AgStar Financial Services, ACA

Quarterly Report
June 30, 2012

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the consolidated financial position and consolidated results of operations of AgStar Financial Services, ACA and its subsidiaries. This discussion should be read in conjunction with both the unaudited consolidated financial information and related notes included in this Quarterly Report as well as Management's Discussion and Analysis included in our 2011 Annual Report for the year ended December 31, 2011.

AgriBank, FCB's (AgriBank) financial condition and results of operations materially affect members' investment in AgStar Financial Services, ACA. To request free copies of the AgriBank and combined AgriBank, FCB and Affiliated Associations' financial reports or additional copies of our report contact us at P.O. Box 4249, Mankato, MN 56002-4249, by phone (866-577-1831), by e-mail to AgStarEteam@agstar.com, or at our website, www.agstar.com. You may also contact AgriBank at 30 East 7th Street, Suite 1600, St. Paul, MN 55101, (651) 282-8800, or by e-mail at agribankmn@agribank.com. The AgriBank and combined AgriBank, FCB and Affiliated Associations' financial reports are also available through AgriBank's website at www.agribank.com.

Loan Portfolio

Loans totaled $5.3 billion at June 30, 2012, a $144.5 million increase from December 31, 2011. This increase was due to our continued focus on client service, marketing excellence, and channel development. Our new volume growth was partially offset by the profitability of our grain and swine clients, reflecting increased repayments, as well as lower operating and term loan demand.

Agricultural and Economic Conditions

We serve many sectors in agriculture including our primary industries of grain, swine, and dairy. Credit quality, delinquencies, and nonaccrual measures showed significant improvement during 2011 and this positive trend is expected to continue throughout 2012.

The United States Department of Agriculture (USDA) weekly crop bulletin released on July 1, 2012 indicated that 31% of the U.S. corn crop was reported in good to excellent condition, down nine points from the previous week and 35 points below the same time last year. Hot and dry weather throughout most of the corn and soybean producing regions led to further crop condition declines during the month of July. Because of this, the USDA recently cut its corn harvest yield estimate to 146 bushels per acre, down 20 bushels from the June estimate, resulting in a total projection of 12.97 billion bushels for 2012/13. Other analysts have the projected yield as low as 133 bushels per acre, with the carryout-to-use ratio decreasing to 5%. However, crop conditions within our territory are much more favorable than overall for the U.S. Producers in our territory are generally mitigating risk by purchasing crop insurance coverage at a high level.

Profit margins have remained positive for swine producers early this year, but margins have recently decreased significantly and are now negative due primarily to increased feed costs. Many swine producers have locked in profitable margins for the balance of 2012 and into 2013. Profit margins for dairy producers, however, have recently improved in spite of increased feed costs. The declining milk production is a direct result of the heat. Margins for ethanol plants have deteriorated to breakeven to negative levels due to the combination of increased corn prices and depressed ethanol prices. There are some ethanol plants throughout the U.S. that have recently idled production due to the current economics. According to the USDA, net farm income is forecasted at $91.7 billion for 2012, down $6.3 billion (6.5%) from 2011, but still the second highest on record. Overall, conditions the past two years have been favorable overall for agricultural producers, resulting in generally positive performance for agribusinesses. Ethanol assets are our largest agribusiness segment and credit quality in this segment has improved significantly since 2009. Additionally, agricultural related businesses have generally been profitable and fared better during the past two years than companies not closely tied to agriculture. Farm real estate values in our territory have continued to show strong increases over the past year and we are projecting the demand for farm real estate to continue to remain strong this year. Values for transitional and recreational property remain low compared to the peak values previously reached.

Our home mortgage portfolio continues to perform better than the overall housing industry in the past few years. Delinquency and foreclosure numbers stabilized in 2010, showed solid improvement in 2011, and has continued to improve in 2012. At the end of the second quarter, the delinquencies in our Home Mortgage portfolio have remained at stable levels. Since the middle of 2007, outside factors including the unemployment rate, energy costs, and the overall sluggish economy have all negatively affected the housing industry. The recovery is predicted to be gradual with hopes that a return to a normal market will occur in the next two or three years. There are positive signs that the economy is turning the corner. An example is the unemployment rate. According to the U. S. Bureau of Labor Statistics, the unemployment rate dropped to 8.2% as of March 31, 2012 and has remained at that level through June. This is the lowest level since February 2009. In addition, interest rates continue to be at record lows. Given the lower rates and larger housing inventory, we believe this is a great time to be a home buyer for borrowers that qualify for a new loan.

Some of our core credit objectives include working with clients to promote risk management, seeking high quality financial statements and production reports, encouraging disciplined marketing plans, and providing individualized servicing plans and strategies. We continue to be involved and support positive legislative changes for agriculture and rural America.

Portfolio Credit Quality

The credit quality of our portfolio continued to improve from December 31, 2011. Adversely classified loans have decreased to 5.0% of the portfolio at June 30, 2012, from 5.7% of the portfolio at December 31, 2011. Adversely classified loans are loans we have identified as showing some credit weakness outside our credit standards. We have considered portfolio credit quality in assessing the reasonableness of our allowance for loan/lease losses.

In some circumstances, we use various governmental guarantee programs to reduce the risk of loss. At June 30, 2012, $307.6 million of our loans were, to some level, guaranteed under these governmental programs.

Excluded in the ratios and volumes discussed in this section are our investment securities. At June 30, 2012, our investment securities totaled $500.4 million, consisting of $316.0 million in mortgage backed securities issued by Federal Agricultural Mortgage Corporation and $184.4 million in investment securities, guaranteed by the Small Business Administration or the United States Department of Agriculture. Had this volume been included, the adversely classified asset ratio at June 30, 2012 would have been 4.6%.

Risk Assets

The following table summarizes risk assets including accrued interest receivable and delinquency information (dollars in thousands):

As of:	**June 30 2012**	December 31 2011
Loans:		
Accruing restructured	**$27**	$ --
Accruing loans 90 days or more past due	**2,075**	40
Nonaccrual	**186,076**	164,690
Total risk loans	**188,178**	164,730
Other property owned	**6,355**	6,954
Total risk assets	**$194,533**	$171,684
Risk loans as a percentage of total loans	**3.5%**	3.2%
Total delinquencies as a percentage of total loans	**1.6%**	1.7%

Our risk assets have increased from December 31, 2011 and remain outside our targeted credit standards.

The increase in accruing loans 90 days or more past due was primarily due to certain ag production and real estate loans. Based on our analysis, these were adequately secured.

The increase in nonaccrual loans was mainly the result of increased volume in the dairy segment and downgrading certain accounts in the dairy, cattle, and consumer related segments of our portfolio. Nonaccrual loan volume is above our credit standards at June 30, 2012, and represented 3.5% of our total portfolio. We are actively engaged in working with clients to provide individualized servicing plans and strategies. At June 30, 2012, 63.6% of our nonaccrual loans were current.

Other property owned declined $599.7 thousand mainly from selling or writing down home mortgage properties.

Allowance for Loan/Lease Losses

The allowance for loan/lease losses is an estimate of losses on loans in our portfolio as of the financial statement date. We determine the appropriate level of allowance for loan/lease losses based on periodic evaluation of factors such as loan loss history, probability of default, estimated severity of loss given default, portfolio quality, and current economic and environmental conditions.

Comparative allowance coverage of various loan categories follows:

Allowance as a percentage of:	**June 30 2012**	December 31 2011
Loans	**0.6%**	0.5%
Nonaccrual loans	**16.4%**	16.3%
Total risk loans	**16.2%**	16.3%

In our opinion, the allowance for loan/lease losses was reasonable in relation to the risk in our loan portfolio at June 30, 2012.

Results of Operations

Net income for the six months ended June 30, 2012 totaled $48.4 million compared to $42.0 million for the same period in 2011. The following table illustrates profitability information:

As of June 30	**2012**	2011
Return on average assets	**1.6%**	1.5%
Return on average members' equity	**11.9%**	11.1%

The following table summarizes the changes in components of net income for the six months ended June 30, 2012 compared to the same period in 2011 (in thousands):

Increase (decrease) in net income	2012 vs 2011
Net interest income	**$3,062**
Provision for loan/lease losses	**(3,349)**
Patronage income	**1,520**
Operating lease income	**(76)**
Other income	**6,806**
Operating expenses	**(1,499)**
Provision for income taxes	**(47)**
Total change in net income	**$6,417**

Net interest income was $76.4 million for the six months ended June 30, 2012. The following table quantifies changes in net interest income for the six months ended June 30, 2012 compared to the same period in 2011 (in thousands):

Change in net interest income	2012 vs 2011
Changes in AgriBank note payable and earning assets	**$4,880**
Changes in rates on AgriBank note payable and earning assets	**(482)**
Changes due to asset securitization	**200**
Changes in deferred income	**42**
Changes due to capital management	**149**
Changes in nonaccrual income and other	**(1,727)**
Net change	**$3,062**

The change in the provision for loan losses compared to 2011 reflects the increase in nonaccrual volume in certain accounts in the dairy, cattle, and bond related segments of our portfolio.

The change in patronage income was related to increased patronage received from AgriBank due to both a higher patronage rate compared to the prior year and increases in our average note payable to AgriBank. Additionally, patronage income on our sale of a participation interest in certain real estate loans to AgriBank increased due to improved profitability of the participation interest loans resulting from improved credit quality and to the 2012 share of distributions from Allocated Insurance Reserve Accounts (AIRA). The AIRA reserve account distributions were established in previous years by the Farm Credit System Insurance Corporation when premiums collected increased the level of the Insurance Fund beyond the required 2% of insured debt. There was no distribution in 2011.

The change in other income was primarily due to our direct share of distributions from AIRA of $6.1 million, and increases in crop insurance commissions and consulting income.

The change in operating expenses was primarily related to increases in public and member relations, purchased professional services, and salary and benefit related expenses. These increases are partially offset by lower Farm Credit System Insurance expense.

The change in provision for income taxes was primarily related to the increased income in the taxable entities partially offset by increased tax benefit caused by the increase in amount of nonqualified patronage allocations redeemed in the first quarter of this year compared to 2011.

We originate rural home loans for resale into the secondary market. We sold loans through the secondary market totaling $36.3 million through June 30, 2012 compared to $14.6 million for the same period in 2011. The fee income from this activity totaled $589 thousand for the six months ended June 30, 2012 compared to $297 thousand for the same period of 2011.

Changes in our return on average assets and return on average members' equity are directly related to the changes in income discussed in this section, changes in assets discussed in the Loan Portfolio section, and changes in capital discussed in the Funding, Liquidity, and Capital section.

Funding, Liquidity, and Capital

We borrow from AgriBank in the form of a line of credit. Our promissory note matured on March 31, 2012 and was renewed for $5.75 billion with a maturity date of March 31, 2013. The note will be renegotiated at that time. The repricing attributes of our line of credit generally correspond to the repricing attributes of our loan portfolio which significantly reduces our market interest rate risk. Our other significant source of funding is our subordinated debt.

Total members' equity increased $29.7 million from December 31, 2011 primarily due to net income for the period and an increase in capital stock and participation certificates partially offset by redemptions of nonqualified patronage allocations**.**

Farm Credit Administration regulations require us to maintain a permanent capital ratio of at least 7%, a total surplus ratio of at least 7%, and a core surplus ratio of at least 3.5%. Refer to Note 9 in our 2011 Annual Report for a more complete description of these ratios. As of June 30, 2012, the ratios were as follows:

- The permanent capital ratio was 14.6%.
- The total surplus ratio was 14.3%.
- The core surplus ratio was 11.1%.

The capital adequacy ratios are directly impacted by the changes in capital as more fully explained in this section and the changes in assets as discussed in the Loan Portfolio section.

Certification

The undersigned certify they have reviewed AgStar Financial Services, ACA's June 30, 2012, Quarterly Report. It has been prepared under the oversight of the audit committee and in accordance with all applicable statutory or regulatory requirements. The information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Lowell Schafer
Chairperson of the Board
AgStar Financial Services, ACA

Paul A. DeBriyn
President and Chief Executive Officer
AgStar Financial Services, ACA

Rodney W. Hebrink
Executive Vice President and Chief Financial Officer
AgStar Financial Services, ACA

August 9, 2012

CONSOLIDATED STATEMENTS OF CONDITION

AgStar Financial Services, ACA
(Dollars in thousands)
(Unaudited)

	June 30 2012	December 31 2011
ASSETS		
Loans	**$5,332,361**	$5,187,874
Allowance for loan/lease losses	**30,533**	26,833
Net loans	**5,301,828**	5,161,041
Investment securities	**500,410**	505,486
Assets held for lease, net	**34,700**	34,688
Accrued interest receivable	**50,600**	46,204
Investment in AgriBank, FCB	**133,387**	130,150
Premises and equipment, net	**17,216**	17,887
Other property owned	**6,355**	6,954
Other assets	**40,306**	44,005
Total assets	**$6,084,802**	$5,946,415
LIABILITIES		
Note payable to AgriBank, FCB	**$5,061,117**	$4,954,046
Subordinated debt	**100,000**	100,000
Accrued interest payable	**23,049**	27,468
Net deferred income tax liability	**7,545**	10,515
Other liabilities	**57,113**	48,150
Total liabilities	**5,248,824**	5,140,179
Contingencies and commitments	**--**	--
MEMBERS' EQUITY		
Capital stock and participation certificates	**15,153**	14,859
Allocated surplus	**295,235**	290,517
Unallocated surplus	**525,590**	500,860
Total members' equity	**835,978**	806,236
Total liabilities and members' equity	**$6,084,802**	$5,946,415

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

CONSOLIDATED STATEMENTS OF INCOME

AgStar Financial Services, ACA
(Dollars in thousands)
(Unaudited)

Period ended June 30	*Three Months Ended* **2012**	2011	*Six Months Ended* **2012**	2011
Interest income	**$63,136**	$64,143	**$126,928**	$128,936
Interest expense	**24,923**	27,655	**50,494**	55,564
Net interest income	**38,213**	36,488	**76,434**	73,372
Provision for loan/lease losses	**3,759**	1,066	**5,483**	2,134
Net interest income after provision for loan/lease losses	**34,454**	35,422	**70,951**	71,238
Other income				
Patronage income	**4,375**	3,518	**7,586**	6,066
Net operating lease income	**479**	489	**938**	1,014
Financially related services income	**5,863**	5,510	**12,385**	11,315
Allocated insurance reserve account distribution	**6,057**	--	**6,057**	--
Fee and miscellaneous income, net	**3,912**	2,512	**5,982**	6,303
Total other income	**20,686**	12,029	**32,948**	24,698
Operating expenses				
Salaries and employee benefits	**18,809**	18,148	**37,570**	37,147
Other operating	**8,252**	8,034	**16,845**	15,769
Total operating expenses	**27,061**	26,182	**54,415**	52,916
Income before income taxes	**28,079**	21,269	**49,484**	43,020
Provision for income taxes	**3,557**	2,708	**1,060**	1,013
Net income	**$24,522**	$18,561	**$48,424**	$42,007

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

CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

AgStar Financial Services, ACA
(Dollars in thousands)
(Unaudited)

	Capital Stock and Participation Certificates	Allocated Surplus	Unallocated Surplus	Total Members' Equity
Balance at December 31, 2010	$14,125	$265,010	$465,463	$744,598
Net income	--	--	42,007	42,007
Surplus allocated as nonqualified patronage	--	20,464	(20,464)	--
Redemption of prior year allocated patronage	--	(13,476)	--	(13,476)
Capital stock/participation certificates issued	809	--	--	809
Capital stock/participation certificates retired	(585)	--	--	(585)
Balance at June 30, 2011	$14,349	$271,998	$487,006	$773,353
Balance at December 31, 2011	**$14,859**	**$290,517**	**$500,860**	**$806,236**
Net income	**--**	**--**	**48,424**	**48,424**
Surplus allocated as nonqualified patronage	**--**	**23,694**	**(23,694)**	**--**
Redemption of prior year allocated patronage	**--**	**(18,976)**	**--**	**(18,976)**
Capital stock/participation certificates issued	**972**	**--**	**--**	**972**
Capital stock/participation certificates retired	**(678)**	**--**	**--**	**(678)**
Balance at June 30, 2012	**$15,153**	**$295,235**	**$525,590**	**$835,978**

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: Organization and Significant Accounting Policies

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim consolidated financial condition and consolidated results of operations. While our accounting policies conform to accounting principles generally accepted in the United States of America (U.S. GAAP) and the prevailing practices within the financial services industry, this interim Quarterly Report is prepared based upon statutory and regulatory requirements and, accordingly, does not include all disclosures required by U.S. GAAP. The results of the six months ended June 30, 2012 are not necessarily indicative of the results to be expected for the year ended December 31, 2012. The interim financial statements and the related notes in this Quarterly Report should be read in conjunction with the consolidated financial statements and related notes included in our 2011 Annual Report for the year ended December 31, 2011.

The consolidated financial statements present the consolidated financial results of AgStar Financial Services, ACA (the parent) and AgStar Financial Services, FLCA and AgStar Financial Services, PCA (the subsidiaries). All material intercompany transactions and balances have been eliminated in consolidation.

Recently Issued or Adopted Accounting Pronouncements

In September 2011, the Financial Accounting Standards Board (FASB) issued guidance entitled, "Compensation – Retirement Benefits – Multiemployer Plans." The guidance is intended to provide more information about an employer's financial obligations to multiemployer pension and post-employment benefit plans which should help financial statement users better understand the financial health of significant plans in which the employer participates. For non-public entities, the disclosures are effective for annual reporting periods ending on or after December 15, 2012. The adoption of this guidance will have no impact on our consolidated financial condition or consolidated results of operations, but will result in additional disclosures.

In June 2011, the FASB issued guidance entitled, "Presentation of Comprehensive Income." The guidance eliminates the current option to report other comprehensive income and its components in the statement of changes in equity. An entity can elect to present items of net income and other comprehensive income in one continuous statement — referred to as the Statement of Comprehensive Income — or in two separate, but consecutive, statements. Each component of net income and each component of other comprehensive income, together with totals for comprehensive income and its two parts — net income and other comprehensive income, would need to be displayed under either alternative. The statement(s) would need to be presented with equal prominence as the other primary financial statements. The guidance is intended to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. For non-public entities, the guidance is effective for fiscal years ending after December 15, 2012, and interim and annual periods thereafter. The adoption of the guidance will have no impact on our consolidated financial condition or consolidated results of operations, but will result in changes to our financial statement presentation.

In May 2011, FASB issued guidance entitled, "Fair Value Measurement – Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRS)." The guidance results in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between U.S. GAAP and IFRS as more fully outlined in the 2011 Annual Report. The amendments are to be applied prospectively. For non-public entities, the amendments are effective for annual periods beginning after December 15, 2011. The adoption of this guidance will have no impact on our consolidated financial condition or consolidated results of operations, but will result in additional disclosures.

In April 2011, the FASB issued guidance entitled, "A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring." The guidance provides additional clarification to creditors for evaluating whether a modification or restructuring of a receivable is a troubled debt restructuring. The guidance is effective for non-public entities for annual periods ending on or after December 15, 2012, including interim periods within those annual periods. The adoption of this guidance did not have a significant impact on our consolidated financial statements.

NOTE 2: Loans and Allowance for Loan/Lease Losses

Loans consisted of the following (dollars in thousands):

As of:	**June 30, 2012**		December 31, 2011	
	Amount	**%**	Amount	%
Real estate mortgage	**$2,613,174**	**49.0%**	$2,455,497	47.3%
Production and intermediate term	**1,558,521**	**29.2%**	1,602,684	30.9%
Agribusiness	**524,095**	**9.8%**	546,843	10.6%
Communication	**134,152**	**2.5%**	123,898	2.4%
Energy	**154,626**	**2.9%**	115,269	2.2%
Rural residential real estate	**93,187**	**1.8%**	89,415	1.7%
Finance/condition sales leases	**112,026**	**2.1%**	110,410	2.1%
Other	**142,580**	**2.7%**	143,858	2.8%
Total	**$5,332,361**	**100.0%**	$5,187,874	100.0%

Delinquency

The following table provides an aging analysis of past due loans by loan type and accrued interest receivable (in thousands):

	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less than 30 Days Past Due	Total Loans	90 Days or More Past Due and Accruing
As of June 30, 2012						
Real estate mortgage	**$31,367**	**$24,150**	**$55,517**	**$2,582,284**	**$2,637,801**	**$787**
Production and intermediate term	**5,056**	**10,997**	**16,053**	**1,558,082**	**1,574,135**	**843**
Agribusiness	**34**	**1,414**	**1,448**	**524,795**	**526,243**	**--**
Communication	**--**	**--**	**--**	**134,288**	**134,288**	**--**
Energy	**--**	**--**	**--**	**155,112**	**155,112**	**--**
Rural residential real estate	**2,281**	**1,603**	**3,884**	**89,603**	**93,487**	**80**
Finance/conditional sales leases	**1,025**	**760**	**1,785**	**110,241**	**112,026**	**365**
Other	**--**	**9,346**	**9,346**	**134,148**	**143,494**	**--**
Total	**$39,763**	**$48,270**	**$88,033**	**$5,288,553**	**$5,376,586**	**$2,075**
As of December 31, 2011						
Real estate mortgage	$27,599	$25,168	$52,767	$2,424,712	$2,477,479	$ --
Production and intermediate term	6,422	10,159	16,581	1,600,848	1,617,429	7
Agribusiness	--	2,165	2,165	546,480	548,645	--
Communication	--	--	--	124,016	124,016	--
Energy	--	--	--	115,355	115,355	--
Rural residential real estate	2,136	1,262	3,398	86,304	89,702	--
Finance/conditional sales leases	384	1,119	1,503	108,907	110,410	33
Other	10,619	--	10,619	134,287	144,906	--
Total	$47,160	$39,873	$87,033	$5,140,909	$5,227,942	$40

Risk Loans

The following table presents information concerning risk loans (in thousands):

As of:	**June 30 2012**	December 31 2011
Volume with specific reserves	**$48,574**	$61,059
Volume without specific reserves	**139,604**	103,671
Total risk loans	**$188,178**	$164,730
Total specific reserves	**$9,811**	$10,198
Six months ended June 30	**2012**	2011
Income on accrual risk loans	**$10**	$45
Income on nonaccrual loans	**2,014**	3,741
Total income on risk loans	**$2,024**	$3,786
Average risk loans	**$183,670**	$184,457

The increase in risk loans without specific reserves was mainly the result of the increase in well secured nonaccrual loan volume. This resulted from increased volume in the dairy segment and from downgrading certain accounts in the dairy, cattle, and bond segments of our portfolio.

Troubled Debt Restructurings

A restructuring of a loan constitutes a troubled debt restructuring, also known as formally restructured, 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. Concessions vary by program and borrower. Concessions may include interest rate reductions, term extensions, payment deferrals, or the acceptance of additional collateral in lieu of payments. In limited circumstances, principal may be forgiven. When a restructured loan constitutes a troubled debt restructuring, these loans are included within our risk loans. All risk loans are analyzed within our allowance for loan/lease losses. We record specific allowance to reduce the carrying amount of the formally restructured loan to the lower of book value or net realizable value of collateral.

The following table presents information regarding troubled debt restructurings that occurred during the six months ended June 30, 2012 (in thousands):

	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
Real estate mortgage	**$4,059**	**$4,059**
Production and intermediate term	**756**	**768**
Total	**$4,815**	**$4,827**

Pre-modification represents the recorded investment just prior to restructuring and post-modification represents the recorded investment immediately following the restructuring. The recorded investment is the face amount of the receivable increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, and acquisition costs and may also reflect a previous direct write-down of the investment.

The following table presents information regarding troubled debt restructurings that occurred within the previous 12 months for which there was a subsequent payment default during the six months ended June 30, 2012 (in thousands):

	Recorded Investment
Real estate mortgage	**$305**
Production and intermediate term	**175**
Total	**$480**

Troubled debt restructurings outstanding at June 30, 2012 totaled $45.0 million, of which all but $27 thousand were in nonaccrual status. Additional commitments to lend to borrowers whose loans have been modified in a troubled debt restructuring were $86 thousand at June 30, 2012.

Allowance for Loan/Lease Losses

A summary of changes in the allowance for loan/lease losses follows (in thousands):

Six months ended June 30	**2012**	2011
Balance at beginning of year	**$26,833**	$39,312
Provision for loan/lease losses	**5,483**	2,134
Loan recoveries	**2,394**	823
Loan chargeoffs	**(4,181)**	(9,292)
Other	**4**	(26)
Balance at end of period	**$30,533**	$32,951

The credit quality of our portfolio continued to improve from December 31, 2011. Adversely classified loans have decreased to 5.0% of the portfolio at June 30, 2012, from 5.7% of the portfolio at December 31, 2011. Provision for loan/lease losses increased $3.3 million mainly due to increases in nonaccrual loan volume in the dairy, cattle, and bond segments.

NOTE 3: Investment Securities

We held investment securities of $500.4 million at June 30, 2012 and $505.5 million at December 31, 2011. Our investment securities consisted of:

- securities containing loans guaranteed by the Small Business Administration (SBA) or by the U.S. Department of Agriculture (USDA), and
- mortgage-backed securities issued by the Federal Agricultural Mortgage Corporation (Farmer Mac).

Our investment securities have been classified as held-to-maturity. The investment portfolio is evaluated for other-than-temporary impairment. To date, we have not recognized any impairment on our investment portfolio.

The following table presents further information on investment securities (dollars in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Weighted Average Yield
As of June 30, 2012					
SBA / USDA	**$184,424**	**$1,641**	**($4,979)**	**$181,086**	**3.8%**
Farmer Mac	**315,986**	**6,434**	**(122)**	**322,298**	**4.9%**
Total	**$500,410**	**$8,075**	**($5,101)**	**$503,384**	**4.5%**
As of December 31, 2011					
SBA / USDA	$165,305	$945	($3,841)	$162,409	3.8%
Farmer Mac	340,181	7,338	(195)	347,324	5.1%
Total	$505,486	$8,283	($4,036)	$509,733	4.7%

Investment income is recorded in “Interest income” on the Consolidated Statements of Income and totaled $9.6 million and $10.0 million for the six months ended June 30, 2012 and 2011, respectively.

The following table presents contractual maturities of our investment securities (in thousands):

As of June 30, 2012	**Amortized Cost**
Less than one year	**$2,653**
One to five years	**34,895**
Five to ten years	**106,759**
More than ten years	**356,103**
Total	**$500,410**

NOTE 4: Capital

On January 18, 2012, the Board of Directors authorized the retirement of the remainder of the $17.8 million of 2002 nonqualified patronage allocations. This retirement was substantially completed in early February of 2012. The timing of this payout occurred within the Board of Directors targeted 7-10 year retirement timeframe. The timing of all future redemptions remains at the discretion of the Board of Directors based on a combination of factors including the risk in our portfolio, earnings, and our current capital position.

NOTE 5: Contingencies and Commitments

In the normal course of business, we have various contingent liabilities and commitments outstanding, primarily commitments to extend credit, which may not be reflected in the accompanying consolidated financial statements. We do not anticipate any material losses because of these contingencies or commitments.

From time to time, we may be named as a defendant in certain lawsuits or legal actions in the normal course of business. At the date of these consolidated financial statements, we were not aware of any such actions that would have a material impact on our financial condition. However, such actions could arise in the future.

NOTE 6: Fair Value Measurements

The FASB guidance on “Fair Value Measurement” defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The guidance also establishes a fair value hierarchy, with three levels of inputs that may be used to measure fair value. Refer to Notes 2 and 14 in our 2011 Annual Report for a more complete description.

We did not have any assets or liabilities measured at fair value on a recurring basis at June 30, 2012 or December 31, 2011. We may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. Information about assets measured at fair value on a non-recurring basis was as follows (in thousands):

	Fair Value Measurement Using			Total Fair	Total Gains
	Level 1	Level 2	Level 3	Value	(Losses)
June 30, 2012					
Loans	**$ --**	**$2,014**	**$38,687**	**$40,701**	**$387**
Other property owned	**--**	**--**	**8,301**	**8,301**	**(742)**
December 31, 2011					
Loans	$ --	$1,972	$51,432	$53,404	$6,476
Other property owned	--	--	8,424	8,424	(1,435)

Loans: Represents the carrying amount and related write-downs of loans which were evaluated for individual impairment based on the appraised value of the underlying collateral. When the value of the collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established. Costs to sell represent transaction costs and are not included as a component of the asset’s fair value.

Other Property Owned: Represents the fair value and related losses of foreclosed assets that were measured at fair value based on the collateral value, which is generally determined using appraisals or other indications based on sales of similar properties. Costs to sell represent transaction costs and are not included as a component of the asset’s fair value.

The fair value measurement would fall under Level 2 of the hierarchy if the process uses independent appraisals and other market-based information. The fair value measurement would fall under Level 3 of the hierarchy if the process requires significant input based on management’s knowledge of and judgment about current market conditions, specific issues relating to the collateral, and other matters.

NOTE 7: Subsequent Events

We have evaluated subsequent events through August 9, 2012, which is the date the consolidated financial statements were available to be issued.

We sold our tax and accounting portfolio to CliftonLarsonAllen LLP (CLA), effective July 1, 2012. Going forward, we have formed a strategic alliance with CLA to provide these services to our clients. This change is not expected to have a material impact on our current financial statements or operations.

We participate with eight other Farm Credit association partners to provide producer financing for agribusiness companies under the trade name, ProPartners Financial (ProPartners). In May 2012, ProPartners announced Northwest Farm Credit Services (Northwest FCS) will join this alliance effective September 1, 2012. The documents are expected to be finalized in July 2012. ProPartners is directed by representatives from the participating associations. The income, expense, and loss sharing arrangements are based on each association’s participation interest in ProPartners’ volume. Each association’s allocation is established according to a prescribed formula which includes risk funds of the associations. The addition of Northwest FCS will allow us to increase our financial strength, processing capacity, technology, expertise and geographic diversity to support our clients’ growth. While our proportionate ownership share will decline, the total volume will increase and as a result is not expected to have a material impact on our financial statements.