

CENTRAL TEXAS FARM CREDIT, ACA

2016 Quarterly Report Second Quarter



For the Quarter Ended June 30, 2016

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.



Boyd J. Chambers, Chief Executive Officer and President

July 29, 2016



Robby A. Halfmann, Chairman, Board of Directors

July 29, 2016



Keith Prater, Controller

July 29, 2016

CENTRAL TEXAS FARM CREDIT, ACA MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the financial performance of the Central Texas Farm Credit, ACA (Agricultural Credit Association), referred to as the Association, for the quarter ended June 30, 2016. These comments should be read in conjunction with the accompanying financial statements and the 2015 Annual Report to Stockholders.

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.

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.

Significant Events

2016

In March 2016, a patronage refund of \$5,600,000 was distributed to the Association's borrowers. The patronage refund was declared by the board of directors in December 2015, and the amount was based on the Association's 2015 operating results.

In 2015, the Association began construction of a new headquarters building located in the city of Early. As of June 30, 2016 the amount of construction in progress related to this project is \$2,010,815 which is captured in premises and equipment on the consolidated balance sheet.

2015

In December 2015, the Association received a direct loan patronage of \$1,448,584 from the Farm Credit Bank of Texas (Bank), representing 42 basis points on the average daily balance of the Association's direct loan with the Bank. During 2015, the Association received \$112,767 in patronage payments from the Bank, based on the Association's stock investment in the Bank.

In March 2015, a patronage refund of \$5,200,000 was distributed to the Association's borrowers. The patronage refund was declared by the board of directors in December 2014, and the amount was based on the Association's 2014 operating results.

2014

In December 2014, the Association received a direct loan patronage of \$1,382,295 from the Bank, representing 43 basis points on the average daily balance of the Association's direct loan with the Bank. In addition, the Association received \$52,750 in patronage payments from the Bank, representing 75 basis points on the average daily balance of Association loan volume in the Bank's participation pool program. The Association also received \$104,954 in patronage payments throughout the course of the year based on the Association's stock investment in the Bank.

Effective October 15, 2014, Michael Antle resigned from his position as controller of Central Texas Farm Credit, ACA. Controller duties were handled by existing Association staff until Keith Prater was hired as the new controller on January 20, 2015.

The chairman of the board and audit committee, Jerry Don Klose, did not run for re-election in April 2014 because he reached the mandatory retirement age of 70. Mr. Klose officially stepped down after the May 2014 board meeting once the election results were known, and his seat had been filled by Steven Lehrmann. At the June 2014 meeting, the board elected Robby A. Halfmann to serve as the board chairman, Kenneth D. Harvick to serve as vice-chairman, and Burl D. Lowery to serve as the audit committee chairman.

2013

In December 2013, the Association received a direct loan patronage of \$1,330,745 from the Bank, representing 44 basis points on the average daily balance of the Association's direct loan with the Bank. During 2013, the Association received \$109,486 in patronage payments from the Bank, based on the Association's stock investment in the Bank.

Effective March 31, 2013 Alan Benedict retired as controller and treasurer of Central Texas Farm Credit, ACA. Mike Antle was promoted to controller effective January 1, 2014.

The board adopted a resolution at its March meeting which amended the ACA bylaws to reduce the size of the board from eight directors (seven stockholder-elected and one director-elected) to six (five stockholder-elected and one director-elected) to be effective upon the close of the Association's Annual Stockholder's Meeting on April 23, 2013. In April 2013, upon the expiration of their terms, directors A. Wayland Shurley and Mickey D. Dillard did not run for re-election because they reached the mandatory retirement age of 70. These positions were eliminated to facilitate the board size reduction plan.

Problem Loans

2016

There were no problem loans through the second quarter of 2016.

2015

During the first quarter of 2015, a nonaccrual loan in the amount of \$85,486 was foreclosed on, and the collateral was then acquired by the Association. The property was sold during the second quarter of 2015 and a gain of \$4,109 was recognized.

2014

During the first quarter of 2014, a recovery of \$8,210 was made on a loan that had been charged off in 2009.

During the second quarter of 2014, a participation loan formally restructured in 2009, and previously reported as a TDR, was paid in full.

During the third quarter of 2014, a recovery of \$25,052 was made on an operating loan that was charged off in 2013.

In 2010, the Association, through a purchased participation as a part of a lending group, acquired a small percentage ownership interest in an ethanol plant. In August 2014, the Association sold its equity interest in the ethanol plant. The total sales price of the Association's equity interest was \$1,400,400 and resulted in a gain on sale of \$877,350.

2013

During the second quarter of 2013 a participation loan that was deemed non-viable in 2012 was further evaluated resulting in the need for an additional \$180,000 to be added to the specific allowance. This resulted in a total specific allowance of \$1,157,000 at the end of the second quarter. In addition, this evaluation resulted in a charge-off of \$670,000. The resulting nonaccrual balance on this loan was \$2,441,721 at the end of the second quarter.

During the fourth quarter the previously mentioned participation loan was revalued as a result of the impending sale of the company's assets. Initially this caused a reduction in the specific allowance in the amount of \$195,425, bringing the overall specific allowance down to \$961,575. After the sale was completed the entire specific allowance of \$961,575 was charged off and a related nonaccrual premium, in the amount of \$3,655, was taken into income. The assets were then moved into acquired property in the amount of \$2,146,491. Soon after the acquired property was set up, the Association received two disbursements of proceeds from the sale in the amounts of \$1,941,809 and \$75,607. These reduced the acquired property balance relating to this loan. The ending overall acquired property balance for 2013 was \$652,125.

During the fourth quarter two operating loans were moved into nonaccrual status and \$179,624 was charged off, resulting in a remaining book balance of \$25,892 as of year-end.

Territory Conditions

The local economy in our chartered territory continues to be relatively strong. Real estate prices are stable and the land sales have continued to increase despite sagging oil and gas prices and the lost income for people connected to those industries. The majority of the Association's new loans made during the past number of years have been to absentee landowners with diverse income sources looking for a place for a small agricultural operation or recreational use. As a result, the Association has a diversified portfolio that is not heavily dependent on agricultural income. Even those borrowers who are primarily agricultural producers typically have outside income from a spouse's employment, part-time jobs, investments, etc. The above is reflected in the Association's sound credit quality and small number of delinquencies.

During the second quarter of 2016, the Association's territory experienced heavy rainfall in most areas. According to a USDA report at quarter end, all of the Association's territory remains out of any dry or drought category, along with 98% of the state. Many

area lakes remain full or near capacity. Pastures have held up well through the quarter but by the end of June typical signs of summer stress had begun with rains tempering in some areas of the territory.

The USDA's report "Texas Crop Progress and Condition" for the last week of June reported 98% of cotton acres planted. Prices were around \$0.63 to \$0.64 per pound which is unchanged from the same period in 2015.

The USDA reported 99% of the corn acres in Texas had emerged and 96% of the sorghum has been planted. As for small grains, 80% of winter wheat was harvested and 82% of oats were harvested throughout the state. Harvest was hampered in some areas of the territory by rainfall. Wheat prices continue to struggle with abundant supply weighing heavily. Prices still hover around the low \$4 per bushel range with near month contracts for July at \$4.16.

Cattle markets have remained volatile throughout the second quarter of 2016. This trend is expected to continue until the dollar weakens enough to spur export demand. Feed costs have remained fairly low along with petroleum related products, and this has helped offset that volatility to some degree.

Most of our borrowers are doing well right now, but many remain cautious due to weakened commodity markets and the possible effect of lower oil prices on the local economies in our territory.

Loan Portfolio:

Total loans outstanding at June 30, 2016, including nonaccrual loans, were \$490,667,793 compared to \$478,375,612 at December 31, 2015, reflecting an increase of 2.6 percent. Nonaccrual loans as a percentage of total loans outstanding were 0.2 percent at June 30, 2016, compared to 0.1 percent at December 31, 2015.

The Association had no recoveries or charge-offs for the quarter ended June 30, 2016, or for the same period in 2015. The Association's allowance for loan losses was 0.2 percent and 0.2 percent of total loans outstanding as of June 30, 2016, and December 31, 2015, respectively.

Currently, the Association has \$1,153,955 in nonaccrual loans stemming from six loans. These loans are included in the Association's core loan portfolio. There have been no material changes in the Association's core portfolio's borrower profile, geographic distribution, commodity concentration, or asset quality.

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. The following table illustrates the Association's components and trends of high-risk assets.

	June 30, 2016		December 31, 2015	
	Amount	%	Amount	%
Nonaccrual	\$ 1,153,955	89.9%	\$ 523,110	80.2%
Other property owned, net	129,075	10.1%	129,075	19.8%
Total	\$ 1,283,030	100.0%	\$ 652,185	100.0%

Results of Operations:

The Association had net income of \$2,412,287 and \$4,722,414 for the three and six months ended June 30, 2016, as compared to net income of \$2,248,976 and \$4,521,524 for the same period in 2015, reflecting an increase of 7.3 and 4.4 percent, respectfully. Net interest income was \$3,524,828 and 7,086,700 for the three and six months ended June 30, 2016, compared to \$3,309,740 and \$6,595,200 for the same periods in 2015.

	Six months ended:			
	June 30, 2016		June 30, 2015	
	Average Balance	Interest	Average Balance	Interest
Loans	\$ 483,368,132	\$ 10,732,021	\$ 421,041,287	\$ 9,460,523
Interest-bearing liabilities	387,210,838	3,645,321	327,126,233	2,865,323
Impact of capital	<u>\$ 96,157,294</u>		<u>\$ 93,915,054</u>	
Net interest income		<u>\$ 7,086,700</u>		<u>\$ 6,595,200</u>

	2016	2015
	Average Yield	Average Yield
Yield on loans	4.46%	4.53%
Cost of interest-bearing liabilities	1.89%	1.77%
Interest rate spread	2.57%	2.76%
Net interest income as a percentage of average earning assets	2.95%	3.16%

	Six months ended:		
	June 30, 2016 vs. June 30, 2015		
	Increase (decrease) due to		
	Volume	Rate	Total
Interest income	\$ 1,404,330	\$ (132,832)	\$ 1,271,498
Interest expense	527,738	252,260	779,998
Net interest income	<u>\$ 876,592</u>	<u>\$ (385,092)</u>	<u>\$ 491,500</u>

Interest income for the three and six months ended June 30, 2016, increased by \$600,467 and \$1,271,498, or 12.6 and 13.4 percent respectively, from the same periods of 2015, primarily due to an increase in average loan volume. Interest expense for the three and six months ended June 30, 2016, increased by \$385,379 and \$779,998, or 26.2 and 27.2 percent, respectfully, from the same periods of 2015 due to increases in interest rates and average debt volume. Average loan volume for the second quarter of 2016 was \$486,567,533, compared to \$425,098,931 in the second quarter of 2015. The average net interest rate spread on the loan portfolio for the second quarter of 2016 was 2.57 percent, compared to 2.76 percent in the second quarter of 2015.

The Association's return on average assets for the six months ended June 30, 2016, was 1.91 percent compared to 2.11 percent for the same period in 2015. The Association's return on average equity for the six months ended June 30, 2016, was 9.21 percent, compared to 9.19 percent for the same period in 2015.

Liquidity and Funding Sources:

The Association secures the majority of its lendable funds from the Farm Credit Bank of Texas (the Bank), which obtains its funds through the issuance of Systemwide obligations and with lendable equity. The following schedule summarizes the Association's borrowings.

	June 30, 2016	December 31, 2015
Note payable to the Bank	\$ 396,300,809	\$ 380,156,061
Accrued interest on note payable	613,844	581,682
Total	<u>\$ 396,914,653</u>	<u>\$ 380,737,743</u>

The Association operates under a general financing agreement (GFA) with the Bank. The current GFA is effective through September 30, 2018. The primary source of liquidity and funding for the Association is a direct loan from the Bank. The outstanding balance of \$396,300,809 as of June 30, 2016, is recorded as a liability on the Association's consolidated balance sheet. The note carried a weighted average interest rate of 1.87 percent at June 30, 2016. 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. The increase in note payable to the Bank and related accrued interest payable since December 31, 2015, is due to the Association's increase in funding needs as evidenced by the increase in total assets from 2015 to 2016. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were \$93,004,325 at June 30, 2016. The maximum amount the Association may borrow from the Bank as of June 30, 2016, was \$494,293,897 as defined by the general financing agreement. The indebtedness continues in effect until the expiration date of the general financing agreement, which is September 30, 2018, 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.

The liquidity policy of the Association is to manage cash balances to maximize debt reduction, and to increase accrual loan volume. This policy will continue to be pursued during 2016 and into the future. As borrower payments are received, they are applied to the Association's note payable to the Bank.

The Association will continue to fund its operations through direct borrowing from the Bank, capital surplus from prior years and borrower stock. It is management's opinion that funds available to the Association are sufficient to fund its operations for the coming year and foreseeable future.

Capital Resources:

The Association's capital position increased by \$4,730,843 at June 30, 2016, compared to December 31, 2015. The Association's debt as a percentage of members' equity was 3.80:1 as of June 30, 2016, compared to 3.88:1 as of December 31, 2015.

Under regulations governing minimum permanent capital adequacy and other capitalization issues, the Association is required to maintain a minimum adjusted permanent capital of 7.0 percent of risk-adjusted assets as defined by the FCA. The Association's permanent capital ratio at June 30, 2016, was 18.9 percent, which is in compliance with the FCA's minimum permanent capital standard. The Association's core surplus ratio and total surplus ratio at June 30, 2016, were 18.5 and 18.5 percent, respectively, which is in compliance with the FCA's minimum surplus standard.

Significant Recent Accounting Pronouncements:

In June 2016, the Financial Accounting Standards Board (FASB) issued guidance entitled "Measurement of Credit Losses on Financial Instruments." 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. For public business entities that are not U.S. Securities and Exchange Commission filers this guidance becomes effective for interim and annual periods beginning after December 15, 2020, with early application permitted. The Association is currently evaluating the impact of adoption on its financial condition and results of operations.

In February 2016, the FASB issued guidance entitled "Leases." The guidance requires the recognition by lessees of lease assets and lease liabilities on the balance sheet for the rights and obligations created by those leases. Leases with lease terms of more than 12 months are impacted by this guidance. This guidance becomes effective for interim and annual periods beginning after December 15, 2018, with early application permitted. The Association is currently evaluating the impact of adoption on its financial condition and results of operations.

In January 2016, the FASB issued guidance entitled “Recognition and Measurement of Financial Assets and Liabilities.” This guidance becomes effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance is not expected to impact the Association’s financial condition or its results of operations.

In August 2014, the FASB issued guidance entitled “Presentation of Financial Statements — Going Concern.” The guidance governs management’s responsibility to evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern and to provide related footnote disclosures. This guidance requires management to perform interim and annual assessments of an entity’s ability to continue as a going concern within one year after the date the financial statements are issued or within one year after the financial statements are available to be issued, when applicable. Substantial doubt exists if it is probable that the entity will be unable to meet its obligations for the assessed period. This guidance becomes effective for interim and annual periods ending after December 15, 2016, and early application is permitted. Management will be required to make its initial assessment as of December 31, 2016. The Association is currently evaluating a potential disclosure for this recent accounting pronouncement.

In May 2014, the FASB issued guidance entitled, “Revenue from Contracts with Customers.” The guidance governs revenue recognition from contracts with customers and requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Financial instruments and other contractual rights within the scope of other guidance issued by the FASB are excluded from the scope of this new revenue recognition guidance. In this regard, a majority of our contracts would be excluded from the scope of this new guidance. In August 2015, the FASB issued an update that defers this guidance by one year, which results in the new revenue standard becoming effective for interim and annual reporting periods beginning after December 15, 2017. The Association is in the process of reviewing contracts to determine the effect, if any, on their financial condition or results of operations.

Regulatory Matters:

On March 10, 2016, the Farm Credit Administration approved a final rule to modify the regulatory capital requirements for System banks and associations. The stated objectives of the proposed rule are as follows:

- To modernize capital requirements while ensuring that the institutions continue to hold sufficient regulatory capital to fulfill their mission as a government-sponsored enterprise,
- To ensure that the System’s capital requirements are comparable to the Basel III framework and the standardized approach that the federal banking regulatory agencies have adopted, but also to ensure that the rules recognize the cooperative structure and the organization of the System,
- To make System regulatory capital requirements more transparent and
- To meet the requirements of section 939A of the Dodd-Frank Act.

The final rule is effective on January 1, 2017. The Association is currently evaluating the impact of the recently announced changes.

Relationship With the Farm Credit Bank of Texas:

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 2015 Annual Report of Central Texas Farm Credit, ACA more fully describe the Association’s relationship with the Bank.

The Texas Farm Credit District’s (District) annual and quarterly stockholder reports, as well as those of the Bank, are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, The Ag Agency, P.O. Box 202590, Austin, Texas 78720, or by calling (512) 483-9204. Copies of the District’s quarterly and annual stockholder reports also can be requested by e-mail at fcb@farmcreditbank.com. The annual and quarterly stockholder reports for the Bank and the District are also available on its website at www.farmcreditbank.com.

The Association’s quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Central Texas Farm Credit, ACA, P.O. Box 511, Coleman, Texas 76834 or calling (325) 625-2165. The annual and quarterly stockholder reports for the Association are also available on its website at www.centraltexasfarmcredit.com. Copies of the Association’s quarterly stockholder reports can also be requested by e-mailing Keith.Prater@farmcreditbank.com.

CENTRAL TEXAS FARM CREDIT, ACA

CONSOLIDATED BALANCE SHEET

	June 30, 2016 (unaudited)	December 31, 2015
<u>ASSETS</u>		
Cash	\$ 683,227	\$ 919,895
Loans	490,667,793	478,375,612
Less: allowance for loan losses	1,051,341	964,227
Net loans	<u>489,616,452</u>	<u>477,411,385</u>
Accrued interest receivable	4,465,942	4,044,051
Investment in and receivable from the Farm Credit Bank of Texas:		
Capital stock	6,817,385	6,817,385
Other	-	57,591
Other property owned, net	129,075	129,075
Premises and equipment, net	3,343,513	1,917,375
Other assets	895,951	190,643
Total assets	<u><u>\$ 505,951,545</u></u>	<u><u>\$ 491,487,400</u></u>
<u>LIABILITIES</u>		
Note payable to the Farm Credit Bank of Texas	\$ 396,300,809	\$ 380,156,061
Advance conditional payments	-	6,604
Accrued interest payable	613,844	581,682
Drafts outstanding	482,897	900,264
Dividends payable	-	5,600,000
Other liabilities	3,073,295	3,492,932
Total liabilities	<u>400,470,845</u>	<u>390,737,543</u>
<u>MEMBERS' EQUITY</u>		
Capital stock and participation certificates	2,245,740	2,232,325
Unallocated retained earnings	103,437,832	98,715,418
Accumulated other comprehensive loss	(202,872)	(197,886)
Total members' equity	<u>105,480,700</u>	<u>100,749,857</u>
Total liabilities and members' equity	<u><u>\$ 505,951,545</u></u>	<u><u>\$ 491,487,400</u></u>

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

CENTRAL TEXAS FARM CREDIT, ACA

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

	Quarter Ended		Six Months Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
<u>INTEREST INCOME</u>				
Loans	\$ 5,378,825	\$ 4,778,358	\$ 10,732,021	\$ 9,460,523
<u>INTEREST EXPENSE</u>				
Note payable to the Farm Credit Bank of Texas	1,853,997	1,468,618	3,645,321	2,865,323
Net interest income	3,524,828	3,309,740	7,086,700	6,595,200
<u>PROVISION FOR LOAN LOSSES (LOAN LOSS REVERSAL)</u>				
	87,515	37,905	127,282	(45,241)
Net interest income after provision for loan losses (loan loss reversal)	3,437,313	3,271,835	6,959,418	6,640,441
<u>NONINTEREST INCOME</u>				
Income from the Farm Credit Bank of Texas:				
Patronage income	326,250	277,332	644,318	546,313
Loan fees	49,269	4,541	85,640	28,086
Financially related services income	1,440	1,823	4,568	4,726
Gain on other property owned, net	-	3,999	-	4,109
Other noninterest income	15,260	21,462	15,260	21,462
Total noninterest income	392,219	309,157	749,786	604,696
<u>NONINTEREST EXPENSES</u>				
Salaries and employee benefits	865,098	859,450	1,756,075	1,705,712
Directors' expense	34,591	36,487	67,833	67,314
Purchased services	41,966	27,344	88,854	85,710
Travel	57,494	46,887	102,507	82,219
Occupancy and equipment	76,115	52,179	139,514	120,379
Communications	28,800	28,850	56,011	56,570
Advertising	76,106	56,976	139,570	139,457
Public and member relations	36,507	36,418	101,589	88,460
Supervisory and exam expense	-	29,657	40,871	68,317
Insurance Fund premiums	144,528	97,654	327,294	194,263
Other noninterest expense	56,040	60,114	166,672	115,212
Total noninterest expenses	1,417,245	1,332,016	2,986,790	2,723,613
NET INCOME	2,412,287	2,248,976	4,722,414	4,521,524
Other comprehensive (loss) income:				
Change in postretirement benefit plans	(2,493)	4,617	(4,986)	9,234
COMPREHENSIVE INCOME	\$ 2,409,794	\$ 2,253,593	\$ 4,717,428	\$ 4,530,758

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

CENTRAL TEXAS FARM CREDIT, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

(unaudited)

	<u>Capital Stock/ Participation Certificates</u>	<u>Retained Earnings Unallocated</u>	<u>Accumulated Other Comprehensive Loss</u>	<u>Total Members' Equity</u>
Balance at December 31, 2014	\$ 2,149,055	\$ 95,250,739	\$ (421,702)	\$ 96,978,092
Comprehensive income	-	4,521,524	9,234	4,530,758
Capital stock/participation certificates issued	159,940	-	-	159,940
Capital stock/participation certificates and allocated retained earnings retired	(135,605)	-	-	(135,605)
Patronage refunds:				
Cash	-	13	-	13
Balance at June 30, 2015	<u>\$ 2,173,390</u>	<u>\$ 99,772,276</u>	<u>\$ (412,468)</u>	<u>\$ 101,533,198</u>
Balance at December 31, 2015	\$ 2,232,325	\$ 98,715,418	\$ (197,886)	\$ 100,749,857
Comprehensive income	-	4,722,414	(4,986)	4,717,428
Capital stock/participation certificates issued	156,500	-	-	156,500
Capital stock/participation certificates and allocated retained earnings retired	(143,085)	-	-	(143,085)
Balance at June 30, 2016	<u>\$ 2,245,740</u>	<u>\$ 103,437,832</u>	<u>\$ (202,872)</u>	<u>\$ 105,480,700</u>

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

CENTRAL TEXAS FARM CREDIT, ACA
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

The Central Texas Farm Credit, ACA (Agricultural Credit Association), referred to as the Association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves the counties of Baylor, Brown, Callahan, Coke, Coleman, Comanche, Concho, Haskell, Irion, Jones, Knox, McCulloch, Menard, Mills, Reagan, Runnels, San Saba, Sterling, and Tom Green. The Association is a lending institution of the Farm Credit System (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, 2015, as contained in the 2015 Annual Report to Stockholders.

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. These interim financial statements should be read in conjunction with the audited financial statements as of and for the year ended December 31, 2015, as contained in the 2015 Annual Report to Stockholders. 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, 2016. Descriptions of the significant accounting policies are included in the 2015 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.

In June 2016, the Financial Accounting Standards Board (FASB) issued guidance entitled “Measurement of Credit Losses on Financial Instruments.” 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. For public business entities that are not U.S. Securities and Exchange Commission filers this guidance becomes effective for interim and annual periods beginning after December 15, 2020, with early application permitted. The Association is currently evaluating the impact of adoption on its financial condition and results of operations.

In February 2016, the FASB issued guidance entitled “Leases.” The guidance requires the recognition by lessees of lease assets and lease liabilities on the balance sheet for the rights and obligations created by those leases. Leases with lease terms of more than 12 months are impacted by this guidance. This guidance becomes effective for interim and annual periods beginning after December 15, 2018, with early application permitted. The Association is currently evaluating the impact of adoption on its financial condition and results of operations.

In January 2016, the FASB issued guidance entitled “Recognition and Measurement of Financial Assets and Liabilities.” This guidance affects, among other things, the presentation and disclosure requirements for financial instruments. For public entities, the guidance eliminates the requirement to disclose the methods and significant assumptions used to estimate the fair value of financial instruments carried at amortized cost. This guidance becomes effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance is not expected to impact the Association’s financial condition or its results of operations.

In August 2014, the FASB issued guidance entitled “Presentation of Financial Statements - Going Concern.” The guidance governs management’s responsibility to evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern and to provide related footnote disclosures. This guidance requires management to perform interim and annual assessments of an entity’s ability to continue as a going concern within one year after the date the financial statements are issued or within one year after the financial statements are available to be issued, when applicable. Substantial doubt exists if it is probable that the entity will be unable to meet its obligations for the assessed period. This guidance becomes effective for interim and annual periods ending after December 15, 2016, and early application is permitted. Management will be required to make its initial assessment as of December 31, 2016. The Association is currently evaluating a potential disclosure for this recent accounting pronouncement.

In May 2014, the FASB issued guidance entitled, “Revenue from Contracts with Customers.” The guidance governs revenue recognition from contracts with customers and requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Financial instruments and other contractual rights within the scope of other guidance issued by the FASB are excluded from the scope of this new revenue recognition guidance. In this regard, a majority of our contracts would be excluded from the scope of this new guidance. In August 2015, the FASB issued an update that defers this guidance by one year, which results in the new revenue standard becoming effective for interim and annual reporting periods beginning after December 15, 2017. The Association is in the process of reviewing contracts to determine the effect, if any, on their financial condition or results of operations.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The preparation of these consolidated financial statements requires the use of management’s estimates. The results for the quarter ended June 30, 2016, are not necessarily indicative of the results to be expected for the year ended December 31, 2016. Certain amounts in the prior period’s financial statements have been reclassified to conform to current financial statement presentation.

NOTE 2 — LOANS AND ALLOWANCE FOR LOAN LOSSES:

A summary of loans follows:

Loan Type	June 30,	December 31,
	2016	2015
	Amount	Amount
Real estate mortgage	\$ 339,262,598	\$ 331,347,509
Production and intermediate term	52,699,721	55,905,333
Agribusiness:		
Processing and marketing	50,083,587	46,294,150
Farm-related business	12,888,359	13,159,218
Loans to cooperatives	4,283,381	769,374
Communication	14,122,455	12,649,114
Energy	13,909,118	15,072,698
Rural residential real estate	2,151,642	1,881,798
Water and waste water	1,266,932	1,296,418
Total	\$ 490,667,793	\$ 478,375,612

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 June 30, 2016:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Agribusiness	\$ 53,092,604	\$ -	\$ -	\$ -	\$ 53,092,604	\$ -
Communication	14,122,455	-	-	-	14,122,455	-
Real estate mortgage	14,096,218	14,997,038	-	-	14,096,218	14,997,038
Energy	13,909,118	-	-	-	13,909,118	-
Production and intermediate term	5,886,192	2,050,256	-	-	5,886,192	2,050,256
Water and waste water	1,266,932	-	-	-	1,266,932	-
Total	\$ 102,373,519	\$ 17,047,294	\$ -	\$ -	\$ 102,373,519	\$ 17,047,294

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. There were no ACPs at June 30, 2016. There were \$6,604 of ACPs at December 31, 2015.

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

	June 30, 2016	December 31, 2015
Nonaccrual loans:		
Real estate mortgage	\$ 1,153,955	\$ 523,110
Total nonaccrual loans	1,153,955	523,110
Total nonperforming loans	1,153,955	523,110
Other property owned	129,075	129,075
Total nonperforming assets	\$ 1,283,030	\$ 652,185

One credit quality indicator utilized by the Association is the Farm Credit Administration Uniform Loan Classification System that categorizes loans into five categories. The categories are defined as follows:

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

The following table shows loans and related accrued interest as a percentage of total loans and related accrued interest receivable by loan type as of:

	June 30, 2016	December 31, 2015
Real estate mortgage		
Acceptable	98.7 %	99.1 %
OAEM	0.9	0.8
Substandard/doubtful	0.4	0.1
	100.0	100.0
Production and intermediate term		
Acceptable	97.2	98.8
OAEM	1.8	1.2
Substandard/doubtful	1.0	-
	100.0	100.0
Agribusiness		
Acceptable	97.7	97.1
OAEM	2.3	2.9
Substandard/doubtful	-	-
	100.0	100.0
Communication		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	100.0	100.0
Energy		
Acceptable	88.7	100.0
OAEM	11.3	-
Substandard/doubtful	-	-
	100.0	100.0
Rural residential real estate		
Acceptable	97.2	96.7
OAEM	2.8	3.3
Substandard/doubtful	-	-
	100.0	100.0
Water and waste water		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	100.0	100.0
Total loans		
Acceptable	98.2	98.8
OAEM	1.4	1.1
Substandard/doubtful	0.4	0.1
	100.0 %	100.0 %

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

June 30, 2016	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 >90 Days and Accruing
Real estate mortgage	\$ 954,649	\$ 728,329	\$ 1,682,978	\$ 341,257,382	\$ 342,940,360	\$ -
Production and intermediate term	278,571	-	278,571	53,065,323	53,343,894	-
Processing and marketing	-	-	-	50,174,116	50,174,116	-
Farm-related business	-	-	-	12,892,702	12,892,702	-
Loans to cooperatives	-	-	-	4,283,770	4,283,770	-
Communication	-	-	-	14,127,153	14,127,153	-
Energy	-	-	-	13,925,477	13,925,477	-
Rural residential real estate	-	-	-	2,179,079	2,179,079	-
Water and waste water	-	-	-	1,267,184	1,267,184	-
Total	\$ 1,233,220	\$ 728,329	\$ 1,961,549	\$ 493,172,186	\$ 495,133,735	\$ -
December 31, 2015	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 >90 Days and Accruing
Real estate mortgage	\$ 1,756,554	\$ 270,519	\$ 2,027,073	\$ 332,636,778	\$ 334,663,851	\$ -
Production and intermediate term	33,539	-	33,539	56,451,131	56,484,670	-
Processing and marketing	-	-	-	46,384,762	46,384,762	-
Farm-related business	-	-	-	13,164,739	13,164,739	-
Loans to cooperatives	-	-	-	769,711	769,711	-
Communication	-	-	-	12,656,856	12,656,856	-
Energy	-	-	-	15,087,088	15,087,088	-
Rural residential real estate	-	-	-	1,904,786	1,904,786	-
Water and waste water	-	-	-	1,296,597	1,296,597	-
Total	\$ 1,790,093	\$ 270,519	\$ 2,060,612	\$ 480,352,448	\$ 482,413,060	\$ -

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

A restructuring of a debt constitutes a troubled debt restructuring if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Troubled debt restructurings are undertaken in order to improve the likelihood of recovery on the loan and may include, but are not limited to, forgiveness of principal or interest, interest rate reductions that are lower than the current market rate for new debt with similar risk, or significant term or payment extensions.

As of June 30, 2016, the Association had no troubled debt restructured loans. In restructuring where principal is forgiven, the amount of forgiveness is immediately charged off. In restructurings where accrued interest is forgiven, the interest is reversed (if current year interest) or charged off (if prior year interest).

The predominant form of concession granted for troubled debt restructuring is extension of the term. Other types of modifications include principal or accrued interest reductions, interest rate decreases and delayed payments, among others. At times, these terms might be offset with incremental payments, collateral or new borrower guarantees, in which case we assess all of the modified terms to determine if the overall modification qualifies as a troubled debt restructuring.

Additional impaired loan information is as follows:

	June 30, 2016			December 31, 2015		
	Recorded Investment	Unpaid Principal Balance ^a	Related Allowance	Recorded Investment	Unpaid Principal Balance ^a	Related Allowance
Impaired loans with a related allowance for credit losses:						
Real estate mortgage	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Total	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	\$ 1,153,955	\$ 1,154,041	\$ -	\$ 523,110	\$ 523,143	\$ -
Total	\$ 1,153,955	\$ 1,154,041	\$ -	\$ 523,110	\$ 523,143	\$ -
Total impaired loans:						
Real estate mortgage	\$ 1,153,955	\$ 1,154,041	\$ -	\$ 523,110	\$ 523,143	\$ -
Total	\$ 1,153,955	\$ 1,154,041	\$ -	\$ 523,110	\$ 523,143	\$ -

^a Unpaid principal balance represents the recorded principal balance of the loan.

	For the Three Months Ended				For the Six Months Ended			
	June 30, 2016		June 30, 2015		June 30, 2016		June 30, 2015	
	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:								
Real estate mortgage	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Total	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Impaired loans with no related allowance for credit losses:								
Real estate mortgage	\$ 1,152,926	\$ -	\$ 217,557	\$ 1,716	\$ 840,122	\$ -	\$ 126,290	\$ 1,340
Total	\$ 1,152,926	\$ -	\$ 217,557	\$ 1,716	\$ 840,122	\$ -	\$ 126,290	\$ 1,340
Total impaired loans:								
Real estate mortgage	\$ 1,152,926	\$ -	\$ 217,557	\$ 1,716	\$ 840,122	\$ -	\$ 126,290	\$ 1,340
Total	\$ 1,152,926	\$ -	\$ 217,557	\$ 1,716	\$ 840,122	\$ -	\$ 126,290	\$ 1,340

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

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communications	Energy	Rural Residential Real Estate	Water and Waste Water	Total
Allowance for Credit Losses:								
Balance at								
March 31, 2016	\$ 196,084	\$ 235,267	\$ 267,766	\$ 108,673	\$ 158,314	\$ 1,376	\$ 10,564	\$ 978,044
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-	-
Provision for loan losses	(5,978)	18,595	49,361	3,963	21,534	336	(296)	87,515
Other	816	(2,396)	(10,629)	(1,011)	(132)	(102)	(764)	(14,218)
Balance at								
June 30, 2016	\$ 190,922	\$ 251,466	\$ 306,498	\$ 111,625	\$ 179,716	\$ 1,610	\$ 9,504	\$ 1,051,341
Balance at								
December 31, 2015	\$ 215,062	\$ 218,497	\$ 252,003	\$ 104,613	\$ 161,844	\$ 1,601	\$ 10,607	\$ 964,227
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-	-
Provision for loan losses	(24,956)	65,382	62,571	8,106	16,421	111	(353)	127,282
Other	816	(32,413)	(8,076)	(1,094)	1,451	(102)	(750)	(40,168)
Balance at								
June 30, 2016	\$ 190,922	\$ 251,466	\$ 306,498	\$ 111,625	\$ 179,716	\$ 1,610	\$ 9,504	\$ 1,051,341
Ending Balance:								
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	190,922	251,466	306,498	111,625	179,716	1,610	9,504	1,051,341
Balance at								
June 30, 2016	\$ 190,922	\$ 251,466	\$ 306,498	\$ 111,625	\$ 179,716	\$ 1,610	\$ 9,504	\$ 1,051,341
Balance at								
March 31, 2015	\$ 158,983	\$ 151,469	\$ 98,516	\$ 21,504	\$ 40,942	\$ 1,206	\$ 1,572	\$ 474,192
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-	-
Provision for loan losses	17,365	11,775	5,705	(461)	(199)	103	3,617	37,905
Other	-	15,671	2,540	31	13	-	(1,389)	16,866
Balance at June 30, 2015	\$ 176,348	\$ 178,915	\$ 106,761	\$ 21,074	\$ 40,756	\$ 1,309	\$ 3,800	\$ 528,963
Balance at								
December 31, 2014	\$ 197,179	\$ 220,963	\$ 96,213	\$ 21,612	\$ 33,922	\$ 1,318	\$ 1,575	\$ 572,782
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-	-
Provision for loan losses	(20,831)	(37,493)	2,402	(1,193)	8,275	(9)	3,608	(45,241)
Other	-	(4,555)	8,146	655	(1,441)	-	(1,383)	1,422
Balance at								
June 30, 2015	\$ 176,348	\$ 178,915	\$ 106,761	\$ 21,074	\$ 40,756	\$ 1,309	\$ 3,800	\$ 528,963
Ending Balance:								
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	176,348	178,915	106,761	21,074	40,756	1,309	3,800	528,963
Balance at								
June 30, 2015	\$ 176,348	\$ 178,915	\$ 106,761	\$ 21,074	\$ 40,756	\$ 1,309	\$ 3,800	\$ 528,963
Recorded Investments in Loans Outstanding:								
Ending Balance at								
June 30, 2016	\$ 342,940,360	\$ 53,343,894	\$ 67,350,588	\$ 14,127,153	\$ 13,925,477	\$ 2,179,079	\$ 1,267,184	\$ 495,133,735
Individually evaluated for impairment	\$ 1,153,955	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,153,955
Collectively evaluated for impairment	\$ 341,786,405	\$ 53,343,894	\$ 67,350,588	\$ 14,127,153	\$ 13,925,477	\$ 2,179,079	\$ 1,267,184	\$ 493,979,780
Ending Balance at								
June 30, 2015	\$ 316,726,759	\$ 46,417,384	\$ 46,519,326	\$ 10,832,985	\$ 14,574,647	\$ 1,876,909	\$ 1,382,748	\$ 438,330,758
Individually evaluated for impairment	\$ 307,393	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 307,393
Collectively evaluated for impairment	\$ 316,419,366	\$ 46,417,384	\$ 46,519,326	\$ 10,832,985	\$ 14,574,647	\$ 1,876,909	\$ 1,382,748	\$ 438,023,365

NOTE 3 — CAPITAL:

The Association's board of directors 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 dividends, 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 of directors 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 portfolio; 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.

An additional component of equity is accumulated other comprehensive loss, which is reported net of taxes, is as follows:

June 30, 2016	Net of Tax
Nonpension postretirement benefits	\$ 202,872
Total	\$ 202,872

June 30, 2015	Net of Tax
Nonpension postretirement benefits	\$ (412,468)
Total	\$ (412,468)

The Association's accumulated other comprehensive loss relates entirely to its nonpension other postretirement benefits. Amortization of prior service credits cost and of actuarial loss are reflected in "Salaries and employee benefits" in the consolidated statement of comprehensive income. The following table summarizes the changes in accumulated other comprehensive income loss for the six months ended June 30:

	<u>2016</u>	<u>2015</u>
Accumulated other comprehensive income (loss) at January 1	\$ (197,886)	\$ (421,702)
Amortization of prior service credit included in salaries and employee benefits	(4,986)	(9,018)
Amortization of actuarial loss included in salaries and employee benefits	-	18,252
Other comprehensive (loss) income, net of tax	(4,986)	9,234
Accumulated other comprehensive loss at June 30	<u>\$ (202,872)</u>	<u>\$ (412,468)</u>

NOTE 4 — INCOME TAXES:

Central Texas Farm Credit, 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. Central Texas Farm Credit, ACA operates as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, Central Texas Farm Credit, ACA can exclude from taxable income amounts distributed as qualified patronage dividends 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 dividends. 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. The Association's valuation allowance was \$1,153,778 as of the quarter ended June 30, 2016, for no available tax benefit as of that point in time.

The subsidiary, Central Texas Federal Land Bank, FLCA, is exempt from federal and other income taxes as provided in the Farm Credit Act of 1971.

NOTE 5 — 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 13 to the 2015 Annual Report to Stockholders for a more complete description.

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

<u>June 30, 2016</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Loans*	\$ -	\$ -	\$ -	\$ -
Other property owned	-	-	129,075	129,075
<u>December 31, 2015</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Loans*	\$ -	\$ -	\$ -	\$ -
Other property owned	-	-	129,075	129,075

*Represents the fair value of certain loans that were evaluated for impairment under authoritative guidance “Accounting by Creditors for Impairment of a Loan.” The fair value was based upon the underlying collateral since these were collateral-dependent loans for which real estate is the collateral.

Information About Nonrecurring Level 3 Fair Value Measurements

With regard to nonrecurring measurements for 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 take into account unobservable inputs, such as income and expense, comparable sales, replacement cost and comparability adjustments.

Valuation Techniques

As more fully discussed in Note 2 to the 2015 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 2015 Annual Report to Stockholders.

Loans Evaluated for Impairment

For certain loans evaluated for impairment under FASB impairment guidance, the fair value is based upon the underlying real estate collateral since the loans were collateral-dependent. 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.

Cash

For cash, the carrying amount is a reasonable estimate of fair value.

NOTE 6 — EMPLOYEE BENEFIT PLANS:

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

	Other Benefits	
	2016	2015
Service cost	\$ 26,897	\$ 30,035
Interest cost	43,889	44,505
Amortization of prior service credits	(8,993)	(9,018)
Amortization of net actuarial loss	4,007	18,252
Net periodic benefit cost	<u>\$ 65,800</u>	<u>\$ 83,774</u>

The Association's liability for the unfunded accumulated obligation for these benefits at June 30, 2016, was \$1,941,688 and is included in "Other Liabilities" in the consolidated balance sheet.

The structure of the District's defined benefit pension plan 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 plan as an expense. As of June 30, 2016, \$122,913 of contributions have been made. The Association presently anticipates contributing an additional \$122,913, to fund the defined benefit pension plan in 2016 for a total of \$245,826.

NOTE 7 — 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 8 — SUBSEQUENT EVENTS:

The Association has evaluated subsequent events through July 29, 2016, which is the date the financial statements were issued. There are no other significant events requiring disclosure as of July 29, 2016.