

# FIRST SOUTH FARM CREDIT, ACA

## 2019 ANNUAL REPORT

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### Management

John W. Barnard.....	President & Chief Executive Officer
Bryan Applewhite .....	Senior Vice President/Chief Financial Officer/Treasurer
Sells J. Newman, Jr. ....	Senior Vice President/Legislative Affairs/Public Relations
Gines Pérez, III .....	Senior Vice President/Chief Credit Officer
Rodney Brantley .....	President, Mississippi Division
Mike Pigg .....	President, Alabama Division
David Wilson .....	President, Louisiana Division
John Hurt .....	President, Capital Markets Division

### Board of Directors

Daniel C. Mattingly.....	Chairman
James F. Martin, III. ....	Vice Chairman
Adam W. Bass.....	Director
John R. Burden.....	Director
Paul Clark.....	Director
Amy C. Ellender.....	Director
Dr. Marty J. Fuller.....	Director
John Ingraffia .....	Director
Wilson E. Judice.....	Director
Kevin Kimzey .....	Director
William T. Kyser.....	Director
Timothy L. Leonard.....	Director
Ray Makamson.....	Director
Alan Marsh.....	Director
Shepherd Morris.....	Director
Thomas H. Nelson, Jr.....	Director
James M. Norsworthy, III .....	Director
Thomas A. Parker.....	Director
Ted S. Passmore .....	Director
Michael W. Patrick.....	Director
Walter R. Richardson .....	Director
Robert D. Thibodeaux.....	Director
Dan West.....	Director

## *Message from the Chief Executive Officer*

On behalf of the Board of Directors, Management and Employees of First South Farm Credit, I am pleased to report that 2019 was an excellent year for your Association. Key performance areas including capital, earnings and asset quality all were excellent. This enabled your First South Board of Directors to continue the trend of returning a portion of our profits to the stockholders.

In April of 2020, approximately \$19.3 million in cash patronage will be paid to First South stockholders. This represents the 25th consecutive year that First South has paid a patronage refund to its member borrowers. Total patronage paid over that 25 year period is \$266.1 million. Returning profits to our stockholders continues to reflect your Association's commitment to operating under the cooperative model.

2019 continued to reflect sound loan growth with our average daily balance of loans increasing 7.13%. We also saw another record year of new loan production, with new loans closed reaching \$282 million. The average daily balance of loans continued the pattern of strong growth, reaching \$2.22 billion at December 31, 2019.

Earnings exceeded our projections with net income of \$44 million. The quality of loan assets with acceptable loan volume was 94.8% at December 31<sup>st</sup> and our permanent capital was 17.52%.

This year also continued the trend of tenured employees reaching retirement and concluding their First South career. Many of these employees retired with 30 and even 40 years of dedicated service to First South. I would like to take this opportunity to thank each of them for their dedication, hard work and commitment to First South. Our future looks bright due largely to their efforts. We have a great staff who will continue this tradition of commitment and hard work.

We have been preparing for retirements through an aggressive succession and recruiting process. The next generation of staff bring a great deal of enthusiasm, expertise and dedication to the continued success of First South. Our investment in hiring, training and developing our new employees will ensure we meet the demands of a modern and competitive market while maintaining the Farm Credit values and cooperative culture First South's Members rely on.

As we are faced with a new decade, the year 2020 almost seems far away. The sound of it feels futuristic but we are here. There are new and amazing technologies that

touch every aspect of our lives and livelihoods. Change is everywhere and is accelerating by the minute. There can be tremendous pressure to "keep up" and opportunities to enhance our delivery of services to our Members should never be missed however, change should never be untaken for its own sake.

First South, in the next decade and beyond, will remain steadfast in focusing on our Members' and rural communities' credit and financial service needs. Your Association is innovative but always with a purpose – new technologies (application processes, online services, and loan systems) must demonstrate value to the Membership. First South will use technology to enhance our relationship skills and never to replace them. Your Association has made substantial steps in the last year to modernize our loan systems and is encouraged by the capability our team demonstrated implementing change while also delivering superior customer service.

Guiding all initiatives and projects are strategic objectives as established by the management team and the First South Board of Directors. The following objectives are unchanged from 2019 because they are fundamental to First South's continued success:

Our strategic priorities are:

- Strong Capital
- An Exceptional Customer Experience
- Operational Excellence
- Enhanced Employee Development

First South is blessed with a territory that is home to some of the best agricultural operations in the country. We are grateful for an unparalleled commodity and geographic diversity that provides stability in financial performance and risk management. The First South team feels honored to serve our Members in Louisiana, Mississippi, and Alabama. Thank you for your business and we look forward to many more productive years together.



John W. Barnard  
*President and Chief Executive Officer*

March 12, 2020

## Report of Management

The accompanying Consolidated Financial Statements and related financial information appearing throughout this annual report have been prepared by management of First South Farm Credit, ACA (Association) in accordance with generally accepted accounting principles appropriate in the circumstances. Amounts which must be based on estimates represent the best estimates and judgments of management. Management is responsible for the integrity, objectivity, consistency, and fair presentation of the Consolidated Financial Statements and financial information contained in this report.

Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all financial statements, and that the assets of the Association are safeguarded. The design and implementation of all systems of internal control are based on judgments required to evaluate the costs of controls in relation to the expected benefits and to determine the appropriate balance between these costs and benefits. The Association maintains an internal audit program to monitor compliance with the systems of internal accounting control. Audits of the accounting records, accounting systems and internal controls are performed and internal audit reports, including appropriate recommendations for improvement, are submitted to the Board of Directors. The Consolidated Financial Statements have been audited by independent auditors, whose report appears elsewhere in this annual report. The Association is also subject to examination by the Farm Credit Administration.

The Consolidated Financial Statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that we have reviewed the 2019 Annual Report of First South Farm Credit, ACA, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and 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.



Daniel C. Mattingly  
Chairman of the Board



John W. Barnard  
Chief Executive Officer



Bryan Applewhite  
Chief Financial Officer

March 12, 2020

## ***Report on Internal Control Over Financial Reporting***

The Association's principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association's Consolidated Financial Statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by, or under the supervision of the Association's principal executives and principal financial officers, or persons performing similar functions, and effected by its Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting information and the preparation of the Consolidated Financial Statements for external purposes in accordance with accounting principles generally accepted in the United States of America and includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Association's assets that could have a material effect on its Consolidated Financial Statements.

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of December 31, 2019. In making the assessment, management used the framework in *Internal Control — Integrated Framework (2013)*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association's management concluded that as of December 31, 2019, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of December 31, 2019.



John W. Barnard  
Chief Executive Officer



Bryan Applewhite  
Chief Financial Officer

March 12, 2020

# Consolidated Five - Year Summary of Selected Financial Data

<i>(dollars in thousands)</i>	December 31,				
	2019	2018	2017	2016	2015
<b>Balance Sheet Data</b>					
Cash	\$ 8,694	\$ 11,502	\$ 9,097	\$ 6,574	\$ 5,617
Loans	2,234,582	2,072,774	1,976,968	1,859,238	1,597,587
Allowance for loan losses	(14,883)	(13,941)	(13,618)	(12,466)	(10,637)
Net loans	2,219,699	2,058,833	1,963,350	1,846,772	1,586,950
Equity investments in other Farm Credit institutions	67,272	67,309	67,363	67,303	78,012
Other property owned	1,031	2,879	551	1,098	974
Other assets	61,840	59,500	57,018	51,805	48,184
Total assets	\$ 2,358,536	\$2,200,023	\$2,097,379	\$1,973,552	\$1,719,737
Notes payable to AgFirst Farm Credit Bank*	\$ 1,845,304	\$1,717,671	\$1,639,346	\$1,543,099	\$1,314,927
Accrued interest payable and other liabilities with maturities of less than one year	70,061	58,652	57,698	73,108	63,868
Total liabilities	1,915,365	1,776,323	1,697,044	1,616,207	1,378,795
Capital stock and participation certificates	51,819	52,969	54,174	56,531	58,523
Retained earnings					
Allocated	256,357	259,012	261,054	221,800	203,534
Unallocated	162,731	138,687	111,152	108,424	106,358
Accumulated other comprehensive income (loss)	(27,736)	(26,968)	(26,045)	(29,410)	(27,473)
Total members' equity	443,171	423,700	400,335	357,345	340,942
Total liabilities and members' equity	\$ 2,358,536	\$2,200,023	\$2,097,379	\$1,973,552	\$1,719,737
<b>Statement of Income Data</b>					
Net interest income	\$ 56,892	\$ 54,273	\$ 51,636	\$ 46,899	\$ 43,884
Provision for loan losses	1,105	1,080	1,285	1,549	1,180
Noninterest income (expense), net	(11,787)	(8,087)	8,882	(11,170)	(11,907)
Net income	\$ 44,000	\$ 45,106	\$ 59,233	\$ 34,180	\$ 30,797
<b>Key Financial Ratios</b>					
Rate of return on average:					
Total assets	1.93%	2.12%	2.92%	1.88%	1.87%
Total members' equity	10.06%	10.89%	16.00%	9.71%	9.30%
Net interest income as a percentage of					
average earning assets	2.61%	2.68%	2.67%	2.73%	2.85%
Net (chargeoffs) recoveries to average loans	(0.007)%	(0.037)%	(0.007)%	0.016%	(0.043)%
Total members' equity to total assets	18.79%	19.26%	19.09%	18.11%	19.83%
Debt to members' equity (:1)	4.32	4.19	4.24	4.52	4.04
Allowance for loan losses to loans	0.67%	0.67%	0.69%	0.67%	0.67%
Permanent capital ratio	17.52%	17.85%	16.92%	17.48%	17.78%
Total surplus ratio	**	**	**	16.55%	17.19%
Core surplus ratio	**	**	**	16.55%	16.60%
Common equity tier 1 capital ratio	17.32%	17.50%	16.43%	**	**
Tier 1 capital ratio	17.32%	17.50%	16.43%	**	**
Total regulatory capital ratio	17.97%	18.29%	17.35%	**	**
Tier 1 leverage ratio	17.42%	17.45%	16.42%	**	**
Unallocated retained earnings (URE) and					
URE equivalents leverage ratio	11.72%	11.34%	10.91%	**	**
<b>Net Income Distribution</b>					
Estimated patronage refunds:					
Cash	\$ 19,300	\$ 17,500	\$ 15,000	\$ 10,700	\$ 9,400
Nonqualified allocated retained earnings	—	—	20,815	10,804	9,849
Nonqualified retained earnings	—	—	20,815	10,804	9,849

\* General financing agreement is renewable on a one-year cycle. The next renewal date is December 31, 2020.

\*\* Not applicable due to changes in regulatory capital requirements effective January 1, 2017.

# Management's Discussion & Analysis of Financial Condition & Results of Operations

(dollars in thousands, except as noted)

## GENERAL OVERVIEW

The following commentary summarizes the financial condition and results of operations of First South Farm Credit, ACA, (Association) for the year ended December 31, 2019 with comparisons to the years ended December 31, 2018 and December 31, 2017. This information should be read in conjunction with the Consolidated Financial Statements, Notes to the Consolidated Financial Statements and other sections in this Annual Report. The accompanying Consolidated Financial Statements were prepared under the oversight of the Audit Committee of the Board of Directors. For a list of the Audit Committee members, refer to the "Report of the Audit Committee" reflected in this Annual Report. Information in any part of this Annual Report may be incorporated by reference in answer or partial answer to any other item of the Annual Report.

The Association is an institution of the Farm Credit System (System), which was created by Congress in 1916 and has served agricultural producers for over 100 years. The System's mission is to maintain and improve the income and well-being of American farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses. The System is the largest agricultural lending organization in the United States. The System is regulated by the Farm Credit Administration, (FCA), which is an independent safety and soundness regulator.

The Association is a cooperative, which is owned by the members (also referred to throughout this Annual Report as stockholders or shareholders) served. The territory of the Association extends across a diverse agricultural region of Alabama, Louisiana and Mississippi. Refer to Note 1, *Organization and Operations*, of the Notes to the Consolidated Financial Statements for counties and parishes in the Association's territory. The Association provides credit to farmers, ranchers, rural residents, and agribusinesses. Our success begins with our extensive agricultural experience and knowledge of the market.

The Association obtains funding from AgFirst Farm Credit Bank (AgFirst or Bank). The Association is materially affected and shareholder investment in the Association could be materially affected by the financial condition and results of operations of the Bank. Copies of the Bank's Annual and Quarterly Reports are on the AgFirst website, [www.agfirst.com](http://www.agfirst.com), or may be obtained at no charge by calling 1-800-845-1745, extension 2832, or writing Susanne Caughman, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202.

Copies of the Association's Annual and Quarterly reports are also available upon request free of charge on the Association's website, [www.firstsouthland.com](http://www.firstsouthland.com), or by calling 1-888-297-1722, or writing Bryan Applewhite, First South

Farm Credit, ACA, Three Paragon Centre, 574 Highland Colony Parkway, Suite 100, Ridgeland, MS 39157. The Association prepares an electronic version of the Annual Report, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report, which is available on the internet, within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Association.

## FORWARD LOOKING INFORMATION

This annual information statement contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Words such as "anticipates," "believes," "could," "estimates," "may," "should," "will," or other variations of these terms are intended to identify the forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions, and expected future developments. However, actual results and developments may differ materially from our expectations and predictions due to a number of risks and uncertainties, many of which are beyond our control. These risks and uncertainties include, but are not limited to:

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international, and farm-related business sectors;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry and the Farm Credit System, as a government-sponsored enterprise, as well as investor and rating-agency reactions to events involving other government-sponsored enterprises and other financial institutions; and
- actions taken by the Federal Reserve System in implementing monetary policy.

## AGRICULTURAL OUTLOOK

Production agriculture is a cyclical business that is heavily influenced by commodity prices, weather, tax and trade policies, interest rates and various other factors that affect supply and demand. The following United States Department of Agriculture (USDA) analysis provides a general understanding of the U.S. agricultural economic outlook.

However, this outlook does not take into account all aspects of the Association’s business. References to USDA information in this section refer to the U.S. agricultural market data and are not limited to information/data for the Association.

Agricultural production is a major use of land in the United States and the value of farm real estate accounted for 83 percent of the total value of the U.S. farm sector assets for 2019 according to the USDA in its February 5, 2020 forecast. Because real estate is such a significant component of the balance sheet of U.S. farms, the value of the farm real estate is a critical measure of the farm sector’s financial performance. Changes in farmland values also affect the financial well-being of agricultural producers because farm real estate serves as the principal source of collateral for farm loans.

USDA’s most recent forecast anticipates that farm sector equity, the difference between farm sector assets and debt, is predicted to rise 1.9 percent in 2019. Farm real estate value is expected to increase 1.8 percent and non-real estate farm assets are expected to increase 3.4 percent, while farm sector debt is forecast to increase 3.4 percent in 2019. Farm real estate debt as a share of total debt has been rising since 2014 and is expected to account for 61.7 percent of total farm debt in 2019.

The USDA is forecasting farm sector solvency ratios to increase slightly in 2019 to 15.5 percent for the debt-to-equity ratio and 13.5 percent for the debt-to-asset ratio, which represent the second highest levels since 2009, but well below the peak of 28.5 percent and 22.2 percent in 1985. Working capital (which is defined as cash and cash convertible assets minus liabilities due to creditors within 12 months) is forecast to decline 12.7 percent in 2019 to \$61 billion from \$70 billion in 2018. Farm sector working capital has steadily declined since peaking at \$165 billion in 2012.

The USDA’s most recent forecast estimates net farm income (income after expenses from production in the current year; a broader measure of profits) for 2019 at \$93.6 billion, a \$9.8 billion increase from 2018, \$6.8 billion above the 10-year average and 24.3 percent below its peak of \$123.7 billion in 2013. However, in terms of inflation adjusted dollars, 2019 net farm income is \$2.7 billion below the 10 year average. The forecasted increase in net farm income for 2019, compared with 2018 is primarily due to increases in direct government payments of \$10.0 billion to \$23.7 billion, primarily driven by higher payments from the Market Facilitation Program (MFP). The MFP was first implemented in 2018 and continued in 2019 to assist farmers impacted by trade disruptions.

The USDA’s outlook projects net farm income for 2020 to increase to \$96.7 billion, a \$3.1 billion or 3.3 percent increase from 2019. The forecasted increase in net farm income for 2020 is primarily due to expected increases in cash receipts for animals and products of \$8.2 billion and crop receipts of \$1.9 billion, partially offset by an \$8.7 billion decrease in direct government payments due to an expected decline in payments from the MFP. The increase in animal and products receipts reflects growth in hogs, milk, cattle and poultry/eggs receipts, while the crop receipts are driven by fruit/nuts and corn. Soybeans receipts are anticipated to decrease as lower quantities outweigh an increase in price.

Expected agricultural commodity prices can influence production decisions of farmers and ranchers on

planted/harvested acreage of crops or inventory of livestock and thus, affect the supply of agricultural commodities. Greater area of planted/ harvested acreage and increased crop yields for some crops in recent years have contributed to increased supply, which exceeded demand. Also impacting yields are the growing conditions that are sensitive to weather conditions. Although not generally affected by weather, livestock and dairy prices are linked to crop prices as feed is a significant input cost to these producers.

Global economic conditions also influence demand for food and agricultural products, which affects U.S. agricultural trade. Therefore, U.S. exports and imports shift to reflect changes in trade policies, world population and economic growth. Also impacting U.S. agricultural trade is global supplies and prices, changes in the value of the U.S. dollar and the government support for agriculture.

Severe wet weather during 2019 adversely affected growing conditions in some production areas. In addition, farmers in certain locations were also impacted by inclement weather during the fall harvest. The impact of the weather related conditions on production agriculture was partially offset by crop insurance proceeds. In addition to weather related challenges, reduced exports resulting from the trade tensions with China added to the already challenging agricultural economy. During 2018 and 2019, the MFP provided a material boost in farm sector income and in early 2020, the United States and China agreed to a “phase one” trade deal, which includes a significant commitment from China to buy agricultural products, among other items. However, the recent spread of the coronavirus (COVID-19) has created uncertainty about China’s economic outlook and its ability to fulfill phase one commitments. Furthermore, African swine fever, which has been negatively impacting Asian hog production, may produce increased U.S. exports of pork and other protein products but could also negatively affect U.S. soybean exports.

The following table sets forth the commodity prices per bushel for certain crops, by hundredweight for hogs, milk, and beef cattle, and by pound for broilers and turkeys from December 31, 2016 to December 31, 2019:

Commodity	12/31/19	12/31/18	12/31/17	12/31/16
Hogs	\$47.30	\$43.40	\$48.60	\$43.10
Milk	\$20.70	\$16.60	\$17.20	\$18.90
Broilers	\$0.45	\$0.51	\$0.50	\$0.48
Turkeys	\$0.62	\$0.50	\$0.53	\$0.74
Corn	\$3.71	\$3.54	\$3.23	\$3.32
Soybeans	\$8.70	\$8.56	\$9.30	\$9.64
Wheat	\$4.64	\$5.28	\$4.50	\$3.90
Beef Cattle	\$118.00	\$117.00	\$118.00	\$111.00

The agricultural environment has been challenging during the past several years for many commodities. Currency fluctuations, ample inventories and U.S. trade policies, including retaliatory actions by other countries, have adversely impacted demand and prices for agricultural exports. This has reduced net farm income and eroded working capital from peak levels in 2012. The agriculture sector continues to adjust to market conditions. While producers’ financial performance generally has been negatively impacted, MFP, crop insurance and producer operating adjustments have helped offset the severity of stress during the past two years.

Looking ahead, the MFP payments are not anticipated to continue and uncertainty remains about agricultural export markets. As a result, the Association's financial performance and credit quality may be negatively impacted but is expected to remain sound overall. Additionally, geographic and commodity diversification across the Association coupled with off-farm income support for many borrowers helps to mitigate the impact of periods of less favorable agricultural conditions. However, agricultural borrowers who are more reliant on off-farm income sources may be more adversely impacted by a weakened general economy.

## CRITICAL ACCOUNTING POLICIES

The financial statements are reported in conformity with accounting principles generally accepted in the United States of America. Our significant accounting policies are critical to the understanding of our results of operations and financial position because some accounting policies require us to make complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. We consider these policies critical because management must make judgments about matters that are inherently uncertain. For a complete discussion of significant accounting policies, see Note 2, *Summary of Significant Accounting Policies*, of the Notes to the Consolidated Financial Statements. The following is a summary of certain critical policies.

- *Allowance for loan losses* — The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs. The allowance for loan losses is determined based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic and political conditions, loan portfolio composition, credit quality and prior loan loss experience.

Significant individual loans are evaluated based on the borrower's overall financial condition, resources, and payment record, the prospects for support from any financially responsible guarantor, and, if appropriate, the estimated net realizable value of any collateral. The allowance for loan losses encompasses various judgments, evaluations and appraisals with respect to the loans and their underlying security that, by nature, contains elements of uncertainty and imprecision. Changes in the agricultural economy and their borrower repayment capacity will cause these various judgments, evaluations and appraisals to change over time. Accordingly, actual circumstances could vary from the Association's expectations and predictions of those circumstances.

Management considers the following factors in determining and supporting the levels of allowance for loan losses: the concentration of lending in agriculture, combined with uncertainties in farmland values, commodity prices, exports, government assistance programs, regional economic effects and weather-related influences. Changes in the factors considered by management in the evaluation of losses in the loan portfolios could result in a change in the allowance for

loan losses and could have a direct impact on the provision for loan losses and the results of operations.

- *Valuation methodologies* — Management applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets for which an observable liquid market exists, such as most investment securities. Management utilizes significant estimates and assumptions to value items for which an observable liquid market does not exist. Examples of these items include impaired loans, other property owned, pension and other postretirement benefit obligations, and certain other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing and liquidation values. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on the Association's results of operations.
- *Pensions — Single Employer Defined Benefit Plan* Certain employees depending on date of employment may participate in the First South Farm Credit, ACA Retirement Plan (the FS Plan), a defined benefit plan. The Plan is noncontributory and includes eligible Association employees. The "Projected Unit Credit" actuarial method is used for financial reporting purposes. Since the FS Plan is a single employer plan, the Association records the FS Plan's funded status and equity items related to prior service cost, accumulated other comprehensive income (loss) and prepaid (accrued) pension expense. The adjustment to other comprehensive income (loss) would be net of deferred taxes, if significant.

The foregoing defined benefit plan is considered single employer, therefore the Association applies the provisions of FASB guidance on employers' accounting for defined benefit pension plans in its standalone financial statements.

See Note 9 for additional information. Pension expense for all plans is recorded in accordance with FASB guidance. Pension expense for the defined benefit retirement plans is determined by actuarial valuations based on certain assumptions, including expected long-term rate of return on plan assets and the discount rate. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that portfolio of assets. The discount rate is used to determine the present value of our future benefit obligations. We selected the discount rate by reference to Hewitt's (a global human resources firm) top quartile rate, actuarial analyses and industry norms.

## ECONOMIC CONDITIONS

Economic conditions within the Association's territory vary, depending on the sector of the economy in question. The general economy is sound, with historically low unemployment and economic growth noted across the three states. Localized stress is seen in areas where local conditions and factors

adversely impact those areas, but on a broader scale, economic conditions and indicators reflect a strong economy.

Conditions vary widely within the agricultural economy. As has been the case for the past several years, prices farmers receive for grain, timber, beef cattle and dairy commodities have presented challenges to those producers as they attempt to generate profits from their operations. Commodity pricing uncertainty has been a risk factor as trade disputes continue to weigh heavily on global markets. Poultry remains the Association's largest individual commodity financed, and

conditions within that industry have remained relatively stable. The poultry segment of our portfolio continues to perform well, as does the segment reliant on non-farm income for repayment

Credit quality remains stable and sound as the Association's borrowers have done a good job of managing the challenges they have faced. The strength of the loan portfolio leaves the Association well positioned to weather volatility and adversity in the general and agricultural economies.

## LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners, and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans through numerous product types. The diversification of the Association loan volume by type for each of the past three years is shown below.

Loan Type	2019		2018		2017	
	Amount	%	Amount	%	Amount	%
Real Estate Mortgage	\$ 1,745,138	78.10%	\$ 1,617,874	78.05%	\$ 1,498,148	75.78%
Production and Intermediate-term	396,010	17.72	375,310	18.11	383,514	19.40
Processing and marketing	50,048	2.24	38,867	1.88	62,001	3.14
Loans to cooperatives	11,581	.52	7,844	.38	3,368	.17
Farm-related business	11,053	.50	12,845	.62	8,561	.43
Rural residential real estate	10,981	.49	9,745	.47	9,302	.47
Communication	6,760	.30	6,664	.32	8,357	.42
Energy	3,011	.13	3,625	.17	3,717	.19
Total	\$ 2,234,582	100.00%	\$ 2,072,774	100.00%	\$ 1,976,968	100.00%

While we make loans and provide financially related services to qualified borrowers in the agricultural and rural sectors and to certain related entities, our loan portfolio is diversified.

The geographic distribution of the loan volume by state for the past three years is as follows:

State	December 31,		
	2019	2018	2017
Alabama	54.49%	52.85%	51.51%
Mississippi	27.82	28.91	29.51
Louisiana	17.69	18.24	18.98
	100.00%	100.00%	100.00%

Commodity and industry categories are based upon the Standard Industry Classification system published by the federal government. The system is used to assign commodity or industry categories based upon the largest agricultural commodity of the customer.

The major commodities in the Association loan portfolio are shown below. The predominant commodities are poultry, real estate, livestock and forestry, which constitute 75 percent of the entire portfolio.

Commodity Group	December 31,					
	2019		2018		2017	
	Amount	%	Amount	%	Amount	%
Poultry	\$ 688,624	31	\$ 643,350	31	\$ 571,994	29
Real Estate	490,908	22	435,086	21	404,188	20
Livestock	283,565	13	255,357	12	240,020	12
Forestry	208,447	9	205,249	10	208,897	11
Cotton	141,604	6	121,793	6	115,080	6
Soybeans	112,367	5	126,524	6	138,512	7
Sugar Cane	80,075	4	64,872	3	67,826	3
Rice	76,717	3	81,848	4	75,120	4
Catfish	35,108	2	28,465	1	22,719	1
Peanuts	16,170	1	19,455	1	19,945	1
Other	100,997	4	90,776	5	112,667	6
Total	\$ 2,234,582	100	\$ 2,072,774	100	\$ 1,976,968	100

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The Association's loan portfolio contains a concentration of poultry, real estate, livestock and forestry producers. Although a large percentage of the loan portfolio is concentrated in these enterprises, many of these operations are diversified within their enterprise and/or with crop production that reduces overall risk exposure. Demand for beef, prices of field grains, and international trade are some of the factors affecting the price of these commodities. Even though the concentration of large loans has increased over the past several years, the agricultural enterprise mix of these loans is diversified and similar to that of the overall portfolio. The risk in the portfolio associated with commodity concentration and large loans is reduced by the range of diversity of enterprises in the Association's territory.

The increase in gross loan volume for the twelve months ended December 31, 2019, is spread across several commodities within the portfolio.

The Association's short-term portfolio, which is heavily influenced by operating-type loans, normally reaches a peak balance in August or September and rapidly declines in the fall months as commodities are marketed and proceeds are applied to repay operating loans.

Participations remain a means for the Association to spread credit concentration risk and manage our capital position. At December 31, 2019, the Association had \$74,350 in loan participations sold compared to \$56,310 at December 31, 2018 and \$63,228 at December 31, 2017.

Loan Participations:	December 31,		
	2019	2018	2017
	<i>(dollars in thousands)</i>		
Participations Purchased– FCS Institutions	\$ 68,210	\$ 49,216	\$ 62,281
Participations Purchased– Non-FCS Institutions	21,059	21,391	32,202
Participations Sold	(74,350)	(56,310)	(63,228)
Total	\$ 14,919	\$ 14,297	\$ 31,255

The Association did not have any loans sold with recourse, retained subordinated participation interests in loans sold, or interests in pools of subordinated participation interests for the period ended December 31, 2019.

The Association sells qualified long-term mortgage loans into the secondary market. For the period ended December 31, 2019, the Association originated loans for resale into the secondary market totaling \$2,948.

### INVESTMENT SECURITIES

As permitted under FCA regulations, the Association is authorized to hold eligible investments for the purposes of reducing interest rate risk and managing surplus short-term funds. The Bank is responsible for approving the investment policies of the Association. The Bank annually reviews the investment portfolio of every association that it funds. At December 31, 2019, the Association had no investment securities.

### CREDIT RISK MANAGEMENT

Credit risk arises from the potential inability of an obligor to meet its repayment obligation. As part of the process to evaluate the success of a loan, the Association continues to review the credit quality of the loan portfolio on an ongoing basis. With the approval of the Association Board of Directors, the Association establishes underwriting standards and lending policies that provide direction to loan officers. Underwriting standards include, among other things, an evaluation of:

- Character – borrower integrity and credit history
- Capacity – repayment capacity of the borrower based on cash flows from operations or other sources of income
- Collateral – protection for the lender in the event of default and a potential secondary source of repayment
- Capital – ability of the operation to survive unanticipated risks
- Conditions – intended use of the loan funds

The credit risk management process begins with an analysis of the borrower’s credit history, repayment capacity, and financial position. Repayment capacity focuses on the borrower’s ability to repay the loan based upon cash flows from operations or other sources of income, including non-farm income. As required by FCA regulations, each institution that makes loans on a collateralized basis must have collateral evaluation policies and procedures. In addition, each loan is assigned a credit risk rating based upon the underwriting

standards. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses, and risks in a particular relationship.

We review the credit quality of the loan portfolio on an ongoing basis as part of our risk management practices. Each loan is classified according to the Uniform Classification System, which is used by all Farm Credit System institutions. Below are the classification definitions.

- 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 facts, conditions and values that make collection in full highly questionable.
- Loss – Assets are considered uncollectible.

The following table presents selected statistics related to the credit quality of loans including accrued interest at December 31.

Credit Quality	2019	2018	2017
Acceptable	94.81%	96.16%	95.94%
OAEM	3.84	2.94	2.92
Substandard/doubtful/loss	1.35	.90	1.14
Total	100.00%	100.00%	100.00%

### Nonperforming Assets

The Association’s loan portfolio is divided into performing and high-risk categories. The high-risk assets, including accrued interest, are detailed below:

High-risk Assets	December 31,		
	2019	2018	2017
	<i>(dollars in thousands)</i>		
Nonaccrual loans	\$ 4,748	\$ 3,750	\$ 6,405
Restructured loans	2,324	2,464	3,342
Accruing loans 90 days past due	–	–	–
Total high-risk loans	7,072	6,214	9,747
Other property owned	1,031	2,879	551
Total high-risk assets	\$ 8,103	\$ 9,093	\$ 10,298
<b>Ratios</b>			
Nonaccrual loans to total loans	.21%	.18%	.32%
High-risk assets to total assets	.34%	.41%	.49%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or future interest accruals, under the contractual terms of the loan. In substance, nonaccrual loans reflect loans where the accrual of interest has been suspended. Total high-risk assets decreased \$990 due to a decrease in other property owned of \$1,848, offset by an increase in nonaccrual loans of \$998. It must be recognized that portions of the agricultural economy remains relatively weak and the portfolio includes accounts that remain under stress. It is possible that additional loans will transition to high risk status in

2020 and the level of high risk loans is likely to fluctuate significantly throughout the year.

Of the \$4,748 in nonaccrual volume at December 31, 2019, \$1,939 was current compared to \$2,056 and \$2,162 at December 31, 2018 and 2017, respectively. Though the aforementioned nonaccrual loans had volume current as to scheduled principal and interest payments, they did not meet all regulatory requirements to be transferred into accrual status.

Loan restructuring is available to financially distressed borrowers. Restructuring of loans occurs when the Association grants a concession to a borrower based on either a court order or good faith in a borrower's ability to return to financial viability. The concessions can be in the form of a modification of terms or rates, a compromise of amounts owed, or deed in lieu of foreclosure. Other receipts of assets and/or equity to pay the loan in full or in part are also considered restructured loans. The type of alternative financing structure chosen is based on minimizing the loss incurred by both the Association and the borrower.

### Allowance for Loan Losses

The allowance for loan losses at each period end was considered by Association management to be adequate to absorb probable losses existing in and inherent to its loan portfolio.

The following table presents the activity in the allowance for loan losses for the most recent three years is shown below.

Allowance for Loan Losses Activity:	Year Ended December 31,		
	2019	2018	2017
	<i>(dollars in thousands)</i>		
Balance at beginning of year	\$ 13,941	\$ 13,618	\$ 12,466
Charge-offs:			
Real estate mortgage	(188)	(296)	(91)
Production and intermediate-term	(136)	(531)	(83)
Rural Residential Real Estate	-	-	-
Agribusiness	-	-	-
Total charge-offs	(324)	(827)	(174)
Recoveries:			
Real estate mortgage	108	2	28
Production and intermediate-term	53	68	13
Rural Residential Real Estate	-	-	-
Agribusiness	-	-	-
Total recoveries	161	70	41
Net (charge-offs) recoveries	(163)	(757)	(133)
Provision for (reversal of allowance for) loan losses	1,105	1,080	1,285
Balance at end of year	\$ 14,883	\$ 13,941	\$ 13,618
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	(.007)%	(.037)%	(.007)%

The allowance for loan losses by loan type for the most recent three years is as follows:

Allowance for Loan Losses by type	December 31,		
	2019	2018	2017
	<i>(dollars in thousands)</i>		
Real estate mortgage	\$ 10,614	\$ 10,411	\$ 9,588
Production and intermediate term	3,646	3,072	3,528
Agribusiness	468	334	390
Rural residential real estate	67	67	50
Energy	53	20	19
Communication	35	37	43
Total	\$ 14,883	\$ 13,941	\$ 13,618

The allowance for loan losses as a percentage of loans outstanding and as a percentage of certain other credit quality indicators is shown below:

Allowance for Loan Losses as a Percentage of:	December 31,		
	2019	2018	2017
Total loans	.67%	.67%	.69%
Nonperforming assets	183.67%	153.32%	139.71%
Nonaccrual loans	313.46%	371.76%	212.62%

Please refer to Note 3, *Loans and Allowance for Loan Losses*, of the Notes to the Consolidated Financial Statements, for further information concerning the allowance for loan losses.

## RESULTS OF OPERATIONS

### Net Interest Income

Net interest income was \$56.9 million, \$54.3 million and \$51.6 million in 2019, 2018 and 2017, respectively. Net interest income is the difference between interest income and interest expense. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets and cost of debt. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following table:

Change in Net Interest Income	Volume*	Rate	Nonaccrual Income	Total
<i>(dollars in thousands)</i>				
<b>12/31/19 - 12/31/18</b>				
Interest income	\$ 8,000	\$ 2,820	\$ -	\$ 10,820
Interest expense	3,896	4,305	-	8,201
Change in net interest income:	\$ 4,104	\$ (1,485)	\$ -	\$ 2,619
<b>12/31/18- 12/31/17</b>				
Interest income	\$ 5,151	\$ 4,987	\$ -	\$ 10,138
Interest expense	2,275	5,226	-	7,501
Change in net interest income:	\$ 2,876	\$ (239)	\$ -	\$ 2,637

\*Volume variances can be the result of increased/decreased loan volume or from changes in the percentage composition of assets and liabilities between periods.

Noninterest Income

Noninterest income for each of the three years ended December 31 is shown in the following table:

Noninterest Income	For the Year Ended December 31,			Percentage Increase (Decrease)	
	2019	2018	2017	2019/ 2018	2018/ 2017
	<i>(dollars in thousands)</i>				
Loan fees	\$ 2,746	\$ 1,281	\$ 2,595	114.36 %	(50.64)%
Fees for financially related services	847	1,020	1,183	(16.96)	(13.78)
Patronage refund from other Farm Credit Institutions	24,444	26,807	27,940	(8.81)	(4.06)
Gains on sales of premises and equipment, net	503	75	29	570.67	158.62
Insurance Fund refunds	432	1,051	–	(58.90)	100.00
Other noninterest income	–	2	–	(100.00)	100.00
Total noninterest income	\$ 28,972	\$ 30,236	\$ 31,747	(4.18)%	(4.76)%

Total noninterest income decreased by \$1,264 from 2018 to 2019 and decreased \$1,511 from 2017 to 2018. The main factors contributing to the decrease in 2019 and 2018 was primarily related to decreased patronage refunds from other Farm Credit institutions of \$2,363 and decreased Insurance

Fund refunds of \$619. These increases were partially offset by increases in loan fees of \$1,465 and an increase in gains on sales of premises and equipment, net, of \$428. The increase in loan fees in 2019 over 2018 relates primarily to the adoption of ASC 310, Non-refundable fees and other costs, in 2018.

Noninterest Expense

Noninterest expense for each of the three years ended December 31 is shown in the following table:

Noninterest Expense	For the Year Ended December 31,			Percentage Increase/(Decrease)	
	2019	2018	2017	2019/ 2018	2018/ 2017
	<i>(dollars in thousands)</i>				
Salaries and employee benefits	\$ 26,897	\$ 26,574	\$ 25,775	1.22 %	3.10 %
Occupancy and equipment	1,939	2,045	1,784	(5.18)	14.63
Insurance Fund premiums	1,500	1,384	2,204	8.38	(37.21)
Losses on other property owned, net	60	111	82	(45.94)	35.37
Other operating expenses	10,355	8,231	(7,096)	25.8	215.99
Total noninterest expense	\$ 40,751	\$ 38,345	\$ 22,749	6.27 %	68.56 %

Noninterest expenses increased overall by \$2,406 in 2019 compared to 2018. The increase was due to increases in other operating expenses of \$2,124, salaries and benefits of \$323 and Insurance Fund premiums of \$116. The increase in other operating expense resulted from increased defined benefit retirement plan cost of \$1,267 related to a market value decrease in plan assets and an accounting change related to the presentation of lease expense of \$506. The salaries and benefits increase of \$323 resulted primarily from an increase of \$594 related to normal salary administration. This was offset by a \$378 decrease in pension expense due to lower service cost.

Other operating expenses increased by \$15,327 in 2018 due mainly to a change in accounting estimate from the prior year. During 2017, the method of recording other postretirement employee benefits (OPEB) plan expense at participating District entities for the multiemployer OPEB plan was modified. Prior to 2017, expense was recorded based on allocations of actuarially-determined costs and any differences between recorded expense and actual contributions were recorded in Other Liabilities on the Balance Sheet. For 2017 and future years, the Association will record other postretirement benefit costs based on the actual contributions to the plan. This change caused the Association to adjust its accounting estimate recorded in Other Liabilities since the

liabilities do not impact future contributions to the plan. The change in estimate resulted in a reduction of Other Liabilities of \$16,202.

Insurance Fund premiums remained relatively stable for the twelve months ended December 31, 2019, compared to the same period of 2018. The Farm Credit System Insurance Corporation (FCSIC) set premiums at 9 basis points for 2019, based on adjusted insured debt outstanding. FCSIC premiums were also set at 9 basis points for 2018. In addition, there was a 10 basis point premium on the average principal outstanding of nonaccrual loans and any other-than-temporarily impaired investments. FCSIC premiums were set at 15 basis points in 2017.

Income Taxes

The Association recorded a provision for income taxes of \$8 for the year ended December 31, 2019, along with a provision for income taxes of \$(22) and \$116 for the years ended December 31, 2018 and 2017, respectively. Refer to Note 12, *Income Taxes*, of the Notes to the Consolidated Financial Statements, for more information concerning Association income taxes.

*Key Results of Operations Comparisons*

Key results of operations comparisons for each of the twelve months ended December 31 are shown in the following table:

Key Results of Operations Comparisons	For the 12 Months Ended		
	2019	2018	2017
Return on average assets	1.93%	2.12%	2.92%
Return on average members' equity	10.06%	10.89%	16.00%
Net interest income as a percentage of average earning assets	2.61%	2.68%	2.67%
Net (charge-offs) recoveries to average loans	(.007)%	(.037)%	(.007)%

A key factor in the growth of net income for future years will be improvement in net interest and noninterest income while attempting to keep operating expenses under control. Our goal is to generate earnings sufficient to fund operations, adequately capitalize the Association, and achieve an adequate rate of return for our members. To meet this goal, the agricultural economy must show continued improvement in the coming years and the Association must meet certain objectives. These objectives are to attract and maintain high quality loan volume priced at competitive rates and to manage credit risk in our entire portfolio, while efficiently meeting the credit needs of our members.

**LIQUIDITY AND FUNDING SOURCES**

*Liquidity and Funding*

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement (GFA). The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association, creating notes payable (or direct loans) to the Bank. The Bank manages interest rate risk through direct loan pricing and asset/liability management. The notes payable are segmented into variable rate and fixed rate components. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. Association capital levels effectively create a borrowing margin between the amount of loans outstanding and the amount of notes payable outstanding. This margin is commonly referred to as "Loanable Funds."

Total notes payable to the Bank at December 31, 2019, was \$1,845,304 as compared to \$1,717,671 at December 31, 2018 and \$1,639,346 at December 31, 2017. The increase of 7.43 percent compared to December 31, 2018 and the increase of 4.78 percent compared to December 31, 2017, are related to continued growth in the loan portfolio. The average volume of outstanding notes payable to the Bank was \$1,793,634, \$1,667,011 and \$1,597,754 for the years ended December 31, 2019, 2018 and 2017, respectively. Refer to Note 6, *Notes Payable to AgFirst Farm Credit Bank*, of the Notes to the Consolidated Financial Statements, for weighted average interest rates and maturities, and additional information concerning the Association's notes payable.

Liquidity management is the process whereby funds are made available to meet all financial commitments including the

extension of credit, payment of operating expenses and payment of debt obligations. The Association receives access to funds through its borrowing relationship with the Bank and from income generated by operations. The liquidity policy of the Association is to manage cash balances to maximize debt reduction and to increase loan volume. As borrower payments are received, they are applied to the Association's note payable to the Bank. Sufficient liquid funds have been available to meet all financial obligations. There are no known trends likely to result in a liquidity deficiency for the Association.

The Association's indebtedness to the Bank represents borrowings by the Association primarily to fund its loan portfolio. This indebtedness is collateralized by a pledge of substantially all of the Association's assets and the terms of the revolving line of credit are governed by the General Financing Agreement (GFA). The GFA defines Association performance criteria for borrowing from the Bank. As of December 31, 2019, the Association was in compliance with all GFA covenants.

The Association had no lines of credit from third party financial institutions as of December 31, 2019.

*Funds Management*

The Bank and the Association manage assets and liabilities to provide a broad range of loan products and funding options, which are designed to allow the Association to be competitive in all interest rate environments. The primary objective of the asset/liability management process is to provide stable and rising earnings, while maintaining adequate capital levels by managing exposure to credit and interest rate risks.

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers fixed, adjustable and variable rate loan products that are marginally priced according to financial market rates. Variable rate loans may be indexed to market indices such as the Prime Rate or the 90-day London Interbank Offered Rate (LIBOR). Adjustable rate mortgages are indexed to U.S. Treasury Rates. Fixed rate loans are priced based on the current cost of System debt of similar terms to maturity.

The majority of the interest rate risk in the Association's Consolidated Balance Sheets is transferred to the Bank through the notes payable structure. The Bank, in turn, actively utilizes funds management techniques to identify, quantify and control risk associated with the loan portfolio.

*Relationship with the Bank*

The Association's statutory obligation to borrow only from the Bank is discussed in Note 6, *Notes Payable to AgFirst Farm Credit Bank*, of the Notes to the Consolidated Financial Statements in this Annual Report.

The Bank's ability to access capital of the Association is discussed in Note 4, *Equity Investments in Other Farm Credit Institutions*, of the Notes to the Consolidated Financial Statements in this Annual Report.

The Bank's role in mitigating the Association's exposure to interest rate risk is described in the "Liquidity and Funding Sources" section of this Management's Discussion and Analysis

and in Note 6, *Notes Payable to AgFirst Farm Credit Bank*, included in this Annual Report.

## CAPITAL RESOURCES

Capital serves to support asset growth and provide protection against unexpected credit and interest rate risk and operating losses. Capital is also needed for future growth and investment in new products and services.

The Association Board of Directors establishes, adopts, and maintains a formal written capital adequacy plan to ensure that adequate capital is maintained for continued financial viability, to provide for growth necessary to meet the needs of members/borrowers, and to ensure that all stockholders are treated equitably. There were no material changes to the capital plan for 2019 that would affect minimum stock purchases or would have an effect on the Association's ability to retire stock and distribute earnings.

Total members' equity at December 31, 2019 increased 4.60 percent to \$443,171 from the December 31, 2018 total of \$423,700. At December 31, 2018, total members' equity increased 5.84 percent from the December 31, 2017 total of \$400,335. The increase in 2019 from 2018 was primarily attributable to an increase in unallocated retained earnings of \$24,044, partially offset by a decrease of allocated retained earnings of \$2,655. The increase in total members' equity to 2018 from 2017 was primarily attributable to an increase in allocated retained earnings of \$27,535.

Total capital stock and participation certificates were \$51,819 at December 31, 2019, compared to \$52,969 at December 31, 2018 and \$54,174 at December 31, 2017. The decreases from year to year are mainly attributable to the Board approved reduction of the borrower investment to 2 percent of the loan, or \$1 thousand whichever is less. This was effective January 1, 2013. Prior to January 1, 2013 the requirement was 2 percent of the loan or \$5 thousand, whichever was less.

See Note 7, *Members' Equity*, of the Consolidated Financial Statements, for further information concerning capital resources.

## PATRONAGE PROGRAM

Prior to the beginning of any fiscal year, the Association's Board of Directors, by adoption of a resolution, may establish a Patronage Allocation Program to distribute its available consolidated net earnings. This resolution provides for the application of net earnings in the manner described in the Association's Bylaws. This includes the setting aside of funds to increase surplus to meet minimum capital adequacy standards established by FCA Regulations, to increase surplus to meet Association capital adequacy standards to a level necessary to support competitive pricing at targeted earnings levels, and for reasonable reserves for necessary purposes of the Association. After excluding net earnings attributable to (a) the portion of loans participated to another institution, and (b) participation loans purchased, remaining consolidated net earnings are eligible for allocation to borrowers. Refer to Note 7, *Members' Equity*, of the Notes to the Consolidated Financial Statements, for more information concerning the

patronage distributions. The Association declared patronage distributions of \$19,300 in 2019, \$17,500 in 2018, and \$56,630 in 2017.

## YOUNG, BEGINNING AND SMALL (YBS) FARMERS AND RANCHERS PROGRAM

The Association's mission includes providing sound and constructive credit and related services to Young, Beginning and Small (YBS) farmers and ranchers. First South's mission is directed by board and management to ensure that our Association is making every effort possible to implement our YBS program.

The Association has in place a flexible YBS program with policies and procedures that are designed to meet the needs of YBS farmers in our Association's territory. The First South Board approves the YBS policy as well as the annual business plan which outlines practices to accomplish the First South YBS mission.

YBS farmers and ranchers are defined as:

- *Young Farmer*: A farmer, rancher, or producer or harvester of aquatic products who is age 35 or younger as of the date the loan is originally made.
- *Beginning Farmer*: A farmer, rancher, or producer or harvester of aquatic products who has 10 years or less farming or ranching experience as of the date the loan is originally made.
- *Small Farmer*: A farmer, rancher, or producer or harvester of aquatic products who normally generates less than \$250 in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

The Association's Young, Beginning, and Small farmer and rancher program (YBS) complies with statutory and regulatory requirements which include qualitative and quantitative goals. Goals include coordinating with government agencies that offer loan guarantees for risk management purposes. First South is an FSA approved lender.

The Association business plan also outlines strategies to increase market share success, a market outreach program that generates participation and involvement by Association staff at the field level. Strategies include (1) YBS Program on the Association website, (2) First South Market Outreach Program, (3) First South Diversity and Inclusion Marketing Plan (4) Country Loan and Small Loan Program, (5) demographic information by state and county, and (6) sponsorships and educational programs. The final results of these outreach and education programs are reported to the Association Board of Directors on an annual basis.

The Association business plan also includes a budget recommended by management that is sufficient to carry out the Association's YBS mission and performance goals.

The following table outlines the loan volume and number of YBS loans in the loan portfolio as of December 31, 2019 for the Association.

	As of December 31, 2019	
	Number of Loans	Amount of Loans
Young	2,404	\$374,834
Beginning	5,077	\$763,399
Small	7,661	\$823,119

For purposes of the above table, a loan could be included in more than one of the categories depending on the characteristics of the underlying borrower.

The 2012 USDA Ag Census data has been used as a benchmark to measure penetration of the Association YBS marketing efforts. The USDA Ag Census data prepared and provided by AgFirst Farm Credit Bank shows the number of YBS farmers in First South Farm Credit Association's territory as of December 31, 2012: Young (4,991); Beginning (20,521); Small (95,491).

The AgFirst demographics show First South segment penetration as a percentage of Association territory totals as follows: Young 27.9%; Beginning 13.7%; Small 4.7%. As of December 31, 2019, of the Association's total portfolio; 14.94% were Young farmers; 30.43% were Beginning farmers; and 32.81% were Small farmers.

Data Source: USDA-NASS 2012 Ag Census of Agriculture Volume I: Geographic Area Series Tables 2 and 45. Other data from AgFirst FCB Marquis standard reports period ending December 2019.

Slight differences between the Census and our YBS information are as follows:

- The Census shows young farmers in a group up to age 34, whereas the Association's YBS information shows young farmers up to age 35.
- The Census shows years on present farm up to nine years, whereas the Association's YBS information shows 10 years or less for a beginning farmer.
- The Census data is based on number of farms, whereas the Association's YBS information is based on number of loans.

## Capital Ratios

The following sets forth the regulatory capital ratios which were effective January 1, 2017:

Ratio	Minimum Requirement	Capital Conservation Buffer*	Minimum Requirement with Capital Conservation Buffer	Capital Ratios as of December 31,		
				2019	2018	2017
Risk-adjusted ratios:						
CET1 Capital	4.5%	1.875%	6.375%	17.32%	17.50%	16.43%
Tier 1 Capital	6.0%	1.875%	7.875%	17.32%	17.50%	16.43%
Total Capital	8.0%	1.875%	9.875%	17.97%	18.29%	17.35%
Permanent Capital	7.0%	0.0%	7.0%	17.52%	17.85%	16.92%
Non-risk-adjusted ratios:						
Tier 1 Leverage	4.0%	1.0%	5.0%	17.42%	17.45%	16.42%
URE and UREE Leverage	1.5%	0.0%	1.5%	11.72%	11.34%	10.91%

\* The capital conservation buffers have a 3 year phase-in period and will become fully effective January 1, 2020. Risk-adjusted ratio minimums will increase 0.625% each year until fully phased in. There is no phase-in period for the tier 1 leverage ratio.

If the capital ratios fall below the minimum regulatory requirements, including the buffer amounts, capital distributions (equity redemptions, dividends, and patronage) and discretionary senior executive bonuses are restricted or prohibited without prior FCA approval.

The following sets forth regulatory capital ratios as previously reported:

	Regulatory Minimum	2016	2015	2014	2013	2012
Permanent Capital Ratio	7.00%	17.48%	17.78%	18.32%	17.76%	16.12%
Total Surplus Ration	7.00%	16.55%	17.19%	17.62%	16.94%	14.86%
Core Surplus Ratio	3.50%	16.55%	16.60%	16.95%	16.20%	14.07%

## REGULATORY MATTERS

On February 13, 2020, the Farm Credit Administration approved a rule that clarifies the factors that System institutions should consider when categorizing high-risk loans and placing them in nonaccrual status. The rule also revises the criteria by which loans are reinstated to accrual status, and revises the application of the criteria to certain loans in

nonaccrual status to distinguish between the types of risk that cause loans to be placed in nonaccrual status.

On September 18, 2019, the Farm Credit Administration issued a proposed rule to amend its investment regulations to allow System associations to purchase and hold the portion of certain loans that non-System lenders originate and sell in the secondary market, and that the USDA unconditionally guarantees or insures as to timely payment of principal and

interest. The rule would authorize associations to buy investments to augment the liquidity of rural credit markets, reduce the capital burden on community banks and other non-System lenders who choose to sell their USDA guaranteed portions of loans, and to enhance the ability of associations to manage risk. The public comment period ended on November 18, 2019.

On September 23, 2019, the Farm Credit Administration issued a proposed rule that would ensure the System’s capital requirements, including certain regulatory disclosures, reflect the current expected credit losses methodology, which revises the accounting for credit losses under U.S. generally accepted accounting principles. The proposed rule identifies which credit loss allowances under the Current Expected Credit Losses (CECL) methodology in the Financial Accounting Standards Board’s “Measurement of Credit Losses on Financial Instruments” are eligible for inclusion in a System institution’s regulatory capital. Credit loss allowances related to loans, lessor’s net investments in leases, and held-to-maturity debt securities would be included in a System institution’s Tier 2 capital up to 1.25 percent of the System institution’s total risk weighted assets. Credit loss allowances for available-for-sale debt securities and purchased credit impaired assets would not be eligible for inclusion in a System institution’s Tier 2 capital. In addition, the proposed regulation does not include a transition phase-in period for the CECL day 1 cumulative effect adjustment to retained earnings on a System institution’s regulatory capital ratios. The public comment period ended on November 22, 2019.

*Future of LIBOR*

In 2017, the United Kingdom’s Financial Conduct Authority, which regulates LIBOR, announced its intention to stop persuading or compelling the group of major banks that sustains LIBOR to submit rate quotations after 2021. As a result, it is uncertain whether LIBOR will continue to be quoted after 2021. The Association has exposure to LIBOR, including in financial instruments that reference LIBOR that mature after 2021.

The exposure arises primarily from loans made to customers and the note payable to AgFirst Farm Credit Bank. Alternative reference rates that replace LIBOR may not yield the same or similar economic results over the lives of the financial instruments, which could adversely affect the value of, and return on, instruments held. In addition, to the extent that a successful transition of the LIBOR-based financial instruments to an alternative rate based index that is endorsed or supported by regulators and generally accepted by the market as a replacement to LIBOR, there could be other ramifications including those that may arise as a result of the need to redeem or terminate such instruments.

Due to the uncertainty regarding the transition of LIBOR-based financial instruments, including when it will happen, the manner in which an alternative reference rate will apply, and the mechanisms for transitioning LIBOR-based instruments to instruments with an alternative rate, the expected financial impact of the LIBOR transition cannot yet be reasonably estimated.

The FCA has issued guidelines for System institutions to follow as they prepare for the expected phase-out of LIBOR. The guidelines direct each System institution to develop a LIBOR transition plan designed to provide an orderly roadmap of actions that will reduce LIBOR exposure over time. The FCA identified the following as important considerations in the development of each entity’s transition plan:

- a governance structure to manage the transition,
- an assessment of exposures to LIBOR,
- an assessment of the fallback provisions in contracts and the impact of a LIBOR phase-out under those provisions,
- the establishment of strategies for reducing each type of LIBOR exposure,
- an assessment of the operational processes that need to be changed,
- a communication strategy for customers and shareholders,
- the establishment of a process to stay abreast of industry developments and best practices,
- the establishment of a process to ensure a coordinated approach, to the extent possible, across the District, and
- a timeframe and action steps for completing key objectives.

The Association will continue to analyze potential risks associated with the LIBOR transition, including financial, accounting, operational, legal, reputational and compliance risks.

At this time, it is difficult to predict whether or when LIBOR will cease to be available or if SOFR will become the benchmark to replace LIBOR. Because transactions occur involving financial instruments that reference LIBOR, these developments could have a material impact on the Association, borrowers, investors, and counterparties.

The following is a summary of Association variable-rate financial instruments with LIBOR exposure at December 31, 2019:

<i>(dollars in millions)</i>	<b>Due in 2020</b>	<b>Due in 2021</b>	<b>Due in 2022 and Thereafter</b>
Loans	\$ 21,315	\$ 18,724	\$ 52,653
Total Assets	<u>\$ 21,315</u>	<u>\$ 18,724</u>	<u>\$ 52,653</u>
Note Payable to AgFirst Farm Credit Bank	\$ 17,255	\$ 15,158	\$ 42,625
Total Liabilities	<u>\$ 17,255</u>	<u>\$ 15,158</u>	<u>\$ 42,625</u>

**RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

Please refer to Note 2, *Summary of Significant Accounting Policies*, in the Notes to the Consolidated Financial Statements for recently issued accounting pronouncements.

The following Accounting Standards Updates (ASUs) were issued by the Financial Accounting Standards Board (FASB) but have not yet been adopted:

Summary of Guidance	Adoption and Potential Financial Statement Impact
<i>ASU 2016-13 – Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments</i>	
<ul style="list-style-type: none"> <li>• Replaces multiple existing impairment standards by establishing a single framework for financial assets to reflect management’s estimate of current expected credit losses (CECL) over the complete remaining life of the financial assets.</li> <li>• Changes the present incurred loss impairment guidance for loans to an expected loss model.</li> <li>• The Update also modifies the other-than-temporary impairment model for debt securities to require an allowance for credit impairment instead of a direct write-down, which allows for reversal of credit impairments in future periods based on improvements in credit.</li> <li>• Eliminates existing guidance for purchased credit impaired (PCI) loans, and requires recognition of an allowance for expected credit losses on these financial assets.</li> <li>• Requires a cumulative-effect adjustment to retained earnings as of the beginning of the reporting period of adoption.</li> <li>• Effective for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years. Early application is permitted.</li> </ul>	<ul style="list-style-type: none"> <li>• Implementation efforts began with establishing a cross-discipline governance structure. The implementation includes identification of key interpretive issues, scoping of financial instruments, and assessing existing credit loss forecasting models and processes against the new guidance.</li> <li>• The new guidance is expected to result in a change in allowance for credit losses due to several factors, including:               <ol style="list-style-type: none"> <li>1. The allowance related to loans and commitments will most likely increase to cover credit losses over the full remaining expected life of the portfolio, and will consider expected future changes in macroeconomic conditions,</li> <li>2. An allowance will be established for estimated credit losses on any debt securities,</li> <li>3. The nonaccretable difference on any PCI loans will be recognized as an allowance, offset by an increase in the carrying value of the related loans.</li> </ol> </li> <li>• The extent of change is under evaluation, but will depend upon the nature and characteristics of the financial instrument portfolios, and the macroeconomic conditions and forecasts at the adoption date.</li> <li>• The guidance is expected to be adopted in first quarter 2023.</li> </ul>

# Disclosure Required by Farm Credit Administration Regulations

## Description of Business

Descriptions of the territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations are incorporated herein by reference to Note 1 of the Consolidated Financial Statements, "Organization and Operations," included in this Annual Report to shareholders.

The description of significant developments that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, and concentrations of assets, if any, is incorporated in "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in this Annual Report.

## Unincorporated Business Entities

At December 31, 2019, the Association had no investment in Unincorporated Business Entities (UBEs).

## Description of Property

The following table sets forth certain information regarding the properties of the reporting entity, all of which are located in Alabama, Mississippi and Louisiana:

Location	Description	Form of ownership
574 Highland Colony Pkwy. Ridgeland, MS	Administrative	Leased
2341 AL Hwy. 21 South Oxford, AL	Branch	Owned
1824 Eva Rd., NE Cullman, AL	Branch	Owned
3201 AL Hwy. 157, Suite 200 Cullman, AL	Underwriting	Leased
320 AL Hwy. 75 N Albertville, AL	Branch	Owned
One Perimeter Park South Birmingham, AL	Branch	Leased
30035 Hwy. 72 West Madison, AL	Branch	Owned
14390 Market Street Moulton, AL	Branch	Owned
970 Hwy. 20 East Tusculumbia, AL	Branch	Owned
700 Hwy. 80 West Demopolis, AL	Branch	Owned
4210 McFarland Blvd. Northport, AL	Branch	Owned
1715 West Second Street Montgomery, AL	Branch	Owned
1401 Forest Avenue Montgomery, AL	Branch	Owned
141 Lee Street Luverne, AL	Branch	Owned
1434 S. Union Ave. Ozark, AL	Branch	Owned
1613 Fredrick Road, Opelika, AL	Division/Branch	Owned
41655 State Hwy 59, Bay Minette, AL	Branch	Owned
5070 Boll Weevil Circle Enterprise, AL	Branch	Owned
1103 Bypass West Andalusia, AL	Branch	Owned
260 Trace Colony Park Drive Ridgeland, MS	Division/Branch	Owned
914 Van Buren Ave. Oxford, MS	Branch	Owned
1626 N Veterans Memorial Blvd. Tupelo, MS	Branch	Leased
306 E. Jefferson St. Aberdeen, MS	Branch	Owned
1009 North Main Street Calhoun City, MS	Branch	Owned

Location	Description	Form of Ownership
1089D Stark Road Starkville, MS	Branch	Leased
103 Professional Plaza Greenwood, MS	Branch	Closed
1703 Hwy 82 W Frontage Rd. Greenwood, MS	Branch	Owned
203 Cossar Blvd. Charleston, MS	Branch	Owned
122 Main Street Indianola, MS	Branch	Leased
505 E. Second St. Clarksdale, MS	Branch	Owned
1021 Highway 82 East Leland, MS	Branch	Owned
9769 Eastside Drive Extension, Newton, MS	Branch	Owned
501 Apache Drive McComb, MS	Branch	Owned
749 Cosby St. Centreville, MS	Branch	Closed
4 Thompson Park Hattiesburg, MS	Branch	Owned
23 Dunnbarr Laurel, MS	Branch	Owned
19550 Old Scenic Hwy. Zachary, LA	Division/Branch	Owned
222 N. Cedar St. Tallulah, LA	Branch	Owned
1896 Hudson Circle, Suite 7, Monroe, LA	Branch	Leased
109 Davis St. Lake Providence, LA	Branch	Owned
811 Jackson St. Winnsboro, LA	Branch	Owned
2308 S. MacArthur Dr. Alexandria, LA	Branch	Owned
321 South Main St. Marksville, LA	Branch	Owned
5057 I-49 S. Service Rd. Opelousas, LA	Branch	Owned
1007 Guy Dr. St. Martinville, LA	Branch	Owned
3206 South LA 13 Crowley, LA	Branch	Owned
4925 East McNeese St. Lake Charles, LA	Branch	Owned
60050 Westway Drive Amite, LA	Branch	Owned
1725 St. Mary Hwy. Thibodaux, LA	Branch	Owned

## Lease Information Disclosure:

Location	Term of Lease	Expiration Date	Monthly Lease Amount
Ridgeland, MS	5 years	03/31/2025	\$17,490.43
Cullman, AL	5 years	06/01/2023	\$3,100.00
Birmingham, AL	18 months	04/30/2020	\$3,331.00
Tupelo, MS	3 years	04/30/2021	\$800.00
Starkville, MS	5 years	09/30/2023	\$2,220.16
Indianola, MS	2 years	07/19/2021	\$300.00
Monroe, LA	1 year	09/30/2020	\$1,200.00

## Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 11 of the Consolidated Financial Statements, "Commitments and Contingencies," included in this Annual Report.

## Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 7 of the Consolidated Financial Statements, "Members' Equity," included in this Annual Report.

**Description of Liabilities**

The description of liabilities, contingent liabilities and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 6, 9 and 11 of the Consolidated Financial Statements included in this Annual Report.

**Management’s Discussion and Analysis of Financial Condition and Results of Operations**

“Management’s Discussion and Analysis of Financial Condition and Results of Operations,” which appears in this Annual Report and is to be disclosed in this section, is incorporated herein by reference.

**Senior Officers**

The following represents certain information regarding the senior officers of the Association and their business experience for the past five years:

Senior Officer	Position & Other Business Interests
John W. Barnard	President & Chief Executive Officer since January 2018. Prior to that, President, Mississippi Division, since April 1994.
Bryan Applewhite	Senior Vice President /Chief Financial Officer /Treasurer since November 2001.
Sells J. Newman, Jr.	Senior Vice President/Legislative Affairs and Public Relations since October 1987.
Gines Pérez, III	Senior Vice President/Chief Credit Officer since September 2019. Prior to that, Senior Vice President/Chief Lending Officer since July 2018. Prior to that, Executive Vice President/Chief Credit Officer-AgChoice Farm Credit since February 2016 , and prior to that, Relationship Manager and various other roles and responsibilities-AgFirst Farm Credit Bank since June 2010.
Randall H. Underwood	Senior Vice President/Chief Credit Officer since April 1994. Retired September 2019.
David Wilson	President, Louisiana Division since January 2012. Prior to that, Branch Manager, Louisiana Division.
Rodney Brantley	President, Mississippi Division since July 2017. Prior to that, Division Vice President, Mississippi Division.
Mike Pigg	President, Alabama Division since January 2016. Prior to that, President, North Alabama Division, since July 2011.
John Hurt	President, Capital Markets Division since July 2018. Prior to that, Capital Markets officer since December 2011.

The total amount of compensation earned by the CEO and senior officers as a group during the years ended December 31, 2019, 2018 and 2017, is as follows:

Name of Individual or Number in Group	Year	Salary	Bonus	Deferred Comp.	Change in Pension Value	Perq/ Other*	Total
John W. Barnard	2019	\$ 350,013	\$ 100,000	\$ -	\$ 1,064,121	\$ 22,274	\$ 1,536,408
John W. Barnard	2018	\$ 325,013	\$ 80,000	\$ -	\$ 50,421	\$ 22,617	\$ 478,051
Roger F. Chappell	2017	\$ 325,013	\$ 109,355	\$ -	\$ 309,150	\$ 27,455	\$ 770,973
8	2019	\$ 1,512,888	\$ 383,255	\$ -	\$ 2,064,797	\$ 127,636	\$ 4,088,576
8	2018	\$ 1,386,694	\$ 536,021	\$ -	\$ 137,481	\$ 103,108	\$ 2,163,304
6	2017	\$ 1,316,358	\$ 393,100	\$ -	\$ 1,247,775	\$ 90,320	\$ 3,047,553

\* The Perquisites/Other amount disclosed in the above chart may include club memberships, automobile and travel allowance, deferred compensation, life insurance, 401(k) contributions, and relocation reimbursement.

For the Retirement Plan, the present value of pension benefits is the value at a specific date of the benefit payment stream an individual is expected to receive upon retirement based on pay and service earned to date. These present values change year over year as (1) pension benefits increase due to an additional year of pay and service being earned under the benefit formula, (2) individuals are one year closer to receiving payments, and (3) the assumptions used to determine the present value change.

The present value of Retirement Plan pension benefits will naturally increase as the benefits earned under the plan increase. Since the pension benefit formula is dependent on base pay, pay increases directly impact the pension values.

The present values are calculated by discounting each expected future benefit payment back to the determination date at a specified interest (or discount) rate. When a year passes, there is one fewer year of discounting, which increases the present value.

Finally, the present value of the expected future benefit payment stream is based on actuarial assumptions, chiefly the discount rate mentioned above. Other assumptions are also used, such as expected retirement age and life expectancy. Changes in the actuarial assumptions can increase or decrease the pension values. The discount rate is updated every year based on the interest rate environment at December 31. A decrease in the discount rate (i.e. less discounting) increases the present values and vice versa. There was a decrease in the discount rate assumption from December 31, 2018 to December 31, 2019, causing the pension values to increase.

Other actuarial assumptions are updated periodically. At December 31, 2019, the mortality improvement assumption was updated to reflect recent mortality studies indicating a lower degree of mortality improvement (and thus slightly shorter life expectancies). This change had a minor impact and resulted in a small decrease in Retirement Plan present values.

Pension Benefits Table  
As of December 31, 2019

Name of Individual or Number in Group	Year	Plan Name	Number of Years Credited Service	Actuarial Present Value of Accumulated Benefits	Payments During 2019
<b>CEO:</b>					
John W. Barnard	2019	First South Retirement Plan	37.83	\$ 2,410,263	\$ -
				\$ 2,410,263	\$ -
<b>Senior Officers and Highly Compensated Employees:</b>					
8 Officers, excluding the CEO	2019	First South Retirement Plan	30.76*	\$ 9,664,187	\$ -
				\$ 9,664,187	\$ -

\*Represents the average years of credited service for the group

In addition to base compensation, the Association offers a Business Incentive Plan to all eligible employees, not including the CEO. The Business Incentive Plan is designed to motivate employees to exceed the business plan goals established by the Board of Directors during the fiscal year. These goals are met and exceeded in three key business areas. Those key areas include return on average daily balance of loans (ROADB), credit quality and growth in average daily balance (ADB). No employee shall receive more than 25 percent of his or her individual base salary in the Business Incentive Plan.

The Association also provides an Executive Incentive Plan for all eligible senior officers, not including the CEO. The Executive Incentive Plan is designed to motivate and reward the senior officers to meet and exceed the financial and performance goals of the Association. The financial and performance goals for this plan are return on average daily balance of loans (ROADB) and operating efficiency in his or her respective area of responsibility. These performance areas are weighted equally. No senior officer shall receive more than 15 percent of his or her individual base salary in the Executive Incentive Plan.

The level of incentive paid to the CEO, if any, is approved by the Board of Directors upon recommendation from the Compensation Committee. The CEO incentive payment is based on various performance factors also designed to meet the goals and objectives set by the Board of Directors.

Incentives are paid within 45 days of the year end. The incentives/bonuses are shown in the year earned which may be different than the year of payment. Eight senior officers shared in the 2019 business incentive and six senior officers shared in the executive incentive.

Disclosure of information on the total compensation paid during 2019 to any senior officer, or to any other individual included in the total, is available to shareholders upon request.

### Directors

Directors and senior officers are reimbursed on an actual cost basis for all expenses incurred in the performance of official duties. Such expenses may include transportation, lodging, meals, tips, tolls, parking of cars, laundry, registration fees, and other expenses associated with travel on official business. A copy of the policy is available to shareholders of the Association upon request.

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was \$311,479 for 2019, \$276,117 for 2018 and \$302,220 for 2017.

Subject to approval by the board, the Association may allow directors honorarium of \$1,000 per day for attendance at regularly scheduled board meetings and auxiliary committee meetings not held in conjunction with regularly scheduled board meetings. In addition, each director shall be paid a quarterly retainer of \$500 with the exception of the board chairman and audit committee chairman which will be \$750 per quarter. Auxiliary meetings such as regional advisory committee meetings, political action committee meetings and other special assignments will be \$500 per day and telephone conference calls will be \$100. Travel compensation to regularly scheduled board meetings and auxiliary committee meetings will be \$.75 per mile. Total compensation paid to directors as a group was \$383,553.

The following represents certain information regarding the directors of the Association, including their principal occupation and employment for the past five years.

**Daniel C. Mattingly, Chairman**, of Belle Rose, Louisiana, is the Agricultural Manager for Lula-Westfield, LLC, two sugarcane processing facilities (raw sugar factories). He assists in managing land holdings of two companies comprised of 40,000 acres, including sugarcane production land, timber property and hunting land. He is the voting member of the company for First South. He has ownership interests in Savoie Industries, Dugas & LeBlanc and Savoie-Mattingly Properties LLC. Mr. Mattingly serves on the board of Assumption Parish Farm Bureau which promotes agriculture in Assumption Parish, LA. He is a member and secretary of the Board of Directors of Savoie Industries Inc., a sugarcane mill, having served on that board for the past 16 years. He is active in the Knights of Columbus and the Agricultural Leaders of Louisiana. Mr. Mattingly has been a member of First South for over 20 years.

**James F. Martin, III, Vice Chairman**, of Enterprise, Alabama, farms 1,200 acres of corn, cotton, peanuts, soybeans and winter grains, along with raising beef cattle and hay. He previously owned and operated a dairy. He is a partner in James Martin Farms, LLC and a partner in Nitram LLC, a real estate ownership company. He also is a member of the Coffee County advisory committee for ALFA and the Coffee Gin Company. He has been a member of First South for over 27 years.

**Adam W. Bass**, of Columbia, Mississippi, has a poultry operation, raises cattle and is also involved in a Christmas tree farm. His business operations include Back Forty Farms, LLC, Bass Poultry Farms, Inc., Bass Trees and Supplies, Inc., and A&W Poultry Farms, LLC. Mr. Bass has been a member of First South for 10 years and was elected to the First South Board of Directors in 2019.

**John R. Burden**, of Baileyton, Alabama, has a dairy operation, Burden Farms LLC. He also raises grain, beef cattle and hay. He is a director for the American Dairy Association, a former member of Patron Council for Goldkist (a poultry integrator), and he is a former director of DHIA, which serves the dairy industry. Mr. Burden has been a member of First South for over 39 years.

**Paul Clark**, of Decatur, Alabama, has a row crop operation, Clark Farms Partnership (Paul Clark Farms, LLC and Marilyn Clark Farms, LLC), in Courtland, Alabama, consisting of 1,875 acres of corn, soybeans and cotton. He was previously co-owner of Clark and Reed, an agricultural consulting firm. He is past president of Alabama Ag Consulting Association, which supports and promotes the profession of agricultural consulting. Mr. Clark has been a member of First South for over 29 years.

**Amy C. Ellender**, of Mer Rouge, Louisiana serves as a board appointed director, and is not a member of the Association. She is an attorney and owner of Ellender Law Firm, APLC in Mer Rouge, with areas of practice including estate planning, successions and probate, agricultural leases and contracts, corporate legal work, farm restructuring and multi district litigation. She is office and financial manager for Clark Farms, a 6,500 acre row crop operation owned and operated by members of her family, for which she prepares and manages all financial records and maintains all farm leases and crop records. She is a member of Ellender Properties, LLC, and a director of Christian Life Fellowship, Inc., a nonprofit Christian summer camp/retreat facility run by her family. Amy received both her B. S. degree in Finance and her J. D. Law degree from Louisiana State University.

**Dr. Marty J. Fuller**, of Starkville, Mississippi, serves as a board appointed director, and is not a member of the Association. Dr. Fuller is President and CEO of Federal Solutions, LLC, a firm specializing in governmental relations. Dr. Fuller serves as Senior Consultant at Cornerstone Government Affairs, a Washington, D. C. based government/public relations firm. Prior to this role he served as the Director of Federal Relations for Mississippi State University. He also served previously as Associate Director of the Mississippi Agricultural and Forestry Experiment Station (MAFES) and is Emeritus Professor in the Department of Agricultural Economics at Mississippi State University. Dr. Fuller was formerly President and CEO of Opswatch, a business development and grant monitoring service company. He has interests in Camgian Microsystems, M and R Land, LLC, High Dice, LLC and Halberd Group, LLC and serves on the local Advisory Board of Cadence Bank. Dr. Fuller received his B. S., M. S. and Ph. D. degrees in Agricultural Economics from Mississippi State University.

**John Ingraffia**, of Husser, Louisiana, is owner/operator of a 200 head dairy operation, producing over 1.5 million pounds of milk annually. He also produces hay. He was recently elected

to the Tangipahoa Parish Council. Mr. Ingraffia, a former member of the Regional Advisory Committee, has been a member of First South for over 35 years.

**Wilson E. Judice** is president and director of Wilson Judice Farms, Inc., formerly a 1,100 acre sugarcane and soybean operation in St. Mary Parish, Louisiana. He owns and operates Bayou Teche Family Farms, a direct market vegetable operation. He is director of Judice Agricultural Services, LLC, an agricultural employment agency serving Wilson Judice Farms. He has served as commissioner on the St. Mary Parish Fire Protection District Two board of directors since 2008. He has served on the LFBF Sugar Advisory Committee since 2011 and on the St. Mary Parish 4-H Advisory Committee since 2012. He is a board member of St. Mary Parish 4-H Foundation. He is a director of Teche Growers Association, a member of the Tri-Parish Row Crop Advisory Committee and an agronomist with the American Sugarcane League. Mr. Judice has been a member of First South for over 6 years.

**Kevin Kimzey**, of Water Valley, Mississippi, farms 2,500 acres of row crops with his family. Commodities include cotton, corn and soybeans. His family also owns 500 acres of pine and hardwood timber. He is owner and operator of Kevin Kimzey Farms. Mr. Kimzey has been a member of First South for 26 years and began serving as a director in 2019.

**William T. (Bill) Kyser**, of Hale County, Alabama, has a catfish, beef cattle, and timber operation. He is a member of Catfish Farmers of America, Alabama Farmers Federation, Hale County Farmers Federation, Auburn Agricultural Alumni Association, Greensboro Farmers Cooperative, and he is a director of the Hale County Cattlemen's Association and Alabama Catfish Producers. These organizations promote agriculture and agricultural commodities nationally and in Alabama. He is co-owner of Alabama Catfish Feed Mill, LLC; Kyser, LLC; Kyser Farms, LLC; Kyser Family Farms, LLC; WTK, LLC; MRSWTK, Inc.; and Catfish Wireless, LLC. Mr. Kyser has been a member of First South for over 49 years.

**Timothy Leonard**, of Summit, Mississippi, owns and operates Leonard Farms, a multi farm poultry operation. He also has a cattle operation and produces hay. He is owner and operator of T & G Poultry Services, which provides repairs, upgrades, litter preparation and service work to local poultry farms, and Meadow Oak Properties LLC, a residential rental company. He is owner of Leonard's Cypress Landing, Inc., d/b/a Cypress Landing, a restaurant. He has been a member of First South for over 18 years.

**Ray Makamson**, of Itta Bena, Mississippi, owns and operates Ray Makamson Farms, a farming operation consisting of over 1,000 acres of cotton, corn and soybeans. The operation includes Eddie & Ray Farms, Inc., Emily & Jason Farms, Inc., Lamar & Ray Farms, Inc., and Ray & Garry Farms, Inc. He is managing partner of a cotton gin, Greenwood Gin, Inc. He is part owner of Makamson Properties, LLC. Mr. Makamson has been a member of First South for over 47 years.

**Alan Marsh**, a resident of Limestone County, Alabama, is a partner and President of Marsh Farms, a 2,500-acre family farming operation consisting of cotton, soybeans and wheat. The operation includes Alan Marsh Farms Inc., Patty Marsh Farms Inc. and South Limestone Farm Inc. He is a director of the Limestone Farmers' Federation and a member of the

National Cotton Council, Cotton Incorporated and Staplcotn, all of which support and promote the cotton industry nationally and in the state of Alabama. He is also President of South Limestone Gin, a local cotton gin. Mr. Marsh currently serves on the Board of Directors of AgFirst Farm Credit Bank. He has been a member of First South for over 44 years.

**Shepherd (Shep) Morris**, of Shorter, Alabama, is owner of Morris and Morris Farms, a 3,400-acre row crop operation growing cotton, corn and sesame, and a 1,000 acre timber operation. He serves as a board member of Autauga Quality Cotton Association, a marketing organization; Choice Cotton Company, a cotton marketing organization; Alabama Cotton Commission and River Bank and Trust, a community bank. He also serves as president of the Macon County Farmers Federation and a supervisor for Macon County Soil and Water District, both promoting agriculture in Macon County, AL. He is president of Milstead Farm Group, Inc., a cotton ginning operation. Mr. Morris has been a member of First South for over 40 years.

**Thomas H. Nelson, Jr.**, of Chatham, Mississippi, has a 6,500-acre row crop operation consisting of Nelson-King Farms, Nelson-King Lands, LLC, E G Nelson Inc., and Everhope Plantation, LLC, producing corn and soybeans. He is a director of Washington County Farm Bureau, which supports and promotes agriculture in Washington County, Mississippi, and is Chairman of the Board of Trustees of Avon United Methodist Church in Avon, MS. Mr. Nelson has been a member of First South for over 29 years.

**James M. Norsworthy, III**, of Jackson, Louisiana, is the owner of One Hundred Cedars Cattle Farm, a 150 head cow/calf operation, manages 500 acres of pine and hardwood timber land, and has a commercial hay operation. He is past Director of Environmental Services for Eastern Louisiana Mental Health Systems. He serves as a board member of the Feliciana Farm Bureau and is a member of the East Feliciana Parish Cattlemen's Association, the Feliciana Forestry Association and the American Angus Association. He is former mayor of the town of Jackson, Louisiana. Mr. Norsworthy served on the Board of Directors of AgFirst Farm Credit Bank until December 31, 2019, where he was chairman of the Governance Committee. He has been a member of First South for over 39 years.

**Thomas A. Parker**, of Lake Providence, Louisiana, has a 4,000 acre farming operation in Lake Providence, Louisiana, consisting of cotton, corn, soybeans and rice. He also operates a 7,500 acre farm consisting of cotton, corn, soybeans and rice in Parkdale, Arkansas. Mr. Parker is a managing partner of Hollybrook Enterprises, a cotton gin, and serves as a director on the Staplcotn Board, an agricultural marketing cooperative. Mr. Parker owns a farm management company, Deep Current Ag Management, that manages farms for individual and institutional investors. His business interests include Brownpark, LLC; Cypress Break, LLC; Tweet & Tap, LLC; Parker Farms, Inc.; Brandy of East Carroll, Inc.; Hardly Able, Inc.; Parker Group Holdings, LLC; Parker Capital Partners, LLC; TM & TP, LLC; RW & TP, LLC; TS & TP, LLC; P & H Partners, LLC; County Line, LLC; P&D Land Company, LLC; TAP Farm, LLC; JLBP Farm, LLC; and NP Farm, LLC. He was formerly the Louisiana member on the Cotton Board, and formerly a producer delegate on the National Cotton Council. He is past President of East Carroll Farm Bureau and

Louisiana Cotton Producers, all of which promote and support cotton and agriculture. Mr. Parker has been a member of First South for over 29 years.

**Ted S. Passmore**, of Deville, Louisiana, has a 6,000 acre row crop operation with his brother that includes Passmore Farms, Delta Farming of Avoyelles LLC, and Delta Farming General Partnership, and produces soybeans, cotton and corn. He is a member of Louisiana Farm Bureau which promotes agriculture in Louisiana. Mr. Passmore has been a member of First South for over 43 years.

**Michael W. Patrick**, of Canton, Mississippi, is a partner in Patrick Farms Joint Venture, a farming operation consisting of 3,700 acres of cotton, corn, wheat, soybeans and timber. He is chairperson of the Madison County USDA/FSA county committee which administers farm commodity, crop insurance, credit, environmental, conservation and assistance programs for farmers and ranchers. He is a commissioner on the Madison County Soil and Water District Board, a unit of county government responsible for soil and water conservation programs within the county boundaries. Mr. Patrick is an owner/officer in Big Black Farms, Inc., Cotton Country Inc. and Cotton Pickers, Inc., agricultural corporations and partners in Patrick Farms Joint Venture. He began serving on the Board of Directors of AgFirst Farm Credit Bank January 1, 2020 and has been a member of First South for over 29 years.

**Walter R. Richardson**, of Leroy, Alabama, has a cattle farm and 1,700 acres of cotton, corn, peanuts, oats and wheat. He serves on the Washington County Soil Conservation Board, is a director of Washington County Farmers Federation which promotes agriculture in Washington County, and is a board member of the Washington County Cattlemen's Association which promotes the cattle industry. Mr. Richardson has been a member of First South for over 39 years.

**Dale Thibodeaux**, of Midland, Louisiana, has a farming operation with his family consisting of 10,000 acres, including 5,200 acres of rice, 3,000 acres of soybeans, and 1,800 acres of crawfish. His business interests include Thibodeaux Group, Thibodeaux Brothers Farm, Thibodeaux Brothers Trucking, Inc., Thibodeaux Land Company, Inc., Thibodeaux Brothers Dryer, Thibodeaux Brothers Water Company, Inc., Thibodeaux Crawfish, LLC, Acadia Processors, LLC, and Krewe du Meanger. He is a director of Acadia Soil and Water Conservation District and a member of the Mermentau River Harbor and Terminal Board, Southwest Farm Service Cooperative, Rice Council, Acadia Rice Growers Association and Louisiana Rail Facility. Mr. Thibodeaux has been a member of First South for over 39 years.

**Dan West**, of Monroe County, Mississippi, is the owner of West Farms and Dan West Farms, a 4,000 acre farming operation consisting of corn, cotton, soybeans, wheat, peanuts and timber. He is managing partner of Eastside Farms, Inc., a member of the Mississippi Peanut Promotion Board, Mississippi Peanut Growers Association, Farmers Gin and Monroe County Farm Bureau. He is an owner/officer of Cotton House, Inc. He has served on the board of Monroe County Farm Bureau, Mississippi Boll Weevil Management Corporation and is a past president of the Mississippi Ginners Association, all of which promote agriculture in Mississippi. Mr. West has been a member of First South for over 40 years.

The following chart details the number of meetings, other activities and additional compensation paid for other activities (if applicable) for each director:

Name of Director	Committee Assignments	Term of Office		Number of Days Served		Compensation		
		Election Year	Current Term Expiration	Board Meeting	Other Official Activities*	Regular Board Meetings	Compensation for Other Activities	Total 2019 Compensation Paid
Daniel Mattingly, Chairman	Credit, Compensation, Retirement, Executive	2019	2022	9	14	\$ 12,796	\$ 9,583	\$ 22,379
James F. (Trey) Martin, III, Vice Chairman	Audit, Compensation, Retirement, Executive	2019	2022	9	18	14,445	9,110	23,555
Marty Fuller	Audit, Compensation, Executive	2017	2020	6	11	6,850	5,900	12,750
Amy Ellender	Audit, Compensation	2019	2022	9	12	11,606	6,640	18,246
Adam Bass	Credit	2019	2022	7	2	8,808	2,000	10,808
Paul Briscoe	Governance	2017	2020	-	-	-	500	500
John R. Burden	Credit, Compensation, Governance	2019	2022	5	7	8,745	5,158	13,903
Paul Clark	Audit, Retirement, Executive	2017	2020	8	19	12,154	8,098	20,252
John G. Ingraffia	Credit	2018	2021	9	8	12,742	7,321	20,063
Wilson E. Judice	Governance	2018	2021	7	2	10,734	3,000	13,734
Kevin Kimsey	Credit	2019	2020	3	0	3,630	1,000	4,630
William T. (Bill) Kyser	Credit	2017	2020	6	2	8,800	3,030	11,830
Timothy L. (Tim) Leonard	Credit, Compensation, Executive	2017	2020	9	15	12,372	9,288	21,660
Ray Makamson	Governance	2018	2021	9	6	12,175	5,150	17,325
Alan Marsh	Governance, Credit, Executive	2017	2020	8	6	12,408	3,400	15,808
Joe H. Morgan	Governance	2016	2019**	-	0	-	1,000	1,000
Shepherd (Shep) Morris	Governance, Compensation	2019	2022	9	11	14,285	8,698	22,983
Thomas H. Nelson, Jr.	Credit, Governance, Compensation	2018	2021	9	6	12,365	5,677	18,042
James M. Norsworthy, III	Audit, Retirement	2017	2020	9	8	12,017	4,523	16,540
Thomas A. Parker	Governance, Compensation, Executive	2019	2022	9	11	9,177	6,464	15,641
Ted S. Passmore	Credit	2019	2022	6	1	7,800	2,500	10,300
Michael W. (Mike) Patrick	Governance, Audit, Retirement, Executive	2018	2021	9	11	11,455	5,736	17,191
Walter R. (Rod) Richardson	Credit, Governance, Compensation, Executive	2018	2021	9	10	13,306	6,896	20,202
Dale Thibodeaux	Credit, Audit, Compensation	2017	2020	8	11	12,416	7,858	20,274
Dan West	Audit, Governance	2019	2022	8	5	11,037	2,900	13,937
<b>Total</b>						<b>\$ 252,123</b>	<b>\$ 131,430</b>	<b>\$ 383,553</b>

\* Includes board committee meetings and other board activities other than regular board meetings

\*\* Because of age limitation, Mr. Joe H. Morgan was not eligible for re-election.

### Transactions with Senior Officers and Directors

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 10 of the Consolidated Financial Statements, "Related Party Transactions," included in this Annual Report. There have been no transactions between the Association and senior officers or directors which require reporting per FCA regulations.

### Involvement in Certain Legal Proceedings

There were no matters which came to the attention of management or the board of directors regarding involvement of current directors or senior officers in specified legal proceedings which should be disclosed in this section. No directors or senior officers have been involved in any legal proceedings during the last five years which require reporting per FCA regulations.

### Relationship with Independent Auditors

There were no changes in or material disagreements with our independent auditors on any matter of accounting principles or financial statement disclosure during this period. Aggregate fees paid by the Association for services rendered by its independent auditors for the year ended December 31, 2019 were as follows:

	2019
<b>Independent Auditors</b>	
PricewaterhouseCoopers LLP	
Audit services	\$ 70,274

Audit fees were for the annual audit of the Consolidated Financial Statements.

### Consolidated Financial Statements

The Consolidated Financial Statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 12, 2020 and the report of management, which appear in this Annual Report, are incorporated herein by reference.

Copies of the Association's unaudited quarterly reports are available upon request free of charge by calling 1-888-297-1722, or writing to Bryan Applewhite, First South Farm Credit, ACA, Three Paragon Centre, Suite 100, 574 Highland Colony Parkway, Ridgeland, MS 39157. Information concerning First South Farm Credit, ACA can be obtained by visiting the association website, www.firstsouthland.com. The Association prepares an electronic version of the Annual Report which is available on the Association's web site within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

### Borrower Information Regulations

Since 1972, Farm Credit Administration (FCA) regulations have required that borrower information be held in strict confidence by Farm Credit System (FCS) institutions, their directors, officers

and employees. These regulations provide Farm Credit institutions clear guidelines for protecting their borrowers' nonpublic personal information.

On November 10, 1999, the FCA Board adopted a policy that requires FCS institutions to formally inform new borrowers at loan closing of the FCA regulations on releasing borrower information and to address this information in the Annual Report. The implementation of these measures ensures that new and existing borrowers are aware of the privacy protections afforded them through FCA regulations and Farm Credit System institution efforts.

**Credit and Services to Young, Beginning, and Small Farmers and Ranchers and Producers or Harvesters of Aquatic Products**

Information to be disclosed in this section is incorporated herein by reference to the similarly named section in the Management's Discussion and Analysis of Financial Condition and Results of Operations section included in this Annual Report to the shareholders.

**Shareholder Investment**

Shareholder investment in the Association could be materially affected by the financial condition and results of operations of AgFirst Farm Credit Bank (Bank or AgFirst). Copies of the Bank's Annual and Quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 2832, or writing Susanne Caughman, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst's web site at [www.agfirst.com](http://www.agfirst.com). The Bank prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year. The Bank prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Bank.

## *Report of the Audit Committee*

The Audit Committee of the Board of Directors (Committee) is comprised of the directors named below. None of the directors who serve on the Committee is an employee of First South Farm Credit, ACA (Association) and in the opinion of the Board of Directors; each is free of any relationship with the Association or management that would interfere with the director's independent judgment on the Committee.

The Committee has adopted a written charter that has been approved by the Board of Directors. The Committee has reviewed and discussed the Association's audited financial statements with management, which has primary responsibility for the financial statements.

PricewaterhouseCoopers LLP (PwC), the Association's independent auditors for 2019, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 114 (*The Auditor's Communication With Those Charged With Governance*). The Committee discussed with PwC its independence from the Association. The Committee also reviewed the non-audit services provided by PwC and concluded that these services were not incompatible with maintaining PwC's independence.

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Association's Annual Report for 2019. The foregoing report is provided by the following independent directors, who constitute the Committee:



Dr. Marty J. Fuller

Chairman of the Audit Committee

### **Members of Audit Committee**

Paul Clark

Amy C. Ellender

James F. Martin, III

James M. Norsworthy, III

Robert D. Thibodeaux

Michael W. Patrick

March 12, 2020



## Report of Independent Auditors

To the Board of Directors and Management of First South Farm Credit, ACA

We have audited the accompanying consolidated financial statements of First South Farm Credit, ACA and its subsidiaries (the "Association"), which comprise the consolidated balance sheets as of December 31, 2019, 2018 and 2017, and the related consolidated statements of income, of comprehensive income, of changes in members' equity and of cash flows for the years then ended.

### ***Management's Responsibility for the Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Association's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of First South Farm Credit, ACA and its subsidiaries as of December 31, 2019, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*PricewaterhouseCoopers LLP*

March 12, 2020

# Consolidated Balance Sheets

<i>(dollars in thousands)</i>	December 31,		
	2019	2018	2017
<b>Assets</b>			
Cash	\$ 8,694	\$ 11,502	\$ 9,097
Loans	2,234,582	2,072,774	1,976,968
Allowance for loan losses	(14,883)	(13,941)	(13,618)
Net loans	2,219,699	2,058,833	1,963,350
Loans held for sale	464	—	—
Accrued interest receivable	22,049	20,103	18,789
Equity investments in other Farm Credit institutions	67,272	67,309	67,363
Premises and equipment, net	13,851	12,213	9,869
Other property owned	1,031	2,879	551
Accounts receivable	24,598	26,944	28,099
Other assets	878	240	261
Total assets	<b>\$ 2,358,536</b>	<b>\$ 2,200,023</b>	<b>\$ 2,097,379</b>
<b>Liabilities</b>			
Notes payable to AgFirst Farm Credit Bank	\$ 1,845,304	\$ 1,717,671	\$ 1,639,346
Accrued interest payable	5,041	4,718	3,911
Patronage refunds payable	19,508	17,555	15,020
Accounts payable	2,665	5,826	8,050
Other liabilities	42,847	30,553	30,717
Total liabilities	<b>1,915,365</b>	<b>1,776,323</b>	<b>1,697,044</b>
Commitments and contingencies (Note 11)			
<b>Members' Equity</b>			
Capital stock and participation certificates	51,819	52,969	54,174
Retained earnings			
Allocated	256,357	259,012	261,054
Unallocated	162,731	138,687	111,152
Accumulated other comprehensive income (loss)	(27,736)	(26,968)	(26,045)
Total members' equity	<b>443,171</b>	<b>423,700</b>	<b>400,335</b>
Total liabilities and members' equity	<b>\$ 2,358,536</b>	<b>\$ 2,200,023</b>	<b>\$ 2,097,379</b>

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

# Consolidated Statements of Income

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2019	2018	2017
<b>Interest Income</b>			
Loans	\$ 116,034	\$ 105,214	\$ 95,076
<b>Interest Expense</b>			
Notes payable to AgFirst Farm Credit Bank	59,142	50,941	43,440
Net interest income	56,892	54,273	51,636
Provision for loan losses	1,105	1,080	1,285
Net interest income after provision for loan losses	55,787	53,193	50,351
<b>Noninterest Income</b>			
Loan fees	2,746	1,281	2,595
Fees for financially related services	847	1,020	1,183
Patronage refunds from other Farm Credit institutions	24,444	26,807	27,940
Gains (losses) on sales of premises and equipment, net	503	75	29
Insurance Fund refunds	432	1,051	—
Other noninterest income	—	2	—
Total noninterest income	28,972	30,236	31,747
<b>Noninterest Expense</b>			
Salaries and employee benefits	26,897	26,574	25,775
Occupancy and equipment	1,946	2,045	1,784
Insurance Fund premiums	1,500	1,384	2,204
(Gains) losses on other property owned, net	60	111	82
Other operating expenses	10,348	8,231	(7,096)
Total noninterest expense	40,751	38,345	22,749
Income before income taxes	44,008	45,084	59,349
Provision (benefit) for income taxes	8	(22)	116
Net income	\$ 44,000	\$ 45,106	\$ 59,233

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

# Consolidated Statements of Comprehensive Income

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2019	2018	2017
Net income	\$ 44,000	\$ 45,106	\$ 59,233
<b>Other comprehensive income net of tax</b>			
Employee benefit plans adjustments	(768)	(923)	3,365
Comprehensive income	<b>\$ 43,232</b>	<b>\$ 44,183</b>	<b>\$ 62,598</b>

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

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# Consolidated Statements of Changes in Members' Equity

<i>(dollars in thousands)</i>	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
		Allocated	Unallocated		
Balance at December 31, 2016	\$ 56,531	\$ 221,800	\$ 108,424	\$ (29,410)	\$ 357,345
Comprehensive income			59,233	3,365	62,598
Capital stock/participation certificates issued/(retired), net	(2,357)				(2,357)
Patronage distribution					
Cash			(15,000)		(15,000)
Nonqualified allocated retained earnings		20,815	(20,815)		—
Nonqualified retained earnings		20,815	(20,815)		—
Retained earnings retired		(2,226)			(2,226)
Patronage distribution adjustment		(150)	125		(25)
<b>Balance at December 31, 2017</b>	<b>\$ 54,174</b>	<b>\$ 261,054</b>	<b>\$ 111,152</b>	<b>\$ (26,045)</b>	<b>\$ 400,335</b>
Comprehensive income			45,106	(923)	44,183
Capital stock/participation certificates issued/(retired), net	(1,205)				(1,205)
Patronage distribution					
Cash			(17,500)		(17,500)
Retained earnings retired		(2,110)			(2,110)
Patronage distribution adjustment		68	(71)		(3)
<b>Balance at December 31, 2018</b>	<b>\$ 52,969</b>	<b>\$ 259,012</b>	<b>\$ 138,687</b>	<b>\$ (26,968)</b>	<b>\$ 423,700</b>
<b>Cumulative effect of change in accounting principle</b>			<b>(321)</b>		<b>(321)</b>
<b>Comprehensive income</b>			<b>44,000</b>	<b>(768)</b>	<b>43,232</b>
<b>Capital stock/participation certificates issued/(retired), net</b>	<b>(1,150)</b>				<b>(1,150)</b>
<b>Patronage distribution</b>					
<b>Cash</b>			<b>(19,300)</b>		<b>(19,300)</b>
<b>Retained earnings retired</b>		<b>(2,655)</b>			<b>(2,655)</b>
<b>Patronage distribution adjustment</b>			<b>(335)</b>		<b>(335)</b>
<b>Balance at December 31, 2019</b>	<b>\$ 51,819</b>	<b>\$ 256,357</b>	<b>\$ 162,731</b>	<b>\$ (27,736)</b>	<b>\$ 443,171</b>

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

# Consolidated Statements of Cash Flows

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2019	2018	2017
<b>Cash flows from operating activities:</b>			
Net income	\$ 44,000	\$ 45,106	\$ 59,233
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	760	422	418
Amortization (accretion) of net deferred loan costs (fees)	(210)	(661)	(101)
Provision for loan losses	1,105	1,080	1,285
(Gains) losses on other property owned	(8)	94	68
(Gains) losses on sales of premises and equipment, net	(503)	(75)	(29)
Changes in operating assets and liabilities:			
Origination of loans held for sale	(2,948)	—	—
Proceeds from sales of loans held for sale, net	2,484	—	—
(Increase) decrease in accrued interest receivable	(1,946)	(1,314)	(985)
(Increase) decrease in accounts receivable	2,346	1,155	(3,472)
(Increase) decrease in other assets	(959)	21	12
Increase (decrease) in accrued interest payable	323	807	662
Increase (decrease) in accounts payable	(3,161)	(2,224)	1,283
Increase (decrease) in other liabilities	11,526	(1,087)	(18,304)
Total adjustments	8,809	(1,782)	(19,163)
Net cash provided by (used in) operating activities	52,809	43,324	40,070
<b>Cash flows from investing activities:</b>			
Net (increase) decrease in loans	(162,479)	(98,516)	(118,947)
(Increase) decrease in equity investments in other Farm Credit institutions	37	54	(60)
Purchases of premises and equipment	(2,502)	(2,789)	(1,168)
Proceeds from sales of premises and equipment	607	98	11
Proceeds from sales of other property owned	2,574	192	1,664
Net cash provided by (used in) investing activities	(161,763)	(100,961)	(118,500)
<b>Cash flows from financing activities:</b>			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	127,633	78,325	96,247
Capital stock and participation certificates issued/(retired), net	(1,150)	(1,205)	(2,357)
Patronage refunds and dividends paid	(17,682)	(14,968)	(10,711)
Retained earnings retired	(2,655)	(2,110)	(2,226)
Net cash provided by (used in) financing activities	106,146	60,042	80,953
Net increase (decrease) in cash	(2,808)	2,405	2,523
Cash, beginning of period	11,502	9,097	6,574
Cash, end of period	\$ 8,694	\$ 11,502	\$ 9,097
<b>Supplemental schedule of non-cash activities:</b>			
Receipt of property in settlement of loans	\$ 718	\$ 2,614	\$ 1,185
Estimated cash dividends or patronage distributions declared or payable	19,300	17,500	15,000
Employee benefit plans adjustments (Note 9)	768	923	(3,365)
<b>Supplemental information:</b>			
Interest paid	\$ 58,819	\$ 50,134	\$ 42,777
Taxes (refunded) paid, net	17	8	45

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

# Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

## Note 1 — Organization and Operations

A. **Organization:** First South Farm Credit, ACA (the Association or ACA) is a member-owned cooperative that provides credit and credit-related services to qualified borrowers in all counties in the states of Alabama and Mississippi, and all but certain parishes within the northwestern portion of Louisiana. The counties and parishes in the respective states are as follows:

*Alabama:* Autauga, Baldwin, Barbour, Bibb, Blount, Bullock, Butler, Calhoun, Chambers, Cherokee, Chilton, Choctaw, Clarke, Clay, Cleburne, Coffee, Colbert, Conecuh, Coosa, Covington, Crenshaw, Cullman, Dale, Dallas, De Kalb, Elmore, Escambia, Etowah, Fayette, Franklin, Geneva, Greene, Hale, Henry, Houston, Jackson, Jefferson, Lamar, Lauderdale, Lawrence, Lee, Limestone, Lowndes, Macon, Madison, Marengo, Marion, Marshall, Mobile, Monroe, Montgomery, Morgan, Perry, Pickens, Pike, Randolph, Russell, St. Clair, Shelby, Sumter, Talladega, Tallapoosa, Tuscaloosa, Walker, Washington, Wilcox and Winston.

*Mississippi:* Adams, Alcorn, Amite, Attala, Benton, Bolivar, Calhoun, Carroll, Chickasaw, Choctaw, Claiborne, Clarke, Clay, Coahoma, Copiah, Covington, Desoto, Forrest, Franklin, George, Greene, Grenada, Hancock, Harrison, Hinds, Holmes, Humphreys, Issaquena, Itawamba, Jackson, Jasper, Jefferson, Jefferson Davis, Jones, Kemper, Lafayette, Lamar, Lauderdale, Lawrence, Leake, Lee, Leflore, Lincoln, Lowndes, Madison, Marion, Marshall, Monroe, Montgomery, Neshoba, Newton, Noxubee, Oktibbeha, Panola, Pearl River, Perry, Pike, Pontotoc, Prentiss, Quitman, Rankin, Scott, Sharkey, Simpson, Smith, Stone, Sunflower, Tallahatchie, Tate, Tippah, Tishomingo, Tunica, Union, Walthall, Warren, Washington, Wayne, Webster, Wilkinson, Winston, Yalobusha and Yazoo.

*Louisiana:* Acadia, Allen, Ascension, Assumption, Avoyelles, Beauregard, Calcasieu, Caldwell, Cameron, Catahoula, Concordia, East Baton Rouge, East Carroll, East Feliciana, Evangeline, Franklin, Grant, Iberia, Iberville, Jefferson, Jefferson Davis, La Salle, Lafayette, Lafourche, Livingston, Madison, Morehouse, Natchitoches, Orleans, Ouachita(parts), Plaquemines, Pointe Coupee, Rapides, Richland, Sabine, St. Bernard, St. Charles, St. Helena, St. James, St. John The Baptist, St. Landry, St. Martin, St. Mary, St. Tammany, Tangipahoa, Tensas, Terrebonne, Vermilion, Vernon, Washington, West Baton Rouge, West Carroll, West Feliciana and Winn.

The Association is a lending institution in the Farm Credit System (System), a nationwide network of cooperatively owned banks and associations. It was established by Acts of Congress and is subject to the provisions of the Farm Credit Act of 1971, as amended (Farm Credit Act). The System specializes in providing financing and related services to qualified borrowers for agricultural and rural purposes.

The nation is served by three Farm Credit Banks (FCBs) and one Agricultural Credit Bank (ACB), (collectively, the System Banks) each of which has specific lending authorities within its chartered territory. The ACB also has additional specific nationwide lending authorities.

Each System Bank serves one or more Agricultural Credit Associations (ACAs) that originate long-term, short-term and intermediate-term loans, Production Credit Associations (PCAs) that originate and service short- and intermediate-term loans, and/or Federal Land Credit Associations (FLCAs) that originate and service long-term real estate mortgage loans. These associations borrow a majority of the funds for their lending activities from their related bank. System Banks are also responsible for supervising the activities of associations within their districts. AgFirst (Bank) and its related associations (Associations or District Associations) are collectively referred to as the AgFirst District. The District Associations jointly own substantially all of AgFirst's voting stock. As of year-end, the District consisted of the Bank and nineteen District Associations. All nineteen are structured as ACA holding companies, with PCA and FLCA subsidiaries. FLCAs are tax-exempt while ACAs and PCAs are taxable.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System banks and associations. The FCA examines the activities of the associations and certain actions by the associations are subject to the prior approval of the FCA and the supervising bank.

The Farm Credit Act also established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (Insured Debt), (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary uses by the Insurance Corporation to provide assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank has been required to pay premiums, which may be passed on to the Association, into the Insurance Fund, based on its average adjusted outstanding Insured Debt until the assets in the Insurance Fund reach the "secure base amount." The secure base amount is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments) or such other percentage of the aggregate obligations as the Insurance Corporation at its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums and may return excess funds above the secure

base amount to System institutions. However, it must still ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

**B. Operations:** The Farm Credit Act sets forth the types of authorized lending activity and financial services that can be offered by the Association, and the persons eligible to borrow.

The Associations borrow from the Bank and in turn may originate and service short- and intermediate-term loans to their members, as well as long-term real estate mortgage loans.

The Bank primarily lends to the District Associations in the form of a line of credit to fund the Associations' earning assets. These lines of credit (or Direct Notes) are collateralized by a pledge of substantially all of each Association's assets. The terms of the Direct Notes are governed by a General Financing Agreement (GFA) between the Bank and Association. Each advance is structured such that the principal cash flow, repricing characteristics, and underlying index (if any) of the advance match those of the assets being funded. By match-funding the Association loans, the Associations' exposure to interest rate risk is minimized.

In addition to providing funding for earning assets, the Bank provides District Associations with banking and support services such as accounting, human resources, information systems, and marketing. The costs of these support services are included in the cost of the Direct Note, or in some cases billed directly to certain Associations that use a specific service.

The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments, and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related businesses.

The Association may sell to any System borrowing member, on an optional basis, credit or term life insurance appropriate to protect the loan commitment in the event of death of the debtor(s). The sale of other insurance necessary to protect a member's farm or aquatic unit is permitted, but limited to hail and multi-peril crop insurance, and insurance necessary to protect the facilities and equipment of aquatic borrowers.

## Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the Association conform with accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results may differ from these estimates.

The accompanying consolidated financial statements include the accounts of the ACA, PCA and FLCA.

Certain amounts in the prior year financial statements may have been reclassified to conform to the current period presentation. Such reclassifications had no effect on net income or total members' equity of prior years.

**A. Cash:** Cash represents cash on hand and on deposit at banks. At the most recent year-end, the Association held \$8,260 in cash in excess of insured amounts.

**B. Loans and Allowance for Loan Losses:** The Association is authorized to make long-term real estate loans with maturities of 5 to 40 years and certain short and intermediate-term loans for agricultural production or operating purposes with maturities of not more than 10 years.

Loans are carried at their principal amount outstanding adjusted for charge-offs, premiums, discounts, deferred loan fees or costs, and derivative instruments and hedging valuation adjustments, if any. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. The difference in the total investment in a loan and its principal amount may be deferred as part of the carrying amount of the loan and the net difference amortized over the life of the related loan as an adjustment to interest income using the effective interest method.

Impaired loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms of the loan and are generally considered substandard or doubtful, which is in accordance with the loan rating model, as described below. Impaired loans include nonaccrual loans, restructured loans, and loans past due 90 days or more and still accruing interest. 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 remains contractually past due 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. A formal restructuring may also cure a past due status.

Loans are generally classified as nonaccrual when principal or interest is delinquent for 90 days (unless adequately collateralized and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in the prior year).

When loans are in nonaccrual status, payments are applied against the recorded investment in the loan asset. If collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it, the interest portion of payments received in cash may be recognized as interest income. Nonaccrual loans may be returned to accrual status when principal and interest are current, prior

charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected, and the loan is not classified “doubtful” or “loss.” Loans are charged off at the time they are determined to be uncollectible.

In cases where the Association makes certain monetary concessions to the borrower through modifications to the contractual terms of the loan, the loan is classified as a restructured loan. A restructured loan constitutes a troubled debt restructuring (TDR) if for economic or legal reasons related to the debtor’s financial difficulties the Association grants a concession to the debtor that it would not otherwise consider. If the borrower’s ability to meet the revised payment schedule is uncertain, the loan is classified as a nonaccrual loan.

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio as of the report date. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through loan charge-offs and allowance reversals. A review of individual loans in each respective portfolio is performed periodically to determine the appropriateness of risk ratings and to ensure loss exposure to the Association has been identified. The allowance for loan losses is a valuation account used to reasonably estimate loan losses as of the financial statement date. Determining the appropriate allowance for loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss.

The Association considers the following factors, among others, when determining the allowance for loan losses:

- Changes in credit risk classifications
- Changes in collateral values
- Changes in risk concentrations
- Changes in weather-related conditions
- Changes in economic conditions

A specific allowance may be established for impaired loans under Financial Accounting Standards Board (FASB) guidance on accounting by creditors for impairment of a loan. Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan’s effective interest rate or, as practically expedient, at the loan’s observable market price or fair value of the collateral if the loan is collateral dependent.

A general allowance may also be established under FASB guidance on accounting for contingencies, to reflect estimated probable credit losses inherent in the remainder of the loan portfolio which excludes impaired loans considered under the specific allowance discussed above. A general allowance can be evaluated on a pool basis for those loans with similar characteristics. The level of the general allowance may be based on management’s best estimate of the likelihood of default adjusted for other relevant factors reflecting the current environment.

The credit risk rating methodology is a key component of the Association’s allowance for loan losses evaluation, and

is generally incorporated into the institution’s loan underwriting standards and internal lending limit. The Association uses a two-dimensional loan rating model based on internally generated combined system risk rating guidance that incorporates a 14-point risk rating scale to identify and track the probability of borrower default and a separate scale addressing loss given default over a period of time. Probability of default is the probability that a borrower will experience a default within 12 months from the date of the determination of the risk rating. 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 is past due more than 90 days. The loss given default is management’s estimate as to the anticipated economic loss on a specific loan assuming default has occurred or is expected to occur within the next 12 months.

Each of the ratings carries a distinct percentage of default probability. The 14-point risk rating scale provides for granularity of the probability of default, especially in the acceptable ratings. There are nine acceptable categories that range from a borrower of the highest quality to a borrower of minimally acceptable quality. The probability of default between 1 and 9 is very narrow and would reflect almost no default to a minimal default percentage. The probability of default grows significantly as a loan moves from a 9 to 10 (other assets especially mentioned) and grows more significantly as a loan moves to a substandard viable level of 11. A substandard non-viable rating of 12 indicates that the probability of default is almost certain. Loans risk rated 13 or 14 are generally written off.

C. **Loans Held for Sale:** Loans are classified as held for sale when there is intent to sell the loans within a reasonable period of time. Loans intended for sale are carried at the lower of cost or fair value.

D. **Other Property Owned (OPO):** Other property owned, consisting of real estate, personal property, and other assets acquired through a collection action, is recorded upon acquisition at fair value less estimated selling costs. Any initial reduction in the carrying amount of a loan to the fair value of the collateral received is charged to the allowance for loan losses. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income, expenses, and carrying value adjustments related to other property owned are included in Gains (Losses) on Other Property Owned, Net in the Consolidated Statements of Income.

E. **Premises and Equipment:** Land is carried at cost. Premises and equipment are carried at cost less accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Gains and losses on dispositions are reflected in current earnings. Maintenance and repairs are charged to expense and improvements are capitalized. Premises and equipment are evaluated for impairment whenever events or circumstances indicate that the carrying value of the asset may not be recoverable.

From time to time, assets classified as premises and equipment are transferred to held for sale for various

reasons. These assets are carried in Other Assets at the lower of the recorded investment in the asset or fair value less estimated cost to sell based upon the property's appraised value at the date of transfer. Any write-down of property held for sale is recorded as a loss in the period identified.

- F. **Investments:** The Association may hold investments as described below.

**Equity Investments in Other Farm Credit System Institutions**

Investments in other Farm Credit System institutions are generally nonmarketable investments consisting of stock and participation certificates, allocated surplus, and reciprocal investments in other institutions regulated by the FCA. These investments are carried at cost and evaluated for impairment based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value.

**Investment Income**

Dividends from Investments in Other Farm Credit Institutions are generally recorded as patronage income and included in Noninterest Income.

- G. **Voluntary Advance Conditional Payments:** The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, the advanced conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as other liabilities in the accompanying Consolidated Balance Sheets. Advanced conditional payments are not insured. Interest is generally paid by the Association on such accounts.

- H. **Employee Benefit Plans:** The Association employees may participate in Association, District and/or multi-district sponsored benefit plans. These plans may include defined benefit final average pay retirement, defined benefit cash balance retirement, defined benefit other postretirement benefits, and defined contribution plans.

**Single Employer Defined Benefit Plan**

Certain employees depending on date of employment may participate in the First South Farm Credit, ACA Retirement Plan (the FS Plan), a defined benefit plan. The Plan is noncontributory and includes eligible Association employees. The "Projected Unit Credit" actuarial method is used for financial reporting purposes. Since the FS Plan is a single employer plan, the Association records the FS Plan's funded status and equity items related to prior service cost, accumulated other comprehensive income (loss) and prepaid (accrued) pension expense. The adjustment to other comprehensive income (loss) would be net of deferred taxes, if significant.

The foregoing defined benefit plan is considered single employer, therefore the Association applies the provisions of FASB guidance on employers' accounting for defined benefit pension and other postretirement plans in its standalone financial statements.

Additional information may be found in Note 9.

**Multiemployer Defined Benefit Plan**

In addition to pension benefits, the Association provides certain health care and life insurance benefits for retired employees (other postretirement benefits) through a multi-district sponsored retiree healthcare plan. Substantially all employees are eligible for those benefits when they reach early retirement age while working for the Association. Authoritative accounting guidance requires the accrual of the expected cost of providing these benefits to an employee, their beneficiaries and covered dependents during the years the employee renders service necessary to become eligible for benefits. The Other Postretirement Benefits plan is unfunded with expenses paid as incurred.

Since the foregoing plan is multiemployer, the Association does not apply the provisions of FASB guidance on employers' accounting for defined benefit pension and other postretirement plans in its stand-alone financial statements. Rather, the effects of this guidance are reflected in the Annual Information Statement of the Farm Credit System.

Additional information may be found in Note 9 and in the Notes to the Annual Information Statement of the Farm Credit System.

**Defined Contribution Plans**

Substantially all employees are eligible to participate in the defined contribution Farm Credit Benefit Alliance (FCBA) 401(k) Plan, subsequently referred to as the 401(k) Plan, which qualifies as a 401(k) plan as defined by the Internal Revenue Code. Employee deferrals are not to exceed the maximum deferral as determined and adjusted by the Internal Revenue Service. Association contributions to the 401(k) Plan are expensed as funded.

Additional information may be found in Note 9.

- I. **Income Taxes:** The Association evaluates tax positions taken in previous and current years according to FASB guidance. A tax position can result in a permanent reduction of income taxes payable, a deferral of income taxes otherwise currently payable to future years, or a change in the expected realizability of deferred tax assets. The term tax position also encompasses, but is not limited to, an entity's status, including its status as a pass-through entity or tax-exempt entity.

The Association is generally subject to Federal and certain other income taxes. As previously described, the ACA holding company has two wholly-owned subsidiaries, a PCA and a FLCA. The FLCA subsidiary is exempt from federal and state income taxes as provided in the Farm Credit Act. The ACA holding company and the PCA subsidiary are subject to federal, state and certain other income taxes.

The Association is eligible to operate 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 refunds in the form of cash, stock or allocated surplus. Provisions for

income taxes are made only on those taxable earnings that will not be distributed as qualified patronage refunds. The Association distributes patronage on the basis of book income.

The Association accounts for income taxes under the asset and liability method, recognizing deferred tax assets and liabilities for the expected future tax consequences of the temporary differences between the carrying amounts and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled.

The Association records a valuation allowance at the balance sheet dates against that portion of the Association's deferred tax assets that, based on management's best estimates of future events and circumstances, more likely than not (a likelihood of more than 50 percent) will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of the expected patronage program, which reduces taxable earnings.

**J. Due from AgFirst Farm Credit Bank:** The Association records patronage refunds from the Bank and certain District Associations on an accrual basis.

**K. Valuation Methodologies:** FASB guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. This guidance also 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. It prescribes three levels of inputs that may be used to measure fair value.

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability.

Level 3 inputs to the valuation methodology are unobservable and supported by little or no market activity. Valuation is determined using pricing models, discounted cash flow methodologies, or similar techniques, and could include significant management judgment or estimation. Level 3 assets and liabilities also could include instruments whose price has been adjusted based on dealer quoted pricing that is different than a third-party valuation or internal model pricing.

The Association may use the Bank, internal resources or third parties to obtain fair value prices. Quoted market prices are generally used when estimating fair values of any assets or liabilities for which observable, active markets exist. A number of methodologies may be employed to value

items for which an observable active market does not exist. Examples of these items include: impaired loans, other property owned, and certain derivatives, investment securities and other financial instruments. Inputs to these valuations can involve estimates and assumptions that require a substantial degree of judgment. Some of the assumptions used include, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing, and liquidation values. The use of different assumptions could produce significantly different asset or liability values, which could have material positive or negative effects on results of operations.

Additional information may be found in Note 8.

**L. Off-Balance-Sheet Credit Exposures:** The credit risk associated with commitments to extend credit and letters of credit is essentially the same as that involved with extending loans to customers and is subject to normal credit policies. Collateral may be obtained based on management's assessment of the customer's creditworthiness.

Commitments to extend credit are agreements to lend to customers, generally having fixed expiration dates or other termination clauses that may require payment of a fee.

Letters of credit are commitments issued to guarantee the performance of a customer to a third party. These letters of credit are issued to facilitate commerce and typically result in the commitment being funded when the underlying transaction is consummated between the customer and third party.

**M. Revenue Recognition:** The Association generates income from multiple sources.

#### **Financial Instruments**

The largest source of revenue for the Association is interest income. Interest income is recognized on an accrual basis driven by nondiscretionary formulas based on written contracts, such as loan agreements or securities contracts. Credit-related fees, including letter of credit fees, finance charges and other fees are recognized in Noninterest Income when earned. Other types of noninterest revenues, such as service charges, professional services and broker fees, are accrued and recognized into income as services are provided and the amount of fees earned is reasonably determinable.

#### **Contracts with Customers**

The Association may maintain contracts with customers to provide support services in various areas such as accounting, lending transactions, consulting, insurance, and information technology. As most of the contracts are to provide access to expertise or system capacity that the Association maintains, there are no material incremental costs to fulfill these contracts that should be capitalized. The Association does not generally incur costs to obtain contracts. Revenue is recognized to reflect the transfer of goods and services to customers in an amount equal to the consideration the Association receives or expects to receive.

**Gains and Losses from Nonfinancial Assets**

Any gains or losses on sales of Premises and Equipment and OPO are included as part of Noninterest Income. These gains and losses are recognized, and the nonfinancial asset is derecognized, when the Association has entered into a valid contract with a noncustomer and transferred control of the asset. If the criteria to meet the definition of a contract have not been met, the Association does not derecognize the nonfinancial asset and any consideration received is recognized as a liability. If the criteria for a contract are subsequently met, or if the consideration received is or becomes nonrefundable, a gain or loss may be recognized at that time.

**N. Leases:****Lessee**

Contracts entered into are evaluated at inception to determine if they contain a lease. Assets and liabilities are recognized on the Consolidated Balance Sheets to reflect the rights and obligations created by any contracts that do. These contracts are then classified as either operating or finance leases.

In the course of normal operations, the Association may enter into leases for various business purposes. Generally, leases are for terms of three to five years and may include options to extend or terminate the arrangement. Any options are assessed individually to determine if it is reasonably certain they will be exercised.

Right-of-use (ROU) assets represent the right to use an underlying asset for the lease term, and lease liabilities represent the obligation to make the payments arising from the lease. ROU assets and lease liabilities are initially recognized based on the present value of lease payments over the lease term. Lease expense for operating leases is recognized on a straight-line basis over the lease term. Lease expense for finance leases is recognized on a declining basis over the lease term.

ROU assets are included on the Consolidated Balance Sheets in Premises and Equipment for finance leases and Other Assets for operating leases. Lease liabilities are included in Other Liabilities on the Consolidated Balance Sheets. Leases with an initial term of 12 months or less are not recorded on the Consolidated Balance Sheets and lease expense is recognized over the lease term.

**Lessor**

The Association may act as lessor in certain contractual arrangements which relate to office space in an owned property and are considered operating leases. Generally, leases are for terms of three to five years and may include options to extend or terminate the arrangement.

Lease income is recognized on a straight-line basis over the lease term. Lease and nonlease components are accounted for separately in the Consolidated Statements of Income. Any initial direct costs are deferred and recognized as an expense over the lease term on the same basis as lease income. Any taxes assessed by a governmental authority are excluded from consideration as variable payments.

Lease receivables and income are included in Accounts Receivable on the Consolidated Balance Sheets and Lease Income in the Consolidated Statements of Income.

**O. Accounting Standards Updates (ASUs):** In January 2020, the FASB issued ASU 2020-01 Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815): Clarifying the Interactions between Topic 321, Topic 323, and Topic 815. The amendments clarify certain interactions between the guidance on accounting for certain equity securities under Topic 321, the guidance on accounting for investments under the equity method in Topic 323, and the guidance in Topic 815. The Update could change how an entity accounts for an equity security under the measurement alternative or a forward contract or purchased option to purchase securities that, upon settlement of the forward contract or exercise of the purchased option, would be accounted for under the equity method of accounting or the fair value option in accordance with Topic 825, Financial Instruments. The amendments are intended to improve current GAAP by reducing diversity in practice and increasing comparability of the accounting for these interactions. For public business entities, the amendments are effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early adoption is permitted, including early adoption in an interim period. Evaluation of any possible effects the guidance may have on the statements of financial condition and results of operations is in progress.

In December 2019, the FASB issued ASU 2019-12 Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes. The amendments simplify the accounting for income taxes by removing the following exceptions:

- Exception to the incremental approach for intraperiod tax allocation when there is a loss from continuing operations and income or a gain from other items (for example, discontinued operations or other comprehensive income),
- Exception to the requirement to recognize a deferred tax liability for equity method investments when a foreign subsidiary becomes an equity method investment,
- Exception to the ability not to recognize a deferred tax liability for a foreign subsidiary when a foreign equity method investment becomes a subsidiary, and
- Exception to the general methodology for calculating income taxes in an interim period when a year-to-date loss exceeds the anticipated loss for the year.

The amendments also simplify the accounting for income taxes by doing the following:

- Requiring that an entity recognize a franchise tax (or similar tax) that is partially based on income as an income-based tax and account for any incremental amount incurred as a non-income-based tax,

- Requiring that an entity evaluate when a step up in the tax basis of goodwill should be considered part of the business combination in which the book goodwill was originally recognized and when it should be considered a separate transaction,
- Specifying that an entity is not required to allocate the consolidated amount of current and deferred tax expense to a legal entity that is not subject to tax in its separate financial statements; however, an entity may elect to do so (on an entity-by-entity basis) for a legal entity that is both not subject to tax and disregarded by the taxing authority,
- Requiring that an entity reflect the effect of an enacted change in tax laws or rates in the annual effective tax rate computation in the interim period that includes the enactment date, and
- Making minor codification improvements for income taxes related to employee stock ownership plans and investments in qualified affordable housing projects accounted for using the equity method.

For public business entities, the amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. Evaluation of any possible effects the guidance may have on the statements of financial condition and results of operations is in progress.

In November 2019, the FASB issued ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842). On the basis of feedback obtained from outreach with stakeholders and monitoring of implementation, the Board has gained a greater understanding about the implementation challenges encountered by all types of entities when adopting a major Update. The challenges are often magnified for private companies, smaller public companies, and not-for-profit organizations. In response to those issues and requests to defer certain major Updates not yet effective for all entities, the Board developed a philosophy to extend and simplify how effective dates are staggered between larger public companies (bucket one) and all other entities (bucket two). Credit Losses guidance in ASU 2016-13 will be effective for all bucket two entities for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years.

In May 2019, the FASB issued ASU 2019-05 Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief. The amendments in this Update provide entities with an option to irrevocably elect the fair value option applied on an instrument-by-instrument basis for certain financial assets upon the adoption of Topic 326. The fair value option election does not apply to held-to-maturity debt securities. For entities that have not yet adopted the amendments in ASU 2016-13, the effective date and transition methodology for the amendments in this Update are the same as in that update. Evaluation of any possible effects the guidance may have on the statements of financial condition and results of operations is in progress.

In April 2019, the FASB issued ASU 2019-04 Codification Improvements to Topic 326 Financial Instruments—Credit Losses, Topic 815 Derivatives and Hedging, and Topic 825 Financial Instruments. The amendments in this Update clarify, correct, and improve various aspects of the guidance in the following Updates related to financial instruments: ASU 2016-01 Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities, ASU 2016-13 Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, and ASU 2017-12 Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. The items addressed generally are not expected to have a significant effect on current accounting practice or to create a significant administrative cost for most entities. For entities that have not yet adopted the amendments in ASU 2016-13, the effective dates and transition requirements for the amendments related to this Update are the same as the effective dates and transition requirements in ASU 2016-13. The transition adjustment includes adjustments made as a result of an entity developing or amending its accounting policy upon adoption of the amendments in this Update for determining when accrued interest receivables are deemed uncollectible and written off. For entities that have adopted the amendments in ASU 2017-12 as of the issuance date of this Update, the effective date is as of the beginning of the first annual period beginning after the issuance date of this Update. For those entities, early adoption is permitted, including adoption on any date on or after the issuance of this Update. The amendments in this Update related to ASU 2016-01 are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted in any interim period following the issuance of this Update as long as the entity has adopted all of the amendments in ASU 2016-01. The amendments in this Update should be applied on a modified-retrospective transition basis by means of a cumulative-effect adjustment to the opening retained earnings balance in the statement of financial position as of the date an entity adopted all of the amendments in ASU 2016-01. Adoption of the guidance related to ASU 2016-01 and ASU 2017-12 is not expected to have an impact on the statements of financial condition or results of operations. Evaluation of any possible effects the ASU 2016-13 guidance may have on the statements of financial condition and results of operations is in progress.

In August 2018, the FASB issued ASU 2018-15 Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract. The amendments align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by the amendments in this Update. The guidance is effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted, including adoption in any interim period, for all

entities. The amendments should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. The guidance will be adopted on a prospective basis in 2020 and is not expected to have a material impact on the statements of financial condition or results of operations.

In August 2018, the FASB issued ASU 2018-14 Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20): Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans. The amendments in this Update remove disclosures that are no longer considered cost beneficial, clarify the specific requirements of certain disclosures, and add new disclosure requirements identified as relevant. Although narrow in scope, the amendments are considered an important part of the FASB’s efforts to improve the effectiveness of disclosures in the notes to financial statements by applying concepts in the Concepts Statement, Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements. The amendments are effective for fiscal years ending after December 15, 2020, for public business entities. Early adoption is permitted. Evaluation of any possible effects the guidance may have on the statements of financial condition and results of operations is in progress.

In August 2018, the FASB issued ASU 2018-13 Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement. The amendments are part of the FASB’s disclosure framework project. The project’s objective and primary focus are to improve the effectiveness of disclosures in the notes to financial statements by facilitating clear communication of the information required by GAAP that is most important to users of each entity’s financial statements. The amendments remove, modify or add certain disclosures contained in the financial statement footnotes related to fair value. Additionally, the guidance is intended to promote the appropriate exercise of discretion by entities when considering fair value measurement disclosures and to clarify that materiality is an appropriate consideration of entities and their auditors when evaluating disclosure requirements. The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Certain amendments should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. Early adoption is permitted upon issuance. Entities are permitted to early adopt any removed or modified disclosures upon issuance of this Update and delay adoption of the additional disclosures until their effective date. The removed disclosures were adopted effective with the 2018 Annual Report, and the remaining disclosures were adopted with the 2019 Annual Report.

In February 2018, the FASB issued ASU 2018-02 Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The guidance allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The amendments

eliminate the stranded tax effects resulting from the Tax Cuts and Jobs Act and are intended to improve the usefulness of information reported to financial statement users. However, because the amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The Update also requires certain disclosures about stranded tax effects. The guidance was effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Adoption of this guidance had no impact on the statements of financial condition and results of operations.

In March 2017, the FASB issued ASU 2017-08 Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. The guidance relates to certain callable debt securities and shortens the amortization period for any premium to the earliest call date. The Update was effective for interim and annual periods beginning after December 15, 2018 for public business entities. Adoption of this guidance had no impact on the statements of financial condition and results of operations.

In February 2017, the FASB issued ASU 2017-06 Plan Accounting: Defined Benefit Pension Plans (Topic 960), Defined Contribution Pension Plans (Topic 962), Health and Welfare Benefit Plans (Topic 965): Employee Benefit Plan Master Trust Reporting (a consensus of the Emerging Issues Task Force). This Update amended the guidance related to employee benefit plan master trust reporting. The new guidance provides for presentation within the plan’s financial statements of its interest in a master trust as a single line item; disclosure of the master trust’s investments by general type as well as by the dollar amount of the plan’s interest in each type; disclosure of the master trust’s other assets and liabilities and the balances related to the plan; and elimination of required disclosures for Section 401(h) accounts that are already provided by the associated defined benefit plan. The amendments were effective for fiscal years beginning after December 15, 2018. Adoption of this guidance did not have a material impact on the statements of financial condition and results of operations.

In June 2016, the FASB issued ASU 2016-13 Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. This Update, and subsequent clarifying guidance issued, is intended to improve financial reporting by requiring timelier recording of credit losses on financial instruments. It requires an organization to measure all expected credit losses for financial assets held at the reporting date. Financial institutions and other organizations will use forward-looking information to estimate their credit losses. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public companies that are not SEC filers, it will take effect for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years. Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 31, 2018. Evaluation of any possible effects the

guidance may have on the statements of financial condition and results of operations is in progress.

In February 2016, the FASB issued ASU 2016-02 Leases (Topic 842). This Update, and subsequent clarifying guidance issued, requires organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Leases are classified as either finance leases or operating leases. This distinction is relevant for the pattern of expense recognition in the income statement. Lessor accounting guidance is largely unchanged from the previous standard. The Update also eliminates leveraged lease accounting but allows existing leveraged leases to continue their current accounting until maturity, termination or modification. The amendments were effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, for public business entities.

#### Transition Information

- The guidance was adopted using the optional modified retrospective method and practical expedients for transition. Under this transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption.
- The package of practical expedients related to initial application of the guidance was elected, which allowed existing leases to be largely accounted for consistent with current guidance, except for the incremental balance sheet recognition for lessees.
- There will not be a material change to the timing of future expense recognition.
- Upon adoption, a cumulative-effect adjustment to equity of approximately \$(321) was recorded. In addition, a Right of Use Asset in the amount of \$1,775 and Lease Liability in the amount of \$2,096 were recognized.
- Given the limited changes to lessor accounting, there were no material changes to recognition or measurement.

#### **Note 3 — Loans and Allowance for Loan Losses**

For a description of the Association's accounting for loans, including impaired loans, and the allowance for loan losses, see Note 2 subsection B above.

Credit risk arises from the potential inability of an obligor to meet its repayment obligation which exists in outstanding loans. The Association manages credit risk associated with lending activities through an assessment of the credit risk profile of an individual obligor. The Association sets its own underwriting standards and lending policies that provide direction to loan officers and are approved by the Board of Directors.

The credit risk management process begins with an analysis of the obligor's credit history, repayment capacity and financial position. Repayment capacity focuses on the obligor's ability to

repay the obligation based on cash flows from operations or other sources of income, including non-farm income. Real estate mortgage loans must be secured by first liens on the real estate collateral. As required by FCA regulations, each institution that makes loans on a secured basis must have collateral evaluation policies and procedures.

The credit risk rating process for loans uses a two-dimensional structure, incorporating a 14-point probability of default scale (see further discussion in Note 2 subsection B above) and a separate scale addressing estimated percentage loss in the event of default. The loan rating structure incorporates borrower risk and transaction risk. Borrower risk is the risk of loss driven by factors intrinsic to the borrower. The transaction risk or facility risk is related to the structure of a credit (tenor, terms, and collateral).

The Association's loan portfolio, which includes purchased interests in loans, has been segmented by the following loan types as defined by the FCA:

- Real estate mortgage loans — loans made to full-time or part-time farmers secured by first lien real estate mortgages with maturities from five to thirty years. These loans may be made only in amounts up to 85 percent of the appraised value of the property taken as security or up to 97 percent of the appraised value if guaranteed by a federal, state, or other governmental agency. The actual percentage of loan-to-appraised value when loans are made is generally lower than the statutory required percentage.
- Production and intermediate-term loans — loans to full-time or part-time farmers that are not real estate mortgage loans. These loans fund eligible financing needs including operating inputs (such as labor, feed, fertilizer, and repairs), livestock, living expenses, income taxes, machinery or equipment, farm buildings, and other business-related expenses. Production loans may be made on a secured or unsecured basis and are most often made for a period of time that matches the borrower's normal production and marketing cycle, which is typically one year or less. Intermediate-term loans are made for a specific term, generally greater than one year and less than or equal to ten years.
- Loans to cooperatives — loans for any cooperative purpose other than for communication, power, and water and waste disposal.
- Processing and marketing loans — loans for operations to process or market the products produced by a farmer, rancher, or producer or harvester of aquatic products, or by a cooperative.
- Farm-related business loans — loans to eligible borrowers that furnish certain farm-related business services to farmers or ranchers that are directly related to their agricultural production.
- Rural residential real estate loans — loans made to individuals, who are not farmers, to purchase a single-family dwelling that will be the primary residence in open country, which may include a town or village that has a population of not more than 2,500 persons. In addition, the loan may be to remodel, improve, or repair a rural home, or to refinance existing debt. These loans are generally secured by a first lien on the property.
- Communication loans — loans primarily to finance rural communication providers.

- Power loans — loans primarily to finance electric generation, transmission and distribution systems serving rural areas.
- Water and waste disposal loans — loans primarily to finance water and waste disposal systems serving rural areas.
- International loans — primarily loans or credit enhancements to other banks to support the export of U.S. agricultural commodities or supplies. The federal government guarantees a substantial portion of these loans.
- Lease receivables — the net investment for all finance leases such as direct financing leases, leveraged leases, and sales-type leases.
- Other (including Mission Related) — additional investments in rural America approved by the FCA on a program or a case-by-case basis. Examples of such investments include partnerships with agricultural and rural community lenders, investments in rural economic development and infrastructure, and investments in obligations and mortgage securities that increase the availability of affordable housing in rural America.

A summary of loans outstanding at period end follows:

	December 31,		
	2019	2018	2017
Real estate mortgage	\$ 1,745,138	\$ 1,617,874	\$ 1,498,148
Production and intermediate-term	396,010	375,310	383,514
Loans to cooperatives	11,581	7,844	3,368
Processing and marketing	50,048	38,867	62,001
Farm-related business	11,053	12,845	8,561
Communication	6,760	6,664	8,357
Power and water/waste disposal	3,011	3,625	3,717
Rural residential real estate	10,981	9,745	9,302
<b>Total loans</b>	<b>\$ 2,234,582</b>	<b>\$ 2,072,774</b>	<b>\$ 1,976,968</b>

A substantial portion of the Association's lending activities is collateralized and the Association's exposure to credit loss associated with lending activities is reduced accordingly.

The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but typically includes farmland and income-producing property, such as crops and livestock, as well as receivables. Real estate loans are collateralized by the first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (97 percent if guaranteed by a government agency) of the property's appraised value. However, a decline in a property's market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the Association in the collateral, may result in loan to value ratios in excess of the regulatory maximum.

The Association may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume, and comply with FCA regulations. The following tables present the principal balance of participation loans at periods ended:

	December 31, 2019							
	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	\$ 10,829	\$ 22,580	\$ —	\$ —	\$ 18,618	\$ —	\$ 29,447	\$ 22,580
Production and intermediate-term	8,880	14,867	62	—	401	—	9,343	14,867
Loans to cooperatives	11,612	—	—	—	—	—	11,612	—
Processing and marketing	11,728	35,425	15,313	1,478	2,000	—	29,041	36,903
Communication	6,758	—	—	—	—	—	6,758	—
Power and water/waste disposal	3,028	—	—	—	—	—	3,028	—
Rural residential real estate	—	—	—	—	40	—	40	—
<b>Total</b>	<b>\$ 52,835</b>	<b>\$ 72,872</b>	<b>\$ 15,375</b>	<b>\$ 1,478</b>	<b>\$ 21,059</b>	<b>\$ —</b>	<b>\$ 89,269</b>	<b>\$ 74,350</b>

	December 31, 2018							
	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	\$ 8,284	\$ 16,457	\$ —	\$ —	\$ 20,953	\$ —	\$ 29,237	\$ 16,457
Production and intermediate-term	4,426	16,235	31	—	396	—	4,853	16,235
Loans to cooperatives	7,873	—	—	—	—	—	7,873	—
Processing and marketing	12,310	21,610	5,995	2,008	—	—	18,305	23,618
Communication	6,661	—	—	—	—	—	6,661	—
Power and water/waste disposal	3,636	—	—	—	—	—	3,636	—
Rural residential real estate	—	—	—	—	42	—	42	—
<b>Total</b>	<b>\$ 43,190</b>	<b>\$ 54,302</b>	<b>\$ 6,026</b>	<b>\$ 2,008</b>	<b>\$ 21,391</b>	<b>\$ —</b>	<b>\$ 70,607</b>	<b>\$ 56,310</b>

December 31, 2017

	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	\$ 6,417	\$ 11,998	\$ -	\$ -	\$ 31,658	\$ -	\$ 38,075	\$ 11,998
Production and intermediate-term	10,696	16,382	-	-	421	-	11,117	16,382
Loans to cooperatives	3,385	-	-	-	-	-	3,385	-
Processing and marketing	16,404	22,793	13,328	12,115	-	-	29,732	34,908
Communication	8,323	-	-	-	-	-	8,323	-
Power and water/waste disposal	3,728	-	-	-	-	-	3,728	-
Rural residential real estate	-	-	-	-	123	-	123	-
Total	\$ 48,953	\$ 51,173	\$ 13,328	\$ 12,115	\$ 32,202	\$ -	\$ 94,483	\$ 63,288

A significant source of liquidity for the Association is the repayments of loans. The following table presents the contractual maturity distribution of loans by loan type at the latest period end:

	December 31, 2019			
	Due Less Than 1 Year	Due 1 Through 5 Years	Due After 5 Years	Total
Real estate mortgage	\$ 49,498	\$ 403,279	\$ 1,292,361	\$ 1,745,138
Production and intermediate-term	149,839	179,468	66,703	396,010
Loans to cooperatives	-	1,212	10,369	11,581
Processing and marketing	15,333	26,139	8,576	50,048
Farm-related business	1,482	5,224	4,347	11,053
Communication	3,152	3,608	-	6,760
Power and water/waste disposal	-	3,011	-	3,011
Rural residential real estate	119	2,013	8,849	10,981
Total loans	\$ 219,423	\$ 623,954	\$ 1,391,205	\$ 2,234,582
Percentages	9.82%	27.92%	62.26%	100.00%

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

The following table shows loans and related accrued interest classified under the FCA Uniform Loan Classification System as a percentage of total loans and related accrued interest receivable by loan type as of:

	December 31,				December 31,		
	2019	2018	2017		2019	2018	2017
<b>Real estate mortgage:</b>				<b>Farm-related business:</b>			
Acceptable	96.64%	96.95%	96.94%	Acceptable	87.97%	97.23%	95.37%
OAEM	2.53	2.36	2.19	OAEM	12.03	2.77	4.63
Substandard/doubtful/loss	0.83	0.69	0.87	Substandard/doubtful/loss	-	-	-
	100.00%	100.00%	100.00%		100.00%	100.00%	100.00%
<b>Production and intermediate-term:</b>				<b>Communication:</b>			
Acceptable	88.25%	92.08%	91.17%	Acceptable	100.00%	100.00%	100.00%
OAEM	7.83	5.91	6.36	OAEM	-	-	-
Substandard/doubtful/loss	3.92	2.01	2.47	Substandard/doubtful/loss	-	-	-
	100.00%	100.00%	100.00%		100.00%	100.00%	100.00%
<b>Loans to cooperatives:</b>				<b>Power and water/waste disposal:</b>			
Acceptable	100.00%	100.00%	100.00%	Acceptable	-%	100.00%	100.00%
OAEM	-	-	-	OAEM	100.00	-	-
Substandard/doubtful/loss	-	-	-	Substandard/doubtful/loss	-	-	-
	100.00%	100.00%	100.00%		100.00%	100.00%	100.00%
<b>Processing and marketing:</b>				<b>Rural residential real estate:</b>			
Acceptable	87.58%	100.00%	100.00%	Acceptable	97.49%	97.90%	99.39%
OAEM	12.42	-	-	OAEM	1.32	0.68	0.61
Substandard/doubtful/loss	-	-	-	Substandard/doubtful/loss	1.19	1.42	-
	100.00%	100.00%	100.00%		100.00%	100.00%	100.00%
				<b>Total loans:</b>			
				Acceptable	94.81%	96.16%	95.94%
				OAEM	3.84	2.94	2.92
				Substandard/doubtful/loss	1.35	0.90	1.14
					100.00%	100.00%	100.00%

The following tables provide an aging analysis of past due loans and related accrued interest as of:

December 31, 2019					
	30 Through 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	\$ 4,012	\$ 1,494	\$ 5,506	\$ 1,755,363	\$ 1,760,869
Production and intermediate-term	1,863	1,194	3,057	398,699	401,756
Loans to cooperatives	—	—	—	11,593	11,593
Processing and marketing	—	—	—	50,305	50,305
Farm-related business	—	—	—	11,262	11,262
Communication	—	—	—	6,787	6,787
Power and water/waste disposal	—	—	—	3,013	3,013
Rural residential real estate	213	—	213	10,833	11,046
Total	\$ 6,088	\$ 2,688	\$ 8,776	\$ 2,247,855	\$ 2,256,631

December 31, 2018					
	30 Through 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	\$ 5,201	\$ 859	\$ 6,060	\$ 1,626,368	\$ 1,632,428
Production and intermediate-term	1,565	822	2,387	378,072	380,459
Loans to cooperatives	—	—	—	7,846	7,846
Processing and marketing	—	—	—	39,049	39,049
Farm-related business	—	—	—	12,989	12,989
Communication	—	—	—	6,665	6,665
Power and water/waste disposal	—	—	—	3,629	3,629
Rural residential real estate	23	—	23	9,789	9,812
Total	\$ 6,789	\$ 1,681	\$ 8,470	\$ 2,084,407	\$ 2,092,877

December 31, 2017					
	30 Through 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	\$ 4,715	\$ 1,747	\$ 6,462	\$ 1,505,256	\$ 1,511,718
Production and intermediate-term	1,620	1,753	3,373	384,972	388,345
Loans to cooperatives	—	—	—	3,369	3,369
Processing and marketing	—	—	—	62,203	62,203
Farm-related business	—	—	—	8,667	8,667
Communication	—	—	—	8,361	8,361
Power and water/waste disposal	—	—	—	3,719	3,719
Rural residential real estate	326	—	326	9,049	9,375
Total	\$ 6,661	\$ 3,500	\$ 10,161	\$ 1,985,596	\$ 1,995,757

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

	December 31,		
	2019	2018	2017
<b>Nonaccrual loans:</b>			
Real estate mortgage	\$ 2,166	\$ 1,552	\$ 2,820
Production and intermediate-term	2,582	2,198	3,585
Total	\$ 4,748	\$ 3,750	\$ 6,405
<b>Accruing restructured loans:</b>			
Real estate mortgage	\$ 1,159	\$ 1,195	\$ 1,711
Production and intermediate-term	1,165	1,269	1,631
Total	\$ 2,324	\$ 2,464	\$ 3,342
<b>Accruing loans 90 days or more past due:</b>			
Total	\$ —	\$ —	\$ —
Total nonperforming loans	\$ 7,072	\$ 6,214	\$ 9,747
Other property owned	1,031	2,879	551
Total nonperforming assets	\$ 8,103	\$ 9,093	\$ 10,298
Nonaccrual loans as a percentage of total loans	0.21%	0.18%	0.32%
Nonperforming assets as a percentage of total loans and other property owned	0.36%	0.44%	0.52%
Nonperforming assets as a percentage of capital	1.83%	2.13%	2.57%

The following table presents information relating to impaired loans (including accrued interest) as defined in Note 2:

	December 31,		
	2019	2018	2017
<b>Impaired nonaccrual loans:</b>			
Current as to principal and interest	\$ 1,939	\$ 2,056	\$ 2,162
Past due	2,809	1,694	4,243
Total	<u>\$ 4,748</u>	<u>\$ 3,750</u>	<u>\$ 6,405</u>
<b>Impaired accrual loans:</b>			
Restructured	\$ 2,324	\$ 2,464	\$ 3,342
90 days or more past due	-	-	-
Total	<u>\$ 2,324</u>	<u>\$ 2,464</u>	<u>\$ 3,342</u>
Total impaired loans	<u>\$ 7,072</u>	<u>\$ 6,214</u>	<u>\$ 9,747</u>
Additional commitments to lend	<u>\$ -</u>	<u>\$ 50</u>	<u>\$ -</u>

The following tables present additional impaired loan information at period end. Unpaid principal balance represents the contractual principal balance of the loan.

	December 31, 2019			Year Ended December 31, 2019	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans
<b>Impaired loans:</b>					
<b>With a related allowance for credit losses:</b>					
Production and intermediate-term	\$ 638	\$ 674	\$ 77	\$ 559	\$ 20
Total	<u>\$ 638</u>	<u>\$ 674</u>	<u>\$ 77</u>	<u>\$ 559</u>	<u>\$ 20</u>
<b>With no related allowance for credit losses:</b>					
Real estate mortgage	\$ 3,325	\$ 5,255	\$ -	\$ 2,914	\$ 104
Production and intermediate-term	3,109	4,303	-	2,723	98
Total	<u>\$ 6,434</u>	<u>\$ 9,558</u>	<u>\$ -</u>	<u>\$ 5,637</u>	<u>\$ 202</u>
<b>Total:</b>					
Real estate mortgage	\$ 3,325	\$ 5,255	\$ -	\$ 2,914	\$ 104
Production and intermediate-term	3,747	4,977	77	3,282	118
Total	<u>\$ 7,072</u>	<u>\$ 10,232</u>	<u>\$ 77</u>	<u>\$ 6,196</u>	<u>\$ 222</u>

	December 31, 2018			Year Ended December 31, 2018	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans
<b>Impaired loans:</b>					
<b>With a related allowance for credit losses:</b>					
Real estate mortgage	\$ 402	\$ 404	\$ 117	\$ 526	\$ 51
Production and intermediate-term	399	434	110	523	50
Total	<u>\$ 801</u>	<u>\$ 838</u>	<u>\$ 227</u>	<u>\$ 1,049</u>	<u>\$ 101</u>
<b>With no related allowance for credit losses:</b>					
Real estate mortgage	\$ 2,345	\$ 4,332	\$ -	\$ 3,072	\$ 296
Production and intermediate-term	3,068	4,137	-	4,018	387
Total	<u>\$ 5,413</u>	<u>\$ 8,469</u>	<u>\$ -</u>	<u>\$ 7,090</u>	<u>\$ 683</u>
<b>Total:</b>					
Real estate mortgage	\$ 2,747	\$ 4,736	\$ 117	\$ 3,598	\$ 347
Production and intermediate-term	3,467	4,571	110	4,541	437
Total	<u>\$ 6,214</u>	<u>\$ 9,307</u>	<u>\$ 227</u>	<u>\$ 8,139</u>	<u>\$ 784</u>

Impaired loans:	December 31, 2017			Year Ended December 31, 2017	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans
<b>With a related allowance for credit losses:</b>					
Production and intermediate-term	\$ 639	\$ 642	\$ 222	\$ 861	\$ 42
Total	\$ 639	\$ 642	\$ 222	\$ 861	\$ 42
<b>With no related allowance for credit losses:</b>					
Real estate mortgage	\$ 4,531	\$ 6,306	\$ –	\$ 6,100	\$ 295
Production and intermediate-term	4,577	5,798	–	6,160	297
Total	\$ 9,108	\$ 12,104	\$ –	\$ 12,260	\$ 592
<b>Total:</b>					
Real estate mortgage	\$ 4,531	\$ 6,306	\$ –	\$ 6,100	\$ 295
Production and intermediate-term	5,216	6,440	222	7,021	339
Total	\$ 9,747	\$ 12,746	\$ 222	\$ 13,121	\$ 634

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

	Real Estate Mortgage	Production and Intermediate-term	Agribusiness*	Communication	Power and Water/Waste Disposal	Rural Residential Real Estate	Total
<b>Activity related to the allowance for credit losses:</b>							
Balance at December 31, 2018	\$ 10,411	\$ 3,072	\$ 334	\$ 37	\$ 20	\$ 67	\$ 13,941
Charge-offs	(188)	(136)	–	–	–	–	(324)
Recoveries	108	53	–	–	–	–	161
Provision for loan losses	283	657	134	(2)	33	–	1,105
Balance at December 31, 2019	\$ 10,614	\$ 3,646	\$ 468	\$ 35	\$ 53	\$ 67	\$ 14,883
Balance at December 31, 2017	\$ 9,588	\$ 3,528	\$ 390	\$ 43	\$ 19	\$ 50	\$ 13,618
Charge-offs	(296)	(531)	–	–	–	–	(827)
Recoveries	2	68	–	–	–	–	70
Provision for loan losses	1,117	7	(56)	(6)	1	17	1,080
Balance at December 31, 2018	\$ 10,411	\$ 3,072	\$ 334	\$ 37	\$ 20	\$ 67	\$ 13,941
Balance at December 31, 2016	\$ 9,050	\$ 2,980	\$ 325	\$ 64	\$ –	\$ 47	\$ 12,466
Charge-offs	(91)	(83)	–	–	–	–	(174)
Recoveries	28	13	–	–	–	–	41
Provision for loan losses	601	618	65	(21)	19	3	1,285
Balance at December 31, 2017	\$ 9,588	\$ 3,528	\$ 390	\$ 43	\$ 19	\$ 50	\$ 13,618
<b>Allowance on loans evaluated for impairment:</b>							
Individually	\$ –	\$ 77	\$ –	\$ –	\$ –	\$ –	\$ 77
Collectively	10,614	3,569	468	35	53	67	14,806
Balance at December 31, 2019	\$ 10,614	\$ 3,646	\$ 468	\$ 35	\$ 53	\$ 67	\$ 14,883
Individually	\$ 117	\$ 110	\$ –	\$ –	\$ –	\$ –	\$ 227
Collectively	10,294	2,962	334	37	20	67	13,714
Balance at December 31, 2018	\$ 10,411	\$ 3,072	\$ 334	\$ 37	\$ 20	\$ 67	\$ 13,941
Individually	\$ –	\$ 222	\$ –	\$ –	\$ –	\$ –	\$ 222
Collectively	9,588	3,306	390	43	19	50	13,396
Balance at December 31, 2017	\$ 9,588	\$ 3,528	\$ 390	\$ 43	\$ 19	\$ 50	\$ 13,618
<b>Recorded investment in loans evaluated for impairment:</b>							
Individually	\$ 3,325	\$ 3,747	\$ –	\$ –	\$ –	\$ –	\$ 7,072
Collectively	1,757,544	398,009	73,160	6,787	3,013	11,046	2,249,559
Balance at December 31, 2019	\$ 1,760,869	\$ 401,756	\$ 73,160	\$ 6,787	\$ 3,013	\$ 11,046	\$ 2,256,631
Individually	\$ 2,747	\$ 3,467	\$ –	\$ –	\$ –	\$ –	\$ 6,214
Collectively	1,629,681	376,992	59,884	6,665	3,629	9,812	2,086,663
Balance at December 31, 2018	\$ 1,632,428	\$ 380,459	\$ 59,884	\$ 6,665	\$ 3,629	\$ 9,812	\$ 2,092,877
Individually	\$ 4,260	\$ 5,216	\$ –	\$ –	\$ –	\$ –	\$ 9,476
Collectively	1,507,458	383,129	74,239	8,361	3,719	9,375	1,986,281
Balance at December 31, 2017	\$ 1,511,718	\$ 388,345	\$ 74,239	\$ 8,361	\$ 3,719	\$ 9,375	\$ 1,995,757

\*Includes the loan types: Loans to cooperatives, Processing and marketing, and Farm-related business.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. There were no new TDRs that occurred during 2019, 2018 or 2017.

Interest concessions may include interest forgiveness and interest deferment. Principal concessions may include principal forgiveness, principal deferment, and maturity extension. Other concessions may include additional compensation received which might be in the form of cash or other assets.

There were no TDRs that occurred during the previous twelve months and for which there was a subsequent payment default during the periods presented. Payment default is defined as a payment that was thirty days or more past due.

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

	Total TDRs			Nonaccrual TDRs		
	December 31,			December 31,		
	2019	2018	2017	2019	2018	2017
Real estate mortgage	\$ 1,208	\$ 1,528	\$ 1,780	\$ 49	\$ 333	\$ 69
Production and intermediate-term	1,165	1,269	1,631	—	—	—
Total loans	\$ 2,373	\$ 2,797	\$ 3,411	\$ 49	\$ 333	\$ 69
Additional commitments to lend	\$ —	\$ —	\$ —			

The following table presents information as of period end:

	December 31, 2019
Carrying amount of foreclosed residential real estate properties held as a result of obtaining physical possession	\$ —
Recorded investment of consumer mortgage loans secured by residential real estate for which formal foreclosure proceedings are in process	\$ —

#### Note 4 — Investments

##### Equity Investments in Other Farm Credit Institutions

Equity investments in other Farm Credit System institutions are generally nonmarketable investments consisting of stock and participation certificates, allocated surplus, and reciprocal investments in other institutions regulated by the FCA. These investments are carried at cost and evaluated for impairment based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value.

The Association is required to maintain ownership in the Bank in the form of Class B or Class C stock as determined by the Bank. The Bank may require additional capital contributions to maintain its capital requirements. The Association's investment in the Bank totaled \$24,484 for 2019, \$22,949 for 2018 and \$21,654 for 2017. The Association owned 8.66 percent of the issued stock of the Bank as of December 31, 2019 net of any reciprocal investment. As of that date, the Bank's assets totaled \$34.5 billion and shareholders' equity totaled \$2.3 billion. The Bank's earnings were \$272 million for 2019. In addition, the Association had investments of \$1,220 related to other Farm Credit institutions at December 31, 2019. The Bank had a reciprocal investment in the Association of \$41,568 representing 8,313,644 shares of its nonvoting common stock at December 31, 2019.

#### Note 5 — Real Estate and Other Property

##### Premises and Equipment

Premises and equipment consists of the following:

	December 31,		
	2019	2018	2017
Land	\$ 3,742	\$ 3,736	\$ 3,711
Buildings and improvements	14,203	13,057	10,654
Furniture and equipment	3,553	2,564	2,651
	21,498	19,357	17,016
Less: accumulated depreciation	7,647	7,144	7,147
Total	\$ 13,851	\$ 12,213	\$ 9,869

##### Other Property Owned

Net (gains) losses on other property owned consist of the following:

	December 31,		
	2019	2018	2017
(Gains) losses on sale, net	\$ (292)	\$ —	\$ (29)
Carrying value unrealized (gains) losses	284	94	97
Operating (income) expense, net	68	17	14
(Gains) losses on other property owned, net	\$ 60	\$ 111	\$ 82

Gains on sales of other property owned were deferred if the sales involved financing from the Association and did not meet the criteria for immediate recognition. There were no deferred gains at December 31, 2019, 2018, and 2017.

#### Note 6 — Debt

##### Notes Payable to AgFirst Farm Credit Bank

Under the Farm Credit Act, the Association is obligated to borrow only from the Bank, unless the Bank approves borrowing from other funding sources. The borrowing relationship is established with the Bank through a General Financing Agreement (GFA). The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The GFA has a one year term which expires on December 31 and is renewable each year. The Association has no reason to believe the GFA will not be renewed upon expiration. The Bank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2019, the Association's notes payable were within the specified limitations.

The Association's indebtedness to the Bank represents borrowings by the Association to fund its earning assets. This indebtedness is collateralized by a pledge of substantially all of the Association's assets and the terms of the revolving lines of

credit are governed by the GFA. Interest rates on both variable and fixed rate advances are generally established loan-by-loan based on the Bank's marginal cost of funds, capital position, operating costs and return objectives. In the event of prepayment of any portion of a fixed rate advance, the Association may incur a prepayment penalty in accordance with the terms of the GFA and which will be included in interest expense. The interest rate is periodically adjusted by the Bank based upon agreement between the Bank and the Association.

The weighted average interest rates on the variable rate advances were 2.77 percent for LIBOR-based loans and 2.91 percent for Prime-based loans, and the weighted average remaining maturities were 3.5 years and 1.2 years, respectively, at December 31, 2019. The weighted-average interest rate on the fixed rate and adjustable rate mortgage (ARM) loans which are match funded by the Bank was 3.27 percent, and the weighted average remaining maturity was 9.3 years at December 31, 2019. The weighted-average interest rate on all interest-bearing notes payable was 3.22 percent and the weighted-average remaining maturity was 8.3 years at December 31, 2019. Gross notes payable consisted of approximately 12.56 percent variable rate and 87.44 percent fixed rate portions, representing a match-funding of the Association's loan volume at December 31, 2019. Notes Payable to AgFirst Farm Credit Bank, as reflected on the Consolidated Balance Sheets, also includes a credit which reduces the notes payable balance and corresponding interest expense. The weighted average maturities described above are related to matched-funded loans. The direct note itself has an annual maturity as prescribed in the GFA.

#### Note 7 — Members' Equity

A description of the Association's capitalization requirements, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below:

- A. **Protected Borrower Stock:** Protection of certain borrower stock is provided under the Farm Credit Act, which requires the Association, when retiring protected borrower stock, to retire such stock at par or stated value regardless of its book value. Protected borrower stock includes capital stock and participation certificates, which were outstanding as of January 6, 1988, or were issued or allocated prior to October 6, 1988. If an Association is unable to retire protected borrower stock at par value or stated value, amounts required to retire this equity would be obtained from the Insurance Fund.
- B. **Capital Stock and Participation Certificates:** In accordance with the Farm Credit Act and the Association's capitalization bylaws, each borrower is required to invest in Class C stock for agricultural loans, or participation certificates in the case of rural home and farm-related business loans, as a condition of borrowing. The initial borrower investment, through either purchase or transfer, must be in an amount equal to 2 percent of the loan, or \$1 thousand, whichever is less. The Board of Directors may increase the amount of investment if necessary to meet the Association's capital needs. Loans designated for sale or sold into the Secondary Market on or after April 16, 1996 will have no voting stock or participation certificate

purchase requirement if sold within 180 days following the date of designation.

The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, but usually does not make a cash investment. The aggregate par value is generally added to the principal amount of the related loan obligation. The Association retains a first lien on the stock or participation certificates owned by borrowers. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding stock or participation certificates.

#### C. Regulatory Capitalization Requirements and

**Restrictions:** An FCA regulation empowers it to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. The Association has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

There are currently no prohibitions in place that would prevent the Association from retiring stock, distributing earnings, or paying dividends per the statutory and regulatory restrictions, and the Association has no reason to believe any such restrictions may apply in the future.

Effective January 1, 2017, the regulatory capital requirements for System banks and associations were modified. These regulations ensure that the System's capital requirements are comparable to the Basel III framework and the standardized approach that the federal banking regulatory agencies have adopted. Regulatory ratios include common equity tier 1 (CET1) capital, tier 1 capital, and total capital risk-based ratios. The regulations also include a tier 1 leverage ratio and an unallocated retained earnings (URE) and URE equivalents (UREE) leverage ratio. The permanent capital ratio (PCR) remains in effect.

The ratios are calculated using three-month average daily balances, in accordance with FCA regulations, as follows:

- The CET1 capital ratio is the sum of statutory minimum purchased borrower stock, other required borrower stock held for a minimum of 7 years, allocated equities held for a minimum of 7 years or not subject to revolvement, unallocated retained earnings, and paid-in capital, less certain regulatory required deductions including the amount of investments in other System institutions, divided by average risk-adjusted assets.
- The tier 1 capital ratio is CET1 capital plus non-cumulative perpetual preferred stock, divided by average risk-adjusted assets.
- The total capital ratio is tier 1 capital plus other required borrower stock held for a minimum of 5 years, subordinated debt and limited-life preferred stock greater than 5 years to maturity at issuance subject to certain limitations, and allowance for loan losses and reserve for unfunded commitments under certain limitations less certain investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.
- The permanent capital ratio is all at-risk borrower stock, any allocated excess stock, unallocated retained earnings,

paid-in capital, subordinated debt and preferred stock subject to certain limitations, less certain investments in other System institutions, divided by PCR risk-adjusted assets.

- The tier 1 leverage ratio is tier 1 capital, divided by average total assets less regulatory deductions to tier 1 capital.

- The URE and UREE leverage ratio is unallocated retained earnings, paid-in capital, and allocated surplus not subject to revolvement less certain regulatory required deductions including the amount of allocated investments in other System institutions divided by average total assets less regulatory deductions to tier 1 capital.

The following sets forth the regulatory capital ratios which were effective January 1, 2017:

Ratio	Minimum Requirement	Capital Conservation Buffer*	Minimum Requirement with Capital Conservation Buffer	Capital Ratios as of December 31,		
				2019	2018	2017
Risk-adjusted ratios:						
CET1 Capital	4.5%	1.875%	6.375%	17.32%	17.50%	16.43%
Tier 1 Capital	6.0%	1.875%	7.875%	17.32%	17.50%	16.43%
Total Capital	8.0%	1.875%	9.875%	17.97%	18.29%	17.35%
Permanent Capital	7.0%	0.0%	7.0%	17.52%	17.85%	16.92%
Non-risk-adjusted ratios:						
Tier 1 Leverage	4.0%	1.0%	5.0%	17.42%	17.45%	16.42%
URE and UREE Leverage	1.5%	0.0%	1.5%	11.72%	11.34%	10.91%

\* The capital conservation buffers have a 3 year phase-in period and became fully effective January 1, 2020. Risk-adjusted ratio minimums increased 0.625% each year until fully phased in. There was no phase-in period for the tier 1 leverage ratio.

If the capital ratios fall below the minimum regulatory requirements, including the buffer amounts, capital distributions (equity redemptions, dividends, and patronage) and discretionary senior executive bonuses are restricted or prohibited without prior FCA approval.

**D. Description of Equities:** The Association is authorized to issue or have outstanding Class A Nonvoting Common Stock, Class C Voting Common Stock, and Class D Preferred Stock, and nonvoting Participation Certificates. All stock and participation certificates have a par or face value of five dollars (\$5.00) per share.

The Association had the following shares outstanding at December 31, 2019:

Class	Protected	Shares Outstanding	
		Number	Aggregate Par Value
A Common/Nonvoting	No	20,281	\$ 101
C Common/Voting	No	1,983,684	9,919
A Common Issued to Bank/Nonvoting	No	8,313,674	41,568
C Participation Certificates/Nonvoting	No	46,098	231
Total Capital Stock and Participation Certificates		10,363,737	\$ 51,819

Protected common stock and participation certificates are retired at par or face value in the normal course of business. At-risk common stock and participation certificates are retired at the sole discretion of the Board at book value not to exceed par or face amounts, provided the minimum capital adequacy standards established by the Board are met.

*Surplus Accounts*

The Association maintains an unallocated surplus account and an allocated surplus account. The minimum aggregate amounts of these two accounts shall be prescribed by the Farm Credit Act and the FCA regulations. The allocated

surplus account consists of earnings held therein and allocated to borrowers on a patronage basis.

In the event of a net loss for any fiscal year, such loss shall be absorbed by, first, charges to the unallocated surplus account; second, impairment of paid-in surplus; and third, impairment of the allocated surplus account on the basis of latest allocations first.

The Association shall have a first lien on all surplus account allocations owned by any borrower, and all distributions thereof, as additional collateral for such borrower's indebtedness to the Association. When the debt of a borrower is in default or is in the process of final liquidation, the Association may, upon notice to the borrower, order any and all surplus account allocations owned by such borrower to be applied against the indebtedness. Any such retirement and application against indebtedness of surplus account allocations shall be before similar retirement and application of stock or participation certificates owned by the borrower.

When all of the stock and participation certificates of the Association owned by a borrower are retired or otherwise disposed of, any surplus account allocations owned by such borrower may also be retired upon request by the borrower and subject to the approval of the Board, and the proceeds paid to the borrower. Alternatively, if the Board so directs, upon notice to the borrower such surplus account allocations may be applied against any of the borrower's indebtedness to the Association.

Subject to the Farm Credit Act and FCA regulations, allocated surplus may be distributed in cash, oldest allocations first. The cash proceeds may be applied against the indebtedness of the borrower to the Association. In no event shall such distributions reduce the surplus account below the minimum amount prescribed by the Farm Credit Act and FCA regulations. Distributions of less than the full amount of all allocations issued as of the same date shall be on a pro rata basis.

Allocated equities shall be retired solely at the discretion of the Board, provided that minimum capital standards established by the FCA and the Board are met.

At December 31, 2019, allocated members' equity consisted of \$126,433 of nonqualified allocated surplus and \$129,924 of nonqualified retained surplus.

*Patronage Distributions*

Prior to the beginning of any fiscal year, the Board, by adoption of a resolution, may obligate the Association to distribute to borrowers on a patronage basis all or any portion of available net earnings for such fiscal year or for that and subsequent fiscal years. Patronage distributions are based on the proportion of the borrower's interest to the amount of interest earned by the Association on its total loans unless another proportionate patronage basis is approved by the Board.

If the Association meets its capital adequacy standards after making the patronage distributions, the patronage distributions may be in cash, authorized stock of the Association, allocations of earnings retained in an allocated members' equity account, or any one or more of such forms of distribution. Patronage distributions of the Association's earnings may be paid on either a qualified or nonqualified basis, or a combination of both, as determined by the Board. A minimum of 20 percent of the total qualified patronage distribution to any borrower for any fiscal year shall always be paid in cash.

*Transfer*

Stock and participation certificates may be transferred only to persons eligible to purchase and hold such stock or participation certificates.

*Impairment*

Any net losses recorded by the Association shall first be applied against unallocated members' equity. To the extent such losses would exceed unallocated members' equity, such losses would be applied consistent with the Association's bylaws and distributed pro rata to each share and/or unit outstanding in the class, in the following order:

1. Allocated Surplus
2. Class A Nonvoting Common Stock and Class C Voting Common Stock and unit of participation certificates outstanding.
3. Class D Preferred Stock Liquidation

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities shall be distributed to the holders of stock and participation certificates in the following order of priority:

1. To the holders of Class D Preferred Stock, if any, pro rata in proportion to the number of shares then issued and outstanding until an amount equal to the aggregate par value of all such shares has been distributed to all such holders.
2. To the holders of Class A Nonvoting Common Stock and Class C Voting Common Stock and participation certificates, pro rata in proportion to the number of shares or units of each such class of stock or
3. Participation certificates then issued and outstanding until an amount equal to the aggregate par value of all such shares or units have been distributed to all such holders.
4. To the holders of allocated surplus evidenced by written notices of allocation on a pro-rata basis until all such allocated surplus has been distributed to such holders.
5. Any remaining assets of the Association after such distributions shall be distributed to the holders of Class A Nonvoting Common Stock and Class C Voting Common Stock, and participation certificates, pro rata in proportion to the number of shares or units then outstanding.

**E. Accumulated Other Comprehensive Income (AOCI):**

	<b>Changes in Accumulated Other Comprehensive income by Component (a)</b>		
	<b>For the Year Ended December 31,</b>		
	<b>2019</b>	<b>2018</b>	<b>2017</b>
<b>Employee Benefit Plans:</b>			
Balance at beginning of period	\$ (26,968)	\$ (26,045)	\$ (29,410)
Other comprehensive income before reclassifications	(2,970)	(2,811)	927
Amounts reclassified from AOCI	2,202	1,888	2,438
Net current period OCI	(768)	(923)	3,365
Balance at end of period	<u>\$ (27,736)</u>	<u>\$ (26,968)</u>	<u>\$ (26,045)</u>

	<b>Reclassifications Out of Accumulated Other Comprehensive Income (b)</b>			
	<b>For the Year Ended December 31,</b>			
	<b>2019</b>	<b>2018</b>	<b>2017</b>	<b>Income Statement Line Item</b>
<b>Defined Benefit Pension Plans:</b>				
Periodic pension costs	\$ (2,202)	\$ (1,888)	\$ (2,438)	See Note 9.
Amounts reclassified	<u>\$ (2,202)</u>	<u>\$ (1,888)</u>	<u>\$ (2,438)</u>	

(a) Amounts in parentheses indicate debits to AOCI.

(b) Amounts in parentheses indicate debits to profit/loss.

**Note 8 — Fair Value Measurement**

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability.

Accounting guidance establishes a hierarchy for disclosure of fair value measurements to maximize the use of observable inputs, that is, inputs that reflect the assumptions market participants would use in pricing an asset or liability based on market data obtained from sources independent of the reporting entity. The hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the hierarchy tiers is based upon the lowest level of input that is significant to the fair value measurement.

Estimating the fair value of the Association's equity investments in the Bank and other Farm Credit institutions is not practicable because the stock is not traded. The net investment is a requirement of borrowing from the Bank and is carried at cost.

The classifications within the fair value hierarchy (See Note 2) are as follows:

**Level 1**

The Association had no Level 1 assets and liabilities measured at fair value on a recurring basis. For cash, the carrying value is primarily utilized as a reasonable estimate of fair value.

**Level 2**

The Association had no Level 2 assets and liabilities measured at fair value on a recurring basis.

**Level 3**

Because no active market exists for the Association's accruing loans, fair value is estimated by discounting the expected future cash flows using the Association's current interest rates at which similar loans currently would be made to borrowers with similar credit risk. The loan portfolio is segregated into pools of loans with homogeneous characteristics based upon repricing and credit risk. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

Fair values of loans in a nonaccrual status are estimated to be the carrying amount of the loan less specific reserves. Certain loans evaluated for impairment under FASB guidance have fair values based upon the underlying collateral, as the loans were collateral-dependent. Specific reserves were established for these loans when the value of the collateral, less estimated cost to sell, was less than the principal balance of the loan. 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.

Notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional

borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association's loan receivables. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.

Other property owned is classified as a Level 3 asset. The fair value is generally determined using formal appraisals of each individual property. These assets are held for sale. Costs to sell represent transaction costs and are not included as a component of the fair value of other property owned. Other property owned consists of real and personal property acquired through foreclosure or deed in lieu of foreclosure and is carried as an asset held for sale, which is generally not its highest and best use. These properties are part of the Association's credit risk mitigation efforts, not its ongoing business. In addition, FCA regulations require that these types of property be disposed of within a reasonable period of time.

For commitments to extend credit, the estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics; therefore, the related credit risk is not significant.

There were no Level 3 assets and liabilities measured at fair value on a recurring basis for the periods presented. The Association had no transfers of assets or liabilities into or out of Level 1 or Level 2 during the periods presented.

Fair values are estimated at each period end date for assets and liabilities measured at fair value on a recurring basis. Other Financial Instruments are not measured at fair value in the statement of financial position, but their fair values are estimated as of each period end date. The following tables summarize the carrying amounts of these assets and liabilities at period end, and their related fair values.

		December 31, 2019				
		Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
<b>Recurring Measurements</b>						
<b>Assets:</b>						
Recurring Assets	\$	–	\$	–	\$	–
<b>Liabilities:</b>						
Recurring Liabilities	\$	–	\$	–	\$	–
<b>Nonrecurring Measurements</b>						
<b>Assets:</b>						
Impaired loans	\$	561	\$	–	\$	561
Other property owned		1,031		–		1,185
Nonrecurring Assets	\$	1,592	\$	–	\$	1,746
<b>Other Financial Instruments</b>						
<b>Assets:</b>						
Cash	\$	8,694	\$	8,694	\$	–
Loans		2,219,602		–		2,211,691
Other Financial Assets	\$	2,228,296	\$	8,694	\$	2,211,691
<b>Liabilities:</b>						
Notes payable to AgFirst Farm Credit Bank	\$	1,845,304	\$	–	\$	1,847,584
Other Financial Liabilities	\$	1,845,304	\$	–	\$	1,847,584
<b>December 31, 2018</b>						
		Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
<b>Recurring Measurements</b>						
<b>Assets:</b>						
Recurring Assets	\$	–	\$	–	\$	–
<b>Liabilities:</b>						
Recurring Liabilities	\$	–	\$	–	\$	–
<b>Nonrecurring Measurements</b>						
<b>Assets:</b>						
Impaired loans	\$	574	\$	–	\$	574
Other property owned		2,879		–		3,311
Nonrecurring Assets	\$	3,453	\$	–	\$	3,885
<b>Other Financial Instruments</b>						
<b>Assets:</b>						
Cash	\$	11,502	\$	11,502	\$	–
Loans		2,058,259		–		2,004,519
Other Financial Assets	\$	2,069,761	\$	11,502	\$	2,004,519
<b>Liabilities:</b>						
Notes payable to AgFirst Farm Credit Bank	\$	1,717,671	\$	–	\$	1,690,148
Other Financial Liabilities	\$	1,717,671	\$	–	\$	1,690,148

December 31, 2017

	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
<b>Recurring Measurements</b>					
<b>Assets:</b>					
Recurring Assets	\$ -	\$ -	\$ -	\$ -	\$ -
<b>Liabilities:</b>					
Recurring Liabilities	\$ -	\$ -	\$ -	\$ -	\$ -
<b>Nonrecurring Measurements</b>					
<b>Assets:</b>					
Impaired loans	\$ 417	\$ -	\$ -	\$ 417	\$ 417
Other property owned	551	-	-	634	634
Nonrecurring Assets	\$ 968	\$ -	\$ -	\$ 1,051	\$ 1,051
<b>Other Financial Instruments</b>					
<b>Assets:</b>					
Cash	\$ 9,097	\$ 9,097	\$ -	\$ -	\$ 9,097
Loans	1,962,933	-	-	1,922,942	1,922,942
Other Financial Assets	\$ 1,972,030	\$ 9,097	\$ -	\$ 1,922,942	\$ 1,932,039
<b>Liabilities:</b>					
Notes payable to AgFirst Farm Credit Bank	\$ 1,639,346	\$ -	\$ -	\$ 1,620,777	\$ 1,620,777
Other Financial Liabilities	\$ 1,639,346	\$ -	\$ -	\$ 1,620,777	\$ 1,620,777

**Uncertainty in Measurements of Fair Value**

Discounted cash flow or similar modeling techniques are generally used to determine the recurring fair value measurements for Level 3 assets and liabilities. Use of these techniques requires determination of relevant inputs and assumptions, some of which represent significant unobservable inputs as indicated in the tables that follow. Accordingly, changes in these unobservable inputs may have a significant impact on fair value.

Certain of these unobservable inputs will (in isolation) have a directionally consistent impact on the fair value of the instrument for a given change in that input. Alternatively, the fair value of the instrument may move in an opposite direction for a given change in another input. Where multiple inputs are used within the valuation technique of an asset or liability, a change in one input in a certain direction may be offset by an opposite change in another input having a potentially muted impact to the overall fair value of that particular instrument. Additionally, a change in one unobservable input may result in a change to another unobservable input (that is, changes in

certain inputs are interrelated with one another), which may counteract or magnify the fair value impact.

**Inputs to Valuation Techniques**

Management determines the Association’s valuation policies and procedures. The Bank performs the majority of the Association’s valuations, and its valuation processes are calibrated annually by an independent consultant. The fair value measurements are analyzed on a quarterly basis. For other valuations, documentation is obtained for third party information, such as pricing, and periodically evaluated alongside internal information and pricing that is available.

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

**Quantitative Information about Recurring and Nonrecurring Level 3 Fair Value Measurements**

	Fair Value	Valuation Technique(s)	Unobservable Input	Range
Impaired loans and other property owned	\$ 1,746	Appraisal	Income and expense Comparable sales Replacement costs Comparability adjustments	* * * *

\* Ranges for this type of input are not useful because each collateral property is unique.

**Information about Other Financial Instrument Fair Value Measurements**

	Valuation Technique(s)	Input
Cash	Carrying value	Par/principal and appropriate interest yield
Loans	Discounted cash flow	Prepayment forecasts Probability of default Loss severity
Notes payable to AgFirst Farm Credit Bank	Discounted cash flow	Prepayment forecasts Probability of default Loss severity

**Note 9 — Employee Benefit Plans**

The Association participates in a single employer benefit plan and two District sponsored benefit plans. These plans include the First South Farm Credit, ACA Retirement Plan (FS Plan), which is a single employer final average pay plan. In addition, the Association participates in a multiemployer defined benefit other postretirement employee benefits plan (OPEB Plan), the Farm Credit Benefits Alliance Retiree and Disabled Medical and Dental Plan, and a defined contribution 401(k) plan. The risks of participating in these multiemployer plans are different from single employer plans in the following aspects:

1. Assets contributed to multiemployer plans by one employer may be used to provide benefits to employees of other participating employers.
2. If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.
3. If the Association chooses to stop participating in some of its multiemployer plans, the Association may be required to contribute to eliminate the underfunded status of the plan.

The District's multiemployer plans are not subject to ERISA and no Form 5500 is required. As such, the following information is neither available for nor applicable to the plans:

1. The Employer Identification Number (EIN) and three-digit Pension Plan Number.
2. The most recent Pension Protection Act (PPA) zone status. Among other factors, plans in the red zone are generally less than 65 percent funded, plans in the yellow zone are less than 80 percent funded, and plans in the green zone are at least 80 percent funded.
3. The "FIP/RP Status" indicating whether a financial improvement plan (FIP) or a rehabilitation plan (RP) is either pending or has been implemented.
4. The expiration date(s) of collective-bargaining agreement(s).

Substantially all employees of the Association hired before January 1, 2009 are eligible to participate in the FS Plan which is a defined benefit plan. This plan is noncontributory, and benefits are based on eligible compensation and years of service. Contributions into the FS Plan were \$2,671 for 2019, \$2,241 for 2018, and \$2,980 for 2017. Expenses for the FS plan were \$3,674 for 2019, \$2,785 for 2018, and \$3,589 for 2017. Service cost is recorded in salaries and benefits and all cost including interest costs, expected return on assets and amortization of gains and losses are recorded in other operating costs.

In addition to providing pension benefits, the Association provides certain medical and dental benefits for eligible retired employees through the OPEB Plan. Substantially all of the Association employees may become eligible for the benefits if they reach early retirement age while working for the Association. Early retirement age is defined as a minimum of age 55 and 10 years of service. Employees hired after December 31, 2002, and employees who separate from service between age 50 and age 55, are required to pay the full cost of their retiree health insurance coverage. Employees who retire subsequent to December 1, 2007 are no longer provided retiree life insurance benefits. The OPEB Plan includes other Farm Credit System employees that are not

employees of the Association or District and is accounted for as a multiemployer plan. The related net benefit plan obligations are not included in the Association's Balance Sheets but are included in the Combined Statement of Condition for the Farm Credit System. The OPEB Plan is unfunded with expenses paid as incurred. Postretirement benefits other than pensions included in employee benefit costs on the Association's Statements of Income were \$716 for 2019, \$710 for 2018, and \$589 for 2017. At December 31, 2019, the total AgFirst District liability balance for the OPEB Plan presented in the Farm Credit System Combined Statement of Condition was \$209,531.

During 2017, the method of recording expenses at participating District entities for the OPEB Plan was modified. Prior to 2017, expense was recorded based on allocations of actuarially-determined costs and any differences between recorded expense and actual contributions were recorded in Other Assets or Other Liabilities on the Consolidated Balance Sheets. For 2017 and future years, participating entities will record employee benefit costs based on the actual contributions to the Plans. This change caused the Association to modify its accounting estimates recorded in Other Assets and Other Liabilities since the assets and liabilities do not impact future contributions to the Plans. The change in estimate resulted in the reduction of Other Liabilities by \$16,202 on the Association's Balance Sheets, and a total reduction of noninterest expenses on the Association's Statements of Income of \$16,202 during 2017.

The Association also participates in a defined contribution Farm Credit Benefits Alliance (FCBA) 401(k) Plan, which qualifies as a 401(k) plan as defined by the Internal Revenue Code. For employees hired on or prior to December 31, 2008, the Association contributes \$0.50 for each \$1.00 of the employee's first 6.00 percent of contribution (based on total compensation) up to the maximum employer contribution of 3.00 percent of total compensation. For employees hired on or after January 1, 2009, the Association contributes \$1.00 for each \$1.00 of the employee's first 6.00 percent of contribution up to the maximum employer contribution of 6.00 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as determined and adjusted by the Internal Revenue Service. The 401(k) Plan costs are expensed as funded. Employer contributions to this plan included in salaries and employee benefit costs were \$1,022, \$955, and \$867 for the years ended December 31, 2019, 2018, and 2017, respectively. Beginning in 2015, contributions include an additional 3.00 percent of eligible compensation for employees hired after December 31, 2008.

FASB guidance further requires the determination of the fair value of plan assets and recognition of actuarial gains and losses, prior service costs or credits, and transition assets or obligations as a component of AOCI. Under the guidance, these amounts are subsequently recognized as components of net periodic benefit costs over time. For 2019, 2018, and 2017, \$(768), \$(923) and \$3,365 has been recognized as net debits and a net credit to AOCI to reflect these elements.

The funding status and the amounts recognized in the Consolidated Balance Sheets of the Association at December 31, for the retirement plan follow:

	<b>Pension Benefits</b>		
	<b>2019</b>	<b>2018</b>	<b>2017</b>
<b>Change in benefit obligation</b>			
Benefit obligation at beginning of year	\$ 103,636	\$ 110,149	\$ 100,773
Service cost	1,876	2,254	2,240
Interest cost	4,460	4,056	4,264
Actuarial loss (gain)	16,249	(8,968)	6,095
Benefits paid	(4,095)	(3,855)	(3,223)
Benefit obligation at end of year	<u>\$ 122,126</u>	<u>\$ 103,636</u>	<u>\$ 110,149</u>
<b>Change in plan assets</b>			
Fair value of plan assets, beginning of year	\$ 76,558	\$ 84,537	\$ 72,405
Actual return on plan assets	18,323	(6,144)	12,557
Employer contributions	2,671	2,241	2,980
Benefits paid	(4,095)	(3,855)	(3,223)
Expenses	(180)	(221)	(182)
Fair value of plan assets, end of year	<u>\$ 93,277</u>	<u>\$ 76,558</u>	<u>\$ 84,537</u>
Funded status	\$ (28,849)	\$ (27,078)	\$ (25,612)
Fourth quarter contributions	-	-	-
Net amount recognized	<u>\$ (28,849)</u>	<u>\$ (27,078)</u>	<u>\$ (25,612)</u>
Amounts recognized consist of:			
Pension assets	\$ -	\$ -	\$ -
Pension liabilities	(28,849)	(27,078)	(25,612)
Net amount recognized	<u>\$ (28,849)</u>	<u>\$ (27,078)</u>	<u>\$ (25,612)</u>

The following represent the amounts included in accumulated other comprehensive income at December 31:

	<b>2019</b>	<b>2018</b>	<b>2017</b>
Net actuarial loss (gain)	\$ 27,736	\$ 26,968	\$ 26,045
Prior service costs (credit)	-	-	-
Net transition obligation (asset)	-	-	-
Total amount recognized in OCI	<u>\$ 27,736</u>	<u>\$ 26,968</u>	<u>\$ 26,045</u>

The accumulated benefit obligation for the defined benefit plans was \$111,418, \$94,493, and \$98,737 at December 31, 2019, 2018 and 2017, respectively.

Information for pension plans with an accumulated benefit obligation in excess of plan assets:

	<b>2019</b>	<b>2018</b>	<b>2017</b>
Projected benefit obligation	\$ 122,126	\$ 103,636	\$ 110,149
Accumulated benefit obligation	111,418	94,493	98,737
Fair value of plan assets	93,277	76,558	84,537

Components of net periodic benefit cost and other amounts recognized in net income for the years December 31 are as follows:

	<b>Pension Benefits</b>		
	<b>2019</b>	<b>2018</b>	<b>2017</b>
<b>Net periodic benefit (income) cost</b>			
Service cost	\$ 1,876	\$ 2,254	\$ 2,240
Interest cost	4,460	4,056	4,264
Expected return on plan assets	(4,864)	(5,413)	(5,353)
Amortization of net (gain) loss	2,202	1,888	2,438
Amortization of prior service cost	-	-	-
Net periodic benefit (income) cost	<u>\$ 3,674</u>	<u>\$ 2,785</u>	<u>\$ 3,589</u>

Other changes in plan assets and benefit obligations recognized in other comprehensive income follows:

	2019	2018	2017
Net actuarial loss (gain)	\$ 2,970	\$ 2,811	\$ (927)
Amortization of net actuarial loss (gain)	(2,202)	(1,888)	(2,438)
Adjustment for adoption of new accounting guidance	—	—	—
Amortization of prior service cost	—	—	—
Amortization of transition obligation (asset)	—	—	—
Total recognized in other comprehensive income	\$ 768	\$ 923	\$ (3,365)
Total recognized in net periodic pension cost and other comprehensive income	\$ 4,442	\$ 3,708	\$ 224

The total estimated net actuarial gain, transition asset/liabilities and prior service cost for the pension plan that will be amortized into income during 2020 is \$2,168.

Assumptions:	2019	2018	2017
<b>Weighted-average assumptions used to determine benefit obligations at December 31</b>			
Discount rate	3.30%	4.40%	3.75%
Rate of compensation increase	5.00%	5.00%	5.00%
<b>Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31</b>			
Discount rate	4.40%	3.75%	4.30%
Expected long-term return on plan assets	6.50%	6.50%	7.50%
Rate of compensation increase	5.00%	5.00%	5.00%

In 2019, 2018, and 2017, the Association used a long-term rate of return of 6.50 percent, 6.50 percent, and 7.50 percent, respectively. The assumption is based on the target allocation for plan assets and capital market forecasts for the asset classes employed. Prevailing market conditions and historical results were used to determine the capital market forecasts used in this 6.50 percent return assumption for 2019.

#### Plan Assets

Plan assets are invested in a number of different asset classes, with each asset class further diversified through the engagement of a number of independent investment managers. This diversification across asset classes and investment managers reduces the investment risk of the plan and avoids any concentration of risk. To further ensure that excessive risk concentrations are avoided, holdings and performance of fund managers is monitored quarterly by an outside pension consulting firm and by the Association retirement committee. There were no significant concentrations of investment risk as of December 31, 2019.

Target allocation for asset categories for 2019 are as follows:

Asset Category	
Equity securities	60-70%
Debt securities	30-40%
	<u>100%</u>

#### Actual Plan Asset Allocation

	2019	2018	2017
Equity Securities	72%	70%	72%
Debt Securities	25%	28%	25%
Other	3%	2%	3%
	<u>100%</u>	<u>100%</u>	<u>100%</u>

The fair values of the Association's pension plan assets by asset category are as follows. See Notes 2 and 8 regarding a description of the three levels of inputs and the classification within the fair value hierarchy.

Asset Category	Fair Value Measurements at December 31, 2019			
	Level 1	Level 2	Level 3	Total Fair Value
Cash and cash equivalents	\$ 2,560	\$ —	\$ —	\$ 2,560
Mutual funds:				
Domestic equity funds	34,856	—	—	34,856
International equity funds	—	—	—	—
Common Collective Trust:				
Fixed income fund	—	—	—	—
Fixed income securities:				
U.S. Treasuries	—	—	—	—
Corporate bonds	—	—	—	—
Mortgage-backed securities	—	—	—	—
Collateralized mortgage obligations	—	—	—	—
Foreign bonds	—	—	—	—
Common stock	1	—	—	1
Total assets in the fair value hierarchy	\$ 37,417	\$ —	\$ —	\$ 37,417
Investments measured at net asset value				55,860
Total assets at fair value				<u>\$ 93,277</u>

<u>Asset Category</u>	<b>Fair Value Measurements at December 31, 2018</b>			
	Level 1	Level 2	Level 3	Total Fair Value
Cash and cash equivalents	\$ 1,653	\$ —	\$ —	\$ 1,653
Mutual funds:				
Domestic equity funds	27,834	—	—	27,834
International equity funds	—	—	—	—
Common Collective Trust:				
Fixed income fund	—	—	—	—
Fixed income securities:				
U.S. Treasuries	—	—	—	—
Corporate bonds	—	—	—	—
Mortgage-backed securities	—	—	—	—
Collateralized mortgage obligations	—	—	—	—
Foreign bonds	—	—	—	—
Common stock	1	—	—	1
Total assets in the fair value hierarchy	\$ 29,488	\$ —	\$ —	\$ 29,488
Investments measured at net asset value				47,070
Total assets at fair value				\$ 76,558

<u>Asset Category</u>	<b>Fair Value Measurements at December 31, 2017</b>			
	Level 1	Level 2	Level 3	Total Fair Value
Cash and cash equivalents	\$ 2,706	\$ —	\$ —	\$ 2,706
Mutual funds:				
Domestic equity funds	29,855	—	—	29,855
International equity funds	—	—	—	—
Common Collective Trust:				
Fixed income fund	—	—	—	—
Fixed income securities:				
U.S. Treasuries	—	—	—	—
Corporate bonds	—	—	—	—
Mortgage-backed securities	—	—	—	—
Collateralized mortgage obligations	—	—	—	—
Foreign bonds	—	—	—	—
Common stock	1	—	—	1
Total assets in the fair value hierarchy	\$ 32,562	\$ —	\$ —	\$ 32,562
Investments measured at net asset value				51,975
Total assets at fair value				\$ 84,537

### Cash Flows

**Contributions:** The total employer contribution expected during 2020 is \$2,671.

**Estimated Benefit Payments:** Estimated future benefit payments are as follows:

2020	\$ 5,283
2021	\$ 5,655
2022	\$ 6,620
2023	\$ 6,796
2024	\$ 6,819
2025-2029	\$ 35,810

Additional information for the multiemployer plans may be found in the Notes to the Annual Information Statement of the Farm Credit System.

### Note 10 — Related Party Transactions

In the ordinary course of business, the Association enters into loan transactions with officers and directors of the Association, their immediate families and other organizations with which such persons may be associated. Such loans are subject to special approval requirements contained in the FCA regulations and are made on the same terms, including interest rates, amortization schedule, and collateral, as those prevailing

at the time for comparable transactions with unaffiliated borrowers.

Total loans to such persons at December 31, 2019 amounted to \$54,504. During 2019, \$55,552 of new loans were made and repayments totaled \$48,640. In the opinion of management, none of these loans outstanding at December 31, 2019 involved more than a normal risk of collectibility.

### Note 11 — Commitments and Contingencies

From time to time, legal actions are pending against the Association in which claims for money damages are asserted. On at least a quarterly basis, the Association assesses its liabilities and contingencies in connection with outstanding legal proceedings utilizing the latest information available. While the outcome of legal proceedings is inherently uncertain, on the basis of information presently available, management, after consultation with legal counsel, is of the opinion that the ultimate liability, if any, from these actions, would not be material in relation to the financial position of the Association. Because it is not probable that the Association will incur a loss or the loss is not estimable, no liability has been recorded for any claims that may be pending. In the normal course of business, the Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers. These financial instruments may include commitments to extend credit or letters of credit.

The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee.

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the Consolidated Balance Sheets until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. At December 31, 2019, \$320,880 of commitments to extend credit and no commercial letters of credit were outstanding. There was no reserve for unfunded commitments included in Other Liabilities in the Consolidated Balance Sheets at December 31, 2019.

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. At December 31, 2019, standby letters of credit outstanding totaled \$1,004 with expiration dates ranging from January 1, 2020 to December 12, 2023. The maximum potential amount of future payments that may be required under these guarantees was \$1,004.

**Note 12 — Income Taxes**

The provision (benefit) for income taxes follows:

	Year Ended December 31,		
	2019	2018	2017
Current:			
Federal	\$ 8	\$ (23)	\$ 108
State	—	1	8
	8	(22)	116
Deferred:			
Federal	—	—	—
State	—	—	—
Total provision (benefit) for income taxes	\$ 8	\$ (22)	\$ 116

The provision (benefit) for income tax differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as follows:

	December 31,		
	2019	2018	2017
Federal tax at statutory rate	\$ 9,242	\$ 9,468	\$ 20,772
State tax, net	—	1	8
Patronage distributions	(4,087)	(3,675)	(5,250)
Tax-exempt FLCA earnings	(5,441)	(5,668)	(12,689)
Change in valuation allowance	254	72	(6,421)
Change in future tax rate	—	—	821
Change in FASB guidance, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" Liability	(161)	(159)	2,350
Other	201	(61)	525
Provision (benefit) for income taxes	\$ 8	\$ (22)	\$ 116

In late December 2017, federal tax legislation was enacted which, among other things, lowered the federal corporate tax rate from 35% to 21% beginning on January 1, 2018. The change to the lower corporate tax rate led to an insignificant remeasurement of the deferred tax liabilities and deferred tax assets in 2017, the period of enactment. Deferred tax assets and liabilities are comprised of the following at:

	December 31,		
	2019	2018	2017
Deferred income tax assets:			
Allowance for loan losses	\$ 745	\$ 754	\$ 798
Nonaccrual loan interest	696	629	646
Pensions and other postretirement benefits	3,702	3,541	3,382
Loan origination fees	8	4	6
Depreciation	17	—	20
Acquired property write downs	11	1	—
Gross deferred tax assets	5,179	4,929	4,852
Less: valuation allowance	(5,179)	(4,925)	(4,852)
Gross deferred tax assets, net of valuation allowance	—	4	—
Deferred income tax liabilities:			
Gross deferred tax liability	—	(4)	—
Net deferred tax asset (liability)	\$ —	\$ —	\$ —

At December 31, 2019, deferred income taxes have not been provided by the Association on approximately \$55.7 million of patronage refunds received from the Bank prior to January 1, 1993.

Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

The Association recorded a valuation allowance of \$5,179, \$4,925 and \$4,852 as of December 31, 2019, 2018 and 2017, respectively. The Association will continue to evaluate the realizability of these deferred tax assets and adjust the valuation allowance accordingly.

There were no uncertain tax positions identified related to the current year and the Association has no unrecognized tax benefits at December 31, 2019 for which liabilities have been established. The Association recognizes interest and penalties, if any, related to unrecognized tax benefits as a component of income tax expense.

The tax years that remain open for federal and major state income tax jurisdictions are 2016 and forward.

**Note 13 — Additional Financial Information**

**Quarterly Financial Information (Unaudited)**

	2019				
	First	Second	Third	Fourth	Total
Net interest income	\$ 13,182	\$ 13,996	\$ 14,991	\$ 14,723	\$ 56,892
Provision for (reversal of allowance for) loan losses	–	530	575	–	1,105
Noninterest income (expense), net	(5,524)	(5,683)	(5,350)	4,770	(11,787)
Net income	\$ 7,658	\$ 7,783	\$ 9,066	\$ 19,493	\$ 44,000

	2018				
	First	Second	Third	Fourth	Total
Net interest income	\$ 12,922	\$ 13,081	\$ 13,988	\$ 14,282	\$ 54,273
Provision for (reversal of allowance for) loan losses	–	430	650	–	1,080
Noninterest income (expense), net	(4,642)	(5,348)	(4,803)	6,706	(8,087)
Net income	\$ 8,280	\$ 7,303	\$ 8,535	\$ 20,988	\$ 45,106

	2017				
	First	Second	Third	Fourth	Total
Net interest income	\$ 12,125	\$ 12,826	\$ 13,588	\$ 13,097	\$ 51,636
Provision for (reversal of allowance for) loan losses	410	450	425	–	1,285
Noninterest income (expense), net	(6,058)	(5,851)	(5,020)	25,811	8,882
Net income	\$ 5,657	\$ 6,525	\$ 8,143	\$ 38,908	\$ 59,233

**Note 14 — Subsequent Events**

The Association evaluated subsequent events and determined that there were none requiring disclosure through March 12, 2020, which was the date the financial statements were issued.