AgStar Financial Services, ACA

Quarterly Report
September 30, 2013

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the consolidated financial position 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 2012 Annual Report for the year ended December 31, 2012.

AgriBank, FCB's (AgriBank) financial condition and results of operations materially impact stockholders' 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 P.O. Box 4249, Mankato, MN 56002-4249, by phone at (866-577-1831), by e-mail at AgStarEteam@agastar.com, or at our website, www.agstar.com. You may also contact AgriBank at 30 East 7th Street, Suite 1600, St. Paul, MN 55101, (651) 282-8800, or by e-mail at financialreporting@agribank.com. The AgriBank and combined AgriBank and Affiliated Associations' financial reports are available through AgriBank's website at www.agribank.com.

Notice of Significant or Material Events

On May 30, 2013, we issued $100 million of Series A-1 non-cumulative perpetual preferred stock. We used the net proceeds from the Series A-1 preferred stock issuance to increase our regulatory capital pursuant to current Farm Credit Administration (FCA) regulations, for the continued development of our business, and for general corporate purposes. For regulatory capital purposes, our Series A-1 preferred stock is included in permanent capital, total surplus, and core surplus, subject to certain limitations. Dividends on Series A-1 preferred stock, if declared by the Board of Directors in its sole discretion, are non-cumulative and are payable quarterly. This issuance of preferred stock is discussed in Note 4 to the accompanying consolidated financial statements.

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 2012 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.

Loan Portfolio

Loans totaled $6.1 billion at September 30, 2013, a $173.6 million increase from December 31, 2012. The increase was due to our continued focus on capitalizing on growth opportunities in our correspondent lending programs in our real estate mortgage portfolio. This increase was partially offset by repayments made by a certain segment of our clients in the grain, swine, and dairy industries resulting from tax planning that occurred in the fourth quarter of 2012.

Agricultural and Economic Conditions

We serve many sectors in agriculture including our primary industries of grain, swine and dairy. We expect continued improvement in credit quality, delinquencies, and nonaccrual measures for the last quarter of 2013.

The latest United States Department of Agriculture (USDA) World Agriculture Supply and Demand Estimates report put 2013 corn production at a record 13.8 billion bushels with season average corn prices from $4.40 to $5.20 per bushel, declining nearly $2 per bushel from the beginning of the year. This decline in corn prices has improved overall margins for the protein and renewable fuels sectors. Conversely, this drop in prices has lowered the projected profitability of grain producers.

Production forecast for soybeans is at 3.15 billion bushels which is slightly down from previous estimates. Season average soybean prices are from $11.50 to $13.50 per bushel. National yield forecasts continue to point toward an average or slightly better yield.

Some clients within our territory were impacted by excessive moisture this past spring, resulting in some corn acres either not being planted or being switched to soybeans. The late frost has helped many of these late plantings reach maturity, although harvest will be later than normal in many areas.

Pork margins have shown improvement from earlier this year as grain prices declined and improved prices have provided livestock producers with an opportunity to improve margins. Profit margins for dairy producers and ethanol facilities are also currently positive and are expected to remain positive at least through the end of 2013. Exports for pork and dairy products remain strong.

According to the USDA, net farm income is forecast at $120.6 billion for 2013. This is nearly 6% higher than the 2012 forecast. Over the last two years overall conditions have been favorable for agricultural producers, generally resulting in positive performance for agribusinesses. The ethanol industry experienced a challenging economic environment in 2012 and credit quality in this segment has moderated relative to the overall portfolio. Additionally, agricultural related businesses have generally been profitable and fared better during the past two years than companies not closely tied to agriculture.

Farm real estate values in our territory showed strong increases during 2012 and 2013 although the lower crop prices may lead to more stable prices in 2014. To date, there have been fewer sales as both buyers and sellers seem to be waiting on crop yields, interest rates and commodity prices before deciding to buy and sell. There have also been a few 'no sales' at recent auctions. Values for transitional and recreational property remain low compared to the peak values previously reached.

Our home mortgage portfolio continues to show solid growth in 2013. Delinquency and credit quality levels have returned to pre-housing industry crisis levels. There continue to be positive signs which help sustain the housing recovery. According to the latest report from the Minnesota Association of REALTORS®, numbers are reflecting a positive trend in the market as the housing market continues to improve. There are over 4,500 more new home listings in September of this year compared to September 2012. Closed sales are similarly trending upwards with a 6.6% increase and an average of 79 days on the market. While the recent interest rate increases have slowed down some of the positive momentum the housing industry has experienced in recent months, current rate levels are still near historic lows.

Finally, according to the U.S. Department of Labor, the national unemployment rate remained at 7.2% as of September 30, 2013.

Portfolio Credit Quality

The credit quality of our portfolio has improved from December 31, 2012. Adversely classified loans decreased to 3.3% of the portfolio at September 30, 2013, from 4.3% of the portfolio at December 31, 2012. Adversely classified loans are loans we have identified as showing some credit weakness outside our credit standards. We have considered portfolio credit quality in assessing the reasonableness of our allowance for loan/lease losses.

In certain circumstances, government guarantee programs are used to reduce the risk of loss. At September 30, 2013, $475.9 million of our loans were, to some level, guaranteed under these governmental programs.

Excluded in the ratios and volumes discussed in this section are our investment securities. At September 30, 2013, our investment securities totaled $475.2 million, consisting of $280.1 million in mortgage backed securities issued by Federal Agricultural Mortgage Corporation and $195.0 million in investment securities, guaranteed by the Small Business Administration (SBA) or the United States Department of Agriculture (USDA). Had this volume been included, the adversely classified asset ratio would be 3.0%.

Risk Assets

The following table summarizes risk information (dollars in thousands):

As of:	**September 30 2013**	December 31 2012
Loans:		
Nonaccrual	**$ 146,375**	$ 151,591
Accruing restructured	**11,788**	102
Accruing loans 90 days or more past due	**1,110**	126
Total risk loans	**159,273**	151,819
Other property owned	**6,105**	10,137
Total risk assets	**$ 165,378**	$ 161,956
Risk loans as a percentage of total loans	**2.6%**	2.6%
Total delinquencies as a percentage of total loans	**1.1%**	1.5%

While our overall credit quality continues to improve, our risk assets, primarily consisting of nonaccrual loan volume, has increased from December 31, 2012 and remains above our targeted level.

Nonaccrual loan volume is above our credit standards at September 30, 2013, and represented 2.4% of our total portfolio. We are actively engaged in working with clients to provide individualized servicing plans and strategies. The majority of the remaining accounts in nonaccrual status are in the dairy sector, are current in repayment, and require additional time and performance to bring them back into performing status. At September 30, 2013, 62.2% of our nonaccrual loans were current.

The increase in accruing restructured loans was primarily the result of loans restructured to improve the borrowers' cash flow. These loans are performing according to the restructure plans.

The increase in accruing loans 90 days or more past due was primarily due to a limited number of loans secured by real estate with a collection plan in place. Our accounting policy generally requires loans past due 90 days to be transferred into nonaccrual status.

Allowance for Loan/Lease Losses

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

The following table presents comparative allowance coverage of various loan categories:

Allowance as a percentage of:	**September 30 2013**	December 31 2012
Loans	**0.4%**	0.5%
Nonaccrual loans	**17.3%**	17.7%
Total risk loans	**15.9%**	17.7%

In our opinion, the allowance for loan/lease losses was reasonable in relation to the risk in our loan portfolio at September 30, 2013.

Results of Operations

Net income for the nine months ended September 30, 2013 totaled $83.9 million compared to $69.7 million for the same period in 2012. The following table illustrates profitability information:

As of September 30	**2013**	2012
Return on average assets	**1.7%**	1.6%
Return on average equity	**11.7%**	11.2%

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

For the nine months ended September 30	**2013**	2012	**Increase (decrease) in net income**
Net interest income	**$ 129,138**	$ 116,560	**$ 12,578**
Provision for (reversal of) loan/lease losses	**725**	7,260	**6,535**
Patronage income	**12,344**	10,846	**1,498**
Other income	**30,143**	34,583	**(4,440)**
Operating expenses	**85,474**	81,890	**(3,584)**
Provision for (benefit from) income taxes	**1,489**	3,182	**1,693**
Net income	**$ 83,937**	$ 69,657	**$ 14,280**

Net interest income was $129.1 million for the nine months ended September 30, 2013. The following table quantifies changes in net interest income for the nine months ended September 30, 2013 compared to the same period in 2012 (in thousands):

	2013 vs 2012
Changes in AgriBank note payable and earning assets balances	**$ 15,359**
Changes in rates on AgriBank note payable and earning assets	**(3,670)**
Changes due to asset securitization	**335**
Changes in deferred income	**51**
Changes due to capital management	**91**
Changes in nonaccrual income and other	**412**
Net change	**$ 12,578**

The change in the provision for (reversal of) loan/lease losses was related to lower adversely classified loan volume and to lower net loan charge-offs in 2013.

The change in patronage income was primarily related to increased patronage received from AgriBank due to a higher average balance on our note payable as well as a higher patronage rate compared to the prior year. Additionally, patronage income on loans in the AgriBank Asset Pool Program decreased due to the share of distributions made to the asset pool in 2012 from Allocated Insurance Reserve Accounts (AIRA) totaling $190 thousand. These reserve accounts were established in previous years by the Farm Credit System Insurance Corporation when premiums collected increased the level of the Insurance Fund above the required 2% of insured debt. There has been no distribution in 2013.

The change in other income was primarily due to our share of non-recurring distributions from AIRA of $6.1 million in 2012. There has not been a similar distribution in 2013. Our income from certain services has also decreased due to our sale of those lines of business during 2012. This decrease was partially offset by an increase in fee income.

The change in operating expenses was primarily related to salaries and benefits expense and to FCS Insurance expense.

The change in provision for (benefit from) income taxes was primarily related to increased tax savings from our patronage program partially offset by an increase in income in our taxable entities.

We originate rural home loans for resale into the secondary market. We sold loans through the secondary market totaling $47.3 million through September 30, 2013 compared to $51.3 million for the same period in 2012. The fee income from this activity totaled $992 thousand for the nine months ended September 30, 2013 compared to $943 thousand for the same period of 2012.

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

Funding, Liquidity, and Capital

We borrow from AgriBank, under a note payable, in the form of a line of credit. Our promissory note matured on March 31, 2013 and was renewed for $6.5 billion with a maturity date of March 31, 2014. The note will be renegotiated at that time. The repricing attributes of our line of credit generally correspond to the repricing attributes of our loan portfolio which significantly reduces our market interest rate risk. Cost of funds associated with our note payable includes a marginal cost of debt component and a spread component, which includes cost of servicing, cost of liquidity, and bank profit. Additionally, a risk premium may also be included in our cost of funds; however we were not subject to a risk premium at September 30, 2013 or December 31, 2012.

Total equity increased $152.4 million from December 31, 2012 primarily due to our issuance of preferred stock, discussed in the Notice of Significant or Material Events above, and to net income for the period, partially offset by redemptions of, and accrued liability for authorized redemptions of, nonqualified patronage allocations and accrued dividends on our preferred stock.

Farm Credit Administration regulations require us to maintain a permanent capital ratio of at least 7.0%, a total surplus ratio of at least 7.0%, and a core surplus ratio of at least 3.5%. Refer to Note 9 in our 2012 Annual Report for a more complete description of these ratios. As of September 30, 2013, the ratios were as follows:

- The permanent capital ratio was 15.8%.
- The total surplus ratio was 15.5%.
- The core surplus ratio was 12.7%.

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

Certification

The undersigned certify they have reviewed AgStar Financial Services, ACA's September 30, 2013 Quarterly Report. It has been prepared under the oversight of the audit committee and in accordance with all applicable statutory or regulatory requirements. The information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Spencer Enninga
Chairperson of the Board
AgStar Financial Services, ACA

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

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

November 7, 2013

CONSOLIDATED STATEMENTS OF CONDITION

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

	September 30 2013	December 31 2012
ASSETS		
Loans	**6,086,965**	5,913,336
Allowance for loan/lease losses	**25,379**	26,814
Net loans	**6,061,586**	5,886,522
Investment securities	**475,164**	484,092
Assets held for lease, net	**35,794**	35,296
Accrued interest receivable	**65,011**	45,029
Investment in AgriBank, FCB	**145,720**	141,137
Premises and equipment, net	**17,663**	18,128
Other property owned	**6,105**	10,137
Other assets	**48,784**	44,031
Total assets	**$ 6,855,827**	$ 6,664,372
LIABILITIES		
Note payable to AgriBank, FCB	**$ 5,616,378**	$ 5,610,487
Subordinated debt	**100,000**	100,000
Accrued interest payable	**24,245**	22,628
Deferred tax liabilities, net	**6,504**	8,751
Other liabilities	**84,616**	50,785
Total liabilities	**5,831,743**	5,792,651
Contingencies and commitments	**--**	--
EQUITY		
Capital stock and participation certificates	**15,806**	15,655
Preferred stock	**100,000**	--
Allocated surplus	**323,627**	302,789
Unallocated surplus	**584,651**	553,277
Total equity	**1,024,084**	871,721
Total liabilities and equity	**$ 6,855,827**	$ 6,664,372

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

CONSOLIDATED STATEMENTS OF INCOME

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

For the period ended September 30	*Three Months Ended* **2013**	2012	*Nine Months Ended* **2013**	2012
Interest income	**$ 68,664**	$ 64,780	**$ 200,263**	$ 191,708
Interest expense	**23,925**	24,654	**71,125**	75,148
Net interest income	**44,739**	40,126	**129,138**	116,560
Provision for (reversal of) loan/lease losses	**(95)**	1,777	**725**	7,260
Net interest income after provision for (reversal of) loan/lease losses	**44,834**	38,349	**128,413**	109,300
Other income				
Patronage income	**4,062**	3,260	**12,344**	10,846
Net operating lease income	**436**	490	**1,235**	1,428
Financially related services income	**4,188**	4,730	**13,830**	17,115
Allocated insurance reserve accounts distribution	**--**	--	**--**	6,057
Fee and miscellaneous income, net	**4,324**	4,001	**15,078**	9,983
Total other income	**13,010**	12,481	**42,487**	45,429
Operating expenses				
Salaries and employee benefits	**20,056**	19,461	**59,339**	57,031
Other operating expenses	**9,231**	8,014	**26,135**	24,859
Total operating expenses	**29,287**	27,475	**85,474**	81,890
Income before income taxes	**28,557**	23,355	**85,426**	72,839
Provision for (benefit from) income taxes	**(6,024)**	2,122	**1,489**	3,182
Net income	**$ 34,581**	$ 21,233	**$ 83,937**	$ 69,657

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)

	Capital Stock and Participation Certificates	Preferred Stock	Allocated Surplus	Unallocated Surplus	Total Equity
Balance at December 31, 2011	$ 14,859	$ --	$ 290,517	$ 500,860	$ 806,236
Net income	--	--	--	69,657	69,657
Surplus allocated as nonqualified patronage, net	--	--	35,336	(35,336)	--
Accrued redemptions of prior year allocated patronage			(41,818)		(41,818)
Capital stock and participation certificates issued	1,475	--	--	--	1,475
Capital stock and participation certificates retired	(939)	--	--	--	(939)
Balance at September 30, 2012	$ 15,395	$ --	$ 284,035	$ 535,181	$ 834,611
Balance at December 31, 2012	$ 15,655	$ --	$ 302,789	$ 553,277	$ 871,721
Net income	**--**	**--**	**--**	**83,937**	**83,937**
Surplus allocated as nonqualified patronage, net	**--**	**--**	**45,730**	**(45,730)**	**--**
Accrued redemptions of prior year allocated patronage	**--**	**--**	**(24,892)**	**--**	**(24,892)**
Preferred stock issued	**--**	**100,000**	**--**	**(3,701)**	**96,299**
Preferred stock dividend declared	**--**	**--**	**--**	**(3,132)**	**(3,132)**
Capital stock and participation certificates issued	**1,392**	**--**	**--**	**--**	**1,392**
Capital stock and participation certificates retired	**(1,241)**	**--**	**--**	**--**	**(1,241)**
Balance at September 30, 2013	**$ 15,806**	**$ 100,000**	**$ 323,627**	**$ 584,651**	**$ 1,024,084**

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: Organization and Significant Accounting Policies

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim consolidated financial condition and consolidated results of operations. While our accounting policies conform to accounting principles generally accepted in the United States of America (U.S. GAAP) and the prevailing practices within the financial services industry, this interim Quarterly Report is prepared based upon statutory and regulatory requirements and, accordingly, does not include all disclosures required by U.S. GAAP. The results of the nine months ended September 30, 2013 are not necessarily indicative of the results to be expected for the year ended December 31, 2013. 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 2012 Annual Report for the year ended December 31, 2012.

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

We have assessed the potential impact of accounting standards that have been issued but are not yet effective and have determined that no such standards are expected to have a material impact to our consolidated financial statements.

NOTE 2: Loans and Allowance for Loan/Lease Losses

Loans consisted of the following (dollars in thousands):

As of:	**September 30, 2013**		December 31, 2012	
	Amount	%	Amount	%
Real estate mortgage	**$ 3,146,873**	**51.7%**	$ 2,889,701	48.9%
Production and intermediate term	**1,693,256**	**27.8%**	1,761,770	29.8%
Agribusiness	**553,191**	**9.1%**	610,220	10.3%
Energy	**171,529**	**2.8%**	162,628	2.8%
Other	**522,116**	**8.6%**	489,017	8.2%
Total	**$ 6,086,965**	**100.0%**	$ 5,913,336	100.0%

The other category is comprised of loans originated under our Mission Related Investment authority, finance and conditional sales leases, and communication, rural residential real estate, and water and waste water loans.

Credit Quality and Delinquency

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, and
- Loss: loans are considered uncollectible.

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

	Acceptable		OAEM		Substandard/ Doubtful/Loss		Total	
As of September 30, 2013	Amount	%	Amount	%	Amount	%	Amount	%
Real estate mortgage	**$ 3,024,257**	**95.0%**	**$ 37,386**	**1.2%**	**$ 122,040**	**3.8%**	**$ 3,183,683**	**100.0%**
Production and intermediate term	**1,634,622**	**95.5%**	**31,735**	**1.8%**	**45,718**	**2.7%**	**1,712,075**	**100.0%**
Agribusiness	**484,712**	**87.3%**	**58,268**	**10.5%**	**12,302**	**2.2%**	**555,282**	**100.0%**
Energy	**171,674**	**100.0%**	**--**	**--**	**--**	**--**	**171,674**	**100.0%**
Other	**495,045**	**94.6%**	**8,552**	**1.6%**	**19,660**	**3.8%**	**523,257**	**100.0%**
Total	**$ 5,810,310**	**94.5%**	**$ 135,941**	**2.2%**	**$ 199,720**	**3.3%**	**$ 6,145,971**	**100.0%**
As of December 31, 2012								
Real estate mortgage	$ 2,711,617	93.1%	$ 38,737	1.3%	$ 161,724	5.6%	$ 2,912,078	100.0%
Production and intermediate term	1,694,965	95.5%	17,618	1.0%	63,034	3.5%	1,775,617	100.0%
Agribusiness	543,715	88.8%	56,453	9.2%	12,498	2.0%	612,666	100.0%
Energy	162,779	100.0%	--	--	--	--	162,779	100.0%
Other	469,808	95.8%	1,480	0.3%	19,032	3.9%	490,320	100.0%
Total	$ 5,582,884	93.8%	$ 114,288	1.9%	$ 256,288	4.3%	$ 5,953,460	100.0%

Credit quality continued to improve from December 31, 2012, resulting from growth in our correspondent bank segments and in our swine and renewable energy segments. Substandard/doubtful/loss loan volume was reduced $56.6 million over the nine months ended September 30, 2013, a 1.0% decrease as a percentage of total loans. Additionally, our adverse assets to risk funds ratio improved to 20.5% at September 30, 2013, from 31.1% at December 31, 2012.

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

	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less than 30 Days Past Due	Total Loans	90 Days or More Past Due and Accruing
As of September 30, 2013						
Real estate mortgage	**$ 12,506**	**$ 26,449**	**$ 38,955**	**$ 3,144,728**	**$ 3,183,683**	**$ 887**
Production and intermediate term	**2,622**	**3,772**	**6,394**	**1,705,681**	**1,712,075**	**223**
Agribusiness	**18**	**--**	**18**	**555,264**	**555,282**	**--**
Energy	**--**	**--**	**--**	**171,674**	**171,674**	**--**
Other	**2,620**	**20,914**	**23,534**	**499,723**	**523,257**	**--**
Total	**$ 17,766**	**$ 51,135**	**$ 68,901**	**$ 6,077,070**	**$ 6,145,971**	**$ 1,110**
As of December 31, 2012						
Real estate mortgage	$ 16,719	$ 33,589	$ 50,308	$ 2,861,770	$ 2,912,078	$ 99
Production and intermediate term	2,561	5,051	7,612	1,768,005	1,775,617	27
Agribusiness	14,158	892	15,050	597,616	612,666	--
Energy	--	--	--	162,779	162,779	--
Other	3,523	10,854	14,377	475,943	490,320	--
Total	$ 36,961	$ 50,386	$ 87,347	$ 5,866,113	$ 5,953,460	$ 126

Risk Loans

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

As of:	September 30 2013	December 31 2012
Volume with specific reserves	$ 35,310	$ 20,279
Volume without specific reserves	123,963	131,540
Total risk loans	$ 159,273	$ 151,819
Total specific reserves	$ 7,167	$ 5,524

For the nine months ended September 30	2013	2012
Income on accrual risk loans	$ 350	$ 29
Income on nonaccrual loans	3,680	3,269
Total income on risk loans	$ 4,030	$ 3,298
Average risk loans	$ 171,263	$ 184,346

While our overall credit quality continues to improve, our risk loans, primarily consisting of nonaccrual and accruing restructured loan volume, has increased from December 31, 2012 and remains above our targeted level.

Troubled Debt Restructurings

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. 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 troubled debt restructurings are considered risk loans. All risk loans are analyzed within our allowance for loan/lease losses. We record a specific allowance to reduce the carrying amount of the formally restructured loan to the lower of book value or net realizable value of collateral.

The following table presents information regarding the recorded investment for troubled debt restructurings that occurred during the nine months ended September 30 (in thousands):

	2013		2012	
	Pre-modification	Post-modification	Pre-modification	Post-modification
Real estate mortgage	$ 8,598	$ 8,590	$ 1,416	$ 1,325
Production and intermediate term	2,734	2,743	1,172	1,191
Communication	9,005	9,005	--	--
Rural residential real estate	135	135	--	--
Total	$ 20,472	$ 20,473	$ 2,588	$ 2,516

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

The majority of the troubled debt restructurings that occurred during the nine months ended September 30, 2013 in the real estate mortgage and production and intermediate term categories were in the dairy sector. They have individualized servicing strategies generally involving a multi-year plan to bring them back into performing status. The troubled debt restructuring in the communication category is the result of one client being restructured.

The following table presents troubled debt restructurings that defaulted during the nine months ended September 30 in which the modification date was within twelve months of the respective reporting period (in thousands):

	2013	2012
Real estate mortgage	$ 8	$ 203
Production and intermediate term	29	174
Total	$ 37	$ 377

Troubled debt restructurings outstanding at September 30, 2013 totaled $51.0 million, of which $39.2 million were in nonaccrual status compared to $37.0 million at December 31, 2012 of which all but $102 thousand were in nonaccrual status. Additional commitments to lend to borrowers whose loans have been modified in a troubled debt restructuring were $5.3 million at September 30, 2013.

Allowance for Loan/Lease Losses

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

Nine months ended September 30	2013	2012
Balance at beginning of year	**$ 26,814**	$ 26,833
Provision for (reversal of) loan/lease losses	**725**	7,260
Loan recoveries	**1,189**	2,588
Loan charge-offs	**(3,349)**	(8,423)
Other	**--**	(16)
Balance at end of period	**$ 25,379**	$ 28,242

The decrease in allowance for loan/lease losses was related to $6.5 million of lower provision expense recorded in 2013 compared to one year ago, reflecting the improvements in adverse loan volume and reduced net charge-offs. In our opinion, the allowance for loan/lease losses was reasonable in relation to the risk in our loan portfolio at September 30, 2013.

NOTE 3: Investment Securities

We held investment securities of $475.2 million at September 30, 2013 and $484.1 million at December 31, 2012. Our investment securities consisted of:

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

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

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

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Weighted Average Yield
As of September 30, 2013					
SBA/USDA	**$ 195,037**	**$ 913**	**$ (8,069)**	**$ 187,881**	**3.8%**
Farmer Mac	**280,127**	**2,204**	**(3,556)**	**278,775**	**4.5%**
Total	**$ 475,164**	**$ 3,117**	**$ (11,625)**	**$ 466,656**	**4.2%**
As of December 31, 2012					
SBA/USDA	$ 181,442	$ 2,117	$ (5,215)	$ 178,344	3.8%
Farmer Mac	302,650	5,361	(112)	307,899	4.7%
Total	$ 484,092	$ 7,478	$ (5,327)	$ 486,243	4.4%

Investment income is recorded in “Interest income” on the Consolidated Statements of Income and totaled $12.6 million and $14.5 million for the nine months ended September 30, 2013 and 2012, respectively.

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

As of September 30, 2013	Amortized Cost
Less than one year	**$ 1,409**
One to five years	**28,254**
Five to ten years	**94,851**
More than ten years	**350,650**
Total	**$ 475,164**

NOTE 4: Capital

On May 30, 2013, we issued $100 million of Series A-1 non-cumulative perpetual preferred stock, representing 100,000 shares at $1,000 per share par value. This series may be held or transferred in blocks having an aggregate par value of not less than $250,000 and an investor must hold at least 250 shares. We used the net proceeds from the Series A-1 preferred stock issuance to increase our regulatory capital pursuant to current FCA regulations, for the continued development of our business, and for general corporate purposes.

Dividends on the Series A-1 preferred stock, if declared by the Board of Directors in its sole discretion, are non-cumulative and are payable quarterly in arrears on the 15th day of February, May, August, and November, beginning on August 15, 2013. Dividends accrue at a fixed annual rate of 6.75% from the date of issuance through August 14, 2023, and beginning on August 15, 2023 will accrue at an annual rate equal to the 3-month USD LIBOR rate, reset quarterly, plus 4.58%. The Series A-1 preferred stock is not mandatorily redeemable at any time. However, the Series A-1 preferred stock will be redeemable at par value, in whole or in part, at our option, quarterly beginning on August 15, 2023. In addition, the Series A-1 preferred stock will be redeemable in whole, at our option, at any time upon the occurrence of certain defined regulatory events. Series A-1 preferred stockholders do not have any voting rights, but may appoint two board observers after six unpaid dividend payments.

The Series A-1 preferred stock is junior to any subordinated debt, existing and future debt obligations, and to any series of preferred stock we may issue in the future with priority rights. Series A-1 preferred stock is senior to outstanding Class B, C, or D common stock, Class E participation certificates, Class H preferred stock, and patronage equities.

On September 18, 2013, the Board of Directors authorized the preferred stock dividend payment scheduled for November and also the retirement of the remainder of the $24.7 million of 2004 nonqualified patronage allocations. This retirement will be substantially completed in November of 2013. The timing of this payout occurred within the Board of Directors targeted 7-10 year retirement timeframe.

The timing of all future redemptions remains at the discretion of the Board of Directors based on a combination of factors including the risk in our portfolio, earnings, and our current capital position.

NOTE 5: Contingencies and Commitments

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

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

NOTE 6: Fair Value Measurements

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. The guidance also establishes a fair value hierarchy, with three levels of inputs that may be used to measure fair value. Refer to Notes 2 and 14 in our 2012 Annual Report for a more complete description of the three input levels.

Non-Recurring Basis

We had no significant assets or liabilities measured at fair value on a recurring basis at September 30, 2013 or December 31, 2012. We may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. Information on assets measured at fair value on a non-recurring basis follows (in thousands):

	Fair Value Measurement Using			Total Fair	Total Gains
	Level 1	Level 2	Level 3	Value	(Losses)
As of September 30, 2013					
Loans	**$ --**	**$ 1,363**	**$ 28,187**	**$ 29,550**	**$ (4,504)**
Other property owned	**--**	**--**	**7,822**	**7,822**	**(1,561)**
As of December 31, 2012					
Loans	$ --	$ 1,774	$ 13,719	$ 15,493	$ (1,828)
Other property owned	--	--	12,065	12,065	(1,484)

Valuation Techniques

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

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

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

NOTE 7: Subsequent Events

We have evaluated subsequent events through November 7, 2013, 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.