Second Quarter Financial Report

June 30, 2019

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Frontier Farm Credit, ACA

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following commentary reviews the consolidated financial position and consolidated results of operations of Frontier Farm Credit, ACA, and its subsidiaries (Frontier Farm Credit). The accompanying consolidated financial statements and notes also contain important information about our financial position and results of operations. You should also read our 2018 Annual Report for a description of our organization, operations and significant accounting policies.

CoBank, ACB's financial condition and results of operations materially affect shareholders' investment in Frontier Farm Credit, ACA. To request a free copy of the combined CoBank, ACB and affiliated associations' financial reports, contact us at PO Box 2409, Omaha, NE 68103-2409, (800) 531-3905 or via email to $sr@frontierfarmcredit.com. You may also obtain copies by accessing CoBank, ACB's website at www.cobank.com.

Forward-Looking Information

Any forward-looking statements in this Quarterly Financial Report are based on current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from expectations due to a number of risks and uncertainties. More information about these risks and uncertainties is contained in our 2018 Annual Report. We undertake no duty to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

Loan Portfolio

Loan volume decreased by $24.5 million from year-end, a decrease of 1.3 percent. The decrease was primarily due to a decrease in production and intermediate term loans.

We recorded a $0.8 million provision for credit losses (net of provision for loan losses and unfunded lending commitments) for the first six months of 2019, as compared with a $1.9 million provision during the first six months of 2018. The allowance for the grain portfolio was favorably impacted by the pay-off of a few large accounts and a reduction in specific reserve allocated to this segment. The portfolio did experience some slight credit deterioration in the cow/calf and renewable fuels industries. In 2018 the credit deterioration was more isolated to the grain portfolio. Net charge-offs for the first six months of 2019 were $74 thousand compared to net charge-offs of $1 thousand in the same period a year ago.

The following table summarizes risk assets (accrual loans include accrued interest receivable) and delinquency information (dollars in thousands):

	June 30, 2019	December 31, 2018
Risk loans:		
Nonaccrual	**$ 13,131**	$ 10,402
Restructured	**81**	369
90 days past due still accruing interest	**1,404**	-
Total risk loans	**14,616**	10,771
Other property owned, net	**279**	279
Total risk assets	**$ 14,895**	$ 11,050
Risk loans as a percentage of total loans	**0.74%**	0.54%
Nonaccrual loans as a percentage of total loans	**0.66%**	0.52%
Current nonaccrual loans as a percentage of total nonaccrual loans	**48.6%**	45.1%
Total delinquencies as a percentage of total loans	**0.78%**	0.55%

Total risk loans have increased since year-end. The increase is primarily due to an increase in nonaccrual loans and loans 90 days past due still accruing interest. The increase in nonaccrual loans is primarily due to accounts in the grain and landlords/investors portfolios. It is our practice to transfer accruing loans that are past due 90 days or more into nonaccrual unless they are adequately secured and in the process of collection. Based on our analysis, loans 90 days or more past due and still accruing interest were adequately secured and in the process of collection. Risk loans as a percentage of total loans remain at acceptable levels.

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

Comparative allowance coverage of various loan categories follows:

	June 30, 2019	December 31, 2018
Allowance as a percentage of:		
Total loans	**0.48%**	0.44%
Nonaccrual loans	**70.83%**	84.60%
Total risk loans	**63.63%**	81.70%
Net charge-offs (recoveries) as a percentage of average loans	**0.01%**	0.02%
Adverse assets to risk funds*	**34.39%**	34.43%

**Risk funds includes permanent capital and allowance for loan losses.*

Our adversely classified assets increased during the first six months of 2019, ending the quarter at 7.2 percent of the portfolio, compared to 6.7 percent of the portfolio at December 31, 2018. Adversely classified are assets we have identified as showing some credit weakness outside our credit standards. We have considered portfolio credit quality in assessing the reasonableness of our allowance for loan losses, and in our opinion, the allowance for loan losses was reasonable in relation to the risk in our loan portfolio at June 30, 2019.

Commodity Review and Outlook Update

The Frontier Farm Credit Appraisal team monitors real estate value trends through semi-annual appraisals of seven benchmark farms in eastern Kansas. The Appraisal team updates benchmark farm values based on the most recently reported real estate sales on January 1st and July 1st each year.

For the first six months of 2019, there was an overall decrease of 3.0 percent in the benchmark values and in the twelve months ended June 30, 2019 there was a 2.4 percent decrease.

Farmland prices were relatively steady across our territory compared to a year ago. There continues to be demand for good quality properties with marginal properties showing weakness. The number of agricultural real estate sales tracked by our appraisal team has been fairly stable over the past four years.

Repayment capacity for our loans is largely dependent upon income from corn, soybeans, wheat and cattle.

The wet spring impeded planting progress for most crop producers. While planting was delayed, most areas of eastern Kansas were able to meet planting intentions. Planting delays and increased anticipation of widespread unplanted acres throughout the corn belt improved the profit margin outlook as futures prices for corn and soybeans improved on anticipated reduction in supply. While improved over 2018 levels, profit margins for soybeans continue to be hampered by very large inventories and continued trade tariffs imposed by China. The wet weather pattern also created negative feeding conditions leading to profit challenges across the beef sector.

Operating loan renewals and the receipt of customer financial information is seasonally concentrated in the first and second quarters of each calendar year. Our review of customer financial information reflected an improvement in the overall profitability within the grain portfolio aided by generally strong yields and Market Facilitation Payments. Despite improved profitability across the sector, the level of adversely classified assets within the loan portfolio increased modestly, while delinquencies and nonaccrual levels remained stable.

Refer to the Commodity Review and Outlook section of Management's Discussion & Analysis in the 2018 Annual Report for further analysis of farm land prices and industry conditions.

Results of Operations

The following table presents profitability information (dollars in thousands):

	For the six months ended June 30,	
	2019	2018
Net income (in thousands)	**$21,572**	$20,202
Return on average assets	**2.09%**	2.01%
Return on average members' equity	**9.45%**	9.48%

Changes in these ratios are directly related to the changes in income discussed in this section, changes in assets discussed in the Loan Portfolio section and changes in capital discussed in the Funding, Liquidity and Members' Equity section.

Major components of the changes in net income for the six months ended June 30, 2019 compared to the same period in 2018 are outlined in the following table (in thousands):

Increase (decrease) in net income	2019 vs. 2018
Net interest income	**1,317**
Provision for credit losses	**1,127**
Noninterest income	**(1,167)**
Noninterest expense	**(5)**
Provision for income taxes, net	**98**
Total change in net income	**$1,370**

Net interest income was $27.4 million for the first six months of 2019 compared to $26.1 million for the first six months of 2018. The annualized net interest margin was 2.82 percent for the first six months of 2019, compared to 2.77 percent for the same period in 2018.

The effects on net interest income from changes in average volumes and rates are quantified in the following table for the six months ended June 30 (in thousands):

	2019 vs. 2018
Change in volume	**$1,053**
Change in rates	**290**
Change in nonaccrual income	**(26)**
Net change	**$1,317**

The variance in the provision for credit losses reflects our assessment of risk in the loan portfolio.

The decrease in noninterest income is primarily due to the $0.5 million 2019 refund from the Farm Credit System Insurance Corporation compared to the refund in 2018 of $1.4 million. The increase in noninterest expense is primarily due to salary, benefits and other expenses partially offset by a reduction in the Farm Credit System Insurance Corporation premiums.

Frontier recorded $6.7 million of operating expenses under the income and expense sharing provisions of the alliance agreement in the first six months of 2019 compared to $6.8 million for the first six months of 2018. Refer to Note 1 in our 2018 Annual Report for additional information on the alliance.

Funding, Liquidity and Members' Equity

We borrow from CoBank, ACB under a note payable, in the form of a line of credit. The note payable is collateralized by a pledge of substantially all of our assets and is governed by a General Financing Agreement (GFA), which provides for an open-ended revolving line of credit. The GFA matures on May 31, 2020, and we expect renewal at that time. Substantially all borrower loans are match-funded with CoBank, ACB which significantly reduces our market interest rate risk. Due to the cooperative structure of the Farm Credit System and as Frontier Farm Credit is a stockholder of CoBank, ACB, we expect this borrowing relationship to continue into the foreseeable future.

The interest rate may periodically be adjusted by CoBank, ACB based on the terms and conditions of the borrowing. CoBank, ACB has established limitations on our ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At June 30, 2019 and at December 31, 2018 we were within the specified limitations.

Our members' equity increased to $473.4 million at June 30, 2019 compared to $451.4 million at December 31, 2018. The increase was due to the net income recorded for the first six months of 2019 and net issuance of capital stock.

Farm Credit Administration regulations require us to maintain minimums for our common equity tier 1, tier 1 capital, total capital and permanent capital risk-based capital ratios. In addition, the Farm Credit Administration requires us to maintain minimums for our non-risk-adjusted ratios of tier 1 leverage and unallocated retained earnings and equivalents leverage. Refer to Note 8 in our 2018 Annual Report for a more complete description of these ratios. The capital adequacy ratios are directly impacted by the changes in capital as more fully discussed in this section and the changes in assets as discussed in the Loan Portfolio section.

	As of June 30, 2019	Regulatory Minimums	Capital Conservation Buffers	Total
Risk-adjusted:				
Common equity tier 1 ratio	**18.23%**	4.5%	2.5% *	
Tier 1 capital ratio	**18.23%**	6.0%	2.5% *	8.5%
Total capital ratio	**18.64%**	8.0%	2.5% *	10.5%
Permanent capital ratio	**18.31%**	7.0%	- %	7.0%
Non-risk-adjusted:				
Tier 1 leverage ratio	**19.83%**	4.0%	1.0%	5.0%
Unallocated retained earnings and equivalents leverage ratio	**21.48%**	1.5%	- %	1.5%

**The 2.5 percent capital conservation buffers over risk-adjusted ratio minimums is being phased in over three years under the Farm Credit Administration capital requirements. The phase in period ends on December 31, 2019.*

Certification

This report has been prepared under the oversight of the Board Audit Committee. The undersigned certify that they have reviewed this report and 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 their knowledge and belief.

Mark Jensen
President and CEO
August 2, 2019

Shane Tiffany
Chairperson, ACA Board of Directors
August 2, 2019

Craig P. Kinnison
Senior Vice-President and CFO
August 2, 2019

Frontier Farm Credit, ACA
Consolidated Balance Sheet
(dollars in thousands)

	June 30, 2019 (unaudited)	December 31, 2018
ASSETS		
Loans	**$1,954,076**	$1,979,557
Allowance for loan losses	**9,300**	8,800
Net loans	**1,944,776**	1,970,757
Accrued interest receivable	**28,838**	27,006
Investment in CoBank, ACB	**64,042**	64,015
Investment in AgDirect, LLP	**4,062**	4,201
Premises and equipment, net	**20,523**	20,902
Other property owned, net	**279**	279
Prepaid benefit expense	**2,608**	2,296
Other assets	**15,560**	25,596
Total assets	**$2,080,688**	$2,115,052
LIABILITIES		
Notes payable	**$1,594,730**	$1,636,637
Accrued interest payable	**3,710**	3,784
Patronage payable	**-**	15,700
Reserve for unfunded lending commitments	**900**	700
Accrued benefits liability	**362**	538
Other liabilities	**7,636**	6,268
Total liabilities	**1,607,338**	1,663,627
MEMBERS' EQUITY		
At-risk capital:		
Class B common stock	**8,171**	8,025
Class C common stock	**236**	233
Accumulated other comprehensive income (loss)	**(101)**	(193)
Retained earnings	**465,044**	443,360
Total members' equity	**473,350**	451,425
Total liabilities and members' equity	**$2,080,688**	$2,115,052

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

Frontier Farm Credit, ACA
Consolidated Statement of Income
(dollars in thousands)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	**2019**	2018
NET INTEREST INCOME				
Interest income	**$24,962**	$22,639	**$49,966**	$44,799
Interest expense	**11,338**	9,667	**22,524**	18,674
Net interest income	**13,624**	12,972	**27,442**	26,125
Provision for credit losses	**1,084**	1,021	**774**	1,901
Net interest income after provision for credit losses	**12,540**	11,951	**26,668**	24,224
NONINTEREST INCOME				
Patronage income from CoBank, ACB	**1,610**	1,768	**3,229**	3,570
Insurance fund refund	**-**	-	**490**	1,351
Loan fees	**198**	352	**540**	722
Insurance services	**20**	96	**165**	246
Distributions from AgDirect, LLP	**223**	212	**420**	422
Mineral income	**277**	216	**690**	434
Other noninterest income	**52**	44	**95**	51
Total noninterest income	**2,380**	2,688	**5,629**	6,796
NONINTEREST EXPENSE				
Salaries and employee benefits	**4,128**	4,184	**8,496**	8,404
Occupancy and equipment expense	**534**	499	**1,055**	993
Insurance fund premiums	**343**	335	**692**	681
Other operating expenses (income)	**(1,183)**	(214)	**482**	642
Total noninterest expense	**3,822**	4,804	**10,725**	10,720
Income before income taxes	**11,098**	9,835	**21,572**	20,300
Provision for income taxes	**-**	(57)	**-**	98
Net income	**$11,098**	$ 9,892	**$21,572**	$20,202
COMPREHENSIVE INCOME				
Amortization of retirement costs	**46**	12	**92**	24
Comprehensive Income	**$11,144**	$ 9,904	**$21,664**	$20,226

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

Frontier Farm Credit, ACA
Consolidated Statement of Changes in Members' Equity
(dollars in thousands)
(unaudited)

	Accumulated Other Comprehensive Income/(Loss)	At-risk Capital: Capital Stock	At-risk Capital: Retained Earnings	Total Members' Equity
Balance at December 31, 2017	($246)	$7,675	$412,636	$420,065
Net income			20,202	20,202
Patronage accrual adjustment			61	61
Change in other comprehensive income	24			24
Capital stock:				
Issued		1,091		1,091
Retired		(709)		(709)
Balance at June 30, 2018	($222)	$8,057	$432,899	$440,734
Balance at December 31, 2018	($193)	$8,258	$443,360	$451,425
Net income			21,572	21,572
Patronage accrual adjustment			112	112
Change in other comprehensive income	92			92
Capital stock:				
Issued		607		607
Retired		(458)		(458)
Balance at June 30, 2019	**($101)**	**$8,407**	**$465,044**	**$473,350**

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

Notes to Consolidated Financial Statements (unaudited)

Note 1 - Organization and Significant Accounting Policies

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim consolidated financial condition and consolidated results of operations. While our accounting policies conform to accounting principles generally accepted in the United States of America (U.S. GAAP) and the prevailing practices within the financial services industry, this interim Quarterly Financial Report is prepared based upon statutory and regulatory requirements and, accordingly, does not include all disclosures required by U.S. GAAP. The results of the six months ended June 30, 2019 are not necessarily indicative of the results to be expected for the year ended December 31, 2019. The interim financial statements and the related notes in this Quarterly Report should be read in conjunction with the consolidated financial statements and related notes included in our 2018 Annual Report for the year ended December 31, 2018.

The consolidated financial statements present the consolidated financial results of Frontier Farm Credit, ACA (the parent) and Frontier Farm Credit, FLCA and Frontier Farm Credit, PCA (the subsidiaries). All material intercompany transactions and balances have been eliminated in consolidation.

Recently Issued or Adopted Accounting Pronouncements

In June 2016, the Financial Accounting Standards Board issued ASU 2016-13 “Financial Instruments – Credit Losses”. The guidance is effective for public business entities for non-United States Securities Exchange Commission filers for the first quarter of 2021 and early adoption is permitted. The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses. We have no plans to early adopt this guidance. We have reviewed the accounting standard, selected our system and are in the process of drafting disclosures. Significant implementation matters yet to be addressed include system development and testing, drafting of accounting policies and designing processes and controls. We are currently unable to estimate the impact on the financial statements.

In February 2016, the Financial Accounting Standards Board issued ASU 2016-02 “Leases.” In July 2018, the Financial Accounting Standards Board issued ASU 2018-11 “Leases (Topic 842): Targeted Improvements.” This guidance is effective for public business entities in its first quarter of 2019 and early adoption is permitted. The guidance modifies the recognition and accounting for lessees and lessors and requires expanded disclosures regarding assumptions used to recognize revenue and expenses related to leases. The guidance includes an optional transition method where an entity is permitted to apply the guidance as of the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings. We adopted this guidance on January 1, 2019. The adoption of this guidance did not have a material impact on our financial condition, results of operations or financial statement disclosures, and had no impact on cash flows.

Note 2 – Loans and Allowance for Credit Losses

Loans consisted of the following (dollars in thousands):

	June 30, 2019		December 31, 2018	
	Amount	**Percentage**	Amount	Percentage
Long-term agricultural mortgage	**$1,101,657**	**56.4 %**	$1,100,562	55.6 %
Production and intermediate term	**492,878**	**25.2**	536,273	27.0
Agribusiness	**217,983**	**11.2**	204,286	10.3
Rural residential real estate	**92,729**	**4.7**	92,346	4.7
Rural infrastructure	**39,379**	**2.0**	36,640	1.9
Agricultural export finance	**9,450**	**0.5**	9,450	0.5
Total loans	**$1,954,076**	**100.0 %**	$1,979,557	100.0 %

Credit Quality

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

- acceptable – loans are expected to be fully collectible and represent the highest quality;
- other assets especially mentioned (OAEM) (special mention) – loans are currently collectible but exhibit some potential weakness;
- substandard – loans exhibit some serious weakness in repayment capacity, equity and/or collateral pledged on the loan;
- doubtful – loans 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 – loans are considered uncollectible.

We had no loans categorized as loss at June 30, 2019 or December 31, 2018.

The following table shows loans and related accrued interest classified under the Farm Credit Administration Uniform Loan Classification System as a percentage of total loans and related accrued interest receivable by loan type (dollars in thousands):

As of June 30, 2019

	Acceptable		**OAEM**		**Substandard/Doubtful**		**Total**
	Amount	**%**	**Amount**	**%**	**Amount**	**%**	**Amount**
Long-term agricultural mortgage	**$985,746**	**88.02%**	**$51,494**	**4.60%**	**$82,640**	**7.38%**	**$1,119,880**
Production and intermediate term	**411,689**	**81.97%**	**36,288**	**7.23%**	**54,262**	**10.80%**	**502,239**
Agribusiness	**210,949**	**96.34%**	**4,401**	**2.01%**	**3,609**	**1.65%**	**218,959**
Rural residential real estate	**89,275**	**96.09%**	**1,329**	**1.43%**	**2,301**	**2.48%**	**92,905**
Rural infrastructure	**38,519**	**97.61%**	**943**	**2.39%**	**-**	**-**	**39,462**
Agricultural export finance	**9,469**	**100.00%**	**-**	**-**	**-**	**-**	**9,469**
Total	**$1,745,647**	**88.03%**	**$94,455**	**4.76%**	**$142,812**	**7.21%**	**$1,982,914**

As of December 31, 2018

	Acceptable		OAEM		Substandard/Doubtful		Total
	Amount	%	Amount	%	Amount	%	Amount
Long-term agricultural mortgage	$1,005,589	89.96%	$38,099	3.41%	$74,054	6.63%	$1,117,742
Production and intermediate term	462,120	84.82%	29,200	5.36%	53,474	9.82%	544,794
Agribusiness	198,890	96.89%	2,052	1.00%	4,323	2.11%	205,265
Rural residential real estate	89,218	96.35%	1,374	1.48%	2,008	2.17%	92,600
Rural infrastructure	34,210	93.24%	2,481	6.76%	-	-	36,691
Agricultural export finance	9,471	100.00%	-	-	-	-	9,471
Total	$1,799,498	89.68%	$73,206	3.65%	$133,859	6.67%	$2,006,563

Delinquency

The following table provides an aging analysis of past due loans and related accrued interest receivable by loan type (in thousands):

As of June 30, 2019	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans	90 Days or More Past Due and Accruing
Long-term agricultural mortgage	**$4,567**	**$ 4,335**	**$8,902**	**$1,110,978**	**$1,119,880**	**-**
Production and intermediate term	**2,500**	**2,906**	**5,406**	**$496,833**	**502,239**	**1,404**
Agribusiness	**-**	**76**	**76**	**$218,884**	**218,960**	-
Rural residential real estate	**840**	**323**	**1,163**	**$91,742**	**92,905**	-
Rural infrastructure	**-**	**-**	**-**	**$39,462**	**39,462**	-
Agricultural export finance	**-**	**-**	**-**	**$9,468**	**9,468**	-
Total	**$7,907**	**$7,640**	**$15,547**	**$1,967,367**	**$1,982,914**	**$1,404**

As of December 31, 2018	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	90 Days or More Past Due and Accruing
Long-term agricultural mortgage	$2,162	$ 3,636	$5,798	$1,111,944	$1,117,742	$ -
Production and intermediate term	2,878	1,512	4,390	540,404	544,794	-
Agribusiness	133	77	210	205,055	205,265	-
Rural residential real estate	529	46	575	92,025	92,600	-
Rural infrastructure	-	-	-	36,691	36,691	-
Agricultural export finance	-	-	-	9,471	9,471	-
Total	$5,702	$5,271	$10,973	$1,995,590	$2,006,563	-

Risk Loans

Risk loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms. Accruing loans include principal and interest. The following tables present information concerning risk loans (in thousands):

	As of June 30,	
	2019	2018
Risk loans with specific allowance	**$ 1,666**	$ 2,638
Risk loans without specific allowance	**12,950**	11,388
Total risk loans	**$14,616**	$14,026
Total specific allowance	**$1,024**	$1,201

	For the six months ended June 30,	
	2019	2018
Interest income recognized on nonaccrual loans	**$126**	$152
Interest income on risk accrual loans	**48**	70
Interest income recognized on risk loans	**$174**	$222
Average risk loans	**$17,592**	$13,976

At June 30, 2019, there were approximately $279 thousand in commitments to lend additional funds to customers whose loans were at risk.

Troubled Debt Restructurings

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

We recorded no troubled debt restructurings in the six months ended June 30, 2019 and June 30, 2018. We also had no troubled debt restructurings that occurred within the previous twelve months for which there was a subsequent payment default during the period ended June 30, 2019.

Troubled debt restructurings outstanding at June 30, 2019, totaled $4.6 million, of which $4.6 million were in nonaccrual status. There were $0.2 million in additional commitments to lend to borrowers whose loans have been modified in a troubled debt restructuring at June 30, 2019.

Allowance for Loan Losses

An analysis of changes in the allowance for credit losses follows (in thousands):

	June 30,	
Allowance for loan losses	**2019**	2018
Balance at beginning of year	**$8,800**	$6,100
Provision for loan losses	**574**	1,701
Charge-offs	**(240)**	(483)
Recoveries	**166**	482
Balance at end of quarter	**$9,300**	$7,800

	June 30,	
Reserve for unfunded lending commitments	**2019**	2018
Balance at beginning of year	**$700**	$700
Addition of unfunded lending commitments	**200**	200
Balance at end of quarter	**$900**	$900

We recorded a $0.8 million provision for credit losses (net of provision for loan losses and unfunded lending commitments) for the first six months of 2019, as compared with a $1.9 million provision during the first six months of 2018. The allowance for the grain portfolio was favorably impacted by the pay-off of a few large accounts and a reduction in specific reserve allocated to this segment. The portfolio did experience some slight credit deterioration in the cow/calf and renewable fuels industries. In 2018 the credit deterioration was more isolated to the grain portfolio. Net charge-offs for the first six months of 2019 were $74 thousand compared to net charge-offs of $1 thousand in the same period a year ago.

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

Note 3 – Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or most advantageous market for the asset or liability. Accounting guidance also establishes a fair value hierarchy, with three levels of inputs that may be used to measure fair value. Refer to Note 2 in our 2018 Annual Report for a more complete description of the three input levels.

We did not have any assets or liabilities measured at fair value on a recurring basis at June 30, 2019, or December 31, 2018. We may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. Information on assets measured at fair value on a non-recurring basis is as follows (in thousands):

	Fair Value Measurement Using			
As of June 30, 2019	**Level 1**	**Level 2**	**Level 3**	**Total Fair Value**
Loans	-	-	**$603**	**$603**
Other property owned	-	-	**$300**	**$300**

	Fair Value Measurement Using			
As of December 31, 2018	Level 1	Level 2	Level 3	Total Fair Value
Loans	-	-	$723	$723
Other property owned	-	-	$300	$300

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

Other property owned: Represents the fair value and related losses of foreclosed assets that were measured at fair value based on the collateral value, which is generally determined using appraisals, or other indications based on sales of similar properties. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. If the process requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters, they fall under Level 3.

Note 4- Commitments and Contingencies

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

From time to time, we may be named as a defendant in certain lawsuits or legal actions in the normal course of business. At the date of these consolidated financial statements, we were not aware of any such actions that would have a material impact on our financial condition. However, such actions could arise in the future.

Note 5- Subsequent Events

We have evaluated subsequent events through August 2, 2019 which is the date the financial statements were available to be issued. There have been no material subsequent events that would require recognition in our Quarterly Report or disclosure in the Notes to Consolidated Financial Statements.