

**HERITAGE LAND BANK, ACA**

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**2020  
Quarterly Report  
Third Quarter**



**For the Quarter Ended September 30, 2020**

**REPORT OF MANAGEMENT**

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



Bill Tandy, Chief Executive Officer  
*October 28, 2020*



R. Scott Line, Chairman, Board of Directors  
*October 28, 2020*



Heath Gattis, Chief Financial Officer  
*October 28, 2020*

# *Third Quarter 2020 Financial Report*

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

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

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

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

### *Significant Events*

The Association's board of directors is committed to returning earnings in the form of a cooperative dividend. In January 2020, the board of directors declared a cash cooperative dividend of approximately \$3.8 million from 2019 profits that was paid March 11, 2020. The cooperative dividend equated to 70 basis points (0.7 percent). Including the cooperative dividend paid in 2020, the aggregate amount paid and allocated to its stockholders for the past 20 years exceeds \$51.7 million.

The United States has been operating under a presidentially declared emergency since March 13, 2020, due to the Coronavirus Disease 2019 (also referred to as COVID-19). The Association continues during these unprecedented times to fulfill its mission to support agriculture and rural communities by providing access to reliable and consistent credit. The Association has been able to maintain access to typical liquidity provided by the General Financing Agreement with Farm Credit Bank of Texas without significant changes to its funding strategies or interest rate risk profile. The Association is closely monitoring its loan portfolio overall and has remained consistent in its portfolio monitoring and servicing practices. The credit quality of the Association's loan portfolio continues to remain strong. Capital levels remained strong to support any adversity or increased loan demand.

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

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

### *Loan Portfolio*

Total loans outstanding at September 30, 2020, including nonaccrual loans and sales contracts, were \$591,952,070 compared to \$551,868,285 at December 31, 2019, reflecting an increase of 7.3 percent. Nonaccrual loans as a percentage of total loans outstanding were 0.2 percent and 0.1 percent at September 30, 2020 and December 31, 2019, respectively.

The Association recorded \$22,061 in recoveries and no charge-offs for the quarter ended September 30, 2020, and \$36,007 in recoveries and no charge-offs for the same period in 2019. The Association's allowance for loan losses was 0.9 percent and 1.0 percent of total loans outstanding as of September 30, 2020, and December 31, 2019, respectively.

## Risk Exposure

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

	September 30, 2020		December 31, 2019	
	Amount	%	Amount	%
Nonaccrual	\$ 953,428	30.8%	\$ 769,944	36.1%
90 days past due and still accruing interest	790,264	25.5%	-	0.0%
Formally restructured	273,424	8.8%	283,410	13.3%
Other property owned, net	1,077,925	34.9%	1,077,925	50.6%
Total	<u>\$ 3,095,041</u>	<u>100.0%</u>	<u>\$ 2,131,279</u>	<u>100.0%</u>

## Results of Operations

The Association had net income of \$2,202,944 and \$6,371,771 for the three and nine months ended September 30, 2020, as compared to net income of \$1,961,747 and \$5,748,550 for the same period in 2019, reflecting an increase of 12.3 percent and 10.8 percent, respectively. Net interest income was \$3,815,256 and \$11,385,199 for the three and nine months ended September 30, 2020, compared to \$3,669,890 and \$10,917,626 for the same period in 2019.

	Nine Months Ended			
	September 30, 2020		September 30, 2019	
	Average Balance	Interest	Average Balance	Interest
Loans	\$ 568,433,999	\$ 21,091,995	\$ 529,055,295	\$ 21,354,336
Investments	-	-	84,343	3,218
Total interest-earning assets	568,433,999	21,091,995	529,139,638	21,357,554
Interest-bearing liabilities	486,860,591	9,706,796	451,050,113	10,439,928
Impact of capital	<u>\$ 81,573,408</u>		<u>\$ 78,089,525</u>	
Net interest income		<u>\$ 11,385,199</u>		<u>\$ 10,917,626</u>
	2020		2019	
	Average Yield		Average Yield	
Yield on loans	4.96%		5.40%	
Yield on investments	0.00%		5.10%	
Total yield on interest-earning assets	4.96%		5.40%	
Cost of interest-bearing liabilities	2.66%		3.09%	
Interest rate spread	2.30%		2.31%	
Net interest income as a percentage of average earning assets	2.68%		2.76%	

	Three months ended:			Nine months ended:		
	September 30, 2020 vs. September 30, 2019			September 30, 2020 vs. September 30, 2019		
	Increase (decrease) due to			Increase (decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
Interest income - loans	\$ 460,065	\$ (1,021,371)	\$ (561,306)	\$ 1,590,901	\$ (1,853,242)	\$ (262,341)
Interest income - investments	-	-	-	(3,221)	3	(3,218)
Total interest income	460,065	(1,021,371)	(561,306)	1,587,680	(1,853,239)	(265,559)
Interest expense	239,876	(946,548)	(706,672)	829,629	(1,562,761)	(733,132)
Net interest income	<u>\$ 220,189</u>	<u>\$ (74,823)</u>	<u>\$ 145,366</u>	<u>\$ 758,051</u>	<u>\$ (290,478)</u>	<u>\$ 467,573</u>

Interest income for the three months ended September 30, 2020 decreased by \$561,306 or 7.7 percent, from the same period of 2019, primarily due to a decrease in interest rates despite an increase in average loan volume. Interest income for the nine months ended September 30, 2020 decreased by \$265,559, or 1.2 percent, from the same period of 2019, primarily due to a decrease in interest rates

despite an increase in average loan volume. Interest expense for the three and nine months ended September 30, 2020, decreased by \$706,672 and \$733,132, or 19.3 percent and 7.0 percent respectively, from the same period of 2019 due to a decrease in interest rates despite an increase in average debt volume. Average loan volume for the third quarter of 2020 was \$578,907,197, compared to \$544,611,499 in the third quarter of 2019. The average net interest rate spread on the loan portfolio for the third quarter of 2020 was 2.29 percent, compared to 2.23 percent in the third quarter of 2019.

The Association's return on average assets for the nine months ended September 30, 2020, was 1.46 percent compared to 1.42 percent for the same period in 2019. The Association's return on average equity for the nine months ended September 30, 2020, was 9.61 percent, compared to 9.09 percent for the same period in 2019.

#### *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.

	<b>September 30, 2020</b>	<b>December 31, 2019</b>
Note payable to the Bank	<b>\$ 508,966,879</b>	\$ 469,151,950
Accrued interest on note payable	<b>933,681</b>	1,208,494
Total	<b><u>\$ 509,900,560</u></b>	<b><u>\$ 470,360,444</u></b>

The Association operates under a general financing agreement (GFA) with the Bank. The current GFA is effective through September 30, 2023. The primary source of liquidity and funding for the Association is a direct loan from the Bank. The outstanding balance of \$509,900,560 as of September 30, 2020, is recorded as a liability on the Association's consolidated balance sheet. The note carried a weighted average interest rate of 2.34 percent at September 30, 2020. The indebtedness is collateralized by a pledge of substantially all of the Association's assets to the Bank and is governed by the GFA. The increase in note payable to the Bank and related accrued interest payable since December 31, 2019, is due to the Association's increase in loan volume. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were \$82,192,185 at September 30, 2020. The maximum amount the Association may borrow from the Bank as of September 30, 2020, was \$592,612,201 as defined by the GFA. The indebtedness continues in effect until the expiration date of the general financing agreement, which is September 30, 2023, unless sooner terminated by the Bank upon the occurrence of an event of default, or by the Association, in the event of a breach of this agreement by the Bank, upon giving the Bank 30 calendar days' prior written notice, or in all other circumstances, upon giving the Bank 120 days' prior written notice.

#### *Capital Resources*

The Association's capital position increased by \$3,372,562 at September 30, 2020, compared to December 31, 2019. The Association's debt as a percentage of members' equity was 5.73:1 as of September 30, 2020, compared to 5.50:1 as of December 31, 2019.

Farm Credit Administration regulations require us 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 September 30, 2020, the Association exceeded all regulatory capital requirements.

#### *Significant Recent Accounting Pronouncements*

In March 2020, the Financial Accounting Standards Board (FASB) issued guidance entitled "Facilitation of the Effects of Reference Rate Reform on Financial Reporting." The guidance provides optional expedients and exceptions for applying GAAP to contracts, hedging relationships, and other transactions affected by reference rate reform. The guidance simplifies the accounting evaluation of contract modifications that replace a reference rate affected by reference rate reform and contemporaneous modifications of other contracts related to the replacement of the reference rate. With respect to hedge accounting, the guidance allows amendment of formal designation and documentation of hedging relationships in certain circumstances as a result of reference rate reform and provides additional expedients for different types of hedges, if certain criteria are met. The optional amendments are effective as of March 12, 2020, through December 31, 2022. The Association is evaluating the impact of adoption on the Association's financial condition and its results of operations.

In December 2019, the FASB issued guidance entitled "Simplifying the Accounting for Income Taxes." This guidance eliminates certain intra period tax allocations, foreign deferred tax recognition, and interim period tax calculations. In addition, the guidance

simplifies disclosure regarding capital and franchise taxes, the allocation of goodwill in business combinations, subsidiary financial statements, and other disclosures. The new guidance is intended to eliminate and/or simplify certain aspects of income tax accounting that are complex or that require significant judgment in application or presentation. The guidance becomes effective for fiscal years beginning after December 15, 2021. Early adoption of the guidance is permitted, and the Association adopted this guidance on January 1, 2020. The adoption of this guidance did not materially impact the Association's financial condition or results of operations.

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

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

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

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

#### *Relationship With the Farm Credit Bank of Texas*

The Association's financial condition may be impacted by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect the stockholder's investment in the Association. The Management's Discussion and Analysis and Notes to Financial Statements contained in the 2019 Annual Report of Heritage Land Bank, 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](http://www.farmcreditbank.com).

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

**HERITAGE LAND BANK, ACA**  
**CONSOLIDATED BALANCE SHEET**

	<b>September 30, 2020 (unaudited)</b>	<b>December 31, 2019</b>
<b><u>ASSETS</u></b>		
Cash	\$ 25,237	\$ 216,467
Loans	591,952,070	551,868,285
Less: allowance for loan losses	5,263,710	5,246,590
Net loans	586,688,360	546,621,695
Accrued interest receivable	3,431,558	2,378,513
Investment in and receivable from the Farm Credit Bank of Texas:		
Capital stock	9,044,195	9,044,195
Other	1,899,733	1,025,489
Other property owned, net	1,077,925	1,077,925
Premises and equipment, net	4,075,975	4,027,666
Other assets	542,273	476,708
Total assets	<b>\$ 606,785,256</b>	<b>\$ 564,868,658</b>
<b><u>LIABILITIES</u></b>		
Note payable to the Farm Credit Bank of Texas	\$ 508,966,879	\$ 469,151,950
Advance conditional payments	-	(349)
Accrued interest payable	933,681	1,208,494
Drafts outstanding	34,620	582,291
Cooperative dividends payable	3,024,926	3,764,000
Other liabilities	3,611,019	3,320,703
Total liabilities	<b>516,571,125</b>	<b>478,027,089</b>
<b><u>MEMBERS' EQUITY</u></b>		
Capital stock and participation certificates	2,609,690	2,511,430
Allocated retained earnings	70	-
Unallocated retained earnings	87,730,174	84,453,728
Accumulated other comprehensive loss	(125,803)	(123,589)
Total members' equity	90,214,131	86,841,569
Total liabilities and members' equity	<b>\$ 606,785,256</b>	<b>\$ 564,868,658</b>

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



HERITAGE LAND BANK, ACA

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
<b><u>INTEREST INCOME</u></b>				
Loans	\$ 6,764,435	\$ 7,325,741	\$ 21,091,995	\$ 21,354,336
Investments	-	-	-	3,218
Total interest income	<u>6,764,435</u>	<u>7,325,741</u>	<u>21,091,995</u>	<u>21,357,554</u>
<b><u>INTEREST EXPENSE</u></b>				
Note payable to the Farm Credit Bank of Texas	2,949,179	3,655,851	9,706,796	10,439,860
Advance conditional payments	-	-	-	68
Total interest expense	<u>2,949,179</u>	<u>3,655,851</u>	<u>9,706,796</u>	<u>10,439,928</u>
Net interest income	<u>3,815,256</u>	<u>3,669,890</u>	<u>11,385,199</u>	<u>10,917,626</u>
<b><u>PROVISION FOR LOAN LOSSES</u></b>				
Net interest income after provision for loan losses	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>3,815,256</u>	<u>3,669,890</u>	<u>11,385,199</u>	<u>10,917,626</u>
<b><u>NONINTEREST INCOME</u></b>				
Income from the Farm Credit Bank of Texas:				
Patronage income	621,823	710,253	2,089,117	2,059,484
Loan fees	104,618	24,616	248,322	52,430
Refunds from Farm Credit System				
Insurance Corporation	-	-	132,471	115,187
Financially related services income	417	482	1,096	1,186
Gain on sale of premises and equipment, net	50,339	-	86,215	54,678
Other noninterest income	21,935	21,242	108,741	72,299
Total noninterest income	<u>799,132</u>	<u>756,593</u>	<u>2,665,962</u>	<u>2,355,264</u>
<b><u>NONINTEREST EXPENSES</u></b>				
Salaries and employee benefits	1,624,861	1,445,609	4,942,747	4,332,366
Directors' expense	39,844	78,185	156,405	225,029
Purchased services	86,243	120,469	341,232	339,733
Travel	59,876	92,193	199,810	239,598
Occupancy and equipment	191,149	200,646	564,813	656,528
Communications	31,543	36,590	111,998	120,406
Advertising	79,764	148,588	347,026	515,157
Public and member relations	48,587	85,225	317,947	411,287
Supervisory and exam expense	42,407	46,722	144,087	140,168
Insurance Fund premiums	139,809	108,981	346,107	316,107
Loss (gain) on sale of premises and equipment, net	17,873	(15,904)	50,052	761
Other noninterest expense	49,488	117,432	157,166	227,200
Total noninterest expenses	<u>2,411,444</u>	<u>2,464,736</u>	<u>7,679,390</u>	<u>7,524,340</u>
<b>NET INCOME</b>	<u>2,202,944</u>	<u>1,961,747</u>	<u>6,371,771</u>	<u>5,748,550</u>
Other comprehensive income:				
Change in postretirement benefit plans	(738)	(1,604)	(2,214)	(4,814)
<b>COMPREHENSIVE INCOME</b>	<u>\$ 2,202,206</u>	<u>\$ 1,960,143</u>	<u>\$ 6,369,557</u>	<u>\$ 5,743,736</u>

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

HERITAGE LAND BANK, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

(unaudited)

	Capital Stock/ Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
		Allocated	Unallocated		
Balance at December 31, 2018	\$ 2,397,570	\$ -	\$ 80,689,837	\$ 17,965	\$ 83,105,372
Comprehensive income	-	-	5,748,550	(4,814)	5,743,736
Capital stock/participation certificates issued	329,575	-	-	-	329,575
Capital stock/participation certificates retired	(225,680)	-	-	-	(225,680)
Cooperative dividends:					
Cash	-	-	(3,001,060)	-	(3,001,060)
Allocated retained earnings	-	-	-	-	-
Balance at September 30, 2019	<u>\$ 2,501,465</u>	<u>\$ -</u>	<u>\$ 83,437,327</u>	<u>\$ 13,151</u>	<u>\$ 85,951,943</u>
Balance at December 31, 2019	\$ 2,511,430	\$ -	\$ 84,453,728	\$ (123,589)	\$ 86,841,569
Comprehensive income	-	-	6,371,771	(2,214)	6,369,557
Capital stock/participation certificates issued	424,710	-	-	-	424,710
Capital stock/participation certificates retired	(326,450)	-	-	-	(326,450)
Cooperative dividends:					
Cash	-	-	(3,095,325)	-	(3,095,325)
Allocated retained earnings	-	70	-	-	70
Balance at September 30, 2020	<u>\$ 2,609,690</u>	<u>\$ 70</u>	<u>\$ 87,730,174</u>	<u>\$ (125,803)</u>	<u>\$ 90,214,131</u>

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

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

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

The Heritage Land Bank, ACA (Agricultural Credit Association), referred to as the Association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves the counties of Anderson, Angelina, Cherokee, Collin, Dallas, Henderson, Hunt, Nacogdoches, Panola, Rockwall, Rusk, Sabine, San Augustine, Shelby, Smith, and Tarrant in the state of Texas. The Association is a lending institution of the Farm Credit System (the System), which was established by Acts of Congress to meet the needs of American agriculture.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. (GAAP) for interim financial information. Accordingly, they do not include all of the disclosures required by GAAP for annual financial statements and should be read in conjunction with the audited consolidated financial statements as of and for the year ended December 31, 2019, as contained in the 2019 Annual Report to Stockholders.

In the opinion of management, the accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles (GAAP), except for the inclusion of a statement of cash flows. GAAP requires 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 the Farm Credit Administration, 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 consolidated financial statements should be read in conjunction with the audited consolidated financial statements as of and for the year ended December 31, 2019, as contained in the 2019 Annual Report to Stockholders. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year ending December 31, 2020. Descriptions of the significant accounting policies are included in the 2019 Annual Report to Stockholders. In the opinion of management, these policies and the presentation of the interim financial condition and results of operations conform with GAAP and prevailing practices within the banking industry.

In March 2020, the Financial Accounting Standards Board (FASB) issued guidance entitled “Facilitation of the Effects of Reference Rate Reform on Financial Reporting.” The guidance provides optional expedients and exceptions for applying GAAP to contracts, hedging relationships, and other transactions affected by reference rate reform. The guidance simplifies the accounting evaluation of contract modifications that replace a reference rate affected by reference rate reform and contemporaneous modifications of other contracts related to the replacement of the reference rate. With respect to hedge accounting, the guidance allows amendment of formal designation and documentation of hedging relationships in certain circumstances as a result of reference rate reform and provides additional expedients for different types of hedges, if certain criteria are met. The optional amendments are effective as of March 12, 2020, through December 31, 2022. The Association is evaluating the impact of adoption on the Association’s financial condition and its results of operations.

In December 2019, the FASB issued guidance entitled “Simplifying the Accounting for Income Taxes.” This guidance eliminates certain intra period tax allocations, foreign deferred tax recognition, and interim period tax calculations. In addition, the guidance simplifies disclosure regarding capital and franchise taxes, the allocation of goodwill in business combinations, subsidiary financial statements, and other disclosures. The new guidance is intended to eliminate and/or simplify certain aspects of income tax accounting that are complex or that require significant judgment in application or presentation. The guidance becomes effective for fiscal years beginning after December 15, 2021. Early adoption of the guidance is permitted, and the Association adopted this guidance on January 1, 2020. The adoption of this guidance did not materially impact the Association’s financial condition or results of operations.

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

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

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

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

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 September 30, 2020, are not necessarily indicative of the results to be expected for the year ended December 31, 2020. Certain amounts in the prior period’s financial statements have been reclassified to conform to current financial statement presentation.

**NOTE 2 — INVESTMENTS:**

*Held-to-Maturity Investments*

During 2019, the Association serviced one Farmer Mac loan until its full repayment at maturity during the second quarter of 2019. The Association did not carry a balance in an investment or Farmer Mac agricultural mortgage-backed securities as of September 30, 2020 and December 31, 2019.

**NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES:**

A summary of loans follows:

Loan Type	September 30, 2020 Amount	December 31, 2019 Amount
Production agriculture:		
Real estate mortgage	\$ 530,220,213	\$ 483,590,514
Production and intermediate term	17,281,879	15,320,383
Rural residential real estate	33,398,695	36,939,753
Agribusiness:		
Processing and marketing	10,864,426	14,746,708
Farm-related business	156,914	1,236,271
Loans to cooperatives	-	486
Lease receivables	29,943	34,170
Total	\$ 591,952,070	\$ 551,868,285

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 September 30, 2020:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
	Real estate mortgage	\$ 10,892,060	\$ 18,227,865	\$ -	\$ -	\$ 10,892,060
Production and intermediate term	3,802,762	-	-	-	3,802,762	-
Agribusiness	6,013,932	1,284,670	-	-	6,013,932	1,284,670
Total	<u>\$ 20,708,754</u>	<u>\$ 19,512,535</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 20,708,754</u>	<u>\$ 19,512,535</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 \$0 and (\$349) at September 30, 2020, and December 31, 2019, respectively.

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

	<u>September 30, 2020</u>	<u>December 31, 2019</u>
<b>Nonaccrual loans:</b>		
Real estate mortgage	\$ 903,148	\$ 769,944
Rural residential real estate	30,069	-
Production and intermediate term	20,211	-
Total nonaccrual loans	<u>953,428</u>	<u>769,944</u>
<b>Accruing restructured loans:</b>		
Real estate mortgage	273,424	283,410
Total accruing restructured loans	<u>273,424</u>	<u>283,410</u>
<b>Accruing loans 90 days or more past due:</b>		
Real estate mortgage	46,092	-
Rural residential real estate	744,172	-
Total accruing loans 90 days or more past due	<u>790,264</u>	<u>-</u>
Total nonperforming loans	2,017,116	1,053,354
Other property owned	1,077,925	1,077,925
Total nonperforming assets	<u>\$ 3,095,041</u>	<u>\$ 2,131,279</u>

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

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

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

	<b>September 30, 2020</b>	December 31, 2019
Real estate mortgage		
Acceptable	<b>98.2</b> %	98.7 %
OAEM	<b>1.4</b>	0.3
Substandard/doubtful	<b>0.4</b>	1.0
	<b>100.0</b>	100.0
Production and intermediate term		
Acceptable	<b>99.4</b>	99.0
OAEM	-	0.4
Substandard/doubtful	<b>0.6</b>	0.6
	<b>100.0</b>	100.0
Agribusiness		
Acceptable	<b>100.0</b>	100.0
OAEM	-	-
Substandard/doubtful	-	-
	<b>100.0</b>	100.0
Rural residential real estate		
Acceptable	<b>96.5</b>	99.8
OAEM	<b>3.4</b>	0.1
Substandard/doubtful	<b>0.1</b>	0.1
	<b>100.0</b>	100.0
Lease receivables		
Acceptable	<b>100.0</b>	100.0
OAEM	-	-
Substandard/doubtful	-	-
	<b>100.0</b>	100.0
Total loans		
Acceptable	<b>98.2</b>	98.8
OAEM	<b>1.4</b>	0.3
Substandard/doubtful	<b>0.4</b>	0.9
	<b>100.0</b> %	<b>100.0</b> %

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

September 30, 2020	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans	Recorded Investment >90 Days and Accruing
Real estate mortgage	\$ 698,657	\$ 811,642	\$ 1,510,299	\$ 531,769,035	\$ 533,279,334	\$ 46,092
Rural residential real estate	9,499	744,172	753,671	32,741,788	33,495,459	744,172
Production and intermediate term	41,797	20,211	62,008	17,459,921	17,521,929	-
Processing and marketing	-	-	-	10,899,098	10,899,098	-
Farm-related business	-	-	-	157,865	157,865	-
Lease receivables	-	-	-	29,943	29,943	-
<b>Total</b>	<b>\$ 749,953</b>	<b>\$ 1,576,025</b>	<b>\$ 2,325,978</b>	<b>\$ 593,057,650</b>	<b>\$ 595,383,628</b>	<b>\$ 790,264</b>

  

December 31, 2019	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans	Recorded Investment >90 Days and Accruing
Real estate mortgage	\$ 1,409,717	\$ 611,174	\$ 2,020,891	\$ 483,586,898	\$ 485,607,789	\$ -
Rural residential real estate	10,330	-	10,330	37,016,126	37,026,456	-
Production and intermediate term	46,781	-	46,781	15,469,051	15,515,832	-
Processing and marketing	-	-	-	14,810,796	14,810,796	-
Farm-related business	-	-	-	1,251,755	1,251,755	-
Lease receivables	-	-	-	34,170	34,170	-
<b>Total</b>	<b>\$ 1,466,828</b>	<b>\$ 611,174</b>	<b>\$ 2,078,002</b>	<b>\$ 552,168,796</b>	<b>\$ 554,246,798</b>	<b>\$ -</b>

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

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

As of September 30, 2020, the total recorded investment of troubled debt restructured loans was \$301,079, including \$27,655 classified as nonaccrual and \$273,424 classified as accrual, with no specific allowance for loan losses. As of September 30, 2020, commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring were \$0 at period end and \$18,645 at December 31, 2019.

In restructurings where principal is forgiven, the amount of the forgiveness is immediately charged off. In restructurings where accrued interest is forgiven, the interest is reversed (if current year interest) or charged off (if prior year interest). There were no TDR charge-offs recorded and no TDR defaults for the quarter ended September 30, 2020.

The predominant form of concession granted for troubled debt restructuring includes extensions and/or rearranging of terms. 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 we assess all of the modified terms to determine if the overall modification qualifies as a troubled debt restructuring.

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

	Loans Modified as TDRs		TDRs in Nonaccrual Status*	
	September 30, 2020	December 31, 2019	September 30, 2020	December 31, 2019
Real estate mortgage	\$ 301,079	\$ 318,269	\$ 27,655	\$ 34,859
<b>Total</b>	<b>\$ 301,079</b>	<b>\$ 318,269</b>	<b>\$ 27,655</b>	<b>\$ 34,859</b>

\* Represents the portion of loans modified as TDRs that are in nonaccrual status.

Additional impaired loan information is as follows:

	September 30, 2020			December 31, 2019		
	Recorded Investment	Unpaid Principal Balance <sup>a</sup>	Related Allowance	Recorded Investment	Unpaid Principal Balance <sup>a</sup>	Related Allowance
Impaired loans with a related allowance for credit losses:						
Real estate mortgage	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Rural residential real estate	-	-	-	-	-	-
Production and intermediate term	-	-	-	-	-	-
Total	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	\$ 1,222,664	\$ 1,220,261	\$ -	\$ 1,053,354	\$ 1,053,514	\$ -
Rural residential real estate	774,241	764,113	-	-	-	-
Production and intermediate term	20,211	20,211	-	-	-	-
Total	\$ 2,017,116	\$ 2,004,585	\$ -	\$ 1,053,354	\$ 1,053,514	\$ -
Total impaired loans:						
Real estate mortgage	\$ 1,222,664	\$ 1,220,261	\$ -	\$ 1,053,354	\$ 1,053,514	\$ -
Rural residential real estate	774,241	764,113	-	-	-	-
Production and intermediate term	20,211	20,211	-	-	-	-
Total	\$ 2,017,116	\$ 2,004,585	\$ -	\$ 1,053,354	\$ 1,053,514	\$ -

<sup>a</sup> Unpaid principal balance represents the recorded principal balance of the loan.

	For the Three Months Ended				For the Nine Months Ended			
	September 30, 2020		September 30, 2019		September 30, 2020		September 30, 2019	
	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:								
Real estate mortgage	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Rural residential real estate	-	-	-	-	-	-	-	-
Production and intermediate term	-	-	-	-	-	-	-	-
Total	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Impaired loans with no related allowance for credit losses:								
Real estate mortgage	\$ 932,637	\$ 8,353	\$ 629,303	\$ 6,691	\$ 635,714	\$ 29,634	\$ 629,127	\$ 21,052
Rural residential real estate	764,234	7,589	-	-	753,295	22,886	-	-
Production and intermediate term	7,644	7,827	-	-	2,600	15,223	-	-
Total	\$ 1,704,515	\$ 23,769	\$ 629,303	\$ 6,691	\$ 1,391,609	\$ 67,743	\$ 629,127	\$ 21,052
Total impaired loans:								
Real estate mortgage	\$ 932,637	\$ 8,353	\$ 629,303	\$ 6,691	\$ 635,714	\$ 29,634	\$ 629,127	\$ 21,052
Rural residential real estate	764,234	7,589	-	-	753,295	22,886	-	-
Production and intermediate term	7,644	7,827	-	-	2,600	15,223	-	-
Total	\$ 1,704,515	\$ 23,769	\$ 629,303	\$ 6,691	\$ 1,391,609	\$ 67,743	\$ 629,127	\$ 21,052



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	Rural Residential Real Estate	Lease Receivables	Mission-Related Investments	Total
<b>Allowance for Credit Losses:</b>								
Balance at June 30, 2020	\$ 2,429,067	\$ 1,264,830	\$ 1,573,584	\$ -	\$ 18,168	\$ -	\$ -	\$ 5,285,649
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	22,061	-	-	-	-	-	22,061
Provision for loan losses	-	-	-	-	-	-	-	-
Other	-	-	(44,000)	-	-	-	-	(44,000)
Balance at September 30, 2020	<u>\$ 2,429,067</u>	<u>\$ 1,286,891</u>	<u>\$ 1,529,584</u>	<u>\$ -</u>	<u>\$ 18,168</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,263,710</u>
Balance at December 31, 2019	\$ 2,429,067	\$ 1,200,931	\$ 1,593,584	\$ 4,840	\$ 18,168	\$ -	\$ -	\$ 5,246,590
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	81,120	-	-	-	-	-	81,120
Provision for loan losses	-	-	-	-	-	-	-	-
Other	-	4,840	(64,000)	(4,840)	-	-	-	(64,000)
Balance at September 30, 2020	<u>\$ 2,429,067</u>	<u>\$ 1,286,891</u>	<u>\$ 1,529,584</u>	<u>\$ -</u>	<u>\$ 18,168</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,263,710</u>
<b>Ending Balance:</b>								
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	2,429,067	1,286,891	1,529,584	-	18,168	-	-	5,263,710
Balance at September 30, 2020	<u>\$ 2,429,067</u>	<u>\$ 1,286,891</u>	<u>\$ 1,529,584</u>	<u>\$ -</u>	<u>\$ 18,168</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,263,710</u>
Balance at June 30, 2019	\$ 2,429,067	\$ 1,075,798	\$ 1,593,584	\$ 4,840	\$ 18,168	\$ -	\$ 2,744	\$ 5,124,201
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	36,007	-	-	-	-	-	36,007
Provision for loan losses	-	-	-	-	-	-	-	-
Other	-	50,000	-	-	-	-	-	50,000
Balance at September 30, 2019	<u>\$ 2,429,067</u>	<u>\$ 1,161,805</u>	<u>\$ 1,593,584</u>	<u>\$ 4,840</u>	<u>\$ 18,168</u>	<u>\$ -</u>	<u>\$ 2,744</u>	<u>\$ 5,210,208</u>
Balance at December 31, 2018	\$ 2,429,067	\$ 987,068	\$ 1,593,584	\$ 4,840	\$ 18,168	\$ -	\$ 2,744	\$ 5,035,471
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	124,737	-	-	-	-	-	124,737
Provision for loan losses	-	-	-	-	-	-	-	-
Other	-	50,000	-	-	-	-	-	50,000
Balance at September 30, 2019	<u>\$ 2,429,067</u>	<u>\$ 1,161,805</u>	<u>\$ 1,593,584</u>	<u>\$ 4,840</u>	<u>\$ 18,168</u>	<u>\$ -</u>	<u>\$ 2,744</u>	<u>\$ 5,210,208</u>
<b>Ending Balance:</b>								
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	2,429,067	1,161,805	1,593,584	4,840	18,168	-	2,744	5,210,208
Balance at September 30, 2019	<u>\$ 2,429,067</u>	<u>\$ 1,161,805</u>	<u>\$ 1,593,584</u>	<u>\$ 4,840</u>	<u>\$ 18,168</u>	<u>\$ -</u>	<u>\$ 2,744</u>	<u>\$ 5,210,208</u>
<b>Recorded Investments in Loans Outstanding:</b>								
Ending Balance at September 30, 2020	<u>\$ 533,279,334</u>	<u>\$ 17,521,929</u>	<u>\$ 11,056,963</u>	<u>\$ -</u>	<u>\$ 33,495,459</u>	<u>\$ 29,943</u>	<u>\$ -</u>	<u>\$ 595,383,628</u>
Individually evaluated for impairment	\$ 1,222,664	\$ 20,211	\$ -	\$ -	\$ 774,241	\$ -	\$ -	\$ 2,017,116
Collectively evaluated for impairment	<u>\$ 532,056,670</u>	<u>\$ 17,501,718</u>	<u>\$ 11,056,963</u>	<u>\$ -</u>	<u>\$ 32,721,218</u>	<u>\$ 29,943</u>	<u>\$ -</u>	<u>\$ 593,366,512</u>
<b>Ending Balance at</b>								
December 31, 2019	<u>\$ 485,607,789</u>	<u>\$ 15,515,832</u>	<u>\$ 16,062,551</u>	<u>\$ -</u>	<u>\$ 37,026,456</u>	<u>\$ 34,170</u>	<u>\$ -</u>	<u>\$ 554,246,798</u>
Individually evaluated for impairment	\$ 1,053,354	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,053,354
Collectively evaluated for impairment	<u>\$ 484,554,435</u>	<u>\$ 15,515,832</u>	<u>\$ 16,062,551</u>	<u>\$ -</u>	<u>\$ 37,026,456</u>	<u>\$ 34,170</u>	<u>\$ -</u>	<u>\$ 553,193,444</u>

**NOTE 4 — LEASES:**

The components of lease expense were as follows:

Classification	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Operating lease cost	\$ 34,787	\$ 44,000	\$ 110,356	\$ 138,749

Other information related to leases was as follows:

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Cash paid for amounts included in the measurement of lease liabilities:				
Operating cash flows from operating leases	\$ 34,787	\$ 44,000	\$ 110,356	\$ 138,749
Right-of-use assets obtained in exchange for lease obligations:				
Operating leases	-	-	-	-

Lease term and discount rate are as follows:

	September 30, 2020	September 30, 2019
Weighted average remaining lease term in years		
Operating leases	1.13	1.81
Weighted average discount rate		
Operating leases	2.84%	2.84%

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

	Operating Leases
2020 (excluding the nine months ended 9/30/20)	\$ 33,767
2021	87,162
2022	35,321
2023	15,680
2024	-
Thereafter	-
Total lease payments	<u>\$ 171,930</u>

## NOTE 5 — CAPITAL:

The Association's board of directors has established a Capital Adequacy Plan (Plan) that includes the capital targets that are necessary to achieve the 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 the Association's customer base; and any other risk-oriented activities, such as funding and interest rate risk, potential obligations under joint and several liability, contingent and off-balance-sheet liabilities or other conditions warranting additional capital. At least quarterly, management reviews the Association's goals and objectives with the board.

### Regulatory Capitalization Requirements

Risk-adjusted:	Regulatory Minimums	Conservation Buffer*	Total	As of September 30, 2020
Common equity tier 1 ratio	4.50%	2.50%	7.00%	14.10%
Tier 1 capital ratio	6.00%	2.50%	8.50%	14.10%
Total capital ratio	8.00%	2.50%	10.50%	15.06%
Permanent capital ratio	7.00%	0.00%	7.00%	14.23%
Non-risk-adjusted:				
Tier 1 leverage ratio	4.00%	1.00%	5.00%	13.64%
UREE leverage ratio	1.50%	0.00%	1.50%	14.75%

  

	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
Numerator:				
Unallocated retained earnings	\$ 85,980,962	\$ 85,980,962	\$ 85,980,962	\$ 85,980,962
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	2,567,021	2,567,021	2,567,021	2,567,021
Allocated equities:				
Nonqualified allocated equities not subject to retirement	(171)	(171)	(171)	(171)
Allowance for loan losses and reserve for credit losses subject to certain limitations	-	-	5,396,656	-
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	(9,044,195)	(9,044,195)	(9,044,195)	(9,044,195)
	\$ 79,503,617	\$ 79,503,617	\$ 84,900,273	\$ 79,503,617
Denominator:				
Risk-adjusted assets excluding allowance	\$ 572,957,445	\$ 572,957,445	\$ 572,957,445	\$ 572,957,445
Regulatory Adjustments and Deductions:				
Regulatory deductions included in total capital	(9,044,195)	(9,044,195)	(9,044,195)	(9,044,195)
Allowance for loan losses	-	-	-	(5,299,679)
	\$ 563,913,250	\$ 563,913,250	\$ 563,913,250	\$ 558,613,571

  

	Tier 1 leverage ratio	UREE leverage ratio
Numerator:		
Unallocated retained earnings	\$ 85,980,962	\$ 85,980,962
Common Cooperative Equities:		
Statutory minimum purchased borrower stock	2,567,021	-
Allocated equities:		
Nonqualified allocated equities not subject to retirement	(171)	(171)
Regulatory Adjustments and Deductions:		
Amount of allocated investments in other System institutions	(9,044,195)	-
Other regulatory required deductions	-	-
	\$ 79,503,617	\$ 85,980,791
Denominator:		
Total Assets	\$ 593,296,731	\$ 593,296,731
Regulatory Adjustments and Deductions:		
Regulatory deductions included in tier 1 capital	(10,393,927)	(10,393,927)
	\$ 582,902,804	\$ 582,902,804

An additional component of equity is accumulated other comprehensive income is as follows:

	Accumulated Other Comprehensive (Loss) Income	
	September 30, 2020	September 30, 2019
Nonpension postretirement benefits	\$ (125,803)	\$ 13,151

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

	<u>2020</u>	<u>2019</u>
Accumulated other comprehensive income (loss) at January 1	\$ (123,589)	\$ 17,965
Amortization of prior service credit included in salaries and employee benefits	(4,812)	(4,814)
Amortization of actuarial loss included in salaries and employee benefits	<u>2,598</u>	<u>-</u>
Other comprehensive loss	<u>(2,214)</u>	<u>(4,814)</u>
Accumulated other comprehensive (loss) income at September 30	<u>\$ (125,803)</u>	<u>\$ 13,151</u>

#### NOTE 6 — INCOME TAXES:

Heritage Land Bank, ACA conducts its business activities through two wholly-owned subsidiaries. Long-term mortgage lending activities are conducted through a wholly-owned FLCA subsidiary which is exempt from federal and state income tax. Short- and intermediate-term lending activities are conducted through a wholly-owned PCA subsidiary. The PCA subsidiary and the ACA holding company are subject to income tax. Heritage Land Bank, ACA operates as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, Heritage Land Bank, ACA can exclude from taxable income amounts distributed as qualified patronage dividends in the form of cash, stock or allocated retained earnings. Provisions for income taxes are made only on those taxable earnings that will not be distributed as qualified patronage dividends. Deferred taxes are recorded at the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the 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.

#### NOTE 7 — FAIR VALUE MEASUREMENTS:

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

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

<u>September 30, 2020</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Assets held in nonqualified benefit trusts	\$ 46,960	-	-	\$ 46,960
<u>December 31, 2019</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Assets held in nonqualified benefit trusts	\$ 36,607	-	-	\$ 36,607

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

<u>September 30, 2020</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:					
Other property owned	\$ -	-	1,077,925	\$ 1,077,925	-

  

<u>December 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:					
Other property owned	\$ -	-	1,077,925	\$ 1,077,925	-

### Uncertainty of Fair Value Measurements

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

### Valuation Techniques

As more fully discussed in Note 15 to the 2019 Annual Report to Stockholders, authoritative guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following represent a brief summary of the valuation techniques used for the Association's assets and liabilities. For a more complete description, see Note 15 to the 2019 Annual Report to Stockholders.

#### *Assets Held in Nonqualified Benefits Trusts*

Assets held in trust funds related to deferred compensation and supplemental retirement plans are classified within Level 1. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace.

#### *Standby Letters of Credit*

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

#### *Loans Evaluated for Impairment*

For certain loans evaluated for impairment under 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.

#### *Commitments to Extend Credit*

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

#### **NOTE 8 — EMPLOYEE BENEFIT PLANS:**

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

Three months ended September 30 :

	Other Benefits	
	2020	2019
Service cost	\$ 5,709	\$ 4,542
Interest cost	11,617	13,961
Amortization of prior service credits	(1,603)	(1,604)
Amortization of net actuarial loss	865	-
Net periodic benefit cost	<u>\$ 16,588</u>	<u>\$ 16,899</u>

Nine months ended September 30 :

	Other Benefits	
	2020	2019
Service cost	\$ 17,127	\$ 13,626
Interest cost	34,848	41,885
Amortization of prior service credits	(4,812)	(4,814)
Amortization of net actuarial loss	2,598	-
Net periodic benefit cost	<u>\$ 49,761</u>	<u>\$ 50,697</u>

The Association's liability for the unfunded accumulated obligation for these benefits at September 30, 2020, was \$1,390,390 and is included in "Other liabilities" on the balance sheet.

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

The defined benefit pension plan of the structure of the Bank and its related associations, collectively referred to as the "District," 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). As of September 30, 2020, no contributions have been made to the defined benefit pension plan. The Association recognizes its amortized annual contributions to the plan as an expense. There are no expected contributions to the District's defined pension plan during 2020.

#### **NOTE 9 — COMMITMENTS AND CONTINGENT LIABILITIES:**

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

**NOTE 10 — SUBSEQUENT EVENTS:**

The Association has evaluated subsequent events through October 28, 2020, which is the date the financial statements were issued. There are no other significant events requiring disclosure as of October 28, 2020.