

# ALABAMA FARM CREDIT, ACA

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## 2013 Quarterly Report Third Quarter



**For the Quarter Ended September 30, 2013**

## REPORT OF MANAGEMENT

The undersigned certify that we have reviewed this report, that it has been prepared in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate and complete to the best of his or her knowledge and belief.



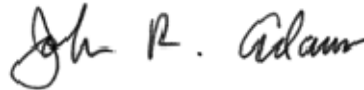
K. Ben Gore, Chief Executive Officer/President  
*November 8, 2013*



Loyd Rutherford, Chairman, Board of Directors  
*November 8, 2013*



Karri H. Sumrall, Chief Financial Officer/Ex. Vice President  
*November 8, 2013*



John R. Adams, CPA, Chairman, Audit Committee  
*November 8, 2013*

**ALABAMA FARM CREDIT, ACA  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following commentary reviews the financial performance of the Alabama Farm Credit, ACA (Agricultural Credit Association), referred to as the Association, for the quarter ended September 30, 2013. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2012 Annual Report to Stockholders.

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

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The consolidated financial statements were prepared under the oversight of the Association's audit committee.

**Significant Events:**

In January 2013, the Association approved a resolution for a \$5,334,166 patronage distribution to its stockholders. The distribution was paid in March 2013. The Association was able to return these funds to its members due to strong earnings over the past three years.

During 2013, the Association has recognized charge-offs of \$1,005,993. Also during 2013, the Association acquired seven properties through foreclosure proceedings, with a net carrying value of \$1,945,777 and sold fifteen acquired properties with a net carrying value of \$2,240,357. At September 30, 2013, the Association had eleven properties totaling \$2,969,344 in Other Property Owned on the balance sheet.

At a July 2013 Special Stockholders Meeting, the Association's stockholders approved an amendment to the Association's capitalization bylaws addressing the amount of stock a borrower must purchase as a condition of borrowing from the Association. The change affected the range within which the board of directors is authorized to set the stock requirement, and also the manner in which the stock requirement is calculated.

In August 2013, the board of directors approved a stock reduction to equalize the stock to all borrowers to the lesser of 2 percent of the aggregate amount of all of the stockholder's loans or \$1,000. The stock reduction was paid in September 2013, in the amount of \$782,125. Further details are discussed in Note 3, "Capital", to the financial statements included in this quarterly report.

**Loan Portfolio:**

The Association makes and services loans to farmers, ranchers, rural homeowners and certain farm-related businesses. The Association's loan volume consists of long-term farm mortgage loans, production and intermediate term loans, and farm-related business loans. These loans are available to eligible borrowers with competitive fixed, adjustable and indexed-based interest rates with loan maturities ranging up to 30 years. Loans serviced by the Association offer several installment payment cycles, the timing of which usually coincides with seasonal cash-flow capabilities of the borrower.

Total loans outstanding at September 30, 2013, including nonaccrual loans, were \$469,968,564 compared to \$445,769,343 at December 31, 2012, reflecting an increase of \$24,199,221 or 5.4 percent.

	<b>September 30, 2013</b>	December 31, 2012
Acceptable	<b>96.6%</b>	84.7%
Special Mention	<b>1.7%</b>	13.3%
Substandard	<b>1.7%</b>	2.0%
	<b>100.0%</b>	100.0%

The Association's credit quality began to deteriorate slightly in late 2008 due primarily to the impact of a poultry integrator in the Association's territory filing Chapter 11 Bankruptcy. This Bankruptcy has had a residual effect on Association grower borrowers as a result of the inherent counterparty risk associated with the integrator. In 2009, the integrator emerged from Bankruptcy and the Association has not experienced any adverse effects to growers with Association loans to date. These loans to this integrator were approved by FCA to be moved back to their appropriate risk rating in mid-June 2013. At June 30, 2013, Association loans to growers of this integrator consisted of 352 loans representing \$83.1 million in volume, of which \$35.7 million are government guaranteed. Loans to this integrator are included in the Special Mention category at December 31, 2012 in the table shown above. The Association adjusted these loans back to the appropriate classification in the third quarter of 2013.

The Association's largest commodity concentration in its loan portfolio continues to be poultry, which is approximately 50.0 percent. The industry is presently stable to improving with market prices for poultry improving and feed cost leveling off to declining. This has resulted in the integrators showing marginal profits for the third quarter. They are reacting to this improvement by returning to a normal egg and chick placement. Overall, the industry remains stable. Production for the remainder of 2013 should increase as markets both in the states and overseas show signs of improving. Several Integrators are offering new grower contracts in order to meet their market demands, with egg and chick placements in Alabama increasing weekly.

Commodity prices remain volatile for production agricultural borrowers but are at all-time highs compared to the five year average for corn, cotton and soybean growers. These higher prices are partially offset by higher input cost and lower government payments. Crop yield for all three commodities was above average last growing season. Record yields coupled with all time high prices resulted in record level profit margins for row crop producers. The Association's territory received above normal moisture during the crop planting season resulting in some delayed plantings. All crops have been or are being harvested now with above average yields being recorded due to the amount of moisture they have received. Livestock producers are seeing higher prices for cattle sold due to the overall low inventory of cattle nationwide and worldwide due to increased demand for beef products compared to the last few years. Beef product prices are at an all-time high in super markets. Cattle prices are projected to remain high with the liquidation of cattle herds in other parts of the country due to severe droughts experienced in the past year. The majority of Association livestock producers have considerable nonfarm income which should lessen the impact of price volatility. The decline in the general economy has shown minimal effects on the Association's non-agricultural income dependent borrowers and their repayment abilities at this time. Delinquency percentages of total volume continue to be at or slightly below prior years' percentages.

Timber markets in 2013 continued to be depressed from previous years due to the decreased demand from the housing market. However, timber prices have improved with an increased demand for wood products as demand for some new construction in housing has improved. A Canadian based Forest Products Corporation producing southern yellow pine dimension lumber has reopened a closed mill in Albertville. The mill is running two shifts now and has 150 employees with future plans of upping production as demand increases. This has provided a welcome increase in demand for pine saw timber in the northeast Alabama area and follows a trend of Canadian based companies buying saw mills in the southeastern United States which is generally seen as a positive trend. However, during the third quarter, a large paper mill located within the Association's territory announced that it would be closing its plant due to losing demand for uncoated freesheet paper products in the United States. This closing represents the loss of approximately 1,100 jobs in the Association's territory.

Overall land values have remained fairly stable or have seen a slight decline in some areas of the Association's territory (recreational and cut-over tracts) based on the current economic climate. The agricultural economy, in general for the area has remained stable to improving in 2013. Favorable weather conditions and higher commodity prices have had a positive effect in stabilizing the farm economy for the year. We will continue to work with our borrowers as all market segments make corrections with minimal restructuring.

The probability of higher input costs, questions about future commodity supplies and prices, no new Farm Bill being passed by legislators, uncertainty of the export markets and unfolding world events increase the level of financial risk in the farming sector and, likewise, the level of credit risk to those financial institutions providing credit to that sector. Given the conditions outlined herein, the quality of the loan portfolio is expected to remain constant or slightly improve throughout 2013. The duration of the weak economy is a concern that has the potential to be more problematic for financial results over the longer term for both the lender and the operator. Continued diligence in the areas of credit controls and monitoring is essential.

#### **Risk Exposure:**

High-risk assets include nonaccrual loans, loans that are past due 90 days or more and still accruing interest, formally restructured loans and other property owned. The following table illustrates the Association's components and trends of high-risk assets.

	<b>September 30, 2013</b>		<b>December 31, 2012</b>	
	<b>Amount</b>	<b>%</b>	<b>Amount</b>	<b>%</b>
Nonaccrual	<b>\$ 3,710,150</b>	<b>42.6%</b>	\$ 4,531,760	44.6%
90 days past due and still accruing interest	<b>106,870</b>	<b>1.2%</b>	212,836	2.1%
Formally restructured	<b>1,919,196</b>	<b>22.1%</b>	1,969,255	19.5%
Other property owned, net	<b>2,969,344</b>	<b>34.1%</b>	3,413,520	33.8%
Total	<b>\$ 8,705,560</b>	<b>100.0%</b>	\$ 10,127,371	100.0%

At September 30, 2013 and December 31, 2012 loans that were considered impaired were \$5,736,216 and \$6,713,851, representing 1.2 percent and 1.5 percent of loan volume, respectively. Impaired loans consist of all high-risk assets except other property owned, net.

High-risk assets decreased by \$1,421,811 or 14.0 percent primarily due to the decrease in nonaccrual volume and other property owned. Since December 31, 2012, the Association has moved thirteen loans totaling \$3,654,465 to nonaccrual status due to delinquency and cashflow issues. All thirteen loans are categorized as Agriculture Real Estate Mortgage. Also since December 31, 2012, the Association has transferred thirteen loans with a carrying value of \$1,945,777 out of nonaccrual status to acquired property where fifteen acquired properties with a net carrying value of \$2,240,357 have sold during the current year. Nonaccrual loans as a percentage of total loans outstanding were 0.8 percent at September 30, 2013, compared to 1.0 percent at December 31, 2012. Management continues to be alert to portfolio trends and has attempted to identify and report problem loans as quickly as possible. Management strives to implement proactive steps and allocate resources to work with distressed borrowers to either work through temporary repayment problems or to orderly liquidate collateral to repay the loan when the borrower's operation is no longer viable.

The Association, in the normal course of business, has participation loans with other Farm Credit associations and Farm Credit Banks. The Association holds interests in loans with geographic or industry related risks that have warranted risk rating reclassifications to nonaccrual status. Performance of these loans remains uncertain even though management constantly monitors these accounts.

Counterparty risk is continually monitored by management of the Association. The Association's primary counterparty risk comes from the poultry integrators to which its borrowers are associated. Because the Association's portfolio has approximately a 50.0 percent concentration in poultry, it mitigates its inherent risks with poultry and the integrators by heavy utilization of government guarantees. Also, the Association's lending territory has multiple integrators which would minimize the risk of counterparty failure or lack of performance. Management analyzes the financial position and performance of these integrators by regularly gathering updated financials and other reports that are made available to the public.

As disclosed in the Association's 2012 Annual Report, it is management's assertion that the allowance coverage is adequate based on historical losses, portfolio stress testing, risk analysis, mitigation of losses due to having first lien real estate with minimal to no price appreciation and having approximately \$82.6 million or 17.6 percent of its portfolio government guaranteed. Management continuously monitors high-risk assets in an effort to reduce their impact on the Association and will continue to work with all of the Association's high-risk borrowers to receive full payment on the debt. Except for the relationship between installment due date and seasonal cash-flow capabilities of the borrower, the Association is not affected by any seasonal characteristics. The factors affecting the operations of the Association are the same factors that would affect any agricultural lender.

The Association recorded no recoveries and \$606,425 in charge-offs for the quarter ended September 30, 2013, and no recoveries and \$28,749 in charge-offs for the same period in 2012. The Association's allowance for loan losses was 0.7 percent of total loans outstanding for both periods ended September 30, 2013, and December 31, 2012.

### **Results of Operations:**

The Association had net income of \$1,943,038 and \$7,519,314 for the three and nine months ended September 30, 2013, as compared to net income of \$1,714,493 and \$6,666,419 for the same period in 2012, reflecting an increase of 13.3 and 12.8 percent, respectively. Net interest income was \$4,072,589 and \$12,003,331 for the three and nine months ended September 30, 2013, compared to \$3,833,608 and \$11,208,498 for the same period in 2012, reflecting an increase of 6.2 and 7.1 percent, respectively. The increase is due to the favorable interest rate charged by the Bank on the note payable and the increase in average balance of loans outstanding as of September 30, 2013, compared to the same period in 2012.

	September 30, 2013		September 30, 2012	
	Average Balance	Interest	Average Balance	Interest
Loans	\$ 456,234,887	\$ 17,611,263	\$ 428,730,648	\$ 17,516,636
Interest-bearing liabilities	383,618,088	5,607,932	361,002,339	6,308,138
Impact of capital	\$ 72,616,799		\$ 67,728,309	
Net interest income		\$ 12,003,331		\$ 11,208,498

	2013	2012
	Average Yield	Average Yield
Yield on loans	5.2%	5.5%
Total yield on interest-earning assets	5.2%	5.5%
Cost of interest-bearing liabilities	2.0%	2.3%
Interest rate spread	3.2%	3.1%
Net interest income as a percentage of average earning assets	3.5%	3.5%

	September 30, 2013 vs. September 30, 2012		
	Increase (decrease) due to		
	Volume	Rate	Total
Interest income - loans	\$ 1,122,699	\$ (1,028,072)	\$ 94,627
Interest expense	394,821	(1,095,027)	(700,206)
Net interest income	\$ 727,878	\$ 66,955	\$ 794,833

Interest income for the three and nine months ended September 30, 2013, increased by \$65,185 and \$94,627, or 1.1 and 0.5 percent, respectively, from the same period of 2012, primarily due to an increase in average loan volume and declines in yields on earning assets. Interest expense for the three and nine months ended September 30, 2013, decreased by \$173,796 and \$700,206, or 8.5 and 11.1 percent, respectively, from the same period of 2012 due to a decrease in interest rates offset by an increase in average debt volume. Average loan volume for the third quarter of 2013 was \$466,021,169, compared to \$436,684,405 in the third quarter of 2012. The Association offers fixed, adjustable and indexed priced loans. These different type loans have different spreads and therefore provide differing net interest margins to the Association. The average net interest rate spread on the loan portfolio for the third quarter of 2013 was 3.2 percent, compared to 3.1 percent in the third quarter of 2012.

Noninterest income for the three months and nine months ended September 30, 2013 decreased by \$58,456, or 13.7 percent and \$457,035, or 27.9 percent when compared to the same period in 2012. This is was primarily due the Association not receiving a refund from the Farm Credit System Insurance Corporation in the current year as it did in 2012 and the decrease in loan fees resulting from the change in the calculation of deferred loan fees.

Noninterest expenses for the three and nine months ended September 30, 2013 increased \$57,294, or 3.4 percent and decreased \$13,789, or 0.3 percent as compared to the same period in 2012. The increase for the three months ended September 30, 2013 is due primarily to an increase in purchased services, travel and Farm Credit System Insurance Corporation (FCSIC) expense. This increase was offset by a decrease in salaries and employee benefits from the restructuring of the FAS91 calculation and losses on the disposal of property owned compared to the same period in 2012. The increase in FCSIC insurance is due to a change in premium base from 5 basis points in 2012 to 10 basis points in 2013. The decrease for the nine months ended September 30, 2013 is due primarily to the restructuring of the estimate used in the FAS91 calculation and larger losses on the disposal of property owned compared to the same period in 2012.

The Association's return on average assets for the nine months ended September 30, 2013, was 2.1 percent compared to 2.0 percent for the same period in 2012. The Association's return on average equity for the nine months ended September 30, 2013, was 11.9 percent, compared to 11.1 percent for the same period in 2012.

## Liquidity and Funding Sources:

The Association secures the majority of its lendable funds from the Farm Credit Bank of Texas (the Bank), which obtains its funds through the issuance of Systemwide obligations and with lendable equity. The following schedule summarizes the Association's borrowings.

	<b>September 30, 2013</b>	<b>December 31, 2012</b>
Note payable to the Bank	\$ 397,277,908	\$ 372,760,946
Accrued interest on note payable	614,719	657,802
Total	<u>\$ 397,892,627</u>	<u>\$ 373,418,748</u>

The Association operates under a general financing agreement (GFA) with the Bank. The current GFA is effective through September 30, 2015. The primary source of liquidity and funding for the Association is a direct loan from the Bank. The outstanding balance of \$397,277,908 as of September 30, 2013, is recorded as a liability on the Association's balance sheet. The note carried a weighted average interest rate of 1.8 percent at September 30, 2013. The indebtedness is collateralized by a pledge of substantially all of the Association's assets to the Bank and is governed by a general financing agreement. The increase in note payable to the Bank and related accrued interest payable since December 31, 2012, is due to the Association's loan portfolio growth and the decrease in weighted average interest rate charged to the Association. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were \$74,119,195 at September 30, 2013. The maximum amount the Association may borrow from the Bank as of September 30, 2013, was \$472,460,954 as defined by the general financing agreement. The indebtedness continues in effect until the expiration date of the general financing agreement, which is September 30, 2015, unless sooner terminated by the Bank upon the occurrence of an event of default, or by the Association, in the event of a breach of this agreement by the Bank, upon giving the Bank 30 calendar days prior written notice, or in all other circumstances, upon giving the Bank 120 days prior written notice.

## Capital Resources:

The Association's capital position increased by \$6,883,051 or 8.6 percent at September 30, 2013, compared to December 31, 2012. The Association's debt as a percentage of members' equity was 4.6:1 as of September 30, 2013, compared to 4.8:1 as of December 31, 2012.

Under regulations governing minimum permanent capital adequacy and other capitalization issues, the Association is required to maintain a minimum adjusted permanent capital of 7.0 percent of risk-adjusted assets as defined by the FCA. The Association's permanent capital ratio at September 30, 2013, was 19.2 percent, which is in compliance with the FCA's minimum permanent capital standard. The Association's core surplus ratio and total surplus ratio at September 30, 2013, were 18.6 and 18.6 percent, respectively, which is in compliance with the FCA's minimum surplus standard.

## Significant Recent Accounting Pronouncements:

In December 2011, the Financial Accounting Standards Board (FASB) issued guidance entitled "Balance Sheet – Disclosures About Offsetting Assets and Liabilities." The guidance requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. This includes the effect or potential effect of rights of offset associated with an entity's recognized assets and recognized liabilities. The requirements apply to recognized financial instruments and derivative instruments that are offset in accordance with the rights of offset set forth in accounting guidance and for those recognized financial instruments and derivative instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset or not. This guidance is to be applied retrospectively for all comparative periods and is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The adoption of this guidance did not impact financial condition or results of operations, but resulted in additional disclosures.

In February 2013, the FASB issued guidance, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." The guidance requires entities to present either parenthetically on the face of the financial statements or in the notes to the financial statements, significant amounts reclassified from each component of accumulated other comprehensive income and the income statement line items affected by the reclassification. The guidance is effective for public entities for annual periods beginning after December 15, 2012, and for nonpublic entities for annual periods beginning after December 15, 2013. The Association has adopted this guidance, which did not impact the financial condition or results of operations, but resulted in additional disclosures which are included in Note 7 – Employee Benefit Plans.

**Relationship With the Farm Credit Bank of Texas:**

The Association's financial condition may be impacted by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect the stockholder's investment in the Association. The Management's Discussion and Analysis and Notes to Financial Statements contained in the 2012 Annual Report of Alabama Farm Credit, ACA more fully describe the Association's relationship with the Bank.

The Texas Farm Credit District's (district) annual and quarterly stockholder reports, as well as those of the Bank, are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, The Ag Agency, P.O. Box 202590, Austin, Texas 78720, or by calling (512) 483-9204. Copies of the district's quarterly and annual stockholder reports also can be requested by e-mail at [fcf@farmcreditBank.com](mailto:fcf@farmcreditBank.com). The annual and quarterly stockholder reports for the Bank and the district are also available on its website at [www.farmcreditBank.com](http://www.farmcreditBank.com).

The Association's quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Alabama Farm Credit, ACA, P.O. Box 639, Cullman, Alabama 35056 or calling (256) 737-7128. Copies of the Association's quarterly stockholder reports can also be requested by e-mailing [karri.sumrall@alabamafarmcredit.com](mailto:karri.sumrall@alabamafarmcredit.com) or can be obtained on its web site at [www.alabamafarmcredit.com](http://www.alabamafarmcredit.com) 40 days after quarter end. The Association's annual stockholder report is available on its Web site at [www.alabamafarmcredit.com](http://www.alabamafarmcredit.com) 75 days after the fiscal year end. Copies of the Association's annual stockholder report can also be requested 90 days after the fiscal year end.



**ALABAMA FARM CREDIT, ACA**

**CONSOLIDATED BALANCE SHEET**

	<b>September 30, 2013 (unaudited)</b>	<b>December 31, 2012</b>
<b><u>ASSETS</u></b>		
Cash	\$ 32,648	\$ 27,178
Loans	469,968,564	445,769,343
Less: allowance for loan losses	3,103,980	3,326,164
Net loans	466,864,584	442,443,179
Accrued interest receivable	6,267,947	4,776,648
Investment in and receivable from the Farm Credit Bank of Texas:		
Capital stock	7,246,510	7,246,510
Other	1,374,594	505,858
Other property owned, net	2,969,344	3,413,520
Premises and equipment	3,570,975	3,597,276
Other assets	574,881	284,179
Total assets	\$ 488,901,483	\$ 462,294,348
<b><u>LIABILITIES</u></b>		
Note payable to the Farm Credit Bank of Texas	\$ 397,277,908	\$ 372,760,946
Accrued interest payable	614,719	657,802
Drafts outstanding	1,194,455	338,940
Patronage distributions payable	184	5,334,272
Other liabilities	2,549,736	2,820,958
Total liabilities	401,637,002	381,912,918
<b><u>MEMBERS' EQUITY</u></b>		
Capital stock and participation certificates	2,039,465	2,670,725
Unallocated retained earnings	85,585,791	78,066,477
Accumulated other comprehensive loss	(360,775)	(355,772)
Total members' equity	87,264,481	80,381,430
Total liabilities and members' equity	\$ 488,901,483	\$ 462,294,348

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

ALABAMA FARM CREDIT, ACA

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

	Quarter Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
<b><u>INTEREST INCOME</u></b>				
Loans	\$ 5,953,239	\$ 5,888,054	\$ 17,611,263	\$ 17,516,636
<b><u>INTEREST EXPENSE</u></b>				
Note payable to the Farm Credit Bank of Texas	1,880,650	2,054,446	5,607,932	6,308,138
Net interest income	4,072,589	3,833,608	12,003,331	11,208,498
<b><u>PROVISION FOR LOAN LOSSES</u></b>				
Net interest income after provision for loan losses	3,329,774	2,985,479	11,219,522	9,923,381
<b><u>NONINTEREST INCOME</u></b>				
Income from the Farm Credit Bank of Texas:				
Patronage income	325,283	332,246	954,495	946,083
Loan fees	37,073	76,803	138,900	309,412
Refunds from Farm Credit System				
Insurance Corporation	-	-	-	298,092
Financially related services income	6,123	6,530	17,506	18,196
Gain on sale of premises and equipment, net	-	10,985	9,413	27,336
Other noninterest income	-	371	62,532	40,762
Total noninterest income	368,479	426,935	1,182,846	1,639,881
<b><u>NONINTEREST EXPENSES</u></b>				
Salaries and employee benefits	956,965	979,084	2,912,728	3,023,586
Directors' expense	46,689	43,923	157,971	161,516
Purchased services	72,269	45,796	268,928	184,992
Travel	155,773	96,594	334,449	245,256
Occupancy and equipment	82,628	69,803	251,613	203,119
Communications	29,877	28,654	88,400	81,468
Advertising	40,006	53,970	172,418	146,341
Public and member relations	68,149	60,620	154,969	127,969
Supervisory and exam expense	34,553	33,798	102,150	105,280
Insurance Fund premiums	74,748	35,934	218,838	104,890
Business insurance	3,170	2,999	75,176	70,300
Loss on other property owned, net	141,854	214,377	4,408	330,063
Loss on sale of premises and equipment, net	83	-	-	-
Other noninterest expense	48,451	32,369	141,006	112,063
Total noninterest expenses	1,755,215	1,697,921	4,883,054	4,896,843
<b>NET INCOME</b>	<b>1,943,038</b>	<b>1,714,493</b>	<b>7,519,314</b>	<b>6,666,419</b>
Other comprehensive loss:				
Change in postretirement benefit plans	(1,668)	(7,230)	(5,003)	(21,690)
Other comprehensive loss, net of tax	(1,668)	(7,230)	(5,003)	(21,690)
<b>COMPREHENSIVE INCOME</b>	<b>\$ 1,941,370</b>	<b>\$ 1,707,263</b>	<b>\$ 7,514,311</b>	<b>\$ 6,644,729</b>

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

ALABAMA FARM CREDIT, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

(unaudited)

	<u>Capital Stock/ Participation Certificates</u>	<u>Retained Earnings Unallocated</u>	<u>Accumulated Other Comprehensive Loss</u>	<u>Total Members' Equity</u>
Balance at December 31, 2011	\$ 2,523,570	\$ 74,129,255	\$ (130,405)	\$ 76,522,420
Comprehensive income	-	6,666,419	(21,690)	6,644,729
Capital stock/participation certificates issued	355,215			355,215
Capital stock/participation certificates retired	(262,210)			(262,210)
Patronage refunds:				
Cash	-	(1,143)	-	(1,143)
<b>Balance at September 30, 2012</b>	<u><u>\$ 2,616,575</u></u>	<u><u>\$ 80,794,531</u></u>	<u><u>\$ (152,095)</u></u>	<u><u>\$ 83,259,011</u></u>
Balance at December 31, 2012	\$ 2,670,725	\$ 78,066,477	\$ (355,772)	\$ 80,381,430
Comprehensive income	-	7,519,314	(5,003)	7,514,311
Capital stock/participation certificates issued	410,820	-	-	410,820
Capital stock/participation certificates retired	(259,955)	-	-	(259,955)
Stock equalization	(782,125)	-	-	(782,125)
<b>Balance at September 30, 2013</b>	<u><u>\$ 2,039,465</u></u>	<u><u>\$ 85,585,791</u></u>	<u><u>\$ (360,775)</u></u>	<u><u>\$ 87,264,481</u></u>

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

**ALABAMA FARM CREDIT, ACA**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

**NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:**

The Alabama Farm Credit, ACA (Agricultural Credit Association), referred to as the Association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves the counties of Blount, Calhoun, Cherokee, Clay, Cleburne, Colbert, Cullman, DeKalb, Etowah, Fayette, Franklin, Jackson, Jefferson, Lamar, Lauderdale, Lawrence, Limestone, Madison, Marion, Marshall, Morgan, Randolph, Shelby, St. Clair, Talladega, Walker and Winston in the state of Alabama.

The Association is a lending institution of the Farm Credit System (the System), which was established by Acts of Congress to meet the needs of American agriculture.

The significant accounting policies followed and the financial condition and results of operations of the Association as of and for the year ended December 31, 2012, are contained in the 2012 Annual Report to Stockholders. These unaudited third quarter 2013 financial statements should be read in conjunction with the 2012 Annual Report to Stockholders.

In December 2011, the Financial Accounting Standards Board (FASB) issued guidance entitled “Balance Sheet – Disclosures About Offsetting Assets and Liabilities.” The guidance requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. This includes the effect or potential effect of rights of offset associated with an entity’s recognized assets and recognized liabilities. The requirements apply to recognized financial instruments and derivative instruments that are offset in accordance with the rights of offset set forth in accounting guidance and for those recognized financial instruments and derivative instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset or not. This guidance is to be applied retrospectively for all comparative periods and is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The adoption of this guidance will not impact financial condition or results of operations, but will result in additional disclosures.

In February 2013, the FASB issued guidance, “Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.” The guidance requires entities to present either parenthetically on the face of the financial statements or in the notes to the financial statements, significant amounts reclassified from each component of accumulated other comprehensive income and the income statement line items affected by the reclassification. The guidance is effective for public entities for annual periods beginning after December 15, 2012, and for nonpublic entities for annual periods beginning after December 15, 2013. The adoption of this guidance did not impact the financial condition or results of operations, but resulted in additional disclosures (See Note 7 – Employee Benefit Plans).

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, except for the inclusion of a statement of cash flows. Generally accepted accounting principles require a business enterprise that provides a set of financial statements reporting both financial position and results of operations to also provide a statement of cash flows for each period for which results of operations are provided. In regulations issued by FCA, Associations have the option to exclude statements of cash flows in interim financial statements. Therefore, the Association has elected not to include a statement of cash flows in these consolidated financial statements.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The preparation of these consolidated financial statements requires the use of management’s estimates. The results for the quarter ended September 30, 2013, are not necessarily indicative of the results to be expected for the year ended December 31, 2013. Certain amounts in the prior period’s financial statements have been reclassified to conform to current financial statement presentation.

## NOTE 2 — LOANS AND ALLOWANCE FOR LOAN LOSSES:

A summary of loans follows:

Loan Type	September 30,	December 31,
	2013	2012
	Amount	Amount
Production agriculture:		
Real estate mortgage	\$ 436,054,031	\$ 423,338,240
Production and intermediate term	19,401,354	12,779,924
Agribusiness:		
Processing and marketing	7,304,832	4,261,273
Farm-related business	309,220	140,123
Rural residential real estate	6,899,127	5,249,783
Total	<u>\$ 469,968,564</u>	<u>\$ 445,769,343</u>

The Association purchases or sells participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration regulations. The following table presents information regarding the balances of participations purchased and sold at September 30, 2013:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
	Real estate mortgage	\$ 1,867,949	\$ -	\$ -	\$ -	\$ 1,867,949
Production and intermediate term	758,394	-	-	-	758,394	-
Agribusiness	7,304,832	-	-	-	7,304,832	-
Total	<u>\$ 9,931,175</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 9,931,175</u>	<u>\$ -</u>

The Association is authorized under the Farm Credit Act to accept “advance conditional payments” (ACPs) from borrowers. To the extent the borrower’s access to such ACPs is restricted and the legal right of setoff exists, the ACPs are netted against the borrower’s related loan balance. Unrestricted advance conditional payments are included in other liabilities. ACPs are not insured, and interest is generally paid by the Association on such balances. Restricted balances of ACPs were \$14,426,035 and \$11,563,402 at September 30, 2013, and December 31, 2012, respectively.

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

	September 30,	December 31,
	2013	2012
<b>Nonaccrual loans:</b>		
Real estate mortgage	\$ 2,580,415	\$ 3,063,014
Agribusiness	1,129,735	1,451,158
Rural residential real estate	-	17,588
Total nonaccrual loans	<u>3,710,150</u>	<u>4,531,760</u>
<b>Accruing restructured loans:</b>		
Real estate mortgage	1,919,196	1,969,255
<b>Accruing loans 90 days or more past due:</b>		
Real estate mortgage	106,870	212,836
Total nonperforming loans	5,736,216	6,713,851
Other property owned	2,969,344	3,413,520
Total nonperforming assets	<u>\$ 8,705,560</u>	<u>\$ 10,127,371</u>

One credit quality indicator utilized by the Association is the Farm Credit Administration Uniform Loan Classification System that categorizes loans into five categories. The categories are defined as follows:

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

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

	<u>September 30, 2013</u>	<u>December 31, 2012</u>
Real estate mortgage		
Acceptable	89.7 %	80.5 %
OAEM	1.7	12.8
Substandard/doubtful	1.4	1.7
	<u>92.8</u>	<u>95.0</u>
Production and intermediate term		
Acceptable	4.1	2.4
Agribusiness		
Acceptable	1.4	0.7
Substandard/doubtful	0.3	0.3
	<u>1.7</u>	<u>1.0</u>
Rural residential real estate		
Acceptable	1.4	1.2
Total loans		
Acceptable	96.6	84.7
OAEM	1.7	13.3
Substandard/doubtful	1.7	2.0
	<u>100.0 %</u>	<u>100.0 %</u>

The following tables provide an age analysis of past due loans (including accrued interest) as of:

<u>September 30, 2013</u>	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans	Recorded Investment >90 Days and Accruing
Real estate mortgage	\$ 2,896,406	\$ 1,179,680	\$ 4,076,086	\$ 437,874,719	\$ 441,950,805	\$ 106,870
Production and intermediate term	37,919	-	37,919	19,706,949	19,744,868	-
Processing and marketing	-	1,129,735	1,129,735	6,177,779	7,307,514	-
Farm-related business	-	-	-	312,771	312,771	-
Rural residential real estate	-	-	-	6,920,553	6,920,553	-
Total	<u>\$ 2,934,325</u>	<u>\$ 2,309,415</u>	<u>\$ 5,243,740</u>	<u>\$ 470,992,771</u>	<u>\$ 476,236,511</u>	<u>\$ 106,870</u>

<u>December 31, 2012</u>	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans	Recorded Investment >90 Days and Accruing
Real estate mortgage	\$ 4,002,888	\$ 2,003,887	\$ 6,006,775	\$ 421,889,542	\$ 427,896,317	\$ 212,836
Production and intermediate term	-	-	-	12,983,290	12,983,290	-
Processing and marketing	-	1,426,398	1,426,398	2,836,035	4,262,433	-
Farm-related business	-	-	-	140,796	140,796	-
Rural residential real estate	-	17,588	17,588	5,245,567	5,263,155	-
Total	<u>\$ 4,002,888</u>	<u>\$ 3,447,873</u>	<u>\$ 7,450,761</u>	<u>\$ 443,095,230</u>	<u>\$ 450,545,991</u>	<u>\$ 212,836</u>

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

A restructuring of a debt constitutes a troubled debt restructuring if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Troubled debt restructurings are

undertaken in order to improve the likelihood of recovery on the loan and may include, but are not limited to, forgiveness of principal or interest, interest rate reductions that are lower than the current market rate for new debt with similar risk, or significant term or payment extensions.

As of September 30, 2013, the total recorded investment of troubled debt restructured loans was \$1,919,196 all of which were classified as accrual. Troubled debt restructurings are analyzed for allowance for loan losses using the specific analysis method. No specific allowances for loan losses were recorded for troubled debt restructuring. There were no commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring for the periods ended September 30, 2013 and December 31, 2012.

There were no troubled debt restructurings that occurred during the three and nine months ended September 30, 2013. Loans formally restructured prior to January 1, 2013, were \$1,919,196.

The following tables present additional information regarding troubled debt restructurings, which includes both accrual and nonaccrual loans with troubled debt restructuring designation, that occurred during the nine months ended September 30, 2012. The premodification outstanding recorded investment represents the recorded investment of the loans as of the quarter end prior to the restructuring. The postmodification outstanding recorded investment represents the recorded investment of the loans as of the quarter end the restructuring occurred.

<u>For the Three Months Ended September 30, 2012</u>	<u>Premodification Outstanding Recorded Investment</u>	<u>Postmodification Outstanding Recorded Investment</u>
Troubled debt restructurings:		
Real estate mortgage	\$ 286,720	\$ 296,000
<u>For the Nine Months Ended September 30, 2012</u>	<u>Premodification Outstanding Recorded Investment</u>	<u>Postmodification Outstanding Recorded Investment</u>
Troubled debt restructurings:		
Real estate mortgage	\$ 442,974	\$ 459,736

In restructurings where principal is forgiven, the amount of the forgiveness is immediately charged off. In restructurings where accrued interest is forgiven, the interest is reversed (if current year interest) or charged off (if prior year interest). There were no restructuring or charge-offs recorded at the modification date for the quarter ending September 30, 2013.

The predominate form of concession granted for troubled debt restructuring included the extension of terms due to cashflow constrictions enabling the borrower to fund the original payment amount. At times these terms might be offset with incremental payments, collateral or new borrower guarantees, in which case we assess all of the modified terms to determine if the overall modification qualifies as a troubled debt restructuring.

The Association had \$126,466 in loans that met the accounting criteria as a troubled debt restructuring that occurred from October 1, 2012 through September 30, 2013, and none of which were in payment default during that same period. A payment default is defined as a payment that is 30 days past due after the date the loan was restructured.

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 at:

	Loans Modified as TDRs		TDRs in Nonaccrual Status*	
	September 30, 2013	December 31, 2012	September 30, 2013	December 31, 2012
Real estate mortgage	\$ 1,919,196	\$ 1,969,255	\$ -	\$ -

\*represents the portion of loans modified as TDRs that are in nonaccrual status

Additional impaired loan information is as follows:

	September 30, 2013			December 31, 2012		
	Recorded Investment	Unpaid Principal Balance <sup>a</sup>	Related Allowance	Recorded Investment	Unpaid Principal Balance <sup>a</sup>	Related Allowance
Impaired loans with a related allowance for credit losses:						
Real estate mortgage	\$ 773,879	\$ 953,189	\$ 283,840	\$ 1,019,008	\$ 1,395,354	\$ 930,565
Processing and marketing	452,396	452,396	226,446	760,722	760,722	452,989
Farm-related business	-	-	-	13,096	13,096	13,096
Total	<u>\$ 1,226,275</u>	<u>\$ 1,405,585</u>	<u>\$ 510,286</u>	<u>\$ 1,792,826</u>	<u>\$ 2,169,172</u>	<u>\$ 1,396,650</u>
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	\$ 3,832,602	\$ 3,845,625	\$ -	\$ 4,226,017	\$ 4,239,714	\$ -
Processing and marketing	677,339	677,339	-	677,340	677,340	-
Rural residential real estate	-	-	-	17,588	14,588	-
Total	<u>\$ 4,509,941</u>	<u>\$ 4,522,964</u>	<u>\$ -</u>	<u>\$ 4,920,945</u>	<u>\$ 4,931,642</u>	<u>\$ -</u>
Total impaired loans:						
Real estate mortgage	\$ 4,606,481	\$ 4,798,814	\$ 283,840	\$ 5,245,105	\$ 5,635,068	\$ 930,565
Processing and marketing	1,129,735	1,129,735	226,446	1,438,062	1,438,062	452,989
Farm-related business	-	-	-	13,096	13,096	13,096
Rural residential real estate	-	-	-	17,588	17,588	-
Total	<u>\$ 5,736,216</u>	<u>\$ 5,928,549</u>	<u>\$ 510,286</u>	<u>\$ 6,713,851</u>	<u>\$ 7,103,814</u>	<u>\$ 1,396,650</u>

<sup>a</sup> Unpaid principal balance represents the recorded principal balance of the loan.

	For the Quarter Ended			
	September 30, 2013		September 30, 2012	
	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:				
Real estate mortgage	\$ 1,351,370	\$ -	\$2,070,716	\$ -
Processing and marketing	452,396	-	101,430	-
Farm-related business	-	-	13,096	-
Total	<u>\$ 1,803,766</u>	<u>\$ -</u>	<u>\$2,185,242</u>	<u>\$ -</u>
Impaired loans with no related allowance for credit losses:				
Real estate mortgage	\$ 3,961,086	\$ 40,057	\$4,214,841	\$ 67,745
Processing and marketing	677,339	-	90,312	-
Farm-related business	12,242	-	-	-
Rural residential real estate	-	-	17,886	-
Total	<u>\$ 4,650,667</u>	<u>\$ 40,057</u>	<u>\$4,323,039</u>	<u>\$ 67,745</u>
Total impaired loans:				
Real estate mortgage	\$ 5,312,456	\$ 40,057	\$6,285,557	\$ 67,745
Processing and marketing	1,129,735	-	191,742	-
Farm-related business	12,242	-	13,096	-
Rural residential real estate	-	-	17,886	-
Total	<u>\$ 6,454,433</u>	<u>\$ 40,057</u>	<u>\$6,508,281</u>	<u>\$ 67,745</u>



	<b>For the Nine Months Ended</b>			
	<b>September 30, 2013</b>		<b>September 30, 2012</b>	
	<b>Average Impaired Loans</b>	<b>Interest Income Recognized</b>	<b>Average Impaired Loans</b>	<b>Interest Income Recognized</b>
Impaired loans with a related allowance for credit losses:				
Real estate mortgage	\$ 1,521,634	\$ -	\$1,880,756	\$ -
Processing and marketing	679,405	-	47,935	-
Farm-related business	9,822	-	9,822	-
Rural residential real estate	-	-	5,836	-
Total	<u>\$ 2,210,861</u>	<u>\$ -</u>	<u>\$1,944,349</u>	<u>\$ -</u>
Impaired loans with no related allowance for credit losses:				
Real estate mortgage	\$ 4,344,850	\$ 124,442	\$5,325,834	\$ 119,281
Processing and marketing	677,339	-	-	-
Farm-related business	3,061	-	3,274	-
Rural residential real estate	4,355	-	11,834	-
Total	<u>\$ 5,029,605</u>	<u>\$ 124,442</u>	<u>\$5,340,942</u>	<u>\$ 119,281</u>
Total impaired loans:				
Real estate mortgage	\$ 5,866,484	\$ 124,442	\$7,206,590	\$ 119,281
Processing and marketing	1,356,744	-	47,935	-
Farm-related business	12,883	-	13,096	-
Rural residential real estate	4,355	-	17,670	-
Total	<u>\$ 7,240,466</u>	<u>\$ 124,442</u>	<u>\$7,285,291</u>	<u>\$ 119,281</u>

A summary of changes in the allowance for loan losses and period end recorded investment including accrued interest in loans is as follows:

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Rural Residential Real Estate	Total
<b>Allowance for Credit Losses:</b>					
<b>Balance at</b>					
<b>June 30, 2013</b>	\$ 2,681,042	\$ 32,390	\$ 245,821	\$ 8,337	\$ 2,967,590
<b>Charge-offs</b>	(593,328)	-	(13,096)	-	(606,424)
<b>Provision for loan losses</b>	746,974	(6,435)	2,741	(466)	742,814
<b>Balance at</b>					
<b>September 30, 2013</b>	\$ 2,834,688	\$ 25,955	\$ 235,466	\$ 7,871	\$ 3,103,980
<b>Balance at</b>					
<b>December 31, 2012</b>	\$ 2,830,928	\$ 22,138	\$ 467,703	\$ 5,395	\$ 3,326,164
<b>Charge-offs</b>	(677,004)	-	(321,423)	(7,566)	(1,005,993)
<b>Provision for loan losses</b>	680,764	3,817	89,186	10,042	783,809
<b>Balance at</b>					
<b>September 30, 2013</b>	\$ 2,834,688	\$ 25,955	\$ 235,466	\$ 7,871	\$ 3,103,980
<b>Ending Balance:</b>					
<b>Individually evaluated for impairment</b>	\$ 310,790	\$ -	\$ 226,446	\$ -	\$ 537,236
<b>Collectively evaluated for impairment</b>	2,523,898	25,955	9,020	7,871	2,566,744
<b>Balance at</b>					
<b>September 30, 2013</b>	\$ 2,834,688	\$ 25,955	\$ 235,466	\$ 7,871	\$ 3,103,980
<b>Balance at</b>					
<b>June 30, 2012</b>	\$ 2,584,561	\$ 12,802	\$ 111	\$ 6,953	\$ 2,604,427
<b>Charge-offs</b>	(2,173)	-	-	(26,576)	(28,749)
<b>Provision for loan losses</b>	821,546	1,608	(1)	24,976	848,129
<b>Balance at</b>					
<b>September 30, 2012</b>	\$ 3,403,934	\$ 14,410	\$ 110	\$ 5,353	\$ 3,423,807
<b>Balance at</b>					
<b>December 31, 2011</b>	\$ 2,300,548	\$ 6,413	\$ 114	\$ 3,930	\$ 2,311,005
<b>Charge-offs</b>	(145,739)	-	-	(26,576)	(172,315)
<b>Provision for loan losses</b>	1,249,125	7,997	(4)	27,999	1,285,117
<b>Balance at</b>					
<b>September 30, 2012</b>	\$ 3,403,934	\$ 14,410	\$ 110	\$ 5,353	\$ 3,423,807
<b>Ending Balance:</b>					
<b>Individually evaluated for impairment</b>	\$ 1,548,101	\$ -	\$ -	\$ -	\$ 1,548,101
<b>Collectively evaluated for impairment</b>	1,855,833	14,410	110	5,353	1,875,706
<b>Balance at</b>					
<b>September 30, 2012</b>	\$ 3,403,934	\$ 14,410	\$ 110	\$ 5,353	\$ 3,423,807

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Rural Residential Real Estate	Total
<b>Recorded Investments in Loans Outstanding: Ending Balance at</b>					
September 30, 2013	\$ 441,950,805	\$ 19,744,868	\$ 7,620,285	\$ 6,920,553	\$ 476,236,511
Individually evaluated for impairment	\$ 4,606,481	\$ -	\$ 1,129,735	\$ -	\$ 5,736,216
Collectively evaluated for impairment	\$ 437,344,324	\$ 19,744,868	\$ 6,490,550	\$ 6,920,553	\$ 470,500,295
Ending Balance at					
September 30, 2012	\$ 426,651,827	\$ 9,480,602	\$ 3,949,534	\$ 5,311,040	\$ 445,393,003
Individually evaluated for impairment	\$ 5,329,308	\$ -	\$ 1,451,158	\$ 17,498	\$ 6,797,964
Collectively evaluated for impairment	\$ 421,322,519	\$ 9,480,602	\$ 2,498,376	\$ 5,293,542	\$ 438,595,039

### NOTE 3 — CAPITAL:

The Association's board of directors has established a Capital Adequacy Plan (Plan) that includes the capital targets that are necessary to achieve the institution's capital adequacy goals as well as the minimum permanent capital standards. The Plan monitors projected dividends, equity retirements and other actions that may decrease the Association's permanent capital. In addition to factors that must be considered in meeting the minimum standards, the board of directors also monitors the following factors: capability of management; quality of operating policies, procedures, and internal controls; quality and quantity of earnings; asset quality and the adequacy of the allowance for losses to absorb potential loss within the loan and lease portfolios; sufficiency of liquid funds; needs of an institution's customer base; and any other risk-oriented activities, such as funding and interest rate risk, potential obligations under joint and several liability, contingent and off-balance-sheet liabilities or other conditions warranting additional capital. At least quarterly, management reviews the Association's goals and objectives with the board.

In January 2013, the Association approved a resolution for a \$5,334,166 patronage distribution to its stockholders. The distribution was paid in March 2013. The Association was able to return these funds to its members due to strong earnings over the past three years.

At a July 2013 Special Stockholders Meeting, the Association's stockholders approved an amendment to the Association's capitalization bylaws addressing the amount of stock a borrower must purchase as a condition of borrowing from the Association. The change affected the range within which the board of directors is authorized to set the stock requirement, and also the manner in which the stock requirement is calculated.

Effective September 1, 2013, the stock requirement changed to be applied at the borrower level instead of the loan level and is now measured as 2 percent of the aggregate of all of a borrower's loans, up to a maximum of \$1,000. Further, if needed to meet regulatory capital adequacy requirements, the maximum amount to which the board of directors may increase the stock requirement to 10 percent of the amount of each of the borrower's loans.

In relation to the amended stock requirement in August 2013, the board of directors approved a "stock equalization" action, or the refund of excess stock amounts to borrowers impacted by the conversion of the stock requirement from the loan level to the borrower level. The stock equalization refund had a minimal impact on the Association's permanent capital ratio. The stock equalization refund of \$782,125 was paid in the third quarter of 2013.

### NOTE 4 – CAPITAL MARKETS

Until the second quarter of 2007, the Association participated in the Capital Markets of the South (CMS), a joint venture created in 2003 for the purpose of expanding the participants' lending opportunities. The CMS group was comprised of the Association, Alabama Ag Credit, ACA, Mississippi Land Bank, ACA, Southern Ag Credit, ACA, and Louisiana Land Bank, ACA. During the second quarter of 2007, the CMS members decided to discontinue and dissolve the joint venture. The associations will continue to service the existing CMS loan portfolio, with revenue and expenses continuing to be shared accordingly as noted below, until such time as all of the loans are fully matured or paid off.

Pursuant to the terms of the alliance, each of the five CMS participating associations generally shares equally in the costs of operating the venture. The Association's pro-rata share of income from CMS operations is recorded in the statement of income in their respective line items. The Association's pro-rata share of expenses from CMS operations is recorded in the statement of income in the line item "Purchased services."

As of September 30, 2013 and December 31, 2012, the Association had CMS related loan volume outstanding in the amount of \$3,756,078 and \$6,046,423 respectively. The Association had unfunded commitments on CMS loans of \$1,200,000 as of September 30, 2013, as compared to \$1,536,000 for the year ended December 31, 2012.

#### **NOTE 5 — INCOME TAXES:**

Alabama Farm Credit, ACA and its subsidiary are subject to federal and certain other income taxes. The Associations are eligible to operate as cooperatives that qualify for tax treatment under Subchapter T of the Internal Revenue code. Under specified conditions, the Associations can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage refunds. During the nine months ended September 30, 2013, the Association participated in a patronage program. Deferred taxes are recorded at the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution and will therefore impact future tax payments. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (more than 50 percent probability), based on management's estimate, that they will not be realized. For the nine months ended September 30, 2013, and 2012, net income for tax purposes

The subsidiary, Alabama Farm Credit, FLCA, is exempt from federal and other income tax as provided in the Farm Credit Act of 1971.

#### **NOTE 6 — FAIR VALUE MEASUREMENTS:**

FASB guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 14 to the 2012 Annual Report to Stockholders for a more complete description.

Assets and liabilities measured at fair value including accrued interest on a nonrecurring basis for each of the fair value hierarchy values are summarized below:

<u>September 30, 2013</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Loans*	\$ -	\$ -	\$ 3,306,734	\$ 3,306,734
Other property owned	-	-	2,969,344	2,969,344
<u>December 31, 2012</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Loans*	\$ -	\$ -	\$ 1,095,165	\$ 1,095,165
Other property owned	-	-	3,413,520	3,413,520

\*Represents the fair value of certain loans that were evaluated for impairment under authoritative guidance "Accounting by Creditors for Impairment of a Loan." The fair value was based upon the underlying collateral since these were collateral-dependent loans for which real estate is the collateral.

As more fully discussed in Note 14 to the 2012 Annual Report to Stockholders, authoritative guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following represent a brief summary of the valuation techniques used for the Association's assets and liabilities. For a more complete description, see Notes to the 2012 Annual Report to Stockholders.

#### *Loans*

For certain loans evaluated for impairment under authoritative guidance, the fair value is based upon the underlying collateral since the loans were collateral-dependent loans for which real estate is the collateral. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the real estate, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established.

#### *Other Property Owned*

Other property owned is generally classified as Level 3. The fair value is based upon the collateral value, which is generally determined using appraisals or other indications based on comparable sales of similar properties. Costs to sell represent transaction costs and are not included as a component of the asset's fair value.

### **NOTE 7 — EMPLOYEE BENEFIT PLANS:**

The following table summarizes the components of net periodic benefit costs of nonpension other postretirement employee benefits for the three months ended September 30:

	Other Benefits	
	2013	2012
Service cost	\$ 9,198	\$ 7,231
Interest cost	18,861	18,583
Amortization of prior service credits	(10,093)	(11,924)
Amortization of net actuarial loss	8,425	4,695
Net periodic benefit cost	<u>\$ 26,391</u>	<u>\$ 18,585</u>

The following table summarizes the components of net periodic benefit costs of nonpension other postretirement employee benefits for the nine months ended September 30:

	Other Benefits	
	2013	2012
Service cost	\$ 27,593	\$ 21,693
Interest cost	56,582	55,749
Amortization of prior service credits	(30,279)	(35,773)
Amortization of net actuarial loss	25,276	14,084
Net periodic benefit cost	<u>\$ 79,172</u>	<u>\$ 55,753</u>

The Association previously disclosed in its financial statements for the year ended December 31, 2012, that it expected to contribute \$31,458 to the district's nonpension other post-retirement benefit in 2013. As of September 30, 2013, \$31,785 of contributions have been made. The Association presently anticipates contributing an additional \$7,936 to fund the district's nonpension other post-retirement benefit pension plan in 2013 for a total of \$39,731.

The Association's liability for the unfunded accumulated obligation for these benefits at September 30, 2013, was \$1,789,743 and is included in "Other Liabilities" in the balance sheet.

The Association's accumulated other comprehensive loss relates entirely to its nonpension other postretirement benefits. Amortization of prior service credits and of actuarial loss are reflected in "Salaries and employee benefits" in the Consolidated Statement of Comprehensive Income. The following table summarizes the changes in accumulated other comprehensive loss for the nine months ended September 30:

	<u>2013</u>	<u>2012</u>
Accumulated other comprehensive loss at January 1	\$ (355,772)	\$ (130,405)
Amortization of prior credit costs included in net periodic postretirement benefit cost	<u>(5,003)</u>	<u>(21,690)</u>
Accumulated other comprehensive loss at September 30	<u>\$ (360,775)</u>	<u>\$ (152,095)</u>

The Association also participates in the district's defined benefit pension plan which is characterized as multiemployer since the assets, liabilities and cost of the plan are not segregated or separately accounted for by participating employers (Bank and associations). The Association recognizes its amortized annual contributions to the plan as an expense. In January 2013 the Association recorded its total defined benefit pension plan contribution amount of \$900,567 to a prepaid account and has recognized \$675,425 of expense through September 30, 2013.

**NOTE 8 — COMMITMENTS AND CONTINGENT LIABILITIES:**

The Association is involved in various legal proceedings in the normal course of business. In the opinion of legal counsel and management, there are no legal proceedings at this time that are likely to materially affect the Association.

**NOTE 9 — SUBSEQUENT EVENTS:**

The Association has evaluated subsequent events through November 8, 2013, which is the date the financial statements were issued. There are no other significant events requiring disclosure as of November 8, 2013.