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Ratings

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AgTexas Farm Credit Services

Primary Credit Analyst:
John Orsatti, CFA, New York + 1 (212) 438 0268; john.orsatti@spglobal.com

Secondary Contact:
Catherine C Mattson, New York + 1 (212) 438 7392; catherine.mattson@spglobal.com

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AgTexas Farm Credit Services

Ratings Score Snapshot

Issuer Credit Rating
BBB/Stable/--

SACP: bbb → **Support: 0** → **Additional factors: 0**

Anchor	bbb+	
Business position	Constrained	-2
Capital and earnings	Very strong	+2
Risk position	Moderate	-1
Funding	Adequate	0
Liquidity	Adequate	
CRA adjustment		0

ALAC support	0
GRE support	0
Group support	0
Sovereign support	0

Issuer credit rating
BBB/Stable/--

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

Credit Highlights

Overview

Key strengths	Key risks
Strong capital position.	Highly concentrated geographic footprint.
Stable access to low-cost matched funding through Farm Credit Bank of Texas.	Concentrated exposure to agricultural sector.
History of stable profitability.	Limited scale compared to peers.

We expect AgTexas Farm Credit Services, an agricultural lender operating within the Farm Credit Bank of Texas (FCBT) district, to maintain its stable operating performance The association has a record of low credit losses, stable earnings, strong capital ratios, and access to low-cost funding from the FCBT.

AgTexas has very limited geographic diversity and concentrated loan exposures to the agricultural industry, in our view. The association's district is limited to certain regions in Texas, and its loan exposure is substantially in the livestock and dairy sectors. It is also one of the smaller associations in terms of total assets, at around $3.1 billion at June 30, 2023. We view these factors negatively because they create additional risk that could threaten stable loan performance due to cyclicality and loan concentrations. Nevertheless, asset quality measures have been good, with adjusted nonperforming assets averaging well below 1% over the past five years.

We believe AgTexas benefits from being a member of the Farm Credit System, with ready access to stable, low-cost funding through its credit line with the FCBT. AgTexas' primary funding source is its credit line with the FCBT. Although we view on-balance-sheet liquidity as thin, we do not expect AgTexas will lose access to its FCBT funding. AgTexas is able to match-fund its loans with low-cost borrowings, which largely neutralizes its interest rate risk and helps it maintain a stable net interest margin.

Although our rating incorporates the funding benefit AgTexas receives as a member of the Farm Credit System, we believe the likelihood the U.S. government would provide extraordinary support directly to AgTexas, if it were in financial stress, is low. In our view, AgTexas' role is of limited importance to the government, and another entity could assume AgTexas' business should it come under significant stress. Additionally, there is no history of the government providing direct support to associations like AgTexas, which limits the link AgTexas has to the U.S. government, in our view. Therefore, we do not include any rating uplift for potential government support.

Outlook

The stable outlook reflects our expectation that the company will maintain a strong capital position, including an S&P Global Ratings risk-adjusted (RAC) ratio above 15%, as well as good loan performance and access to low-cost funding from FCBT over at least the next two years.

Downside scenario

We could lower the ratings if AgTexas' RAC ratio declines below 15% on a sustained basis, if asset quality deteriorates meaningfully, or if the company were to lose access to its low-cost funding from the FCBT. However, we think it is very unlikely that AgTexas would lose its FCBT funding.

Upside scenario

While less likely over the next two years, we could raise our ratings if AgTexas expands its geographic reach and further diversifies its loan portfolio while maintaining a very strong RAC ratio.

Anchor: Adjusted To Reflect Regulatory Oversight And Access To Stable Low-Cost Funding

Our starting point--or anchor--for our rating on AgTexas is 'bb+', in line with that for other U.S. companies that we rate under our nonbank financial institutions criteria. Because of AgTexas' public policy role, access to government-related entity (GRE) funding, and regulated status, we raise its anchor to 'bbb+', three notches above our anchor for other finance companies and equal to that of U.S. banks. This is to account for the Farm Credit Administration's regulatory oversight and the company's favorable funding through its position in the Farm Credit System (FCS).

Business Position: Constrained By Its Limited Geographic Reach And Concentrated Exposure To The Agricultural Industry

AgTexas' creditworthiness is constrained by its limited geographic footprint in the state of Texas, small scale compared with other farm credit associations (with total assets of only around $3.1 billion), and concentrated exposure to agricultural lending, particularly in livestock and dairy. These factors are partially offset by its solid market share and reasonably good revenue diversification.

AgTexas operates through two wholly owned subsidiaries, AgTexas PCA (PCA) and AgTexas FCLA (FCLA). The company has four main lines of business: loans, lease programs, insurance programs, and treasury management services.

PCA focuses on short- and intermediate-term loans for agricultural production and operating purposes, while FCLA focuses on secured long-term agricultural real estate and rural home mortgage loans. We think AgTexas' experienced management team and organic growth strategy support its stability, as indicated by its history of solid loan performance, consistent earnings, and low credit losses.

The association operates in 43 counties in the Panhandle, Central, and South Plains regions of Texas, with loan exposures of roughly 47%, 23%, and 10%, respectively. The remaining loan exposure is in participations from other FCS entities around the U.S., which provides some geographic diversification.

AgTexas' charter prevents it from expanding operations outside of Texas and limits loan exposure to the agricultural industry. However, we view these limits somewhat negatively given the volatility in agricultural commodities. After strong farm income growth of 15.5% in 2022, the U.S. Department of Agriculture forecasts net farm income to decline by 15.9% to $137 billion in 2023, which would still exceed the $130.5 billion average over 2002-2022.

Capital And Earnings: Very Strong Capital Ratios Supported By Stable Earnings

AgTexas benefits from stable profitability and strong regulatory capital ratios. We project that its RAC ratio (14.9% at June 30, 2023) will exceed the low end of our 'very strong' range of 15% at the end of the 2023.

AgTexas' regulatory common equity Tier 1 and Tier 1 capital ratios increased slightly to 9.89% and 12.67% at June 30, 2023, from 9.80% and 12.63% at Dec. 31, 2022, respectively, as earnings retention modestly exceeded loan growth. We expect AgTexas will maintain its capital ratios, supported by solid earnings, modest annual loan growth of 3%-4% over the next few years, and patronage expected to remain at about 50% of earnings.

We expect AgTexas' earnings to remain healthy, with revenue growth in line with loan growth, fairly flat expenses and provisions, and stable net interest margins. Contributing to AgTexas' stable earnings is the association's significant portion of noninterest revenue, which was around 33% in the first half 2023 and has consistently averaged above 30%.

Approximately 73% of the association's noninterest income comes from patronage dividends AgTexas receives as a stockholder in FCBT. The association's efficiency ratio has been fairly stable, with operating expenses around 42% of operating revenue in the first half of 2023, in line with its average since 2019. Although earnings are not the association's sole objective, we view certain profitability metrics such as return on average adjusted assets as healthy, averaging 1.82% during the first half of 2023.

Based on our view of the stability of AgTexas' earnings and its generally conservative financial policies, we believe it's positioned to continue its current patronage policy without hurting capital ratios. The association pays patronage to its members of approximately 50% of earnings each year.

Since 2021, AgTexas has shifted to paying all cash patronage plus allocated surplus, with no stock patronage. However, in order to remain competitive with peers, it could decide to resume paying a portion of its patronage in stock in the future.

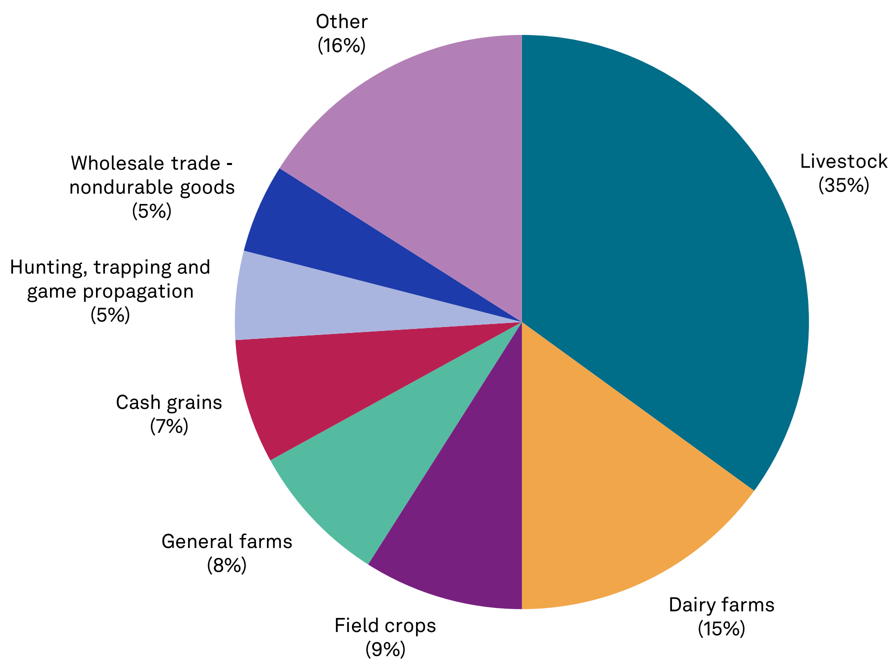
Risk Position: Solid Credit Quality With Agricultural Industry Exposure

AgTexas benefits from its long history of low credit losses and conservative lending practices, offset by the limited diversity of its loan portfolio and geographic reach, which we believe could make the company more susceptible to regional or sector volatility.

The association's largest exposures include livestock at roughly 35% of total loans and dairy at around 15% (see chart 1). To offset concentration risks, the company uses stress testing and concentration limits as a percent of capital to limit and assess exposures. To date, no material losses have been identified nor limits violated.

Chart 1

AgTexas Farm Credit Services loan composition
As of year-end 2022



Source: Company filings.

AgTexas maintains good asset quality, but it lags peers in certain metrics. For example, the ratio of adjusted nonperforming assets excluding troubled debt restructurings to customer loans and other real estate as of June 30, 2023 was 0.91% by our calculation, at the higher end of the range for its peers. However, credit losses have been minimal and less volatile over the past few years.

We believe AgTexas has little asset-sensitivity risk because of the matched funding it receives as part of the general funding agreement (GFA) with FCBT. This type of funding significantly reduces the probability of asset-liability pricing mismatch. AgTexas must remain compliant with certain covenants of the GFA and has no history of noncompliance.

Funding And Liquidity: Stable, Though Concentrated, Access To Low-Cost Matched Funding

In our view, AgTexas' funding and liquidity are adequate to meet its short- and long-term needs. As a farm cooperative member of FCBT district, AgTexas satisfies all its funding needs through a wholesale note with FCBT. The note is governed by a GFA with a three-year term. This is AgTexas' sole source of funding and accessibility requires compliance with certain performance covenants and submission of a borrowing base, all of which are reviewed monthly.

Despite the concentrated nature of AgTexas' funding, we believe the likelihood of disruption is low, and the association will be able to maintain access to its note with FCBT based on historical financial performance and consistent compliance with the GFA requirements.

The current GFA expired Sept. 30, 2023; however, AgTexas has received notice of intent to renew it and the new GFA will mature Sept. 30, 2026. The association is not authorized to take retail deposits from customers and is thus immune to deposit flight risk.

We view AgTexas' liquidity less favorably than some peers, largely owing to limited on-balance-sheet liquidity, which consisted of minimal cash balances and a small investment portfolio. As of June 30, 2023, the association's investment portfolio consisted mostly of Small Business Administration securities and totaled $167 million, or roughly 5.4% of total assets.

The shortfall in AgTexas' on-balance-sheet liquidity is reflected in our calculation of its broad liquid assets to short-term wholesale funding, which was a low 0.19x at June 30, 2023. While we expect the association to maintain low on-balance-sheet liquidity, we also think AgTexas' reliance on its GFA with FCBT will provide sufficient liquidity for the association when needed. As of June 30, 2023, AgTexas had around 25% unused capacity under its existing $3.5 billion credit line.

Support: No Uplift For Government Support

While the rating incorporates the ongoing funding benefits that the association receives as a member of the Farm Credit System, we believe the likelihood of the U.S. federal government providing extraordinary support directly to AgTexas in the event of financial distress is low. Our assessment is that AgTexas' individual role is of limited importance to the federal government.

In addition, we view AgTexas as having a limited link to the government. Its members privately own AgTexas, and the government has no history of providing extraordinary government support directly to associations like it. Therefore, the issuer credit rating does not incorporate any uplift for extraordinary government support.

Environmental, Social, And Governance

Social factors are a positive consideration in our credit rating analysis of AgTexas. As an association in the FCS, AgTexas benefits from low-cost funding, which helps it support rural communities and agriculture. Moreover, its cooperative structure prioritizes access and benefits for its member-owners and leads it to maintain strong risk-adjusted capital with less focus on short-term profitability.

Key Statistics

Table 1

AgTexas Farm Credit Services--Key figures

		--Year ended Dec. 31--			
(Mil. $)	**2023***	**2022**	**2021**	**2020**	**2019**
Adjusted assets	3,083	2,996	2,927	2,364	2,193
Customer loans (gross)	2,794	2,747	2,709	2,184	2,014
Adjusted common equity	348	320	296	278	256
Operating revenues	55	105	87	74	68
Noninterest expenses	23	41	37	31	31
Core earnings	28	57	49	41	34

*Data as of June 30.

Table 2

AgTexas Farm Credit Services--Business position

		--Year ended Dec. 31--			
(%)	**2023***	**2022**	**2021**	**2020**	**2019**
Return on average common equity	16.46	18.48	16.90	15.43	13.66

*Data as of June 30.

Table 3

AgTexas Farm Credit Services--Capital and earnings

		--Year ended Dec. 31--			
(%)	**2023***	**2022**	**2021**	**2020**	**2019**
Tier 1 capital ratio	12.67	12.63	13.23	11.57	12.16
S&P Global Ratings' RAC ratio before diversification	14.90	14.30	14.61	13.25	NA
Adjusted common equity/total adjusted capital	81.32	80.02	78.73	100.00	100.00
Net interest income/operating revenues	66.52	63.16	66.30	65.93	69.22
Fee income/operating revenues	7.28	9.59	5.37	6.82	7.06

Table 3

AgTexas Farm Credit Services--Capital and earnings (cont.)

		--Year ended Dec. 31--			
(%)	2023*	2022	2021	2020	2019
Market-sensitive income/operating revenues	0.30	0.17	0.49	0.71	0.30
Cost to income ratio	41.66	39.39	42.27	42.24	45.22
Preprovision operating income/average assets	2.12	2.16	1.90	1.87	1.77
Core earnings/average managed assets	1.82	1.93	1.83	1.81	1.60

*Data as of June 30.

Table 4

AgTexas Farm Credit Services--Risk position

		--Year ended Dec. 31--			
(%)	2023*	2022	2021	2020	2019
Growth in customer loans	3.41	1.42	24.03	8.45	2.87
Total managed assets/adjusted common equity (x)	8.85	9.35	9.89	8.49	8.56
New loan loss provisions/average customer loans	0.17	0.04	-0.02	0.02	0.13
Net charge-offs/average customer loans	0.07	-0.01	-0.02	-0.02	0.04
Adjusted NPAs excl. TDRs / customer loans + OREO (%)	0.91	1.00	0.33	0.45	0.38
Loan loss reserves / adjusted NPAs excl. TDRs (%)	39.09	29.22	76.81	65.97	78.65

*Data as of June 30.

Table 5

Agtexas Farm Credit Services--Funding and liquidity

		--Year ended Dec. 31--			
(%)	2023*	2022	2021	2020	2019
Long-term funding ratio	71.64	71.52	71.54	71.23	71.22
Stable funding ratio	74.07	72.20	72.49	71.52	71.81
Short-term wholesale funding/funding base	33.00	33.00	32.74	32.68	32.65
Broad liquid assets/short-term wholesale funding (x)	0.19	0.16	0.15	0.12	0.13
Broad liquid assets/total assets	5.42	4.34	4.08	3.42	3.76
Short-term wholesale funding/total wholesale funding	32.02	31.99	31.72	32.68	32.65

*Data as of June 30.

AgTexas Farm Credit Services--Rating component scores

Issuer Credit Rating	BBB/Stable/--
SACP	bbb
Anchor	bbb+
Economic risk	3
Industry risk	3
Business position	Constrained
Capital and earnings	Very strong
Risk position	Moderate
Funding	Adequate

AgTexas Farm Credit Services--Rating component scores (cont.)	
Issuer Credit Rating	**BBB/Stable/--**
Liquidity	Adequate
Comparable ratings analysis	0
Support	0
ALAC support	0
GRE support	0
Group support	0
Sovereign support	0
Additional factors	0

ALAC--Additional loss-absorbing capacity. GRE--Government-related entity. SACP--Stand-alone credit profile.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Federal Farm Credit Banks, Oct. 9, 2023
- S&P Global Ratings Update On ESG Credit Indicators, Aug. 4, 2023
- AgTexas Farm Credit Services, Oct. 19, 2022
- ESG Credit Indicator Report Card: U.S., Canadian, And EMEA Nonbank Finance Companies, May 18, 2022

Ratings Detail (As Of October 26, 2023)*	
AgTexas Farm Credit Services	
Issuer Credit Rating	BBB/Stable/--
Preferred Stock	BB
Issuer Credit Ratings History	
23-Sep-2021	BBB/Stable/--

Ratings Detail (As Of October 26, 2023)*(cont.)	
Sovereign Rating	
United States	AA+/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.