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*AgSouth Farm Credit, ACA*

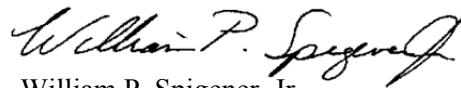
# THIRD QUARTER 2014

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## CERTIFICATION

The undersigned certify that we have reviewed the September 30, 2014 quarterly report of AgSouth Farm Credit, ACA, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.



William P. Spigener, Jr.  
Chief Executive Officer



Alisa D. Gunter  
Chief Financial Officer



Charles C. Rucks  
Chairman of the Board

November 7, 2014

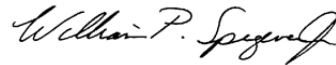
# Report on Internal Control Over Financial Reporting

The Association's principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association's Consolidated Financial Statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by, or under the supervision of the Association's principal executives and principal financial officers, or persons performing similar functions, and affected by its Board of Directors, management and other personnel. This process provides reasonable assurance regarding the reliability of financial reporting information and the preparation of the Consolidated Financial Statements for external purposes in accordance with accounting principles generally accepted in the United States of America.


Internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Association's assets that could have a material effect on its Consolidated Financial Statements.

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of September 30, 2014. In making the assessment, management used the framework in *Internal Control — Integrated Framework*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association concluded that as of September 30, 2014, the internal control over financial reporting was effective based upon the COSO (1992) criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of September 30, 2014.



William P. Spigener  
Chief Executive Officer



Alisa D. Gunter  
Chief Financial Officer

November 7, 2014

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

*(dollars in thousands)*

The following commentary reviews the financial condition and results of operations of AgSouth Farm Credit, ACA (Association) for the period ended September 30, 2014. This information should be read in conjunction with the accompanying financial statements, notes to the financial statements, and the 2013 Annual Report of AgSouth Farm Credit. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

## FORWARD LOOKING INFORMATION

This quarterly report contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Words such as “anticipates,” “believes,” “could,” “estimates,” “may,” “should,” “will,” or other variations of these terms are intended to identify the forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions, and expected future developments. However, actual results and developments may differ materially from our expectations and predictions due to a number of risks and uncertainties, many of which are beyond our control. These risks and uncertainties include, but are not limited to:

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international, and farm-related business sectors;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry; and
- actions taken by the Federal Reserve System in implementing monetary policy.

## LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage

loans. The Association's loan portfolio is diversified over a wide range of agricultural commodities produced in our region, including poultry (broilers, turkeys and eggs), timber, sod and nursery, field grains, soybeans and hay, cotton, horses, blueberries, fruits, nuts and beef cattle. Loans to producers of these commodities total \$1,312,643 or 86.30 percent of the Association's portfolio. Farm size varies, and many of the Association customers have diversified farming operations. These factors, along with the numerous opportunities for non-farm income in the area, reduce to some degree the level of income dependency on any given commodity.

During the third quarter of 2014 the Association originated \$26,554 in loans for the secondary market. Originations at the same period 2013 were \$30,738. The 13.61 percent decrease is the result of a reduction in the number of refinance requests during 2014 and the weak purchase market. AgSouth's performance mirrors the overall housing finance industry for the period. As of September 30, 2014, the Association held \$2,958 in qualifying loans for sale.

## Georgia Region

The 2014 growing season has been mostly favorable for spring planted crops in the state of Georgia. Major crops of cotton, corn, peanuts, and soybeans have and are expected to continue to produce good yields. The cotton crop is rated 54 percent good to excellent by USDA with another 30 percent rated fair. Peanuts are 50 percent good to excellent with another 30 percent fair. Soybeans are rated 56 percent good to excellent with another 32 percent fair. Yields of these major crops are expected to be fairly good overall, however; prices have dropped considerably from a year ago which is going to have an adverse impact on net farm income for producers growing these commodities. Many of our growers do utilize forward pricing on cotton and grow peanuts based on contract prices, therefore many will not experience the full price decline which has occurred over the course of 2014 in each of these markets. While cash flow is expected to be much tighter than the last several years we do expect it to remain positive. The sweet onion season has completed with prices averaging \$14.00 per 40lb equivalent coupled with fairly good yields which resulted in a profitable season for most growers. Pasture and hay conditions within our region are slightly less favorably rated by USDA with 40 percent good to excellent and 5 percent fair.

Cattle markets remain extremely high and many producers are expanding. Low feed cost are increasing the profitability within the cattle industry as well as the whole meat complex. The poultry sector is doing very well benefiting from low feed

cost as well and improved meat prices. We are seeing expansion in the poultry industry with several integrators in our area adding additional growers and new broiler houses. This expansion is expected to increase the demand for credit from the poultry industry at both the grower and integrator level, creating lending opportunities for the Association. Broilers are Georgia's number one commodity and the state leads the nation in broiler production along with being number one in the nation in peanut, pecan, and watermelon production.

The dairy industry continues experiencing very favorable conditions with low feed cost and high milk prices. Class 1 milk is averaging over \$5.00/cwt. higher than last year and is currently in the \$28.00/cwt. range. Timber markets have slightly rebounded from the second quarter with stronger lumber prices. Framing lumber began the year in the \$350 per thousand board feet range, dropped in the second quarter to around \$300/1000bf, and has now increased back to \$347/1000bf as of October. Pulpwood and hardwood saw timber markets remain very strong with chip-n-saw and pine saw timber markets stable. Continued improvement in the housing market is expected to bring improved prices to the pine saw timber and chip-n-saw stumpage prices. The wood pellet market remains strong and pellet mills are operating profitably with many expanding production.

Georgia has a very strong export market for agricultural products including poultry and wood products such as lumber, pulp, paper, and paperboard. The port of Savannah, with the deepening project underway at this time, is expected to become the busiest port in the nation and will continue to be a positive economic force in Georgia. The general economy within the state appears to be improving with a housing market that continues to improve and positive signs from the manufacturing sector during the third quarter. Home prices are up 7.5 percent in 2014 over 2013 and Georgia's PMI (Purchasing Managers Index), which measures manufacturing activity, jumped 12 points in August to 61. However; the one troubling factor continues to be the high level of unemployment at 8.1 percent. Unemployment which had dropped to 6.9 percent in April of this year has regressed back up to 8.1 percent in August. Overall, improvements in the economy should reverse this trend in the fourth quarter.

Land value trends in cropland remain positive and the once declining woodland land value trend has stabilized and is moving in a slightly positive direction according to the latest land value studies. The number of land sales transactions is also increasing presenting the Association with additional lending opportunities.

### **South Carolina Region**

Crop growing conditions in South Carolina have been favorable for most of the year as rainfall has been both adequate and timely in most areas of the state serviced by AgSouth. Heat damage to crops during the summer months was relatively insignificant. Corn harvest is now essentially complete and yields were average for most producers. Peanut

harvest is projected at about 34 percent complete, while cotton harvest is just beginning and projected at 13 percent. Both the 2014 peanut and cotton harvests are in line with the five year average for these two crops. The peanut crop is presently rated 100 percent fair to excellent, with 83 percent good to excellent. Cotton is rated 97 percent fair to excellent in condition with 70 percent good to excellent. Soybean harvest at quarter-end had not started but 10 percent of the crop is now mature. Peanuts are produced on a contract basis in South Carolina, while other crops are priced at the time of sale absent forward pricing being utilized by the individual grower. Price risk has increased for the 2014 corn, cotton, and soybean crops as commodity prices in general have regressed over the course of the operating cycle for these crops. Operations on average remain profitable but net income has decreased compared to the past several years.

The lower crop prices have led to lower feed costs for the poultry industry which is significant for the South Carolina region of the Association. As a result, profitability has continued to improve for this sector. At quarter-end, chicks placed are 122 percent of the previous year which reflects growth in the sector. Several broiler integrators are currently expanding their grower base through both new growers and expansion of houses allotted to present growers. This expansion has presented lending opportunities for the South Carolina region of the Association. A high percentage of the Association's poultry loans continue to be guaranteed by FSA, and some larger facilities are being guaranteed by a combined SBA/FSA guarantee arrangement.

Timber processors continue to remain very profitable as prices for virtually all processed products have increased dramatically over the past three years. Stumpage prices for both sawtimber and pulpwood have improved but have not seen the price improvement noted for processed products such as lumber, pulp, and paper. Pine pulpwood stumpage demand remains stronger than sawtimber with the southeast region of the country outpacing pulpwood prices in other regions. Nationally, both housing starts and residential construction continue to improve which bodes well for stable to improving stumpage prices into the foreseeable future.

The South Carolina real estate market appears stable to improving. South Carolina farm real estate is averaging \$3,010 per acre in 2014 which represents a 1.0 percent increase over the previous year. Cropland is averaging a \$2,460 per acre sales price for the year, and that value is an increase of less than one percent over the same period in 2013. The slight increase in value is reflective of the southeast region as a whole which has projected a 1.1 percent increase for both farm real estate and cropland over the past year. Land values have not increased in South Carolina as fast as the national average. Within the various communities of the state serviced by the Association, location and production factors obviously impact real estate values differently, but the studies reviewed and referenced reflect improved trends collectively for farm real estate and cropland throughout South Carolina.

Repayment from nonfarm income is important to a significant part of the Association's portfolio. Accordingly, general economic trends are important within the state. State unemployment has increased over the past few months and at mid-third quarter was at 6.4 percent, which is slightly higher than the national average of 6.1 percent. Unemployment in South Carolina for the third quarter 2014 compares favorably to the previous year results which reflected an unemployment rate of 7.5 percent. Overall, economists continue to reflect on the state's economy as stable with strong potential for growth late in 2014 and 2015.

## ASSOCIATION BALANCE SHEET

The gross loan volume of the Association as of September 30, 2014, was \$1,520,999, an increase of \$24,446 or 1.63 percent as compared to \$1,496,553 at December 31, 2013. Net loans outstanding at September 30, 2014 were \$1,509,064 as compared to \$1,484,905 at December 31, 2013. Net loans accounted for 94.27 percent of total assets at September 30, 2014, as compared to 93.15 percent of total assets at December 31, 2013.

The increase in gross loan volume during the reporting period is attributed to advances on operating funds as well as new term loans exceeding payments and payoffs. Commercial bank competition for good, quality loans continues to be a challenge for the lending staff as it has increased substantially within the Association's territory.

The Association typically structures loans to meet the needs of the borrower. Many term loans are made for ten years or less allowing the borrower to build equity faster and thus reducing the risk in the loan portfolio.

At December 31, 2013, the Association held Investment securities totaling \$7,193. These investments are Rural America Bonds made under the authority for Mission Related Investments granted by the Farm Credit Administration. At September 30, 2014, investment securities totaled \$11,984, an increase of \$4,791. The 66.61 percent increase is from a new investment purchased in the first quarter of 2014.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level and credit administration remains satisfactory. Nonaccrual loans decreased from \$20,071 at December 31, 2013, to \$12,508 at September 30, 2014. The balance of nonaccrual loans is reduced by liquidations, returning loans to accrual status, or transferring assets to other property owned. These activities exceeded any transfers to nonaccrual status during the period ending September 30, 2014. Association staff is working diligently to work out all nonaccrual debt situations, and additional transfers may occur as the economy remains sluggish.

Other property owned increased to \$3,869 at September 30, 2014 from \$1,731 at December 31, 2013. The increase of \$2,138 or 123.51 percent in other property owned is the result of

transfers to other property owned during the reporting period, including one significant transfer. The Association is actively marketing all properties for sale. For details, please visit our website at [www.agsouthfc.com](http://www.agsouthfc.com) and click on Property For Sale.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions. The allowance for loan losses at September 30, 2014, was \$11,935 compared to \$11,648 at December 31, 2013, and was considered by management to be adequate to cover possible losses. The slight increase in the allowance account is the result of recoveries of amounts previously charged off. The Asset/Liability Committee (ALCO) of the Association, which is comprised of members of senior management and staff assigned to special assets management, met in September to review the allowance account. The ALCO determined that an addition to the allowance account was not needed at this time. The ALCO considered the general economic conditions, the potential for further deterioration in the existing portfolio and the possibility for some loan growth in the next quarter in determining the level of allowance.

Investments in other Farm Credit institutions increased from \$21,507 at December 31, 2013 to \$21,560 at September 30, 2014. The increase of \$53 or less than one percent is the result of the true up of actual allocated receivable accounts from other Farm Credit institutions between December 2013 and September 2014. The Association records are closed with estimates of these allocated receivable amounts until the final patronage process runs and final amounts are calculated.

Premises and equipment, net decreased \$236 from \$15,894 at December 31, 2013 to \$15,658 at September 30, 2014. The decrease is the result of normal activity within the premises and equipment accounts. No significant assets sales or purchases were made in the reporting period.

Accounts receivable decreased \$19,509 from \$28,008 at December 31, 2013 to \$8,499 at September 30, 2014. The 2013 amount also included a special patronage distribution of \$17,916. This line item includes the accrual of patronage income year to date from AgFirst to the Association. As of September 30, 2014 only three quarters of accrual had been recorded.

Other assets decreased \$4,108 from \$13,154 at December 31, 2013 to \$9,046 at September 30, 2014. The majority of other assets is made up of prepaid retirement expense which decreased \$4,396 between December 31, 2013 and September 30, 2014.

On the liability side of the balance sheet, Patronage refunds payable decreased \$8,730 from \$8,799 at December 31, 2013 to \$69 at September 30, 2014. The decrease is the result of estimated cash portion of the 2013 Patronage distribution on the Association's records at December 31, 2013 after the final patronage amounts were calculated. These amounts cleared the commercial bank during the reporting period.

Accounts payable decreased \$59 from \$1,674 at December 31, 2013 to \$1,615 at September 30, 2014. The 3.52 percent decrease is due to the payable established to pay the insurance premiums on loans to the FCSIC. At December 31, 2013, this payable was \$1,147 and at September 30, 2014 the payable had been reduced to \$1,024.

Other liabilities decreased \$1,443 from \$23,774 at December 31, 2013 to \$22,331 at September 30, 2014. The 6.07 percent decrease is due to the liability of \$3,019 set aside in December 2013 to pay incentive earned in 2013. As of September 30, 2014, this liability amount was \$1,104 based upon calculations completed at quarter end.

Protected borrower stock decreased from \$16 at December 31, 2013 to \$4 at September 30, 2014. In October 2013, the Association's board of directors elected to retire the remaining protected borrower stock where possible.

Unprotected borrower stock increased from \$7,192 at December 31, 2013 to \$7,432 at September 30, 2014. The increase of \$240 or 3.34 percent is due to new borrowers purchasing stock during the reporting period.

Allocated surplus decreased from \$110,391 at December 31, 2013 to \$91,733 at September 30, 2014. This is a decrease of \$18,658 or 16.90 percent. The decrease in allocated surplus is due to the revolvment of allocated equities from the December 2008 fiscal year. These equities were retired in April 2014 and totaled \$19,291.

Unallocated surplus increased \$26,176 or 15.54 percent. The balance of \$194,578 at September 30, 2014 includes the retention of a portion of 2013 fiscal year end earnings and earnings year to date in 2014.

## **RESULTS OF OPERATIONS**

### ***For the three months ended September 30, 2014***

Net income for the three months ended September 30, 2014, totaled \$9,706 as compared to \$9,713 for the same period in 2013. This is a decrease of \$7 or less than one percent. The following commentary explains the variance.

At September 30, 2014, interest income increased \$356 from \$22,359 at September 30, 2013 to \$22,715. This increase of 1.59 percent is primarily due to the collection of interest income on the Association's investment portfolio. For the three months ending September 30, 2013, interest income on investments totaled \$62 compared to \$187 for the three months ended September 30, 2014. Nonaccrual income, which is included in interest income, was \$244 for the three months ended September 30, 2014, as compared to \$441 for the same period in 2013.

Interest expense for the three months ended September 30, 2014 decreased \$52 from \$8,194 at September 30, 2013 to \$8,142 at September 30, 2014. The variance is not considered material.

Net interest income before the provision for loan loss increased \$408 for the three months ended September 30, 2014, as compared to the same period in 2013 due primarily to the factors discussed above.

Net interest income after the provision for loan losses increased \$341 during the quarter ending September 30, 2014. A small reversal of the provision was made in the quarter ending September 30, 2013. The reversal was necessary to move general allowance to Other Liabilities to cover potential losses on undrawn loan commitment. In the same period in 2014, no provision entry was necessary. Undrawn loan commitment balances have decreased during the reporting period and no additional provision was required.

Noninterest income increased \$15 over the same period last year. Loan fees decreased \$218 or 27.49 percent. The loan fee variance can be tied to the decrease in demand for loans sold on the secondary market.

Fees for financially related services decreased \$10 from \$263 at September 30, 2013 compared to \$253 at September 30, 2014. The decrease of 3.80 percent is due to timing of collection of commissions from the sale of multi-peril insurance, and leasing activity is also lower in the 2014 reporting period when compared to 2013 resulting in a lower amount of lease income.

Patronage refunds from other Farm Credit institutions increased \$81 from \$2,674 at September 30, 2013 to \$2,755 at September 30, 2014. The increase of 3.03 percent is the result of the higher direct note balance at AgFirst Farm Credit Bank, which generates a higher patronage refund.

Gains on the sale of rural home loans increased \$42 from \$307 at September 30, 2013 compared to \$349 at September 30, 2014. While originations between the two reporting periods have decreased, the yield premium resulting in a gain has increased slightly. Demand for home loans has declined due to the weak purchase market and the higher interest rate environment which has slowed refinance activity.

Gains on the sale of premises and equipment for the period ending September 30, 2014 totaled \$39 compared to \$20 for the period ending September 30, 2013. During both reporting periods, the Association recorded gains on the sale of several Association automobiles that were replaced.

Gains on the sale of other transactions totaled \$42. This is an increase of \$111 over a loss of \$69 in the same period in 2013. In 2014, the Association had gains on investments in the Rabbi Trust and a reversal to bring the reserve for undrawn commitments to the correct balance. In the 2013 reporting period a provision entry to establish the reserve for unfunded commitment was necessary.

Other noninterest income was \$8 during the three months ended September 30, 2014, compared to \$18 for the three months ending September 30, 2013. This line item captures the volume premium paid by AgFirst for secondary market loans sold to AgFirst. Due to lower amount of originations, the volume premium is less.

Noninterest expense for the three months ended September 30, 2014, increased \$345 or 4.04 percent when compared to the same period of 2013. Salaries and employee benefits expense increased \$93 between the two reporting periods. The increase in salaries and employee benefits is due to the increase in health care expense for employees and retirees.

Occupancy and equipment expense at September 30, 2014 was \$517 compared to \$503 for the same period in 2013. The increase of \$14 or 2.78 percent is the result of maintenance and repairs completed in the 2014 time frame and higher utility costs.

The Insurance Fund premiums increased \$61 from \$291 at September 30, 2013 to \$352 at September 30, 2014. The variance is due to the higher premium on accruing loans assessed in 2014 by the Insurance Fund and a higher balance of accruing loans outstanding.

In the three months ending September 30, 2014, the Association experienced losses and expenses on the sale of Other Property Owned in the amount of \$118. During the same period of 2013, the Association booked losses and expenses on the sale of Other Property Owned of \$139. The losses in the 2014 reporting period were activity on several pieces of Other Property Owned held by the Association as well as losses recorded at the time of the sale. Some pieces are under contract for less than the current carrying value, while other write-downs were needed due to new appraisals.

Other operating expenses increased \$198 from \$1,410 at September 30, 2013, compared to \$1,608 at September 30, 2014. The increase of 14.04 percent is attributed to an increase in travel, purchased services, training, and public and member relations expenses between the reporting periods. The Association continues to experience higher travel expense due to the increase in the cost of operating Association automobiles. Other operating expenses also include communications, data processing, and all other expenses necessary to run the business.

#### ***For the nine months ended September 30, 2014***

Net income for the nine months ended September 30, 2014, totaled \$27,080 as compared to \$27,639 for the same period in 2013. This is a decrease of \$559 or 2.02 percent. The following narrative will explain the variance.

At September 30, 2014, interest income increased \$779 compared to the same period in 2013. The increase was due to the increase in investment interest income and an increase in nonaccrual interest income earned. The investment interest income is generated from several Rural America Bonds made

under the Farm Credit Administration's (FCA) Mission Related Investment Program. In the first quarter of 2014, the Association booked a new bond investment which generated additional interest income. Nonaccrual income, which is included in interest income, was \$806 for the nine months ended September 30, 2014, as compared to \$541 for the same period in 2013. The increase of \$265 or 48.98 percent is the result of the recognition of interest income when nonaccrual loans pay off or are reinstated to accrual status.

Interest expense decreased \$614 for the nine months ended September 30, 2014 to \$23,507 compared to \$24,121 at September 30, 2013. Due to the capital retention at the end of fiscal year 2013, and a change in the interest rate by AgFirst, the Association's increased lendable equity is reducing interest expense more so than in 2013.

Net interest income before the provision for loan loss increased \$1,393 or 3.32 percent for the nine months ended September 30, 2014 as compared to the same period in 2013 primarily due to the increase in loan volume and investment income and nonaccrual income earned in 2014 as described above.

Net interest income after the provision for loan losses increased \$1,154 in the period ending September 30, 2014. The provision reversal amount in the 2013 reporting period totaled \$239 and there was no provision or reversal in the 2014 reporting period. In September 2014, the Association's ALCO made the decision that the allowance account was adequate and that no adjustment was necessary. This decision was made after analyzing the risk in the current portfolio. The ALCO analysis included reviewing historical trends, loan size, loan performance and credit quality reports.

Noninterest income decreased \$1,676 over the same period last year. Loan fees decreased \$747 or 29.0 percent. In the first nine months of 2014, fees earned on loans sold in the secondary market have been significantly lower. The volume of loans sold decreased between the two reporting periods due to the weak purchase market and the lack of refinancing due to a higher interest rate environment. These two events in the secondary mortgage market caused a decline in secondary mortgage market activity resulting in lower fee income.

Fees for financially related services decreased \$176 from \$737 at September 30, 2013 compared to \$561 at September 30, 2014. The 23.88 percent decrease in fees for financially related services is the result of a decrease in leasing income between the two reporting periods. Leasing activity in 2014 is significantly lower than 2013 activity.

The patronage refunds from other Farm Credit institutions decreased \$512 from \$9,181 at September 30, 2013 to \$8,669 at September 30, 2014. The decrease is the result of a special patronage distribution of \$859 from AgFirst Farm Credit bank due to their 2013 year to date earnings. No special distribution was received in 2014. The amount of special distribution is determined by the AgFirst Farm Credit Board of Directors and

based upon the financial results of the AgFirst Farm Credit Bank (See Note 10, Subsequent Events).

Gains on the sale of rural home loans decreased \$436 from \$1,188 at September 30, 2013 to \$752 at September 30, 2014. Gains decreased due to the decline in loan originations sold between the reporting periods due to the weaker housing market.

Gains on the sale of premises and equipment were \$76 for the period ending September 30, 2014 compared to \$70 for the period ending September 30, 2013. The gains were recorded when Association automobiles were replaced.

Gains on other transactions totaled \$66 for the nine months ended September 30, 2014 compared to a loss of \$195 for the same period in 2013. The loss recorded in 2013 was the result of the need to establish a contingent liability for undrawn commitment loans. It was not necessary to increase the liability in the 2014 reporting period.

Other noninterest income decreased \$72 from \$271 at September 30, 2013 compared to \$199 at September 30, 2014. The variance of 26.57 percent is due to volume premiums paid by AgFirst for secondary market activity. In 2013, the Association earned \$63 in volume premiums and for the period ending September 30, 2014, the Association has only earned \$18 in volume premiums.

Noninterest expense for the nine months ended September 30, 2014, increased \$45 compared to the same period of 2013. Salaries and employee benefit expense increased \$397 between the two reporting periods. The 2.00 percent increase in salaries and employee benefits is tied to the increase in merit pay and medical benefits between the two reporting periods.

The Association booked an accrual for the 2014 incentive payment based upon plan results which is included in salary and benefit expense. The Association evaluated 2014 performance measures for incentive purposes and determined that some employees would earn incentive in 2014. Based upon this information, the Association accrued \$1,104 in incentive in June 2014. Incentive measures will be re-evaluated prior to the end of the fourth quarter 2014 to determine if an additional accrual is warranted.

Occupancy and equipment expense at September 30, 2014 was \$1,702 compared to \$1,637 for the same period in 2013. The increase is from the normal cost of operations and some timing differences of expenses.

The Insurance Fund premium increased from \$853 at September 30, 2013 to \$1,024 at September 30, 2014. The increase of 20.05 percent is tied to the increase in the premium on loans in accrual. In 2013, the FCSIC was 5 basis points for accruing volume and 15 basis points for nonaccrual volume. In 2014, the charge for accruing volume increased to 10 basis points and the nonaccrual premium remained unchanged.

Losses on the sale or write down of other property owned totaled \$254 for the nine months ending September 30, 2014. When compared to the same period in 2013, losses on other property owned totaled \$1,200. The losses or write-downs were required after new contracts, sale closings, and/or new appraisals were obtained and the book value needed to more accurately reflect the current market value. In the 2013 reporting period, some significant sales and write-downs occurred on other property owned.

Other operating expenses increased \$358 from September 30, 2013, \$4,805 compared to \$5,163 at September 30, 2014. The increase is primarily timing differences between the two reporting periods. This line item includes communications, travel, advertising, public and member relations and all other expenses necessary to carry on business.

## FUNDING SOURCES

The principal source of funds for the Association is the borrowing relationship established with AgFirst Farm Credit Bank (the Bank) through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at September 30, 2014 was \$1,280,526 as compared to \$1,271,311 at December 31, 2013. The increase in the notes payable correlates to the increase in gross loans during the reporting period.

## CAPITAL RESOURCES

Total members' equity at December 31, 2013 totaled \$285,777. At September 30, 2014 total members' equity had increased by \$7,762 to \$293,539. The increase in total members' equity is due to the increase in unallocated retained earnings offset by a decrease in allocated retained earnings between the two reporting periods. At December 31, 2013, allocated retained earnings totaled \$110,391. At September 30, 2014, the allocated retained earnings had decreased to \$91,733. The decrease in allocated retained earnings is due to the revolvment of allocated surplus from the 2008 fiscal year. This revolvment totaled \$19,291.

Unallocated equities increased \$26,176 from \$168,402 at December 31, 2013 to \$194,578 at September 30, 2014. The increase is the result of earnings retained for capital purposes at year end 2013 and year to date earnings in 2014.

Total capital stock and participation certificates were \$7,436 on September 30, 2014, compared to \$7,208 on December 31,



2013. The increase is attributed to the purchase of new stock and participation certificates for new borrowing entities offset by the retirement of stock and participation certificates on loans liquidated in the normal course of business.

FCA regulations require all Farm Credit Institutions to maintain minimum permanent capital, total surplus, and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus, and core surplus, as defined in FCA regulations, by a risk-adjusted asset base. As of September 30, 2014, the Association's total surplus ratio and core surplus ratio were 18.05 percent and 14.39 percent, respectively, and the permanent capital ratio was 18.56 percent. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

The Association has a portion of the portfolio in an in-portfolio guarantee program with Farmer Mac. The purpose of these guarantees is to improve the Association's capital position. At September 30, 2014, the Association had loans totaling \$20,381 in this program. The cost of the guarantees year to date was \$89. The use of the Farmer Mac in-portfolio guarantees had a positive effect on the Association's capital ratios.

At the present time, the Association's capital position remains strong and well above regulatory minimums. At December 31, 2013, the Association's permanent capital ratio was 18.69 percent. The slight decrease to 18.56 percent permanent capital at September 30, 2014 is the result of the slight growth in the Association's balance sheet offset by the Association's decision to retain income in unallocated surplus. The Association continues to utilize various loan guarantee programs, including FSA, SBA and Farmer Mac to offset risk and improve the capital position. The Association has other tools available to strengthen the capital position. These options include selling additional loans to AgFirst and others, placing additional pools of loans with Farmer Mac in the in-portfolio guarantee program, and participating with AgFirst in a capitalized participation pool. Should additional measures be needed to improve the Association's capital ratios, Association management will study all options and make a recommendation to the Board for consideration.

## **REGULATORY MATTERS**

On October 11, 2012, the Board entered into a Supervisory Agreement with the FCA. The Supervisory Agreement requires the Association to take corrective actions with respect to certain areas of its operations including standards of conduct, acquired property, borrower rights and board policies. On September 24, 2014, the Association was notified that the Supervisory Agreement was terminated by the FCA board on September 16, 2014. Pursuant to the termination, all corrective actions required under the Supervisory Agreement are now complete and the Board resolved the underlying conditions.

## ***Other Matters***

On March 31, 2014, the FCA published an interim final rule rescinding all requirements for nonbinding advisory votes on senior officer compensation at System banks and associations. The comment period for the interim rule ended on April 30, 2014 and the final rule became effective on June 18, 2014.

On July 25, 2014, the FCA published a proposed rule in the Federal Register to revise the requirements governing the eligibility of investments for System banks and associations. The public comment period ended on October 23, 2014. The stated objectives of the proposed rule are as follows:

- To strengthen the safety and soundness of System banks and associations.
- To ensure that System banks hold sufficient liquidity to continue operations and pay maturing obligations in the event of market disruption.
- To enhance the ability of the System banks to supply credit to agricultural and aquatic producers.
- To comply with the requirements of section 939A of the Dodd-Frank Act.
- To modernize the investment eligibility criteria for System banks.
- To revise the investment regulation for System associations to improve their investment management practices so they are more resilient to risk.

On September 4, 2014, the FCA published a proposed rule in the Federal Register to modify the regulatory capital requirements for System banks and associations. The public comment period ends on January 2, 2015. The stated 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 (Dodd-Frank Act).

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**RECENTLY ISSUED ACCOUNTING  
PRONOUNCEMENTS**

Please refer to Note 1, “*Organization, Significant Accounting Policies, and Recently Issued Accounting Pronouncements*”, in the Notes to the Financial Statements, and the 2013 Annual Report to Shareholders for recently issued accounting pronouncements.

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**NOTE:** Shareholder investment in the Association is materially affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst’s annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 2832, or writing Susanne Caughman, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, [www.agfirst.com](http://www.agfirst.com). Copies of the Association’s annual and quarterly reports are also available upon request free of charge by calling 1-800-310-4805, ext. 6737, writing Alisa D. Gunter, CFO, AgSouth Farm Credit, ACA, PO Box 4966, Spartanburg, SC 29305, or accessing the website [www.agsouthfc.com](http://www.agsouthfc.com). The Association prepares an electronic version of the Annual Report which is available on the Association’s web site within 75 days after the end of the fiscal year and distributes the Annual report to Shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

# AgSouth Farm Credit, ACA

## Consolidated Balance Sheets

<i>(dollars in thousands)</i>	September 30, 2014 <i>(unaudited)</i>	December 31, 2013 <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 1,923	\$ 7,061
Investment securities:		
Held to maturity (fair value of \$11,985 and \$7,132, respectively)	11,984	7,193
Loans	1,520,999	1,496,553
Allowance for loan losses	(11,935)	(11,648)
Net loans	1,509,064	1,484,905
Loans held for sale	2,958	535
Accrued interest receivable	16,191	14,148
Investments in other Farm Credit institutions	21,560	21,507
Premises and equipment, net	15,658	15,894
Other property owned	3,869	1,731
Accounts receivable	8,499	28,008
Other assets	9,046	13,154
Total assets	<u>\$ 1,600,752</u>	<u>\$ 1,594,136</u>
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 1,280,526	\$ 1,271,311
Accrued interest payable	2,672	2,801
Patronage refunds payable	69	8,799
Accounts payable	1,615	1,674
Other liabilities	22,331	23,774
Total liabilities	<u>1,307,213</u>	<u>1,308,359</u>
Commitments and contingencies		
<b>Members' Equity</b>		
Protected borrower stock	4	16
Capital stock and participation certificates	7,432	7,192
Retained earnings		
Allocated	91,733	110,391
Unallocated	194,578	168,402
Accumulated other comprehensive income (loss)	(208)	(224)
Total members' equity	<u>293,539</u>	<u>285,777</u>
Total liabilities and members' equity	<u>\$ 1,600,752</u>	<u>\$ 1,594,136</u>

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

# AgSouth Farm Credit, ACA

## Consolidated Statements of Income

(unaudited)

<i>(dollars in thousands)</i>	For the three months ended September 30,		For the nine months ended September 30,	
	2014	2013	2014	2013
<b>Interest Income</b>				
Loans	\$ 22,528	\$ 22,297	\$ 66,263	\$ 65,831
Investments	187	62	537	190
Total interest income	22,715	22,359	66,800	66,021
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	8,128	8,193	23,464	24,111
Other	14	1	43	10
Total interest expense	8,142	8,194	23,507	24,121
Net interest income	14,573	14,165	43,293	41,900
Provision for (reversal of allowance for) loan losses	—	(67)	—	(239)
Net interest income after provision for (reversal of allowance for) loan losses	14,573	14,232	43,293	42,139
<b>Noninterest Income</b>				
Loan fees	575	793	1,829	2,576
Fees for financially related services	253	263	561	737
Patronage refunds from other Farm Credit institutions	2,755	2,674	8,669	9,181
Gains (losses) on sales of rural home loans, net	349	307	752	1,188
Gains (losses) on sales of premises and equipment, net	39	20	76	70
Gains (losses) on other transactions	42	(69)	66	(195)
Other noninterest income	8	18	199	271
Total noninterest income	4,021	4,006	12,152	13,828
<b>Noninterest Expense</b>				
Salaries and employee benefits	6,289	6,196	20,217	19,820
Occupancy and equipment	517	503	1,702	1,637
Insurance Fund premiums	352	291	1,024	853
(Gains) losses on other property owned, net	118	139	254	1,200
Other operating expenses	1,608	1,410	5,163	4,805
Total noninterest expense	8,884	8,539	28,360	28,315
Income before income taxes	9,710	9,699	27,085	27,652
Provision (benefit) for income taxes	4	(14)	5	13
Net income	\$ 9,706	\$ 9,713	\$ 27,080	\$ 27,639

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

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AgSouth Farm Credit, ACA

# Consolidated Statements of Comprehensive Income

*(unaudited)*

<i>(dollars in thousands)</i>	For the three months ended September 30,		For the nine months ended September 30,	
	2014	2013	2014	2013
Net income	\$ 9,706	\$ 9,713	\$ 27,080	\$ 27,639
<b>Other comprehensive income net of tax</b>				
Employee benefit plans adjustments	5	22	16	66
Comprehensive income	\$ 9,711	\$ 9,735	\$ 27,096	\$ 27,705

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

**AgSouth Farm Credit, ACA**  
**Consolidated Statements of Changes in**  
**Members' Equity**

*(unaudited)*

<i>(dollars in thousands)</i>	Protected Borrower Stock	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2012	\$ 78	\$ 7,030	\$ 113,193	\$ 146,871	\$ (607)	\$ 266,565
Comprehensive income				27,639	66	27,705
Protected borrower stock issued/(retired), net	(19)					(19)
Capital stock/participation certificates issued/(retired), net		131				131
Retained earnings retired			(22,624)			(22,624)
Patronage distribution adjustment			(24)	34		10
Balance at September 30, 2013	\$ 59	\$ 7,161	\$ 90,545	\$ 174,544	\$ (541)	\$ 271,768
Balance at December 31, 2013	\$ 16	\$ 7,192	\$ 110,391	\$ 168,402	\$ (224)	\$ 285,777
Comprehensive income				27,080	16	27,096
Protected borrower stock issued/(retired), net	(12)					(12)
Capital stock/participation certificates issued/(retired), net		240				240
Retained earnings retired			(19,291)			(19,291)
Patronage distribution adjustment			633	(904)		(271)
Balance at September 30, 2014	\$ 4	\$ 7,432	\$ 91,733	\$ 194,578	\$ (208)	\$ 293,539

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

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*AgSouth Farm Credit, ACA*

# Notes to the Consolidated Financial Statements

*(dollars in thousands, except as noted)  
(unaudited)*

## **Note 1 — Organization, Significant Accounting Policies, and Recently Issued Accounting Pronouncements**

### **Organization**

The accompanying financial statements include the accounts of AgSouth Farm Credit, ACA (the Association). A description of the organization and operations, the significant accounting policies followed, and the financial condition and results of operations for the Association as of and for the year ended December 31, 2013, are contained in the 2013 Annual Report to Shareholders. These unaudited interim consolidated financial statements should be read in conjunction with the latest Annual Report to Shareholders.

### **Basis of Presentation**

In the opinion of management, the accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles (GAAP) and prevailing practices within the banking industry.

Certain amounts in the prior period's consolidated financial statements may have been reclassified to conform to the current period presentation. Such reclassifications had no effect on the prior period net income or total capital as previously reported.

The results of any interim period are not necessarily indicative of the results to be expected for a full year.

### **Significant Accounting Policies**

The Association maintains an allowance for loan losses at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio as of the report date. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through loan charge-offs and allowance reversals. A review of individual loans in each respective portfolio is performed periodically to determine the appropriateness of risk ratings and to ensure loss exposure to the Association has been identified.

### **Recently Issued Accounting Pronouncements**

In August 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-15, "Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern." The Update is

intended to define management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. Under Generally Accepted Accounting Principles (GAAP), financial statements are prepared under the presumption that the reporting organization will continue to operate as a going concern, except in limited circumstances. Financial reporting under this presumption is commonly referred to as the going concern basis of accounting. The going concern basis of accounting is critical to financial reporting because it establishes the fundamental basis for measuring and classifying assets and liabilities. Currently, GAAP lacks guidance about management's responsibility to evaluate whether there is substantial doubt about the organization's ability to continue as a going concern or to provide related footnote disclosures. The Update provides guidance to an organization's management, with principles and definitions that are intended to reduce diversity in the timing and content of disclosures that are commonly provided by organizations today in the financial statement footnotes. The amendments in this Update apply to all companies and not-for-profit organizations and become effective in the annual period ending after December 15, 2016, with early application permitted.

In August 2014, the FASB issued ASU 2014-14, "Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure." Currently, there is diversity in practice related to how creditors classify certain government-guaranteed mortgage loans upon foreclosure. The amendments in this Update require that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the following conditions are met: 1. The loan has a government guarantee that is not separable from the loan before foreclosure; 2. At the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim; 3. At the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The amendments in this Update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. For all other entities, the amendments in this Update are effective for annual periods ending after December 15, 2015, and interim periods beginning after December 15, 2015.

In June 2014, the FASB issued ASU 2014-11, “Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures,” which changes the accounting for repurchase-to-maturity transactions and repurchase financing arrangements. It also requires enhanced disclosures about repurchase agreements and other similar transactions. The new guidance aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements such that, these transactions would all be accounted for as secured borrowings. The accounting changes in this Update are effective for public companies for the first interim or annual period beginning after December 15, 2014. In addition, for public companies, the disclosure for certain transactions accounted for as a sale is effective for the first interim or annual period beginning on or after December 15, 2014, and the disclosure for transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and interim periods beginning after March 15, 2015. For all other entities, all changes are effective for annual periods beginning after December 15, 2014, and interim periods beginning after December 15, 2015. Earlier application for a public company is prohibited, but all other companies and organizations may elect to apply the requirements for interim periods beginning after December 15, 2014.

In May 2014, the FASB, responsible for U.S. Generally Accepted Accounting Principles (U.S. GAAP), and the International Accounting Standards Board (IASB), responsible for International Financial Reporting Standards (IFRS), jointly issued converged standards on the recognition of revenue from contracts with customers. ASU 2014-09, “Revenue from Contracts with Customers (Topic 606)” and IFRS 15 “Revenue from Contracts with Customers” are intended to improve the financial reporting of revenue and comparability of the top line in financial statements globally and supersede substantially all previous revenue recognition guidance. The core principle of the new standards is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services. The new standard also will result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and improve guidance for multiple-element arrangements. Because of the pervasive nature of the new guidance, the boards have established a joint transition resource group in order to aid transition to the new standard. For public entities reporting under U.S. GAAP, the amendments in the Update are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. For nonpublic entities, the amendments are effective for annual reporting periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. A nonpublic entity

may elect to adopt this guidance earlier under certain circumstances. The amendments are to be applied retrospectively. The Association has identified ancillary revenues that will be subject to this guidance. However, because financial instruments are not within the scope of the guidance, it is expected that adoption will not have a material impact on the Association’s financial condition or results of operations, but may result in additional disclosures.

In April 2014, the FASB issued ASU 2014-08, “Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity.” The amendments in this Update change the requirements for reporting discontinued operations in Subtopic 205-20. A discontinued operation may include a component of an entity or a group of components of an entity, or a business or nonprofit activity. A disposal of a component of an entity or a group of components of an entity is required to be reported in discontinued operations only if the disposal represents a strategic shift that has (or will have) a major effect on an entity’s operations and financial results. A public business entity and a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market should apply the amendments in this Update prospectively to both of the following: (1) All disposals (or classifications as held for sale) of components of an entity that occur within annual periods beginning on or after December 15, 2014, and interim periods within those years and (2) All businesses or nonprofit activities that, on acquisition, are classified as held for sale that occur within annual periods beginning on or after December 15, 2014, and interim periods within those years.

In March 2014, the FASB issued ASU 2014-06, “Technical Corrections and Improvements Related to Glossary Terms (Master Glossary).” The amendments in this Update relate to glossary terms, cover a wide range of Topics in the Codification and are presented in four sections: Deletion of Master Glossary Terms, Addition of Master Glossary Term Links, Duplicate Master Glossary Terms, and Other Technical Corrections Related to Glossary Terms. These amendments did not have transition guidance and were effective upon issuance for both public entities and nonpublic entities.

In January 2014, the FASB issued ASU 2014-04, “Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40) - Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.” The objective of the amendments in this Update is to reduce diversity by clarifying when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The amendments are effective for public business entities for annual periods, and interim periods within



those annual periods, beginning after December 15, 2014. For entities other than public business entities, the amendments in this Update are effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. An entity can elect to adopt the amendments in this Update using either a modified retrospective transition method or a prospective transition method. Early adoption is permitted.

Other recently issued accounting pronouncements are discussed in the 2013 Annual Report to Shareholders.

## Note 2 — Loans and Allowance for Loan Losses

For a complete description of the Association's accounting for loans (including impaired loans and the allowance for loan losses) and definitions of loan types, see the 2013 Annual Report to Shareholders.

Credit risk arises from the potential inability of an obligor to meet its repayment obligation. The Association manages credit risk associated with lending activities through an assessment of the credit risk profile of an individual obligor. The Association sets its own underwriting standards and lending policies that provide direction to loan officers and are approved by the board of directors.

A summary of loans outstanding at period end follows:

	September 30, 2014	December 31, 2013
Real estate mortgage	\$ 1,220,568	\$ 1,206,662
Production and intermediate-term	245,306	238,212
Processing and marketing	5,711	4,458
Farm-related business	9,368	9,501
Rural residential real estate	39,501	37,160
Other (including Mission Related)	545	560
Total Loans	<u>\$ 1,520,999</u>	<u>\$ 1,496,553</u>

A substantial portion of the Association's lending activities is collateralized, and exposure to credit loss associated with lending activities is reduced accordingly.

The Association may 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 tables present participation loan balances at periods ended:

	September 30, 2014							
	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	\$ 415	\$ 103,681	\$ —	\$ 10,068	\$ —	\$ —	\$ 415	\$ 113,749
Production and intermediate-term	—	50,198	1,367	—	1,500	—	2,867	50,198
Processing and marketing	—	6,387	—	8,594	—	—	—	14,981
Farm-related business	—	9,167	—	—	—	—	—	9,167
Total	<u>\$ 415</u>	<u>\$ 169,433</u>	<u>\$ 1,367</u>	<u>\$ 18,662</u>	<u>\$ 1,500</u>	<u>\$ —</u>	<u>\$ 3,282</u>	<u>\$ 188,095</u>

	December 31, 2013							
	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	\$ 436	\$ 113,058	\$ —	\$ 7,117	\$ —	\$ —	\$ 436	\$ 120,175
Production and intermediate-term	—	64,867	1,089	—	1,668	40	2,757	64,907
Processing and marketing	—	7,499	—	6,770	—	—	—	14,269
Farm-related business	—	5,417	—	—	—	—	—	5,417
Total	<u>\$ 436</u>	<u>\$ 190,841</u>	<u>\$ 1,089</u>	<u>\$ 13,887</u>	<u>\$ 1,668</u>	<u>\$ 40</u>	<u>\$ 3,193</u>	<u>\$ 204,768</u>

The March 31, 2014 table incorrectly reflected \$8,531 as Real Estate Participations Sold Outside Farm Credit System. This amount should have been included in Participations Sold within AgFirst District.

A significant source of liquidity for the Association is the repayments and maturities of loans. The following table presents the contractual maturity distribution of loans by loan type at the latest period end:

September 30, 2014				
	Due less than 1 year	Due 1 Through 5 years	Due after 5 years	Total
Real estate mortgage	\$ 79,325	\$ 260,840	\$ 880,403	\$ 1,220,568
Production and intermediate-term	108,699	91,360	45,247	245,306
Processing and marketing	2,718	2,210	783	5,711
Farm-related business	1,646	4,594	3,128	9,368
Rural residential real estate	6,328	3,322	29,851	39,501
Other (including Mission Related)	-	-	545	545
Total Loans	<u>\$ 198,716</u>	<u>\$ 362,326</u>	<u>\$ 959,957</u>	<u>\$ 1,520,999</u>
Percentage	<u>13.07%</u>	<u>23.82%</u>	<u>63.11%</u>	<u>100.00%</u>

The following table shows loans and related accrued interest, classified under the FCA Uniform Loan Classification System, as a percentage of total loans and related accrued interest receivable by loan type as of:

	September 30, 2014	December 31, 2013		September 30, 2014	December 31, 2013
<b>Real estate mortgage:</b>			<b>Farm-related business:</b>		
Acceptable	95.10%	94.34%	Acceptable	99.74%	94.25%
OAEM	3.02	3.09	OAEM	0.22	5.68
Substandard/doubtful/loss	1.88	2.57	Substandard/doubtful/loss	0.04	0.07
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>
<b>Production and intermediate-term:</b>			<b>Rural residential real estate:</b>		
Acceptable	95.83%	93.65%	Acceptable	97.18%	97.07%
OAEM	2.13	2.60	OAEM	1.05	1.16
Substandard/doubtful/loss	2.04	3.75	Substandard/doubtful/loss	1.77	1.77
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>
<b>Processing and marketing:</b>			<b>Other (including Mission Related):</b>		
Acceptable	100.00%	100.00%	Acceptable	100.00%	100.00%
OAEM	-	-	OAEM	-	-
Substandard/doubtful/loss	-	-	Substandard/doubtful/loss	-	-
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>
			<b>Total Loans:</b>		
			Acceptable	95.32%	94.31%
			OAEM	2.79	2.97
			Substandard/doubtful/loss	1.89	2.72
				<u>100.00%</u>	<u>100.00%</u>

The following tables provide an age analysis of past due loans and related accrued interest as of:

September 30, 2014						
	30 Through 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 or More Past Due and Accruing Interest
Real estate mortgage	\$ 8,353	\$ 3,159	\$ 11,512	\$ 1,220,778	\$ 1,232,290	\$ -
Production and intermediate-term	906	819	1,725	247,571	249,296	8
Processing and marketing	-	-	-	5,729	5,729	-
Farm-related business	22	1	23	9,437	9,460	-
Rural residential real estate	384	127	511	39,183	39,694	-
Other (including Mission Related)	-	-	-	548	548	-
Total	<u>\$ 9,665</u>	<u>\$ 4,106</u>	<u>\$ 13,771</u>	<u>\$ 1,523,246</u>	<u>\$ 1,537,017</u>	<u>\$ 8</u>

December 31, 2013						
	30 Through 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 or More Past Due and Accruing Interest
Real estate mortgage	\$ 6,908	\$ 4,379	\$ 11,287	\$ 1,205,879	\$ 1,217,166	\$ -
Production and intermediate-term	4,021	906	4,927	236,606	241,533	-
Processing and marketing	-	-	-	4,487	4,487	-
Farm-related business	-	1	1	9,603	9,604	-
Rural residential real estate	549	198	747	36,576	37,323	-
Other (including Mission Related)	-	-	-	561	561	-
Total	<u>\$ 11,478</u>	<u>\$ 5,484</u>	<u>\$ 16,962</u>	<u>\$ 1,493,712</u>	<u>\$ 1,510,674</u>	<u>\$ -</u>

The recorded investment in a receivable is the face amount increased or decreased by applicable accrued interest, unamortized premium, discount, finance charges, or acquisition costs and may also reflect a previous direct write-down of the investment.

Nonperforming assets (including related accrued interest) and related credit quality statistics at period end were as follows:

	September 30, 2014	December 31, 2013
<b>Nonaccrual loans:</b>		
Real estate mortgage	\$ 9,018	\$ 12,944
Production and intermediate-term	3,004	6,517
Farm-related business	4	7
Rural residential real estate	482	603
Total	<u>\$ 12,508</u>	<u>\$ 20,071</u>
<b>Accruing restructured loans:</b>		
Real estate mortgage	\$ 8,103	\$ 12,751
Production and intermediate-term	1,324	1,038
Farm-related business	191	196
Rural residential real estate	169	—
Total	<u>\$ 9,787</u>	<u>\$ 13,985</u>
<b>Accruing loans 90 days or more past due:</b>		
Production and intermediate-term	\$ 8	\$ —
Total	<u>\$ 8</u>	<u>\$ —</u>
Total nonperforming loans	\$ 22,303	\$ 34,056
Other property owned	3,869	1,731
Total	<u>\$ 26,172</u>	<u>\$ 35,787</u>
Nonaccrual loans as a percentage of total loans	0.82%	1.34%
Nonperforming assets as a percentage of total loans and other property owned	1.72%	2.39%
Nonperforming assets as a percentage of capital	8.92%	12.52%

The following table presents information relating to impaired loans (including accrued interest) at period end. Impaired loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms of the loan.

	September 30, 2014	December 31, 2013
<b>Impaired nonaccrual loans:</b>		
Current as to principal and interest	\$ 6,012	\$ 9,249
Past due	6,496	10,822
Total	<u>12,508</u>	<u>20,071</u>
<b>Impaired accrual loans:</b>		
Restructured	9,787	13,985
90 days or more past due	8	—
Total	<u>9,795</u>	<u>13,985</u>
Total impaired loans	<u>\$ 22,303</u>	<u>\$ 34,056</u>

The following tables present additional impaired loan information at period end. Unpaid principal balance represents the contractual principal balance of the loan.

	September 30, 2014			Quarter Ended September 30, 2014		Nine Months Ended September 30, 2014	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans	Average Impaired Loans	Interest Income Recognized on Impaired Loans
<b>Impaired loans with a related allowance for credit losses:</b>							
Real estate mortgage	\$ 1,095	\$ 1,100	\$ 94	\$ 1,333	\$ 19	\$ 1,528	\$ 61
Production and intermediate-term	78	78	4	94	1	108	4
Farm-related business	—	—	—	—	—	—	—
Rural residential real estate	—	—	—	—	—	—	—
Total	\$ 1,173	\$ 1,178	\$ 98	\$ 1,427	\$ 20	\$ 1,636	\$ 65
<b>Impaired loans with no related allowance for credit losses:</b>							
Real estate mortgage	\$ 16,026	\$ 19,010	\$ —	\$ 19,493	\$ 278	\$ 22,360	\$ 893
Production and intermediate-term	4,258	5,246	—	5,180	74	5,941	237
Farm-related business	195	218	—	237	3	272	11
Rural residential real estate	651	756	—	793	11	909	36
Total	\$ 21,130	\$ 25,230	\$ —	\$ 25,703	\$ 366	\$ 29,482	\$ 1,177
<b>Total impaired loans:</b>							
Real estate mortgage	\$ 17,121	20,110	94	\$ 20,826	\$ 297	\$ 23,888	\$ 954
Production and intermediate-term	4,336	5,324	4	5,274	75	6,049	241
Farm-related business	195	218	—	237	3	272	11
Rural residential real estate	651	756	—	793	11	909	36
Total	\$ 22,303	\$ 26,408	\$ 98	\$ 27,130	\$ 386	\$ 31,118	\$ 1,242

	December 31, 2013			Year Ended December 31, 2013	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans
<b>Impaired loans with a related allowance for credit losses:</b>					
Real estate mortgage	\$ 704	\$ 1,028	\$ 295	\$ 629	\$ 43
Production and intermediate-term	113	211	56	102	7
Farm-related business	—	—	—	—	—
Rural residential real estate	—	—	—	—	—
Total	\$ 817	\$ 1,239	\$ 351	\$ 731	\$ 50
<b>Impaired loans with no related allowance for credit losses:</b>					
Real estate mortgage	\$ 24,991	\$ 27,739	\$ —	\$ 22,363	\$ 1,525
Production and intermediate-term	7,442	9,336	—	6,659	454
Farm-related business	203	226	—	181	12
Rural residential real estate	603	719	—	539	37
Total	\$ 33,239	\$ 38,020	\$ —	\$ 29,742	\$ 2,028
<b>Total impaired loans:</b>					
Real estate mortgage	\$ 25,695	\$ 28,767	\$ 295	\$ 22,992	\$ 1,568
Production and intermediate-term	7,555	9,547	56	6,761	461
Farm-related business	203	226	—	181	12
Rural residential real estate	603	719	—	539	37
Total	\$ 34,056	\$ 39,259	\$ 351	\$ 30,473	\$ 2,078

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at each reporting period. A summary of changes in the allowance for loan losses and recorded investment in loans for each reporting period follows:

	Real Estate Mortgage	Production and Intermediate- term	Agribusiness*	Rural Residential Real Estate	Other (including Mission Related)	Total
<b>Activity related to the allowance for credit losses:</b>						
Balance at June 30, 2014	\$ 9,454	\$ 1,907	\$ 115	\$ 303	\$ 4	\$ 11,783
Charge-offs	(11)	(95)	—	(5)	—	(111)
Recoveries	155	58	—	37	13	263
Provision for loan losses	(14)	54	2	(29)	(13)	—
Balance at September 30, 2014	\$ 9,584	\$ 1,924	\$ 117	\$ 306	\$ 4	\$ 11,935
Balance at December 31, 2013	\$ 9,397	\$ 1,862	\$ 106	\$ 279	\$ 4	\$ 11,648
Charge-offs	(237)	(145)	(1)	(9)	—	(392)
Recoveries	410	114	89	41	25	679
Provision for loan losses	14	93	(77)	(5)	(25)	—
Balance at September 30, 2014	\$ 9,584	\$ 1,924	\$ 117	\$ 306	\$ 4	\$ 11,935
Balance at June 30, 2013	\$ 8,017	\$ 2,430	\$ 109	\$ 237	\$ 4	\$ 10,797
Charge-offs	(213)	(4)	—	(37)	—	(254)
Recoveries	27	2	1	6	—	36
Provision for loan losses	(23)	(60)	(17)	34	(1)	(67)
Balance at September 30, 2013	\$ 7,808	\$ 2,368	\$ 93	\$ 240	\$ 3	\$ 10,512
Balance at December 31, 2012	\$ 8,008	\$ 2,483	\$ 148	\$ 230	\$ 4	\$ 10,873
Charge-offs	(432)	(84)	—	(37)	—	(553)
Recoveries	257	88	30	56	—	431
Provision for loan losses	(25)	(119)	(85)	(9)	(1)	(239)
Balance at September 30, 2013	\$ 7,808	\$ 2,368	\$ 93	\$ 240	\$ 3	\$ 10,512
<b>Allowance on loans evaluated for impairment:</b>						
Individually	\$ 94	\$ 4	\$ —	\$ —	\$ —	\$ 98
Collectively	9,490	1,920	117	306	4	11,837
Balance at September 30, 2014	\$ 9,584	\$ 1,924	\$ 117	\$ 306	\$ 4	\$ 11,935
Individually	\$ 295	\$ 56	\$ —	\$ —	\$ —	\$ 351
Collectively	9,102	1,806	106	279	4	11,297
Balance at December 31, 2013	\$ 9,397	\$ 1,862	\$ 106	\$ 279	\$ 4	\$ 11,648
<b>Recorded investment in loans evaluated for impairment:</b>						
Individually	\$ 8,987	\$ 3,003	\$ 3	\$ 479	\$ —	\$ 12,472
Collectively	1,223,303	246,293	15,186	39,215	548	1,524,545
Balance at September 30, 2014	\$ 1,232,290	\$ 249,296	\$ 15,189	\$ 39,694	\$ 548	\$ 1,537,017
Individually	\$ 12,938	\$ 6,530	\$ 6	\$ 601	\$ —	\$ 20,075
Collectively	1,204,228	235,003	14,085	36,722	561	1,490,599
Balance at December 31, 2013	\$ 1,217,166	\$ 241,533	\$ 14,091	\$ 37,323	\$ 561	\$ 1,510,674

\*Includes the loan types; Loans to cooperatives, Processing and marketing, and Farm-related business.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. The following tables present additional information about pre-modification and post-modification outstanding recorded investment and the effects of the modifications that occurred during the periods presented.

	Three months ended September 30, 2014					Charge-offs
	Interest Concessions	Principal Concessions	Other Concessions	Total		
<b>Pre-modification Outstanding Recorded Investment</b>						
Real estate mortgage	\$ 881	\$ 78	\$ —	\$ 959		
Production and intermediate-term	—	810	—	810		
Total	\$ 881	\$ 888	\$ —	\$ 1,769		
<b>Post-modification Outstanding Recorded Investment</b>						
Real estate mortgage	\$ 896	\$ 78	\$ —	\$ 974	\$ —	
Production and intermediate-term	—	715	—	715		
Total	\$ 896	\$ 793	\$ —	\$ 1,689	\$ —	

Nine months ended September 30, 2014					
	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
<b>Pre-modification Outstanding</b>					
<b>Recorded Investment</b>					
Real estate mortgage	\$ 1,547	\$ 381	\$ –	\$ 1,928	
Production and intermediate-term	–	964	–	964	
Rural residential real estate	71	–	93	164	
Total	\$ 1,618	\$ 1,345	\$ 93	\$ 3,056	
<b>Post-modification Outstanding</b>					
<b>Recorded Investment</b>					
Real estate mortgage	\$ 1,567	\$ 381	\$ –	\$ 1,948	\$ –
Production and intermediate-term	–	832	–	832	–
Rural residential real estate	71	–	93	164	(4)
Total	\$ 1,638	\$ 1,213	\$ 93	\$ 2,944	\$ (4)

Three months ended September 30, 2013					
	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
<b>Pre-modification Outstanding</b>					
<b>Recorded Investment</b>					
Real estate mortgage	\$ –	\$ 461	\$ 5,754	\$ 6,215	
Total	\$ –	\$ 461	\$ 5,754	\$ 6,215	
<b>Post-modification Outstanding</b>					
<b>Recorded Investment</b>					
Real estate mortgage	\$ –	\$ 238	\$ 5,815	\$ 6,053	\$ –
Total	\$ –	\$ 238	\$ 5,815	\$ 6,053	\$ –

Nine months ended September 30, 2013					
	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
<b>Pre-modification Outstanding</b>					
<b>Recorded Investment</b>					
Real estate mortgage	\$ 2,504	\$ 555	\$ 6,182	\$ 9,241	
Production and intermediate-term	–	41	48	89	
Rural residential real estate	139	–	–	139	
Total	\$ 2,643	\$ 596	\$ 6,230	\$ 9,469	
<b>Post-modification Outstanding</b>					
<b>Recorded Investment</b>					
Real estate mortgage	\$ 2,509	\$ 333	\$ 6,237	\$ 9,079	\$ –
Production and intermediate-term	–	42	41	83	–
Rural residential real estate	139	–	–	139	–
Total	\$ 2,648	\$ 375	\$ 6,278	\$ 9,301	\$ –

Interest concessions may include interest forgiveness and interest deferment. Principal concessions may include principal forgiveness, principal deferment, and maturity extension. Other concessions may include additional compensation received which might be in the form of cash or other assets.

The following table presents outstanding recorded investment for TDRs that occurred during the previous twelve months and for which there was a subsequent payment default during the period. Payment default is defined as a payment that was thirty days or more past due.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Real estate mortgage	\$ 540	\$ 227	\$ 1,434	\$ 591
Production and intermediate-term	–	82	1,705	200
Total	\$ 540	\$ 309	\$ 3,139	\$ 791

The following table provides information on outstanding loans restructured in troubled debt restructurings at period end. These loans are included as impaired loans in the impaired loan table:

	Total TDRs		Nonaccrual TDRs	
	September 30, 2014	December 31, 2013	September 30, 2014	December 31, 2013
Real estate mortgage	\$ 12,484	\$ 18,013	\$ 4,381	\$ 5,262
Production and intermediate-term	3,508	3,028	2,184	1,990
Farm-related business	192	197	1	1
Rural residential real estate	447	261	278	261
Total Loans	\$ 16,631	\$ 21,499	\$ 6,844	\$ 7,514
Additional commitments to lend	\$ -	\$ -		

### Note 3 — Investment Securities

The Association's held-to-maturity investments consist primarily of Rural America Bonds, which are private placement securities purchased under the Mission Related Investment program approved by the FCA. In its Conditions of Approval for the program, the FCA considers a Rural America Bond ineligible if its investment rating, based on the internal 14-point risk rating scale used to also grade loans, falls below 9 and requires System institutions to provide notification to FCA when a security becomes ineligible.

A summary of the amortized cost and fair value of investment securities held-to-maturity follows:

	September 30, 2014				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Mission Related Investments	\$ 11,984	\$ 109	\$ (108)	\$ 11,985	6.12%

	December 31, 2013				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Mission Related Investments	\$ 7,193	\$ 35	\$ (96)	\$ 7,132	5.47%

A summary of the contractual maturity, amortized cost and estimated fair value of investment securities held-to-maturity follows:

	September 30, 2014		
	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	\$ 3,195	\$ 3,087	4.89%
After one year through five years	-	-	-
After five years through ten years	-	-	-
After ten years	8,789	8,898	6.56
Total	\$ 11,984	\$ 11,985	6.12%

A portion of these investments have contractual maturities in excess of ten years. However, expected maturities for these types of securities can differ from contractual maturities because borrowers may have the right to prepay obligations with or without prepayment penalties.

An investment is considered impaired if its fair value is less than its cost. A continuous unrealized loss position for an investment is based on the date the impairment was first identified. The following tables show the fair value and gross unrealized losses for investments that were in a continuous unrealized loss position aggregated by investment category.

	September 30, 2014			
	Less than 12 Months		Greater than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mission Related Investments	\$ 3,087	\$ (108)	\$ -	\$ -

	December 31, 2013			
	Less than 12 Months		Greater than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mission Related Investments	\$ 3,098	\$ (96)	\$ -	\$ -

FASB guidance contemplates numerous factors in determining whether an impairment is other-than-temporary. These factors include: (1) whether or not management intends to sell the security, (2) whether it is more likely than not that management would be required to sell the security before recovering its costs, and (3) whether management expects to recover the security's entire amortized cost basis (even if there is no intention to sell). If the Association intends to sell the security or it is more likely than not that it would be required to sell the security, the impairment loss equals the full difference between amortized cost and fair value of the security. When the Association does not intend to sell securities in an unrealized loss position and it is not more likely than not that it would be required to sell the securities, other-than-temporary impairment loss is separated into credit loss and non-credit loss. Credit loss is defined as the shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis.

The Association performs periodic credit reviews, including other-than-temporary impairment analyses, on its investment securities portfolio. The objective is to quantify future possible loss of principal or interest due on securities in the portfolio. Factors considered in determining whether an impairment is other-than-temporary include among others: (1) the length of time and the extent to which the fair value is less than cost, (2) adverse conditions specifically related to the industry, (3) geographic area

and the condition of the underlying collateral, (4) payment structure of the security, (5) ratings by rating agencies, (6) the credit worthiness of bond insurers, and (7) volatility of the fair value changes.

The Association uses the present value of cash flows expected to be collected from each debt security to determine the amount of credit loss. This technique requires assumptions related to the underlying collateral, including default rates, amount and timing of prepayments, and loss severity. Assumptions can vary widely from security to security and are influenced by such factors as loan interest rate, geographical location of the borrower, borrower characteristics, and collateral type.

Significant inputs used to estimate the amount of credit loss include, but are not limited to, performance indicators of the underlying assets in the security (including default rates, delinquency rates, and percentage of nonperforming assets), loan-to-collateral value ratios, third-party guarantees, current levels of subordination, vintage, geographic concentration, and credit ratings. The Association may obtain assumptions for the default rate, prepayment rate, and loss severity rate from an independent third party, or generate the assumptions internally.

The Association has not recognized any credit losses as any impairments were deemed temporary and resulted from non-credit related factors. The Association has the ability and intent to hold these temporarily impaired investments until a recovery of unrealized losses occurs, which may be at maturity, and at this time expects to collect the full principal amount and interest due on these securities, especially after considering credit enhancements.

### *Investments in other Farm Credit Institutions*

The Association is required to maintain ownership in the Bank of Class B and Class C stock as determined by the Bank. The Bank may require additional capital contributions to maintain its capital requirements. The Association owns 7.08 percent of the issued stock of the Bank as of September 30, 2014 net of any reciprocal investment. As of that date, the Bank's assets totaled \$29.0 billion and shareholders' equity totaled \$2.4 billion. The Bank's earnings were \$282 million for the first nine months of 2014. In addition, the Association has an investment of \$3,900 related to other Farm Credit institutions.

### **Note 4 — Debt**

#### *Notes Payable to AgFirst Farm Credit Bank*

The Association's indebtedness to AgFirst Farm Credit Bank (AgFirst or the Bank) represents borrowings by the Association to fund its loan portfolio. This indebtedness is collateralized by a pledge of substantially all of the Association's assets. The contractual terms of the revolving line of credit are contained in the General Financing Agreement (GFA). The GFA also defines Association performance criteria for borrowing from the Bank, which includes borrowing base margin, earnings and capital covenants, among others.

### **Note 5 — Members' Equity**

#### *Accumulated Other Comprehensive Income (AOCI)*

The following tables present activity related to AOCI for the periods presented:

	<b>Changes in Accumulated Other Comprehensive income by Component (a)</b>			
	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
<b>Employee Benefit Plans:</b>				
Balance at beginning of period	\$ (213)	\$ (563)	\$ (224)	\$ (607)
Other comprehensive income before reclassifications	—	—	—	—
Amounts reclassified from AOCI	5	22	16	66
Net current period other comprehensive income	5	22	16	66
Balance at end of period	\$ (208)	\$ (541)	\$ (208)	\$ (541)

	<b>Reclassifications Out of Accumulated Other Comprehensive Income (b)</b>				
	<b>For the three months ended</b>		<b>For the nine months ended</b>		<b>Income Statement Line Item</b>
	<b>September 30,</b>		<b>September 30,</b>		
<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>		
<b>Defined Benefit Pension Plans:</b>					
Periodic pension costs	\$ (5)	\$ (22)	\$ (16)	\$ (66)	See Note 7.
Net amounts reclassified	\$ (5)	\$ (22)	\$ (16)	\$ (66)	

(a) Amounts in parentheses indicate debits to AOCI.

(b) Amounts in parentheses indicate debits to profit/loss.



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## Note 6 — Fair Value Measurement

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability.

Accounting guidance establishes a hierarchy for disclosure of fair value measurements to maximize the use of observable inputs, that is, inputs that reflect the assumptions market participants would use in pricing an asset or liability based on market data obtained from sources independent of the reporting entity. The hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the hierarchy tiers is based upon the lowest level of input that is significant to the fair value measurement.

Estimating the fair value of the Association's investment in the Bank and Other Farm Credit Institutions is not practicable because the stock is not traded. The net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying Consolidated Balance Sheets.

The classifications within the fair value hierarchy are as follows:

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.

Level 2 inputs include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability.

Level 3 inputs are unobservable and supported by little or no market activity. Valuation is determined using pricing models, discounted cash flow methodologies, or similar techniques, and could include significant management judgment or estimation. Level 3 assets and liabilities also could include instruments whose price has been adjusted based on dealer quoted pricing that is different than the third-party valuation or internal model pricing.

For a complete discussion of the inputs and other assumptions considered in assigning various assets and liabilities to the fair value hierarchy levels, see the latest Annual Report to Shareholders.

There were no Level 3 assets and liabilities measured at fair value on a recurring basis for the periods presented. The Association had no transfers of assets or liabilities into or out of Level 1 or Level 2 during the periods presented.

### **SENSITIVITY TO CHANGES IN SIGNIFICANT UNOBSERVABLE INPUTS**

Discounted cash flow or similar modeling techniques are generally used to determine the recurring fair value

measurements for Level 3 assets and liabilities. Use of these techniques requires determination of relevant inputs and assumptions, some of which represent significant unobservable inputs as indicated in the tables that follow. Accordingly, changes in these unobservable inputs may have a significant impact on fair value.

Certain of these unobservable inputs will (in isolation) have a directionally consistent impact on the fair value of the instrument for a given change in that input. Alternatively, the fair value of the instrument may move in an opposite direction for a given change in another input. Where multiple inputs are used within the valuation technique of an asset or liability, a change in one input in a certain direction may be offset by an opposite change in another input having a potentially muted impact to the overall fair value of that particular instrument. Additionally, a change in one unobservable input may result in a change to another unobservable input (that is, changes in certain inputs are interrelated with one another), which may counteract or magnify the fair value impact.

### **Investment Securities**

The fair values of predominantly all level 3 investment securities have consistent inputs, valuation techniques and correlation to changes in underlying inputs. The models used to determine fair value for these instruments use certain significant unobservable inputs within a discounted cash flow or market comparable pricing valuation technique. Such inputs generally include discount rate components including risk premiums, prepayment estimates, default estimates and loss severities.

These level 3 assets would decrease (increase) in value based upon an increase (decrease) in discount rates, defaults, or loss severities. Conversely, the fair value of these assets would generally increase (decrease) in value if the prepayment input were to increase (decrease).

### **Inputs to Valuation Techniques**

Management determines the Association's valuation policies and procedures. The Bank performs the majority of the Association's valuations, and its valuation processes are calibrated annually by an independent consultant. The fair value measurements are analyzed on a quarterly basis. For other valuations, documentation is obtained for third party information, such as pricing, and periodically evaluated alongside internal information and pricing that is available.

Quoted market prices are generally not available for the instruments presented below. Accordingly fair values are based on 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**

	Fair Value	Valuation Technique(s)	Unobservable Input	Range
Impaired loans and other property owned	\$ 26,335	Appraisal	Income and expense Comparable sales Replacement cost Comparability adjustments	* * * *

\* Ranges for this type of input are not useful because each collateral property is unique.

**Information about Other Financial Instrument Fair Value Measurements**

	Valuation Technique(s)	Input
Cash	Carrying Value	Par/Principal and appropriate interest yield
Loans	Discounted cash flow	Prepayment forecasts Probability of default Loss severity
Investment securities, held-to-maturity	Discounted cash flow	Risk adjusted discount rate
Notes payable to AgFirst Farm Credit Bank	Discounted cash flow	Prepayment forecasts Probability of default Loss severity

The following tables present the carrying amounts and fair values of assets and liabilities that are measured at fair value on a recurring and nonrecurring basis, as well as those financial instruments not measured at fair value, for each of the hierarchy levels at the period ended:

	At or for the Nine Months Ended September 30, 2014					Fair Value Effects On Earnings
	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value	
<b>Recurring Measurements</b>						
<b>Assets:</b>						
Assets held in Trust funds	\$ 1,255	\$ 1,255	\$ –	\$ –	\$ 1,255	
Recurring Assets	\$ 1,255	\$ 1,255	\$ –	\$ –	\$ 1,255	
<b>Liabilities:</b>						
Recurring Liabilities	\$ –	\$ –	\$ –	\$ –	\$ –	
<b>Nonrecurring Measurements</b>						
<b>Assets:</b>						
Impaired loans	\$ 22,205	\$ –	\$ –	\$ 22,205	\$ 22,205	\$ 540
Other property owned	3,869	–	–	4,130	4,130	(140)
Nonrecurring Assets	\$ 26,074	\$ –	\$ –	\$ 26,335	\$ 26,335	\$ 400
<b>Other Financial Instruments</b>						
<b>Assets:</b>						
Cash	\$ 1,923	\$ 1,923	\$ –	\$ –	\$ 1,923	
Investment securities, held-to-maturity	11,984	–	–	11,985	11,985	
Loans	1,489,817	–	–	1,497,865	1,497,865	
Other Financial Assets	\$ 1,503,724	\$ 1,923	\$ –	\$ 1,509,850	\$ 1,511,773	
<b>Liabilities:</b>						
Notes payable to AgFirst Farm Credit Bank	\$ 1,280,526	\$ –	\$ –	\$ 1,270,443	\$ 1,270,443	
	\$ 1,280,526	\$ –	\$ –	\$ 1,270,443	\$ 1,270,443	

**At or for the Year ended December 31, 2013**

	<b>Total Carrying Amount</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total Fair Value</b>	<b>Fair Value Effects On Earnings</b>
<b>Recurring Measurements</b>						
<b>Assets:</b>						
Assets held in Trust funds	\$ 1,003	\$ 1,003	\$ –	\$ –	\$ 1,003	
Recurring Assets	\$ 1,003	\$ 1,003	\$ –	\$ –	\$ 1,003	
<b>Liabilities:</b>						
Recurring Liabilities	\$ –	\$ –	\$ –	\$ –	\$ –	
<b>Nonrecurring Measurements</b>						
<b>Assets:</b>						
Impaired loans	\$ 33,705	\$ –	\$ –	\$ 33,705	\$ 33,705	\$ (276)
Other property owned	1,731	–	–	1,920	1,920	(1,647)
Nonrecurring Assets	\$ 35,436	\$ –	\$ –	\$ 35,625	\$ 35,625	\$ (1,923)
<b>Other Financial Instruments</b>						
<b>Assets:</b>						
Cash	\$ 7,061	\$ 7,061	\$ –	\$ –	\$ 7,061	
Investment securities, held-to-maturity	7,193	–	–	7,132	7,132	
Loans	1,451,735	–	–	1,452,649	1,452,649	
Other Financial Assets	\$ 1,465,989	\$ 7,061	\$ –	\$ 1,459,781	\$ 1,466,842	
<b>Liabilities:</b>						
Notes payable to AgFirst Farm Credit Bank	\$ 1,271,311	\$ –	\$ –	\$ 1,257,195	\$ 1,257,195	
Other Financial Liabilities	\$ 1,271,311	\$ –	\$ –	\$ 1,257,195	\$ 1,257,195	

**Note 7 — Employee Benefit Plans**

The following is a table of retirement and other postretirement benefit expenses for the Association:

	For the three months ended September 30,		For the nine months ended September 30,	
	2014	2013	2014	2013
Pension	\$ 1,534	\$ 1,577	\$ 4,603	\$ 4,731
401(k)	137	129	463	416
Other postretirement benefits	265	256	795	767
Total	\$ 1,936	\$ 1,962	\$ 5,861	\$ 5,914

The following is a table of retirement and other postretirement benefit contributions for the Association:

	Actual YTD Through 9/30/14	Projected Contributions For Remainder of 2014	Projected Total Contributions 2014
Pension	\$ 64	\$ 4,691	\$ 4,755
Other postretirement benefits	581	232	813
Total	\$ 645	\$ 4,923	\$ 5,568

Contributions in the above table include allocated estimates of funding for multi-employer plans in which the Association participates. These amounts may change when a total funding amount and allocation is determined by the respective Plan's Sponsor Committee. Also, market conditions could impact discount rates and return on plan assets which could change contributions necessary before the next plan measurement date of December 31, 2014.

Further details regarding employee benefit plans are contained in the 2013 Annual Report to Shareholders.

In May 2014, the AgFirst Plan Sponsor Committee voted to approve changes to certain employee benefit plans as follows:

- (1) On January 1, 2015, the AgFirst Farm Credit Cash Balance Retirement Plan (Cash Balance Plan) will be frozen, employer contributions will cease, and the Cash Balance Plan will be closed to new entrants.
- (2) In lieu of participation in and contributions to the Cash Balance Plan, additional employer contributions will be made to the Farm Credit Benefits Alliance 401(k) Plan.

The above changes are expected to become officially executed Plan amendments in November 2014. The Cash Balance Plan will not be terminated on January 1, 2015, but is expected to be terminated in 2015 or 2016 once all necessary actions have been performed and approvals obtained. Participants in the Cash Balance Plan will continue to receive employer contributions to their hypothetical cash balance accounts through the end of 2014, at which time contributions will cease. Participants will continue receiving interest credits on the same basis as currently being provided until the Cash Balance Plan is terminated. Participants who are not already fully vested in their accounts will automatically become 100 percent vested on December 31, 2014. Following the termination of the Cash Balance Plan, vested benefits will be distributed to participants.

Beginning on January 1, 2015, for participants in the Cash Balance Plan and eligible employees hired on or after this date, an additional employer contribution will be made to the Farm Credit Benefits Alliance 401(k) Plan equal to 3 percent of the participants' eligible compensation.

Accounting related to the curtailment of future benefit service under the Cash Balance Plan, as prescribed in ASC 715 "Compensation – Retirement Benefits", is expected to be triggered in November 2014 when the plan amendments are

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officially executed. This accounting is not expected to have a material impact on the Association's financial condition or results of operations.

#### **Note 8 — Commitments and Contingent Liabilities**

From time to time, legal actions are pending against the Association in which claims for money damages are asserted. On at least a quarterly basis, the Association assesses its liabilities and contingencies in connection with outstanding legal proceedings utilizing the latest information available. While the outcome of legal proceedings is inherently uncertain, on the basis of information presently available, management, after consultation with legal counsel, is of the opinion that the ultimate liability, if any, from these actions, would not be material in relation to the financial position of the Association. Because it is not probable that the Association will incur a loss or the loss is not estimable, no liability has been recorded for any claims that may be pending.

#### **Note 9 — Regulatory Enforcement Matters**

On October 11, 2012, the Board entered into a Supervisory Agreement with the FCA. The Supervisory Agreement requires the Association to take corrective actions with respect to certain areas of its operations including standards of conduct, acquired property, borrower rights and board policies. On September 24, 2014, the Association was notified that the Supervisory Agreement was terminated by the FCA board on September 16, 2014. Pursuant to the termination, all corrective actions required under the Supervisory Agreement are now complete and the Board resolved the underlying conditions.

#### **Note 10 — Subsequent Events**

The Association has evaluated subsequent events and has determined, except as described below, there are none requiring disclosure through November 7, 2014, which is the date the financial statements were issued.

On October 20, 2014, AgFirst's Board of Directors declared a special patronage distribution to be paid on January 1, 2015. The Association will receive approximately \$15,046 which will be recorded in October 2014 as patronage refunds from other Farm Credit institutions.