

ALABAMA AG CREDIT, ACA

**2023
Quarterly Report
Third Quarter**



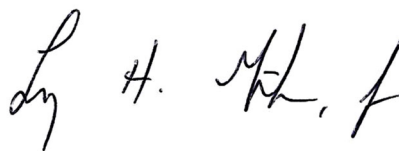
For the Quarter Ended September 30, 2023

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.



Douglas Thiessen, Chief Executive Officer
November 9, 2023



Larry H. Gibson, Jr., Chairman, Board of Directors
November 9, 2023



Heather Smith, Sr. VP/Chief Financial Officer
November 9, 2023



Richard M. Stabler, CPA, Retired, Chairman, Audit Committee
November 9, 2023

Third Quarter 2023 Financial Report

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ALABAMA AG CREDIT, ACA
MANAGEMENT’S DISCUSSION AND ANALYSIS

(dollars in thousands, except as noted)

The following commentary reviews the financial performance of the Alabama Ag Credit, AC, referred to as the Association, for the quarter ended September 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

Efforts by the Federal Reserve to combat high inflation by increasing interest rates (11 increases ranging from 25 to 75-basis points since March 2022) have impacted the Association as well as all farm credit and commercial lenders. Higher interest rates, along with other factors, caused the Farm Credit Bank of Texas (FCBT) to re-evaluate its Business Plan for 2023. The results indicate a significant decrease in patronage income that will be distributed to the associations. In the third quarter, the Association adjusted its accrual to reflect the lower patronage estimate’s impact on net income.

Loan Portfolio

The Association makes and services loans to farmers, ranchers, rural homeowners, and certain farm-related businesses. The Association’s loan volume consists of long-term farm mortgage loans, production and intermediate-term loans, and farm-related business loans. These loans are available to eligible borrowers with competitive prime- and index-based, fixed, and adjustable interest rates and loan maturities ranging up to 40 years. Loans serviced by the Association offer several installment payment cycles, the timing of which usually coincides with seasonal cash-flow capabilities of the borrower.

Total loans outstanding at September 30, 2023, including nonaccrual loans and sales contracts, were \$1,334,237,705 compared to \$1,292,527,515 at December 31, 2022, reflecting an increase of 3.2%. Nonaccrual loans as a percentage of total loans outstanding were 0.1% at September 30, 2023, compared to 0.1% at December 31, 2022.

The Association recorded \$8,006 in recoveries and \$0 in charge-offs for the quarter ended September 30, 2023, and \$8,709 in recoveries and \$0 in charge-offs for the same period in 2022. The Association’s allowance for loan losses was 0.7% and 0.7% of total loans outstanding as of September 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.

	September 30, 2023		December 31, 2022	
	Amount	%	Amount	%
Nonaccrual	\$ 1,007,669	74.3%	\$ 1,285,695	100.0%
90 days past due and still accruing interest	191,200	12.8%	-	0.0%
Total	\$ 1,198,869	100.0%	\$ 1,285,695	100.0%

Results of Operations

The Association had net income of \$4,886,482 and \$15,775,035 for the three and nine months ended September 30, 2023, as compared to net income of \$5,565,789 and \$16,122,297 for the same period in 2022, reflecting a decrease of 12.2% and 2.2%. Net interest income was \$8,923,987 and \$26,268,702 for the three and nine months ended September 30, 2023, compared to \$8,252,768 and \$24,108,731 for the same period in 2022.

	Nine Months Ended			
	September 30, 2023		September 30, 2022	
	Average Balance	Interest	Average Balance	Interest
Loans	\$ 1,310,672,270	\$ 52,668,525	\$ 1,262,139,927	\$ 42,002,277
Interest-bearing liabilities	1,103,661,292	26,399,823	1,062,790,713	17,893,546
Impact of capital	<u>\$ 207,010,978</u>		<u>\$ 199,349,214</u>	
Net interest income		<u>\$ 26,268,702</u>		<u>\$ 24,108,731</u>

	2023		2022	
	Average Yield		Average Yield	
	Yield on loans	5.4%		4.4%
Cost of interest-bearing liabilities	3.2%		2.3%	
Interest rate spread	2.2%		2.2%	
Net interest income as a percentage of average earning assets	2.7%		2.6%	

	Nine months ended: September 30, 2023 vs. September 30, 2022		
	Increase (decrease) due to		
	Volume	Rate	Total
Interest income - loans	\$ 1,614,788	\$ 9,051,460	\$ 10,666,248
Interest expense	687,849	7,818,428	8,506,277
Net interest income	<u>\$ 926,939</u>	<u>\$ 1,233,032</u>	<u>\$ 2,159,971</u>

Interest income for the three and nine months ended September 30, 2023, increased by \$3,477,438 and \$10,666,248, or 23.2% and 25.4% respectively, 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 three and nine months ended September 30, 2023, increased by \$2,806,219 and \$8,506,277, or 41.7% and 47.5%, 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 third quarter of 2023 was \$1,310,672,270, compared to \$1,262,139,927 in the third quarter of 2022. The average net interest rate spread on the loan portfolio for the third quarter of 2023 was 2.2%, compared to 2.2% in the third quarter of 2022.

Noninterest income for the three and nine months ended September 30, 2023, decreased by \$1,099,847 and \$964,888, or 69.5% and 80%, over the same period of 2022. The decreases are due primarily to decreases in patronage income from the Bank and a decrease in loan fees in 2023 compared to 2022. The decrease in loans fees is due to a decrease in new loan originations and other servicing actions due to the higher rate environment as compared to prior year.

Noninterest expenses for the three and nine months ended September 30, 2023, increased by \$114,819 and \$975,379, or 2.6% and 7.4%, as compared to the same periods in 2022. The increase is primarily due to increases in salaries and benefits, travel, and occupancy and equipment expenses, offset by lower advertising, public relations and insurance expense. The increase in salaries and benefits is due primarily to the cost-of-living increases over the same period in the prior year. Travel increased primarily due to increase costs and additional training related to the Farm View conversion. Occupancy and equipment increased primarily due to increased costs for office space and new Tuscaloosa location. The decrease in insurance expense was due to a decrease in rate charged on Insurance Fund premiums.

The Association's return on average assets for the nine months ended September 30, 2023, was 1.5% compared to 1.7% for the same period in 2022. The Association's return on average equity for the nine months ended September 30, 2023, was 8.8%, compared to 9.9% 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.

	September 30, 2023	December 31, 2022
Note payable to the Bank	\$ 1,124,489,691	\$ 1,081,493,220
Accrued interest on note payable	3,229,347	2,621,259
Total	\$ 1,127,719,038	\$ 1,084,114,479

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 \$1,124,489,691 as of September 30, 2023, is recorded as a liability on the Association's balance sheet. The note carried a weighted average interest rate of 3.5% at September 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 general financing agreement. The increase in note payable to the Bank and related accrued interest payable since December 31, 2022, is due to the Association's increase in loan portfolio growth. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were \$210,924,139 at September 30, 2023. The maximum amount the Association may borrow from the Bank as of September 30, 2023, was \$1,360,000,000 as defined by the general financing agreement. The indebtedness continues in effect until the expiration date of the general financing agreement, 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. A new GFA was executed effective October 1, 2023 effective through September 30, 2024.

Capital Resources

The Association's capital position increased by \$15,748,291 at September 30, 2023, compared to December 31, 2022. The Association's debt as a percentage of members' equity was 4.8:1 as of September 30, 2023, compared to 5.0:1 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 September 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 Association 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 annual and quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Alabama Ag Credit, ACA, 7480 Halcyon Pointe Drive, Suite 201, Montgomery, AL 36117 or calling (334)270-8687. The quarterly stockholder reports will be available on the Association's website at www.AlabamaAgCredit.com approximately 40 days after quarter end. Copies of the Association's quarterly stockholder reports can also be requested by e-mailing Info@AlabamaAgCredit.com. The Association's annual stockholder report is available on its website 75 days after the fiscal year end. Copies of the Association's annual stockholder report can also be requested 90 days after the fiscal year end.

Alabama Ag Credit, ACA

CONSOLIDATED BALANCE SHEETS

	September 30, 2023 (unaudited)	December 31, 2022
<u>ASSETS</u>		
Cash	\$ 13,640	\$ 10,074
Loans	1,334,237,705	1,292,527,515
Less: allowance for loan losses	8,703,698	8,412,353
Net loans	1,325,534,007	1,284,115,162
Accrued interest receivable	13,196,760	10,874,358
Investment in and receivable from the Farm		
Credit Bank of Texas:		
Capital stock	21,327,170	21,327,170
Other	3,972,591	2,730,550
Premises and equipment, net	6,802,659	6,551,637
Other assets	1,900,889	1,920,291
Total assets	\$ 1,372,747,716	\$ 1,327,529,242
<u>LIABILITIES</u>		
Note payable to the Farm Credit Bank of Texas	\$ 1,124,489,691	\$ 1,081,493,220
Accrued interest payable	3,229,347	2,621,259
Drafts outstanding	797,645	-
Patronage distributions payable	6,750	13,092,453
Other liabilities	7,434,222	9,280,540
Total liabilities	1,135,957,655	1,106,487,472
<u>MEMBERS' EQUITY</u>		
Capital stock and participation certificates	4,460,200	4,484,775
Unallocated retained earnings	231,921,131	216,118,555
Accumulated other comprehensive income	408,730	438,440
Total members' equity	236,790,061	221,041,770
Total liabilities and members' equity	\$ 1,372,747,716	\$ 1,327,529,242

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

Alabama Ag Credit, ACA

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
<u>INTEREST INCOME</u>				
Loans	\$ 18,459,626	\$ 14,982,188	\$ 52,668,525	\$ 42,002,277
<u>INTEREST EXPENSE</u>				
Note payable to the Farm Credit Bank of Texas	9,535,639	6,729,420	26,399,823	17,893,546
Net interest income	8,923,987	8,252,768	26,268,702	24,108,731
<u>PROVISION FOR LOAN LOSSES</u>				
	(12,398)	(137,975)	222,831	(313,290)
Net interest income after provision for loan losses	8,936,385	8,390,743	26,045,871	24,422,021
<u>NONINTEREST INCOME</u>				
Income from the Farm Credit Bank of Texas:				
Patronage income	440,782	1,489,044	3,494,655	4,305,496
Loan fees	11,488	41,128	207,076	260,034
Gain (loss) on sale of premises and equipment, net	29,784	51,109	124,036	152,850
Other noninterest income	284	905	40,792	113,067
Total noninterest income	482,338	1,582,186	3,866,559	4,831,447
<u>NONINTEREST EXPENSES</u>				
Salaries and employee benefits	2,815,058	2,480,734	8,473,318	7,491,515
Directors' expense	71,562	98,787	337,568	318,505
Purchased services	169,074	119,200	390,656	297,583
Travel	194,515	264,139	662,962	659,876
Occupancy and equipment	257,839	298,125	912,599	874,888
Communications	73,869	96,978	238,335	265,201
Advertising	99,921	75,500	348,840	258,864
Public and member relations	160,741	209,723	445,199	489,908
Supervisory and exam expense	118,607	106,722	332,052	315,792
Insurance fund premiums	466,916	502,741	1,639,308	1,730,789
Other components of net periodic postretirement benefit cost	15,005	26,092	45,016	78,276
Other noninterest expense	79,231	128,777	281,832	351,108
Total noninterest expenses	4,522,338	4,407,518	14,107,685	13,132,305
NET INCOME	4,896,385	5,565,411	15,804,745	16,121,163
Other comprehensive income:				
Change in postretirement benefit plans	(9,903)	378	(29,710)	1,134
COMPREHENSIVE INCOME	\$ 4,886,482	\$ 5,565,789	\$ 15,775,035	\$ 16,122,297

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

Alabama Ag 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	\$ 4,437,945	\$ 206,271,466	\$ (430,075)	\$ 210,279,336
Net income	-	16,121,163	-	16,121,163
Other comprehensive income	-	-	1,134	1,134
Capital stock/participation certificates issued	556,540	-	-	556,540
Capital stock/participation certificates retired	(487,885)	-	-	(487,885)
Patronage refunds:				
Change in patronage declared and paid	-	(20,574)	-	(20,574)
Balance at September 30, 2022	<u>\$ 4,506,600</u>	<u>\$ 222,372,055</u>	<u>\$ (428,941)</u>	<u>\$ 226,449,714</u>
Balance at December 31, 2022	\$ 4,484,775	\$ 216,118,555	\$ 438,440	\$ 221,041,770
Net income	-	15,804,745	-	15,804,745
Other comprehensive income	-	-	(29,710)	(29,710)
Capital stock/participation certificates issued	408,290	-	-	408,290
Capital stock/participation certificates retired	(432,865)	-	-	(432,865)
Change in accounting standard, CECL	-	(2,169)	-	(2,169)
Balance at September 30, 2023	<u>\$ 4,460,200</u>	<u>\$ 231,921,131</u>	<u>\$ 408,730</u>	<u>\$ 236,790,061</u>

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

ASSOCIATION NEW MODEL
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Unaudited (dollar amounts in thousands, except per share amounts and as otherwise noted)

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

Alabama Ag 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 Autauga, Baldwin, Barbour, Bibb, Bullock, Butler, Chambers, Chilton, Choctaw, Clarke, Coffee, Conecuh, Coosa, Covington, Crenshaw, Dale, Dallas, Elmore, Escambia, Geneva, Greene, Hale, Henry, Houston, Lee, Lowndes, Macon, Marengo, Mobile, Monroe, Montgomery, Perry, Pickens, Pike, Russell, Sumter, Tallapoosa, Tuscaloosa, Washington, and Wilcox in the state of Alabama. 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 accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles (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 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, 2022, as contained in the 2022 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, 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.

Recently Adopted Accounting Pronouncements

The Association adopted 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:

(in millions)	December 31,	CECL	January 1, 2023
	2022	adoption	
		impact	
Assets:			
Allowance for credit losses on loans	\$ 8,412,353	\$ 61,137	\$ 8,473,490
Liabilities:			
Allowance for credit losses on unfunded commitments	\$ 102,415	\$ (58,968)	\$ 43,447
Retained earnings:			
Unallocated retained earnings, net of tax	\$ 221,041,770	\$ (2,169)	\$ 221,039,601

A.. 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 loan 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 having 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 Condensed Statement of Condition. 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 – Effective January 1, 2023, the allowance for credit losses (ACL) 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 credit losses on 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;
- Nature of the loan portfolio, including the terms of the loans;
- Experience, ability and depth of the lending management and other relevant staff;
- Volume and severity of past due and adversely classified or graded loans and the volume of nonaccrual loans;
- Quality of the loan review and process;
- Value of underlying collateral for collateral-dependent loans;
- Existence and effect of any concentrations of credit and changes in the level of such concentrations; and
- 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 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 one-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 loan 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 loan 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 loan 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 Combined Statement of Condition. 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 Association 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 LOAN LOSSES:

A summary of loans follows:

Loan Type	September 30,	December 31,
	2023	2022
	Amount	Amount
Production agriculture:		
Real estate mortgage	\$ 989,661,830	\$ 1,013,944,825
Production and intermediate-term	162,835,925	126,122,570
Agribusiness:		
Loans to cooperatives	11,396,271	9,583,687
Processing and marketing	53,166,820	50,185,010
Farm-related business	29,187,347	22,718,221
Communication	4,173,201	-
Energy	5,787,732	1,008,908
Water and waste-water	10,468,268	8,012,493
Rural residential real estate	59,403,630	58,435,280
Agricultural export finance	8,156,681	2,516,520
Total	\$ 1,334,237,705	\$ 1,292,527,514

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 at September 30, 2023:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations	Participations	Participations	Participations	Participations	Participations
	Purchased	Sold	Purchased	Sold	Purchased	Sold
Real estate mortgage	\$ 11,229,822	\$ 26,269,094	\$ -	\$ -	\$ 11,229,822	\$ 26,269,094
Production and intermediate-term	34,014,558	6,357,984	-	-	34,014,558	6,357,984
Agribusiness	63,159,487	38,540,013	-	4,728,956	63,159,487	43,268,969
Communication	4,173,201	-	-	-	4,173,201	-
Energy	5,787,732	-	-	-	5,787,732	-
Water and waste-water	10,468,268	-	-	-	10,468,268	-
Agricultural export finance	8,156,681	-	-	-	8,156,681	-
Total	\$136,989,749	\$ 71,167,091	\$ -	\$ 4,728,956	\$136,989,749	\$ 75,896,047

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 \$10,729,198 and \$20,107,767 at September 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 our 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, institutions 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% of the original appraised value of the property taken as security or up to 97% 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 track 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 shows loans under the Farm Credit Administration Uniform Loan Classification System as a percentage of total loans by loan type:

	<u>September 30,</u> <u>2023</u>	<u>December 31,</u> <u>2022</u>
Real estate mortgage		
Acceptable	98.5 %	98.4 %
OAEM	1.0	1.0
Substandard/doubtful	0.6	0.6
	<u>100.1</u>	<u>100.0</u>
Production and intermediate-term		
Acceptable	99.1	98.8
OAEM	0.1	1.1
Substandard/doubtful	0.8	0.1
	<u>100.0</u>	<u>100.0</u>
Agribusiness		
Acceptable	91.1	100.0
OAEM	8.9	-
Substandard/doubtful	-	-
	<u>100.0</u>	<u>100.0</u>
Energy and water/waste-water		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	<u>100.0</u>	<u>100.0</u>
Communication		
Acceptable	100.0	-
OAEM	-	-
Substandard/doubtful	-	-
	<u>100.0</u>	<u>-</u>
Rural residential real estate		
Acceptable	99.8	99.7
OAEM	0.1	0.1
Substandard/doubtful	0.1	0.3
	<u>100.0</u>	<u>100.0</u>
Agricultural export finance		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	<u>100.0</u>	<u>100.0</u>
Total loans		
Acceptable	98.1	98.6
OAEM	1.4	0.9
Substandard/doubtful	0.5	0.5
	<u>100.0 %</u>	<u>100.0 %</u>

Accrued interest receivable on loans of \$13,196,760 and \$10,874,358 at September 30, 2023 and December 31, 2022 have been excluded from the amortized cost of loans and reported separately in the Balance Sheet. The Association did not write off accrued interest receivable during the three months and nine months ended September 30, 2023.

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

	September 30, December 31,	
	2023	2022
Nonaccrual loans:		
Real estate mortgage	\$ 1,007,669	\$ 1,249,576
Rural residential real estate	-	36,119
Total nonaccrual loans	<u>1,007,669</u>	<u>\$ 1,285,695</u>
Accruing loans 90 days or more past due:		
Production and intermediate-term	191,200	-
Total nonperforming assets	<u>\$ 1,198,869</u>	<u>\$ 1,285,695</u>
Nonaccrual loans as a percentage of total loans	0.08%	0.10%
Nonperforming assets as a percentage of total loans and other property owned	0.09%	0.10%
Nonperforming assets as a percentage of capital	0.51%	0.58%

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

	September 30, 2023			Interest Income Recognized	
	Amortized Cost with Allowance	Amortized Cost without Allowance	Total	For the Three Months Ended September 30, 2023	For the Nine Months Ended September 30, 2023
Nonaccrual loans:					
Real estate mortgage	\$ 661,548	\$ 346,121	\$ 1,007,669	\$ (269)	\$ 34,866
Total nonaccrual loans	<u>\$ 661,548</u>	<u>\$ 346,121</u>	<u>\$ 1,007,669</u>	<u>\$ (269)</u>	<u>\$ 34,866</u>

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

	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
September 30, 2023						
Real estate mortgage	\$ 3,834,083	\$ 202,890	\$ 4,036,973	\$ 995,145,294	\$ 999,182,267	\$ -
Production and intermediate term	225,011	191,200	416,211	165,246,244	165,662,455	191,200
Loans to cooperatives	-	-	-	11,459,578	11,459,578	-
Processing and marketing	-	-	-	53,402,442	53,402,442	-
Farm-related business	-	-	-	29,441,438	29,441,438	-
Communication	-	-	-	4,230,300	4,230,300	-
Energy	-	-	-	5,795,839	5,795,839	-
Water and waste-water	-	-	-	10,477,107	10,477,107	-
Rural residential real estate	77,511	-	77,511	59,529,515	59,607,026	-
Agricultural export finance	-	-	-	8,176,012	8,176,012	-
Total	<u>\$ 4,136,605</u>	<u>\$ 394,090</u>	<u>\$ 4,530,695</u>	<u>\$ 1,342,903,769</u>	<u>\$ 1,347,434,464</u>	<u>\$ 191,200</u>

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

	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
December 31, 2022						
Real estate mortgage	\$ 2,806,127	\$ 276,680	\$ 3,082,807	\$1,019,318,707	\$1,022,401,514	\$ -
Production and intermediate term	50,777	-	50,777	127,795,525	127,846,302	-
Loans to cooperatives	-	-	-	9,605,579	9,605,579	-
Processing and marketing	-	-	-	50,428,252	50,428,252	-
Farm-related business	-	-	-	22,908,124	22,908,124	-
Energy	-	-	-	1,014,137	1,014,137	-
Water and waste-water	-	-	-	8,014,810	8,014,810	-
Rural residential real estate	86,713	36,119	122,832	58,503,862	58,626,694	-
Agricultural export finance	-	-	-	2,556,461	2,556,461	-
Total	<u>\$ 2,943,617</u>	<u>\$ 312,799</u>	<u>\$ 3,256,416</u>	<u>\$1,300,145,457</u>	<u>\$1,303,401,873</u>	<u>\$ -</u>

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% of the Association's lending and leasing limit base but the Association's boards of directors have generally established more restrictive lending limits.

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	Agri-business	Communi- cations	Energy and Water/Waste Disposal	Rural Residential Real Estate	Other	Total
Allowance for Credit Losses on Loans:								
Balance at June 30, 2023	\$ 7,412,887	\$ 854,812	\$ 172,644	\$ 5,058	\$ 17,330	\$ 246,208	\$ 3,301	\$ 8,712,240
Charge-offs	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Recoveries	\$ 8,006	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 8,006
Provision for credit losses/(Loan loss reversal)	\$ (176,203)	\$ 162,742	\$ (3,879)	\$ 103	\$ (1,001)	\$ 1,693	\$ (3)	\$ (16,548)
Balance at September 30, 2023	\$ 7,244,690	\$ 1,017,554	\$ 168,765	\$ 5,161	\$ 16,329	\$ 247,901	\$ 3,298	\$ 8,703,698
Balance at December 31, 2022	\$ 7,744,134	\$ 443,269	\$ 130,793	\$ -	\$ 7,173	\$ 84,321	\$ 2,663	\$ 8,412,353
Cumulative effect of a change in accounting principle	\$ (570,293)	\$ 337,592	\$ 108,787	\$ -	\$ 5,909	\$ 174,622	\$ 4,520	\$ 61,137
Balance at January 1, 2023	\$ 7,173,841	\$ 780,861	\$ 239,580	\$ -	\$ 13,082	\$ 258,943	\$ 7,183	\$ 8,473,490
Charge-offs	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Recoveries	\$ 22,683	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 22,683
Provision for loan losses (loan loss reversal)	\$ 48,166	\$ 236,693	\$ (70,815)	\$ 5,161	\$ 3,247	\$ (11,042)	\$ (3,885)	\$ 207,525
Balance at September 30, 2023	\$ 7,244,690	\$ 1,017,554	\$ 168,765	\$ 5,161	\$ 16,329	\$ 247,901	\$ 3,298	\$ 8,703,698
Balance at June 30, 2022	\$ 7,845,123	\$ 573,776	\$ 144,640	\$ -	\$ 7,322	\$ 79,896	\$ 1,544	\$ 8,652,301
Charge-offs	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Recoveries	\$ 8,709	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 8,709
Provision for loan losses (loan loss reversal)	\$ (153,126)	\$ 11,062	\$ (872)	\$ -	\$ (517)	\$ 5,107	\$ 372	\$ (137,974)
Other	\$ (858)	\$ (13,646)	\$ (7,549)	\$ -	\$ 336	\$ 159	\$ (650)	\$ (22,208)
Balance at September 30, 2022	\$ 7,699,848	\$ 571,192	\$ 136,219	\$ -	\$ 7,141	\$ 85,162	\$ 1,266	\$ 8,500,828
Balance at December 31, 2021	\$ 8,000,301	\$ 617,395	\$ 104,326	\$ -	\$ 7,692	\$ 73,156	\$ 1,256	\$ 8,804,126
Charge-offs	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Recoveries	\$ 25,902	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 25,902
Provision for loan losses (loan loss reversal)	\$ (318,763)	\$ (37,618)	\$ 32,744	\$ -	\$ (1,334)	\$ 11,483	\$ 198	\$ (313,290)
Other	\$ (7,592)	\$ (8,585)	\$ (851)	\$ -	\$ 783	\$ 523	\$ (188)	\$ (15,910)
Balance at September 30, 2022	\$ 7,699,848	\$ 571,192	\$ 136,219	\$ -	\$ 7,141	\$ 85,162	\$ 1,266	\$ 8,500,828
Allowance for Unfunded Commitments:								
Balance at June 30, 2023	\$ 4,986	\$ 27,934	\$ 15,031	\$ -	\$ 3,186	\$ 774	\$ 2,691	\$ 54,602
Provision for unfunded commitments	\$ 1,915	\$ 2,141	\$ (805)	\$ -	\$ (42)	\$ (33)	\$ 975	\$ 4,151
Balance at September 30, 2023	\$ 6,901	\$ 30,075	\$ 14,226	\$ -	\$ 3,144	\$ 741	\$ 3,666	\$ 58,753
Balance at December 31, 2022	\$ 8,643	\$ 67,822	\$ 23,380	\$ -	\$ -	\$ 117	\$ 2,452	\$ 102,414
Cumulative effect of a change in accounting principle	\$ (2,330)	\$ (50,674)	\$ (6,493)	\$ -	\$ -	\$ 8	\$ 522	\$ (58,967)
Balance at January 1, 2023	\$ 6,313	\$ 17,148	\$ 16,887	\$ -	\$ -	\$ 125	\$ 2,974	\$ 43,447
Provision for unfunded commitments	\$ (5,725)	\$ (4,221)	\$ (19,548)	\$ -	\$ 3,144	\$ 491	\$ (2,282)	\$ (28,141)
Balance at September 30, 2023	\$ 6,901	\$ 30,075	\$ 14,226	\$ -	\$ 3,144	\$ 741	\$ 3,666	\$ 58,753

¹ For periods prior to January 1, 2023, the allowance for loan 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.

The following table presents additional information regarding troubled debt restructurings that occurred during the period:

	For the Nine Months Ended September 30, 2022	
	Pre-modification Outstanding Recorded Investment*	Post-modification Outstanding Recorded Investment*
Troubled debt restructurings:		
Real estate mortgage	1,559,017	1,563,937
Total	1,559,017	1,563,937

*Pre-modification represents the recorded investment just prior to restructuring and post-modification represents the recorded investment immediately following the restructuring. The recorded investment is the face amount of the receivable 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 the investment.

The Association had no troubled debt restructurings that occurred within the previous 12 months and for which there was a payment default during the period ended September 30, 2022.

The following table presents information regarding troubled debt restructurings that occurred within the previous 12 months and for which there was a payment default during the period:

The following table provides information on outstanding loans restructured in troubled debt restructurings:

	September 30, 2022	
	Loans Modified as Troubled Debt Restructurings	Troubled Debt Restructurings in Nonaccrual Status*
Real estate mortgage	\$ 5,996,807	\$ 1,636,746
Production and intermediate-term	1,176,606	96,000
Total	\$ 7,173,413	\$ 1,732,746

*Represents the portion of loans modified as troubled debt restructurings that were in nonaccrual status.

NOTE 3 — 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.

Regulatory Capitalization Requirements

Risk-adjusted:	Regulatory Minimums with Buffer	As of September 30, 2023
Common equity tier 1 ratio	7.00%	15.35%
Tier 1 capital ratio	8.50%	15.35%
Total capital ratio	10.50%	15.99%
Permanent capital ratio	7.00%	15.45%
Non-risk-adjusted:		
Tier 1 leverage ratio	5.00%	15.73%
UREE leverage ratio	1.50%	15.39%

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

	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
Numerator:				
Unallocated retained earnings	\$ 226,965,186	\$ 226,965,186	\$ 226,965,186	\$ 226,965,186
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	4,457,936	4,457,936	4,457,936	4,457,936
Allowance for loan losses and reserve for credit losses subject to certain limitations	-	-	8,768,185	-
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	(21,327,170)	(21,327,170)	(21,327,170)	(21,327,170)
	<u>\$ 210,095,952</u>	<u>\$ 210,095,952</u>	<u>\$ 218,864,137</u>	<u>\$ 210,095,952</u>
Denominator:				
Risk-adjusted assets excluding allowance	\$ 1,389,842,488	\$ 1,389,842,488	\$ 1,389,842,488	\$ 1,389,842,488
Regulatory Adjustments and Deductions:				
Regulatory deductions included in total capital	(21,327,170)	(21,327,170)	(21,327,170)	(21,327,170)
Allowance for loan losses	-	-	-	(8,713,763)
	<u>\$ 1,368,515,318</u>	<u>\$ 1,368,515,318</u>	<u>\$ 1,368,515,318</u>	<u>\$ 1,359,801,555</u>

	Tier 1 leverage ratio	UREE leverage ratio
Numerator:		
Unallocated retained earnings	\$ 226,965,186	\$ 226,965,186
Common Cooperative Equities:		
Statutory minimum purchased borrower stock	4,457,936	-
Regulatory Adjustments and Deductions:		
Amount of allocated investments in other System institutions	(21,327,170)	(21,327,170)
	<u>\$ 210,095,952</u>	<u>\$ 205,638,016</u>
Denominator:		
Total Assets	1,360,173,841	1,360,173,841
Regulatory Adjustments and Deductions:		
Regulatory deductions included in tier 1 capital	(24,405,614)	(24,405,614)
	<u>\$ 1,335,768,227</u>	<u>\$ 1,335,768,227</u>

The following table presents the components of capital:

	September 30, 2023	December 31, 2022
Capital stock and participation certificates	\$ 4,460,200	\$ 4,484,775
Accumulated other comprehensive loss	408,730	438,440
Retained earnings ¹	231,921,131	216,118,555
Total Capital	<u>\$ 236,790,061</u>	<u>\$ 221,041,770</u>

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

An additional component of equity is accumulated other comprehensive income. The Association's accumulated other comprehensive loss relates entirely to its non-pension other postretirement benefits. Amortization of prior service (credits) cost and of actuarial (gain) loss are reflected in "Salaries and employee benefits" in the Consolidated Statements of Comprehensive Income. The following table presents the activity in the accumulated other comprehensive loss, net of tax by component:

	<u>2023</u>	<u>2022</u>
Balance at June 30	\$ 418,634	\$ (429,319)
Net current period other comprehensive income	(9,904)	378
Balance at September 30	\$ 408,730	\$ (428,941)
Balance at January 1	\$ 438,440	\$ (430,075)
Net current period other comprehensive income	(29,710)	1,134
Balance at September 30	\$ 408,730	\$ (428,941)

The Association's accumulated other comprehensive income (loss) relates entirely to its non-pension other postretirement benefits. Amortization of prior service (credits) cost and of actuarial (gain) loss are reflected in "Salaries and employee benefits" in the Consolidated Statements of Comprehensive Income. The following table summarizes the change in accumulated other comprehensive income (loss) for the nine months ended September 30:

	<u>2023</u>	<u>2022</u>
Accumulated other comprehensive income (loss) at January 1	\$ 438,440	\$(430,075)
Amortization of actuarial (gain) loss included in salaries and employee benefits	(29,710)	1,134
Accumulated other comprehensive income (loss) at September 30	\$ 408,730	\$ (428,941)

NOTE 4 — INCOME TAXES:

Alabama Ag 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. Alabama Ag Credit, ACA, operates as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, Alabama Ag 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 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.

NOTE 5 — 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:

<u>September 30, 2023</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Assets held in non-qualified benefits trusts	<u>\$ 199,236</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 199,236</u>
Total assets	<u>\$ 199,236</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 199,236</u>
December 31, 2022	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Assets held in non-qualified benefits trusts	<u>\$ 165,430</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 165,430</u>
Total assets	<u>\$ 165,430</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 165,430</u>

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

<u>September 30, 2023</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>	<u>Total Gains (Losses)</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>		
Assets:					
Loans*	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 506,767</u>	<u>\$ 506,767</u>	<u>\$ -</u>
December 31, 2022	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>	<u>Total Gains (Losses)</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>		
Assets:					
Loans*	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 6,720,193</u>	<u>\$ 6,720,193</u>	<u>\$ -</u>

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

Information About Recurring and Nonrecurring Level 3 Fair Value Measurements

With regard to nonrecurring measurements for impaired loans and other property owned, it is not practicable to provide specific information on inputs, as each collateral property is unique. The Associations 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.

Uncertainty of Fair Value Measurements

For recurring fair value measurements categorized within Level 3 of the fair value hierarchy, the significant unobservable inputs used in the fair value measurement of the mortgage-backed securities are prepayment rates, probability of default and loss severity in the event of default. Significant increases (decreases) in any of those inputs in isolation would have resulted in a significantly lower (higher) fair value measurement.

Generally, a change in the assumption used for the probability of default would have been accompanied by a directionally similar change in the assumption used for the loss severity and a directionally opposite change in the assumption used for prepayment rates.

Quoted market prices are generally not available for the instruments presented below. Accordingly, fair values are based on internal models that consider judgments regarding anticipated cash flows, future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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.

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 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. As of September 30, 2023, the Association has no other property owned in the consolidated balance sheet.

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.

Commitments to Extend Credit

The fair value of commitments is estimated using the fees currently charged for similar agreements, taking into account the remaining terms of the agreements and the creditworthiness of the counterparties. For fixed-rate loan commitments, estimated fair value also considers the difference between current levels of interest rates and the committed rates.

NOTE 6 — EMPLOYEE BENEFIT PLANS:

Employee Retirement Plans: As discussed in Note 2 and Note 11 to the 2022 Annual Report to Stockholders, employees of the Association participate in either the Texas Farm Credit District's (District) defined benefit pension plan (DB Plan) or the District's defined contribution plan (DC Plan).

The structure of the DB Plan is characterized as multi-employer 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 annual contribution is paid in January of each year and amortized into expense on a monthly basis; unamortized contributions are included in "Other Assets" in the consolidated balance sheet. The following table represents DB contributions made, amounts amortized into expense, and the remaining unamortized contributions amounts as of September 30:

	<u>2023</u>	<u>2022</u>
DB Contribution	\$ 348,799	\$ 629,364
YTD Amortization	261,599	472,023
Unamortized Contributions	\$ 87,200	\$ 157,341

Association contributions to the DC Plan are expensed as incurred. For the nine months ended September 30, 2023 and 2022, the Association recognized pension costs for the DC Plan of \$365,362 and \$312,695, respectively.

Employees are also eligible to participate in the Farm Credit Benefits Alliance 401(k) Plan. Contributions to the 401(k) plan are expensed as incurred. The Association's contributions to the 401(k) plan were \$281,135 and \$183,405 for the nine months ended September 30, 2023 and 2022, respectively.

Other Postretirement Benefits: In addition to pension benefits, the Association provides certain health care benefits to qualifying retired employees (other postretirement benefits). These benefits are not characterized as multi-employer, and consequently, the liability for these benefits is included in the consolidated balance sheet. The following table summarizes the components of net periodic benefit costs of non-pension other postretirement employee benefits for the three months and nine months ended September 30:

Three months ended September 30:

	<u>Other Benefits</u>	
	<u>2023</u>	<u>2022</u>
Service cost	\$ 10,502	\$ 17,451
Interest cost	32,412	25,714
Amortization of prior service (credits) costs	(5,056)	(5,056)
Amortization of net actuarial (gain) loss	(4,848)	5,434
Net periodic benefit cost	\$ 33,010	\$ 43,543

Nine months ended September 30:

	<u>Other Benefits</u>	
	<u>2023</u>	<u>2022</u>
Service cost	\$ 31,506	\$ 52,353
Interest cost	97,236	77,142
Amortization of prior service (credits) costs	(15,168)	(15,168)
Amortization of net actuarial (gain) loss	(14,544)	16,302
Net periodic benefit cost	\$ 99,030	\$ 130,629

The Association's liability for the unfunded accumulated obligation for these benefits at September 30, 2023, and December 31, 2022, was \$2,608,435 and \$2,533,599, respectively, and is included in other liabilities on the balance sheet.

NOTE 7 — 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 8 — SUBSEQUENT EVENTS:

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