



**Legacy**  
Ag Credit, ACA  
2013 ANNUAL REPORT



## Letter From the Chairman and the President/CEO

Dear Legacy Stockholders:

Dedicated, hardworking, optimistic, loyal, flexible: these are just a few words that come to mind to describe you, the member-borrowers of Legacy Ag Credit.

Due to these characteristics of our member-borrowers, as well as the governance of our board of directors and hard work of our employees, Legacy Ag Credit achieved strong results in 2013. The achievements reached in 2013 continue to strengthen the Association as well as allowing your directors to declare a cash patronage.

We are pleased to report net income for 2013 of just over \$3.9 million. Additionally, your Association's capital position, the foundation of any business including ours, increased to over 20 percent. This level of capital positions the Association to meet the needs of you, our member-borrowers, by providing consistent financing to you and your operations. Legacy Ag Credit is dedicated to the mission of being the premier agricultural lender within our territory while providing superior customer service.

As a result of the financial achievements of 2013, the Board of Directors declared a cash patronage of \$1.25 million which will be paid in March of 2014. The directors and employees of Legacy Ag Credit continually seek opportunities and operate under cooperative principles with you, our stockholders, in mind. This cash patronage reflects an approximate 67-basis-point reduction in the effective borrowing rate of an average borrower of Legacy Ag Credit for 2013.

During 2013, the Association continued building the foundation for growth within our organization, while continuing to focus on improving credit quality and our financial strength. Our member-borrowers benefit from the success of our cooperative model, and over the last year, Legacy Ag Credit remained dedicated to introducing our model, products and services to new member-borrowers within our territory while deepening our relationship with current member-borrowers. Growth and prosperity benefit all member-borrowers of Legacy Ag Credit, and our Association is prepared to meet your financing needs.

Legacy Ag Credit, ACA is excited to share the story of our commitment to agriculture, and we look forward to serving others within our territory so they too may benefit from our products and services, patronage program, and the Farm Credit System.

On behalf of the board of directors and employees of Legacy Ag Credit, we look forward to continuing to serve you and your financing needs.

We sincerely appreciate your business!



Joseph Crouch, President



Jerry Cordell, Chairman of the Board

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## REPORT OF MANAGEMENT

The consolidated financial statements of Legacy Ag Credit, ACA (Association) are prepared by management, who is responsible for the statements' 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 appropriate in the circumstances. Other financial information included in the annual report is consistent with that in the consolidated financial statements.

To meet its responsibility for reliable financial information, management depends on the Farm Credit Bank of Texas' and the Association's accounting and internal control systems, which have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded and transactions are properly authorized and recorded. The systems have been designed to recognize that the cost of controls must be related to the benefits derived. The consolidated financial statements are audited by PricewaterhouseCoopers LLP, independent accountants, who conduct a review of internal controls solely for the purpose of establishing a basis for reliance thereon in determining the nature, extent and timing of audit tests applied in the audit of the consolidated financial statements in accordance with auditing standards generally accepted in the United States of America. The Association is also examined by the Farm Credit Administration.

The board of directors has overall responsibility for the Association's systems of internal control and financial reporting. The board consults regularly with management and reviews the results of the audits and examinations referred to previously.

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



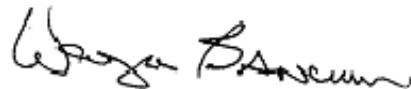
Joseph Crouch, Chief Executive Officer  
*March 7, 2014*



Jerry Cordell, Chairman, Board of Directors  
*March 7, 2014*



Daryl D. Belt, Chief Financial Officer  
*March 7, 2014*



Wayne Bawcum, CPA, Chairman, Audit Committee  
*March 7, 2014*

## REPORT OF AUDIT COMMITTEE

The Audit Committee (committee) is composed of the entire board of directors of Legacy Ag Credit, ACA. In 2013, 18 committee meetings were held. The committee oversees the scope of Legacy Ag Credit, ACA's system of internal controls and procedures, and the adequacy of management's action with respect to recommendations arising from those auditing activities. The committee's approved responsibilities are described more fully in the Audit Committee Charter, which is available on request or on Legacy Ag Credit, ACA's website. The committee approved the appointment of PricewaterhouseCoopers LLP for 2013.

Management is responsible for Legacy Ag Credit, ACA's internal controls and the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. The consolidated financial statements are prepared under the oversight of the committee. PricewaterhouseCoopers LLP is responsible for performing an independent audit of Legacy Ag Credit, ACA's consolidated financial statements in accordance with auditing standards generally accepted in the United States of America and for issuing a report thereon. The committee's responsibilities include monitoring and overseeing the processes.

In this context, the committee reviewed and discussed Legacy Ag Credit, ACA's audited consolidated financial statements for the year ended December 31, 2013 (audited consolidated financial statements) with management and PricewaterhouseCoopers LLP. The committee also reviews with PricewaterhouseCoopers LLP the matters required to be discussed by authoritative guidance, "The Auditor's Communication With Those Charged With Governance," and both PricewaterhouseCoopers LLP's and Legacy Ag Credit, ACA's internal auditors directly provide reports on significant matters to the committee.

The committee discussed with PricewaterhouseCoopers LLP its independence from Legacy Ag Credit, ACA. The committee also reviewed the nonaudit services provided by PricewaterhouseCoopers LLP and concluded that these services were not incompatible with maintaining the independent accountant's independence. The committee has discussed with management and PricewaterhouseCoopers LLP such other matters and received such assurances from them as the committee deemed appropriate.

Based on the foregoing review and discussions and relying thereon, the committee recommended that the board of directors include the audited consolidated financial statements in Legacy Ag Credit, ACA's Annual Report to Stockholders for the year ended December 31, 2013.

### Audit Committee Members

Wayne Bawcum, CPA, Chairman  
Jerry Cordell, Vice Chairman  
Cody Newman  
A. G. Sandifeer  
Terry D. Milligan  
Paul Nicklas  
Ron Gabriel

*March 7, 2014*

**LEGACY AG CREDIT, ACA**

**FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA**

(unaudited)

(dollars in thousands)

	<u>2013</u>	2012	2011	2010	2009
<b><u>Balance Sheet Data</u></b>					
<u>Assets</u>					
Cash	\$ 84	\$ 84	\$ 88	\$ 63	\$ 1,473
Loans	216,168	212,343	216,045	250,449	291,523
Less: allowance for loan losses	3,299	3,269	5,788	10,396	10,001
Net loans	<u>212,869</u>	209,074	210,257	240,053	281,522
Investment in and receivable from the Farm Credit Bank of Texas	4,236	4,188	4,492	6,379	5,132
Other property owned, net	787	3,957	5,113	3,809	2,368
Other assets	1,877	2,026	2,136	2,522	3,245
Total assets	<u>\$ 219,853</u>	<u>\$ 219,329</u>	<u>\$ 222,086</u>	<u>\$ 252,826</u>	<u>\$ 293,740</u>
<u>Liabilities</u>					
Obligations with maturities of one year or less	\$ 2,125	\$ 919	\$ 714	\$ 601	\$ 1,330
Obligations with maturities greater than one year	169,534	173,302	180,005	212,999	249,288
Total liabilities	<u>171,659</u>	174,221	180,719	213,600	250,618
<u>Members' Equity</u>					
Capital stock and participation certificates	1,022	998	1,017	1,122	1,193
Unallocated retained earnings	46,935	44,020	40,194	37,899	41,805
Accumulated other comprehensive income	237	90	156	205	124
Total members' equity	<u>48,194</u>	45,108	41,367	39,226	43,122
Total liabilities and members' equity	<u>\$ 219,853</u>	<u>\$ 219,329</u>	<u>\$ 222,086</u>	<u>\$ 252,826</u>	<u>\$ 293,740</u>
<b><u>Statement of Income Data</u></b>					
Net interest income	\$ 7,784	\$ 7,317	\$ 6,327	\$ 6,422	\$ 8,345
(Provision for loan losses) or loan loss reversal	(765)	713	(713)	(8,465)	(9,922)
Income from the Farm Credit Bank of Texas	826	850	963	1,337	1,198
Other noninterest income	521	646	139	503	371
Noninterest expense	(4,451)	(5,400)	(4,421)	(3,703)	(5,200)
Net income (loss)	<u>\$ 3,915</u>	<u>\$ 4,126</u>	<u>\$ 2,295</u>	<u>\$ (3,906)</u>	<u>\$ (5,208)</u>
<b><u>Key Financial Ratios for the Year</u></b>					
Return on average assets	1.8%	1.9%	0.97%	-1.4%	-1.7%
Return on average members' equity	8.3%	9.4%	5.8%	-8.9%	-10.3%
Net interest income as a percentage of average earning assets	3.7%	3.4%	2.7%	2.3%	2.8%
Net charge-offs (recoveries) as a percentage of average loans	0.4%	0.8%	2.3%	2.9%	0.1%

**LEGACY AG CREDIT, ACA**

**FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA**  
**(unaudited)**  
**(dollars in thousands)**

	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
<b><u>Key Financial Ratios at Year End</u></b>					
Members' equity as a percentage of total assets	<b>21.9%</b>	20.6%	18.6%	15.5%	14.7%
Debt as a percentage of members' equity	<b>356.2%</b>	386.2%	436.9%	544.5%	581.2%
Allowance for loan losses as a percentage of loans	<b>1.5%</b>	1.5%	2.7%	4.2%	3.4%
Permanent capital ratio	<b>20.9%</b>	19.1%	15.8%	14.3%	14.4%
Core surplus ratio	<b>20.4%</b>	18.7%	15.4%	13.8%	14.0%
Total surplus ratio	<b>20.4%</b>	18.7%	15.4%	13.8%	14.0%
<b><u>Net Income Distribution</u></b>					
Cash patronage distributions	\$ <b>1,000</b>	\$ 304	\$ -	\$ -	\$ 1,000

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following commentary explains management's assessment of the principal aspects of the consolidated financial condition and results of operations of Legacy Ag Credit, ACA, including its wholly-owned subsidiaries, Legacy, PCA and Legacy Land Bank, FLCA (Association) for the years ended December 31, 2013, 2012 and 2011, and should be read in conjunction with the accompanying consolidated financial statements. The accompanying financial statements were prepared under the oversight of the Association's audit committee.

### **Forward-Looking Information:**

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

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international and farm-related business sectors;
- weather-related, disease-related and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry; and
- actions taken by the Federal Reserve System in implementing monetary policy.

### **Significant Events:**

The Farm Credit Administration (FCA) terminated the Supervisory Agreement (Agreement) with Legacy Ag Credit, ACA effective January 23, 2014. The Association has been returned to normal supervision. Details regarding the Agreement can be found in Note 15 to the consolidated financial statements, "Regulatory Enforcement Matters."

In December 2013, the Association received a direct loan patronage of \$753,292 from the Farm Credit Bank of Texas (Bank), representing 44 basis points on the average daily balance of the Association's direct loan with the Bank. During 2013, the Association received \$72,553 in patronage payments from the Bank, based on the Association's stock investment in the Bank.

In January 2013, the FCA granted approval for the Association to distribute a \$1,000,000 patronage related to 2012 operations. The patronage was paid in March 2013.

In January 2014, the FCA granted approval for the Association to distribute a \$1,250,000 patronage related to 2013 operations. The patronage will be paid in March 2014.

### **Loan Portfolio:**

The Association makes and services loans to farmers, ranchers, rural homeowners and certain farm-related businesses. The Association's loan volume consists of long-term farm mortgage loans, production and intermediate-term loans, and farm-related business loans. These loan products are available to eligible borrowers with competitive variable, fixed, adjustable and prime-based interest rates. Loan maturities range from one to 40 years, with annual operating loans comprising the majority of the commercial loans and 20- to 30-year maturities comprising the majority of the mortgage loans. Loans serviced by the Association offer several installment payment cycles, the timing of which usually coincides with the seasonal cash-flow capabilities of the borrower.

The composition of the Association's loan portfolio, including principal less funds held of \$216,168,241, \$212,343,402 and \$216,045,218 as of December 31, 2013, 2012 and 2011, respectively, is described more fully in detailed tables in Note 3 to the consolidated financial statements, "Loans and Allowance for Loan Losses" included in this annual report.



## Purchase and Sales of Loans:

During 2013, 2012 and 2011, the Association participated in loans with other lenders. As of December 31, 2013, 2012 and 2011, these participations totaled \$21,936,254, \$19,757,810 and \$14,611,169, or 10.1 percent, 9.3 percent and 6.8 percent of loans, respectively. The Association had no participations with entities outside the District. The Association has also sold participations of \$1,098,215, \$1,132,500 and \$0 as of December 31, 2013, 2012 and 2011, respectively.

During 2013, the Association sold loans related to two borrowers to local lending institutions which resulted in the recognition of a gain of \$77,871.

During 2012, the Association sold four loans relating to one borrower to a local lending institution which resulted in the recognition of a gain of \$159,761.

## Risk Exposure:

High-risk assets include nonaccrual loans, loans that are past due 90 days or more and still accruing interest, formally restructured loans, and other property owned. The following table illustrates the Association's components and trends of high-risk assets serviced for the prior three years as of December 31:

	2013		2012		2011	
	Amount	%	Amount	%	Amount	%
Nonaccrual	\$ 3,957,739	48.4%	\$ 7,574,544	49.3%	\$ 18,989,576	75.6%
90 days past due and still accruing interest	-	0.0%	-	0.0%	4,434	0.0%
Formally restructured	3,440,598	42.0%	3,832,732	24.9%	1,014,795	4.0%
Other property owned, net	787,368	9.6%	3,956,869	25.8%	5,112,615	20.4%
Total	\$ 8,185,705	100.0%	\$ 15,364,145	100.0%	\$ 25,121,420	100.0%

At December 31, 2013, 2012 and 2011, loans that were considered impaired were \$7,398,337, \$11,407,276 and \$20,008,805, representing 3.4 percent, 5.4 percent and 9.3 percent of loan volume, respectively. Impaired loans consist of all high-risk assets except other property owned.

Other property owned consisted of 2 properties at December 31, 2013. This included inventory and an equity interest in a biofuels plant. The net carrying value of the properties is equivalent to its fair value of \$787,368, which is net of an allowance of \$24,118. During 2013, there were 15 sales of other property owned. The total sales price of these properties totaled \$3,905,882 and resulted in a net gain on sale of \$314,651. Net operating expenses incurred on other property owned were \$29,317.

Except for the relationship between installment due date and seasonal cash-flow capabilities of the borrower, the Association is not affected by any seasonal characteristics. The factors affecting the operations of the Association are the same factors that would affect any agricultural real estate lender.

## Allowance for Loan Losses:

The following table provides relevant information regarding the allowance for loan losses as of, or for the year ended, December 31:

	2013	2012	2011
Allowance for loan losses	\$ 3,299,523	\$ 3,269,104	\$ 5,787,913
Allowance for loan losses to total loans	1.5%	1.5%	2.7%
Allowance for loan losses to nonaccrual loans	83.4%	43.2%	30.5%
Allowance for loan losses to impaired loans	44.6%	28.7%	28.9%
Net charge-offs to average loans	0.4%	0.8%	2.3%

The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition, collateral value, portfolio quality, current production conditions and economic conditions, and prior loan loss experience. Management considers the following factors in determining and supporting the level of allowance for loan losses: the concentration of lending in agriculture, combined with uncertainties associated with

farmland values, commodity prices, exports, government assistance programs, regional economic effects and weather-related influences.

Based upon ongoing risk assessment and the allowance for loan losses procedures outlined above, the allowance for loan losses of \$3,299,523, \$3,269,104 and \$5,787,913 at December 31, 2013, 2012 and 2011, respectively, is considered adequate by management to compensate for inherent losses in the loan portfolio at such dates. Management's process for the evaluation of allowance for loan losses includes a portfolio analysis and historical loss experience. In view of the above process, management believes that the allowance is adequate.

### Results of Operations:

The Association's net income for the year ended December 31, 2013, was \$3,915,034 as compared to \$4,126,249 for the year ended December 31, 2012, reflecting a decrease of \$211,215, or 5.1 percent. The Association's net income for the year ended December 31, 2011, was \$2,295,023. Net income increased \$1,831,226, or 79.8 percent, in 2012 versus 2011.

Net interest income for 2013, 2012 and 2011 was \$7,784,097, \$7,317,038 and \$6,327,129, respectively, reflecting increases of \$467,059, or 6.4 percent, for 2013 versus 2012 and \$989,909, or 15.6 percent, for 2012 versus 2011. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets and cost of debt. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following tables:

	2013		2012		2011	
	Average Balance	Interest	Average Balance	Interest	Average Balance	Interest
Loans	\$ 211,497,863	\$ 11,406,892	\$ 212,936,637	\$ 11,853,236	\$ 233,187,636	\$ 12,454,809
Interest-bearing liabilities	169,368,597	3,622,795	175,118,710	4,536,198	195,756,700	6,127,680
Impact of capital	\$ 42,129,266		\$ 37,817,927		\$ 37,430,936	
Net interest income		\$ 7,784,097		\$ 7,317,038		\$ 6,327,129

	2013	2012	2011
	Average Yield	Average Yield	Average Yield
Yield on loans	5.39%	5.57%	5.34%
Cost of interest-bearing liabilities	2.14%	2.59%	3.13%
Interest rate spread	3.25%	2.98%	2.21%

	2013 vs. 2012			2012 vs. 2011		
	Increase (decrease) due to			Increase (decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
Interest income - loans	\$ (80,126)	\$ (366,218)	\$ (446,344)	\$ (1,081,626)	\$ 480,053	\$ (601,573)
Interest expense	(148,951)	(764,452)	(913,403)	(646,031)	(945,451)	(1,591,482)
Net interest income	\$ 68,825	\$ 398,234	\$ 467,059	\$ (435,595)	\$ 1,425,504	\$ 989,909

Interest income for 2013 decreased by \$446,344, or 3.8 percent, compared to 2012, primarily due to decreases in interest rates and a decrease in average loan volume. Interest expense for 2013 decreased by \$913,403, or 20.1 percent, compared to 2012 due to decreases in interest rates and average interest-bearing liabilities. The interest rate spread increased by 27 basis points to 3.25 percent in 2013 from 2.98 percent in 2012, primarily because of the changes outlined above. The interest rate spread increased by 77 basis points to 2.98 percent in 2012 from 2.21 percent in 2011, primarily because of decreases in both loan volume and interest rates on interest bearing liabilities. The Association controls interest rate margins through its loan pricing and matched funding provided by interest rate programs with the Bank. See "Liquidity and Funding Sources" below for further information.

Noninterest income for 2013 decreased by \$149,848, or 10.0 percent, compared to 2012, due primarily to a \$159,761 gain on sale of loans and \$271,076 refund distribution from the Farm Credit System Insurance Corporation (FCSIC or Insurance Fund), both of which occurred in 2012. This was offset by a \$285,334 gain on other property owned, net which was recorded in 2013. Noninterest income for 2012 increased by \$393,968, or 35.7 percent, compared to 2011, due primarily to a \$159,761 gain on sale of loans and a \$271,076 refund distribution from FCSIC. Distributions from the FCSIC received in 2012 included reserves it held in excess of its secure base amount.

Provisions for loan losses increased by \$1,477,399, or 207.3 percent, compared to 2012, due primarily to Association provision requirements in 2013 for impaired assets as compared to net reversals of such provisions in 2012.

Operating expenses consist primarily of salaries, employee benefits and purchased services. Expenses for purchased services may include administrative services, marketing, information systems, accounting and loan processing, among others. The \$948,973 decrease in operating expenses in 2013 from 2012 is primarily related to a \$1,071,374 reduction in provision for other property owned. Operating expenses also included an increase of \$59,183 in premiums to the Insurance Fund, resulting from an increase in the premium rates from 5 basis points in 2012 to 10 basis points in 2013. Operating expenses increased by \$978,655, or 22.1 percent, in 2012 compared to 2011. Salaries and employee benefit expenses increased by \$530,316, or 25.2 percent, for 2012 versus 2011 due to incentives paid in 2012 along with an increase in staffing levels. Advertising, public and member relation expenses increased by \$103,119, or 136.4 percent, for 2012 versus 2011 due to increases primarily in billboard expenditures and donations. Premiums to the Insurance Fund decreased by \$44,889 resulting from a decrease in the premium rates from 20 basis points in 2011 to 5 basis points in 2012. Provision for other property owned increased by \$772,736, or 208.2 percent, compared to 2011 due to a decrease in appraisal values.

For the year ended December 31, 2013, the Association's return on average assets was 1.8 percent, as compared to 1.9 percent and 0.97 percent for the years ended December 31, 2012 and 2011, respectively. For the year ended December 31, 2013, the Association's return on average members' equity was 8.3 percent, as compared to 9.4 percent and 5.8 percent for the years ended December 31, 2012 and 2011, respectively.

Because the Association depends on the Bank for funding, any significant positive or negative factors affecting the operations of the Bank would have a similar effect on the operations of the Association.

### **Liquidity and Funding Sources:**

The interest rate risk inherent in the Association's loan portfolio is substantially mitigated through the funding relationship with the Bank. The Bank manages interest rate risk through its direct loan pricing and asset/liability management process.

The primary source of liquidity and funding for the Association is a direct loan from the Bank. The outstanding balance of \$169,229,588, \$172,960,131 and \$179,552,956 as of December 31, 2013, 2012 and 2011, respectively, is recorded as a liability on the Association's consolidated balance sheet. The note carried a weighted average interest rate of 2.14 percent, 2.38 percent and 3.02 percent at December 31, 2013, 2012 and 2011, respectively. The indebtedness is collateralized by a pledge of substantially all of the Association's assets to the Bank and is governed by a general financing agreement (GFA). The decrease in note payable to the Bank and related accrued interest payable since December 31, 2012, is due to an increase in the Association's own funds. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were \$45,249,278, \$39,221,904 and \$36,666,671 at December 31, 2013, 2012 and 2011, respectively. The maximum amount the Association may borrow from the Bank as of December 31, 2013, was \$200,275,239 as defined by the general financing agreement. The indebtedness continues in effect until the expiration date of the general financing agreement, which is September 30, 2015, unless sooner terminated by the Bank upon the occurrence of an event of default, or by the Association, in the event of a breach of this agreement by the Bank, upon giving the Bank 30 calendar days' prior written notice, or in all other circumstances, upon giving the Bank 120 days' prior written notice.

In 2011 the Association was subject to remedies associated with the covenants in the GFA due to not achieving minimum standards for return on assets, liquidity and adversely classified assets to risk funds. The Bank issued limited waivers to the GFA for 2011 related to not achieving these minimum standards subject to the Association meeting other designated conditions. In 2012, the Association was in compliance with all covenants of the GFA except for adverse assets to risk funds being 51.8 percent, in excess of 50 percent, but less than 75 percent, which is not considered an "event of default" of the GFA covenants as a Bank approved corrective action plan was in place. As of December 31, 2013, the Association was in compliance with all covenants of the GFA.

The liquidity policy of the Association is to manage cash balances, to maximize debt reduction and to increase accrual loan volume. This policy will continue to be pursued during 2014. As borrower payments are received, they are applied to the Association's note payable to the Bank.

The Association will continue to fund its operations through direct borrowings from the Bank, capital surplus from prior years and borrower stock. It is management's opinion that funds available to the Association are sufficient to fund its operations for the coming year.

## **Capital Resources:**

The Association's capital position remains strong, with total members' equity of \$48,194,243, \$45,108,003 and \$41,366,579 at December 31, 2013, 2012 and 2011, respectively. Under regulations governing minimum permanent capital adequacy and other capitalization issues, the Association is required to maintain a minimum adjusted permanent capital of 7.0 percent of risk-adjusted assets as defined by the FCA. The permanent capital ratio measures available at-risk capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the institution's financial capacity to absorb potential losses beyond that provided in the allowance for loss accounts. The Association's permanent capital ratio at December 31, 2013, 2012 and 2011 was 20.9 percent, 19.1 percent and 15.8 percent, respectively. The core surplus ratio measures available core surplus capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the quality of capital that exists to maintain stable earnings and financial strength. The Association's core surplus ratio at December 31, 2013, 2012 and 2011 was 20.4 percent, 18.7 percent and 15.4 percent, respectively, which is in compliance with the FCA's minimum ratio requirement of 3.5 percent. The total surplus ratio measures available surplus capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the reserves existing to protect borrowers' investments in the Association. The Association's total surplus ratio at December 31, 2013, 2012 and 2011 was 20.4 percent, 18.7 percent and 15.4 percent, respectively, which is in compliance with the FCA's minimum ratio requirement of 7.0 percent.

In 2013, 2012 and 2011, the Association paid patronage of \$1,000,000, \$300,000 and \$0, respectively. See Note 9 to the consolidated financial statements, "Members' Equity," included in this annual report, for further information.

## **Relationship With the Bank:**

The Association's statutory obligation to borrow only from the Bank is discussed in Note 8 to the consolidated financial statements, "Note Payable to the Bank," included in this annual report.

The Bank's ability to access capital of the Association is discussed in Note 2 to the consolidated financial statements, "Summary of Significant Accounting Policies," included in this annual report, within the section "Capital Stock Investment in the Farm Credit Bank of Texas."

The Bank's role in mitigating the Association's exposure to interest rate risk is described in the section "Liquidity and Funding Sources" of Management's Discussion and Analysis and in Note 8 to the consolidated financial statements, "Note Payable to the Bank," included in this annual report.

The Bank provides computer systems to support the critical operations of all District associations. In addition, each Association has operating systems and facility-based systems that are not supported by the Bank. As disclosed in Note 12 to the consolidated financial statements, "Related Party Transactions," included in this annual report, the Bank provides many services that the Association can utilize, such as administrative, marketing, information systems and accounting services. Additionally, the Bank bills District expenses to the associations, such as the Farm Credit System Insurance Corporation insurance premiums. As of April 2011, the Bank only bills associations for direct pass-through expenses and no longer bills for allocated expenses.

## **Summary:**

Over the past 97 years, regardless of the state of the agricultural economy, your Association's board of directors and management, as well as the board of directors and management of the Bank, have been committed to offering their borrowers a ready source of financing at a competitive price.



## Independent Auditor's Report

To the Board of Directors and Members of  
Legacy Ag Credit, ACA:

We have audited the accompanying consolidated financial statements of Legacy Ag Credit, ACA and its subsidiaries (the Association), which comprise the consolidated balance sheets as of December 31, 2013, 2012 and 2011, and the related consolidated statements of comprehensive income, of changes in members' equity and of 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 Legacy Ag Credit, ACA and its subsidiaries at December 31, 2013, 2012 and 2011, 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 7, 2014

**LEGACY AG CREDIT, ACA**

**CONSOLIDATED BALANCE SHEET**

	December 31,		
	2013	2012	2011
<b><u>Assets</u></b>			
Cash	\$ 83,987	\$ 83,981	\$ 88,115
Loans	216,168,241	212,343,402	216,045,218
Less: allowance for loan losses	3,299,523	3,269,104	5,787,913
Net loans	212,868,718	209,074,298	210,257,305
Accrued interest receivable	1,174,518	1,289,288	1,409,584
Investment in and receivable from the Farm			
Credit Bank of Texas:			
Capital stock	3,398,855	3,514,195	3,974,680
Other	837,026	673,863	517,370
Other property owned, net	787,368	3,956,869	5,112,615
Premises and equipment	584,179	634,284	597,750
Other assets	118,073	102,271	128,619
Total assets	<b>\$ 219,852,724</b>	<b>\$ 219,329,049</b>	<b>\$ 222,086,038</b>
<b><u>Liabilities</u></b>			
Note payable to the Farm Credit Bank of Texas	\$ 169,229,588	\$ 172,960,131	\$ 179,552,956
Advance conditional payments	4,323	1,690	1,203
Accrued interest payable	303,766	341,626	457,633
Drafts outstanding	1,282,129	231,371	84,403
Dividends payable	-	-	4,315
Other liabilities	838,675	686,228	618,949
Total liabilities	<b>171,658,481</b>	<b>174,221,046</b>	<b>180,719,459</b>
<b><u>Members' Equity</u></b>			
Capital stock and participation certificates	1,021,690	997,825	1,016,900
Unallocated retained earnings	46,935,078	44,020,044	40,193,795
Accumulated other comprehensive income	237,475	90,134	155,884
Total members' equity	<b>48,194,243</b>	<b>45,108,003</b>	<b>41,366,579</b>
Total liabilities and members' equity	<b>\$ 219,852,724</b>	<b>\$ 219,329,049</b>	<b>\$ 222,086,038</b>

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

**LEGACY AG CREDIT, ACA**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	Year Ended December 31,		
	2013	2012	2011
<b><u>Interest Income</u></b>			
Loans	\$ 11,406,892	\$ 11,853,236	\$ 12,454,809
<b><u>Interest Expense</u></b>			
Note payable to the Farm Credit Bank of Texas	3,622,748	4,536,190	6,126,992
Advance conditional payments	47	8	688
Total interest expense	3,622,795	4,536,198	6,127,680
Net interest income	7,784,097	7,317,038	6,327,129
<b><u>Provision for Loan Losses (Loan Loss Reversal)</u></b>			
Net interest income after provision for losses (loan loss reversal)	7,019,249	(712,551)	713,453
<b><u>Noninterest Income</u></b>			
Income from the Farm Credit Bank of Texas:			
Patronage income	825,845	850,371	963,025
Loan fees	125,499	182,709	123,541
Refunds from Farm Credit System Insurance Corporation	-	271,076	-
Financially related services income	556	563	717
Gain on other property owned, net	285,334	4,210	-
Gain on sale of loans	77,871	159,761	-
Other noninterest income	31,262	27,525	14,964
Total noninterest income	1,346,367	1,496,215	1,102,247
<b><u>Noninterest Expenses</u></b>			
Salaries and employee benefits	2,608,109	2,638,619	2,108,303
Directors' expense	239,701	222,394	173,620
Purchased services	409,624	427,793	543,520
Travel	220,957	177,973	148,827
Occupancy and equipment	229,107	205,122	163,004
Communications	62,268	46,116	38,091
Advertising	122,807	101,283	40,391
Public and member relations	96,374	77,416	35,189
Supervisory and exam expense	94,901	118,100	146,179
Insurance Fund premiums	210,305	151,122	196,011
Provision for other property owned	72,485	1,143,859	371,123
Loss on other property owned, net	-	-	264,952
Loss on sale of premises and equipment, net	309	3,901	-
Other noninterest expense	83,635	85,857	191,690
Total noninterest expenses	4,450,582	5,399,555	4,420,900
<b>NET INCOME</b>	<b>3,915,034</b>	<b>4,126,249</b>	<b>2,295,023</b>
Other comprehensive income:			
Change in postretirement benefit plans	147,341	(65,750)	(48,934)
<b>COMPREHENSIVE INCOME</b>	<b>\$ 4,062,375</b>	<b>\$ 4,060,499</b>	<b>\$ 2,246,089</b>

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

**LEGACY AG CREDIT, ACA**

**CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY**

	<b>Capital Stock/ Participation Certificates</b>	<b>Retained Earnings Unallocated</b>	<b>Accumulated Other Comprehensive Income</b>	<b>Total Members' Equity</b>
Balance at December 31, 2010	\$ 1,121,985	\$ 37,898,772	\$ 204,818	\$ 39,225,575
Comprehensive income	-	2,295,023	(48,934)	2,246,089
Capital stock/participation certificates issued	55,885	-	-	55,885
Capital stock/participation certificates and allocated retained earnings retired	(160,970)	-	-	(160,970)
Balance at December 31, 2011	1,016,900	40,193,795	155,884	41,366,579
Comprehensive income	-	4,126,249	(65,750)	4,060,499
Capital stock/participation certificates issued	99,380	-	-	99,380
Capital stock/participation certificates and allocated retained earnings retired	(118,455)	-	-	(118,455)
Patronage declared	-	(300,000)	-	(300,000)
Balance at December 31, 2012	997,825	44,020,044	90,134	45,108,003
Comprehensive income	-	3,915,034	147,341	4,062,375
Capital stock/participation certificates issued	138,990	-	-	138,990
Capital stock/participation certificates and allocated retained earnings retired	(115,125)	-	-	(115,125)
Patronage declared	-	(1,000,000)	-	(1,000,000)
<b>Balance at December 31, 2013</b>	<b>\$ 1,021,690</b>	<b>\$ 46,935,078</b>	<b>\$ 237,475</b>	<b>\$ 48,194,243</b>

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



**LEGACY AG CREDIT, ACA**

**CONSOLIDATED STATEMENT OF CASH FLOWS**

	Year Ended December 31,		
	2013	2012	2011
<b>Cash flows from operating activities:</b>			
Net income	\$ 3,915,034	\$ 4,126,249	\$ 2,295,023
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses or (loan loss reversal)	764,848	(712,551)	713,453
Provision for other property owned, net	72,485	1,143,859	371,123
(Gain) loss on other property owned, net	(285,334)	(4,210)	264,952
Gain on sale of loans, net	(77,871)	(159,761)	-
Depreciation	179,795	72,828	99,649
Loss on sale of premises and equipment, net	309	3,901	-
Decrease in accrued interest receivable	114,770	120,296	191,531
(Increase) decrease in other receivables from the Farm Credit Bank of Texas	(163,163)	(156,493)	1,115,851
(Increase) decrease in other assets	(15,802)	26,348	251,719
Decrease in accrued interest payable	(37,860)	(116,007)	(136,467)
Increase in other liabilities	299,788	1,529	10,190
Net cash provided by operating activities	<u>4,766,999</u>	<u>4,345,988</u>	<u>5,177,024</u>
<b>Cash flows from investing activities:</b>			
(Increase) decrease in loans, net	(5,083,469)	(1,194,197)	24,133,886
Cash recoveries of loans previously charged off	12,300	233,644	173,896
Proceeds from redemption of investment in the Farm Credit Bank of Texas	115,340	460,485	770,895
Purchases of premises and equipment	(63,759)	(174,542)	(147,707)
Proceeds from sales of premises and equipment	-	31,800	-
Proceeds from sales of other property owned	3,905,882	3,061,448	2,825,874
Net cash (used in) provided by investing activities	<u>(1,113,706)</u>	<u>2,418,638</u>	<u>27,756,844</u>

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

**LEGACY AG CREDIT, ACA**

**CONSOLIDATED STATEMENT OF CASH FLOWS**

	Year Ended December 31,		
	2013	2012	2011
<b>Cash flows from financing activities:</b>			
Net repayment of note payable to the Farm Credit Bank of Texas	(3,730,543)	(6,592,825)	(32,852,007)
Increase in drafts outstanding	1,050,758	146,968	47,965
Increase in advance conditional payments	2,633	487	-
Issuance of capital stock and participation certificates	138,990	99,380	55,885
Retirement of capital stock and participation certificates	(115,125)	(118,455)	(160,970)
Cash patronage distributions	(1,000,000)	(304,315)	-
Net cash used in financing activities	(3,653,287)	(6,768,760)	(32,909,127)
Net increase (decrease) in cash	6	(4,134)	24,741
Cash at the beginning of the year	83,981	88,115	63,374
Cash at the end of the year	\$ 83,987	\$ 83,981	\$ 88,115

**Supplemental schedule of noncash investing and financing activities:**

Loans transferred to other property owned	\$ 1,167,664	\$ 2,925,222	\$ 4,765,675
Loans charged off	746,729	2,039,902	5,494,971

**Supplemental cash information:**

Cash paid during the year for:			
Interest	\$ 3,737,565	\$ 4,652,205	\$ 6,264,147

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

**LEGACY AG CREDIT, ACA**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 — ORGANIZATION AND OPERATIONS:**

- A. Organization: Legacy Ag Credit, ACA, including its wholly-owned subsidiaries, Legacy, PCA and Legacy Land Bank, FLCA (collectively called “the Association”), is a member-owned cooperative which provides credit and credit-related services to, or for the benefit of, eligible borrowers/stockholders for qualified agricultural purposes in the counties of Franklin, Gregg, Harrison, Hopkins, Kaufman, Marion, Rains, Upshur, Van Zandt and Wood in the state of Texas.

The Association is a lending institution of the Farm Credit System (System), a nationwide system of cooperatively owned Banks and associations that was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (Act). At December 31, 2013, the System consisted of three Farm Credit Banks (FCBs) and their affiliated associations, one Agricultural Credit Bank (ACB) and its affiliated associations, the Federal Farm Credit Banks Funding Corporation (Funding Corporation), and various service and other organizations.

The Farm Credit Bank of Texas (Bank) and its related associations are collectively referred to as the “District.” The Bank provides funding to all associations within the District and is responsible for supervising certain activities of the District associations. At December 31, 2013, the District consisted of the Bank, one FLCA and 16 ACA parent companies, which have two wholly-owned subsidiaries, a FLCA and a PCA, operating in or servicing the states of Alabama, Louisiana, Mississippi, New Mexico and Texas. ACA parent companies provide financing and related services through their FLCA and PCA subsidiaries. The FLCA makes secured long-term agricultural real estate and rural home mortgage loans. The PCA makes short- and intermediate-term loans for agricultural production or operating purposes.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System Banks and associations. The FCA examines the activities of System associations to ensure their compliance with the Farm Credit Act, FCA regulations, and safe and sound Banking practices.

The Act established the Farm Credit System Insurance Corporation (FCSIC) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations, (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for the discretionary uses by the FCSIC of providing assistance to certain troubled System institutions and to cover the operating expenses of the FCSIC. Each System Bank has been required to pay premiums, which may be passed on to the Association, into the Insurance Fund, based on its annual average adjusted outstanding insured debt until the monies in the Insurance Fund reach the “secure base amount,” which is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments) or other such percentage of the aggregate obligations as the FCSIC in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the FCSIC is required to reduce premiums as necessary to maintain the Insurance Fund at the 2 percent level. As required by the Farm Credit Act, as amended, the FCSIC may return excess funds above the secure base amount to System institutions.

FCA regulations require borrower information to be held in strict confidence by Farm Credit institutions, their directors, officers and employees. Directors and employees of the Farm Credit institutions are prohibited, except under specified circumstances, from disclosing nonpublic personal information about members.

- B. Operations: The Act sets forth the types of authorized lending activity, persons eligible to borrow and financial services that can be offered by the Association. The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents and farm-related businesses. The Association makes and services short- and intermediate-term loans for agricultural production or operating purposes, and secured long-term real estate mortgage loans, with funding from the Bank.

The Association also serves as an intermediary in offering credit life insurance and multi-peril crop insurance.

The Association’s financial condition may be affected by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect stockholders’ investments in the Association. Upon request, stockholders of the Association will be provided with the Farm Credit Bank of Texas and District associations’ Annual Report to Stockholders,

which includes the combined financial statements of the Bank and all of the District associations. The District's annual report discusses the material aspects of the financial condition, changes in financial condition, and results of operations for the Bank and the District. In addition, the District's annual report identifies favorable and unfavorable trends, significant events, uncertainties and the impact of activities of the Insurance Fund.

The lending and financial services offered by the Bank are described in Note 1, "Organization and Operations," of the District's annual report to stockholders.

## **NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:**

The accounting and reporting policies of the Association conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the Banking industry. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results could differ from those estimates. Certain amounts in prior years' consolidated financial statements have been reclassified to conform to current financial statement presentation. The consolidated financial statements include the accounts of Legacy, PCA and Legacy Land Bank, FLCA. All significant intercompany transactions have been eliminated in consolidation.

### **A. Recently Issued or Adopted Accounting Pronouncements:**

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

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

- B. Cash and Cash Equivalents:** Cash and cash equivalents, as included in the statement of cash flows, represent cash on hand and on deposit at local banks.
- C. Loans and Allowance for Loan Losses:** Long-term real estate mortgage loans generally have original maturities ranging from five to 40 years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less. Loans are carried at their principal amount outstanding adjusted for charge-offs and deferred loan fees or costs. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. Authoritative accounting guidance requires loan origination fees and direct loan origination costs, if material, to be capitalized and the net fee or cost to be amortized over the life of the related loan as an adjustment to yield.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms of the loan and are generally considered substandard or doubtful, which is in accordance with the loan rating model, as described below. Impaired loans include nonaccrual loans, restructured loans, and loans past due 90 days or more and still accruing interest. A loan is considered contractually past due when any principal repayment or interest payment required by the loan instrument is not received on or before the due date. A loan shall remain contractually past due until it is formally restructured or until the entire amount past due, including principal, accrued interest and penalty interest incurred as a result of past-due status, is collected or otherwise discharged in full.

Impaired loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days (unless adequately secured and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt.

Additionally, all loans over 180 days past due are placed in nonaccrual status. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is either reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in prior years). Loans are charged off at the time they are determined to be uncollectible.

A restructured loan constitutes a troubled debt restructuring (TDR) if for economic or legal reasons related to the debtor's financial difficulties the Association grants a concession to the debtor that it would not otherwise consider. A concession is generally granted in order to minimize the Association's economic loss and avoid foreclosure. Concessions vary by program and are borrower-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. A loan restructured in a troubled debt restructuring is an impaired loan.

Payments received on nonaccrual loans are generally applied to the recorded investment in the loan asset. If collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it, the interest portion of payments is recognized as current interest income. Nonaccrual loans may be returned to accrual status when principal and interest are current, the borrower has demonstrated payment performance, there are no unrecovered prior charge-offs, and collection of future payments is no longer in doubt. If previously unrecognized interest income exists at the time the loan is transferred to accrual status, cash received at the time of or subsequent to the transfer is first recorded as interest income until such time as the recorded balance equals the contractual indebtedness of the borrower.

The Bank and related associations use a two-dimensional loan rating model based on an internally generated combined system risk-rating guidance that incorporates a 14-point risk-rating scale to identify and track the probability of borrower default and a separate scale addressing loss given default over a period of time. Probability of default is the probability that a borrower will experience a default within 12 months from the date of the determination of the risk rating. A default is considered to have occurred if the lender believes the borrower will not be able to pay its obligation in full or the borrower is past due more than 90 days. The loss given default is management's estimate as to the anticipated economic loss on a specific loan, assuming default has occurred or is expected to occur within the next 12 months.

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

The credit risk-rating methodology is a key component of the Association's allowance for loan losses evaluation, and is generally incorporated into its loan underwriting standards and internal lending limit. The allowance for loan losses is maintained at a level considered adequate by management to provide for probable losses inherent in the loan portfolio. The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition, collateral value, portfolio quality, current production conditions and economic conditions, and prior loan loss experience. Management considers the following factors in determining and supporting the level of allowance for loan losses: the concentration of lending in agriculture, combined with uncertainties associated with farmland values, commodity prices, exports, government assistance programs, regional economic effects and weather-related influences. The allowance for loan losses encompasses various judgments, evaluations and appraisals with respect to the loans and their underlying security that, by their nature, contain elements of uncertainty and imprecision. Changes in the agricultural economy and their impact on borrower repayment capacity will cause these various judgments, evaluations and appraisals to change over time. Accordingly, actual circumstances could vary significantly from the institutions' expectations and predictions of those circumstances.

The allowance for loan losses includes components for loans individually evaluated for impairment and loans collectively evaluated for impairment. Generally, for loans individually evaluated the allowance for loan losses represents the difference between the recorded investment in the loan and the present value of the cash flows expected to be collected discounted at the loan's effective interest rate, or at the fair value of the collateral, less estimated costs to sell, if the loan is collateral-dependent. For those loans collectively evaluated for impairment, the allowance for loan losses is determined using the risk-rating model.

- D. Capital Stock Investment in the Farm Credit Bank of Texas: The Association's investment in the Bank is in the form of Class A voting capital stock and allocated retained earnings. This investment is adjusted periodically based on the Association's proportional utilization of the Bank compared to other District associations. The Bank requires a minimum stock investment of

2 percent of the Association's average borrowing from the Bank. This investment is carried at cost plus allocated equities in the accompanying consolidated balance sheet.

If needed to meet regulatory capital adequacy requirements, the board of directors of the Bank may increase the percentage of stock held by an Association from 2 percent of the average outstanding balance of borrowings from the Bank to a maximum of 5 percent of the average outstanding balance of borrowings from the Bank.

- E. **Other Property Owned, Net:** Other property owned, net, consists 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 losses. On at least an annual basis, 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. Income and expenses from operations and carrying value adjustments are included in net gains (losses) on other property owned in the consolidated statements of comprehensive income.
- F. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. Depreciation is provided on the straight-line method using estimated useful lives of the assets. Gains and losses on dispositions are reflected in current operations. Maintenance and repairs are charged to operating expense, and improvements are capitalized.
- G. **Advance Conditional Payments:** The Association is authorized under the Act to accept advance payments from borrowers. To the extent that the borrower's access to such funds is restricted, the advance conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as liabilities in the accompanying consolidated balance sheet. Advance conditional payments are not insured. Interest is generally paid by the Association on such accounts at rates established by the board of directors.
- H. **Employee Benefit Plans:** Employees of the Association participate in either the District defined benefit retirement plan (DB Plan) or the defined contribution plan (DC Plan). All eligible employees may participate in the Farm Credit Benefits Alliance 401(k) Plan. Also, the Association sponsors a nonqualified defined contribution 401(k) plan. The DB Plan is closed to new participants. Participants generally include employees hired prior to January 1, 1996. The DB Plan is noncontributory and provides benefits based on salary and years of service. The "projected unit credit" actuarial method is used for financial reporting and funding purposes for the DB Plan.

Participants in the DC Plan generally include employees who elected to transfer from the DB Plan prior to January 1, 1996, and employees hired on or after January 1, 1996. Participants in the DC Plan direct the placement of their employers' contributions, 5.0 percent of eligible pay for the year ended December 31, 2013, made on their behalf into various investment alternatives.

The structure of the District's DB Plan is characterized as multi-employer, since neither the assets, liabilities nor costs of the plan are segregated or separately accounted for by the associations. No portion of any surplus assets is available to the associations, nor are the associations required to pay for plan liabilities upon withdrawal from the plans. As a result, the associations recognize as pension cost the required contribution to the plans for the year. Contributions due and unpaid are recognized as a liability. The Association recognized pension costs for the DC Plan of \$88,785, \$103,668 and \$76,042 for the years ended December 31, 2013, 2012 and 2011, respectively. For the DB Plan, the Association recognized pension costs of \$33,810, \$32,372 and \$96,228 for the years ended December 31, 2013, 2012 and 2011, respectively.

The Association also participates in the Farm Credit Benefits Alliance 401(k) Plan, which requires the associations to match 100 percent of employee contributions up to 3.0 percent of eligible earnings and to match 50 percent of employee contributions for the next 2.0 percent of employee contributions, up to a maximum employer contribution of 4.0 percent of eligible earnings. Association 401(k) plan costs are expensed as incurred. The Association's contributions to the 401(k) plan were \$68,435, \$76,895 and \$51,761 for the years ended December 31, 2013, 2012 and 2011, respectively.

In addition to the DB Plan, the DC Plan, and the Farm Credit Benefits Alliance 401(k) plans above, the Association sponsors a defined contribution supplemental retirement plan. This plan is a nonqualified 401(k) plan; however, to date no contributions to the plan have been made. Therefore, there are no associated liabilities included in the Association's balance sheet. Likewise, there have been no employee benefit costs related to the nonqualified plan included in the Association's consolidated statement of comprehensive income.

In addition to pension benefits, the Association provides certain health care and life insurance benefits to qualifying retired employees (other postretirement benefits). These benefits are not characterized as multi-employer and, consequently, the

liability for these benefits is included in other liabilities. For further information on the Association's employee benefit plans, see Note 11, "Employee Benefit Plans."

- I. **Income Taxes:** The ACA holding company conducts its business activities through two wholly-owned subsidiaries. Long-term mortgage lending activities are operated through the wholly-owned FLCA subsidiary, which is exempt from federal and state income tax. Short- and intermediate-term lending activities are operated through the wholly-owned PCA subsidiary. Operating expenses are allocated to each subsidiary based on estimated relative service. All significant transactions between the subsidiaries and the parent company have been eliminated in consolidation. The ACA, along with the PCA subsidiary, is subject to income tax. The Association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the Association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated retained earnings. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage refunds. The Association distributes patronage on the basis of book income. Deferred taxes are recorded on the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution and will therefore impact future tax payments. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (over 50 percent probability), based on management's estimate, that they will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of the Association's expected patronage program, which reduces taxable earnings.
- J. **Patronage Refunds From the Farm Credit Bank of Texas:** The Association records patronage refunds from the Bank on an accrual basis.
- K. **Fair Value Measurement:** The FASB guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. It 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 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury, other U.S. government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets. Also included in Level 1 are assets held in trust funds, which relate to deferred compensation and our supplemental retirement plan. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace. Pension plan assets that are invested in equity securities, including mutual funds and fixed-income securities that are actively traded, are also included in Level 1.

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: (a) quoted prices for similar assets or liabilities in active markets; (b) 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; (c) inputs other than quoted prices that are observable such as interest rates and yield curves, prepayment speeds, credit risks and default rates; and (d) inputs derived principally from or corroborated by observable market data by correlation or other means. This category generally includes certain U.S. government and agency mortgage-backed debt securities, corporate debt securities, and derivative contracts. Pension plan assets that are derived from observable inputs, including corporate bonds and mortgage-backed securities, are reported in Level 2.

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 are considered Level 3. These unobservable inputs reflect the reporting entity's 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. This category generally includes certain private equity investments, retained residual interests in securitizations, asset-backed securities, highly structured or long-term derivative contracts, certain loans and other property owned. Pension plan assets such as certain mortgage-backed securities that are supported by little or no market data in determining the fair value are included in Level 3.

The fair value disclosures are presented in Note 13, "Fair Value Measurements."

- L. **Off-balance-sheet credit exposures:** Commitments to extend credit are agreements to lend to customers, generally having fixed expiration dates or other termination clauses that may require payment of a fee. Commercial letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. These letters of credit are issued to facilitate commerce and typically result in the commitment being funded when the underlying transaction is consummated between the

customer and third party. The credit risk associated with commitments to extend credit and commercial letters of credit is essentially the same as that involved with extending loans to customers and is subject to normal credit policies. Collateral may be obtained based on management's assessment of the customer's creditworthiness.

**NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES:**

A summary of loans as of December 31 follows:

Loan Type	2013		2012		2011	
	Amount	%	Amount	%	Amount	%
Real estate mortgage	\$ 186,292,980	86.2%	\$ 184,136,993	86.8%	\$ 191,119,752	88.4%
Production and intermediate term	9,377,704	4.3%	7,312,162	3.4%	10,980,709	5.1%
Energy	7,565,963	3.5%	6,992,953	3.3%	3,810,508	1.8%
Agribusiness:						
Loans to cooperatives	-	0.0%	-	0.0%	12,736	0.0%
Processing and marketing	5,037,275	2.3%	8,040,305	3.8%	5,786,617	2.7%
Rural residential real estate	4,652,548	2.2%	2,431,042	1.1%	1,600,744	0.7%
Water and waste water	1,819,168	0.8%	1,853,165	0.9%	1,866,682	0.9%
Communication	1,422,603	0.7%	1,576,782	0.7%	867,470	0.4%
Total	\$ 216,168,241	100.0%	\$ 212,343,402	100.0%	\$ 216,045,218	100.0%

The Association may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration regulations. The following table presents information regarding participations purchased and sold as of December 31, 2013:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
	Real estate mortgage	\$ 2,919,361	\$ 1,098,215	\$ -	\$ -	\$ 2,919,361
Production and intermediate term	3,234,496	-	-	-	3,234,496	-
Agribusiness	5,037,275	-	-	-	5,037,275	-
Communication	1,422,603	-	-	-	1,422,603	-
Energy	7,503,351	-	-	-	7,503,351	-
Water and waste water	1,819,168	-	-	-	1,819,168	-
Total	\$ 21,936,254	\$ 1,098,215	\$ -	\$ -	\$ 21,936,254	\$ 1,098,215

Geographic Distribution:

County	2013	2012	2011
Van Zandt	18.3%	19.5%	19.5%
Hopkins	15.0%	16.9%	15.8%
Kaufman	11.9%	13.5%	13.6%
Wood	7.7%	8.7%	8.8%
Upshur	6.1%	7.6%	8.5%
Harrison	5.1%	5.7%	5.7%
Franklin	4.5%	4.7%	4.8%
Marion	1.7%	1.8%	1.7%
Rains	1.3%	0.6%	0.8%
Gregg	1.1%	1.2%	1.0%
Other	27.3%	19.8%	19.8%
<b>Totals</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

The Association's concentration of credit risk in various agricultural commodities is shown in the following table. While the amounts represent the Association's maximum potential credit risk as it relates to recorded loan principal, a substantial portion of the Association's lending activities is collateralized, and the Association's exposure to credit loss associated with lending activities



is reduced accordingly. An estimate of the Association's credit risk exposure is considered in the determination of the allowance for loan losses.

Portfolio Composition:

Operation/Commodity	2013		2012		2011	
	Amount	%	Amount	%	Amount	%
Livestock, except dairy and poultry	\$ 82,302,640	38.1%	\$ 77,354,201	36.4%	\$ 83,780,554	38.8%
Field crops except cash grains	34,373,413	15.9%	36,494,862	17.2%	35,667,066	16.5%
Poultry and eggs	21,673,277	10.0%	22,523,822	10.6%	24,742,561	11.5%
Timber	18,607,424	8.6%	16,041,683	7.6%	17,746,784	8.2%
Dairy farms	14,049,285	6.5%	18,063,216	8.5%	21,261,175	9.8%
Hunting, trapping and game propagation	8,700,621	4.0%	6,840,152	3.2%	6,222,880	2.9%
Electric services	7,004,478	3.2%	6,431,004	3.0%	3,245,657	1.5%
Real estate	6,149,207	2.8%	6,314,983	3.0%	6,314,983	2.9%
Animal specialties	3,937,959	1.8%	2,522,453	1.2%	2,616,403	1.2%
Rural home loans	2,730,896	1.3%	1,300,137	0.6%	1,212,018	0.6%
Food and kindred products	2,595,103	1.2%	3,471,430	1.6%	1,267,583	0.6%
Wholesale trade - nondurable goods	2,417,925	1.1%	902,469	0.4%	777,736	0.4%
Wheat	1,939,049	0.9%	2,000,000	1.0%	-	0.0%
Water Supply	1,819,168	0.9%	1,853,165	0.9%	1,848,101	0.9%
Agricultural services	1,612,860	0.7%	2,473,448	1.2%	2,376,344	1.1%
Communication	1,492,307	0.7%	1,579,004	0.7%	867,470	0.4%
Paper and allied products	1,113,918	0.6%	727,392	0.4%	506,174	0.2%
Chemical and allied products	942,764	0.4%	2,067,086	1.0%	2,132,860	1.0%
Cash grains	816,729	0.4%	185,375	0.1%	191,934	0.1%
Metal cans	532,348	0.3%	2,538,146	1.2%	2,544,709	1.2%
Bituminous coal and lignite mining	498,873	0.2%	498,603	0.2%	500,000	0.2%
Fruit and tree nuts	386,036	0.2%	-	0.0%	-	0.0%
General farms, primarily crops	332,616	0.2%	-	0.0%	-	0.0%
Horticultural specialties	55,428	0.0%	56,691	0.0%	57,881	0.0%
Vegetables and melons	50,357	0.0%	53,138	0.0%	108,866	0.0%
Trucking and courier services, except air	28,994	0.0%	50,942	0.0%	55,479	0.0%
Lumber and wood products, except furniture	4,566	0.0%	-	0.0%	-	0.0%
Total	<b>\$ 216,168,241</b>	<b>100.0%</b>	<b>\$ 212,343,402</b>	<b>100.0%</b>	<b>\$ 216,045,218</b>	<b>100.0%</b>

The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies but typically includes farmland and income-producing property, such as crops and livestock, as well as receivables. Long-term real estate loans are secured by the first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (or 97 percent if guaranteed by a government agency) of the property's appraised value. However, a decline in a property's market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the Association in the collateral, may result in the loan-to-value ratios in excess of the regulatory maximum.

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

	<b>December 31, 2013</b>	December 31, 2012	December 31, 2011
<b>Nonaccrual loans:</b>			
Real estate mortgage	\$ 3,799,919	\$ 5,553,086	\$ 16,154,404
Production and intermediate term	134,682	917,254	2,807,146
Agribusiness	-	1,078,545	-
Rural residential real estate	23,138	25,659	28,026
Total nonaccrual loans	<u>3,957,739</u>	<u>7,574,544</u>	<u>18,989,576</u>
<b>Accruing restructured loans:</b>			
Real estate mortgage	<u>3,440,598</u>	<u>3,832,732</u>	<u>1,014,795</u>
Total accruing restructured loans	<u>3,440,598</u>	<u>3,832,732</u>	<u>1,014,795</u>
<b>Accruing loans 90 days or more past due:</b>			
Production and intermediate term	-	-	4,434
Total accruing loans 90 days or more past due	<u>-</u>	<u>-</u>	<u>4,434</u>
Total nonperforming loans	<u>7,398,337</u>	11,407,276	20,008,805
Other property owned	<u>787,368</u>	<u>3,956,869</u>	<u>5,112,615</u>
Total nonperforming assets	<u>\$ 8,185,705</u>	<u>\$ 15,364,145</u>	<u>\$ 25,121,420</u>

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

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

The following table shows loans and related accrued interest classified under the Farm Credit Administration's Uniform Loan Classification System as a percentage of total loans and related accrued interest receivable by loan type as of December 31:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Real estate mortgage			
Acceptable	<b>78.1</b> %	68.2 %	64.8 %
OAEM	<b>14.9</b>	23.2	23.0
Substandard/doubtful	<b>7.0</b>	8.6	12.2
	<b>100.0</b>	100.0	100.0
Production and intermediate term			
Acceptable	<b>76.7</b>	72.0	51.7
OAEM	<b>1.0</b>	4.2	3.8
Substandard/doubtful	<b>22.3</b>	23.8	44.5
	<b>100.0</b>	100.0	100.0
Loans to cooperatives			
Acceptable	-	-	100.0
OAEM	-	-	-
Substandard/doubtful	-	-	-
	-	-	100.0
Processing and marketing			
Acceptable	<b>100.0</b>	86.6	80.7
OAEM	-	-	-
Substandard/doubtful	-	13.4	19.3
	<b>100.0</b>	100.0	100.0
Communication			
Acceptable	<b>100.0</b>	100.0	100.0
OAEM	-	-	-
Substandard/doubtful	-	-	-
	<b>100.0</b>	100.0	100.0
Energy			
Acceptable	<b>100.0</b>	100.0	100.0
OAEM	-	-	-
Substandard/doubtful	-	-	-
	<b>100.0</b>	100.0	100.0
Water and waste water			
Acceptable	<b>100.0</b>	100.0	100.0
OAEM	-	-	-
Substandard/doubtful	-	-	-
	<b>100.0</b>	100.0	100.0
Rural residential real estate			
Acceptable	<b>95.1</b>	87.2	79.6
OAEM	<b>4.4</b>	11.8	18.7
Substandard/doubtful	<b>0.5</b>	1.0	1.7
	<b>100.0</b>	100.0	100.0
Total Loans			
Acceptable	<b>80.1</b>	70.9	65.7
OAEM	<b>13.0</b>	20.4	20.9
Substandard/doubtful	<b>6.9</b>	8.7	13.4
	<b>100.0</b> %	100.0 %	100.0 %

The following tables provide an age analysis of past due loans (including accrued interest) as of December 31, 2013, 2012 and 2011:

December 31, 2013:	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or less than 30 Days Past Due	Total Loans	Recorded Investment >90 Days and Accruing
Real estate mortgage	\$ 2,013,580	\$ 171,498	\$ 2,185,078	\$ 185,218,833	\$ 187,403,911	\$ -
Production and intermediate term	-	-	-	9,419,070	9,419,070	-
Processing and marketing	-	-	-	5,039,375	5,039,375	-
Communication	-	-	-	1,422,762	1,422,762	-
Energy	-	-	-	7,573,872	7,573,872	-
Water and waste water	-	-	-	1,819,956	1,819,956	-
Rural residential real estate	-	-	-	4,663,813	4,663,813	-
<b>Total</b>	<b>\$ 2,013,580</b>	<b>\$ 171,498</b>	<b>\$ 2,185,078</b>	<b>\$ 215,157,681</b>	<b>\$ 217,342,759</b>	<b>\$ -</b>

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	Recorded Investment >90 Days and Accruing
Real estate mortgage	\$ 1,693,968	\$ 390,127	\$ 2,084,095	\$ 183,223,167	\$ 185,307,262	\$ -
Production and intermediate term	239,361	-	239,361	7,116,833	7,356,194	-
Processing and marketing	-	1,049,056	1,049,056	6,994,728	8,043,784	-
Communication	-	-	-	1,577,039	1,577,039	-
Energy	-	-	-	7,057,654	7,057,654	-
Water and waste water	-	-	-	1,853,926	1,853,926	-
Rural residential real estate	-	-	-	2,436,831	2,436,831	-
<b>Total</b>	<b>\$ 1,933,329</b>	<b>\$ 1,439,183</b>	<b>\$ 3,372,512</b>	<b>\$ 210,260,178</b>	<b>\$ 213,632,690</b>	<b>\$ -</b>

December 31, 2011:	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or less than 30 Days Past Due	Total Loans	Recorded Investment >90 Days and Accruing
Real estate mortgage	\$ 2,767,314	\$ 1,401,792	\$ 4,169,106	\$ 188,236,657	\$ 192,405,763	\$ -
Production and intermediate term	871,131	177,198	1,048,329	9,997,206	11,045,535	4,434
Loans to cooperatives	-	-	-	12,904	12,904	-
Processing and marketing	-	-	-	5,790,981	5,790,981	-
Communication	-	-	-	867,777	867,777	-
Energy	-	-	-	3,854,634	3,854,634	-
Water and waste water	-	-	-	1,872,124	1,872,124	-
Rural residential real estate	-	-	-	1,605,084	1,605,084	-
<b>Total</b>	<b>\$ 3,638,445</b>	<b>\$ 1,578,990</b>	<b>\$ 5,217,435</b>	<b>\$ 212,237,367</b>	<b>\$ 217,454,802</b>	<b>\$ 4,434</b>

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

A restructuring of a debt constitutes a troubled debt restructuring if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Troubled debt restructurings are undertaken in order to improve the likelihood of recovery on the loan and may include, but are not limited to, forgiveness of principal or interest, interest rate reductions that are lower than the current market rate for new debt with similar risk, or significant term or payment extensions.

As of December 31, 2013, the total recorded investment of troubled debt restructured loans was \$3,506,694 including \$66,096 classified as nonaccrual and \$3,440,598 classified as accrual, with specific allowance for loan losses of \$657,229. The specific allowance is determined quarterly through a net realizable value analysis for each individual loan asset. As of December 31, 2013, there were no commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring.

The following tables present additional information regarding troubled debt restructurings, which includes both accrual and nonaccrual loans with troubled debt restructuring designation, that occurred during the years ended December 31, 2013, 2012 and 2011. The pre-modification outstanding recorded investment represents the recorded investment of the loans as of the quarter end prior to the restructuring. The post-modification outstanding recorded investment represents the recorded investment of the loans as of the quarter end the restructuring occurred.

<b>March 31, 2013:</b>	<b>Pre-modification Outstanding Recorded Investment</b>	<b>Post-modification Outstanding Recorded Investment</b>
<b>Troubled debt restructurings:</b>		
<b>Production and intermediate term*</b>	<b>\$ 58,745</b>	<b>\$ 60,246</b>
<b>Total</b>	<b>\$ 58,745</b>	<b>\$ 60,246</b>

\* Loans were paid off during the second quarter of 2013.

December 31, 2012:	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
<b>Troubled debt restructurings:</b>		
Real estate mortgage	\$ 501,378	\$ 426,132
<b>Total</b>	<b>\$ 501,378</b>	<b>\$ 426,132</b>

December 31, 2011:	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
<b>Troubled debt restructurings:</b>		
Real estate mortgage	\$ 5,689,747	\$ 4,651,264
Production and intermediate term	2,186,236	1,334,790
<b>Total</b>	<b>\$ 7,875,983</b>	<b>\$ 5,986,054</b>

In restructurings where principal is forgiven, the amount of the forgiveness is immediately charged off. In restructurings where accrued interest is forgiven, the interest is reversed (if current year interest) or charged off (if prior year interest).

The predominant form of concession granted for troubled debt restructuring includes principal and interest reduction. Other types of modifications include extension of the term and delayed payments, among others. At times these terms might be offset with incremental payments, collateral or new borrower guarantees, in which case the Association assesses all of the modified terms to determine if the overall modification qualifies as a troubled debt restructuring.

The following table presents information regarding loans that met the accounting criteria as a troubled debt restructuring and that occurred within the previous 12 months of that year and for which there was a payment default during the period. There were no loans in 2013 or 2012 that met the accounting criteria as a troubled debt restructuring and that occurred within the previous 12 months of that year and for which there was a payment default during the period. A payment default is defined as a payment that is 30 days past due after the date the loan was restructured.

Troubled debt restructurings that subsequently defaulted:	Recorded Investment at December 31, 2011
Real estate mortgage	\$ 150,000
Production and intermediate term	68,094
<b>Total</b>	<b>\$ 218,094</b>

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

	Loans Modified as TDRs		
	December 31, 2013	December 31, 2012	December 31, 2011
Troubled debt restructurings:			
Real estate mortgage	\$ 3,506,694	\$ 3,904,062	\$ 3,802,997
Production and intermediate term	-	451,176	1,195,776
<b>Total</b>	<b>\$ 3,506,694</b>	<b>\$ 4,355,238</b>	<b>\$ 4,998,773</b>
	TDRs on Nonaccrual Status*		
	December 31, 2013	December 31, 2012	December 31, 2011
Troubled debt restructurings:			
Real estate mortgage	\$ 66,096	\$ 71,330	\$ 2,788,202
Production and intermediate term	-	451,176	1,195,776
<b>Total</b>	<b>\$ 66,096</b>	<b>\$ 522,506</b>	<b>\$ 3,983,978</b>

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

Additional impaired loan information is as follows:

	Recorded Investment at 12/31/2013	Unpaid Principal Balance <sup>a</sup>	Related Allowance	Average Impaired Loans	Interest Income Recognized
<b>Impaired loans with a related allowance for credit losses:</b>					
Real estate mortgage	\$ 3,581,383	\$ 3,581,383	\$ 811,407	\$ 3,090,783	\$ 198,463
Production and intermediate term	122,739	131,320	73,196	145,145	5,398
<b>Total</b>	<b>\$ 3,704,122</b>	<b>\$ 3,712,703</b>	<b>\$ 884,603</b>	<b>\$ 3,235,928</b>	<b>\$ 203,861</b>
<b>Impaired loans with no related allowance for credit losses:</b>					
Real estate mortgage	\$ 3,659,134	\$ 3,672,081	\$ -	\$ 3,691,829	\$ 114,649
Production and intermediate term	11,943	2,958,603	-	3,429	136,955
Rural residential real estate	23,138	23,200	-	24,310	-
<b>Total</b>	<b>\$ 3,694,215</b>	<b>\$ 6,653,884</b>	<b>\$ -</b>	<b>\$ 3,719,568</b>	<b>\$ 251,604</b>
<b>Total impaired loans:</b>					
Real estate mortgage	\$ 7,240,517	\$ 7,253,464	\$ 811,407	\$ 6,782,612	\$ 313,112
Production and intermediate term	134,682	3,089,923	73,196	148,574	142,353
Rural residential real estate	23,138	23,200	-	24,310	-
<b>Total</b>	<b>\$ 7,398,337</b>	<b>\$ 10,366,587</b>	<b>\$ 884,603</b>	<b>\$ 6,955,496</b>	<b>\$ 455,465</b>

	Recorded Investment at 12/31/2012	Unpaid Principal Balance <sup>a</sup>	Related Allowance	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:					
Real estate mortgage	\$ 5,284,921	\$ 5,304,271	\$ 890,563	\$ 5,161,924	\$ 51,453
Production and intermediate term	294,024	297,959	96,421	248,983	3,879
Processing and marketing	570,541	570,541	334,336	448,950	-
Total	<u>\$ 6,149,486</u>	<u>\$ 6,172,771</u>	<u>\$ 1,321,320</u>	<u>\$ 5,859,857</u>	<u>\$ 55,332</u>
Impaired loans with no related allowance for credit losses:					
Real estate mortgage	\$ 4,100,896	\$ 4,104,401	\$ -	\$ 4,133,953	\$ 110,537
Production and intermediate term	623,231	3,603,907	-	901,236	30,665
Processing and marketing	508,004	508,004	-	399,741	-
Rural residential real estate	25,659	25,721	-	26,891	-
Total	<u>\$ 5,257,790</u>	<u>\$ 8,242,033</u>	<u>\$ -</u>	<u>\$ 5,461,821</u>	<u>\$ 141,202</u>
Total impaired loans:					
Real estate mortgage	\$ 9,385,817	\$ 9,408,672	\$ 890,563	\$ 9,295,877	\$ 161,990
Production and intermediate term	917,255	3,901,866	96,421	1,150,219	34,544
Processing and marketing	1,078,545	1,078,545	334,336	848,691	-
Rural residential real estate	25,659	25,721	-	26,891	-
Total	<u>\$ 11,407,276</u>	<u>\$ 14,414,804</u>	<u>\$ 1,321,320</u>	<u>\$ 11,321,678</u>	<u>\$ 196,534</u>
	Recorded Investment at 12/31/2011	Unpaid Principal Balance <sup>a</sup>	Related Allowance	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:					
Real estate mortgage	\$ 8,788,955	\$ 10,196,149	\$ 3,077,792	\$ 8,479,558	\$ 14,802
Production and intermediate term	256,397	1,010,198	173,484	214,154	7,858
Total	<u>\$ 9,045,352</u>	<u>\$ 11,206,347</u>	<u>\$ 3,251,276</u>	<u>\$ 8,693,712</u>	<u>\$ 22,660</u>
Impaired loans with no related allowance for credit losses:					
Real estate mortgage	\$ 8,380,245	\$ 8,501,034	\$ -	\$ 8,322,323	\$ 529,135
Production and intermediate term	2,555,182	6,090,618	-	2,603,682	1,527
Rural residential real estate	28,026	28,035	-	29,423	-
Total	<u>\$ 10,963,453</u>	<u>\$ 14,619,687</u>	<u>\$ -</u>	<u>\$ 10,955,428</u>	<u>\$ 530,662</u>
Total impaired loans:					
Real estate mortgage	\$ 17,169,200	\$ 18,697,183	\$ 3,077,792	\$ 16,801,881	\$ 543,937
Production and intermediate term	2,811,579	7,100,816	173,484	2,817,836	9,385
Rural residential real estate	28,026	28,035	-	29,423	-
Total	<u>\$ 20,008,805</u>	<u>\$ 25,826,034</u>	<u>\$ 3,251,276</u>	<u>\$ 19,649,140</u>	<u>\$ 553,322</u>

<sup>a</sup>Unpaid principal balance represents the contractual obligations of the loans.

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2013, 2012 and 2011.

Interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans at December 31:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Interest income which would have been recognized under the original terms	\$ 785,227	\$ 848,793	\$ 2,649,897
Less: interest income recognized	<u>(455,465)</u>	<u>(196,534)</u>	<u>(553,322)</u>
Foregone interest income	<u>\$ 329,762</u>	<u>\$ 652,259</u>	<u>\$ 2,096,575</u>

A summary of the changes in the allowance for credit losses and the ending balance of loans outstanding are as follows:

	<u>Real Estate Mortgage</u>	<u>Production and Intermediate Term</u>	<u>Agribusiness</u>	<u>Communication</u>	<u>Energy</u>	<u>Water and Waste Water</u>	<u>Rural Residential Real Estate</u>	<u>Loans to Cooperatives</u>	<u>Total</u>
<b>Allowance for Credit Losses:</b>									
Balance at									
December 31, 2012	\$ 2,668,962	\$ 223,875	\$ 341,542	\$ 3,312	\$ 16,014	\$ 11,015	\$ 4,384	\$ -	\$ 3,269,104
Charge-offs	(412,618)	-	(334,111)	-	-	-	-	-	(746,729)
Recoveries	-	12,300	-	-	-	-	-	-	12,300
Provision for loan losses	738,683	16,629	(1,152)	(248)	9,831	(696)	1,801	-	764,848
Balance at									
December 31, 2013	<u>\$ 2,995,027</u>	<u>\$ 252,804</u>	<u>\$ 6,279</u>	<u>\$ 3,064</u>	<u>\$ 25,845</u>	<u>\$ 10,319</u>	<u>\$ 6,185</u>	<u>\$ -</u>	<u>\$ 3,299,523</u>
Ending Balance: individually evaluated for impairment	<u>\$ 811,407</u>	<u>\$ 73,196</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 884,603</u>
Ending Balance: collectively evaluated for impairment	<u>\$ 2,183,620</u>	<u>\$ 179,608</u>	<u>\$ 6,279</u>	<u>\$ 3,064</u>	<u>\$ 25,845</u>	<u>\$ 10,319</u>	<u>\$ 6,185</u>	<u>\$ -</u>	<u>\$ 2,414,920</u>
<b>Recorded Investment in Loans Outstanding:</b>									
Ending Balance at									
December 31, 2013	<u>\$187,403,911</u>	<u>\$ 9,419,070</u>	<u>\$ 5,039,375</u>	<u>\$ 1,422,762</u>	<u>\$ 7,573,872</u>	<u>\$ 1,819,956</u>	<u>\$ 4,663,813</u>	<u>\$ -</u>	<u>\$ 217,342,759</u>
Ending balance for loans individually evaluated for impairment	<u>\$ 7,240,517</u>	<u>\$ 134,682</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 23,138</u>	<u>\$ -</u>	<u>\$ 7,398,337</u>
Ending balance for loans collectively evaluated for impairment	<u>\$180,163,394</u>	<u>\$ 9,284,388</u>	<u>\$ 5,039,375</u>	<u>\$ 1,422,762</u>	<u>\$ 7,573,872</u>	<u>\$ 1,819,956</u>	<u>\$ 4,640,675</u>	<u>\$ -</u>	<u>\$ 209,944,422</u>



	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communication	Energy	Water and Waste Water	Rural Residential Real Estate	Loans to Cooperatives	Total
<b>Allowance for Credit Losses:</b>									
Balance at									
December 31, 2011	\$ 5,125,016	\$ 603,133	\$ 35,874	\$ 1,006	\$ 8,375	\$ 11,015	\$ 3,464	\$ 30	\$ 5,787,913
Charge-offs	(1,915,205)	(124,697)	-	-	-	-	-	-	(2,039,902)
Recoveries	200	233,444	-	-	-	-	-	-	233,644
Provision for loan losses	(541,049)	(488,005)	305,668	2,306	7,639	-	920	(30)	(712,551)
Balance at									
December 31, 2012	<u>\$ 2,668,962</u>	<u>\$ 223,875</u>	<u>\$ 341,542</u>	<u>\$ 3,312</u>	<u>\$ 16,014</u>	<u>\$ 11,015</u>	<u>\$ 4,384</u>	<u>\$ -</u>	<u>\$ 3,269,104</u>

Ending Balance: individually evaluated for impairment	<u>\$ 890,563</u>	<u>\$ 96,421</u>	<u>\$ 334,336</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,321,320</u>
Ending Balance: collectively evaluated for impairment	<u>\$ 1,778,399</u>	<u>\$ 127,454</u>	<u>\$ 7,206</u>	<u>\$ 3,312</u>	<u>\$ 16,014</u>	<u>\$ 11,015</u>	<u>\$ 4,384</u>	<u>\$ -</u>	<u>\$ 1,947,784</u>

**Recorded Investment  
in Loans Outstanding:**

Ending Balance at									
December 31, 2012	<u>\$185,307,262</u>	<u>\$ 7,356,194</u>	<u>\$ 8,043,784</u>	<u>\$ 1,577,039</u>	<u>\$ 7,057,654</u>	<u>\$ 1,853,926</u>	<u>\$ 2,436,831</u>	<u>\$ -</u>	<u>\$ 213,632,690</u>
Ending balance for loans individually evaluated for impairment	<u>\$ 9,385,817</u>	<u>\$ 917,255</u>	<u>\$ 1,078,545</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 25,659</u>	<u>\$ -</u>	<u>\$ 11,407,276</u>
Ending balance for loans collectively evaluated for impairment	<u>\$175,921,445</u>	<u>\$ 6,438,939</u>	<u>\$ 6,965,239</u>	<u>\$ 1,577,039</u>	<u>\$ 7,057,654</u>	<u>\$ 1,853,926</u>	<u>\$ 2,411,172</u>	<u>\$ -</u>	<u>\$ 202,225,414</u>

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communication	Energy	Water and Waste Water	Rural Residential Real Estate	Loans to Cooperatives	Total
<b>Allowance for Credit Losses:</b>									
Balance at									
December 31, 2010	\$ 5,843,908	\$ 4,471,835	\$ 75,658	\$ -	\$ -	\$ -	\$ 4,134	\$ -	\$ 10,395,535
Charge-offs	(2,860,369)	(2,633,648)	-	-	-	-	(954)	-	(5,494,971)
Recoveries	25,250	147,692	-	-	-	-	954	-	173,896
Provision for loan losses	2,116,227	(1,382,746)	(39,754)	1,006	8,375	11,015	(670)	-	713,453
Balance at									
December 31, 2011	<u>\$ 5,125,016</u>	<u>\$ 603,133</u>	<u>\$ 35,904</u>	<u>\$ 1,006</u>	<u>\$ 8,375</u>	<u>\$ 11,015</u>	<u>\$ 3,464</u>	<u>\$ -</u>	<u>\$ 5,787,913</u>

Ending Balance: individually evaluated for impairment	<u>\$ 3,077,792</u>	<u>\$ 173,484</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,251,276</u>
Ending Balance: collectively evaluated for impairment	<u>\$ 2,047,224</u>	<u>\$ 429,649</u>	<u>\$ 35,904</u>	<u>\$ 1,006</u>	<u>\$ 8,375</u>	<u>\$ 11,015</u>	<u>\$ 3,464</u>	<u>\$ -</u>	<u>\$ 2,536,637</u>

**Recorded Investment  
in Loans Outstanding:**

Ending Balance at									
December 31, 2011	<u>\$192,405,763</u>	<u>\$11,045,535</u>	<u>\$ 5,803,885</u>	<u>\$ 867,777</u>	<u>\$ 3,854,634</u>	<u>\$ 1,872,124</u>	<u>\$ 1,605,084</u>	<u>\$ -</u>	<u>\$ 217,454,802</u>
Ending balance for loans individually evaluated for impairment	<u>\$ 17,169,200</u>	<u>\$ 2,811,579</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 28,026</u>	<u>\$ -</u>	<u>\$ 20,008,805</u>
Ending balance for loans collectively evaluated for impairment	<u>\$175,236,563</u>	<u>\$ 8,233,956</u>	<u>\$ 5,803,885</u>	<u>\$ 867,777</u>	<u>\$ 3,854,634</u>	<u>\$ 1,872,124</u>	<u>\$ 1,577,058</u>	<u>\$ -</u>	<u>\$ 197,445,997</u>

**NOTE 4 – INVESTMENT IN THE FARM CREDIT BANK OF TEXAS:**

The investment in the Farm Credit Bank of Texas is a requirement of borrowing from the Bank and is carried at cost plus allocated equities, not fair value, in the accompanying consolidated balance sheet. Estimating the fair value of the Association's investment in the Farm Credit Bank of Texas is not practicable because the stock is not traded. The Association owns 1.53 percent of the issued stock of the Bank as of December 31, 2013. As of that date, the Bank's assets totaled \$16.2 billion and members' equity totaled \$1.393 billion. The Bank's earnings were \$179.8 million during 2013.

**NOTE 5 — PREMISES AND EQUIPMENT:**

Premises and equipment consisted of the following at December 31:

	<b>2013</b>	2012	2011
Land and improvements	\$ 97,859	\$ 97,859	\$ 97,859
Building and improvements	<b>508,040</b>	508,040	500,733
Furniture and equipment	<b>54,384</b>	54,384	66,810
Computer equipment and software	<b>121,093</b>	133,818	111,548
Automobiles	<b>326,134</b>	299,429	290,223
	<b>1,107,510</b>	1,093,530	1,067,173
Accumulated depreciation	<b>(523,331)</b>	(459,246)	(469,423)
Total	<b>\$ 584,179</b>	\$ 634,284	\$ 597,750

The Association owns buildings in Sulphur Springs, Canton and Gilmer and leases office space in Kaufman, Longview and Sulphur Springs (2 locations). The Kaufman and Longview building leases are on a month to month basis. Both Sulphur Springs building leases are one-year leases which expire in 2014. General office equipment is leased with expiration in 2016. Lease expense was \$48,499, \$39,268 and \$27,235 for 2013, 2012 and 2011, respectively. Minimum annual lease payments for the next five years are as follows:

	Operating
2014	\$ 31,618
2015	3,468
2016	867
2017	-
2018	-
Thereafter	-
Total	<b>\$ 35,953</b>

**NOTE 6 – OTHER PROPERTY OWNED, NET:**

Net gain (loss) on other property owned, net consists of the following for the years ended December 31:

	<b>2013</b>	2012	2011
Gain (loss) on sale, net	\$ 314,651	\$ 94,338	\$ (20,632)
Operating income (expense), net	<b>(29,317)</b>	(90,128)	(244,320)
Net gain (loss) on other property owned	<b>\$ 285,334</b>	\$ 4,210	\$ (264,952)

Other property owned consisted of 2 properties at December 31, 2013. This included inventory and an equity interest in a biofuels plant. The net carrying value of the properties is equivalent to its fair value of \$787,368, which is net of an allowance of \$24,118. During 2013, there were 15 sales of other property owned. The total sales price of these properties totaled \$3,905,882 and resulted in a net gain on sale of \$314,651. Net operating expenses incurred on other property owned were \$29,317.

**NOTE 7 – OTHER ASSETS AND OTHER LIABILITIES:**

Other assets comprised the following at December 31:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Accounts receivable - other	\$ 118,073	\$ 98,708	\$ 123,304
Other	-	3,563	5,315
Total	<u>\$ 118,073</u>	<u>\$ 102,271</u>	<u>\$ 128,619</u>

Other liabilities comprised the following at December 31:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Accounts payable	\$ 564,333	\$ 289,691	\$ 267,189
Post-retirement benefits liability	158,406	303,088	250,489
Accrued annual leave	98,308	93,449	101,271
Other	17,628	-	-
Total	<u>\$ 838,675</u>	<u>\$ 686,228</u>	<u>\$ 618,949</u>

**NOTE 8 — NOTE PAYABLE TO THE BANK:**

The interest rate risk inherent in the Association's loan portfolio is substantially mitigated through the funding relationship with the Bank. The Bank manages interest rate risk through its direct loan pricing and asset/liability management process. The Association's indebtedness to the Bank represents borrowings by the Association to fund the majority of its loan portfolio. The indebtedness is collateralized by a pledge of substantially all of the Association's assets, and is governed by a general financing agreement. The interest rate on the direct loan is based upon the Bank's cost of funding the loans the Association has outstanding to its borrowers. The indebtedness continues in effect until the expiration date of the general financing agreement, which is September 30, 2015, unless sooner terminated by the Bank upon the occurrence of an event of default, or by the Association, in the event of a breach of this agreement by the Bank, upon giving the Bank 30 calendar days' prior written notice, or in all other circumstances, upon giving the Bank 120 days' prior written notice.

The total amount and the weighted average interest rate of the Association's direct loan from the Bank at December 31, 2013, 2012 and 2011, was \$169,229,588 at 2.14 percent, \$172,960,131 at 2.38 percent and \$179,552,956 at 3.02 percent, respectively.

Under the Act, the Association is obligated to borrow only from the Bank unless the Bank approves borrowing from other funding sources. The Bank and FCA regulations have established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2013, 2012 and 2011, the Association's note payable was within the specified limitations. The maximum amount the Association may borrow from the Bank as of December 31, 2013, was \$200,275,239, as defined by the general financing agreement.

In addition to borrowing limits, the financing agreement establishes certain covenants including limits on leases, investments, other debt, and dividend and patronage distributions; minimum standards for return on assets and for liquidity; and provisions for conducting business, maintaining records, reporting financial information, and establishing policies and procedures. Remedies specified in the general financing agreement associated with the covenants include additional reporting requirements, development of action plans, increases in interest rates on indebtedness, reduction of lending limits or repayment of indebtedness.

In 2011, the Association was subject to remedies associated with the covenants in the GFA due to not achieving minimum standards for return on assets, liquidity and adversely classified assets to risk funds. The Bank issued limited waivers to the GFA for 2011 related to not achieving these minimum standards subject to the Association meeting other designated conditions. In 2012, the Association was in compliance with all covenants of the GFA except for adverse assets to risk funds being 51.8 percent, in excess of 50 percent, but less than 75 percent, which is not considered an "event of default" of the GFA covenants as a Bank approved corrective action plan was in place. As of December 31, 2013, the Association was in compliance with all covenants of the GFA.

## NOTE 9 — MEMBERS' EQUITY:

A description of the Association's capitalization requirements, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below.

Protection of certain borrower equity is provided under the Act that requires the Association, when retiring protected borrower equity, to retire such equity at par or stated value regardless of its book value. Protected borrower equity includes capital stock, participation certificates and allocated equities that were outstanding as of January 6, 1988, or were issued or allocated prior to October 6, 1988. If an Association is unable to retire protected borrower equity at par value or stated value, amounts required to retire this equity would be obtained from the Insurance Fund.

In accordance with the Act and the Association's capitalization bylaws, each borrower is required to invest in the Association as a condition of borrowing. The investment in Class A capital stock (for farm loans) or participation certificates (for rural home and farm related business loans) is equal to 2 percent of the loan amount, up to a maximum amount of \$1,000. The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, usually by adding the aggregate par value of the capital stock or participation certificates to the principal amount of the related loan obligation. The capital stock or participation certificates are subject to a first lien by the Association. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding capital stock or participation certificates.

If needed to meet regulatory capital adequacy requirements, the board of directors of the Association may increase the percentage of stock requirement for each borrower up to a maximum of 5 percent of the loan amount.

Each owner of Class A is entitled to a single vote, while participation certificates provide no voting rights to their owners.

Within two years of repayment of a loan, the Association capital bylaws require the conversion of any borrower's outstanding Class A to Class C stock. Class C stock has no voting rights except in a case where a new issuance of preferred stock has been submitted to stockholders affected by the preference. Redemption of Class C shares is made solely at the discretion of the Association's board of directors. The Association had no Class C stock as of December 31, 2013, 2012 or 2011.

All borrower stock is at-risk. As such, losses that result in impairment of capital stock or participation certificates shall be borne on a pro rata basis by all holders of Class A capital stock, Class C capital stock and participation certificates. In the event of liquidation of the Association, capital stock and participation certificates would be utilized as necessary to satisfy any remaining obligations in excess of the amounts realized on the sale or liquidation of assets. Any excess of the amounts realized on the sale or liquidation of assets over the Association's obligations to external parties and to the Bank would be distributed to the Association's stockholders.

Dividends and patronage distributions may be paid on the capital stock and participation certificates of the Association, as the board of directors may determine by resolution, subject to capitalization requirements as defined by the FCA. Amounts not distributed are retained as unallocated retained earnings. The following dividends and patronage distributions were declared and paid in 2013, 2012 and 2011, respectively:

<u>Date Declared</u>	<u>Date Paid</u>	<u>Patronage</u>
January 2013	March 2013	\$1,000,000
February 2012	April 2012	300,000

There were no patronage declarations or payments in fiscal year 2011.

The FCA's capital adequacy regulations require the Association to achieve permanent capital and total surplus of at least 7.0 percent and core surplus of at least 3.5 percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the ratio requirements can initiate certain mandatory and possibly additional discretionary actions by the FCA that, if undertaken, could have a direct material effect on the Association's financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to stockholders unless prescribed capital standards are met. As of December 31, 2013, the Association is not prohibited from retiring stock, though the Association is prohibited from distributing earnings without prior approval from the FCA due to the provisions of the Supervisory Agreement. The Association's permanent capital ratio, core surplus ratio and total surplus ratio at December 31, 2013, were 20.9 percent, 20.4 percent and 20.4 percent, respectively.

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

An FCA regulation empowers the FCA to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. The Association has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

At December 31, the Association had the following shares of Class A stock and participation certificates outstanding at a par value of \$5 per share:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Class A stock	199,286	195,817	199,791
Participation certificates	5,052	3,748	3,589
Total	<u>204,338</u>	<u>199,565</u>	<u>203,380</u>

An additional component of equity is accumulated other comprehensive income, which is reported net of taxes as follows:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Nonpension postretirement benefits	\$ 237,475	\$ 90,134	\$ 155,884

The Association's accumulated other comprehensive income relates entirely to its nonpension other postretirement benefits. The following table summarizes the changes in accumulated other comprehensive income for the year ended December 31:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Accumulated other comprehensive income at January 1	\$ 90,134	\$ 155,884	\$ 204,818
Actuarial gains/(losses)	156,991	(43,087)	(16,857)
Amortization of prior service credit (costs) included in salaries and employee benefits	(8,547)	(17,149)	(19,795)
Amortization of actuarial gain (loss) included in salaries and employee benefits	<u>(1,103)</u>	<u>(5,514)</u>	<u>(12,282)</u>
Other comprehensive income (loss), net of tax	<u>147,341</u>	<u>(65,750)</u>	<u>(48,934)</u>
Accumulated other comprehensive income at December 31	<u>\$ 237,475</u>	<u>\$ 90,134</u>	<u>\$ 155,884</u>

#### NOTE 10 — INCOME TAXES:

There was no provision for income taxes for the years ended December 31, 2013, 2012 or 2011.

The provision for income tax differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as follows for the years ended December 31:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Federal tax at statutory rate	\$ 1,370,262	\$ 1,402,925	\$ 780,308
Effect of nontaxable FLCA subsidiary	(1,839,079)	(1,739,774)	(796,773)
Change in valuation allowance	596,580	344,587	10,662
Other	<u>(127,763)</u>	<u>(7,738)</u>	<u>5,803</u>
Provision for income taxes	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Deferred tax assets and liabilities in accordance with accounting guidance, “Accounting for Income Taxes,” are composed of the following at December 31:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
<u>Deferred Tax Assets</u>			
Allowance for loan losses	\$ 87,714	\$ 76,124	\$ 204,697
Loss carryforwards	5,010,228	4,425,238	3,936,289
Allowance for other property owned	-	-	15,789
Gross deferred tax assets	<u>5,097,942</u>	<u>4,501,362</u>	<u>4,156,775</u>
Deferred tax asset valuation allowance	<u>(5,097,942)</u>	<u>(4,501,362)</u>	<u>(4,156,775)</u>
Net deferred tax asset (liability)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

The Association recorded valuation allowances of \$5,097,942, \$4,501,362 and \$4,156,775 during 2013, 2012 and 2011, respectively. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (over 50 percent probability), based on management’s estimate, that they will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of the Association’s expected patronage program, which reduces taxable earnings. The Association will continue to evaluate the realizability of the deferred tax assets and adjust the valuation allowance accordingly.

**NOTE 11 — EMPLOYEE BENEFIT PLANS:**

**Employee Retirement Plans:** Employees of the Association participate in either the defined benefit retirement plan (DB plan) or the defined contributions plan (DC plan) and are eligible to participate in the Farm Credit Benefits Alliance 401(k) Plan. Also, the Association sponsors a nonqualified defined contribution 401(k) plan. These plans are described more fully in section I of Note 2, “Summary of Significant Accounting Policies.”

The structure of the District’s DB plan is characterized as multi-employer, since neither the assets, liabilities nor cost of any plan is segregated or separately accounted for by participating employers (Bank and associations). No portion of any surplus assets is available to any participating employer. As a result, participating employers of the plan only recognize as cost the required contributions for the period and a liability for any unpaid contributions required for the period of their financial statements. Plan obligations, assets and the components of annual benefit expenses are recorded and reported upon District combination only. The Association records current contributions to the DB plan as an expense in the current year.

The DB plan is noncontributory and benefits are based on salary and years of service. The legal name of the plan is Farm Credit Bank of Texas Pension Plan; its employer identification number is 74-1110170. The DB plan is not subject to any contractual expiration dates. The DB plan’s funding policy is to fund current year benefits expected to be earned by covered employees plus an amount to improve the accumulated benefit obligation funded status by a percentage approved by the plan sponsor. The plan sponsor is the board of the Farm Credit Bank of Texas. The “projected unit credit” actuarial method is used for both financial reporting and funding purposes. District employers have the option of providing enhanced retirement benefits, under certain conditions, within the DB plan, to facilitate reorganization and/or restructuring. Actuarial information regarding the DB pension plan accumulated benefit obligation and plan asset is calculated for the District as a whole and is presented in the District’s Annual Report to Stockholders. The actuarial present value of vested and nonvested accumulated benefit obligation exceeded the net assets of the DB plan as of December 31, 2013.

The risks of participating in these multi-employer plans are different from single-employer plans in the following aspects:

- a. Assets contributed to the multi-employer plan by one employer may be used to provide benefits to employees of other participating employers.
- b. If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.
- c. If the Association chooses to stop participating in some of its multi-employer plans, it may be required to pay the plan an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

The following table includes additional information regarding the funded status of the plan, the Association's contributions, and the percentage of Association contribution to total plan contributions for the years ended December 31, 2013, 2012 and 2011:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Funded status of plan	77.3 %	65.0 %	64.9 %
Association's contribution	\$ 33,810	\$ 32,372	\$ 96,228
Percentage of Association's contribution to total contributions	0.2 %	0.2 %	0.4 %

The funded status presented above is based on the percentage of plan assets to projected benefit obligations. DB plan funding is based on the percentage of plan assets to the accumulated benefit obligation, which was 86.1 percent, 72.7 percent and 72.6 percent at December 31, 2013, 2012 and 2011, respectively.

**Other Postretirement Benefits:** In addition to pension benefits, the Association provides certain health care benefits to qualifying retired employees (other postretirement benefits). These benefits are not characterized as multi-employer and, consequently, the liability for these benefits is included in other liabilities. Employees hired prior to January 1, 2004, and who are at least 55 years of age (or at least age 50 with 30 years of service) may retire and have their medical premium paid on a percentage of cost sharing basis predicated on length of employment service. Employees hired before this date that have reached the age requirement and have 25 years of service will receive 100 percent of their medical premium paid. Employees hired after January 1, 2004, will be eligible for access only to retiree medical benefits for themselves, but will be responsible for 100 percent of the premium.

The following table reflects the benefit obligation, cost and actuarial assumptions for the Association's other postretirement benefits:

**Retiree Welfare Benefit Plans**

<b>Disclosure Information Related to Retirement Benefits</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
<b>Change in Accumulated Postretirement Benefit Obligation</b>			
Accumulated postretirement benefit obligation, beginning of year	\$ 303,088	\$ 250,489	\$ 223,844
Service cost	11,774	9,364	9,274
Interest cost	13,093	12,504	12,414
Plan participants' contributions	630	613	584
Actuarial loss (gain)	(156,991)	43,087	16,857
Benefits paid	(13,188)	(12,969)	(12,484)
Accumulated postretirement benefit obligation, end of year	\$ 158,406	\$ 303,088	\$ 250,489
<b>Change in Plan Assets</b>			
Plan assets at fair value, beginning of year	\$ -	\$ -	\$ -
Company contributions	12,558	12,356	11,900
Plan participants' contributions	630	613	584
Benefits paid	(13,188)	(12,969)	(12,484)
Plan assets at fair value, end of year	\$ -	\$ -	\$ -
Funded status of the plan	\$ (158,406)	\$ (303,088)	\$ (250,489)
<b>Amounts Recognized in Statement of Financial Position</b>			
Other liabilities	\$ (158,406)	\$ (303,088)	\$ (250,489)
<b>Amounts Recognized in Accumulated Other Comprehensive Income</b>			
Net actuarial loss (gain)	\$ (198,174)	\$ (42,286)	\$ (90,887)
Prior service cost (credit)	(39,301)	(47,848)	(64,997)
Total	\$ (237,475)	\$ (90,134)	\$ (155,884)
<b>Weighted-Average Assumptions Used to Determine Obligations at Year End</b>			
Measurement date	12/31/2013	12/31/2012	12/31/2011
Discount rate	5.20%	4.40%	5.10%
Health care cost trend rate assumed for next year (pre-/post-65) - medical	7.50%/6.50%	7.25%/6.50%	8.50%/6.75%
Health care cost trend rate assumed for next year - Rx	6.50%	7.75%	8.00%
Ultimate health care cost trend rate	5.00%	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2024	2023	2018



<b>Total Cost</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Service cost	\$ 11,774	\$ 9,364	\$ 9,274
Interest cost	13,093	12,504	12,414
Amortization of:			
Unrecognized prior service cost	(8,547)	(17,149)	(19,795)
Unrecognized net loss (gain)	(1,103)	(5,514)	(12,282)
Net postretirement benefit cost	\$ 15,217	\$ (795)	\$ (10,389)

**Other Changes in Plan Assets and Projected Benefit Obligation Recognized in Other Comprehensive Income**

Net actuarial loss (gain)	\$ (156,991)	\$ 43,087	\$ 16,857
Amortization of net actuarial loss (gain)	8,547	5,514	12,282
Amortization of prior service cost	1,103	17,149	19,795
Total recognized in other comprehensive income	\$ (147,341)	\$ 65,750	\$ 48,934

**AOCI Amounts Expected to be Amortized Into Expense in 2014**

Unrecognized prior service cost	\$ (8,547)
Unrecognized net loss (gain)	(1,103)
Total	\$ (9,650)

**Weighted-Average Assumptions Used to Determine Benefit Cost**

	<b>12/31/2012</b>	<b>12/31/2011</b>	<b>12/31/2010</b>
Measurement date			
Discount rate	4.40%	5.10%	5.70%
Health care cost trend rate assumed for next year (pre-/post-65) - medical	7.25%/6.50%	8.50%/6.75%	7.50%/6.50%
Health care cost trend rate assumed for next year - Rx	7.75%	8.00%	10.00%
Ultimate health care cost trend rate	5.00%	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2023	2018	2017

**Expected Future Cash Flows**

**Expected Benefit Payments (net of employee contributions)**

Fiscal 2014	\$ 11,255
Fiscal 2015	11,571
Fiscal 2016	12,002
Fiscal 2017	12,714
Fiscal 2018	13,833
Fiscal 2019–2023	80,126

**Expected Contributions**

Fiscal 2014	\$ 11,255
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**NOTE 12 — RELATED PARTY TRANSACTIONS:**

Directors of the Association, except for any director-elected directors, are required to be borrowers/stockholders of the Association. Also, in the ordinary course of business, the Association may enter into loan origination or servicing transactions with its officers, relatives of officers and directors, or with organizations with which such persons are associated. Such loans are subject to special approval requirements contained in FCA regulations and are made on the same terms, including interest rates, amortization schedule and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

Total loans to such persons for the Association amounted to \$1,865,140, \$944,888 and \$820,244 at December 31, 2013, 2012 and 2011, respectively. During 2013, \$1,050,001 of new loans were made, and repayments totaled \$613,823. The remaining change in related party balances from December 31, 2012 to December 31, 2013 related to loans to individuals who were no longer considered related parties or for outstanding loans to individuals who were considered related parties as of December 31, 2013. In the opinion of management, no such loans outstanding at December 31, 2013, 2012 and 2011 involved more than a normal risk of collectability.

Expenses included in purchased services may include purchased services such as administrative services, marketing, information systems and accounting services and allocations of expenses incurred by the Bank and passed through to the associations, such as FCSIC expenses. The Bank charges the individual associations directly for these services based on each Association's proportionate usage. These expenses totaled \$336,596, \$241,526 and \$226,920 in 2013, 2012 and 2011, respectively. As of April 2011, the Bank only bills associations for direct pass-through expenses and no longer bills for allocated expenses.

The Association received patronage payments from the Bank totaling \$825,845, \$850,371 and \$963,025 during 2013, 2012 and 2011, respectively.

**NOTE 13 — FAIR VALUE MEASUREMENTS:**

Accounting guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. See Note 2, "Summary of Significant Accounting Policies," for additional information.

*Quantitative Information about Recurring and Nonrecurring Level 3 Fair Value Measurements*

With regard to impaired loans and other property owned, it is not practicable to provide specific information on inputs as each collateral property is unique. System institutions utilize appraisals to value these loans and other property owned and take into account unobservable inputs such as income and expense, comparable sales, replacement cost and comparability adjustments.

The Association had no assets or liabilities measured at fair value on a recurring basis for 2013, 2012 or 2011.

## Information about Other Financial Instrument Fair Value Measurements:

	<u>Valuation Technique(s)</u>	<u>Input</u>
Cash	Carrying value	Par/principal and appropriate interest yield
Loans	Discounted cash flow	Prepayment forecasts Probability of default Loss severity
Note payable to the Farm Credit Bank of Texas	Discounted cash flow	Benchmark yield curve Derived yield spread Own credit risk

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

December 31, 2013	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Loans	\$ -	\$ -	\$ 3,762,018	\$ 3,762,018
Other property owned	-	-	787,368	787,368
December 31, 2012				
	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Loans	\$ -	\$ -	\$ 6,586,875	\$ 6,586,875
Other property owned	-	-	3,956,869	3,956,869
December 31, 2011				
	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Loans	\$ -	\$ -	\$ 7,031,226	\$ 7,031,226
Other property owned	-	-	5,112,615	5,112,615

Financial assets and financial liabilities measured at carrying amounts and not measured at fair value on the consolidated balance sheet for each of the fair value hierarchy values are summarized as follows:

	December 31, 2013				Total Fair Value
	Total Carrying Amount	Level 1	Level 2	Level 3	
<b>Assets:</b>					
Cash	\$ 83,987	\$ 83,987	\$ -	\$ -	\$ 83,987
Net loans	209,106,700	-	-	208,116,649	208,116,649
<b>Total Assets</b>	<b>\$ 209,190,687</b>	<b>\$ 83,987</b>	<b>\$ -</b>	<b>\$ 208,116,649</b>	<b>\$ 208,200,636</b>
<b>Liabilities:</b>					
Note Payable to the Farm Credit Bank of Texas	\$ 169,229,588	\$ -	\$ -	\$ 168,454,516	\$ 168,454,516
<b>Total Liabilities</b>	<b>\$ 169,229,588</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 168,454,516</b>	<b>\$ 168,454,516</b>
	December 31, 2012				Total Fair Value
	Total Carrying Amount	Level 1	Level 2	Level 3	
Assets:					
Cash	\$ 83,981	\$ 83,981	\$ -	\$ -	\$ 83,981
Net loans	202,487,423	-	-	204,763,331	204,763,331
<b>Total Assets</b>	<b>\$ 202,571,404</b>	<b>\$ 83,981</b>	<b>\$ -</b>	<b>\$ 204,763,331</b>	<b>\$ 204,847,312</b>
Liabilities:					
Note Payable to the Farm Credit Bank of Texas	\$ 172,960,131	\$ -	\$ -	\$ 174,813,926	\$ 174,813,926
<b>Total Liabilities</b>	<b>\$ 172,960,131</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 174,813,926</b>	<b>\$ 174,813,926</b>

December 31, 2011

	Total Carrying Amount	Total Fair Value
Assets:		
Cash	\$ 88,115	\$ 88,115
Net loans	210,257,305	226,372,150
Total Assets	<u>\$210,345,420</u>	<u>\$226,460,265</u>
Liabilities:		
Note Payable to the Farm Credit Bank of Texas	<u>\$179,552,956</u>	<u>\$180,816,339</u>
Total Liabilities	<u>\$179,552,956</u>	<u>\$180,816,339</u>

### Valuation Techniques

As more fully discussed in Note 2, “Summary of Significant Accounting Policies,” accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following represent a brief summary of the valuation techniques used by the Bank and associations for assets and liabilities:

#### *Loans*

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

#### *Other Property Owned*

Other property owned is generally classified as Level 3. The process for measuring the fair value of other property owned involves the use of appraisals or other market-based information. Costs to sell represent transaction costs and are not included as a component of the asset’s fair value. As a result, these fair value measurements fall within Level 3 of the hierarchy.

#### *Note payable to the Farm Credit Bank of Texas*

The note payable to the Bank is not regularly traded; thus, quoted market prices are not available. Fair value of this instrument is discounted based on the Association’s and Bank’s loan rates as well as on management estimates. For the purposes of this estimate it is assumed that the cash flow on the note is equal to the principal payments on the Association’s loan receivables plus accrued interest on the note payable. This assumption implies that earnings on the Association’s interest margin are used to fund operating expenses and capital expenditures. Management has no basis to determine whether the fair values would be indicative of the value negotiated in an actual sale.

#### **NOTE 14 — COMMITMENTS AND CONTINGENCIES:**

In addition to those commitments and contingencies discussed in Note 2, “Summary of Significant Accounting Policies,” the Association is involved in various legal proceedings in the ordinary course of business. In the opinion of legal counsel and management, there are no legal proceedings at this time that are likely to materially affect the Association.

The Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers in the form of commitments to extend credit and commercial letters of credit. These financial instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2013, \$9,013,535 of commitments and \$456,789 of commercial letters of credit were outstanding.

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the consolidated balance sheet until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers, and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management’s credit evaluation of the borrower.

#### **NOTE 15 - REGULATORY ENFORCEMENT MATTERS:**

Effective January 23, 2014, the Farm Credit Administration (FCA) terminated the Supervisory Agreement (Agreement) with Legacy Ag Credit, ACA. The Association has been returned to normal supervision. Historical actions related to the Agreement are listed below:

In early 2009, the Association underwent an examination by the FCA. As a result of this examination, an enforcement action (Supervisory Agreement) by the FCA was instituted against the Association in November 2009. The basis of the enforcement action was unsafe and unsound practices and conditions and violations of FCA regulations within the Association.

In March of 2011, a revised Supervisory Agreement was entered into between the FCA and the Association's board which superseded and terminated the November 2009 Supervisory Agreement. In general, the basis for the revised Supervisory Agreement was that the board’s actions and corrective action plans, although improving, had not yet resulted in a substantial improvement in the quality of the Association’s portfolio or the Association’s financial condition and performance.

In January 2012, the FCA granted approval for the Association to distribute a \$300,000 patronage related to 2011 operations. The patronage was paid in April 2012.

In January 2013, the FCA granted approval for the Association to distribute a \$1,000,000 patronage related to 2012 operations. The patronage was paid in March 2013.

In January 2014, the FCA granted approval for the Association to distribute a \$1,250,000 patronage related to 2013 operations. The patronage will be paid in March 2014.

In January 2014, the FCA terminated the Supervisory Agreement (Agreement) with Legacy Ag Credit, ACA. The Association has been returned to normal supervision.

**NOTE 16 – QUARTERLY FINANCIAL INFORMATION (UNAUDITED):**

Quarterly results of operations for the years ended December 31 (in thousands) follow:

	2013				
	First	Second	Third	Fourth	Total
Net interest income	\$ 1,865	\$ 1,949	\$ 2,031	\$ 1,939	\$ 7,784
(Provision for) reversal of loan losses	(478)	(326)	81	(42)	(765)
Noninterest income (expense), net	(709)	(653)	(934)	(808)	(3,104)
Net income	<u>\$ 678</u>	<u>\$ 970</u>	<u>\$ 1,178</u>	<u>\$ 1,089</u>	<u>\$ 3,915</u>
	2012				
	First	Second	Third	Fourth	Total
Net interest income	\$ 2,007	\$ 1,751	\$ 1,716	\$ 1,843	\$ 7,317
(Provision for) reversal of loan losses	276	240	7	190	713
Noninterest income (expense), net	(834)	(494)	(763)	(1,813)	(3,904)
Net income	<u>\$ 1,449</u>	<u>\$ 1,497</u>	<u>\$ 960</u>	<u>\$ 220</u>	<u>\$ 4,126</u>
	2011				
	First	Second	Third	Fourth	Total
Net interest income	\$ 1,574	\$ 1,484	\$ 1,636	\$ 1,633	\$ 6,327
(Provision for) reversal of loan losses	(158)	(697)	(1,428)	1,570	(713)
Noninterest income (expense), net	(971)	(833)	(940)	(575)	(3,319)
Net income	<u>\$ 445</u>	<u>\$ (46)</u>	<u>\$ (732)</u>	<u>\$ 2,628</u>	<u>\$ 2,295</u>

**NOTE 17 — SUBSEQUENT EVENTS:**

The Association has evaluated subsequent events through March 7, 2014, which is the date the financial statements were issued or available to be issued.

The Farm Credit Administration (FCA) terminated the revised Supervisory Agreement (Agreement) with Legacy Ag Credit, ACA effective January 23, 2014. The Association has been returned to normal supervision. Details regarding the Agreement can be found in Note 15 to the consolidated financial statements, "Regulatory Enforcement Matters".

In January 2014, the FCA granted approval for the Association to distribute a \$1,250,000 patronage related to 2013 operations. The patronage will be paid in March 2014.

There are no other subsequent events requiring disclosure as of March 7, 2014.

## **DISCLOSURE INFORMATION AND INDEX**

### *Disclosures Required by Farm Credit Administration Regulations*

#### **DESCRIPTION OF BUSINESS**

The description of the territory served, the persons eligible to borrow, the types of lending activities engaged in and the financial services offered, and related Farm Credit organizations required to be disclosed in this section is incorporated herein by reference from Note 1 to the consolidated financial statements, "Organization and Operations," included in this annual report.

The descriptions of significant developments that had or could have a material impact on earnings, interest rates to borrowers, patronage, or dividends and acquisitions or dispositions of material assets, changes in the reporting entity, changes in patronage policies or practices and financial assistance provided by or to the Association through loss sharing or capital preservation agreements or from any other source, if any, required to be disclosed in this section are incorporated herein by reference from "Management's Discussion and Analysis of Financial Condition and Results of Operations," included in this annual report.

#### **DESCRIPTION OF PROPERTY**

The Legacy Ag Credit, ACA (Association) serves its 10-county territory through its main administrative and lending office at 303 Connally St., Sulphur Springs, Texas 75482. Additionally, there are four branch lending offices located throughout the territory. The Association owns the office buildings in Sulphur Springs, Gilmer and Canton, free of debt. The Association leases two office buildings in Sulphur Springs and one office building each in Kaufman and Longview.

#### **LEGAL PROCEEDINGS**

The Farm Credit Administration (FCA) terminated the Supervisory Agreement (Agreement) with Legacy Ag Credit, ACA effective January 23, 2014. The Association has been returned to normal supervision. Details regarding the Agreement can be found in Note 15 to the consolidated financial statements, "Regulatory Enforcement Matters."

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

#### **DESCRIPTION OF CAPITAL STRUCTURE**

The information required to be disclosed in this section is incorporated herein by reference from Note 9 to the consolidated financial statements, "Members' Equity," included in this annual report.

#### **DESCRIPTION OF LIABILITIES**

The description of liabilities required to be disclosed in this section is incorporated herein by reference from Note 8, "Note Payable to the Bank," Note 11, "Employee Benefit Plans," and in "Management's Discussion and Analysis of Financial Condition and Results of Operations," included in this annual report.

The description of contingent liabilities required to be disclosed in this section is incorporated herein by reference from Notes 2 and 14 to the consolidated financial statements, "Summary of Significant Accounting Policies" and "Commitments and Contingencies," respectively, included in this annual report.

#### **RELATIONSHIP WITH THE FARM CREDIT BANK OF TEXAS**

The Association's financial condition may be impacted by factors that affect the Farm Credit Bank of Texas (Bank), as discussed in Note 1 to the consolidated financial statements, "Organization and Operations," included in this annual report. The financial condition and results of operations of the Bank may materially affect the stockholders' investment in the Association.

The Farm Credit Bank of Texas and District associations' (District) annual and quarterly stockholder reports are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, The Ag Agency, P.O. Box 202590, Austin, Texas 78720-2590 or calling (512) 483-9204. Copies of the District's annual and quarterly stockholder reports can also be requested by e-mailing [fcf@farmcreditbank.com](mailto:fcf@farmcreditbank.com). The District's annual and quarterly stockholder reports are also available on its website at [www.farmcreditbank.com](http://www.farmcreditbank.com).

The Association's quarterly stockholder reports are also available free of charge, upon request. These reports will be available approximately 40 days after quarter end and can be obtained by writing to Legacy Ag Credit, ACA 303 Connally St., Sulphur Springs, Texas 75482 or calling (903) 885-9566. Copies of the Association's quarterly stockholder reports can also be requested by e-mailing [sherry.jennings@legacyaca.com](mailto:sherry.jennings@legacyaca.com). The Association's annual stockholder report is available on its website at [www.legacyaca.com](http://www.legacyaca.com) 75 days after the fiscal year end or 40 days after quarter end for quarterly reports. Copies of the Association's annual stockholder report can also be requested 90 days after the fiscal year end.

### SELECTED FINANCIAL DATA

The selected financial data for the five years ended December 31, 2013, required to be disclosed, is incorporated herein by reference to the "Five-Year Summary of Selected Consolidated Financial Data" included in this annual report to stockholders.

### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

"Management's Discussion and Analysis," which precedes the consolidated financial statements in this annual report, is incorporated herein by reference.

### DIRECTORS AND SENIOR OFFICERS

The Association's member-elected and director-elected board of directors and senior officers are as follows:

NAME	POSITION	DATE ELECTED/ EMPLOYED	TERM EXPIRES
Jerry Cordell	Chairman of the Board	1979	2014
Wayne Bawcum, CPA	Director at Large	2008	2016
Dr. Herb Marlow*	Director	2010	2013
Terry D. Milligan	Director	2010	2016
Cody Newman	Vice Chairman	2000	2016
A.G. Sandifeer	Director	2001	2014
Ron Gabriel	Director	2011	2015
Paul Nicklas	Director	2013	2015
Joseph Crouch	CEO	2008	-
Al Conner	CCO	2012	-
Sherry Jennings	SVP / CAO	2007	-
Daryl D. Belt	SVP / CFO	2007	-

\*Term expired in 2013

A brief statement of the business and employment background of each director and senior officer is provided for informational purposes.

**Jerry Cordell**, Chairman of the board. Mr. Cordell owns and operates a beef cattle operation in Kaufman County and previously owned an agricultural retail business. Mr. Cordell currently serves as director and vice president of the Farmer's Market in Kaufman, Texas, and formerly served as a member of the Kaufman County Hay Show board. He has served as a director of Legacy Ag Credit, ACA since 1979. He was elected board chairman in 2010 and has served continuously in this position since that time.

**Wayne Bawcum**, CPA, Chairman of the audit committee. Mr. Bawcum is a CPA and is currently a partner with Bawcum and Preuss, CPAs in Sulphur Springs, Texas. He has served as director at large since 2008.

**Terry D. Milligan**, Director. Mr. Milligan has been employed by the U.S.D.A. for 32 years. He owns and operates a beef yearling grazing operation in Van Zandt County. He has served as director since his election in 2010.



**Cody Newman**, Vice chairman of the board. Mr. Newman is president and a partner in a family business, the Newman Corporation, which manages and develops oil, gas, real estate and ranch properties. Mr. Newman serves on the board of the Upshur Rural Electric Cooperative Corporation and previously served as a school board member for Harleton ISD for 12 years. He served as director at large for the Association since 2000 and was elected director in 2008. He was elected board vice chairman in 2010 and has served continuously in that position since that time. Additionally, he serves as audit committee vice chairman and previously served as chairman of the compensation committee.

**A.G. Sandifeer**, Director. Mr. Sandifeer retired from TXU after 36 years of service and from J & L Utility Construction Co., after 16 years of service. He owns and operates a cow/calf operation in Hopkins County, Texas, and also serves as chief of the Dike Volunteer Fire Department. He has served as a director since 2001.

**Ron Gabriel**, Director. Mr. Gabriel owns and operates oil field service companies and a beef cattle, horse and hay operation in Van Zandt County. He is the owner and president of EDI Energy Services, Turbo Drilling Fluids and Four Star Management Group. He is past chairman of the Legacy Ag Credit, ACA nominating committee, and previously served on the Spring Hill School Board for six years. He was elected as a director in 2011 and has served continuously since that time.

**Paul Nicklas**, Director. Mr. Nicklas resides in Canton, Texas, where he owns and operates a commercial cow/calf operation, concentrating on alternative marketing strategies, breed composition and sire selection. Additionally, he owns and operates a small business in Van Zandt, Kaufman and Henderson counties. Mr. Nicklas is a licensed Texas real estate agent, a professional bondsman of Texas, and a retired Texas peace officer. He has served as director since his election in 2013.

**Joseph Crouch**, Chief Executive Officer. Mr. Crouch joined Legacy Ag Credit, ACA in 2008 where he has served as Senior Credit Officer, Special Assets Manager, and Chief Credit Officer prior to being appointed CEO in April 2013. Mr. Crouch began his banking career in 1997 and performed various roles for commercial banks located in the Panhandle of Texas and throughout West Texas. Mr. Crouch also serves as a director on the board of the Hopkins County Memorial Hospital. Mr. Crouch received a degree in agribusiness and economics from West Texas A&M University in Canyon, Texas.

**Al Conner** serves as chief credit officer. Mr. Conner joined Legacy Ag Credit, ACA in December 2012. Mr. Conner began his Farm Credit career in 1976 as a loan officer for the Federal Land Bank of Vidalia, Georgia, and Ohoopie PCA. Mr. Conner served as branch manager for the Federal Land Bank of Gainesville, Florida and North Florida, PCA in Lake City, Florida, from 1979 to 1982. Mr. Conner moved to Columbia, South Carolina, in April 1982 where he continued his Farm Credit career until his retirement from the AgFirst Farm Credit Bank in March 2011. Mr. Conner gained extensive lending experience during this 29-year tenure with the AgFirst Farm Credit Bank where he served as a senior loan officer, senior credit reviewer, vice president in charge of credit review, and vice president/relationship manager. Mr. Conner holds a B.S. in dairy science from the University of Georgia.

**Sherry Jennings** joined Legacy Ag Credit, ACA in 2007 and serves as SVP and chief administrative officer. Ms. Jennings has over 20 years' banking experience in the Sulphur Springs area, most recently serving as senior administrative officer with Guaranty Bond Bank. Ms. Jennings began her banking career in 1988 with Texas Commercial Savings, continuing while under the management of the Resolution Trust Corporation, and served as administrative officer of First American Bank & Mortgage until the merger with Guaranty Bond Bank. She has extensive operational experience, including credit operations and human resource management. She attended Texas A&M University in Commerce, Texas (formerly East Texas State University).

**Daryl D. Belt** serves as SVP and chief financial officer. Mr. Belt joined the Association in 2007 and has been with the Farm Credit System since 1993 in various capacities with associations and the district bank (FCBT). Mr. Belt was with JPMorgan Chase & Co. for 10 years prior to joining Farm Credit and was also a Realtor with Sotheby's International Realty in Austin, Texas from 2006 through 2007. Mr. Belt holds a B.B.A. in finance from the University of Texas.

## COMPENSATION OF DIRECTORS

Directors were compensated for their service to the Association in the form of an honorarium at the rate of \$650 per day for official activities and \$150 per day for teleconference meetings, and they were reimbursed for certain expenses incurred while representing the Association in an official capacity. Mileage for attending official meetings during 2013 was paid at the IRS-approved rate of 56.5 cents per mile. A copy of the travel policy is available to stockholders of the Association upon request.

Director	Number of Days Served Associated With		Total Compensation in 2013
	Board Meetings	Other Official Activities	
Jerry Cordell	17	45	\$ 31,450
Wayne Bawcum, CPA	16	39	22,500
Dr. Herb Marlow*	7	14	11,150
Terry D. Milligan	17	28	24,400
Cody Newman	17	35	25,450
A.G. Sandifeer	16	30	26,050
Ron Gabriel	16	29	25,400
Paul Nicklas	9	13	12,450
			\$ 178,850

\*Term expired in 2013

The aggregate compensation paid to directors in 2013, 2012 and 2011 was \$178,850, \$162,050 and \$135,250, respectively. Additional detail regarding director compensation paid for committee service (which is included in the table above) is as follows:

Director	Committee		
	Audit	Compliance and Compensation	Other Official Activities
Jerry Cordell	\$ 900	\$ 1,350	\$ 18,650
Wayne Bawcum, CPA	1,050	1,850	9,700
Dr. Herb Marlow*	450	-	6,650
Terry D. Milligan	1,050	-	12,800
Cody Newman	1,050	1,350	12,500
A.G. Sandifeer	1,050	-	15,100
Ron Gabriel	1,050	-	14,450
Paul Nicklas	600	-	6,000
	\$ 7,200	\$ 4,550	\$ 95,850

\*Term expired in 2013

The aggregate amount of reimbursement for travel, subsistence and other related expenses paid to directors and on their behalf was \$60,755, \$60,344 and \$37,074 in 2013, 2012 and 2011, respectively.

## COMPENSATION OF SENIOR OFFICERS

### Compensation Discussion and Analysis – Senior Officers

The compensation plan for all employees provides for base salaries to be administered consistent with competitive financial industry survey data of like-sized financial institutions. In 2013 and 2012 bonuses were paid in accordance with the bonus plan as discussed below in the Chief Executive Officer (CEO) Compensation Table Policy. A bonus of \$500 (gross) was paid to all employees in 2011.

## Chief Executive Officer (CEO) Compensation Policy

The CEO's base salary is benchmarked against that paid to CEOs of other financial institutions. Effective November 1, 2012, the CCO, Joseph Crouch, was appointed Interim CEO by the Association board and was named CEO in April, 2013.

A critical factor to the Association's success is its ability to attract, develop and retain staff that is knowledgeable and efficient in their ability to support the Association in the execution of its strategic objectives and delivery of Association results that maximize the value to the stockholders. This objective holds particularly true for the Association's chief executive officer (CEO) and senior officer group. The Association operates utilizing a compensation program which focuses on the performance and contributions of its employees in achieving the Association's financial and operational objectives, all for the ultimate benefit of its stockholder/members. The Association's board of directors, through its compensation committee, establishes salary and incentive programs utilizing data derived from independent third-party compensation specialists in the financial services sector to ensure that salary and incentive structures are in line with market-comparable positions. Studies provided by third-party compensation specialists form the foundation for the Association's evaluation and establishment of salary and incentive plans used by the Association.

All Association employees, including senior officers, can earn compensation above base salary through an annual success-sharing incentive plan. The term of the plan is each calendar year beginning January 1 through December 31. The plan is based upon the achievement of predetermined Association performance goals for net income, new loan growth, credit quality and acquired property volume. The following criteria is also used for determining eligibility for the incentive pay: (1) the Association must not be in default of the General Financing Agreement with the Farm Credit Bank of Texas (2) the Association cannot receive an overall rating of "unsatisfactory" on credit administration by the Internal Credit Review and/or FCA examinations (3) there must be material income from operations beyond what is needed to fund the incentive plan and (4) eligible employees must receive an annual performance rating of "meets standards of good competent performance" on his/her individual performance review.

### Summary Compensation Table

The following table summarizes the compensation paid to the CEO and all senior officers of the Association during 2013, 2012 and 2011. This may include other non-senior officers if their total compensation is within the top five highest paid employees. Amounts reflected in the table are presented in the year the compensation was earned.

Name of Individual or number in group	Year	Deferred/				Total
		Salary (b)	Bonus (c)	Perquisite (d)	Other (e)	
Joseph Crouch CEO	2013	\$ 206,008	\$ 36,000	\$ 42,443	\$ -	\$ 284,451
	2012	153,506	43,500	35,205	-	232,211
Gregory M. Cunningham CEO	2012	185,965	-	37,564	25,579	249,108
	2011	205,008	500	39,536	-	245,044
Aggregate Number of Senior Officers and Other Highly Compensated Employees (a)						
(5)	2013	545,355	87,019	118,512	-	750,886
(3)	2012	302,750	68,498	73,348	-	444,596
(4)	2011	417,390	2,000	89,295	-	508,685

(a) Excludes CEO.

(b) Gross salary.

(c) Includes bonuses paid within the first 30 days of the subsequent calendar year.

(d) Deferred/Perquisites include all non salary related benefits provided to the employee such as 401(K) matching and contributions to the Defined Contribution retirement plan (as discussed in Note 2 H), medical and dental insurance premiums paid by the employer, imputed income on employer paid life insurance and imputed income for personal use of Association vehicles (as described below).

(e) Amounts in the "Other" column for 2012 represent a cash payment of accrued annual leave for Mr. Cunningham.

Disclosure of information on the total compensation paid and the arrangements of the compensation plans during the last fiscal year to any senior officer or to any other employee included in the aggregate are available and will be disclosed to shareholders of the institution upon request.

Certain employees are assigned Association-owned vehicles for use in normal business operations. For all personal mileage traveled in Association vehicles, the Association includes in the earnings of the respective employees an amount derived by an IRS established method. Amounts relating to personal use of Association vehicles are included in the “Deferred/Perquisite” column in the table above along with other Association-provided benefits. Employees who use their personal automobile for business purposes were reimbursed during 2013 at the IRS-approved rate of 56.5 cents per mile.

On October 3, 2012, FCA adopted a regulation that requires all System institutions to hold advisory votes on the compensation for all senior officers and/or the CEO when the compensation of either the CEO or the senior officer group increases by 15 percent or more from the previous reporting period. In addition, the regulation requires associations to hold an advisory vote on CEO and/or senior officer compensation when 5 percent of the voting stockholders petition for the vote and to disclose the petition authority in the annual report to shareholders. The regulation became effective December 17, 2012, and the base year for determining whether there is a 15 percent or greater increase was 2013. No association has held an advisory vote based on a stockholder petition in 2013.

On January 17, 2014, the President of the United States signed into law the Consolidated Appropriations Act, which includes language prohibiting the FCA from using any funds available “to implement or enforce” the regulation. In addition, on February 7, 2014, the President of the United States signed into law the Agricultural Act of 2014. Section 5404 of the law directs FCA to within 60 days of enactment of the law “review its rules to reflect the Congressional intent that a primary responsibility of boards of directors of Farm Credit System institutions, as elected representatives of their stockholders, is to oversee compensation practices.” FCA has not yet taken any action with respect to their regulation in response to these actions.

Neither the CEO nor any other senior officer received noncash compensation exceeding \$5,000 in 2013, 2012 or 2011.

All employees are reimbursed for reasonable travel, subsistence and other related expenses while conducting Association business. A copy of the Association’s travel policy is available to shareholders upon request.

#### **TRANSACTIONS WITH DIRECTORS AND SENIOR OFFICERS**

The Association’s policies on loans to and transactions with its officers and directors, required to be disclosed in this section, are incorporated herein by reference from Note 12 to the consolidated financial statements, “Related Party Transactions,” included in this annual report.

#### **DIRECTORS’ AND SENIOR OFFICERS’ INVOLVEMENT IN CERTAIN LEGAL PROCEEDINGS**

There have been no events that have occurred in the last 5 years (bankruptcy, conviction or naming in a criminal proceeding, or judgment or finding limiting a right to engage in a business) that are material to the evaluation of the ability or integrity of any person who served as director or senior officer of the Association.

#### **RELATIONSHIP WITH INDEPENDENT AUDITOR**

The Association selected PricewaterhouseCoopers LLP to audit its financial statements and provide an opinion thereon for its 2013 annual report. The total fees paid for professional services rendered by PricewaterhouseCoopers LLP for the Association during 2013 were \$41,750 for audit services and \$8,700 for tax services.

#### **RELATIONSHIP WITH UNINCORPORATED BUSINESS ENTITIES**

The Association has business relationships with LWES, LLC and LAC Asset Holding, LLC, both of which are limited liability companies, formed for the purpose of acquiring and managing unusual and complex collateral (acquired property).

## FINANCIAL STATEMENTS

The financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 7, 2014, and the report of management in this annual report to stockholders, are incorporated herein by reference.

### MEMBER/SHAREHOLDER PRIVACY

Members' nonpublic personal financial information is protected by Farm Credit Administration regulation. Our directors and employees are restricted from disclosing information not normally contained in published reports or press releases about the Association or its members.

### CREDIT AND SERVICES TO YOUNG, BEGINNING AND SMALL FARMERS AND RANCHERS, AND PRODUCERS OR HARVESTERS OF AQUATIC PRODUCTS

The Association will make a concerted and cooperative effort to offer credit and related services to young, beginning or small (YBS) farmers, ranchers, producers or harvesters of aquatic products as supported by their creditworthiness. Sound and constructive credit to YBS farmers may include credit for nonagricultural purposes (Other Credit Needs) as well as agricultural purposes.

#### DEFINITIONS:

- \* Young Farmer – age 35 or younger
- \* Beginning Farmer – 10 years or less experience
- \* Small Farmer - \$250,000 or less gross agricultural income

#### DEMOGRAPHIC DATA:

Per 2007 USDA <u>Census of Agriculture*</u>			Legacy Ag Credit, ACA				
			2013		2012		
			Loan count	%	Loan count	%	
Young Farmers	582	4.1%	Young Farmers	270	18.1%	290	19.4%
Beginning Farmers	4,493	31.7%	Beginning Farmers	866	58.0%	882	59.1%
Small Farmers	13,780	97.3%	Small Farmers	1,263	84.7%	1,252	83.9%
Total Farms	14,166		Total Loans	1,492		1,493	

\* For ten chartered Association counties

#### ASSOCIATION GOAL:

The Association finished the year below our 2013 Loans Outstanding goals. However, the Association continues to improve its market presence and the overall goals established for Gross New Business to YBS borrowers were exceeded during 2013.

The largest potential for future penetration, based on the Demographic Data, is in the Small farmer category. While the Association far exceeded its goal of new Small farmer relationships, the overall volume fell short of our goal. This is due to the fact that the average loan size to these operations was smaller than predicted. While Small farmers currently represent roughly 85 percent of the Association's loan portfolio as of December 31, 2013, the Association recognizes that, based on the demographics, there remains additional opportunity to serve this segment within the Association's territory.

As the Association continues to build momentum in the marketplace, the Association has established similar goals for 2014 as in 2013. Legacy Ag Credit is proud to introduce Farm Credit products and services to this segment of our agricultural community. We are committed to providing consistent financing to Young, Beginning, and Small farmers producing the food and fiber that we enjoy today in this great country. The impressive level by which our number of new Young, Beginning, and Small relationships exceeded goal evidences the Association's desire to provide financing to all creditworthy YBS farmers within our territory.

The following chart identifies the Association's goals for years 2014, 2015, and 2016. Based on these goals, the Association expects that the volume and number of YBS farmers served throughout this timeline in our territory will continue to grow.

**2013 Actual Numbers**

*(000's omitted)*

Category	Loans Outstanding		Gross New Business	
	Number of Loans	Volume	Number of Loans	Volume
Young	270	\$25,611	37	\$3,788
Beginning	866	\$121,886	138	\$24,040
Small	1,263	\$147,628	231	\$30,208

**2013 Goals**

Category	Loans Outstanding		Gross New Business	
	Number of Loans	Volume	Number of Loans	Volume
Young	300	\$28,416	30	\$2,636
Beginning	913	\$121,669	99	\$25,382
Small	1,296	\$148,793	181	\$36,871

**2014 Goals (3.5% Increase/2013)**

Category	Loans Outstanding		Gross New Business Plus Commitments FYE	
	Number of Loans	Volume	Number of Loans	Volume
Young	279	\$26,507	38	\$3,921
Beginning	896	\$126,152	143	\$24,881
Small	1,307	\$152,795	239	\$31,265

**2015 Goals (5% increase/2014)**

Category	Loans Outstanding		Gross New Business Plus Commitments FYE	
	Number of Loans	Volume	Number of Loans	Volume
Young	293	\$27,833	40	\$4,117
Beginning	941	\$132,460	150	\$26,125
Small	1,373	\$160,435	251	\$32,829

**2016 Goals (5.5% increase/2015)**

Category	Loans Outstanding		Gross New Business Plus Commitments FYE	
	Number of Loans	Volume	Number of Loans	Volume
Young	310	\$29,364	42	\$4,343
Beginning	993	\$139,745	158	\$27,562
Small	1,448	\$169,259	265	\$34,634

**RELATED SERVICES:**

The Association has strengthened its outreach program to YBS farmers. These efforts include offering related services to YBS borrowers. The Association also recognizes and supports the federal and state guarantee programs available to YBS farmers. The Association continues to coordinate efforts to utilize these and other available programs with local FSA and SBA offices. Other

related services the Association coordinates in response to the needs of its YBS borrowers include title insurance, credit life insurance, and fee appraisal services.

#### OUTREACH TO YBS SEGMENT:

Efforts to reach all YBS segments are evidenced by the Association's continued participation in many local activities, including 4-H and FFA events, youth livestock shows, hay shows, chamber events, rodeos and support for local charitable and service organizations. Specifically, Legacy Ag Credit, ACA staff members have attended Texas Agri-life events sponsored by the Extension Service and CEU programs, that provided ongoing training designed specifically to address the needs of the beginning farmer. Legacy Ag Credit, ACA used these opportunities to provide information about our Association and the Farm Credit System to YBS farmers in attendance. Livestock show animals were purchased through many of our local county livestock shows, and Association staff members were a visible presence at area hay shows. The Association's presence at these events provided market recognition and opportunities to illustrate the various credit tools Farm Credit offers to both current borrowers and future borrowers. Legacy Ag Credit, ACA took other opportunities to be visible within our territory to YBS farmers by setting up booths and marketing material at trade shows, equipment auctions, and charitable events. The Association selected and sponsored a borrower for the 2013 Farm Credit Young Leaders Program. This program is designed to give current and future leaders insight into the ways that Farm Credit supports agriculture. Additionally, the Association renewed its participation in the FCBT membership and sponsorship program, which supports various YBS statewide organizations and events. These efforts not only target today's YBS segments but the next generation of potential Association borrowers as well. The Association will continue to broaden and enhance its YBS outreach program through activities mentioned above and new opportunities that arise in our territory.

#### STRATEGIES:

- Through staff meetings and periodic memorandums, review the Association's YBS farmer and new generation loan programs and policies with Association personnel to ensure an understanding of and compliance with policies and procedures.
- Ensure YBS loans are properly identified and classified in accordance with Systemwide classification standards.
- Internal controls, and more specifically, the lines of responsibility in administering the YBS program, are contained within existing Association loan policies and procedures regarding standard and new generation loan programs. Each loan officer is charged with maintaining soundness and monitoring performance results within the YBS loan portfolio.
- Increase utilization of the Association's new generation loan program. The Association's goal is to close five loans for \$50,000 in 2014, 10 loans for \$100,000 in 2015, and 20 loans for \$200,000 in 2016.
- Ensure the Association's marketing program adequately targets YBS farmers and ranchers by requiring that branch offices participate in at least one YBS marketing activity on a quarterly basis. Activities will include but not be limited to 4-H and FFA events, youth livestock shows, hay shows, chamber events, support to local charitable and service organizations and other related service events. Documentation of all such activities is required and reported quarterly to Legacy's board of directors.
- Review and update, when needed, the Association lending standards to ensure maximum penetration in the YBS farmer market based on their creditworthiness and the financial ability of the Association.
- Promoting the YBS Program with a positive attitude is required by the entire staff.
- Opportunities to cooperate will include utilization of the Association's new generation program, with coordinated efforts with USDA on its young and beginning farmer participation programs.
- An annual report of the Association's YBS loan related data is submitted to the Farm Credit Bank of Texas after each calendar year end. The Farm Credit Bank of Texas compiles YBS data on a District-wide basis and submits to FCA and to the Association board of directors. A capsule report of YBS loan-related statistics is provided to the Association board of directors on a quarterly basis. Reporting to stockholders is contained in the Annual Report, which is completed during the first quarter of each calendar year for the preceding full calendar year.
- Monitor closely the clear lines of responsibility for YBS Program implementation by loan officers. Additionally, track performance and results of the Association's YBS Program and report quarterly to the Association's board of directors.