Fulfilling Our Mission

2014

THIRD QUARTER REPORT

September 30, 2014

TEXAS FARM CREDIT DISTRICT

THIRD 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 nine months ended September 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 September 30, 2014, was $136,620, an increase of $30,714, or 29.0 percent, over the same period of 2013. The increase in net income consisted of an $11,248 decrease in noninterest expense, a $9,694 increase in net interest income, an $8,529 decrease in provision for loan losses and a $1,778 increase in noninterest income, offset by a $535 increase in provision for income taxes.

Net income for the nine months ended September 30, 2014, was $360,029, an increase of $34,686, or 10.7 percent, over the same period of 2013. The increase in net income consisted of a $23,649 decrease in provision for loan losses, a $13,985 increase in net interest income, a $1,361 decrease in noninterest expense and a $131 decrease in provision for income taxes, offset by a $4,440 decrease in noninterest income.

Net Interest Income

Net interest income for the three months ended September 30, 2014, was $167,532, an increase of $9,694, or 6.1 percent, over the same period of 2013. The increase in net interest income was due to the effects of a $1.52 billion increase in combined district average earning assets, offset by a decrease in the net interest rate spread of 2 basis points to 2.82 percent. The increase in earning assets was due to increases in association average loan volume, the bank's investment portfolio and in the bank's participation loan portfolio. The decrease in the interest rate spread was due mainly to a 6-basis-point decrease in the effective rate on average earning assets, offset by a 4-basis-point decrease in the effective rate of average interest-bearing liabilities. The decline in the net interest rate spread is reflective of the low interest rate environment combined with competitive pressures. The district's associations' increase in average loan volume was due mainly to improved general economic conditions.

Net interest income for the nine months ended September 30, 2014, was $487,199, an increase of $13,985, or 3.0 percent, over the same period of 2013. The increase was primarily the result of a $1.40 billion increase in combined district average earning assets, offset by an 11-basis-point decrease in the net interest rate spread to 2.80 percent for the nine months ended September 30, 2014. The increase in earning assets was due to increases in association average loan volume, the bank's investment portfolio and in the bank's participation loan portfolio. The decrease in the net interest rate spread included a 12-basis-point decline in the effective rate on average earning assets, and a 1-basis-point decrease in the effective cost of average interest-bearing liabilities. The decline in the net interest rate spread is reflective of the low interest rate environment combined with competitive pressures. The district's associations had an increase in average loan volume of $732.9 million, due mainly to improved general economic conditions. Interest expense for the first nine months of 2014 included a $469 decrease in concession expenses recognized on callable debt as a result of a $646.9 million decrease in debt called in the first nine months of 2014, compared to the same period in 2013. The bank called $2.02 billion in debt in the nine months ended September 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 September 30, 2014, totaled $4,115, a decrease of $8,529 from the $4,414 provision for the second quarter of 2013. The decrease included a $4.2 million decrease in required specific reserve at the bank due to a payoff on a nonaccrual loan. Negative provision for loan losses, standby letters of credit and unfunded commitments for the nine months ended September 30, 2014, was $10,909, a decrease of $23,649, or 185.6 percent, from the $12,740 provision for the first nine months of 2013. The decrease included an $11,208 decrease at district associations and a $12,441 reduction in the bank's provision for credit losses. The negative provision for credit losses for the nine months ended September 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 September 30, 2014, was $13,698, an increase of $1,778, or 14.9 percent, from the same period of 2013. The increase was primarily due to a $2,184 increase in fees for loan-related services, a $1,140 decrease in fair value on loans purchased in the secondary market (due primarily to changes in the interest rate environment), a $588 increase in all other noninterest income items, collectively, and a $146 increase 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 for OTTI investment securities during the third quarters of 2013 or 2014.

Noninterest income for the nine months ended September 30, 2014, was $39,874, a decrease of $4,440, or 10.0 percent, from the same period of 2013. The decrease was primarily due to a $5,220 decrease in fees for loan-related services, a $405 decrease in patronage income and a $202 decrease in fair value on loans purchased in the secondary market (due primarily to changes in the interest rate environment), offset by a $143 decrease in credit losses recognized on OTTI investments, and a $1,244 increase in all other noninterest income 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 nine months ended September 30, 2014, as compared to $143 for the same period in 2013.

Noninterest Expense

Noninterest expense for the three months ended September 30, 2014, was $48,712, a decrease of $11,248, or 18.8 percent, over the same period of 2013. The decrease is primarily attributable to a $14,578 decrease in net losses on other property owned (OPO), offset by a $1,105 increase in premiums to the Farm Credit System Insurance Corporation (FCSIC), a $987 increase in other operating expenses, an $804 increase in occupancy and equipment expenses and a $434 increase in salaries and benefits. The decrease in losses on OPO included a $15,083 increase in gains on sales of OPO, including $15,310 in gains recognized on the sale of equity shares in an ethanol-related OPO held by 11 of the district's associations in August 2014. 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 $553 increase in advertising and member relations expenses and a $147 increase in travel expense. The increase in occupancy and equipment expenses included a $674 increase in computer expenses. The increase in salaries and benefits included a $2,279 increase in compensation and related payroll taxes (primarily at the district associations), net of a $2,284 decrease in pension and retirement expenses resulting mainly from actuarial gains in the district's defined benefit pension plan.

Noninterest expense for the nine months ended September 30, 2014, was $177,706, a decrease of $1,361, or 0.8 percent, over the same period of 2013. The decrease is primarily attributable to a $15,170 decrease in net losses on other property owned (OPO), offset by a $3,903 increase in salaries and benefits, a $3,613 increase in other operating expenses, a $3,289 increase in occupancy and equipment expenses and a $3,004 increase in premiums to the FCSIC. The decrease in losses on OPO included a $13,614 increase in gains on sales of OPO at the district's associations (including the $15,310 gain described previously), a $1,131 decrease in carrying value adjustments on OPO ($824 at the bank and $307 at the district's associations), a $240 decrease in net expenses on OPO and a $185 increase in gains on sales of OPO at the bank. The increase in salaries and benefits included an $8,867 increase in compensation and related payroll taxes (primarily at the district's associations), net of a $6,488 decrease in pension and retirement expenses resulting mainly from actuarial gains in the district's defined benefit pension plan. The increase in other operating expenses included a $1,745 increase in advertising and member relations expenses and a $566 increase in professional and contract services. The increase in occupancy and equipment expenses included a $3,043 increase in computer expenses. Premiums to the FCSIC, assessed on average System debt outstanding, increased from 10 basis points in 2013 to 12 basis points in 2014.

Key results of operations comparisons:

	Annualized for the Nine Months Ended 9/30/2014	Annualized for the Nine Months Ended 9/30/2013
Return on average assets	**2.11%**	2.03%
Return on average members' equity	**12.90%**	12.44%
Net interest income as a percentage of average earning assets	**2.96%**	3.07%
Charge-offs, net of recoveries, to average loans	**0.02%**	0.27%
Operating expenses as a percentage of net interest income and noninterest income	**36.62%**	34.62%
Operating expenses as a percentage of average earning assets	**1.17%**	1.16%

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 nine months ended September 30:

	2014	2013
Change in unrealized losses on available-for-sale securities		
Net decrease (increase) in unrealized losses on investment securities	**$ 9,035**	$ (53,968)
Decrease in noncredit portion of other-than-temporary impairment (OTTI) losses	**59**	1,139
Reclassification adjustment for OTTI credit losses included in net income	**-**	143
Net decrease (increase) in unrealized losses on securities	**9,094**	(52,686)
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	**(1,012)**	(834)
Amortization of net losses	**6,150**	12,034
Net change in pension and postretirement benefit plans	**5,464**	11,200
Change in cash flow derivative instruments		
Unrealized (losses) gains on interest rate caps	**(608)**	145
Reclassification of loss recognized in interest expense	**1,917**	1,067
Net change in cash flow derivative instruments	**1,309**	1,212
Other comprehensive income (loss)	**$ 15,867**	$ (40,274)

FINANCIAL CONDITION

Loan Portfolio

Gross loan volume at September 30, 2014, was $18.69 billion, an increase of $966.9 million, or 5.5 percent, from $17.73 billion at December 31, 2013, and an increase of $1.36 billion, or 7.8 percent, from $17.33 billion at September 30, 2013. The increase in the loan portfolio during the first nine months of 2014 was due primarily to growth in the associations' loan portfolios of $894.8 million and in the bank's capital markets portfolio of $79.2 million.

The bank's capital markets loan portfolio predominantly includes participations, syndications and purchased whole loans, along with other financing structures within our lending authorities. The bank also refers to the capital markets portfolio as participations purchased. In addition to purchasing loans from our district associations, which may exceed their hold limits, the bank actively pursues the purchase of participations and syndications originated outside of the district's territory by other System institutions, commercial banks and other lenders. These loans may be held as earning assets of the bank or sub-participated to the associations or to other System entities.

Loans classified under the Farm Credit Administration's (FCA) Uniform Loan Classification System as "acceptable" or "other assets especially mentioned" as a percentage of total loans and accrued interest receivable were 98.5 percent at September 30, 2014, 97.8 percent at December 31, 2013, and 97.5 percent at September 30, 2013. Nonaccrual loans for the district were 0.72 percent of total loans at September 30, 2014, compared to 0.91 percent at December 31, 2013, and 1.21 percent at September 30, 2013.

Total district high-risk asset volume decreased by $46.2 million, or 17.4 percent, to $219.0 million at September 30, 2014, from $265.2 million at December 31, 2013.

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

			Increase (Decrease)				
		September 30, 2014		$	%		December 31, 2013
Nonaccrual loans	**$**	**134.6**	$	(26.7)	(16.6) %	$	161.3
Formally restructured loans		**42.2**		(11.0)	(20.7)		53.2
Loans 90 days past due and still accruing interest		**7.9**		4.3	119.4		3.6
Total impaired loans		**184.7**		(33.4)	(15.3)		218.1
Other property owned, net		**34.3**		(12.8)	(27.2)		47.1
Total high-risk assets	**$**	**219.0**	$	(46.2)	(17.4) %	$	265.2

The $26.7 million decrease in nonaccrual loans from December 31, 2013, to September 30, 2014, is primarily the result of $62.3 million in repayments, $5.8 million in transfers to other property owned, $3.3 million in transfers to accrual status and $2.4 million in net chargeoffs, offset by $41.3 million in transfers to nonaccrual and $9.2 million in advances on nonaccrual loan committed lines of credit. The district had significant decreases in nonaccrual loans in the dairy, timber, cattle and ethanol sectors, partially offset by increases in the general farms sector. At September 30, 2014, $61.7 million, or 45.8 percent, of the district's nonaccrual loans were considered current as to principal and interest. Continued satisfactory payment performance on these loans may indicate potential for a return to accrual status. At September 30, 2014, the district had $1,366 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 $11.6 million decrease in real estate mortgage loans, primarily due to repayments. Of the total decrease in restructured loans, $10.9 million occurred at district associations and $141 occurred at the bank. The decrease in OPO was due primarily to dispositions of $14.3 million at district associations and $2.8 million at the bank and to valuation adjustments at the district associations, offset by $5.8 million in additions to OPO 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 0.99 percent of total loans at September 30, 2014, and 1.23 percent of total loans at December 31, 2013.

The allowance for loan losses at September 30, 2014, totaled $59,220 and constituted 0.32 percent of total loans and was a decrease of $14,944, or 20.2 percent, from the allowance for loan losses at December 31, 2013. The decrease was primarily due to $10.9 million in negative provision for loan losses recorded during the nine months ended September 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 32.1 percent as of September 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 $5.5 million at September 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 $4.41 billion, or 18.8 percent, of total assets at September 30, 2014, compared to $4.33 billion, or 19.3 percent, at December 31, 2013, an increase of $88.4 million, or 2.0 percent. At September 30, 2014, the district's cash balance was $455.7 million, a decrease of $154.4 million from the balance at December 31, 2013. Cash held at the Federal Reserve Bank at September 30, 2014, totaled $439.6 million, compared to $572.8 million 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 September 30, 2014, the bank had 238 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 $987.3 million, or 5.4 percent, from December 31, 2013, to September 30, 2014.

Investments

The district's investments at September 30, 2014, included the bank's available-for-sale portfolio with a fair value of $3.81 billion and the district associations' held-to-maturity portfolio recorded at an amortized cost of $40.6 million at September 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 $88.6 million. The district's held-to-maturity portfolio consisted of Farmer Mac AMBS held by district associations which had an amortized cost of $40.6 million and a fair value of $40.4 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:

	September 30, 2014		December 31, 2013	
	Amortized Cost	**Fair Value**	Amortized Cost	Fair Value
Agency-guaranteed debt	**$ 137,333**	**$ 133,365**	$ 135,738	$ 130,024
Corporate debt	**223,966**	**224,073**	250,312	249,579
Federal agency collateralized mortgage-backed securities:				
GNMA	**1,643,857**	**1,633,720**	1,690,952	1,680,426
FNMA and FHLMC	**1,758,251**	**1,753,586**	1,431,037	1,421,578
Other collateralized mortgage-backed securities	**6,796**	**6,614**	7,736	7,529
Asset-backed securities	**56,681**	**56,730**	51,320	51,296
Total available-for-sale investments	**$ 3,826,884**	**$ 3,808,088**	$ 3,567,095	$ 3,540,432

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

	September 30, 2014		December 31, 2013	
	Amortized Cost	**Fair Value**	Amortized Cost	Fair Value
Agricultural mortgage-backed securities	**$ 91,059**	**$ 88,647**	$ 101,063	$ 97,423

During the nine months ended September 30, 2014, there was a decrease in unrealized losses on investments totaling $9,095, due primarily to changes in the interest rate environment.

At September 30, 2014, the bank had one asset-backed security (ABS) that was considered other-than-temporarily impaired (OTTI). During the nine months ended September 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 $59, 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 September 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 $7,664 and a fair value of $7,488 at September 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				
September 30, 2014	AAA/Aaa	AA/Aa	Split Rated	AA/Aa	A/A	BBB/Baa	CCC/Caa	Total
Agency-guaranteed debt*	$ -	$ -	$ 133,365	$ -	$ -	$ -	$ -	$ 133,365
Corporate debt	-	74,954	149,119	-		-	-	224,073
Federal agency collateralized mortgage-backed securities*								
GNMA	-	-	1,633,720	-	-	-	-	1,633,720
FNMA and FHLMC	-	-	1,753,586	-	-	-	-	1,753,586
Other collateralized mortgage-backed securities	-	-	-	2,419	-	4,195	-	6,614
Asset-backed securities	55,857	-	-	-	563	-	310	56,730
Total	$ 55,857	$ 74,954	$ 3,669,790	$ 2,419	$ 563	$ 4,195	$ 310	$ 3,808,088

	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 September 30, 2014, totaled $3,909,188, consisting of $600,000 of Class B non-cumulative subordinated perpetual preferred stock, $60,531 of capital stock and participation certificates and $3,191,846 in retained earnings, offset by $95,087 in accumulated other comprehensive loss. The balance in equity reflected an increase of $334,953, or 9.4 percent, from equity at December 31, 2013, due primarily to net income of $360,029, other comprehensive income of $15,867 and net stock issuance of $1,286, offset by preferred stock dividends of $30,187 and $12,042 in patronage distributions. As of September 30, 2014, the bank and all district associations exceeded all regulatory capital requirements.

Key financial condition comparisons:

	September 30, 2014	December 31, 2013
Members' equity to assets	**16.63%**	15.98%
Total liabilities to members' equity	**5.01:1**	5.26:1
Allowance for loan losses to total loans	**0.32%**	0.42%

OTHER

CONDITIONS IN THE TEXAS DISTRICT

As of the third quarter of 2014, portions of Alabama, New Mexico and Texas were in a state of drought. Nevertheless, the Texas District, in general, benefited from a year-over-year improvement in soil moisture levels. This has generally resulted in healthier pasture and range conditions as well as sufficient moisture for the production of field crops. While the threat of drought remains, adequate topsoil and subsoil moisture levels across the district should continue to support pasture and range conditions as well as promote optimism and planting activity during the next planting season. However, as farmers look forward to the next planting season, the potential for a lower price environment could dictate total acres planted and changes in price relationships may cause crop allocations to change.

For 2014, most crops across the Texas District states are being harvested. According to the September 30, 2014, USDA crop progress report, cotton conditions across the district are primarily in fair to good condition, with a strong improvement in production forecasted for the state of Texas, which is primarily attributable to improved growing conditions in the Southern High Plains. Nevertheless, improved production levels are expected to be met by lower market prices for cotton, driven by increased global stocks. The corn crop in the states of Texas and New Mexico primarily ranged from fair to excellent condition, while the crop in the eastern states neared completion of harvest. The soybean crop's conditions across the eastern states primarily ranged from fair to excellent; however, double-crop soybeans in Alabama have suffered from the drier conditions that have recently developed in many parts of the state. With the USDA forecasting record crops for corn and soybeans, stocks of both commodities are expected to increase, resulting in weaker prices than in past years. Farmers in the district continue to use risk management tools, such as programs under the U.S. Farm Bill, multi-peril crop insurance and forward, futures and options contracts.

Across most of the district, reduced feed prices, coupled with the continuation of historically high 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 previous prolonged drought conditions in the U.S. Plains States; however, cattle ranchers in many areas in the district have begun the process of expanding their herds through increased cow and heifer retention. Cattle feedlots continue to manage through the effects of smaller herds; however, elevated beef prices and a strong corn crop have aided profitability. Dairy producers are currently benefiting from very strong milk prices and are feeling some relief due to reduced feed costs. Given the limited supplies of meat and poultry, caused by the recent reduction to the cattle herd, the effects of the porcine virus on pork production and the continued decline in feed costs, poultry integrators have been able to maintain margins. 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 continue to play a supportive role in the agricultural concentrations in the district loan portfolio, which is expected to contribute to the preservation of credit quality. 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.

AgTexas Farm Credit Services and Great Plains Ag Credit, ACA have requested and received approval of a merger from the FCA. On October 17, 2014, the stockholders of both associations voted to approve the merger at their respective stockholders' meetings, which commenced a 35-day reconsideration period. If approved, the merger would be effective January 1, 2015.

RATING AGENCY ACTIONS

Moody's Investors Service Ratings Actions

On October 30, 2014, Moody's Investors Service (Moody's) 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 stable outlook reflects the strong market conditions for agricultural lending, as well as Moody's expectation that the bank's consistent performance and strong capital level will continue.

Fitch Ratings Actions

On September 23, 2014, Fitch Ratings affirmed the bank's long-term and short-term issuer default ratings (IDRs) at "AA-" and "F1+," respectively, with a stable outlook. Fitch also affirmed the bank's subordinated debt rating at "A+," its noncumulative perpetual preferred stock rating at "BBB" and its support floor at "AA-." Fitch also affirmed the Farm Credit System's long-term and short-term issuer default ratings (IDRs) at "AAA" and "F1+," respectively, with a stable outlook, and its support floor at "AAA." As a government-sponsored entity, the System benefits from implicit government support, and thus, the ratings and rating outlook are directly linked to the U.S. sovereign rating. The affirmation of the System banks' IDRs reflect their prudent, conservative credit culture, their unique funding advantage and their structural second-loss position on the majority of their loan portfolio.

REGULATORY MATTERS

As of September 30, 2014, FCA had enforcement actions in place against one association in the district, which has not had, and is not expected to have, a significant impact on the bank.

On March 13, 2014, the FCA Board approved an interim final rule to remove all requirements related to nonbinding advisory votes regarding chief executive officer (CEO) and senior officer compensation at Farm Credit System institutions. The 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 regulations 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 July 25, 2014, the Farm Credit Administration Board published 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 90-day comment period expired October 23, 2014.

On September 4, 2014, the Farm Credit Administration published 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.

The 120-day public comment period will expire January 2, 2015.

On September 24, 2014, the Farm Credit Administration Board published a joint proposed rule with the Office of the Controller of the Currency, the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and the Federal Housing Financing Agency to establish minimum margin and capital requirements for registered swap dealers, major swap participants, security-based swap dealers and major security-based swap participants that one of those agencies regulates that implements sections 731 and 764 of the Dodd-Frank Wall Street Reform and Consumer Protection Act requiring the adoptions of rules to establish capital requirements and initial and variation margin requirements for such entities and their counterparties on all non-cleared swaps and non-cleared security-based swaps. The comment period for this rule expires November 24, 2014.

OTHER MATTERS

The bank and a district association, Capital Farm Credit, ACA, have joined seven other Farm Credit organizations and Advantage Capital Partners to create the Advantage Capital Agribusiness Fund. The fund was formed as a Rural Business Investment Company and is conditionally licensed by the U.S. Department of Agriculture through its Rural Business Investment Program to promote economic development in Rural America. The investment objectives of the fund are to develop a balanced and diversified portfolio of junior capital investments and focus on later-stage growth-oriented small businesses involved in agriculture, processing and marketing of agricultural products, farm supply, input suppliers and rural communications. The fund will consider investment opportunities in any rural area in the U.S. Total eventual fund size will be $150 million, and initial funding began in November 2014.

The undersigned certify that we have reviewed the September 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

November 7, 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 chief executive officer and our chief financial officer, as appropriate, to allow timely decisions to be made regarding disclosure. With management's input, the chief executive officer and chief financial officer evaluated our disclosure controls and procedures as of the end of and for the period covered by this quarterly report, and have concluded that our disclosure controls and procedures are effective as of that date. This evaluation relies upon the evaluations made by the individual associations and the related certifications they provide to the bank.

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

Larry R. Doyle
Chief Executive Officer

Amie Pala
Chief Financial Officer

November 7, 2014

Combined Balance Sheets

(dollars in thousands)	**September 30, 2014 (Unaudited)**	December 31, 2013
Assets		
Cash	**$ 455,698**	$ 610,056
Federal funds sold	**20,769**	21,809
Investment securities	**3,937,310**	3,693,524
Loans (includes $56,787 and $58,461 at fair value held under fair value option)	**18,692,370**	17,725,520
Less allowance for loan losses	**59,220**	74,164
Net loans	**18,633,150**	17,651,356
Accrued interest receivable	**175,167**	136,610
Other property owned, net	**34,263**	47,142
Premises and equipment, net	**88,313**	79,454
Other assets	**160,171**	132,888
Total assets	**$ 23,504,841**	$ 22,372,839
Liabilities and members' equity		
Liabilities		
Bonds and notes, net	**$ 19,239,290**	$ 18,252,012
Subordinated debt	**50,000**	50,000
Accrued interest payable	**40,072**	39,853
Patronage distributions payable	**4,584**	134,376
Preferred stock dividends payable	**20,063**	20,063
Other liabilities	**241,644**	302,300
Total liabilities	**19,595,653**	18,798,604
Commitments and contingent liabilities (Note 4)		
Members' equity		
Preferred stock	**600,000**	600,000
Capital stock and participation certificates	**60,531**	59,225
Allocated retained earnings	**518,719**	516,859
Unallocated retained earnings	**2,673,127**	2,486,368
Additional paid-in-capital	**151,898**	22,737
Accumulated other comprehensive loss	**(95,087)**	(110,954)
Total members' equity	**3,909,188**	3,574,235
Total liabilities and members' equity	**$ 23,504,841**	$ 22,372,839

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

Combined Statements of Comprehensive Income

(unaudited)

(dollars in thousands)	Quarter Ended September 30, 2014	Quarter Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Interest Income				
Investment securities	**$ 14,058**	$13,223	**$ 40,164**	$41,403
Loans	**200,027**	189,533	**586,919**	564,325
Total interest income	**214,085**	202,756	**627,083**	605,728
Interest Expense				
Bonds, notes and subordinated debt	**40,103**	38,379	**120,498**	113,268
Notes payable and other	**6,450**	6,539	**19,386**	19,246
Total interest expense	**46,553**	44,918	**139,884**	132,514
Net interest income	**167,532**	157,838	**487,199**	473,214
(Negative provision) provision for credit losses	**(4,115)**	4,414	**(10,909)**	12,740
Net interest income after (negative provision) provision for loan losses	**171,647**	153,424	**498,108**	460,474
Noninterest Income				
Patronage income	**4,262**	4,116	**13,450**	13,855
Loan-related fees	**9,095**	6,911	**20,619**	25,839
(Loss) gain on loans held under fair value option	**(742)**	398	**(98)**	104
Miscellaneous income, net	**1,083**	495	**5,903**	4,659
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	**13,698**	11,920	**39,874**	44,314
Noninterest Expense				
Salaries and employee benefits	**34,327**	33,893	**105,899**	101,996
Occupancy and equipment	**5,985**	5,181	**18,740**	15,451
Insurance Fund premiums	**5,008**	3,903	**14,680**	11,676
(Gains) losses on other property owned, net	**(14,562)**	16	**(15,287)**	(117)
Other operating expenses	**17,954**	16,967	**53,674**	50,061
Total noninterest expense	**48,712**	59,960	**177,706**	179,067
Income before provision for income taxes	**136,633**	105,384	**360,276**	325,721
Provision for (benefit from) income taxes	**13**	(522)	**247**	378
Net Income	**136,620**	105,906	**360,029**	325,343
Other comprehensive income (loss)				
Change in pension and postretirement benefit plans	**1,729**	3,763	**5,464**	11,200
Change in unrealized loss on investments	**(6,822)**	(14,342)	**9,094**	(52,686)
Change in cash flow derivative instruments	**691**	192	**1,309**	1,212
Total other comprehensive (loss) income	**(4,402)**	(10,387)	**15,867**	(40,274)
Comprehensive Income	**$ 132,218**	$ 95,519	**$ 375,896**	$ 285,069

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

Combined Statements of Changes in Members' Equity

(unaudited)

(dollars in thousands)	Preferred Stock	Capital Stock	Allocated Retained Earnings	Unallocated Retained Earnings	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
Balance at December 31, 2012	$ 482,000	$ 59,859	$ 419,721	$ 2,412,571	$ 22,737	$ (110,807)	$ 3,286,081
Net income	-	-	-	325,343	-	-	325,343
Other comprehensive loss	-	-	-	-	-	(40,274)	(40,274)
Issuance of Class B; Series 2 preferred stock	300,000	-	-	-	-	-	300,000
Issuance costs on preferred stock	-	-	-	(4,054)	-	-	(4,054)
Capital stock/participation certificates issued	-	7,081	-	-	-	-	7,081
Capital stock/participation certificates and allocated retained earnings retired	-	(7,666)	-	-	-	-	(7,666)
Preferred stock dividends accrued	-	-	-	(29,868)	-	-	(29,868)
Patronage distributions							
Cash	-	-	(42,666)	(11,445)	-	-	(54,111)
Members' equity	-	-	(1,296)	1,296	-	-	-
Balance at September 30, 2013	$ 782,000	$ 59,274	$ 375,759	$ 2,693,843	$ 22,737	$ (151,081)	$ 3,782,532
Balance at December 31, 2013	$ 600,000	$ 59,225	$ 516,859	$ 2,486,368	$ 22,737	$ (110,954)	$ 3,574,235
Net income	-	-	-	360,029	-	-	360,029
Other comprehensive gain	-	-	-	-	-	15,867	15,867
Capital stock/participation certificates issued	-	6,001	-	-	-	-	6,001
Capital stock/participation certificates and allocated retained earnings retired	-	(4,695)	(20)	-	-	-	(4,715)
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	-	-	-	(30,187)	-	-	(30,187)
Patronage distributions							
Cash	-	-	-	(12,042)	-	-	(12,042)
Members' equity	-	-	1,903	(1,903)	-	-	-
Balance at September 30, 2014	**$ 600,000**	**$ 60,531**	**$ 518,719**	**$ 2,673,127**	**$ 151,898**	**$ (95,087)**	**$ 3,909,188**

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

Combined Statements of Cash Flows

(unaudited)

(dollars in thousands)	Nine Months Ended September 30, 2014	2013
Operating activities		
Net income	**$ 360,029**	$ 325,343
Reconciliation of net income to net cash provided by operating activities		
(Negative provision) provision for loan losses	**(10,909)**	12,740
Provision for losses on other property owned	**1,016**	2,147
Depreciation and amortization on premises and equipment	**8,493**	7,156
Accretion of net discount on loans	**8,810**	4,829
Amortization and accretion on debt instruments	**(2,722)**	(2,491)
Amortization of net premium on investment securities	**1,656**	160
Decrease (increase) in fair value on loans under fair value option	**98**	(104)
Gain of sale of loans	**-**	(1,902)
Gains from sales of other property owned, net	**(16,412)**	(2,613)
Losses on impairment of investments available-for-sale	**-**	143
Gains from sales of premises and equipment	**(6,080)**	(3,018)
Allocated equity patronage from System bank	**(13,083)**	(12,406)
Increase in accrued interest receivable	**(38,557)**	(35,058)
Increase in other assets	**(12,892)**	(580)
Increase in accrued interest payable	**219**	6,687
Decrease in other liabilities	**(37,124)**	(18,260)
Net cash provided by operating activities	**242,542**	282,773
Investing activities		
Net decrease (increase) in federal funds	**1,040**	(30,286)
Investment securities		
Purchases	**(901,998)**	(1,024,769)
Proceeds from maturities, calls and prepayments	**665,651**	791,920
Proceeds from sales	**-**	6,528
Increase in loans, net	**(1,001,728)**	(593,301)
Proceeds from sale of loans	**-**	324,149
Proceeds from sales of other property owned, net	**32,357**	34,344
Proceeds from sales of premises and equipment	**3,740**	2,568
Expenditures for premises and equipment	**(15,012)**	(13,468)
Net cash used in investing activities	**(1,215,950)**	(502,315)
Financing activities		
Bonds and notes issued	**7,647,081**	6,854,622
Bonds and notes retired	**(6,657,081)**	(6,924,464)
(Decrease) increase in advanced conditional payments	**(215)**	2,312
Bank Class B preferred stock issued	**-**	300,000
Issuance costs on perferred stock	**-**	(4,054)
Capital stock and participation certificates issued	**6,001**	7,081
Capital stock and participation certificates retired	**(4,715)**	(7,666)
Cash dividends on preferred stock	**(30,187)**	(29,868)
Cash patronage distributions paid	**(141,834)**	(109,655)
Net cash provided by financing activities	**819,050**	88,308
Net decrease in cash	**(154,358)**	(131,234)
Cash at beginning of year	**610,056**	512,842
Cash at end of quarter	**455,698**	381,608
Supplemental schedule of noncash investing and financing activities		
Financed sales of other property owned	**$ 1,754**	$ 5,137
Loan assets transferred to other property owned	**5,836**	13,120
Net decrease (increase) in unrealized losses on investment securities	**9,094**	(52,686)
Cash dividends or patronage distributions payable	**4,584**	45,638
Supplemental schedule of noncash changes in fair value related to hedging activities		
Decrease in bonds and notes	**$ -**	$ (91)
Supplemental information		
Cash paid for:		
Interest	**$ 139,665**	$ 125,827
Income taxes	**-**	293

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 third 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.

In May 2014, the FASB issued guidance entitled, “Revenue from Contracts with Customers.” The guidance governs revenue recognition from contracts with customers and requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Financial instruments and other contractual rights within the scope of other guidance issued by the FASB are excluded from the scope of this new revenue recognition guidance. In this regard, a majority of our contracts would be excluded from the scope of this new guidance. The guidance becomes effective for the first interim reporting period within the annual reporting periods after December 15, 2016. The bank and associations are in the process of reviewing contracts to determine the effect, if any, on their financial condition or results of operations.

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 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 September 30, 2014, and December 31, 2013, is as follows.

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agency-guaranteed debt	$ 137,333	$ -	$ (3,968)	$ 133,365	1.61 %
Corporate debt	223,966	438	(331)	224,073	0.77
Federal agency collateralized mortgage-backed securities					
GNMA	1,643,857	6,440	(16,577)	1,633,720	1.48
FNMA and FHLMC	1,758,251	6,538	(11,203)	1,753,586	1.31
Other collateralized mortgage-backed securities	6,796	-	(182)	6,614	2.76
Asset-backed securities	56,681	51	(2)	56,730	0.60
Total available-for-sale investments	**$ 3,826,884**	**$ 13,467**	**$ (32,263)**	**$ 3,808,088**	**1.35** %

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	$ 91,059	$ -	$ (2,412)	$ 88,647	4.11 %

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 September 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	$ -	$ -	$ 8,091	$ 125,274	$ 133,365
Corporate debt	90,102	133,971	-	-	224,073
Federal agency collateralized mortgage-backed securities					
GNMA	-	1,487	23,487	1,608,746	1,633,720
FNMA and FHLMC	-	32,016	188,132	1,533,438	1,753,586
Other collateralized mortgage-backed securities	-	15	-	6,599	6,614
Asset-backed securities	3,534	46,076	-	7,120	56,730
Total fair value	**$ 93,636**	**$ 213,565**	**$ 219,710**	**$ 3,281,177**	**$ 3,808,088**
Total amortized cost	**$ 93,567**	**$ 212,864**	**$ 218,973**	**$ 3,301,480**	**$ 3,826,884**
Weighted average yield	**0.54%**	**0.99%**	**1.95%**	**1.36%**	**1.35%**

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	$	88,647
Total amortized cost	**$**	**91,059**
Weighted average yield		**4.11%**

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 September 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	$ 33,304	$ (93)	$ 92,632	$ (3,875)	$ 125,936	$ (3,968)
Corporate debt	39,729	(225)	14,877	(106)	54,606	(331)
Federal agency collateralized mortgage-backed securities						
GNMA	546,027	(3,473)	522,202	(13,104)	1,068,229	(16,577)
FNMA and FHLMC	505,127	(2,384)	439,607	(8,819)	944,734	(11,203)
Other collateralized mortgage-backed securities	4,180	(26)	2,434	(156)	6,614	(182)
Asset-backed securities	-	-	563	(2)	563	(2)
Total	**$ 1,128,367**	**$ (6,201)**	**$ 1,072,315**	**$ (26,062)**	**$ 2,200,682**	**$ (32,263)**

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 nine months ended September 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 nine months ended September 30, 2014, totaling $59, is included as a credit to other comprehensive loss. At September 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:

	September 30, 2014	
Assumptions Used	Mortgage-Backed Securities	Asset-Backed Securities
Default by range	0.7% - 4.1%	4.0% - 6.9%
Prepayments rate by range	4.0% - 17.5%	2.5% - 4.9%
Loss severity by range	9.2% - 34.5%	55.5% - 57.8%

	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 nine months ended:

	For the Three Months Ended September 30,		**For the Nine Months Ended September 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 September 30, 2014, is as follows:

	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**	**Weighted Average Yield**
Agricultural mortgage-backed securities	$ 40,575	$ 189	$ (333)	$ 40,431	4.58 %

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 September 30, 2014:

	Due after one year through five years	Due after five years through 10 years	Total
Fair value of agricultural mortgage-backed securities	$ 24,942	$ 15,489	$ 40,431
Total amortized cost	**$ 24,815**	**$ 15,760**	**$ 40,575**
Weighted average yield	**4.99%**	**3.92%**	**4.58%**

NOTE 3 — LOANS AND RESERVES FOR CREDIT LOSSES

A summary of the district's loans follows:

	September 30, 2014	December 31, 2013
Real estate mortgage	**$ 11,220,611**	$10,794,302
Production and intermediate term	**2,096,506**	1,877,296
Loans to cooperatives	**200,103**	173,572
Processing and marketing	**2,418,855**	2,345,046
Farm-related business	**380,015**	226,110
Communication	**340,949**	304,755
Energy (rural utilities)	**1,258,283**	1,343,360
Water and waste disposal	**159,249**	133,975
Rural residential real estate	**252,781**	225,942
Agricultural export finance	**31,058**	19,788
Lease receivables	**4,123**	4,411
Loans to other financing institutions	**30,451**	34,380
Mission-related	**299,386**	242,583
	$ 18,692,370	$ 17,725,520

The bank's capital markets loan portfolio predominantly includes participations, syndications and purchased whole loans, along with other financing structures within our lending authorities. The bank also refers to the capital markets portfolio as participations purchased. In addition to purchasing loans from our district associations, which may exceed their hold limits, the bank actively pursues the purchase of participations and syndications originated outside of the district's territory by other System institutions, commercial banks and other lenders. These loans may be held as earning assets of the bank or sub-participated to the associations or to other System entities. 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 district balances of participations purchased and sold, excluding syndications, at September 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	$ 128,724	$ 156,730	$ 33,410	$ 20,856	$ 162,134	$ 177,586
Production and intermediate term	368,522	421,676	4,734	24,618	373,256	446,294
Agribusiness	1,344,669	34,989	48,123	4,348	1,392,792	39,337
Communication	341,431	-	-	-	341,431	-
Energy (rural utilities)	1,262,188	3,321	-	-	1,262,188	3,321
Water and waste disposal	139,464	-	-	-	139,464	-
Agricultural export finance	30,933	-	-	-	30,933	-
Lease receivables	3,883	-	28	-	3,911	-
Mission-related	7,888	-	4,418	-	12,306	-
Loans to other financing institutions	-	15,943	-	-	-	15,943
Direct note receivable from district associations	-	3,650,000	-	-	-	3,650,000
Total	**$ 3,627,702**	**$ 4,282,659**	**$ 90,713**	**$ 49,822**	**$ 3,718,415**	**$ 4,332,481**

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 September 30, 2014, ACPs netted against borrowers’ related loan balances totaled $186,467 and ACPs included in other liabilities totaled $28,677, 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 $56,787 at September 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 nine months ended September 30, 2014:

Balance at January 1, 2014	**$ 58,461**
Net losses on financial instruments under fair value option	**(98)**
Change in premium	**(1,576)**
Balance at September 30, 2014	**$ 56,787**

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

	September 30, 2014	December 31, 2013
Nonaccrual loans:		
Real estate mortgage	**$ 104,912**	$ 108,370
Production and intermediate term	**20,478**	38,410
Agribusiness	**6,065**	11,988
Rural residential real estate	**1,026**	1,302
Energy and water/waste disposal	**2,123**	1,171
Lease receivables	**35**	48
Total nonaccrual loans	**134,639**	161,289
Accruing restructured loans:		
Real estate mortgage	**22,161**	33,717
Production and intermediate term	**13,595**	14,129
Agribusiness	**-**	105
Rural residential real estate	**283**	72
Mission-related	**6,169**	5,189
Total accruing restructured loans	**42,208**	53,212
Accruing loans 90 days or more past due:		
Real estate mortgage	**6,334**	754
Production and intermediate term	**145**	2,371
Rural residential real estate	**137**	-
Mission-related	**1,270**	496
Total accruing loans 90 days or more past due	**7,886**	3,621
Total nonperforming loans	**184,733**	218,122
Other property owned, net	**34,263**	47,142
Total nonperforming assets	**$ 218,996**	$ 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:

	September 30, 2014		December 31, 2013	
Real estate mortgage:				
Acceptable	**96.6**	**%**	96.1	%
OAEM	**1.5**		1.7	
Substandard/Doubtful	**1.9**		2.2	
	100.0	**%**	100.0	%
Production and intermediate term:				
Acceptable	**95.9**	**%**	93.5	%
OAEM	**1.7**		2.7	
Substandard/Doubtful	**2.4**		3.8	
	100.0	**%**	100.0	%
Agribusiness:				
Acceptable	**99.2**	**%**	98.3	%
OAEM	**0.5**		0.8	
Substandard/Doubtful	**0.3**		0.9	
	100.0	**%**	100.0	%
Energy and water/waste disposal:				
Acceptable	**98.7**	**%**	97.3	%
OAEM	**1.2**		-	
Substandard/Doubtful	**0.1**		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	**97.3**	**%**	96.9	%
OAEM	**1.1**		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	**93.0**	**%**	92.2	%
OAEM	**6.0**		6.5	
Substandard/Doubtful	**1.0**		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	**97.7**	**%**	97.4	%
OAEM	**-**		-	
Substandard/Doubtful	**2.3**		2.6	
	100.0	**%**	100.0	%
Total loans:				
Acceptable	**97.2**	**%**	96.4	%
OAEM	**1.3**		1.4	
Substandard/Doubtful	**1.5**		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:

September 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	$ 69,290	$ 49,726	$ 119,016	$ 11,220,605	$ 11,339,621	$ 6,334
Production and intermediate term	4,045	7,471	11,516	2,110,196	2,121,712	145
Agribusiness	469	2,690	3,159	3,010,753	3,013,912	-
Communication	-	-	-	341,220	341,220	-
Energy and water/waste disposal	988	1,135	2,123	1,420,653	1,422,776	-
Rural residential real estate	2,536	269	2,805	251,154	253,959	137
Agricultural export finance	-	-	-	31,022	31,022	-
Lease receivables	27	-	27	4,174	4,201	-
Loans to other financing institutions	-	-	-	30,492	30,492	-
Mission-related	2,804	1,270	4,074	298,185	302,259	1,270
Total	**$ 80,159**	**$ 62,561**	**$ 142,720**	**$18,718,454**	**$18,861,174**	**$ 7,886**

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 September 30, 2014			At December 31, 2013		
Impaired loans with a related allowance for loan losses:	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**	Recorded Investment	Unpaid Principal Balance	Related Allowance
Real estate mortgage	**$ 23,155**	**$ 25,522**	**$ 5,740**	$ 41,123	$ 50,123	$ 9,905
Production and intermediate term	**4,170**	**4,830**	**1,975**	27,653	28,654	6,212
Processing and marketing	**1,152**	**1,763**	**274**	6,878	10,871	2,401
Farm-related business	**937**	**4,861**	**138**	1,068	4,992	191
Energy and water/waste disposal	**2,123**	**2,123**	**2,098**	1,171	1,171	1,147
Rural residential real estate	**27**	**78**	**4**	253	253	14
Mission-related	**2,615**	**2,615**	**175**	2,331	2,331	78
Total	**$ 34,179**	**$ 41,792**	**$ 10,404**	$ 80,477	$ 98,395	$ 19,948
Impaired loans with no related allowance for loan losses:						
Real estate mortgage	**$ 110,252**	**$ 130,873**	**$ -**	$ 101,718	$ 111,132	$ -
Production and intermediate term	**30,048**	**49,061**	**-**	27,256	49,522	-
Processing and marketing	**3,780**	**29,741**	**-**	3,856	28,391	-
Farm-related business	**196**	**810**	**-**	292	1,000	-
Energy and water/waste disposal	**-**	**22,731**	**-**	-	22,796	-
Rural residential real estate	**1,419**	**1,597**	**-**	1,120	1,210	-
Lease receivables	**35**	**35**	**-**	48	48	-
Mission-related	**4,824**	**8,430**	**-**	3,354	7,088	-
Total	**$ 150,554**	**$ 243,278**	**$ -**	$ 137,644	$ 221,187	$ -
Total impaired loans:						
Real estate mortgage	**$ 133,407**	**$ 156,395**	**$ 5,740**	$ 142,841	$ 161,255	$ 9,905
Production and intermediate term	**34,218**	**53,891**	**1,975**	54,909	78,176	6,212
Processing and marketing	**4,932**	**31,504**	**274**	10,734	39,262	2,401
Farm-related business	**1,133**	**5,671**	**138**	1,360	5,992	191
Energy and water/waste disposal	**2,123**	**24,854**	**2,098**	1,171	23,967	1,147
Rural residential real estate	**1,446**	**1,675**	**4**	1,373	1,463	14
Lease receivables	**35**	**35**	**-**	48	48	-
Mission-related	**7,439**	**11,045**	**175**	5,685	9,419	78
Total	**$ 184,733**	**$ 285,070**	**$ 10,404**	$ 218,121	$ 319,582	$ 19,948

	For the Three Months Ended				For the Nine Months Ended			
	September 30, 2014		September 30, 2013		**September 30, 2014**		September 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	**$ 23,047**	**$ 537**	$ 43,128	$ 206	**$ 27,649**	**$ 674**	$ 50,917	$ 452
Production and intermediate term	**4,155**	**8**	33,492	116	**15,672**	**16**	18,745	418
Processing and marketing	**1,187**	**-**	22,130	29	**1,784**	**-**	35,271	128
Farm-related business	**952**	**-**	3,476	-	**1,013**	**-**	4,098	-
Communication	**-**	**-**	1,331	28	**-**	**-**	2,806	115
Energy and water/waste disposal	**2,131**	**-**	1,267	-	**2,104**	**-**	1,422	-
Rural residential real estate	**25**	**-**	483	4	**66**	**1**	320	4
Mission-related	**2,616**	**72**	-	-	**2,564**	**187**	-	-
Total	**$ 34,113**	**$ 617**	$ 105,307	$ 383	**$ 50,852**	**$ 878**	$ 113,579	$ 1,117
Impaired loans with no related allowance for loan losses:								
Real estate mortgage	**$ 109,454**	**$ 2,105**	$ 125,983	$ 2,559	**$ 107,118**	**$ 4,360**	$ 140,868	$ 6,019
Production and intermediate term	**29,851**	**793**	23,496	991	**26,678**	**2,018**	24,249	2,521
Loans to cooperatives	**-**	**5**	-	-	**562**	**27**	-	-
Processing and marketing	**4,148**	**6**	14,350	22	**4,010**	**6**	13,491	65
Farm-related business	**204**	**17**	334	64	**187**	**83**	3,029	162
Communication	**-**	**-**	333	-	**-**	**-**	554	-
Energy and water/waste disposal	**-**	**-**	-	-	**-**	**1**	-	-
Rural residential real estate	**1,434**	**14**	1,475	19	**1,442**	**34**	1,444	45
Lease receivables	**37**	**-**	53	-	**41**	**-**	57	-
Mission-related	**4,633**	**90**	-	9	**4,303**	**227**	451	37
Total	**$ 149,761**	**$ 3,030**	$ 166,024	$ 3,664	**$ 144,341**	**$ 6,756**	$ 184,143	$ 8,849
Total impaired loans:								
Real estate mortgage	**$ 132,501**	**$ 2,642**	$ 169,111	$ 2,765	**$ 134,767**	**$ 5,034**	$ 191,785	$ 6,471
Production and intermediate term	**34,006**	**801**	56,988	1,107	**42,350**	**2,034**	42,994	2,939
Loans to cooperatives	**-**	**5**	-	-	**562**	**27**	-	-
Processing and marketing	**5,335**	**6**	36,480	51	**5,794**	**6**	48,762	193
Farm-related business	**1,156**	**17**	3,810	64	**1,200**	**83**	7,127	162
Communication	**-**	**-**	1,664	28	**-**	**-**	3,360	115
Energy and water/waste disposal	**2,131**	**-**	1,267	-	**2,104**	**1**	1,422	-
Rural residential real estate	**1,459**	**14**	1,958	23	**1,508**	**35**	1,764	49
Lease receivables	**37**	**-**	53	-	**41**	**-**	57	-
Mission-related	**7,249**	**162**	-	9	**6,867**	**414**	451	37
Total	**$ 183,874**	**$ 3,647**	$ 271,331	$ 4,047	**$ 195,193**	**$ 7,634**	$ 297,722	$ 9,966

At September 30, 2014, impaired loans of $34.2 million had a related specific allowance of $10.4 million, while the remaining $150.6 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 September 30, 2014, was $183.9 million. The district recognized interest income of $3.6 million on impaired loans during the three months ended September 30, 2014.

The average recorded investment in impaired loans for the nine months ended September 30, 2014, was $195.2 million. The district recognized interest income of $7.6 million on impaired loans during the nine months ended September 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 June 30, 2014	$ 34,430	$ 14,963	$ 7,305	$ 705	$ 5,279	$ 422	$ 7	$ 49	$ -	$ 216	$ 63,376
Charge-offs	(458)	(25)	(197)	-	-	(3)	-	-	-	-	(683)
Recoveries	271	249	234	-	-	-	-	-	-	-	754
Provision (negative provision) for credit losses	1,711	(4,804)	(976)	(1)	(55)	8	-	(1)	-	3	(4,115)
Adjustment due to merger	-	(1)	-	-	(1)	-	-	-	-	-	(2)
Other *	(156)	109	(53)	(27)	17	-	-	-	-	-	(110)
Balance at September 30, 2014	$ 35,798	$ 10,491	$ 6,313	$ 677	$ 5,240	$ 427	$ 7	$ 48	$ -	$ 219	$ 59,220
Balance at December 31, 2013	$ 42,429	$ 13,591	$ 11,654	$ 641	$ 5,222	$ 429	$ 7	$ 49	$ -	$ 142	$ 74,164
Charge-offs	(3,422)	(365)	(625)	-	-	(82)	-	-	-	-	(4,494)
Recoveries	410	1,215	380	-	57	-	-	-	-	-	2,062
(Negative provision) provision for credit losses	(2,829)	(3,605)	(4,428)	85	(338)	104	-	(1)	-	103	(10,909)
Adjustment due to merger	(1,696)	(193)	(88)	(2)	(242)	(24)	-	-	-	-	(2,245)
Other *	906	(152)	(580)	(47)	541	-	-	-	-	(26)	642
Balance at September 30, 2014	$ 35,798	$ 10,491	$ 6,313	$ 677	$ 5,240	$ 427	$ 7	$ 48	$ -	$ 219	$ 59,220
Individually evaluated for impairment	5,804	1,994	1,279	-	2,098	11	-	-	-	174	11,360
Collectively evaluated for impairment	29,994	8,497	5,034	677	3,142	416	7	48	-	45	47,860
Loans acquired with deteriorated credit quality	-	-	-	-	-	-	-	-	-	-	-
Balance at September 30, 2014	$ 35,798	$ 10,491	$ 6,313	$ 677	$ 5,240	$ 427	$ 7	$ 48	$ -	$ 219	$ 59,220
Balance at June 30, 2013	$ 40,502	$ 23,029	$ 21,604	$ 639	$ 5,335	$ 358	$ 6	$ 29	$ -	$ 67	$ 91,569
Charge-offs	(4,189)	(1,505)	(4,631)	-	-	(118)	-	-	-	-	(10,443)
Recoveries	294	349	82	-	-	11	-	-	-	-	736
Provision for credit losses	9,652	(6,313)	(558)	395	962	238	(5)	22	-	21	4,414
Other *	(83)	(232)	(9)	(1)	(532)	-	-	-	-	-	(857)
Balance at September 30, 2013	$ 46,176	$ 15,328	$ 16,488	$ 1,033	$ 5,765	$ 489	$ 1	$ 51	$ -	$ 88	$ 85,419
Balance at December 31, 2012	$ 42,868	$ 20,939	$ 36,753	$ 2,602	$ 3,213	$ 398	$ 3	$ 30	$ -	$ 36	$ 106,842
Charge-offs	(6,641)	(5,947)	(25,233)	-	-	(142)	-	-	-	-	(37,963)
Recoveries	853	879	1,167	-	-	25	-	-	-	-	2,924
Provision for credit losses	9,179	(283)	3,742	(1,567)	1,390	208	(2)	21	-	52	12,740
Other *	(83)	(260)	59	(2)	1,162	-	-	-	-	-	876
Balance at September 30, 2013	$ 46,176	$ 15,328	$ 16,488	$ 1,033	$ 5,765	$ 489	$ 1	$ 51	$ -	$ 88	$ 85,419
Individually evaluated for impairment	12,137	6,829	8,321	375	1,155	111	-	-	-	-	28,928
Collectively evaluated for impairment	34,039	8,499	8,167	658	4,610	378	1	51	-	88	56,491
Loans acquired with deteriorated credit quality	-	-	-	-	-	-	-	-	-	-	-
Balance at September 30, 2013	$ 46,176	$ 15,328	$ 16,488	$ 1,033	$ 5,765	$ 489	$ 1	$ 51	$ -	$ 88	$ 85,419
Recorded Investments in Loans Outstanding:											
Ending balance at September 30, 2014	$ 11,339,621	$ 2,121,712	$ 3,013,912	$ 341,220	$ 1,422,776	$ 253,959	$ 31,022	$ 4,201	$ 30,492	$ 302,259	$ 18,861,174
Individually evaluated for impairment	$ 139,638	$ 35,225	$ 8,184	$ -	$ 2,123	$ 1,793	$ -	$ 35	$ -	$ 7,319	$ 194,317
Collectively evaluated for impairment	$ 11,198,647	$ 2,086,363	$ 3,005,576	$ 341,220	$ 1,420,653	$ 252,166	$ 31,022	$ 4,166	$ 30,492	$ 294,940	$ 18,665,245
Loans acquired with deteriorated credit quality	$ 1,336	$ 124	$ 152	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,612
Ending balance at September 30, 2013	$ 10,781,975	$ 1,928,637	$ 2,577,542	$ 276,112	$ 1,439,623	$ 217,462	$ 20,991	$ 4,081	$ 30,196	$ 216,352	$ 17,492,971
Individually evaluated for impairment	$ 167,009	$ 57,177	$ 36,138	$ 1,614	$ 1,562	$ 2,417	$ -	$ 51	$ -	$ -	$ 265,968
Collectively evaluated for impairment	$ 10,614,379	$ 1,870,847	$ 2,541,404	$ 274,498	$ 1,438,061	$ 215,045	$ 20,991	$ 4,030	$ 30,196	$ 216,352	$ 17,225,803
Loans acquired with deteriorated credit quality	$ 587	$ 613	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,200

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

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

As of September 30, 2014, the total recorded investment of troubled debt restructured loans was $65,220, including $23,012 classified as nonaccrual and $42,208 classified as accrual, with specific allowance for loan losses of $3,020. Additional commitments to lend to borrowers whose loan terms have been modified in TDRs were $159 at September 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	
	September 30, 2014	December 31, 2013	**September 30, 2014**	December 31, 2013
Real estate mortgage	**$ 38,266**	$ 51,548	**$ 16,105**	$ 17,831
Production and intermediate term	**16,933**	14,535	**3,338**	406
Agribusiness	**3,564**	8,525	**3,564**	8,419
Rural residential real estate	**288**	109	**5**	38
Mission-related	**6,169**	5,189	**-**	-
Total	**$ 65,220**	$ 79,906	**$ 23,012**	$ 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 nine months ended September 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 September 30, 2014:

	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	$ 1,983	$ 1,579
Total	$ 1,983	$ 1,579

For the three months ended September 30, 2013:

	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	$ 119	$ 119
Production and intermediate term	23	22
Agribusiness	4,485	997
Rural residential real estate	9	8
Total	$ 4,636	$ 1,146

For the nine months ended September 30, 2014:

	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	$ 5,539	$ 5,128
Production and intermediate term	2,836	3,105
Rural residential real estate	190	222
Mission-related	941	955
Total	$ 9,506	$ 9,410

For the nine months ended September 30, 2013:

	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	$ 932	$ 888
Production and intermediate term	165	166
Agribusiness	4,485	997
Rural residential real estate	96	105
Total	$ 5,678	$ 2,156

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 and principal reduction.

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

	Recorded Investment at September 30, 2014	Recorded Investment at September 30, 2013
Troubled debt restructurings that subsequently defaulted:		
Real estate mortgage	$ 232	$ 108
Rural residential real estate	7	-
Total	$ 239	$ 108

NOTE 4 — COMMITMENTS AND CONTINGENT LIABILITIES

The bank is primarily liable for its portion of Systemwide debt obligations. Additionally, the bank is jointly and severally liable for the consolidated Systemwide bonds and notes of the other System banks. Total consolidated bank and Systemwide obligations of the System at September 30, 2014, were approximately $214.4 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 September 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	**$ 20,769**	$ -	$ 20,769	$ -
Investments available for sale:				
Corporate debt	**224,073**	-	224,073	-
Agency-guaranteed debt	**133,365**	-	133,365	-
Mortgage-backed securities	**3,393,920**	-	3,369,100	24,820
Asset-backed securities	**56,730**	-	55,857	873
Mission-related and other available-for-sale investments	**88,647**	-	-	88,647
Loans valued under the fair value option	**56,787**	-	56,787	-
Derivative assets	**929**	-	929	-
Assets held in nonqualified benefit trusts	**5,825**	5,825	-	-
Total assets	**$ 3,981,045**	$ 5,825	$ 3,860,880	$ 114,340
Liabilities:				
Standby letters of credit	**$ 909**	$ -	$ -	$ 909
Total liabilities	**$ 909**	$ -	$ -	$ 909

The following table represents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period from June 30, 2014, to September 30, 2014:

	Assets					Liabilities	
	Corporate Debt	Agency-Guaranteed Debt	Mortgage-Backed Securities	Agricultural Mortgage-Backed Securities	Asset-Backed Securities	Standby Letters of Credit	Net
Balance at June 30, 2014	$ -	$ -	$ 36,963	$ 96,447	$ 918	$ 1,096	$133,232
Net gains included in other comprehensive loss	-	-	(108)	1	39	-	(68)
Purchases, issuances and settlements	-	-	17,815	(7,801)	(84)	(187)	10,117
Transfers into Level 3	-	-	-	-	-	-	-
Transfers out of Level 3	-	-	(29,850)	-	-	-	(29,850)
Balance at September 30, 2014	$ -	$ -	$ 24,820	$ 88,647	$ 873	$ 909	$113,431
The amount of losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets or liabilities still held at September 30, 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 September 30, 2014:

	Assets					Liabilities	
	Corporate Debt	Agency-Guaranteed Debt	Mortgage-Backed Securities	Agricultural Mortgage-Backed Securities	Asset-Backed Securities	Standby Letters of Credit	Net
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	(256)	1,228	70	-	1,071
Purchases, issuances and settlements	-	(195)	146,272	(10,004)	(354)	(94)	135,813
Transfers into Level 3	-	-	-	-	-	1,003	(1,003)
Transfers out of Level 3	(15,000)	(26,783)	(128,725)	-	-	-	(170,508)
Balance at September 30, 2014	$ -	$ -	$ 24,820	$ 88,647	$ 873	$ 909	$113,431
The amount of losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets or liabilities still held at September 30, 2014	$ -	$ -	$ -	$ -	$ -	$ -	$ -

There were no transfers of assets or liabilities into or out of Level 1 from other levels during the nine months ended September 30, 2014. Agricultural mortgage-backed securities are included in Level 3 due to limited activity or less transparency around inputs to their valuation. At September 30, 2014, Level 3 investments included one 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 nine months of 2014, three 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 nine 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 nine months ended September 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 September 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	**$ 142,361**	$ -	$ -	$ 142,361	**$ (4,493)**
Other property owned	**38,070**	-	-	38,070	**15,287**
Total assets	**$ 180,431**	$ -	$ -	$ 180,431	**$ 10,794**

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 June 30, 2013, to September 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 June 30, 2013	$ 59,882	$ 29,116	$ 98,807	$ 105,622	$ 3,195	$ -	$ 296,622
Net (losses) gains included in other comprehensive income	-	(540)	673	770	17	-	920
Purchases, issuances and settlements	(25,012)	7,615	59,242	(3,534)	(191)	-	38,120
Transfers into Level 3	-	-	-	-	-	-	-
Transfers out of Level 3	(19,870)	(9,574)	(78,924)	-	-	-	(108,368)
Balance at September 30, 2013	$ 15,000	$ 26,617	$ 79,798	$ 102,858	$ 3,021	$ -	$ 227,294
The amount of losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets or liabilities still held at September 30, 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 September 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 (losses) gains included in other comprehensive income	(76)	(1,040)	(296)	(1,105)	591	-	(1,926)
Net (losses) gains included in earnings	-	-	(143)	-	-	-	(143)
Purchases, issuances and settlements	(25,012)	37,231	156,264	(11,516)	(666)	(4,764)	151,537
Transfers into Level 3	-	-	15,821	-	-	-	15,821
Transfers out of Level 3	(19,870)	(24,691)	(118,786)	-	-	-	(163,347)
Balance at September 30, 2013	$ 15,000	$ 26,617	$ 79,798	$ 102,858	$ 3,021	$ -	$ 227,294
The amount of losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets or liabilities still held at September 30, 2013	$ -	$ -	$ -	$ -	$ -	$ -	$ -

There were no transfers of assets or liabilities into or out of Level 1 from other levels during the nine months ended September 30, 2013. Agricultural mortgage-backed securities are included in Level 3 due to limited activity or less transparency around inputs to their valuation. At September 30, 2013, Level 3 investments included two agency MBS, three agency-guaranteed debt instruments and one corporate debt instrument due to the fact that their valuations were based on Level 3 criteria (broker quotes) and certain non-agency MBS and non-agency ABS backed by home equity. In the first nine 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. For the nine months ended September 30, 2013, 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; subsequent valuations using Level 3 criteria (broker quotes) were the basis for transfers into 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:

	September 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	**$ 455,698**	$ 455,698	$ -	$ -	$ 455,698	**$ 610,056**	$ 610,056	$ -	$ -	$ 610,056
Mission-related and other held-to-maturity investments	**40,575**	-	-	40,431	40,431	**55,669**	-	-	55,116	55,116
Net loans	**18,434,002**	-	-	18,475,099	18,475,099	**17,436,561**	-	-	17,363,491	17,363,491
Total assets	**$ 18,930,275**	$ 455,698	$ -	$ 18,515,530	$ 18,971,228	**$ 18,102,286**	$ 610,056	$ -	$ 17,418,607	$ 18,028,663
Liabilities:										
Systemwide debt securities and other notes	**$ 19,239,290**	$ -	$ -	$ 19,289,778	$ 19,289,778	**$ 18,252,012**	$ -	$ -	$ 18,218,619	$ 18,218,619
Subordinated debt	**50,000**	-	-	54,076	54,076	**50,000**	-	-	54,407	54,407
	$ 19,289,290	$ -	$ -	$ 19,343,854	$ 19,343,854	**$ 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.

Bonds and Notes

Systemwide debt securities are not all traded in the secondary market and those that are traded may not have readily available quoted market prices. Therefore, the fair value of the instruments is estimated by calculating the discounted value of the expected future cash flows. The discount rates used are based on the sum of quoted market yields for the Treasury yield curve and an estimated yield-spread relationship between System debt instruments and Treasury securities. We estimate an appropriate yield-spread taking into consideration selling group member (banks and securities dealers) yield indications, observed new government-sponsored enterprise debt security pricing, and pricing levels in the related U.S. dollar interest rate swap market.

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 September 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	-	-	50	50
Maturities/Amortizations	-	-	(80)	(80)
Balance at September 30, 2014	**$ -**	**$ -**	**$ 665**	**$ 665**

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

To minimize the risk of credit losses, the bank deals with counterparties that have an investment grade or better credit rating from a major rating agency, and also monitors the credit standing and levels of exposure to individual counterparties. The bank does not anticipate nonperformance by any of these counterparties. The bank typically enters into master agreements that contain netting provisions. These provisions allow the bank to require the net settlement of covered contracts with the same counterparty in the event of default by the counterparty on one or more contracts. However, derivative contracts must be reflected in the financial statements on a gross basis regardless of the netting agreement. Another way the bank minimizes the risk of credit losses from derivatives is that substantially all derivative contracts are supported by bilateral collateral agreements with counterparties requiring the posting of collateral in the event certain dollar thresholds of exposure of one party to the other one are reached; which thresholds may vary depending on the counterparty's credit rating. At September 30, 2014, and December 31, 2013, the bank's exposure to counterparties was $929 and $831, respectively. At September 30, 2014, and December 31, 2013, the bank had posted no securities as collateral, nor had any counterparty been required to post collateral.

The bank's derivative activities are monitored by its Asset-Liability Management Committee (ALCO) as part of the ALCO's oversight of the bank's asset/liability and treasury functions. The bank's ALCO is responsible for approving hedging strategies that are developed within parameters established by the bank's board of directors through the bank's analysis of data derived from financial simulation models and other internal and industry sources. The resulting hedging strategies are then incorporated into the bank's overall interest rate risk-management strategies. The bank held no derivatives that were not designated as hedges at September 30, 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 September 30, 2014, and December 31, 2013, consisted of interest rate caps.

Derivatives designated as hedging instruments	Balance Sheet Location	Fair Value 9/30/2014	Fair Value 12/31/2013	Balance Sheet Location	Fair Value 9/30/2014	Fair Value 12/31/2013
Interest rate caps	Other assets	$ 929	$ 831	Other liabilities	$ -	$ -

Derivatives designated as hedging instruments	Amount of (Loss) Gain Recognized in OCL on Derivatives (Effective Portion)		Location of Gain Reclassification from AOCI into Income	Amount of Gain Reclassified from AOCL into Income (Effective Portion)	
	September 30,			September 30,	
	2014	2013		2014	2013
Interest rate caps	$ (608)	$ 145	Interest expense	$ 1,917	$ 1,067

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 nine months ended September 30:

	Defined Benefit Pension Plans		Other Postretirement Benefits	
	2014	2013	**2014**	2013
Service cost	**$ 3,706**	$ 4,394	**$ 932**	$ 1,189
Interest cost	**11,937**	11,305	**2,038**	2,012
Expected return on plan assets	**(15,236)**	(14,049)	**-**	-
Amortization of prior service costs	**27**	27	**(921)**	(921)
Amortization of net loss	**6,065**	12,326	**73**	573
Net periodic benefit cost	**$ 6,499**	$ 14,003	**$ 2,122**	$ 2,853

As of September 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 nine months ended September 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	9,035	9,035		
Decrease in noncredit portion of other-than-temporary impairment (OTTI) losses	59	59		
Net decrease in unrealized losses on securities	9,094	9,094		
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	(1,012)		(1,012)	
Amortization of net losses	6,150		6,150	
Net change in pension and postretirement benefit plans	5,464		5,464	
Change in cash flow derivative instruments				
Unrealized losses on interest rate caps	(608)			(608)
Reclassification of loss recognized in interest expense	1,917			1,917
Net change in cash flow derivative instruments	1,309			1,309
Total other comprehensive income	**15,867**	**9,094**	**5,464**	**1,309**
Balance, September 30, 2014	**$ (95,087)**	**$ (21,209)**	**$ (70,735)**	**$ (3,143)**

The following table summarizes the changes in the balance of the components of AOCL for the nine months ended September 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	(53,968)	(53,968)		
Decrease in noncredit portion of other-than-temporary impairment (OTTI) losses	1,139	1,139		
Reclassification adjustment for OTTI credit losses included in net income	143	143		
Net decrease in unrealized gains on securities	(52,686)	(52,686)		
Change in pension and postretirement benefit plans				
Amounts amortized into net periodic expense:				
Amortization of prior service credits	(834)		(834)	
Amortization of net losses	12,034		12,034	
Net change in pension and postretirement benefit plans	11,200		11,200	
Change in cash flow derivative instruments				
Unrealized gains on interest rate caps	145			145
Reclassification of loss recognized in interest expense	1,067			1,067
Net change in cash flow derivative instruments	1,212			1,212
Total other comprehensive (loss) income	(40,274)	(52,686)	11,200	1,212
Balance, September 30, 2013	$ (151,081)	$ (18,582)	$ (127,496)	$ (5,003)

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

Component of AOCL	Amount Reclassified from AOCL		Affected Line in the Statement of Comprehensive Income
	2014	2013	
Impairment losses on other-than-temporarily-impaired investments	**$ -**	$ 143	Impairment losses on investments
Amortization of net charges on pension and postretirement benefit plans	**5,138**	11,200	Salaries and employee benefits
Amortization on cash flow hedges	**1,917**	1,067	Interest expense
Total reclassifications	**$ 7,055**	$ 12,410	

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 November 7, 2014, which is the date the financial statements were issued. There are no other significant subsequent events requiring disclosure as of November 7, 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	September 30, 2014	December 31, 2013
Cash	$ 451,671	$ 602,452
Federal funds sold and overnight investments	20,769	21,809
Investment securities	3,896,735	3,637,855
Loans	12,704,592	11,778,741
Less allowance for loan losses	6,449	13,660
Net loans	12,698,143	11,765,081
Accrued interest receivable	44,300	37,657
Other property owned, net	10,839	13,812
Premises and equipment, net	22,804	23,214
Other assets	118,565	110,837
Total assets	$ 17,263,826	$ 16,212,717
Bonds and notes	$ 15,589,290	$ 14,602,012
Subordinated debt	50,000	50,000
Accrued interest payable	37,986	37,749
Preferred stock dividends payable	20,063	20,063
Other liabilities	49,418	109,646
Total liabilities	15,746,757	14,819,470
Preferred stock	600,000	600,000
Capital stock	220,761	220,543
Retained earnings	719,162	605,817
Accumulated other comprehensive loss	(22,854)	(33,113)
Total shareholders' equity	1,517,069	1,393,247
Total liabilities and shareholders' equity	$ 17,263,826	$ 16,212,717

	Nine Months Ended September 30,	
Statement of income data	2014	2013
Interest income	$ 288,209	$ 276,727
Interest expense	120,498	113,268
Net interest income	167,711	163,459
(Negative provision) provision for loan losses	(5,852)	6,589
Net interest income after (negative provision) provision for loan losses	173,563	156,870
Noninterest income	29,046	34,859
Noninterest expense	56,228	51,854
Net income	146,381	139,875
Other comprehensive income (loss):		
Change in postretirement benefit plans	(144)	(130)
Change in fair value of investments	9,094	(52,686)
Change in cash flow derivative instruments	1,309	1,212
Total other comprehensive income (loss)	10,259	(51,604)
Comprehensive Income	$ 156,640	$ 88,271