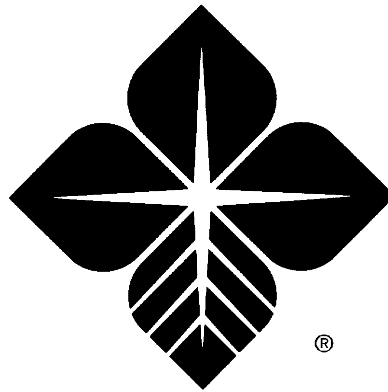
HERITAGE LAND BANK, ACA

2019
Quarterly Report
Third Quarter



For the Quarter Ended September 30, 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.

Bill Tandy, Chief Executive Officer
November 4, 2019

R. Scott Line, Chairman, Board of Directors
November 4, 2019

Heath Gattis, Chief Financial Officer
November 4, 2019

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, 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 Association 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 patronage distribution. In January 2019, the Board of Directors declared a cash patronage distribution of approximately $3.5 million from 2018 profits that was paid March 21, 2019. The patronage distribution equated to 70 basis points (0.7 percent). Including the patronage paid in 2019, the aggregate amount paid and allocated to its stockholders for the past 20 years exceeds $47.9 million.

Loan Portfolio:

Total loans outstanding at September 30, 2019, including nonaccrual loans and sales contracts, were $548,451,944 compared to $511,650,491 at December 31, 2018, reflecting an increase of 7.2 percent. Nonaccrual loans as a percentage of total loans outstanding were less than 0.1 percent at September 30, 2019 and December 31, 2018.

The Association recorded $36,007 in recoveries and no charge-offs for the quarter ended September 30, 2019, and $41,382 in recoveries and no charge-offs for the same period in 2018. The Association's allowance for loan losses was 0.9 percent and 1.0 percent of total loans outstanding as of September 30, 2019, and December 31, 2018, 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, 2019		December 31, 2018	
	Amount	**%**	Amount	%
Nonaccrual	**$ 391,381**	**22.3%**	$ 330,545	18.8%
Formally restructured	**284,992**	**16.3%**	347,652	19.8%
Other property owned, net	**1,077,925**	**61.4%**	1,077,925	61.4%
Total	**$ 1,754,298**	**100.0%**	$ 1,756,122	100.0%

Investments:

During the third quarter of 2019, the Association did not exchange any additional mortgage loans that previously were covered under a long-term standby commitment to purchase agreement with Federal Agricultural Mortgage Corporation (Farmer Mac) for a Farmer Mac guaranteed agricultural mortgage-backed security. The Association serviced one Farmer Mac loan until its full payment at maturity during the second quarter of 2019 and no longer carries this balance on the consolidated balance sheet.

Results of Operations:

The Association had net income of $1,961,747 and $5,748,550 for the three and nine months ended September 30, 2019, as compared to net income of $2,647,621 and $6,097,144 for the same period in 2018, reflecting decreases of 25.9 and 6.1 percent, respectively. Net interest income was $3,669,890 and $10,917,626 for the three and nine months ended September 30, 2019, compared to $3,467,813 and $10,183,312 for the same period in 2018.

	Nine Months Ended			
	September 30, 2019		September 30, 2018	
	Average Balance	**Interest**	Average Balance	Interest
Loans	**$ 529,055,295**	**$ 21,354,336**	$ 486,567,663	$ 18,544,958
Investments	**84,343**	**3,218**	247,051	10,243
Total interest-earning assets	**529,139,638**	**21,357,554**	486,814,714	18,555,201
Interest-bearing liabilities	**451,050,113**	**10,439,928**	412,741,578	8,371,889
Impact of capital	**$ 78,089,525**		$ 74,073,136	
Net interest income		**$ 10,917,626**		$ 10,183,312

	2019 Average Yield	2018 Average Yield
Yield on loans	**5.40%**	5.10%
Yield on investments	**5.10%**	5.54%
Total yield on interest-earning assets	**5.40%**	5.10%
Cost of interest-bearing liabilities	**3.09%**	2.71%
Interest rate spread	**2.31%**	2.39%
Net interest income as a percentage of average earning assets	**2.76%**	2.80%

	Nine Months Ended September 30, 2019 vs. September 30, 2018		
	Increase (decrease) due to		
	Volume	**Rate**	**Total**
Interest income - loans	**$ 1,619,349**	**$ 1,190,029**	**$ 2,809,378**
Interest income - investments	**(6,746)**	**(279)**	**(7,025)**
Total interest income	**1,612,603**	**1,189,750**	**2,802,353**
Interest expense	**777,031**	**1,291,008**	**2,068,039**
Net interest income	**$ 835,572**	**$ (101,258)**	**$ 734,314**

Interest income for the three and nine months ended September 30, 2019, increased by $815,944 and $2,802,353, or 12.5 and 15.1 percent respectively, from the same period of 2018, primarily due to an increase in average loan volume. Interest expense for the three and nine months ended September 30, 2019, increased by $613,867 and $2,068,039, or 20.2 and 24.7 percent, from the same period of 2018 due to an increase in interest rates in conjunction with an increase in average debt volume. Average loan volume for the third quarter of 2019 was $544,611,499, compared to $499,338,831 in the third quarter of 2018. The average net interest rate spread on the loan portfolio for the third quarter of 2019 was 2.23 percent, compared to 2.34 percent in the third quarter of 2018.

The Association's return on average assets for the nine months ended September 30, 2019, was 1.42 percent compared to 1.41 percent for the same period in 2018. The Association's return on average equity for the nine months ended September 30, 2019, was 9.09 percent, compared to 8.72 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.

		September 30, 2019		December 31, 2018
Note payable to the Bank	**$**	**469,398,932**	$	433,622,808
Accrued interest on note payable		**1,180,122**		1,093,909
Total	**$**	**470,579,054**	$	434,716,717

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 $469,398,932 as of September 30, 2019, is recorded as a liability on the Association's balance sheet. The note carried a weighted average interest rate of 3.06 percent at September 30, 2019. 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 the note payable to the Bank and related accrued interest payable since December 31, 2018, 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 $78,199,167 at September 30, 2019. The maximum amount the Association may borrow from the bank as of September 30, 2019, was $547,658,108 as defined by the GFA. 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.

Capital Resources:

The Association's capital position increased by $2,846,571 at September 30, 2019, compared to December 31, 2018. The Association's debt as a percentage of members' equity was 5.54:1 as of September 30, 2019, compared to 5.31:1 as of December 31, 2018.

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, 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 August 2017, the FASB issued guidance entitled "Targeted Improvements to Accounting for Hedging Activities." The guidance better aligns an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. The amendments in this guidance require an entity to present the earnings effect of the hedging instrument in the same income statement line item in which the earnings effect of the hedged item is reported. This guidance also addresses the timing of effectiveness testing, qualitative and quantitative effectiveness testing and components that can be excluded from effectiveness testing. This guidance became effective for interim and annual periods beginning after December 15, 2018. The adoption of this guidance did not materially impact the Association's financial condition or its results of operations but did impact the derivative 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. The Association adopted this guidance on January 1, 2019 and upon adoption, recorded right of use assets and lease liability in the amount of $374,615.

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 Heritage Land Bank, ACA more fully describe the Association's relationship with the Bank.

The Texas Farm Credit District's (District) annual and quarterly stockholder reports, as well as those 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 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.* Copies of the Association's quarterly stockholder reports can also be requested by e-mailing *stephanie.king@heritagelandbank.com.*

HERITAGE LAND BANK, ACA

CONSOLIDATED BALANCE SHEETS

	September 30, 2019 (unaudited)	December 31, 2018
ASSETS		
Cash	**$ 670,015**	$ 1,344,622
Investments	**-**	183,684
Loans	**548,451,944**	511,650,491
Less: allowance for loan losses	**5,210,208**	5,035,471
Net loans	**543,241,736**	506,615,020
Accrued interest receivable	**2,760,414**	2,265,310
Investment in and receivable from the Farm Credit Bank of Texas:		
Capital stock	**8,283,735**	8,283,735
Other	**1,755,000**	408,925
Other property owned, net	**1,077,925**	1,077,925
Premises and equipment, net	**4,098,295**	3,615,673
Other assets	**520,744**	291,576
Total assets	**$ 562,407,864**	$ 524,086,470
LIABILITIES		
Note payable to the Farm Credit Bank of Texas	**$ 469,398,932**	$ 433,622,808
Advance conditional payments	**1,598**	11,997
Accrued interest payable	**1,180,122**	1,093,909
Drafts outstanding	**4,195**	71,561
Dividends payable	**2,788,734**	3,303,494
Other liabilities	**3,082,340**	2,877,329
Total liabilities	**476,455,921**	440,981,098
MEMBERS' EQUITY		
Capital stock and participation certificates	**2,501,465**	2,397,570
Unallocated retained earnings	**83,437,327**	80,689,837
Accumulated other comprehensive income	**13,151**	17,965
Total members' equity	**85,951,943**	83,105,372
Total liabilities and members' equity	**$ 562,407,864**	$ 524,086,470

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,	
	2019	2018	**2019**	2018
INTEREST INCOME				
Loans	**$ 7,325,741**	$ 6,506,984	**$ 21,354,336**	$ 18,544,958
Investments	**-**	2,813	**3,218**	10,243
Total interest income	**7,325,741**	6,509,797	**21,357,554**	18,555,201
INTEREST EXPENSE				
Note payable to the Farm Credit Bank of Texas	**3,655,851**	3,041,984	**10,439,860**	8,371,889
Advance conditional payments	**-**	-	**68**	-
Total interest expense	**3,655,851**	3,041,984	**10,439,928**	8,371,889
Net interest income	**3,669,890**	3,467,813	**10,917,626**	10,183,312
PROVISION FOR LOAN LOSSES	**-**	-	-	-
Net interest income after provision for loan losses	**3,669,890**	3,467,813	**10,917,626**	10,183,312
NONINTEREST INCOME				
Income from the Farm Credit Bank of Texas:				
Patronage income	**710,253**	588,401	**2,059,484**	1,675,374
Loan fees	**24,616**	14,173	**52,430**	9,500
Refunds from Farm Credit System Insurance Corporation	**-**	9	**115,187**	299,749
Financially related services income	**482**	530	**1,186**	1,431
Gain (loss) on other property owned, net	**15,904**	790,568	**(761)**	783,115
Gain (loss) on sale of premises and equipment, net	**-**	(232)	**54,678**	(232)
Other noninterest income	**21,242**	28,932	**72,299**	117,633
Total noninterest income	**772,497**	1,422,381	**2,354,503**	2,886,570
NONINTEREST EXPENSES				
Salaries and employee benefits	**1,445,609**	1,320,607	**4,332,366**	4,130,449
Directors' expense	**78,185**	56,343	**225,029**	188,932
Purchased services	**120,469**	80,608	**339,733**	283,213
Travel	**92,193**	56,910	**239,598**	177,860
Occupancy and equipment	**200,646**	195,480	**656,528**	538,517
Communications	**36,590**	44,933	**120,406**	131,262
Advertising	**148,588**	147,929	**515,157**	429,547
Public and member relations	**85,225**	87,490	**411,287**	413,482
Supervisory and exam expense	**46,722**	35,063	**140,168**	120,193
Insurance Fund premiums	**108,981**	103,714	**316,107**	300,493
Other noninterest expense	**117,432**	113,496	**227,200**	258,790
Total noninterest expenses	**2,480,640**	2,242,573	**7,523,579**	6,972,738
NET INCOME	**1,961,747**	2,647,621	**5,748,550**	6,097,144
Other comprehensive income:				
Change in postretirement benefit plans	**(1,604)**	(2,703)	**(4,814)**	(8,110)
COMPREHENSIVE INCOME	**$ 1,960,143**	$ 2,644,918	**$ 5,743,736**	$ 6,089,034

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 Unallocated	Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
Balance at December 31, 2017	$ 2,317,035	$ 76,156,072	$ (149,812)	$ 78,323,295
Net income	-	6,097,144	-	6,097,144
Other comprehensive income	-	-	(8,110)	(8,110)
Capital stock/participation certificates issued	311,645	-	-	311,645
Capital stock/participation certificates retired	(252,020)	-	-	(252,020)
Patronage distributions accrued	-	(2,475,000)	-	(2,475,000)
Balance at September 30, 2018	$ 2,376,660	$ 79,778,216	$ (157,922)	$ 81,996,954
Balance at December 31, 2018	$ 2,397,570	$ 80,689,837	$ 17,965	$ 83,105,372
Net income	-	5,748,550	-	5,748,550
Other comprehensive income	-	-	(4,814)	(4,814)
Capital stock/participation certificates issued	329,575	-	-	329,575
Capital stock/participation certificates retired	(225,680)	-	-	(225,680)
Patronage distributions accrued	-	(3,001,060)	-	(3,001,060)
Balance at September 30, 2019	**$ 2,501,465**	**$ 83,437,327**	**$ 13,151**	**$ 85,951,943**

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

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 (System), which was established by Acts of Congress to meet the needs of American agriculture.

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

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In August 2017, the FASB issued guidance entitled "Targeted Improvements to Accounting for Hedging Activities." The guidance better aligns an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. The amendments in this guidance require an entity to present the earnings effect of the hedging instrument in the same income statement line item in which the earnings effect of the hedged item is reported. This guidance also addresses the timing of effectiveness testing, qualitative

and quantitative effectiveness testing and components that can be excluded from effectiveness testing. This guidance became effective for interim and annual periods beginning after December 15, 2018. The adoption of this guidance did not materially impact the Association's financial condition or its results of operations but did impact the derivative 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. The Association adopted this guidance on January 1, 2019 and upon adoption, recorded right of use assets and a lease liability in the amount of $374,615.

The consolidated financial statements comprise the operations of the Association 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, 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 — INVESTMENTS:

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

	September 30, 2019				
	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**	**Weighted Average Yield**
Agricultural mortgage-backed securities	**$ -**	**$ -**	**$ -**	**$ -**	**- %**

	December 31, 2018				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	$ 183,684	$ -	$ (1,652)	$ 182,032	5.05%

The Association serviced one Farmer Mac loan until its full repayment at maturity during the second quarter of 2019.

NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES:

A summary of loans follows:

Loan Type	**September 30, 2019 Amount**	December 31, 2018 Amount
Production agriculture:		
Real estate mortgage	**$ 479,390,597**	$ 450,603,837
Production and intermediate term	**17,023,393**	14,547,184
Rural residential real estate	**35,758,621**	33,830,955
Agribusiness:		
Processing and marketing	**15,004,735**	10,924,542
Farm-related business	**1,138,576**	1,552,434
Loans to cooperatives	**100,486**	486
Lease receivables	**35,536**	39,445
Mission-related investments	**-**	151,608
Total	**$ 548,451,944**	$ 511,650,491

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, 2019:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	$ 2,679,312	$ 66,207,386	$ -	$ -	$ 2,679,312	$ 66,207,386
Agribusiness	11,504,737	1,284,670	-	-	11,504,737	1,284,670
Total	$ 14,184,049	$ 67,492,056	$ -	$ -	$ 14,184,049	$ 67,492,056

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 $1,598 and $11,997 at September 30, 2019, and December 31, 2018, respectively.

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

	September 30, 2019	December 31, 2018
Nonaccrual loans:		
Real estate mortgage	**$ 391,381**	$ 330,545
Total nonaccrual loans	**391,381**	330,545
Accruing restructured loans:		
Real estate mortgage	**284,992**	347,652
Total accruing restructured loans	**284,992**	347,652
Total nonperforming loans	**676,373**	678,197
Other property owned	**1,077,925**	1,077,925
Total nonperforming assets	**$ 1,754,298**	$ 1,756,122

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:

	September 30, 2019	December 31, 2018
Real estate mortgage		
Acceptable	**98.4** %	97.8 %
OAEM	**0.3**	0.7
Substandard/doubtful	**1.3**	1.5
	100.0	100.0
Production and intermediate term		
Acceptable	**99.1**	98.6
OAEM	**0.3**	0.5
Substandard/doubtful	**0.6**	0.9
	100.0	100.0
Agribusiness		
Acceptable	**100.0**	100.0
OAEM	**-**	-
Substandard/doubtful	**-**	-
	100.0	100.0
Rural residential real estate		
Acceptable	**99.8**	99.9
OAEM	**0.1**	-
Substandard/doubtful	**0.1**	0.1
	100.0	100.0
Lease receivables		
Acceptable	**100.0**	100.0
OAEM	**-**	-
Substandard/doubtful	**-**	-
	100.0	100.0
Mission-related investments		
Acceptable	**-**	100.0
OAEM	**-**	-
Substandard/doubtful	**-**	-
	-	100.0
Total loans		
Acceptable	**98.6**	98.1
OAEM	**0.3**	0.6
Substandard/doubtful	**1.1**	1.3
	100.0 %	100.0 %

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

September 30, 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	**$ 1,406,549**	**$ 236,450**	**$ 1,642,999**	**$ 480,089,881**	**$ 481,732,880**	**$ -**
Rural residential real estate	**278,385**	**-**	**278,385**	**35,569,981**	**35,848,366**	**-**
Production and intermediate term	**2,585**	**-**	**2,585**	**17,298,648**	**17,301,233**	**-**
Processing and marketing	**-**	**-**	**-**	**15,050,056**	**15,050,056**	**-**
Farm-related business	**-**	**-**	**-**	**1,143,713**	**1,143,713**	**-**
Loans to cooperatives	**-**	**-**	**-**	**100,574**	**100,574**	**-**
Lease receivables	**-**	**-**	**-**	**35,536**	**35,536**	**-**
Mission-related investments	**-**	**-**	**-**	**-**	**-**	**-**
Total	**$ 1,687,519**	**$ 236,450**	**$ 1,923,969**	**$ 549,288,389**	**$ 551,212,358**	**$ -**

December 31, 2018	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	$ 4,072,891	$ 44,008	$ 4,116,899	$ 448,348,541	$ 452,465,440	$ -
Rural residential real estate	61,330	-	61,330	33,843,698	33,905,028	-
Production and intermediate term	94,991	-	94,991	14,737,125	14,832,116	-
Processing and marketing	-	-	-	10,945,974	10,945,974	-
Farm-related business	-	-	-	1,575,493	1,575,493	-
Loans to cooperatives	-	-	-	485	485	-
Lease receivables	-	-	-	39,445	39,445	-
Mission-related investments	-	-	-	151,820	151,820	-
Total	$ 4,229,212	$ 44,008	$ 4,273,220	$ 509,642,581	$ 513,915,801	$ -

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 September 30, 2019, the total recorded investment of troubled debt restructured loans was $400,794, including $115,802 classified as nonaccrual and $284,992 classified as accrual, with no specific allowance for loan losses. As of September 30, 2019, commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring were $16,464 at period end and $9,268 at December 31, 2018.

In restructurings where principal is forgiven, the amount of the forgiveness is immediately charged off. In restructurings where accrued interest is forgiven, the interest is reversed (if current year interest) or charged off (if prior year interest). There were no charge-offs recorded at the modification date for the quarter ending September 30, 2019.

The predominant form of concession granted for troubled debt restructuring includes extension 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.

There were no loans that met the accounting criteria as a troubled debt restricting and that occurred within the previous 12 months of that year and for which there was a payment default during the period. A payment default is defined as a payment that is 30 days past due after the date the loan was restructured.

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

	Loans Modified as TDRs		TDRs in Nonaccrual Status*	
	September 30, 2019	December 31, 2018	**September 30, 2019**	December 31, 2018
Real estate mortgage	**$ 400,794**	$ 465,852	**$ 115,802**	$ 118,200
Total	**$ 400,794**	$ 465,852	**$ 115,802**	$ 118,200

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

Additional impaired loan information is as follows:

	September 30, 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	**$ -**	**$ -**	**$ -**	$ -	$ -	$ -
Total	**$ -**	**$ -**	**$ -**	$ -	$ -	$ -
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	**$ 676,373**	**$ 676,611**	**$ -**	$ 676,843	$ 684,905	$ -
Total	**$ 676,373**	**$ 676,611**	**$ -**	$ 676,843	$ 684,905	$ -
Total impaired loans:						
Real estate mortgage	**$ 676,373**	**$ 676,611**	**$ -**	$ 676,843	$ 684,905	$ -
Total	**$ 676,373**	**$ 676,611**	**$ -**	$ 676,843	$ 684,905	$ -

[a] Unpaid principal balance represents the recorded principal balance of the loan.

	For the Three Months Ended				For the Nine Months Ended			
	September 30, 2019		September 30, 2018		**September 30, 2019**		September 30, 2018	
	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	**$ -**	**$ -**	$ -	$ -	**$ -**	**$ -**	$ -	$ -
Production and intermediate term	**-**	**-**	-	-	**-**	**-**	-	-
Total	**$ -**	**$ -**	$ -	$ -	**$ -**	**$ -**	$ -	$ -
Impaired loans with no related allowance for credit losses:								
Real estate mortgage	**$ 629,303**	**$ 6,691**	$ 826,629	$ 9,952	**$ 629,127**	**$ 21,052**	$ 844,674	$ 27,241
Production and intermediate term	**-**	**-**	-	1,490	**-**	**-**	19	4,990
Total	**$ 629,303**	**$ 6,691**	$ 826,629	$ 11,442	**$ 629,127**	**$ 21,052**	$ 844,693	$ 32,231
Total impaired loans:								
Real estate mortgage	**$ 629,303**	**$ 6,691**	$ 826,629	$ 9,952	**$ 629,127**	**$ 21,052**	$ 844,674	$ 27,241
Production and intermediate term	**-**	**-**	-	1,490	**-**	**-**	19	4,990
Total	**$ 629,303**	**$ 6,691**	$ 826,629	$ 11,442	**$ 629,127**	**$ 21,052**	$ 844,693	$ 32,231

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
Allowance for Credit Losses:								
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
Other	-	50,000	-	-	-	-	-	50,000
Balance at September 30, 2019	$ 2,429,067	$ 1,161,805	$ 1,593,584	$ 4,840	$ 18,168	$ -	$ 2,744	$ 5,210,208
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
Other	-	50,000	-	-	-	-	-	50,000
Balance at September 30, 2019	$ 2,429,067	$ 1,161,805	$ 1,593,584	$ 4,840	$ 18,168	$ -	$ 2,744	$ 5,210,208
Ending Balance:								
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	$ 2,429,067	$ 1,161,805	$ 1,593,584	$ 4,840	$ 18,168	$ -	$ 2,744	$ 5,210,208
Balance at June 30, 2018	$ 2,429,067	$ 929,725	$ 1,619,584	$ 4,840	$ 18,168	$ -	$ 2,744	$ 5,004,128
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	41,382	-	-	-	-	-	41,382
Other	-	-	-	-	-	-	-	-
Balance at September 30, 2018	$ 2,429,067	$ 971,107	$ 1,619,584	$ 4,840	$ 18,168	$ -	$ 2,744	$ 5,045,510
Balance at December 31, 2017	$ 2,429,067	$ 826,461	$ 1,619,584	$ 4,840	$ 18,168	$ -	$ 2,744	$ 4,900,864
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	144,646	-	-	-	-	-	144,646
Other	-	-	-	-	-	-	-	-
Balance at September 30, 2018	$ 2,429,067	$ 971,107	$ 1,619,584	$ 4,840	$ 18,168	$ -	$ 2,744	$ 5,045,510
Ending Balance:								
Individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Collectively evaluated for impairment	2,429,067	971,107	1,619,584	4,840	18,168	-	2,744	5,045,510
Balance at September 30, 2018	$ 2,429,067	$ 971,107	$ 1,619,584	$ 4,840	$ 18,168	$ -	$ 2,744	$ 5,045,510

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communications	Rural Residential Real Estate	Lease Receivables	Mission-Related Investments	Total
Recorded Investments in Loans Outstanding:								
Ending Balance at September 30, 2019	$ 481,732,880	$ 17,301,233	$ 16,294,343	$ -	$ 35,848,366	$ 35,536	$ -	$ 551,212,358
Individually evaluated for impairment	$ -	$ -	$ 676,373	$ -	$ -	$ -	$ -	$ 676,373
Collectively evaluated for impairment	$ 481,732,880	$ 17,301,233	$ 15,617,970	$ -	$ 35,848,366	$ 35,536	$ -	$ 550,535,985
Ending Balance at December 31, 2018	$ 452,465,440	$ 14,832,116	$ 12,521,952	$ -	$ 33,905,028	$ 39,445	$ 151,820	$ 513,915,801
Individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Collectively evaluated for impairment	$ 452,465,440	$ 14,832,116	$ 12,521,952	$ -	$ 33,905,028	$ 39,445	$ 151,820	$ 513,915,801

NOTE 4 — LEASES:

Adoption of the leasing standard impacted our previously reported results as follows:

	Balance Sheet Classification	**As of September 30, 2019**	As Previously Reported December 31, 2018	Lease Standard Adjustment	As Restated January 1, 2019
Operating leases	Operating lease right-of-use asset	**$ 289,305**	$ -	$ 374,615	$ 374,615
Total lease assets		**$ 289,305**	$ -	$ 374,615	$ 374,615
Operating leases	Operating lease liabilities	**$ (289,305)**	$ -	$ (374,615)	$ (374,615)
Total lease liabilities		**$ (289,305)**	$ -	$ (374,615)	$ (374,615)

The components of lease expense were as follows:

Classification	For the Nine Months Ended September 30, 2019
Operating lease cost	$ 138,749
Net lease cost	$ 138,749

Other information related to leases was as follows:

	For the Nine Months Ended September 30, 2019
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases	$ 138,749

Lease term and discount rate are as follows:

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

Future minimum lease payments under non-cancellable leases as of September 30, 2019 were as follows:

	Operating Leases
2019 (excluding the nine months ended 9/30/19)	$ 38,975
2020	130,474
2021	55,592
2022	11,458
2023	-
Thereafter	-
Total	$ 236,499

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 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 September 30, 2019**	As of December 31, 2018
Common equity tier 1 ratio	4.50%	2.50%	7.00%	**14.50%**	15.15%
Tier 1 capital ratio	6.00%	2.50%	8.50%	**14.50%**	15.15%
Total capital ratio	8.00%	2.50%	10.50%	**15.50%**	16.20%
Permanent capital ratio	7.00%	0.00%	7.00%	**14.65%**	15.30%
Non-risk-adjusted:					
Tier 1 leverage ratio	4.00%	1.00%	5.00%	**13.89%**	14.56%
UREE leverage ratio	1.50%	0.00%	1.50%	**14.95%**	15.57%

September 30, 2019	**Common equity tier 1 ratio**	**Tier 1 capital ratio**	**Total capital ratio**	**Permanent capital ratio**
Numerator:				
Unallocated retained earnings	**$ 82,013,543**	**$ 82,013,543**	**$ 82,013,543**	**$ 82,013,543**
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	**2,472,730**	**2,472,730**	**2,472,730**	**2,472,730**
Allowance for loan losses and reserve for credit losses subject to certain limitations	**-**	**-**	**5,264,514**	**-**
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	**(8,283,735)**	**(8,283,735)**	**(8,283,735)**	**(8,283,735)**
	$ 76,202,538	**$ 76,202,538**	**$ 81,467,052**	**$ 76,202,538**
Denominator:				
Risk-adjusted assets excluding allowance	**$ 533,750,773**	**$ 533,750,773**	**$ 533,750,773**	**$ 533,750,773**
Regulatory Adjustments and Deductions:				
Regulatory deductions included in total capital	**(8,283,735)**	**(8,283,735)**	**(8,283,735)**	**(8,283,735)**
Allowance for loan losses	**-**	**-**	**-**	**(5,141,847)**
	$ 525,467,038	**$ 525,467,038**	**$ 525,467,038**	**$ 520,325,191**

December 31, 2018	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
Numerator:				
Unallocated retained earnings	$ 78,907,712	$ 78,907,712	$ 78,907,712	$ 78,907,712
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	2,382,481	2,382,481	2,382,481	2,382,481
Allowance for loan losses and reserve for credit losses subject to certain limitations	-	-	5,156,136	-
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	(7,537,465)	(7,537,465)	(7,537,465)	(7,537,465)
	$ 73,752,728	$ 73,752,728	$ 78,908,864	$ 73,752,728
Denominator:				
Risk-adjusted assets excluding allowance	$ 494,500,416	$ 494,500,416	$ 494,500,416	$ 494,500,416
Regulatory Adjustments and Deductions:				
Regulatory deductions included in total capital	(7,537,465)	(7,537,465)	(7,537,465)	(7,537,465)
Allowance for loan losses	-	-	-	(5,052,380)
	$ 486,962,951	$ 486,962,951	$ 486,962,951	$ 481,910,571

	September 30, 2019		December 31, 2018	
	Tier 1 leverage ratio	**UREE leverage ratio**	Tier 1 leverage ratio	UREE leverage ratio
Numerator:				
Unallocated retained earnings	**$ 82,013,543**	**$ 82,013,543**	$ 78,907,712	$ 78,907,712
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	**2,472,730**	**-**	2,382,481	-
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	**(8,283,735)**	**-**	(7,537,465)	-
	$ 76,202,538	**$ 82,013,543**	$ 73,752,728	$ 78,907,712
Denominator:				
Total Assets	**$557,989,932**	**$557,989,932**	$ 515,475,423	$ 515,475,423
Regulatory Adjustments and Deductions:				
Regulatory deductions included in tier 1 capital	**(9,416,944)**	**(9,416,944)**	(8,794,457)	(8,794,457)
	$ 548,572,988	**$ 548,572,988**	$ 506,680,966	$ 506,680,966

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

	Accumulated Other Comprehensive Income (Loss)	
	September 30, 2019	September 30, 2018
Nonpension postretirement benefits	**$ 13,151**	$ (157,922)

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 nine months ended September 30:

	2019	2018
Accumulated other comprehensive income (loss) at January 1	**$ 17,965**	$ (149,812)
Amortization of prior service credits included in salaries and employee benefits	**(4,814)**	(10,164)
Amortization of actuarial loss included in salaries and employee benefits	**-**	2,054
Other comprehensive loss	**(4,814)**	(8,110)
Accumulated other comprehensive income (loss) at September 30	**$ 13,151**	$ (157,922)

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 14 to the 2018 Annual Report to Stockholders for a more complete description.

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

September 30, 2019	**Fair Value Measurement Using**			**Total Fair**
	Level 1	**Level 2**	**Level 3**	**Value**
Assets:				
Assets held in nonqualified benefit trusts	**$ 34,552**	**-**	**-**	**$ 34,552**

December 31, 2018	Fair Value Measurement Using			Total Fair
	Level 1	Level 2	Level 3	Value
Assets:				
Assets held in nonqualified benefit trusts	$ 23,556	-	-	$ 23,556

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

September 30, 2019	**Fair Value Measurement Using**			**Total Fair**
	Level 1	**Level 2**	**Level 3**	**Value**
Assets:				
Other property owned	**$ -**	**-**	**1,077,925**	**$ 1,077,925**

December 31, 2018	Fair Value Measurement Using			Total Fair
	Level 1	Level 2	Level 3	Value
Assets:				
Other property owned	$ -	-	1,077,925	$ 1,077,925

Uncertainty of Fair Value Measurements

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

With regard to nonrecurring measurements for 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 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 14 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 Note 14 to the 2018 Annual Report to Stockholders.

Investment Securities

Where quoted prices are available in an active market, available-for-sale securities would be classified as Level 1. If quoted prices are not available in an active market, the fair value of securities is estimated using quoted prices for similar securities received from pricing services or discounted cash flows. Generally, these securities would be classified as Level 2. This would include U.S. Treasury, U.S. agency and certain mortgage-backed securities. Where there is limited activity or less transparency around inputs to the valuation, the securities are classified as Level 3. Securities classified within Level 3 include a small portion of asset-backed securities and certain mortgage-backed securities, including private label-FHA/VA securities and those issued by Farmer Mac.

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.

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 months and nine months ended September 30:

Three months ended September 30 :

	Other Benefits	
	2019	2018
Service cost	**$ 4,542**	$ 5,393
Interest cost	**13,961**	13,272
Amortization of prior service credits	**(1,604)**	(3,387)
Amortization of net actuarial loss	**-**	684
Net periodic benefit cost	**$ 16,899**	$ 15,962

Nine months ended September 30 :

	Other Benefits	
	2019	2018
Service cost	**$ 13,626**	$ 16,182
Interest cost	**41,885**	39,815
Amortization of prior service credits	**(4,814)**	(10,164)
Amortization of net actuarial loss	**-**	2,054
Net periodic benefit cost	**$ 50,697**	$ 47,887

The Association's liability for the unfunded accumulated obligation for these benefits at September 30, 2019, was $1,224,554 and is included in "Other liabilities" in the balance sheet.

The components of net periodic benefit cost other than amortization are included in the line item "Salaries and employee benefits" 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. There are no expected contributions to the District's defined pension plan during 2019.

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 November 4, 2019, which is the date the financial statements were issued. There are no other significant events requiring disclosure as of November 4, 2019.