

CENTRAL TEXAS FARM CREDIT, ACA

2023 Quarterly Report Second Quarter



For the Quarter Ended June 30, 2023

REPORT OF MANAGEMENT

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



Zach May, Chief Executive Officer
August 9, 2023



Robby A. Halfmann, Chairman, Board of Directors
August 9, 2023



Keith Prater, Chief Financial Officer
August 9, 2023

Second Quarter 2023 Financial Report

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CENTRAL TEXAS FARM CREDIT, ACA MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the financial performance of the Central Texas Farm Credit, ACA (Agricultural Credit Association), referred to as the Association, for the quarter ended June 30, 2023. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2022 Annual Report to Stockholders.

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 consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The consolidated financial statements were prepared under the oversight of the Association's audit committee.

Significant Events

2023

In March 2023, a patronage refund of \$8,300,000 was distributed to the Association's borrowers. The patronage refund was declared by the board of directors in December 2022, and the amount was based on the Association's 2022 operating results.

2022

In December 2022, the Association received a direct loan patronage of \$3,401,142 from the Farm Credit Bank of Texas (the Bank), representing 64 basis points on the average daily balance of the Association's direct loan with the Bank. During 2022, the Association received an additional \$241,454 in patronage payment from the Bank, based on the Association's stock investment in the Bank. Also, the Association received a capital markets patronage of \$82,044 from the Bank, representing 78 basis points on the Association's average balance of participations in the Bank's patronage pool program.

In July 2022, Boyd J. Chambers, president and chief executive officer of the Association, informed the board of directors of his decision to retire in mid-2023. Upon his announcement, the board placed in motion a plan to identify and evaluate candidates, and appoint a new chief executive officer. In December 2022, Zach May was named chief executive officer effective July 1, 2023. Mr. May has 14 years of experience with the Association and has served as Chief Operating Officer since 2009.

In March 2022, a patronage refund of \$7,900,000 was distributed to the Association's borrowers. The patronage refund was declared by the board of directors in December 2021, and the amount was based on the Association's 2021 operating results.

2021

In December 2021, the Association received a direct loan patronage of \$3,139,643 from the Bank, representing 63 basis points on the average daily balance of the Association's direct loan with the Bank. During 2021, the Association received an additional \$171,285 in patronage payment from the Bank, based on the Association's stock investment in the Bank. Also, the Association received a capital markets patronage of \$75,968 from the Bank, representing 76 basis points on the Association's average balance of participations in the Bank's patronage pool program.

In March 2021, a patronage refund of \$7,241,217 was distributed to the Association's borrowers. The patronage refund was declared by the board of directors in December 2020, and the amount was based on the Association's 2020 operating results.

Territory Conditions:

The local economy in our chartered territory continued to remain relatively strong in the second quarter of 2023. Real estate values have stabilized with residential and land sales slowing some due to rising costs of construction and rapid increases in interest rates.

The majority of the Association's new loans made during the past number of years have been to absentee landowners with diverse income sources looking for a place for a small agricultural operation or recreational use. As a result, the Association has a diversified portfolio that is not heavily dependent on agricultural income. Even those borrowers who are primarily agricultural producers typically have outside income from a spouse's employment, part-time jobs, investments, etc. The above is reflected in the Association's sound credit quality and small number of delinquencies.

According to the June USDA Drought Monitor report, all of our territory was in a drought ranging from abnormally dry to moderate drought. It was reported that 43.77 percent of the state had received enough rains to not be considered dry or in drought. Our territory received several rains during the second quarter, but the rain subsided for the most part in June. Also, summer heat moved in, threatening to move the area back into dryer conditions. Pasture conditions had improved in a few areas but have started regressing due to lack of enough follow up rain showers coupled with much higher temperatures. Pasture conditions were rated poor to fair due to heat stress across much of the state.

The USDA’s report “Texas Crop Progress and Condition” for the last week of June 2023, reported 86 percent of wheat was harvested, down 6 points from the previous year. Oat acres were reported 90 percent harvested, down 4 points from the previous year.

Cotton was reported statewide as 96 percent planted, down 4 points from the previous year and 36 percent squaring, up 2 points from the previous year. Crop conditions were 29 percent of acreage good, 34 percent fair and 21 percent poor. Cotton futures for October 2023 were in the low .80s, remaining fairly steady into early 2024.

Cattle markets continued to climb in the second quarter of 2023. August live cattle futures were trading in the low \$170s/cwt near the end of June with forward contracts moving up with a range of \$175/cwt in October to \$179/cwt in December. Feeder cattle were showing the most promise with August trading at \$235/cwt and forward contracts advancing with November peaking at \$241/cwt, falling back to \$240/cwt in January.

Class III milk futures in June were trading at \$15/cwt with forward contracts increasing to \$17/cwt by September, peaking in November at 18.38/cwt. Forward contracts suggest pricing will continue to fluctuate in a range of \$17/cwt to \$18/cwt through the remainder of 2023 and early 2024.

Loan Portfolio

Total loans outstanding on June 30, 2023, including nonaccrual loans, were \$653,831,310 compared to \$640,374,007 on December 31, 2022, reflecting an increase of 2.1 percent. Nonaccrual loans as a percentage of total loans outstanding were 0.9 percent at June 30, 2023, compared to 0.4 percent at December 31, 2022.

The Association recorded \$3,677 in recoveries and no charge-offs for the quarter ended June 30, 2023, and no recoveries and charge-offs for the same period in 2022. The Association’s allowance for credit losses on loans was 0.3 percent and 0.2 percent of total loans outstanding as of June 30, 2023, and December 31, 2022, respectively.

Risk Exposure

High-risk assets include nonaccrual loans, loans that are past due 90 days or more and still accruing interest, formally restructured loans and other property owned. The following table illustrates the Association’s components and trends of high-risk assets.

	June 30, 2023		December 31, 2022	
	Amount	%	Amount	%
Nonaccrual	\$ 4,278,652	74.2%	\$ 2,847,641	100.0%
90 days past due and still accruing interest	1,485,838	25.8%	-	0.0%
Total	\$ 5,764,490	100.0%	\$ 2,847,641	100.0%

Results of Operations

The Association had net income of \$2,263,888 and \$5,431,270 for the three and six months ended June 30, 2023, as compared to net income of \$2,869,609 and \$5,724,114 for the same period in 2022, reflecting a decrease of 21.1 percent and 5.1 percent. Net interest income was \$4,846,277 and \$9,721,615 for the three and six months ended June 30, 2023, compared to \$4,508,773 and \$8,960,827 for the same period in 2022.

	Six Months Ended			
	June 30, 2023		June 30, 2022	
	Average Balance	Interest	Average Balance	Interest
Loans	\$ 656,414,900	\$ 19,371,196	\$ 640,344,274	\$ 14,464,134
Interest-bearing liabilities	544,333,905	9,649,581	531,418,757	5,503,307
Impact of capital	<u>\$ 112,080,995</u>		<u>\$ 108,925,517</u>	
Net interest income		<u>\$ 9,721,615</u>		<u>\$ 8,960,827</u>
	2023		2022	
	Average Yield		Average Yield	
Yield on loans	5.95%		4.56%	
Cost of interest-bearing liabilities	3.57%		2.09%	
Interest rate spread	2.38%		2.47%	
Net interest income as a percentage of average earning assets	2.99%		2.82%	

	Six months ended: June 30, 2023 vs. June 30, 2022		
	Increase due to		
	Volume	Rate	Total
Interest income - loans	\$ 363,008	\$ 4,544,054	\$ 4,907,062
Interest expense	133,745	4,012,529	4,146,274
Net interest income	<u>\$ 229,263</u>	<u>\$ 531,525</u>	<u>\$ 760,788</u>

Interest income for the six months ended June 30, 2023, increased by \$4,907,062, or 33.9 percent, from the same period of 2022, primarily due to increases in yields on earning assets and an increase in average loan volume. Interest expense for the six months ended June 30, 2023, increased by \$4,146,274, or 75.3 percent, from the same period of 2022 due to an increase in interest rates and an increase in average debt volume. Average loan volume for the six months ended June 30, 2023 was \$656,414,900, compared to \$640,344,274 in the second quarter of 2022. The average net interest rate spread on the loan portfolio for the second quarter of 2023 was 2.38 percent, compared to 2.47 percent in the second quarter of 2022.

The Association's return on average assets for the six months ended June 30, 2023, was 1.61 percent compared to 1.74 percent for the same period in 2022. The Association's return on average equity for the six months ended June 30, 2023, was 8.58 percent, compared to 9.43 percent for the same period in 2022.

Liquidity and Funding Sources

The Association secures the majority of its lendable funds from the Farm Credit Bank of Texas (the Bank), which obtains its funds through the issuance of System-wide obligations and with lendable equity. The following schedule summarizes the Association's borrowings.

	June 30, 2023	December 31, 2022
Note payable to the Bank	\$ 541,836,104	\$ 526,409,194
Accrued interest on note payable	1,684,690	1,449,051
Total	<u>\$ 543,520,794</u>	<u>\$ 527,858,245</u>

The Association operates under a general financing agreement (GFA) with the Bank. The current GFA is effective through September 30, 2023. The primary source of liquidity and funding for the Association is a direct loan from the Bank. The outstanding balance of \$541,836,104 as of June 30, 2023, is recorded as a liability on the Association's balance sheet. The note carried a weighted average interest rate of 3.81 percent on June 30, 2023. 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 increase in note payable to the Bank since December 31, 2022, is due to the Association's increase in accrual loan volume. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were \$108,511,257 on June 30, 2023. The maximum amount the Association may borrow from the Bank as of June 30, 2023, was \$659,102,587 as defined by the GFA. The indebtedness continues in effect until the expiration date of the GFA, which is September 30, 2023, 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 capital position increased by \$5,632,334 on June 30, 2023, compared to December 31, 2022. The Association's debt as a percentage of members' equity was 4.21:1 as of June 30, 2023, compared to 4.35:1 as of December 31, 2022.

Farm Credit Administration regulations require the Association 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. As of June 30, 2023, the Association exceeded all regulatory capital requirements.

Significant Recent Accounting Pronouncements

Refer to Note 1 – "Organization and Significant Accounting Policies" in this quarterly report for disclosures of recent accounting pronouncements which may impact the Association's consolidated financial position and results of operations and for critical accounting policies.

Relationship With the Farm Credit Bank of Texas

The Association's financial condition may be impacted by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect the stockholder's investment in the Association. The Management's Discussion and Analysis and Notes to Financial Statements contained in the 2022 Annual Report of Central Texas Farm Credit, ACA more fully describe the Association's relationship with the Bank. The annual and quarterly stockholder reports of the Bank can be found at the Bank's website at www.farmcreditbank.com.

The Association's quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Central Texas Farm Credit, ACA, 1026 Early Boulevard, Early, Texas 76802 or calling (325) 643-5563. The annual and quarterly stockholder reports for the Association are also available on its website at www.centraltexasfarmcredit.com. Copies of the Association's quarterly stockholder reports can also be requested by e-mailing Keith.Praeter@farmcreditbank.com.

CENTRAL TEXAS FARM CREDIT, ACA

CONSOLIDATED BALANCE SHEETS

	June 30, 2023 (unaudited)	December 31, 2022
<u>ASSETS</u>		
Cash	\$ 535	\$ 1,060
Loans	653,831,310	640,374,007
Less: allowance for credit losses	2,246,924	1,426,947
Net loans	651,584,386	638,947,060
Accrued interest receivable	6,900,874	7,243,702
Investment in and receivable from the Farm Credit Bank of Texas:		
Capital stock	10,644,260	10,644,260
Other	515,136	2,572,032
Premises and equipment, net	5,387,660	5,478,861
Other assets	2,084,099	328,671
Total assets	\$ 677,116,950	\$ 665,215,646
<u>LIABILITIES</u>		
Note payable to the Farm Credit Bank of Texas	\$ 541,836,104	\$ 526,409,194
Accrued interest payable	1,684,690	1,449,051
Dividends payable	-	8,300,000
Other liabilities	3,557,215	4,650,794
Total liabilities	547,078,009	540,809,039
<u>MEMBERS' EQUITY</u>		
Capital stock and participation certificates	1,996,085	2,025,230
Unallocated retained earnings	127,792,474	122,114,885
Accumulated other comprehensive income	250,382	266,492
Total members' equity	130,038,941	124,406,607
Total liabilities and members' equity	\$ 677,116,950	\$ 665,215,646

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

CENTRAL TEXAS FARM CREDIT, ACA

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

	Quarter Ended		Six Months Ended	
	June 30,		June 30,	
	2023	2022	2023	2022
<u>INTEREST INCOME</u>				
Loans	\$ 9,870,692	\$ 7,446,649	\$ 19,371,196	\$ 14,464,134
<u>INTEREST EXPENSE</u>				
Note payable to the Farm Credit Bank of Texas	5,024,415	2,937,876	9,649,581	5,503,307
Net interest income	4,846,277	4,508,773	9,721,615	8,960,827
<u>PROVISION FOR CREDIT LOSSES</u>				
Net interest income after provision for credit losses	1,010,210	176,164	913,668	197,627
	3,836,067	4,332,609	8,807,947	8,763,200
<u>NONINTEREST INCOME</u>				
Income from the Farm Credit Bank of Texas:				
Patronage income	871,833	814,567	1,717,468	1,581,723
Loan fees	39,703	50,966	74,332	95,213
Financially related services income	627	955	4,990	4,769
Loss on sale of premises and equipment, net	-	-	-	(1,194)
Other noninterest income	30,829	-	31,636	48,870
Total noninterest income	942,992	866,488	1,828,426	1,729,381
<u>NONINTEREST EXPENSES</u>				
Salaries and employee benefits	1,510,139	1,331,883	2,942,881	2,774,686
Directors' expense	44,220	48,054	93,877	95,746
Purchased services	100,282	56,365	306,953	164,918
Travel	92,956	57,926	140,943	107,953
Occupancy and equipment	165,327	134,932	344,654	285,061
Communications	32,616	32,954	68,269	76,347
Advertising	56,261	54,891	164,401	124,784
Public and member relations	117,398	106,928	202,052	191,581
Supervisory and exam expense	63,682	61,205	127,365	122,410
Insurance fund premiums	229,971	302,459	585,987	609,951
Other components of net periodic postretirement benefit cost	20,536	20,061	40,759	40,122
Other noninterest expense	81,783	121,830	186,962	174,908
Total noninterest expenses	2,515,171	2,329,488	5,205,103	4,768,467
NET INCOME	2,263,888	2,869,609	5,431,270	5,724,114
Other comprehensive income:				
Change in postretirement benefit plans	(8,055)	(5,118)	(16,110)	(10,236)
COMPREHENSIVE INCOME	\$ 2,255,833	\$ 2,864,491	\$ 5,415,160	\$ 5,713,878

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

CENTRAL TEXAS FARM CREDIT, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

(unaudited)

	<u>Capital Stock/ Participation Certificates</u>	<u>Unallocated Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Members' Equity</u>
Balance at December 31, 2021	\$ 2,117,870	\$ 117,664,002	\$ (55,433)	\$ 119,726,439
Comprehensive income	-	5,724,114	(10,236)	5,713,878
Capital stock/participation certificates and allocated retained earnings issued	165,845	-	-	165,845
Capital stock/participation certificates and allocated retained earnings retired	(219,030)	-	-	(219,030)
Patronage refunds:				
Cash	-	-	-	-
Balance at June 30, 2022	<u>\$ 2,064,685</u>	<u>\$ 123,388,116</u>	<u>\$ (65,669)</u>	<u>\$ 125,387,132</u>
Balance at December 31, 2022	\$ 2,025,230	\$ 122,114,885	\$ 266,492	\$ 124,406,607
Cumulative effect of change in accounting principle (Note 1)	-	253,393	-	253,393
Balance at January 1, 2023	2,025,230	122,368,278	266,492	124,660,000
Comprehensive income	-	5,431,270	(16,110)	5,415,160
Capital stock/participation certificates and allocated retained earnings issued	105,825	-	-	105,825
Capital stock/participation certificates and allocated retained earnings retired	(134,970)	-	-	(134,970)
Patronage refunds:				
Cash	-	(7,074)	-	(7,074)
Balance at June 30, 2023	<u>\$ 1,996,085</u>	<u>\$ 127,792,474</u>	<u>\$ 250,382</u>	<u>\$ 130,038,941</u>

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

CENTRAL TEXAS FARM CREDIT, ACA
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

The Central Texas Farm Credit, ACA (Agricultural Credit Association), referred to as the Association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves the counties of Baylor, Brown, Callahan, Coke, Coleman, Comanche, Concho, Haskell, Irion, Jones, Knox, McCulloch, Menard, Mills, Reagans, Runnels, San Saba, Sterling, Stonewall, and Tom Green in the state of Texas. The Association is a lending institution of the Farm Credit System (the System), which was established by Acts of Congress to meet the needs of American agriculture.

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. (GAAP) for interim financial information. Accordingly, they do not include all of the disclosures required by GAAP for annual financial statements and should be read in conjunction with the audited financial statements as of and for the year ended December 31, 2022, as contained in the 2022 Annual Report to Stockholders.

In the opinion of management, the unaudited financial information is complete and reflects all adjustments, consisting of normal recurring adjustments, necessary for a fair statement of results for the interim periods. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year ending December 31, 2023. Descriptions of the significant accounting policies are included in the 2022 Annual Report to 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.

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 refinancing 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 became 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 became effective for interim and annual reporting periods beginning after December 15, 2022.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The preparation of these consolidated financial statements requires the use of management’s estimates. The results for the quarter ended March 31, 2023, are not necessarily indicative of the results to be expected for the year ended December 31, 2023. Certain amounts in the prior period’s financial statements have been reclassified to conform to current financial statement presentation.

Recently Adopted Accounting Pronouncements

The Association adopted Financial Accounting Standards Board (FASB) guidance entitled “Measurement of Credit Losses on Financial Instruments” and other subsequently issued accounting standards updates related to credit losses on January 1, 2023. This guidance replaced the current incurred loss impairment methodology with a single allowance framework for financial assets carried at amortized cost and certain off-balance sheet credit exposures. This guidance requires management to consider in its estimate of the allowance for credit losses (ACL) relevant historical events, current conditions and reasonable and supportable forecasts that affect the collectability of the assets. In addition, the guidance amends existing impairment guidance for held-to-maturity and available-for-sale investments to incorporate an allowance for credit losses related to these securities, which will allow for the reversal of credit impairments in the event that the credit of an issuer improves.

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

The following table presents the impact to the allowance for credit losses and retained earnings upon adoption of this guidance on January 1, 2023:

	December 31, 2022	CECL adoption impact	January 1, 2023
Assets:			
Allowance for credit losses on loans	\$ 1,426,947	\$ (138,248)	\$ 1,288,699
Deferred tax assets	651,408	-	651,408
Liabilities:			
Allowance for credit losses on unfunded commitments	\$ 225,323	\$ (115,145)	\$ 110,178
Deferred tax liabilities	(651,408)	-	(651,408)
Retained earnings:			
Unallocated retained earnings, net of tax	\$ 122,114,885	\$ 253,393	\$ 122,368,278

Loans and Allowance for Credit Losses

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

Nonaccrual Loans

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

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

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

Accrued Interest Receivable

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

Loan Modifications to Borrowers Experiencing Financial Difficulty

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

Collateral Dependent Loans

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

Allowance for Credit Losses

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

- the allowance for credit losses on loans (ACLL); and
- the allowance for unfunded commitments, which is presented on the balance sheet in other liabilities.

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

Methodology for Allowance for Credit Losses on Loans

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

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

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

In estimating the component of the ACLL that share common risk characteristics, loans are evaluated collectively and segregated into loan pools considering the risk associated with the specific pool. Relevant risk characteristics include loan type, commodity, credit quality rating, delinquency category or business segment or a combination of these classes. The allowance is determined based on a quantitative calculation of the expected life-of-loan loss percentage for each loan category by considering the probability of default, based on the migration of loans from performing to loss by credit quality rating or delinquency buckets using historical life-of-loan analysis periods for loan types, and the severity of loss, based on the aggregate net lifetime losses incurred per loan pool.

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

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

The Association uses multiple scenarios over a reasonable and supportable forecast period of two years. Subsequent to the forecast period, the Association reverts to long run historical loss experience beyond the two years on a straight-line basis over a two-year reversion period to inform the estimate of losses for the remaining contractual life of the loan portfolio.

The economic forecasts incorporate macroeconomic variables, including unemployment rates, real gross domestic product levels and corporate bond spreads, as well as net farm income and agricultural commodity prices. Also considered are loan and borrower characteristics, such as internal risk ratings, delinquency status, collateral type, and the remaining term of the loan, adjusted for expected prepayments.

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

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

Allowance for Credit Losses on Unfunded Commitments

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

NOTE 2 — LOANS AND ALLOWANCE FOR CREDIT LOSSES:

A summary of loans follows:

<u>Loan Type</u>	<u>June 30, 2023</u>	<u>December 31, 2022</u>
Production agriculture:		
Real estate mortgage	\$ 449,143,687	\$ 456,460,621
Production and intermediate-term	91,673,140	78,334,756
Agribusiness:		
Processing and marketing	52,968,577	51,786,443
Farm-related business	21,758,413	19,545,152
Loans to cooperatives	5,058,603	6,266,947
Communication	13,976,299	13,625,571
Energy	6,482,327	5,104,698
International	6,358,624	3,915,065
Water and waste-water	5,762,611	4,669,377
Rural residential real estate	649,029	665,377
Total	<u>\$ 653,831,310</u>	<u>\$ 640,374,007</u>

The Association purchases or sells participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration regulations. The following table presents information regarding the balances of participations purchased and sold as of June 30, 2023:

	<u>Other Farm Credit Institutions</u>		<u>Non-Farm Credit Institutions</u>		<u>Total</u>	
	<u>Participations Purchased</u>	<u>Participations Sold</u>	<u>Participations Purchased</u>	<u>Participations Sold</u>	<u>Participations Purchased</u>	<u>Participations Sold</u>
	Real estate mortgage	\$ 31,356,079	\$ 15,415,113	\$ -	\$ -	\$ 31,356,079
Production and intermediate-term	25,632,054	11,623,667	-	-	25,632,054	11,623,667
Agribusiness	61,584,068	3,770,810	-	-	61,584,068	3,770,810
Communication	13,976,299	-	-	-	13,976,299	-
Energy	6,482,327	-	-	-	6,482,327	-
International	6,358,624	-	-	-	6,358,624	-
Water and waste-water	5,762,611	-	-	-	5,762,611	-
Total	<u>\$ 151,152,062</u>	<u>\$ 30,809,590</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 151,152,062</u>	<u>\$ 30,809,590</u>

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 may be paid by the Association on such balances. The Association had no balances of ACP on June 30, 2023, and December 31, 2022, respectively.

Credit Quality

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

The Association uses a two-dimensional risk rating model based on an internally generated combined System risk rating guidance that incorporates a 14-point probability of default rating scale to identify and tracks the probability of borrower default and a separate scale addressing loss given default. Probability of default is the probability that a borrower will experience a default during the life of

the loan. The loss given default is management's estimate as to the anticipated principal loss on a specific loan assuming default occurs during the remaining life of the loan. A default is considered to have occurred if the lender believes the borrower will not be able to pay its obligation in full or the borrower or the loan is classified nonaccrual. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses and risks in a particular relationship. The Association reviews, at least on an annual basis, or when a credit action is taken the probability of default category.

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

- acceptable — assets are expected to be fully collectible and represent the highest quality;
- other assets especially mentioned (OAEM) — assets are currently collectible but exhibit some potential weakness;
- substandard — assets exhibit some serious weakness in repayment capacity, equity, or collateral pledged on the loan;
- doubtful — assets exhibit similar weaknesses to substandard assets; however, doubtful assets have additional weaknesses in existing facts, conditions and values that make collection in full highly questionable; and
- loss — assets are considered uncollectible.

The following table presents credit quality indicators by loan type and the related principal balance:

	Term Loans				Revolving Loans		Total
	Amortized Cost by Origination Year				Amortized Cost		
	2023	2022	2021	Prior	Basis		
Real estate mortgage							
Acceptable	\$ 24,024,066	\$ 73,428,615	\$ 111,672,344	\$ 236,402,763	\$ 36,069	\$ 445,563,857	
OAEM	-	-	1,531,767	352,724	-	1,884,491	
Substandard/Doubtful	-	-	1,485,838	209,501	-	1,695,339	
	<u>\$ 24,024,066</u>	<u>\$ 73,428,615</u>	<u>\$ 114,689,949</u>	<u>\$ 236,964,988</u>	<u>\$ 36,069</u>	<u>\$ 449,143,687</u>	
Production and intermediate-term							
Acceptable	\$ 4,251,393	\$ 12,019,805	\$ 12,240,090	\$ 9,945,399	\$ 51,065,882	\$ 89,522,569	
OAEM	-	-	70,289	-	156,138	226,427	
Substandard/Doubtful	279,702	43,378	-	1,601,064	-	1,924,144	
	<u>\$ 4,531,095</u>	<u>\$ 12,063,183</u>	<u>\$ 12,310,379</u>	<u>\$ 11,546,463</u>	<u>\$ 51,222,020</u>	<u>\$ 91,673,140</u>	
Agribusiness							
Acceptable	\$ 5,990,167	\$ 22,434,971	\$ 17,883,475	\$ 13,173,578	\$ 17,199,531	\$ 76,681,722	
OAEM	-	-	961,537	-	204,201	1,165,738	
Substandard/Doubtful	180,193	-	-	89,994	1,667,946	1,938,133	
	<u>\$ 6,170,360</u>	<u>\$ 22,434,971</u>	<u>\$ 18,845,012</u>	<u>\$ 13,263,572</u>	<u>\$ 19,071,678</u>	<u>\$ 79,785,593</u>	
Communications							
Acceptable	\$ 4,294,874	\$ -	\$ 3,399,786	\$ 5,357,448	\$ 924,191	\$ 13,976,299	
OAEM	-	-	-	-	-	-	
Substandard/Doubtful	-	-	-	-	-	-	
	<u>\$ 4,294,874</u>	<u>\$ -</u>	<u>\$ 3,399,786</u>	<u>\$ 5,357,448</u>	<u>\$ 924,191</u>	<u>\$ 13,976,299</u>	
Energy							
Acceptable	\$ 1,997,259	\$ -	\$ 1,376,180	\$ 2,737,707	\$ -	\$ 6,111,146	
OAEM	-	-	-	-	-	-	
Substandard/Doubtful	-	-	-	371,141	40	371,181	
	<u>\$ 1,997,259</u>	<u>\$ -</u>	<u>\$ 1,376,180</u>	<u>\$ 3,108,848</u>	<u>\$ 40</u>	<u>\$ 6,482,327</u>	
International							
Acceptable	\$ -	\$ 6,231,166	\$ -	\$ -	\$ 127,458	\$ 6,358,624	
OAEM	-	-	-	-	-	-	
Substandard/Doubtful	-	-	-	-	-	-	
	<u>\$ -</u>	<u>\$ 6,231,166</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 127,458</u>	<u>\$ 6,358,624</u>	
Water and Waste Water							
Acceptable	\$ 998,049	\$ 2,068,722	\$ 2,496,559	\$ -	\$ 199,281	\$ 5,762,611	
OAEM	-	-	-	-	-	-	
Substandard/Doubtful	-	-	-	-	-	-	
	<u>\$ 998,049</u>	<u>\$ 2,068,722</u>	<u>\$ 2,496,559</u>	<u>\$ -</u>	<u>\$ 199,281</u>	<u>\$ 5,762,611</u>	
Rural residential real estate							
Acceptable	\$ -	\$ 144,900	\$ -	\$ 504,129	\$ -	\$ 649,029	
OAEM	-	-	-	-	-	-	
Substandard/Doubtful	-	-	-	-	-	-	
	<u>\$ -</u>	<u>\$ 144,900</u>	<u>\$ -</u>	<u>\$ 504,129</u>	<u>\$ -</u>	<u>\$ 649,029</u>	
Total Loans							
Acceptable	\$ 41,555,808	\$ 116,328,179	\$ 149,068,434	\$ 268,121,024	\$ 69,552,412	\$ 644,625,857	
OAEM	-	-	2,563,593	352,724	360,339	3,276,656	
Substandard/Doubtful	459,895	43,378	1,485,838	2,271,700	1,667,986	5,928,797	
	<u>\$ 42,015,703</u>	<u>\$ 116,371,557</u>	<u>\$ 153,117,865</u>	<u>\$ 270,745,448</u>	<u>\$ 71,580,737</u>	<u>\$ 653,831,310</u>	

The following table shows loans under the Farm Credit Administration Uniform Loan Classification System as a percentage of total loans by loan type as of December 31, 2022:

	June 30, 2023	December 31, 2022
Real estate mortgage		
Acceptable	99.2 %	99.3 %
OAEM	0.4	0.3
Substandard/doubtful	0.4	0.4
	100.0	100.0
Production and intermediate-term		
Acceptable	97.7	99.7
OAEM	0.2	0.2
Substandard/doubtful	2.1	0.1
	100.0	100.0
Agribusiness		
Acceptable	96.1	94.0
OAEM	1.5	1.4
Substandard/doubtful	2.4	4.6
	100.0	100.0
Communication		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	100.0	100.0
Energy		
Acceptable	94.3	84.8
OAEM	-	-
Substandard/doubtful	5.7	15.2
	100.0	100.0
International		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	100.0	100.0
Water/waste water		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	100.0	100.0
Rural residential real estate		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	100.0	100.0
Total loans		
Acceptable	98.6	98.6
OAEM	0.5	0.4
Substandard/doubtful	0.9	1.0
	100.0 %	100.0 %

The Association had accrued interest receivable on loans of \$6,900,874 and \$7,243,702 on June 30, 2023 and December 31, 2022 respectively, which have been excluded from the amortized cost of loans and reported separately in the Consolidated Balance Sheet.

The following table reflects nonperforming assets, which consist of nonaccrual loans, accruing loans 90 days or more, and other property owned and related credit quality statistics:

	June 30, 2023	December 31, 2022
Nonaccrual loans:		
Agribusiness	\$ 1,938,134	\$ 1,845,550
Production and intermediate-term	1,783,597	-
Energy	371,181	783,159
Real estate mortgage	185,740	218,932
Total nonaccrual loans	<u>4,278,652</u>	<u>2,847,641</u>
Accruing loans 90 days or more past due:		
Real estate mortgage	\$ 1,485,838	\$ -
Total accruing loans 90 days or more past due	<u>1,485,838</u>	<u>-</u>
Other property owned	-	-
Total nonperforming assets	<u>\$ 5,764,490</u>	<u>\$ 2,847,641</u>
Nonaccrual loans as a percentage of total loans	0.65%	0.44%
Nonperforming assets as a percentage of total loans and other property owned	0.88%	0.44%
Nonperforming assets as a percentage of capital	4.43%	2.29%

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

	June 30, 2023			Interest Income Recognized For the Six Months Ended June 30, 2023
	Amortized Cost with Allowance	Amortized Cost without Allowance	Total	
Nonaccrual loans:				
Agribusiness	\$ 1,757,941	\$ 180,193	\$ 1,938,134	\$ -
Production and intermediate-term	1,601,064	182,533	1,783,597	35,726
Energy and Water/waste disposal	371,181	-	371,181	-
Real estate mortgage	-	185,740	185,740	-
Total nonaccrual loans	<u>\$ 3,730,186</u>	<u>\$ 548,466</u>	<u>\$ 4,278,652</u>	<u>\$ 35,726</u>

The following tables provide an aging analysis of past due loans at amortized cost by portfolio segment as of:

June 30, 2023	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	\$ 233,263	\$ 1,485,838	\$ 1,719,101	\$ 447,424,586	\$ 449,143,687	\$ 1,485,838
Production and intermediate term	17,406	-	17,406	91,655,734	91,673,140	-
Processing and marketing	1,757,940	-	1,757,940	51,210,637	52,968,577	-
Farm-related business	-	-	-	21,758,413	21,758,413	-
Communication	2,425,905	-	2,425,905	11,550,394	13,976,299	-
Energy	-	40	40	6,482,287	6,482,327	-
International	-	-	-	6,358,624	6,358,624	-
Water and waste-water	-	-	-	5,762,611	5,762,611	-
Loans to cooperatives	-	-	-	5,058,603	5,058,603	-
Rural residential real estate	-	-	-	649,029	649,029	-
Total	<u>\$ 4,434,514</u>	<u>\$ 1,485,878</u>	<u>\$ 5,920,392</u>	<u>\$ 647,910,918</u>	<u>\$ 653,831,310</u>	<u>\$ 1,485,838</u>

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

December 31, 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	\$ 580,087	\$ -	\$ 580,087	\$ 461,516,631	\$ 462,096,718	\$ -
Production and intermediate term	80,800	-	80,800	79,364,345	79,445,145	-
Processing and marketing	557,949	143,210	701,159	51,304,871	52,006,030	-
Farm-related business	-	-	-	19,677,201	19,677,201	-
Communication	-	-	-	13,685,742	13,685,742	-
Energy	-	957	957	5,142,329	5,143,286	-
International	-	-	-	3,951,160	3,951,160	-
Water and waste-water	-	-	-	4,670,861	4,670,861	-
Loans to cooperatives	-	-	-	6,274,924	6,274,924	-
Rural residential real estate	-	-	-	666,642	666,642	-
Total	\$ 1,218,836	\$ 144,167	\$ 1,363,003	\$ 646,254,706	\$ 647,617,709	\$ -

A loan is considered collateral dependent when the borrower is experiencing financial difficulty and repayment is expected to be provided substantially through the operation or sale of the collateral. The collateral dependent loans are primarily real estate mortgage and rural residential real estate loans.

Allowance for Credit Losses

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

Effective January 1, 2023, the Association adopted the CECL accounting guidance as described in Note 1. A summary of changes in the allowance for credit losses by portfolio segment are as follows:

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communi- cations	Energy	Water and Waste Disposal	Rural Residential Real Estate	International	Total
Allowance for Credit Losses on Loans:									
Balance at March 31, 2023	\$ 467,095	\$ 159,407	\$ 367,878	\$ 10,390	\$ 224,098	\$ 4,221	\$ 119	\$ 2,808	\$ 1,236,016
Charge-offs	-	-	-	-	-	-	-	-	-
Recoveries	3,677	-	-	-	-	-	-	-	3,677
Provision for (reversal of) credit loss	67,562	287,075	715,907	2,682	(67,319)	1,206	1	117	1,007,231
Other	-	-	-	-	-	-	-	-	-
Balance at June 30, 2023	\$ 538,334	\$ 446,482	\$ 1,083,785	\$ 13,072	\$ 156,779	\$ 5,427	\$ 120	\$ 2,925	\$ 2,246,924
Balance at December 31, 2022	\$ 305,431	\$ 270,913	\$ 577,823	\$ 32,844	\$ 224,567	\$ 10,615	\$ 233	\$ 4,521	\$ 1,426,947
Cumulative effect of a change in accounting principle	163,091	(93,160)	(176,994)	(21,546)	(1,116)	(5,914)	(103)	(2,506)	(138,248)
Balance at January 1, 2023	468,522	177,753	400,829	11,298	223,451	4,701	130	2,015	1,288,699
Charge-offs	-	-	-	-	-	-	-	-	-
Recoveries	3,677	-	-	-	-	-	-	-	3,677
Provision for (reversal of) credit loss	66,135	268,729	682,956	1,774	(66,672)	726	(10)	910	954,548
Other	-	-	-	-	-	-	-	-	-
Balance at June 30, 2023	\$ 538,334	\$ 446,482	\$ 1,083,785	\$ 13,072	\$ 156,779	\$ 5,427	\$ 120	\$ 2,925	\$ 2,246,924
Balance at March 31, 2022 ¹	\$ 361,984	\$ 360,239	\$ 494,387	\$ 33,179	\$ 377,721	\$ 4,630	\$ 1,330	\$ 9,392	\$ 1,642,862
Charge-offs	-	-	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-	-	-
Provision for (reversal of) credit loss	5,087	(38,150)	209,937	(618)	(124)	1,179	(1,061)	(86)	176,164
Other	(2)	(16,610)	(13,577)	(177)	-	3,983	17	(285)	(26,651)
Balance at June 30, 2022	\$ 367,069	\$ 305,479	\$ 690,747	\$ 32,384	\$ 377,597	\$ 9,792	\$ 286	\$ 9,021	\$ 1,792,375
Balance at December 31, 2021	\$ 359,949	\$ 405,304	\$ 459,979	\$ 32,536	\$ 377,690	\$ 3,038	\$ 1,386	\$ 8,975	\$ 1,648,857
Charge-offs	-	-	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-	-	-
Provision for (reversal of) credit loss	7,250	(59,256)	248,274	(103)	(310)	2,786	(1,100)	86	197,627
Other	(130)	(40,569)	(17,506)	(49)	217	3,968	-	(40)	(54,109)
Balance at June 30, 2022	\$ 367,069	\$ 305,479	\$ 690,747	\$ 32,384	\$ 377,597	\$ 9,792	\$ 286	\$ 9,021	\$ 1,792,375
Allowance for Unfunded Commitments:									
Balance at March 31, 2023	\$ 24	\$ 14,695	\$ 49,618	\$ 615	\$ 1	\$ 286	\$ -	\$ 1,080	\$ 66,319
Provision for unfunded commitments	144	4,121	(2,771)	90	-	1,091	-	304	2,979
Balance at June 30, 2023	\$ 168	\$ 18,816	\$ 46,847	\$ 705	\$ 1	\$ 1,377	\$ -	\$ 1,384	\$ 69,298
Balance at December 31, 2022	\$ 137	\$ 94,010	\$ 124,215	\$ 1,922	\$ 2	\$ 694	\$ -	\$ 4,343	\$ 225,323
Cumulative effect of a change in accounting	(99)	(70,808)	(40,275)	(1,156)	(1)	(389)	-	(2,417)	(115,145)
Balance at January 1, 2023	38	23,202	83,940	766	1	305	-	1,926	110,178
Provision for unfunded commitments	130	(4,386)	(37,093)	(61)	-	1,072	-	(542)	(40,880)
Balance at June 30, 2023	\$ 168	\$ 18,816	\$ 46,847	\$ 705	\$ 1	\$ 1,377	\$ -	\$ 1,384	\$ 69,298

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

Troubled Debt Restructurings

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

As of June 30, 2023, the Association had no troubled debt restructured loans. As of December 31, 2022, the Association had one trouble debt restructured loan.

NOTE 3 —LEASES:

The components of lease expense were as follows:

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2023	June 30, 2022	June 30, 2023	June 30, 2022
Operating lease cost	\$ 4,228	\$ 4,228	\$ 8,456	\$ 8,456
Net lease cost	\$ 4,228	\$ 4,228	\$ 8,456	\$ 8,456

Other information related to leases was as follows:

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2023	June 30, 2022	June 30, 2023	June 30, 2022
Cash paid for amounts included in the measurement of lease liabilities:				
Operating cash flows from operating leases	\$ 5,810	\$ 5,670	\$ 11,480	\$ 11,340

Lease term and discount rate are as follows:

	June 30, 2023	December 31, 2022
Weighted average remaining lease term in years		
Operating leases	0.83	1.33
Weighted average discount rate		
Operating leases	3.81%	3.22%

Future minimum lease payments under non-cancellable leases as of June 30, 2023, were as follows:

	Total
2023 (excluding the six months ended 6/30/23)	\$ 11,760
2024	7,840
2025	-
2026	-
Thereafter	-
Total	\$ 19,600

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 Association's capital adequacy goals as well as the minimum permanent capital standards. The Plan monitors projected dividends, equity retirements and other actions that may decrease the Association's permanent 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 Association'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.

	June 30, 2023	December 31, 2022
Capital stock and participation certificates	\$ 1,996,085	\$ 2,025,230
Accumulated other comprehensive loss	250,382	266,492
Retained earnings ¹	127,792,474	122,114,885
Total Capital	\$ 130,038,941	\$ 124,406,607

¹ Retained earnings for the quarter ended June 30, 2023, reflects an increase from the cumulative effect of a change in accounting principle for CECL on January 1, 2023.

Regulatory Capitalization Requirements

Risk-adjusted:	Regulatory Minimums with Buffer	As of June 30, 2023
Common equity tier 1 ratio	7.00%	16.91%
Tier 1 capital ratio	8.50%	16.91%
Total capital ratio	10.50%	17.10%
Permanent capital ratio	7.00%	16.94%
<hr/>		
Non-risk-adjusted:		
Tier 1 leverage ratio	5.00%	17.54%
UREE leverage ratio	1.50%	17.24%

The details for the amounts used in the calculation of the regulatory capital ratios as of June 30, 2023:

	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
Numerator:				
Unallocated retained earnings	\$ 126,013,298	\$ 126,013,298	\$ 126,013,298	\$ 126,013,298
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	2,000,049	2,000,049	2,000,049	2,000,049
Allowance for credit losses and reserve for credit losses subject to certain limitations	-	-	1,332,315	-
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	(10,644,260)	(10,644,260)	(10,644,260)	(10,644,260)
	<u>\$ 117,369,087</u>	<u>\$ 117,369,087</u>	<u>\$ 118,701,402</u>	<u>\$ 117,369,087</u>
Denominator:				
Risk-adjusted assets excluding allowance	\$ 704,621,115	\$ 704,621,115	\$ 704,621,115	\$ 704,621,115
Regulatory Adjustments and Deductions:				
Regulatory deductions included in total capital	(10,644,260)	(10,644,260)	(10,644,260)	(10,644,260)
Allowance for credit losses	-	-	-	(1,265,476)
	<u>\$ 693,976,855</u>	<u>\$ 693,976,855</u>	<u>\$ 693,976,855</u>	<u>\$ 692,711,379</u>

	Tier 1 leverage ratio	UREE leverage ratio
Numerator:		
Unallocated retained earnings	\$ 126,013,298	\$ 126,013,298
Common Cooperative Equities:		
Statutory minimum purchased borrower stock	2,000,049	-
Regulatory Adjustments and Deductions:		
Amount of allocated investments in other System institutions	(10,644,260)	(10,644,260)
	<u>\$ 117,369,087</u>	<u>\$ 115,369,038</u>
Denominator:		
Total Assets	\$ 682,781,275	\$ 682,781,275
Regulatory Adjustments and Deductions:		
Regulatory deductions included in tier 1 capital	(13,563,013)	(13,563,013)
	<u>\$ 669,218,262</u>	<u>\$ 669,218,262</u>

The following tables present the activity in the accumulated other comprehensive income (loss), net of tax by component:

	Accumulated Other Comprehensive Income (Loss)	
Balance at March 31, 2023	\$	258,437
Other comprehensive income before reclassifications		<u>(8,055)</u>
Net current period other comprehensive income		<u>(8,055)</u>
Balance at June 30, 2023	\$	<u>250,382</u>
Balance at January 1, 2023	\$	266,492
Other comprehensive income before reclassifications		<u>(16,110)</u>
Net current period other comprehensive income		<u>(16,110)</u>
Balance at June 30, 2023	\$	<u>250,382</u>
	Accumulated Other Comprehensive Income (Loss)	
Balance at March 31, 2022	\$	(60,551)
Other comprehensive income before reclassifications		<u>(5,118)</u>
Net current period other comprehensive income		<u>(5,118)</u>
Balance at June 30, 2022	\$	<u>(65,669)</u>
Balance at January 1, 2022	\$	(55,433)
Other comprehensive income before reclassifications		<u>(10,236)</u>
Net current period other comprehensive income		<u>(10,236)</u>
Balance at June 30, 2022	\$	<u>(65,669)</u>

NOTE 5 — INCOME TAXES:

Central Texas Farm Credit, ACA conducts its business activities through two wholly-owned subsidiaries. Long-term mortgage lending activities are conducted through a wholly-owned FLCA subsidiary which is exempt from federal and state income tax. Short- and intermediate-term lending activities are conducted through a wholly-owned PCA subsidiary. The PCA subsidiary and the ACA holding company are subject to income tax. Central Texas Farm Credit, ACA operates as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, Central Texas Farm Credit, ACA can exclude from taxable income amounts distributed as qualified patronage dividends in the form of cash, stock or allocated retained earnings. Provisions for income taxes are made only on those taxable earnings that will not be distributed as qualified patronage dividends. Deferred taxes are recorded at the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the Association 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.

NOTE 6 — FAIR VALUE MEASUREMENTS:

Accounting guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 13 in the 2022 Annual Report to Stockholders for a more complete description.

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

June 30, 2023	Fair Value Measurement Using			Total Fair Value	Total Gains (Losses)
	Level 1	Level 2	Level 3		
Assets:					
Loans	\$ -	\$ -	\$ 2,439,020	\$ 2,439,020	\$ -
December 31, 2022					
Assets:					
Loans	\$ -	\$ -	\$ 2,309,096	\$ 2,309,096	\$ -

Valuation Techniques

As more fully discussed in Note 13 to the 2022 Annual Report to Stockholders, 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 the 2022 Annual Report to Stockholders.

Loans Evaluated for Impairment

For certain loans evaluated for impairment under FASB impairment guidance, the fair value is based upon the underlying collateral since the loans are collateral-dependent loans for which real estate is the collateral. 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.

Cash

For cash, the carrying amount is a reasonable estimate of fair value.

Loans

Fair value is estimated by discounting the expected future cash flows using the Association's current interest rates at which similar loans would be made to borrowers with similar credit risk. The discount rates are based on the Association's current loan origination rates as well as management's estimates of credit risk. Management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale and could be less.

For purposes of estimating fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics. Expected future cash flows, primarily based on contractual terms, and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

The fair value of loans in nonaccrual status that are current as to principal and interest is estimated as described above, with appropriately higher interest rates which reflect the uncertainty of continued cash flows. For collateral-dependent impaired loans, it is assumed that collection will result only from the disposition of the underlying collateral.

NOTE 7 — EMPLOYEE BENEFIT PLANS:

The following table summarizes the components of net periodic benefit costs for the three and six months ended June 30:

Three months ended June 30:

	Other Benefits	
	2023	2022
Service cost	\$ 5,371	\$ 8,755
Interest cost	23,220	16,424
Amortization of prior service credits	(5,119)	(5,118)
Amortization of net actuarial gain	(2,936)	-
Net periodic benefit cost	<u>\$ 20,536</u>	<u>\$ 20,061</u>

Six months ended June 30:

	Other Benefits	
	2023	2022
Service cost	\$ 10,645	\$ 17,509
Interest cost	46,224	32,848
Amortization of prior service credits	(10,239)	(10,236)
Amortization of net actuarial gain	(5,871)	-
Net periodic benefit cost	<u>\$ 40,759</u>	<u>\$ 40,121</u>

The Association's liability for the unfunded accumulated obligation for these benefits on June 30, 2023, was \$1,826,609 and is included in other liabilities on the 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 income statement.

The structure of the District'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 previously disclosed in its financial statements for the year ended December 31, 2022, that it expected to contribute \$74,876 to the District's defined benefit pension plan in 2023. As of June 30, 2023, \$40,759 of contributions have been made. The Association presently anticipates contributing an additional \$40,127 to fund the defined benefit pension plan in 2023 for a total of \$80,886.

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 — SUBSEQUENT EVENTS:

The Association has evaluated subsequent events through August 9, 2023, which is the date the financial statements were issued. There are no other significant events requiring disclosure as of August 9, 2023.