Fulfilling Our Mission

2014
SECOND QUARTER REPORT
June 30, 2014

TEXAS FARM CREDIT DISTRICT

SECOND QUARTER 2014

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

(dollars in thousands, except as noted)

The following discussion reviews the combined financial condition and results of operations of the Farm Credit Bank of Texas (bank), its affiliated Federal Land Credit Association (FLCA) and affiliated Agricultural Credit Associations (ACAs) for the six months ended June 30, 2014. The FLCA and ACAs are collectively referred to as associations, and the bank and its affiliated associations are collectively referred to as the district. These comments should be read in conjunction with the accompanying combined financial statements and footnotes, along with the 2013 Annual Report to stockholders. The accompanying financial statements were prepared under the oversight of the bank's audit committee.

RESULTS OF OPERATIONS

Net Income

Net income for the quarter ended June 30, 2014, was $117,163, an increase of $13,539, or 13.1 percent, over the same period of 2013. The increase in net income consisted of a $12,916 decrease in provision for loan losses, a $4,892 increase in net interest income, a $673 increase in noninterest income, and a $31 decrease in provision for income taxes, offset by a $4,973 increase in noninterest expense.

Net income for the six months ended June 30, 2014, was $223,409, an increase of $3,972, or 1.8 percent, over the same period of 2013. The increase in net income consisted of a $15,120 decrease in provision for loan losses, a $4,291 increase in net interest income, and a $666 decrease in provision for income taxes, offset by a $9,887 increase in noninterest expense and a $6,218 decrease in noninterest income.

Net Interest Income

Net interest income for the three months ended June 30, 2014, was $162,308, an increase of $4,892, or 3.1 percent, over the same period of 2013. The increase in net interest income was due to the effects of a $1.39 billion increase in combined district average earning assets, offset by a decrease in the net interest rate spread of 10 basis points to 2.80 percent. The increase in earning assets was due to increases in the bank's participation loan and investment portfolios and an increase in association average loan volume. The decrease in the interest rate spread was due mainly to a 12-basis-point decrease in the effective rate on average earning assets, offset by a 2-basis-point decrease in the effective rate of average interest-bearing liabilities. The decline in the net interest rate spread resulted primarily from competitive pressures and spread compression due to demand for high quality loans and investment securities. The district's associations' increase in average loan volume was due mainly to improved general economic conditions.

Net interest income for the six months ended June 30, 2014, was $319,667, an increase of $4,291, or 1.4 percent, over the same period of 2013. The increase was primarily the result of a $1.35 billion increase in combined district average earning assets, offset by a 16-basis-point decrease in the net interest rate spread to 2.79 percent for the six months ended June 30, 2014. The increase in average earning assets was due to increases in the bank's capital market loan and investment portfolios and in the associations' loan portfolios. The decrease in the net interest rate spread included a 15-basis-point decline in the effective rate on average earning assets, and a 1-basis-point increase in the effective cost of average interest-bearing liabilities. The decline in the net interest rate spread resulted primarily from competitive pressures and spread compression due to demand for high quality loans and investment securities. The district's associations had an increase in average loan volume of $682.6 million, due mainly to improved general economic conditions. Interest expense for the first six months of 2014 included a $1.4 million decrease in concession expenses recognized on callable debt as a result of a $976.7 million decrease in debt called in the first six months of 2014, compared to the same period in 2013. The bank called $1.59 billion in debt in the six months ended June 30, 2014.

Provision for Loan Losses

The district's negative provision for loan losses, standby letters of credit and unfunded commitments for the quarter ended June 30, 2014, totaled $4,975, a decrease of $12,916 from the $7,941 provision for the second quarter of 2013. Negative provision for loan losses, standby letters of credit and unfunded commitments for the six months ended June 30, 2014, was $6,794, a decrease of $15,120, or 181.6 percent, from the $8,326 provision for the first six months of 2013. The decrease included a $9,280 decrease at district associations and a $5,840 reduction in the bank's provision for credit losses. The negative provision for credit losses for the six months ended June 30, 2014, was primarily due to reductions in required specific provisions on impaired loans and improvements in the credit quality in the loan portfolios of the bank and district associations.

Noninterest Income

Noninterest income for the quarter ended June 30, 2014, was $13,829, an increase of $673, or 5.1 percent, from the same period of 2013. The increase was primarily due to a $951 increase in fair value on loans purchased in the secondary market (due primarily to changes in the interest rate environment), and a $1,084 increase in all other noninterest items, collectively, offset by a $1,057 decrease in fees for loan-related services and a $305 decrease in patronage income. The bank has elected a fair value option for financial presentation purposes on certain loans purchased in 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.

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. The bank recorded no credit losses on OTTI securities during the quarter ended June 30, 2014.

Noninterest income for the six months ended June 30, 2014, was $26,176, a decrease of $6,218, or 19.2 percent, from the same period of 2013. The decrease was primarily due to a $7,404 decrease in fees for loan-related services and a $551 decrease in patronage income, offset by a $938 increase in fair value on loans purchased in the secondary market (due primarily to changes in the interest rate environment), a $143 decrease in credit losses recognized on OTTI investments, and a $656 increase in all other noninterest items, collectively. The decrease in fees for loan-related services is primarily due to a $6.0 million prepayment fee the bank received on a participation loan in the first quarter of 2013. The bank recorded no credit losses on OTTI securities during the six months ended June 30, 2014.

Noninterest Expense

Noninterest expense for the three months ended June 30, 2014, was $63,886, an increase of $4,973, or 8.4 percent, over the same period of 2013. The increase is primarily attributable to a $997 increase in premiums to the FCSIC, a $936 increase in salaries and benefits, a $739 increase in occupancy and equipment expenses, a $719 increase in net losses on other property owned (OPO), and a $1,582 increase in other operating expenses. Premiums to the FCSIC, assessed on average System debt outstanding, increased from 10 basis points in 2013 to 12 basis points in 2014. The increase in salaries and benefits included a $2,628 increase in compensation and related payroll taxes (primarily at the district associations), net of a $2,256 decrease in pension and retirement expenses resulting mainly from actuarial gains in the district's defined benefit pension plan. The increase in occupancy and equipment expenses included a $600 increase in computer expenses. The increase in losses on OPO included a $1,099 decrease in gains on sales of OPO at the district's associations. The increase in other operating expenses included a $413 increase in professional and contract, a $394 increase in advertising and member relations expenses, and a $253 increase in communications expense.

Noninterest expense for the six months ended June 30, 2014, was $128,994, an increase of $9,887, or 8.3 percent, over the same period of 2013. The increase is primarily attributable to a $3,469 increase in salaries and benefits, a $2,485 increase in occupancy and equipment expenses, a $2,626 increase in other operating expenses, and a $1,899 increase in premiums to the FCSIC, offset by a $592 decrease in net losses on other property owned (OPO). The increase in salaries and benefits included a $6,588 increase in compensation and related payroll taxes (primarily at the district's associations), net of a $4,204 decrease in pension and retirement expenses resulting mainly from actuarial gains in the district's defined benefit pension plan. Premiums to the FCSIC, assessed on average System debt outstanding, increased from 10 basis points in 2013 to 12 basis points in 2014. The increase in other operating expenses included a $1,192 increase in advertising and member relations expenses and a $917 increase in professional and contract services. The decrease in losses on OPO included a $1,593 decrease in carrying value adjustments on OPO ($920 at the bank and $673 at the district's associations), a $189 increase in gains on sales of OPO at the bank and a $281 decrease in net expenses on OPO, offset by a $1,472 decrease in gains on sales of OPO at the district's associations.

Key results of operations comparisons:

	Annualized for the Six Months Ended 6/30/2014	Annualized for the Six Months Ended 6/30/2013
Return on average assets	**1.99%**	2.08%
Return on average members' equity	**12.26%**	13.06%
Net interest income as a percentage of average earning assets	**2.95%**	3.10%
Charge-offs, net of recoveries, to average loans	**0.03%**	0.30%
Operating expenses as a percentage of net interest income and noninterest income	**37.51%**	34.29%
Operating expenses as a percentage of average earning assets	**1.20%**	1.17%

Other Comprehensive (Loss) Income

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

The table below summarizes changes in elements included in other comprehensive (loss) income for the six months ended June 30:

	2014	2013
Change in unrealized losses on available-for-sale securities		
Net decrease (increase) in unrealized losses on investment securities	**$ 15,895**	$ (39,457)
Decrease in noncredit portion of other-than-temporary impairment (OTTI) losses	**21**	970
Reclassification adjustment for OTTI credit losses included in net income	**-**	143
Net decrease (increase) in unrealized losses on securities	**15,916**	(38,344)
Change in pension and postretirement benefit plans		
Change due to effect of merger	**326**	-
Amounts amortized into net periodic expense:		
Amortization of prior service credits	**(694)**	(1,162)
Amortization of net losses	**4,103**	8,599
Net change in pension and postretirement benefit plans	**3,735**	7,437
Change in cash flow derivative instruments		
Unrealized (losses) gains on interest rate caps	**(591)**	393
Reclassification of loss recognized in interest expense	**1,209**	627
Net change in cash flow derivative instruments	**618**	1,020
Other comprehensive income (loss)	**$ 20,269**	$ (29,887)

FINANCIAL CONDITION

Loan Portfolio

Gross loan volume at June 30, 2014, was $18,232,539, an increase of $507,019, or 2.9 percent, from $17,725,520 at December 31, 2013, and an increase of $1,067,759, or 6.2 percent, from $17,164,780 at June 30, 2013. The increase in the loan portfolio during the first six months of 2014 was due primarily to growth in the bank's capital markets portfolio of $44.5 million and in the associations' loan portfolios of $462.2 million.

Loans classified under the Farm Credit Administration (FCA)'s Uniform Loan Classification System as "acceptable" or "other assets especially mentioned" as a percentage of total loans and accrued interest receivable were 98.2 percent at June 30, 2014, 97.8 percent at December 31, 2013, and 97.2 percent at June 30, 2013. Nonaccrual loans for the district were 0.79 percent of total loans at June 30, 2014, compared to 0.91 percent at December 31, 2013, and 1.33 percent at June 30, 2013.

Total district high-risk asset volume decreased by $29.8 million, or 11.2 percent, to $235.4 million at June 30, 2014, from $265.2 million at December 31, 2013.

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

	June 30, 2014	Increase (Decrease) $	Increase (Decrease) %	December 31, 2013
Nonaccrual loans	**$ 143.7**	$ (17.6)	(10.9) %	$ 161.3
Formally restructured loans	**42.7**	(10.5)	(19.7)	53.2
Loans 90 days past due and still accruing interest	**6.7**	3.1	86.1	3.6
Total impaired loans	**193.1**	(25.0)	(11.5)	218.1
Other property owned, net	**42.3**	(4.8)	(10.2)	47.1
Total high-risk assets	**$ 235.4**	$ (29.8)	(11.2) %	$ 265.2

The $17.6 million decrease in nonaccrual loans from December 31, 2013, to June 30, 2014, is primarily the result of $37.1 million in repayments, $3.2 million in transfers to accrual status, $3.1 million in transfers to other property owned, and $2.5 million in net chargeoffs, offset by $24.2 million in transfers to nonaccrual and $6.7 million in advances on nonaccrual loan committed lines of credit. The district had significant decreases in nonaccrual loans in the dairy, timber and ethanol sectors, partially offset by increases in the general farms sector. At June 30, 2014, $76.5 million, or 53.2 percent, of the district's nonaccrual loans were considered current as to principal and interest. Continued satisfactory payment performance on these loans may indicate potential for a return to accrual status. At June 30, 2014, the district had $2.8 million in nonaccrual loans on which interest income is recognized upon cash receipts, compared to $4.5 million at December 31, 2013. The decrease in formally restructured loans included an $11.3 million decrease in real estate mortgage loans, primarily due to repayments. Of the total decrease in restructured loans, $10.5 million occurred at district associations and $38 occurred at the bank. The decrease in OPO was due primarily to dispositions of $3.3 million at the bank and $3.7 million at district associations. Impaired loans, consisting of nonaccrual loans, formally restructured loans and loans past due 90 days or more and still accruing interest, constituted 1.06 percent of total loans at June 30, 2014, and 1.23 percent of total loans at December 31, 2013.

The allowance for loan losses at June 30, 2014, totaled $63,376 and constituted 0.35 percent of total loans and was a decrease of $10,788, or 14.5 percent, from the allowance for loan losses at December 31, 2013. The decrease was primarily due to $6.8 million in negative provision for loan losses recorded during the six months ended June 30, 2014. Additional information about the allowance for loan losses is included in Note 3, "Loans and Reserves for Credit Losses." The allowance for loan losses as a percentage of impaired loans was 32.8 percent as of June 30, 2014, as compared to 34.0 percent as of December 31, 2013. The nature of the security supporting many of the impaired loans (primarily first lien real estate) is considered in the determination of necessary allowances for loan losses. The district also had reserves for losses on letters of credit and unfunded commitments totaling $5.4 million at June 30, 2014, which included specific reserves for two letters of credit and a general reserve for credit losses on letters of credit and unfunded commitments, representing management's estimate of probable credit losses related to letters of credit and unfunded commitments.

Liquidity and Funding Sources

Cash and available-for-sale investment securities totaled $4,434,674, or 19.3 percent, of total assets at June 30, 2014, compared to $4,325,389, or 19.3 percent, at December 31, 2013, an increase of $109,285, or 2.5 percent. At June 30, 2014, the district's cash balance was $545,178, a decrease of $64,878 from the balance at December 31, 2013. Cash held at the Federal Reserve Bank at June 30, 2014, totaled $520,223, compared to $572,754 at December 31, 2013. The bank maintains levels of cash and other highly liquid assets to meet loan demand, maturing debt and other liquidity needs. At June 30, 2014, the bank had 241 days of liquidity to cover maturing debt obligations, as compared to 268 days at December 31, 2013. Interest-bearing liabilities, consisting of bonds, notes and subordinated debt, increased by $631,394, or 3.4 percent, from December 31, 2013, to June 30, 2014.

Investments

The district's investments at June 30, 2014, included the bank's available-for-sale portfolio with a fair value of $3.73 billion and the district associations' held-to-maturity portfolio recorded at an amortized cost of $42.0 million at June 30, 2014. The available-for-sale investments included a liquidity portfolio and a portfolio of other investments. The bank's available-for-sale liquidity portfolio consisted primarily of federal agency-guaranteed collateralized mortgage-backed securities, corporate debt, agency-guaranteed debt, asset-backed securities and other collateralized mortgage-backed securities. The available-for-sale portfolio of other investments consisted of Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed agricultural mortgage-backed securities (AMBS) held by the bank that had a fair value of $96.4 million. The district's held-to-maturity portfolio consisted of Farmer Mac AMBS held by district associations which had an amortized cost of $42.0 million and a fair value of $41.9 million.

The Farmer Mac AMBS are backed by loans originated by the associations and previously held by the associations under Farmer Mac's long-term standby 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 following table summarizes the bank's available-for-sale liquidity portfolio holdings:

	June 30, 2014		December 31, 2013	
	Amortized Cost	**Fair Value**	Amortized Cost	Fair Value
Agency-guaranteed debt	**$ 130,143**	**$ 126,306**	$ 135,738	$ 130,024
Corporate debt	**223,990**	**224,401**	250,312	249,579
Federal agency collateralized mortgage-backed securities:				
GNMA	**1,698,396**	**1,694,195**	1,690,952	1,680,426
FNMA and FHLMC	**1,638,292**	**1,633,960**	1,431,037	1,421,578
Other collateralized mortgage-backed securities	**7,184**	**7,113**	7,736	7,529
Asset-backed securities	**43,309**	**43,365**	51,320	51,296
Total available-for-sale investments	**$ 3,741,314**	**$ 3,729,340**	$ 3,567,095	$ 3,540,432

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

	June 30, 2014		December 31, 2013	
	Amortized Cost	**Fair Value**	Amortized Cost	Fair Value
Agricultural mortgage-backed securities	**$ 98,860**	**$ 96,447**	$ 101,063	$ 97,423

During the six months ended June 30, 2014, there was a decrease in unrealized losses on investments totaling $15,916, due primarily to changes in the interest rate environment.

At June 30, 2014, the bank had one asset-backed security (ABS) that was considered other-than-temporarily impaired (OTTI). During the six months ended June 30, 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 $21, 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 (except mortgage securities) and other obligations fully insured or guaranteed by the U.S., its agencies, instrumentalities and corporations are considered eligible investments under the 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 June 30, 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 $8,136 and a fair value of $8,030 at June 30, 2014.

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

	Eligible			Ineligible				
June 30, 2014	AAA/Aaa	AA/Aa	Split Rated	AA/Aa	A/A	BBB/Baa	CCC/Caa	Total
Agency-guaranteed debt*	$ -	$ -	$ 126,306	$ -	$ -	$ -	$ -	$ 126,306
Corporate debt	-	74,975	149,426	-		-	-	224,401
Federal agency collateralized mortgage-backed securities*								
GNMA	-	-	1,694,195	-	-	-	-	1,694,195
FNMA and FHLMC	-	-	1,633,960	-	-	-	-	1,633,960
Other collateralized mortgage-backed securities	-	-	-	2,657	-	4,456	-	7,113
Asset-backed securities	42,447	-	-	-	640	-	278	43,365
Total	$ 42,447	$ 74,975	$ 3,603,887	$ 2,657	$ 640	$ 4,456	$ 278	$ 3,729,340

	Eligible			Ineligible				
December 31, 2013	AAA/Aaa	AA/Aa	Split Rated	AA/Aa	A/A	BBB/Baa	CCC/Caa	Total
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
Total	$ 50,138	$ 75,832	$ 3,405,775	$ 2,696	$ 882	$ 4,833	$ 276	$ 3,540,432

*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

The district's combined capital at June 60, 2014, totaled $3,783,400, consisting of $600,000 of Class B non-cumulative subordinated perpetual preferred stock, $59,946 of capital stock and participation certificates, and $3,062,241 in retained earnings, offset by $90,685 in accumulated other comprehensive loss. The balance in equity reflected an increase of $209,165 from equity at December 31, 2013, due primarily to net income of $223,409 and $20,269 in other comprehensive gains, offset by preferred stock dividends of $25,125 and $10,105 in patronage distributions.

As of June 30, 2014, the bank and all district associations exceeded all regulatory capital requirements. Total members' equity increased $209,165, or 5.9 percent, from December 31, 2013, to the June 30, 2014, total of $3,783,400. This increase is the result of net income of $223,409 for the six months ended June 30, 2014 and a $20,269 increase in accumulated other comprehensive gains, offset by dividends on preferred stock totaling $25,125, patronage accrual of $10,105 and net stock issuances of $717.

Key financial condition comparisons:

	June 30, 2014	December 31, 2013
Members' equity to assets	**16.43%**	15.98%
Total liabilities to members' equity	**5.09:1**	5.26:1
Allowance for loan losses to total loans	**0.35%**	0.42%

OTHER

CONDITIONS IN THE TEXAS DISTRICT

During the second 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 conditions, as well as sufficient moisture for field crops. Late spring and early summer rains have improved conditions in Texas, with the majority of Texas regions now carrying improved levels of topsoil moisture. This has improved pasture and range conditions in the state, as well as the outlook for field crops. Nevertheless, drought conditions in most of north Texas continue to be classified as severe to exceptional. Nearly the entire state of New Mexico remains in a state of drought. Despite the drought conditions, field crops remain in fair to good condition, while pasture and range land are primarily rated as poor.

The 2014 farm season is in progress, as most crops across district states are in the ground. Farmers across the eastern states and Texas have had the benefit of late spring and early summer rains, and most major crops are reported as being in fair to excellent condition. Looking forward to the late summer and early fall, the focus will be on precipitation and temperatures and the impact on harvested acres, yields and, ultimately, price. Farmers in the district continue to use risk management tools, such as programs under the U.S. Farm Bill and multi-peril crop insurance, as well as forward, futures and options contracts.

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. The cattle industry continues to experience contracted herd levels due to the prolonged drought conditions; however, cattle ranchers in many areas in the district have begun the process of expanding the herd through increased heifer retention. Cattle feedlots continue to manage through the effects of a smaller herd, while 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, effects of the porcine virus on the pork production and the decline in feed costs, 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.

Labor markets are generally improving, and the housing and construction sector continues to recover. Global supply and demand dynamics are favorable to the district loan portfolio, and are 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 May 5, 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.

On July 1, 2014, Moody's Investors Service affirmed the bank's issuer rating at "Aa3," its subordinated debt rating at "A2," and its noncumulative preferred stock rating at "Baa1 (hyb)," with a stable outlook. The Aa3 issuer rating reflects the bank's "a1" baseline credit assessment (BCA), very high cooperative support from the other Federal Farm Credit Banks and moderate support from the U.S. Government, which has an "Aaa," stable outlook. The bank's subordinated debt and preferred stock ratings incorporate the bank's BCA and very high cooperative support from the other Federal Farm Credit Banks. The bank's BCA incorporates its solid capital levels, adequate risk-adjusted profitability and liquidity as well as the benefits associated with its lending to related associations and their strong capital levels. The "a1" BCA is one of Moody's highest assessments of any financial institution, both domestically and globally.

REGULATORY MATTERS

As of June 30, 2014, FCA had an enforcement action 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 comment period for the interim rule ended on April 30, 2014, and the final rule became effective on June 18, 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. 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 a government-sponsored enterprise.
- 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.

Once the proposed rule is published in the Federal Register, the 120-day public comment period will commence.

On June 12, 2014, the Farm Credit Administration Board approved a proposed rule to modify regulations related to eligible investments for the banks and associations of the Farm Credit System (FCS or System). The proposed rule would strengthen the safety and soundness of the investment activities of System banks by more accurately reflecting the risk in particular investments. It would also comply with a provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act by replacing credit rating requirements with other standards of creditworthiness. In addition, the proposed rule would grant associations greater flexibility regarding the risk management purposes for which they may hold investments while placing new limits on the amounts and types of investments they may hold. It would strengthen risk management practices at associations and require greater bank oversight of association investments. The proposed rule will require the 30-day period for congressional review before being published in the Federal Register with a 90-day comment period.

The undersigned certify that we have reviewed the June 30, 2014, quarterly report of the Farm Credit Bank of Texas and district associations, that the report has been prepared in accordance with all applicable statutory or regulatory requirements, and that the information included herein is true, accurate and complete to the best of our knowledge and belief.

Larry R. Doyle
Chief Executive Officer

James F. Dodson
Chairman of the Board

Amie Pala
Chief Financial Officer

August 8, 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 chief financial officer evaluated our disclosure controls and procedures as of the end of and for the period covered by this quarterly report, and have concluded that our disclosure controls and procedures are effective as of that date. This evaluation relies upon the evaluations made by the individual associations and the related certifications they provide to the bank.

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

Larry R. Doyle	Amie Pala
Chief Executive Officer	Chief Financial Officer

August 8, 2014

Combined Balance Sheets

(dollars in thousands)	June 30, 2014 (Unaudited)	December 31, 2013
Assets		
Cash	**$ 545,178**	$ 610,056
Federal funds sold	**21,758**	21,809
Investment securities	**3,867,738**	3,693,524
Loans (includes $58,060 and $58,461 at fair value held under fair value option)	**18,232,539**	17,725,520
Less allowance for loan losses	**63,376**	74,164
Net loans	**18,169,163**	17,651,356
Accrued interest receivable	**145,969**	136,610
Other property owned, net	**42,300**	47,142
Premises and equipment, net	**85,210**	79,454
Other assets	**145,113**	132,888
Total assets	**$ 23,022,429**	$ 22,372,839
Liabilities and members' equity		
Liabilities		
Bonds and notes, net	**$ 18,883,406**	$ 18,252,012
Subordinated debt	**50,000**	50,000
Accrued interest payable	**36,783**	39,853
Patronage distributions payable	**6,472**	134,376
Preferred stock dividends payable	**20,063**	20,063
Other liabilities	**242,305**	302,300
Total liabilities	**19,239,029**	18,798,604
Commitments and contingent liabilities (Note 4)		
Members' equity		
Preferred stock	**600,000**	600,000
Capital stock and participation certificates	**59,946**	59,225
Allocated retained earnings	**518,079**	516,859
Unallocated retained earnings	**2,544,162**	2,486,368
Additional paid-in-capital	**151,898**	22,737
Accumulated other comprehensive loss	**(90,685)**	(110,954)
Total members' equity	**3,783,400**	3,574,235
Total liabilities and members' equity	**$ 23,022,429**	$ 22,372,839

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

Combined Statements of Comprehensive Income

(unaudited)

	Quarter Ended June 30,		Six Months Ended June 30,	
(dollars in thousands)	**2014**	2013	**2014**	2013
Interest Income				
Investment securities	**$ 13,375**	$ 13,980	**$ 26,106**	$ 28,180
Loans	**194,887**	187,575	**386,892**	374,792
Total interest income	**208,262**	201,555	**412,998**	402,972
Interest Expense				
Bonds and notes	**39,466**	37,651	**80,395**	74,889
Notes payable and other	**6,488**	6,488	**12,936**	12,707
Total interest expense	**45,954**	44,139	**93,331**	87,596
Net interest income	**162,308**	157,416	**319,667**	315,376
(Negative provision) provision for loan losses	**(4,975)**	7,941	**(6,794)**	8,326
Net interest income after provision for loan losses	**167,283**	149,475	**326,461**	307,050
Noninterest Income				
Patronage income	**4,164**	4,469	**9,188**	9,739
Loan-related fees	**5,785**	6,842	**11,524**	18,928
Gain (loss) on loans held under fair value option	**80**	(871)	**644**	(294)
Miscellaneous income, net	**3,800**	2,716	**4,820**	4,164
Impairment losses on investments				
Total other-than-temporary impairment gains (losses)	**-**	-	**-**	(143)
Less: portion of gain (loss) recognized in other comprehensive income	**-**	-	**-**	-
Net impairment loss recognized in earnings	**-**	-	**-**	(143)
Total noninterest income	**13,829**	13,156	**26,176**	32,394
Noninterest Expense				
Salaries and employee benefits	**34,030**	33,094	**71,572**	68,103
Occupancy and equipment	**5,972**	5,233	**12,755**	10,270
Insurance Fund premiums	**4,937**	3,940	**9,672**	7,773
Losses (gains) on other property owned, net	**64**	(655)	**(725)**	(133)
Other operating expenses	**18,883**	17,301	**35,720**	33,094
Total noninterest expense	**63,886**	58,913	**128,994**	119,107
Income before provision for income taxes	**117,226**	103,718	**223,643**	220,337
Provision for income taxes	**63**	94	**234**	900
Net Income	**117,163**	103,624	**223,409**	219,437
Other comprehensive income (loss)				
Change in pension and postretirement benefit plans	**1,832**	3,778	**3,735**	7,437
Change in unrealized gain on investments	**8,928**	(32,179)	**15,916**	(38,344)
Change in cash flow derivative instruments	**336**	693	**618**	1,020
Total other comprehensive income (loss)	**11,096**	(27,708)	**20,269**	(29,887)
Comprehensive Income	**$ 128,259**	$ 75,916	**$ 243,678**	$ 189,550

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

Combined Statements of Changes in Members' Equity

(unaudited)

(dollars in thousands)	Preferred Stock	Capital Stock	Allocated Retained Earnings	Unallocated Retained Earnings	Additional Paid-In Capital	Accumulated Other Comprehensive (Loss) Income	Total Members' Equity
Balance at December 31, 2012	$ 482,000	$ 59,859	$ 419,721	$ 2,412,571	$ 22,737	$ (110,807)	$ 3,286,081
Net income	-	-	-	219,437	-	-	219,437
Other comprehensive loss	-	-	-	-	-	(29,887)	(29,887)
Capital stock/participation certificates issued	-	4,740	-	-	-	-	4,740
Capital stock/participation certificates and allocated retained earnings retired	-	(4,338)	(1,948)	-	-	-	(6,286)
Preferred stock dividends accrued	-	-	-	(21,881)	-	-	(21,881)
Patronage distributions							
Cash	-	-	-	(8,498)	-	-	(8,498)
Members' equity	-	-	504	(504)	-	-	-
Balance at June 30, 2013	$ 482,000	$ 60,261	$ 418,277	$ 2,601,125	$ 22,737	$ (140,694)	$ 3,443,706
Balance at December 31, 2013	$ 600,000	$ 59,225	$ 516,859	$ 2,486,368	$ 22,737	$ (110,954)	$ 3,574,235
Net income	-	-	-	223,409	-	-	223,409
Other comprehensive gain	-	-	-	-	-	20,269	20,269
Capital stock/participation certificates issued	-	3,574	-	-	-	-	3,574
Capital stock/participation certificates and allocated retained earnings retired	-	(2,853)	(4)	-	-	-	(2,857)
Impact of association merger:							
Equity issued upon association merger	-	4,306	-	-	129,161	-	133,467
Equity retired upon association merger	-	(4,306)	(23)	(129,138)	-	-	(133,467)
Preferred stock dividends accrued	-	-	-	(25,125)	-	-	(25,125)
Patronage distributions							
Cash	-	-	-	(10,105)	-	-	(10,105)
Members' equity	-	-	1,247	(1,247)	-	-	-
Balance at June 30, 2014	**$ 600,000**	**$ 59,946**	**$ 518,079**	**$ 2,544,162**	**$ 151,898**	**$ (90,685)**	**$ 3,783,400**

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

Combined Statements of Cash Flows

(unaudited)

(dollars in thousands)	Six Months Ended June 30, 2014	2013
Operating activities		
Net income	**$ 223,409**	$ 219,437
Reconciliation of net income to net cash provided by operating activities		
(Negative provision) provision for loan losses	**(6,794)**	8,326
Provision for losses on other property owned	**283**	1,877
Depreciation and amortization on premises and equipment	**5,554**	4,639
Accretion of net discount on loans	**5,826**	2,753
Amortization and accretion on debt instruments	**(1,824)**	(1,656)
Amortization of net discount on investment securities	**(436)**	(582)
(Increase) decrease in fair value on loans under fail value option	**(644)**	294
Gains from sales of other property owned, net	**(1,042)**	(2,326)
Losses on impairment of investments available-for-sale	**-**	143
Gains from sales of premises and equipment	**(4,016)**	(1,002)
Allocated equity patronage from System bank	**(13,083)**	(12,406)
Increase in accrued interest receivable	**(9,359)**	(12,315)
Decrease in other assets	**1,476**	5,519
(Decrease) increase in accrued interest payable	**(3,070)**	1,221
Decrease in other liabilities	**(44,746)**	(26,228)
Net cash provided by operating activities	**151,534**	187,694
Investing activities		
Net decrease in federal funds sold	**51**	1,648
Investment securities		
Purchases	**(601,103)**	(703,993)
Proceeds from maturities, calls and prepayments	**443,241**	543,384
Proceeds from sales	**-**	6,528
Increase in loans, net	**(539,218)**	(410,053)
Proceeds from sale of loans	**-**	324,149
Proceeds from sales of other property owned, net	**6,938**	30,590
Proceeds from sales of premises and equipment	**2,857**	1,616
Expenditures for premises and equipment	**(10,151)**	(10,270)
Net cash used in investing activities	**(697,385)**	(216,401)
Financing activities		
Bonds and notes issued	**5,293,008**	5,397,677
Bonds and notes retired	**(4,659,790)**	(5,376,715)
Increase in advanced conditional payments	**10,172**	1,102
Capital stock and participation certificates issued	**3,574**	4,740
Capital stock and participation certificates retired	**(2,857)**	(4,338)
Cash dividends on preferred stock	**(25,125)**	(21,881)
Cash patronage distributions paid	**(138,009)**	(105,995)
Net cash provided by (used in) financing activities	**480,973**	(105,410)
Net decrease in cash	**(64,878)**	(134,117)
Cash at beginning of year	**610,056**	512,842
Cash at end of quarter	**545,178**	378,725
Supplemental schedule of noncash investing and financing activities		
Financed sales of other property owned	**$ 1,800**	$ 4,744
Loan assets transferred to other property owned	**3,137**	11,039
Net decrease (increase) in unrealized losses on investment securities	**15,916**	(38,344)
Cash dividends or patronage distributions payable	**6,472**	5,633
Supplemental schedule of noncash changes in fair value related to hedging activities		
Decrease in bonds and notes	**$ -**	$ (91)
Supplemental information		
Cash paid for:		
Interest	**$ 96,401**	$ 86,375
Income taxes	**-**	272

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

Notes to Combined Financial Statements

Unaudited (dollar amounts in thousands unless otherwise noted)

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

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

The significant accounting policies followed and the financial condition and results of operations of the combined bank and associations as of and for the year ended December 31, 2013, are contained in the 2013 Annual Report to stockholders (Annual Report). These unaudited second 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 district, and conform to generally accepted accounting principles. The preparation of these financial statements requires the use of management's estimates. The results of operations for any interim period are not necessarily indicative of the results to be expected for the entire year.

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 is 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

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, corporate debt, agency-guaranteed debt and asset-backed securities. The majority of the liquidity portfolio'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 other investments portfolio consists of Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed agricultural mortgage-backed securities (AMBS) purchased during the second quarter of 2010, the first quarter of 2012 and the second quarter of 2014. A summary of the amortized cost and fair value of investment securities available for sale, at June 30, 2014, and December 31, 2013, is as follows.

Investments in the bank's available-for-sale liquidity portfolio at June 30, 2014:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agency-guaranteed debt	$ 130,143	$ 20	$ (3,857)	$ 126,306	1.53 %
Corporate debt	223,990	527	(116)	224,401	0.76
Federal agency collateralized mortgage-backed securities					
GNMA	1,698,396	8,836	(13,037)	1,694,195	1.48
FNMA and FHLMC	1,638,292	5,179	(9,511)	1,633,960	1.23
Other collateralized mortgage-backed securities	7,184	-	(71)	7,113	2.74
Asset-backed securities	43,309	90	(34)	43,365	0.62
Total available-for-sale investments	**$ 3,741,314**	**$ 14,652**	**$ (26,626)**	**$ 3,729,340**	**1.32 %**

Investments in the bank's available-for-sale other investments portfolio at June 30, 2014:

	June 30, 2014				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	$ 98,860	$ -	$ (2,413)	$ 96,447	4.23 %

Investments in the bank's 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	**$ 3,567,095**	**$ 14,763**	**$ (41,426)**	**$ 3,540,432**	**1.28 %**

Investments in the bank's 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 June 30, 2014:

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

	Due in one year or less	Due after one year through five years	Due after five years through 10 years	Due after 10 years	Total
Agency-guaranteed debt	$ -	$ -	$ -	$ 126,306	$ 126,306
Corporate debt	50,129	174,272	-	-	224,401
Federal agency collateralized mortgage-backed securities					
GNMA	-	1,658	26,813	1,665,724	1,694,195
FNMA and FHLMC	-	29,216	209,898	1,394,846	1,633,960
Other collateralized mortgage-backed securities	-	18	-	7,095	7,113
Asset-backed securities	-	35,894	-	7,471	43,365
Total fair value	**$ 50,129**	**$ 241,058**	**$ 236,711**	**$ 3,201,442**	**$ 3,729,340**
Total amortized cost	**$ 50,062**	**$ 240,161**	**$ 234,442**	**$ 3,216,649**	**$ 3,741,314**
Weighted average yield	**0.54%**	**0.89%**	**2.01%**	**1.31%**	**1.32%**

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

	Due after one year through five years
Fair value of agricultural mortgage-backed securities	$ 96,447
Total amortized cost	**$ 98,860**
Weighted average yield	**4.23%**

Other-Than-Temporarily Impaired Investments Evaluation

The following table shows the bank's available-for-sale liquidity portfolio investments by gross unrealized losses and fair value, aggregated by investment category and length of time, for the securities that have been in a continuous unrealized loss position at June 30, 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	$ 14,285	$ (31)	$ 94,845	$ (3,826)	$ 109,130	$ (3,857)
Corporate debt	39,881	(71)	14,936	(45)	54,817	(116)
Federal agency collateralized mortgage-backed securities						
GNMA	538,846	(4,268)	433,659	(8,769)	972,505	(13,037)
FNMA and FHLMC	400,873	(1,073)	496,662	(8,438)	897,535	(9,511)
Other collateralized mortgage-backed securities	4,456	(26)	2,657	(45)	7,113	(71)
Asset-backed securities	-	-	918	(34)	918	(34)
Total	**$ 998,341**	**$ (5,469)**	**$ 1,043,677**	**$ (21,157)**	**$ 2,042,018**	**$ (26,626)**

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

In the six months ended June 30, 2014, the bank did not recognize any other-than-temporary impairment credit losses. The non-credit-related net decrease in fair value on the bank's other-than-temporarily impaired investments for the six months ended June 30, 2014, totaling $21, is included as a credit to other comprehensive loss. At June 30, 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:

	June 30, 2014	
Assumptions Used	Mortgage-Backed Securities	Asset-Backed Securities
Default by range	0.9% - 4.2%	4.5% - 8.1%
Prepayments rate by range	4.2% - 19.3%	1.9% - 4.4%
Loss severity by range	10.0% - 39.3%	62.6% - 65.1%

	December 31, 2013	
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 and six months ended:

	For the Three Months Ended June 30,		**For the Six Months Ended June 30,**	
	2014	2013	**2014**	2013
Credit loss component, beginning of period	**$ 454**	$ 1,600	**$ 454**	$ 5,084
Additions:				
Subsequent credit impairment	**-**	-	**-**	143
Reductions:				
For securities sold	**-**	-	**-**	(3,627)
Credit loss component end of period	**$ 454**	$ 1,600	**$ 454**	$ 1,600

Held-to-Maturity Investments

The district's held-to-maturity investments consist of Farmer Mac guaranteed agricultural mortgage-backed securities and are held by district associations. A summary of the amortized cost and fair value of held-to-maturity investment securities at June 30, 2014, is as follows:

	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**	**Weighted Average Yield**
Agricultural mortgage-backed securities	$ 41,951	$ 228	$ (278)	$ 41,901	4.59 %

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

The following table summarizes the contractual maturity, fair value, amortized cost and weighted average yield of the district's held-to-maturity investments at June 30, 2014:

	Due after one year through five years	Due after five years through 10 years	Total
Fair value of agricultural mortgage-backed securities	$ 25,886	$ 16,015	$ 41,901
Total amortized cost	**$ 25,701**	**$ 16,250**	**$ 41,951**
Weighted average yield	**4.98%**	**3.96%**	**4.59%**

NOTE 3 — LOANS AND RESERVES FOR CREDIT LOSSES

A summary of the district's loans follows:

	June 30, 2014	December 31, 2013
Real estate mortgage	**$ 11,014,159**	$10,794,302
Production and intermediate term	**1,960,250**	1,877,296
Loans to cooperatives	**222,042**	173,572
Processing and marketing	**2,425,629**	2,345,046
Farm-related business	**223,072**	226,110
Communication	**350,308**	304,755
Energy (rural utilities)	**1,288,307**	1,343,360
Water and waste disposal	**147,868**	133,975
Rural residential real estate	**244,782**	225,942
Agricultural export finance	**19,949**	19,788
Lease receivables	**4,235**	4,411
Loans to other financing institutions	**36,922**	34,380
Mission-related	**295,016**	242,583
	$ 18,232,539	$ 17,725,520

The bank and associations purchase or sell participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration (FCA) regulations. The following table presents information regarding the balances of participations purchased and sold, excluding syndications, at June 30, 2014.

	Other Farm Credit Institutions (Outside of the Texas District)		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	$ 141,342	$ 154,906	$ 50,041	$ 20,391	$ 191,383	$ 175,297
Production and intermediate term	359,683	427,587	13,926	25,086	373,609	452,673
Agribusiness	1,281,236	18,269	29,575	9,027	1,310,811	27,296
Communication	350,722	-	-	-	350,722	-
Energy (rural utilities)	1,292,096	3,321	-	-	1,292,096	3,321
Water and waste disposal	137,613	-	-	-	137,613	-
Agricultural export finance	19,821	-	-	-	19,821	-
Lease receivables	3,919	-	31	-	3,950	-
Mission-related	7,932	-	4,418	-	12,350	-
Loans to other financing institutions	-	23,071	-	-	-	23,071
Direct note receivable from district associations	-	3,650,000	-	-	-	3,650,000
Total	**$ 3,594,364**	**$ 4,277,154**	**$ 97,991**	**$ 54,504**	**$ 3,692,355**	**$ 4,331,658**

The bank and associations are 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. ACPs which are held by the district but cannot be used to reduce outstanding loan balances, except at the direction of the borrower, are classified as other liabilities in the combined balance sheets. ACPs are not insured, and interest is generally paid by the associations on such balances. At June 30, 2014, ACPs netted against borrowers’ related loan balances totaled $173,699 and ACPs included in other liabilities totaled $39,064, compared to $136,512 and $28,892, respectively, at 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 $58,060 at June 30, 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 six months ended June 30, 2014:

Balance at January 1, 2014	**$ 58,461**
Net gains on financial instruments under fair value option	**644**
Change in premium	**(1,045)**
Balance at June 30, 2014	**$ 58,060**

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

	June 30, 2014	December 31, 2013
Nonaccrual loans:		
Real estate mortgage	**$ 102,148**	$ 108,370
Production and intermediate term	**31,384**	38,410
Agribusiness	**6,848**	11,988
Rural residential real estate	**1,114**	1,302
Energy and water/waste disposal	**2,159**	1,171
Lease receivables	**39**	48
Total nonaccrual loans	**143,692**	161,289
Accruing restructured loans:		
Real estate mortgage	**22,435**	33,717
Production and intermediate term	**13,868**	14,129
Agribusiness	**-**	105
Rural residential real estate	**288**	72
Mission-related	**6,080**	5,189
Total accruing restructured loans	**42,671**	53,212
Accruing loans 90 days or more past due:		
Real estate mortgage	**2,670**	754
Production and intermediate term	**905**	2,371
Agribusiness	**1,780**	-
Rural residential real estate	**123**	-
Mission-related	**1,264**	496
Total accruing loans 90 days or more past due	**6,742**	3,621
Total nonperforming loans	**193,105**	218,122
Other property owned, net	**42,300**	47,142
Total nonperforming assets	**$ 235,405**	$ 265,264

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

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

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

	June 30, 2014		December 31, 2013	
Real estate mortgage:				
Acceptable	**96.5**	**%**	96.1	%
OAEM	**1.6**		1.7	
Substandard/Doubtful	**1.9**		2.2	
	100.0	**%**	100.0	%
Production and intermediate term:				
Acceptable	**95.2**	**%**	93.5	%
OAEM	**1.7**		2.7	
Substandard/Doubtful	**3.1**		3.8	
	100.0	**%**	100.0	%
Agribusiness:				
Acceptable	**98.5**	**%**	98.3	%
OAEM	**1.0**		0.8	
Substandard/Doubtful	**0.5**		0.9	
	100.0	**%**	100.0	%
Energy and water/waste disposal:				
Acceptable	**98.6**	**%**	97.3	%
OAEM	**-**		-	
Substandard/Doubtful	**1.4**		2.7	
	100.0	**%**	100.0	%
Communication:				
Acceptable	**99.6**	**%**	99.5	%
OAEM	**-**		-	
Substandard/Doubtful	**0.4**		0.5	
	100.0	**%**	100.0	%
Rural residential real estate:				
Acceptable	**97.1**	**%**	96.9	%
OAEM	**1.3**		1.2	
Substandard/Doubtful	**1.6**		1.9	
	100.0	**%**	100.0	%
Agricultural export finance:				
Acceptable	**100.0**	**%**	100.0	%
OAEM	**-**		-	
Substandard/Doubtful	**-**		-	
	100.0	**%**	100.0	%
Lease receivables:				
Acceptable	**92.8**	**%**	92.2	%
OAEM	**6.1**		6.5	
Substandard/Doubtful	**1.1**		1.3	
	100.0	**%**	100.0	%
Loans to other financing institutions:				
Acceptable	**100.0**	**%**	100.0	%
OAEM	**-**		-	
Substandard/Doubtful	**-**		-	
	100.0	**%**	100.0	%
Mission-related:				
Acceptable	**97.6**	**%**	97.4	%
OAEM	**-**		-	
Substandard/Doubtful	**2.4**		2.6	
	100.0	**%**	100.0	%
Total loans:				
Acceptable	**96.9**	**%**	96.4	%
OAEM	**1.3**		1.4	
Substandard/Doubtful	**1.8**		2.2	
	100.0	**%**	100.0	%

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

June 30, 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	$ 59,224	$ 48,234	$ 107,458	$ 11,005,283	$ 11,112,741	$ 2,670
Production and intermediate term	8,835	8,984	17,819	1,963,433	1,981,252	905
Agribusiness	691	4,865	5,556	2,876,691	2,882,247	1,780
Communication	-	-	-	350,648	350,648	-
Energy and water/waste disposal	1,004	1,154	2,158	1,438,873	1,441,031	-
Rural residential real estate	2,853	327	3,180	242,238	245,418	123
Agricultural export finance	-	-	-	19,971	19,971	-
Lease receivables	-	-	-	4,334	4,334	-
Loans to other financing institutions	-	-	-	36,964	36,964	-
Mission-related	7,599	1,265	8,864	288,907	297,771	1,264
Total	**$ 80,206**	**$ 64,829**	**$ 145,035**	**$18,227,342**	**$18,372,377**	**$ 6,742**

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	$ 39,855	$ 45,347	$ 85,202	$ 10,802,797	$ 10,887,999	$ 754
Production and intermediate term	13,255	16,762	30,017	1,865,035	1,895,052	2,371
Agribusiness	1,723	2,743	4,466	2,751,517	2,755,983	-
Communication	-	-	-	305,050	305,050	-
Energy and water/waste disposal	-	-	-	1,481,665	1,481,665	-
Rural residential real estate	1,899	329	2,228	224,751	226,979	-
Agricultural export finance	-	-	-	19,828	19,828	-
Lease receivables	-	-	-	4,507	4,507	-
Loans to other financing institutions	-	-	-	34,421	34,421	-
Mission-related	8,535	496	9,031	235,847	244,878	496
Total	$ 65,267	$ 65,677	$ 130,944	$ 17,725,418	$ 17,856,362	$ 3,621

Additional impaired loan information is as follows:

	At June 30, 2014			At December 31, 2013		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
Impaired loans with a related allowance for loan losses:						
Real estate mortgage	$ 21,317	$ 23,742	$ 6,138	$ 41,123	$ 50,123	$ 9,905
Production and intermediate term	21,101	21,763	7,252	27,653	28,654	6,212
Processing and marketing	1,973	3,984	396	6,878	10,871	2,401
Farm-related business	1,010	4,934	134	1,068	4,992	191
Energy and water/waste disposal	2,159	2,159	2,134	1,171	1,171	1,147
Rural residential real estate	22	73	4	253	253	14
Mission-related	2,543	2,543	148	2,331	2,331	78
Total	$ 50,125	$ 59,198	$ 16,206	$ 80,477	$ 98,395	$ 19,948
Impaired loans with no related allowance for loan losses:						
Real estate mortgage	$ 105,936	$ 124,646	$ -	$ 101,718	$ 111,132	$ -
Production and intermediate term	25,056	44,902	-	27,256	49,522	-
Loans to cooperatives	1,685	1,685	-	-	-	-
Processing and marketing	3,789	28,171	-	3,856	28,391	-
Farm-related business	171	821	-	292	1,000	-
Energy and water/waste disposal	-	22,731	-	-	22,796	-
Rural residential real estate	1,503	1,679	-	1,120	1,210	-
Lease receivables	39	39	-	48	48	-
Mission-related	4,801	8,509	-	3,354	7,088	-
Total	$ 142,980	$ 233,183	$ -	$ 137,644	$ 221,187	$ -
Total impaired loans:						
Real estate mortgage	$ 127,253	$ 148,388	$ 6,138	$ 142,841	$ 161,255	$ 9,905
Production and intermediate term	46,157	66,665	7,252	54,909	78,176	6,212
Loans to cooperatives	1,685	1,685	-	-	-	-
Processing and marketing	5,762	32,155	396	10,734	39,262	2,401
Farm-related business	1,181	5,755	134	1,360	5,992	191
Energy and water/waste disposal	2,159	24,890	2,134	1,171	23,967	1,147
Rural residential real estate	1,525	1,752	4	1,373	1,463	14
Lease receivables	39	39	-	48	48	-
Mission-related	7,344	11,052	148	5,685	9,419	78
Total	$ 193,105	$ 292,381	$ 16,206	$ 218,121	$ 319,582	$ 19,948

	For the Three Months Ended				For the Six Months Ended			
	June 30, 2014		June 30, 2013		**June 30, 2014**		June 30, 2013	
Impaired loans with a related allowance for loan losses:	**Average Impaired Loans**	**Interest Income Recognized**	Average Impaired Loans	Interest Income Recognized	**Average Impaired Loans**	**Interest Income Recognized**	Average Impaired Loans	Interest Income Recognized
Real estate mortgage	**$ 21,293**	**$ 90**	$ 54,376	$ 121	**$ 29,988**	**$ 137**	$ 54,876	$ 246
Production and intermediate term	**21,635**	**5**	16,739	76	**21,526**	**8**	11,249	302
Processing and marketing	**2,136**	**-**	33,277	19	**2,087**	**-**	41,951	99
Farm-related business	**1,032**	**-**	295	-	**1,044**	**-**	4,415	-
Communication	**-**	**-**	1,793	87	**-**	**-**	3,556	87
Energy and water/waste disposal	**2,161**	**-**	1,715	-	**2,090**	**-**	1,500	-
Rural residential real estate	**57**	**-**	107	-	**87**	**1**	237	-
Mission-related	**2,541**	**66**	-	-	**2,537**	**115**	-	-
Total	**$ 50,855**	**$ 161**	$ 108,302	$ 303	**$ 59,359**	**$ 261**	$ 117,784	$ 734
Impaired loans with no related allowance for loan losses:								
Real estate mortgage	**$ 111,258**	**$ 1,010**	$ 142,940	$ 1,363	**$ 105,930**	**$ 2,255**	$ 148,433	$ 3,460
Production and intermediate term	**24,241**	**547**	23,394	480	**25,065**	**1,225**	24,632	1,530
Loans to cooperatives	**1,685**	**22**	-	-	**847**	**22**	-	-
Processing and marketing	**3,676**	**-**	12,034	32	**3,939**	**-**	13,054	43
Farm-related business	**175**	**39**	8,424	47	**178**	**66**	4,399	98
Communication	**-**	**-**	662	-	**-**	**-**	666	-
Energy and water/waste disposal	**-**	**1**	-	-	**-**	**1**	-	-
Rural residential real estate	**1,490**	**13**	1,636	21	**1,447**	**20**	1,428	26
Lease receivables	**41**	**-**	57	-	**43**	**-**	59	-
Mission-related	**4,734**	**79**	1,355	28	**4,136**	**137**	681	28
Total	**$ 147,300**	**$ 1,711**	$ 190,502	$ 1,971	**$ 141,585**	**$ 3,726**	$ 193,352	$ 5,185
Total impaired loans:								
Real estate mortgage	**$ 132,551**	**$ 1,100**	$ 197,316	$ 1,484	**$ 135,918**	**$ 2,392**	$ 203,309	$ 3,706
Production and intermediate term	**45,876**	**552**	40,133	556	**46,591**	**1,233**	35,881	1,832
Loans to cooperatives	**1,685**	**22**	-	-	**847**	**22**	-	-
Processing and marketing	**5,812**	**-**	45,311	51	**6,026**	**-**	55,005	142
Farm-related business	**1,207**	**39**	8,719	47	**1,222**	**66**	8,814	98
Communication	**-**	**-**	2,455	87	**-**	**-**	4,222	87
Energy and water/waste disposal	**2,161**	**1**	1,715	-	**2,090**	**1**	1,500	-
Rural residential real estate	**1,547**	**13**	1,743	21	**1,534**	**21**	1,665	26
Lease receivables	**41**	**-**	57	-	**43**	**-**	59	-
Mission-related	**7,275**	**145**	1,355	28	**6,673**	**252**	681	28
Total	**$ 198,155**	**$ 1,872**	$ 298,804	$ 2,274	**$ 200,944**	**$ 3,987**	$ 311,136	$ 5,919

At June 30, 2014, impaired loans of $50.1 million had a related specific allowance of $16.2 million, while the remaining $143.0 million of impaired loans had no related specific allowance as a result of adequate collateralization.

The average recorded investment in impaired loans for the three months ended June 30, 2014, was $198.2 million. The district recognized interest income of $1.9 million on impaired loans during the three months ended June 30, 2014.

The average recorded investment in impaired loans for the six months ended June 30, 2014, was $200.9 million. The district recognized interest income of $4.0 million on impaired loans during the six months ended June 30, 2014.

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	Lease Receivables	Loans to OFIs	Mission-Related	Total
Allowance for Loan Losses:											
Balance at March 31, 2014	$42,622	$14,301	$7,983	$695	$4,897	$430	$7	$50	$ -	$227	$ 71,212
Charge-offs	(2,707)	(275)	(59)	-	-	(78)	-	-	-	-	(3,119)
Recoveries	100	57	91	-	-	-	-	-	-	-	248
Provision for credit losses	(5,643)	975	(237)	25	(153)	70	-	(1)	-	(11)	(4,975)
Adjustment due to merger	-	2	-	-	-	-	-	-	-	-	2
Other *	58	(97)	(473)	(15)	535	-	-	-	-	-	8
Balance at June 30, 2014	$ 34,430	$ 14,963	$ 7,305	$ 705	$ 5,279	$ 422	$ 7	$ 49	$ -	$ 216	$ 63,376
Balance at December 31, 2013	$42,429	$13,591	$11,654	$641	$5,222	$429	$7	$49	$ -	$142	$ 74,164
Charge-offs	(2,964)	(340)	(428)	-	-	(79)	-	-	-	-	(3,811)
Recoveries	139	966	146	-	57	-	-	-	-	-	1,308
Provision for credit losses	(4,540)	1,199	(3,452)	86	(283)	96	-	-	-	100	(6,794)
Adjustment due to merger	(1,696)	(192)	(88)	(2)	(241)	(24)	-	-	-	-	(2,243)
Other *	1,062	(261)	(527)	(20)	524	-	-	-	-	(26)	752
Balance at June 30, 2014	$ 34,430	$ 14,963	$ 7,305	$ 705	$ 5,279	$ 422	$ 7	$ 49	$ -	$ 216	$ 63,376
Individually evaluated for impairment	6,173	7,248	1,640	-	2,134	28	-	-	-	171	17,394
Collectively evaluated for impairment	28,257	7,715	5,665	705	3,145	394	7	49	-	45	45,982
Loans acquired with deteriorated credit quality	-	-	-	-	-	-	-	-	-	-	-
Balance at June 30, 2014	$ 34,430	$ 14,963	$ 7,305	$ 705	$ 5,279	$ 422	$ 7	$ 49	$ -	$ 216	$ 63,376
Balance at March 31, 2013	$ 37,893	$ 19,689	$ 33,323	$ 2,452	$ 5,157	$ 410	$ 2	$ 30	$ -	$ 69	$ 99,025
Charge-offs	(1,431)	(4,218)	(11,076)	-	-	(10)	-	-	-	-	(16,735)
Recoveries	31	317	944	-	-	-	-	-	-	-	1,292
Provision for credit losses	4,001	7,224	(1,643)	(1,812)	212	(42)	4	(1)	-	(2)	7,941
Other *	8	17	56	(1)	(34)	-	-	-	-	-	46
Balance at June 30, 2013	$ 40,502	$ 23,029	$ 21,604	$ 639	$ 5,335	$ 358	$ 6	$ 29	$ -	$ 67	$ 91,569
Balance at December 31, 2012	$ 42,868	$ 20,939	$ 36,753	$ 2,602	$ 3,213	$ 398	$ 3	$ 30	$ -	$ 36	$ 106,842
Charge-offs	(2,452)	(4,442)	(20,602)	-	-	(24)	-	-	-	-	(27,520)
Recoveries	559	530	1,085	-	-	14	-	-	-	-	2,188
Provision for credit losses	(473)	6,030	4,300	(1,962)	428	(30)	3	(1)	-	31	8,326
Other *	-	(28)	68	(1)	1,694	-	-	-	-	-	1,733
Balance at June 30, 2013	$ 40,502	$ 23,029	$ 21,604	$ 639	$ 5,335	$ 358	$ 6	$ 29	$ -	$ 67	$ 91,569
Individually evaluated for impairment	14,700	6,855	12,458	439	1,688	62	-	-	-	-	36,202
Collectively evaluated for impairment	25,085	15,953	9,146	200	3,647	296	6	29	-	67	54,429
Loans acquired with deteriorated credit quality	717	221	-	-	-	-	-	-	-	-	938
Balance at June 30, 2013	$ 40,502	$ 23,029	$ 21,604	$ 639	$ 5,335	$ 358	$ 6	$ 29	$ -	$ 67	$ 91,569
Recorded Investments in Loans Outstanding:											
Ending balance at June 30, 2014	$11,112,741	$ 1,981,252	$ 2,882,247	$ 350,648	$ 1,441,031	$ 245,418	$ 19,971	$ 4,334	$ 36,964	$297,771	$ 18,372,377
Individually evaluated for impairment	$ 134,034	$ 47,017	$ 10,658	$ -	$ 2,159	$ 1,890	$ -	$ 39	$ -	$ 7,284	$ 203,081
Collectively evaluated for impairment	$10,976,689	$ 1,934,104	$ 2,871,433	$ 350,648	$ 1,438,872	$ 243,528	$ 19,971	$ 4,295	$ 36,964	$290,487	$ 18,166,991
Loans acquired with deteriorated credit quality	$ 2,018	$ 131	$ 156	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 2,305
Ending balance at June 30, 2013	$10,577,248	$1,958,712	$2,527,659	$289,053	$1,495,849	$212,043	$14,627	$4,048	$37,022	$185,835	$ 17,302,096
Individually evaluated for impairment	$187,036	$51,615	$46,384	$1,675	$2,102	$3,315	$ -	$55	$ -	$1,347	$ 293,529
Collectively evaluated for impairment	$10,388,016	$ 1,905,667	$ 2,481,275	$ 287,378	$ 1,493,747	$ 208,728	$ 14,627	$ 3,993	$ 37,022	$184,488	$ 17,004,941
Loans acquired with deteriorated credit quality	$ 2,196	$ 1,430	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 3,626

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

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

As of June 30, 2014, the total recorded investment of troubled debt restructured loans was $65,692, including $23,021 classified as nonaccrual and $42,671 classified as accrual, with specific allowance for loan losses of $3,422. Additional commitments to lend to borrowers whose loan terms have been modified in TDRs were $3,431 at June 30, 2014 and $163 at December 31, 2013.

The following table summarizes TDR loan balances by loan type:

	Loans Modified as TDRs		TDRs in Nonaccrual Status	
	June 30, 2014	December 31, 2013	**June 30, 2014**	December 31, 2013
Real estate mortgage	**$ 38,256**	$ 51,548	**$ 15,821**	$ 17,831
Production and intermediate term	**17,149**	14,535	**3,281**	406
Agribusiness	**3,914**	8,525	**3,914**	8,419
Rural residential real estate	**293**	109	**5**	38
Mission-related	**6,080**	5,189	**-**	-
Total	**$ 65,692**	$ 79,906	**$ 23,021**	$ 26,694

The following tables present additional information regarding troubled debt restructurings, which includes both accrual and nonaccrual loans with troubled debt restructuring designation, that occurred during the three and six months ended June 30, 2014 and 2013. The premodification outstanding recorded investment represents the recorded investment of the loans as of the quarter end prior to the restructuring. The postmodification outstanding recorded investment represents the recorded investment of the loans as of the quarter end after the restructuring.

For the three months ended June 30, 2014:

	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	$ 3,366	$ 3,365
Production and intermediate term	2,826	3,095
Total	$ 6,192	$ 6,460

For the three months ended June 30, 2013:

	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	$ 84	$ 93
Production and intermediate term	83	83
Rural residential real estate	88	96
Total	$ 255	$ 272

For the six months ended June 30, 2014:

	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	$ 3,556	$ 3,548
Production and intermediate term	2,836	3,105
Rural residential real estate	190	222
Mission-related	941	955
Total	$ 7,523	$ 7,830

For the six months ended June 30, 2013:

	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	$ 813	$ 770
Production and intermediate term	142	143
Rural residential real estate	88	96
Total	$ 1,043	$ 1,009

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

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

	Recorded Investment at June 30, 2014	Recorded Investment at June 30, 2013
Troubled debt restructurings that subsequently defaulted:		
Real estate mortgage	$ 233	$ 99
Rural residential real estate	5	-
Total	$ 238	$ 99

NOTE 4 — COMMITMENTS AND CONTINGENT LIABILITIES

The bank is primarily liable for its portion of Systemwide debt obligations. Additionally, the bank is jointly and severally liable for the consolidated Systemwide bonds and notes of the other System banks. Total consolidated bank and Systemwide obligations of the System at June 30, 2014, were approximately $212.4 billion.

In the normal course of business, the district has various outstanding commitments and contingent liabilities, including the possibility of actions against the district 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 district.

NOTE 5 — FAIR VALUE MEASUREMENTS

Accounting guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 2, “Summary of Significant Accounting Policies,” of the 2013 Annual Report for a more complete description.

Assets and liabilities recorded at fair value on a recurring basis at June 30, 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)
Assets:				
Federal funds	**$ 21,758**	$ -	$ 21,758	$ -
Investments available for sale:				
Corporate debt	**224,401**	-	224,401	-
Agency-guaranteed debt	**126,306**	-	126,306	-
Mortgage-backed securities	**3,335,268**	-	3,298,305	36,963
Asset-backed securities	**43,365**	-	42,447	918
Mission-related and other available-for-sale investments	**96,447**	-	-	96,447
Loans valued under the fair value option	**58,060**	-	58,060	
Derivative assets	**658**	-	658	-
Assets held in nonqualified benefit trusts	**5,655**	5,655	-	-
Total assets	**$ 3,911,918**	$ 5,655	$ 3,771,935	$ 134,328
Liabilities:				
Standby letters of credit	**$ 1,096**	$ -	$ -	$ 1,096
Total liabilities	**$ 1,096**	$ -	$ -	$ 1,096

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 March 31, 2014, to June 30, 2014:

	Corporate Debt	Agency-Guaranteed Debt	Mortgage-Backed Securities	Agricultural Mortgage-Backed Securities	Asset-Backed Securities	Standby Letters of Credit	Total
Available-for-sale investment securities:							
Balance at March 31, 2014	$ -	$ 9,201	$ 106,250	$ 93,287	$ 996	$ 1,003	$ 210,737
Net gains included in other comprehensive loss	-	-	27	704	13	-	744
Purchases, issuances and settlements	-	-	29,561	2,456	(91)	-	31,926
Transfers into Level 3	-	-	-	-	-	93	93
Transfers out of Level 3	-	(9,201)	(98,875)	-	-	-	(108,076)
Balance at June 30, 2014	$ -	$ -	$ 36,963	$ 96,447	$ 918	$ 1,096	$ 135,424
The amount of losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets or liabilities still held at June 30, 2014	$ -	$ -	$ -	$ -	$ -	$ -	$ -

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 June 30, 2014:

	Corporate Debt	Agency-Guaranteed Debt	Mortgage-Backed Securities	Agricultural Mortgage-Backed Securities	Asset-Backed Securities	Standby Letters of Credit	Total
Balance at January 1, 2014	$ 15,000	$ 26,949	$ 7,529	$ 97,423	$ 1,157	$ -	$ 148,058
Net gains (losses) included in other comprehensive loss	-	29	(148)	1,227	31	-	1,139
Purchases, issuances and settlements	-	(195)	128,457	(2,203)	(270)	-	125,789
Transfers into Level 3	-	-	-	-	-	1,096	1,096
Transfers out of Level 3	(15,000)	(26,783)	(98,875)	-	-	-	(140,658)
Balance at June 30, 2014	$ -	$ -	$ 36,963	$ 96,447	$ 918	$ 1,096	$ 135,424
The amount of losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets or liabilities still held at June 30, 2014	$ -	$ -	$ -	$ -	$ -	$ -	$ -

There were no transfers of assets or liabilities into or out of Level 1 from other levels during the six months ended June 30, 2014. Agricultural mortgage-backed securities are included in Level 3 due to limited activity or less transparency around inputs to their valuation. At June 30, 2014, Level 3 investments included two agency MBS 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 six months of 2014, two agency MBS, three 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 six months 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 six months ended June 30, 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 June 30, 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)
Assets:					
Loans	**$ 145,321**	$ -	$ -	$ 145,321	**$ (3,810)**
Other property owned	**47,000**	-	-	47,000	**725**
Total assets	**$ 192,321**	$ -	$ -	$ 192,321	**$ (3,085)**

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

	Fair Value Measurements at December 31, 2013			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Federal funds	**$ 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	**5,127**	5,127	-	-
Total assets	**$ 3,724,083**	$ 5,127	$ 3,570,898	$ 148,058
Liabilities:				
Standby letters of credit	**$ 1,372**	$ -	$ 1,372	$ -
Total liabilities	**$ 1,372**	$ -	$ 1,372	$ -

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 March 31, 2013, to June 30, 2013:

	Corporate Debt	Agency-Guaranteed Debt	Mortgage-Backed Securities	Agricultural Mortgage-Backed Securities	Asset-Backed Securities	Loans Under Fair Value Option	Total
Available-for-sale investment securities:							
Balance at March 31, 2013	$ 59,939	$ 19,975	$ 61,237	$ 111,755	$ 3,457	$ -	$ 256,363
Net (losses) gains included in other comprehensive income	(57)	(475)	(1,695)	(1,729)	1	-	(3,955)
Purchases, issuances and settlements	-	9,616	63,306	(4,404)	(263)	-	68,255
Transfers into Level 3	-	-	15,821	-	-	-	15,821
Transfers out of Level 3	-	-	(39,862)	-	-	-	(39,862)
Balance at June 30, 2013	$ 59,882	$ 29,116	$ 98,807	$ 105,622	$ 3,195	$ -	$ 296,622
The amount of losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets or liabilities still held at June 30, 2013	$ -	$ -	$ -	$ -	$ -	$ -	$ -

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 June 30, 2013:

	Corporate Debt	Agency-Guaranteed Debt	Mortgage-Backed Securities	Agricultural Mortgage-Backed Securities	Asset-Backed Securities	Loans Under Fair Value Option	Total
Available-for-sale investment securities:							
Balance at January 1, 2013	$ 59,958	$ 15,117	$ 26,938	$ 115,479	$ 3,096	$ 4,764	$ 225,352
Net gains (losses) included in other comprehensive income	(76)	(500)	(969)	(1,875)	574	-	(2,846)
Net gains (losses) included in earnings	-	-	(143)	-	-	-	(143)
Purchases, issuances and settlements	-	29,616	97,022	(7,982)	(475)	(4,764)	113,417
Transfers into Level 3	-	-	15,821	-	-	-	15,821
Transfers out of Level 3	-	(15,117)	(39,862)	-	-	-	(54,979)
Balance at June 30, 2013	$ 59,882	$ 29,116	$ 98,807	$ 105,622	$ 3,195	$ -	$ 296,622
The amount of losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets or liabilities still held at June 30, 2013	$ -	$ -	$ -	$ -	$ -	$ -	$ -

There were no transfers of assets or liabilities into or out of Level 1 from other levels during the six months ended June 30, 2013. Agricultural mortgage-backed securities are included in Level 3 due to limited activity or less transparency around inputs to their valuation. At June 30, 2013, Level 3 investments included three agency MBS, three agency-guaranteed debt instruments and three 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 six 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. During the six months ended June 30, 2013, one agency MBS, which had previously been valued using independent third-party valuation services using Level 2 criteria was valued at June 30, 2013, using Level 3 criteria (broker quotes), and was, accordingly, transferred from Level 2 to Level 3.

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)
Assets:					
Loans	**$ 156,334**	$ -	$ -	$ 156,334	**$ (44,111)**
Other property owned	**52,380**	-	-	52,380	**4,718**
Total assets	**$ 208,714**	$ -	$ -	$ 208,714	**$ (39,393)**

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:

	June 30, 2014					December 31, 2013				
		Fair Value Measurements Using					Fair Value Measurements Using			
	Total Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value	Total Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
Assets:										
Cash	**$ 545,178**	$ 545,178	$ -	$ -	$ 545,178	**$ 610,056**	$ 610,056	$ -	$ -	$ 610,056
Mission-related and other held-to-maturity investments	**41,951**	-	-	41,901	41,901	**55,669**	-	-	55,116	55,116
Net loans	**17,965,782**	-	-	18,069,127	18,069,127	**17,436,561**	-	-	17,363,491	17,363,491
Total assets	**$ 18,552,911**	$ 545,178	$ -	$ 18,111,028	$ 18,656,206	**$ 18,102,286**	$ 610,056	$ -	$ 17,418,607	$ 18,028,663
Liabilities:										
Systemwide debt securities and other notes	**$ 18,883,406**	$ -	$ -	$ 18,963,014	$ 18,963,014	**$ 18,252,012**	$ -	$ -	$ 18,218,619	$ 18,218,619
Subordinated debt	**50,000**	-	-	54,451	54,451	**50,000**	-	-	54,407	54,407
	$ 18,933,406	$ -	$ -	$ 19,017,465	$ 19,017,465	**$ 18,302,012**	$ -	$ -	$ 18,273,026	$ 18,273,026

Valuation Techniques

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

Investments Available for Sale

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

Derivative Assets and Liabilities

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

Assets Held in Nonqualified Benefit Trusts

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

Standby Letters of Credit

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

Loans

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

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

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

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 Measurements

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

Information About Recurring and Nonrecurring Level 2 Fair Value Measurements

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

Information About Other Financial Instrument Fair Value Measurements

	Valuation Technique(s)	Input
Cash	Carrying value	Actual balances
Loans	Discounted cash flow	Prepayment forecasts Appropriate interest rate yield curve 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 June 30, 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 district's assets are interest-earning assets (principally loans and investments) that tend to be medium-term floating-rate instruments. In order to match the asset structure, interest rate swaps in which the bank pays the floating rate and receives the fixed rate (receive-fixed swaps) can 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:

	Receive-Fixed Swaps	Pay-Fixed Swaps	Interest Rate Caps	Total
Balance at January 1, 2014	$ -	$ -	$ 695	$ 695
Additions	-	-	30	30
Maturities/Amortizations	-	-	(30)	(30)
Balance at June 30, 2014	**$ -**	**$ -**	**$ 695**	**$ 695**

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

To minimize the risk of credit losses, the bank deals with counterparties that have an investment grade or better credit rating from a major rating agency, and also monitors the credit standing and levels of exposure to individual counterparties. The bank does not anticipate nonperformance by any of these counterparties. The bank typically enters into master agreements that contain netting provisions. These provisions allow the bank to require the net settlement of covered contracts with the same counterparty in the event of default by the counterparty on one or more contracts. However, derivative contracts must be reflected in the financial statements on a gross basis regardless of the netting agreement. Another way the bank minimizes the risk of credit losses from derivatives is that substantially all derivative contracts are supported by bilateral collateral agreements with counterparties requiring the posting of collateral in the event certain dollar thresholds of exposure of one party to the other one are reached; which thresholds may vary depending on the counterparty's credit rating. At June 30, 2014, and December 31, 2013, the bank's exposure to counterparties, net of collateral, was $658 and $831, respectively. At June 30, 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 June 30, 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 June 30, 2014, and December 31, 2013, consisted of interest rate caps.

Derivatives designated as hedging instruments	Balance Sheet Location	Fair Value 6/30/2014	Fair Value 12/31/2013	Balance Sheet Location	Fair Value 6/30/2014	Fair Value 12/31/2013
Interest rate caps	Other assets	$ 658	$ 831	Other liabilities	$ -	$ -

Derivatives designated as hedging instruments	Amount of (Loss) Gain Recognized in OCL on Derivatives (Effective Portion) June 30, 2014	2013	Location of Gain Reclassification from AOCI into Income	Amount of Gain Reclassified from AOCL into Income (Effective Portion) June 30, 2014	2013
Interest rate caps	$ (591)	$ 393	Interest expense	$ 1,209	$ 627

NOTE 7 — EMPLOYEE BENEFIT PLANS

Employees of the bank and district associations participate in either the defined benefit retirement plan or a defined contribution plan (DC Plan) and are eligible to participate in the district's 401(k) plan. Employer contributions to the DC Plan and 401(k) plan are expensed as incurred. The multiemployer structure of the district's defined benefit pension plan results in the recording of this plan only upon combination.

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

	Defined Benefit Pension Plan		Other Postretirement Benefits	
	2014	2013	**2014**	2013
Service cost	**$ 2,470**	$ 2,929	**$ 621**	$ 793
Interest cost	**7,958**	7,537	**1,359**	1,341
Expected return on plan assets	**(10,157)**	(9,366)	**-**	-
Amortization of prior service costs	**18**	18	**(614)**	(614)
Amortization of net loss	**4,043**	8,217	**49**	382
Net periodic benefit cost	**$ 4,332**	$ 9,335	**$ 1,415**	$ 1,902

As of June 30, 2014, contributions of $12.2 million have been made to the defined benefit pension plan. The district presently anticipates no additional contributions to fund its pension plan in 2014.

NOTE 8 — INCOME TAXES

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

NOTE 9 — ACCUMULATED OTHER COMPREHENSIVE LOSS

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

The following table summarizes the changes in the balance of the components of AOCL for the six months ended June 30, 2014:

	Total	Unrealized Loss on Securities	Pension and Other Post-retirement Benefit Plans	Cash Flow Derivative Instruments
Balance, January 1, 2014	$ (110,954)	$ (30,303)	$ (76,199)	$ (4,452)
Change in unrealized losses on available-for-sale securities				
Net decrease in unrealized losses on investment securities	15,895	15,895		
Decrease in noncredit portion of other-than-temporary impairment (OTTI) losses	21	21		
Net decrease in unrealized losses on securities	15,916	15,916		
Change in pension and postretirement benefit plans				
Change due to effect of merger	326		326	
Amounts amortized into net periodic expense:				
Amortization of prior service credits	(694)		(694)	
Amortization of net losses	4,103		4,103	
Net change in pension and postretirement benefit plans	3,735		3,735	
Change in cash flow derivative instruments				
Unrealized losses on interest rate caps	(591)			(591)
Reclassification of loss recognized in interest expense	1,209			1,209
Net change in cash flow derivative instruments	618			618
Total other comprehensive income	**20,269**	**15,916**	**3,735**	**618**
Balance, June 30, 2014	**$ (90,685)**	**$ (14,387)**	**$ (72,464)**	**$ (3,834)**

The following table summarizes the changes in the balance of the components of AOCI for the six months ended June 30, 2013:

	Total	Unrealized Gain (Loss) on Securities	Pension and Other Post-retirement Benefit Plans	Cash Flow Derivative Instruments
Balance, January 1, 2013	$ (110,807)	$ 34,104	$ (138,696)	$ (6,215)
Change in unrealized gains on available-for-sale securities				
Net decrease in unrealized gains on investment securities	(39,457)	(39,457)		
Decrease in noncredit portion of other-than-temporary impairment (OTTI) losses	970	970		
Reclassification adjustment for OTTI credit losses included in net income	143	143		
Net decrease in unrealized gains on securities	(38,344)	(38,344)		
Change in pension and postretirement benefit plans				
Amounts amortized into net periodic expense:				
Amortization of prior service credits	(1,162)		(1,162)	
Amortization of net losses	8,599		8,599	
Net change in pension and postretirement benefit plans	7,437		7,437	
Change in cash flow derivative instruments				
Unrealized gains on interest rate caps	393			393
Reclassification of loss recognized in interest expense	627			627
Net change in cash flow derivative instruments	1,020			1,020
Total other comprehensive (loss) income	(29,887)	(38,344)	7,437	1,020
Balance, June 30, 2013	$ (140,694)	$ (4,240)	$ (131,259)	$ (5,195)

The following table summarizes reclassifications from AOCL to the Combined Statements of Comprehensive Income:

Component of AOCL	Amount Reclassified from AOCL 2014	2013	Affected Line in the Statement of Comprehensive Income
Impairment losses on other-than-temporarily-impaired investments	**$ -**	$ 143	Impairment losses on investments
Amortization of net charges on pension and postretirement benefit plans	**3,409**	7,437	Salaries and employee benefits
Amortization on cash flow hedges	**1,209**	627	Interest expense
Total reclassifications	**$ 4,618**	$ 8,207	

NOTE 10 — ASSOCIATION MERGER

Effective January 1, 2014, Texas Land Bank, ACA headquartered in Waco, Texas, merged into Lone Star, ACA headquartered in Fort Worth, Texas. The merged association is using the Lone Star, ACA name and is headquartered in Fort Worth, Texas. Also, effective January 1, 2014, AgriLand, Farm Credit Services headquartered in Tyler, Texas, merged into Texas AgFinance, Farm Credit Services, headquartered in Robstown, Texas, forming Texas Farm Credit Services, with its headquarters located in Robstown, Texas. The primary reason for the mergers was based on a determination that the combined organizations should be financially and operationally stronger than the respective associations on a stand-alone basis. The acquisition method of accounting, required for mergers of cooperatives occurring after January 1, 2009, was used in the mergers.

NOTE 11 — SUBSEQUENT EVENTS

The district has evaluated subsequent events through August 8, 2014, which is the date the financial statements were issued. There are no other significant subsequent events requiring disclosure as of August 8, 2014.

NOTE 12 — BANK-ONLY FINANCIAL DATA

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

Balance sheet data	**June 30, 2014**	December 31, 2013
Cash	**$ 542,045**	$ 602,452
Federal funds sold and overnight investments	**21,758**	21,809
Investment securities	**3,825,787**	3,637,855
Loans	**12,295,277**	11,778,741
Less allowance for loan losses	**11,609**	13,660
Net loans	**12,283,668**	11,765,081
Accrued interest receivable	**39,918**	37,657
Other property owned, net	**10,936**	13,812
Premises and equipment, net	**23,240**	23,214
Other assets	**114,842**	110,837
Total assets	**$ 16,862,194**	$ 16,212,717
Bonds and notes	**$ 15,233,406**	$ 14,602,012
Subordinated debt	**50,000**	50,000
Accrued interest payable	**34,708**	37,749
Preferred stock dividends payable	**20,063**	20,063
Other liabilities	**49,836**	109,646
Total liabilities	**15,388,013**	14,819,470
Preferred stock	**600,000**	600,000
Capital stock	**220,761**	220,543
Retained earnings	**670,095**	605,817
Accumulated other comprehensive loss	**(16,675)**	(33,113)
Total shareholders' equity	**1,474,181**	1,393,247
Total liabilities and shareholders' equity	**$ 16,862,194**	$ 16,212,717

	Six Months Ended June 30,	
Statement of income data	**2014**	2013
Interest income	**$ 188,478**	$ 185,087
Interest expense	**80,395**	74,889
Net interest income	**108,083**	110,198
(Negative provision) provision for credit losses	**(695)**	5,145
Net interest income after provision for credit losses	**108,778**	105,053
Noninterest income	**19,701**	25,949
Noninterest expense	**37,185**	34,629
Net income	**91,294**	96,373
Other comprehensive income (loss):		
Change in postretirement benefit plans	**(96)**	(87)
Change in fair value of investments	**15,916**	(38,344)
Change in cash flow derivative instruments	**618**	1,020
Total other comprehensive income (loss)	**16,438**	(37,411)
Comprehensive Income	**$ 107,732**	$ 58,962