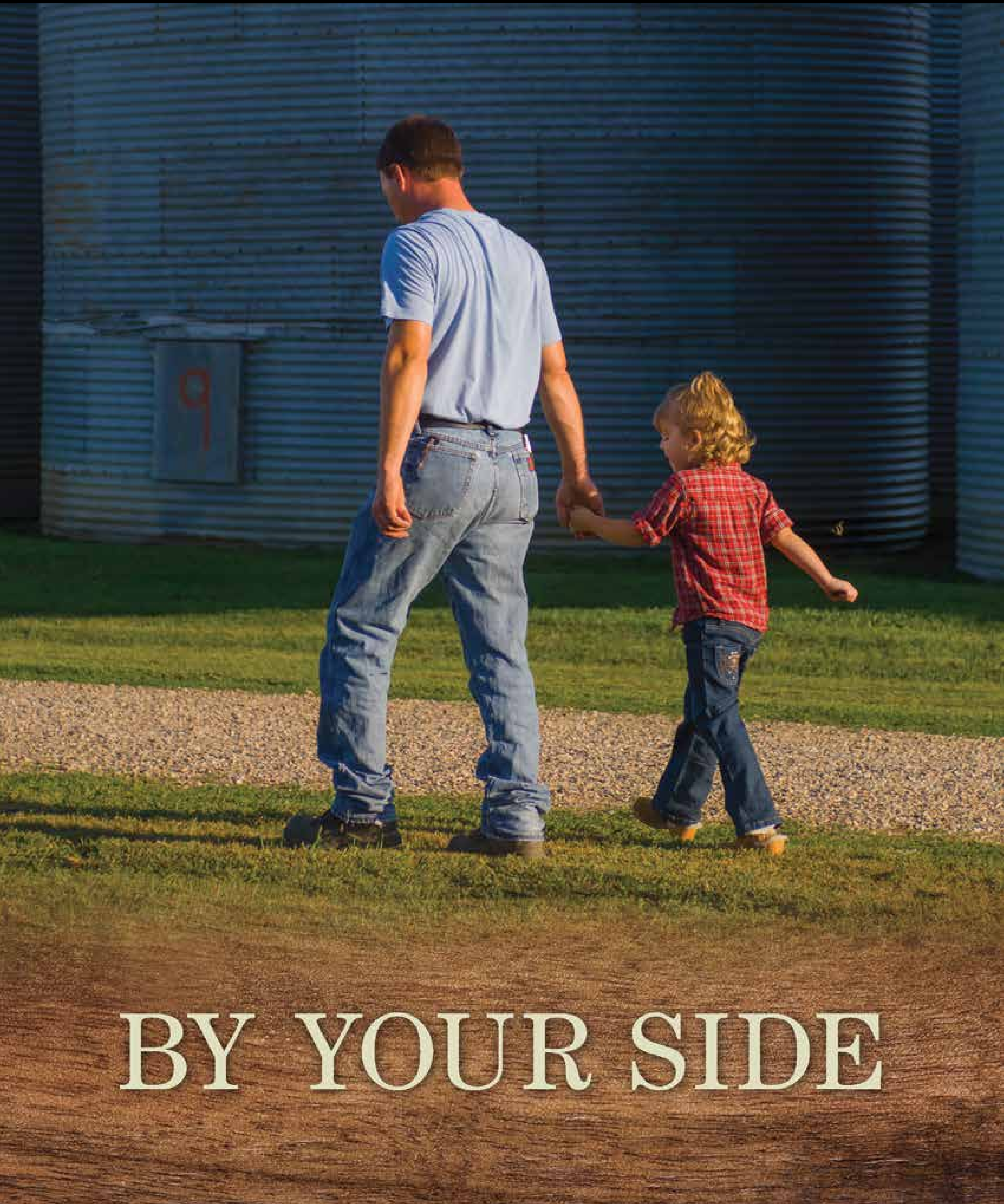
AgStar
Financial Services, ACA



BY YOUR SIDE

BY YOUR SIDE

Life in rural America is extraordinary.

There's no place we'd rather be.

We help one another, because
the life we've chosen isn't always easy.

We work together.

We walk together.

We stand together.

At AgStar, we're your friends,
neighbors and partners.

Our place is right here.

By your side.

OUR MISSION STATEMENT

Enhancing Life in Agriculture and Rural America

AgStar Financial Services is a cooperative owned by client-stockholders. As part of the Farm Credit System, we serve 69 counties in Minnesota and northwest Wisconsin.

For more than 95 years, we've been here, by your side, providing opportunities and improving lives. By offering high quality financial products and services, along with financial and business education programs, we strengthen the economy of the region we serve.

SUCCEEDING WITH YOU

When AgStar succeeds, you succeed.

As a financial services cooperative, AgStar distributes patronage dividends to our 15,300 stockholders. We base allocations on company earnings and the amount of products or services stockholders purchase from AgStar during the year.

2012 was a landmark year for AgStar and our clients. We retired the remaining patronage allocations for 2002 and 2003, totaling over $40 million to eligible stockholders.

Since the inception of the program in 1998, AgStar has allocated $392 million in patronage dividends and retired more than $80 million to qualified stockholders. We're helping you succeed by returning wealth to our region and communities.

GROWING WITH YOU

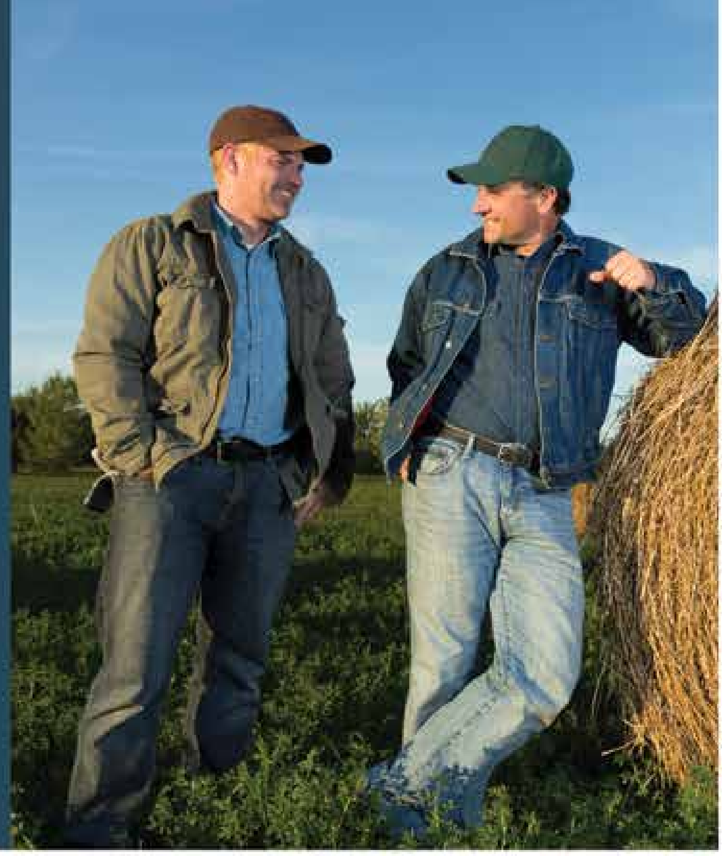
At AgStar, we understand you are looking for insights and information to help give you an edge. That's why in 2012 we launched AgStar Edge, our Center for Education, Development, Growth and Expertise.

We asked farmers how we could help them achieve their goals. And their responses shaped the services offered by AgStar Edge – which now include classes, online information, insights and guidance. We help you make better decisions, assess your strengths and weaknesses, understand global markets and become more confident in applying risk management techniques.

Through AgStar Edge, we help you create a competitive edge with objective, practical knowledge that allows you to reduce risk and grow your operation.

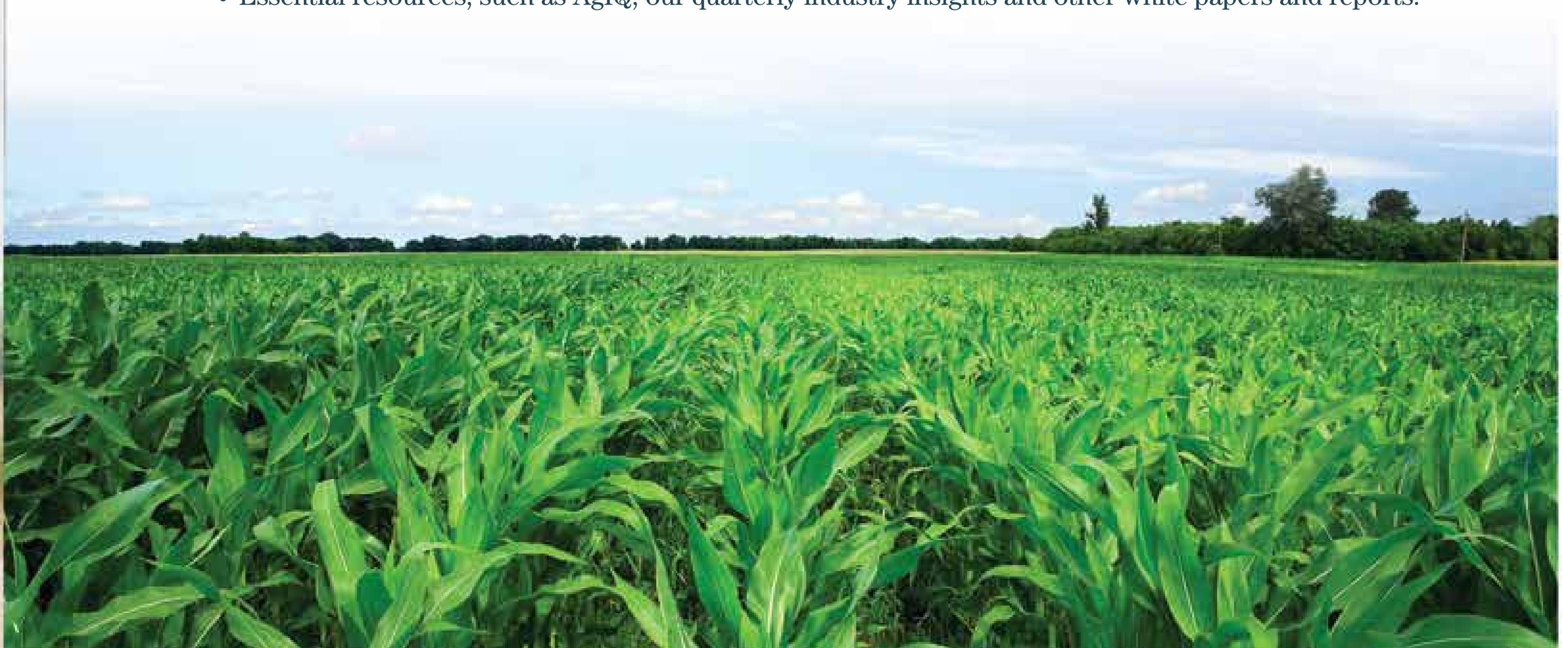
"We truly believe the programs offered through AgStar Edge will help our clients stay ahead of the curve through a competitive advantage. Each client has access to experts they can rely on through AgStar Edge."

Paul DeBriyn, AgStar President & CEO



AGSTAR EDGE RESOURCES INCLUDE:

- Weekly blog posts from AgStar experts, including the well-known video-based *Hog Blog* from the swine team and reports from the dairy team and grain team.
- Webinars on timely topics with AgStar and national ag experts.
- Newsletters packed with industry news and insights, along with a dedicated Risk Management newsletter.
- Ag industry news and articles plus specific grain, swine and dairy expertise.
- Workshops and events on topics such as financial analysis, margin management, marketing tools, credit topics and many more.
- Annual GroundBreakers Conferences, Outlook Meetings and Women's Seminars.
- Essential resources, such as AgIQ, our quarterly industry insights and other white papers and reports.



FOCUSING ON YOUR FUTURE

The future of agriculture is vitally important to you – and to the growth of our region. In 2012, AgStar sponsored a Purple Ribbon Video Contest for youth.

Organized through Facebook,™ the contest encouraged youth in three separate age groups to submit videos demonstrating how they get their animals ready to show. Contestants submitted their videos, which were posted online and voted on by page visitors. We saw an extremely positive response. The video contest allowed young farmers to share their passion with their peers and the wider community. And spreading rapidly through social media, it helped educate consumers about agriculture by making a personal connection with younger farmers.

We announced the Purple Ribbon Video Contest winners at the grand opening of the AgStar Arena at the Minnesota State Fair. Each of the three winners received a $500 scholarship.

SUPPORTING YOUR COMMUNITIES

EMERGENCY RESPONSE

In 2012, the AgStar Fund for Rural America awarded $128,000 to 92 communities through the Emergency Response Equipment Grant Program. Due to increased need, AgStar doubled the number of departments served and increased the budget for the program by 25 percent.

Since the Fund's inception in 2001, we have awarded nearly $568,000 to fire departments, ambulance teams and rescue squads in Minnesota and Wisconsin. Funds help with purchases such as grain bin rescue equipment, communications equipment, hoses, rigs, medical supplies and more.

AGSTAR ARENA

At AgStar, we support agriculture-based activities – especially programs such as 4-H and FFA, which shape tomorrow's leaders. To show our commitment, AgStar was the lead financial sponsor of a new agriculture building on the Minnesota State Fairgrounds.

We dedicated the AgStar Arena, which serves as an equine and livestock facility, on August 23, 2012.

The 27,000-square-foot arena is used during the Minnesota State Fair by 4-H, FFA and State Fair open class exhibitors, complementing activities at other facilities. It is also available for extended seasonal use for equine and livestock shows. More than 150,000 visitors and exhibitors are expected to use the AgStar Arena annually during the fair.

"We appreciate the generosity of AgStar and others. Because of this, our state fair is one of the best national expositions, providing the very best in agricultural education and 4-H and FFA youth leadership participation from every county in Minnesota."

Kay Cady
Executive Director, Minnesota State Fair Foundation

INVESTING IN RURAL COMMUNITIES

AgStar's Rural Capital Network specializes in strengthening our region by investing in rural communities. In June 2012, Essentia Health – Northern Pines opened its new facility, funded by the AgStar Rural Capital Network, in northeast Minnesota.

The project replaced an off-campus, aging clinic facility with a 13,000-square-foot medical clinic attached to the existing hospital and nursing home. Project improvements included renovations in the hospital and purchase of new equipment.

"The folks in Aurora are going to continue to see quality health care, they are going to see an improvement in the quality of life in their community, and they are going to see increased employment and economic prosperity from this project."

John Monson
Senior Vice President, Investments in Rural America,
Leader, AgStar Rural Capital Network

ENHANCING RELATIONSHIPS

In 2012, AgStar adopted the Team Relationship Philosophy to enhance the service and value we provide to you. Based on each individual's needs and goals, you are assigned a cross-functional team of advisors.

The approach provides you with a team of experts who offer a wide range of knowledge and experience. Not only do answers and solutions come more quickly and efficiently, but also directly from the team member with expertise in that area.

The Team Relationship Philosophy relies on trust, collaboration and shared ownership, leveraging AgStar resources and external alliances to achieve your success.

ENCOURAGING PROGRESS

AgStar's Mobile Banking went live for clients with an online banking account. With Mobile Banking, you can access your account on your cell phone. It's free, convenient and secure. You can use mobile banking to access account information, transfer funds, pay bills and complete a variety of financial transactions.

EMPOWERING YOU WITH MARGIN MANAGER PLUS

For several years, AgStar has provided you with Margin Manager to help calculate the per bushel impact of various decisions. It's intended to help you make more informed decisions and manage to a margin rather than to a revenue-only or cost-only basis.

Margin Manager Plus brings the Margin Manager toolset into an online environment and presents clients with immediate decision-making information. By adding the optional Optimizer service, you can see which grain buying location offers the best price.

Using Margin Manager data, the market price and basis for each purchasing location, as well as the user's own transportation and storage costs, Margin Manager Plus provides a recommended sales location for your grain to maximize available margins. The system automatically shows you the calculated margin in an easy to read dashboard.

BUSINESS UNITS

ENCOURAGING PROGRESS

In 2012, AgStar developed and adopted the Team Relationship Philosophy. This brings a full circle of unique advisors to each client and enables our client-facing sales and service delivery teams to better serve our core market and specialized industry clients.

Our **CORE MARKETS TEAM** focuses on this delivery model, providing our array of services from loans and leases to crop insurance and consulting to over 14,000 clients and producers. This new structure enables our team to collaborate with other professionals with specialized knowledge, depending on the client's specific goals and unique needs. Our industry specialists possess extensive knowledge in their areas of expertise, providing financing to commercial producers, agribusinesses and processors primarily focused in swine, dairy and bio-energy.

Our consulting team provides business advice and professional services such as family business consulting, succession planning and estate planning. Services are provided across all commodities with particular expertise in the dairy, swine and cash grain industry segments.

Our **HOME MORTGAGE SERVICES** (www.AgStarHome.com) team provides home financing options for clients in rural areas or communities with populations of 2,500 or less. The focal points of this segment are mortgages to buy, build or refinance residences or acreages. We also offer title insurance and home equity loans.

The **RURAL CAPITAL NETWORK** (www.AgStarRuralCapitalNetwork.com) team is devoted to supporting community and economic development, infrastructure needs, revitalization projects and minority lending in rural America. AgStar Rural Capital Network invests in projects through the purchase of bonds issued by local communities, organizations or businesses. In addition, this team partners with other Farm Credit associations and local community banks focusing on investing in critical access hospitals, assisted-living facilities, dental facilities, rural rental multi-family housing and business expansions.

The **CAPITAL MARKETS** team focuses on relationships with commercial banks, Farm Credit Institutions and other lending partners in buying loan participations and syndications. This specialized team provides a national marketing vehicle to gain improved access to the agribusiness and commercial producer loan market, and provides portfolio diversity, earnings and market intelligence to the organization.

AGRI-ACCESS® (www.Agri-Access.com) operates as a unit of AgStar Financial Services, ACA and focuses primarily on purchasing participations in agricultural real estate loans, rural home loans and leases on a wholesale basis. Agri-Access also services agricultural loans for other institutional investors. The main Agri-Access contact office is located in Des Moines, Iowa. We also have contact offices in Woodland, California and Meridian, Idaho.

PRODUCTS & SERVICES

LOANS
Operating Loans
Equipment Loans
Real Estate Loans
Starter Loans

LEASING
Equipment and Machinery Leases
Truck and Trailer Leases
Vehicle Leases
Building and Facility Leases

INSURANCE
Crop Hail Insurance
Multi-Peril Crop Insurance
Specialty Crop Insurance
Life Insurance

HOME MORTGAGES
Home Loans
One-Close Construction Loans
Hobby Farm Loans
Manufactured Housing Loans
Home Site Loans
Recreational Land Loans
Home Equity Loans

BUSINESS SERVICES
Fleet Services
Appraisal Services
Cash Management Services

CONSULTING SERVICES
Succession Planning
Business Planning
Retirement and Estate Planning
Financial Management

LEADERSHIP

At AgStar, the leadership team is always by your side. That's because our board members are mostly producers – and they're elected by client-stockholders. Their interests and goals are the same as yours. And they're focused on AgStar's mission of enhancing life in agriculture and rural America.

Our executive team carries out the board's directives. The vision, expertise and strategic direction of AgStar's leadership team are vital to our growth and success.

Paul A. DeBriyn
President and CEO

EXECUTIVE TEAM (above)
Front row: Joe Deufel, Jodie Hermer, Mark Greenwood
Middle row: Paul Erickson, John Monson, Paul Kohls, Rod Hebrink
Back row: John Hemstock, Tim Tracy, James (Wick) Manley, Paul DeBriyn

BOARD OF DIRECTORS (below)
Front row: Kevin Koppendrayer, Theresa (Ann) Broome, Spencer Enninga, Kaye Compart, Terry Ebeling
Back row: Rick Sommers, David Bollman, Lowell Schafer, Larry Fischer, William McCue, Lawrence Romuald, Dale Holmgren, Wesley Beck, Steve Johnson, William Kiehne, David Kretzschmar, Greg Nelson

Spencer Enninga
Chairperson of the Board
AgStar Financial Services, ACA

Paul A. DeBriyn
President and CEO
AgStar Financial Services, ACA

TO OUR STOCKHOLDERS

2012 was interesting for agriculture and the general economy. We experienced market volatility, economic pressures and increasing land values. Moreover, the uncertainty around the Farm Bill and the fiscal cliff put significant pressure on farmers, ranchers and rural America. Mother Nature added to the mix with everything from flooding in the northern parts of our area in the spring to drought conditions covering most of the farm belt over the summer and fall.

Through it all, we who are passionate about agriculture and the health of rural America carry on, working together and optimistically planning for the future.

AgStar is doing well during this next phase of the journey. Because of the increased level of cash many clients had due to high commodity prices, we had a record level of pay down on operating/revolving loans, but we simultaneously made a record level of new loans in our core markets. New volume was strong in almost every business segment, including a record level of net new acres for crop insurance.

For the first time in our history, AgStar achieved a milestone $107 million in net income translating to over $55 million in allocated patronage. AgStar Home Mortgage Services reached $500 million in total volume. We've also made outstanding progress in reducing risk in our portfolio over the last three years, improving the adverse assets to risk funds ratio to 31 percent at year end.

Our client satisfaction, client loyalty and team engagement are at world class levels, and the *Star Tribune* recognized AgStar as one of the top ten workplaces in Minnesota. We have an awesome team that serves awesome clients. We are proud of this.

WHEN AGSTAR SUCCEEDS, YOU SUCCEED

For AgStar and for our clients, 2012 was a landmark year. We retired the remaining patronage allocations for 2002 and 2003, totaling over $40 million to eligible stockholders. This is the first time we have distributed two patronage allocations in one year.

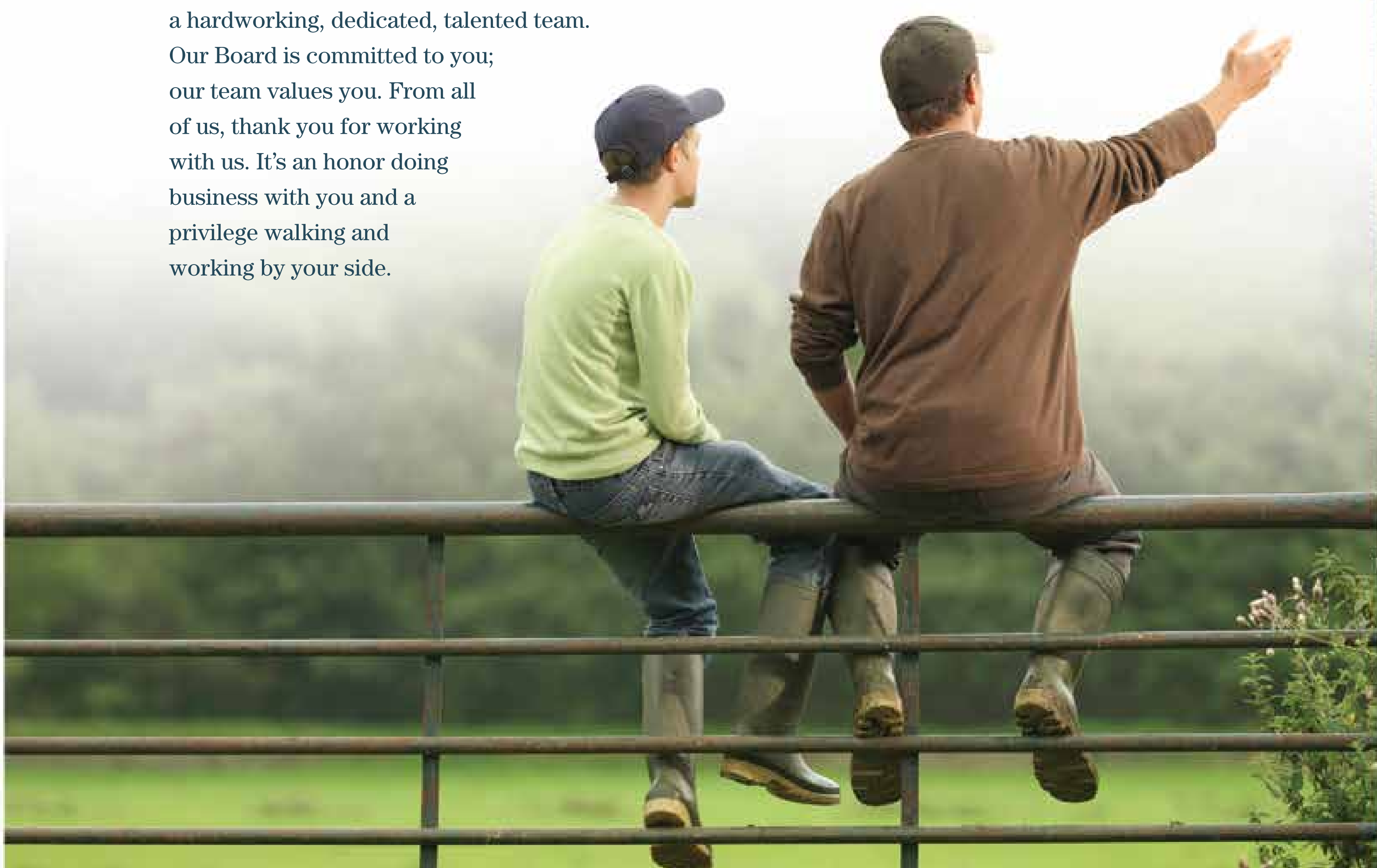
At AgStar, we believe in the rural tradition of helping our neighbors and sharing the bounty. It's likely we've supported a program in a community close to your home. For over a decade, the AgStar Fund for Rural America has made it a priority to give back by supporting programs that improve the rural communities we serve. In 2012, AgStar donated $685,000 to many deserving organizations including 4-H, FFA, Emergency Medical Services, county fair buildings, support for minority farmers and other projects. Since the program's inception in 2001, our contributions have totaled over $4 million. We believe giving back to our rural communities to enhance the quality of life is important.

GROWING WITH YOU

In August, we held the grand opening of the AgStar Arena at the Minnesota State Fair. We have never had so many positive unsolicited comments from clients and interested parties on such an investment. The educational programs held in this facility will help prepare our youth for their roles as future leaders in agriculture and in rural communities. Through this venue, consumers will see the expertise, confidence and poise of rural youth and witness the respect they have for animals. All of us in agriculture need to help consumers build a deeper understanding of, and appreciation for, production agriculture.

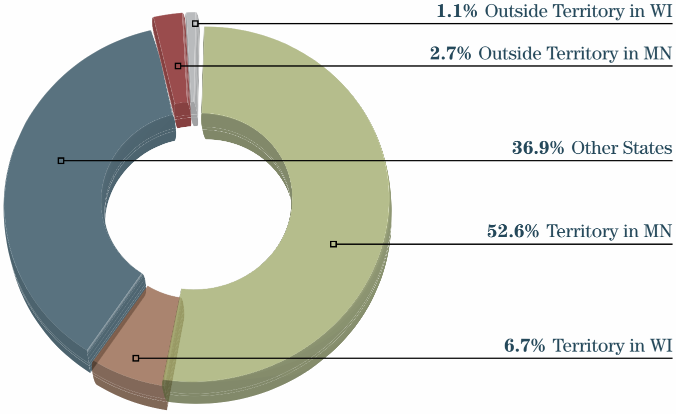
Clients have told us they would like someone to take the clutter out of the entire information overload. Last summer, we launched AgStar Edge, or AgStar's Center for Education, Development, Growth and Expertise. Through conferences, seminars, webinars, industry-position white papers and more, AgStar Edge provides guidance, insight and expertise to help our clients stay sharp and keep their edge.

They say you reveal a lot about yourself by the company you keep. At AgStar, we are fortunate to be surrounded by innovative, bright, passionate clients and a hardworking, dedicated, talented team. Our Board is committed to you; our team values you. From all of us, thank you for working with us. It's an honor doing business with you and a privilege walking and working by your side.



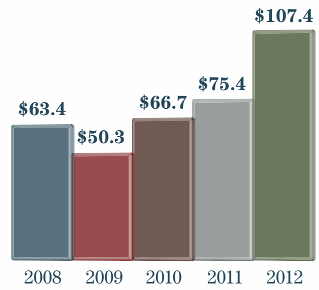
FINANCIAL HIGHLIGHTS

VOLUME BY AREA



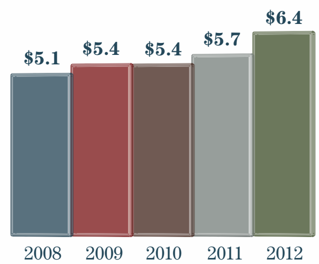
NET INCOME AFTER TAX

(In Millions)

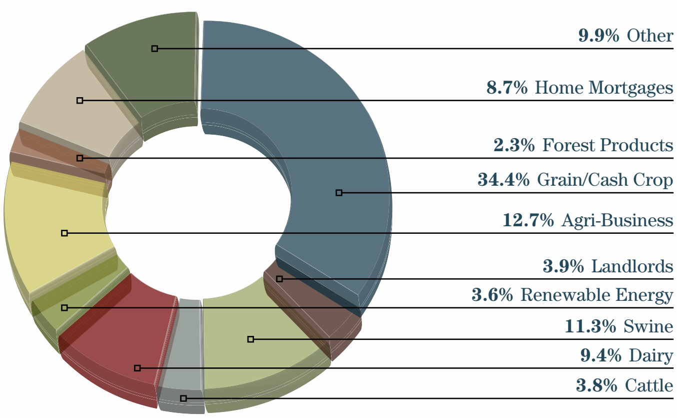


EARNING ASSETS

(In Billions)

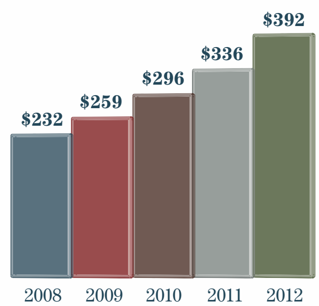


VOLUME BY ENTERPRISE



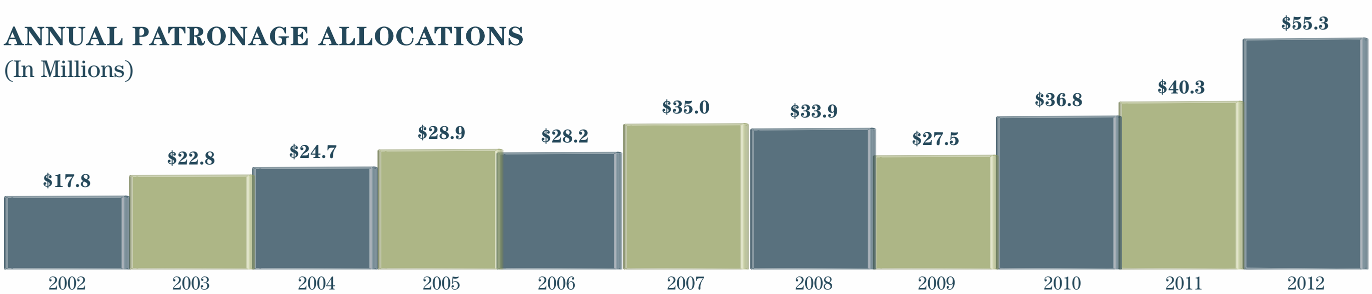
CUMULATIVE PATRONAGE ALLOCATIONS

(In Millions)



ANNUAL PATRONAGE ALLOCATIONS

(In Millions)



$872 MILLION Member Equity (Total Capital)

7.44% Compound Annual Growth Rate for the Last Five Years

613 Full-Time Equivalent Team Members

15,300 Number of Voting Stockholders

27,219 AgStar Clients

FINANCIAL RESULTS

CONSOLIDATED FIVE-YEAR SUMMARY OF SELECTED FINANCIAL DATA

AgStar Financial Services, ACA

(Dollars in thousands)

	2012	2011	2010	2009	2008
Statement of Condition Data					
Loans	**$5,913,336**	$5,187,874	$4,915,210	$4,809,853	$4,471,889
Allowance for loan/lease losses	**26,814**	26,833	39,312	60,501	29,765
Net loans	**5,886,522**	5,161,041	4,875,898	4,749,352	4,442,124
Investment in AgriBank, FCB	**141,137**	130,150	126,160	132,962	126,995
Investment securities	**484,092**	505,486	467,143	510,027	604,049
Other property owned	**10,137**	6,954	5,851	4,406	5,338
Other assets	**142,484**	142,784	138,539	140,012	134,096
Total assets	**$6,664,372**	$5,946,415	$5,613,591	$5,536,759	$5,312,602
Obligations with maturities of one year or less	**$5,692,651**	$5,040,179	$4,768,993	$4,859,639	$4,684,703
Obligations with maturities greater than one year	**100,000**	100,000	100,000	--	--
Total liabilities	**5,792,651**	5,140,179	4,868,993	4,859,639	4,684,703
Capital stock and participation certificates	**15,655**	14,859	14,125	13,400	12,791
Allocated surplus	**302,789**	290,517	265,010	229,862	204,300
Unallocated surplus	**553,277**	500,860	465,463	433,858	410,808
Total stockholders' equity	**871,721**	806,236	744,598	677,120	627,899
Total liabilities and stockholders' equity	**$6,664,372**	$5,946,415	$5,613,591	$5,536,759	$5,312,602
Statement of Income Data					
Net interest income	**$158,151**	$147,565	$128,747	$127,426	$120,093
Provision for loan/lease losses	**7,182**	7,400	23,550	47,638	24,883
Patronage income	**18,338**	17,133	19,478	17,003	14,947
Other expense, net	**65,297**	71,112	46,200	46,193	42,541
Provision for (benefit from) income taxes	**(3,371)**	10,774	11,772	342	4,226
Net income	**$107,381**	$75,412	$66,703	$50,256	$63,390
Key Financial Ratios					
Return on average assets	**1.8%**	1.3%	1.2%	0.9%	1.3%
Return on average stockholders' equity	**12.9%**	9.7%	9.4%	7.7%	10.4%
Net interest income as a percentage of average earning assets	**2.7%**	2.7%	2.5%	2.4%	2.5%
Stockholders' equity as a percentage of total assets	**13.1%**	13.6%	13.3%	12.2%	11.8%
Net charge-offs as a percentage of average earning assets	**0.1%**	0.4%	0.8%	0.4%	0.1%
Net charge-offs as a percentage of average loans	**0.1%**	0.4%	0.9%	0.4%	0.1%
Allowance for loan/lease losses as a percentage of loans	**0.5%**	0.5%	0.8%	1.3%	0.7%
Permanent capital ratio	**13.9%**	14.6%	15.8%	12.1%	10.9%
Total surplus ratio	**13.7%**	14.4%	15.5%	11.8%	10.7%
Core surplus ratio	**10.9%**	11.2%	11.1%	9.5%	9.1%
Other					
Net surplus allocated under nonqualified patronage program	**$54,966**	$40,015	$36,409	$27,206	$33,769
Redemption in cash of nonqualified written notices of allocation under nonqualified patronage program	**$42,694**	$14,508	$1,261	$1,644	$11,536

Surplus was allocated to stockholders under our nonqualified patronage program for the five years as disclosed above. Certain amounts of this allocated surplus were redeemed for cash, also disclosed above. There were no distributions of qualified patronage during the years presented. Surplus allocated under the patronage program represents management's estimate of these equity allocations. Actual results could differ from those estimates. No other income was distributed to stockholders in the form of dividends, stock, or allocated surplus during the five years presented.

MANAGEMENT'S DISCUSSION AND ANALYSIS

AgStar Financial Services, ACA

The following commentary reviews the consolidated financial position and consolidated results of operations of AgStar Financial Services, ACA and its subsidiaries and provides additional specific information. The accompanying consolidated financial statements and notes to the consolidated financial statements also contain important information about our financial position and results of operations.

Forward-Looking Information

This Annual Report includes 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 "anticipate", "believe", "estimate", "may", "expect", "intend", and similar expressions are used to identify such forward-looking statements. These statements reflect our current views with respect to future events. However, actual results may differ materially from our expectations due to a number of risks and uncertainties which may be beyond our control. These risks and uncertainties include, but are not limited to:

- political, legal, regulatory, financial, and economic conditions and developments in the United States (U.S.) and abroad,
- economic fluctuations in the agricultural and farm-related business sectors,
- unfavorable weather, disease, and other adverse climatic or biological conditions that periodically occur and impact agricultural productivity and income,
- changes in U.S. government support of the agricultural industry and the Farm Credit System (System) as a government-sponsored enterprise, as well as investor and rating agency actions relating to events involving the U.S. government, other government-sponsored enterprises, and other financial institutions,
- actions taken by the Federal Reserve System in implementing monetary policy,
- credit, interest rate, and liquidity risk inherent in our lending activities, and
- changes in our assumptions for determining the allowance for loan/lease losses, other than temporary impairment, and fair value measurements.

Loan Portfolio

Agricultural and Economic Conditions

We are chartered to serve territories in Minnesota and Wisconsin and serve many sectors in agriculture including our primary industries of grain, swine, and dairy. We also serve the housing, energy, and food processing and distribution segments. Credit quality, delinquencies, and nonaccrual measures showed significant improvement during 2012 and this positive trend is expected to continue in 2013. The United States Department of Agriculture (USDA) crop report released on January 1, 2013 estimates the 2012 corn crop yield at 123 bushels per acre and total production of 10.8 billion bushels. The same report estimated a U.S. soybean yield of 40 bushels per acre and total production of 3 billion bushels. For Minnesota, the October 30, 2012, Agri-View report estimated an average corn yield of 168 bushels per acre and an average soybean yield of 43 bushels per acre.

Profits realized for the primary segments of our portfolio were mostly favorable during 2012. National drought conditions propelled corn and soybean prices higher although margins for grain producers will likely narrow in 2013 based on current expectations. The increase in prices had a negative impact on input costs for livestock producers and ethanol facilities. Profit margins for swine and dairy producers were generally at break-even to a slight gain despite increased input costs. Profit margins tightened to break-even or net losses for ethanol plants in 2012. Margins are projected to be positive for 2013 in dairy, break-even for ethanol, and break-even or better in swine.

According to the USDA, net farm income is forecast at $114.0 billion for 2012, down $3.9 billion (3.3%) from 2011. Net cash income is expected to decline by almost $1.9 billion, to $132.8 billion when compared to the record $134.7 billion in 2011. The report stated that "solid gains in the projected annual value of U.S. agricultural production will be more than offset by increases in purchased inputs and payments to stakeholders. In particular, feed expenses are forecasted to increase almost $10 billion in 2012." The report also stated that "farm equity is projected to achieve a new record high in 2012 as expected growth in farm assets exceeds the expected increase in farm debt. Debt repayment capacity utilization--a measure of farm exposure to financial risk--is forecasted to tick upward while remaining at a near-historic low level."

Conditions over the past two to three 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 remained relatively stable, but as previously described, may see some deterioration in 2013. Agricultural related businesses have generally been profitable and fared better during the past several years than companies not closely tied to agriculture.

Farm real estate values in our territory continued to show strong increases during 2012 with demand for farm real estate continuing to be strong. Values for transitional and recreational property remain low compared to the peak values previously reached.

Our home mortgage portfolio has performed better than the overall housing industry the past few years. Delinquencies and foreclosure numbers stabilized in 2010, and have shown gradual improvement the past two years. The housing recovery is expected to continue for the next two to three years. There are positive signs that the economy has turned the corner; with the unemployment rate being an example. According to the U.S. Bureau of Labor Statistics, the national unemployment rate dropped to 7.8% in December 2012, the lowest since February 2009. The Minnesota (5.5%) and Wisconsin (6.6%) unemployment rates are better than the national average. Interest rates continue to be at record lows.

Declining land values following sustained periods of land value increases have historically created conditions of considerable risk for collateral-based lenders. Nominal and real (inflation-adjusted) agricultural land values have increased in proportions similar to other asset classes such as stocks and urban residential and commercial land during the last decade, but agricultural land values escaped the valuation declines that other assets suffered during the recession. This is largely because grain farming remained profitable throughout the economic crisis period.

Our credit risk policies emphasize loan repayment capacity in addition to conservative assessments of collateral values that secure loans. Although Farm Credit Administration regulations allow real estate mortgage loans of up to 85% of appraised value, our underwriting standards generally limit lending to no more than 65% of sustainable value (based on crop production history) at origination for agricultural production land. While underwriting exceptions on loan-to-appraised-value are sometimes granted, in such cases offsetting strengths are generally present in other areas.

We do extensive monitoring of land values in our territory, conducted by licensed real estate appraisers, of a sample of benchmark farms selected to represent our lending footprint. The most recent real estate market survey, as of June 30, 2012, indicated that regional agricultural land value ranges in some areas of our territory had increased as much as 29.2% in the previous 12 months. On average, however, our real estate values increased 17.7% over that same period. In addition, qualitative surveys of lending officers, compiled by the Federal Reserve Banks of Chicago, Kansas City, and Minneapolis as of September 30, 2012 indicated sharply increasing farmland values. The Banks cited survey findings of a year-over-year increase in the value of non-irrigated farmland of 24-30%.

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

Portfolio Distribution

We are chartered to serve certain counties in Minnesota and Wisconsin. At December 31, 2012, approximately 52.6% of our loan and lease portfolio, combined with the assets underlying our investments, was within our territory in Minnesota, 6.7% was within our territory in Wisconsin, 2.7% was in Minnesota outside our territory, and 1.1% was in Wisconsin outside our territory.

Our loan and lease portfolio, plus the assets underlying our investments, are concentrated in grain, dairy, and swine production, with 55.1% of the total in these categories. Due to the high concentration in grain production, the commercial loan portfolio exhibits some seasonality. These loans are normally at their lowest levels during the winter months because of operating repayments following harvest and then increase throughout the year as clients borrow for operating and capital needs. More information on commodities is included in Note 3.

Loan Volume

Total loans and finance and conditional sales leases (hereinafter referred to collectively as loans) were $5.9 billion at December 31, 2012, an increase of $725.5 million from December 31, 2011. The components of total loans are outlined in the following table (in thousands):

As of December 31	**2012**	2011	2010
Real estate mortgage	**$2,782,812**	$2,340,792	$2,126,644
Production and intermediate term	**1,732,881**	1,565,041	1,492,963
Agribusiness	**608,641**	543,531	589,177
Communication	**137,221**	123,898	111,795
Energy	**162,628**	115,269	92,801
Rural residential real estate	**93,914**	86,299	79,454
Finance/conditional sales leases	**112,391**	108,590	104,514
Other	**131,257**	139,764	127,058
Nonaccrual	**151,591**	164,690	190,804
Total loans	**$5,913,336**	$5,187,874	$4,915,210

The increase in total loans from December 31, 2011 is due to our continued focus on client service, marketing excellence, and channel development in all our business units. Additionally, operating loans increased in the fourth quarter due to tax planning done by a certain segment of our clients and a large number of real estate transactions closed as a result of the uncertainty in the tax rate changes for 2013. These increases were partially offset by a decrease in nonaccrual loans due to settling adverse asset volume mainly through upgrading, payoffs, paydowns, or charge-offs on certain accounts in the swine and dairy segments of our portfolio.

Analysis of Risk

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

As of December 31	**2012**	2011	2010
Loans:			
Accruing restructured	**$102**	$ --	$ --
Accruing loans 90 days or more past due	**126**	40	1,570
Nonaccrual	**151,591**	164,690	190,804
Total risk loans	**151,819**	164,730	192,374
Other property owned	**10,137**	6,954	5,851
Total risk assets	**$161,956**	$171,684	$198,225
Risk loans as a percentage of total loans	**2.6%**	3.2%	3.9%
Total delinquencies as a percentage of total loans	**1.5%**	1.7%	2.4%

Our risk assets have decreased from December 31, 2011. The decrease in nonaccrual loans was due to settling volume mainly through upgrading, payoffs, paydowns, or charge-offs on certain accounts in the swine and dairy segments of our portfolio. Adversely classified assets are assets identified as showing some credit weakness outside our credit standards. While still above our credit standards, at December 31, 2012, our nonaccrual loan volume as a percentage of our total portfolio improved 0.7% from December 31, 2011, to 2.5%. We continue to be actively engaged in working with clients to provide individualized servicing plans and strategies. At December 31, 2012, 64.1% of our nonaccrual loans were current.

Based on our analysis, all loans 90 days or more past due and still accruing interest were adequately secured and in the process of collection and, as such, were eligible to remain in accruing status.

The credit quality of our portfolio improved during 2012. Our adversely classified assets ratio improved 1.4 percentage points to 4.3% of the portfolio at December 31, 2012 from 5.7% of the portfolio at December 31, 2011. Adversely classified assets are assets 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.

Most dairy producers experienced tighter margins during 2012 compared to 2011 due to higher feed costs and lower milk prices. For the year, most operations will likely experience a profit, although feed costs will be variable across farms. Dairy exports are expected to keep milk prices at profitable levels in 2013. Dairy portfolio quality is expected to improve in 2013 as clients' 2012 profitability and balance sheet improvement are accounted for in credit quality adjustments. Collection of some adverse assets should also have a positive impact on the quality of the dairy portfolio.

Pork production has been profitable from 2010-2012 despite rising feed costs. Strong export markets along with the use of contracting and hedging for risk management are helping most producers to remain profitable. Volatility will continue to be the norm and margin management is key to on-going viability. There have been opportunities for our clients to lock in positive margins for 2013 and many clients have taken advantage of these opportunities.

The volatility of corn and soybean prices created an added risk for producers to manage, particularly for the protein sectors of our portfolio.

Crop producers have enjoyed several years of strong income driven by export demand and the expanded use of grains for bio-fuel production. Credit quality in this segment is strong. With drought conditions adversely impacting U.S. corn and soybean production in 2012, prices increased and, as such, we expect grain producer incomes to remain favorable. Strong liquidity and equity positions should be maintained and we expect continued favorable credit quality in this portfolio segment during the next 12 months. Domestic stocks of corn and soybeans are at relatively low levels, impacting industries which use those commodities for inputs as well as consumers. Grain producers in Minnesota and Wisconsin generally experienced a good year in 2012.

Conditions the past two to three years have been favorable overall for agricultural producers resulting in positive performance generally for agribusinesses. Ethanol assets are our largest agribusiness segment and credit quality in this segment remained relatively stable, but may see some deterioration in 2013 as the current narrow margin environment continues. Profitability was attainable for some producers, but break-even or net losses were experienced by others in 2012.

In addition, significant steps to manage risk in the portfolio have been taken through enhancement of enterprise risk management and continuing efforts to promote financial counseling. We also actively consider portfolio credit quality in assessing the reasonableness of our allowance for loan/lease losses.

In certain circumstances, we use various government guarantee programs to reduce the risk of loss in our portfolio. At December 31, 2012, $79.9 million of our loans were, to some level, guaranteed under these government programs. In addition, at December 31, 2012, $244.1 million of our loans were guaranteed through the Federal Agricultural Mortgage Corporation Standby Commitment Program.

Excluded in the ratios and volumes as discussed in this section are our investment securities. At December 31, 2012, our investment securities totaled $484.1 million, consisting of $302.7 million in mortgage-backed securities issued and guaranteed by the Federal Agricultural Mortgage Corporation (Farmer Mac) and $181.4 million in investment securities, issued and guaranteed by the Small Business Administration (SBA) or USDA. Had this volume been included, the adversely classified asset ratio would be 4.0% at December 31, 2012, compared to 5.2% at December 31, 2011. Additional investment securities information is included in Notes 4 and 15.

Analysis of the 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 the 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.

The following table presents allowance coverage, charge-off, and adverse asset information:

As of December 31	**2012**	2011	2010
Allowance as a percentage of:			
Loans	**0.5%**	0.5%	0.8%
Nonaccrual loans	**17.7%**	16.3%	20.6%
Total risk loans	**17.7%**	16.3%	20.4%
Net charge-offs as a percentage of average earning assets	**0.1%**	0.4%	0.8%
Net charge-offs as a percentage of average loans	**0.1%**	0.4%	0.9%
Adverse assets to risk funds	**31.1%**	38.2%	53.8%

Our allowance levels reflect the continued improvements made in our portfolio. Larger provision expense was taken in prior years reflecting the impact of the volatility in the commodity and financial markets during those years. In 2012, as in 2011, adverse accounts have paid down or off, been upgraded, or have taken charge-offs. In our opinion the allowance was reasonable in relation to the probable losses in the portfolio as of December 31, 2012.

Additional loan information is included in Notes 3, 12, 13, 14, and 15.

Investment Securities

In addition to loans and leases, we hold investment securities. Our investments primarily include:

- mortgage-backed securities issued and guaranteed by Farmer Mac and
- investment securities issued and guaranteed by SBA or USDA.

Investment securities totaled $484.1 million, $505.5 million, and $467.1 million at December 31, 2012, 2011, and 2010, respectively.

The investment portfolio is evaluated for other-than-temporary impairment. To date, we have not recognized any impairment on our investment portfolio.

Additional investment securities information is included in Notes 4 and 15.

Results of Operations

The following table illustrates profitability information (dollars in thousands):

For the year ended December 31	**2012**	2011	2010
Net income	**$107,381**	$75,412	$66,703
Return on average assets	**1.8%**	1.3%	1.2%
Return on average stockholders' equity	**12.9%**	9.7%	9.4%

Changes in these ratios relate directly to:

- changes in income as discussed below,
- changes in assets as discussed in the Loan Portfolio and Investment Securities sections, and
- changes in stockholders’ equity as discussed in the Capital Adequacy section.

The following table summarizes the changes in components of net income (in thousands):

	Year ended December 31			Increase (decrease) in net income	
	2012	2011	2010	**2012 vs 2011**	2011 vs. 2010
Net interest income	**$158,151**	$147,565	$128,747	**$10,586**	$18,818
Provision for loan/lease losses	**7,182**	7,400	23,550	**218**	16,150
Patronage income	**18,338**	17,133	19,478	**1,205**	(2,345)
Other income, net	**45,962**	39,479	49,942	**6,483**	(10,463)
Operating expenses	**111,259**	110,591	96,142	**(668)**	(14,449)
Provision for (benefit from) income taxes	**(3,371)**	10,774	11,772	**14,145**	998
Net income	**$107,381**	$75,412	$66,703	**$31,969**	$8,709

Net Interest Income

Net interest income was $158.2 million for the year ended December 31, 2012. The following table quantifies changes in net interest income (in thousands):

	2012 vs. 2011	2011 vs. 2010
Changes in AgriBank, FCB note payable and earning assets	**$12,321**	$7,776
Changes in rates on AgriBank, FCB note payable and earning assets	**(1,083)**	2,206
Changes due to asset securitization	**404**	504
Changes due to capital management	**327**	4,924
Changes in nonaccrual income and other	**(1,383)**	3,408
Net change	**$10,586**	$18,818

Net interest income included income on nonaccrual loans that totaled $4.5 million, $5.9 million, and $3.8 million in 2012, 2011, and 2010, respectively. Nonaccrual income is recognized when:

- received in cash,
- collection of the recorded investment is fully expected, and
- prior charge-offs have been recovered.

Net interest margin (net interest income divided by average earning assets) was 2.7%, 2.7%, and 2.5% in 2012, 2011, and 2010, respectively. If interest rates rise in 2013, we would anticipate some compression in interest rate margins. However, we expect our loan and lease products to remain competitive in the market place in 2013.

Provision for Loan/Lease Losses

The variance in the provision for loan/lease losses is related to our estimate of losses in our portfolio for the applicable years. See Note 3 for additional discussion.

Patronage Income

We received patronage income based on the average balance of our note payable to AgriBank, FCB (AgriBank). AgriBank's Board of Directors sets the patronage rate. We recorded patronage income of $16.2 million, $14.7 million, and $19.2 million in 2012, 2011, and 2010, respectively. Changes in our note payable to AgriBank and patronage rate changes caused the variances in the patronage income amounts. The patronage rates paid by AgriBank were 32 basis points, 31 basis points, and 42 basis points in 2012, 2011, and 2010, respectively.

We also participate in a program with AgriBank in which we sold participation interests in certain real estate loans. As part of this program we received patronage income in an amount that approximated the net earnings of those loans. Net earnings represents the net interest income associated with these loans adjusted for certain fees and costs specific to the related loans as well as adjustments deemed appropriate by AgriBank related to the credit performance of the loans, as applicable. In addition, we received patronage income in an amount that approximated the wholesale patronage had we retained the volume. Patronage declared on the loans in this program is solely at the discretion of the AgriBank Board of Directors. We recorded such patronage income of $2.1 million, $2.5 million, and $238 thousand in 2012, 2011, and 2010, respectively. The patronage recorded included $190 thousand and $169 thousand of our share of the distributions from the Allocated Insurance Reserve Accounts (AIRA) related to this program in 2012 and 2010, respectively. These reserve accounts were established in previous years by the Farm Credit System Insurance Corporation when premiums collected increased the level of the Farm Credit Insurance Fund beyond the required 2% of insured debt. No such distribution was received in 2011.

Other Income

The increase in other income is primarily due to our share of distributions from AIRA. We received $6.1 million in 2012 and $5.7 million in 2010. There was no distribution in 2011. Additionally as a result of our marketing efforts, our secondary market, appraisal, title, and loan/lease fee income increased $2.4 million over the 2011 levels. These increases were partially offset by a decline in crop insurance and tax and accounting income of $1.9 million from 2011. Crop insurance income decreased as a result of a lower cap income level and reduced profit share, partially offset by an increase in acres covered by insurance. Effective July 1, 2012, we sold our tax and accounting portfolio to CliftonLarsonAllen LLP, causing the decline in tax and accounting income.

We originate rural home loans for resale in the secondary market. We sold loans in the secondary market totaling $77.1 million, $52.4 million, and $57.9 million in 2012, 2011, and 2010, respectively. The fee income from this activity totaled $1.5 million, $865 thousand, and $1.1 million in 2012, 2011, and 2010, respectively.

Operating Expenses

The following presents a comparison of operating expenses by major category and the net pre-tax operating rate (total on-going expenses less financially related services income and fees earned, divided by average earning assets) for the past three years (dollars in thousands):

For the year ended December 31	**2012**	2011	2010
Salaries and employee benefits	**$78,161**	$75,352	$65,897
Purchased and vendor services	**6,286**	6,905	6,663
Communications	**1,604**	1,538	1,517
Occupancy and equipment	**9,569**	9,094	8,196
Advertising and promotion	**5,481**	5,658	3,704
Examination	**1,569**	1,609	1,391
Farm Credit System insurance	**2,660**	2,996	2,505
Other	**5,929**	7,439	6,269
Total operating expenses	**$111,259**	$110,591	$96,142
Net pre-tax operating rate	**1.10%**	1.17%	0.89%

Salary and benefits expense increased $2.8 million primarily related to normal salary and benefit increases, an increase in the number of team members in our ProPartners Financial (ProPartners) alliance, and increased variable compensation expense resulting from favorable business results. These increases were partially offset by no longer having tax and accounting team members as of July 1, 2012, affecting all employee-related expense categories.

Occupancy and equipment increased $475 thousand due to incurring a full year of technology related expenses and amortization costs from implementing a new internet banking platform and client relationship management system in 2011. These are offset by lower purchased services for these same projects in 2012.

FCS insurance expense declined $336 thousand due to a reduction in the premium rate from 6 basis points in 2011 to 5 basis points in 2012 on accrual loans and from 16 basis points in 2011 to 15 basis points in 2012 on nonaccrual loans.

Other expense was $1.5. million lower in 2012 resulting mainly from lower intangible expense amortization, lower synthetic securitization amortized expenses, and higher expense offsets from our facilitating association role in providing services to the ProPartners alliance.

Provision for (Benefit from) Income Taxes

The change in provision for (benefit from) income taxes is primarily due to a tax reduction caused by patronage redemptions and a decrease in pre-tax income of the taxable entities only. This decrease in taxable entity income was primarily from higher provision for loan/lease losses expense, specific to those entities. See Note 10 for additional discussion of the tax effect of our patronage program.

Funding and Liquidity

Funding

We borrow from AgriBank under a note payable, in the form of a line of credit, as described in Note 7. During 2012, our average balance was $5.1 billion with an average interest rate of 1.8%. Our average balance during 2011 was $4.7 billion with an average interest rate of 2.1% and during 2010 our average balance was $4.6 billion with an average interest rate of 2.6%. Unallocated surplus is another source of lendable funds.

In March 2010, we issued $100 million of subordinated notes due in 2025 with a fixed interest rate of 9% per annum. These notes are unsecured and subordinate to all other categories of creditors, including general creditors, and senior to all classes of stockholders. At our option, we may redeem all or some of the notes at any time on or after a date 10 years from the closing date. The transaction increased our regulatory permanent capital and total surplus ratios under the Farm Credit Administration regulations and positions us for the future.

Liquidity

Our approach to sustaining sufficient liquidity to fund operations and meet current obligations is to maintain an adequate line of credit with AgriBank. At December 31, 2012, we had $372.2 million available under our line of credit. We generally apply excess cash to this line of credit.

We offer variable, fixed, capped, indexed, and adjustable interest rate loan and lease programs to our clients.

We determine interest margins charged on each lending program based on:

- cost of funds,
- market conditions, and
- the need to generate sufficient earnings.

The repricing attributes of our line of credit generally correspond to the repricing attributes of our loan portfolio which significantly reduces our interest rate risk.

We have a financial relationship with Farmer Mac to provide a standby commitment program for the repayment of principal and interest on certain loans. In the event of default, subject to certain conditions, we have the right to sell the loans identified in the agreement to Farmer Mac. This program remains in place until receipt of full payment. As of December 31, 2012, $244.1 million of our loans were in this program. We also purchase mortgage-backed security investments from Farmer Mac. These investments are held-to-maturity, are included in “Investment securities” on the Consolidated Statements of Condition, and totaled $302.7 million, $340.2 million, and $386.9 million as of December 31, 2012, 2011, and 2010, respectively.

Capital Adequacy

Total stockholders' equity increased $65.5 million during 2012 primarily due to net income for the period and an increase in capital stock and participation certificates partially offset by patronage distributions.

Stockholders' equity position information follows (dollars in thousands):

As of December 31	**2012**	2011	2010
Stockholders' equity	**$871,721**	$806,236	$744,598
Surplus as a percentage of stockholders' equity	**98.2%**	98.2%	98.1%
Permanent capital ratio	**13.9%**	14.6%	15.8%
Total surplus ratio	**13.7%**	14.4%	15.5%
Core surplus ratio	**10.9%**	11.2%	11.1%

Our capital plan is designed to maintain an adequate amount of surplus and allowance for loan/lease losses which represents our reserve for adversity prior to impairment of stock. We manage our capital to allow us to meet stockholder needs and protect stockholder interests, both now and in the future. In the fourth quarter of 2008, we entered into a capital pass through agreement with AgriBank allowing us to count $61 million of our investment in AgriBank as permanent capital. This was originally entered into to improve our overall capital position. Given the improvement in our capital position, this agreement was terminated at the end of 2010.

In March 2010, we issued $100 million of aggregate principal amount of Series A Subordinated Notes (Notes), due in 15 years. The Notes bear a fixed interest rate of 9.0% per annum, payable semi-annually. Our Board of Directors has authorized up to a maximum of $200 million for subordinated debt issuance. At our option, we may redeem all or some of the Notes, at any time on or after a date 10 years from the closing date. This debt is subordinate to all other creditor debt, including general creditors, but senior to all classes of stock. Additional information is included in Note 8. The issuance proceeds increased our regulatory permanent capital and total surplus ratios.

At December 31, 2012, our permanent capital, total surplus, and core surplus ratios exceeded the regulatory minimum requirements. Additional discussion of these regulatory ratios is included in Note 9.

In addition to these regulatory requirements, we establish an optimum permanent capital target. This target allows us to maintain a capital base adequate for future growth and investment in new products and services. The target is subject to revision as circumstances change. As of December 31, 2012, our optimum permanent capital target was 12.25%.

Given the volatile financial and commodity markets, our capital position and risk in the portfolio, our Board of Directors delayed redeeming nonqualified patronage distributions in 2010, except for estate retirements and distributions applied to charge-offs. On January 20, 2011, the Board of Directors authorized the retirement of the remainder of the $13.9 million of 2001 nonqualified patronage allocations. This retirement was substantially completed by February 1, 2011. 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 by February 1, 2012. On September 19, 2012, the Board of Directors authorized the retirement of the remainder of the $22.8 million of 2003 nonqualified patronage allocations. This retirement was substantially completed by December 1, 2012. The timing of these payouts 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. Further information regarding our patronage distributions is included in Notes 9 and 10.

The changes in our capital ratios reflect changes in capital and assets. Refer to the Loan Portfolio and the Investment Securities sections for further discussion of the changes in assets. Additional stockholders' equity information is included in Note 9.

Programs

We are involved in a number of initiatives designed to improve our credit delivery, related services, and marketplace presence.

AgStar Fund for Rural America

Created in 2001, the AgStar Fund for Rural America (Fund) helps create stability and strength by investing in quality of life programs that create future opportunities for rural residents and their communities. In 2012, the Fund awarded $685 thousand through scholarships, grants, and sponsorships to support ag-related programs. The Fund is managed by an internal committee.

Highlights of the 2012 Fund activities include:

- Awarded over $100 thousand in grants to support local organizations that benefit agriculture and rural residents, supporting education, the environment, technology, and quality of life.
- Awarded $128 thousand to the Emergency Response Program providing rural communities with response equipment, technology, and turnout gear.
- Donated $30 thousand to high school agriculture classrooms, funding the technology and equipment needs in agricultural education.

Mission Related Investments

The public mission of the System has always been to provide financing to agriculture and rural areas. Our primary focus has always been and will remain financing production agriculture. Because of the changing needs of rural America, we have placed additional emphasis on investing in rural communities and businesses by creating the Rural Capital Network. This unit makes investments in rural America through the purchase of bonds, focusing on rural businesses, health care, and housing facilities. Additionally, we continue to have minority investments in a few small-scale local economic development corporations.

At the end of 2012, we had invested $139.9 million in bonds, compared to $146.1 million and $129.6 million at the end of 2011 and 2010, respectively. We had also invested $91 thousand in local economic development corporations at the end of 2012, compared to $96 thousand and $86 thousand at the end of 2011 and 2010, respectively.

Patronage

Since 1998, our Board of Directors has allocated $391.5 million of nonqualified patronage dividends to our stockholders. Our nonqualified patronage allocation is based on a Board of Directors resolution requiring an allocation of annual net patronage-eligible earnings. For 2012, this amounted to $55.3 million, spread between our stockholders. Allocated patronage equities have no voting rights and are redeemed at the sole discretion of the Board of Directors.

Operating Business Units

Agri-Access®

We have entered into agreements with certain financial institutions to provide correspondent lending programs under the trade name Agri-Access®, which operates as a unit of AgStar Financial Services, ACA. Agri-Access focuses primarily on purchasing participations in agricultural real estate loans, rural home loans, and leases on a wholesale basis. Agri-Access also services loan portfolios for other institutional investors. At the end of 2012, 87 banks, bank holding companies, or non-bank financial service firms had active signed agreements in the Agri-Access network. These financial services firms are disbursed throughout the United States. The main Agri-Access contact office is located in Des Moines, Iowa. We also have contact offices in both Woodland, California and Meridian, Idaho. Further information can be obtained at www.agri-access.com.

Client Solutions Team

We provide operating, term, and real estate loans, leases, crop insurance, life insurance, and consulting services to over 14,000 core market clients and producers who are typically in the grain, dairy, and swine industries. This structure enables our team to collaborate with other professionals with specialized knowledge, depending on the client’s specific goals and unique needs.

Our industry specialists possess broad, extensive knowledge and experience in their areas of expertise, providing financing to commercial producers, agribusinesses, and processors, primarily focused in swine, dairy, and bio-energy.

Our Home Mortgage Services team provides home financing options for rural residents living in the country or in communities with populations of 2,500 or less. The focal points of this segment are mortgages to buy, build, or refinance residences or acreages. Title insurance, appraisal services, and home equity loans are also offered. Further information can be obtained at www.AgStarHome.com.

Our consulting team provides business advice and professional services such as family business consulting, succession planning, and estate planning. Services are provided across all commodities with particular expertise in the dairy, swine, and cash grain industry segments.

Capital Markets

The Capital Markets team focuses on relationships with commercial banks, Farm Credit Institutions, and other lending partners in buying loan participations and syndications. This specialized team provides a national marketing vehicle to gain improved access to the agribusiness and commercial producer loan market, and provides portfolio diversity, earnings, and market intelligence to the organization.

Rural Capital Network

The Rural Capital Network team is devoted to supporting community and economic development, infrastructure needs, revitalization projects, and minority lending in rural America. AgStar Rural Capital Network invests in projects through the purchase of bonds issued by local communities, organizations, or businesses. In addition, this team partners with other Farm Credit associations and local community banks focusing on investing in critical access hospitals, assisted-living facilities, dental facilities, rural rental multi-family housing, business expansions, and other similar enterprises. Further information can be obtained at www.RuralCapitalNetwork.AgStar.com.

Other Relationships

Asset Securitization

In November 2005, we securitized and sold a $96.5 million participation interest in $98.5 million of certain term agriculture loans to an investor and retained the remaining participation interest, the right to certain other residual cash flows, and servicing rights associated with the revolving securitization structure. Effective January 1, 2010, this transaction was consolidated into our financial statements and resulted in an increase in loans and related assets totaling approximately $39 million and a related increase in notes payable and related liabilities of approximately $38 million. On April 15, 2010, this securitization was terminated through our payment of all outstanding liabilities associated with the securitization structure.

Farmer Mac

We have a financial relationship with Farmer Mac to provide a standby commitment program for the repayment of principal and interest on certain loans. As of December 31, 2012, $244.1 million of our loans were in this program. Additionally, we are an approved mortgage loan central servicer for Farmer Mac. As of December 31, 2012, the total loan volume being serviced was $112 million. Income from this servicing for the year ended December 31, 2012 totaled $99 thousand. We also purchase mortgage-backed security investments from Farmer Mac. These investments are held-to-maturity, are included in “Investment securities” in the Consolidated Statements of Condition, and totaled $302.7 million, $340.2 million, and $386.9 million as of December 31, 2012, 2011, and 2010, respectively.

Fleet Management

We offer fleet management services to small and mid-sized agribusinesses. Depending on the program selected, services range from customized vehicle ordering, combined with lease financing, to full service program options of providing fuel cards, maintenance management, 24/7 emergency roadside assistance, and vehicle disposal service. Additionally, we make available customized vehicle ordering and leasing options to the System entities. At the end of 2012, we have ordered vehicles for 25 System entities. We have manufacturer's fleet codes for the following brands: Ford, General Motors, Chrysler, Toyota, Nissan, Mazda, Volvo, and Subaru.

ProPartners Financial

We have an alliance with nine other Farm Credit association partners to provide producer financing for agribusiness companies under the trade name ProPartners Financial (ProPartners). In September 2012, Northwest Farm Credit Services (Northwest) joined the alliance resulting in expanded agribusiness client programs in which ProPartners loans can be originated. The addition of Northwest increased our financial strength, processing capacity, technology, expertise, and geographic diversity to support our clients' growth. ProPartners is directed by representatives from the participating associations and has employees in California, Illinois, Indiana, Kansas, Minnesota, Missouri, North Dakota, Tennessee, and Washington. 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. We had $112.7 million, $119.2 million, and $108.9 million of ProPartners volume at December 31, 2012, 2011, and 2010, respectively.

As the facilitating association for ProPartners, we provide, and are compensated for, various support functions. This includes human resources, accounting, payroll, reporting, and other finance functions.

Synthetic Securitization

On March 8, 2012, we terminated the Credit Default Swap Agreement (Agreement) entered into on October 9, 2009 with AgFunding 2009-A LLC. The loan pool balance was $40.3 million at the time of termination. Early redemption was allowed by the Agreement once the aggregate outstanding principal balance of the pool was less than 20% of the original $202 million note balance. The balance of the pool was $50.4 million and $98.7 million as of December 31, 2011, and 2010, respectively. There were five tranches in the synthetic securitization. The Junior Risk tranche, held by us, had the first risk of loss and totaled $1.7 million on March 8, 2012. The next risk of loss fell into Tranches A, B, and C and these totaled $1.4 million on March 8, 2012. Tranches A, B, and C were owned by a third party. In 2011, one $58 thousand loss was taken against the Junior Risk tranche. No other losses were incurred under the Agreement.

Trade Credit

We have entered into agreements with certain dealer networks to provide alternative service delivery channels to clients. These trade credit opportunities create more flexible and accessible financing options to clients through programs such as dealer point-of-purchase financing.

Relationship with AgriBank

Borrowing

We borrow from AgriBank to fund our lending operations in accordance with the Farm Credit Act. Approval from AgriBank is required for us to borrow elsewhere. A General Financing Agreement, as discussed in Note 7, governs this lending relationship.

Cost of funds under the General Financing Agreement includes:

- a marginal cost of debt component,
- a spread component, which includes cost of servicing, cost of liquidity, and bank profit, and
- a risk premium component, if applicable.

The marginal cost of debt approach simulates matching the cost of underlying debt with substantially the same terms as the anticipated terms of our loans to clients. This methodology substantially protects us from market interest rate risk.

During 2010 and 2011, we were subject to a 6 basis point risk premium. Based on improvements in certain risk ratios throughout 2011, we were not subject to a risk premium in 2012 and are not subject to a risk premium in 2013.

Investment

We are required to invest in AgriBank capital stock as a condition of borrowing. This investment may be in the form of purchased stock or stock representing previously distributed AgriBank surplus. As of December 31, 2012, we were required to maintain a stock investment equal to 2.5% of the average quarterly balance of our note payable to AgriBank plus an additional 1.0% on growth that exceeded a targeted rate. AgriBank's current bylaws allow AgriBank to increase the required investment to 4.0%. However, AgriBank currently has not communicated a plan to increase the required investment. In addition, we are required to hold AgriBank stock equal to 8.0% of the quarter end asset pool program participation loan balance.

At December 31, 2012, $98.2 million of our investment in AgriBank consisted of stock representing distributed AgriBank surplus and $42.9 million consisted of purchased investment. For the periods presented in this report, we have received no dividend income on this stock investment and we do not anticipate any in future years.

Patronage

We receive different types of discretionary patronage from AgriBank. AgriBank's Board of Directors sets the level of patronage for each of the following:

- patronage on our note payable with AgriBank and
- patronage based on the balance and net earnings of the pool of loans sold to AgriBank.

Patronage income on our note payable with AgriBank was received in the form of cash and AgriBank stock.

Purchased Services

We purchase various services from AgriBank including:

- certain information system services,
- certain financial services,
- certain accounting and reporting services, and
- certain retail product processing and support services.

The total cost of services we purchased from AgriBank was $1.8 million, $2.1 million, and $2.1 million in 2012, 2011, and 2010, respectively. Beginning in January 2012, we now purchase our benefit and payroll services from Farm Credit Foundations, which resulted in the decrease in total cost of services purchased from AgriBank.

Relationship with Other Farm Credit Institutions

Investment in Other Farm Credit Institutions

We have a relationship with CoBank, ACB (CoBank) which involves purchasing or selling participation interests in loans. CoBank also provides certain cash management services to some of our clients. To support these cash management services, we have a cash management agreement with CoBank that includes a $7 million back-up cash management settlement facility. As part of this relationship, our equity investment in CoBank was $871 thousand, $1.0 million, and $1.1 million at December 31, 2012, 2011, and 2010, respectively. CoBank provides direct loan funds to associations in its chartered territory and also makes loans to cooperatives and other eligible clients.

AgriBank, FCB's financial condition and results of operations materially affect stockholders' investment in AgStar Financial Services, ACA. To request a free copy of the AgriBank or the combined AgriBank and Affiliated Associations' financial reports 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 or contact AgriBank, FCB at 30 East 7th Street, Suite 1600, St. Paul, MN 55101, (651) 282-8800, or by e-mail to agribankmn@agribank.com. The reports are also available through AgriBank, FCB's website at www.agribank.com.

To request a free copy of our annual or quarterly reports contact us as stated above. The annual report is available on our website approximately 75 days after the end of the calendar year and stockholders are provided a copy of such report 90 days after the end of the calendar year. The quarterly reports are available on our website approximately 40 days after the end of each calendar quarter.

REPORT OF MANAGEMENT

We prepare the consolidated financial statements of AgStar Financial Services, ACA (the Association) and are responsible for their integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. The consolidated financial statements, in our opinion, fairly present the financial condition of the Association. Other financial information included in the Annual Report is consistent with that on the consolidated financial statements.

To meet our responsibility for reliable financial information, we depend on accounting and internal control systems designed to provide reasonable but not absolute assurance that assets are safeguarded and transactions are properly authorized and recorded. Costs must be reasonable in relation to the benefits derived when designing accounting and internal control systems. Financial operations audits are performed to monitor compliance. PricewaterhouseCoopers LLP, our independent auditors, audit the consolidated financial statements. They also conduct a review of internal controls to the extent necessary to comply with generally accepted auditing standards in the United States of America. The Farm Credit Administration also performs examinations for safety and soundness as well as compliance with applicable laws and regulations.

The Board of Directors has overall responsibility for our system of internal control and financial reporting. The Board of Directors and its Audit Committee consults regularly with us and meets periodically with the independent auditors and other auditors to review the scope and results of their work. The independent auditors have direct access to the Board of Directors, which is composed solely of directors who are not officers or employees of the Association.

The undersigned certify we have reviewed the Association's Annual Report and it has been prepared in accordance with all applicable statutory or regulatory requirements and the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Spencer Enninga
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

March 1, 2013

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The AgStar Financial Services, ACA (the Association) principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association's consolidated financial statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by, or under the supervision of the Association's principal executives and principal financial officers, or persons performing similar functions, and effected by its Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting information and the preparation of the consolidated financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America and includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Association's assets that could have a material effect on its consolidated financial statements.

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of December 31, 2012. In making the assessment, management used the framework in Internal Control — Integrated Framework, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association concluded that as of December 31, 2012, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of December 31, 2012.

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

March 1, 2013

REPORT OF AUDIT COMMITTEE

AgStar
Financial Services, ACA

The consolidated financial statements were prepared under the oversight of the Audit Committee. The Audit Committee is composed of six members of the Board of Directors of AgStar Financial Services, ACA (the Association). The Audit Committee oversees the scope of the Association's internal audit program, the approval, and independence of PricewaterhouseCoopers LLP (PwC) as independent auditors, the adequacy of the Association's system of internal controls and procedures, and the adequacy of management's action with respect to recommendations arising from those auditing activities. The Audit Committee's responsibilities are described more fully in the Internal Control Policy and the Audit Committee Charter.

Management is responsible for internal controls and the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. PwC is responsible for performing an independent audit of the consolidated financial statements in accordance with generally accepted auditing standards in the United States of America and to issue their report based on their audit. The Audit Committee's responsibilities include monitoring and overseeing these processes.

In this context, the Audit Committee reviewed and discussed the audited consolidated financial statements for the year ended December 31, 2012, with management. The Audit Committee also reviewed with PwC the matters required to be discussed by Statement on Auditing Standards No. 114, *The Auditor's Communication with Those Charged with Governance*, and both PwC and the internal auditors directly provided reports on significant matters to the Audit Committee.

The Audit Committee had discussions with and received written disclosures from PwC confirming its independence. The Audit Committee also reviewed the non-audit services provided by PwC, if any, and concluded these services were not incompatible with maintaining PwC's independence. The Audit Committee discussed with management and PwC such other matters and received such assurances from them as the Audit Committee deemed appropriate.

Based on the foregoing review and discussions, and relying thereon, the Audit Committee recommended that the Board of Directors include the audited consolidated financial statements in the Annual Report for the year ended December 31, 2012.

Kevin Koppendrayer
Chairperson of the Audit Committee
AgStar Financial Services, ACA

Other Committee Members:
Lawrence Romuald, Vice Chairperson of the Audit Committee
Wesley Beck
Terry Ebeling
Spencer Enninga
Larry Fischer

March 1, 2013

pwc

Independent Auditor's Report

To the Board of Directors and Stockholders of AgStar Financial Services, ACA,

We have audited the accompanying consolidated financial statements of AgStar Financial Services, ACA (the Association) and its subsidiaries, which comprise the consolidated statements of condition as of December 31, 2012, 2011 and 2010, and the related consolidated statements of income, changes in stockholders' equity and cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Association's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of AgStar Financial Services, ACA and its subsidiaries at December 31, 2012, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

March 1, 2013

PricewaterhouseCoopers LLP, Suite 1400, 225 South Sixth Street, Minneapolis, MN 55402
T: (612) 596 6000, F: (612) 373 7160, www.pwc.com/us

CONSOLIDATED STATEMENTS OF CONDITION

AgStar Financial Services, ACA

(in thousands)

As of December 31	**2012**	2011	2010
ASSETS			
Loans	**$5,913,336**	$5,187,874	$4,915,210
Allowance for loan/lease losses	**26,814**	26,833	39,312
Net loans	**5,886,522**	5,161,041	4,875,898
Investment securities	**484,092**	505,486	467,143
Assets held for lease, net	**35,296**	34,688	35,608
Accrued interest receivable	**45,029**	46,204	43,577
Investment in AgriBank, FCB	**141,137**	130,150	126,160
Premises and equipment, net	**18,128**	17,887	15,285
Other property owned	**10,137**	6,954	5,851
Other assets	**44,031**	44,005	44,069
Total assets	**$6,664,372**	$5,946,415	$5,613,591
LIABILITIES			
Note payable to AgriBank, FCB	**$5,610,487**	$4,954,046	$4,694,170
Subordinated debt	**100,000**	100,000	100,000
Accrued interest payable	**22,628**	27,468	30,354
Deferred tax liabilities, net	**8,751**	10,515	3,376
Other liabilities	**50,785**	48,150	41,093
Total liabilities	**5,792,651**	5,140,179	4,868,993
Contingencies and commitments	**--**	--	--
STOCKHOLDERS' EQUITY			
Capital stock and participation certificates	**15,655**	14,859	14,125
Allocated surplus	**302,789**	290,517	265,010
Unallocated surplus	**553,277**	500,860	465,463
Total stockholders' equity	**871,721**	806,236	744,598
Total liabilities and stockholders' equity	**$6,664,372**	$5,946,415	$5,613,591

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

CONSOLIDATED STATEMENTS OF INCOME

AgStar Financial Services, ACA

(in thousands)

Year ended December 31	**2012**	2011	2010
Interest income	**$257,851**	$258,149	$257,358
Interest expense	**99,700**	110,584	128,611
Net interest income	**158,151**	147,565	128,747
Provision for loan/lease losses	**7,182**	7,400	23,550
Net interest income after provision for loan/lease losses	**150,969**	140,165	105,197
Other income			
Patronage income	**18,338**	17,133	19,478
Net operating lease income	**1,839**	2,005	2,250
Financially related services income	**22,471**	23,813	25,167
Fee and miscellaneous income, net	**21,652**	13,661	22,525
Total other income	**64,300**	56,612	69,420
Operating Expenses			
Salaries and employee benefits	**78,161**	75,352	65,897
Farm Credit System insurance	**2,660**	2,996	2,505
Other operating expenses	**30,438**	32,243	27,740
Total operating expenses	**111,259**	110,591	96,142
Income before income taxes	**104,010**	86,186	78,475
Provision for (benefit from) income taxes	**(3,371)**	10,774	11,772
Net income	**$107,381**	$75,412	$66,703

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

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

AgStar Financial Services, ACA

(in thousands)

	Capital Stock and Participation Certificates	Allocated Surplus	Unallocated Surplus	Total Stockholders' Equity
Balance at December 31, 2009	$13,400	$229,862	$433,858	$677,120
Net income	--	--	66,703	66,703
Cumulative effect of change in accounting principle	--	--	1,311	1,311
Net surplus allocated under nonqualified patronage program	--	36,409	(36,409)	--
Redemption of prior year allocated patronage	--	(1,261)	--	(1,261)
Capital stock/participation certificates issued	1,615	--	--	1,615
Capital stock/participation certificates retired	(890)	--	--	(890)
Balance at December 31, 2010	14,125	265,010	465,463	744,598
Net income	--	--	75,412	75,412
Net surplus allocated under nonqualified patronage program	--	40,015	(40,015)	--
Redemption of prior year allocated patronage	--	(14,508)	--	(14,508)
Capital stock/participation certificates issued	1,763	--	--	1,763
Capital stock/participation certificates retired	(1,029)	--	--	(1,029)
Balance at December 31, 2011	14,859	290,517	500,860	806,236
Net income	**--**	**--**	**107,381**	**107,381**
Net surplus allocated under nonqualified patronage program	**--**	**54,966**	**(54,964)**	**2**
Redemption of prior year allocated patronage	**--**	**(42,694)**	**--**	**(42,694)**
Capital stock/participation certificates issued	**2,084**	**--**	**--**	**2,084**
Capital stock/participation certificates retired	**(1,288)**	**--**	**--**	**(1,288)**
Balance at December 31, 2012	**$15,655**	**$302,789**	**$553,277**	**$871,721**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

AgStar Financial Services, ACA

(in thousands)

Year ended December 31	**2012**	2011	2010
Cash flows from operating activities			
Net income	**$107,381**	$75,412	$66,703
Depreciation on premises and equipment	**4,258**	3,681	3,470
Gain on sale of premises and equipment	**(675)**	(352)	(331)
Depreciation on assets held for lease	**8,088**	7,822	7,993
Gain on disposal of assets held for lease	**(184)**	(165)	(151)
Amortization of premiums on loans and investment securities	**1,073**	852	857
Provision for loan/lease losses	**7,182**	7,400	23,550
Stock patronage received from Farm Credit Institutions	**(8,161)**	(9,750)	(7,408)
Loss on other property owned, net	**1,484**	1,435	1,505
Changes in operating assets and liabilities:			
Accrued interest receivable	**(6,967)**	(4,588)	2,519
Other assets	**(72)**	(6)	(9,390)
Accrued interest payable	**(4,840)**	(2,886)	(1,924)
Other liabilities	**2,203**	14,398	(3,047)
Net cash provided by operating activities	**110,770**	93,253	84,346
Cash flows from investing activities			
Increase in loans, net	**(731,279)**	(296,682)	(154,284)
(Purchases) redemptions of investment in AgriBank, FCB, net	**(2,862)**	5,733	14,176
Redemptions of investment in other Farm Credit Institutions, net	**82**	97	--
Decrease (increase) in investment securities, net	**20,172**	(39,218)	42,002
Purchases of assets held for lease, net	**(8,512)**	(6,737)	(4,440)
Proceeds from sales of other property owned	**2,950**	4,260	8,042
Purchases of premises and equipment, net	**(3,824)**	(5,931)	(2,964)
Increase in restricted cash	**(1,332)**	(202)	(3,503)
Net cash used in investing activities	**(724,605)**	(338,680)	(100,971)
Cash flows from financing activities			
Increase (decrease) in note payable to AgriBank, FCB, net	**656,441**	259,876	(82,172)
Issuance of subordinated debt	**--**	--	100,000
Patronage distributions	**(42,692)**	(14,508)	(1,261)
Capital stock and participation certificates issued, net	**86**	59	58
Net cash provided by financing activities	**613,835**	245,427	16,625
Net change in cash	**--**	--	--
Cash at beginning of year	**--**	--	--
Cash at end of year	**$ --**	$ --	$ --
Supplemental schedule of non-cash activities			
Stock financed by loan activities	**$1,269**	$1,119	$1,011
Stock applied against loan principal	**555**	435	342
Stock applied against interest	**4**	9	2
Interest transferred to loans	**8,138**	1,952	4,799
Loans transferred to other property owned	**8,571**	7,732	11,459
Financed sales of other property owned	**954**	934	467
Cumulative effect of change in accounting principle	**--**	--	1,311
Increase in payable to Farmer Mac not yet settled	**(1,332)**	(202)	(3,503)
Supplemental information			
Interest paid	**$104,540**	$113,470	$130,535
Taxes paid	**2,544**	2,145	10,732

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AgStar Financial Services, ACA

NOTE 1: ORGANIZATION AND OPERATIONS

Association

AgStar Financial Services, ACA and its subsidiaries, AgStar Financial Services, FLCA and AgStar Financial Services, PCA are lending institutions of the Farm Credit System (System). We are a stockholder-owned cooperative providing credit and credit-related services to, or for the benefit of, eligible borrowers for qualified agricultural purposes in the counties of Aitkin, Anoka, Benton, Blue Earth, Brown, Carlton, Carver, Cass, Chisago, Cook, Cottonwood, Crow Wing, Dakota, Dodge, Faribault, Fillmore, Freeborn, Goodhue, Hennepin, Houston, Isanti, Itasca, Jackson, Kanabec, Lake, LeSueur, McLeod, Martin, Mille Lacs, Morrison, Mower, Murray, Nicollet, Nobles, Olmsted, Pine, Pipestone, Ramsey, Rice, Rock, St. Louis, Scott, Sibley, Sherburne, Stearns, Steele, southern Todd, Wabasha, Waseca, Washington, Watonwan, Winona, and Wright counties in the state of Minnesota and Ashland, Barron, Bayfield, Burnett, Chippewa, Douglas, Dunn, Eau Claire, Iron, Pepin, Pierce, Polk, Rusk, St. Croix, Sawyer, and Washburn counties in the state of Wisconsin.

We borrow from AgriBank, FCB (AgriBank) and provide financing and related services to our clients. Our ACA holds all the stock of the FLCA and PCA subsidiaries and provides lease financing options for agricultural production or operating purposes. The FLCA makes secured long-term agricultural real estate, rural home, and part-time farmer mortgage loans and holds certain types of investments. The PCA makes short-term and intermediate-term loans and holds certain types of investments. We also service certain loans.

We, along with certain other System institutions, own Farm Credit Foundations (Foundations) which provides benefit and payroll services.

We offer various risk management services, including credit life, term life, credit disability, debt protection, title, crop hail, and multi-peril crop insurance for clients and those eligible to borrow. We also offer fee appraisals, retirement and succession planning, farm business consulting, producer education, auction, title search, and fleet management services to our clients.

Farm Credit System and District

Farm Credit System Lending Institutions: The System is a nationwide system of cooperatively owned banks and associations established by Congress to meet the credit needs of American agriculture. At December 31, 2012, the System consisted of three Farm Credit Banks, one Agricultural Credit Bank, and 82 associations. AgriBank, a System bank, and its affiliated associations are collectively referred to as the AgriBank Farm Credit District (AgriBank District or the District). At December 31, 2012, the District consisted of 17 Agricultural Credit Associations (ACA) that each has wholly-owned Federal Land Credit Association (FLCA) and Production Credit Association (PCA) subsidiaries.

FLCAs are authorized to originate long-term real estate mortgage loans. PCAs are authorized to originate short-term and intermediate-term loans. ACAs are authorized to originate long-term real estate mortgage loans and short-term and intermediate-term loans either directly or through their subsidiaries. Associations are authorized to provide lease financing options for agricultural purposes and are also authorized to purchase and hold certain types of investments. AgriBank provides funding to all associations chartered within the District.

Associations are authorized to provide, either directly or in participation with other lenders, credit and related services to eligible clients. Eligible clients may include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related service businesses. In addition, associations can participate with other lenders in loans to similar entities. Similar entities are parties that are not eligible for a loan from a System lending institution, but have operations that are functionally similar to the activities of eligible clients.

Farm Credit System Regulator: The Farm Credit Administration (FCA) is authorized by Congress to regulate the System banks and associations. We are examined by the FCA and certain association actions are subject to the prior approval of the FCA and/or AgriBank.

Farm Credit Insurance Fund: The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is used:

- to ensure the timely payment of principal and interest on Farm Credit Systemwide debt obligations,
- to ensure the retirement of protected client capital at par or stated value, and
- for other specified purposes.

At the discretion of the Insurance Corporation, the Insurance Fund is also available to provide assistance to certain troubled System institutions and for the operating expenses of the Insurance Corporation. Each System bank is required to pay premiums into the Insurance Fund until the assets in the Insurance Fund equal 2% of the aggregated insured obligations adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments. This percentage of aggregate obligations can be changed by the Insurance Corporation, at its sole discretion, to a percentage it determines to be actuarially sound.

The basis for assessing premiums is debt outstanding, with adjustments made for nonaccrual loans and impaired investment securities which are assessed a surcharge. A deduction from the premium base is taken for loans and investment securities that are guaranteed. The premium rate on this base was 5 basis points, 6 basis points, and 5 basis points for 2012, 2011, and 2010, respectively. In 2013, this premium increased to 10 basis points. Throughout this period, the surcharge on nonaccrual loans and impaired investments has been 10 basis points. AgriBank, in turn, assesses premiums to the associations each year based on these same factors.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Accounting Principles and Reporting Policies

Our accounting and reporting policies conform to accounting principles generally accepted in the United States of America (GAAP) and the prevailing practices within the financial services industry. Preparing financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

Certain amounts in prior years' financial statements have been reclassified to conform to the current year's presentation.

Principles of Consolidation

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

Significant Accounting Policies

Loans: Loans are carried at their principal amount outstanding net of any unearned income, cumulative charge-offs, unamortized deferred fees, costs on originated loans, and unamortized premiums or discounts on purchased loans. Loan interest is accrued and credited to interest income based upon the daily principal amount outstanding. Material fees, net of related costs, are deferred and recognized over the life of the loan as an adjustment to net interest income. Other loan origination fees are recorded as income because the net amount of these fees and related expenses is not material to the consolidated financial statements taken as a whole.

We place loans in nonaccrual status when:

- principal or interest is delinquent for 90 days or more (unless the loan is well secured and in the process of collection) or
- circumstances indicate that full collection is not expected.

When a loan is placed in nonaccrual status, we reverse current year accrued interest to the extent principal plus accrued interest before the transfer exceeds the net realizable value of the collateral. Any unpaid interest accrued in a prior year is capitalized to the recorded investment of the loan. Any cash received on nonaccrual loans is applied to reduce the recorded investment in the loan, except in those cases where the collection of the recorded investment is fully expected and the loan does not have any unrecovered prior charge-offs. In these circumstances interest is credited to income when cash is received. Loans are charged off at the time they are determined to be uncollectible.

Nonaccrual loans may be returned to accrual status when:

- principal and interest are current,
- prior charge-offs have been recovered,
- the ability of the client to fulfill the contractual repayment terms is fully expected,
- the client has demonstrated payment performance, and
- the loan is not classified as doubtful or loss.

A restructured loan constitutes a troubled debt restructuring if, for economic or legal reasons related to the client's financial difficulties, we grant a concession to the debtor that we would not otherwise consider. A concession is generally granted in order to minimize economic loss and avoid foreclosure. Concessions vary by program, are client-specific, and 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. Loans classified as troubled debt restructurings are considered risk loans and also are known as formally restructured loans.

Allowance for Loan/Lease Losses: The allowance for loan/lease losses is an estimate of losses in our loan 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,
- loss given default,
- portfolio quality, and
- current economic and environmental conditions.

Loans in our portfolio that are considered impaired are analyzed individually to establish a specific allowance for impaired loans. A loan is impaired when it is probable that all amounts due under the contractual terms of the loan agreement will not be collected. We generally measure impairment based on the net realizable value of the collateral. All risk loans are considered to be impaired loans. Risk loans include:

- accruing restructured loans,
- accruing loans 90 days or more past due, and
- nonaccrual loans.

We record a specific allowance to reduce the carrying amount of the risk loan to the lower of book value or the net realizable value of collateral. When we deem a loan to be uncollectible, we charge the loan principal and prior year(s) accrued interest against the allowance for loan/lease losses. Subsequent recoveries, if any, are added to the allowance for loan/lease losses.

An allowance is recorded for probable and estimable credit losses as of the financial statement date for loans that are not individually assessed as impaired. We use a two-dimensional loan risk rating model that incorporates a 14-point rating scale to identify and track the probability of client default and a separate 6-point scale addressing the loss given default. The combination of estimated default probability and loss given default is the primary basis for recognition and measurement of loan collectability of these pools of loans.

Changes in the allowance for loan/lease losses consist of provision activity (recorded in "Provision for loan/lease losses" on the Consolidated Statements of Income), recoveries, and charge-offs.

Investment Securities: We are authorized to purchase and hold certain types of investments. As we have the positive intent and ability to hold these investments to maturity, they have been classified as held-to-maturity and are carried at cost adjusted for the amortization of premiums and accretion of discounts. If an investment is determined to be other-than-temporarily impaired, the carrying value of the security is written down to fair value. The impairment loss is separated into credit related and non-credit related components. The credit related component is expensed through earnings in the period of impairment. The non-credit related component is recognized in other comprehensive income and amortized over the remaining life of the security as an increase in the security's carrying amount.

Investment in AgriBank: Accounting for our stock investment in AgriBank is on a cost plus allocated equities basis.

Premises and Equipment: The carrying amount of premises and equipment is at cost, less accumulated depreciation. Calculation of depreciation is generally on the straight-line method over the estimated useful lives of the assets. Gains or losses on disposition are included in “Fee and miscellaneous income, net” on the Consolidated Statements of Income. Depreciation, maintenance, and repair expenses are included in “Other operating expenses” on the Consolidated Statements of Income and improvements are capitalized.

Other Property Owned: Other property owned, consisting of real and personal property acquired through foreclosure or deed in lieu of foreclosure, is recorded at fair value less estimated selling costs upon acquisition. Any initial reduction in the carrying amount of a loan to the fair value of the collateral received is charged to the allowance for loan/lease losses. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Related income, expenses, and gains or losses from operations and carrying value adjustments are included in “Fee and miscellaneous income, net” on the Consolidated Statements of Income.

Leases: We have finance, conditional sales, and operating leases. Under finance/conditional sales leases, unearned income from lease contracts represents the excess of gross lease receivables plus residual receivables over the cost of leased equipment. We amortize net unearned finance income to earnings using the interest method. The carrying amount of finance/conditional sales leases is included in “Loans” on the Consolidated Statements of Condition and represents lease rent receivables net of the unearned income plus the residual receivable. We recognize operating lease revenue evenly over the term of the lease in “Net operating lease income” on the Consolidated Statements of Income. We charge depreciation and other expenses against revenue as incurred. The carrying amount of operating leases is included in “Assets held for lease, net” on the Consolidated Statements of Condition and represents the asset cost net of accumulated depreciation.

Post-Employment Benefit Plans: The District has various post-employment benefit plans in which Association employees participate.

The defined contribution plan allows eligible employees to save for their retirement either pre-tax, post-tax, or both, with an employer match on a percentage of the employee’s contributions. All team members hired after December 31, 2006 only participate in this plan. We provide benefits under this plan in the form of a fixed percentage of salary contribution in addition to the employer match. Employer contributions are expensed when incurred.

Certain employees also participate in the defined benefit retirement plan of the District. The plan is comprised of two benefit formulas. At their option, employees hired prior to October 1, 2001 are on the cash balance formula or on the final average pay formula. Between October 1, 2001 and December 31, 2006, all new benefits-eligible employees are on the cash balance formula. Effective January 1, 2007, the defined benefit retirement plan was closed to new employees. The District plan utilizes the "Projected Unit Credit" actuarial method for financial reporting purposes and the "Entry Age Normal Cost" method for funding purposes.

Certain employees also participate in the non-qualified defined benefit Pension Restoration Plan of the AgriBank District. This plan restores retirement benefits to certain highly compensated eligible employees that would have been provided under the qualified plan if such benefits were not above the Internal Revenue Code compensation or other limits.

We also provide certain health insurance benefits to eligible retired employees according to the terms of those benefit plans. The anticipated cost of these benefits is accrued during the employees’ active service period.

Income Taxes: The ACA and PCA accrue federal and certain state income taxes. The ACA and PCA are exempt from Minnesota state income tax. Deferred tax assets and liabilities are recognized for future tax consequences of temporary differences between the carrying amounts and tax basis of assets and liabilities. Deferred tax assets are recorded if the deferred tax asset is more likely than not to be realized. If the realization test cannot be met, the deferred tax asset is reduced by a valuation allowance. The expected future tax consequences of uncertain income tax positions are accrued.

The FLCA is exempt from federal and other taxes to the extent provided in the Farm Credit Act.

Patronage Program: We have a nonqualified patronage program that requires the allocation of earnings for each fiscal year provided all statutory and regulatory capital requirements have been met. Nonqualified patronage distributions do not qualify as a deduction from our taxable income, and the client receiving it does not record it as taxable income, until it is redeemed at some future date. The redemption of nonqualified patronage distributions is at the discretion of the Board of Directors.

Statements of Cash Flows: For purposes of reporting cash flow, cash includes cash on hand.

Fair Value Measurement: The Financial Accounting Standards Board (FASB) guidance on "Fair Value Measurements" describes three levels of inputs that may be used to measure fair value.

Level 1 — Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 — Observable inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly or indirectly. Level 2 inputs include the following:

- quoted prices for similar assets or liabilities in active markets,
- quoted prices for identical or similar assets or liabilities in markets that are not active so that they are traded less frequently than exchange-traded instruments, the prices are not current or principal market information is not released publicly,
- inputs that are observable such as interest rates and yield curves, prepayment speeds, credit risks, and default rates, and
- inputs derived principally from or corroborated by observable market data by correlation or other means.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. These unobservable inputs reflect our own assumptions about assumptions that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Recently Issued or Adopted Accounting Pronouncements

In December 2011, the FASB issued guidance entitled, "Balance Sheet – Disclosures about Offsetting Assets and Liabilities." In January 2013, the FASB issued clarifying guidance surrounding the scope of financial instruments covered under this guidance. The offsetting disclosures are only applied to derivatives, repurchase agreements and securities lending transactions. The guidance requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. This includes the effect or potential effect of rights of setoff associated with an entity's recognized assets and recognized liabilities. The requirements apply to in scope financial instruments that are offset in accordance with the rights of offset set forth in accounting guidance and for those financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset or not. This guidance is to be applied retroactively for all comparative periods and is effective for annual and interim reporting periods beginning on or after January 1, 2013. The adoption of this guidance will have no impact on our consolidated financial condition or consolidated results of operations.

In September 2011, the 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 did not have any impact on our consolidated financial condition or consolidated results of operations, but resulted in additional disclosures in Note 11.

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. 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 did not have any impact on our consolidated financial condition or consolidated results of operations. If, in future periods, we have other comprehensive income, expanded financial statement presentation will be required.

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. The amendments include the following:

- Application of the highest and best use valuation premise is only relevant when measuring the fair value of nonfinancial assets.
- An exception to the requirement for measuring fair value when a reporting entity manages its financial instruments on the basis of its net exposure, rather than its gross exposure, to market risks such as interest rate risk and credit risk of counterparties.
- Expansion of the disclosures about fair value measurements. New disclosures are required about the use of a nonfinancial asset measured or disclosed at fair value if its use differs from its highest and best use.

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 did not have any impact on our consolidated financial condition or consolidated results of operations and did not result in additional disclosures at this time.

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 condition or consolidated results of operations and did not result in additional disclosures.

NOTE 3: LOANS AND ALLOWANCE FOR LOAN/LEASE LOSSES

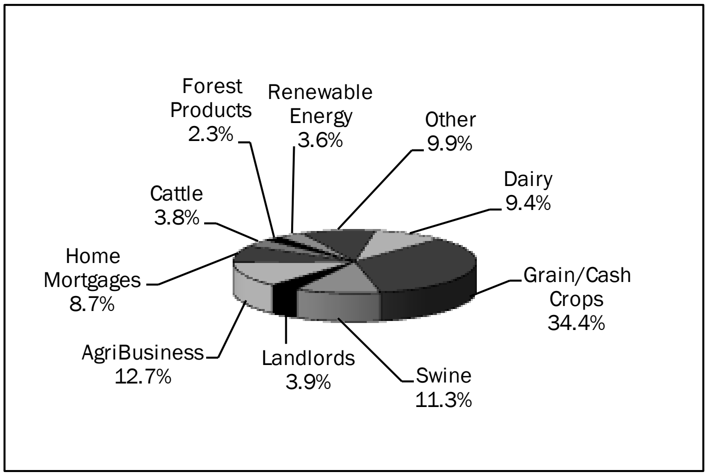
Loans consisted of the following (dollars in thousands):

	2012		2011		2010	
As of December 31	Amount	**%**	Amount	%	Amount	%
Real estate mortgage	**$2,889,701**	**48.9%**	$2,455,497	47.3%	$2,236,980	45.5%
Production and intermediate term	**1,761,770**	**29.8%**	1,602,684	30.9%	1,550,029	31.5%
Agribusiness	**610,220**	**10.3%**	546,843	10.6%	605,919	12.3%
Communication	**137,221**	**2.3%**	123,898	2.4%	111,795	2.3%
Energy	**162,628**	**2.8%**	115,269	2.2%	92,801	1.9%
Rural residential real estate	**97,398**	**1.6%**	89,415	1.7%	82,796	1.7%
Finance/conditional sales leases	**113,742**	**1.9%**	110,410	2.1%	106,483	2.2%
Other	**140,656**	**2.4%**	143,858	2.8%	128,407	2.6%
Total	**$5,913,336**	**100.0%**	$5,187,874	100.0%	$4,915,210	100.0%

Portfolio Concentrations

We have concentrations with individual clients, within various agricultural commodities, and within our chartered territory. At December 31, 2012, volume plus commitments to our ten largest clients totaled an amount equal to 3.4% of total loans and commitments.

Our agricultural commodity concentrations at December 31, 2012, were as follows:



The commodity concentrations have not changed materially from prior years.

While these concentrations represent our maximum potential credit risk as it relates to recorded loan principal, a substantial portion of our lending activities are collateralized. This reduces our exposure to credit loss associated with our lending activities. We consider credit risk exposure in establishing the allowance for loan/lease losses.

Asset Securitization

In 2005, we securitized and sold a $96.5 million participation interest in $98.5 million of certain agriculture loans to an investor and retained the remaining participation interest, the right to certain other residual cash flows, and servicing rights associated with the revolving securitization structure. The revolving period under this agreement ended on November 1, 2008 and no additional loan pools were added to the securitization subsequent to that date. The securitization was structured without recourse to us and without restrictions on the participated interests. Effective January 1, 2010, this transaction was consolidated into our financial statements and resulted in an increase in loans and related assets totaling approximately $39 million and a related increase in notes payable and related liabilities of approximately $38 million. On April 15, 2010, this securitization was terminated through our payment of all outstanding liabilities associated with the securitization structure.

Participations

We may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume, or comply with FCA Regulations or General Financing Agreement (GFA) limitations.

The following table presents information regarding participations purchased and sold (in thousands):

	AgriBank, FCB		Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations		Participations		Participations		Participations	
As of December 31, 2012	Purchased	Sold	Purchased	Sold	Purchased	Sold	Purchased	Sold
Real estate mortgage	**$ --**	**($207,281)**	**$162,721**	**($197,756)**	**$732,676**	**($44,392)**	**$895,397**	**($449,429)**
Production and intermediate term	**--**	**(113,165)**	**46,663**	**(833,291)**	**768,884**	**(84,987)**	**815,547**	**(1,031,443)**
Agribusiness	**--**	**(64,209)**	**201,785**	**(203,510)**	**176,759**	**(296,894)**	**378,544**	**(564,613)**
Communication	**--**	**--**	**137,104**	**--**	**--**	**--**	**137,104**	**--**
Energy	**--**	**(16,365)**	**180,467**	**--**	**--**	**--**	**180,467**	**(16,365)**
Rural residential real estate	**--**	**(130)**	**--**	**(1,906)**	**3,010**	**--**	**3,010**	**(2,036)**
Finance/conditional sales leases	**--**	**(1,490)**	**--**	**(509)**	**199**	**--**	**199**	**(1,999)**
Other	**--**	**--**	**--**	**(379)**	**--**	**(4,962)**	**--**	**(5,341)**
Total	**$ --**	**($402,640)**	**$728,740**	**($1,237,351)**	**$1,681,528**	**($431,235)**	**$2,410,268**	**($2,071,226)**
As of December 31, 2011								
Real estate mortgage	$ --	($218,133)	$175,415	($95,738)	$603,748	($28,096)	$779,163	($341,967)
Production and intermediate term	--	(117,741)	28,888	(885,623)	721,237	(143,535)	750,125	(1,146,899)
Agribusiness	--	(61,830)	174,647	(250,236)	173,738	(357,701)	348,385	(669,767)
Communication	--	--	123,814	--	--	--	123,814	--
Energy	--	(11,354)	127,451	--	--	--	127,451	(11,354)
Rural residential real estate	--	(131)	--	--	2,002	--	2,002	(131)
Finance/conditional sales leases	--	(3,462)	9,974	(6,664)	398	--	10,372	(10,126)
Other	--	--	--	--	--	(5,000)	--	(5,000)
Total	$ --	($412,651)	$640,189	($1,238,261)	$1,501,123	($534,332)	$2,141,312	($2,185,244)

Credit Quality and Delinquency

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

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

The following table summarizes loans and related accrued interest classified under the FCA Uniform Classification System by loan type (dollars in thousands):

	Acceptable		OAEM		Substandard/ Doubtful/Loss		Total	
As of December 31, 2012	Amount	%	Amount	%	Amount	%	Amount	%
Real estate mortgage	**$2,711,617**	**93.1%**	**$38,737**	**1.3%**	**$161,724**	**5.6%**	**$2,912,078**	**100.0%**
Production and intermediate term	**1,694,965**	**95.5%**	**17,618**	**1.0%**	**63,034**	**3.5%**	**1,775,617**	**100.0%**
Agribusiness	**543,715**	**88.8%**	**56,453**	**9.2%**	**12,498**	**2.0%**	**612,666**	**100.0%**
Communication	**130,673**	**95.2%**	**262**	**0.2%**	**6,396**	**4.6%**	**137,331**	**100.0%**
Energy	**162,779**	**100.0%**	**--**	**--**	**--**	**--**	**162,779**	**100.0%**
Rural residential real estate	**92,811**	**95.0%**	**275**	**0.3%**	**4,593**	**4.7%**	**97,679**	**100.0%**
Finance/conditional sales leases	**110,895**	**97.5%**	**943**	**0.8%**	**1,904**	**1.7%**	**113,742**	**100.0%**
Other	**135,429**	**95.7%**	**--**	**--**	**6,139**	**4.3%**	**141,568**	**100.0%**
Total loan portfolio	**$5,582,884**	**93.8%**	**$114,288**	**1.9%**	**$256,288**	**4.3%**	**$5,953,460**	**100.0%**
As of December 31, 2011								
Real estate mortgage	$2,211,334	89.2%	$73,464	3.0%	$192,681	7.8%	$2,477,479	100.0%
Production and intermediate term	1,494,124	92.4%	53,838	3.3%	69,467	4.3%	1,617,429	100.0%
Agribusiness	481,951	87.8%	51,863	9.5%	14,831	2.7%	548,645	100.0%
Communication	116,462	93.9%	7,554	6.1%	--	--	124,016	100.0%
Energy	115,355	100.0%	--	--	--	--	115,355	100.0%
Rural residential real estate	84,343	94.0%	1,541	1.7%	3,818	4.3%	89,702	100.0%
Finance/conditional sales leases	106,004	96.0%	1,346	1.2%	3,060	2.8%	110,410	100.0%
Other	131,171	90.5%	435	0.3%	13,300	9.2%	144,906	100.0%
Total loan portfolio	$4,740,744	90.7%	$190,041	3.6%	$297,157	5.7%	$5,227,942	100.0%

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

As of December 31, 2012	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 Past Due and Accruing
Real estate mortgage	**$16,719**	**$33,589**	**$50,308**	**$2,861,770**	**$2,912,078**	**$99**
Production and intermediate term	**2,561**	**5,051**	**7,612**	**1,768,005**	**1,775,617**	**27**
Agribusiness	**14,158**	**892**	**15,050**	**597,616**	**612,666**	**--**
Communication	**--**	**--**	**--**	**137,331**	**137,331**	**--**
Energy	**--**	**--**	**--**	**162,779**	**162,779**	**--**
Rural residential real estate	**2,697**	**1,458**	**4,155**	**93,524**	**97,679**	**--**
Finance/conditional sales leases	**826**	**1,167**	**1,993**	**111,749**	**113,742**	**--**
Other	**--**	**8,229**	**8,229**	**133,339**	**141,568**	**--**
Total	**$36,961**	**$50,386**	**$87,347**	**$5,866,113**	**$5,953,460**	**$126**
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

A loan is considered a risk loan if it is probable that we will be unable to collect all principal and interest according to the loan agreement.

The following table presents risk loan information (in thousands).

As of December 31	**2012**	2011	2010
Nonaccrual loans:			
Current	**$97,123**	$105,736	$97,814
Past due	**54,468**	58,954	92,990
Total nonaccrual loans	**151,591**	164,690	190,804
Accruing restructured loans	**102**	--	--
Accruing loans 90 days or more past due	**126**	40	1,570
Total risk loans	**$151,819**	$164,730	$192,374
Volume with specific reserves	**$20,279**	$61,059	$84,309
Volume without specific reserves	**131,540**	103,671	108,065
Total risk loans	**$151,819**	$164,730	$192,374
Total specific reserves	**$5,524**	$10,198	$16,674
For the year ended December 31	**2012**	2011	2010
Income on accrual risk loans	**$55**	$99	$293
Income on nonaccrual loans	**4,509**	5,927	3,801
Total income on risk loans	**$4,564**	$6,026	$4,094
Average recorded investment	**$178,683**	$201,267	$205,069

To mitigate credit risk, we have entered into a Standby Commitment to Purchase Agreement with the Federal Agricultural Mortgage Corporation (Farmer Mac). In the event of default, subject to certain conditions, we have the right to sell the loans identified in the agreement to Farmer Mac. This agreement remains in place until receipt of full payment. The balance of loans under this agreement was $244.1 million, $223.7 million, and $200.4 million at December 31, 2012, 2011, and 2010, respectively. Fees paid to Farmer Mac for these commitments totaled $1.2 million, $1.1 million, and $1.1 million in 2012, 2011, and 2010, respectively. These amounts are included in “Other operating expenses” on the Consolidated Statements of Income. Sales of loans to Farmer Mac under this agreement have been minimal, with $432 thousand of sales occurring in 2012. There were no sales of loans to Farmer Mac under this agreement during 2011 or 2010.

On March 8, 2012, we terminated the Credit Default Swap Agreement entered into on October 9, 2009 with AgFunding 2009-A LLC. The loan pool balance was then $40.3 million. Early redemption was allowed by the Agreement once the aggregate outstanding principal balance of the pool was less than 20% of the original $202 million note balance. The balance of the pool was $50.4 million and $98.7 million as of December 31, 2011, and 2010, respectively. There were five tranches in the synthetic securitization. The Junior Risk tranche, held by us, had the first risk of loss and totaled $1.7 million on March 8, 2012. The next risk of loss fell into Tranches A, B, and C and these totaled $1.4 million on March 8, 2012. Tranches A, B, and C were owned by a third party. In 2011, one $58 thousand loss was taken against the Junior Risk tranche. No other losses were incurred under the agreement.

Nonaccrual loans by loan type were as follows (in thousands):

As of December 31	**2012**	2011	2010
Nonaccrual loans:			
Real estate mortgage	**$106,889**	$114,705	$110,337
Production and intermediate term	**28,889**	37,644	57,066
Agribusiness	**1,579**	3,311	16,742
Rural residential real estate	**3,484**	3,116	3,343
Finance/conditional sales leases	**1,351**	1,820	1,969
Other	**9,399**	4,094	1,347
Total nonaccrual loans	**$151,591**	$164,690	$190,804

Accruing loans 90 days or more past due and related accrued interest by loan type were as follows (in thousands):

As of December 31	**2012**	2011	2010
Accruing loans 90 days or more past due:			
Real estate mortgage	**$99**	$ --	$442
Production and intermediate term	**27**	7	577
Rural residential real estate	**--**	--	4
Finance/conditional sales leases	**--**	33	547
Total accruing loans 90 days or more past due	**$126**	$40	$1,570

Based on our analysis, all loans 90 days or more past due and still accruing interest were adequately secured and in the process of collection and, as such, were eligible to remain in accruing status.

All risk loans are considered to be impaired loans.

The following table provides additional impaired loan information (in thousands):

	As of December 31, 2012			For the period ended December 31, 2012	
	Recorded Investment[1]	Unpaid Principal Balance[2]	Related Allowance	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:					
Real estate mortgage	**$15,004**	**$25,936**	**$3,909**	**$30,555**	**$ --**
Production and intermediate term	**1,745**	**2,047**	**910**	**7,911**	**--**
Agribusiness	**892**	**853**	**87**	**696**	**--**
Rural residential real estate	**759**	**883**	**116**	**671**	**--**
Finance/conditional sales leases	**708**	**708**	**202**	**860**	**--**
Other	**1,171**	**1,401**	**300**	**1,518**	**--**
Total	**$20,279**	**$31,828**	**$5,524**	**$42,211**	**$ --**
Impaired loans with no related allowance for credit losses:					
Real estate mortgage	**$92,011**	**$124,828**	**$ --**	**$94,533**	**$3,338**
Production and intermediate term	**27,247**	**51,049**	**--**	**28,918**	**989**
Agribusiness	**686**	**1,346**	**--**	**1,731**	**129**
Rural residential real estate	**2,725**	**3,444**	**--**	**2,839**	**105**
Finance/conditional sales leases	**643**	**643**	**--**	**605**	**--**
Other	**8,228**	**8,176**	**--**	**7,846**	**3**
Total	**$131,540**	**$189,486**	**$ --**	**$136,472**	**$4,564**
Total impaired loans:					
Real estate mortgage	**$107,015**	**$150,764**	**$3,909**	**$125,088**	**$3,338**
Production and intermediate term	**28,992**	**53,096**	**910**	**36,829**	**989**
Agribusiness	**1,578**	**2,199**	**87**	**2,427**	**129**
Rural residential real estate	**3,484**	**4,327**	**116**	**3,510**	**105**
Finance/conditional sales leases	**1,351**	**1,351**	**202**	**1,465**	**--**
Other	**9,399**	**9,577**	**300**	**9,364**	**3**
Total	**$151,819**	**$221,314**	**$5,524**	**$178,683**	**$4,564**

	As of December 31, 2011			For the period ended December 31, 2011	
	Recorded Investment[1]	Unpaid Principal Balance[2]	Related Allowance	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:					
Real estate mortgage	$36,506	$47,735	$5,577	$37,578	$ --
Production and intermediate term	20,494	22,825	3,378	20,642	--
Agribusiness	--	24	--	6	--
Rural residential real estate	464	599	76	490	--
Finance/condtional sales leases	1,667	1,667	517	2,053	--
Other	1,928	6,378	650	1,442	--
Total	$61,059	$79,228	$10,198	$62,211	$ --
Impaired loans with no related allowance for credit losses:					
Real estate mortgage	$78,199	$95,894	$ --	$89,560	$3,035
Production and intermediate term	17,157	45,984	--	28,042	897
Agribusiness	3,311	8,486	--	15,996	1,199
Rural residential real estate	2,652	3,036	--	3,089	787
Finance/condtional sales leases	186	175	--	106	--
Other	2,166	2,234	--	2,263	108
Total	$103,671	$155,809	$ --	$139,056	$6,026
Total impaired loans:					
Real estate mortgage	$114,705	$143,629	$5,577	$127,138	$3,035
Production and intermediate term	37,651	68,809	3,378	48,684	897
Agribusiness	3,311	8,510	--	16,002	1,199
Rural residential real estate	3,116	3,635	76	3,579	787
Finance/condtional sales leases	1,853	1,842	517	2,159	--
Other	4,094	8,612	650	3,705	108
Total	$164,730	$235,037	$10,198	$201,267	$6,026

[1]The recorded investment in the receivable is the face amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, and acquisition costs and may also reflect a previous direct charge-off of the investment.
[2]Unpaid principal balance represents the contractual principal balance of the loan.

We had $864 thousand in commitments to lend additional money to clients whose loans were at risk at December 31, 2012.

Troubled Debt Restructurings

Included within our loans are troubled debt restructurings, also known as formally restructured. These loans have been modified by granting a concession in order to maximize the collection of amounts due when a client is experiencing financial difficulties. Loans classified as troubled debt restructurings are considered risk loans. All risk loans are analyzed within our allowance for loan/lease losses.

The following table presents information regarding troubled debt restructurings that occurred during the year ended December 31 (in thousands):

	2012		2011	
	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
Real estate mortgage	**$1,416**	**$1,325**	$22,524	$22,917
Production and intermediate term	**1,205**	**1,224**	5,563	5,801
Agribusiness	**--**	**--**	9,308	9,308
Total	**$2,621**	**$2,549**	$37,395	$38,026

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 charge-off of the investment.

The following table presents troubled debt restructurings that defaulted during the years ended December 31 in which the modification date was within 12 months of the beginning of the respective reporting period (in thousands):

	2012	2011
Real estate mortgage	**$464**	$9,900
Production and intermediate term	**303**	5
Total	**$767**	$9,905

Troubled debt restructurings outstanding at December 31, 2012 totaled $37.0 million, of which all but $102 thousand were in nonaccrual status compared to $35.2 million at December 31, 2011 all of which were in nonaccrual status. Additional commitments to lend to clients whose loans have been modified in a troubled debt restructuring were $1.7 million at December 31, 2012.

Allowance for Loan/Lease Losses

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

For the year ended December 31	**2012**	2011	2010
Balance at beginning of year	**$26,833**	$39,312	$60,501
Provision for loan/lease losses	**7,182**	7,400	23,550
Loan recoveries	**3,351**	3,043	2,899
Loan charge-offs	**(10,533)**	(22,860)	(46,629)
Leasing and other, net	**(19)**	(62)	(1,009)
Balance at end of year	**$26,814**	$26,833	$39,312

A summary of changes in the allowance for loan/lease losses and period end recorded investments in loans by loan type follows (in thousands):

	Real estate mortgage	Production and intermediate term	Agribusiness	Rural residential real estate	Finance/ conditional sales leases	Other	Total
Allowance for loan/lease losses:							
Balance at December 31, 2011	**$12,447**	**$9,504**	**$1,876**	**$233**	**$1,332**	**$1,441**	**$26,833**
Provision for (reversal of) loan/lease losses	**5,544**	**(96)**	**1,204**	**590**	**(348)**	**288**	**7,182**
Loan recoveries	**1,332**	**1,297**	**308**	**29**	**353**	**32**	**3,351**
Loan charge-offs	**(6,479)**	**(2,645)**	**(541)**	**(452)**	**(166)**	**(250)**	**(10,533)**
Other	**--**	**--**	**--**	**--**	**--**	**(19)**	**(19)**
Balance at December 31, 2012	**$12,844**	**$8,060**	**$2,847**	**$400**	**$1,171**	**$1,492**	**$26,814**
Ending balance: individually evaluated for impairment	**$3,909**	**$910**	**$87**	**$116**	**$202**	**$300**	**$5,524**
Ending balance: collectively evaluated for impairment	**$8,935**	**$7,150**	**$2,760**	**$284**	**$969**	**$1,192**	**$21,290**
Recorded investments in loans outstanding:							
Ending balance at December 31, 2012	**$2,912,078**	**$1,775,617**	**$612,666**	**$97,679**	**$113,742**	**$441,678**	**$5,953,460**
Ending balance: individually evaluated for impairment	**$107,015**	**$28,992**	**$1,578**	**$3,484**	**$1,351**	**$9,399**	**$151,819**
Ending balance: collectively evaluated for impairment	**$2,805,063**	**$1,746,625**	**$611,088**	**$94,195**	**$112,391**	**$432,279**	**$5,801,641**
Allowance for loan/lease losses:							
Balance at December 31, 2010	$12,988	$17,661	$5,609	$318	$1,717	$1,019	$39,312
Provision for (reversal of) loan/lease losses	2,637	(2,316)	2,470	321	(480)	4,768	7,400
Loan recoveries	1,080	958	470	16	519	--	3,043
Loan charge-offs	(4,258)	(6,799)	(6,673)	(422)	(424)	(4,284)	(22,860)
Other	--	--	--	--	--	(62)	(62)
Balance at December 31, 2011	$12,447	$9,504	$1,876	$233	$1,332	$1,441	$26,833
Ending balance: individually evaluated for impairment	$5,577	$3,378	$ --	$76	$517	$650	$10,198
Ending balance: collectively evaluated for impairment	$6,870	$6,126	$1,876	$157	$815	$791	$16,635
Recorded investments in loans outstanding:							
Ending balance at December 31, 2011	$2,477,479	$1,617,429	$548,645	$89,702	$110,410	$384,277	$5,227,942
Ending balance: individually evaluated for impairment	$114,705	$37,651	$3,311	$3,116	$1,853	$4,094	$164,730
Ending balance: collectively evaluated for impairment	$2,362,774	$1,579,778	$545,334	$86,586	$108,557	$380,183	$5,063,212

In the table above, Other includes Communication and Energy loans.

NOTE 4: INVESTMENT SECURITIES

We held investment securities of $484.1 million, $505.5 million, and $467.1 million at December 31, 2012, 2011, and 2010, respectively. Our investment securities consisted of:

- securities containing loans issued and guaranteed by the Small Business Administration (SBA) or the United States Department of Agriculture (USDA), and
- mortgage-backed securities issued and guaranteed by Farmer Mac.

The 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):

As of December 31, 2012	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Weighted Average Yield
SBA / USDA	**$181,442**	**$2,117**	**($5,215)**	**$178,344**	**3.8%**
Farmer Mac	**302,650**	**5,361**	**(112)**	**307,899**	**4.7%**
Total	**$484,092**	**$7,478**	**($5,327)**	**$486,243**	**4.4%**

As of December 31, 2011	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Weighted Average Yield
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%

As of December 31, 2010	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Weighted Average Yield
SBA / USDA	$80,208	$77	($668)	$79,617	3.4%
Farmer Mac	386,935	7,136	(1,889)	392,182	5.4%
Total	$467,143	$7,213	($2,557)	$471,799	5.1%

Investment income is recorded in “Interest income” on the Consolidated Statements of Income and totaled $19.1 million, $20.1 million, and $22.2 million in 2012, 2011, and 2010, respectively.

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

As of December 31, 2012	Amortized Cost
Less than one year	**$2,461**
One to five years	**28,115**
Five to ten years	**96,749**
More than ten years	**356,767**
Total	**$484,092**

In 2009, we established an indemnification allowance relating to one loan in the Farmer Mac mortgage-backed security pool. The indemnification allowance was no longer necessary in 2012. The balance of the indemnification allowance was $1.6 million at both December 31, 2011 and December 31, 2010.

NOTE 5: INVESTMENT IN AGRIBANK

At December 31, 2012, we were required by AgriBank to maintain an investment equal to 2.5% of the average quarterly balance of our note payable to AgriBank, plus an additional 1% on growth that exceeded a targeted rate, plus 8% of the quarter end balance of the participation interests in real estate loans sold to AgriBank under the asset pool program.

The balance of our investment in AgriBank, all required stock, was $141.1 million, $130.2 million, and $126.2 million at December 31, 2012, 2011, and 2010, respectively.

NOTE 6: PREMISES AND EQUIPMENT, NET AND ASSETS HELD FOR LEASE

Premises and equipment consisted of the following (in thousands):

As of December 31	**2012**	2011	2010
Land, buildings, and improvements	**$11,595**	$11,301	$11,148
Furniture and equipment	**25,697**	24,108	20,062
Subtotal	**37,292**	35,409	31,210
Less: accumulated depreciation	**(19,164)**	(17,522)	(15,925)
Total	**$18,128**	$17,887	$15,285

We also hold property for agricultural leasing, primarily farm equipment and livestock facilities. The following table provides a summary of our net operating lease income and property held for lease by major category (in thousands):

	2012	2011	2010
For the year ended December 31:			
Net operating lease income	**$1,839**	$2,005	$2,250
As of December 31:			
Farm equipment	**$35,623**	$35,756	$37,117
Facilities	**17,154**	17,965	16,336
Subtotal	**52,777**	53,721	53,453
Less: accumulated depreciation	**(17,481)**	(19,033)	(17,845)
Total	**$35,296**	$34,688	$35,608

The following is a schedule of expected future minimum rentals on operating leases as of December 31, 2012 (in thousands):

For the year ending December 31	
2013	$8,266
2014	6,427
2015	4,871
2016	2,897
2017	1,120
Subsequent years	850
Total minimum future rentals	$24,431

NOTE 7: NOTE PAYABLE TO AGRIBANK

Our note payable to AgriBank represents borrowings, in the form of a line of credit, to fund our loan portfolio. The line of credit is governed by a General Financing Agreement (GFA) and our assets serve as collateral. The total line of credit was $6 billion, $5.75 billion, and $5.75 billion at December 31, 2012, 2011, and 2010, respectively, and the outstanding principal under the line of credit was $5.6 billion, $5.0 billion, and $4.7 billion at December 31, 2012, 2011, and 2010, respectively. The interest rate is adjusted monthly and was 1.6%, 2.0%, and 2.3% at December 31, 2012, 2011, and 2010, respectively. The maturity date is March 31, 2013, for our note payable, at which time the note will be renegotiated. During 2010 and 2011, we were subject to a 6 basis point risk premium. Based on improvements in certain risk ratios throughout 2011, we were not subject to a risk premium in 2012 and are not subject to a risk premium in 2013.

The GFA provides for limitations on our ability to borrow funds based on specified factors or formulas relating primarily to outstanding balances, credit quality, and financial condition. At December 31, 2012, and throughout the year, we were within the specified limitations and in compliance with all debt covenants.

NOTE 8: SUBORDINATED DEBT

In March 2010, we issued $100 million of aggregate principal amount of Series A Subordinated Notes (Notes), due in 15 years. The Notes bear a fixed interest rate of 9.0% per annum, payable semi-annually. Our Board of Directors has authorized up to a maximum of $200 million for subordinated debt issuance. At our option, we may redeem all or some of the Notes, at any time on or after a date 10 years from the closing date. This debt is subordinate to all other creditor debt, including general creditors, and senior to all classes of stock. Proceeds have increased our regulatory permanent capital and total surplus ratios and position us for the future. Our subordinated debt is not considered System debt and is not an obligation of, nor guaranteed by any System entity. Further, payments on the subordinated Notes are not insured by the Insurance Corporation.

NOTE 9: STOCKHOLDERS' EQUITY

Capitalization Requirements

In accordance with the Farm Credit Act, each client is required to invest in us as a condition of obtaining a loan. As authorized by the Agricultural Credit Act and our capital bylaws, our Board of Directors has adopted a capital plan that establishes a stock purchase requirement for obtaining a loan of 2% of the client's total loan(s) or one thousand dollars, whichever is less. The purchase of one participation certificate is required of all clients to whom a lease is issued and of all non-stockholder clients who purchase financial services. The Board of Directors may increase the amount of required investment to the extent authorized in the capital bylaws. The client acquires ownership of the capital stock at the time the loan or lease is made. The aggregate par value of the stock is added to the principal amount of the related obligation. We retain a first lien on the stock or participation certificates owned by clients.

Regulatory Capitalization Requirements

Under capital adequacy regulations, we are required to maintain a permanent capital ratio of at least 7.0%, a total surplus ratio of at least 7.0%, and a core surplus ratio of at least 3.5%. The calculation of these ratios in accordance with FCA Regulations is discussed as follows:

- The permanent capital ratio is average at-risk capital divided by average risk-adjusted assets. At December 31, 2012, our ratio was 13.9%.
- The total surplus ratio is average unallocated surplus less any deductions made in the computation of permanent capital divided by average risk-adjusted assets. At December 31, 2012, our ratio was 13.7%.
- The core surplus ratio is average unallocated surplus less any deductions made in the computation of total surplus and less any excess stock investment in AgriBank divided by average risk-adjusted assets. At December 31, 2012, our ratio was 10.9%.

We have an agreement with AgriBank which defines how our investment in AgriBank is allocated in calculating regulatory capital ratios. According to the agreement, we include in our ratios all of our investment in AgriBank that is in excess of the required amount. Under a capital pass through agreement, that amount was $61 million at December 31, 2010. At the end of 2010, the $61 million capital pass through agreement was terminated. At December 31, 2012 and December 31, 2011, we had no excess investment in AgriBank and counted no investment in AgriBank in our ratios.

Description of Equities

As of December 31, 2012, we had 2,902,000 outstanding shares of Class B common stock and 229,074 outstanding shares of Class E participation certificates. All shares and participation certificates were at-risk and $5.00 par value.

Under our bylaws, we are also authorized to issue Class C and Class D common stock. Each of these classes of stock is at-risk and nonvoting with a $5.00 par value per share. We also are authorized to issue Class H preferred stock, an at-risk nonvoting stock with a $1.00 par value per share. Currently, no stock of these classes has been issued.

Only holders of Class B stock have voting rights. Our bylaws allow us to pay dividends of up to eight percent on any classes of stock. However, no dividends have been declared to date.

Our bylaws generally permit stock and participation certificates to be retired at the discretion of the Board of Directors and in accordance with our capitalization plans, provided prescribed capital standards have been met. At December 31, 2012, we exceeded the prescribed standards. We do not anticipate any significant changes in capital that would affect the normal retirement of stock.

In the event of our liquidation or dissolution, according to our bylaws, any remaining assets after payment or retirement of all liabilities will be distributed in the following order of priority:

- first, to holders of Class H preferred stock,
- second, to holders of Class B, C, and D common stock and Class E participation certificate pro rata to all such stock,
- third, to stockholders who have received capital through patronage transactions pro rata to all such capital, and
- lastly, any remaining assets shall be distributed to current and former stockholders based on relative patronage transactions.

In the event of impairment, at the discretion of the Board of Directors, losses will be absorbed by unallocated capital reserves, Patronage Equities, or the concurrent impairment of all classes of stock, provided that no shares of Class H Preferred Stock may be impaired until all other classes of stock and participation certificates are fully impaired.

All classes of stock and participation certificates are transferable to other clients who are eligible to hold such class of stock or participation certificates. Transfers of Class B common stock are subject to the approval of the Board of Directors. Transfers of Class C or D common stock or Class E participation certificates are only allowed if we meet the regulatory minimum capital requirements.

Patronage Distributions

We made net nonqualified patronage allocations of $55.0 million, $40.0 million, and $36.4 million in 2012, 2011, and 2010, respectively. Our nonqualified patronage allocation is based on a Board of Directors resolution requiring an allocation of annual net patronage-eligible earnings for each fiscal year. Patronage equities have no voting rights, are redeemed at the sole discretion of the Board of Directors and are transferable only if specifically authorized by the Board of Directors.

Given the volatile financial and commodity markets, our capital position and risk in the portfolio, our Board of Directors delayed redeeming nonqualified patronage distributions in 2010, except for estate retirements and distributions applied to charge-offs. On January 20, 2011, the Board of Directors authorized the retirement of the remainder of the $13.9 million of 2001 nonqualified patronage allocations. This retirement was substantially completed by February 1, 2011. 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 by February 1, 2012. On September 19, 2012, the Board of Directors authorized the retirement of the remainder of the $22.8 million of 2003 nonqualified patronage allocations. This retirement was substantially completed by December 1, 2012. The timing of these payouts 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.

We received a special stock patronage refund of $4.6 million from AgriBank on December 31, 2002. This stock received would be subject to tax only upon conversion to cash. Effective in 2002, our Board of Directors passed a resolution stating that, should we realize additional taxable income from the conversion of this stock, we will declare a patronage distribution to our stockholders at such time in an amount equivalent to the amount of such additional taxable income realized.

The FCA Regulations prohibit patronage distributions to the extent they would reduce our permanent capital ratio below the minimum permanent capital adequacy standards. We do not foresee any events that would result in this prohibition in 2013.

NOTE 10: INCOME TAXES

Provision for (Benefit from) Income Taxes

Our provision for (benefit from) income taxes follows (dollars in thousands):

For the year ended December 31	**2012**	2011	2010
Current:			
Federal	**($1,788)**	$3,392	$4,525
State	**181**	243	110
Total current	**(1,607)**	3,635	4,635
Deferred:			
Federal	**(1,573)**	6,948	7,070
State	**(191)**	191	67
Total deferred	**(1,764)**	7,139	7,137
Provision for (benefit from) income taxes	**($3,371)**	$10,774	$11,772
Effective tax rate	**(3.2%)**	12.5%	15.0%

The following table quantifies the differences between the provision for (benefit from) income taxes and income taxes at the statutory rates (in thousands):

For the year ended December 31	**2012**	2011	2010
Federal tax at statutory rate (34%)	**$35,364**	$29,304	$26,682
Impact of graduated rates	**96**	361	323
State tax, net	**69**	260	233
Patronage distributions	**(6,928)**	(349)	(333)
Effect of non-taxable entity	**(25,183)**	(16,693)	(15,355)
Other	**(6,789)**	(2,109)	222
Provision for (benefit from) income taxes	**($3,371)**	$10,774	$11,772

Tax Related Matters

In 2012, a tax reduction (included in Other in the preceding table) in the amount of $6.8 million was recorded, reflecting the deduction on the 2011 tax return from the 2002 nonqualified patronage retired in the first quarter of 2012. In 2011, a tax reduction in the amount of $2.1 million was recorded, reflecting the deduction on the 2010 tax return from the 2001 nonqualified patronage retired in the first quarter of 2011.

Also in 2012, a tax reduction was recorded reflecting the 2003 nonqualified patronage retired in the fourth quarter of 2012. This reduction is reflected in the above table in the “Patronage distributions” adjustment.

Deferred Income Taxes

Tax laws require certain items to be included in our tax returns at different times than the items are reflected on our Consolidated Statements of Income. Some of these items are temporary differences that will reverse over time. We record the tax effect of temporary differences as deferred tax assets and liabilities netted on our Consolidated Statements of Condition.

Deferred tax assets and liabilities were composed of the following (in thousands):

As of December 31	**2012**	2011	2010
Allowance for loan/lease losses	**$4,831**	$4,426	$9,912
Postretirement benefit accrual	**427**	387	347
Deferred fee income, net	**625**	638	638
Accrued incentive	**1,151**	655	1,206
Leasing related, net	**(14,224)**	(15,555)	(13,722)
Accrued patronage income not received	**(832)**	(891)	(1,606)
Accrued pension asset	**(125)**	(226)	(692)
Depreciation	**(370)**	64	(11)
Other assets	**321**	283	802
Other liabilities	**(555)**	(296)	(250)
Deferred tax liabilities, net	**($8,751)**	($10,515)	($3,376)
Gross deferred tax assets	**$7,355**	$6,453	$12,905
Gross deferred tax liabilities	**($16,106)**	($16,968)	($16,281)

A valuation allowance for the deferred tax assets was not necessary at December 31, 2012, 2011, or 2010.

We have not provided for deferred income taxes on approximately $59.8 million of patronage allocations received from AgriBank prior to 1993. Such allocations, distributed in the form of stock, are subject to tax only upon conversion to cash. Our intent is to permanently maintain this investment in AgriBank. Also, we have not provided deferred income taxes on $4.6 million of patronage allocations in the form of AgriBank stock distributed in 2002 to the ACA and PCA. The Board of Directors has passed a resolution that, should this stock ever be converted to cash, creating a tax liability, an equal amount will be distributed to patrons at that time under our patronage program. Additionally, we have not provided deferred income taxes on accumulated FLCA earnings of $547.3 million as it is our intent to permanently maintain this equity in the FLCA or to distribute the earnings to stockholders in a manner that results in no additional tax liability to us.

Our income tax returns are subject to review by various U.S. taxing authorities. We record accruals for items that we believe may be challenged by these taxing authorizes. However, we had no uncertain income tax positions at December 31, 2012. In addition, we believe we are no longer subject to income tax examinations for years prior to 2009.

NOTE 11: EMPLOYEE BENEFIT PLANS

Pension and Post-Employment Benefit Plans

Complete financial information for the pension and post-employment benefit plans may be found in the Combined AgriBank, FCB and Affiliated Associations 2012 Annual Report (District financial statements).

The Farm Credit Foundations Coordinating and Trust Committees provide oversight of the District benefit plans. The governance committees are either elected or appointed representatives (senior leadership and/or Board of Director members) from the participating organizations. The Coordinating Committee is responsible for decisions regarding benefits at the direction of the participating employers. The Trust Committee is responsible for fiduciary and plan administrative functions.

Pension Plan: Certain employees participate in the AgriBank District Retirement Plan, a District-wide multi-employer defined benefit retirement plan. The Department of Labor has determined the plan to be a governmental plan; therefore, the plan is not subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended (ERISA). As the plan is not subject to ERISA, the plan's benefits are not insured by the Pension Benefit Guaranty Corporation. Accordingly, the amount of accumulated benefits that participants would receive in the event of the plan's termination is contingent on the sufficiency of the plan's net assets to provide benefits at that time. This Plan is noncontributory and covers eligible District employees. The assets, liabilities, and costs of the plan are not segregated by participating entities. As such, plan assets are available for any of the participating employers' retirees at any point in time. Additionally, if a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers. Further, if we choose to stop participating in the plan, we may be required to pay an amount based on the underfunded status of the plan, referred to as a withdrawal liability. Because of the multi-employer nature of the plan, any individual employer is not able to unilaterally change the provisions of the plan. If an employee moves to another employer within the same plan, the employee benefits under the plan transfer. Benefits are based on salary and years of service. There is no collective bargaining agreement in place as part of this plan.

As disclosed in the District financial statements, the defined benefit pension plan reflects an unfunded liability totaling $442.6 million at December 31, 2012. The pension benefits funding status reflects the net of the fair value of the plan assets and the projected benefit obligation at the date of these consolidated financial statements. The projected benefit obligation is the actuarial present value of all benefits attributed by the pension benefit formula to employee service rendered prior to the measurement date based on assumed future compensation levels. The projected benefit obligation of the District-wide plan was $1.1 billion, $934.8 million, and $834.2 million at December 31, 2012, 2011, and 2010, respectively. The fair value of the plan assets was $640.1 million, $557.6 million, and $573.0 million at December 31, 2012, 2011, and 2010, respectively. The amount of the pension benefits and funding status is subject to many variables including performance of plan assets and interest rate levels. Therefore, changes in assumptions could significantly affect these estimates.

Costs are determined for each individual employer based on costs directly related to their current employees as well as an allocation of the remaining costs based proportionately on the estimated projected liability of the employer under this plan. We recognize our proportional share of expense and contribute a proportional share of funding. Total plan expense for participating employers was $52.7 million, $44.0 million, and $37.0 million for 2012, 2011, and 2010, respectively. Our allocated share of plan expenses included in “Salaries and employee benefits” on the Consolidated Statements of Income was $6.7 million, $5.7 million, and $5.0 million for 2012, 2011, and 2010, respectively. Participating employers contributed $51.3 million, $27.9 million, and $25.3 million to the plan in 2012, 2011, and 2010, respectively. Our allocated share of these pension contributions was $6.6 million, $3.9 million, and $3.7 million for 2012, 2011, and 2010, respectively. While the plan is a governmental plan and is not subject to minimum funding requirements, the employers contribute amounts necessary on an actuarial basis to provide the plan with sufficient assets to meet the benefits to be paid to participants. The amount of the total District employer contributions expected to be paid into the pension plans during 2013 is $57.2 million. Our allocated share of these pension contributions is expected to be $8.1 million. The amount ultimately to be contributed and the amount ultimately recognized as expense as well as the timing of those contributions and expenses, are subject to many variables including performance of plan assets and interest rate levels. These variables could result in actual contributions and expenses being greater than or less than the amounts reflected in the District financial statements.

Retiree Medical Plans: District employers also provide certain health insurance benefits to eligible retired employees according to the terms of the benefit plan. The anticipated costs of these benefits are accrued during the period of the employee’s active status. Postretirement benefits included in “Salaries and employee benefits” on the Consolidated Statements of Income were $221 thousand, $252 thousand, and $242 thousand for 2012, 2011, and 2010, respectively. Our cash contributions were equal to the benefits paid and were $122 thousand, $115 thousand, and $117 thousand for 2012, 2011, and 2010, respectively.

Nonqualified Retirement Plan: We also participate in a District-wide non-qualified defined benefit Pension Restoration Plan. This plan restores retirement benefits to certain highly compensated eligible employees that would have been provided under the qualified plan if such benefits were not above the Internal Revenue Code compensation or other limits. Costs are determined for each individual employer based on costs directly related to their current employees. Total Pension Restoration Plan expense for participating employers was $2.4 million, $2.5 million, and $1.7 million for 2012, 2011, and 2010, respectively. Our allocated share of plan expenses included in “Salaries and employee benefits” on the Consolidated Statements of Income was $423 thousand, $747 thousand, and $455 thousand for 2012, 2011, and 2010, respectively. The Pension Restoration Plan is unfunded and we make annual contributions to fund benefits paid to our retirees covered by the plan. We made no cash contributions or benefit payments in 2012, 2011, or 2010 related to this plan.

Retirement Savings Plan

We also participate in a defined contribution retirement savings plan. For employees hired before January 1, 2007, employee contributions are matched dollar for dollar up to 2% and 50 cents on the dollar on the next 4% on both pre-tax and post-tax contributions. The maximum employer match is 4%. For employees hired after December 31, 2006, we contribute 3% of the employee’s compensation and will match employee contributions dollar for dollar up to a maximum of 6% on both pre-tax and post-tax contributions. The maximum employer contribution is 9%. Employer contribution expenses are included in “Salaries and employee benefits” on the Consolidated Statements of Income under the plan were $3.0 million, $2.7 million, and $2.3 million in 2012, 2011, and 2010, respectively. These expenses are equal to our cash contributions for each year.

NOTE 12: RELATED PARTY TRANSACTIONS

In the ordinary course of business, we may enter into loan transactions with our officers, directors, their immediate family members, and other organizations with which such persons may be associated. Such transactions are subject to special approval requirements contained in FCA Regulations and are made on the same terms, including interest rates, amortization schedules, and collateral, as those prevailing at the time for comparable transactions with other persons. In our opinion, none of these loans outstanding at December 31, 2012 involved more than a normal risk of collectability.

The following table represents information on loans and leases to related parties (in thousands):

	2012	2011	2010
As of December 31:			
Total related party loans and leases	**$29,842**	$24,144	$22,999
For the year ended December 31:			
Advances to related parties	**$24,815**	$19,676	$19,708
Repayments by related parties	**21,272**	13,884	16,129

The composition of related parties can be different each year end primarily due to changes in the make-up of our Board of Directors. Advances and repayments to related parties at the end of each year are included in the preceding chart.

We purchase various services from AgriBank including certain information systems, financial, accounting and reporting, and retail product processing and support services. The total cost of services we purchased from AgriBank was $1.8 million, $2.1 million, and $2.1 million in 2012, 2011, and 2010, respectively.

We have an agreement with CoBank to provide certain cash management services to some of our clients. To support these cash management services, we have a cash management agreement with CoBank that includes a $7 million back-up cash management settlement facility.

We purchase certain benefit and payroll services from Foundations. Foundations was operated as a part of AgriBank prior to January 1, 2012 when it formed a System service corporation. The System entities using Foundations' services contributed an investment into the service corporation in January 2012. Our investment was $83 thousand at December 31, 2012. The total cost of services purchased from Foundations was $334 thousand in 2012.

NOTE 13: CONTINGENCIES AND COMMITMENTS

In the normal course of business, we have various contingent liabilities and commitments outstanding 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.

We have commitments to extend credit and letters of credit to satisfy the financing needs of our clients. These financial instruments involve, to varying degrees, elements of credit risk not recognized in the financial statements. Commitments to extend credit are agreements to lend to a client as long as there is not a violation of any condition established in the loan contract. Standby letters of credit are agreements to pay a beneficiary if there is a default on a contractual arrangement. At December 31, 2012, we had commitments to extend credit and unexercised commitments related to standby letters of credit of $1.7 billion. Additionally, we had $38.4 million of issued standby letters of credit and $2.6 million of other commitments as of December 31, 2012.

Commitments to extend credit and letters of credit generally have fixed expiration dates or other termination clauses and we may require payment of a fee. If commitments to extend credit and letters of credit remain unfulfilled or have not expired, they may have credit risk not recognized in the financial statements. Many of the commitments to extend credit and letters of credit will expire without being fully drawn upon. Therefore, the total commitments do not necessarily represent future cash requirements. Certain letters of credit may have recourse provisions that would enable us to recover from third parties amounts paid under guarantees, thereby limiting our maximum potential exposure. The credit risk involved in issuing these financial instruments is essentially the same as that involved in extending loans to clients and we apply the same credit policies.

NOTE 14: 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 in the principal or most advantageous market for the asset or liability. The guidance also establishes a fair value hierarchy, with three levels of inputs that may be used to measure fair value. Refer to Note 2 for a more complete description of the three input levels.

Non-Recurring Basis

We do not have any assets or liabilities measured at fair value on a recurring basis at December 31, 2012, 2011, or 2010. We may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. Information on assets measured at fair value on a non-recurring basis follows (in thousands):

As of December 31, 2012	Fair Value Measurement Using			Total Fair	Total Gains
	Level 1	Level 2	Level 3	Value	(Losses)
Loans	**$ --**	**$1,774**	**$13,719**	**$15,493**	**($1,828)**
Other property owned	**--**	**--**	**12,065**	**12,065**	**(1,484)**
As of December 31, 2011	Fair Value Measurement Using			Total Fair	Total Gains
	Level 1	Level 2	Level 3	Value	(Losses)
Loans	$ --	$1,972	$51,432	$53,404	$6,476
Other property owned	--	--	8,424	8,424	(1,435)
As of December 31, 2010	Fair Value Measurement Using			Total Fair	Total Gains
	Level 1	Level 2	Level 3	Value	(Losses)
Loans	$ --	$11,530	$59,486	$71,016	$16,532
Other property owned	--	--	7,275	7,275	(1,505)

Valuation Techniques

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 15: FAIR VALUE OF FINANCIAL INSTRUMENTS

Quoted market prices are generally not available for our financial instruments. Accordingly, we base fair values on:

- judgments regarding future expected losses,
- current economic conditions,
- risk characteristics of various financial instruments,
- credit risk, and
- other factors.

These estimates involve uncertainties and matters of judgment and cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Estimating the fair value of our investment in AgriBank is not practical because the stock is not traded. As discussed in Notes 2 and 5, the investment is a requirement of borrowing from AgriBank.

A description of the methods and assumptions used to estimate the fair value of each class of our financial instruments, for which it is practical to estimate that value, follows:

Net loans: The estimate of the fair value of loan assets is determined by discounting the expected future cash flows using current interest rates. Current interest rates are estimated based on similar loans made or loans repriced to clients with similar credit risk. This methodology is used because no active market exists for the vast majority of these loans. Since the discount rates are based upon internal pricing mechanisms and other estimates, we cannot determine whether the fair values presented would equal the exit price negotiated in an actual sale. Furthermore, certain statutory or regulatory factors not considered in the valuation, such as the unique statutory rights of System borrowers, could render our portfolio unmarketable outside the System.

We segregate the loan portfolio into pools of loans with homogenous characteristics for purposes of determining fair value of loans not individually impaired. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

For fair value of loans individually impaired, we assume collection will result only from the sale of the underlying collateral. Fair value is estimated to equal the total net realizable value of the underlying collateral. Costs to sell represent transaction costs and are not included as a component of the asset's fair value.

Investment securities: If an active market exists, the fair value is based on currently quoted market prices. For those securities for which an active market does not exist, we estimate the fair value of these investments by discounting the expected future cash flows using current interest rates adjusted for credit risk.

Note payable to AgriBank: Estimating the fair value of the note payable to AgriBank is determined by segregating the note into pricing pools according to the types and terms of the underlying loans funded. We discount the estimated cash flows from these pools using the current rate charged by AgriBank for additional borrowings with similar characteristics.

Subordinated debt: We estimate the fair value of the subordinated debt by discounting the expected future cash requirements using current interest rates.

Commitments to extend credit and letters of credit: Estimating the fair value of commitments and letters of credit is determined by the inherent credit loss in such instruments.

The estimated fair value of our financial instruments is as follows (in thousands):

As of December 31	**2012** Carrying Amount	**2012** Fair Value	2011 Carrying Amount	2011 Fair Value	2010 Carrying Amount	2010 Fair Value
Financial assets:						
Net loans	**$5,886,522**	**$5,977,781**	$5,161,041	$5,251,334	$4,875,898	$4,919,897
Investment securities	**484,092**	**486,243**	505,486	509,733	467,143	471,799
Financial liabilities:						
Note payable to AgriBank	**$5,610,487**	**$5,681,952**	$4,954,046	$5,028,579	$4,694,170	$4,737,763
Subordinated debt	**100,000**	**116,193**	100,000	112,278	100,000	103,844
Unrecognized financial instruments:						
Commitments to extend credit and letters of credit		**($2,156)**		($1,975)		($1,627)

NOTE 16: QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Quarterly consolidated results of operations for the year ended December 31 follows (in thousands):

2012	First	Second	Third	Fourth	Total
Net interest income	**$38,221**	**$38,213**	**$40,126**	**$41,591**	**$158,151**
Provision for (reversal of) loan/lease losses	**1,724**	**3,759**	**1,777**	**(78)**	**7,182**
Patronage income	**3,211**	**4,375**	**3,260**	**7,492**	**18,338**
Other expense, net	**18,303**	**10,750**	**18,254**	**17,990**	**65,297**
Provision for (benefit from) income taxes	**(2,497)**	**3,557**	**2,122**	**(6,553)**	**(3,371)**
Net income	**$23,902**	**$24,522**	**$21,233**	**$37,724**	**$107,381**

2011	First	Second	Third	Fourth	Total
Net interest income	$36,884	$36,488	$37,046	$37,147	$147,565
Provision for loan/lease losses	1,068	1,066	3,367	1,899	7,400
Patronage income	2,548	3,518	3,187	7,880	17,133
Other expense, net	16,613	17,671	16,888	19,940	71,112
Provision for (benefit from) income taxes	(1,695)	2,708	4,701	5,060	10,774
Net income	$23,446	$18,561	$15,277	$18,128	$75,412

2010	First	Second	Third	Fourth	Total
Net interest income	$32,407	$31,352	$31,506	$33,482	$128,747
Provision for loan/lease losses	9,557	5,993	3,000	5,000	23,550
Patronage income	2,555	2,511	2,483	11,929	19,478
Other expense, net	4,719	11,010	14,892	15,579	46,200
Provision for (benefit from) income taxes	2,668	2,725	2,620	3,759	11,772
Net income	$18,018	$14,135	$13,477	$21,073	$66,703

NOTE 17: SUBSEQUENT EVENTS

We have evaluated subsequent events through March 1, 2013, which is the date the financial statements were available to be issued. There have been no material subsequent events that would require recognition in our 2012 Consolidated Financial Statements or disclosures in the Notes to Consolidated Financial Statements.

DISCLOSURE INFORMATION REQUIRED BY REGULATIONS

AgStar Financial Services, ACA
(Unaudited)

Description of Business

General information regarding the business is discussed in Note 1 of this Annual Report.

The description of significant business developments, if any, is discussed in the “Management's Discussion and Analysis" portion of this Annual Report.

Description of Property

The following table sets forth certain information regarding our properties

Location	Description	Usage
Apple Valley, MN	Leased	Branch
Baldwin, WI	Owned	Branch
Bloomington, IL	Leased	Commercial Unit
Blue Earth, MN	Leased	Branch
Des Moines, IA	Leased	Branch
Duluth, MN	Leased	Contact Office
Fargo, ND	Leased	Commercial Unit
Glencoe, MN	Owned	Branch
Lake Elmo, MN	Leased	Commercial Unit
Mankato, MN	Owned	Branch/Headquarters
Meridian, ID	Leased	Contact Office
Northfield, MN	Leased	Branch
Rice Lake, WI	Owned	Branch
Rochester, MN	Leased	Branch
St. Cloud, MN	Owned	Branch
Woodland, CA	Leased	Contact Office
Worthington, MN	Leased	Branch

Legal Proceedings

Information regarding legal proceedings is discussed in Note 13 of this Annual Report. We were not subject to any enforcement actions at December 31, 2012.

Description of Capital Structure

Information regarding our capital structure is discussed in Note 9 of this Annual Report.

Description of Liabilities

Information regarding liabilities is discussed in Notes 7, 8, 9, 10, 11, 13, and 15 of this Annual Report.

Selected Financial Data

The "Consolidated Five-Year Summary of Selected Financial Data” is presented at the beginning of this Annual Report.

Management’s Discussion and Analysis

Information regarding any material aspects of our financial condition, changes in financial condition, and results of operations are discussed in the "Management's Discussion and Analysis” portion of this Annual Report.

Board of Directors

Information regarding directors who served as of December 31, 2012, including business experience in the last five years and any other business interest where a director serves on the board of directors or as a senior officer follows:

Spencer Enninga, Chairperson of the Board, is a self-employed grain and livestock farmer and a seed sales representative. His current term on the board began in 2011 and expires in 2014.

Kaye Compart, Vice Chairperson, is a self-employed livestock and grain farmer. She is also the Secretary of South Central Saddle Club, Mankato, MN, involved in horse shows, and a board member of the South Central Chapter of the University of Minnesota Alumni Association, Mankato, MN. Her current term on the board began in 2012 and expires in 2015.

Wesley Beck is a self-employed grain and livestock farmer. He also serves on the board of Madelia/Lake Crystal Mutual Insurance Company, Madelia, MN, a property and casualty insurer. His current term on the board began in 2011 and expires in 2014.

David Bollman is a self-employed dairy and grain farmer. His current term on the board began in 2010 and expires in 2013.

Theresa Ann Broome, Outside Director, is a human resources executive and consultant. From April, 2006 to August, 2010, she was a Sr. Vice President, Human Resources for American Achievement Corporation, Austin, TX, a consumer goods holding company. From August, 2010 to March, 2012, she was the Chief People Officer for Lower Colorado River Authority, Austin, TX, a power plant and park management company. She is currently a self-employed Human Resources Consultant and is also on the board of Proxomo, Plano, TX, an application development company. Prior to that, she had business and human resources careers at Coca Cola Enterprises and the U.S. Postal Service. Her current term on the board began in 2012 and expires in 2015.

Terry Ebeling is a self-employed grain farmer. He also serves as a director of Al-Corn Clean Fuel, Claremont, MN, an ethanol cooperative. His current term on the board began in 2010 and expires in 2013.

Larry Fischer is a self-employed grain and livestock farmer. He is also President and Treasurer of Fischer Dairies, Inc., Sleepy Eye, MN, a dairy operation. His current term on the board began in 2012 and expires in 2015.

Dale Holmgren is a self-employed grain and livestock farmer. He is also President of Svin Hus, Inc., Mankato, MN, a swine operation. His current term on the board began in 2010 and expires in 2013.

Steven Johnson is a self-employed grain farmer. He also serves on the board of Windom Hospital Foundation, a fund raising organization. His current term on the board began in 2010 and expires in 2013.

William Kiehne is a self-employed grain and livestock farmer. He is also President of Central Fillmore Foods, Harmony, MN, a swine operation. His current term on the board began in 2011 and expires in 2014.

Kevin Koppendrayer is a self-employed grain farmer and a seed sales representative. He is also the owner of Koppendrayer Trucking, Princeton, MN. His current term on the board began in 2012 and expires in 2015.

David Kretzschmar is a self-employed dairy and grain farmer. He is also President of Kretzschmar Holsteins, Inc., Mellen, WI, a dairy operation. His current term on the board began in 2011 and expires in 2014.

William McCue is a self-employed grain farmer. His current term on the board began in 2010 and expires in 2013.

Gregory Nelson is a self-employed grain and livestock farmer. He is also on the board of the Wisconsin Beef Council, a trade group. His current term on the board began in 2011 and expires in 2014.

Lawrence Romuald, Outside Director, is the Treasurer and CFO of Cooperative Resources International, Shawano, WI, a holding cooperative, the Immediate Past President of the National Society of Accountants for Cooperatives, Dayton, OH, and the Vice Chairperson of the Plan Sponsor Committee for Foundations, a pension and benefits organization. His current term on the board began in 2012 and expires in 2014.

Lowell Schafer is a self-employed livestock farmer. His current term on the board began in 2012 and expires in 2015.

Rick Sommers is a self-employed dairy farmer. He is also President of Sommertime Dairy, Inc., Waseca, MN, a dairy operation. His current term on the board began in 2012 and expires in 2015.

Pursuant to our bylaws, Directors are paid a reasonable amount for attendance at board meetings, committee meetings, or other special assignments. Directors are also reimbursed for reasonable expenses incurred in connection with such meetings or assignments. In 2012, the Board of Directors' per diem rate was $400 per day plus travel time compensation for each meeting attended. The Board of Directors regular monthly meetings are normally two days in length. In addition, they hold two, three-day planning sessions annually. In 2012, each Director received a $1,000 per month retainer fee, with the exception of the chairperson who received a $1,500 per month retainer fee. Board committee chairperson for the Audit Committee, Human Resources Committee, and the Credit Committee each received an additional retainer of $100 per month. Each Director is eligible for a variable retainer fee based on companywide financial and business objectives. The award is calculated as a percentage of the Director's annual per diem compensation. The performance criteria include return on equity, operating revenue growth, adverse assets to risk funds ratio, net operating rate, client satisfaction, and client loyalty. Under the terms of the plan, no payments are made in the event our return on equity or adverse assets to risk funds ratio fall outside specified threshold levels. The percentage used in the award calculation depends on the actual results for each performance criteria.

Information regarding compensation for each director who served during 2012 follows:

	Number of Days Served		Compensation		
	Board Meetings	Other Official Activities	for Service on a Board Committee	Name of Committee	Total Compensation in 2012 [1]
Wesley Beck	22	18	$2,631	Audit	$34,022
David Bollman	22	27	2,543	Human Resources	40,306
Theresa Ann Broome [2]	4	2	400	Human Resources	4,416
Kaye Compart	22	24	2,432	Human Resources	35,704
Terry Ebeling	19	20	1,842	Audit	33,468
Spencer Enninga	22	20	3,090	Audit	36,653
Larry Fischer [3]	4	2	423	Audit	4,494
Dale Holmgren	22	24	2,023	Credit/Human Resources [6]	36,657
Steven Johnson	22	22	2,003	Human Resources	37,242
William Kiehne	22	27	2,428	Credit	40,382
Kevin Koppendrayer	22	31	2,513	Audit	42,595
David Kretzschmar	22	20	2,975	Credit	36,596
William McCue	22	15	1,839	Credit	33,102
Gregory Nelson	22	25	2,008	Credit	37,088
Kent Ringkob [4]	17	19	2,505	Human Resources	31,151
Lawrence Romuald	20	11	3,318	Audit	30,090
Lowell Schafer	22	26	2,395	Audit/Credit [7]	43,731
Rick Sommers	22	22	1,996	Credit	36,428
Steve Sviggum [5]	--	--	--		3,568
Total	350	355	$39,364		$597,693

[1] Compensation in 2012 includes taxable fringe benefits, if applicable.
[2] First appointed to Board in 2012.
[3] First elected to Board in 2012.
[4] No longer on Board at December 31, 2012.
[5] Elected to Board in 2011. Resigned in January, 2012.
[6] Detail for compensation for service on Committees: Credit - $1,517, Human Resources - $506.
[7] Detail for compensation for service on Committees: Audit - $1,912, Credit - $483.

Senior Officers

The senior officers, and the date each began in his current position, include:

Paul A. DeBriyn	President and Chief Executive Officer	July, 1995
Joseph R. Deufel	Executive Vice President, Chief Credit Officer and Asst Secretary	July, 1991
Rodney W. Hebrink	Executive Vice President and Chief Financial Officer	December, 1985
James W. Manley	Executive Vice President and Chief Relationship Mgmt Officer	September, 2001
Paul B. Kohls	Sr. Vice President, General Counsel, and Secretary	January, 2012

All of the senior officers have held their current positions for the past five years, with the exception of Mr. Kohls.

Prior to 2012, Mr. Kohls was an Assistant General Counsel with us, originally hired in 2010. From 2005 to 2010, he was an attorney and Director of Government Affairs for Allianz Life Insurance Company of North America. During that same period, he was also a member of the Minnesota House of Representatives.

Information related to compensation paid to senior officers will be provided in our Annual Meeting Information Statement (AMIS). The AMIS will be available for public inspection at our Mankato office once it has been mailed to our stockholders.

Transactions with Senior Officers and Directors

Information regarding related party transactions is discussed in Note 12 of this Annual Report.

Travel, Subsistence, and Other Related Expenses

Directors and senior officers are reimbursed for reasonable travel, subsistence, and other related expenses associated with business functions. A copy of our policy for reimbursing these costs is available by contacting 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.

The total directors' travel, subsistence, and other related expenses were $154 thousand, $159 thousand, and $138 thousand in 2012, 2011, and 2010, respectively.

Involvement in Certain Legal Proceedings

No events occurred during the past five years that are material to evaluating the ability or integrity of any person who served as a director or senior officer on January 1, 2013 or at any time during 2012.

Client Privacy

Clients' nonpublic personal financial information is protected by Farm Credit Administration Regulation. Except as provided for in those Regulations, our directors and employees are restricted from disclosing information not normally contained in published reports or press releases about us or our clients without client consent. We do not sell or trade clients' personal information to marketing companies or information brokers. Client information may be disclosed, for example:

- to other Farm Credit System institutions in contemplation of the extension of credit or in servicing existing credit,
- as a credit reference for clients with other lenders with the client's written consent,
- to provide impersonal information to a credit bureau or consumer reporting agency,
- in certain legal or law enforcement proceedings,
- to external, internal, or Farm Credit Administration auditors in a review of client files during regular reviews or examinations, or
- to provide copies of real estate appraisals, if needed by an employee to become a licensed real estate appraiser, when required by State agencies.

Relationship with Qualified Public Accountant

There were no changes in independent auditors since the last Annual Report to Stockholders and we are in agreement with the opinion expressed by the independent auditors. The total fees paid during 2012 were $115 thousand. The fees paid were for audit services.

Financial Statements

The "Report of Management", "Report on Internal Control Over Financial Reporting", "Report of Audit Committee", "Independent Auditor's Report", "Consolidated Financial Statements", and "Notes to Consolidated Financial Statements" are presented prior to this portion of the Annual Report.

Credit and Services to Young, Beginning, and Small Farmers and Ranchers Program

Information regarding credit and services to young, beginning, and small farmers and ranchers, and producers or harvesters of aquatic products is discussed in an addendum to this Annual Report.

Equal Employment Opportunity

We are an equal opportunity employer. It is our policy to provide equal employment opportunity to all persons regardless of race, color, sex, creed, religion, national origin, age, disability, marital status, sexual orientation, public assistance status, veteran status, genetic information, pregnancy or any other status protected by law. We comply with all federal, state, and local equal opportunity employment regulations. All personnel decisions and processes relating to our employees and job applicants are conducted in an environment free of discrimination and harassment. We are committed to recruiting, hiring, training, and promoting without regard to the above listed factors.

Funds Held Policy

Purpose

This policy provides direction to management for administering uninsured voluntary and involuntary accounts in compliance with FCA Regulation 614.4175.

Objective

FCA Regulation 614.4513 provides that the association may provide funds to borrowers from voluntary advance conditional payment accounts in lieu of increasing the borrower's loan. The association also may establish involuntary payment accounts for purposes identified in the regulation and this policy. The direction in this policy provides for regulatory compliance in the administration of such voluntary and involuntary accounts and their management to avoid liquidity risk.

Voluntary Advance Conditional Payment Accounts

Voluntary advance conditional payments are available for the benefit and convenience of clients who desire to make conditional payments. The voluntary account balance may not exceed the outstanding balance on the related loan(s). Loans having a prepayment penalty or variable interest rate cap should not have a funds held balance greater than 10% of the principal balance.

The association will generally pay interest for the time voluntary funds are held unapplied at a floating rate of 50 basis points above the Federal Open Market Committee's target for the federal funds rate. Rate changes will be effective within 60 days of a change by the Federal Reserve board. If this calculated rate exceeds a loan's current billed interest rate, the association will pay a minimum interest rate of 50 basis points less than the loan's billed interest rate. ALCO shall have the authority to adjust the rate paid on funds held if the federal funds rate target no longer provides a reasonable correlation to the Association's variable cost of funds. Any change by ALCO in the method of determining the funds held rate shall be reported to the board within 60 days. The association will pay interest equal to the loan's billing rate on funds held required to be maintained either as a condition of the loan or required as a consequence of the repayment structure.

Withdrawal of Funds

Funds in a funds held account may be available to be returned to clients, upon request, for an eligible loan purpose in lieu of increasing the client's loan. Withdrawals from Funds Held in general should be limited and in general should not be less than $100. Upon the death of a client who has funds held balances, the association does not set up death beneficiaries or "payable on death" designations to distribute funds held balances.

Involuntary Payment Accounts

The association may establish involuntary payment accounts including, but not limited to, funds held for borrowers, such as loan proceeds to be disbursed for which the borrower is obligated; the unapplied insurance proceeds arising from any insured loss; any insurance premiums and applicable taxes collected in advance in connection with any loan.

Amounts in involuntary payments accounts must be reasonable for the purpose for which the account is intended, for example, equal to annual payments of insurance and taxes plus a reasonable contingency, funds for construction projects, or insurance proceeds to rebuild.

The association may pay a different rate of interest on funds held that are required to be maintained either as a condition of the loan or which have other restricted purposes such as insurance and tax escrows or insurance proceeds. If the interest rate on the involuntary payment account is above the association's standard funds held rate, the funds held balance should be limited to 20% of the principal balance.

ALCO shall have authority to adjust the rate paid on funds held if the federal funds rate target no longer provides a reasonable correlation to the Association's variable cost of funds. Any change by ALCO in the method of determining the funds held rate shall be reported to the board within 60 days.

Withdrawal of Funds on Involuntary Payment Accounts

Involuntary payment accounts may be used only for their specifically designated purpose. Withdrawal of escrow funds may be permitted if the funds are needed to protect the loan collateral or it is not adverse to the association's best interest to release the funds.

Agreement/Disclosures

The association shall require written agreements with borrowers and adequate disclosures regarding:

- The uninsured status of voluntary advance conditional payment funds or voluntary payment account funds and an explanation of the risk in the event of the association's liquidation;
- Limits on amounts that can be paid into voluntary advance conditional payment accounts or voluntary payment accounts;
- Interest rates that will be paid, including the terms of variable interest rates; and
- Withdrawal guidelines.

Liquidation

In the event of association liquidation, all borrowers having funds in voluntary or involuntary uninsured accounts shall be notified in accordance with FCA Regulation 627.2735. The notice shall advise that the funds ceased earning interest when the receivership was instituted, and the funds will be applied against the outstanding indebtedness of any loans of such borrower unless, within 15 days of such notice, the borrower directs the receiver to otherwise apply such funds in the manner provided for in existing loan documents.

The CEO, or other officer designated by the CEO, shall be responsible for developing and maintaining procedures to ensure administration of this policy.

The Board of Directors shall review the ongoing adequacy of this policy at least annually.

Delegated and Retained Authorities

All authorities included in the operating parameters are delegated as specified and to the extent not delegated are retained by the Board of Directors.

Exceptions

Any exceptions to this policy shall require approval of the Board of Directors and, at the option of the Board, may receive post approval.

Reporting

Material issues regarding this policy shall be reported to the Board of Directors by the CEO, or other association officer designated by the CEO, at such times and in such format as the CEO determines appropriate.

Revision Approval Date: 2/26/03; 2/22/07; 12/17/09; 11/18/10

Initial Board Approval Date: 12/16/98

Related Documents

FCA Regulations 614.4175 and 627.2735; FCA BL-030

Young, Beginning, and Small Farmers and Ranchers Program

AgStar Financial Services, ACA

We have specific programs in place to serve the credit related needs of young, beginning, and small farmers and ranchers in our territory. The definitions of young, beginning, and small farmers and ranchers are as follows:

- Young: A farmer, rancher, or producer or harvester of aquatic products who is age 35 or younger as of the loan transaction date.
- Beginning: A farmer, rancher or producer or harvester of aquatic products who has 10 years or less farming or ranching experiences as of the loan transaction date.
- Small: A farmer, rancher, or producer or harvester of aquatic products who normally generates less than $250 thousand in annual gross sales of agricultural or aquatic products.

Mission Statement: We will provide ongoing access to credit, related services and outreach programs to qualified young, beginning, and small farmers.

Policy to complete Mission Statement: We will actively develop and execute an annual business plan to qualified young, beginning, and small (YBS) farmers. This plan will target and serve YBS farmers through a variety of credit and outreach programs in an effort to help the next generation of farmers succeed. We are further committed to supporting educational and developmental opportunities to this segment of farmers.

2012 Business Environment

The number of young farmers within our territory has been on a decline for several years. The 2002 USDA census data showed the young farmer population within our territory at 7%. Data from the 2007 USDA census revealed the young farmer population has declined to 6%. In comparison, 19% of our total loans are to young farmers. (The USDA census information and FCA definition of young farmers varies slightly. USDA information is reported for farmers 34 years of age and younger, versus the FCA's definition of 35 years of age and younger.)

The number of beginning farmers has also diminished over the past years. According to the USDA census, beginning farmers within our territory dropped from 23% in 2002 to 20% in 2007. Using the FCA definition, 22% of our total loans are made to beginning farmers. (The USDA census information and FCA definition of beginning farmers slightly differs. While FCA defines a beginning farmer as an individual with 10 years or less experience, the USDA reports those who have been farming the same farm for 9 years or less.)

In the small farmer area there has been a widening disparity in gross farm income (GFI) between the large and small farmers. Of farmers surveyed in the 2002 census, 91% had less than $250 thousand in total value of sales. In the 2007 USDA census, this dropped to 87%. Forty-five percent of our total loans are to small farmers. (The FCA definition of a small farm [less than $250 thousand in annual gross sales] varies some from the USDA census information, which is reported as total value of sales.)

In 2012, we targeted $3.7 billion of aggregate YBS lending. Total aggregate YBS lending at year end 2012 was just under $4 billion, putting us above our targeted levels. Positive results were posted overall for the number of new loans and leases to YBS farmers in 2012.

Our YBS goals and results for 2012 were:

Total number of loans to Young, Beginning and Small Farmers			
	Goal	Actual	% of Goal
Young	9,200	9,342	102%
Beginning	10,650	10,957	103%
Small	22,400	22,216	99%

New loans made in 2012 to Young, Beginning and Small Farmers				
	Number of loans		Volume (in millions)	
	Goal	Actual	Goal	Actual
Young	3,536	3,786	$379	$438
Beginning	3,685	4,043	$445	$524
Small	9,462	9,281	$529	$572

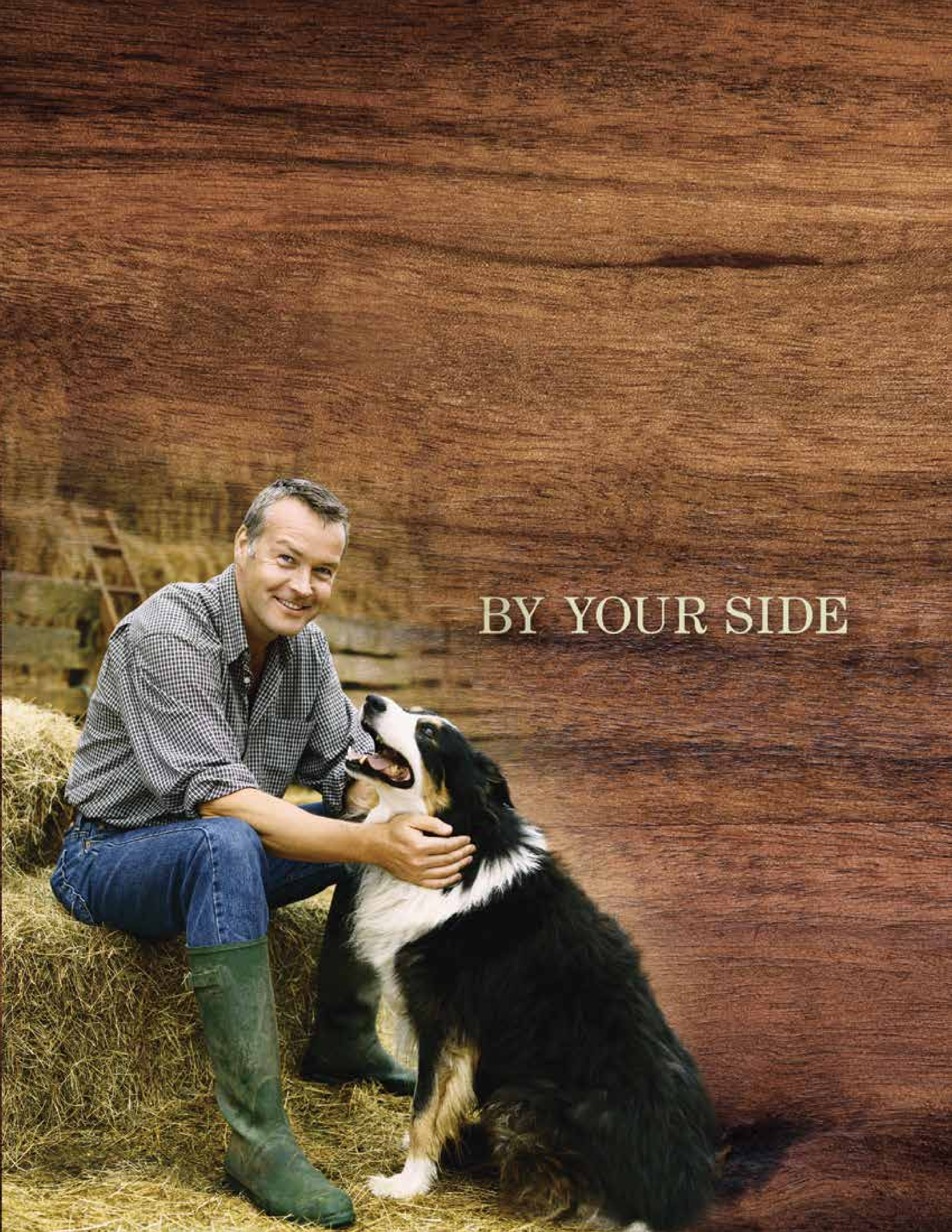
The number of new loans to YBS farmers exceeded targeted levels, except for small farmers, which fell slightly short of the target. Of the loans that utilized government agency guarantees in 2012, 54% were to YBS farmers.

2012 Highlights

Each of our Financial Service Officers was charged with establishing relationships and writing new loans with six new, young or beginning farmer prospects in 2012. The average number of new, young, or beginning clients per Financial Service Officer achieved was 10.1, surpassing the targeted level. Ongoing informal mentoring and financial counseling is provided as a normal course of business to young and beginning farmers. Closely linked to the mentoring program is the offering of related services. Financial Service Officers, through their normal course of business, also discuss the advantages and availability of other products and services, including crop insurance, cash management, and online banking services which are also available to YBS farmers.

As part of our YBS educational and outreach initiatives, we offered the “GroundBreakers Educational Conference” in February 2012. The two-day conference featured sessions on the current economic impacts on agriculture, advocating for agriculture using social media, and ways to improve profitability. The conference was attended by over 250 clients and prospects. Additionally, the AgStar Scholars program (supported by the AgStar Fund for Rural America) continues to offer financial assistance and internship opportunities to students studying agriculture at the University of Minnesota or the University of Wisconsin – River Falls. Nine college students were awarded scholarships in 2012. The Fund also awarded twenty $1,000 scholarships to graduating high school seniors who are moving on to study agriculture at the university or technical college level. We continue to provide young and beginning farmers with tuition assistance for state Farm Business Management programs. The program provided partial tuition assistance to 14 clients and non-clients throughout our territory in 2012. We continue to be a financial sponsor of many innovative programs and conferences, the MN FFA Star awards, and the “Ag in the Classroom” program, just to name a few.

Programs for YBS farmers include standards and guidelines to provide for extension of sound and constructive credit, consistent with our business objectives. We review the YBS lending programs and underwriting standards on an ongoing basis. To minimize credit and profit risk exposure, maximum portfolio concentration and program graduation criteria were included in the program. In 2012, the risk pool available annually for YBS farmer loans and leases was increased to $50 million. In 2012, $40.6 million of the risk pool was utilized. The usage of the risk pool has increased significantly over the past few years as a result of continued YBS program enhancements.


BY YOUR SIDE

AgStar
Financial Services, ACA

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