Farm Credit Midsouth, ACA

Quarterly Report
September 30, 2019

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the consolidated financial condition and consolidated results of operations of Farm Credit Midsouth, ACA and its subsidiaries Farm Credit Midsouth, FLCA and Farm Credit Midsouth, PCA. This discussion should be read in conjunction with both the unaudited consolidated financial information and related notes included in this Quarterly Report as well as Management's Discussion and Analysis included in our Annual Report for the year ended December 31, 2018 (2018 Annual Report).

Due to the nature of our financial relationship with AgriBank, FCB (AgriBank), the financial condition and results of operations of AgriBank materially impact our members' investment. To request free copies of AgriBank financial reports or additional copies of our report, contact us at:

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FORWARD-LOOKING INFORMATION

Any forward-looking statements in this Quarterly 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.

AGRICULTURAL AND ECONOMIC CONDITIONS

Harvest is well under way in the association territory and most of the crops are looking pretty good for those acres that were planted. According to the Arkansas Crop Progress report dated October 6, 2019, Cotton harvested was 41% a little ahead of the 5-year average of 28% with 83% being Good to Excellent condition. Rice harvested was 82% a little under the 5-year average of 87%. Soybeans harvested was 38% a little behind the 5-year average of 47% with 57% being Good to Excellent and 30% reported as in Fair condition. Peanuts dug were 66% and 28% harvested. The peanuts were reported to be 89% Good to Excellent condition. Weather conditions have been very good for harvesting with highs in the 80's.

Crop prices continue to fluctuate as the United States and China work out their trade agreements. Offsetting low crop prices was President Trump's announcement of $16 Billion in Aid to farmers (Market Facilitation Program 2) (MFP2) due to the prolonged China Trade war. The Market Facilitation payments along with anticipated PLC/ARC payments should help our farmers break-even.

Ground breaking for the new Delta Peanut Processing Plant in Jonesboro was August 27, 2019. The plant which is located on 71-acres in the Craighead Technology Park is scheduled to open in Spring of 2020 and will be the first shelling operation in the State of Arkansas. The plant is estimated to cost $70M and will ultimately create 130 new jobs in the Jonesboro area according to the August 27, 2019 Jonesboro Unlimited article.

LOAN PORTFOLIO

Loan Portfolio

Total loans were $1.0 billion at September 30, 2019, an increase of $109.3 million from December 31, 2018. The increase was primarily due to $135 million of new money offset by normal repayments. Operating loan balances experienced a high during September with a $66 million increase over year-end 2018.

Portfolio Credit Quality

The credit quality of our portfolio improved from December 31, 2018. Adversely classified loans decreased to 1.4% of the portfolio at September 30, 2019, from 4.4% of the portfolio at December 31, 2018. Adversely classified loans are loans 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.

In certain circumstances, government agency guarantee programs are used to reduce the risk of loss. At September 30, 2019, $9.5 million of our loans were, to some level, guaranteed under these government programs.

Risk Assets

Components of Risk Assets

(dollars in thousands) As of:	**September 30 2019**	December 31 2018
Loans:		
Nonaccrual	**$ 6,585**	$ 10,594
Accruing restructured	**405**	510
Accruing loans 90 days or more past due	**--**	--
Total risk loans	**6,990**	11,104
Other property owned	**--**	534
Total risk assets	**$ 6,990**	$ 11,638
Total risk loans as a percentage of total loans	**0.7%**	1.2%
Nonaccrual loans as a percentage of total loans	**0.6%**	1.1%
Current nonaccrual loans as a percentage of total nonaccrual loans	**40.7%**	55.7%
Total delinquencies as a percentage of total loans	**0.4%**	1.2%

Note: Accruing loans include accrued interest receivable.

Our risk assets have decreased from December 31, 2018, and have remained at acceptable levels. Total risk loans as a percentage of total loans were well within our established risk management guidelines.

The decrease in nonaccrual loans was primarily due reinstatements to accrual status and normal repayments. Nonaccrual loans remained at an acceptable level at September 30, 2019, and December 31, 2018.

Allowance for Loan Losses

The allowance for loan losses is an estimate of losses on loans inherent 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, estimated probability of default, estimated loss severity, portfolio quality, and current economic and environmental conditions.

Allowance Coverage Ratios

As of:	**September 30 2019**	December 31 2018
Allowance as a percentage of:		
Loans	**0.3%**	0.4%
Nonaccrual loans	**42.4%**	34.8%
Total risk loans	**40.0%**	32.2%

In our opinion, the allowance for loan losses was reasonable in relation to the risk in our loan portfolio at September 30, 2019.

RESULTS OF OPERATIONS

Profitability Information

(dollars in thousands) For the nine months ended September 30	**2019**	2018
Net income	**$ 13,317**	$ 12,805
Return on average assets	**1.9%**	1.9%
Return on average members' equity	**7.9%**	8.0%

Changes presented in the profitability information chart relate directly to:

- Changes in income discussed in this section
- Changes in assets discussed in the Loan Portfolio section
- Changes in capital discussed in the Funding, Liquidity, and Capital section

Changes in Significant Components of Net Income

(in thousands) For the nine months ended September 30		2019		2018		Increase (decrease) in net income
Net interest income	$	**20,082**	$	19,222	$	**860**
(Reversal of) provision for loan losses		**(913)**		945		**1,858**
Patronage income		**2,929**		2,114		**815**
Other income, net		**870**		3,304		**(2,434)**
Operating expenses		**11,118**		10,602		**(516)**
Provision for income taxes		**359**		288		**(71)**
Net income	$	**13,317**	$	12,805	$	**512**

Changes in Net Interest Income

(in thousands) For the nine months ended September 30		2019 vs 2018
Changes in volume	$	**536**
Changes in interest rates		**220**
Changes in nonaccrual income and other		**104**
Net change	$	**860**

The change in the (reversal of) provision for loan losses was related to decreased nonaccruals and minimal loan growth.

Patronage Income

(in thousands) For the nine months ended September 30		2019		2018
Wholesale patronage:				
Cash	$	**1,041**	$	1,827
Stock		**1,671**		--
Pool program patronage		**217**		287
Total patronage income	$	**2,929**	$	2,114

Total wholesale patronage increased primarily as a result of a higher patronage rate for the nine months ended September 30, 2019, compared to the same period of 2018. Wholesale patronage may be paid in cash or AgriBank stock. As discussed in our Annual Report, AgriBank will pay patronage in the form of allocated stock as necessary to meet all regulatory capital requirements, while optimizing capital throughout the District. The amount of stock patronage may vary from quarter-to-quarter as AgriBank updates their forecasts for the year, and the final amount of stock patronage will be determined at the end of the year.

The change in other income, net was primarily due to the 2018 reversal of a contingent liability in the amount of $2.0 million. In addition, our share of the Allocated Insurance Reserve Accounts (AIRA) received from the Farm Credit System Insurance Corporation (FCSIC) was $210 thousand in 2019, compared to $519 thousand in 2018. The AIRA was established by FCSIC when premiums collected increased the level of the Insurance Fund beyond the required 2% of insured debt. Refer to the 2018 Annual Report for additional information about the FCSIC.

The increase in operating expenses were primarily due to Salaries & Incentives related to additional positions added over the year, Furniture & Equipment, and Public Relations.

The association added two new positions hiring Melissa Powell as Marketing Manager, and Amy Privett as Human Resource/Executive Administration Assistant. In addition Farm Credit Midsouth added Ralph Stewart as Chief Credit Officer in July, 2019. Ralph will officially start his position as CCO effective October 1, 2019. The hiring of a new Chief Credit Officer was due to the upcoming retirement of the current Chief Credit Officer Davy Crockett. Davy will retire in February, 2020. Furniture and fixtures also increased due to the association building a new office in Paragould and the associated furniture purchases that were required. The new office accommodates branch and central office staff. Public and member relations increased primarily due to an increased focus on providing value to our customers.

The change in provision for income taxes was primarily related to timing differences between book and tax income.

FUNDING, LIQUIDITY, AND CAPITAL

We borrow from AgriBank, under a note payable, in the form of a line of credit. Our note payable matures on April 30, 2020, at which time the note will be renegotiated. The repricing attributes of our line of credit generally correspond to the repricing attributes of our loan portfolio, which significantly reduces our market interest rate risk. Due to the cooperative structure of the Farm Credit System and as we are a stockholder of AgriBank, we expect this borrowing relationship to continue into the foreseeable future. Our other source of lendable funds is from unallocated surplus.

The components of cost of funds associated with our note payable include:

- A marginal cost of debt component

- A spread component, which includes cost of servicing, cost of liquidity, and bank profit
- A risk premium component, if applicable

We were not subject to a risk premium at September 30, 2019, or December 31, 2018.

Total members' equity increased $8.4 million from December 31, 2018, primarily due to net income for the period, partially offset by patronage distribution accruals. The change in accumulated other comprehensive loss is the amortization impact of prior service cost and unamortized actuarial gain/loss related to the Pension Restoration Plan. Refer to Note 8 in our 2018 Annual Report for more information on the Pension Restoration Plan.

The Farm Credit Administration (FCA) 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 FCA 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 6 in our 2018 Annual Report for a more complete description of these ratios.

Regulatory Capital Requirements and Ratios

As of:	**September 30 2019**	December 31 2018	Regulatory Minimums	Capital Conservation Buffer	Total
Risk-adjusted:					
Common equity tier 1 ratio	**19.7%**	19.8%	4.5%	2.5%*	7.0%
Tier 1 capital ratio	**19.7%**	19.8%	6.0%	2.5%*	8.5%
Total capital ratio	**20.0%**	20.1%	8.0%	2.5%*	10.5%
Permanent capital ratio	**19.8%**	19.8%	7.0%	N/A	7.0%
Non-risk-adjusted:					
Tier 1 leverage ratio	**21.1%**	21.0%	4.0%	1.0%	5.0%
Unallocated retained earnings and equivalents leverage ratio	**21.2%**	21.2%	1.5%	N/A	1.5%

*The 2.5% capital conservation buffer over risk-adjusted ratio minimums is being phased in over three years under the FCA capital requirements. The phase in period ends on December 31, 2019.

The capital adequacy ratios are directly impacted by the changes in capital as more fully explained in this section and the changes in assets as discussed in the Loan Portfolio section.

CERTIFICATION

The undersigned have reviewed the September 30, 2019, Quarterly Report of Farm Credit Midsouth, ACA, which has been prepared under the oversight of the Audit Committee and in accordance with all applicable statutory or regulatory requirements. The information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Chris Roberts
Chairman of the Board
Farm Credit Midsouth, ACA

James McJunkins
President and Chief Executive Officer
Farm Credit Midsouth, ACA

Shari J. Wilson
Executive Vice President of Finance, Chief Financial Officer
Farm Credit Midsouth, ACA

November 8, 2019

CONSOLIDATED STATEMENTS OF CONDITION

Farm Credit Midsouth, ACA
(in thousands)
(Unaudited)

As of:		**September 30 2019**		December 31 2018
ASSETS				
Loans	**$**	**1,010,697**	$	901,382
Allowance for loan losses		**2,794**		3,682
Net loans		**1,007,903**		897,700
Investment in AgriBank, FCB		**20,465**		18,794
Accrued interest receivable		**27,055**		21,209
Other property owned		**--**		534
Deferred tax assets, net		**166**		520
Other assets		**12,331**		12,035
Total assets	**$**	**1,067,920**	$	950,792
LIABILITIES				
Note payable to AgriBank, FCB	**$**	**825,588**	$	714,589
Accrued interest payable		**5,633**		5,178
Patronage distribution payable		**4,950**		6,500
Other liabilities		**2,948**		4,103
Total liabilities		**839,119**		730,370
Contingencies and commitments (Note 3)				
MEMBERS' EQUITY				
Capital stock and participation certificates		**1,886**		1,895
Unallocated surplus		**227,081**		218,714
Accumulated other comprehensive loss		**(166)**		(187)
Total members' equity		**228,801**		220,422
Total liabilities and members' equity	**$**	**1,067,920**	$	950,792

The accompanying notes are an integral part of these Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Farm Credit Midsouth, ACA
(in thousands)
(Unaudited)

	Three Months Ended		Nine Months Ended	
For the period ended September 30	**2019**	2018	**2019**	2018
Interest income	**$ 12,950**	$ 12,304	**$ 35,381**	$ 32,190
Interest expense	**5,633**	5,075	**15,299**	12,968
Net interest income	**7,317**	7,229	**20,082**	19,222
(Reversal of) provision for loan losses	**(39)**	797	**(913)**	945
Net interest income after (reversal of) provision for loan losses	**7,356**	6,432	**20,995**	18,277
Other income				
Patronage income	**1,082**	768	**2,929**	2,114
Financially related services income	**252**	270	**329**	320
Fee income	**7**	48	**433**	365
Allocated Insurance Reserve Accounts distribution	**--**	--	**210**	519
Miscellaneous income (loss), net	**16**	24	**(102)**	2,100
Total other income	**1,357**	1,110	**3,799**	5,418
Operating expenses				
Salaries and employee benefits	**2,406**	2,293	**7,211**	6,913
Other operating expenses	**1,369**	1,244	**3,907**	3,689
Total operating expenses	**3,775**	3,537	**11,118**	10,602
Income before income taxes	**4,938**	4,005	**13,676**	13,093
Provision for (benefit from) income taxes	**131**	(170)	**359**	288
Net income	**$ 4,807**	$ 4,175	**$ 13,317**	$ 12,805
Other comprehensive income				
Employee benefit plans activity	**$ 7**	$ 11	**$ 21**	$ 32
Total other comprehensive income	**7**	11	**21**	32
Comprehensive income	**$ 4,814**	$ 4,186	**$ 13,338**	$ 12,837

The accompanying notes are an integral part of these Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

Farm Credit Midsouth, ACA
(in thousands)
(Unaudited)

	Protected Members' Equity	Capital Stock and Participation Certificates	Unallocated Surplus	Accumulated Other Comprehensive Loss	Total Members' Equity
Balance at December 31, 2017	$ 2	$ 1,904	$ 206,715	$ (286)	$ 208,335
Net income	--	--	12,805	--	12,805
Other comprehensive income	--	--	--	32	32
Unallocated surplus designated for patronage distributions	--	--	(4,199)	--	(4,199)
Capital stock and participation certificates issued	--	106	--	--	106
Capital stock and participation certificates retired	(2)	(115)	--	--	(117)
Balance at September 30, 2018	$ --	$ 1,895	$ 215,321	$ (254)	$ 216,962
Balance at December 31, 2018	$ --	$ 1,895	$ 218,714	$ (187)	$ 220,422
Net income	**--**	**--**	**13,317**	**--**	**13,317**
Other comprehensive income	**--**	**--**	**--**	**21**	**21**
Unallocated surplus designated for patronage distributions	**--**	**--**	**(4,950)**	**--**	**(4,950)**
Capital stock and participation certificates issued	**--**	**99**	**--**	**--**	**99**
Capital stock and participation certificates retired	**--**	**(108)**	**--**	**--**	**(108)**
Balance at September 30, 2019	**$ --**	**$ 1,886**	**$ 227,081**	**$ (166)**	**$ 228,801**

The accompanying notes are an integral part of these Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

The Consolidated Financial Statements contain all adjustments necessary for a fair presentation of the interim Consolidated Statements of Condition and Consolidated Statements of Comprehensive Income. Our accounting policies conform to accounting principles generally accepted in the United States of America (GAAP) and the prevailing practices within the financial services industry. This interim Quarterly Report is prepared based upon statutory and regulatory requirements and in accordance with GAAP. However, certain disclosures required by GAAP are omitted. The results of the nine months ended September 30, 2019, are not necessarily indicative of the results to be expected for the year ending 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 Annual Report for the year ended December 31, 2018 (2018 Annual Report).

The Consolidated Financial Statements present the consolidated financial results of Farm Credit Midsouth, ACA (the Association) and its subsidiaries Farm Credit Midsouth, FLCA and Farm Credit Midsouth, PCA. All material intercompany transactions and balances have been eliminated in consolidation.

Recently Issued or Adopted Accounting Pronouncements

We have assessed the potential impact of accounting standards that have been issued by the Financial Accounting Standards Board (FASB) and have determined the following standards to be applicable to our business. While we are a nonpublic entity, our financial results are closely related to the performance of the combined Farm Credit System. Therefore, we typically adopt accounting pronouncements on the public business entities effective date or aligned with other System institutions, whichever is earlier.

Standard and effective date	Description	Adoption status and financial statement impact
In February 2016, the FASB issued Accounting Standards Update (ASU) 2016-02 “Leases.” In July 2018, the FASB issued ASU 2018-11 “Leases (Topic 842): Targeted Improvements.” The 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. Upon adoption, a liability for lease obligations and a corresponding right-of-use asset is recognized on the Consolidated Statements of Condition for all lease arrangements spanning more than 12 months. 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, using the transition guidance allowing for the application of the transition requirements on the effective date with the effects initially recognized as a cumulative effect adjustment to the opening balance of retained earnings. In addition, we elected the package of practical expedients permitted under the transition guidance, which among other things, allowed us to carry forward the historical lease classification. We also elected the hindsight practical expedient to determine the lease term for existing leases. The adoption of this guidance did not have a material impact on our financial condition, results of operations, and financial statement disclosures, and had no impact on cash flows.
In June 2016, the FASB issued ASU 2016-13 “Financial Instruments – Credit Losses.” This guidance is effective for public business entities for non-U.S. 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.	On October 16, 2019, the FASB voted to defer effective dates for various standards for certain entities, which includes ASU 2016-13. We have determined we qualify for the delay in the required adoption date for this standard. We are evaluating the deferral and have not yet determined if we will early adopt the standard. We have reviewed the accounting standard, selected and substantially completed development of our system, and are in the process of drafting disclosures. Significant implementation matters yet to be addressed include system testing, drafting of accounting policies, and designing processes and controls. We are currently unable to estimate the impact on the financial statements.

NOTE 2: LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans by Type

(dollars in thousands) As of:	**September 30, 2019** Amount	**September 30, 2019** %	December 31, 2018 Amount	December 31, 2018 %
Real estate mortgage	**$ 500,933**	**49.5%**	$ 502,091	55.7%
Production and intermediate-term	**436,263**	**43.2%**	341,894	37.9%
Agribusiness	**71,519**	**7.1%**	56,084	6.2%
Other	**1,982**	**0.2%**	1,313	0.2%
Total	**$ 1,010,697**	**100.0%**	$ 901,382	100.0%

The other category is primarily comprised of rural residential real estate loans.

Delinquency

Aging Analysis of Loans

(in thousands) **As of September 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
Real estate mortgage	**$ 138**	**$ 1,569**	**$ 1,707**	**$ 512,478**	**$ 514,185**
Production and intermediate-term	**145**	**1,885**	**2,030**	**446,780**	**448,810**
Agribusiness	**--**	**410**	**410**	**72,358**	**72,768**
Other	**--**	**--**	**--**	**1,989**	**1,989**
Total	**$ 283**	**$ 3,864**	**$ 4,147**	**$ 1,033,605**	**$ 1,037,752**

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
Real estate mortgage	$ 1,428	$ 1,569	$ 2,997	$ 510,420	$ 513,417
Production and intermediate-term	4,790	3,067	7,857	342,901	350,758
Agribusiness	--	--	--	57,099	57,099
Other	--	--	--	1,317	1,317
Total	$ 6,218	$ 4,636	$ 10,854	$ 911,737	$ 922,591

Note: Accruing loans include accrued interest receivable.

There were no loans 90 days or more past due and still accruing interest at September 30, 2019, or December 31, 2018.

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.

Risk Loan Information

(in thousands) As of:	**September 30 2019**	December 31 2018
Volume with specific allowance	**$ 1,877**	$ 3,172
Volume without specific allowance	**5,113**	7,932
Total risk loans	**$ 6,990**	$ 11,104
Total specific allowance	**$ 350**	$ 1,009
For the nine months ended September 30	**2019**	2018
Income on accrual risk loans	**$ 49**	$ 18
Income on nonaccrual loans	**289**	185
Total income on risk loans	**$ 338**	$ 203
Average risk loans	**$ 9,701**	$ 9,157

Note: Accruing loans include accrued interest receivable.

We did not have any material commitments to lend additional money to borrowers whose loans were classified as risk loans at September 30, 2019.

Troubled Debt Restructurings (TDRs)

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 TDRs 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.

There were no TDRs that occurred during the nine months ended September 30, 2019, or 2018.

There were no TDRs that defaulted during the nine months ended September 30, 2019, or 2018 in which the modification was within twelve months of the respective reporting period.

TDRs Outstanding in the Production and Intermediate-Term Loan Category

(in thousands) As of:	**September 30 2019**	December 31 2018
TDRs in accrual status	**$ 405**	$ 510
TDRs in nonaccrual status	**40**	400
Total TDRs	**$ 445**	$ 910

There were no commitments to lend to borrowers whose loans have been modified in a TDR at September 30, 2019.

Allowance for Loan Losses

Changes in Allowance for Loan Losses

(in thousands) Nine months ended September 30	**2019**	2018
Balance at beginning of period	**$ 3,682**	$ 2,593
(Reversal of) provision for loan losses	**(913)**	945
Loan recoveries	**27**	24
Loan charge-offs	**(2)**	--
Balance at end of period	**$ 2,794**	$ 3,562

NOTE 3: CONTINGENCIES AND COMMITMENTS

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 Consolidated Financial Statements. We do not anticipate any material losses because of these contingencies or commitments.

We may be named as a defendant in certain lawsuits or legal actions in the normal course of business. In 2009, we were named as a counter-defendant based on various lender liability type of theories in an on-going foreclosure lawsuit. On October 26, 2015, the case was heard by a jury, and on November 3, 2015, a verdict was rendered against the Association. We appealed the verdict, and on April 4, 2018, the Arkansas Court of Appeals substantially reversed all of the verdict. The decision of the Arkansas Court of Appeals was subsequently upheld by the Arkansas Supreme Court on June 21, 2018, when the Court denied the defendants' Petition for Review. The judgment on that portion of the verdict that was not reversed has since been paid by the Association. Although some issues remain for resolution this decision effectively ends the lender liability portion of the litigation. We had previously recorded a $2.3 million liability for this lawsuit, of which $2.0 million has been overturned and therefore reversed. The difference is included in "Other liabilities" in the Consolidated Statements of Condition. At the date of these Consolidated Financial Statements, our management team was not aware of any material actions. However, management cannot ensure that such actions or other contingencies will not arise in the future.

NOTE 4: 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 input levels 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 September 30, 2019, or December 31, 2018.

Non-Recurring

We may be required, from time to time, to measure certain assets at fair value on a non-recurring basis.

Assets Measured at Fair Value on a Non-recurring Basis

(in thousands)

	As of September 30, 2019			
	Fair Value Measurement Using			Total Fair
	Level 1	Level 2	Level 3	Value
Impaired loans	**$ --**	**$ --**	**$ 1,603**	**$ 1,603**
Other property owned	**--**	**--**	**--**	**--**
	As of December 31, 2018			
	Fair Value Measurement Using			Total Fair
	Level 1	Level 2	Level 3	Value
Impaired loans	$ --	$ --	$ 2,272	$ 2,272
Other property owned	--	--	555	555

Valuation Techniques

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 are classified as 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 are classified as 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 uses observable market-based information, they are classified as 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 property and other matters, they are classified as Level 3.

NOTE 5: SUBSEQUENT EVENTS

We have evaluated subsequent events through November 8, 2019, which is the date the Consolidated 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.