

# Fulfilling Our Mission



2014

FIRST QUARTER REPORT

March 31, 2014



F A R M C R E D I T B A N K O F T E X A S

# ***FIRST QUARTER 2014***

## **Table of Contents**

Management's Discussion and Analysis of Financial Condition and Results of Operations .....	2
Controls and Procedures .....	11
Financial Statements:	
Balance Sheets .....	12
Statements of Comprehensive Income.....	13
Statements of Changes in Shareholders' Equity .....	14
Statements of Cash Flows .....	15
Notes to Financial Statements.....	16

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

*(dollars in thousands, except as noted)*

The following discussion reviews the financial condition and results of operations of the Farm Credit Bank of Texas (bank) for the three months ended March 31, 2014. These comments should be read in conjunction with the accompanying financial statements and footnotes, along with the 2013 Annual Report to shareholders. The accompanying financial statements were prepared under the oversight of the bank's audit committee.

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

The United States is currently served by three Farm Credit Banks (FCBs), each of which has specific authority to fund affiliated associations and other financing institutions (OFIs) making loans to agricultural producers, farm-related businesses and rural home owners within a regional chartered territory (or district), and by one Agricultural Credit Bank (ACB), which has the lending authority of an FCB within its chartered territory and nationwide authority limited to finance agricultural cooperatives and rural utilities. The FCBs and the ACB are collectively referred to as "System banks." As FCBs, the primary purpose of the System banks is to serve as a source of funding for System associations within their districts. The System associations make loans to or for the benefit of eligible borrowers for qualified purposes.

The bank and its affiliated associations collectively are referred to as the "district." At March 31, 2014, the bank provided financing to 15 district associations and certain other financing institutions.

### **RESULTS OF OPERATIONS**

#### *Net Income*

Net income for the three months ended March 31, 2014, was \$44,806, a decrease of \$8,966, or 16.7 percent, over the same period of 2013. The decrease in net income for the three months ended March 31, 2014, consisted of a \$5,137 decrease in noninterest income, a \$3,757 decrease in net interest income, and a \$970 increase in noninterest expense, offset by a \$898 decrease in provision for credit losses.

#### *Net Interest Income*

Net interest income for the three months ended March 31, 2014, was \$51,941, a decrease of \$3,757, or 6.7 percent, over the same period of 2013. The decrease in net interest income was attributable to a 20-basis-point decrease in the bank's interest rate spread to 127 basis points, offset by the effects of a volume increase of \$912.6 million in the bank's average earning assets. The interest rate spread decrease included a 16-basis-point decrease in the effective rate on earning assets and a 4-basis-point increase in the effective rate on interest-bearing liabilities for the three months ended March 31, 2014, compared to the three months ended March 31, 2013. The effective rates on earning assets have declined as new volume and existing loan repricings are reflective of the low interest rate environment combined with high levels of competition in the capital markets. The increase in the bank's average earning assets included an increase in its capital market loans, investment portfolio and direct notes from associations. Interest expense for the first three months of 2014 reflected a \$325 decrease in concession expenses recognized on callable debt as a result of a \$430.2 million decrease in debt called in the first three months of 2014, compared to the same period in 2013. The bank called \$890.0 million in debt in the three

months ended March 31, 2014. The bank's effective rate on interest-bearing liabilities has increased as the bank has begun to fund loan growth with longer-term debt.

#### *Provision for Credit Losses*

The bank's negative provision for credit losses for the three months ended March 31, 2014, totaled \$3, a decrease of \$898, or 100.3 percent, over the \$895 provision for credit losses for the first three months of 2013.

#### *Noninterest Income*

Noninterest income for the three months ended March 31, 2014, was \$10,615, a decrease of \$5,137, or 32.6 percent, over the same period of 2013. The decrease was due mainly to a \$6,021 decrease in loan-related fee income, a \$13 decrease in fair value on loans previously purchased in the secondary market, and a \$6 decrease in all other income items, collectively, offset by a \$666 increase in services billed to associations, a \$143 decrease in credit losses realized on OTTI investment securities, and a \$94 increase in patronage income. The decrease in loan-related fee income is primarily due to a nonrecurring \$6.0 million prepayment fee on one large loan received in the first quarter of 2013. The bank has elected a fair value option for financial presentation purposes on certain 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 instruments. The decrease in fair value on these loans is largely a result of changes in the interest rate environment. As discussed in the "Investments" section of this Management's Discussion and Analysis, the bank performs other-than-temporary impairment (OTTI) assessments on investment securities based on evaluations of both current and future market and credit conditions at each quarter end. During the first quarter of 2014, the bank recorded no credit losses for OTTI purposes, compared to a \$143 loss realized on the sale of one security during the first quarter of 2013.

#### *Noninterest Expense*

Noninterest expense for the three months ended March 31, 2014, was \$17,753, an increase of \$970, or 5.8 percent, over the same period of 2013. The increase was attributable to a \$917 increase in occupancy and equipment expenses, a \$398 increase in salaries and employee benefits, a \$352 increase in premiums assessed by the FCSIC, and a \$159 increase in other operating expenses, offset by an \$856 decrease in losses on other property owned (OPO). The increase in occupancy and equipment included a \$1,183 increase in computer expenses, which included a \$913 increase in software maintenance and licensing and a \$295 increase in depreciation due mainly to internally developed software that has been placed in service. The \$398 increase in salaries and benefits included a \$378 increase in compensation and related payroll taxes. Premiums to the FCSIC increased as a result of the rate increase from 10 basis points in 2013 to 12 basis points in 2014 and an increase in average covered debt outstanding. The decrease in losses on OPO included a \$661 decrease in provision for losses on OPO, a \$150 increase in net gains on disposition of OPO, and a \$45 decrease in net expenses on OPO.

**Key results of operations comparisons:**

	<b>Annualized for the Three Months Ended 3/31/2014</b>	Annualized for the Three Months Ended 3/31/2013
Return on average assets	<b>1.12%</b>	1.42%
Return on average shareholders' equity	<b>12.75%</b>	16.81%
Net interest income as a percentage of average earning assets	<b>1.34%</b>	1.53%
Charge-offs, net of recoveries, to average loans	<b>0.01%</b>	0.16%
Operating expenses as a percentage of net interest income and noninterest income	<b>29.18%</b>	22.99%
Operating expenses as a percentage of average earning assets	<b>0.47%</b>	0.45%

*Other Comprehensive Loss*

Other comprehensive loss 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 bank, these elements include unrealized gains or losses on the bank's available-for-sale investment portfolio, elements of certain postretirement benefit changes, and changes in the value of cash flow derivative instruments.

The table below summarizes the changes in elements included in other comprehensive loss for the three months ended March 31:

	<b>2014</b>	2013
Change in unrealized losses on available-for-sale securities		
Net decrease (increase) in unrealized losses on investment securities	\$ <b>6,979</b>	\$ (7,338)
Decrease in noncredit portion of other-than-temporary impairment (OTTI) losses	<b>9</b>	1,030
Reclassification adjustment for OTTI credit losses included in net income	-	143
Net change in unrealized gains (losses) on securities	<b>6,988</b>	(6,165)
Change in postretirement benefit plans		
Amounts amortized into net periodic expense:		
Amortization of prior service credits	<b>(48)</b>	(48)
Amortization of net losses	-	4
Net change in postretirement benefit plans	<b>(48)</b>	(44)
Change in cash flow derivative instruments		
Gains (losses) on interest rate caps	<b>(288)</b>	54
Reclassification of loss recognized in interest expense	<b>570</b>	273
Net change in cash flow derivative instruments	<b>282</b>	327
Other comprehensive income (loss)	<b>\$ 7,222</b>	\$ (5,882)

**FINANCIAL CONDITION***Loan Portfolio*

Gross loan volume at March 31, 2014, was \$12,027,106, an increase of \$248,365, or 2.1 percent, compared to \$11,778,741 at December 31, 2013. The increase in the loan portfolio is attributable to growth in the bank's capital markets loan portfolio and an increase in the bank's direct loans to associations.

In 2011, 2012 and July 2013 the bank purchased a total of \$53,011 in loan participations from two district associations in Capitalized Participation Pool (CPP) transactions. As a condition of the transactions, the bank redeemed stock in the amount of 2.0 percent of the par value of the loans purchased, and the associations bought bank stock equal to 8.0 percent of the purchased loans' par value. CPP loans held at March 31, 2014, totaled \$38,963.

Loans classified under the Farm Credit Administration's Uniform Loan Classification System as "acceptable" or "other assets especially mentioned" were 98.4 percent of total loans and accrued interest at March 31, 2014, compared to 98.2 percent at December 31, 2013. The increase included the effects of high-quality loans added to the bank's capital markets loan portfolio.

The table below summarizes the balances of the bank's high-risk assets at March 31, 2014, compared to the balances at December 31, 2013:

	<b>March 31, 2014</b>	Increase (Decrease)		<b>December 31, 2013</b>
		\$	%	
Nonaccrual loans	<b>\$ 22,697</b>	\$ (5,435)	(19.32) %	\$ 28,132
Formally restructured loans	<b>12,354</b>	(128)	(1.03)	12,482
Loans 90 days past due and still accruing interest	<b>5</b>	5	-	-
Total impaired loans	<b>35,056</b>	(5,558)	(13.68)	40,614
Other property owned, net	<b>11,079</b>	(2,733)	(19.79)	13,812
Total high-risk assets	<b>\$ 46,135</b>	\$ (8,291)	(15.23) %	\$ 54,426

The decrease in nonaccrual loans was due mainly to repayments of \$9,045 and net charge-offs of \$243, net of \$3,853 in advances on nonaccrual loans. During the three months ended March 31, 2014, the bank recorded charge-offs totaling \$290 against the allowance for loan losses due to known losses on loans in ethanol sectors. At March 31, 2014, \$6.1 million, or 26.7 percent, of the bank's nonaccrual loans were considered current as to principal and interest. Continued satisfactory payment performance on these loans may indicate potential for a return to accrual status. At March 31, 2014, the bank had \$1.5 million in nonaccrual loans on which cash payments are recognized as interest income, compared to \$1.5 million at December 31, 2013. The decrease in other property owned included a \$5,414 net decrease in real estate properties held, and a \$2,681 decrease in the fair value adjustments on other property owned. The decrease in properties held resulted primarily from the disposal of two properties totaling \$3,228, with a net gain of \$415 on disposition.

Impaired loans, consisting of nonaccrual loans and formally restructured loans, and loans 90 days past due and still accruing interest, constituted 0.3 percent of gross loans at March 31, 2014, and 0.3 percent of gross loans at December 31, 2013.

At March 31, 2014, the bank had reserves for credit losses totaling \$18,942, including an allowance for loan losses of \$14,391 and a reserve for losses on unfunded commitments of \$4,551. The allowance for

loan losses of \$14,391 equated to 0.12 percent of total loans outstanding and 0.3 percent of capital market loans outstanding. The \$4,551 reserve for losses included a general reserve for losses on unused loan commitments, a general reserve for losses on letters of credit and a specific reserve related to one letter of credit, representing management's estimate of probable credit losses related to letters of credit.

In December 2013, the bank implemented a change in its general reserve methodology by reserving against 50 percent on any unused loan commitments. The bank also adopted revised Moody's probability of default percentages which were applied for calculations of general reserves for loans and unfunded commitments (letters of credit and unused commitments).

The allowance for loan losses as a percentage of impaired loans was 41.05 percent as of March 31, 2014, as compared to 33.6 percent as of December 31, 2013. The nature of the collateral (primarily first lien real estate) supporting many of the impaired loans is considered in the determination of necessary allowances for loan losses.

### *Liquidity and Funding Sources*

Cash and investment securities totaled \$4,244,997, or 25.8 percent, of total assets at March 31, 2014, compared to \$4,262,116, or 26.3 percent, at December 31, 2013, a decrease of \$17,119, or 0.4 percent. At March 31, 2014, the bank's cash balance was \$468,558, a \$133,894 decrease from December 31, 2013. Cash held at the Federal Reserve Bank at March 31, 2014, totaled \$445,441, compared to \$572,754 at December 31, 2013. Levels of cash and other highly liquid assets are maintained to meet loan demand, debt servicing and other liquidity needs. At March 31, 2014, the bank had 260 days of liquidity to cover maturing debt obligations. Interest-bearing liabilities, consisting of bonds, notes and subordinated debt, increased by \$252,878, or 1.7 percent, from December 31, 2013, to March 31, 2014.

### *Investments*

The bank's investments are all considered available for sale, and include a liquidity portfolio and a portfolio of other investments. The liquidity portfolio had a fair value of \$3.66 billion at March 31, 2014, and consisted primarily of federal agency-guaranteed collateralized mortgage-backed securities, corporate debt, agency-guaranteed debt, asset-backed securities and other collateralized mortgage-backed securities. The bank's other investments, totaling \$93.3 million, consisted of Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed agricultural mortgage-backed securities (AMBS) purchased from district associations. The Farmer Mac securities are backed by loans originated by the associations and previously held by the associations under the Farmer Mac long-term standby commitment to purchase agreements.

Farmer Mac is a government-sponsored enterprise and is examined and regulated by FCA. It provides a secondary market 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 majority of the bank's mortgage-backed securities were federal agency-guaranteed collateralized mortgage-backed securities, including Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC) securities.

The following table summarizes the bank's liquidity portfolio holdings:

	<b>March 31, 2014</b>		December 31, 2013	
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
Agency-guaranteed debt	\$ 132,945	\$ 127,926	\$ 135,738	\$ 130,024
Corporate debt	245,275	245,251	250,312	249,579
Federal agency-guaranteed collateralized mortgage-backed securities:				
GNMA	1,686,820	1,678,568	1,690,952	1,680,426
FNMA and FHLMC	1,565,847	1,559,007	1,431,037	1,421,578
Other collateralized mortgage-backed securities	7,476	7,375	7,736	7,529
Asset-backed securities	43,774	43,813	51,320	51,296
Total available-for-sale investments	<u>\$ 3,682,137</u>	<u>\$ 3,661,940</u>	<u>\$ 3,567,095</u>	<u>\$ 3,540,432</u>

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

	<b>March 31, 2014</b>		December 31, 2013	
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
Agricultural mortgage-backed securities	\$ 96,404	\$ 93,287	\$ 101,063	\$ 97,423

During the three months ended March 31, 2014, there was a decrease in unrealized losses on investments totaling \$6,988, due primarily to recent changes in the interest rate environment.

At March 31, 2014, the bank had one ABS that was considered other-than-temporarily impaired (OTTI). During the three months ended March 31, 2014, there were no credit losses recognized on OTTI investments. The non-credit-related unrealized loss on the bank's other-than-temporarily impaired investment, totaling \$42, is included in accumulated other comprehensive loss. 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."

FCA 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 and other obligations fully insured or guaranteed by the U.S. government, its agencies, instrumentalities and corporations are considered eligible investments under the FCA's regulations, even if downgraded. Under the regulations, these investments have no final maturity limit, no credit rating requirement by NRSROs, no investment portfolio limit or other requirements. If an investment no longer meets the credit rating criteria, the investment becomes ineligible. To date, the FCA has not required disposition of any of these securities. While these investments do not meet the FCA's standards for liquidity, they are included in the net collateral calculation at the lower of market or book value.

At March 31, 2014, the bank held seven 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 \$8,519 and a fair value of \$8,371 at March 31, 2014.



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

	Eligible			Ineligible				Total
	AAA/Aaa	AA/Aa	Split Rated	AA/Aa	A/A	BBB/Baa	CCC/Caa	
<u>March 31, 2014</u>								
Agency-guaranteed debt	\$ -	\$ -	\$ 127,926	\$ -	\$ -	\$ -	\$ -	\$ 127,926
Corporate debt	-	86,052	159,199	-	-	-	-	245,251
Federal agency collateralized mortgage-backed securities*								
GNMA	-	-	1,678,568	-	-	-	-	1,678,568
FNMA and FHLMC	-	-	1,559,007	-	-	-	-	1,559,007
Other collateralized mortgage-backed securities	-	-	-	2,678	-	4,697	-	7,375
Asset-backed securities	42,817	-	-	-	725	-	271	43,813
<b>Total</b>	<b>\$ 42,817</b>	<b>\$ 86,052</b>	<b>\$ 3,524,700</b>	<b>\$ 2,678</b>	<b>\$ 725</b>	<b>\$ 4,697</b>	<b>\$ 271</b>	<b>\$ 3,661,940</b>
<u>December 31, 2013</u>								
Agency-guaranteed debt	\$ -	\$ -	\$ 130,024	\$ -	\$ -	\$ -	\$ -	\$ 130,024
Corporate debt	-	75,832	173,747	-	-	-	-	249,579
Federal agency collateralized mortgage-backed securities*								
GNMA	-	-	1,680,426	-	-	-	-	1,680,426
FNMA and FHLMC	-	-	1,421,578	-	-	-	-	1,421,578
Other collateralized mortgage-backed securities	-	-	-	2,696	-	4,833	-	7,529
Asset-backed securities	50,138	-	-	-	882	-	276	51,296
<b>Total</b>	<b>\$ 50,138</b>	<b>\$ 75,832</b>	<b>\$ 3,405,775</b>	<b>\$ 2,696</b>	<b>\$ 882</b>	<b>\$ 4,833</b>	<b>\$ 276</b>	<b>\$ 3,540,432</b>

\*Due to credit rating actions in 2011 which downgraded the credit rating of 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, these investments were reported as eligible split-rated investments.

### Capital Resources

At March 31, 2014, and at December 31, 2013, the bank had \$600.0 million of Class B non-cumulative subordinated perpetual preferred stock.

As of March 31, 2014, the bank exceeded the minimum permanent capital, core surplus, total surplus and net collateral ratio requirements under Farm Credit Administration regulations. At March 31, 2014, the bank's permanent capital ratio was 18.19 percent, core surplus was 9.42 percent, total surplus was 15.04 percent and the net collateral ratio was 108.78 percent. Shareholders' equity at March 31, 2014, totaled \$1,439,272, an increase of \$46,025 from December 31, 2013. This increase is the result of net income of \$44,806 for the three months ended March 31, 2014 and a \$7,222 decrease in accumulated other comprehensive loss, offset by dividends on preferred stock totaling \$5,062 and patronage paid of \$941. Other comprehensive income of \$7,222 included a decrease in unrealized losses on investments of \$6,988 and a \$282 decrease in unrealized losses on cash flow derivative instruments, net of a \$48 amortization of other postretirement benefits. The decrease in unrealized losses on investment securities was due primarily to recent changes in the interest rate environment.

### Key financial condition comparisons:

	<u>March 31, 2014</u>	<u>December 31, 2013</u>
Permanent capital ratio	<b>18.19%</b>	21.64%
Net collateral ratio	<b>108.78%</b>	108.67%
Allowance and reserve for credit losses to total loans	<b>0.16%</b>	0.16%

## **OTHER**

### **CONDITIONS IN THE TEXAS FARM CREDIT DISTRICT**

During the first quarter of 2014, states in the eastern portion of the district continued to benefit from adequate to surplus levels of soil moisture, generally resulting in good pasture and range condition as well as sufficient moisture for field crops. Meanwhile, soil moisture levels in the majority of Texas and New Mexico are carrying a shortfall, as most areas within Texas and New Mexico are in some stage of drought. On a more regional focus, drought conditions in most of central and north Texas are currently being classified as extreme and exceptional, while east Texas and south Texas are in general benefiting from higher levels of soil moisture and are no longer considered to be in any stage of drought. Most recently, moderate to heavy rains have fallen across most parts of Alabama, Mississippi and Louisiana, while rainfall in Texas and New Mexico has been isolated and more sporadic.

In the Texas District, planting season for most crops is now under way; however, crop progress for the eastern states is behind the five-year average due to cool, wet conditions. According to the USDA's Prospective Plantings Report, farmers are expected to more heavily allocate acres to both soybeans and cotton, which can primarily be attributed to changes in the price relationships for alternative crops. Looking forward to the early summer months, the focus will be on growing conditions and the impact on harvested acres, yields and, ultimately, price. Dry-land cotton farmers in Texas and New Mexico will continue to use multi-peril crop insurance as protection against the risk of drought.

Across most of the district, reduced feed prices, coupled with generally higher protein prices, have had a positive impact on the livestock, poultry and dairy industries. Throughout most of Texas and New Mexico, the cattle industry continues to experience significant contraction due to the prolonged drought conditions; however, cattle ranchers have begun the process of expanding the herd through increased heifer retention. Feedlots continue to struggle with cattle numbers as well as margins; however, elevated beef prices and a strong corn crop have aided profitability. Dairy producers are currently benefiting from very strong milk prices and are feeling some relief due to reduced feed costs. Given the declining number of cattle being fattened out to finish and the harvest of the record corn crop, poultry growers should be able to maintain margins, despite increased production of chicken. As livestock producers manage profitability, risk management of operations will continue to provide protection from commodity price volatility and the threat of rising production costs. Due to the district's limited exposure to pork, recent developments related to swine viruses are expected to have little to no impact on the bank's loan portfolio.

Nonfarm labor markets are generally improving, and the housing and construction sector continues to recover. Global supply and demand dynamics continue to play a supportive role in the agricultural concentrations in the district loan portfolio, which is expected to contribute to the preservation of credit quality moving further into 2014. As always, weather conditions, as well as other macro-economic forces, such as unemployment and foreign demand, might impact portfolio profitability going forward. However, the district continues to be supported by strong credit quality and well-balanced portfolio diversification.

### **ASSOCIATION MERGERS**

In 2014, there were two mergers affecting four district associations. The mergers of Lone Star, ACA and Texas Land Bank, ACA, forming Lone Star, ACA, and of Texas AgFinance and AgriLand, Farm Credit Services, forming Texas Farm Credit Services, became effective January 1, 2014. The mergers were accounted for under the acquisition method of accounting under generally accepted accounting principles. As of January 1, 2014, the number of affiliated associations in the district decreased from 17 to 15, consisting of 14 ACAs and one FLCA.

## RATING AGENCY ACTIONS

### *Fitch Ratings Actions*

On March 21, 2014, Fitch Ratings affirmed the bank's long-term and short-term issuer default ratings (IDRs) at "AA-" and "F1+," respectively, with a stable outlook. Fitch also affirmed the bank's subordinated debt rating at "A+," its noncumulative perpetual preferred stock rating at "BBB" and its support floor at "AA-." Fitch also affirmed the Farm Credit System's long-term and short-term issuer default ratings (IDRs) at "AAA" and "F1+," respectively, with a stable outlook, and its support floor at "AAA." As a government-sponsored entity, the System benefits from implicit government support, and thus, the ratings and rating outlook are directly linked to the U.S. sovereign rating. The affirmation of the System banks' IDRs reflect their prudent, conservative credit culture, their unique funding advantage and their structural second-loss position on the majority of their loan portfolio.

## REGULATORY MATTERS

As of March 31, 2014, FCA had enforcement actions in place against one association in the district, which has not had, and is not expected to have, a significant impact on the bank.

On March 13, 2014, the FCA Board approved an interim final rule to remove all requirements related to nonbinding advisory votes regarding chief executive officer (CEO) and senior officer compensation at Farm Credit System institutions. The interim final rule will become effective 30 days after publication in the Federal Register during which either body of Congress is in session, which is expected to be during the second quarter of 2014. Other provisions of recent regulation regarding enhanced transparency of compensation for CEOs and senior officers and enhanced responsibilities of the compensation committees of boards of directors continue to be in effect.

On May 8, 2014, the Farm Credit Administration approved a proposed rule to modify the regulatory capital requirements for System banks and associations. (See Note 9 to the accompanying financial statements for further discussion on the proposed rule.)

The undersigned certify that we have reviewed the March 31, 2014, quarterly report of the Farm Credit Bank of Texas, that the report has been prepared in accordance with all applicable statutory or regulatory requirements, and that the information included herein is true, accurate and complete to the best of our knowledge and belief.



Larry R. Doyle  
Chief Executive Officer



James F. Dodson  
Chairman of the Board



Amie Pala  
Chief Financial Officer

May 9, 2014

## Controls and Procedures

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

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



Larry R. Doyle  
Chief Executive Officer



Amie Pala  
Chief Financial Officer

May 9, 2014

## Balance Sheets

(dollars in thousands)	March 31, 2014 (Unaudited)	December 31, 2013
<b>Assets</b>		
Cash	\$ 468,558	\$ 602,452
Federal funds sold and overnight investments	21,212	21,809
Investment securities	3,755,227	3,637,855
Loans (includes \$58,505 and \$58,461 at fair value held under fair value option)	12,027,106	11,778,741
Less allowance for loan losses	14,391	13,660
Net loans	12,012,715	11,765,081
Accrued interest receivable	43,149	37,657
Other property owned, net	11,079	13,812
Premises and equipment, net	24,161	23,214
Other assets	115,024	110,837
<b>Total assets</b>	<b>\$ 16,451,125</b>	<b>\$ 16,212,717</b>
<b>Liabilities and shareholders' equity</b>		
<b>Liabilities</b>		
Bonds and notes, net	\$ 14,854,890	\$ 14,602,012
Subordinated debt	50,000	50,000
Accrued interest payable	38,896	37,749
Reserve for credit losses	4,551	5,529
Preferred stock dividends payable	20,063	20,063
Other liabilities	43,453	104,117
<b>Total liabilities</b>	<b>15,011,853</b>	<b>14,819,470</b>
<b>Commitments and contingent liabilities (Note 4)</b>		
<b>Shareholders' equity</b>		
Preferred stock	600,000	600,000
Capital stock	220,543	220,543
Allocated retained earnings	20,310	20,314
Unallocated retained earnings	624,310	585,503
Accumulated other comprehensive loss	(25,891)	(33,113)
<b>Total shareholders' equity</b>	<b>1,439,272</b>	<b>1,393,247</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 16,451,125</b>	<b>\$ 16,212,717</b>

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

## Statements of Comprehensive Income

(unaudited)

(dollars in thousands)	Quarter Ended March 31,	
	2014	2013
<b>Interest Income</b>		
Investment securities	\$ 12,117	\$ 13,423
Loans	80,753	79,513
<b>Total interest income</b>	<b>92,870</b>	92,936
<b>Interest Expense</b>		
Bonds, notes and subordinated debt	40,929	37,238
<b>Total interest expense</b>	<b>40,929</b>	37,238
<b>Net interest income</b>	<b>51,941</b>	55,698
(Negative provision) provision for credit losses	(3)	895
<b>Net interest income after provision for loan losses</b>	<b>51,944</b>	54,803
<b>Noninterest Income</b>		
Patronage income	5,364	5,270
Fees for services to associations	1,374	708
Loan-related fees	3,068	9,089
Gain on loans held under fair value option	564	577
Miscellaneous income, net	245	251
Impairment losses on investments		
Total other-than-temporary impairment losses	-	(143)
Less: portion of gain (loss) recognized in other comprehensive income	-	-
Net impairment loss recognized in earnings	-	(143)
<b>Total noninterest income</b>	<b>10,615</b>	15,752
<b>Noninterest Expense</b>		
Salaries and employee benefits	7,597	7,199
Occupancy and equipment	3,364	2,447
Insurance Fund premiums	1,759	1,407
Losses (gains) on other property owned, net	(501)	355
Other operating expenses	5,534	5,375
<b>Total noninterest expense</b>	<b>17,753</b>	16,783
<b>Net Income</b>	<b>44,806</b>	53,772
<b>Other comprehensive income (loss)</b>		
Change in postretirement benefit plans	(48)	(44)
Change in unrealized loss on investments	6,988	(6,165)
Change in cash flow derivative instruments	282	327
<b>Total other comprehensive income (loss)</b>	<b>7,222</b>	(5,882)
<b>Comprehensive Income</b>	<b>\$ 52,028</b>	\$ 47,890

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

**Statements of Changes in Shareholders' Equity**

(unaudited)

(dollars in thousands)	Preferred Stock	Capital Stock	Allocated Retained Earnings	Unallocated Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2012	\$ 482,000	\$ 212,588	\$ 16,984	\$ 534,438	\$ 27,833	\$ 1,273,843
Net income	-	-	-	53,772	-	53,772
Other comprehensive loss	-	-	-	-	(5,882)	(5,882)
Patronage distributions						
Cash	-	-	-	(941)	-	(941)
Shareholders' equity	-	-	1	(1)	-	-
<b>Balance at March 31, 2013</b>	<b>\$ 482,000</b>	<b>\$ 212,588</b>	<b>\$ 16,985</b>	<b>\$ 587,268</b>	<b>\$ 21,951</b>	<b>\$ 1,320,792</b>
Balance at December 31, 2013	\$ 600,000	\$ 220,543	\$ 20,314	\$ 585,503	\$ (33,113)	\$ 1,393,247
Net income	-	-	-	44,806	-	44,806
Other comprehensive gain	-	-	-	-	7,222	7,222
Preferred stock dividends accrued	-	-	-	(5,062)	-	(5,062)
Patronage distributions						
Cash	-	-	-	(941)	-	(941)
Shareholders' equity	-	-	(4)	4	-	-
<b>Balance at March 31, 2014</b>	<b>\$ 600,000</b>	<b>\$ 220,543</b>	<b>\$ 20,310</b>	<b>\$ 624,310</b>	<b>\$ (25,891)</b>	<b>\$ 1,439,272</b>

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

## Statements of Cash Flows

(unaudited)

(dollars in thousands)	Three Months Ended March 31,	
	2014	2013
<b>Operating activities</b>		
Net income	\$ 44,806	\$ 53,772
Reconciliation of net income to net cash provided by operating activities		
(Negative provision) provision for credit losses	(3)	895
(Negative provision) provision for losses on other property owned	(81)	580
Depreciation and amortization on premises and equipment	1,142	869
Accretion of net discount on loans	1,441	248
Amortization and accretion on debt instruments	(911)	(832)
Amortization of net discount on investment securities	(730)	(1,208)
Increase in fair value on loans under fair value option	(564)	(577)
Gains from sales of other property owned, net	(414)	(264)
Losses on impairment of investments available-for-sale	-	143
Gains from sales of premises and equipment	(16)	-
Allocated equity patronage from System bank	(13,083)	(12,406)
Increase in accrued interest receivable	(5,492)	(8,580)
Decrease in other assets	9,178	9,318
Increase in accrued interest payable	1,147	3,473
Decrease in other liabilities	(11,660)	(6,423)
Net cash provided by operating activities	24,760	39,008
<b>Investing activities</b>		
Net decrease in federal funds	597	3,466
Investment securities		
Purchases	(307,887)	(291,790)
Proceeds from maturities, calls and prepayments	198,233	251,729
Proceeds from sales	-	6,528
Increase in loans, net	(281,676)	(222,947)
Proceeds from sales of other property owned, net	3,228	6,436
Proceeds from sales of premises and equipment	33	-
Expenditures for premises and equipment	(2,106)	(2,680)
Net cash used in investing activities	(389,578)	(249,258)
<b>Financing activities</b>		
Bonds and notes issued	2,643,463	2,817,261
Bonds and notes retired	(2,389,674)	(2,780,624)
Cash dividends on preferred stock	(5,062)	-
Cash patronage distributions paid	(17,803)	(12,882)
Net cash provided by financing activities	230,924	23,755
Net decrease in cash	(133,894)	(186,495)
Cash at beginning of year	602,452	502,242
Cash at end of quarter	\$ 468,558	\$ 315,747
<b>Supplemental schedule of noncash investing and financing activities</b>		
Net decrease (increase) in unrealized losses on investment securities	\$ 6,988	\$ (6,165)
<b>Supplemental schedule of noncash changes in fair value related to hedging activities</b>		
Decrease in bonds and notes	\$ -	\$ (66)
<b>Supplemental information</b>		
Interest paid	\$ 39,782	\$ 33,765

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



## Notes to Financial Statements

*Unaudited (dollar amounts in thousands unless otherwise noted)*

### NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements include the accounts of the Farm Credit Bank of Texas (bank). The significant accounting policies followed and the financial condition and results of operations of the bank as of and for the year ended December 31, 2013, are contained in the 2013 Annual Report to shareholders (Annual Report). These unaudited first quarter 2014 financial statements should be read in conjunction with the Annual Report.

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

The bank and its affiliated associations (district), are part of the federally chartered Farm Credit System (System). The bank provides funding to district associations, which, in turn, provide credit to their borrower-shareholders. At March 31, 2014, the bank provided financing to 15 district associations and certain other financing institutions.

In February 2013, the FASB issued guidance, "Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income." The guidance requires entities to present either parenthetically on the face of the financial statements or in the notes to the financial statements, significant amounts reclassified from each component of accumulated other comprehensive income and the income statement line items affected by the reclassification. The guidance became effective for public entities for annual periods beginning after December 15, 2012, and for nonpublic entities for annual periods beginning after December 15, 2013. The adoption of this guidance did not impact the financial condition or results of operations, but resulted in additional disclosures.

### NOTE 2 — INVESTMENTS

#### Available for Sale

The bank's available-for-sale investments include a liquidity portfolio and a portfolio of other investments. The liquidity portfolio consists primarily of mortgage-backed securities (MBS), corporate debt, agency-guaranteed debt and asset-backed securities (ABS). The majority of the liquidity portfolio's MBS were federal agency-guaranteed collateralized MBS, including Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC) securities. The bank's other investments portfolio consists of Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed agricultural mortgage-backed securities (AMBS) purchased from district associations. A summary of the amortized cost and fair value of investment securities available for sale, at March 31, 2014, and December 31, 2013, is included in the following tables.

Investments in the available-for-sale liquidity portfolio at March 31, 2014:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agency-guaranteed debt	\$ 132,945	\$ 1	\$ (5,020)	\$ 127,926	1.53 %
Corporate debt	245,275	502	(526)	245,251	0.81
Federal agency collateralized mortgage-backed securities					
GNMA	1,686,820	8,872	(17,124)	1,678,568	1.45
FNMA and FHLMC	1,565,847	5,003	(11,843)	1,559,007	1.17
Other collateralized mortgage-backed securities	7,476	61	(162)	7,375	2.74
Asset-backed securities	43,774	86	(47)	43,813	0.63
Total available-for-sale investments	<b>\$ 3,682,137</b>	<b>\$ 14,525</b>	<b>\$ (34,722)</b>	<b>\$ 3,661,940</b>	<b>1.28 %</b>

Investments in the available-for-sale other investments portfolio at March 31, 2014:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	\$ 96,404	\$ -	\$ (3,117)	\$ 93,287	4.26 %

Investments in the available-for-sale liquidity portfolio at December 31, 2013:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agency-guaranteed debt	\$ 135,738	\$ -	\$ (5,714)	\$ 130,024	1.53 %
Corporate debt	250,312	482	(1,215)	249,579	0.83
Federal agency collateralized mortgage-backed securities					
GNMA	1,690,952	9,400	(19,926)	1,680,426	1.43
FNMA and FHLMC	1,431,037	4,838	(14,297)	1,421,578	1.16
Other collateralized mortgage-backed securities	7,736	-	(207)	7,529	2.76
Asset-backed securities	51,320	43	(67)	51,296	0.61
Total available-for-sale investments	<b>\$ 3,567,095</b>	<b>\$ 14,763</b>	<b>\$ (41,426)</b>	<b>\$ 3,540,432</b>	<b>1.28 %</b>

Investments in the available-for-sale other investments portfolio at December 31, 2013:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	\$ 101,063	\$ -	\$ (3,640)	\$ 97,423	4.29 %

The following tables summarize the contractual maturity, fair value, amortized cost and weighted average yield of available-for-sale investments at March 31, 2014:

Investments in the available-for-sale liquidity portfolio:

	<b>Due in one year or less</b>	<b>Due after one year through five years</b>	<b>Due after five years through 10 years</b>	<b>Due after 10 years</b>	<b>Total</b>
Agency-guaranteed debt	\$ -	\$ -	\$ -	\$ 127,926	\$ 127,926
Corporate debt	51,382	193,869	-	-	245,251
Federal agency collateralized mortgage-backed securities					
GNMA	-	-	43,732	1,634,836	1,678,568
FNMA and FHLMC	-	34,638	132,597	1,391,772	1,559,007
Other collateralized mortgage-backed securities	-	-	84	7,291	7,375
Asset-backed securities	-	35,882	-	7,931	43,813
<b>Total fair value</b>	<b>\$ 51,382</b>	<b>\$ 264,389</b>	<b>\$ 176,413</b>	<b>\$ 3,169,756</b>	<b>\$ 3,661,940</b>
Total amortized cost	\$ 51,352	\$ 263,833	\$ 174,139	\$ 3,192,813	\$ 3,682,137
Weighted average yield	0.90%	0.87%	2.16%	1.28%	1.28%

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

	<b>Due after one year through five years</b>
Fair value of agricultural mortgage-backed securities	\$ 93,287
Total amortized cost	\$ 96,404
Weighted average yield	4.26%

## Other-Than-Temporarily Impaired Investments Evaluation

The following table shows available-for-sale liquidity portfolio investments by gross unrealized losses and fair value, aggregated by investment category and length of time, for securities that have been in a continuous unrealized loss position at March 31, 2014. 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
Agency-guaranteed debt	\$ 95,422	\$ (3,910)	\$ 17,884	\$ (1,110)	\$ 113,306	\$ (5,020)
Corporate debt	69,401	(526)	-	-	69,401	(526)
Federal agency collateralized mortgage-backed securities						
GNMA	854,467	(11,633)	118,479	(5,491)	972,946	(17,124)
FNMA and FHLMC	814,077	(8,814)	92,129	(3,029)	906,206	(11,843)
Other collateralized mortgage-backed securities	-	-	2,678	(162)	2,678	(162)
Asset-backed securities	-	-	996	(47)	996	(47)
<b>Total</b>	<b>\$ 1,833,367</b>	<b>\$ (24,883)</b>	<b>\$ 232,166</b>	<b>\$ (9,839)</b>	<b>\$ 2,065,533</b>	<b>\$ (34,722)</b>

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

In the three months ended March 31, 2014, the bank did not recognize any other-than-temporary impairment credit losses. The non-credit-related net increase in fair value on the bank's other-than-temporarily impaired investments for the three months ended March 31, 2014, totaling \$9, is included as a credit to other comprehensive loss. At March 31, 2014, the bank had one asset-backed security that was considered to be other-than-temporarily impaired.

As the bank has no intention to sell the security deemed other-than-temporarily impaired and will not more likely than not be required to sell the security before recovery, only the credit loss portion of impairment would be recognized through earnings. 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. 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:

	<b>March 31, 2014</b>	
Assumptions Used	Mortgage- Backed Securities	Asset-Backed Securities
Default by range	0.8% - 8.2%	11.8% - 18.7%
Prepayments rate by range	4.7% - 19.7%	5.9% - 9.1%
Loss severity by range	15.5% - 26.9%	49.3% - 57.2%

	<b>December 31, 2013</b>	
Assumptions Used	Mortgage- Backed Securities	Asset-Backed Securities
Default by range	0.5% - 6.1%	8.1% - 12.4%
Prepayments rate by range	4.0% - 19.4%	2.8% - 6.8%
Loss severity by range	17.0% - 31.0%	55.9% - 59.7%

The following is a rollforward of the amount related to credit losses recognized for the three months ended March 31:

	<b>2014</b>	2013
Credit loss component, beginning of period	\$ 454	\$ 5,084
Reductions:		
For securities sold	-	(3,484)
Credit loss component end of period	\$ 454	\$ 1,600

**NOTE 3 — LOANS AND RESERVES FOR CREDIT LOSSES**

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

	<b>March 31, 2014</b>	December 31, 2013
Direct notes receivable from district associations and OFIs	\$ 7,476,117	\$ 7,360,025
Participations purchased	4,549,038	4,416,737
Other bank-owned loans	1,951	1,979
Total	\$ 12,027,106	\$ 11,778,741

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

	<b>March 31, 2014</b>	December 31, 2013
Direct notes receivable from district associations	\$ 7,438,603	\$ 7,325,645
Real estate mortgage	379,124	387,766
Production and intermediate term	426,743	458,351
Loans to cooperatives	245,080	139,994
Processing and marketing	1,767,581	1,725,617
Farm-related business	138,958	131,366
Communication	273,262	230,499
Energy (rural utilities)	1,144,245	1,177,463
Water and waste disposal	123,451	114,704
Rural residential real estate	21	21
Agricultural export finance	19,378	19,651
Loans to other financing institutions	37,514	34,380
Mission-related	33,146	33,284
Total	<b>\$ 12,027,106</b>	<b>\$ 11,778,741</b>

The bank purchases or sells 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 March 31, 2014.

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations	Participations	Participations	Participations	Participations	Participations
	Purchased	Sold	Purchased	Sold	Purchased	Sold
Real estate mortgage	\$ 360,063	\$ 295,933	\$ 24,497	\$ -	\$ 384,560	\$ 295,933
Production and intermediate term	946,859	579,167	11,280	24,401	958,139	603,568
Agribusiness	1,287,621	468,819	47,331	-	1,334,952	468,819
Communication	380,857	107,246	-	-	380,857	107,246
Energy (rural utilities)	1,318,403	183,715	-	-	1,318,403	183,715
Water and waste disposal	136,953	23,242	-	-	136,953	23,242
Agricultural export finance	19,378	-	-	-	19,378	-
Mission-related	5,078	-	-	-	5,078	-
Loans to other financing institutions	-	23,071	-	-	-	23,071
Direct note receivable from district associations	-	3,650,000	-	-	-	3,650,000
<b>Total</b>	<b>\$ 4,455,212</b>	<b>\$ 5,331,193</b>	<b>\$ 83,108</b>	<b>\$ 24,401</b>	<b>\$ 4,538,320</b>	<b>\$ 5,355,594</b>

In 2011 and 2012, the bank purchased \$20,653 in loan participations from a district association in a Capitalized Participation Pool (CPP) transaction, and in July 2013 purchased another \$32,358 in loan participations from another association under the same terms. The purchases represent 80.0 percent of the outstanding balances of the loans placed by the association in the CPP. As a condition of the transactions, the bank redeemed stock in the amount of 2.0 percent of the par value of the loans purchased, and the association bought bank stock equal to 8.0 percent of the purchased loans' par value. CPP loans held at March 31, 2014, totaled \$38,963.

The bank is authorized under the Farm Credit Act to accept "advance conditional payments" (ACPs) from borrowers. To the extent the borrower's access to such ACPs is restricted and the legal right of setoff exists, the ACPs are netted against the borrower's related loan balance. Unrestricted advance conditional

payments are included in other liabilities. ACPs are not insured, and interest is generally paid by the bank on such balances. There were no significant balances of ACPs at March 31, 2014, or December 31, 2013.

During 2012, the bank 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 \$58,505 at March 31, 2014. 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 three months ended March 31, 2014:

Balance at January 1, 2014	<b>\$ 58,461</b>
Net gains on financial instruments under fair value option	<b>564</b>
Change in premium	<b>(520)</b>
Balance at March 31, 2014	<b><u>\$ 58,505</u></b>

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

	<b>March 31, 2014</b>	December 31, 2013
<b>Nonaccrual loans:</b>		
Real estate mortgage	\$ 4,431	\$ 5,722
Production and intermediate term	16,092	19,091
Agribusiness	-	2,148
Energy and water/waste disposal	2,174	1,171
Total nonaccrual loans	22,697	28,132
<b>Accruing restructured loans:</b>		
Real estate mortgage	882	897
Production and intermediate term	8,597	8,752
Mission-related	2,875	2,833
Total accruing restructured loans	12,354	12,482
<b>Accruing loans 90 days or more past due:</b>		
Real estate mortgage	5	-
Total accruing loans 90 days or more past due	5	-
Total nonperforming loans	35,056	40,614
Other property owned, net	11,079	13,812
Total nonperforming assets	\$ 46,135	\$ 54,426

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:

	March 31, 2014	December 31, 2013
<b>Real estate mortgage:</b>		
Acceptable	95.6 %	95.3 %
OAEM	2.2	2.2
Substandard/Doubtful	2.2	2.5
	<b>100.0 %</b>	<b>100.0 %</b>
<b>Production and intermediate term:</b>		
Acceptable	92.2 %	91.3 %
OAEM	3.7	2.5
Substandard/Doubtful	4.1	6.2
	<b>100.0 %</b>	<b>100.0 %</b>
<b>Agribusiness:</b>		
Acceptable	99.1 %	99.4 %
OAEM	0.9	0.5
Substandard/Doubtful	-	0.1
	<b>100.0 %</b>	<b>100.0 %</b>
<b>Energy and water/waste disposal:</b>		
Acceptable	99.1 %	98.0 %
OAEM	-	-
Substandard/Doubtful	0.9	2.0
	<b>100.0 %</b>	<b>100.0 %</b>
<b>Communication:</b>		
Acceptable	100.0 %	100.0 %
OAEM	-	-
Substandard/Doubtful	-	-
	<b>100.0 %</b>	<b>100.0 %</b>
<b>Rural residential real estate:</b>		
Acceptable	100.0 %	100.0 %
OAEM	-	-
Substandard/Doubtful	-	-
	<b>100.0 %</b>	<b>100.0 %</b>
<b>Agricultural export finance:</b>		
Acceptable	100.0 %	100.0 %
OAEM	-	-
Substandard/Doubtful	-	-
	<b>100.0 %</b>	<b>100.0 %</b>
<b>Direct notes to associations:</b>		
Acceptable	98.0 %	97.9 %
OAEM	-	-
Substandard/Doubtful	2.0	2.1
	<b>100.0 %</b>	<b>100.0 %</b>
<b>Loans to other financing institutions:</b>		
Acceptable	100.0 %	100.0 %
OAEM	-	-
Substandard/Doubtful	-	-
	<b>100.0 %</b>	<b>100.0 %</b>
<b>Mission-related:</b>		
Acceptable	92.4 %	92.3 %
OAEM	-	-
Substandard/Doubtful	7.6	7.7
	<b>100.0 %</b>	<b>100.0 %</b>
<b>Total loans:</b>		
Acceptable	98.1 %	97.9 %
OAEM	0.3	0.3
Substandard/Doubtful	1.6	1.8
	<b>100.0 %</b>	<b>100.0 %</b>

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

March 31, 2014

	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	\$ 14	\$ 4,460	\$ 4,474	\$ 378,235	\$ 382,709	\$ 5
Production and intermediate term	11,012	-	11,012	417,655	428,667	-
Agribusiness	4,074	-	4,074	2,158,714	2,162,788	-
Communication	-	-	-	273,528	273,528	-
Energy and water/waste disposal	1,163	-	1,163	1,271,799	1,272,962	-
Rural residential real estate	-	-	-	21	21	-
Agricultural export finance	-	-	-	19,415	19,415	-
Direct notes to associations	-	-	-	7,453,948	7,453,948	-
Loans to other financing institutions	-	-	-	37,556	37,556	-
Mission-related	2,333	-	2,333	31,017	33,350	-
<b>Total</b>	<b>\$ 18,596</b>	<b>\$ 4,460</b>	<b>\$ 23,056</b>	<b>\$12,041,888</b>	<b>\$12,064,944</b>	<b>\$ 5</b>

December 31, 2013

	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	\$ -	\$ 5,746	\$ 5,746	\$ 385,162	\$ 390,908	\$ -
Production and intermediate term	2,154	6,993	9,147	450,582	459,729	-
Agribusiness	-	-	-	2,005,361	2,005,361	-
Communication	-	-	-	230,715	230,715	-
Energy and water/waste disposal	-	-	-	1,296,223	1,296,223	-
Rural residential real estate	-	-	-	21	21	-
Agricultural export finance	-	-	-	19,691	19,691	-
Direct notes to associations	-	-	-	7,340,822	7,340,822	-
Loans to other financing institutions	-	-	-	34,421	34,421	-
Mission-related	2,364	-	2,364	31,195	33,559	-
<b>Total</b>	<b>\$ 4,518</b>	<b>\$ 12,739</b>	<b>\$ 17,257</b>	<b>\$ 11,794,193</b>	<b>\$ 11,811,450</b>	<b>\$ -</b>

Additional impaired loan information is as follows:

	At March 31, 2014			At December 31, 2013		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
<b>Impaired loans with a related allowance for credit losses:</b>						
Real estate mortgage	\$ 2,933	\$ 2,933	\$ 2,072	\$ 4,225	\$ 4,225	\$ 1,725
Production and intermediate term	13,372	13,372	4,811	17,367	17,367	4,621
Processing and marketing	-	-	-	2,148	2,814	1,000
Energy and water/waste disposal	2,174	2,174	2,149	1,171	1,171	1,147
Mission-related	203	203	70	-	-	-
Total	<u>\$ 18,682</u>	<u>\$ 18,682</u>	<u>\$ 9,102</u>	<u>\$ 24,911</u>	<u>\$ 25,577</u>	<u>\$ 8,493</u>
<b>Impaired loans with no related allowance for credit losses:</b>						
Real estate mortgage	\$ 2,385	\$ 6,961	\$ -	\$ 2,394	\$ 6,956	\$ -
Production and intermediate term	11,317	14,266	-	10,476	13,270	-
Processing and marketing	-	1,381	-	-	1,381	-
Energy and water/waste disposal	-	17,578	-	-	17,619	-
Mission-related	2,672	5,813	-	2,833	6,018	-
Total	<u>\$ 16,374</u>	<u>\$ 45,999</u>	<u>\$ -</u>	<u>\$ 15,703</u>	<u>\$ 45,244</u>	<u>\$ -</u>
<b>Total impaired loans:</b>						
Real estate mortgage	\$ 5,318	\$ 9,894	\$ 2,072	\$ 6,619	\$ 11,181	\$ 1,725
Production and intermediate term	24,689	27,638	4,811	27,843	30,637	4,621
Processing and marketing	-	1,381	-	2,148	4,195	1,000
Energy and water/waste disposal	2,174	19,752	2,149	1,171	18,790	1,147
Mission-related	2,875	6,016	70	2,833	6,018	-
Total	<u>\$ 35,056</u>	<u>\$ 64,681</u>	<u>\$ 9,102</u>	<u>\$ 40,614</u>	<u>\$ 70,821</u>	<u>\$ 8,493</u>

	For the Three Months Ended			
	March 31, 2014		March 31, 2013	
	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized
<b>Impaired loans with a related allowance for credit losses:</b>				
Real estate mortgage	\$ 2,933	\$ -	\$ 10,019	\$ -
Production and intermediate term	14,509	-	795	-
Processing and marketing	-	-	20,000	24
Communication	-	-	2,125	-
Energy and water/waste disposal	2,018	-	1,284	-
Mission-related	203	4	-	-
Total	\$ 19,663	\$ 4	\$ 34,223	\$ 24
<b>Impaired loans with no related allowance for credit losses:</b>				
Real estate mortgage	\$ 4,149	\$ 79	\$ 24,585	\$ 218
Production and intermediate term	11,281	381	9,114	459
Communication	-	-	606	-
Mission-related	2,600	40	-	-
Total	\$ 18,030	\$ 500	\$ 34,305	\$ 677
<b>Total impaired loans:</b>				
Real estate mortgage	\$ 7,082	\$ 79	\$ 34,604	\$ 218
Production and intermediate term	25,790	381	9,909	459
Processing and marketing	-	-	20,000	24
Communication	-	-	2,731	-
Energy and water/waste disposal	2,018	-	1,284	-
Mission-related	2,803	44	-	-
Total	\$ 37,693	\$ 504	\$ 68,528	\$ 701

The average recorded investment in impaired loans for the three months ended March 31, 2014, was \$37.7 million. The bank recognized interest income of \$504 on impaired loans during the three months ended March 31, 2014.

At March 31, 2014, impaired loans of \$18.7 million had a related specific allowance of \$9.1 million, while the remaining \$16.4 million of impaired loans had no related specific allowance as a result of adequate collateralization.

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	Agricultural Export Finance	Direct Notes to Associations	Loans to OFIs	Mission-Related	Total
<b>Allowance for Credit Losses</b>											
Balance at December 31, 2013	\$ 1,954	\$ 5,075	\$ 2,781	\$ 215	\$ 3,596	\$ -	\$ 7	\$ -	\$ -	\$ 32	\$ 13,660
Charge-offs	-	-	(290)	-	-	-	-	-	-	-	(290)
Recoveries	-	-	5	-	41	-	-	-	-	-	46
Provision for credit losses	468	189	(757)	-	-	-	-	-	-	97	(3)
Other *	1,004	-	-	-	-	-	-	-	-	(26)	978
Balance at March 31, 2014	\$ 3,426	\$ 5,264	\$ 1,739	\$ 215	\$ 3,637	\$ -	\$ 7	\$ -	\$ -	\$ 103	\$ 14,391
Individually evaluated for impairment	2,072	4,811	-	-	2,149	-	-	-	-	-	70
Collectively evaluated for impairment	1,354	453	1,739	215	1,488	-	7	-	-	33	5,289
Loans acquired with deteriorated credit quality	-	-	-	-	-	-	-	-	-	-	-
Balance at March 31, 2014	\$ 3,426	\$ 5,264	\$ 1,739	\$ 215	\$ 3,637	\$ -	\$ 7	\$ -	\$ -	\$ 103	\$ 14,391
Balance at December 31, 2012	\$ 2,992	\$ 633	\$ 10,448	\$ 1,315	\$ 1,859	\$ -	\$ 3	\$ -	\$ -	\$ 8	\$ 17,258
Charge-offs	(56)	-	(4,411)	-	-	-	-	-	-	-	(4,467)
Recoveries	-	-	-	-	-	-	-	-	-	-	-
Provision for credit losses	224	101	442	(87)	195	-	(1)	-	-	21	895
Other *	(6)	-	-	-	1,725	-	-	-	-	-	1,719
Balance at March 31, 2013	\$ 3,154	\$ 734	\$ 6,479	\$ 1,228	\$ 3,779	\$ -	\$ 2	\$ -	\$ -	\$ 29	\$ 15,405
Individually evaluated for impairment	2,135	-	4,175	1,000	1,725	-	-	-	-	-	9,035
Collectively evaluated for impairment	221	542	2,304	228	2,054	-	2	-	-	29	5,380
Loans acquired with deteriorated credit quality	798	192	-	-	-	-	-	-	-	-	990
Balance at March 31, 2013	\$ 3,154	\$ 734	\$ 6,479	\$ 1,228	\$ 3,779	\$ -	\$ 2	\$ -	\$ -	\$ 29	\$ 15,405
<b>Recorded Investments in Loans Outstanding:</b>											
Ending balance at March 31, 2014	\$ 382,709	\$ 428,667	\$ 2,162,788	\$ 273,528	\$ 1,272,962	\$ 21	\$ 19,415	\$ 7,453,948	\$ 37,556	\$ 33,350	\$ 12,064,944
Individually evaluated for impairment	\$ 5,313	\$ 24,689	\$ -	\$ -	\$ 2,174	\$ -	\$ -	\$ -	\$ -	\$ 2,875	\$ 35,051
Collectively evaluated for impairment	\$ 377,396	\$ 403,978	\$ 2,162,788	\$ 273,528	\$ 1,270,788	\$ 21	\$ 19,415	\$ 7,453,948	\$ 37,556	\$ 30,475	\$ 12,029,893
Loans acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Ending balance at March 31, 2013	\$ 325,775	\$ 484,137	\$ 1,908,350	\$ 224,980	\$ 1,308,049	\$ 26	\$ 5,555	\$ 7,198,760	\$ 68,999	\$ 35,426	\$ 11,560,057
Individually evaluated for impairment	\$ 22,537	\$ 8,568	\$ 18,021	\$ 2,599	\$ 1,725	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 53,450
Collectively evaluated for impairment	\$ 300,333	\$ 474,144	\$ 1,890,329	\$ 222,381	\$ 1,306,324	\$ 26	\$ 5,555	\$ 7,198,760	\$ 68,999	\$ 35,426	\$ 11,502,277
Loans acquired with deteriorated credit quality	\$ 2,905	\$ 1,425	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 4,330

\* 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 (TDR) if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. 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 March 31, 2014, the total recorded investment of troubled debt restructured loans was \$15,287, including \$2,933 classified as nonaccrual and \$12,354 classified as accrual, with specific allowance for loan losses of \$2,142. Additional commitments to lend to borrowers whose loan terms have been modified in TDRs were \$32 at March 31, 2014 and at December 31, 2013.

The following table summarizes TDR loan balances by loan type:

	Loans Modified as TDRs		TDRs in Nonaccrual Status	
	March 31, 2014	December 31, 2013	March 31, 2014	December 31, 2013
Real estate mortgage	\$ 3,816	\$ 3,830	\$ 2,933	\$ 2,933
Production and intermediate term	8,596	8,752	-	-
Agribusiness	-	2,148	-	2,148
Mission-related	2,875	2,833	-	-
Total	<u>\$ 15,287</u>	<u>\$ 17,563</u>	<u>\$ 2,933</u>	<u>\$ 5,081</u>

During the three months ended March 31, 2014, there were no restructured loans designated as troubled debt restructurings. During the period there were no payment defaults on loans that were restructured during the previous 12 months. A payment default is defined as a payment that is 30 days past due after the date the loan was restructured.

**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 March 31, 2014, were approximately \$211.7 billion.

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 2013 Annual Report for a more complete description.

Assets and liabilities recorded at fair value on a recurring basis at March 31, 2014, for each of the fair value hierarchy levels are summarized below:

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
Federal funds	\$ 21,212	\$ -	\$ 21,212	\$ -
Investments available for sale:				
Corporate debt	245,251	-	245,251	-
Agency-guaranteed debt	127,926	-	118,725	9,201
Mortgage-backed securities	3,244,950	-	3,138,700	106,250
Asset-backed securities	43,813	-	42,817	996
Mission-related and other available-for-sale investments	93,287	-	-	93,287
Loans valued under the fair value option	58,505	-	58,505	-
Derivative assets	961	-	961	-
Assets held in nonqualified benefit trusts	274	274	-	-
Total assets	<u>\$ 3,836,179</u>	<u>\$ 274</u>	<u>\$ 3,626,171</u>	<u>\$ 209,734</u>
<b>Liabilities:</b>				
Standby letters of credit	\$ 832	\$ -	\$ -	\$ 832
Total liabilities	<u>\$ 832</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 832</u>

#### *Loans With Fair Value Option*

During 2012, the bank 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. It requires entities to display the fair value of those assets for which the entity has chosen to use fair value on the face of the statement of condition. 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 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, 2014, to March 31, 2014:

	Corporate Debt	Agency- Guaranteed Debt	Mortgage- Backed Securities	Agricultural Mortgage- Backed Securities	Asset- Backed Securities	Standby Letters of Credit
Balance at January 1, 2014	\$ 15,000	\$ 26,949	\$ 7,529	\$ 97,423	\$ 1,157	\$ -
Net (losses) gains included in other comprehensive loss	-	29	(175)	523	18	-
Purchases, issuances and settlements	-	(195)	98,896	(4,659)	(179)	-
Transfers into Level 3	-	-	-	-	-	832
Transfers out of Level 3	(15,000)	(17,582)	-	-	-	-
Balance at March 31, 2014	<u>\$ -</u>	<u>\$ 9,201</u>	<u>\$ 106,250</u>	<u>\$ 93,287</u>	<u>\$ 996</u>	<u>\$ 832</u>
The amount of losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets or liabilities still held at March 31, 2014	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

There were no transfers of assets or liabilities into or out of Level 1 from other levels during the three months ended March 31, 2014. Agricultural mortgage-backed securities are included in Level 3 due to limited activity or less transparency around inputs to their valuation. At March 31, 2014, Level 3 investments included three agency MBS and one agency-guaranteed debt instrument due to the fact that their valuations were based on Level 3 criteria (broker quotes) and certain non-agency MBS and non-agency ABS backed by home equity. In the first three months of 2014, two agency-guaranteed debt instruments and one corporate debt instrument 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. The liability for standby letters of credit was transferred into Level 3 during the first quarter of 2014 due to a determination that their valuation, based on fees currently charged for similar agreements, may not closely correlate to a fair value for instruments that are not regularly traded in the secondary market. For the three months ended March 31, 2014, all transfers into and out of Level 3 were related to sources of pricing information. Valuations subsequent to purchase which are obtained from independent third party services utilizing Level 2 criteria were the basis for transfers out of Level 3.

Assets and liabilities measured at fair value on a nonrecurring basis at March 31, 2014, for each of the fair value hierarchy levels are summarized below:

	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)
<b>Assets:</b>					
Loans	\$ 13,595	\$ -	\$ -	\$ 13,595	\$ (290)
Other property owned	12,310	-	-	12,310	501
Total assets	<u>\$ 25,905</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 25,905</u>	<u>\$ 211</u>



Assets and liabilities measured at fair value on a recurring basis at December 31, 2013, for each of the fair value hierarchy levels are summarized below:

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
Federal funds	\$ 21,809	\$ -	\$ 21,809	\$ -
Investments available for sale:				
Corporate debt	249,580	-	234,580	15,000
Agency-guaranteed debt	130,024	-	103,075	26,949
Mortgage-backed securities	3,109,532	-	3,102,003	7,529
Asset-backed securities	51,296	-	50,139	1,157
Mission-related and other available-for-sale investments	97,423	-	-	97,423
Loans valued under the fair value option	58,461	-	58,461	-
Derivative assets	831	-	831	-
Assets held in nonqualified benefit trusts	182	182	-	-
<b>Total assets</b>	<b>\$ 3,719,138</b>	<b>\$ 182</b>	<b>\$ 3,570,898</b>	<b>\$ 148,058</b>
<b>Liabilities:</b>				
Standby letters of credit	\$ 1,190	\$ -	\$ 1,190	\$ -
<b>Total liabilities</b>	<b>\$ 1,190</b>	<b>\$ -</b>	<b>\$ 1,190</b>	<b>\$ -</b>

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, 2013, to March 31, 2013:

	Corporate Debt	Agency- Guaranteed Debt	Mortgage- Backed Securities	Agricultural Mortgage- Backed Securities	Asset- Backed Securities	Total
Available-for-sale investment securities:						
Balance at January 1, 2013	\$ 59,958	\$ 15,117	\$ 26,938	\$ 115,479	\$ 3,096	\$ 220,588
Net gains (losses) included in other comprehensive income	(19)	(25)	726	(146)	573	1,109
Net gains (losses) included in earnings	-	-	(143)	-	-	(143)
Purchases, issuances and settlements	-	20,000	33,716	(3,578)	(212)	49,926
Transfers out of Level 3	-	(15,117)	-	-	-	(15,117)
<b>Balance at March 31, 2013</b>	<b>\$ 59,939</b>	<b>\$ 19,975</b>	<b>\$ 61,237</b>	<b>\$ 111,755</b>	<b>\$ 3,457</b>	<b>\$ 256,363</b>

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 March 31, 2013

	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
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There were no transfers of assets or liabilities into or out of Level 1 from other levels during the three months ended March 31, 2013. Agricultural mortgage-backed securities are included in Level 3 due to limited activity or less transparency around inputs to their valuation. At March 31, 2013, Level 3 investments included one agency MBS and two corporate debt instruments due to the fact that their valuations were based on Level 3 criteria (broker quotes) and certain non-agency MBS and non-agency

ABS backed by home equity. In the first three months of 2013, an agency-guaranteed debt instrument which had previously been included in Level 3 was valued using independent third-party valuation services using Level 2 criteria and was, accordingly, transferred from Level 3 to Level 2.

Assets and liabilities measured at fair value on a nonrecurring basis at December 31, 2013, for each of the fair value hierarchy levels are summarized below:

	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)
<b>Assets:</b>					
Loans	\$ 19,639	\$ -	\$ -	\$ 19,639	\$ (10,206)
Other property owned	15,347	-	-	15,347	(79)
Total assets	\$ 34,986	\$ -	\$ -	\$ 34,986	\$ (10,285)

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:

	March 31, 2014					December 31, 2013				
	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	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
<b>Assets:</b>										
Cash	\$ 468,558	\$ 468,558	\$ -	\$ -	\$ 468,558	\$ 602,452	\$ 602,452	\$ -	\$ -	\$ 602,452
Net loans	11,940,615	-	-	11,892,165	11,892,165	11,686,981	-	-	11,655,947	11,655,947
Total assets	\$ 12,409,173	\$ 468,558	\$ -	\$ 11,892,165	\$ 12,360,723	\$ 12,289,433	\$ 602,452	\$ -	\$ 11,655,947	\$ 12,258,399
<b>Liabilities:</b>										
Systemwide debt securities	\$ 14,854,890	\$ -	\$ -	\$ 14,870,730	\$ 14,870,730	\$ 14,602,012	\$ -	\$ -	\$ 14,563,935	\$ 14,563,935
Subordinated debt	50,000	-	-	54,299	54,299	50,000	-	-	54,407	54,407
	\$ 14,904,890	\$ -	\$ -	\$ 14,925,029	\$ 14,925,029	\$ 14,652,012	\$ -	\$ -	\$ 14,618,342	\$ 14,618,342

## Valuation Techniques

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

### 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. To estimate the fair value of investments, the bank obtains prices from third-party pricing services. This would include certain mortgage-backed and asset-backed securities. Where there is limited activity or less transparency around inputs to the valuation, the securities are classified as Level 3. Investments classified as Level 3 primarily consist of the certain non-agency mortgage-backed securities and asset-backed securities valued using independent third-party valuation services. Also included in the bank's Level 3 assets are the Farmer Mac AMBS.

### *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 fair value interest rate swaps, interest rate caps and cash flow interest rate swaps. The models used to determine the fair value of derivative assets and liabilities use an income approach based on observable inputs, primarily the LIBOR swap curve and volatility assumptions about future interest rate movements.

### *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 bank's current interest rates at which similar loans would be made to borrowers with similar credit risk. As the discount rates are based on the bank's loan rates as well as on management estimates, management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale.

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

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. Generally, these loans would be classified as Level 2. To estimate the fair value of these instruments, the bank obtains prices from third-party pricing services.

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 (OPO) is generally classified as Level 3 of the fair value hierarchy. The process for measuring the fair value of other property owned involves the use of independent appraisals or other market-based information. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. As a result, these fair value measurements fall within Level 3 of the hierarchy.

***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***

	<b>Valuation Technique(s)</b>	<b>Unobservable Input</b>
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***

	<b>Valuation Technique(s)</b>	<b>Input</b>
Federal funds sold	Carrying value	Par/principal
Investment securities available for sale	Quoted prices	Price for similar asset
	Discounted cash flow	Constant prepayment rate Appropriate interest rate yield curve
Loans held under the fair value option	Quoted prices	Price for similar instruments
	Discounted cash flow	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***

	<b>Valuation Technique(s)</b>	<b>Input</b>
Cash	Carrying value	Actual balances
Loans	Discounted cash flow	Prepayment forecasts
		Appropriate interest rate yield curve
		Probability of default
		Loss severity
Systemwide debt securities and subordinated debt	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.

Although the bank held no interest rate swaps at March 31, 2014, it may enter into these derivative transactions to lower funding costs, diversify sources of funding, alter interest rate exposures arising from mismatches between assets and liabilities, or better manage liquidity. Interest rate swaps allow the bank to raise long-term borrowings at fixed rates and swap them into floating rates to better match the repricing characteristics of earning assets. Under interest rate swap arrangements, the bank agrees with other parties to exchange, at specified intervals, payment streams calculated on a specified notional principal amount, with at least one stream based on a specified floating-rate index.

A substantial amount of the bank's assets are interest-earning assets (principally loans and investments) that tend to be medium-term floating-rate instruments. In order to match the asset structure, interest rate swaps in which the bank pays the floating rate and receives the fixed rate (receive-fixed swaps) may be 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 may also enter 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. The notional amounts and primary types of derivative instruments used and the amount of activity during the period are summarized in the following table:

	<b>Receive-Fixed Swaps</b>	<b>Pay-Fixed Swaps</b>	<b>Interest Rate Caps</b>	<b>Total</b>
Balance at January 1, 2014	\$ -	\$ -	\$ 695	\$ 695
Additions	-	-	30	30
Maturities/Amortizations	-	-	(30)	(30)
Balance at March 31, 2014	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 695</b>	<b>\$ 695</b>

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 March 31, 2014, and December 31, 2013, the bank's exposure to counterparties, net of collateral, was \$961 and \$831, respectively. At March 31, 2014, and December 31, 2013, 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 March 31, 2014, or December 31, 2013.

*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 loss. The bank's cash flow hedges at March 31, 2014, and December 31, 2013, consisted of interest rate caps.

<b>Derivatives designated as hedging instruments</b>	<b>Balance Sheet Location</b>	<b>Fair Value 3/31/2014</b>	<b>Fair Value 12/31/2013</b>	<b>Balance Sheet Location</b>	<b>Fair Value 3/31/2014</b>	<b>Fair Value 12/31/2013</b>
Interest rate caps	Other assets	961	831	Other liabilities	-	-

<b>Derivatives designated as hedging instruments</b>	<b>Amount of (Loss) Gain Recognized in OCL on Derivatives (Effective Portion)</b>		<b>Location of Gain Reclassification from AOCI into Income</b>	<b>Amount of Gain Reclassified from AOCL into Income (Effective Portion)</b>	
	<b>March 31,</b>			<b>March 31,</b>	
	<b>2014</b>	<b>2013</b>		<b>2014</b>	<b>2013</b>
Interest rate caps	\$ (288)	\$ 54	Interest expense	\$ 570	\$ 273

**NOTE 7 — EMPLOYEE BENEFIT PLANS**

In addition to pension benefits, the bank provides certain health care benefits to qualifying retired employees (other postretirement benefits). These benefits are not characterized as multiemployer and, consequently, the liability for these benefits is included in other liabilities. Bank employees hired after January 1, 2004, will be eligible for retiree medical benefits for themselves and their spouses at their expense but will be responsible for 100 percent of the related premiums. The following table summarizes the components of net periodic benefit costs for the bank's other postretirement benefit costs for the three months ended March 31:

	Other Postretirement Benefits	
	<b>2014</b>	2013
Service cost	\$ 53	\$ 69
Interest cost	<b>106</b>	106
Amortization of prior service costs	<b>(48)</b>	(48)
Amortization of net loss	-	4
Net periodic benefit cost	<b>\$ 111</b>	\$ 131

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

**NOTE 8 — ACCUMULATED OTHER COMPREHENSIVE LOSS**

Accumulated other comprehensive (loss) income (AOCL) 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 bank, these elements include unrealized gains or losses on the bank's available-for-sale investment portfolio, amortization of retirement benefit elements and changes in the value of cash flow derivative instruments.



The following table summarizes the changes in the balance of the components of AOCL for the three months ended March 31, 2014:

	Total	Unrealized Loss on Securities	Retirement Benefit Plans	Cash Flow Derivative Instruments
Balance, January 1, 2014	\$ (33,113)	\$ (30,303)	\$ 1,642	\$ (4,452)
Change in unrealized losses on available-for-sale securities				
Net decrease in unrealized losses on investment securities	6,979	6,979		
Decrease in noncredit portion of other-than-temporary impairment (OTTI) losses	9	9		
Net increase in unrealized losses on securities	<u>6,988</u>	<u>6,988</u>		
Change in postretirement benefit plans				
Amounts amortized into net periodic expense:				
Amortization of prior service credits	(48)		(48)	
Net change in postretirement benefit plans	<u>(48)</u>		<u>(48)</u>	
Change in cash flow derivative instruments				
Gains on interest rate caps	(288)			(288)
Reclassification of amount recognized in interest expense	570			570
Net change in cash flow derivative instruments	<u>282</u>			<u>282</u>
<b>Total other comprehensive income (loss)</b>	<b>7,222</b>	<b>6,988</b>	<b>(48)</b>	<b>282</b>
<b>Balance, March 31, 2014</b>	<b><u>\$ (25,891)</u></b>	<b><u>\$ (23,315)</u></b>	<b><u>\$ 1,594</u></b>	<b><u>\$ (4,170)</u></b>

The following table summarizes the changes in the balance of the components of AOCI for the three months ended March 31, 2013:

	Total	Unrealized Gain on Securities	Retirement Benefit Plans	Cash Flow Derivative Instruments
Balance, January 1, 2013	\$ 27,833	\$ 34,104	\$ (56)	\$ (6,215)
Change in unrealized gains on available-for-sale securities				
Net decrease in unrealized gains on investment securities	(7,338)	(7,338)		
Decrease in noncredit portion of other-than-temporary impairment (OTTI) losses	1,030	1,030		
Reclassification adjustment for OTTI credit losses included in net income	143	143		
Net increase in unrealized losses on securities	<u>(6,165)</u>	<u>(6,165)</u>		
Change in postretirement benefit plans				
Amounts amortized into net periodic expense:				
Amortization of prior service credits	(48)		(48)	
Amortization of net losses	4		4	
Net change in postretirement benefit plans	<u>(44)</u>		<u>(44)</u>	
Change in cash flow derivative instruments				
Losses on interest rate caps	54			54
Reclassification of loss recognized in interest expense	273			273
Net change in cash flow derivative instruments	<u>327</u>			<u>327</u>
Total other comprehensive (loss) income	(5,882)	(6,165)	(44)	327
Balance, March 31, 2013	<b><u>\$ 21,951</u></b>	<b><u>\$ 27,939</u></b>	<b><u>\$ (100)</u></b>	<b><u>\$ (5,888)</u></b>

The following table summarizes reclassifications from AOCL to the Statements of Comprehensive Income for the three months ended March 31:

<u>Component of AOCL</u>	<u>Amount Reclassified from AOCL</u>		<u>Affected Line in the Statement of Comprehensive Income</u>
	<u>2014</u>	<u>2013</u>	
Impairment losses on other-than-temporarily-impaired investments	\$ -	\$ 143	Impairment losses on investments
Amortization of net credits on post-retirement benefit plan	(48)	(44)	Salaries and employee benefits
Amortization on cash flow hedges	<u>570</u>	<u>273</u>	Interest expense
Total reclassifications	<u>\$ 522</u>	<u>\$ 372</u>	

**NOTE 9 — SUBSEQUENT EVENTS**

In April 2014, the bank purchased \$4,228 in loan participations and \$9,052 in Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed agricultural mortgage-backed securities (AMBS) from a district association in Capitalized Participation Pool (CPP) transactions. As a condition of the transactions, the bank redeemed stock in the amount of 2.0 percent of the par value of the loans and AMBS purchased, and the association bought back stock equal to 8.0 percent of the purchased loans' par value and 1.6 percent of the AMBS' par value.

On May 8, 2014, the Farm Credit Administration approved a proposed rule to modify the regulatory capital requirements for System banks and associations. The objectives of the proposed rule are as follows:

- To modernize capital requirements while ensuring that institutions continue to hold sufficient regulatory capital to fulfill their mission as government-sponsored enterprises.
- To ensure that the System's capital requirements are comparable to the Basel III framework and the standardized approach that the federal banking regulatory agencies have adopted, but also to ensure that the rules recognize the cooperative structure and the organization of the System.
- To make System regulatory capital requirements more transparent.
- To meet the requirements of section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The proposed rule will require the 30-day period for congressional review before being published in the Federal Register with a 120-day comment period.

The bank has evaluated subsequent events through May 9, 2014, which is the date the financial statements were issued. There are no other significant subsequent events requiring disclosure as of May 9, 2014.

**NOTE 10 — COMBINED ASSOCIATION FINANCIAL DATA**

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

<b>Balance sheet data</b>	<b>March 31, 2014</b>	<b>December 31, 2013</b>
Cash	\$ 4,821	7,604
Investment securities	51,721	55,669
Loans	13,356,861	13,260,228
Less allowance for loan losses	56,821	60,504
Net loans	<u>13,300,040</u>	<u>13,199,724</u>
Accrued interest receivable	109,657	114,131
Other property owned, net	33,182	33,330
Other assets	337,885	334,355
Total assets	<u>\$ 13,837,306</u>	<u>\$ 13,744,813</u>
Notes payable	\$ 11,063,152	\$ 10,962,399
Other liabilities	238,113	312,219
Total liabilities	<u>11,301,265</u>	<u>11,274,618</u>
Capital stock and participation certificates	228,062	80,696
Retained earnings	2,305,809	2,387,250
Accumulated other comprehensive income	2,170	2,249
Total members' equity	<u>2,536,041</u>	<u>2,470,195</u>
Total liabilities and members' equity	<u>\$ 13,837,306</u>	<u>\$ 13,744,813</u>

<b>Statement of income data</b>	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
Interest income	\$ 157,064	\$ 152,822
Interest expense	50,572	49,510
Net interest income	106,492	103,312
Negative provision for loan losses	(1,816)	(510)
Net interest income after provision		
for loan losses	108,308	103,822
Noninterest income	13,827	13,814
Other expense	49,616	43,575
Provision for income taxes	171	806
Net income	<u>72,348</u>	<u>73,255</u>
Other comprehensive loss:		
Change in postretirement benefit plans	(79)	(414)
Total other comprehensive loss	(79)	(414)
Comprehensive Income	<u>\$ 72,269</u>	<u>\$ 72,841</u>