STAYING THE COURSE

2012 THIRD QUARTER REPORT

TEXAS FARM CREDIT DISTRICT

SEPTEMBER 30, 2012

THIRD QUARTER 2012

Table of Contents

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 three and nine months ended September 30, 2012. 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 2011 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, 2012, was $98,164, an increase of $2,259, or 2.4 percent, over the same period of 2011. The $2,259 increase in net income for the third quarter of 2012 consisted of a $5,214 increase in net interest income, a $2,874 increase in noninterest income, a $1,019 decrease in provision for loan losses, and a $359 decrease in provision for income taxes, offset by a $7,207 increase in noninterest expense.

Net income for the nine months ended September 30, 2012, was $320,744, an increase of $34,327, or 12.0 percent, over the same period of 2011. The increase in net income for the nine months ended September 30, 2012, consisted of a $32,873 increase in noninterest income, a $5,539 increase in net interest income, and a $5,278 decrease in provision for loan losses, offset by a $9,168 increase in noninterest expense and a $195 increase in provision for income taxes.

Net Interest Income

Net interest income for the three months ended September 30, 2012, was $153,480, an increase of $5,214 over the same period of 2011. The increase in net interest income was due to the effects of a $1.20 billion increase in combined district average earning assets, offset by a decrease in the net interest rate spread of 5 basis points to 2.89 percent. The increase in earning assets was due to increases in the bank's participation loan and investment portfolios and an increase in association average loan volume. The decrease in the interest rate spread was due mainly to a 30-basis-point decrease in the effective rate on earning assets, offset by a 25-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. The decrease in the interest rate spread is largely the result of borrowers' repricings and market-based compression of interest rate spreads. The district's associations had increases in interest rate spreads and in average loan volume.

Net interest income for the nine months ended September 30, 2012, was $458,753, an increase of $5,539, or 1.2 percent, over the same period of 2011. The increase was primarily the result of a $745.7 million increase in combined district average earning assets, offset by a 6-basis-point decrease in the net interest rate spread to 2.96 percent for the nine months ended September 30, 2012. The increase in average earning assets was due to increases in the bank's participation loan and investment portfolios, offset by the decrease in the nine-month-average association loan volume. The decrease in the net interest rate spread included a 27-basis-point decrease in the effective rate on earning assets, net of a 21-basis-point decrease in the effective cost of debt. The effective rates on earning assets have decreased due to borrowers' repricings on earning assets in a lower-interest-rate environment. Also, there has been compression in interest rate spreads due to current conditions in the financial markets. The district's associations had an increase in interest rate spreads, offset by the effects of a decrease in average loan volume, due mainly to general economic conditions, which have resulted in a decline of demand for rural real estate, and pay-downs afforded by high commodity prices for some district borrowers compared to the same period of 2011. Interest expense for the first nine months of 2012 included a $3,208 increase in concession expenses recognized on callable debt related to a $286.1 million increase in debt called in the first nine months of 2012, compared to the same period in 2011. The bank called $7.19 billion in debt in the nine months ended September 30, 2012. The district will benefit prospectively from calling debt and replacing it with lower cost debt; however, the benefit is due to the current low interest rate environment and is expected to diminish over time.

Provision for Loan Losses

The district’s provision for credit losses for the quarter ended September 30, 2012, totaled $11,818, a decrease of $1,019 from the $12,837 provision for the third quarter of 2011. Provision for loan losses and provision for losses on standby letters of credit and unfunded commitments for the nine months ended September 30, 2012, were $32,832, a decrease of $5,278, or 13.8 percent, from the $38,110 provision for the first nine months of 2011. The district’s provision for loan losses consisted primarily of specific allowances on particular loans and exposures. The provisions recorded for the nine months ended September 30, 2012, included significant provisions related to ethanol, land in transition, a meat packing plant and a geothermal power plant, as well as other borrowers impacted by the overall downturn in the general economy.

Noninterest Income

Noninterest income for the quarter ended September 30, 2012, was $16,482, an increase of $2,874, or 21.1 percent, from the same period of 2011. The increase for the third quarter of 2012 over the same period of 2011 was due mainly to a $2,008 increase in loan-related fee income, a $1,158 increase in fair value on loans purchased in the secondary market, a $14 increase in gains realized on the sale of an other-than-temporarily impaired (OTTI) investment, and a $6 increase in other noninterest items, collectively, offset by a $312 decrease in patronage income. The increase in fees for loan-related services included a $3.0 million prepayment fee the bank received on a participation loan. The bank has elected to use a fair value option on certain loans purchased in the secondary market. Changes in the fair values of those loans are included in earnings. As discussed in the “Investments” section of this Management’s Discussion and Analysis, the bank performs other-than-temporary impairment assessments on OTTI investment securities based on evaluations of both current and future market and credit conditions at each quarter end. Assessments made for the third quarter did not indicate any credit losses on OTTI securities on hand at September 30, 2012.

Noninterest income for the nine months ended September 30, 2012, was $66,181, an increase of $32,873, or 98.7 percent, from the same period of 2011. The increase was primarily due to $22,862 in refunds from the Farm Credit System Insurance Corporation (FCSIC), a $4,927 increase in fees for loan-related services, a $2,117 increase in fair value on loans purchased in the secondary market, a $2,086 decrease in credit losses recognized on OTTI investments, a $14 increase in gains realized on the sale of an OTTI investment, and a $1,095 increase in all other noninterest items, collectively, offset by a $228 decrease in patronage. The refunds from the FCSIC, which insures the System’s debt obligations, were nonrecurring and were based on reserves in excess of their required secure base amount. The increase in fees for loan-related services included a $3.0 million prepayment fee the bank received on a participation loan. The $2,086 decrease in credit losses recognized on other-than-temporarily impaired investments reflects the difference between the credit losses of $2,087 and the credit loss of $1 recognized during the nine months ended September 30, 2011 and 2012, respectively.

Noninterest Expense

Noninterest expense for the three months ended September 30, 2012, was $60,005, an increase of $7,207, or 13.7 percent, over the same period of 2011. The increase is primarily attributable to a $3,510 increase in net losses on other property owned (OPO), a $2,231 increase in salaries and benefits, a $1,336 increase in other operating expenses, and a $409 increase in occupancy and equipment, offset by a $279 decrease in premiums to the Insurance Fund. The increase in net losses on OPO included a $3,666 increase in provisions for losses on OPO at the district's associations and a $2,619 increase in provision for losses on OPO at the bank, offset by a $2,372 increase in gains on sales of OPO and a $403 decrease in net expenses on OPO. The increase in salaries and benefits included a $1,353 increase in pension and retirement expenses and a $1,111 increase in compensation and related payroll taxes. The increase in pension and retirement expenses included a $1,953 increase in the district's defined benefit plan, net of an $825 decrease in expenses related to the bank's supplemental defined benefit pension plan, which was terminated in 2011. The increase in other operating expenses included a $469 increase in professional and contract services, a $259 increase in advertising and member relations and a $608 increase in all other operating expenses, collectively. Premiums to the Insurance Fund decreased due primarily to the effects of a premium rate decrease from the 6-basis-point rate in 2011 to a rate of 5 basis points for 2012.

Noninterest expense for the nine months ended September 30, 2012, was $171,024, an increase of $9,168, or 5.7 percent, over the same period of 2011. The increase is primarily attributable to a $6,759 increase in salaries and benefits, a $3,828 increase in other operating expenses, and a $783 increase in occupancy and equipment expenses, offset by a $1,185 decrease in net losses on OPO and a $1,017 decrease in premiums to the Insurance Fund. The increase in salaries and benefits included a $4,268 increase in pension and retirement expenses and a $3,240 increase in compensation and related payroll taxes (primarily at the district's associations), offset by a $671 increase in capitalization of salaries and benefits related to internal development of software at the bank, and a $78 net decrease in other benefits. The increase in pension and retirement expense included a $5,860 increase in the district's defined benefit pension plan, net of a $2,476 decrease in the bank's supplemental defined benefit pension plan, which was terminated in 2011. The increase in other operating expenses included a $1,278 increase in advertising and member relations, a $483 increase in training expenses, a $464 increase in travel expense, a $405 increase in assessments from the Funding Corporation, and a $1,198 net increase in all other operating expenses, collectively. The decrease in losses on OPO included a $4,056 increase in gains on sales of OPO, a $1,080 decrease in provision for losses on OPO at the district's associations, and a $607 decrease in net expenses on OPO, offset by a $4,558 increase in provision for losses on OPO at the bank. Premiums to the Insurance Fund decreased due primarily to the effects of a premium rate decrease from the 6-basis-point rate in 2011 to a rate of 5 basis points for 2012.

Key results of operations comparisons:

	Annualized for the Nine Months Ended 9/30/2012	Annualized for the Nine Months Ended 9/30/2011
Return on average assets	**2.11%**	1.96%
Return on average members' equity	**13.14%**	12.32%
Net interest income as a percentage of average earning assets	**3.13%**	3.22%
Charge-offs, net of recoveries, to average loans	**0.24%**	0.53%
Operating expenses as a percentage of net interest income and noninterest income	**30.18%**	30.43%
Operating expenses as a percentage of average earning assets	**1.08%**	1.05%

Other Comprehensive Income (Loss)

In June 2011, guidance entitled "Comprehensive Income – Presentation of Comprehensive Income" was issued, which required a more prominent financial statement presentation of other comprehensive income in the financial statements. Previously, the presentation of the elements of other comprehensive income in the Combined Statements of Changes in Members' Equity was acceptable. The new guidance requires the presentation of other comprehensive income along with the components of net income, or in a separate financial statement immediately following the Combined Statements of Income. Retrospective application is required. The district has elected to use the single statement approach, presenting the elements of net income and comprehensive income in a single Combined Statements of Comprehensive Income.

Other comprehensive income consists of certain gains, losses or costs for which values are included in assets or liabilities on the balance sheets, but which have not yet been recognized in earnings. In the balance sheet, they are included in accumulated other comprehensive loss in the shareholders' equity section. For the district, these elements include unrealized gains or losses on the bank's available-for-sale investment portfolio, elements of certain pension and retirement benefit changes, and changes in the value of cash flow derivative instruments.

The table below summarizes changes in elements included in other comprehensive income for the nine months ended September 30:

	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Change in unrealized gains on available-for-sale securities		
Increase in unrealized gains on investment securities	**$ 4,174**	$ 9,174
Decrease (increase) in noncredit portion of other-than-temporary impairment (OTTI) losses	**3,777**	628
Reclassification adjustment for OTTI credit losses included in net income	**1**	2,087
Net change in unrealized gains on securities	**7,952**	11,889
Change in retirement benefit plans		
Amounts amortized into net periodic expense:		
Amortization of prior service credits	**(1,318)**	(1,234)
Amortization of net losses	**10,609**	5,416
Amortization of net loss due to curtailment/termination	**-**	1,596
Net change in retirement benefit plans	**9,291**	5,778
Change in cash flow derivative instruments		
Unrealized losses on interest rate caps	**(1,018)**	(3,723)
Gains on cash flow interest rate swaps	**-**	5
Reclassification of loss recognized in interest expense	**323**	18
Net change in cash flow derivative instruments	**(695)**	(3,700)
Other comprehensive income	**$ 16,548**	$ 13,967

FINANCIAL CONDITION

Loan Portfolio

Gross loan volume at September 30, 2012, was $16,587,819, an increase of $963,806, or 6.2 percent, from $15,624,013 at December 31, 2011, and an increase of $1,321,667, or 8.7 percent, from $15,266,152 at September 30, 2011. The increase in the loan portfolio during the first nine months of 2012 was due to growth in the bank's participation loan portfolio, and an increase in loans at district associations.

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 96.5 percent at September 30, 2012, 95.4 percent at December 31, 2011, and 94.6 percent at September 30, 2011. Nonaccrual loans for the district were 2.10 percent of total loans at September 30, 2012, compared to 2.92 percent at December 31, 2011, and 3.70 percent at September 30, 2011.

Total district high-risk asset volume decreased by $91.4 million, or 15.8 percent, to $487.9 million at September 30, 2012, from $579.3 million at December 31, 2011.

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

	September 30, 2012	Increase (Decrease) $	Increase (Decrease) %	December 31, 2011
Nonaccrual loans	**$ 347.7**	$ (107.8)	(23.7) %	$ 455.5
Formally restructured loans	**50.7**	21.1	71.3	29.6
Loans 90 days past due and still accruing interest	**5.7**	(0.6)	(9.5)	6.3
Total impaired loans	**404.1**	(87.3)	(17.8)	491.4
Other property owned, net	**83.8**	(4.1)	(4.7)	87.9
Total high-risk assets	**$ 487.9**	$ (91.4)	(15.8) %	$ 579.3

The $107.8 million decrease in nonaccrual loans from December 31, 2011, to September 30, 2012, is primarily the result of $121.3 million in repayments, $40.5 million in transfers to other property owned, $35.0 million in charge-offs, and $31.5 million in transfers to accrual status, offset by $98.1 million in transfers to nonaccrual, $19.7 million in advances on nonaccrual loans, and $5.3 million in recoveries. The district had significant decreases in the beef and livestock, land in transition, timber, dairy, citrus fruits, and canned fruits and vegetable sectors, partially offset by significant increases in the meat packing and ethanol sectors. At September 30, 2012, $163.1 million, or 46.9 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, 2012, the district had $40.2 million in nonaccrual loans on which interest income is recognized upon cash receipts, compared to $72.1 million at December 31, 2011. The increase in formally restructured loans included an $11.9 million increase in production and intermediate term loans, an $11.8 million increase in real estate mortgage loans, and a $5.2 million increase in agribusiness loans, offset by a $7.7 million decrease in processing and marketing loans. Of the total increase in restructured loans, $11.8 million occurred at district associations and $9.3 million occurred at the bank. Impaired loans, consisting of nonaccrual loans, formally restructured loans and loans past due 90 days or more and still accruing interest, constituted 2.44 percent of total loans at September 30, 2012, and 3.14 percent of total loans at December 31, 2011.

The $112,289 allowance for loan losses at September 30, 2012, constituted 0.68 percent of total loans and was a decrease of $1,828, or 1.6 percent, from the allowance for loan losses at December 31, 2011. The decrease was primarily due to charge-offs, net of recoveries, of $29.7 million, which was slightly less than the $32.8 million in provisions for loan losses recorded during the nine months ended September 30, 2012. 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 27.8 percent as of September 30, 2012, as compared to 23.2 percent as of December 31, 2011. 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 letters of credit and unfunded commitments totaling $6.0 million at September 30, 2012, which included a specific reserve for one letter of credit and 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 $3,739,626, or 18.1 percent, of total assets at September 30, 2012, compared to $3,741,334, or 19.0 percent, at December 31, 2011, a decrease of $1,708, or 0.05 percent. At September 30, 2012, the district's cash balance was $355,923, a decrease of $76,796 from the balance at December 31, 2011. Cash held at the Federal Reserve Bank at September 30, 2012, totaled $336,670, compared to $391,832 at December 31, 2011. The bank maintains levels of cash and other highly liquid assets to meet loan demand, debt servicing and other liquidity needs. At September 30, 2012, the bank had 224 days of liquidity to cover maturing debt obligations. Interest-bearing liabilities, consisting of bonds, notes and subordinated debt, increased by $817,084, or 5.1 percent, from December 31, 2011, to September 30, 2012.

Investments

The district's investments included an available-for-sale portfolio with a fair value of $3.27 billion held by the bank and a held-to-maturity portfolio recorded at an amortized cost of $75.8 million at September 30, 2012. The available-for-sale investments included a liquidity portfolio and a portfolio of other investments. The bank's available-for-sale liquidity portfolio consisted primarily of federal agency collateralized mortgage-backed securities, 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 $122.1 million and were held by the bank. The district's held-to-maturity portfolio consisted of Farmer Mac AMBS held by district associations which had an amortized cost of $75.8 million and a fair value of $75.5 million.

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 following table summarizes the bank's available-for-sale liquidity portfolio holdings:

	September 30, 2012		December 31, 2011	
	Amortized Cost	**Fair Value**	Amortized Cost	Fair Value
FDIC-guaranteed corporate debt	**$ -**	**$ -**	$ 169,871	$ 169,999
Corporate debt	**148,445**	**148,571**	83,306	82,464
Federal agency collateralized mortgage-backed securities:				
GNMA	**1,570,448**	**1,597,560**	1,689,535	1,719,158
FNMA and FHLMC	**1,326,303**	**1,341,719**	1,011,508	1,023,548
Other collateralized mortgage-backed securities	**33,860**	**31,517**	49,208	40,872
Asset-backed securities	**31,727**	**30,944**	15,080	13,721
Total available-for-sale investments	**$ 3,110,783**	**$ 3,150,311**	$ 3,018,508	$ 3,049,762

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

	September 30, 2012		December 31, 2011	
	Amortized Cost	**Fair Value**	Amortized Cost	Fair Value
Agricultural mortgage-backed securities	**$ 124,110**	**$ 122,111**	$ 112,597	$ 110,921

Federal agency collateralized mortgage-backed securities comprised 93.3 percent of the bank's liquidity portfolio. Pricing on agency securities remains strong due to stabilization in the agency market and increased demand for quality agency structures. The increase in corporate debt was due to purchases of $65.0 million par value during 2012. The increase in asset-backed securities (ABS) was due to purchases of three equipment-related ABS totaling $37,000 in 2012, net of pay-downs and maturities. The increase in the bank's available-for-sale other investments portfolio of agricultural mortgage-backed securities (AMBS) included the bank's purchase of an AMBS from a district association in January 2012, net of repayments on available-for-sale AMBS through the quarter ended September 30, 2012.

At September 30, 2012, the bank had four mortgage-backed securities (MBS) and two ABS that were considered other-than-temporarily impaired (OTTI). During the nine months ended September 30, 2012, there was a credit loss on one OTTI investment which totaled $1 and a credit gain due to the sale of one OTTI investment which totaled $14. The non-credit-related unrealized losses on the bank's other-than-temporarily impaired investments, totaling $2.3 million, is included in accumulated 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, 2012, the bank held nine investments that were ineligible for liquidity purposes by FCA regulations, due to credit ratings that were below AAA rating by all NRSROs. Those ineligible securities had an amortized cost basis of $32,827 and a fair value of $29,858 at September 30, 2012.

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

	Eligible				Ineligible					
September 30, 2012	AAA/Aaa	AA/Aa	F1/P1/A1	Split Rated	AA/Aa	BBB/Baa	BB/Ba	CCC/Caa	CC/Ca	Total
FDIC-guaranteed corporate debt	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Corporate debt	-	51,597	25,000	71,974	-	-	-	-	-	148,571
Federal agency collateralized mortgage-backed securities*										
GNMA	-	-	-	1,597,560	-	-	-	-	-	1,597,560
FNMA and FHLMC	-	-	-	1,341,719	-	-	-	-	-	1,341,719
Other collateralized mortgage-backed securities	-	-	-	3,407	-	5,934	8,806	10,882	2,488	31,517
Asset-backed securities	8,579	-	19,105	1,513	-	-	-	1,747	-	30,944
Total	$ 8,579	$ 51,597	$ 44,105	$3,016,173	$ -	$ 5,934	$ 8,806	$ 12,629	$ 2,488	$ 3,150,311

	Eligible				Ineligible					
December 31, 2011	AAA/Aaa	AA/Aa	F1/P1/A1	Split Rated	AA/Aa	BBB/Baa	BB/Ba	CCC/Caa	CC/Ca	Total
FDIC-guaranteed corporate debt*	$ 30,045	$ -	$ -	$ 139,954	$ -	$ -	$ -	$ -	$ -	$ 169,999
Corporate debt	-	67,531	-	14,933	-	-	-	-	-	82,464
Federal agency collateralized mortgage-backed securities*										
GNMA	-	-	-	1,719,158	-	-	-	-	-	1,719,158
FNMA and FHLMC	-	-	-	1,023,548	-	-	-	-	-	1,023,548
Other collateralized mortgage-backed securities	-	-	-	3,066	6,273	-	8,684	20,207	2,642	40,872
Asset-backed securities	10,271	-	-	1,835	-	-	-	1,615	-	13,721
Total	$ 40,316	$ 67,531	$ -	$2,902,494	$ 6,273	$ -	$ 8,684	$ 21,822	$ 2,642	$ 3,049,762

* In August 2011, while Moody's Investors 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.

Capital Resources

At September 30, 2012, 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 noncumulative subordinated perpetual preferred stock.

As of September 30, 2012, the bank and all district associations exceeded all regulatory capital requirements. Total members' equity increased $252,778, or 8.1 percent, from December 31, 2011, to the September 30, 2012, total of $3,356,906. This increase is the result of net income of $320,744 for the nine months ended September 30, 2012, and a $16,548 increase in other comprehensive income, offset by dividends on preferred stock totaling $21,881, net stock retirements at district associations of $44, and patronage accruals of $62,589. The patronage accruals include a $55.0 million revolvement from allocated equities by a district association.

Key financial condition comparisons:

	September 30, 2012	December 31, 2011
Members' equity to assets	**16.26%**	15.80%
Total liabilities to members' equity	**5.15:1**	5.33:1
Allowance and reserve for credit losses to total loans	**0.71%**	0.73%

OTHER

CONDITIONS IN THE TEXAS DISTRICT

During the third quarter of 2012, farmers and ranchers in the district benefited from improved growing conditions resulting from cooler temperatures and better than expected moisture. Advantageous weather during the summer for most of the southeast and large portions of Texas and New Mexico resulted in favorable growing conditions leading to a currently strong harvesting season. Small pockets of abnormally dry to exceptional drought continue to impact portions of New Mexico, Texas and Alabama. While soil moisture and lack of rainfall in these areas stressed farming and livestock operations, overall district pasture and growing conditions, particularly in the eastern states and portions of central and eastern Texas, have improved significantly versus 2011.

Across those areas of the district that have seen an improvement in weather conditions, most irrigated and dry-land farmers are experiencing better than average yields on higher priced grain and feed prices. However, both irrigated and dry-land farmers continue to face increased input costs associated with water, pesticide and fertilizer. In the portions of the states most impacted by drought, poor to average crop yields can be expected, and multi-peril crop insurance will continue to be a risk management tool used by farmers. Persistence of the drought in the mid-western United States has greatly impacted pastures, causing the cattle supply to continue to decline. Feed and hay prices continue to impact national livestock operators, while prices for beef remain higher due to less national supply.

Across the district, higher third quarter commodity prices strengthened the margins of both livestock producers and farmers. Favorable weather conditions should result in better than average crop yields, and strong agricultural commodity prices will advance the profitability of district portfolios. Risk mitigation tools such as FSA guarantees and multi-peril crop insurance continue to provide stability to district loan portfolios, while high levels of diversification and nonfarm income continue to enhance the credit quality of the existing borrowers.

RATING AGENCY ACTIONS

Moody's Investors Service Rating Actions

On August 2, 2011, Moody's Investors Service affirmed the bank's investment grade of Aa2 issuer rating. Previously, Moody's had affirmed the bank's A1 subordinated debt rating, A2 cumulative preferred stock rating and A3 noncumulative preferred stock rating, citing the bank's strong credit performance, very high support from the System and very high support from the U.S. government. In Moody's annual credit opinion for the bank issued August 1, 2012, the bank's ratings remained the same. While the issuer outlook changed from "ratings under review" to "negative" due to linkage with the U.S. government's "negative" outlook on its AAA long-term debt rating, the bank's preferred stock ratings have a "stable" outlook based on strong market conditions for agriculture and consistent financial performance.

Fitch Ratings Actions

On March 8, 2012, Fitch Ratings applied revised criteria for rating all financial institutions' hybrid capital instruments. This resulted in the downgrades of 1,068 outstanding hybrid capital instruments across the financial services sector. The impact to the bank was a downgrade in its cumulative preferred stock rating from "A" to "BBB+" and a downgrade in its noncumulative preferred stock rating from "A" to "BBB." Fitch continues to rate the bank's long- and short-term Issuer Default Rating at "AA-" and "F1+," respectively, with a stable outlook. On October 11, 2012, Fitch Ratings affirmed (with a "stable" outlook) the bank's ratings for long- and short-term Issuer Default Rating at "AA-" and "F1+," respectively, its cumulative preferred stock at "BBB+," noncumulative preferred stock at "BBB" and subordinated debt at "A+."

REGULATORY MATTERS

As of September 30, 2012, FCA had enforcement actions in place against three associations in the district, which have not had, and are not expected to have, a significant impact on the bank. Prior to September 30, 2012, the FCA terminated the enforcement action against one district association.

At its September 13, 2012, meeting, the FCA board approved a rule affecting disclosures of compensation of senior officers by System banks and associations. According to the final rule, certain reports to stockholders must include disclosure of supplemental retirement plans, disclosure of the risk and reward structure for senior officer compensation plans, a discussion of the relationship of compensation to performance, and timely, transparent reporting of significant or material events that occur at System institutions between annual reporting periods. The rule also establishes minimum responsibilities to be performed by an institution's compensation committee and provides that System banks and associations provide for a nonbinding, advisory vote by shareholders on senior officer compensation upon certain events. The rule will become effective 30 days after the publication in the Federal Register during which either body of Congress is in session. Notice of the effective date will be published in the Federal Register.

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

James F. Dodson
Chairman of the Board

Amie Pala
Chief Financial Officer

November 9, 2012

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, 2012

Combined Balance Sheets

(dollars in thousands)	September 30, 2012 (Unaudited)	December 31, 2011
Assets		
Cash	**$ 355,923**	$ 432,719
Federal funds sold	**35,518**	20,687
Investment securities	**3,348,185**	3,287,928
Loans (includes $64,266 and $0 at fair value held under fair value option)	**16,587,819**	15,624,013
Less allowance for loan losses	**112,289**	114,117
Net loans	**16,475,530**	15,509,896
Accrued interest receivable	**172,620**	141,567
Other property owned, net	**83,848**	87,956
Premises and equipment, net	**67,687**	61,820
Other assets	**108,767**	99,918
Total assets	**$ 20,648,078**	$ 19,642,491
Liabilities and members' equity		
Liabilities		
Bonds and notes, net	**$ 16,862,625**	$ 16,045,541
Subordinated debt	**50,000**	50,000
Accrued interest payable	**38,182**	37,912
Patronage distributions payable	**59,247**	83,440
Preferred stock dividends payable	**21,881**	21,881
Other liabilities	**259,237**	299,589
Total liabilities	**17,291,172**	16,538,363
Commitments and contingent liabilities (Note 4)		
Members' equity		
Preferred stock, net	**482,000**	482,000
Capital stock and participation certificates	**60,056**	60,024
Allocated retained earnings	**320,710**	374,231
Unallocated retained earnings	**2,547,246**	2,257,527
Additional paid-in-capital	**22,737**	22,737
Accumulated other comprehensive loss	**(75,843)**	(92,391)
Total members' equity	**3,356,906**	3,104,128
Total liabilities and members' equity	**$ 20,648,078**	$ 19,642,491

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

Combined Statements of Comprehensive Income

(unaudited)

	Quarter Ended September 30,		Nine Months Ended September 30,	
(dollars in thousands)	**2012**	2011	**2012**	2011
Interest Income				
Investment securities	**$ 14,133**	$ 15,126	**$ 44,883**	$ 49,026
Loans	**188,575**	189,885	**562,974**	573,468
Total interest income	**202,708**	205,011	**607,857**	622,494
Interest Expense				
Bonds, notes and subordinated debt	**42,882**	50,758	**129,804**	150,730
Notes payable and other	**6,346**	5,987	**19,300**	18,550
Total interest expense	**49,228**	56,745	**149,104**	169,280
Net interest income	**153,480**	148,266	**458,753**	453,214
Provision for loan losses	**11,818**	12,837	**32,832**	38,110
Net interest income after provision for loan losses	**141,662**	135,429	**425,921**	415,104
Noninterest Income				
Patronage income	**3,513**	3,825	**12,994**	13,222
Loan-related fees	**10,988**	8,980	**25,122**	20,195
Refunds from Farm Credit System Insurance Corporation	**-**	-	**22,862**	-
Gain on loans held under fair value option	**1,158**	-	**2,718**	-
Miscellaneous income, net	**809**	803	**2,472**	1,978
Impairment gains (losses) on investments				
Net other-than-temporary impairment gains (losses)	**14**	(447)	**13**	(1,557)
Less: portion of gain (loss) recognized in other comprehensive income	**-**	(447)	**-**	530
Net impairment gain (loss) recognized in earnings	**14**	-	**13**	(2,087)
Total noninterest income	**16,482**	13,608	**66,181**	33,308
Noninterest Expense				
Salaries and employee benefits	**31,261**	29,030	**94,876**	88,117
Occupancy and equipment	**4,381**	3,972	**12,933**	12,150
Insurance Fund premiums	**1,930**	2,209	**5,674**	6,691
Losses on other property owned, net	**7,570**	4,060	**12,617**	13,802
Other operating expenses	**14,863**	13,527	**44,924**	41,096
Total noninterest expense	**60,005**	52,798	**171,024**	161,856
Income before provision for income taxes	**98,139**	96,239	**321,078**	286,556
Provision for (benefit from) income taxes	**(25)**	334	**334**	139
Net Income	**98,164**	95,905	**320,744**	286,417
Other comprehensive income				
Change in retirement benefit plans	**3,097**	1,918	**9,291**	5,778
Change in unrealized gain on investments	**9,652**	6,881	**7,952**	11,889
Change in cash flow derivative instruments	**28**	(1,221)	**(695)**	(3,700)
Total other comprehensive income	**12,777**	7,578	**16,548**	13,967
Comprehensive Income	**$ 110,941**	$ 103,483	**$ 337,292**	$ 300,384

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, 2010	$ 482,000	$ 61,843	$ 327,435	$ 2,121,822	$ 22,622	$ (49,391)	$ 2,966,331
Net income	-	-	-	286,417	-	-	286,417
Other comprehensive gain	-	-	-	-	-	13,967	13,967
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	-	-	(52,175)	(5,636)	-	-	(57,811)
Members' equity	-	-	1,317	(1,317)	-	-	-
Balance at September 30, 2011	$ 482,000	$ 60,515	$ 276,577	$ 2,378,467	$ 22,864	$ (35,424)	$ 3,184,999
Balance at December 31, 2011	$ 482,000	$ 60,024	$ 374,231	$ 2,257,527	$ 22,737	$ (92,391)	$ 3,104,128
Net income	-	-	-	320,744	-	-	320,744
Other comprehensive gain	-	-	-	-	-	16,548	16,548
Capital stock/participation certificates issued	-	6,285	-	-	-	-	6,285
Capital stock/participation certificates and allocated retained earnings retired	-	(6,253)	(76)	-	-	-	(6,329)
Preferred stock dividends accrued	-	-	-	(21,881)	-	-	(21,881)
Patronage distributions							
Cash	-	-	(55,000)	(7,589)	-	-	(62,589)
Members' equity	-	-	1,555	(1,555)	-	-	-
Balance at September 30, 2012	**$ 482,000**	**$ 60,056**	**$ 320,710**	**$ 2,547,246**	**$ 22,737**	**$ (75,843)**	**$ 3,356,906**

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, 2012	2011
Operating activities		
Net income	**$ 320,744**	$ 286,417
Reconciliation of net income to net cash provided by operating activities		
Provision for loan losses	**32,832**	38,110
Provision for losses on other property owned	**14,957**	11,479
Depreciation and amortization on premises and equipment	**5,530**	4,961
Accretion of net discount on loans	**1,281**	(3,573)
Amortization and accretion on debt instruments	**(2,965)**	(3,301)
Amortization of net premium on investment securities	**1,299**	6,607
Increase in fair value on loans under fair value option	**(1,928)**	-
Gains from sales of other property owned, net	**(3,579)**	(478)
(Gains) losses on impairment of investments available-for-sale	**(13)**	2,087
Gains from sales of premises and equipment	**(3,110)**	(2,912)
Allocated equity patronage from System bank	**(12,445)**	(12,247)
Increase in accrued interest receivable	**(31,053)**	(18,776)
Decrease in other assets	**2,545**	2,754
Increase (decrease) in accrued interest payable	**270**	(6,834)
Increase (decrease) in other liabilities	**39,852**	(28,636)
Net cash provided by operating activities	**364,217**	275,658
Investing activities		
Net increase in federal funds sold	**(14,831)**	(299)
Investment securities		
Purchases	**(946,315)**	(655,435)
Proceeds from maturities, calls and prepayments	**886,257**	574,452
Proceeds from sales	**6,467**	-
(Increase) decrease in loans, net	**(1,060,414)**	238,563
Proceeds from sales of other property owned, net	**33,720**	55,546
Proceeds from sales of premises and equipment	**2,794**	2,698
Expenditures for premises and equipment	**(11,081)**	(5,114)
Net cash (used in) provided by investing activities	**(1,103,403)**	210,411
Financing activities		
Bonds and notes issued	**11,812,898**	11,526,030
Bonds and notes retired	**(10,992,979)**	(11,854,452)
Increase in advanced conditional payments	**574**	18,362
Capital stock and participation certificates issued	**6,285**	5,191
Capital stock and participation certificates retired	**(6,329)**	(7,215)
Cash dividends on preferred stock	**(21,881)**	(21,881)
Cash patronage distributions paid	**(136,178)**	(69,199)
Net cash provided by (used in) financing activities	**662,390**	(403,164)
Net (decrease) increase in cash	**(76,796)**	82,905
Cash at beginning of year	**432,719**	453,322
Cash at end of quarter	**355,923**	536,227
Supplemental schedule of noncash investing and financing activities		
Financed sales of other property owned	**$ 5,282**	$ 15,498
Loan assets transferred to other property owned	**40,464**	49,793
Net increase in unrealized gains on investment securities	**7,952**	11,889
Cash dividends or patronage distributions payable	**59,247**	54,623
Supplemental schedule of noncash changes in fair value related to hedging activities		
Increase (decrease) in bonds and notes	**$ 130**	$ (1,026)
Supplemental information		
Cash paid for:		
Interest	**$ 148,834**	$ 176,114
Income taxes	**66**	275

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, 2011, are contained in the 2011 Annual Report to stockholders (Annual Report). These unaudited third quarter 2012 financial statements should be read in conjunction with the Annual Report.

In December 2011, the Financial Accounting Standards Board (FASB) issued guidance entitled, "Balance Sheet – Disclosures about Offsetting Assets and Liabilities." The guidance requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. This includes the effect or potential effect of rights of setoff associated with an entity's recognized assets and recognized liabilities. The requirements apply to recognized financial instruments and derivative instruments that are offset in accordance with the rights of offset set forth in accounting guidance and for those recognized financial instruments and derivative instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset or not. This guidance is to be applied retrospectively for all comparative periods and is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The adoption of this guidance will not impact the financial condition or results of operations of the district, but will result in additional disclosures.

In September 2011, the 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, 2012 for nonpublic entities. The amendments should be applied retrospectively for all prior periods presented. The adoption did not impact the district combined financial condition or results of operation.

In June and December 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 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. This guidance did not change the items that must be reported in other comprehensive income. With either approach, an entity is required to present reclassification adjustments for items reclassified from other comprehensive income to net income in the statement(s). The December 2011 guidance deferred the effective date for the presentation of reclassification adjustments.

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 did not impact the financial condition or results of operations of the district, but resulted 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 clarify certain aspects of the fair value measurement and disclosure requirements. The amendments are to be applied prospectively. The amendments are effective during interim and annual periods beginning after December 31, 2011. The adoption of this guidance did not impact the financial condition or results of operations of the district but resulted in additional disclosures.

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 troubled debt restructuring. In evaluating whether a restructuring is a troubled debt restructuring, a creditor must separately conclude that both of the following exist: (1) the restructuring constitutes a concession, and (2) the debtor is experiencing financial difficulties. The guidance is effective for nonpublic entities for annual periods ending on or after December 15, 2012, including interim periods within those annual periods. The adoption of this guidance was not material to the financial condition or results of operations of the district, but resulted 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 bank’s available-for-sale investments include a liquidity portfolio and a portfolio of other investments. The liquidity portfolio consists primarily of corporate debt, mortgage-backed securities and asset-backed securities. 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 other investments portfolio consists of Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed agricultural mortgage-backed securities (AMBS) purchased during the second quarter of 2010 and first quarter of 2012. A summary of the amortized cost and fair value of investment securities available for sale, at September 30, 2012, and December 31, 2011, is as follows.

Investments in the bank's available-for-sale liquidity portfolio at September 30, 2012:

	September 30, 2012								
		Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Fair Value	Weighted Average Yield
FDIC-guaranteed corporate debt	$	-	$	-	$	-	$	-	- %
Corporate debt		148,445		291		(165)		148,571	0.87
Federal agency collateralized mortgage-backed securities									
GNMA		1,570,448		27,126		(14)		1,597,560	1.66
FNMA and FHLMC		1,326,303		15,438		(22)		1,341,719	1.48
Other collateralized mortgage-backed securities		33,860		5		(2,348)		31,517	5.72
Asset-backed securities		31,727		66		(849)		30,944	0.84
Total available-for-sale investments	**$**	**3,110,783**	**$**	**42,926**	**$**	**(3,398)**	**$**	**3,150,311**	**1.58** %

Investments in the bank's available-for-sale other investments portfolio at September 30, 2012:

	September 30, 2012								
		Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	$	124,110	$	-	$	(1,999)	$	122,111	4.42 %

Investments in the bank's available-for-sale liquidity portfolio at December 31, 2011:

	December 31, 2011								
		Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Fair Value	Weighted Average Yield
FDIC-guaranteed corporate debt	$	169,871	$	128	$	-	$	169,999	0.36 %
Corporate debt		83,306		8		(850)		82,464	1.08
Federal agency collateralized mortgage-backed securities									
GNMA		1,689,535		29,635		(12)		1,719,158	1.80
FNMA and FHLMC		1,011,508		12,626		(586)		1,023,548	1.88
Other collateralized mortgage-backed securities		49,208		-		(8,336)		40,872	6.11
Asset-backed securities		15,080		2		(1,361)		13,721	1.65
Total available-for-sale investments	**$**	**3,018,508**	**$**	**42,399**	**$**	**(11,145)**	**$**	**3,049,762**	**1.78** %

Investments in the bank's available-for-sale other investments portfolio at December 31, 2011:

	December 31, 2011								
		Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	$	112,597	$	-	$	(1,676)	$	110,921	4.79 %

The following tables summarize the contractual maturity, fair value, amortized cost and weighted average yield of available-for-sale investments at September 30, 2012:

Investments in the bank's 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	$ -	$ -	$ -	$ -	$ -
Corporate debt	57,058	91,513	-	-	148,571
Federal agency collateralized mortgage-backed securities					
GNMA	-	-	16,527	1,581,033	1,597,560
FNMA and FHLMC	1,038	4,687	132,243	1,203,751	1,341,719
Other collateralized mortgage-backed securities	-	-	70	31,447	31,517
Asset-backed securities	19,105	-	-	11,839	30,944
Total fair value	**$ 77,201**	**$ 96,200**	**$ 148,840**	**$ 2,828,070**	**$ 3,150,311**
Total amortized cost	**$ 77,081**	**$ 96,003**	**$ 145,271**	**$ 2,792,428**	**$ 3,110,783**
Weighted average yield	**0.65%**	**1.14%**	**2.37%**	**1.58%**	**1.58%**

Investments in the bank's available-for-sale other investments portfolio:

	Due after one year through five years
Fair value of agricultural mortgage-backed securities	$ 122,111
Total amortized cost	**$ 124,110**
Weighted average yield	**4.42%**

Other-Than-Temporarily Impaired Investments Evaluation

The following table shows the bank's 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, 2012. The continuous loss position is based on the date the impairment was first identified:

	Less Than 12 Months		Greater Than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
FDIC-guaranteed corporate debt	$ -	$ -	$ -	$ -	$ -	$ -
Corporate debt	15,130	(15)	14,850	(150)	29,980	(165)
Federal agency collateralized mortgage-backed securities						
GNMA	30,256	(14)	-	-	30,256	(14)
FNMA and FHLMC	30,062	(22)	-	-	30,062	(22)
Other collateralized mortgage-backed securities	-	-	25,583	(2,348)	25,583	(2,348)
Asset-backed securities	-	-	3,260	(849)	3,260	(849)
Total	**$ 75,448**	**$ (51)**	**$ 43,693**	**$ (3,347)**	**$ 119,141**	**$ (3,398)**

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).

For the nine months ended September 30, 2012, the bank recognized other-than-temporary impairment credit losses on one asset-backed security totaling $1. 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, 2012, totaling $3,777, is included as a credit to other comprehensive income. The bank realized a $14 gain on the sale of an other-than-temporarily impaired investment in September 2012. At September 30, 2012, the bank had four 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 2012. 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 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 are the assumptions used at:

Assumptions Used	September 30, 2012 Mortgage-backed securities	September 30, 2012 Asset-backed securities
Default by range	1.9% - 8.5%	7.5% - 13.3%
Prepayments rate by range	5.6% - 17.7%	1.6% - 2.7%
Loss severity by range	26.0% - 44.8%	46.9% - 54.2%

Assumptions Used	December 31, 2011 Mortgage-backed securities	December 31, 2011 Asset-backed securities
Default by range	2.7% - 12.0%	8.3% - 13.5%
Prepayments rate by range	3.9% - 14.4%	1.5% - 2.5%
Loss severity by range	31.2% - 52.9%	58.3% - 64.2%

The following is a rollforward of the amount related to credit losses recognized during the period:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	**2012**	2011
Credit loss component, beginning of period	**$ 9,922**	$ 9,921	**$ 9,921**	$ 7,834
Additions:				
Initial credit impairment	**-**	-	**-**	241
Subsequent credit impairment	**-**	-	**1**	1,846
Reductions:				
For securities sold	**(2,535)**	-	**(2,535)**	-
For increases in expected cash flows	**-**	-	**-**	-
Credit loss component end of period	**$ 7,387**	$ 9,921	**$ 7,387**	$ 9,921

Held-to-Maturity Investments

The district's held-to-maturity investments consisted of Farmer Mac guaranteed agricultural mortgage-backed securities and are held by district associations. A summary of the amortized cost and fair value of held-to-maturity investment securities at September 30, 2012, is as follows:

	September 30, 2012				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	$ 75,763	$ 342	$ (628)	$ 75,477	4.72 %

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 the district's loans follows:

	September 30, 2012	December 31, 2011
Real estate mortgage	**$ 10,229,515**	$ 10,165,704
Production and intermediate term	**1,866,891**	1,668,820
Loans to cooperatives	**219,168**	171,904
Processing and marketing	**1,993,618**	1,651,723
Farm-related business	**200,305**	235,023
Communication	**341,884**	279,696
Energy (utilities)	**1,178,638**	902,666
Water and waste disposal	**104,566**	101,698
Rural residential real estate	**199,627**	198,630
International	**202**	229
Lease receivables	**4,702**	13,334
Loans to other financing institutions	**58,733**	82,901
Mission-related	**189,970**	151,685
	$ 16,587,819	$ 15,624,013

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, 2012.

	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	$ 96,837	$ 167,047	$ 68,770	$ 23,096	$ 165,607	$ 190,143
Production and intermediate term	250,103	286,511	65,491	2,380	315,594	288,891
Agribusiness	959,127	16,007	148,841	1,438	1,107,968	17,445
Communication	338,418	-	-	-	338,418	-
Energy	1,183,298	3,486	-	-	1,183,298	3,486
Water and waste disposal	104,685	-	-	-	104,685	-
Lease receivables	4,157	-	135	-	4,292	-
Mission-related	8,115	-	4,554	-	12,669	-
Direct note receivable from district associations	-	3,400,000	-	-	-	3,400,000
Total	**$ 2,944,740**	**$ 3,873,051**	**$ 287,791**	**$ 26,914**	**$ 3,232,531**	**$ 3,899,965**

During the first nine months of 2012, the district elected the fair value option for certain callable loans purchased on the secondary market at a significant premium. The fair value option provides an irrevocable option to elect fair value as an alternative measurement for selected financial assets. The fair value of loans held under the fair value option totaled $64,266 at September 30, 2012. Fair value is used for both the initial and subsequent measurement of the designated instrument, with the changes in fair value recognized in net income. On these instruments, the related contractual interest income and premium amortization are recorded as Interest Income in the Statements of Comprehensive Income. The remaining changes in fair value on these instruments are recorded as net gains (losses) in Noninterest Income on the Statements of Comprehensive Income. The fair value of these instruments is included in Level 2 in the fair value hierarchy for assets recorded at fair value on a recurring basis.

The following is a summary of the transactions on loans for which the fair value option has been elected for the nine months ended September 30, 2012:

Balance at January 1, 2012	$	-
New transactions elected for fair value option		**93,189**
Maturities, repayments and calls by issuers		**(29,998)**
Net gains (losses)on financial instruments under fair value option		**2,718**
Change in premium		**(1,643)**
Balance at September 30, 2012	**$**	**64,266**

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

	September 30, 2012	December 31, 2011
Nonaccrual loans:		
Real estate mortgage	**$ 223,693**	$ 318,798
Production and intermediate term	**24,143**	60,511
Agribusiness	**91,864**	57,205
Communication	**6,280**	4,479
Rural residential real estate	**1,687**	1,828
Energy and water/waste disposal	**-**	9,043
Lease receivables	**67**	2,881
Mission-related	**-**	749
Total nonaccrual loans	**347,734**	455,494
Accruing restructured loans:		
Real estate mortgage	**31,146**	19,321
Production and intermediate term	**14,358**	2,439
Agribusiness	**5,197**	7,796
Rural residential real estate	**35**	32
Total accruing restructured loans	**50,736**	29,588
Accruing loans 90 days or more past due:		
Real estate mortgage	**3,884**	1,432
Production and intermediate term	**79**	2,177
Agribusiness	**131**	2,684
Mission-related	**1,608**	-
Total accruing loans 90 days or more past due	**5,702**	6,293
Total nonperforming loans	**404,172**	491,375
Other property owned, net	**83,848**	87,956
Total nonperforming assets	**$ 488,020**	$ 579,331

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, 2012		December 31, 2011	
Real estate mortgage:				
Acceptable	**92.8**	**%**	91.5	%
OAEM	**3.8**		4.0	
Substandard/Doubtful	**3.4**		4.5	
	100.0	**%**	100.0	%
Production and intermediate term:				
Acceptable	**93.4**	**%**	89.6	%
OAEM	**3.4**		5.2	
Substandard/Doubtful	**3.2**		5.2	
	100.0	**%**	100.0	%
Agribusiness:				
Acceptable	**91.4**	**%**	87.1	%
OAEM	**4.2**		6.6	
Substandard/Doubtful	**4.4**		6.3	
	100.0	**%**	100.0	%
Energy and water/waste disposal:				
Acceptable	**95.2**	**%**	94.8	%
OAEM	**1.7**		2.2	
Substandard/Doubtful	**3.1**		3.0	
	100.0	**%**	100.0	%
Communication:				
Acceptable	**98.2**	**%**	98.4	%
OAEM	**-**		-	
Substandard/Doubtful	**1.8**		1.6	
	100.0	**%**	100.0	%
Rural residential real estate:				
Acceptable	**95.9**	**%**	95.8	%
OAEM	**2.0**		1.9	
Substandard/Doubtful	**2.1**		2.3	
	100.0	**%**	100.0	%
International:				
Acceptable	**100.0**	**%**	100.0	%
OAEM	**-**		-	
Substandard/Doubtful	**-**		-	
	100.0	**%**	100.0	%
Lease receivables:				
Acceptable	**98.6**	**%**	78.6	%
OAEM	**-**		-	
Substandard/Doubtful	**1.4**		21.4	
	100.0	**%**	100.0	%
Loans to other financing institutions:				
Acceptable	**100.0**	**%**	100.0	%
OAEM	**-**		-	
Substandard/Doubtful	**-**		-	
	100.0	**%**	100.0	%
Mission-related:				
Acceptable	**96.6**	**%**	95.1	%
OAEM	**-**		0.4	
Substandard/Doubtful	**3.4**		4.5	
	100.0	**%**	100.0	%
Total loans:				
Acceptable	**93.0**	**%**	91.2	%
OAEM	**3.5**		4.2	
Substandard/Doubtful	**3.5**		4.6	
	100.0	**%**	100.0	%

The following tables provide an age analysis of past due loans (including accrued interest) for the entire loan portfolio (including nonaccrual loans) as of:

<u>September 30, 2012</u>

	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	$ 66,730	$ 118,360	$ 185,090	$ 10,162,498	$ 10,347,588	$ 3,884
Production and intermediate term	14,017	11,382	25,399	1,863,063	1,888,462	79
Agribusiness	14,164	15,809	29,973	2,396,895	2,426,868	131
Communication	-	-	-	342,356	342,356	-
Energy and water/waste disposal	-	-	-	1,291,347	1,291,347	-
Rural residential real estate	3,234	114	3,348	197,564	200,912	-
International	-	-	-	202	202	-
Lease receivables	-	-	-	4,794	4,794	-
Loans to other financing institutions	-	-	-	58,823	58,823	-
Mission-related	4,925	1,608	6,533	185,078	191,611	1,608
Total	**$ 103,070**	**$ 147,273**	**$ 250,343**	**$16,502,620**	**$16,752,963**	**$ 5,702**

<u>December 31, 2011</u>

	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	$ 53,518	$ 171,907	$ 225,425	$ 10,040,235	$ 10,265,660	$ 1,432
Production and intermediate term	8,939	27,704	36,643	1,647,985	1,684,628	2,177
Agribusiness	2,900	26,970	29,870	2,037,299	2,067,169	2,684
Communication	-	-	-	280,176	280,176	-
Energy and water/waste disposal	-	9,044	9,044	1,001,752	1,010,796	-
Rural residential real estate	2,415	574	2,989	196,735	199,724	-
International	-	-	-	230	230	-
Lease receivables	-	2,759	2,759	10,707	13,466	-
Loans to other financing institutions	-	-	-	83,023	83,023	-
Mission-related	3,095	-	3,095	149,710	152,805	-
Total	$ 70,867	$ 238,958	$ 309,825	$ 15,447,852	$ 15,757,677	$ 6,293

Additional impaired loan information is as follows:

	At September 30, 2012			At December 31, 2011		
Impaired loans with a related allowance for loan losses:	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**	Recorded Investment	Unpaid Principal Balance	Related Allowance
Real estate mortgage	**$ 76,636**	**$ 96,710**	**$ 17,506**	$ 118,349	$ 150,418	$ 24,586
Production and intermediate term	**13,906**	**19,302**	**5,735**	23,467	34,507	12,407
Processing and marketing	**60,192**	**60,808**	**22,747**	15,675	16,176	7,828
Farm-related business	**12,232**	**12,470**	**3,211**	10,953	11,449	2,655
Communication	**5,174**	**5,174**	**3,743**	3,770	3,770	2,989
Energy and water/waste disposal	**-**	**-**	**-**	9,043	9,043	850
Rural residential real estate	**568**	**574**	**117**	477	492	119
Lease receivables	**-**	**-**	**-**	2,759	2,759	27
Mission-related	**-**	**-**	**-**	94	664	94
Total	**$ 168,708**	**$ 195,038**	**$ 53,059**	$ 184,587	$ 229,278	$ 51,555
Impaired loans with no related allowance for loan losses:						
Real estate mortgage	**$ 182,087**	**$ 186,309**	**$ -**	$ 221,202	$ 237,867	$ -
Production and intermediate term	**24,674**	**51,678**	**-**	41,660	64,060	-
Processing and marketing	**24,026**	**51,139**	**-**	32,299	59,019	-
Farm-related business	**742**	**7,846**	**-**	8,759	19,116	-
Communication	**1,106**	**1,106**	**-**	709	709	-
Energy and water/waste disposal	**-**	**22,796**	**-**	-	13,753	-
Rural residential real estate	**1,154**	**1,306**	**-**	1,382	1,515	-
Lease receivables	**67**	**67**	**-**	122	122	-
Mission-related	**1,608**	**5,347**	**-**	655	3,809	-
Total	**$ 235,464**	**$ 327,594**	**$ -**	$ 306,788	$ 399,970	$ -
Total impaired loans:						
Real estate mortgage	**$ 258,723**	**$ 283,019**	**$ 17,506**	$ 339,551	$ 388,285	$ 24,586
Production and intermediate term	**38,580**	**70,980**	**5,735**	65,127	98,567	12,407
Processing and marketing	**84,218**	**111,947**	**22,747**	47,974	75,195	7,828
Farm-related business	**12,974**	**20,316**	**3,211**	19,712	30,565	2,655
Communication	**6,280**	**6,280**	**3,743**	4,479	4,479	2,989
Energy and water/waste disposal	**-**	**22,796**	**-**	9,043	22,796	850
Rural residential real estate	**1,722**	**1,880**	**117**	1,859	2,007	119
Lease receivables	**67**	**67**	**-**	2,881	2,881	27
Mission-related	**1,608**	**5,347**	**-**	749	4,473	94
Total	**$ 404,172**	**$ 522,632**	**$ 53,059**	$ 491,375	$ 629,248	$ 51,555

	For the Three Months Ended				For the Nine Months Ended			
	September 30, 2012		September 30, 2011		**September 30, 2012**		September 30, 2011	
Impaired loans with a related allowance for loan losses:	**Average Impaired Loans**	**Interest Income Recognized**	Average Impaired Loans	Interest Income Recognized	**Average Impaired Loans**	**Interest Income Recognized**	Average Impaired Loans	Interest Income Recognized
Real estate mortgage	**$ 76,701**	**$ 28**	$ 170,514	$ 97	**$ 86,067**	**$ 88**	$ 165,241	$ 502
Production and intermediate term	**13,479**	**33**	31,769	7	**18,237**	**49**	30,621	80
Processing and marketing	**43,875**	**-**	39,841	-	**35,867**	**619**	42,477	22
Farm-related business	**12,244**	**81**	7,869	29	**13,998**	**40**	8,001	87
Communication	**3,966**	**-**	4,140	-	**3,818**	**-**	4,198	-
Energy and water/waste disposal	**-**	**-**	-	-	**2,969**	**-**	-	-
Rural residential real estate	**563**	**5**	703	-	**417**	**2**	556	4
Lease receivables	**-**	**-**	-	-	**916**	**-**	-	-
Mission-related	**-**	**-**	-	-	**103**	**-**	-	-
Total	**$ 150,828**	**$ 147**	$ 254,836	$ 133	**$ 162,392**	**$ 798**	$ 251,094	$ 695
Impaired loans with no related allowance for loan losses:								
Real estate mortgage	**$ 209,682**	**$ 1,480**	$ 306,666	$ 2,931	**$ 212,562**	**$ 4,319**	$ 350,738	$ 6,767
Production and intermediate term	**29,049**	**419**	53,375	279	**33,635**	**981**	54,645	757
Loans to cooperatives	**-**	**-**	-	-	**-**	**-**	127	9
Processing and marketing	**18,733**	**196**	28,710	101	**23,410**	**996**	29,898	322
Farm-related business	**957**	**56**	14,345	14	**3,232**	**424**	15,043	142
Communication	**764**	**-**	1,090	-	**724**	**-**	1,574	-
Energy and water/waste disposal	**-**	**-**	9,400	-	**1,901**	**-**	8,173	4
Rural residential real estate	**1,107**	**4**	772	3	**1,288**	**13**	838	10
Lease receivables	**69**	**-**	2,862	-	**73**	**-**	2,827	-
Mission-related	**1,851**	**30**	-	-	**2,283**	**91**	-	-
Total	**$ 262,212**	**$ 2,185**	$ 417,220	$ 3,328	**$ 279,108**	**$ 6,824**	$ 463,863	$ 8,011
Total impaired loans:								
Real estate mortgage	**$ 286,383**	**$ 1,508**	$ 477,180	$ 3,028	**$ 298,629**	**$ 4,407**	$ 515,979	$ 7,269
Production and intermediate term	**42,528**	**452**	85,144	286	**51,872**	**1,030**	85,266	837
Loans to cooperatives	**-**	**-**	-	-	**-**	**-**	127	9
Processing and marketing	**62,608**	**196**	68,551	101	**59,277**	**1,615**	72,375	344
Farm-related business	**13,201**	**137**	22,214	43	**17,230**	**464**	23,044	229
Communication	**4,730**	**-**	5,230	-	**4,542**	**-**	5,772	-
Energy and water/waste disposal	**-**	**-**	9,400	-	**4,870**	**-**	8,173	4
Rural residential real estate	**1,670**	**9**	1,475	3	**1,705**	**15**	1,394	14
Lease receivables	**69**	**-**	2,862	-	**989**	**-**	2,827	-
Mission-related	**1,851**	**30**	-	-	**2,386**	**91**	-	-
Total	**$ 413,040**	**$ 2,332**	$ 672,056	$ 3,461	**$ 441,500**	**$ 7,622**	$ 714,957	$ 8,706

At September 30, 2012, impaired loans of $168.7 million had a related specific allowance of $53.1 million, while the remaining $235.5 million of impaired loans had no related specific allowance as a result of adequate collateralization. District charge-offs in the first nine months of 2012 were predominantly made against loans to borrowers in the ethanol, land in transition, lessors of real property, timber, livestock, citrus fruit and dairy sectors.

The average recorded investment in impaired loans for the three months ended September 30, 2012, was $413.0 million. The district recognized interest income of $2.3 million on impaired loans during the three months ended September 30, 2012.

The average recorded investment in impaired loans for the nine months ended September 30, 2012, was $441.5 million. The district recognized interest income of $7.6 million on impaired loans during the nine months ended September 30, 2012.

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 $5,531 and $12,949 at September 30, 2012, and December 31, 2011, respectively, net of the unaccreted discount of $3 and $439, at September 30, 2012, and December 31, 2011, respectively. During the nine months ended September 30, 2012, the bank recorded provisions for loan losses related to these loans totaling $4,020. The allowance for loan losses related to these loans was $1,029 and $1,264 at September 30, 2012, and December 31, 2011, respectively.

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

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communications	Energy and Water/Waste Disposal	Rural Residential Real Estate	International	Lease Receivables	Loans to OFIs	Mission-Related	Total
Allowance for Loan Losses:											
Balance at June 30, 2012	$ 51,632	$ 19,811	$ 26,267	$ 3,721	$ 3,050	$ 391	$ -	$ 30	$ -	$ 168	$ 105,070
Charge-offs	(2,243)	(1,450)	(273)	-	55	(67)	-	-	-	(75)	(4,053)
Recoveries	1,007	975	202	-	-	-	-	-	-	-	2,184
Provision for loan losses	(1,310)	1,646	8,701	26	2,784	26	-	1	-	(56)	11,818
Other *	(9)	1	4	-	(2,726)	-	-	-	-	-	(2,730)
Balance at September 30, 2012	$ 49,077	$ 20,983	$ 34,901	$ 3,747	$ 3,163	$ 350	$ -	$ 31	$ -	$ 37	$ 112,289
Balance at December 31, 2011	$ 62,514	$ 21,748	$ 23,241	$ 3,374	$ 2,624	$ 436	$ -	$ 58	$ -	$ 122	$ 114,117
Charge-offs	(18,309)	(6,133)	(1,312)	-	(8,988)	(184)	-	-	-	(93)	(35,019)
Recoveries	3,167	1,693	485	-	-	4	-	-	-	-	5,349
Provision for loan losses	1,201	3,678	12,492	373	15,013	94	-	(27)	-	8	32,832
Other *	504	(3)	(5)	-	(5,486)	-	-	-	-	-	(4,990)
Balance at September 30, 2012	$ 49,077	$ 20,983	$ 34,901	$ 3,747	$ 3,163	$ 350	$ -	$ 31	$ -	$ 37	$ 112,289
Individually evaluated for impairment	18,892	5,845	26,069	2,989	-	137	-	-	-	-	53,932
Collectively evaluated for impairment	29,402	14,893	8,832	758	3,163	213	-	31	-	37	57,329
Loans acquired with deteriorated credit quality	783	245	-	-	-	-	-	-	-	-	1,028
Balance at September 30, 2012	$ 49,077	$ 20,983	$ 34,901	$ 3,747	$ 3,163	$ 350	$ -	$ 31	$ -	$ 37	$ 112,289
Balance at June 30, 2011	$ 86,130	$ 32,008	$ 30,068	$ 3,966	$ 883	$ 908	$ -	$ 58	$ -	$ -	$ 154,021
Charge-offs	(15,623)	(3,190)	(10,912)	-	-	(29)	-	-	-	-	(29,754)
Recoveries	300	510	1,317	-	(6)	-	-	-	-	-	2,121
Provision for loan losses	3,944	2,395	5,989	(305)	962	(130)	-	(19)	-	-	12,836
Other *	(281)	(36)	(99)	(1)	(9)	-	-	-	-	-	(426)
Balance at September 30, 2011	$ 74,470	$ 31,687	$ 26,363	$ 3,660	$ 1,830	$ 749	$ -	$ 39	$ -	$ -	$ 138,798
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
Individually evaluated for impairment	36,621	19,627	12,969	2,990	-	208	-	-	-	-	72,415
Collectively evaluated for impairment	34,994	11,799	13,394	670	1,830	541	-	39	-	-	63,267
Loans acquired with deteriorated credit quality	2,855	261	-	-	-	-	-	-	-	-	3,116
Balance at September 30, 2011	$ 74,470	$ 31,687	$ 26,363	$ 3,660	$ 1,830	$ 749	$ -	$ 39	$ -	$ -	$ 138,798
Recorded Investments in Loans Outstanding:											
Ending balance at September 30, 2012	$ 10,347,588	$ 1,888,462	$ 2,426,868	$ 342,356	$ 1,291,347	$ 200,912	$ 202	$ 4,794	$ 58,823	$ 191,611	$ 16,752,963
Individually evaluated for impairment	$ 255,883	$ 37,281	$ 95,853	$ 6,280	$ -	$ 2,236	$ -	$ 66	$ -	$ 1,550	$ 399,149
Collectively evaluated for impairment	$ 10,085,343	$ 1,847,557	$ 2,331,015	$ 336,076	$ 1,291,347	$ 198,676	$ 202	$ 4,728	$ 58,823	$ 190,061	$ 16,343,828
Loans acquired with deteriorated credit quality	$ 6,362	$ 3,624	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 9,986
Ending 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
Individually evaluated for impairment	$ 407,687	$ 74,089	$ 88,004	$ 7,445	$ 9,400	$ 1,681	$ -	$ 2,874	$ -	$ -	$ 591,180
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
Loans acquired with deteriorated credit quality	$ 18,067	$ 10,323	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 28,390

* Reserve for losses on standby letters of credit and unfunded commitments recorded in other liabilities

A restructuring of a debt constitutes a troubled debt restructuring if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Troubled debt restructurings are undertaken in order to improve the likelihood of recovery on the loan and may include, but are not limited to, forgiveness of principal or interest, interest rate reductions that are lower than the current market rate for new debt with similar risk, or significant term or payment extensions.

As of September 30, 2012, the total recorded investment of troubled debt restructured loans was $86,425, including $35,689 classified as nonaccrual and $50,736 classified as accrual, with specific allowance for loan losses of $2,160. As of September 30, 2012, commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring were $771.

The following table summarizes TDR loan balances by loan type:

	Loans Modified as TDRs		TDRs in Nonaccrual Status	
	September 30, 2012	December 31, 2011	September 30, 2012	December 31, 2011
Real estate mortgage	$ 57,778	$ 36,645	$ 26,632	$ 17,324
Production and intermediate term	19,038	19,038	4,680	16,599
Agribusiness	9,575	12,216	4,377	4,420
Rural residential real estate	34	32	-	-
Total	$ 86,425	$ 67,931	$ 35,689	$ 38,343

The following tables present additional information regarding troubled debt restructurings, which includes both accrual and nonaccrual loans with troubled debt restructuring designation, that occurred during the three and nine months ended September 30, 2012. The premodification outstanding recorded investment represents the recorded investment of the loans as of the quarter end prior to the restructuring. The postmodification outstanding recorded investment represents the recorded investment of the loans as of the quarter-end after the restructuring.

For the three months ended September 30, 2012:

	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	$ 1,246	$ 1,209
Production and intermediate term	46	45
Total	$ 1,292	$ 1,254

For the nine months ended September 30, 2012:

	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	$ 22,774	$ 21,772
Production and intermediate term	4,714	3,966
Total	$ 27,488	$ 25,738

The predominate form of concession granted for troubled debt restructuring includes extension of the term and delayed payments. Other types of modifications included interest rate reduction.

A payment default is defined as a payment that is 30 days past due after the date the loan was restructured. The following table presents information regarding troubled debt restructurings that occurred within the previous 12 months and for which there was a payment default during the period:

	Recorded Investment at September 30, 2012
Troubled debt restructurings that subsequently defaulted:	
Real estate mortgage	$ 8,052
Production and intermediate term	2,054
Total	$ 10,106

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, 2012, were approximately $192.5 billion.

During the third quarter of 2012, a district association, the bank and officers of the association and the bank were named as counter-defendants in a lawsuit involving loans between the association and a borrower which were subsequently sold to the bank. The association and the bank believe the borrower’s position is without merit and intends to vigorously defend the parties named in the litigation. In addition, in the normal course of business, the bank has various outstanding commitments and contingent liabilities, including the possibility of actions against the bank in which claims for monetary damages may be asserted. Management and legal counsel are not aware of any other pending lawsuits or actions. Upon the basis of current information, management and legal counsel are of the opinion that the ultimate liability, if any, resulting from lawsuits or other pending actions will not be material in relation to the financial position, results of operations or cash flows of the bank.

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 2011 Annual Report for a more complete description.

Assets and liabilities recorded at fair value on a recurring basis at September 30, 2012, for each of the fair value hierarchy levels are summarized below:

	Fair Value Measurements at September 30, 2012			
	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	**$ 35,518**	$ -	$ 35,518	$ -
Investments available for sale:				
Corporate debt	**148,571**	-	93,721	54,850
Mortgage-backed securities	**2,970,796**	-	2,939,279	31,517
Asset-backed securities	**30,944**	-	27,684	3,260
Mission-related and other available-for-sale investments	**122,111**	-	-	122,111
Loans valued under the fair value option	**64,266**	-	60,790	3,476
Derivative assets	**863**	-	863	-
Assets held in nonqualified benefit trusts	**3,515**	3,515	-	-
Total assets	**$ 3,376,584**	$ 3,515	$ 3,157,855	$ 215,214
Liabilities:				
Standby letters of credit	**$ 2,068**	$ -	$ 2,068	$ -
Total liabilities	**$ 2,068**	$ -	$ 2,068	$ -

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 June 30, 2012, to September 30, 2012:

	Corporate Debt	Mortgage-Backed Securities	Agricultural Mortgage-Backed Securities	Asset-Backed Securities	Loans Under Fair Value Option	Total
Available-for-sale investment securities:						
Balance at June 30, 2012	$ 14,850	$172,891	$ 127,173	$ 15,211	$ 1,638	$331,763
Net gains (losses) included in other comprehensive income	-	3,045	317	272		3,634
Net gains included in earnings	-	14	-	-	-	14
Purchases, issuances and settlements	40,000	(10,634)	(5,379)	(223)	-	23,764
Transfers out of Level 3	-	(133,799)	-	(12,000)	-	(145,799)
Balance at September 30, 2012	$ 54,850	$ 31,517	$ 122,111	$ 3,260	$ 1,638	$213,376
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, 2012	$ -	$ -	$ -	$ -	$ -	$ -

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, 2012, to September 30, 2012:

	Corporate Debt Securities	Mortgage-Backed Securities	Agricultural Mortgage-Backed Securities	Asset-Backed Securities	Loans Under Fair Value Option	Total
Available-for-sale investment securities:						
Balance at January 1, 2012	$ 82,464	$ 40,872	$ 110,921	$ 3,450		$ 237,707
Net gains (losses) included in other comprehensive income	67	5,722	(323)	510		5,976
Net gains (losses) included in earnings	-	14	-	(1)	7	20
Purchases, issuances and settlements	40,000	151,345	11,513	11,301	1,631	215,790
Transfers out of Level 3	(67,681)	(166,436)	-	(12,000)	-	(246,117)
Balance at September 30, 2012	$ 54,850	$ 31,517	$ 122,111	$ 3,260	$ 1,638	$ 213,376
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, 2012	$ -	$ -	$ -	$ 1	$ -	$ 1

There were no transfers of assets or liabilities into or out of Level 1 from other levels during the nine months ended September 30, 2012. Agricultural mortgage-backed securities are included in Level 3 due to limited activity or less transparency around inputs to their valuation. The net purchases and settlements in agricultural mortgage-backed securities include the bank's purchase of additional AMBS from a district association during the quarter ended September 30, 2012. At September 30, 2012, Level 3 investments included five agency MBS, one corporate debt instrument and one asset-backed security due to the fact that their valuations were based on Level 3 criteria (broker quotes), certain non-agency MBS and non-agency ABS backed by home equity, and certain loans held under the fair value option by a district association. In the first nine months of 2012, corporate debt instruments and an agency MBS which had previously been included in Level 3 were valued using independent third-party valuation services using Level 2 criteria and were, accordingly, transferred from Level 3 to Level 2.

Assets and liabilities measured at fair value on a nonrecurring basis at September 30, 2012, for each of the fair value hierarchy levels are summarized below:

	Fair Value Measurement at September 30, 2012				
	Total	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total Gains (Losses)**
Assets:					
Loans	**$ 303,440**	$ -	$ -	$ 303,440	**$ (35,019)**
Other property owned	**93,164**	-	-	93,164	**(12,616)**
Total assets	**$ 396,604**	$ -	$ -	$ 396,604	**$ (47,635)**

Assets and liabilities recorded at fair value on a recurring basis at December 31, 2011, for each of the fair value hierarchy levels are summarized below:

	Fair Value Measurements at December 31, 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	**$ 20,687**	$ -	$ 20,687	$ -
Investments available for sale:				
Corporate debt	**252,463**	-	169,999	82,464
Mortgage-backed securities	**2,783,579**	-	2,742,707	40,872
Asset-backed securities	**13,721**	-	10,271	3,450
Mission-related and other available-for-sale investments	**110,921**	-	-	110,921
Derivative assets	**1,726**	-	1,726	-
Assets held in nonqualified benefit trusts	**2,691**	2,691	-	-
Total assets	**$ 3,185,788**	$ 2,691	$ 2,945,390	$ 237,707
Liabilities:				
Derivative liabilities	**$ 486**	$ -	$ 486	$ -
Standby letters of credit	**3,093**	-	3,093	-
Total liabilities	**$ 3,579**	$ -	$ 3,579	$ -

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 June 30, 2011, to September 30, 2011:

	Corporate Debt	Mortgage-Backed Securities	Agricultural Mortgage-Backed Securities	Asset-Backed Securities	Total
Available-for-sale investment securities:					
Balance at June 30, 2011	$ 31,955	$ 103,697	$ 131,021	$ 5,020	$ 271,693
Net gains (losses) included in other comprehensive income	(623)	(1,685)	1,549	(187)	(946)
Net losses included in earnings	-	-	-	-	-
Purchases, issuances and settlements	26,428	48,994	(9,869)	(798)	64,755
Transfers out of Level 3	-	(50,566)	-	-	(50,566)
Balance at September 30, 2011	$ 57,760	$ 100,440	$ 122,701	$ 4,035	$ 284,936
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	$ -	$ -	$ -	$ -	$ -

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:

	Corporate Debt	Mortgage-Backed Securities	Agricultural Mortgage-Backed Securities	Asset-Backed Securities	Total
Available-for-sale investment securities:					
Balance at January 1, 2011	$ -	$ 100,385	$ 140,503	$ 6,760	$ 247,648
Net gains included in other comprehensive income	(547)	(510)	2,948	119	2,010
Net losses included in earnings	-	(1,934)	-	(153)	(2,087)
Purchases, issuances and settlements	58,307	88,533	(20,750)	(2,691)	123,399
Transfers out of Level 3	-	(86,034)	-	-	(86,034)
Balance at September 30, 2011	$ 57,760	$ 100,440	$ 122,701	$ 4,035	$ 284,936
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	$ -	$ 1,934	$ -	$ 153	$ 2,087

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 broker quotes 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 December 31, 2011, for each of the fair value hierarchy levels are summarized below:

	Fair Value Measurement at December 31, 2011				
	Total	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total Gains (Losses)**
Assets:					
Loans	$ 534,460	$ -	$ -	$ 534,460	$ (102,586)
Other property owned	94,534	-	-	94,534	(18,740)
Total assets	$ 628,994	$ -	$ -	$ 628,994	$ (121,326)

Financial assets and financial liabilities measured at carrying amounts and not measured at fair value on the Balance Sheet for each of the fair value hierarchy values are summarized as follows:

	September 30, 2012					December 31, 2011	
		Fair Value Measurements Using					
	Total Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value	Total Carrying Amount	Total Fair Value
Assets:							
Cash	**$ 355,923**	$ 355,923	$ -	$ -	$ 355,923	$ 432,719	$ 432,719
Mission-related and other held-to-maturity investments	**75,763**	-	-	75,477	75,477	127,245	127,039
Net loans	**16,220,113**	-	-	16,433,587	16,433,587	14,975,436	15,399,752
Total assets	**$ 16,651,799**	$ 355,923	$ -	$ 16,509,064	$ 16,864,987	$ 15,535,400	$ 15,959,510
Liabilities:							
Systemwide debt securities and other notes	**$ 16,862,625**	$ -	$ -	$ 17,103,700	$ 17,103,700	$ 16,045,541	$ 16,268,118
Subordinated debt	**50,000**	-	-	57,419	57,419	50,000	56,963
	$ 16,912,625	$ -	$ -	$ 17,161,119	$ 17,161,119	$ 16,095,541	$ 16,325,081

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:

Investments Available for Sale

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.

Derivative Assets and Liabilities

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.

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.

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

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 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.

For loans which are valued at fair value under the fair value pricing option, if quoted prices are not available in an active market, the fair value is estimated using pricing models, quoted prices for similar instruments received from pricing services or discounted cash flows. To estimate the fair value of these instruments, the bank obtains prices from third-party pricing services. Generally, these loans would be classified as Level 2. Loans held under the fair value option by a district association whose values are not obtained from third-party pricing services are classified as Level 3.

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.

Subordinated Debt

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

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.

Sensitivity to Changes in Significant Unobservable Inputs

For recurring fair value measurements categorized within Level 3 of the fair value hierarchy, the significant unobservable inputs used in the fair value measurement of the mortgage-backed securities are prepayment rates, probability of default and loss severity in the event of default. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement.

Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for the loss severity and a directionally opposite change in the assumption used for prepayment rates.

Quoted market prices may not be available for the instruments presented below. Accordingly, fair values are based on internal models that consider judgments regarding anticipated cash flows, future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Quantitative Information About Recurring and Nonrecurring Level 3 Fair Value Measurement

	Valuation Technique(s)	Unobservable Input
Mortgage-backed securities	Discounted cash flow	Prepayment rate Probability of default Loss severity
Asset-backed securities	Discounted cash flow	Prepayment rate Probability of default Loss severity
Mission-related investments	Discounted cash flow	Prepayment rates

Information About Recurring and Nonrecurring Level 2 Fair Value Measurements

	Valuation Technique(s)	Input
Federal funds sold	Carrying value	Par/principal
Investment securities available for sale	Quoted prices Discounted cash flow	Price for similar security Constant prepayment rate Appropriate interest rate yield curve
Loans held under the fair value option	Quoted prices Discounted cash flow	Price for similar security Constant prepayment rate Appropriate interest rate yield curve
Interest rate swaps	Discounted cash flow	Appropriate interest rate yield curve
Interest rate caps	Discounted cash flow	Appropriate interest rate yield curve Annualized volatility

Information About Other Financial Instrument Fair Value Measurements

	Valuation Technique(s)	Input
Cash	Carrying value	Actual balances
Loans	Discounted cash flow	Prepayment forecasts Appropriate interest rate yield curve
Systemwide debt securities, subordinated debt and other bonds	Discounted cash flow	Benchmark yield curve Derived yield spread Own credit risk

NOTE 6 — 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, 2012	$ 175	$ -	$ 645	$ 820
Additions	-	-	50	50
Maturities/Amortizations	(75)	-	-	(75)
Balance at September 30, 2012	**$ 100**	**$ -**	**$ 695**	**$ 795**

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, 2012, and December 31, 2011, the bank's exposure to counterparties, net of collateral, was $863 and $1.7 million, respectively. At September 30, 2012, and December 31, 2011, the bank had posted no securities as collateral, nor has any counterparty been required to post 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, 2012, or December 31, 2011.

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 9/30/2012	Fair Value 12/31/2011	Balance Sheet Location	Fair Value 9/30/2012	Fair Value 12/31/2011
Receive fixed	Other assets	$ 143	$ 499	Other liabilities	$ -	$ 486
Interest rate caps	Other assets	720	1,227	Other liabilities	-	-

Derivatives designated as hedging instruments	Amount of (Loss) Gain Recognized in OCI on Derivatives (Effective Portion)		Location of Gain Reclassification from AOCI into Income	Amount of Gain Reclassified from AOCI into Income (Effective Portion)	
	September 30,			September 30,	
	2012	2011		2012	2011
Interest rate caps	$ (1,018)	$ (3,723)	Interest expense	$ 323	$ 18
Cash flow derivatives	-	5			

NOTE 7 — 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 multiemployer structure of the district's defined benefit pension plan results in the recording of this plan only upon combination. In addition, the bank had a supplemental defined benefit pension plan, which was discontinued effective January 16, 2011, and for which final distributions were made in January 2012.

The following table summarizes the components of net periodic benefit costs for 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	
	2012	2011	**2012**	2011
Service cost	**$ 4,084**	$ 3,860	**$ 1,038**	$ 1,033
Interest cost	**11,732**	11,380	**1,984**	2,080
Expected return on plan assets	**(12,169)**	(12,225)	**-**	-
Amortization of prior service costs	**27**	27	**(1,345)**	(1,261)
Amortization of net loss	**10,354**	5,200	**255**	216
Amortization of loss due to curtailment/termination	**-**	1,596	**-**	-
Net periodic benefit cost	**$ 14,028**	$ 9,838	**$ 1,932**	$ 2,068

As of September 30, 2012, contributions of $15.8 million have been made to the defined benefit pension plan. The district presently anticipates no additional contributions to fund its pension plan in 2012.

NOTE 8 — 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 9 — ACCUMULATED OTHER COMPREHENSIVE INCOME

Accumulated other comprehensive income includes the accumulated balance of certain gains, losses or costs for which values are included in assets or liabilities on the balance sheets, but which have not yet been recognized in earnings. For the district, these elements include unrealized gains or losses on the bank's available-for-sale investment portfolio, elements of certain pension and retirement benefit changes, and changes in the value of cash flow derivative instruments.

The following table summarizes the changes in the balance of the components of accumulated other comprehensive loss for the nine months ended September 30, 2012:

	Total	Unrealized Gain on Securities	Retirement Benefit Plans	Cash Flow Derivative Instruments
Balance, January 1, 2012	$ (92,391)	$ 29,577	$ (116,286)	$ (5,682)
Change in unrealized gains on available-for-sale securities				
Net change in unrealized gains on investment securities	4,174	4,174		
Decrease in noncredit portion of other-than-temporary impairment (OTTI) losses	3,777	3,777		
Reclassification adjustment for OTTI credit losses included in net income	1	1		
Net change in unrealized gains on securities	7,952	7,952		
Change in retirement benefit plans				
Amounts amortized into net periodic expense:				
Amortization of prior service credits	(1,318)		(1,318)	
Amortization of net losses	10,609		10,609	
Net change in retirement benefit plans	9,291		9,291	
Change in cash flow derivative instruments				
Unrealized losses on interest rate caps	(1,018)			(1,018)
Reclassification of loss recognized in interest expense	323			323
Net change in cash flow derivative instruments	(695)			(695)
Total other comprehensive income (loss)	**16,548**	**7,952**	**9,291**	**(695)**
Balance, September 30, 2012	**$ (75,843)**	**$ 37,529**	**$ (106,995)**	**$ (6,377)**

The following table summarizes the changes in the balance of the components of accumulated other comprehensive loss for the nine months ended September 30, 2011:

	Total	Unrealized Gain on Securities	Retirement Benefit Plans	Cash Flow Derivative Instruments
Balance, January 1, 2011	$ (49,391)	$ 24,586	$ (71,671)	$ (2,306)
Change in unrealized gains on available-for-sale securities				
Net change in unrealized gains on investment securities	9,174	9,174		
Increase in noncredit portion of other-than-temporary impairment (OTTI) losses	628	628		
Reclassification adjustment for OTTI credit losses included in net income	2,087	2,087		
Net change in unrealized gains on securities	11,889	11,889		
Change in retirement benefit plans				
Amounts amortized into net periodic expense:				
Amortization of prior service credits	(1,234)		(1,234)	
Amortization of net losses	5,416		5,416	
Amortization of net loss due to curtailment/termination	1,596		1,596	
Net change in retirement benefit plans	5,778		5,778	
Change in cash flow derivative instruments				
Losses on interest rate caps	(3,723)			(3,723)
Gains on cash flow interest rate swaps	5			5
Reclassification of loss recognized in interest expense	18			18
Net change in cash flow derivative instruments	(3,700)			(3,700)
Total other comprehensive income (loss)	13,967	11,889	5,778	(3,700)
Balance, September 30, 2011	$ (35,424)	$ 36,475	$ (65,893)	$ (6,006)

NOTE 10 — SUBSEQUENT EVENTS

The district has evaluated subsequent events through November 9, 2012, which is the date the financial statements were issued. There are no significant subsequent events requiring disclosure as of November 9, 2012.

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, 2012**	December 31, 2011
Cash	**$ 352,432**	$ 424,667
Federal funds sold and overnight investments	**35,518**	20,687
Investment securities	**3,272,422**	3,160,683
Loans	**11,109,684**	10,287,377
Less allowance for credit losses	**17,034**	15,659
Net loans	**11,092,650**	10,271,718
Accrued interest receivable	**44,452**	41,314
Other property owned, net	**31,063**	28,748
Premises and equipment, net	**18,393**	13,814
Other assets	**92,585**	87,603
Total assets	**$ 14,939,515**	$ 14,049,234
Bonds and notes	**$ 13,462,625**	$ 12,645,541
Subordinated debt	**50,000**	50,000
Accrued interest payable	**36,122**	35,751
Preferred stock dividends payable	**21,881**	21,881
Other liabilities	**46,555**	85,705
Total liabilities	**13,617,183**	12,838,878
Preferred stock	**482,000**	482,000
Capital stock	**216,839**	216,839
Retained earnings	**591,266**	486,371
Accumulated other comprehensive income	**32,227**	25,146
Total shareholders' equity	**1,322,332**	1,210,356
Total liabilities and shareholders' equity	**$ 14,939,515**	$ 14,049,234

	Nine Months Ended September 30,	
Statement of income data	**2012**	2011
Interest income	**$ 294,542**	$ 320,120
Interest expense	**129,815**	150,733
Net interest income	**164,727**	169,387
Provision for credit losses	**26,951**	10,491
Net interest income after provision for credit losses	**137,776**	158,896
Noninterest income	**40,562**	22,629
Noninterest expense	**48,268**	45,807
Net income	**130,070**	135,718
Other comprehensive income:		
Change in retirement benefit plans	**(176)**	1,428
Change in fair value of investments	**7,952**	11,889
Change in cash flow derivative instruments	**(695)**	(3,700)
Total other comprehensive income	**7,081**	9,617
Comprehensive Income	**$ 137,151**	$ 145,335