

AG 
TEXAS
FARM CREDIT SERVICES
Quarterly Report

**The Third Quarter Ended
September 30, 2020**



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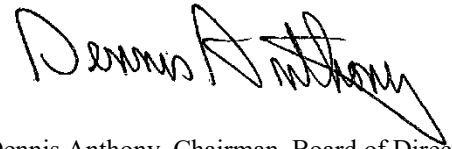
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The consolidated financial statements of *AgTexas Farm Credit Services* (“**Association**”) are prepared by management, who is responsible for the statements’ integrity and objectivity, including amounts that must necessarily be based on judgments 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.



Tim McDonald, Chief Executive Officer
November 5, 2020



Dennis Anthony, Chairman, Board of Directors
November 5, 2020



Jeff Fairchild, Chief Financial Officer
November 5, 2020

Management's Discussion & Analysis

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, 2020, and should be read in conjunction with the accompanying *consolidated financial statements* (“**CFS**”) and the *Association’s 2019 Annual Report to Stockholders* (“**2019 Annual Report**”). Management prepared the accompanying CFS under the oversight of the Association’s Audit Committee.

Significant Events.

The United States has been operating under a presidentially declared emergency since March 13, 2020 due to the Coronavirus Disease 2019 (also referred to as COVID-19). The Association continues during these unprecedented times to fulfill its mission to support agriculture and rural communities by providing access to reliable and consistent credit. The Association has implemented a response related to the COVID-19 pandemic. The Association continues to implement procedures to potentially limit the spread, but still provide customer service. Capital levels remained strong to support any adversity or continuing loan demand. As it relates to the Association’s internal controls over financial reporting and disclosure controls and procedures, the controls and procedures continue to operate effectively and no material changes to the controls or financial systems have occurred or are contemplated.

On March 27, 2020, Congress passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Among other provisions, the CARES Act provided funding and authority to bolster certain programs offered by the United States Department of Agriculture (USDA). On April 17, 2020, the USDA announced a \$19 billion Coronavirus Food Assistance Program (CFAP), that provides a \$16 billion program of direct payments for agricultural producers that have been impacted by the decline in commodity prices and the disruption in food supply chains related to COVID-19, and a \$3 billion food purchase and distribution program. The CARES Act also appropriated funds for the Paycheck Protection Program (PPP), a guaranteed loan program administered by the U.S. Small Business Administration (SBA). The purpose of the program is to support payroll and certain other financial needs of small businesses during the COVID-19 pandemic. The impact of the support programs for agriculture and related industries is undeterminable at this point in time. Due to the impact COVID-19 has had on our borrowers, the Association implemented payment deferral programs for borrowers directly affected by COVID-19. In addition, the Association also helped originate SBA PPP loans for our borrowers.

The USDA announced on September 18, 2020, that it will provide additional direct assistance of up to \$14 billion to farmers and ranchers who continue to face market disruptions and associated costs due to COVID-19. Eligible farmers, including row crop, livestock, and specialty crop producers, can sign up for aid at USDA Farm Service Agency offices through mid-December 2020.

The overall impact of COVID-19 continues to evolve and future events are uncertain. Challenging economic conditions are likely ahead. COVID-19 has caused many countries, including the U.S., to impose restrictions on travel and public gatherings. It is too early to accurately assess the potential impact of COVID-19 on the global, U.S. and district economies. The Association will continue to closely monitor the situation in the coming quarters.

The U.S. Bureau of Labor Statistics reported on October 2, 2020, that total nonfarm payroll employment rose month-over-month by 661,000 in September, and the national unemployment rate declined from 8.4 to 7.9 percent. The Texas economy showed continued signs of expansion in August, as payrolls increased month-over-month and the unemployment rate fell from 8.0 to 6.8 percent. Although countries around the world continue to be impacted by COVID-19, economists generally believe that the U.S. economy began to recover during the third quarter. According to the Third Quarter 2020 Survey of Professional Forecasters published by the Federal Reserve Bank of Philadelphia, economists expect real GDP to have increased at an annualized rate of about 19.1 percent in the third quarter.

West Texas Intermediate (WTI) crude oil prices decreased year-over-year from approximately \$54 per barrel in September 2019 to approximately \$40 per barrel by the end of September 2020. On a quarter over-quarter basis, the average price of WTI rose by

Management's Discussion & Analysis

approximately \$1 per barrel in the third quarter. According to Baker Hughes, the U.S. rotary rig count decreased year-over-year from 860 rigs during the week ending on September 27, 2019 to 261 rigs during the week ending September 30, 2020. The rig count, often seen as a leading indicator of activity in the petroleum industry, reached a multi-year low in August of 244 rigs before recovering slightly in September.

According to the most recent USDA farm income projections presented on September 2, 2020, net farm income, a broad measure of profits, is forecasted to increase by \$19 billion (22.7 percent) year-over-year to \$102.7 billion in 2020. Net cash farm income is similarly forecasted to increase by \$4.9 billion (4.5 percent) year-over-year to \$115.2 billion in 2020. If realized, both income measures would be above the 20-year inflation-adjusted historical average. According to the USDA, the anticipated increase in net farm income is driven by higher government payments and lower anticipated expenses. Farm equity is forecasted to increase by 0.7 percent, while debt to equity is expected to rise by 0.4 percentage points to 16.2 percent.

Weather across most of the U.S. was relatively volatile during the third quarter. The 2020 hurricane season has been one of the most active on record. Tropical systems, such as Hurricanes Laura and Sally, brought heavy precipitation, localized flooding and wind damage to affected areas, including along the U.S. Gulf Coast, during the third quarter. Precipitation from these and other storm systems generally ensured that the southeastern U.S. remained relatively drought-free. Conversely, the western half of the country has experienced worsening drought and high temperatures. These conditions have fueled historic wildfires along the West Coast. In early October, Cal Fire reported that over 4 million acres had burned during 2020 in California alone, more than double the prior calendar year record observed in 2018.

In its September 2020 World Agricultural Supply and Demand Estimate (WASDE) report, USDA projected lower season-average prices in the 2020/2021 marketing year for several crops, including corn and cotton. Meanwhile, USDA expects soybean prices to rise by about 8 percent season-over-season in the 2020/2021 marketing year. Milk prices have been volatile during 2020, and USDA anticipates that all milk prices will fall by about 5 percent in 2020 compared to the 2019 average. Steer, barrow and gilt and poultry prices are projected to decrease in 2020 before increasing in 2021.

Association borrowers utilize risk management tools, such as federally-sponsored crop insurance programs and forward, futures and options contracts, to mitigate risk and enhance margins. The Association's portfolio continues to be supported by strong credit quality, high levels of capital, and diversification.

The Association distributed patronage of approximately \$15.1 million in cash and an additional \$3.2 million in allocated equities in the first quarter of 2020. This represented the 2019 patronage declared by the Association.

Loan Portfolio.

Total loans outstanding at September 30, 2020, including nonaccrual loans, were \$2,117,906,485 compared to \$2,013,703,362 at December 31, 2019, reflecting an increase of 5.2 percent. Nonaccrual loans as a percentage of total loans outstanding were 0.4 percent at September 30, 2020, compared to 0.4 percent at December 31, 2019.

The Association recorded \$978,517 in recoveries and \$777,726 in charge-offs for the nine months ended September 30, 2020, and \$318,990 in recoveries and \$1,067,351 in charge-offs for the same period in 2019. The Association's allowance for credit losses, which consists of the allowance for loan losses and the reserve for unfunded credit commitments, was 0.41 percent and 0.36 percent of total loans outstanding as of September 30, 2020, and December 31, 2019, respectively. The increase is due to an increase in general reserves.

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, 2020	September 30, 2019	December 31, 2019
Acceptable	94.8%	95.6%	94.1%
OAEM	2.6%	2.3%	3.4%
Substandard/doubtful	2.6%	2.1%	2.5%
	100.0%	100.0%	100.0%

Management's Discussion & Analysis

Changes in the Association's loan portfolio from December 31, 2019 to September 30, 2020 follow:

Loan Type	September 30, 2020		December 31, 2019	
	Amount	%	Amount	%
Real estate mortgage	\$ 1,129,699,557	53.4%	\$ 1,084,069,296	53.7%
Production and intermediate term	688,295,293	32.5%	659,679,343	32.8%
Agribusiness:				
Loans to cooperatives	8,922,763	0.4%	3,538,860	0.2%
Processing and marketing	152,662,722	7.2%	132,037,952	6.6%
Farm-related business	28,547,908	1.3%	22,600,552	1.1%
Communication	18,941,692	0.9%	19,222,731	1.0%
Energy	7,683,558	0.4%	7,271,541	0.4%
Water and waste water	4,662,998	0.2%	-	0.0%
Rural residential real estate	7,908,339	0.4%	8,362,492	0.4%
Lease receivables	3,340,917	0.2%	913,850	0.0%
Mission-related investments	67,240,738	3.2%	76,006,745	3.8%
Total	<u>\$ 2,117,906,485</u>	<u>100.1%</u>	<u>\$ 2,013,703,362</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, FCA new 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 and 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, 2020		December 31, 2019	
	Amount	%	Amount	%
Nonaccrual	\$ 8,517,075	32.4%	\$ 7,722,827	30.1%
90 days past due and still accruing interest	1,176,044	4.5%	-	0.0%
Formally restructured	16,690,500	63.3%	17,924,921	69.9%
Other property owned, net	-	0.0%	-	0.0%
Total	<u>\$ 26,383,619</u>	<u>100.2%</u>	<u>\$ 25,647,748</u>	<u>100.0%</u>

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Results of Operations. Changes in the Association's results of operations for the three and nine months ended September 30, 2020 and September 30, 2019 follow:

	For the three months ended		For the nine months ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Interest income	\$ 21,311,885	\$ 26,048,831	\$ 66,285,382	\$ 75,727,222
Interest expense	(8,859,112)	(13,879,621)	(30,636,148)	(40,537,633)
(Provision for) reversal of loan losses	<u>(810,044)</u>	<u>(873,385)</u>	<u>(1,232,301)</u>	<u>(2,298,264)</u>
Net interest margin	11,642,729	11,295,825	34,416,933	32,891,325
Noninterest income	7,077,620	5,533,381	17,408,233	15,040,694
Noninterest expense	<u>(7,155,679)</u>	<u>(7,577,751)</u>	<u>(22,544,318)</u>	<u>(23,141,207)</u>
Net income	<u>\$ 11,564,670</u>	<u>\$ 9,251,455</u>	<u>\$ 29,280,848</u>	<u>\$ 24,790,812</u>

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 decrease in interest income and expense are due to decreasing interest rates offset by growth in volume. The changes in "(Provision for) reversal of loan losses" are due changes in recoveries and charge-offs along with an increase in allowance for loan loss. Noninterest income increases are due to increases in patronage income. Noninterest expenses are comparable to the prior period and are below budget projections due to reduced travel and other expenses due to COVID-19.

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

	For the nine months ended September 30, 2020		For the nine months ended September 30, 2019	
	Average Balance	Interest	Average Balance	Interest
	Total loans and investments	2,103,416,256	66,285,382	2,006,350,432
Interest-bearing liabilities	1,883,379,748	30,636,148	1,802,635,055	40,537,633
Impact of capital	<u>\$ 220,036,508</u>		<u>\$ 203,715,377</u>	
Net interest income		<u>\$ 35,649,234</u>		<u>\$ 35,189,589</u>

	2020	2019
	Average Yield	Average Yield
Yield on loans and investments	4.20%	5.05%
Cost of interest-bearing	2.17%	3.01%
Interest rate spread	2.03%	2.04%
Interest rate margin	2.26%	2.34%

	Nine months ended September 30:		
	2020 vs. 2019		
	Increase (decrease) due to		
	Volume	Rate	Total
Interest income	\$ 3,679,726	\$ (13,121,566)	\$ (9,441,840)
Interest expense	1,824,476	(11,725,961)	(9,901,485)
Net interest income	<u>\$ 1,855,249</u>	<u>\$ (1,395,604)</u>	<u>\$ 459,645</u>

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The Association’s return on average assets was 2.04% and 1.71% for the quarters ended September 30, 2020 and 2019, respectively, and 1.78% and 1.58% for the nine months ended September 30, 2020 and 2019, respectively. The increase in return on average assets for the three and nine months ended September 30, 2020 is due to increased net income, which is explained above. The Association’s return on average equity was 15.42% and 13.14% for the quarters ended September 30, 2020 and 2019, respectively, and 13.54% and 12.17% for the nine months ended September 30, 2020 and 2019, respectively. The changes in return on average equity for the period mirrors the return on average assets above.

Liquidity and Funding Sources. *Interest rate risk* (“IRR”) inherent in the loan portfolio is substantially mitigated through the funding relationship with the FCBT. 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, 2020	December 31, 2019
Note payable to the Bank	\$ 1,954,360,782	\$ 1,872,168,788
Accrued interest on note payable	2,848,599	4,358,348
Total	<u>\$ 1,957,209,381</u>	<u>\$ 1,876,527,136</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 \$1,954,360,782 as of September 30, 2020, is recorded as a liability on the Association’s balance sheet. The note carried a weighted average interest rate of 1.73 percent at September 30, 2020. 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, 2019, is due to the Association’s increase in investment volume. The Association’s own funds, which represent the amount of the Association’s loan portfolio funded by the Association’s equity, were \$224,099,212 at September 30, 2020. The maximum amount the Association may borrow from the bank as of September 30, 2020, was \$2,177,933,908 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 \$304,034,250 and \$275,570,321 at September 30, 2020 and December 31, 2019, respectively, a \$28,463,929 increase, which approximates current earnings. The Association’s debt as a percentage of members’ equity was 6.53:1 as of September 30, 2020, compared to 6.96:1 as of December 31, 2019. 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, 2020, 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 10, *Note Payable to FCBT*, in the Association’s consolidated financial statements in the 2019 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 2019 Annual Report, within the *Farm Credit Bank of Texas Capital Stock* 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 10, *Note Payable to FCBT*, in the Association’s consolidated financial statements in the 2019 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 14, *Related Party Transactions*, in the Association’s consolidated financial statements in the 2019 Annual Report, FCBT provides many services to the Association, which include administrative, marketing, accounting services and information systems.

Management's Discussion & Analysis

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) 483-9204. 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

	September 30, 2020	December 31, 2019
	Unaudited	Audited
<u>Assets</u>		
Cash	\$ 9,164	\$ 8,995
Investments	77,485,850	82,342,471
Loans	2,117,906,485	2,013,703,362
Less: allowance for loan losses	7,114,955	6,074,288
Net loans	2,110,791,530	2,007,629,074
Accrued interest receivable	23,511,542	25,109,254
Investment in and receivable from the Farm Credit Bank of Texas:		
Capital stock	36,992,210	37,072,250
Other	15,040,130	15,355,572
Premises and equipment	24,209,986	23,845,668
Other assets	1,459,186	1,165,473
Total assets	\$ 2,289,499,598	\$ 2,192,528,757
<u>Liabilities</u>		
Note payable to the Farm Credit Bank of Texas	\$ 1,954,360,782	\$ 1,872,168,788
Advance conditional payments	12,628,026	8,757,369
Accrued interest payable	2,848,599	4,358,348
Accrued postretirement benefit liability	7,643,480	7,530,780
Patronage distributions payable	318	15,065,059
Other liabilities	7,984,143	9,078,092
Total liabilities	1,985,465,348	1,916,958,436
<u>Members' Equity</u>		
Capital stock and participation certificates	4,231,545	4,160,515
Preferred stock	20,000,000	20,000,000
Allocated retained earnings	21,422,838	21,422,837
Unallocated retained earnings	183,460,239	155,179,391
Additional paid-in capital	75,310,003	75,310,003
Accumulated other comprehensive income	(390,375)	(502,425)
Total members' equity	304,034,250	275,570,321
Total liabilities and members' equity	\$ 2,289,499,598	\$ 2,192,528,757

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



Unaudited Consolidated Statements of Comprehensive Income

	For the three months ended		For the nine months ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
<u>Interest income</u>				
Loans	\$ 21,111,580	\$ 25,515,269	\$ 65,509,549	\$ 74,460,194
Investments	200,305	533,562	775,833	1,267,028
Total interest income	<u>21,311,885</u>	<u>26,048,831</u>	<u>66,285,382</u>	<u>75,727,222</u>
<u>Interest expense</u>				
Note payable to the Farm Credit Bank of Texas	8,857,690	13,866,372	30,617,923	40,492,005
Advance conditional payments	1,422	13,249	18,225	45,628
Total interest expense	<u>8,859,112</u>	<u>13,879,621</u>	<u>30,636,148</u>	<u>40,537,633</u>
Net interest income	12,452,773	12,169,210	35,649,234	35,189,589
Provision for loan losses	810,044	873,385	1,232,301	2,298,264
Net interest income after provision for losses	<u>11,642,729</u>	<u>11,295,825</u>	<u>34,416,933</u>	<u>32,891,325</u>
<u>Noninterest income</u>				
Farm Credit Bank of Texas patronage income	4,477,472	3,707,801	12,442,678	10,738,751
Loan fees	253,404	102,641	678,341	474,067
Fees for financially related services	1,904,458	1,518,318	2,520,862	2,761,429
Other	442,286	204,621	1,766,352	1,066,447
Total noninterest income	<u>7,077,620</u>	<u>5,533,381</u>	<u>17,408,233</u>	<u>15,040,694</u>
<u>Noninterest expenses</u>				
Salaries and employee benefits	4,848,900	4,950,188	15,296,728	15,541,908
Directors' expense	98,888	104,959	253,388	313,542
Purchased services	270,491	272,048	1,223,400	1,045,487
Travel	250,943	433,091	754,163	1,040,702
Occupancy and equipment	359,109	401,906	1,230,872	1,195,692
Communication	79,985	73,594	261,019	255,448
Advertising	172,506	179,665	430,479	457,707
Public and member relations	164,137	209,672	553,649	630,148
Federally regulated examination fees	149,316	141,831	409,451	408,103
FCSIC insurance premiums	410,992	312,460	974,317	927,866
Other components of net periodic postretirement benefit cost	55,283	65,290	165,848	195,870
Other noninterest expense	295,129	433,047	991,004	1,128,734
Total noninterest expenses	<u>7,155,679</u>	<u>7,577,751</u>	<u>22,544,318</u>	<u>23,141,207</u>
Net income	<u>11,564,670</u>	<u>9,251,455</u>	<u>29,280,848</u>	<u>24,790,812</u>
Other comprehensive income (loss):				
Change in postretirement benefit plans	(8,658)	(11,967)	(25,974)	(35,901)
Change in fair value of available for sale investments	190,493	(115,926)	138,024	162,538
Total other comprehensive income (loss)	<u>181,835</u>	<u>(127,893)</u>	<u>112,050</u>	<u>126,637</u>
Comprehensive income	<u>\$ 11,746,505</u>	<u>\$ 9,123,562</u>	<u>\$ 29,392,898</u>	<u>\$ 24,917,449</u>

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



Unaudited Consolidated Statements of Changes in Members' Equity

	Capital Stock/ Participation Certificates	Preferred Stock	Retained Earnings		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
			Allocated	Unallocated			
Balance at December 31, 2018	\$ 4,090,470	\$20,000,000	\$ 20,738,085	\$ 139,586,873	\$ 75,310,003	\$ 105,270	\$ 259,830,701
Comprehensive income	-	-	-	24,790,812	-	126,637	24,917,449
Capital stock/participation certificates issued	568,215	-	-	-	-	-	568,215
Capital stock/participation certificates retired	(490,685)	-	-	-	-	-	(490,685)
Preferred stock dividends: Paid	-	-	-	(1,000,000)	-	-	(1,000,000)
Patronage dividends: Paid or accrued	-	-	(371)	-	-	-	(371)
Balance at September 30, 2019	<u>\$ 4,168,000</u>	<u>\$20,000,000</u>	<u>\$ 20,737,714</u>	<u>\$ 163,377,685</u>	<u>\$ 75,310,003</u>	<u>\$ 231,907</u>	<u>\$ 283,825,309</u>
Balance at December 31, 2019	\$ 4,160,515	\$20,000,000	\$ 21,422,837	\$ 155,179,391	\$ 75,310,003	\$ (502,425)	\$ 275,570,321
Comprehensive income	-	-	-	29,280,848	-	112,050	29,392,898
Capital stock/participation certificates issued	665,760	-	-	-	-	-	665,760
Capital stock/participation certificates retired	(594,730)	-	-	-	-	-	(594,730)
Preferred stock dividends: Paid	-	-	-	(1,000,000)	-	-	(1,000,000)
Patronage dividends: Paid or accrued	-	-	1	-	-	-	1
Balance at September 30, 2020	<u>\$ 4,231,545</u>	<u>\$20,000,000</u>	<u>\$ 21,422,838</u>	<u>\$ 183,460,239</u>	<u>\$ 75,310,003</u>	<u>\$ (390,375)</u>	<u>\$ 304,034,250</u>

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

Notes to Unaudited Consolidated Financial Statements

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, 2019, as contained in the 2019 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, 2019 as contained in the 2019 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, 2020. Descriptions of the significant accounting policies are included in the 2019 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 2020, the Financial Accounting Standards Board (“FASB”) issued guidance entitled “Facilitation of the Effects of Reference Rate Reform on Financial Reporting.” The guidance provides optional expedients and exceptions for applying GAAP to contracts, hedging relationships and other transactions affected by reference rate reform. The guidance simplifies the accounting evaluation of contract modifications that replace a reference rate affected by reference rate reform and contemporaneous modifications of other contracts related to the replacement of the reference rate. With respect to hedge accounting, the guidance allows amendment of formal designation and documentation of hedging relationships in certain circumstances as a result of reference rate reform and provides additional expedients for different types of hedges, if certain criteria are met. The optional amendments are effective as of March 12, 2020, through December 31, 2022. The Association is evaluating the impact of adoption on its financial condition and its results of operations.

In December 2019, FASB issued guidance entitled “Simplifying the Accounting for Income Taxes.” This guidance eliminates certain intra period tax allocations, foreign deferred tax recognition and interim period tax calculations. In addition, the guidance simplifies disclosure regarding capital and franchise taxes, the allocation of goodwill in business combinations, subsidiary financial statements and other disclosures. The new guidance is intended to eliminate and/or simplify certain aspects of income tax accounting that are complex or that require significant judgment in application or presentation. The guidance becomes effective for fiscal years beginning after December 15, 2021. Early adoption of the guidance is permitted and the institution adopted this guidance on January 1, 2020. The adoption of this guidance did not materially impact the Association’s financial condition or results of operations.

Notes to Unaudited Consolidated Financial Statements

In August 2018, FASB issued guidance entitled “Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Cost.” The guidance aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by this guidance. This guidance became effective for interim and annual periods beginning after December 15, 2019. The guidance also requires an entity (customer) to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. It further specifies where to present expense and payments in the financial statements. The guidance is to be applied on a retrospective or prospective basis to all implementation costs incurred after the date of adoption. The adoption of this guidance did not materially impact the Association’s financial condition or its results of operations.

In August 2018, the FASB issued guidance entitled “Disclosure Framework — Changes to the Disclosure Requirements for Defined Benefit Plans.” The guidance modifies the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. This guidance becomes effective for fiscal years ending after December 15, 2020. Early adoption is permitted. The guidance is to be applied on a retrospective basis for all periods. The adoption of this guidance will not impact the Association’s financial condition or its results of operations, but will impact the employee benefit plan disclosures.

In August 2018, the FASB issued guidance entitled “Disclosure Framework — Changes to the Disclosure Requirements for Fair Value Measurement.” The guidance modifies the requirements on fair value measurements by removing, modifying or adding to the disclosures. This guidance became effective for interim and annual periods beginning after December 15, 2019. Early adoption was permitted and an entity was permitted to early adopt any removal or modified disclosures and delay adoption of the additional disclosures until their effective date. The Association early adopted the removal and modified disclosures during the fourth quarter of 2018. The adoption of this guidance did not impact the Association’s financial condition or its results of operations but did impact the fair value measurements disclosures.

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 methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses. For public business entities that are not U.S. Securities and Exchange Commission filers this guidance was to become effective for interim and annual periods beginning after December 15, 2020, with early application permitted. In November 2019, the FASB issued an update that amends the mandatory effective date for this guidance for certain institutions. The change resulted from a change in the effective date philosophy that extends and simplifies the adoption by staggering the dates between large public entities and other entities. As a result of the change, the new credit loss standard, for those institutions qualifying for the delay, becomes effective for interim and annual reporting periods beginning after December 15, 2022, with early adoption permitted. The Association qualifies for the delay in the adoption date. The Association continues to evaluate the impact of adoption on the Association’s financial condition and its results of operations.

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

Note 2: Investment Securities

Held to Maturity (“HTM”)

Federal Agricultural Mortgage Corporation (“Farmer Mac”) guaranteed *agricultural mortgage-backed securities (“AMBS”)* comprise the Association’s 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, 2020	1,320,339	\$ 53,751	\$ -	\$ 1,374,090	5.79%
December 31, 2019	1,575,855	29,154	-	1,605,009	5.88%

Notes to Unaudited Consolidated Financial Statements

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 3.4 years as of September 30, 2020, 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 consists 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	Gross	Gross	Fair Value	Weighted
	Cost	Unrealized Gains	Unrealized Losses		Average Yield
September 30, 2020	\$75,905,929	259,582	\$ -	76,165,511	3.19%
December 31, 2019	80,645,058	121,558	-	80,766,616	5.00%

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, 2020:

	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	\$ -	\$ -	\$ 25,251,588	\$ 50,913,923	\$ 76,165,511
Amortized cost	-	-	25,274,076	50,631,853	75,905,929
Weighted average yield	0.00%	0.00%	3.90%	2.83%	3.19%

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:

Notes to Unaudited Consolidated Financial Statements

Loan Type	September 30, 2020		December 31, 2019	
	Amount	%	Amount	%
Real estate mortgage	\$ 1,129,699,557	53.4%	\$ 1,084,069,296	53.7%
Production and intermediate term	688,295,293	32.5%	659,679,343	32.8%
Agribusiness:				
Loans to cooperatives	8,922,763	0.4%	3,538,860	0.2%
Processing and marketing	152,662,722	7.2%	132,037,952	6.6%
Farm-related business	28,547,908	1.3%	22,600,552	1.1%
Communication	18,941,692	0.9%	19,222,731	1.0%
Energy	7,683,558	0.4%	7,271,541	0.4%
Water and waste water	4,662,998	0.2%	-	0.0%
Rural residential real estate	7,908,339	0.4%	8,362,492	0.4%
Lease receivables	3,340,917	0.2%	913,850	0.0%
Mission-related investments	67,240,738	3.2%	76,006,745	3.8%
Total	\$ 2,117,906,485	100.1%	\$ 2,013,703,362	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, 2020 and December 31, 2019, follow:

	September 30, 2020	December 31, 2019
Real estate mortgage	\$ 4,794,523	\$ 6,559,731
Mission-related investments	1,352,228	1,238,501
Total premium	\$ 6,146,751	\$ 7,798,232

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, 2020 follow:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
	Real estate mortgage	\$ 81,873,781	\$ 310,346,772	\$ 215,248,739	\$ 2,477,891	\$ 297,122,520
Production and intermediate term	54,174,983	452,083,515	-	-	54,174,983	452,083,515
Agribusiness	128,635,970	39,458,785	-	-	128,635,970	39,458,785
Communication	18,941,692	-	-	-	18,941,692	-
Energy	7,683,558	-	-	-	7,683,558	-
Water and waste water	4,662,998	-	-	-	4,662,998	-
Lease receivables	3,340,917	-	-	-	3,340,917	-
Total	\$ 299,313,899	\$ 801,889,072	\$ 215,248,739	\$ 2,477,891	\$ 514,562,638	\$ 804,366,963

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 \$34,832,385 and \$26,801,404 at September 30, 2020 and December 31, 2019, respectively.

Notes to Unaudited Consolidated Financial Statements

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, 2020	December 31, 2019
Nonaccrual loans:		
Real estate mortgage	\$ 4,814,045	\$ 3,587,809
Production and intermediate term	2,504,842	2,955,200
Agribusiness	19,974	35,624
Rural residential real estate	169,020	-
Mission-related investments	1,009,194	1,144,194
Total nonaccrual loans	8,517,075	7,722,827
Accruing restructured loans:		
Real estate mortgage	15,879,642	17,016,301
Production and intermediate term	810,858	908,620
Total accruing restructured loans	16,690,500	17,924,921
Accruing loans 90 days or more past due:		
Real estate mortgage	964,944	-
Mission-related investments	211,100	-
Total accruing loans 90 days or more past due	1,176,044	-
Total non-performing loans	26,383,619	25,647,748
Other property owned	-	-
Total non-performing assets	\$ 26,383,619	\$ 25,647,748

Notes to Unaudited Consolidated Financial Statements

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

September 30, 2020						
	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	\$ 6,902,075	\$ 2,084,836	\$ 8,986,911	\$ 1,135,049,328	\$ 1,144,036,239	\$ 964,944
Production and intermediate-term	883,777	584,379	1,468,156	694,123,200	695,591,356	-
Loans to cooperatives	-	-	-	8,930,864	8,930,864	-
Processing and marketing	441	-	441	153,157,808	153,158,249	-
Farm-related business	-	19,974	19,974	28,686,383	28,706,357	-
Communication	-	-	-	18,943,792	18,943,792	-
Energy	-	-	-	7,688,504	7,688,504	-
Water and waste water	-	-	-	4,663,277	4,663,277	-
Rural residential real estate	-	-	-	7,951,990	7,951,990	-
Lease receivables	-	-	-	3,347,252	3,347,252	-
Mission-related investments	1,293,636	1,220,294	2,513,930	65,466,629	67,980,559	211,100
Total	\$ 9,079,929	\$ 3,909,483	\$ 12,989,412	\$ 2,128,009,027	\$ 2,140,998,439	\$ 1,176,044

December 31, 2019						
	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or less than 30 Days Past Due	Total Loans	Recorded Investment >90 days and Accruing
Real estate mortgage	\$ 2,308,279	\$ 1,141,591	\$ 3,449,870	\$ 1,094,886,611	\$ 1,098,336,481	\$ -
Production and intermediate-term	2,186,443	1,122,026	3,308,469	665,192,865	668,501,334	-
Loans to cooperatives	-	-	-	3,540,043	3,540,043	-
Processing and marketing	-	-	-	132,738,468	132,738,468	-
Farm-related business	-	35,624	35,624	22,630,461	22,666,085	-
Communication	-	-	-	19,224,171	19,224,171	-
Energy	-	-	-	7,295,894	7,295,894	-
Rural residential real estate	-	-	-	8,389,729	8,389,729	-
Lease receivables	-	-	-	917,007	917,007	-
Mission-related investments	1,044,151	1,055,186	2,099,337	74,439,121	76,538,458	-
Total	\$ 5,538,873	\$ 3,354,427	\$ 8,893,300	\$ 2,029,254,370	\$ 2,038,147,670	\$ -

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.

Notes to Unaudited Consolidated Financial Statements

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, 2020	December 31, 2019
Real estate mortgage		
Acceptable	95.6%	95.9%
OAEM	2.1%	2.2%
Substandard/doubtful	2.3%	1.9%
	<u>100.0%</u>	<u>100.0%</u>
Production and intermediate term		
Acceptable	94.3%	91.9%
OAEM	2.4%	3.8%
Substandard/doubtful	3.3%	4.3%
	<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	87.0%	86.4%
OAEM	9.5%	13.6%
Substandard/doubtful	3.5%	0.0%
	<u>100.0%</u>	<u>100.0%</u>
Farm-related business		
Acceptable	99.9%	99.8%
OAEM	0.0%	0.0%
Substandard/doubtful	0.1%	0.2%
	<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%	0.0%
OAEM	0.0%	0.0%
Substandard/doubtful	0.0%	0.0%
	<u>100.0%</u>	<u>0.0%</u>
Rural residential real estate		
Acceptable	97.9%	97.8%
OAEM	0.0%	2.2%
Substandard/doubtful	2.1%	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	98.5%	98.5%
OAEM	0.0%	0.0%
Substandard/doubtful	1.5%	1.5%
	<u>100.0%</u>	<u>100.0%</u>
Total Loans		
Acceptable	94.8%	94.1%
OAEM	2.6%	3.4%
Substandard/doubtful	2.6%	2.5%
	<u>100.0%</u>	<u>100.0%</u>

Notes to Unaudited Consolidated Financial Statements

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, 2020			December 31, 2019		
	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	\$ 2,197,714	\$ 2,588,605	\$ 371,000	\$ 1,081,478	\$ 1,329,769	\$ 172,000
Production and intermediate term	286,560	286,560	285,000	1,102,911	1,126,521	636,800
Farm-related business	-	-	-	-	-	-
Rural residential real estate	-	-	-	-	-	-
Mission-related investments	-	-	-	-	-	-
Total	\$ 2,484,274	\$ 2,875,165	\$ 656,000	\$ 2,184,389	\$ 2,456,290	\$ 808,800
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	\$ 19,460,917	\$ 20,673,650	\$ -	\$ 19,522,632	\$ 20,700,734	\$ -
Production and intermediate term	3,029,140	8,623,388	-	2,760,909	8,675,203	-
Farm-related business	19,974	19,974	-	35,624	35,624	-
Rural residential real estate	169,020	169,020	-	-	-	-
Mission-related investments	1,220,294	1,210,519	-	1,144,194	1,144,194	-
Total	\$ 23,899,345	\$ 30,696,551	\$ -	\$ 23,463,359	\$ 30,555,755	\$ -
Total impaired loans:						
Real estate mortgage	\$ 21,658,631	\$ 23,262,255	\$ 371,000	\$ 20,604,110	\$ 22,030,503	\$ 172,000
Production and intermediate term	3,315,700	8,909,948	285,000	3,863,820	9,801,724	636,800
Farm-related business	19,974	19,974	-	35,624	35,624	-
Rural residential real estate	169,020	169,020	-	-	-	-
Mission-related investments	1,220,294	1,210,519	-	1,144,194	1,144,194	-
Total	\$ 26,383,619	\$ 33,571,716	\$ 656,000	\$ 25,647,748	\$ 33,012,045	\$ 808,800

Notes to Unaudited Consolidated Financial Statements

	For the nine months ended September 30, 2020		For the nine months ended September 30, 2019		For the Year Ended December 31, 2019	
	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	\$ 1,103,486	\$ -	\$ 1,327,859	\$ -	\$ 1,265,758	\$ -
Production and intermediate term	300,571	-	1,082,689	31,419	749,737	5,194
Farm-related business	-	-	-	-	-	-
Rural residential real estate	-	-	-	-	-	-
Mission-related investments	-	-	-	-	-	-
Total	<u>\$ 1,404,057</u>	<u>\$ -</u>	<u>\$ 2,410,548</u>	<u>\$ 31,419</u>	<u>\$ 2,015,495</u>	<u>\$ 5,194</u>
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	\$19,628,593	\$ 712,657	\$13,712,724	\$ 268,441	\$18,693,048	\$ 914,073
Production and intermediate term	3,394,667	55,928	2,696,734	17,818	2,771,003	115,768
Farm-related business	29,221	-	111,467	-	94,994	-
Rural residential real estate	136,386	-	-	-	-	-
Mission-related investments	1,281,194	6,998	1,180,927	5,431	1,177,951	5,430
Total	<u>\$24,470,061</u>	<u>\$ 775,583</u>	<u>\$17,701,852</u>	<u>\$ 291,690</u>	<u>\$22,736,996</u>	<u>\$ 1,035,271</u>
Total impaired loans:						
Real estate mortgage	\$20,732,079	\$ 712,657	\$15,040,583	\$ 268,441	\$19,958,806	\$ 914,073
Production and intermediate term	3,695,238	55,928	3,779,423	49,237	3,520,740	120,962
Farm-related business	29,221	-	111,467	-	94,994	-
Rural residential real estate	136,386	-	-	-	-	-
Mission-related investments	1,281,194	6,998	1,180,927	5,431	1,177,951	5,430
Total	<u>\$25,874,118</u>	<u>\$ 775,583</u>	<u>\$20,112,400</u>	<u>\$ 323,109</u>	<u>\$24,752,491</u>	<u>\$ 1,040,465</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 30, 2019.

For the nine months ended September 30, 2019	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	<u>\$ 9,178,664</u>	<u>\$ 9,230,919</u>

The following table provides additional information on troubled debt restructurings that occurred in the nine months ended September 30, 2020.

Notes to Unaudited Consolidated Financial Statements

For the nine months ended September 30, 2020	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Troubled debt restructurings:		
Production and intermediate term	\$ 955,501	\$ 1,003,918

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, 2020, the total recorded investment of troubled debt restructured loans was \$18,589,853, of which \$1,899,353 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, 2020 and \$0 at December 31, 2019.

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, 2020	December 31, 2019	September 30, 2020	December 31, 2019
Real estate mortgage	\$ 15,879,642	\$ 17,016,301	\$ -	\$ -
Production and intermediate term	1,770,051	908,620	959,193	-
Farm-related business	19,974	35,624	19,974	35,624
Mission-related investments	920,186	1,055,186	920,186	1,055,186
Total	\$ 18,589,853	\$ 19,015,731	\$ 1,899,353	\$ 1,090,810

*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.

Notes to Unaudited Consolidated Financial Statements

Allowance for Loan Losses (“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	Lease Receivable	Mission- Related Investments	Total
Allowance for Loan Losses:									
Balance at									
December 31, 2019	\$ 1,525,554	\$ 3,748,407	\$ 730,161	\$ 38,983	\$ 18,383	\$ 7,676	\$ 4,170	\$ 954	\$ 6,074,288
Charge-offs	(142,725)	(635,001)	-	-	-	-	-	-	(777,726)
Recoveries	-	978,517	-	-	-	-	-	-	978,517
Provision for loan losses	646,890	100,664	452,466	1,749	18,744	2,557	8,906	325	1,232,301
Other	334	(329,512)	(66,018)	77	2,808	(114)	-	-	(392,425)
Balance at									
September 30, 2020	\$ 2,030,053	\$ 3,863,075	\$ 1,116,609	\$ 40,809	\$ 39,935	\$ 10,119	\$ 13,076	\$ 1,279	\$ 7,114,955
Ending Balance:									
Individually evaluated for impairment	\$ 371,000	\$ 285,000	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 656,000
Collectively evaluated for impairment	\$ 1,659,053	\$ 3,578,075	\$ 1,116,609	\$ 40,809	\$ 39,935	\$ 10,119	\$ 13,076	\$ 1,279	\$ 6,458,955
Acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Recorded Investment in Loans Outstanding:									
Ending Balance at									
September 30, 2020	\$1,144,036,239	\$ 695,591,356	\$190,795,470	\$ 18,943,792	\$12,351,781	\$ 7,951,990	\$3,347,252	\$ 67,980,559	\$ 2,140,998,439
Individually evaluated for impairment	\$ 21,658,631	\$ 3,315,700	\$ 19,974	\$ -	\$ -	\$ 169,020	\$ -	\$ 1,220,294	\$ 26,383,619
Collectively evaluated for impairment	\$1,122,377,608	\$ 692,275,656	\$190,775,496	\$ 18,943,792	\$12,351,781	\$ 7,782,970	\$3,347,252	\$ 66,760,265	\$ 2,114,614,820
Acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Allowance for Loan Losses:									
Balance at									
December 31, 2018	\$ 1,787,292	\$ 2,341,392	\$ 350,374	\$ 37,020	\$ 23,802	\$ 5,693	\$ 1,982	\$ 12,653	\$ 4,560,208
Charge-offs	(1,033,419)	(33,932)	-	-	-	-	-	-	(1,067,351)
Recoveries	13,549	305,441	-	-	-	-	-	-	318,990
Provision for loan losses	676,134	1,440,597	186,363	3,012	3,762	(110)	201	(11,695)	2,298,264
Other	(3,148)	(234,776)	(22,543)	(175)	2,018	457	-	-	(258,167)
Balance at									
September 30, 2019	\$ 1,440,408	\$ 3,818,722	\$ 514,194	\$ 39,857	\$ 29,582	\$ 6,040	\$ 2,183	\$ 958	\$ 5,851,944
Ending Balance:									
Individually evaluated for impairment	\$ 165,400	\$ 1,052,320	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,217,720
Collectively evaluated for impairment	\$ 1,275,008	\$ 2,766,402	\$ 514,194	\$ 39,857	\$ 29,582	\$ 6,040	\$ 2,183	\$ 958	\$ 4,634,224
Acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Recorded Investment in Loans Outstanding:									
Ending Balance at									
September 30, 2019	\$1,090,384,860	\$ 683,585,084	\$142,396,612	\$ 19,469,549	\$ 6,723,356	\$ 6,792,087	\$ 498,882	\$ 78,013,966	\$ 2,027,864,396
Individually evaluated for impairment	\$ 13,041,381	\$ 4,108,800	\$ 67,624	\$ -	\$ -	\$ -	\$ -	\$ 1,174,989	\$ 18,392,794
Collectively evaluated for impairment	\$1,077,343,479	\$ 679,476,284	\$142,328,988	\$ 19,469,549	\$ 6,723,356	\$ 6,792,087	\$ 498,882	\$ 76,838,977	\$ 2,009,471,602
Acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

Notes to Unaudited Consolidated Financial Statements

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 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 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.

	Capital			As of September 30, 2020	As of December 31, 2019
	Regulatory Minimums	Conservation Buffer	Total		
Risk-adjusted:					
Common equity tier 1 ratio	4.50%	2.50%	7.00%	11.64%	12.16%
Tier 1 capital ratio	6.00%	2.50%	8.50%	11.64%	12.16%
Total capital ratio	8.00%	2.50%	10.50%	13.03%	13.62%
Permanent capital ratio	7.00%	0.00%	7.00%	12.67%	13.29%
Non-risk-adjusted:					
Tier 1 leverage ratio	4.00%	1.00%	5.00%	10.60%	10.41%
UREE leverage ratio	1.50%	0.00%	1.50%	10.63%	10.36%

Following are the amounts included in the calculation of the capital ratios as of September 30, 2020:

	Regulatory Capital		Risk weighted assets/ Adjusted average total assets	
	9/30/2020	12/31/2019	9/30/2020	12/31/2019
Risk-adjusted capital ratios				
Common equity tier 1 ratio	\$ 233,725,156	\$ 223,393,367	\$ 2,008,656,711	\$ 1,837,865,372
Tier 1 capital ratio	233,725,156	223,393,367	2,008,656,711	1,837,865,372
Total capital ratio	261,712,368	250,359,946	2,008,656,711	1,837,865,372
Permanent capital ratio	253,725,156	243,393,367	2,002,405,373	1,832,011,014
Non-risk-adjusted capital ratios				
Tier 1 leverage ratio	233,725,156	223,393,367	2,205,216,805	2,145,227,470
UREE leverage ratio	234,303,911	222,296,229	2,205,216,805	2,145,227,470

Preferred stock issuance. 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% for ten years, payable semi-annually. After ten years, the dividend rate becomes a floating rate at 5.00% above 6-month LIBOR. On or after 5 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.

Notes to Unaudited Consolidated Financial Statements

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 2020, 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, AgTexas, 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 15 to the 2019 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, 2020	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Assets held in nonqualified benefit trusts	\$ 186,341	\$ -	\$ -	\$ 186,341
SBA pool securities	-	76,165,511	-	76,165,511
December 31, 2019	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Assets held in nonqualified benefit trusts	\$ 157,739	\$ -	\$ -	\$ 157,739
SBA pool securities	-	80,766,616	-	80,766,616

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

September 30, 2020	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Loans*	\$ -	\$ -	\$ 1,828,274	\$ 1,828,274
December 31, 2019	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Loans*	\$ -	\$ -	\$ 1,375,589	\$ 1,375,589

*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.

Notes to Unaudited Consolidated Financial Statements

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 2019 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 2019 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. The fair value of these loans would fall under Level 2 of the hierarchy if the process uses independent appraisals and other market-based information.

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:

	2020	2019
Service cost	\$ 89,021	\$ 81,720
Interest cost	191,822	231,771
Amortization of prior service credits	(35,901)	(35,901)
Amortization of net actuarial loss	9,927	-
Net periodic benefit cost	<u>\$ 254,869</u>	<u>\$ 277,590</u>

Notes to Unaudited Consolidated Financial Statements

The Association's liability for the unfunded accumulated obligation for these benefits at September 30, 2020, was \$7,643,480 and is included in "Accrued postretirement benefit liability" in 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 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 \$1,115,458 to the District's defined benefit pension plan in 2020. Pension plan funding expense was \$836,593 and \$1,343,702 for the nine months ended September 30, 2020 and 2019.

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, 2020 and 2019.

	<u>Total</u>	<u>Unrealized gain on SBA pool securities</u>	<u>Retirement benefit plans</u>
AOCI at			
December 31, 2019	\$ (502,425)	\$ 121,558	\$ (623,983)
SBA pool securities:			
Net change in unrealized gains	138,024	138,024	-
Retirement benefit plans:			
Amortization of prior service credits	<u>(25,974)</u>	<u>-</u>	<u>(25,974)</u>
AOCI at			
September 30, 2020	<u>\$ (390,375)</u>	<u>\$ 259,582</u>	<u>\$ (649,957)</u>

	<u>Total</u>	<u>Unrealized gain on SBA pool securities</u>	<u>Retirement benefit plans</u>
AOCI at			
December 31, 2018	\$ 105,270	\$ -	\$ 105,270
SBA pool securities:			
Net change in unrealized gains	162,538	162,538	-
Retirement benefit plans:			
Amortization of prior service credits and net actuarial loss	<u>(35,901)</u>	<u>-</u>	<u>(35,901)</u>
AOCI at			
September 30, 2019	<u>\$ 231,907</u>	<u>\$ 162,538</u>	<u>\$ 69,369</u>

Notes to Unaudited Consolidated Financial Statements

Note 10: Subsequent Events

Association management has evaluated subsequent events through November 5, 2020, which is the date the CFS were issued or available to be issued, with no significant events to report.