

LEGACY AG CREDIT, ACA

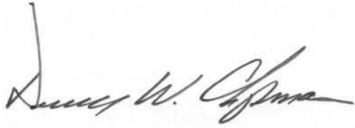
2023
Second quarter



For the Six Months Ended June 30, 2023

REPORT OF MANAGEMENT

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



Derrell W. Chapman, CPA, Chief Executive Officer
August 9, 2023



Terry Milligan, Chairman, Board of Directors
August 9, 2023



Heather Johnson, CPA, Chief Financial Officer
August 9, 2023

Second Quarter 2023 Financial Report

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LEGACY AG CREDIT, ACA
MANAGEMENT’S DISCUSSION AND ANALYSIS
(dollars in thousands, except as noted)

The following commentary reviews the financial performance of Legacy Ag Credit, ACA (association or Legacy), for the quarter ended June 30, 2023. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2022 Annual Report to Stockholders.

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

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

Significant Events

In January 2023, the board of directors approved a patronage payment of \$3,231,000 related to 2022 earnings, which was paid in March 2023.

With the help of the Farm Credit Bank of Texas (the bank or FCBT), Legacy underwent a conversion to FarmView, an enhancement in lending technology geared at bringing the association closer to our customers throughout the loan process. Significant time has been invested by lending staff, lending support staff and loan operations in training for this conversion, which occurred in June 2023.

Loan Portfolio

Total loans outstanding at June 30, 2023, including nonaccrual loans and sales contracts, were \$361,075,273 compared to \$363,932,965 at December 31, 2022, reflecting a decrease of 0.8%. Nonaccrual loans as a percentage of total loans outstanding were 0.81% at June 30, 2023, compared to 0.83% at December 31, 2022.

The association recorded \$4,142 in recoveries and \$0 in charge-offs for the quarter ended June 30, 2023, and \$900 in recoveries and \$0 in charge-offs for the same period in 2022. The association’s allowance for loan losses was 0.31% and 0.34% of total loans outstanding as of June 30, 2023, and December 31, 2022, 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.

	High-Risk Assets			
	June 30, 2023		December 31, 2022	
	Amount	%	Amount	%
Nonaccrual	\$ 2,942,739	100.0%	\$ 3,032,482	78.5%
Formally restructured	-	0.0%	833,006	21.5%
Total	\$ 2,942,739	100.0%	\$ 3,865,488	100.0%

Results of Operations

The association had net income of \$1,678,889 and \$3,360,775 for the three and six months ended June 30, 2023, as compared to net income of \$1,344,484 and \$2,595,759 for the same period in 2022, reflecting an increase of 24.9% and 29.5%. Net interest income was \$2,610,190 and \$5,436,875 for the three and six months ended June 30, 2023, compared to \$2,474,152 and \$4,885,542 for the same period in 2022.

	Six Months Ended			
	June 30, 2023		June 30, 2022	
	Average Balance	Interest	Average Balance	Interest
Loans	\$ 365,557,017	\$ 10,165,837	\$ 354,447,974	\$ 8,071,616
Interest-bearing liabilities	308,955,502	4,728,962	298,286,968	3,186,074
Impact of capital	<u>\$ 56,601,515</u>		<u>\$ 56,161,006</u>	
Net interest income		<u>\$ 5,436,875</u>		<u>\$ 4,885,542</u>

	2023	2022
	Average Yield	Average Yield
Yield on loans	5.61%	4.59%
Cost of interest-bearing liabilities	3.09%	2.15%
Interest rate spread	2.52%	2.44%
Net interest income as a percentage of average earning assets	3.00%	2.78%

	Six months ended: June 30, 2023 vs. June 30, 2022		
	Increase (decrease) due to		
	Volume	Rate	Total
Interest income - loans	\$ 252,978	\$ 1,841,243	\$ 2,094,221
Interest expense	113,956	1,428,932	1,542,888
Net interest income	<u>\$ 139,023</u>	<u>\$ 412,310</u>	<u>\$ 551,333</u>

Interest income for the three and six months ended June 30, 2023, increased by \$863,971 and \$2,094,221, or 20.8% and 26.0% respectively, from the same period of 2022, primarily due to increases in yields on earning assets and an increase in average loan volume. Interest expense for the three and six months ended June 30, 2023, increased by \$727,933 and \$1,542,888, or 43.1% and volume for the second quarter of 2023 was \$363,569,889, compared to \$358,479,681 in the second quarter of 2022. The average net interest rate spread on the loan portfolio for the second quarter of 2023 was 2.40%, compared to 2.42% in the second quarter of 2022.

The association's return on average assets for the six months ended June 30, 2023, was 1.79% compared to 1.43% for the same period in 2022. The association's return on average equity for the six months ended June 30, 2023, was 10.18%, compared to 8.14% for the same period in 2022.

Liquidity and Funding Sources

The association secures the majority of its lendable funds from FCBT, which obtains its funds through the issuance of System-wide obligations and with lendable equity. The following schedule summarizes the association's borrowings.

	June 30, 2023	December 31, 2022
Note payable to the bank	\$ 305,061,463	\$ 305,607,123
Accrued interest on note payable	802,722	742,186
Total	<u>\$ 305,864,185</u>	<u>\$ 306,349,309</u>

The association operates under a general financing agreement (GFA) with the bank. The current GFA is effective through September 30, 2023. The primary source of liquidity and funding for the association is a direct loan from the bank. The outstanding balance of \$305,061,463 as of June 30, 2023, is recorded as a liability on the association's balance sheet. The note carried a weighted average interest rate of 3.09 % at June 30, 2023. The indebtedness is collateralized by a pledge of substantially all of the association's assets to the bank and is governed by the general financing agreement. The decrease in note payable to the bank and increase in related accrued interest payable since December 31, 2022, is due to the association's decrease in loan volume coupled

with a higher weighted average interest rate. The association's own funds, which represent the amount of the association's loan portfolio funded by the association's equity, were \$52,441,575 at June 30, 2023. The maximum amount the association may borrow from the bank as of June 30, 2023, was \$356,428,731 as defined by the general financing agreement. The indebtedness continues in effect until the expiration date of the general financing agreement, which is September 30, 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. The Association has received a draft of a revised GFA and anticipates that a revised agreement will be approved by the board and executed prior to the expiration of the current GFA.

Capital Resources

The association's capital position increased by \$41,711 at June 30, 2023, compared to December 31, 2022 due to earnings offset by the establishment of a \$3,231,241 patronage payable during the first quarter of 2023 and a direct reduction to equity of \$74,000 at January 1, 2023 related to the cumulative effect of a change in accounting principle. The association's debt as a ratio of members' equity was 4.53:1 as of June 30, 2023, compared to 4.55:1 as of December 31, 2022.

Farm Credit Administration regulations require the association to maintain minimums for various regulatory capital ratios. New regulations became effective January 1, 2017, which replaced the previously required core surplus and total surplus ratios with common equity tier 1, tier 1 capital, and total capital risk-based capital ratios. The new regulations also added tier 1 leverage and unallocated retained earnings and equivalents (UREE) ratios. The permanent capital ratio continues to remain in effect, with some modifications to align with the new regulations. As of June 30, 2023, the association exceeded all regulatory capital requirements.

Significant Recent Accounting Pronouncements

Refer to Note 1 – "Organization and Significant Accounting Policies" in this quarterly report for disclosures of recent accounting pronouncements which may impact the association's consolidated financial position and results of operations and for critical accounting policies.

Relationship With the Farm Credit Bank of Texas

The association's financial condition may be impacted by factors that affect the bank. The financial condition and results of operations of the bank may materially affect the stockholder's investment in the association. The Management's Discussion and Analysis and Notes to Financial Statements contained in the 2022 Annual Report of Association more fully describe the association's relationship with the bank.

The annual and quarterly stockholder reports of the bank can be found at the bank's website at www.farmcreditbank.com.

The association's quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Legacy Ag Credit, ACA, 303 Connally St., Sulphur Springs, TX 75482 or calling (903) 885-9566. The annual and quarterly stockholder reports for the association are also available on its website at www.legacyaca.com. Copies of the association's quarterly stockholder reports can also be requested by e-mailing sherry.sturgis@legacyaca.com.

Legacy Ag Credit, ACA

CONSOLIDATED BALANCE SHEETS

	June 30, 2023 (unaudited)	December 31, 2022
<u>ASSETS</u>		
Cash	\$ 127,477	\$ 127,481
Loans	361,075,273	363,932,965
Less: allowance for loan losses	1,135,007	1,243,348
Net loans	<u>359,940,266</u>	<u>362,689,617</u>
Accrued interest receivable	2,398,445	1,808,462
Investment in and receivable from the Farm Credit Bank of Texas:		
Capital stock	6,016,770	6,016,770
Other	1,215,262	401,341
Premises and equipment, net	5,321,731	5,076,354
Other assets	272,151	240,754
Total assets	<u><u>\$ 375,292,102</u></u>	<u><u>\$ 376,360,779</u></u>
<u>LIABILITIES</u>		
Note payable to the Farm Credit Bank of Texas	\$ 305,061,463	\$ 305,607,123
Advance conditional payments	11,601	-
Accrued interest payable	802,722	742,186
Drafts outstanding	121,182	454,833
Other liabilities	1,457,439	1,760,653
Total liabilities	<u><u>307,454,407</u></u>	<u><u>308,564,795</u></u>
<u>MEMBERS' EQUITY</u>		
Capital stock and participation certificates	1,180,110	1,192,520
Non-qualified allocated retained earnings	22,858,251	21,076,255
Unallocated retained earnings	43,740,736	45,466,759
Accumulated other comprehensive income (loss)	58,598	60,450
Total members' equity	<u><u>67,837,695</u></u>	<u><u>67,795,984</u></u>
Total liabilities and members' equity	<u><u>\$ 375,292,102</u></u>	<u><u>\$ 376,360,779</u></u>

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

Legacy Ag Credit, ACA

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

	Quarter Ended		Six Months Ended	
	June 30,		June 30,	
	2023	2022	2023	2022
<u>INTEREST INCOME</u>				
Loans	5,027,619	4,163,648	10,165,837	8,071,616
<u>INTEREST EXPENSE</u>				
Note payable to the Farm Credit Bank of Texas	2,417,291	1,689,496	4,728,781	3,186,074
Advance conditional payments	138	-	181	-
Total interest expense	<u>2,417,429</u>	<u>1,689,496</u>	<u>4,728,962</u>	<u>3,186,074</u>
Net interest income	<u>2,610,190</u>	<u>2,474,152</u>	<u>5,436,875</u>	<u>4,885,542</u>
<u>PROVISION FOR LOAN LOSSES</u>				
	(80,684)	24,773	(167,332)	41,553
Net interest income after provision for loan losses	<u>2,690,874</u>	<u>2,449,379</u>	<u>5,604,207</u>	<u>4,843,989</u>
<u>NONINTEREST INCOME</u>				
Income from the Farm Credit Bank of Texas:				
Patronage income	529,548	520,053	1,089,328	1,020,608
Loan fees	63,789	140,838	130,948	248,515
Financially related services income	8	13	102	91
Gain (loss) on sale of premises and equipment, net	324,283	(5,135)	322,861	(5,135)
Other noninterest income	(2,130)	68,124	27,625	115,216
Total noninterest income	<u>915,498</u>	<u>723,893</u>	<u>1,570,864</u>	<u>1,379,295</u>
<u>NONINTEREST EXPENSES</u>				
Salaries and employee benefits	1,167,414	1,116,058	2,334,558	2,243,646
Directors' expense	68,578	58,932	128,091	140,790
Purchased services	134,133	139,624	253,351	274,227
Travel	54,086	66,940	111,649	137,198
Occupancy and equipment	164,824	148,937	319,842	281,793
Communications	29,752	24,091	58,435	46,485
Advertising	47,875	24,700	80,956	52,653
Public and member relations	54,373	21,732	97,493	52,118
Supervisory and exam expense	32,429	30,063	64,859	60,124
Insurance fund premiums	105,662	141,942	217,700	231,004
Other components of net periodic postretirement benefit cost	1,844	1,770	3,688	3,541
Other noninterest expense	66,513	53,999	143,674	103,946
Total noninterest expenses	<u>1,927,483</u>	<u>1,828,788</u>	<u>3,814,296</u>	<u>3,627,525</u>
Income before income taxes	<u>1,678,889</u>	<u>1,344,484</u>	<u>3,360,775</u>	<u>2,595,759</u>
NET INCOME	<u>1,678,889</u>	<u>1,344,484</u>	<u>3,360,775</u>	<u>2,595,759</u>
Other comprehensive income:				
Change in postretirement benefit plans	(926)	(391)	(1,852)	(782)
Other comprehensive income, net of tax	<u>(926)</u>	<u>(391)</u>	<u>(1,852)</u>	<u>(782)</u>
COMPREHENSIVE INCOME	<u>1,677,963</u>	<u>1,344,093</u>	<u>3,358,923</u>	<u>2,594,977</u>

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

Legacy Ag Credit, 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, 2021	\$ 1,171,860	\$ 20,081,509	\$ 43,660,726	\$ 1,412	\$ 64,915,507
Net income	-	-	2,595,759	-	2,595,759
Other comprehensive income	-	-	-	(782)	(782)
Capital stock/participation certificates and allocated retained earnings issued	122,245	-	-	-	122,245
Capital stock/participation certificates and allocated retained earnings retired	(81,370)	-	-	-	(81,370)
Patronage distributions declared:					
Cash	-	-	(2,845,692)	-	(2,845,692)
Nonqualified allocations	-	-	-	-	-
Balance at June 30, 2022	\$ 1,212,735	\$ 20,081,509	\$ 43,410,793	\$ 630	\$ 64,705,667
Balance at December 31, 2022	\$ 1,192,520	\$ 21,076,255	\$ 45,466,759	\$ 60,450	\$ 67,795,984
Net income	-	-	3,360,775	-	3,360,775
Other comprehensive income	-	-	-	(1,852)	(1,852)
Capital stock/participation certificates and allocated retained earnings issued	66,265	-	-	-	66,265
Capital stock/participation certificates and allocated retained earnings retired	(78,675)	-	-	-	(78,675)
Cumulative effect of CECL implementation		-	(74,032)	-	(74,032)
Patronage distributions declared:					
Cash	-	-	(3,230,770)	-	(3,230,770)
Nonqualified allocations	-	1,781,996	(1,781,996)	-	-
Balance at June 30, 2023	\$ 1,180,110	\$ 22,858,251	\$ 43,740,736	\$ 58,598	\$ 67,837,695

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

**ASSOCIATION NEW MODEL
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Unaudited (dollar amounts in thousands, except per share amounts and as otherwise noted)

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

Legacy 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 Franklin, Gregg, Harrison, Hopkins, Kaufman, Marion, Rains, Upshur, Van Zandt, and Wood 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 financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. (GAAP) for interim financial information. Accordingly, they do not include all of the disclosures required by GAAP for annual financial statements and should be read in conjunction with the audited financial statements as of and for the year ended December 31, 2022, as contained in the 2022 Annual Report to Stockholders.

In the opinion of management, the unaudited financial information is complete and reflects all adjustments, consisting of normal recurring adjustments, necessary for a fair statement of results for the interim periods. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year ending December 31, 2023. Descriptions of the significant accounting policies are included in the 2022 Annual Report to Stockholders. In the opinion of management, these policies and the presentation of the interim financial condition and results of operations conform with GAAP and prevailing practices within the banking industry.

Recently Adopted Accounting Pronouncements

The association adopted FASB guidance entitled “Measurement of Credit Losses on Financial Instruments” and other subsequently issued accounting standards updates related to credit losses on January 1, 2023. This guidance replaced the current incurred loss impairment methodology with a single allowance framework for financial assets carried at amortized cost and certain off-balance sheet credit exposures. This guidance requires management to consider in its estimate of the allowance for credit losses (ACL) relevant historical events, current conditions and reasonable and supportable forecasts that affect the collectability of the assets. In addition, the guidance amends existing impairment guidance for held-to-maturity and available-for-sale investments to incorporate an allowance for credit losses related to these securities, which will allow for the reversal of credit impairments in the event that the credit of an issuer improves.

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

The following table presents the impact to the allowance for credit losses and retained earnings upon adoption of this guidance on January 1, 2023:

	December 31, 2022		CECL adoption impact		January 1, 2023
Assets:					
Allowance for credit losses on loans	\$ 1,243,348	\$	34,787	\$	1,278,135
Liabilities:					
Allowance for credit losses on unfunded commitments	\$ -	\$	39,245	\$	39,245
Retained earnings:					
Unallocated retained earnings, net of tax	\$ 66,543,014	\$	74,032	\$	66,617,046

A. Loans and Allowance for Credit Losses

Loans are generally carried at their principal amount outstanding adjusted for charge-offs. Loan origination fees and direct loan origination costs that were netted and capitalized in prior years are amortized over the average life of the related loan as an adjustment to interest income. Loan prepayment fees are reported in interest income. Interest on loans is accrued and credited to interest income based on the daily principal amount outstanding.

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

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

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

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

Loan Modifications to Borrowers Experiencing Financial Difficulty

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

Collateral dependent loans

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

Allowance for Credit Losses

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

- the allowance for credit losses on loans (ACLL)
- the allowance for unfunded commitments, which is presented on the balance sheet in other liabilities, and
- the allowance for credit losses on investment securities, which covers held-to-maturity and available-for-sale securities and is recognized within each investment securities classification on the Condensed Statement of Condition.

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

Methodology for Allowance for Credit Losses on Loans

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

The association employs a disciplined process and methodology to establish its ACLL that has two basic components: first, an asset-specific component involving individual loans that do not share risk characteristics with other loans and the measurement of expected credit losses for such individual loans; and second, a pooled component for estimated expected credit losses for pools of loans that share similar risk characteristics.

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

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

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

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

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

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

In addition to the quantitative calculation, the association considers the imprecision inherent in the process and methodology, emerging risk assessments and other subjective factors, which may lead to a management adjustment to the modeled ACLL results. Expected credit loss estimates also include consideration of expected cash recoveries on loans previously charged-off

or expected recoveries on collateral dependent loans where recovery is expected through sale of the collateral. The economic forecasts are updated on a quarterly basis.

Prior to January 1, 2023, the allowance for loan losses was maintained at a level considered adequate to provide for probable losses existing in and inherent in the loan portfolio. The allowance was based on a periodic evaluation of the loan portfolio in which numerous factors are considered, including economic conditions, collateral values, borrowers' financial conditions, loan portfolio composition and prior loan loss experience. The allowance for loan losses encompassed various judgments, evaluations and appraisals with respect to the loans and their underlying collateral that, by their nature, contain elements of uncertainty and imprecision. Changes in the agricultural economy and their impact on borrower repayment capacity would cause these various judgments, evaluations and appraisals to change over time. Management considered a number of factors in determining and supporting the levels of the allowances for loan losses, which include, but are not limited to, the concentration of lending in agriculture, combined with uncertainties associated with farmland values, commodity prices, exports, government assistance programs, regional economic effects and weather-related influences.

Allowance for Credit Losses on Unfunded Commitments

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

NOTE 2 — LOANS AND ALLOWANCE FOR LOAN LOSSES:

A summary of loans follows:

<u>Loan Type</u>	<u>June 30,</u>	<u>December 31,</u>
	<u>2023</u>	<u>2022</u>
	<u>Amount</u>	<u>Amount</u>
Production agriculture:		
Real estate mortgage	\$ 304,412,911	\$ 308,324,835
Production and intermediate-term	11,592,965	10,867,818
Agribusiness:		
Loans to cooperatives	3,077,344	4,584,393
Processing and marketing	16,518,812	16,158,542
Farm-related business	2,263,213	2,275,713
Communication	7,783,686	7,224,417
Energy	2,800,126	3,236,720
Water and waste-water	2,997,098	1,998,630
Rural residential real estate	9,629,118	9,261,897
Total	\$ 361,075,273	\$ 363,932,965

The association purchases or sells participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration regulations. The following table presents information regarding the balances of participations purchased and sold at June 30, 2023:

	<u>Other Farm Credit Institutions</u>		<u>Non-Farm Credit Institutions</u>		<u>Total</u>	
	<u>Participations</u>	<u>Participations</u>	<u>Participations</u>	<u>Participations</u>	<u>Participations</u>	<u>Participations</u>
	<u>Purchased</u>	<u>Sold</u>	<u>Purchased</u>	<u>Sold</u>	<u>Purchased</u>	<u>Sold</u>
Real estate mortgage	\$ 15,635,234	\$ 9,568,576	\$ -	\$ -	\$ 15,635,234	\$ 9,568,576
Production and intermediate-term	4,132,473	-	-	-	4,132,473	-
Agribusiness	21,859,368	-	-	-	21,859,368	-
Communication	7,783,686	-	-	-	7,783,686	-
Energy	2,800,126	-	-	-	2,800,126	-
Water and waste-water	2,997,098	-	-	-	2,997,098	-
Total	\$ 55,207,985	\$ 9,568,576	\$ -	\$ -	\$ 55,207,985	\$ 9,568,576

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 \$11,601 and \$0 at June 30, 2023, and December 31, 2022, respectively.

Credit Quality

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

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

Each of the probability of default categories carries a distinct percentage of default probability. The probability of default rate between one and nine of the acceptable categories is very narrow and would reflect almost no default to a minimal default percentage. The probability of default rate grows more rapidly as a loan moves from acceptable to other assets especially mentioned and grows significantly as a loan moves to a substandard (viable) level. A substandard (non-viable) rating indicates that the probability of default is almost certain. These categories are defined as follows:

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

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

	Term Loans Amortized Cost by Origination Year						Revolving Loans Amortized Cost	
	2023	2022	2021	2020	2019	Prior	Basis	Total
Real estate mortgage								
Acceptable	\$ 14,830,964	\$ 62,053,685	\$ 76,775,128	\$ 39,774,993	\$ 28,601,773	\$ 72,263,401	\$ 47,677	\$ 294,347,621
OAEM	-	1,366,056	-	269,587	-	739,146	2,146,718	4,521,507
Substandard/Doubtful	-	-	1,017,223	137,436	-	883,090	-	2,037,749
	<u>\$ 14,830,964</u>	<u>\$ 63,419,741</u>	<u>\$ 77,792,351</u>	<u>\$ 40,182,016</u>	<u>\$ 28,601,773</u>	<u>\$ 73,885,637</u>	<u>\$ 2,194,395</u>	<u>\$ 300,906,877</u>
Production and intermediate-term								
Acceptable	\$ 209,921	\$ 483,163	\$ 283,530	\$ 189,512	\$ 115,185	\$ 2,138,074	\$ 8,162,908	\$ 11,582,293
OAEM	-	-	-	-	-	10,672	-	10,672
Substandard/Doubtful	-	-	-	-	-	-	-	-
	<u>\$ 209,921</u>	<u>\$ 483,163</u>	<u>\$ 283,530</u>	<u>\$ 189,512</u>	<u>\$ 115,185</u>	<u>\$ 2,148,746</u>	<u>\$ 8,162,908</u>	<u>\$ 11,592,965</u>
Agribusiness								
Acceptable	\$ 2,859,403	\$ 8,249,460	\$ 1,963,618	\$ 2,263,213	\$ 800,000	\$ 1,994,752	\$ 2,556,963	\$ 20,687,409
OAEM	-	-	-	-	-	-	-	-
Substandard/Doubtful	-	-	-	60,110	-	-	1,111,850	1,171,960
	<u>\$ 2,859,403</u>	<u>\$ 8,249,460</u>	<u>\$ 1,963,618</u>	<u>\$ 2,323,323</u>	<u>\$ 800,000</u>	<u>\$ 1,994,752</u>	<u>\$ 3,668,813</u>	<u>\$ 21,859,369</u>
Communications								
Acceptable	\$ 2,261,827	\$ -	\$ -	\$ 5,521,859	\$ -	\$ -	\$ -	\$ 7,783,686
OAEM	-	-	-	-	-	-	-	-
Substandard/Doubtful	-	-	-	-	-	-	-	-
	<u>\$ 2,261,827</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,521,859</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 7,783,686</u>
Energy and Water/waste disposal								
Acceptable	\$ 998,049	\$ -	\$ -	\$ -	\$ -	\$ 4,793,202	\$ 5,941	\$ 5,797,192
OAEM	-	-	-	-	-	-	-	-
Substandard/Doubtful	-	-	-	-	-	-	32	32
	<u>\$ 998,049</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,793,202</u>	<u>\$ 5,973</u>	<u>\$ 5,797,224</u>
Rural residential real estate								
Acceptable	\$ 550,627	\$ 2,720,129	\$ 3,386,424	\$ 1,845,525	\$ 273,009	\$ 853,404	\$ -	\$ 9,629,118
OAEM	-	-	-	-	-	-	-	-
Substandard/Doubtful	-	-	-	-	-	-	-	-
	<u>\$ 550,627</u>	<u>\$ 2,720,129</u>	<u>\$ 3,386,424</u>	<u>\$ 1,845,525</u>	<u>\$ 273,009</u>	<u>\$ 853,404</u>	<u>\$ -</u>	<u>\$ 9,629,118</u>
Total Loans								
Acceptable	\$ 21,710,791	\$ 73,506,437	\$ 82,408,700	\$ 49,595,102	\$ 29,789,967	\$ 82,042,833	\$ 10,773,489	\$ 349,827,319
OAEM	-	1,366,056	-	269,587	-	749,818	2,146,718	4,532,179
Substandard/Doubtful	-	-	1,017,223	197,546	-	883,090	1,111,882	3,209,741
	<u>\$ 21,710,791</u>	<u>\$ 74,872,493</u>	<u>\$ 83,425,923</u>	<u>\$ 50,062,235</u>	<u>\$ 29,789,967</u>	<u>\$ 83,675,741</u>	<u>\$ 14,032,089</u>	<u>\$ 357,569,239</u>

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

	June 30, 2023	December 31, 2022
Real estate mortgage		
Acceptable	97.8 %	99.0 %
OAEM	1.5	0.4
Substandard/doubtful	0.7	0.6
	100.0	100.0
Production and intermediate-term		
Acceptable	99.9	99.9
OAEM	0.1	0.1
Substandard/doubtful	-	-
	100.0	100.0
Agribusiness		
Acceptable	94.6	94.7
OAEM	-	-
Substandard/doubtful	5.4	5.3
	100.0	100.0
Energy and water/waste-water		
Acceptable	100.0	94.9
OAEM	-	-
Substandard/doubtful	-	5.1
	100.0	100.0
Communication		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	100.0	100.0
Rural residential real estate		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	100.0	100.0
Total loans		
Acceptable	97.8	98.7
OAEM	1.3	0.4
Substandard/doubtful	0.9	0.9
	100.0 %	100.0 %

Accrued interest receivable on loans of \$2,398,445 and \$1,808,462 at June 30, 2023 and December 31, 2022 have been excluded from the amortized cost of loans and reported separately in the Balance Sheet.

The following table reflects nonperforming assets, which consist of nonaccrual loans and other property owned and related credit quality statistics:

	June 30, 2023	December 31, 2022
Nonaccrual loans:		
Real estate mortgage	\$ 1,770,747	\$ 1,531,950
Agribusiness	1,171,960	1,230,368
Energy	32	270,164
Total nonaccrual loans	<u>\$ 2,942,739</u>	<u>\$ 3,032,482</u>
Accruing loans 90 days or more past due:		
Real estate mortgage	\$ -	\$ 833,006
Total nonperforming assets	<u>\$ 2,942,739</u>	<u>\$ 3,865,488</u>
Nonaccrual loans as a percentage of total loans	0.81%	0.83%
Nonperforming assets as a percentage of total loans	0.81%	1.07%
Nonperforming assets as a percentage of capital	4.34%	5.70%

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

	June 30, 2023			Interest Income Recognized	
	Amortized Cost with Allowance	Amortized Cost without Allowance	Total	For the Three Months Ended June 30, 2023	For the Six Months Ended June 30, 2023
Nonaccrual loans:					
Real estate mortgage	\$ -	\$ 1,766,933	\$ 1,766,933	\$ (113,357)	\$ (4,247)
Agribusiness	1,111,850	-	1,111,850	-	-
Processing and Marketing	-	60,110	60,110	-	-
Total nonaccrual loans	<u>\$ 1,111,850</u>	<u>\$ 1,827,043</u>	<u>\$ 2,938,893</u>	<u>\$ (113,357)</u>	<u>\$ (4,247)</u>

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

June 30, 2023	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	\$ 991,770	\$ 1,017,223	\$ 2,008,993	\$ 304,472,345	\$ 306,481,338
Production and intermediate term	53,778	-	53,778	11,686,383	11,740,161	-
Loans to cooperatives	-	-	-	3,108,502	3,108,502	-
Processing and marketing	1,171,960	-	1,171,960	15,384,195	16,556,155	-
Farm-related business	-	-	-	2,276,434	2,276,434	-
Communication	-	-	-	7,810,470	7,810,470	-
Energy	-	33	33	2,809,505	2,809,538	-
Water and waste-water	-	-	-	3,030,385	3,030,385	-
Rural residential real estate	-	-	-	9,660,735	9,660,735	-
Total	<u>\$ 2,217,508</u>	<u>\$ 1,017,256</u>	<u>\$ 3,234,764</u>	<u>\$ 360,238,954</u>	<u>\$ 363,473,718</u>	<u>\$ -</u>

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

December 31, 2022	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	\$ 355,876	\$ 675,028	\$ 1,030,904	\$ 308,829,509	\$ 309,860,413	\$ -
Production and intermediate term	-	-	-	10,960,092	10,960,092	-
Loans to cooperatives	-	-	-	4,609,760	4,609,760	-
Processing and marketing	371,966	95,473	467,439	15,744,625	16,212,064	-
Farm-related business	-	-	-	2,287,215	2,287,215	-
Communication	-	-	-	7,246,589	7,246,589	-
Energy	-	766	766	3,245,582	3,246,348	-
Water and waste-water	-	-	-	2,028,852	2,028,852	-
Rural residential real estate	40,644	-	40,644	9,249,449	9,290,093	-
Total	\$ 768,486	\$ 771,267	\$ 1,539,753	\$ 364,201,673	\$ 365,741,426	\$ -

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

Allowance for Credit Losses

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

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

	Real Estate Mortgage	Production and Intermediate- Term	Agri-business	Communi- cations	Energy and Water/Waste Disposal	Rural Residential Real Estate	International	Total
Allowance for Credit Losses on Loans:								
Balance at March 31, 2023	\$ (765,730)	\$ (27,443)	\$ (324,262)	\$ (9,478)	\$ (56,450)	\$ (25,689)	\$ (8)	\$ (1,209,060)
Transfers to/from reserve for unfunded commitments	(142)	(2,004)	(899)	(103)	(6)	-	63	(3,092)
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	(596)	-	-	(2,942)	-	-	(3,538)
Provision for credit losses/(Loan loss reversal)	20,305	7,813	2,630	(5,059)	55,888	(840)	(55)	80,682
Balance at June 30, 2023	\$ (745,567)	\$ (22,230)	\$ (322,532)	\$ (14,640)	\$ (3,510)	\$ (26,529)	\$ 0	\$ (1,135,007)
Balance at December 31, 2022	\$ (863,646)	\$ (16,578)	\$ (297,202)	\$ (3,060)	\$ (55,522)	\$ (7,340)	\$ -	\$ (1,243,348)
Cumulative effect of a change in accounting principle	38,313	(14,684)	(33,954)	(5,719)	(1,151)	(17,593)	-	(34,788)
Balance at January 1, 2023	(825,333)	(31,262)	(331,156)	(8,779)	(56,673)	(24,933)	-	(1,278,136)
Transfers to/from reserve for unfunded commitments	(280)	(4,519)	(14,561)	(128)	(16)	-	42	(19,461)
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	(1,800)	-	-	(2,942)	-	-	(4,742)
Provision for loan losses (loan loss reversal)	80,049	15,349	23,185	(5,732)	56,119	(1,596)	(43)	167,332
Balance at June 30, 2023	\$ (1,570,897)	\$ (53,493)	\$ (653,688)	\$ (23,419)	\$ (60,184)	\$ (51,462)	\$ (0)	\$ (1,135,007)
Balance at March 31, 2022	\$ (1,061,789)	\$ (314,528)	\$ (46,130)	\$ (3,054)	\$ (3,201)	\$ (6,684)	\$ -	\$ (1,435,386)
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	(900)	-	-	-	-	-	(900)
Provision for loan losses (loan loss reversal)	(11,424)	(3,772)	(10,045)	5	644	(180)	-	(24,772)
Balance at June 30, 2022	\$ (1,073,213)	\$ (319,200)	\$ (56,175)	\$ (3,049)	\$ (2,557)	\$ (6,864)	\$ -	\$ (1,461,058)
Balance at December 31, 2021	\$ (820,811)	\$ (301,325)	\$ (32,877)	\$ (2,994)	\$ (253,374)	\$ (6,025)	\$ -	\$ (1,417,406)
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	(2,100)	-	-	-	-	-	(2,100)
Provision for loan losses (loan loss reversal)	(252,402)	(15,775)	(23,298)	(55)	250,817	(839)	-	(41,552)
Balance at June 30, 2022	\$ (1,073,213)	\$ (319,200)	\$ (56,175)	\$ (3,049)	\$ (2,557)	\$ (6,864)	\$ -	\$ (1,461,058)

¹ For periods prior to January 1, 2023, the allowance for loan losses was based on probable and estimable losses inherent in the loan portfolio

The association did not materially modify any loans with borrowers experiencing financial difficulty as of June 30, 2023.

Troubled Debt Restructurings

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

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:

	December 31, 2022	
	Loans Modified as Troubled Debt Restructurings	Troubled Debt Restructurings in Nonaccrual Status*
Real estate mortgage	\$ 1,508,034	\$ 675,028
Energy	270,164	270,164
Total	\$ 1,778,198	\$ 945,192

*Represents the portion of loans modified as troubled debt restructurings that were in nonaccrual status.

NOTE 3 — CAPITAL:

The association's board of directors has established a Capital Adequacy Plan (Plan) that includes the capital targets that are necessary to achieve the association's capital adequacy goals as well as the minimum permanent capital standards. The Plan monitors projected dividends, equity retirements and other actions that may decrease the association's permanent capital. In addition to factors that must be considered in meeting the minimum standards, the board of directors also monitors the following factors: capability of management; quality of operating policies, procedures and internal controls; quality and quantity of earnings; asset quality and the adequacy of the allowance for losses to absorb potential loss within the loan and lease portfolios; sufficiency of liquid funds; needs of an 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.

	June 30, 2023	December 31, 2022
Capital stock and participation certificates	\$ 1,180,110	\$ 1,192,520
Accumulated other comprehensive loss	66,598,987	60,450
Retained earnings ¹	58,598	66,543,014
Total Capital	\$ 67,837,695	\$ 67,795,984

¹ Retained earnings for the six months ended June 30, 2023, reflects a +decrease from the cumulative effect of a change in accounting principle for CECL on January 1, 2023.

Regulatory Capitalization Requirements

Risk-adjusted:	Regulatory Minimums with Buffer	As of June 30, 2023
Common equity tier 1 ratio	7.00%	18.12%
Tier 1 capital ratio	8.50%	18.12%
Total capital ratio	10.50%	18.50%
Permanent capital ratio	7.00%	18.19%
Non-risk-adjusted:		
Tier 1 leverage ratio	5.00%	16.24%
UREE leverage ratio	1.50%	15.92%

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

	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
Numerator:				
Unallocated retained earnings	\$ 42,136,587	\$ 42,136,587	\$ 42,136,587	\$ 42,136,587
Statutory minimum purchased borrower stock	1,181,503	1,181,503	1,181,503	1,181,503
Nonqualified allocated equities not subject to retirement	22,858,251	22,858,251	22,858,251	22,858,251
Allowance for loan losses and reserve for credit losses subject to certain limitations	-	-	1,235,406	-
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	(6,016,770)	(6,016,770)	(6,016,770)	(6,016,770)
	<u>\$ 60,159,571</u>	<u>\$ 60,159,571</u>	<u>\$ 61,394,977</u>	<u>\$ 60,159,571</u>
Denominator:				
Risk-adjusted assets excluding allowance	\$ 337,937,785	\$ 337,937,785	\$ 337,937,785	\$ 337,937,785
Regulatory Adjustments and Deductions:				
Regulatory deductions included in total capital	(6,016,770)	(6,016,770)	(6,016,770)	(6,016,770)
Allowance for loan losses	-	-	-	(1,219,174)
	<u>\$ 331,921,015</u>	<u>\$ 331,921,015</u>	<u>\$ 331,921,015</u>	<u>\$ 330,701,841</u>
Calculated Ratio	18.12%	18.12%	18.50%	18.19%

	Tier 1 leverage ratio	UREE leverage ratio
Numerator:		
Unallocated retained earnings	\$ 42,136,587	\$ 42,136,587
Common Cooperative Equities:		
Statutory minimum purchased borrower stock	1,181,503	-
Nonqualified allocated equities not subject to retirement	22,858,251	22,858,251
Regulatory Adjustments and Deductions:		
Amount of allocated investments in other System institutions	(6,016,770)	(6,016,770)
	<u>\$ 60,159,571</u>	<u>\$ 58,978,068</u>
Denominator:		
Total Assets	\$ 377,987,225	\$ 377,987,225
Regulatory Adjustments and Deductions:		
Regulatory deductions included in tier 1 capital	(7,631,387)	(7,631,387)
	<u>\$ 370,355,838</u>	<u>\$ 370,355,838</u>
Calculated Ratio	16.24%	15.92%

The following tables present the activity in the accumulated other comprehensive income (loss), net of tax by component:

Accum Other Comp Income (Loss)	
June 30, 2023	
	<u>Net of Tax</u>
Nonpension postretirement benefits	\$ 58,598
	<u>Net of Tax</u>
June 30, 2022	
Nonpension postretirement benefits	\$ 630

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

	<u>2023</u>	<u>2022</u>
Accumulated other comprehensive income (loss) at January 1	\$ 60,450	\$ 1,412
Amortization of prior service (credit) costs included in salaries and employee benefits	(783)	(782)
Amortization of actuarial (gain) loss included in salaries and employee benefits	(1,069)	-
Other comprehensive income (loss), net of tax	(1,852)	(782)
Accumulated other comprehensive income (loss) at June 30	\$ 58,598	\$ 630

NOTE 4 — INCOME TAXES:

Legacy conducts its business activities through two wholly-owned subsidiaries. Long-term mortgage lending activities are conducted through a wholly-owned Federal Land Credit Association (“FLCA”) subsidiary which is exempt from federal and state income tax. Short- and intermediate-term lending activities are conducted through a wholly-owned Production Credit Association (“PCA”) subsidiary. The PCA subsidiary and the ACA holding company are subject to income tax. The association operates as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the association can exclude from taxable income amounts distributed as qualified patronage 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 5 — FAIR VALUE MEASUREMENTS:

Accounting guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 13 in the 2022 Annual Report to Stockholders for a more complete description.

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

June 30, 2023	<u>Fair Value Measurement Using</u>		
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Assets:			
Loans	\$ -	\$ -	\$ 788,885
 December 31, 2022			
	<u>Fair Value Measurement Using</u>		
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Assets:			
Loans	\$ -	\$ -	\$ 1,324,866

Quantitative Information about Recurring and Nonrecurring Level 3 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. The associations 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 13 to the 2022 Annual Report to Stockholders, authoritative guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following represent a brief summary of the valuation techniques used for the association’s assets and liabilities. For a more complete description, see the 2022 Annual Report to Stockholders

Loans Evaluated for Impairment

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

Other Property Owned

Other property owned is generally classified as Level 3 of the fair value hierarchy. The process for measuring the fair value of the other property owned involves the use of independent appraisals and other market-based information. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. As a result, these fair value measurements fall within Level 3 of the hierarchy. As of June 30, 2023, Legacy has no Other property owned.

Cash

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

Loans

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

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

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

Commitments to Extend Credit

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

NOTE 6 — EMPLOYEE BENEFIT PLANS:

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

Three months ended June 30:

	Other Benefits	
	2023	2022
Service cost	\$ 862	\$ 1,332
Interest cost	2,769	2,161
Amortization of prior service (credits) costs	(391)	(391)
Amortization of net actuarial (gain) loss	(535)	-
Net periodic benefit cost	\$ 2,705	\$ 3,102

Six months ended June 30:

	Other Benefits	
	2023	2022
Service cost	\$ 1,723	\$ 2,664
Interest cost	5,539	4,323
Amortization of prior service (credits) costs	(783)	(782)
Amortization of net actuarial (gain) loss	(1,069)	-
Net periodic benefit cost	\$ 5,410	\$ 6,205

The association's liability for the unfunded accumulated obligation for these benefits at June 30, 2023, was \$222,313 and is included in other liabilities on the balance sheet.

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

The structure of the district's defined benefit pension plan is characterized as multiemployer since the assets, liabilities and cost of the plan are not segregated or separately accounted for by participating employers (bank and associations). The association recognizes its amortized annual contributions to the plan as an expense. The association previously disclosed in its financial statements for the year ended December 31, 2022, that it expected to contribute \$14,382 to the district's defined benefit pension plan in 2023. As of June 30, 2023, \$7,191 of contributions have been made. The association presently anticipates contributing an additional \$7,191 to fund the defined benefit pension plan in 2023 for a total of \$14,382.

NOTE 7 — COMMITMENTS AND CONTINGENT LIABILITIES:

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

NOTE 8 — SUBSEQUENT EVENTS:

The association has evaluated subsequent events through August 9, 2023, which is the date the financial statements were issued. There are no other significant events requiring disclosure as of August 9, 2023.