

# THIRD QUARTER 2012

## TABLE OF CONTENTS

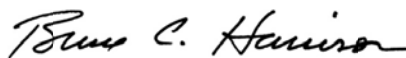
Report on Internal Control Over Financial Reporting.....	2
Management's Discussion and Analysis of Financial Condition and Results of Operations.....	3
Consolidated Financial Statements	
Consolidated Balance Sheets.....	6
Consolidated Statements of Comprehensive Income.....	7
Consolidated Statements of Changes in Members' Equity.....	8
Notes to the Consolidated Financial Statements.....	9

## CERTIFICATION

The undersigned certify that we have reviewed the September 30, 2012 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 8, 2012

# 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.

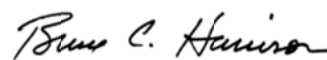
Internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions 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, 2012. 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, 2012, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of September 30, 2012.



Ricky Bitner  
Chief Executive Officer



Bruce C. Harrison  
Chief Financial Officer

November 8, 2012

# 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, 2012. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2011 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, 2012, was \$291,305 a decrease of \$37,563, as compared to \$328,868 at December 31, 2011. Net loans outstanding gross loans net of the allowance for loan losses at September 30, 2012, were \$287,052 as compared to \$322,290 at December 31, 2011. Net loans accounted for 91.17 percent of total assets at September 30, 2012, as compared to 91.78 percent of total assets at December 31, 2011. The reduction in loan volume was due to normal principal payments, several large payoffs and movements of loans to other property owned, offset by modest new loan activity.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality has deteriorated due to poor credit administration under previous management and a downturn in the overall economic environment. Nonaccrual loans were \$22,427, a decrease of \$10,515 from \$32,942 at December 31, 2011. 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, 2012 was \$4,253 as compared to \$6,578 at December 31, 2011, a decrease of \$2,325. This decrease was primarily due to charge-offs against the allowance for loan losses of \$2,840 offset by provisions of \$400 and recoveries of \$116.

The allowance for loan loss of \$4,253 at September 30, 2012 was considered by management to be adequate to cover probable losses. The allowance for loan losses of \$4,253 represents 1.46 percent of the loan balances as of September 30, 2012. The other property owned was \$13,905 as of September 30, 2012 as compared to \$12,349 at December 31, 2011. This net increase of \$1,556 was due to acquisitions of \$8,950, write-downs of \$6,890 and sales of \$504.

Amounts due from AgFirst Farm Credit Bank decreased to \$1,865 as of September 30, 2012 as compared to \$3,253 as of December 31, 2011. These amounts represent patronage due from AgFirst at both September 30, 2012 and December 31, 2011. The decrease of \$1,380 is primarily due to the fact that the amount due at September 30, 2012 was for three quarters and the amount due at December 31, 2011 was for four quarters, along with the fact that the December amount included a receivable of \$806 as a special distribution whereas the September balance included a special distribution of \$180.

## **RESULTS OF OPERATIONS**

### ***For the three months ending September 30, 2012***

Net income for the three months ending September 30, 2012, totaled \$971, as compared to net income of \$228 for the same period in 2011, an increase in income of \$743. Components of the increase in net income are discussed further in the following paragraphs.

For the three months ending September 30, 2012, interest income decreased by \$798 or 18.09 percent compared to the same period ending September 30, 2011. For the three months ending September 30, 2012 interest expense decreased by \$794 or 35.50 percent, compared to the period ending September 30, 2011. These decreases resulted in a decrease in net interest income of \$4, compared to the period ending September 30, 2011.

The provision for loan losses for the three months ending September 30, 2012 was \$400 compared to a reversal of \$95 for the three months ending September 30, 2011.

Noninterest income for the three months ending September 30, 2012 totaled \$733, as compared to a loss of \$420 for the same period of 2011, an increase in income of \$1,153. This increase in noninterest income was primarily due

to decrease in losses on the sale of OPO and expenses related to OPO of \$1,251, a decrease in patronage from the Bank of \$75 and a decrease in fee income of \$41.

Noninterest expense for the three months ending September 30, 2012 totaled \$1,533, as compared to \$1,622 for the same period of 2011, a decrease of \$89. This decrease was primarily due to a decrease in salaries and benefits of \$89, a decrease in insurance fund premiums of \$24 offset by an increase in occupancy and equipment of \$7 and an increase in other expenses of \$17.

#### ***For the nine months ending September 30, 2012***

Net income for the nine months ending September 30, 2012, totaled \$3,550 as compared to net income of \$1,815 for the same period in 2011, an increase in net income of \$1,735.

For the nine months ending September 30, 2012, interest income decreased by \$2,127 or 15.67 percent compared to the same period ending September 30, 2011. For the nine months ending September 30, 2012 interest expense decreased by \$2,385 or 33.15 percent, compared to the period ending September 30, 2011. These decreases resulted in an increase in net interest income of \$258, compared to the period ending September 30, 2011.

The provision for loan losses for the nine months ending September 30, 2012 was \$400 compared to \$52 for the nine months ending September 30, 2011.

Noninterest income for the nine months ending September 30, 2012, totaled \$2,069, as compared to \$91 for the same period of 2011, an increase of \$1,978. This increase was primarily due to a decrease in the equity in earnings of other Farm Credit institutions of \$134 and a decrease in losses on other property owned of \$1,694, an increase in FCSIC refund of \$449 and an increase in loan fees of \$38.

Noninterest expense for the nine months ending September 30, 2012 totaled \$4,750, as compared to \$4,597 for the same period of 2011, an increase of \$153. This increase was primarily due to an increase in salaries and benefits of \$110, an increase in other expenses of \$108, offset by a decrease in insurance fund premiums of \$65.

#### **FUNDING SOURCES**

The principal source of funds for the Association is the borrowing relationship established with AgFirst Farm Credit Bank (the 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. The Bank 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, 2012 was \$236,515 as compared to \$275,586 at December 31, 2011. The reduction in notes payable to the Bank was due to normal principal payments on the direct note, several large payoffs, offset by modest increases in the direct note due to new loan activity. See Note 4 in the Notes to the Consolidated Financial Statements for additional information on the status of compliance with covenants under the General Financing Agreement.

#### **CAPITAL RESOURCES**

Total members' equity at September 30, 2012 increased \$3,310 to \$75,307 from the December 31, 2011 total of \$71,997. Total capital stock and participation certificates were \$888 as of September 30, 2012, a decrease of \$58 compared to \$946 at December 31, 2011.

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, 2012 the Association's total surplus ratio and core surplus ratio were 21.50 percent and 20.65 percent, respectively, and the permanent capital ratio was 21.78 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,

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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 from March 26, 2012 through March 30, 2012 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 2011 Annual Report to Shareholders for recently issued accounting pronouncements.

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**NOTE:** Shareholder investment in the Association could be 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, 2012</b> <i>(unaudited)</i>	<b>December 31, 2011</b> <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 13	\$ 284
Loans	291,305	328,868
Less: allowance for loan losses	4,253	6,578
Net loans	287,052	322,290
Accrued interest receivable	2,204	2,534
Investments in other Farm Credit institutions	7,091	7,221
Premises and equipment, net	1,261	1,256
Other property owned	13,905	12,349
Due from AgFirst Farm Credit Bank	1,865	3,253
Other assets	1,467	1,966
Total assets	\$ 314,858	\$ 351,153
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 236,515	\$ 275,586
Accrued interest payable	458	660
Patronage refunds payable	31	31
Other liabilities	2,547	2,879
Total liabilities	239,551	279,156
Commitments and contingencies		
<b>Members' Equity</b>		
Protected borrower stock	4	5
Capital stock and participation certificates	884	941
Retained earnings		
Allocated	51,649	51,831
Unallocated	22,770	19,220
Total members' equity	75,307	71,997
Total liabilities and members' equity	\$ 314,858	\$ 351,153

*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>	<b>For the three months ended September 30,</b>		<b>For the nine months ended September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
<b>Interest Income</b>				
Loans	\$ 3,614	\$ 4,413	\$ 11,441	\$ 13,568
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	1,443	2,238	4,810	7,195
Net interest income	2,171	2,175	6,631	6,373
Provision for (reversal of allowance for) loan losses	400	(95)	400	52
Net interest income after provision for (reversal of allowance for) loan losses	1,771	2,270	6,231	6,321
<b>Noninterest Income</b>				
Loan fees	21	62	118	156
Patronage refunds from other Farm Credit institutions	567	642	2,093	2,227
Gains (losses) on other property owned, net	127	(1,125)	(613)	(2,307)
Gains (losses) on sales of premises and equipment, net	16	—	20	6
Insurance Fund refunds	—	—	449	—
Other noninterest income	2	1	2	9
Total noninterest income (loss)	733	(420)	2,069	91
<b>Noninterest Expense</b>				
Salaries and employee benefits	1,043	1,132	3,305	3,195
Occupancy and equipment	84	77	232	232
Insurance Fund premiums	36	60	114	179
Other operating expenses	370	353	1,099	991
Total noninterest expense	1,533	1,622	4,750	4,597
Income before income taxes	971	228	3,550	1,815
Provision for income taxes	—	—	—	—
Net income	971	228	3,550	1,815
Other comprehensive income	—	—	—	—
Comprehensive income	\$ 971	\$ 228	\$ 3,550	\$ 1,815

*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)*

	<b>Protected Borrower Stock</b>	<b>Capital Stock and Participation Certificates</b>	<b>Retained Earnings</b>		<b>Total Members' Equity</b>
			<b>Allocated</b>	<b>Unallocated</b>	
Balance at December 31, 2010	\$ 7	\$ 1,014	\$ 51,936	\$ 17,448	\$ 70,405
Comprehensive income				1,815	1,815
Protected borrower stock retired	(2)				(2)
Capital stock/participation certificates issued/(retired), net		(67)			(67)
Retained earnings retired			(49)		(49)
<b>Balance at September 30, 2011</b>	<b>\$ 5</b>	<b>\$ 947</b>	<b>\$ 51,887</b>	<b>\$ 19,263</b>	<b>\$ 72,102</b>
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 certificates issued/(retired), net		(57)			(57)
Retained earnings retired			(182)		(182)
<b>Balance at September 30, 2012</b>	<b>\$ 4</b>	<b>\$ 884</b>	<b>\$ 51,649</b>	<b>\$ 22,770</b>	<b>\$ 75,307</b>

*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**

The accompanying financial statements include the accounts of Farm Credit of Northwest Florida, ACA (the Association). A description of the organization and operations of the Association, the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2011, are contained in the 2011 Annual Report to Shareholders. These unaudited third quarter 2012 consolidated financial statements should be read in conjunction with the 2011 Annual Report to Shareholders.

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. The results for the nine months ended September 30, 2012, are not necessarily indicative of the results to be expected for the year ending December 31, 2012.

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

The Association maintains an allowance for loan losses in accordance with GAAP. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of September 30, 2012, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

### **Recently Issued Accounting Pronouncements**

In June 2011, the Financial Accounting Standards Board (FASB) issued ASU 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income." This amendment is intended to increase the prominence of other comprehensive income in financial statements. The current option that permits the presentation of other comprehensive income in the statement of changes in equity was eliminated. The main provisions of the guidance provides that an entity that reports items of other comprehensive income has the option to present comprehensive income in either one or two consecutive financial statements: (1) A single statement must present the components of net income and total net

income, the components of other comprehensive income and total other comprehensive income, and a total for comprehensive income; (2) In a two-statement approach, an entity must present the components of net income and total net income in the first statement. That statement must be immediately followed by a financial statement that presents the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income. With either approach, an entity is required to present reclassification adjustments for items reclassified from other comprehensive income to net income in the statement(s). This guidance is to be applied retrospectively. For public entities, it is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this guidance did not impact the Association's financial condition or results of operations, but resulted in changes to the presentation of comprehensive income. In December 2011, the FASB issued guidance (ASU 2011-12; Topic 220) to defer the new requirement to present components of accumulated other comprehensive income reclassified as components of net income on the face of the financial statements. All other requirements in the guidance for comprehensive income were required to be adopted as set forth in the June 2011 guidance. The deferral is effective at the same time the new standard on comprehensive income is adopted.

In May 2011, the FASB issued ASU 2011-04, "Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs." The amendments change the wording used to describe the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The amendments include the following: (1) Application of the highest and best use and valuation premise is only relevant when measuring the fair value of nonfinancial assets (does not apply to financial assets and liabilities); (2) Aligns the fair value measurement of instruments classified within an entity's shareholders' equity with the guidance for liabilities. As a result, an entity should measure the fair value of its own equity instruments from the perspective of a market participant that holds the instruments as assets; (3) Clarifies that a reporting entity should disclose quantitative information about the unobservable inputs used in a fair value measurement that is categorized within Level 3 of the fair value hierarchy; (4) An exception to the requirement for measuring fair value when a reporting entity manages its financial instruments on the basis of its net exposure, rather than its gross exposure, to those risks; (5) Clarifies that the application of premiums and discounts in a fair value

measurement is related to the unit of account for the asset or liability being measured at fair value. Premiums or discounts related to size as a characteristic of the entity's holding (that is, a blockage factor) instead of as a characteristic of the asset or liability (for example, a control premium), are not permitted. A fair value measurement that is not a Level 1 measurement may include premiums or discounts other than blockage factors when market participants would incorporate the premium or discount into the measurement at the level of the unit of account specified in other guidance; (6) Expansion of the disclosures about fair value measurements. The most significant change will require entities, for their recurring Level 3 fair value measurements, to disclose quantitative information about unobservable inputs used, a description of the valuation processes used by the entity, and a qualitative discussion about the sensitivity of the measurements. New disclosures are required about the use of a nonfinancial asset measured or disclosed at fair value if its use differs from its highest and best use. In addition, entities must report the level in the fair value hierarchy of assets and liabilities not recorded at fair value but where fair value is disclosed. The amendments are to be applied prospectively. The amendments are effective during interim and annual periods beginning after December 15, 2011. Early application is not permitted. The adoption of this guidance did not impact the Association's financial condition or results of operations, but resulted in significant additional disclosures.

In April 2011, the FASB issued ASU 2011-02, "Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring," which provides for clarification on whether a restructuring constitutes

a troubled debt restructuring (TDR). In evaluating whether a restructuring is a TDR, a creditor must separately conclude that both of the following exists: (1) the restructuring constitutes a concession, and (2) the debtor is experiencing financial difficulties. The guidance is effective for nonpublic entities, for annual periods ending on or after December 15, 2012, including interim periods within those annual periods. The guidance should be applied retrospectively to the beginning of the annual period of adoption. The new disclosures about TDR activity required by the guidance on "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses," as discussed below, are effective for annual reporting periods ending after December 15, 2011.

In January 2011, the FASB issued ASU 2011-01, "Receivables (Topic 310): Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings." This amendment temporarily delayed the effective date of the disclosures about TDRs required by the guidance previously issued on "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses." The effective date of the new disclosures about TDRs coincides with the guidance for determining what constitutes a TDR as described above. The adoption of this guidance had no material impact on the Association's financial condition and results of operations but resulted in significant additional disclosures.

Other recently issued accounting pronouncements are discussed in the 2011 Annual Report to Shareholders.

## NOTE 2 – LOANS AND ALLOWANCE FOR LOAN LOSSES

A summary of loans outstanding at period end were as follows:

	<b>September 30, 2012</b>	<b>December 31, 2011</b>
Real estate mortgage	\$ 182,118	\$ 196,777
Production and intermediate-term	100,132	125,166
Agribusiness		
Processing and marketing	3,377	2,005
Farm-related business	1,038	132
Total agribusiness	4,415	2,137
Communication	975	-
Rural residential real estate	3,665	4,788
Total Loans	<u>\$ 291,305</u>	<u>\$ 328,868</u>

The Association may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume, and comply with Farm Credit Administration regulations. Participation loan balances at period end were as follows:

**September 30, 2012**

	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	\$ -	\$ 59,343	\$ -	\$ 4,141	\$ 261	\$ -	\$ 261
Production and intermediate-term Agribusiness	-	11,595	-	-	3,000	2,370	3,000	13,965
Processing and marketing Farm-Related Business	2,801	29	-	-	-	-	2,801	29
Total agribusiness	923	-	-	-	-	-	923	-
Communication	3,724	29	-	-	-	-	3,724	29
Total	975	-	-	-	-	-	975	-
<b>Total</b>	<b>\$ 4,699</b>	<b>\$ 70,967</b>	<b>\$ -</b>	<b>\$ 4,141</b>	<b>\$ 3,261</b>	<b>\$ 2,370</b>	<b>\$ 7,960</b>	<b>\$ 77,478</b>

**December 31, 2011**

	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	\$ -	\$ 49,817	\$ -	\$ 4,497	\$ 267	\$ -	\$ 267
Production and intermediate-term Agribusiness	-	20,593	-	-	3,433	2,428	3,433	23,021
Processing and marketing	1,388	-	-	-	-	-	1,388	-
<b>Total</b>	<b>\$ 1,388</b>	<b>\$ 70,410</b>	<b>\$ -</b>	<b>\$ 4,497</b>	<b>\$ 3,700</b>	<b>\$ 2,428</b>	<b>\$ 5,088</b>	<b>\$ 77,335</b>

Significant sources of liquidity for the Association are the repayments and maturities of loans. The following table presents the contractual maturity distribution of loans by loan type at September 30, 2012 and indicates that approximately 19.27 percent of loans had maturities of less than one year:

	Due less than 1 year	Due 1 Through 5 years	Due after 5 years	Total
Real estate mortgage	\$ 10,799	\$ 79,070	\$ 92,249	\$ 182,118
Production and intermediate-term Agribusiness	40,774	54,641	4,717	100,132
Processing and marketing Farm-related business	2,791	586	-	3,377
Total agribusiness	1	923	114	1,038
Communication	2,792	1,509	114	4,415
Rural residential real estate	975	-	-	975
<b>Total Loans</b>	<b>\$ 56,140</b>	<b>\$ 136,345</b>	<b>\$ 98,820</b>	<b>\$ 291,305</b>

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

	September 30, 2012	December 31, 2011		September 30, 2012	December 31, 2011
<b>Real estate mortgage:</b>			<b>Total agribusiness:</b>		
Acceptable	81.77%	82.89%	Acceptable	99.89%	100.00%
OAEM	8.09	8.05	OAEM	-	-
Substandard/doubtful/loss	10.14	9.06	Substandard/doubtful/loss	0.11	-
	100.00%	100.00%		100.00%	100.00%
<b>Production and intermediate-term:</b>			<b>Communication:</b>		
Acceptable	64.02%	54.38%	Acceptable	100.00%	-%
OAEM	6.87	18.33	OAEM	-	-
Substandard/doubtful/loss	29.11	27.29	Substandard/doubtful/loss	-	-
	100.00%	100.00%		100.00%	-%
<b>Agribusiness:</b>			<b>Rural residential real estate:</b>		
<b>Processing and marketing:</b>			Acceptable	69.69%	74.20%
Acceptable	99.88%	100.00%	OAEM	-	2.73
OAEM	-	-	Substandard/doubtful/loss	30.31	23.07
Substandard/doubtful/loss	0.12	-		100.00%	100.00%
	100.00%	100.00%			
<b>Farm-related business:</b>			<b>Total Loans:</b>		
Acceptable	99.90%	99.24%	Acceptable	75.85%	72.04%
OAEM	-	-	OAEM	7.43	11.83
Substandard/doubtful/loss	0.10	0.76	Substandard/doubtful/loss	16.72	16.13
	100.00%	100.00%		100.00%	100.00%

The following tables provide an aging analysis of past due loans and related accrued interest.

	September 30, 2012					
	30 Through 89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans	Recorded Investment 90 Days or More Past Due and Accruing Interest
Real estate mortgage	\$ 1,734	\$ 4,974	\$ 6,708	\$ 176,955	\$ 183,663	\$ -
Production and intermediate-term	3,734	8,488	12,222	88,552	100,774	-
Agribusiness						
Processing and marketing	-	4	4	3,377	3,381	-
Farm-related business	-	1	1	1,041	1,042	-
Total agribusiness	-	5	5	4,418	4,423	-
Communication	-	-	-	975	975	-
Rural residential real estate	57	298	355	3,319	3,674	170
Total	\$ 5,525	\$ 13,765	\$ 19,290	\$ 274,219	\$ 293,509	\$ 170
	December 31, 2011					
	30 Through 89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans	Recorded Investment 90 Days or More Past Due and Accruing Interest
Real estate mortgage	\$ 7,068	\$ 6,025	\$ 13,093	\$ 185,475	\$ 198,568	\$ -
Production and intermediate-term	3,248	21,986	25,234	100,660	125,894	-
Agribusiness						
Processing and marketing	-	(10)	(10)	2,019	2,009	-
Farm-related business	-	1	1	130	131	-
Total agribusiness	-	(9)	(9)	2,149	2,140	-
Rural residential real estate	201	285	486	4,314	4,800	-
Total	\$ 10,517	\$ 28,287	\$ 38,804	\$ 292,598	\$ 331,402	\$ -

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

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

	September 30, 2012	December 31, 2011
<b>Nonaccrual loans:</b>		
Real estate mortgage	\$ 5,256	\$ 6,075
Production and intermediate-term	17,037	26,556
Agribusiness		
Processing and marketing	4	(10)
Farm-related business	1	1
Total agribusiness	5	(9)
Rural residential real estate	128	320
Total nonaccrual loans	<u>\$ 22,426</u>	<u>\$ 32,942</u>
<b>Accruing restructured loans:</b>		
Real estate mortgage	\$ -	\$ -
Production and intermediate-term	208	-
Agribusiness		
Processing and marketing	-	-
Farm-related business	-	-
Total agribusiness	-	-
Rural residential real estate	478	490
Total accruing restructured loans	<u>\$ 686</u>	<u>\$ 490</u>
<b>Accruing loans 90 days or more past due:</b>		
Real estate mortgage	\$ -	\$ -
Production and intermediate-term	-	-
Agribusiness		
Processing and marketing	-	-
Farm-related business	-	-
Total agribusiness	-	-
Rural residential real estate	170	-
Total accruing loans 90 days or more past due	<u>\$ 170</u>	<u>\$ -</u>
Total nonperforming loans	<u>\$ 23,282</u>	<u>\$ 33,432</u>
Other property owned	13,905	12,349
Total nonperforming assets	<u>\$ 37,187</u>	<u>\$ 45,781</u>
Nonaccrual loans as a percentage of total loans	7.70%	10.02%
Nonperforming assets as a percentage of total loans and other property owned	12.18%	13.42%
Nonperforming assets as a percentage of capital	<u>49.38%</u>	<u>63.59%</u>

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, 2012	December 31, 2011
<b>Impaired nonaccrual loans:</b>		
Current as to principal and interest	\$ 8,598	\$ 4,597
Past due	13,828	28,345
Total impaired nonaccrual loans	<u>22,426</u>	<u>32,942</u>
<b>Impaired accrual loans:</b>		
Restructured	686	490
90 days or more past due	170	-
Total impaired accrual loans	<u>856</u>	<u>490</u>
Total impaired loans	<u>\$ 23,282</u>	<u>\$ 33,432</u>

The following tables present additional information concerning impaired loans and related allowance by loan type at period end.

	September 30, 2012			Quarter Ended September 30, 2012		Nine Months Ended September 30, 2012	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans	Average Impaired Loans	Interest Income Recognized on Impaired Loans
<b>Impaired loans with a related allowance for credit losses:</b>							
Real estate mortgage	\$ 2,315	\$ 2,418	\$ 388	\$ 2,500	\$ 7	\$ 2,959	\$ 33
Production and intermediate-term Agribusiness	6,050	8,517	731	6,535	18	7,734	87
Processing and marketing Farm-related business	-	-	-	-	-	-	-
Total agribusiness	-	-	-	-	-	-	-
Rural residential real estate	102	369	14	110	-	130	1
Total	\$ 8,467	\$ 11,304	\$ 1,133	\$ 9,145	\$ 25	\$ 10,823	\$ 121
<b>Impaired loans with no related allowance for credit losses:</b>							
Real estate mortgage	\$ 2,941	\$ 5,253	\$ -	\$ 3,177	\$ 8	\$ 3,760	\$ 42
Production and intermediate-term Agribusiness	11,195	12,228	-	12,092	34	14,310	159
Processing and marketing Farm-related business	4	1,228	-	4	-	5	-
Total agribusiness	1	1,535	-	1	-	1	-
Rural residential real estate	5	2,763	-	5	-	6	-
Total	674	897	-	728	2	862	10
Total	\$ 14,815	\$ 21,141	\$ -	\$ 16,002	\$ 44	\$ 18,938	\$ 211
<b>Total impaired loans:</b>							
Real estate mortgage	\$ 5,256	\$ 7,671	\$ 388	\$ 5,677	\$ 15	\$ 6,719	\$ 75
Production and intermediate-term Agribusiness	17,245	20,745	731	18,627	52	22,044	246
Processing and marketing Farm-related business	4	1,228	-	4	-	5	-
Total agribusiness	1	1,535	-	1	-	1	-
Rural residential real estate	5	2,763	-	5	-	6	-
Total	776	1,266	14	838	2	992	11
Total	\$ 23,282	\$ 32,445	\$ 1,133	\$ 25,147	\$ 69	\$ 29,761	\$ 332

	December 31, 2011			Year Ended December 31, 2011	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans
<b>Impaired loans with a related allowance for credit losses:</b>					
Real estate mortgage	\$ 2,737	\$ 2,800	\$ 317	\$ 4,171	\$ 40
Production and intermediate-term Agribusiness	17,703	19,977	3,456	26,978	259
Rural residential real estate	285	536	20	434	4
Total	\$ 20,725	\$ 23,313	\$ 3,793	\$ 31,583	\$ 303
<b>Impaired loans with no related allowance for credit losses:</b>					
Real estate mortgage	\$ 3,338	\$ 5,621	\$ -	\$ 5,086	\$ 49
Production and intermediate-term Agribusiness	8,853	9,238	-	13,490	129
Processing and marketing Farm-related business	(10)	1,228	-	(15)	-
Total agribusiness	1	1,536	-	1	-
Rural residential real estate	(9)	2,764	-	(14)	-
Total	525	740	-	800	8
Total	\$ 12,707	\$ 18,363	\$ -	\$ 19,362	\$ 186
<b>Total impaired loans:</b>					
Real estate mortgage	\$ 6,075	\$ 8,421	\$ 317	\$ 9,257	\$ 89
Production and intermediate-term Agribusiness	26,556	29,215	3,456	40,468	388
Processing and marketing Farm-related business	(10)	1,228	-	(15)	-
Total agribusiness	1	1,536	-	1	-
Rural residential real estate	(9)	2,764	-	(14)	-
Total	810	1,276	20	1,234	12
Total	\$ 33,432	\$ 41,676	\$ 3,793	\$ 50,945	\$ 489

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 at period end were as follows:

	Real Estate Mortgage	Production and Intermediate- term	Agribusiness	Communication	Rural Residential Real Estate	Total
<b>Allowance for credit losses:</b>						
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
Balance at June 30, 2011	\$ 3,006	\$ 5,653	\$ 7	\$ -	\$ 393	\$ 9,059
Charge-offs	(396)	(20)	(21)	-	(49)	(486)
Recoveries	1	-	-	-	44	45
Provision for loan losses	(47)	269	21	-	(338)	(95)
Other	(311)	311	-	-	-	-
Balance at September 30, 2011	\$ 2,253	\$ 6,213	\$ 7	\$ -	\$ 50	\$ 8,523
Balance at December 31, 2010	\$ 5,488	\$ 4,026	\$ 10	\$ -	\$ 574	\$ 10,098
Charge-offs	(1,257)	(632)	(74)	-	(269)	(2,232)
Recoveries	561	-	-	-	44	605
Provision for loan losses	(2,228)	2,508	71	-	(299)	52
Other	(311)	311	-	-	-	-
Balance at September 30, 2011	\$ 2,253	\$ 6,213	\$ 7	\$ -	\$ 50	\$ 8,523
Loans individually evaluated for impairment	\$ 388	\$ 731	\$ -	\$ -	\$ 14	\$ 1,133
Loans collectively evaluated for impairment	1,985	1,037	48	11	39	3,120
Balance at September 30, 2012	\$ 2,373	\$ 1,768	\$ 48	\$ 11	\$ 53	\$ 4,253
Loans individually evaluated for impairment	\$ 317	\$ 3,456	\$ -	\$ -	\$ 20	\$ 3,793
Loans collectively evaluated for impairment	1,755	970	19	-	41	2,785
Balance at December 31, 2011	\$ 2,072	\$ 4,426	\$ 19	\$ -	\$ 61	\$ 6,578
<b>Recorded investment in loans outstanding:</b>						
Loans individually evaluated for impairment	\$ 5,256	\$ 17,038	\$ 5	\$ -	\$ 128	\$ 22,427
Loans collectively evaluated for impairment	178,407	83,736	4,418	975	3,546	271,082
Ending balance at September 30, 2012	\$ 183,663	\$ 100,774	\$ 4,423	\$ 975	\$ 3,674	\$ 293,509
Loans individually evaluated for impairment	\$ 6,075	\$ 26,556	\$ (9)	\$ -	\$ 320	\$ 32,942
Loans collectively evaluated for impairment	192,493	99,338	2,149	-	4,480	298,460
Ending balance at December 31, 2011	\$ 198,568	\$ 125,894	\$ 2,140	\$ -	\$ 4,800	\$ 331,402

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. The tables do not include purchased credit impaired loans.

	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)	\$ -

**Three months ended September 30, 2011**

	Pre-modification Outstanding Recorded Investment			
	Interest Concessions	Principal Concessions	Other Concessions	Total
<b>Troubled debt restructurings:</b>				
Rural residential real estate	-	495	-	495
Total	\$ -	\$ 495	\$ -	\$ 495

**Three months ended September 30, 2011**

	Post-modification Outstanding Recorded Investment				Effects of Modification	
	Interest Concessions	Principal Concessions	Other Concessions	Total	Provisions	Charge-offs
<b>Troubled debt restructurings:</b>						
Rural residential real estate	-	495	-	495	(340)	-
Total	\$ -	\$ 495	\$ -	\$ 495	\$ (340)	\$ -

**Nine months ended September 30, 2011**

	Pre-modification Outstanding Recorded Investment			
	Interest Concessions	Principal Concessions	Other Concessions	Total
<b>Troubled debt restructurings:</b>				
Rural residential real estate	-	495	-	495
Total	\$ -	\$ 495	\$ -	\$ 495

**Nine months ended September 30, 2011**

	Post-modification Outstanding Recorded Investment				Effects of Modification	
	Interest Concessions	Principal Concessions	Other Concessions	Total	Provisions	Charge-offs
<b>Troubled debt restructurings:</b>						
Rural residential real estate	-	495	-	495	(340)	-
Total	\$ -	\$ 495	\$ -	\$ 495	\$ (340)	\$ -

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 2012. Payment default is defined as a payment that was thirty days or more past due.

TDRs outstanding at period end totaled \$6,317, of which \$5,631 were in nonaccrual status.



### NOTE 3 – EMPLOYEE BENEFIT PLANS

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

	For the nine months ended September 30,	
	2012	2011
Pension	\$ 508	\$ 486
401(k)	106	81
Other postretirement benefits	69	91
Total	<u>\$ 683</u>	<u>\$ 658</u>

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

	Actual YTD Through 9/30/12	Projected Contributions For Remainder of 2012	Projected Total Contributions 2012
Pension	\$ -	\$ 534	\$ 534
Other postretirement benefits	107	35	142
Total	<u>\$ 107</u>	<u>\$ 569</u>	<u>\$ 676</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, 2012.

Further details regarding employee benefit plans are contained in the 2011 Annual Report to Shareholders.

### NOTE 4 – NOTES PAYABLE TO AGFIRST FARM CREDIT BANK

The Association's indebtedness to 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 and the terms of the revolving line of credit are governed by the General Financing Agreement (GFA). The GFA defines Association performance criteria for borrowing from the Bank, which includes borrowing base margin, earnings, and capital covenants. The Association failed to meet its earnings covenant under the GFA at December 31, 2011. The default allows the Bank, in conjunction with the FCA, to accelerate repayment of all indebtedness. The Bank approved a waiver of the default and allowed the Association to continue to operate under a special credit agreement (SCA). At June 30, 2012, the Association was in compliance with the earnings covenant under the GFA and therefore the SCA was terminated effective June 30, 2012. The Association was in compliance with the GFA covenants at September 30, 2012.

### NOTE 5 – 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 fair value 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 valuation 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 valuation hierarchy 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 1.96 percent of the issued stock of the Bank as of September 30, 2012 net of any reciprocal investment. As of that date, the Bank's assets totaled \$28.8 billion and shareholders' equity totaled 2.5 billion. The Bank's earnings were \$358 million for the first nine months of 2012. In addition, the Association has an investment of \$428 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. The Association has no Level 1 assets or liabilities measured at fair value on a recurring basis at September 30, 2012. 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 has no Level 2 assets or liabilities measured at fair value on a recurring basis at September 30, 2012.

The carrying value of accrued interest approximates its 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. Level 3 assets at September 30, 2012 include impaired loans which represent the fair value of certain loans that were evaluated for impairment under FASB guidance. The fair value was based upon the underlying collateral since these were collateral-dependent. When the value of the collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established. The fair value 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.

### INFORMATION ABOUT 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 certain System financial instruments, as described 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	\$ 37,145	Appraisal	Income and expense Comparable sales Replacement costs Comparability adjustments	* * * *

\* 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 rates Probability of default Loss severity Annualized volatility
Accrued interest	Carrying value	Coupon interest rates
Notes payable to AgFirst Farm Credit Bank	Discounted cash flow	Prepayment rates Probability of default Loss severity Annualized volatility

The following table presents 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:

	September 30, 2012						Total Fair Value	Fair Value Effects On Earnings
	Total Carrying Amount	Level 1	Level 2	Level 3				
<b>Recurring Measurements</b>								
<b>Assets:</b>								
Recurring Assets	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	
<b>Liabilities:</b>								
Recurring Liabilities	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	
<b>Nonrecurring Measurements</b>								
<b>Assets:</b>								
Impaired loans	\$ 22,149	\$ -	\$ -	\$ 22,149	\$ 22,149	\$ 22,149	\$	(65)
Other property owned	13,905	-	-	14,996	14,996	14,996		(432)
Nonrecurring Assets	\$ 36,054	\$ -	\$ -	\$ 37,145	\$ 37,145	\$ 37,145	\$	(497)
<b>Other Financial Instruments</b>								
<b>Assets:</b>								
Cash	\$ 13	\$ 13	\$ -	\$ -	\$ -	\$ 13		
Loans	264,903	-	-	265,686	265,686	265,686		
Accrued interest receivable	2,204	-	2,204	-	2,204	2,204		
Other Assets	\$ 267,120	\$ 13	\$ 2,204	\$ 265,686	\$ 267,903	\$ 267,903		
<b>Liabilities:</b>								
Notes payable to AgFirst Farm Credit Bank	\$ 236,515	\$ -	\$ -	\$ 238,364	\$ 238,364	\$ 238,364		
Accrued interest payable	458	-	458	-	458	458		
Other Liabilities	\$ 236,973	\$ -	\$ 458	\$ 238,364	\$ 238,822	\$ 238,822		

Assets and liabilities measured at fair value on a nonrecurring basis at December 31, 2011 for each of the fair value hierarchy values are summarized below.

	December 31, 2011				YTD Total Gains (Losses)
	Level 1	Level 2	Level 3	Total Fair Value	
<b>Assets:</b>					
Impaired Loans	\$ -	\$ -	\$ 16,801	\$ 16,801	\$ (1,605)
Other property owned	\$ -	\$ -	\$ 13,220	\$ 13,220	\$ (3,740)

The estimated fair values of the Association's financial instruments at December 31, 2011 are as follows:

	December 31, 2011	
	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>		
Cash	\$ 284	\$ 284
Loans, net of allowance	\$ 322,290	\$ 324,119
Accrued interest receivable	\$ 2,534	\$ 2,534
<b>Financial liabilities:</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 276,246	\$ 279,103

#### NOTE 6 – 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 7 – SUBSEQUENT EVENTS

The Association has evaluated subsequent events and has determined there are none requiring disclosure through November 8, 2012, which is the date the financial statements were issued.