

**HERITAGE LAND BANK, ACA**

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**2023  
Quarterly Report  
Second Quarter**



**For the Quarter Ended June 30, 2023**

## 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.

/s/ William M Tandy

/s/ Kevin Sampson

William M. Tandy, Chief Executive Officer

Kevin Sampson, Chairman, Board of Directors

*August 8, 2023*

*August 8, 2023*

/s/ Heath Gattis

Heath Gattis, Chief Financial Officer

*August 8, 2023*

# *Second Quarter 2023 Financial Report*

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## HERITAGE LAND BANK, ACA MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the financial performance of the Heritage Land Bank, ACA (Agricultural Credit Association), referred to as the Association, for the quarter ended June 30, 2023. These comments should be read in conjunction with the accompanying financial statements and the 2022 Annual Report to Stockholders.

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*

The Association's board of directors is committed to returning earnings in the form of a cooperative dividend. In January 2023, the board of directors declared a cash cooperative dividend distribution of approximately \$6.4 million from 2022 profits that was paid March 16, 2023. The cooperative dividend distribution equated to 100 basis points (1.0 percent). Since 2000, Heritage Land Bank has returned a total of \$58.2 million in cash to borrowers.

Monthly, the Association accrues income for an annual patronage dividend received in December of each year at the discretion of the Farm Credit Bank of Texas. The level of the Association's accrual of projected patronage income is based on history and annual expectations. Based on information received after June 30, the Association's expectations for the Farm Credit Bank 2023 patronage to the Association have been reduced significantly. As such, the Association's accrual of anticipated income for the remainder of 2023 will be reduced to match revised expectations. This reduction in patronage accrual will have the effect of reducing the Association's net income and will likely, as a consequence, reduce the Association's annual dividend to stockholders.

### *Loan Portfolio*

Total loans outstanding at June 30, 2023, including nonaccrual loans and sales contracts, were \$680,783,083 compared to \$669,320,338 at December 31, 2022, reflecting an increase 1.7 percent. Nonaccrual loans as a percentage of total loans outstanding were 0.01 percent at June 30 2023, compared to 0.02 percent at December 31, 2022.

The Association recorded \$24,576 in recoveries and no charge-offs for the quarter ended June 30, 2023, and \$38,728 in recoveries and no charge-offs for the same period in 2022. The Association's allowance for credit losses on loans was 0.8 percent of total loans outstanding as of June 30, 2023 and December 31, 2022.

### *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, 2023</u>		<u>December 31, 2022</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Nonaccrual	\$ 91,607	46.2%	\$ 108,736	61.1%
90 days past due and still accruing interest	106,633	53.8%	-	0.0%
Formally restructured	-	0.0%	69,313	38.9%
<b>Total</b>	<u>\$ 198,240</u>	<u>100.0%</u>	<u>\$ 178,049</u>	<u>100.0%</u>

## Results of Operations

The Association had net income of \$2,104,070 and \$4,679,106 for the three and six months ended June 30, 2023, as compared to net income of \$2,260,034 and \$4,764,859 for the same period in 2022, reflecting a decrease of 6.9 percent and 1.8 percent, respectively. Net interest income was \$4,445,914 and \$8,980,667 for the three and six months ended June 30, 2023, compared to \$4,330,172 and \$8,697,692 for the same period in 2022.

	Six Months Ended			
	June 30, 2023		June 30, 2022	
	Average Balance	Interest	Average Balance	Interest
Loans	\$ 670,338,552	\$ 16,661,144	\$ 662,014,164	\$ 14,657,645
Interest-bearing liabilities	576,291,920	7,680,477	570,686,139	5,959,953
Impact of capital	<u>\$ 94,046,632</u>		<u>\$ 91,328,025</u>	
Net interest income		<u>\$ 8,980,667</u>		<u>\$ 8,697,692</u>
	2023		2022	
	Average Yield		Average Yield	
Yield on loans	5.01%		4.46%	
Cost of interest-bearing liabilities	2.69%		2.11%	
Interest rate spread	2.32%		2.35%	
Net interest income as a percentage of average earning assets	2.70%		2.65%	

	Six months ended: June 30, 2023 vs. June 30, 2022		
	Increase due to		
	Volume	Rate	Total
Interest income - loans	\$ 184,310	\$ 1,819,189	\$ 2,003,499
Interest expense	58,544	1,661,980	1,720,524
Net interest income	<u>\$ 125,766</u>	<u>\$ 157,209</u>	<u>\$ 282,975</u>

Interest income for the three and six months ended June 30, 2023 increased by \$1,009,049 and \$2,003,499, or 13.6 percent and 13.7 percent, respectively, from the same period of 2022, primarily due to an increase in yields on earning assets. Interest expense for the three and six months ended June 30, 2023 increased by \$893,307 and \$1,720,524, or 29.0 percent and 28.9 percent, respectively, from the same period of 2022, primarily due to an increase in interest rates. Average loan volume for the second quarter of 2023 was \$670,151,523, compared to \$664,589,767 in the second quarter of 2022. The average net interest rate spread on the loan portfolio for the second quarter of 2023 was 2.28 percent, compared to 2.32 percent in the second quarter of 2022.

The Association's return on average assets for the six months ended June 30, 2023 was 1.37 percent, compared to 1.42 percent for the same period in 2022. The Association's return on average equity for the six months ended June 30, 2023 was 9.30 percent compared to 9.78 percent for the same period in 2022.

## 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, 2023	December 31, 2022
Note payable to the Bank	\$ 589,253,680	\$ 572,082,121
Accrued interest on note payable	1,358,108	1,206,494
Total	<u>\$ 590,611,788</u>	<u>\$ 573,288,615</u>

The Association operates under a general financing agreement (GFA) with the Bank. The current GFA is effective through September 30, 2023. The primary source of liquidity and funding for the Association is a direct loan from the Bank. The outstanding balance of \$589,253,680 as of June 30, 2023 is recorded as a liability on the Association's balance sheet. The note carried a weighted average interest rate of 2.91 percent at June 30, 2023. The indebtedness is collateralized by a pledge of substantially all of the Association's assets to the Bank and is governed by the GFA. The increase in note payable to the Bank and related accrued interest payable since December 31, 2022 is due to the Association's increase in loan volume and in increase in interest rates. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were \$90,087,983 at June 30, 2023. The maximum amount the Association may borrow from the Bank as of June 30, 2023 was \$681,425,955 as defined by the GFA. The indebtedness continues in effect until the expiration date of the GFA, which is September 30, 2023, 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 notice.

### *Capital Resources*

The Association's capital position increased by \$1,216,367 at June 30, 2023 compared to December 31, 2022. The Association's debt as a percentage of members' equity was 5.88:1 as of June 30, 2023, compared to 5.81:1 as of December 31, 2022.

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, 2023, 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 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 2022 Annual Report of Heritage Land Bank, ACA more fully describe the Association's relationship with the Bank.

The annual and quarterly stockholder reports of the Bank can be found at the Bank's website at [www.farmcreditbank.com](http://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 Heritage Land Bank, ACA, 4608 Kinsey Drive, Tyler, Texas 75703, or calling (903) 534-4975. The annual and quarterly stockholder reports for the Association are also available on its website at [www.heritagelandbank.com](http://www.heritagelandbank.com). Copies of the Association's quarterly stockholder reports can also be requested by e-mailing [stephanie.king@heritagelandbank.com](mailto:stephanie.king@heritagelandbank.com).

**HERITAGE LAND BANK, ACA**

**CONSOLIDATED BALANCE SHEETS**

	<b>June 30, 2023 (unaudited)</b>	<b>December 31, 2022</b>
<b><u>ASSETS</u></b>		
Cash	\$ 5,936	\$ 10,710
Loans	680,783,083	669,320,338
Less: allowance for credit losses on loans	5,530,101	5,505,525
Net loans	675,252,982	663,814,813
Accrued interest receivable	3,438,318	2,967,626
Investment in and receivable from the Farm Credit Bank of Texas:		
Capital stock	11,432,815	11,432,815
Other	2,024,292	311,967
Premises and equipment, net	6,815,744	5,903,709
Other assets	864,985	556,966
Total assets	<b>\$ 699,835,072</b>	<b>\$ 684,998,606</b>
<b><u>LIABILITIES</u></b>		
Note payable to the Farm Credit Bank of Texas	\$ 589,253,680	\$ 572,082,121
Advance conditional payments	9,753	17,402
Accrued interest payable	1,358,108	1,206,694
Drafts outstanding	37,104	51,765
Cooperative dividends payable	3,409,000	6,435,520
Other liabilities	4,014,156	4,668,200
Total liabilities	<b>598,081,801</b>	<b>584,461,702</b>
<b><u>MEMBERS' EQUITY</u></b>		
Capital stock and participation certificates	2,622,385	2,664,455
Unallocated retained earnings	99,040,052	97,778,405
Accumulated other comprehensive income	90,834	94,044
Total members' equity	<b>101,753,271</b>	<b>100,536,904</b>
Total liabilities and members' equity	<b>\$ 699,835,072</b>	<b>\$ 684,998,606</b>

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

HERITAGE LAND BANK, ACA

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

	Quarter Ended		Six Months Ended	
	June 30,		June 30,	
	2023	2022	2023	2022
<b><u>INTEREST INCOME</u></b>				
Loans	\$ 8,423,318	\$ 7,414,269	\$ 16,661,144	\$ 14,657,645
<b><u>INTEREST EXPENSE</u></b>				
Note payable to the Farm Credit Bank of Texas	3,977,306	3,084,094	7,680,277	5,959,943
Advance conditional payments	98	3	200	10
Total interest expense	3,977,404	3,084,097	7,680,477	5,959,953
Net interest income	4,445,914	4,330,172	8,980,667	8,697,692
<b><u>PROVISION FOR CREDIT LOSSES ON LOANS</u></b>				
Net interest income after provision for credit losses on loans	4,445,914	4,330,172	8,980,667	8,697,692
<b><u>NONINTEREST INCOME</u></b>				
Income from the Farm Credit Bank of Texas:				
Patronage income	900,912	1,104,439	2,051,965	2,106,823
Loan fees	34,711	36,259	70,799	68,003
Refunds from Farm Credit System Insurance Corporation	(1,950)	44,355	7,739	122,580
Financially related services income	231	371	467	533
Gain on sale of premises and equipment, net	-	24,553	-	72,837
Other noninterest income	15,358	16,274	30,716	38,735
Total noninterest income	949,262	1,226,251	2,161,686	2,409,511
<b><u>NONINTEREST EXPENSES</u></b>				
Salaries and employee benefits	1,840,753	1,942,680	3,678,824	3,904,440
Directors' expense	72,278	61,285	155,590	132,190
Purchased services	181,419	105,724	296,136	199,776
Travel	104,844	84,104	184,257	137,844
Occupancy and equipment	349,695	268,573	661,502	494,692
Communications	32,371	31,457	61,075	63,055
Advertising	150,533	79,726	264,619	158,796
Public and member relations	192,122	278,202	346,706	385,765
Supervisory and exam expense	61,736	58,931	123,472	117,862
Insurance fund premiums	255,485	342,164	529,355	577,043
Loss (gain) on other property owned, net	-	15	-	(629)
Other noninterest expense	49,870	43,528	161,711	171,510
Total noninterest expenses	3,291,106	3,296,389	6,463,247	6,342,344
<b>NET INCOME</b>	<b>2,104,070</b>	<b>2,260,034</b>	<b>4,679,106</b>	<b>4,764,859</b>
Other comprehensive income:				
Change in postretirement benefit plans	(1,605)	3,999	(3,210)	7,998
<b>COMPREHENSIVE INCOME</b>	<b>\$ 2,102,465</b>	<b>\$ 2,264,033</b>	<b>\$ 4,675,896</b>	<b>\$ 4,772,857</b>

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



HERITAGE LAND BANK, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

(unaudited)

	<u>Capital Stock/ Participation Certificates</u>	<u>Retained Earnings Unallocated</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Members' Equity</u>
Balance at December 31, 2021	\$ 2,717,525	\$ 94,289,309	\$ (310,037)	\$ 96,696,797
Comprehensive income	-	4,764,859	7,998	4,772,857
Capital stock/participation certificates issued	199,795	-	-	199,795
Capital stock/participation certificates retired	(237,190)	-	-	(237,190)
Cooperative dividends:				
Cash	-	(2,100,156)	-	(2,100,156)
Balance at June 30, 2022	<u>\$ 2,680,130</u>	<u>\$ 96,954,012</u>	<u>\$ (302,039)</u>	<u>\$ 99,332,103</u>
Balance at December 31, 2022	\$ 2,664,455	\$ 97,778,405	\$ 94,044	\$ 100,536,904
Comprehensive income	-	4,679,106	(3,210)	4,675,896
Capital stock/participation certificates issued	108,605	-	-	108,605
Capital stock/participation certificates retired	(150,675)	-	-	(150,675)
Cooperative dividends:				
Cash	-	(3,417,459)	-	(3,417,459)
<b>Balance at June 30, 2023</b>	<u><b>\$ 2,622,385</b></u>	<u><b>\$ 99,040,052</b></u>	<u><b>\$ 90,834</b></u>	<u><b>\$ 101,753,271</b></u>

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

**HERITAGE LAND BANK, ACA**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(unaudited)

**NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:**

The Heritage Land Bank, ACA (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, Cherokee, Collin, Dallas, Henderson, Hunt, Nacogdoches, Panola, Rockwall, Rusk, Sabine, San Augustine, Shelby, Smith, and Tarrant 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 consolidated 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, 2022, as contained in the 2022 Annual Report to Stockholders.

In the opinion of management, the unaudited financial information is complete and reflects all adjustments, consisting of normal recurring adjustments, necessary for a fair statement of results for the interim periods. 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, 2023. Descriptions of the significant accounting policies are included in the 2022 Annual Report to Stockholders. In the opinion of management, these policies and the presentation of the interim financial condition and results of operations conform with GAAP and prevailing practices within the banking industry.

*Recently Adopted Accounting Pronouncements*

The Association adopted the Financial Accounting Standards board (FASB) guidance entitled “Measurement of Credit Losses on Financial Instruments” and other subsequently issued accounting standards updates related to credit losses on January 1, 2023. This guidance replaced the current incurred loss impairment methodology with a single allowance framework for financial assets carried at amortized cost and certain off-balance sheet credit exposures. This guidance requires management to consider in its estimate of the allowance for credit losses (ACL) relevant historical events, current conditions, and reasonable and supportable forecasts that affect the collectability of the assets. In addition, the guidance amends existing impairment guidance for held-to-maturity and available-for-sale investments to incorporate an allowance for credit losses related to these securities, which will allow for the reversal of credit impairments in the event that the credit of an issuer improves. The adoption of this guidance was not material to the allowance for credit losses and retained earnings.

Also adopted effective January 1, 2023, was the updated guidance entitled “Financial Instruments – Credit Losses: Troubled Debt Restructurings and Vintage Disclosure.” This guidance requires the creditor to determine whether a modification results in a new loan or a continuation of an existing loan, among other disclosures specific to modifications with borrowers that are experiencing financial difficulties. The update eliminated the accounting guidance for troubled debt restructurings by creditors. The update also requires disclosure of current period gross write-offs by year of origination for financing receivables and net investments in leases.

*Loans and Allowance for Credit Losses*

Loans are generally carried at their principal amount outstanding adjusted for charge-offs, deferred loan fees or costs, and valuation adjustments relating to hedging activities. Loan origination fees and direct loan origination costs are netted and capitalized, and the net fee or cost is amortized over the average life of the related loan as an adjustment to interest income. Loan prepayment fees are reported in interest income. Interest on loans is accrued and credited to interest income based on the daily principal amount outstanding.

*Nonaccrual Loans*

Nonaccrual loans are loans for which there is reasonable doubt that all principal and interest will not be collected according to the original contractual terms and are generally considered substandard or doubtful, which is in accordance with the loan rating model, as described below. A loan is considered contractually past due when any principal repayment or interest payment required by the loan instrument is not received on or before the due date. A loan shall remain contractually past due until it is modified or until the entire amount past due, including principal, accrued interest, and penalty interest incurred as the result of past due status, is collected or otherwise discharged in full.

Consistent with prior practice, loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days (unless adequately secured and in the process of collection), circumstances indicate that collection of principal and interest is in doubt or legal action, including foreclosure or other forms of collateral conveyance, has been initiated to collect the outstanding principal and interest. At the time a loan is placed in nonaccrual status, accrued interest that is considered uncollectible is reversed (if accrued in the current year) or charged against the allowance for credit losses on loans (if accrued in prior years). Loans are charged-off at the time they are determined to be uncollectible.

When loans are in nonaccrual status, interest payments received in cash are generally recognized as interest income if the collectability of the loan principal is fully expected and certain other criteria are met. Otherwise, payments received on nonaccrual loans are applied against the recorded investment in the loan asset. Nonaccrual loans are returned to accrual status if all contractual principal and interest is current, the borrower is fully expected to fulfill the contractual repayments terms, and after remaining current as to principal and interest for a sustained period or have a recent repayment pattern demonstrating future repayment capacity to make on-time payments. If previously unrecognized interest income exists at the time the loan is transferred to accrual status, cash received at the time of or subsequent to the transfer should first be recorded as interest income until such time as the recorded balance equals the contractual indebtedness of the borrower.

#### *Accrued Interest Receivable*

The Association elected to continue classifying accrued interest on loans in accrued interest receivable and not as part of loans on the Consolidated Balance Sheets. The Association also elected to not estimate an allowance on interest receivable balances because the nonaccrual policies in place provide for the accrual of interest to cease on a timely basis when all contractual amounts are not expected.

#### *Loan Modifications to Borrowers Experiencing Financial Difficulty*

Loan modifications may be granted to borrowers experiencing financial difficulty. Modifications can be in the form of one or a combination of principal forgiveness, interest rate reduction, other-than-insignificant payment delay, or a term extension. Covenant waivers and modifications of contingent acceleration clauses are not considered term extensions.

#### *Collateral Dependent Loans*

Collateral dependent loans are loans secured by collateral, including but not limited to agricultural real estate, crop inventory, equipment, and livestock. CECL requires the Association to measure the expected credit losses based on fair value of the collateral at the reporting date when the Association determines that foreclosure is probable. Additionally, CECL allows a fair value practical expedient as a measurement approach for loans when the repayment is expected to be provided substantially through the operation or sale of the collateral when the borrower is experiencing financial difficulties. Under the practical expedient measurement approach, the expected credit losses is based on the difference between the fair value of the collateral less estimated costs to sell and the amortized cost basis of the loan.

#### *Allowance for Credit Losses*

Beginning January 1, 2023, the allowance for credit losses represents the estimated current expected credit losses over the remaining contractual life of financial assets measured at amortized cost and certain off-balance sheet credit exposures. The ACL takes into consideration relevant information about past events, current conditions, and reasonable and supportable macroeconomic forecasts of future conditions. The contractual term excludes expected extensions, renewals, and modifications unless the extension or renewal options are not unconditionally cancellable. The ACL comprises:

- the allowance for credit losses on loans (ACLL); and
- the allowance for unfunded commitments, which is presented on the Consolidated Balance Sheets in other liabilities.

Determining the appropriateness of the allowance is complex and requires judgment by management about the effect of matters that are inherently uncertain. Subsequent evaluations of the loan portfolio, considering macroeconomic conditions, forecasts, and other factors prevailing at the time may result in significant changes in the ACL in those future periods.

#### *Methodology for Allowance for Credit Losses on Loans*

The ACLL represents management's estimate of credit losses over the remaining expected life of loans. Loans are evaluated on the amortized cost basis, including premiums, discounts, and fair value hedge accounting adjustments.

The Association employs a disciplined process and methodology to establish its ACLL that has two basic components: first, an asset-specific component involving individual loans that do not share risk characteristics with other loans and the measurement of expected

credit losses for such individual loans; and second, a pooled component for estimated expected credit losses for pools of loans that share similar risk characteristics.

Asset-specific loans are generally collateral-dependent loans (including those loans for which foreclosure is probable) and nonaccrual loans. For an asset-specific loan, expected credit losses are measured as the difference between the amortized cost basis in the loan and the present value of expected future cash flows discounted at the loan's effective interest rate except that, for collateral-dependent loans, credit loss is measured as the difference between the amortized cost basis in the loan and the fair value of the underlying collateral. The fair value of the collateral is adjusted for the estimated cost to sell if repayment or satisfaction of a loan is dependent on the sale (rather than only on the operation) of the collateral. In accordance with the Association's appraisal policy, the fair value of collateral-dependent loans is based upon independent third-party appraisals or on collateral valuations prepared by in-house appraisers. When an updated appraisal or collateral valuation is received, management reassesses the need for adjustments to the loan's expected credit loss measurements and, where appropriate, records an adjustment. If the calculated expected credit loss is determined to be permanent, fixed, or non-recoverable, the credit loss portion of the loan will be charged off against the allowance for credit losses.

In estimating the component of the ACLL that share common risk characteristics, loans are evaluated collectively and segregated into loan pools considering the risk associated with the specific pool. Relevant risk characteristics include loan type, commodity, credit quality rating, delinquency category, or business segment, or a combination of these classes. The allowance is determined based on a quantitative calculation of the expected life-of-loan loss percentage for each loan category by considering the probability of default, based on the migration of loans from performing to loss by credit quality rating or delinquency buckets using historical life-of-loan analysis periods for loan types, and the severity of loss, based on the aggregate net lifetime losses incurred per loan pool.

The components of the ACLL also consider factors for each loan pool to adjust for differences between the historical period used to calculate historical default and loss severity rates and expected conditions over the remaining lives of the loans in the portfolio related to:

- Lending policies and procedures;
- National, regional, and local economic business conditions and developments that affect the collectability of the portfolio, including the condition of various markets;
- Nature of the loan portfolio, including the terms of the loans;
- Experience, ability, and depth of the lending management and other relevant staff;
- Volume and severity of past due and adversely classified or graded loans and the volume of nonaccrual loans;
- Quality of the loan review and process;
- Value of underlying collateral for collateral-dependent loans;
- Existence and effect of any concentrations of credit and changes in the level of such concentrations; and
- Effect of external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the existing portfolio.

The Association uses multiple scenarios over a reasonable and supportable forecast period of three years. Subsequent to the forecast period, the Association reverts to long-run historical loss experience beyond the three years on a straight-line basis over a two-year reversion period to inform the estimate of losses for the remaining contractual life of the loan portfolio.

The economic forecasts incorporate macroeconomic variables, including unemployment rates, real gross domestic product levels, and corporate bond spreads, as well as net farm income and agricultural commodity prices. Also considered are loan and borrower characteristics, such as internal risk ratings, delinquency status, collateral type, and the remaining term of the loan, adjusted for expected prepayments.

In addition to the quantitative calculation, the Association considers the imprecision inherent in the process and methodology, emerging risk assessments, and other subjective factors, which may lead to a management adjustment to the modeled ACLL results. Expected credit loss estimates also include consideration of expected cash recoveries on loans previously charged-off or expected recoveries on collateral dependent loans where recovery is expected through sale of the collateral. The economic forecasts are updated on a quarterly basis.

Prior to January 1, 2023, the allowance for credit losses on loans was maintained at a level considered adequate to provide for probable losses existing in and inherent in the loan portfolio. The allowance was based on a periodic evaluation of the loan portfolio in which numerous factors were considered, including economic conditions, collateral values, borrowers' financial conditions, loan portfolio composition, and prior loan loss experience. The allowance for credit losses on loans encompassed various judgments, evaluations, and appraisals with respect to the loans and their underlying collateral that, by their nature, contain elements of uncertainty and imprecision. Changes in the agricultural economy and their impact on borrower repayment capacity would cause these various judgments, evaluations, and appraisals to change over time. Management considered a number of factors in determining and

supporting the levels of the allowances for credit losses on loans, which include, but are not limited to, the concentration of lending in agriculture combined with uncertainties associated with farmland values, commodity prices, exports, government assistance programs, regional economic effects, and weather-related influences.

#### *Allowance for Credit Losses on Unfunded Commitments*

The Association evaluates the need for an allowance for credit losses on unfunded commitments under CECL and, if required, an amount is recognized and included in other liabilities on the Consolidated Balance Sheets. The amount of expected losses is determined by calculating a commitment usage factor over the contractual period for exposures that are not unconditionally cancellable by the Association and applying the loss factors used in the ACLL methodology to the results of the usage calculation. No allowance for credit losses are recorded for commitments that are unconditionally cancellable.

#### **NOTE 2 — LOANS AND ALLOWANCE FOR CREDIT LOSSES:**

A summary of loans follows:

<b>Loan Type</b>	<b>June 30, 2023</b>	December 31, 2022
	<b>Amount</b>	Amount
Production agriculture:		
Real estate mortgage	\$ 630,424,354	\$ 618,100,967
Production and intermediate-term	12,030,061	12,376,486
Rural residential real estate	25,226,315	26,408,451
Agribusiness:		
Processing and marketing	11,290,201	10,974,072
Farm-related business	1,547,082	1,171,210
Lease receivables	265,070	289,152
<b>Total</b>	<b>\$ 680,783,083</b>	<b>\$ 669,320,338</b>

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, 2023:

	<b>Other Farm Credit Institutions</b>		<b>Non-Farm Credit Institutions</b>		<b>Total</b>	
	<b>Participations Purchased</b>	<b>Participations Sold</b>	<b>Participations Purchased</b>	<b>Participations Sold</b>	<b>Participations Purchased</b>	<b>Participations Sold</b>
	Real estate mortgage	\$ 14,123,383	\$ 29,721,833	\$ -	\$ -	\$ 14,123,383
Agribusiness	6,007,854	-	-	-	6,007,854	-
Production and intermediate-term	55,904	1,284,670	-	-	55,904	1,284,670
<b>Total</b>	<b>\$ 20,187,141</b>	<b>\$ 31,006,503</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 20,187,141</b>	<b>\$ 31,006,503</b>

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. ACPs are not insured, and interest is generally paid by the Association on such balances. Balances of ACPs were \$9,753 and \$17,402 at June 30 2023, and December 31, 2022, respectively.

#### **Credit Quality**

Credit risk arises from the potential inability of an obligor to meet its payment obligation and exists in the Association’s outstanding loans, letters of credit, and unfunded loan commitments. The Association manages credit risk associated with the retail lending activities through an analysis of the credit risk profile of an individual borrower using its own set of underwriting standards and lending policies, approved by its board of directors, which provides direction to its loan officers. The retail credit risk management process begins with an analysis of the borrower’s credit history, repayment capacity, financial position, and collateral, which includes an analysis of credit scores for smaller loans. Repayment capacity focuses on the borrower’s ability to repay the loan based on cash flows from operations or other sources of income, including off-farm income. Real estate mortgage loans must be secured by first liens on the real estate (collateral). As required by Farm Credit Administration regulations, each association that makes loans on a secured basis must have collateral evaluation policies and procedures. Real estate mortgage loans may be made only in amounts up to 85 percent of the original appraised value of the property taken as security or up to 97 percent of the appraised value if guaranteed by a state, federal, or other governmental agency. The actual loan to appraised value when loans are made is generally lower than the statutory maximum percentage. Loans other than real estate mortgage may be made on a secured or unsecured basis.

The Association uses a two-dimensional risk rating model based on an internally generated combined System risk rating guidance that incorporates a 14-point probability of default rating scale to identify and tracks the probability of borrower default and a separate scale addressing loss given default. Probability of default is the probability that a borrower will experience a default during the life of the loan. The loss given default is management's estimate as to the anticipated principal loss on a specific loan assuming default occurs during the remaining life of the loan. A default is considered to have occurred if the lender believes the borrower will not be able to pay its obligation in full or the borrower or the loan is classified nonaccrual. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses, and risks in a particular relationship.

Each of the probability of default categories carries a distinct percentage of default probability. The probability of default rate between one and nine of the acceptable categories is very narrow and would reflect almost no default to a minimal default percentage. The probability of default rate grows more rapidly as a loan moves from acceptable to other assets especially mentioned and grows significantly as a loan moves to a substandard (viable) level. A substandard (non-viable) rating indicates that the probability of default is almost certain. These 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, or collateral pledged on the loan;
- Doubtful — assets exhibit similar weaknesses to substandard assets; however, doubtful assets have additional weaknesses in existing facts, conditions, and values that make collection in full highly questionable; and
- Loss — assets are considered uncollectible.

The following table presents credit quality indicators by loan type and the related principal balance:

	Term Loans				Revolving Loans	Total
	Amortized Cost by Origination Year					
	2023	2022	2021	Prior		
<b>Real estate mortgage</b>						
Acceptable	\$ 53,270,319	\$ 112,881,451	\$ 162,825,812	\$ 296,246,725	\$ -	\$ 625,224,307
OAEM	-	-	2,598,273	1,784,724	-	4,382,997
Substandard/Doubtful	-	110,586	-	706,464	-	817,050
	<u>\$ 53,270,319</u>	<u>\$ 112,992,037</u>	<u>\$ 165,424,085</u>	<u>\$ 298,737,913</u>	<u>\$ -</u>	<u>\$ 630,424,354</u>
<b>Production and intermediate-term</b>						
Acceptable	\$ 668,152	\$ 2,827,175	\$ 2,186,076	\$ 1,684,224	\$ 3,884,029	\$ 11,249,656
OAEM	222,225	-	-	-	499,963	722,188
Substandard/Doubtful	-	4,821	40,876	12,520	-	58,217
	<u>\$ 890,377</u>	<u>\$ 2,831,996</u>	<u>\$ 2,226,952</u>	<u>\$ 1,696,744</u>	<u>\$ 4,383,992</u>	<u>\$ 12,030,061</u>
<b>Rural residential real estate</b>						
Acceptable	\$ 190,639	\$ 1,379,981	\$ 4,956,065	\$ 18,602,655	\$ -	\$ 25,129,340
OAEM	-	-	-	92,120	-	92,120
Substandard/Doubtful	-	-	-	4,855	-	4,855
	<u>\$ 190,639</u>	<u>\$ 1,379,981</u>	<u>\$ 4,956,065</u>	<u>\$ 18,699,630</u>	<u>\$ -</u>	<u>\$ 25,226,315</u>
<b>Agribusiness</b>						
Acceptable	\$ -	\$ 2,488,682	\$ -	\$ 8,833,633	\$ 1,514,479	\$ 12,836,794
OAEM	-	-	-	-	-	-
Substandard/Doubtful	-	-	-	489	-	489
	<u>\$ -</u>	<u>\$ 2,488,682</u>	<u>\$ -</u>	<u>\$ 8,834,122</u>	<u>\$ 1,514,479</u>	<u>\$ 12,837,283</u>
<b>Lease receivables</b>						
Acceptable	\$ -	\$ -	\$ -	\$ 265,070	\$ -	\$ 265,070
OAEM	-	-	-	-	-	-
Substandard/Doubtful	-	-	-	-	-	-
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 265,070</u>	<u>\$ -</u>	<u>\$ 265,070</u>
<b>Total Loans</b>						
Acceptable	\$ 54,129,110	\$ 119,577,289	\$ 169,967,953	\$ 325,632,307	\$ 5,398,508	\$ 674,705,167
OAEM	222,225	-	2,598,273	1,876,844	499,963	5,197,305
Substandard/Doubtful	-	115,407	40,876	724,328	-	880,611
	<u>\$ 54,351,335</u>	<u>\$ 119,692,696</u>	<u>\$ 172,607,102</u>	<u>\$ 328,233,479</u>	<u>\$ 5,898,471</u>	<u>\$ 680,783,083</u>

The following table shows loans under the Farm Credit Administration Uniform Loan Classification System as a percentage of total loans by loan type as of:

	<b>June 30, 2023</b>	December 31, 2022
Real estate mortgage		
Acceptable	99.2 %	99.8 %
OAEM	0.7	0.1
Substandard/doubtful	0.1	0.1
	<b>100.0</b>	100.0
Production and intermediate-term		
Acceptable	93.5	99.6
OAEM	6.0	-
Substandard/doubtful	0.5	0.4
	<b>100.0</b>	100.0
Rural residential real estate		
Acceptable	99.6	99.6
OAEM	0.4	0.4
Substandard/doubtful	0.0	-
	<b>100.0</b>	100.0
Agribusiness		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	<b>100.0</b>	100.0
Lease receivables		
Acceptable	100.0	-
OAEM	-	-
Substandard/doubtful	-	-
	<b>100.0</b>	-
Total loans		
Acceptable	99.1	99.8
OAEM	0.8	0.1
Substandard/doubtful	0.1	0.1
	<b>100.0 %</b>	<b>100.0 %</b>

Accrued interest receivable on loans of \$3,438,318 and \$2,967,626 at June 30 2023 and December 31, 2022 have been excluded from the amortized cost of loans and reported separately in the Consolidated Balance Sheets.

The following table reflects nonperforming assets, which consist of nonaccrual loans, loans that are past due 90 days or more and still accruing interest, and other property owned, and related credit quality statistics:

	<u>June 30,</u> <u>2023</u>	<u>December 31,</u> <u>2022</u>
<b>Nonaccrual loans:</b>		
Real estate mortgage	\$ 86,263	\$ 103,006
Rural residential real estate	4,855	5,730
Agribusiness	489	-
Total nonaccrual loans	<u>91,607</u>	<u>108,736</u>
<b>Accruing loans 90 days or more past due:</b>		
Real estate mortgage	<u>106,633</u>	-
Total accruing loans 90 days or more past due	<u>106,633</u>	-
<b>Other property owned</b>		
	-	-
<b>Total nonperforming assets</b>	<u>\$ 198,240</u>	<u>\$ 108,736</u>
Nonaccrual loans as a percentage of total loans	0.01%	0.02%
Nonperforming assets as a percentage of total loans and other property owned	0.03%	0.02%
Nonperforming assets as a percentage of capital	0.19%	0.11%

The following table provides the amortized cost for nonaccrual loans with and without a related allowance for credit losses on loans, as well as interest income recognized on nonaccrual loans during the period:

	<u>June 30, 2023</u>			<u>Interest Income Recognized</u>	
	<u>Amortized Cost with Allowance</u>	<u>Amortized Cost without Allowance</u>	<u>Total</u>	<u>For the Three Months Ended June 30, 2023</u>	<u>For the Six Months Ended June 30, 2023</u>
<b>Nonaccrual loans:</b>					
Real estate mortgage	\$ -	\$ 86,263	\$ 86,263	\$ -	\$ -
Rural residential real estate	4,855	-	4,855	-	-
Agribusiness	-	489	489	-	-
Total nonaccrual loans	<u>\$ 4,855</u>	<u>\$ 86,752</u>	<u>\$ 91,607</u>	<u>\$ -</u>	<u>\$ -</u>

The following tables provide an aging analysis of past due loans at amortized cost by portfolio segment as of:

<u>June 30, 2023</u>	<u>30-89 Days Past Due</u>	<u>90 Days or More Past Due</u>	<u>Total Past Due</u>	<u>Not Past Due or Less Than 30 Days Past Due</u>	<u>Total Loans</u>	<u>Recorded Investment &gt;90 Days and Accruing</u>
Real estate mortgage	\$ 1,205,331	\$ 192,896	\$ 1,398,227	\$ 629,026,127	\$ 630,424,354	\$ 106,633
Production and intermediate-term	348,108	-	348,108	11,681,953	12,030,061	-
Rural residential real estate	96,975	-	96,975	25,129,340	25,226,315	-
Processing and marketing	-	489	489	11,289,712	11,290,201	-
Farm-related business	-	-	-	1,547,082	1,547,082	-
Lease receivables	-	-	-	265,070	265,070	-
Total	<u>\$ 1,650,414</u>	<u>\$ 193,385</u>	<u>\$ 1,843,799</u>	<u>\$ 678,939,284</u>	<u>\$ 680,783,083</u>	<u>\$ 106,633</u>

Prior to the adoption of CECL, the aging analysis of past due loans reported included accrued interest as follows:

<u>December 31, 2022</u>	<u>30-89 Days Past Due</u>	<u>90 Days or More Past Due</u>	<u>Total Past Due</u>	<u>Not Past Due or Less Than 30 Days Past Due</u>	<u>Total Loans</u>	<u>Recorded Investment &gt;90 Days and Accruing</u>
Real estate mortgage	\$ 325,094	\$ 103,006	\$ 428,100	\$ 620,342,661	\$ 620,770,761	\$ -
Production and intermediate-term	-	-	-	12,566,913	12,566,913	-
Rural residential real estate	95,553	-	95,553	26,379,059	26,474,612	-
Processing and marketing	-	-	-	10,995,043	10,995,043	-
Farm-related business	-	-	-	1,190,523	1,190,523	-
Lease receivables	-	-	-	290,112	290,112	-
Total	<u>\$ 420,647</u>	<u>\$ 103,006</u>	<u>\$ 523,653</u>	<u>\$ 671,764,311</u>	<u>\$ 672,287,964</u>	<u>\$ -</u>



A loan is considered collateral dependent when the borrower is experiencing financial difficulty and repayment is expected to be provided substantially through the operation or sale of the collateral. The collateral dependent loans are primarily real estate mortgage and rural residential real estate loans.

## Allowance for Credit Losses

The credit risk rating methodology is a key component of the Association's allowance for credit losses evaluation and is generally incorporated into the Association's loan underwriting standards and internal lending limits. In addition, borrower and commodity concentration lending and leasing limits have been established by the Association to manage credit exposure. The regulatory limit to a single borrower or lessee is 15 percent of the Association's lending and leasing limit base, but the Association's boards of directors have generally established more restrictive lending limits.

Effective January 1, 2023, the Association adopted the CECL accounting guidance as described in Note 1. A summary of changes in the allowance for credit losses by portfolio segment are as follows:

	Real Estate Mortgage	Production and Intermediate-Term	Agribusiness	Rural Residential Real Estate	Lease Receivables	Total
<b>Allowance for Credit Losses on Loans:</b>						
Balance at March 31, 2023	\$ 2,490,467	\$ 1,436,813	\$ 1,573,477	\$ 18,168	\$ -	\$ 5,518,925
Charge-offs	-	-	-	-	-	-
Recoveries	-	9,172	2,004	-	-	11,176
Provision for credit losses on loans	-	-	-	-	-	-
Balance at June 30, 2023	\$ 2,490,467	\$ 1,445,985	\$ 1,575,481	\$ 18,168	\$ -	\$ 5,530,101
Balance at December 31, 2022	\$ 2,477,067	\$ 1,436,813	\$ 1,573,477	\$ 18,168	\$ -	\$ 5,505,525
Charge-offs	-	-	-	-	-	-
Recoveries	13,400	9,172	2,004	-	-	24,576
Provision for credit losses on loans	-	-	-	-	-	-
Balance at June 30, 2023	\$ 2,490,467	\$ 1,445,985	\$ 1,575,481	\$ 18,168	\$ -	\$ 5,530,101
Balance at March 31, 2022 <sup>1</sup>	\$ 2,453,067	\$ 1,405,913	\$ 1,569,584	\$ 18,168	\$ -	\$ 5,446,732
Charge-offs	-	-	-	-	-	-
Recoveries	12,000	12,893	-	-	-	24,893
Provision for credit losses on loans	-	-	-	-	-	-
Balance at June 30, 2022	\$ 2,465,067	\$ 1,418,806	\$ 1,569,584	\$ 18,168	\$ -	\$ 5,471,625
Balance at December 31, 2021	\$ 2,453,067	\$ 1,392,078	\$ 1,569,584	\$ 18,168	\$ -	\$ 5,432,897
Charge-offs	-	-	-	-	-	-
Recoveries	12,000	26,728	-	-	-	38,728
Provision for credit losses on loans	-	-	-	-	-	-
Balance at June 30, 2022	\$ 2,465,067	\$ 1,418,806	\$ 1,569,584	\$ 18,168	\$ -	\$ 5,471,625
<b>Allowance for Unfunded Commitments:</b>						
Balance at March 31, 2023	\$ 100,000	\$ -	\$ -	\$ -	\$ -	\$ 100,000
Provision for unfunded commitments	-	-	-	-	-	-
Balance at June 30, 2023	\$ 100,000	\$ -	\$ -	\$ -	\$ -	\$ 100,000
Balance at December 31, 2022	\$ 100,000	\$ -	\$ -	\$ -	\$ -	\$ 100,000
Provision for unfunded commitments	-	-	-	-	-	-
Balance at June 30, 2023	\$ 100,000	\$ -	\$ -	\$ -	\$ -	\$ 100,000

<sup>1</sup> For periods prior to January 1, 2023, the allowance for credit losses on loans was based on probable and estimable losses inherent in the loan portfolio.

## Troubled Debt Restructurings

Prior to January 1, 2023, the adoption of updated FASB guidance on loan modifications, a restructuring of a loan constituted a troubled debt restructuring, also known as formally restructured, if the creditor for economic or legal reasons related to the borrower's financial difficulties granted a concession to the borrower that it would not otherwise consider. Concessions varied by program and were borrower-specific and could include interest rate reductions, term extensions, payment deferrals, or the acceptance of additional collateral in lieu of payments. In limited circumstances, principal may have been forgiven. When a restructured loan constituted a troubled debt restructuring, these loans were included within impaired loans under nonaccrual or accruing restructured loans.

As of June 30, 2023, the Association had no modified loans with borrowers experiencing financial difficulties.

### NOTE 3 — LEASES:

The components of lease expense were as follows:

<u>Classification</u>	For the Three Months Ended		For the Six Months Ended	
	<u>June 30, 2023</u>	<u>June 30, 2022</u>	<u>June 30, 2023</u>	<u>June 30, 2022</u>
Operating lease cost	<u>\$ 10,169</u>	<u>\$ 9,814</u>	<u>\$ 20,338</u>	<u>\$ 19,628</u>
Net lease cost	<u>\$ 10,169</u>	<u>\$ 9,814</u>	<u>\$ 20,338</u>	<u>\$ 19,628</u>

Other information related to leases was as follows:

	For the Three Months Ended		For the Six Months Ended	
	<u>June 30, 2023</u>	<u>June 30, 2022</u>	<u>June 30, 2023</u>	<u>June 30, 2022</u>
Cash paid for amounts included in the measurement of lease liabilities:				
Operating cash flows from operating leases	\$ 10,169	\$ 9,814	\$ 20,338	\$ 19,628

Lease term and discount rate are as follows:

	<u>June 30, 2023</u>	<u>December 31, 2022</u>
Weighted average remaining lease term in years		
Operating leases	1.96	2.16
Weighted average discount rate		
Operating leases	2.84%	2.84%

Future minimum lease payments under non-cancellable leases as of June 30, 2023 were as follows:

	<u>Operating Leases</u>
2023 (excluding the six months ended 6/30/23)	\$ 12,142
2024	16,207
2025	10,805
2026	-
Thereafter	-
Total	<u>\$ 39,154</u>

## NOTE 4 — 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 credit losses to absorb potential loss within the loan and lease portfolios; sufficiency of liquid funds; needs of the 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.

	<u>June 30, 2023</u>	<u>December 31, 2022</u>
Capital stock and participation certificates	\$ 2,622,385	\$ 2,664,455
Accumulated other comprehensive income	90,834	94,044
Unallocated retained earnings	99,040,052	97,778,405
<b>Total Capital</b>	<b>\$ 101,753,271</b>	<b>\$ 100,536,904</b>

### Regulatory Capitalization Requirements

<b>Risk-adjusted:</b>	<b>Regulatory Minimums with Buffer</b>	<b>As of June 30, 2023</b>
Common equity tier 1 ratio	7.00%	13.39%
Tier 1 capital ratio	8.50%	13.39%
Total capital ratio	10.50%	14.24%
Permanent capital ratio	7.00%	13.51%
<b>Non-risk-adjusted:</b>		
Tier 1 leverage ratio	5.00%	13.11%
UREE leverage ratio	1.50%	12.72%

The details for the amounts used in the calculation of the regulatory capital ratios as of June 30, 2023 are as follows:

	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
<b>Numerator:</b>				
Unallocated retained earnings	\$ 97,775,384	\$ 97,775,384	\$ 97,775,384	\$ 97,775,384
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	2,629,596	2,629,596	2,629,596	2,629,596
Allowance for credit losses on loans and reserve for credit losses subject to certain limitations	-	-	5,625,831	-
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	(11,432,815)	(11,432,815)	(11,432,815)	(11,432,815)
	<b>\$ 88,972,165</b>	<b>\$ 88,972,165</b>	<b>\$ 94,597,996</b>	<b>\$ 88,972,165</b>
<b>Denominator:</b>				
Risk-adjusted assets excluding allowance	\$ 675,662,671	\$ 675,662,671	\$ 675,662,671	\$ 675,662,671
Regulatory Adjustments and Deductions:				
Regulatory deductions included in total capital	(11,432,815)	(11,432,815)	(11,432,815)	(11,432,815)
Allowance for credit losses	-	-	-	(5,525,831)
	<b>\$ 664,229,856</b>	<b>\$ 664,229,856</b>	<b>\$ 664,229,856</b>	<b>\$ 658,704,025</b>

	Tier 1 leverage ratio	UREE leverage ratio
<b>Numerator:</b>		
Unallocated retained earnings	\$ 97,775,384	\$ 97,775,384
Common Cooperative Equities:		
Statutory minimum purchased borrower stock	2,629,596	-
Regulatory Adjustments and Deductions:		
Amount of allocated investments in other System institutions	(11,432,815)	(11,432,815)
	<u>\$ 88,972,165</u>	<u>\$ 86,342,569</u>
<b>Denominator:</b>		
Total Assets	\$ 691,476,370	\$ 691,476,370
Regulatory Adjustments and Deductions:		
Regulatory deductions included in tier 1 capital	(12,686,721)	(12,686,721)
	<u>\$ 678,789,649</u>	<u>\$ 678,789,649</u>

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

	2023	2022
Accumulated other comprehensive income (loss) at January 1	\$ 94,044	\$ (310,037)
Amortization of prior service credits included		
in salaries and employee benefits	(3,210)	(3,206)
Amortization of actuarial loss included		
in other noninterest expense	-	11,204
Other comprehensive (loss) income	(3,210)	7,998
Accumulated other comprehensive income (loss) at June 30	<u>\$ 90,834</u>	<u>\$ (302,039)</u>

#### NOTE 5 — INCOME TAXES:

Heritage Land Bank, 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. Heritage Land Bank, ACA operates as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, Heritage Land Bank, 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 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.

## NOTE 6 — FAIR VALUE MEASUREMENTS:

Accounting guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 14 in the 2022 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, 2023</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
<b>Assets:</b>				
Assets held in non-qualified benefits trusts	<u>\$ 79,170</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 79,170</u>
<u>December 31, 2022</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
<b>Assets:</b>				
Assets held in non-qualified benefits trusts	<u>\$ 63,500</u>	<u>-</u>	<u>-</u>	<u>\$ 63,500</u>

### Valuation Techniques

As more fully discussed in Note 14 to the 2022 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 the 2022 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 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.

#### *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 Association's current interest rates at which similar loans would be made to borrowers with similar credit risk. The discount rates are based on the Association's 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.

## Commitments to Extend Credit

The fair value of commitments is estimated using the fees currently charged for similar agreements, taking into account the remaining terms of the agreements and the creditworthiness of the counterparties. For fixed-rate loan commitments, estimated fair value also considers the difference between current levels of interest rates and the committed rates.

## NOTE 7 — EMPLOYEE BENEFIT PLANS:

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

### Three months ended June 30:

	Other Benefits	
	2023	2022
Service cost	\$ 6,201	\$ 8,806
Interest cost	16,803	12,821
Amortization of prior service credits	(1,605)	(1,603)
Amortization of net actuarial loss	-	5,602
<b>Net periodic benefit cost</b>	<b>\$ 21,399</b>	<b>\$ 25,626</b>

### Six months ended June 30:

	Other Benefits	
	2023	2022
Service cost	\$ 12,402	\$ 17,613
Interest cost	33,606	25,641
Amortization of prior service credits	(3,210)	(3,206)
Amortization of net actuarial loss	-	11,204
<b>Net periodic benefit cost</b>	<b>\$ 42,798</b>	<b>\$ 51,252</b>

The Association's liability for the unfunded accumulated obligation for these benefits at June 30 2023 was \$1,341,812 and is included in other liabilities on the Consolidated Balance Sheet.

The components of net periodic benefit cost other than the amortization of net actuarial loss component are included in the line item "Salaries and employee benefits" in the Consolidated Statements of Comprehensive Income.

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, 2022 that it expected to contribute \$44,009 to the District's defined benefit pension plan in 2023. As of June 30, 2023, \$35,147 of contributions have been made to the defined benefit pension plan. The Association presently anticipates contributing an additional \$35,147 to fund the defined benefit pension plan in 2023 for a total of \$70,294.

**NOTE 8 — 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 9 — SUBSEQUENT EVENTS:**

Monthly, the Association accrues income for an annual patronage dividend received in December of each year at the discretion of the Farm Credit Bank of Texas. The level of the Association's accrual of projected patronage income is based on history and annual expectations. Based on information received after June 30, the Association's expectations for the Farm Credit Bank 2023 patronage to the Association have been reduced significantly. As such, the Association's accrual of anticipated income for the remainder of 2023 will be reduced to match revised expectations. This reduction in patronage accrual will have the effect of reducing the Association's net income and will likely, as a consequence, reduce the Association's annual dividend to stockholders.

The Association has evaluated subsequent events through August 8, 2023, which is the date the financial statements were issued. There are no other significant events requiring disclosure as of August 8, 2023.