AgStar Financial Services, ACA

Quarterly Report
June 30, 2016

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the consolidated financial condition and consolidated results of operations of AgStar Financial Services, ACA (the parent) and AgStar Financial Services, FLCA and AgStar Financial Services, PCA (the subsidiaries). This discussion should be read in conjunction with both the unaudited consolidated financial information and related notes included in this Quarterly Report as well as Management's Discussion and Analysis included in our Annual Report for the year ended December 31, 2015 (2015 Annual Report).

AgriBank, FCB's (AgriBank) financial condition and results of operations materially impact members' investment in AgStar Financial Services, ACA. To request free copies of the AgriBank and combined AgriBank and affiliated Associations' financial reports or additional copies of our report, contact us at:

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NOTICE OF SIGNIFICANT OR MATERIAL EVENTS

We are committed to the success of agriculture, rural communities and most importantly, our client-owners. Every day, we partner with our clients to deliver the insights and expert guidance they've come to expect and count on from their financial services provider. To be that trusted advisor, we're consistently looking for ways to better serve our clients and return value to our stockholders. It's a business objective we've been committed to for the long haul and one we believe matches the strides of our clients – constantly evolving and growing to better our operation.

The Boards of Directors of 1st Farm Credit Services, ACA, AgStar Financial Services, ACA, and Badgerland Financial, ACA are in the process of due diligence to evaluate a potential merger among the three associations. Badgerland Financial, ACA serves the southern 33 Wisconsin counties, and 1st Farm Credit Services, ACA serves the northern 42 counties of Illinois.

While our markets may differ in some ways, our philosophies and focus on client relationships and commitment to rural communities and agriculture are closely aligned. Our due diligence evaluation includes the guidance and assistance of staff and industry experts. We expect the process to conclude in the third quarter of this year. If all three Boards of Directors decide to recommend a merger, a number of additional regulatory and procedural steps will be completed before our client-owners will have the opportunity to vote on the proposal in early 2017.

FORWARD-LOOKING INFORMATION

Any forward-looking statements in this Quarterly Report are based on current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from expectations due to a number of risks and uncertainties. More information about these risks and uncertainties is contained in our 2015 Annual Report. We undertake no duty to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

AGRICULTURAL AND ECONOMIC CONDITIONS

We serve many sectors in agriculture including our primary industries of grain, swine, and dairy. Additionally, we serve the rural housing, energy, and food processing segments. Credit quality, delinquencies, and nonaccrual measures remained stable during the second quarter of 2016. Looking forward, the prospects are more challenging, particularly for grain producers. While many clients enjoy large equity positions, some future deterioration is expected particularly if lower grain prices continue throughout 2016 and beyond. Nonetheless, the quality of the crop portfolio continues to be strong at 96.6% non-adverse.

As of July 12, 2016, the United States Department of Agriculture (USDA) estimated 2015/16 corn production at 13.6 billion bushels, down 4.2% from the 2014/15 marketing year. Estimated average yields were 168.4 bushels per acre, down from 171.0 bushels per acre in 2014/15. Ending corn stocks for 2015/16 were estimated to be 1.7 billion bushels, roughly flat from the season's beginning stocks. The USDA projected season-average farm price for corn for the season ending spring 2016 at $3.60 to $3.70 per bushel. For the coming season, USDA currently projects a 6.6% increase in corn production as well as a modest increase in domestic consumption and exports. As such, USDA projects ending stocks for corn at 2.1 billion bushels and a season price between $3.10 and $3.70 per bushel. However, the March 2017 Chicago Board of Trade (CBOT) futures contract average was $3.80 in the first four months of the year, and was above $4.00 for most of May and June.

The USDA is currently estimating 2015/16 soybean production at 3.9 billion bushels, flat compared to 2014/15. The yield per harvested acre is estimated to be 48.0 bushels per acre, slightly up from 47.5 bushels per acre in 2014/15. Overall global production of soybeans is expected to be down led by the reductions in Argentina and, to a lesser extent, Brazil. Soybean exports in the 2015/16 season are expected to finish at 1.8 billion bushels, down only 48 million despite a significant rise in the average value of the U.S. Dollar. The expected average farm price for the season is $9.05 per bushel. The USDA forecasts a modest reduction in U.S. soybean production for the upcoming 2016/17 season at 3.9 billion bushels. Despite this forecast for production declines, the USDA expects a 7% increase in total U.S. exports along with a concurrent rise in overall global production. Net global production increases are forecasted to be outpaced by global consumption, leading to lower ending stocks in 2017. Consequently, USDA projects the 2016/17season-average farm price for soybeans at $8.75 to $10.25 per bushel. In similar fashion to corn, soybean futures on the CBOT rose above $11.00 during the month of June.

Following two straight years of profitable growth, prices and margins were less favorable for hog producers in 2015 and the first half of 2016. Nevertheless, the quality of the swine portfolio remains very strong at 98.6% non-adverse. The protracted strength of the U.S. dollar has had more limited impact on exports than originally expected. USDA forecasts for pork exports in 2016 and 2017 continue an increasing trend since 2014. The USDA is projecting a steady growth of U.S. production of pork between 2015 and 2017 along with a declining price. U.S. inventory of all hogs and pigs on June 1, 2016 was 68.4 million head. This was up 2% from June 1, 2015, and up 1% from March 1, 2016. This is the highest June 1 inventory of all hogs and pigs since USDA estimates began in 1964. Notwithstanding, the USDA also notes that as of June, producers intend to farrow 2% less sows during the June-August 2016 quarter compared to actual farrowings during the same period in 2015. Intended farrowings for September-November 2016 are also down 1% and 3% from 2015 and 2014, respectively.

U.S. milk production has been steadily increasing since 2003. The initial USDA milk production forecast for 2016 at 212.4 billion pounds was 1.8% higher than 2015, and it reports that milk production across the country remained steady to higher as spring weather advanced. The effects of ongoing drought conditions in the West are being more than offset by increased production in the Midwest – most notably in Wisconsin thanks to favorable weather conditions and ample supply of feed. However, the increased supply in the Midwest has not been met with a comparable increase in demand and/or capacity from processors. Declining expectations for milk prices continued into 2016 as the dairy industry's production shift continues to work its way through the system. The USDA estimates an average price received by farmers for all milk of $15.55 to $15.85 per cwt in 2016, down from the USDA estimated average price of $17.08 per cwt in 2015, but up from expectations in the first quarter. The USDA is forecasting additional margin expansion in 2017 with an expected average price of $15.70-$16.70 per cwt. The quality of the dairy portfolio declined modestly from 97.5% non-adverse at year end to 95.0% at June 30th.

After years of steady increase, farm land values in our area have moderately declined in some areas; and are expected to continue to moderate as we progress through 2016 in response to lower commodity prices. According to a USDA August 2015 survey, cropland values in Minnesota declined 2.5% compared to the August 2014 survey; however, over the same time period, Wisconsin cropland increased 5.7%. Given solid net worth positions and conservative borrowing characteristics, U.S. agriculture is well-positioned to handle a decline in land values without enduring significant financial stress and hardship. Additionally, the moderation in land values has the potential to lead to declines in cash rent, which often represents as much as a third of total direct expenses. According to a survey done by AgriBank, cash rents in Minnesota declined by 2.7% in 2015.

Our rural home mortgage portfolio credit quality remains strong. The economy continues to generate a number of positive economic signals for the housing market including continually lower interest rates. Home ownership in the U.S. is now 63.6% which is just off 50-year lows. According to the CoreLogic HPI, home prices nationwide increased by 5.9% year over year in May 2016, and remained between 5% and 6% for the 22nd consecutive month. CoreLogic HPI also forecasts prices will rise 5.3% over the following 12 months. Additionally, recent reports from the twelve Federal Reserve Districts suggest that national economic activity continued to expand from mid-May through the end of June, and the U.S. Bureau of Labor Statistics reported that the national unemployment rate remains below 5%. The current economy, low interest rates and housing prices have made the environment very good for new home buyers.

In response to the potential changes in the economic environment, some of our core credit objectives include working with clients to promote risk management, ensuring high quality financial statements and production reports, encouraging disciplined marketing plans, and providing individualized servicing plans and strategies.

LOANS HELD TO MATURITY

Loans Held to Maturity

Loans held to maturity were $7.9 billion at June 30, 2016, an increase of $325.4 million from December 31, 2015. The increase was primarily due to an increase in net participations purchased, partially offset by repayments made by borrowers in our production agriculture sectors.

Portfolio Credit Quality

The credit quality of our portfolio declined from December 31, 2015. Adversely classified loans increased to 2.6% of the portfolio at June 30, 2016, from 1.8% of the portfolio at December 31, 2015. Adversely classified loans are loans we have identified as showing some credit weakness outside our credit standards. We have considered portfolio credit quality in assessing the reasonableness of our allowance for loan losses. The credit quality has declined in our grain and dairy portfolios due to lower grain and milk prices.

In certain circumstances, Federal Agricultural Mortgage Corporation and government agency guarantee programs are used to reduce the risk of loss. At June 30, 2016, $676.4 million of our loans were, to some level, guaranteed under these government programs.

Risk Assets

Risk assets are comprised of nonaccrual loans, accruing restructured loans, accruing loans 90 days or more past due, and other property owned.

Components of Risk Assets

(dollars in thousands) As of:	**June 30 2016**	December 31 2015
Loans:		
Nonaccrual	**$ 64,743**	$ 48,897
Accruing restructured	**14,794**	21,072
Accruing loans 90 days or more past due	**3,510**	124
Total risk loans	**83,047**	70,093
Other property owned	**1,294**	1,060
Total risk assets	**$ 84,341**	$ 71,153
Total risk loans as a percentage of total loans	**1.0%**	0.9%
Nonaccrual loans as a percentage of total loans	**0.8%**	0.6%
Current nonaccrual loans as a percentage of total nonaccrual loans	**66.7%**	69.1%
Total delinquencies as a percentage of total loans	**0.8%**	0.4%

Note: Accruing loans include accrued interest receivable.

Our risk assets have increased from December 31, 2015, but remain at acceptable levels. Despite the increase in risk assets, total risk loans as a percentage of total loans remains well within our established risk management guidelines.

The increase in nonaccrual loans was due to certain accounts in our grain and dairy portfolios, partially offset by the upgrading of a communications account. Nonaccrual loans remained at an acceptable level at June 30, 2016.

The decrease in accruing restructured loans was the result of an account in our dairy portfolio being downgraded to a nonaccrual loan during the first quarter of 2016.

The increase in accruing loans 90 days or more past due was primarily due to certain real estate mortgage and production and intermediate term loans in our grain portfolio. Our accounting policy requires accruing loans past due 90 days to be transferred into nonaccrual status unless adequately secured and in the process of collection. Based on our analysis, all accruing loans 90 days or more past due were eligible to remain in accruing status.

The increase in total delinquencies as a percentage of total loans was the result of financial stress in the grain industry. Delinquencies may continue to increase if lower grain prices persist.

Allowance for Loan Losses

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

Allowance Coverage Ratios

As of:	**June 30 2016**	December 31 2015
Allowance as a percentage of:		
Loans	**0.4%**	0.4%
Nonaccrual loans	**48.8%**	55.4%
Total risk loans	**38.0%**	38.6%

The increase in allowance for loan losses from December 31, 2015 was related to provision expense recorded to reflect the deterioration in our grain portfolio. In our opinion, the allowance for loan losses was reasonable in relation to the risk in our loan portfolio at June 30, 2016.

LOANS HELD FOR SALE

We originate loans held for sale under our RuraLiving® program, a rural residential mortgage program designed to provide qualified borrowers with additional options for competitive rate financing of rural homes in small towns or homes that are part of a hobby farm, pastureland, or tillable acreage. Loans closed under this program will be sold to and securitized by a third party investor. At June 30, 2016, the volume in this program was $28.6 million, a $6.8 million decrease from December 31, 2015. The decrease was the result of loans being sold to and securitized by a third party investor and partially offset by loans held for sale being originated.

RESULTS OF OPERATIONS

Profitability Information

(dollars in thousands) For the six months ended June 30		**2016**		2015
Net income	**$**	**57,720**	$	56,035
Return on average assets		**1.4%**		1.5%
Return on average equity		**9.2%**		9.6%

Changes in these ratios are directly related to the changes in income discussed in this section, changes in assets discussed in the Loan Portfolio section, and changes in capital discussed in the Funding, Liquidity, and Capital section.

Changes in Significant Components of Net Income

(in thousands) For the six months ended June 30		**2016**		2015		**Increase (decrease) in net income**
Net interest income	**$**	**102,392**	$	95,989	**$**	**6,403**
Provision for loan losses		**4,356**		1,700		**(2,656)**
Patronage income		**11,940**		8,901		**3,039**
Other income, net		**20,595**		20,599		**(4)**
Operating expenses		**67,213**		62,588		**(4,625)**
Provision for income taxes		**5,638**		5,166		**(472)**
Net income	**$**	**57,720**	$	56,035	**$**	**1,685**

Changes in Net Interest Income

(in thousands) For the six months ended June 30		**2016 vs 2015**
Changes in volume	**$**	**11,562**
Changes in interest rates		**(5,006)**
Changes in asset securitization		**109**
Changes in nonaccrual income and other		**(262)**
Net change	**$**	**6,403**

The change in the provision for loan losses was related to deterioration of loans in our grain portfolio.

Patronage income was impacted by three factors during the six months ended June 30, 2016. First, it was impacted by an increase in patronage income received on loans in the AgriBank Asset Pool Program due to a higher average balance of our portfolio in the AgriBank Asset Pool Program, compared to the prior year. Secondly, additional patronage accrued related to an increase in wholesale spread on our note payable. Thirdly, the first two factors were partially offset by a decrease in patronage income related to a lower patronage rate applied to the average balance on our note payable with AgriBank compared to the prior year.

We originated rural home loans for resale into the secondary market. We sold loans in the secondary market totaling $23.0 million through June 30, 2016 compared to $32.1 million for the same period in 2015. The fee income from this activity totaled $564 thousand for the six months ended June 30, 2016 compared to $660 thousand for the same period of 2015.

The change in operating expenses was primarily related to increases in salary and benefits expense, Farm Credit System Insurance Corporation (FCSIC) expense, and furniture and equipment expense. FCSIC expense increased in 2016 primarily due to an increase in the premium rate charged on accrual loans by FCSIC from 13 basis points in 2015 to 16 basis points for the first half and 18 basis points for the second half of 2016.The FCSIC Board meets periodically throughout the year to review premium rates and has the ability to change these rates at any time.

FUNDING, LIQUIDITY, AND CAPITAL

We borrow from AgriBank, under a note payable, in the form of a line of credit. Our note payable matured on March 31, 2016 and was renewed for $8.5 billion with a maturity date of March 31, 2017. The note payable will be renegotiated at that time. The repricing attributes of our line of credit generally correspond to the repricing attributes of our loan portfolio which significantly reduces our market interest rate risk. Due to the cooperative structure of the Farm Credit System and as we are a stockholder of AgriBank, we expect this borrowing relationship to continue into the foreseeable future.

Cost of funds associated with our note payable includes a marginal cost of debt component, a spread component, which includes cost of servicing, cost of liquidity, and bank profit, and, if applicable, a risk premium component. However, we were not subject to a risk premium at June 30, 2016 or December 31, 2015.

Total equity increased $53.9 million from December 31, 2015 primarily due to net income for the period, which was partially offset by preferred stock dividend accruals and accrued redemptions of nonqualified patronage allocations.

Farm Credit Administration regulations require us to maintain a certain level for our permanent capital ratio, total surplus ratio, and core surplus ratio. Refer to Note 11 in our 2015 Annual Report for a more complete description of these ratios.

Select Capital Ratios

As of	Regulatory Minimums	**June 30 2016**	December 31 2015
Permanent capital ratio	7.0%	**14.4%**	14.8%
Total surplus ratio	7.0%	**14.2%**	14.5%
Core surplus ratio	3.5%	**11.9%**	12.3%

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

REGULATORY MATTERS

Regulatory Capital Requirements

On March 10, 2016, the FCA Board approved a final rule to modify the regulatory capital requirements for System Banks and Associations. The stated objectives of the rule are to:

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

The final rule replaces existing core surplus and total surplus ratios with common equity tier 1, tier 1, and total capital risk-based capital ratios. The final rule also adds a tier 1 leverage ratio. The permanent capital ratio continues to remain in effect with the final rule. Refer to Note 5 of the accompanying Consolidated Financial Statements for additional information regarding these ratios.

The effective date of the new capital requirements is January 1, 2017. We are currently evaluating the impact of the recently announced changes.

Investment Securities Eligibility

On June 12, 2014, the FCA Board approved a proposed rule to revise the requirements governing the eligibility of investments for System Banks and Associations. The stated objectives of the proposed rule are to:

- Strengthen the safety and soundness of System Banks and Associations
- Ensure that System Banks hold sufficient liquidity to continue operations and pay maturing obligations in the event of market disruption
- Enhance the ability of the System Banks to supply credit to agricultural and aquatic producers
- Comply with the requirements of section 939A of the Dodd-Frank Act
- Modernize the investment eligibility criteria for System Banks
- Revise the investment regulation for System Associations to improve their investment management practices so they are more resilient to risk

The public comment period ended on October 23, 2014.

CERTIFICATION

The undersigned have reviewed the June 30, 2016 Quarterly Report of AgStar Financial Services, ACA, which has been prepared under the oversight of the Audit Committee and in accordance with all applicable statutory or regulatory requirements. The information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Kaye Compart
Chairperson of the Board
AgStar Financial Services, ACA

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

Jase L. Wagner
Senior Vice President and Chief Financial Officer
AgStar Financial Services, ACA

August 8, 2016

CONSOLIDATED STATEMENTS OF CONDITION

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

As of:		June 30 2016		December 31 2015
ASSETS				
Loans held to maturity	**$**	**7,897,484**	$	7,572,042
Allowance for loan losses		**31,569**		27,071
Net loans held to maturity		**7,865,915**		7,544,971
Loans held for sale		**28,550**		35,380
Net loans		**7,894,465**		7,580,351
Unrestricted cash		**2,000**		1,900
Investment securities		**459,737**		442,972
Assets held for lease, net		**35,792**		38,396
Accrued interest receivable		**65,090**		58,734
Investment in AgriBank, FCB		**180,235**		171,395
Premises and equipment, net		**17,720**		18,072
Other property owned		**1,294**		1,060
Other assets		**55,857**		48,830
Total assets	**$**	**8,712,190**	$	8,361,710
LIABILITIES				
Note payable to AgriBank, FCB	**$**	**7,227,322**	$	6,949,764
Subordinated debt		**99,552**		99,491
Accrued interest payable		**30,791**		26,805
Deferred tax liabilities, net		**1,263**		3,614
Other liabilities		**72,194**		54,902
Total liabilities		**7,431,122**		7,134,576
Contingencies and commitments (Note 6)				
EQUITY				
Preferred stock		**100,000**		100,000
Capital stock and participation certificates		**15,982**		16,085
Allocated surplus		**435,979**		406,758
Unallocated surplus		**729,107**		704,291
Total equity		**1,281,068**		1,227,134
Total liabilities and equity	**$**	**8,712,190**	$	8,361,710

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

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

	Three Months Ended		Six Months Ended	
For the period ended June 30	**2016**	2015	**2016**	2015
Interest income	**$ 84,350**	$ 74,770	**$ 166,264**	$ 148,851
Interest expense	**32,695**	26,907	**63,872**	52,862
Net interest income	**51,655**	47,863	**102,392**	95,989
Provision for loan losses	**2,252**	1,700	**4,356**	1,700
Net interest income after provision for loan losses	**49,403**	46,163	**98,036**	94,289
Other income				
Patronage income	**6,036**	4,589	**11,940**	8,901
Net operating lease income	**284**	406	**662**	886
Financially related services income	**5,069**	5,240	**10,072**	9,751
Fee and miscellaneous income, net	**4,921**	5,946	**9,861**	9,962
Total other income	**16,310**	16,181	**32,535**	29,500
Operating expenses				
Salaries and employee benefits	**21,521**	21,235	**45,457**	42,739
Farm Credit System insurance	**2,887**	2,027	**5,683**	4,086
Other operating expenses	**7,928**	8,106	**16,073**	15,763
Total operating expenses	**32,336**	31,368	**67,213**	62,588
Income before income taxes	**33,377**	30,976	**63,358**	61,201
Provision for income taxes	**2,903**	2,150	**5,638**	5,166
Net income	**$ 30,474**	$ 28,826	**$ 57,720**	$ 56,035
Other comprehensive income				
Investment securities available-for-sale:				
Not-other-than-temporarily-impaired investments	**$ --**	$ (201)	**$ --**	$ (82)
Total other comprehensive income	**--**	(201)	**--**	(82)
Comprehensive income	**$ 30,474**	$ 28,625	**$ 57,720**	$ 55,953

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

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

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

	Preferred Stock	Capital Stock and Participation Certificates	Allocated Surplus	Unallocated Surplus	Accumulated Other Comprehensive Income	Total Equity
Balance at December 31, 2014	$ 100,000	$ 16,177	$ 371,004	$ 650,915	$ 82	$ 1,138,178
Net income	--	--	--	56,035	--	56,035
Other comprehensive income	--	--	--	--	(82)	(82)
Net surplus allocated under nonqualified patronage program	--	--	28,714	(28,714)	--	--
Redemption of prior year allocated patronage	--	--	(318)	--	--	(318)
Preferred stock dividend	--	--	--	(3,375)	--	(3,375)
Capital stock and participation certificates issued	--	663	--	--	--	663
Capital stock and participation certificates retired	--	(731)	--	--	--	(731)
Balance at June 30, 2015	$ 100,000	$ 16,109	$ 399,400	$ 674,861	$ --	$ 1,190,370
Balance at December 31, 2015	$ 100,000	$ 16,085	$ 406,758	$ 704,291	$ --	$ 1,227,134
Net income	**--**	**--**	**--**	**57,720**	**--**	**57,720**
Other comprehensive income	**--**	**--**	**--**	**--**	**--**	**--**
Net surplus allocated under nonqualified patronage program	**--**	**--**	**29,529**	**(29,529)**	**--**	**--**
Redemption of prior year allocated patronage	**--**	**--**	**(308)**	**--**	**--**	**(308)**
Preferred stock dividend	**--**	**--**	**--**	**(3,375)**	**--**	**(3,375)**
Capital stock and participation certificates issued	**--**	**650**	**--**	**--**	**--**	**650**
Capital stock and participation certificates retired	**--**	**(753)**	**--**	**--**	**--**	**(753)**
Balance at June 30, 2016	**$ 100,000**	**$ 15,982**	**$ 435,979**	**$ 729,107**	**$ --**	**$ 1,281,068**

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

The Consolidated Financial Statements contain all adjustments necessary for a fair presentation of the interim consolidated financial condition and consolidated results of operations. While our accounting policies conform to accounting principles generally accepted in the United States of America (U.S. GAAP) and the prevailing practices within the financial services industry, this interim Quarterly Report is prepared based upon statutory and regulatory requirements and, accordingly, does not include all disclosures required by U.S. GAAP. The results of the six months ended June 30, 2016 are not necessarily indicative of the results to be expected for the year ending December 31, 2016. The interim financial statements and the related notes in this Quarterly Report should be read in conjunction with the Consolidated Financial Statements and related notes included in our Annual Report for the year ended December 31, 2015 (2015 Annual Report).

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

Recently Issued or Adopted Accounting Pronouncements

The following accounting standards have been issued during the second quarter of 2016, but are not yet effective.

In June 2016, the Financial Accounting Standards Board (FASB) issued guidance entitled "Measurement of Credit Losses on Financial Instruments." The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses. The guidance is effective for public entities for annual reporting periods beginning after December 15, 2020, including interim periods within those annual periods. Early adoption is permitted as of annual reporting periods beginning after December 15, 2018, including interim periods within those annual periods. We are currently evaluating the impact of the guidance on our financial condition, results of operations, cash flows, and financial statement disclosures.

Refer to Note 2 in our 2015 Annual Report for additional information on other accounting standards that have been issued, but are not yet effective. We are currently evaluating the impact of the guidance on our Consolidated Financial Statements. No accounting pronouncements were adopted during the six months ended June 30, 2016.

NOTE 2: LOANS HELD TO MATURITY AND ALLOWANCE FOR LOAN LOSSES

Loans by Type

(dollars in thousands)

As of:	June 30, 2016		December 31, 2015	
	Amount	%	Amount	%
Real estate mortgage	**$ 3,800,171**	**48.1%**	$ 3,675,008	48.5%
Production and intermediate term	**1,923,777**	**24.4%**	2,020,921	26.7%
Agribusiness	**1,220,706**	**15.4%**	920,347	12.2%
Other	**952,830**	**12.1%**	955,766	12.6%
Total	**$ 7,897,484**	**100.0%**	$ 7,572,042	100.0%

The other category is primarily comprised of energy, communication, rural residential real estate, and international related loans as well as finance and conditional sales leases and bonds originated under our mission related investment authority.

Credit Quality

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

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

We had no loans categorized as loss at June 30, 2016 or December 31, 2015.

Credit Quality of Loans

(dollars in thousands)	Acceptable		OAEM		Substandard/ Doubtful		Total	
As of June 30, 2016	Amount	%	Amount	%	Amount	%	Amount	%
Real estate mortgage	**$ 3,629,116**	**94.6%**	**$ 110,783**	**2.9%**	**$ 97,428**	**2.5%**	**$ 3,837,327**	**100.0%**
Production and intermediate term	**1,789,226**	**92.1%**	**67,699**	**3.5%**	**84,836**	**4.4%**	**1,941,761**	**100.0%**
Agribusiness	**1,194,079**	**97.6%**	**14,454**	**1.2%**	**15,221**	**1.2%**	**1,223,754**	**100.0%**
Other	**903,315**	**94.6%**	**38,354**	**4.0%**	**13,189**	**1.4%**	**954,858**	**100.0%**
Total	**$ 7,515,736**	**94.5%**	**$ 231,290**	**2.9%**	**$ 210,674**	**2.6%**	**$ 7,957,700**	**100.0%**

	Acceptable		OAEM		Substandard/ Doubtful		Total	
As of December 31, 2015	Amount	%	Amount	%	Amount	%	Amount	%
Real estate mortgage	$ 3,564,761	96.2%	$ 85,808	2.3%	$ 56,311	1.5%	$ 3,706,880	100.0%
Production and intermediate term	1,962,292	96.3%	33,079	1.6%	43,275	2.1%	2,038,646	100.0%
Agribusiness	891,229	96.6%	14,207	1.5%	17,267	1.9%	922,703	100.0%
Other	916,462	95.7%	20,813	2.2%	20,517	2.1%	957,792	100.0%
Total	$ 7,334,744	96.2%	$ 153,907	2.0%	$ 137,370	1.8%	$ 7,626,021	100.0%

Note: Accruing loans include accrued interest receivable.

Delinquency

Aging Analysis of Loans

(in thousands) **As of June 30, 2016**	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	90 Days or More Past Due and Accruing
Real estate mortgage	**$ 19,497**	**$ 10,303**	**$ 29,800**	**$ 3,807,527**	**$ 3,837,327**	**$ 1,807**
Production and intermediate term	**21,923**	**10,483**	**32,406**	**1,909,355**	**1,941,761**	**1,703**
Agribusiness	**57**	**--**	**57**	**1,223,697**	**1,223,754**	**--**
Other	**2,917**	**2,129**	**5,046**	**949,812**	**954,858**	**--**
Total	**$ 44,394**	**$ 22,915**	**$ 67,309**	**$ 7,890,391**	**$ 7,957,700**	**$ 3,510**

As of December 31, 2015	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	90 Days or More Past Due and Accruing
Real estate mortgage	$ 12,952	$ 4,039	$ 16,991	$ 3,689,889	$ 3,706,880	$ 27
Production and intermediate term	3,409	6,890	10,299	2,028,347	2,038,646	28
Agribusiness	98	--	98	922,605	922,703	--
Other	3,366	1,549	4,915	952,877	957,792	69
Total	$ 19,825	$ 12,478	$ 32,303	$ 7,593,718	$ 7,626,021	$ 124

Note: Accruing loans include accrued interest receivable.

Risk Loans

Risk loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms.

Risk Loan Information

(in thousands) As of:		June 30 2016		December 31 2015
Volume with specific reserves	$	11,869	$	4,785
Volume without specific reserves		71,178		65,308
Total risk loans	$	83,047	$	70,093
Total specific reserves	$	4,529	$	2,230
For the six months ended June 30		2016		2015
Income on accrual risk loans	$	520	$	716
Income on nonaccrual loans		2,897		3,379
Total income on risk loans	$	3,417	$	4,095
Average risk loans	$	75,863	$	79,284

Note: Accruing loans include accrued interest receivable.

We did not have any material commitments to lend additional money to borrowers whose loans were at risk at June 30, 2016.

Troubled Debt Restructurings (TDRs)

In situations where, for economic or legal reasons related to the borrower's financial difficulties, we grant a concession for other than an insignificant period of time to the borrower that we would not otherwise consider, the related loan is classified as a troubled debt restructuring, also known as a restructured loan. A concession is generally granted in order to minimize economic loss and avoid foreclosure. Concessions vary by program and borrower and may include interest rate reductions, term extensions, payment deferrals, or an acceptance of additional collateral in lieu of payments. In limited circumstances, principal may be forgiven. Loans classified as TDRs are considered risk loans. All risk loans are analyzed within our allowance for loan losses. We record a specific allowance to reduce the carrying amount of the restructured loan to the lower of book value or net realizable value of collateral.

TDR Activity

(in thousands) Six months ended June 30	2016				2015			
		Pre-modification		Post-modification		Pre-modification		Post-modification
Real estate mortgage	$	--	$	--	$	--	$	282
Production and intermediate term		781		778		575		295
Agribusiness		69		69		--		--
Total	$	850	$	847	$	575	$	577

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

The primary types of modification during the six months ended June 30, 2016 were deferral of principal and extension of maturity.

We had TDRs in the production and intermediate term loan category of $229 thousand and $7 thousand that defaulted during the six months ended June 30, 2016 and 2015, respectively in which the modifications were within twelve months of the respective reporting period.

TDRs Outstanding

(in thousands) As of:		June 30 2016		December 31 2015
Accrual status:				
Real estate mortgage	$	12,938	$	17,193
Production and intermediate term		1,856		3,879
Agribusiness		--		--
Other		--		--
Total TDRs in accrual status	$	14,794	$	21,072
Nonaccrual status:				
Real estate mortgage	$	8,298	$	4,929
Production and intermediate term		5,327		5,582
Agribusiness		69		--
Other		91		8,407
Total TDRs in nonaccrual status	$	13,785	$	18,918
Total TDRs status:				
Real estate mortgage	$	21,236	$	22,122
Production and intermediate term		7,183		9,461
Agribusiness		69		--
Other		91		8,407
Total TDRs	$	28,579	$	39,990

The decrease in outstanding TDRs from December 31, 2015 to June 30, 2016 is primarily due to one borrower refinancing their notes.

Additional commitments to lend to borrowers whose loans have been modified in a TDR were $1.5 million at June 30, 2016.

Allowance for Loan Losses

Changes for Allowance for Loan Losses

(in thousands) Six months ended June 30		2016		2015
Balance at beginning of period	$	27,071	$	23,655
Provision for loan losses		4,356		1,700
Loan recoveries		704		402
Loan charge-offs		(562)		(1,124)
Balance at end of period	$	31,569	$	24,633

The increase in allowance for loan losses from June 30, 2015 was related to provision expense recorded to reflect the deterioration in our grain portfolio.

NOTE 3: INVESTMENT SECURITIES

We have held-to-maturity investment securities of $459.7 million at June 30, 2016 and $443.0 million at December 31, 2015. Our investment securities consisted of:

- Mortgage-backed securities (MBS) issued by the Federal Agricultural Mortgage Corporation (Farmer Mac) or guaranteed by the Small Business Administration (SBA) or by the United States Department of Agriculture (USDA)
- Asset-backed securities (ABS) guaranteed by SBA or USDA
- Municipal bonds

The investment securities have been classified as held-to-maturity. MBS are generally longer-term investments and ABS are generally shorter-term investments. Farmer Mac guaranteed investments are typically MBS while SBA and USDA guaranteed investments may be comprised of either MBS or ABS. All of our held-to-maturity investment securities, except $4.9 million, were fully guaranteed by Farmer Mac, SBA, or USDA at June 30, 2016 and December 31, 2015.

Additional Held-to-Maturity Investment Securities Information

(dollars in thousands) **As of June 30, 2016**	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Weighted Average Yield
MBS	**$ 418,427**	**$ 5,866**	**$ (7,005)**	**$ 417,288**	**4.0%**
ABS	**36,374**	**5**	**(1,993)**	**34,386**	**2.1%**
Municipal bonds	**4,936**	**35**	**--**	**4,971**	**6.4%**
Total	**$ 459,737**	**$ 5,906**	**$ (8,998)**	**$ 456,645**	**3.9%**

As of December 31, 2015	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Weighted Average Yield
MBS	$ 396,433	$ 1,542	$ (9,213)	$ 388,762	3.6%
ABS	41,603	1	(2,376)	39,228	1.9%
Municipal bonds	4,936	--	(251)	4,685	6.4%
Total	$ 442,972	$ 1,543	$ (11,840)	$ 432,675	3.5%

Investment income is recorded in "Interest income" in the Consolidated Statements of Comprehensive Income and totaled $8.0 million and $7.4 million for the six months ended June 30, 2016 and 2015, respectively.

Contractual Maturities of Held-to-Maturity Investment Securities

(in thousands) **As of June 30, 2016**	Amortized Cost
Less than one year	**$ 1,452**
One to five years	**29,589**
Five to ten years	**63,835**
More than ten years	**364,861**
Total	**$ 459,737**

A summary of investments in an unrealized loss position presented by the length of time the investments have been in continuous unrealized loss position follows:

(in thousands)	Less than 12 months		Greater than 12 months	
As of June 30, 2016	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
MBS	**$ 9,874**	**$ 301**	**$ 89,736**	**$ 6,704**
ABS	**4,290**	**293**	**27,581**	**1,700**
Municipal bonds	**--**	**--**	**--**	**--**
Total	**$ 14,164**	**$ 594**	**$ 117,317**	**$ 8,404**

	Less than 12 months		Greater than 12 months	
As of December 31, 2015	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
MBS	$ 100,500	$ 2,221	$ 152,190	$ 6,992
ABS	10,221	538	27,360	1,838
Municipal bonds	4,665	251	--	--
Total	$ 115,386	$ 3,010	$ 179,550	$ 8,830

Unrealized losses greater than 12 months associated with held-to-maturity investment securities are not considered to be other-than-temporary due to the 100% guarantee of the principal by Farmer Mac, SBA, or USDA. However, the premiums paid to purchase the investment are not guaranteed and are amortized over the maturity of each loan on a straight-line basis as a reduction of interest income. Repayment of principal is assessed at least quarterly, and any remaining unamortized premium is taken as a reduction to interest income if principal repayment is unlikely, or when a demand for payment is made for the guarantee. At June 30, 2016, the majority of the $8.4 million unrealized loss greater than 12 months represents unamortized premium.

We had no outstanding available-for-sale investment securities at June 30, 2016 or December 31, 2015.

Additional Available-for-Sale Investment Securities Information

(in thousands) For the six months ended June 30	**2016**	2015
Proceeds from sales	**$ 49,002**	$ 30,724
Realized gains on sales, net	**408**	129
Unrealized gains (losses)	**--**	(82)

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

NOTE 4: OTHER INVESTMENT

We and other Farm Credit Institutions are among the forming limited partners for a $154.5 million Rural Business Investment Company (RBIC) established on October 3, 2014. The RBIC facilitates equity and debt investments in agriculture-related businesses that create growth and job opportunities in rural America. Our total commitment is $20.0 million through October 2019. Our investment in the RBIC is recorded in “Other assets” in the Consolidated Statements of Condition, and totaled $5.1 million at June 30, 2016 and $4.2 million at December 31, 2015.

The investment was evaluated for impairment. To date, we have not recognized any impairment on this investment. During the six months ended June 30, 2016 we received a distribution of $250 thousand as the RBIC sold an investment. The distribution was a return of contributed capital and therefore reduced our recorded investment. To date, no income has been distributed from the RBIC.

NOTE 5: EQUITY

Regulatory Capitalization Requirements

On March 10, 2016, the FCA Board approved a final rule to modify the regulatory capital requirements for System Banks and Associations. The final rule replaces existing core surplus and total surplus ratios with common equity tier 1, tier 1, and total capital risk-based capital ratios. The final rule also adds a tier 1 leverage ratio. The permanent capital ratio continues to remain in effect with the final rule. The effective date of the new capital requirements is January 1, 2017.

FCA Revised Capital Requirements

	Regulatory Minimums	Capital Conservation Buffer	Total
Risk adjusted:			
Common equity Tier 1 ratio	4.5%	2.5%	7.0%
Tier 1 capital ratio	6.0%	2.5%	8.5%
Total capital ratio	8.0%	2.5%	10.5%
Non-risk adjusted:			
Tier 1 leverage ratio	4.0%	1.0%	5.0%

If capital ratios fall below the total requirements, including the buffer amounts, capital distributions (equity redemptions, dividends, and patronage) and discretionary senior executive bonuses are restricted or prohibited without prior FCA approval.

NOTE 6: CONTINGENCIES AND COMMITMENTS

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

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

We are among the forming limited partners in a RBIC. Refer to Note 4 for additional discussion regarding this commitment.

NOTE 7: FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or most advantageous market for the asset or liability. Accounting guidance also establishes a fair value hierarchy, with three levels of inputs that may be used to measure fair value. Refer to Note 2 in our 2015 Annual Report for a more complete description of the three input levels.

Recurring Basis

The following represents a summary of the assets, valuation techniques, and inputs used to measure fair value on a recurring basis:

Loans held for sale: The loans held for sale portfolio is held at fair value. Fair value is based on quoted market prices, where available, or the prices for other similar mortgage loans with similar characteristics. As necessary, these prices are adjusted for typical securitization activities, including servicing value, portfolio composition, market conditions, and liquidity. We had loans held for sale of $28.6 million and $35.4 million as of June 30, 2016 and December 31, 2015, respectively, which were valued using Level 3 inputs. Total fair value gains related to these loans of $343 thousand for the six months ended June 30, 2016, compared to $97 thousand of fair value losses for the same period of 2015, were recognized in "Fee and miscellaneous income, net" in the Consolidated Statements of Comprehensive Income.

Investment securities available-for-sale: Investment securities available-for-sale are held at fair value. Fair value is based on quoted market prices, where available, or the prices for other similar securities with similar characteristics. As necessary, these prices are adjusted for typical securitization activities, including servicing value, portfolio composition, market conditions, and liquidity. We had no investment securities available-for-sale at June 30, 2016 or December 31, 2015. Losses on available-for-sale investments totaled $82 thousand for the six months ended June 30, 2015, which were recognized in "Other comprehensive income" in the Consolidated Statements of Comprehensive Income. During the six months ended June 30, 2015 we sold available-for-sale investment securities with total sales proceeds of $30.7 million, resulting in a gain of $129 thousand, which was recognized in "Fee and miscellaneous income, net" in the Consolidated Statement of Comprehensive Income. During the six months ended June 30, 2016 we sold available-for-sale investment securities with total sales proceeds of $49.0 million, resulting in a gain of $408 thousand, which was recognized in "Fee and miscellaneous income, net" in the Consolidated Statements of Comprehensive Income.

Derivatives: If an active market exists, the fair value of our derivative financial instruments called TBAs is based on currently quoted market prices. We had TBAs with a notional value of $53.0 million and $42.7 million as of June 30, 2016 and December 31, 2015, respectively, which were used to manage exposure to interest rate risk and changes in the fair value of loans held for sale and the interest rate lock commitments that are determined prior to funding. We also used these instruments to hedge the changes in fair value related to investment securities available-for-sale. These derivatives were recorded on a net basis using Level 1 fair value inputs. Net losses related to TBAs sold, combined with fair value gains on the TBAs, resulted in a net loss of $1.4 million for the six months ended June 30, 2016, compared to $20 thousand for the same period of 2015. These were included in "Fee and miscellaneous income, net" in the Consolidated Statements of Comprehensive Income.

Non-Recurring Basis

We may also be required, from time to time, to measure certain assets at fair value on a non-recurring basis. The following represents a summary of the assets, valuation techniques, and inputs used to measure fair value on a non-recurring basis:

Impaired loans: Represents the carrying amount and related write-downs of loans which were evaluated for individual impairment based on the appraised value of the underlying collateral. When the value of the collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. If the process uses independent appraisals and other market-based information, they are classified as Level 2. If the process requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters, they are classified as Level 3.

Other property owned: Represents the fair value and related losses of foreclosed assets that were measured at fair value based on the collateral value, which is generally determined using appraisals, or other indications based on sales of similar properties. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. If the process uses independent appraisals and other market-based information, they are classified as Level 2. If the process requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the property and other matters, they are classified as Level 3.

Assets Measured at Fair Value on a Non-recurring Basis

(in thousands)

	As of June 30, 2016				Six months ended June 30, 2016
	Fair Value Measurement Using			Total Fair	Total (Losses)
	Level 1	Level 2	Level 3	Value	Gains
Impaired loans	**$ --**	**$ 2,162**	**$ 5,545**	**$ 7,707**	**$ (2,667)**
Other property owned	**--**	**--**	**1,475**	**1,475**	**48**

	As of December 31, 2015				Six months ended June 30, 2015
	Fair Value Measurement Using			Total Fair	Total (Losses)
	Level 1	Level 2	Level 3	Value	Gains
Impaired loans	$ --	$ 1,493	$ 1,190	$ 2,683	$ (1,267)
Other property owned	--	--	1,473	1,473	455

NOTE 8: SUBSEQUENT EVENTS

We have evaluated subsequent events through August 8, 2016, which is the date the Consolidated Financial Statements were available to be issued. There have been no material subsequent events that would require recognition in our Quarterly Report or disclosure in the Notes to Consolidated Financial Statements.