




# TEXAS FARM CREDIT



## 2019 ANNUAL REPORT

December 31, 2019

# WORKING HARD TO HELP OUR **CUSTOMERS GROW**



*“I wouldn’t be able to farm without Texas Farm Credit. The entire team rallied around me. They opened the door for me to build my own business.”*

## **BLAKE BICKHAM**

**B**lake Bickham graduated from Texas Tech University in 2018, prepared to become a teacher. Instead of teaching, she decided to start her own ag operation on her family’s farm in South Texas.

Assisting young, beginning and small farmers is one way Texas Farm Credit carries out its mission to support agriculture and rural communities. As Bickham navigates her career, her lender — Texas Farm Credit — will be with her every step of the way.

“I wouldn’t be able to farm without Texas Farm Credit,” Bickham says. “The entire team rallied around me. They opened the door for me to build my own business.”

To help her get started, Blake’s dad made her an offer like the one his dad made him. Blake could lease the same 300 acres that her father started farming in the 1980s.

For her first crop, she planted 50/50 cotton and grain sorghum.

“It’s challenging and exciting to be my own boss,” the fourth-generation farmer says. “I can’t wait to see what the future holds.”

At Texas Farm Credit, we enjoy nothing more than helping our member-borrowers succeed. Whether they are expanding their own operations, improving their leadership skills or helping to grow their local economies, these three customers caught our eye in 2019.



**TOMMY HANKA**

**T**ommy Hanka grows 500 acres of bok choy and napa cabbage on his farm in Edinburg, Texas. Even while meeting the growing demand for Asian vegetables, crop diversification is a priority.

Hanka farms another 1,000 acres, including 200 acres of short-day onions. He also grows cotton, corn and sorghum and owns a sod farm that provides steady income.

"Veggies are my main crop," he says. "I keep the commodity crops for rotation and to keep my key tractor drivers and irrigators busy year-round," Hanka says.

Billy Best, Texas Farm Credit branch manager, says Hanka is one of the most diverse operators he's worked with in his Farm Credit career.

"While working toward long-term goals," says Best, "he is mitigating risk through a wide range of income streams ranging from vegetables, sod and cotton production to custom harvesting."

Hanka has found a reliable partner in Texas Farm Credit.

"Texas Farm Credit has really helped me out," Hanka said. "I can't say enough good things about them. They are pleasant, competent, and they look out for you."



**CRAIN AND ASHLEY ZDANSKY**

**C**rain and Ashley Zdansky of Raymondville, Texas, represented Texas Farm Credit at the annual Farm Credit Young Leaders Program in Washington, D.C. and New York City. The four-day program teaches young farmers and ranchers about the Farm Credit System, the legislative process and the nation's financial markets.

In Washington, D.C., the couple joined over 700 other Farm Credit borrowers and directors at a meeting with U.S. Agriculture Secretary Sonny Perdue. They discussed policy issues with U.S. Sens. Ted Cruz and John Cornyn, and U.S. Rep. Filemon Vela.

Next, the Zdanskys visited the Federal Farm Credit Banks Funding Corporation in New Jersey. The funding corporation buys and sells the notes and bonds that fund Farm Credit lending cooperatives.

Reflecting on the program, Ashley wants other farmers to know about the value of Farm Credit.

"It's important to extend what we know to other young farmers, especially about the Farm Credit System and how they contribute to, not just our success, but the success of all rural America," Ashley says.

The Zdanskys grow sorghum, cotton, sesame and sugarcane on their farms in South Texas.



Dear Stockholders,

Texas Farm Credit is a story of progress – year after year. In 2019, we generated strong earnings, opened new offices and continued to accelerate our investment in borrower-focused services and technology. And while we expanded our operations, we continued to focus on efficiency, diversification and responsible fiscal management in order to add value for our customers.

Texas Farm Credit marked another year of solid financial performance. In 2019, we exceeded the financial projections in our business plan by more than \$1 million. Our net income of \$29.1 million was one of the highest on record. Total loan volume grew by 7%. Credit quality remained strong, with 98.2% percent of loans classified as acceptable or special mention.

In short, the association increased its revenues, but held overhead constant. When Texas Farm Credit does well financially, our members benefit. That’s an important reason for doing business with a customer-owned lending cooperative. Strong performance allows us to return more to you in the form of patronage payments.

We are pleased that 2019 was the 21st consecutive year we returned cash to customers and the ninth consecutive year we returned allocated surplus.

The association declared its largest patronage to date, returning \$27.7 million of 2018 net earnings to stockholders last spring. Of this amount, we distributed \$11.5 million as cash – the largest cash distribution to date. Later in the year, we distributed an additional \$6.3 million to customers. This distribution represents surplus earnings that were allocated to borrowers in 2012 for future payment and retained as capital to fund growth.

While 2019 was a great year for many of our producers, low commodity prices remained a challenge for some farmers. As an experienced rural lender, Texas Farm Credit understands the cyclical nature of agriculture. To help, we implemented additional training for staff on how to identify and work with distressed borrowers to find the best financing solutions.

Texas Farm Credit’s strong performance in 2019 is largely the result of our commitment to our owners. By focusing on meeting your production credit, insurance and mortgage financing needs, we were able to:

**Deliver the best customer experiences.** We invested in innovations to improve the customer experience both in person and online. Customers can expect the same great level of service no matter how they interact with us.

**Improve operating efficiencies.** We expanded new technologies and enhanced our employee training and development program to deliver improved services in a more efficient and effective way.

**Offer greater access to Texas Farm Credit services.** We understand the importance convenience plays in doing business. So, we expanded by building a new office in Brenham and opening a branch in Laredo.

**Grow our related services programs.** We expanded and enhanced our crop and pasture insurance programs and home loan services in order to provide greater resources to our customers.

As we embark on 2020, we will continue to prioritize our mission of supporting rural communities and agriculture with reliable, consistent credit and financial services.

Thank you for your business, and best wishes for a prosperous year ahead.

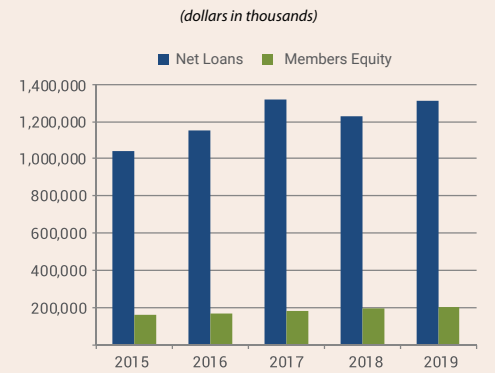
Sincerely,

/s/ Mark Miller

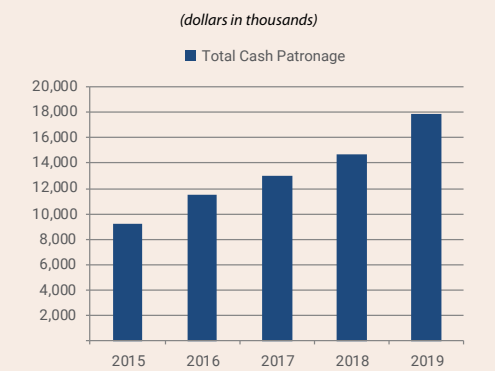
Mark Miller  
Chief Executive Officer

## FINANCIAL HIGHLIGHTS

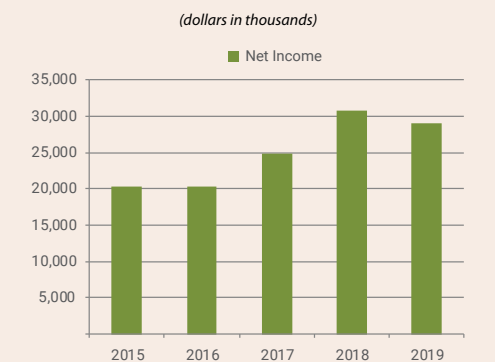
### END-OF-YEAR NET LOANS AND MEMBERS' EQUITY



### CASH PATRONAGE PAYMENTS



### NET INCOME



### END-OF-YEAR CREDIT QUALITY



## Table of Contents

Report of Management .....	2
Report on Internal Control Over Financial Reporting.....	3
Report of Audit Committee .....	4
Five-Year Summary of Selected Consolidated Financial Data .....	5
Management’s Discussion and Analysis of Financial Condition and Results of Operations (Unaudited).....	7
Report of Independent Auditors .....	17
Consolidated Financial Statements.....	18
Notes to Consolidated Financial Statements .....	23
Disclosure Information and Index (Unaudited).....	56

## REPORT OF MANAGEMENT

The consolidated financial statements of Texas Farm Credit Services (Association) are prepared by management, who is responsible for the statements' integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. Other financial information included in the annual report is consistent with that in the consolidated financial statements.

To meet its responsibility for reliable financial information, management depends on the Farm Credit Bank of Texas' and the Association's accounting and internal control systems, which have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded and transactions are properly authorized and recorded. The systems have been designed to recognize that the cost of controls must be related to the benefits derived. The consolidated financial statements are audited by PricewaterhouseCoopers LLP, independent accountants, who also conduct a review of internal controls to the extent necessary to comply with auditing standards solely for the purpose of establishing a basis for reliance thereon in determining the nature, extent and timing of audit tests applied in the audit of the consolidated financial statements in accordance with auditing standards generally accepted in the United States of America. The Association is also examined by the Farm Credit Administration.

The board of directors has overall responsibility for the Association's systems of internal control and financial reporting. The board consults regularly with management and reviews the results of the audits and examinations referred to previously.

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

/s/ Mark Miller

Mark Miller, Chief Executive Officer

*March 9, 2020*

/s/ James R. Dawley

James R. Dawley, Chairman, Board of Directors

*March 9, 2020*

/s/ Keith A. Ibrom

Keith A. Ibrom, Chief Financial Officer

*March 9, 2020*

## REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Association’s chief executive officer and chief financial officer, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association’s consolidated financial statements. For purposes of this report, “internal control over financial reporting” is defined as a process designed by, or under the supervision of, the Association’s principal executives and principal financial officers, or persons performing similar functions, and effected by its boards of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting information and the preparation of the consolidated financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America 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 Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Association’s assets that could have a material effect on its consolidated financial statements.

The Association’s management has completed an assessment of the effectiveness of internal control over financial reporting as of December 31, 2019. In making the assessment, management used the framework in Internal Control—Integrated Framework, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the “COSO” criteria.

Based on the assessment performed, the Association concluded that as of December 31, 2019, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of December 31, 2019. A review of the assessment performed was reported to the Association’s audit committee.

/s/ Mark Miller

/s/ Keith A. Ibrom

Mark Miller, Chief Executive Officer

Keith A. Ibrom, Chief Financial Officer

*March 9, 2020*

*March 9, 2020*

## REPORT OF AUDIT COMMITTEE

The audit committee (committee) is composed of eight members of the board of directors of Texas Farm Credit Services. In 2019, four committee meetings were held. The committee oversees the scope of Texas Farm Credit Services' system of internal controls and procedures, and the adequacy of management's action with respect to recommendations arising from those auditing activities. The committee's approved responsibilities are described more fully in the Audit Committee Charter, which is available on request or on Texas Farm Credit Services' website. The committee approved the appointment of PricewaterhouseCoopers LLP for 2019.

Management is responsible for Texas Farm Credit Services' internal controls and the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. The consolidated financial statements are prepared under the oversight of the committee. PricewaterhouseCoopers LLP is responsible for performing an independent audit of Texas Farm Credit Services' consolidated financial statements in accordance with auditing standards generally accepted in the United States of America and for issuing a report thereon. The committee's responsibilities include monitoring and overseeing these processes.

In this context, the committee reviewed and discussed Texas Farm Credit Services' audited consolidated financial statements for the year ended December 31, 2019 (audited consolidated financial statements) with management and PricewaterhouseCoopers LLP. The committee also reviews with PricewaterhouseCoopers LLP the matters required to be discussed by authoritative guidance "The Auditor's Communication With Those Charged With Governance," and both PricewaterhouseCoopers LLP's and Texas Farm Credit Services' internal auditors directly provide reports on significant matters to the committee.

The committee discussed with PricewaterhouseCoopers LLP its independence from Texas Farm Credit Services. The committee also reviewed the nonaudit services provided by PricewaterhouseCoopers LLP and concluded that these services were not incompatible with maintaining the independent accountant's independence. The committee has discussed with management and PricewaterhouseCoopers LLP such other matters and received such assurances from them as the committee deemed appropriate.

Based on the foregoing review and discussions and relying thereon, the committee recommended that the board of directors include the audited consolidated financial statements in Texas Farm Credit Services' Annual Report to Stockholders for the year ended December 31, 2019.

### Audit Committee Members

Gregory T. Richbourg, Audit Committee Chairman  
Marion Vines Durand, Audit Committee Vice Chairwoman  
Jerry Chappell, Audit Committee Member  
James R. Dawley, Audit Committee Member  
David Henneke, Audit Committee Member  
Bobby Hobson, Audit Committee Member  
John Prukop, Audit Committee Member  
Mark Reus, Audit Committee Member

*March 9, 2020*



**TEXAS FARM CREDIT SERVICES**

**FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA**  
(unaudited)  
(dollars in thousands)

	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b><u>Balance Sheet Data</u></b>					
<u>Assets</u>					
Cash	\$ 7,188	\$ 5,082	\$ 4,852	\$ 6,024	\$ 851
Investments	2,661	3,060	3,610	4,498	5,230
Loans	1,314,083	1,227,197	1,316,909	1,150,515	1,039,169
Less: allowance for loan losses	4,324	2,996	3,526	3,686	2,819
Net loans	<u>1,309,759</u>	<u>1,224,201</u>	<u>1,313,383</u>	<u>1,146,829</u>	<u>1,036,350</u>
Investment in and receivable from the Farm Credit Bank of Texas	23,197	23,228	22,570	19,514	17,721
Other property owned, net	3,101	-	26	90	105
Other assets	30,007	26,332	24,693	22,192	19,344
Total assets	<u>\$ 1,375,913</u>	<u>\$ 1,281,903</u>	<u>\$ 1,369,134</u>	<u>\$ 1,199,147</u>	<u>\$ 1,079,601</u>
<u>Liabilities</u>					
Obligations with maturities of one year or less	\$ 27,700	\$ 24,058	\$ 29,296	\$ 24,250	\$ 22,551
Obligations with maturities greater than one year	1,143,305	1,061,991	1,158,538	1,004,141	894,083
Total liabilities	<u>1,171,005</u>	<u>1,086,049</u>	<u>1,187,834</u>	<u>1,028,391</u>	<u>916,634</u>
<u>Members' Equity</u>					
Capital stock and participation certificates	3,791	4,100	4,013	3,729	3,535
Additional paid-in capital	47,596	47,596	47,596	47,596	47,596
Allocated retained earnings	56,437	54,987	46,040	44,799	8,600
Unallocated retained earnings	97,794	89,370	84,440	75,018	103,722
Accumulated other comprehensive loss	(710)	(199)	(789)	(386)	(486)
Total members' equity	<u>204,908</u>	<u>195,854</u>	<u>181,300</u>	<u>170,756</u>	<u>162,967</u>
Total liabilities and members' equity	<u>\$ 1,375,913</u>	<u>\$ 1,281,903</u>	<u>\$ 1,369,134</u>	<u>\$ 1,199,147</u>	<u>\$ 1,079,601</u>
<b><u>Statement of Income Data</u></b>					
Net interest income	\$ 36,935	\$ 36,390	\$ 36,658	\$ 32,177	\$ 29,820
(Provision for loan losses) or loan loss reversal	(2,135)	1,025	(752)	(603)	(807)
Income from the Farm Credit Bank of Texas	11,149	8,463	5,530	5,145	5,032
Other noninterest income	6,928	8,606	5,214	3,520	4,238
Noninterest expense	(23,797)	(23,296)	(21,300)	(19,867)	(18,291)
(Provision for) benefit from income taxes	-	(432)	(521)	(15)	358
Net income	<u>\$ 29,080</u>	<u>\$ 30,756</u>	<u>\$ 24,829</u>	<u>\$ 20,357</u>	<u>\$ 20,350</u>
<b><u>Key Financial Ratios for the Year</u></b>					
Return on average assets	2.2%	2.3%	1.9%	1.8%	2.0%
Return on average members' equity	13.9%	15.7%	13.6%	11.8%	12.5%
Net interest income as a percentage of average earning assets	2.9%	2.8%	2.9%	2.9%	3.0%
Net charge-offs (recoveries) as a percentage of average loans	0.0%	0.0%	0.1%	0.0%	-0.1%

**TEXAS FARM CREDIT SERVICES**

**FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA  
(unaudited)  
(dollars in thousands)**

	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b><u>Key Financial Ratios at Year End *</u></b>					
Members' equity as a percentage of total assets	<b>14.9%</b>	15.3%	13.2%	14.2%	15.1%
Debt as a percentage of members' equity	<b>571.5%</b>	554.5%	655.2%	602.3%	562.5%
Allowance for loan losses as a percentage of loans	<b>0.3%</b>	0.2%	0.3%	0.3%	0.3%
Common equity tier 1 ratio	<b>14.2%</b>	14.8%	13.2%	n/a	n/a
Tier 1 capital ratio	<b>14.2%</b>	14.8%	13.2%	n/a	n/a
Total capital ratio	<b>14.5%</b>	15.1%	13.5%	n/a	n/a
Permanent capital ratio	<b>14.2%</b>	14.9%	13.2%	14.9%	16.1%
Tier 1 leverage ratio	<b>14.0%</b>	14.6%	12.7%	n/a	n/a
UREE leverage ratio	<b>10.6%</b>	10.6%	9.2%	n/a	n/a
<b><u>Net Income Distribution</u></b>					
Patronage dividends:					
Cash	\$ <b>17,866</b>	\$ 14,655	\$ 12,989	\$ 11,534	\$ 9,231
Allocated retained earnings	<b>7,750</b>	6,924	6,121	4,910	1,298

\*Effective January 1, 2017 the new regulatory capital ratios were implemented by the Association. The Association's ratios remained well above the regulatory minimums, including the conservation and leverage buffers at December 31, 2019. For more information, see Note 11 in the accompanying consolidated financial statements, "Members' Equity" included in this annual report.

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS  
(Unaudited)**

The following commentary explains management's assessment of the principal aspects of the consolidated financial condition and results of operations of Texas Farm Credit Services, including its wholly-owned subsidiaries, Texas Farm Credit Services, PCA and Texas Farm Credit Services, FLCA (Association) for the years ended December 31, 2019, 2018 and 2017, and should be read in conjunction with the accompanying consolidated financial statements. The accompanying financial statements were prepared under the oversight of the Association's audit committee.

**Forward-Looking Information:**

This annual information statement contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Words such as "anticipates," "believes," "could," "estimates," "may," "should," "will" or other variations of these terms are intended to identify the forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions and expected future developments. However, actual results and developments may differ materially from our expectations and predictions due to a number of risks and uncertainties, many of which are beyond our control. These risks and uncertainties include, but are not limited to:

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international and farm-related business sectors;
- weather-related, disease-related and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry and the System as a government-sponsored enterprise, as well as investor and rating agency reactions to events involving the U.S. government and government-sponsored enterprises; and
- actions taken by the Federal Reserve System in implementing monetary policy.

**Commodity Review and Outlook:**

For years, producers have faced challenges unique to the agricultural market. Unpredictable weather, fluctuating commodity prices and compressed profit margins are just a few of the challenges present in today's agricultural market. As an experienced rural lender, Texas Farm Credit Services understands the cyclical nature of agriculture. Texas Farm Credit Services is committed to our owners. The Association is focused on meeting our owner's production credit requirements, insurance demands and mortgage financing needs. Texas Farm Credit Services remains committed to our mission of supporting rural communities and agriculture with reliable, consistent credit and financial services.

**Significant Events:**

In 2019, one of the Association's board of directors rendered his retirement notice based on personal reasons. The board appointed a regional replacement director to serve the remainder of the term for the unplanned retirement. Three board members rendered their retirement notices in 2018. Two members were scheduled for retirement as part of a board-approved restructuring plan. The third board member rendered his retirement notice based on personal reasons. The board appointed a regional replacement director to serve the remainder of the term for the unplanned retirement. All of the retiring board members had long tenures with the Association ranging from 19 years to over 36 years of service on the Association's board of directors.

Effective February 15, 2018, the Association entered into a Non-Capitalization Participation Pool (NCP) agreement with the Farm Credit Bank of Texas (Bank) in which the Bank purchased a pool of loans in the amount of \$98,651,561 from the Association. Effective October 15, 2018, the NCP agreement with the Bank was amended to facilitate the Bank's purchase of an additional pool of loans in the amount of \$99,631,162. The NCP agreement requires the Association to service the loans in return for a patronage from the Bank equal to what the Association would have earned were the loans on its books, less a fee. The benefit of the NCP agreement to the Association is a low-cost improvement to its capital position.

**Patronage Refunds Received from FCBT:**

In December 2019, the Association received a direct loan patronage of \$5,408,214 from the Bank, representing 48 basis points on the average daily balance of the Association's direct loan with the Bank. The Association received a \$4,494,711 patronage based

on its Capitalized and Non-Capitalized Participation Pool agreements with the Bank. During 2019, the Association received \$701,321 in patronage payments from the Bank, based on the Association's stock investment in the Bank. Also, the Association received a capital markets patronage of \$544,313 from the Bank, representing 75 basis points on the Association's average balance of participations in the Bank's patronage pool program.

#### Patronage Refunds by Association:

In April 2019, Texas Farm Credit Services declared a \$27,716,880 patronage for all members who had outstanding accrual loans with the Association during fiscal year 2018. The Association patronage paid members \$11,566,880 in cash, \$7,400,000 in redeemable allocated surplus eligible for future cash distribution and \$8,750,000 in Association retained allocated surplus. In December 2019, the Association distributed \$6,298,009 in cash patronage from redeemable allocated surplus originally declared in 2012.

For more than 85 years, the Association has continued to provide its members with quality financial services. The board of directors and management remain committed to maintaining the financial integrity of the Association while offering competitive loan products that meet the financial needs of agricultural producers.

#### Loan Portfolio:

The Association makes and services loans to farmers, ranchers, rural homeowners and certain farm-related businesses. The Association's loan volume consists of long-term farm mortgage loans, production and intermediate-term loans, and farm-related business loans. These loan products are available to eligible borrowers with competitive variable, fixed, adjustable, LIBOR-based and prime-based interest rates. Loan maturities range from one to 30 years, with annual operating loans comprising the majority of the commercial loans and 15- to 30-year maturities comprising the majority of the mortgage loans. Loans serviced by the Association offer several installment payment cycles, the timing of which usually coincides with the seasonal cash-flow capabilities of the borrower.

The composition of the Association's loan portfolio, including principal less funds held totaling \$1,314,083,263, \$1,227,196,988 and \$1,316,909,540 as of December 31, 2019, 2018 and 2017, respectively, is described more fully in detailed tables in Note 4 to the consolidated financial statements, "Loans and Allowance for Loan Losses" included in this annual report.

At December 31, 2019, the Association held loans totaling \$802,600 extended under the Rural America Bond Program approved by the FCA. The program is designed to meet the growing and changing needs of agricultural enterprises, agribusinesses and rural communities by providing investment in rural areas.

#### Purchase and Sales of Loans:

During 2019, 2018 and 2017, the Association was participating in loans with other lenders. As of December 31, 2019, 2018 and 2017, these participations totaled \$116,615,682, \$103,240,529 and \$114,127,104, or 8.9 percent, 8.4 percent and 8.7 percent of loans, respectively. Included in these amounts are participations purchased from entities outside the District of \$19,136,746, \$15,873,365 and \$15,368,777, or 1.5 percent, 1.3 percent and 1.2 percent of loans, respectively. The Association has also sold participations of \$242,048,435, \$219,680,076 and \$13,379,928 as of December 31, 2019, 2018 and 2017, respectively.

#### Risk Exposure:

High-risk assets include nonaccrual loans, loans that are past due 90 days or more and still accruing interest, formally restructured loans and other property owned, net.

The following table illustrates the Association's components and trends of high-risk assets serviced for the prior three years as of December 31:

	2019		2018		2017	
	Amount	%	Amount	%	Amount	%
Nonaccrual	\$ 8,349,534	68.1%	\$ 9,611,745	77.8%	\$ 6,915,545	85.2%
90 days past due and still accruing interest	5	0.0%	633,586	5.1%	26,980	0.3%
Formally restructured	810,911	6.6%	2,113,522	17.1%	1,149,794	14.2%
Other property owned, net	3,101,394	25.3%	-	0.0%	25,786	0.3%
Total	<u>\$ 12,261,844</u>	<u>100.0%</u>	<u>\$ 12,358,853</u>	<u>100.0%</u>	<u>\$ 8,118,105</u>	<u>100.0%</u>

At December 31, 2019, 2018 and 2017, loans that were considered impaired were \$9,160,450, \$12,358,853 and \$8,092,319, representing 0.7 percent, 1.0 percent and 0.6 percent of loan volume, respectively. Impaired loans consist of all high-risk assets, except other property owned, net.

The Association held two properties classified as other property owned as of December 31, 2019. The larger property is a cold storage facility located in Hidalgo County. It was transferred to other property owned with a value of \$3,643,250, and the Association established an allowance for other property owned of \$699,106. The carrying value of \$2,944,144 represents the estimated fair valuation of the property as of December 31, 2019. The second property classified as other property owned is 27 acres located in Bandera County. The carrying value of \$157,250 represents the estimated fair valuation of the property as of December 31, 2019.

Except for the relationship between installment due date and seasonal cash-flow capabilities of the borrower, the Association is not affected by any seasonal characteristics. The factors affecting the operations of the Association are the same factors that would affect any agricultural real estate lender. To help mitigate and diversify credit risk, the Association has employed practices including securitization of loans, obtaining credit guarantees and engaging in loan participations.

#### Allowance for Loan Losses:

The following table provides relevant information regarding the allowance for loan losses as of, or for the year ended, December 31:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Allowance for loan losses	\$ 4,323,904	\$ 2,996,303	\$ 3,526,196
Provision for (reversal of) loan losses	1,435,839	(1,024,937)	751,890
Loans charged off	(668,890)	(23,800)	(1,097,229)
Recoveries	478,986	517,714	217,006
Allowance for loan losses to total loans	0.3%	0.2%	0.3%
Allowance for loan losses to nonaccrual loans	51.8%	31.2%	51.0%
Allowance for loan losses to impaired loans	47.2%	24.2%	43.6%
Net charge-offs to average loans	0.0%	0.0%	0.1%

The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition, collateral value, portfolio quality, current production conditions and economic conditions, and prior loan loss experience. Management may consider other qualitative factors in determining and supporting the level of allowance for loan losses including but 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, borrower repayment capacity, depth of lender staff, and/or past trends, and weather-related influences.

Based upon ongoing risk assessment and the allowance for loan losses procedures outlined above, the allowance for loan losses of \$4,323,904, \$2,996,303 and \$3,526,196 at December 31, 2019, 2018 and 2017, respectively, is considered adequate by management to compensate for inherent losses in the loan portfolio at such dates. Based on analysis performed by the Association, it concluded the entire balance of nonaccrual loans is well securitized by either a prioritized security interest in real estate, equipment or livestock with values in excess of the principal loan balances less selling expenses, or an agency guarantee.

#### Results of Operations:

The Association's net income for the year ended December 31, 2019, was \$29,080,299 as compared to \$30,755,646 for the year ended December 31, 2018, reflecting a decrease of \$1,675,347, or -5.4 percent. The Association's net income for the year ended December 31, 2017, was \$24,828,541. Net income increased \$5,927,105, or 23.9 percent, in 2018 versus 2017.

Net interest income for 2019, 2018 and 2017 was \$36,935,217, \$36,389,777 and \$36,657,572, respectively, reflecting an increase of \$545,440, or 1.5 percent, for 2019 versus 2018 and a decrease of \$267,795, or 0.7 percent, for 2018 versus 2017. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets and cost of debt.

The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following tables:

	2019		2018		2017	
	Average Balance	Interest	Average Balance	Interest	Average Balance	Interest
Loans	\$ 1,286,986,163	\$ 71,381,626	\$ 1,283,785,917	\$ 66,833,677	\$ 1,263,157,782	\$ 61,693,450
Investments	2,762,953	174,334	3,283,259	190,630	4,034,273	206,411
Total interest-earning assets	1,289,749,116	71,555,960	1,287,069,176	67,024,307	1,267,192,055	61,899,861
Interest-bearing liabilities	1,121,255,209	34,620,743	1,127,142,720	30,634,530	1,113,274,504	25,242,289
Impact of capital	\$ 168,493,907		\$ 159,926,456		\$ 153,917,551	
Net interest income		\$ 36,935,217		\$ 36,389,777		\$ 36,657,572

	2019		2018		2017	
	Average Yield		Average Yield		Average Yield	
Yield on loans	5.55%		5.21%		4.88%	
Yield on investments	6.31%		5.81%		5.12%	
Total yield on interest-earning assets	5.55%		5.21%		4.88%	
Cost of interest-bearing liabilities	3.09%		2.72%		2.27%	
Interest rate spread	2.46%		2.49%		2.62%	

	2019 vs. 2018			2018 vs. 2017		
	Increase (decrease) due to			Increase (decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
Interest income - loans	\$ 166,605	\$ 4,381,344	\$ 4,547,949	\$ 1,007,499	\$ 4,132,728	\$ 5,140,227
Interest income - investments	(30,209)	13,913	(16,296)	(38,425)	22,644	(15,781)
Total interest income	136,396	4,395,257	4,531,653	969,074	4,155,372	5,124,446
Interest expense	(160,017)	4,146,230	3,986,213	314,448	5,077,793	5,392,241
Net interest income	\$ 296,413	\$ 249,027	\$ 545,440	\$ 654,626	\$ (922,421)	\$ (267,795)

Interest income for 2019 increased by \$4,531,653, or 6.8 percent, compared to 2018, primarily due to increases in interest rates and a slight increase in interest-bearing assets. Interest expense for 2019 increased by \$3,986,213, or 13.0 percent, compared to 2018, due to increases in funding rates and a slight increase in interest-bearing debt. The interest rate spread decreased by 3 basis points to 2.46 percent in 2019 from 2.49 percent in 2018, primarily because the Association has experienced strong market demand and competition for quality credits, which has resulted in compressed interest rate spreads. The interest rate spread decreased by 13 basis points to 2.49 percent in 2018 from 2.62 percent in 2017, primarily due to increased competition with lower competitive market rates.

Noninterest income for 2019 increased by \$1,008,474, or 5.9 percent, compared to 2018, due primarily to increases in patronage income. Noninterest income for 2018 increased by \$6,324,983, or 58.9 percent, compared to 2017, due primarily to increases in patronage income and financially related service income.

Provisions for loan losses and other property owned increased by \$3,159,882, or 308.3 percent, compared to 2018, due primarily to large loan loss reversals in 2018, resulting from credit upgrades and recoveries of previously charged-off principal balances. The Association recorded a provision for other property owned of \$699,106 in 2019, compared to no provision in 2018.

Operating expenses consist primarily of salaries, employee benefits and purchased services. Expenses for purchased services may include administrative services, marketing, information systems, accounting and loan processing, among others. The Association's noninterest expenses for 2019 increased \$500,738, or 2.1 percent, compared to 2018, due primarily to increases in occupancy and equipment expenses related to completion of several branch office construction projects. Noninterest expenses for 2018 increased \$1,995,838, or 9.4 percent, compared to 2017, due primarily to increased salaries and benefits. Authoritative accounting guidance requiring the capitalization and amortization of loan origination fees and costs resulted in the capitalization of \$2,101,509, \$2,073,318 and \$2,151,447 for 2019, 2018 and 2017, respectively, in origination costs, which will be amortized over the life of the loans as an adjustment to yield in net interest income. The capitalized costs consisted of salaries and benefits related to loan originations.

For the year ended December 31, 2019, the Association's return on average assets was 2.2 percent, as compared to 2.3 percent and 1.9 percent for the years ended December 31, 2018 and 2017, respectively. For the year ended December 31, 2019, the Association's return on average members' equity was 13.9 percent, as compared to 15.7 percent and 13.6 percent for the years ended December 31, 2018 and 2017, respectively.

Because the Association depends on the Bank for funding, any significant positive or negative factors affecting the operations of the Bank may have an effect on the operations of the Association.

### **Liquidity and Funding Sources:**

The interest rate risk inherent in the Association's loan portfolio is substantially mitigated through the funding relationship with the Bank. The Bank manages interest rate risk through its direct loan pricing and asset/liability management process.

The primary source of liquidity and funding for the Association is a direct loan from the Bank. The outstanding balance of \$1,140,484,754, \$1,059,336,455 and \$1,156,165,343 as of December 31, 2019, 2018 and 2017, respectively, is recorded as a liability on the Association's balance sheet. The note carried a weighted average interest rate of 3.09 percent, 2.72 percent and 2.27 percent for the years ended December 31, 2019, 2018 and 2017, respectively. The indebtedness is collateralized by a pledge of substantially all of the Association's assets to the Bank and is governed by a general financing agreement. The increase in note payable to the Bank and related accrued interest payable since December 31, 2018, is due to increased debt on match-funded loan assets. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were \$176,404,728, \$170,620,117 and \$164,284,423 at December 31, 2019, 2018 and 2017, respectively. The maximum amount the Association may borrow from the Bank as of December 31, 2019, was \$1,319,652,185 as defined by the general financing agreement. The indebtedness continues in effect until the expiration date of the general financing agreement, which is September 30, 2020, unless sooner terminated by the Bank upon the occurrence of an event of default, or by the Association, in the event of a breach of this agreement by the Bank, upon giving the Bank 30 calendar days' prior written notice, or in all other circumstances, upon giving the Bank 120 days' prior written notice.

The liquidity policy of the Association is to manage cash balances, to maximize debt reduction and to increase accrual loan volume. This policy will continue to be pursued in 2020. As borrower payments are received, they are applied to the Association's note payable to the Bank.

In July 2017, the United Kingdom's Financial Conduct Authority, the authority regulating the London Inter-Bank Offered Rate (LIBOR) announced that it will stop persuading or compelling banks to submit rates for the calculation of the LIBOR after 2021. Since this announcement, central banks around the world, including the Federal Reserve, have commissioned working groups with the goal of finding suitable replacements for LIBOR. In the United States, efforts to identify a set of alternative U.S. dollar reference interest rates include proposals by the Alternative Reference Rates Committee (ARRC) of the Federal Reserve Board and the Federal Reserve Bank of New York. Specifically, the ARRC has proposed the Secured Overnight Financing Rate (SOFR) as the recommended alternative to LIBOR. SOFR is based on a broad segment of the overnight Treasury repurchase market and is a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities. The Bank and Association are currently evaluating the impacts of a potential phase-out of the LIBOR benchmark interest rate, including the possibility of using SOFR as an alternative to LIBOR. The transition from LIBOR to SOFR is expected to be complex and to include the development of term and credit adjustments to minimize, to the extent possible, discrepancies between LIBOR and SOFR. Uncertainty as to the nature of such potential changes, alternative reference rates or other reforms may adversely affect the trading market for LIBOR-based instruments, including certain Farm Credit Systemwide debt securities, the Bank's borrowings, loans, investments, derivatives, and other assets and liabilities that are indexed to LIBOR.

The Bank established a LIBOR Workgroup, with cross-functional representation from the finance, operations, credit and legal departments. The LIBOR Workgroup is progressing in implementing its transition plan to an alternative benchmark rate. The LIBOR Workgroup coordinates outreach to the District's associations and with other Farm Credit System institutions, especially the Funding Corporation. The Association has established a LIBOR Phase-Out Committee that developed an initial action plan for transition to an alternate benchmark rate.

The Association will continue to fund its operations through direct borrowings from the Bank, capital surplus from prior years and borrower stock. It is management's opinion that funds available to the Association are sufficient to fund its operations for the coming year.

## **Capital Resources:**

The Association's capital position remains strong, with total members' equity of \$204,908,714, \$195,854,739 and \$181,300,035 at December 31, 2019, 2018 and 2017, respectively.

New regulations became effective January 1, 2017, which replaced the previously required core surplus and total surplus ratios with common equity tier 1, tier 1 capital and total capital risk-based capital ratios. The new regulations also added tier 1 leverage and unallocated retained earnings and equivalents (UREE) ratios. The permanent capital ratio continues to remain in effect, with some modifications to align with the new regulations. Under regulations governing minimum permanent capital adequacy and other capitalization issues, the Association is required to maintain a minimum adjusted permanent capital of 7.0 percent of risk-adjusted assets as defined by the FCA. The permanent capital ratio measures available at-risk capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the institution's financial capacity to absorb potential losses beyond that provided in the allowance for loss accounts. The Association's permanent capital ratio at December 31, 2019, 2018 and 2017 was 14.2 percent, 14.9 percent and 13.2 percent, respectively.

Under the new regulations, the Association is required to maintain a minimum common equity tier 1 (CET1), tier 1 capital and total capital ratios of 4.5 percent, 6.0 percent and 8.0 percent, along with a capital conservation buffer of 2.5 percent applicable to each ratio, respectively. The 2.5 percent capital conservation buffer was phased in over a three-year period ending on December 31, 2019. The Association's common equity tier 1 ratio at December 31, 2019, 2018 and 2017 was 14.2 percent, 14.8 percent and 13.2 percent, respectively. The tier 1 capital ratio at December 31, 2019, 2018 and 2017 was 14.2 percent, 14.8 percent and 13.2 percent, respectively. The total capital ratio was 14.5 percent, 15.1 percent and 13.5 percent at December 31, 2019, 2018 and 2017, respectively. Under the new regulations, the Association is required to maintain a minimum tier 1 leverage ratio of 4.0 percent, along with a leverage buffer of 1.0 percent, and a minimum unallocated retained earnings equivalents (UREE) leverage ratio of 1.5 percent. The Association's tier 1 leverage ratio at December 31, 2019, 2018 and 2017 was 14.0 percent, 14.6 percent and 12.7 percent, respectively. The UREE leverage ratio was 10.6 percent, 10.6 percent and 9.2 percent at December 31, 2019, 2018 and 2017, respectively.

In 2019, 2018 and 2017, the Association paid patronage distributions of \$17,866,041, \$14,654,774 and \$12,989,434, respectively. In December 2019, the board of directors approved an estimated cash patronage distribution of \$12,840,000 to be paid in April 2020. See Note 11 to the consolidated financial statements, "Members' Equity," included in this annual report, for further information.

## **Significant Recent Accounting Pronouncements:**

In December 2019, the Financial Accounting Standards Board (FASB) issued guidance entitled "Simplifying the Accounting for Income Taxes." This guidance eliminates certain intra period tax allocations, foreign deferred tax recognition and interim period tax calculations. In addition, the guidance simplifies disclosure regarding capital and franchise taxes, the allocation of goodwill in business combinations, subsidiary financial statements and other disclosures. The new guidance is intended to eliminate and/or simplify certain aspects of income tax accounting that are complex or that require significant judgment in application or presentation. The guidance becomes effective for fiscal years after December 15, 2021. Early adoption of the guidance is permitted, and the Association adopted the new standard on January 1, 2020. No cumulative-effect adjustments will be recorded to retained earnings or current year results of operations. The adoption of this guidance will not impact the Association's financial condition or its results of operations, nor will the guidance impact the presentation of taxes for prior periods in the year 2020 interim or year-end financial statements.

In August 2018, the Financial Accounting Standards Board (FASB) issued guidance entitled "Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Cost." The guidance aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by this guidance. This guidance becomes effective for interim and annual periods beginning after December 15, 2019. The guidance also requires an entity (customer) to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. It further specifies where to present expense and payments in the financial statements. Early adoption is permitted. The guidance is to be applied on a retrospective or prospective basis to all implementation costs incurred after the date of adoption. The Association anticipates no impact on the Association's financial condition and its results of operations.



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

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

In February 2018, the Financial Accounting Standards Board (FASB) issued guidance entitled “Income Statement — Reporting Comprehensive Income — Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.” This guidance allows for the reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the recently issued tax legislation, Tax Cuts and Jobs Act (TCJA) that lowered the federal corporate tax rate from 35 percent to 21 percent. The amount of the reclassification shall include the effect of the change in the tax rate on gross deferred tax amounts and related valuation allowances at the date of enactment of the TCJA related to items remaining in accumulated other comprehensive income. The guidance becomes effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The adoption of this guidance did not impact the Association’s financial condition and its results of operations.

In August 2017, the FASB issued guidance entitled “Targeted Improvements to Accounting for Hedging Activities.” The guidance better aligns an entity’s risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. The amendments in this guidance require an entity to present the earnings effect of the hedging instrument in the same income statement line item in which the earnings effect of the hedged item is reported. This guidance also addresses the timing of effectiveness testing, qualitative and quantitative effectiveness testing and components that can be excluded from effectiveness testing. This guidance became effective for interim and annual periods beginning after December 15, 2018. The adoption of this guidance did not impact the Association’s financial condition or its results of operations.

In March 2017, the FASB issued guidance entitled “Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Cost.” The guidance requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. Other components are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. This guidance becomes effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not materially impact the Association’s financial condition but did change the classification of certain items in the results of operations.

In June 2016, the FASB issued guidance entitled “Measurement of Credit Losses on Financial Instruments.” The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses. For public business entities that are not U.S. Securities and Exchange Commission filers, this guidance becomes effective for interim and annual periods beginning after December 15, 2020, with early application permitted. In November 2019, the FASB issued an update that amends the mandatory effective date for this guidance for certain institutions. The change resulted from a change in the effective date philosophy that extends and simplifies the adoption by staggering the dates between large public entities and other entities. As a result of the change, the new credit loss standard becomes effective for interim and annual reporting periods beginning after December 15, 2022, with early adoption permitted. The Association qualifies for the delay in the adoption date. The Association is evaluating the impact of adoption on the Association’s financial condition and its results of operations.

In February 2016, the FASB issued guidance entitled “Leases.” The guidance requires the recognition by lessees of lease assets and lease liabilities on the balance sheet for the rights and obligations created by those leases. Leases with lease terms of more than 12 months are impacted by this guidance. This guidance became effective for interim and annual periods beginning after December 15, 2018. The adoption of this guidance did not materially impact the Association’s financial condition or its results of operations but did impact lease disclosures. The Association adopted this guidance January 1, 2019, and upon adoption, recorded a recorded a \$222,662 right of use asset and lease liability.

## Regulatory Matters:

At December 31, 2019, the Association was not under written agreements with the Farm Credit Administration.

On June 12, 2018, the Farm Credit Administration (FCA) published a final rule revising the requirements governing the eligibility of investments for System Banks and Associations. The stated objectives of the final rule are as follows:

- To strengthen investment practices at System Banks and Associations to enhance their safety and soundness;
- To ensure that System Banks hold sufficient high-quality liquid investments for liquidity purposes;
- To enhance the ability of the System Banks to supply credit to agricultural and aquatic producers and their cooperatives in times of financial distress;
- To comply with the requirements of section 939A of the Dodd-Frank Act;
- To modernize the investment eligibility criteria for System Banks; and
- To revise the investment regulation for System Associations to improve their investment management practices so they are more resilient to risk.

The regulation became effective January 1, 2019.

On June 15, 2018, the FCA published a proposed rule to amend its regulations governing standards of conduct of directors and employees of System institutions and require every System Bank and Association to have a Standards of Conduct Program based on core principles to put into effect ethical values as part of corporate culture. The stated objectives of the proposed rule are to:

- Establish principles for ethical conduct and recognize each System institution's responsibility for promoting an ethical culture;
- Provide each System institution flexibility to develop specific guidelines on acceptable practices suitable for its business;
- Encourage each System institution to foster core ethical values and conduct as part of its corporate culture;
- Require each System institution to develop strategies and a system of internal controls to promote institution and individual accountability in ethical conduct, including by establishing a Standards of Conduct Program and adopting a Code of Ethics; and
- Remove prescriptive requirements of the regulations that do not promote these objectives.

The deadline for the submission of public comments was September 13, 2018.

On August 24, 2018, the FCA published for public comment a proposed rule that would modify the existing outside director eligibility criteria to accomplish the following objectives:

- Amend the eligibility criteria for outside directors in § 611.220(a);
- Remove the definition of outside director in § 619.9225;
- Strengthen the safety and soundness of System institutions; and
- Incorporate best practices for corporate governance for System institutions.

The proposed regulation would expand the list of persons who would be excluded from nomination for an outside director's seat to ensure the independence of outside directors. The list would include borrowers of the institution, immediate family members of any director, officer, employee, agent, stockholder or borrower of any System institution, and anyone who has a controlling interest in an entity that borrows from any System institution or any affiliated organization of a System institution. The deadline for the submission of public comments was October 23, 2018.

On January 22, 2019, the Farm Credit Administration issued an information memorandum citing the fact that effective December 20, 2018, the Agriculture Improvement Act of 2018 repealed the limitations on Bank director compensation contained in section 4.21 of the Farm Credit Act of 1971, as amended. As a result, beginning in 2019, the Farm Credit Administration will no longer calculate the maximum annual compensation adjustments in FCA regulation § 611.400(b)(c) but will continue to review System Bank director compensation to ensure that pay levels do not adversely affect the safety and soundness of System institutions.

On February 21, 2019, an advance notice of proposed rulemaking on ways to collect, evaluate and report data on the System's service to young, beginning and small farmers (YBS) was published in the Federal Register. The purpose of the advance notice of proposed rulemaking is to gather public input on how FCA might:

- Improve the accuracy, transparency and process by which FCA ensures that YBS farmer data is properly collected and reported by the System;
- Clarify the definitions of terms related to the collection, reporting and identification of YBS farmer data;
- Ensure the definitions of YBS farmers and related terms remain relevant and reflective of the evolving agricultural economy; and
- Evaluate the effectiveness of each System institution's YBS program to achieve its mission of serving YBS farmers.

The comment period ended on May 22, 2019.

On March 19, 2019, an interim final rule on margin and capital requirements for covered swap entities was published in the Federal Register. Five federal agencies acted to ensure that qualifying swaps may be transferred from a United Kingdom (UK) entity to an affiliate in the European Union (EU) or the United States without triggering new margin requirements. The interim final rule adopted would ensure that any legacy swap currently exempt from the agencies' rule on margin for noncleared swaps would not become subject to the rule if such swap is amended solely for the purpose of transferring it to an affiliate as a result of a non-negotiated UK withdrawal from the EU. The comment period ended on April 18, 2019.

On April 3, 2019, a proposed rule was published in the Federal Register on the criteria for reinstating nonaccrual loans. The objectives of the proposed rule are to:

- Enhance the usefulness of high-risk loan categories;
- Replace the subjective measure of "reasonable doubt" used for reinstating loans to accrual status with a measurable standard;
- Improve the timely recognition of a change in a loan's status; and
- Update existing terminology and make other grammatical changes.

The comment period ended on June 3, 2019.

On September 18, 2019, a proposed rule was published in the Federal Register to address changes to allow Farm Credit System (FCS or System) Associations to purchase and hold the portion of certain loans that non-FCS lenders originate and sell in the secondary market, and that the United States Department of Agriculture (USDA) unconditionally guarantees or insures as to the timely payment of principal and interest. The objectives of the proposed rule are to authorize FCS Associations to buy as investments for risk management purposes, portions of certain loans that non-System lenders originate, and the USDA fully guarantees as to principal and interest to:

- Augment the liquidity of rural credit markets;
- Reduce the capital burden on community Banks and other non-System lenders who choose to sell their USDA guaranteed portions of loans, so they may extend additional credit in rural areas; and
- Enhance the ability of Associations to manage risk.

The comment period ended on November 18, 2019.

On September 23, 2019, a proposed rule was published in the Federal Register to address changes to capital and other regulations, including certain regulatory disclosure requirements, in response to recent changes in the U.S. generally accepted accounting principles (U.S. GAAP). The objectives of the proposed rule are to:

- Ensure that the System's capital requirements, including certain regulatory disclosures, reflect the current expected credit losses methodology, which revises the accounting for credit losses under U.S. GAAP; and
- Ensure that conforming amendments to other regulations accurately reference credit losses.

The comment period ended on November 22, 2019.

On November 7, 2019, a proposed rule was published in the Federal Register by five federal agencies that would amend the agencies' regulations that require swap dealers and security-based swap dealers under the agencies' respective jurisdictions to

exchange margin with their counterparties for swaps that are not centrally cleared (Swap Margin Rule). The Swap Margin Rule as adopted in 2015 takes effect under a phased compliance schedule spanning from 2016 through 2020, and the dealers covered by the rule continue to hold swaps in their portfolios that were entered into before the effective dates of the rule. Such swaps are grandfathered from the Swap Margin Rule's requirements until they expire according to their terms. The proposed rule would permit swaps entered into prior to an applicable compliance date (legacy swaps) to retain their legacy status in the event that they are amended to replace an interBank offered rate (IBOR) or other discontinued rate, repeal the inter-affiliate initial margin provisions, introduce an additional compliance date for initial margin requirements, clarify the point in time at which trading documentation must be in place, permit legacy swaps to retain their legacy status in the event that they are amended due to technical amendments, notional reductions, or portfolio compression exercises, and make technical changes to relocate the provision addressing amendments to legacy swaps that are made to comply with the Qualified Financial Contract Rules, as defined in the Supplementary Information section.

The comment period ended on December 9, 2019.

### **Relationship with the Bank:**

The Association's statutory obligation to borrow only from the Bank is discussed in Note 10 to the consolidated financial statements, "Note Payable to the Bank," included in this annual report.

The Bank's ability to access capital of the Association is discussed in Note 2 to the consolidated financial statements, "Summary of Significant Accounting Policies," included in this annual report, within the section "Capital Stock Investment in the Bank."

The Bank's role in mitigating the Association's exposure to interest rate risk is described in the section "Liquidity and Funding Sources" of Management's Discussion and Analysis and in Note 10 to the consolidated financial statements, "Note Payable to the Bank," included in this annual report.

The Bank provides computer systems to support the critical operations of all District Associations. In addition, each Association has operating systems and facility-based systems that are not supported by the Bank. As disclosed in Note 14 to the consolidated financial statements, "Related Party Transactions," included in this annual report, the Bank provides many services that the Association can utilize, such as administrative, marketing, information systems and accounting services. Additionally, the Bank bills District expenses to the Associations, such as the Farm Credit System Insurance Corporation insurance premiums.

### **Summary:**

Over the past 85 years, regardless of the state of the agricultural economy, your Association's board of directors and management, as well as the board of directors and management of the Bank, have been committed to offering their borrowers a ready source of financing at a competitive price. Your continued support will be critical to the success of this Association.



## Report of Independent Auditors

To the Board of Directors of Texas Farm Credit Services, ACA

We have audited the accompanying consolidated financial statements of Texas Farm Credit Services, ACA and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2019, December 31, 2018, and December 31, 2017, and the related consolidated statements of comprehensive income, changes in members' equity and cash flows for the years then ended.

### ***Management's Responsibility for the Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Texas Farm Credit Services and its subsidiaries as of December 31, 2019, December 31, 2018, and December 31, 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*PricewaterhouseCoopers LLP*

March 9, 2020

**TEXAS FARM CREDIT SERVICES**

**CONSOLIDATED BALANCE SHEET**

	December 31,		
	2019	2018	2017
<b><u>Assets</u></b>			
Cash	\$ 7,188,050	\$ 5,081,707	\$ 4,851,927
Investments	2,660,691	3,060,007	3,610,101
Loans	1,314,083,263	1,227,196,988	1,316,909,540
Less: allowance for loan losses	4,323,904	2,996,303	3,526,196
Net loans	1,309,759,359	1,224,200,685	1,313,383,344
Accrued interest receivable	11,020,248	10,012,908	9,505,127
Investment in and receivable from the Farm Credit Bank of Texas:			
Capital stock	22,652,940	23,172,405	22,561,865
Other	543,605	55,654	7,969
Deferred taxes, net	708,499	562,889	846,682
Other property owned, net	3,101,394	-	25,786
Premises and equipment	14,937,777	12,494,409	11,792,126
Other assets	3,340,834	3,262,652	2,549,016
Total assets	<u>\$ 1,375,913,397</u>	<u>\$ 1,281,903,316</u>	<u>\$ 1,369,133,943</u>
<b><u>Liabilities</u></b>			
Note payable to the Farm Credit Bank of Texas	\$ 1,140,484,754	\$ 1,059,336,455	\$ 1,156,165,343
Advance conditional payments	535,693	569,632	588,149
Accrued interest payable	2,820,460	2,654,747	2,290,533
Drafts outstanding	121,374	37,790	6,880,257
Patronage distributions payable	12,840,000	11,500,000	9,277,000
Other liabilities	14,202,402	11,949,953	12,632,626
Total liabilities	<u>1,171,004,683</u>	<u>1,086,048,577</u>	<u>1,187,833,908</u>
<b><u>Members' Equity</u></b>			
Capital stock and participation certificates	3,791,365	4,100,095	4,013,280
Additional paid-in capital	47,596,495	47,596,495	47,596,495
Allocated retained earnings	56,437,331	54,986,492	46,040,084
Unallocated retained earnings	97,793,661	89,370,242	84,438,778
Accumulated other comprehensive loss	(710,138)	(198,585)	(788,602)
Total members' equity	<u>204,908,714</u>	<u>195,854,739</u>	<u>181,300,035</u>
Total liabilities and members' equity	<u>\$ 1,375,913,397</u>	<u>\$ 1,281,903,316</u>	<u>\$ 1,369,133,943</u>

*The accompanying notes are an integral part of these consolidated financial statements.  
Texas Farm Credit Services — 2019 Annual Report*

**TEXAS FARM CREDIT SERVICES**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	Year Ended December 31,		
	2019	2018	2017
<b><u>Interest Income</u></b>			
Loans	\$ 71,381,626	\$ 66,833,677	\$ 61,693,450
Investments	174,334	190,630	206,411
Total interest income	<u>71,555,960</u>	<u>67,024,307</u>	<u>61,899,861</u>
<b><u>Interest Expense</u></b>			
Note payable to the Farm Credit Bank of Texas	34,512,112	30,462,425	24,983,148
Advance conditional payments	4,834	7,472	5,371
Other	103,797	164,633	253,770
Total interest expense	<u>34,620,743</u>	<u>30,634,530</u>	<u>25,242,289</u>
Net interest income	<u>36,935,217</u>	<u>36,389,777</u>	<u>36,657,572</u>
Provision for (reversal of) loan losses and other property owned	<u>2,134,945</u>	<u>(1,024,937)</u>	<u>751,890</u>
Net interest income after provision for losses	<u>34,800,272</u>	<u>37,414,714</u>	<u>35,905,682</u>
<b><u>Noninterest Income</u></b>			
Income from the Farm Credit Bank of Texas:			
Patronage income	11,148,559	8,462,542	5,529,559
Loan fees	2,161,675	1,620,903	1,224,340
Financially related services income	3,946,509	5,274,970	2,909,199
Gain on other property owned, net	40,913	415,205	47,255
Gain on sale of premises and equipment, net	299,470	361,201	873,568
Other noninterest income	479,898	933,729	159,646
Total noninterest income	<u>18,077,024</u>	<u>17,068,550</u>	<u>10,743,567</u>
<b><u>Noninterest Expenses</u></b>			
Salaries and employee benefits	15,418,896	15,426,788	13,515,195
Directors' expense	536,190	414,577	370,052
Purchased services	794,292	737,536	791,450
Travel	1,405,732	1,359,129	1,220,876
Occupancy and equipment	1,883,676	1,441,652	1,275,463
Communications	383,211	379,717	368,547
Advertising	201,008	286,064	166,713
Public and member relations	777,856	845,256	775,621
Supervisory and exam expense	443,453	401,997	362,118
Insurance Fund premiums	921,259	924,599	1,463,218
Other noninterest expense	1,031,191	1,078,711	990,935
Total noninterest expenses	<u>23,796,764</u>	<u>23,296,026</u>	<u>21,300,188</u>
Income before income taxes	<u>29,080,532</u>	<u>31,187,238</u>	<u>25,349,061</u>
Provision for income taxes	<u>233</u>	<u>431,592</u>	<u>520,520</u>
<b>NET INCOME</b>	<u>29,080,299</u>	<u>30,755,646</u>	<u>24,828,541</u>
Other comprehensive income:			
Other comprehensive income, net of tax	<u>(511,553)</u>	<u>590,017</u>	<u>(402,845)</u>
<b>COMPREHENSIVE INCOME</b>	<u>\$ 28,568,746</u>	<u>\$ 31,345,663</u>	<u>\$ 24,425,696</u>

*The accompanying notes are an integral part of these consolidated financial statements.  
Texas Farm Credit Services — 2019 Annual Report*

TEXAS FARM CREDIT SERVICES

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

	Capital Stock/ Participation Certificates	Additional Paid-in-Capital	Retained Earnings		Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2016	\$ 3,728,785	\$ 47,596,495	\$ 44,798,656	\$ 75,018,099	\$ (385,757)	\$ 170,756,278
Comprehensive income	-	-	-	24,828,541	(402,845)	24,425,696
Capital stock/participation certificates issued	497,705	-	-	-	-	497,705
Capital stock/participation certificates retired	(213,210)	-	-	-	-	(213,210)
Patronage dividends:						
Cash patronage and retired allocated retained earnings	-	-	(4,879,175)	(9,287,259)	-	(14,166,434)
Capital stock/participation certificates and allocated retained earnings	-	-	6,120,603	(6,120,603)	-	-
Balance at December 31, 2017	4,013,280	47,596,495	46,040,084	84,438,778	(788,602)	181,300,035
Comprehensive income	-	-	-	30,755,646	590,017	31,345,663
Capital stock/participation certificates issued	405,265	-	-	-	-	405,265
Capital stock/participation certificates retired	(318,450)	-	-	-	-	(318,450)
Patronage dividends:						
Cash patronage and retired allocated retained earnings	-	-	(5,238,499)	(11,500,000)	-	(16,738,499)
Capital stock/participation certificates and allocated retained earnings	-	-	14,184,907	(14,324,182)	-	(139,275)
Balance at December 31, 2018	4,100,095	47,596,495	54,986,492	89,370,242	(198,585)	195,854,739
Comprehensive income	-	-	-	29,080,299	(511,553)	28,568,746
Capital stock/participation certificates issued	409,855	-	-	-	-	409,855
Capital stock/participation certificates retired	(718,585)	-	-	-	-	(718,585)
Patronage dividends:						
Cash patronage and retired allocated retained earnings	-	-	(6,299,161)	(12,906,880)	-	(19,206,041)
Capital stock/participation certificates and allocated retained earnings	-	-	7,750,000	(7,750,000)	-	-
<b>Balance at December 31, 2019</b>	<b>\$ 3,791,365</b>	<b>\$ 47,596,495</b>	<b>\$ 56,437,331</b>	<b>\$ 97,793,661</b>	<b>\$ (710,138)</b>	<b>\$ 204,908,714</b>

*The accompanying notes are an integral part of these consolidated financial statements.  
Texas Farm Credit Services — 2019 Annual Report*



**TEXAS FARM CREDIT SERVICES**

**CONSOLIDATED STATEMENT OF CASH FLOWS**

	Year Ended December 31,		
	2019	2018	2017
<b>Cash flows from operating activities:</b>			
Net income	\$ 29,080,299	\$ 30,755,646	\$ 24,828,541
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses or (loan loss reversal)	1,435,839	(1,024,937)	751,890
Provision for acquired property	699,106	-	-
Gain on sale of other property owned, net	(40,913)	(415,205)	(47,255)
Depreciation	1,152,071	816,750	653,233
Amortization (accretion) of net (premiums) discounts in investments	(178,963)	(261,098)	(213,752)
Gain on sale of premises and equipment, net	(299,470)	(361,201)	(873,568)
Increase in accrued interest receivable	(1,007,340)	(507,781)	(1,431,045)
(Increase) decrease in other receivables from the Farm Credit Bank of Texas	(487,951)	(47,685)	8,727
(Increase) decrease in deferred tax assets	(145,610)	283,793	493,575
Increase in other assets	(78,182)	(713,636)	(321,656)
Increase in accrued interest payable	165,713	364,214	600,153
Increase (decrease) in other liabilities	1,822,562	(91,526)	330,508
Net cash provided by operating activities	<u>32,117,161</u>	<u>28,797,334</u>	<u>24,779,351</u>
<b>Cash flows from investing activities:</b>			
(Increase) decrease in loans, net	(91,117,576)	84,632,102	(166,943,663)
Cash recoveries of loans previously charged off	478,986	517,714	217,006
Proceeds from redemption (purchase) of investment in the Farm Credit Bank of Texas	519,465	(610,540)	(3,064,330)
Investment securities held-to-maturity			
Proceeds from maturities, calls and prepayments	405,269	553,813	888,265
Purchases of premises and equipment	(3,823,252)	(1,855,730)	(3,365,008)
Proceeds from sales of premises and equipment	564,541	630,184	2,233,577
Proceeds from sales of other property owned	40,913	5,985,434	138,596
Net cash (used in) provided by investing activities	<u>(92,931,654)</u>	<u>89,852,977</u>	<u>(169,895,557)</u>

*The accompanying notes are an integral part of these consolidated financial statements.  
Texas Farm Credit Services — 2019 Annual Report*

**TEXAS FARM CREDIT SERVICES**

**CONSOLIDATED STATEMENT OF CASH FLOWS**

	Year Ended December 31,		
	2019	2018	2017
<b>Cash flows from financing activities:</b>			
Net draws on (repayment of) note payable to the Farm Credit Bank of Texas	81,045,962	(96,991,588)	153,462,075
Increase (decrease) in drafts outstanding	83,584	(6,842,467)	3,313,491
Decrease in advance conditional payments	(33,939)	(18,517)	(126,568)
Issuance of capital stock and participation certificates	409,855	405,265	497,705
Retirement of capital stock and participation certificates	(718,585)	(318,450)	(213,210)
Patronage distributions paid	(17,866,041)	(14,654,774)	(12,989,434)
Net cash provided by (used in) financing activities	62,920,836	(118,420,531)	143,944,059
Net increase (decrease) in cash	2,106,343	229,780	(1,172,147)
Cash at the beginning of the year	5,081,707	4,851,927	6,024,074
Cash at the end of the year	\$ 7,188,050	\$ 5,081,707	\$ 4,851,927
 <b>Supplemental schedule of noncash investing and financing activities:</b>			
Loans transferred to other property owned	\$ 3,800,500	\$ 5,544,443	\$ 27,240
Loans charged off	668,890	23,800	1,097,229
Cash patronage distributions declared	12,840,000	11,500,000	9,277,000
Transfer of allowance for loan losses from (into) reserve for unfunded commitments	81,666	1,130	(31,125)
 <b>Supplemental cash information:</b>			
Cash paid during the year for:			
Interest	\$ 34,670,530	\$ 30,433,904	\$ 24,687,653
Income taxes	135,000	27,868	33,195

*The accompanying notes are an integral part of these consolidated financial statements.  
Texas Farm Credit Services — 2019 Annual Report*

**TEXAS FARM CREDIT SERVICES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 — ORGANIZATION, MERGERS AND OPERATIONS:**

- A. Organization: Texas Farm Credit Services, including its wholly-owned subsidiaries, Texas Farm Credit Services, PCA and Texas Farm Credit Services, FLCA (collectively called “the Association”), is a member-owned cooperative that provides credit and credit-related services to, or for the benefit of, eligible borrowers/stockholders for qualified agricultural purposes in the counties of Anderson, Angelina, Aransas, Atascosa, Austin, Bandera, Bee, Bexar, Bowie, Brooks, Cameron, Camp, Cass, Chambers, Cherokee, Collin, Cook, Dallas, Delta, Denton, DeWitt, Dimmitt, Duval, Edwards, Fannin, Fayette, Franklin, Freestone, Frio, Goliad, Gonzales, Grayson, Gregg, Guadalupe, Hardin, Harrison, Henderson, Hidalgo, Hopkins, Houston, Hunt, Jasper, Jefferson, Jim Hogg, Jim Wells, Karnes, Kaufman, Kenedy, Kerr, Kinney, Kleberg, Lamar, LaSalle, Lavaca, Leon, Liberty, Limestone, Live Oak, Marion, Maverick, McMullen, Medina, Montgomery, Morris, Nacogdoches, Newton, Nueces, Orange, Panola, Polk, Rains, Real, Red River, Rockwall, Rusk, Sabine, San Augustine, San Jacinto, San Patricio, Shelby, Smith, Starr, Titus, Trinity, Tyler, Upshur, Uvalde, Val Verde, Van Zandt, Walker, Waller, Washington, Webb, Willacy, Wilson, Wood, Zapata, and Zavala, parts of Refugio, and the lower half of Lee in the State of Texas.

The Association is a lending institution of the Farm Credit System (System), a nationwide system of cooperatively owned Banks and Associations that was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (Act). At December 31, 2019, the System consisted of three Farm Credit Banks (FCBs) and their affiliated Associations, one Agricultural Credit Bank (ACB) and its affiliated Associations, the Federal Farm Credit Banks Funding Corporation (Funding Corporation) and various service and other organizations.

The Farm Credit Bank of Texas (Bank) and its related Associations are collectively referred to as the “District.” The Bank provides funding to all Associations within the District and is responsible for supervising certain activities of the District Associations. At December 31, 2019, the District consisted of the Bank, one FLCA and 13 ACA parent companies, which have two wholly-owned subsidiaries, an FLCA and a PCA, operating in or servicing the states of Alabama, Louisiana, Mississippi, New Mexico and Texas. ACA parent companies provide financing and related services through their FLCA and PCA subsidiaries. The FLCA makes secured long-term agricultural real estate and rural home mortgage loans. The PCA makes short- and intermediate-term loans for agricultural production or operating purposes.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System Banks and Associations. The FCA examines the activities of System Associations to ensure their compliance with the Farm Credit Act, FCA regulations, and safe and sound Banking practices.

The Act established the Farm Credit System Insurance Corporation (FCSIC) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations, (2) to ensure the retirement of protected borrower capital at par or stated value and (3) for other specified purposes. The Insurance Fund is also available for the discretionary uses by the FCSIC of providing assistance to certain troubled System institutions and to cover the operating expenses of the FCSIC. Each System Bank has been required to pay premiums, which may be passed on to the Association, into the Insurance Fund, based on its annual average adjusted outstanding insured debt until the monies in the Insurance Fund reach the “secure base amount,” which is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments) or other such percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the FCSIC is required to reduce premiums as necessary to maintain the Insurance Fund at the 2 percent level. As required by the Farm Credit Act, as amended, the FCSIC may return excess funds above the secure base amount to System institutions.

FCA regulations require borrower information to be held in strict confidence by Farm Credit institutions, their directors, officers and employees. Directors and employees of the Farm Credit institutions are prohibited, except under specified circumstances, from disclosing nonpublic personal information about members.

- B. Operations: The Act sets forth the types of authorized lending activity, persons eligible to borrow and financial services that can be offered by the Association. The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers,

producers or harvesters of aquatic products, rural residents and farm-related businesses. The Association makes and services short- and intermediate-term loans for agricultural production or operating purposes, and secured long-term real estate mortgage loans, with funding from the Bank.

The Association also serves as an intermediary in offering credit life insurance, multi-peril crop insurance and pasture, rangeland and forage insurance.

The Association's financial condition may be affected by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect stockholders' investments in the Association. Upon request, stockholders of the Association will be provided with the Farm Credit Bank of Texas Annual Report to Stockholders.

## **NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:**

### ***Basis of Presentation and Consolidation***

The consolidated financial statements (the "financial statements") of the Association have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"). In consolidation, all significant intercompany accounts and transactions are eliminated and all material wholly-owned and majority-owned subsidiaries are consolidated unless GAAP requires otherwise.

### ***Reclassifications***

Certain amounts in prior year's financial statements have been reclassified to conform to current financial statement presentation. The consolidated financial statements include the accounts of Texas Farm Credit Services, PCA and Texas Farm Credit Services, FLCA.

### ***Use of Estimates***

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of deferred tax assets, the determination of fair value of financial instruments and subsequent impairment analysis.

The accounting and reporting policies of the Association conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results could differ from those estimates. The consolidated financial statements include the accounts of Texas Farm Credit Services, PCA and Texas Farm Credit Services, FLCA. All significant intercompany transactions have been eliminated in consolidation.

#### **A. Recently Issued or Adopted Accounting Pronouncements:**

In December 2019, the Financial Accounting Standards Board (FASB) issued guidance entitled "Simplifying the Accounting for Income Taxes." This guidance eliminates certain intra period tax allocations, foreign deferred tax recognition and interim period tax calculations. In addition, the guidance simplifies disclosure regarding capital and franchise taxes, the allocation of goodwill in business combinations, subsidiary financial statements and other disclosures. The new guidance is intended to eliminate and/or simplify certain aspects of income tax accounting that are complex or that require significant judgement in application or presentation. The guidance becomes effective for fiscal years after December 15, 2021. Early adoption of the guidance is permitted and the Association adopted the new standard on January 1, 2020. No cumulative-effect adjustments will be recorded to retained earnings or current year results of operations. The adoption of this guidance will not impact the Association's financial condition or its results of operations; nor will the guidance impact the presentation of taxes for prior periods in the year 2020 interim or year-end financial statements.

In August 2018, the Financial Accounting Standards Board (FASB) issued guidance entitled "Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Cost." The guidance aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The accounting for the service element of a hosting arrangement

that is a service contract is not affected by this guidance. This guidance becomes effective for interim and annual periods beginning after December 15, 2019. The guidance also requires an entity (customer) to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. It further specifies where to present expense and payments in the financial statements. Early adoption is permitted. The guidance is to be applied on a retrospective or prospective basis to all implementation costs incurred after the date of adoption. The Association anticipates no impact on the Association's financial condition and its results of operations.

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

In August 2018, the FASB issued guidance entitled "Disclosure Framework — Changes to the Disclosure Requirements for Fair Value Measurement." The guidance modifies the requirements on fair value measurements by removing, modifying or adding to the disclosures. This guidance becomes effective for interim and annual periods beginning after December 15, 2019. The adoption of this guidance did not impact the Association's financial condition or its results of operations, but did impact the fair value measurements disclosures. The Association early adopted the removal and modified disclosures during the fourth quarter of 2018.

In February 2018, the Financial Accounting Standards Board (FASB) issued guidance entitled "Income Statement — Reporting Comprehensive Income — Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." This guidance allows for the reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the recently issued tax legislation, Tax Cuts and Jobs Act (TCJA) that lowered the federal corporate tax rate from 35 percent to 21 percent. The amount of the reclassification shall include the effect of the change in the tax rate on gross deferred tax amounts and related valuation allowances at the date of enactment of the TCJA related to items remaining in accumulated other comprehensive income. The guidance becomes effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The adoption of this guidance did not impact the Association's financial condition and its results of operations.

In August 2017, the FASB issued guidance entitled "Targeted Improvements to Accounting for Hedging Activities." The guidance better aligns an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. The amendments in this guidance require an entity to present the earnings effect of the hedging instrument in the same income statement line item in which the earnings effect of the hedged item is reported. This guidance also addresses the timing of effectiveness testing, qualitative and quantitative effectiveness testing and components that can be excluded from effectiveness testing. This guidance became effective for interim and annual periods beginning after December 15, 2018. The adoption of this guidance did not impact the Association's financial condition or its results of operations.

In March 2017, the FASB issued guidance entitled "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Cost." The guidance requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. Other components are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. This guidance becomes effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not materially impact the Association's financial condition but did change the classification of certain items in the results of operations.

In June 2016, the FASB issued guidance entitled "Measurement of Credit Losses on Financial Instruments." The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses. For public business entities that are not U.S. Securities and Exchange Commission filers, this guidance becomes effective for interim and annual periods beginning after December 15, 2020, with early application permitted. In November 2019, the FASB issued an update that amends the mandatory effective date for this guidance for certain institutions. The change resulted from a change in the effective date philosophy that extends and simplifies the adoption by staggering the dates between large public entities and other entities. As a result of the change, the new credit loss standard becomes effective for interim and annual reporting periods

beginning after December 15, 2022, with early adoption permitted. The Association qualifies for the delay in the adoption date. The Association is evaluating the impact of adoption on the Association's financial condition and its results of operations.

In February 2016, the FASB issued guidance entitled "Leases." The guidance requires the recognition by lessees of lease assets and lease liabilities on the balance sheet for the rights and obligations created by those leases. Leases with lease terms of more than 12 months are impacted by this guidance. This guidance became effective for interim and annual periods beginning after December 15, 2018. The adoption of this guidance did not materially impact the Association's financial condition or its results of operations but did impact lease disclosures. The Association adopted this guidance January 1, 2019, and upon adoption, recorded a \$222,662 right of use asset and lease liability.

- B. Cash: Cash, as included in the financial statements, represents cash on hand and deposits at local banks.
- C. Investments: The Association's investments include mortgage-backed securities issued by Federal Agricultural Mortgage Corporation (Farmer Mac) for which the Association has the intent and ability to hold to maturity and which are consequently classified as held to maturity. Held-to-maturity investments are carried at cost, adjusted for the amortization of premiums and accretion of discounts. Changes in the fair value of these investments are not recorded unless the investment is deemed to be other-than-temporarily impaired. Impairment is considered to be other-than-temporary if the present value of cash flows expected to be collected from the debt security is less than the amortized cost basis of the security (any such shortfall is referred to as a "credit loss"). If an entity intends to sell an impaired debt security or is more likely than not to be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the impairment is other-than-temporary and should be recognized currently in earnings in an amount equal to the entire difference between fair value and amortized cost. If a credit loss exists, but an entity does not intend to sell the impaired debt security and is not more likely than not to be required to sell before recovery, the impairment is other-than-temporary and should be separated into (i) the estimated amount relating to credit loss, and (ii) the amount relating to all other factors. Only the estimated credit loss amount is recognized currently in earnings, with the remainder of the loss amount recognized in other comprehensive income.

Gains and losses on the sales of investments available for sale are determined using the specific identification method. Premiums and discounts are amortized or accreted into interest income over the term of the respective issues. The Association does not hold investments for trading purposes.

In accordance with the Farm Credit Administration regulations, the Association, with the approval of the Bank, may purchase and hold investments to manage risks. The Association must identify and evaluate how the investments that it purchases contributes to management of its risks. Only securities that are issued by, or are unconditionally guaranteed or insured as to the timely payment of principal and interest by, the United States Government or its agencies are investments that the Association may acquire. The total amount of investments allowed must not exceed 10 percent of the Association's total outstanding loans.

The investments may not necessarily be held to maturity and accordingly would be classified as available for sale. These investments are reported at fair value and unrealized holding gains and losses on investments that are reported as a separate component of members' equity (accumulated other comprehensive income (loss)), net of tax. Changes in the fair value of these investments are reflected as direct charges or credits to other comprehensive income, unless the investment is deemed to be other than temporarily impaired. Impairment is considered to be other-than-temporary if the present value of cash flows expected to be collected from the debt security is less than the amortized cost basis of the security (any such shortfall is referred to as a "credit loss"). If an entity intends to sell an impaired debt security or is more likely than not to be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the impairment is other-than-temporary and should be recognized currently in earnings in an amount equal to the entire difference between fair value and amortized cost. If a credit loss exists, but an entity does not intend to sell the impaired debt security and is not more likely than not to be required to sell before recovery, the impairment is other-than-temporary and should be separated into (i) the estimated amount relating to credit loss, and (ii) the amount relating to all other factors. Only the estimated credit loss amount is recognized currently in earnings, with the remainder of the loss amount recognized in other comprehensive income.

In subsequent periods, if the present value of cash flows expected to be collected is less than the amortized cost basis, the institution would record an additional other-than-temporary impairment and adjust the yield of the security prospectively. The amount of total other-than-temporary impairment for an available-for-sale security that previously was impaired is determined as the difference between its carrying amount prior to the determination of other-than-temporary impairment and its fair value.

The Association may also hold additional investments in accordance with mission-related and other investment programs approved by the Farm Credit Administration. These programs allow the Association to make investments that further the

System's mission to serve rural America. These other investments are not included in the investment limitation specified by the Farm Credit Administration regulations. Mortgage-backed securities issued by Farmer Mac are considered other investments. Other investments for which the Association has the intent and ability to hold to maturity are classified as held-to-maturity and carried at cost, adjusted for the amortization of premiums and accretion of discounts. Farmer Mac investments are classified either as held-to-maturity or available-for-sale depending on the institution's ability and intent to hold the investment to maturity.

- D. Loans and Allowance for Loan Losses: Long-term real estate mortgage loans generally have original maturities ranging from five to 30 years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less. Loans are carried at their principal amount outstanding adjusted for charge-offs and net deferred loan fees or costs. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. Authoritative accounting guidance requires loan origination fees and direct loan origination costs, if material, to be capitalized and the net fee or cost to be amortized over the life of the related loan as an adjustment to yield.

Loans acquired in a business combination are initially recognized at fair value, and therefore, no "carryover" of the allowance for loan losses is permitted. Those loans with evidence of credit quality deterioration at purchase are required to follow the authoritative accounting guidance on "Accounting for Certain Loans or Debt Securities Acquired in a Transfer." This guidance addresses accounting for differences between contractual cash flows and cash flows expected to be collected from the initial investment in loans if those differences are attributable, at least in part, to credit quality. The initial fair values for these types of loans are determined by discounting both principal and interest cash flows expected to be collected using an observable discount rate for similar instruments with adjustments that management believes a market participant would consider in determining fair value. Subsequent decreases to expected principal cash flows will result in a charge to the provision for loan losses and a corresponding increase to allowance for loan losses. Subsequent increases in expected principal cash flows will result in recovery of any previously recorded allowance for loan losses, to the extent applicable, and a reclassification from nonaccretable difference to accretable yield for any remaining increase. For variable rate loans, expected future cash flows were initially based on the rate in effect at acquisition; expected future cash flows are recalculated as rates change over the lives of the loans.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms of the loan and are generally considered substandard or doubtful, which is in accordance with the loan rating model, as described below. Impaired loans include nonaccrual loans, restructured loans, and loans past due 90 days or more and still accruing interest. 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 formally restructured or until the entire amount past due, including principal, accrued interest and penalty interest incurred as a result of past-due status, is collected or otherwise discharged in full.

A restructured loan constitutes a troubled debt restructuring (TDR) if for economic or legal reasons related to the debtor's financial difficulties the Association grants a concession to the debtor that it would not otherwise consider.

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) or circumstances indicate that collection of principal and/or interest is in doubt. Additionally, all loans over 180 days past due are placed in nonaccrual status. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is either reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in prior years). Loans are charged-off at the time they are determined to be uncollectible.

A concession is generally granted in order to minimize the Association's economic loss and avoid foreclosure. Concessions vary by program and are borrower-specific and may include interest rate reductions, term extensions, payment deferrals or the acceptance of additional collateral in lieu of payments. In limited circumstances, principal may be forgiven. A loan restructured in a troubled debt restructuring is an impaired loan.

Payments received on nonaccrual loans are generally applied to the recorded investment in the loan asset. If collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it, the interest portion of payments is recognized as current interest income. Nonaccrual loans may be returned to accrual status when principal and interest are current, the borrower has demonstrated payment performance, there are no unrecovered prior charge-offs and collection of future payments is no longer in doubt. 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 is first recorded as interest income until such time as the recorded balance equals the contractual indebtedness of the borrower.

The Bank and related associations use a two-dimensional loan rating model based on an internally generated combined system risk-rating guidance that incorporates a 14-point risk-rating scale to identify and track the probability of borrower default and a separate scale addressing loss given default over a period of time. Probability of default is the probability that a borrower will experience a default within 12 months from the date of the determination of the risk rating. 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 is past due more than 90 days. The loss given default is management's estimate as to the anticipated economic loss on a specific loan assuming default has occurred or is expected to occur within the next 12 months.

Each of the probability of default categories carries a distinct percentage of default probability. The 14-point risk-rating scale provides for granularity of the probability of default, especially in the acceptable ratings. There are nine acceptable categories that range from a borrower of the highest quality to a borrower of minimally acceptable quality. The probability of default between 1 and 9 is very narrow and would reflect almost no default to a minimal default percentage. The probability of default grows more rapidly as a loan moves from a "9" to other assets especially mentioned (OAEM) and grows significantly as a loan moves to a substandard (viable) level. A substandard (non-viable) rating indicates that the probability of default is almost certain.

The credit risk-rating methodology is a key component of the Association's allowance for loan losses evaluation. The allowance for loan losses is maintained at a level considered adequate by management to provide for probable losses inherent in the loan portfolio. The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition, collateral value, portfolio quality, current production conditions and economic conditions, and prior loan loss experience. Management considers the following factors in determining and supporting the level of allowance for loan losses: 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. The allowance for loan losses encompasses various judgments, evaluations and appraisals with respect to the loans and their underlying security that, by their nature, contain elements of uncertainty and imprecision. Changes in the agricultural economy and their impact on borrower repayment capacity will cause these various judgments, evaluations and appraisals to change over time. Accordingly, actual circumstances could vary significantly from the Association's expectations and predictions of those circumstances.

The allowance for loan losses includes components for loans individually evaluated for impairment and loans collectively evaluated for impairment. Generally, for loans individually evaluated the allowance for loan losses represents the difference between the recorded investment in the loan and the present value of the cash flows expected to be collected discounted at the loan's effective interest rate, or at the fair value of the collateral, less estimated costs to sell, if the loan is collateral-dependent. For those loans collectively evaluated for impairment, the allowance for loan losses is determined using the risk-rating model.

Transfers of an entire financial asset, group of entire financial assets, or a participating interest in an entire financial asset are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Association, (2) the transferee obtains the right to pledge or exchange the transferred assets, and (3) the Association does not maintain effective control over the transferred assets.

The Association purchases loan and lease participations from other System and non-System entities to generate additional earnings and diversify risk related to existing commodities financed and the geographic area served. Additionally, the Association sells a portion of certain large loans to other System and non-System entities to reduce risk and comply with established lending limits. Loans are sold and the sale terms comply with requirements under ASC 860 "Transfers and Servicing."

- E. Capital Stock Investment in the Farm Credit Bank of Texas: The Association's investment in the Bank is in the form of Class A voting capital stock and allocated retained earnings. This investment is adjusted periodically based on the Association's proportional utilization of the Bank compared to other District Associations. The Bank requires a minimum stock investment of 2 percent of the Association's average borrowing from the Bank. This investment is carried at cost plus allocated equities in the accompanying consolidated balance sheet.

If needed to meet regulatory capital adequacy requirements, the board of directors of the Bank may increase the percentage of stock held by an Association from 2 percent of the average outstanding balance of borrowings from the Bank to a maximum of 5 percent of the average outstanding balance of borrowings from the Bank.



- F. **Other Property Owned, Net:** Other property owned, net, consists of real and personal property acquired through foreclosure or deed in lieu of foreclosure, and is recorded at fair value less estimated selling costs upon acquisition and is included in other assets in the consolidated balance sheet. Any initial reduction in the carrying amount of a loan to the fair value of the collateral received is charged to the allowance for loan losses. On at least an annual basis, revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income and expenses from operations and carrying value adjustments are included in net gains (losses) on other property owned in the Consolidated Statements of Comprehensive Income.
- G. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. Depreciation is provided on the straight-line method using estimated useful lives of the assets. Gains and losses on dispositions are reflected in current operations. Maintenance and repairs are charged to operating expense, and improvements are capitalized.
- H. **Advance Conditional Payments:** The Association is authorized under the Act to accept advance payments from borrowers. To the extent that the borrower's access to such funds is restricted, the advance conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as liabilities in the accompanying consolidated balance sheet. Advance conditional payments are not insured. Interest is generally paid by the Association on such accounts at rates established by the board of directors.
- I. **Employee Benefit Plans:** Employees of the Association participate in either the District defined benefit retirement plan (DB plan) or the defined contribution plan (DC plan). All eligible employees may participate in the Farm Credit Benefits Alliance 401(k) Plan. Also, the Association sponsors a nonqualified defined contribution 401(k) plan. The DB plan is closed to new participants. Participants generally include employees hired prior to January 1, 1996. The DB plan is noncontributory and provides benefits based on salary and years of service. The "projected unit credit" actuarial method is used for financial reporting and funding purposes for the DB plan.

Participants in the DC plan generally include employees who elected to transfer from the DB plan prior to January 1, 1996, and employees hired on or after January 1, 1996. Participants in the DC plan direct the placement of their employers' contributions, 5.0 percent of eligible pay for the year ended December 31, 2019, made on their behalf into various investment alternatives.

The structure of the District's DB plan is characterized as multi-employer, since neither the assets nor liabilities costs of the plan are segregated or separately accounted for by the Associations. No portion of any surplus assets is available to the Associations, nor are the Associations required to pay for plan liabilities upon withdrawal from the plans. As a result, the Associations recognize as pension cost the required contribution to the plans for the year. Contributions due and unpaid are recognized as a liability. The Association recognized pension costs for the DC plan of \$642,151, \$641,432 and \$566,078 for the years ended December 31, 2019, 2018 and 2017, respectively. For the DB plan, the Association recognized pension costs of \$420,239, \$485,749 and \$493,153 for the years ended December 31, 2019, 2018 and 2017, respectively.

The Association also participates in the Farm Credit Benefits Alliance 401(k) Plan, which requires the Associations to match 100 percent of employee contributions up to 3.0 percent of eligible earnings and to match 50 percent of employee contributions for the next 2.0 percent of employee contributions, up to a maximum employer contribution of 4.0 percent of eligible earnings. Association 401(k) plan costs are expensed as incurred. The Association's contributions to the 401(k) plan were \$485,776, \$458,924 and \$408,059 for the years ended December 31, 2019, 2018 and 2017, respectively.

In addition to the DB plan, the DC plan and the Farm Credit Benefits Alliance 401(k) plans above, the Association sponsors a defined contribution supplemental retirement plan. This plan is a nonqualified 401(k) plan; therefore, the associated liabilities are included in the Association's consolidated balance sheet in other liabilities. The expenses of the nonqualified plan included in the Association's employee benefit costs were \$57,044, \$89,070 and \$73,945 for the years ended December 31, 2019, 2018 and 2017, respectively.

In addition to pension benefits, the Association provides certain health care and life insurance benefits to qualifying retired employees (other postretirement benefits). These benefits are not characterized as multi-employer and, consequently, the liability for these benefits is included in other liabilities on the consolidated balance sheet.

- J. **Income Taxes:** The ACA holding company conducts its business activities through two wholly-owned subsidiaries. Long-term mortgage lending activities are operated through the wholly-owned FLCA subsidiary, which is exempt from federal and state

income tax. Short- and intermediate-term lending activities are operated through the wholly-owned PCA subsidiary. Operating expenses are allocated to each subsidiary based on estimated relative service. All significant transactions between the subsidiaries and the parent company have been eliminated in consolidation. The ACA, along with the PCA subsidiary, is subject to income tax. The Association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the Association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated retained earnings. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage refunds. Deferred taxes are provided on the Association's taxable income on the basis of a proportionate share of the tax effect of temporary differences not allocated in patronage form. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (over 50 percent probability), based on management's estimate, that they will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of the Association's expected patronage program, which reduces taxable earnings. The Association has no valuation allowance on its net deferred tax assets because management estimates a full utilization of these assets.

Deferred income taxes have not been provided by the Association on patronage stock distributions from the Bank prior to January 1, 1993, the adoption date of the FASB guidance on income taxes. Management's intent is (1) to permanently invest these and other undistributed earnings in the Bank, thereby indefinitely postponing their conversion to cash, or (2) to pass through any distribution related to pre-1993 earnings to Association borrowers through qualified patronage allocations.

The Association has not provided deferred income taxes on amounts allocated to the Association that relate to the Bank's post-1992 earnings to the extent that such earnings will be passed through to Association borrowers through qualified patronage allocations. Additionally, deferred income taxes have not been provided on the Bank's post-1992 unallocated earnings. The Bank currently has no plans to distribute unallocated Bank earnings and does not contemplate circumstances that, if distributions were made, would result in taxes being paid at the Association level.

- K. Patronage Refunds from the Farm Credit Bank of Texas: The Association records patronage refunds from the Bank on an accrual basis.
- L. Fair Value Measurement: The FASB guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. It describes three levels of inputs that may be used to measure fair value:

Level 1 — Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury, other U.S. government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets. Also included in Level 1 are assets held in trust funds, which relate to deferred compensation and the supplemental retirement plan. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace. Pension plan assets that are invested in equity securities, including mutual funds and fixed-income securities that are actively traded, are also included in Level 1.

Level 2 — Observable inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly or indirectly. Level 2 inputs include the following: (a) quoted prices for similar assets or liabilities in active markets; (b) quoted prices for identical or similar assets or liabilities in markets that are not active so that they are traded less frequently than exchange-traded instruments, the prices are not current or principal market information is not released publicly; (c) inputs other than quoted prices that are observable such as interest rates and yield curves, prepayment speeds, credit risks and default rates; and (d) inputs derived principally from or corroborated by observable market data by correlation or other means. This category generally includes certain U.S. government and agency mortgage-backed debt securities, corporate debt securities, and derivative contracts. Pension plan assets that are derived from observable inputs, including corporate bonds and mortgage-backed securities, are reported in Level 2.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities are considered Level 3. These unobservable inputs reflect the reporting entity's own assumptions about assumptions that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain private equity investments, retained residual interests in securitizations, asset-backed securities, highly structured or long-term derivative contracts, certain loans and other

property owned. Pension plan assets such as certain mortgage-backed securities that are supported by little or no market data in determining the fair value are included in Level 3.

The fair value disclosures are presented in Note 15, “Fair Value Measurements.”

- M. Off-balance-sheet credit exposures: Commitments to extend credit are agreements to lend to customers, generally having fixed expiration dates or other termination clauses that may require payment of a fee. Commercial letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. These letters of credit are issued to facilitate commerce and typically result in the commitment being funded when the underlying transaction is consummated between the customer and third party. The credit risk associated with commitments to extend credit and commercial letters of credit is essentially the same as that involved with extending loans to customers and is subject to normal credit policies. Collateral may be obtained based on management’s assessment of the customer’s creditworthiness.

**NOTE 3 — INVESTMENTS:**

*Held-to-Maturity Investments:*

The Association holds Farmer Mac agricultural mortgage-backed securities. These securities were agricultural mortgage loans previously covered under a Long-Term Standby Commitment to Purchase agreement with the Federal Agricultural Mortgage Corporation (Farmer Mac) that were subsequently securitized. No gain or loss was recognized in the financial statements upon completion of the securitization. Terms of the agreement call for a guarantee fee of 20-50 basis points to be paid to Farmer Mac, and for the Association to receive a 30-basis-point fee for servicing the underlying loans.

The following is a summary of Farmer Mac agricultural mortgage-backed securities:

	<b>December 31, 2019</b>				
	<b>Amortized Cost</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>	<b>Weighted Average Yield</b>	<b>Weighted Average Life</b>
Agricultural mortgage-backed securities	\$ 2,660,691	\$ (6,243)	\$ 2,654,448	5.53%	3.81 Years
	<b>December 31, 2018</b>				
	<b>Amortized Cost</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>	<b>Weighted Average Yield</b>	<b>Weighted Average Life</b>
Agricultural mortgage-backed securities	\$ 3,060,007	\$ (49,014)	\$ 3,010,993	5.79%	3.86 Years
	<b>December 31, 2017</b>				
	<b>Amortized Cost</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>	<b>Weighted Average Yield</b>	<b>Weighted Average Life</b>
Agricultural mortgage-backed securities	\$ 3,610,101	\$ (68,174)	\$ 3,541,927	5.09%	4.67 Years

#### NOTE 4 — LOANS AND ALLOWANCE FOR LOAN LOSSES:

A summary of loans as of December 31 follows:

Loan Type	2019		2018		2017	
	Amount	%	Amount	%	Amount	%
Real estate mortgage	\$ 982,110,300	74.8%	\$ 915,254,428	74.6%	\$ 1,007,745,314	76.5%
Production and intermediate term	223,427,089	17.0%	222,682,563	18.1%	208,283,040	15.8%
Agribusiness:						
Processing and marketing	75,272,101	5.7%	62,157,061	5.1%	69,328,935	5.3%
Loans to cooperatives	12,955,307	1.0%	9,160,494	0.7%	6,725,217	0.5%
Farm-related business	3,021,587	0.2%	3,693,306	0.3%	5,459,052	0.4%
Communication	10,543,602	0.8%	5,930,022	0.5%	10,118,637	0.8%
Energy	2,803,913	0.2%	3,293,715	0.3%	3,814,546	0.3%
Rural residential real estate	2,284,841	0.2%	2,755,973	0.2%	3,090,413	0.2%
Mission-related investments	1,664,523	0.1%	2,269,426	0.2%	2,344,386	0.2%
Total	<u>\$ 1,314,083,263</u>	<u>100.0%</u>	<u>\$ 1,227,196,988</u>	<u>100.0%</u>	<u>\$ 1,316,909,540</u>	<u>100.0%</u>

At December 31, 2019, the Association held loans totaling \$802,600 extended under the Rural America Bond Program approved by the FCA. The program is designed to meet the growing and changing needs of agricultural enterprises, agribusinesses and rural communities by providing investment in rural areas.

The Association may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration regulations. The following table presents information regarding participations purchased and sold as of December 31, 2019:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
	Real estate mortgage	\$ 14,887,635	\$ 177,671,003	\$ 492,937	\$ -	\$ 15,380,572
Production and intermediate term	24,849,568	1,597,079	-	-	24,849,568	1,597,079
Agribusiness	63,038,027	62,780,353	-	-	63,038,027	62,780,353
Communication	10,543,602	-	-	-	10,543,602	-
Energy	2,803,913	-	-	-	2,803,913	-
Total	<u>\$ 116,122,745</u>	<u>\$ 242,048,435</u>	<u>\$ 492,937</u>	<u>\$ -</u>	<u>\$ 116,615,682</u>	<u>\$ 242,048,435</u>

Geographic Distribution of Loan Volume by County:

County	2019	2018	2017
Hidalgo	6.8%	7.1%	7.2%
Bandera	3.0%	3.3%	4.0%
Fayette	3.0%	3.1%	2.5%
Nueces	2.9%	3.4%	2.8%
Zavala	2.5%	2.9%	1.8%
Washington	2.5%	2.5%	2.8%
Henderson	2.4%	1.9%	1.5%
Austin	2.1%	2.0%	1.6%
Medina	2.0%	1.2%	1.0%
Other	72.8%	72.6%	74.8%
	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

The Association's concentration of credit risk in various agricultural commodities is shown in the following table. While the amounts represent the Association's maximum potential credit risk as it relates to recorded loan principal, a substantial portion of the Association's lending activities is collateralized, and the Association's exposure to credit loss associated with lending activities is reduced accordingly. An estimate of the Association's credit risk exposure is considered in the determination of the allowance for loan losses.

Operation/Commodity	2019		2018		2017	
	Amount	%	Amount	%	Amount	%
Crops and Agricultural Commodities	\$ 421,212,353	32.1%	\$ 392,942,740	32.0%	\$ 389,069,236	29.5%
Hunting, Trapping & Game Propagation	378,990,323	28.8%	347,497,299	28.3%	399,212,032	30.3%
Livestock	339,997,952	25.9%	330,641,421	26.9%	356,959,801	27.1%
Farm-Related Operations	171,463,868	13.0%	152,905,600	12.5%	168,198,848	12.8%
Rural Home Loans	2,418,767	0.2%	3,209,928	0.3%	3,469,623	0.3%
	<b>\$ 1,314,083,263</b>	<b>100.0%</b>	<b>\$ 1,227,196,988</b>	<b>100.0%</b>	<b>\$ 1,316,909,540</b>	<b>100.0%</b>

The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies but typically includes farmland and income-producing property, such as crops and livestock, as well as receivables. Long-term real estate loans are secured by the first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (or 97 percent if guaranteed by a government agency) of the property's appraised value. However, a decline in a property's market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the Association in the collateral, may result in the loan-to-value ratios in excess of the regulatory maximum.

To mitigate the risk of loan losses, the Association has obtained loan guarantees in the form of standby commitments to purchase qualifying loans from Farmer Mac through an arrangement with the Bank. The agreements, which will remain in place until the loans are paid in full, give the Association the right to sell the loans identified in the agreements to Farmer Mac in the event of defaults (typically four months past due), subject to certain conditions. At December 31, 2019, 2018 and 2017, loans totaling \$25,374,738, \$22,214,583 and \$29,942,314, respectively, were guaranteed by these commitments. Fees paid for these guarantees totaled \$117,402, \$135,296 and \$179,456 in 2019, 2018 and 2017, respectively, and are included in "other noninterest expense."

Impaired loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms.

Nonperforming assets (including related accrued interest) and related credit quality statistics are as follows:

	December 31, 2019	December 31, 2018	December 31, 2017
<b>Nonaccrual loans:</b>			
Real estate mortgage	\$ 5,288,762	\$ 5,791,230	\$ 3,420,947
Production and intermediate term	3,023,155	3,789,357	3,463,440
Rural residential real estate	37,617	31,158	31,158
Total nonaccrual loans	<b>8,349,534</b>	9,611,745	6,915,545
<b>Accruing restructured loans:</b>			
Real estate mortgage	-	1,274,222	286,090
Mission-related investments	810,911	839,300	863,704
Total accruing restructured loans	<b>810,911</b>	2,113,522	1,149,794
<b>Accruing loans 90 days or more past due:</b>			
Production and intermediate term	5	633,586	7,146
Agribusiness	-	-	19,834
Total accruing loans 90 days or more past due	<b>5</b>	633,586	26,980
Total nonperforming loans	<b>9,160,450</b>	12,358,853	8,092,319
Other property owned	3,101,394	-	25,786
Total nonperforming assets	<b>\$ 12,261,844</b>	\$ 12,358,853	\$ 8,118,105

One credit quality indicator utilized by the Bank and the Association is the Farm Credit Administration's 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 and/or collateral pledged on the loan,
- Doubtful – assets exhibit similar weaknesses to substandard assets; however, doubtful assets have additional weaknesses in existing factors, conditions and values that make collection in full highly questionable, and
- Loss – assets are considered uncollectible.

The following table shows loans and related accrued interest classified under the Farm Credit Administration’s Uniform Loan Classification System as a percentage of total loans and related accrued interest receivable by loan type as of December 31:

	<u>2019</u>		<u>2018</u>		<u>2017</u>
Real estate mortgage					
Acceptable	96.1	%	97.4	%	97.7
OAEM	2.6	%	1.3	%	1.1
Substandard/doubtful	1.3	%	1.3	%	1.2
	<u>100.0</u>	%	<u>100.0</u>	%	<u>100.0</u>
Production and intermediate term					
Acceptable	89.6	%	88.9	%	91.2
OAEM	5.6	%	7.2	%	3.3
Substandard/doubtful	4.8	%	3.9	%	5.5
	<u>100.0</u>	%	<u>100.0</u>	%	<u>100.0</u>
Loans to cooperatives					
Acceptable	94.9	%	100.0	%	100.0
OAEM	5.1	%	-	%	-
	<u>100.0</u>	%	<u>100.0</u>	%	<u>100.0</u>
Processing and marketing					
Acceptable	92.9	%	100.0	%	100.0
OAEM	7.1	%	-	%	-
	<u>100.0</u>	%	<u>100.0</u>	%	<u>100.0</u>
Farm-related business					
Acceptable	100.0	%	100.0	%	100.0
Communication					
Acceptable	100.0	%	86.2	%	100.0
OAEM	-	%	13.8	%	-
	<u>100.0</u>	%	<u>100.0</u>	%	<u>100.0</u>
Energy					
Acceptable	100.0	%	72.9	%	73.2
OAEM	-	%	27.1	%	26.8
	<u>100.0</u>	%	<u>100.0</u>	%	<u>100.0</u>
Rural residential real estate					
Acceptable	74.6	%	78.1	%	84.0
OAEM	23.8	%	20.8	%	15.0
Substandard/doubtful	1.6	%	1.1	%	1.0
	<u>100.0</u>	%	<u>100.0</u>	%	<u>100.0</u>
Mission-related investments					
Acceptable	100.0	%	100.0	%	100.0
Total Loans					
Acceptable	94.8	%	95.9	%	96.7
OAEM	3.4	%	2.4	%	1.5
Substandard/doubtful	1.8	%	1.7	%	1.8
	<u>100.0</u>	%	<u>100.0</u>	%	<u>100.0</u>

There were no loans and related interest in the loss category.

The following tables provide an aging analysis of past due loans (including accrued interest) as of December 31, 2019, 2018 and 2017:

December 31, 2019:	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or less than 30 Days Past Due	Total Loans	Recorded Investment >90 Days and Accruing
Real estate mortgage	\$ 7,750,213	\$ 1,889,151	\$ 9,639,364	\$ 980,688,535	\$ 990,327,899	\$ -
Production and intermediate term	996,705	702,530	1,699,235	224,103,142	225,802,377	5
Agribusiness:						
Processing and marketing	-	-	-	75,468,841	75,468,841	-
Loans to cooperatives	-	-	-	13,054,651	13,054,651	-
Farm-related business	-	-	-	3,039,972	3,039,972	-
Communication	-	-	-	10,544,242	10,544,242	-
Energy	-	-	-	2,806,945	2,806,945	-
Rural residential real estate	119,183	37,617	156,800	2,135,253	2,292,053	-
Mission-related investments	69,590	-	69,590	1,602,533	1,672,123	-
<b>Total</b>	<b>\$ 8,935,691</b>	<b>\$ 2,629,298</b>	<b>\$ 11,564,989</b>	<b>\$ 1,313,444,114</b>	<b>\$ 1,325,009,103</b>	<b>\$ 5</b>
December 31, 2018:	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or less than 30 Days Past Due	Total Loans	Recorded Investment >90 Days and Accruing
Real estate mortgage	\$ 8,766,334	\$ 621,596	\$ 9,387,930	\$ 912,976,163	\$ 922,364,093	\$ -
Production and intermediate term	1,881,598	633,804	2,515,402	222,722,678	225,238,080	633,586
Agribusiness:						
Processing and marketing	-	-	-	62,317,756	62,317,756	-
Loans to cooperatives	-	-	-	9,215,999	9,215,999	-
Farm-related business	-	-	-	3,715,221	3,715,221	-
Communication	-	-	-	5,930,414	5,930,414	-
Energy	-	-	-	3,299,372	3,299,372	-
Rural residential real estate	128,126	31,158	159,284	2,606,101	2,765,385	-
Mission-related investments	-	-	-	2,272,441	2,272,441	-
<b>Total</b>	<b>\$ 10,776,058</b>	<b>\$ 1,286,558</b>	<b>\$ 12,062,616</b>	<b>\$ 1,225,056,145</b>	<b>\$ 1,237,118,761</b>	<b>\$ 633,586</b>
December 31, 2017:	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or less than 30 Days Past Due	Total Loans	Recorded Investment >90 Days and Accruing
Real estate mortgage	\$ 7,053,818	\$ 18,035	\$ 7,071,853	\$ 1,007,842,028	\$ 1,014,913,881	\$ -
Production and intermediate term	1,104,442	414,612	1,519,054	208,705,515	210,224,569	7,146
Agribusiness:						
Processing and marketing	-	19,834	19,834	69,462,829	69,482,663	19,834
Loans to cooperatives	973,312	-	973,312	5,806,653	6,779,965	-
Farm-related business	-	5	5	5,489,401	5,489,406	-
Communication	-	-	-	10,156,088	10,156,088	-
Energy	-	-	-	3,822,948	3,822,948	-
Rural residential real estate	168,712	-	168,712	2,935,008	3,103,720	-
Mission-related investments	98,183	-	98,183	2,252,528	2,350,711	-
<b>Total</b>	<b>\$ 9,398,467</b>	<b>\$ 452,486</b>	<b>\$ 9,850,953</b>	<b>\$ 1,316,472,998</b>	<b>\$ 1,326,323,951</b>	<b>\$ 26,980</b>

Note: The recorded investment in the receivable is the face amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges or acquisition costs, and may also reflect a previous direct write-down of the investment.

A restructuring of a debt constitutes a troubled debt restructuring if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Troubled debt restructurings are undertaken in order to improve the likelihood of recovery on the loan and may include, but are not limited to, forgiveness of principal or interest, interest rate reductions that are lower than the current market rate for new debt with similar risk, or significant term or payment extensions.

As of December 31, 2019, the total recorded investment of troubled debt restructured loans was \$3,270,633, including \$2,459,722 classified as nonaccrual and \$810,911 classified as accrual, with specific allowance for loan losses of \$16,509. As of December 31, 2019, commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring were \$25,818.

The following tables present additional information regarding troubled debt restructurings, which includes both accrual and nonaccrual loans with troubled debt restructuring designation, that occurred during the years ended December 31, 2019 and 2018. The pre-modification outstanding recorded investment represents the recorded investment of the loans as of the quarter end prior to the restructuring. The post-modification outstanding recorded investment represents the recorded investment of the loans as of the quarter end the restructuring occurred. The Association did not have any troubled debt restructurings that occurred for the year ended December 31, 2017.

<b>December 31, 2019:</b>	<b>Pre-modification Outstanding Recorded Investment</b>	<b>Post-modification Outstanding Recorded Investment</b>
<b>Troubled debt restructurings:</b>		
<b>Production and intermediate term</b>	<b>\$ 1,648,826</b>	<b>\$ 2,469,281</b>
 December 31, 2018:	 Pre-modification Outstanding Recorded Investment	 Post-modification Outstanding Recorded Investment
<b>Troubled debt restructurings:</b>		
Real estate mortgage	\$ 1,028,673	\$ 1,015,938

In restructurings where principal is forgiven, the amount of the forgiveness is immediately charged off. In restructurings where accrued interest is forgiven, the interest is reversed (if current year interest) or charged off (if prior year interest). There were no charge-offs recorded at the modification dates related to troubled debt restructurings that occurred during the years ending December 31, 2019 and 2018.

The predominant form of concession granted for troubled debt restructuring includes loan modifications which include interest rates lower than the borrower could otherwise receive in the market based on credit worthiness. Other types of modifications include extension of the term, principal or accrued interest reductions, interest rate decreases and delayed payments. At times these terms might be offset with incremental payments, collateral or new borrower guarantees, in which case the Association assesses all of the modified terms to determine if the overall modification qualifies as a troubled debt restructuring.

For the years ended December 31, 2019, 2018 and 2017, no loans that met the accounting criteria as a troubled debt restructuring and that occurred within the previous 12 months of that year had a payment default during the period. A payment default is defined as a payment that is 30 days past due after the date the loan was restructured.

The Association made no additional commitments to lend to borrowers whose loans were modified in troubled debt restructurings.

The following table provides information on outstanding loans restructured in troubled debt restructurings at period end. These loans are included as impaired loans in the impaired loan table:

	<u>Loans Modified as TDRs in Accrual Status</u>		
	<u>December 31, 2019</u>	<u>December 31, 2018</u>	<u>December 31, 2017</u>
Troubled debt restructurings:			
Real estate mortgage	\$ -	\$ 1,274,222	\$ 286,090
Mission-related investments	<b>810,911</b>	839,300	863,704
Total	<b><u>\$ 810,911</u></b>	<b><u>\$ 2,113,522</u></b>	<b><u>\$ 1,149,794</u></b>
	<u>Loans Modified as TDRs in Nonaccrual Status</u>		
	<u>December 31, 2019</u>	<u>December 31, 2018</u>	<u>December 31, 2017</u>
Troubled debt restructurings:			
Real estate mortgage	\$ 230,237	\$ 45,165	\$ 45,165
Production and intermediate term	<b>2,229,485</b>	-	-
Total	<b><u>\$ 2,459,722</u></b>	<b><u>\$ 45,165</u></b>	<b><u>\$ 45,165</u></b>



Additional impaired loan information is as follows:

	Recorded Investment at 12/31/2019	Unpaid Principal Balance <sup>a</sup>	Related Allowance	Average Impaired Loans	Interest Income Recognized
<b>Impaired loans with a related allowance for credit losses:</b>					
Mission-related investments	\$ 53,715	\$ 53,003	\$ 16,509	\$ 53,331	\$ 4,294
<b>Impaired loans with no related allowance for credit losses:</b>					
Real estate mortgage	\$ 5,288,762	\$ 5,393,514	\$ -	\$ 5,601,507	\$ 108,870
Production and intermediate term	3,023,160	5,428,487	-	4,134,498	23,982
Rural residential real estate	37,617	72,517	-	32,149	-
Mission-related investments	757,196	749,597	-	758,804	46,318
Total	<u>\$ 9,106,735</u>	<u>\$ 11,644,115</u>	<u>\$ -</u>	<u>\$ 10,526,958</u>	<u>\$ 179,170</u>
<b>Total impaired loans:</b>					
Real estate mortgage	\$ 5,288,762	\$ 5,393,514	\$ -	\$ 5,601,507	\$ 108,870
Production and intermediate term	3,023,160	5,428,487	-	4,134,498	23,982
Rural residential real estate	37,617	72,517	-	32,149	-
Mission-related investments	810,911	802,600	16,509	812,135	50,612
Total	<u>\$ 9,160,450</u>	<u>\$ 11,697,118</u>	<u>\$ 16,509</u>	<u>\$ 10,580,289</u>	<u>\$ 183,464</u>

	Recorded Investment at 12/31/2018	Unpaid Principal Balance <sup>a</sup>	Related Allowance	Average Impaired Loans	Interest Income Recognized
<b>Impaired loans with a related allowance for credit losses:</b>					
Mission-related investments	\$ 54,728	\$ 54,003	\$ 15,552	\$ 54,830	\$ 4,402
<b>Impaired loans with no related allowance for credit losses:</b>					
Real estate mortgage	\$ 7,065,452	\$ 7,174,681	\$ -	\$ 5,161,674	\$ 140,964
Production and intermediate term	4,422,943	6,625,277	-	3,608,834	45,646
Rural residential real estate	31,158	66,058	-	31,158	-
Mission-related investments	784,572	776,717	-	784,298	47,686
Total	<u>\$ 12,304,125</u>	<u>\$ 14,642,733</u>	<u>\$ -</u>	<u>\$ 9,585,964</u>	<u>\$ 234,296</u>
<b>Total impaired loans:</b>					
Real estate mortgage	\$ 7,065,452	\$ 7,174,681	\$ -	\$ 5,161,674	\$ 140,964
Production and intermediate term	4,422,943	6,625,277	-	3,608,834	45,646
Rural residential real estate	31,158	66,058	-	31,158	-
Mission-related investments	839,300	830,720	15,552	839,128	52,088
Total	<u>\$ 12,358,853</u>	<u>\$ 14,696,736</u>	<u>\$ 15,552</u>	<u>\$ 9,640,794</u>	<u>\$ 238,698</u>

	Recorded Investment at 12/31/2017	Unpaid Principal Balance <sup>a</sup>	Related Allowance	Average Impaired Loans	Interest Income Recognized
<b>Impaired loans with a related allowance for credit losses:</b>					
Production and intermediate term Mission-related investments	\$ 50,000	\$ 77,400	\$ 12,500	\$ 104,855	\$ -
	65,671	64,889	26,446	66,179	4,929
Total	<u>\$ 115,671</u>	<u>\$ 142,289</u>	<u>\$ 38,946</u>	<u>\$ 171,034</u>	<u>\$ 4,929</u>
<b>Impaired loans with no related allowance for credit losses:</b>					
Real estate mortgage	\$ 3,707,037	\$ 3,913,019	\$ -	\$ 957,017	\$ 136,103
Production and intermediate term	3,420,586	6,079,222	-	884,326	122,225
Processing and marketing	19,834	19,495	-	255,190	12,793
Rural residential real estate	31,158	66,058	-	40,554	-
Mission-related investments	798,033	790,000	-	796,575	48,596
Total	<u>\$ 7,976,648</u>	<u>\$ 10,867,794</u>	<u>\$ -</u>	<u>\$ 2,933,662</u>	<u>\$ 319,717</u>
<b>Total impaired loans:</b>					
Real estate mortgage	\$ 3,707,037	\$ 3,913,019	\$ -	\$ 957,017	\$ 136,103
Production and intermediate term	3,470,586	6,156,622	12,500	989,181	122,225
Processing and marketing	19,834	19,495	-	255,190	12,793
Rural residential real estate	31,158	66,058	-	40,554	-
Mission-related investments	863,704	854,889	26,446	862,754	53,525
Total	<u>\$ 8,092,319</u>	<u>\$ 11,010,083</u>	<u>\$ 38,946</u>	<u>\$ 3,104,696</u>	<u>\$ 324,646</u>

<sup>a</sup>Unpaid principal balance represents the recorded principal balance of the loan.

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2019, 2018 and 2017.

Interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans at December 31:

	2019	2018	2017
Interest income that would have been recognized under the original terms	\$ 1,471,742	\$ 982,558	\$ 706,156
Less: interest income recognized	(183,464)	(238,698)	(324,646)
Foregone interest income	<u>\$ 1,288,278</u>	<u>\$ 743,860</u>	<u>\$ 381,510</u>

A summary of the changes in the allowance for credit losses and the ending balance of loans outstanding are as follows:

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communication	Energy	Rural Residential Real Estate	Lease Receivable	Mission- Related Investments	Total
<b>Allowance for Credit Losses:</b>									
Balance at									
December 31, 2018	\$ 1,321,472	\$ 860,965	\$ 746,813	\$ 9,978	\$ 20,898	\$ 11,724	\$ -	\$ 24,453	\$ 2,996,303
Charge-offs	(195,867)	(473,023)	-	-	-	-	-	-	(668,890)
Recoveries	971	478,015	-	-	-	-	-	-	478,986
Provision for loan losses	747,273	688,566	-	-	-	-	-	-	1,435,839
Other	(20,446)	102,112	-	-	-	-	-	-	81,666
Balance at									
December 31, 2019	\$ 1,853,403	\$ 1,656,635	\$ 746,813	\$ 9,978	\$ 20,898	\$ 11,724	\$ -	\$ 24,453	\$ 4,323,904
Ending Balance:									
individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 16,509	\$ 16,509
Ending Balance:									
collectively evaluated for impairment	\$ 1,853,403	\$ 1,656,635	\$ 746,813	\$ 9,978	\$ 20,898	\$ 11,724	\$ -	\$ 7,944	\$ 4,307,395
<b>Recorded Investment in Loans Outstanding:</b>									
Ending Balance at									
December 31, 2019	\$ 990,327,899	\$ 225,802,377	\$ 91,563,464	\$ 10,544,242	\$ 2,806,945	\$ 2,292,053	\$ -	\$ 1,672,123	\$ 1,325,009,103
Ending balance for loans individually evaluated for impairment	\$ 5,290,729	\$ 3,023,155	\$ -	\$ -	\$ -	\$ 37,617	\$ -	\$ 802,600	\$ 9,154,101
Ending balance for loans collectively evaluated for impairment	\$ 984,851,187	\$ 222,779,222	\$ 91,563,464	\$ 10,544,242	\$ 2,806,945	\$ 2,254,436	\$ -	\$ 869,523	\$ 1,315,669,019
Ending balance for loans acquired with deteriorated credit quality	\$ 185,983	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 185,983

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communication	Energy	Rural Residential Real Estate	Lease Receivable	Mission- Related Investments	Total
<b>Allowance for Credit Losses:</b>									
Balance at									
December 31, 2017	\$ 1,739,723	\$ 972,579	\$ 746,813	\$ 9,978	\$ 20,898	\$ 11,724	\$ 28	\$ 24,453	\$ 3,526,196
Charge-offs	-	(23,800)	-	-	-	-	-	-	(23,800)
Recoveries	15,978	501,736	-	-	-	-	-	-	517,714
Provision for loan losses	(432,488)	(592,449)	-	-	-	-	-	-	(1,024,937)
Other	(1,741)	2,899	-	-	-	-	(28)	-	1,130
Balance at									
December 31, 2018	\$ 1,321,472	\$ 860,965	\$ 746,813	\$ 9,978	\$ 20,898	\$ 11,724	\$ -	\$ 24,453	\$ 2,996,303
Ending Balance:									
individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 15,552	\$ 15,552
Ending Balance:									
collectively evaluated for impairment	\$ 1,321,472	\$ 860,965	\$ 746,813	\$ 9,978	\$ 20,898	\$ 11,724	\$ -	\$ 8,901	\$ 2,980,751
<b>Recorded Investment in Loans Outstanding:</b>									
Ending Balance at									
December 31, 2018	\$ 922,364,093	\$ 225,238,080	\$ 75,248,976	\$ 5,930,414	\$ 3,299,372	\$ 2,765,385	\$ -	\$ 2,272,441	\$ 1,237,118,761
Ending balance for loans individually evaluated for impairment	\$ 7,071,327	\$ 4,412,840	\$ -	\$ -	\$ -	\$ 31,158	\$ -	\$ 830,719	\$ 12,346,044
Ending balance for loans collectively evaluated for impairment	\$ 915,097,478	\$ 220,825,240	\$ 75,248,976	\$ 5,930,414	\$ 3,299,372	\$ 2,734,227	\$ -	\$ 1,441,722	\$ 1,224,577,429
Ending balance for loans acquired with deteriorated credit quality	\$ 195,288	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 195,288

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communication	Energy	Rural Residential Real Estate	Lease Receivable	Mission- Related Investments	Total
<b>Allowance for Credit Losses:</b>									
Balance at									
December 31, 2016	\$ 1,287,214	\$ 1,584,546	\$ 746,813	\$ 9,978	\$ 20,898	\$ 11,724	\$ 28	\$ 24,453	\$ 3,685,654
Charge-offs	3,963	(1,101,192)	-	-	-	-	-	-	(1,097,229)
Recoveries	197,370	19,636	-	-	-	-	-	-	217,006
Provision for loan losses	251,176	500,714	-	-	-	-	-	-	751,890
Other	-	(31,125)	-	-	-	-	-	-	(31,125)
Balance at									
December 31, 2017	\$ 1,739,723	\$ 972,579	\$ 746,813	\$ 9,978	\$ 20,898	\$ 11,724	\$ 28	\$ 24,453	\$ 3,526,196
Ending Balance: individually evaluated for impairment	\$ -	\$ 12,500	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 26,446	\$ 38,946
Ending Balance: collectively evaluated for impairment	\$ 1,739,723	\$ 960,079	\$ 746,813	\$ 9,978	\$ 20,898	\$ 11,724	\$ 28	\$ (1,993)	\$ 3,487,250
<b>Recorded Investment in Loans Outstanding:</b>									
Ending Balance at									
December 31, 2017	\$ 1,014,913,881	\$ 210,224,569	\$ 81,752,034	\$ 10,156,088	\$ 3,822,948	\$ 3,103,720	\$ -	\$ 2,350,711	\$ 1,326,323,951
Ending balance for loans individually evaluated for impairment	\$ 3,738,414	\$ 3,470,578	\$ 19,495	\$ -	\$ -	\$ 31,158	\$ -	\$ 854,889	\$ 8,114,534
Ending balance for loans collectively evaluated for impairment	\$ 1,010,954,448	\$ 206,745,711	\$ 81,732,539	\$ 10,156,088	\$ 3,822,948	\$ 3,072,562	\$ -	\$ 1,495,822	\$ 1,317,980,118
Ending balance for loans acquired with deteriorated credit quality	\$ 221,019	\$ 8,280	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 229,299

## NOTE 5 — LEASES

Adoption of the leasing standard impacted our previously reported results as follows:

	Balance Sheet Classification	As of December 31, 2019	As Previously Reported December 31, 2018	Lease Standard Adjustment	As Adopted January 1, 2019
Operating leases	Operating lease right-of-use asset-building	\$ 363,720	\$ -	\$ 222,662	\$ 222,662
Operating leases	Operating lease right-of-use liabilities-building	\$ 363,720	\$ -	\$ 222,662	\$ 222,662

The Components of lease expense were as follows:

	December 31, 2019
Operating lease cost classified as right-to-use assets	\$ 148,417
Short-term lease cost not capitalized as assets	21,000
Finance lease cost	
Amortization of right-of-use assets	4,022
Net lease cost	\$ 173,439

Other information related to leases was as follows:

	<u>December 31, 2019</u>
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows for operating leases	\$ 152,439
Right-of-use assets obtained in exchange for lease obligations:	
Operating leases	\$ 148,417

Lease term and discount rate are as follows:

	<u>December 31, 2019</u>
Weighted average remaining lease term in years	
Operating leases	3.01
Weighted average discount rate	
Operating leases	2.71%

Future minimum lease payments under non-cancellable leases as of December 31, 2019 were as follows:

	<u>Operating Leases</u>
2020	\$ 104,346
2021	82,504
2022	55,966
2023	50,845
Thereafter (2024-2026)	100,657
Total lease payments	<u>\$ 394,318</u>

#### NOTE 6 — INVESTMENT IN THE FARM CREDIT BANK OF TEXAS:

The investment in the Farm Credit Bank of Texas is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying consolidated balance sheet. Estimating the fair value of the Association's investment in the Farm Credit Bank of Texas is not practicable because the stock is not traded. The Association owned 6.8 percent, 7.3 percent and 7.5 percent of the issued stock of the Bank as of December 31, 2019, 2018 and 2017. As of those dates, the Bank's assets totaled \$25.7 billion, \$24.5 billion and \$22.8 billion, and members' equity totaled \$1.8 billion, \$1.8 billion and \$1.7 billion. The Bank's earnings were \$203.0 million, \$190.5 million and \$196.0 million during 2019, 2018 and 2017.

#### NOTE 7 — PREMISES AND EQUIPMENT:

Premises and equipment consisted of the following at December 31:

	<u>2019</u>	2018	2017
Land	\$ 2,431,558	\$ 1,929,732	\$ 1,939,839
Building and improvements	12,688,257	10,011,082	9,718,720
Furniture and equipment	1,585,179	1,227,904	1,004,224
Computer equipment and software	743,036	662,917	631,381
Automobiles	1,785,284	1,522,208	1,496,010
Construction in progress	410,719	1,192,114	650,441
	<u>19,644,033</u>	16,545,957	15,440,615
Accumulated depreciation	(4,706,256)	(4,051,548)	(3,648,489)
Total	<u>\$ 14,937,777</u>	\$ 12,494,409	\$ 11,792,126

The Association leases office space in Bonham, Brenham, Dallas, Gainesville, Heath, Laredo, McAllen, Paris, Prosper and Taft. Lease expense was \$159,039, \$126,980 and \$81,813 for 2019, 2018 and 2017, respectively. The lease contracts range from monthly lease terms up to seven-year lease terms. None of the leases qualify as capital leases, and all lease contracts are considered operating leases. Minimum annual lease payments for the next five years total \$339,412. See Note 5 – Leases for further details.

**NOTE 8 — OTHER PROPERTY OWNED, NET:**

Net gain (loss) on other property owned, net consists of the following for the years ended December 31:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Gain on sale, net	\$ 41,464	\$ 1,098	\$ 48,611
Operating (expense) income, net	(551)	414,107	(1,356)
Net gain on other property owned	<u>\$ 40,913</u>	<u>\$ 415,205</u>	<u>\$ 47,255</u>

The Association held two properties classified as other property owned as of December 31, 2019. The larger property is a cold storage facility located in Hidalgo County. It was transferred to other property owned with a value of \$3,643,250, and the Association established an allowance for other property owned of \$699,106. The carrying value of \$2,944,144 represents the estimated fair valuation of the property as of December 31, 2019. The second property classified as other property owned is 27 acres located in Bandera County. The carrying value of \$157,250 represents the estimated fair valuation of the property less applicable costs as of December 31, 2019.

**NOTE 9 — OTHER ASSETS AND OTHER LIABILITIES:**

Other assets comprised the following at December 31:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Intangible Assets	\$ 2,135,855	\$ 2,313,997	\$ 1,920,000
Nonqualified deferred compensation	595,536	529,193	386,568
Right-of-use asset - building leases	363,720	-	-
Prepaid expenses	221,866	397,833	216,671
Accounts receivable - other	14,949	12,721	16,869
Farmer Mac stock	8,000	8,000	8,000
Miscellaneous assets	908	908	908
Total	<u>\$ 3,340,834</u>	<u>\$ 3,262,652</u>	<u>\$ 2,549,016</u>

Other liabilities comprised the following at December 31:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Operating accounts payable	\$ 6,910,158	\$ 5,594,727	\$ 5,445,839
Post-retirement benefits liability	4,751,534	4,154,101	4,616,376
Insurance payable	926,727	940,030	1,472,375
Accrued annual leave	731,122	668,982	628,424
Lease liability - building leases	363,720	-	-
Allowance on unfunded loans	346,607	428,273	429,403
Federal income taxes payable	138,204	127,361	-
Miscellaneous liabilities	34,330	36,479	40,209
Total	<u>\$ 14,202,402</u>	<u>\$ 11,949,953</u>	<u>\$ 12,632,626</u>

The Association owns three crop insurance agencies within its territory. One agency was purchased in August 2018 for \$572,140, one agency was purchased in September 2017 for \$1,500,000, and one agency was purchased in March 2016 for \$600,000. All three purchases are classified as intangible assets based on goodwill resulting from the expected future benefit of customer contracts. Amortization of \$178,142 was recorded for 2019, and amortization of \$178,142 per year is estimated over the five succeeding fiscal years. At December 31, 2019, the balance of these intangible assets after amortization reported was \$2,135,855.

**NOTE 10 — NOTE PAYABLE TO THE BANK:**

The interest rate risk inherent in the Association's loan portfolio is substantially mitigated through the funding relationship with the Bank. The Bank manages interest rate risk through its direct loan pricing and asset/liability management process. The Association's indebtedness to the Bank represents borrowings by the Association to fund the majority of its loan portfolio. The indebtedness is collateralized by a pledge of substantially all of the Association's assets and is governed by a general financing agreement. The interest rate on the direct loan is based upon the Bank's cost of funding the loans the Association has outstanding to its borrowers.

The indebtedness continues in effect until the expiration date of the general financing agreement, which is September 30, 2020, unless sooner terminated by the Bank upon the occurrence of an event of default, or by the Association, in the event of a breach of this agreement by the Bank, upon giving the Bank 30 calendar days' prior written notice, or in all other circumstances, upon giving the Bank 120 days' prior written notice.

The total amount and the weighted average interest rate of the Association's direct loan from the Bank at December 31, 2019, 2018 and 2017, was \$1,140,484,754 at 3.09 percent, \$1,059,336,455 at 2.72 percent and \$1,156,165,343 at 2.27 percent, respectively.

Under the Act, the Association is obligated to borrow only from the Bank unless the Bank approves borrowing from other funding sources. The Bank and FCA regulations have established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2019, 2018 and 2017, the Association's note payable was within the specified limitations. The maximum amount the Association may borrow from the Bank as of December 31, 2019, was \$1,319,652,185, as defined by the general financing agreement.

In addition to borrowing limits, the financing agreement establishes certain covenants including limits on leases, investments, other debt, and dividend and patronage distributions; minimum standards for return on assets and for liquidity; and provisions for conducting business, maintaining records, reporting financial information, and establishing policies and procedures. Remedies specified in the general financing agreement associated with the covenants include additional reporting requirements, development of action plans, increases in interest rates on indebtedness, reduction of lending limits or repayment of indebtedness. As of and for the years ended December 31, 2019, 2018 and 2017, the Association was not subject to remedies associated with the covenants in the general financing agreement.

#### **NOTE 11 — MEMBERS' EQUITY:**

A description of the Association's capitalization requirements, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below.

Since the Association operates for the mutual benefit of its customer-owners and other customers and not for the benefit of any other equity investors, capital stock provides no significant interest in corporate earnings or growth. Specifically, due to restrictions in applicable regulations and bylaws, the Association can issue stock only at its par value of \$5 per share, the stock is not tradable, and the stock can be retired only for the lesser of par value or book value. In these and other respects, the shares of stock in one association that were converted to shares of another association had identical rights and attributes. For this reason, the conversion of stock pursuant to the mergers occurred at a one-for-one exchange ratio. Management believes that because the stock in each association is fixed in value, the stock issued pursuant to the mergers provides no basis for estimating the fair value of the consideration transferred pursuant to the mergers. In the absence of a purchase price determination, the acquiring association identified and estimated the acquisition date fair value of the net assets of the acquired association instead of the acquisition date fair value of the equity interests transferred as consideration. The fair value of the assets acquired, including specific intangible assets and liabilities assumed, were measured based on various estimates using assumptions that management believes are reasonable utilizing information then available. This evaluation produced a fair value of identifiable assets acquired and liabilities assumed that was substantially equal to the fair value of the member interests transferred in the mergers. The excess value received, by the acquiring association from the acquired association, over the par value of capital stock and participation certificates issued in the mergers was considered to be additional paid-in capital.

The Association classifies its retained earnings as either allocated or unallocated. Allocated retained earnings represents allocated patronage surplus that is eligible for cash redemption after seven years from issuance. Redemption of allocated retained earnings is at the sole discretion of the Association's board of directors. Unallocated retained earnings represent undistributed profits and nonqualified patronage surplus that has restrictions for future redemption.

Protection of certain borrower equity is provided under the Act that requires the Association, when retiring protected borrower equity, to retire such equity at par or stated value regardless of its book value. Protected borrower equity includes capital stock, participation certificates and allocated equities that were outstanding as of January 6, 1988, or were issued or allocated prior to October 6, 1988. If an Association is unable to retire protected borrower equity at par value or stated value, amounts required to retire this equity would be obtained from the Insurance Fund.

In accordance with the Act and the Association's capitalization bylaws, each borrower is required to invest in the Association as a condition of borrowing. Borrowers are required to purchase investment in Class B capital stock (in the case of agricultural loans to producers) or participation certificates (in the purchase of rural home loans and farm-related business loans) equal to 2.0 percent of

the principal amount of their cumulative loan balances for both PCA and FLCA members with a maximum of \$1,000. The borrower usually acquires the Class B capital stock or participation certificates by adding the aggregate par value to the disbursement on the initial loan obligation. The capital stock or participation certificates are subject to a first lien by the Association. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding capital stock or participation certificates.

If needed to meet regulatory capital adequacy requirements, the board of directors of the Association may increase the percentage of stock requirement for each borrower up to a maximum of 10.0 percent of the loan amount.

Each owner or joint owners of Class B capital stock are entitled to a single vote. Participation certificates provide no voting rights to their owners.

Borrowers who wish to retain their investment in the Association after liquidating their loan balance may convert their Class B capital stock holdings to Class A capital stock. Within two years of repayment of a loan, the Association capital bylaws require the conversion of any borrower's outstanding Class B to Class A capital stock. Class A capital stock has no voting rights, except in a case where a new issuance of preferred stock has been submitted to stockholders affected by the preference. Redemption of all stock shares is made solely at the discretion of the Association's board of directors. At December 31, 2019, 2018 and 2017, the Association had \$67,995, \$410,845 and \$350,985, respectively, of Class A stock.

All borrower stock is at risk. Any losses which result in any impairment of the Association's capital stock shall be borne ratably, by each share or unit of all classes of common stock and participation certificates. Impaired stock and participation certificates shall be restored in the reverse sequence until each share of stock and unit of participation certificates has a book value equal to the par or face value, respectively. In the event of the liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities shall be distributed to stockholders.

Patronage distributions may be paid on the capital stock and participation certificates of the Association, as the board of directors may determine by resolution, subject to capitalization requirements as defined by the FCA. Amounts declared but not distributed in cash are retained as allocated and unallocated retained earnings based on the classification of the distribution as qualified or nonqualified. The following patronage distributions were declared and paid in cash, allocated and/or unallocated retained earnings in 2019, 2018 and 2017, respectively:

<u>Date Declared</u>	<u>Date Paid or Payable</u>	<u>Total Patronage</u>
December 2019	April 2020	\$ 20,590,000
December 2019	December 2019	\$ 6,298,009
March 2019	April 2019	\$ 66,880
December 2018	April 2019	\$ 18,900,000
October 2018	December 2018	\$ 5,238,499
December 2017	April 2018	\$ 16,177,000
October 2017	December 2017	\$ 4,876,781
December 2016	April 2017	\$ 14,210,000

The Farm Credit Administration sets minimum regulatory capital requirements for Banks and Associations. Effective January 1, 2017, new regulatory capital requirements for Banks and Associations were adopted. These new requirements replaced the core surplus and total surplus requirements with common equity tier 1, tier 1 capital and total capital risk-based capital ratio requirements. The new requirements also replaced the existing net collateral ratio for System Banks with a tier 1 leverage ratio and an unallocated retained earnings and equivalents (UREE) leverage ratio that are applicable to both the banks and associations. The permanent capital ratio continues to remain in effect; however, the risk-adjusted assets are calculated differently than in the past. As of December 31, 2019, the Association is not prohibited from retiring stock or distributing earnings. Furthermore, neither the board nor senior management knows of any such prohibitions that may apply during the subsequent fiscal year.



The following sets forth the regulatory capital ratio requirements and ratios at December 31, 2019:

Risk-adjusted:	Regulatory Minimums	Conservation Buffer*	Total	As of December 31, 2019
Common equity tier 1 ratio	4.50%	2.50%	7.00%	14.19%
Tier 1 capital ratio	6.00%	2.50%	8.50%	14.19%
Total capital ratio	8.00%	2.50%	10.50%	14.49%
Permanent capital ratio	7.00%	0.00%	7.00%	14.23%
Non-risk-adjusted:				
Tier 1 leverage ratio**	4.00%	1.00%	5.00%	14.04%
UREE leverage ratio	1.50%	0.00%	1.50%	10.62%

\*The 2.5% capital conservation buffer for the risk-adjusted ratios was phased in over a three year period ending on December 31, 2019. There is no phase-in of the leverage buffer.

\*\*Must include the regulatory minimum requirement for the URE and UREE Leverage ratio

Risk-adjusted assets have been defined by FCA Regulations as the Statement of Condition assets and off balance-sheet commitments adjusted by various percentages, depending on the level of risk inherent in the various types of assets. The primary changes that generally have the impact of increasing risk-adjusted assets (decreasing risk-based regulatory capital ratios) were as follows:

- Inclusion of off-balance-sheet commitments less than 14 months
- Increased risk-weighting of most loans 90 days past due or in nonaccrual status

Risk-adjusted assets are calculated differently for the permanent capital ratio (referred herein as PCR risk-adjusted assets) compared to the other risk-based capital ratios. The primary difference is the deduction of the allowance for loan losses from risk-adjusted assets for the permanent capital ratio.

The ratios are based on a three-month average daily balance in accordance with FCA regulations and are calculated as follows:

- Common equity tier 1 ratio is statutory minimum purchased borrower stock, other required borrower stock held for a minimum of 7 years, allocated equities held for a minimum of 7 years or not subject to revolvment, unallocated retained earnings, paid-in capital, less certain regulatory required deductions including the amount of allocated investments in other System institutions, and the amount of purchased investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.
- Tier 1 capital ratio is common equity tier 1 plus noncumulative perpetual preferred stock, divided by average risk-adjusted assets.
- Total capital is tier 1 capital plus other required borrower stock held for a minimum of 5 years, allocated equities held for a minimum of 5 years, subordinated debt and limited-life preferred stock greater than 5 years to maturity at issuance subject to certain limitations, allowance and reserve for credit losses under certain limitations less certain investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.
- Permanent capital ratio (PCR) is all at-risk borrower stock, any allocated excess stock, unallocated retained earnings, paid-in capital, subordinated debt and preferred subject to certain limitations, less certain allocated and purchased investments in other System institutions, divided by PCR risk-adjusted assets.
- Tier 1 leverage ratio is tier 1 capital, including regulatory deductions, divided by average assets less regulatory deductions subject to tier 1 capital.
- UREE leverage ratio is unallocated retained earnings, paid-in capital, allocated surplus not subject to revolvment less certain regulatory required deductions including the amount of allocated investments in other System institutions divided by average assets less regulatory deductions subject to tier 1 capital.

If the capital ratios fall below the total requirements, including the buffer amounts, capital distributions (equity redemptions, dividends and patronage) and discretionary senior executive bonuses are restricted or prohibited without prior FCA approval.

The components of the Association's risk-adjusted capital, based on 90-day average balances, were as follows at December 31, 2019:

	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
<b>Numerator:</b>				
Unallocated retained earnings	\$ 66,217,851	\$ 66,217,851	\$ 66,217,851	\$ 66,217,851
Paid-in capital	47,596,495	47,596,495	47,596,495	47,596,495
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	3,799,219	3,799,219	3,799,219	3,799,219
Allocated equities held $\geq 7$	54,021,783	54,021,783	54,021,783	54,021,783
Nonqualified allocated equities not subject to retirement	41,817,342	41,817,342	41,817,342	41,817,342
Allowance for loan losses and reserve for credit losses subject to certain limitations*			3,962,790	
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	(23,091,599)	(23,091,599)	(23,091,599)	(23,091,599)
Other regulatory required deductions	(2,286,286)	(2,286,286)	(2,286,286)	(2,286,286)
	<u>\$ 188,074,805</u>	<u>\$ 188,074,805</u>	<u>\$ 192,037,595</u>	<u>\$ 188,074,805</u>
<b>Denominator:</b>				
Risk-adjusted assets excluding allowance	\$ 1,350,443,942	\$ 1,350,443,942	\$ 1,350,443,942	\$ 1,350,443,942
Regulatory Adjustments and Deductions:				
Regulatory deductions included in total capital	(25,377,885)	(25,377,885)	(25,377,885)	(25,377,885)
Allowance for loan losses				(3,715,140)
	<u>\$ 1,325,066,057</u>	<u>\$ 1,325,066,057</u>	<u>\$ 1,325,066,057</u>	<u>\$ 1,321,350,917</u>
<b>Calculated ratio</b>	<b>14.19%</b>	<b>14.19%</b>	<b>14.49%</b>	<b>14.23%</b>

\*Capped at 1.25 percent of risk-adjusted assets

The components of the Association's nonrisk-adjusted capital, based on 90-day average balances, were as follows at December 31, 2019:

	Tier 1 leverage ratio	UREE leverage ratio
<b>Numerator:</b>		
Unallocated retained earnings	\$ 66,217,851	\$ 66,217,851
Paid-in capital	47,596,495	47,596,495
Common Cooperative Equities:		
Statutory minimum purchased borrower stock	3,799,219	-
Allocated equities:		
Allocated equities held $\geq 7$	54,021,783	-
Nonqualified allocated equities not subject to retirement	41,817,342	41,817,342
Regulatory Adjustments and Deductions:		
Amount of allocated investments in other System institutions	(23,091,599)	(11,022,481)
Other regulatory required deductions	(2,286,286)	(2,286,286)
	<u>\$ 188,074,805</u>	<u>\$ 142,322,921</u>
<b>Denominator:</b>		
Total Assets	\$ 1,371,199,715	\$ 1,371,199,715
Regulatory Adjustments and Deductions:		
Regulatory deductions included in tier 1 capital	(31,219,064)	(31,219,064)
	<u>\$ 1,339,980,651</u>	<u>\$ 1,339,980,651</u>
<b>Calculated ratio</b>	<b>14.04%</b>	<b>10.62%</b>

The Association's board of directors has established a Capital Adequacy Plan (Plan) that includes the capital targets that are necessary to achieve the institution's capital adequacy goals as well as the minimum capital standards. The Plan monitors projected patronage distributions, equity retirements and other actions that may decrease the Association's capital. In addition to factors that must be considered in meeting the minimum standards, the board of directors also monitors the following factors: capability of management; quality of operating policies, procedures and internal controls; quality and quantity of earnings; asset quality and the adequacy of the allowance for losses to absorb potential loss within the loan and lease portfolios; sufficiency of liquid funds; needs of an institution's customer base; and any other risk-oriented activities, such as funding and interest rate risk, potential obligations under joint and several liability, contingent and off-balance-sheet liabilities or other conditions warranting additional capital. At least quarterly, management reviews the Association's goals and objectives with the board of directors.

An FCA regulation empowers the FCA to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. The Association has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

The Association is authorized to have outstanding Class A common stock, Class B common stock, Class P common stock, Class C preferred stock and participation certificates. Borrowers who hold Class B common stock or participation certificates are eligible for patronage distribution from fiscal year net earnings. Subsequent distribution of allocated surplus does not require the recipient be a current stockholder of the Association. The Association has not issued and has no outstanding Class P common stock or Class C preferred stock.

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after the payment or retirement of all liabilities would be distributed to holders of stock and participation certificates. First, to the holder's pro-rata of Class C preferred stock then outstanding until an amount equal to the aggregate par value of such stock has been distributed to such holder. Second, to the holders of common stock and participation certificates, pro-rata in proportion to the number of shares of units of stock or participation certificates then outstanding until an amount equal to the aggregate par value or unit value of all shares of such stock and participation certificates issued and outstanding has been distributed to such holders.

At December 31, the Association had the following shares of Class A capital stock, Class B stock and participation certificates outstanding at a par value of \$5 per share:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Class A stock	13,799	82,169	70,197
Class B stock	737,144	729,314	722,711
Participation certificates	7,330	8,536	9,748
Total	<u>758,273</u>	<u>820,019</u>	<u>802,656</u>

An additional component of equity is accumulated other comprehensive income, which is reported net of taxes as follows:

<b>Accumulated Other Comprehensive Loss</b>	
<b>December 31, 2019</b>	<b>Net of Tax</b>
Nonpension postretirement benefits	<u>\$ (710,138)</u>
December 31, 2018	Net of Tax
Nonpension postretirement benefits	<u>\$ (198,585)</u>
December 31, 2017	Net of Tax
Nonpension postretirement benefits	<u>\$ (788,602)</u>

The Association's accumulated other comprehensive income (loss) relates entirely to its nonpension other postretirement benefits.

The following table summarizes the changes in accumulated other comprehensive income (loss) and the location on the income statement for the year ended December 31:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Accumulated other comprehensive income (loss) at January 1	\$ (198,585)	\$ (788,602)	\$ (385,757)
Actuarial (losses) gains	(489,837)	420,140	(376,318)
Prior service credit	-	150,058	-
Amortization of prior service credits included in salaries and employee benefits	(21,716)	(22,176)	(29,569)
Amortization of actuarial loss included in salaries and employee benefits	-	41,995	3,042
Other comprehensive income (loss), net of tax	(511,553)	590,017	(402,845)
Accumulated other comprehensive income at December 31	<u>\$ (710,138)</u>	<u>\$ (198,585)</u>	<u>\$ (788,602)</u>

#### NOTE 12 — INCOME TAXES:

The provision for (benefit from) income taxes follows for the years ended December 31:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Current:			
Federal	\$ 145,843	\$ 147,799	\$ 26,945
Deferred:			
Federal	(145,610)	283,793	493,575
Total provision for income taxes	<u>\$ 233</u>	<u>\$ 431,592</u>	<u>\$ 520,520</u>

In December 2017, a new tax bill that lowered the 2018 corporate tax rate to 21% from the 2017 tax rate of 35% was signed into law. Generally Accepted Accounting Principles (GAAP) required the Association to revalue its deferred tax assets at the new lower tax rate and record any adjustment in 2017. The reevaluation under the new 21% corporate tax rate resulted in a decrease in deferred tax assets of \$564,455. The decrease in the Association's deferred tax assets was recorded as a deferred tax expense for December 2017.

The provision for (benefit from) income tax differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as follows for the years ended December 31:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Federal tax at statutory rate	\$ 6,106,912	\$ 6,549,320	\$ 8,872,171
Effect of nontaxable FLCA subsidiary	(5,148,411)	(5,457,793)	(7,685,723)
Patronage distributions	(945,000)	(840,000)	(1,050,000)
Other	(13,268)	180,065	(180,383)
Change in deferred tax rate	-	-	564,455
Provision for income taxes	<u>\$ 233</u>	<u>\$ 431,592</u>	<u>\$ 520,520</u>

Deferred tax assets and liabilities in accordance with accounting guidance, "Accounting for Income Taxes," are comprised of the following at December 31:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
<u>Deferred Tax Assets</u>			
Allowance for loan losses	\$ 649,125	\$ 503,478	\$ 527,525
Postretirement benefits, other	59,374	59,411	106,348
Loss carryforwards	-	-	212,809
Deferred tax asset	<u>\$ 708,499</u>	<u>\$ 562,889</u>	<u>\$ 846,682</u>

The calculation of tax assets and liabilities involves various management estimates and assumptions as to the future taxable earnings. At December 31, 2019, nonpatronage income is expected to be 15.0 percent of total taxable income (before patronage) and all nonpatronage income is expected to be retained by the Association on a tax basis. The expected future tax rates are based upon enacted tax laws.

Upon formation of the ACA, the PCA transferred certain loans to the FLCA as permitted by the Act. The PCA did not transfer any allowance for loan losses related to the loans transferred. As a result, deferred taxes attributable to the allowance for loan losses subject to the transfer did not change.

The ACA is required to maintain an investment in the Bank of 2 percent of the average direct note. This investment can be held by both the PCA and FLCA. A deferred tax liability is established for the PCA for any excess investment in the Bank over that allocated to the 2 percent investment requirement. Upon formation of the ACA, additional amounts of excess investment previously held by the PCA were included in the calculation of the 2 percent requirement of the ACA. The PCA did not hold any excess investment as of December 31, 2019, 2018 and 2017, respectively.

The Association expects to fully utilize its gross deferred tax assets and has no deferred tax valuation allowance. The Association will continue to evaluate the realizability of the deferred tax assets.

#### **NOTE 13 — EMPLOYEE BENEFIT PLANS:**

**Employee Retirement Plans:** Employees of the Association participate in either the defined benefit retirement plan (DB plan) or the defined contributions plan (DC plan) and are eligible to participate in the Farm Credit Benefits Alliance 401(k) Plan. These plans are described more fully in section I of Note 2, “Summary of Significant Accounting Policies.” The structure of the District’s DB plan is characterized as multi-employer, since neither the assets, liabilities nor cost of any plan is segregated or separately accounted for by participating employers (Bank and Associations). No portion of any surplus assets is available to any participating employer. As a result, participating employers of the plan only recognize as cost the required contributions for the period and a liability for any unpaid contributions required for the period of their financial statements. Plan obligations, assets and the components of annual benefit expenses are recorded and reported upon District combination only. The Association records current contributions to the DB plan as an expense in the current year.

The CEO and certain executive or highly-compensated employees in the Association are eligible to participate in a separate nonqualified supplemental 401(k) plan, named the Farm Credit Benefits Alliance Nonqualified Supplemental 401(k) Plan (supplemental 401(k) plan). This plan allows District employers to elect to participate in any or all of the following benefits:

- Restored Employer Contributions – to allow “make-up” contributions for eligible employees whose benefits to the qualified 401(k) plan were limited by the Internal Revenue Code during the year
- Elective Deferrals – to allow eligible employees to make pre-tax deferrals of compensation above and beyond any deferrals into the qualified 401(k) plan
- Discretionary Contributions – to allow participating employers to make a discretionary contribution to an eligible employee’s account in the plan, and to designate a vesting schedule

The Association elected to participate in the District’s nonqualified defined contribution 401(k) plan, although participation from qualifying employees was limited. Contributions of \$57,044, \$89,070 and \$73,945 were made to this plan for the years ended December 31, 2019, 2018 and 2017. There were no payments made from the supplemental 401(k) plan to active employees during 2019, 2018 and 2017.

The DB plan is noncontributory, and benefits are based on salary and years of service. The legal name of the plan is Farm Credit Bank of Texas Pension Plan; its employer identification number is 74-1110170. The DB plan is not subject to any contractual expiration dates. The DB plan’s funding policy is to fund current year benefits expected to be earned by covered employees plus an amount to improve the accumulated benefit obligation funded status by a percentage approved by the plan sponsor. The plan sponsor is the board of the Farm Credit Bank of Texas. The “projected unit credit” actuarial method is used for both financial reporting and funding purposes. District employers have the option of providing enhanced retirement benefits, under certain conditions, within the DB plan, to facilitate reorganization and/or restructuring. The actuarial present value of vested and nonvested accumulated benefit obligation exceeded the net assets of the DB plan as of December 31, 2019.

The risks of participating in these multi-employer plans are different from single-employer plans in the following aspects:

- a. Assets contributed to the multi-employer plan by one employer may be used to provide benefits to employees of other participating employers.

- b. If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.
- c. If the Association chooses to stop participating in some of its multi-employer plans, it may be required to pay the plan an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

The following table includes additional information regarding the funded status of the plan, the Association's contributions, and the percentage of Association contribution to total plan contributions for the years ended December 31, 2019, 2018 and 2017:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Funded status of plan	66.2 %	68.0 %	69.7 %
Association's contribution	\$ 420,239	\$ 485,749	\$ 493,153
Percentage of association's contribution to total contributions	5.2 %	5.0 %	4.3 %

The funded status presented above is based on the percentage of plan assets to projected benefit obligations. DB plan funding is based on the percentage of plan assets to the accumulated benefit obligation, which was 68.0 percent, 70.1 percent and 73.4 percent at December 31, 2019, 2018 and 2017, respectively.

**Other Postretirement Benefits:** In addition to pension benefits, the Association provides certain health care benefits to qualifying retired employees (other postretirement benefits). These benefits are not characterized as multi-employer, and consequently, the liability for these benefits is included in other liabilities.

The following table reflects the benefit obligation, cost and actuarial assumptions for the Association's other postretirement benefits:

<b>Disclosure Information Related to Retirement Benefits</b>	<b>2019</b>	<b>2018</b>	<b>2017</b>
<b>Change in Accumulated Postretirement Benefit Obligation</b>			
Accumulated postretirement benefit obligation, beginning of year	\$ 4,154,101	\$ 4,616,376	\$ 4,114,750
Service cost	54,963	67,544	56,211
Interest cost	193,316	182,225	186,694
Plan participants' contributions	35,431	47,313	46,188
Plan amendments	-	(150,058)	-
Actuarial loss (gain)	489,837	(420,140)	376,318
Benefits paid	<u>(176,114)</u>	<u>(189,159)</u>	<u>(163,785)</u>
Accumulated postretirement benefit obligation, end of year	\$ 4,751,534	\$ 4,154,101	\$ 4,616,376
<b>Change in Plan Assets</b>			
Company contributions	\$ 140,683	\$ 141,846	\$ 117,597
Plan participants' contributions	35,431	47,313	46,188
Benefits paid	<u>(176,114)</u>	<u>(189,159)</u>	<u>(163,785)</u>
Plan assets at fair value, end of year	\$ -	\$ -	\$ -
Funded status of the plan	\$ (4,751,534)	\$ (4,154,101)	\$ (4,616,376)
<b>Amounts Recognized in Statement of Financial Position</b>			
Other liabilities	\$ (4,751,534)	\$ (4,154,101)	\$ (4,616,376)
<b>Amounts Recognized in Accumulated Other Comprehensive Income</b>			
Net actuarial loss	\$ 838,480	\$ 348,643	\$ 810,778
Prior service credit	<u>(128,342)</u>	<u>(150,058)</u>	<u>(22,176)</u>
Total	\$ 710,138	\$ 198,585	\$ 788,602
<b>Weighted-Average Assumptions Used to Determine Obligations at Year End</b>			
Measurement date	12/31/2019	12/31/2018	12/31/2017
Discount rate	3.45%	4.75%	4.00%
Health care cost trend rate assumed for next year (pre-/post-65) - medical	6.90%/6.40%	7.30%/6.90%	7.70%/6.90%
Ultimate health care cost trend rate	4.50%	4.50%	4.50%
Year that the rate reaches the ultimate trend rate	2028	2027	2026

<b>Total Cost</b>	<b>2019</b>	<b>2018</b>	<b>2017</b>
Service cost	\$ 54,963	\$ 67,544	\$ 56,211
Interest cost	193,316	182,225	186,694
Amortization of:			
Unrecognized prior service credit	(21,716)	(22,176)	(29,569)
Unrecognized net loss	-	41,995	3,042
Net postretirement benefit cost	\$ 226,563	\$ 269,588	\$ 216,378
<b>Other Changes in Plan Assets and Projected Benefit Obligation Recognized in Other Comprehensive Income</b>			
Net actuarial loss (gain)	\$ 489,837	\$ (420,140)	\$ 376,318
Amortization of net actuarial loss	-	(41,995)	(3,042)
Prior service credit	-	(150,058)	-
Amortization of prior service credit	21,716	22,176	29,569
Total recognized in other comprehensive income	\$ 511,553	\$ (590,017)	\$ 402,845
<b>AOCI Amounts Expected to be Amortized into Expense</b>			
Unrecognized prior service credit	\$ (21,716)	\$ (21,716)	\$ (22,176)
Unrecognized net loss	40,686	-	41,995
Total	\$ 18,970	\$ (21,716)	\$ 19,819
<b>Weighted-Average Assumptions Used to Determine Benefit Cost</b>			
Measurement date	12/31/2018	12/31/2017	12/31/2016
Discount rate	4.75%	4.00%	4.60%
Health care cost trend rate assumed for next year (pre-/post-65) - medical	7.30%/6.90%	7.70%/6.90%	6.75%/6.50%
Ultimate health care cost trend rate	4.50%	4.50%	4.50%
Year that the rate reaches the ultimate trend rate	2027	2026	2024
<b>Expected Future Cash Flows</b>	<b>2019</b>	<b>2018</b>	<b>2017</b>
<b>Expected Benefit Payments (net of employee contributions)</b>			
Fiscal 2020	\$ 156,449	\$ 168,166	\$ 164,012
Fiscal 2021	171,220	183,932	181,081
Fiscal 2022	181,781	195,348	196,633
Fiscal 2023–2027	201,091	217,340	1,161,974
Fiscal 2024–2028	206,427	1,183,906	-
Fiscal 2025–2029	1,155,688	-	-
<b>Expected Contributions</b>			
Fiscal 2020	\$ 156,449	\$ 168,166	\$ 164,012

#### NOTE 14 — RELATED PARTY TRANSACTIONS:

Directors of the Association, except for any director-elected directors, are required to be borrowers/stockholders of the Association. Also, in the ordinary course of business, the Association may enter into loan origination or servicing transactions with its officers, relatives of officers and directors, or with organizations with which such persons are associated. Such loans are subject to special approval requirements contained in FCA regulations and are made on the same terms, including interest rates, amortization schedule and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

Total loans to such persons at December 31, 2019, 2018 and 2017 for the Association amounted to \$39,830,894, \$31,074,175 and \$28,307,208. During 2019, 2018 and 2017, \$51,625,687, \$36,361,503 and \$33,599,631 of new loans and loan draws were made, and repayments totaled \$42,868,968, \$33,594,536 and \$32,600,870, respectively. In the opinion of management, no such loans outstanding at December 31, 2019, 2018 and 2017 involved more than a normal risk of collectability.

Expenses included in purchased services may include purchased services such as administrative services, marketing, information systems and accounting services and allocations of expenses incurred by the Bank and passed through to the associations, such as FCSIC expenses. The Bank charges the individual associations directly for these services based on each association's proportionate usage. These expenses totaled \$794,292, \$737,536 and \$791,450 in 2019, 2018 and 2017, respectively.

The Association received patronage payments from the Bank totaling \$11,148,559, \$8,462,542 and \$5,529,559 during 2019, 2018 and 2017, respectively.

**NOTE 15 — FAIR VALUE MEASUREMENTS:**

Accounting guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in 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,” for additional information.

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

<b>December 31, 2019</b>	<b>Fair Value Measurement Using</b>		
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Assets:			
Loans	\$ -	\$ -	\$ 37,206
Other property owned	-	-	3,101,394
<b>December 31, 2018</b>	<b>Fair Value Measurement Using</b>		
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Assets:			
Loans	\$ -	\$ -	\$ 39,176
Other property owned	-	-	-
<b>December 31, 2017</b>	<b>Fair Value Measurement Using</b>		
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Assets:			
Loans	\$ -	\$ -	\$ 76,725
Other property owned	-	-	25,786

Financial assets and financial liabilities measured at carrying amounts and not measured at fair value on the consolidated balance sheets for each of the fair value hierarchy values are summarized as follows:

	<b>December 31, 2019</b>				
	<b>Total Carrying Amount</b>	<b>Fair Value Measurement Using</b>			<b>Total Fair Value</b>
		<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	
Assets:					
Cash	\$ 7,188,050	\$ 7,188,050	\$ -	\$ -	\$ 7,188,050
Investments	2,660,691	-	-	2,654,448	2,654,448
Net loans	1,309,243,619	-	-	1,313,871,891	1,313,871,891
Total Assets	<u>\$ 1,319,092,360</u>	<u>\$ 7,188,050</u>	<u>\$ -</u>	<u>\$ 1,316,526,339</u>	<u>\$ 1,323,714,389</u>
Liabilities:					
Note payable to bank	<u>\$ 1,140,484,754</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,144,534,916</u>	<u>\$ 1,144,534,916</u>



December 31, 2018  
Fair Value Measurement Using

	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
<b>Assets:</b>					
Cash	\$ 5,081,707	\$ 5,081,707	\$ -	\$ -	\$ 5,081,707
Investments	3,060,007	-	-	3,010,993	3,010,993
Net loans	1,223,544,092	-	-	1,195,608,979	1,195,608,979
Total Assets	<u>\$ 1,231,685,806</u>	<u>\$ 5,081,707</u>	<u>\$ -</u>	<u>\$ 1,198,619,972</u>	<u>\$ 1,203,701,679</u>
<b>Liabilities:</b>					
Note payable to bank	<u>\$ 1,059,336,455</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,035,243,031</u>	<u>\$ 1,035,243,031</u>

December 31, 2017  
Fair Value Measurement Using

	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
<b>Assets:</b>					
Cash	\$ 4,851,927	\$ 4,851,927	\$ -	\$ -	\$ 4,851,927
Investments	3,610,101	-	-	3,541,927	3,541,927
Net loans	1,312,964,155	-	-	1,283,163,750	1,283,163,750
Total Assets	<u>\$ 1,321,426,183</u>	<u>\$ 4,851,927</u>	<u>\$ -</u>	<u>\$ 1,286,705,677</u>	<u>\$ 1,291,557,604</u>
<b>Liabilities:</b>					
Note payable to bank	<u>\$ 1,156,165,343</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,129,959,892</u>	<u>\$ 1,129,959,892</u>

With regard to nonrecurring measurements for impaired loans and other property owned, it is not practicable to provide specific information on inputs as each collateral property is unique. System institutions utilize appraisals to value these loans and other property owned and take into account unobservable inputs such as income and expense, comparable sales, replacement cost and comparability adjustments.

Information about Recurring and Nonrecurring Level 3 Fair Value Measurements:

	<b><u>Valuation Technique(s)</u></b>	<b><u>Unobservable Input</u></b>	<b><u>Range of Inputs</u></b>
Investments held to maturity	Discounted cash flow	Prepayment rates	2.3% - 38.0%
	<b><u>Valuation Technique(s)</u></b>	<b><u>Input</u></b>	
Cash	Carrying value	Par/principal and appropriate interest yield	
Investments held to maturity	Discounted cash flow	Prepayment rates, Probability of default, Loss severity	
Loans	Discounted cash flow	Prepayment forecasts, Probability of default, Loss severity	
Note payable to bank	Discounted cash flow	Benchmark yield curve, Derived yield spread, Own credit risk	
Other interest bearing liabilities	Carrying value	Par/principal and appropriate interest yield	

## Valuation Techniques

As more fully discussed in Note 2, “Summary of Significant Accounting Policies,” 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 in active markets 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. The following represent a brief summary of the valuation techniques used by the Association for assets and liabilities:

### *Investments*

Where quoted prices are available in an active market, available-for-sale securities would be classified as Level 1. If quoted prices are not available in an active market, the fair value of securities is estimated using pricing models that utilize observable inputs, quoted prices for similar securities received from pricing services or discounted cash flows. Generally, these securities would be classified as Level 2. This would include certain mortgage-backed and asset-backed securities. Where there is limited activity or less transparency around inputs to the valuation, the securities are classified as Level 3. Securities classified within Level 3 include a small portion of asset-backed securities and certain mortgage-backed securities, including private label-FHA/VA securities and those issued by Farmer Mac.

### *Assets Held in Nonqualified Benefits Trusts*

Assets held in trust funds related to deferred compensation and supplemental retirement plans are classified within Level 1. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace.

### *Standby Letters of Credit*

The fair value of letters of credit approximate the fees currently charged for similar agreements or the estimated cost to terminate or otherwise settle similar obligations.

### *Loans Evaluated for Impairment*

For certain loans evaluated for impairment under impairment guidance, the fair value is based upon the underlying collateral since the loans are collateral-dependent loans. The fair value measurement process uses independent appraisals and other market-based information, but in many cases, it also requires significant input based on management’s knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, a majority of these loans have fair value measurements that fall within Level 3 of the fair value hierarchy. When the value of the collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established. The fair value of these loans would fall under Level 2 of the hierarchy if the process uses independent appraisals and other market-based information.

### *Other Property Owned*

Other property owned is generally classified as Level 3 of the fair value hierarchy. The process for measuring the fair value of other property owned involves the use of appraisals or other market-based information. Costs to sell represent transaction costs and are not included as a component of the asset’s fair value.

## **NOTE 16 — COMMITMENTS AND CONTINGENCIES**

In addition to those commitments and contingencies discussed in Note 2, “Summary of Significant Accounting Policies,” the Association is involved in various legal proceedings in the ordinary course of business. In the opinion of legal counsel and management, there are no legal proceedings at this time that are likely to materially affect the Association.

The Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers in the form of commitments to extend credit and commercial letters of credit. These financial instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are

agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2019, \$225,596,997 of commitments to extend credit were outstanding.

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the consolidated balance sheets until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers, and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

**NOTE 17 — QUARTERLY FINANCIAL INFORMATION (UNAUDITED):**

Quarterly results of operations for the years ended December 31 (in thousands) follow:

	2019				
	First	Second	Third	Fourth	Total
Net interest income	\$ 9,014	\$ 9,152	\$ 9,396	\$ 9,373	\$ 36,935
(Provision for) reversal of loan losses and OPO	(320)	60	(295)	(1,580)	(2,135)
Noninterest income (expense), net	(1,779)	(1,586)	(1,860)	(495)	(5,720)
Net income	<u>\$ 6,915</u>	<u>\$ 7,626</u>	<u>\$ 7,241</u>	<u>\$ 7,298</u>	<u>\$ 29,080</u>
	2018				
	First	Second	Third	Fourth	Total
Net interest income	\$ 9,260	\$ 9,282	\$ 9,160	\$ 8,688	\$ 36,390
(Provision for) reversal of loan losses	(12)	421	561	55	1,025
Noninterest income (expense), net	(1,875)	(1,995)	(2,164)	(625)	(6,659)
Net income	<u>\$ 7,373</u>	<u>\$ 7,708</u>	<u>\$ 7,557</u>	<u>\$ 8,118</u>	<u>\$ 30,756</u>
	2017				
	First	Second	Third	Fourth	Total
Net interest income	\$ 8,740	\$ 9,340	\$ 9,424	\$ 9,154	\$ 36,658
(Provision for) reversal of loan losses	(371)	(176)	(168)	(37)	(752)
Noninterest income (expense), net	(2,564)	(3,114)	(2,776)	(2,623)	(11,077)
Net income	<u>\$ 5,805</u>	<u>\$ 6,050</u>	<u>\$ 6,480</u>	<u>\$ 6,494</u>	<u>\$ 24,829</u>

**NOTE 18 — SUBSEQUENT EVENTS:**

The Association has evaluated subsequent events through March 9, 2020, which is the date the financial statements were issued or available to be issued and has determined that there were no other events requiring disclosure.

## **DISCLOSURE INFORMATION AND INDEX**

(Unaudited)

*Disclosures Required by Farm Credit Administration Regulations*

### **DESCRIPTION OF BUSINESS**

The description of the territory served, the persons eligible to borrow, the types of lending activities engaged in and the financial services offered, and related Farm Credit organizations required to be disclosed in this section is incorporated herein by reference from Note 1 to the consolidated financial statements, “Organization, Mergers and Operations,” included in this annual report.

The descriptions of significant developments that had or could have a material impact on earnings, interest rates to borrowers, patronage, or dividends and acquisitions or dispositions of material assets, changes in the reporting entity, changes in patronage policies or practices and financial assistance provided by or to the Association through loss sharing or capital preservation agreements or from any other source, if any, required to be disclosed in this section are incorporated herein by reference from “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” included in this annual report.

### **DESCRIPTION OF PROPERTY**

Texas Farm Credit Services (the Association) serves its 100-county territory through its main administrative and lending office at 545 South Highway 77, Robstown, Texas 78380. Additionally, there are 20 branch lending offices, three administrative offices, three crop insurance offices and two satellite offices located throughout the territory. The Association owns the Bandera, Beaumont, Bonham, Brenham, Fairfield, Nacogdoches, Pleasanton, Raymondville Crop Insurance, Raymondville Lending, Robstown Administrative, Robstown Branch, San Antonio, Sulphur Springs, Taft Crop Insurance, The Woodlands, Tyler Administrative, Tyler Branch, Uvalde and Weslaco offices, free of debt. The Association leases office space in Brenham for an additional administrative office. The Association operates leased satellite offices in Dallas and McAllen. The Association leases offices for its lending operations in Gainesville, Heath, Laredo, Paris and Prosper. In 2019, completed the construction of the new administrative and lending facility in Brenham. The Association opened a new leased lending office during 2019 in Laredo.

### **LEGAL PROCEEDINGS**

In the ordinary course of business, the Association is involved in various legal proceedings. In the opinion of legal counsel and management, there are no legal proceedings at this time that are likely to materially affect the consolidated financial statements of the Association.

### **DESCRIPTION OF CAPITAL STRUCTURE**

The information required to be disclosed in this section is incorporated herein by reference from Note 11 to the consolidated financial statements, “Members’ Equity,” included in this annual report.

### **DESCRIPTION OF LIABILITIES**

The description of liabilities required to be disclosed in this section is incorporated herein by reference from Note 10, “Note Payable to the Bank,” Note 13, “Employee Benefit Plans,” and in “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” included in this annual report.

The description of contingent liabilities required to be disclosed in this section is incorporated herein by reference from Notes 2 and 16 to the consolidated financial statements, “Summary of Significant Accounting Policies” and “Commitments and Contingencies,” respectively, included in this annual report.

### **RELATIONSHIP WITH THE FARM CREDIT BANK OF TEXAS**

The Association’s financial condition may be impacted by factors that affect the Farm Credit Bank of Texas (Bank), as discussed in Note 1 to the consolidated financial statements, “Organization, Mergers and Operations,” included in this annual report. The financial condition and results of operations of the Bank may materially affect the stockholders’ investment in the Association.

The annual and quarterly stockholder reports of the Farm Credit Bank of Texas (Bank) are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, Corporate Communications, P.O. Box 202590, Austin, Texas

78720-2590 or calling (512) 465-1881. Copies of the Bank annual and quarterly stockholder reports can also be requested by e-mailing [fcf@farmcreditbank.com](mailto:fcf@farmcreditbank.com). The annual and quarterly stockholder reports are also available on its website at [www.farmcreditbank.com](http://www.farmcreditbank.com).

The Association's quarterly stockholder reports are also available free of charge, upon request. These reports will be available approximately 40 days after quarter end and can be obtained by writing to Texas Farm Credit Services, P.O. Box 711, Robstown, Texas 78380 or calling (361) 387-8563. Copies of the Association's quarterly stockholder reports can also be requested by e-mailing [kibrom@texasfcs.com](mailto:kibrom@texasfcs.com) or are available on the Association's website [www.texasfcs.com](http://www.texasfcs.com). The Association's annual stockholder report is available on its website 75 days after the fiscal year end. Copies of the Association's annual stockholder report can also be requested 90 days after the fiscal year end.

### SELECTED FINANCIAL DATA

The selected financial data for the five years ended December 31, 2019, required to be disclosed, is incorporated herein by reference to the "Five-Year Summary of Selected Consolidated Financial Data" included in this annual report to stockholders.

### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

"Management's Discussion and Analysis," which precedes the consolidated financial statements in this annual report, is incorporated herein by reference.

### DIRECTORS AND SENIOR OFFICERS

The Association's member-elected and director-elected board of directors and senior officers are as follows:

<u>NAME</u>	<u>POSITION</u>	<u>DATE ELECTED/ EMPLOYED</u>	<u>TERM EXPIRES</u>
Thomas Barker	Director	2012	2021
Jerry Chappell	Director	2013	2022
James Dawley	Director-Chairman	2003	2020
Marion Vines Durand	Director-Appointed Stockholder	2012	2021
Roxann Garvin	Director-Appointed Stockholder	2019	2020
Jack Harbison, Jr.	Director	1994	2021
David Henneke	Director-Appointed Non-Stockholder	2005	2020
David N. Hill	Director/Retired	2000	2019
Bobby Hobson	Director	2008	2022
John Prukop	Director-Vice Chairman	1990	2020
Mark Reus	Director	2018	2022
Gregory T. Richbourg	Director-Appointed Non-Stockholder	2010	2020
Mark Miller	Chief Executive Officer	1989	---
Keith A. Ibrom	Chief Financial Officer	1999	---
John O'Brien, IV	Chief Credit Officer	2000	---
John Parker	Chief Information Officer	2003	---
Jolene Curtis	Chief Operations Officer	2004	---
Lane Pepper	Chief Risk Officer	2004	---
Joe Valladares	Chief Audit Officer	2005	---
Lori V. Graham	General Counsel	2014	---

A brief statement of the business and employment background of each director and senior officer is provided for informational purposes.

**Thomas Barker** resides in Winona, Texas, and has been manager of Seven P Ranch, a 1,750-acre registered Simmental operation located near Tyler, Texas, for the past 10 years.

**Jerry Chappell** resides in Lyford, Texas, and is a Partner in Chappell Farms, a family partnership. They primarily farm cotton and grain. Mr. Chappell serves on the Willacy County Farm Bureau, which is a nonprofit organization dedicated to promoting, protecting and representing the interests of U.S. farmers. He also serves on the Texas Boll Weevil Eradication Lower Rio Grande Valley Steering Committee, which is a liaison between cotton producers of the Lower Rio Grande Valley and the Boll Weevil Eradication Foundation, is a director for the Rio Grande Valley CCA, which promotes conservation of coastal sport fisheries, is a member of the Rio Grande Valley IPM Steering Committee, which promotes the integrated pest management to farmers of the Rio Grande Valley, and is a director for the Appraisal Review Board, which is a decision-making body that issues determinations of statutorily authorized protests and challenges brought by property owners and taxing units.

**James R. Dawley** is a resident of the Mexia area of Texas and was born and raised on a farm/ranch in Honest Ridge, Texas, in Limestone County. He currently runs a cow/calf operation in Limestone County and owns and operates Sheffield Farm and Ranch Supply in Mexia, Texas. Mr. Dawley is an officer for the Limestone County Farm Bureau, a support organization for agriculture, as well as the secretary/treasurer of the Limestone County Young Farmers, which promotes agriculture in the area.

**Marion Vines Durand** is a resident of Lufkin, Texas, where she serves as an officer and director of Angelina Ranch and Timber, Inc. and Lufkin Business Park II, Inc. Mrs. Durand is a retired certified public accountant and is active in several other agricultural sectors, including timber, land management, cattle ranching and farming. Mrs. Durand also serves as a manager of the Dan M Vines Limited Partnership and DMV Interest, LLC.

**Roxann Garvin**, is a resident of Winnsboro, Texas, where she manages her family's operation. Mrs. Garvin and her husband run a cow-calf operation, four breeder farms with Pilgrim's Pride, and maintain 800 acres for grazing and hay production.

**Jack Harbison, Jr.** lives in Hidalgo County, Texas, where he farms cotton, milo, vegetables, and sugarcane. Mr. Harbison is president and director of the Hidalgo and Cameron Counties Irrigation District No. 9 that sells raw irrigation water for over 80,000 acres of farmland and municipalities. He serves as vice chairman for Hidalgo County on the board of directors of the Rio Grande Valley Sugar Growers, Inc., a co-op that grinds sugarcane and produces raw sugar and molasses, and serves as the secretary on the board of directors of Rio Farms, Inc., which is a 20,000-acre research and development farm. He also serves on the board of directors of Queen City Growers Co-op which is a part of Ross Gin Company, Ltd. that gins cotton and sells cottonseed.

**David Henneke** is a retired investment advisor with more than 20 years' banking experience. Mr. Henneke resides in Alice, Texas and has served on the board of directors since 2005.

**David N. Hill** resides in Queen City, Texas, in Cass County. He is the owner/operator of Hill Timber & Dozer Service Co. Mr. Hill is also a rancher and is involved in hay production. Mr. Hill owns a 250-head stocker and 500-head mother-cattle operation on 650 acres of owned land and 2,000 acres of leased land. He also performs contract work for site prep replanting, land clearing and timber management. Mr. Hill is a member of the FSA Committee/Board, which is an advisory board made up of local farmers and ranchers. Mr. Hill retired from the board effective September 2019.

**Bobby Hobson** is a resident of Nacogdoches County, Texas. He is the owner/operator of a 17-house broiler farm with a 350,000-bird capacity. He also runs a cow-calf operation on 1,000 acres of owned and leased land as well as operates a custom hay bailing business with his brother, Larry Hobson. Mr. Hobson is president of the Douglass ISD school board and serves as chairman on the Nacogdoches County Soil and Water Conservation Board, which manages the quality of water and soil in Nacogdoches County.

**John Prukop** lives in Nueces County, Texas and has been farming since 1974 in Jim Wells, Kleberg and Nueces counties and farms vegetable and melons in Hidalgo County. Mr. Prukop serves as chairman of the Kleberg-Kenedy Soil and Water Conservation District, which manages the quality of water and soil in Kleberg and Kenedy Counties and is a director on the National Watermelon Promotion Board, whose purpose is to maintain and expand existing markets and develop new markets for fresh watermelon. He is an advisor to the South Texas Property Rights Association, which protects the rights of property owners in South Texas.

**Mark Reus** lives in Hondo, Texas, where he serves as the managing partner for Reus Grain, LP, a family operation. Reus Grain, LP cleans and processes grains for bagging and bulk deliver to wholesale and retail customers for deer and wildlife feeding.

**Gregory T. Richbourg** is an equal shareholder in the public accounting firm of Gollob Morgan Peddy PC in Tyler, Texas. Mr. Richbourg previously served as Vice President of Richbourg & Associates, PC, CPA's from 1998 to its June 2014 merger with Gollob Morgan Peddy PC. Mr. Richbourg is a certified public accountant and a member of the American Institute and Texas Society of Certified Public Accountants. He currently serves on the boards of directors for several local nonprofit organizations, including the Tyler Catholic School Foundation (treasurer), as well as Tyler Friends of the Poor (president) and the East Texas Area Council-Boy Scouts of America (treasurer).

**Mark A. Miller** has served as chief executive officer since January 1, 2013<sup>1</sup>. Prior to this appointment, Mr. Miller served as executive vice president and chief credit officer. He has been with the organization since March 1989 when he accepted a position as loan officer and since that time has served as branch manager and chief operations officer.

**Keith A. Ibrom** has served as chief financial officer since 1999<sup>2</sup>. Mr. Ibrom is a certified public accountant. Mr. Ibrom is also a general partner of a family cattle operation in DeWitt County, Texas, and he and his wife also own real estate rental properties as well as a pet boarding and daycare business.

**John O'Brien, IV** has served as chief credit officer since January 1, 2013<sup>3</sup>. Mr. O'Brien began with Texas AgFinance in 2000, where he served as a loan officer, branch manager, YBS portfolio manager, crop insurance division manager, and manager of association participation loans. Mr. O'Brien is also part owner in Taste Cattle Company, LLC, a cow-calf operation in Refugio and Goliad counties.

**John Parker** has served as chief information officer since February 7, 2018. Prior to this appointment, Mr. Parker served as senior vice president IT systems. He has been with the organization since May 2003 when he accepted a position as loan officer, and since that time, Mr. Parker has served as assistant vice president of lending, IT systems analyst, and vice president IT systems. In addition to his current role with the organization, Mr. Parker also serves as pastor at New Beginning Fellowship, a church located in Sinton, Texas.

**Jolene Curtis** assumed the role of chief operating officer on January 1, 2016. Ms. Curtis has been with Texas Farm Credit Services since 2004, during which time she served as a loan officer trainee, loan officer and vice president of operations. In the vice president of operations role, she oversaw the rural home loan program as well as marketing and crop insurance functions. Mrs. Curtis serves as an executive board member and treasurer for the Brenham State Supported Living Center Volunteer Services Council. Along with her husband, she owns Curtis Wildlife and Agricultural Services, LLC, which provides wildlife and agricultural consulting services. Ms. Curtis is also a partner in Tandem Partners, LLC, a company that owns rental real estate properties.

**Lane Pepper** assumed the role of chief risk officer in April of 2017. Prior to this appointment, Mr. Pepper served as senior vice president commercial credit. He has been with the organization since 2004 when he accepted a position as loan officer and since that time has served in various leadership roles within both the credit and finance departments. Mr. Pepper has earned the chartered financial analyst designation. Mr. Pepper serves as treasurer of the Annapolis Christian Academy board of trustees.

**Joe Valladares** has served as chief audit officer since January 2017. Prior to this appointment, Mr. Valladares served as internal audit director beginning in 2014. He also served as chief financial officer at another association since 2011 where he provided leadership in finance, accounting, human resources, operations and technology.

**Lori V. Graham** assumed the role of General Counsel in April 21, 2014. Prior to this, Ms. Graham practiced law specializing in insurance defense, real estate, and oil and gas litigation. Ms. Graham serves as the secretary of the Washington County Child Welfare Board, a nonprofit organization created to sponsor public awareness of child abuse prevention and provide support to local CPS and foster families.

## COMPENSATION OF DIRECTORS

Elected directors were compensated for their service to the Association in the form of an honorarium at the rate of \$650 per day for director meetings and committee meetings, and they were reimbursed for certain expenses incurred while representing the Association in an official capacity. Appointed directors were compensated for their service to the Association in the form of an honorarium at the rate of \$750 per day for director meetings and committee meetings, and they were reimbursed for certain expenses incurred while representing the Association in an official capacity. In addition to the honorarium, all directors receive an annual retainer. The chairman of the board receives a \$13,000 annual retainer, the vice-chairman of the board receives an \$11,000 retainer, and the chairman of the audit committee receives a \$9,000 annual retainer. The remaining directors receive an \$8,000 per director annual retainer, and all directors serving on the audit committee receive an additional \$2,000 annual retainer. Directors are compensated for all conference calls at a rate of \$150 per call. Mileage for attending official meetings during 2019 was paid at the IRS-approved rate of 58.0 cents per mile. A copy of the travel policy is available to stockholders of the Association upon request.

<sup>1</sup> Mr. Miller was chief executive officer of Texas AgFinance from January 1, 2013 to January 1, 2014, when it merged to become Texas Farm Credit Services.

<sup>2</sup> Mr. Ibrom served as chief financial officer of Texas AgFinance from July 6, 1999 to January 1, 2014, when it merged to become Texas Farm Credit Services.

<sup>3</sup> Mr. O'Brien was chief credit officer of Texas AgFinance from January 1, 2013 to January 1, 2014, when it merged to become Texas Farm Credit Services.

<u>Director</u>	<u>Number of Meetings Served</u>		<u>2019 Compensation</u>
	<u>Board Meeting</u>	<u>Audit, Compensation and Other Special Meetings</u>	
Thomas Barker	7	3	\$ 19,850
Jerry Chappell	7	9	26,700
James R. Dawley	7	9	42,750
Marion Vines Durand	7	6	26,400
Roxann Garvin	2	1	2,100
Jack Harbison, Jr.	6	3	15,950
David Henneke	7	9	28,525
David N. Hill	2	1	13,200
Bobby Hobson	7	9	28,100
John Prukop	7	6	36,075
Mark Reus	7	7	21,200
Gregory T. Richbourg	5	9	28,625
			<u>\$ 289,475</u>

The Association's entire board of directors serve on the compensation committee. Eight directors serve on the audit committee and five directors serve on the governance committee. The Association held a total of seven board of directors meetings, four audit committee meetings, three compensation committee meetings and two conference call governance committee meetings during 2019. This compares to seven board of directors meetings, four audit committee meetings, three compensation committee meetings and one governance committee meeting in 2018 and six board of director meetings, four audit committee meetings, three compensation committee meetings and four governance committee meetings in 2017.

The aggregate compensation paid to directors in 2019, 2018 and 2017 was \$289,475, \$238,725 and \$238,025, respectively. The aggregate amount of reimbursement for travel, subsistence and other related expenses paid to directors and on their behalf was \$50,769, \$45,696 and \$49,174 in 2019, 2018 and 2017, respectively.

### COMPENSATION OF SENIOR OFFICERS

#### Compensation Discussion and Analysis – Senior Officers

The board of directors has established a compensation committee consisting of at least three board members, each of whom shall be free from any relationship that would interfere with the exercise of his or her independent judgment as a committee member as determined by the board of directors. The primary function of the compensation committee is to assist the board in fulfilling its responsibilities with respect to matters involving the compensation of the board and the chief executive officer, to review the compensation policies and plans for senior officers and employees, and to approve the overall compensation program for senior officers. A copy of the compensation committee charter is available to the public on the Association's website at [www.texasfcs.com](http://www.texasfcs.com).

The compensation committee approves the Association's incentive plan annually. The incentive plan is based on the Association meeting certain financial objectives established in the Association's annual Business Plan submitted to the Farm Credit Administration and approved by the board. The incentive plan is based on the Association's fiscal year of operations. The incentive plan requires that the Association meet certain net earnings objectives to ensure adequate capital levels to support predetermined board objectives. The incentive plan also requires that the Association meet pre-established interest rate spread objectives and credit quality objectives. The incentive plan is structured so that an incentive pool of dollars is paid if the incentive plan objectives are met. A staggered incentive pool of dollars is available to employees if objectives are less than fully achieved. There were no material amendments to the incentive plan for 2019.

All employees are eligible to participate in the Association's incentive plan if they were employed on or before July 1 of the fiscal year of that year's incentive plan. Employees must receive a satisfactory performance evaluation to receive incentive payments from that year's incentive plan. If an employee does not receive a satisfactory performance evaluation, their incentive is calculated as if it was to be paid and withheld from distribution. It does not go back into the incentive pool of dollars to be distributed to other participants. Employees with less than five years of service are subject to a vesting schedule for incentive payments. The vesting schedule is based on five years of service. Employees receive a 20 percent vestment percentage for each year of service. Employee



payment of prior year's vested incentives is not dependent on the employee receiving a satisfactory performance evaluation for the current year's incentive plan. Undistributed unvested incentives are forfeited if an employee voluntarily or involuntarily terminates employment.

### Chief Executive Officer (CEO) Compensation Policy

The CEO's salary is established by the board of directors at the beginning of each fiscal year. The CEO participates in the Association's incentive plan. The CEO bonus is dependent on the Association meeting the financial objectives approved by the compensation committee.

### Summary Compensation Table

The following table summarizes the compensation paid to the CEO and all senior officers of the Association during 2019, 2018 and 2017. This may include other nonsenior officers if their total compensation is within the top five highest paid employees. Amounts reflected in the table are presented in the year the compensation was earned.

<b>Chief Executive Officer</b>	<b>Year</b>	<b>Salary ( b )</b>	<b>Bonus ( c )</b>	<b>Total</b>
<b>Mark Miller</b>	<b>2019</b>	<b>\$ 420,000</b>	<b>\$ 157,548</b>	<b>\$ 577,548</b>
Mark Miller	2018	\$ 390,000	\$ 145,612	\$ 535,612
Mark Miller	2017	\$ 365,000	\$ 118,701	\$ 483,701
<b>Aggregate Number of Senior Officers &amp; other highly compensated employees ( a )</b>				
	<b>Year</b>	<b>Salary ( b )</b>	<b>Bonus ( c )</b>	<b>Total</b>
<b>5 Officers,</b>	<b>2019</b>	<b>\$ 947,000</b>	<b>\$ 355,234</b>	<b>\$ 1,302,234</b>
4 Officers, 1 Non-Officer	2018	\$ 728,910	\$ 650,910	\$ 1,379,820
4 Officers, 1 Non-Officer	2017	\$ 702,660	\$ 586,095	\$ 1,288,755

(a) Aggregate number of senior officers/highly compensated individuals, excluding CEO.

(b) Gross salary, including retention plan compensation for certain senior officers.

(c) Bonuses paid within the first 30 days of the subsequent calendar year.

Disclosure of information on the total compensation paid and the arrangements of the compensation plans during the last fiscal year to any senior officer or to any other officer included in the aggregate are available and will be disclosed to shareholders of the Association upon request.

### Pension Benefits Table

Neither the CEO nor any of the highly compensated employees disclosed above in aggregate participate in the Farm Credit Bank of Texas Pension Plan (the "Pension Plan"), which is a qualified defined benefit retirement plan.

Employees assigned Association vehicles are given the option to drive a company-owned vehicle or receive a compatible auto allowance to purchase a personal vehicle. Employees opting for the auto allowance are liable for all payroll taxes. The auto allowance is exempt from 401(k) matching and is not included in any incentive calculations. Employees who drive company-owned vehicles have personal miles reported to the IRS as fringe benefits that are considered additional taxable income to the employee. Employees who use their personal automobiles for business purposes were reimbursed in 2019 at the IRS-approved rate of 58.0 cents per mile.

Neither the CEO nor any other senior officer received noncash compensation exceeding \$5,000 in 2019, 2018 and 2017.

Senior officers, including the CEO, are reimbursed for reasonable travel, subsistence and other related expenses while conducting Association business. A copy of the Association's travel policy is available to shareholders upon request.

## **TRANSACTIONS WITH DIRECTORS AND SENIOR OFFICERS**

The Association's policies on loans to and transactions with its officers and directors, required to be disclosed in this section, are incorporated herein by reference from Note 14 to the consolidated financial statements, "Related Party Transactions," included in this annual report.

### **DIRECTORS' AND SENIOR OFFICERS' INVOLVEMENT IN CERTAIN LEGAL PROCEEDINGS**

The Association has no senior officers or directors with any involvement in certain legal proceedings as described in FCA §620.6(f).

### **RELATIONSHIP WITH INDEPENDENT AUDITOR**

No change in auditors has taken place since the last annual report to stockholders, and no disagreements with auditors has occurred that the Association is required to report to the Farm Credit Administration under part 621 of the FCA regulations governing this disclosure. The fees paid in 2019 for professional audit services rendered for the Association by the independent auditors, PricewaterhouseCoopers LLP, were \$102,336. The fees paid in 2019 for professional tax services rendered for the Association by the independent auditors, PricewaterhouseCoopers LLP, were \$10,300. No other services were provided by the independent auditors, PricewaterhouseCoopers LLP.

### **RELATIONSHIP WITH UNINCORPORATED BUSINESS ENTITIES**

The Association organized an unincorporated business entity (UBE) to help manage properties acquired through collateral on defaulted participated loans. The Association and the participants in the loans, which include the Bank and two other Farm Credit lenders, formed MB BP Properties Joint Venture, LLC, in 2011 for the purpose of managing the operations of two surrendered properties. The ownership in the UBE was based on each participant's percentage ownership in the surrendered properties. The Association's ownership percentage in the UBE is 5.35 percent. Both properties were sold during 2014. The UBE remained active during 2016 to resolve several minor outstanding expenses. All UBE activities were finalized in 2016, and the UBE was dissolved in 2017.

## **FINANCIAL STATEMENTS**

The financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 9, 2020, and the report of management in this annual report to stockholders are incorporated herein by reference.

## **MEMBER/SHAREHOLDER PRIVACY**

Members' nonpublic personal financial information is protected by Farm Credit Administration regulation. Our directors and employees are restricted from disclosing information not normally contained in published reports or press releases about the Association or its members.

### **CREDIT AND SERVICES TO YOUNG, BEGINNING AND SMALL FARMERS AND RANCHERS, AND PRODUCERS OR HARVESTERS OF AQUATIC PRODUCTS**

The Association has established a policy related to providing credit and services to young, beginning and small (YBS) farmers and ranchers. "Young" farmers and ranchers are defined as producers whose age is 35 years or younger as of the loan's transaction date. "Beginning" farmers and ranchers are producers that have 10 years or less of farming or ranching experience as of the loan transaction date. A producer is considered a "small" farmer and rancher if they normally generate \$250,000 or less in annual gross sales of agricultural products.

The Association's YBS definitions differ slightly from those used by the United States Department of Agriculture (USDA). USDA defines a "young" farmer and rancher as a producer under the age of 35. USDA defines a "beginning" farmer and rancher as a producer with less than 10 years of farming or ranching experience.

The Association created a YBS mission statement to help guide its efforts. The mission statement is as follows:

Texas Farm Credit Services is committed to attracting, growing, and retaining the YBS volume in its territory. The aging demographic in its service area has made YBS lending a top priority for maintaining the long-term viability of the Association.

The Association is committed to cooperating with all farm credit institutions, state and federal agencies, such as the USDA and Small Business Administration, commercial lending institutions, and all other guarantors or cosigners to benefit young, beginning and small producers. It has committed staff and financial resources to the development and execution of its YBS program.

Each year, the Association establishes objectives related to its YBS program. The objectives are approved by the board of directors and are included in the Association's strategic plan. The following table summarizes the Association's 2019 objectives compared to actual results.

<b>YBS Program - New Loan Volume</b>	<b>2019 Goal</b>	<b>2019 Result</b>
Young farmers and ranchers	\$ 75,000,000	\$ 80,335,000
Beginning farmers and ranchers	\$ 200,000,000	\$ 233,472,000
Small farmers and ranchers	\$ 210,000,000	\$ 234,766,000

<b>YBS Program - Percentage of New Loan Volume</b>	<b>2019 Goal</b>	<b>2019 Result</b>
Young farmers and ranchers	15.0%	12.7%
Beginning farmers and ranchers	35.0%	37.0%
Small farmers and ranchers	50.0%	37.2%

<b>YBS Program - Number of New Loans</b>	<b>2019 Goal</b>	<b>2019 Result</b>
Young farmers and ranchers	190	174
Beginning farmers and ranchers	500	473
Small farmers and ranchers	650	584

The board of directors remains committed to the YBS program. It has committed staff and financial resources to the development and execution of its YBS program. The 2020 objectives that were approved by the board of directors and included in the Association's strategic plan are summarized in the following table.

<b>YBS Program - Number of Loans</b>	<b>2020 Goal</b>
Young farmers and ranchers	756
Beginning farmers and ranchers	2,330
Small farmers and ranchers	3,040

<b>YBS Program - Percentage of Total Number of Loans</b>	<b>Total Loans</b>
Young farmers and ranchers	17.2%
Beginning farmers and ranchers	52.9%
Small farmers and ranchers	69.1%

<b>YBS Program - Combined Segments</b>	<b>Total Loans</b>
% of Total Number of Loans	72.4%
% of Total Volume of Loans	58.9%

The following tables represent YBS demographics for the State of Texas, the Association's territory and the Association. The YBS demographics for the State of Texas and the Association's territory are based on the USDA-NASS 2012 Census. The Association's YBS data is based on 2019 data.

<b>YBS Program - State of Texas</b>	<b>Total</b>	<b>Number</b>	<b>Percentage of Total</b>
Agricultural producers in Texas	248,809		
Young farmers and ranchers in Texas		10,091	4.1%
Beginning farmers and ranchers in Texas		65,547	26.3%
Small farmers and ranchers in Texas		238,454	95.8%

<b>YBS Program - Association's Territory</b>	<b>Total</b>	<b>Number</b>	<b>Percentage of Total</b>
Agricultural producers in Association's territory	123,739		
Young farmers and ranchers in territory		9,694	7.8%
Beginning farmers and ranchers in territory		36,624	29.6%
Small farmers and ranchers in territory		121,255	98.0%

<b>YBS Program - Association</b>	<b>Total</b>	<b>Number</b>	<b>Percentage of Total</b>
Agricultural producer's loans in the Association	4,272		
Young farmers and ranchers loans in the Association		735	17.2%
Beginning farmers and ranchers loans in the Association		2,303	53.9%
Small farmers and ranchers loans in the Association		2,993	70.1%



**SERVING 100  
TEXAS COUNTIES  
AND DELIVERING  
EVEN GREATER VALUE  
TO OUR CUSTOMERS**

**AGRICULTURE LENDING**

- Cow-Calf, Stocker and Feedlot Operations
- Crop Operations
- Planting and Harvesting Expenses
- Timber Operations
- Nurseries

**RURAL REAL ESTATE FINANCING**

- Farms and Ranches
- Recreational Property
- Hunting Ranches
- Property Improvements

**INSURANCE SERVICES**

- Crop Insurance
- Pasture, Rangeland and Forage (PRF) Insurance
- Annual Forage Insurance
- Life Insurance
- Livestock Risk Protection (LRP) Insurance

**HOME MORTGAGES**

Offering these home loan programs:

- Rural Home Program
- Rural Home Jumbo Program
- Conventional Program
- Conventional Jumbo Program
- Portfolio Loans
- FHA Program

Certain conditions may apply. Texas Farm Credit is an Equal Housing Lender. As prohibited by federal law, we do not engage in business practices that discriminate on the basis of race, color, religion, national origin, sex, marital status or age (provided you have the capacity to enter into a binding contract), because all or part of your income may be derived from a public assistance program, or because you have, in good faith, exercised any right under the Consumer Credit Protection Act. The federal agency that administers our compliance with these federal laws is the Federal Trade Commission, Equal Credit Opportunity, Washington, DC, 20580. The Texas Farm Credit National Mortgage Licensing System number is 962054. For more information visit [www.texasfcs.com](http://www.texasfcs.com)



**Texas Farm Credit Services**

545 S. Highway 77  
Robstown, TX 78380

ADDRESS SERVICE REQUESTED

PRSRST STD  
US POSTAGE  
PAID  
AUSTIN TEXAS  
PERMIT #1845



**WE FINANCE  
RURAL  
TEXAS**



exas Farm Credit offers loans and related services for recreational property, rural homes, farms and ranches, insurance services and hunting ranches.



**TEXAS  
FARM CREDIT**

**TexasFarmCredit.com | 800.950.8563**