Farm Credit Midsouth, ACA

Quarterly Report
June 30, 2020

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the consolidated financial condition and consolidated results of operations of Farm Credit Midsouth, ACA and its subsidiaries, Farm Credit Midsouth, FLCA and Farm Credit Midsouth, PCA. This discussion should be read in conjunction with both the unaudited consolidated financial information and related notes included in this Quarterly Report as well as Management's Discussion and Analysis included in our Annual Report for the year ended December 31, 2019 (2019 Annual Report).

Due to the nature of our financial relationship with AgriBank, FCB (AgriBank), the financial condition and results of operations of AgriBank materially impact our members' investment. To request free copies of AgriBank financial reports or additional copies of our report, contact us at:

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FORWARD-LOOKING INFORMATION

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

AGRICULTURAL AND ECONOMIC CONDITIONS

According to the United States Department of Agriculture (USDA) Crop Progress and Condition Report for the week ending June 28, 2020, 52% of the corn is silking compared to the 5 year average of 81%. Managers are reporting that the corn crop in our area is progressing well after getting a late start; the southern portion of the state is reporting that the corn has tasseled. Corn conditions in all of our area are considered good to excellent. Rice emerged was 97% compared to the 5 year average of 99%. The rice crop in our territory looks very good and prices are higher than last year. According to the USDA, cotton squaring was at 68% compared to the 5 year average of 83%. The cotton crop is making good progress with managers reporting that the crop looks very healthy so far. Strong yields are expected, however, prices are low which will impact customer profitability. Peanuts in the area are looking very good with some counties reporting higher acreage allotted to this crop. Soybeans appear to be right on target with the USDA report showing soybeans emerged at 92%, which is consistent with the 5 year average.

The Arkansas State unemployment rate was 9.4% as of May, 2020 (not seasonally adjusted), significantly higher than the previous year. The National Average was 13%, also significantly higher than the previous year. All counties in our territory saw an increase in unemployment due to the COVID-19 shutdowns. Our customer base is not heavily reliant on off-farm income, therefore the impact of the COVID-19 shutdown on our customers appears to be minimal at this time. In April, the Association started making Paycheck Protection Program (PPP) loans through the U.S. Small Business Administration (SBA). We have made 24 loans with this program. In addition, the association introduced a new payment deferment program to help those that were having trouble making their payments due to COVID-19 related issues. We have had 2 customers utilize this program. There is still a great deal of uncertainty relating to COVID-19, the increasing numbers being reported and the impact on the economy in general. Additional concern exist about whether the government will have the resources to make Market Facilitation Program payments this year. Many have been able to break-even in their operations with the additional payments that have been received the last two years. With prices on most commodities continuing to be low many will struggle to break-even if these payments are not received.

LOAN PORTFOLIO

Loan Portfolio

Total loans were $1.0 billion at June 30, 2020, an increase of $63.9 million from December 31, 2019. The increase was primarily due to growth in both our mortgage and commercial portfolios. Our mortgage portfolio had normal repayments offset by approximately $111.4 million of new loan money for a net increase of $29.8 million from December 31, 2019. Our commercial portfolio also had normal repayments offset by approximately $76.9 million in new loans for a net increase of $34.1 million.

The U.S. government has instituted various programs in support of the COVID-19 economic recovery. In early 2020, Congress passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Among other provisions, the CARES Act and congressional approval made available for small businesses approximately $660.0 billion under the PPP, which is a guaranteed loan program administered by the SBA. We obtained approval from the SBA in April 2020 to participate as a lender in the PPP. Loan applicants with 500 or fewer employees or who fit within the revenue-based size standard and who are eligible to receive financing under the Farm Credit Act and the Farm Credit Administration (FCA) Regulations are able to borrow from our association under this program. The PPP provides for loan forgiveness under limited circumstances and loan payments can be deferred up to six months. Since beginning the program, we have successfully processed $542.5 million in PPP loans for customers with production and intermediate-term and agribusiness type loans. To date, no loans have been forgiven and nearly all payments have been deferred.

Portfolio Credit Quality

The credit quality of our portfolio declined from December 31, 2019. Adversely classified loans increased to 1.2% of the portfolio at June 30, 2020, from 0.6% of the portfolio at December 31, 2019. Adversely classified loans are loans we have identified as showing some credit weakness outside our credit standards. We have considered portfolio credit quality in assessing the reasonableness of our allowance for loan losses.

While overall credit quality remains strong, the impact of the global pandemic disruption to many agriculture industries, and with commodity prices expected to remain at relatively low levels, grower margins will likely be negatively impacted in 2020. These conditions may result in increases to adverse credit quality and related provision for credit losses.

In certain circumstances, government agency guarantee programs are used to reduce the risk of loss. At June 30, 2020, $8.7 million of our loans were, to some level, guaranteed under these government programs.

Risk Assets

Components of Risk Assets

(dollars in thousands) As of:	**June 30, 2020**	December 31, 2019
Loans:		
Nonaccrual	**$ 9,350**	$ 600
Accruing restructured	**3**	24
Accruing loans 90 days or more past due	**--**	395
Total risk loans	**9,353**	1,019
Other property owned	**--**	--
Total risk assets	**$ 9,353**	$ 1,019
Total risk loans as a percentage of total loans	**0.9%**	0.1%
Nonaccrual loans as a percentage of total loans	**0.9%**	0.1%
Current nonaccrual loans as a percentage of total nonaccrual loans	**37.8%**	16.8%
Total delinquencies as a percentage of total loans	**0.6%**	0.1%

Note: Accruing loans include accrued interest receivable.

The increase in nonaccrual loans was primarily due to one relationship that was moved to nonaccrual during the first quarter of 2020. Nonaccrual loans remained at an acceptable level at June 30, 2020, and December 31, 2019.

In April 2020, we implemented a borrower relief program related to the COVID-19 global pandemic. The program is generally for borrowers with acceptable credit quality and who have experienced COVID-19 related financial difficulty. The relief comes in a variety of ways, but most predominantly payment deferral for up to six months on loans with monthly payments. Any remaining balances will be due with the final payment at maturity. To date, there have not been significant actions taken under this program. However, our program may continue to evolve and is dependent on the prolonged nature of the economic disruption. Lastly, we continue to work with each borrower on a case-by-case basis, which may involve loan restructurings outside the COVID-19 relief program.

The increase in total delinquencies as a percentage of total loans was primarily due to the relationship that was moved to nonaccrual.

Allowance for Loan Losses

The allowance for loan losses is an estimate of losses on loans inherent in our portfolio as of the financial statement date. We determine the appropriate level of allowance for loan losses based on periodic evaluation of factors such as loan loss history, estimated probability of default, estimated loss severity, portfolio quality, and current economic and environmental conditions.

Allowance Coverage Ratios

As of:	**June 30, 2020**	December 31, 2019
Allowance as a percentage of:		
Loans	**0.4%**	0.3%
Nonaccrual loans	**38.1%**	447.0%
Total risk loans	**38.1%**	263.2%

In our opinion, the allowance for loan losses was reasonable in relation to the risk in our loan portfolio at June 30, 2020. The allowance increased $880 thousand since December 31, 2019. The majority of this increase is due to a specific reserve related to the relationship that was moved to nonaccrual.

RESULTS OF OPERATIONS

Profitability Information

(dollars in thousands) For the six months ended June 30,		**2020**		2019
Net income	**$**	**5,451**	$	8,510
Return on average assets		**1.1%**		1.9%
Return on average members' equity		**4.6%**		7.6%

Changes presented in the profitability information chart relate directly to:

- Changes in income discussed in this section
- Changes in assets discussed in the Loan Portfolio section
- Changes in capital discussed in the Funding, Liquidity, and Capital section

Changes in Significant Components of Net Income

(in thousands) For the six months ended June 30,		**2020**		2019		**Decrease in net income**
Net interest income	**$**	**12,436**	$	12,765	**$**	**(329)**
Provision for (reversal of) loan losses		**3,927**		(874)		**(4,801)**
Non-interest income		**3,945**		2,432		**1,513**
Non-interest expense		**7,645**		7,333		**(312)**
(Benefit from) provision for income taxes		**(642)**		228		**870**
Net income	**$**	**5,451**	$	8,510	**$**	**(3,059)**

Net Interest Income

Changes in Net Interest Income

(in thousands) For the six months ended June 30,		**2020 vs 2019**
Changes in volume	**$**	**841**
Changes in interest rates		**(861)**
Changes in nonaccrual income and other		**(309)**
Net change	**$**	**(329)**

Provision for (Reversal of) Loan Losses

The change in the provision for (reversal of) loan losses was related to our estimate of losses in our portfolio for the applicable years.

A total of $3.9 million provision has been required this year to reasonably reflect the estimated credit loss in the loan portfolio. The majority of the provision requirement was due to a single relationship being moved to nonaccrual and requiring a $2.9 million charge-off and an additional net $1.7 million specific reserve.

Non-Interest Income

The change in non-interest income was primarily due to patronage income and financially related services income.

Patronage Income: We may receive patronage from AgriBank and other Farm Credit Institutions. Patronage distributions from AgriBank and other Farm Credit Institutions are declared solely at the discretion of each institution's Board of Directors.

Patronage Income

(in thousands) For the six months ended June 30,		2020		2019
Wholesale patronage	**$**	**1,955**	$	1,691
Pool program patronage		**132**		156
Total patronage income	**$**	**2,087**	$	1,847
Form of patronage distributions:				
Cash	**$**	**2,087**	$	802
Stock		**--**		1,045
Total patronage income	**$**	**2,087**	$	1,847

Financially Related Services Income: The increase in financially related services income was primarily due to conversion fees. We were able to take advantage of the low interest rate environment and convert many of our customers to a lower interest rate, which resulted in significant fee income for the Association.

Non-Interest Expense

Non-interest expenses increased from 2019 levels primarily in the areas of salaries & benefits, cost of space, and purchased services offset by decreases in furniture, training and travel.

The association has added 6 new positions in 2020 to accommodate for succession planning as well as increased bench strength. These additions allow us to serve our customers more effectively. In 2019 we completed our new Paragould location. This building has increased our 2020 depreciation and lawn care cost which are partially offset by a decrease in furniture and equipment. In addition, our Jonesboro location had a major repair during 2020. Purchased services have increased as we continue to develop our systems and related security infrastructure. Decreases in training and travel expense are partially attributable to COVID-19.

(Benefit from) Provision for Income Taxes

The change in (benefit from) provision for income taxes was primarily related to the large provision expense during 2020.

FUNDING, LIQUIDITY, AND CAPITAL

We borrow from AgriBank, under a note payable, in the form of a line of credit. Our note payable is scheduled to mature on April 30, 2022. The note payable will be renegotiated no later than the maturity date. The repricing attributes of our line of credit generally correspond to the repricing attributes of our loan portfolio, which significantly reduces our market interest rate risk. Due to the cooperative structure of the Farm Credit System and as we are a stockholder of AgriBank, we expect this borrowing relationship to continue into the foreseeable future.

The components of cost of funds associated with our note payable include:

- A marginal cost of debt component
- A spread component, which includes cost of servicing, cost of liquidity, and bank profit
- A risk premium component, if applicable

We were not subject to a risk premium at June 30, 2020, or December 31, 2019.

Total members' equity increased $2.2 million from December 31, 2019, primarily due to net income for the period offset by amounts set aside for 2020 patronage distribution. The change in accumulated other comprehensive loss is the amortization impact of prior service cost and unamortized gain/loss related to the Pension Restoration Plan. Refer to Note 8 in our 2019 Annual Report for more information on the Pension Restoration Plan.

The FCA Regulations require us to maintain minimums for our common equity tier 1, tier 1 capital, total capital, and permanent capital risk-based capital ratios. In addition, the FCA requires us to maintain minimums for our non-risk-adjusted ratios of tier 1 leverage and unallocated retained earnings and equivalents leverage. Refer to Note 6 in our 2019 Annual Report for a more complete description of these ratios.

Regulatory Capital Requirements and Ratios

As of:	**June 30, 2020**	December 31, 2019	Regulatory Minimums	Capital Conservation Buffer	Total
Risk-adjusted:					
Common equity tier 1 ratio	**20.2%**	19.9%	4.5%	2.5%	7.0%
Tier 1 capital ratio	**20.2%**	19.9%	6.0%	2.5%	8.5%
Total capital ratio	**20.7%**	20.2%	8.0%	2.5%	10.5%
Permanent capital ratio	**20.3%**	20.0%	7.0%	N/A	7.0%
Non-risk-adjusted:					
Tier 1 leverage ratio	**22.4%**	21.5%	4.0%	1.0%	5.0%
Unallocated retained earnings and equivalents leverage ratio	**22.6%**	21.7%	1.5%	N/A	1.5%

Capital ratios are directly impacted by the changes in capital, as more fully explained in this section, the changes in assets, as discussed in the Loan Portfolio section, and off-balance sheet commitments.

OTHER MATTERS

Relationships with Other Farm Credit Institutions

SunStream Business Services: SunStream Business Services (SunStream) was previously a division of AgriBank. Effective April 1, 2020, SunStream is a System service corporation and we are a partial owner and continue to purchase services from SunStream. We purchase various services from SunStream, which include financial and retail systems, tax reporting services, technology services, and insurance services. Our entire investment in SunStream was called on April 1, 2020, at which time $125 thousand was paid in cash and the remainder is due in January 2021. As of June 30, 2020, our investment in SunStream was $225 thousand.

Arkansas and COVID-19

COVID-19 is still alive and wreaking havoc on Arkansas, the United States and World economic systems. Active cases continue to rise in the state as more tests are being performed. Arkansas schools are set to reopen for the fall as well as sporting activities, both of which could present some challenges to keep the COVID-19 numbers under control. The association is in phase 2 of their recovery plan. At this point, our office locations are open to customers while maintaining social distancing and mask protocols.

CERTIFICATION

The undersigned have reviewed the June 30, 2020, Quarterly Report of Farm Credit Midsouth, ACA, which has been prepared under the oversight of the Audit Committee and in accordance with all applicable statutory or regulatory requirements. The information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Dane Coomer
Chairman of the Board
Farm Credit Midsouth, ACA

James McJunkins
President and Chief Executive Officer
Farm Credit Midsouth, ACA

Shari J. Wilson
Executive Vice President of Finance, Chief Financial Officer
Farm Credit Midsouth, ACA

August 7, 2020

CONSOLIDATED STATEMENTS OF CONDITION

Farm Credit Midsouth, ACA
(in thousands)
(Unaudited)

As of:		June 30, 2020		December 31, 2019
ASSETS				
Loans	**$**	**1,000,633**	$	936,733
Allowance for loan losses		**3,562**		2,682
Net loans		**997,071**		934,051
Investment in AgriBank, FCB		**20,696**		20,696
Accrued interest receivable		**13,512**		22,412
Deferred tax assets, net		**51**		--
Other assets		**15,122**		13,730
Total assets	**$**	**1,046,452**	$	990,889
LIABILITIES				
Note payable to AgriBank, FCB	**$**	**801,803**	$	742,342
Accrued interest payable		**3,723**		5,365
Deferred tax liabilities, net		**--**		46
Patronage distribution payable		**3,300**		6,600
Other liabilities		**2,426**		3,522
Total liabilities		**811,252**		757,875
Contingencies and commitments (Note 3)				
MEMBERS' EQUITY				
Capital stock and participation certificates		**1,921**		1,896
Unallocated surplus		**233,391**		231,240
Accumulated other comprehensive loss		**(112)**		(122)
Total members' equity		**235,200**		233,014
Total liabilities and members' equity	**$**	**1,046,452**	$	990,889

The accompanying notes are an integral part of these Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Farm Credit Midsouth, ACA
(in thousands)
(Unaudited)

	Three Months Ended		Six Months Ended	
For the period ended June 30,	**2020**	2019	**2020**	2019
Interest income	**$ 9,917**	$ 11,456	**$ 20,658**	$ 22,431
Interest expense	**3,723**	4,950	**8,222**	9,666
Net interest income	**6,194**	6,506	**12,436**	12,765
Provision for (reversal of) loan losses	**1,047**	--	**3,927**	(874)
Net interest income after provision for (reversal of) loan losses	**5,147**	6,506	**8,509**	13,639
Non-interest income				
Patronage income	**1,137**	1,195	**2,087**	1,847
Financially related services income	**23**	38	**35**	77
Fee income	**760**	310	**1,372**	426
Allocated Insurance Reserve Accounts distribution	**--**	--	**194**	210
Other non-interest income (loss), net	**70**	17	**257**	(118)
Total non-interest income	**1,990**	1,560	**3,945**	2,442
Non-interest expense				
Salaries and employee benefits	**2,333**	2,406	**4,995**	4,805
Other operating expense	**1,246**	1,288	**2,639**	2,538
Other non-interest expense	**--**	--	**11**	--
Total non-interest expense	**3,579**	3,694	**7,645**	7,343
Income before income taxes	**3,558**	4,372	**4,809**	8,738
(Benefit from) provision for income taxes	**(91)**	(159)	**(642)**	228
Net income	**$ 3,649**	$ 4,531	**$ 5,451**	$ 8,510
Other comprehensive income				
Employee benefit plans activity	**$ 5**	$ 7	**$ 10**	$ 14
Total other comprehensive income	**5**	7	**10**	14
Comprehensive income	**$ 3,654**	$ 4,538	**$ 5,461**	$ 8,524

The accompanying notes are an integral part of these Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

Farm Credit Midsouth, ACA
(in thousands)
(Unaudited)

	Capital Stock and Participation Certificates	Unallocated Surplus	Accumulated Other Comprehensive Loss	Total Members' Equity
Balance at December 31, 2018	$ 1,895	$ 218,714	$ (187)	$ 220,422
Net income	--	8,510	--	8,510
Other comprehensive income	--	--	14	14
Unallocated surplus designated for patronage distributions	--	(3,299)	--	(3,299)
Capital stock and participation certificates issued	67	--	--	67
Capital stock and participation certificates retired	(93)	--	--	(93)
Balance at June 30, 2019	$ 1,869	$ 223,925	$ (173)	$ 225,621
Balance at December 31, 2019	$ 1,896	$ 231,240	$ (122)	$ 233,014
Net income	**--**	**5,451**	**--**	**5,451**
Other comprehensive income	**--**	**--**	**10**	**10**
Unallocated surplus designated for patronage distributions	**--**	**(3,300)**	**--**	**(3,300)**
Capital stock and participation certificates issued	**116**	**--**	**--**	**116**
Capital stock and participation certificates retired	**(91)**	**--**	**--**	**(91)**
Balance at June 30, 2020	**$ 1,921**	**$ 233,391**	**$ (112)**	**$ 235,200**

The accompanying notes are an integral part of these Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

The Consolidated Financial Statements contain all adjustments necessary for a fair presentation of the interim Consolidated Statements of Condition and Consolidated Statements of Comprehensive Income. Our accounting and reporting policies conform to accounting principles generally accepted in the United States of America (GAAP) and the prevailing practices within the financial services industry. This interim Quarterly Report is prepared based upon statutory and regulatory requirements and in accordance with GAAP. However, certain disclosures required by GAAP are omitted. The results of the six months ended June 30, 2020, are not necessarily indicative of the results to be expected for the year ending December 31, 2020. The interim financial statements and the related notes in this Quarterly Report should be read in conjunction with the Consolidated Financial Statements and related notes included in our Annual Report for the year ended December 31, 2019 (2019 Annual Report).

Certain amounts in prior periods' financial statements have been reclassified to conform to the current period's presentation.

The Consolidated Financial Statements present the consolidated financial results of Farm Credit Midsouth, ACA and its subsidiaries Farm Credit Midsouth, FLCA and Farm Credit Midsouth, PCA. All material intercompany transactions and balances have been eliminated in consolidation.

Recently Issued or Adopted Accounting Pronouncements

We have assessed the potential impact of accounting standards that have been issued by the Financial Accounting Standards Board (FASB) and have determined the following standards to be applicable to our business. While we are a nonpublic entity, our financial results are closely related to the performance of the combined Farm Credit System. Therefore, we typically adopt accounting pronouncements in alignment with other System institutions.

Standard and effective date	Description	Adoption status and financial statement impact
In June 2016, the FASB issued Accounting Standards Update (ASU) 2016-13 "Financial Instruments - Credit Losses." The guidance was originally effective for non-U.S. Securities Exchange Commission filers for our first quarter of 2021. In November 2019, the FASB issued ASU 2019-10 which amends the mandatory effective date for this guidance for certain institutions. We have determined we qualify for the deferral of the mandatory effective date. As a result of the change, the standard is effective for our first quarter of 2023 and early adoption is permitted.	The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses.	We do not expect to early adopt the standard. We have reviewed the accounting standard, selected and substantially completed development and testing of our system, and are in the process of drafting disclosures. Significant implementation matters yet to be addressed include drafting of accounting policies and designing processes and controls. We are currently unable to estimate the impact on our financial statements.

NOTE 2: LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans by Type

(dollars in thousands)

As of:	June 30, 2020		December 31, 2019	
	Amount	%	Amount	%
Real estate mortgage	**$ 536,318**	**53.6%**	$ 508,522	54.3%
Production and intermediate-term	**394,405**	**39.4%**	367,809	39.3%
Agribusiness	**67,912**	**6.8%**	58,107	6.2%
Other	**1,998**	**0.2%**	2,295	0.2%
Total	**$ 1,000,633**	**100.0%**	$ 936,733	100.0%

The other category is primarily composed of rural residential real estate related loans.

Delinquency

Aging Analysis of Loans

(in thousands) **As of June 30, 2020**	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less than 30 Days Past Due	Total	Accruing Loans 90 Days or More Past Due
Real estate mortgage	**$ 414**	**$ --**	**$ 414**	**$ 543,044**	**$ 543,458**	**$ --**
Production and intermediate-term	**43**	**5,812**	**5,855**	**394,099**	**399,954**	**--**
Agribusiness	**--**	**--**	**--**	**68,729**	**68,729**	**--**
Other	**--**	**--**	**--**	**2,004**	**2,004**	**--**
Total	**$ 457**	**$ 5,812**	**$ 6,269**	**$ 1,007,876**	**$ 1,014,145**	**$ --**

As of December 31, 2019	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less than 30 Days Past Due	Total	Accruing Loans 90 Days or More Past Due
Real estate mortgage	$ --	$ --	$ --	$ 519,734	$ 519,734	$ --
Production and intermediate-term	52	447	499	377,503	378,002	--
Agribusiness	--	395	395	58,712	59,107	395
Other	--	--	--	2,302	2,302	--
Total	$ 52	$ 842	$ 894	$ 958,251	$ 959,145	$ 395

Note: Accruing loans include accrued interest receivable.

Risk Loans

Risk loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms.

Risk Loan Information

(in thousands) As of:	**June 30, 2020**	December 31, 2019
Volume with specific allowance	**$ 6,752**	$ 452
Volume without specific allowance	**2,601**	567
Total risk loans	**$ 9,353**	$ 1,019
Total specific allowance	**$ 1,677**	$ 210
For the six months ended June 30,	**2020**	2019
Income on accrual risk loans	**$ 5**	$ 44
(Reversal) income on nonaccrual loans	**$ (30)**	279
Total (reversal) income on risk loans	**$ (25)**	$ 323
Average risk loans	**$ 6,581**	$ 10,742

Note: Accruing loans include accrued interest receivable.

We had no commitments to lend additional money to borrowers whose loans were classified as risk loans at June 30, 2020.

Troubled Debt Restructurings (TDRs)

In situations where, for economic or legal reasons related to the borrower's financial difficulties, we grant a concession for other than an insignificant period of time to the borrower that we would not otherwise consider, the related loan is classified as a troubled debt restructuring, also known as a restructured loan. A concession is generally granted in order to minimize economic loss and avoid foreclosure. Concessions vary by program and borrower and may include interest rate reductions, term extensions, payment deferrals, or an acceptance of additional collateral in lieu of payments. In limited circumstances, principal may be forgiven. Loans classified as TDRs are considered risk loans. All risk loans are analyzed within our allowance for loan losses. We record a specific allowance to reduce the carrying amount of the restructured loan to the lower of book value or net realizable value of collateral.

There were no TDRs that occurred during the six months ended June 30, 2020, or 2019.

There were no TDRs that defaulted during the six months ended June 30, 2020, or 2019 in which the modification was within twelve months of the respective reporting period.

TDRs Outstanding in the Production and Intermediate-Term Loan Category

(in thousands) As of:		**June 30, 2020**		December 31, 2019
TDRs in accrual status	**$**	**3**	$	24
TDRs in nonaccrual status		**33**		37
Total TDRs	**$**	**36**	$	61

There were no commitments to lend to borrowers whose loans have been modified in a TDR at June 30, 2020.

Allowance for Loan Losses

Changes in Allowance for Loan Losses

(in thousands) Six months ended June 30,		**2020**		2019
Balance at beginning of period	**$**	**2,682**	$	3,682
Provision for (reversal of) loan losses		**3,927**		(874)
Loan recoveries		**4**		24
Loan charge-offs		**(3,051)**		(2)
Balance at end of period	**$**	**3,562**	$	2,830

NOTE 3: CONTINGENCIES AND COMMITMENTS

In the normal course of business, we have various contingent liabilities and commitments outstanding, primarily commitments to extend credit, which may not be reflected in the Consolidated Financial Statements. We do not anticipate any material losses because of these contingencies or commitments.

We may be named as a defendant in certain lawsuits or legal actions in the normal course of business. In 2009, we were named as a counter-defendant based on various lender liability type of theories in an on-going foreclosure lawsuit. On October 26, 2015, the case was heard by a jury, and on November 3, 2015, a verdict was rendered against the Association. We appealed the verdict, and on April 4, 2018, the Arkansas Court of Appeals substantially reversed all of the verdict. The decision of the Arkansas Court of Appeals was subsequently upheld by the Arkansas Supreme Court on June 21, 2018, when the Court denied the defendants' Petition for Review. This decision effectively ends the lender liability portion of the litigation. We had previously recorded a $2.3 million liability for this lawsuit, of which $2.0 million has been overturned and therefore reversed. The difference is included in “Other liabilities” in the Consolidated Statements of Condition. At the date of these Consolidated Financial Statements, our management team was not aware of any material actions. However, management cannot ensure that such actions or other contingencies will not arise in the future.

NOTE 4: FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or most advantageous market for the asset or liability. Accounting guidance also establishes a fair value hierarchy, with three input levels that may be used to measure fair value. Refer to Note 2 in our 2019 Annual Report for a more complete description of the three input levels.

We did not have any assets or liabilities measured at fair value on a recurring basis at June 30, 2020, or December 31, 2019.

Non-Recurring

We may be required, from time to time, to measure certain assets at fair value on a non-recurring basis.

Assets Measured at Fair Value on a Non-recurring Basis

(in thousands) **As of June 30, 2020**	Fair Value Measurement Using						
		Level 1		Level 2		Level 3	Total Fair Value
Impaired loans	**$**	**--**	**$**	**--**	**$**	**5,328**	**$ 5,328**

As of December 31, 2019	Fair Value Measurement Using						
		Level 1		Level 2		Level 3	Total Fair Value
Impaired loans	$	--	$	--	$	255	$ 255

Valuation Techniques

Impaired loans: Represents the carrying amount of loans which were evaluated for individual impairment based on the appraised value of the underlying collateral. 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. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. If the process uses observable market-based information, they are classified as Level 2. If the process requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters, they are classified as Level 3.

NOTE 5: SUBSEQUENT EVENTS

We have evaluated subsequent events through August 7, 2020, which is the date the Consolidated Financial Statements were available to be issued. There have been no material subsequent events that would require recognition in our Quarterly Report or disclosure in the Notes to Consolidated Financial Statements.