



2011 SECOND QUARTER REPORT
FARM CREDIT BANK OF TEXAS
JUNE 30, 2011



SECOND QUARTER 2011

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

(dollars in thousands, except as noted)

The following discussion reviews the financial condition and results of operations of the Farm Credit Bank of Texas (bank) for the three and six months ended June 30, 2011. These comments should be read in conjunction with the accompanying financial statements and footnotes, along with the 2010 Annual Report to shareholders. The accompanying financial statements were prepared under the oversight of the bank's audit committee.

The bank is a member of the Farm Credit System (System), a nationwide network of cooperatively owned financial institutions established by and subject to the provisions of the Farm Credit Act of 1971, as amended, and the regulations of the Farm Credit Administration (FCA) promulgated thereunder.

The United States is currently served by four Farm Credit Banks (FCBs), each of which has specific regional lending authority within a chartered territory (or district), and by one Agricultural Credit Bank (ACB), which has the lending authority of an FCB within its chartered territory and limited nationwide lending authority. The FCBs and the ACB are collectively referred to as "System banks." The primary purpose of the FCBs is to serve as a source of funding for System associations within their districts. The System associations make loans to or for the benefit of eligible borrowers for qualified purposes.

The bank and its affiliated associations collectively are referred to as the district. At June 30, 2011, the bank provided financing to 17 district associations and certain other financing institutions.

RESULTS OF OPERATIONS

Net Income

Net income for the quarter ended June 30, 2011, was \$49,462, an increase of \$3,665, or 8.0 percent, over the same period of 2010. The \$3,665 increase in net income for the second quarter of 2011 consisted of an \$8,327 increase in net interest income and a \$6,025 decrease in provision for credit losses, offset by an \$8,118 decrease in noninterest income and a \$2,569 increase in noninterest expense.

Net income for the six months ended June 30, 2011, was \$91,267, an increase of \$10,237, or 12.6 percent, over the same period of 2010. The increase in net income for the six months ended June 30, 2011, consisted of an \$18,595 increase in net interest income and a \$1,283 decrease in provision for credit losses, offset by an \$8,575 decrease in noninterest income and a \$1,066 increase in noninterest expense.

Net Interest Income

Net interest income for the three months ended June 30, 2011, was \$56,862, an increase of \$8,327, or 17.2 percent, from the three months ended June 30, 2010. The increase in net interest income for the quarter ended June 30, 2011, was attributable to a 25-basis-point increase in the bank's interest rate spread, offset by a volume decrease of \$90.9 million in the bank's average earning assets. Interest rate spreads increased primarily as a result of a 68-basis-point reduction in the effective rate on debt from the second quarter of 2010 to the second quarter of 2011, which was achieved largely due to the bank's ability to call higher-cost debt and replace it with lower-cost debt during that period.

Net interest income for the six months ended June 30, 2011, was \$116,838, an increase of \$18,595, or 18.9 percent, over the same period of 2010. The increase in net interest income was attributable to a 28-basis-point increase in the bank's interest rate spread, and a volume increase of \$83.8 million in the bank's average earning assets. The interest rate spread increased primarily as a result of a 77-basis-point

reduction in the effective rate on debt from the six months ended June 30, 2010, to the six months ended June 30, 2011, which was achieved largely due to the bank's ability to call higher-cost debt and replace it with lower-cost debt during that period. The bank's ability to benefit from calling debt due to the current low interest rate environment is not expected to continue into the future. The increase in the bank's average earning assets was due to increases in the bank's investment and participation loan portfolios. Direct notes receivable from district associations decreased due to scheduled repayments, enhanced credit standards and reduction in growth, as general economic conditions resulted in a decline of demand for rural real estate.

Provision for Credit Losses

The bank's negative provision for credit losses for the quarter ended June 30, 2011, totaled \$520, a decrease of \$6,025 over the \$5,505 provision for the second quarter of 2010.

Provision for credit losses for the six months ended June 30, 2011, totaled \$9,932, a decrease of \$1,283, or 11.4 percent, over the \$11,215 provision for the first six months of 2010. The provision for credit losses for the six months ended June 30, 2011, consisted primarily of specific provisions related to the land in transition and ethanol sectors. There is no provision for credit losses recorded for the bank's direct notes receivable from associations and other financing institutions.

Noninterest Income

Noninterest income for the quarter ended June 30, 2011, was \$7,561, a decrease of \$8,118, or 51.8 percent, over the same period of 2010. The decrease for the second quarter of 2011 over the same period of 2010 was due mainly to a \$7,982 refund distribution in April 2010 from the Farm Credit System Insurance Corporation (FCSIC or Insurance Fund) and a \$1,318 decrease in services billed to district associations, offset by a \$635 increase in loan-related fees, a \$273 increase in patronage income and a \$282 decrease in credit losses recognized on other-than-temporarily impaired investments. The 2010 distributions by the FCSIC included reserves it held in excess of its secure base amount in 2003 which had been previously allocated to its Allocated Insurance Reserves Accounts, and also included reserves in excess of its secure base amount in 2009 which were likewise allocated. The 2008 Farm Bill amended the Farm Credit Act and simplified the formula for payments from the Allocated Insurance Reserves Accounts to allow more immediate distributions of excess Insurance Fund balances to System banks. The 2010 FCSIC refund is included in Miscellaneous income, net, in this report's Combined Statements of Income. The decrease in services billed to associations reflects the bank's decision, effective April 2011, to bill associations for direct pass-through expenses only and no longer bill for allocated expenses. As discussed in the "Investments" section of this Management's Discussion and Analysis, the bank performs other-than-temporary impairment assessments on investment securities based on evaluations of both current and future market and credit conditions at each quarter end. The \$282 decrease in credit losses reflects the difference between the \$474 in credit losses on two investments in the second quarter of 2010 and the \$192 in credit losses recognized in the quarter ended June 30, 2011.

Noninterest income for the six months ended June 30, 2011, was \$14,854, a decrease of \$8,575, or 36.6 percent, over the same period of 2010. The decrease was due mainly to a \$7,982 refund in FCSIC distributions of excess reserves from prior periods recorded in April 2010, discussed above, a \$1,484 decrease in services billed to associations, and a \$271 increase in credit losses recognized on other-than-temporarily impaired investments, offset by a \$1,042 increase in loan-related fee income and a \$176 increase in patronage income. The decrease in services billed to associations reflects the bank's decision effective April 2011 to bill associations for direct pass-through expenses only and no longer bill for allocated expenses. The \$271 increase in credit losses recognized on other-than-temporarily impaired investments reflects the difference between the credit losses of \$1,816 and \$2,087 recognized during the

six months ended June 30, 2010 and 2011, respectively. In both periods, credit losses were recognized on six investments.

Noninterest Expense

Noninterest expense for the three months ended June 30, 2011, was \$15,481, an increase of \$2,569, or 19.9 percent, over the same period of 2010. The increase was attributable to a \$1,414 increase in salaries and employee benefits, a \$606 increase in premiums assessed by the Insurance Fund, a \$587 increase in occupancy and equipment expenses, and a \$150 increase in other operating expenses, offset by a \$188 decrease in losses on other property owned (OPO). The increase in salaries and benefits included an \$838 increase in pension and retirement expenses, a \$538 increase in compensation and related payroll taxes, and a \$38 increase in other benefits. The increase in pension and retirement included a \$580 increase related to amortization of settlement charges on the bank's supplemental pension plan, which was discontinued effective January 16, 2011, and a \$261 increase in contributions to the district's defined benefit pension plan. The increase in premiums assessed by the Insurance Fund was due to a retroactive rate adjustment in June 2010, effecting a rate reduction from 10 basis points to 5 basis points, and to a rate increase to 6 basis points for 2011. The increase in occupancy and equipment expense included a \$377 increase in cost of space, due mainly to a lease amendment which extended the term and expanded the space of the bank's headquarters, and a \$203 increase in computer expenses, which includes depreciation on new lending systems computer software which was placed in service in July 2010. The increase in other operating expenses included a \$141 increase in travel expense, a \$106 increase in professional and contract services, and a \$115 increase in all other operating expenses, collectively, offset by a \$212 decrease in assessments from the Federal Farm Credit Banks Funding Corporation (Funding Corporation). The decrease in losses on OPO included a \$165 decrease in provisions for losses on OPO and a \$24 increase in gains on disposals.

Noninterest expense for the six months ended June 30, 2011, was \$30,493, an increase of \$1,066, or 3.6 percent, over the same period of 2010. The increase was attributable to a \$1,047 increase in occupancy and equipment expenses, a \$246 increase in premiums assessed by the Insurance Fund, a \$205 increase in losses on OPO, and a \$5 increase in salaries and employee benefits, offset by a \$437 decrease in other operating expenses. The increase in occupancy and equipment expenses included a \$637 increase in cost of space, due mainly to a lease amendment which extended the term and expanded the space of the bank's headquarters, and a \$385 increase in computer expenses, which includes depreciation on new lending systems computer software which was placed in service in July 2010. Premiums to the Insurance Fund increased due to a rate increase from 5 basis points in 2010 to 6 basis points in 2011. The increase in losses on OPO included a \$149 decrease in net gains on disposals of OPO and a \$45 increase in provisions for losses on OPO. The decrease in other operating expenses included a \$490 decrease in assessments from the Federal Farm Credit Banks Funding Corporation (Funding Corporation) and a \$166 decrease in advertising and member relations, offset by a \$228 increase in travel expenses and a \$9 net increase in all other operating expenses, collectively. The increase in salaries and benefits included a \$1,403 increase in pension and retirement expenses, a \$1,099 increase in regular salaries and related payroll taxes due to annual raises and increased personnel, and a \$77 increase in other benefits, offset by the effects of Success Sharing bonuses, approved by the board of directors and recorded in January 2010 for the prior year which totaled \$2,574. The Success Sharing bonuses for 2010 were approved by the board of directors and accrued in December 2010. The increase in pension and retirement expense included a \$1,160 increase related to amortization of settlement charges on the bank's supplemental pension plan, which was discontinued effective January 16, 2011, and a \$521 increase in contributions to the district defined benefit pension plan.

Key results of operations comparisons:

	Annualized for the Six Months Ended 6/30/2011	Annualized for the Six Months Ended 6/30/2010
Return on average assets	1.31%	1.17%
Return on average shareholders' equity	15.41%	18.92%
Net interest income as a percentage of average earning assets	1.74%	1.47%
Charge-offs, net of recoveries, to average loans	0.13%	0.13%
Operating expenses as a percentage of net interest income and noninterest income	22.93%	24.11%
Operating expenses as a percentage of average earning assets	0.45%	0.44%

FINANCIAL CONDITION

Loan Portfolio

Gross loan volume at June 30, 2011, was \$10,339,089, a decrease of \$124,945, or 1.2 percent, compared to \$10,464,034 at December 31, 2010. The decrease in the loan portfolio is mainly attributable to a decrease in the bank's direct loans to associations and other financing institutions, offset by growth in the bank's participation loan portfolio. Direct notes to associations have decreased as enhanced credit standards and repayments on existing loans have reduced the size of their loan portfolios.

In June 2011, the bank purchased \$13,191 in loan participations from a district association in a Capitalized Participation Pool (CPP) transaction. The purchase represented 80.0 percent of the outstanding balances of the loans placed by the association in the CPP. As a condition of the transaction, the bank redeemed stock in the amount of 2.0 percent of the par value of the loans purchased, and the association bought bank stock equal to 8.0 percent of the purchased loans' par value.

Loans classified under the Farm Credit Administration's Uniform Loan Classification System as "acceptable" or "other assets especially mentioned" were 94.8 percent of total loans and accrued interest at June 30, 2011, compared to 92.8 percent at December 31, 2010.

The table below summarizes the balances of the bank's high-risk assets at June 30, 2011, compared to the balances at December 31, 2010:

	June 30, 2011	Increase (Decrease)		December 31, 2010
		\$	%	
Nonaccrual loans	\$ 160,567	\$ 40,368	33.58 %	\$ 120,199
Formally restructured loans	2,638	2,284	645.20	354
Loans 90 days past due and still accruing interest	8	8	-	-
Total impaired loans	163,213	42,660	35.39	120,553
Other property owned, net	2,522	(316)	(11.13)	2,838
Total high-risk assets	\$ 165,735	\$ 42,344	34.32 %	\$ 123,391

The increase in nonaccrual loans is primarily due to the addition of loans in the land in transition, timber and ethanol sectors. The increase in formally restructured loans was due primarily to a loan in the ethanol sector that had previously been in nonaccrual status; the loan has had improved performance while operating under the restructuring agreement. During the six months ended June 30, 2011, the bank recorded charge-offs totaling \$7.2 million against the allowance for loan losses due to known losses on loans in the ethanol and land in transition sectors. At June 30, 2011, \$56.3 million, or 35.1 percent, of the bank's nonaccrual loans were considered current as to principal and interest. Continued satisfactory payment performance on these loans may indicate potential for a return to accrual status. At June 30, 2011, the bank had \$15.9 million in nonaccrual loans on which cash payments are recognized as interest income, compared to \$6.6 million at December 31, 2010. The decrease in other property owned included a \$26 net decrease in properties held and a \$290 increase in the allowance for losses on other property owned. The decrease in properties held resulted from the sale of two properties totaling \$848 and the addition of one property totaling \$822.

Impaired loans, consisting of nonaccrual loans and formally restructured loans, and loans 90 days past due and still accruing interest, constituted 1.6 percent of gross loans at June 30, 2011, and 1.2 percent of gross loans at December 31, 2010. The bank had other property owned totaling \$2,522 at June 30, 2011, which included two properties purchased from a district association in March 2010, and the collateral on

three loans purchased from a district association which subsequently were foreclosed, net of a \$210 allowance for losses on one of the other properties owned.

At June 30, 2011, the bank had reserves for credit losses totaling \$32.2 million, including an allowance for loan losses of \$31.4 million and a reserve for losses on unfunded commitments of \$776. The allowance for loan losses of \$31,381 equated to 0.30 percent of total loans outstanding and 1.0 percent of participation loans outstanding. The allowance for loan losses at June 30, 2011, was attributable to participation loans and loans purchased from a district association. The \$776 reserve for losses on unfunded commitments was a general reserve for losses on letters of credit, representing management's estimate of probable credit losses related to letters of credit and unfunded commitments.

The allowance for loan losses as a percentage of impaired loans was 19.23 percent as of June 30, 2011, as compared to 23.8 percent as of December 31, 2010. The nature of the collateral (primarily first lien real estate) supporting many of the impaired loans is considered in the determination of necessary allowances for loan losses.

Liquidity and Funding Sources

Cash and investment securities totaled \$3,451,085, or 24.8 percent, of total assets at June 30, 2011, compared to \$3,534,250, or 25.1 percent, at December 31, 2010, a decrease of \$83,165, or 2.4 percent. At June 30, 2011, the bank's cash balance was \$321,925, a \$114,941 decrease from December 31, 2010. Cash held at the Federal Reserve Bank at June 30, 2011, totaled \$309,784, compared to \$412,056 at December 31, 2010. Levels of cash and other highly liquid assets are managed to meet loan demand, debt servicing and other liquidity needs. At June 30, 2011, the bank had 228 days of liquidity to cover cash flows required for maturing debt obligations. Interest-bearing liabilities, consisting of bonds, notes and subordinated debt, decreased by \$252,519, or 2.0 percent.

Investments

The bank's investments are all considered available for sale, and include a liquidity portfolio and a portfolio of other investments. The liquidity portfolio had a fair value of \$2.98 billion at June 30, 2011, and consisted primarily of federal agency collateralized mortgage-backed securities, FDIC-guaranteed corporate debt, other collateralized mortgage-backed securities and asset-backed securities. The bank's other investments, totaling \$131.0 million, consisted of Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed agricultural mortgage-backed securities (AMBS) purchased in June 2010 from two district associations. The Farmer Mac securities are backed by loans originated by the associations and previously held by the associations under the Farmer Mac long-term standby commitments to purchase agreements.

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

The bank's liquidity portfolio consisted of FDIC-guaranteed corporate debt, corporate debt, mortgage-backed and asset-backed securities as follows (in thousands):

	<u>June 30, 2011</u>		<u>December 31, 2010</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
FDIC-guaranteed corporate debt	\$ 299,667	\$ 300,420	\$ 300,531	\$ 302,091
Corporate debt	31,879	31,955	-	-
Federal agency collateralized mortgage-backed securities:				
GNMA	1,693,509	1,719,906	1,650,736	1,672,578
FNMA and FHLMC	843,835	855,500	873,286	886,851
Other collateralized mortgage-backed securities	58,042	53,130	71,192	64,918
Asset-backed securities	17,982	16,818	11,493	10,005
Total available-for-sale investments	<u>\$ 2,944,914</u>	<u>\$ 2,977,729</u>	<u>\$ 2,907,238</u>	<u>\$ 2,936,443</u>

The bank's other investments portfolio consisted of Farmer Mac AMBS securities as follows:

	<u>June 30, 2011</u>		<u>December 31, 2010</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
Agricultural mortgage-backed securities	\$ 134,241	\$ 131,021	\$ 145,122	\$ 140,503

Federal agency collateralized mortgage-backed securities comprised 86.5 percent of the bank's liquidity portfolio at June 30, 2011. Pricing on agency securities remains strong due to stabilization in the agency market, and increased demand for quality agency structures. The decreases in other collateralized mortgage-backed securities are due primarily to repayments on those securities from December 31, 2010 to June 30, 2011.

At June 30, 2011, the bank had five mortgage-backed securities and two asset-backed securities that were considered other-than-temporarily impaired (OTTI). Credit losses on OTTI investments totaled \$192 and \$2,087 for the quarter and six months ended June 30, 2011, respectively. During the quarter ended March 31, 2011, the bank recognized OTTI credit losses totaling \$1,895 on five mortgage-backed investments and one asset-backed security. The additional credit losses for the quarter and six months ended June 30, 2011, were driven by the continued deterioration in the housing market outlook. The non-credit-related net increase in fair value on the bank's other-than-temporarily impaired investments for the six months ended June 30, 2011, totaling \$977, is included as a credit to other comprehensive income. The bank performs other-than-temporary impairment assessments on investment securities based on evaluations of both current and future market and credit conditions at each quarter end. The process for evaluation of impairment of investments is more fully discussed in Note 2, "Investments."

Farm Credit Administration regulations define eligible investments by specifying credit rating criteria, final maturity limit, percentage of investment portfolio limit and certain other requirements for each investment type. At the time the investments are purchased, they must be highly rated by at least one Nationally Recognized Statistical Rating Organization (NRSRO), such as Moody's Investors Service, Standard & Poor's or Fitch Ratings. U.S. Treasury securities, U.S. agency securities (except mortgage securities) and other obligations fully insured or guaranteed by the U.S., its agencies, instrumentalities and corporations are considered eligible investments under the Farm Credit Administration's regulations, even if downgraded. Under the regulations, these investments have no final maturity limit, no credit rating requirement by NRSROs, investment portfolio limit, or other requirements. If an investment no

longer meets the credit rating criteria, the investment becomes ineligible. A bank must dispose of an investment that becomes ineligible within six months, unless the Farm Credit Administration approves, in writing, a plan that authorizes the bank to divest the instrument over a longer period of time. The Farm Credit Administration has approved, with conditions, plans submitted by the bank to continue to hold all ineligible investments at this time. To date, the Farm Credit Administration has not required disposition of any of these securities.

At June 30, 2011, the bank held 10 investments that were ineligible for liquidity purposes by FCA regulations, due to credit ratings that were below AAA by all NRSROs. Those ineligible securities had an amortized cost basis of \$46,612 and a fair value of \$41,731 at June 30, 2011.

The following table sets forth the bank's portfolio of liquidity investments at fair value by credit rating:

	Eligible			Ineligible					Total
	AAA/Aaa	AA/Aa	Split Rated	AA/Aa	BBB/Baa	BB/Ba	B3/CCC/ CC	CCC/Caa	
June 30, 2011									
FDIC-guaranteed corporate debt	\$ 300,420	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 300,420
Corporate debt	-	31,955	-	-	-	-	-	-	31,955
Federal agency collateralized mortgage-backed securities	2,575,406	-	-	-	-	-	-	-	2,575,406
Other collateralized mortgage-backed securities	903	-	12,422	10,573	-	5,055	4,496	19,681	53,130
Asset-backed securities	11,798	-	3,094	-	-	-	-	1,926	16,818
Total	\$ 2,888,527	\$ 31,955	\$ 15,516	\$ 10,573	\$ -	\$ 5,055	\$ 4,496	\$ 21,607	\$ 2,977,729
December 31, 2010									
FDIC-guaranteed corporate debt	\$ 302,091	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 302,091
Federal agency collateralized mortgage-backed securities	2,559,429	-	-	-	-	-	-	-	2,559,429
Other collateralized mortgage-backed securities	5,918	-	10,896	11,745	-	6,953	6,293	23,113	64,918
Asset-backed securities	3,294	-	4,305	-	418	1,668	-	320	10,005
Total	\$ 2,870,732	\$ -	\$ 15,201	\$ 11,745	\$ 418	\$ 8,621	\$ 6,293	\$ 23,433	\$ 2,936,443

Capital Resources

At June 30, 2011, the bank had \$482.0 million in preferred stock outstanding, consisting of \$182.0 million in Class A cumulative perpetual preferred stock and \$300.0 million of Class B non-cumulative subordinated perpetual preferred stock. The Class B preferred stock was issued in August 2010. The Class B preferred stock is not mandatorily redeemable at any time, but may be redeemed in whole or in part at the option of the bank after the dividend payment date in June 2020. The Class B preferred stock ranks junior, both as to dividends and upon liquidation, to the bank's Class A preferred stock, and senior to all of the bank's outstanding capital stock. For regulatory purposes, the Class B preferred stock is included in permanent capital, total surplus and core surplus within certain limitations. Due to regulatory limitations on third-party capital, the preferred stock issuance will require that subordinated debt no longer receive favorable treatment in the bank's net collateral ratio or other regulatory capital ratios.

As of June 30, 2011, the bank exceeded the minimum permanent capital, core surplus, total surplus and net collateral ratio requirements under Farm Credit Administration regulations. At June 30, 2011, the bank's permanent capital ratio was 20.67 percent, core surplus was 10.03 percent, total surplus was 16.76 percent and the net collateral ratio was 108.58 percent. Total shareholders' equity at June 30, 2011, totaled \$1,221,755, an increase of \$70,897 from December 31, 2010. This increase is the result of net income of \$91,267 for the six months ended June 30, 2011, a \$5,008 increase in unrealized gains on

investment securities, a \$792 net increase in net issuances of capital stock and \$952 in amortization related to retirement benefits, offset by dividends on preferred stock totaling \$21,881, patronage paid of \$2,762, primarily on the associations' and OFIs' stock investment in the bank, and a \$2,479 unrealized loss on cash flow hedge instruments. On June 15, 2011, accrued preferred stock dividends payable totaling \$21,881 were paid, and on June 30, 2011, preferred stock dividends payable on December 15, 2011 were accrued. The change in unrealized gains on investment securities was due primarily to changes in the market value of fixed-rate mortgage-backed securities, whose values have changed as interest rates have fluctuated during the period, and to changes in the market value of mortgage-backed and asset-backed securities.

Key financial condition comparisons:

	June 30, 2011	December 31, 2010
Permanent capital ratio	20.67%	22.00%
Net collateral ratio	108.58%	107.91%
Allowance and reserve for credit losses to total loans	0.30%	0.27%

OTHER

EFFECTS OF DROUGHT CONDITIONS IN THE TEXAS DISTRICT

Drought conditions in Texas and New Mexico have had an impact on agriculture, primarily in New Mexico and the Panhandle region of Texas. Dry land farm conditions have been and are very poor in this region, and irrigated farms will experience significant increases in pumping costs and other input costs. Fortunately for the Texas District entities, there is not significant exposure to wheat, which was severely impacted in the plains in West Texas and New Mexico. Also, in New Mexico and West Texas, the drought was evident early enough for farmers to limit planting, and exposure has also been mitigated by crop insurance. While credit quality is not expected to change substantially, production loan volume is expected to be below normal for the year for these affected areas.

In South Texas, while crop conditions have not been as severe as in the Panhandle region, dry land farming conditions have been and are poor, and yields on dry land cotton are expected to be half the normal crop yield. Irrigated crop conditions are near average, although pumping and other input costs are expected to increase significantly. Crop insurance has also mitigated much of the risk in South Texas, as the majority of district associations' borrowers utilize crop insurance.

In the eastern states of the district, heat and drought conditions, particularly in the southernmost regions, have stressed crop conditions as well as cattle operations.

While cattle prices have declined from the record prices experienced in the first quarter of 2011, prices are still slightly higher than they were at year-end 2010. Since 2010, high feed costs and good cattle prices have resulted in a reduction of herd sizes. Drought in the region and wildfires in West Texas have intensified this trend, as the loss of thousands of acres of grazing land has caused the movement of more cattle to feedlots. Adequate water for cattle in the region has become a much greater concern. The movement of cattle to feedlots may cause a decline in some of the above-normal profit margin cattle producers experienced in the first quarter of 2011.

GOVERNMENTAL AND RATING AGENCY ACTIONS

The recent U.S. congressional negotiations regarding the government's debt limit and long-term budget imbalances have further highlighted the risks to the Farm Credit System (System) relating to the U.S. government's fiscal conditions. These risks include the implied link between the credit rating of the System and that of the U.S. government, given the System's status as a government-sponsored enterprise (GSE).

Moody's Investor Service Rating Actions

On August 2, 2011, Moody's Investor Service (Moody's) confirmed the bank's issuer rating of Aa2. This confirmation was made in conjunction with its confirmation of the Aaa government bond rating of the United States following the raising of the debt limit on August 2, 2011. Previously, Moody's had affirmed the bank's subordinated debt rating of A1 and its preferred stock ratings of A2 for cumulative preferred stock and A3 for noncumulative preferred stock, citing the bank's strong credit performance, very high support from the System, and very high support from the U.S. government.

In addition, on August 2, 2011, Moody's confirmed the Aaa ratings of financial institutions directly linked to the U.S. government, including the System, and confirmed the Aaa ratings of securities directly linked to the U.S. government or the affected financial institutions. This rating applies to Systemwide debt issued by the Federal Farm Credit Banks Funding Corporation, which is marketed and sold through a network of investment dealers and dealer banks. While Moody's did confirm the U.S. government bond rating, they placed a negative outlook on the rating, indicating a risk of downgrade in the event of weakening of fiscal discipline, failure to adopt additional measures, deterioration of economic conditions or appreciable rises in the U.S. government's funding costs. If the U.S. government bond rating were to be downgraded, Moody's has indicated that its long-term credit rating for the System may also be downgraded, due to its GSE status. Moody's has affirmed their short-term credit rating for the System.

Fitch Ratings Actions

Fitch Ratings last week affirmed the System's high investment-grade long-term issuer default rating (IDR) of "AAA" and a short-term IDR of "F1+." The rating outlook is stable. The affirmation reflects the System's consistent operating performance, good asset quality metrics, conservative liquidity and capital management, as well as resilient funding sources.

However, with the System being a GSE, the FCS ratings are susceptible to a negative rating action given its linkage to the U.S. sovereign rating. Fitch will be concluding its review of the U.S. sovereign rating by the end of August 2011, but at the present time, Fitch anticipates that FCS ratings will remain equalized with that of the resultant action on the U.S. sovereign rating.

Standard & Poor's Rating Actions

On August 5, 2011, Standard & Poor's (S&P) lowered its long-term sovereign credit rating on the United States of America to "AA+" from "AAA," while affirming its "A-1+" short-term rating and removing both ratings from its CreditWatch status. The rating agency cited less stable political governance and policymaking evidenced in prolonged controversy over raising the statutory debt ceiling, as well as a resulting agreement that fell short of a comprehensive fiscal program. Furthermore, S&P indicated that the outlook on the long-term rating is negative.

In related actions, on August 8, 2011, S&P also lowered the long-term issuer credit ratings and related issue ratings of 10 of the 12 Federal Home Loan Banks (FHLBs), the senior debt issued by the FHLB System, senior issue ratings on Fannie Mae and Freddie Mac, and senior debt issued by the System from “AAA” to “AA+.” The outlooks for the 12 FHLBs, and the issue level ratings for Fannie Mae, Freddie Mac, the FHLB System and the System are negative, due to their GSE status. The downgrade of the senior debt issued by the System was due to the System having a likelihood of receiving support from the government, if ever needed. S&P does not issue ratings on the Farm Credit Bank of Texas.

While the full implications of these rating agency actions are not known, reductions in the System’s credit rating may increase the System’s borrowing costs and may limit its access to capital markets, reducing its flexibility to issue debt across the full spectrum of the yield curve.

REGULATORY MATTERS

During the quarter ended March 31, 2011, the Farm Credit Administration (FCA) brought an enforcement action against one association in the district and a written enforcement agreement against another district association was replaced with a new agreement. As of June 30, 2011, FCA had enforcement actions in place against four associations in the district, which have not had, and are not expected to have, a significant impact on the bank.

The undersigned certify that we have reviewed the June 30, 2011, quarterly report of the Farm Credit Bank of Texas, that the report has been prepared in accordance with all applicable statutory or regulatory requirements, and that the information included herein is true, accurate and complete to the best of our knowledge and belief.



Larry R. Doyle
Chief Executive Officer



Ralph W. Cortese
Chairman of the Board



Amie Pala
Chief Financial Officer

August 10, 2011

Controls and Procedures

The Farm Credit Bank of Texas (bank) maintains a system of disclosure controls and procedures. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information disclosed by us in our quarterly and annual reports is accumulated and communicated to our management, including our principal executive officer and our principal financial officer, as appropriate, to allow timely decisions to be made regarding disclosure. With management's input, the chief executive officer and the chief financial officer have evaluated our disclosure controls and procedures as of the end of and for the period covered by this quarterly report, and have concluded that our disclosure controls and procedures are effective as of that date.

The bank also maintains a system of internal controls. The "internal controls" as defined by the American Institute of Certified Public Accountants' Codification of Statement on Auditing Standards, AU Section 319, means a process — effected by the board of directors, management and other personnel — designed to provide reasonable assurance regarding the achievement of objectives in the reliability of our financial reporting, the effectiveness and efficiency of operations, and of compliance with applicable laws and regulations. We continually assess the adequacy of our internal control over financial reporting and enhance our controls in response to internal control assessments, and internal and external audit and regulatory recommendations. There have been no significant changes in our internal controls or in other factors that could significantly affect such controls subsequent to the date we carried out our evaluations.



Larry R. Doyle
Chief Executive Officer



Amie Pala
Chief Financial Officer

August 10, 2011

Balance Sheets

(dollars in thousands)	June 30, 2011 (Unaudited)	December 31, 2010
Assets		
Cash	\$ 321,925	\$ 436,866
Federal funds sold and overnight investments	20,410	20,438
Investment securities	3,108,750	3,076,946
Loans	10,339,089	10,464,034
Less allowance for loan losses	31,381	28,678
Net loans	<u>10,307,708</u>	10,435,356
Accrued interest receivable	40,669	45,298
Other property owned, net	2,522	2,838
Premises and equipment, net	15,473	15,833
Other assets	<u>77,844</u>	74,628
Total assets	<u>\$ 13,895,301</u>	<u>\$ 14,108,203</u>
Liabilities and shareholders' equity		
Liabilities		
Bonds and notes, net	\$ 12,527,413	\$ 12,779,932
Subordinated debt	50,000	50,000
Accrued interest payable	41,052	43,869
Reserve for credit losses	776	314
Preferred stock dividends payable	21,881	21,881
Other liabilities	<u>32,424</u>	61,349
Total liabilities	<u>12,673,546</u>	<u>12,957,345</u>
Commitments and contingent liabilities (Note 4)		
Shareholders' equity		
Preferred stock, net	482,000	482,000
Capital stock	229,191	228,399
Allocated retained earnings	11,144	11,144
Unallocated retained earnings	474,445	407,821
Accumulated other comprehensive income	<u>24,975</u>	21,494
Total shareholders' equity	<u>1,221,755</u>	<u>1,150,858</u>
Total liabilities and shareholders' equity	<u>\$ 13,895,301</u>	<u>\$ 14,108,203</u>

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

Statements of Income

(unaudited)

(dollars in thousands)	Quarter Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Interest Income				
Investment securities	\$ 14,619	\$ 16,756	\$ 30,074	\$ 33,434
Loans	93,077	105,942	186,736	214,644
Total interest income	107,696	122,698	216,810	248,078
Interest Expense				
Bonds, notes and subordinated debt	50,834	74,163	99,972	149,835
Total interest expense	50,834	74,163	99,972	149,835
Net interest income	56,862	48,535	116,838	98,243
(Negative provision) provision for credit losses	(520)	5,505	9,932	11,215
Net interest income after provision for loan losses	57,382	43,030	106,906	87,028
Noninterest Income				
Patronage income	4,098	3,825	8,734	8,558
Fees for services to associations	816	2,134	2,796	4,280
Loan-related fees	2,773	2,138	5,210	4,168
Miscellaneous income, net	66	8,056	201	8,239
Impairment losses on investments				
Total other-than-temporary impairment losses	(645)	(491)	(1,110)	(768)
Less: portion of (loss) gain recognized in other comprehensive income	(453)	(17)	977	1,048
Net impairment loss recognized in earnings	(192)	(474)	(2,087)	(1,816)
Total noninterest income	7,561	15,679	14,854	23,429
Noninterest Expense				
Salaries and employee benefits	7,619	6,205	15,747	15,742
Occupancy and equipment	1,987	1,400	4,049	3,002
Insurance Fund premiums	650	44	1,256	1,010
Losses on other property owned, net	70	258	296	91
Other operating expenses	5,155	5,005	9,145	9,582
Total noninterest expense	15,481	12,912	30,493	29,427
Net Income	\$ 49,462	\$ 45,797	\$ 91,267	\$ 81,030

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

Statements of Changes in Shareholders' Equity

(unaudited)

(dollars in thousands)	Preferred Stock	Capital Stock	Allocated Retained Earnings	Unallocated Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at December 31, 2009	\$ 200,000	\$ 237,361	\$ 8,029	\$ 365,031	\$ 10,871	\$ 821,292
Comprehensive income						
Net income	-	-	-	81,030	-	81,030
Change in pension and postretirement benefit plans	-	-	-	-	144	144
Net change in unrealized net gains on investment securities	-	-	-	-	14,495	14,495
Noncredit portion of current other-than-temporary impairment losses	-	-	-	-	1,048	1,048
Net change in unrealized net losses on cash flow derivatives	-	-	-	-	(2,463)	(2,463)
Total comprehensive income	-	-	-	81,030	13,224	94,254
Capital stock retired	-	(637)	-	-	-	(637)
Preferred stock dividends paid	-	-	-	(7,561)	-	(7,561)
Patronage distributions						
Cash	-	-	-	(2,633)	-	(2,633)
Shareholders' equity	-	-	2	(2)	-	-
Balance at June 30, 2010	\$ 200,000	\$ 236,724	\$ 8,031	\$ 435,865	\$ 24,095	\$ 904,715
Balance at December 31, 2010	\$ 482,000	\$ 228,399	\$ 11,144	\$ 407,821	\$ 21,494	\$ 1,150,858
Comprehensive income						
Net income	-	-	-	91,267	-	91,267
Change in pension and postretirement benefit plans	-	-	-	-	952	952
Net change in unrealized net gains on investment securities	-	-	-	-	4,031	4,031
Noncredit portion of current other-than-temporary impairment losses	-	-	-	-	977	977
Net change in unrealized net losses on cash flow derivatives	-	-	-	-	(2,479)	(2,479)
Total comprehensive income	-	-	-	91,267	3,481	94,748
Capital stock issued	-	1,056	-	-	-	1,056
Capital stock retired	-	(264)	-	-	-	(264)
Preferred stock dividends accrued	-	-	-	(21,881)	-	(21,881)
Patronage distributions						
Cash	-	-	-	(2,762)	-	(2,762)
Balance at June 30, 2011	\$ 482,000	\$ 229,191	\$ 11,144	\$ 474,445	\$ 24,975	\$ 1,221,755

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

Statements of Cash Flows

(unaudited)

(dollars in thousands)	Six Months Ended June 30,	
	2011	2010
Operating activities		
Net income	\$ 91,267	\$ 81,030
Reconciliation of net income to net cash provided by operating activities		
Provision for credit losses	9,932	11,215
Provision for losses on other property owned	290	245
Depreciation and amortization on premises and equipment	1,231	752
Accretion of net discount on loans	(2,962)	(130)
Amortization and accretion on debt instruments	(2,268)	(2,585)
Amortization of net premium (discount) on investment securities	4,211	(10,122)
Gains from sales of other property owned, net	(19)	(167)
Losses on impairment of investments available for sale	2,087	1,816
Allocated equity patronage from System bank	(12,240)	(12,476)
Decrease (increase) in accrued interest receivable	4,816	(583)
Decrease in other assets	5,917	8,343
Decrease in accrued interest payable	(3,004)	(11,218)
Decrease in other liabilities	(5,761)	(10,992)
Net cash provided by operating activities	<u>93,497</u>	<u>55,128</u>
Investing activities		
Net decrease (increase) in federal funds	28	(67)
Investment securities		
Purchases	(406,350)	(1,371,116)
Proceeds from maturities, calls and prepayments	373,256	518,645
Redemption of investment in Farmer Mac preferred stock	-	7,000
Decrease in loans, net	107,770	418,239
Expenditures from purchase of loans	-	(32,822)
Proceeds from sales of other property owned, net	866	806
Expenditures for premises and equipment	(871)	(4,036)
Net provided by investing activities	<u>74,699</u>	<u>(463,351)</u>
Financing activities		
Bonds and notes issued	5,876,740	9,778,516
Bonds and notes retired	(6,126,368)	(9,450,558)
Capital stock issued	1,056	-
Capital stock retired		
and allocated retained earnings distributed	(264)	(637)
Cash dividends on preferred stock	(21,881)	(7,561)
Cash patronage distributions paid	(12,420)	(12,282)
Net cash (used in) provided by financing activities	<u>(283,137)</u>	<u>307,478</u>
Net decrease in cash	(114,941)	(100,745)
Cash at beginning of year	436,866	470,425
Cash at end of quarter	<u>\$ 321,925</u>	<u>\$ 369,680</u>
Supplemental schedule of noncash investing and financing activities		
Loans transferred to other property owned	\$ 821	\$ 2,917
Net increase in unrealized gains on investment securities	5,008	15,543
Supplemental schedule of noncash changes in fair value related to hedging activities		
(Decrease) increase in bonds and notes	\$ (623)	\$ 1,097
Supplemental information		
Interest paid	\$ 102,976	\$ 161,053

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

Notes to Financial Statements

Unaudited (dollar amounts in thousands unless otherwise noted)

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements include the accounts of the Farm Credit Bank of Texas (bank). The significant accounting policies followed and the financial condition and results of operations of the bank as of and for the year ended December 31, 2010, are contained in the 2010 Annual Report to shareholders (Annual Report). These unaudited second quarter 2011 financial statements should be read in conjunction with the Annual Report.

In June 2011, the Financial Accounting Standards Board (FASB) issued guidance entitled, “Comprehensive Income – Presentation of Comprehensive Income.” This guidance 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 has been eliminated. The main provisions of the guidance provide 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:

- 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.
- 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.

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 will not impact financial condition or results of operations, but will result in changes to the presentation of comprehensive income.

In May 2011, the FASB issued guidance entitled, “Fair Value Measurement – 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. Aligning 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. Clarifying 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. Clarifying 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.

In January 2011, the FASB issued guidance entitled, "Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings." This guidance temporarily delayed the effective date of the disclosures about troubled debt restructurings 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 troubled debt restructurings (TDR) coincides with the guidance for determining what constitutes a TDR as described below.

In April 2011, the FASB issued its guidance entitled, "A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring," which provides for clarification on whether a restructuring constitutes a 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. For nonpublic entities, the guidance is effective for annual periods ending on or after December 15, 2012, including interim periods within those annual periods. The bank and associations are currently evaluating the impact of adoption of this Standard on the financial condition or results of operations. The adoption will result in additional disclosures.

In July 2010, the FASB issued guidance on "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses." This guidance is intended to provide additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of its allowance for credit losses. Existing disclosures are amended to include additional disclosures of financing receivables on a disaggregated basis (by portfolio segment and class of financing receivable) including, among others, a rollforward schedule of the allowance for credit losses from the beginning of the reporting period to the end of the period on a portfolio segment basis, with the ending balance further disaggregated on the basis of the method of impairment (individually or collectively evaluated). The guidance also calls for new disclosures including but not limited to credit quality indicators at the end of the reporting period by class of financing receivables, the aging of past due financing receivables, nature and extent of financing receivables modified as troubled debt restructurings

by class, and the effect on the allowance for credit losses. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The adoption of this Standard did not impact the bank's or its related associations' financial condition or results of operations, but did result in significant additional disclosures.

In January 2010, the FASB issued guidance on "Fair Value Measurements and Disclosures," which is to improve disclosures about fair value measurement by increasing transparency in financial reporting. The changes will provide a greater level of disaggregated information and more robust disclosures of valuation techniques and inputs to fair value measurement. The new disclosures and clarification of existing disclosures were effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the rollforward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this Standard did not impact the bank's and its related associations' financial condition or results of operations but did result in additional disclosures.

The accompanying financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations of the bank, and conform to generally accepted accounting principles. The preparation of these financial statements requires the use of management's estimates. The results of operations for any interim period are not necessarily indicative of the results to be expected for the entire year.

The bank and its affiliated associations (district), are part of the federally chartered Farm Credit System (System). The bank provides funding to district associations, which, in turn, provide credit to their borrower-shareholders. At June 30, 2011, the bank provided financing to 17 district associations and certain other financing institutions.

NOTE 2 — INVESTMENTS

Available for Sale

The bank's available-for-sale investments include a liquidity portfolio and a portfolio of other investments. The liquidity portfolio consists primarily of FDIC-guaranteed corporate debt instruments, other corporate debt instruments, mortgage-backed investments and asset-backed investments. The bank's other investments portfolio consists of Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed agricultural mortgage-backed securities (AMBS) purchased during the second quarter of 2010. A summary of the amortized cost and fair value of investment securities available for sale, at June 30, 2011, and December 31, 2010, is included in the following tables.

Investments in the available-for-sale liquidity portfolio at June 30, 2011:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
FDIC-guaranteed corporate debt	\$ 299,667	\$ 777	\$ (24)	\$ 300,420	0.87 %
Corporate debt	31,879	89	(13)	31,955	1.25
Federal agency collateralized mortgage-backed securities	2,537,344	39,368	(1,306)	2,575,406	1.86
Other collateralized mortgage-backed securities	58,042	60	(4,972)	53,130	5.90
Asset-backed securities	17,982	19	(1,183)	16,818	1.81
Total liquidity investments	\$ 2,944,914	\$ 40,313	\$ (7,498)	\$ 2,977,729	1.84 %

Investments in the available-for-sale other investments portfolio at June 30, 2011:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	\$ 134,241	\$ -	\$ (3,220)	\$ 131,021	4.94 %

Investments in the available-for-sale liquidity portfolio at December 31, 2010:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
FDIC-guaranteed corporate debt	\$ 300,531	\$ 1,724	\$ (164)	\$ 302,091	0.84 %
Federal agency collateralized mortgage-backed securities	2,524,022	36,453	(1,046)	2,559,429	2.00
Other collateralized mortgage-backed securities	71,192	68	(6,342)	64,918	5.97
Asset-backed securities	11,493	1	(1,489)	10,005	3.13
Total liquidity investments	\$ 2,907,238	\$ 38,246	\$ (9,041)	\$ 2,936,443	- %

Investments in the available-for-sale other investments portfolio at December 31, 2010:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	\$ 145,122	\$ -	\$ (4,619)	\$ 140,503	5.07 %

The following table is a summary of the contractual maturity, fair value, amortized cost and weighted average yield of available-for-sale investments at June 30, 2011:

Investments in the available-for-sale liquidity portfolio:

	Due in one year or less	Due after one year through five years	Due after five years through 10 years	Due after 10 years	Total
FDIC-guaranteed corporate debt	\$ 300,420	\$ -	\$ -	\$ -	\$ 300,420
Corporate debt	-	31,955	-	-	31,955
Federal agency collateralized mortgage-backed securities	-	31,629	236,862	2,306,915	2,575,406
Other collateralized mortgage-backed securities	-	-	2,552	50,578	53,130
Asset-backed securities	-	1,798	-	15,020	16,818
Total fair value	\$ 300,420	\$ 65,382	\$ 239,414	\$ 2,372,513	\$ 2,977,729
Total amortized cost	\$ 299,667	\$ 64,328	\$ 235,390	\$ 2,345,529	\$ 2,944,914
Weighted average yield	0.87%	2.95%	2.33%	1.88%	1.84%

Investments in the available-for-sale other investments portfolio:

	Due after one year through five years
Fair value of agricultural mortgage-backed securities	\$ 131,021
Total amortized cost	\$ 134,241
Weighted average yield	4.94%

Other-Than-Temporarily Impaired Investments Evaluation

The following table shows available-for-sale liquidity portfolio investments by gross unrealized losses and fair value, aggregated by investment category and length of time that the securities have been in a continuous unrealized loss position at June 30, 2011. The continuous loss position is based on the date the impairment was first identified:

	Less Than 12 Months		Greater Than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
FDIC-guaranteed corporate debt	\$ 170,140	\$ (24)	\$ -	\$ -	\$ 170,140	\$ (24)
Corporate debt	9,986	(13)	-	-	9,986	(13)
Federal agency collateralized mortgage-backed securities	554,230	(1,210)	82,417	(96)	636,647	(1,306)
Other collateralized mortgage-backed securities	15,934	(922)	34,820	(4,050)	50,754	(4,972)
Asset-backed securities	-	-	5,020	(1,183)	5,020	(1,183)
Total	\$ 750,290	\$ (2,169)	\$ 122,257	\$ (5,329)	\$ 872,547	\$ (7,498)

The bank evaluates investment securities for other-than-temporary impairment on a quarterly basis. Impairment is considered to be other than temporary if an entity (i) intends to sell the security, (ii) is more likely than not to be required to sell the security before recovering its cost, or (iii) does not expect to recover the security's entire amortized cost basis (even if the entity does not intend to sell).

The bank recognized other-than-temporary impairment credit losses on one mortgage-backed security and one asset-backed security totaling \$192 during the quarter ended June 30, 2011. For the six months ended June 30, 2011, the bank recognized other-than-temporary impairment credit losses on five mortgage-backed securities and one asset-backed security totaling \$2,087. The non-credit-related net increase in fair value on the bank's other-than-temporarily impaired investments for the six months ended June 30, 2011, totaling \$977, is included as a credit to other comprehensive income. At June 30, 2011, the bank had five mortgage-backed securities and two asset-backed securities that were considered to be other-than-temporarily impaired.

As the bank has no intention to sell the securities deemed other-than-temporarily impaired and will not more likely than not be required to sell the securities before recovery, the credit loss portion of impairment was recognized through earnings for the first six months of 2011. To measure the amount related to credit loss in the determination of other-than-temporary impairment, the bank utilizes a third-party vendor's services for cash flow modeling and projection of credit losses for specific non-agency residential mortgage-backed securities and subprime asset-backed securities. Applicable securities are identified through prior analysis based on the deterioration of price and credit ratings. Significant inputs utilized in the methodology of the modeling include assumptions surrounding market data (interest rates and home prices) and the applicable securities' loan level data. Loan level data evaluated includes loan status, coupon and resets, FICO scores, loan-to-value, geography, property type, etc. Loan level data is then combined with assumptions surrounding future behavior of home prices, prepayment rates, default rates and loss severity to arrive at cash flow projections for the underlying collateral. Default rate assumptions are generally estimated using historical loss and performance information to estimate future defaults. The default rates used at June 30, 2011, ranged from 5.9 percent to 12.5 percent for non-agency mortgage-backed securities and ranged from 8.8 percent to 14.3 percent for the asset-backed securities. Prepayment rate assumptions are based on historical prepayment rates and ranged from 2.8 percent to 12.1 percent for non-agency mortgage-backed securities and ranged from 1.2 percent to 2.3 percent for the asset-backed securities at June 30, 2011. At June 30, 2011, the loss severity assumptions ranged from

41.3 percent to 60.6 percent for non-agency mortgage-backed securities and ranged from 65.3 percent to 73.0 percent for the asset-backed securities. The present value of these cash flow projections is then evaluated against the specific security's structure and credit enhancement to determine if the bond will absorb losses.

The following is a rollforward of the amount related to credit losses recognized during the six months ended June 30, 2011:

Credit losses for which a portion of an other-than-temporary impairment was recognized in OCI at January 1, 2011	\$ 7,834
Additions for the amount related to credit loss for which other-than-temporary impairment was not previously recognized	241
Increases to amount related to credit loss for which other-than-temporary impairment was previously recognized when it did not intend to sell and it is not more likely than not that it will be required to sell	<u>1,846</u>
Credit losses for which a portion of an other-than-temporary impairment was recognized in OCI at June 30, 2011	<u><u>\$ 9,921</u></u>

The following is a rollforward of the amount related to credit losses recognized during the six months ended June 30, 2010:

Credit losses for which a portion of an other-than-temporary impairment was recognized in OCI at January 1, 2010	\$ 6,005
Additions for the amount related to credit loss for which other-than-temporary impairment was not previously recognized	300
Increases to amount related to credit loss for which other-than-temporary impairment was previously recognized when it did not intend to sell and it is not more likely than not that it will be required to sell	<u>1,516</u>
Credit losses for which a portion of an other-than-temporary impairment was recognized in OCI at June 30, 2010	<u><u>\$ 7,821</u></u>

NOTE 3 — LOANS AND RESERVES FOR CREDIT LOSSES

Loans, including direct notes to district associations and other financing institutions (OFIs), participations purchased, and other bank-owned loans, comprised the following categories at:

	June 30, 2011	December 31, 2010
Direct notes receivable from district associations and OFIs	\$ 7,247,766	\$ 7,530,019
Participations purchased	3,064,417	2,905,985
Other bank-owned loans	26,906	28,030
Balance at end of period	<u><u>\$ 10,339,089</u></u>	<u><u>\$ 10,464,034</u></u>

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

	June 30, 2011	December 31, 2010
Direct notes receivable from		
district associations	\$ 7,162,789	\$ 7,454,282
Real estate mortgage	402,621	425,945
Production and intermediate term	353,086	346,302
Loans to cooperatives	267,156	232,105
Processing and marketing	922,925	824,956
Farm-related business	62,807	21,783
Communication	177,808	198,597
Energy (utilities)	784,952	810,287
Water and waste disposal	97,991	50,000
Rural residential real estate	1,792	1,791
Loans to other financing institutions	84,977	75,737
Mission related	20,185	22,249
	\$ 10,339,089	\$ 10,464,034

The bank and associations purchase or sell participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration regulations. The following table presents information regarding the balances of participations purchased and sold, excluding syndications, at June 30, 2011.

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
	Real estate mortgage	\$ 320,547	\$ 104,071	\$ 118,694	\$ -	\$ 439,241
Production and intermediate term	350,919	144,990	88,148	-	439,067	144,990
Agribusiness	1,279,438	427,130	245,284	-	1,524,722	427,130
Communication	239,257	61,477	-	-	239,257	61,477
Energy	851,767	76,443	9,400	-	861,167	76,443
Water and waste disposal	97,991	-	-	-	97,991	-
Rural residential real estate	1,758	-	-	-	1,758	-
Total	\$ 3,141,677	\$ 814,111	\$ 461,526	\$ -	\$ 3,603,203	\$ 814,111

In June 2011, the bank purchased \$13,191 in loan participations from a district association in a Capitalized Participation Pool (CPP) transaction. The purchase represented 80.0 percent of the outstanding balances of the loans placed by the association in the CPP. As a condition of the transaction, the bank redeemed stock in the amount of 2.0 percent of the par value of the loans purchased, and the association bought bank stock equal to 8.0 percent of the purchased loans' par value.

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

	June 30, 2011		December 31, 2010
Nonaccrual loans:			
Real estate mortgage	\$ 104,678	\$	77,120
Production and intermediate term	17,061		17,551
Agribusiness	26,043		21,291
Communication	3,385		4,237
Energy and water/waste disposal	9,400		-
Total nonaccrual loans	\$ 160,567	\$	120,199
Accruing restructured loans:			
Real estate mortgage	\$ 204	\$	354
Agribusiness	2,434		-
Total accruing restructured loans	\$ 2,638	\$	354
Accruing loans 90 days or more past due:			
Real estate mortgage	\$ 8	\$	-
Total accruing loans 90 days or more past due	\$ 8	\$	-
Total nonperforming loans	163,213		120,553
Other property owned	2,522		2,838
Total nonperforming assets	\$ 165,735	\$	123,391

One credit quality indicator utilized by the bank and associations is the Farm Credit Administration Uniform Loan Classification System that categorizes loans into five categories. The categories are defined as follows:

- Acceptable – assets are expected to be fully collectible and represent the highest quality,
- Other assets especially mentioned (OAEM) – assets are currently collectible but exhibit some potential weakness,
- Substandard – assets exhibit some serious weakness in repayment capacity, equity and/or collateral pledged on the loan,
- Doubtful – assets exhibit similar weaknesses to substandard assets; however, doubtful assets have additional weaknesses in existing factors, conditions and values that make collection in full highly questionable, and
- Loss – assets are considered uncollectible.

The following table shows loans and related accrued interest as a percentage of total loans and related accrued interest receivable by loan type as of:

	June 30, 2011	December 31, 2010
Real estate mortgage:		
Acceptable	59.9 %	69.0 %
OAEM	12.3	3.1
Substandard/Doubtful	27.8	27.9
	100.0 %	100.0 %
Production and intermediate term:		
Acceptable	90.4 %	84.9 %
OAEM	4.0	8.1
Substandard/Doubtful	5.6	7.0
	100.0 %	100.0 %
Agribusiness:		
Acceptable	89.5 %	86.7 %
OAEM	6.3	9.1
Substandard/Doubtful	4.2	4.2
	100.0 %	100.0 %
Energy and water/waste disposal:		
Acceptable	98.6 %	98.9 %
OAEM	0.3	-
Substandard/Doubtful	1.1	1.1
	100.0 %	100.0 %
Communication:		
Acceptable	98.1 %	97.9 %
OAEM	-	-
Substandard/Doubtful	1.9	2.1
	100.0 %	100.0 %
Rural residential real estate:		
Acceptable	100.0 %	100.0 %
OAEM	-	-
Substandard/Doubtful	-	-
	100.0 %	100.0 %
Direct notes to associations:		
Acceptable	78.8 %	74.3 %
OAEM	16.5	18.4
Substandard/Doubtful	4.7	7.3
	100.0 %	100.0 %
Loans to other financing institutions:		
Acceptable	100.0 %	100.0 %
OAEM	-	-
Substandard/Doubtful	-	-
	100.0 %	100.0 %
Mission related:		
Acceptable	86.1 %	87.3 %
OAEM	1.0	0.9
Substandard/Doubtful	12.9	11.8
	100.0 %	100.0 %
Total loans:		
Acceptable	82.0 %	78.4 %
OAEM	12.8	14.4
Substandard/Doubtful	5.2	7.2
	100.0 %	100.0 %

The following table provides an age analysis of past due loans (including accrued interest) as of June 30, 2011:

	90 Days			Not Past Due		Recorded Investment > 90 Days and Accruing
	30-89 Days	or More	Total	or Less Than	Total	
	Past Due	Past Due	Past Due	30 Days Past Due	Loans	
Real estate mortgage	\$ 6,713	\$ 71,708	\$ 78,421	\$ 329,092	\$ 407,513	\$ 8
Production and intermediate term	259	16,792	17,051	336,882	353,933	-
Agribusiness	-	3,012	3,012	1,254,322	1,257,334	-
Communication	-	-	-	178,101	178,101	-
Energy and water/waste disposal	-	9,400	9,400	877,990	887,390	-
Rural residential real estate	-	-	-	35	35	-
Direct notes to associations	-	-	-	7,183,293	7,183,293	-
Loans to other financing institutions	-	-	-	85,109	85,109	-
Mission related	-	-	-	20,322	20,322	-
Total	\$ 6,972	\$ 100,912	\$ 107,884	\$ 10,265,146	\$ 10,373,030	\$ 8

Additional impaired loan information is as follows:

	At June 30, 2011			For the Three Months Ended June 30, 2011		For the Six Months Ended June 30, 2011	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:							
Real estate mortgage	\$ 56,723	\$ 70,209	\$ 18,327	\$ 63,087	\$ 7	\$ 62,566	\$ 21
Production and intermediate term	3,871	3,830	215	3,865	1	3,362	12
Processing and marketing	25,638	25,638	5,538	23,970	4	24,082	4
Communication	2,499	2,499	3,000	2,515	-	2,525	-
Energy and water/waste disposal	-	-	-	-	-	-	1
Total	\$ 88,731	\$ 102,176	\$ 27,080	\$ 93,437	\$ 12	\$ 92,535	\$ 38
Impaired loans with no related allowance for credit losses:							
Real estate mortgage	\$ 48,167	\$ 49,171	\$ -	\$ 53,933	\$ 217	\$ 34,926	\$ 436
Production and intermediate term	13,190	14,504	-	15,757	-	15,753	11
Processing and marketing	2,839	5,423	-	3,686	68	3,258	74
Communication	886	886	-	1,591	-	1,640	-
Energy and water/waste disposal	9,400	17,975	-	9,405	-	7,248	4
Total	\$ 74,482	\$ 87,959	\$ -	\$ 84,372	\$ 285	\$ 62,825	\$ 525
Total impaired loans:							
Real estate mortgage	\$ 104,890	\$ 119,380	\$ 18,327	\$ 117,020	\$ 224	\$ 97,492	\$ 457
Production and intermediate term	17,061	18,334	215	19,622	1	19,115	23
Processing and marketing	28,477	31,061	5,538	27,656	72	27,340	78
Communication	3,385	3,385	3,000	4,106	-	4,165	-
Energy and water/waste disposal	9,400	17,975	-	9,405	-	7,248	5
Total	\$ 163,213	\$ 190,135	\$ 27,080	\$ 177,809	\$ 297	\$ 155,360	\$ 563

	At December 31, 2010			For the Twelve Months Ended December 31, 2010	
	Recorded	Unpaid Principal	Related	Average	Interest Income
	Investment	Balance	Allowance	Impaired Loans	Recognized
Impaired loans with a related allowance for credit losses:					
Real estate mortgage	\$ 48,556	\$ 53,677	\$ 15,879	\$ 40,118	\$ 168
Production and intermediate term	991	2,952	480	10,197	43
Processing and marketing	18,840	19,362	2,973	11,225	47
Farm-related business	-	-	-	6,034	25
Communication	4,237	2,587	3,000	2,689	11
Rural residential real estate	-	-	-	2	-
Total	\$ 72,624	\$ 78,578	\$ 22,332	\$ 70,265	\$ 294
Impaired loans with no related allowance for credit losses:					
Real estate mortgage	\$ 28,918	\$ 38,625	\$ -	\$ 35,503	\$ 1,135
Production and intermediate term	16,560	17,347	-	8,668	36
Processing and marketing	2,451	5,488	-	9,542	40
Farm-related business	-	-	-	5,129	22
Communication	-	1,725	-	2,286	9
Energy and water/waste disposal	-	8,832	-	-	-
Rural residential real estate	-	-	-	2	-
Total	\$ 47,929	\$ 72,017	\$ -	\$ 61,130	\$ 1,242
Total impaired loans:					
Real estate mortgage	\$ 77,474	\$ 92,302	\$ 15,879	\$ 75,621	\$ 1,303
Production and intermediate term	17,551	20,299	480	18,865	79
Processing and marketing	21,291	24,850	2,973	20,767	87
Farm-related business	-	-	-	11,163	47
Communication	4,237	4,312	3,000	4,975	20
Energy and water/waste disposal	-	8,832	-	-	-
Rural residential real estate	-	-	-	4	-
Total	\$ 120,553	\$ 150,595	\$ 22,332	\$ 131,395	\$ 1,536

The average recorded investment in impaired loans for the three months ended June 30, 2011, was \$177.8 million. The bank recognized interest income of \$298 on impaired loans during the three months ended June 30, 2011.

The average recorded investment in impaired loans for the six months ended June 30, 2011, was \$155.4 million. The bank recognized interest income of \$564 on impaired loans during the six months ended June 30, 2011.

At June 30, 2011, impaired loans of \$88.7 million had a related specific allowance of \$27.1 million, while the remaining \$74.5 million of impaired loans had no related specific allowance as a result of adequate collateralization.

The bank's impaired loans included loans which were acquired in March 2010 with evidence of credit deterioration. The loans are recorded at the present value of expected future cash flows. These loans had a balance of \$20,955 and \$21,911 at June 30, 2011, and December 31, 2010, respectively, net of the unaccreted discount of \$1,106 and \$1,814, at June 30, 2011, and December 31, 2010, respectively. During the six months ended June 30, 2011, the bank recorded provisions for loan losses related to these loans totaling \$1,036. The allowance for loan losses related to these loans was \$2,902 and \$1,866 at June 30, 2011, and December 31, 2010, respectively.

A summary of changes in the allowance for loan losses and period-end recorded investment in loans is as follows:

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communications	Energy and Water/Waste Disposal	Rural Residential Real Estate	Direct Notes to Associations	Loans to OFIs	Mission Related	Total
Allowance for Credit Losses:										
Balance at December 31, 2010	\$ 16,883	\$ 1,323	\$ 5,242	\$ 3,417	\$ 1,809	\$ 4	\$ -	\$ -	\$ -	\$ 28,678
Charge-offs	(3,247)	(641)	-	-	(3,319)	-	-	-	-	(7,207)
Recoveries	6	-	119	-	315	-	-	-	-	440
Provision for loan losses	5,658	(110)	2,791	(244)	1,841	(4)	-	-	-	9,932
Adjustment due to merger	-	-	-	-	-	-	-	-	-	-
Other	(462)	-	-	-	-	-	-	-	-	(462)
Balance at June 30, 2011	<u>\$ 18,838</u>	<u>\$ 572</u>	<u>\$ 8,152</u>	<u>\$ 3,173</u>	<u>\$ 646</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 31,381</u>
Ending Balance: individually evaluated for impairment	<u>\$ 15,887</u>	<u>\$ -</u>	<u>\$ 5,539</u>	<u>\$ 3,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 24,426</u>
Ending Balance: collectively evaluated for impairment	<u>\$ 511</u>	<u>\$ 357</u>	<u>\$ 2,613</u>	<u>\$ 173</u>	<u>\$ 646</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,300</u>
Ending Balance: loans acquired with deteriorated credit quality	<u>\$ 2,440</u>	<u>\$ 215</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,655</u>
Recorded Investments in Loans Outstanding:										
Balance at June 30, 2011	<u>\$ 407,513</u>	<u>\$ 353,933</u>	<u>\$ 1,257,334</u>	<u>\$ 178,101</u>	<u>\$ 887,390</u>	<u>\$ 35</u>	<u>\$ 7,183,293</u>	<u>\$ 85,109</u>	<u>\$ 20,322</u>	<u>\$ 10,373,030</u>
Ending Balance for loans individually evaluated for impairment	<u>\$ 91,804</u>	<u>\$ 9,193</u>	<u>\$ 28,476</u>	<u>\$ 3,385</u>	<u>\$ 9,400</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 142,258</u>
Ending Balance for loans collectively evaluated for impairment	<u>\$ 302,623</u>	<u>\$ 336,871</u>	<u>\$ 1,228,858</u>	<u>\$ 174,716</u>	<u>\$ 877,990</u>	<u>\$ 35</u>	<u>\$ 7,183,293</u>	<u>\$ 85,109</u>	<u>\$ 20,322</u>	<u>\$ 10,209,817</u>
Ending Balance for loans acquired with deteriorated credit quality	<u>\$ 13,086</u>	<u>\$ 7,869</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 20,955</u>

NOTE 4 — COMMITMENTS AND CONTINGENT LIABILITIES

The bank is primarily liable for its portion of Systemwide debt obligations. Additionally, the bank is jointly and severally liable for the consolidated Systemwide bonds and notes of the other System banks. Total consolidated bank and Systemwide obligations of the System at June 30, 2011, were approximately \$187.3 billion.

NOTE 5 — FAIR VALUE MEASUREMENTS

Accounting guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 2, “Summary of Significant Accounting Policies,” of the 2010 Annual Report for a more complete description.

Assets and liabilities measured at fair value on a recurring basis at June 30, 2011, for each of the fair value hierarchy levels are summarized below:

	Fair Value Measurements at June 30, 2011			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Federal funds	\$ 20,410	\$ -	\$ 20,410	\$ -
Investments available for sale	3,108,750	-	2,837,057	271,693
Derivative assets	3,398	-	3,398	-
Assets held in nonqualified benefit trusts	294	294	-	-
Total	\$ 3,132,852	\$ 294	\$ 2,860,865	\$ 271,693
Liabilities:				
Standby letters of credit	\$ 2,398	\$ -	\$ 2,398	\$ -
Total	\$ 2,398	\$ -	\$ 2,398	\$ -

The following table represents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period from January 1, 2011, to June 30, 2011:

	Corporate Debt	Mortgage- Backed Securities	Asset- Backed Securities	Total
Available-for-sale investment securities:				
Balance at January 1, 2011	\$ -	\$ 240,888	\$ 6,760	\$ 247,648
Net gains included in other comprehensive income	76	2,574	306	2,956
Net losses included in earnings	-	(1,934)	(153)	(2,087)
Purchases, issuances and settlements	31,879	28,658	(1,893)	58,644
Transfers out of Level 3	-	(35,468)	-	(35,468)
Balance at June 30, 2011	\$ 31,955	\$ 234,718	\$ 5,020	\$ 271,693
The amount of losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets or liabilities still held at June 30, 2011				
	\$ -	\$ 1,934	\$ 153	\$ 2,087

There were no transfers of assets or liabilities into or out of Level 1 from other levels during the six months ended June 30, 2011. At December 31, 2010, Level 3 investments included two agency mortgage-backed securities due to the fact that their valuations were based on Level 3 criteria (broker quotes) and certain non-agency mortgage-backed and asset-backed securities. In 2011 the two agency mortgage-backed securities, totaling \$35,468, were valued using independent third-party valuation services using Level 2 criteria and were, accordingly, transferred from Level 3 to Level 2. There were no other transfers into or out of Level 2 during the six months ended June 30, 2011.

Assets and liabilities measured at fair value on a nonrecurring basis at June 30, 2011, for each of the fair value hierarchy levels are summarized below:

	Fair Value Measurement at June 30, 2011				Total Gains (Losses)
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Assets:					
Loans	\$ 136,132	\$ -	\$ -	\$ 136,132	\$ (7,207)
Other property owned	2,522			2,522	(296)
Total assets	<u>\$ 138,654</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 138,654</u>	<u>\$ (7,503)</u>

Assets and liabilities measured at fair value on a recurring basis at December 31, 2010, for each of the fair value hierarchy levels are summarized below:

	Fair Value Measurements at December 31, 2010			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Federal funds	\$ 20,438	\$ -	\$ 20,438	\$ -
Investments available for sale	3,076,946	-	2,829,298	247,648
Derivative assets	6,512	-	6,512	-
Assets held in nonqualified benefit trusts	369	369	-	-
Total	<u>\$ 3,104,265</u>	<u>\$ 369</u>	<u>\$ 2,856,248</u>	<u>\$ 247,648</u>
Liabilities:				
Derivative liabilities	\$ 5	\$ -	\$ 5	\$ -
Standby letters of credit	2,398	-	2,398	-
Total	<u>\$ 2,403</u>	<u>\$ -</u>	<u>\$ 2,403</u>	<u>\$ -</u>

In December 2010, the bank transferred certain non-agency mortgage-backed and asset-backed securities totaling \$107,145 from Level 2 to Level 3. The decision to move these investments to Level 3 was based on the relatively illiquid current market for these investments, which were valued by independent third-party valuation services which used Level 2 and Level 3 criteria in their valuations. The significant inputs included volatility, prepayment rates, market spreads and dealer quotes.

The following table represents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period from January 1, 2010, to June 30, 2010:

	Corporate Debt	Mortgage- Backed Securities	Asset- Backed Securities	Total
Available-for-sale investment securities:				
Balance at January 1, 2010	\$ -	\$ -	\$ -	\$ -
Net gains included in other comprehensive income	-	378	-	378
Net losses included in earnings	-	-	-	-
Purchases, issuances and settlements	-	159,272	-	159,272
Transfers out of Level 3	-	-	-	-
Balance at June 30, 2010	<u>\$ -</u>	<u>\$ 159,650</u>	<u>\$ -</u>	<u>\$ 159,650</u>
The amount of losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets or liabilities still held at June 30, 2010				
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Assets and liabilities measured at fair value on a nonrecurring basis at December 31, 2010, for each of the fair value hierarchy levels are summarized below:

	Fair Value Measurement at December 31, 2010				Total Gains (Losses)
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Assets:					
Loans	\$ 50,293	\$ -	\$ -	\$ 50,293	\$ (33,176)
Other property owned	2,838			2,838	491
Total assets	<u>\$ 53,131</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 53,131</u>	<u>\$ (32,685)</u>

Valuation Techniques

As more fully discussed in Note 2, "Summary of Significant Accounting Policies," of the Annual Report, accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following represent a brief summary of the valuation techniques used for the bank's assets and liabilities:

Investment Securities

Where quoted prices are available in an active market, available-for-sale securities would be classified as Level 1. If quoted prices are not available in an active market, the fair value of securities is estimated using pricing models, quoted prices for similar securities received from pricing services or discounted cash flows. Generally, these securities would be classified as Level 2. To estimate the fair value of investments, the bank obtains prices from third-party pricing services. This would include certain mortgage-backed and asset-backed securities. Where there is limited activity or less transparency around inputs to the valuation, the securities are classified as Level 3. Investments classified as Level 3 primarily consist of the certain non-agency mortgage-backed securities and asset-backed securities valued using

independent third-party valuation services. Also included in the bank's Level 3 assets are the Farmer Mac AMBS.

Assets Held in Nonqualified Benefit Trusts

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

Derivatives

The bank's derivative positions are valued using internally developed models that use, as their basis, readily observable market parameters and are classified within Level 2 of the valuation hierarchy. Such derivatives include fair value interest rate swaps, interest rate caps and cash flow interest rate swaps. The models used to determine the fair value of derivative assets and liabilities use an income approach based on observable inputs, primarily the LIBOR swap curve and volatility assumptions about future interest rate movements.

Standby Letters of Credit

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

Loans

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

Other Property Owned

Other property owned is generally classified as Level 3. The fair value is based upon the collateral less estimated costs to sell. Costs to sell represent transaction costs and are not included as a component of the asset's fair value.

NOTE 6 — FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the carrying amounts and estimated values of the bank's financial instruments at June 30, 2011, and December 31, 2010.

The estimated fair values of the bank's financial instruments follow:

	June 30, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash, federal funds sold and investment securities	\$ 3,451,085	\$ 3,451,085	\$ 3,534,250	\$ 3,534,250
Loans	10,339,089	10,666,893	10,464,034	10,705,755
Allowance for loan losses	(31,381)	—	(28,678)	—
Loans, net	10,307,708	10,666,893	10,435,356	10,705,755
Derivative assets	3,398	3,398	6,512	6,512
Financial liabilities				
Bonds and notes	12,527,413	12,658,045	12,779,932	12,873,642
Subordinated debt	50,000	54,088	50,000	52,851
Derivative liabilities	-	-	5	5

A description of the methods and assumptions used to estimate the fair value of each class of the bank's financial instruments for which it is practicable to estimate that value follows:

Cash and Federal Funds Sold:

The carrying value is a reasonable estimate of fair value.

Investment Securities:

If an active market exists, the fair value is based on currently quoted market prices. For those securities for which an active market does not exist, the fair value is determined as described in Note 5, "Fair Value Measurements."

Loans:

Fair value is estimated by discounting the expected future cash flows using the bank's current interest rates at which similar loans would be made to borrowers with similar credit risk. As the discount rates are based on the bank's loan rates as well as on management estimates, management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale.

For purposes of determining fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics. Expected future cash flows and discount rates reflecting appropriate credit risk are determined separately for each individual pool.

Fair value of loans in a nonaccrual status that are current as to principal and interest is estimated as described above, with appropriately higher discount rates to reflect the uncertainty of continued cash flows. For noncurrent nonaccrual loans, it is assumed that collection will result only from the disposition of the underlying collateral. Fair value of these loans is estimated to equal the aggregate net realizable value of the underlying collateral, discounted at an interest rate that appropriately reflects the uncertainty of the expected future cash flows over the average disposal period.

Bonds and Notes:

Systemwide bonds and notes are not regularly traded; thus, quoted market prices are not available. Fair value of these instruments is estimated by discounting expected future cash flows based on the quoted market price of new issues of Systemwide bonds with similar-maturity terms.

Subordinated Debt:

The fair value of these obligations is determined by discounting expected future cash flows based on the Treasury yield curve.

Derivative Assets and Liabilities:

The fair value of derivative financial instruments is the estimated amount that a bank would receive or pay to replace the instruments at the reporting date, considering the current interest rate environment and the current creditworthiness of the counterparties. Where such quoted market prices do not exist, these values are generally provided by sources outside the respective bank or by internal market valuation models.

NOTE 7 — DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

The bank maintains an overall interest rate risk management strategy that incorporates the use of derivative products to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. The bank's goal is to manage interest rate sensitivity by modifying the repricing or maturity characteristics of certain balance sheet assets and liabilities so that movements in interest rates do not adversely affect the net interest margin. As a result of interest rate fluctuations, hedged fixed-rate assets and liabilities will appreciate or depreciate in market value. The effect of this unrealized appreciation or depreciation is expected to be substantially offset by the bank's gains or losses on the derivative instruments that are linked to these hedged assets and liabilities. Another result of interest rate fluctuations is that the interest income and interest expense of hedged floating-rate assets and liabilities will increase or decrease. The effect of this variability in earnings is expected to be substantially offset by the bank's gains and losses on the derivative instruments that are linked to these hedged assets and liabilities. The bank considers the strategic use of derivatives to be a prudent method of managing interest rate sensitivity, as it prevents earnings from being exposed to undue risk posed by changes in interest rates.

The bank enters into derivative transactions, particularly interest rate swaps, to lower funding costs, diversify sources of funding, alter interest rate exposures arising from mismatches between assets and liabilities, or better manage liquidity. Interest rate swaps allow the bank to raise long-term borrowings at fixed rates and swap them into floating rates to better match the repricing characteristics of earning assets. Under interest rate swap arrangements, the bank agrees with other parties to exchange, at specified intervals, payment streams calculated on a specified notional principal amount, with at least one stream based on a specified floating-rate index.

A substantial amount of the bank's assets are interest-earning assets (principally loans and investments) that tend to be medium-term floating-rate instruments. In order to match the asset structure, interest rate swaps in which the bank pays the floating rate and receives the fixed rate (receive fixed swaps) are used to reduce the impact of market fluctuations on the bank's net interest income. Because the size of swap positions needed to reduce the impact of market fluctuations varies over time, the bank also enters into swaps in which it receives the floating rate and pays the fixed rate (pay fixed swaps) when necessary to reduce its net position.

The bank may purchase interest rate options, such as caps, in order to reduce the impact of rising interest rates on its floating-rate debt, and floors, in order to reduce the impact of falling interest rates on its

floating-rate assets. The notional amounts and primary types of derivative instruments used and the amount of activity during the period are summarized in the following table:

	Receive-Fixed Swaps	Pay-Fixed Swaps	Interest Rate Caps	Total
Balance at January 1, 2011	\$ 125	\$ 25	\$ 645	\$ 795
Maturities/Amortizations	-	(25)	-	(25)
Balance at June 30, 2011	\$ 125	\$ -	\$ 645	\$ 770

By using derivative products, the bank exposes itself to credit and market risk. If a counterparty fails to fulfill its performance obligations under a derivative contract, the bank's credit risk will equal the fair-value gain in a derivative. Generally, when the fair value of a derivative contract is positive, this indicates that the counterparty owes the bank, thus creating a repayment (credit) risk for the bank. When the fair value of the derivative contract is negative, the bank owes the counterparty and, therefore, assumes no repayment risk.

To minimize the risk of credit losses, the bank deals with counterparties that have an investment grade or better credit rating from a major rating agency, and also monitors the credit standing and levels of exposure to individual counterparties. The bank does not anticipate nonperformance by any of these counterparties. The bank typically enters into master agreements that contain netting provisions. These provisions allow the bank to require the net settlement of covered contracts with the same counterparty in the event of default by the counterparty on one or more contracts. However, derivative contracts must be reflected in the financial statements on a gross basis regardless of the netting agreement. Another way the bank minimizes the risk of credit losses from derivatives is that substantially all derivative contracts are supported by bilateral collateral agreements with counterparties requiring the posting of collateral in the event certain dollar thresholds of exposure of one party to the other one are reached, which thresholds may vary depending on the counterparty's credit rating. At June 30, 2011, and December 31, 2010, the bank's exposure to counterparties, net of collateral, was \$3.6 million and \$6.5 million, respectively. At June 30, 2011, and December 31, 2010, the bank had posted no securities as collateral.

The bank's derivative activities are monitored by its Asset-Liability Management Committee (ALCO) as part of the ALCO's oversight of the bank's asset/liability and treasury functions. The bank's ALCO is responsible for approving hedging strategies that are developed within parameters established by the bank's board of directors through the bank's analysis of data derived from financial simulation models and other internal and industry sources. The resulting hedging strategies are then incorporated into the bank's overall interest rate risk-management strategies. The bank held no derivatives that were not designated as hedges at June 30, 2011, or December 31, 2010.

Fair Value Hedges

The bank's derivative instruments that are designated and qualify as a fair value hedge all meet the standards for accounting treatment that presume full effectiveness. Accordingly, no gain or loss is recognized in earnings.

Cash Flow Hedges

The bank's derivative instruments that are designated and qualify as a cash flow hedge all meet the standards for accounting treatment that presume full effectiveness. Thus, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income.

Derivatives designated as hedging instruments	Balance	Fair	Fair	Balance	Fair	Fair
	Sheet Location	Value 6/30/2011	Value 12/31/2010	Sheet Location	Value 6/30/2011	Value 12/31/2010
Receive fixed	Other assets	\$ 1,225	\$ 1,848	Other liabilities	\$ -	\$ -
Pay fixed	Other assets	-	-	Other liabilities	-	5
Interest rate caps	Other assets	2,174	4,664	Other liabilities	-	-

Derivatives designated as hedging instruments	Amount of Gain (Loss) Recognized in OCI on Derivatives (Effective Portion)		Location of Gain Reclassification from AOCI into Income	Amount of Gain Reclassified from AOCI into Income (Effective Portion)	
	June 30			June 30	
	2011	2010		2011	2010
Interest rate caps	\$ (2,490)	\$ (2,711)	Interest expense	\$ 7	\$ -
Cash flow derivatives	5	248			

NOTE 8 — EMPLOYEE BENEFIT PLANS

The following table summarizes the components of net periodic benefit costs for the bank's supplemental defined benefit pension plan and for the bank's other postretirement benefit costs for the six months ended June 30:

	Supplemental Defined Pension Benefits		Other Postretirement Benefits	
	2011	2010	2011	2010
Service cost	\$ -	\$ 78	\$ 109	\$ 95
Interest cost	48	119	228	213
Amortization of prior service costs	-	177	(145)	(150)
Amortization of net loss	32	116		
Amortization of net loss due to curtailment/termination	1,305	-	-	-
Net periodic benefit cost	<u>\$ 1,385</u>	<u>\$ 490</u>	<u>\$ 192</u>	<u>\$ 158</u>

The bank's supplemental defined benefit pension plan was terminated effective January 16, 2011. By terminating the plan, no further vesting or benefit will occur subsequent to January 16, 2011, and remaining unpaid vested benefits will be distributed in a cash lump sum payment to the participating bank employees after a one year deferral period. The amortization of estimated settlement expenses for the quarter ended June 30, 2011, are included in "Amortization of loss due to curtailment/termination" in the table above.

The structure of the district's defined benefit pension plan is characterized as multi-employer, since the assets, liabilities and cost of the plan are not segregated or separately accounted for by participating employers (bank and associations).

NOTE 9 — SUBSEQUENT EVENTS

The bank has evaluated subsequent events through August 10, 2011, which is the date the financial statements were issued. There are no significant subsequent events requiring disclosure as of August 10, 2011.

NOTE 10 — COMBINED ASSOCIATION FINANCIAL DATA

Condensed financial information for the associations follows. All significant transactions and balances between the associations are eliminated in combination. The multi-employer structure of certain of the district's retirement and benefit plans results in the recording of these plans only in the district's combined financial statements.

Balance sheet data	June 30, 2011	December 31, 2010
Cash	\$ 8,519	\$ 16,456
Investment securities	140,320	154,616
Loans	12,353,748	12,594,842
Less allowance for loan losses	122,640	134,467
Net loans	<u>12,231,108</u>	<u>12,460,375</u>
Accrued interest receivable	131,519	131,765
Other property owned, net	68,721	75,286
Other assets	326,829	316,290
Total assets	<u>\$ 12,907,016</u>	<u>\$ 13,154,788</u>
Notes payable	\$ 10,562,579	\$ 10,837,130
Other liabilities	138,140	218,178
Total liabilities	<u>10,700,719</u>	<u>11,055,308</u>
Capital stock and participation certificates	81,916	82,643
Retained earnings	2,123,116	2,014,996
Accumulated other comprehensive income	1,265	1,841
Total members' equity	<u>2,206,297</u>	<u>2,099,480</u>
Total liabilities and members' equity	<u>\$ 12,907,016</u>	<u>\$ 13,154,788</u>

Statement of income data	Six Months Ended June 30,	
	2011	2010
Interest income	\$ 329,923	\$ 358,328
Interest expense	139,797	171,965
Net interest income	190,126	186,363
Provision for loan losses	15,341	37,253
Net interest income after provision		
for loan losses	174,785	149,110
Noninterest income	26,040	37,216
Other expense	87,348	88,404
Benefit from income taxes	(195)	(682)
Net income	<u>\$ 113,672</u>	<u>\$ 98,604</u>

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