AgriBank

# District Connected

AgriBank, FCB and Affiliated Associations
Quarterly Report- First Quarter 2014
March 31, 2014

Copies of quarterly and annual reports are available upon request by contacting AgriBank, FCB, 30 E. 7th Street, Suite 1600, St. Paul, MN 55101 or by calling (651) 282-8800. Reports are also available at www.agribank.com.

# Management's Discussion and Analysis

**AgriBank, FCB and Affiliated Associations**

The following discussion is a review of the combined financial position and results of operations of AgriBank, FCB (AgriBank) and Affiliated Associations which are part of the Farm Credit System (the System). This information should be read in conjunction with the accompanying combined financial statements, the notes to the combined financial statements and the 2013 annual report.

We serve customers in states across America's heartland. AgriBank provides funding to, and is primarily owned by its affiliated Associations. AgriBank and its affiliated Associations are collectively referred to as the District. The affiliated Associations are chartered to serve customers in substantially all of Arkansas, Illinois, Indiana, Iowa, Kentucky, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, Tennessee, Wisconsin and Wyoming. The affiliated Associations provide credit and financial services to farmers, ranchers, rural residents and agribusinesses.

## Forward-Looking Information

Any forward-looking statements in this quarterly report are based on current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from expectations due to a number of risks and uncertainties. More information about these risks and uncertainties is contained in our 2013 annual report. We undertake no duty to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

## Results of Operations

District net income for the three months ended March 31, 2014 was $435.8 million, a 1.8 percent increase, compared to $427.9 million for the same period in 2013. The return on average assets was 1.8 percent for the three months ended March 31, 2014 and 2013.

**Changes in Significant Components of Net Income**
(in millions)

| For the three months ended March 31, | 2014 | 2013 | Increase (Decrease) in Net Income |
|---|---|---|---|
| Net interest income | **$638.3** | $606.8 | $31.5 |
| Reversal of (provision for) credit losses | **6.0** | (1.8) | 7.8 |
| Non-interest income | **68.3** | 84.6 | (16.3) |
| Salaries and employee benefits | **(162.5)** | (151.8) | (10.7) |
| Other operating expenses | **(75.1)** | (71.6) | (3.5) |
| Farm Credit System insurance expense | **(21.8)** | (17.0) | (4.8) |
| Loss on debt extinguishment | **--** | (4.0) | 4.0 |
| Net impairment losses recognized in earnings | **(0.2)** | (0.4) | 0.2 |
| Provision for income taxes | **(17.2)** | (16.9) | (0.3) |
| Net income | **$435.8** | $427.9 | $7.9 |

Net interest income for the three months ended March 31, 2014 increased $31.5 million, or 5.2 percent, compared to the same period in 2013. Net interest income continues to be strong and primarily reflects loan growth. This was partially offset by the reduction in the positive impact on net interest income of our funding actions. As expected, the positive impact on net interest income from callable debt replacement activity, along with the pace of refinancing activity by customers, has diminished due to rising intermediate rates.

In general, operating loans, which are typically variable rate, have the highest spreads. Longer term fixed rate loans generally carry narrower spreads. As the product mix between operating and real estate or intermediate term loans changes, the interest rate spreads we earn may change accordingly.

**Changes in Net Interest Income**

(in millions)

| **For the three months ended March 31,** | **2014 vs. 2013** | | |
|---|---|---|---|
| Increase (decrease) due to: | **Volume** | **Rate** | **Total** |
| Interest income: | | | |
| Loans | **$62.5** | **$(14.9)** | **$47.6** |
| Investments | **0.9** | **(6.7)** | **(5.8)** |
| Other earning assets | **(1.3)** | **0.5** | **(0.8)** |
| Total interest income | **62.1** | **(21.1)** | **41.0** |
| Interest expense: | | | |
| Systemwide debt securities and other | **(12.8)** | **3.3** | **(9.5)** |
| Net change in net interest income | **$49.3** | **$(17.8)** | **$31.5** |

Information regarding the year-to-date average daily balances (ADBs) and annualized average rates earned and paid on our portfolio follows:

(in millions)

| **For the three months ended March 31,** | **2014** | | | 2013 | | |
|---|---|---|---|---|---|---|
| | **ADB** | **Rate** | **NII** | ADB | Rate | NII |
| Interest earning assets: | | | | | | |
| Accrual loans | **$81,096.3** | **4.03%** | **$816.6** | $74,824.0 | 4.12% | $770.8 |
| Nonaccrual loans | **618.2** | **5.58%** | **8.6** | 715.5 | 3.67% | 6.6 |
| Investment securities and federal funds | **15,316.3** | **0.78%** | **30.0** | 14,931.2 | 0.96% | 35.8 |
| Other earning assets | **9.9** | **9.03%** | **0.2** | 82.2 | 5.25% | 1.1 |
| Total | **97,040.7** | **3.53%** | **855.4** | 90,552.9 | 3.60% | 814.3 |
| Interest bearing liabilities | **81,273.7** | **1.08%** | **217.1** | 76,653.9 | 1.08% | 207.5 |
| Interest rate spread | **$15,767.0** | **2.45%** | | $13,899.0 | 2.52% | |
| Impact of equity financing | | **0.18%** | | | 0.16% | |
| Net interest margin | | **2.63%** | | | 2.68% | |
| Net interest income | | | **$638.3** | | | $606.8 |

Net interest margin decreased five basis points over the same period last year primarily due to a six basis point decline in interest rate spread, partially offset by a one point increase in the impact of equity financing. The decline was the result of decreased interest rate spreads, primarily related to competitive pressures, a reduction in our production and intermediate term volume which generally carries a higher spread and a reduction in the positive impact from our funding actions. Additionally, the decrease in investment securities interest rates earned was primarily related to $2.0 million of non-recurring interest income recognized on two previously impaired securities that were paid off in the first quarter of 2013. Equity financing represents the benefit of non-interest rate bearing funding, which slightly increased due to an increase in equity primarily related to retained net income, partially offset by patronage paid to borrowers. Changes in loans are further discussed in the Loan Portfolio section of this report.

The District's reversal of provision for credit losses for the three months ended March 31, 2014 was $6.0 million, compared to provision for credit losses of $1.8 million for the same period in 2013. The amounts reflect the change in the estimated losses in the loan portfolio during the periods. There was $3.1 million of reversal of provision for loan losses primarily due to reversals of industry reserves for the beef feedlot industry at one affiliated Association, as well as generally improved credit quality at certain affiliated Associations. This was partially offset by the replenishment of reserves on loans evaluated collectively. Included in the reversal of provision for credit losses were reversals of provision expense for unfunded commitments and unfunded letters of credit of $2.3 million and $0.6 million, respectively. The reserves for unfunded commitments and letters of credit are recorded as liabilities on the Combined Statements of Condition. Comparatively, the provision for credit losses recorded for the same period in 2013 was primarily due to a slight deterioration in collateral values on some loans that were individually evaluated as well as the replenishment of reserves on loans evaluated collectively.

The decrease in non-interest income was primarily due to a decrease in loan prepayment and fee income that resulted from one large prepayment of $14.4 million received in 2013.

The net increase in salaries and employee benefits resulted from the following:

- A $12.3 million increase in salary expense, primarily due to annual merit increases as well as an increase in head count of 187 full-time equivalents (3.2 percent) from March 31, 2013 to March 31, 2014.
- A $1.6 million decrease in benefits expense driven primarily by: i) a decrease in pension expense of $4.3 million, reflecting the impact of the increase in the discount rate used for expense purposes, ii) a $1.0 million increase in medical and dental insurance expenses due to the rising cost of medical care and iii) an increase in defined contribution plan expense of $0.9 million, reflecting the increase in staffing (all new employees are in this plan).

Farm Credit System insurance expense increased by $4.8 million reflecting the Farm Credit System Insurance Corporation premium rate of 12 basis points for the three months ended March 31, 2014, compared to 10 basis points for the same period in 2013.

The loss on debt extinguishment of $4.0 million related to AgriBank's transfer of $20.0 million of debt at fair value to another Farm Credit System bank to restructure liabilities in March 2013. This transaction was for the purpose of asset/liability rebalancing due to a large prepayment of a loan. The loss was more than offset by the receipt of fee income of $14.4 million on the loan prepayment. There was no debt extinguishment in 2014.

## Loan Portfolio

**Components of Loans**

| (in millions) | **March 31, 2014** | December 31, 2013 |
|---|---|---|
| Accrual loans: | | |
| Real estate mortgage | **$47,320.7** | $47,314.7 |
| Production and intermediate term | **20,257.7** | 21,959.6 |
| Agribusiness | **7,831.5** | 6,975.2 |
| Rural residential real estate | **2,579.4** | 2,583.1 |
| Other | **3,251.0** | 3,311.3 |
| Nonaccrual loans | **632.0** | 626.4 |
| Total loans | **$81,872.3** | $82,770.3 |

District loans totaled $81.9 billion at March 31, 2014, a $0.9 billion, or 1.1 percent, decrease from December 31, 2013. The decrease in total loans was primarily due to seasonal paydowns on operating lines of credit (primarily production and intermediate term sector) as many borrowers sold crops to paydown operating lines, partially offset by operating line draws to cover margin calls related to the increase in pork prices. The decrease in total loans was also partially offset by an increase in the agribusiness sector primarily due to continued activity in large multiple lender credits within cooperatives and processing and marketing loans.

**Components of Risk Assets**

| (in millions) | **March 31, 2014** | December 31, 2013 |
|---|---|---|
| Nonaccrual loans | **$632.1** | $626.4 |
| Accruing restructured loans | **50.9** | 53.3 |
| Accruing loans 90 days or more past due | **24.1** | 2.2 |
| Total risk loans | **707.1** | 681.9 |
| Other property owned | **33.3** | 33.4 |
| Total risk assets | **$740.4** | $715.3 |
| Risk loans as a % of total loans | **0.86%** | 0.82% |
| Delinquencies as a % of total loans | **0.53%** | 0.44% |

Note: Accruing loans include accrued interest receivable.

Our risk assets have increased slightly from December 31, 2013, however, they remain at acceptable levels. Total risk loans as a percentage of total loans remains within our established risk management guidelines.

Credit quality on loans remained at acceptable levels with 97.8 percent of our portfolio in the acceptable and special mention categories at March 31, 2014, compared to 98.0 percent at December 31, 2013. Adversely classified loans were 2.2 percent at March 31, 2014, compared to 2.0 percent at December 31, 2013.

Nonaccrual loans represented 0.8 percent of total loans at March 31, 2014 and December 31, 2013. At March 31, 2014, 68.4 percent of nonaccrual loans were current as to principal and interest, compared to 67.0 percent at December 31, 2013.

Our accounting policy generally requires loans past due 90 days to be transferred into nonaccrual status. Based on management's analysis, all accruing loans 90 days or more past due were adequately secured and in the process of collection and, as such, were eligible to remain in accruing status.

**Allowance Coverage Ratios**

| | **March 31, 2014** | December 31, 2013 |
|---|---|---|
| Allowance as a % of: | | |
| Loans | **0.28%** | 0.29% |
| Nonaccrual loans | **36.49%** | 37.73% |
| Total risk loans | **32.62%** | 34.66% |
| Net charge-offs (recoveries) as a % of average loans | **0.00%** | (0.00%) |
| Adverse loans as a % of risk funds* | **10.56%** | 9.96% |

*Risk funds includes total capital and allowance for loan losses.

The District's allowance for loan losses is an estimate of losses on loans in the AgriBank and affiliated Association portfolios as of the financial statement date. AgriBank and affiliated Associations' management determine the appropriate allowance levels based on a periodic evaluation of factors such as loan loss history, estimated probability of default, estimated loss severity, portfolio quality and current economic and environmental conditions. During the three months ended March 31, 2014, we decreased our allowance for loan losses by $5.7 million. The decline in the allowance was primarily driven by reversals of provision for loan losses of $3.1 million (not including reversals of provision for unfunded commitments and unfunded letters of credit of $2.3 million and $0.6 million, respectively) and net charge-offs of $2.6 million. The amounts reflect the change in the estimated losses in the loan portfolio during the periods. AgriBank and affiliated Associations' management consider the allowance for loan losses at March 31, 2014 to be reasonable in relation to the risk in the loan portfolios.

## Agricultural Conditions

The U.S. Department of Agriculture's initial projection of 2014 net farm income indicates a decrease, compared to 2013, of 26.6 percent to $95.8 billion. The 2014 projection is the lowest level since 2010, but $8 billion above the previous 10-year average and still one of the highest levels of net farm income on record. The forecasted decrease is largely driven by expected lower crop revenues due to lower crop prices.

The passage of the Agricultural Act of 2014 (the Act) is generally positive, as it continues the economic safety net for agriculture producers. The Act replaces a system of annual direct payments with a set of programs that only trigger payments in years with low prices and/or low farm revenue. In addition, the Act strengthens the Federal Crop Insurance program by providing a county-level revenue product that covers part of a producer's deductible. It also provides dairy producers with a new program that makes payments when margins over feed costs are low.

*Land Values*

The AgriBank District continues to monitor agricultural land values. We conduct an annual Benchmark Survey, completed by licensed real estate appraisers, of a sample of benchmark farms selected to represent the lending footprint of affiliated Associations throughout the District. The District will complete its annual survey as of June 30, 2104 which will be released during the third quarter of 2014.

Qualitative surveys of lending officers compiled by the Federal Reserve Banks of Chicago, Kansas City, Minneapolis and St. Louis as of the end of the fourth quarter 2013 indicated increasing farmland values. The Federal Reserve Banks surveys cited year-over-year increases in the average value of non-irrigated cropland of 4.4 percent to 12.2 percent, but respondents indicated that growth in farmland values appears to be slowing.

Declining land values are a potential lending risk following periods of sustained, rapid land value increases. Nominal and real (inflation-adjusted) agricultural land values have increased in proportions greater than other asset classes such as stocks and urban residential and commercial land during the last decade, but District agricultural land values have, for the most part, escaped the valuation declines that other assets suffered during the 2008 financial crisis and subsequent recession. This is largely because the agricultural sector, particularly crop farming, has remained profitable throughout the economic crisis period, and demand for agricultural land has remained very strong. Lower commodity prices for corn, soybeans and other feed grains, however, are expected to adversely affect land values.

AgriBank District credit risk policies focus on loan repayment capacity in addition to conservative loan-to-value levels on the collateral that secures loans. Although FCA regulations allow real estate mortgage loans of up to 85 percent of appraised value, our underwriting standards generally limit lending to no more than 65 percent at origination. Due to very strong land values in much of our District, many affiliated Associations have implemented risk management practices that incorporate loan-to-appraised value thresholds below the 65 percent level. In addition, many District lenders impose lending caps per acre based on the land’s sustainable income-producing capacity. While underwriting exceptions on loan-to-appraised-value are sometimes granted, in such cases loans are typically structured with shorter amortization schedules and/or additional principal payments in the early years to reduce risk.

## Funding, Liquidity and Shareholders’ Equity

AgriBank is responsible for meeting the District's funding, liquidity and asset/liability management needs. Access to the unsecured debt capital markets remains its primary source of liquidity. The System continues to have reliable access to the debt capital markets to support its mission of providing credit to farmers, ranchers and other eligible borrowers. During the three months ended March 31, 2014, investor demand for Systemwide Debt Securities has remained favorable.

AgriBank also maintains liquidity through its investment portfolio. AgriBank’s liquidity policy and FCA regulations require maintaining a minimum of 90 days of liquidity on a continuous basis. The days of liquidity measurement refers to the number of days that maturing debt is covered by liquid investments. AgriBank currently operates with a liquidity operating target of at least 120 days. As of March 31, 2014, AgriBank had sufficient liquidity to fund all debt maturing within 162 days.

The composition of the liquidity investment portfolio is structured to provide at least 15 days of liquidity coverage from cash, overnight investments and U.S. Treasury securities less than three years in maturity. Other short term money market investments, as well as government and agency mortgage-backed securities are positioned to cover regulatory requirements for 30- and 90-day intervals. Additionally, a supplemental liquidity buffer provides days coverage in excess of 90 days from money market instruments greater than 90 days in maturity, asset-backed securities and non-agency mortgage-backed securities. At March 31, 2014 AgriBank held qualifying assets in excess of each incremental level to meet the liquidity coverage intervals.

Total shareholders' equity at March 31, 2014 was $16.9 billion, a $409.0 million increase from December 31, 2013. Shareholders' equity increased primarily due to net income for the period, partially offset by earnings reserved for patronage distributions and preferred stock dividends.

At March 31, 2014, AgriBank and each affiliated Association exceeded the regulatory minimum capital ratios, which are further discussed in Note 4 to the combined financial statements.

## Certification

The undersigned have reviewed the March 31, 2014 quarterly report of AgriBank, FCB and Affiliated Associations which has been prepared under the oversight of the AgriBank Audit Committee 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.

Douglas A. Felton

Douglas Felton
Chairman of the Board
AgriBank, FCB
May 9, 2014

L. William York

L. William York
Chief Executive Officer
AgriBank, FCB
May 9, 2014

Brian J. O'Keane

Brian J. O'Keane
Executive Vice President, Banking and Finance and Chief Financial Officer
AgriBank, FCB
May 9, 2014

# Combined Statements of Condition

## AgriBank, FCB and Affiliated Associations

| *(Dollars in thousands)*<br>*(unaudited)* | **March 31, 2014** | December 31, 2013 |
|---|---|---|
| **Assets** | | |
| Loans | **$81,872,286** | $82,770,309 |
| Allowance for loan losses | **230,611** | 236,312 |
| Net loans | **81,641,675** | 82,533,997 |
| Investment securities - AgriBank, FCB | **11,918,169** | 11,555,272 |
| Investment securities - Affiliated Associations | **1,907,222** | 1,968,260 |
| Other earning assets | **--** | 74,048 |
| Cash | **781,911** | 1,162,636 |
| Federal funds | **1,461,171** | 911,644 |
| Accrued interest receivable | **719,396** | 824,289 |
| Premises and equipment, net | **413,301** | 408,690 |
| Deferred tax assets, net | **15,846** | 15,023 |
| Assets held for lease, net | **552,940** | 608,848 |
| Derivative assets | **49,236** | 74,706 |
| Other property owned | **33,309** | 33,379 |
| Debt issuance costs | **28,603** | 35,249 |
| Cash collateral pledged to counterparties | **10,422** | 4,254 |
| Other assets | **135,398** | 119,162 |
| Total assets | **$99,668,599** | $100,329,457 |
| **Liabilities** | | |
| Bonds and notes | **$81,079,626** | $81,889,124 |
| Subordinated notes | **600,000** | 600,000 |
| Accrued interest payable | **211,617** | 197,840 |
| Derivative liabilities | **7,207** | 181 |
| Deferred tax liabilities, net | **139,749** | 159,586 |
| Accounts payable | **96,643** | 155,131 |
| Patronage payable | **23,397** | 239,364 |
| Post-employment liability | **314,710** | 310,576 |
| Cash collateral pledged by counterparties | **14,370** | 24,170 |
| Other liabilities | **258,280** | 239,463 |
| Total liabilities | **82,745,599** | 83,815,435 |
| Commitments and contingencies | **--** | -- |
| **Shareholders' equity** | | |
| Perpetual preferred stock | **350,000** | 350,000 |
| Protected borrower equities | **296** | 299 |
| Capital stock and participation certificates | **262,140** | 265,174 |
| Allocated surplus | **352,744** | 339,360 |
| Unallocated surplus | **16,231,076** | 15,838,875 |
| Accumulated other comprehensive loss | **(309,639)** | (314,550) |
| Noncontrolling interest | **36,383** | 34,864 |
| Total shareholders' equity | **16,923,000** | 16,514,022 |
| Total liabilities and shareholders' equity | **$99,668,599** | $100,329,457 |

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

# Combined Statements of Comprehensive Income

## AgriBank, FCB and Affiliated Associations

*(Dollars in thousands)*
*(Unaudited)*

| For the three months ended March 31, | 2014 | 2013 |
|---|---|---|
| **Interest income** | | |
| Loans | **$825,069** | $777,463 |
| Investment securities and other earning assets | **30,219** | 36,838 |
| Total interest income | **855,288** | 814,301 |
| **Interest expense** | **216,957** | 207,499 |
| Net interest income | **638,331** | 606,802 |
| **(Reversal of) provision for credit losses** | **(5,969)** | 1,822 |
| Net interest income after (reversal of) provision for credit losses | **644,300** | 604,980 |
| **Non-interest income** | | |
| Financially related services | **20,066** | 18,546 |
| Mineral income | **20,368** | 17,275 |
| Loan prepayment and fee income | **14,740** | 32,033 |
| Miscellaneous income and other gains, net | **13,117** | 16,696 |
| Total non-interest income | **68,291** | 84,550 |
| **Non-interest expense** | | |
| Salaries and employee benefits | **162,484** | 151,811 |
| Other operating expenses | **75,151** | 71,540 |
| Farm Credit System insurance expense | **21,811** | 16,955 |
| Loss on debt extinguishment | -- | 3,951 |
| Impairment losses recognized in earnings: | | |
| Total other-than-temporary impairment losses | **391** | 443 |
| Portion of loss recognized in other comprehensive income | **(241)** | - |
| Net impairment losses recognized in earnings | **150** | 443 |
| Total non-interest expense | **259,596** | 244,700 |
| Income before income taxes | **452,995** | 444,830 |
| Provision for income taxes | **17,169** | 16,884 |
| **Net income** | **$435,826** | $427,946 |
| **Other comprehensive income** | | |
| Investments available-for-sale: | | |
| Not-other-than-temporarily-impaired investments | **$12,095** | $(20,568) |
| Other-than-temporarily-impaired investments | **7,569** | 28,667 |
| Derivatives and hedging activity | **(21,531)** | 17,890 |
| Employee benefit plans activity | **6,778** | 10,348 |
| Total other comprehensive income | **4,911** | 36,337 |
| **Comprehensive income** | **$440,737** | $464,283 |

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

# Combined Statements of Changes in Shareholders' Equity

## AgriBank, FCB and Affiliated Associations

*(Dollars in thousands)*

*(Unaudited)*

| | Perpetual Preferred Stock | Protected Borrower Equities | Capital Stock and Participation Certificates | Allocated Surplus | Unallocated Surplus | Accumulated Other Comprehensive Income (Loss) | Noncontrolling Interest | Total |
|---|---|---|---|---|---|---|---|---|
| Balance at December 31, 2012 | $ -- | $305 | $261,818 | $302,789 | $14,324,793 | $(583,324) | $22,082 | $14,328,463 |
| Noncontrolling interest equity investment | | | | | | | 837 | 837 |
| Net income | | | | | 427,946 | | | 427,946 |
| Other comprehensive income | | | | | | 36,337 | | 36,337 |
| Patronage | | | | | (20,394) | | | (20,394) |
| Surplus allocated under nonqualified patronage program | | | | 13,613 | (13,613) | | | -- |
| Redemption of surplus allocated under nonqualified patronage program | | | | (305) | | | | (305) |
| Capital stock/participation certificates issued | | | 6,506 | | | | | 6,506 |
| Capital stock/participation certificates retired | | (2) | (6,616) | | | | | (6,618) |
| Balance at March 31, 2013 | $ -- | $303 | $261,708 | $316,097 | $14,718,732 | $(546,987) | $22,919 | $14,772,772 |
| | | | | | | | | |
| Balance at December 31, 2013 | $350,000 | $299 | $265,174 | $339,360 | $15,838,875 | $(314,550) | $34,864 | $16,514,022 |
| Noncontrolling interest equity investment | | | | | | | **1,519** | **1,519** |
| Net income | | | | | **435,826** | | | **435,826** |
| Other comprehensive income | | | | | | **4,911** | | **4,911** |
| Patronage | | | | | **(24,179)** | | | **(24,179)** |
| Surplus allocated under nonqualified patronage program | | | | **13,462** | **(13,462)** | | | **--** |
| Redemption of surplus allocated under nonqualified patronage program | | | | **(78)** | | | | **(78)** |
| Perpetual preferred stock dividends | | | | | **(5,984)** | | | **(5,984)** |
| Capital stock/participation certificates issued | | | **5,063** | | | | | **5,063** |
| Capital stock/participation certificates retired | | **(3)** | **(8,097)** | | | | | **(8,100)** |
| **Balance at March 31, 2014** | **$350,000** | **$296** | **$262,140** | **$352,744** | **$16,231,076** | **$(309,639)** | **$36,383** | **$16,923,000** |

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

# Combined Statements of Cash Flows

**AgriBank, FCB and Affiliated Associations**

*(Dollars in thousands)*
*(Unaudited)*

| For the three months ended March 31, | 2014 | 2013 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net income | **$435,826** | $427,946 |
| Depreciation on premises and equipment | **9,694** | 8,845 |
| Gain on sales of premises and equipment | **(209)** | (850) |
| Depreciation on assets held for lease | **24,531** | 22,579 |
| Gain on disposal of assets held for lease | **(513)** | (447) |
| (Reversal of) provision for credit losses | **(5,969)** | 1,822 |
| Gain on other property owned | **(129)** | (2,462) |
| Loss on debt extinguishment | **--** | 3,951 |
| (Gain) loss on derivative activities | **(142)** | 769 |
| Net impairment losses recognized in earnings | **150** | 443 |
| Amortization of premiums and discounts on loans and investments | **9,931** | 11,555 |
| Changes in operating assets and liabilities: | | |
| Accrued interest receivable | **104,893** | 80,681 |
| Other assets | **(10,413)** | 4,269 |
| Accrued interest payable | **13,777** | 12,897 |
| Other liabilities | **(48,164)** | (61,523) |
| Net cash provided by operating activities | **533,263** | 510,475 |
| **Cash flows from investing activities** | | |
| Decrease in loans, net | **887,051** | 1,495,845 |
| Proceeds from sales of other property owned | **8,080** | 7,218 |
| Decrease in other earning assets, net | **74,048** | 73,103 |
| Increase in investment securities, net | **(291,753)** | (488,210) |
| Sales (purchases) of assets held for lease, net | **31,890** | (12,285) |
| Purchases of premises and equipment, net | **(14,096)** | (14,153) |
| Net cash provided by investing activities | **695,220** | 1,061,518 |
| **Cash flows from financing activities** | | |
| Consolidated bonds and notes issued | **66,212,315** | 48,957,326 |
| Consolidated bonds and notes retired | **(67,010,706)** | (50,321,057) |
| Decrease in cash collateral pledged by counterparties | **(9,800)** | (670) |
| Increase in cash collateral pledged to counterparties | **(6,168)** | -- |
| Patronage distribution paid | **(238,943)** | (209,066) |
| Redemption of surplus allocated under nonqualified patronage program | **(78)** | (305) |
| Capital stock/participation certificates retired, net | **(3,458)** | (438) |
| Perpetual preferred stock dividends paid | **(4,362)** | -- |
| Increase in noncontrolling interest | **1,519** | 837 |
| Net cash used in financing activities | **(1,059,681)** | (1,573,373) |
| Net increase (decrease) in cash and federal funds | **168,802** | (1,380) |
| Cash and federal funds at beginning of period | **2,074,280** | 1,305,301 |
| Cash and federal funds at end of period | **$2,243,082** | $1,303,921 |
| **Supplemental schedule of non-cash activities** | | |
| Decrease in derivative assets | **$25,470** | $10,073 |
| Increase (decrease) in derivative liabilities | **7,026** | (6,322) |
| Decrease in bonds from derivative activity | **(11,107)** | (20,872) |
| (Decrease) increase in shareholders' equity from cash flow derivatives | **(21,531)** | 17,890 |
| Increase in shareholders' equity from investment securities | **19,664** | 8,099 |
| Increase in shareholders' equity from employee benefits | **6,778** | 10,348 |
| Loans transferred to other property owned | **8,460** | 15,235 |
| Preferred stock dividends accrued but not paid | **4,297** | -- |
| Patronage distributions payable to members | **23,397** | 20,536 |
| Financed sales of other property owned | **(579)** | (541) |
| Stock patronage issued | **421** | 326 |
| **Supplemental Information** | | |
| Interest paid | **$203,180** | $194,602 |
| Taxes paid (received) | **6,587** | (1,491) |

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

# Notes to Combined Financial Statements

**AgriBank, FCB and Affiliated Associations**

## NOTE 1

## Organization and Significant Accounting Policies

AgriBank, FCB (AgriBank) and Affiliated Associations comprise one of the Districts of the Farm Credit System (the System), a nationwide system of cooperatively owned Banks and Associations, established by Congress and subject to the provisions of the Farm Credit Act of 1971, as amended. The System specializes in providing financing and related services to qualified borrowers for agricultural and rural purposes. AgriBank and its affiliated Associations are collectively referred to as the District. At March 31, 2014, the District had 17 Agricultural Credit Association parent Associations, each of which has wholly owned Federal Land Credit Association and Production Credit Association subsidiaries. AgriBank serves as the intermediary between the financial markets and the retail lending activities of the District Associations.

A description of the organization and operation of the District, significant accounting policies followed, combined financial condition and results of operations as of and for the year ended December 31, 2013 are contained in the 2013 annual report. These unaudited first quarter 2014 combined financial statements should be read in conjunction with the annual report. The results for the three months ended March 31, 2014 are not necessarily indicative of the results to be expected for the year ended December 31, 2014.

The accompanying combined financial statements include the accounts of AgriBank combined with its 17 affiliated Associations and certain related entities. All significant transactions and balances between AgriBank and the Associations have been eliminated in combination. The accompanying combined financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform to accounting principles generally accepted in the United States of America and prevailing practices within the financial services industry.

**Recently Issued or Adopted Accounting Pronouncements**

In February 2013, the FASB issued guidance, *"Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date."* The guidance requires entities to measure these obligations as the sum of (1) the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and (2) any additional amount the reporting entity expects to pay on behalf of its co-obligors. In addition, this guidance requires entities to disclose the nature and amount of the obligation as well as other information about those obligations. The new guidance is effective for interim and annual periods beginning on January 1, 2014 and should be applied retrospectively to obligations with joint and several liabilities that exist at January 1, 2014. Earlier adoption is permitted. The adoption of this guidance did not impact the financial condition or results of operations.

## NOTE 2

# Loans and Allowance for Loan Losses

**Loans by Type**

| (in thousands) | March 31, 2014 | | December 31, 2013 | |
|---|---|---|---|---|
| | Amount | % | Amount | % |
| Real estate mortgage | $47,689,035 | 58.3% | $47,686,983 | 57.6% |
| Production and intermediate term | 20,421,496 | 24.9% | 22,118,298 | 26.7% |
| Agribusiness | 7,865,293 | 9.6% | 7,003,623 | 8.5% |
| Rural residential real estate | 2,621,146 | 3.2% | 2,626,429 | 3.2% |
| Other | 3,275,316 | 4.0% | 3,334,976 | 4.0% |
| Total loans | $81,872,286 | 100.0% | $82,770,309 | 100.0% |

The other category is primarily comprised of communication and energy-related loans, finance leases and loans originated under our Mission Related Investment authority as well as loans to AgriBank's other financial institutions.

### Participations

We may purchase or sell participation interests with other parties in order to diversify risk, manage loans and comply with Farm Credit Administration (FCA) regulations or affiliated Association General Financing Agreement limitations.

**Participations Purchased and Sold**

| (in thousands) | Other Farm Credit Institutions | | Non-Farm Credit Institutions | | Total | |
|---|---|---|---|---|---|---|
| As of March 31, 2014 | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold |
| Real estate mortgage | $865,911 | $225,744 | $2,235,413 | $37,038 | $3,101,324 | $262,782 |
| Production and intermediate term | 652,483 | 557,931 | 3,350,079 | 51,373 | 4,002,562 | 609,304 |
| Agribusiness | 3,910,667 | 839,398 | 674,850 | 196,657 | 4,585,517 | 1,036,055 |
| Rural residential real estate | 115 | 79 | 20,148 | 5,901 | 20,263 | 5,980 |
| Other | 1,855,413 | 119,404 | 8,765 | -- | 1,864,178 | 119,404 |
| Total loans | $7,284,589 | $1,742,556 | $6,289,255 | $290,969 | $13,573,844 | $2,033,525 |

| (in thousands) | Other Farm Credit Institutions | | Non-Farm Credit Institutions | | Total | |
|---|---|---|---|---|---|---|
| As of December 31, 2013 | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold |
| Real estate mortgage | $862,927 | $207,673 | $2,245,710 | $33,421 | $3,108,637 | $241,094 |
| Production and intermediate term | 530,562 | 588,758 | 3,663,849 | 51,918 | 4,194,411 | 640,676 |
| Agribusiness | 3,238,941 | 773,923 | 716,793 | 196,717 | 3,955,734 | 970,640 |
| Rural residential real estate | 115 | -- | 20,352 | 6,118 | 20,467 | 6,118 |
| Other | 1,713,359 | 113,357 | 10,640 | -- | 1,723,999 | 113,357 |
| Total loans | $6,345,904 | $1,683,711 | $6,657,344 | $288,174 | $13,003,248 | $1,971,885 |

Information in the preceding chart excludes loans entered into under our Mission Related Investment and leasing authorities.

## Portfolio Performance

One credit quality indicator we utilize is the FCA Uniform Loan Classification System that categorizes loans into five categories. The categories are defined as follows:

- Acceptable – assets are non-criticized assets representing the highest quality. They are expected to be fully collectible. This category is further differentiated into various probabilities of default;
- Other Assets Especially Mentioned (Special Mention) – are currently collectible but exhibit some potential weakness. These assets involve increased credit risk, but not to the point of justifying a substandard classification;
- Substandard – assets exhibit some serious weakness in repayment capacity, equity and/or collateral pledged on the loan;
- Doubtful – assets exhibit similar weaknesses as substandard assets. However, doubtful assets have additional weaknesses in existing factors, conditions and values that make collection in full highly questionable; and
- Loss – assets are considered uncollectible.

**Credit Quality of Loans**

| (in thousands)<br>**As of March 31, 2014** | **Acceptable** | | **Special mention** | | **Substandard/Doubtful** | | **Total** | |
|---|---|---|---|---|---|---|---|---|
| Real estate mortgage | **$46,636,855** | **96.9%** | **$572,603** | **1.2%** | **$902,912** | **1.9%** | **$48,112,370** | **100.0%** |
| Production and intermediate term | **19,657,249** | **95.2%** | **465,824** | **2.3%** | **513,105** | **2.5%** | **20,636,178** | **100.0%** |
| Agribusiness | **7,431,042** | **94.1%** | **234,049** | **3.0%** | **232,690** | **2.9%** | **7,897,781** | **100.0%** |
| Rural residential real estate | **2,525,145** | **95.9%** | **19,202** | **0.7%** | **89,325** | **3.4%** | **2,633,672** | **100.0%** |
| Other | **3,231,648** | **98.5%** | **9,132** | **0.3%** | **40,804** | **1.2%** | **3,281,584** | **100.0%** |
| Total loans | **$79,481,939** | **96.2%** | **$1,300,810** | **1.6%** | **$1,778,836** | **2.2%** | **$82,561,585** | **100.0%** |

| (in thousands)<br>As of December 31, 2013 | Acceptable | | Special mention | | Substandard/Doubtful | | Total | |
|---|---|---|---|---|---|---|---|---|
| Real estate mortgage | $46,791,884 | 97.2% | $503,036 | 1.0% | $873,388 | 1.8% | $48,168,308 | 100.0% |
| Production and intermediate term | 21,533,626 | 96.2% | 417,099 | 1.9% | 428,706 | 1.9% | 22,379,431 | 100.0% |
| Agribusiness | 6,597,908 | 93.8% | 203,128 | 2.9% | 230,737 | 3.3% | 7,031,773 | 100.0% |
| Rural residential real estate | 2,528,998 | 95.8% | 24,352 | 0.9% | 86,432 | 3.3% | 2,639,782 | 100.0% |
| Other | 3,278,263 | 98.1% | 13,441 | 0.4% | 49,418 | 1.5% | 3,341,122 | 100.0% |
| Total loans | $80,730,679 | 96.6% | $1,161,056 | 1.4% | $1,668,681 | 2.0% | $83,560,416 | 100.0% |

Note: Accruing loans include accrued interest receivable.

**Aging Analysis of Loans**

| (in thousands) As of March 31, 2014 | 30-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or Less than 30 Days Past Due | Total Loans | Accruing loans 90 days or more past |
|---|---|---|---|---|---|---|
| Real estate mortgage | **$108,940** | **$96,079** | **$205,019** | **$47,907,351** | **$48,112,370** | **$10,055** |
| Production and intermediate term | **128,322** | **44,817** | **173,139** | **20,463,039** | **20,636,178** | **11,136** |
| Agribusiness | **1,227** | **7,672** | **8,899** | **7,888,882** | **7,897,781** | **--** |
| Rural residential real estate | **21,656** | **11,002** | **32,658** | **2,601,014** | **2,633,672** | **188** |
| Other | **11,943** | **4,918** | **16,861** | **3,264,723** | **3,281,584** | **2,725** |
| Total loans | **$272,088** | **$164,488** | **$436,576** | **$82,125,009** | **$82,561,585** | **$24,104** |

| (in thousands) As of December 31, 2013 | 30-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or Less than 30 Days Past Due | Total Loans | Accruing loans 90 days or more past |
|---|---|---|---|---|---|---|
| Real estate mortgage | $118,857 | $90,214 | $209,071 | $47,959,237 | $48,168,308 | $1,347 |
| Production and intermediate term | 58,982 | 35,955 | 94,937 | 22,284,494 | 22,379,431 | 605 |
| Agribusiness | 435 | 3,498 | 3,933 | 7,027,840 | 7,031,773 | 1 |
| Rural residential real estate | 26,555 | 10,508 | 37,063 | 2,602,719 | 2,639,782 | -- |
| Other | 11,195 | 10,908 | 22,103 | 3,319,019 | 3,341,122 | 269 |
| Total loans | $216,024 | $151,083 | $367,107 | $83,193,309 | $83,560,416 | $2,222 |

Note: Accruing loans include accrued interest receivable.

## Impaired Assets

Risk loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms.

**Risk Loan Information**

(in thousands)

| | **March 31, 2014** | December 31, 2013 |
|---|---|---|
| Nonaccrual loans: | | |
| Current as to principal and interest | **$432,248** | $419,473 |
| Past due | **199,790** | 206,931 |
| Total nonaccrual loans | **632,038** | 626,404 |
| Accruing restructured loans | **50,918** | 53,250 |
| Accruing loans 90 days or more past due | **24,104** | 2,222 |
| Total risk loans | **$707,060** | $681,876 |
| | | |
| Volume with specific reserves | **$167,086** | $158,783 |
| Volume without specific reserves | **539,974** | 523,093 |
| Total risk loans | **$707,060** | $681,876 |
| | | |
| Specific reserves | **$50,147** | $48,661 |
| | | |
| **For the three months ended March 31,** | **2014** | 2013 |
| | | |
| Income on accrual risk loans | **$864** | $816 |
| Income on nonaccrual loans | **8,626** | 6,558 |
| Total income on risk loans | **$9,490** | $7,374 |
| | | |
| Average risk loans | **$689,784** | $786,849 |

Note: Accruing loans include accrued interest receivable.

**Risk Assets by Loan Type**

| (in thousands) | **March 31, 2014** | December 31, 2013 |
|---|---|---|
| Nonaccrual loans: | | |
| Real estate mortgage | **$368,308** | $372,295 |
| Production and intermediate term | **163,781** | 158,716 |
| Agribusiness | **33,747** | 28,412 |
| Rural residential real estate | **41,699** | 43,308 |
| Other | **24,503** | 23,673 |
| Total nonaccrual loans | **$632,038** | $626,404 |
| | | |
| Accruing restructured loans: | | |
| Real estate mortgage | **$40,589** | $42,007 |
| Production and intermediate term | **6,528** | 6,576 |
| Agribusiness | **3,136** | 4,178 |
| Rural residential real estate | **665** | 489 |
| Total accruing restructured loans | **$50,918** | $53,250 |
| | | |
| Accruing loans 90 days or more past due: | | |
| Real estate mortgage | **$10,055** | $1,347 |
| Production and intermediate term | **11,136** | 605 |
| Agribusiness | **--** | 1 |
| Rural residential real estate | **188** | -- |
| Other | **2,725** | 269 |
| Total accruing loans 90 days or more past due | **$24,104** | $2,222 |
| | | |
| Total risk loans | **$707,060** | $681,876 |
| Other property owned | **$33,309** | $33,379 |
| Total risk assets | **$740,369** | $715,255 |

Note: Accruing loans include accrued interest receivable.

All risk loans are considered to be impaired loans.

**Additional Impaired Loan Information by Loan Type**

| (in thousands) | As of March 31, 2014 | | | For the three months ended March 31, 2014 | |
|---|---|---|---|---|---|
| | Recorded Investment* | Unpaid Principal Balance** | Related Allowance | Average Impaired Loans | Interest Income Recognized |
| Impaired loans with a related allowance for loan losses: | | | | | |
| Real estate mortgage | $69,598 | $83,376 | $16,815 | $64,560 | $ -- |
| Production and intermediate term | 66,540 | 73,311 | 24,013 | 64,466 | -- |
| Agribusiness | 1,445 | 1,473 | 337 | 1,376 | -- |
| Rural residential real estate | 7,097 | 9,652 | 1,742 | 7,063 | -- |
| Other | 22,406 | 24,405 | 7,240 | 21,906 | -- |
| Total | $167,086 | $192,217 | $50,147 | $159,371 | $ -- |
| Impaired loans with no related allowance for loan losses: | | | | | |
| Real estate mortgage | $349,354 | $446,068 | $ -- | $343,710 | $5,282 |
| Production and intermediate term | 114,905 | 175,798 | -- | 107,587 | 2,756 |
| Agribusiness | 35,438 | 46,304 | -- | 39,066 | 777 |
| Rural residential real estate | 35,455 | 47,293 | -- | 35,995 | 613 |
| Other | 4,822 | 4,787 | -- | 4,055 | 62 |
| Total | $539,974 | $720,250 | $ -- | $530,413 | $9,490 |
| Total impaired loans: | | | | | |
| Real estate mortgage | $418,952 | $529,444 | $16,815 | $408,270 | $5,282 |
| Production and intermediate term | 181,445 | 249,109 | 24,013 | 172,053 | 2,756 |
| Agribusiness | 36,883 | 47,777 | 337 | 40,442 | 777 |
| Rural residential real estate | 42,552 | 56,945 | 1,742 | 43,058 | 613 |
| Other | 27,228 | 29,192 | 7,240 | 25,961 | 62 |
| Total | $707,060 | $912,467 | $50,147 | $689,784 | $9,490 |

| (in thousands) | As of December 31, 2013 | | | For the three months ended March 31, 2013 | |
|---|---|---|---|---|---|
| | Recorded Investment* | Unpaid Principal Balance** | Related Allowance | Average Impaired Loans | Interest Income Recognized |
| Impaired loans with a related allowance for loan losses: | | | | | |
| Real estate mortgage | $68,318 | $80,667 | $18,316 | $95,820 | $ -- |
| Production and intermediate term | 61,362 | 68,184 | 22,114 | 91,011 | -- |
| Agribusiness | 1,729 | 1,733 | 530 | 2,872 | -- |
| Rural residential real estate | 6,520 | 8,965 | 1,427 | 8,616 | -- |
| Other | 20,854 | 21,344 | 6,274 | 15,545 | -- |
| Total | $158,783 | $180,893 | $48,661 | $213,864 | $ -- |
| Impaired loans with no related allowance for loan losses: | | | | | |
| Real estate mortgage | $347,331 | $448,053 | $ -- | $364,765 | $3,359 |
| Production and intermediate term | 104,535 | 166,789 | -- | 110,330 | 2,698 |
| Agribusiness | 30,862 | 42,252 | -- | 41,574 | 866 |
| Rural residential real estate | 37,277 | 51,070 | -- | 41,629 | 393 |
| Other | 3,088 | 3,111 | -- | 14,687 | 58 |
| Total | $523,093 | $711,275 | $ -- | $572,985 | $7,374 |
| Total impaired loans: | | | | | |
| Real estate mortgage | $415,649 | $528,720 | $18,316 | $460,585 | $3,359 |
| Production and intermediate term | 165,897 | 234,973 | 22,114 | 201,341 | 2,698 |
| Agribusiness | 32,591 | 43,985 | 530 | 44,446 | 866 |
| Rural residential real estate | 43,797 | 60,035 | 1,427 | 50,245 | 393 |
| Other | 23,942 | 24,455 | 6,274 | 30,232 | 58 |
| Total | $681,876 | $892,168 | $48,661 | $786,849 | $7,374 |

*The recorded investment in the receivable is the face amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges and acquisition costs and may also reflect a previous direct write-down of the investment. The recorded investment may be less than the unpaid principal balance as payments on non-cash basis nonaccrual loans reduce the recorded investment.

**Unpaid principal balance represents the contractual principal balance of the loan.