

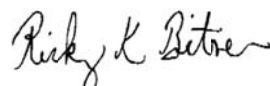
# THIRD QUARTER 2013

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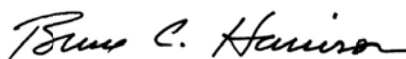
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## CERTIFICATION

The undersigned certify that we have reviewed the September 30, 2013 quarterly report of Farm Credit of Northwest Florida, ACA, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.



Ricky K. Bitner  
Chief Executive Officer



Bruce C. Harrison  
Chief Financial Officer



Richard Terry  
Chairman of the Board

November 7, 2013

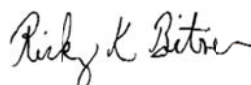
# Report on Internal Control Over Financial Reporting

The Association's principal executives and principal financial officers, 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 Board of Directors, management and other personnel. This process provides 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.

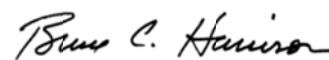
Internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions 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 September 30, 2013. 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 September 30, 2013, the internal control over financial reporting was effective based upon the COSO (1992) criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of September 30, 2013.



Ricky Bitner  
Chief Executive Officer



Bruce C. Harrison  
Chief Financial Officer

November 7, 2013

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

*(dollars in thousands)*

The following commentary reviews the financial condition and results of operations of Farm Credit of Northwest Florida, ACA (Association) for the period ending September 30, 2013. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2012 Annual Report of the Association.

## **LOAN PORTFOLIO**

The Association provides funds to farmers, rural homeowners and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans. The Association's loan portfolio is diversified over a range of agricultural commodities including forestry, row crops, livestock, peanuts, horticulture, dairies and rural homes. Farm size varies and many of the borrowers in the region have diversified farming operations. This factor, along with the numerous opportunities for non-farm income in the area, somewhat reduces the level of dependency on any single commodity.

The gross loan volume of the Association as of September 30, 2013, was \$272,446 a decrease of \$1,002 as compared to \$273,448 at December 31, 2012. Net loans outstanding, gross loans net of the allowance for loan losses, at September 30, 2013, were \$267,465 as compared to \$268,899 at December 31, 2012. Net loans accounted for 92.33 percent of total assets at September 30, 2013, as compared to 92.00 percent of total assets at December 31, 2012. The reduction in loan volume was due primarily to normal principal payments and movements of loans to other property owned, partially offset by new loan activity.

Portfolio credit quality has improved due to management efforts to work through problem loans and the general improvement in the overall economic environment. Nonaccrual loans were \$12,398 at September 30, 2013, a decrease of \$8,051 from \$20,449 at December 31, 2012.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions.

The allowance for loan losses at September 30, 2013 was \$4,981 as compared to \$4,549 at December 31, 2012, an increase of \$432. This increase reflected charge-offs against the allowance for loan losses of \$959 and reversals of \$350, offset by recoveries of \$1,741.

The allowance for loan loss of \$4,981 at September 30, 2013 was considered by management to be adequate to cover possible losses. The allowance for loan losses represents 1.83 percent of gross loan volume as of September 30, 2013. Other property owned (OPO) was \$10,898 as of September 30, 2013 as compared to \$10,105 at December 31, 2012. This net increase of \$793 was due to acquisitions of \$3,352, write-downs of \$405 and sales of \$2,154.

Amounts due from AgFirst Farm Credit Bank (AgFirst) decreased to \$1,482 as of September 30, 2013 as compared to \$2,907 as of December 31, 2012. These amounts represent patronage due from AgFirst at both September 30, 2013 and December 31, 2012. The decrease of \$1,425 was primarily due to the fact that the amount due at September 30, 2013 was for three quarters and the amount due at December 31, 2012 was for four quarters, along with the fact that the December amount included a receivable of \$692 as a special distribution whereas the September balance did not include a special distribution.

## **RESULTS OF OPERATIONS**

### ***For the three months ending September 30, 2013***

Net income for the three months ending September 30, 2013, totaled \$664, as compared to net income of \$971 for the same period in 2012, a decrease of \$307. Components of the decrease in net income are discussed further in the following paragraphs.

For the three months ending September 30, 2013, interest income decreased by \$432 or 11.95 percent compared to the same period ending September 30, 2012. For the three months ending September 30, 2013 interest expense decreased by \$236 or 16.35 percent, compared to the period ending September 30, 2012. These decreases resulted in a decrease in net interest income of \$196, compared to the period ending September 30, 2012.

There was no provision or reversal of loan losses for the three months ending September 30, 2013, compared with a provision of \$400 for the three months ending September 30, 2012.

Noninterest income for the three months ending September 30, 2013 totaled \$407, as compared to \$733 for the same period of 2012, a decrease of \$326. This decrease in noninterest income reflects a decrease in patronage from AgFirst of \$78 and increased losses and expenses on OPO of \$300, partially offset by an increase in fee income of \$40 and gains on the sale of rural home loans of \$30.

Noninterest expense for the three months ending September 30, 2013 totaled \$1,792, as compared to \$1,533 for the same period of 2012, an increase of \$259. This increase was due to increases in salaries and benefits of \$59, insurance fund premiums of \$19, occupancy and equipment of \$6 and other operating expenses of \$175. The increase in salaries and benefits was due primarily to higher benefit costs. The increase in other operating expenses was due primarily to increases in legal expenses associated with nonaccrual loans.

#### ***For the nine months ending September 30, 2013***

Net income for the nine months ending September 30, 2013, totaled \$2,407 as compared to net income of \$3,550 for the same period in 2012, a decrease in net income of \$1,143.

For the nine months ending September 30, 2013, interest income decreased by \$1,950 or 17.04 percent compared to the same period ending September 30, 2012. For the nine months ending September 30, 2013 interest expense decreased by \$1,257 or 26.13 percent, compared to the period ending September 30, 2012. These decreases resulted in a decrease in net interest income of \$693, compared to the period ending September 30, 2012. The net decrease of \$693 was due to a decrease of \$543 related to interest rates and a decrease of \$150 related to volume.

There was a reversal of loan losses of \$350 for the nine months ending September 30, 2013 as compared to a provision of \$400 for the period ending September 30, 2012.

Noninterest income for the nine months ending September 30, 2013, totaled \$1,225, as compared to \$2,069 for the same period of 2012, a decrease of \$844. This decrease in noninterest income reflects a decrease in patronage from AgFirst of \$476 and a decrease in insurance refunds of \$449, partially offset by an increase in fee income of \$26, a decrease in losses on the sale of OPO and expenses related to OPO of \$37, and an increase in other gains of \$18.

## **FUNDING SOURCES**

The principal source of funds for the Association is the borrowing relationship established with AgFirst Farm Credit Bank through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. AgFirst advances funds to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at September 30, 2013 was \$207,701 as compared to \$210,507 at December 31, 2012. The reduction in notes payable to AgFirst was due primarily to the decrease in loan volume and increase in members' equity.

## **CAPITAL RESOURCES**

Total members' equity at September 30, 2013 increased \$981 to \$78,794 from the December 31, 2012 total of \$77,813. Total capital stock and participation certificates were \$834 as of September 30, 2013, a decrease of \$67 compared to \$901 at December 31, 2012.

Farm Credit Administration (FCA) regulations require all Farm Credit institutions to maintain minimum permanent capital, total surplus and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus and core surplus as defined in FCA regulations, by a risk-adjusted asset base. As of September 30, 2013 the Association's total surplus ratio and core surplus ratio were 25.24 percent and 24.55 percent, respectively, and the permanent capital ratio was 25.53 percent. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

## **REGULATORY MATTERS**

On April 20, 2011 the Farm Credit Administration (FCA) entered into a written supervisory agreement with the Board of Directors of the Association. The previous written supervisory agreement between the FCA and the Association, dated April 6, 2010, was terminated by the April 20, 2011 agreement. The written supervisory agreement dated April 20, 2011 requires the Association to take corrective actions and other actions with respect to certain areas of its operations, including board operations, director fiduciary duties, board consultant functions, nominating committee assistance, strategic and business planning, staffing, internal controls, asset quality, loan portfolio management, allowance for loan loss, collateral risk, capital, earnings and liquidity.

Conditions and events that led to the need for this agreement include rapid growth between 2003-2007, deterioration of loan quality, liberal loan structures, lack of oversight to credit policies and procedures, lack of sufficient staff training, high staff turn-over and lack of diversification in the portfolio (concentration in real estate lending).

The Association has taken action to correct weaknesses in its board operations, strategic planning, staffing, internal controls, asset quality, loan portfolio management, portfolio risk, capital, earnings and liquidity; however, all necessary improvements had not been realized as of April 20, 2011.

The Board will continue to address the requirements of the agreement dated April 20, 2011 by establishing a collateral risk program, conducting an assessment of board and staff training needs and providing the necessary training, and by establishing improved credit policy direction and guidance.

The written supervisory agreement dated April 20, 2011 requires the Board to continue to engage an Independent Board Consultant to advise and counsel the Board in fulfilling its fiduciary responsibilities and to perform other functions as specified in the agreement.

The Association's supervisory agreement with the FCA requires that all new loans must be of acceptable quality at origination under the Uniform Classification System. However, the agreement provides that the Institution may extend or renew loans of less than acceptable quality to existing customers if such extensions or renewals are done in accordance with sound and documented risk management strategies.

FCA examiners were on site the weeks of June 3 and 10, 2013 to determine the Association's performance and condition based on the FCA's ongoing oversight and risk-based examination activities. The Association has made progress in complying with the written supervisory agreement. However, the Association remains under supervision as of the date of this report.

## **RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

Please refer to Note 1, "*Organization, Significant Accounting Policies, and Recently Issued Accounting Pronouncements*", in the Notes to the Financial Statements, and the 2012 Annual Report to Shareholders for recently issued accounting pronouncements.

**NOTE:** Shareholder investment in the Association is materially affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst's annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 2832, or writing Susanne Caughman, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, [www.agfirst.com](http://www.agfirst.com). Copies of the Association's annual and quarterly reports are also available upon request free of charge by calling 850-526-4910 ext. 103, or writing Bruce C. Harrison, Chief Financial Officer, Farm Credit of Northwest Florida, ACA, P.O. Box 7000, Marianna, FL 32447, or accessing the website, [www.farmcredit-fl.com](http://www.farmcredit-fl.com). The Association prepares a quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

# Farm Credit of Northwest Florida, ACA

## Consolidated Balance Sheets

| <i>(dollars in thousands)</i>                 | <b>September 30,<br/>2013</b><br><i>(unaudited)</i> | <b>December 31,<br/>2012</b><br><i>(audited)</i> |
|---|---|--|
| <b>Assets</b>                                 |   |  |
| Cash  | \$ —  | \$ 40  |
| Loans   | 272,446   | 273,448  |
| Less: allowance for loan losses               | 4,981   | 4,549  |
| Net loans                                     | 267,465   | 268,899  |
| Loans held for sale                           | —   | 273  |
| Accrued interest receivable                   | 1,909   | 1,985  |
| Investments in other Farm Credit institutions | 4,917   | 5,017  |
| Premises and equipment, net                   | 1,403   | 1,233  |
| Other property owned                          | 10,898  | 10,105   |
| Due from AgFirst Farm Credit Bank             | 1,482   | 2,907  |
| Other assets                                  | 1,603   | 1,824  |
| Total assets                                  | \$ 289,677  | \$ 292,283                                       |
| <b>Liabilities</b>                            |   |  |
| Notes payable to AgFirst Farm Credit Bank     | \$ 207,701  | \$ 210,507                                       |
| Accrued interest payable                      | 391   | 437  |
| Patronage refunds payable                     | 23  | 1,281  |
| Other liabilities                             | 2,768   | 2,245  |
| Total liabilities                             | 210,883   | 214,470  |
| Commitments and contingencies                 |   |  |
| <b>Members' Equity</b>                        |   |  |
| Protected borrower stock                      | 3   | 4  |
| Capital stock and participation certificates  | 831   | 897  |
| Retained earnings                             |   |  |
| Allocated                                     | 56,243  | 51,622   |
| Unallocated                                   | 21,717  | 25,290   |
| Total members' equity                         | 78,794  | 77,813   |
| Total liabilities and members' equity         | \$ 289,677  | \$ 292,283                                       |

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

# Farm Credit of Northwest Florida, ACA

## Consolidated Statements of Comprehensive Income

*(unaudited)*

| <i>(dollars in thousands)</i>   | For the three months<br>ended September 30, |          | For the nine months<br>ended September 30, |           |
|---|---|----------|--|-----------|
|   | 2013  | 2012     | 2013                                       | 2012      |
| <b>Interest Income</b>  |   |          |  |           |
| Loans   | \$ 3,182                                    | \$ 3,614 | \$ 9,491                                   | \$ 11,441 |
| <b>Interest Expense</b>   |   |          |  |           |
| Notes payable to AgFirst Farm Credit Bank                                       | 1,207                                       | 1,443    | 3,553                                      | 4,810     |
| Net interest income   | 1,975                                       | 2,171    | 5,938                                      | 6,631     |
| Provision for (reversal of allowance for) loan losses                           | —   | 400      | (350)                                      | 400       |
| Net interest income after provision for (reversal of allowance for) loan losses | 1,975                                       | 1,771    | 6,288                                      | 6,231     |
| <b>Noninterest Income</b>   |   |          |  |           |
| Loan fees   | 61  | 21       | 144  | 118       |
| Patronage refunds from other Farm Credit institutions                           | 489   | 567      | 1,617                                      | 2,093     |
| Gains (losses) on other property owned, net                                     | (173)                                       | 127      | (576)                                      | (613)     |
| Gains (losses) on sales of rural home loans, net                                | 30  | —        | 40   | —         |
| Gains (losses) on sales of premises and equipment, net                          | —   | 16       | —  | 20        |
| Insurance Fund refunds  | —   | —        | —  | 449       |
| Other noninterest income  | —   | 2        | —  | 2         |
| Total noninterest income  | 407   | 733      | 1,225                                      | 2,069     |
| <b>Noninterest Expense</b>  |   |          |  |           |
| Salaries and employee benefits  | 1,102                                       | 1,043    | 3,318                                      | 3,305     |
| Occupancy and equipment   | 90  | 84       | 264  | 232       |
| Insurance Fund premiums   | 55  | 36       | 164  | 114       |
| Other operating expenses  | 545   | 370      | 1,434                                      | 1,099     |
| Total noninterest expense   | 1,792                                       | 1,533    | 5,180                                      | 4,750     |
| Income before income taxes  | 590   | 971      | 2,333                                      | 3,550     |
| Provision (benefit) for income taxes  | (74)  | —        | (74)                                       | —         |
| Net income  | 664   | 971      | 2,407                                      | 3,550     |
| Other comprehensive income  | —   | —        | —  | —         |
| Comprehensive income  | \$ 664                                      | \$ 971   | \$ 2,407                                   | \$ 3,550  |

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

Farm Credit of Northwest Florida, ACA

# Consolidated Statements of Changes in Members' Equity

*(unaudited)*

*(dollars in thousands)*

|  | Protected<br>Borrower<br>Stock | Capital<br>Stock and<br>Participation<br>Certificates | Retained Earnings |                  | Total<br>Members'<br>Equity |
|--|--------------------------------|---|-------------------|------------------|-----------------------------|
|  |                                |   | Allocated         | Unallocated      |                             |
| Balance at December 31, 2011                                       | \$ 5                           | \$ 941  | \$ 51,831         | \$ 19,220        | \$ 71,997                   |
| Comprehensive income   |                                |   |                   | 3,550            | 3,550                       |
| Protected borrower stock retired                                   | (1)                            |   |                   |                  | (1)                         |
| Capital stock/participation<br>certificates issued/(retired), net  |                                | (57)  |                   |                  | (57)                        |
| Retained earnings retired  |                                |   | (182)             |                  | (182)                       |
| Balance at September 30, 2012                                      | <u>\$ 4</u>                    | <u>\$ 884</u>   | <u>\$ 51,649</u>  | <u>\$ 22,770</u> | <u>\$ 75,307</u>            |
| Balance at December 31, 2012                                       | \$ 4                           | \$ 897  | \$ 51,622         | \$ 25,290        | \$ 77,813                   |
| Comprehensive income   |                                |   |                   | 2,407            | 2,407                       |
| Protected borrower stock retired                                   | (1)                            |   |                   |                  | (1)                         |
| Capital stock/participation<br>certificates issued/(retired), net  |                                | (66)  |                   |                  | (66)                        |
| Patronage distribution<br>Nonqualified allocated retained earnings |                                |   | 5,980             | (5,980)          | -                           |
| Retained earnings retired  |                                |   | (1,359)           |                  | (1,359)                     |
| Balance at September 30, 2013                                      | <u>\$ 3</u>                    | <u>\$ 831</u>   | <u>\$ 56,243</u>  | <u>\$ 21,717</u> | <u>\$ 78,794</u>            |

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



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*Farm Credit of Northwest Florida, ACA*

# Notes to the Consolidated Financial Statements

*(dollars in thousands, except as noted)  
(unaudited)*

## **NOTE 1 – ORGANIZATION, SIGNIFICANT ACCOUNTING POLICIES, AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

### **Organization**

The accompanying financial statements include the accounts of Farm Credit of Northwest Florida, ACA (the Association). A description of the organization and operations, the significant accounting policies followed, and the financial condition and results of operations for the Association as of and for the year ended December 31, 2012, are contained in the 2012 Annual Report to Shareholders. These unaudited interim consolidated financial statements should be read in conjunction with the latest Annual Report to Shareholders.

### **Basis of Presentation**

In the opinion of management, the accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles (GAAP) and prevailing practices within the banking industry.

Certain amounts in the prior period's consolidated financial statements may have been reclassified to conform to the current period presentation. Such reclassifications had no effect on the prior period net income or total capital as previously reported.

The results of any interim period are not necessarily indicative of the results to be expected for a full year.

### **Significant Accounting Policies**

The Association maintains an allowance for loan losses at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio as of the report date. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through loan charge-offs and allowance reversals. A review of individual loans in each respective portfolio is performed periodically to determine the appropriateness of risk ratings and to ensure loss exposure to the Association has been identified.

### **Recently Issued Accounting Pronouncements**

In February 2013 the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2013-04, "Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for which the Total Amount of the Obligation Is Fixed at the Reporting Date," which addresses the recognition, measurement and disclosure of certain obligations including debt arrangements, other contractual obligations, and settled litigation and judicial rulings. The amendments are to be applied retrospectively to all prior periods presented for those obligations resulting from joint and several liability arrangements within the ASU's scope that exist at the beginning of an entity's fiscal year of adoption. An entity may elect to use hindsight for the comparative periods (if it changed its accounting as a result of adopting the amendments in the ASU) and should disclose that fact. The amendments are effective for public entities for fiscal years, and interim periods within those years, beginning after December 15, 2013. For nonpublic entities, the amendments are effective for fiscal years ending after December 15, 2014, and interim periods and annual periods thereafter. Early application is permitted. It is not anticipated the adoption of this guidance will have a material impact on the Association's financial condition or results of operations but could result in additional disclosures.

In February 2013 the FASB issued ASU 2013-02, "Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." The ASU is intended to improve the transparency of reporting reclassifications out of accumulated other comprehensive income (AOCI). The amendments do not change the requirements for reporting net income or other comprehensive income in financial statements. However, the amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. For public entities, the amendments are effective prospectively for reporting periods

beginning after December 15, 2012. For nonpublic entities, the amendments are effective prospectively for reporting periods beginning after December 15, 2013. Early application is permitted.

In January 2013, the FASB issued ASU 2013-01 "Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities." The ASU clarifies that ordinary trade receivables and payables are not in the scope of ASU 2011-11, "Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities." Specifically, ASU 2011-11 applies only to derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with specific criteria or subject to a master netting arrangement or similar agreement. The effective date is the same as that for ASU 2011-11 below.

In December 2011, the FASB issued ASU 2011-11, "Balance Sheet (Topic 210) - Disclosures about Offsetting Assets and Liabilities." The guidance requires an entity to disclose

information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. This includes the effect or potential effect of rights of setoff associated with an entity's recognized assets and recognized liabilities. The requirements apply to recognized financial instruments and derivative instruments that are offset in accordance with accounting guidance and for those recognized financial instruments and derivative instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset or not. This guidance is to be applied retrospectively for all comparative periods and is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The adoption of this guidance, in conjunction with ASU 2013-01 above, did not impact the Association's financial condition or its results of operations, but did result in additional disclosures.

Other recently issued accounting pronouncements are discussed in the 2012 Annual Report to Shareholders.

## NOTE 2 – LOANS AND ALLOWANCE FOR LOAN LOSSES

For a complete description of the Association's accounting for loans (including impaired loans and the allowance for loan losses) and definitions of loan types, see the 2012 Annual Report to Shareholders.

Credit risk arises from the potential inability of an obligor to meet its repayment obligation. The Association manages credit risk associated with lending activities through an assessment of the credit risk profile of an individual obligor. The Association sets its own underwriting standards and lending policies that provide direction to loan officers and are approved by the board of directors.

A summary of loans outstanding at period end follows:

|                                  | September 30, 2013 |         | December 31, 2012 |         |
|----------------------------------|--------------------|---------|-------------------|---------|
| Real estate mortgage             | \$                 | 181,566 | \$                | 181,224 |
| Production and intermediate-term |                    | 76,737  |                   | 83,517  |
| Loans to cooperatives            |                    | 13      |                   | -       |
| Processing and marketing         |                    | 9,102   |                   | 3,022   |
| Farm-related business            |                    | 78      |                   | 974     |
| Communication                    |                    | 1,400   |                   | 1,456   |
| Rural residential real estate    |                    | 3,550   |                   | 3,255   |
| Total Loans                      | \$                 | 272,446 | \$                | 273,448 |

A substantial portion of the Association's lending activities is collateralized, and exposure to credit loss associated with lending activities is reduced accordingly.

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 (FCA) regulations. The following tables present participation loan balances at periods ended:

|                                  | September 30, 2013       |                     |                           |                     |                            |                     |                          |                     |
|----------------------------------|--------------------------|---------------------|---------------------------|---------------------|----------------------------|---------------------|--------------------------|---------------------|
|                                  | Within AgFirst District  |                     | Within Farm Credit System |                     | Outside Farm Credit System |                     | Total                    |                     |
|                                  | Participations Purchased | Participations Sold | Participations Purchased  | Participations Sold | Participations Purchased   | Participations Sold | Participations Purchased | Participations Sold |
| Real estate mortgage             | \$ -                     | \$ 54,835           | \$ -                      | \$ 3,760            | \$ 254                     | \$ -                | \$ 254                   | \$ 58,595           |
| Production and intermediate-term | -                        | 11,085              | -                         | -                   | 3,000                      | 2,250               | 3,000                    | 13,335              |
| Processing and marketing         | 8,572                    | -                   | -                         | -                   | -                          | -                   | 8,572                    | -                   |
| Communication                    | 1,399                    | -                   | -                         | -                   | -                          | -                   | 1,399                    | -                   |
| Total                            | \$ 9,971                 | \$ 65,920           | \$ -                      | \$ 3,760            | \$ 3,254                   | \$ 2,250            | \$ 13,225                | \$ 71,930           |

**December 31, 2012**

|                                  | <b>Within AgFirst District</b>  |                            | <b>Within Farm Credit System</b> |                            | <b>Outside Farm Credit System</b> |                            | <b>Total</b>                    |                            |
|----------------------------------|---------------------------------|----------------------------|----------------------------------|----------------------------|-----------------------------------|----------------------------|---------------------------------|----------------------------|
|                                  | <b>Participations Purchased</b> | <b>Participations Sold</b> | <b>Participations Purchased</b>  | <b>Participations Sold</b> | <b>Participations Purchased</b>   | <b>Participations Sold</b> | <b>Participations Purchased</b> | <b>Participations Sold</b> |
| Real estate mortgage             | \$ -                            | \$ 54,271                  | \$ -                             | \$ 4,159                   | \$ 259                            | \$ -                       | \$ 259                          | \$ 58,430                  |
| Production and intermediate-term | 2,500                           | 14,137                     | -                                | -                          | 3,001                             | 2,352                      | 5,501                           | 16,489                     |
| Processing and marketing         | 2,486                           | -                          | -                                | -                          | -                                 | -                          | 2,486                           | -                          |
| Farm-related business            | 864                             | -                          | -                                | -                          | -                                 | -                          | 864                             | -                          |
| Communication                    | 1,456                           | -                          | -                                | -                          | -                                 | -                          | 1,456                           | -                          |
| <b>Total</b>                     | <b>\$ 7,306</b>                 | <b>\$ 68,408</b>           | <b>\$ -</b>                      | <b>\$ 4,159</b>            | <b>\$ 3,260</b>                   | <b>\$ 2,352</b>            | <b>\$ 10,566</b>                | <b>\$ 74,919</b>           |

A significant source of liquidity for the Association is the repayments and maturities of loans. The following table presents the contractual maturity distribution of loans by loan type at the latest period end:

|                                  | <b>September 30, 2013</b>   |                              |                          |                   |
|----------------------------------|-----------------------------|------------------------------|--------------------------|-------------------|
|                                  | <b>Due less than 1 year</b> | <b>Due 1 Through 5 years</b> | <b>Due after 5 years</b> | <b>Total</b>      |
| Real estate mortgage             | \$ 6,272                    | \$ 57,006                    | \$ 118,288               | \$ 181,566        |
| Production and intermediate-term | 23,254                      | 45,797                       | 7,686                    | 76,737            |
| Loans to cooperatives            | -                           | 13                           | -                        | 13                |
| Processing and marketing         | 619                         | 4,574                        | 3,909                    | 9,102             |
| Farm-related business            | -                           | (3)                          | 81                       | 78                |
| Communication                    | -                           | -                            | 1,400                    | 1,400             |
| Rural residential real estate    | 565                         | 1,117                        | 1,868                    | 3,550             |
| <b>Total Loans</b>               | <b>\$ 30,710</b>            | <b>\$ 108,504</b>            | <b>\$ 133,232</b>        | <b>\$ 272,446</b> |
| <b>Percentage</b>                | <b>11.27%</b>               | <b>39.83%</b>                | <b>48.90%</b>            | <b>100.00%</b>    |

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

|  | <b>September 30, 2013</b> | <b>December 31, 2012</b> |                                       | <b>September 30, 2013</b> | <b>December 31, 2012</b> |
|--|---------------------------|--------------------------|---------------------------------------|---------------------------|--------------------------|
| <b>Real estate mortgage:</b>             |                           |                          | <b>Farm-related business:</b>         |                           |                          |
| Acceptable                               | 84.98%                    | 82.14%                   | Acceptable                            | 100.00%                   | 100.00%                  |
| OAEM                                     | 5.45                      | 8.70                     | OAEM                                  | -                         | -                        |
| Substandard/doubtful/loss                | 9.57                      | 9.16                     | Substandard/doubtful/loss             | -                         | -                        |
|  | <u>100.00%</u>            | <u>100.00%</u>           |                                       | <u>100.00%</u>            | <u>100.00%</u>           |
| <b>Production and intermediate-term:</b> |                           |                          | <b>Communication:</b>                 |                           |                          |
| Acceptable                               | 61.63%                    | 55.72%                   | Acceptable                            | 100.00%                   | 100.00%                  |
| OAEM                                     | 3.48                      | 8.36                     | OAEM                                  | -                         | -                        |
| Substandard/doubtful/loss                | 34.89                     | 35.92                    | Substandard/doubtful/loss             | -                         | -                        |
|  | <u>100.00%</u>            | <u>100.00%</u>           |                                       | <u>100.00%</u>            | <u>100.00%</u>           |
| <b>Loans to cooperatives:</b>            |                           |                          | <b>Rural residential real estate:</b> |                           |                          |
| Acceptable                               | -%                        | -%                       | Acceptable                            | 76.17%                    | 77.26%                   |
| OAEM                                     | -                         | -                        | OAEM                                  | 0.49                      | -                        |
| Substandard/doubtful/loss                | 100.00                    | -                        | Substandard/doubtful/loss             | 23.34                     | 22.74                    |
|  | <u>100.00%</u>            | <u>-%</u>                |                                       | <u>100.00%</u>            | <u>100.00%</u>           |
| <b>Processing and marketing:</b>         |                           |                          | <b>Total Loans:</b>                   |                           |                          |
| Acceptable                               | 100.00%                   | 100.00%                  | Acceptable                            | 78.87%                    | 74.38%                   |
| OAEM                                     | -                         | -                        | OAEM                                  | 4.62                      | 8.32                     |
| Substandard/doubtful/loss                | -                         | -                        | Substandard/doubtful/loss             | 16.51                     | 17.30                    |
|  | <u>100.00%</u>            | <u>100.00%</u>           |                                       | <u>100.00%</u>            | <u>100.00%</u>           |

The following tables provide an age analysis of past due loans and related accrued interest as of:

| September 30, 2013               |                                   |                             |                   |   |             |  |
|----------------------------------|-----------------------------------|-----------------------------|-------------------|---|-------------|--|
|                                  | 30 Through<br>89 Days Past<br>Due | 90 Days or<br>More Past Due | Total Past<br>Due | Not Past Due<br>or Less Than<br>30 Days Past<br>Due | Total Loans | Recorded<br>Investment 90<br>Days or More Past<br>Due and Accruing<br>Interest |
| Real estate mortgage             | \$ 726                            | \$ 1,100                    | \$ 1,826          | \$ 181,096  | \$ 182,922  | \$ -   |
| Production and intermediate-term | 3,191                             | 5,488                       | 8,679             | 68,580  | 77,259      | -  |
| Loans to cooperatives            | 13                                | -                           | 13                | -   | 13          | -  |
| Processing and marketing         | -                                 | (10)                        | (10)              | 9,130   | 9,120       | -  |
| Farm-related business            | -                                 | -                           | -                 | 78  | 78          | -  |
| Communication                    | -                                 | -                           | -                 | 1,400   | 1,400       | -  |
| Rural residential real estate    | 385                               | 553                         | 938               | 2,625   | 3,563       | -  |
| Total                            | \$ 4,315                          | \$ 7,131                    | \$ 11,446         | \$ 262,909  | \$ 274,355  | \$ -   |

| December 31, 2012                |                                   |                             |                   |   |             |  |
|----------------------------------|-----------------------------------|-----------------------------|-------------------|---|-------------|--|
|                                  | 30 Through<br>89 Days Past<br>Due | 90 Days or<br>More Past Due | Total Past<br>Due | Not Past Due<br>or Less Than<br>30 Days Past<br>Due | Total Loans | Recorded<br>Investment 90<br>Days or More Past<br>Due and Accruing<br>Interest |
| Real estate mortgage             | \$ 1,167                          | \$ 3,859                    | \$ 5,026          | \$ 177,691  | \$ 182,717  | \$ -   |
| Production and intermediate-term | 4,555                             | 11,521                      | 16,076            | 67,917  | 83,993      | -  |
| Processing and marketing         | -                                 | (10)                        | (10)              | 3,037   | 3,027       | -  |
| Farm-related business            | -                                 | -                           | -                 | 978   | 978         | -  |
| Communication                    | -                                 | -                           | -                 | 1,457   | 1,457       | -  |
| Rural residential real estate    | 21                                | 105                         | 126               | 3,135   | 3,261       | -  |
| Total                            | \$ 5,743                          | \$ 15,475                   | \$ 21,218         | \$ 254,215  | \$ 275,433  | \$ -   |

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

Nonperforming assets (including related accrued interest) and related credit quality statistics at period end were as follows:

|  | September 30, 2013 | December 31, 2012 |
|--|--------------------|-------------------|
| <b>Nonaccrual loans:</b>   |                    |                   |
| Real estate mortgage   | \$ 2,761           | \$ 4,040          |
| Production and intermediate-term   | 9,069              | 16,426            |
| Processing and marketing   | (10)               | (10)              |
| Farm-related business  | -                  | -                 |
| Rural residential real estate  | 578                | (7)               |
| Total nonaccrual loans   | \$ 12,398          | \$ 20,449         |
| <b>Accruing restructured loans:</b>  |                    |                   |
| Real estate mortgage   | \$ 389             | \$ -              |
| Production and intermediate-term   | 4,438              | 206               |
| Processing and marketing   | -                  | -                 |
| Farm-related business  | -                  | -                 |
| Rural residential real estate  | -                  | 476               |
| Total accruing restructured loans  | \$ 4,827           | \$ 682            |
| <b>Accruing loans 90 days or more past due:</b>                              |                    |                   |
| Real estate mortgage   | \$ -               | \$ -              |
| Production and intermediate-term   | -                  | -                 |
| Processing and marketing   | -                  | -                 |
| Farm-related business  | -                  | -                 |
| Rural residential real estate  | -                  | -                 |
| Total accruing loans 90 days or more past due                                | \$ -               | \$ -              |
| Total nonperforming loans  | \$ 17,225          | \$ 21,131         |
| Other property owned   | 10,898             | 10,105            |
| Total nonperforming assets   | \$ 28,123          | \$ 31,236         |
| Nonaccrual loans as a percentage of total loans                              | 4.55%              | 7.48%             |
| Nonperforming assets as a percentage of total loans and other property owned | 9.93%              | 11.02%            |
| Nonperforming assets as a percentage of capital                              | 35.69%             | 40.14%            |

The following table presents information relating to impaired loans (including accrued interest) at period end. Impaired loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms of the loan.

|                                      | September 30, 2013 | December 31, 2012 |
|--------------------------------------|--------------------|-------------------|
| Impaired nonaccrual loans:           |                    |                   |
| Current as to principal and interest | \$ 2,502           | \$ 4,974          |
| Past due                             | 9,896              | 15,475            |
| Total impaired nonaccrual loans      | <u>12,398</u>      | <u>20,449</u>     |
| Impaired accrual loans:              |                    |                   |
| Restructured                         | 4,827              | 682               |
| 90 days or more past due             | -                  | -                 |
| Total impaired accrual loans         | <u>4,827</u>       | <u>682</u>        |
| Total impaired loans                 | <u>\$ 17,225</u>   | <u>\$ 21,131</u>  |

The following tables present additional impaired loan information at period end.

|  | September 30, 2013     |                                |                      | Quarter Ended<br>September 30, 2013 |  | Nine Months Ended<br>September 30, 2013 |  |
|--|------------------------|--------------------------------|----------------------|-------------------------------------|--|---|--|
|  | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Impaired<br>Loans        | Interest Income<br>Recognized on<br>Impaired Loans | Average<br>Impaired<br>Loans            | Interest Income<br>Recognized on<br>Impaired Loans |
| <b>Impaired loans with a related allowance for credit losses:</b>  |                        |                                |                      |                                     |  |   |  |
| Real estate mortgage   | \$ 1,350               | \$ 1,644                       | \$ 205               | \$ 1,645                            | \$ 3   | \$ 1,680                                | \$ 22  |
| Production and intermediate-term                                   | 4,858                  | 5,609                          | 624                  | 5,915                               | 9  | 6,044                                   | 80   |
| Processing and marketing   | -                      | -                              | -                    | -                                   | -  | -                                       | -  |
| Farm-related business  | -                      | -                              | -                    | -                                   | -  | -                                       | -  |
| Rural residential real estate                                      | 578                    | 915                            | 427                  | 704                                 | 1  | 719                                     | 9  |
| Total  | <u>\$ 6,786</u>        | <u>\$ 8,168</u>                | <u>\$ 1,256</u>      | <u>\$ 8,264</u>                     | <u>\$ 13</u>                                       | <u>\$ 8,443</u>                         | <u>\$ 111</u>                                      |
| <b>Impaired loans with no related allowance for credit losses:</b> |                        |                                |                      |                                     |  |   |  |
| Real estate mortgage   | \$ 1,800               | \$ 2,002                       | -                    | \$ 2,191                            | \$ 3   | \$ 2,239                                | \$ 29  |
| Production and intermediate-term                                   | 8,649                  | 8,957                          | -                    | 10,536                              | 17   | 10,762                                  | 141  |
| Processing and marketing   | (10)                   | 1,228                          | -                    | (12)                                | -  | (12)                                    | -  |
| Farm-related business  | -                      | -                              | -                    | -                                   | -  | -                                       | -  |
| Rural residential real estate                                      | -                      | -                              | -                    | -                                   | -  | -                                       | -  |
| Total  | <u>\$ 10,439</u>       | <u>\$ 12,187</u>               | <u>\$ -</u>          | <u>\$ 12,715</u>                    | <u>\$ 20</u>                                       | <u>\$ 12,989</u>                        | <u>\$ 170</u>                                      |
| <b>Total impaired loans:</b>                                       |                        |                                |                      |                                     |  |   |  |
| Real estate mortgage   | \$ 3,150               | \$ 3,646                       | \$ 205               | \$ 3,836                            | \$ 6   | \$ 3,919                                | \$ 51  |
| Production and intermediate-term                                   | 13,507                 | 14,566                         | 624                  | 16,451                              | 26   | 16,806                                  | 221  |
| Processing and marketing   | (10)                   | 1,228                          | -                    | (12)                                | -  | (12)                                    | -  |
| Farm-related business  | -                      | -                              | -                    | -                                   | -  | -                                       | -  |
| Rural residential real estate                                      | 578                    | 915                            | 427                  | 704                                 | 1  | 719                                     | 9  |
| Total  | <u>\$ 17,225</u>       | <u>\$ 20,355</u>               | <u>\$ 1,256</u>      | <u>\$ 20,979</u>                    | <u>\$ 33</u>                                       | <u>\$ 21,432</u>                        | <u>\$ 281</u>                                      |

|  | December 31, 2012      |                                |                      | Year Ended December 31, 2012 |  |
|--|------------------------|--------------------------------|----------------------|------------------------------|--|
|  | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Impaired<br>Loans | Interest Income<br>Recognized on<br>Impaired Loans |
| <b>Impaired loans with a related allowance for credit losses:</b>  |                        |                                |                      |                              |  |
| Real estate mortgage   | \$ 3,123               | \$ 3,209                       | \$ 424               | \$ 4,108                     | \$ 403   |
| Production and intermediate-term                                   | 3,793                  | 5,997                          | 480                  | 4,990                        | 490  |
| Rural residential real estate                                      | (7)                    | 475                            | 14                   | (9)                          | (1)  |
| Total  | <u>\$ 6,909</u>        | <u>\$ 9,681</u>                | <u>\$ 918</u>        | <u>9,089</u>                 | <u>892</u>   |
| <b>Impaired loans with no related allowance for credit losses:</b> |                        |                                |                      |                              |  |
| Real estate mortgage   | \$ 917                 | \$ 2,607                       | -                    | \$ 1,206                     | \$ 119   |
| Production and intermediate-term                                   | 12,839                 | 13,846                         | -                    | 16,888                       | 1,657  |
| Processing and marketing   | (10)                   | 1,228                          | -                    | (13)                         | (1)  |
| Farm-related business  | -                      | -                              | -                    | -                            | -  |
| Rural residential real estate                                      | 476                    | 479                            | -                    | 626                          | 62   |
| Total  | <u>\$ 14,222</u>       | <u>\$ 18,160</u>               | <u>-</u>             | <u>\$ 18,707</u>             | <u>\$ 1,837</u>                                    |
| <b>Total impaired loans:</b>                                       |                        |                                |                      |                              |  |
| Real estate mortgage   | \$ 4,040               | \$ 5,816                       | \$ 424               | \$ 5,314                     | \$ 522   |
| Production and intermediate-term                                   | 16,632                 | 19,843                         | 480                  | 21,878                       | 2,147  |
| Processing and marketing   | (10)                   | 1,228                          | -                    | (13)                         | (1)  |
| Farm-related business  | -                      | -                              | -                    | -                            | -  |
| Rural residential real estate                                      | 469                    | 954                            | 14                   | 617                          | 61   |
| Total  | <u>\$ 21,131</u>       | <u>\$ 27,841</u>               | <u>\$ 918</u>        | <u>27,796</u>                | <u>2,729</u>                                       |

Unpaid principal balance represents the contractual principal balance of the loan.

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at each reporting period.

A summary of changes in the allowance for loan losses and recorded investment in loans for each reporting period follows:

|  | Real Estate<br>Mortgage | Production and<br>Intermediate-<br>term | Agribusiness* | Communication | Rural<br>Residential<br>Real Estate | Total      |
|--|-------------------------|---|---------------|---------------|-------------------------------------|------------|
| <b>Allowance for credit losses:</b>              |                         |   |               |               |                                     |            |
| Balance at June 30, 2013                         | \$ 2,625                | \$ 1,784                                | \$ 119        | \$ 18         | \$ 463                              | \$ 5,009   |
| Charge-offs                                      | (221)                   | (59)                                    | -             | -             | -                                   | (280)      |
| Recoveries                                       | 111                     | 137                                     | -             | -             | 4                                   | 252        |
| Provision for loan losses                        | 223                     | (235)                                   | 9             | 1             | 2                                   | -          |
| Balance at September 30, 2013                    | \$ 2,738                | \$ 1,627                                | \$ 128        | \$ 19         | \$ 469                              | \$ 4,981   |
| Balance at December 31, 2012                     | \$ 2,853                | \$ 1,564                                | \$ 54         | \$ 20         | \$ 58                               | \$ 4,549   |
| Charge-offs                                      | (442)                   | (486)                                   | (3)           | -             | (28)                                | (959)      |
| Recoveries                                       | 1,141                   | 448                                     | -             | -             | 152                                 | 1,741      |
| Provision for loan losses                        | (814)                   | 101                                     | 77            | (1)           | 287                                 | (350)      |
| Balance at September 30, 2013                    | \$ 2,738                | \$ 1,627                                | \$ 128        | \$ 19         | \$ 469                              | \$ 4,981   |
| Balance at June 30, 2012                         | \$ 2,296                | \$ 3,054                                | \$ 41         | \$ 10         | \$ 43                               | \$ 5,444   |
| Charge-offs                                      | (140)                   | (1,391)                                 | (30)          | -             | (52)                                | (1,613)    |
| Recoveries                                       | 2                       | 20                                      | -             | -             | -                                   | 22         |
| Provision for loan losses                        | 215                     | 85                                      | 37            | 1             | 62                                  | 400        |
| Balance at September 30, 2012                    | \$ 2,373                | \$ 1,768                                | \$ 48         | \$ 11         | \$ 53                               | \$ 4,253   |
| Balance at December 31, 2011                     | \$ 2,072                | \$ 4,426                                | \$ 19         | \$ -          | \$ 61                               | \$ 6,578   |
| Charge-offs                                      | (349)                   | (2,377)                                 | (43)          | -             | (72)                                | (2,841)    |
| Recoveries                                       | 17                      | 99                                      | -             | -             | -                                   | 116        |
| Provision for loan losses                        | 633                     | (380)                                   | 72            | 11            | 64                                  | 400        |
| Balance at September 30, 2012                    | \$ 2,373                | \$ 1,768                                | \$ 48         | \$ 11         | \$ 53                               | \$ 4,253   |
| Loans individually evaluated for impairment      | \$ 205                  | \$ 624                                  | \$ -          | \$ -          | \$ 427                              | \$ 1,256   |
| Loans collectively evaluated for impairment      | 2,533                   | 1,003                                   | 128           | 19            | 42                                  | 3,725      |
| Balance at September 30, 2013                    | \$ 2,738                | \$ 1,627                                | \$ 128        | \$ 19         | \$ 469                              | \$ 4,981   |
| Loans individually evaluated for impairment      | \$ 424                  | \$ 480                                  | \$ -          | \$ -          | \$ 14                               | \$ 918     |
| Loans collectively evaluated for impairment      | 2,429                   | 1,084                                   | 54            | 20            | 44                                  | 3,631      |
| Balance at December 31, 2012                     | \$ 2,853                | \$ 1,564                                | \$ 54         | \$ 20         | \$ 58                               | \$ 4,549   |
| <b>Recorded investment in loans outstanding:</b> |                         |   |               |               |                                     |            |
| Loans individually evaluated for impairment      | \$ 2,761                | \$ 9,069                                | \$ (10)       | \$ -          | \$ 578                              | \$ 12,398  |
| Loans collectively evaluated for impairment      | 180,161                 | 68,190                                  | 9,221         | 1,400         | 2,985                               | 261,957    |
| Ending balance at September 30, 2013             | \$ 182,922              | \$ 77,259                               | \$ 9,211      | \$ 1,400      | \$ 3,563                            | \$ 274,355 |
| Loans individually evaluated for impairment      | \$ 4,040                | \$ 16,426                               | \$ (10)       | \$ -          | \$ (7)                              | \$ 20,449  |
| Loans collectively evaluated for impairment      | 178,676                 | 67,567                                  | 4,015         | 1,457         | 3,269                               | 254,984    |
| Ending balance at December 31, 2012              | \$ 182,716              | \$ 83,993                               | \$ 4,005      | \$ 1,457      | \$ 3,262                            | \$ 275,433 |

\*Includes the loan types; Loans to cooperatives, Processing and marketing, and Farm-related business.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) 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. The following tables present additional information about activity that occurred during the periods presented related to TDRs. There were no TDRs for the three or nine month periods ended September 30, 2013.

| Three months ended September 30, 2012            |                      |                       |                   |       |
|--|----------------------|-----------------------|-------------------|-------|
| Pre-modification Outstanding Recorded Investment |                      |                       |                   |       |
|  | Interest Concessions | Principal Concessions | Other Concessions | Total |
| <b>Troubled debt restructurings:</b>             |                      |                       |                   |       |
| Production and intermediate-term                 | -                    | -                     | -                 | -     |
| Total  | \$ -                 | \$ -                  | \$ -              | \$ -  |

| Three months ended September 30, 2012             |                      |                       |                   |       |                         |             |
|---|----------------------|-----------------------|-------------------|-------|-------------------------|-------------|
| Post-modification Outstanding Recorded Investment |                      |                       |                   |       | Effects of Modification |             |
|   | Interest Concessions | Principal Concessions | Other Concessions | Total | Provisions              | Charge-offs |
| <b>Troubled debt restructurings:</b>              |                      |                       |                   |       |                         |             |
| Production and intermediate-term                  | -                    | -                     | -                 | -     | (8)                     | -           |
| Total   | \$ -                 | \$ -                  | \$ -              | \$ -  | \$ (8)                  | \$ -        |

| Nine months ended September 30, 2012             |                      |                       |                   |        |
|--|----------------------|-----------------------|-------------------|--------|
| Pre-modification Outstanding Recorded Investment |                      |                       |                   |        |
|  | Interest Concessions | Principal Concessions | Other Concessions | Total  |
| <b>Troubled debt restructurings:</b>             |                      |                       |                   |        |
| Production and intermediate-term                 | -                    | 210                   | -                 | 210    |
| Total  | \$ -                 | \$ 210                | \$ -              | \$ 210 |

| Nine months ended September 30, 2012              |                      |                       |                   |        |                         |             |
|---|----------------------|-----------------------|-------------------|--------|-------------------------|-------------|
| Post-modification Outstanding Recorded Investment |                      |                       |                   |        | Effects of Modification |             |
|   | Interest Concessions | Principal Concessions | Other Concessions | Total  | Provisions              | Charge-offs |
| <b>Troubled debt restructurings:</b>              |                      |                       |                   |        |                         |             |
| Production and intermediate-term                  | -                    | 210                   | -                 | 210    | (8)                     | -           |
| Total   | \$ -                 | \$ 210                | \$ -              | \$ 210 | \$ (8)                  | \$ -        |

Interest concessions may include interest forgiveness and interest deferment. Principal concessions may include principal forgiveness, principal deferment, and maturity extension. Other concessions may include additional compensation received which might be in the form of cash or other assets.

There were no TDRs that occurred during the previous twelve months and for which there was a subsequent payment default during the periods presented. Payment default is defined as a payment that was thirty days or more past due.

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

|                                  | Total TDRs         |                   | Nonaccrual TDRs    |                   |
|----------------------------------|--------------------|-------------------|--------------------|-------------------|
|                                  | September 30, 2013 | December 31, 2012 | September 30, 2013 | December 31, 2012 |
| Real estate mortgage             | \$ 565             | \$ 154            | \$ 176             | \$ 154            |
| Production and intermediate-term | 5,071              | 5,489             | 633                | 5,283             |
| Rural residential real estate    | 477                | 476               | 477                | -                 |
| Total Loans                      | \$ 6,113           | \$ 6,119          | \$ 1,286           | \$ 5,437          |
| Additional commitments to lend   | \$ -               | \$ -              |                    |                   |

### NOTE 3 – EMPLOYEE BENEFIT PLANS

The following is a table of retirement and other postretirement benefit expenses for the Association:

|                               | For the three months<br>Ended September 30, |               | For the nine months<br>Ended September 30, |               |
|-------------------------------|---|---------------|--|---------------|
|                               | 2013  | 2012          | 2013                                       | 2012          |
| Pension                       | \$ 167                                      | \$ 169        | \$ 500                                     | \$ 508        |
| 401(k)                        | 36  | 29            | 101  | 106           |
| Other postretirement benefits | 27  | 23            | 82   | 69            |
| Total                         | <u>\$ 230</u>                               | <u>\$ 221</u> | <u>\$ 683</u>                              | <u>\$ 683</u> |

The following is a table of retirement and other postretirement benefit contributions for the Association:

|                               | Actual<br>YTD<br>Through<br>9/30/13 | Projected<br>Contributions<br>For Remainder<br>Of 2013 | Projected<br>Total<br>Contributions<br>2013 |
|-------------------------------|-------------------------------------|--|---|
|                               | Pension                             | \$ -   | \$ 556                                      |
| Other postretirement benefits | 93                                  | 38   | 131   |
| Total                         | <u>\$ 93</u>                        | <u>\$ 594</u>  | <u>\$ 687</u>                               |

Contributions in the above table include allocated estimates of funding for multi-employer plans in which the Association participates. These amounts may change when a total funding amount and allocation is determined by the respective Plan's Sponsor Committee. Also, market conditions could impact discount rates and return on plan assets which could change contributions necessary before the next plan measurement date of December 31, 2013.

Further details regarding employee benefit plans are contained in the 2012 Annual Report to Shareholders.

### NOTE 4 – COMMITMENTS AND CONTINGENT LIABILITIES

From time to time, legal actions are pending against the Association in which claims for money damages are asserted. On at least a quarterly basis, the Association assesses its liabilities and contingencies in connection with outstanding legal proceedings utilizing the latest information available. While the outcome of legal proceedings is inherently uncertain, on the basis of information presently available, management, after consultation with legal counsel, is of the opinion that the ultimate liability, if any, from these actions, would not be material in relation to the financial position of the Association. Because it is not probable that the Association will incur a loss or the loss is not estimable, no liability has been recorded for any claims that may be pending.

### NOTE 5 – NOTES PAYABLE TO AGFIRST FARM CREDIT BANK

The Association's indebtedness to AgFirst Farm Credit Bank (AgFirst or the Bank) represents borrowings by the Association primarily to fund its loan portfolio. This indebtedness is collateralized by a pledge of substantially all of the Association's assets. The contractual terms of the revolving line of credit are contained in the General Financing Agreement (GFA). The GFA also defines Association performance criteria for borrowing from the Bank, which includes borrowing base margin, earnings and capital covenants, among others.

### NOTE 6 – FAIR VALUE MEASUREMENT

Fair value is defined 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.

Accounting guidance establishes a hierarchy for disclosure of fair value measurements to maximize the use of observable inputs, that is, inputs that reflect the assumptions market participants would use in pricing an asset or liability based on market data obtained from sources independent of the reporting entity. The hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the hierarchy tiers is based upon the lowest level of input that is significant to the fair value measurement.

Estimating the fair value of the Association's investment in the Bank and Other Farm Credit Institutions is not practicable because the stock is not traded. The net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying Consolidated Balance Sheets. The Association owns 1.64 percent of the issued stock of the Bank as of September 30, 2013 net of any reciprocal investment. As of that date, the Bank's assets totaled \$28.5 billion and shareholders' equity totaled \$2.4 billion. The Bank's earnings were \$350 million for the first nine months of 2013. In addition, the Association has an investment of \$407 related to other Farm Credit institutions.

The classifications of the Association's financial instruments within the fair value hierarchy are as follows:

#### Level 1

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.

For cash, the carrying value is primarily utilized as a reasonable estimate of fair value.



## Level 2

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability. The Association had no Level 2 assets or liabilities measured at fair value.

## Level 3

Level 3 inputs to the valuation methodology are unobservable and supported by little or no market activity. Valuation is determined using pricing models, discounted cash flow methodologies, or similar techniques, and could include significant management judgment or estimation. Level 3 assets and liabilities also could include instruments whose price has been adjusted based on dealer quoted pricing that is different than the third-party valuation or internal model pricing.

Because no active market exists for the Association's accruing loans, fair value is estimated by discounting the expected future cash flows using the Association's current interest rates at which similar loans currently would be made to borrowers with similar credit risk. The loan portfolio is segregated into pools of loans with homogeneous characteristics based upon repricing and credit risk. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

Fair values of loans in a nonaccrual status are estimated to be the carrying amount of the loan less specific reserves. Certain loans evaluated for impairment under FASB guidance have fair values based upon the underlying collateral, as the loans were collateral-dependent. Specific reserves were established for these loans when the value of the collateral, less estimated cost to sell, was less than the principal balance of the loan. 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.

The notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association's loan receivables. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.

Other property owned is classified as a Level 3 asset. The fair value is generally determined using formal appraisals of each individual property. These assets are held for sale. Costs to sell represent transaction costs and are not included as a component of the fair value of other property owned. Other property owned consists of real and personal property acquired through foreclosure or deed in lieu of foreclosure and is carried as an asset held for sale, which is generally not its highest and best use. These properties are part of the Association's credit risk mitigation efforts, not its ongoing business. In addition, FCA regulations require that these types of property be disposed of within a reasonable period of time.

For commitments to extend credit, the estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics; therefore, the related credit risk is not significant.

## SENSITIVITY TO CHANGES IN SIGNIFICANT UNOBSERVABLE INPUTS

Discounted cash flow or similar modeling techniques are generally used to determine the recurring fair value measurements for Level 3 assets and liabilities. Use of these techniques requires determination of relevant inputs and assumptions, some of which represent significant unobservable inputs as indicated in the tables that follow. Accordingly, changes in these unobservable inputs may have a significant impact on fair value.

Certain of these unobservable inputs will (in isolation) have a directionally consistent impact on the fair value of the instrument for a given change in that input. Alternatively, the fair value of the instrument may move in an opposite direction for a given change in another input. Where multiple inputs are used within the valuation technique of an asset or liability, a change in one input in a certain direction may be offset by an opposite change in another input having a potentially muted impact to the overall fair value of that particular instrument. Additionally, a change in one unobservable input may result in a change to another unobservable input (that is, changes in certain inputs are interrelated with one another), which may counteract or magnify the fair value impact.

## Other Property Owned/Impaired Loans

Other property owned and impaired loans are valued using appraisals, market comparable sales, replacement costs and income and expense (cash flow) techniques. Certain unobservable inputs are used within these techniques to determine the Level 3 fair value of these properties. The significant unobservable inputs are primarily sensitive only to industry, geographic and overall economic conditions, and/or specific attributes of each property.

## Inputs to Valuation Techniques

Management determines the Association's valuation policies and procedures. The Bank performs the majority of the Association's valuations, and its valuation processes are calibrated annually by an independent consultant. The fair value measurements are analyzed on a quarterly basis. For other valuations, documentation is obtained for third party information, such as pricing, and periodically evaluated alongside internal information and pricing that is available. Quoted market prices are generally not available for the instruments presented below.

Accordingly fair values are based on judgments regarding anticipated cash flows, future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Other fair value measurements may use contractual payments and a risk adjusted discount rate, which is generated using the Association's 14-point risk rating scale. An increase in risk rating will generally produce a lower fair value measurement.

### Quantitative Information about Recurring and Nonrecurring Level 3 Fair Value Measurements

|   | Fair Value | Valuation Technique(s) | Unobservable Input   | Range            |
|---|------------|------------------------|--|------------------|
| Impaired loans and other property owned | \$ 28,585  | Appraisal              | Income and expense<br>Comparable sales<br>Replacement costs<br>Comparability adjustments | *<br>*<br>*<br>* |

\* Ranges for this type of input are not useful because each collateral property is unique.

### Information about Other Financial Instrument Fair Value Measurements

|   | Valuation Technique(s) | Input   |
|---|------------------------|---|
| Cash                                      | Carrying Value         | Par/Principal and appropriate interest yield                    |
| Loans                                     | Discounted cash flow   | Prepayment forecasts<br>Probability of default<br>Loss severity |
| Notes payable to AgFirst Farm Credit Bank | Discounted cash flow   | Prepayment forecasts<br>Probability of default<br>Loss severity |

The following tables present the carrying amounts and fair values of assets and liabilities that are measured at fair value on a recurring and nonrecurring basis, as well as those financial instruments not measured at fair value, for each of the hierarchy levels at the period ended:

### At or for the Nine Months Ended September 30, 2013

|   | Total Carrying Amount | Level 1 | Level 2 | Level 3    | Total Fair Value | Fair Value Effects On Earnings |
|---|-----------------------|---------|---------|------------|------------------|--------------------------------|
| <b>Recurring Measurements</b>             |                       |         |         |            |                  |                                |
| <b>Assets:</b>                            |                       |         |         |            |                  |                                |
| Recurring Assets                          | \$ -                  | \$ -    | \$ -    | \$ -       | \$ -             | \$ -                           |
| <b>Liabilities:</b>                       |                       |         |         |            |                  |                                |
| Recurring Liabilities                     | \$ -                  | \$ -    | \$ -    | \$ -       | \$ -             | \$ -                           |
| <b>Non recurring Measurements</b>         |                       |         |         |            |                  |                                |
| <b>Assets:</b>                            |                       |         |         |            |                  |                                |
| Impaired loans                            | \$ 15,969             | \$ -    | \$ -    | \$ 15,969  | \$ 15,969        | \$ 443                         |
| Other property owned                      | 10,898                | -       | -       | 12,616     | 12,616           | (408)                          |
| Nonrecurring Assets                       | \$ 26,867             | \$ -    | \$ -    | \$ 28,585  | \$ 28,585        | \$ 35                          |
| <b>Other Financial Instruments</b>        |                       |         |         |            |                  |                                |
| <b>Assets:</b>                            |                       |         |         |            |                  |                                |
| Loans                                     | 251,496               | -       | -       | 249,737    | 249,737          |                                |
| Other Assets                              | \$ 251,496            | \$ -    | \$ -    | \$ 249,737 | \$ 249,737       |                                |
| <b>Liabilities:</b>                       |                       |         |         |            |                  |                                |
| Notes payable to AgFirst Farm Credit Bank | \$ 207,701            | \$ -    | \$ -    | \$ 205,773 | \$ 205,773       |                                |
| Other Liabilities                         | \$ 207,701            | \$ -    | \$ -    | \$ 205,773 | \$ 205,773       |                                |

**At or for the Year Ended December 31, 2012**

|   | <b>Total<br/>Carrying<br/>Amount</b> | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total Fair<br/>Value</b> | <b>Fair Value<br/>Effects<br/>On Earnings</b> |
|---|--------------------------------------|----------------|----------------|----------------|-----------------------------|---|
| <b>Recurring Measurements</b>             |                                      |                |                |                |                             |   |
| <b>Assets:</b>                            |                                      |                |                |                |                             |   |
| Recurring Assets                          | \$ -                                 | \$ -           | \$ -           | \$ -           | \$ -                        |   |
| <b>Liabilities:</b>                       |                                      |                |                |                |                             |   |
| Recurring Liabilities                     | \$ -                                 | \$ -           | \$ -           | \$ -           | \$ -                        |   |
| <b>Nonrecurring Measurements</b>          |                                      |                |                |                |                             |   |
| <b>Assets:</b>                            |                                      |                |                |                |                             |   |
| Impaired loans                            | \$ 20,213                            | \$ -           | \$ -           | \$ 20,213      | \$ 20,213                   | \$ 1,246                                      |
| Other property owned                      | 10,105                               | -              | -              | 10,874         | 10,874                      | (1,514)                                       |
| Nonrecurring Assets                       | \$ 30,318                            | \$ -           | \$ -           | \$ 31,087      | \$ 31,087                   | \$ (268)                                      |
| <b>Other Financial Instruments</b>        |                                      |                |                |                |                             |   |
| <b>Assets:</b>                            |                                      |                |                |                |                             |   |
| Cash                                      | \$ 40                                | \$ 40          | \$ -           | \$ -           | \$ 40                       |   |
| Loans                                     | 248,959                              | -              | -              | 249,165        | 249,165                     |   |
| Other Assets                              | \$ 248,999                           | \$ 40          | \$ -           | \$ 249,165     | \$ 249,205                  |   |
| <b>Liabilities:</b>                       |                                      |                |                |                |                             |   |
| Notes payable to AgFirst Farm Credit Bank | \$ 210,507                           | \$ -           | \$ -           | \$ 211,350     | \$ 211,350                  |   |
| Other Liabilities                         | \$ 210,507                           | \$ -           | \$ -           | \$ 211,350     | \$ 211,350                  |   |

**NOTE 7 – REGULATORY ENFORCEMENT MATTERS**

On April 20, 2011 the Farm Credit Administration (FCA) entered into a written supervisory agreement with the Board of Directors of the Association. The previous written supervisory agreement between the FCA and the Association, dated April 6, 2010, was terminated by the April 20, 2011 agreement. The written supervisory agreement dated April 20, 2011 requires the Association to take corrective actions and other actions with respect to certain areas of its operations, including board operations, director fiduciary duties, board consultant functions, nominating committee assistance, strategic and business planning, staffing, internal controls, asset quality, loan portfolio management, allowance for loan loss, collateral risk, capital, earnings and liquidity.

See further discussion of the written supervisory agreement in the “Regulatory Matters” section of Management’s Discussion and Analysis of Financial Condition and Results of Operation contained in this Quarterly Report.

**NOTE 8 – SUBSEQUENT EVENTS**

The Association has evaluated subsequent events and has determined that, except as described below, there are none requiring disclosure through November 7, 2013, which is the date the financial statements were issued.

On October 21, 2013, AgFirst’s Board of Directors declared a special patronage distribution to be paid on January 1, 2014. The Association will receive approximately \$2,936 which will be recorded in October 2013 as patronage refunds from other Farm Credit institutions.