

2019

ANNUAL REPORT



AGCREDIT

CENTRAL KENTUCKY AGRICULTURAL CREDIT ASSOCIATION

2019 ANNUAL REPORT

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Management

James W. Caldwell.....	President and Chief Executive Officer
Marcus G. Barnett	Vice President and Chief Financial Officer
Jonathan T. Noe	Vice President and Chief Lending Officer
Shane Turner	Vice President and Chief Risk Officer

Board of Directors

James Alvin Lyons.....	Chairman
James C. Rankin III.....	Vice Chairman
Patrick Higginbotham	Director
Joe Myers	Director
Lee Hood.....	Director
Mary-Lynn Hinkel	Director
Dan Grigson	Director

Message from the President

Our Market, Our Method, Our Mission

“The more things change, the more they stay the same.” So true and applicable in so many respects. This familiar quote is attributed to 19th century French novelist Jean-Baptiste Alphonse Karr and remains true and applicable to this day. As we review the 2019 results for Central Kentucky Ag Credit, I encourage you to think about how much things have changed in the past few years, and in doing so, to also reflect on the constants. For our organization, this boils down to the consideration of Our Market, Our Method and Our Mission.

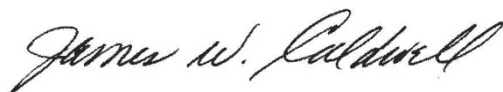
The quickest way to define our market is geographically – the 17 county area in the Bluegrass Region of Kentucky. However, it goes beyond simple geography and listing the counties surrounding Lexington. Our market is a collection of the people and entities engaged in the business of agriculture and in making a home for their families in the Kentucky countryside. In this respect, the market is ever changing and evolving. Not so long ago, agriculture in our region was dominated by burley tobacco production. Lexington was touted as the largest burley market in the world as nearly everyone associated with farming had some type of connection to the crop. Today, tobacco is still an important part of our diversified agricultural mix, but its dominance in the area has past. Beef cattle now seems to claim the leadership mantle for a Bluegrass Region with plentiful rainfall, rolling hillsides and grass. But even that characterization is too simple as equine and row crop production are also large components. Furthermore, an ever-growing segment of producers is engaged in the production of local food supplies which are distributed through farmers markets and other non-traditional outlets.

So we see our market has changed, but the overarching goals of the farmers remain the same. The commodity mix is different, but those age-old challenges associated with agriculture still loom on the horizon – weather, price volatility, commodity cycles, and consumer preferences to name a few. Yes, the market in Central Kentucky is different today and will continue to change, but the need for a strong and reliable financial partner to help achieve those goals and meet those challenges is still there.

The method of delivery of our products is an easy place to observe change. Like every aspect of our society, technology has been a disruptive force and will continue to be into the foreseeable future. The pace of growth in technology is fast and the digital world we live in is complex. Today, our focus for delivering our products and services centers on keeping up with the customer’s demands for technology solutions to their needs. But it goes well beyond using technology to process accounts and underwrite loans. We are constantly looking for ways to improve communications with our customers and the public. In doing so, we have gained efficiencies we couldn’t even imagine just a few decades ago. Year after year, our Association has continued to grow, but we have been able to maintain operating costs and staff levels because of the efficiency gained from leveraging technology.

We no longer use three-part carbon paper for loan applications, or a typewriter to prepare promissory notes. But sound financial analysis still occurs and the documents still need to be prepared. The core functions of our business are unchanged as we seek to make the best decisions possible for our borrowers and our lending cooperative. The methods we use to accomplish them may have changed, but these basic functions are still critical to our success.

Which brings us to the mission of our Association – where it all comes together. Changes in our market and our method are many and obvious. In just a few paragraphs above, we have only scratched the surface outlining some of the aspects of change we have seen in recent years: “*The more things change...*” But in spite of all the change we have seen, Central Kentucky Ag Credit exists today to serve farmers and rural homeowners, just like we did when we were organized in 1934 as part of the nationwide Farm Credit System. It’s a System with a clear mission: To support rural communities and agriculture with reliable, consistent credit and financial services, today and tomorrow. “*the more they stay the same.*”



James W. Caldwell
Chief Executive Officer

March 12, 2020

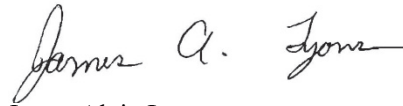
Report of Management

The accompanying consolidated financial statements and related financial information appearing throughout this annual report have been prepared by management of Central Kentucky Agricultural Credit Association (Association) in accordance with generally accepted accounting principles appropriate in the circumstances. Amounts which must be based on estimates represent the best estimates and judgments of management. Management is responsible for the integrity, objectivity, consistency, and fair presentation of the consolidated financial statements and financial information contained in this report.

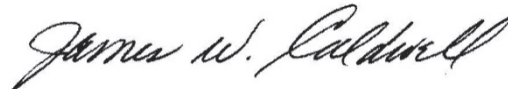
Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all financial statements, and that the assets of the Association are safeguarded. The design and implementation of all systems of internal control are based on judgments required to evaluate the costs of controls in relation to the expected benefits and to determine the appropriate balance between these costs and benefits. The Association maintains an internal audit program to monitor compliance with the systems of internal accounting control. Audits of the accounting records, accounting systems and internal controls are performed and internal audit reports, including appropriate recommendations for improvement, are submitted to the Board of Directors.

The consolidated financial statements have been audited by independent auditors, whose report appears elsewhere in this annual report. The Association is also subject to examination by the Farm Credit Administration.

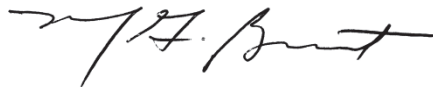
The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that we have reviewed the 2019 Annual Report of Central Kentucky Agricultural Credit Association, that the report has been prepared under the oversight of the audit committee of the Board of Directors and 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.



James Alvin Lyons
Chairman of the Board



James W. Caldwell
Chief Executive Officer



Marcus G. Barnett
Chief Financial Officer

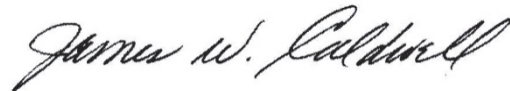
March 12, 2020

Report on Internal Control Over Financial Reporting

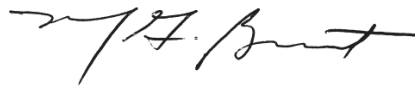
The Association's principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association's Consolidated Financial Statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by, or under the supervision of the Association's principal executives and principal financial officers, or persons performing similar functions, and effected by its Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting information and the preparation of the Consolidated Financial Statements for external purposes in accordance with accounting principles generally accepted in the United States of America and includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Association's assets that could have a material effect on its Consolidated Financial Statements.

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of December 31, 2019. In making the assessment, management used the framework in *Internal Control — Integrated Framework (2013)*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association's management concluded that as of December 31, 2019, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of December 31, 2019.



James W. Caldwell
Chief Executive Officer



Marcus G. Barnett
Chief Financial Officer

March 12, 2020

Consolidated Five - Year Summary of Selected Financial Data

<i>(dollars in thousands)</i>	December 31,				
	2019	2018	2017	2016	2015
Balance Sheet Data					
Cash	\$ 2,468	\$ 3,046	\$ 2,028	\$ 1,605	\$ 1,250
Loans	533,741	513,045	471,730	426,095	407,863
Allowance for loan losses	(4,257)	(4,277)	(4,037)	(3,695)	(3,771)
Net loans	529,484	508,768	467,693	422,400	404,092
Equity investments in other Farm Credit institutions	7,106	7,099	7,117	7,113	7,079
Other property owned	—	—	8	8	—
Other assets	16,606	16,924	16,341	17,219	15,241
Total assets	\$ 555,664	\$ 535,837	\$ 493,187	\$ 448,345	\$ 427,662
Notes payable to AgFirst Farm Credit Bank*	\$ 452,919	\$ 441,115	\$ 406,457	\$ 368,038	\$ 353,034
Accrued interest payable and other liabilities with maturities of less than one year	7,192	6,996	6,695	7,278	6,519
Total liabilities	460,111	448,111	413,152	375,316	359,553
Capital stock and participation certificates	3,910	4,225	4,698	4,993	6,784
Retained earnings					
Allocated	67,498	61,064	54,453	48,344	42,801
Unallocated	24,145	22,437	20,884	19,692	18,524
Total members' equity	95,553	87,726	80,035	73,029	68,109
Total liabilities and members' equity	\$ 555,664	\$ 535,837	\$ 493,187	\$ 448,345	\$ 427,662
Statement of Income Data					
Net interest income	\$ 13,257	\$ 12,600	\$ 11,560	\$ 11,096	\$ 10,555
Provision for (reversal of allowance for) loan losses	—	500	350	(50)	(35)
Noninterest income (expense), net	(951)	108	(317)	(1,309)	(1,295)
Net income	\$ 12,306	\$ 12,208	\$ 10,893	\$ 9,837	\$ 9,295
Key Financial Ratios					
Rate of return on average:					
Total assets	2.30%	2.41%	2.36%	2.27%	2.30%
Total members' equity	13.29%	14.41%	14.14%	13.81%	14.21%
Net interest income as a percentage of					
average earning assets	2.55%	2.57%	2.59%	2.66%	2.71%
Net (chargeoffs) recoveries to average loans	(0.004)%	(0.053)%	(0.002)%	(0.006)%	(0.022)%
Total members' equity to total assets	17.20%	16.37%	16.23%	16.29%	15.93%
Debt to members' equity (:1)	4.82	5.11	5.16	5.14	5.28
Allowance for loan losses to loans	0.80%	0.83%	0.86%	0.87%	0.92%
Permanent capital ratio	18.12%	17.45%	16.91%	17.79%	17.58%
Total surplus ratio	**	**	**	16.96%	16.28%
Core surplus ratio	**	**	**	16.96%	16.28%
Common equity tier 1 capital ratio	17.92%	17.23%	16.66%	**	**
Tier 1 capital ratio	17.92%	17.23%	16.66%	**	**
Total regulatory capital ratio	18.80%	18.12%	17.54%	**	**
Tier 1 leverage ratio	15.99%	15.08%	14.63%	**	**
Unallocated retained earnings (URE) and URE equivalents leverage ratio	15.62%	14.73%	14.29%	**	**
Net Income Distribution					
Estimated patronage refunds:					
Cash	\$ 4,161	\$ 4,040	\$ 3,590	\$ 3,105	\$ 2,617
Nonqualified retained earnings	6,242	6,591	6,112	5,766	5,561

* General financing agreement is renewable on a one-year cycle. The next renewal date is December 31, 2020.

** Not applicable due to changes in regulatory capital requirements effective January 1, 2017.

Management's Discussion & Analysis of Financial Condition & Results of Operations

(dollars in thousands, except as noted)

GENERAL OVERVIEW

The following commentary summarizes the financial condition and results of operations of Central Kentucky Agricultural Credit Association (Association) for the year ended December 31, 2019 with comparisons to the years ended December 31, 2018 and December 31, 2017. This information should be read in conjunction with the Consolidated Financial Statements, Notes to the Consolidated Financial Statements and other sections in this Annual Report. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors. For a list of the Audit Committee members, refer to the "Report of the Audit Committee" reflected in this Annual Report. Information in any part of this Annual Report may be incorporated by reference in answer or partial answer to any other item of the Annual Report.

The Association is an institution of the Farm Credit System (System), which was created by Congress in 1916 and has served agricultural producers for over 100 years. The System's mission is to maintain and improve the income and well-being of American farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses. The System is the largest agricultural lending organization in the United States. The System is regulated by the Farm Credit Administration, (FCA), which is an independent safety and soundness regulator.

The Association is a cooperative, which is owned by the members (also referred to throughout this Annual Report as stockholders or shareholders) served. The territory of the Association extends across a diverse agricultural region of Kentucky. Refer to Note 1, *Organization and Operations*, of the Notes to the Consolidated Financial Statements for counties in the Association's territory. The Association provides credit to farmers, ranchers, rural residents, and agribusinesses. Our success begins with our extensive agricultural experience and knowledge of the market.

The Association obtains funding from AgFirst Farm Credit Bank (AgFirst or Bank). The Association is materially affected and shareholder investment in the Association may be materially affected by the financial condition and results of operations of the Bank. Copies of the Bank's Annual and Unaudited Quarterly Reports are on the AgFirst website, www.agfirst.com, or may be obtained at no charge by calling 1-800-845-1745, extension 2832, or writing Susanne Caughman, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202.

Copies of the Association's Annual and Unaudited Quarterly reports are also available upon request free of charge on the Association's website, www.agcreditonline.com, or by calling 1-859-253-3249, extension 607, or writing Marcus G. Barnett, Central Kentucky Agricultural Credit Association, P. O. Box

1290, Lexington, KY 40588-1290. The Association prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report, which is available on the internet, within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Association.

FORWARD LOOKING INFORMATION

This annual information statement contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Words such as "anticipates," "believes," "could," "estimates," "may," "should," "will," or other variations of these terms are intended to identify the forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions, and expected future developments. However, actual results and developments may differ materially from our expectations and predictions due to a number of risks and uncertainties, many of which are beyond our control. These risks and uncertainties include, but are not limited to:

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international, and farm-related business sectors;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry and the Farm Credit System, as a government-sponsored enterprise, as well as investor and rating-agency reactions to events involving other government-sponsored enterprises and other financial institutions; and
- actions taken by the Federal Reserve System in implementing monetary policy.

CRITICAL ACCOUNTING POLICIES

The financial statements are reported in conformity with accounting principles generally accepted in the United States of America. Our significant accounting policies are critical to the understanding of our results of operations and financial position because some accounting policies require us to make complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. We consider these policies critical because management must make judgments about matters that

are inherently uncertain. For a complete discussion of significant accounting policies, see Note 2, *Summary of Significant Accounting Policies*, of the Notes to the Consolidated Financial Statements. The following is a summary of certain critical policies.

- *Allowance for loan losses* — The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs. The allowance for loan losses is determined according to generally accepted accounting principles and is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including current production and economic conditions, loan portfolio composition, collateral value, portfolio quality and prior loan loss experience.

Significant individual loans are evaluated based on the borrower's overall financial condition, resources, and payment record, the prospects for support from any financially responsible guarantor, and, if appropriate, the estimated net realizable value of any collateral. The allowance for loan losses encompasses various judgments, evaluations and appraisals with respect to the loans and their underlying security that, by nature, contains elements of uncertainty and imprecision. Changes in the agricultural economy and their borrower repayment capacity will cause these various judgments, evaluations and appraisals to change over time. Accordingly, actual circumstances could vary from the Association's expectations and predictions of those circumstances.

Management considers the following factors in determining and supporting the levels of allowance for loan losses: the concentration of lending in agriculture, combined with uncertainties in farmland values, commodity prices, exports, government assistance programs, regional economic effects and weather-related influences. Changes in the factors considered by management in the evaluation of losses in the loan portfolios could result in a change in the allowance for loan losses and could have a direct impact on the provision for loan losses and the results of operations.

- *Valuation methodologies* — Management applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets for which an observable liquid market exists, such as most investment securities. Management utilizes significant estimates and assumptions to value items for which an observable liquid market does not exist. Examples of these items include impaired loans, other property owned, pension and other postretirement benefit obligations, and certain other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing and liquidation values. The use of different assumptions could produce significantly

different results, which could have material positive or negative effects on the Association's results of operations.

ECONOMIC CONDITIONS

The agricultural economy of the territory serviced by the Association is very diverse. It is comprised of a significant beef concentration, as well as equine and grain. The cattle industry has seen a leveling off of prices since the market decline in late 2015 and early 2016. 2020 prices look to be flat to slightly improving for the near term as projected cattle numbers are currently low. However, the beef outlook is still somewhat guarded. The equine market has seen considerable improvement over the last couple of years. Recent horse sales in the area have been much stronger, and it appears that this has positively affected the equine real estate market as well. The equine market could be characterized as steady to improving. The grain market continues to be dealing with a very large surplus, which is driving demand and prices down. Other than a weather event or some other event that significantly decreases production, or a trade event that increases demand, it seems unlikely that an increase in prices is on the horizon for the near future. Overall, the market outlook continues to be uncertain.

Farm size varies and many borrowers in the region have diversified farming operations. This factor, along with numerous opportunities for non-farm employment in the area, significantly impacts the level of dependency on any given commodity. Farm real estate values are mixed with some indication that the market is tightening.

The Association's primary competition continues to come from several banks and one System institution. There has been little change in our market base over the past year. During 2018, the Association targeted certain areas of our business with hopes of increasing market share. Continued efforts are being made to expand services, increase public knowledge of our services and streamline our current delivery of products to enhance our existing portfolio.

LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners, and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans through numerous product types. The diversification of the Association loan volume by type for each of the past three years is shown below.

Loan Type	December 31,					
	2019		2018		2017	
	<i>(dollars in thousands)</i>					
Real estate mortgage	\$ 352,112	65.97%	\$ 331,734	64.66%	\$ 300,833	63.77%
Production and intermediate-term	160,493	30.07	165,054	32.17	156,798	33.24
Rural residential real estate	9,574	1.80	8,550	1.67	8,111	1.72
Processing and marketing	1,993	0.37	1,114	0.22	1,168	0.25
Farm-related business	9,569	1.79	6,593	1.28	4,820	1.02
Loans to cooperatives	—	—	—	—	—	—
Total	\$ 533,741	100.00%	\$ 513,045	100.00%	\$ 471,730	100.00%

While we make loans and provide financial related services to qualified borrowers in the agricultural and rural sectors and to certain related entities, our loan portfolio is diversified.

The geographic distribution of the loan volume by branch/operating unit for the past three years is as follows:

Branch/Operating Unit	December 31,		
	2019	2018	2017
Lebanon	27.50%	26.65%	26.71%
Lexington	20.15	20.20	21.08
Paris	15.52	15.85	15.35
Danville	14.17	14.47	13.84
Stanford	10.03	10.66	11.13
Richmond	8.30	8.27	8.45
Frankfort	4.14	3.71	3.23
Participations Purchased	0.19	0.19	0.21
	100.00%	100.00%	100.00%

Commodity and industry categories are based upon the Standard Industrial Classification system published by the federal government. The system is used to assign commodity or industry categories based upon the largest agricultural commodity of the customer.

The major commodities in the Association loan portfolio are shown below. The predominant commodities are beef cattle, horses, row crops, and hay/pasture, which constitute approximately 82 percent of the entire portfolio.

Commodity Group	December 31,					
	2019		2018		2017	
	<i>(dollars in thousands)</i>					
Beef Cattle	\$ 234,580	44%	\$ 236,067	46%	\$ 222,018	47%
Row Crops	79,580	15	70,235	14	43,782	9
Horses	76,589	14	76,589	15	67,458	14
Hay/Pasture	47,960	9	41,826	8	40,063	9
Tobacco	29,133	6	28,958	6	30,569	6
Ag Services	16,669	3	16,333	3	14,237	3
Rural Home	9,122	2	8,500	2	8,515	2
Dairy	7,754	1	6,025	1	8,627	2
Other	32,354	6	28,512	5	36,461	8
Total	\$ 533,741	100%	\$ 513,045	100%	\$ 471,730	100%

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The Association's loan portfolio contains a concentration of beef cattle and horse producers. Although a large percentage of the loan portfolio is concentrated in these

commodities, many of these operations are diversified within their enterprise and/or with crop production that reduces overall risk exposure. Demand for beef, prices of field grains, and international trade are some of the factors affecting the price of these commodities. At December 31, 2019, the Association's total commitments to its ten largest borrowers was \$42,161, representing 7.90 percent of total loans. The concentration of large loans has increased somewhat over the past several years. The agricultural enterprise mix of these loans however is diversified and similar to that of the overall portfolio. The risk in the portfolio associated with commodity concentration and large loans is reduced by the range of diversity of enterprises in the Association's territory, the borrowers' ability to supplement borrowings with non-farm income, and the level of guarantees obtained on the portfolio.

The increase in gross loan volume for the twelve months ended December 31, 2019, is primarily attributed to increases in farm real estate loans. The Association has attracted some large real estate loans over the past few years in addition to normal business. The short-term portfolio, which is heavily influenced by operating-type loans, normally reaches a peak balance in November and declines in the winter months as commodities are marketed and proceeds are applied to repay the operating loans.

During 2019, the Association continued activity in the selling of loan participations within and outside of the System. This provides a means for the Association to spread credit concentration risk.

The main commodity type in the Participations Purchased portfolio is prepared feeds which accounts for 100% of the portfolio. While these participations help spread total portfolio concentration, they also possess unique risks that include exposure to general economic trends, changes in government policy and counterparty risk. The Association manages this risk through routine monitoring, borrowing base reporting and policy driven portfolio limits. Counterparty risks on the entire Participations Purchased portfolio are reduced by the inclusion of System institutions as the lead lender in 100% of the portfolio.

Loan Participations:	December 31,		
	2019	2018	2017
	<i>(dollars in thousands)</i>		
Participations Purchased			
– FCS Institutions	\$ 1,037	\$ 993	\$ 1,010
Participations Sold	(39,534)	(40,331)	(32,511)
Total	\$ (38,497)	\$ (39,338)	\$ (31,501)

The Association did not have any loans sold with recourse, retained subordinated participation interests in loans sold, or interests in pools of subordinated participation interests for the period ended December 31, 2019.

The Association sells qualified long-term mortgage loans into the secondary market. For the period ended December 31, 2019, the Association originated and sold into the secondary market loans totaling \$18,391.

To mitigate risk of loan losses, the Association may enter into guarantee arrangements with certain GSEs, including the Federal Agricultural Mortgage Corporation (Farmer Mac), and state or federal agencies. These guarantees generally remain in place until the loans are paid in full or expire and give the Association the right to be reimbursed for losses incurred or to sell designated loans to the guarantor in the event of default (typically four months past due), subject to certain conditions. At December 31, 2019, the guaranteed balance of designated loans under these agreements was \$79,342.

CREDIT RISK MANAGEMENT

Credit risk arises from the potential inability of an obligor to meet its repayment obligation. As part of the process to evaluate the success of a loan, the Association continues to review the credit quality of the loan portfolio on an ongoing basis. With the approval of the Association Board of Directors, the Association establishes underwriting standards and lending policies that provide direction to loan officers. Underwriting standards include, among other things, an evaluation of:

- Character – borrower integrity and credit history
- Capacity – repayment capacity of the borrower based on cash flows from operations or other sources of income
- Collateral – protection for the lender in the event of default and a potential secondary source of repayment
- Capital – ability of the operation to survive unanticipated risks
- Conditions – intended use of the loan funds

The credit risk management process begins with an analysis of the borrower’s credit history, repayment capacity, and financial position. Repayment capacity focuses on the borrower’s ability to repay the loan based upon cash flows from operations or other sources of income, including non-farm income. Real estate loans must be collateralized by first liens on the real estate (collateral). As required by FCA regulations, each institution that makes loans on a collateralized 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 collateral 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. Appraisals are required for loans of more than one hundred thousand dollars. In addition, each loan is assigned a credit risk rating based upon the underwriting standards. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses, and risks in a particular relationship.

We review the credit quality of the loan portfolio on an ongoing basis as part of our risk management practices. Each loan is classified according to the Uniform Classification System, which is used by all Farm Credit System institutions. Below are the classification definitions.

- 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 facts, conditions and values that make collection in full highly questionable.
- Loss – Assets are considered uncollectible.

The following table presents selected statistics related to the credit quality of loans including accrued interest at December 31.

Credit Quality	2019	2018	2017
Acceptable & OAEM	99.00%	98.63%	97.32%
Substandard	0.95%	1.36%	2.65%
Doubtful	0.05%	0.01%	0.03%
Loss	0.00%	0.00%	0.00%
Total	100.00%	100.00%	100.00%

Nonperforming Assets

The Association’s loan portfolio is divided into performing and high-risk categories. The Administrative Office Credit Department monitors and works with loans classified as high-risk. The high-risk assets, including accrued interest, are detailed in the following table:

High-risk Assets	December 31,		
	2019	2018	2017
	<i>(dollars in thousands)</i>		
Nonaccrual loans	\$ 4,533	\$ 2,967	\$ 1,703
Restructured loans	2,071	1,136	1,242
Accruing loans 90 days past due	508	695	20
Total high-risk loans	7,112	4,798	2,965
Other property owned	–	–	8
Total high-risk assets	\$ 7,112	\$ 4,798	\$ 2,973
Ratios			
Nonaccrual loans to total loans	0.85%	0.58%	0.36%
High-risk assets to total assets	1.28%	0.90%	0.60%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the full collection of principal and/or future interest accruals under the contractual terms of the loan. In substance, nonaccrual loans reflect loans where the accrual of interest has been suspended. Nonaccrual loans increased \$1,566 or 52.78 percent in 2019. This increase resulted primarily from the placing of one larger loan into nonaccrual status. Of the \$4,533 in nonaccrual volume at December 31, 2019, \$1,157 or 25.52 percent, compared to 17.21 percent and 41.16 percent at December 31, 2018 and 2017, respectively, was current as to scheduled principal and interest payments, but did not meet all regulatory requirements to be transferred into accrual status.

Loan restructuring is available to financially distressed borrowers. Restructuring of loans occurs when the Association grants a concession to a borrower based on either a court order or good faith in a borrower's ability to return to financial viability. The concessions can be in the form of a modification of terms or rates, a compromise of amounts owed, or deed in lieu of foreclosure. Other receipts of assets and/or equity to pay the loan in full or in part are also considered restructured loans. The type of alternative financing structure chosen is based on minimizing the loss incurred by both the Association and the borrower.

Allowance for Loan Losses

The allowance for loan losses at each period end was considered by Association management to be adequate to absorb probable losses existing in and inherent to its loan portfolio.

The following table presents the activity in the allowance for loan losses for the most recent three years.

Allowance for Loan Losses Activity:	Year Ended December 31,		
	2019	2018	2017
	<i>(dollars in thousands)</i>		
Balance at beginning of year	\$ 4,277	\$ 4,037	\$ 3,695
Charge-offs:			
Production and intermediate-term	(20)	(263)	-
Rural residential real estate	-	-	(14)
Total charge-offs	(20)	(263)	(14)
Recoveries:			
Production and intermediate-term	-	3	6
Total recoveries	-	3	6
Net (charge-offs) recoveries	(20)	(260)	(8)
Provision for (reversal of allowance for) loan losses	-	500	350
Balance at end of year	\$ 4,257	\$ 4,277	\$ 4,037
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	(0.004)%	(0.053)%	(0.002)%

The net loan charge-offs were primarily associated with charge-offs taken on one loan account. The decrease in the allowance for loan losses was associated with the charge-offs taken during the year.

The allowance for loan losses by loan type for the most recent three years is as follows.

Allowance for Loan Losses by Type	December 31,		
	2019	2018	2017
	<i>(dollars in thousands)</i>		
Real estate mortgage	\$ 3,055	\$ 3,114	\$ 2,466
Production and intermediate-term	1,096	1,068	1,460
Agribusiness	58	45	48
Rural residential real estate	48	50	63
Total loans	\$ 4,257	\$ 4,277	\$ 4,037

The allowance for loan losses as a percentage of loans outstanding and as a percentage of certain other credit quality indicators is shown below:

Allowance for Loan Losses as a Percentage of:	December 31,		
	2019	2018	2017
Total loans	0.80%	0.83%	0.86%
Nonperforming loans	59.86%	89.14%	136.20%
Nonaccrual loans	93.91%	144.15%	237.05%

Please refer to Note 3, *Loans and Allowance for Loan Losses*, of the Notes to the Consolidated Financial Statements, for further information concerning the allowance for loan losses.

RESULTS OF OPERATIONS

Net Interest Income

Net interest income was \$13,257, \$12,600 and \$11,560 in 2019, 2018 and 2017, respectively. Net interest income is the difference between interest income and interest expense. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets and cost of debt. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following table:

	Volume*	Rate	Total
12/31/19 - 12/31/18			
Interest income	\$ 1,815	\$ 255	\$ 2,070
Interest expense	(651)	(762)	(1,413)
Change in net interest income	\$ 1,164	\$ (507)	\$ 657
12/31/18 - 12/31/17			
Interest income	\$ 2,059	\$ 1,524	\$ 3,583
Interest expense	(1,038)	(1,505)	(2,543)
Change in net interest income	\$ 1,021	\$ 19	\$ 1,040

* Volume variances can be the result of increased/decreased loan volume or from changes in the percentage composition of assets and liabilities between periods.

Noninterest Income

Noninterest income for each of the three years ended December 31 is shown in the following table:

Noninterest Income	For the Year Ended			Percentage Increase/(Decrease)	
	December 31,			2019	2018
	2019	2018	2017	2018	2017
	<i>(dollars in thousands)</i>				
Loan fees	\$ 873	\$ 696	\$ 620	25.43 %	12.26 %
Patronage refund from other Farm Credit Institutions	6,050	6,762	6,730	(10.53)	0.48
Gains (losses) on sales of rural home loans	9	9	11	-	(18.18)
Gains (losses) from sales of premises and equipment, net	14	-	6	100.00	(100.00)
Insurance Fund refunds	99	460	-	(78.48)	100.00
Other noninterest income	28	45	34	(37.78)	32.35
Total noninterest income	\$ 7,073	\$ 7,972	\$ 7,401	(11.28) %	7.72 %

Regarding patronage refunds received from other Farm Credit Institutions, the Association received \$3,480 in a patronage refund and \$2,570 in a special distribution from the Bank for the year ended December 31, 2019, compared to \$3,308 and \$3,454 for 2018, and \$3,045 and \$3,662 for 2017.

Noninterest Expense

Noninterest expense for each of the three years ended December 31 is shown in the following table:

Noninterest Expense	For the Year Ended			Percentage Increase/(Decrease)	
	December 31,			2019	2018
	2019	2018	2017	2018	2017
	<i>(dollars in thousands)</i>				
Salaries and employee benefits	\$ 4,628	\$ 4,269	\$ 3,913	8.41%	9.10%
Post retirement benefits	992	1,267	1,432	(21.70)	(11.52)
Occupancy and equipment expense	430	366	353	17.49	3.68
Insurance Fund premium	338	317	483	6.62	(34.37)
(Gains) losses on other property owned, net	-	(1)	-	100.00	(100.00)
Other operating expense	1,633	1,642	1,525	(0.55)	7.67
Total noninterest expense	\$ 8,021	\$ 7,860	\$ 7,706	2.05%	2.00%

Salaries and employee benefits increased in 2019, as compared with 2018, primarily due to increased costs associated with additional staffing, merit increases and health insurance. Post retirement benefits decreased \$275 or 21.70 percent in 2019 as compared with 2018. The primary reason for the decrease in post retirement benefits is an increase in the discount rate used to calculate the pension expense. Refer to Note 9, *Employee Benefit Plans*, of the Notes to the Consolidated Financial Statements, for further information concerning postretirement benefit expenses.

Occupancy and equipment expense increased \$64 or 17.49 percent in 2019 as compared with 2018. This increase is primarily associated with increased depreciation expense on furniture and equipment, increased maintenance and repairs on association property, and increased property taxes. Insurance Fund premiums increased \$21 or 6.62 percent for the twelve months ended December 31, 2019, compared to the same period of 2018 due primarily to an increase in the size of the Association's notes payable with AgFirst. Other operating expenses decreased \$9 or 0.55 percent in 2019 as compared with 2018. The decrease is primarily associated with an increase in several expense items, offset by a large decrease in guarantee fee expenses.

Income Taxes

The Association recorded a provision for income taxes of \$3 for the year ended December 31, 2019, as compared to a provision of \$4 for 2018 and a provision of \$12 for 2017. Refer to Note 2, *Summary of Significant Accounting Policies, Income Taxes*, of the Notes to the Consolidated Financial Statements, for more information concerning Association income taxes.

Key Results of Operations Comparisons

Key results of operations comparisons for each of the twelve months ended December 31 are shown in the following table:

Key Results of Operations Comparisons	For the 12 Months Ended		
	12/31/19	12/31/18	12/31/17
Return on average assets	2.30%	2.41%	2.36%
Return on average members' equity	13.29%	14.41%	14.14%
Net interest income as a percentage of average earning assets	2.55%	2.58%	2.59%
Net (charge-offs) recoveries to average loans	(0.004)%	(0.053)%	(0.002)%

The primary factors influencing the decreases in return on average assets and return on members' equity were proportionately larger increases in association assets and members' equity than the increase in net earnings.

Key factors in the growth of net income for future years will be continued improvement in net interest and noninterest income along with a moderate increase in operating expenses and additional provisions made for loan losses. Our goal is to generate earnings sufficient to fund operations, adequately capitalize the Association, and achieve an adequate rate of return for our members. To meet this goal, the agricultural economy must continue to remain healthy and the Association must meet certain objectives. These objectives are to attract and maintain high quality loan volume priced at competitive rates and to manage credit risk in our entire portfolio, while efficiently meeting the credit needs of our members.

LIQUIDITY AND FUNDING SOURCES

Liquidity and Funding

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement (GFA). The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association, creating notes payable (or direct loans) to the Bank. The Bank manages interest rate risk through direct loan pricing and

asset/liability management. The notes payable are segmented into variable rate and fixed rate components. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. Association capital levels effectively create a borrowing margin between the amount of loans outstanding and the amount of notes payable outstanding. This margin is commonly referred to as "Loanable Funds." Interest rates on both variable and fixed rate notes payable are generally established loan-by-loan based on the Bank's marginal cost of funds, capital position, operating costs and return objectives. In the event of prepayment of any portion of a fixed rate advance, the Association may incur a prepayment penalty in accordance with the terms of the GFA, which will be included in interest expense. The interest rate is periodically adjusted by the Bank based upon an agreement between the Bank and the Association.

The weighted average interest rates on the variable rate notes were 2.81 percent for LIBOR-based loans, 2.91 percent for Prime-based loans, and the weighted average remaining maturities were 1.6 years and 1.3 years, respectively, at December 31, 2019. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) notes payable which are match funded by the Bank was 3.25 percent and the weighted average remaining maturity was 14.2 years at December 31, 2019. The weighted average interest rate on all interest-bearing notes payable was 3.20 percent and the weighted average remaining maturity was 12.4 years at December 31, 2019.

Variable rate and fixed rate notes payable represent approximately -1.24 percent and 101.24 percent, respectively, of total notes payable at December 31, 2019.

Total notes payable to the Bank at December 31, 2019, was \$452,919 as compared to \$441,115 at December 31, 2018 and \$406,457 at December 31, 2017. The increase of 2.68 percent compared to December 31, 2018 and the increase of 8.53 percent compared to December 31, 2017, was attributable to the loan growth in the Association. The average volume of outstanding notes payable to the Bank was \$438,217 and \$417,672 for the years ended December 31, 2019 and 2018, respectively. Refer to Note 6, *Notes Payable to AgFirst Farm Credit Bank*, of the Notes to the Consolidated Financial Statements, for additional information concerning the Association's notes payable.

Liquidity management is the process whereby funds are made available to meet all financial commitments including the extension of credit, payment of operating expenses and payment of debt obligations. The Association receives access to funds through its borrowing relationship with the Bank and from income generated by operations. The liquidity policy of the Association is to manage cash balances to maximize debt reduction and to increase loan volume. As borrower payments are received, they are applied to the Association's note payable to the Bank. The Association's participation in investments and secondary market programs provides additional liquidity. Sufficient liquid funds have been available to meet all financial obligations. There are no known trends likely to result in a liquidity deficiency for the Association.

The Association had no lines of credit outstanding from third party financial institutions as of December 31, 2019.

Funds Management

The Bank and the Association manage assets and liabilities to provide a broad range of loan products and funding options, which are designed to allow the Association to be competitive in all interest rate environments. The primary objective of the asset/liability management process is to provide stable and rising earnings, while maintaining adequate capital levels by managing exposure to credit and interest rate risks.

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers fixed, adjustable and variable rate loan products that are marginally priced according to financial market rates. Variable rate loans may be indexed to market indices such as the Prime Rate or the 90-day London Interbank Offered Rate (LIBOR). Adjustable rate mortgages are indexed to U.S. Treasury Rates. Fixed rate loans are priced based on the current cost of System debt of similar terms to maturity.

The majority of the interest rate risk in the Association's Consolidated Balance Sheets is transferred to the Bank through the notes payable structure. The Bank, in turn, actively utilizes funds management techniques to identify, quantify and control risk associated with the loan portfolio. The Association utilizes differential pricing for its loans based on credit risk, length of maturity, service cost, and market variables, thereby giving the Association the ability in large part to control its interest rate margins. Net interest income as a percentage of average earning assets was 2.55% for 2019, 2.57% for 2018, and 2.59% for 2017. The decrease in net interest income as a percentage of average earning assets for 2019 as compared to the previous year is primarily due to a decrease in the average interest rate margin realized on the loan portfolio as compared to the previous year.

Future of LIBOR

In 2017, the United Kingdom's Financial Conduct Authority, which regulates LIBOR, announced its intention to stop persuading or compelling the group of major banks that sustains LIBOR to submit rate quotations after 2021. As a result, it is uncertain whether LIBOR will continue to be quoted after 2021. The Association has exposure to LIBOR, including in financial instruments that reference LIBOR that mature after 2021.

The exposure arises primarily from loans made to customers and the note payable to the Bank. Alternative reference rates that replace LIBOR may not yield the same or similar economic results over the lives of the financial instruments, which could adversely affect the value of, and return on, instruments held. In addition, to the extent that a successful transition of the LIBOR-based financial instruments to an alternative rate based index that is endorsed or supported by regulators and generally accepted by the market as a replacement to LIBOR, there could be other ramifications including those that may arise as a result of the need to redeem or terminate such instruments.

Due to the uncertainty regarding the transition of LIBOR-based financial instruments, including when it will happen, the manner in which an alternative reference rate will apply, and the

mechanisms for transitioning LIBOR-based instruments to instruments with an alternative rate, the expected financial impact of the LIBOR transition cannot yet be reasonably estimated.

The FCA has issued guidelines for System institutions to follow as they prepare for the expected phase-out of LIBOR. The guidelines direct each System institution to develop a LIBOR transition plan designed to provide an orderly roadmap of actions that will reduce LIBOR exposure over time. The FCA identified the following as important considerations in the development of each entity's transition plan:

- a governance structure to manage the transition,
- an assessment of exposures to LIBOR,
- an assessment of the fallback provisions in contracts and the impact of a LIBOR phase-out under those provisions,
- the establishment of strategies for reducing each type of LIBOR exposure,
- an assessment of the operational processes that need to be changed,
- a communication strategy for customers and shareholders,
- the establishment of a process to stay abreast of industry developments and best practices,
- the establishment of a process to ensure a coordinated approach, to the extent possible, across the District, and
- a timeframe and action steps for completing key objectives.

The Association will continue to analyze potential risks associated with the LIBOR transition, including financial, accounting, operational, legal, reputational and compliance risks.

At this time, it is difficult to predict whether or when LIBOR will cease to be available or if SOFR will become the benchmark to replace LIBOR. Because transactions occur involving financial instruments that reference LIBOR, these developments could have a material impact on the Association, borrowers, investors, and counterparties.

The following is a summary of Association variable-rate financial instruments with LIBOR exposure at December 31, 2019:

<i>(dollars in thousands)</i>	Due in 2020	Due in 2021	Due in 2022 and Thereafter
Loans	\$6,268	\$5,750	\$6,676
Total Assets	\$6,268	\$5,750	\$6,676
Note Payable to Bank	\$5,381	\$4,936	\$5,731
Total Liabilities	\$5,381	\$4,936	\$5,731

Relationship with the Bank

In both financial and non-financial areas, the Association has a materially interdependent relationship with the Bank.

The Association's statutory obligation to borrow only from the Bank is discussed in Note 6, *Notes Payable to AgFirst Farm Credit Bank*, of the Notes to the Consolidated Financial Statements in this annual report.

The Bank's ability to require additional capital contributions from the Association is discussed in Note 4, *Investment in Other Farm Credit Institutions*, included in this annual report.

The Bank's role in mitigating the Association's exposure to interest rate risk is described in the "Liquidity and Funding" section of this Management's Discussion and Analysis and in Note 6, *Notes Payable to AgFirst Farm Credit Bank*, included in this annual report.

The Association receives a patronage refund from the Bank which it records on an accrual basis.

In addition to the financial relationships described, the Association may act as a service provider to the Bank on certain participation loans that the Association has sold to the Bank. The Bank also provides operational assistance to the Association in many areas including cash management, accounting and reporting, human resources, computer networks and technology.

CAPITAL RESOURCES

Capital serves to support asset growth and provide protection against unexpected credit and interest rate risk and operating losses. Capital is also needed for future growth and investment in new products and services.

The Association Board of Directors establishes, adopts, and maintains a formal written capital adequacy plan to ensure that adequate capital is maintained for continued financial viability, to provide for growth necessary to meet the needs of members/borrowers, and to ensure that all stockholders are treated equitably. There were no material changes to the capital plan for 2019 that would affect minimum stock purchases or would have an effect on the Association's ability to retire stock and distribute earnings. The Association Board of Directors adopted a change in the maximum member stock requirement, effective March 1, 2016, whereby the maximum requirement was reduced to 2% or \$1,000, whichever is less, from the previous requirement of 2% or \$3,000, whichever is less.

Total members' equity at December 31, 2019, increased 8.92 percent to \$95,553 from the December 31, 2018, total of \$87,726. At December 31, 2018, total members' equity increased 9.91 percent from the December 31, 2017 total of \$80,035. The increases were primarily attributed to net income, partially offset by cash patronage paid.

Total capital stock and participation certificates were \$3,910 on December 31, 2019, compared to \$4,225 on December 31, 2018 and \$4,698 on December 31, 2017. The decrease was primarily attributed to the association making an additional stock purchase in the Bank as a part of its annual stock equalization process. The additional stock purchase was facilitated by reducing a Bank reciprocal stock balance held on the Association's balance sheet.

FCA regulations require all Farm Credit institutions to maintain minimum levels of several regulatory capital and leverage ratios. Effective January 1, 2017, the regulatory capital requirements for System Banks and Associations were modified. The new regulations ensure that the System's capital requirements are comparable to the Basel III framework and the standardized approach that the federal banking regulatory agencies have adopted. New regulations replaced total surplus and core surplus ratios with common equity tier 1 (CET1), tier 1 capital, and total capital risk-based capital ratios, as well as a tier 1 leverage ratio and an unallocated retained earnings equivalents (UREE) leverage ratio. The permanent capital ratio remains in effect. The capital ratios are calculated by dividing

various levels of capital by a risk-adjusted asset base. Risk-adjusted assets have been defined by FCA regulations as balance sheet assets and off-balance sheet commitments adjusted by various percentages, depending on the level of risk inherent in the various types of assets. Calculation of permanent capital ratio risk-adjusted assets includes the allowance for loan losses as a deduction from risk-adjusted assets. This differs from the other risk-based capital calculations. The leverage ratios are calculated by dividing various types of capital by total regulatory assets (not risk-adjusted). For all periods represented, the Association exceeded the minimum regulatory standard for all of the ratios.

The following sets forth the regulatory capital ratios, which were effective January 1, 2017:

	2019	2018	2017	Minimum Requirement	Capital Conservation Buffer*	Regulatory Minimum with Capital Conservation Buffer
CET1 capital ratio	17.92%	17.23%	16.66%	4.5%	1.875%	6.375%
Tier 1 capital ratio	17.92%	17.23%	16.66%	6.0%	1.875%	7.875%
Total capital ratio	18.80%	18.12%	17.54%	8.0%	1.875%	9.875%
Permanent capital ratio	18.12%	17.45%	16.91%	7.0%	0.000%	7.00%
Tier 1 leverage ratio	15.99%	15.08%	14.63%	4.0%	1.000%	5.00%
UREE leverage ratio	15.62%	14.73%	14.29%	1.5%	0.000%	1.50%

*-The capital conservation buffers had a 3 year phase-in period and became fully effective January 1, 2020. Risk-adjusted ratio minimums increased 0.625% each year until fully phased in. There was no phase-in period for the Tier 1 Leverage Ratio.

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

The following sets forth regulatory capital ratios as previously reported:

	2016	2015	2014	2013	2012	Regulatory Minimum
Permanent capital ratio	17.79%	17.58%	16.85%	15.99%	14.18%	7.00%
Total surplus ratio	16.96%	16.28%	15.54%	14.62%	12.80%	7.00%
Core surplus ratio	16.96%	16.28%	15.54%	14.62%	12.69%	3.50%

The increase in the Association's regulatory capital ratios for December 31, 2019 was attributed to increased retained earnings from net income proportionately stronger than the growth in loan volume. There are no trends, commitments, contingencies, or events that are likely to affect the Association's ability to meet regulatory minimum capital standards and capital adequacy requirements.

See Note 7, *Members' Equity*, of the Consolidated Financial Statements, for further information concerning capital resources.

PATRONAGE PROGRAM

Prior to the beginning of any fiscal year, the Association's Board of Directors, by adoption of a resolution, may establish a Patronage Allocation Program to distribute to borrowers on a patronage basis all or any portion of its available patronage sourced consolidated net earnings. This resolution provides for the application of net earnings in the manner described in the Association's Bylaws. This includes the setting aside of funds to increase surplus to meet minimum capital adequacy standards established by FCA Regulations, to increase surplus to meet Association capital adequacy standards to a level necessary to

support competitive pricing at targeted earnings levels, and for reasonable reserves for necessary purposes of the Association. After excluding net earnings attributable to (a) purchase money mortgages and sales contracts, (b) participation loans purchased, (c) loans specified in advance as non-patronage, (d) the Association's defined benefit retirement plan income, (e) extraordinary income resulting from a change in accounting procedure, and (f) other non-patronage income as allowed by law, including lease income, the remaining consolidated net earnings are eligible for allocation to borrowers. Refer to Note 7, *Members' Equity*, of the Notes to the Consolidated Financial Statements, for more information concerning the patronage allocations. The Association declared total patronage allocations of \$10,403 in 2019, \$10,631 in 2018, and \$9,702 in 2017. Of those amounts, the Association declared a cash patronage payable of \$4,161 in 2019, \$4,040 in 2018 and \$3,590 in 2017. The remaining patronage allocations were in the form of allocated retained earnings. With the resulting improvements in earnings and capital levels, the Association increased its cash patronage payout percentage for 2018 and 2019.

YOUNG, BEGINNING AND SMALL (YBS) FARMERS AND RANCHERS PROGRAM

The Association’s mission is to provide financial services to agriculture and the rural community, which includes providing credit to Young*, Beginning** and Small*** farmers.

- * Young farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who are age 35 or younger as of the date the loan is originally made.
- ** Beginning farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who have 10 years or less farming or ranching experience as of the date the loan is originally made.
- *** Small farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who normally generate less than \$250 in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

Because of the unique needs of these individuals, and their importance to the future growth of the Association, the Association has established annual marketing goals to increase our market share of loans to YBS farmers. Specific marketing plans have been developed to target these groups, and resources have been designated to help ensure YBS borrowers have access to a stable source of credit. Actual program results in 2019 were 100% of program goals or better in all categories except number and volume of beginning farmer loans, which were at 97.65% of program goal and 93.16% of program goal, respectively.

The following table outlines the loan volume and number of YBS loans in the loan portfolio for the Association.

	As of December 31, 2019			
	Number of Loans		Amount of Loans	
	Actual	Goal	Actual	Goal
Young	1,268	1,230	\$91,705	\$91,000
Beginning	1,289	1,320	98,750	106,000
Small	4,373	4,100	244,717	225,000

Note: For purposes of the above table, a loan could be classified in more than one category, depending upon the characteristics of the underlying borrower.

The 2012 USDA-NASS Ag census data has been used as a benchmark to measure penetration of the Association’s marketing efforts. The census data indicated that within the Association’s chartered territory (counties) there were 14,597 reported farmers of which by definition 957 or 6.56 percent were Young, 2,995 or 20.52 percent were Beginning, and 14,001 or 95.92 percent were Small. Comparatively, as of December 31, 2019, the demographics of the Association’s agricultural portfolio contained 2,876 farmers, of which by definition 667 or 23.19 percent were Young, 776 or 26.98 percent were Beginning and 2,290 or 79.62 percent were Small.

In addition to our marketing strategies, in 2019 the Association utilized the following strategies and outreach programs:

- Support of 4H, FFA and young farmer organizations through sponsorships and donations.
- Offering loan guarantees and interest rate subsidies through Preferred Lender Programs with Farm Services Administration (FSA).
- FSA Loan Guarantee Fee Subsidy Program.

- Reduced Rate Coordination Programs with the Kentucky Agricultural Finance Corporation.
- Utilizing the Central Kentucky Ag Start Program, a program developed in collaboration with a Young Farmers Advisory Council.

The Association met its 2019 qualitative goals in coordination of programs, FSA Guarantee Loan Volume, Reduced Rate Coordination Program, and statewide youth program advertising and sponsorships.

The Associate Business Analyst and the Assistant Vice President & Marketing Specialist coordinate the Association’s efforts for YBS programs. The Association includes YBS goals in the annual strategic plan, and reports on those goals and achievements to the Board of Directors on a quarterly basis.

Demographics

The Association has used the 2012 USDA-NASS Ag Census as our source of demographic data for the counties in our territory. There are several differences in the methods by which the demographic and YBS Farmer data is presented. Young farmers are defined by the FCA as 35 years old or less. The USDA-NASS Ag Census demographic stratification breaks at 34 years old, which was used to compare to FCA’s definition. Beginning farmers are defined by the FCA as having 10 years or less farming experience. There is no measurement matching this definition in the USDA-NASS Ag Census; however the census does identify farmers on their current farm less than 10 years. That statistic may include beginning farmers, but may also include experienced farmers who have recently changed farmsteads. As with the case of the Young information, the Beginning information in the USDA-NASS Ag Census is not an exact comparison to the FCA definition, but will be utilized as the best comparison available. The FCA Small definition matches with the USDA-NASS Ag Census delineation of farm entities with sales of less than \$250 thousand. Other data differences: The farmers experience is as of the date of the USDA-NASS Ag Census, while the Association data is compiled as to the date the loan was made. Small farmers is by each individual farm entity from the USDA-NASS Ag Census data, while the Association data is compiled as of the date of the loan and represents the total value of sales of closely related entities rather than individual entities. The USDA-NASS Ag Census data reflects all farms whether they use debt or not. While the statistical results of the USDA-NASS Ag Census do not match the FCA definitions exactly and there are timing issues, they do provide a consistent source of measurement with which to assess Association targets and goals.

REGULATORY MATTERS

On February 13, 2020, the Farm Credit Administration approved a rule that clarifies the factors that System institutions should consider when categorizing high-risk loans and placing them in nonaccrual status. The rule also revises the criteria by which loans are reinstated to accrual status, and revises the application of the criteria to certain loans in nonaccrual status to distinguish between the types of risk that cause loans to be placed in nonaccrual status.

On September 18, 2019, the Farm Credit Administration issued a proposed rule to amend its investment regulations to allow System associations to purchase and hold the portion of certain loans that non-System lenders originate and sell in the secondary market, and that the USDA unconditionally guarantees or insures as to timely payment of principal and interest. The rule would authorize associations to buy investments to augment the liquidity of rural credit markets, reduce the capital burden on community banks and other non-System lenders who choose to sell their USDA guaranteed portions of loans, and to enhance the ability of associations to manage risk. The public comment period ended on November 18, 2019.

On September 23, 2019, the Farm Credit Administration issued a proposed rule that would ensure the System’s capital requirements, including certain regulatory disclosures, reflect the current expected credit losses methodology, which revises the accounting for credit losses under U.S. generally accepted

accounting principles. The proposed rule identifies which credit loss allowances under the Current Expected Credit Losses (CECL) methodology in the Financial Accounting Standards Board’s “Measurement of Credit Losses on Financial Instruments” are eligible for inclusion in a System institution’s regulatory capital. Credit loss allowances related to loans, lessor’s net investments in leases, and held-to-maturity debt securities would be included in a System institution’s Tier 2 capital up to 1.25 percent of the System institution’s total risk weighted assets. Credit loss allowances for available-for-sale debt securities and purchased credit impaired assets would not be eligible for inclusion in a System institution’s Tier 2 capital. In addition, the proposed regulation does not include a transition phase-in period for the CECL day 1 cumulative effect adjustment to retained earnings on a System institution’s regulatory capital ratios. The public comment period ended on November 22, 2019.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Please refer to Note 2, *Summary of Significant Accounting Policies*, in the Notes to the Consolidated Financial Statements for recently issued accounting pronouncements.

The following Accounting Standards Updates (ASUs) were issued by the Financial Accounting Standards Board (FASB) but have not yet been adopted:

Summary of Guidance	Adoption and Potential Financial Statement Impact
<i>ASU 2016-13 – Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments</i>	
<ul style="list-style-type: none"> • Replaces multiple existing impairment standards by establishing a single framework for financial assets to reflect management’s estimate of current expected credit losses (CECL) over the complete remaining life of the financial assets. • Changes the present incurred loss impairment guidance for loans to an expected loss model. • The Update also modifies the other-than-temporary impairment model for debt securities to require an allowance for credit impairment instead of a direct write-down, which allows for reversal of credit impairments in future periods based on improvements in credit. • Eliminates existing guidance for purchased credit impaired (PCI) loans, and requires recognition of an allowance for expected credit losses on these financial assets. • Requires a cumulative-effect adjustment to retained earnings as of the beginning of the reporting period of adoption. • Effective for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years. Early application is permitted. 	<ul style="list-style-type: none"> • Implementation efforts began with establishing a cross-discipline governance structure. The implementation includes identification of key interpretive issues, scoping of financial instruments, and assessing existing credit loss forecasting models and processes against the new guidance. • The new guidance is expected to result in a change in allowance for credit losses due to several factors, including: <ol style="list-style-type: none"> 1. The allowance related to loans and commitments will most likely increase to cover credit losses over the full remaining expected life of the portfolio, and will consider expected future changes in macroeconomic conditions, 2. An allowance will be established for estimated credit losses on any debt securities, 3. The nonaccretable difference on any PCI loans will be recognized as an allowance, offset by an increase in the carrying value of the related loans. • The extent of change is under evaluation, but will depend upon the nature and characteristics of the financial instrument portfolios, and the macroeconomic conditions and forecasts at the adoption date. • The guidance is expected to be adopted in first quarter 2023.

Disclosure Required by Farm Credit Administration Regulations

Description of Business

Descriptions of the territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations are incorporated herein by reference to Note 1, *Organization and Operations*, of the Consolidated Financial Statements included in this Annual Report to shareholders.

The description of significant developments that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, developments that had or could have a material impact on patronage or dividends, changes in patronage policies and practices, and concentrations of assets, if any, is incorporated in "*Management's Discussion and Analysis of Financial Condition and Results of Operations*" included in this Annual Report.

Description of Property

The following table sets forth certain information regarding the properties of the reporting entity, all of which are located in Kentucky:

Location	Description	Form of Ownership
640 South Broadway Lexington	Administrative	Owned
640 South Broadway Lexington	Branch	Owned
485 N Danville Bypass Danville	Branch	Owned
1000 Ival James Boulevard Richmond	Branch	Owned
201 Commerce Drive Paris	Branch	Owned
842 W Main Lebanon	Branch	Owned
106 Agriculture Way Stanford	Branch	Owned
1120 US Highway 127 South Frankfort	Branch	Leased

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 11, *Commitments and Contingencies*, of the Consolidated Financial Statements included in this Annual Report.

Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 7, *Members' Equity*, of the Consolidated Financial Statements included in this Annual Report.

Description of Liabilities

The description of liabilities, contingent liabilities and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 6, 9 and 11 of the Consolidated Financial Statements included in this Annual Report.

Management's Discussion and Analysis of Financial Condition and Results of Operations

"*Management's Discussion and Analysis of Financial Condition and Results of Operations*," which appears in this Annual Report and is to be disclosed in this section, is incorporated herein by reference.

Senior Officers

The following represents certain information regarding the senior officers of the Association:

Senior Officer	Position
James W. Caldwell	<i>President and Chief Executive Officer</i> - since January, 2009
Jonathan T. Noe	<i>Vice President and Chief Lending Officer</i> - since September, 2008
Marcus G. Barnett	<i>Vice President and Chief Financial Officer</i> - since August, 2004
Shane Turner	<i>Vice President and Chief Risk Officer</i> - since October, 2017

The business experience for the past five years for senior officers is with the Farm Credit System.

The total amount of compensation (in whole dollars) earned by the CEO and the highest paid officers (excluding the CEO) as a group during the years ended December 31, 2019, 2018 and 2017, is presented in the following tables. The first table presented illustrates actual compensation received in cash in the form of salary and bonus.

Name of Individual or Number in Group	Year	Received Compensation		
		Salary	Bonus	Total Received (a)
James W. Caldwell	2019	\$ 329,213	\$ 3,900	\$ 333,113
James W. Caldwell	2018	\$ 306,012	\$ 3,900	\$ 309,912
James W. Caldwell	2017	\$ 285,011	\$ 5,400	\$ 290,411
5	2019	\$ 749,029	\$ 38,213	\$ 787,242
5	2018	\$ 706,927	\$ 33,608	\$ 740,535
5	2017	\$ 670,876	\$ 45,093	\$ 715,969

The table below discloses forms of perquisites and other noncash compensation and these items are described in detail in the subsequent paragraphs, which do not reflect actual cash compensation received by the CEO or officers presented. The total of all cash (a) and noncash (b) compensation for the CEO and officers is also presented here.

Name of Individual or Number in Group	Perquisites and Other Compensation			Total Compensation (a+b)
	Change in Pension**	Perq./ Other*	Total Perq. and Other (b)	
James W. Caldwell	\$ 484,763	\$ 9,307	\$ 494,070	\$ 827,183
James W. Caldwell	\$ 40,560	\$ 9,706	\$ 50,266	\$ 360,178
James W. Caldwell	\$ 87,365	\$ 8,085	\$ 95,450	\$ 385,861
5	\$ 1,047,893	\$ 5,113	\$ 1,053,006	\$ 1,840,248
5	\$ 2,050	\$ 5,543	\$ 7,593	\$ 748,128
5	\$ 512,262	\$ 5,747	\$ 518,009	\$ 1,233,978

*The Perquisites/Other amount disclosed in the above chart includes automobile compensation, cost of group insurance in excess of \$50,000, and spousal travel.

**This figure is a third party actuarial determination of the change in present value of the estimated pension cash flows. This does not represent any actual cash compensation provided to any employee, but is simply a change in the calculation that is affected by a number of assumptions and inputs.

The total compensation paid during 2019 to any senior officer, or to any other employee included in the aggregate group total as reported in the table above is available and will be disclosed to the shareholders of the institution upon request.

On October 3, 2012, FCA adopted a regulation that requires enhanced disclosures pertaining to Senior Officer compensation, specifically additional information pertaining to the present value of pension benefits and the change in the present value of pension benefits from the previous year.

The present value of pension benefits is the value at a specific date of the expected future benefit payment stream based on actuarial assumptions, chiefly the discount rate. Other assumptions are also used, such as expected retirement age and life expectancy. Actuarial assumptions are updated periodically. Changes in the actuarial assumptions can increase or decrease the pension values.

The discount rate, which is derived using an AA corporate bond yield curve, is updated every year based on the interest rate environment at December 31. A decrease in the discount rate will normally increase the present values and vice versa.

In addition to the discount rate, other factors such as increases in compensation or additional years of service for plan participants will also cause a change in the present value of pension benefits. Specifically, an additional year of service leading up to the earliest unreduced retirement date and increases in compensation may lead to increases in present value of pension benefits. An additional year of service past

the unreduced retirement date may lead to a decrease in the present value of pension benefits.

For pension values at December 31, 2019, the increase was due to a significant decrease in the discount rate and an increase in benefit accruals due to the passage of another year. At December 31, 2018, an increase in the discount rate assumption caused pension values to decrease, but this was offset by other factors such as increases in compensation and additional years of service for plan participants. A decrease in the discount rate assumption from the prior year was the primary cause for the increase in pension values at December 31, 2017.

On February 4, 2015, the FCA Board approved the final rule, "Disclosure to Shareholders; Pension Benefit Disclosures." The rule amends FCA regulations to exclude employee compensation from being reported in the Summary Compensation Table if the employee would be considered a "highly compensated employee" solely because of payments related to or change(s) in value of the employee's qualified pension plan provided that the plan was available to all similarly situated employees on the same basis at the time the employee joined the plan.

Additional information on pension benefits related to the CEO and the highest paid officers as a group for the year ended December 31, 2019 is as follows:

Pension Benefits Table
As of December 31, 2019

Name of Individual or Number in Group	Year	Plan Name	Number of Years Credited Service	Actuarial Present Value of Accumulated Benefits**	Payments During 2019
James W. Caldwell	2019	Independent Associations Retirement Plan	39	\$ 2,905,792	\$ —
Senior Officers and Highly Compensated Employees:					
5	2019	Independent Associations Retirement Plan	*26	\$ 3,937,002	\$ —

* Represents the average years of credited service for the group.

**This figure is a third party actuarial determination of the present value of the estimated pension cash flows. Please refer to information provided above giving further explanation of assumptions used in order to calculate the present value of pension benefits.

In addition to a base salary, the branch lending staff can earn additional compensation under an incentive plan. There were no material changes to the incentive plan adopted for 2019 as the plan design continues to motivate new business development. In addition to this incentive plan for the lending staff, the entire Association staff, including senior officers, may receive a bonus at the discretion of the Board of Directors. While discretionary, these bonuses are generally based on the efforts of staff, including senior officers, in striving to accomplish business plan objectives such as profitability, growth, credit quality and overall performance. All of these bonuses were paid in the 2019 calendar year. Additionally, all employees are reimbursed for all direct travel expenses incurred when traveling on Association business. A copy of the travel policy is available to shareholders upon written request.

Directors

Directors are reimbursed on an actual cost basis for all expenses incurred in the performance of official duties. Such expenses may include transportation, lodging, meals, tips, tolls, parking of cars, laundry, registration fees, and other expenses associated with travel on official business. A copy of the policy is available to shareholders of the Association upon request.

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was \$25,278 for 2019, \$25,662 for 2018 and \$25,955 for 2017.

Subject to approval by the board, the Association may allow the chairman of the board of directors, the chairman of the audit committee, and other director’s honoraria of \$800, \$750 and \$700 respectively for attendance at meetings, committee meetings, or special assignments. Directors also receive \$100 for participation in board or committee related conference calls. In 2019, total cash compensation paid to directors as a group was \$76,300. No non-cash compensation was paid to directors in 2019.

The following represents certain information regarding the directors of the Association and their principal occupations:

James Alvin Lyons was re-elected to a four-year term on the Board of Directors at the 2016 Annual Meeting. His current term expires in 2020. He presently serves as Chairman of the

Board, a position he has held since April 2011. During the past 5 years, Mr. Lyons has produced alfalfa, corn, soybeans, wheat, has a commercial cow-calf program and backgrounds feeder cattle on his farming operation in Scott County. Mr. Lyons serves as a Board member of the Scott County Farm Bureau and is a member of the Scott County Beef Improvement Board. In addition, he serves as a member of the Scott County Rural Land Management Board. Mr. Lyons is also a Magistrate on the Scott County Fiscal Court. Since January 2018, Mr. Lyons has served as a director for the AgFirst Farm Credit Bank. During 2019, Mr. Lyons served 10 days at Association Board meetings, 4 days in other official activities, participated in 2 conference calls, and was paid \$11,400 in compensation.

James C. (“Jim”) Rankin III was elected to a four-year term on the Board of Directors at the 2016 Annual Meeting. His current term expires in 2020. He presently serves as Vice Chairman of the Board, a position he has held since February 2014. During the past 5 years, Mr. Rankin has produced soybeans, wheat and alfalfa on his farming operation in Bourbon County. Mr. Rankin owns thoroughbred mares, and boards mares and foals. He also raises thoroughbreds for racing. In addition, Mr. Rankin partners with a son in the thoroughbred horse operation, in a cow/calf operation, feeders, hay and grain. He also partners with another son in a cow/calf operation, feeders, hay and grain. Mr. Rankin also serves on the District Advisory Council for the AgFirst Farm Credit Bank. During 2019, Mr. Rankin served 9 days at Association Board meetings, 7 days in other official activities, participated in 2 conference calls, and was paid \$11,400 in compensation.

Patrick Higginbotham was elected to a four-year term on the Board of Directors at the 2019 Annual Meeting. His current term expires in 2023. During the past five years, Mr. Higginbotham has served as a pharmacist at the Veterans Administration Hospital in Lexington, Kentucky. He also serves as an adjunct faculty member at the University of Kentucky College of Pharmacy. He runs a horse boarding operation and produces hay on his farm in Fayette County. In addition, Mr. Higginbotham serves on the Fayette County Farm Bureau Board of Directors. During 2019, Mr. Higginbotham served 9 days at Association Board meetings, 6 days in other official activities, participated in 1 conference call, and was paid \$10,600 in compensation.

Joe Myers was elected to a four-year term on the Board of Directors at the 2018 Annual Meeting. His current term expires in 2022. During the past 5 years, Mr. Myers has owned and operated Myers Angus Farm, an 80 head purebred angus cow operation on his farming operation in Mercer County, marketing registered bulls, females, and embryos throughout Kentucky, multiple states, and foreign countries. He also serves as a Beef Sire Analyst for Select Sires, Inc. where he is responsible for purchasing/leasing bulls to enter into the A.I. Genetics Program. Mr. Myers serves on the Central Kentucky Angus Association Board, and the Mercer County Cattleman’s Board. During 2019, Mr. Myers served 10 days at Association Board meetings, 3 days in other official activities, participated in 2 conference calls, and was paid \$9,300 in compensation.

Lee Hood was elected to a four-year term on the Board of Directors at the 2017 Annual Meeting. Her current term expires in 2021. During the past 5 years, Ms. Hood has served as Chief Financial officer for Clements Ag Supply, Inc. in Springfield, Kentucky. She owns and leases land in Washington County where she operates a cow/calf operation, backgrounds feeder cattle, and produces 300 acres of hay. Since 2019, Ms. Hood has served as Chair of the Board Audit Committee. During 2019, Ms. Hood served 10 days at Association Board meetings, 6 days in other official activities, participated in 2 conference calls, and was paid \$12,000 in compensation.

Pursuant to the Agricultural Credit Act of 1987 and in compliance with Association Bylaws, the Association Board of Directors first elected during 2001 a member to the Board who is not a director, officer, employee or shareholder of any Farm Credit System institution (i.e. Outside Director).

Dan Grigson was first elected as an Outside Director by the Association Board of Directors in 2017. His current term expires in April 2021. Mr. Grigson retired from the University of Kentucky College of Agriculture in 2017 where he served as an Agricultural Extension Agent from 1974 through 2016. He currently serves on the staff of the Spurlin Funeral Home. During the past 5 years Mr. Grigson has served as a director of the Buffalo Springs Cemetery Board. He has also served as a director of the Lincoln County Fair Board, and as Vice President of the Lincoln County Farm Bureau Federation. During 2019, Mr. Grigson served 10 days at Association Board meetings, 6 days in other official activities, participated in 2 conference calls, and was paid \$11,400 in compensation.

Mary-Lynn Hinkel was first elected as an Outside Director by the Association Board of Directors in 2014. She was reelected in 2016, and her current term expires in April 2020. She currently serves as the Chair of the Board Human Resources Committee. Ms. Hinkel retired from CMTA Consulting Engineers in 2019 where she served as HR Staffing Coordinator, recruiting staff for eight offices located throughout the U.S. Previously, Ms. Hinkel was Associate Director of Tax Services at Dean, Dorton, Allen, Ford, PLLC where she provided compliance services including tax, financial statements and accounting for business, individuals, and non-profit organizations. Her services concentrated in physicians and the healthcare industry, manufacturing, and real estate of closely-held and family-owned businesses. During the past 5 years Ms. Hinkel has served on the United Way of

the Bluegrass Agency Review Executive Committee, and as a Banking Committee member for Equestrian Events, Inc. She has served as a past member of the Finance Committee and Education Committee for the Cathedral of Christ the King. She has also served as a Board Member and Treasurer for Lexington and Central Kentucky Youth Salute. During 2019, Ms. Hinkel served 9 days at Association Board meetings, 5 days in other official activities, participated in 2 conference calls, and was paid \$10,200 in compensation.

Transactions with Senior Officers and Directors

The reporting entity’s policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 10, *Related Party Transactions*, of the Consolidated Financial Statements included in this Annual Report. There have been no transactions between the Association and senior officers or directors which require reporting per FCA regulations.

Transactions Other Than Loans

There have been no transactions that occurred at any time during the year ended December 31, 2019, between the Association and senior officers or directors, their immediate family members or any organizations with which they are affiliated, which require reporting per FCA regulations. There were no transactions with any senior officer or director related to the purchase or retirement of preferred stock of the Association for the year ended December 31, 2019.

Involvement in Certain Legal Proceedings

There were no matters which came to the attention of management or the board of directors regarding involvement of current directors or senior officers in specified legal proceedings which should be disclosed in this section. No directors or senior officers have been involved in any legal proceedings during the last five years which require reporting per FCA regulations.

Involvement in Unincorporated Business Entities

The Association holds no equity investments in Unincorporated Business Entities (UBEs) at December 31, 2019.

Relationship with Independent Auditors

There were no changes in or material disagreements with our independent auditors on any matter of accounting principle or financial statement disclosure during this period.

Aggregate fees incurred by the Association for services rendered by its independent auditors for the year ended December 31, 2019 were as follows:

	<u>2019</u>
<i>Independent Auditors</i>	
PricewaterhouseCoopers LLP	
Audit services	\$ 67,500
Total	<u>\$ 67,500</u>

Audit fees were for the annual audit of the consolidated financial statements.

Consolidated Financial Statements

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 12, 2020 and the report of management, which appear in this Annual Report are incorporated herein by reference.

Copies of the Association's Unaudited Quarterly reports are available upon request free of charge by calling 1-859-253-3249, or writing Marcus G. Barnett, Chief Financial Officer, Central Kentucky Agricultural Credit Association, P.O. Box 1290, Lexington, Kentucky 40588-1290, or accessing the website, www.agcreditonline.com. The Association prepares an electronic version of the Annual Report which is available on the Association's website within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Unaudited Quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

Borrower Information Regulations

Since 1972, Farm Credit Administration (FCA) regulations have required that borrower information be held in strict confidence by Farm Credit System (FCS) institutions, their directors, officers and employees. These regulations provide Farm Credit institutions clear guidelines for protecting their borrowers' nonpublic personal information.

On November 10, 1999, the FCA Board adopted a policy that requires FCS institutions to formally inform new borrowers at loan closing of the FCA regulations on releasing borrower information and to address this information in the Annual Report. The implementation of these measures ensures that new and existing borrowers are aware of the privacy protections afforded them through FCA regulations and Farm Credit System institution efforts.

Credit and Services to Young, Beginning, and Small Farmers and Ranchers and Producers or Harvesters of Aquatic Products

Information to be disclosed in this section is incorporated herein by reference to the similarly named section in the *"Management's Discussion and Analysis of Financial Condition and Results of Operations"* section included in this Annual Report to the shareholders.

Shareholder Investment

Shareholder investment in the Association may be materially affected by the financial condition and results of operations of AgFirst Farm Credit Bank (Bank or AgFirst). Copies of the Bank's Annual and Unaudited Quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 2832, or writing Susanne Caughman, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst's web site at www.agfirst.com. The Bank prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year. The Bank prepares an electronic version of the

Unaudited Quarterly report within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Bank.

Report of the Audit Committee

The Audit Committee of the Board of Directors (Committee) is comprised of the directors named below. None of the directors who serve on the Committee is an employee of Central Kentucky Agricultural Credit Association (Association) and in the opinion of the Board of Directors, each is free of any relationship with the Association or management that would interfere with the director's independent judgment on the Committee.

The Committee has adopted a written charter that has been approved by the Board of Directors. The Committee has reviewed and discussed the Association's audited financial statements with management, which has primary responsibility for the financial statements.

PricewaterhouseCoopers LLP (PwC), the Association's independent auditors for 2019, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 114 (*The Auditor's Communication With Those Charged With Governance*). The Committee discussed with PwC its independence from Central Kentucky Agricultural Credit Association. The Committee also reviewed the non-audit services provided by PwC and concluded that these services were not incompatible with maintaining PwC's independence.

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Association's Annual Report for 2019. The foregoing report is provided by the following independent directors, who constitute the Committee:



Lee M. Hood
Chairperson of the Audit Committee

Members of Audit Committee

James Alvin Lyons
James C. Rankin III
Patrick Higginbotham
Joe Myers
Mary-Lynn Hinkel
Dan Grigson

March 12, 2020



Report of Independent Auditors

To the Board of Directors and Management of Central Kentucky Agricultural Credit Association

We have audited the accompanying consolidated financial statements of Central Kentucky Agricultural Credit Association and its subsidiaries (the "Association"), which comprise the consolidated balance sheets as of December 31, 2019, 2018 and 2017, and the related consolidated statements of income, of comprehensive income, of changes in members' equity and of cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Association's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Central Kentucky Agricultural Credit Association and its subsidiaries as of December 31, 2019, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

March 12, 2020

Consolidated Balance Sheets

<i>(dollars in thousands)</i>	December 31,		
	2019	2018	2017
Assets			
Cash	\$ 2,468	\$ 3,046	\$ 2,028
Loans	533,741	513,045	471,730
Allowance for loan losses	(4,257)	(4,277)	(4,037)
Net loans	529,484	508,768	467,693
Loans held for sale	207	—	133
Accrued interest receivable	7,417	7,155	6,467
Equity investments in other Farm Credit institutions	7,106	7,099	7,117
Premises and equipment, net	2,847	2,927	2,960
Other property owned	—	—	8
Accounts receivable	6,077	6,815	6,758
Other assets	58	27	23
Total assets	\$ 555,664	\$ 535,837	\$ 493,187
Liabilities			
Notes payable to AgFirst Farm Credit Bank	\$ 452,919	\$ 441,115	\$ 406,457
Accrued interest payable	1,222	1,259	1,007
Patronage refunds payable	4,310	4,141	3,694
Accounts payable	758	652	536
Advanced conditional payments	3	—	—
Other liabilities	899	944	1,458
Total liabilities	460,111	448,111	413,152
Commitments and contingencies (Note 11)			
Members' Equity			
Capital stock and participation certificates	3,910	4,225	4,698
Retained earnings			
Allocated	67,498	61,064	54,453
Unallocated	24,145	22,437	20,884
Total members' equity	95,553	87,726	80,035
Total liabilities and members' equity	\$ 555,664	\$ 535,837	\$ 493,187

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

Consolidated Statements of Comprehensive Income

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2019	2018	2017
Interest Income			
Loans	\$ 27,897	\$ 25,826	\$ 22,243
Interest Expense			
Notes payable to AgFirst Farm Credit Bank	14,640	13,226	10,683
Net interest income	13,257	12,600	11,560
Provision for loan losses	—	500	350
Net interest income after provision for loan losses	13,257	12,100	11,210
Noninterest Income			
Loan fees	873	696	620
Lease income	25	44	33
Patronage refunds from other Farm Credit institutions	6,050	6,762	6,730
Gains (losses) on sales of rural home loans, net	9	9	11
Gains (losses) on sales of premises and equipment, net	14	—	6
Insurance Fund refunds	99	460	—
Other noninterest income	3	1	1
Total noninterest income	7,073	7,972	7,401
Noninterest Expense			
Salaries and employee benefits	5,620	5,536	5,050
Occupancy and equipment	430	366	353
Insurance Fund premiums	338	317	483
(Gains) losses on other property owned, net	—	(1)	—
Other operating expenses	1,633	1,642	1,820
Total noninterest expense	8,021	7,860	7,706
Income before income taxes	12,309	12,212	10,905
Provision (benefit) for income taxes	3	4	12
Net income	12,306	12,208	10,893
Other comprehensive income	—	—	—
Comprehensive income	\$ 12,306	\$ 12,208	\$ 10,893

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

Consolidated Statements of Changes in Members' Equity

<i>(dollars in thousands)</i>	Capital Stock and Participation Certificates	Retained Earnings		Total Members' Equity
		Allocated	Unallocated	
Balance at December 31, 2016	\$ 4,993	\$ 48,344	\$ 19,692	\$ 73,029
Comprehensive income			10,893	10,893
Capital stock/participation certificates issued/(retired), net	(295)			(295)
Patronage distribution				
Cash			(3,590)	(3,590)
Nonqualified retained earnings		6,112	(6,112)	—
Patronage distribution adjustment		(3)	1	(2)
Balance at December 31, 2017	<u>\$ 4,698</u>	<u>\$ 54,453</u>	<u>\$ 20,884</u>	<u>\$ 80,035</u>
Comprehensive income			12,208	12,208
Capital stock/participation certificates issued/(retired), net	(473)			(473)
Patronage distribution				
Cash			(4,040)	(4,040)
Nonqualified retained earnings		6,591	(6,591)	—
Patronage distribution adjustment		20	(24)	(4)
Balance at December 31, 2018	<u>\$ 4,225</u>	<u>\$ 61,064</u>	<u>\$ 22,437</u>	<u>\$ 87,726</u>
Comprehensive income			12,306	12,306
Capital stock/participation certificates issued/(retired), net	(315)			(315)
Patronage distribution				
Cash			(4,161)	(4,161)
Nonqualified retained earnings		6,242	(6,242)	—
Patronage distribution adjustment		192	(195)	(3)
Balance at December 31, 2019	<u>\$ 3,910</u>	<u>\$ 67,498</u>	<u>\$ 24,145</u>	<u>\$ 95,553</u>

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

Consolidated Statements of Cash Flows

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2019	2018	2017
Cash flows from operating activities:			
Net income	\$ 12,306	\$ 12,208	\$ 10,893
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	199	159	162
Amortization (accretion) of net deferred loan costs (fees)	(2)	(1)	(1)
Provision for loan losses	—	500	350
(Gains) losses on sales of premises and equipment, net	(14)	—	(6)
(Gains) losses on sales of rural home loans, net	(9)	(9)	(11)
Changes in operating assets and liabilities:			
Origination of loans held for sale	(18,391)	(12,964)	(11,110)
Proceeds from sales of loans held for sale, net	18,193	13,106	12,416
(Increase) decrease in accrued interest receivable	(262)	(688)	(686)
(Increase) decrease in accounts receivable	738	(57)	(1,623)
(Increase) decrease in other assets	(31)	(4)	1,838
Increase (decrease) in accrued interest payable	(37)	252	192
Increase (decrease) in accounts payable	106	116	(173)
Increase (decrease) in other liabilities	(45)	(514)	(1,101)
Total adjustments	445	(104)	247
Net cash provided by (used in) operating activities	12,751	12,104	11,140
Cash flows from investing activities:			
Net (increase) decrease in loans	(20,714)	(41,574)	(45,642)
(Increase) decrease in equity investments in other Farm Credit institutions	(7)	18	(4)
Purchases of premises and equipment	(132)	(126)	(108)
Proceeds from sales of premises and equipment	27	—	6
Proceeds from sales of other property owned	—	8	—
Net cash provided by (used in) investing activities	(20,826)	(41,674)	(45,748)
Cash flows from financing activities:			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	11,804	34,658	38,419
Net increase (decrease) in advanced conditional payments	3	—	—
Capital stock and participation certificates issued/(retired), net	(315)	(473)	(295)
Patronage refunds and dividends paid	(3,995)	(3,597)	(3,093)
Net cash provided by (used in) financing activities	7,497	30,588	35,031
Net increase (decrease) in cash	(578)	1,018	423
Cash, beginning of period	3,046	2,028	1,605
Cash, end of period	\$ 2,468	\$ 3,046	\$ 2,028
Supplemental schedule of non-cash activities:			
Estimated cash dividends or patronage distributions declared or payable	\$ 4,161	\$ 4,040	\$ 3,590
Supplemental information:			
Interest paid	\$ 14,677	\$ 12,974	\$ 10,492
Taxes (refunded) paid, net	9	10	(69)

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

Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

Note 1 — Organization and Operations

A. **Organization:** Central Kentucky Agricultural Credit Association (Association) is a member-owned cooperative that provides credit and credit-related services to qualified borrowers in the counties of Anderson, Bourbon, Boyle, Clark, Fayette, Franklin, Garrard, Harrison, Jessamine, Lincoln, Madison, Marion, Mercer, Montgomery, Scott, Washington and Woodford in the state of Kentucky.

The Association is a lending institution in the Farm Credit System (System), a nationwide network of cooperatively owned banks and associations. It was established by Acts of Congress and is subject to the provisions of the Farm Credit Act of 1971, as amended (Farm Credit Act). The System specializes in providing financing and related services to qualified borrowers for agricultural and rural purposes.

The nation is served by three Farm Credit Banks (FCBs) and one Agricultural Credit Bank (ACB), (collectively, the System Banks) each of which has specific lending authorities within its chartered territory. The ACB also has additional specific nationwide lending authorities.

Each System Bank serves one or more Agricultural Credit Associations (ACAs) that originate long-term, short-term and intermediate-term loans, Production Credit Associations (PCAs) that originate and service short- and intermediate-term loans, and/or Federal Land Credit Associations (FLCAs) that originate and service long-term real estate mortgage loans. These associations borrow a majority of the funds for their lending activities from their related bank. System Banks are also responsible for supervising the activities of associations within their districts. AgFirst (Bank) and its related associations (Associations or District Associations) are collectively referred to as the AgFirst District. The District Associations jointly own substantially all of AgFirst's voting stock. As of year-end, the District consisted of the Bank and nineteen District Associations. All nineteen were structured as ACA holding companies, with PCA and FLCA subsidiaries. FLCAs are tax-exempt while ACAs and PCAs are taxable.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System banks and associations. The FCA examines the activities of the associations and certain actions by the associations are subject to the prior approval of the FCA and the supervising bank.

The Farm Credit Act also established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (Insured Debt), (2) to ensure

the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary uses by the Insurance Corporation to provide assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank has been required to pay premiums, which may be passed on to the Association, into the Insurance Fund, based on its average adjusted outstanding Insured Debt until the assets in the Insurance Fund reach the "secure base amount." The secure base amount is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments) or such other percentage of the aggregate obligations as the Insurance Corporation at its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums and may return excess funds above the secure base amount to System institutions. However, it must still ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

B. **Operations:** The Farm Credit Act sets forth the types of authorized lending activity and financial services that can be offered by the Association, and the persons eligible to borrow.

The Associations borrow from the Bank and in turn may originate and service short- and intermediate-term loans to their members, as well as long-term real estate mortgage loans.

The Bank primarily lends to the District Associations in the form of a line of credit to fund the Associations' earning assets. These lines of credit (or Direct Notes) are collateralized by a pledge of substantially all of each Association's assets. The terms of the Direct Notes are governed by a General Financing Agreement (GFA) between the Bank and Association. Each advance is structured such that the principal cash flow, repricing characteristics, and underlying index (if any) of the advance match those of the assets being funded. By match-funding the Association loans, the Associations' exposure to interest rate risk is minimized.

In addition to providing funding for earning assets, the Bank provides District Associations with banking and support services such as accounting, human resources, information systems, and marketing. The costs of these support services are included in cost of the Direct Note, or in some cases billed directly to certain Associations that use a specific service.

The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments, and related services to eligible borrowers.

Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related businesses.

The Association may sell to any System borrowing member, on an optional basis, credit or term life insurance appropriate to protect the loan commitment in the event of death of the debtor(s). The sale of other insurance necessary to protect a member's farm or aquatic unit is permitted, but limited to hail and multi-peril crop insurance, and insurance necessary to protect the facilities and equipment of aquatic borrowers.

Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the Association conform with accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results may differ from these estimates.

The accompanying consolidated financial statements include the accounts of the ACA, PCA and FLCA.

Certain amounts in the prior year financial statements may have been reclassified to conform to the current period presentation. Such reclassifications had no effect on net income or total members' equity of prior years.

A. **Cash:** Cash represents cash on hand and on deposit at banks. At the most recent year-end, the Association held \$2,155 in cash in excess of insured amounts.

B. **Loans and Allowance for Loan Losses:** The Association is authorized to make long-term real estate loans with maturities of 5 to 40 years and certain short- and intermediate-term loans for agricultural production or operating purposes with maturities of not more than 10 years.

Loans are carried at their principal amount outstanding adjusted for charge-offs, premiums, discounts, deferred loan fees or costs, and derivative instruments and hedging valuation adjustments, if any. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. The difference in the total investment in a loan and its principal amount may be deferred as part of the carrying amount of the loan and the net difference amortized over the life of the related loan as an adjustment to interest income using the effective interest method.

Impaired loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms of the loan and are generally considered substandard or doubtful, which is in accordance with the loan rating model, as described below. Impaired loans include nonaccrual loans, restructured loans, and loans past

due 90 days or more and still accruing interest. 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 remains contractually past due 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. A formal restructuring may also cure a past due status.

Loans are generally classified as nonaccrual when principal or interest is delinquent for 90 days (unless adequately collateralized and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in the prior year).

When loans are in nonaccrual status, payments are applied against the recorded investment in the loan asset. If collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it, the interest portion of payments received in cash may be recognized as interest income. Nonaccrual loans may be returned to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected, and the loan is not classified "doubtful" or "loss." Loans are charged off at the time they are determined to be uncollectible.

In cases where the Association makes certain monetary concessions to the borrower through modifications to the contractual terms of the loan, the loan is classified as a restructured loan. A restructured loan constitutes a troubled debt restructuring (TDR) if for economic or legal reasons related to the debtor's financial difficulties the Association grants a concession to the debtor that it would not otherwise consider. If the borrower's ability to meet the revised payment schedule is uncertain, the loan is classified as a nonaccrual loan.

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio as of the report date. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through loan charge-offs and allowance reversals. A review of individual loans in each respective portfolio is performed periodically to determine the appropriateness of risk ratings and to ensure loss exposure to the Association has been identified. The allowance for loan losses is a valuation account used to reasonably estimate loan losses as of the financial statement date. Determining the appropriate allowance for loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss.

The Association considers the following factors, among others, when determining the allowance for loan losses:

- Changes in credit risk classifications

- Changes in collateral values
- Changes in risk concentrations
- Changes in weather-related conditions
- Changes in economic conditions

A specific allowance may be established for impaired loans under Financial Accounting Standards Board (FASB) guidance on accounting by creditors for impairment of a loan. Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent.

A general allowance may also be established under FASB guidance on accounting for contingencies, to reflect estimated probable credit losses inherent in the remainder of the loan portfolio which excludes impaired loans considered under the specific allowance discussed above. A general allowance can be evaluated on a pool basis for those loans with similar characteristics. The level of the general allowance may be based on management's best estimate of the likelihood of default adjusted for other relevant factors reflecting the current environment.

The credit risk rating methodology is a key component of the Association's allowance for loan losses evaluation, and is generally incorporated into the institution's loan underwriting standards and internal lending limit. The Association uses a two-dimensional loan rating model based on internally generated combined system risk rating guidance that incorporates a 14-point risk rating scale to identify and track the probability of borrower default and a separate scale addressing loss given default over a period of time. Probability of default is the probability that a borrower will experience a default within 12 months from the date of the determination of the risk rating. 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 is past due more than 90 days. The loss given default is management's estimate as to the anticipated economic loss on a specific loan assuming default has occurred or is expected to occur within the next 12 months.

Each of the ratings carries a distinct percentage of default probability. The 14-point risk rating scale provides for granularity of the probability of default, especially in the acceptable ratings. There are nine acceptable categories that range from a borrower of the highest quality to a borrower of minimally acceptable quality. The probability of default between 1 and 9 is very narrow and would reflect almost no default to a minimal default percentage. The probability of default grows significantly as a loan moves from a 9 to 10 (other assets especially mentioned) and grows more significantly as a loan moves to a substandard viable level of 11. A substandard non-viable rating of 12 indicates that the probability of default is almost certain. Loans risk rated 13 or 14 are generally written off.

- C. **Loans Held for Sale:** Loans are classified as held for sale when there is intent to sell the loans within a reasonable period of time. Loans intended for sale are carried at the lower of cost or fair value.

- D. **Other Property Owned (OPO):** Other property owned, consisting of real estate, personal property, and other assets acquired through a collection action, is recorded upon acquisition at fair value less estimated selling costs. Any initial reduction in the carrying amount of a loan to the fair value of the collateral received is charged to the allowance for loan losses. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income, expenses, and carrying value adjustments related to other property owned are included in Gains (Losses) on Other Property Owned, Net in the Consolidated Statements of Comprehensive Income.

- E. **Premises and Equipment:** Land is carried at cost. Premises and equipment are carried at cost less accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Gains and losses on dispositions are reflected in current earnings. Maintenance and repairs are charged to expense and improvements are capitalized. Premises and equipment are evaluated for impairment whenever events or circumstances indicate that the carrying value of the asset may not be recoverable.

From time to time, assets classified as premises and equipment are transferred to held for sale for various reasons. These assets are carried in Other Assets at the lower of the recorded investment in the asset or fair value less estimated cost to sell based upon the property's appraised value at the date of transfer. Any write-down of property held for sale is recorded as a loss in the period identified.

- F. **Investments:** The Association may hold investments as described below.

Equity Investments in Other Farm Credit System Institutions

Investments in other Farm Credit System institutions are generally nonmarketable investments consisting of stock and participation certificates, allocated surplus, and reciprocal investments in other institutions regulated by the FCA. These investments are carried at cost and evaluated for impairment based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value.

Investment Income

Dividends from Investments in Other Farm Credit Institutions are generally recorded as patronage income and included in Noninterest Income.

- G. **Voluntary Advance Conditional Payments:** The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, the advanced conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as other liabilities in the accompanying Consolidated Balance Sheets. Advanced conditional payments are not insured.

Interest is generally paid by the Association on such accounts.

- H. **Employee Benefit Plans:** The Association participates in District and multi-district sponsored benefit plans. These plans may include defined benefit final average pay retirement, defined benefit cash balance retirement, defined benefit other postretirement benefits, and defined contribution plans.

Defined Contribution Plans

Substantially all employees are eligible to participate in the defined contribution Farm Credit Benefit Alliance (FCBA) 401(k) Plan, subsequently referred to as the 401(k) Plan, which qualifies as a 401(k) plan as defined by the Internal Revenue Code. Employee deferrals are not to exceed the maximum deferral as determined and adjusted by the Internal Revenue Service. Company contributions to the 401(k) Plan are expensed as funded.

Additional information may be found in Note 9.

Mutiemployer Defined Benefit Plans

Substantially all employees hired before January 1, 2009 may participate in the Independent Associations Retirement Plan (Plan), which is a defined benefit plan and considered multiemployer under FASB accounting guidance. The Plan is noncontributory and includes eligible Association and District employees. The “Projected Unit Credit” actuarial method is used for financial reporting purposes.

In addition to pension benefits, the Association provides certain health care and life insurance benefits for retired employees (other postretirement benefits) through a multi-district sponsored retiree healthcare plan. Substantially all employees are eligible for those benefits when they reach early retirement age while working for the Association. Authoritative accounting guidance requires the accrual of the expected cost of providing these benefits to an employee, their beneficiaries and covered dependents during the years the employee renders service necessary to become eligible for benefits.

Since the foregoing plans are multiemployer, the Association does not apply the provisions of FASB guidance on employers’ accounting for defined benefit pension and other postretirement plans in its stand-alone financial statements. Rather, the effects of this guidance are reflected in the Annual Information Statement of the Farm Credit System.

Additional information may be found in Note 9 and in the Notes to the Annual Information Statement of the Farm Credit System.

- I. **Income Taxes:** The Association evaluates tax positions taken in previous and current years according to FASB guidance. A tax position can result in a permanent reduction of income taxes payable, a deferral of income taxes otherwise currently payable to future years, or a change in the expected realizability of deferred tax assets. The term tax position also encompasses, but is not limited

to, an entity’s status, including its status as a pass-through entity or tax-exempt entity.

The Association is generally subject to Federal and certain other income taxes. As previously described, the ACA holding company has two wholly-owned subsidiaries, a PCA and a FLCA. The FLCA subsidiary is exempt from federal and state income taxes as provided in the Farm Credit Act. The ACA holding company and the PCA subsidiary are subject to federal, state and certain other income taxes.

The Association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the Association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those taxable earnings that will not be distributed as qualified patronage refunds. The Association distributes patronage on the basis of book income.

The Association accounts for income taxes under the asset and liability method, recognizing deferred tax assets and liabilities for the expected future tax consequences of the temporary differences between the carrying amounts and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled.

The Association records a valuation allowance at the balance sheet dates against that portion of the Association’s deferred tax assets that, based on management’s best estimates of future events and circumstances, more likely than not (a likelihood of more than 50 percent) will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of the expected patronage program, which reduces taxable earnings.

- J. **Due from AgFirst Farm Credit Bank:** The Association records patronage refunds from the Bank and certain District Associations on an accrual basis.

- K. **Valuation Methodologies:** FASB guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. This guidance also 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. It prescribes three levels of inputs that may be used to measure fair value.

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets;

quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability.

Level 3 inputs to the valuation methodology are unobservable and supported by little or no market activity. Valuation is determined using pricing models, discounted cash flow methodologies, or similar techniques, and could include significant management judgment or estimation. Level 3 assets and liabilities also could include instruments whose price has been adjusted based on dealer quoted pricing that is different than a third-party valuation or internal model pricing.

The Association may use the Bank, internal resources or third parties to obtain fair value prices. Quoted market prices are generally used when estimating fair values of any assets or liabilities for which observable, active markets exist.

A number of methodologies may be employed to value items for which an observable active market does not exist. Examples of these items include: impaired loans, other property owned, and certain derivatives, investment securities and other financial instruments. Inputs to these valuations can involve estimates and assumptions that require a substantial degree of judgment. Some of the assumptions used include, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing, and liquidation values. The use of different assumptions could produce significantly different asset or liability values, which could have material positive or negative effects on results of operations.

Additional information may be found in Note 8.

- L. **Off-Balance-Sheet Credit Exposures:** The credit risk associated with commitments to extend credit and letters of credit is essentially the same as that involved with extending loans to customers and is subject to normal credit policies. Collateral may be obtained based on management's assessment of the customer's creditworthiness.

Commitments to extend credit are agreements to lend to customers, generally having fixed expiration dates or other termination clauses that may require payment of a fee.

Letters of credit are commitments issued to guarantee the performance of a customer to a third party. These letters of credit are issued to facilitate commerce and typically result in the commitment being funded when the underlying transaction is consummated between the customer and third party.

- M. **Revenue Recognition:** The Association generates income from multiple sources.

Financial Instruments

The largest source of revenue for the Association is interest income. Interest income is recognized on an accrual basis driven by nondiscretionary formulas based on written contracts, such as loan agreements or securities contracts.

Credit-related fees, including letter of credit fees, finance charges and other fees are recognized in Noninterest Income when earned. Other types of noninterest revenues, such as service charges, professional services and broker fees, are accrued and recognized into income as services are provided and the amount of fees earned is reasonably determinable.

Contracts with Customers

The Association maintains contracts with customers to provide support services in various areas such as accounting, lending transactions, consulting, insurance, and information technology. As most of the contracts are to provide access to expertise or system capacity that the Association maintains, there are no material incremental costs to fulfill these contracts that should be capitalized. The Association does not generally incur costs to obtain contracts. Revenue is recognized to reflect the transfer of goods and services to customers in an amount equal to the consideration the Association receives or expects to receive.

Gains and Losses from Nonfinancial Assets

Any gains or losses on sales of Premises and Equipment and OPO are included as part of Noninterest Income. These gains and losses are recognized, and the nonfinancial asset is derecognized, when the Association has entered into a valid contract with a noncustomer and transferred control of the asset. If the criteria to meet the definition of a contract have not been met, the Association does not derecognize the nonfinancial asset and any consideration received is recognized as a liability. If the criteria for a contract are subsequently met, or if the consideration received is or becomes nonrefundable, a gain or loss may be recognized at that time.

N. **Leases:**

Lessee

Contracts entered into are evaluated at inception to determine if they contain a lease. Assets and liabilities are recognized on the Consolidated Balance Sheets to reflect the rights and obligations created by any contracts that do. These contracts are then classified as either operating or finance leases.

In the course of normal operations, the Association may enter into leases for various business purposes. Generally, leases are for terms of three to five years and may include options to extend or terminate the arrangement. Any options are assessed individually to determine if it is reasonably certain they will be exercised.

Right-of-use (ROU) assets represent the right to use an underlying asset for the lease term, and lease liabilities represent the obligation to make the payments arising from the lease. ROU assets and lease liabilities are initially recognized based on the present value of lease payments over the lease term. Lease expense for operating leases is recognized on a straight-line basis over the lease term. Lease expense for finance leases is recognized on a declining basis over the lease term.

ROU assets are included on the Consolidated Balance Sheets in Premises and Equipment for finance leases and

Other Assets for operating leases. Lease liabilities are included in Other Liabilities on the Consolidated Balance Sheets. Leases with an initial term of 12 months or less are not recorded on the Consolidated Balance Sheets and lease expense is recognized over the lease term.

Lessor

The Association acts as lessor in certain contractual arrangements. The contracts relate to office space in an owned property and are considered operating leases. Generally, leases are for terms of three to five years and may include options to extend or terminate the arrangement.

Lease income is recognized on a straight-line basis over the lease term. Lease and nonlease components are accounted for separately in the Consolidated Statements of Comprehensive Income. Any initial direct costs are deferred and recognized as an expense over the lease term on the same basis as lease income. Any taxes assessed by a governmental authority are excluded from consideration as variable payments.

Lease receivables and income are included in Accounts Receivable on the Consolidated Balance Sheets and Lease Income in the Consolidated Statements of Comprehensive Income.

O. **Accounting Standards Updates (ASUs):** In January 2020, the FASB issued ASU 2020-01 Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815): Clarifying the Interactions between Topic 321, Topic 323, and Topic 815. The amendments clarify certain interactions between the guidance on accounting for certain equity securities under Topic 321, the guidance on accounting for investments under the equity method in Topic 323, and the guidance in Topic 815. The Update could change how an entity accounts for an equity security under the measurement alternative or a forward contract or purchased option to purchase securities that, upon settlement of the forward contract or exercise of the purchased option, would be accounted for under the equity method of accounting or the fair value option in accordance with Topic 825, Financial Instruments. The amendments are intended to improve current GAAP by reducing diversity in practice and increasing comparability of the accounting for these interactions. For public business entities, the amendments are effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early adoption is permitted, including early adoption in an interim period. Evaluation of any possible effects the guidance may have on the statements of financial condition and results of operations is in progress.

In December 2019, the FASB issued ASU 2019-12 Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes. The amendments simplify the accounting for income taxes by removing the following exceptions:

- Exception to the incremental approach for intraperiod tax allocation when there is a loss from continuing operations and income or a gain

- from other items (for example, discontinued operations or other comprehensive income),
- Exception to the requirement to recognize a deferred tax liability for equity method investments when a foreign subsidiary becomes an equity method investment,
- Exception to the ability not to recognize a deferred tax liability for a foreign subsidiary when a foreign equity method investment becomes a subsidiary, and
- Exception to the general methodology for calculating income taxes in an interim period when a year-to-date loss exceeds the anticipated loss for the year.

The amendments also simplify the accounting for income taxes by doing the following:

- Requiring that an entity recognize a franchise tax (or similar tax) that is partially based on income as an income-based tax and account for any incremental amount incurred as a non-income-based tax,
- Requiring that an entity evaluate when a step up in the tax basis of goodwill should be considered part of the business combination in which the book goodwill was originally recognized and when it should be considered a separate transaction,
- Specifying that an entity is not required to allocate the consolidated amount of current and deferred tax expense to a legal entity that is not subject to tax in its separate financial statements; however, an entity may elect to do so (on an entity-by-entity basis) for a legal entity that is both not subject to tax and disregarded by the taxing authority,
- Requiring that an entity reflect the effect of an enacted change in tax laws or rates in the annual effective tax rate computation in the interim period that includes the enactment date, and
- Making minor codification improvements for income taxes related to employee stock ownership plans and investments in qualified affordable housing projects accounted for using the equity method.

For public business entities, the amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. Evaluation of any possible effects the guidance may have on the statements of financial condition and results of operations is in progress.

In November 2019, the FASB issued ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842). On the basis of feedback obtained from outreach with stakeholders and monitoring of implementation, the Board has gained a greater understanding about the implementation challenges encountered by all types of entities when adopting a major Update. The challenges are often magnified for private companies, smaller public companies, and not-for-profit organizations. In response to

those issues and requests to defer certain major Updates not yet effective for all entities, the Board developed a philosophy to extend and simplify how effective dates are staggered between larger public companies (bucket one) and all other entities (bucket two). Credit Losses guidance in ASU 2016-13 will be effective for all bucket two entities for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years.

In May 2019, the FASB issued ASU 2019-05 Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief. The amendments in this Update provide entities with an option to irrevocably elect the fair value option applied on an instrument-by-instrument basis for certain financial assets upon the adoption of Topic 326. The fair value option election does not apply to held-to-maturity debt securities. For entities that have not yet adopted the amendments in ASU 2016-13, the effective date and transition methodology for the amendments in this Update are the same as in that update. Evaluation of any possible effects the guidance may have on the statements of financial condition and results of operations is in progress.

In April 2019, the FASB issued ASU 2019-04 Codification Improvements to Topic 326 Financial Instruments—Credit Losses, Topic 815 Derivatives and Hedging, and Topic 825 Financial Instruments. The amendments in this Update clarify, correct, and improve various aspects of the guidance in the following Updates related to financial instruments: ASU 2016-01 Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities, ASU 2016-13 Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, and ASU 2017-12 Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. The items addressed generally are not expected to have a significant effect on current accounting practice or to create a significant administrative cost for most entities. For entities that have not yet adopted the amendments in ASU 2016-13, the effective dates and transition requirements for the amendments related to this Update are the same as the effective dates and transition requirements in ASU 2016-13. The transition adjustment includes adjustments made as a result of an entity developing or amending its accounting policy upon adoption of the amendments in this Update for determining when accrued interest receivables are deemed uncollectible and written off. For entities that have adopted the amendments in ASU 2017-12 as of the issuance date of this Update, the effective date is as of the beginning of the first annual period beginning after the issuance date of this Update. For those entities, early adoption is permitted, including adoption on any date on or after the issuance of this Update. The amendments in this Update related to ASU 2016-01 are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted in any interim period following the issuance of this Update as long as the entity has adopted all of the amendments in ASU 2016-01. The amendments in this Update should be applied on a modified-retrospective transition basis by means of a cumulative-effect adjustment to the opening retained earnings balance in the statement of financial position as of the date an entity adopted all of the amendments in ASU

2016-01. Adoption of the guidance related to ASU 2016-01 and ASU 2017-12 is not expected to have an impact on the statements of financial condition or results of operations. Evaluation of any possible effects the ASU 2016-13 guidance may have on the statements of financial condition and results of operations is in progress.

In August 2018, the FASB issued ASU 2018-15 Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract. The amendments align 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 the amendments in this Update. The guidance is effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted, including adoption in any interim period, for all entities. The amendments should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. The guidance will be adopted on a prospective basis in 2020 and is not expected to have a material impact on the statements of financial condition or results of operations.

In August 2018, the FASB issued ASU 2018-13 Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement. The amendments are part of the FASB’s disclosure framework project. The project’s objective and primary focus are to improve the effectiveness of disclosures in the notes to financial statements by facilitating clear communication of the information required by GAAP that is most important to users of each entity’s financial statements. The amendments remove, modify or add certain disclosures contained in the financial statement footnotes related to fair value. Additionally, the guidance is intended to promote the appropriate exercise of discretion by entities when considering fair value measurement disclosures and to clarify that materiality is an appropriate consideration of entities and their auditors when evaluating disclosure requirements. The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Certain amendments should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. Early adoption is permitted upon issuance. Entities are permitted to early adopt any removed or modified disclosures upon issuance of this Update and delay adoption of the additional disclosures until their effective date. The removed disclosures were adopted effective with the 2018 Annual Report, and the remaining disclosures were adopted with the 2019 Annual Report.

In February 2018, the FASB issued ASU 2018-02 Income Statement—Reporting Comprehensive Income (Topic 220):

Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The guidance allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The amendments eliminate the stranded tax effects resulting from the Tax Cuts and Jobs Act and are intended to improve the usefulness of information reported to financial statement users. However, because the amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The Update also requires certain disclosures about stranded tax effects. The guidance was effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Adoption of this guidance had no impact on the statements of financial condition and results of operations.

In March 2017, the FASB issued ASU 2017-08 Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. The guidance relates to certain callable debt securities and shortens the amortization period for any premium to the earliest call date. The Update was effective for interim and annual periods beginning after December 15, 2018 for public business entities. Adoption of this guidance had no impact on the statements of financial condition and results of operations.

In June 2016, the FASB issued ASU 2016-13 Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. This Update, and subsequent clarifying guidance issued, is intended to improve financial reporting by requiring timelier recording of credit losses on financial instruments. It requires an organization to measure all expected credit losses for financial assets held at the reporting date. Financial institutions and other organizations will use forward-looking information to estimate their credit losses. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public companies that are not SEC filers, it will take effect for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years. Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 31, 2018. Evaluation of any possible effects the guidance may have on the statements of financial condition and results of operations is in progress.

In February 2016, the FASB issued ASU 2016-02 Leases (Topic 842). This Update, and subsequent clarifying guidance issued, requires organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Leases are classified as either finance leases or operating leases. This distinction is relevant for the pattern of expense recognition in the income statement. Lessor accounting guidance is largely unchanged from the previous standard. The Update also eliminates leveraged lease accounting but allows existing leveraged leases to continue their current

accounting until maturity, termination or modification. The amendments were effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, for public business entities.

Transition Information

- The guidance was adopted using the optional modified retrospective method and practical expedients for transition. Under this transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption.
- The package of practical expedients related to initial application of the guidance was elected, which allowed existing leases to be largely accounted for consistent with current guidance, except for the incremental balance sheet recognition for lessees.
- There will not be a material change to the timing of future expense recognition.
- Upon adoption, a cumulative-effect adjustment to equity of less than \$1 was recorded. In addition, a Right of Use Asset in the amount of \$50 and Lease Liability in the amount of \$50 were recognized.
- Given the limited changes to lessor accounting, there were no material changes to recognition or measurement.

Note 3 — Loans and Allowance for Loan Losses

For a description of the Association's accounting for loans, including impaired loans, and the allowance for loan losses, see Note 2 subsection B above.

Credit risk arises from the potential inability of an obligor to meet its repayment obligation which exists in outstanding loans. The Association manages credit risk associated with lending activities through an assessment of the credit risk profile of an individual obligor. The Association sets its own underwriting standards and lending policies that provide direction to loan officers and are approved by the Board of Directors.

The credit risk management process begins with an analysis of the obligor's credit history, repayment capacity and financial position. Repayment capacity focuses on the obligor's ability to repay the obligation based on cash flows from operations or other sources of income, including non-farm income. Real estate mortgage loans must be secured by first liens on the real estate collateral. As required by FCA regulations, each institution that makes loans on a secured basis must have collateral evaluation policies and procedures.

The credit risk rating process for loans uses a two-dimensional structure, incorporating a 14-point probability of default scale (see further discussion in Note 2 subsection B above) and a separate scale addressing estimated percentage loss in the event of default. The loan rating structure incorporates borrower risk and transaction risk. Borrower risk is the risk of loss driven by factors intrinsic to the borrower. The transaction risk or facility

risk is related to the structure of a credit (tenor, terms, and collateral).

The Association’s loan portfolio, which includes purchased interests in loans, has been segmented by the following loan types as defined by the FCA:

- Real estate mortgage loans — loans made to full-time or part-time farmers secured by first lien real estate mortgages with maturities from five to thirty years. These loans may be made only in amounts up to 85 percent of the appraised value of the property taken as security or up to 97 percent of the appraised value if guaranteed by a federal, state, or other governmental agency. The actual percentage of loan-to-appraised value when loans are made is generally lower than the statutory required percentage.
- Production and intermediate-term loans — loans to full-time or part-time farmers that are not real estate mortgage loans. These loans fund eligible financing needs including operating inputs (such as labor, feed, fertilizer, and repairs), livestock, living expenses, income taxes, machinery or equipment, farm buildings, and other business-related expenses. Production loans may be made on a secured or unsecured basis and are most often made for a period of time that matches the borrower’s normal production and marketing cycle, which is typically one year or less. Intermediate-term loans are made for a specific term, generally greater than one year and less than or equal to ten years.
- Loans to cooperatives — loans for any cooperative purpose other than for communication, power, and water and waste disposal.
 - Processing and marketing loans — loans for operations to process or market the products produced by a farmer, rancher, or producer or harvester of aquatic products, or by a cooperative.

- Farm-related business loans — loans to eligible borrowers that furnish certain farm-related business services to farmers or ranchers that are directly related to their agricultural production.
- Rural residential real estate loans — loans made to individuals, who are not farmers, to purchase a single-family dwelling that will be the primary residence in open country, which may include a town or village that has a population of not more than 2,500 persons. In addition, the loan may be to remodel, improve, or repair a rural home, or to refinance existing debt. These loans are generally secured by a first lien on the property.
- Communication loans — loans primarily to finance rural communication providers.
- Power loans — loans primarily to finance electric generation, transmission and distribution systems serving rural areas.
- Water and waste disposal loans — loans primarily to finance water and waste disposal systems serving rural areas.
- International loans — primarily loans or credit enhancements to other banks to support the export of U.S. agricultural commodities or supplies. The federal government guarantees a substantial portion of these loans.
- Lease receivables — the net investment for all finance leases such as direct financing leases, leveraged leases, and sales-type leases.
- Other (including Mission Related) — additional investments in rural America approved by the FCA on a program or a case-by-case basis. Examples of such investments include partnerships with agricultural and rural community lenders, investments in rural economic development and infrastructure, and investments in obligations and mortgage securities that increase the availability of affordable housing in rural America.

A summary of loans outstanding at period end follows:

	December 31,		
	2019	2018	2017
Real estate mortgage	\$ 352,112	\$ 331,734	\$ 300,833
Production and intermediate-term	160,493	165,054	156,798
Processing and marketing	1,993	1,114	1,168
Farm-related business	9,569	6,593	4,820
Rural residential real estate	9,574	8,550	8,111
Total loans	<u>\$ 533,741</u>	<u>\$ 513,045</u>	<u>\$ 471,730</u>

A substantial portion of the Association’s lending activities is collateralized and the Association’s exposure to credit loss associated with lending activities is reduced accordingly.

The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management’s credit evaluation of the borrower. Collateral held varies, but typically includes farmland and income-producing property, such as crops and livestock, as well as receivables. Long-term real estate loans are collateralized by the first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (97 percent if guaranteed by a government agency) of the property’s appraised value. However, a decline in a property’s market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the Association in the collateral, may result in loan to value ratios in excess of the regulatory maximum.

The Association may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume, and comply with FCA regulations. The following tables present the principal balance of participation loans at periods ended:

December 31, 2019								
Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total		
Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	
Real estate mortgage	\$ -	\$ 13,211	\$ -	\$ -	\$ -	\$ 6,953	\$ -	\$ 20,164
Production and intermediate-term	-	9,008	-	-	-	2,271	-	11,279
Processing and marketing	1,037	-	-	-	-	-	1,037	-
Farm-related business	-	7,319	-	-	-	772	-	8,091
Total	\$ 1,037	\$ 29,538	\$ -	\$ -	\$ -	\$ 9,996	\$ 1,037	\$ 39,534

December 31, 2018								
Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total		
Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	
Real estate mortgage	\$ -	\$ 17,516	\$ -	\$ -	\$ -	\$ 6,578	\$ -	\$ 24,094
Production and intermediate-term	-	4,974	-	-	-	2,312	-	7,286
Processing and marketing	993	-	-	-	-	8	993	8
Farm-related business	-	7,997	-	-	-	946	-	8,943
Total	\$ 993	\$ 30,487	\$ -	\$ -	\$ -	\$ 9,844	\$ 993	\$ 40,331

December 31, 2017								
Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total		
Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	
Real estate mortgage	\$ -	\$ 13,789	\$ -	\$ -	\$ -	\$ 5,934	\$ -	\$ 19,723
Production and intermediate-term	-	4,897	-	-	-	1,439	-	6,336
Processing and marketing	1,010	-	-	-	-	16	1,010	16
Farm-related business	-	6,187	-	-	-	249	-	6,436
Total	\$ 1,010	\$ 24,873	\$ -	\$ -	\$ -	\$ 7,638	\$ 1,010	\$ 32,511

A significant source of liquidity for the Association is the repayments of loans. The following table presents the contractual maturity distribution of loans by loan type at the latest period end:

December 31, 2019				
	Due Less Than 1 Year	Due 1 Through 5 Years	Due After 5 Years	Total
Real estate mortgage	\$ 4,668	\$ 24,575	\$ 322,869	\$ 352,112
Production and intermediate-term	46,418	80,548	33,527	160,493
Processing and marketing	-	1,033	960	1,993
Farm-related business	544	4,834	4,191	9,569
Rural residential real estate	1,162	324	8,088	9,574
Total loans	\$ 52,792	\$ 111,314	\$ 369,635	\$ 533,741
Percentage	9.89%	20.86%	69.25%	100.00%

The recorded investment in a 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.

The following table shows loans and related accrued interest classified under the FCA Uniform Loan Classification System as a percentage of total loans and related accrued interest receivable by loan type as of:

	December 31,				December 31,		
	2019	2018	2017		2019	2018	2017
Real estate mortgage:				Farm-related business:			
Acceptable	95.85%	95.81%	95.58%	Acceptable	100.00%	100.00%	100.00%
OAEM	3.26	2.81	1.94	OAEM	-	-	-
Substandard/doubtful/loss	0.89	1.38	2.48	Substandard/doubtful/loss	-	-	-
	100.00%	100.00%	100.00%		100.00%	100.00%	100.00%
Production and intermediate-term:				Rural residential real estate:			
Acceptable	95.88%	95.65%	95.42%	Acceptable	96.13%	92.93%	89.91%
OAEM	2.85	3.08	1.64	OAEM	2.31	2.69	2.94
Substandard/doubtful/loss	1.27	1.27	2.94	Substandard/doubtful/loss	1.56	4.38	7.15
	100.00%	100.00%	100.00%		100.00%	100.00%	100.00%
Processing and marketing:				Total loans:			
Acceptable	48.58%	100.00%	100.00%	Acceptable	95.76%	95.77%	95.48%
OAEM	51.42	-	-	OAEM	3.24	2.86	1.84
Substandard/doubtful/loss	-	-	-	Substandard/doubtful/loss	1.00	1.37	2.68
	100.00%	100.00%	100.00%		100.00%	100.00%	100.00%

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

	December 31, 2019				
	30 Through 89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans
Real estate mortgage	\$ 643	\$ 1,974	\$ 2,617	\$ 353,729	\$ 356,346
Production and intermediate-term	396	2,326	2,722	160,862	163,584
Processing and marketing	-	-	-	2,010	2,010
Farm-related business	-	-	-	9,619	9,619
Rural residential real estate	4	-	4	9,595	9,599
Total	\$ 1,043	\$ 4,300	\$ 5,343	\$ 535,815	\$ 541,158

	December 31, 2018				
	30 Through 89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans
Real estate mortgage	\$ 645	\$ 598	\$ 1,243	\$ 334,359	\$ 335,602
Production and intermediate-term	918	2,413	3,331	164,958	168,289
Processing and marketing	-	-	-	1,117	1,117
Farm-related business	3	-	3	6,618	6,621
Rural residential real estate	30	-	30	8,541	8,571
Total	\$ 1,596	\$ 3,011	\$ 4,607	\$ 515,593	\$ 520,200

	December 31, 2017				
	30 Through 89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans
Real estate mortgage	\$ 453	\$ 292	\$ 745	\$ 303,746	\$ 304,491
Production and intermediate-term	965	439	1,404	158,159	159,563
Processing and marketing	-	-	-	1,171	1,171
Farm-related business	7	-	7	4,832	4,839
Rural residential real estate	110	-	110	8,023	8,133
Total	\$ 1,535	\$ 731	\$ 2,266	\$ 475,931	\$ 478,197

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

	December 31,		
	2019	2018	2017
Nonaccrual loans:			
Real estate mortgage	\$ 1,828	\$ 735	\$ 794
Production and intermediate-term	2,559	1,961	609
Rural residential real estate	146	271	300
Total	<u>\$ 4,533</u>	<u>\$ 2,967</u>	<u>\$ 1,703</u>
Accruing restructured loans:			
Real estate mortgage	\$ 1,390	\$ 1,093	\$ 1,242
Production and intermediate-term	681	43	-
Total	<u>\$ 2,071</u>	<u>\$ 1,136</u>	<u>\$ 1,242</u>
Accruing loans 90 days or more past due:			
Real estate mortgage	\$ 251	\$ 91	-
Production and intermediate-term	257	604	20
Total	<u>\$ 508</u>	<u>\$ 695</u>	<u>\$ 20</u>
Total nonperforming loans	\$ 7,112	\$ 4,798	\$ 2,965
Other property owned	-	-	8
Total nonperforming assets	<u>\$ 7,112</u>	<u>\$ 4,798</u>	<u>\$ 2,973</u>
Nonaccrual loans as a percentage of total loans	0.85%	0.58%	0.36%
Nonperforming assets as a percentage of total loans and other property owned	1.33%	0.94%	0.63%
Nonperforming assets as a percentage of capital	<u>7.44%</u>	<u>5.47%</u>	<u>3.71%</u>

The following table presents information relating to impaired loans (including accrued interest) as defined in Note 2:

	December 31,		
	2019	2018	2017
Impaired nonaccrual loans:			
Current as to principal and interest	\$ 1,158	\$ 511	\$ 701
Past due	3,375	2,456	1,002
Total	<u>\$ 4,533</u>	<u>\$ 2,967</u>	<u>\$ 1,703</u>
Impaired accrual loans:			
Restructured	\$ 2,071	\$ 1,136	\$ 1,242
90 days or more past due	508	695	20
Total	<u>\$ 2,579</u>	<u>\$ 1,831</u>	<u>\$ 1,262</u>
Total impaired loans	<u>\$ 7,112</u>	<u>\$ 4,798</u>	<u>\$ 2,965</u>
Additional commitments to lend	\$ 120	\$ 57	\$ 193

The following tables present additional impaired loan information at period end. Unpaid principal balance represents the contractual principal balance of the loan.

	December 31, 2019			Year Ended December 31, 2019	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans
Impaired loans:					
With a related allowance for credit losses:					
Real estate mortgage	\$ 196	\$ 315	\$ -	\$ 171	\$ 3
Production and intermediate-term	1,605	1,536	288	1,401	23
Rural residential real estate	-	-	-	-	-
Total	<u>\$ 1,801</u>	<u>\$ 1,851</u>	<u>\$ 288</u>	<u>\$ 1,572</u>	<u>\$ 26</u>
With no related allowance for credit losses:					
Real estate mortgage	\$ 3,273	\$ 3,322	\$ -	\$ 2,857	\$ 46
Production and intermediate-term	1,892	1,913	-	1,651	27
Rural residential real estate	146	219	-	128	2
Total	<u>\$ 5,311</u>	<u>\$ 5,454</u>	<u>\$ -</u>	<u>\$ 4,636</u>	<u>\$ 75</u>
Total impaired loans:					
Real estate mortgage	\$ 3,469	\$ 3,637	\$ -	\$ 3,028	\$ 49
Production and intermediate-term	3,497	3,449	288	3,052	50
Rural residential real estate	146	219	-	128	2
Total	<u>\$ 7,112</u>	<u>\$ 7,305</u>	<u>\$ 288</u>	<u>\$ 6,208</u>	<u>\$ 101</u>

Impaired loans:	December 31, 2018			Year Ended December 31, 2018	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans
With a related allowance for credit losses:					
Real estate mortgage	\$ -	\$ -	\$ -	\$ -	\$ -
Production and intermediate-term	299	293	91	273	9
Rural residential real estate	-	-	-	-	-
Total	\$ 299	\$ 293	\$ 91	\$ 273	\$ 9
With no related allowance for credit losses:					
Real estate mortgage	\$ 1,919	\$ 2,127	\$ -	\$ 1,752	\$ 55
Production and intermediate-term	2,309	2,322	-	2,106	66
Rural residential real estate	271	350	-	247	8
Total	\$ 4,499	\$ 4,799	\$ -	\$ 4,105	\$ 129
Total impaired loans:					
Real estate mortgage	\$ 1,919	\$ 2,127	\$ -	\$ 1,752	\$ 55
Production and intermediate-term	2,608	2,615	91	2,379	75
Rural residential real estate	271	350	-	247	8
Total	\$ 4,798	\$ 5,092	\$ 91	\$ 4,378	\$ 138

Impaired loans:	December 31, 2017			Year Ended December 31, 2017	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans
With a related allowance for credit losses:					
Real estate mortgage	\$ 131	\$ 151	\$ 6	\$ 156	\$ 4
Production and intermediate-term	376	376	199	449	12
Rural residential real estate	-	-	-	-	-
Total	\$ 507	\$ 527	\$ 205	\$ 605	\$ 16
With no related allowance for credit losses:					
Real estate mortgage	\$ 1,905	\$ 2,147	\$ -	\$ 2,272	\$ 62
Production and intermediate-term	253	334	-	301	8
Rural residential real estate	300	360	-	358	10
Total	\$ 2,458	\$ 2,841	\$ -	\$ 2,931	\$ 80
Total impaired loans:					
Real estate mortgage	\$ 2,036	\$ 2,298	\$ 6	\$ 2,428	\$ 66
Production and intermediate-term	629	710	199	750	20
Rural residential real estate	300	360	-	358	10
Total	\$ 2,965	\$ 3,368	\$ 205	\$ 3,536	\$ 96

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*	Rural Residential Real Estate	Total
Activity related to the allowance for credit losses:					
Balance at December 31, 2018	\$ 3,114	\$ 1,068	\$ 45	\$ 50	\$ 4,277
Charge-offs	—	(20)	—	—	(20)
Recoveries	—	—	—	—	—
Provision for loan losses	(59)	48	13	(2)	—
Balance at December 31, 2019	\$ 3,055	\$ 1,096	\$ 58	\$ 48	\$ 4,257
Balance at December 31, 2017	\$ 2,466	\$ 1,460	\$ 48	\$ 63	\$ 4,037
Charge-offs	—	(263)	—	—	(263)
Recoveries	—	3	—	—	3
Provision for loan losses	648	(132)	(3)	(13)	500
Balance at December 31, 2018	\$ 3,114	\$ 1,068	\$ 45	\$ 50	\$ 4,277
Balance at December 31, 2016	\$ 2,308	\$ 1,296	\$ 13	\$ 78	\$ 3,695
Charge-offs	—	—	—	(14)	(14)
Recoveries	—	6	—	—	6
Provision for loan losses	158	158	35	(1)	350
Balance at December 31, 2017	\$ 2,466	\$ 1,460	\$ 48	\$ 63	\$ 4,037
Allowance on loans evaluated for impairment:					
Individually	\$ —	\$ 288	\$ —	\$ —	\$ 288
Collectively	3,055	808	58	48	3,969
Balance at December 31, 2019	\$ 3,055	\$ 1,096	\$ 58	\$ 48	\$ 4,257
Individually	\$ —	\$ 91	\$ —	\$ —	\$ 91
Collectively	3,114	977	45	50	4,186
Balance at December 31, 2018	\$ 3,114	\$ 1,068	\$ 45	\$ 50	\$ 4,277
Individually	\$ 6	\$ 199	\$ —	\$ —	\$ 205
Collectively	2,460	1,261	48	63	3,832
Balance at December 31, 2017	\$ 2,466	\$ 1,460	\$ 48	\$ 63	\$ 4,037
Recorded investment in loans evaluated for impairment:					
Individually	\$ 3,469	\$ 3,497	\$ —	\$ 146	\$ 7,112
Collectively	352,877	160,087	11,629	9,453	534,046
Balance at December 31, 2019	\$ 356,346	\$ 163,584	\$ 11,629	\$ 9,599	\$ 541,158
Individually	\$ 1,919	\$ 2,608	\$ —	\$ 271	\$ 4,798
Collectively	333,683	165,681	7,738	8,300	515,402
Balance at December 31, 2018	\$ 335,602	\$ 168,289	\$ 7,738	\$ 8,571	\$ 520,200
Individually	\$ 2,036	\$ 734	\$ —	\$ 195	\$ 2,965
Collectively	302,455	158,829	6,010	7,938	475,232
Balance at December 31, 2017	\$ 304,491	\$ 159,563	\$ 6,010	\$ 8,133	\$ 478,197

*Includes the loan types; Loans to cooperatives, Processing and marketing, and Farm-related business.

To mitigate risk of loan losses, the Association may enter into guarantee arrangements with certain GSEs, including the Federal Agricultural Mortgage Corporation (Farmer Mac), and state or federal agencies. These guarantees generally remain in place until the loans are paid in full or expire and give the Association the right to be reimbursed for losses incurred or to sell designated loans to the guarantor in the event of default (typically four months past due), subject to certain conditions. The guaranteed balance of designated loans under these agreements was \$79,342, \$85,832, and \$78,263 at December 31, 2019, 2018, and 2017, respectively. Fees paid for such guarantee commitments totaled \$88, \$200, and \$140 for 2019, 2018, and 2017 respectively. These amounts are classified as noninterest expense.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) 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. The following tables present additional information about pre-modification and post-modification outstanding recorded investment and the effects of the modifications that occurred during the periods presented. There were no new TDRs that occurred during 2017.

Outstanding Recorded Investment	Year Ended December 31, 2019					Charge-offs
	Interest Concessions	Principal Concessions	Other Concessions	Total		
Pre-modification:						
Real estate mortgage	\$ -	\$ 92	\$ -	\$ 92		
Production and intermediate-term	-	558	-	558		
Total	\$ -	\$ 650	\$ -	\$ 650		
Post-modification:						
Real estate mortgage	\$ -	\$ 92	\$ -	\$ 92	\$ -	
Production and intermediate-term	-	558	-	558		
Total	\$ -	\$ 650	\$ -	\$ 650	\$ -	

Outstanding Recorded Investment	Year Ended December 31, 2018					Charge-offs
	Interest Concessions	Principal Concessions	Other Concessions	Total		
Pre-modification:						
Production and intermediate-term	\$ -	\$ 45	\$ -	\$ 45		
Total	\$ -	\$ 45	\$ -	\$ 45		
Post-modification:						
Production and intermediate-term	\$ -	\$ 45	\$ -	\$ 45	\$ -	
Total	\$ -	\$ 45	\$ -	\$ 45	\$ -	

Interest concessions may include interest forgiveness and interest deferment. Principal concessions may include principal forgiveness, principal deferment, and maturity extension. Other concessions may include additional compensation received which might be in the form of cash or other assets.

There were no TDRs that occurred during the previous twelve months and for which there was a subsequent payment default during periods presented. Payment default is defined as a payment that was thirty days or more past due.

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

	Total TDRs			Nonaccrual TDRs		
	December 31,			December 31,		
	2019	2018	2017	2019	2018	2017
Real estate mortgage	\$ 1,390	\$ 1,093	\$ 1,242	\$ -	\$ -	\$ -
Production and intermediate-term	681	43	-	-	-	-
Total loans	\$ 2,071	\$ 1,136	\$ 1,242	\$ -	\$ -	\$ -
Additional commitments to lend	\$ -	\$ -	\$ -			

The following table presents information as of period end:

	December 31, 2019
Carrying amount of foreclosed residential real estate properties held as a result of obtaining physical possession	\$ -
Recorded investment of consumer mortgage loans secured by residential real estate for which formal foreclosure proceedings are in process	\$ 207

Note 4 — Investments

Equity Investments in Other Farm Credit Institutions
Equity investments in other Farm Credit System institutions are generally nonmarketable investments consisting of stock and participation certificates, allocated surplus, and reciprocal investments in other institutions regulated by the FCA. These investments are carried at cost and evaluated for impairment

based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value.

The Association is required to maintain ownership in the Bank in the form of Class B or Class C stock as required by the Bank. The Bank may require additional capital contributions to maintain its capital requirements. The Association's investment in the Bank totaled \$6,908 at December 31, 2019. In addition, the Bank had a reciprocal investment in the

Association of \$843 at December 31, 2019. The Association's resulting net investment in the Bank was \$6,065 for 2019, \$5,699 for 2018 and \$5,159 for 2017. The Association owned 2.14 percent of the issued stock of the Bank as of December 31, 2019 net of any reciprocal investment. As of that date, the Bank's assets totaled \$34.5 billion and shareholders' equity totaled \$2.3 billion. The Bank's earnings were \$272 million for 2019. In addition, the Association had investments of \$198 related to other Farm Credit institutions at December 31, 2019.

Note 5 — Real Estate and Other Property

Premises and Equipment

Premises and equipment consists of the following:

	December 31,		
	2019	2018	2017
Land	\$ 756	\$ 756	\$ 753
Buildings and improvements	3,462	3,449	3,440
Furniture and equipment	1,348	1,283	1,432
	5,566	5,488	5,625
Less: accumulated depreciation	2,719	2,561	2,665
Total	\$ 2,847	\$ 2,927	\$ 2,960

Other Property Owned

Net (gains) losses on other property owned consist of the following:

	December 31,		
	2019	2018	2017
(Gains) losses on sale, net	\$ -	\$ -	\$ -
Carrying value unrealized (gains) losses	-	-	-
Operating (income) expense, net	-	(1)	-
(Gains) losses on other property owned, net	\$ -	\$ (1)	\$ -

Gains on sales of other property owned were deferred if the sales involved financing from the Association and did not meet the criteria for immediate recognition. There were no deferred gains at December 31, 2019, 2018, and 2017.

Note 6 — Debt

Notes Payable to AgFirst Farm Credit Bank

Under the Farm Credit Act, the Association is obligated to borrow only from the Bank, unless the Bank approves borrowing from other funding sources. The borrowing relationship is established with the Bank through a General Financing Agreement (GFA). The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The GFA has a one year term which expires on December 31 and is renewable each year. The Association has no reason to believe the GFA will not be renewed upon expiration. The Bank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2019, the Association's notes payable were within the specified limitations.

The Association's indebtedness to the Bank represents borrowings by the Association to fund its earning assets. This indebtedness is collateralized by a pledge of substantially all of the Association's assets and the terms of the revolving lines of credit are governed by the GFA. Interest rates on both variable and fixed rate advances are generally established loan-by-loan based on the Bank's marginal cost of funds, capital position, operating costs and return objectives. In the event of prepayment of any portion of a fixed rate advance, the Association may incur a prepayment penalty in accordance with the terms of the GFA, which will be included in interest expense. The interest rate is periodically adjusted by the Bank based upon an agreement between the Bank and the Association.

The weighted average interest rates on the variable rate advances were 2.81 percent for LIBOR-based loans and 2.91 percent for Prime-based loans, and the weighted average remaining maturities were 1.6 years and 1.3 years, respectively, at December 31, 2019. The weighted-average interest rate on the fixed rate and adjustable rate mortgage (ARM) loans which are match funded by the Bank was 3.25 percent, and the weighted average remaining maturity was 14.2 years at December 31, 2019. The weighted-average interest rate on all interest-bearing notes payable was 3.20 percent and the weighted-average remaining maturity was 12.4 years at December 31, 2019. Gross notes payable consist of approximately 14.38 percent variable rate and 85.62 percent fixed rate portions, representing a match-funding of the Association's loan volume at December 31, 2019. Notes Payable to AgFirst Farm Credit Bank, as reflected on the Consolidated Balance Sheets, also includes a credit which reduces the notes payable balance and corresponding interest expense. The direct note itself has an annual maturity as prescribed in the GFA.

Note 7 — Members' Equity

A description of the Association's capitalization requirements, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below:

- A. **Capital Stock and Participation Certificates:** In accordance with the Farm Credit Act and the Association's capitalization bylaws, each borrower is required to invest in Common stock for agricultural loans, or participation certificates in the case of rural home and farm-related business loans, as a condition of borrowing. The initial borrower investment, through either purchase or transfer, must be in an amount equal to two percent of the loan amount or \$1 thousand, whichever is less. The Association bylaws permit the Board of Directors, at their discretion, to establish an investment range between a minimum of two percent of the loan amount or \$1 thousand, whichever is less, and a maximum not to exceed ten percent of the loan amount. The Board of Directors may increase the amount of investment if necessary to meet the Association's capital needs. Loans designated for sale or sold into the Secondary Market on or after April 16, 1996 will have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation.

The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, but usually does not make a cash investment. The aggregate par value is generally added to the principal amount of the related loan obligation. The Association retains a first lien on the stock or participation certificates owned by borrowers. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding stock or participation certificates.

B. Regulatory Capitalization Requirements and Restrictions: An FCA regulation empowers it to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. The Association has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

There are currently no prohibitions in place that would prevent the Association from retiring stock, distributing earnings, or paying dividends per the statutory and regulatory restrictions, and the Association has no reason to believe any such restrictions may apply in the future.

Effective January 1, 2017, the regulatory capital requirements for System banks and associations were modified. These regulations ensure that the System’s capital requirements are comparable to the Basel III framework and the standardized approach that the federal banking regulatory agencies have adopted. Regulatory ratios include common equity tier 1 (CET1) capital, tier 1 capital, and total capital risk-based ratios. The regulations also include a tier 1 leverage ratio and an unallocated retained earnings (URE) and URE equivalents (UREE) leverage ratio. The permanent capital ratio (PCR) remains in effect.

The ratios are calculated using three-month average daily balances, in accordance with FCA regulations, as follows:

- The CET1 capital ratio is the sum of statutory minimum purchased borrower stock, other required borrower stock held for a minimum of 7 years, allocated equities held for a minimum of 7 years or not subject to revolvement, unallocated retained earnings, and paid-in capital, less certain regulatory required deductions including the amount of investments in other System institutions, divided by average risk-adjusted assets.
- The tier 1 capital ratio is CET1 capital plus non-cumulative perpetual preferred stock, divided by average risk-adjusted assets.
- The total capital ratio is tier 1 capital plus other required borrower stock held for a minimum of 5 years, subordinated debt and limited-life preferred stock greater than 5 years to maturity at issuance subject to certain limitations, and allowance for loan losses and reserve for unfunded commitments under certain limitations less certain investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.
- The permanent capital ratio is all at-risk borrower stock, any allocated excess stock, unallocated retained earnings, paid-in capital, subordinated debt and preferred stock subject to certain limitations, less certain investments in other System institutions, divided by PCR risk-adjusted assets.
- The tier 1 leverage ratio is tier 1 capital, divided by average total assets less regulatory deductions to tier 1 capital.
- The URE and UREE leverage ratio is unallocated retained earnings, paid-in capital, and allocated surplus not subject to revolvement less certain regulatory required deductions including the amount of allocated investments in other System institutions divided by average total assets less regulatory deductions to tier 1 capital.

The following sets forth the regulatory capital ratios which were effective January 1, 2017:

Ratio	Minimum Requirement	Capital Conservation Buffer*	Minimum Requirement with Capital Conservation Buffer	Capital Ratios as of December 31,		
				2019	2018	2017
Risk-adjusted ratios:						
CET1 Capital	4.5%	1.875%	6.375%	17.92%	17.23%	16.66%
Tier 1 Capital	6.0%	1.875%	7.875%	17.92%	17.23%	16.66%
Total Capital	8.0%	1.875%	9.875%	18.80%	18.12%	17.54%
Permanent Capital	7.0%	0.0%	7.0%	18.12%	17.45%	16.91%
Non-risk-adjusted ratios:						
Tier 1 Leverage	4.0%	1.0%	5.0%	15.99%	15.08%	14.63%
URE and UREE Leverage	1.5%	0.0%	1.5%	15.62%	14.73%	14.29%

* The capital conservation buffers have a 3 year phase-in period and became fully effective January 1, 2020. Risk-adjusted ratio minimums increased 0.625% each year until fully phased in. There was no phase-in period for the tier 1 leverage ratio.

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

C. Description of Equities: The Association is authorized to issue or have outstanding nonvoting Class A Preferred Stock, nonvoting Class B Common Stock, voting Class C Common Stock, nonvoting Class C Participation Certificates and such other classes of equity as may be provided for in amendments to the bylaws in such amounts

as may be necessary to conduct the Association’s business. All stock and participation certificates have a par or face value of five dollars (\$5.00) per share.

The Board, at its sole discretion, may declare dividends on either the Class A Preferred Stock alone, or on all classes of Stock and Participation certificates during any fiscal year. However, dividends shall not be paid on common stock or participation certificates in any year with respect to which the Association has obligated itself to distribute patronage refunds.

The Association had the following shares outstanding at December 31, 2019:

Class	Protected	Shares Outstanding	
		Number	Aggregate Par Value
B Common/Nonvoting	No	218	\$ 1
C Common/Voting	No	590,054	2,950
A Common Issued to Bank/Nonvoting	No	168,502	843
C Participation Certificates/Nonvoting	No	23,259	116
Total Capital Stock and Participation Certificates		782,033	\$ 3,910

At-risk common stock and participation certificates are retired at the sole discretion of the Board at book value not to exceed par or face amounts, provided the minimum capital adequacy standards established by the Board are met.

Retained Earnings

The Association maintains an unallocated retained earnings account and an allocated retained earnings account. The minimum aggregate amount of these two accounts is determined by the Board. At the end of any fiscal year, if the retained earnings accounts otherwise would be less than the minimum amount determined by the Board as necessary to maintain adequate capital reserves to meet the commitments of the Association, the Association shall apply earnings for the year to the unallocated retained earnings account in such amounts as may be determined necessary by the Board. Unallocated retained earnings are maintained for each borrower to permit liquidation on a patronage basis.

The Association maintains an allocated retained earnings account consisting of earnings held and allocated to borrowers on a patronage basis. In the event of a net loss for any fiscal year, such allocated retained earnings account will be subject to full impairment in the order specified in the bylaws beginning with the most recent allocation.

The Association has a first lien and security interest on all retained earnings account allocations owned by any borrowers, and all distributions thereof, as additional collateral for their indebtedness to the Association. When the debt of a borrower is in default or is in the process of final liquidation by payment or otherwise, the Association, upon approval of the Board, may order any and all retained earnings account allocations owned by such borrower to be applied on the indebtedness.

Allocated equities shall be retired solely at the discretion of the Board, provided that minimum capital standards established by the FCA and the Board are met. Nonqualified retained surplus is considered to be permanently invested in the Association and as such, there is no plan to revolve or retire this surplus. All nonqualified distributions are tax deductible only when redeemed.

At December 31, 2019, allocated members’ equity consisted of \$67,498 of nonqualified retained surplus.

Patronage Distributions

Prior to the beginning of any fiscal year, the Board, by adoption of a resolution, may obligate the Association to distribute to Patrons, on a patronage basis, all or any portion of available net earnings for such fiscal year or for that and subsequent fiscal years. Patrons are defined as Members, Equity holders, and other customers, borrowers and financial institutions with which the Association shall conduct business as identified by the Board in the obligation resolution. Patronage distributions are based on the proportion of the Patron’s interest to the amount of interest earned by the Association on its total loans unless another proportionate patronage basis is approved by the Board.

If the Association meets its capital adequacy standards after making the patronage distributions, the patronage distributions may be in cash, authorized stock of the Association, allocations of earnings retained in an allocated members’ equity account, or any one or more of such forms of distribution. Patronage distributions of the Association’s earnings may be paid on either a qualified or nonqualified basis, or a combination of both, as determined by the Board. A minimum of 20 percent of the total qualified patronage distribution to any borrower for any fiscal year shall always be paid in cash. Amounts not distributed are retained as unallocated members’ equity.

Transfer

Classes B and C Common Stock and Participation Certificates may be transferred to persons or entities eligible to purchase or hold such equities as provided in the Association’s bylaws. Class A Preferred Stock may be transferred in the manner set forth in the resolution authorizing the issuance of such Stock.

Impairment

Any net losses recorded by the Association shall first be applied against unallocated members’ equity. To the extent that such losses would exceed unallocated members’ equity, such losses would be applied consistent with the Association’s bylaws and distributed pro rata to each share and/or unit outstanding in the class, in the following order:

1. Class A Common Stock, Class B Common Stock, Class C Common Stock and unit of Participation Certificates
2. Class A Preferred Stock

Liquidation

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities should be distributed to the holders of the outstanding stock and participation certificates in the following order:

1. Class A Preferred Stock
2. Classes A, B and C Common Stock and Participation Certificates
3. Allocated retained earnings evidenced by qualified written notices of allocation, in the order of the year of issuance and pro-rata by year of issuance
4. Allocated retained earnings evidenced by nonqualified written notices of allocation, in the year of issuance and pro-rata by year of issuance
5. All unallocated retained earnings earned after April 1, 1995, shall be distributed to all Patrons from April 1, 1995, through the date of liquidation on a patronage basis
6. Any remaining assets of the Association after such distribution shall be distributed ratably to the holders of all classes of stock and participation certificates in proportion to their ownership

Note 8 — Fair Value Measurement

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability.

Accounting guidance establishes a hierarchy for disclosure of fair value measurements to maximize the use of observable inputs, that is, inputs that reflect the assumptions market participants would use in pricing an asset or liability based on market data obtained from sources independent of the reporting entity. The hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the hierarchy tiers is based upon the lowest level of input that is significant to the fair value measurement.

Estimating the fair value of the Association's equity investments in the Bank and other Farm Credit institutions is not practicable because the stock is not traded. The net investment is a requirement of borrowing from the Bank and is carried at cost.

The classifications within the fair value hierarchy (See Note 2) are as follows:

Level 1

The Association has no Level 1 assets or liabilities measured at fair value on a recurring basis at December 31, 2019. For cash, the carrying value is primarily utilized as a reasonable estimate of fair value.

Level 2

The Association had no Level 2 assets or liabilities measured at fair value on a recurring basis at December 31, 2019.

Level 3

Because no active market exists for the Association's accruing loans, fair value is estimated by discounting the expected future cash flows using the Association's current interest rates at which similar loans currently would be made to borrowers with similar credit risk. The loan portfolio is segregated into pools of loans with homogeneous characteristics based upon repricing and credit risk. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

Fair values of loans in a nonaccrual status are estimated to be the carrying amount of the loan less specific reserves. Certain loans evaluated for impairment under FASB guidance have fair values based upon the underlying collateral, as the loans were collateral-dependent. Specific reserves were established for these loans when the value of the collateral, less estimated cost to sell, was less than the principal balance of the loan. 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.

Notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association's loan receivables. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.

Other property owned is classified as a Level 3 asset. The fair value is generally determined using formal appraisals of each individual property. These assets are held for sale. Costs to sell represent transaction costs and are not included as a component of the fair value of other property owned. Other property owned consists of real and personal property acquired through foreclosure or deed in lieu of foreclosure and is carried as an asset held for sale, which is generally not its highest and best use. These properties are part of the Association's credit risk mitigation efforts, not its ongoing business. In addition, FCA regulations require that these types of property be disposed of within a reasonable period of time.

For commitments to extend credit, the estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics; therefore, the related credit risk is not significant.

There were no Level 3 assets and liabilities measured at fair value on a recurring basis for the periods presented. The Association had no transfers of assets or liabilities into or out of Level 1 or Level 2 during the periods presented.

Fair values are estimated at each period end date for assets and liabilities measured at fair value on a recurring basis. Other Financial Instruments are not measured at fair value in the statement of financial position, but their fair values are estimated as of each period end date. The following tables summarize the carrying amounts of these assets and liabilities at period end, and their related fair values.

December 31, 2019					
	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
Recurring Measurements					
Assets:					
Recurring Assets	\$ -	\$ -	\$ -	\$ -	\$ -
Liabilities:					
Recurring Liabilities	\$ -	\$ -	\$ -	\$ -	\$ -
Nonrecurring Measurements					
Assets:					
Impaired loans	\$ 1,513	\$ -	\$ -	\$ 1,513	\$ 1,513
Other property owned	-	-	-	-	-
Nonrecurring Assets	\$ 1,513	\$ -	\$ -	\$ 1,513	\$ 1,513
Other Financial Instruments					
Assets:					
Cash	\$ 2,468	\$ 2,468	\$ -	\$ -	\$ 2,468
Loans	528,178	-	-	524,723	524,723
Other Financial Assets	\$ 530,646	\$ 2,468	\$ -	\$ 524,723	\$ 527,191
Liabilities:					
Notes payable to AgFirst Farm Credit Bank	\$ 452,919	\$ -	\$ -	\$ 451,835	\$ 451,835
Other Financial Liabilities	\$ 452,919	\$ -	\$ -	\$ 451,835	\$ 451,835

December 31, 2018					
	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
Recurring Measurements					
Assets:					
Recurring Assets	\$ -	\$ -	\$ -	\$ -	\$ -
Liabilities:					
Recurring Liabilities	\$ -	\$ -	\$ -	\$ -	\$ -
Nonrecurring Measurements					
Assets:					
Impaired loans	\$ 208	\$ -	\$ -	\$ 208	\$ 208
Other property owned	-	-	-	-	-
Nonrecurring Assets	\$ 208	\$ -	\$ -	\$ 208	\$ 208
Other Financial Instruments					
Assets:					
Cash	\$ 3,046	\$ 3,046	\$ -	\$ -	\$ 3,046
Loans	508,560	-	-	493,247	493,247
Other Financial Assets	\$ 511,606	\$ 3,046	\$ -	\$ 493,247	\$ 496,293
Liabilities:					
Notes payable to AgFirst Farm Credit Bank	\$ 441,115	\$ -	\$ -	\$ 431,598	\$ 431,598
Other Financial Liabilities	\$ 441,115	\$ -	\$ -	\$ 431,598	\$ 431,598

	December 31, 2017				
	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
Recurring Measurements					
Assets:					
Recurring Assets	\$ -	\$ -	\$ -	\$ -	\$ -
Liabilities:					
Recurring Liabilities	\$ -	\$ -	\$ -	\$ -	\$ -
Nonrecurring Measurements					
Assets:					
Impaired loans	\$ 302	\$ -	\$ -	\$ 302	\$ 302
Other property owned	8	-	-	9	9
Nonrecurring Assets	\$ 310	\$ -	\$ -	\$ 311	\$ 311
Other Financial Instruments					
Assets:					
Cash	\$ 2,028	\$ 2,028	\$ -	\$ -	\$ 2,028
Loans	467,524	-	-	455,704	455,704
Other Financial Assets	\$ 469,552	\$ 2,028	\$ -	\$ 455,704	\$ 457,732
Liabilities:					
Notes payable to AgFirst Farm Credit Bank	\$ 406,457	\$ -	\$ -	\$ 399,924	\$ 399,924
Other Financial Liabilities	\$ 406,457	\$ -	\$ -	\$ 399,924	\$ 399,924

Uncertainty in Measurements of Fair Value

Discounted cash flow or similar modeling techniques are generally used to determine the recurring fair value measurements for Level 3 assets and liabilities. Use of these techniques requires determination of relevant inputs and assumptions, some of which represent significant unobservable inputs as indicated in the tables that follow. Accordingly, changes in these unobservable inputs may have a significant impact on fair value.

Certain of these unobservable inputs will (in isolation) have a directionally consistent impact on the fair value of the instrument for a given change in that input. Alternatively, the fair value of the instrument may move in an opposite direction for a given change in another input. Where multiple inputs are used within the valuation technique of an asset or liability, a change in one input in a certain direction may be offset by an opposite change in another input having a potentially muted impact to the overall fair value of that particular instrument. Additionally, a change in one unobservable input may result in a change to another unobservable input (that is, changes in

certain inputs are interrelated with one another), which may counteract or magnify the fair value impact.

Inputs to Valuation Techniques

Management determines the Association’s valuation policies and procedures. The Bank performs the majority of the Association’s valuations, and its valuation processes are calibrated annually by an independent consultant. The fair value measurements are analyzed on a quarterly basis. For other valuations, documentation is obtained for third party information, such as pricing, and periodically evaluated alongside internal information and pricing that is available.

Quoted market prices are generally not available for certain System financial instruments, as described below. Accordingly fair values are based on judgments regarding anticipated cash flows, future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Quantitative Information about Recurring and Nonrecurring Level 3 Fair Value Measurements

	Fair Value	Valuation Technique(s)	Unobservable Input	Range
Impaired loans and other property owned	\$ 1,513	Appraisal	Income and expense	*
			Comparable sales	*
			Replacement costs	*
			Comparability adjustments	*

* Ranges for this type of input are not useful because each collateral property is unique.

Information about Other Financial Instrument Fair Value Measurements

	Valuation Technique(s)	Input
Cash	Carrying value	Par/principal and appropriate interest yield
Loans	Discounted cash flow	Prepayment forecasts Probability of default Loss severity
Notes payable to AgFirst Farm Credit Bank	Discounted cash flow	Prepayment forecasts Probability of default Loss severity

Note 9 — Employee Benefit Plans

The Association participates in three District sponsored benefit plans. These plans include a multiemployer defined benefit pension plan, the Independent Associations Retirement Plan, which is a final average pay plan (IAR Plan). In addition, the Association participates in a multiemployer defined benefit other postretirement benefits plan (OPEB Plan), the Farm Credit Benefits Alliance Retiree and Disabled Medical and Dental Plan, and a defined contribution 401(k) plan. The risks of participating in these multiemployer plans are different from single employer plans in the following aspects:

1. Assets contributed to multiemployer plans by one employer may be used to provide benefits to employees of other participating employers.
2. If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.
3. If the Association chooses to stop participating in some of its multiemployer plans, the Association may be required to contribute to eliminate the underfunded status of the plan.

The District's multiemployer plans are not subject to ERISA and no Form 5500 is required. As such, the following information is neither available for nor applicable to the plans:

1. The Employer Identification Number (EIN) and three-digit Pension Plan Number
2. The most recent Pension Protection Act (PPA) zone status. Among other factors, plans in the red zone are generally less than 65 percent funded, plans in the yellow zone are less than 80 percent funded, and plans in the green zone are at least 80 percent funded.
3. The "FIP/RP Status" indicating whether a financial improvement plan (FIP) or a rehabilitation plan (RP) is either pending or has been implemented.
4. The expiration date(s) of collective-bargaining agreement(s).

The IAR Plan covers employees hired prior to January 1, 2009 and includes other District employees that are not employees of the Association. It is accounted for as a multiemployer plan. The related net benefit plan obligations are not included in the Association's Balance Sheets but are included in the Combined Balance Sheets for the AgFirst District. IAR Plan expenses included in employee benefit costs on the Association's Statements of Income were \$646 for 2019, \$953 for 2018, and \$848 for 2017. At December 31, 2019, 2018, and 2017, the total liability balance for the IAR Plan presented in the District Combined Balance Sheets was \$14,603, \$8,626, and \$15,078, respectively. The IAR Plan was 83.65 percent, 88.42 percent, and 81.82 percent funded to the projected benefit obligation as of December 31, 2019, 2018, and 2017, respectively.

In addition to providing pension benefits, the Association provides certain medical and dental benefits for eligible retired employees through the OPEB Plan. Substantially all of the Association employees may become eligible for the benefits if they reach early retirement age while working for the Association. Early retirement age is defined as a minimum of age 55 and 10 years of service. Employees hired after December 31, 2002, and employees who separate from

service between age 50 and age 55, are required to pay the full cost of their retiree health insurance coverage. Employees who retire subsequent to December 1, 2007 are no longer provided retiree life insurance benefits. The OPEB Plan includes other Farm Credit System employees that are not employees of the Association or District and is accounted for as a multiemployer plan. The related net benefit plan obligations are not included in the Association's Balance Sheets but are included in the Combined Statement of Condition for the Farm Credit System. The OPEB Plan is unfunded with expenses paid as incurred. Postretirement benefits other than pensions included in employee benefit costs on the Association's Statements of Income were \$78 for 2019, \$76 for 2018, and \$72 for 2017. At December 31, 2019, the total AgFirst District liability balance for the OPEB Plan presented in the Farm Credit System Combined Statement of Condition was \$209,531.

During 2017, the method of recording expenses at participating District entities for the IAR and OPEB Plans was modified. Prior to 2017, expense was recorded based on allocations of actuarially-determined costs and any differences between recorded expense and actual contributions were recorded in Other Assets or Other Liabilities on the Consolidated Balance Sheets. For 2017 and future years, participating entities will record employee benefit costs based on the actual contributions to the Plans. This change caused the Association to modify its accounting estimates recorded in Other Assets and Other Liabilities since the assets and liabilities do not impact future contributions to the Plans. The change in estimate resulted in the reduction of Other Assets by \$1,762 and the reduction of Other Liabilities by \$1,467 on the Association's Balance Sheets, and a total addition of noninterest expenses on the Association's Statements of Income of \$295 during 2017.

The Association also participates in a defined contribution Farm Credit Benefits Alliance (FCBA) 401(k) Plan (401(k) Plan), which qualifies as a 401(k) plan as defined by the Internal Revenue Code. This 401(k) plan requires the Association to match 100 percent of employee optional contributions up to a maximum employee contribution of 6.00 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as determined and adjusted by the Internal Revenue Service. The 401(k) Plan costs are expensed as funded. Employer contributions to this plan included in salaries and employee benefit costs were \$268, \$238, and \$217 for the years ended December 31, 2019, 2018, and 2017, respectively. Beginning in 2015, contributions include an additional 3.00 percent of eligible compensation for employees hired after December 31, 2008.

Additional information for the above may be found in the Notes to the Annual Information Statement of the Farm Credit System.

Note 10 — Related Party Transactions

In the ordinary course of business, the Association enters into loan transactions with officers and directors of the Association, their immediate families and other organizations with which such persons may be associated. Such loans are subject to special approval requirements contained in the FCA regulations and are made on the same terms, including

interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

Total loans to such persons at December 31, 2019 amounted to \$4,427. During 2019, \$2,437 of new loans were made and repayments totaled \$2,557. In the opinion of management, none of these loans outstanding at December 31, 2019 involved more than a normal risk of collectability.

Note 11 — Commitments and Contingencies

From time to time, legal actions are pending against the Association in which claims for money damages are asserted. On at least a quarterly basis, the Association assesses its liabilities and contingencies in connection with outstanding legal proceedings utilizing the latest information available. While the outcome of legal proceedings is inherently uncertain, on the basis of information presently available, management, after consultation with legal counsel, is of the opinion that the ultimate liability, if any, from these actions, would not be material in relation to the financial position of the Association. Because it is not probable that the Association will incur a loss or the loss is not estimable, no liability has been recorded for any claims that may be pending.

In the normal course of business, the Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers. These financial instruments may include commitments to extend credit or letters of credit.

The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee.

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the Consolidated Balance Sheets until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. At December 31, 2019, \$50,372 of commitments to extend credit and no commercial letters of credit were outstanding with no related reserve for unfunded commitments included in Other Liabilities in the Consolidated Balance Sheets at December 31, 2019.

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. At December 31, 2019, standby letters of credit outstanding totaled \$10 with expiration dates ranging from January 1, 2020 to June 30, 2020. The maximum potential amount of future payments that may be required under these guarantees was \$10.

Note 12 — Income Taxes

The provision (benefit) for income taxes follows:

	Year Ended December 31,		
	2019	2018	2017
Current:			
Federal	\$ 3	\$ 4	\$ 12
State	—	—	—
	<u>\$ 3</u>	<u>\$ 4</u>	<u>\$ 12</u>
Deferred:			
Federal	—	—	—
State	—	—	—
Total provision (benefit) for income taxes	<u>\$ 3</u>	<u>\$ 4</u>	<u>\$ 12</u>

The provision (benefit) for income tax differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as follows:

	December 31,		
	2019	2018	2017
Federal tax at statutory rate	\$ 2,585	\$ 2,564	\$ 3,817
Patronage distributions	(874)	(848)	(1,257)
Tax-exempt FLCA earnings	(1,760)	(1,749)	(2,685)
Change in deferred tax asset valuation allowance	51	38	(121)
Deferred tax rate change	—	—	260
Other	1	(1)	(2)
Provision (benefit) for income taxes	<u>\$ 3</u>	<u>\$ 4</u>	<u>\$ 12</u>

In late December 2017, federal tax legislation was enacted which, among other things, lowered the federal corporate tax rate from 35% to 21% beginning on January 1, 2018. The change to the lower corporate tax rate led to an insignificant remeasurement of the deferred tax liabilities and deferred tax assets in 2017, the period of enactment. Deferred tax assets and liabilities are comprised of the following at:

	December 31,		
	2019	2018	2017
Deferred income tax assets:			
Allowance for loan losses	\$ 306	\$ 296	\$ 301
Annual leave	74	69	65
Nonaccrual loan interest	132	82	45
Pensions and other postretirement benefits	—	—	—
Other	—	—	—
Gross deferred tax assets	<u>512</u>	<u>447</u>	<u>411</u>
Less: valuation allowance	(478)	(428)	(390)
Gross deferred tax assets, net of valuation allowance	<u>34</u>	<u>19</u>	<u>21</u>
Deferred income tax liabilities:			
Pensions and other postretirement benefits	—	—	—
Depreciation	(34)	(19)	(21)
Other	—	—	—
Gross deferred tax liability	<u>(34)</u>	<u>(19)</u>	<u>(21)</u>
Net deferred tax asset (liability)	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

At December 31, 2019, deferred income taxes have not been provided by the Association on approximately \$6 million of its investment in the Bank. Management expects that these earnings will not be converted to cash.

The Association recorded a valuation allowance of \$478, \$428 and \$390 as of December 31, 2019, 2018 and 2017, respectively. The Association will continue to evaluate the realizability of these deferred tax assets and adjust the valuation allowance accordingly.

There were no uncertain tax positions identified related to the current year and the Association has no unrecognized tax benefits at December 31, 2019 for which liabilities have been established. The Association recognizes interest and penalties, if any, related to unrecognized tax benefits as a component of income tax expense.

The tax years that remain open for federal and major state income tax jurisdictions are 2016 and forward.

Note 13 — Additional Financial Information

Quarterly Financial Information (Unaudited)

	2019				
	First	Second	Third	Fourth	Total
Net interest income	\$ 3,230	\$ 3,319	\$ 3,398	\$ 3,310	\$ 13,257
Provision for (reversal of allowance for) loan losses	-	-	-	-	-
Noninterest income (expense), net	(831)	(827)	(855)	1,562	(951)
Net income	\$ 2,399	\$ 2,492	\$ 2,543	\$ 4,872	\$ 12,306

	2018				
	First	Second	Third	Fourth	Total
Net interest income	\$ 3,024	\$ 3,117	\$ 3,177	\$ 3,282	\$ 12,600
Provision for (reversal of allowance for) loan losses	-	-	200	300	500
Noninterest income (expense), net	(520)	(834)	(855)	2,317	108
Net income	\$ 2,504	\$ 2,283	\$ 2,122	\$ 5,299	\$ 12,208

	2017				
	First	Second	Third	Fourth	Total
Net interest income	\$ 2,807	\$ 2,800	\$ 2,939	\$ 3,014	\$ 11,560
Provision for (reversal of allowance for) loan losses	-	-	-	350	350
Noninterest income (expense), net	(886)	(834)	(701)	2,104	(317)
Net income	\$ 1,921	\$ 1,966	\$ 2,238	\$ 4,768	\$ 10,893

Note 14 — Subsequent Events

The Association evaluated subsequent events and determined that there were none requiring disclosure through March 12, 2020, which was the date the financial statements were issued.



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