Quarterly REPORT

SECOND QUARTER 2014

AGFIRST
FARM CREDIT BANK

SECOND QUARTER 2014

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CERTIFICATION

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

Robert H. Spiers, Jr.
Chairman of the Board

Leon T. Amerson
Chief Executive Officer & President

Charl L. Butler
Chief Financial Officer

August 7, 2014

Report on Internal Control Over Financial Reporting

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

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

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

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

Leon T. Amerson
Chief Executive Officer & President

Charl L. Butler
Chief Financial Officer

August 7, 2014

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

The following discussion reviews the financial condition and results of operations of AgFirst Farm Credit Bank (AgFirst or Bank) as of and for the three and six month periods ended June 30, 2014. These comments should be read in conjunction with the accompanying financial statements, the Notes to the Financial Statements, and the 2013 Annual Report of AgFirst Farm Credit Bank. AgFirst and its related associations (Associations or District Associations) are collectively referred to as the District. The accompanying financial statements were prepared under the oversight of the Audit Committee of the AgFirst Board of Directors.

Key ratios and data reported below, and in the accompanying financial statements, address the financial performance of AgFirst. However, neither the three months nor the six months results of operations may be indicative of an entire year due to the seasonal nature of a portion of AgFirst's business.

FORWARD-LOOKING INFORMATION

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

- political, legal, regulatory, financial markets, and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural infrastructure, international, and farm-related business sectors, as well as in the general economy;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income of District borrowers;
- changes in United States Government support of the agricultural industry and the Farm Credit System (System) as a government-sponsored enterprise (GSE), as well as investor and rating agency reactions to events involving the U.S. Government, other GSEs and other financial institutions; and
- actions taken by the Federal Reserve System in implementing monetary and fiscal policy, as well as other policies and actions of the federal government that impact the financial services industry and the debt markets.

FINANCIAL CONDITION

Loan Portfolio

AgFirst's loan portfolio consists of direct loans to District Associations (Direct Notes), loan participations/ syndications purchased (Capital Markets), Correspondent Lending loans (primarily first lien rural residential mortgages), and loans to Other Financing Institutions (OFIs) as shown below:

Loan Portfolio *(dollars in thousands)*	**June 30, 2014**		**December 31, 2013**		**June 30, 2013**	
Direct Notes*	$ 14,023,422	69.16%	$ 13,990,178	69.25%	$ 13,702,608	68.34%
Capital Markets*	3,726,106	18.38	3,726,378	18.45	3,917,884	19.54
Correspondent Lending	2,431,828	11.99	2,401,563	11.89	2,346,660	11.70
Loans to OFIs	95,975	0.47	83,116	0.41	83,578	0.42
Total	$ 20,277,331	100.00%	$ 20,201,235	100.00%	$ 20,050,730	100.00%

**Net of participations sold.*

Total loans outstanding were $20.277 billion at June 30, 2014, an increase of $76.1 million, or 0.38 percent, compared to total loans outstanding at December 31, 2013 and an increase of $226.6 million, or 1.13 percent, since June 30, 2013. Compared to 2013 year end, excluding Bank patronage payments to Associations of approximately $337.7 million which were applied to the Association Direct Notes at the beginning of 2014, loan volume at June 30, 2014 increased 2.05 percent. Overall, Bank loan demand continues to be challenged due to a number of reasons, including higher than the historical average capital at the District Associations, which has slowed Direct Note borrowings. Low economic growth has inhibited loan demand from borrowers in economically dependent sectors and borrowers dependent on non-farm income. An increasingly competitive environment for agricultural loans has also challenged volume. Future Bank loan demand is difficult to predict; however, it is expected to remain modest through 2014 as those factors discussed above are anticipated to persist.

Credit Quality

Credit quality of AgFirst's loans is shown below:

	Total Loan Portfolio Credit Quality as of:		
Classification	**June 30, 2014**	**December 31, 2013**	**June 30, 2013**
Acceptable	89.35%	89.00%	86.69%
OAEM *	10.12%	6.89%	8.87%
Adverse **	0.53%	4.11%	4.44%

**Other Assets Especially Mentioned*
***Adverse loans include substandard, doubtful, and loss loans.*

The changes in credit quality reflected in the table above were primarily due to changes in credit quality of the Direct Notes, which is discussed in the Direct Notes section below. Loan portfolio credit quality at the producer level reflected improvement due to stabilization of economic conditions. Most distressed property sales are now occurring at or near appraised values, indicating that real estate values have stabilized in most District markets. Grain prices have returned to more normal levels due to higher than expected inventory and harvest levels. This benefitted the poultry, cattle, and swine sectors. Improved housing starts have positively impacted certain housing-related segments such as forestry and nursery/greenhouse.

Under the terms of a financial assistance agreement, the Bank may be required to purchase certain high risk assets from a District Association. If such a purchase occurs, it likely would not have a material adverse effect on either the financial condition or future operating results of the Bank. See Note 8, *Commitments and Contingent Liabilities*, in the Notes to the Financial Statements for further information.

The credit conditions discussed above directly affect the credit quality of the Bank's participation/syndication loan portfolio. They also affect the credit quality of loan portfolios and earnings performance of the individual District Associations, which impacts the quality of the Bank's Direct Notes. Credit quality is anticipated to improve incrementally during the remainder of 2014 assuming stable economic conditions.

Direct Notes

AgFirst's primary business is to provide funding, operational support, and technology services to District Associations. Each Association, in addition to the Bank, is a federally chartered instrumentality of the United States and is regulated by the Farm Credit Administration (FCA). AgFirst has a revolving line of credit, referred to as a Direct Note, in place with each of the District Associations. Each of the Associations funds its lending and general corporate activities primarily by borrowing under its Direct Note. Lending terms are specified in a separate General Financing Agreement (GFA) between AgFirst and each Association. Each GFA contains minimum borrowing base margin, capital, and earnings requirements that must be maintained by the Association.

At June 30, 2014, the total Direct Note volume outstanding was $14.023 billion, an increase of $33.2 million, or 0.24 percent, compared to December 31, 2013. When compared to 2013 year end excluding Bank patronage payments of approximately $337.7 million referenced in the *Loan Portfolio* section above, Direct Note volume increased 2.65%. See the *Loan Portfolio* section above for the primary reasons for the modest growth in the Direct Note volume from December 2013 to June 2014.

The following table presents selected statistics related to the credit quality of the Direct Note portfolio including accrued interest:

Direct Note Credit Quality as of

	June 30, 2014		December 31, 2013		June 30, 2013	
Classification	**% Total**	**# Total**	**% Total**	**# Total**	**% Total**	**# Total**
Acceptable	86.34%	14	85.96%	14	83.14%	13
OAEM *	13.66%	5	9.23%	4	12.09%	5
Adverse **	0.00%	0	4.81%	1	4.77%	1

**Other Assets Especially Mentioned*
***Adverse loans include substandard, doubtful, and loss loans.*

As of June 30, 2014, fourteen of the nineteen District Associations' Direct Notes, representing 86.34 percent of the Direct Note portfolio, were classified acceptable. The five remaining Direct Notes, representing 13.66 percent of the portfolio, were classified as OAEM. From December 31, 2013 to June 30, 2014, the classification of the Direct Note for one Association improved from adverse to OAEM.

Presently, collection of the full Direct Note amount due is expected for all Associations in accordance with the contractual terms of the debt arrangements, and no allowance has been recorded for Direct Notes. All assets of the various Associations are pledged as collateral for their respective Direct Notes. In the opinion of management, all Association Direct Notes are adequately collateralized. The risk funds of an Association, including both capital and the allowance for loan losses, also protect the interest of the Bank should a Direct Note default.

As of June 30, 2014, five District Associations, with combined assets of $3.733 billion, were operating under written supervisory agreements with the FCA. Those agreements require the District Associations to take corrective actions with respect to one or more of the following: asset quality, capital, portfolio management, and corporate governance. Also, as of June 30, 2014, one District Association was operating under a special credit agreement pursuant to its GFA as a result of events of default under the GFA. Neither these enforcement actions nor GFA events of default are expected to have a significant adverse impact on the Bank's or District's financial condition or results of operations.

Capital Markets

The Capital Markets portfolio consists primarily of loan participations and syndications. As of June 30, 2014, this portfolio totaled $3.726 billion, a decrease of $272 thousand, or 0.01 percent, from December 31, 2013. Borrower demand in this portfolio is anticipated to reflect modest improvement for the remainder of 2014.

AgFirst employs a number of management techniques to limit credit risk, including underwriting standards, limits on the amounts of loans purchased from a single originator, and maximum hold positions to a single borrower and commodity. Although the participations/syndications portfolio is comprised of a small number of relatively large loans, it is diversified both geographically and on a commodity basis. Management makes adjustments to credit policy and underwriting standards when appropriate as a part of the ongoing risk management process.

Credit quality statistics for the participations/syndications portfolio are shown in the following chart:

	Participations/Syndications Credit Quality as of:		
Classification	**June 30, 2014**	**December 31, 2013**	**June 30, 2013**
Acceptable	93.48%	93.14%	90.87%
OAEM	3.71%	2.64%	3.10%
Adverse	2.81%	4.22%	6.03%

**Other Assets Especially Mentioned*
***Adverse loans include substandard, doubtful, and loss loans.*

Improvement in the overall credit quality of the participations/syndications portfolio is reflective of the incremental improvement in general economic conditions, including employment, the housing market, and real estate values.

Correspondent Lending

AgFirst also maintains a Correspondent Lending Unit, which consists primarily of first lien residential mortgages. As of June 30, 2014, the correspondent lending portfolio totaled $2.432 billion. From December 31, 2013 to June 30, 2014, this portfolio increased $30.3 million, or 1.26 percent.

Substantially all loans originated on or before July 31, 2013 in the correspondent lending portfolio have guarantees from the Federal National Mortgage Association (Fannie Mae) and/or the Federal Agricultural Mortgage Corporation (Farmer Mac), thereby limiting credit risk to AgFirst. The guarantees are in the form of Long-Term Standby Commitments to Purchase, which give AgFirst the right to deliver delinquent loans to the guarantor at par. The Fannie Mae guarantee program ended on July 31, 2013. Subsequent to this date, new loans in this portfolio purchased by the Bank are held without a Fannie Mae guarantee. At June 30, 2014, $2.121 billion of loans in the correspondent lending portfolio were guaranteed and $310.7 million were unguaranteed. The Bank's methodology of establishing and maintaining the allowance for loan losses related to this portfolio reflects the discontinuation of the Fannie Mae guarantee program.

At June 30, 2014, 99.93 percent of the correspondent lending portfolio was classified as acceptable and 0.07 percent was classified as substandard.

Rural home loans combined with Rural Home Mortgage-backed Securities, which totaled $2.780 billion at June 30, 2014, are limited to 15 percent of total loans outstanding as defined by FCA. Based on June 30, 2014 levels, the Bank has unused capacity of $273.8 million under a total limit of $3.053 billion. The Bank monitors this position and will consider options to reduce the Rural Home asset level with actions including, but not limited to, securitizing and selling a portion of its future rural home loan production. See Note 3, *Investment Securities*, for further discussion of Rural Home Mortgage-backed Securities.

Nonaccrual Loans

Nonaccrual loans represent all loans for which there is a reasonable doubt as to the collection of principal and/or interest under the contractual terms of the loan. Nonaccrual loans for the Bank at June 30, 2014 of $48.7 million decreased 18.23 percent compared to $59.6 million at December 31, 2013. The decrease of $10.9 million resulted primarily from repayments of $14.8 million offset in part by $4.9 million of transfers into nonaccrual. At June 30, 2014, total nonaccrual loans were primarily classified in the tree fruits/nuts (35.31 percent of the total), forestry (23.06 percent), and nursery/greenhouse (22.93 percent) segments. Nonaccrual loans were 0.24 percent and 0.30 percent of total loans outstanding at June 30, 2014 and December 31, 2013, respectively.

Troubled Debt Restructurings

A troubled debt restructuring (TDR) occurs when a borrower is experiencing financial difficulties and a concession is granted to the borrower that the Bank would not otherwise consider. Concessions are granted to borrowers based on either an assessment of the borrower's ability to return to financial viability or a court order. The concessions can be in the form of a modification of terms, rates, or amounts owed. Acceptance of other assets and/or equity as payment may also be considered a concession. The type of alternative financing granted is chosen in order to minimize the loss incurred by the Bank. TDRs decreased $5.2 million since December 31, 2013 and totaled $31.6 million at June 30, 2014. TDRs were comprised of $9.1 million of accruing restructured loans and $22.5 million of nonaccrual restructured loans. Restructured loans were primarily in the nursery/greenhouse (38.32 percent of the total), forestry (21.15 percent), and other real estate (16.32 percent) segments.

Other Property Owned

Other property owned (OPO) consists primarily of assets once pledged as loan collateral that were acquired through foreclosure or deeded to the Bank (or a lender group) in satisfaction of secured loans. OPO is generally comprised of real estate, equipment, and equity interests in companies or partnerships. OPO decreased $6.2 million since December 31, 2013 and totaled $3.4 million at June 30, 2014. The decrease was primarily due to disposals of $6.0 million. The two largest OPO holdings at June 30, 2014 were two land holdings which totaled $2.8 million (80.41 percent of the total).

Allowance for Loan Losses

The Bank maintains an allowance for loan losses at a level management considers adequate to provide for probable and estimable credit losses within the loan portfolio as of each reported balance sheet date. The allowance for loan losses was $22.1 million at June 30, 2014, as compared with $22.9 million at December 31, 2013, which was a decrease of $809 thousand. The primary activities within the allowance for the six months ended June 30, 2014 were reversals of the allowance for loan losses of $4.4 million, partially offset by provision expense of $2.6 million and recoveries of $1.2 million. The largest provision reversal ($1.3 million) and the largest recovery ($898 thousand) related to one loan in the forestry segment. See *Provision for Loan Losses* section below for additional details regarding loan loss provision expense and reversals. The allowance at June 30, 2014 included specific reserves of $7.8 million (35.48 percent of the total) and general reserves of $14.3 million (64.52 percent). The general reserves at June 30, 2014 included $2.9 million of allowance provided by the Bank for loans in the correspondent lending portfolio purchased after July 31, 2013 which are being held without a Fannie Mae guarantee. See further discussion in the *Correspondent Lending* section above. None of the allowance relates to the Direct Note portfolio as mentioned in the *Direct Note* section above. The total allowance at June 30, 2014 was comprised primarily of reserves for the nursery/greenhouse (19.33 percent of the total), forestry (17.90 percent), tree fruits/nuts (16.03 percent), and rural home loan (13.21 percent) segments. See Note 2, *Loans and Allowance for Loan Losses*, in the Notes to the Financial Statements for further information.

Liquidity and Funding Sources

One of AgFirst's primary responsibilities is to maintain sufficient liquidity to fund the lending operations of the District Associations, in addition to its own needs. Along with normal cash flows associated with lending operations, AgFirst has two primary sources of liquidity: the capacity to issue Systemwide Debt Securities through the Federal Farm Credit Banks Funding Corporation; and cash and investments. The Bank also maintains several lines of credit with commercial banks, as well as securities repurchase agreement facilities.

The U.S. Government does not guarantee, directly or indirectly, Systemwide Debt Securities. However, the Farm Credit System, as a GSE, has benefited from broad access to the domestic and global capital markets. This access has provided the System with a dependable source of competitively priced debt which is critical for supporting the System's mission of providing credit to agriculture and rural America. The implied link between the credit rating of the System and the U.S. Government, given the System's status as a GSE and continued concerns regarding the government's borrowing limit and budget imbalances, could pose risk to the System in the future.

AgFirst's primary source of liquidity comes from its ability to issue Systemwide Debt Securities, which are the general unsecured joint and several obligations of the System banks. AgFirst continually raises funds in the debt markets to support its mission, to repay maturing Systemwide Debt Securities, and to meet other obligations.

On September 24, 2013, the Farm Credit System Insurance Corporation (FCSIC) entered into an agreement with the Federal Financing Bank, a federal instrumentality subject to the supervision and direction of the U.S. Treasury, pursuant to which the Federal Financing Bank could advance funds to FCSIC. Under its existing statutory authority, FCSIC would use these funds to provide assistance to the System banks in exigent market circumstances which threaten the banks' ability to pay maturing debt obligations. The agreement provides for advances of up to $10 billion and terminates on September 30, 2014, unless otherwise extended. This agreement is expected to be renewed prior to its expiration. Each funding obligation of the Federal Financing Bank is subject to various terms and conditions and, as a result, there can be no assurance that funding will be available when needed by AgFirst or the System.

Currently, Standard & Poor's Ratings Services, Moody's Investor Service and Fitch Ratings have assigned long-term debt ratings for the System of AA+, Aaa, and AAA and short-term debt ratings of A-1+, P-1, and F-1, respectively. Standard & Poor's and Moody's outlook for the System is stable. In October 2013, Fitch changed its outlook for the System from stable to negative in connection with Fitch's placement of the U.S. Government on negative watch. Negative changes to the System's credit ratings could reduce earnings by increasing debt funding costs, and could also have a material adverse effect on liquidity, the ability to conduct normal business operations, and the Bank's overall financial condition and results of operations. However, AgFirst anticipates continued access to funding necessary to support the District's and Bank's needs.

At June 30, 2014, AgFirst had $25.687 billion in total debt outstanding compared to $26.225 billion at December 31, 2013. Total interest-bearing liabilities decreased primarily due to the decrease in liquidity investments as discussed elsewhere in this report, which, when combined with an increase in retained earnings, reduced funding requirements.

Cash and cash equivalents, which decreased $438.8 million from December 31, 2013 to a total of $744.9 million at June 30, 2014, consist primarily of cash on deposit and money market securities that are short-term in nature (from overnight maturities to maturities that range up to 90 days). Incremental movements in cash balances are due primarily to changes in liquidity needs in relation to upcoming debt maturities between reporting periods.

Investment securities totaled $6.835 billion, or 24.27 percent of total assets at June 30, 2014, compared to $7.153 billion, or 24.80 percent, as of December 31, 2013. Investment securities decreased $318.0 million (4.45 percent), compared to December 31, 2013. Management maintains the available-for-sale liquidity investment portfolio size generally proportionate with that of the loan portfolio and within regulatory and policy guidelines.

Investment securities classified as being available-for-sale totaled $6.264 billion at June 30, 2014. Available-for-sale investments at June 30, 2014 included $4.222 billion in U.S. Government guaranteed securities, $1.835 billion in U.S. Government agency guaranteed securities, $167.4 million in non-agency collateralized mortgage obligations (CMOs), and $40.0 million in asset-backed securities. Since the majority of the portfolio is invested in agency securities, the portfolio is highly liquid and potential credit loss exposure is limited.

As of June 30, 2014, AgFirst exceeded all applicable regulatory liquidity requirements. FCA regulations require that the Bank have a liquidity policy that establishes a minimum total "coverage" level of 90 days and that short-term liquidity requirements must be met by certain high quality investments or cash. "Coverage" is defined as the number of days that maturing debt could be funded with eligible cash, cash equivalents, and available-for-sale investments maintained by the Bank.

Eligible liquidity investments are classified according to three liquidity quality levels with level 1 being the highest. The first 15 days of minimum liquidity coverage are met using only level 1 instruments, which include cash and cash equivalents. Days 16 through 30 of minimum liquidity coverage are met using level 1 and level 2 instruments. Level 2 consists primarily of U.S. Government guaranteed securities. Days 31 through 90 are met using level 1, level 2, and level 3 securities. Level 3 consists primarily of U.S. agency investments. Additionally, a supplemental liquidity buffer in excess of the 90-day minimum liquidity reserve is set to provide coverage to at least 120 days.

At June 30, 2014, AgFirst met all individual level criteria and had a total of 232 days of maturing debt coverage compared to 246 days at December 31, 2013. Cash provided by the Bank's operating activities, primarily generated from net interest income in excess of operating expenses and maturities in the loan portfolio, is an additional source of liquidity for the Bank that is not reflected in the coverage calculation.

Net unrealized gains related to investment securities were $109.5 million at June 30, 2014, compared to $100.7 million at December 31, 2013. These net unrealized gains are reflected in Accumulated Other Comprehensive Income (AOCI) in the Financial Statements. The net unrealized gains stem from normal market factors such as the current interest rate environment.

The Bank performs periodic credit reviews, including other-than-temporary impairment analyses, on its entire investment securities portfolio. Based on the results of all analyses, the Bank recognized other-than-temporary credit related impairment of $1.5 million for the six months ended June 30, 2014, which was included in Net Other-than-temporary Impairment Losses in the Statements of Income. See Note 3, *Investment Securities*, in the Notes to the Financial Statements for further information.

Capital Resources

Total shareholders' equity increased $187.3 million (8.73 percent) from December 31, 2013 to a total of $2.334 billion at June 30, 2014. This increase is primarily attributed to 2014 unallocated retained earnings from net income of $183.5 million.

On May 15, 2013, the Bank redeemed and cancelled the entire $150.0 million of Perpetual Non-Cumulative Preferred Stock issued October 14, 2003. This redemption was in accordance with the Board approved capital plan. The stock was redeemed at its par value together with accrued and unpaid dividends. See Note 5, *Shareholders' Equity*, in the Notes to the Financial Statements for further information.

Regulatory Capital Ratios

AgFirst's regulatory ratios are shown in the following table:

	Regulatory Minimum	**6/30/14**	**12/31/13**	**6/30/13**
Permanent Capital Ratio	7.00%	22.24%	22.85%	22.23%
Total Surplus Ratio	7.00%	22.20%	22.81%	22.19%
Core Surplus Ratio	3.50%	19.63%	19.98%	19.55%
Net Collateral Ratio	103.00%	107.80%	106.83%	107.57%

The FCA sets minimum regulatory capital adequacy requirements for System banks and associations. These requirements are based on regulatory ratios as defined by the FCA, which include permanent capital, total surplus, core surplus, and for System banks only, net collateral. The permanent capital ratio is calculated by dividing permanent capital by a risk-adjusted asset base. The total surplus ratio is calculated by dividing total surplus by a risk-adjusted asset base and the core surplus ratio is calculated by dividing core surplus by a risk-adjusted asset base. Risk-adjusted assets refer to the total dollar amount of the institution's assets adjusted by an appropriate credit conversion factor as defined by regulation. Generally, higher credit conversion factors are applied to assets with more inherent risk. Unlike the permanent capital, total surplus and core surplus ratios, the net collateral ratio does not incorporate any risk-adjusted weighting of assets. The net collateral ratio is calculated by dividing the Bank's collateral, as defined by FCA regulations, by total liabilities. The permanent capital, total surplus, and core surplus ratios are calculated using three-month average daily balances and the net collateral ratio is calculated using period end balances.

For all periods presented, AgFirst exceeded minimum regulatory standards for all of the ratios. The Bank's permanent capital, total surplus, and core surplus ratios decreased at June 30, 2014 as compared to December 31, 2013. Because, these three ratios are calculated using a three month average daily balance for both capital and assets, total Bank declared patronage of $353.8 million in 2013, which represented approximately 77.4% of 2013 net income and primarily accrued in the fourth quarter of 2013, was fully reflected in these three ratios at June 30, 2014.

On May 8, 2014, the FCA approved a proposed rule to modify the regulatory capital requirements for System banks and associations. See *Regulatory Matters* section below for further discussion on the proposed rule.

RESULTS OF OPERATIONS

Net income for the three months ended June 30, 2014 was $95.0 million compared to $110.8 million for the three months ended June 30, 2013, a decrease of $15.8 million, or 14.28 percent. Net income for the six months ended June 30, 2014 was $183.5 million compared to $232.0 million for the corresponding period in 2013, a decrease of $48.5 million, or 20.92 percent.

Key Results of Operations Comparisons

	Annualized for the six months ended June 30, 2014	For the year ended December 31, 2013	Annualized for the six months ended June 30, 2013
Return on average assets	1.33%	1.61%	1.65%
Return on average shareholders' equity	16.47%	19.45%	19.67%
Net interest income as a percentage of average earning assets	1.78%	1.96%	2.04%
Operating expense as a percentage of net interest income and noninterest income	24.87%	20.39%	18.72%
Net (charge-offs) recoveries to average loans	0.01%	(0.06)%	(0.02)%

The first four ratios above have deteriorated in 2014 primarily due to a decrease in net interest income which is discussed below. For the operating expense as a percentage of net interest income and noninterest income ratio, operating expense consists primarily of noninterest expense (see discussion below) excluding losses/gains from other property owned. The net (charge-offs) recoveries to average loans ratio has improved in 2014 due to provision recoveries discussed below.

Net Interest Income

Net interest income for the three months ended June 30, 2014 was $121.0 million compared to $136.3 million for the same period of 2013, a decrease of $15.4 million or 11.27 percent. For the six months ended June 30, 2014, net interest income was $237.7 million compared to $276.6 million for the same period of 2013, a decrease of $38.9 million, or 14.07 percent. The net interest margin was 1.79 percent and 1.78 percent, a decrease of 21 and 26 basis points, respectively, for the three and six month periods of 2014 compared to the prior year. This decline was primarily the result of lower earning asset yields, but was also negatively impacted by higher rates paid on interest bearing liabilities. Over time, as interest rates change and as assets prepay or reprice, the positive impact on the net interest margin that the Bank has experienced over the last several years from calling debt will continue to diminish. Lower average balances of investments, as previously discussed, also decreased net interest income.

The following table illustrates the changes in net interest income:

	For the three months ended June 30, 2014 vs. June 30, 2013			For the six months ended June 30, 2014 vs. June 30, 2013		
	Increase (decrease) due to changes in:			Increase (decrease) due to changes in:		
(dollars in thousands)	Volume	Rate	Total	Volume	Rate	Total
Interest Income:						
Loans	$ 1,099	$ (6,690)	$ (5,591)	$ 1,723	$ (17,626)	$ (15,903)
Investments & Cash Equivalents	(1,976)	(2,489)	(4,465)	(4,364)	(7,133)	(11,497)
Total Interest Income	$ (877)	$ (9,179)	$ (10,056)	$ (2,641)	$ (24,759)	$ (27,400)
Interest Expense:						
Interest-Bearing Liabilities	$ (615)	$ 5,921	$ 5,306	$ (1,187)	$ 12,705	$ 11,518
Changes in Net Interest Income	$ (262)	$ (15,100)	$ (15,362)	$ (1,454)	$ (37,464)	$ (38,918)

Provision for Loan Losses

AgFirst measures risks inherent in its loan portfolio on an ongoing basis and, as necessary, recognizes provision for loan loss expense so that appropriate allowances for loan losses are maintained. Loan loss provision was a net reversal (recovery) of $2.4 million and $1.9 million for the three and six months ended June 30, 2014, respectively, compared to net reversals of $1.8 million and $1.5 million for the corresponding periods in 2013. For the three months ended June 30, 2014, net reversal of allowance for loan losses primarily related to borrowers in the tree fruits/nuts ($1.6 million) and forestry ($1.3 million) segments, partially offset by provision expense in the rural home loan ($1.4 million) segment. For the six months ended June 30, 2014, net reversals primarily related to borrowers in the forestry ($1.6 million) and tree fruits/nuts ($1.5 million) segments, partially offset by provision expense in the rural home loan ($2.0 million) segment. See Note 2, *Loans and Allowance for Loan Losses,* in the Notes to the Financial Statements for further information.

Noninterest Income

The following table illustrates the changes in noninterest income:

Change in Noninterest Income	**For the three months ended June 30,**			**For the six months ended June 30,**		
(dollars in thousands)	**2014**	**2013**	**Increase/ (Decrease)**	**2014**	**2013**	**Increase/ (Decrease)**
Loan fees	$ 2,012	$ 2,623	$ (611)	$ 4,410	$ 5,346	$ (936)
Building lease income	611	1,123	(512)	1,623	2,183	(560)
Net impairment losses on investments	(101)	(953)	852	(1,452)	(2,071)	619
Gains (losses) on investments, net	–	–	–	53	7,592	(7,539)
Gains (losses) on called debt	(2,352)	(2,296)	(56)	(5,215)	(4,002)	(1,213)
Gains (losses) on other transactions	344	193	151	603	(227)	830
Other noninterest income	921	1,278	(357)	2,271	2,830	(559)
Total noninterest income	$ 1,435	$ 1,968	$ (533)	$ 2,293	$ 11,651	$ (9,358)

For the three months ended June 30, 2014 compared to the corresponding period in 2013, noninterest income decreased $533 thousand primarily as a result of lower loan fees and building lease income, partially offset by lower impairment losses on investments.

Loan fees for the three month periods decreased $611 thousand primarily as a result of competitive capital market conditions.

The decline in building lease income for the three month periods was primarily due to the Bank occupying space in 2014 in its new office building that was previously leased to tenants.

Net impairment losses on investments decreased $852 thousand for the three month periods primarily from improvement in credit quality of home equity loans which collateralize most of the Bank's impaired investments.

Noninterest income decreased $9.4 million for the six months ended June 30, 2014 compared to the six months ended June 30, 2013 primarily as a result of lower gains on investments.

Gains on investments for the six month periods decreased $7.5 million primarily due to $7.6 million of securities gains recognized in March 2013 on bond sales that were made to manage the investment portfolio's size within regulatory guidelines. See discussion of investments in Note 3, *Investment Securities,* in the Notes to the Financial Statements for further information.

Increased losses on called debt of $1.2 million also contributed to the decline in noninterest income for the six month periods. Concession or debt issuance expense is amortized over the life of the underlying debt security. When debt securities are called prior to maturity, any unamortized concession is expensed. The called debt expense is more than offset by interest expense savings realized as called debt is replaced by new debt issued at a lower rate of interest. Over time, the favorable effect on net interest income is diminished as earning assets reprice downward.

Loan fees decreased $936 thousand for the six month periods primarily due to the competitive capital market environment mentioned above.

Lower net impairment losses on investments for the six month periods of $619 thousand resulted primarily from improvement in credit quality of home equity loans which collateralize most of the Bank's impaired investments, as mentioned above.

For the six month periods, gains on other transactions increased $830 thousand primarily due to a $771 thousand decrease in reserve expense for unfunded commitments resulting from a reduction in unfunded commitments.

Noninterest Expenses

The following table illustrates the changes in noninterest expense:

Change in Noninterest Expenses	**For the three months ended June 30,**			**For the six months ended June 30,**		
(dollars in thousands)	**2014**	**2013**	**Increase/ (Decrease)**	**2014**	**2013**	**Increase/ (Decrease)**
Salaries and employee benefits	$ 13,732	$ 11,696	$ 2,036	$ 27,124	$ 23,617	$ 3,507
Occupancy and equipment	5,333	4,256	1,077	10,416	8,508	1,908
Insurance Fund premiums	2,245	521	1,724	4,544	2,621	1,923
Other operating expenses	9,704	10,204	(500)	17,614	19,214	(1,600)
Losses (gains) from other property owned	(1,191)	2,610	(3,801)	(1,316)	3,772	(5,088)
Total noninterest expenses	$ 29,823	$ 29,287	$ 536	$ 58,382	$ 57,732	$ 650

Noninterest expense for the three and six months ended June 30, 2014 increased $536 thousand and $650 thousand, respectively, compared to the corresponding periods in 2013. For both the three and six month periods, increases in salaries and employee benefits, occupancy and equipment, and Insurance Fund premiums were partially offset by decreases in other operating expenses and losses from other property owned.

Salaries and employee benefits increased $2.0 million and $3.5 million for the three and six month periods, respectively. This was primarily due to a $1.0 million and $2.0 million increase, respectively, from a change in the accrual methodology for cash incentives in 2014 to record the related expense throughout the year. These expenses were recorded primarily in the month of December in previous years. Normal salary administration and higher employee benefit costs also contributed to the increase in salaries and employee benefits.

Occupancy and equipment expense increased $1.1 million and $1.9 million for the three and six month periods, respectively, primarily as a result of increases in depreciation and amortization expenses related to the Bank's new data center.

For the three and six month periods, Insurance Fund premiums increased $1.7 million and $1.9 million, respectively, primarily as a result of a $1.4 million insurance fund premium reimbursement received by the Bank in May 2013, after the Farm Credit System Insurance Corporation (FCSIC) made a clarification that cash held in a deposit account at the Federal Reserve Bank qualifies as a deduction in the premium calculation. The reimbursement was for the periods July 1, 2008, when the premium methodology initially changed to a debt basis, through December 31, 2012. Also contributing to the higher expense for the 2014 periods was an increase in the base annual premium rate to 12 basis points in 2014 from 10 basis points in 2013. The FCSIC Board makes premium rate adjustments, as necessary, to maintain the secure base amount which is based upon insured debt outstanding at System banks.

Other operating expenses decreased $500 thousand and $1.6 million for the three and six month periods, respectively, primarily due to $1.2 million and $2.3 million less, respectively, in correspondent lending servicing expenses related to guarantee fees.

Losses on other property owned decreased $3.8 million and $5.1 million for the three and six month periods, respectively, in part due to a $2.4 million gain on sale of an ethanol property recognized in June 2014 that had previously been deferred. Also, writedowns on other property owned decreased $1.9 million and $2.9 million for the three and six month periods, respectively, primarily due to stabilized real estate values. See *Other Property Owned* section above for further information.

DISTRICT MERGER ACTIVITY

Please refer to Note 10, *Business Combinations,* in the Notes to the Financial Statements for information regarding merger activity in the District.

REGULATORY MATTERS

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

On May 8, 2014, the FCA approved a proposed rule to modify the regulatory capital requirements for System banks and associations. The stated objectives of the proposed rule are as follows:

- To modernize capital requirements while ensuring that institutions continue to hold sufficient regulatory capital to fulfill their mission as a government-sponsored enterprise.
- To ensure that the System's capital requirements are comparable to the Basel III framework and the standardized approach that the federal banking regulatory agencies have adopted, but also to ensure that the rules recognize the cooperative structure and the organization of the System.
- To make System regulatory capital requirements more transparent.
- To meet the requirements of section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

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

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

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

The public comment period ends on October 23, 2014.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Please refer to Note 1, *Organization, Significant Accounting Policies, and Recently Issued Accounting Pronouncements,* in the Notes to the Financial Statements, and the 2013 Annual Report of AgFirst Farm Credit Bank for recently issued accounting pronouncements.

NOTE: Shareholder investment in a District Association is materially affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst's annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 2832, or writing Susanne Caughman, Reporting Manager, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Combined information concerning AgFirst Farm Credit Bank and District Associations can also be obtained at the Bank's website, *www.agfirst.com*. AgFirst prepares a quarterly report within 40 days after the end of each fiscal quarter, except that no quarterly report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

Balance Sheets

(dollars in thousands)	June 30, 2014	December 31, 2013
	(unaudited)	*(audited)*
Assets		
Cash	**$ 521,037**	$ 1,038,870
Cash equivalents	**223,911**	144,885
Investment securities:		
Available for sale (amortized cost of $6,154,715 and $6,462,222, respectively)	**6,264,225**	6,562,976
Held to maturity (fair value of $595,205 and $599,601, respectively)	**570,591**	589,812
Total investment securities	**6,834,816**	7,152,788
Loans	**20,277,331**	20,201,235
Allowance for loan losses	**(22,099)**	(22,908)
Net loans	**20,255,232**	20,178,327
Accrued interest receivable	**60,737**	63,070
Accounts receivable	**56,757**	55,933
Investments in other Farm Credit System institutions	**67,289**	67,466
Premises and equipment, net	**63,272**	52,599
Other property owned	**3,441**	9,621
Other assets	**71,008**	80,783
Total assets	**$ 28,157,500**	$ 28,844,342
Liabilities		
Systemwide bonds payable	**$ 22,053,589**	$ 24,315,776
Systemwide notes payable	**3,633,268**	1,909,103
Accrued interest payable	**44,588**	54,059
Accounts payable	**47,088**	368,670
Other liabilities	**44,913**	49,987
Total liabilities	**25,823,446**	26,697,595
Commitments and contingencies (Note 8)		
Shareholders' Equity		
Perpetual preferred stock	**125,250**	125,250
Capital stock and participation certificates	**305,192**	308,972
Additional paid-in-capital	**36,580**	36,580
Retained earnings		
Allocated	**704**	726
Unallocated	**1,760,293**	1,577,676
Accumulated other comprehensive income (loss)	**106,035**	97,543
Total shareholders' equity	**2,334,054**	2,146,747
Total liabilities and equity	**$ 28,157,500**	$ 28,844,342

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

Statements of Income

(unaudited)

(dollars in thousands)	For the three months ended June 30, 2014	For the three months ended June 30, 2013	For the six months ended June 30, 2014	For the six months ended June 30, 2013
Interest Income				
Investment securities and other	**$ 31,973**	$ 36,438	**$ 65,424**	$ 76,921
Loans	**140,105**	145,696	**276,692**	292,595
Total interest income	**172,078**	182,134	**342,116**	369,516
Interest Expense	**51,103**	45,797	**104,413**	92,895
Net interest income	**120,975**	136,337	**237,703**	276,621
Provision for (reversal of allowance for) loan losses	**(2,416)**	(1,814)	**(1,867)**	(1,480)
Net interest income after provision for loan losses	**123,391**	138,151	**239,570**	278,101
Noninterest Income				
Loan fees	**2,012**	2,623	**4,410**	5,346
Building lease income	**611**	1,123	**1,623**	2,183
Total other-than-temporary impairment losses	**—**	(552)	**(74)**	(1,165)
Portion of loss recognized in other comprehensive income	**(101)**	(401)	**(1,378)**	(906)
Net other-than-temporary impairment losses	**(101)**	(953)	**(1,452)**	(2,071)
Gains (losses) on investments, net	**—**	—	**53**	7,592
Gains (losses) on called debt	**(2,352)**	(2,296)	**(5,215)**	(4,002)
Gains (losses) on other transactions	**344**	193	**603**	(227)
Other noninterest income	**921**	1,278	**2,271**	2,830
Total noninterest income	**1,435**	1,968	**2,293**	11,651
Noninterest Expenses				
Salaries and employee benefits	**13,732**	11,696	**27,124**	23,617
Occupancy and equipment	**5,333**	4,256	**10,416**	8,508
Insurance Fund premiums	**2,245**	521	**4,544**	2,621
Other operating expenses	**9,704**	10,204	**17,614**	19,214
Losses (gains) from other property owned	**(1,191)**	2,610	**(1,316)**	3,772
Total noninterest expenses	**29,823**	29,287	**58,382**	57,732
Net income	**$ 95,003**	$ 110,832	**$ 183,481**	$ 232,020

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

Statements of Comprehensive Income

(unaudited)

(dollars in thousands)	For the three months ended June 30, 2014	For the three months ended June 30, 2013	For the six months ended June 30, 2014	For the six months ended June 30, 2013
Net income	**$ 95,003**	$ 110,832	**$ 183,481**	$ 232,020
Other comprehensive income net of tax:				
Unrealized gains (losses) on investments:				
Other-than-temporarily impaired	**2,389**	2,759	**9,231**	8,537
Not other-than-temporarily impaired	**1,303**	(55,338)	**(419)**	(59,181)
Change in value of cash flow hedges	**(191)**	(319)	**(454)**	(701)
Employee benefit plans adjustments	**67**	94	**134**	186
Other comprehensive income (Note 5)	**3,568**	(52,804)	**8,492**	(51,159)
Comprehensive income	**$ 98,571**	$ 58,028	**$ 191,973**	$ 180,861

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

Statements of Changes in Shareholders' Equity

(unaudited)

(dollars in thousands)	Perpetual Preferred Stock	Capital Stock and Participation Certificates	Additional Paid-In-Capital	Retained Earnings Allocated	Retained Earnings Unallocated	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at December 31, 2012	$275,250	$ 332,705	$ 36,580	$ 795	$ 1,481,432	$ 171,468	$ 2,298,230
Comprehensive income					232,020	(51,159)	180,861
Capital stock/participation certificates issued/(retired), net		(311)					(311)
Redemption of perpetual preferred stock (Note 5)	(150,000)						(150,000)
Dividends paid on perpetual preferred stock					(5,463)		(5,463)
Cash patronage declared					(10,000)		(10,000)
Retained earnings retired				(69)			(69)
Patronage distribution adjustment					(10)		(10)
Balance at June 30, 2013	$125,250	$ 332,394	$ 36,580	$ 726	$ 1,697,979	$ 120,309	$ 2,313,238
Balance at December 31, 2013	$125,250	$ 308,972	$ 36,580	$ 726	$ 1,577,676	$ 97,543	$ 2,146,747
Comprehensive income					**183,481**	**8,492**	**191,973**
Capital stock/participation certificates issued/(retired), net		**(3,775)**					**(3,775)**
Dividends paid on perpetual preferred stock					**(866)**		**(866)**
Retained earnings retired				**(22)**			**(22)**
Patronage distribution adjustment		**(5)**			**2**		**(3)**
Balance at June 30, 2014	**$125,250**	**$ 305,192**	**$ 36,580**	**$ 704**	**$ 1,760,293**	**$ 106,035**	**$ 2,334,054**

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

Statements of Cash Flows

(unaudited)

(dollars in thousands)	For the six months ended June 30, 2014	2013
Cash flows from operating activities:		
Net income	**$ 183,481**	$ 232,020
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation on premises and equipment	**3,827**	3,265
Premium amortization (discount accretion) on investment securities	**4,222**	6,588
(Premium amortization) discount accretion on bonds and notes	**3,421**	3,621
Provision for (reversal of allowance for) loan losses	**(1,867)**	(1,480)
(Gains) losses on other property owned, net	**(1,894)**	3,653
Net impairment losses on investments	**1,452**	2,071
(Gains) losses on investments, net	**(53)**	(7,592)
(Gains) losses on other transactions	**(603)**	227
Net change in loans held for sale	**4,716**	8,576
Changes in operating assets and liabilities:		
(Increase) decrease in accrued interest receivable	**2,333**	4,058
(Increase) decrease in accounts receivable	**(824)**	15,407
(Increase) decrease in other assets	**4,633**	1,650
Increase (decrease) in accrued interest payable	**(9,471)**	3,033
Increase (decrease) in accounts payable	**22,011**	(23,544)
Increase (decrease) in other liabilities	**(4,372)**	(4,260)
Total adjustments	**27,531**	15,273
Net cash provided by (used in) operating activities	**211,012**	247,293
Cash flows from investing activities:		
Investment securities purchased	**(357,902)**	(1,123,779)
Investment securities sold or matured	**678,611**	1,144,307
Net (increase) decrease in loans	**(80,273)**	145,066
(Increase) decrease in investments in other Farm Credit System institutions	**177**	83
Purchase of premises and equipment, net	**(14,427)**	(1,870)
Proceeds from sale of other property owned	**8,555**	7,080
Net cash provided by (used in) investing activities	**234,741**	170,887
Cash flows from financing activities:		
Bonds and notes issued	**12,550,107**	12,967,718
Bonds and notes retired	**(13,086,408)**	(13,545,980)
Capital stock and participation certificates issued/retired, net	**(3,775)**	(311)
Cash distribution to shareholders	**(343,596)**	(185,993)
Redemption of perpetual preferred stock	**—**	(150,000)
Dividends paid on perpetual preferred stock	**(866)**	(5,463)
Retained earnings retired	**(22)**	(69)
Net cash provided by (used in) financing activities	**(884,560)**	(920,098)
Net increase (decrease) in cash and cash equivalents	**(438,807)**	(501,918)
Cash and cash equivalents, beginning of period	**1,183,755**	873,165
Cash and cash equivalents, end of period	**$ 744,948**	$ 371,247
Supplemental schedule of non-cash investing and financing activities:		
Receipt of property in settlement of loans	**$ 481**	$ 3,010
Change in unrealized gains (losses) on investments, net	**8,812**	(50,644)
Employee benefit plans adjustments	**(134)**	(186)
Non-cash changes related to interest rate hedging activities:		
Increase (decrease) in bonds and notes	**$ (5,142)**	$ (8,730)
Decrease (increase) in other assets	**5,142**	8,730
Supplemental information:		
Interest paid	**$ 110,463**	$ 86,241

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

Notes to the Financial Statements

(unaudited)

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

Organization

The accompanying financial statements include the accounts of AgFirst Farm Credit Bank (AgFirst or Bank). AgFirst and its related Agricultural Credit Associations (Associations or District Associations) are collectively referred to as the AgFirst District (District). A complete description of the organization and operations, the significant accounting policies followed, and the financial condition and results of operations of the Bank as of and for the year ended December 31, 2013 are contained in the 2013 Annual Report to Shareholders. These unaudited interim financial statements should be read in conjunction with the latest Annual Report to Shareholders.

Basis of Presentation

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

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

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

Significant Accounting Policies

The Bank maintains an allowance for loan losses at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio as of the report date. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through loan charge-offs and allowance reversals. A review of individual loans in each respective portfolio is performed periodically to determine the appropriateness of risk ratings and to ensure loss exposure to the Bank has been identified. Certain loan pools acquired from several of the District Associations are analyzed in accordance with the selling Association's allowance methodologies for assigning general and specific allowances. The allowance for loan losses is a valuation account used to reasonably estimate loan losses as of the financial statement date. Determining the appropriate allowance for loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss. The Bank considers factors such as credit risk classifications, collateral values, risk concentrations, weather related conditions, current production and economic conditions, and prior loan loss experience, among others, when determining the allowance for loan losses.

A specific allowance may be established for impaired loans under Financial Accounting Standards Board (FASB) guidance on accounting by creditors for impairment of a loan. Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or at the loan's observable market price, or fair value of the collateral if the loan is collateral dependent.

A general allowance may also be established under FASB guidance on accounting for contingencies to reflect estimated probable credit losses incurred in the remainder of the loan portfolio at the financial statement date. The general allowance excludes loans included under the specific allowance discussed above, unless specific characteristics of the loan indicate that it is probable that there would be an incurred loss in a group of loans with those characteristics. The level of the general allowance may be based on management's best estimate of the likelihood of default adjusted for other relevant factors reflecting the current environment.

The credit risk rating methodology is a key component of the Bank's allowance for loan losses evaluation, and is generally incorporated into the institution's loan underwriting standards and internal lending limit. The Bank uses a two-dimensional loan rating model based on internally generated combined system risk rating guidance that incorporates a 14-point risk rating scale to identify and track the probability of borrower default and a separate scale addressing loss given default over a period of time. Probability of default is the probability that a borrower will experience a default within 12 months from the date of the determination of the risk rating. A default is considered to have occurred if the lender believes the borrower will not be able to pay its obligation in full or the borrower is past due more than 90 days. The loss given default is management's estimate as to the anticipated economic loss on a specific loan assuming default has occurred or is expected to occur within the next 12 months.

Each of the 14 categories carries a distinct percentage of default probability. The 14-point risk rating scale provides for granularity of the probability of default, especially in the acceptable ratings. There are nine acceptable categories that range from a borrower of the highest quality to a borrower of minimally acceptable quality. The probability of default between 1 and 9 is very narrow and would reflect almost no default to a minimal default percentage. The probability of default grows more rapidly as a loan moves from a "9" to other assets especially mentioned and grows significantly as a loan moves to a substandard (viable) level. A substandard (non-viable) rating indicates that the probability of default is almost certain.

Recently Issued Accounting Pronouncements

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

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

In January 2014 the FASB issued ASU 2014-04, "Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure." The objective of the amendments in this Update is to reduce diversity by clarifying when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The amendments are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. For entities other than public business entities, the amendments in this Update are effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. An entity can elect to adopt the amendments in this Update using either a modified retrospective transition method or a prospective transition method. Early adoption is permitted.

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

Note 2 — Loans and Allowance for Loan Losses

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

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

The credit risk management process begins with an analysis of the obligor's credit history, repayment capacity and financial position. Repayment capacity focuses on the obligor's ability to repay the obligation based on cash flows from operations or other sources of income, including non-farm income. Real estate mortgage loans must be secured by first liens on the real estate collateral. As required by Farm Credit Administration (FCA) regulations, each institution that makes loans on a secured basis must have collateral evaluation policies and procedures.

The credit risk rating process for loans uses a two-dimensional structure, incorporating a 14-point probability of default scale (as discussed in Note 1 above) and a separate scale addressing estimated percentage loss in the event of default. The loan rating structure incorporates borrower risk and transaction risk. Borrower risk is the risk of loss driven by factors intrinsic to the borrower. The transaction risk is related to the structure of a credit (tenor, terms, and collateral).

A summary of loans outstanding at period end follows:

(dollars in thousands)	June 30, 2014	December 31, 2013
Direct notes	$ 14,023,422	$ 13,990,178
Real estate mortgage	948,688	971,017
Production and intermediate-term	1,016,243	1,215,480
Loans to cooperatives	216,479	202,142
Processing and marketing	809,258	610,065
Farm-related business	158,971	141,530
Communication	212,500	198,546
Energy and water/waste disposal	430,507	453,361
Rural residential real estate	2,354,663	2,324,956
Loans to other financing institutions (OFIs)	95,975	83,116
Other (including Mission Related)	10,625	10,844
Total Loans	$ 20,277,331	$ 20,201,235

A substantial portion of the Bank's loan portfolio consists of notes receivable from District Associations (Direct Notes). These notes are used by the Associations to fund their loan portfolios, which collateralize the notes. Therefore, the Bank's concentration of credit risk in various agricultural commodities associated with these notes approximates that of the District as a whole. Loan concentrations are considered to exist when there are amounts loaned to a multiple number of borrowers engaged in similar activities, which would cause them to be similarly impacted by economic or other conditions. A substantial portion of the Associations' lending activities is collateralized, and their exposure to credit loss associated with lending activities is reduced accordingly, which further mitigates credit risk to the Bank.

The Bank may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume, and comply with FCA regulations. The following tables present the principal balance of participation loans at periods ended:

	June 30, 2014							
	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
(dollars in thousands)	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Direct note	$ –	$ –	$ –	$ 210,763	$ –	$ –	$ –	$ 210,763
Real estate mortgage	737,000	40,186	179,566	18,114	14,867	–	931,433	58,300
Production and intermediate-term	893,045	187,134	309,980	164,366	174,713	1,980	1,377,738	353,480
Loans to cooperatives	6,617	21,334	222,821	–	9,005	–	238,443	21,334
Processing and marketing	122,303	386,437	532,761	40,404	588,017	5,000	1,243,081	431,841
Farm-related business	32,036	16,076	95,299	–	48,340	–	175,675	16,076
Communication	–	69,362	272,568	–	9,900	–	282,468	69,362
Energy and water/waste disposal	–	20,470	446,048	–	6,696	–	452,744	20,470
Rural residential real estate	197	–	–	–	–	–	197	–
Other (including Mission Related)	10,776	–	–	–	–	–	10,776	–
Total	$ 1,801,974	$ 740,999	$ 2,059,043	$ 433,647	$ 851,538	$ 6,980	$ 4,712,555	$ 1,181,626

	December 31, 2013							
	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
(dollars in thousands)	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Direct notes	$ –	$ –	$ –	$ 200,000	$ –	$ –	$ –	$ 200,000
Real estate mortgage	780,538	33,918	163,856	30,554	15,607	–	960,001	64,472
Production and intermediate-term	1,137,162	210,211	346,781	220,747	185,446	18,333	1,669,389	449,291
Loans to cooperatives	4,409	4,425	188,961	–	13,942	–	207,312	4,425
Processing and marketing	45,388	282,395	371,087	17,685	497,901	–	914,376	300,080
Farm-related business	31,081	21,075	89,209	–	43,089	–	163,379	21,075
Communication	–	63,728	253,034	–	9,950	–	262,984	63,728
Energy and water/waste disposal	–	22,357	470,753	–	6,870	–	477,623	22,357
Rural residential real estate	202	–	–	–	–	–	202	–
Other (including Mission Related)	10,911	–	–	–	–	–	10,911	–
Total	$ 2,009,691	$ 638,109	$ 1,883,681	$ 468,986	$ 772,805	$ 18,333	$ 4,666,177	$ 1,125,428

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

	June 30, 2014			
(dollars in thousands)	Due less than 1 year	Due 1 through 5 years	Due after 5 years	Total
Direct notes	$ 660,706	$ 3,033,112	$ 10,329,604	$ 14,023,422
Real estate mortgage	45,003	261,731	641,954	948,688
Production and intermediate-term	162,184	581,362	272,697	1,016,243
Loans to cooperatives	55,332	107,012	54,135	216,479
Processing and marketing	14,924	471,852	322,482	809,258
Farm-related business	5,325	113,185	40,461	158,971
Communication	–	155,734	56,766	212,500
Energy and water/waste disposal	55,666	109,237	265,604	430,507
Rural residential real estate	72	2,609	2,351,982	2,354,663
Loans to OFIs	46,897	46,628	2,450	95,975
Other (including Mission Related)	–	279	10,346	10,625
Total Loans	$ 1,046,109	$ 4,882,741	$ 14,348,481	$ 20,277,331
Percentage	5.16%	24.08%	70.76%	100.00%

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

	June 30, 2014	December 31, 2013
Direct notes:		
Acceptable	86.34%	85.96%
OAEM	13.66	9.23
Substandard/doubtful/loss	–	4.81
	100.00%	100.00%
Real estate mortgage:		
Acceptable	89.75%	88.50%
OAEM	3.13	3.77
Substandard/doubtful/loss	7.12	7.73
	100.00%	100.00%
Production and intermediate-term:		
Acceptable	86.69%	88.34%
OAEM	9.71	4.95
Substandard/doubtful/loss	3.60	6.71
	100.00%	100.00%
Loans to cooperatives:		
Acceptable	100.00%	100.00%
OAEM	–	–
Substandard/doubtful/loss	–	–
	100.00%	100.00%
Processing and marketing:		
Acceptable	99.20%	99.99%
OAEM	0.80	–
Substandard/doubtful/loss	–	0.01
	100.00%	100.00%
Farm-related business:		
Acceptable	98.04%	97.78%
OAEM	1.96	2.22
Substandard/doubtful/loss	–	–
	100.00%	100.00%

	June 30, 2014	December 31, 2013
Communication:		
Acceptable	100.00%	100.00%
OAEM	–	–
Substandard/doubtful/loss	–	–
	100.00%	100.00%
Energy and water/waste disposal:		
Acceptable	100.00%	100.00%
OAEM	–	–
Substandard/doubtful/loss	–	–
	100.00%	100.00%
Rural residential real estate:		
Acceptable	99.93%	99.97%
OAEM	–	–
Substandard/doubtful/loss	0.07	0.03
	100.00%	100.00%
Loans to OFIs:		
Acceptable	100.00%	100.00%
OAEM	–	–
Substandard/doubtful/loss	–	–
	100.00%	100.00%
Other (including Mission Related):		
Acceptable	96.53%	96.98%
OAEM	–	–
Substandard/doubtful/loss	3.47	3.02
	100.00%	100.00%
Total Loans:		
Acceptable	89.35%	89.00%
OAEM	10.12	6.89
Substandard/doubtful/loss	0.53	4.11
	100.00%	100.00%

The following tables provide an age analysis of the recorded investment in past due loans as of:

	June 30, 2014					
(dollars in thousands)	**30 Through 89 Days Past Due**	**90 Days or More Past Due**	**Total Past Due**	**Not Past Due or Less Than 30 Days Past Due**	**Total Loans**	**Recorded Investment 90 Days or More Past Due and Accruing Interest**
Direct notes	$ –	$ –	$ –	$ 14,049,394	$ 14,049,394	$ –
Real estate mortgage	2,008	18,913	20,921	933,809	954,730	411
Production and intermediate-term	127	4,289	4,416	1,017,244	1,021,660	–
Loans to cooperatives	–	–	–	217,088	217,088	–
Processing and marketing	–	1,229	1,229	809,985	811,214	–
Farm-related business	–	–	–	159,320	159,320	–
Communication	–	–	–	212,695	212,695	–
Energy and water/waste disposal	–	–	–	431,641	431,641	–
Rural residential real estate	33,941	3,082	37,023	2,325,976	2,362,999	2,244
Loans to OFIs	–	–	–	96,103	96,103	–
Other (including Mission Related)	–	–	–	10,745	10,745	–
Total	$ 36,076	$ 27,513	$ 63,589	$ 20,264,000	$ 20,327,589	$ 2,655

	December 31, 2013					
(dollars in thousands)	**30 Through 89 Days Past Due**	**90 Days or More Past Due**	**Total Past Due**	**Not Past Due or Less Than 30 Days Past Due**	**Total Loans**	**Recorded Investment 90 Days or More Past Due and Accruing Interest**
Direct notes	$ –	$ –	$ –	$ 14,018,100	$ 14,018,100	$ –
Real estate mortgage	1,196	31,818	33,014	943,672	976,686	564
Production and intermediate-term	121	2,266	2,387	1,218,757	1,221,144	–
Loans to cooperatives	–	–	–	202,701	202,701	–
Processing and marketing	6	1,229	1,235	610,229	611,464	–
Farm-related business	–	–	–	141,930	141,930	–
Communication	–	–	–	198,721	198,721	–
Energy and water/waste disposal	–	–	–	454,410	454,410	–
Rural residential real estate	38,526	3,057	41,583	2,291,609	2,333,192	1,651
Loans to OFIs	–	–	–	83,228	83,228	–
Other (including Mission Related)	–	–	–	10,965	10,965	–
Total	$ 39,849	$ 38,370	$ 78,219	$ 20,174,322	$ 20,252,541	$ 2,215

The recorded investment in a 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.

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

(dollars in thousands)	June 30, 2014	December 31, 2013
Nonaccrual loans:		
Real estate mortgage	$ 40,865	$ 47,017
Production and intermediate-term	6,243	10,188
Rural residential real estate	1,623	2,389
Total nonaccrual loans	$ 48,731	$ 59,594
Accruing restructured loans:		
Real estate mortgage	$ 3,684	$ 4,218
Production and intermediate-term	544	–
Rural residential real estate	363	–
Other (including Mission Related)	4,497	4,582
Total accruing restructured loans	$ 9,088	$ 8,800
Accruing loans 90 days or more past due:		
Real estate mortgage	$ 411	$ 564
Rural residential real estate	2,244	1,651
Total accruing loans 90 days or more past due	$ 2,655	$ 2,215
Total nonperforming loans	$ 60,474	$ 70,609
Other property owned	3,441	9,621
Total nonperforming assets	$ 63,915	$ 80,230
Nonaccrual loans as a percentage of total loans	0.24%	0.30%
Nonperforming assets as a percentage of total loans and other property owned	0.32%	0.40%
Nonperforming assets as a percentage of capital	2.74%	3.74%

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

(dollars in thousands)	June 30, 2014	December 31, 2013
Impaired nonaccrual loans:		
Current as to principal and interest	$ 23,605	$ 23,234
Past due	25,126	36,360
Total impaired nonaccrual loans	48,731	59,594
Impaired accrual loans:		
Restructured	9,088	8,800
90 days or more past due	2,655	2,215
Total impaired accrual loans	11,743	11,015
Total impaired loans	$ 60,474	$ 70,609

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

	June 30, 2014			Quarter Ended June 30, 2014		Six Months Ended June 30, 2014	
(dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans	Average Impaired Loans	Interest Income Recognized on Impaired Loans
Impaired loans with a related allowance for credit losses:							
Real estate mortgage	$ 20,229	$ 31,162	$ 5,908	$ 20,248	$ –	$ 20,294	$ –
Production and intermediate-term	4,897	6,503	1,754	4,902	2	4,764	2
Processing and marketing	–	–	–	–	–	–	–
Rural residential real estate	224	224	25	224	–	112	–
Other (including mission-related)	4,437	4,451	153	4,441	140	4,095	140
Total	$ 29,787	$ 42,340	$ 7,840	$ 29,815	$ 142	$ 29,265	$ 142
Impaired loans with no related allowance for credit losses:							
Real estate mortgage	$ 24,731	$ 41,270	$ –	$ 27,542	$ 54	$ 28,190	$ 107
Production and intermediate-term	1,890	2,527	–	3,891	4	4,993	4
Processing and marketing	–	1,229	–	(3)	–	13	–
Rural residential real estate	4,006	4,782	–	4,528	38	6,574	108
Other (including mission-related)	60	–	–	178	(70)	509	–
Total	$ 30,687	$ 49,808	$ –	$ 36,136	$ 26	$ 40,279	$ 219
Total impaired loans:							
Real estate mortgage	$ 44,960	$ 72,432	$ 5,908	$ 47,790	$ 54	$ 48,484	$ 107
Production and intermediate-term	6,787	9,030	1,754	8,793	6	9,757	6
Processing and marketing	–	1,229	–	(3)	–	13	–
Rural residential real estate	4,230	5,006	25	4,752	38	6,686	108
Other (including mission-related)	4,497	4,451	153	4,619	70	4,604	140
Total	$ 60,474	$ 92,148	$ 7,840	$ 65,951	$ 168	$ 69,544	$ 361

	December 31, 2013			Year Ended December 31, 2013	
(dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans
Impaired loans with a related allowance for credit losses:					
Real estate mortgage	$ 24,138	$ 32,509	$ 6,276	$ 19,141	$ –
Production and intermediate-term	8,715	12,779	2,099	18,906	14
Processing and marketing	–	–	–	5,192	–
Rural residential real estate	–	–	–	169	–
Other (including Mission Related)	4,557	4,535	153	903	–
Total	$ 37,410	$ 49,823	$ 8,528	$ 44,311	$ 14
Impaired loans with no related allowance for credit losses:					
Real estate mortgage	$ 27,661	$ 43,909	$ –	$ 27,311	$ 257
Production and intermediate-term	1,473	2,052	–	8,370	374
Processing and marketing	–	1,228	–	2,368	–
Rural residential real estate	4,040	4,040	–	4,338	104
Other (including Mission Related)	25	–	–	347	284
Total	$ 33,199	$ 51,229	$ –	$ 42,734	$ 1,019
Total impaired loans:					
Real estate mortgage	$ 51,799	$ 76,418	$ 6,276	$ 46,452	$ 257
Production and intermediate-term	10,188	14,831	2,099	27,276	388
Processing and marketing	–	1,228	–	7,560	–
Rural residential real estate	4,040	4,040	–	4,507	104
Other (including Mission Related)	4,582	4,535	153	1,250	284
Total	$ 70,609	$ 101,052	$ 8,528	$ 87,045	$ 1,033

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at each reporting period.

A summary of changes in the allowance for loan losses and recorded investment in loans for each reporting period follows:

(dollars in thousands)	**Direct Note**	**Real Estate Mortgage**	**Production and Intermediate-term**	**Agribusiness***	**Communication**	**Energy and Water/Waste Disposal**	**Rural Residential Real Estate**	**Other (including Mission Related)**	**Total**
Allowance for credit losses:									
Balance at March 31, 2014	$ –	$ 9,220	$ 8,702	$ 2,363	$ 522	$ 842	$ 1,631	$ 176	$ 23,456
Charge-offs	–	–	–	–	–	–	(83)	–	(83)
Recoveries	–	1	903	–	–	–	–	238	1,142
Provision for loan losses	–	(438)	(2,984)	(133)	103	(98)	1,373	(239)	(2,416)
Balance at June 30, 2014	$ –	$ 8,783	$ 6,621	$ 2,230	$ 625	$ 744	$ 2,921	$ 175	$ 22,099
Balance at December 31, 2013	$ –	$ 9,681	$ 8,763	$ 1,933	$ 497	$ 823	$ 1,052	$ 159	$ 22,908
Charge-offs	–	–	–	–	–	–	(104)	–	(104)
Recoveries	–	21	903	–	–	–	–	238	1,162
Provision for loan losses	–	(919)	(3,045)	297	128	(79)	1,973	(222)	(1,867)
Balance at June 30, 2014	$ –	$ 8,783	$ 6,621	$ 2,230	$ 625	$ 744	$ 2,921	$ 175	$ 22,099
Balance at March 31, 2013	$ –	$ 9,490	$ 27,732	$ 5,913	$ 459	$ 843	$ 1	$ 421	$ 44,859
Charge-offs	–	–	(1)	(2,000)	–	–	(68)	–	(2,069)
Recoveries	–	152	184	–	–	–	–	–	336
Provision for loan losses	–	520	(2,430)	85	(52)	88	344	(369)	(1,814)
Balance at June 30, 2013	$ –	$ 10,162	$ 25,485	$ 3,998	$ 407	$ 931	$ 277	$ 52	$ 41,312
Balance at December 31, 2012	$ –	$ 9,548	$ 26,933	$ 6,510	$ 405	$ 764	$ 1	$ 378	$ 44,539
Charge-offs	–	(1)	(61)	(2,000)	–	–	(68)	–	(2,130)
Recoveries	–	152	184	–	–	–	–	47	383
Provision for loan losses	–	463	(1,571)	(512)	2	167	344	(373)	(1,480)
Balance at June 30, 2013	$ –	$ 10,162	$ 25,485	$ 3,998	$ 407	$ 931	$ 277	$ 52	$ 41,312
Loans individually evaluated for impairment	$ –	$ 5,908	$ 1,754	$ –	$ –	$ –	$ 25	$ 153	$ 7,840
Loans collectively evaluated for impairment	–	2,875	4,867	2,230	625	744	2,896	22	14,259
Balance at June 30, 2014	$ –	$ 8,783	$ 6,621	$ 2,230	$ 625	$ 744	$ 2,921	$ 175	$ 22,099
Loans individually evaluated for impairment	$ –	$ 6,276	$ 2,099	$ –	$ –	$ –	$ –	$ 153	$ 8,528
Loans collectively evaluated for impairment	–	3,405	6,664	1,933	497	823	1,052	6	14,380
Balance at December 31, 2013	$ –	$ 9,681	$ 8,763	$ 1,933	$ 497	$ 823	$ 1,052	$ 159	$ 22,908
Recorded investment in loans outstanding:									
Loans individually evaluated for impairment	$ 14,049,394	$ 119,294	$ 6,786	$ –	$ –	$ –	$ 2,094,345	$ 4,437	$ 16,274,256
Loans collectively evaluated for impairment	–	835,436	1,014,874	1,187,622	212,695	431,641	268,654	102,411	4,053,333
Ending balance at June 30, 2014	$ 14,049,394	$ 954,730	$ 1,021,660	$ 1,187,622	$ 212,695	$ 431,641	$ 2,362,999	$ 106,848	$ 20,327,589
Loans individually evaluated for impairment	$ 14,018,100	$ 152,567	$ 81,899	$ 86	$ –	$ –	$ 2,332,989	$ 4,557	$ 16,590,198
Loans collectively evaluated for impairment	–	824,119	1,139,245	956,009	198,721	454,410	203	89,636	3,662,343
Ending balance at December 31, 2013	$ 14,018,100	$ 976,686	$ 1,221,144	$ 956,095	$ 198,721	$ 454,410	$ 2,333,192	$ 94,193	$ 20,252,541

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

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. The following tables present additional information about pre-modification and post-modification outstanding recorded investment and the effects of the modifications that occurred during the periods presented. The tables do not include any purchased credit impaired loans. There were no TDRs that occurred during the three months ended June 30, 2013.

	Three months ended June 30, 2014				
	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
Pre-modification Outstanding Recorded Investment					
Production and intermediate-term	$ –	$ 540	$ –	$ 540	
Total	$ –	$ 540	$ –	$ 540	
Post-modification Outstanding Recorded Investment					
Production and intermediate-term	$ –	$ 540	$ –	$ 540	$ –
Total	$ –	$ 540	$ –	$ 540	$ –

	Six months ended June 30, 2014				
	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
Pre-modification Outstanding Recorded Investment					
Real estate mortgage	$ –	$ 293	$ –	$ 293	
Production and intermediate-term	–	540	–	540	
Total	$ –	$ 833	$ –	$ 833	
Post-modification Outstanding Recorded Investment					
Real estate mortgage	$ –	$ 293	$ –	$ 293	$ –
Production and intermediate-term	–	540	–	540	–
Total	$ –	$ 833	$ –	$ 833	$ –

	Six months ended June 30, 2013				
	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
Pre-modification Outstanding Recorded Investment					
Real estate mortgage	$ –	$ 2,488	$ –	$ 2,488	
Total	$ –	$ 2,488	$ –	$ 2,488	
Post-modification Outstanding Recorded Investment					
Real estate mortgage	$ –	$ 2,488	$ –	$ 2,488	$ –
Total	$ –	$ 2,488	$ –	$ 2,488	$ –

Interest concessions may include interest forgiveness and interest deferment. Principal concessions may include principal forgiveness, principal deferment, and maturity extension.

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

	Three months ended June 30,		Six months ended June 30,	
	2014	**2013**	**2014**	**2013**
Defaulted troubled debt restructurings:				
Production and intermediate-term	$ –	$ 898	$ –	$ 1,864
Processing and marketing	–	8,870	–	19,129
Total	$ –	$ 9,768	$ –	$ 20,993

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

	Total TDRs		Nonaccrual TDRs	
	June 30, 2014	**December 31, 2013**	**June 30, 2014**	**December 31, 2013**
Real estate mortgage	$ 21,250	$ 24,861	$ 17,566	$ 20,643
Production and intermediate-term	5,105	7,393	4,561	7,393
Rural residential real estate	738	–	375	–
Other (including Mission Related)	4,497	4,582	–	–
Total Loans	$ 31,590	$ 36,836	$ 22,502	$ 28,036
Additional commitments to lend	$ 446	$ 2,325		

Note 3 — Investment Securities

AgFirst's investments consist primarily of mortgage-backed securities (MBSs) collateralized by U.S. Government or U.S. agency guaranteed residential and commercial mortgages. They are held to maintain a liquidity reserve, manage short-term surplus funds, and manage interest rate risk. These securities meet the applicable FCA regulatory guidelines related to government agency guaranteed investments.

Included in the available-for-sale investments are non-agency collateralized mortgage obligations (CMOs) and asset-backed securities (ABSs). These securities must meet the applicable FCA regulatory guidelines, which require them to be high quality, senior class, and rated in the top category (AAA/Aaa) by Nationally Recognized Statistical Rating Organizations (NRSROs) at the time of purchase. To achieve these ratings, the securities may have a guarantee of timely payment of principal and interest, credit enhancements achieved through over-collateralization or other means, priority of payments for senior classes over junior classes, or bond insurance. All of the non-agency securities owned have one or more credit enhancement features.

The FCA considers a non-agency security ineligible if it falls below AAA/Aaa credit rating criteria and requires Farm Credit System (System) institutions to provide notification to the FCA when a security is downgraded below that rating. Non-agency CMO and ABS securities not rated in the top category by at least one of the NRSROs at June 30, 2014 had a fair value of $166.2 million and $35.0 million, respectively. For each of these investment securities in the Bank's portfolio rated below AAA/Aaa, the FCA has approved, with conditions, for the Bank to continue to hold these investments.

Held-to-maturity investments consist of Mission Related Investments, acquired primarily under the Rural Housing Mortgage-Backed Securities (RHMS) and Rural America Bond (RAB) pilot programs. RHMS must be fully guaranteed by a government agency or government sponsored enterprise. RABs are private placement securities, which generally have some form of credit enhancement.

In its Conditions of Approval for the program, the FCA considers a Rural America Bond ineligible if its investment rating, based on the internal 14-point risk rating scale used to also grade loans, falls below 9. FCA approval has been obtained to allow the Bank to continue to hold five Rural America Bonds whose credit quality has deteriorated beyond the program limits.

Effective December 31, 2014, the FCA will conclude each pilot program approved after 2004 as part of the Investment in Rural America (Mission Related Investments) program. Each institution participating in such programs may continue to hold its investment through the maturity dates for the investments, provided the institution continues to meet all approval conditions. The FCA can consider participation in these programs on a case-by-case basis.

During the first six months of 2014, proceeds from sales of investments were $2.7 million and realized gains were $53 thousand. During the first six months of 2013, proceeds from sales of investments were $122.2 million and realized gains were $7.6 million.

Available-for-sale

A summary of the amortized cost and fair value of debt securities held as available-for-sale investments follows:

	June 30, 2014				
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Govt. Guaranteed	$ 4,122,389	$ 106,745	$ (7,548)	$ 4,221,586	1.90%
U.S. Govt. Agency Guaranteed	1,826,982	20,587	(12,341)	1,835,228	0.98
Non-Agency CMOs (a)	186,335	35	(18,956)	167,414	0.62
Asset-Backed Securities (a)	19,009	21,335	(347)	39,997	2.96
Total	$ 6,154,715	$ 148,702	$ (39,192)	$ 6,264,225	1.59%

	December 31, 2013				
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Govt. Guaranteed	$ 4,499,265	$ 109,799	$ (5,992)	$ 4,603,072	1.97%
U.S. Govt. Agency Guaranteed	1,741,732	20,351	(14,463)	1,747,620	1.04
Non-Agency CMOs (b)	200,246	18	(26,778)	173,486	0.63
Asset-Backed Securities (b)	20,979	18,502	(683)	38,798	6.38
Total	$ 6,462,222	$ 148,670	$ (47,916)	$ 6,562,976	1.69%

(a) Gross unrealized losses include noncredit related other-than-temporary impairment included in Accumulated Other Comprehensive Income (AOCI) of $13.3 million for Non-Agency CMOs and $0 for Asset-Backed Securities.
(b) Gross unrealized losses include noncredit related other-than temporary impairment included in AOCI of $19.7 million for Non-Agency CMOs and $0 for Asset-Backed Securities.

Held-to-maturity

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

	June 30, 2014				
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Govt. Agency Guaranteed	$ 435,268	$ 24,223	$ (9,011)	$ 450,480	3.91%
RABs and Other (a)	135,323	10,264	(862)	144,725	6.00
Total	$ 570,591	$ 34,487	$ (9,873)	$ 595,205	4.40%

	December 31, 2013				
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Govt. Agency Guaranteed	$ 449,938	$ 22,065	$ (16,819)	$ 455,184	4.23%
RABs and Other (b)	139,874	7,619	(3,076)	144,417	6.02
Total	$ 589,812	$ 29,684	$ (19,895)	$ 599,601	4.65%

(a) Gross unrealized losses include noncredit related other-than-temporary impairment included in AOCI of $0 for Rural America Bonds.
(b) Gross unrealized losses include noncredit related other-than-temporary impairment included in AOCI of $56 thousand for Rural America Bonds.

A summary of the contractual maturity, estimated fair value and amortized cost of investment securities at June 30, 2014 follows:

Available-for-sale

	Due in 1 year or less		Due after 1 year through 5 years		Due after 5 years through 10 years		Due after 10 years		Total	
(dollars in thousands)	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield
U.S. Govt. Guaranteed	$ –	– %	$ 40	0.35 %	$ 51,983	0.63 %	$ 4,169,563	1.91 %	$ 4,221,586	1.90 %
U.S. Govt. Agency Guaranteed	1	1.82	25,372	1.02	67,336	1.48	1,742,519	0.97	1,835,228	0.98
Non-Agency CMOs	–	–	–	–	1,231	0.88	166,183	0.62	167,414	0.62
Asset-Backed Securities	–	–	–	–	–	–	39,997	2.96	39,997	2.96
Total fair value	$ 1	1.82 %	$ 25,412	1.02 %	$ 120,550	1.10 %	$ 6,118,262	1.60 %	$ 6,264,225	1.59 %
Total amortized cost	$ 1		$ 25,296		$ 119,331		$ 6,010,087		$ 6,154,715	

Held-to-maturity

	Due in 1 year or less		Due after 1 year through 5 years		Due after 5 years through 10 years		Due after 10 years		Total	
(dollars in thousands)	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield
U.S. Govt. Agency Guaranteed	$ –	– %	$ 495	4.67 %	$ –	– %	$ 434,773	3.90 %	$ 435,268	3.91 %
RABs and Other	15,494	7.00	16,995	5.82	34,217	5.89	68,617	5.88	135,323	6.00
Total amortized cost	$ 15,494	7.00 %	$ 17,490	5.79 %	$ 34,217	5.89 %	$ 503,390	4.17 %	$ 570,591	4.40 %
Total fair value	$ 16,471		$ 18,852		$ 37,203		$ 522,679		$ 595,205	

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

An investment is considered impaired if its fair value is less than its cost. This also applies to those securities other-than-temporarily impaired for which a credit loss has been recognized but noncredit-related losses continue to remain unrealized. The following tables show the fair value and gross unrealized losses for investments that have been in a continuous unrealized loss position aggregated by investment category at each reporting period. A continuous unrealized loss position for an investment is measured from the date the impairment was first identified.

	June 30, 2014					
	Less than 12 Months		12 Months or Greater		Total	
(dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Govt. Guaranteed	$ 748,961	$ (1,846)	$ 468,930	$ (5,702)	$ 1,217,891	$ (7,548)
U.S. Govt. Agency Guaranteed	542,826	(4,183)	764,802	(17,169)	1,307,628	(21,352)
Non-Agency CMOs	5,819	(332)	160,520	(18,624)	166,339	(18,956)
Asset-Backed Securities	–	–	7,352	(347)	7,352	(347)
RABs and Other	1,960	(31)	21,950	(831)	23,910	(862)
Total	$ 1,299,566	$ (6,392)	$ 1,423,554	$ (42,673)	$ 2,723,120	$ (49,065)

(dollars in thousands)	December 31, 2013 Less than 12 Months Fair Value	Unrealized Losses	12 Months or Greater Fair Value	Unrealized Losses	Total Fair Value	Unrealized Losses
U.S. Govt. Guaranteed	$ 880,174	$ (4,540)	$ 146,638	$ (1,452)	$ 1,026,812	$ (5,992)
U.S. Govt. Agency Guaranteed	935,615	(23,928)	380,282	(7,354)	1,315,897	(31,282)
Non-Agency CMOs	–	–	173,289	(26,778)	173,289	(26,778)
Asset-Backed Securities	–	–	7,915	(683)	7,915	(683)
RABs and Other	42,919	(2,745)	2,282	(331)	45,201	(3,076)
Total	$ 1,858,708	$ (31,213)	$ 710,406	$ (36,598)	$ 2,569,114	$ (67,811)

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

The Bank performs periodic credit reviews, including other-than-temporary impairment analyses, on its investment securities portfolio. The objective is to quantify future possible loss of principal or interest due on securities in the portfolio. Factors considered in determining whether an impairment is other-than-temporary include among others: (1) the length of time and the extent to which the fair value is less than cost, (2) adverse conditions specifically related to the industry, (3) geographic area and the condition of the underlying collateral, (4) payment structure of the security, (5) ratings by rating agencies, (6) the creditworthiness of bond insurers, and (7) volatility of the fair value changes.

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

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

Following are the assumptions used at:

Assumptions Used	June 30, 2014 Mortgage-backed Securities	Asset-backed Securities
Default rate by range	0.37% to 45.07%	7.12% to 61.06%
Prepayment rate by range	5.06% to 11.93%	5.68% to 16.07%
Loss severity by range	3.92% to 63.61%	57.32% to 100.00%

Assumptions Used	December 31, 2013 Mortgage-backed Securities	Asset-backed Securities
Default rate by range	0.46% to 46.36%	7.77% to 61.91%
Prepayment rate by range	4.59% to 10.37%	5.02% to 15.08%
Loss severity by range	4.16% to 64.28%	57.46% to 100.00%

Based on the results of all analyses, the Bank has recognized credit-related other-than-temporary impairment of $1.5 million for 2014, which is included in Net Other-than-temporary Impairment Losses in the Statements of Income. Since the Bank does not intend to sell these other-than-temporarily impaired debt securities and is not more likely than not to be required to sell before recovery, the total other-than-temporary impairment is reflected in the Statements of Income with: (1) a net other-than-temporary impairment amount related to estimated credit loss, and (2) an amount relating to all other factors, recognized as a reclassification to or from Other Comprehensive Income.

The following schedule details the activity related to cumulative credit losses on investments recognized in earnings for which a portion of an other-than-temporary impairment was recognized in other comprehensive income:

	For the three months ended June 30,		For the six months ended June 30	
(dollars in thousands)	**2014**	**2013**	**2014**	**2013**
Amount related to credit loss-beginning balance	$ 58,305	$ 56,388	$ 57,131	$ 55,654
Additions for initial credit impairments	–	339	–	339
Additions for subsequent credit impairments	101	614	1,452	1,732
Reductions for increases in expected cash flows	(242)	(194)	(419)	(578)
Reductions for securities sold/settled/matured	–	–	–	–
Amount related to credit loss-ending balance	58,164	57,147	58,164	57,147
Life to date incurred credit losses	(20,626)	(18,573)	(20,626)	(18,573)
Remaining unrealized credit losses	$ 37,538	$ 38,574	$ 37,538	$ 38,574

For all other impaired investments, the Bank has not recognized any credit losses as the impairments are deemed temporary and result from noncredit related factors. The Bank has the ability and intent to hold these investments until a recovery of unrealized losses occurs, which may be at maturity, and at this time expects to collect the full principal amount and interest due on these securities. Substantially all of these investments were in U.S. Government agency securities and the Bank expects these securities would not be settled at a price less than their amortized cost.

Note 4 — Debt

Bonds and Notes

AgFirst, unlike commercial banks and other depository institutions, obtains funds for its lending operations primarily from the sale of Systemwide Debt Securities issued jointly by the System banks through the Funding Corporation. Certain conditions must be met before AgFirst can participate in the issuance of Systemwide Debt Securities. As one condition of participation, AgFirst is required by the Farm Credit Act and FCA regulations to maintain specified eligible assets at least equal in value to the total amount of debt obligations outstanding for which it is primarily liable. This requirement does not provide holders of Systemwide Debt Securities with a security interest in any assets of the banks.

In accordance with FCA regulations, each issuance of Systemwide Debt Securities ranks equally with other unsecured Systemwide Debt Securities. Systemwide Debt Securities are not issued under an indenture and no trustee is provided with respect to these securities. Systemwide Debt Securities are not subject to acceleration prior to maturity upon the occurrence of any default or similar event.

The System may issue the following types of Systemwide Debt Securities:

- Federal Farm Credit Banks Consolidated Systemwide Bonds,
- Federal Farm Credit Banks Consolidated Systemwide Discount Notes,
- Federal Farm Credit Banks Consolidated Systemwide Master Notes,
- Federal Farm Credit Banks Global Debt Securities, and
- Federal Farm Credit Banks Consolidated Systemwide Medium-Term Notes.

Additional information regarding Systemwide Debt Securities can be found in their respective offering circulars.

The following table provides a summary of AgFirst's participation in outstanding Systemwide Debt Securities by maturity. Weighted average interest rates include the effect of related derivative financial instruments.

June 30, 2014						
	Bonds		**Discount Notes**		**Total**	
Maturities	**Amortized Cost**	**Weighted Average Interest Rate**	**Amortized Cost**	**Weighted Average Interest Rate**	**Amortized Cost**	**Weighted Average Interest Rate**
	(dollars in thousands)					
One year or less	$ 5,741,082	0.22%	$ 3,633,268	0.13%	$ 9,374,350	0.19%
Greater than one year to two years	5,443,700	0.43	–	–	5,443,700	0.43
Greater than two years to three years	3,414,797	0.88	–	–	3,414,797	0.88
Greater than three years to four years	2,046,940	1.16	–	–	2,046,940	1.16
Greater than four years to five years	1,624,555	1.38	–	–	1,624,555	1.38
Greater than five years	3,782,515	2.29	–	–	3,782,515	2.29
Total	$ 22,053,589	0.90%	$ 3,633,268	0.13%	$ 25,686,857	0.79%

Discount notes are issued with maturities ranging from 1 to 365 days. The average maturity of discount notes at June 30, 2014 was 124 days.

Note 5 — Shareholders' Equity

Perpetual Preferred Stock

Payment of dividends or redemption price on issued Preferred Stock may be restricted if the Bank fails to satisfy applicable minimum capital adequacy, surplus, and collateral requirements.

On May 15, 2013, the Bank redeemed and cancelled the entire $150.0 million of Perpetual Non-Cumulative Preferred Stock issued October 14, 2003. The stock was redeemed at its par value together with accrued and unpaid dividends.

Accumulated Other Comprehensive Income

The following presents activity related to AOCI for the three and six month periods ended June 30:

Changes in Accumulated Other Comprehensive Income by Component *(a)*

	For the three months ended June 30,		For the six months ended June 30,	
(dollars in thousands)	**2014**	**2013**	**2014**	**2013**
Investment Securities:				
Balance at beginning of period	$ 105,818	$ 176,482	$ 100,698	$ 174,547
Other comprehensive income before reclassifications	3,591	(53,532)	7,413	(45,123)
Amounts reclassified from AOCI	101	953	1,399	(5,521)
Net current period other comprehensive income	3,692	(52,579)	8,812	(50,644)
Balance at end of period	$ 109,510	$ 123,903	$ 109,510	$ 123,903
Cash Flow Hedges:				
Balance at beginning of period	$ 26	$ 1,132	$ 289	$ 1,514
Other comprehensive income before reclassifications	92	–	92	–
Amounts reclassified from AOCI	(283)	(319)	(546)	(701)
Net current period other comprehensive income	(191)	(319)	(454)	(701)
Balance at end of period	$ (165)	$ 813	$ (165)	$ 813
Employee Benefit Plans:				
Balance at beginning of period	$ (3,377)	$ (4,501)	$ (3,444)	$ (4,593)
Other comprehensive income before reclassifications	–	–	–	–
Amounts reclassified from AOCI	67	94	134	186
Net current period other comprehensive income	67	94	134	186
Balance at end of period	$ (3,310)	$ (4,407)	$ (3,310)	$ (4,407)
Total Accumulated Other Comprehensive Income:				
Balance at beginning of period	$ 102,467	$ 173,113	$ 97,543	$ 171,468
Other comprehensive income before reclassifications	3,683	(53,532)	7,505	(45,123)
Amounts reclassified from AOCI	(115)	728	987	(6,036)
Net current period other comprehensive income	3,568	(52,804)	8,492	(51,159)
Balance at end of period	$ 106,035	$ 120,309	$ 106,035	$ 120,309

Reclassifications Out of Accumulated Other Comprehensive Income *(b)*

(dollars in thousands)	For the three months ended June 30,		For the six months ended June 30,		
	2014	**2013**	**2014**	**2013**	**Income Statement Line Item**
Investment Securities:					
Sales gains & losses	$ –	$ –	$ 53	$ 7,592	Gains (losses) on investments, net
Holding gains & losses	(101)	(953)	(1,452)	(2,071)	Net other-than-temporary impairment
Net amounts reclassified	(101)	(953)	(1,399)	5,521	
Cash Flow Hedges:					
Interest income	191	319	454	701	See Note 11.
Noninterest income	92	–	92	–	See Note 11.
Net amounts reclassified	283	319	546	701	
Employee Benefit Plans:					
Periodic pension costs	(67)	(94)	(134)	(186)	See Note 7.
Net amounts reclassified	(67)	(94)	(134)	(186)	
Total reclassifications for period	$ 115	$ (728)	$ (987)	$ 6,036	

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

Note 6 — Fair Value Measurement

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

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

The classifications within the fair value hierarchy are as follows:

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets. Level 1 assets and liabilities could include investment securities and derivative contracts that are traded in an active exchange market, in addition to certain U.S. Treasury securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 inputs include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability. Level 2 assets and liabilities could include investment securities that are traded in active, non-exchange markets and derivative contracts that are traded in active, over-the-counter markets.

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

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

The following tables present the changes in Level 3 assets and liabilities measured at fair value on a recurring basis for the periods presented. The Bank had no transfers of assets or liabilities into or out of Level 1 or Level 2 during the reporting period.

(dollars in thousands)	**Asset Backed Securities**	**Non-Agency CMOs**	**Standby Letters of Credit**
Balance at December 31, 2013	$ 38,798	$ 173,486	$ 745
Total gains or (losses) realized/unrealized:			
Included in earnings	–	(1,321)	–
Included in other comprehensive income	3,168	7,839	–
Issuances	–	–	318
Settlements	(1,969)	(12,590)	–
Transfers in and/or out of Level 3	–	–	–
Balance at June 30, 2014	$ 39,997	$ 167,414	$ 1,063

(dollars in thousands)	**Asset-Backed Securities**	**Non-Agency CMOs**	**Standby Letters of Credit**
Balance at December 31, 2012	$ 33,390	$ 204,699	$ 1,089
Total gains or (losses) realized/unrealized:			
Included in earnings	(28)	(1,705)	–
Included in other comprehensive income	4,873	7,752	–
Issuances	–	–	–
Settlements	(2,480)	(24,459)	(27)
Transfers in and/or out of Level 3	–	–	–
Balance at June 30, 2013	$ 35,755	$ 186,287	$ 1,062

SENSITIVITY TO CHANGES IN SIGNIFICANT UNOBSERVABLE INPUTS

Discounted cash flow or similar modeling techniques are generally used to determine the recurring fair value measurements for Level 3 assets and liabilities. Use of these techniques requires determination of relevant inputs and assumptions, some of which represent significant unobservable inputs as indicated in the tables that follow. Accordingly, changes in these unobservable inputs may have a significant impact on fair value.

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

Investment Securities

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

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

Generally, a change in the assumption used for defaults is accompanied by a directionally similar change in the risk premium component of the discount rate (specifically, the portion related to credit risk) and a directionally opposite change in the assumption used for prepayments. Unobservable inputs for loss severities do not normally increase or decrease based on movements in the other significant unobservable inputs for these Level 3 assets.

Derivative Instruments

Level 3 derivative instruments consist of forward contracts that represent a hedge of an unrecognized firm commitment to purchase agency securities at a future date. The value of the forward is the difference between the fair value of the security at inception of the forward and the measurement date. Significant inputs for these valuations would be discount rate and volatility. These Level 3 derivatives would decrease (increase) in value based upon an increase (decrease) in the discount rate.

Generally, for derivative instruments which are subject to changes in the value of the underlying referenced instrument, change in the assumption used for default rate is accompanied by directionally similar change in the risk premium component of the discount rate (specifically, the portion related to credit risk) and a directionally opposite change in the assumption used for prepayment rates.

Unobservable inputs for discount rate and volatility do not increase or decrease based on movements in other significant unobservable inputs for these Level 3 instruments.

Other Property Owned/Impaired Loans

Other property owned and impaired loans are valued using appraisals, market comparable sales, replacement costs and income and expense (cash flow) techniques. Certain unobservable inputs are used within these techniques to determine the Level 3 fair value of these properties. The significant unobservable inputs are primarily sensitive only to industry, geographic and overall economic conditions, and/or specific attributes of each property.

Inputs to Valuation Techniques

Management determines the Bank's valuation policies and procedures. Internal valuation processes are calibrated annually by an independent consultant. Fair value measurements are analyzed on a periodic basis. Documentation is obtained for third party information, such as pricing, and periodically evaluated alongside internal information and pricing.

Quoted market prices are generally not available for the instruments presented below. Accordingly, fair values are based on judgments regarding anticipated cash flows, future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Quantitative Information about Recurring and Nonrecurring Level 3 Fair Value Measurements

	Fair Value		Valuation Technique(s)	Unobservable Input	Range
Forward contracts – when-issued securities	$	–	Broker/Consensus pricing	Offered quotes	None outstanding
Non-agency securities	$	207,411	Vendor priced	**	
Impaired loans and other property owned	$	56,435	Appraisal	Income and expense	*
				Comparable sales	*
				Replacement cost	*
				Comparability adjustments	*

** Ranges for this type of input are not useful because each collateral property is unique.*
*** The significant unobservable inputs used to estimate fair value for Level 3 assets and liabilities that are obtained from third party vendors are not included in the table as the specific inputs applied are not provided by the vendor.*

Information about Recurring and Nonrecurring Level 2 Fair Value Measurements

	Valuation Technique(s)	Input
Investments available-for-sale	Discounted cash flow	Constant prepayment rate
		Probability of default
		Loss severity
	Quoted prices	Price for similar security
	Vendor priced	***
Federal funds sold, securities purchased under resale agreements and other	Carrying value	Par/principal and appropriate interest yield
Interest rate swaps	Discounted cash flow	Annualized volatility
		Counterparty credit risk
		Own credit risk

**** The inputs used to estimate fair value for assets and liabilities that are obtained from third party vendors are not included in the table as the specific inputs applied are not provided by the vendor.*

Information about Other Financial Instrument Fair Value Measurements

	Valuation Technique(s)	Input
Loans	Discounted cash flow	Prepayment forecasts
		Probability of default
		Loss severity
Cash and cash equivalents	Carrying value	Par/principal and appropriate interest yield
RABs and other	Discounted cash flow	Risk adjusted spread
		Prepayment rates
		Probability of default
		Loss severity
Assets held in trust funds	Quoted prices	Price for identical security
Bonds and notes	Discounted cash flow	Benchmark yield curve
		Derived yield spread
		Own credit risk
Cash collateral	Carrying value	Par/principal and appropriate interest yield

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

	At or for the Six Months Ended June 30, 2014					
(dollars in thousands)	**Total Carrying Amount**	**Level 1**	**Level 2**	**Level 3**	**Total Fair Value**	**Fair Value Effects On Earnings**
Recurring Measurements						
Assets:						
Investments available-for-sale:						
U.S. Govt. Guaranteed	$ 4,221,586	$ –	$ 4,221,586	$ –	$ 4,221,586	
U.S. Govt. Agency Guaranteed	1,835,228	–	1,835,228	–	1,835,228	
Non-Agency CMOs	167,414	–	–	167,414	167,414	
Asset-backed securities	39,997	–	–	39,997	39,997	
Total investments available-for-sale	6,264,225	–	6,056,814	207,411	6,264,225	
Federal funds sold, securities purchased under resale agreements, and other	223,911	–	223,911	–	223,911	
Interest rate swaps and other derivative instruments	22,373	–	22,373	–	22,373	
Assets held in trust funds	7,766	7,766	–	–	7,766	
Recurring Assets	$ 6,518,275	$ 7,766	$ 6,303,098	$ 207,411	$ 6,518,275	
Liabilities:						
Interest rate swaps and other derivative instruments	$ –	$ –	$ –	$ –	$ –	
Collateral liabilities	–	–	–	–	–	
Standby letters of credit	1,063	–	–	1,063	1,063	
Recurring Liabilities	$ 1,063	$ –	$ –	$ 1,063	$ 1,063	
Nonrecurring Measurements						
Assets:						
Impaired loans	$ 52,634	$ –	$ –	$ 52,634	$ 52,634	$ 1,746
Other property owned	3,441	–	–	3,801	3,801	1,894
Nonrecurring Assets	$ 56,075	$ –	$ –	$ 56,435	$ 56,435	$ 3,640
Other Financial Instruments						
Assets:						
Cash	$ 521,037	$ 521,037	$ –	$ –	$ 521,037	
Investments held to maturity	570,591	–	450,480	144,725	595,205	
Loans	20,202,598	–	–	20,195,554	20,195,554	
Other Financial Assets	$ 21,294,226	$ 521,037	$ 450,480	$ 20,340,279	$ 21,311,796	
Liabilities:						
Systemwide debt securities	$ 25,686,857	$ –	$ –	$ 25,638,472	$ 25,638,472	
Other Financial Liabilities	$ 25,686,857	$ –	$ –	$ 25,638,472	$ 25,638,472	

(dollars in thousands)	At or for the Year Ended December 31, 2013 Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value	Fair Value Effects On Earnings
Recurring Measurements						
Assets:						
Investments available-for-sale:						
U.S. Govt. Guaranteed	$ 4,603,072	$ –	$ 4,603,072	$ –	$ 4,603,072	
U.S. Govt. Agency Guaranteed	1,747,620	–	1,747,620	–	1,747,620	
Non-Agency CMOs	173,486	–	–	173,486	173,486	
Asset-backed securities	38,798	–	–	38,798	38,798	
Total investments available-for-sale	6,562,976	–	6,350,692	212,284	6,562,976	
Federal funds sold, securities purchased under resale agreements, and other	144,885	–	144,885	–	144,885	
Interest rate swaps and other derivative instruments	27,514	–	27,514	–	27,514	
Assets held in trust funds	6,533	6,533	–	–	6,533	
Recurring Assets	$ 6,741,908	$ 6,533	$ 6,523,091	$ 212,284	$ 6,741,908	
Liabilities:						
Interest rate swaps and other derivative instruments	$ –	$ –	$ –	$ –	$ –	
Collateral liabilities	–	–	–	–	–	
Standby letters of credit	745	–	–	745	745	
Recurring Liabilities	$ 745	$ –	$ –	$ 745	$ 745	
Nonrecurring Measurements						
Assets:						
Impaired loans	$ 62,081	$ –	$ –	$ 62,081	$ 62,081	$ 4,577
Other property owned	9,621	–	–	10,387	10,387	519
Nonrecurring Assets	$ 71,702	$ –	$ –	$ 72,468	$ 72,468	$ 5,096
Other Financial Instruments						
Assets:						
Cash	$ 1,038,870	$ 1,038,870	$ –	$ –	$ 1,038,870	
Investments held to maturity	589,812	–	455,184	144,417	599,601	
Loans	20,116,246	–	–	19,938,324	19,938,324	
Other Financial Assets	$ 21,744,928	$ 1,038,870	$ 455,184	$ 20,082,741	$ 21,576,795	
Liabilities:						
Systemwide debt securities	$ 26,224,879	$ –	$ –	$ 25,994,336	$ 25,994,336	
Other Financial Liabilities	$ 26,224,879	$ –	$ –	$ 25,994,336	$ 25,994,336	

Note 7 — Employee Benefit Plans

Following are retirement and other postretirement benefit expenses for the Bank:

(dollars in thousands)	For the three months ended June 30, 2014	2013	For the six months ended June 30, 2014	2013
Pension	$ 2,402	$ 2,425	$ 4,805	$ 4,849
401k	396	309	764	608
Other postretirement benefits	272	269	544	539
Total	$ 3,070	$ 3,003	$ 6,113	$ 5,996

Following are retirement and other postretirement benefit contributions for the Bank. Projections are based upon actuarially determined amounts as of the most recent measurement date of December 31, 2013.

(dollars in thousands)	Actual YTD Through 6/30/14	Projected Contributions for Remainder of 2014	Projected Total Contributions 2014
Pensions	$ 289	$ 7,145	$ 7,434
Other postretirement benefits	504	545	1,049
Total	$ 793	$ 7,690	$ 8,483

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

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

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

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

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

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

Accounting related to the curtailment of future benefit service under the Cash Balance Plan, as prescribed in ASC 715 "Compensation – Retirement Benefits", is expected to be triggered in November 2014 when the plan amendments are officially executed. This accounting is not expected to have a material impact on the Bank's financial condition or results of operations.

Note 8 — Commitments and Contingent Liabilities

Association Financial Assistance

Effective January 1, 2011, Farm Credit of North Florida, ACA, and Farm Credit of Southwest Florida, ACA, merged with and into Farm Credit of South Florida, ACA. Farm Credit of South Florida then changed its name to Farm Credit of Florida, ACA. As part of the merger, those Associations entered into an agreement with the Bank under which the Bank would provide limited financial assistance to the merged Association in the event of substantial further deterioration in the combined high risk asset portfolio of the merged Association. This agreement relates only to a finite pool of high risk assets of the merged Association existing at the merger date, which had a net book value at January 1, 2011 of $250.0 million. At June 30, 2014, those assets had a net book value of $54.7 million. This agreement with the Bank does not include losses that are sustained outside of the high risk asset pool. Protection to the Bank, such as limitations on the Association's ability to make patronage distributions and certain other restrictions, is provided in the agreement if certain merged Association capital ratios fail to meet minimum established levels.

Under the financial assistance agreement, if specified minimum levels of capital allocated to the high risk asset pool are not maintained by the merged Association, the Bank would provide financial assistance as stipulated in the agreement. The assistance consists of three components. First, the Bank would allow the Association to include AgFirst allocated stock owned by the merged Association in its capital ratio computations. This allocated stock has been counted entirely by the Bank in its capital ratio computations under an existing capital sharing arrangement. Second, the Bank would redeem purchased stock held by the merged Association up to the total amount outstanding, and the redeemed amount would be included in capital ratio computations by the merged Association. This purchased stock has been counted entirely by the Bank in its capital ratio computations under an existing capital sharing arrangement. The third and final level of assistance, if elected by the merged Association, would be a purchase by the Bank of the high risk asset pool from the merged Association at net book value. There would also be a corresponding repurchase by the merged Association of its previously redeemed stock in the Bank and a return to the capital sharing arrangement allowing the Bank to count the allocated stock in its capital ratio computations in amounts necessary to satisfy the capitalization requirement under the Bank's capitalization plan then in effect.

No assistance was provided by the Bank to the merged Association under the agreement at June 30, 2014 or December 31, 2013. A total of $9.8 million of assistance was available at June 30, 2014 and December 31, 2013 to the merged Association under the first and second support levels of the agreement. Any assistance provided in the future likely would not have a material adverse impact on either the financial condition or future operating results of the Bank.

Other Commitments and Contingencies

Under the Farm Credit Act of 1971, each System bank is primarily liable for its portion of Systemwide bond and discount note obligations. Additionally, the four banks are jointly and severally liable for the bonds and notes of the other System banks under the terms of the Joint and Several Liability Allocation Agreement. Published in the Federal Register, the agreement prescribes the payment mechanisms to be employed in the event one of the banks is unable to meet its debt obligations.

In the event a bank is unable to timely pay principal or interest on an insured debt obligation for which the bank is primarily liable, the Insurance Corporation must expend amounts in the Insurance Fund to the extent available to ensure the timely payment of principal and interest on the insured debt obligation. The provisions of the Farm Credit Act providing for joint and several liability of the banks on the obligation cannot be invoked until the amounts in the Insurance Fund have been exhausted. However, because of other mandatory and discretionary uses of the Insurance Fund, there is no assurance that there will be sufficient funds to pay the principal or interest on the insured debt obligation.

Once joint and several liability is initiated, the FCA is required to make "calls" to satisfy the liability first on all non-defaulting banks in the proportion that each non-defaulting bank's available collateral (collateral in excess of the aggregate of the banks' collateralized obligations) bears to the aggregate available collateral of all non-defaulting banks. If these calls do not satisfy the liability, then a further call would be made in proportion to each non-defaulting bank's remaining assets. Upon making a call on non-defaulting banks with respect to a Systemwide Debt Security issued on behalf of a defaulting bank, the FCA is required to appoint the Insurance Corporation as the receiver for the defaulting bank. The receiver would be required to expeditiously liquidate assets of the bank.

During the periods presented, AgFirst did not make any payments, and as of the report date does not anticipate making any payments, on behalf of its co-obligors under the Joint and Several Liability Allocation Agreement.

(dollars in billions)		**6/30/14**		**12/31/13**
Total System bonds and notes	$	212.371	$	207.489
AgFirst bonds and notes	$	25.687	$	26.225

There are no material claims pending against the Bank in which money damages are asserted.

Note 9 — Additional Financial Information

Offsetting of Financial and Derivative Assets

June 30, 2014						
				Gross Amounts Not Offset in the Balance Sheets		
(dollars in thousands)	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Balance Sheets	Net Amounts of Assets Presented in the Balance Sheets	Financial Instruments	Cash Collateral Received	Net Amount
Derivatives	$ 22,373	$ –	$ 22,373	$ (4,072)	$ –	$ 18,301
Reverse repurchase and similar arrangements	223,911	–	223,911	(223,911)	–	–
Total	$ 246,284	$ –	$ 246,284	$ (227,983)	$ –	$ 18,301

December 31, 2013						
				Gross Amounts Not Offset in the Balance Sheets		
(dollars in thousands)	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Balance Sheets	Net Amounts of Assets Presented in the Balance Sheets	Financial Instruments	Cash Collateral Received	Net Amount
Derivatives	$ 27,514	$ –	$ 27,514	$ (8,589)	$ –	$ 18,925
Reverse repurchase and similar arrangements	144,885	–	144,885	(144,885)	–	–
Total	$ 172,399	$ –	$ 172,399	$ (153,474)	$ –	$ 18,925

There were no liabilities subject to master netting arrangements or similar agreements during the reporting periods.

A description of the rights of setoff associated with recognized derivative assets and liabilities subject to enforceable master netting arrangements is located in Note 11, *Derivative Financial Instruments and Hedging Activities*.

The reverse repurchase agreements are accounted for as collateralized lending.

Note 10 — Business Combinations

In February 2014, the Boards of Directors of AgChoice Farm Credit, ACA and MidAtlantic Farm Credit, ACA (collectively referred to as the "Merger Associations") signed a Letter of Intent to merge. The Letter of Intent to merge allowed the Merger Associations to explore the benefits of a merger. During the second quarter of 2014, the Boards of the Merger Associations determined a merger would not be in the best interests of their shareholders and discontinued merger discussions.

Note 11 — Derivative Financial Instruments and Hedging Activities

One of the Bank's goals is to minimize interest rate sensitivity by managing the repricing characteristics of assets and liabilities so that the net interest margin is not adversely affected by movements in interest rates. The Bank maintains an overall interest rate risk management strategy that may incorporate the use of derivative instruments to lower cost of funding or to reduce interest rate risk. Currently, the primary derivative type used by the Bank is interest rate swaps, which convert fixed interest rate debt to a lower floating interest rate than was achievable from issuing floating rate debt with identical repricing characteristics. They may allow the Bank to lower funding costs, allow it to diversify sources of funding, or alter interest rate exposures arising from mismatches between assets and liabilities. Under these arrangements, the Bank agrees with other parties to exchange, at specified intervals, payment streams calculated on a specified notional principal amount, with at least one stream based on a specified floating rate index.

The Bank may also purchase interest rate derivatives such as caps, in order to reduce the impact of rising interest rates on its floating-rate debt, and floors, in order to reduce the impact of falling interest rates on its floating-rate assets. In addition, the Bank may also fix a price to be paid in the future which qualifies as a derivative forward contract.

As a result of interest rate fluctuations, interest income and interest expense related to hedged variable-rate assets and liabilities, respectively, will increase or decrease. Another result of interest rate fluctuations is that hedged fixed-rate assets and liabilities will appreciate or depreciate in market value. The effects of any earnings variability or unrealized changes in market value are expected to be substantially offset by the Bank's gains or losses on the derivative instruments that are linked to these hedged assets and liabilities. The Bank considers its strategic use of derivatives to be a prudent method of managing interest rate sensitivity, as it prevents earnings from being exposed to undue risk posed by changes in interest rates.

The primary types of derivative instrument used and the amount of activity for the periods presented is summarized in the following table:

	For the Six Months Ended June 30,			
	2014		2013	
Notional Amounts *(dollars in millions)*	**Receive-Fixed Swaps**	**Forward Contracts**	**Receive-Fixed Swaps**	**Forward Contracts**
Balance at beginning of period	$ 250	$ –	$ 360	$ –
Additions	–	2	–	–
Maturities/amortization	–	(2)	(50)	–
Terminations	–	–	–	–
Balance at end of period	$ 250	$ –	$ 310	$ –

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

To minimize the risk of credit losses, the Bank transacts with counterparties that have an investment grade credit rating from a major rating agency and also monitors the credit standing of, and levels of exposure to, individual counterparties. The Bank typically enters into master agreements that contain netting provisions. These provisions allow the Bank to require the net settlement of covered contracts with the same counterparty in the event of default by the counterparty on one or more contracts. The Bank does not anticipate nonperformance by any of these counterparties. A number of swaps are supported by collateral arrangements with counterparties. Accounting guidance requires a pledgee to reflect as a liability the value of any cash collateral held in its statement of condition. However, securities held as collateral are not reported in the pledgee's statement of condition, even though in the custody of the pledgee.

Counterparty exposure related to derivatives at:

(dollars in millions)	**June 30, 2014**	**December 31, 2013**
Estimated Gross Credit Risk	$22.4	$27.5
Percent of Notional	8.95%	11.01%
Cash Collateral Held *(on balance sheet)*	$–	$–
Securities Collateral Held *(off balance sheet)*	$4.1	$8.6
Cash Collateral Posted *(off balance sheet)*	$–	$–
Securities Collateral Posted *(on balance sheet)*	$–	$–

The Bank's derivative activities are monitored by its Asset-Liability Management Committee (ALCO) as part of the Committee's oversight of the Bank's asset/liability and treasury functions. The ALCO is responsible for approving hedging strategies that are developed within parameters established by the Bank's Board of Directors through the analysis of data derived from financial simulation models and other internal and industry sources. The resulting hedging strategies are then incorporated into the Bank's overall interest rate risk-management strategies.

Fair Value Hedges

For derivative instruments designated as fair value hedges, the gains or losses on the derivative, as well as the offsetting loss or gain on the hedged item attributable to the hedged risk, are recognized in current earnings. The Bank includes the gain or loss on the hedged items in the same line item (interest expense) as the offsetting loss or gain on the related interest rate swaps. The amount of the loss on interest rate swaps recognized in interest expense for the six months ended June 30, 2014 was $5.1 million, while the amount of the gain on the Systemwide Debt Securities was $5.1 million. The amount of the loss on interest rate swaps recognized in interest expense for the six months ended June 30, 2013 was $8.7 million, while the amount of the gain on the Systemwide Debt Securities was $8.7 million. Gains and losses on each derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings.

Cash Flow Hedges

From time to time, the Bank may acquire when-issued securities, generally government agency guaranteed bonds. The when-issued transactions are contracts to purchase securities that will not be delivered until 30 or more days in the future. These purchase commitments are considered derivatives (cash flow hedges) in the form of forward contracts. Any differences in market value of the contracted securities, between the purchase and reporting or settlement date, represent the value of the forward contracts. These amounts are included in Other Comprehensive Income (OCI), and Other Liabilities or Other Assets as appropriate, as firm commitments in the Bank's Balance Sheet for each period end. As of the periods presented, the Bank had not committed to purchase any when-issued bonds.

For derivative instruments that are designated and qualify as a cash flow hedge, such as the Bank's forward contracts, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings.

Fair Values of Derivative Instruments

The following tables represent the fair value of derivative instruments for the periods presented:

(dollars in thousands)	**Balance Sheet Classification – Assets**	**6/30/14 Fair Value**	**Balance Sheet Classification – Liabilities**	**6/30/14 Fair Value**
Derivatives designated as hedging instruments:				
Receive-fixed swaps	Other Assets	$ 22,373	Other Liabilities	$ –
Forward contracts	Other Assets	–	Other Liabilities	–
Total		$ 22,373		$ –

(dollars in thousands)	**Balance Sheet Classification – Assets**	**12/31/13 Fair Value**	**Balance Sheet Classification – Liabilities**	**12/31/13 Fair Value**
Derivatives designated as hedging instruments:				
Receive-fixed swaps	Other Assets	$ 27,514	Other Liabilities	$ –
Forward contracts	Other Assets	–	Other Liabilities	–
Total		$ 27,514		$ –

The following tables set forth the amount of net gain (loss) recognized in the Statements of Income and, for cash flow hedges, the amount of net gain (loss) recognized in the Balance Sheets for the periods presented.

(dollars in thousands)	**Location of Gain or (Loss) Recognized in the Statements of Income**	**Amount of Gain or (Loss) Recognized in the Statements of Income 2014**	**2013**
Derivatives – Fair Value Hedging Relationships:			
Receive-fixed swaps	Noninterest Income	$ –	$ –

(dollars in thousands)	**Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) 2014**	**2013**	**Location of Gain or (Loss) Reclassified from AOCI into Income (Effective Portion)**	**Amount of Gain or (Loss) Reclassified from AOCI into Income (Effective Portion) 2014**	**2013**	**Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)**	**Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing) 2014**	**2013**
Derivatives – Cash Flow Hedging Relationships:								
Firm Commitments	$ –	$ –	Interest Income	$ 454	$ 701	Interest Income	$ –	$ –
Forward Contracts	(92)	–	Gains (Losses) on Other Transactions	92	–	Gains (Losses) on Other Transactions	–	–

Note 12 — Subsequent Events

The Bank has evaluated subsequent events and has determined there are none requiring disclosure through August 7, 2014, which is the date the financial statements were issued.