



2019 PATRONAGE PROGRAM

COOPERATIVE OPERATION

Lone Star, ACA (the “Association”) is a cooperative organization operating with and through its PCA and FLCA subsidiaries for the mutual benefit of its member-borrowers. As a cooperative, the Association strives to return a portion of its profits to its eligible Members (as the term “Member(s)” is defined below) based on earnings generated from their business activity (borrowing) with the Association. This return comes in the form of patronage distributions. Patronage distributions benefit eligible Members by effectively reducing their cost of borrowing from the Association.

This document summarizes the Association’s patronage distribution program for 2019 as authorized under the Association’s Bylaws, Board resolutions, and the Association’s applicable policies, procedures, and programs. If you have any questions regarding the program, then please contact our Chief Financial Officer at the Association’s headquarters in Fort Worth.

COMMITMENT TO DISTRIBUTE PATRONAGE EARNINGS

The Association is obligated to distribute its net earnings to its eligible Members on a patronage basis if a distribution is declared by the Association’s Board of Directors. This obligation to make “patronage distributions” is found in Section 840 of the Association’s Bylaws and the resolutions adopted by the Board under this section.

Patronage distributions for a particular year may be made only from the Association’s Patronage Earnings for such year. Patronage Earnings is defined as the Association’s consolidated net earnings, as computed for book purposes, attributable to loans capitalized by Association stock that are outstanding during the year (each of which is a “Patronage Loan(s)” or “Patronage Transaction(s)"). However, the following loans are excluded from patronage eligibility and, thus, do not entitle the borrower to receive patronage distributions and, therefore, do not qualify as eligible Patronage Loans:

- (a) all loans with the borrower when any loan with such borrower has a charge-off in whole or in part that has not been fully recovered;

- (b) a loan that is in non-interest earning status, as designated by the Association, as of the end of the year;
- (c) a loan that was designated by the Association as being in non-interest earning status and was not fully restored to accrual status or was liquidated prior to year-end at an amount less than the full balance owed;
- (d) a loan for which the borrower has declared Chapter 7 bankruptcy and, as of the end of the year or as of the time the cash patronage checks are issued, has not reaffirmed the debt or has reaffirmed the debt on terms other than those set forth in the loan documents;
- (e) a loan for which the borrower has declared bankruptcy and, as of the end of the year or as of the time the cash patronage checks are issued, is not operating under a confirmed plan or is operating under a confirmed plan that modified the terms of the loan documents;
- (f) any advances or extensions in connection with debtor-in-possession financing.

As indicated above, if a borrower's loan is in non-interest earning status, as designated by the Association, as of the end of the year, then the borrower shall not be eligible for a patronage distribution with respect to such loan. Non-interest earning status means that accounting principles do not allow the Association to accrue interest income on the loan due to questions regarding collectability. A borrower may not necessarily receive notice when the borrower's loan is placed in non-interest earning status.

Net earnings arising from transactions other than Patronage Loans, such as non-member financially-related services and insurance, are treated as non-patronage earnings. Non-patronage earnings are not eligible for patronage distribution. Expenses will be allocated equitably in computing Patronage Earnings and non-patronage earnings.

PATRONAGE DISTRIBUTION AND PATRONAGE ELIGIBILITY

Prior to the end of the year, the Board shall determine the amount of the Association's Patronage Earnings that must be retained as reasonable reserves for the necessary purposes of the Association. The balance of the Patronage Earnings, if any, shall be distributed to eligible members who had an eligible Patronage Loan outstanding during the year ("Member(s)"); the term "Member(s)" only includes borrowers who are eligible to receive patronage distributions pursuant to the Association's Bylaws and applicable policies, procedures, and programs and only includes borrowers whose loans constitute eligible Patronage Loans under this program. Each Member's share of the patronage distribution shall be based on the allocation methodology described below.

Importantly, if the Association does not generate positive Patronage Earnings for the year, there can be no patronage distribution. Also, even with positive Patronage Earnings, there may be instances when, in light of the Association's financial condition, a patronage distribution may not be made without the consent of the Association's funding bank or its regulator.

PATRONAGE BASIS ALLOCATION METHODOLOGY

The patronage distribution authorized by the Board shall be allocated among Members based on each Member's proportionate contribution to Patronage Earnings. The patronage distribution shall be allocated to each Member based on the Average Daily Balance of the Patronage Transactions with or for such Member as a percentage of the Average Daily Balance of all Patronage Transactions outstanding during the year. Such allocation formula shall exclude those loans for which the Member is not eligible for patronage as indicated above. When the Association sells an interest in a Patronage Transaction under a participation agreement that is intended to not result in any revenue loss to the Association on the portion sold, the Member's patronage calculation shall include the average outstanding volume for the portion sold.

FORM OF DISTRIBUTION

Patronage distributions may be in the form of cash or equity authorized under the Association's Bylaws. The equity may be either Class P Common Stock or an allocation of surplus. For tax purposes, a distributed equity is characterized as either a qualified written notice of allocation (a "Qualified Notice(s)") or a nonqualified written notice of allocation (a "Nonqualified Notice(s)"). In general, a Member must report as taxable income the full face amount of each Qualified Notice in the year in which the Qualified Notice is received. A Nonqualified Notice is not taxable to the Member unless the Association redeems it for cash or property.

When the Board declares the patronage distribution, it will determine the form of the distribution (e.g., a mix of cash, Qualified Notices, and/or Nonqualified Notices).

If a patronage distribution is issued in Qualified Notice or Nonqualified Notice form, then such notice will indicate the Association's intention to redeem/revolve the equity in the future or its plan to retain the capital indefinitely.

It is not contemplated that the Association will issue Qualified Notices. However, if Qualified Notices are distributed, then the cash distribution to each Member will exceed 20% of the total patronage distribution (excluding any Nonqualified Notices) pursuant to the requirements of tax law.

At the Association's option, the cash patronage amount may be applied against the borrower's loan balance(s) if:

- The borrower is not in compliance under the loan documents at the end of the year or at the time the cash patronage checks are issued;
- The patronage check has not been cashed within 120 days after the date on which the check was issued; or
- Permitted by the loan documents, agreement of the parties, or law.

IMPACT OF PRIOR CHARGE-OFFS

If the Association incurs a charge-off on a borrower's loan that is not subsequently fully recovered, then subsequent loans to such borrower may be made on a non-patronage basis.

OTHER MATTERS

Member Consent to Include Patronage Into Taxable Income

Prior to transacting business with any member, such member will receive a copy of the Association's Capitalization Bylaws. Pursuant to such Capitalization Bylaws, each member consents that the amount of any distributions with respect to the member's patronage that are made in or evidenced by "Qualified Written Notices of Allocation," including patronage allocations of surplus account and patronage refunds paid in Class P Common Stock of the Association, and which are received by the member from the Association, will be taken into account (as income) by the member at their stated dollar amounts in the manner provided in 26 U.S.C. 1385(a) in the taxable year in which such written notices of allocation are received by the member.

Resolution Declaring Patronage Dividend

No later than 60 days after the end of the fiscal year, the Board intends to adopt a resolution declaring the patronage distribution and specifying the form(s) of distribution (qualified versus nonqualified). The resolution shall provide the timing of the patronage distribution, which shall occur no later than 8½ months after the end of the fiscal year.

Patronage Notification

Within 8½ months after the end of the fiscal year, the Association will send a notification to Members, which informs them of their patronage distribution, encloses the patronage check and any equity distribution, and informs them of their obligation to include any qualified written notices of allocation in their taxable income.

Each January, the Association will send each Patron an IRS Form 1099-PATR (and any other required tax information returns) reporting the total of all taxable patronage distributions issued to the Patron during the previous year.