Farm Credit of Western Oklahoma, ACA

Quarterly Report
June 30, 2023

The shareholders' investment in Farm Credit of Western Oklahoma, ACA is materially affected by the financial condition and results of operations of CoBank, ACB, (CoBank). The 2022 CoBank Annual Report to Shareholders and the CoBank quarterly shareholders' reports are available free of charge by accessing CoBank's web site, **www.cobank.com**, or may be obtained at no charge by contacting us at Farm Credit of Western Oklahoma, ACA, 3302 Williams Avenue, Woodward, Oklahoma 73801, or by calling 580-256-3465 or toll free 1-800-299-3465.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Unaudited)

The following discussion summarizes the financial position and results of operations of Farm Credit of Western Oklahoma, ACA (the Association) for the six months ended June 30, 2023, with comparisons to prior periods. You should read these comments along with the accompanying financial statements and footnotes and the 2022 Annual Report to Shareholders. The accompanying financial statements were prepared under the oversight of our Audit Committee.

Loan demand has been strong during 2023. Most of our lending territory continues to experience drought conditions, however conditions are improving. USDA rates the majority of soil moisture conditions across the state of Oklahoma as adequate to short, which reiterates that moisture conditions throughout the state are improving. According to the USDA, growing crop conditions in Oklahoma are predominately in the fair to good range.

While the U.S. economy remains healthy, supply chain disruptions, labor shortages, fuel prices, inflation, rising interest rates, weather related events, and recession pressures remain concerns. The inflation rate has declined during 2023, which supports increased consumer spending. The rural economy continues to benefit from the strong U.S. economy, driving higher levels of spending and investment by businesses and consumers. Most agricultural commodity prices have remained strong despite some decline in grain prices from the sharp increases in 2022. Cattle prices, however, have experienced significant increases during 2023. The Russia/Ukraine conflict has also impacted certain agricultural commodity prices and created additional volatility and uncertainty in the markets. From a monetary policy perspective, the Fed has continued to fight inflationary pressure with interest rate hikes, resulting in three interest rate increases in 2023 of 25 basis points each, and more expected in the future. Anticipation of tighter monetary policy is contributing to a stronger dollar and changes in the shape of the yield curve.

The uncertainty of continued strength in the value of agricultural real estate is an economic concern to the agricultural industry; however, average real estate values in Oklahoma continue to show signs of improvement. USDA National Agricultural Statistics indicate that Oklahoma farm real estate values increased by 11.4% in 2022, however the continuation of Oklahoma real estate appreciation remains in question given the other factors previously mentioned. Future land value studies will indicate to what level the current stress in the agricultural economy is influencing land values across the region. Given the current environment, it will be important to continue to evaluate the sustainability of this market strength over time.

Our Association continues to analyze the material effects of transition risks related to climate change that may affect our business, financial condition, and results of operations. These risks include policy and regulatory changes that could impose operational and compliance burdens, market trends that may alter business opportunities, credit risks, litigation risks, and technological changes. Agricultural producers continue to adjust to changing climate conditions and have implemented additional practices of no-till planting, minimal till practices, cover crops, and other water conservation techniques to manage reduced amounts of rainfall and to keep their farmland in a state of sustainable production. Currently, we are not aware of any specific material impacts on our business, results of operations, or financial conditions from the effects of climate change transition risks.

LOAN PORTFOLIO

Loans outstanding at June 30, 2023, totaled $1.68 billion, an increase of $91.7 million, or 5.77%, from loans of $1.59 billion at December 31, 2022. The increase was primarily due to loan growth in the real estate mortgage loans, loans to cooperatives, as well as processing and marketing loans. Most of the overall loan growth was the result of participations purchased.

RESULTS OF OPERATIONS

Net income for the six months ended June 30, 2023, was $12.3 million, an increase of $602 thousand, or 5.13%, from the same period ended one year ago. The increase was primarily due to an increase in net interest income, partially offset by a decrease in noninterest income and an increase in noninterest expense.

For the six months ended June 30, 2023, net interest income was $23.9 million, an increase of $6.4 million, or 36.40%, compared with the six months ended June 30, 2022. The increase in net interest income was due to loan volume growth and additional earnings from equity positioning.

The credit loss reversal for the six months ended June 30, 2023, was $177 thousand, an increase of $72 thousand, or 68.57% from the credit loss reversal for the same period ended one year ago. The credit loss reversal for the six months ended June 30, 2023 was primarily a result of the adoption of the new accounting standard on current expected credit losses (CECL), increased loan volume, as well as changes in the risk profile for certain loans.

Noninterest income decreased $2.0 million during the first six months of 2023 compared with the first six months of 2022 primarily due to equity positioning income of $2.8 million received from CoBank during the first six months of

2022. Patronage distributions from Farm Credit institutions increased $600 thousand in the first six months ended June 30, 2023, compared with the first six months in 2022 primarily due to loan growth and the merger with Farm Credit of Enid effective November 1, 2022.

Mineral income of $591 thousand was recognized during the first six months of 2023. Of this amount, $567 thousand was received from CoBank. The increase for the six months ended June 30, 2023, compared with the first six months of 2022 is primarily due to the merger with Farm Credit of Enid, and additional income during the reporting period from 15 new wells.

During the first six months of 2023, noninterest expense increased $3.8 million to $15.8 million, primarily due to increased salaries and employee benefits, increased cost from our service provider, AgVantis, increased purchased services, and increased advertising and public member relations expense, due primarily to merger with Farm Credit of Enid.

Farm Credit System Insurance Corporation (FCSIC) premiums increased $156 thousand for the six months ended June 30, 2023 compared with the same period in 2022 due to an increase in average loan volume partially offset by a decrease in the insurance premium accrual assessment rate on Systemwide adjusted insured debt from 20 basis points to 18 basis points.

CAPITAL RESOURCES

Our shareholders' equity at June 30, 2023, was $330.1 million, an increase from $317.7 million at December 31, 2022. This increase is due to net income and the amortization of pension costs included in the net periodic benefit cost, offset by net stock reductions and the cumulative effect of adopting CECL.

OTHER MATTERS

Effective January 1, 2023, our Association adopted the new standard on current expected credit losses (CECL), under which the allowance is measured based on management's best estimate of current expected credit losses over the remaining contractual life of the loan. Prior periods presented reflect measurement of the allowance based on management's estimate of probable incurred credit losses. For more information, see Note 1 – Organization and Significant Accounting Policies.

On March 5, 2021, the United Kingdom's Financial Conduct Authority (UKFCA) formally announced that all London Interbank Offered Rate (LIBOR) tenors will either be discontinued or no longer be representative immediately after December 31, 2021. As a result, the UKFCA has closely worked with market participants and regulatory authorities around the world to ensure that alternatives to LIBOR are available and that existing contracts can be transitioned onto these alternatives to safeguard financial stability and market integrity.

While our Association currently holds legacy LIBOR indexed loans in our portfolio, we have adopted a transition plan to reduce LIBOR exposures and stop the inflow of new LIBOR volume. We have analyzed potential risks associated with the LIBOR transition, including financial, operational, legal, tax, reputational, and compliance risks. Since we engage in transactions involving financial instruments that reference LIBOR, these developments did not have a material impact on the Association and our borrowers. Management has documented and worked through the LIBOR transition plan with our funding bank and service provider to address the phase out of LIBOR rates, including any updates to processes and loan servicing technology. All exposure to LIBOR is related to our participations purchased portfolio.

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

John Grunewald	Jamey B. Mitchell	Roger Fischer
President/CEO	CFO	Chairman of the Board
August 7, 2023	August 7, 2023	August 7, 2023

Consolidated Statement of Condition

(Dollars in Thousands)

	June 30 2023	December 31 2022
	UNAUDITED	AUDITED
ASSETS		
Loans	**$ 1,681,659**	$ 1,589,950
Less allowance for loan losses	**1,805**	1,838
Net loans	**1,679,854**	1,588,112
Cash	**5,373**	5,332
Accrued interest receivable	**33,609**	25,739
Investment in CoBank, ACB	**38,553**	43,963
Premises and equipment, net	**9,991**	9,670
Prepaid benefit expense	**10,773**	11,259
Other assets	**7,501**	10,854
Total assets	**$ 1,785,654**	$ 1,694,929
LIABILITIES		
Note payable to CoBank, ACB	**$ 1,420,669**	$ 1,332,337
Advance conditional payments	**20,980**	20,188
Accrued interest payable	**4,063**	3,243
Patronage distributions payable	**-**	9,800
Accrued benefits liability	**1,696**	1,594
Reserve for unfunded commitments	**589**	653
Other liabilities	**7,593**	9,439
Total liabilities	**$ 1,455,590**	$ 1,377,254
Commitments and Contingencies		
SHAREHOLDERS' EQUITY		
Capital stock	**2,885**	2,897
Additional paid-in capital	**146,592**	146,592
Unallocated retained earnings	**181,314**	169,046
Accumulated other comprehensive income/(loss)	**(727)**	(860)
Total shareholders' equity	**330,064**	317,675
Total liabilities and shareholders' equity	**$ 1,785,654**	$ 1,694,929

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

Consolidated Statement of Comprehensive Income

(Dollars in Thousands)

UNAUDITED	For the three months ended June 30 2023	2022	For the six months ended June 30 2023	2022
INTEREST INCOME				
Loans	**$ 24,364**	$ 12,653	**$ 46,527**	$ 25,568
Total interest income	**24,364**	12,653	**46,527**	25,568
INTEREST EXPENSE				
Note payable to CoBank, ACB	**11,949**	4,037	**22,416**	8,007
Other	**112**	14	**192**	25
Total interest expense	**12,061**	4,051	**22,608**	8,032
Net interest income	**12,303**	8,602	**23,919**	17,536
Provision for credit losses/(Credit loss reversals)	**410**	(91)	**(177)**	(105)
Net interest income after provision for credit losses/credit loss reversals	**11,893**	8,693	**24,096**	17,641
NONINTEREST INCOME				
Financially related services income	**5**	1	**16**	3
Loan fees	**97**	44	**228**	89
Patronage distribution from Farm Credit institutions	**1,573**	1,192	**3,141**	2,541
Mineral income	**317**	232	**591**	456
Equity positioning income from CoBank	**-**	-	**-**	2,844
Other noninterest income	**86**	19	**86**	134
Total noninterest income	**2,078**	1,488	**4,062**	6,067
NONINTEREST EXPENSE				
Salaries and employee benefits	**4,056**	2,682	**8,069**	5,582
Occupancy and equipment	**265**	187	**580**	436
Purchased services from AgVantis, Inc.	**1,023**	864	**2,046**	1,727
Farm Credit Insurance Fund premium	**564**	562	**1,103**	947
Merger related costs	**-**	301	**120**	336
Supervisory and examination costs	**135**	99	**269**	199
Other noninterest expense	**1,530**	1,108	**3,625**	2,737
Total noninterest expense	**7,573**	5,803	**15,812**	11,964
Net income	**6,398**	4,378	**12,346**	11,744
COMPREHENSIVE INCOME				
Amortization of retirement costs	**66**	8	**133**	16
Total comprehensive income	**$ 6,464**	$ 4,386	**$ 12,479**	$ 11,760

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

Consolidated Statement of Changes in Shareholders' Equity

(Dollars in Thousands)

UNAUDITED	Capital Stock	Additional Paid-In Capital	Unallocated Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total Shareholders' Equity
Balance at December 31, 2021	$ 2,433	$ 81,946	$ 157,147	$ (181)	$ 241,345
Comprehensive income			11,744	16	11,760
Stock issued	104				104
Stock retired	(104)				(104)
Balance at June 30, 2022	$ 2,433	$ 81,946	$ 168,891	$ (165)	$ 253,105
Balance at December 31, 2022	$ 2,897	$ 146,592	$ 169,046	$ (860)	$ 317,675
Comprehensive income			12,346	133	12,479
Stock issued	100				100
Stock retired	(112)				(112)
Cumulative effect of CECL adoption			(78)		(78)
Balance at June 30, 2023	**$ 2,885**	**$ 146,592**	**$ 181,314**	**$ (727)**	**$ 330,064**

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

NOTES TO FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

A description of the organization and operations of Farm Credit of Western Oklahoma, ACA (the Association), the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2022, are contained in the 2022 Annual Report to Shareholders. These unaudited second quarter 2023 financial statements should be read in conjunction with the 2022 Annual Report to Shareholders.

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 Shareholders.

In the opinion of management, all adjustments, consisting of normal recurring adjustments necessary for a fair statement of results for the interim periods, have been made. 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 Shareholders. In the opinion of management, these policies and the presentation of the interim financial condition and results of operations conform with GAAP and prevailing practices within the banking industry.

Recently Adopted or Issued Accounting Pronouncements

The Association adopted the Financial Accounting Standards Board (FASB) updated guidance entitled “Financial Instruments – Credit Losses: Troubled Debt Restructurings and Vintage Disclosure” on January 1, 2023. 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 and requires disclosure of current period gross write-offs by year of origination for financing receivables and net investments in leases on a prospective basis.

The Association also adopted the FASB guidance entitled “Measurement of Credit Losses on Financial Instruments” (CECL) 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 that estimates the current expected credit losses over the remaining contractual life for all financial assets measured at amortized cost and certain off-balance sheet credit exposures. This guidance is applied on a modified retrospective basis. This framework 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 consider macroeconomic conditions. The adoption of this guidance did not have a material impact on our financial statements.

The following table presents the balance sheet impact to the allowance for credit losses and capital upon adoption of this guidance on January 1, 2023.

(dollars in thousands)	December 31, 2022	CECL Adoption Impact	January 1, 2023
Assets:			
Allowance for credit losses on loans	$ 1,838	$ 77	$ 1,915
Deferred tax assets	-	-	-
Liabilities:			
Allowance for credit losses on unfunded commitments	$ 653	$ 1	$ 654
Deferred tax liabilities	-	-	-
Retained earnings:			
Unallocated retained earnings, net of tax	$ 169,046	$ (78)	$ 168,968

In March 2020, the FASB issued guidance entitled “Facilitation of the Effects of Reference Rate Reform on Financial Reporting.” The guidance provided optional expedients and exceptions for applying GAAP to contracts and other transactions affected by reference rate reform. The guidance simplifies the accounting evaluation of contract modifications that replace a reference rate affected by reference rate reform and contemporaneous modifications of other contracts related to the replacement of the reference rate. In December 2022, the FASB issued ASU 2022-06, "Reference Rate Reform (Topic 848): Deferral of the Sunset Date of Topic 848". This ASU defers the sunset date of the guidance in Topic 848 on reference rate reform from December 31, 2022 to December 31, 2024. This ASU is effective upon issuance. The adoption of this guidance did not have a material impact on our financial statements.

Loans and Allowance for Credit Losses

Loans are generally carried at their principal amount outstanding adjusted for charge-offs, deferred loan fees, or costs. 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) and/or included in the recorded nonaccrual balance (if accrued in prior years). Loans are charged-off at the time they are determined to be uncollectible.

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

Accrued Interest Receivable

The Association elected to continue classifying accrued interest on loans in accrued interest receivable and not as part of loans on the Consolidated Statement of Condition. The Association has 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 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 an 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

Effective January 1, 2023, the ACL represents the estimated current expected credit losses over the remaining contractual life of the loans 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) and
- the allowance for credit losses on unfunded commitments, which is presented separately on the Consolidated Statement of Condition.

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

Methodology for Allowance for Credit Losses on Loans

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

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

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

In estimating the pooled component of the ACLL for loan pools 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, further segregated by commodity type and probability of default. 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 and the severity of loss given default. Loss given default is determined for each pool based on the aggregate net lifetime losses incurred within that pool. 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 loan is 90 days or more past due. Due to limited loss history across the portfolio, the Association used peer data within their quantitative adjustment component for loan pools that have experienced minimal loss history.

The pooled 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 a single economic scenario over reasonable and supportable forecast period of 12 months. Subsequent to the forecast period, the Association reverts to long run historical loss experience beyond the 12 months, utilizing an accumulated quarter method, to inform the estimate of losses for the remaining contractual life of the loan portfolio.

The economic forecasts are updated on a quarterly basis and incorporate macroeconomic variables, including agricultural commodity prices, unemployment rates, Gross Domestic Product (GDP) annual growth rates, government spending to GDP, real consumer spending, United States exports, inflation, and Fed Funds rates.

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

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

Allowance for Credit Losses on Unfunded Commitments

The Association evaluates the need for an allowance for credit losses on unfunded commitments under CECL and if required, an amount is recognized and reported separately on the Consolidated Statement of Condition. 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 is recorded for commitments that are unconditionally cancellable.

NOTE 2 - LOANS AND ALLOWANCE FOR CREDIT LOSSES

A summary of loans follows.

(dollars in thousands)	**June 30, 2023**	December 31, 2022
Real estate mortgage	**$ 1,112,364**	$ 1,081,515
Production and intermediate-term	**388,772**	388,699
Agribusiness	**115,190**	73,316
Rural infrastructure	**56,884**	38,092
Agricultural export finance	**6,850**	6,809
Rural residential real estate	**1,599**	1,519
Total loans	**$ 1,681,659**	$ 1,589,950

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

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
(dollars in thousands)	Purchased	Sold	Purchased	Sold	Purchased	Sold
Real estate mortgage	$ 48,706	$ 7,254	$ 152,685	$ -	$ 201,391	$ 7,254
Production and intermediate-term	56,289	3,525	-	-	56,289	3,525
Agribusiness	73,418	602	-	-	73,418	602
Rural infrastructure	56,884	-	-	-	56,884	-
Agricultural export finance	6,850	-	-	-	6,850	-
Total	$ 242,147	$ 11,381	$ 152,685	$ -	$ 394,832	$ 11,381

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 loan is 90 days or more past due. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses, and risks in a particular relationship. The Association reviews, at least on an annual basis, or when a credit action is taken, the probability of default category.

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

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

	June 30, 2023	December 31, 2022[1]
Real estate mortgage		
Acceptable	**97.31%**	97.21%
OAEM	**1.47%**	1.46%
Substandard	**1.22%**	1.33%
Total	**100.00%**	100.00%
Production and intermediate-term		
Acceptable	**97.11%**	97.05%
OAEM	**2.06%**	2.43%
Substandard	**0.83%**	0.52%
Total	**100.00%**	100.00%
Agribusiness		
Acceptable	**97.18%**	100.00%
OAEM	**1.31%**	-
Substandard	**1.51%**	-
Total	**100.00%**	100.00%
Rural infrastructure		
Acceptable	**100.00%**	99.02%
Substandard	**-**	0.98%
Total	**100.00%**	100.00%
Agricultural export finance		
Acceptable	**100.00%**	100.00%
Total	**100.00%**	100.00%
Rural residential real estate		
Acceptable	**100.00%**	100.00%
Total	**100.00%**	100.00%
Total Loans		
Acceptable	**97.36%**	97.35%
OAEM	**1.54%**	1.59%
Substandard	**1.10%**	1.06%
Total	**100.00%**	100.00%

[1] Prior to the adoption of CECL on January 1, 2023, loans were presented with accrued interest receivable.

Accrued interest receivable on all accruing loans at June 30, 2023 has been excluded from the amortized cost of loans and reported separately in the Consolidated Statement of Condition.

Nonperforming assets consist of nonaccrual loans, accruing loans 90 days or more past due, and other property owned. The following table shows these nonperforming assets and related credit quality statistics as follows:

(dollars in thousands)	**June 30, 2023**	December 31, 2022
Nonaccrual loans		
Real estate mortgage	**$ 5,137**	$ 10,021
Production and intermediate-term	**8**	479
Total nonaccrual loans	**$ 5,145**	$ 10,500
Accruing loans 90 days past due		
Real estate mortgage	**$ 877**	$ 666
Total accruing loans 90 days past due	**$ 877**	$ 666
Total nonperforming loans	**$ 6,022**	$ 11,166
Total nonperforming assets	**$ 6,022**	$ 11,166
Nonaccrual loans to total loans	**0.31%**	0.66%
Nonperforming assets to total loans	**0.36%**	0.70%
Nonperforming assets to total shareholders' equity	**1.82%**	3.51%

The Association had no other property owned for the periods presented.

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

	June 30, 2023		
(dollars in thousands)	Amortized Cost with Allowance	Amortized Cost without Allowance	Total
Nonaccrual loans			
Real estate mortgage	$ -	$ 5,137	$ 5,137
Production and intermediate-term	(51)	59	8
Total	$ (51)	$ 5,196	$ 5,145

	Interest Income Recognized	
(dollars in thousands)	For the Three Months Ended June 30, 2023	For the Six Months Ended June 30, 2023
Nonaccrual loans		
Real estate mortgage	$ 450	$ 509
Production and intermediate-term	59	63
Total	$ 509	$ 572

The following tables provide an age analysis of past due loans at amortized cost.

	June 30, 2023					
(dollars in thousands)	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or less than 30 Days Past Due	Total Loans	Recorded Investment Accruing Loans 90 Days or More Past Due
Real estate mortgage	$ 578	$ 1,860	$ 2,438	$ 1,109,926	$ 1,112,364	$ 877
Production and intermediate-term	37	(52)	(15)	388,787	388,772	-
Agribusiness	-	-	-	115,190	115,190	-
Rural infrastructure	-	-	-	56,884	56,884	-
Agricultural export finance	-	-	-	6,850	6,850	-
Rural residential real estate	-	-	-	1,599	1,599	-
Total	$ 615	$ 1,808	$ 2,423	$ 1,679,236	$ 1,681,659	$ 877

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

	December 31, 2022					
(dollars in thousands)	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or less than 30 Days Past Due	Total Loans	Recorded Investment Accruing Loans 90 Days or More Past Due
Real estate mortgage	$ 687	$ 5,315	$ 6,002	$ 1,093,454	$ 1,099,456	$ 666
Production and intermediate-term	453	415	868	394,986	395,854	-
Agribusiness	-	-	-	73,798	73,798	-
Rural infrastructure	-	-	-	38,200	38,200	-
Agricultural export finance	-	-	-	6,853	6,853	-
Rural residential real estate	-	-	-	1,528	1,528	-
Total	$ 1,140	$ 5,730	$ 6,870	$ 1,608,819	$ 1,615,689	$ 666

Allowance for Credit Losses

The credit risk rating methodology is a key component of the Association’s allowance for credit losses evaluation and is generally incorporated into the Association’s loan underwriting standards and internal lending limits. In addition, borrower and commodity concentration lending and leasing limits have been established by the Association to manage credit exposure. The regulatory limit to a single borrower or lessee is 15% of the Association’s lending and leasing limit base, but the Association’s board of directors has 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 Association adopted the CECL accounting guidance as described in Note 1. A summary of changes in the allowance for loan losses is as follows:

(dollars in thousands)	Balance at March 31, 2023	Charge-offs	Recoveries	Provision for Loan Losses/ (Loan Loss Reversals)	Balance at June 30, 2023
Real estate mortgage	$ 242	$ -	$ -	$ (8)	$ 234
Production and intermediate-term	888	-	1	(79)	810
Agribusiness	29	-	-	70	99
Rural infrastructure	402	-	-	258	660
Agricultural export finance	-	-	-	1	1
Rural residential real estate	1	-	-	-	1
Total	$ 1,562	$ -	$ 1	$ 242	$ 1,805

(dollars in thousands)	Balance at December 31, 2022	Cumulative Effect of CECL Adoption	Balance at January 1, 2023	Charge-offs	Recoveries	Provision for Loan Losses/ (Loan Loss Reversals)	Balance at June 30, 2023
Real estate mortgage	$ 502	$ (248)	$ 254	$ -	$ -	$ (20)	$ 234
Production and intermediate-term	1,139	64	1,203	-	2	(395)	810
Agribusiness	117	(46)	71	-	-	28	99
Rural infrastructure	77	309	386	-	-	274	660
Agricultural export finance	1	(1)	-	-	-	1	1
Rural residential real estate	2	(1)	1	-	-	-	1
Total	$ 1,838	$ 77	$ 1,915	$ -	$ 2	$ (112)	$ 1,805

(dollars in thousands)	Balance at March 31, 2022	Charge-offs	Recoveries	Provision for Loan Losses/ (Loan Loss Reversals)	Balance at June 30, 2022
Real estate mortgage	$ 522	$ -	$ -	$ (24)	$ 498
Production and intermediate-term	1,136	-	-	(179)	957
Agribusiness	181	-	-	(46)	135
Rural infrastructure	18	-	-	3	21
Agricultural export finance	1	-	-	-	1
Rural residential real estate	1	-	-	1	2
Total	$ 1,859	$ -	$ -	$ (245)	$ 1,614

(dollars in thousands)	Balance at December 31, 2021	Charge-offs	Recoveries	Provision for Loan Losses/ (Loan Loss Reversals)	Balance at June 30, 2022
Real estate mortgage	$ 514	$ -	$ -	$ (16)	$ 498
Production and intermediate-term	1,164	-	55	(262)	957
Agribusiness	116	-	-	19	135
Rural infrastructure	21	-	-	-	21
Agricultural export finance	1	-	-	-	1
Rural residential real estate	6	-	-	(4)	2
Total	$ 1,822	$ -	$ 55	$ (263)	$ 1,614

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

The Association maintains a separate reserve for unfunded commitments, which is included in Liabilities on the Association's Consolidated Statement of Condition. The related provision for the reserve for unfunded commitments is included as part of the provision for credit losses on the Consolidated Statement of Comprehensive Income, along with the provision for loan losses. A summary of changes in the reserve for unfunded commitments follows:

(dollars in thousands)	For the Three Months Ended June 30, 2023	For the Six Months Ended June 30, 2023
Balance at beginning of period	$ 421	$ 653
Cumulative Effect of CECL Adoption		1
Balance at January 1		$ 654
Provision for/(Reversal of) reserve for unfunded commitment	168	(65)
Total	$ 589	$ 589

(dollars in thousands)	For the Three Months Ended June 30, 2022	For the Six Months Ended June 30, 2022
Balance at beginning of period	$ 549	$ 545
Provision for reserve for unfunded commitment	154	158
Total	$ 703	$ 703

Loan Modifications to Borrowers Experiencing Financial Difficulties

Loan modifications may be granted to borrowers experiencing financial difficulty. Qualifying disclosable modifications are one or a combination of principal forgiveness, interest rate reduction, forbearance, other-than-insignificant payment deferral or term extension. Covenant waivers and modifications of contingent acceleration clauses are not considered term extensions. Other-than-insignificant payment deferrals may provide the borrower with a temporary payment extension, which has been defined as cumulative or individual forbearance or payment delay greater than or equal to 6 months. These deferred payments may be capitalized into the principal balance of the loan and amortized with no extension of maturity or with the deferred payment due at the time of original maturity.

The following tables show the amortized cost basis at June 30, 2023 for loan modifications granted to borrowers experiencing financial difficulty, disaggregated by loan type and type of modification granted.

	Term or Payment Extension			
	For the Three Months Ended		For the Six Months Ended	
(dollars in thousands)	June 30, 2023	% of Total Loans	June 30, 2023	% of Total Loans
Production and intermediate-term	$ 268	0.07%	$ 268	0.07%
Total loans	$ 268	0.07%	$ 268	0.07%

	Combination - Interest Rate Reduction and Term or Payment Extension			
	For the Three Months Ended		For the Six Months Ended	
(dollars in thousands)	June 30, 2023	% of Total Loans	June 30, 2023	% of Total Loans
Production and intermediate-term	$ 74	0.02%	$ 74	0.02%
Total loans	$ 74	0.02%	$ 74	0.02%

Accrued interest receivable related to loan modifications granted to borrowers experiencing financial difficulty as of the three and six months ended June 30, 2023 was $8 thousand.

The following tables describe the financial effect of the modifications made to borrowers experiencing financial difficulty during the three and six months ended June 30, 2023:

	Term or Payment Extension
	Financial Effect
Production and intermediate-term	Added a weighted average of 2,644 days to the life of the loan.

	Combination – Interest Rate Reduction and Term or Payment Extension
	Financial Effect
Production and intermediate-term	Added a weighted average of 1,780 days to the life of the loan and reduced weighted average contractual interest rate by 0.35%.

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 June 30, 2023:

	Payment Status of Loans Modified in Past Six Months		
(dollars in thousands)	Current	30-89 Days Past Due	90 Days or More Past Due
Production and intermediate-term	$ 342	$ -	$ -
Total	$ 342	$ -	$ -

Additional commitments to lend to borrowers experiencing financial difficulty whose loans have been modified were $3 thousand at June 30, 2023.

Troubled Debt Restructuring

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

The following table presents additional information regarding troubled debt restructurings that occurred during the period.

	For the Three Months Ended June 30, 2022		For the Six Months Ended June 30, 2022	
(dollars in thousands)	Pre-modification Outstanding Recorded Investment*	Post-modification Outstanding Recorded Investment*	Pre-modification Outstanding Recorded Investment*	Post-modification Outstanding Recorded Investment*
Troubled debt restructurings:				
Real estate mortgage	$ 1,361	$ 1,361	$ 4,783	$ 4,783
Production and intermediate-term	-	-	852	852
Total	$ 1,361	$ 1,361	$ 5,635	$ 5,635

* Pre-modification represents the recorded investment in the loan receivable just prior to restructuring and post-modification represents the recorded investment in the loan receivable immediately following the restructuring. The recorded investment is the face amount of the loan receivable increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, or acquisition costs and may also reflect a previous direct write-down of the investment.

The Association had no TDR's within the previous 12 months and for which there were subsequent payment defaults at December 31, 2022.

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

(dollars in thousands)	Loans modified as TDRs December 31, 2022	TDRs in Nonaccrual Status* December 31, 2022
Real estate mortgage	$ 3,771	$ 3,771
Production and intermediate-term	136	136
Total	$ 3,907	$ 3,907

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

NOTE 3 – CAPITAL

Our Association's unallocated retained earnings for the quarter ended June 30, 2023 reflects a decrease from the cumulative effect of a change in accounting principle for CECL on January 1, 2023. The impact of adoption was not material to the Association's capital ratios. A summary of select capital ratios based on a three-month average and minimums set by the Farm Credit Administration follows.

	As of June 30, 2023	As of December 31, 2022	Regulatory Minimums	Capital Conservation Buffer	Total
Risk Adjusted:					
Common equity tier 1 ratio	17.74%	17.96%	4.5%	2.5%	7.0%
Tier 1 capital ratio	17.74%	17.96%	6.0%	2.5%	8.5%
Total capital ratio	17.87%	18.12%	8.0%	2.5%	10.5%
Permanent capital ratio	17.76%	17.98%	7.0%	-	7.0%
Non-risk-adjusted:					
Tier 1 leverage ratio	16.74%	16.82%	4.0%	1.0%	5.0%
Unallocated retained earnings and equivalents leverage ratio	16.57%	16.64%	1.5%	-	1.5%

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

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

	For the Three Months Ended June 30		For the Six Months Ended June 30	
(dollars in thousands)	**2023**	2022	**2023**	2022
Pension and other benefit plans:				
Beginning balance	**$ (793)**	$ (173)	**$ (860)**	$ (181)
Amounts reclassified from accumulated other comprehensive income/loss	**66**	8	**133**	16
Net current period other comprehensive income/(loss)	**66**	8	**133**	16
Ending balance	**$ (727)**	$ (165)	**$ (727)**	$ (165)

The following table represents reclassifications out of accumulated other comprehensive income/loss.

(dollars in thousands)	Amount Reclassified from Accumulated Other Comprehensive Income/Loss For the Three Months Ended June 30 **2023**	2022	Location of Gain/Loss Recognized in Statement of Income
Pension and other benefit plans:			
Net actuarial loss	**$ 66**	$ 8	Salaries and employee benefits
Total reclassifications	**$ 66**	$ 8	

(dollars in thousands)	Amount Reclassified from Accumulated Other Comprehensive Income/Loss For the Six Months Ended June 30 **2023**	2022	Location of Gain/Loss Recognized in Statement of Income
Pension and other benefit plans:			
Net actuarial loss	**$ 133**	$ 16	Salaries and employee benefits
Total reclassifications	**$ 133**	$ 16	

NOTE 4 - FAIR VALUE MEASUREMENTS

Accounting guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 2 of the 2022 Annual Report to Shareholders for a more complete description.

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

	Fair Value Measurement Using			**Total Fair Value**
(dollars in thousands)	**Level 1**	**Level 2**	**Level 3**	
Assets held in nonqualified benefits trusts				
June 30, 2023	**$ 2,157**	**$ -**	**$ -**	**$ 2,157**
December 31, 2022	$ 1,633	$ -	$ -	$ 1,633

The Association had no liabilities measured at fair value on a recurring basis at June 30, 2023 or December 31, 2022.

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

	Fair Value Measurement Using			**Total Fair Value**
(dollars in thousands)	**Level 1**	**Level 2**	**Level 3**	
Loans				
June 30, 2023	**$ -**	**$ -**	**$ 34**	**$ 34**
December 31, 2022	$ -	$ -	$ 671	$ 671

With regard to impaired loans and other property owned, it is not practicable to provide specific information on inputs as each collateral property is unique. System institutions utilize appraisals to value these loans and other property owned and takes into account unobservable inputs such as income and expense, comparable sales, replacement cost, and comparability adjustments.

The Association had no liabilities measured at fair value on a non-recurring basis at June 30, 2023 or December 31, 2022.

Valuation Techniques

As more fully discussed in Note 2 of the 2022 Annual Report to Shareholders, accounting guidance establishes a fair value hierarchy, which requires an Association to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following presents a brief summary of the valuation techniques used by the Association for assets and liabilities, subject to fair value measurement.

Assets Held in Non-Qualified 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.

Loans Evaluated for Impairment

For impaired loans measured on a non-recurring basis, the fair value is based upon the underlying collateral since the loans are collateral-dependent loans. 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, these fair value measurements fall within Level 3 of the hierarchy. When the value of the collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established.

NOTE 5 - SUBSEQUENT EVENTS

The Association has evaluated subsequent events through August 7, 2023, which is the date the financial statements were issued, and no material subsequent events were identified.