National Rural Utilities Cooperative Finance Corporation
FY21 Third-Quarter Investor Call
April 16, 2021
1:00 PM EST

Operator: Good day, and welcome to the Third Quarter Fiscal Year 2021 Investor Conference Call. Today's conference is being recorded. At this time, I would like to turn the call over to Ling Wang, please go ahead.

Ling Wang: Hi, good afternoon. This is Ling Wang, Vice President of Capital Markets at National Rural Utilities Cooperative Finance Corporation. Welcome to our fiscal year 2021 third-quarter investor call, which covers the three-month period from November 30, 2020, to February 28, 2021, as well as the nine-month period from May 30, 2020, to February 28, 2021. Joining our call this afternoon is Andrew Don, our Chief Financial Officer.

Before we begin, let me remind you that some information provided and comments made during today's call will contain certain forward-looking statements within the Securities Act of 1933 as amended, and the Exchange Act of 1934 as amended. Forward-looking statements, which are based on certain assumptions and describe our future plans, strategies, and expectations, are generally identified by our use of words, such as intend, plan, may, should, will, project, estimate, anticipate, believe, expect, continue, potential, opportunity and similar expressions, whether in the negative or affirmative. All statements about future expectations or projections are forward-looking statements.

Although we believe that the expectations reflected in our forward-looking statements are based on reasonable assumptions, actual results and performance may differ materially from our forward-looking statements. Factors that could cause future results to vary from our forward-looking statements about our current expectations are included in our annual and quarterly periodic reports filed with the US Securities and Exchange Commission. All the forward-looking statements are made as of today, April 16, 2021, and we undertake no obligation to update or publicly release any revisions to forward-looking statements to reflect events, circumstances, or changes in expectations. After the statements are made, today's remarks will also include certain non-GAAP financial measures. Please refer to our Form 10-Q as filed with the SEC, and also posted on our website for a discussion of why we believe our adjusted measures provide useful information in analyzing CFC’s financial performance and the reconciliation to the most comparable GAAP measures.

We will have a Q & A session at the end of this presentation. You can ask questions via phone or submit your questions online. If you are participating in this event via our webcast, we encourage you to take this opportunity to ask any questions you may have. In addition, all of the materials for this event, including the presentation slides and the financial reports are available on our Investor Relations section of our website at www.nrucfc.coop. A replay and a call transcript will be made available on our website after the event. With that, I'll turn the call over to Andrew.

Andrew Don: Thank you, Ling, and again, good afternoon, and thank you for joining us today for National Rural Utilities Cooperative Finance Corporation’s call to review our financial performance for our third fiscal quarter end for the nine months of fiscal year 2021, which is for the period ended February 28, 2021.

Our total assets at February 28, 2021, were approximately $29.42 billion, an increase of

$1.24 billion from the prior fiscal quarter-end and an increase of $1.26 billion from May 31, 2020, prior fiscal year-end. Our loans to members totaled $28.33 billion, an increase of $1.26 billion or 5% during the current quarter and an increase of $1.63 billion or 6% during the nine months ended February 28, 2021. The current quarter increase in loans to members was driven by an increase in long-term loans of $449 million and an increase in line of credit loans of $816 million. The year-to-date increase in loans to members was driven by an increase in long-term loans of $941 million and an increase in line of credit loans of $684 million. During the nine months ended February 28, 2021, we experienced increases in CFC distribution loans of $1.11 billion, CFC power supply loans of $456 million, NCSC loans of $24 million, and RTFC loans of $46 million, and a decrease in CFC statewide and associate loans of $9 million.

The nine months ended February 28, 2021, CFC's long-term loan advances totaled $2.05 billion consisting of $1.73 billion or 84% for capital expenditure purposes and $188 million or 9% to refinance other lender's debt. In comparison, during the same prior-year period long-term loan advances totaled $1.95 billion with $1.5 billion or 77% for capital expenditure purposes and $358 million or 18% for the refinancing of other lender's debt. As mentioned earlier, our line of credit loans outstanding increased by $816 million during the current quarter and $684 million during the nine-month period.., The majority or $526 million of the increase in line of credit loans occurred during February 2021 and was primarily driven by loan advances to borrowers affected by the polar vortex storm in Texas and some parts of the Midwest region.

Our members' equity, which excludes cumulative derivative forward value losses and accumulated other comprehensive loss increased by $19 million from the prior quarter, which was driven by our adjusted net income of $19 million for the current quarter. Our members' equity increased by $62 million from our prior fiscal year-end of May 31, 2020, driven by our adjusted net income of $126 million for the nine-month period, partially offset by CFC's Board of Director's authorization in the first fiscal quarter to retire patronage capital of $60 million.

Our adjusted debt to equity ratio increased to 6.21 to 1 at February 28, 2021, from 5.85 to 1 at May 31, 2020. The increase was primarily attributable to an increase in our debt outstanding in order to fund the growth in our loan portfolio. Specifically, line of credit loans outstanding at February 28, 2021, totaled $2.25 billion, an increase of $684 million from the $1.56 billion outstanding at May 31, 2020. Over the last six quarters, our average line of credit loans outstanding balance at each quarter-end was $1.68 billion. Overall, we expect our adjusted debt to equity ratio will remain above our targeted threshold of 6 to 1 for the next 12 months. Based on our adjusted debt and adjusted equity amounts at February 28, 2021, an increase or decrease in adjusted liabilities of $600 million with no change in adjusted equity or an increase or decrease in adjusted equity of $100 million with no change in adjusted liabilities would result in an increase or decrease in our adjusted debt to equity ratio of approximately 0.15 percent.

For the current quarter ended February 28, 2021, CFC generated an adjusted net income of $19 million and an adjusted TIER of 1.09 times compared with adjusted net income of $47 million and an adjusted TIER of 1.21 times for the same prior-year quarter. The $28 million decrease in adjusted net income in the current quarter from the same prior-year quarter was attributable to the increase in the provision of credit losses of $31 million due to a current quarter addition to the allowance of $33 million due to the significant adverse financial impact of the surge in wholesale power prices during the February 2021 polar vortex on two of our Texas power supply members, namely Brazos Electric Power and Rayburn Country Electric Cooperative.

Our business fundamentals remain strong. Adjusted net interest income for the quarter increased by $6 million or 8% to $75 million driven by an increase in the adjusted net yield of 6 basis points or 6% to 1.08%, and an increase in average earning assets of $818 million or a 3%. The increase in the adjusted net interest yield reflected the favorable impact of a reduction in our adjusted average cost of funds of 29 basis points to 3.1%, partially offset by a decrease in the average yield on interest-earning assets of 21 basis points to 3.99%. Adjusted net interest income for the nine-month period increased by $20 million or 10% to $220 million driven by an increase in the adjusted net interest yield of 6 basis points, or 6% to 1.05% and an increase in average interest-earning assets of $779 million or 3%.

The increase in adjusted net interest income for the year-to-date period was also attributable to the decrease in our average cost of funds that was partially offset by a reduction in the average yield on interest-earning assets. The overall lower interest rate environment, most notably the steep decline in short-term interest rates since March 2020 contributed to the current quarter and year-to-date decreases in both our average cost of funds and our average asset yield.

For the nine months ended February 28, 2021, CFC generated an adjusted net income of $126 million and an adjusted TIER of 1.20 times, compared with an adjusted net income of $151 million and an adjusted TIER of 1.23 times for the same prior-year period. The $25 million decrease in adjusted net income for the nine-month period from the comparable prior year period was largely due to an increase in the provision of credit losses of $34 million resulting from the current quarter addition to the allowance of $33 million, of which $31 million was attributable to the adverse impact on two of our members, the spike in power prices during the February 2021, polar vortex mentioned earlier.

We believe that if the recent steepening of the yield curve remains or continues it will have a positive impact on our adjusted net interest income and adjusted net interest yield over the next 12 months.

We continue to actively monitor the COVID-19 pandemic impact on our borrowers' financial conditions and analyze key credit metrics of our borrowers to facilitate the timely identification of loans with potential credit weaknesses and any notable shifts in the quality of our loan portfolio. We believe the pandemic has not had a significant negative impact on CFC's financial condition and operating results as well as our members' financial conditions.

We are also continuing to monitor developments related to the electricity market in Texas, and are in active conversations with our Texas electric cooperative members to assess and identify any further potential impact on the credit quality of our Texas loan portfolio.

The overall composition of our loan portfolio at quarter-end, February 28, 2021, remained similar to the composition of the prior fiscal year-end of May 31, 2020, with $27.9 billion or 99% of our portfolio consisting of loans to rural electric systems and $431 million or 1% to the telecommunication sector.

CFC’s long-term fixed-rate loans accounted for 90% of our loans outstanding at February 28, 2021, compared with 92% at the May 31, 2020 year-end. We typically lend to our members on a senior secured basis with 92% of our loans being senior secured at February 28, 2021, compared with 94% as of May 31, 2020.

The decreases in the percentage of fixed-rate and senior secured loans resulted from a disproportionately higher increase in unsecured line of credit loans than secured long-term loans during the current year-to-date period, relative to the outstanding amounts at the prior fiscal year-end.

At February 28, 2021, line of credit loans outstanding totaled $2.25 billion and accounted for 8% of total loans outstanding. In comparison, at May 31, 2020, line of credit loans outstanding totaled $1.56 billion or 6% of total loans outstanding. As I mentioned earlier, the majority of the increase in line of credit loans occurred during February, as advances were made to members affected by the February 2021 polar vortex storm to meet their increased weather-related funding needs. We expect that a large portion of these line of credit loan advances will be refinanced via longer term loans over the next 6 to 12 months, either with us or with other lenders.

Our non-performing loans increased to $240 million or 0.85% of total loans outstanding at February 28, 2021, from $168 million or 0.63% of total loans outstanding at May 31, 2020. The increase was primarily attributable to our classification of loans outstanding to Brazos Electric Power Cooperative totaling $82 million as of February 28, 2021, as non-performing due to its bankruptcy filing on March 1, 2021. We also classified loans outstanding to two RTFC telecommunication borrowers totaling $10 million as non-performing as of February 28, 2021.

Our allowance for credit losses increased by $33 million to $92 million as of February 28, 2021, from $59 million from the prior quarter-end due to the current quarter addition of $33 million, which was primarily attributable to the two Texas power supply borrowers that were exposed to elevated power prices during the February 2021 winter storm due to insufficient generation supply to meet their power distribution obligations.

Our allowance for credit losses increased by $39 million from our prior fiscal year-end of May 31, 2020. The increase was attributable to the current quarter addition of $33 million previously mentioned, and an increase in the allowance for credit losses of $4 million from the adoption of CECL on June 1, 2020. Our allowance coverage ratio was at 32 basis points at February 28, 2021, compared with 20 basis points at May 31, 2020.

Despite the current quarter increase in the allowance for credit losses, we believe the overall credit quality of our loan portfolio remained strong as of February 28, 2021. We believe the adverse impact on the credit quality of our loan portfolio from the February 2021 winter storm is primarily limited to Brazos Electric Power Cooperative and Rayburn Country Electric Cooperative. Due to the Brazos Electric bankruptcy filing on March 1, 2021, we expect that Brazos will be unable to make future scheduled loan payments without approval of the bankruptcy court. On the other hand, Rayburn Country Electric Cooperative is current on all of its debt obligations.

We did not have any loan charge-offs during the nine-month period ended February 28, 2021, or during the last three fiscal years. Prior to Brazos' bankruptcy filing, we had not experienced any loan defaults or charge-offs in our electric utility and telecommunications loan portfolios since fiscal year 2013 and 2017 respectively.

Our total debt outstanding increased to $27.21 billion as of February 28, 2021, an increase of $1.21 billion from May 31, 2020, primarily to fund the net loan growth of $1.63 billion through the nine-month period.

CFC continues to maintain diverse funding sources to minimize the risk of being dependent on any single source or market. As of February 28, 2021, $5.31 billion of CFC's funding came from our members in the form of short-term and long-term investments compared with $5.42 billion in May 31, 2020. Our member investments represented 20% of our total debt outstanding at February 28, 2021, compared with 21% at May 31, 2020. Over the last 12 quarters, our member investments have averaged approximately $4.95 billion each quarter-end.

At February 28, 2021, our funding under the Guaranteed Underwriter Program and notes payable with Farmer Mac totaled $8.71 billion or 32% of our total debt outstanding, a decrease of $615 million from May 31, 2020. The decrease was due to the maturities of several Farmer Mac notes and scheduled principal amortization payments under both funding programs.

Our capital markets-related funding sources totaled $13.19 billion at February 28, 2021, an increase of $1.94 billion from the prior fiscal year-end. The increase in our capital markets funding was attributable to increases in our dealer medium-term notes and dealer commercial paper outstanding of $1.29 billion, $655 million respectively.

During the nine-month period, we accessed the debt capital markets several times, largely to fund the loan growth as well as debt maturities. In October 2020, we closed a $400 million Sustainability Collateral Trust Bond transaction. In early February 2021, we issued $350 million, 10-year collateral trust bonds, and $500 million of 3-year dealer medium-term notes.

During mid-to-late February, we issued three medium-term notes totaling $925 million with 2-year and 5-year maturities to fund the unexpected strong loan demand we experienced during the period. During the nine-month period, we issued $1.43 billion in non-member medium-term notes and had maturities totaling $141 million. In addition, we issued $750 million in collateral trust bonds and had maturities totaling $755 million. At February 28, 2021 capital markets-related funding sources accounted for 48% of our total funding compared with 43% of the prior fiscal year-end.

At February 28, 2021, 58% of our total debt was secured and 42% was unsecured compared with 64% secured and 36% unsecured at May 31, 2020. The change in our secured versus unsecured funding mix was partly due to the February issuance of $1.43 billion of dealer medium-term notes, largely to fund the increase in demand from our members for the line of credit loan products. Our short-term borrowings totaled $4.41 billion accounting for 16% of our total debt outstanding at February 28, 2021, compared with $3.96 billion or 15% of total debt outstanding at May 31, 2020. The majority or 85% of our short-term borrowings came from member investments at February 28, 2021, compared with 94% of the prior fiscal year-end. As we have repeatedly stated, the investment from our members is a very reliable funding source with little reinvestment risk, as our members consistently invest a large portion of their excess funds with CFC.

This slide presents CFC's long-term debt maturities amortization from April 2021 to March 2022, which we believe is very manageable. For the next 12 months from this April, we have a total of $2.55 billion of debt maturities, including $800 million of dealer medium-term note maturities, $560 million in Farmer Mac loan maturities, $482 million in our member medium-term note maturities, and $405 million in collateral trust bond maturities. Our members traditionally have re-invested their maturing investments with us. We do not have any large concentrations in our remaining debt maturities, and we believe we have ample sources of liquidity to meet each of the maturities as will be highlighted on the next slide.

This slide depicts the various non-capital market sources of liquidity that CFC had in place at February 28, 2021, compared with the prior fiscal year-end. Our availability under the Guaranteed Underwriter Program increased by $375 million from the prior fiscal year-end. In November 2020, we closed an additional $375 million committed loan facility with the Federal Financing Bank under the Guaranteed Underwriter Program, which allows us to borrow any time before July 15, 2025, for up to 30 years at a very attractive all-in spread of 42.5 to 55 basis points.

As indicated in the graph, we had an aggregate of approximately $7.09 billion of member and non-member debt maturities scheduled over the next 12 months at February 28, 2021, compared with $6.02 billion at May 31, 2020. The $1.06 billion increase was primarily due to a $655 million increase in dealer commercial paper outstanding as we did not have any dealer commercial paper outstanding at the prior fiscal year-end and a $423 million increase in scheduled long-term debt maturities.

At February 28, 2021, we had access to $9.26 billion in liquidity, $2.17 billion in excess, or 1.3 times the combined member and non-member debt maturities. Approximately 55% or $3.92 billion in debt maturities over the next 12 months represent short-term investments that our members have with CFC. We consider our member investments to be a very stable and reliable source of funding for CFC. If we excluded the $3.92 billion debt maturities related to our members' short-term investments, we would have total liquidity of $6.09 billion or 2.9 times dealer commercial paper and the current portion non-member long-term debt scheduled to mature during the 12 months subsequent to February 28, 2021.

This slide presents CFC's projected long-term debt issuance needs over the next 18 months, subsequent to February 28, 2021. Our uses of cash are for two primary purposes: to refinance existing debt maturities and to fund loan growth.

We expect approximately $1.2 billion of net loan growth over the next 18 months with nearly 60% of this amount occurring between now and the end of August 2021.

The scheduled amortization or repayments of loans from our members represents a source of cash. In addition, as indicated in the last column, we expect long-term debt issuances over this time period of approximately $3.6 billion, two-thirds to refinance existing long-term debt maturities, and one-third to fund our anticipated loan growth.

Also note that the other sources and uses of cash column in the middle of the slide reflects net increases or decreases to our deal commercial paper outstanding, short-term member investments, and investment portfolio.

For future potential funding needs, we will continue to look to balance capital market and non-capital market secure and unsecured financings, while always looking to access the most attractive cost of funds for our member borrowers.

To conclude our call, I'd like to leave you with a few key takeaways when you consider CFC as an investment opportunity. These items are areas that CFC has consistently focused on and represent key credit strengths when viewing CFC as an investment.

As indicated, CFC's ratings remain strong despite the downgrade from S&P. On March 5, 2021, S&P downgraded CFC's issuer credit rating from A to A- and revised its outlook on CFC to negative. S&P cited the downgrade was due to a shift from S&P's view of CFCs risk position from strong to adequate due to CFC's loan portfolio concentration in the state of Texas. S&P also revised its outlook on CFC to negative based on the potential for additional elevated credit stress posed by Texas electric cooperatives due to the February 2021 winter storm. Moody's and Fitch continue to monitor the developments in Texas and have not taken any rating actions on CFC.

While we strongly disagree with S&P's position, we will continue to have discussions with Standard and Poor's regarding their assessment of CFC’s loan portfolio, financial profile, and other business fundamentals. As we have previously disclosed, CFC’s long-term incentive plan is tied to our credit ratings. Specifically, in order to receive a payout under our long-term incentive plan, we must maintain an A/A2 issuer credit rating with a stable outlook. Our primary corporate goal is to maintain strong long-term credit fundamentals for our members and investors.

The overall quality of our loan portfolios continues to be strong with 99% of our loans to rural electric systems and 92% of our loans being on a senior secured basis. We had no charge-offs during the nine months ended February 28, 2021, or during the last three fiscal years. Prior to Brazos' bankruptcy filing, we had not experienced any loan defaults or charge-offs in our electric portfolio since fiscal year 2013. In addition, our exposure to Brazos' is only $85 million. The coverage ratio of our allowance for credit losses was at 32 basis points of our total loan portfolio at February 28, 2021.

In CFC's 51-year history throughout various economic cycles, we have experienced very limited charge-offs, loan defaults, loan delinquencies, and non-performing loans in our electric portfolio. We believe the pandemic has had no significant impact on the credit quality of our loan portfolio. Although the surge in wholesale power prices in Texas and natural gas prices during the winter storm in February 2021 has had an unfavorable financial impact on some of our Texas-based borrowers we believe the significant adverse financial impact is only limited to the two Texas electric power supply borrowers we discussed earlier.

CFC continues to receive strong support from our members, both in terms of new lending business and as a valuable funding source. Our member investments continue to grow and stood at $5.31 billion at February 28, 2021, representing 20% of our total funding compared with $4.17 billion or 18% at our fiscal year-end 2016.

As a member-owned cooperative organization, CFC cannot issue common or preferred equity. However, we are committed to grow our equity through retained earnings. Our members' equity has grown by 36% to $1.77 billion from $1.3 billion since our fiscal year-end 2016. We continue to maintain diversified funding sources and a strong liquidity profile. Our funding sources are very well established and have remained stable.

From a liquidity perspective at February 28, 2021, we had $745 million of cash, cash equivalents and short- to intermediate-term liquid fixed income investment securities, $2.72 billion committed revolving credit facilities from our relationship banks, $1.28 billion committed availability in the Guaranteed Underwriter Program and $2.82 billion revolving credit capacity via the Farmer Mac secured note purchase agreements.

These sources together with $1.69 billion in scheduled loan amortization and other repayments from our members resulted in CFC having $9.26 billion of liquidity available at February 28, 2021, to meet the $7.09 billion in debt maturities over the next 12 months, a 1.3 times liquidity coverage ratio. Excluding debt maturities related to our member investments, which historically have had a high re-investment rate, our liquidity coverage ratio would be 2.9 times.

Thank you once again for joining us today to review our results for the first nine months ended February 28, 2021. We appreciate your interest in CFC and look forward to discussing our financial performance and funding plans in the future. I'd like to ask the operator to open the lines for any questions and suggest that you submit your questions by the web service so that we may respond to those as well. Thank you.

Operator: If you would like to ask a question, please signal by pressing star one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star one to ask a question, we'll pause just for a moment to allow everyone an opportunity to signal for questions. First question comes from Chad Stogel.

Chad Stogel: Good afternoon. Yeah, my question just relates to the ongoing situation in Texas. And you may, you know, you mentioned that you're comfortable that the situation for you is limited to those two supply companies. What are you watching going forward in terms of the development from the state and you know, how this, how the payment get sorted out, you know, ERCOT, as it regards your comfort with just those two and that it is limited to that. And is there anything that we should be focused on looking forward, in your opinion?

Andrew Don: Yeah, no. As we've said, you know, pretty consistently since, you know, the activity in February and the ratings action in March, you know, we have had very, well, we have continual discussion with all our members. Certainly, the other generating companies in the state of Texas. We're obviously know what their funding needs were, they've obviously been very transparent on what the impact to them was from a you know, kind of a liquidity need or, you know, kind of short-term funding need as well as, you know, the total cost to them, if you will, from that Texas event. And they have all been able to manage through that. We have had some, you know, incremental borrowings with some of them. And in fact, I had some one borrowed and has subsequently repaid us in full.

So, we feel, you know, we certainly have had communication with every borrower. And again, it was primarily the funding need was primarily housed at the generation companies versus because obviously that's where the power bill from ERCOT went to. And you know, how they chose to, you know, pass that down to their members is obviously something they manage and typically are doing that over anywhere from a couple of years to a longer period of time, as it relates to the, a larger the more, you know, challenged situations, you know, namely Rayburn and Brazos. Obviously, Brazos is in bankruptcy and will go through that process and including obviously you know, coming together with a plan, you know, as we noted, we have very limited exposure to the Brazos bankruptcy, it's only 85 million in the aggregate.

With Rayburn, we have, obviously, we have a very close an ongoing dialogue with them on a weekly basis to kind of keep in touch with what they're doing and they're indicating they're going to continue to work through it. And you know, probably, the best solution would be the ability for these borrowers to affect the securitization. You know, I don't know how closely you followed it, but essentially there's legislation that's needed to be passed in the Texas houses to allow cooperatives to do securitization, but we believe that, you know, there's a reasonably good probability of that happening. And that if that legislation does pass that, you know, Rayburn in particular, would look to the securitization market to you know, basically pay off, pay its invoices and pay any debt that it has taken on related to the invoices due to ERCOT and have that paid out over a longer period of time.

So, that's what we're seeing as relates to Texas. And again, outside of Texas or outside of ERCOT, you know, primarily, miso we found that, you know, all of the entities that were impacted by the weather, wasn't purely Texas have been able to manage through that from a liquidity and funding perspective. And, you know, we'll again, look to pass through those costs, you know, over a couple of years to maybe a longer period of time.

Chad Stogel: And just as a follow-up, is there any concern as a regard to another way that that Texas has talked about and nothing concrete yet, but kind of the reshuffling of the costs and saying that some overcharged, someone undercharged the cost and the revenue, if that gets moved around, can that have an effect on borrowers or is that not something that that's really what's keeping you up at night?

Andrew Don: Yeah, we don't believe that. I think what you're referring to has been termed repricing, if you will, you know, where they're reallocating that. That discussion is pretty well ended. I don't think that's likely to happen as a practical matter. So, whatever the invoices are that are due are not going to change due to some reallocation of that.

Chad Stogel: Okay, great. Thanks for your time.

Operator: Our next question comes from Jude Scaglione.

Jude Scaglione: Hi, how are you? Thanks for the call. So, just a follow-up with respect to the Texas market. I just want to have a better understanding, I guess, of your view from a risk perspective of that market I'm assuming if securitization goes through that that's a positive for you for you guys, and hopefully, that would translate into some positive action on the rating agency side. But presumably like, if something like that didn't occur and you're kind of faced with the ongoing risk of what kind of happened, how would you view that market and which I guess, would you be looking to kind of pull back the loan portfolio in that particular area?

Andrew Don: I mean, again, we believe that the credit risks are concentrated in terms of, you know, being a challenging situation with those, with the two names that we specifically referenced. We believe that the other, you know, again, the other, there are some cooperatives in the state of Texas that are not part of the G&T. They maybe, they have other power supply arrangements whether it's contracts or with people like the Lower Colorado River Authority. So, there are other supply arrangements out there. But having said that again, we have a regular weekly dialogue with all of our members, including our Texas members in particular at this time, and have a very good handle on their funding needs. And because again, this was a, you know, a five-day event, if you will.

That happened obviously, you know, now, two months ago. So, I think everyone pretty well knows what their financial impact has been and, you know, have had the time to think about how they want to pass that increased cost to their members. So, I think that, again, it's a pretty well-known number right now. Obviously, the initial issue was just getting the funding and the liquidity, if you will, to obviously pay that invoice. And but you know, we're not, believing that people will have, nobody is indicating any stress, outside of the Rayburn and Brazos situations. So, you know, now, to be frank, I mean, obviously, you know, Rayburn, we've disclosed what their total invoices due to ERCOT are. They're in the, I think 800 million range and they've paid a certain amount of that.

So, they still have unpaid invoices of a significant amount if they can do the securitization and have those costs spread over a longer period of time, that's obviously the way to do it. If, for some reason, securitization doesn't come to pass or, you know, it's a challenging thing to put together, you know, we would obviously talk to Rayburn about what they plan to do about that. They have consistently indicated to us that their last option would be to consider any type of a bankruptcy. So, we're going to continue to work with them to look for other solutions.

Jude Scaglione: Right. No, that's helpful. I guess, just maybe asking the question a little bit differently then. This event kind of moving path, let's assume there was no kind of reform measures in Texas that would help whether it was securitization or kind of price gap for low demand or something like that. Does that then change, I guess, your view on lending within that market?

Andrew Don: Sure. Yeah. No, I'm sorry. That was the second part of your question. I mean, yeah, yeah. I think that you know, I don't know if you're aware they've already made a change within the Texas market. I think the prior kind of what I'll call default or, price cap for was 9,000 per megawatt hour. That was, I think for the month, for the summer, that's been reduced to 2000. Having said all that, that's obviously still a large number. I think what we would, in terms of reducing our exposure to Texas, I mean, we we're there to support our members. I think that having said that, we're not going to take undue risk with any one member that impacts the whole organization. So, I think that, we would look to do a greater amount of due diligence about the potential impacts of those entities that don't have from power supply contracts, or, what is the situation with either their contractual relationships or their counterparties to make sure that we've got more information and are more satisfied with their ability to perform as a practical matter.

I mean, obviously, this was a highly improbable, but a high impact event. So, I think that, we would want to make sure that we've spent more time with those entities that are more exposed to the market. And again, I think that this prior event certainly indicated which entities were more exposed. I mean there were some other of our electric cooperatives were not exposed at all. They had, they owned generation and they were able to perform. So, they were, not really impacted at all. So, I think, we obviously knew all of these factors ahead of time about, what the various exposures to the market were. I think it's just going forward making sure that anybody that is exposed has a very good answer for why they're taking that exposure. And it's probably with those types of entities that we would potentially revisit our exposure limits.

Jude Scaglione: That's very, very helpful. Thank you.

Operator: Okay. There are no further questions in the queue at this time.

Andrew Don: I think we had a couple that were submitted electronically. So, I think one, it says the 10-Q disclosed to the 10 of the 16 defaults, not including Brazos resulted in zero loss while the other six were just 86 million, obviously, there's uncertainty on resolving the issue in Texas, but how would you say these cumulative losses compared to what is likely to happen with the two troubled borrowers in Texas?

Well, as we indicated, we did see an increase in our loan loss allowance. You know, this quarter, again, you know, the vast majority, you know, from 95% of that was attributable to those two borrowers. So, you can figure out those mathematically. I mean we believe that I mean, in the instance of Brazos we've seen where debt is trading in the market and to be frank, we could probably sell our exposure and get out for what our current addition to the loan loss allowance was for related to Brazos.

As it relates to Rayburn, again, we've disclosed previously that we have about 380 million of exposure with about 180 million of that, or so being on a senior secured basis where we're comfortable with that. I think the unsecured piece with Rayburn is, the, kind of the undetermined outcome. We obviously did increase our loan loss allowance for that. I think it really is going to depend on, what I'll call the worst outcome for Rayburn happens and, what we view as the plan that's going to be. But we believe our current addition to the loan loss appropriately and adequately reflects the potential loss that we believe exists with those two borrowers. And again, that's the majority of the 33 million increase that we had this quarter is directly attributable to those two.

The second question is online, can you please elaborate on the management incentives linked to ratings?

Yes, we have had for a significant period of time, a long-term incentive plan, or, a kind of bonus plan that is tied to CFC's unsecured credit ratings, and basically the concept behind it was that the Board of Directors recognize how important credit ratings are to CFC. So, wanting to provide, obviously, a strong message about maintaining high credit ratings, which obviously, every company's goal or most companies but how it's directly tied is that essentially, if CFC's issuer or unsecured rating has to be at a level of either A or A2 for there to be any payout. So, it's a kind of a plan that looks at our ratings at the fiscal year end of May 31 at each fiscal year end and what the ratings are on that date determines whether there's a payout or not. So, obviously, at the current time, with having a rating of A- versus the minimum required of A would result in no payout.

Are there any more?

Operator: A reminder, if you would like to ask a question over the phone, please press star one.

Andrew Don: Okay. We have another question here, there was another scare recently about spot prices hitting 9,000 per megawatt hour in Texas. So, it appears that's happening with more frequency I think that what we have heard is that a result of the winter storm and some unseasonably warmer weather and that there were maintenance issues with some of the generating companies, is what were really required that, you know, some of the generators were taking units offline to do maintenance and other things like that. And that's what kind of caused some temporary spikes. I don't think it had, it was directly related to anything other than that.

Having said that, as I mentioned for the summer, which is typically what Texas is, a summer peaking environment they have limited the maximum price or reduced it from the 9,000 a megawatt hour to 2000. But, and obviously, I think that it's fair to say that the regulator in Texas will be very focused on reliability as well as appropriate capacity levels in that market. So, I mean, obviously, you know, it was an event that nobody certainly felt was going to happen. It's going to take time for them to shall we say, adjust it and fix it, but I think that will be what happens longer term.

Operator: There are no questions in the queue.

Andrew Don: Okay, great. Well, appreciate everybody's attendance today and your questions. We look forward to talking with you in the future. Please feel free to call us anytime if we can answer any of your questions related to this or any other topics. Thanks, and have a good day.

Operator: Thank you, ladies and gentlemen, this concludes today's teleconference. You may now disconnect.