FARM CREDIT
OF SOUTHERN COLORADO

2023

Q3 SHAREHOLDER REPORT

NOTICE TO STOCKHOLDERS

The shareholders' investment in Farm Credit of Southern Colorado, ACA is materially affected by the financial condition and results of operations of CoBank, ACB (CoBank). The 2022 CoBank Annual Report to Shareholders, and the CoBank quarterly shareholders' reports are available free of charge by accessing CoBank's website, www.cobank.com, or may be obtained at no charge by contacting us at:

Farm Credit of Southern Colorado, ACA
5110 Edison Avenue, PO Box 75640
Colorado Springs, Colorado 80970-5640
Phone Number: 800-815-8559

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Unaudited)

The following discussion summarizes the financial position and results of operations of Farm Credit of Southern Colorado, ACA (the Association) for the nine months ended September 30, 2023, with comparisons to prior periods. You should read these comments along with the accompanying financial statements and footnotes and the 2022 Annual Report to Shareholders. The accompanying financial statements were prepared under the oversight of our Audit Committee.

While the United States (U.S.) economy remains healthy, supply chain disruptions, labor shortages, fuel prices, inflation, rising interest rates, weather related events, and recession pressures remain a concern. The steady strengthening of labor markets and increased consumer spending through the current year have led to economic growth. The rural economy continues to benefit from the strong U.S. economy, driving higher levels of spending and investment by businesses and consumers. Most agricultural commodity prices have remained strong despite some decline from the sharp increases in 2022. The Russia/Ukraine conflict has also impacted certain agricultural commodity prices and created additional volatility and uncertainty in the markets. Although inflation has continued to decline through 2023, the Fed has indicated that it will continue to fight inflationary pressure with interest rate hikes and restrictive monetary policies. The anticipation of a tighter monetary policy is contributing to a stronger dollar and changes in the shape of the yield curve.

Economic conditions in our territory remain steady. Although prices at the farm gate have softened, crop yields are strong and are expected to support net farm income. Inflation, rising interest rates, and rising fuel prices are the main concerns for our local communities.

Drought conditions in our territory have worsened during the third quarter; however, this is an expected seasonal change and is not particularly concerning for our Association. The southwestern portion of our territory, the southern front range, and the San Luis Valley are experiencing U.S. Department of Agriculture Drought Monitor classifications ranging from DO (Abnormally Dry) to D2 (Severe Drought). While this is an increase from the second quarter, it is not uncommon for these areas to experience drier conditions in the fall. The northern and southeastern counties in our territory are not currently showing drought conditions.

Grain markets softened during the third quarter of 2023. Despite the fact that pricing opportunities throughout our territory were not as favorable for crop producers in the third quarter, prices are maintaining profitable levels for commodities grown in our territory. Strong yield expectations for spring planted crops including corn, proso millet, and milo have weakened basis bids in our territory. Hay markets remain strong due to drought conditions throughout the southwestern U.S. and the corresponding demand to draw hay into other regions.

The livestock producers in our territory are experiencing excellent weather, abundant grass, and strong markets for all classes of cattle. Excellent spring moisture conditions carried into the third quarter with abundant forage. Prices remain strong for stocker cattle and the national market offered consistent opportunities to price cattle at profitable levels. Values for fat cattle and feeder cattle have been on an upward trend through the third quarter of 2023. Markets also maintained a strong demand for quality bred heifers and cows.

The winter wheat in our territory is being planted into adequate soil moisture as we close out the third quarter of 2023. Futures prices for this commodity have declined, however, good planting conditions exist and there are expectations for an average crop as we look forward to 2024.

Spring crops including corn, proso millet, and milo are also in good condition. While some areas received hail damage, improved drought conditions have translated to above average yield expectations for producers of all spring planted crops. The combination of yield and price should support profitability for grain producers in 2023.

Potatoes are primarily grown in the San Luis Valley, which is in the southwestern region of our territory. Potato harvest is approximately two thirds complete with the crop in average condition. Production across the nation has decreased prices. Yields and prices are now more in line with normal expectations for this region. Producers are expected to maintain profitability in the San Luis Valley.

Although real estate transactions continue at a slower than normal pace, prices remain steady. Despite strong demand for properties, we are experiencing some softening in the loan market as the rising rate environment has slowed demand for real estate loans. Cash continues to be a strong competitor.

LOAN PORTFOLIO

Loans outstanding at September 30, 2023, totaled \$1.48 billion, an increase of \$32.8 million, or 2.3%, from loans of \$1.45 billion at December 31, 2022. The increase was primarily due to increases in our purchased participations and core portfolios. The growth is primarily due to increases in communication, production and intermediate, and energy loans, partially offset by decreases in processing and marketing loans and loans to cooperatives.

RESULTS OF OPERATIONS

Net income for the nine months ended September 30, 2023, was $18.0 million, an increase of $1.7 million, or 10.7%, from the same period ended one year ago. The increase is primarily due to increases in net interest income and noninterest income, partially offset by increases in the provision for credit losses and noninterest expense.

For the nine months ended September 30, 2023, net interest income was $31.9 million, an increase of $3.9 million, or 14.1%, compared with the nine months ended September 30, 2022. Net interest income increased as a result of an increase in our average accrual loan volume, increased return on our loanable funds along with interest income recognized from the payoff of a large nonaccrual loan, partially offset by a decrease in our average loan spread.

The provision for credit losses for the nine months ended September 30, 2023, was $1.7 million, an increase of $1.1 million from the provision for credit losses of $637 thousand for the same period ended one year ago. The provision for credit losses in 2023 is primarily driven by a capital markets complex moving to nonaccrual which required a specific reserve for anticipated future losses. The provision for credit loss in the first nine months of 2022 was primarily due to credit quality deterioration in the purchased participations portfolio and the establishment of specific reserves for one loan complex, partially offset by a decreased provision for unfunded commitments.

Noninterest income increased $215 thousand during the first nine months of 2023 compared with the first nine months of 2022 primarily due to increases in loan fees and patronage distributions from Farm Credit institutions, partially offset by decreases in mineral income and other noninterest income. The increase in loan fees is primarily due to non-deferrable fees earned on our purchased participation loans. Patronage distribution from Farm Credit institutions increased due to an increase in our CoBank patronage as a result of an increase in our average net note payable to CoBank. The decrease in other noninterest income is due to a decrease in allocated savings from our captive insurance company and a decrease in gains on fixed assets.

We received mineral income of $729 thousand during the first nine months of 2023, which is distributed to us quarterly by CoBank. The decrease for the nine months ended September 30, 2023, compared with first nine months of 2022 is due to a decrease in the price paid for production.

During the first nine months of 2023, noninterest expense increased $1.3 million to $18.4 million, primarily due to increases in salaries and employee benefits, other noninterest expense, and purchased services from AgVantis, partially offset by a decrease in Farm Credit Insurance Fund premiums. Salaries and employee benefits increased $864 thousand primarily due to an increase in salaries, pension expense, and medical insurance expense, partially offset by a decrease in incentive expense. Other noninterest expense increased $351 thousand primarily due to an increase in employee training and public and member relations expenses. Purchased services from AgVantis increased $186 thousand due to an increase in the annual subscription fee. Farm Credit System Insurance Corporation (FCSIC) premiums decreased $96 thousand for the nine months ended September 30, 2023 compared with the same period in 2022 primarily due to a decrease in the insurance premium accrual assessment rate on Systemwide adjusted insured debt from 20 basis points to 18 basis points.

CAPITAL RESOURCES

Our shareholders' equity at September 30, 2023, was $317.0 million, an increase from $290.8 million at December 31, 2022. This increase is due to net income of $18.0 million, net stock issuances of $6.1 million, and $2.2 million recognized from the January 1, 2023 adoption of the new standard on current expected credit losses (CECL).

OTHER MATTERS

Effective January 1, 2023, our Association adopted the new standard on current expected credit losses (CECL), under which the allowance is measured based on management's best estimate of current expected credit losses over the remaining contractual life of the loan. Prior periods presented reflect measurement of the allowance based on management's estimate of probable incurred credit losses. For more information, see Note 1 – Organization and Significant Accounting Policies.

On March 5, 2021, the United Kingdom's Financial Conduct Authority (UKFCA) formally announced that all London Interbank Offered Rate (LIBOR) tenors will either be discontinued or no longer be representative immediately after December 31, 2021. As a result, the UKFCA has closely worked with market participants and regulatory authorities around the world to ensure that alternatives to LIBOR are available and that existing contracts can be transitioned onto these alternatives to safeguard financial stability and market integrity.

At September 30, 2023, our Association did not hold any legacy LIBOR indexed loans in our portfolio and these developments did not have a material impact on the Association and our borrowers. We adopted a transition plan to reduce LIBOR exposures and stop the inflow of new LIBOR volume. Management documented and worked through the LIBOR transition plan with our funding bank and service provider to address the phase out of LIBOR rates, including any updates to processes and loan servicing technology.

As our Association has embraced the trend of remote and hybrid work over the past few years, our utilization of space in our administrative office building in Colorado Springs has decreased. In our continued efforts to be good stewards of our resources and capital, management presented, and the Board of Directors approved a plan to sell the building. On August 3, 2023, the Association executed a contract to list the building for sale.

As the Board and Management team focus on our long-term strategic goals and objectives, the board voted in their July 19th board meeting to support the recommendation for Farm Credit of Southern Colorado to enter into a contract with nCino OpCo, Inc. for loan origination software. This software investment will be leveraged to enhance the customer and employee experience as it relates to our loan origination process.

The undersigned certify they have reviewed this report, this report has been prepared in accordance with all applicable statutory or regulatory requirements, and the information contained herein is true, accurate, and complete to the best of his or her knowledge and belief.

//signature on file//
Whitney Hansen
Board Chair
November 7, 2023

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Jeremy M Anderson
President & CEO
November 7, 2023

//signature on file//
Shawna R Neppl
CFO
November 7, 2023

Consolidated Statement of Condition

(Dollars in Thousands)

	September 30 2023	December 31 2022
	UNAUDITED	AUDITED
ASSETS		
Loans	$ 1,484,261	$ 1,451,447
Less allowance for loan losses	3,386	3,793
Net loans	1,480,875	1,447,654
Cash	1,715	7,924
Accrued interest receivable	29,112	21,531
Investment in CoBank, ACB	35,418	35,313
Investment in AgDirect	1,733	1,708
Premises and equipment, net	11,905	11,901
Prepaid benefit expense	7,188	7,675
Other assets	6,719	8,775
Total assets	$ 1,574,665	$ 1,542,481
LIABILITIES		
Note payable to CoBank, ACB	$ 1,215,529	$ 1,210,396
Advance conditional payments	24,194	19,409
Accrued interest payable	3,586	3,037
Patronage distributions payable	-	9,500
Accrued benefits liability	139	141
Reserve for unfunded commitments	382	576
Other liabilities	13,812	8,581
Total liabilities	$ 1,257,642	$ 1,251,640
Commitments and Contingencies		
SHAREHOLDERS' EQUITY		
Preferred stock	6,882	778
Capital stock	1,840	1,816
Unallocated retained earnings	308,301	288,247
Total shareholders' equity	317,023	290,841
Total liabilities and shareholders' equity	$ 1,574,665	$ 1,542,481

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

Consolidated Statement of Comprehensive Income

(Dollars in Thousands)

UNAUDITED	For the three months ended September 30 **2023**	2022	For the nine months ended September 30 **2023**	2022
INTEREST INCOME				
Loans	**$ 23,487**	$ 16,625	**$ 65,256**	$ 44,314
Total interest income	**23,487**	16,625	**65,256**	44,314
INTEREST EXPENSE				
Note payable to CoBank, ACB	**11,768**	6,803	**32,786**	16,294
Other	**225**	48	**569**	63
Total interest expense	**11,993**	6,851	**33,355**	16,357
Net interest income	**11,494**	9,774	**31,901**	27,957
Provision for credit losses	**47**	882	**1,713**	637
Net interest income after provision for credit losses	**11,447**	8,892	**30,188**	27,320
NONINTEREST INCOME				
Financially related services income	**44**	25	**121**	89
Loan fees	**319**	157	**650**	372
Patronage distribution from Farm Credit institutions	**1,453**	1,419	**4,348**	4,231
Mineral income	**183**	370	**729**	892
Other noninterest income	**143**	113	**353**	402
Total noninterest income	**2,142**	2,084	**6,201**	5,986
NONINTEREST EXPENSE				
Salaries and employee benefits	**3,530**	3,176	**9,963**	9,099
Occupancy and equipment	**251**	271	**892**	890
Purchased services from AgVantis, Inc.	**791**	730	**2,375**	2,189
Farm Credit Insurance Fund premium	**517**	557	**1,548**	1,644
Supervisory and examination costs	**133**	119	**370**	336
Other noninterest expense	**1,114**	1,091	**3,251**	2,900
Total noninterest expense	**6,336**	5,944	**18,399**	17,058
Income before income taxes	**7,253**	5,032	**17,990**	16,248
Provision for income taxes	**10**	5	**24**	15
Net income/Comprehensive income	**$ 7,243**	$ 5,027	**$ 17,966**	$ 16,233

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

Consolidated Statement of Changes in Shareholders' Equity

(Dollars in Thousands)

UNAUDITED	Preferred Stock	Capital Stock	Unallocated Retained Earnings	Total Shareholders' Equity
Balance at December 31, 2021	$ 776	$ 1,777	$ 274,582	$ 277,135
Comprehensive income			16,233	16,233
Stock issued	-	179		179
Stock retired	(1)	(133)		(134)
Preferred stock dividends	1		(3)	(2)
Balance at September 30, 2022	$ 776	$ 1,823	$ 290,812	$ 293,411
Balance at December 31, 2022	$ 778	$ 1,816	$ 288,247	$ 290,841
Comprehensive income			17,966	17,966
Stock issued	6,686	119		6,805
Stock retired	(674)	(95)		(769)
Preferred stock dividends	92		(155)	(63)
Cumulative effect of CECL adoption			2,243	2,243
Balance at September 30, 2023	**$ 6,882**	**$ 1,840**	**$ 308,301**	**$ 317,023**

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

NOTES TO FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

A description of the organization and operations of Farm Credit of Southern Colorado, ACA (the Association), the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2022, are contained in the 2022 Annual Report to Shareholders. These unaudited third quarter 2023 financial statements should be read in conjunction with the 2022 Annual Report to Shareholders.

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, 2022, as contained in the 2022 Annual Report to Shareholders.

In the opinion of management, all adjustments, consisting of normal recurring adjustments necessary for a fair statement of results for the interim periods, have been made. 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, 2023. Descriptions of the significant accounting policies are included in the 2022 Annual Report to Shareholders. 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.

Recently Adopted or Issued Accounting Pronouncements

The Association adopted the Financial Accounting Standards Board (FASB) updated guidance entitled “Financial Instruments – Credit Losses: Troubled Debt Restructurings and Vintage Disclosure” on January 1, 2023. This guidance requires the creditor to determine whether a modification results in a new loan or a continuation of an existing loan, among other disclosures specific to modifications with borrowers that are experiencing financial difficulties. The update eliminated the accounting guidance for troubled debt restructurings by creditors and requires disclosure of current period gross write-offs by year of origination for financing receivables and net investments in leases on a prospective basis.

The Association also adopted the FASB guidance entitled “Measurement of Credit Losses on Financial Instruments” (CECL) and other subsequently issued accounting standards updates related to credit losses on January 1, 2023. This guidance replaced the current incurred loss impairment methodology with a single allowance framework that estimates the current expected credit losses over the remaining contractual life for all financial assets measured at amortized cost and certain off-balance sheet credit exposures. This guidance is applied on a modified retrospective basis. This framework requires management to consider in its estimate of the allowance for credit losses (ACL) relevant historical events, current conditions, and reasonable and supportable forecasts that consider macroeconomic conditions.

The following table presents the balance sheet impact to the allowance for credit losses and capital upon adoption of this guidance on January 1, 2023.

(dollars in thousands)	December 31, 2022	CECL adoption impact	January 1, 2023
Assets:			
Allowance for credit losses on loans	$ 3,793	$ (2,071)	$ 1,722
Deferred tax assets	–	–	–
Liabilities:			
Allowance for credit losses on unfunded commitments	$ 576	$ (172)	$ 404
Deferred tax liabilities	–	–	–
Retained earnings:			
Unallocated retained earnings, net of tax	$ 288,247	$ 2,243	$ 290,490

In March 2020, the FASB issued guidance entitled “Facilitation of the Effects of Reference Rate Reform on Financial Reporting.” The guidance provided optional expedients and exceptions for applying GAAP to contracts and other transactions affected by reference rate reform. The guidance simplifies the accounting evaluation of contract modifications that replace a reference rate affected by reference rate reform and contemporaneous modifications of other contracts related to the replacement of the reference rate. In December 2022, the FASB issued ASU 2022-06, “Reference Rate Reform (Topic 848): Deferral of the Sunset Date of Topic 848”. This ASU defers the sunset date of the guidance in Topic 848 on reference rate reform from December 31, 2022 to December 31, 2024. This ASU is effective upon issuance. The adoption of this guidance did not have a material impact on our financial statements.

Loans and Allowance for Credit Losses

Loans are generally carried at their principal amount outstanding adjusted for charge-offs, deferred loan fees, or costs. Loan origination fees and direct loan origination costs are netted and capitalized, and the net fee or cost is amortized over the average life of the related loan as an adjustment to interest income. Loan prepayment fees are reported in interest income. Interest on loans is accrued and credited to interest income based on the daily principal amount outstanding.

Nonaccrual Loans

Nonaccrual loans are loans for which there is reasonable doubt that all principal and interest will not be collected according to the original contractual terms and are generally considered substandard or doubtful, which is in accordance with the loan rating model, as described below. A loan is considered contractually past due when any principal repayment or interest payment required by the loan instrument is not received on or before the due date. A loan shall remain contractually past due until it is modified or until the entire amount past due, including principal, accrued interest, and penalty interest incurred as the result of past due status, is collected or otherwise discharged in full.

Consistent with prior practice, loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days (unless adequately secured and in the process of collection), circumstances indicate that collection of principal and interest is in doubt or legal action, including foreclosure or other forms of collateral conveyance, has been initiated to collect the outstanding principal and interest. At the time a loan is placed in nonaccrual status, accrued interest that is considered uncollectible is reversed (if accrued in the current year) and/or included in the recorded nonaccrual balance (if accrued in prior years). Loans are charged-off at the time they are determined to be uncollectible.

When loans are in nonaccrual status, interest payments received in cash are generally recognized as interest income if the collectability of the loan principal is fully expected and certain other criteria are met. Otherwise, payments received on nonaccrual loans are applied against the recorded investment in the loan asset. Nonaccrual loans are returned to accrual status if all contractual principal and interest is current, the borrower is fully expected to fulfill the contractual repayments terms, and after remaining current as to principal and interest for a sustained period or have a recent repayment pattern demonstrating future repayment capacity to make on-time payments. If previously unrecognized interest income exists at the time the loan is transferred to accrual status, cash received at the time of or subsequent to the transfer should first be recorded as interest income until such time as the recorded balance equals the contractual indebtedness of the borrower.

Accrued Interest Receivable

The Association elected to continue classifying accrued interest on loans in accrued interest receivable and not as part of loans on the Consolidated Statement of Condition. The Association has also elected to not estimate an allowance on interest receivable balances because the nonaccrual policies in place provide for the accrual of interest to cease on a timely basis when all contractual amounts are not expected.

Loan Modifications to Borrowers Experiencing Financial Difficulty

Loan modifications may be granted to borrowers experiencing financial difficulty. Modifications can be in the form of one or a combination of principal forgiveness, interest rate reduction, other-than-insignificant payment delay or term extension. Covenant waivers and modifications of contingent acceleration clauses are not considered term extensions.

Collateral-Dependent Loans

Collateral-dependent loans are loans secured by collateral, including but not limited to agricultural real estate, crop inventory, equipment, and livestock. CECL requires an Association to measure the expected credit losses based on fair value of the collateral at the reporting date when the Association determines that foreclosure is probable. Additionally, CECL allows a fair value practical expedient as a measurement approach for loans when the repayment is expected to be provided substantially through the operation or sale of the collateral when the borrower is experiencing financial difficulties. Under the practical expedient measurement approach, the expected credit losses is based on the difference between the fair value of the collateral less estimated costs to sell and the amortized cost basis of the loan.

Allowance for Credit Losses

Effective January 1, 2023, the ACL represents the estimated current expected credit losses over the remaining contractual life of the loans measured at amortized cost and certain off-balance sheet credit exposures. The ACL takes into consideration relevant information about past events, current conditions, and reasonable and supportable macroeconomic forecasts of future conditions. The contractual term excludes expected extensions, renewals, and modifications, unless the extension or renewal options are not unconditionally cancellable. The ACL comprises:

- the allowance for credit losses on loans (ACLL) and
- the allowance for credit losses on unfunded commitments, which is presented separately on the Consolidated Statement of Condition.

Determining the appropriateness of the allowance is complex and requires judgment by management about the effect of matters that are inherently uncertain. Subsequent evaluations of the loan portfolio, considering macroeconomic conditions, forecasts, and other factors prevailing at the time, may result in significant changes in the ACL in those future periods.

Methodology for Allowance for Credit Losses on Loans

The ACLL represents management's estimate of credit losses over the remaining expected life of loans. Loans are evaluated on the amortized cost basis, including premiums, discounts, and fair value adjustments.

The Association employs a disciplined process and methodology to establish its ACLL that has two basic components: first, an asset-specific component involving individual loans that do not share risk characteristics with other loans and the measurement of expected credit losses for such individual loans; and second, a pooled component for estimated expected credit losses for pools of loans that share similar risk characteristics.

Asset-specific loans are generally collateral-dependent loans (including those loans for which foreclosure is probable) and nonaccrual loans. For an asset-specific loan, expected credit losses are measured as the difference between the amortized cost basis in the loan and the present value of expected future cash flows discounted at the loan's effective interest rate except that, for collateral-dependent loans, credit loss is measured as the difference between the amortized cost basis in the loan and the fair value of the underlying collateral. The fair value of the collateral is adjusted for the estimated cost to sell if repayment or satisfaction of a loan is dependent on the sale (rather than only on the operation) of the collateral. In accordance with the Association's appraisal policy, the fair value of collateral-dependent loans is based upon independent third-party appraisals or on collateral valuations prepared by in-house appraisers. When an updated appraisal or collateral valuation is received, management reassesses the need for adjustments to the loan's expected credit loss measurements and, where appropriate, records an adjustment. If the calculated expected credit loss is determined to be permanent, fixed, or non-recoverable, the credit loss portion of the loan will be charged off against the allowance for credit losses.

In estimating the pooled component of the ACLL for loan pools that share common risk characteristics, loans are evaluated collectively and segregated into loan pools considering the risk associated with the specific pool. Relevant risk characteristics include loan type, credit quality rating, delinquency category, or business segment or a combination of these classes. The allowance is determined based on a quantitative calculation of the expected life-of-loan loss percentage for each loan category by considering the probability of default, based on the migration of loans from performing to loss by credit quality rating or delinquency buckets using historical life-of-loan analysis periods for loan types and severity of loss, based on the aggregate net lifetime losses incurred per loan pool. A default is considered to have occurred if the lender believes the borrower will not be able to pay its obligation in full or the loan is 90 days or more past due. Due to limited loss history across the portfolio, the Association used peer data within their quantitative adjustment component for loan pools that have experienced minimal loss history.

The pooled component of the ACLL also considers factors for each loan pool to adjust for differences between the historical period used to calculate historical default and loss severity rates and expected conditions over the remaining lives of the loans in the portfolio related to:

- lending policies and procedures,
- national, regional, and local economic business conditions, and developments that affect the collectability of the portfolio, including the condition of various markets,
- the nature of the loan portfolio, including the terms of the loans,
- the experience, ability, and depth of the lending management and other relevant staff,
- the volume and severity of past due and adversely classified or graded loans and the volume of nonaccrual loans,
- the quality of the loan review and process,
- the value of underlying collateral for collateral-dependent loans,
- the existence and effect of any concentrations of credit and changes in the level of such concentrations, and,
- the effect of external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the existing portfolio.

The Association uses a single economic scenario over reasonable and supportable forecast period of 12 months. Subsequent to the forecast period, the Association reverts to long run historical loss experience beyond the 12 months, utilizing an accumulated quarter method, to inform the estimate of losses for the remaining contractual life of the loan portfolio.

The economic forecasts are updated on a quarterly basis and incorporate macroeconomic variables, including agricultural commodity prices, unemployment rates, Gross Domestic Product (GDP) annual growth rates, government spending as a percentage of GDP, real consumer spending, United States exports, inflation, and the federal funds rate.

In addition to the quantitative calculation, the Association considers the imprecision inherent in the process and methodology, emerging risk assessments, and other subjective factors, which may lead to a management adjustment to the modeled ACLL results. Expected credit loss estimates also include consideration of expected cash recoveries on loans previously charged-off or expected recoveries on collateral-dependent loans where recovery is expected through sale of the collateral. The economic forecasts are updated on a quarterly basis.

Prior to January 1, 2023, the allowance for loan losses was maintained at a level considered adequate to provide for probable losses existing in and inherent in the loan portfolio. The allowance was based on a periodic evaluation of the loan portfolio in which numerous factors are considered, including economic conditions, collateral values, borrowers' financial conditions, loan portfolio composition, and prior loan loss experience. The allowance for loan losses encompassed various judgments, evaluations, and appraisals with respect to the loans and their underlying collateral that, by their nature, contain elements of uncertainty and imprecision. Changes in the agricultural economy and their impact on borrower repayment capacity would cause these various judgments, evaluations, and appraisals to change over time. Management considered a number of factors in determining and supporting the levels of the allowances for loan losses, which include, but are not limited to, the concentration of lending in agriculture, combined with uncertainties associated with farmland values, commodity prices, exports, government assistance programs, regional economic effects, and weather-related influences.

Allowance for Credit Losses on Unfunded Commitments

The Association evaluates the need for an allowance for credit losses on unfunded commitments under CECL and if required, an amount is recognized and reported separately on the Consolidated Statement of Condition. The amount of expected losses is determined by calculating a commitment usage factor over the contractual period for exposures that are not unconditionally cancellable by the Association and applying the loss factors used in the ACLL methodology to the results of the usage calculation. No allowance for credit losses is recorded for commitments that are unconditionally cancellable.

NOTE 2 - LOANS AND ALLOWANCE FOR CREDIT LOSSES

A summary of loans follows.

(dollars in thousands)	**September 30, 2023**	December 31, 2022
Real estate mortgage	**$ 946,652**	$ 942,374
Production and intermediate-term	**243,331**	229,723
Agribusiness	**186,668**	195,262
Rural infrastructure	**95,806**	71,550
Agricultural export finance	**11,048**	11,781
Rural residential real estate	**17**	18
Mission-related	**739**	739
Total loans	**$ 1,484,261**	$ 1,451,447

The Association purchases and 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, 2023:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
(dollars in thousands)	Purchased	Sold	Purchased	Sold	Purchased	Sold
Real estate mortgage	$ 43,384	$ 62,240	$ –	$ 6,513	$ 43,384	$ 68,753
Production and intermediate-term	57,924	–	–	–	57,924	–
Agribusiness	180,830	–	–	–	180,830	–
Rural infrastructure	95,806	–	–	–	95,806	–
Agricultural export finance	11,048	–	–	–	11,048	–
Total	$ 388,992	$ 62,240	$ –	$ 6,513	$ 388,992	$ 68,753

Credit Quality

Credit risk arises from the potential inability of an obligor to meet its payment obligation and exists in our outstanding loans, letters of credit, and unfunded loan commitments. The Association manages credit risk associated with the retail lending activities through an analysis of the credit risk profile of an individual borrower using its own set of underwriting standards and lending policies, approved by its board of directors, which provides direction to its loan officers. The retail credit risk management process begins with an analysis of the borrower's credit history, repayment capacity, financial position, and collateral, which includes an analysis of credit scores for smaller loans. Repayment capacity focuses on the borrower's ability to repay the loan based on cash flows from operations or other sources of income, including off-farm income. Real estate mortgage loans must be secured by first liens on the real estate (collateral). As required by Farm Credit Administration regulations, each institution that makes loans on a secured basis must have collateral evaluation policies and procedures. Real estate mortgage loans may be made only in amounts up to 85% of the original appraised value of the property taken as security or up to 97% of the appraised value if guaranteed by a state, federal, or other governmental agency. The actual loan to appraised value when loans are made is generally lower than the statutory maximum percentage. Loans other than real estate mortgage may be made on a secured or unsecured basis.

The Association uses a two-dimensional risk rating model based on an internally generated combined System risk rating guidance that incorporates a 14-point probability of default rating scale to identify and track the probability of borrower default and a separate scale addressing loss given default. Probability of default is the probability that a borrower will experience a default during the life of the loan. The loss given default is management's estimate as to the anticipated principal loss on a specific loan assuming default occurs during the remaining life of the loan. A default is considered to have occurred if the lender believes the borrower will not be able to pay its obligation in full or the loan is 90 days or more past due. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses, and risks in a particular relationship. The Association reviews, at least on an annual basis, or when a credit action is taken, the probability of default category.

Each of the probability of default categories carries a distinct percentage of default probability. The probability of default rate between one and nine of the acceptable categories is very narrow and would reflect almost no default to a minimal default percentage. The probability of default rate grows more rapidly as a loan moves from acceptable to other assets especially mentioned and grows significantly as a loan moves to a substandard (viable) level. A substandard (non-viable) rating indicates that the probability of default is almost certain. These 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.
- Loss – assets are considered uncollectible.

The following table shows loans under the Farm Credit Administration Uniform Loan Classification System as a percentage of total loans by loan type as of:

	September 30, 2023	December 31, 2022[1]
Real estate mortgage		
Acceptable	**96.50%**	95.56%
OAEM	**0.45%**	2.42%
Substandard	**3.05%**	1.98%
Doubtful	**–**	0.04%
Total	**100.00%**	100.00%
Production and intermediate-term		
Acceptable	**96.51%**	96.98%
OAEM	**0.02%**	1.52%
Substandard	**3.47%**	1.50%
Total	**100.00%**	100.00%
Agribusiness		
Acceptable	**95.71%**	94.86%
OAEM	**0.95%**	2.87%
Substandard	**3.34%**	2.27%
Total	**100.00%**	100.00%
Rural infrastructure		
Acceptable	**95.31%**	95.15%
OAEM	**4.69%**	2.22%
Substandard	**–**	2.63%
Total	**100.00%**	100.00%
Agricultural export finance		
Acceptable	**100.00%**	100.00%
Total	**100.00%**	100.00%
Rural residential real estate		
Acceptable	**100.00%**	100.00%
Total	**100.00%**	100.00%
Mission-related		
Substandard	**100.00%**	100.00%
Total	**100.00%**	100.00%
Total Loans		
Acceptable	**96.30%**	95.66%
OAEM	**0.71%**	2.30%
Substandard	**2.99%**	2.01%
Doubtful	**–**	0.03%
Total	**100.00%**	100.00%

[1] Prior to the adoption of CECL on January 1, 2023, loans were presented with accrued interest receivable.

Accrued interest receivable on all accruing loans at September 30, 2023 has been excluded from the amortized cost of loans and reported separately in the Consolidated Statement of Condition.

Nonperforming assets consist of nonaccrual loans, accruing loans 90 days or more past due, and other property owned. The following table shows these nonperforming assets and related credit quality statistics as follows:

(dollars in thousands)	**September 30, 2023**	December 31, 2022
Nonaccrual loans		
Real estate mortgage	**$ 807**	$ 2,804
Production and intermediate-term	**5,978**	882
Agribusiness	**–**	2,504
Total nonaccrual loans	**$ 6,785**	$ 6,190
Accruing restructured loans		
Real estate mortgage		$ 399
Total accruing restructured loans		$ 399
Accruing loans 90 days past due		
Real estate mortgage	**$ 103**	$ –
Total accruing loans 90 days past due	**$ 103**	$ –
Total nonperforming assets[1]	**$ 6,888**	$ 6,589
Nonaccrual loans to total loans	**0.46%**	0.43%
Nonperforming assets[1] to total loans	**0.46%**	0.45%
Nonperforming assets[1] to total shareholders' equity	**2.17%**	2.27%

[1] Prior to the adoption of CECL on January 1, 2023, nonperforming assets included accruing restructured loans.

The Association had no other property owned for the periods presented.

The following tables provide the amortized cost for nonaccrual loans with and without a related allowance for loan losses, as well as interest income recognized on nonaccrual loans during the period:

	September 30, 2023		
(dollars in thousands)	Amortized Cost with Allowance	Amortized Cost without Allowance	Total
Nonaccrual loans:			
Real estate mortgage	$ –	$ 807	$ 807
Production and intermediate-term	5,749	229	5,978
Total	$ 5,749	$ 1,036	$ 6,785

	Interest Income Recognized	
(dollars in thousands)	For the Three Months Ended September 30, 2023	For the Nine Months Ended September 30, 2023
Nonaccrual loans:		
Real estate mortgage	$ 1,405	$ 1,409
Production and intermediate-term	–	60
Agribusiness	99	99
Total	$ 1,504	$ 1,568

The following tables provide an age analysis of past due loans at amortized cost.

	September 30, 2023					
(dollars in thousands)	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or less than 30 Days Past Due	Total Loans	Recorded Investment Accruing Loans 90 Days or More Past Due
Real estate mortgage	$ 1,183	$ 522	$ 1,705	$ 944,947	$ 946,652	$ 103
Production and intermediate-term	594	–	594	242,737	243,331	–
Agribusiness	–	–	–	186,668	186,668	–
Rural infrastructure	–	–	–	95,806	95,806	–
Agricultural export finance	–	–	–	11,048	11,048	–
Rural residential real estate	–	–	–	17	17	–
Mission-related	–	–	–	739	739	–
Total	$ 1,777	$ 522	$ 2,299	$1,481,962	$1,484,261	$ 103

Prior to the adoption of CECL, the age analysis of past due loans included accrued interest as follows:

	December 31, 2022					
(dollars in thousands)	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or less than 30 Days Past Due	Total Loans	Recorded Investment Accruing Loans 90 Days or More Past Due
Real estate mortgage	$ 177	$ –	$ 177	$ 957,844	$ 958,021	$ –
Production and intermediate-term	1,328	–	1,328	233,006	234,334	–
Agribusiness	–	–	–	196,270	196,270	–
Rural infrastructure	–	–	–	71,767	71,767	–
Agricultural export finance	–	–	–	11,827	11,827	–
Rural residential real estate	–	–	–	19	19	–
Mission-related	–	–	–	740	740	–
Total	$ 1,505	$ –	$ 1,505	$1,471,473	$1,472,978	$ –

Allowance for Credit Losses

The credit risk rating methodology is a key component of the Association's allowance for credit losses evaluation and is generally incorporated into the Association's loan underwriting standards and internal lending limits. In addition, borrower and commodity concentration lending and leasing limits have been established by the Association to manage credit exposure. The regulatory limit to a single borrower or lessee is 15% of the Association's lending and leasing limit base, but the Association's board of directors has generally established more restrictive lending limits. This limit applies to Associations with long-term and short- and intermediate-term lending authorities.

Effective January 1, 2023, the Association adopted the CECL accounting guidance as described in Note 1. A summary of changes in the allowance for loan losses is as follows**:**

(dollars in thousands)	Balance at June 30, 2023	Charge-offs	Recoveries	Provision for Loan Losses/ (Loan Loss Reversals)	Balance at September 30, 2023
Real estate mortgage	$ 286	$ –	$ –	$ (6)	$ 280
Production and intermediate-term	1,893	–	–	604	2,497
Agribusiness	605	138	67	(483)	51
Rural infrastructure	589	–	–	(31)	558
Total	$ 3,373	$ 138	$ 67	$ 84	$ 3,386

(dollars in thousands)	Balance at December 31, 2022	Cumulative Effect of CECL Adoption	Balance at January 1, 2023	Charge-offs	Recoveries	Provision for Loan Losses/ (Loan Loss Reversals)	Balance at September 30, 2023
Real estate mortgage	$ 1,416	$ (1,116)	$ 300	$ –	$ –	$ (20)	$ 280
Production and intermediate-term	645	(172)	473	–	–	2,024	2,497
Agribusiness	1,112	(501)	611	138	67	(489)	51
Rural infrastructure	506	(168)	338	–	–	220	558
Agricultural export finance	7	(7)	–	–	–	–	–
Mission-related	107	(107)	–	–	–	–	–
Total	$ 3,793	$ (2,071)	$ 1,722	$ 138	$ 67	$ 1,735	$ 3,386

(dollars in thousands)	Balance at June 30, 2022	Charge-offs	Recoveries	Provision for Loan Losses/ (Loan Loss Reversals)	Balance at September 30, 2022
Real estate mortgage	$ 825	$ –	$ –	$ 556	$ 1,381
Production and intermediate-term	650	–	–	(24)	626
Agribusiness	997	–	–	162	1,159
Rural infrastructure	249	–	–	230	479
Agricultural export finance	8	–	–	(2)	6
Mission-related	107	–	–	–	107
Total	$ 2,836	$ –	$ –	$ 922	$ 3,758

(dollars in thousands)	Balance at December 31, 2021	Charge-offs	Recoveries	Provision for Loan Losses/ (Loan Loss Reversals)	Balance at September 30, 2022
Real estate mortgage	$ 943	$ –	$ –	$ 438	$ 1,381
Production and intermediate-term	997	–	–	(371)	626
Agribusiness	800	–	–	359	1,159
Rural infrastructure	240	–	–	239	479
Agricultural export finance	5	–	–	1	6
Mission-related	115	–	–	(8)	107
Total	$ 3,100	$ –	$ –	$ 658	$ 3,758

For periods prior to January 1, 2023, the allowance for loan losses was based on probable and estimable losses inherent in the loan portfolio.

The Association maintains a separate reserve for unfunded commitments, which is included in Liabilities on the Association's Consolidated Statement of Condition. The related provision for the reserve for unfunded commitments is included as part of the provision for credit losses on the Consolidated Statement of Comprehensive Income, along with the provision for loan losses. A summary of changes in the reserve for unfunded commitments follows:

(dollars in thousands)	For the Three Months Ended September 30, 2023	For the Nine Months Ended September 30, 2023
Balance at beginning of period	$ 419	$ 576
Cumulative Effect of CECL Adoption		(172)
Balance at January 1		$ 404
Reversal of reserves for unfunded commitments	(37)	(22)
Total	$ 382	$ 382

(dollars in thousands)	For the Three Months Ended September 30, 2022	For the Nine Months Ended September 30, 2022
Balance at beginning of period	$ 587	$ 568
Reversal of reserves for unfunded commitments	(40)	(21)
Total	$ 547	$ 547

Loan Modifications to Borrowers Experiencing Financial Difficulties

Loan modifications may be granted to borrowers experiencing financial difficulty. Qualifying disclosable modifications are one or a combination of principal forgiveness, interest rate reduction, forbearance, other-than-insignificant payment deferral or term extension. Covenant waivers and modifications of contingent acceleration clauses are not considered term extensions. Other-than-insignificant payment deferrals may provide the borrower with a temporary payment extension, which has been defined as cumulative or individual forbearance or payment delay generally greater than or equal to six months. These deferred payments may be capitalized into the principal balance of the loan and amortized with no extension of maturity or with the deferred payment due at the time of original maturity.

The following table shows the amortized cost basis at September 30, 2023 for loan modifications granted to borrowers experiencing financial difficulty, disaggregated by loan type and type of modification granted.

	Term Extension			
	For the Three Months Ended		For the Nine Months Ended	
(dollars in thousands)	September 30, 2023	% of Total Loan Type	September 30, 2023	% of Total Loan Type
Production and intermediate-term	$ –	–	$ 826	0.34%
Agribusiness	546	0.29%	2,532	1.36%
Total	$ 546		$ 3,358	

Accrued interest receivable related to loan modifications granted to borrowers experiencing financial difficulty as of the three and nine months ended September 30, 2023 was $6 thousand and $104 thousand, respectively.

The following table describes the financial effect of the modifications made to borrowers experiencing financial difficulty during the three and nine months ended September 30, 2023:

	Weighted-Average Term Extension (in days)	
	For the Three Months Ended September 30, 2023	For the Nine Months Ended September 30, 2023
Production and intermediate-term	–	282
Agribusiness	731	872

There were no defaults in the nine months ended September 30, 2023 on loans to borrowers experiencing financial difficulty that received a modification on or after January 1, 2023, the date of adoption of the guidance "Financial Instruments – Credit Losses: Troubled Debt Restructurings and Vintage Disclosure."

The following table sets forth an aging analysis of loans to borrowers experiencing financial difficulty that were modified on or after January 1, 2023, the date of the adoption of the guidance noted above, through September 30, 2023:

	Payment Status of Loans Modified in the Past Nine Months		
(dollars in thousands)	Current	30-89 Days Past Due	90 Days or More Past Due
Production and intermediate-term	$ 746	$ 80	$ –
Agribusiness	2,532	–	–
Total loans	$ 3,278	$ 80	$ –

Additional commitments to lend to borrowers experiencing financial difficulty whose loans have been modified were $396 thousand at September 30, 2023.

Troubled Debt Restructuring

Prior to January 1, 2023, the adoption of updated FASB guidance on loan modifications, a restructuring of a loan constituted a troubled debt restructuring, also known as formally restructured, if the creditor for economic or legal reasons related to the borrower's financial difficulties granted a concession to the borrower that it would not otherwise consider. Concessions varied by program and were borrower-specific and could include interest rate reductions, term extensions, payment deferrals, or the acceptance of additional collateral in lieu of payments. In limited circumstances, principal may have been forgiven. When a restructured loan constituted a troubled debt restructuring, these loans were included within our impaired loans under nonaccrual or accruing restructured loans.

The Association had no TDRs within the previous 12 months and for which there were subsequent payment defaults at December 31, 2022.

The following table provides information on outstanding loans restructured in troubled debt restructurings.

(dollars in thousands)	Loans Modified as TDRs December 31, 2022	TDRs in Nonaccrual Status* December 31, 2022
Real estate mortgage	$ 399	$ –
Total	$ 399	$ –

* Represents the portion of loans modified as troubled debt restructurings that were in nonaccrual status.

NOTE 3 – CAPITAL

Our Association's unallocated retained earnings for the quarter ended September 30, 2023 reflects an increase from the cumulative effect of a change in accounting principle for CECL on January 1, 2023. The impact of adoption was not material to the Association's capital ratios. A summary of select capital ratios based on a three-month average and minimums set by the Farm Credit Administration follows.

	As of September 30, 2023	As of December 31, 2022	Regulatory Minimums	Capital Conservation Buffer	Total
Risk Adjusted:					
Common equity tier 1 ratio	**16.73%**	16.39%	4.5%	2.5%	7.0%
Tier 1 capital ratio	**16.73%**	16.39%	6.0%	2.5%	8.5%
Total capital ratio	**16.97%**	16.66%	8.0%	2.5%	10.5%
Permanent capital ratio	**17.20%**	16.48%	7.0%	–	7.0%
Non-Risk Adjusted:					
Tier 1 leverage ratio	**17.61%**	17.17%	4.0%	1.0%	5.0%
Unallocated retained earnings and equivalents leverage ratio	**17.49%**	17.04%	1.5%	–	1.5%

If capital ratios fall below the regulatory minimum plus buffer amounts, capital distributions (equity redemptions, cash dividend payments, and cash patronage payments) and discretionary senior executive bonuses are restricted or prohibited without prior FCA approval.

NOTE 4 - PREMISES AND EQUIPMENT

On August 3, 2023, the Association executed a contract to list the Colorado Springs administrative building for sale. The utilization of space in the building has decreased as a result of the Association embracing the trend of remote and hybrid work over the past three years. The building was listed for sale with a commercial real estate broker and is expected to sell within a year. The administrative office building assets, with a net book value of $5.8 million, are presented in the premises and equipment line of the Consolidated Statement of Condition.

NOTE 5 - FAIR VALUE MEASUREMENTS

Accounting 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 of the 2022 Annual Report to Shareholders for a more complete description.

Assets measured at fair value on a recurring basis are summarized below:

	Fair Value Measurement Using			**Total Fair Value**
(dollars in thousands)	**Level 1**	**Level 2**	**Level 3**	
Assets held in nonqualified benefits trusts				
September 30, 2023	**$ 170**	**$ –**	**$ –**	**$ 170**
December 31, 2022	$ 133	$ –	$ –	$ 133

The Association had no liabilities measured at fair value on a recurring basis at September 30, 2023 or December 31, 2022.

Assets measured at fair value on a non-recurring basis for each of the fair value hierarchy values are summarized below:

	Fair Value Measurement Using			**Total Fair Value**
(dollars in thousands)	**Level 1**	**Level 2**	**Level 3**	
Loans				
September 30, 2023	**$ –**	**$ –**	**$ 3,705**	**$ 3,705**
December 31, 2022	$ –	$ –	$ 2,013	$ 2,013

With regard to impaired loans, 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 takes into account unobservable inputs such as income and expense, comparable sales, replacement cost, and comparability adjustments.

The Association had no liabilities measured at fair value on a non-recurring basis at September 30, 2023 or December 31, 2022.

Valuation Techniques

As more fully discussed in Note 2 of the 2022 Annual Report to Shareholders, accounting guidance establishes a fair value hierarchy, which requires an Association to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following presents a brief summary of the valuation techniques used by the Association for assets and liabilities, subject to fair value measurement.

Assets Held in Non-Qualified 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.

Loans Evaluated for Impairment

For impaired loans measured on a non-recurring basis, the fair value is based upon the underlying collateral since the loans are collateral-dependent loans. 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 collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established.

NOTE 6 - SUBSEQUENT EVENTS

The Association has evaluated subsequent events through November 7, 2023, which is the date the financial statements were issued, and no material subsequent events were identified.