# LONE STAR, ACA

## 2016
## Quarterly Report
## Third Quarter

## For the Quarter Ended September 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.

Troy Bussmeir, Chief Executive Officer

*November 7, 2016*

Tom Johnson, Chairman, Board of Directors

*November 7, 2016*

M'Lissa Kiel, Chief Financial Officer

*November 7, 2016*

Don Crawford, Chairman, Audit Committee

*November 7, 2016*

# LONE STAR, ACA
# MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the financial performance of the Lone Star, ACA (Agricultural Credit Association), referred to as the association, for the quarter ended September 30, 2016. These comments should be read in conjunction with the accompanying financial statements and the December 31, 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:**

In December 2015, the board of Lone Star, ACA declared a 100 basis point (1.0 percent) cash patronage paid in March of 2016, based on 2015 earnings. The patronage was paid to eligible borrowers based on their average outstanding loan balance for the year ending December 31, 2015. The patronage amount paid was $12,923,433. The association's capital position remains strong and is 18.8 percent for the period ending June 2016.

In 2015, the association paid patronage of $16,220,729, comprised of distributions of $12,105,352, which represents the 100 basis point cash patronage declared in December 2014 by the board of Lone Star, ACA and $4,115,377, which represents the distribution of equities allocated to the stockholders of the former Texas Land Bank, ACA.

Effective January 1, 2014, the association merged with Texas Land Bank, ACA through a business acquisition in accordance with authoritative accounting guidance. Texas Land Bank, ACA was previously headquartered in Waco, TX and served a territory covering 16 counties in Central Texas. The types of loans and commodities financed by Texas Land Bank, ACA were very similar to those of the association. The association's board of directors and management feel this acquisition provided the association with a stronger capital position through higher earnings, an increased market share of agricultural financing and extended an overall improved quality of farm credit lending to its stockholders and territory served.

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

**Loan Portfolio:**

Total loans outstanding at September 30, 2016, including nonaccrual loans and sales contracts, were $1,631,646,523 compared to $1,553,141,676 at December 31, 2015, reflecting an increase of 5.1 percent. Nonaccrual loans as a percentage of total loans outstanding were 0.3 percent at September 30, 2016, compared to 0.4 percent at December 31, 2015.

The association recorded $129,484 in recoveries and $0 in charge-offs for the quarter ended September 30, 2016, and $101,895 in recoveries and $0 in charge-offs for the same period in 2015. The association's allowance for loan losses was 0.4 percent and 0.4 percent of total loans outstanding as of September 30, 2016, and December 31, 2015, respectively.

**Risk Exposure:**

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

| | **September 30, 2016** | | December 31, 2015 | |
|---|---|---|---|---|
| | **Amount** | **%** | Amount | % |
| Nonaccrual | **$ 4,691,240** | **60.6%** | $ 6,386,670 | 98.2% |
| Formally restructured | **3,044,931** | **39.4%** | 39,842 | 0.6% |
| Other property owned, net | **-** | **0.0%** | 78,518 | 1.2% |
| Total | **$ 7,736,171** | **100.0%** | $ 6,505,030 | 100.0% |

**Results of Operations:**

The association had net income of $7,144,178 and $20,998,480 for the three and nine months ended September 30, 2016, as compared to net income of $5,633,753 and $20,000,671 for the same period in 2015, reflecting an increase of 26.8 and 5.0 percent. Net interest income was $11,199,702 and 32,861,691 for the three and nine months ended September 30, 2016, compared to $11,718,513 and $33,049,307 for the same period in 2015.

| | Nine months ended: | | | |
|---|---|---|---|---|
| | **September 30, 2016** | | September 30, 2015 | |
| | **Average Balance** | **Interest** | Average Balance | Interest |
| Loans | **$ 1,606,581,818** | **$ 52,572,558** | $ 1,454,648,324 | $ 50,019,049 |
| Total interest-earning assets | **1,606,581,818** | **52,572,558** | 1,454,648,324 | 50,019,049 |
| Interest-bearing liabilities | **1,287,857,287** | **19,710,867** | 1,143,541,812 | 16,969,742 |
| Impact of capital | **$ 318,724,531** | | $ 311,106,512 | |
| Net interest income | | **$ 32,861,691** | | $ 33,049,307 |

| | **2016 Average Yield** | 2015 Average Yield |
|---|---|---|
| Yield on loans | **4.37%** | 4.60% |
| Total yield on interest-earning assets | **4.37%** | 4.60% |
| Cost of interest-bearing liabilities | **2.04%** | 1.98% |
| Interest rate spread | **2.33%** | 2.61% |
| Net interest income as a percentage of average earning assets | **2.73%** | 3.04% |

| | **Nine months ended: September 30, 2016 vs. September 30, 2015** | | |
|---|---|---|---|
| | **Increase (decrease) due to** | | |
| | **Volume** | **Rate** | **Total** |
| Interest income - loans | **$ 5,229,201** | **$ (2,675,692)** | **$ 2,553,509** |
| Total interest income | **5,229,201** | **(2,675,692)** | **2,553,509** |
| Interest expense | **2,143,611** | **597,514** | **2,741,125** |
| Net interest income | **$ 3,085,590** | **$ (3,273,206)** | **$ (187,616)** |

Interest income for the three and nine months ended September 30, 2016, increased by $350,030 and $2,553,509, or 2.0 and 5.1 percent respectively, from the same period of 2015, primarily due to an increase in average loan volume offset by lower yield on loans. Interest expense for the three and nine months ended September 30, 2016, increased by $868,841 and $2,741,125, or 14.7 and 16.2 percent, from the same period of 2015 due to an increase in average interest-bearing liabilities and rates. Average loan volume for the third quarter of 2016 was $1,632,447,253, compared to $1,487,901,176 in the third quarter of 2015. The average net interest rate spread on the loan portfolio for the third quarter of 2016 was 2.33 percent, compared to 2.71 percent in the third quarter of 2015.

The association's return on average assets for the nine months ended September 30, 2016, was 1.71 percent compared to 1.80 percent for the same period in 2015. The association's return on average equity for the nine months ended September 30, 2016, was 8.29 percent, compared to 8.16 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.

| | **September 30, 2016** | December 31, 2015 |
|---|---|---|
| Note payable to the bank | **$ 1,307,855,999** | $ 1,229,343,523 |
| Accrued interest on note payable | **2,166,139** | 2,027,520 |
| Total | **$ 1,310,022,138** | $ 1,231,371,043 |

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 $1,307,855,999 as of September 30, 2016, is recorded as a liability on the association's balance sheet. The note carried a weighted average interest rate of 1.99 percent at September 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, correlates directly with the overall growth in association accrual loan volume and increased demand for real estate transactions. The association's own funds, which represent the amount of the association's loan portfolio funded by the association's equity, were $324,222,884 at September 30, 2016. The maximum amount the association may borrow from the bank as of September 30, 2016, was $1,633,212,723 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.

**Capital Resources:**

The association's capital position increased by $21,001,826 at September 30, 2016, compared to December 31, 2015. The association's debt as a percentage of members' equity was 3.78:1 as of September 30, 2016, compared to 3.83:1 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 September 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 September 30, 2016, were 18.3 and 18.5 percent, respectively, which is in compliance with the FCA's minimum surplus standard.

**Significant Recent Accounting Pronouncements:**

In August 2016, the Financial Accounting Standards Board (FASB) issued guidance entitled "Classification of Certain Cash Receipts and Cash Payments." The guidance addresses specific cash flow issues with the objective of reducing the diversity in the classification of these cash flows. Included in the cash flow issues are debt prepayment or debt extinguishment costs and settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing. 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 Bank's financial condition or its results of operations but could change the classification of certain items in the statement of cash flows. The Association is currently evaluating the impact of adoption on its financial condition and results of operations. The adoption of this guidance is not expected to impact the Association's financial condition or its results of operations.

In June 2016, the 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. The adoption of this guidance is not expected to impact the Association's financial condition or its 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 adoption of this guidance is not expected to impact the Association's financial condition or its results of operations.

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 adoption of this guidance is not expected to impact the Association's financial condition or its 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. The implementation of this new standard is not expected to impact the Association's financial condition or its results of operations.

**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 Lone Star, 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 Lone Star, ACA, 1612 Summit Avenue, Suite 300, Fort Worth, Texas, 76102 or calling (817)332-6565. Copies of the association's quarterly stockholder reports can also be requested by e-mailing *nick.acosta@lonestaragcredit.com.* The association makes its annual and quarterly stockholder reports available on its website at *www.lonestaragcredit.com*.

**LONE STAR, ACA**

**CONSOLIDATED BALANCE SHEET**

| | September 30, 2016 (unaudited) | December 31, 2015 |
|---|---|---|
| **ASSETS** | | |
| Cash | $ 234,385 | $ 55,698 |
| Loans | 1,631,646,523 | 1,553,141,676 |
| Less: allowance for loan losses | (6,749,503) | (6,817,421) |
| Net loans | 1,624,897,020 | 1,546,324,255 |
| Accrued interest receivable | 10,697,693 | 8,422,280 |
| Investment in and receivable from the Farm Credit Bank of Texas: | | |
| Capital stock | 23,280,780 | 23,280,780 |
| Other | 5,167,719 | 1,047,251 |
| Other property owned, net | - | 78,518 |
| Premises and equipment, net | 3,248,180 | 3,082,233 |
| Other assets | 1,044,939 | 824,830 |
| Total assets | $ 1,668,570,716 | $ 1,583,115,845 |
| **LIABILITIES** | | |
| Note payable to the Farm Credit Bank of Texas | $ 1,307,855,999 | $ 1,229,343,523 |
| Accrued interest payable | 2,166,139 | 2,027,520 |
| Drafts outstanding | 65,166 | 219,479 |
| Dividends payable | - | 12,847,681 |
| Other liabilities | 9,767,410 | 10,963,466 |
| Total liabilities | 1,319,854,714 | 1,255,401,669 |
| **MEMBERS' EQUITY** | | |
| Capital stock and participation certificates | 6,407,760 | 6,339,120 |
| Additional paid-in capital | 91,343,553 | 91,343,553 |
| Allocated retained earnings | 3,000,029 | 3,000,029 |
| Unallocated retained earnings | 248,774,949 | 227,852,221 |
| Accumulated other comprehensive income (loss) | (810,289) | (820,747) |
| Total members' equity | 348,716,002 | 327,714,176 |
| Total liabilities and members' equity | $ 1,668,570,716 | $ 1,583,115,845 |

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

**LONE STAR, ACA**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**
(unaudited)

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2016** | 2015 | **2016** | 2015 |
| **INTEREST INCOME** | | | | |
| Loans | **$ 17,989,043** | $ 17,639,013 | **$ 52,572,558** | $ 50,019,049 |
| Total interest income | **17,989,043** | 17,639,013 | **52,572,558** | 50,019,049 |
| **INTEREST EXPENSE** | | | | |
| Note payable to the Farm Credit Bank of Texas | **6,789,337** | 5,920,498 | **19,710,852** | 16,969,738 |
| Advance conditional payments | **4** | 2 | **15** | 4 |
| Total interest expense | **6,789,341** | 5,920,500 | **19,710,867** | 16,969,742 |
| Net interest income | **11,199,702** | 11,718,513 | **32,861,691** | 33,049,307 |
| **PROVISION FOR LOAN LOSSES** | **(404,248)** | 1,836,582 | (380,557) | 1,467,426 |
| Net interest income after provision for loan losses | **11,603,950** | 9,881,931 | **33,242,248** | 31,581,881 |
| **NONINTEREST INCOME** | | | | |
| Income from the Farm Credit Bank of Texas: | | | | |
| Patronage income | **1,504,342** | 1,367,020 | **4,442,973** | 4,010,547 |
| Loan fees | **75,202** | 100,040 | **240,445** | 362,878 |
| Financially related services income | **2,175** | 2,505 | **8,250** | 8,769 |
| Gain (loss) on other property owned, net | **(54,989)** | 53,122 | **22,187** | 125,337 |
| Gain (loss) on sale of premises and equipment, net | **(486)** | (80) | **(1,114)** | 7,079 |
| Other noninterest income | **49,553** | 17,920 | **206,163** | 198,018 |
| Total noninterest income | **1,575,797** | 1,540,527 | **4,918,904** | 4,712,628 |
| **NONINTEREST EXPENSES** | | | | |
| Salaries and employee benefits | **3,624,562** | 3,807,400 | **10,108,477** | 10,367,860 |
| Directors' expense | **98,200** | 88,606 | **381,554** | 401,440 |
| Purchased services | **281,057** | 203,151 | **821,540** | 613,420 |
| Travel | **215,211** | 225,586 | **605,496** | 558,992 |
| Occupancy and equipment | **342,813** | 293,970 | **1,016,093** | 847,802 |
| Communications | **85,655** | 97,446 | **268,606** | 266,213 |
| Advertising | **215,641** | 198,522 | **597,495** | 651,099 |
| Public and member relations | **332,321** | 249,640 | **833,015** | 655,691 |
| Supervisory and exam expense | **133,933** | 108,305 | **350,543** | 291,316 |
| Insurance Fund premiums | **558,827** | 359,127 | **1,698,250** | 1,226,891 |
| Provisions for acquired property losses | **-** | - | **-** | 13,818 |
| Other noninterest expense | **147,474** | 173,476 | **471,964** | 440,157 |
| Total noninterest expenses | **6,035,694** | 5,805,229 | **17,153,033** | 16,334,699 |
| Income before income taxes | **7,144,053** | 5,617,229 | **21,008,119** | 19,959,810 |
| Provision for (benefit from) income taxes | **(125)** | (16,524) | **9,639** | (40,861) |
| **NET INCOME** | **7,144,178** | 5,633,753 | **20,998,480** | 20,000,671 |
| Other comprehensive income: | | | | |
| Change in postretirement benefit plans | **3,486** | 9,357 | **10,458** | 28,071 |
| Other comprehensive income, net of tax | **3,486** | 9,357 | **10,458** | 28,071 |
| **COMPREHENSIVE INCOME** | **$ 7,147,664** | $ 5,643,110 | **$ 21,008,938** | $ 20,028,742 |

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

**LONE STAR, ACA**

**CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY**

(unaudited)

| | Capital Stock/ Participation Certificates | Additional Paid-in-Capital | Retained Earnings Allocated | Retained Earnings Unallocated | Accumulated Other Comprehensive Income (Loss) | Total Members' Equity |
|---|---|---|---|---|---|---|
| Balance at December 31, 2014 | $ 6,366,550 | $ 91,343,553 | $ 7,115,406 | $ 213,132,634 | $ (1,335,657) | $ 316,622,486 |
| Comprehensive income | - | - | - | 20,000,671 | 28,071 | 20,028,742 |
| Capital stock/participation certificates and allocated retained earnings issued | 617,495 | - | - | - | - | 617,495 |
| Capital stock/participation certificates and allocated retained earnings retired | (631,745) | - | - | - | - | (631,745) |
| Balance at September 30, 2015 | $ 6,352,300 | $ 91,343,553 | $ 7,115,406 | $ 233,133,305 | $ (1,307,586) | $ 336,636,978 |
| | | | | | | |
| Balance at December 31, 2015 | $ 6,339,120 | $ 91,343,553 | $ 3,000,029 | $ 227,852,221 | $ (820,747) | $ 327,714,176 |
| Comprehensive income | - | - | - | 20,998,480 | 10,458 | 21,008,938 |
| Capital stock/participation certificates and allocated retained earnings issued | 663,680 | - | - | - | - | 663,680 |
| Capital stock/participation certificates and allocated retained earnings retired | (595,040) | - | - | - | - | (595,040) |
| Patronage refunds: | | | | | | |
| Cash | - | - | - | (75,752) | - | (75,752) |
| **Balance at September 30, 2016** | **$ 6,407,760** | **$ 91,343,553** | **$ 3,000,029** | **$ 248,774,949** | **$ (810,289)** | **$ 348,716,002** |

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

## NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

The Lone Star, 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 Bell, Borden, Bosque, Bowie, Burnet, Camp, Cass, Cooke, Coryell, Dallas, Delta, Denton, Eastland, Ellis, Erath, Falls, Fannin, Fisher, Freestone, Grayson, Hamilton, Hill, Hood, Johnson, Kent, Lamar, Lampasas, Limestone, McLennan, Milam, Mitchell, Morris, Navarro, Nolan, Palo Pinto, Parker, Red River, Scurry, Shackelford, Somerville, Stephens, Tarrant, Taylor, Throckmorton, Titus, Williamson, Wise and Young in the state of Texas.

Effective January 1, 2014, the association merged with Texas Land Bank, ACA. The primary reason for the merger was based on a determination that the combined organization would be financially and operationally stronger than either association on a stand-alone basis. The merger was accounted for under the acquisition method of accounting.

Since the association operates for the mutual benefit of its customer-owners and other customers and not for the benefit of any other equity investors, capital stock provides no significant interest in corporate earnings or growth. Specifically, due to restrictions in applicable regulations and their bylaws, the associations can issue stock only at its par value of $5 per share, the stock is not tradable, and the stock can be retired only for the lesser of par value or book value. In these and other respects, the shares of stock in one association that were converted to shares of another association had identical rights and attributes. For this reason, the conversion of stock pursuant to the merger occurred at a one-for-one exchange ratio. Management believes that because the stock in each association is fixed in value, the stock issued pursuant to the merger provides no basis for estimating the fair value of the consideration transferred pursuant to the merger. In the absence of a purchase price determination, the acquiring association identified and estimated the acquisition date fair value of the net assets of the acquired association instead of the acquisition date fair value of the equity interests transferred as consideration. The fair value of the assets acquired, including specific intangible assets and liabilities assumed, were measured based on various estimates using assumptions that management believes are reasonable utilizing information currently available. This evaluation produced a fair value of identifiable assets acquired and liabilities assumed that was substantially equal to the fair value of the member interests transferred in the merger. The excess value received, by the acquiring association from the acquired association, over the par value of capital stock and participation certificates issued in the merger is considered to be additional paid-in capital.

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 August 2016, the Financial Accounting Standards Board (FASB) issued guidance entitled "Classification of Certain Cash Receipts and Cash Payments." The guidance addresses specific cash flow issues with the objective of reducing the diversity in the classification of these cash flows. Included in the cash flow issues are debt prepayment or debt extinguishment costs and settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing. 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 Bank's financial condition or its results of operations but could change the classification of certain items in the statement of cash flows. The adoption of this guidance is not expected to impact the Association's financial condition or its results of operations.

In June 2016, 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. The adoption of this guidance is not expected to impact the Association's financial condition or its 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. The adoption of this guidance is not expected to impact the Association's financial condition or its 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 adoption of this guidance is not expected to impact the Association's financial condition or its results of operations.

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 adoption of this guidance is not expected to impact the Association's financial condition or its 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 September 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 | **September 30, 2016 Amount** | December 31, 2015 Amount |
|---|---|---|
| Production agriculture: | | |
| Real estate mortgage | **$ 1,276,925,260** | $ 1,203,918,222 |
| Production and intermediate term | **121,130,471** | 127,913,676 |
| Agribusiness: | | |
| Loans to cooperatives | **15,339,492** | 5,281,321 |
| Processing and marketing | **126,096,857** | 114,463,149 |
| Farm-related business | **18,336,788** | 17,751,374 |
| Communication | **1,143,069** | 5,627,078 |
| Energy | **49,522,221** | 52,821,315 |
| Water and waste water | **5,489,319** | 5,505,528 |
| Rural residential real estate | **17,663,046** | 19,860,013 |
| Total | **$ 1,631,646,523** | $ 1,553,141,676 |

The association purchases or sells participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration regulations. The following table presents information regarding the balances of participations purchased and sold at September 30, 2016:

| | Other Farm Credit Institutions | | Total | |
|---|---|---|---|---|
| | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold |
| Real estate mortgage | $ 23,037,447 | $ 25,555,885 | $ 23,037,447 | $ 25,555,885 |
| Production and intermediate term | 30,471,813 | 689,530 | 30,471,813 | 689,530 |
| Agribusiness | 146,626,951 | - | 146,626,951 | - |
| Communication | 1,143,069 | - | 1,143,069 | - |
| Energy | 49,522,221 | - | 49,522,221 | - |
| Water and waste water | 5,489,319 | - | 5,489,319 | - |
| Total | $ 256,290,820 | $ 26,245,415 | $ 256,290,820 | $ 26,245,415 |

The association is authorized under the Farm Credit Act to accept "advance conditional payments" (ACPs) from borrowers. To the extent the borrower's access to such ACPs is restricted and the legal right of setoff exists, the ACPs are netted against the borrower's related loan balance. Unrestricted advance conditional payments are included in other liabilities. ACPs are not insured, and interest is generally paid by the association on such balances. Balances of ACPs were $13,601,176 and $9,220,734 at September 30, 2016, and December 31, 2015, respectively.

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

| | **September 30, 2016** | December 31, 2015 |
|---|---|---|
| **Nonaccrual loans:** | | |
| Real estate mortgage | **$ 3,733,282** | $ 6,213,342 |
| Production and intermediate term | **56,702** | 21,576 |
| Rural residential real estate | **901,256** | 151,752 |
| Total nonaccrual loans | **4,691,240** | 6,386,670 |
| | | |
| **Accruing restructured loans:** | | |
| Real estate mortgage | **3,044,931** | 35,213 |
| Production and intermediate term | **-** | 4,629 |
| Total accruing restructured loans | **3,044,931** | 39,842 |
| | | |
| Total nonperforming loans | **7,736,171** | 6,426,512 |
| Other property owned | **-** | 78,518 |
| Total nonperforming assets | **$ 7,736,171** | $ 6,505,030 |

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:

| | **September 30, 2016** | December 31, 2015 |
|---|---|---|
| Real estate mortgage | | |
| Acceptable | **98%** | 97% |
| OAEM | **1%** | 2% |
| Substandard/doubtful | **1%** | 1% |
| | **100%** | 100% |
| Production and intermediate term | | |
| Acceptable | **97%** | 100% |
| OAEM | **2%** | 0% |
| Substandard/doubtful | **1%** | 0% |
| | **100%** | 100% |
| Agribusiness | | |
| Acceptable | **97%** | 97% |
| OAEM | **3%** | 3% |
| Substandard/doubtful | **0%** | 0% |
| | **100%** | 100% |
| Energy and water/waste water | | |
| Acceptable | **98%** | 100% |
| OAEM | **2%** | 0% |
| Substandard/doubtful | **0%** | 0% |
| | **100%** | 100% |
| Communication | | |
| Acceptable | **100%** | 81% |
| OAEM | **0%** | 0% |
| Substandard/doubtful | **0%** | 19% |
| | **100%** | 100% |
| Rural residential real estate | | |
| Acceptable | **92%** | 93% |
| OAEM | **1%** | 1% |
| Substandard/doubtful | **7%** | 6% |
| | **100%** | 100% |
| Total loans | | |
| Acceptable | **97%** | 97% |
| OAEM | **2%** | 2% |
| Substandard/doubtful | **1%** | 1% |
| | **100%** | 100% |

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

| **September 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** |
|---|---|---|---|---|---|
| **Real estate mortgage** | **$ 3,743,018** | **$ 873,936** | **$ 4,616,954** | **$ 1,281,597,316** | **$ 1,286,214,270** |
| **Production and intermediate term** | **120,769** | **56,702** | **177,471** | **121,928,512** | **122,105,983** |
| **Loans to cooperatives** | **-** | **-** | **-** | **15,364,187** | **15,364,187** |
| **Processing and marketing** | **-** | **-** | **-** | **126,224,130** | **126,224,130** |
| **Farm-related business** | **-** | **-** | **-** | **18,404,240** | **18,404,240** |
| **Communication** | **-** | **-** | **-** | **1,143,141** | **1,143,141** |
| **Energy** | **-** | **-** | **-** | **49,687,086** | **49,687,086** |
| **Water and waste water** | **-** | **-** | **-** | **5,495,698** | **5,495,698** |
| **Rural residential real estate** | **11,552** | **712,698** | **724,250** | **16,981,231** | **17,705,481** |
| **Total** | **$ 3,875,339** | **$ 1,643,336** | **$ 5,518,675** | **$ 1,636,825,541** | **$ 1,642,344,216** |

| 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 |
|---|---|---|---|---|---|
| Real estate mortgage | $ 580,298 | $ 385,948 | $ 966,246 | $ 1,210,322,703 | $ 1,211,288,949 |
| Production and intermediate term | 1,004 | 20,628 | 21,632 | 128,556,293 | 128,577,925 |
| Loans to cooperatives | - | - | - | 5,297,043 | 5,297,043 |
| Processing and marketing | - | - | - | 114,554,886 | 114,554,886 |
| Farm-related business | - | - | - | 17,798,766 | 17,798,766 |
| Communication | - | - | - | 5,628,201 | 5,628,201 |
| Energy | - | - | - | 52,990,544 | 52,990,544 |
| Water and waste water | - | - | - | 5,509,822 | 5,509,822 |
| Rural residential real estate | 831,640 | - | 831,640 | 19,086,180 | 19,917,820 |
| Total | $ 1,412,942 | $ 406,576 | $ 1,819,518 | $ 1,559,744,438 | $ 1,561,563,956 |

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 September 30, 2016, the total recorded investment of troubled debt restructured loans was $3,363,784, including $318,853 classified as nonaccrual and $3,044,931 classified as accrual, with no specific allowance for loan losses. As of September 30, 2016, there were no commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring at period end and at December 31, 2015.

The following tables present additional information regarding troubled debt restructurings, which includes both accrual and nonaccrual loans with troubled debt restructuring designation, that occurred during the three and nine months ended September 30, 2016. The premodification outstanding recorded investment represents the recorded investment of the loans as of the quarter end prior to the restructuring. The postmodification outstanding recorded investment represents the recorded investment of the loans as of the quarter end the restructuring occurred. Loans formally restructured prior to January 1, 2016, were $3,275,340.

There were no loans with troubled debt restructuring designation that occurred during the three months ended September 30, 2016.

| For the Three Months Ended September 30, 2015 | Premodification Outstanding Recorded Investment | Postmodification Outstanding Recorded Investment |
|---|---|---|
| Troubled debt restructurings: | | |
| Real estate mortgage | $ 71,714 | $ 70,681 |
| Total | $ 71,714 | $ 70,681 |

| For the Nine Months Ended September 30, 2016 | Premodification Outstanding Recorded Investment | Postmodification Outstanding Recorded Investment |
|---|---|---|
| Troubled debt restructurings: | | |
| Real estate mortgage | $ 86,863 | $ 85,388 |
| Total | $ 86,863 | $ 85,388 |

| For the Nine Months Ended September 30, 2015 | Premodification Outstanding Recorded Investment | Postmodification Outstanding Recorded Investment |
|---|---|---|
| Troubled debt restructurings: | | |
| Real estate mortgage | $ 71,714 | $ 70,681 |
| Total | $ 71,714 | $ 70,681 |

In restructurings where principal is forgiven, the amount of the 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). There were no restructurings where principal was forgiven that required a charge off, at the modification date, for the quarter ending September 30, 2016.

The predominate form of concession granted for troubled debt restructuring includes a delay in the repayment of principal. At times these terms might be offset with incremental payments, collateral or new borrower guarantees, in which case the association assesses all of the modified terms to determine if the overall modification qualifies as a troubled debt restructuring.

At September 30, 2016, the association had no loans that met the accounting criteria as a troubled debt restructuring and that occurred within the previous 12 months of that year and for which there was a payment default during the period. A payment default is defined as a payment that is 30 days past due after the date the loan was restructured.

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

| | Loans Modified as TDRs | | TDRs in Nonaccrual Status* | |
|---|---|---|---|---|
| | September 30, 2016 | December 31, 2015 | September 30, 2016 | December 31, 2015 |
| Real estate mortgage | $ 3,363,784 | $ 4,123,426 | $ 318,852 | $ 4,088,213 |
| Production and intermediate term | - | 4,629 | - | - |
| Total | $ 3,363,784 | $ 4,128,055 | $ 318,852 | $ 4,088,213 |

*represents the portion of loans modified as TDRs that are in nonaccrual status

Additional impaired loan information is as follows:

| | **September 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 | **$ 820,285** | **$ 842,447** | **$ 64,384** | $ 158,029 | $ 158,029 | $ 40,866 |
| Production and intermediate term | **45,051** | **45,051** | **-** | - | - | - |
| Energy and water/waste water | **-** | **-** | **-** | - | - | - |
| Rural residential real estate | **-** | **-** | **-** | - | - | - |
| Total | **$ 865,336** | **$ 887,498** | **$ 64,384** | $ 158,029 | $ 158,029 | $ 40,866 |
| Impaired loans with no related allowance for credit losses: | | | | | | |
| Real estate mortgage | **$ 5,957,928** | **$ 6,065,240** | **$ -** | $ 6,090,526 | $ 6,187,062 | $ - |
| Production and intermediate term | **11,651** | **344,225** | **-** | 26,205 | 418,417 | - |
| Energy and water/waste water | **-** | **-** | **-** | - | 1,706,959 | - |
| Rural residential real estate | **901,256** | **901,449** | **-** | 151,752 | 151,946 | - |
| Total | **$ 6,870,835** | **$ 7,310,914** | **$ -** | $ 6,268,483 | $ 8,464,384 | $ - |
| Total impaired loans: | | | | | | |
| Real estate mortgage | **$ 6,778,213** | **$ 6,907,687** | **$ 64,384** | $ 6,248,555 | $ 6,345,091 | $ 40,866 |
| Production and intermediate term | **56,702** | **389,276** | **-** | 26,205 | 418,417 | - |
| Energy and water/waste water | **-** | **-** | **-** | - | 1,706,959 | - |
| Rural residential real estate | **901,256** | **901,449** | **-** | 151,752 | 151,946 | - |
| Total | **$ 7,736,171** | **$ 8,198,412** | **$ 64,384** | $ 6,426,512 | $ 8,622,413 | $ 40,866 |

[a] Unpaid principal balance represents the recorded principal balance of the loan.

| | For the Three Months Ended | | | | For the Nine Months Ended | | | |
|---|---|---|---|---|---|---|---|---|
| | **September 30, 2016** | | September 30, 2015 | | **September 30, 2016** | | September 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 | **$ 648,545** | **$ 1,009** | $ 4,523,103 | $ - | **$ 261,120** | **$ 375** | $4,995,873 | $ 541 |
| Production and intermediate term | **31,340** | **151** | 33,924 | - | **10,447** | **64** | 43,899 | - |
| Farm-related business | **-** | **-** | - | - | **-** | **-** | - | - |
| Rural residential real estate | **-** | **-** | - | - | **145,367** | **-** | - | - |
| Total | **$ 679,885** | **$ 1,160** | $ 4,557,027 | $ - | **$ 416,934** | **$ 439** | $5,039,772 | $ 541 |
| Impaired loans with no related allowance for credit losses: | | | | | | | | |
| Real estate mortgage | **$ 6,104,428** | **$ 94,386** | $ 2,185,550 | $ 7,822 | **$ 6,049,974** | **$ 101,980** | $2,560,880 | $ 20,469 |
| Production and intermediate term | **12,385** | **-** | 14,710 | 66 | **30,034** | **-** | 81,560 | 236 |
| Farm-related business | **-** | **2,393** | 1,766 | 2,962 | **-** | **6,372** | 10,914 | 6,891 |
| Rural residential real estate | **856,862** | **879** | 153,794 | - | **419,311** | **2,559** | 157,873 | - |
| Total | **$ 6,973,675** | **$ 97,658** | $ 2,355,820 | $ 10,850 | **$ 6,499,319** | **$ 110,911** | $2,811,227 | $ 27,596 |
| Total impaired loans: | | | | | | | | |
| Real estate mortgage | **$ 6,752,973** | **$ 95,395** | $ 6,708,653 | $ 7,822 | **$ 6,311,094** | **$ 102,355** | $7,556,753 | $ 21,010 |
| Production and intermediate term | **43,725** | **151** | 48,634 | 66 | **40,481** | **64** | 125,459 | 236 |
| Farm-related business | **-** | **2,393** | 1,766 | 2,962 | **-** | **6,372** | 10,914 | 6,891 |
| Rural residential real estate | **856,862** | **879** | 153,794 | - | **564,678** | **2,559** | 157,873 | - |
| Total | **$ 7,653,560** | **$ 98,818** | $ 6,912,847 | $ 10,850 | **$ 6,916,253** | **$ 111,350** | $7,850,999 | $ 28,137 |

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 and Water/Waste Water | Rural Residential Real Estate | Total |
|---|---|---|---|---|---|---|---|
| **Allowance for Credit Losses:** | | | | | | | |
| Balance at June 30, 2016 | $ 5,567,875 | $ 823,043 | $ 460,198 | $ 3,175 | $ 103,673 | $ 115,892 | $ 7,073,856 |
| Charge-offs | - | - | - | - | - | - | - |
| Recoveries | - | 22,064 | 107,420 | - | - | - | 129,484 |
| Provision for loan losses | (37,183) | (120,744) | (179,820) | (580) | (19,530) | (46,391) | (404,248) |
| Other | (24,658) | (2,209) | (21,879) | (5) | (838) | - | (49,589) |
| Balance at September 30, 2016 | $ 5,506,034 | $ 722,154 | $ 365,919 | $ 2,590 | $ 83,305 | $ 69,501 | $ 6,749,503 |
| Balance at December 31, 2015 | $ 5,884,916 | $ 299,660 | $ 285,442 | $ 88,173 | $ 100,696 | $ 158,534 | $ 6,817,421 |
| Charge-offs | (34,534) | - | - | - | - | - | (34,534) |
| Recoveries | 2,769 | 76,374 | 322,260 | - | - | - | 401,403 |
| Provision for loan losses | (348,099) | 374,460 | (206,893) | (87,607) | (22,989) | (89,429) | (380,557) |
| Other | 982 | (28,339) | (34,891) | 2,024 | 5,598 | 396 | (54,230) |
| Balance at September 30, 2016 | $ 5,506,034 | $ 722,155 | $ 365,918 | $ 2,590 | $ 83,305 | $ 69,501 | $ 6,749,503 |
| Ending Balance: | | | | | | | |
| Individually evaluated for impairment | $ 64,384 | $ - | $ - | $ - | $ - | $ - | $ 64,384 |
| Collectively evaluated for impairment | 5,441,650 | 722,155 | 365,918 | 2,590 | 83,305 | 69,501 | 6,685,119 |
| Balance at September 30, 2016 | $ 5,506,034 | $ 722,155 | $ 365,918 | $ 2,590 | $ 83,305 | $ 69,501 | $ 6,749,503 |
| Balance at June 30, 2015 | $ 4,679,834 | $ 259,906 | $ 192,190 | $ 95,506 | $ 106,150 | $ 132,381 | $ 5,465,967 |
| Charge-offs | - | - | - | - | - | - | - |
| Recoveries | 30,282 | - | 71,613 | - | - | - | 101,895 |
| Provision for loan losses | 1,902,567 | 28,863 | (69,654) | (5,278) | (40,002) | 20,085 | 1,836,581 |
| Other | 4,434 | 39,757 | 38,926 | 2,804 | 23,661 | (639) | 108,943 |
| Balance at September 30, 2015 | $ 6,617,117 | $ 328,526 | $ 233,075 | $ 93,032 | $ 89,809 | $ 151,827 | $ 7,513,386 |
| Balance at December 31, 2014 | $ 5,026,771 | $ 218,384 | $ 164,934 | $ 26,522 | $ 96,650 | $ 149,949 | $ 5,683,210 |
| Charge-offs | (171,007) | - | - | - | - | - | (171,007) |
| Recoveries | 66,085 | 59,242 | 271,453 | - | - | 3,478 | 400,258 |
| Provision for loan losses | 1,694,251 | (6,599) | (249,743) | 64,456 | (33,978) | (961) | 1,467,426 |
| Other | 1,017 | 57,499 | 46,431 | 2,054 | 27,137 | (639) | 133,499 |
| Balance at September 30, 2015 | $ 6,617,117 | $ 328,526 | $ 233,075 | $ 93,032 | $ 89,809 | $ 151,827 | $ 7,513,386 |
| Ending Balance: | | | | | | | |
| Individually evaluated for impairment | $ 1,068,711 | $ - | $ - | $ - | $ - | $ - | $ 1,068,711 |
| Collectively evaluated for impairment | 5,510,839 | 312,698 | 233,075 | 93,032 | 89,809 | 151,827 | 6,391,280 |
| Loans acquired with deteriorated credit quality | 37,567 | 15,828 | - | - | - | - | 53,395 |
| Balance at September 30, 2015 | $ 6,617,117 | $ 328,526 | $ 233,075 | $ 93,032 | $ 89,809 | $ 151,827 | $ 7,513,386 |

| | Real Estate Mortgage | Production and Intermediate Term | Agribusiness | Communications | Energy and Water/Waste Water | Rural Residential Real Estate | Total |
|---|---|---|---|---|---|---|---|
| **Recorded Investments in Loans Outstanding:** | | | | | | | |
| Ending Balance at September 30, 2016 | $ 1,286,214,270 | $ 122,105,983 | $ 159,992,557 | $ 1,143,141 | $ 55,182,784 | $ 17,705,481 | $1,642,344,216 |
| Individually evaluated for impairment | $ 6,547,979 | $ 45,051 | $ - | $ - | $ - | $ 901,256 | $ 7,494,286 |
| Collectively evaluated for impairment | $ 1,279,436,057 | $ 122,049,281 | $ 159,992,557 | $ 1,143,141 | $ 55,182,784 | $ 16,804,225 | $1,634,608,045 |
| Loans acquired with deteriorated credit quality | $ 230,234 | $ 11,651 | $ - | $ - | $ - | $ - | $ 241,885 |
| Ending Balance at September 30, 2015 | $ 1,199,103,664 | $ 121,850,119 | $ 113,122,260 | $ 5,616,846 | $ 56,440,180 | $ 19,946,018 | $1,516,079,087 |
| Individually evaluated for impairment | $ 6,426,221 | $ 12,652 | $ - | $ - | $ - | $ - | $ 6,438,873 |
| Collectively evaluated for impairment | $ 1,192,213,898 | $ 121,803,393 | $ 113,122,260 | $ 5,616,846 | $ 56,440,180 | $ 19,946,018 | $1,509,142,595 |
| Loans acquired with deteriorated credit quality | $ 463,545 | $ 34,074 | $ - | $ - | $ - | $ - | $ 497,619 |

## 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 and lease portfolios; sufficiency of liquid funds; needs of an institution's customer base; and any other risk-oriented activities, such as funding and interest rate risk, potential obligations under joint and several liability, contingent and off-balance-sheet liabilities or other conditions warranting additional capital. At least quarterly, management reviews the association's goals and objectives with the board.

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

**Other Comp Income (Loss)**

| **September 30, 2016** | **Before Tax** | **Deferred Tax** | **Net of Tax** |
|---|---|---|---|
| **Nonpension postretirement benefits** | **$ 10,458** | **$ -** | **$ 10,458** |
| **Total** | **$ 10,458** | **$ -** | **$ 10,458** |

| September 30, 2015 | Before Tax | Deferred Tax | Net of Tax |
|---|---|---|---|
| Nonpension postretirement benefits | $ 28,071 | $ - | $ 28,071 |
| Total | $ 28,071 | $ - | $ 28,071 |

The association's accumulated other comprehensive income (loss) relates entirely to its nonpension other postretirement benefits. Amortization of prior service (credits) cost and of actuarial (gain) 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 nine months ended September 30:

| | **2016** | 2015 |
|---|---|---|
| Accumulated other comprehensive income (loss) at January 1 | **$ (820,747)** | $(1,335,657) |
| Actuarial gains/(losses) | **-** | - |
| Amortization of prior service (credit) costs included in salaries and employee benefits | **82,145** | 120,226 |
| Amortization of actuarial (gain) loss included in salaries and employee benefits | **(71,687)** | (92,155) |
| Other comprehensive income (loss), net of tax | **10,458** | 28,071 |
| Accumulated other comprehensive income (loss) at September 30 | **$ (810,289)** | $ (1,307,586) |

## NOTE 4 — INCOME TAXES:

Lone Star, ACA conducts its business activities through two wholly-owned subsidiaries. Long-term mortgage lending activities are conducted through a wholly-owned FLCA subsidiary which is exempt from federal and state income tax. Short- and intermediate-term lending activities are conducted through a wholly-owned PCA subsidiary. The PCA subsidiary and the ACA holding company are subject to income tax. Lone Star, ACA operates as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, Lone Star, ACA can exclude from taxable income amounts distributed as qualified patronage 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.

## 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 2 to the 2015 Annual Report to Stockholders for a more complete description.

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 take into account unobservable inputs such as income and expense, comparable sales, replacement cost and comparability adjustments.

Information about Other Financial Instrument Fair Value Measurements:

| | Valuation Technique(s) | Input |
|---|---|---|
| Cash | Carrying value | Par/principal and appropriate interest yield |
| Loans | Discounted cash flow | Prepayment forecasts<br>Probability of default<br>Loss severity |
| Other interest bearing liabilities | Carrying value | Par/principal and appropriate interest yield |

Assets and liabilities measured at fair value on a recurring basis at September 30, 2016 and December 31, 2015 only include nonqualified benefit trusts. This Level 1 asset was $133,307 and $98,115 at September 30, 2016 and December 31, 2015, respectively.

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

| **September 30, 2016** | **Fair Value Measurement Using** | | | **Total Fair** |
|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Value** |
| Assets: | | | | |
| Loans* | **$ -** | **$ -** | **$ 752,800** | **$ 752,800** |
| Other property owned | **-** | **-** | **-** | **-** |

| December 31, 2015 | Fair Value Measurement Using | | | Total Fair |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Value |
| Assets: | | | | |
| Loans* | $ - | $ - | $ 47,755 | $ 47,755 |
| Other property owned | - | - | 78,518 | 78,518 |

*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.

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.

*Investment Securities*

Where quoted prices are available in an active market, available-for-sale securities would be classified as Level 1. If quoted prices are not available in an active market, the fair value of securities is estimated using pricing models that utilize observable inputs, quoted prices for similar securities received from pricing services or discounted cash flows. Generally, these securities would be classified as Level 2. This would include certain mortgage-backed and asset-backed securities. Where there is limited activity or less transparency around inputs to the valuation, the securities are classified as Level 3. Securities classified within Level 3 include asset-based securities and certain mortgage-backed securities, including private label-FHA/VA securities and those issued by Farmer Mac.

*Assets Held in Nonqualified Benefits Trusts*

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

*Standby Letters of Credit*

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

*Loans*

For certain loans evaluated for impairment under impairment guidance, the fair value is based upon the underlying collateral since the loans are collateral-dependent loans for which real estate is the collateral. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the 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.

*Other Property Owned*

Other property owned is generally classified as Level 3. The process for measuring the fair value of other property owned involves the use of appraisals or 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.

The fair value of commitments is estimated using the fees currently charged for similar agreements, taking into account the remaining terms of the agreements and the creditworthiness of the counterparties. For fixed-rate loan commitments, estimated fair value also considers the difference between current levels of interest rates and the committed rates.

## NOTE 6 — EMPLOYEE BENEFIT PLANS:

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

| | Other Benefits | |
|---|---|---|
| | **2016** | 2015 |
| Service cost | **$ 58,302** | $ 58,651 |
| Interest cost | **158,613** | 144,248 |
| Amortization of prior service (credits) costs | **(26,067)** | (91,302) |
| Amortization of net actuarial (gain) loss | **36,528** | 31,642 |
| Net periodic benefit cost | **$ 227,376** | $ 143,239 |

The association's liability for the unfunded accumulated obligation for these benefits at September 30, 2016, was $4,683,547 and is included in "Other Liabilities" in the 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. The association previously disclosed in its financial statements for the year ended December 31, 2015, that it expected to contribute $625,890 to the district's defined benefit pension plan in 2016. As of September 30, 2016, $469,418 of contributions have been made. The association presently anticipates contributing an additional $156,472 to fund the defined benefit pension plan in 2016 for a total of $625,890.

## 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 November 7, 2016, which is the date the financial statements were issued. There are no other significant events requiring disclosure as of November 7, 2016.