LONE STAR, ACA

2023
Quarterly Report
Third Quarter

LONE STAR AG CREDIT

For the Quarter Ended September 30, 2023

REPORT OF MANAGEMENT

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

Joe H. Hayman, Chief Executive Officer

November 9, 2023

Brent Neuhaus, Chairman, Board of Directors

November 9, 2023

Nicholas Acosta, Chief Financial Officer

November 9, 2023

David Conrad, Chairman, Audit Committee

November 9, 2023

Third Quarter 2023 Financial Report

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LONE STAR, ACA
MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis reviews the consolidated financial performance of Lone Star, ACA, (ACA) including its wholly-owned subsidiaries Lone Star, FLCA and Lone Star, PCA, (collectively referred to herein as the "Association") for the three and nine months ended September 30, 2023. The discussion should be read in conjunction with the Association's Annual Report to Stockholders, and notes thereto, for the year ended December 31, 2022. Operating results for the three and nine months ended September 30, 2023, are not necessarily indicative of the results for the year ending December 31, 2023, or any future period.

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

Since 1917, the Association and its predecessors have provided its members with quality financial services. The Board and management remain committed to maintaining the financial integrity of the Association while offering competitive loan products that meet the financial needs of agricultural producers.

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

Patronage Refunds by Association:

In December 2022, the Board declared a cash patronage in the amount of $25,897,526 paid in March 2023, based on 2022 patronage-sourced earnings. The patronage was paid to eligible borrowers based on their net interest margin of all Patronage Transactions outstanding for the year ending December 31, 2022. The Association's total capital position remains strong after the declaration and distribution of patronage at 15.4 percent for the period ending September 30, 2023.

Patronage Refunds Received from the Farm Credit Bank of Texas (Bank):

On a monthly basis the Association accrues income for the direct loan earnings patronage it expects to receive in December of each year from the Bank. Although, the distribution of the direct loan earnings patronage is at the discretion of the Bank, the Association's accrual rate is based on historical information and expectations set forth in the Bank's annual Strategic Business Plan. During the quarter ended September 30, 2023, the Association was informed of the Bank's inability to meet expectations as it relates to earnings, capital and other profitability metrics which negatively impacts the Bank's ability to distribute the direct loan earnings patronage at historical or previously planned levels. Consequently, the Association has reduced the accrual of direct loan earnings patronage income for the remainder of 2023 to align with the Bank's revised expectations. This reduces the earnings available to the Association for its own patronage distributions.

The Bank also communicated changes in their patronage program beginning in 2024 which is also expected to result in reduced direct loan earnings patronage levels in future periods.

The following table provides information on the patronage received from the Bank for the year ended December 31, 2022:

		2022
Direct loan patronage	$	13,464,849
Stock investment in the Bank		785,113
Participation's patronage		709,454
Agricultural mortgage backed securities investment patronage		75,735
Total Patronage Received	$	15,035,151

The direct note patronage received represents 66 basis points on average daily balance of the Association's direct loan with the Bank.

Loan Portfolio:

The Association makes and services loans to farmers, ranchers, rural homeowners and certain farm-related businesses. These loan products are available to eligible borrowers with competitive variable, fixed, adjustable, SOFR-based, and prime-based interest rates. Commercial loans primarily consist of operating loans and short-term loans for working capital, equipment and livestock. Mortgage loans primarily consist of 5- to 30- year maturities. Loans serviced by the Association offer several installment payment cycles, the timing of which usually coincides with the seasonal cash-flow capabilities of the borrower. The Association's loan portfolio consists of long-term farm mortgage loans, production and intermediate-term loans, farm-related business loans and rural infrastructure loans through purchased participations.

Total loans outstanding at September 30, 2023, including nonaccrual loans, were $2,498,356,967 compared to $2,488,863,549 at December 31, 2022, reflecting an increase of 0.4 percent. Total nonaccrual loans outstanding at September 30, 2023, were $8,828,470 compared to $1,835,657 at December 31, 2022, reflecting an increase of 380.9 percent attributed to a capital markets relationship moving to nonaccrual status. Nonaccrual loans as a percentage of total loans outstanding were 0.4 percent at September 30, 2023, compared to 0.1 percent at December 31, 2022.

The Association recorded $1,137 in recoveries and no charge-offs for the quarter ended September 30, 2023, and $ 8,053 in recoveries and no charge-offs for the same period in 2022. The Association's allowance for credit losses was 0.3 percent and 0.2 percent of total loans outstanding as of September 30, 2023, and December 31, 2022, respectively.

Risk Exposure:

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

High-Risk Assets

	September 30, 2023		December 31, 2022	
	Amount	**%**	Amount	%
Nonaccrual	**$ 8,828,470**	**100.0%**	$ 1,835,657	63.0%
Formally restructured loans	**-**	**0.0%**	1,079,596	37.0%
Total	**$ 8,828,470**	**100.0%**	$ 2,915,253	100.0%

At September 30, 2023, and December 31, 2022, the Association held no property classified as other property owned, net, and no loans that are past due 90 days or more and still accruing interest.

Results of Operations:

The Association had net income of $6,858,354 and $31,366,378 for the three and nine months ended September 30, 2023, as compared to net income of $11,897,658 and $38,441,703 for the same period in 2022, reflecting a decrease of 42.4 percent and 18.4 percent, respectively. Net interest income was $16,981,431 and $17,353,076 for the three months ended September 30, 2023, and September 30, 2022, respectively, reflecting a decrease of 2.1 percent. Net interest income was $51,189,464 and $50,670,936 for the nine months ended September 30, 2023, and September 30, 2022, respectively, reflecting an increase of 1.0 percent.

Nine Months Ended

	September 30, 2023		September 30, 2022	
	Average Balance	**Interest**	Average Balance	Interest
Loans	**$ 2,507,153,676**	**$ 100,776,094**	$ 2,408,946,003	$ 83,547,626
Total interest-earning assets	**2,507,153,676**	**100,776,094**	2,408,946,003	83,547,626
Interest-bearing liabilities	**2,114,276,335**	**49,586,630**	2,031,987,965	32,876,690
Impact of capital	**$ 392,877,341**		$ 376,958,038	
Net interest income		**$ 51,189,464**		$ 50,670,936

	2023 Average Yield	2022 Average Yield
Yield on loans	**5.37%**	4.64%
Total yield on interest-earning assets	**5.37%**	4.64%
Cost of interest-bearing liabilities	**3.14%**	2.16%
Interest rate spread	**2.23%**	2.48%

	Nine months ended: September 30, 2023 vs 2022		
	Increase (decrease) due to		
	Volume	**Rate**	**Total**
Interest income - loans	**$ 3,406,060**	**$ 13,822,408**	**$17,228,468**
Interest expense	**1,331,389**	**15,378,551**	**16,709,940**
Net interest income	**$ 2,074,671**	**$ (1,556,143)**	**$ 518,528**

Interest income for the three and nine months ended September 30, 2023, increased by $4,428,543 and $17,228,468, or 14.8 percent and 20.6 percent, respectively, from the same period of 2022, primarily due to an increase in average interest-earning assets and yield on interest-earning assets. Interest expense for the three and nine months ended September 30, 2023, increased by $4,800,188 and $16,709,940, or 37.9 percent and 50.8 percent, respectively, from the same period of 2022, due to an increase in interest-bearing liabilities and the cost of interest-bearing liabilities. Average loan volume for the third quarter of 2023 was $2,495,263,240, compared to $2,471,846,277 in the third quarter of 2022. The average net interest rate spread on the loan portfolio for the third quarter of 2023 was 2.18 percent, compared to 2.42 percent in the third quarter of 2022.

The Association's return on average assets for the nine months ended September 30, 2023, was 1.63 percent compared to 2.09 percent for the same period in 2022. The Association's return on average equity for the nine months ended September 30, 2023, was 9.75 percent, compared to 12.68 percent for the same period in 2022.

Noninterest income for the three and nine months ended September 30, 2023, decreased by $2,541,584 and $2,526,033, or 64.1 percent and 21.8 percent, respectively, from the same period in 2022, primarily due to a decrease in patronage income from the Bank directly resulting from the Bank's financial performance issues impacting its ability to generate sufficient earnings to distribute a patronage at planned levels. Noninterest expenses for the three and nine months ended September 30, 2023, increased by $1,875,896 and $3,248,938, or 20.0 percent and 13.0 percent, respectively, from the same period of 2022, primarily due to an increase in other noninterest expense attributed to one-time merger costs and legal expenses, offset by a reduction in salary and employee benefits.

Provisions for credit losses for the three and nine months ended September 30, 2023, increased by $245,811 and $1,821,094, or 1,091.0 percent and 163.0 percent, respectively, from the same period of 2022, primarily due to a capital markets relationship moving to nonaccrual status which required specific reserves in 2023.

Liquidity and Funding Sources:

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

	September 30, 2023	December 31, 2022
Note payable to the Bank	**$ 2,100,331,105**	$ 2,081,970,432
Accrued interest on note payable	**5,796,962**	4,983,163
Total	**$ 2,106,128,067**	$ 2,086,953,595

The outstanding balance of the note payable to the Bank of $2,100,331,105 as of September 30, 2023, is recorded as a liability on the Association's Consolidated Balance Sheet. The note carried a weighted average interest rate of 3.39 percent at September 30, 2023. The indebtedness is collateralized by a pledge of substantially all of the Association's assets to the Bank and is governed by the General Financing Agreement (GFA). The increase in note payable to the Bank since December 31, 2022, correlates directly with the overall increase in the Association's accrual loan volume for the period. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were $401,567,614 at September 30, 2023. The maximum amount the Association may borrow from the Bank as of September 30, 2023, was $2,506,908,853 as defined by the GFA. The indebtedness continues in effect until the expiration date of the GFA, which is September 30, 2026, unless sooner terminated by the Bank upon the occurrence of an event of default, or by the Association, in the event of a breach of this agreement by the Bank, upon giving the Bank 30 calendar days' prior written notice, or in all other circumstances, upon giving the Bank 120 days' prior written notice.

Capital Resources:

The Association's capital position increased by $30,824,619 at September 30, 2023, compared to December 31, 2022. The Association's debt as a percentage of members' equity was 4.79:1 as of September 30, 2023, compared to 5.17:1 as of December 31, 2022.

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

Economic Conditions:

The Association continues to fulfill its mission to support agriculture and rural communities by providing access to reliable and consistent credit. The Association is closely monitoring its loan portfolio overall and is particularly focused on sectors that may be pressured by factors such as persistently high inflation, a rapidly increasing interest rate environment, changing collateral values, and financial market stress. Capital levels remained strong to support any adversity.

The Consumer Price Index for All Urban Consumers increased by 3.7 percent for the 12-month period ending September 2023, well above the long-term target of approximately 2.0 percent. However, recent inflation rates represent significant declines from the four-decade high of 9.1 percent reached in June 2022. The Federal Open Market Committee (FOMC) decided to keep the target Federal funds rate constant within the 5.25–5.50 percent range in September 2023, after raising the rate by 25 basis points in July 2023 for a total increase of about 525 basis points since mid-March 2022. The FOMC stated that it remains strongly committed to returning inflation to its 2.0 percent objective while achieving maximum employment.

On September 28, 2023, the U.S. Bureau of Economic Analysis (BEA) released its third estimate of real gross domestic product (GDP) for the second quarter of 2023. U.S. real GDP growth reached 2.1 percent during the second quarter of 2023, down from 2.2 percent during the first quarter of 2023. According to BEA data released on September 29, 2023, personal income growth rate for Texas during the second quarter of 2023 amounted to 4.0 percent compared to national personal income annualized rate of 4.3 percent.

The U.S. Bureau of Labor Statistics indicated that the U.S. unemployment rate remained steady month-over-month at 3.8 percent in September 2023. The August 2023 state unemployment rate in Texas was 4.1 percent which was more than the national average.

West Texas Intermediate (WTI) crude oil futures prices (front month) increased to an average of about $82 per barrel during the third quarter of 2023, up from nearly $74 per barrel in the prior quarter but down from about $91 per barrel during the same period a year ago. In the October 2023 edition of the Short-Term Energy Outlook, the U.S. Energy Information Administration estimated that the monthly average WTI spot price would be about $80 per barrel in 2023 and $91 per barrel in 2024. U.S. crude oil production is expected to reach record levels in 2023 and 2024, driven primarily by growth in the Permian Basin.

On August 31, 2023, the U.S. Department of Agriculture (USDA) presented its latest farm income forecast. Net farm income (nominal), a broad measure of profits, is forecasted at $141.3 billion in 2023, a decrease of $41.7 billion, or 22.8 percent, relative to 2022. This follows a record high of $183.0 billion in 2022. Total production expenses (nominal) are forecasted to increase by about 6.9 percent in 2023 to $458.0 billion. Farm sector assets and equity are both forecasted to increase by about 6.6 percent and 6.8 percent, respectively, while farm debt is forecasted to increase by about 4.9 percent in nominal terms. The debt-to-asset ratio is forecasted to continue to improve in 2023.

The October 2023 edition of the USDA World Agricultural Supply and Demand Estimates (WASDE) report states that farmers are expected to receive lower average farm prices for corn (-24.3 percent), wheat (-17.3 percent), soybeans (-9.2 percent) and cotton (-5.7 percent) in the 2023/24 marketing year compared to the previous season. Similarly, after rising nearly 37.0 percent in 2022, the average price received by farmers for all milk is projected to decrease by about 18.3 percent YOY in 2023 and by 0.7 percent in 2024. USDA projected average steer prices (5-Area, Direct) will increase YOY by about 22.8 percent in 2023, while broiler and barrow and gilt prices are projected to decline by about 11.7 percent and 16.2 percent, respectively. USDA also projected higher average prices for steers and barrows and gilts in 2024 but lower prices for broilers. Random length lumber futures prices (front month) declined by about 1.3 percent month-over-month and 1.8 percent YOY in September 2023, closing at about $500 per thousand board feet.

During 2023, agricultural producers and processors may be negatively impacted by several factors, including volatile commodity prices, high input costs, export market disruptions, geopolitical challenges, economic slowdown, and adverse weather conditions.

Significant Recent Accounting Pronouncements:

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

Relationship With the Bank:

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

The annual and quarterly stockholder reports of the Bank are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, Corporate Communications, P.O. Box 202590, Austin, Texas 78720, or by calling (512) 465-1881. The annual and quarterly stockholder reports are also available on its website at *www.farmcreditbank.com*.

The Association's annual and quarterly stockholder reports are also available free of charge, upon request. The annual and quarterly stockholder reports are available approximately 75 days after year end and 40 days after quarter end, respectively, and can be obtained by writing to Lone Star, ACA, 1612 Summit Avenue, Suite 300, Fort Worth, Texas 76102 or calling (817) 332-6565. The annual and quarterly stockholder reports for the Association are also available on its website at *www.lonestaragcredit.com*. Copies of the reports can also be requested by e-mailing *ShareHolderRelations@lonestaragcredit.com.*

LONE STAR, ACA

CONSOLIDATED BALANCE SHEETS

		September 30, 2023 (unaudited)		December 31, 2022
ASSETS				
Cash	$	**139,764**	$	34,734
Loans		**2,498,356,967**		2,488,863,549
Less: allowance for credit losses on loans		**(6,550,305)**		(5,746,994)
Net loans		**2,491,806,662**		2,483,116,555
Accrued interest receivable		**17,598,186**		12,614,518
Investment in and receivable from the Bank:				
Capital stock		**40,634,395**		40,638,710
Other		**7,953,279**		2,356,854
Premises and equipment, net		**3,842,421**		3,770,067
Other assets		**3,871,896**		4,122,189
Total assets	$	**2,565,846,603**	$	2,546,653,627
LIABILITIES				
Note payable to the Bank	$	**2,100,331,105**	$	2,081,970,432
Accrued interest payable		**5,796,962**		4,983,163
Drafts outstanding		**62,876**		257,815
Patronage dividends payable		**-**		25,897,526
Other liabilities		**16,207,199**		20,920,849
Total liabilities		**2,122,398,142**		2,134,029,785
MEMBERS' EQUITY				
Capital stock and participation certificates		**5,812,355**		5,816,750
Additional paid-in capital		**91,343,553**		91,343,553
Unallocated retained earnings		**346,130,659**		315,281,755
Accumulated other comprehensive income		**161,894**		181,784
Total members' equity		**443,448,461**		412,623,842
Total liabilities and members' equity	$	**2,565,846,603**	$	2,546,653,627

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

LONE STAR, ACA

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	**2023**	2022
INTEREST INCOME				
Loans	**$ 34,459,871**	$ 30,031,328	**$ 100,776,094**	$ 83,547,626
Total interest income	**34,459,871**	30,031,328	**100,776,094**	83,547,626
INTEREST EXPENSE				
Note payable to the Bank	**17,477,274**	12,678,186	**49,580,563**	32,876,425
Advance conditional payments	**1,166**	66	**6,067**	265
Total interest expense	**17,478,440**	12,678,252	**49,586,630**	32,876,690
Net interest income	**16,981,431**	17,353,076	**51,189,464**	50,670,936
PROVISION FOR (REVERSAL OF) CREDIT LOSSES	**268,341**	22,530	**703,854**	(1,117,240)
Net interest income after provision for (reversal of) credit losses	**16,713,090**	17,330,546	**50,485,610**	51,788,176
NONINTEREST INCOME				
Income from the Bank:				
Patronage income	**1,279,920**	3,627,628	**8,442,910**	10,518,510
Loan fees	**126,869**	175,382	**374,362**	543,498
Financially related services income	**392**	859	**2,087**	2,572
Gain on sale of premises and equipment, net	**9,320**	125,914	**159,722**	270,067
Other noninterest income	**6,511**	34,813	**97,807**	268,274
Total noninterest income	**1,423,012**	3,964,596	**9,076,888**	11,602,921
NONINTEREST EXPENSES				
Salaries and employee benefits	**4,488,169**	5,677,585	**13,783,416**	13,923,692
Directors' expense	**126,111**	117,564	**434,987**	382,040
Purchased services	**383,128**	597,967	**1,864,762**	1,659,560
Travel	**243,718**	293,337	**559,068**	704,916
Occupancy and equipment	**721,468**	677,625	**2,120,318**	2,047,630
Communications	**69,390**	69,125	**206,068**	198,471
Advertising	**216,374**	269,719	**597,660**	796,274
Public and member relations	**434,061**	223,995	**1,153,059**	953,946
Supervisory and exam expense	**171,946**	158,908	**515,842**	476,726
Insurance fund premiums	**894,803**	982,052	**2,694,548**	2,858,176
Other components of net periodic postretirement benefit cost	**50,166**	50,453	**150,498**	151,355
Other noninterest expense	**3,467,809**	272,917	**4,098,560**	777,062
Total noninterest expenses	**11,267,143**	9,391,247	**28,178,786**	24,929,848
Income before income taxes	**6,868,959**	11,903,895	**31,383,712**	38,461,249
Provision for income taxes	**10,605**	6,237	**17,334**	19,546
NET INCOME	**6,858,354**	11,897,658	**31,366,378**	38,441,703
Other comprehensive income:				
Change in postretirement benefit plans	**(6,630)**	7,827	**(19,890)**	23,481
COMPREHENSIVE INCOME	**$ 6,851,724**	$ 11,905,485	**$ 31,346,488**	$ 38,465,184

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

LONE STAR, ACA

CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY
(unaudited)

	Capital Stock/ Participation Certificates	Additional Paid-in-Capital	Retained Earnings Allocated	Retained Earnings Unallocated	Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
Balance at December 31, 2021	$ 5,929,630	$ 91,343,553	$ -	$ 290,017,251	$ (954,347)	$ 386,336,087
Comprehensive income	-	-	-	38,441,703	23,481	38,465,184
Capital stock/participation certificates issued	582,305	-	-	-	-	582,305
Capital stock/participation certificates retired	(639,385)	-	-	-	-	(639,385)
Dividends declared	-	-	-	73,936	-	73,936
Balance at September 30, 2022	$ 5,872,550	$ 91,343,553	$ -	$ 328,532,890	$ (930,866)	$ 424,818,127
Balance at December 31, 2022	$ 5,816,750	$ 91,343,553	$ -	$ 315,281,755	$ 181,784	$ 412,623,842
Comprehensive income	-	-	-	31,366,378	(19,890)	31,346,488
Capital stock/participation certificates issued	386,750	-	-	-	-	386,750
Capital stock/participation certificates retired	(391,145)	-	-	-	-	(391,145)
Dividends declared	-	-	-	(385,101)	-	(385,101)
Cumulative impact of adoption of new accounting standard	-	-	-	(132,373)	-	(132,373)
Balance at September 30, 2023	**$ 5,812,355**	**$ 91,343,553**	**$ -**	**$ 346,130,659**	**$ 161,894**	**$ 443,448,461**

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

NOTE 1 — ORGANIZATION, MERGERS, AND SIGNIFICANT ACCOUNTING POLICIES:

Lone Star, ACA, including its wholly-owned subsidiaries, Lone Star, PCA and Lone Star, FLCA, is a member-owned cooperative which provides credit and credit-related services to, or for the benefit of, eligible borrowers/stockholders for qualified agricultural purposes in the counties of Bell, Borden, Bosque, Bowie, Burnet, Camp, Cass, Cooke, Coryell, Dallas, Delta, Denton, Eastland, Ellis, Erath, Falls, Fannin, Fisher, Freestone, Grayson, Hamilton, Hill, Hood, Johnson, Kent, Lamar, Lampasas, Limestone, McLennan, Milam, Mitchell, Morris, Navarro, Nolan, Palo Pinto, Parker, Red River, Scurry, Shackelford, Somervell, Stephens, Tarrant, Taylor, Throckmorton, Titus, Williamson, Wise and Young in the state of Texas. The Association is a lending institution of the Farm Credit System, which was established by Acts of Congress to meet the needs of American agriculture.

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. (GAAP) for interim financial information. Accordingly, they do not include all of the disclosures required by GAAP for annual financial statements and should be read in conjunction with the audited financial statements as of and for the year ended December 31, 2022, as contained in the 2022 Annual Report to Stockholders. Certain amounts in the prior period's financial statements have been reclassified to the current period's financial statement presentation.

In the opinion of management, the accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles (GAAP), except for the inclusion of a statement of cash flows. GAAP require a business enterprise that provides a set of financial statements reporting both financial position and results of operations to also provide a statement of cash flows for each period for which results of operations are provided. In regulations issued by FCA, associations have the option to exclude statements of cash flows in interim financial statements. Therefore, the Association has elected not to include a statement of cash flows in these consolidated financial statements. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year ending December 31, 2023. Descriptions of the significant accounting policies are included in the 2022 Annual Report to Stockholders. In the opinion of management, these policies and the presentation of the interim financial condition and results of operations conform with GAAP and prevailing practices within the banking industry.

Effective November 19, 2022, the Association signed a letter of intent to pursue a merger transaction with Ag New Mexico Farm Credit, ACA ("Ag New Mexico"). On September 11, 2023, the Association and Ag New Mexico were granted "preliminary approval" for the merger by FCA. On October 25, 2023, the voting stockholders for both associations voted to approve the merger at their respective special meeting of stockholders. The merger is conditioned on FCA granting final approval of the merger. The proposed effective date for the merger is December 1, 2023, or such later date agreed by the associations and approved by FCA.

Recently Adopted Accounting Pronouncements:

The Association adopted the Financial Accounting Standards Board (FASB) guidance entitled "Measurement of Credit Losses on Financial Instruments" and other subsequently issued accounting standards updates related to credit losses on January 1, 2023. This guidance replaced the current incurred loss impairment methodology with a single allowance framework for financial assets carried at amortized cost and certain off-balance sheet credit exposures. This guidance requires management to consider in its estimate of the allowance for credit losses (ACL) relevant historical events, current conditions and reasonable and supportable forecasts that affect the collectability of the assets.

Also adopted effective January 1, 2023, was the updated guidance entitled "Financial Instruments – Credit Losses: Troubled Debt Restructurings and Vintage Disclosure." This guidance requires the creditor to determine whether a modification results in a new loan or a continuation of an existing loan, among other disclosures specific to modifications with borrowers that are experiencing financial difficulties. The update eliminated the accounting guidance for troubled debt restructurings by creditors.

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

	December 31, 2022	CECL adoption impact	January 1, 2023
Assets:			
Allowance for credit losses on loans	$ 5,746,994	$ (30,078)	$ 5,716,916
Liabilities:			
Allowance for credit losses on unfunded commitments	$ 114,594	$ 162,451	$ 277,045
Retained earnings:			
Unallocated retained earnings, net of tax	$ 315,281,755	$ (132,373)	$ 315,149,382

Loans

Loans are generally carried at their principal amount outstanding adjusted for charge-offs, deferred loan fees or costs, and valuation adjustments relating to hedging activities. Loan origination fees and direct loan origination costs are netted and capitalized and the net fee or cost is amortized over the average life of the related loan as an adjustment to interest income. Loan prepayment fees are reported in interest income. Interest on loans is accrued and credited to interest income based on the daily principal amount outstanding.

Nonaccrual Loans

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

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

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

Accrued interest receivable

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

Loan Modifications to Borrowers Experiencing Financial Difficulty

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

Collateral dependent loans

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

Allowance for Credit Losses

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

- the allowance for credit losses on loans (ACLL)
- the allowance for unfunded commitments, which is presented on the balance sheet in other liabilities

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

Methodology for Allowance for Credit Losses on Loans

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

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

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

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

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

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

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

The economic forecasts incorporate macroeconomic variables, including unemployment rates, U.S. BBB Credit Spread, and Dow Jones Total Stock Market Index. Also considered are loan and borrower characteristics, such as internal risk ratings, delinquency status, collateral type, and the remaining term of the loan, adjusted for expected prepayments.

In addition to the quantitative calculation, the Association considers the imprecision inherent in the process and methodology, emerging risk assessments and other subjective factors, which may lead to a management adjustment to the modeled ACLL results. Expected credit loss estimates also include consideration of expected cash recoveries on loans previously charged-off or expected recoveries on collateral dependent loans where recovery is expected through sale of the collateral. The economic forecasts are updated on a quarterly basis.

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

Allowance for Credit Losses on Unfunded Commitments

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

NOTE 2 — LOANS AND ALLOWANCE FOR CREDIT LOSSES:

A summary of loans follows:

	September 30, 2023	December 31, 2022
Loan Type	**Amount**	Amount
Production agriculture:		
Real estate mortgage	**$ 2,049,166,693**	$ 2,069,475,017
Production and intermediate-term	**134,171,185**	124,941,954
Agribusiness:		
Loans to cooperatives	**19,338,893**	14,324,718
Processing and marketing	**152,227,735**	152,485,459
Farm-related business	**43,368,388**	46,743,665
Communication	**43,281,408**	42,348,853
Energy	**35,139,923**	21,699,213
Water and wastewater	**2,429,242**	982,235
Rural residential real estate	**8,338,731**	7,464,319
International	**10,894,769**	8,398,116
Total	**$ 2,498,356,967**	$ 2,488,863,549

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

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	$ 24,328,888	$ 217,411,345	$ 4,400,568	$ -	$ 28,729,456	$ 217,411,345
Production and intermediate-term	83,492,142	34,533	-	-	83,492,142	34,533
Agribusiness	195,772,550	5,224,745	-	-	195,772,550	5,224,745
Communication	43,281,408	-	-	-	43,281,408	-
Energy	35,139,923	-	-	-	35,139,923	-
Water and wastewater	2,429,242	-	-	-	2,429,242	-
International	10,894,769	-	-	-	10,894,769	-
Total	$ 395,338,922	$ 222,670,623	$ 4,400,568	$ -	$ 399,739,490	$ 222,670,623

The Association is authorized under the Farm Credit Act to accept "advance conditional payments" (ACPs) from borrowers. To the extent the borrower's access to such ACPs is restricted and the legal right of setoff exists, the ACPs are netted against the borrower's related loan balance. Unrestricted advance conditional payments are included in other liabilities. ACPs are not insured, and interest is generally paid by the Association on such balances. Balances of ACPs were $17,299,860 and $18,126,378 at September 30, 2023, and December 31, 2022, respectively.

Credit Quality

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

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

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

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

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

	September 30, 2023	December 31, 2022
Real estate mortgage		
Acceptable	**99%**	100%
OAEM	**0%**	0%
Substandard/doubtful	**1%**	0%
	100%	100%
Production and intermediate term		
Acceptable	**95%**	100%
OAEM	**0%**	0%
Substandard/doubtful	**5%**	0%
	100%	100%
Loan to cooperatives		
Acceptable	**100%**	100%
OAEM	**0%**	0%
Substandard/doubtful	**0%**	0%
	100%	100%
Processing and marketing		
Acceptable	**97%**	96%
OAEM	**3%**	0%
Substandard/doubtful	**0%**	4%
	100%	100%
Farm-related business		
Acceptable	**100%**	100%
OAEM	**0%**	0%
Substandard/doubtful	**0%**	0%
	100%	100%
Communication		
Acceptable	**100%**	100%
OAEM	**0%**	0%
Substandard/doubtful	**0%**	0%
	100%	100%
Energy		
Acceptable	**99%**	98%
OAEM	**0%**	0%
Substandard/doubtful	**1%**	2%
	100%	100%
Water and wastewater		
Acceptable	**100%**	100%
OAEM	**0%**	0%
Substandard/doubtful	**0%**	0%
	100%	100%
Rural residential real estate		
Acceptable	**100%**	100%
OAEM	**0%**	0%
Substandard/doubtful	**0%**	0%
	100%	100%
International		
Acceptable	**100%**	100%
OAEM	**0%**	0%
Substandard/doubtful	**0%**	0%
	100%	100%
Total loans		
Acceptable	**99%**	99%
OAEM	**0%**	0%
Substandard/doubtful	**1%**	1%
	100%	100%

There were no loans and related interest in the loss category.

Accrued interest receivable on loans of $17,598,186 and $12,614,518 at September 30, 2023, and December 31, 2022, have been excluded from the amortized cost of loans and reported separately in the Balance Sheet. The Association did not write off any accrued interest receivable for the three or nine months ended September 30, 2023, and 2022.

The following table reflects nonperforming assets, which consist of nonaccrual loans, accruing loans 90 days or more delinquent, and other property owned and related credit quality statistics:

	September 30, 2023	December 31, 2022
Nonaccrual loans:		
Real estate mortgage	**$ 2,273,522**	$ 1,461,521
Production and intermediate-term	**6,300,809**	32,878
Energy	**251,857**	334,090
Rural residential real estate	**2,282**	7,168
Total nonaccrual loans	**8,828,470**	1,835,657
Total nonperforming assets	**$ 8,828,470**	$ 1,835,657
Nonaccrual loans as a percentage of total loans	**0.4%**	0.1%
Nonperforming assets as a percentage of total loans and other property owned	**0.4%**	0.1%
Nonperforming assets as a percentage of capital	**2.0%**	0.4%

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

	September 30, 2023			Interest Income Recognized	
	Amortized Cost with Allowance	Amortized Cost without Allowance	Total	For the Three Months Ended September 30, 2023	For the Nine Months Ended September 30, 2023
Nonaccrual loans:					
Real estate mortgage	$ -	$ 2,273,522	$ 2,273,522	$ 24,027	$ 53,577
Production and intermediate-term	1,626,284	4,674,525	6,300,809	-	42,684
Agribusiness	-	-	-	-	-
Energy	251,857	-	251,857	-	-
Rural residential real estate	-	2,282	2,282	1,440	4,320
Total nonaccrual loans	$ 1,878,141	$ 6,950,329	$ 8,828,470	$ 25,467	$ 100,581

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

September 30, 2023	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans
Real estate mortgage	$ 24,400,711	$ -	$ 24,400,711	$ 2,024,765,982	$ 2,049,166,693
Production and intermediate term	41,909	1,134,451	1,176,360	132,994,825	134,171,185
Loans to cooperatives	-	-	-	19,338,893	19,338,893
Processing and marketing	-	-	-	152,227,735	152,227,735
Farm-related business	-	-	-	43,368,388	43,368,388
Communication	-	-	-	43,281,408	43,281,408
Energy	-	-	-	35,139,923	35,139,923
Water and wastewater	-	-	-	2,429,242	2,429,242
Rural residential real estate	-	-	-	8,338,731	8,338,731
International	-	-	-	10,894,769	10,894,769
Total	$ 24,442,620	$ 1,134,451	$ 25,577,071	$ 2,472,779,896	$ 2,498,356,967

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

December 31, 2022	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans
Real estate mortgage	$ 508,353	$ 315,940	$ 824,293	$ 2,078,776,121	$ 2,079,600,414
Production and intermediate term	4,289	-	4,289	126,039,300	126,043,589
Loans to cooperatives	-	-	-	14,346,406	14,346,406
Processing and marketing	-	-	-	153,254,734	153,254,734
Farm-related business	-	-	-	46,931,645	46,931,645
Communication	-	-	-	42,473,341	42,473,341
Energy	-	-	-	21,871,080	21,871,080
Water and wastewater	-	-	-	981,441	981,441
Rural residential real estate	3,569	-	3,569	7,482,145	7,485,714
International	-	-	-	8,489,703	8,489,703
Total	$ 516,211	$ 315,940	$ 832,151	$ 2,500,645,916	$ 2,501,478,067

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

Allowance for Credit Losses

The credit risk rating methodology is a key component of the Association's allowance for credit losses evaluation, and is incorporated into the Association's loan underwriting standards and internal lending limits. In addition, borrower and commodity concentration lending and leasing limits have been established to manage credit exposure. The regulatory limit to a single borrower or lessee is 15% of the Association's lending and leasing limit base but the System Institution's boards of directors have generally established more restrictive lending limits. This limit applies to associations with long-term and short- and intermediate-term lending authorities.

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

	Real Estate Mortgage	Production and Intermediate-Term	Agribusiness	Communications	Energy	Water and Wastewater	Rural Residential Real Estate	International	Total
Allowance for Credit Losses on Loans:									
Balance at June 30, 2023	$ 4,277,621	$ 1,316,539	$ 477,246	$ 53,018	$ 114,135	$ 2,813	$ 18,912	$ 6,697	$ 6,266,981
Recoveries	-	1,137	-	-	-	-	-	-	1,137
Provision for (reversal of) credit losses on loans	298,337	(11,304)	(10,941)	2,358	4,048	(170)	(32)	(109)	282,187
Balance at September 30, 2023	**$ 4,575,958**	**$ 1,306,372**	**$ 466,305**	**$ 55,376**	**$ 118,183**	**$ 2,643**	**$ 18,880**	**$ 6,588**	**$ 6,550,305**
Balance at December 31, 2022*	$ 4,342,114	$ 385,628	$ 769,541	$ 83,506	$ 130,241	$ 1,752	$ 17,835	$ 16,377	$ 5,746,994
Cumulative effect of a change in accounting principle	224,230	(244,862)	67,965	(45,873)	(21,401)	(1,429)	1,217	(9,925)	(30,078)
Balance at January 1, 2023	4,566,344	140,766	837,506	37,633	108,840	323	19,052	6,452	5,716,916
Recoveries	-	3,811	1,170	-	-	-	-	-	4,981
Provision for (reversal of) credit losses on loans	9,614	1,161,795	(372,371)	17,743	9,343	2,320	(172)	136	828,408
Balance at September 30, 2023	**$ 4,575,958**	**$ 1,306,372**	**$ 466,305**	**$ 55,376**	**$ 118,183**	**$ 2,643**	**$ 18,880**	**$ 6,588**	**$ 6,550,305**
Balance at June 30, 2022	$ 4,742,071	$ 397,117	$ 821,257	$ 95,862	$ 137,320	$ 3,398	$ 20,888	$ 20,455	$ 6,238,368
Recoveries	-	6,790	1,263	-	-	-	-	-	8,053
Provision for (reversal of) credit losses on loans	31,892	(3,296)	594	(3,472)	(1,838)	(1,558)	(1,141)	1,349	22,530
Provision for (reversal of) credit losses on unfunded commitments	-	(11,617)	(7,837)	(280)	139	135	-	(1,323)	(20,783)
Balance at September 30, 2022	$ 4,773,963	$ 388,994	$ 815,277	$ 92,110	$ 135,621	$ 1,975	$ 19,747	$ 20,481	$ 6,248,168
Balance at December 31, 2021	$ 5,552,628	$ 468,317	$ 970,569	$ 122,826	$ 151,869	$ 14,337	$ 29,682	$ 25,316	$ 7,335,544
Recoveries	-	16,008	2,604	-	-	-	-	-	18,612
Provision for (reversal of) credit losses on loans	(778,707)	(99,188)	(166,459)	(30,591)	(16,378)	(12,497)	(9,935)	(3,485)	(1,117,240)
Provision for (reversal of) credit losses on unfunded commitments	42	3,857	8,563	(125)	130	135	-	(1,350)	11,252
Balance at September 30, 2022	$ 4,773,963	$ 388,994	$ 815,277	$ 92,110	$ 135,621	$ 1,975	$ 19,747	$ 20,481	$ 6,248,168
Allowance for Unfunded Commitments:									
Balance at June 30, 2023	$ 132	$ 18,324	$ 129,612	$ 2,455	$ 998	$ 6,896	$ -	$ 7,920	$ 166,337
Provision for (reversal of) credit losses on unfunded commitments	(78)	(106)	(13,598)	(38)	(85)	(240)	-	299	(13,846)
Balance at September 30, 2023	**$ 54**	**$ 18,218**	**$ 116,014**	**$ 2,417**	**$ 913**	**$ 6,656**	**$ -**	**$ 8,219**	**$ 152,491**
Balance at December 31, 2022*	$ 45	$ 26,375	$ 83,273	$ 935	$ 707	$ -	$ -	$ 3,259	$ 114,594
Cumulative effect of a change in accounting principle	2	(7,263)	163,127	1,090	692	-	-	4,803	162,451
Balance at January 1, 2023	47	19,112	246,400	2,025	1,399	-	-	8,062	277,045
Provision for (reversal of) credit losses on unfunded commitments	7	(894)	(130,386)	392	(486)	6,656	-	157	(124,554)
Balance at September 30, 2023	**$ 54**	**$ 18,218**	**$ 116,014**	**$ 2,417**	**$ 913**	**$ 6,656**	**$ -**	**$ 8,219**	**$ 152,491**

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

The following table shows the amortized cost basis and financial effect for loan modifications granted to borrowers experiencing financial difficulty, disaggregated by loan type and type of modification granted, for the three and nine months ended September 30, 2023:

	Real estate mortgage		
For the Three Months Ended September 30, 2023	Amortized Cost Basis	% of Total Loans	Financial Effect of Loan Modifications
Term or Payment Extension	**$ 967,349**	**0%**	Provided four-month payment deferrals with delayed amounts added to loan maturity.
Total	**$ 967,349**		

	Real estate mortgage		
For the Nine Months Ended September 30, 2023	Amortized Cost Basis	% of Total Loans	Financial Effect of Loan Modifications
Term or Payment Extension	**$ 983,562**	**0%**	Provided payment deferrals with delayed amounts primarily added to loan maturity.
Total	**$ 983,562**		

There was no accrued interest receivable related to loan modifications granted to borrowers experiencing financial difficulty as of the three and nine months ended September 30, 2023.

There were no loans to borrowers experiencing financial difficulty that received a modification on or after January 1, 2023, the date of adoption of the guidance "Financial Instruments – Credit Losses: Troubled Debt Restructurings and Vintage Disclosure," through September 30, 2023, and that defaulted in the period presented.

The following table sets forth an aging analysis of loans to borrowers experiencing financial difficulty that were modified on or after January 1, 2023, the date of the adoption of the guidance noted above, through September 30, 2023:

	Payment Status of Loans Modified in the Past 12 Months		
	Current	**30-89 Days Past Due**	**90 Days or More Past Due**
Real estate mortgage	$ 983,562	$ -	$ -
Total	**$ 983,562**	**$ -**	**$ -**

There were no additional commitments to lend to borrowers experiencing financial difficulty whose loans have been modified as of September 30, 2023.

Troubled Debt Restructurings

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

There were no loans with troubled debt restructuring designation that occurred during the three and nine months ended September 30, 2022. As of September 30, 2022, the Association did not have any loans that met the criteria as a troubled debt restructuring and that occurred within the previous 12 months of that year for which there was a payment default.

The following table provides information on outstanding loans restructured in troubled debt restructurings:

	September 30, 2022	
	Loans Modified as Troubled Debt Restructurings	Troubled Debt Restructurings in Nonaccrual Status
Real estate mortgage	$ 1,181,627	$ 1,070,643
Total	$ 1,181,627	$ 1,070,643

NOTE 3 —LEASES:

The components of lease expense were as follows:

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2023	September 30, 2022	**September 30, 2023**	September 30, 2022
Operating lease cost	**$ 152,604**	$ 151,236	**$ 458,108**	$ 455,392
Net lease cost	**$ 152,604**	$ 151,236	**$ 458,108**	$ 455,392

Other information related to leases was as follows:

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2023	September 30, 2022	**September 30, 2023**	September 30, 2022
Cash paid for amounts included in the measurement of lease liabilities:				
Operating cash flows from operating leases	**$ 154,775**	$ 151,415	**$ 462,646**	$ 446,530

Lease term and discount rate are as follows:

	September 30, 2023	December 31, 2022
Weighted average remaining lease term in years		
Operating leases	**2.1**	2.4
Weighted average discount rate		
Operating leases	**2.5%**	2.4%

Future minimum lease payments under non-cancellable leases as of September 30, 2023, were as follows:

	Operating Leases
2023	$ 155,475
2024	413,739
2025	202,713
2026	113,598
Total	$ 885,525

NOTE 4 — CAPITAL:

The Association's Board has established a Capital Adequacy Plan (Plan) that includes the capital targets that are necessary to achieve the institution's capital adequacy goals as well as the minimum permanent capital standards. The Plan monitors projected patronage, equity retirements and other actions that may decrease the Association's permanent capital. In addition to factors that must be considered in meeting the minimum standards, the Board also monitors the following factors: capability of management; quality of operating policies, procedures and internal controls; quality and quantity of earnings; asset quality and the adequacy of the allowance for losses to absorb potential loss within the loan and lease portfolios; sufficiency of liquid funds; needs of an institution's customer base; and any other risk-oriented activities, such as funding and interest rate risk, potential obligations under joint and several liability, contingent and off-balance-sheet liabilities or other conditions warranting additional capital. At least quarterly, management reviews the Association's goals and objectives with the Board.

Regulatory Capitalization Requirements

Risk-adjusted:	Regulatory Minimums wih Buffer	As of September 30, 2023
Common equity tier 1 ratio	7.00%	15.39%
Tier 1 capital ratio	8.50%	15.39%
Total capital ratio	10.50%	15.65%
Permanent capital ratio	7.00%	15.43%
Non-risk-adjusted:		
Tier 1 leverage ratio	5.00%	15.64%
UREE leverage ratio	1.50%	15.40%

Risk-adjusted assets have been defined by FCA Regulations as the Statement of Condition assets and off-balance-sheet commitments adjusted by various percentages, depending on the level of risk inherent in the various types of assets. The primary changes which generally have the impact of increasing risk-adjusted assets (decreasing risk-based regulatory capital ratios) were as follows:

- Inclusion of off-balance-sheet commitments less than 14 months
- Increased risk-weighting of most loans 90 days past due or in nonaccrual status

Risk-adjusted assets is calculated differently for the permanent capital ratio (referred herein as PCR risk-adjusted assets) compared to the other risk-based capital ratios. The primary difference is the deduction of the allowance for credit losses from risk-adjusted assets for the permanent capital ratio.

The ratios are based on a three-month average daily balance in accordance with FCA regulations and are calculated as follows:

- Common equity tier 1 ratio is 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, paid-in capital, less certain regulatory required deductions including the amount of allocated investments in other System institutions, and the amount of purchased investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.
- Tier 1 capital ratio is common equity tier 1 plus non-cumulative perpetual preferred stock, divided by average risk-adjusted assets.
- Total capital is tier 1 capital plus other required borrower stock held for a minimum of 5 years, allocated equities 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, allowance and reserve for credit losses under certain limitations less certain investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.
- Permanent capital ratio (PCR) is all at-risk borrower stock, any allocated excess stock, unallocated retained earnings, paid-in capital, subordinated debt and preferred subject to certain limitations, less certain allocated and purchased investments in other System institutions, divided by PCR risk-adjusted assets.
- Tier 1 leverage ratio is tier 1 capital, including regulatory deductions, divided by average assets less regulatory deductions subject to tier 1 capital.
- UREE leverage ratio is unallocated retained earnings, paid-in capital, allocated surplus not subject to revolvement less certain regulatory required deductions including the amount of allocated investments in other System institutions divided by average assets less regulatory deductions subject to tier 1 capital.

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

The components of the Association's risk-adjusted capital, based on 90 day average balances, were as follows at September 30, 2023:

	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
Numerator:				
Unallocated retained earnings	$ 270,663,426	$ 270,663,426	$ 270,663,426	$ 270,663,426
Paid-in capital	91,343,553	91,343,553	91,343,553	91,343,553
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	5,810,922	5,810,922	5,810,922	5,810,922
Nonqualified allocated equities not subject to retirement	65,733,966	65,733,966	65,733,966	65,733,966
Allowance for loan losses and reserve for credit losses subject to certain limitations	-	-	6,437,478	-
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	(40,635,387)	(40,635,387)	(40,635,387)	(40,635,387)
	$ 392,916,480	$ 392,916,480	$ 399,353,958	$ 392,916,480
Denominator:				
Risk-adjusted assets excluding allowance	$ 2,593,225,992	$ 2,593,225,992	$ 2,593,225,992	$ 2,593,225,992
Regulatory Adjustments and Deductions:				
Regulatory deductions included in total capital	(40,635,387)	(40,635,387)	(40,635,387)	(40,635,387)
Allowance for loan losses	-	-	-	(6,271,870)
	$ 2,552,590,605	$ 2,552,590,605	$ 2,552,590,605	$ 2,546,318,735

The components of the Association's non-risk-adjusted capital, based on 90 day average balances, were as follows at September 30, 2023:

	Tier 1 leverage ratio	UREE leverage ratio
Numerator:		
Unallocated retained earnings	$ 270,663,426	$ 270,663,426
Paid-in capital	91,343,553	91,343,553
Common Cooperative Equities:		
Statutory minimum purchased borrower stock	5,810,922	-
Nonqualified allocated equities not subject to retirement	65,733,966	65,733,966
Regulatory Adjustments and Deductions:		
Amount of allocated investments in other System institutions	(40,635,387)	(40,635,387)
	$ 392,916,480	$ 387,105,558
Denominator:		
Total Assets	$ 2,560,640,533	$ 2,560,640,533
Regulatory Adjustments and Deductions:		
Regulatory deductions included in tier 1 capital	(47,619,866)	(47,619,866)
	$ 2,513,020,667	$ 2,513,020,667

	September 30, 2023	December 31, 2022
Capital stock and participation certificates	**$ 5,812,355**	$ 5,816,750
Additional paid-in-capital	**91,343,553**	91,343,553
Accumulated other comprehensive income	**161,894**	181,784
Retained earnings[1]	**346,130,659**	315,281,755
Total Capital	**$ 443,448,461**	$ 412,623,842

[1] Retained earnings for the quarter ended September 30, 2023, reflects a decrease from the cumulative effect of a change in accounting principle for CECL on January 1, 2023.

The Association's accumulated other comprehensive (loss) income relates entirely to its nonpension other postretirement benefits. The following table summarizes the change in accumulated other comprehensive (loss) income for the nine months ended September 30:

	2023	2022
Accumulated other comprehensive income (loss) at January 1	**$ 181,784**	$ (954,347)
Amortization of prior service credit included in salaries and employee benefits	**(19,890)**	(19,885)
Amortization of actuarial loss included in salaries and employee benefits	**-**	43,366
Other comprehensive (loss) income, net of tax	**(19,890)**	23,481
Accumulated other comprehensive income (loss) at September 30	**$ 161,894**	$ (930,866)

NOTE 5 — INCOME TAXES:

Lone Star, ACA conducts its business activities through two wholly-owned subsidiaries. Long-term mortgage lending activities are conducted through a wholly-owned FLCA subsidiary which is exempt from federal and state income tax. Short- and intermediate-term lending activities are conducted through a wholly-owned PCA subsidiary. The PCA subsidiary and the ACA holding company are subject to income tax. Lone Star, ACA operates as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, Lone Star, ACA can exclude from taxable income amounts distributed as qualified patronage in the form of cash, stock or allocated retained earnings. Provisions for income taxes are made only on those taxable earnings that will not be distributed as qualified patronage. Deferred taxes are recorded at the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution and will therefore impact future tax payments. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (more than 50 percent probability), based on management's estimate, that they will not be realized.

As of September 30, 2023, the deferred income tax valuation allowance was $10,427,537.

NOTE 6 — FAIR VALUE MEASUREMENTS:

FASB guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 15 to the 2022 Annual Report to Stockholders for a more complete description.

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

September 30, 2023	**Fair Value Measurement Using**			**Total Fair**
	Level 1	**Level 2**	**Level 3**	**Value**
Assets:				
Assets held in non-qualified benefits trusts	**$475,716**	**$ -**	**$ -**	**$ 475,716**
Total assets	**$475,716**	**$ -**	**$ -**	**$ 475,716**

December 31, 2022	**Fair Value Measurement Using**			**Total Fair**
	Level 1	**Level 2**	**Level 3**	**Value**
Assets:				
Assets held in non-qualified benefits trusts	$ 374,027	$ -	$ -	$ 374,027
Total assets	$ 374,027	$ -	$ -	$ 374,027

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

September 30, 2023	**Fair Value Measurement Using**			**Total Fair**
	Level 1	**Level 2**	**Level 3**	**Value**
Assets:				
Loans	**$ -**	**$ -**	**$619,561**	**$ 619,561**

December 31, 2022	**Fair Value Measurement Using**			**Total Fair**
	Level 1	**Level 2**	**Level 3**	**Value**
Assets:				
Loans	$ -	$ -	$ 233,536	$ 233,536

Valuation Techniques

As more fully discussed in Note 2 to the 2022 Annual Report to Stockholders, authoritative guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following represent a brief summary of the valuation techniques used for the Association's assets and liabilities. For a more complete description, see Notes to the 2022 Annual Report to Stockholders.

Assets Held in Nonqualified Benefits Trusts

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

Standby Letters of Credit

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

Loans Evaluated for Impairment

For certain loans evaluated for impairment under impairment guidance, the fair value is based upon the underlying collateral since the loans are collateral-dependent loans for which real estate is the collateral. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, a majority of these loans have fair value measurements that fall within Level 3 of the fair value hierarchy. When the value of the real estate, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established. The fair value of these loans would fall under Level 2 of the hierarchy if the process uses independent appraisals and other market-based information.

Other Property Owned

Other property owned is generally classified as Level 3 of the fair value hierarchy. The process for measuring the fair value of the other property owned involves the use of independent appraisals and other market-based information. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. As a result, these fair value measurements fall within Level 3 of the hierarchy.

NOTE 7 — EMPLOYEE BENEFIT PLANS:

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

	Other Benefits	
	2023	2022
Service cost	**$ 45,953**	$ 61,957
Interest cost	**170,388**	127,874
Amortization of prior service credits	**(19,890)**	(19,885)
Amortization of net actuarial loss	**-**	43,366
Net periodic benefit cost	**$ 196,451**	$ 213,312

The Association's liability for the unfunded accumulated obligation for these benefits at September 30, 2023, was $4,527,539 and is included in other liabilities on the Consolidated Balance Sheet.

The components of net periodic benefit cost other than the service cost component are included in the line item "other components of net periodic postretirement benefit cost" in the Consolidated Statements of Comprehensive Income.

The structure of the district's defined benefit retirement plan (DB plan), which is noncontributory and benefits are based on salary and years of service, is characterized as multiemployer since the assets, liabilities and cost of the plan are not segregated or separately accounted for by participating employers (Bank and associations). The Association recognizes its amortized annual contributions to the DB plan as an expense. The Association has contributed $231,320 to fund the DB plan for 2023. As of September 30, 2023, the Association has expensed and recognized $173,490.

NOTE 8 — COMMITMENTS AND CONTINGENT LIABILITIES:

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

NOTE 9 — SUBSEQUENT EVENTS:

The Association has evaluated subsequent events through November 9, 2023, which is the date the financial statements were issued or available to be issued, and did not note any subsequent events requiring disclosure as of November 9, 2023.