

TEXAS FARM CREDIT SERVICES

2020 Quarterly Report Second Quarter



For the Quarter Ended June 30, 2020

REPORT OF MANAGEMENT

The consolidated financial statements of Texas Farm Credit Services (Association) are prepared by management, who is responsible for the statements' integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America appropriate in the circumstances. Other financial information included in the quarterly report is consistent with that in the consolidated financial statements and there are no significant changes in the Association's internal controls or in other factors that could significantly affect such controls during the year.

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.



Mark Miller, Chief Executive Officer
August 5, 2020



Gregory T. Richbourg, Audit Committee Chairman
August 5, 2020



Keith A. Ibrom, Chief Financial Officer
August 5, 2020

**TEXAS FARM CREDIT SERVICES
MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following commentary reviews the financial performance of the Texas Farm Credit Services, an Agricultural Credit Association (ACA), referred to as the Association, for the quarter ended June 30, 2020. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2019 Annual Report to Stockholders.

The Association is a member of the Farm Credit System (System), a nationwide network of cooperatively owned financial Associations 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

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. Loan volume increased as borrowers increased their liquidity and cash positions. In response, the Association increased its cash position to accommodate the potential liquidity needs of those borrowers in case of any market disruptions. The Association was able to maintain access to borrowings, fund incremental needs and increase liquidity without significant changes to its funding strategies or interest rate risk profiles. Through June 30, 2020 and the date of this report, there have been no observable delinquencies or credit metrics impacting the credit quality of the Association's loan portfolio related to COVID-19. 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.

The Association has implemented a payment deferral program to provide relief to Association borrowers affected by COVID-19. Each borrower is evaluated on an individual basis with payments being deferred for up to 90 days. The Association will continue to monitor the impact of COVID-19 on Association borrowers.

Loan Portfolio

Total loans outstanding at June 30, 2020, including nonaccrual loans and sales contracts, were \$1,434,194,822 compared to \$1,314,083,263 at December 31, 2019, reflecting an increase of 9.1%. Nonaccrual loans as a percentage of total loans outstanding were 0.7% at June 30, 2020, compared to 0.6% at December 31, 2019.

The Association recorded \$2,392 in recoveries and \$0 in charge-offs for the quarter ended June 30, 2020, and \$2,000 in recoveries and \$0 in charge-offs for the same period in 2019. The Association's allowance for loan losses was 0.4% and 0.3% of total loans outstanding as of June 30, 2020, and December 31, 2019, respectively.

The Association continues to experience strong demand for new loans throughout its 100-county territory. Management's focus is on growing the Association's earning assets while maintaining a high level of acceptable credit quality with adequate capital.

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.

	<u>June 30, 2020</u>		<u>December 31, 2019</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Nonaccrual	\$ 10,331,589	70.4%	\$ 8,349,534	68.1%
90 days past due and still accruing interest	169,870	1.2%	5	0.0%
Formally restructured	783,530	5.3%	810,911	6.6%
Other property owned, net	3,393,901	23.1%	3,101,394	25.3%
Total	<u>\$ 14,678,890</u>	<u>100.0%</u>	<u>\$ 12,261,844</u>	<u>100.0%</u>

Results of Operations

The Association had net income of \$8,587,702 and \$15,958,763 for the three and six months ended June 30, 2020, as compared to net income of \$7,626,039 and \$14,541,052 for the same period in 2019, reflecting an increase of 12.6% and 9.8%. Net interest income was \$9,887,018 and \$19,394,249 for the three and six months ended June 30, 2020, compared to \$9,152,276 and \$18,166,154 for the same period in 2019.

	Six Months Ended			
	June 30,		June 30,	
	2020		2019	
	Average		Average	
	Balance	Interest	Balance	Interest
Loans	\$ 1,359,977,878	\$ 34,581,698	\$ 1,264,902,475	\$ 35,098,491
Investments	2,010,350	57,344	2,845,157	90,515
Total interest-earning assets	1,361,988,228	34,639,042	1,267,747,632	35,189,006
Interest-bearing liabilities	1,189,144,272	15,244,793	1,099,729,769	17,022,852
Impact of capital	\$ 172,843,956		\$ 168,017,863	
Net interest income		\$ 19,394,249		\$ 18,166,154
	2020		2019	
	Average Yield		Average Yield	
Yield on loans	5.11%		5.60%	
Yield on investments	5.74%		6.42%	
Total yield on interest-earning assets	5.11%		5.60%	
Cost of interest-bearing liabilities	2.58%		3.12%	
Interest rate spread	2.53%		2.48%	
Net interest income as a percentage of average earning assets	2.86%		2.89%	

	Six months ended:		
	June 30, 2020 vs. June 30, 2019		
	Increase (decrease) due to		
	Volume	Rate	Total
Interest income - loans	\$ 2,645,484	\$ (3,162,277)	\$ (516,793)
Interest income - investments	(26,632)	(6,539)	(33,171)
Total interest income	2,618,852	(3,168,816)	(549,964)
Interest expense	1,387,911	(3,165,970)	(1,778,059)
Net interest income	\$ 1,230,941	\$ (2,846)	\$ 1,228,095

Interest income for the three and six months ended June 30, 2020, decreased by \$1,198,246 and \$549,964, or 6.7% and 1.6% respectively, from the same period of 2019, primarily due to declines in yields on earning assets offset by an increase in average loan volume. Interest expense for the three and six months ended June 30, 2020, decreased by \$1,932,988 and \$1,778,059, or 23.0% and 10.5%, from the same period of 2019 due to a decrease in interest rates offset by an increase in average debt volume. Average loan volume, including investments, for the six months ended June 30, 2020 was \$1,361,988,228, compared to \$1,267,747,632 for the same period in 2019. The average net interest rate spread on the loan portfolio for the six months ended June 30, 2020 was 2.53%, compared to 2.48% for the same period in 2019.

The Association's return on average assets for the six months ended June 30, 2020, was 2.25% compared to 2.22% for the same period in 2019. The Association's return on average equity for the six months ended June 30, 2020, was 15.07%, compared to 14.47% for the same period in 2019.

Noninterest income for the six months ended June 30, 2020, increased by \$1,862,758, or 23.1 percent, compared to the same period of 2019, primarily due to increases in loan fees and financially related services income. Noninterest expenses for the six months ended

June 30, 2020, increased by \$662,984, or 5.8 percent, compared to the same period of 2019, due to increases in salaries and employee benefits and occupancy expense. Provisions for loan losses for the six months ended June 30, 2020, increased by \$1,339,791, or 516.4 percent, compared to the same period of 2019, due to an increase in valuation related to the uncertainty related to the COVID-19 pandemic, additional loan growth and increases in specific loan reserves.

Liquidity and Funding Sources

The Association secures the majority of its lendable funds from the Farm Credit Bank of Texas (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	\$ 1,265,060,575	\$ 1,140,484,754
Accrued interest on note payable	2,191,727	2,820,460
Total	\$ 1,267,252,302	\$ 1,143,305,214

The Association operates under a general financing agreement (GFA) with the Bank. The current GFA is effective through September 30, 2020. The primary source of liquidity and funding for the Association is a direct loan from the Bank. The outstanding balance of \$1,265,060,575 as of June 30, 2020, is recorded as a liability on the Association's balance sheet. The note carried a weighted average interest rate of 2.58 percent at 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 related accrued interest payable since December 31, 2019, is due to the Association's increase in debt related to its match funding of new loans. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were \$171,983,304 at June 30, 2020. The maximum amount the Association may borrow from the Bank as of June 30, 2020, was \$1,440,296,696 as defined by the general financing agreement. The indebtedness continues in effect until the expiration date of the general financing agreement, 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.

The liquidity policy of the Association is to manage cash balances, to maximize debt reduction and to increase accrual loan volume. This policy will continue to be pursued in 2020. As borrower payments are received, they are applied to the Association's note payable to the Bank

Capital Resources

The Association's capital position increased by \$16,091,070 at June 30, 2020, compared to December 31, 2019. The Association's debt as a percentage of members' equity was 5.79:1 as of June 30, 2020, compared to 5.71:1 as of December 31, 2019.

Farm Credit Administration 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.

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 Associations 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 Texas Farm Credit Services 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, or by calling (512) 483-9204. The annual and quarterly stockholder reports for the Bank are also available on its website at www.farmcreditbank.com.

The Association's quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Texas Farm Credit Services, 545 S. Hwy 77, Robstown, Texas, 78380 or calling (361) 387-8563. The annual and quarterly stockholder reports for the Association are also available on its website at www.texasfcs.com. Copies of the Association's quarterly stockholder reports can also be requested by e-mailing kibrom@texasfcs.com.

TEXAS FARM CREDIT SERVICES

CONSOLIDATED BALANCE SHEET

	June 30, 2020 (unaudited)	December 31, 2019
<u>ASSETS</u>		
Cash	\$ 6,281,830	\$ 7,188,050
Investments	1,197,821	2,660,691
Loans	1,434,194,822	1,314,083,263
Less: allowance for loan losses	6,040,471	4,323,904
Net loans	<u>1,428,154,351</u>	<u>1,309,759,359</u>
Accrued interest receivable	14,428,649	11,020,248
Investment in and receivable from the Farm		
Credit Bank of Texas:		
Capital stock	22,554,100	22,652,940
Other	4,743,271	543,605
Deferred taxes, net	1,035,582	708,499
Other property owned, net	3,393,901	3,101,394
Premises and equipment, net	14,861,921	14,937,777
Other assets	3,416,674	3,340,834
Total assets	<u><u>\$ 1,500,068,100</u></u>	<u><u>\$ 1,375,913,397</u></u>
<u>LIABILITIES</u>		
Note payable to the Farm Credit Bank of Texas	\$ 1,265,060,575	\$ 1,140,484,754
Advance conditional payments	292,604	535,693
Accrued interest payable	2,191,727	2,820,460
Drafts outstanding	100,061	121,374
Patronage distributions payable	-	12,840,000
Other liabilities	11,423,349	14,202,402
Total liabilities	<u><u>1,279,068,316</u></u>	<u><u>1,171,004,683</u></u>
<u>MEMBERS' EQUITY</u>		
Capital stock and participation certificates	3,914,890	3,791,365
Additional paid-in capital	47,596,495	47,596,495
Allocated retained earnings	56,436,626	56,437,331
Unallocated retained earnings	113,752,425	97,793,661
Accumulated other comprehensive income (loss)	(700,652)	(710,138)
Total members' equity	<u>220,999,784</u>	<u>204,908,714</u>
Total liabilities and members' equity	<u><u>\$ 1,500,068,100</u></u>	<u><u>\$ 1,375,913,397</u></u>

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

TEXAS FARM CREDIT SERVICES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

	Quarter Ended		Six Months Ended	
	June 30,		June 30,	
	2020	2019	2020	2019
<u>INTEREST INCOME</u>				
Loans	\$ 16,737,724	\$ 17,912,730	\$ 34,581,698	\$ 35,098,491
Investments	20,029	43,269	57,344	90,515
Total interest income	<u>16,757,753</u>	<u>17,955,999</u>	<u>34,639,042</u>	<u>35,189,006</u>
<u>INTEREST EXPENSE</u>				
Note payable to the Farm Credit Bank of Texas	6,870,702	8,802,520	15,243,662	17,020,196
Advance conditional payments	33	1,203	1,131	2,656
Total interest expense	<u>6,870,735</u>	<u>8,803,723</u>	<u>15,244,793</u>	<u>17,022,852</u>
Net interest income	<u>9,887,018</u>	<u>9,152,276</u>	<u>19,394,249</u>	<u>18,166,154</u>
<u>Provision for (reversal of) loan losses</u>	<u>603,906</u>	<u>(60,600)</u>	<u>1,599,263</u>	<u>259,472</u>
Net interest income after provision for loan losses	<u>9,283,112</u>	<u>9,212,876</u>	<u>17,794,986</u>	<u>17,906,682</u>
<u>NONINTEREST INCOME</u>				
Income from the Farm Credit Bank of Texas:				
Patronage income	2,456,158	2,478,832	5,002,937	4,994,468
Loan fees	1,018,285	582,349	2,149,541	1,015,871
Refunds from Farm Credit System Insurance Corporation	-	-	262,284	293,696
Financially related services income	1,215,091	632,217	2,198,554	1,618,773
Gain on sale of premises and equipment, net	62,871	7,176	112,416	2,257
Other noninterest income	96,302	67,797	206,177	144,086
Total noninterest income	<u>4,848,707</u>	<u>3,768,371</u>	<u>9,931,909</u>	<u>8,069,151</u>
<u>NONINTEREST EXPENSES</u>				
Salaries and employee benefits	3,970,515	3,468,432	8,144,916	7,702,840
Directors' expense	60,362	68,351	257,949	262,223
Purchased services	244,079	233,255	530,893	449,003
Travel	191,666	317,690	502,862	578,344
Occupancy and equipment	487,757	378,688	956,546	748,169
Communications	106,729	96,644	164,864	170,371
Advertising	47,411	37,814	101,786	79,915
Public and member relations	91,316	178,470	302,735	314,180
Supervisory and exam expense	110,666	110,929	221,332	221,858
Insurance Fund premiums	219,520	227,268	429,562	442,991
Loss on other property owned, net	27,279	-	68,230	-
Other noninterest expense	115,554	180,269	413,540	462,337
Total noninterest expenses	<u>5,672,854</u>	<u>5,297,810</u>	<u>12,095,215</u>	<u>11,432,231</u>
Income before income taxes	<u>8,458,965</u>	<u>7,683,437</u>	<u>15,631,680</u>	<u>14,543,602</u>
(Benefit from) provision for income taxes	<u>(128,737)</u>	<u>57,398</u>	<u>(327,083)</u>	<u>2,550</u>
NET INCOME	<u>8,587,702</u>	<u>7,626,039</u>	<u>15,958,763</u>	<u>14,541,052</u>
Other comprehensive income:				
Change in postretirement benefit plans	4,743	(5,430)	9,486	(10,860)
COMPREHENSIVE INCOME	<u>\$ 8,592,445</u>	<u>\$ 7,620,609</u>	<u>\$ 15,968,249</u>	<u>\$ 14,530,192</u>

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

TEXAS FARM CREDIT SERVICES

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	\$ 4,100,095	\$ 47,596,495	\$ 54,986,492	\$ 89,370,242	\$ (198,585)	\$ 195,854,739
Comprehensive income	-	-	-	14,541,052	(10,860)	14,530,192
Capital stock/participation certificates and allocated retained earnings issued	214,885	-	-	-	-	214,885
Capital stock/participation certificates and allocated retained earnings retired	(162,020)	-	-	-	-	(162,020)
Patronage refunds:						
Cash	-	-	(1,152)	(66,881)	-	(68,033)
Balance at June 30, 2019	<u>\$ 4,152,960</u>	<u>\$ 47,596,495</u>	<u>\$ 54,985,340</u>	<u>\$ 103,844,413</u>	<u>\$ (209,445)</u>	<u>\$ 210,369,763</u>
Balance at December 31, 2019	\$ 3,791,365	\$ 47,596,495	\$ 56,437,331	\$ 97,793,661	\$ (710,138)	\$ 204,908,714
Comprehensive income	-	-	-	15,958,763	9,486	15,968,249
Capital stock/participation certificates and allocated retained earnings issued	236,700	-	-	-	-	236,700
Capital stock/participation certificates and allocated retained earnings retired	(113,175)	-	-	-	-	(113,175)
Stock equalization						-
Patronage refunds:						
Cash	-	-	(705)	1	-	(704)
Balance at June 30, 2020	<u>\$ 3,914,890</u>	<u>\$ 47,596,495</u>	<u>\$ 56,436,626</u>	<u>\$ 113,752,425</u>	<u>\$ (700,652)</u>	<u>\$ 220,999,784</u>

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

TEXAS FARM CREDIT SERVICES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

The Texas Farm Credit Services (Agricultural Credit Association), referred to as the Association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves the counties of Anderson, Angelina, Aransas, Atascosa, Austin, Bandera, Bee, Bexar, Bowie, Brooks, Cameron, Camp, Cass, Chambers, Cherokee, Collin, Cook, Dallas, Delta, Denton, DeWitt, Dimmitt, Duval, Edwards, Fannin, Fayette, Franklin, Freestone, Frio, Goliad, Gonzales, Grayson, Gregg, Guadalupe, Hardin, Harrison, Henderson, Hidalgo, Hopkins, Houston, Hunt, Jasper, Jefferson, Jim Hogg, Jim Wells, Karnes, Kaufman, Kenedy, Kerr, Kinney, Kleberg, Lamar, LaSalle, Lavaca, Leon, Liberty, Limestone, Live Oak, Marion, Maverick, McMullen, Medina, Montgomery, Morris, Nacogdoches, Newton, Nueces, Orange, Panola, Polk, Rains, Real, Red River, Rockwall, Rusk, Sabine, San Augustine, San Jacinto, San Patricio, Shelby, Smith, Starr, Titus, Trinity, Tyler, Upshur, Uvalde, Val Verde, Van Zandt, Walker, Waller, Washington, Webb, Willacy, Wilson, Wood, Zapata, and Zavala, parts of Refugio, and the lower half of Lee in the State of Texas. The Association is a lending Association 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.

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 Association is evaluating the impact of adoption on the Association’s financial condition and 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 Association adopted this guidance on January 1, 2020. The adoption of this guidance did not materially impact the Association’s financial condition or results of operations.

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 adoption of this guidance did not materially 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 Associations. 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 Associations 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.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The preparation of these consolidated financial statements requires the use of management’s estimates. The results for the quarter ended June 30, 2020, are not necessarily indicative of the results to be expected for the year ended December 31, 2019. Certain amounts in the prior period’s financial statements have been reclassified to conform to current financial statement presentation.

NOTE 2 — INVESTMENTS:

The following is a summary of Farmer Mac agricultural mortgage-backed securities:

	June 30, 2020				
	Amortized Cost	Gross Unrealized Gains	Fair Value	Weighted Average Yield	Weighted Average Yield
Agricultural mortgage-backed securities	\$ 1,197,821	\$ 40,281	\$ 1,238,102	5.47%	4.41 Years
	December 31, 2019				
	Amortized Cost	Gross Unrealized Losses	Fair Value	Weighted Average Yield	Weighted Average Yield
Agricultural mortgage-backed securities	\$ 2,660,691	\$ (6,243)	\$ 2,654,448	5.53%	3.81 Years

NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES:

A summary of loans follows:

Loan Type	June 30, 2020 Amount	December 31, 2019 Amount
Production agriculture:		
Real estate mortgage	\$ 1,051,783,759	\$ 982,110,300
Production and intermediate term	255,122,697	223,427,089
Agribusiness:		
Processing and marketing	82,502,283	75,272,101
Loans to cooperatives	15,303,620	12,955,307
Farm-related business	3,970,606	3,021,587
Communication	17,429,061	10,543,602
Energy	2,573,861	2,803,913
Water and waste water	2,362,827	-
Mission-related investments	1,610,306	1,664,523
Rural residential real estate	1,535,802	2,284,841
Total	\$ 1,434,194,822	\$ 1,314,083,263

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 Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
	Real estate mortgage	\$ 37,537,652	\$170,159,550	\$ 21,017,892	\$ -	\$ 58,555,544
Production and intermediate term	29,873,366	1,653,175	-	-	29,873,366	1,653,175
Agribusiness	71,126,823	63,699,623	-	-	71,126,823	63,699,623
Communication	17,429,061	-	-	-	17,429,061	-
Energy	2,573,861	-	-	-	2,573,861	-
Water and waste water	2,362,827	-	-	-	2,362,827	-
Total	\$160,903,590	\$235,512,348	\$ 21,017,892	\$ -	\$181,921,482	\$235,512,348

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 \$292,604 and \$535,693 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, 2020	December 31, 2019
Nonaccrual loans:		
Real estate mortgage	\$ 7,162,507	\$ 5,288,762
Production and intermediate term	3,169,082	3,023,155
Rural residential real estate	-	37,617
Total nonaccrual loans	<u>10,331,589</u>	<u>8,349,534</u>
Accruing restructured loans:		
Mission-related investments	<u>783,530</u>	810,911
Total accruing restructured loans	<u>783,530</u>	810,911
Accruing loans 90 days or more past due:		
Real estate mortgage	69,893	-
Production and intermediate term	<u>99,977</u>	<u>5</u>
Total accruing loans 90 days or more past due	<u>169,870</u>	<u>5</u>
Total nonperforming loans	11,284,989	9,160,450
Other property owned	<u>3,393,901</u>	<u>3,101,394</u>
Total nonperforming assets	<u>\$ 14,678,890</u>	<u>\$ 12,261,844</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	96.7 %	96.1 %
OAEM	2.2 %	2.6 %
Substandard/doubtful	1.1 %	1.3 %
	100.0 %	100.0 %
Production and intermediate term		
Acceptable	90.3 %	89.6 %
OAEM	3.7 %	5.6 %
Substandard/doubtful	6.0 %	4.8 %
	100.0 %	100.0 %
Loans to cooperatives		
Acceptable	99.4 %	94.9 %
OAEM	0.6 %	5.1 %
Substandard/doubtful	- %	-
	100.0 %	100.0 %
Processing and marketing		
Acceptable	93.5 %	92.9 %
OAEM	4.1 %	7.1 %
Substandard/doubtful	2.4 %	-
	100.0 %	100.0 %
Farm-related business		
Acceptable	100.0 %	100.0 %
OAEM	- %	-
Substandard/doubtful	- %	-
	100.0 %	100.0 %
Communication		
Acceptable	100.0 %	100.0 %
OAEM	- %	-
Substandard/doubtful	- %	-
	100.0 %	100.0 %
Energy		
Acceptable	100.0 %	100.0 %
OAEM	- %	-
Substandard/doubtful	- %	-
	100.0 %	100.0 %
Waste/water disposal		
Acceptable	100.0 %	-
OAEM	- %	-
Substandard/doubtful	- %	-
	100.0 %	-
Rural residential real estate		
Acceptable	65.6 %	74.6 %
OAEM	34.4 %	23.8 %
Substandard/doubtful	- %	1.6 %
	100.0 %	100.0 %
Mission-related investments		
Acceptable	100.0 %	100.0 %
OAEM	- %	-
Substandard/doubtful	- %	-
	100.0 %	100.0 %
Total loans		
Acceptable	95.4 %	94.8 %
OAEM	2.6 %	3.4 %
Substandard/doubtful	2.0 %	1.8 %
	100.0 %	100.0 %

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	Recorded Investment >90 Days and Accruing
Real estate mortgage	\$ 2,912,448	\$ 4,381,615	\$ 7,294,063	\$ 1,054,751,280	\$ 1,062,045,343	\$ 69,893
Production and intermediate term	1,856,687	990,037	2,846,724	255,903,433	258,750,157	99,977
Processing and marketing	-	-	-	82,754,058	82,754,058	-
Loans to cooperatives	-	-	-	15,522,292	15,522,292	-
Farm-related business	-	-	-	3,991,366	3,991,366	-
Communication	-	-	-	17,430,016	17,430,016	-
Energy	-	-	-	2,588,697	2,588,697	-
Water and waste water	-	-	-	2,362,970	2,362,970	-
Rural residential real estate	114,661	-	114,661	1,427,281	1,541,942	-
Mission-related investments	-	-	-	1,617,390	1,617,390	-
Total	\$ 4,883,796	\$ 5,371,652	\$ 10,255,448	\$ 1,438,348,783	\$ 1,448,604,231	\$ 169,870

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	Recorded Investment >90 Days and Accruing
Real estate mortgage	\$ 7,750,213	\$ 1,889,151	\$ 9,639,364	\$ 980,688,535	\$ 990,327,899	-
Production and intermediate term	996,705	702,530	1,699,235	224,103,142	225,802,377	5
Processing and marketing	-	-	-	75,468,841	75,468,841	-
Loans to cooperatives	-	-	-	13,054,651	13,054,651	-
Farm-related business	-	-	-	3,039,972	3,039,972	-
Communication	-	-	-	10,544,242	10,544,242	-
Energy	-	-	-	2,806,945	2,806,945	-
Rural residential real estate	119,183	37,617	156,800	2,135,253	2,292,053	-
Mission-related investments	69,590	-	69,590	1,602,533	1,672,123	-
Total	\$ 8,935,691	\$ 2,629,298	\$ 11,564,989	\$ 1,313,444,114	\$ 1,325,009,103	\$ 5

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.

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 \$3,195,846, including \$2,412,316 classified as nonaccrual and \$783,530 classified as accrual, with specific allowance for loan losses of \$363,609. As of June 30, 2020, commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring were \$55,818 at period end and \$25,818 at December 31, 2019.

There were not troubled debt restructurings that occurred during the six months ended June 30, 2020. Loans formally restructured prior to January 1, 2020, were \$3,195,846.

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 charge-offs recorded for the quarter ending June 30, 2020.

The predominant form of concession granted for troubled debt restructuring includes loan modifications in which interest rates are lower than the borrower could otherwise receive in the market based on credit worthiness. Other types of modifications include extension of the term, principal or accrued interest reductions, interest rate decreases and delayed payments, among others. At times, these terms might be offset with incremental payments, collateral or new borrower guarantees, in which case we assess all of the modified terms to determine if the overall modification qualifies as a troubled debt restructuring.

There were no loans that met the accounting criteria as a troubled debt restructuring and that occurred within the previous 12 months and for which there was a subsequent 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:

	Loans Modified as TDRs		TDRs in Nonaccrual Status*	
	June 30, 2020	December 31, 2019	June 30, 2020	December 31, 2019
Real estate mortgage	\$ 212,831	\$ 230,237	\$ 212,831	\$ 230,237
Production and intermediate term	2,199,485	2,229,485	2,199,485	2,229,485
Mission-related investments	783,530	810,911	-	-
Total	\$ 3,195,846	\$ 3,270,633	\$ 2,412,316	\$ 2,459,722

*represents the portion of loans modified as TDRs that are in nonaccrual status

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:						
Production and intermediate term	\$ 2,099,880	\$ 2,099,880	\$ 363,195	\$ -	\$ -	\$ -
Mission-related investments	52,701	52,002	17,003	53,715	53,003	16,509
Total	\$ 2,152,581	\$ 2,151,882	\$ 380,198	\$ 53,715	\$ 53,003	\$ 16,509
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	\$ 7,232,400	\$ 7,325,540	\$ -	\$ 5,288,762	\$ 5,393,514	\$ -
Production and intermediate term	1,169,179	3,546,072	-	3,023,160	5,428,487	-
Rural residential real estate	-	-	-	37,617	72,517	-
Mission-related investments	730,829	723,486	-	757,196	749,597	-
Total	\$ 9,132,408	\$ 11,595,098	\$ -	\$ 9,106,735	\$ 11,644,115	\$ -
Total impaired loans:						
Real estate mortgage	\$ 7,232,400	\$ 7,325,540	\$ -	\$ 5,288,762	\$ 5,393,514	\$ -
Production and intermediate term	3,269,059	5,645,952	363,195	3,023,160	5,428,487	-
Rural residential real estate	-	-	-	37,617	72,517	-
Mission-related investments	783,530	775,488	17,003	810,911	802,600	16,509
Total	\$ 11,284,989	\$ 13,746,980	\$ 380,198	\$ 9,160,450	\$ 11,697,118	\$ 16,509

^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:								
Production and intermediate term	\$ 1,988,594	\$ -	\$ -	\$ -	\$ 1,965,469	\$ -	\$ -	\$ -
Mission-related investments	52,376	1,053	53,332	1,073	52,689	2,119	53,665	2,161
Total	<u>\$ 2,040,970</u>	<u>\$ 1,053</u>	<u>\$ 53,332</u>	<u>\$ 1,073</u>	<u>\$ 2,018,158</u>	<u>\$ 2,119</u>	<u>\$ 53,665</u>	<u>\$ 2,161</u>
Impaired loans with no related allowance for credit losses:								
Real estate mortgage	\$ 6,334,739	\$ 3,482	\$ 6,973,587	\$ 29,116	\$ 4,833,973	\$ 80,225	\$ 7,013,882	\$ 47,696
Production and intermediate term	1,166,586	18,987	4,699,905	19,787	1,166,341	26,797	4,691,734	23,330
Rural residential real estate	-	-	31,158	-	-	-	31,158	-
Mission-related investments	733,014	11,167	759,095	11,584	741,126	22,598	767,691	23,430
Total	<u>\$ 8,234,339</u>	<u>\$ 33,636</u>	<u>\$12,463,745</u>	<u>\$ 60,487</u>	<u>\$ 6,741,440</u>	<u>\$ 129,620</u>	<u>\$12,504,465</u>	<u>\$ 94,456</u>
Total impaired loans:								
Real estate mortgage	\$ 6,334,739	\$ 3,482	\$ 6,973,587	\$ 29,116	\$ 4,833,973	\$ 80,225	\$ 7,013,882	\$ 47,696
Production and intermediate term	3,155,180	18,987	4,699,905	19,787	3,131,810	26,797	4,691,734	23,330
Rural residential real estate	-	-	31,158	-	-	-	31,158	-
Mission-related investments	785,390	12,220	812,427	12,657	793,815	24,717	821,356	25,591
Total	<u>\$10,275,309</u>	<u>\$ 34,689</u>	<u>\$12,517,077</u>	<u>\$ 61,560</u>	<u>\$8,759,598</u>	<u>\$ 131,739</u>	<u>\$12,558,130</u>	<u>\$ 96,617</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	Mission-Related Investments	Total
Allowance for Credit Losses:								
Balance at March 30, 2020	\$ 1,395,508	\$ 3,800,730	\$ 141,983	\$ 14,793	\$ 3,772	\$ 2,240	\$ 18,887	\$ 5,377,913
Recoveries	2,392	-	-	-	-	-	-	2,392
Provision for loan losses	(43,159)	649,902	(12,488)	7,277	2,498	(288)	164	603,906
Other	(9,809)	66,069	-	-	-	-	-	56,260
Balance at June 30, 2020	<u>\$ 1,344,932</u>	<u>\$ 4,516,701</u>	<u>\$ 129,495</u>	<u>\$ 22,070</u>	<u>\$ 6,270</u>	<u>\$ 1,952</u>	<u>\$ 19,051</u>	<u>\$ 6,040,471</u>
Balance at December 31, 2019	\$ 1,853,403	\$ 1,656,635	\$ 746,813	\$ 9,978	\$ 20,898	\$ 11,724	\$ 24,453	\$ 4,323,904
Recoveries	30,625	-	-	-	-	-	-	30,625
Provision for loan losses	(536,033)	2,770,324	(617,318)	12,092	(14,628)	(9,772)	(5,402)	1,599,263
Other	(3,063)	89,742	-	-	-	-	-	86,679
Balance at June 30, 2020	<u>\$ 1,344,932</u>	<u>\$ 4,516,701</u>	<u>\$ 129,495</u>	<u>\$ 22,070</u>	<u>\$ 6,270</u>	<u>\$ 1,952</u>	<u>\$ 19,051</u>	<u>\$ 6,040,471</u>
Ending Balance:								
Individually evaluated for impairment	\$ -	\$ 363,195	\$ -	\$ -	\$ -	\$ -	\$ 17,003	\$ 380,198
Collectively evaluated for impairment	1,344,932	4,153,506	129,495	22,070	6,270	1,952	2,048	5,660,273
Balance at June 30, 2020	<u>\$ 1,344,932</u>	<u>\$ 4,516,701</u>	<u>\$ 129,495</u>	<u>\$ 22,070</u>	<u>\$ 6,270</u>	<u>\$ 1,952</u>	<u>\$ 19,051</u>	<u>\$ 6,040,471</u>
Balance at March 30, 2019	\$ 1,351,888	\$ 1,215,923	\$ 746,813	\$ 9,978	\$ 20,898	\$ 11,724	\$ 24,453	\$ 3,381,677
Recoveries	-	2,000	-	-	-	-	-	2,000
Provision for loan losses	141,575	(202,175)	-	-	-	-	-	(60,600)
Other	(519)	53,034	-	-	-	-	-	52,515
Balance at June 30, 2019	<u>\$ 1,492,944</u>	<u>\$ 1,068,782</u>	<u>\$ 746,813</u>	<u>\$ 9,978</u>	<u>\$ 20,898</u>	<u>\$ 11,724</u>	<u>\$ 24,453</u>	<u>\$ 3,375,592</u>
Balance at December 31, 2018	\$ 1,321,472	\$ 860,965	\$ 746,813	\$ 9,978	\$ 20,898	\$ 11,724	\$ 24,453	\$ 2,996,303
Recoveries	-	6,000	-	-	-	-	-	6,000
Provision for loan losses	167,074	92,398	-	-	-	-	-	259,472
Other	4,398	109,419	-	-	-	-	-	113,817
Balance at June 30, 2019	<u>\$ 1,492,944</u>	<u>\$ 1,068,782</u>	<u>\$ 746,813</u>	<u>\$ 9,978</u>	<u>\$ 20,898</u>	<u>\$ 11,724</u>	<u>\$ 24,453</u>	<u>\$ 3,375,592</u>
Ending Balance:								
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 16,222	\$ 16,222
Collectively evaluated for impairment	1,492,944	1,068,782	746,813	9,978	20,898	11,724	8,231	3,359,370
Balance at June 30, 2019	<u>\$ 1,492,944</u>	<u>\$ 1,068,782</u>	<u>\$ 746,813</u>	<u>\$ 9,978</u>	<u>\$ 20,898</u>	<u>\$ 11,724</u>	<u>\$ 24,453</u>	<u>\$ 3,375,592</u>

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communications	Energy and Water/Waste Water	Rural Residential Real Estate	Mission-Related Investments	Total
Recorded Investments								
in Loans Outstanding:								
Ending Balance at								
June 30, 2020	\$ 1,062,045,343	\$ 258,750,157	\$ 102,267,716	\$ 17,430,016	\$ 4,951,667	\$ 1,541,942	\$ 1,617,390	\$ 1,448,604,231
Individually evaluated for impairment	\$ 7,232,400	\$ 3,269,059	\$ -	\$ -	\$ -	\$ -	\$ 783,530	\$ 11,284,989
Collectively evaluated for impairment	\$ 1,054,812,943	\$ 255,481,098	\$ 102,267,716	\$ 17,430,016	\$ 4,951,667	\$ 1,541,942	\$ 833,860	\$ 1,437,319,242
Ending Balance at								
June 30, 2019	\$ 966,314,980	\$ 243,145,178	\$ 90,024,565	\$ 8,356,020	\$ 3,065,273	\$ 2,347,273	\$ 2,227,487	\$ 1,315,480,776
Individually evaluated for impairment	\$ 7,453,949	\$ 5,129,811	\$ -	\$ -	\$ -	\$ 31,158	\$ 811,989	\$ 13,426,907
Collectively evaluated for impairment	\$ 958,675,956	\$ 238,015,367	\$ 90,024,565	\$ 8,356,020	\$ 3,065,273	\$ 2,316,115	\$ 1,415,498	\$ 1,301,868,794
Loans acquired with deteriorated credit quality	\$ 185,075	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 185,075

NOTE 4 —LEASES:

The components of lease expense were as follows:

	Classification	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	Right of use asset	\$ 32,297	\$ 36,778	\$ 64,454	\$ 68,155
Short-term lease cost		4,200	3,300	9,601	6,600
Finance lease cost:					
Amortization of right-of-use assets		600	2,150	2,400	2,793
Net lease cost		\$ 37,097	\$ 42,228	\$ 76,455	\$ 77,548

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	\$ 32,897	\$ 38,928	\$ 66,854	\$ 70,948
Right-of-use assets obtained in exchange for lease obligations:				
Operating leases	32,297	36,778	64,454	68,155

Lease term and discount rate are as follows:

	June 30, 2020	December 31, 2019
Weighted average remaining lease term in years		
Operating leases	4.50	3.01
Weighted average discount rate		
Operating leases	1.31%	2.71%

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)	\$ 49,122
2021	96,696
2022	74,686
2023	55,525
2024	45,751
Thereafter	54,906
Total	<u>\$ 376,686</u>

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 Association's capital adequacy goals as well as the minimum permanent capital standards. The Plan monitors projected 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 Association'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%	13.31%
Tier 1 capital ratio	6.00%	2.50%	8.50%	13.31%
Total capital ratio	8.00%	2.50%	10.50%	13.71%
Permanent capital ratio	7.00%	0.00%	7.00%	13.36%
<hr/>				
Non-risk-adjusted:				
Tier 1 leverage ratio	4.00%	1.00%	5.00%	13.28%
UREE leverage ratio	1.50%	0.00%	1.50%	9.87%

(dollars in thousands)	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
Numerator:				
Unallocated retained earnings	\$ 59,705,592	\$ 59,705,592	\$ 59,705,592	\$ 59,705,592
Paid-in capital	47,596,495	47,596,495	47,596,495	47,596,495
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	3,857,005	3,857,005	3,857,005	3,857,005
Allocated equities:				
Allocated equities held ≥ 7	56,436,743	56,436,743	56,436,743	56,436,743
Nonqualified allocated equities not subject to retirement	46,817,342	46,817,342	46,817,342	46,817,342
Allowance for loan losses and reserve for credit losses subject to certain limitations	-	-	5,709,036	-
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	(22,573,769)	(22,573,769)	(22,573,769)	(22,573,769)
Other regulatory required deductions	(2,135,855)	(2,135,855)	(2,135,855)	(2,135,855)
	<u>\$ 189,703,553</u>	<u>\$ 189,703,553</u>	<u>\$ 195,412,589</u>	<u>\$ 189,703,553</u>
Denominator:				
Risk-adjusted assets excluding allowance	1,450,242,931	1,450,242,931	1,450,242,931	1,450,242,931
Regulatory Adjustments and Deductions:				
Regulatory deductions included in total capital	(24,709,624)	(24,709,624)	(24,709,624)	(24,709,624)
Allowance for loan losses	-	-	-	(5,394,098)
	<u>\$ 1,425,533,307</u>	<u>\$ 1,425,533,307</u>	<u>\$ 1,425,533,307</u>	<u>\$ 1,420,139,209</u>
Calculated Ratio	13.31%	13.31%	13.71%	13.36%

(dollars in thousands)	Tier 1 leverage ratio	UREE leverage ratio
Numerator:		
Unallocated retained earnings	\$ 59,705,592	\$ 59,705,592
Paid-in capital	47,596,495	47,596,495
Common Cooperative Equities:		
Statutory minimum purchased borrower stock	3,857,005	-
Allocated equities:		
Allocated equities held ≥ 7	56,436,743	-
Nonqualified allocated equities not subject to retirement	46,817,342	46,817,342
Regulatory Adjustments and Deductions:		
Amount of allocated investments in other System institutions	(22,573,769)	(11,022,481)
Other regulatory required deductions	(2,135,855)	(2,135,855)
	<u>\$ 189,703,553</u>	<u>\$ 140,961,093</u>
Denominator:		
Total Assets	\$ 1,455,465,956	\$ 1,455,465,956
Regulatory Adjustments and Deductions:		
Regulatory deductions included in tier 1 capital	(27,445,098)	(27,445,098)
	<u>\$ 1,428,020,858</u>	<u>\$ 1,428,020,858</u>
Calculated Ratio	13.28%	9.87%

An additional component of equity is accumulated other comprehensive loss, which is reported net of taxes, is as follows:

Accum Other Comp Loss

June 30, 2020	Net of Tax
Nonpension postretirement benefits	\$ (700,652)
June 30, 2019	Net of Tax
Nonpension postretirement benefits	\$ (209,445)

The Association's accumulated other comprehensive loss relates entirely to its nonpension other postretirement benefits. Amortization of prior service (credits) cost and of actuarial (gain) loss are reflected in "Salaries and employee benefits" in the Consolidated Statements of Comprehensive Income. The following table summarizes the change in accumulated other comprehensive loss for the six months ended June 30:

	<u>2020</u>	<u>2019</u>
Accumulated other comprehensive loss at January 1	\$ (710,138)	\$ (198,585)
Amortization of prior service credit included in salaries and employee benefits	(10,858)	(10,860)
Amortization of actuarial loss included in salaries and employee benefits	<u>20,344</u>	<u>-</u>
Other comprehensive gain (loss), net of tax	<u>9,486</u>	<u>(10,860)</u>
Accumulated other comprehensive loss at June 30	<u>\$ (700,652)</u>	<u>\$ (209,445)</u>

NOTE 6 — INCOME TAXES:

Texas Farm Credit Services 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. Texas Farm Credit Services operates as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, Texas Farm Credit Services 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 Association 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. The Association has no valuation allowance on its deferred tax assets because management estimates full utilization of these assets.

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 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*	\$ -	\$ -	\$ 1,772,386	\$ 1,772,386
Other property owned	-	-	3,393,901	3,393,901
<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*	\$ -	\$ -	\$ 37,206	\$ 37,206
Other property owned	-	-	3,101,394	3,101,394

*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.

Information About Nonrecurring Level 3 Fair Value Measurements

With regard to nonrecurring measurements for impaired loans and other property owned, it is not practicable to provide specific information on inputs, as each collateral property is unique. System Associations utilize appraisals to value these loans and other property owned and take into account unobservable inputs, such as income and expense, comparable sales, replacement cost and comparability adjustments.

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.

Loans Evaluated for Impairment

For certain loans evaluated for impairment under FASB 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.

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 the other property owned involves the use of independent appraisals and other market-based information. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. As a result, these fair value measurements fall within Level 3 of the hierarchy.

Cash

For cash, the carrying amount is a reasonable estimate of fair value.

Loans

Fair value is estimated by discounting the expected future cash flows using the Associations' current interest rates at which similar loans would be made to borrowers with similar credit risk. The discount rates are based on the Associations' current loan origination rates as well as management's estimates of credit risk. Management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale and could be less.

For purposes of estimating fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics. Expected future cash flows, primarily based on contractual terms, and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

The fair value of loans in nonaccrual status that are current as to principal and interest is estimated as described above, with appropriately higher interest rates which reflect the uncertainty of continued cash flows. For collateral-dependent impaired loans, it is assumed that collection will result only from the disposition of the underlying collateral.

NOTE 8 — EMPLOYEE BENEFIT PLANS:

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

Three months ended June 30 :

	Other Benefits	
	2020	2019
Service cost	\$ 14,303	\$ 13,741
Interest cost	40,313	48,329
Amortization of prior service credits	(5,429)	(5,430)
Amortization of net actuarial loss	10,172	-
Net periodic benefit cost	<u>\$ 59,359</u>	<u>\$ 56,640</u>

Six months ended June 30 :

	Other Benefits	
	2020	2019
Service cost	\$ 28,605	\$ 27,482
Interest cost	80,626	96,658
Amortization of prior service credits	(10,858)	(10,860)
Amortization of net actuarial loss	20,343	-
Net periodic benefit cost	<u>\$ 118,716</u>	<u>\$ 113,280</u>

The Association's liability for the unfunded accumulated obligation for these benefits at June 30, 2020, was \$4,789,638 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 structure of the district's defined benefit pension plan 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 plan as an expense. The Association previously disclosed in its financial statements for the year ended December 31, 2019, that it expected to contribute \$238,309 to the district's defined benefit pension plan in 2020. As of June 30, 2020, \$119,155 of contributions have been expensed. The Association presently does not anticipate additional contributions will be required in 2020.

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 5, 2020, which is the date the financial statements were issued. There are no other significant events requiring disclosure as of this date.