# Quarterly Report to Stockholders

AMERICAN AGCREDIT

MONEY FOR AGRICULTURE

as of June 30, 2020

# Management's Discussion and Analysis

The following discussion summarizes the financial position and results of operations of American AgCredit, ACA and its subsidiaries (collectively "the Association") as of the second quarter of 2020. This commentary should be read with the accompanying consolidated financial statements and the related notes appearing in this report along with our 2019 Annual Report. The discussion includes significant known trends, commitments, events, or uncertainties that have impacted or are reasonably likely to impact our financial condition and results of operations. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of our Board of Directors.

Our annual and quarterly reports to shareholders are available on our website, www.AgLoan.com, or can be obtained free of charge by calling our corporate headquarters at (707) 545-1200. Additionally, the financial condition and results of operations of CoBank, ACB (CoBank), our funding bank, materially affect the risk associated with shareholder investments in American AgCredit. Shareholders of American AgCredit may obtain copies of CoBank's Quarterly or Annual Report to Shareholders free of charge by accessing CoBank's website, www.CoBank.com, calling (800) 542-8072, or mailing CoBank at 6340 S. Fiddlers Green Circle, Greenwood Village, CO 80111.

As a cooperative, American AgCredit is owned by the members we serve. Our territory extends across a diverse agricultural region that includes parts of California, Kansas, Oklahoma, Colorado, and New Mexico, as well as the states of Nevada and Hawaii. Arguably, the Association has the strongest geographic and commodity diversification within the Farm Credit System.

### Forward Looking Statements

Any forward-looking statements in this report are based on current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from expectations due to a number of risks and uncertainties. More information about these risks and uncertainties is contained in our 2019 Annual Report. We undertake no duty to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

### COVID-19 Impact to Association Operations

The Association continues to closely monitor the impact of the COVID-19 worldwide pandemic to its operations and borrowers. At the onset of the pandemic, the Association activated its disaster recovery and business interruption procedures, and our employees began working remotely in compliance with shelter in place orders. Our borrowers were able to conduct business with us through the use of online banking and other technologies. The Association has developed a phased approach that will allow branches to open in accordance with their state and local recommendations. Customers can obtain up-to-date information on each office location at www.agloan.com/locations.

### COVID-19 Customer Assistance and Loan Relief Options

The Association created several customer assistance and loan relief programs for eligible borrowers as a result of COVID-19. Loan assistance programs include term and mortgage payment deferrals for up to six months, interest-only payment options and loan maturity extensions for up to twelve months, as well as lease payment deferrals. These loan assistance programs are available for borrowers through March 1, 2021. The Association is also assisting customers in navigating various national, state, local, and private relief programs available to farmers and ranchers.

The Association is a participating lender in the SBA's Paycheck Protection Program (PPP), which offers loans designed to provide direct incentive for small businesses to keep their workers employed. Under the program, if loan proceeds are used for payroll, rent, mortgage interest, or utilities, and other conditions are met, SBA will forgive the loan and accrued interest of the borrower. If not forgiven, a PPP loan will bear interest at a fixed 1.00% rate with a two to five year maturity and payments deferred for six months. These loans are 100% guaranteed by SBA. As of June 30, 2020, the Association originated approximately $120 million in PPP loans, providing relief for an estimated 16,000 jobs.

### Overall Economic Outlook and Commodity Review

After a record 128 months of economic expansion, the COVID-19 pandemic caused an economic recession starting in February. Unemployment precipitously increased to 14.7% in April, although as governmental restrictions have generally relaxed, unemployment

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declined to 11.1% in June according to the Bureau of Labor Statistics. The future state of unemployment will depend heavily upon future progression of the pandemic and government orders. On July 1, the United States-Mexico-Canada Agreement (USMCA) entered into force. The agreement is generally seen as favorable for farmers and ranchers as its terms provide new market access for certain agricultural commodities, especially dairy, while preserving the zero-tariff platform for other commodities.

The financial markets experienced extreme volatility and entered a bear market in a historically short period of time. Equity markets rallied from March lows, with the S&P 500 rising 20% in the second quarter, representing the biggest quarterly increase since the fourth quarter of 1998.

The Federal Open Market Committee lowered the federal funds rate twice in March to a target range between 0-0.25%, representing the largest emergency rate reduction in its history and a return to levels similar to those during the Great Recession. The Federal Reserve has signaled that it intends to keep the federal funds rate near zero for at least the next 18 months. In response, the Association lowered its reference rates between 75 and 100 basis points effective April 1.

The federal government has also taken action in response to COVID-19, including direct cash payments to most Americans, extended unemployment benefits, and federal loan guarantees. Additionally, portions of enacted legislation, such as the CARES Act, provide support to agricultural producers. This includes direct support to the USDA, child nutrition programs, the Commodity Credit Corporation, and the Supplemental Nutrition Assistance Program. Agricultural producers were generally able to continue production as an essential service exempt from local shelter-in-place restrictions. In April, the USDA announced the Coronavirus Food Assistance Program, which provides for $16 billion in direct support to farmers and ranchers based on actual losses, and $3 billion in food purchases for distribution to food banks, community and faith based organizations, and other non-profits serving Americans in need. Other national programs made available include the USDA Coronavirus Food Assistance Program, the Federal Reserve Main Street Lending Program, and the U.S. Chamber of Commerce Save Small Business Fund.

The Association's commodity portfolio remains well-diversified. Wine grapes and wine and field crops lead our commodity portfolio at 17.3% and 14.7%, respectively followed by dairies and dairy products at 11.8%, tree fruits & nuts at 11.0%, beef at 10.1%, and forest products at 9.1%. The top six commodities make up 74.0% of the total portfolio with the remaining 26.0% spread over sixteen additional categories, including an "Other" category. The bulk of the Association's wine portfolio continues to be centered in the super- and ultra-premium segments of the wine market. Field crops consist primarily of wheat, corn, soybeans, alfalfa, sorghum, and other grains. Tree fruits and nuts consists primarily of almonds, walnuts and orchards in California's Central Valley and Hawaii.

Following is a summary of economic conditions among the Association's significant commodities:

- **Wine grapes and wine:** The wine industry continues to work through the effects of the COVID-19 pandemic. Wine sales overall have been mixed. Although off-premise and direct-to-consumer wine sales have increased relative to the prior year, as a result of local restrictions, on-premise sales at bars, restaurants, and tasting rooms have sharply declined. Additionally, exports have declined 5% from the previous year as slower global growth and higher exchange rates has weighed down global demand for U.S. wine. Wineries with flexible marketing models are more likely to weather difficult conditions. Concern regarding wine sales have impacted grape contracts, creating uncertainty for grape growers. Many producers are actively looking for cost cutting measures or have invested in replants to take unneeded acres out of production. Bulk wine prices remain low, however inventory levels have been decreasing in recent months.
- **Field Crops:** Prices for most grains and soybeans remain subdued as relatively high stocks have been met with uncertainty of demand. COVID-19 relief programs have aided profit margins for most producers. Planting conditions were mostly positive; although drought conditions emerging in June have weighed on some areas of the Association's territory. China has begun to increase the pace of purchases, however exports are below prior years' levels. The USDA estimated a record number of acres planted to corn, but as supply has outrun demand, the price of corn has declined sharply. Acres planted to wheat have decreased,

resulting in a decline of overall production which has helped to rebalance stocks-to-use ratios. Demand for wheat products have increased recently as a result of changing consumer purchasing trends caused by the pandemic.

- **Dairy:** Dairy prices were volatile during the second quarter of 2020. The USDA's Coronavirus Farm Assistance Program (CFAP) has allocated $317 million for dairy product purchases. That announcement caused Class III milk prices to increase to recent highs. However, the uniform milk price within the Association's territory overall declined, meaning second quarter margins were negative to breakeven for most producers. Most industry experts expect domestic demand to return to historical trends later in 2020. However, the supply of milk produced has increased and will pressure marketing services to increase demand to shore up overall profitability.

- **Tree fruits and nuts:** Uncertain demand remains in light of the COVID-19 pandemic. Favorable weather conditions resulted in an extremely high 2020 California almond crop yield projection by the USDA of 3.00 billion meat pounds, representing an 18% increase from the prior year's crop. As the almond industry relies on export markets, the effect of the COVID-19 pandemic and a strong U.S. dollar is causing export projections to be markedly subdued. Early estimates indicate 2020 crop prices could be 15-25% lower than 2019. Pistachios and walnut production also is expected to be strong in 2020. Cherry production in California is expected to be significantly lower than previous years, caused by a poor bloom followed by pocketed showers during harvest.

- **Beef:** COVID-19 resulted in a sharp decrease in slaughter capacity. This resulted in an excess supply of live cattle and a decreased supply of wholesale beef. As a result, projected returns for finished cattle have slid negative, although as processing capacity returns in the second half of the year, prices are expected to increase from recent lows. Calf prices remain below the prior year, however declines in the cow-calf sector have been less steep. Despite the sharp reduction of beef products used in restaurants, convention centers, sports arenas, and similar locations, overall demand for beef remains good.

- **Forest products:** Demand largely follows the economic conditions of housing and construction spending. Many mills and loggers curtailed production soon after the COVID-19 pandemic emerged. The decline in production helped to keep prices for many forest products from sharply declining. The tissue and pulp industries continue to perform well as the pandemic has shifted consumer demand to favor the products manufactured by these industries. Demand for construction materials remained fair from March through May as demand for home projects helped offset the loss of commercial construction. Favorable home mortgage rates combined with homeowners embarking on more home improvement projects into the summer could help spur demand. Combined with production curtailments, prices for some construction materials increased to pre-COVID-19 levels. Log prices have declined somewhat in 2020, although not to the level of initial projections at the time the pandemic emerged.

Abnormally dry or drought conditions continued to be of concern in a portion of the Association's territory. Areas of California, Nevada, and Colorado have seen worsening drought conditions as spring precipitation was below average. Areas of southern Colorado are in extreme drought conditions.

### Loan Portfolio

Total loan volume exceeded $12.7 billion at June 30, 2020, an increase of $891 million from $11.8 billion at December 31, 2019. The increase was caused both by draws on existing facilities and new originations, partially offset by anticipated seasonal loan repayments. On a year-over-year basis, loan volume increased by $2.1 billion when compared to June 30, 2019, resulting in a growth rate of 19.8%. Although credit quality has slightly decreased to 98.0% from 98.6% at December 31, 2019, the Association's overall credit quality remains strong. We will continue to monitor the effect of COVID-19 on our borrowers' credit quality and any resulting impact on our allowance for loan losses.

In addition to the $12.7 billion of loan and lease volume reported on our balance sheet, we serviced an additional $5.7 billion of loan volume for other institutions as of June 30, 2020.

### Nonearning Assets

Nonaccrual loan volume increased by $14.9 million to $57.2 million at June 30, 2020, compared to $42.2 million at December 31, 2019. The change in nonaccrual loan volume was primarily due to transfers to nonaccrual status and disbursements on nonaccrual loans of $22.2

## Management's Discussion and Analysis

million, partially offset by $6.1 million year-to-date net repayments on nonaccrual loans. Nonaccrual loan volume represented just 0.45% of total loan volume at the end of June 30, 2020, compared to 0.56% at June 30, 2019 and 0.46% at December 31, 2019.

**Allowance for Credit Losses**

The allowance for credit losses is composed of the allowance for loan losses (ALL) and the reserve for unfunded commitments. The allowance for loan losses is an estimate of losses on loans in our portfolio as of the financial statement date. The appropriate level of allowance for loan losses is determined based on periodic evaluation of factors such as loan loss history, portfolio quality, estimated collateral values, and current economic and environmental conditions. Total allowance for credit losses was $38.6 million at June 30, 2020, which included a $34.1 million allowance for loan losses and a $4.5 million reserve for unfunded commitments. The reserve for unfunded commitments is reported with Other Liabilities on the Consolidated Statements of Condition.

**Financial Condition and Results of Operations**

Net Income for the six months ended June 30, 2020 was $115.5 million compared to $91.9 million for the same period last year, an increase of $23.6 million. The change in net income was primarily due to the following reasons.

- Net interest income increased by $27.5 million year-over-year due to growth in accrual loan volume.
- Provision for loan losses increased by $5.4 million year-over-year primarily due to an increase in loan volume.
- Noninterest income increased by $13.6 million year-over-year. The increase was primarily due to a $10.8 million increase in patronage from other Farm Credit institutions and $3.5 million in fees related to the origination of PPP loans.
- Noninterest expense increased by $12.1 million compared to the same period last year, driven by a $14.5 million increase in salaries and benefits.

The major components of change in net income are summarized as follows.

| | For the Six Months Ended | | Increase (Decrease) in |
|---|---|---|---|
| | **June 30, 2020** | **June 30, 2019** | **Net Income** |
| Net interest income | $173,404 | $145,948 | $27,456 |
| Provision for credit losses | (8,931) | (3,568) | (5,363) |
| Patronage income | 39,411 | 28,603 | 10,808 |
| Other income, net | 15,629 | 12,813 | 2,816 |
| Operating expenses | (103,994) | (91,856) | (12,138) |
| Provision for income taxes | (2) | (18) | 16 |
| **Net income** | **$115,517** | **$91,922** | **$23,595** |

The following table shows the Association's year-to-date annualized return on average assets, return on equity, and net interest margin.

| | June 30, | |
|---|---|---|
| | **2020** | **2019** |
| Return on average assets | 1.78% | 1.67% |
| Return on equity | 10.02% | 8.69% |
| Net interest margin | 2.83% | 2.81% |

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**Liquidity and Funding**

Liquidity is necessary to meet our financial obligations, such as paying our note with CoBank, funding loans and other commitments, and funding operations in a low cost manner. Our liquidity policy is intended to manage short-term cash flow, maximize debt reductions, and liquidate nonearning assets. Our direct loan with CoBank, cash on hand, and borrower loan repayments provide adequate liquidity to fund our ongoing operations and other commitments.

**Members' Equity**

The Association's capital position remains very strong. Total members' equity was $2.372 billion at the end of the second quarter, an increase of $144.3 million from $2.228 billion at December 31, 2019. The increase was primarily due to favorable year-to-date earnings along with a $31.4 million increase in preferred stock. The Association was in compliance with all capital ratio requirements at June 30, 2020. The Association's strong earnings and capital position enable us to effectively serve our mission, our customers and support our ability to maintain our cash patronage program.

**Certification**

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

| George Fontes<br>Chairman | Byron Enix<br>Chief Executive Officer | Vern Zander<br>Chief Financial Officer |
|---|---|---|

August 7, 2020

## Consolidated Statements of Condition *(dollars in thousands)*

| | June 30, 2020 | December 31, 2019 |
|---|---|---|
| | *(Unaudited)* | *(Audited)* |
| **ASSETS** | | |
| Loans | $12,735,905 | $11,844,790 |
| Less: allowance for loan losses | (34,093) | (25,807) |
| Net loans | 12,701,812 | 11,818,983 |
| Accrued interest receivable | 114,472 | 111,419 |
| Investment in CoBank | 395,443 | 392,959 |
| Investment in AgDirect | 15,346 | 14,105 |
| Premises and equipment, net | 124,386 | 127,454 |
| Other property owned | 4,779 | 4,779 |
| Cash | 5,560 | 60,006 |
| Other assets | 116,296 | 133,717 |
| **Total assets** | **$13,478,094** | **$12,663,422** |
| **LIABILITIES** | | |
| Notes payable to CoBank | $10,874,405 | $10,074,698 |
| Accrued interest payable | 26,335 | 28,462 |
| Funds Held accounts | 105,871 | 97,211 |
| Cash patronage and preferred stock dividends payable | 8 | 115,413 |
| Reserve for unfunded commitments | 4,518 | 3,745 |
| Other liabilities | 95,058 | 116,312 |
| **Total liabilities** | **11,106,195** | **10,435,841** |
| **MEMBERS' EQUITY** | | |
| Preferred stock | 159,363 | 127,955 |
| Common stock and participation certificates | 9,861 | 9,545 |
| Additional paid-in capital | 683,656 | 683,656 |
| Unallocated retained surplus | 1,531,786 | 1,420,692 |
| Accumulated other comprehensive loss | (12,767) | (14,267) |
| **Total members' equity** | **2,371,899** | **2,227,581** |
| **Total liabilities and members' equity** | **$13,478,094** | **$12,663,422** |

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

## Consolidated Statements of Comprehensive Income *(dollars in thousands)*

| *(Unaudited)* | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | **2020** | **2019** | **2020** | **2019** |
| **INTEREST INCOME** | | | | |
| Loans | $131,139 | $138,848 | $274,609 | $274,733 |
| **Total interest income** | **131,139** | **138,848** | **274,609** | **274,733** |
| **INTEREST EXPENSE** | | | | |
| Notes payable CoBank | 44,263 | 64,902 | 100,533 | 127,533 |
| Funds Held and other interest | 226 | 658 | 672 | 1,252 |
| **Total interest expense** | **44,489** | **65,560** | **101,205** | **128,785** |
| **Net interest income** | **86,650** | **73,288** | **173,404** | **145,948** |
| Provision for credit losses | (3,670) | (2,482) | (8,931) | (3,568) |
| **Net interest income after provision for credit losses** | **82,980** | **70,806** | **164,473** | **142,380** |
| **NON-INTEREST INCOME** | | | | |
| Patronage distributions from CoBank | 12,570 | 11,003 | 24,368 | 22,071 |
| Patronage distributions from other Farm Credit institutions | 9,092 | 3,755 | 14,076 | 5,796 |
| Patronage distributions from AgDirect | 568 | 432 | 967 | 719 |
| Loan origination fees | 6,044 | 2,703 | 8,904 | 4,042 |
| Servicing fees and late charges | 659 | 774 | 959 | 2,315 |
| Financially related services | 584 | 1,037 | 1,540 | 2,049 |
| Miscellaneous | 695 | 553 | 4,226 | 4,424 |
| **Total non-interest income** | **30,212** | **20,257** | **55,040** | **41,416** |
| **NON-INTEREST EXPENSES** | | | | |
| Salaries and benefits | 35,047 | 27,164 | 68,810 | 54,263 |
| Occupancy and equipment expense | 2,455 | 3,228 | 4,955 | 6,388 |
| Insurance fund premiums | 2,070 | 1,882 | 4,003 | 3,712 |
| Supervisory and examination expense | 811 | 781 | 1,622 | 1,532 |
| Other operating expenses | 11,679 | 13,121 | 24,604 | 25,961 |
| **Total non-interest expenses** | **52,062** | **46,176** | **103,994** | **91,856** |
| Income before income taxes | 61,130 | 44,887 | 115,519 | 91,940 |
| Provision for income taxes | (2) | (2) | (2) | (18) |
| **Net income** | **$61,128** | **$44,885** | **$115,517** | **$91,922** |
| **COMPREHENSIVE INCOME** | | | | |
| Actuarial gain in retirement obligation | 750 | 582 | 1,500 | 1,164 |
| **Total comprehensive income** | **$61,878** | **$45,467** | **$117,017** | **$93,086** |

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

## Consolidated Statements of Changes in Members' Equity *(dollars in thousands)*

**For the Three Months Ended June 30, 2019 and 2020**

| *(Unaudited)* | Common Stock and Participation Certificates | Preferred Stock | Additional Paid-in Capital | Unallocated Retained Surplus | Accumulated Other Comprehen-sive Loss | Total Members' Equity |
|---|---|---|---|---|---|---|
| **Balance at December 31, 2018** | **$8,791** | **$125,766** | **$656,723** | **$1,336,892** | **$(12,252)** | **$2,115,920** |
| Comprehensive income | | | | 91,922 | 1,164 | 93,086 |
| Common stock/participation certificates issued | 522 | 125,313 | | | | 125,835 |
| Common stock/participation certificates retired | (329) | (99,888) | | | | (100,217) |
| Preferred stock dividends paid | | 1,788 | | | | 1,788 |
| Preferred stock dividends accrued | | | | (1,790) | | (1,790) |
| **Balance at June 30, 2019** | **$8,984** | **$152,979** | **$656,723** | **$1,427,024** | **$(11,088)** | **$2,234,622** |
| | | | | | | |
| **Balance at December 31, 2019** | **$9,545** | **$127,955** | **$683,656** | **$1,420,692** | **$(14,267)** | **$2,227,581** |
| Comprehensive income | | | | 115,517 | 1,500 | 117,017 |
| Common stock/participation certificates issued | 641 | 110,928 | | | | 111,569 |
| Common stock/participation certificates retired | (325) | (80,335) | | | | (80,660) |
| Preferred stock dividends paid | | 815 | | | | 815 |
| Preferred stock dividends accrued | | | | (813) | | (813) |
| Adjustment to prior period patronage accrual | | | | (3,610) | | (3,610) |
| **Balance at June 30, 2020** | **$9,861** | **$159,363** | **$683,656** | **$1,531,786** | **$(12,767)** | **$2,371,899** |

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

# Notes to the Consolidated Financial Statements *(dollars in thousands, except as noted.)*

*(Unaudited)*

## NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

A description of the organization and operations of American AgCredit, ACA (Association), the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2019 are contained in the 2019 Annual Report to Stockholders (2019 Annual Report). The financial statements were prepared under the oversight of the audit committee of the board of directors.

The accompanying unaudited second quarter 2020 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, 2019 as contained in the 2019 Annual Report.

In the opinion of management, this unaudited financial information 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, 2020. Descriptions of the significant accounting policies are included in the 2019 Annual Report. In the opinion of management, these policies and the presentation of the interim financial condition and results of operations conform with GAAP and prevailing practices within the banking industry.

In March 2020, the Financial Accounting Standards Board (FASB) issued guidance entitled "Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting." This guidance provides optional expedients and exceptions for applying accounting guidance to contracts, hedging relationships, and other transactions that reference LIBOR or another reference rate expected to be discontinued because of reference rate reform. The expedients generally allow for a continuance of a contract or hedging relationship when ordinarily accounting guidance would stipulate the creation of a new contract or designation of a hedging relationship. When elected, the optional expedients for contract modifications must be applied consistently for all similar eligible contracts or eligible transactions. The amendments in this guidance are effective for all entities as of March 12, 2020 through December 31, 2022. The Association is evaluating the impact of adoption on the institution’s financial condition and its results of operations.

Refer to Note 2 in our 2019 Annual Report for additional information on other accounting standards that have been issued, but are not yet effective. The Association is evaluating the impact of adoption of these standards on its financial condition and results of operations.

## NOTE 2 – LOANS AND ALLOWANCE FOR LOAN LOSSES

Components of loans in the Consolidated Statements of Condition are as follows:

| | June 30, 2020 | | December 31, 2019 | |
|---|---|---|---|---|
| | Amount | Percentage | Amount | Percentage |
| Real estate mortgage | $6,999,993 | 55.0% | $6,564,171 | 55.4% |
| Production and intermediate-term | 2,816,720 | 22.1% | 2,692,055 | 22.7% |
| Agribusiness | 2,446,968 | 19.2% | 2,236,569 | 18.9% |
| Rural infrastructure | 428,619 | 3.4% | 308,040 | 2.6% |
| Agricultural export finance | 41,560 | 0.3% | 41,558 | 0.4% |
| Rural residential real estate | 2,045 | 0.0% | 2,397 | 0.0% |
| Total loans | **$12,735,905** | **100.0%** | **$11,844,790** | **100.0%** |

### PARTICIPATION INTERESTS

The Association, in the normal course of business, purchases and sells participation interests with other parties in order to diversify risk, manage loan volume, and comply with Farm Credit Administration regulations. All loans sold to other parties are sold without recourse.

The following table presents information regarding participations purchased and sold at June 30, 2020:

| | Other Farm Credit Institutions | | Non-Farm Credit Institutions | | Total | |
|---|---|---|---|---|---|---|
| | Participations | | Participations | | Participations | |
| | Purchased | Sold | Purchased | Sold | Purchased | Sold |
| Real estate mortgage | $378,133 | $1,614,116 | $0 | $0 | $378,133 | $1,614,116 |
| Production and intermediate-term | 513,444 | 933,510 | - | - | 513,444 | 933,510 |
| Agribusiness | 1,537,117 | 2,118,701 | 237 | - | 1,537,354 | 2,118,701 |
| Rural infrastructure | 397,334 | 65,782 | - | - | 397,334 | 65,782 |
| Agricultural export finance | 41,560 | - | - | - | 41,560 | - |
| Total | **$2,867,588** | **$4,732,109** | **$237** | **$0** | **$2,867,825** | **$4,732,109** |

### CREDIT QUALITY

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 determination of the allowance for loan losses is based on estimates that are susceptible to changes in the economic environment and market conditions, and is based on the Association's past loss experience, known and inherent risks in the portfolio, the estimated value of the underlying collateral, and current economic conditions. Management believes that as of June 30, 2020, the allowance for loan losses is adequate based on information currently available.

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 June 30, 2020 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Acceptable | | OAEM | | Substandard/Doubtful | | Total |
| | Amount | % | Amount | % | Amount | % | Amount |
| Real estate mortgage | $6,742,396 | 95.2% | $181,897 | 2.6% | $160,252 | 2.2% | $7,084,545 |
| Production and intermediate-term | 2,674,199 | 94.3% | 100,988 | 3.6% | 61,132 | 2.1% | 2,836,319 |
| Agribusiness | 2,409,685 | 98.1% | 32,414 | 1.3% | 14,578 | 0.6% | 2,456,677 |
| Rural infrastructure | 394,317 | 91.9% | 8,248 | 1.9% | 26,367 | 6.2% | 428,932 |
| Rural residential real estate | 1,809 | 88.1% | 109 | 5.3% | 136 | 6.6% | 2,054 |
| Agricultural export finance | 41,850 | 100.0% | - | 0.0% | - | 0.0% | 41,850 |
| Total | **$12,264,256** | **95.5%** | **$323,656** | **2.5%** | **$262,465** | **2.0%** | **$12,850,377** |

| | As of December 31, 2019 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Acceptable | | OAEM | | Substandard/Doubtful | | Total |
| | Amount | % | Amount | % | Amount | % | Amount |
| Real estate mortgage | $6,342,291 | 95.5% | $201,923 | 3.0% | $98,171 | 1.5% | $6,642,386 |
| Production and intermediate-term | 2,547,434 | 93.8% | 119,081 | 4.4% | 48,541 | 1.8% | 2,715,056 |
| Agribusiness | 2,211,838 | 98.5% | 13,062 | 0.6% | 21,187 | 0.9% | 2,246,087 |
| Rural infrastructure | 281,641 | 91.3% | 23,219 | 7.5% | 3,545 | 1.1% | 308,406 |
| Rural residential real estate | 2,175 | 90.4% | 85 | 3.5% | 146 | 6.1% | 2,406 |
| Agricultural export finance | 41,868 | 100.0% | - | 0.0% | - | 0.0% | 41,868 |
| Total | **$11,427,248** | **95.6%** | **$357,370** | **3.0%** | **$171,591** | **1.4%** | **$11,956,209** |

## Notes to the Consolidated Financial Statements *(continued)*

### IMPAIRED ASSETS

Impaired assets (including related accrued interest) are as follows:

| | June 30, 2020 | December 31, 2019 |
|---|---|---|
| **Nonaccrual loans:** | | |
| Real estate mortgage | $40,434 | $28,849 |
| Production and intermediate-term | 8,001 | 7,579 |
| Agribusiness | 8,598 | 5,681 |
| Rural residential real estate | 135 | 123 |
| Total nonaccrual loans | 57,168 | 42,232 |
| **Accruing restructured loans:** | | |
| Real estate mortgage | 11,116 | 13,390 |
| Production and intermediate-term | 17 | 18 |
| Total accruing restructured loans | 11,133 | 13,408 |
| **Accruing loans > 90 days past due:** | | |
| Real estate mortgage | 804 | - |
| Production and intermediate-term | 52 | - |
| Total accruing loans > 90 days past due | 856 | - |
| **Total impaired loans** | **69,157** | **55,640** |
| Other property owned | 4,779 | 4,779 |
| **Total impaired assets** | **$73,936** | **$60,419** |

Additional impaired loan information is as follows:

| | At June 30, 2020 | | | For the Six Months Ended June 30, 2020 | |
|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Impaired Loans | Interest Income Recognized |
| Impaired loans: | | | | | |
| with a related allowance for credit losses | $7,505 | $9,211 | $2,848 | $3,957 | $0 |
| with no related allowance for credit losses | 61,652 | 79,875 | - | 54,376 | 3,577 |
| **Total** | **$69,157** | **$89,086** | **$2,848** | **$58,333** | **$3,577** |

| | At June 30, 2019 | | | For the Six Months Ended June 30, 2019 | |
|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Impaired Loans | Interest Income Recognized |
| Impaired loans: | | | | | |
| with a related allowance for credit losses | $10,763 | $12,105 | $4,710 | $7,963 | $11 |
| with no related allowance for credit losses | 50,890 | 72,782 | - | 43,218 | 2,176 |
| **Total** | **$61,653** | **$84,887** | **$4,710** | **$51,181** | **$2,187** |

### DELINQUENCY

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

| June 30, 2020 | 30-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or Less than 30 Days Past Due | Total Loans |
|---|---|---|---|---|---|
| Real estate mortgage | $8,180 | $17,624 | $25,804 | $7,058,742 | $7,084,546 |
| Production and intermediate-term | 1,718 | 2,984 | 4,702 | 2,831,617 | 2,836,319 |
| Agribusiness | 1,468 | - | 1,468 | 2,455,210 | 2,456,678 |
| Rural infrastructure | - | - | - | 428,932 | 428,932 |
| Rural residential real estate | - | 134 | 134 | 1,919 | 2,053 |
| Agricultural export finance | - | - | - | 41,849 | 41,849 |
| **Total** | **$11,366** | **$20,742** | **$32,108** | **$12,818,269** | **$12,850,377** |

| December 31, 2019 | 30-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or Less than 30 Days Past Due | Total Loans |
|---|---|---|---|---|---|
| Real estate mortgage | $19,324 | $11,675 | $30,999 | $6,611,091 | $6,642,090 |
| Production and intermediate-term | 4,198 | 4,837 | 9,035 | 2,706,317 | 2,715,352 |
| Agribusiness | 373 | - | 373 | 2,245,715 | 2,246,088 |
| Rural infrastructure | - | - | - | 308,406 | 308,406 |
| Rural residential real estate | 23 | 116 | 139 | 2,266 | 2,405 |
| Agricultural export finance | - | - | - | 41,868 | 41,868 |
| **Total** | **$23,918** | **$16,628** | **$40,546** | **$11,915,663** | **$11,956,209** |

# Notes to the Consolidated Financial Statements *(continued)*

### TROUBLED DEBT RESTRUCTURINGS

A restructuring of debt constitutes a troubled debt restructuring (TDR) if the creditor for economic reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider.

The following table presents additional information regarding TDRs, whether accrual or non-accrual, that occurred during the first six months of 2020. The Association had no new TDRs in the first six months of 2019.

| | For the Six Months Ended June 30, 2020 | |
|---|---|---|
| | Pre-modification Outstanding Recorded Investment* | Post-modification Outstanding Recorded Investment* |
| Troubled debt restructurings: | | |
| Real estate mortgage | $0 | $0 |
| **Total** | **$0** | **$0** |

*Pre-modification represents the recorded investment prior to restructuring and post-modification represents the recorded investment immediately following the restructuring. The recorded investment is the face amount of the receivable, 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.

In the allowance for loan loss analysis, TDR loans are individually evaluated and a specific allowance is established based on the likelihood the current events will result in an anticipated loss on the individual loans.

The following table provides information on outstanding principal balance of loans restructured in TDR at period-end. These loans are included as impaired loans in the impaired loan table at June 30, 2020:

| | TDRs in Accrual Status | | TDRs in Nonaccrual Status | | Total TDRs | |
|---|---|---|---|---|---|---|
| | **Jun. 30, 2020** | **Dec. 31, 2019** | **Jun. 30, 2020** | **Dec. 31, 2019** | **Jun. 30, 2020** | **Dec. 31, 2019** |
| Real estate mortgage | $11,101 | $11,423 | $2,669 | $843 | $13,770 | $12,266 |
| Production and intermediate-term | 18 | 1,952 | - | - | 18 | 1,952 |
| Agribusiness | - | - | 4,024 | 4,608 | 4,024 | 4,608 |
| **Total** | **$11,119** | **$13,375** | **$6,693** | **$5,451** | **$17,812** | **$18,826** |

Additional commitments to lend to borrowers whose loans have been modified in TDRs were $1.6 million at period end.

# Notes to the Consolidated Financial Statements *(continued)*

## ALLOWANCE FOR LOAN LOSSES

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

| | Allowance for Loan Losses | | | Recorded Investments in Loans Outstanding | | |
|---|---|---|---|---|---|---|
| | **Balance at Jun. 30, 2020** | Individually Evaluated for Impairment | Collectively Evaluated for Impairment | **Balance at Jun. 30, 2020** | Individually Evaluated for Impairment | Collectively Evaluated for Impairment |
| Real estate mortgage | $11,119 | $1,319 | $9,800 | $7,084,545 | $52,354 | $7,032,191 |
| Production and intermediate-term | 14,026 | 320 | 13,706 | 2,836,319 | 8,070 | 2,828,249 |
| Agribusiness | 7,366 | 1,209 | 6,157 | 2,456,678 | 8,598 | 2,448,080 |
| Rural infrastructure | 1,377 | - | 1,377 | 428,932 | - | 428,932 |
| Rural residential real estate | 1 | - | 1 | 2,054 | 135 | 1,919 |
| Agricultural export finance | 204 | - | 204 | 41,849 | - | 41,849 |
| Total | **$34,093** | **$2,848** | **$31,245** | **$12,850,377** | **$69,157** | **$12,781,220** |

| | Allowance for Loan Losses | | | Recorded Investments in Loans Outstanding | | |
|---|---|---|---|---|---|---|
| | **Balance at Dec. 31, 2019** | Individually Evaluated for Impairment | Collectively Evaluated for Impairment | **Balance at Dec. 31, 2019** | Individually Evaluated for Impairment | Collectively Evaluated for Impairment |
| Real estate mortgage | $6,676 | $0 | $6,676 | $6,642,090 | $42,239 | $6,599,851 |
| Production and intermediate-term | 11,666 | 129 | 11,537 | 2,715,352 | 7,597 | 2,707,755 |
| Agribusiness | 6,703 | 1,387 | 5,316 | 2,246,088 | 5,682 | 2,240,406 |
| Rural infrastructure | 564 | - | 564 | 308,406 | - | 308,406 |
| Rural residential real estate | 2 | - | 2 | 2,405 | 122 | 2,283 |
| Agricultural export finance | 196 | - | 196 | 41,868 | - | 41,868 |
| Total | **$25,807** | **$1,516** | **$24,291** | **$11,956,209** | **$55,640** | **$11,900,569** |

A summary of the changes in the Allowance for Loan Losses is as follows:

| | June 30, | |
|---|---|---|
| | **2020** | **2019** |
| **Allowance for Loan Losses** | | |
| Balance at beginning of year | $25,807 | $21,359 |
| Charge-offs | (1,031) | (805) |
| Recoveries | 1,160 | 781 |
| Provision for/(Reversal of) loan losses | 8,157 | 1,246 |
| **Balance at end of quarter** | **$34,093** | **$22,581** |

## NOTE 3 – LEASES

The balance sheet effect of operating leases, for office space, and finance leases, for vehicles, are included in premises and equipment and other liabilities on the balance sheet. Right-of-use assets represent the Association's right to use an underlying asset for the lease term and lease liabilities represent the Association's obligation to make lease payments arising from the lease.

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

| | Operating Leases | Finance Leases | Total |
|---|---|---|---|
| 2020 (excluding the three months ended 6/30/20) | $444 | $258 | $702 |
| 2021 | 823 | 632 | 1,455 |
| 2022 | 682 | 410 | 1,092 |
| 2023 | 582 | 367 | 949 |
| 2024 | 557 | 22 | 579 |
| Thereafter | 2,200 | - | 2,200 |
| **Total lease payments** | **5,288** | **1,689** | **6,977** |
| Less: interest | - | (104) | (104) |
| **Total** | **$5,288** | **$1,585** | **$6,873** |

Right-of-use assets, net of accumulated amortization, amounted to $5.5 million for the period ended June 30, 2020.

## NOTE 4 – MEMBERS' EQUITY

The table below shows the Association's regulatory capital requirements and ratios as of June 30, 2020. The Association exceeded all regulatory minimum capital requirements as of June 30, 2020.

| | Regulatory Minimums | Capital Conservation Buffer | Total | Jun. 30, 2020 | Dec. 31, 2019 |
|---|---|---|---|---|---|
| Risk-adjusted: | | | | | |
| Common Equity Tier 1 Capital | 4.5% | 2.5% | 7.0% | **12.13%** | **13.40%** |
| Tier 1 Capital | 6.0% | 2.5% | 8.5% | **12.13%** | **13.40%** |
| Total Capital | 8.0% | 2.5% | 10.5% | **12.37%** | **13.60%** |
| Permanent Capital | 7.0% | 0.0% | 7.0% | **13.34%** | **14.58%** |
| Non-risk-adjusted: | | | | | |
| Tier 1 Leverage | 4.0% | 1.0% | 5.0% | **13.64%** | **15.33%** |
| URE and UREE Leverage | 1.5% | 0.0% | 1.5% | **14.48%** | **15.67%** |

## Notes to the Consolidated Financial Statements *(continued)*

Association shareholders have approved a class of preferred stock known as H Stock. At June 30, 2020, 500 million shares of the stock were authorized at $1.00 par value. H Stock ownership is limited to existing common stockholders of the Association and is considered "at-risk." The stock bears a dividend rate that is set by the Board of Directors. Retirement of the stock is at the discretion of the Board. At June 30, 2020, there were 159,363,240 shares of H Stock issued and outstanding. The dividend rate at June 30, 2020 was 0.60%.

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

| **Balance at December 31, 2019** | **Pension and Other Benefit Plans** | **Accumulated Other Comprehensive Loss** |
|---|---|---|
| Other comprehensive loss before reclassifications | $(14,267) | $(14,267) |
| Amounts reclassified from accumulated other comprehensive loss | 1,500 | 1,500 |
| Net current period other comprehensive income | 1,500 | 1,500 |
| **Balance at June 30, 2020** | **$(12,767)** | **$(12,767)** |

| **Balance at December 31, 2018** | **Pension and Other Benefit Plans** | **Accumulated Other Comprehensive Loss** |
|---|---|---|
| Other comprehensive loss before reclassifications | $(12,252) | $(12,252) |
| Amounts reclassified from accumulated other comprehensive loss | 1,164 | 1,164 |
| Net current period other comprehensive income | 1,164 | 1,164 |
| **Balance at June 30, 2019** | **$(11,088)** | **$(11,088)** |

The following table represents reclassifications out of accumulated other comprehensive income (loss):

| | **For the Six Months Ended** | | **Location of Gain/(Loss) Recognized in Statement of Income** |
|---|---|---|---|
| | **Jun. 31, 2020** | **Jun. 31, 2019** | |
| Pension and other benefit plans: | | | |
| Net actuarial gain | $1,500 | $1,164 | Salaries & Benefits |
| **Total amounts reclassified** | **$1,500** | **$1,164** | |

## NOTE 5 – FAIR VALUE MEASUREMENTS

Accounting standards define 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 2 to the 2019 Annual Report.

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

| | June 30, 2020 Fair Value Measurement Using | | December 31, 2019 Fair Value Measurement Using | |
|---|---|---|---|---|
| | **Level 1** | **Level 3** | **Level 1** | **Level 3** |
| **Measured at fair value on a recurring basis:** | | | | |
| Assets held in nonqualified benefits trusts | $18,136 | | $20,352 | |
| **Measured at fair value on a non-recurring basis:** | | | | |
| Loans | | $4,657 | | $3,966 |
| Other Property Owned | | $4,425 | | $6,200 |

During the reporting periods presented, the Association recorded no transfers in or out of Levels 1, 2, or 3. The Association had no liabilities measured at fair value on a recurring basis for the periods presented.

**Valuation Techniques:** Accounting 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 Associations' assets and liabilities.

**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 other property owned involves the use of independent appraisals or other market-based information. Costs to sell represent transaction costs and are not included as a component of the asset's fair value.

**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.

## NOTE 6 - SUBSEQUENT EVENTS

The Association has evaluated subsequent events through August 7, 2020, which is the date the financial statements were available to be issued.