations, subsidiary financial statements and other disclosures. The new guidance is intended to eliminate and/or simplify certain aspects of income tax accounting that are complex or that require significant judgment in application or presentation. The guidance becomes effective for fiscal years beginning after December 15, 2021. Early adoption of the guidance is permitted and the institution adopted this guidance on January 1, 2020. The adoption of this guidance did not impact the institution’s financial condition or results of operations; nor did the guidance impact the presentation of taxes for prior periods in these interim financial statements.

In August 2018, FASB issued guidance entitled “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 became 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. The guidance is to be applied on a retrospective or prospective basis to all implementation costs incurred after the date of adoption. The Association early adopted to be in line with the FCS. The adoption of this guidance did not impact the Association's financial condition or its results of operations.

In August 2018, the FASB issued guidance entitled "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 the Association's financial condition or its results of operations, but will impact the employee benefit plan disclosures.

In August 2018, the FASB issued guidance entitled "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 became effective for interim and annual periods beginning after December 15, 2019. Early adoption was permitted and an entity was permitted to early adopt any removal or modified disclosures and delay adoption of the additional disclosures until their effective date. The Association early adopted the removal and modified disclosures during the fourth quarter of 2018. The adoption of this guidance did not impact the Association's financial condition or its results of operations, but did impact the fair value measurements disclosures.

In June 2016, the FASB issued guidance entitled "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. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses. For public business entities that are not U.S. Securities and Exchange Commission filers this guidance was to become effective for interim and annual periods beginning after December 15, 2020, with early application permitted. In November 2019, the FASB issued an update that amends the mandatory effective date for this guidance for certain institutions. The change resulted from a change in the effective date philosophy that extends and simplifies the adoption by staggering the dates between large public entities and other entities. As a result of the change, the new credit loss standard, for those institutions qualifying for the delay, becomes effective for interim and annual reporting periods beginning after December 15, 2022, with early adoption permitted. The Association qualifies for the delay in the adoption date. The Association continues to evaluate the impact of adoption on the Association's financial condition and its results of operations.

NOTE 2 — INVESTMENTS:

The Association may hold mission-related and other investments. The Farm Credit Administration approves mission-related programs and other mission-related investments. The following is a summary of mission-related and other investments that are held to maturity:

During 2010, the Association exchanged loans totaling \$59,626,146 for Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed mortgage-backed securities (AMBS). The loans were previously covered under the Long-Term Standby Commitment to Purchase Agreements with Farmer Mac. No gain or loss was recognized in the financial statements upon completion of the exchange transactions.

Effective January 26, 2012, the Bank purchased the Association's securitized Farmer Mac Agricultural Mortgage Backed Securities (AMBS) Investments. The purchase of \$35,459,508 included outstanding principal and accrued interest as of that date. There was no gain or loss recognized by the Association on this transaction. The Association will continue to service the underlying loans that were included in this security. Also, for 2012 there was no effect to the Association's income based on this transaction as the Bank was able to pay the Association a patronage equivalent to the net interest that it would have earned on the AMBS investment. The amount of patronage received in 2019 was \$145,426. However, for future years, the Bank's payment of patronage is at the discretion of the Bank's board of directors. The remaining balance of the AMBS investment at June 30, 2020 was \$4,883,695.

NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES:

A summary of loans follows:

Loan Type	June 30,	December 31,
	2020	2019
	Amount	Amount
Production agriculture:		
Real estate mortgage	\$ 1,396,450,497	\$ 1,292,173,087
Production and intermediate term	104,531,017	90,965,270
Agribusiness:		
Loans to cooperatives	17,927,074	8,713,334
Processing and marketing	148,772,614	143,710,232
Farm-related business	25,235,156	21,554,430
Communication	38,650,459	23,407,450
Energy	32,883,476	36,294,005
Water and waste water	9,547,128	5,574,542
Rural residential real estate	10,835,374	9,279,066
Total	<u>\$ 1,784,832,795</u>	<u>\$ 1,631,671,416</u>

The Association purchases or sells participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration regulations. The following table presents information regarding the balances of participations purchased and sold at June 30, 2020:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations	Participations	Participations	Participations	Participations	Participations
	Purchased	Sold	Purchased	Sold	Purchased	Sold
Real estate mortgage	\$ 24,414,604	\$ 7,324,537	\$ 1,953,160	\$ -	\$ 26,367,764	\$ 7,324,537
Production and intermediate term	34,311,869	-	-	-	34,311,869	-
Agribusiness	164,614,008	6,633,554	-	-	164,614,008	6,633,554
Communication	38,650,459	-	-	-	38,650,459	-
Energy	32,883,476	-	-	-	32,883,476	-
Water and waste water	7,930,974	-	1,616,154	-	9,547,128	-
Total	<u>\$ 302,805,390</u>	<u>\$ 13,958,091</u>	<u>\$ 3,569,314</u>	<u>\$ -</u>	<u>\$ 306,374,704</u>	<u>\$ 13,958,091</u>

The Association is authorized under the Farm Credit Act to accept “advance conditional payments” (ACPs) from borrowers. To the extent the borrower’s access to such ACPs is restricted and the legal right of setoff exists, the ACPs are netted against the borrower’s related loan balance. Unrestricted advance conditional payments are included in other liabilities. ACPs are not insured, and interest is generally paid by the Association on such balances. Balances of ACPs were \$15,805,692 and \$12,280,155 at June 30, 2020, and December 31, 2019, respectively.

Nonperforming assets (including related accrued interest) and related credit quality statistics are as follows:

	June 30,	December 31,
	2020	2019
Nonaccrual loans:		
Real estate mortgage	\$ 5,314,749	\$ 3,295,585
Production and intermediate term	69,173	29,940
Rural residential real estate	2,515	8,370
Total nonaccrual loans	<u>5,386,437</u>	<u>3,333,895</u>
Accruing restructured loans:		
Real estate mortgage	115,188	101,701
Production and intermediate term	1,037,315	1,047,872
Total accruing restructured loans	<u>1,152,503</u>	<u>1,149,573</u>
Total nonperforming loans	<u>6,538,940</u>	<u>4,483,468</u>
Total nonperforming assets	<u>\$ 6,538,940</u>	<u>\$ 4,483,468</u>

One credit quality indicator utilized by the Association is the Farm Credit Administration 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; and
- Loss – assets are considered uncollectible.

The following table shows loans and related accrued interest as a percentage of total loans and related accrued interest receivable by loan type as of:

	June 30, 2020	December 31, 2019
Real estate mortgage		
Acceptable	97%	96%
OAEM	2%	3%
Substandard/doubtful	1%	1%
	100%	100%
Production and intermediate term		
Acceptable	88%	91%
OAEM	10%	8%
Substandard/doubtful	2%	1%
	100%	100%
Loans to cooperatives		
Acceptable	100%	100%
OAEM	0%	0%
Substandard/doubtful	0%	0%
	100%	100%
Processing and marketing		
Acceptable	93%	93%
OAEM	4%	7%
Substandard/doubtful	3%	0%
	100%	100%
Farm-related business		
Acceptable	100%	100%
OAEM	0%	0%
Substandard/doubtful	0%	0%
	100%	100%
Communication		
Acceptable	100%	100%
OAEM	0%	0%
Substandard/doubtful	0%	0%
	100%	100%
Energy		
Acceptable	89%	89%
OAEM	0%	0%
Substandard/doubtful	11%	11%
	100%	100%
Water and waste water		
Acceptable	100%	100%
OAEM	0%	0%
Substandard/doubtful	0%	0%
	100%	100%
Rural residential real estate		
Acceptable	98%	98%
OAEM	1%	1%
Substandard/doubtful	1%	1%
	100%	100%
Total loans		
Acceptable	96%	96%
OAEM	3%	3%
Substandard/doubtful	1%	1%
	100%	100%

The following tables provide an age analysis of past due loans (including accrued interest) as of:

June 30, 2020	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans
Real estate mortgage	\$ 4,630,235	\$ 2,475,043	\$ 7,105,278	\$ 1,398,959,305	\$ 1,406,064,583
Production and intermediate term	930,056	-	930,056	104,399,050	105,329,106
Loans to cooperatives	-	-	-	17,943,488	17,943,488
Processing and marketing	-	-	-	148,983,056	148,983,056
Farm-related business	-	-	-	25,541,985	25,541,985
Communication	-	-	-	38,652,825	38,652,825
Energy	-	-	-	33,014,753	33,014,753
Water and waste water	-	-	-	9,552,502	9,552,502
Rural residential real estate	-	127	127	10,874,259	10,874,386
Total	\$ 5,560,291	\$ 2,475,170	\$ 8,035,461	\$ 1,787,921,223	\$ 1,795,956,684

December 31, 2019	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans
Real estate mortgage	\$ 6,102,762	\$ 993,465	\$ 7,096,227	\$ 1,293,326,351	\$ 1,300,422,578
Production and intermediate term	270,694	29,940	300,634	91,189,762	91,490,396
Loans to cooperatives	-	-	-	8,721,392	8,721,392
Processing and marketing	-	-	-	143,952,511	143,952,511
Farm-related business	-	-	-	21,580,739	21,580,739
Communication	-	-	-	23,409,603	23,409,603
Energy	-	-	-	36,427,019	36,427,019
Water and waste water	-	-	-	5,586,319	5,586,319
Rural residential real estate	19,491	-	19,491	9,284,398	9,303,889
Total	\$ 6,392,947	\$ 1,023,405	\$ 7,416,352	\$ 1,633,478,094	\$ 1,640,894,446

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.

Troubled Debt Restructuring: A restructuring of a debt constitutes a troubled debt restructuring if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Troubled debt restructurings (TDRs) are undertaken in order to improve the likelihood of recovery on the loan and may include, but are not limited to, forgiveness of principal or interest, interest rate reductions that are lower than the current market rate for new debt with similar risk, or significant term or payment extensions.

As of June 30, 2020, the total recorded investment of troubled debt restructured loans was \$2,595,091, including \$1,442,588 classified as nonaccrual and \$1,152,503 classified as accrual, with specific allowance for loan losses of \$193,069. There were no commitments to lend funds to borrowers whose loan terms have been modified in a trouble debt restructuring as of June 30, 2020 and December 31, 2019.

The following tables present additional information regarding troubled debt restructurings, which includes both accrual and nonaccrual loans with troubled debt restructuring designation, that occurred during the three and six months ended June 30, 2020. The premodification outstanding recorded investment represents the recorded investment of the loans as of the quarter end prior to the restructuring. The postmodification outstanding recorded investment represents the recorded investment of the loans as of the quarter end the restructuring occurred.

<u>For the Three Months Ended June 30, 2020</u>	<u>Premodification Outstanding Recorded Investment</u>	<u>Postmodification Outstanding Recorded Investment</u>
Troubled debt restructurings:		
Real estate mortgage	\$ 1,421,186	\$ 1,407,303
Total	\$ 1,421,186	\$ 1,407,303
<u>For the Three Months Ended June 30, 2019</u>	<u>Premodification Outstanding Recorded Investment</u>	<u>Postmodification Outstanding Recorded Investment</u>
Troubled debt restructurings:		
Real estate mortgage	\$ 26,000	\$ 23,433
Total	\$ 26,000	\$ 23,433
<u>For the Six Months Ended June 30, 2020</u>	<u>Premodification Outstanding Recorded Investment</u>	<u>Postmodification Outstanding Recorded Investment</u>
Troubled debt restructurings:		
Real estate mortgage	\$ 1,421,186	\$ 1,407,303
Total	\$ 1,421,186	\$ 1,407,303
<u>For the Six Months Ended June 30, 2019</u>	<u>Premodification Outstanding Recorded Investment</u>	<u>Postmodification Outstanding Recorded Investment</u>
Troubled debt restructurings:		
Real estate mortgage	\$ 26,000	\$ 23,433
Total	\$ 26,000	\$ 23,433

In restructurings where principal is forgiven, the amount of the forgiveness is immediately charged off. In restructurings where accrued interest is forgiven, the interest is reversed (if current year interest) or charged off (if prior year interest). There were no restructurings where principal was forgiven that required a charge-off, at the modification date, for the three and six months ended June 30, 2020 and 2019, respectively.

The predominant form of concession granted for troubled debt restructuring includes an extension of the term, principal or accrued interest reduction, interest rate decrease or delayed in repayment of principal, among others. At times, these terms might be offset with incremental payments, collateral or new borrower guarantees, in which case the Association assesses all the modified terms to determine if the overall modification qualifies as a troubled debt restructuring.

As of June 30, 2020, and 2019, respectively, the Association had no loans that met the accounting criteria as a troubled debt restructuring and that occurred within the previous 12 months of that year and for which there was a payment default during the period. A payment default is defined as a payment that is 30 days past due after the date the loan was restructured.

The following table provides information on outstanding loans restructured in troubled debt restructurings at period end. These loans are included as impaired loans in the impaired loan table at:

	<u>Loans Modified as TDRs</u>		<u>TDRs in Nonaccrual Status</u>		<u>TDRs in Accrual Status</u>		<u>Specific Allowance</u>	
	<u>June 30, 2020</u>	<u>December 31, 2019</u>	<u>June 30, 2020</u>	<u>December 31, 2019</u>	<u>June 30, 2020</u>	<u>December 31, 2019</u>	<u>June 30, 2020</u>	<u>December 31, 2019</u>
Real estate mortgage	\$ 1,557,776	\$ 159,540	\$ 1,442,588	\$ 57,839	\$ 115,188	\$ 101,701	\$ -	\$ -
Production and intermediate term	1,037,315	1,048,029	-	157	1,037,315	1,047,872	193,069	206,034
Total	\$ 2,595,091	\$ 1,207,569	\$ 1,442,588	\$ 57,996	\$ 1,152,503	\$ 1,149,573	\$ 193,069	\$ 206,034

Additional impaired loan information is as follows:

	June 30, 2020			December 31, 2019		
	Recorded Investment	Unpaid Principal Balance ^a	Related Allowance	Recorded Investment	Unpaid Principal Balance ^a	Related Allowance
Impaired loans with a related allowance for credit losses:						
Real estate mortgage	\$ 403,817	\$ 403,817	\$ -	\$ -	\$ -	\$ -
Production and intermediate term	1,037,315	1,033,458	193,069	1,047,872	1,043,822	206,034
Total	<u>\$1,441,132</u>	<u>\$1,437,275</u>	<u>\$ 193,069</u>	<u>\$ 1,047,872</u>	<u>\$ 1,043,822</u>	<u>\$ 206,034</u>
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	\$5,026,120	\$ 5,024,669	\$ -	\$ 3,397,286	\$ 3,452,225	\$ -
Production and intermediate term	69,173	100,234	-	29,940	235,980	-
Rural residential real estate	2,515	2,711	-	8,370	8,566	-
Total	<u>\$5,097,808</u>	<u>\$ 5,127,614</u>	<u>\$ -</u>	<u>\$ 3,435,596</u>	<u>\$ 3,696,771</u>	<u>\$ -</u>
Total impaired loans:						
Real estate mortgage	\$5,429,937	\$ 5,428,486	\$ -	\$ 3,397,286	\$ 3,452,225	\$ -
Production and intermediate term	1,106,488	1,133,692	193,069	1,077,812	1,279,802	206,034
Rural residential real estate	2,515	2,711	-	8,370	8,566	-
Total	<u>\$6,538,940</u>	<u>\$ 6,564,889</u>	<u>\$ 193,069</u>	<u>\$ 4,483,468</u>	<u>\$ 4,740,593</u>	<u>\$ 206,034</u>

^a Unpaid principal balance represents the recorded principal balance of the loan.

	For the Three Months Ended				For the Six Months Ended			
	June 30, 2020		June 30, 2019		June 30, 2020		June 30, 2019	
	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:								
Real estate mortgage	\$ 403,817	\$ -	\$ -	\$ -	\$ 213,003	\$ -	\$ -	\$ -
Production and intermediate term	1,035,669	13,283	-	-	1,038,376	26,624	-	-
Total	<u>\$1,439,486</u>	<u>\$ 13,283</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$1,251,379</u>	<u>\$ 26,624</u>	<u>\$ -</u>	<u>\$ -</u>
Impaired loans with no related allowance for credit losses:								
Real estate mortgage	\$3,632,046	\$ 21,973	\$ 3,322,196	\$ 5,820	\$3,477,479	\$ 20,518	\$ 3,615,377	\$ 10,466
Production and intermediate term	64,353	160	1,111,640	13,520	48,720	122	1,126,701	29,961
Rural residential real estate	3,342	2,343	98,137	-	5,078	2,343	115,569	-
Total	<u>\$3,699,741</u>	<u>\$ 24,476</u>	<u>\$ 4,531,973</u>	<u>\$ 19,340</u>	<u>\$3,531,277</u>	<u>\$ 22,983</u>	<u>\$ 4,857,647</u>	<u>\$ 40,427</u>
Total impaired loans:								
Real estate mortgage	\$4,035,863	\$ 21,973	\$ 3,322,196	\$ 5,820	\$3,690,482	\$ 20,518	\$ 3,615,377	\$ 10,466
Production and intermediate term	1,100,022	13,443	1,111,640	13,520	1,087,096	26,746	1,126,701	29,961
Rural residential real estate	3,342	2,343	98,137	-	5,078	2,343	115,569	-
Total	<u>\$5,139,227</u>	<u>\$ 37,759</u>	<u>\$ 4,531,973</u>	<u>\$ 19,340</u>	<u>\$4,782,656</u>	<u>\$ 49,607</u>	<u>\$ 4,857,647</u>	<u>\$ 40,427</u>

A summary of changes in the allowance for loan losses and period end recorded investment in loans is as follows:

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communications	Energy and Water/Waste Water	Rural Residential Real Estate	Total
Allowance for Credit Losses:							
Balance at March 30, 2020	\$ 5,507,832	\$ 772,301	\$ 1,094,665	\$ 93,295	\$ 222,037	\$ 40,499	\$ 7,730,629
Charge-offs	-	(3,782)	-	-	-	-	(3,782)
Recoveries	53,860	4,488	-	-	-	-	58,348
Provision for loan losses	116,057	74,633	(14,156)	55,366	3,072	5,123	240,095
Other	262	(1,919)	(20,490)	(4)	159	-	(21,992)
Balance at June 30, 2020	<u>\$ 5,678,011</u>	<u>\$ 845,721</u>	<u>\$ 1,060,019</u>	<u>\$ 148,657</u>	<u>\$ 225,268</u>	<u>\$ 45,622</u>	<u>\$ 8,003,298</u>
Balance at December 31, 2019	\$ 4,713,632	\$ 969,201	\$ 835,460	\$ 20,870	\$ 451,789	\$ 138,131	\$ 7,129,083
Charge-offs	-	(42,314)	-	-	-	-	(42,314)
Recoveries	53,860	11,614	-	-	-	-	65,474
Provision for loan losses	909,446	(109,687)	204,829	127,409	(231,391)	(92,509)	808,097
Other	1,073	16,907	19,730	378	4,870	-	42,958
Balance at June 30, 2020	<u>\$ 5,678,011</u>	<u>\$ 845,721</u>	<u>\$ 1,060,019</u>	<u>\$ 148,657</u>	<u>\$ 225,268</u>	<u>\$ 45,622</u>	<u>\$ 8,003,298</u>
Ending Balance:							
Individually evaluated for impairment	\$ -	\$ 193,069	\$ -	\$ -	\$ -	\$ -	\$ 193,069
Collectively evaluated for impairment	5,678,011	652,652	1,060,019	148,657	225,268	45,622	7,810,229
Balance at June 30, 2020	<u>\$ 5,678,011</u>	<u>\$ 845,721</u>	<u>\$ 1,060,019</u>	<u>\$ 148,657</u>	<u>\$ 225,268</u>	<u>\$ 45,622</u>	<u>\$ 8,003,298</u>
Balance at March 30, 2019	\$ 6,263,622	\$ 1,220,768	\$ 420,736	\$ 11,967	\$ 561,424	\$ 56,511	\$ 8,535,028
Charge-offs	-	(4,601)	-	-	-	-	(4,601)
Recoveries	57,105	156,218	10,704	-	-	-	224,027
(Reversal of) provision for loan loss	(1,454,650)	(466,088)	147,264	4,737	10,156	(1,510)	(1,760,091)
Other	1	47,650	(12,717)	(611)	3,592	-	37,915
Balance at June 30, 2019	<u>\$ 4,866,078</u>	<u>\$ 953,947</u>	<u>\$ 565,987</u>	<u>\$ 16,093</u>	<u>\$ 575,172</u>	<u>\$ 55,001</u>	<u>\$ 7,032,278</u>
Balance at December 31, 2018	\$ 6,497,578	\$ 1,457,800	\$ 350,450	\$ 12,783	\$ 224,208	\$ 102,611	\$ 8,645,430
Charge-offs	(141,299)	(31,688)	-	-	-	(50,249)	(223,236)
Recoveries	57,105	175,650	15,904	-	-	-	248,659
(Reversal of) provision for loan loss	(1,547,198)	(666,212)	229,301	3,855	346,798	2,639	(1,630,817)
Other	(108)	18,397	(29,668)	(545)	4,166	-	(7,758)
Balance at June 30, 2019	<u>\$ 4,866,078</u>	<u>\$ 953,947</u>	<u>\$ 565,987</u>	<u>\$ 16,093</u>	<u>\$ 575,172</u>	<u>\$ 55,001</u>	<u>\$ 7,032,278</u>
Ending Balance:							
Collectively evaluated for impairment	\$ 4,866,078	\$ 953,947	\$ 565,987	\$ 16,093	\$ 575,172	\$ 55,001	\$ 7,032,278
Balance at June 30, 2019	<u>\$ 4,866,078</u>	<u>\$ 953,947</u>	<u>\$ 565,987</u>	<u>\$ 16,093</u>	<u>\$ 575,172</u>	<u>\$ 55,001</u>	<u>\$ 7,032,278</u>

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communications	Energy and Water/Waste Water	Rural Residential Real Estate	Total
Recorded Investments							
in Loans Outstanding:							
Ending Balance at							
June 30, 2020	\$ 1,406,064,583	\$ 105,329,106	\$ 192,468,529	\$ 38,652,825	\$ 42,567,255	\$ 10,874,386	\$ 1,795,956,684
Individually evaluated for impairment	\$ 5,429,937	\$ 1,106,488	\$ -	\$ -	\$ -	\$ 2,515	\$ 6,538,940
Collectively evaluated for impairment	\$ 1,400,634,646	\$ 104,222,618	\$ 192,468,529	\$ 38,652,825	\$ 42,567,255	\$ 10,871,871	\$ 1,789,417,744
Ending Balance at							
December 31, 2019	\$ 1,300,422,578	\$ 91,490,396	\$ 174,254,642	\$ 23,409,603	\$ 42,013,338	\$ 9,303,889	\$ 1,640,894,446
Individually evaluated for impairment	\$ 3,397,286	\$ 1,077,812	\$ -	\$ -	\$ -	\$ 8,370	\$ 4,483,468
Collectively evaluated for impairment	\$ 1,297,025,292	\$ 90,412,584	\$ 174,254,642	\$ 23,409,603	\$ 42,013,338	\$ 9,295,519	\$ 1,636,410,978

NOTE 4 —LEASES:

The components of lease expense were as follows:

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
Operating lease cost	\$ 157,029	\$ 144,128	\$ 315,817	\$ 287,964
Net lease cost	\$ 157,029	\$ 144,128	\$ 315,817	\$ 287,964

Other information related to leases was as follows:

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
Cash paid for amounts included in the measurement of lease liabilities:				
Operating cash flows from operating leases	\$ 145,752	\$ 135,816	\$ 291,503	\$ 270,460

Lease term and discount rate are as follows:

	June 30, 2020	December 31, 2019
Weighted average remaining lease term in years		
Operating leases	3.3	3.7
Weighted average discount rate		
Operating leases	2.9%	2.8%

Future minimum lease payments under non-cancellable leases as of June 30, 2020 were as follows:

	Operating Leases
2020 (excluding the six months ended 6/30/20)	\$ 292,108
2021	596,639
2022	393,669
2023	354,246
2024	150,104
Total lease payments	1,786,766

NOTE 5 — CAPITAL:

The Association's board of directors has established a Capital Adequacy Plan (Plan) that includes the capital targets that are necessary to achieve the institution's capital adequacy goals as well as the minimum permanent capital standards. The Plan monitors projected patronage dividends, equity retirements and other actions that may decrease the Association's permanent capital. In addition to factors that must be considered in meeting the minimum standards, the board of directors also monitors the following factors: capability of management; quality of operating policies, procedures and internal controls; quality and quantity of earnings; asset quality and the adequacy of the allowance for losses to absorb potential loss within the loan and lease portfolios; sufficiency of liquid funds; needs of an institution's customer base; and any other risk-oriented activities, such as funding and interest rate risk, potential obligations under joint and several liability, contingent and off-balance-sheet liabilities or other conditions warranting additional capital. At least quarterly, management reviews the Association's goals and objectives with the board.

Regulatory Capitalization Requirements

Risk-adjusted:	Regulatory Minimums	Conservation Buffer*	Total	As of June 30, 2020
Common equity tier 1 ratio	4.50%	2.50%	7.00%	18.39%
Tier 1 capital ratio	6.00%	2.50%	8.50%	18.39%
Total capital ratio	8.00%	2.50%	10.50%	18.82%
Permanent capital ratio	7.00%	0.00%	7.00%	18.47%
Non-risk-adjusted:				
Tier 1 leverage ratio	4.00%	1.00%	5.00%	19.23%
UREE leverage ratio	1.50%	0.00%	1.50%	20.34%

Risk-adjusted assets have been defined by FCA Regulations as the Statement of Condition assets and off-balance-sheet commitments adjusted by various percentages, depending on the level of risk inherent in the various types of assets. The primary changes which generally have the impact of increasing risk-adjusted assets (decreasing risk-based regulatory capital ratios) were as follows:

- Inclusion of off-balance-sheet commitments less than 14 months
- Increased risk-weighting of most loans 90 days past due or in nonaccrual status

Risk-adjusted assets is calculated differently for the permanent capital ratio (referred herein as PCR risk-adjusted assets) compared to the other risk-based capital ratios. The primary difference is the deduction of the allowance for loan losses from risk-adjusted assets for the permanent capital ratio.

The ratios are based on a three-month average daily balance in accordance with FCA regulations and are calculated as follows:

- Common equity tier 1 ratio is statutory minimum purchased borrower stock, other required borrower stock held for a minimum of 7 years, allocated equities held for a minimum of 7 years or not subject to revolvement, unallocated retained earnings, paid-in capital, less certain regulatory required deductions including the amount of allocated investments in other System institutions, and the amount of purchased investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.
- Tier 1 capital ratio is common equity tier 1 plus non-cumulative perpetual preferred stock, divided by average risk-adjusted assets.
- Total capital is tier 1 capital plus other required borrower stock held for a minimum of 5 years, allocated equities held for a minimum of 5 years, subordinated debt and limited-life preferred stock greater than 5 years to maturity at issuance subject to certain limitations, allowance and reserve for credit losses under certain limitations less certain investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.
- Permanent capital ratio (PCR) is all at-risk borrower stock, any allocated excess stock, unallocated retained earnings, paid-in capital, subordinated debt and preferred subject to certain limitations, less certain allocated and purchased investments in other System institutions, divided by PCR risk-adjusted assets.
- Tier 1 leverage ratio is tier 1 capital, including regulatory deductions, divided by average assets less regulatory deductions subject to tier 1 capital.

- UREE leverage ratio is unallocated retained earnings, paid-in capital, allocated surplus not subject to revolvement less certain regulatory required deductions including the amount of allocated investments in other System institutions divided by average assets less regulatory deductions subject to tier 1 capital.

If the capital ratios fall below the minimum regulatory requirements, including the capital conservation and leverage buffer amounts, capital distributions (equity redemptions, dividends, and patronage) and discretionary bonus payments to senior officers are restricted or prohibited without prior FCA approval.

The components of the Association's risk-adjusted capital, based on 90 day average balances, were as follows at June 30, 2020:

	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
Numerator:				
Unallocated retained earnings	\$ 199,024,099	\$ 199,024,099	\$ 199,024,099	\$ 199,024,099
Paid-in capital	91,343,553	91,343,553	91,343,553	91,343,553
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	5,537,378	5,537,378	5,537,378	5,537,378
Allocated equities:				
Nonqualified allocated equities not subject to retirement	65,733,966	65,733,966	65,733,966	65,733,966
Allowance for loan losses and reserve for credit losses subject to certain limitations	-	-	7,858,532	-
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	(25,010,291)	(25,010,291)	(25,010,291)	(25,010,291)
	<u>\$ 336,628,705</u>	<u>\$ 336,628,705</u>	<u>\$ 344,487,237</u>	<u>\$ 336,628,705</u>
Denominator:				
Risk-adjusted assets excluding allowance	\$ 1,855,164,634	\$ 1,855,164,634	\$ 1,855,164,634	\$ 1,855,164,634
Regulatory Adjustments and Deductions:				
Regulatory deductions included in total capital	(25,010,291)	(25,010,291)	(25,010,291)	(25,010,291)
Allowance for loan losses	-	-	-	(7,741,449)
	<u>\$ 1,830,154,343</u>	<u>\$ 1,830,154,343</u>	<u>\$ 1,830,154,343</u>	<u>\$ 1,822,412,894</u>

The components of the Association's non-risk-adjusted capital, based on 90 day average balances, were as follows at June 30, 2020:

	Tier 1 leverage ratio	UREE leverage ratio
Numerator:		
Unallocated retained earnings	\$ 199,024,099	\$ 199,024,099
Paid-in capital	91,343,553	91,343,553
Common Cooperative Equities:		
Statutory minimum purchased borrower stock	5,537,378	-
Allocated equities:		
Nonqualified allocated equities not subject to retirement	65,733,966	65,733,966
Regulatory Adjustments and Deductions:		
Amount of allocated investments in other System institutions	(25,010,291)	(1,000)
	<u>\$ 336,628,705</u>	<u>\$ 356,100,618</u>
Denominator:		
Total Assets	\$ 1,777,958,565	\$ 1,777,958,565
Regulatory Adjustments and Deductions:		
Regulatory deductions included in tier 1 capital	(27,094,731)	(27,094,731)
	<u>\$ 1,750,863,834</u>	<u>\$ 1,750,863,834</u>

The Association's accumulated other comprehensive income (loss) relates entirely to its nonpension other postretirement benefits. The following table summarizes the change in accumulated other comprehensive income (loss) for the six months ended June 30:

	<u>2020</u>	<u>2019</u>
Accumulated other comprehensive income (loss) at January 1	\$ (889,531)	\$ (399,101)
Amortization of prior service (credit) costs included in salaries and employee benefits	(13,258)	(13,258)
Amortization of actuarial (gain) loss included in salaries and employee benefits	<u>27,004</u>	<u>7,966</u>
Other comprehensive income (loss), net of tax	<u>13,746</u>	<u>(5,292)</u>
Accumulated other comprehensive income (loss) at June 30	<u>\$ (875,785)</u>	<u>\$ (404,393)</u>

NOTE 6 — INCOME TAXES:

Lone Star, ACA conducts its business activities through two wholly-owned subsidiaries. Long-term mortgage lending activities are conducted through a wholly-owned FLCA subsidiary which is exempt from federal and state income tax. Short- and intermediate-term lending activities are conducted through a wholly-owned PCA subsidiary. The PCA subsidiary and the ACA holding company are subject to income tax. Lone Star, ACA operates as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, Lone Star, ACA can exclude from taxable income amounts distributed as qualified patronage dividends in the form of cash, stock or allocated retained earnings. Provisions for income taxes are made only on those taxable earnings that will not be distributed as qualified patronage dividends. Deferred taxes are recorded at the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution and will therefore impact future tax payments. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (more than 50 percent probability), based on management's estimate, that they will not be realized.

As of June 30, 2020, the deferred income tax valuation allowance was \$10,582,649.

NOTE 7 — FAIR VALUE MEASUREMENTS:

FASB guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 15 to the 2019 Annual Report to Stockholders for a more complete description.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

<u>June 30, 2020</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Assets held in nonqualified benefit trusts	<u>\$211,537</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 211,537</u>
Total assets	<u>\$211,537</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 211,537</u>
<u>December 31, 2019</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Assets held in nonqualified benefit trusts	<u>\$ 254,306</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 254,306</u>
Total assets	<u>\$ 254,306</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 254,306</u>

Assets and liabilities measured at fair value on a nonrecurring basis for each of the fair value hierarchy values are summarized below:

<u>June 30, 2020</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Loans*	<u>\$ -</u>	<u>\$ -</u>	<u>\$1,248,063</u>	<u>\$1,248,063</u>
<u>December 31, 2019</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Loans*	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 841,838</u>	<u>\$ 841,838</u>

*Represents the fair value of certain loans that were evaluated for impairment under the authoritative guidance "Accounting by Creditors for Impairment of a Loan." The fair value was based upon the underlying collateral since these were collateral-dependent loans for which real estate is the collateral.

Valuation Techniques

As more fully discussed in Note 2 to the 2019 Annual Report to Stockholders, authoritative 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 represent a brief summary of the valuation techniques used for the Association's assets and liabilities. For a more complete description, see Notes to the 2019 Annual Report to Stockholders.

Assets Held in Nonqualified Benefits 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.

Standby Letters of Credit

The fair value of letters of credit approximate the fees currently charged for similar agreements or the estimated cost to terminate or otherwise settle similar obligations.

Loans Evaluated for Impairment

For certain loans evaluated for impairment under impairment guidance, the fair value is based upon the underlying collateral since the loans are collateral-dependent loans for which real estate is the collateral. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, a majority of these loans have fair value measurements that fall within Level 3 of the fair value hierarchy. When the value of the real estate, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established. The fair value of these loans would fall under Level 2 of the hierarchy if the process uses independent appraisals and other market-based information.

Fair Value of Concessions Granted

The Association has recorded amounts related to the fair value of concessions granted for certain loans related to the breach of Association policies in 2016 and 2017. These amounts are netted against the unpaid principal balance of the related loans similar to a discount. The concessions granted were either through the refinancing of a relationship or as a result of acceptance of rates and terms previously negotiated, which were more favorable than market terms and rates. The fair value of the concessions are based on the expected future cash flows under the new contractual terms, discounted at a market interest rate. The fair value of the concessions is amortized into interest income over the contractual life of the related loans.

Other Property Owned

Other property owned is generally classified as Level 3 of the fair value hierarchy. 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.

NOTE 8 — EMPLOYEE BENEFIT PLANS:

The following table summarizes the components of net periodic benefit costs of nonpension other postretirement employee benefits for the six months ended June 30:

	Other Benefits	
	2020	2019
Service cost	\$ 35,496	\$ 50,105
Interest cost	109,107	107,602
Amortization of prior service (credits) costs	(13,257)	(13,035)
Amortization of net actuarial (gain) loss	7,966	42,655
Net periodic benefit cost	\$ 139,312	\$ 187,327

The Association's liability for the unfunded accumulated obligation for these benefits at June 30, 2020, was \$5,288,855 and is included in other liabilities on the balance sheet.

The components of net periodic benefit cost other than the service cost component are included in the line item "other components of net periodic postretirement benefit cost" in the income statement. The Association previously disclosed in its financial statements for the year ended December 31, 2019, that it expects to contribute \$199,549 to the district's DC plan in 2020.

The structure of the district's DB plan, which is noncontributory and benefits are based on salary and years of service, is characterized as multiemployer since the assets, liabilities and cost of the plan are not segregated or separately accounted for by participating employers (Bank and associations). The Association recognizes its amortized annual contributions to the DB plan as an expense. The Association has contributed \$55,308 to fund the DB plan for 2020. As of June 30, 2020, the Association has expensed and recognized \$27,654.

NOTE 9 — COMMITMENTS AND CONTINGENT LIABILITIES:

The Association is involved in various legal proceedings in the normal course of business. In the opinion of legal counsel and management, there are no legal proceedings at this time that are likely to materially affect the Association.

NOTE 10 — SUBSEQUENT EVENTS:

The Association has evaluated subsequent events through August 7, 2020 which is the date the financial statements were issued or available to be issued.

There are no other significant events requiring disclosure as of August 7, 2020.