# Strength *and* Agility

Second Quarter Report 2023

FARM CREDIT BANK OF TEXAS

# *Second Quarter 2023 Financial Report*

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# Management's Discussion and Analysis of Financial Condition and Results of Operations

*(dollars in thousands, except as noted)*

The following discussion reviews the financial condition and results of operations of the Farm Credit Bank of Texas (the Bank) for the three and six months ended June 30, 2023. These comments should be read in conjunction with the accompanying financial statements and footnotes, along with the 2022 Annual Report to shareholders. The accompanying financial statements were prepared under the oversight of the Bank's Audit Committee.

The Bank 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 United States (U.S.) is currently served by three Farm Credit Banks (FCBs) and one Agricultural Credit Bank (ACB). Each of the FCBs has specific authority to fund affiliated associations and other financing institutions (OFIs) which make loans to agricultural producers, farm-related businesses and rural homeowners within a regional chartered territory (or district). The ACB has the same lending authority as the FCBs within its chartered territory and has additional authority to finance agricultural cooperatives and rural utilities nationwide. The FCBs and the ACB are collectively referred to as "System banks." The primary purpose of the System banks is to serve as a source of funding for System associations within their respective districts. The System associations make loans to or for the benefit of borrowers for qualified purposes. At June 30, 2023, the Bank provided financing to 14 associations within its chartered territory (District Associations) and certain OFIs.

The accompanying financial statements relate solely to the Bank and exclude financial information of the District Associations. The Bank and the District Associations are collectively referred to as the Texas District. The Bank separately publishes certain unaudited combined financial information of the Texas District, including a condensed statement of condition and statement of income, which can be found on the Bank's website at *www.farmcreditbank.com*.

## CONDITIONS IN THE TEXAS DISTRICT

The Bank continues to fulfill its mission to support agriculture and rural communities by providing access to reliable and consistent credit in the midst of above normal financial and macroeconomic volatility driven by atypical factors such as a continuously inverted yield curve and persistently high inflation. Federal Reserve officials continue to battle inflation by continuing to tighten monetary policy. Despite these turbulent times, credit quality at the Bank has remained strong. Volatility in credit risk ratings is likely to remain a concern in the near future due to cost inflation, the relatively high cost of debt and an underlying recession risk.

The Consumer Price Index for All Urban Consumers increased by 3.0% for the 12-month period ending June 2023, above the long-term target of approximately 2.0%. However, recent inflation rates represent significant declines from the four-decade high of 9.1% reached in June 2022. The Federal Open Market Committee (FOMC) raised the Federal funds rate to a target range of 5.25 – 5.50% in July 2023. The 25 basis point increase in July lead to a cumulative increase of about 525 basis points since mid-March 2022. The FOMC reiterated its commitment to returning inflation to its 2.0% objective, which may require further tightening in future periods.

On June 29, the U.S. Bureau of Economic Analysis (BEA) released its third estimate of real gross domestic product (GDP) for the first quarter of 2023. U.S. real GDP growth decelerated but continued to expand during the first quarter of 2023 by about 2.0%, down from 2.6% during the fourth quarter of 2022, but up from -1.6% during the same period a year ago. The International Monetary Fund's World

Economic Outlook projects that U.S. real GDP growth will be 1.6% in 2023 and 1.1% in 2024. Additionally, BEA released first quarter 2023 annualized real GDP growth rates for the states within the Texas District on June 30, 2023. Growth rates among Texas District states similarly decelerated during the first quarter of 2023 and ranged from a low of 0.1% in Alabama to a high of 3.0% in Texas. Economic activity in the agriculture, forestry, fishing, and hunting sector increased in 33 states and was the leading contributor to growth in 13 states, including North Dakota, Nebraska, South Dakota, Kansas and Montana, the five states with the largest increases in real GDP.

The U.S. Bureau of Labor Statistics indicated that the U.S. unemployment rate increased month-over-month from 3.4% in April to 3.7% in May 2023. The May 2023 state unemployment rates in the Texas District ranged from a low of 2.2% in Alabama to a high of 4.1% in Texas. Three of the five Texas District states (i.e., Alabama, New Mexico and Mississippi) attained year-over-year declines in the unemployment rate in May 2023.

West Texas Intermediate (WTI) crude oil futures prices (front-month) decreased to an average of about $74 per barrel during the second quarter of 2023, down from $76 per barrel in the prior quarter and about $109 per barrel during the same period a year ago. In the June 2023 edition of the Short-Term Energy Outlook, the U.S. Energy Information Administration estimated that the monthly average WTI spot price would be about $75 per barrel in 2023 and nearly $79 per barrel in 2024. U.S. crude oil production is expected to reach record levels in 2023 and 2024, driven primarily by growth in the Permian Basin.

On June 30, 2023, the U.S. Department of Agriculture (USDA) released its 2023 Acreage report. Corn planted area was estimated at 94.1 million acres in 2023, up nearly 6.2% from last year, and revised up by about 2.0% from the prior report. Corn planted acreage is expected to be up or unchanged from the previous year in 43 of the 48 estimating states. Soybean planted area for 2023 was estimated at 83.5 million acres, down about 4.5% from last year. All wheat planted area is estimated at 49.6 million acres, up about 8.5% from 2022. All cotton planted area was estimated at 11.1 million acres, down about 19.4% from last year. Estimated planted acres of soybeans, wheat, and cotton were revised down in this update. These estimates are derived via a survey of farmers' intentions and are subject to change throughout the season.

The June 2023 edition of the USDA World Agricultural Supply and Demand Estimates (WASDE) report states that farmers are expected to receive lower average farm prices for corn (-27.3%), soybeans (-14.8%), wheat (-13.0%), and cotton (-6.1%) in the 2023/24 marketing year compared to the previous season. Similarly, the average price received by farmers for all milk is projected to decrease by about 21.0% year-over-year in 2023 and by 1.5% in 2024 after rising nearly 37.0% in 2022. USDA projects that average steer prices (5-Area, Direct) will increase year-over-year by about 18.9% in 2023, while broilers and barrows and gilts prices are projected to decline by about 7.4% and 20.4%, respectively. Random length lumber futures prices (front-month) declined by about 14.6% year-over-year as of June 2023; however, on a month-over-month basis, prices rose by nearly 12.8% in June.

During 2023, agricultural producers and processors may be negatively impacted by several factors, including volatile commodity prices, high input costs, export market disruptions, geopolitical challenges, and adverse weather conditions. The Bank's loan portfolio is well-supported by industry diversification and conservative advance rates. Additionally, a high percentage of the Bank's borrowers primarily rely on non-farm sources of income to repay their loans.

## ADOPTION OF NEW ACCOUNTING STANDARD

Effective January 1, 2023, the Bank adopted the current expected credit losses (CECL) accounting guidance that replaced the incurred loss guidance. CECL established a single allowance framework for all financial assets carried at amortized cost, certain off-balance sheet credit exposures, and changed the impairment recognition model for available-for-sale securities. The guidance requires management to consider in its estimate of allowance for credit losses (ACL) relevant historical events, current conditions and reasonable and supportable forecasts that affect the collectability of the assets. The adoption of this guidance resulted in a cumulative effect transition adjustment at January 1, 2023 reflecting an increase in the Bank's ACL of $8.4 million on outstanding loans and unfunded commitments and a corresponding decrease in retained earnings. The adoption did not warrant a cumulative effect transition adjustment for the Bank's available-for-sale securities.

## RESULTS OF OPERATIONS

*Net Income*

Net income for the three months ended June 30, 2023 was $44.0 million, a decrease of $19.2 million, or 30.42%, over the same period of 2022. The decrease in net income was driven by a $10.9 million decrease in net interest income and an $8.8 million increase in provision for credit losses.

Net income for the six months ended June 30, 2023 was $78.4 million, a decrease of $52.4 million, or 40.09%, over the same period of 2022. The decrease in net income was driven by a $32.1 million increase in provision for credit losses and a $21.5 million decrease in net interest income.

*Net Interest Income*

Net interest income for the three months ended June 30, 2023 was $85.4 million, a decrease of $10.9 million, or 11.37%, from the three months ended June 30, 2022. The decrease in net interest income reflects the impact of a 24 basis point decrease in the net interest rate spread from 1.07% to 0.83%, partially offset by the impact of a $2.14 billion increase in the Bank's average interest earning assets for the three months ended June 30, 2023 compared to the same period ended June 30, 2022. The decrease in the net interest rate spread reflects the impact of a 181 basis point increase in the average cost of debt, partially offset by a 157 basis point increase in yields on average interest earning assets. Net interest margin for the three months ended June 30, 2023 was 0.94% compared to 1.13% for the three months ended June 30, 2022.

Net interest income for the six months ended June 30, 2023 was $171.8 million, a decrease of $21.5 million, or 11.14%, from the six months ended June 30, 2022. The decrease in net interest income reflects the impact of a 25 basis point decrease in the net interest rate spread from 1.10% to 0.85%, partially offset by the impact of a $2.44 billion increase in the Bank's average interest earning assets for the six months ended June 30, 2023 compared to the same period ended June 30, 2022. The decrease in the net interest rate spread reflects the impact of a 180 basis point increase in the average cost of debt, partially offset by a 155 basis point increase in yields on average interest earning assets. Net interest margin for the six months ended June 30, 2023 was 0.96% compared to 1.15% for the six months ended June 30, 2022. The increase in interest earning assets was primarily driven by growth in the capital markets loan portfolio and an increase in direct note receivables.

*Provision for Credit Losses*

As previously discussed, on January 1, 2023, the Bank adopted the CECL accounting guidance for determining the allowance for credit losses. Prior to January 1, 2023, the allowance for credit losses was based on probable and estimable losses inherent in the loan portfolio.

During the three months ended June 30, 2023, the Bank recorded a provision for credit losses of $9.7 million compared to $905 thousand in the same period of 2022. The provision for credit losses for the three months ended June 30, 2023 primarily reflects an increase in specific reserves resulting from credit deterioration among select borrowers in the agribusiness and production and intermediate-term sectors. The provision for credit losses for the three months ended June 30, 2023 also reflects an increase in general reserves partially due to rating downgrades that occurred during the quarter as well as a change in one of the underlying assumptions used in the general reserve calculation for prepayment speed.

During the six months ended June 30, 2023, the Bank recorded a provision for credit losses of $32.1 million compared to $40 thousand in the same period of 2022. The provision for credit losses for the six months ended June 30, 2023 was primarily due to specific reserves and related charge-offs resulting from credit deterioration among select borrowers in the agribusiness, energy and production and intermediate-term sectors. Macroeconomic conditions, including inflationary pressure and high input costs, contributed to reduced liquidity and profitability for some of these borrowers. In spite of these conditions, overall loan credit quality remained stable at 99.5% acceptable and special mention at June 30, 2023 as compared to 99.7% at December 31, 2022.

*Noninterest Income*

Noninterest income for the three months ended June 30, 2023 was $8.5 million, consistent with the same period of 2022.

Noninterest income for the six months ended June 30, 2023 was $20.5 million, an increase of $2.8 million, or 15.92%, over the same period of 2022. The increase in noninterest income was driven by an increase of $1.7 million in other income, primarily related to a $2.0 million gain on extinguishment of debt and a $1.2 million gain on a swap unwind that occurred in the first quarter of 2023 as well as an increase of $1.3 million in fees for services to District Associations.

*Noninterest Expense*

Noninterest expense for the three months ended June 30, 2023 was $40.1 million, a slight decrease of $552 thousand, or 1.36%, over the same period of 2022. The decrease was associated with a $1.0 million decrease in salaries and employee benefits and a $905 thousand decrease in Farm Credit System Insurance Corporation (FCSIC) premiums, largely offset by higher occupancy and equipment of $1.7 million due to software licensing and depreciation expense.

Noninterest expense for the six months ended June 30, 2023 was $81.8 million, an increase of $1.6 million, or 2.03%, over the same period of 2022. The increase for the six months ended June 30, 2023 was primarily due to an increase of $3.7 million in occupancy and equipment due to software licensing and depreciation expense, partially offset by lower professional fees of $3.1 million.

*Key Results of Operations*

| | **Annualized for the Six Months Ended June 30,** | |
|---|---|---|
| | **2023** | **2022** |
| Return on average assets | **0.42%** | 0.76% |
| Return on average shareholders' equity | **9.32%** | 13.60% |
| Net interest margin | **0.96%** | 1.15% |
| Charge-offs, net of recoveries, to average loans | **0.08%** | —% |
| Operating expenses as a percentage of net interest income and noninterest income | **42.53%** | 37.98% |
| Operating expenses as a percentage of average earning assets | **0.45%** | 0.48% |

*Other Comprehensive Loss*

Other comprehensive loss consists of certain gains, losses or costs for which values are included in assets or liabilities on the balance sheets but have not yet been recognized in earnings. On the balance sheets, they are included in accumulated other comprehensive loss in the statement of shareholders' equity. These elements include unrealized gains or losses on the Bank's available-for-sale (AFS) investment portfolio, changes in elements of the postretirement benefit plans and changes in the value of cash flow derivative instruments.

The table below summarizes the changes in elements included in other comprehensive loss (income):

| | Six Months Ended June 30, | |
|---|---|---|
| | **2023** | **2022** |
| Change in unrealized losses on AFS securities | | |
| Net increase in unrealized losses on AFS securities | **$ (36,511)** | $ (359,508) |
| Net change in unrealized losses on AFS securities | **(36,511)** | (359,508) |
| Change in postretirement benefit plans | | |
| Amounts amortized into net periodic expense: | | |
| Amortization of prior service credits and actuarial gains | **(115)** | (40) |
| Net change in postretirement benefit plans | **(115)** | (40) |
| Change in cash flow derivative instruments | | |
| Net increase in unrealized gains on cash flow derivative instruments | **6,923** | 71,725 |
| Reclassification of (gains) losses recognized in interest expense | **(1,147)** | 124 |
| Net change in cash flow derivative instruments | **5,776** | 71,849 |
| Other comprehensive income (loss) | **$ (30,850)** | $ (287,699) |

During the six months ended June 30, 2023, the Bank recognized other comprehensive loss of $30.9 million compared to other comprehensive loss of $287.7 million in the prior year period. The improvement was driven by a decrease in unrealized losses on the Bank's AFS securities from the prior year quarter as a result of changes in interest rates, partially offset by lower gains on unrealized gains on cash flow derivative instruments since the prior year quarter resulting from changes in the valuation of interest rate swaps held by the Bank.

## FINANCIAL CONDITION

*Loan Portfolio*

Gross loan volume at June 30, 2023 was $29.05 billion, an increase of $780.9 million, or 2.76%, compared to $28.26 billion at December 31, 2022, reflecting increases in both the direct note receivables from District Associations and OFIs and the capital markets loan portfolio. The increase in direct note receivables totaled $569.0 million reflecting steady loan demand from farmers, ranchers and agribusinesses within the Texas District's chartered territory.

The capital markets loan portfolio reflected an increase of $211.9 million from year-end 2022. The increase in the capital markets loan portfolio primarily resulted from increases in the energy and production and intermediate-term loan sectors driven by increased utilization on existing lines of credit.

The Bank's capital markets loan portfolio, also referred to as the participations purchased loan portfolio, predominantly includes participations, syndications and purchased whole loans, along with other financing structures within our lending authorities. In addition to purchasing loans from the District Associations, which may exceed their hold limits, the Bank seeks the purchase of participations and syndications originated outside of the Texas District's territory by other System institutions, commercial banks and other lenders. The Bank's capital markets loan portfolio depends to a significant degree on relationships with other Farm Credit institutions. These loans may be held as interest earning assets of the Bank or sub-participated to the District Associations or to other System entities.

The Bank has purchased loan participations and Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed agricultural mortgage-backed securities (AMBS) from District Associations in Capitalized Participation Pool (CPP) transactions. CPP loans held at June 30, 2023, totaled $95.4 million and were included in loans on the balance sheet. There were no CPP purchases during the six months ended June 30, 2023. The balance of the AMBS CPP was $8.8 million at June 30, 2023, and was included in investment securities on the balance sheet.

Farmer Mac is a government-sponsored enterprise and is examined and regulated by the FCA. It provides a secondary market for agricultural and rural home mortgage loans that meet certain underwriting standards. Farmer Mac is authorized to provide loan guarantees and to be a direct pooler of agricultural mortgage loans. Farmer Mac is owned by both System and non-System investors, and its board of directors has both System and non-System representation. Farmer Mac is not liable for any debt or obligation of any System institution and no System institution other than Farmer Mac is liable for any debt or obligation of Farmer Mac.

The Bank may also purchase loans from District Associations in Non-Capitalized Participation Pool (NCPP) transactions. During the six months ended June 30, 2023, the Bank purchased $50.6 million in loan participations from a District Association in a NCPP transaction which resulted in net stock retirements of $1.0 million. The NCPP loans' balance was $209.9 million at June 30, 2023 and was included in loans on the balance sheet.

At June 30, 2023, 99.5% of the Bank's loans were classified as either acceptable or other assets especially mentioned under the Farm Credit Administration's Uniform Loan Classification System based on the amortized cost basis of the loans (principal balance adjusted for discounts, premiums, charge-offs, recoveries and deferred loan fees or costs). At December 31, 2022, 99.7% of the Bank's loans were classified as either acceptable or other assets especially mentioned based on the loan principal balance and the related accrued interest receivable.

The table below summarizes the amortized cost of the Bank's nonperforming assets, which consist of nonaccrual loans, accruing loans 90 days or more past due and other property owned, at June 30, 2023 and December 31, 2022:

| | | | Change | |
|---|---|---|---|---|
| | **June 30, 2023** | **December 31, 2022** | **$** | **%** |
| Nonaccrual loans | **$ 72,231** | $ 29,994 | $ 42,237 | 140.82 % |
| Accruing loans 90 days or more past due | **2,053** | — | 2,053 | — |
| Other property owned | **—** | — | — | — |
| Total nonperforming assets | **$ 74,284** | $ 29,994 | $ 44,290 | 147.66 % |

Nonaccrual loans at June 30, 2023 reflect the movement of loans during the first half of 2023 to nonaccrual resulting from credit deterioration among select borrowers in the agribusiness, production and intermediate-term and energy sectors. At June 30, 2023, and December 31, 2022, the Bank did not have any other property owned (OPO). At June 30, 2023 and December 31, 2022, total nonperforming assets represented 0.25% and 0.11% of loans, respectively.

At June 30, 2023, the Bank had reserves for credit losses totaling $47.2 million, with an allowance for credit losses of $42.5 million and a reserve for losses on unfunded commitments of $4.7 million. The reserves for credit losses relates to the Bank's capital markets loan portfolio. The allowance for loan losses of $42.5 million at June 30, 2023 equated to 15 basis points of total loans outstanding and 48 basis points of capital market loans outstanding. At December 31, 2022, the Bank had reserves for credit losses totaling $17.8 million, with an allowance for loan losses of $15.7 million and a reserve for losses on unfunded commitments of $2.1 million. At June 30, 2023, there was no reserve for credit losses associated with the direct note receivable portfolio.

The allowance for credit losses as a percentage of nonperforming loans was 63.48% at June 30, 2023, compared to 59.21% at December 31, 2022.

*Liquidity and Funding Sources*

The Bank's primary source of liquidity is the ability to issue Systemwide debt securities, which are the general unsecured joint and several obligations of the System banks. During the six months ended June 30, 2023, the System continued to have reliable access to the debt capital markets to support its mission of providing credit to farmers, ranchers and other eligible borrowers. The Federal Reserve raised rates by 425 basis points in 2022 and has raised rates by 100 basis points year-to-date through July 2023, which is continuing to drive higher Treasury yields, widening spreads and increasing volatility.

As a secondary source of liquidity, the Bank maintains an investment portfolio composed primarily of high-quality liquid securities. These securities provide a stable source of income for the Bank, and their high quality ensures the portfolio can quickly be converted to cash should the need arise.

Cash, Federal funds sold, overnight investments and investment securities totaled $7.38 billion, or 19.97%, of total assets at June 30, 2023, compared to $7.10 billion, or 19.72%, of total assets at December 31, 2022. At June 30, 2023, the Bank's cash balance was $194.6 million, of which $170.4 million was held at the Federal Reserve Bank.

Each System bank is required to maintain a minimum of 90 days of liquidity coverage on a continuous basis. The days of liquidity measurement refers to the number of days that maturing debt could be funded with eligible cash and investment securities. At June 30, 2023, the Bank exceeded all applicable regulatory liquidity requirements and had 193 days of liquidity.

### *Investments*

The Bank's investments are all classified as available-for-sale, and include a liquidity portfolio and a portfolio of other investments which consists of Farmer Mac AMBS securities. The Bank's liquidity portfolio and other investment holdings are summarized in the following table:

| | June 30, 2023 | | December 31, 2022 | |
|---|---|---|---|---|
| | **Amortized Cost** | **Fair Value** | **Amortized Cost** | **Fair Value** |
| *Liquidity Portfolio:* | | | | |
| Agency-guaranteed debt | **$ 39,088** | **$ 38,027** | $ 54,888 | $ 53,301 |
| Certificates of deposit | **200,000** | **199,758** | 200,000 | 199,009 |
| Corporate debt | **207,943** | **202,330** | 240,914 | 234,778 |
| Federal agency collateralized mortgage-backed securities: | | | | |
| GNMA | **3,286,582** | **2,848,549** | 3,070,832 | 2,683,020 |
| FNMA and FHLMC | **2,685,575** | **2,508,484** | 2,652,701 | 2,469,209 |
| U.S. Treasury securities | **891,859** | **874,358** | 841,444 | 818,844 |
| Asset-backed securities | **188,266** | **186,023** | 188,983 | 186,521 |
| Total liquidity investments | **$ 7,499,313** | **$ 6,857,529** | $ 7,249,762 | $ 6,644,682 |
| *Other Investments:* | | | | |
| Agricultural mortgage-backed securities | **$ 9,944** | **$ 8,811** | $ 11,595 | $ 10,270 |

FCA regulations also define eligible investments by specifying credit criteria and the percentage of investment portfolio limit for each investment type. If an investment no longer meets the eligibility criteria, the investment becomes ineligible for inclusion in the liquidity portfolio. At June 30, 2023, the Bank had no investments which were ineligible for liquidity purposes.

### *Capital Resources*

At June 30, 2023, the Bank's total shareholders' equity totaled $1.63 billion and consisted of $750.0 million of Class B noncumulative subordinated perpetual preferred stock, $469.2 million of capital stock, $981.2 million of retained earnings and $571.2 million of accumulated other comprehensive losses. Total shareholders' equity at June 30, 2023 reflects the impact of an $8.4 million reduction in retained earnings due to the cumulative effect adjustment for the adoption of CECL effective January 1, 2023. Additionally, shareholders' equity increased by $5.8 million due to net income of $78.4 million and a decrease in the accumulated other comprehensive loss of $30.9 million, partially offset by preferred stock dividends of $23.2 million, patronage distributions of $8.3 million, and an $1.8 million retirement of capital stock.

FCA regulations require the Bank to maintain minimum ratios, including capital conservation buffers, for various regulatory capital ratios. At June 30, 2023, the Bank exceeded all regulatory capital requirements including the capital conservation buffers.

The following table reflects the Bank's regulatory capital ratios as of:

| | June 30, 2023 | December 31, 2022 | Total Regulatory Requirements Including Capital Conservation Buffers |
|---|---|---|---|
| Common equity tier 1 ratio | **8.12 %** | 8.66 % | 7.00 % |
| Tier 1 capital ratio | **12.73** | 13.42 | 8.50 |
| Total capital ratio | **12.96** | 13.50 | 10.50 |
| Permanent capital ratio | **12.75** | 13.43 | 7.00 |
| Tier 1 leverage ratio | **5.61** | 5.94 | 5.00 |
| UREE leverage ratio | **2.11** | 2.50 | 1.50 |

## RATING AGENCY ACTION

On May 24, 2023, Fitch Ratings placed the U.S. sovereign's AAA long-term issuer default rating (IDR) on rating watch negative. On May 26, 2023, the System and the Farm Credit System Banks', including the Farm Credit Bank of Texas, long-term IDR, short-term IDR and government support ratings were placed on rating watch negative. On August 1, 2023, Fitch Ratings lowered the U.S. sovereign's long-term IDR to AA+ from AAA; the F1+ short-term rating was affirmed. The outlook on the long-term debt rating was revised to stable. Subsequently, on August 2, 2023, Fitch Ratings lowered the long-term IDR for the System to AA+ from AAA and affirmed the F1+ short-term rating. The outlook on the long-term debt rating was revised to stable. Fitch also lowered the individual long-term IDRs of the Farm Credit System Banks, including the Farm Credit Bank of Texas, to A+. The short-term IDRs were affirmed at F1+. The outlook on the long-term IDR for each System Bank was revised to stable from rating watch negative.

As a government-sponsored enterprise, the System and the Farm Credit System Banks' benefit from implicit government support and therefore, the ratings are directly linked to the U.S. sovereign rating.

## DERIVATIVE PRODUCTS

Derivative products are a part of the Bank's interest rate risk management process and are used to manage interest rate and liquidity risks and to lower the overall cost of funds. The Bank does not hold or enter into derivative transactions for trading purposes. The aggregate notional amount of the Bank's derivative products was $1.67 billion at June 30, 2023 and $1.54 billion at December 31, 2022. At June 30, 2023, cleared counterparties' net credit asset exposure to the Bank was $49.9 million, compared to $46.6 million at December 31, 2022. At June 30, 2023, the notional amount of cleared cash flow hedges was $1.55 billion with associated posted initial margin of $47.3 million. At June 30, 2023, the Bank had received cash collateral from the counterparty of $71.2 million. Cleared derivatives require the payment of initial and variation margin as protection against default. As of June 30, 2023, the Bank had a net cash collateral liability position of $23.9 million compared to $19.7 million at December 31, 2022. At June 30, 2023, the Bank had a derivative asset value of $70.4 million, compared to a derivative asset value of $64.7 million at December 31, 2022.

During the six months ended June 30, 2023, a bond matured that was hedged by a LIBOR swap and the Bank chose to unwind the swap and eliminate the LIBOR exposure ahead of the LIBOR cession date of June 30, 2023. The Bank recorded a $1.2 million gain as a result of this swap unwind.

## LIBOR TRANSITION

On March 5, 2021, the United Kingdom's Financial Conduct Authority (the UK FCA) announced that the ICE Benchmark Administration (IBA) (the entity regulated by the UK FCA that is responsible for calculating the London Inter-Bank Offered Rate (LIBOR)) had notified the UK FCA of its intent, among other things, to cease providing certain U.S. dollar LIBOR settings as of June 30, 2023. In the announcement, the UK FCA confirmed that all 35 LIBOR tenors (including with respect to U.S. dollar LIBOR) were discontinued or declared non-representative as of either: (a) immediately after December 31, 2021 or (b) immediately after June 30, 2023.

The Bank implemented a LIBOR transition plan in accordance with Farm Credit Administration's guidance and analyzed potential risks associated with the LIBOR transition, including, but not limited to, financial, market, accounting, operational, legal, tax, reputational and compliance risks through the cessation date of June 30, 2023.

The following is a summary of principal balances on variable-rate financial instruments with remaining LIBOR exposure at June 30, 2023. For these variable-rate products, the next rate reset date was after June 30, 2023. These instruments contain appropriate fallback provisions and will reset to a non-LIBOR based rate at the next rate reset date. Exposure to these instruments is limited to the Bank in this illustration:

| | Due after June 30, 2023 | Total |
|---|---|---|
| **Assets** | | |
| Loans | $ 691,509 | $ 691,509 |
| Investment securities | 527,855 | 527,855 |
| **Total assets** | 1,219,364 | 1,219,364 |
| | | |
| **Liabilities and shareholders' equity** | | |
| Bonds and notes, net | $ — | $ — |
| Preferred stock | 400,000 | 400,000 |
| **Total liabilities and shareholders' equity** | $ 400,000 | $ 400,000 |

Note: Included in this table are preferred stock issuances that currently have fixed dividend rates but convert to LIBOR-indexed variable rates in the future. Since LIBOR will no longer be available or, to the extent available, non-representative after June 30, 2023, the annual rate will be replaced by a CME term SOFR-based rate either by bi-lateral negotiation or by operation of law. The preferred stock is perpetual and may be redeemed in 2023 or thereafter. For additional information regarding preferred stock, see Note 11 in the 2022 Annual Report.

| | Due after June 30, 2023 | Total |
|---|---|---|
| Derivatives (notional amount) | $ 265,000 | $ 265,000 |

The following is a summary of variable-rate financial instruments indexed to SOFR:

| | June 30, 2023 |
|---|---|
| **Assets** | |
| Loans | $ 5,368,271 |
| Investment securities | 1,242,991 |
| **Total assets** | $ 6,611,262 |
| | |
| **Liabilities and shareholders' equity** | |
| Bonds and notes, net | $ 7,910,000 |
| **Total liabilities and shareholders' equity** | $ 7,910,000 |
| | |
| Derivatives (notional amount) | $ 1,400,000 |

## REGULATORY MATTERS

At June 30, 2023, there were no District Associations operating under written agreements with the Farm Credit Administration (FCA).

On January 13, 2023, the FCA issued an advance notice of proposed rulemaking on the regulatory capital framework for Farmer Mac. The comment period ended on April 26, 2023.

# Report of Management

The undersigned certify that we have reviewed the June 30, 2023, quarterly report of the Farm Credit Bank of Texas, that the report has been prepared in accordance with all applicable statutory or regulatory requirements, and that the information included herein is true, accurate and complete to the best of our knowledge and belief.

James F. Dodson
Chair of the Board

Amie Pala
Chief Executive Officer

Brandon Blaut
Executive Vice President, Chief Financial Officer

August 9, 2023

# Controls and Procedures

As of June 30, 2023, management of the Farm Credit Bank of Texas (the Bank) carried out an evaluation with the participation of the Bank's management, including the chief executive officer (CEO) and executive vice president, chief financial officer (CFO), of the effectiveness of the design and operation of the respective disclosure controls and procedures[(1)] with respect to this quarterly report. This evaluation is based on testing of the design and effectiveness of key internal controls, certifications and other information furnished by the CEO and CFO of the Bank, as well as incremental procedures performed by the Bank. Based upon and as of the date of the Bank's evaluation, the CEO and the CFO concluded that the disclosure controls and procedures are effective in alerting them on a timely basis of any material information relating to the Bank that is required to be disclosed by the Bank in the quarterly information statement it files or submits to the Farm Credit Administration.

There have been no significant changes in the Bank's internal control over financial reporting[(2)] that occurred during the quarter ended June 30, 2023, that have materially affected, or are reasonably likely to materially affect, the Bank's internal control over financial reporting.

| | |
|---|---|
| Amie Pala<br>Chief Executive Officer | Brandon Blaut<br>Executive Vice President, Chief Financial Officer |

August 9, 2023

[(1)] For purposes of this discussion, ''disclosure controls and procedures'' are defined as controls and procedures of the Bank that are designed to ensure that the financial information required to be disclosed by the Bank in this quarterly report is recorded, processed, summarized and reported within the time periods specified under the rules and regulations of the Farm Credit Administration.

[(2)] For purposes of this discussion, ''internal control over financial reporting'' is defined as a process designed by, or under the supervision of, the Bank's principal executive officer and principal financial officer, or persons performing similar functions, and effected by the Bank's Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Bank's financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Bank; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of the Bank's financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Bank are being made only in accordance with authorizations of management and directors of the Bank; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Bank's assets that could have a material effect on the Bank's financial statements.

**CERTIFICATION**

I, Amie Pala, chief executive officer of Farm Credit Bank of Texas (the Bank), a Federally chartered instrumentality under the Farm Credit Act of 1971, as amended, certify that:

1. I have reviewed this quarterly report of the Bank.

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.

3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Bank as of, and for, the periods presented in this report.

4. The Bank's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for the Bank and have:

    a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Bank is made known to us, particularly during the period in which this report is being prepared;

    b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c. evaluated the effectiveness of the Bank's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d. disclosed in this report any change in the Bank's internal control over financial reporting that occurred during the Bank's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting.

5. The Bank's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Bank's auditors and the Bank's Audit Committee:

    a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize and report financial information; and

    b. any fraud, whether or not material, that involves management or other employees who have a significant role in the Bank's internal control over financial reporting.

Amie Pala
Chief Executive Officer

August 9, 2023

**CERTIFICATION**

I, Brandon Blaut, executive vice president, chief financial officer of Farm Credit Bank of Texas (the Bank), a Federally chartered instrumentality under the Farm Credit Act of 1971, as amended, certify that:

1. I have reviewed this quarterly report of the Bank.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.
3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Bank as of, and for, the periods presented in this report.
4. The Bank's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for the Bank and have:
   a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Bank is made known to us, particularly during the period in which this report is being prepared;
   b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c. evaluated the effectiveness of the Bank's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d. disclosed in this report any change in the Bank's internal control over financial reporting that occurred during the Bank's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting.
5. The Bank's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Bank's auditors and the Bank's Audit Committee:
   a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize and report financial information; and
   b. any fraud, whether or not material, that involves management or other employees who have a significant role in the Bank's internal control over financial reporting.

Brandon Blaut
Executive Vice President, Chief Financial Officer

August 9, 2023

## Balance Sheets

*(Unaudited)*

| (dollars in thousands) | June 30, 2023 | December 31, 2022 |
|---|---|---|
| **Assets** | | |
| Cash | **$ 194,589** | 141,487 |
| Federal funds sold and overnight investments | **316,755** | 301,678 |
| Investment securities | **6,866,340** | 6,654,952 |
| Loans | **29,045,118** | 28,264,222 |
| Less allowance for credit losses on loans | **42,484** | 15,706 |
| Net loans | **29,002,634** | 28,248,516 |
| Accrued interest receivable | **138,637** | 122,465 |
| Premises and equipment, net | **125,558** | 134,754 |
| Other assets | **290,101** | 386,288 |
| **Total assets** | **$ 36,934,614** | $ 35,990,140 |
| **Liabilities and shareholders' equity** | | |
| **Liabilities** | | |
| Bonds and notes, net | **$ 34,989,690** | $ 33,971,742 |
| Accrued interest payable | **165,260** | 135,676 |
| Reserve for losses on unfunded commitments | **4,671** | 2,052 |
| Preferred stock dividends payable | **11,600** | 11,600 |
| Patronage payable | — | 46,071 |
| Other liabilities | **134,205** | 199,636 |
| **Total liabilities** | **$ 35,305,426** | $ 34,366,777 |
| **Commitments and contingencies (Note 5)** | | |
| **Shareholders' equity** | | |
| Preferred stock | **$ 750,000** | $ 750,000 |
| Capital stock | **469,240** | 471,029 |
| Allocated retained earnings | **74,047** | 74,043 |
| Unallocated retained earnings | **907,110** | 868,650 |
| Accumulated other comprehensive loss | **(571,209)** | (540,359) |
| **Total shareholders' equity** | **1,629,188** | 1,623,363 |
| **Total liabilities and shareholders' equity** | **$ 36,934,614** | $ 35,990,140 |

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

## Statements of Comprehensive Income

*(Unaudited)*

| (dollars in thousands) | Three Months Ended June 30, 2023 | Three Months Ended June 30, 2022 | Six Months Ended June 30, 2023 | Six Months Ended June 30, 2022 |
|---|---|---|---|---|
| **Interest Income** | | | | |
| Loans | **$ 297,725** | $ 178,089 | **$ 574,557** | $ 334,971 |
| Investment securities | **59,976** | 24,889 | **112,150** | 46,052 |
| **Total interest income** | **357,701** | 202,978 | **686,707** | 381,023 |
| **Interest Expense** | | | | |
| Bonds and notes | **272,350** | 106,679 | **514,908** | 187,688 |
| **Net interest income** | **85,351** | 96,299 | **171,799** | 193,335 |
| **Provision for credit losses** | **9,749** | 905 | **32,126** | 40 |
| **Net interest income after provision for credit losses** | **75,602** | 95,394 | **139,673** | 193,295 |
| **Noninterest Income** | | | | |
| Patronage income | **3,956** | 3,293 | **7,230** | 7,564 |
| Fees for services to District Asociations | **1,864** | 1,126 | **4,559** | 3,309 |
| Fees for loan-related services | **3,397** | 3,533 | **6,219** | 6,030 |
| Other (loss) income, net | **(676)** | 584 | **2,466** | 759 |
| **Total noninterest income** | **8,541** | 8,536 | **20,474** | 17,662 |
| **Noninterest Expense** | | | | |
| Salaries and employee benefits | **14,279** | 15,263 | **28,941** | 29,413 |
| Occupancy and equipment | **9,262** | 7,554 | **20,705** | 16,986 |
| FCSIC premiums | **5,654** | 6,559 | **10,831** | 10,626 |
| Other components of net periodic postretirement benefit cost | **66** | 77 | **133** | 155 |
| Other operating expenses | **10,882** | 11,242 | **21,158** | 22,958 |
| **Total noninterest expense** | **40,143** | 40,695 | **81,768** | 80,138 |
| **Net Income** | **44,000** | 63,235 | **78,379** | 130,819 |
| **Other comprehensive (loss) income** | | | | |
| Change in unrealized losses on investments | **(88,218)** | (134,069) | **(36,511)** | (359,508) |
| Change in postretirement benefit plans | **(58)** | (21) | **(115)** | (40) |
| Change in cash flow derivative instruments | **37,593** | 28,178 | **5,776** | 71,849 |
| **Total other comprehensive income** | **(50,683)** | (105,912) | **(30,850)** | (287,699) |
| **Comprehensive Income** | **$ (6,683)** | $ (42,677) | **$ 47,529** | $ (156,880) |

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

## Statements of Changes in Shareholders' Equity

*(Unaudited)*

| (dollars in thousands) | Preferred Stock | Capital Stock | Retained Earnings Allocated | Retained Earnings Unallocated | Accumulated Other Comprehensive Loss | Total Shareholders' Equity |
|---|---|---|---|---|---|---|
| Balance at December 31, 2021 | $ 750,000 | $ 410,373 | $ 66,490 | $ 868,365 | $ (96,836) | $ 1,998,392 |
| Net income | — | — | — | 130,819 | — | 130,819 |
| Other comprehensive loss | — | — | — | — | (287,699) | (287,699) |
| Capital stock and allocated retained earnings retired | — | (928) | — | — | — | (928) |
| Preferred stock dividends | — | — | — | (23,200) | — | (23,200) |
| Patronage distributions | | | | | | |
| Cash | — | — | — | (4,886) | — | (4,886) |
| Shareholders' equity | — | — | 314 | (314) | — | — |
| Balance at June 30, 2022 | $ 750,000 | $ 409,445 | $ 66,804 | $ 970,784 | $ (384,535) | $ 1,812,498 |
| | | | | | | |
| **Balance at December 31, 2022** | **$ 750,000** | **$ 471,029** | **$ 74,043** | **$ 868,650** | **$ (540,359)** | **$ 1,623,363** |
| Cumulative effect of a change in accounting principle | **—** | **—** | **—** | **(8,368)** | **—** | **(8,368)** |
| Balance at January 1, 2023 | **750,000** | **471,029** | **74,043** | **860,282** | **(540,359)** | **1,614,995** |
| Net income | **—** | **—** | **—** | **78,379** | **—** | **78,379** |
| Other comprehensive loss | **—** | **—** | **—** | **—** | **(30,850)** | **(30,850)** |
| Capital stock and allocated retained earnings retired | **—** | **(1,789)** | **—** | **—** | **—** | **(1,789)** |
| Preferred stock dividends | **—** | **—** | **—** | **(23,200)** | **—** | **(23,200)** |
| Patronage distributions | | | | | | |
| Cash | **—** | **—** | **—** | **(8,347)** | **—** | **(8,347)** |
| Shareholders' equity | **—** | **—** | **4** | **(4)** | **—** | **—** |
| Balance at June 30, 2023 | **750,000** | **469,240** | **74,047** | **907,110** | **(571,209)** | **1,629,188** |

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

## Statements of Cash Flows

*(Unaudited)*

| (dollars in thousands) | Six Months Ended June 30, 2023 | 2022 |
|---|---|---|
| **Cash Flows From Operating Activities** | | |
| Net income | **$ 78,379** | $ 130,819 |
| Reconciliation of net income to net cash provided by operating activities | | |
| Provision for credit losses | **32,126** | 40 |
| Depreciation and amortization on premises and equipment | **9,342** | 6,067 |
| Discount accretion on loans (premium amortization) | **(3,412)** | 2,843 |
| Amortization and accretion on debt instruments | **(3,717)** | 13,165 |
| (Discount) premium amortization on investments | **(5,084)** | 1,530 |
| Gain on extinguishment of debt | **(1,986)** | — |
| Gain on sale of loans | **(32)** | (6) |
| Allocated equity patronage from System bank retired (distributed) | **25,438** | (2,561) |
| (Gain) loss on disposals of premises and equipment | **(63)** | 54 |
| Increase in accrued interest receivable | **(16,172)** | (14,984) |
| Decrease in other assets, net | **68,288** | 2,087 |
| Increase in accrued interest payable | **29,584** | 25,298 |
| Decrease in other liabilities, net | **(47,572)** | (1,715) |
| **Net cash provided by operating activities** | **165,119** | 162,637 |
| **Cash Flows From Investing Activities** | | |
| Net increase in Federal funds sold and repurchase agreements | **(15,077)** | (154,214) |
| Investment securities | | |
| Purchases | **(949,479)** | (1,317,687) |
| Proceeds from maturities, calls and prepayments | **706,664** | 962,326 |
| Increase in loans, net | **(919,488)** | (2,028,973) |
| Proceeds from sales of loans | **117,110** | 8,342 |
| Proceeds from sales of premises and equipment | **106** | 102 |
| Expenditures for premises and equipment | **(189)** | (253) |
| Investments/distributions in other earning assets | **(122)** | (1,599) |
| **Net cash used in investing activities** | **(1,060,475)** | (2,531,956) |
| **Cash Flows From Financing Activities** | | |
| Bonds and notes issued | **16,415,500** | 21,253,745 |
| Bonds and notes retired | **(15,391,849)** | (18,673,655) |
| (Increase) decrease in cash collateral posted with a counterparty | **(4,511)** | 48,117 |
| Increase in cash collateral posted by a counterparty | **8,725** | 11,605 |
| Capital stock retired and allocated retained earnings distributed | **(1,789)** | (614) |
| Cash dividends on preferred stock | **(23,200)** | (23,200) |
| Cash patronage distributions paid | **(54,418)** | (44,218) |
| **Net cash provided by financing activities** | **948,458** | 2,571,780 |
| Net increase in cash | **53,102** | 202,461 |
| Cash at beginning of year | **141,487** | 156,986 |
| **Cash at End of Quarter** | **$ 194,589** | $ 359,447 |
| **Supplemental Schedule of Noncash Investing and Financing Activities** | | |
| Net decrease (increase) in unrealized losses on investment securities | **$ (36,511)** | $ (359,508) |
| Preferred stock dividends payable | **11,600** | 11,600 |
| Patronage distribution stock adjustment | **4** | 314 |
| **Supplemental Information** | | |
| Interest paid | **$ 485,325** | $ 162,390 |

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

# Notes to Financial Statements

*(Unaudited, dollar amounts in thousands, except as otherwise noted)*

## NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

The Farm Credit Bank of Texas (the Bank) is a member of the Farm Credit System (System), a nationwide network of cooperatively owned financial institutions. At June 30, 2023, the Bank provided financing to 14 associations within its chartered territory (District Associations) and certain OFIs. These financial statements relate solely to the Bank and exclude financial information of the District Associations.

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

In the opinion of management, all adjustments, consisting of normal recurring adjustments, necessary for a fair statement of results for the interim periods have been made. The preparation of the financial statements in accordance with U.S. 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 year ending December 31, 2023. Descriptions of the significant accounting policies are included in the 2022 Annual Report. In the opinion of management, these policies and the presentation of the interim financial condition and results of operations conform with U.S. GAAP and prevailing practices within the banking industry.

### Recently Adopted Accounting Pronouncements

The Bank adopted the Financial Accounting Standards Board (FASB) guidance entitled “Measurement of Credit Losses on Financial Instruments” and other subsequently issued accounting standards updates related to credit losses on January 1, 2023. This guidance replaced the current incurred loss impairment methodology with a single allowance framework that estimates the current expected credit losses (CECL) over the remaining contractual life for all financial assets carried at amortized cost and certain off-balance sheet credit exposures. This guidance is applied on a modified retrospective basis. This framework 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 consider macroeconomic conditions. 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 write-offs by year of origination for financing receivables and net investments in leases on a prospective basis.

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

| | December 31, 2022 | CECL Adoption Impact | January 1, 2023 |
|---|---|---|---|
| **Assets:** | | | |
| Allowance for credit losses on loans | $ 15,706 | $ 4,864 | $ 20,570 |
| **Liabilities:** | | | |
| Allowance for credit losses on unfunded commitments | 2,052 | 3,505 | 5,557 |
| **Retained earnings:** | | | |
| Unallocated retained earnings | $ 868,650 | $ (8,369) | $ 860,281 |

**Summary of Significant Accounting Policies Impacted by the CECL Adoption**

A. Investments

As more fully described in the 2022 Annual Report, the Bank, as permitted under the FCA regulations, holds investments for purposes of maintaining a liquidity reserve, managing short-term surplus funds and managing interest rate risk in an amount not to exceed 35% of its total outstanding loans. These investments have been classified as available-for-sale. These investments are reported at fair value and unrealized holding gains and losses on investments are reported as a separate component of members' equity (accumulated other comprehensive loss). The Bank may also hold additional investments in accordance with other investment programs approved by the Farm Credit Administration.

The guidance also amended the previous other-than-temporary impairment (OTTI) model for investments available-for-sale to incorporate an allowance for credit losses.

Impairment may result from credit deterioration of the issuer or collateral underlying the security. In performing an assessment of whether any decline in fair value is due to a credit loss, all relevant information is considered at the individual security level. For mortgage-backed and asset-backed securities, performance indicators considered related to the underlying assets include default rates, delinquency rates, percentage of nonperforming assets, debt-to-collateral ratios, third-party guarantees, current levels of subordination, vintage, geographic concentration, analyst reports and forecasts, credit ratings and other market data.

With respect to certain classes of debt securities, primarily U.S. Treasuries and government guaranteed agency securities, management considers the history of credit losses, current conditions and reasonable and supportable forecasts, which may indicate that the expectation that nonpayment of the amortized cost basis is or continues to be zero, even if the U.S. government were to technically default. Therefore, for those securities, the Bank does not record expected credit losses.

Available-for-sale debt securities in unrealized loss positions are evaluated for impairment related to credit losses at least quarterly. For available-for-sale debt securities, a decline in fair value due to estimated credit loss results in recording an allowance for credit losses to the extent the fair value is less than the amortized cost basis. Declines in fair value that have not been recorded through an allowance for credit losses, such as declines due to changes in market interest rates, are recorded through other comprehensive income.

If the intention is to sell a debt security or it is more likely than not to be required to sell the security before recovery of its amortized cost basis, the debt security is written down to its fair value and the write down is charged against the allowance for credit losses with any incremental impairment reported in earnings.

B. 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 are capitalized and the fee is amortized over the average life of the related loan as an adjustment to interest income. Loan prepayment fees are reported in interest income. Interest on loans is accrued and credited to interest income based on the daily principal amount outstanding.

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

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

When loans are in nonaccrual status, interest payments received in cash are generally recognized as interest income if the collectability of the loan principal is fully expected and certain other criteria are met. Otherwise, payments received on nonaccrual loans are applied against the recorded investment in the loan asset. Nonaccrual loans are returned to accrual status if all contractual principal and interest is current, the borrower is fully expected to fulfill the contractual repayment 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 Bank 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 Balance Sheet.

*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 Bank to measure the expected credit losses based on fair value of the collateral at the reporting date when the Bank 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 loss is based on the difference between the fair value of the collateral less estimated costs to sell and the amortized cost basis of the loan.

*Allowance for Credit Losses* – Beginning January 1, 2023, the allowance for credit losses (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)
- the allowance for losses on unfunded commitments, which is presented on the balance sheet in other liabilities, and
- the allowance for credit losses on investment securities, which covers held-to-maturity and available-for-sale securities, is recognized within each investment securities classification on the Balance Sheet.

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 expected life of a loan is determined based on the contractual term of the loan, anticipated prepayment rates, cancellation features and certain extension and call options. The ACLL is estimated using a probability of default (PD) and loss given default (LGD) model wherein impairment is calculated by multiplying the PD (probability the loan will default in a given timeframe) by the LGD (percentage of the loan expected to be collected at default.)

The Bank 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 Bank'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, credit quality rating, delinquency category 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 and the severity of loss, based on the aggregate net lifetime losses incurred per loan pool.

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

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

The Bank uses multiple scenarios over a reasonable and supportable forecast period of two years. Subsequent to the forecast period, the Bank reverts to long-run historical loss experience beyond the two years 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. The Bank also considers 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 Bank 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 Bank 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 Balance Sheet. The amount of expected losses is determined by calculating a commitment usage factor over the contractual period for exposures that are not unconditionally cancellable by the Bank 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 — INVESTMENT SECURITIES

### Available-for-Sale Investments

The Bank's available-for-sale investments include a liquidity portfolio and a portfolio of other investments. The liquidity portfolio consists primarily of agency-guaranteed debt instruments, mortgage-backed securities (MBS), U.S. Treasury securities, asset-backed securities (ABS), corporate debt and certificates of deposit. The majority of the liquidity portfolio's MBS were Federal agency-guaranteed collateralized MBS, including Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC) securities. The Bank's other investments portfolio consists of Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed agricultural mortgage-backed securities (AMBS) purchased from District Associations.

A summary of the amortized cost and fair value of the available-for-sale investment securities in the liquidity portfolio and other investment portfolio at June 30, 2023, and December 31, 2022, is included in the following tables.

| **June 30, 2023** | **Amortized Cost** | **Allowance for Credit Losses** | **Gross Unrealized Gains** | **Gross Unrealized Losses** | **Fair Value** | **Weighted Average Yield** |
|---|---|---|---|---|---|---|
| *Liquidity Portfolio:* | | | | | | |
| Agency-guaranteed debt | **$ 39,088** | **$ —** | **$ 2** | **$ (1,063)** | **$ 38,027** | **3.19%** |
| Certificates of deposit | **200,000** | **—** | **56** | **(298)** | **199,758** | **4.65** |
| Corporate debt | **207,943** | **—** | **—** | **(5,613)** | **202,330** | **3.51** |
| Federal agency collateralized mortgage-backed securities: | | | | | | |
| GNMA | **3,286,582** | **—** | **6** | **(438,039)** | **2,848,549** | **2.34** |
| FNMA and FHLMC | **2,685,575** | **—** | **898** | **(177,989)** | **2,508,484** | **3.70** |
| U.S. Treasury securities | **891,859** | **—** | **6** | **(17,507)** | **874,358** | **2.99** |
| Asset-backed securities | **188,266** | **—** | **196** | **(2,439)** | **186,023** | **4.46** |
| Total liquidity investments | **$ 7,499,313** | **$ —** | **$ 1,164** | **$ (642,948)** | **$ 6,857,529** | **3.06%** |
| *Other Investments:* | | | | | | |
| Agricultural mortgage-backed securities | **$ 9,944** | **$ —** | **$ —** | **$ (1,133)** | **$ 8,811** | **5.18%** |

| **December 31, 2022** | **Amortized Cost** | **Gross Unrealized Gains** | **Gross Unrealized Losses** | **Fair Value** | **Weighted Average Yield** |
|---|---|---|---|---|---|
| *Liquidity Portfolio:* | | | | | |
| Agency-guaranteed debt | $ 54,888 | $ — | $ (1,587) | $ 53,301 | 2.79% |
| Certificate of deposit | 200,000 | — | (991) | 199,009 | 4.46 |
| Corporate debt | 240,914 | 135 | (6,271) | 234,778 | 2.83 |
| Federal agency collateralized mortgage-backed securities: | | | | | |
| GNMA | 3,070,832 | 736 | (388,548) | 2,683,020 | 2.04 |
| FNMA and FHLMC | 2,652,701 | 49 | (183,541) | 2,469,209 | 3.04 |
| U.S. Treasury securities | 841,444 | 2 | (22,602) | 818,844 | 1.91 |
| Asset-backed securities | 188,983 | 345 | (2,807) | 186,521 | 3.76 |
| Total liquidity investments | $ 7,249,762 | $ 1,267 | $ (606,347) | $ 6,644,682 | 2.53% |
| *Other Investments:* | | | | | |
| Agricultural mortgage-backed securities | $ 11,595 | $ — | $ (1,325) | $ 10,270 | 4.81% |

The following tables summarize the contractual maturity, fair value, amortized cost and weighted average yield of available-for-sale investments at June 30, 2023.

| | Due in One Year Or Less | Due After One Year Through Five Years | Due After Five Years Through 10 Years | Due After 10 Years | Total |
|---|---|---|---|---|---|
| *Liquidity Portfolio:* | | | | | |
| Agency-guaranteed debt | $ 2,098 | $ 35,929 | $ — | $ — | $ 38,027 |
| Certificates of deposit | 199,758 | — | — | — | 199,758 |
| Corporate debt | 44,465 | 157,865 | — | — | 202,330 |
| Federal agency collateralized mortgage-backed securities: | | | | | |
| GNMA | — | 10,119 | 13,455 | 2,824,975 | 2,848,549 |
| FNMA and FHLMC | 1,391 | 218,598 | 1,025,188 | 1,263,307 | 2,508,484 |
| U.S. Treasury securities | 537,923 | 336,435 | — | — | 874,358 |
| Asset-backed securities | — | 115,659 | 23,432 | 46,932 | 186,023 |
| Total fair value | $ 785,635 | $ 874,605 | $ 1,062,075 | $ 4,135,214 | $ 6,857,529 |
| Total amortized cost | $ 793,649 | $ 901,267 | $ 1,077,497 | $ 4,726,900 | $ 7,499,313 |
| Weighted average yield | 3.50% | 3.26% | 5.22% | 2.45% | 3.06% |
| *Other Investments:* | | | | | |
| Fair value of agricultural mortgage-backed securities | $ — | $ 8,811 | $ — | $ — | $ 8,811 |
| Total amortized cost | $ — | $ 9,944 | $ — | $ — | $ 9,944 |
| Weighted average yield | —% | 5.18% | —% | —% | 5.18% |

As discussed in Note 1, effective January 1, 2023 the Bank adopted the CECL guidance which amends existing impairment guidance for held-to-maturity and available-for-sale investments to incorporate an allowance. At June 30, 2023, U.S. Treasury and agency, and all (or substantially all) mortgage-backed securities had a zero loss assumption. The Bank evaluates investment securities with unrealized losses for impairment on a quarterly basis. As a result of the assessment as of June 30, 2023, the Bank concluded that it does not intend to sell any securities and it is not more likely than not that it would be required to sell any securities, prior to recovery of the amortized cost basis. If it is determined that a security is impaired, the Bank will evaluate whether credit impairment exists by comparing the present value of the expected cash flows to the security's amortized cost basis. Credit impairment is recorded as an ACL for debt securities. The Bank concluded that a credit impairment did not exist at June 30, 2023.

The following table shows investment securities by gross unrealized losses and fair value, aggregated by investment category and length of time the securities have been in a continuous unrealized loss position at June 30, 2023. The continuous loss position is based on the date the impairment was first identified.

| | Less Than 12 Months | | Greater Than 12 Months | | Total | |
|---|---|---|---|---|---|---|
| | **Fair Value** | **Unrealized Losses** | **Fair Value** | **Unrealized Losses** | **Fair Value** | **Unrealized Losses** |
| Agency-guaranteed debt | **$ —** | **$ —** | **$ 30,928** | **$ (1,063)** | **$ 30,928** | **$ (1,063)** |
| Certificates of deposit | **149,702** | **(298)** | **—** | **—** | **149,702** | **(298)** |
| Corporate debt | **32,839** | **(161)** | **169,491** | **(5,452)** | **202,330** | **(5,613)** |
| Federal agency collateralized mortgage-backed securities: | | | | | | |
| GNMA | **624,246** | **(22,960)** | **2,223,369** | **(415,079)** | **2,847,615** | **(438,039)** |
| FNMA and FHLMC | **467,583** | **(6,826)** | **1,805,243** | **(171,163)** | **2,272,826** | **(177,989)** |
| U.S. Treasury securities | **245,638** | **(267)** | **528,852** | **(17,240)** | **774,490** | **(17,507)** |
| Asset-backed securities | **91,047** | **(386)** | **48,564** | **(2,053)** | **139,611** | **(2,439)** |
| Total | **$ 1,611,055** | **$ (30,898)** | **$ 4,806,447** | **$ (612,050)** | **$ 6,417,502** | **$ (642,948)** |

## NOTE 3 — LOANS AND ALLOWANCE FOR CREDIT LOSSES

### Loans

Loans comprised the following categories at:

| | June 30, 2023 | December 31, 2022 |
|---|---|---|
| Direct notes receivable from District Associations and OFIs | **$ 20,120,863** | $ 19,551,823 |
| Participations purchased | **8,924,255** | 8,712,399 |
| Total loans | **$ 29,045,118** | $ 28,264,222 |

A summary of the Bank's loans by type follows:

| | June 30, 2023 | December 31, 2022 |
|---|---|---|
| Direct notes receivable from | | |
| District Associations | **$ 20,068,678** | $ 19,499,945 |
| Real estate mortgage | **1,123,533** | 1,096,090 |
| Production and intermediate-term | **1,144,966** | 1,067,229 |
| Agribusiness | | |
| Loans to cooperatives | **533,578** | 503,670 |
| Processing and marketing | **3,319,842** | 3,407,164 |
| Farm-related business | **237,896** | 261,843 |
| Communications | **816,085** | 785,563 |
| Energy (rural utilities) | **1,416,101** | 1,303,639 |
| Water and waste disposal | **221,844** | 187,044 |
| Rural home | **3,109** | 1,815 |
| International | **100,213** | 88,285 |
| Mission-related | **2,082** | 2,172 |
| Lease receivables | **5,006** | 7,885 |
| Loans to OFIs | **52,185** | 51,878 |
| Total loans | **$ 29,045,118** | $ 28,264,222 |

The Bank's capital markets loan portfolio, also referred to as the participations purchased loan portfolio, predominantly includes participations, syndications and purchased whole loans, along with other financing structures within our lending authorities. In addition to purchasing loans from our District Associations, which may exceed their hold limits, the Bank seeks the purchase of participations and syndications originated outside of the Texas District's territory by other System institutions, commercial banks and other lenders. Our capital markets loan portfolio depends to a significant degree on our relationships with other Farm Credit institutions. These loans may be held as interest earning assets of the Bank or sub-participated to the District Associations or other System entities.

The Bank purchases or sells participation interests with other parties in order to diversify risk, manage loan volume and comply with FCA regulations.

The following table presents information regarding the balances of loans purchased and sold, excluding syndications, at June 30, 2023:

| | Other Farm Credit Institutions | | Non-Farm Credit Institutions | | Total | |
|---|---|---|---|---|---|---|
| | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold |
| Real estate mortgage | $ 1,315,173 | $ 306,799 | $ 53,608 | $ — | $ 1,368,781 | $ 306,799 |
| Production and intermediate-term | 2,705,040 | 1,813,230 | 65,417 | — | 2,770,457 | 1,813,230 |
| Agribusiness | 2,731,508 | 857,206 | 39,457 | — | 2,770,965 | 857,206 |
| Communications | 995,626 | 179,156 | — | — | 995,626 | 179,156 |
| Energy (rural utilities) | 1,522,956 | 106,812 | — | — | 1,522,956 | 106,812 |
| Water and waste disposal | 285,094 | 63,048 | — | — | 285,094 | 63,048 |
| Rural home | 5,893 | — | — | — | 5,893 | — |
| International | 163,962 | 63,547 | — | — | 163,962 | 63,547 |
| Mission-related | 2,082 | — | — | — | 2,082 | — |
| Lease receivables | 6,248 | 1,247 | — | — | 6,248 | 1,247 |
| Direct notes receivable from District Associations | — | 4,350,000 | — | — | — | 4,350,000 |
| Total | **$ 9,733,582** | **$ 7,741,045** | **$ 158,482** | **$ —** | **$ 9,892,064** | **$ 7,741,045** |

The Bank has purchased loan participations and Farmer Mac guaranteed AMBS from District Associations in Capitalized Participation Pool (CPP) transactions. As a condition of the transactions, the Bank redeemed common stock in the amount of 2.00% of the par value of the loans purchased, and the District Associations bought Bank stock equal to 8.00% of the purchased loans' par value and 1.60% of the AMBS's par value. There were no CPP purchases during the six months ended June 30, 2023. CPP loans held at June 30, 2023, totaled $95.4 million and were included in loans on the balance sheet. The balance of the AMBS CPP was $8.8 million at June 30, 2023, and was included in investment securities on the balance sheet.

The Bank may also purchase loans from District Associations in Non-Capitalized Participation Pool (NCPP) transactions. As a condition of the transactions, the Bank redeems common stock in the amount of 2.00% of the par value of the loans purchased. During the six months ended June 30, 2023, the Bank purchased $50.6 million in loan participations from a District Association in a NCPP transaction which resulted in net stock retirements of $1.0 million. The NCPP loans balance was $209.9 million at June 30, 2023, and was included in loans on the balance sheet.

During the six months ended June 30, 2023, the Bank sold eight loans with amortized costs of $128.2 million, resulting in losses of $11.1 million which were recorded as charge-offs within the allowance for credit losses.

### 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 Bank 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 FCA 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 mortgages may be made on a secured or unsecured basis.

The Bank uses a two-dimensional risk rating model based on guidance developed by the System 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 within 12 months from the date of the analysis. Loss given default is management's estimate of the anticipated principal loss on a specific loan assuming default occurs within the next 12 months. 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. Generally, the Bank reviews the probability of default and loss given default ratings assigned to loans on at least an annual basis.

One credit quality indicator utilized by the Bank is the Farm Credit Administration Uniform Loan Classification System that categorizes loans into five categories. The 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 factors, conditions and values that make collection in full highly questionable; and
- Loss – assets are considered uncollectible.

The following table presents the amortized cost of loans classified under the Uniform Loan Classification System as a percentage of the amortized cost of total loans:

| | **June 30, 2023** |
|---|---|
| Acceptable | **99.0 %** |
| OAEM | **0.5** |
| Substandard/Doubtful | **0.5** |
| | **100.0 %** |

The following table presents credit quality indicators by loan type and the related amortized cost loan balance for the loan participation portfolio as of June 30, 2023:

| | Term Loans by Origination Year | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **2023** | **2022** | **2021** | **2020** | **2019** | **Prior** | **Revolving Loans** | **Revolving Loans Converted to Term Loans** | **Total** |
| **Real estate mortgage** | | | | | | | | | |
| Acceptable | $ 31,979 | $ 195,700 | $ 223,595 | $ 114,339 | $ 123,701 | $ 323,726 | $ 93,904 | $ 3,449 | $ 1,110,393 |
| OAEM | — | — | 989 | — | — | — | — | — | 989 |
| Substandard/Doubtful | — | — | — | — | 2,271 | 544 | 9,336 | — | 12,151 |
| Total | $ 31,979 | $ 195,700 | $ 224,584 | $ 114,339 | $ 125,972 | $ 324,270 | $ 103,240 | $ 3,449 | $ 1,123,533 |
| Current period gross charge-offs | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| **Production and intermediate-term** | | | | | | | | | |
| Acceptable | $ 52,161 | $ 127,716 | $ 74,731 | $ 16,445 | $ 9,790 | $ 129,815 | $ 688,089 | $ — | $ 1,098,747 |
| OAEM | — | — | — | — | — | — | — | — | — |
| Substandard/Doubtful | 4,620 | 7,442 | — | — | 26,625 | — | 7,532 | — | 46,219 |
| Total | $ 56,781 | $ 135,158 | $ 74,731 | $ 16,445 | $ 36,415 | $ 129,815 | $ 695,621 | $ — | $ 1,144,966 |
| Current period gross charge-offs | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| **Agribusiness** | | | | | | | | | |
| Acceptable | $ 340,460 | $ 917,577 | $ 589,861 | $ 247,487 | $ 235,958 | $ 488,399 | $ 1,070,229 | $ 10,000 | $ 3,899,971 |
| OAEM | — | 21,847 | 32,811 | — | 7,992 | — | 40,444 | 775 | 103,869 |
| Substandard/Doubtful | 14,146 | — | 26,816 | 16,534 | — | 7,653 | 22,327 | — | 87,476 |
| Total | $ 354,606 | $ 939,424 | $ 649,488 | $ 264,021 | $ 243,950 | $ 496,052 | $ 1,133,000 | $ 10,775 | $ 4,091,316 |
| Current period gross charge-offs | $ — | $ 5,938 | $ — | $ — | $ — | $ 2,572 | $ 2,612 | $ — | $ 11,122 |
| **Communications** | | | | | | | | | |
| Acceptable | $ 74,303 | $ 178,439 | $ 216,057 | $ 204,778 | $ 17,472 | $ 77,410 | $ 47,626 | $ — | $ 816,085 |
| OAEM | — | — | — | — | — | — | — | — | — |
| Substandard/Doubtful | — | — | — | — | — | — | — | — | — |
| Total | $ 74,303 | $ 178,439 | $ 216,057 | $ 204,778 | $ 17,472 | $ 77,410 | $ 47,626 | $ — | $ 816,085 |
| Current period gross charge-offs | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| **Energy and water/waste disposal** | | | | | | | | | |
| Acceptable | $ 85,007 | $ 449,623 | $ 147,709 | $ 58,090 | $ 27,333 | $ 580,695 | $ 211,330 | $ 38,381 | $ 1,598,168 |
| OAEM | — | 9,316 | 12,708 | — | — | 11,426 | 1,124 | — | 34,574 |
| Substandard/Doubtful | — | — | — | — | 2,594 | 2,412 | 197 | — | 5,203 |
| Total | $ 85,007 | $ 458,939 | $ 160,417 | $ 58,090 | $ 29,927 | $ 594,533 | $ 212,651 | $ 38,381 | $ 1,637,945 |
| Current period gross charge-offs | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| **Rural home** | | | | | | | | | |
| Acceptable | $ — | $ 439 | $ 663 | $ 1,393 | $ 231 | $ 383 | $ — | $ — | $ 3,109 |
| OAEM | — | — | — | — | — | — | — | — | — |
| Substandard/Doubtful | — | — | — | — | — | — | — | — | — |
| Total | $ — | $ 439 | $ 663 | $ 1,393 | $ 231 | $ 383 | $ — | $ — | $ 3,109 |
| Current period gross charge-offs | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| **International** | | | | | | | | | |
| Acceptable | $ — | $ 67,234 | $ 29,325 | $ — | $ — | $ — | $ 3,654 | $ — | $ 100,213 |
| OAEM | — | — | — | — | — | — | — | — | — |
| Substandard/Doubtful | — | — | — | — | — | — | — | — | — |
| Total | $ — | $ 67,234 | $ 29,325 | $ — | $ — | $ — | $ 3,654 | $ — | $ 100,213 |
| Current period gross charge-offs | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — |

| | Term Loans by Origination Year | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2023 | 2022 | 2021 | 2020 | 2019 | Prior | Revolving Loans | Revolving Loans Converted to Term Loans | Total |
| **Mission-related** | | | | | | | | | |
| Acceptable | $ — | $ — | $ — | $ — | $ — | $ 2,082 | $ — | $ — | $ 2,082 |
| OAEM | — | — | — | — | — | — | — | — | — |
| Substandard/Doubtful | — | — | — | — | — | — | — | — | — |
| Total | $ — | $ — | $ — | $ — | $ — | $ 2,082 | $ — | $ — | $ 2,082 |
| Current period gross charge-offs | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| **Lease receivables** | | | | | | | | | |
| Acceptable | $ — | $ — | $ — | $ — | $ — | $ 5,006 | $ — | $ — | $ 5,006 |
| OAEM | — | — | — | — | — | — | — | — | — |
| Substandard/Doubtful | — | — | — | — | — | — | — | — | — |
| Total | $ — | $ — | $ — | $ — | $ — | $ 5,006 | $ — | $ — | $ 5,006 |
| Current period gross charge-offs | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| **Direct notes to District Associations:** | | | | | | | | | |
| Acceptable | $ — | $ — | $ — | $ — | $ — | $ — | $ 20,068,678 | $ — | $ 20,068,678 |
| OAEM | — | — | — | — | — | — | — | — | — |
| Substandard/Doubtful | — | — | — | — | — | — | — | — | — |
| Total | $ — | $ — | $ — | $ — | $ — | $ — | $ 20,068,678 | $ — | $ 20,068,678 |
| Current period gross charge-offs | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| **Loans to other financing institutions** | | | | | | | | | |
| Acceptable | $ — | $ — | $ — | $ — | $ — | $ — | $ 52,185 | $ — | $ 52,185 |
| OAEM | — | — | — | — | — | — | — | — | — |
| Substandard/Doubtful | — | — | — | — | — | — | — | — | — |
| Total | $ — | $ — | $ — | $ — | $ — | $ — | $ 52,185 | $ — | $ 52,185 |
| Current period gross charge-offs | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| **Total loans** | | | | | | | | | |
| Acceptable | $ 583,910 | $ 1,936,728 | $ 1,281,941 | $ 642,532 | $ 414,485 | $ 1,607,516 | $ 22,235,695 | $ 51,830 | $ 28,754,637 |
| OAEM | — | 31,163 | 46,508 | — | 7,992 | 11,426 | 41,568 | 775 | 139,432 |
| Substandard/Doubtful | 18,766 | 7,442 | 26,816 | 16,534 | 31,490 | 10,609 | 39,392 | — | 151,049 |
| Total | $ 602,676 | $ 1,975,333 | $ 1,355,265 | $ 659,066 | $ 453,967 | $ 1,629,551 | $ 22,316,655 | $ 52,605 | $ 29,045,118 |
| Current period gross charge-offs | $ — | $ 5,938 | $ — | $ — | $ — | $ 2,572 | $ 2,612 | $ — | $ 11,122 |

The following table presents loans and related accrued interest classified under the Uniform Loan Classification System as a percentage of total loans and related accrued interest receivable by loan type:

| | December 31, 2022 |
|---|---|
| **Real estate mortgage:** | |
| Acceptable | 99.9 % |
| OAEM | 0.1 |
| Substandard/Doubtful | — |
| | 100.0 % |
| **Production and intermediate-term:** | |
| Acceptable | 99.2 % |
| OAEM | — |
| Substandard/Doubtful | 0.8 |
| | 100.0 % |
| **Agribusiness:** | |
| Acceptable | 96.3 % |
| OAEM | 1.7 |
| Substandard/Doubtful | 2.0 |
| | 100.0 % |
| **Communications:** | |
| Acceptable | 100.0 % |
| OAEM | — |
| Substandard/Doubtful | — |
| | 100.0 % |
| **Energy & water/waste disposal:** | |
| Acceptable | 98.8 % |
| OAEM | 0.8 |
| Substandard/Doubtful | 0.4 |
| | 100.0 % |
| **Rural home:** | |
| Acceptable | 100.0 % |
| OAEM | — |
| Substandard/Doubtful | — |
| | 100.0 % |
| **International:** | |
| Acceptable | 100.0 % |
| OAEM | — |
| Substandard/Doubtful | — |
| | 100.0 % |
| **Mission-related:** | |
| Acceptable | 100.0 % |
| OAEM | — |
| Substandard/Doubtful | — |
| | 100.0 % |
| **Lease receivables:** | |
| Acceptable | 100.0 % |
| OAEM | — |
| Substandard/Doubtful | — |
| | 100.0 % |
| **Direct notes to District Associations:** | |
| Acceptable | 100.0 % |
| OAEM | — |
| Substandard/Doubtful | — |
| | 100.0 % |
| **Loans to OFIs:** | |
| Acceptable | 100.0 % |
| OAEM | — |
| Substandard/Doubtful | — |
| | 100.0 % |
| **Total Loans:** | |
| Acceptable | 99.4 % |
| OAEM | 0.3 |
| Substandard/Doubtful | 0.3 |
| | 100.0 % |

Accrued interest receivable on loans of $110.0 million and $101.5 million at June 30, 2023 and December 31, 2022 have been excluded from the amortized cost of loans and is reported separately in the Balance Sheet. During the three months ended June 30, 2023, the Bank did not reverse any accrued interest receivable against interest income. During the six months ended June 30, 2023, the Bank reversed $699 thousand of accrued interest receivable against interest income.

The following table reflects nonperforming assets, which consist of nonaccrual loans, accruing loans 90 days or more past due and other property owned:

| | June 30, 2023 | December 31, 2022 |
|---|---|---|
| Nonaccrual loans | | |
| Production and intermediate-term | **$ 34,248** | $ — |
| Agribusiness | **32,779** | 26,559 |
| Energy and water/waste disposal | **5,204** | 3,435 |
| Total nonaccrual loans | **72,231** | 29,994 |
| Accruing loans 90 days or more past due | | |
| Real estate mortgage | **2,053** | — |
| Total accruing loans 90 days or more past due | **2,053** | — |
| Other property owned | **—** | — |
| Total nonperforming assets | **$ 74,284** | $ 29,994 |
| Nonaccrual loans as a percentage of total loans | **0.25 %** | 0.11 % |
| Nonperforming assets as a percentage of total loans and other property owned | **0.26** | 0.11 |
| Nonperforming assets as a percentage of capital | **4.56** | 1.85 |

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 loans during the period:

| | June 30, 2023 | | | Interest Income Recognized Three Months Ended June 30, 2023 | Interest Income Recognized Six Months Ended June 30, 2023 |
|---|---|---|---|---|---|
| | Amortized Cost with Allowance | Amortized Cost without Allowance | Total | | |
| Nonaccrual loans | | | | | |
| Production and intermediate-term | **$ 34,248** | **$ —** | **$ 34,248** | **$ —** | **$ —** |
| Agribusiness | **32,779** | **—** | **32,779** | **—** | **—** |
| Energy and water/waste disposal | **5,204** | **—** | **5,204** | **—** | **—** |
| Total nonaccrual loans | **$ 72,231** | **$ —** | **$ 72,231** | **$ —** | **$ —** |

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

| **June 30, 2023** | **30-89 Days Past Due** | **90 Days or More Past Due** | **Total Past Due** | **Not Past Due or Less Than 30 Days Past Due** | **Total Loans** | **Accruing Loans 90 Days or More Past Due** |
|---|---|---|---|---|---|---|
| **Real estate mortgage** | **$ 241** | **$ 2,053** | **$ 2,294** | **$ 1,121,239** | **$ 1,123,533** | **$ 2,053** |
| **Production and intermediate-term** | **2,949** | **—** | **2,949** | **1,142,017** | **1,144,966** | **—** |
| **Agribusiness** | **16,880** | **11,394** | **28,274** | **4,063,042** | **4,091,316** | **—** |
| **Communications** | **—** | **—** | **—** | **816,085** | **816,085** | **—** |
| **Energy & water/waste disposal** | **—** | **—** | **—** | **1,637,945** | **1,637,945** | **—** |
| **Rural home** | **85** | **—** | **85** | **3,024** | **3,109** | **—** |
| **International** | **—** | **—** | **—** | **100,213** | **100,213** | **—** |
| **Mission-related** | **—** | **—** | **—** | **2,082** | **2,082** | **—** |
| **Lease receivables** | **—** | **—** | **—** | **5,006** | **5,006** | **—** |
| **Direct notes to District Associations** | **—** | **—** | **—** | **20,068,678** | **20,068,678** | **—** |
| **Loans to OFIs** | **—** | **—** | **—** | **52,185** | **52,185** | **—** |
| **Total** | **$ 20,155** | **$ 13,447** | **$ 33,602** | **$29,011,516** | **$29,045,118** | **$ 2,053** |

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

| **December 31, 2022** | **30-89 Days Past Due** | **90 Days or More Past Due** | **Total Past Due** | **Not Past Due or Less Than 30 Days Past Due** | **Total Loans** | **Accruing Loans 90 Days or More Past Due** |
|---|---|---|---|---|---|---|
| Real estate mortgage | $ 164 | $ — | $ 164 | $ 1,107,641 | $ 1,107,805 | $ — |
| Production and intermediate-term | — | — | — | 1,074,968 | 1,074,968 | — |
| Agribusiness | 5,393 | 1,384 | 6,777 | 4,192,808 | 4,199,585 | — |
| Communications | — | — | — | 787,968 | 787,968 | — |
| Energy & water/waste disposal | — | 2 | 2 | 1,498,411 | 1,498,413 | — |
| Rural home | — | — | — | 1,821 | 1,821 | — |
| International | — | — | — | 89,201 | 89,201 | — |
| Mission-related | — | — | — | 2,195 | 2,195 | — |
| Lease receivables | — | — | — | 7,929 | 7,929 | — |
| Direct notes to District Associations | — | — | — | 19,543,825 | 19,543,825 | — |
| Loans to OFIs | — | — | — | 52,054 | 52,054 | — |
| Total | $ 5,557 | $ 1,386 | $ 6,943 | $28,358,821 | $28,365,764 | $ — |

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 agribusiness and energy loans.

## Allowance for Credit Losses

The credit risk rating methodology is a key component of the Bank's allowance for credit losses evaluation, and is generally incorporated into the Bank's loan underwriting standards and internal lending limits. In addition, borrower and commodity concentration lending and leasing limits have been established by the Bank to manage credit exposure. The regulatory limit to a single borrower or lessee is 15% of the Bank's lending and leasing limit base but the Bank's Board of Directors have generally established more restrictive lending limits.

Effective January 1, 2023, the Bank adopted the CECL accounting guidance as described in Note 1. A summary of changes in the allowance for credit losses by portfolio segment for the three and six months ended June 30, 2023 are as follows:

| | Real Estate Mortgage | Production and Intermediate-term | Agri-business | Comm-unications | Energy and Water/ Waste Disposal | Rural Home | Inter-national | Mission-Related | Lease Receivables | Direct Notes to District Associations | Loans to OFIs | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Allowance for Loan Losses:** | | | | | | | | | | | | |
| Balance at March 31, 2023 | $ 1,321 | $ 1,170 | $ 24,878 | $ 960 | $ 4,030 | $ 1 | $ 51 | $ 7 | $ — | $ — | $ — | $ 32,418 |
| Charge-offs | — | — | — | — | — | — | — | — | — | — | — | — |
| Recoveries | — | — | — | — | 8 | — | — | 10 | — | — | — | 18 |
| Provision for credit losses (loan loss reversal) | 576 | 8,451 | 732 | 5 | 300 | 2 | (7) | (11) | — | — | — | 10,048 |
| Balance at June 30, 2023 | $ 1,897 | $ 9,621 | $ 25,610 | $ 965 | $ 4,338 | $ 3 | $ 44 | $ 6 | $ — | $ — | $ — | $ 42,484 |
| **Reserve for losses on unfunded commitments:** | | | | | | | | | | | | |
| Balance at March 31, 2023 | $ 279 | $ 301 | $ 3,459 | $ 135 | $ 764 | $ — | $ 32 | $ — | $ — | $ — | $ — | $ 4,970 |
| (Loan loss reversal) provision for credit losses | (28) | (83) | (157) | (32) | (6) | — | 7 | — | — | — | — | $ (299) |
| Balance at June 30, 2023 | $ 251 | $ 218 | $ 3,302 | $ 103 | $ 758 | $ — | $ 39 | $ — | $ — | $ — | $ — | $ 4,671 |

| | Real Estate Mortgage | Production and Intermediate-term | Agri-business | Comm-unications | Energy and Water/ Waste Disposal | Rural Home | Inter-national | Mission-Related | Lease Receivables | Direct Notes to District Associations | Loans to OFIs | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Allowance for Loan Losses:** | | | | | | | | | | | | |
| Balance at December 31, 2022 | $ 447 | $ 1,411 | $ 11,283 | $ 521 | $ 1,951 | $ — | $ 31 | $ 59 | $ 3 | $ — | $ — | $ 15,706 |
| Cumulative effect of a change in accounting principle | 724 | (285) | 3,701 | 202 | 518 | 1 | 21 | (17) | (1) | — | — | 4,864 |
| Balance at January 1, 2023 | 1,171 | 1,126 | 14,984 | 723 | 2,469 | 1 | 52 | 42 | 2 | — | — | 20,570 |
| Charge-offs | — | — | (11,122) | — | — | — | — | — | — | — | — | (11,122) |
| Recoveries | — | — | — | — | 8 | — | — | 16 | — | — | — | 24 |
| Provision for credit losses (loan loss reversal) | 726 | 8,495 | 21,748 | 242 | 1,861 | 2 | (8) | (52) | (2) | — | — | 33,012 |
| Balance at June 30, 2023 | $ 1,897 | $ 9,621 | $ 25,610 | $ 965 | $ 4,338 | $ 3 | $ 44 | $ 6 | $ — | $ — | $ — | $ 42,484 |
| **Reserve for losses on unfunded commitments:** | | | | | | | | | | | | |
| Balance at December 31, 2022 | $ 83 | $ 196 | $ 1,430 | $ 45 | $ 287 | $ — | $ 11 | $ — | $ — | $ — | $ — | $ 2,052 |
| Cumulative effect of a change in accounting principle | 232 | 107 | 2,580 | 77 | 484 | — | 25 | — | — | — | — | 3,505 |
| Balance at January 1, 2023 | 315 | 303 | 4,010 | 122 | 771 | — | 36 | — | — | — | — | 5,557 |
| (Loan loss reversal) provision for credit losses | (64) | (85) | (708) | (19) | (13) | — | 3 | — | — | — | — | (886) |
| Balance at June 30, 2023 | $ 251 | $ 218 | $ 3,302 | $ 103 | $ 758 | $ — | $ 39 | $ — | $ — | $ — | $ — | $ 4,671 |

A summary of changes in the allowance for credit losses by portfolio segment for the three and six months ended June 30, 2022 are as follows:

| | Real Estate Mortgage | Production and Intermediate -term | Agri-business | Comm-unications | Energy and Water/ Waste Disposal | Rural Home | Inter-national | Mission-Related | Lease Receivables | Direct Notes to District Associations | Loans to OFIs | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Allowance for Loan Losses[1]:** | | | | | | | | | | | | |
| Balance at March 31, 2022 | $ 490 | $ 1,308 | $ 6,477 | $ 485 | $ 2,091 | $ — | $ 31 | $ 59 | $ 32 | $ — | $ — | $ 10,973 |
| Charge-offs | — | — | — | — | — | — | — | — | — | — | — | — |
| Recoveries | — | — | — | — | — | — | — | — | — | — | — | — |
| Provision for credit losses (loan loss reversal) | (50) | (11) | 953 | 8 | 9 | — | (2) | — | (2) | — | — | 905 |
| Other[2] | 4 | 4 | (402) | (4) | 22 | — | (2) | — | — | — | — | (378) |
| Balance at June 30, 2022 | $ 444 | $ 1,301 | $ 7,028 | $ 489 | $ 2,122 | $ — | $ 27 | $ 59 | $ 30 | $ — | $ — | $ 11,500 |
| **Balance at Reserve for losses on unfunded commitments[(2)]:** | | | | | | | | | | | | |
| Balance at March 31, 2022 | $ 39 | $ 250 | $ 785 | $ 41 | $ 332 | $ — | $ 13 | $ — | $ — | $ — | $ — | $ 1,460 |
| Provision for credit losses (loan loss reversal) | (4) | (4) | 402 | 4 | (21) | — | 1 | — | — | — | — | 378 |
| Balance at June 30, 2022 | $ 35 | $ 246 | $ 1,187 | $ 45 | $ 311 | $ — | $ 14 | $ — | $ — | $ — | $ — | $ 1,838 |

[1] For the period prior to January 1, 2023, the allowance for loan losses was based on probable and estimable losses inherent in the loan portfolio.

[2] Reserve for losses on letters of credit and unfunded commitments recorded in other liabilities.

| | Real Estate Mortgage | Production and Intermediate -term | Agri-business | Comm-unications | Energy and Water/ Waste Disposal | Rural Home | Inter-national | Mission-Related | Lease Receivables | Direct Notes to District Associations | Loans to OFIs | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Allowance for Loan Losses[1]:** | | | | | | | | | | | | |
| Balance at December 31, 2021 | $ 466 | $ 1,316 | $ 5,952 | $ 409 | $ 3,606 | $ — | $ 27 | $ 58 | $ 35 | $ — | $ — | $ 11,869 |
| Charge-offs | — | — | — | — | — | — | — | — | — | — | — | — |
| Recoveries | — | — | — | — | — | — | — | — | — | — | — | — |
| Provision for credit losses (loan loss reversal) | (14) | (3) | 1,477 | 93 | (1,509) | — | — | 1 | (5) | — | — | 40 |
| Other[2] | (8) | (12) | (401) | (13) | 25 | — | — | — | — | — | — | (409) |
| Balance at June 30, 2022 | $ 444 | $ 1,301 | $ 7,028 | $ 489 | $ 2,122 | $ — | $ 27 | $ 59 | $ 30 | $ — | $ — | $ 11,500 |
| **Reserve for losses on unfunded commitments[(2)]:** | | | | | | | | | | | | |
| Balance at December 31, 2021 | $ 604 | $ 234 | $ 209 | $ 32 | $ 336 | $ — | $ 14 | $ — | $ 1 | $ — | $ — | $ 1,430 |
| Provision for credit losses (loan loss reversal) | (569) | 12 | 978 | 13 | (25) | — | — | — | (1) | — | — | 408 |
| Balance at June 30, 2022 | $ 35 | $ 246 | $ 1,187 | $ 45 | $ 311 | $ — | $ 14 | $ — | $ — | $ — | $ — | $ 1,838 |

[1] For the period prior to January 1, 2023, the allowance for loan losses was based on probable and estimable losses inherent in the loan portfolio.

[2] Reserve for losses on letters of credit and unfunded commitments recorded in other liabilities.

## Loan Modifications

No loan modifications to borrowers experiencing financial difficulty occurred during the three months ended June 30, 2023. During the six months ended June 30, 2023, the Bank modified a loan to a borrower experiencing financial difficulty in the agribusiness sector with an amortized cost of $9.6 million as of June 30, 2023 through a 34-month extension of the maturity date. Accrued interest receivable related to this loan modification was $283 thousand at June 30, 2023. Subsequent to this modification, the loan has not experienced default and as of June 30, 2023 is current in all required payments. The Bank does not have any additional commitments to lend to this borrower as of June 30, 2023.

## Troubled Debt Restructurings

Prior to the adoption of updated FASB guidance on loan modifications on January 1, 2023, 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 provides information on outstanding loans restructured in TDRs at December 31, 2022:

| | Total Loans Modified as TDRs | TDRs in Nonaccrual Status |
|---|---|---|
| Energy | $ 540 | $ 540 |
| Mission-related | 2,195 | — |
| Total | $ 2,735 | $ 540 |

There were no new loans designated as TDRs during the six months ended June 30, 2022 and there were no payment defaults on loans that were restructured during the previous 12 months. A payment default is defined as a payment that is 30 days past due after the date the loan was restructured.

## NOTE 4 — LEASES

The Bank evaluates contractual agreements at inception to determine if they meet the criteria for a lease. Leases with an initial term of 12 months or less are not recorded on the balance sheet with lease expense recognized on a straight-line basis over the lease term. Operating leases are included in other assets for right-of-use (ROU) assets and other liabilities for lease liabilities on the balance sheet.

ROU assets represent the Bank’s right to use an underlying asset for the lease term and lease liabilities represent the Bank’s obligation to make lease payments arising from the lease agreement. Operating ROU assets and liabilities are recognized based on the present value of the lease payments over the lease term. The Bank’s lease terms may include options to extend or terminate the lease when it is reasonably certain that the Bank will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

The Bank maintains a lease for its headquarters facility in Austin, Texas which currently expires in December 2034. This lease is for approximately 111,500 square feet of office space ranging from $18 to $38 per square foot during the term of the lease. Lease expense for the headquarters facility includes certain operating expenses passed through from the landlord.

The Bank currently holds leases for postage machines, copiers and ice machines. The postage machines lease had an original term ending August 2020 but was renewed and currently expires in September 2023. A lease for copiers expired in March 2023 and was replaced with a new copier lease which expires in August 2026.

Lease expenses, which are included as a component of occupancy and equipment expense in the statements of comprehensive income, totaled $1.3 million and $2.7 million for the three and six months ended June 30, 2023, respectively. For the three and six months ended June 30, 2022, lease expense totaled $1.2 million and $2.6 million, respectively. Other information related to leases was as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | **2023** | **2022** | **2023** | **2022** |
| Cash paid for amounts included in the measurement of lease liabilities - Operating cash flows for operating leases | **$ 730** | $ 718 | **$ 1,467** | $ 1,436 |

At June 30, 2023, the weighted-average remaining lease term for the building, copier and postage machine leases was 11.54 years and the weighted-average discount rate was 2.42%. At December 31, 2022, the weighted-average remaining lease term for the building, copiers and postage leases was 12.07 years and the weighted-average discount rate was 2.42%. The discount rates were determined using the

Bank's incremental borrowing rate for bonds with terms similar to the lease terms. The following are the undiscounted cash flows for operating leases at June 30, 2023:

| | Maturities of Lease Liabilities |
|---|---|
| Remainder of 2023 | $ 1,463 |
| 2024 | 3,113 |
| 2025 | 3,543 |
| 2026 | 3,582 |
| 2027 | 3,622 |
| Thereafter | 27,463 |
| Total undiscounted cash flows | 42,786 |
| Less interest expense | 2,034 |
| Lease liability | **$ 40,752** |

Lease expense for leases with terms of 12 months or less was $8 thousand and $15 thousand for the three and six months ended June 30, 2023, respectively, compared with $10 thousand and $20 thousand for the three and six months ended June 30, 2022.

## NOTE 5 — COMMITMENTS AND CONTINGENCIES

The Bank is primarily liable for its portion of Systemwide debt obligations. Additionally, the Bank is jointly and severally liable for the consolidated Systemwide bonds and notes of the other System banks. Total consolidated Bank and Systemwide obligations of the System at June 30, 2023 were approximately $396.32 billion.

In the normal course of business, the Bank has various outstanding commitments and contingent liabilities, including the possibility of actions against the Bank in which claims for monetary damages may be asserted. Management and legal counsel are not aware of any other pending lawsuits or actions. Upon the basis of current information, management and legal counsel are of the opinion that the ultimate liability, if any, resulting from lawsuits or other pending actions will not be material in relation to the financial position, results of operations or cash flows of the Bank.

## NOTE 6 — FAIR VALUE MEASUREMENTS

U.S. GAAP defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. See Note 2, "Summary of Significant Accounting Policies" in the 2022 Annual Report for a more complete description.

Assets and liabilities measured at fair value on a recurring basis at June 30, 2023, for each of the fair value hierarchy levels are summarized below:

| | Fair Value Measurement | | | |
|---|---|---|---|---|
| | **Total** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| **Assets:** | | | | |
| Federal funds sold and other overnight funds | **$ 316,755** | $ — | $ 316,755 | $ — |
| Available-for-sale investments | | | | |
| Agency-guaranteed debt | **38,027** | — | 38,027 | — |
| Certificates of deposit | **199,758** | — | 199,758 | — |
| Corporate debt | **202,330** | — | 202,330 | — |
| Mortgage-backed securities | **5,357,033** | — | 5,303,691 | 53,342 |
| U.S. Treasury securities | **874,358** | — | 874,358 | — |
| Asset-backed securities | **186,023** | — | 186,023 | — |
| Other available-for-sale investments | **8,811** | — | — | 8,811 |
| Derivative assets | **(830)** | — | (830) | — |
| Assets held in nonqualified benefit trusts | **1,502** | 1,502 | — | — |
| Total assets | **$ 7,183,767** | $ 1,502 | $ 7,120,112 | $ 62,153 |
| **Liabilities:** | | | | |
| Derivative liabilities | **$ (47,260)** | $ — | $ (47,260) | $ — |
| Letters of credit | **1,256** | — | — | 1,256 |
| Total liabilities | **$ (46,004)** | $ — | $ (47,260) | $ 1,256 |

At June 30, 2023, the Bank had a derivative asset position of $70.4 million and received $71.2 million in cash collateral against that position during the quarter which resulted in a net contra-asset of $830 thousand. At June 30, 2023, the Bank had no derivative liability position and posted $47.3 million of initial margin in cash collateral which resulted in a net contra-liability of $47.3 million.

The table below represents a reconciliation of Level 3 assets and liabilities measured at fair value on a recurring basis for the period from April 1, 2023, to June 30, 2023:

| | Assets | | Liabilities | |
|---|---|---|---|---|
| | **Mortgage-Backed Securities** | **Agricultural Mortgage-Backed Securities** | **Letters of Credit** | **Net** |
| Balance at April 1, 2023 | $ 125,677 | $ 9,414 | $ 2,293 | $ 132,798 |
| Net gains included in other comprehensive income | (453) | 4 | — | (449) |
| Purchases, issuances, (sales) and (settlements) | 53,795 | (607) | (1,037) | 54,225 |
| Transfers out of Level 3 | (125,677) | — | — | (125,677) |
| Balance at June 30, 2023 | **$ 53,342** | **$ 8,811** | **$ 1,256** | **$ 60,897** |
| The amount of gains/losses for the period included in other comprehensive income attributable to the change in unrealized gains or losses relating to assets or liabilities still held at June 30, 2023 | **$ (453)** | **$ 4** | **$ —** | **$ (449)** |

The table below represents a reconciliation of Level 3 assets and liabilities measured at fair value on a recurring basis for the period from January 1, 2023, to June 30, 2023:

| | Assets | | Liabilities | |
|---|---|---|---|---|
| | Mortgage-Backed Securities | Agricultural Mortgage-Backed Securities | Letters of Credit | Net |
| Balance at January 1, 2023 | $ — | $ 10,270 | $ 2,223 | $ 8,047 |
| Net gains included in other comprehensive income | 424 | 192 | — | 616 |
| Purchases, issuances, (sales) and (settlements) | 178,595 | (1,651) | (967) | 177,911 |
| Transfers out of Level 3 | (125,677) | — | — | (125,677) |
| Balance at June 30, 2023 | $ 53,342 | $ 8,811 | $ 1,256 | $ 60,897 |
| The amount of gains/losses for the period included in other comprehensive income attributable to the change in unrealized gains or losses relating to assets or liabilities still held at June 30, 2023 | $ 424 | $ 192 | $ — | $ 616 |

There were transfers of assets out of Level 3 to other levels during the six months ended June 30, 2023. Transfers of MBS from Level 3 to Level 2 were the result of market pricing becoming subsequently available. MBS were included in Level 3 since their valuation was based on Level 3 criteria (broker quotes). AMBS were included in Level 3 due to limited activity or less transparency around inputs to their valuation. The liability for letters of credit were included in Level 3 because the valuation, which is based on fees charged for similar agreements, may not closely correlate to a fair value for instruments not regularly traded in the secondary market.

Assets and liabilities measured at fair value on a nonrecurring basis at June 30, 2023, for each of the fair value hierarchy levels are summarized below:

| | Fair Value Measurements | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| **Assets:** | | | | |
| **Loans** | $ 47,228 | $ — | $ — | $ 47,228 |
| **Total assets** | $ 47,228 | $ — | $ — | $ 47,228 |

Assets and liabilities measured at fair value on a recurring basis at December 31, 2022, for each of the fair value hierarchy levels are summarized below:

| | Fair Value Measurements | | | |
|---|---|---|---|---|
| | **Total** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| Assets: | | | | |
| Federal funds sold and other overnight funds | $ 301,678 | $ — | $ 301,678 | $ — |
| Available-for-sale investments | | | | |
| Certificates of deposit | 199,009 | — | 199,009 | — |
| Agency-guaranteed debt | 53,301 | — | 53,301 | — |
| Corporate debt | 234,778 | — | 234,778 | — |
| Mortgage-backed securities | 5,152,229 | — | 5,152,229 | — |
| U.S. Treasury securities | 818,844 | — | 818,844 | — |
| Asset-backed securities | 186,521 | — | 186,521 | — |
| Other available-for-sale investments | 10,270 | — | — | 10,270 |
| Derivative assets | 2,212 | — | 2,212 | — |
| Assets held in nonqualified benefit trusts | 1,183 | 1,183 | — | — |
| Total assets | $ 6,960,025 | $ 1,183 | $ 6,948,572 | $ 10,270 |
| | | | | |
| Liabilities: | | | | |
| Derivative liabilities | $ (42,749) | $ — | $ (42,749) | $ — |
| Letters of credit | 2,223 | — | — | 2,223 |
| Total liabilities | $ (40,526) | $ — | $ (42,749) | $ 2,223 |

At December 31, 2022, there was no posted variation margin on derivatives. At December 31, 2022, the Bank had a derivative asset position of $64.7 million and received $62.5 million in cash collateral against this position which resulted in a net derivative asset of $2.2 million. At December 31, 2022, the Bank posted $42.7 million of initial margin in cash collateral with no related liability exposure.

The following table represents a reconciliation of Level 3 assets and liabilities measured at fair value on a recurring basis for the period from April 1, 2022, to June 30, 2022:

| | Assets | | Liabilities | |
|---|---|---|---|---|
| | Mortgage-Backed Securities | Agricultural Mortgage- Backed Securities | Letters of Credit | Net |
| Balance at April 1, 2022 | $ 131,910 | $ 12,475 | $ 2,382 | $ 142,003 |
| Net losses included in other comprehensive losses | — | (497) | — | (497) |
| Purchases, issuances (sales) and (settlements) | — | (699) | — | (699) |
| Transfers out of Level 3 | (131,910) | — | — | (131,910) |
| Balance at June 30, 2022 | $ — | $ 11,279 | $ 2,382 | $ 8,897 |
| The amount of gains/losses for the period included in other comprehensive income attributable to the change in unrealized gains or losses relating to assets or liabilities still held at June 30, 2022 | $ — | $ (497) | $ — | $ (497) |

The following table represents a reconciliation of Level 3 assets and liabilities measured at fair value on a recurring basis for the period from January 1, 2022, to June 30, 2022:

| | Assets | | Liabilities | |
|---|---|---|---|---|
| | Mortgage-Backed Securities | Agricultural Mortgage- Backed Securities | Letters of Credit | Net |
| Balance at January 1, 2022 | $ 58,959 | $ 14,209 | $ 3,306 | $ 69,862 |
| Net losses included in other comprehensive losses | (1,910) | (815) | — | (2,725) |
| Purchases, issuances (sales) and (settlements) | 133,820 | (2,115) | (924) | 132,629 |
| Transfers out of Level 3 | (190,869) | — | — | (190,869) |
| Balance at June 30, 2022 | $ — | $ 11,279 | $ 2,382 | $ 8,897 |
| The amount of gains/losses for the period included in other comprehensive income attributable to the change in unrealized gains or losses relating to assets or liabilities still held at June 30, 2022 | $ (1,910) | $ (815) | $ — | $ (2,725) |

There were transfers of assets out of Level 3 to other levels during the three months ended March 31, 2022. Transfers of MBS from Level 3 to Level 2 were the result of market pricing becoming subsequently available. MBS were included in Level 3 since their valuation is based on Level 3 criteria (broker quotes). AMBS were included in Level 3 due to limited activity or less transparency around inputs to their valuation. The liability for letters of credit were included in Level 3 because the valuation, which is based on fees charged for similar agreements, may not closely correlate to a fair value for instruments not regularly traded in the secondary market.

Assets and liabilities measured at fair value on a nonrecurring basis at December 31, 2022, for each of the fair value hierarchy levels are summarized below:

| | Fair Value Measurement | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | | |
| Loans | $ 24,981 | $ — | $ — | $ 24,981 |
| Total assets | $ 24,981 | $ — | $ — | $ 24,981 |

The fair value of financial instruments measured at carrying amounts on the balance sheet for each of the fair value hierarchy values are summarized as follows:

| | **Fair Value Measurement** | | | | |
|---|---|---|---|---|---|
| **June 30, 2023:** | **Total Carrying Amount** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** | **Total Fair Value** |
| **Financial Assets:** | | | | | |
| **Cash** | **$ 194,589** | $ 194,589 | $ — | $ — | $ 194,589 |
| **Net loans** | **29,002,634** | — | — | 27,178,959 | 27,178,959 |
| **Total assets** | **$ 29,197,223** | $ 194,589 | $ — | $ 27,178,959 | $ 27,373,548 |
| **Financial Liabilities:** | | | | | |
| **Systemwide debt securities** | **$ 34,989,690** | $ — | $ — | $ 33,310,998 | $ 33,310,998 |
| **Total liabilities** | **$ 34,989,690** | $ — | $ — | $ 33,310,998 | $ 33,310,998 |

| | **Fair Value Measurement** | | | | |
|---|---|---|---|---|---|
| **December 31, 2022:** | **Total Carrying Amount** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** | **Total Fair Value** |
| Financial Assets: | | | | | |
| Cash | $ 141,487 | $ 141,487 | $ — | $ — | $ 141,487 |
| Net loans | 28,248,516 | — | — | 26,378,160 | 26,378,160 |
| Total assets | $ 28,390,003 | $ 141,487 | $ — | $ 26,378,160 | $ 26,519,647 |
| Financial Liabilities: | | | | | |
| Systemwide debt securities | $ 33,971,742 | $ — | $ — | $ 31,873,887 | $ 31,873,887 |
| Total liabilities | $ 33,971,742 | $ — | $ — | $ 31,873,887 | $ 31,873,887 |

## Valuation Techniques

As more fully discussed in Note 2, “Summary of Significant Accounting Policies” in the 2022 Annual Report, authoritative accounting 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. Fair values of financial instruments represent the estimated amount to be received to sell an asset or paid to transfer or extinguish a liability among willing participants at the reporting date. Due to the uncertainty of expected cash flows resulting from financial instruments, the use of different assumptions and valuation methodologies could significantly affect the estimated fair value amounts. Accordingly, certain of the estimated fair values may not be indicative of the amounts for which the financial instruments could be exchanged in a current or future market transaction.

### *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 vendor pricing, prepayment rates, probability of default and loss severity in the event of default which are inclusive of some uncertainty at the reporting date.

Quoted market prices may not be 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. 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. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

*Information About Recurring and Nonrecurring Level 3 Fair Value Measurements*

| | **Fair Value at** | | | | **Range of Inputs / Weighted Average** | |
|---|---|---|---|---|---|---|
| | **June 30, 2023** | **December 31, 2022** | **Valuation Technique(s)** | **Unobservable Input** | **June 30, 2023** | **December 31, 2022** |
| Other investments | **$ 8,811** | $ 10,270 | Discounted cash flow | Prepayment rates | **3.0% - 32.13% / 9.56%** | 3.0% - 32.13% / 9.56% |
| Mortgage-backed securities | **53,342** | — | Vendor priced | — | **—** | — |

In regard to nonperforming loans and other property owned (OPO), 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 OPO and consider unobservable inputs such as income and expense, comparable sales, replacement cost and comparability adjustments.

*Information about Recurring and Nonrecurring Level 2 Fair Value Measurements*

| | **Valuation Technique(s)** | **Input** |
|---|---|---|
| Federal funds sold | Carrying value | Par/principal |
| Available-for-sale investment securities | Quoted prices<br>Discounted cash flow | Price for similar security<br>Constant prepayment rate<br>Appropriate interest rate yield curve |
| Interest rate caps | Discounted cash flow | Appropriate interest rate yield curve<br>Annualized volatility |
| Interest rate swaps | Discounted cash flow | Benchmark yield curve<br>Counterparty credit risk<br>Volatility |

## NOTE 7 — ASSET/LIABILITY OFFSETTING

Most derivative transactions with swap dealers are cleared through a Futures Commission Merchant (FCM). Cleared derivative contracts are required to be 100% collateralized and the Derivatives Clearing Organization (DCO) takes on the obligation of both sides of the transaction. The Bank's interest rate cap derivatives are under bilateral collateral and netting agreements that require the net settlement of covered contracts.

Notwithstanding collateral and netting provisions, our derivative assets and liabilities are not offset on the accompanying balance sheets. The amount of collateral received or pledged is calculated on a net basis by counterparty.

The following table summarizes overnight investments, derivative assets and liabilities and amounts of collateral exchanged pursuant to our agreements.

| | | Amounts Not Offset on the Balance Sheet | | |
|---|---|---|---|---|
| **June 30, 2023** | **Gross Amounts of Assets/Liabilities Presented on the Balance Sheet** | **Cash Collateral Received/ (Pledged)** | **Investment Securities Received/Pledged as Collateral** | **Net Amount** |
| Assets: | | | | |
| Interest rate swaps and other derivatives | **$ 70,375** | **$ 71,205** | **$ —** | **$ (830)** |
| Federal funds sold and overnight investments | **316,755** | **—** | **—** | **316,755** |
| Liabilities: | | | | |
| Interest rate swaps and other derivatives | **—** | **(47,260)** | **—** | **(47,260)** |
| | | | | |
| **December 31, 2022** | | | | |
| Assets: | | | | |
| Interest rate swaps and other derivatives | $ 64,692 | $ 62,480 | $ — | $ 2,212 |
| Federal funds sold and overnight investments | 301,678 | — | — | 301,678 |
| Liabilities: | | | | |
| Interest rate swaps and other derivatives | — | (42,749) | — | (42,749) |

## NOTE 8 — DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Bank maintains an overall interest rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. The Bank's goal is to manage interest rate sensitivity by modifying the repricing or maturity characteristics of certain balance sheet liabilities so that the net interest margin is not adversely affected by movements in interest rates. The Bank considers the strategic use of derivatives to be a prudent method of managing interest rate sensitivity as it prevents earnings from being exposed to undue risk posed by changes in interest rates.

The Bank may enter into derivative transactions to lower funding costs, diversify sources of funding, alter interest rate exposures arising from mismatches between assets and liabilities, or better manage liquidity. Under interest rate swap arrangements, the Bank agrees with other parties to exchange, at specified intervals, payment streams calculated on a specified notional amount, with at least one stream based on a specified floating-rate index. The Bank may purchase interest rate options, such as caps and floors, in order to manage the impact of changes in interest rates.

At June 30, 2023, the Bank held interest rate caps with a notional amount of $115.0 million and a net fair value asset of $672 thousand, and pay-fixed interest rate swaps with a notional amount of $1.55 billion and a net fair value asset of $69.7 million. At June 30, 2023, there was $830 thousand of excess variation margin on the pay-fixed interest rate swaps. The primary types of derivative instruments used and the activity (notional amount of derivatives) during the six months ended June 30, 2023, are summarized in the following table:

| | Pay-Fixed Swaps | Interest Rate Caps | Total |
|---|---|---|---|
| Balance at January 1, 2023 | $ 1,425,000 | $ 115,000 | $ 1,540,000 |
| Additions | 500,000 | — | 500,000 |
| Maturities/Termination | (375,000) | — | (375,000) |
| Balance at June 30, 2023 | $ 1,550,000 | $ 115,000 | $ 1,665,000 |

To minimize the risk of credit losses, the Bank maintains collateral agreements to limit exposure to agreed-upon thresholds, deals with counterparties that have an investment grade or better credit rating from a major rating agency, and monitors the credit standing and levels of exposure to individual counterparties. The Bank typically enters into master agreements that contain netting provisions. These provisions allow the Bank to require the net settlement of covered contracts with the same counterparty in the event of default by the counterparty on one or more contracts. At June 30, 2023, the Bank had posted $47.3 million of cash as collateral as initial margin as compared to $42.7 million at December 31, 2022. At June 30, 2023, the Bank had a derivative asset value of $70.4 million and received $71.2 million in cash collateral against that position during the quarter from a counterparty. At December 31, 2022, the Bank had a derivative asset value of $64.7 million and received $62.5 million of cash as collateral.

*Derivative – Counterparty Exposure*

The following table represents the credit ratings of counterparties to whom the Bank had credit exposure at June 30, 2023:

| | Remaining Years to Maturity | | | | | |
|---|---|---|---|---|---|---|
| | Less Than One Year to Five Years | More Than Five Years | Total Gains (Losses)* | Exposure | Collateral (Posted) Received** | Exposure Net of Collateral |
| Moody's Credit Rating | | | | | | |
| A3 | $ 22 | $ — | $ 22 | $ 22 | $ — | $ 22 |
| Aa1 | 552 | — | 552 | 552 | — | 552 |
| Aa2 | 97 | — | 97 | 97 | — | 97 |
| Aa3 | 31,793 | 41,389 | 73,182 | 73,182 | 23,945 | 49,237 |
| **Total** | $ 32,464 | $ 41,389 | $ 73,853 | $ 73,853 | $ 23,945 | $ 49,908 |

*Represents gain or loss positions on derivative instruments with individual counterparties. Net gains or losses represent the exposure to credit losses estimated by calculating the cost, on a present value basis, to replace all outstanding derivative contracts within a maturity category. Within each maturity category, contracts in a loss position are netted against contracts in a gain position with the same counterparty.

**Represents the netting of cash collateral posted of and received by counterparties under enforceable netting agreements. At June 30, 2023, the Bank had posted $47.3 million of cash as collateral and received cash collateral of $71.2 million, from a counterparty.

*Fair Value Hedges*

For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative as well as the offsetting loss or gain on the hedged item (principally, debt securities) attributable to the hedge risk are recognized in current earnings. The Bank includes the gain or loss on the hedged items in the same line item (interest expense) as the offsetting loss or gain on the related interest rate swaps. At June 30, 2023 and December 31, 2022, the Bank had no fair value hedged items.

*Cash Flow Hedges*

The Bank clears certain cash flow hedges through a futures commission merchant (FCM), with a clearinghouse or central counterparty (CCP). At June 30, 2023, the Bank had a notional amount of cleared cash flow hedges of $1.55 billion with associated posted initial margin of $47.3 million. At June 30, 2023, the Bank received cash collateral from the counterparty of $71.2 million. At December 31, 2022, the notional amount of cleared cash flow hedges was $1.43 billion, with associated posted initial margin of $42.7 million.

The Bank's derivative instruments at June 30, 2023, and December 31, 2022, which are designated and qualify as a cash flow hedge, met the standards for accounting treatment. Thus, the effective portion of the gain or loss on the derivative was reported as a component of other comprehensive income. In the next 12 months, we expect to reclassify to earnings losses of $226 thousand recorded in accumulated other comprehensive loss (AOCL) as of June 30, 2023. For cash flow hedges with any ineffectiveness, it is recognized as interest expense into current period earnings.

The following table represents the fair value of cash flow derivative instruments, inclusive of posted or received variation margin for cleared activity as of June 30, 2023 and December 31, 2022.

| | | Fair Value at | | | Fair Value at | |
|---|---|---|---|---|---|---|
| | **Balance Sheet Location** | **June 30, 2023** | **December 31, 2022** | **Balance Sheet Location** | **June 30, 2023** | **December 31, 2022** |
| Interest rate caps | Other assets | **$ 672** | $ 878 | Other liabilities | **$ —** | $ — |
| Pay-fixed swaps | Other assets | **(1,502)** | 1,334 | Other liabilities | **—** | — |
| | | **$ (830)** | $ 2,212 | | **$ —** | $ — |

| | (Loss) Gain Recognized in AOCL on Derivatives at June 30, | | | Amount of (Loss) Gain Reclassified from AOCL at June 30, | |
|---|---|---|---|---|---|
| | **2023** | **2022** | | **2023** | **2022** |
| Interest rate caps | **$ (206)** | $ 511 | Interest expense | **$ (95)** | $ (124) |
| Pay-fixed swaps | **7,129** | 71,214 | Other income, net | **1,242** | — |
| | **$ 6,923** | $ 71,725 | | **$ 1,147** | $ (124) |

## NOTE 9 — CAPITAL

The FCA sets minimum regulatory capital requirements, including capital conservation buffers, for banks and associations. These requirements are split into minimum requirements for risk-adjusted ratios and non-risk-adjusted ratios. The risk-adjusted ratios include common equity tier 1, tier 1 capital, total capital and permanent capital ratios. The non-risk-adjusted ratios include tier 1 leverage and unallocated retained earnings (URE) and URE equivalents (UREE) leverage ratios. As of June 30, 2023, the Bank exceeded all regulatory capital requirements, including the capital conservation buffers.

The following table reflects the Bank's capital ratios:

| Risk-adjusted | Regulatory Requirements Including Capital Conservation Buffers | As of June 30, 2023 | As of December 31, 2022 |
|---|---|---|---|
| Common equity tier 1 ratio | 7.00 % | **8.12 %** | 8.66 % |
| Tier 1 capital ratio | 8.50 | **12.73** | 13.42 |
| Total capital ratio | 10.50 | **12.96** | 13.50 |
| Permanent capital ratio | 7.00 | **12.75** | 13.43 |
| | | | |
| Non-risk-adjusted | | | |
| Tier 1 leverage ratio | 5.00 % | **5.61 %** | 5.94 % |
| UREE leverage ratio | 1.50 | **2.11** | 2.50 |

Risk-adjusted assets have been defined by FCA regulations as the balance sheet assets and off-balance sheet commitments adjusted by various percentages, depending on the level of risk inherent in the various types of assets.

If the capital ratios fall below the minimum regulatory requirements, capital distributions (equity redemptions, dividends and patronage) and discretionary bonus payments to senior officers are restricted or prohibited without prior FCA approval.

The components of the Bank's risk-adjusted capital, based on 90-day average balances, were as follows at June 30, 2023:

| **(dollars in thousands)** | **Common Equity Tier 1 Ratio** | **Tier 1 Capital Ratio** | **Total Capital Ratio** | **Permanent Capital Ratio** |
|---|---|---|---|---|
| Numerator: | | | | |
| Unallocated retained earnings | **$ 907,247** | **$ 907,247** | **$ 907,247** | **$ 907,247** |
| Adjustments for patronage or dividend accrued receivables and payables | **4,550** | **4,550** | **4,550** | **4,550** |
| Common Cooperative Equities: | | | | |
| Purchased other required stock ≥7 years | **434,069** | **434,069** | **434,069** | **434,069** |
| Allocated stock ≥7 years | **36,042** | **36,042** | **36,042** | **36,042** |
| Allocated equities: | | | | |
| Allocated equities held ≥7 years | **74,047** | **74,047** | **74,047** | **74,047** |
| Noncumulative perpetual preferred stock | **—** | **750,000** | **750,000** | **750,000** |
| Allowance for loan losses and reserve for losses on unfunded commitments subject to certain limitations | **—** | **—** | **37,660** | **—** |
| Regulatory Adjustments and Deductions: | | | | |
| Amount of allocated investments in other System institutions | **(132,178)** | **(132,178)** | **(132,178)** | **(132,178)** |
| Other regulatory required deductions | **(217)** | **(217)** | **(217)** | **(217)** |
| Total | **$ 1,323,560** | **$ 2,073,560** | **$ 2,111,220** | **$ 2,073,560** |
| Denominator: | | | | |
| Risk-adjusted assets excluding allowance | **$ 16,291,137** | **$ 16,291,137** | **$ 16,291,137** | **$ 16,291,137** |
| Regulatory Adjustments and Deductions: | | | | |
| Allowance for loan losses | **—** | **—** | **—** | **(32,693)** |
| Total | **$ 16,291,137** | **$ 16,291,137** | **$ 16,291,137** | **$ 16,258,444** |

The components of the Bank's risk-adjusted capital, based on 90-day average balances, were as follows at December 31, 2022:

| (dollars in thousands) | Common Equity Tier 1 Ratio | Tier 1 Capital Ratio | Total Capital Ratio | Permanent Capital Ratio |
|---|---|---|---|---|
| Numerator: | | | | |
| Unallocated retained earnings | $ 1,051,848 | $ 1,051,848 | $ 1,051,848 | $ 1,051,848 |
| Less adjustments for patronage or dividend accrued receivables and payables | (5,165) | (5,165) | (5,165) | (5,165) |
| Common Cooperative Equities: | | | | |
| Purchased other required stock ≥7 years | 374,887 | 374,887 | 374,887 | 374,887 |
| Allocated stock ≥7 years | 36,042 | 36,042 | 36,042 | 36,042 |
| Allocated equities: | | | | |
| Allocated equities held ≥7 years | 66,961 | 66,961 | 66,961 | 66,961 |
| Noncumulative perpetual preferred stock | — | 750,000 | 750,000 | 750,000 |
| Allowance for loan losses and reserve for losses on unfunded commitments subject to certain limitations | — | — | 13,110 | — |
| Regulatory Adjustments and Deductions: | | | | |
| Amount of allocated investments in other System institutions | (157,616) | (157,616) | (157,616) | (157,616) |
| Other regulatory required deductions | (217) | (217) | (217) | (217) |
| Total | $ 1,366,740 | $ 2,116,740 | $ 2,129,850 | $ 2,116,740 |
| Denominator: | | | | |
| Risk-adjusted assets excluding allowance | $ 15,778,318 | $ 15,778,318 | $ 15,778,318 | $ 15,778,318 |
| Regulatory Adjustments and Deductions: | | | | |
| Allowance for loan losses | — | — | — | (11,310) |
| Total | $ 15,778,318 | $ 15,778,318 | $ 15,778,318 | $ 15,767,008 |

The components of the Bank's non-risk-adjusted capital, based on 90-day average balances, were as follows at June 30, 2023:

| (dollars in thousands) | | Tier 1 Leverage Ratio | UREE Leverage Ratio |
|---|---|---|---|
| Numerator: | | | |
| Unallocated retained earnings | | **$ 907,247** | **$ 907,247** |
| Adjustments for patronage or dividend accrued receivables and payables | | **4,550** | **4,550** |
| Common Cooperative Equities: | | | |
| Purchased other required stock ≥7 years | | **434,069** | **—** |
| Allocated stock ≥7 years | | **36,042** | **—** |
| Allocated equities: | | | |
| Allocated equities held ≥7 years | | **74,047** | **—** |
| Noncumulative perpetual preferred stock | | **750,000** | **—** |
| Regulatory Adjustments and Deductions: | | | |
| Amount of allocated investments in other System institutions | | **(132,178)** | **(132,178)** |
| Other regulatory required deductions | | **(217)** | **(217)** |
| | Total | **$ 2,073,560** | **$ 779,402** |
| Denominator: | | | |
| Total assets | | **37,087,898** | **37,087,898** |
| Regulatory Adjustments and Deductions: | | | |
| Regulatory deductions included in tier 1 capital | | **(137,534)** | **(137,534)** |
| | Total | **$ 36,950,364** | **$ 36,950,364** |

The components of the Bank's non-risk-adjusted capital, based on 90-day average balances, were as follows at December 31, 2022:

| (dollars in thousands) | | Tier 1 Leverage Ratio | UREE Leverage Ratio |
|---|---|---|---|
| Numerator: | | | |
| Unallocated retained earnings | | $ 1,051,848 | $ 1,051,848 |
| Adjustments for patronage or dividend accrued receivables and payables | | (5,165) | (5,165) |
| Common Cooperative Equities: | | | |
| Purchased other required stock ≥7 years | | 374,887 | — |
| Allocated stock ≥7 years | | 36,042 | — |
| Allocated equities: | | | |
| Allocated equities held ≥7 years | | 66,961 | — |
| Noncumulative perpetual preferred stock | | 750,000 | — |
| Regulatory Adjustments and Deductions: | | | |
| Amount of allocated investments in other System institutions | | (157,616) | (157,616) |
| Other regulatory required deductions | | (217) | (217) |
| | Total | $ 2,116,740 | $ 888,850 |
| Denominator: | | | |
| Total assets | | $ 35,781,758 | $ 35,781,758 |
| Regulatory Adjustments and Deductions: | | | |
| Regulatory deductions included in tier 1 capital | | (168,168) | (168,168) |
| | Total | $ 35,613,590 | $ 35,613,590 |

## NOTE 10 — EMPLOYEE BENEFIT PLANS

In addition to pension benefits, the Bank provides certain health care benefits to qualifying retired employees (other postretirement benefits). These benefits are not characterized as multiemployer and, consequently, the liability for these benefits is included in other liabilities. Bank employees hired after January 1, 2004, may be eligible for retiree medical benefits for themselves and their spouses at their expense and will be responsible for 100% of the related premiums. The following table summarizes the components of net periodic benefit costs for the Bank's other postretirement benefit costs for the six months ended June 30:

| | **2023** | 2022 |
|---|---|---|
| Service cost | **$ 53** | $ 97 |
| Interest cost | **248** | 195 |
| Amortization of: | | |
| Prior service credits | **(40)** | (40) |
| Net actuarial gains | **(75)** | — |
| | **$ 186** | $ 252 |

The components of net periodic benefit cost other than the service cost component are included in other components of net periodic postretirement benefit cost on the Statements of Comprehensive Income.

The structure of the Texas District's defined benefit pension plan is characterized as multiemployer, since neither the assets, liabilities nor cost of any plan is segregated or separately accounted for by participating employers (Bank and District Associations).

## NOTE 11 — ACCUMULATED OTHER COMPREHENSIVE LOSS

AOCL 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 Bank, these elements include unrealized gains or losses on the Bank's available-for-sale (AFS) investment portfolio, amortization of postretirement benefit elements and changes in the value of cash flow derivative instruments.

The following is a summary of the components of AOCL and the changes that occurred during the six months ended June 30, 2023:

| | **Total** | **Unrealized Losses on Investments** | **Postretirement Benefit Plans** | **Cash Flow Derivative Instruments** |
|---|---|---|---|---|
| **Balance at January 1, 2023** | **$ (540,359)** | **$ (606,405)** | **$ 2,146** | **$ 63,900** |
| Change in unrealized losses on AFS securities: | | | | |
| Net decrease in unrealized losses on AFS securities | **(36,511)** | **(36,511)** | | |
| Net change in unrealized losses on AFS securities | **(36,511)** | **(36,511)** | | |
| Change in postretirement benefit plans: | | | | |
| Amounts amortized into net periodic expense: | | | | |
| Amortization of prior service credits and actuarial gains | **(115)** | | **(115)** | |
| Net change in postretirement benefit plans | **(115)** | | **(115)** | |
| Change in cash flow derivative instruments: | | | | |
| Net increase in unrealized gains on cash flow derivative instruments | **6,923** | | | **6,923** |
| Reclassification of net gains recognized in net income | **(1,147)** | | | **(1,147)** |
| Net change in cash flow derivative instruments | **5,776** | | | **5,776** |
| **Total other comprehensive (loss) income** | **(30,850)** | **(36,511)** | **(115)** | **5,776** |
| **Balance at June 30, 2023** | **$ (571,209)** | **$ (642,916)** | **$ 2,031** | **$ 69,676** |

The following is a summary of the components of AOCL and the changes that occurred during the six months ended June 30, 2022:

| | Total | Unrealized Losses on Investments | Postretirement Benefit Plans | Cash Flow Derivative Instruments |
|---|---|---|---|---|
| Balance at January 1, 2022 | $ (96,836) | $ (29,865) | $ (773) | $ (66,198) |
| Change in unrealized gains on AFS securities: | | | | |
| Net increase in unrealized losses on AFS securities | (359,508) | (359,508) | | |
| Net change in unrealized gains on AFS securities | (359,508) | (359,508) | | |
| Change in postretirement benefit plans: | | | | |
| Amounts amortized into net periodic expense: | | | | |
| Amortization of prior service credits | (40) | | (40) | |
| Net change in postretirement benefit plans | (40) | | (40) | |
| Change in cash flow derivative instruments: | | | | |
| Net increase in unrealized gains on cash flow derivative instruments | 71,725 | | | 71,725 |
| Reclassification of losses recognized in interest expense | 124 | | | 124 |
| Net change in cash flow derivative instruments | 71,849 | | | 71,849 |
| Total other comprehensive (loss) income | (287,699) | (359,508) | (40) | 71,849 |
| Balance at June 30, 2022 | $ (384,535) | $ (389,373) | $ (813) | $ 5,651 |

The following table summarizes reclassifications from AOCL to the Statements of Comprehensive Income for the six months ended June 30, 2023, and the same period for 2022:

| | Amount Reclassified from AOCL | | |
|---|---|---|---|
| Component of AOCL | 2023 | 2022 | Location of Losses (Gains) Recognized on the Statements of Comprehensive Income |
| Amortization of net credits on postretirement benefit plan | **$ (115)** | $ (40) | Salaries and employee benefits |
| Reclassification of gain on cash flow hedge unwind | **(1,242)** | — | Other income, net |
| Amortization of cash flow hedges | **95** | 124 | Interest expense |
| Total reclassifications | **$ (1,262)** | $ 84 | |

## NOTE 12 — SUBSEQUENT EVENTS

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

## NOTE 13 — COMBINED DISTRICTWIDE FINANCIAL STATEMENTS

The accompanying financial statements relate solely to the Bank and exclude financial information of the District Associations. The Bank separately publishes certain unaudited combined financial information of the Texas District, including a condensed statement of condition and statement of income, which can be found on the Bank's website at *www.farmcreditbank.com*.

## ADDITIONAL REGULATORY INFORMATION

*(Unaudited)*

### Disclosure Map

The following table summarizes the interim disclosure requirements and indicates where each matter is disclosed in this quarterly report.

| Disclosure Requirement | Description | June 30, 2023 Quarterly Report Reference |
|---|---|---|
| Scope of Application | Corporate entity and structure | Page 54 |
| Capital Structure | Regulatory capital components | Page 55 |
| Capital Adequacy | Risk-weighted assets | Page 56 |
| | Regulatory capital ratios | Page 56 |
| Capital Buffers | Quantitative disclosures | Page 56 |
| Credit Risk | Summary of exposures | Page 57 |
| | Industry distribution | Page 57 |
| | Contractual maturity | Page 57 |
| | Geographic distribution | Page 58 |
| | Nonperforming loans and allowance for credit losses | Note 3 on Pages 28-38 |
| Counterparty Credit Risk-Related Exposures | Counterparty exposures | Page 58 |
| Credit Risk Mitigation | Exposures with reduced capital requirements | Page 58 |
| Securitization | Securitization exposures | Pages 58-59 |
| Equities | General description | Page 59 |
| Interest Rate Risk for Non-Trading Activities | Interest rate sensitivity | Page 59 |

The following disclosures contain regulatory disclosures as required under FCA Regulation Section 628.63 for risk-adjusted ratios: common equity tier 1, tier 1 capital and total capital. Refer to Note 9 of the accompanying financial statements for information regarding the statutorily required permanent capital ratio. As required, these disclosures are made available for at least three years and can be accessed at Farm Credit Bank of Texas' website at *www.farmcreditbank.com*. FCA Regulation Section 628.62(a) requires each System bank to provide timely public disclosures at the end of each calendar quarter. Qualitative disclosures that typically do not change each quarter may be disclosed annually after the end of the fourth calendar quarter, provided that any significant changes are disclosed in the interim.

### Scope of Application

The disclosures herein relate solely to the Bank and exclude financial information of the District Associations. The Bank has no subsidiaries; therefore, the financial statements are only those of the Bank and are not consolidated with any other entity.

## Capital Structure

The following table provides a summary of the Bank's capital structure at June 30, 2023:

| | | 90-Day Average Balance |
|---|---|---|
| **Common equity tier 1 capital (CET1)** | | |
| Common cooperative equities: | | |
| Purchased other required stock ≥7 years | $ | **434,069** |
| Allocated stock ≥7 years | | **36,042** |
| Other required member purchased stock | | — |
| Allocated equities: | | |
| Qualified allocated equities subject to retirement | | **74,047** |
| Nonqualified allocated equities subject to retirement | | — |
| Nonqualified allocated equities not subject to retirement | | — |
| Unallocated retained earnings | | **907,247** |
| Adjustments for patronage or dividend accrued receivables and payables | | **4,550** |
| Paid-in capital | | — |
| Regulatory adjustments and deductions made to CET1 | | **(132,395)** |
| **Total CET1** | **$** | **1,323,560** |
| **Additional tier 1 capital (AT1)** | | |
| Noncumulative perpetual preferred stock | $ | **750,000** |
| Regulatory adjustments and deductions made to AT1 capital | | — |
| **Total AT1 capital** | | **750,000** |
| **Total tier 1 capital** | **$** | **2,073,560** |
| **Tier 2 capital** | | |
| Common cooperative equities not included in CET1 | $ | — |
| Tier 2 capital elements (allowance for loan losses) | | **37,660** |
| Regulatory adjustments and deductions made to tier 2 capital | | — |
| **Total tier 2** | **$** | **37,660** |
| **Total capital** | **$** | **2,111,220** |

## Capital Adequacy and Capital Buffers

The Bank's risk-adjusted regulatory capital ratios are calculated by dividing the relevant total capital elements by risk-weighted assets. The following table provides the Bank's risk-weighted assets at June 30, 2023:

| | | 90-Day Average Balance |
|---|---|---|
| **On-Balance Sheet Assets:** | | |
| Exposures to sovereign entities | $ | — |
| Exposures to supranational entities and Multilateral Development Banks | | — |
| Exposures to government-sponsored entities (direct notes to District Associations) | | **4,005,848** |
| Exposures to depository institutions, foreign banks and credit unions | | **1,006** |
| Exposures to public sector entities | | — |
| Corporate exposures, including borrower loans and exposures to other financing institutions | | **8,954,685** |
| Residential mortgage exposures | | — |
| Past due and nonaccrual exposures | | **107,696** |
| Securitization exposures | | **126,090** |
| Exposures to other assets | | **857,815** |
| Total Risk-Weighted Assets, On-Balance Sheet Assets | | **14,053,140** |
| **Off-Balance Sheet Assets:** | | |
| Letters of Credit | | **103,938** |
| Commitments | | **2,116,867** |
| Repo-styled transactions | | **69** |
| Over-the-counter derivatives | | **13,305** |
| Unsettled transactions | | — |
| Cleared transactions | | — |
| All other off-balance sheet exposures | | **3,818** |
| Total Risk-Weighted Assets, Off-Balance Sheet Assets | | **2,237,997** |
| **Total Risk-Weighted Assets Before Adjustments** | | **16,291,137** |
| Additions: | | |
| Intra-system equity investments | | **132,395** |
| Deductions: | | |
| Regulatory capital deductions | | **(132,395)** |
| **Total Standardized Risk-Weighted Assets** | **$** | **16,291,137** |

## Capital and Leverage Ratios

As of June 30, 2023, the Bank was well-capitalized and exceeded all capital requirements. The Bank's excess leverage of 0.61% is equal to the tier 1 leverage ratio minus the minimum tier 1 leverage ratio requirement. Because the Bank's capital and leverage ratios exceeded the minimum regulatory requirements of 10.50% and 5.00%, respectively, the Bank currently has no limitations on its distributions and discretionary bonus payments.

| | Regulatory Minimums | Capital Conservation Buffers | Ratios as of June 30, 2023 | Calculated Buffers |
|---|---|---|---|---|
| Common equity tier 1 capital ratio | 4.50 % | 2.50 % | **8.12 %** | 3.62 % |
| Tier 1 capital ratio | 6.00 | 2.50 | **12.73** | 6.73 |
| Total capital ratio | 8.00 | 2.50 | **12.96** | 4.96 |
| Tier 1 leverage ratio | 4.00 | 1.00 | **5.61** | 1.61 |

## Credit Risk

System entities have specific lending authorities within their chartered territories. The Bank is chartered to serve the District Associations which are located in Texas, Alabama, Mississippi, Louisiana and most of New Mexico. Our chartered territory is referred to as the Texas District. The Bank serves its chartered territory by lending to the Federal Land Credit Association (FLCA) and Agricultural Credit Associations (ACAs). The allowance for loan losses is determined based on a periodic evaluation of the loan portfolio, which identifies loans that may be impaired based on characteristics such as probability of default (PD) and loss given default (LGD). Allowance needs by geographic region are only considered in circumstances that may not otherwise be reflected in the PD and LGD, such as flooding or drought. There was no allowance attributed to a geographic area as of June 30, 2023.

Refer to the Risk-Adjusted Asset table below for the Bank's total loans, investment securities, off-balance sheet commitments and over-the-counter (OTC) derivatives. The following table illustrates the Bank's total loan exposure (including commitments) by loan type at June 30, 2023.

| | Total Exposure |
|---|---|
| Direct notes receivable from District Associations | $ **26,124,737** |
| Real estate mortgage | **1,242,676** |
| Production and intermediate-term | **1,545,668** |
| Agribusiness | |
| Loans to cooperatives | **1,149,486** |
| Processing and marketing | **4,870,201** |
| Farm-related business | **448,347** |
| Communications | **903,388** |
| Energy (rural utilities) | **2,390,723** |
| Water and waste disposal | **338,656** |
| Mission-related | **2,082** |
| Rural residential real estate | **3,109** |
| International | **354,921** |
| Leases | **5,006** |
| Loans to other financing institutions | **69,509** |
| Total | $ **39,448,509** |

The following table provides an overview of the remaining contractual maturity of the Bank's credit risk portfolio categorized by exposure at June 30, 2023. The remaining contractual maturity for the Bank's direct notes from the District Associations is included in the loans line item based on the contractual terms of the underlying association retail loans. Unfunded commitments for direct notes from District Associations reflects the aggregate remaining amount that the District Associations can borrow from the Bank and is included in the unfunded commitments line item within the due in one year or less column.

| (dollars in thousands) | Due in one year or less | Due after one year through five years | Due after five years | Total |
|---|---|---|---|---|
| Loans | $ **4,721,470** | $ **9,067,017** | $ **15,256,631** | $ **29,045,118** |
| Off-balance sheet commitments | | | | |
| Financial letters of credit | **44,248** | **49,702** | **241** | **94,191** |
| Performance letters of credit | **7,933** | **6,758** | **—** | **14,691** |
| Commercial letters of credit | **1,354** | **3,062** | **—** | **4,416** |
| Unfunded commitments | **7,305,313** | **2,800,309** | **184,471** | **10,290,093** |
| Investments | **785,635** | **883,416** | **5,197,289** | **6,866,340** |
| Derivatives (notional) | **150,000** | **765,000** | **750,000** | **1,665,000** |
| Total | $ **13,015,953** | $ **13,575,264** | $ **21,388,632** | $ **47,979,849** |

The following table illustrates the Bank's total exposure (including commitments) by geographic distribution based on the headquarters location of the underlying retail loans for the Bank and District Associations at June 30, 2023:

| State** | Percentage |
|---|---|
| Texas | **48 %** |
| Alabama | **5** |
| Mississippi | **5** |
| Louisiana | **4** |
| California | **4** |
| All other states | **34** |
| | **100 %** |

**The geographic distribution is based on the state in which the borrower is headquartered and may not be representative of their operations or business activities.

Refer to Note 3 of the accompanying financial statements for amounts of loans in nonaccrual status, the allowance at the end of each reporting period, charge-offs during the period, and changes in components of our allowance for credit losses.

### Counterparty Credit Risk and Credit Risk Mitigation

The table below shows derivatives by underlying exposure type, segregated among interest rate caps, pay-fixed swaps and receive-fixed swaps, which were traded in OTC markets at June 30, 2023.

| | Notional | Fair Values |
|---|---|---|
| Interest rate caps | **$ 115,000** | **$ 672** |
| Pay-fixed swaps | **1,550,000** | **(1,502)** |
| Total Derivatives | **$ 1,665,000** | **$ (830)** |

The following table provides the total exposure covered by guarantees/credit derivatives for each separately disclosed credit risk portfolio and the risk-weighted asset amount associated with that exposure. The Bank did not hold eligible financial collateral for its loan, investment and derivative portfolios at June 30, 2023.

| Government Guaranteed Asset Type (dollars in thousands) | 90-Day Average Balance | Risk Weighting | Risk-Weighted Amount |
|---|---|---|---|
| Investments | **$ 5,371,074** | **0%** | **$ —** |
| Loans | **2,037** | **0%** | **—** |
| Total | **$ 5,373,111** | | **$ —** |

### Securitization

The Bank currently only participates in credit-related securitizations as investors through the purchase of ABS as included in its investment portfolio. The Bank also holds securitization exposures through the purchase of U.S. government and agency-guaranteed securities. The Bank did not transfer any exposures that it had originated or purchased from a third party in connection with a securitization of assets as of June 30, 2023, nor did it have any outstanding exposures that it intended to be securitized at June 30, 2023. The Bank did not retain any credit-related re-securitization exposures at June 30, 2023.

Below is an overview of our purchased securitization exposures held at June 30, 2023, by exposure type and categorized by risk-weighting band and risk-based capital approach. At June 30, 2023, the Bank did not hold any off-balance sheet securitization exposures nor were any securitization exposures deducted from capital.

| Description of Securitization | Risk-Based Capital Approach | Exposure Amount (dollars in thousands) | Risk Weighting |
|---|---|---|---|
| Agency MBS: | | | |
| GNMA | Standardized risk weighting | $ 3,286,582 | 0% |
| FNMA and FHLMC | Standardized risk weighting | 2,685,575 | 0%-20% |
| Total agency MBS | | $ 5,972,157 | |
| ABS: | | | |
| Small Business Administration | Standardized risk weighting | $ 72,277 | 0% |
| ABS | Gross-up | 131,609 | 20%-100% |
| Total ABS | | $ 203,886 | |

## Equities

The Bank is a limited partner in certain Rural Business Investment Companies (RBICs) for various relationship and strategic reasons. These RBICs facilitate equity and debt investments in agriculture-related businesses that create growth and job opportunities in rural America. These investments are accounted for under the equity method, as the Bank is considered to have significant influence. These investments are not publicly traded, and the book value approximates fair value. The Bank had no unrealized gains or losses either carried on the balance sheet or recognized through earnings.

| As of June 30, 2023 | Disclosed in Other Assets | Life-to-Date (Losses) Recognized in Retained Earnings* |
|---|---|---|
| RBICs | $ 25,051 | $ (4,489) |

*Retained earnings is included in common equity tier 1 and total capital ratios.

## Interest Rate Risk

The following table sets forth the Bank's projected annual net interest income and market value of equity for interest rate movements as prescribed by policy, based on the Bank's interest-earning assets and interest-bearing liabilities at June 30, 2023:

| Basis points: | -200 | -100 | +100 | +200 |
|---|---|---|---|---|
| Change in net interest income | -3.74% | -2.45% | 2.49% | 4.51% |
| Change in market value of equity | 19.23% | 8.81% | -7.19% | -12.98% |