



2011 THIRD QUARTER REPORT
TEXAS FARM CREDIT DISTRICT
SEPTEMBER 30, 2011

THIRD QUARTER 2011

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

(dollars in thousands, except as noted)

The following discussion reviews the combined financial condition and results of operations of the Farm Credit Bank of Texas (bank), its affiliated Federal Land Credit Association (FLCA) and affiliated Agricultural Credit Associations (ACAs) for the nine months ended September 30, 2011. The FLCA and ACAs are collectively referred to as associations, and the bank and its affiliated associations are collectively referred to as the district. These comments should be read in conjunction with the accompanying combined financial statements and footnotes, along with the 2010 Annual Report to stockholders. The accompanying financial statements were prepared under the oversight of the bank's audit committee.

RESULTS OF OPERATIONS

Net Income

Net income for the quarter ended September 30, 2011, was \$95,905, an increase of \$46,634, or 94.6 percent, over the same period of 2010. The \$46,634 increase in net income for the third quarter of 2011 consisted of a \$47,944 decrease in provision for credit losses, a \$3,916 increase in net interest income and a \$121 decrease in provision for income taxes, offset by a \$4,603 increase in noninterest expense and a \$744 decrease in noninterest income.

Net income for the nine months ended September 30, 2011, was \$286,417, an increase of \$74,302, or 35.0 percent, over the same period of 2010. The increase in net income for the nine months ended September 30, 2011, consisted of a \$71,139 decrease in provision for loan losses and a \$28,481 increase in net interest income, offset by a \$13,083 decrease in noninterest income, an \$11,869 increase in noninterest expense, and a \$366 increase in provision for income taxes.

Net Interest Income

Net interest income for the three months ended September 30, 2011, was \$148,266, an increase of \$3,916 over the same period of 2010. The increase in net interest income was due to an increase in the net interest rate spread of 13 basis points to 2.94 percent, offset by the effects of a \$169.2 million decrease in average earning assets. The increase in the interest rate spread was due mainly to a 38-basis-point decrease in the effective rate of debt, made possible by the bank's ability to call higher-cost debt and replace it with lower-cost debt in the last year. Interest rate spreads increased at the district's associations, offset by the effects of a decrease in association average loan volume. The decrease in earning assets was due to the decrease in association loan volume, offset by increases in the bank's participation loan and investment portfolios.

Net interest income for the nine months ended September 30, 2011, was \$453,214, an increase of \$28,481, or 6.7 percent, over the same period of 2010. The increase was primarily the result of an increase in the net interest rate spread of 24 basis points to 3.02 percent for the nine months ended September 30, 2011. The increase in the net interest rate spread was due primarily to a 57-basis-point decrease in the effective cost of debt resulting from the bank's ability to call and replace debt with lower rates in the last year. Interest rate spreads increased at the district's associations, offset by the effects of a decrease in association average loan volume. There was a \$94.6 million increase in the district's average earning assets, resulting from an increase in the bank's investment and participation loan portfolio, offset by the decrease in association average loan volume. The decrease in district average loan volume for the quarter and nine months ended September 30, 2011, was due to decreases in loan volume at district associations resulting from scheduled repayments, enhanced credit standards on association retail loan

portfolios and reduced loan demand as general economic conditions continue to result in a decline in demand for rural real estate.

Provision for Loan Losses

The district's provision for credit losses for the quarter ended September 30, 2011, totaled \$12,837, a decrease of \$47,944 from the \$60,781 provision for the third quarter of 2010. Provision for loan losses and provision for losses on standby letters of credit for the nine months ended September 30, 2011, was \$38,110, a decrease of \$71,139, or 65.1 percent, from the \$109,249 provision for the first nine months of 2010. The district's provision for loan losses consists primarily of specific allowances on particular loans and exposures. The decreases in provision for credit losses for the quarter and nine months ended September 30, 2011, from the same periods of 2010 result from decreases in specific exposures from the higher levels of credit deterioration experienced during 2010. The provisions recorded for the nine months ended September 30, 2011, included significant provisions related to land in transition, livestock and dairy, as well as other borrowers impacted by the overall downturn in the general economy.

Noninterest Income

Noninterest income for the quarter ended September 30, 2011, was \$13,608, a decrease of \$744, or 5.2 percent, from the same period of 2010. The decrease for the third quarter of 2011 over the same period of 2010 was due mainly to a \$785 decrease in loan-related fee income and a \$58 decrease in patronage income, offset by a \$99 increase in miscellaneous income. 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. There were no credit losses recognized on other-than-temporarily impaired investments in the third quarter of 2011 or 2010.

Noninterest income for the nine months ended September 30, 2011, was \$33,308, a decrease of \$13,083, or 28.2 percent, from the same period of 2010. The decrease was primarily due to refund distributions in the first quarter of 2010 from the Farm Credit System Insurance Corporation (FCSIC or Insurance Fund) totaling \$22,268, a \$529 decrease from the 2010 gain on sale of investments, and a \$271 increase in credit losses recognized on other-than-temporarily impaired investment securities, offset by a \$7,248 decrease from the 2010 losses an association incurred on the sale of loans, a \$2,300 increase in fees for loan-related services, a \$332 increase in patronage, and a \$105 increase in all other noninterest income items, collectively. 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 gain on sale of investments is due to an association's sale of investments in 2010; there were no sales of investments in the nine months ended September 30, 2011. 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 nine months ended September 30, 2010 and 2011, respectively. The association's loss on sale of loans resulted from the sale of loans with credit deterioration to the bank in March 2010.

Noninterest Expense

Noninterest expense for the three months ended September 30, 2011, was \$52,798, an increase of \$4,603, or 9.6 percent, over the same period of 2010. The increase is primarily attributable to a \$3,269 increase in salaries and benefits, a \$315 increase in net losses on other property owned (OPO), a \$245 increase in

premiums to the Insurance Fund, a \$245 increase in travel expenses, a \$207 increase in occupancy and equipment, a \$95 increase in advertising and member relations, and a \$227 net increase in all other expenses, collectively. Salaries and benefits increased as the amount that was capitalized as a cost of loan originations decreased compared to 2010. As loan originations have decreased in 2011, the salaries and benefits capitalized as part of the cost of those loan originations have decreased. Additionally, district associations had a \$1,411 increase in salaries and related payroll taxes and a \$445 increase in other benefits. Offsetting these increases to salaries was a \$1,032 decrease in pension and retirement expenses. The increase in net losses on OPO resulted from a \$2,060 increase in net losses on dispositions of OPO and a \$126 increase in net expenses on OPO, offset by a \$1,872 decrease in provision for losses on OPO. The increase in net losses on OPO is largely attributable to declines in the value of underlying real estate collateral. The increase in premiums assessed by the Insurance Fund was due to a rate increase from 5 basis points in 2010 to 6 basis points in 2011.

Noninterest expense for the nine months ended September 30, 2011, was \$161,856, an increase of \$11,869, or 7.9 percent, over the same period of 2010. The increase is primarily attributable to a \$7,806 increase in salaries and benefits, a \$1,610 increase in net losses on OPO, a \$1,292 increase in occupancy and equipment expenses, and an \$848 increase in premiums to the Insurance Fund, offset by a \$313 decrease in other operating expenses. Salaries and benefits increased as the amount that was capitalized as a cost of loan originations decreased compared to 2010. As loan originations have decreased in 2011, the salaries and benefits capitalized as part of the cost of those loan originations have decreased. In addition, salaries capitalized as part of the development of the bank's lending systems decreased since the first phase was completed in July 2010. Furthermore, district associations had an increase in compensation and related payroll taxes of \$4,434 and a \$520 increase in other benefits. The bank had a \$2,276 decrease in compensation and related payroll taxes due to 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. Offsetting these increases to salaries was a \$2,980 decrease in pension and retirement expenses. The increase in net losses on OPO resulted from a \$1,661 increase in net losses on dispositions of OPO and a \$130 increase in net expenses on OPO, offset by a \$182 decrease in provision for losses on OPO. The increase in premiums assessed by the Insurance Fund was due to a rate increase from 5 basis points in 2010 to 6 basis points for 2011.

Key results of operations comparisons:

	Annualized for the Nine Months Ended 9/30/2011	Annualized for the Nine Months Ended 9/30/2010
Return on average assets	1.96%	1.46%
Return on average members' equity	12.32%	10.56%
Net interest income as a percentage of average earning assets	3.22%	3.03%
Charge-offs, net of recoveries, to average loans	0.53%	0.72%
Operating expenses as a percentage of net interest income and noninterest income	30.43%	29.25%
Operating expenses as a percentage of average earning assets	1.05%	0.98%

FINANCIAL CONDITION

Loan Portfolio

Gross loan volume at September 30, 2011, was \$15,266,152, a decrease of \$362,738, or 2.3 percent, from \$15,628,890 at December 31, 2010, and a decrease of \$401,780, or 2.6 percent, from \$15,667,932 at September 30, 2010. The reduction in the loan portfolio during the first nine months of 2011 was due to a \$399.6 million decrease in loans at district associations, offset by increases in the bank's participation loan portfolio. Loan volume at the district associations decreased due to scheduled repayments, enhanced credit standards on association retail loan portfolios and reduced loan demand as general economic conditions continue to result in a decline in demand for rural real estate.

Loans classified under the Farm Credit Administration's Uniform Loan Classification System as "acceptable" or "other assets especially mentioned" as a percentage of total loans and accrued interest receivable were 94.6 percent at September 30, 2011, 93.2 percent at December 31, 2010, and 93.2 percent at September 30, 2010. Nonaccrual loans for the district were 3.70 percent of total loans at September 30, 2011, compared to 4.37 percent at December 31, 2010, and 4.32 percent at September 30, 2010.

Total district high-risk asset volume decreased by \$94.1 million, or 12.2 percent, to \$678.5 million at September 30, 2011, from \$772.6 million at December 31, 2010.

Comparative balances of high-risk assets follow (in millions):

	September 30, 2011	Increase (Decrease)		December 31, 2010
		\$	%	
Nonaccrual loans	\$ 565.5	\$ (117.6)	(17.2) %	\$ 683.1
Formally restructured loans	33.4	24.4	271.1	9.0
Loans 90 days past due and still accruing interest	2.7	0.3	12.5	2.4
Total impaired loans	601.6	(92.9)	(13.4)	694.5
Other property owned, net	76.9	(1.2)	(1.5)	78.1
Total high-risk assets	\$ 678.5	\$ (94.1)	(12.2) %	\$ 772.6

The \$117.6 million decrease in nonaccrual loans from December 31, 2010, to September 30, 2011, is primarily the result of \$66.6 million in charge-offs, the restructuring of loans totaling \$24.4 million, repayments and movement to other property owned. The district had significant decreases in the dairy, land in transition and ethanol sectors. The \$24.4 million increase in formally restructured loans consisted primarily of loans to four borrowers in the ethanol, dairy and land in transition sectors which had been in nonaccrual status prior to the loans' restructuring. Compliance with terms of the new loan agreements has resulted in these loans moving to accrual status. District charge-offs, which totaled \$66.6 million in the first nine months of 2011, included charge-offs against loans to borrowers in the land in transition, livestock and ethanol sectors. At September 30, 2011, \$232.5 million, or 41.1 percent, of the district'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 September 30, 2011, the district had \$90.8 million in nonaccrual loans on which interest income is recognized upon cash receipts, compared to \$90.5 million at December 31, 2010. Impaired loans, consisting of nonaccrual loans, formally restructured loans, and loans past due 90 days or more and still accruing interest, constituted 3.87 percent of gross loans at September 30, 2011, and 4.44 percent of gross loans at December 31, 2010.

The \$138,798 allowance for loan losses at September 30, 2011, constituted 0.91 percent of total loans and was a decrease of \$24,347, or 14.9 percent from the allowance for loan losses at December 31, 2010. The decrease was primarily due to net charge-offs of \$61.5 million, which was greater than the \$38.1 million in provisions for loan losses. Additional information about the allowance for loan losses is included in Note 3, "Loans and Reserves for Credit Losses." The allowance for loan losses as a percentage of impaired loans was 23.1 percent as of September 30, 2011, as compared to 23.5 percent as of December 31, 2010. The nature of the security (primarily first lien real estate) supporting many of the impaired loans is considered in the determination of necessary allowances for loan losses. The district also had reserves for losses on unfunded commitments totaling \$1,439 at September 30, 2011, which was a general reserve for credit losses on letters of credit and unfunded commitments, representing management's estimate of probable credit losses related to letters of credit and unfunded commitments.

Liquidity and Funding Sources

Cash and available-for-sale investment securities totaled \$3,872,704, or 20.0 percent, of total assets at September 30, 2011, compared to \$3,705,322, or 18.9 percent, at December 31, 2010, an increase of \$167,382, or 4.5 percent. At September 30, 2011, the district's cash balance was \$536,227, an increase of \$82,905 from the balance at December 31, 2010. Cash held at the Federal Reserve Bank at September 30, 2011, totaled \$515,923, compared to \$412,056 at December 31, 2010. The bank manages levels of cash and other highly liquid assets to meet loan demand, debt servicing and other liquidity needs. At September 30, 2011, the bank had 234 days of liquidity to cover cash flows required for maturing debt obligations. Interest-bearing liabilities, consisting of bonds, notes and subordinated debt, decreased by \$332,749, or 2.1 percent.

Investments

The district's investments included an available-for-sale portfolio with a fair value of \$3.2 billion and a held-to-maturity portfolio recorded at an amortized cost of \$131.0 million at September 30, 2011. The available-for-sale investments included a liquidity portfolio and a portfolio of other investments. The district's available-for-sale liquidity portfolio consisted primarily of federal agency collateralized mortgage-backed securities, FDIC-guaranteed corporate debt, corporate debt, other collateralized mortgage-backed securities and asset-backed securities. The available-for-sale portfolio of other investments consisted of Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed agricultural mortgage-backed securities (AMBS) that had a fair value of \$124.4 million. The district's held-to-maturity portfolio consisted of Farmer Mac AMBS held by district associations which had an amortized cost of \$131,044 and a fair value of \$131,244.

The Farmer Mac AMBS are backed by loans originated by the associations and previously held by the associations under Farmer Mac's long-term standby commitments to purchase agreements. Farmer Mac is a government-sponsored enterprise (GSE) 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 district's available-for-sale liquidity portfolio consisted of FDIC-guaranteed corporate debt, corporate debt, mortgage-backed securities and asset-backed securities. The majority of the bank's mortgage-backed securities were federal agency collateralized mortgage-backed securities, including Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC) securities. The following table summarizes the bank's liquidity portfolio holdings (in thousands):

	<u>September 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	\$ 299,229	\$ 299,556	\$ 300,531	\$ 302,091
Corporate debt	58,307	57,760	-	-
Federal agency collateralized mortgage-backed securities:				
GNMA	1,743,764	1,776,722	1,650,736	1,672,578
FNMA and FHLMC	853,975	867,308	873,286	886,851
Other collateralized mortgage-backed securities	52,301	45,741	71,192	64,918
Asset-backed securities	16,273	14,908	11,493	10,005
Total available-for-sale investments	<u>\$ 3,023,849</u>	<u>\$ 3,061,995</u>	<u>\$ 2,907,238</u>	<u>\$ 2,936,443</u>

The district's available-for-sale other investments portfolio consisted of Farmer Mac AMBS securities as follows:

	<u>September 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	\$ 124,372	\$ 122,701	\$ 145,122	\$ 140,503

Federal agency collateralized mortgage-backed securities comprised 86.3 percent of the district's liquidity portfolio. 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.

At September 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 \$2,087 for the nine months ended September 30, 2011. 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. During the quarter ended June 30, 2011, the bank recognized OTTI credit losses totaling \$192 on five mortgage-backed investments and two asset-backed securities. The bank had recognized no OTTI credit losses during the third quarter of 2011 or 2010. The additional credit losses for the nine months ended September 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 nine months ended September 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 September 30, 2011, the bank held 11 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 \$50,634 and a fair value of \$43,860 at September 30, 2011.

The following table sets forth investments available-for-sale within the liquidity portfolio at fair value by credit rating:

	Eligible			Ineligible						Total
	AAA/Aaa	AA/Aa	Split Rated	AA/BBB		B3/CCC/				
				AA/Aa	Rated	BBB/Baa	BB/Ba	CC	CCC/Caa	
September 30, 2011										
FDIC-guaranteed corporate debt*	\$ 299,556	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 299,556
Corporate debt	14,918	42,842	-	-	-	-	-	-	-	57,760
Federal agency collateralized mortgage-backed securities*										
GNMA	1,776,722	-	-	-	-	-	-	-	-	1,776,722
FNMA and FHLMC	867,308	-	-	-	-	-	-	-	-	867,308
Other collateralized mortgage-backed securities	231	-	3,306	9,404	6,428	-	3,521	-	22,851	45,741
Asset-backed securities	10,873	-	2,379	-	-	-	-	-	1,656	14,908
Total	\$ 2,969,608	\$ 42,842	\$ 5,685	\$ 9,404	\$ 6,428	\$ -	\$ 3,521	\$ -	\$ 24,507	\$ 3,061,995

* In August 2011, while Moody's Investor Service and Fitch Ratings confirmed their highest ratings ("Aaa" and "AAA," respectively) of the U.S. government debt and that of government-sponsored enterprises, Standard & Poor's Rating Services lowered its long-term sovereign credit rating on the U.S. government from "AAA" to "AA+" and also lowered the long-term credit ratings of government-sponsored enterprises due to the potential reduction in the capacity of the U.S. government to support these securities and not as a result of credit concerns related to the underlying structure of the investment.

	Eligible			Ineligible						Total
	AAA/Aaa	AA/Aa	Split Rated	AA/BBB		B3/CCC/				
				AA/Aa	Rated	BBB/Baa	BB/Ba	CC	CCC/Caa	
December 31, 2010										
FDIC-guaranteed corporate debt	\$ 302,091	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 302,091
Federal agency collateralized mortgage-backed securities										
GNMA	1,672,578	-	-	-	-	-	-	-	-	1,672,578
FNMA and FHLMC	886,851	-	-	-	-	-	-	-	-	886,851
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 September 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 September 30, 2011, the bank and all district associations exceeded all regulatory liquidity requirements. Total members' equity increased \$218,668, or 7.4 percent, from December 31, 2010, to the September 30, 2011, total of \$3,185,029. This increase is the result of net income of \$286,417 for the nine months ended September 30, 2011, an \$11,889 increase in unrealized gains on investment securities, and amortization related to retirement benefits of \$5,778, offset by patronage of \$58,265 (including \$50,858 in revolvement of allocated equity), dividends on preferred stock totaling \$21,881, a \$3,700 unrealized net loss on cash flow hedge instruments, and net stock retirements at district associations of \$1,570. 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 improved as interest rates have decreased.

Key financial condition comparisons:

	September 30, 2011	December 31, 2010
Members' equity to assets	16.41%	15.17%
Total liabilities to members' equity	5.09:1	5.59:1
Allowance for loan losses to total loans	0.92%	1.04%

OTHER

EFFECTS OF DROUGHT CONDITIONS IN THE TEXAS DISTRICT

Severe drought conditions in the district which have persisted through the third quarter of 2011, particularly in Texas, New Mexico and eastern Louisiana, have had a dramatic impact on agriculture. 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. In New Mexico and West Texas, the drought was evident early enough for farmers to limit inputs, 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.

Since 2010, high feed costs, poor grazing conditions and strong cattle prices have resulted in a reduction of herd sizes. However, in 2011, the effects of extended severe drought conditions and wildfires on pasturage and water supply have intensified the sell-off of cattle inventories. High export demand, fueled by current exchange rate conditions, raised beef prices during 2011, allowing many district producers to sell herds and capture profit rather than face increasing costs of holding cattle. Many of these producers will not restock until pasture conditions and water availability improve. Although a significant portion of

the district's livestock exposure is supported by other sources of repayment, loan volume is expected to decrease under existing conditions.

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 non-cumulative 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 processed using 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. Moody's has affirmed their short-term credit rating for the System.

Fitch Ratings Actions

On August 16, 2011, Fitch Ratings 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.

On September 13, 2011, Fitch Ratings affirmed the bank's long- and short-term IDRs at "AA-" and "F1+", respectively. The rating outlook is stable and reflects Fitch's view of the bank's ability to manage through the current and anticipated stress resulting from weather-related issues or weakness in any specific agricultural sector. Further, the stable outlook considers the bank's ability to meet its mission of providing for the funding and liquidity needs of its agricultural district given a short-term disruption in its access to funding.

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. The downgrade of the senior debt issued by the System was due to the System having a very high likelihood of receiving support from the government, if needed. S&P does not issue ratings on the Farm Credit Bank of Texas.

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 September 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 September 30, 2011, quarterly report of the Farm Credit Bank of Texas and district associations, 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

November 9, 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 chief financial officer 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. This evaluation relies upon the evaluations made by the individual associations and the related certifications they provide to the bank.

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

November 9, 2011

Combined Balance Sheets

(dollars in thousands)	September 30, 2011 (Unaudited)	December 31, 2010
Assets		
Cash	\$ 536,227	\$ 453,322
Federal funds sold	20,737	20,438
Investment securities	3,315,740	3,231,562
Loans	15,266,152	15,628,890
Less allowance for loan losses	138,798	163,145
Net loans	<u>15,127,354</u>	<u>15,465,745</u>
Accrued interest receivable	172,799	154,023
Other property owned, net	76,868	78,124
Premises and equipment, net	62,906	62,539
Other assets	<u>94,593</u>	<u>89,831</u>
Total assets	<u><u>\$ 19,407,224</u></u>	<u><u>\$ 19,555,584</u></u>
Liabilities and members' equity		
Liabilities		
Bonds and notes, net	\$ 15,847,183	\$ 16,179,932
Subordinated debt	50,000	50,000
Accrued interest payable	39,047	45,881
Patronage distributions payable	54,623	66,011
Preferred stock dividends payable	21,881	21,881
Other liabilities	<u>209,491</u>	<u>225,548</u>
Total liabilities	<u>16,222,225</u>	<u>16,589,253</u>
Commitments and contingent liabilities (Note 4)		
Members' equity		
Preferred stock, net	482,000	482,000
Capital stock and participation certificates	60,515	61,843
Allocated retained earnings	276,577	327,435
Unallocated retained earnings	2,378,467	2,121,822
Additional paid-in-capital	22,864	22,622
Accumulated other comprehensive loss	<u>(35,424)</u>	<u>(49,391)</u>
Total members' equity	<u>3,184,999</u>	<u>2,966,331</u>
Total liabilities and members' equity	<u><u>\$ 19,407,224</u></u>	<u><u>\$ 19,555,584</u></u>

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

Combined Statements of Income

(unaudited)

(dollars in thousands)	Quarter Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Interest Income				
Investment securities	\$ 15,126	\$ 19,275	\$ 49,026	\$ 58,048
Loans	189,885	199,482	573,468	607,508
Total interest income	205,011	218,757	622,494	665,556
Interest Expense				
Bonds and notes	50,758	68,411	150,730	218,455
Notes payable and other	5,987	5,996	18,550	22,368
Total interest expense	56,745	74,407	169,280	240,823
Net interest income	148,266	144,350	453,214	424,733
Provision for loan losses	12,837	60,781	38,110	109,249
Net interest income after provision for loan losses	135,429	83,569	415,104	315,484
Noninterest Income				
Patronage income	3,825	3,883	13,222	12,890
Loan-related fees	8,980	9,765	20,195	17,895
Gain from sale of investment securities	-	-	-	529
Miscellaneous income, net	803	704	1,978	16,893
Impairment losses on investments				
Total other-than-temporary impairment losses	(447)	(2,133)	(1,557)	(2,901)
Less: portion of (gain) loss recognized in other comprehensive income	(447)	(2,133)	530	(1,085)
Net impairment loss recognized in earnings	-	-	(2,087)	(1,816)
Total noninterest income	13,608	14,352	33,308	46,391
Noninterest Expense				
Salaries and employee benefits	29,030	25,761	88,117	80,311
Occupancy and equipment	3,972	3,765	12,150	10,858
Insurance Fund premiums	2,209	1,964	6,691	5,843
Losses on other property owned, net	4,060	3,745	13,802	12,192
Other operating expenses	13,527	12,960	41,096	40,783
Total noninterest expense	52,798	48,195	161,856	149,987
Income before provision for income taxes	96,239	49,726	286,556	211,888
Provision for (benefit from) income taxes	334	455	139	(227)
Net Income	\$ 95,905	\$ 49,271	\$ 286,417	\$ 212,115

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

Combined Statements of Changes in Members' Equity

(unaudited)

(dollars in thousands)	Preferred Stock	Capital Stock	Allocated Retained Earnings	Unallocated Retained Earnings	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
Balance at December 31, 2009	\$ 202,754	\$ 63,202	\$ 266,991	\$ 2,061,299	\$ -	\$ (76,842)	\$ 2,517,404
Comprehensive income							
Net income	-	-	-	212,115	-	-	212,115
Change in pension and postretirement benefit plans	-	-	-	-	-	6,532	6,532
Net change in unrealized net gains on investment securities	-	-	-	-	-	27,491	27,491
Noncredit portion of current other-than-temporary impairment losses	-	-	-	-	-	(1,085)	(1,085)
Net change in unrealized net losses on cash flow derivatives	-	-	-	-	-	(3,273)	(3,273)
Total comprehensive income	-	-	-	212,115	-	29,665	241,780
Capital stock/participation certificates issued	-	5,383	-	-	-	-	5,383
Capital stock/participation certificates and allocated retained earnings retired	-	(6,200)	(30)	-	-	-	(6,230)
Preferred stock issued	300,000	-	-	-	-	-	300,000
Issuance on costs on preferred stock	-	-	-	(3,365)	-	-	(3,365)
Preferred stock retired	(3,000)	-	-	-	-	-	(3,000)
Discount on retirement of preferred stock	-	-	-	121	-	-	121
Impact of association merger:							
Equity issued upon association merger	-	479	2,332	-	10,166	-	12,977
Equity retired upon association merger	-	(479)	(2,332)	(9,728)	-	-	(12,539)
Preferred stock dividends accrued	-	-	-	(16,247)	-	-	(16,247)
Preferred stock dividends paid	-	-	-	(7,611)	-	-	(7,611)
Patronage distributions							
Cash	-	-	-	(20,729)	-	-	(20,729)
Members' equity	-	-	(14,038)	14,038	-	-	-
Balance at September 30, 2010	\$ 499,754	\$ 62,385	\$ 252,923	\$ 2,229,893	\$ 10,166	\$ (47,177)	\$ 3,007,944
Balance at December 31, 2010	\$ 482,000	\$ 61,843	\$ 327,435	\$ 2,121,822	\$ 22,622	\$ (49,391)	\$ 2,966,331
Comprehensive income							
Net income	-	-	-	286,417	-	-	286,417
Change in pension and postretirement benefit plans	-	-	-	-	-	5,778	5,778
Net change in unrealized net gains on investment securities	-	-	-	-	-	11,359	11,359
Noncredit portion of current other-than-temporary impairment losses	-	-	-	-	-	530	530
Net change in unrealized net losses on cash flow derivatives	-	-	-	-	-	(3,700)	(3,700)
Total comprehensive income	-	-	-	286,417	-	13,967	300,384
Capital stock/participation certificates issued	-	5,191	-	-	-	-	5,191
Capital stock/participation certificates and allocated retained earnings retired	-	(6,519)	-	(696)	-	-	(7,215)
Equity related to association merger	-	-	-	(242)	242	-	-
Preferred stock dividends accrued	-	-	-	(21,881)	-	-	(21,881)
Patronage distributions							
Cash	-	-	-	(8,270)	-	-	(8,270)
Members' equity	-	-	(50,858)	1,317	-	-	(49,541)
Balance at September 30, 2011	\$ 482,000	\$ 60,515	\$ 276,577	\$ 2,378,467	\$ 22,864	\$ (35,424)	\$ 3,184,999

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

Combined Statements of Cash Flows

(unaudited)

(dollars in thousands)	Nine Months Ended September 30,	
	2011	2010
Operating activities		
Net income	\$ 286,417	\$ 212,115
Reconciliation of net income to net cash provided by operating activities		
Provision for loan losses	38,110	109,249
Provision for losses on other property owned	11,479	11,660
Depreciation and amortization on premises and equipment	4,961	4,566
Accretion of net discount on loans	(3,573)	(389)
Amortization and accretion on debt instruments	(3,301)	(3,773)
Amortization of net premium (discount) on investment securities	6,607	(6,172)
(Gain) Losses on sale of investment securities	-	(529)
Gains from sales of other property owned, net	(478)	(1,183)
Losses on impairment of investments available-for-sale	2,087	1,816
Gains from sales of premises and equipment	(2,912)	(5,134)
Allocated equity patronage from System bank	(12,247)	(12,487)
Increase in accrued interest receivable	(18,776)	(18,070)
Decrease in other assets	2,754	23,718
Decrease in accrued interest payable	(6,834)	(23,698)
Decrease in other liabilities	(28,636)	(22,602)
Net cash provided by operating activities	<u>275,658</u>	<u>269,087</u>
Investing activities		
Net increase in federal funds sold	(299)	(2,199)
Investment securities		
Purchases	(655,435)	(1,818,522)
Proceeds from maturities, calls and prepayments	574,452	749,191
Proceeds from sales	-	54,095
Redemption of investment in Farmer Mac preferred stock	-	7,000
Decrease in loans, net	238,563	380,591
Expenditures from purchase of loans	-	(32,822)
Proceeds from sales of other property owned, net	55,546	28,772
Proceeds from sales of premises and equipment	2,698	2,497
Expenditures for premises and equipment	(5,114)	(8,169)
Net cash provided by (used in) investing activities	<u>210,411</u>	<u>(639,566)</u>
Financing activities		
Bonds and notes issued	11,526,030	16,276,209
Bonds and notes retired	(11,854,452)	(16,239,506)
Increase (decrease) in advanced conditional payments	18,362	(6,372)
Bank Class B preferred stock issued	-	300,000
Issuance costs on preferred stock	-	(3,365)
Bank Class A preferred stock redeemed	-	(3,000)
Discount on redemption of Class A preferred stock	-	121
Capital stock and participation certificates issued	5,191	6,066
Capital stock and participation certificates retired	(7,215)	(6,475)
Cash dividends on preferred stock	(21,881)	(7,611)
Cash patronage distributions paid	(69,199)	(45,395)
Net cash (used in) provided by financing activities	<u>(403,164)</u>	<u>270,672</u>
Net increase (decrease) in cash	82,905	(99,807)
Cash at beginning of year	453,322	500,967
Cash at end of quarter	<u>\$ 536,227</u>	<u>\$ 401,160</u>
Supplemental schedule of noncash investing and financing activities		
Financed sales of other property owned	\$ 15,498	\$ 5,936
Loan assets transferred to other property owned	49,793	59,132
Net increase in unrealized gains on investment securities	11,889	26,407
Cash dividends or patronage distributions payable	54,623	18,308
Supplemental schedule of noncash changes in fair value related to hedging activities		
(Decrease) increase in bonds and notes	\$ (1,026)	\$ 1,427
Supplemental information		
Cash paid for:		
Interest	\$ 176,114	\$ 264,521
Income taxes	275	227

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

Notes to Combined Financial Statements

Unaudited (dollar amounts in thousands unless otherwise noted)

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

The accompanying combined financial statements (financial statements) include the accounts of the Farm Credit Bank of Texas (bank) and the accounts of its affiliated Agricultural Credit Associations (ACAs) and Federal Land Credit Association (FLCA) in the Farm Credit System (System). The ACAs and FLCA are collectively referred to as associations, and the bank and its affiliated associations are collectively referred to as the district. The financial statements also reflect the investments in and allocated earnings of the service organizations in which the bank has a partial ownership interest. All significant transactions and balances between the bank and the associations have been eliminated in combination.

The significant accounting policies followed and the financial condition and results of operations of the combined bank and associations as of and for the year ended December 31, 2010, are contained in the 2010 Annual Report to stockholders (Annual Report). These unaudited third quarter 2011 financial statements should be read in conjunction with the Annual Report.

In September 2011, the Financial Accounting Standards Board (FASB) issued guidance entitled, “Compensation – Retirement Benefits – Multiemployer Plans.” The guidance is intended to provide more information about an employer’s financial obligations to a multiemployer pension plan, which should help financial statement users better understand the financial health of significant plans in which the employer participates. The additional disclosures include: a) a description of the nature of plan benefits, b) a qualitative description of the extent to which the employer could be responsible for the obligations of the plan, including benefits earned by employees during employment with another employer, and c) other quantitative information to help users understand the financial information about the plan. The amendments are effective for annual periods for fiscal years ending after December 15, 2011. The amendments should be applied retrospectively for all prior periods presented.

In June 2011, the 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 and 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 district, 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.

NOTE 2 — INVESTMENTS

Investments Available for Sale

The district’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, mortgage-backed investments and asset-backed investments. The majority of the liquidity portfolio’s mortgage-backed securities were federal agency collateralized mortgage-backed securities, including Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA), and Federal Home Loan Mortgage Corporation (FHLMC) securities. 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 September 30, 2011, and December 31, 2010, is as follows:

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
FDIC-guaranteed corporate debt	\$ 299,229	\$ 355	\$ (28)	\$ 299,556	0.88 %
Corporate debt	58,307	-	(547)	57,760	1.12
Federal agency collateralized mortgage-backed securities					
GNMA	1,743,764	33,146	(188)	1,776,722	1.79
FNMA and FHLMC	853,975	13,826	(493)	867,308	1.83
Other collateralized mortgage-backed securities	52,301	-	(6,560)	45,741	6.02
Asset-backed securities	16,273	5	(1,370)	14,908	1.72
Total available-for-sale investments	\$ 3,023,849	\$ 47,332	\$ (9,186)	\$ 3,061,995	1.78 %

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	\$ 124,372	\$ -	\$ (1,671)	\$ 122,701	4.93 %

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					
GNMA	1,650,736	22,543	(701)	1,672,578	1.88
FNMA and FHLMC	873,286	13,910	(345)	886,851	2.20
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 available-for-sale investments	\$ 2,907,238	\$ 38,246	\$ (9,041)	\$ 2,936,443	1.97 %

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 tables summarize the contractual maturity, fair value, amortized cost and weighted average yield of available-for-sale investments at September 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	\$ 299,556	\$ -	\$ -	\$ -	\$ 299,556
Corporate debt	-	57,760	-	-	57,760
Federal agency collateralized mortgage-backed securities					
GNMA	-	-	3,869	1,772,853	1,776,722
FNMA and FHLMC	-	24,688	207,166	635,454	867,308
Other collateralized mortgage-backed securities	-	-	360	45,381	45,741
Asset-backed securities	-	1,158	-	13,750	14,908
Total fair value	\$ 299,556	\$ 83,606	\$ 211,395	\$ 2,467,438	\$ 3,061,995
Total amortized cost	\$ 299,228	\$ 83,468	\$ 207,112	\$ 2,434,041	\$ 3,023,849
Weighted average yield	0.88%	2.15%	2.24%	1.84%	1.78%

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

	<u>Due after one year through five years</u>
Fair value of agricultural mortgage-backed securities	\$ 122,701
Total amortized cost	\$ 124,372
Weighted average yield	4.93%

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 September 30, 2011. The continuous loss position is based on the date the impairment was first identified:

	Less Than		Greater Than		Total	
	12 Months		12 Months			
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
FDIC-guaranteed corporate debt	\$ 119,246	\$ (177)	\$ -	\$ -	\$ 119,246	\$ (177)
Corporate debt	36,017	(398)	-	-	36,017	(398)
Federal agency collateralized mortgage-backed securities						
GNMA	220,964	(136)	189,634	(51)	410,598	(187)
FNMA and FHLMC	238,373	(493)	-	-	238,373	(493)
Other collateralized mortgage-backed securities	10,344	(883)	35,397	(5,678)	45,741	(6,561)
Asset-backed securities	-	-	4,035	(1,370)	4,035	(1,370)
Total	\$ 624,944	\$ (2,087)	\$ 229,066	\$ (7,099)	\$ 854,010	\$ (9,186)

The district 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 no other-than-temporary impairment credit losses during the quarter ended September 30, 2011. For the nine months ended September 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 nine months ended September 30, 2011, totaling \$977, is included as a credit to other comprehensive income. At September 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 nine 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 September 30, 2011, ranged from 5.7 percent to 12.4 percent for non-agency mortgage-backed securities and ranged from 8.4 percent to 13.9 percent for the asset-backed securities. Prepayment rate assumptions are based on historical prepayment rates and ranged from 3.4 percent to 13.7 percent for non-agency mortgage-backed securities and ranged from 1.3 percent to 2.4

percent for the asset-backed securities at September 30, 2011. At September 30, 2011, the loss severity assumptions ranged from 37.7 percent to 56.5 percent for non-agency mortgage-backed securities and ranged from 61.2 percent to 68.4 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 period:

	For the Three Months		For the Nine Months	
	Ended September 30,		Ended September 30,	
	2011	2010	2011	2010
Credit loss component, beginning of period	\$ 9,921	\$ 7,821	\$ 7,834	\$ 6,005
Additions:				
Initial credit impairment	-	-	241	300
Subsequent credit impairment	-	-	1,846	1,516
Reductions:				
For securities sold	-	-	-	-
For increases in expected cash flows	-	-	-	-
Credit loss component, end of period	<u>\$ 9,921</u>	<u>\$ 7,821</u>	<u>\$ 9,921</u>	<u>\$ 7,821</u>

Held-to-Maturity Investments

The district's held-to-maturity investments consisted of Farmer Mac guaranteed agricultural mortgage-backed securities. A summary of the amortized cost and fair value of held-to-maturity investment securities at September 30, 2011, is as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	\$ 131,044	\$ 1,205	\$ (1,005)	\$ 131,244	5.03 %

During 2010, the Farmer Mac guaranteed AMBS were received in exchange for mortgage loans which were previously covered under the long-term standby commitment to purchase agreements with Farmer Mac. No gain or loss was recognized in the financial statements upon completion of the exchange transactions. The associations continue to service the loans included in these transactions. These investments in guaranteed securities are included in Investments in this report's Combined Balance Sheet.

NOTE 3 — LOANS AND RESERVES FOR CREDIT LOSSES

A summary of loans follows:

	September 30,	December 31,
	2011	2010
Real estate mortgage	\$ 10,257,969	\$ 10,487,949
Production and intermediate term	1,647,203	1,792,513
Loans to cooperatives	165,516	274,621
Processing and marketing	1,417,427	1,346,887
Farm-related business	121,884	172,501
Communication	267,840	264,634
Energy (utilities)	888,760	881,227
Water and waste disposal	103,637	50,261
Rural residential real estate	201,883	209,708
International	233	245
Lease receivables	13,822	8,511
Loans to other financing institutions	73,737	75,737
Mission related	106,241	64,096
	<u>\$ 15,266,152</u>	<u>\$ 15,628,890</u>

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 September 30, 2011.

	Other Farm Credit Institutions					
	(Outside of the Texas District)		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	\$ 69,560	\$ 86,181	\$ 210,014	\$ 21,619	\$ 279,574	\$ 107,800
Production and intermediate term	180,404	177,555	38,937	1,235	219,341	178,790
Agribusiness	768,696	5,967	214,370	-	983,066	5,967
Communication	265,942	-	-	-	265,942	-
Energy	880,514	3,567	9,400	-	889,914	3,567
Water and waste disposal	102,826	-	-	-	102,826	-
Rural residential real estate	1,758	-	-	-	1,758	-
Lease receivables	5,592	-	265	-	5,857	-
Total	<u>\$ 2,275,292</u>	<u>\$ 273,270</u>	<u>\$ 472,986</u>	<u>\$ 22,854</u>	<u>\$ 2,748,278</u>	<u>\$ 296,124</u>

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

	September 30, 2011	December 31, 2010
Nonaccrual loans:		
Real estate mortgage	\$ 391,724	\$ 440,836
Production and intermediate term	77,867	102,027
Agribusiness	76,929	129,220
Communication	5,198	6,129
Rural residential real estate	1,506	2,019
Energy and water/waste disposal	9,400	-
Lease receivables	2,874	2,836
Total nonaccrual loans	\$ 565,498	\$ 683,067
Accruing restructured loans:		
Real estate mortgage	\$ 20,442	\$ 1,491
Production and intermediate term	4,362	2,510
Agribusiness	8,579	4,982
Rural residential real estate	40	-
Total accruing restructured loans	\$ 33,423	\$ 8,983
Accruing loans 90 days or more past due:		
Real estate mortgage	\$ 2,656	\$ 2,198
Production and intermediate term	6	93
Rural residential real estate	-	105
Total accruing loans 90 days or more past due	\$ 2,662	\$ 2,396
Total nonperforming loans	601,583	694,446
Other property owned	76,868	78,124
Total nonperforming assets	\$ 678,451	\$ 772,570

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:

	September 30, 2011	December 31, 2010
Real estate mortgage:		
Acceptable	90.5 %	89.2 %
OAEM	4.1	4.3
Substandard/Doubtful	5.4	6.5
	100.0 %	100.0 %
Production and intermediate term:		
Acceptable	87.6 %	83.0 %
OAEM	6.0	8.1
Substandard/Doubtful	6.4	8.9
	100.0 %	100.0 %
Agribusiness:		
Acceptable	83.8 %	76.4 %
OAEM	8.6	12.7
Substandard/Doubtful	7.6	10.9
	100.0 %	100.0 %
Energy and water/waste disposal:		
Acceptable	96.7 %	99.0 %
OAEM	2.4	-
Substandard/Doubtful	0.9	1.0
	100.0 %	100.0 %
Communication:		
Acceptable	98.1 %	97.7 %
OAEM	-	-
Substandard/Doubtful	1.9	2.3
	100.0 %	100.0 %
Rural residential real estate:		
Acceptable	95.3 %	95.2 %
OAEM	2.4	2.7
Substandard/Doubtful	2.3	2.1
	100.0 %	100.0 %
International:		
Acceptable	100.0 %	100.0 %
OAEM	-	-
Substandard/Doubtful	-	-
	100.0 %	100.0 %
Lease receivables:		
Acceptable	78.8 %	63.5 %
OAEM	-	2.6
Substandard/Doubtful	21.2	33.9
	100.0 %	100.0 %
Loans to other financing institutions:		
Acceptable	100.0 %	100.0 %
OAEM	-	-
Substandard/Doubtful	-	-
	100.0 %	100.0 %
Mission related:		
Acceptable	93.6 %	89.5 %
OAEM	0.5	0.6
Substandard/Doubtful	5.9	9.9
	100.0 %	100.0 %
Total loans:		
Acceptable	90.1 %	87.9 %
OAEM	4.5	5.3
Substandard/Doubtful	5.4	6.8
	100.0 %	100.0 %

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

	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans	Recorded Investment > 90 Days and Accruing
Real estate mortgage	\$ 93,294	\$ 222,355	\$ 315,649	\$ 10,071,877	\$ 10,387,526	\$ 2,656
Production and intermediate term	16,296	33,397	49,693	1,616,993	1,666,686	6
Agribusiness	1,112	35,561	36,673	1,674,233	1,710,906	-
Communication	-	-	-	268,415	268,415	-
Energy and water/waste disposal	-	9,400	9,400	988,753	998,153	-
Rural residential real estate	2,166	153	2,319	199,110	201,429	-
International	-	-	-	233	233	-
Lease receivables	-	2,810	2,810	11,126	13,936	-
Loans to other financing institutions	-	-	-	73,826	73,826	-
Mission related	-	-	-	107,600	107,600	-
Total	\$ 112,868	\$ 303,676	\$ 416,544	\$ 15,012,166	\$ 15,428,710	\$ 2,662

Additional impaired loan information is as follows:

	At September 30, 2011			For the Three Months Ended September 30, 2011		For the Nine Months Ended September 30, 2011	
	Recorded Investment	Unpaid		Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized
		Principal Balance	Related Allowance				
Impaired loans with a related allowance for credit losses:							
Real estate mortgage	\$ 161,569	\$ 205,802	\$ 36,196	\$ 170,514	\$ 97	\$ 165,241	\$ 502
Production and intermediate term	29,942	39,530	19,681	31,769	7	30,621	80
Processing and marketing	38,765	39,322	8,127	39,841	-	42,477	22
Farm-related business	7,857	8,137	3,210	7,869	29	8,001	87
Communication	3,962	3,962	2,982	4,140	-	4,198	-
Rural residential real estate	692	713	188	703	-	556	4
Total	\$ 242,787	\$ 297,466	\$ 70,384	\$ 254,836	\$ 133	\$ 251,094	\$ 695
Impaired loans with no related allowance for credit losses:							
Real estate mortgage	\$ 253,253	\$ 265,462	\$ -	\$ 306,666	\$ 2,931	\$ 350,738	\$ 6,767
Production and intermediate term	52,293	78,533	-	53,375	279	54,645	757
Loans to cooperatives	-	-	-	-	-	127	9
Processing and marketing	24,424	52,610	-	28,710	101	29,898	322
Farm-related business	14,462	19,592	-	14,345	14	15,043	142
Communication	1,236	1,236	-	1,090	-	1,574	-
Energy and water/waste disposal	9,400	23,153	-	9,400	-	8,173	4
Rural residential real estate	854	990	-	772	3	838	10
Lease receivables	2,874	2,874	-	2,862	-	2,827	-
Total	\$ 358,796	\$ 444,450	\$ -	\$ 417,220	\$ 3,328	\$ 463,863	\$ 8,011
Total impaired loans:							
Real estate mortgage	\$ 414,822	\$ 471,264	\$ 36,196	\$ 477,180	\$ 3,028	\$ 515,979	\$ 7,269
Production and intermediate term	82,235	118,063	19,681	85,144	286	85,266	837
Loans to cooperatives	-	-	-	-	-	127	9
Processing and marketing	63,189	91,932	8,127	68,551	101	72,375	344
Farm-related business	22,319	27,729	3,210	22,214	43	23,044	229
Communication	5,198	5,198	2,982	5,230	-	5,772	-
Energy and water/waste disposal	9,400	23,153	-	9,400	-	8,173	4
Rural residential real estate	1,546	1,703	188	1,475	3	1,394	14
Lease receivables	2,874	2,874	-	2,862	-	2,827	-
Total	\$ 601,583	\$ 741,916	\$ 70,384	\$ 672,056	\$ 3,461	\$ 714,957	\$ 8,706

	At December 31, 2010			For the Twelve Months Ended December 31, 2010	
	Recorded Investment	Unpaid		Average Impaired Loans	Interest Income Recognized
		Principal Balance	Related Allowance		
Impaired loans with a related allowance for credit losses:					
Real estate mortgage	\$ 170,333	\$ 209,522	\$ 48,136	\$ 151,736	\$ 1,597
Production and intermediate term	45,839	57,932	24,336	45,242	492
Processing and marketing	52,836	60,998	12,205	37,319	381
Farm-related business	23,882	24,947	10,081	17,499	172
Communication	4,596	2,953	3,236	3,501	22
Energy and water/waste disposal	-	-	-	5	-
Rural residential real estate	617	659	121	698	9
Lease receivables	21	24	10	501	6
Total	\$ 298,124	\$ 357,035	\$ 98,125	\$ 256,501	\$ 2,679
Impaired loans with no related allowance for credit losses:					
Real estate mortgage	\$ 274,192	\$ 294,903	\$ -	\$ 244,233	\$ 3,322
Production and intermediate term	58,791	87,771	-	62,293	723
Processing and marketing	34,776	59,385	-	49,471	551
Farm-related business	22,709	37,861	-	22,673	246
Communication	1,533	3,280	-	3,528	25
Energy and water/waste disposal	-	14,131	-	7	-
Rural residential real estate	1,507	1,732	-	1,067	14
Lease receivables	2,814	2,807	-	767	10
Total	\$ 396,322	\$ 501,870	\$ -	\$ 384,039	\$ 4,891
Total impaired loans:					
Real estate mortgage	\$ 444,525	\$ 504,425	\$ 48,136	\$ 395,969	\$ 4,919
Production and intermediate term	104,630	145,703	24,336	107,535	1,215
Processing and marketing	87,612	120,383	12,205	86,790	932
Farm-related business	46,591	62,808	10,081	40,172	418
Communication	6,129	6,233	3,236	7,029	47
Energy and water/waste disposal	-	14,131	-	12	-
Rural residential real estate	2,124	2,391	121	1,765	23
Lease receivables	2,835	2,831	10	1,268	16
Total	\$ 694,446	\$ 858,905	\$ 98,125	\$ 640,540	\$ 7,570

At September 30, 2011, impaired loans of \$242.8 million had a related specific allowance of \$70.4 million, while the remaining \$358.8 million of impaired loans had no related specific allowance as a result of adequate collateralization. District charge-offs in the first nine months of 2011 were predominantly made against loans to borrowers in the land in transition, ethanol and livestock sectors.

The average recorded investment in impaired loans for the three months ended September 30, 2011, was \$672.1 million. The district recognized interest income of \$3.5 million on impaired loans during the three months ended September 30, 2011.

The average recorded investment in impaired loans for the nine months ended September 30, 2011, was \$715.0 million. The district recognized interest income of \$8.7 million on impaired loans during the nine months ended September 30, 2011.

The district's impaired loans included loans with evidence of credit deterioration which the bank acquired in March 2010. The loans are recorded at the present value of expected future cash flows. These loans had a balance of \$19,768 and \$21,911 at September 30, 2011, and December 31, 2010, respectively, net of the unaccrued discount of \$781 and \$1,814, at September 30, 2011, and December 31, 2010, respectively. During the nine months ended September 30, 2011, the bank recorded provisions for loan losses related to these loans totaling \$2,069. The allowance for loan losses related to these loans was \$3,116 and \$1,866 at September 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 Waste/Water Disposal	Rural Residential Real Estate	International	Lease Receivables	Loans to OFIs	Mission Related	Total
Allowance for Credit Losses:											
Balance at December 31, 2010	\$ 96,132	\$ 31,290	\$ 28,656	\$ 3,925	\$ 2,101	\$ 995	\$ 1	\$ 45	\$ -	\$ -	\$ 163,145
Charge-offs	(36,070)	(7,272)	(19,765)	-	(3,319)	(134)	-	-	-	-	(66,560)
Recoveries	700	1,255	2,635	-	429	31	-	-	-	-	5,050
Provision for loan losses	14,510	6,450	14,936	(264)	2,628	(143)	(1)	(6)	-	-	38,110
Other	(802)	(36)	(99)	(1)	(9)	-	-	-	-	-	(947)
Balance at September 30, 2011	\$ 74,470	\$ 31,687	\$ 26,363	\$ 3,660	\$ 1,830	\$ 749	\$ -	\$ 39	\$ -	\$ -	\$ 138,798
Ending Balance: individually evaluated for impairment	\$ 36,621	\$ 19,627	\$ 12,969	\$ 2,990	\$ -	\$ 208	\$ -	\$ -	\$ -	\$ -	\$ 72,415
Ending Balance: collectively evaluated for impairment	\$ 34,994	\$ 11,799	\$ 13,394	\$ 670	\$ 1,830	\$ 541	\$ -	\$ 39	\$ -	\$ -	\$ 63,267
Ending Balance: loans acquired with deteriorated credit quality	\$ 2,855	\$ 261	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 3,116
Recorded Investments in Loans Outstanding:											
Balance at September 30, 2011	\$10,387,526	\$ 1,666,686	\$ 1,710,906	\$ 268,415	\$ 998,153	\$ 201,429	\$ 233	\$ 13,936	\$73,826	\$107,600	\$15,428,710
Ending Balance for loans individually evaluated for impairment	\$ 407,687	\$ 74,089	\$ 88,004	\$ 7,445	\$ 9,400	\$ 1,681	\$ -	\$ 2,874	\$ -	\$ -	\$ 591,180
Ending Balance for loans collectively evaluated for impairment	\$ 9,961,772	\$ 1,582,274	\$ 1,622,902	\$ 260,970	\$ 988,753	\$ 199,748	\$ 233	\$ 11,062	\$73,826	\$107,600	\$14,809,140
Ending Balance for loans acquired with deteriorated credit quality	\$ 18,067	\$ 10,323	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 28,390

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 September 30, 2011, were approximately \$183.4 billion.

Other actions are pending against district associations in which claims for monetary damages are asserted. Upon the basis of current information, management and legal counsel are of the opinion that the ultimate liability, if any, resulting from a lawsuit and other pending actions against the bank or district associations will not be material in relation to the financial position, results of operations or cash flows of the district.

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 September 30, 2011, for each of the fair value hierarchy levels are summarized below:

	Fair Value Measurements at September 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	\$ 20,737	\$ -	\$ 20,737	\$ -
Investments available for sale	3,184,696	-	2,899,760	284,936
Derivative assets	1,762	-	1,762	-
Assets held in nonqualified benefit trusts	2,789	2,789	-	-
Total	\$ 3,209,984	\$ 2,789	\$ 2,922,259	\$ 284,936
Liabilities:				
Standby letters of credit	\$ 2,843	\$ -	\$ 2,843	\$ -
	\$ 2,843	\$ -	\$ 2,843	\$ -

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 September 30, 2011:

	<u>Corporate Debt</u>	<u>Mortgage- Backed Securities</u>	<u>Asset- Backed Securities</u>	<u>Total</u>
Available-for-sale investment securities:				
Balance at January 1, 2011	\$ -	\$ 240,888	\$ 6,760	\$ 247,648
Net gains (losses) included in other comprehensive income	(547)	2,438	119	2,010
Net losses included in earnings	-	(1,934)	(153)	(2,087)
Purchases, issuances and settlements	58,307	67,783	(2,691)	123,399
Transfers out of Level 3	-	(86,034)	-	(86,034)
Balance at September 30, 2011	<u>\$ 57,760</u>	<u>\$ 223,141</u>	<u>\$ 4,035</u>	<u>\$ 284,936</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 September 30, 2011	<u>\$ -</u>	<u>\$ 1,934</u>	<u>\$ 153</u>	<u>\$ 2,087</u>

There were no transfers of assets or liabilities into or out of Level 1 from other levels during the nine months ended September 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. In addition, two agency mortgage-backed securities purchased in 2011 and originally valued using independent third-party valuations using Level 3 criteria, totaling \$50,566, were subsequently valued using independent third-party valuation services using Level 2 criteria and transferred to Level 2.

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

	Fair Value Measurements at September 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	\$ 544,040	\$ -	\$ -	\$ 544,040	\$ (66,560)
Other property owned	83,745	-	-	83,745	(13,802)
Total assets	\$ 627,785	\$ -	\$ -	\$ 627,785	\$ (80,362)

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	\$ 20,439	\$ -	\$ 20,439	\$ -
Investments available for sale	3,076,946	-	2,829,298	247,648
Derivative assets	6,512	-	6,512	-
Assets held in nonqualified benefit trusts	2,247	2,247	-	-
Total	\$ 3,106,144	\$ 2,247	\$ 2,856,249	\$ 247,648
Liabilities:				
Derivative liabilities	\$ 5	\$ -	\$ 5	\$ -
Standby letters of credit	2,843	-	2,843	-
	\$ 2,848	\$ -	\$ 2,848	\$ -

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 September 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	-	1,201	-	1,201
Net losses included in earnings	-	-	-	-
Purchases, issuances and settlements	-	150,404	-	150,404
Transfers out of Level 3	-	-	-	-
Balance at September 30, 2010	<u>\$ -</u>	<u>\$ 151,605</u>	<u>\$ -</u>	<u>\$ 151,605</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 September 30, 2010

<u>\$ -</u>	<u>\$ 1,424</u>	<u>\$ 392</u>	<u>\$ 1,816</u>
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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 Measurements 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	\$ 199,999	\$ -	\$ -	\$ 199,999	\$ (129,101)
Other property owned	86,490	-	-	86,490	(15,151)
Total assets	<u>\$ 286,489</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 286,489</u>	<u>\$ (144,252)</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 and its affiliated associations' 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. This would include certain

mortgage-backed and asset-backed securities. To estimate the fair value of investments, the bank obtains prices from third-party pricing services. Where there is limited activity or less transparency around inputs to the valuation, the securities are classified as Level 3. Securities classified as Level 3 primarily consist of certain non-agency mortgage-backed and asset-backed securities valued using independent third-party valuation services. Also included in the district's Level 3 assets are its investment in 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 basic interest rate swaps and cash flow derivatives. 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 district's financial instruments at September 30, 2011, and December 31, 2010.

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

	<u>September 30, 2011</u>		<u>December 31, 2010</u>	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Financial assets				
Cash, federal funds sold and investment securities	\$ 3,872,704	\$ 3,872,904	\$ 3,705,322	\$ 3,704,582
Loans	15,266,152	15,476,175	15,628,890	15,454,918
Allowance for loan losses	(138,798)	—	(163,145)	—
Loans, net	15,127,354	15,476,175	15,465,745	15,454,918
Derivative assets	1,762	1,762	6,512	6,512
Financial liabilities				
Bonds and notes	15,847,183	16,066,764	16,179,932	16,273,642
Subordinated debt	50,000	56,792	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 district'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 district'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 district's loan rates as well as on management's 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 district'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 September 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 September 30, 2011, and December 31, 2010, the bank's exposure to counterparties, net of collateral, was \$1.8 million and \$6.5 million, respectively. At September 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 September 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 Sheet Location	Fair Value 9/30/2011	Fair Value 12/31/2010	Balance Sheet Location	Fair Value 9/30/2011	Fair Value 12/31/2010
Receive fixed	Other assets	\$ 822	\$ 1,848	Other liabilities	\$ -	\$ -
Pay fixed	Other assets	-	-	Other liabilities	-	5
Interest rate caps	Other assets	940	4,664	Other liabilities	-	-

Derivatives designated as hedging instruments	Amount of Gain (Loss) Recognized in OCI on Derivatives		Location of Gain Reclassification from AOCI into Income	Amount of Gain Reclassified from AOCI into Income (Effective Portion)	
	September 30,			September 30,	
	2011	2010		2011	2010
Interest rate caps	\$ (3,724)	\$ (3,052)	Interest expense	\$ 18	\$ -
Cash flow derivatives	5	(222)			

NOTE 8 — EMPLOYEE BENEFIT PLANS

Employees of the bank and district associations participate in either the defined benefit retirement plan or a defined contribution plan (DC Plan) and are eligible to participate in the district's 401(k) plan. Employer contributions to the DC Plan and 401(k) plan are expensed as incurred. The multi-employer structure of the district's defined benefit pension plan results in the recording of this plan only upon combination. In addition, the bank has a supplemental defined benefit pension plan, which has been discontinued effective January 16, 2011, with expected final distributions to be made in 2012. The following table summarizes the components of net periodic benefit costs for both of the district's defined benefit pension plans and for other postretirement benefit costs for the nine months ended September 30:

	Defined Benefit Pension Plans		Other Postretirement Benefits	
	2011	2010	2011	2010
Service cost	\$ 3,860	\$ 4,475	\$ 1,033	\$ 920
Interest cost	11,380	12,108	2,080	1,858
Expected return on plan assets	(12,225)	(10,228)	-	-
Amortization of prior service costs	27	293	(1,261)	(1,299)
Amortization of net loss	5,247	7,331	216	94
Amortization of loss due to curtailment/termination	1,957	-	-	-
Net periodic benefit cost	<u>\$ 10,246</u>	<u>\$ 13,979</u>	<u>\$ 2,068</u>	<u>\$ 1,573</u>

As of September 30, 2011, contributions of \$22.9 million have been made for pension benefits. The district presently anticipates no additional contributions to fund its pension plan in 2011.

NOTE 9 — INCOME TAXES

The bank and its affiliated associations did not have any uncertain tax positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within the next 12 months.

NOTE 10 — SUBSEQUENT EVENTS

The district has evaluated subsequent events through November 9, 2011, which is the date the financial statements were issued. There are no significant subsequent events requiring disclosure as of November 9, 2011.

NOTE 11 — BANK-ONLY FINANCIAL DATA

Condensed financial information for the bank follows. All significant transactions and balances between the bank and associations are eliminated in combination.

Balance sheet data	September 30, 2011	December 31, 2010
Cash	\$ 530,228	\$ 436,866
Federal funds sold and overnight investments	20,737	20,438
Investment securities	3,184,696	3,076,946
Loans	9,997,499	10,464,034
Less allowance for credit losses	19,607	28,678
Net loans	<u>9,977,892</u>	<u>10,435,356</u>
Accrued interest receivable	42,417	45,298
Other property owned, net	14,969	2,838
Premises and equipment, net	15,233	15,833
Other assets	79,779	74,628
Total assets	<u>\$ 13,865,951</u>	<u>\$ 14,108,203</u>
Bonds and notes	\$ 12,447,183	\$ 12,779,932
Subordinated debt	50,000	50,000
Accrued interest payable	37,040	43,869
Preferred stock dividends payable	21,881	21,881
Other liabilities	38,846	61,663
Total liabilities	<u>12,594,950</u>	<u>12,957,345</u>
Preferred stock	482,000	482,000
Capital stock	229,191	228,399
Retained earnings	528,699	418,965
Accumulated other comprehensive income	31,111	21,494
Total shareholders' equity	<u>1,271,001</u>	<u>1,150,858</u>
Total liabilities and shareholders' equity	<u>\$ 13,865,951</u>	<u>\$ 14,108,203</u>

Statement of income data	Nine Months Ended September 30,	
	2011	2010
Interest income	\$ 320,120	\$ 367,422
Interest expense	150,733	218,247
Net interest income	169,387	149,175
Provision for credit losses	10,491	28,628
Net interest income after provision		
for credit losses	158,896	120,547
Noninterest income	22,629	35,557
Noninterest expense	45,807	42,325
Net income	<u>\$ 135,718</u>	<u>\$ 113,779</u>