

AG 
TEXAS
FARM CREDIT SERVICES
Quarterly Report

**The Third Quarter Ended
September 30, 2022**



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Report of Management

The consolidated financial statements of *AgTexas Farm Credit Services* (“**Association**”) are prepared by management, who is responsible for the statements’ integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America appropriate in the circumstances. Other financial information included in the quarterly report is consistent with that in the consolidated financial statements and there are no significant changes in the Association’s internal controls or in other factors that could significantly affects such controls during the quarter.

The undersigned certify that this quarterly report has been reviewed and 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 his knowledge and belief.

A handwritten signature in black ink, appearing to read "Tim McDonald".

Tim McDonald, Chief Executive Officer
November 2, 2022

A handwritten signature in black ink, appearing to read "Dennis Anthony".

Dennis Anthony, Chairman, Board of Directors
November 2, 2022

A handwritten signature in black ink, appearing to read "Jeff Fairchild".

Jeff Fairchild, Chief Financial Officer
November 2, 2022

Management’s Discussion and Analysis (Dollars in thousands, except as noted)

The third quarter consolidated financial statements of AgTexas Farm Credit Services, including its wholly-owned subsidiaries AgTexas, PCA and AgTexas, FLCA (collectively referred to herein as the “**Association**”), is unaudited, but contains all adjustments necessary for a fair presentation of the interim financial condition and results of operations. The statements are prepared in conformity with generally accepted accounting principles and prevailing practices within the banking industry. In preparing these consolidated statements and meeting its responsibility for reliable financial information, management depends upon the Association’s accounting and internal control systems which have been designed to provide reasonable assurance that assets are safeguarded and transactions are properly authorized and recorded.

The Association is a member of the *Farm Credit System* (“**System**”), a nationwide network of cooperatively owned financial institutions established by and subject to the provisions of the Farm Credit Act of 1971, as amended, and the regulations of the *Farm Credit Administration* (“**FCA**”) promulgated thereunder.

The following commentary explains management’s assessment of the principal aspects of the consolidated financial condition and results of operations of the Association for the three and nine months ended September 30, 2022, and should be read in conjunction with the accompanying *consolidated financial statements* (“**CFS**”) and the *Association’s 2021 Annual Report to Stockholders* (“**2021 Annual Report**”). Management prepared the accompanying CFS under the oversight of the Association’s Audit Committee.

Significant Events.

The Association distributed patronage of approximately \$26 million in cash in the first quarter of 2022. This represented the 2021 patronage declared by the Association.

In January 2017, the Association received clearance from FCA and the board approved the issuance of 20 million shares of a series of preferred stock, par value of \$1.00 per share. The stock was issued March 24, 2017. The stock was designated as Fixed-to-Floating Rate Perpetual Cumulative Preferred Stock, Series A (“**Series A Preferred Stock**”). The Series A Preferred Stock became redeemable in March of 2022. In the third quarter of 2022, the board of directors and FCA approved the redemption of all the Series A Preferred Stock. The Series A Preferred Stock was redeemed in September 2022.

Loan Portfolio.

Total loans outstanding at September 30, 2022, including nonaccrual loans, were \$2,688,547 compared to \$2,708,548 at December 31, 2021, reflecting a decrease of 0.7 percent. Nonaccrual loans as a percentage of total loans outstanding were 0.7 percent at September 30, 2022, compared to 0.2 percent at December 31, 2021.

The Association recorded \$5 in recoveries and \$0 in charge-offs for the nine months ended September 30, 2022, and \$512 in recoveries and \$2 in charge-offs for the same period in 2021. The Association’s allowance for credit losses, which consists of the allowance for loan losses and the reserve for unfunded credit commitments, was 0.43 percent and 0.30 percent of total loans outstanding as of September 30, 2022, and December 31, 2021, respectively.

The financial performance of the Association may be significantly impacted by the quality of loans within the loan portfolio. Internal policies and procedures, as well as third party credit reviews and examinations help to ensure asset quality is properly reflected. Additional detail on credit quality is illustrated in the following table.

	September 30, 2022	September 30, 2021	December 31, 2021
Acceptable	95.4%	96.0%	96.4%
OAEM	3.4%	2.7%	2.3%
Substandard/doubtful	1.2%	1.3%	1.3%
	100.0%	100.0%	100.0%

Changes in the Association’s loan portfolio from December 31, 2021 to September 30, 2022 follow:

Loan Type	September 30, 2022		December 31, 2021	
	Amount	%	Amount	%
Real estate mortgage	\$ 1,484,336	55.3%	\$ 1,461,475	53.9%
Production and intermediate term	866,723	32.2%	928,309	34.3%
Agribusiness:				
Loans to cooperatives	12,727	0.5%	10,636	0.4%
Processing and marketing	187,490	7.0%	173,655	6.4%
Farm-related business	54,016	2.0%	46,719	1.7%
Communication	16,525	0.6%	14,960	0.6%
Energy	4,270	0.2%	4,543	0.2%
Water and waste water	6,595	0.2%	3,829	0.1%
Rural residential real estate	6,087	0.2%	6,134	0.2%
Agricultural export finance	10,005	0.4%	10,004	0.4%
Lease receivables	9,235	0.3%	10,809	0.4%
Mission-related investments	30,538	1.1%	37,475	1.4%
Total	<u>\$ 2,688,547</u>	<u>100.0%</u>	<u>\$ 2,708,548</u>	<u>100.0%</u>

The Association’s portfolio includes significant mission-related investments authorized under the FCA approved *Rural America Bond Pilot Program* (“**RAB**”). The RAB program was designed to meet the growing and changing needs of agricultural enterprises, agribusinesses, and various infrastructure needs in rural communities through investment in these areas. The RAB pilot program ended as of December 31, 2014. FCA approved new investment regulations that became effective January 1, 2019. Effective February 25, 2019, the Association began purchasing USDA 100% unconditional guaranteed loans that are considered mission-related investments included in the above table.

Effective January 1, 2019, new FCA investment regulations provided authorization for the Association to invest in *Small Business Administration* (“**SBA**”) pool securities. As a part of the conditions of the authorization, the investments are required to be 100% unconditionally guaranteed by the federal government or its agencies. For more information see Note 2 in the “Notes to Unaudited Consolidated Financial Statements”.

Risk Exposure. High-risk assets include impaired loans and other property owned. Impaired loans are comprised of nonaccrual, past due ≥ 90 days and still accruing interest, and formally restructured loans. The following table illustrates the Association’s components and trends of high-risk assets:

	September 30, 2022		December 31, 2021	
	Amount	%	Amount	%
Nonaccrual	\$ 19,892	60.3%	\$ 6,733	44.2%
90 days past due and still accruing interest	7,893	24.0%	2,267	14.9%
Formally restructured	5,166	15.7%	6,233	40.9%
Other property owned, net	-	0.0%	-	0.0%
Total	<u>\$ 32,951</u>	<u>100.0%</u>	<u>\$ 15,233</u>	<u>100.0%</u>

Results of Operations. Changes in the Association’s results of operations for the three and nine months ended September 30, 2022 and 2021 follow:

	For the three months ended		For the nine months ended	
	September 30, 2022	September 30, 2021	September 30, 2022	September 30, 2021
Interest income	\$ 32,744	\$ 23,398	\$ 85,073	\$ 66,630
Interest expense	(15,822)	(8,694)	(36,152)	(24,751)
(Provision for) reversal of loan losses	(1,631)	(913)	(3,518)	(340)
Net interest margin	15,291	13,791	45,403	41,539
Noninterest income	9,994	7,361	28,399	20,462
Noninterest expense	(11,189)	(9,063)	(32,112)	(26,644)
Net income	\$ 14,096	\$ 12,089	\$ 41,690	\$ 35,357

Net interest margin (interest income less interest expense) is the principal source of earnings and results from relative volumes of interest-earning assets and interest-bearing liabilities, yields on interest-earning assets, and rates on interest-bearing liabilities. The increase in interest income is primarily due to the growth in volume quarter over quarter and higher interest rates. The changes in “(Provision for) reversal of loan losses” are due to increases in specific reserves along with an increase in allowance for loan loss. Noninterest income increase is due to increases in patronage income, insurance income, and appraisal income. Noninterest expense increase is due to increases in salaries and FCS Insurance Premiums.

The effects of changes in average volumes, yields, and rates on interest margin follow:

	For the nine months ended September 30, 2022		For the nine months ended September 30, 2021	
	Average Balance	Interest	Average Balance	Interest
	Total loans and investments	2,788,982	85,073	2,373,787
Interest-bearing liabilities	2,448,638	36,152	2,128,153	24,751
Impact of capital	\$ 340,344		\$ 245,634	
Net interest income		\$ 48,921		\$ 41,879

	2022	2021
	Average Yield	Average Yield
Yield on loans and investments	4.08%	3.75%
Cost of interest-bearing	1.97%	1.55%
Interest rate spread	2.10%	2.20%
Interest rate margin	2.35%	2.36%

	Nine months ended September 30:		
	2022 vs. 2021		
	Increase (decrease) due to		
	Volume	Rate	Total
Interest income	\$ 11,645	\$ 6,798	\$ 18,443
Interest expense	3,715	7,686	11,401
Net interest income	\$ 7,930	\$ (888)	\$ 7,042

The Association’s return on average assets was 1.92% and 1.83% for the quarters ended September 30, 2022 and 2021, respectively, and 1.93% and 1.92% for the nine months ended September 30, 2022 and 2021, respectively. The increase in return on average assets for the three months and nine months ended September 30, 2022 is due to increased net income, which is explained above. The Association’s return on average equity was 13.24% and 14.70% for the quarters ended September 30, 2022 and 2021, respectively, and 13.53% and 15.03% for the nine months ended September 30, 2022 and 2021, respectively. The decrease in return on average equity for the three months and nine months ended September 30, 2022 is due to the issuance of Series B Preferred stock in October of 2021.

Liquidity and Funding Sources. *Interest rate risk (“IRR”)* inherent in the loan portfolio is substantially mitigated through the funding relationship with the *Farm Credit Bank of Texas (“FCBT” or “bank”)*. FCBT manages IRR through direct loan pricing and asset/liability management. The Association’s primary source of liquidity and funding is a direct note payable to FCBT. The following schedule summarizes the Association’s borrowings:

	September 30, 2022	December 31, 2021
Note payable to FCBT	\$ 2,466,181	\$ 2,470,340
Accrued interest on note payable	5,547	3,066
Total	<u>\$ 2,471,728</u>	<u>\$ 2,473,406</u>

The Association operates under a *general financing agreement (“GFA”)* with the bank. The current GFA is effective through September 30, 2023. The outstanding balance of \$2,466,181 as of September 30, 2022, is recorded as a liability on the Association’s balance sheet. The note carried a weighted average interest rate of 2.75 percent at September 30, 2022. The indebtedness is collateralized by a pledge of substantially all of the Association’s assets to the bank and is governed by the GFA. The decrease in note payable to the bank since December 31, 2021, is due to the Association’s decrease in loan volume. The Association’s own funds, which represent the amount of the Association’s loan portfolio funded by the Association’s equity, were \$323,520 at September 30, 2022. The maximum amount the Association may borrow from the bank as of September 30, 2022, was \$2,806,900 as defined by the GFA. The indebtedness continues in effect until the expiration date of the GFA, unless sooner terminated by the bank upon the occurrence of an event of default, or by the Association, in the event of a breach of this agreement by the bank, upon giving the bank 30 calendar days’ prior written notice, or in all other circumstances, upon giving the bank 120 days’ prior written notice.

Capital Resources. The Association’s members’ equity was \$413,566 and \$396,080 at September 30, 2022 and December 31, 2021, respectively, a \$17,486 increase, which approximates current earnings less \$20,000 from the Series A Preferred Stock redemption that occurred in September of 2022 and preferred stock dividends. The Association’s debt as a percentage of members’ equity was 6.11:1 as of September 30, 2022, compared to 6.39:1 as of December 31, 2021. FCA regulations require associations to maintain minimums for various regulatory capital ratios. New regulations became effective January 1, 2017, which replaced the previously required core surplus and total surplus ratios with common equity tier 1, tier 1 capital and total capital risk-based capital ratios. The new regulations also added tier 1 leverage and *unallocated retained earnings and equivalents (“UREE”)* ratios. The permanent capital ratio continues to remain in effect, with some modifications to align with the new regulations. See note 4 in the *Notes to Unaudited Consolidated Financial Statements*. As of September 30, 2022, the Association exceeded all regulatory capital requirements.

Significant Recent Accounting Pronouncements. See Note 1 in CFS.

Relationship With FCBT. The Association has a statutory obligation to borrow only from FCBT, which is discussed in note 9, *Note Payable to FCBT*, in the Association’s consolidated financial statements in the 2021 Annual Report.

FCBT’s ability to access Association capital is discussed in note 2, *Summary of Significant Accounting Policies*, in the Association’s consolidated financial statements in the 2021 Annual Report, within the *Capital Stock Investment in the FCBT* section.

FCBT’s role to help mitigate Association exposure to IRR is described in the *Liquidity and Funding Sources* section of *Management’s Discussion and Analysis of Financial Condition and Results of Operations* and note 9, *Note Payable to FCBT*, in the Association’s consolidated financial statements in the 2021 Annual Report.

FCBT provides computer systems to support the critical operations of all *10th Farm Credit District* (“**District**”) associations. In addition, each association has operating systems and facility-based systems that are not supported by FCBT. As disclosed in note 13, *Related Party Transactions*, in the Association’s consolidated financial statements in the 2021 Annual Report, FCBT provides many services to the Association, which include administrative, marketing, accounting services and information systems.

The Association’s financial condition may be impacted by factors that affect FCBT. The financial condition and results of operations of FCBT may materially affect Association stockholders’ investment in the Association.

Annual and Quarterly Stockholder Report Availability. FCBT’s annual and quarterly stockholder reports are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, Corporate Communications, P.O. Box 202590, Austin, Texas 78720, or by calling (512) 465-1881. The annual and quarterly stockholder reports for FCBT are also available on its website at www.farmcreditbank.com.

Annual and quarterly stockholder reports for the Association are available free of charge on the Association’s website www.agtexas.com or by *i*) writing to AgTexas Farm Credit Services, 5004 N. Loop 289, Lubbock, Texas 79416, *ii*) calling (806) 687-4068, or *iii*) e-mailing jeff.fairchild@agtexas.com.



Consolidated Balance Sheets
(Dollars in thousands)

	September 30, 2022	December 31, 2021
	Unaudited	Audited
<u>Assets</u>		
Cash	\$ 9	\$ 3,283
Investments (\$130,855 and \$115,262, at fair value)	131,654	116,210
Loans	2,688,547	2,708,548
Less: allowance for loan losses	9,416	6,913
Net loans	2,679,131	2,701,635
Accrued interest receivable	30,145	25,062
Investment in and receivable from the Farm Credit Bank of Texas:		
Capital stock	43,397	43,449
Other	26,607	11,015
Premises and equipment	26,398	24,808
Other assets	3,416	2,020
 Total assets	 <u>\$ 2,940,757</u>	 <u>\$ 2,927,482</u>
<u>Liabilities</u>		
Note payable to the Farm Credit Bank of Texas	\$ 2,466,181	\$ 2,470,340
Advance conditional payments	29,792	10,429
Accrued interest payable	5,547	3,066
Accrued postretirement benefit liability	7,861	7,789
Patronage and dividends payable	1,150	27,282
Other liabilities	16,660	12,496
 Total liabilities	 <u>2,527,191</u>	 <u>2,531,402</u>
<u>Members' Equity</u>		
Capital stock and participation certificates	4,453	4,491
Preferred stock	80,000	100,000
Allocated retained earnings	19,742	19,742
Unallocated retained earnings	236,396	199,156
Additional paid-in capital	72,711	72,711
Accumulated other comprehensive income	264	(20)
 Total members' equity	 <u>413,566</u>	 <u>396,080</u>
 Total liabilities and members' equity	 <u>\$ 2,940,757</u>	 <u>\$ 2,927,482</u>

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



Unaudited Consolidated Statements of Comprehensive Income
(Dollars in thousands)

	For the three months ended		For the nine months ended	
	September 30, 2022	September 30, 2021	September 30, 2022	September 30, 2021
<u>Interest income</u>				
Loans	\$ 32,071	\$ 23,248	\$ 83,973	\$ 66,032
Investments	673	150	1,100	598
Total interest income	<u>32,744</u>	<u>23,398</u>	<u>85,073</u>	<u>66,630</u>
<u>Interest expense</u>				
Note payable to the Farm Credit Bank of Texas	15,777	8,693	36,087	24,748
Advance conditional payments	45	1	65	3
Total interest expense	<u>15,822</u>	<u>8,694</u>	<u>36,152</u>	<u>24,751</u>
Net interest income	16,922	14,704	48,921	41,879
Provision for (reversal of) loan losses	1,631	913	3,518	340
Net interest income after provision for (reversal of) losses	<u>15,291</u>	<u>13,791</u>	<u>45,403</u>	<u>41,539</u>
<u>Noninterest income</u>				
Farm Credit Bank of Texas patronage income	6,416	5,690	19,046	15,868
Loan fees	276	(64)	880	463
Fees for financially related services	2,777	1,450	6,355	2,633
Other	525	285	2,118	1,498
Total noninterest income	<u>9,994</u>	<u>7,361</u>	<u>28,399</u>	<u>20,462</u>
<u>Noninterest expenses</u>				
Salaries and employee benefits	6,644	6,153	19,922	17,865
Directors' expense	130	69	351	198
Purchased services	319	342	1,511	1,345
Travel	487	427	1,358	1,008
Occupancy and equipment	751	388	1,734	1,254
Communication	80	81	251	260
Advertising	220	191	560	478
Public and member relations	283	211	840	681
Federally regulated examination fees	217	162	540	433
FCSIC insurance premiums	1,024	713	3,041	1,990
Other components of net periodic postretirement benefit cost	50	47	150	140
Other noninterest expense	984	279	1,854	992
Total noninterest expenses	<u>11,189</u>	<u>9,063</u>	<u>32,112</u>	<u>26,644</u>
Net income	<u>14,096</u>	<u>12,089</u>	<u>41,690</u>	<u>35,357</u>
Other comprehensive income (loss):				
Change in postretirement benefit plans	(10)	(7)	(31)	(21)
Change in fair value of available for sale investments	46	6	315	359
Total other comprehensive income (loss)	<u>36</u>	<u>(1)</u>	<u>284</u>	<u>338</u>
Comprehensive income	<u>\$ 14,132</u>	<u>\$ 12,088</u>	<u>\$ 41,974</u>	<u>\$ 35,695</u>

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



Unaudited Consolidated Statements of Changes in Members' Equity
(Dollars in thousands)

	Participation Certificates	Preferred Stock	Retained Earnings		Paid-In Capital	Comprehensive Income (Loss)	Members' Equity
			Allocated	Unallocated			
Balance at December 31, 2020	\$ 4,258	\$ 20,000	\$ 22,231	\$ 176,650	\$ 75,310	\$ (415)	\$ 298,034
Comprehensive income	-	-	-	35,357	-	338	35,695
Capital stock/participation certificates issued	814	-	-	-	-	-	814
Capital stock/participation certificates retired	(619)	-	-	-	-	-	(619)
Preferred stock dividends:							
Paid or declared	-	-	-	(1,000)	-	-	(1,000)
Patronage dividends:							
Paid or accrued	-	-	(1)	-	-	-	(1)
Balance at September 30, 2021	<u>\$ 4,453</u>	<u>\$ 20,000</u>	<u>\$ 22,230</u>	<u>\$ 211,007</u>	<u>\$ 75,310</u>	<u>\$ (77)</u>	<u>\$ 332,923</u>
Balance at December 31, 2021	\$ 4,491	\$ 100,000	\$ 19,742	\$ 199,156	\$ 72,711	\$ (20)	\$ 396,080
Comprehensive income	-	-	-	41,690	-	284	41,974
Capital stock/participation certificates issued	630	-	-	-	-	-	630
Capital stock/participation certificates retired	(668)	-	-	-	-	-	(668)
Preferred stock redeemed	-	(20,000)	-	-	-	-	(20,000)
Preferred stock dividends:							
Paid or declared	-	-	-	(4,450)	-	-	(4,450)
Patronage dividends:							
Paid or accrued	-	-	-	-	-	-	-
Balance at September 30, 2022	<u>\$ 4,453</u>	<u>\$ 80,000</u>	<u>\$ 19,742</u>	<u>\$ 236,396</u>	<u>\$ 72,711</u>	<u>\$ 264</u>	<u>\$ 413,566</u>

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

September 30, 2022 Quarterly Report

Note 1: Organization, Operations and Significant Accounting Policies

AgTexas Farm Credit Services and its wholly-owned subsidiaries, *AgTexas, PCA* (“PCA”) and *AgTexas, FLCA* (“FLCA”), are collectively referred to herein as the “Association.” The Association provides financing and related services through FLCA and PCA. FLCA makes secured long-term agricultural real estate and rural home mortgage loans. PCA makes short- and intermediate-term loans for agricultural production or operating purposes.

These notes and the encompassing consolidated financial statements for the Association (collectively referred to herein as “CFS”), include the accounts of PCA and FLCA. All significant intercompany balances and transactions are eliminated in consolidation. In management’s opinion, the CFS reflect all adjustments necessary to fairly state results for the interim periods presented, which are of a normal recurring nature.

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, 2021, as contained in the 2021 Annual Report to Stockholders.

In the opinion of management, the CFS contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with GAAP, except for the inclusion of a statement of cash flows. GAAP require a business enterprise that provides a set of financial statements reporting both financial position and results of operations to also provide a statement of cash flows for each period for which results of operations are provided. In regulations issued by *Farm Credit Administration* (“FCA”), associations have the option to exclude statements of cash flows in interim financial statements. Therefore, the Association has elected not to include a statement of cash flows in these consolidated financial statements. These interim financial statements should be read in conjunction with the audited financial statements as of and for the year ended December 31, 2021 as contained in the 2021 Annual Report to Stockholders. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year ending December 31, 2022. Descriptions of the significant accounting policies are included in the 2021 Annual Report to Stockholders. In the opinion of management, these policies and the presentation of the interim financial condition and results of operations conform with GAAP and prevailing practices within the banking industry.

Significant Recent Accounting Pronouncements. In March 2022, the Financial Accounting Standards Board (“FASB”) issued an update entitled, “Financial Instruments - Credit Losses: Troubled Debt Restructurings and Vintage Disclosures.” The guidance eliminates the accounting guidance for troubled debt restructurings (“TDRs”) by creditors while enhancing disclosure requirements for certain loan refinancings and restructurings when a borrower is experiencing financial difficulty. The creditor will have to apply the guidance to determine whether a modification results in a new loan or a continuation of an existing loan. In addition to the TDR guidance, the update requires public business entities to disclose current period gross write-offs by year of origination for financing receivables and net investments in leases within the scope of the credit losses standard. These amendments will be effective for the Association at the time of adoption of the measurement of credit losses on financial instruments standard on January 1, 2023.

In June 2016, the FASB issued guidance entitled “Measurement of Credit Losses on Financial Instruments.” The guidance replaces the current incurred loss impairment methodology with a single allowance framework for financial assets carried at amortized cost, which reflects management’s estimate of expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to held-to-maturity securities and depending on the situation available-for-sale securities would also be recorded through an allowance for credit losses. For public business entities that are not U.S. Securities and Exchange Commission filers, including this association, this guidance becomes effective for interim and annual reporting periods beginning after December 15, 2022. We continue to test and refine our current expected loss models.

The Association intends to estimate losses over a two-year forecast period using a range of macroeconomic variables and then revert to the Association’s historical loss experience over an extended period of time. The impact of adoption of the standard is expected to increase or decrease the allowance for credit losses related to loans and unfunded commitments by less than \$2,500. The change in the allowance is primarily driven by the terms of the loans and the probability of default. This estimate will ultimately depend on the nature of the loan portfolio, final validation of models and methodologies, management’s judgments, including macroeconomic conditions and related forecasts at the adoption date of January 1, 2023.

The Association does not expect its held-to-maturity or available-for-sale securities to be materially impacted by the adoption of this standard as a majority of the portfolio consists of U.S. agency securities that inherently have an immaterial risk of loss.

Reclassifications. Certain prior year amounts have been aggregated, rounded and/or reclassified to conform with the current financial statement presentation

Rounding. Certain amounts in tables may not agree due to rounding.

Note 2: Investment Securities

Held to Maturity (“HTM”)

Federal Agricultural Mortgage Corporation (“**Farmer Mac**”) guaranteed *agricultural mortgage-backed securities* (“**AMBS**”) comprise the Association’s HTM investment portfolio, and the Association services the underlying loans. Additional information follows:

	AMBS				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
September 30, 2022	\$ 799	\$ -	\$ (50)	\$ 749	4.89%
December 31, 2021	948	20	-	968	4.89%

The Association has not experienced impairments of these securities. Farmer Mac guarantees the underlying mortgages, and the Association has the ability and intent to hold these securities to maturity or pay-off and it is unlikely the Association would be required to sell these securities. These AMBS have contractual weighted average maturities of 4.92 years as of September 30, 2022, however, expected maturities differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Available for sale (“AFS”)

The Association’s AFS investment securities consist entirely of *Small Business Administration* (“**SBA**”) pool securities. A summary of the amortized cost and fair value of AFS investment securities is as follows:

	SBA pool securities				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
September 30, 2022	\$ 129,869	\$ 1,154	\$ (168)	\$ 130,855	4.42%
December 31, 2021	114,592	780	(110)	115,262	3.06%

The following table is a summary of the contractual maturity, fair value, amortized cost and weighted average yield of AFS investments securities at September 30, 2022:

	SBA pool securities				
	Due in 1 Year or Less	Due After 1 Year Through 5 Years	Due After 5 Years Through 10 Years	Due After 10 Years	Total
Fair value	\$ -	\$ -	\$ 41,384	\$ 89,471	\$ 130,855
Amortized cost	-	-	40,950	88,919	129,869
Weighted average yield	0.00%	0.00%	5.03%	4.14%	4.42%

Note 3: Loans and Allowance for Loan Losses (“ALL”)

Loans. Loan carrying amounts (outstanding principal adjusted as applicable for capitalized accrued interest, direct partial charge-offs, deferred fees or costs on originated loans, and unamortized purchase premiums and discounts; excludes uncapitalized accrued interest) by portfolio segment follows:

Loan Type	September 30, 2022		December 31, 2021	
	Amount	%	Amount	%
Real estate mortgage	\$ 1,484,336	55.3%	\$ 1,461,475	53.9%
Production and intermediate term	866,723	32.2%	928,309	34.3%
Agribusiness:				
Loans to cooperatives	12,727	0.5%	10,636	0.4%
Processing and marketing	187,490	7.0%	173,655	6.4%
Farm-related business	54,016	2.0%	46,719	1.7%
Communication	16,525	0.6%	14,960	0.6%
Energy	4,270	0.2%	4,543	0.2%
Water and waste water	6,595	0.2%	3,829	0.1%
Rural residential real estate	6,087	0.2%	6,134	0.2%
Agricultural export finance	10,005	0.4%	10,004	0.4%
Lease receivables	9,235	0.3%	10,809	0.4%
Mission-related investments	30,538	1.1%	37,475	1.4%
Total	\$ 2,688,547	100.0%	\$ 2,708,548	100.0%

Mission-related investment and real estate mortgage loans purchased with 100% U.S. government agency or government sponsored enterprise guarantees present essentially no credit risk other than purchase premiums, which are forfeited when borrowers prepay or refinance their loans before the premiums are fully amortized. Management anticipates and considers potential prepayments to estimate an appropriate amortization period. Net purchased premiums included in the mission-related investment and real estate mortgage loan balances above as of September 30, 2022 and December 31, 2021, follow:

	September 30, 2022	December 31, 2021
Real estate mortgage	\$ 1,967	\$ 2,924
Mission-related investments	474	699
Total premium	\$ 2,441	\$ 3,623

The Association may purchase or sell participations in loans to diversify risk, manage loan volume, and comply with FCA regulations. Participation carrying amount details as of September 30, 2022 follow:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations	Participations	Participations	Participations	Participations	Participations
	Purchased	Sold	Purchased	Sold	Purchased	Sold
Real estate mortgage	\$ 129,303	\$ 669,246	\$ 152,223	\$ -	\$ 281,526	\$ 669,246
Production and intermediate term	107,845	469,176	73,806	-	181,651	469,176
Agribusiness	163,296	43,223	1,520	-	164,816	43,223
Communication	16,525	-	-	-	16,525	-
Energy	4,270	-	-	-	4,270	-
Water and waste water	6,594	-	-	-	6,594	-
Agricultural export finance	10,005	-	-	-	10,005	-
Lease receivables	9,235	-	-	-	9,235	-
Mission-related investments	-	-	30,064	-	30,064	-
Total	\$ 447,073	\$ 1,181,645	\$ 257,613	\$ -	\$ 704,686	\$ 1,181,645

The Association is authorized under the Farm Credit Act to accept *advance conditional payments* (“ACPs”) from borrowers. To the extent the borrower’s access to such ACPs is restricted and the legal right of setoff exists, the ACPs are netted against the borrower’s related loan balance. Unrestricted advance conditional payments are included in other liabilities. ACPs are not insured, and interest is generally paid by the Association on such balances. Balances of ACPs were \$53,059 and \$33,428 at September 30, 2022 and December 31, 2021, respectively.

Credit Quality. Loans are the Association’s primary asset. Collectability of these assets is critical to the Association’s financial position and results of operations. Collectability is primarily a function of credit quality.

Loans that have not performed in accordance with terms demonstrate heightened credit risk, and the level and trends in non-performing loans is a strong indicator of credit quality. Non-performing loans and *other property owned* (“OPO”) comprise non-performing assets.

The recorded investment in a loan, as defined by GAAP, includes the outstanding principal adjusted, as applicable, for accrued interest, direct partial charge-offs, deferred fees or costs on originated loans, and unamortized purchase premiums and discounts; the recorded investment in a loan does not include an allocation of the ALL or any specific valuation adjustments. The recorded investment in non-performing asset balances by loan portfolio segment and OPO follow:

	September 30, 2022	December 31, 2021
Nonaccrual loans:		
Real estate mortgage	\$ 11,194	\$ 5,731
Production and intermediate term	5,559	854
Agribusiness	3,139	-
Rural residential real estate	-	147
Mission-related investments	-	1
Total nonaccrual loans	<u>19,892</u>	<u>6,733</u>
Accruing restructured loans:		
Real estate mortgage	5,166	6,128
Production and intermediate term	-	105
Total accruing restructured loans	<u>5,166</u>	<u>6,233</u>
Accruing loans 90 days or more past due:		
Real estate mortgage	3,065	479
Production and intermediate term	-	1,788
Mission-related investments	4,828	-
Total accruing loans 90 days or more past due	<u>7,893</u>	<u>2,267</u>
Total non-performing loans	32,951	15,233
Other property owned	-	-
Total non-performing assets	<u>\$ 32,951</u>	<u>\$ 15,233</u>

Age analysis of the recorded investment (including accrued interest) in past due loans by loan segment follows:

September 30, 2022	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 >90 days and Accruing
Real estate mortgage	\$ 6,292	\$ 10,311	\$ 16,603	\$ 1,484,956	\$ 1,501,559	\$ 3,065
Production and intermediate-term	1,816	4,784	6,600	870,229	876,829	-
Loans to cooperatives	-	-	-	12,765	12,765	-
Processing and marketing	301	-	301	188,134	188,435	-
Farm-related business	-	-	-	54,420	54,420	-
Communication	-	-	-	16,528	16,528	-
Energy	-	-	-	4,299	4,299	-
Water and waste water	-	-	-	6,606	6,606	-
Rural residential real estate	-	-	-	6,119	6,119	-
Agricultural export finance	-	-	-	10,064	10,064	-
Lease receivables	-	-	-	9,256	9,256	-
Mission-related investments	7,181	4,828	12,009	18,872	30,881	4,828
Total	<u>\$ 15,590</u>	<u>\$ 19,923</u>	<u>\$ 35,513</u>	<u>\$ 2,682,248</u>	<u>\$ 2,717,761</u>	<u>\$ 7,893</u>

December 31, 2021	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 >90 days and Accruing
Real estate mortgage	\$ 4,000	\$ 3,921	\$ 7,921	\$ 1,469,016	\$ 1,476,937	\$ 479
Production and intermediate-term	1,006	1,788	2,794	933,318	936,112	1,788
Loans to cooperatives	-	-	-	10,642	10,642	-
Processing and marketing	-	-	-	174,389	174,389	-
Farm-related business	-	-	-	46,824	46,824	-
Communication	-	-	-	14,961	14,961	-
Energy	-	-	-	4,553	4,553	-
Water and waste water	-	-	-	3,830	3,830	-
Rural residential real estate	-	-	-	6,154	6,154	-
Agricultural export finance	-	-	-	10,028	10,028	-
Lease receivables	167	-	167	10,701	10,868	-
Mission-related investments	246	1	247	37,517	37,764	-
Total	\$ 5,419	\$ 5,710	\$ 11,129	\$ 2,721,933	\$ 2,733,062	\$ 2,267

Note: The recorded investment in the receivable is the face amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges or acquisition costs, and may also reflect a previous direct write-down of investment.

Management has rated each loan in the portfolio using the System's 14-point rating system. These aggregated classifications are a significant indicator of credit quality. The classification categories are defined as follows:

- Acceptable – assets are expected to be fully collectible and represent the highest quality;
- Other assets especially mentioned (“**OAEM**”) – assets are currently collectible but exhibit some potential weakness;
- Substandard – assets exhibit some serious weakness in repayment capacity, equity and/or collateral pledged on the loan;
- Doubtful – assets exhibit similar weaknesses to substandard assets; however, doubtful assets have additional weaknesses in existing factors, conditions and values that make collection in full highly questionable; and
- Loss – assets are considered uncollectible.

The following table presents the Association's loan portfolio segment balances, including accrued interest thereon, as a percentage of the total category, as classified by management and aggregated under the FCA's Uniform Loan Classification System:

	September 30, 2022	December 31, 2021
Real estate mortgage		
Acceptable	95.8%	96.9%
OAEM	3.0%	1.6%
Substandard/doubtful	1.3%	1.5%
	<u>100.0%</u>	<u>100.0%</u>
Production and intermediate term		
Acceptable	95.8%	96.3%
OAEM	3.2%	2.4%
Substandard/doubtful	0.9%	1.3%
	<u>100.0%</u>	<u>100.0%</u>
Loans to cooperatives		
Acceptable	100.0%	100.0%
OAEM	0.0%	0.0%
Substandard/doubtful	0.0%	0.0%
	<u>100.0%</u>	<u>100.0%</u>
Processing and marketing		
Acceptable	87.1%	89.3%
OAEM	10.3%	9.7%
Substandard/doubtful	2.6%	1.0%
	<u>100.0%</u>	<u>100.0%</u>
Farm-related business		
Acceptable	100.0%	100.0%
OAEM	0.0%	0.0%
Substandard/doubtful	0.0%	0.0%
	<u>100.0%</u>	<u>100.0%</u>
Communication		
Acceptable	100.0%	100.0%
OAEM	0.0%	0.0%
Substandard/doubtful	0.0%	0.0%
	<u>100.0%</u>	<u>100.0%</u>
Energy		
Acceptable	100.0%	100.0%
OAEM	0.0%	0.0%
Substandard/doubtful	0.0%	0.0%
	<u>100.0%</u>	<u>100.0%</u>
Water and waste water		
Acceptable	100.0%	100.0%
OAEM	0.0%	0.0%
Substandard/doubtful	0.0%	0.0%
	<u>100.0%</u>	<u>100.0%</u>
Rural residential real estate		
Acceptable	100.0%	97.6%
OAEM	0.0%	0.0%
Substandard/doubtful	0.0%	2.4%
	<u>100.0%</u>	<u>100.0%</u>
Agricultural export finance		
Acceptable	100.0%	100.0%
OAEM	0.0%	0.0%
Substandard/doubtful	0.0%	0.0%
	<u>100.0%</u>	<u>100.0%</u>
Lease receivables		
Acceptable	100.0%	100.0%
OAEM	0.0%	0.0%
Substandard/doubtful	0.0%	0.0%
	<u>100.0%</u>	<u>100.0%</u>
Mission-related investments		
Acceptable	100.0%	100.0%
OAEM	0.0%	0.0%
Substandard/doubtful	0.0%	0.0%
	<u>100.0%</u>	<u>100.0%</u>
Total Loans		
Acceptable	95.4%	96.4%
OAEM	3.4%	2.3%
Substandard/doubtful	1.2%	1.3%
	<u>100.0%</u>	<u>100.0%</u>

Based on current information and events, management has determined it is probable that scheduled payments of principal or interest on the following loans may not be collected when due according to the contractual terms of the loan agreements and has classified these loans as impaired. Once classified as impaired, management then determines the amount of impairment, if any, on each individual impaired loan; aggregated impairment on individual impaired loans is included in management's estimate of an appropriate ALL at each reporting date.

Impaired loan information, by loan portfolio segment, follows:

	September 30, 2022			December 31, 2021		
	Recorded Investment	Unpaid Principal Balance ^a	Related Allowance	Recorded Investment	Unpaid Principal Balance ^a	Related Allowance
Impaired loans with a related allowance for credit losses:						
Real estate mortgage	\$ 1,797	\$ 1,797	\$ 498	\$ -	\$ -	\$ -
Agribusiness	3,139	3,152	159	-	-	-
Total	<u>\$ 4,936</u>	<u>\$ 4,949</u>	<u>\$ 657</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	\$ 17,628	\$ 17,669	\$ -	\$ 12,338	\$ 13,237	\$ -
Production and intermediate term	5,559	5,668	-	2,747	3,228	-
Agribusiness	-	-	-	-	1	-
Rural residential real estate	-	-	-	147	147	-
Mission-related investments	4,828	4,591	-	1	1	-
Total	<u>\$ 28,015</u>	<u>\$ 27,928</u>	<u>\$ -</u>	<u>\$ 15,233</u>	<u>\$ 16,614</u>	<u>\$ -</u>
Total impaired loans:						
Real estate mortgage	\$ 19,425	\$ 19,466	\$ 498	\$ 12,338	\$ 13,237	\$ -
Production and intermediate term	5,559	5,668	-	2,747	3,228	-
Agribusiness	3,139	3,152	159	-	1	-
Rural residential real estate	-	-	-	147	147	-
Mission-related investments	4,828	4,591	-	1	1	-
Total	<u>\$ 32,951</u>	<u>\$ 32,877</u>	<u>\$ 657</u>	<u>\$ 15,233</u>	<u>\$ 16,614</u>	<u>\$ -</u>

	For the nine months ended September 30, 2022		For the nine months ended September 30, 2021		For the Year Ended December 31, 2021	
	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:						
Real estate mortgage	\$ 1,852	\$ -	\$ 960	\$ -	\$ -	\$ -
Agribusiness	1,996	48	-	-	-	-
Total	<u>\$ 3,848</u>	<u>\$ 48</u>	<u>\$ 960</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	\$ 13,114	\$ 396	\$ 10,754	\$ 291	\$ 10,817	\$ 389
Production and intermediate term	2,717	84	1,251	13	2,814	99
Agribusiness	-	-	-	10	-	10
Rural residential real estate	-	-	160	-	157	-
Mission-related investments	4,591	159	525	489	393	489
Total	<u>\$ 20,422</u>	<u>\$ 639</u>	<u>\$ 12,690</u>	<u>\$ 803</u>	<u>\$ 14,181</u>	<u>\$ 987</u>
Total impaired loans:						
Real estate mortgage	\$ 14,966	\$ 396	\$ 11,714	\$ 291	\$ 10,817	\$ 389
Production and intermediate term	2,717	84	1,251	13	2,814	99
Agribusiness	1,996	48	-	10	-	10
Rural residential real estate	-	-	160	-	157	-
Mission-related investments	4,591	159	525	489	393	489
Total	<u>\$ 24,270</u>	<u>\$ 687</u>	<u>\$ 13,650</u>	<u>\$ 803</u>	<u>\$ 14,181</u>	<u>\$ 987</u>

^a Unpaid principal balance represents the recorded principal balance of the loan.

A restructuring of a debt constitutes a troubled debt restructuring if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Troubled debt restructurings are undertaken in order to improve the likelihood of recovery on the loan and may include, but are not limited to, forgiveness of principal or interest, interest rate reductions that are lower than the current market rate for new debt with similar risk, or significant term or payment extensions.

The following table provides additional information on troubled debt restructurings that occurred in the nine months ended September 2021. There were no troubled debt restructurings in the nine months ended September 30, 2022.

For the nine months ended September 30, 2021	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Troubled debt restructurings:		
Production and intermediate term	\$ 56	\$ 58

The premodification outstanding recorded investment represents the recorded investment of the loans as of the quarter end prior to the restructuring. The postmodification outstanding recorded investment represents the recorded investment of the loans as of the quarter end the restructuring occurred.

As of September 30, 2022, the total recorded investment of troubled debt restructured loans was \$5,941, of which \$775 was classified as nonaccrual, with specific allowance for loan losses of \$0. Commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring were \$0 at September 30, 2022 and \$0 at December 31, 2021.

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

	Loans Modified as TDRs		TDRs in Nonaccrual Status*	
	September 30, 2022	December 31, 2021	September 30, 2022	December 31, 2021
Real estate mortgage	\$ 5,166	\$ 6,182	\$ -	\$ 54
Production and intermediate term	775	959	775	854
Mission-related investments	-	1	-	1
Total	\$ 5,941	\$ 7,142	\$ 775	\$ 909

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

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

There were no loans that met the accounting criteria as a troubled debt restructuring and that occurred within the previous 12 months for which there was a subsequent payment default during the period. A payment default is defined as a payment that is 30 days past due after the date the loan was restructured.

ALL. A summary of changes in ALL and period end recorded investment in loans is as follows:

	Real Estate Mortgage	Production and Intermediate Term	Agri- business	Commun- ication	Energy, water and waste water	Rural Residential Real Estate	Agricultural export finance	Lease Receivable	Mission- Related Investments	Total
Allowance for Loan Losses:										
Balance at										
December 31, 2021	\$ 1,863	\$ 3,532	\$ 1,421	\$ 27	\$ 20	\$ 6	\$ 12	\$ 31	\$ 1	\$ 6,913
Charge-offs	-	-	-	-	-	-	-	-	-	-
Recoveries	-	5	-	-	-	-	-	-	-	5
Provision for loan losses	1,492	1,661	350	2	(6)	-	(1)	20	-	3,518
Other	(1)	(968)	(55)	-	3	(1)	1	1	-	(1,020)
Balance at										
September 30, 2022	\$ 3,354	\$ 4,230	\$ 1,716	\$ 29	\$ 17	\$ 5	\$ 12	\$ 52	\$ 1	\$ 9,416
Ending Balance:										
Individually evaluated for impairment	\$ 498	\$ -	\$ 159	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 657
Collectively evaluated for impairment	\$ 2,856	\$ 4,230	\$ 1,557	\$ 29	\$ 17	\$ 5	\$ 12	\$ 52	\$ 1	\$ 8,759
Acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Recorded Investment in Loans Outstanding:										
Ending Balance at										
September 30, 2022	\$ 1,501,559	\$ 876,829	\$ 255,620	\$ 16,528	\$ 10,905	\$ 6,119	\$ 10,064	\$ 9,256	\$ 30,881	\$ 2,717,761
Individually evaluated for impairment	\$ 19,425	\$ 5,559	\$ 3,139	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 4,828	\$ 32,951
Collectively evaluated for impairment	\$ 1,482,134	\$ 871,270	\$ 252,481	\$ 16,528	\$ 10,905	\$ 6,119	\$ 10,064	\$ 9,256	\$ 26,053	\$ 2,684,810
Acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Allowance for Loan Losses:										
Balance at										
December 31, 2020	\$ 1,773	\$ 3,284	\$ 1,341	\$ 39	\$ 34	\$ 12	\$ -	\$ 20	\$ 1	\$ 6,504
Charge-offs	-	-	(2)	-	-	-	-	-	-	(2)
Recoveries	190	321	1	-	-	-	-	-	-	512
Provision for loan losses	90	358	(116)	(7)	(7)	(3)	17	8	-	340
Other	(6)	58	59	-	(3)	-	(5)	-	-	103
Balance at										
September 30, 2021	\$ 2,047	\$ 4,021	\$ 1,283	\$ 32	\$ 24	\$ 9	\$ 12	\$ 28	\$ 1	\$ 7,457
Ending Balance:										
Individually evaluated for impairment	\$ 92	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 92
Collectively evaluated for impairment	\$ 1,955	\$ 4,021	\$ 1,283	\$ 32	\$ 24	\$ 9	\$ 12	\$ 28	\$ 1	\$ 7,365
Acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Recorded Investment in Loans Outstanding:										
Ending Balance at										
September 30, 2021	\$ 1,380,058	\$ 859,055	\$ 213,341	\$ 16,168	\$ 10,051	\$ 7,895	\$ 10,027	\$ 10,239	\$ 46,590	\$ 2,553,424
Individually evaluated for impairment	\$ 11,620	\$ 981	\$ -	\$ -	\$ -	\$ 152	\$ -	\$ -	\$ -	\$ 12,753
Collectively evaluated for impairment	\$ 1,368,438	\$ 858,074	\$ 213,341	\$ 16,168	\$ 10,051	\$ 7,743	\$ 10,027	\$ 10,239	\$ 46,590	\$ 2,540,671
Acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

Note 4: Capital

The Association's board of directors has established a *Capital Adequacy Plan* (“**Plan**”) that includes the capital targets that are necessary to achieve the institution's capital adequacy goals as well as the minimum capital standards. The Plan monitors projected dividends, equity retirements and other actions that may decrease the Association's capital. In addition to factors that must be considered in meeting the minimum standards, the board of directors also monitors the following factors: capability of management; quality of operating policies, procedures and internal controls; quality and quantity of earnings; asset quality and the adequacy of the allowance for losses to absorb potential loss within the loan and lease portfolios; sufficiency of liquid funds; needs of an institution's customer base; and any other risk-oriented activities, such as funding and interest rate risk, potential obligations under joint and several liability, contingent and off-balance-sheet liabilities or other conditions warranting additional capital. At least quarterly, management reviews the Association's goals and objectives with the board.

Regulatory Capitalization Requirements.

	Regulatory Minimums	Capital Conservation Buffer	Total	As of September 30, 2022	As of December 31, 2021
Risk-adjusted:					
Common equity tier 1 ratio	4.50%	2.50%	7.00%	9.76%	10.30%
Tier 1 capital ratio	6.00%	2.50%	8.50%	12.66%	13.23%
Total capital ratio	8.00%	2.50%	10.50%	13.53%	14.36%
Permanent capital ratio	7.00%	0.00%	7.00%	13.20%	14.06%
Non-risk-adjusted:					
Tier 1 leverage ratio	4.00%	1.00%	5.00%	12.23%	12.22%
UREE leverage ratio	1.50%	0.00%	1.50%	8.59%	9.59%

Following are the amounts included in the calculation of the capital ratios as of September 30, 2022:

	Regulatory Capital		Risk weighted assets/ Adjusted average total assets	
	9/30/2022	12/31/2021	9/30/2022	12/31/2021
Risk-adjusted capital ratios				
Common equity tier 1 ratio	\$ 269,648	\$ 263,530	\$ 2,762,272	\$ 2,557,815
Tier 1 capital ratio	349,648	338,470	2,762,272	2,557,815
Total capital ratio	373,701	367,358	2,762,272	2,557,815
Permanent capital ratio	363,680	358,470	2,754,389	2,550,362
Non-risk-adjusted capital ratios				
Tier 1 leverage ratio	349,648	338,470	2,858,841	2,769,936
UREE leverage ratio	245,449	265,507	2,858,841	2,769,936

Preferred stock issuance. In September 2021, the Association received clearance from FCA and the board approved the issuance of 80,000 shares of a series of preferred stock, par value of \$1,000 per share. The stock was issued October 6, 2021. The stock is designated as Fixed Rate Reset Perpetual Non-Cumulative Preferred Stock, Series B (“**Series B Preferred Stock**”). The Series B Preferred Stock has a fixed rate dividend of 5.75 percent for five years, payable quarterly. After five years, the dividend rate resets to the Five-Year Treasury Rate plus 4.74 percent. On or after five years, the Association may, at its option, redeem all or part of the Series B Preferred Stock. The Series B Preferred Stock is non-voting, except: (i) to materially change the Association's Charter or Bylaws that would materially adversely affect the holder of Series B Preferred Stock, (ii) to create, issue or authorize any class of stock ranking senior to the Series B Preferred Stock as to dividends or liquidation, (iii) certain other limited circumstances detailed in the offering circular.

In January 2017, the Association received clearance from FCA and the board approved the issuance of 20 million shares of a series of preferred stock, par value of \$1.00 per share. The stock was issued March 24, 2017. The stock is designated as Fixed-to-Floating Rate Perpetual Cumulative Preferred Stock, Series A (“**Series A Preferred Stock**”). The Series A Preferred Stock has a fixed rate dividend of 5 percent for 10 years, payable semi-annually. After 10 years, the dividend rate becomes a floating rate at 5.00 percent above 6-month LIBOR. On or after five years, the Association may, at its option, redeem all or part of the Series A Preferred Stock. The Series A Preferred Stock is non-voting, except: (i) to materially change the Association’s Charter or Bylaws that would materially adversely affect the holder of Series A Preferred Stock, (ii) to create, issue or authorize any class of stock ranking senior to the Series A Preferred Stock as to dividends or liquidation. The Series A Preferred Stock became redeemable in March of 2022. In the third quarter of 2022, the board of directors and FCA approved the redemption of all the Series A Preferred Stock. The Series A Preferred Stock was redeemed in September 2022.

Note 5: Income taxes

The Association is subject to federal and certain other income taxes. The Association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue code. Under specified conditions, the Association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage refunds. During 2022, the Association is participating in a patronage program. Deferred taxes are recorded at the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution and will therefore impact future tax payments. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (more than 50 percent probability), based on management’s estimate, that they will not be realized. The subsidiary, FLCA, is exempt from federal and other income taxes as provided in the Farm Credit Act of 1971.

Note 6: Fair Value Measurements

FASB guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See note 14 to the 2021 Annual Report to Stockholders for a more complete description.

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

September 30, 2022	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Assets held in nonqualified benefit trusts	\$ 240	\$ -	\$ -	\$ 240
SBA pool securities	-	130,855	-	130,855
December 31, 2021	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Assets held in nonqualified benefit trusts	\$ 230	\$ -	\$ -	\$ 230
SBA pool securities	-	115,262	-	115,262

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

September 30, 2022	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Loans*	\$ -	\$ -	\$ 4,279	\$ 4,279

December 31, 2021	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Loans*	\$ -	\$ -	\$ -	\$ -

*Represents the fair value of certain loans that were evaluated for impairment under authoritative guidance “*Accounting by Creditors for Impairment of a Loan*.” The fair value was based upon the underlying collateral since these were collateral-dependent loans for which real estate is the collateral.

Information About Recurring and Nonrecurring Level 3 Fair Value Measurements

With regard to nonrecurring measurements for impaired loans and other property owned, it is not practicable to provide specific information on inputs, as each collateral property is unique. System institutions utilize appraisals to value these loans and other property owned and take into account unobservable inputs, such as income and expense, comparable sales, replacement cost and comparability adjustments.

Information About Recurring and Nonrecurring Level 2 Fair Value Measurements

SBA pool securities are valued using a third-party pricing vendor. The Association's vendor utilizes major pricing services including Reuters and Intercontinental Exchange. The market values are based on inputs other than quoted prices, including:

- Quoted prices for similar assets in active markets.
- Quoted prices for identical or similar assets in markets that are not active.
- Inputs other than quoted prices, which provide a reasonable basis for fair value determination. Such inputs may include interest rates and yield curves, volatilities, prepayment speeds, credit risks and default rates.
- Inputs derived principally from observable market data.

Valuation Techniques

As more fully discussed in note 2 to the 2021 Annual Report, authoritative guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following represent a brief summary of the valuation techniques used for the Association’s assets and liabilities. For a more complete description, see notes to the 2021 Annual Report.

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

Loans Evaluated for Impairment. For certain loans evaluated for impairment under FASB impairment guidance, the fair value is based upon the underlying real estate collateral since the loans were collateral-dependent. 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, a majority of these loans have fair value measurements that fall within Level 3 of the fair value hierarchy. When the value of the real estate, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established.

Other property owned. Other property owned is generally classified as Level 3 of the fair value hierarchy. The process for measuring the fair value of the other property owned involves the use of independent appraisals and other market-based information. Costs to sell represent transaction costs and are not included as a component of the asset’s fair value. As a result, these fair value measurements fall within Level 3 of the hierarchy.

Note 7: Employee Benefit Plans

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

	2022	2021
Service cost	\$ 78	\$ 81
Interest cost	181	161
Amortization of prior service credits	(36)	(36)
Amortization of net actuarial loss	5	15
Net periodic benefit cost	\$ 228	\$ 221

The Association’s liability for the unfunded accumulated obligation for these benefits at September 30, 2022, was \$7,861 and is included in “Accrued postretirement benefit liability” in the consolidated balance sheet. The components of net periodic benefit cost other than the service cost component are included in the line item "Other components of net periodic postretirement benefit cost" in the consolidated statement of comprehensive income.

The structure of the Association’s defined benefit pension plan is characterized as multiemployer since the assets, liabilities and cost of the plan are not segregated or separately accounted for by participating employers (bank and associations). The Association recognizes its amortized annual contributions to the plan as an expense. The Association contributed \$1,593 to the District’s defined benefit pension plan in 2022. Pension plan funding expense was \$1,195 and \$1,678 for the nine months ended September 30, 2022 and 2021.

Note 8: Commitments and Contingent Liabilities

The Association is involved in various legal proceedings in the normal course of business. In the opinion of legal counsel and management, there are no legal proceedings at this time that are likely to materially affect the Association.

Note 9: Accumulated Other Comprehensive Income (Loss) (“AOCI”)

AOCI includes the accumulated balance of certain gains, losses or costs for which values are included in assets or liabilities on the balance sheets, but which have not yet been recognized in earnings. For the Association, these elements include unrealized gains or losses on the AFS investment securities and amortization of retirement benefit elements. The following table summarizes the changes in the components of AOCI for the nine months ended September 30, 2022 and 2021.

	<u>Total</u>	<u>Unrealized gain on SBA pool securities</u>	<u>Retirement benefit plans</u>
AOCI at			
December 31, 2021	\$ (20)	\$ 670	\$ (690)
SBA pool securities:			
Net change in unrealized gains	315	315	-
Retirement benefit plans:			
Amortization of prior service credits	(36)	-	(36)
Amortization of net actuarial loss	5	-	5
AOCI at			
September 30, 2022	<u>\$ 264</u>	<u>\$ 985</u>	<u>\$ (721)</u>
	<u>Total</u>	<u>Unrealized gain on SBA pool securities</u>	<u>Retirement benefit plans</u>
AOCI at			
December 31, 2020	\$ (414)	\$ 327	\$ (741)
SBA pool securities:			
Net change in unrealized gains	359	359	-
Retirement benefit plans:			
Amortization of prior service credits and net actuarial loss	(36) 15	- -	(36) 15
AOCI at			
September 30, 2021	<u>\$ (76)</u>	<u>\$ 686</u>	<u>\$ (762)</u>

Note 10: Subsequent Events

Association management has evaluated subsequent events through November 2, 2022, which is the date the CFS were issued or available to be issued, with no significant events to report.