

CENTRAL TEXAS FARM CREDIT, ACA

2019 Quarterly Report First Quarter



For the Quarter Ended March 31, 2019

REPORT OF MANAGEMENT

The undersigned certify that we have reviewed this report, that it has been prepared in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate and complete to the best of our knowledge and belief.



Boyd J. Chambers, Chief Executive Officer and President
May 7, 2019



Robby A. Halfmann, Chairman, Board of Directors
May 7, 2019



Keith Prater, Chief Financial Officer
May 7, 2019

CENTRAL TEXAS FARM CREDIT, ACA MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the financial performance of the Central Texas Farm Credit, ACA (Agricultural Credit Association), referred to as the Association, for the quarter ended March 31, 2019. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2018 Annual Report to Stockholders.

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

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

Significant Events:

2019

In March 2019, a patronage refund of \$6,500,000 was distributed to the Association's borrowers. The patronage refund was declared by the board of directors in December 2018, and the amount was based on the Association's 2018 operating results.

2018

In December 2018, the Association received a direct loan patronage of \$1,762,208 from the Farm Credit Bank of Texas (Bank), representing 44 basis points on the average daily balance of the Association's direct loan with the Bank. During 2018, the Association received \$209,974 in patronage payments from the Bank, based on the Association's stock investment in the Bank. The Association received a capital markets patronage of \$65,095 from the Bank, representing 66 basis points on the Association's average balance of participations in the Bank's patronage pool. In August of 2018, CoBank announced that its board of directors approved a special, one-time patronage distribution as part of a broader plan to share the benefits of federal tax reform legislation with eligible customer-owners. This resulted in the Bank's receipt of a special patronage distribution from CoBank in September of 2018, and the Association's pro-rata share of the distribution was \$39,424.

In March 2018, a patronage refund of \$6,300,000 was distributed to the Association's borrowers. The patronage refund was declared by the board of directors in December 2017, and the amount was based on the Association's 2017 operating results.

2017

In December 2017, the Association received a direct loan patronage of \$1,531,794 from the Farm Credit Bank of Texas (Bank), representing 39 basis points on the average daily balance of the Association's direct loan with the Bank. During 2017, the Association received \$166,872 in patronage payments from the Bank, based on the Association's stock investment in the Bank. Also, the Association received a capital markets patronage of \$49,651 from the Bank, representing 75 basis points on the Association's average balance of participations in the Bank's patronage pool program.

2016

In December 2016, the Association received a direct loan patronage of \$1,592,290 from the Bank, representing 41 basis points on the average daily balance of the Association's direct loan with the Bank. During 2016, the Association also received \$128,071 in patronage payments from the Bank, based on the Association's stock investment in the Bank. In addition, the Association received a capital markets patronage of \$54,450 from the Bank, representing 75 basis points on the Association's average balance of participations in the Bank's patronage pool program.

In September 2016, the Association completed construction of a new headquarters building located in the city of Early, which is included in premises and equipment on the consolidated balance sheet.

In March 2016, a patronage refund of \$5,600,000 was distributed to the Association's borrowers. The patronage refund was declared by the board of directors in December 2015, and the amount was based on the Association's 2015 operating results.

Loan Portfolio:

Total loans outstanding at March 31, 2019, including nonaccrual loans and sales contracts, were \$514,138,884 compared to \$509,538,598 at December 31, 2018, reflecting an increase of 0.9 percent. Nonaccrual loans as a percentage of total loans outstanding were 0.4 percent at March 31, 2019, compared to 0.6 percent at December 31, 2018.

The Association recorded no recoveries and \$16,434 in charge-offs for the quarter ended March 31, 2019, and \$52,508 in recoveries and \$17,992 in charge-offs for the same period in 2018. The Association's allowance for loan losses was 0.2 percent of total loans outstanding as of March 31, 2019 and December 31, 2018.

Currently, Association has \$1,866,583 in nonaccrual loans which are included in the Association's core loan portfolio. There have been no material changes in the Association's core portfolio's borrower profile, geographic distribution, commodity concentration, or asset quality.

Problem Loans

2019

During the first quarter of 2019, the Association recorded two charge-offs in the amount of \$16,434 and no recoveries were recorded.

2018

During the first quarter of 2018, the Association recorded a charge-off in the amount of \$17,992.

A recovery of \$52,508 was recorded due to a payoff on a nonaccrual loan in the first quarter of 2018.

During the first quarter of 2018, a capital markets loan was downgraded to nonaccrual and a specific allowance of \$438,893 was recorded to provision expense.

2017

The Association did not have any reportable problem loan activity in 2017.

2016

During the third quarter of 2016, a nonaccrual loan in the amount of \$198,666 was foreclosed on. The property was sold during the quarter and the Association was paid in full.

During the third quarter of 2016, three production and intermediate term loans to a borrower were downgraded to Substandard Non-Accrual and a subsequent charge-off of \$1,029,171 was recognized.

After the sale of acquired property in 2013, a balance of \$129,075 was held in acquired property to represent funds still owed to the Association. During the third quarter of 2016 that amount was charged off as the collection of those funds was no longer expected.

Territory Conditions

The local economy in the Association's chartered territory remains relatively strong. Real estate values have remained stable or increase slightly and land sales have continued to be stable despite volatile ag-related commodities and petroleum prices and the resulting loss of income for people connected to those industries. The majority of the Association's new loans made in recent years have been to absentee landowners with diverse income sources looking for a place for a small agricultural operation or recreational use. As a result, the Association has a diversified portfolio that is not heavily dependent on agricultural income. Even those borrowers who are primarily agricultural producers typically have outside income from a spouse's employment, part-time jobs, investments, etc. The above is reflected in the Association's sound credit quality and small number of delinquencies.

By the end of the first quarter of 2019, our territory was in fair condition with some dry to moderately dry areas. According to the March 2019 USDA Drought Monitor Report, most of the territory was outside of the dry zone and pasture conditions were considered good in most areas.

The USDA's report "Texas Crop Progress and Condition" for the last week of March 2019 reported that seven percent of cotton acres were planted. Corn crops were well under way with 51 percent of acreage planted and 25 percent of acreage emerged in the state. As for small grains, eight percent of wheat was headed and 19 percent of oat acreage had been planted with 18 percent emerging.

Cattle markets have been fairly steady in the first quarter and early second quarter of 2019. Continued exports and consumer demand at home have allowed the market to remain stable. Some are forecasting a slight decrease in cattle prices in the latter half of 2019 due to concerns of the outcome of some trade negotiations that could cause supply build up if exports are hindered. USDA reported in “Cattle on Feed” dated March 22, 2019, cattle and calves on feed for slaughter in Texas feedlots with capacities exceeding 1,000 head, totaled 2.77 million, an increase of three percent over the same period in 2018.

According to the USDA “Milk Production” report released on March 19, 2019, Texas milk production in February totaled 1.053 billion pounds, a 7.7% increase compared to February of 2018 due to slightly higher cow numbers and a per cow increase in production. CME futures indicate improved dairy prices with April trading at \$15.91/cwt and forward contracts trading over \$16/cwt in August and climbing through October.

Most of the Association’s borrowers continue to do well right now, but many remain cautious due to volatile commodity markets. Management realizes the impact the current commodity environment could potentially have on borrowers. We feel our portfolio is very well managed as operating loans are reviewed at least annually and, in some cases, more often. It is our belief that the PD rating accurately reflect the risk level of the portfolio and no impairment pool for any specific commodity is necessary at this time.

Risk Exposure:

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

	March 31, 2019		December 31, 2018	
	Amount	%	Amount	%
Nonaccrual	\$ 1,866,583	100.0%	\$ 2,946,650	100.0%
90 days past due and still accruing interest	-	0.0%	-	0.0%
Other property owned, net	-	0.0%	-	0.0%
Total	\$ 1,866,583	100.0%	\$ 2,946,650	100.0%

Results of Operations:

The Association had net income of \$2,444,502 for the three months ended March 31, 2019, as compared to net income of \$2,648,304 for the same period in 2018, reflecting a decrease of 7.7 percent. Net interest income was \$3,885,446 for the three months ended March 31, 2019, compared to \$3,711,393 for the same period in 2018.

	Three Months Ended			
	March 31, 2019		March 31, 2018	
	Average Balance	Interest	Average Balance	Interest
Loans	\$ 512,542,450	\$ 6,967,761	\$ 492,123,320	\$ 6,053,332
Interest-bearing liabilities	408,488,432	3,082,315	390,146,469	2,341,939
Impact of capital	\$ 104,054,018		\$ 101,976,851	
Net interest income		\$ 3,885,446		\$ 3,711,393

	2019	2018
	Average Yield	Average Yield
Yield on loans	5.51%	4.99%
Cost of interest-bearing liabilities	3.06%	2.43%
Interest rate spread	2.45%	2.56%
Net interest income as a percentage of average earning assets	3.07%	3.06%

**Three months ended:
March 31, 2019 vs. March 31, 2018**

	Increase due to		
	Volume	Rate	Total
Interest income - loans	\$ 251,164	\$ 663,265	\$ 914,429
Interest expense	110,100	630,276	740,376
Net interest income	<u>\$ 141,064</u>	<u>\$ 32,989</u>	<u>\$ 174,053</u>

Interest income for the three months ended March 31, 2019, increased by \$914,429, or 15.1 percent, from the same period of 2018, primarily due to increases in yields on earning assets and an increase in average loan volume. Interest expense for the three months ended March 31, 2019, increased by \$740,376, or 31.6 percent, from the same period of 2018 due to an increase in interest rates and an increase in average debt volume. Average loan volume for the first quarter of 2019 was \$512,542,450, compared to \$492,123,320 in the first quarter of 2018. The average net interest rate spread on the loan portfolio for the first quarter of 2019 was 2.45 percent, compared to 2.56 percent in the first quarter of 2018.

The Association's return on average assets for the three months ended March 31, 2019, was 1.87 percent compared to 2.30 percent for the same period in 2018. The Association's return on average equity for the three months ended March 31, 2019, was 8.87 percent, compared to 10.76 percent for the same period in 2018.

Liquidity and Funding Sources:

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

	March 31, 2019	December 31, 2018
Note payable to the Bank	\$ 411,358,046	\$ 404,917,907
Accrued interest on note payable	1,081,735	1,014,757
Total	<u>\$ 412,439,781</u>	<u>\$ 405,932,664</u>

The Association operates under a general financing agreement (GFA) with the Bank. The current GFA is effective through September 30, 2020. The primary source of liquidity and funding for the Association is a direct loan from the Bank. The outstanding balance of \$411,358,046 as of March 31, 2019, is recorded as a liability on the Association's balance sheet. The note carried a weighted average interest rate of 2.97 percent at March 31, 2019. The indebtedness is collateralized by a pledge of substantially all of the Association's assets to the Bank and is governed by the general financing agreement. The increase in note payable to the Bank and related accrued interest payable since December 31, 2018, is due to the Association's increase in increase in loan volume. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were \$102,250,756 at March 31, 2019. The maximum amount the Association may borrow from the Bank as of March 31, 2019, was \$518,354,245 as defined by the general financing agreement. The indebtedness continues in effect until the expiration date of the general financing agreement, which is September 30, 2020, unless sooner terminated by the Bank upon the occurrence of an event of default, or by the Association, in the event of a breach of this agreement by the Bank, upon giving the Bank 30 calendar days' prior written notice, or in all other circumstances, upon giving the Bank 120 days' prior written notice.

The liquidity policy of the Association is to manage cash balances, to maximize debt reduction, and to increase accrual loan volume. This policy will continue to be pursued during 2019. As borrower payments are received, they are applied to the Association's note payable to the Bank.

The Association will continue to fund its operations through direct borrowings from the Bank, capital surplus from prior years, and borrower stock. It is management's opinion that funds available to the Association are sufficient to fund its operations for the coming year.

Capital Resources:

The Association's capital position increased by \$2,441,354 at March 31, 2019, compared to December 31, 2018. The Association's debt as a percentage of members' equity was 3.71:1 as of March 31, 2019, compared to 3.77:1 as of December 31, 2018.

Farm Credit Administration regulations requires the Association to maintain minimums for various regulatory capital ratios. New regulations became effective January 1, 2017, which replaced the previously required core surplus and total surplus ratios with common equity tier 1, tier 1 capital, and total capital risk-based capital ratios. The new regulations also added tier 1 leverage and unallocated retained earnings and equivalents (UREE) ratios. The permanent capital ratio continues to remain in effect, with some modifications to align with the new regulations. As of March 31, 2019, the Association exceeded all regulatory capital requirements.

Significant Recent Accounting Pronouncements:

In August 2018, the Financial Accounting Standards Board (FASB) issued guidance entitled "Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Cost." The guidance aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by this guidance. This guidance becomes effective for interim and annual periods beginning after December 15, 2019. The guidance also requires an entity (customer) to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. It further specifies where to present expense and payments in the financial statements. Early adoption is permitted. The guidance is to be applied on a retrospective or prospective basis to all implementation costs incurred after the date of adoption. The Association is evaluating the impact of adoption on the Association's financial condition and its results of operations.

In August 2018, the FASB issued guidance entitled "Disclosure Framework — Changes to the Disclosure Requirements for Defined Benefit Plans." The guidance modifies the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. This guidance becomes effective for fiscal years ending after December 15, 2020. Early adoption is permitted. The guidance is to be applied on a retrospective basis for all periods. The adoption of this guidance will not impact the Association's financial condition or its results of operations, but will impact the employee benefit plan disclosures.

In August 2018, the FASB issued guidance entitled "Disclosure Framework — Changes to the Disclosure Requirements for Fair Value Measurement." The guidance modifies the requirements on fair value measurements by removing, modifying or adding to the disclosures. This guidance becomes effective for interim and annual periods beginning after December 15, 2019. Early adoption is permitted and an entity is permitted to early adopt any removal or modified disclosures and delay adoption of the additional disclosures until their effective date. The adoption of this guidance will not impact the Association's financial condition or its results of operations, but will impact the fair value measurements disclosures.

In June 2016, the FASB issued guidance entitled "Measurement of Credit Losses on Financial Instruments." The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses. For public business entities that are not U.S. Securities and Exchange Commission filers this guidance becomes effective for interim and annual periods beginning after December 15, 2020, with early application permitted. The Association is evaluating the impact of adoption on its financial condition and results of operations.

In February 2016, the FASB issued guidance entitled "Leases." The guidance requires the recognition by lessees of lease assets and lease liabilities on the balance sheet for the rights and obligations created by those leases. Leases with lease terms of more than 12 months are impacted by this guidance. The guidance and related amendments in this update became effective for interim and annual periods beginning after December 15, 2018, with early application permitted. The adoption of this guidance did not materially impact the Association's financial condition and results of operations but did impact lease disclosures.

Regulatory Matters:

On March 10, 2016, the Farm Credit Association approved a final rule to modify the regulatory capital requirements for System banks and associations. The stated objectives of the proposed rule are as follows:

- To modernize capital requirements while ensuring that the institutions continue to hold sufficient regulatory capital to fulfill their mission as a government-sponsored enterprise,
- To 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, but also to ensure that the rules recognize the cooperative structure and the organization of the System,
- To make system regulatory capital requirements more transparent, and
- To meet the requirements of Section 939A of the Dodd-Frank Act.

Relationship With the Farm Credit Bank of Texas:

The Association's financial condition may be impacted by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect the stockholder's investment in the Association. The Management's Discussion and Analysis and Notes to Financial Statements contained in the 2018 Annual Report of Central Texas Farm Credit, ACA more fully describe the Association's relationship with the Bank.

The annual and quarterly stockholder reports of the Bank are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, Corporate Communications, P.O. Box 202590, Austin, Texas 78720, or by calling (512) 483-9204. The annual and quarterly stockholder reports for the Bank are also available on its website at www.farmcreditbank.com.

The Association's quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Central Texas Farm Credit, ACA, 1026 Early Boulevard, Early, Texas, 76802, or calling (325) 643-5563. The annual and quarterly stockholder reports for the Association are also available on its website at www.centraltexasfarmcredit.com. Copies of the Association's quarterly stockholder reports can also be requested by e-mailing Keith.Prater@farmcreditbank.com.

CENTRAL TEXAS FARM CREDIT, ACA

CONSOLIDATED BALANCE SHEET

	March 31, 2019 (unaudited)	December 31, 2018
<u>ASSETS</u>		
Cash	\$ 7,485	\$ 11,112
Loans	514,138,884	509,538,598
Less: allowance for loan losses	<u>1,126,256</u>	<u>1,012,884</u>
Net loans	513,012,628	508,525,714
Accrued interest receivable	6,041,302	5,341,573
Investment in and receivable from the Farm Credit Bank of Texas:		
Capital stock	7,961,880	7,961,880
Other	461,515	911,339
Premises and equipment, net	3,752,576	3,663,056
Other assets	<u>777,613</u>	<u>206,771</u>
Total assets	<u><u>\$ 532,014,999</u></u>	<u><u>\$ 526,621,445</u></u>
<u>LIABILITIES</u>		
Note payable to the Farm Credit Bank of Texas	\$ 411,358,046	\$ 404,917,907
Advance conditional payments	10,448	10,576
Accrued interest payable	1,081,735	1,014,757
Dividends payable	-	6,500,000
Other liabilities	<u>6,633,831</u>	<u>3,688,620</u>
Total liabilities	<u><u>419,084,060</u></u>	<u><u>416,131,860</u></u>
<u>MEMBERS' EQUITY</u>		
Capital stock and participation certificates	2,260,160	2,258,190
Unallocated retained earnings	110,613,027	108,168,525
Accumulated other comprehensive income	<u>57,752</u>	<u>62,870</u>
Total members' equity	<u><u>112,930,939</u></u>	<u><u>110,489,585</u></u>
Total liabilities and members' equity	<u><u>\$ 532,014,999</u></u>	<u><u>\$ 526,621,445</u></u>

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

CENTRAL TEXAS FARM CREDIT, ACA

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

	Three Months Ended	
	March 31,	
	2019	2018
<u>INTEREST INCOME</u>		
Loans	\$ 6,967,761	\$ 6,053,332
<u>INTEREST EXPENSE</u>		
Note payable to the Farm Credit Bank of Texas	3,082,315	2,341,939
Net interest income	3,885,446	3,711,393
<u>PROVISION FOR LOAN LOSSES</u>		
Net interest income after provision for loan losses	124,680	71,069
	3,760,766	3,640,324
<u>NONINTEREST INCOME</u>		
Income from the Farm Credit Bank of Texas:		
Patronage income	454,830	351,405
Loan fees	30,609	31,942
Financially related services income	3,147	3,147
Other noninterest income	120,948	285,566
Total noninterest income	609,534	672,060
<u>NONINTEREST EXPENSES</u>		
Salaries and employee benefits	1,158,415	982,643
Directors' expense	34,450	30,606
Purchased services	91,935	64,462
Travel	46,968	41,158
Occupancy and equipment	115,682	95,391
Communications	35,569	27,975
Advertising	42,283	58,079
Public and member relations	104,841	103,251
Supervisory and exam expense	54,392	54,715
Insurance Fund premiums	168,791	148,984
Other noninterest expense	72,472	56,816
Total noninterest expenses	1,925,798	1,664,080
NET INCOME	2,444,502	2,648,304
Other comprehensive income:		
Change in postretirement benefit plans	(5,118)	3,081
COMPREHENSIVE INCOME	\$ 2,439,384	\$ 2,651,385

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

CENTRAL TEXAS FARM CREDIT, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

(unaudited)

	<u>Capital Stock/ Participation Certificates</u>	<u>Retained Earnings Unallocated</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Members' Equity</u>
Balance at December 31, 2017	\$ 2,305,685	\$ 105,344,781	\$ (386,966)	\$ 107,263,500
Comprehensive income	-	2,648,304	3,081	2,651,385
Capital stock/participation certificates and allocated retained earnings issued	65,945	-	-	65,945
Capital stock/participation certificates and allocated retained earnings retired	(94,160)	-	-	(94,160)
Balance at March 31, 2018	<u>\$ 2,277,470</u>	<u>\$ 107,993,085</u>	<u>\$ (383,885)</u>	<u>\$ 109,886,670</u>
Balance at December 31, 2018	\$ 2,258,190	\$ 108,168,525	\$ 62,870	\$ 110,489,585
Comprehensive income	-	2,444,502	(5,118)	2,439,384
Capital stock/participation certificates and allocated retained earnings issued	78,205	-	-	78,205
Capital stock/participation certificates and allocated retained earnings retired	(76,235)	-	-	(76,235)
Balance at March 31, 2019	<u>\$ 2,260,160</u>	<u>\$ 110,613,027</u>	<u>\$ 57,752</u>	<u>\$ 112,930,939</u>

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

CENTRAL TEXAS FARM CREDIT, ACA
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

The Central Texas Farm Credit, ACA (Agricultural Credit Association), referred to as the Association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves the counties of Baylor, Brown, Callahan, Coke, Coleman, Comanche, Concho, Haskell, Irion, Jones, Knox, McCulloch, Menard, Mills, Regan, Runnels, San Saba, Sterling, and Tom Green in the State of Texas. The Association is a lending institution of the Farm Credit System (the System), which was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971 as amended.

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. (GAAP) for interim financial information. Accordingly, they do not include all of the disclosures required by GAAP for annual financial statements and should be read in conjunction with the audited financial statements as of and for the year ended December 31, 2018, as contained in the 2018 Annual Report to Stockholders.

In the opinion of management, the accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles (GAAP), except for the inclusion of a statement of cash flows. GAAP require a business enterprise that provides a set of financial statements reporting both financial position and results of operations to also provide a statement of cash flows for each period for which results of operations are provided. In regulations issued by FCA, associations have the option to exclude statements of cash flows in interim financial statements. Therefore, the Association has elected not to include a statement of cash flows in these consolidated financial statements. These interim financial statements should be read in conjunction with the audited financial statements as of and for the year ended December 31, 2018, as contained in the 2018 Annual Report to Stockholders. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year ending December 31, 2018. Descriptions of the significant accounting policies are included in the 2018 Annual Report to Stockholders. In the opinion of management, these policies and the presentation of the interim financial condition and results of operations conform with GAAP and prevailing practices within the banking industry.

In August 2018, the Financial Accounting Standards Board (FASB) issued guidance entitled “Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Cost.” The guidance aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by this guidance. This guidance becomes effective for interim and annual periods beginning after December 15, 2019. The guidance also requires an entity (customer) to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. It further specifies where to present expense and payments in the financial statements. Early adoption is permitted. The guidance is to be applied on a retrospective or prospective basis to all implementation costs incurred after the date of adoption. The Association is evaluating the impact of adoption on the Association’s financial condition and its results of operations.

In August 2018, the FASB issued guidance entitled “Disclosure Framework — Changes to the Disclosure Requirements for Defined Benefit Plans.” The guidance modifies the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. This guidance becomes effective for fiscal years ending after December 15, 2020. Early adoption is permitted. The guidance is to be applied on a retrospective basis for all periods. The adoption of this guidance will not impact the Association’s financial condition or its results of operations, but will impact the employee benefit plan disclosures.

In August 2018, the FASB issued guidance entitled “Disclosure Framework — Changes to the Disclosure Requirements for Fair Value Measurement.” The guidance modifies the requirements on fair value measurements by removing, modifying, or adding to the disclosures. This guidance becomes effective for interim and annual periods beginning after December 15, 2019. Early adoption is permitted and an entity is permitted to early adopt any removal or modified disclosures and delay adoption of the additional disclosures until their effective date. The adoption of this guidance will not impact the Association’s financial condition or its results of operations but will impact the fair value measurements disclosures. The Association early adopted the removal and modified disclosures during the fourth quarter of 2018.

In June 2016, the FASB issued guidance entitled “Measurement of Credit Losses on Financial Instruments.” The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-

sale securities would also be recorded through an allowance for credit losses. For public business entities that are not U.S. Securities and Exchange Commission filers this guidance becomes effective for interim and annual periods beginning after December 15, 2020, with early application permitted. The Association is evaluating the impact of adoption on its financial condition and results of operations.

In February 2016, the FASB issued guidance entitled “Leases.” The guidance requires the recognition by lessees of lease assets and lease liabilities on the balance sheet for the rights and obligations created by those leases. Leases with lease terms of more than 12 months are impacted by this guidance. The guidance and related amendments in this update became effective for interim and annual periods beginning after December 15, 2018, with early application permitted. The adoption of this guidance did not materially impact the Association’s financial condition and results of operations but did impact lease disclosures.

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

NOTE 2 — LOANS AND ALLOWANCE FOR LOAN LOSSES:

A summary of loans follows:

Loan Type	March 31, 2019 Amount	December 31, 2018 Amount
Production agriculture:		
Real estate mortgage	\$ 355,729,714	\$ 354,178,439
Production and intermediate term	77,100,053	76,764,413
Agribusiness:		
Processing and marketing	43,075,102	40,002,467
Farm-related business	14,885,715	16,073,468
Loans to cooperatives	3,409,359	2,287,400
Communication	10,399,672	10,459,954
Energy	8,810,038	9,073,421
Rural residential real estate	729,231	699,036
Total	<u>\$ 514,138,884</u>	<u>\$ 509,538,598</u>

The Association purchases or sells participation interests with other parties in order to diversify risk, manage loan volume, and comply with Farm Credit Administration regulations. The following table presents information regarding the balances of participations purchased and sold at March 31, 2019:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations	Participations	Participations	Participations	Participations	Participations
	Purchased	Sold	Purchased	Sold	Purchased	Sold
Production and intermediate term	\$ 17,979,256	\$ 10,731,240	\$ -	\$ -	\$ 17,979,256	\$ 10,731,240
Agribusiness	48,522,114	-	-	-	48,522,114	-
Communication	10,399,672	-	-	-	10,399,672	-
Energy	8,810,038	-	-	-	8,810,038	-
Real estate mortgage	6,576,807	11,528,059	-	-	6,576,807	11,528,059
Total	<u>\$92,287,887</u>	<u>\$22,259,299</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$92,287,887</u>	<u>\$22,259,299</u>

The Association is authorized under the Farm Credit Act to accept “advance conditional payments” (ACPs) from borrowers. To the extent the borrower’s access to such ACPs is restricted and the legal right of setoff exists, the ACPs are netted against the borrower’s related loan balance. Unrestricted advance conditional payments are included in other liabilities. ACPs are not insured, and interest is generally paid by the Association on such balances. Balances of ACPs were \$10,448 and \$10,576 at March 31, 2019, and December 31, 2018, respectively.

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

	<u>March 31,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
Nonaccrual loans:		
Real estate mortgage	\$ 1,330,242	\$2,025,718
Production and intermediate term	495,365	920,932
Energy	40,976	-
Total nonaccrual loans	1,866,583	2,946,650
Total nonperforming loans	1,866,583	2,946,650
Total nonperforming assets	\$ 1,866,583	\$2,946,650

One credit quality indicator utilized by the Association is the Farm Credit Administration Uniform Loan Classification System that categorizes loans into five categories. The categories are defined as follows:

- Acceptable – assets are expected to be fully collectible and represent the highest quality;
- Other assets especially mentioned (OAEM) – assets are currently collectible but exhibit some potential weakness;
- Substandard – assets exhibit some serious weakness in repayment capacity, equity, and/or collateral pledged on the loan;
- Doubtful – assets exhibit similar weaknesses to substandard assets; however, doubtful assets have additional weaknesses in existing factors, conditions, and values that make collection in full highly questionable; and
- Loss – assets are considered uncollectible.

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

	March 31, 2019		December 31, 2018	
Real estate mortgage				
Acceptable	94.7	%	94.5	%
OAEM	4.7		4.7	
Substandard/doubtful	0.6		0.8	
	100.0		100.0	
Production and intermediate term				
Acceptable	93.7		91.8	
OAEM	5.4		6.5	
Substandard/doubtful	0.9		1.7	
	100.0		100.0	
Agribusiness				
Acceptable	100.0		100.0	
OAEM	-		-	
Substandard/doubtful	-		-	
	100.0		100.0	
Energy				
Acceptable	65.9		90.1	
OAEM	9.9		9.9	
Substandard/doubtful	24.2		-	
	100.0		100.0	
Communication				
Acceptable	100.0		100.0	
OAEM	-		-	
Substandard/doubtful	-		-	
	100.0		100.0	
Rural residential real estate				
Acceptable	100.0		100.0	
OAEM	-		-	
Substandard/doubtful	-		-	
	100.0		100.0	
Total loans				
Acceptable	94.8		94.7	
OAEM	4.2		4.5	
Substandard/doubtful	1.0		0.8	
	100.0	%	100.0	%

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

<u>March 31, 2019</u>	<u>30-89 Days Past Due</u>	<u>90 Days or More Past Due</u>	<u>Total Past Due</u>	<u>Not Past Due or Less Than 30 Days Past Due</u>	<u>Total Loans</u>	<u>Recorded Investment >90 Days and Accruing</u>
Real estate mortgage	\$ 3,828,197	\$ 1,058,793	\$ 4,886,990	\$ 355,587,887	\$ 360,474,877	\$ -
Production and intermediate term	435,787	59,578	495,365	77,703,387	78,198,752	-
Processing and marketing	-	-	-	43,166,092	43,166,092	-
Farm-related business	-	-	-	14,930,599	14,930,599	-
Communication	-	-	-	10,403,500	10,403,500	-
Energy	-	-	-	8,862,382	8,862,382	-
Loans to cooperatives	-	-	-	3,412,193	3,412,193	-
Rural residential real estate	-	-	-	731,791	731,791	-
Total	\$ 4,263,984	\$ 1,118,371	\$ 5,382,355	\$ 514,797,831	\$ 520,180,186	\$ -

<u>December 31, 2018</u>	<u>30-89 Days Past Due</u>	<u>90 Days or More Past Due</u>	<u>Total Past Due</u>	<u>Not Past Due or Less Than 30 Days Past Due</u>	<u>Total Loans</u>	<u>Recorded Investment >90 Days and Accruing</u>
Real estate mortgage	\$ 3,504,977	\$ 1,613,541	\$ 5,118,518	\$ 353,207,102	\$ 358,325,620	\$ -
Production and intermediate term	425,389	716,961	1,142,350	76,676,484	77,818,834	-
Processing and marketing	-	-	-	40,061,377	40,061,377	-
Farm-related business	-	-	-	16,135,257	16,135,257	-
Communication	-	-	-	10,461,413	10,461,413	-
Energy	-	-	-	9,089,359	9,089,359	-
Loans to cooperatives	-	-	-	2,286,708	2,286,708	-
Rural residential real estate	-	-	-	701,603	701,603	-
Total	\$ 3,930,366	\$ 2,330,502	\$ 6,260,868	\$ 508,619,303	\$ 514,880,171	\$ -

Note: The recorded investment in the receivable is the face amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, or acquisition costs, and may also reflect a previous direct write-down of the investment.

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

As of March 31, 2019, the Association had no troubled debt restructured loans. In structuring where principal is forgiven, the amount of forgiveness is immediately charged off. In restructurings where accrued interest is forgiven, the interest is reversed (if current year interest) or charged off (if prior year interest).

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

Additional impaired loan information is as follows:

	March 31, 2019			December 31, 2018		
	Recorded Investment	Unpaid Principal Balance ^a	Related Allowance	Recorded Investment	Unpaid Principal Balance ^a	Related Allowance
Impaired loans with a related allowance for credit losses:						
Real estate mortgage	\$ 248,905	\$ 264,774	\$ 5,000	\$ 264,667	\$ 264,774	\$ 15,526
Production and intermediate term Energy	-	-	-	-	-	-
	<u>40,976</u>	<u>40,976</u>	<u>66,667</u>	<u>-</u>	<u>-</u>	<u>66,667</u>
Total	<u>\$ 289,881</u>	<u>\$ 305,750</u>	<u>\$ 71,667</u>	<u>\$ 264,667</u>	<u>\$ 264,774</u>	<u>\$ 82,193</u>
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	\$1,081,337	\$1,081,337	\$ -	\$1,761,051	\$1,767,651	\$ -
Production and intermediate term Energy	495,365	2,620,054	-	920,932	3,044,947	-
	-	-	-	-	-	-
Total	<u>\$1,576,702</u>	<u>\$3,701,391</u>	<u>\$ -</u>	<u>\$2,681,983</u>	<u>\$4,812,598</u>	<u>\$ -</u>
Total impaired loans:						
Real estate mortgage	\$1,330,242	\$1,346,111	\$ 5,000	\$2,025,718	\$2,032,425	\$ 15,526
Production and intermediate term Energy	495,365	2,620,054	-	920,932	3,044,947	-
	40,976	40,976	66,667	-	-	66,667
Total	<u>\$1,866,583</u>	<u>\$4,007,141</u>	<u>\$ 71,667</u>	<u>\$2,946,650</u>	<u>\$5,077,372</u>	<u>\$ 82,193</u>

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

	For the Quarter & Year Ended March 31, 2019		For the Quarter & Year Ended March 31, 2018	
	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:				
Real estate mortgage	\$ 263,966	\$ -	\$ -	\$ -
Production and intermediate term Energy	-	-	-	-
	<u>1,366</u>	<u>-</u>	<u>95,808</u>	<u>235</u>
Total	<u>\$ 265,332</u>	<u>\$ -</u>	<u>\$ 95,808</u>	<u>\$ 235</u>
Impaired loans with no related allowance for credit losses:				
Real estate mortgage	\$1,081,337	\$ -	\$1,576,209	\$ 1,667
Production and intermediate term Energy	545,631	-	1,933,983	366
	-	-	-	-
Total	<u>\$1,626,968</u>	<u>\$ -</u>	<u>\$3,510,192</u>	<u>\$ 2,033</u>
Total impaired loans:				
Real estate mortgage	\$1,345,303	\$ -	\$1,576,209	\$ 1,667
Production and intermediate term Energy	545,631	-	1,933,983	366
	1,366	-	95,808	235
Total	<u>\$1,892,300</u>	<u>\$ -</u>	<u>\$3,606,000</u>	<u>\$ 2,268</u>

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

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communications	Energy	Rural Residential Real Estate	Total
Allowance for Credit Losses:							
Balance at December 31, 2018	\$ 317,464	\$ 379,003	\$ 203,931	\$ 43,278	\$ 68,997	\$ 211	\$ 1,012,884
Charge-offs	(15,761)	(673)	-	-	-	-	(16,434)
Recoveries	-	-	-	-	-	-	-
Provision for loan losses	(382)	(21,580)	15,044	3,867	127,620	111	124,680
Other	367	(2)	3,358	(154)	1,557	-	5,126
Balance at March 31, 2019	\$ 301,688	\$ 356,748	\$ 222,333	\$ 46,991	\$ 198,174	\$ 322	\$ 1,126,256
Ending Balance:							
Individually evaluated for impairment	\$ 5,000	\$ -	\$ -	\$ -	\$ 66,667	\$ -	\$ 71,667
Collectively evaluated for impairment	296,688	356,748	222,333	46,991	131,507	322	1,054,589
Balance at March 31, 2019	\$ 301,688	\$ 356,748	\$ 222,333	\$ 46,991	\$ 198,174	\$ 322	\$ 1,126,256
Balance at							
December 31, 2017	\$ 252,274	\$ 414,969	\$ 256,914	\$ 51,606	\$ 312,302	\$ 916	\$ 1,288,981
Charge-offs	-	(17,992)	-	-	-	-	(17,992)
Recoveries	52,508	-	-	-	-	-	52,508
Provision for loan losses	(67,336)	(32,891)	(5,489)	(2,462)	179,476	(229)	71,069
Other	4	(23,575)	10,448	237	(24,301)	251	(36,936)
Balance at March 31, 2018	\$ 237,450	\$ 340,511	\$ 261,873	\$ 49,381	\$ 467,477	\$ 938	\$ 1,357,630
Ending Balance:							
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ 387,185	\$ -	\$ 387,185
Collectively evaluated for impairment	237,450	340,511	261,873	49,381	80,292	938	970,445
Balance at March 31, 2018	\$ 237,450	\$ 340,511	\$ 261,873	\$ 49,381	\$ 467,477	\$ 938	\$ 1,357,630
Recorded Investments in Loans Outstanding:							
Ending Balance at							
March 31, 2019	\$360,474,877	\$ 78,198,752	\$61,508,884	\$ 10,403,500	\$ 8,862,382	\$ 731,791	\$520,180,186
Individually evaluated for impairment	\$ 1,371,218	\$ 495,365	\$ -	\$ -	\$ -	\$ -	\$ 1,866,583
Collectively evaluated for impairment	\$359,103,659	\$ 77,703,387	\$61,508,884	\$ 10,403,500	\$ 8,862,382	\$ 731,791	\$518,313,603
Ending Balance at							
March 31, 2018	\$344,376,773	\$ 64,949,585	\$60,884,206	\$ 11,262,240	\$ 11,215,460	\$1,175,671	\$493,863,935
Individually evaluated for impairment	\$ 1,642,794	\$ 1,841,386	\$ -	\$ -	\$ 1,499,990	\$ -	\$ 4,984,170
Collectively evaluated for impairment	\$342,733,979	\$ 63,108,199	\$60,884,206	\$ 11,262,240	\$ 9,715,470	\$1,175,671	\$488,879,765

NOTE 3 — CAPITAL:

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

Regulatory Capitalization Requirements

Risk-adjusted:	Regulatory Minimums	Conservation Buffer	Total	As of March 31, 2019	
Common equity tier 1 ratio	4.50%	2.50%	7.00%	18.71%	
Tier 1 capital ratio	6.00%	2.50%	8.50%	18.71%	
Total capital ratio	8.00%	2.50%	10.50%	18.93%	
Permanent capital ratio	7.00%	0.00%	7.00%	18.74%	
Non-risk-adjusted:					
Tier 1 leverage ratio	4.00%	1.00%	5.00%	19.82%	
UREE leverage ratio	1.50%	0.00%	1.50%	20.91%	

(dollars in thousands)	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
Numerator:				
Unallocated retained earnings	\$109,145,120	\$109,145,120	\$109,145,120	\$109,145,120
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	2,261,127	2,261,127	2,261,127	2,261,127
Allowance for loan losses and reserve for credit losses subject to certain limitations			1,243,267	
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	(7,958,049)	(7,958,049)	(7,958,049)	(7,958,049)
	\$ 103,448,198	\$ 103,448,198	\$ 104,691,465	\$ 103,448,198
Denominator:				
Risk-adjusted assets excluding allowance	\$560,989,585	\$560,989,585	\$560,989,585	\$560,989,585
Regulatory Adjustments and Deductions:				
Regulatory deductions included in total capital	(7,958,049)	(7,958,049)	(7,958,049)	(7,958,049)
Allowance for loan losses				(1,016,027)
	\$ 553,031,536	\$ 553,031,536	\$ 553,031,536	\$ 552,015,509

(dollars in thousands)	Tier 1 leverage ratio	UREE leverage ratio
Numerator:		
Unallocated retained earnings	\$109,145,120	\$109,145,120
Common Cooperative Equities:		
Statutory minimum purchased borrower stock	2,261,127	-
Regulatory Adjustments and Deductions:		
Amount of allocated investments in other System institutions	(7,958,049)	-
	\$ 103,448,198	\$ 109,145,120
Denominator:		
Total Assets	\$532,145,546	\$532,145,546
Regulatory Adjustments and Deductions:		
Regulatory deductions included in tier 1 capital	(10,105,868)	(10,105,868)
	\$ 522,039,678	\$ 522,039,678

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

Accum Other Comp Income (Loss)	
March 31, 2019	Net of Tax
Nonpension postretirement benefits	\$ (57,752)
Total	\$ (57,752)
March 31, 2018	Net of Tax
Nonpension postretirement benefits	\$ (383,885)
Total	\$ (383,885)

The Association's accumulated other comprehensive income (loss) relates entirely to its nonpension other postretirement benefits. Amortization of prior service credits and of actuarial loss are reflected in "Salaries and employee benefits" in the Consolidated Statement of Comprehensive Income. The following table summarizes the changes in accumulated other comprehensive income (loss) for the three months ended March 31:

	<u>2019</u>	<u>2018</u>
Accumulated other comprehensive income (loss) at January 1	\$ 62,870	\$(386,966)
Amortization of prior service credit included		
in salaries and employee benefits	(5,118)	(3,375)
Amortization of actuarial loss included		
in salaries and employee benefits	-	6,456
Other comprehensive income (loss), net of tax	<u>(5,118)</u>	<u>3,081</u>
Accumulated other comprehensive income at March 31	<u>\$ 57,752</u>	<u>\$(383,885)</u>

NOTE 4 — INCOME TAXES:

Central Texas Farm Credit, ACA conducts its business activities through two wholly-owned subsidiaries. Long-term mortgage lending activities are conducted through a wholly-owned FLCA subsidiary which is exempt from federal and state income tax. Short- and intermediate-term lending activities are conducted through a wholly-owned PCA subsidiary. The PCA subsidiary and the ACA holding company are subject to income tax. Central Texas Farm Credit, ACA operates as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, Central Texas Farm Credit, ACA can exclude from taxable income amounts distributed as qualified patronage dividends in the form of cash, stock, or allocated retained earnings. Provisions for income taxes are made only on those taxable earnings that will not be distributed as qualified patronage dividends. Deferred taxes are recorded at the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution and will therefore impact future tax payments. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (more than 50 percent probability), based on management's estimate, that they will not be realized. The Association's valuation allowance was \$678,379 as of the quarter ended March 31, 2019 for no available tax benefit as of that point in time.

NOTE 5 — FAIR VALUE MEASUREMENTS:

FASB guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 13 to the 2018 Annual Report to Stockholders for a more complete description.

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

<u>March 31, 2019</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>	<u>Total Gains (Losses)</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>		
Assets:					
Loans*	\$ -	\$ -	\$234,083	\$ 234,083	\$ -
Other property owned	-	-	-	-	-
<u>December 31, 2018</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>	<u>Total Gains (Losses)</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>		
Assets:					
Loans*	\$ -	\$ -	\$182,581	\$ 182,581	\$ -
Other property owned	-	-	-	-	-

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

Valuation Techniques

As more fully discussed in Note 2 to the 2018 Annual Report to Stockholders, authoritative guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following represent a brief summary of the valuation techniques used for the Association’s assets and liabilities. For a more complete description, see Notes to the 2018 Annual Report to Stockholders.

Loans Evaluated for Impairment

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

Other Property Owned

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

Cash

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

Loans

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

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

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

NOTE 6 — EMPLOYEE BENEFIT PLANS:

The following table summarizes the components of net periodic benefit costs of nonpension other postretirement employee benefits for the three months ended March 31:

	Other Benefits	
	2019	2018
Service cost	\$ 9,598	\$ 13,031
Interest cost	22,637	22,588
Amortization of prior service credits	(5,118)	(3,375)
Amortization of net actuarial loss	-	3,081
Net periodic benefit cost	<u>\$ 27,117</u>	<u>\$ 35,325</u>

The Association’s liability for the unfunded accumulated obligation for these benefits at March 31, 2019, was \$1,954,582 and is included in “Other Liabilities” in the balance sheet.

The components of net periodic benefit cost other than the service cost component are included in the line item "other components of net periodic postretirement benefit cost" in the income statement.

The structure of the district’s defined benefit pension plan is characterized as multiemployer since the assets, liabilities, and cost of the plan are not segregated or separately accounted for by participating employers (bank and associations). The Association recognizes its amortized annual contributions to the plan as an expense. The Association previously disclosed in its financial statements for the year ended December 31, 2018, that it expected to contribute \$57,666 to the District’s defined benefit pension plan in 2019. As of March 31, 2019, \$27,117 of contributions have been made. The Association presently anticipates contributing an additional \$81,345 to fund the defined benefit pension plan in 2018 for a total of \$108,462.

NOTE 7 — COMMITMENTS AND CONTINGENT LIABILITIES:

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

NOTE 8 — SUBSEQUENT EVENTS:

The Association has evaluated subsequent events through May 7, 2019, which is the date the financial statements were issued. There are no other significant events requiring disclosure as of May 7, 2019.