# GreenStone Farm Credit Services, ACA

**Quarterly Report**
**March 31, 2014**

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the consolidated financial condition and consolidated results of operations of GreenStone Farm Credit Services, ACA (the parent) and GreenStone Farm Credit Services, FLCA and GreenStone Farm Credit 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 2013 Annual Report for the year ended December 31, 2013.

AgriBank, FCB's (AgriBank) financial condition and results of operations materially impact members' investment in GreenStone Farm Credit 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 3515 West Road, East Lansing, MI 48823, (800) 968-0061, or by e-mail to *Travis.Jones@greenstonefcs.com*, or through our website at *www.greenstonefcs.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 also available through AgriBank's website at *www.agribank.com*.

### 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 2013 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

Overall, the agriculture outlook for 2014 is one of reduced profit expectations. The United States Department of Agriculture's longer term forecast is net farm income will contract over the next several years from the record level in 2013 of $130.5 billion to $96.9 billion in 2014, $92.7 billion in 2015, and $95.2 billion in 2016. In 2014, there will be a wide range of profit variability by industry. Row crop operations will likely experience the greatest degree of net farm income reduction while the dairy and protein sector are poised to see an improvement in profitability. Sector outlook summary; (a) dairy margins will be excellent for the first half of 2014 and compress slightly during the second half of the year, (b) hog and poultry industries are projected to operate at a positive margin for the first half of 2014, followed by compressing margins during the second half of 2014 as increasing supplies will outstrip export market capacity, (c) fertilizer prices will decline but fuel, seed, and chemical prices will increase slightly over 2013 levels, and (d) short-term rates will remain flat with long-term interest rates rising slightly over the course of the year.

Row crop operations will see a significant contraction in profit levels. Corn, soybeans, and sugar beets appear to be entering into a correction period as the commodity carryout/use ratios revert to historical averages. Operations with a high cost structure (fixed and variable) will slide to negative net income levels this year. Efficient operations will have an opportunity for a breakeven to small profit.

Early reports are the long, cold winter will have an adverse effect on several of our fruit industries with damage being reported by peach, grape, and blueberry producers. In 2013, blueberry early season crop prices reduced significantly, placing a significant strain on industry profit levels. The price outlook for 2014 is similar to 2013 for this industry. The price outlook for the apple, grape, and cherry industries is for an average year. A second large crop in 2014 will challenge the level of profitability in these industries.

It appears spring will be coming late to Michigan and Northeast Wisconsin for the second straight year. If the abnormal cold and wet weather conditions continue into the months of April and May, the greenhouse industry and row crop operations will be impacted negatively for the second straight year.

Michigan and Northeast Wisconsin farmland prices are moving closer to a market ceiling. The rate of increase in land prices slowed significantly in the second half of 2013. While quality cropland continues to sell well, lower quality cropland prices are starting to soften. Since last fall, there has been an increase in the number of "no sale" land auctions, an indication that buyer and seller price expectations have diverged. Within this general market direction, regional variability will continue. In areas dominated by row crop operations, the significant declines in corn, soybean, and sugar beet prices this past year have tempered the enthusiasm for purchasers to bid cropland prices higher. Cropland prices in areas with a significant concentration of large dairy operations continue to see very aggressive bidding. Overall, if milk prices decline and a large corn and soybean crop is produced in 2014, we anticipate the market will start to accelerate the price correction process for rental rates and land prices by this time next year.

## LOAN PORTFOLIO

Owned loan volume totaled $6.1 billion at March 31, 2014, a $187.4 million decrease from December 31, 2013.

Total owned and managed loan volume, including serviced volume on the real estate loans sold to AgriBank was $6.4 billion at March 31, 2014, a $198.6 million decrease from December 31, 2013. Our combined mortgage portfolio decreased $35.5 million, or 0.7% from December 31, 2013. The asset decrease in the mortgage portfolio during the period was attributed to all market segments except Capital Markets, which grew 8.6% from year-end. Our short-term commercial loan portfolio decreased $163.1 million, or 8.8% from December 31, 2013. This seasonally expected reduction is attributed to two factors. First is the positive general financial condition of customers across the majority of our major commodity and industry segments. Principal prepayments coming from earnings as well as a delayed need for operating disbursements have resulted in a seasonal decline in commercial volume. Secondly, the seasonal repayment of tax planning disbursements from November and December 2013, as well as the significant number of annual payments being due in the first quarter, contributed to the seasonally expected reduction in commercial volume for the period. When compared to March 2013, owned and managed mortgage volume is up 9.4% and commercial loan volume is up 0.2%. Both of these reflect an asset growth rate year over year that supports our 2014 Business Plan.

### Portfolio Credit Quality

Credit quality remained strong during the first quarter of 2014. Acceptable loan credit quality, as measured under the Uniform Classification System, remained unchanged from the beginning of the year at 96.2%. Year over year, credit quality improved 1.2 percentage points from 95.0% acceptable at March 31, 2013. The level of loan quality is currently above the strategic objective of 90.0% of the portfolio rated acceptable. Portfolio assets criticized as being less than acceptable are comprised of 1.0% other assets especially mentioned (OAEM) and 2.8% adversely classified. Both categories remained unchanged from December 31, 2013.

Adversely classified loans are identified as having material credit weaknesses which, if left uncorrected, result in a greater than normal risk. Portfolio credit quality is considered when assessing the reasonableness of our allowance for loan losses. The resulting level of credit quality, when combined with our earnings and addition to capital surplus, results in an adverse assets to risk funds ratio of 16.8%. This ratio has improved since December 31, 2013 when it was 18.7%. This ratio is a good measure of our risk bearing ability.

In certain circumstances, government guarantee programs are used to reduce the risk of loss. At March 31, 2014, $273.5 million of our loans were, to some level, guaranteed under these programs.

### Risk Assets

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

| As of: | **March 31 2014** | December 31 2013 |
|---|---|---|
| Loans: | | |
| Nonaccrual | **$70,709** | $57,885 |
| Accruing restructured | **1,899** | 1,923 |
| Accruing loans 90 days or more past due | **126** | -- |
| Total risk loans | **72,734** | 59,808 |
| Acquired property | **14,292** | 12,751 |
| Total risk assets | **$87,026** | $72,559 |
| Risk loans as a percentage of total loans | **1.2%** | 1.0% |
| Nonaccrual loans as a percentage of total loans | **1.2%** | 0.9% |
| Total delinquencies as a percentage of total loans | **0.6%** | 0.6% |

Our risk assets have increased slightly from December 31, 2013 but remain at acceptable levels. Total risk loans as a percentage of total loans remains well within our established risk management guidelines.

Nonaccrual loans increased from $57.9 million at December 31, 2013 to $70.7 million at March 31, 2014. The increase was primarily due to one large farm relationship downgraded to nonaccrual status during the first quarter. As of March 31, 2014, the nonaccrual loan portfolio volume was comprised of approximately 33% greenhouse and nursery loans, 16% part-time farmers, and 13% dairy loans. Nonaccrual loans remained at an acceptable level at March 31, 2014 and 64.5% of our nonaccrual loans were current in their payment status.

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

Acquired property inventory increased slightly from $12.8 million at December 31, 2013 to $14.3 million at March 31, 2014. The increase was primarily due to the addition of nine new properties during the first quarter.

### 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, 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: | **March 31 2014** | December 31 2013 |
|---|---|---|
| Loans | **0.6%** | 0.6% |
| Nonaccrual loans | **50.8%** | 67.0% |
| Total risk loans | **49.3%** | 64.8% |

The allowance for loan losses decreased $2.9 million from December 31, 2013 to March 31, 2014. During the first quarter of 2014, a reversal of loan loss provision of $2.5 million was recorded, as well as $358 thousand of net charge-offs. The decrease in the allowance for loan losses is primarily due to changes in the credit quality of a significant loan relationship and the decrease in our loan volume.

From time to time, credit losses may be recorded to establish a reserve on unfunded loan commitments. Throughout the year a portion of an established liability may be funded. As a result of any funding, an allowance for loan loss is established through a provision for loan losses while a reversal of credit losses simultaneously occurs. During the year ended December 31, 2013, $2.4 million of provision expense was recorded to establish a reserve on unfunded loan commitments. The accrued credit losses are recorded in “other liabilities” in the Consolidated Statements of Condition. The “Reversal of provision for credit losses” in the Consolidated Statements of Income includes a reversal of provision for loan losses of $2.5 million as well as a reversal of provision for credit losses on unfunded loan commitments of $1.3 million. The accrued credit losses related to unfunded loan commitments were $1.1 million and $2.4 million as of March 31, 2014 and December 31, 2013, respectively.

In our opinion, the allowance for loan losses was reasonable in relation to the risk in our loan portfolio at March 31, 2014.

## RESULTS OF OPERATIONS

Net income for the three months ended March 31, 2014 totaled $38.2 million compared to $33.5 million for the same period in 2013. The following table illustrates profitability information:

| For the three months ended March 31 | **2014** | 2013 |
|---|---|---|
| Return on average assets | **2.4%** | 2.3% |
| Return on average members' equity | **13.0%** | 12.6% |

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

| For the three months ended March 31 | **2014** | 2013 | **Increase (decrease) in net income** |
|---|---|---|---|
| Net interest income | **$44,184** | $42,198 | **$1,986** |
| Reversal of provision for credit losses | **(3,826)** | (1,280) | **2,546** |
| Patronage income | **6,756** | 6,151 | **605** |
| Financially related services income | **2,565** | 2,088 | **477** |
| Fee income | **687** | 756 | **(69)** |
| Acquired property income (loss), net | **199** | (275) | **474** |
| Miscellaneous income, net | **332** | 604 | **(272)** |
| Operating expenses | **18,216** | 17,013 | **(1,203)** |
| Provision for income taxes | **2,156** | 2,291 | **135** |
| Net income | **$38,177** | $33,498 | **$4,679** |

Net interest income was $44.2 million for the three months ended March 31, 2014. The following table quantifies changes in net interest income for the three months ended March 31, 2014 compared to the same period in 2013 (in thousands):

| | **2014 vs 2013** |
|---|---|
| Changes in volume | **$4,073** |
| Changes in rates | **(1,986)** |
| Changes in nonaccrual income and other | **(101)** |
| Net change | **$1,986** |

The change in the reversal of provision for credit losses includes a reversal of provision for loan losses of $2.5 million, which was primarily due to improved credit quality. In addition, a $1.3 million reversal of provision for credit losses was recorded on unfunded loan commitments due to loans being drawn upon during the first quarter.

The change in patronage income was primarily due to an increased partnership distribution from our participation in the AgDirect trade credit financing program.

The change in operating expenses was primarily related to increases in salaries and employee benefits and Farm Credit System insurance expense compared to the prior year.

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

## FUNDING, LIQUIDITY, AND CAPITAL

We borrow from AgriBank, under a note payable, in the form of a line of credit. Our note payable matures January 31, 2015, at which time the note will be renegotiated. 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, a spread component, which includes cost of servicing, cost of liquidity, bank profit, and, if applicable, a risk premium component. However, we were not subject to a risk premium at March 31, 2014 or December 31, 2013.

Total members' equity increased $31.2 million from December 31, 2013 primarily due to net income for the period partially offset by patronage distribution accruals.

Farm Credit Administration (FCA) 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 8 in our 2013 Annual Report for a more complete description of these ratios. As of March 31, 2014, the ratios were as follows:

- The permanent capital ratio was 15.6%.
- The total surplus ratio was 15.3%.
- The core surplus ratio was 15.3%.

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

## RELATIONSHIP WITH AGRIBANK

We are required to invest in AgriBank capital stock as a condition of borrowing. Effective January 1, 2014, we entered into a contractual agreement with AgriBank whereby our required investment in AgriBank was reduced by $40.0 million. In return for this lower required investment amount, we agreed to pay an additional spread on a portion of our note payable with AgriBank equal to the reduction in our required investment. The positive impact of this transaction on our capital adequacy ratios was approximately 0.5%.

On March 5, 2014, the AgriBank Board of Directors approved an amendment to the AgriBank capital plan which reduced the base required stock investment for all affiliated associations, including GreenStone Farm Credit Services, ACA, from 2.5% to 2.25% effective March 31, 2014.

## RELATIONSHIP WITH OTHER FARM CREDIT INSTITUTIONS

We have a relationship with Farm Credit Leasing (FCL), a System entity specializing in leasing products and providing industry expertise. Leases are originated and serviced by FCL and we purchase a participation interest in the cash flows in some of the transactions. Additionally, on January 2, 2014, we sold substantially our entire leasing portfolio, $26.3 million of lease volume, to FCL.

## ADDITIONAL REGULATORY INFORMATION

On March 13, 2014, the FCA Board approved an interim final rule to remove all requirements related to advisory votes at Farm Credit institutions. Upon its effective date, advisory votes on CEO and/or senior officer compensation will no longer be required.

## CERTIFICATION

The undersigned certify they have reviewed GreenStone Farm Credit Services, ACA's March 31, 2014 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.

Scott A. Roggenbuck
Chairperson of the Board
GreenStone Farm Credit Services, ACA

David B. Armstrong
Chief Executive Officer
GreenStone Farm Credit Services, ACA

Travis D. Jones
Chief Financial Officer
GreenStone Farm Credit Services, ACA

May 6, 2014

# CONSOLIDATED STATEMENTS OF CONDITION

*GreenStone Farm Credit Services, ACA*

*(in thousands)*

*(Unaudited)*

| As of: | **March 31 2014** | December 31 2013 |
|---|---|---|
| **ASSETS** | | |
| Loans | **$6,062,498** | $6,249,883 |
| Allowance for loan losses | **35,894** | 38,772 |
| Net loans | **6,026,604** | 6,211,111 |
| Investment in AgriBank, FCB | **101,918** | 157,945 |
| Investment securities | **30,601** | 32,233 |
| Accrued interest receivable | **37,956** | 43,327 |
| Premises and equipment, net | **33,035** | 33,342 |
| Acquired property | **14,292** | 12,751 |
| Deferred tax assets, net | **7,325** | 5,975 |
| Other assets | **34,651** | 44,530 |
| Total assets | **$6,286,382** | $6,541,214 |
| **LIABILITIES** | | |
| Note payable to AgriBank, FCB | **$5,024,968** | $5,296,022 |
| Accrued interest payable | **19,700** | 20,108 |
| Patronage distribution payable | **6,950** | 29,000 |
| Other liabilities | **47,645** | 40,172 |
| Total liabilities | **5,099,263** | 5,385,302 |
| Contingencies and commitments | **--** | -- |
| **MEMBERS' EQUITY** | | |
| Protected members' equity | **3** | 3 |
| Capital stock and participation certificates | **20,581** | 20,614 |
| Unallocated surplus | **1,166,535** | 1,135,295 |
| Total members' equity | **1,187,119** | 1,155,912 |
| Total liabilities and members' equity | **$6,286,382** | $6,541,214 |

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

# CONSOLIDATED STATEMENTS OF INCOME

*GreenStone Farm Credit Services, ACA*

*(in thousands)*

*(Unaudited)*

| *For the three months ended March 31* | **2014** | 2013 |
|---|---|---|
| **Interest income** | **$64,623** | $60,856 |
| **Interest expense** | **20,439** | 18,658 |
| Net interest income | **44,184** | 42,198 |
| **Reversal of provision for credit losses** | **(3,826)** | (1,280) |
| Net interest income after reversal of provision for credit losses | **48,010** | 43,478 |
| **Non-interest income** | | |
| Patronage income | **6,756** | 6,151 |
| Financially related services income | **2,565** | 2,088 |
| Fee income | **687** | 756 |
| Acquired property income (loss), net | **199** | (275) |
| Miscellaneous income, net | **332** | 604 |
| Total non-interest income | **10,539** | 9,324 |
| **Operating expenses** | | |
| Salaries and employee benefits | **11,721** | 10,873 |
| Other operating expenses | **6,495** | 6,140 |
| Total operating expenses | **18,216** | 17,013 |
| Income before income taxes | **40,333** | 35,789 |
| **Provision for income taxes** | **2,156** | 2,291 |
| **Net income** | **$38,177** | $33,498 |

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

# CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

*GreenStone Farm Credit Services, ACA*
*(in thousands)*
*(Unaudited)*

| | Protected Members' Equity | Capital Stock and Participation Certificates | Unallocated Surplus | Total Members' Equity |
|---|---|---|---|---|
| Balance at December 31, 2012 | $3 | $19,742 | $1,029,162 | $1,048,907 |
| Net income | -- | -- | 33,498 | 33,498 |
| Unallocated surplus designated for patronage distributions | -- | -- | (5,629) | (5,629) |
| Capital stock and participation certificates issued | -- | 556 | -- | 556 |
| Capital stock and participation certificates retired | -- | (361) | -- | (361) |
| Balance at March 31, 2013 | $3 | $19,937 | $1,057,031 | $1,076,971 |
| Balance at December 31, 2013 | $3 | $20,614 | $1,135,295 | $1,155,912 |
| **Net income** | **--** | **--** | **38,177** | **38,177** |
| **Unallocated surplus designated for patronage distributions** | **--** | **--** | **(6,937)** | **(6,937)** |
| **Capital stock and participation certificates issued** | **--** | **331** | **--** | **331** |
| **Capital stock and participation certificates retired** | **--** | **(364)** | **--** | **(364)** |
| **Balance at March 31, 2014** | **$3** | **$20,581** | **$1,166,535** | **$1,187,119** |

*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 three months ended March 31, 2014 are not necessarily indicative of the results to be expected for the year ended December 31, 2014. 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 2013 Annual Report.

The consolidated financial statements present the consolidated financial results of GreenStone Farm Credit Services, ACA (the parent) and GreenStone Farm Credit Services, FLCA and GreenStone Farm Credit 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 LOSSES

Loans consisted of the following (dollars in thousands):

| As of: | **March 31, 2014** | | December 31, 2013 | |
|---|---|---|---|---|
| | **Amount** | **Percentage** | Amount | Percentage |
| Real estate mortgage | **$3,687,474** | **60.8%** | $3,709,470 | 59.4% |
| Production and intermediate term | **1,728,592** | **28.5** | 1,907,963 | 30.5 |
| Agribusiness | **362,989** | **6.0** | 346,387 | 5.5 |
| Other | **283,443** | **4.7** | 286,063 | 4.6 |
| Total | **$6,062,498** | **100.0%** | $6,249,883 | 100.0% |

The other category is comprised of rural residential real estate, communication, and energy related loans as well as loans originated under our mission related investment authority.

#### Delinquency

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 March 31, 2014** | | | | | | |
| **Real estate mortgage** | **$8,306** | **$11,753** | **$20,059** | **$3,690,043** | **$3,710,102** | **$70** |
| **Production and intermediate term** | **8,923** | **1,416** | **10,339** | **1,731,740** | **1,742,079** | **56** |
| **Agribusiness** | **41** | **4,554** | **4,595** | **359,421** | **364,016** | **--** |
| **Other** | **2,964** | **1,014** | **3,978** | **279,938** | **283,916** | **--** |
| **Total** | **$20,234** | **$18,737** | **$38,971** | **$6,061,142** | **$6,100,113** | **$126** |
| As of December 31, 2013 | | | | | | |
| Real estate mortgage | $14,324 | $9,503 | $23,827 | $3,709,785 | $3,733,612 | $ -- |
| Production and intermediate term | 6,422 | 1,287 | 7,709 | 1,917,432 | 1,925,141 | -- |
| Agribusiness | -- | -- | -- | 347,591 | 347,591 | -- |
| Other | 4,403 | 700 | 5,103 | 281,421 | 286,524 | -- |
| Total | $25,149 | $11,490 | $36,639 | $6,256,229 | $6,292,868 | $ -- |

**Risk Loans**

The following table presents risk loan information (accruing loans include accrued interest receivable) (in thousands):

| As of: | **March 31 2014** | December 31 2013 |
|---|---|---|
| Volume with specific reserves | **$41,689** | $39,030 |
| Volume without specific reserves | **31,045** | 20,778 |
| Total risk loans | **$72,734** | $59,808 |
| Total specific reserves | **$18,863** | $17,168 |
| For the three months ended March 31 | **2014** | 2013 |
| Income on accrual risk loans | **$25** | $12 |
| Income on nonaccrual loans | **1,006** | 243 |
| Total income on risk loans | **$1,031** | $255 |
| Average risk loans | **$60,944** | $71,003 |

**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, 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 troubled debt restructurings 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.

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

| | **2014** | | 2013 | |
|---|---|---|---|---|
| | **Pre-modification** | **Post-modification** | Pre-modification | Post-modification |
| Real estate mortgage | **$292** | **$292** | $185 | $185 |
| Production and intermediate term | **--** | **--** | 2,148 | 2,148 |
| Total | **$292** | **$292** | $2,333 | $2,333 |

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.

There were no troubled debt restructurings that defaulted during the three months ended March 31, 2014 or 2013 in which the modification was within twelve months of the respective reporting period.

The following table presents information regarding troubled debt restructurings outstanding (in thousands):

| As of: | **March 31 2014** | December 31 2013 |
|---|---|---|
| Troubled debt restructurings in accrual status | **$1,899** | $1,923 |
| Troubled debt restructurings in nonaccrual status | **3,872** | 4,001 |
| Troubled debt restructurings | **$5,771** | $5,924 |

There were no additional commitments to lend to borrowers whose loans have been modified in a troubled debt restructuring at March 31, 2014.

**Allowance for Loan Losses**

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

| Three months ended March 31 | **2014** | 2013 |
|---|---|---|
| Balance at beginning of year | **$38,772** | $41,964 |
| Reversal of loan loss provision | **(2,520)** | (1,280) |
| Loan recoveries | **87** | 2,177 |
| Loan charge-offs | **(445)** | (1,300) |
| Balance at end of period | **$35,894** | $41,561 |

The allowance for loan losses decreased $2.9 million from December 31, 2013 to March 31, 2014. During the first quarter of 2014, a reversal of loan loss provision of $2.5 million was recorded, as well as $358 thousand of net charge-offs. The decrease in the allowance for loan losses is primarily due to changes in the credit quality of a significant loan relationship and the decrease in our loan volume.

From time to time, credit losses may be recorded to establish a reserve on unfunded loan commitments. Throughout the year a portion of an established liability may be funded. As a result of any funding, an allowance for loan loss is established through a provision for loan losses while a reversal of credit losses simultaneously occurs. During the year ended December 31, 2013, $2.4 million of provision expense was recorded to establish a reserve on unfunded loan commitments. The accrued credit losses are recorded in "other liabilities" in the Consolidated Statements of Condition. The "Reversal of provision for credit losses" in the Consolidated Statements of Income includes a reversal of provision for loan losses of $2.5 million as well as a reversal of provision for credit losses on unfunded loan commitments of $1.3 million. The accrued credit losses related to unfunded loan commitments were $1.1 million and $2.4 million as of March 31, 2014 and December 31, 2013, respectively.

## NOTE 3: INVESTMENT IN AGRIBANK, FCB

As of March 31, 2014, we were required by AgriBank to maintain an investment equal to 2.25% of the average quarterly balance of our note payable to AgriBank plus an additional 1.0% on growth that exceeded a targeted rate. Previously, the required investment was equal to 2.5%.

The balance of our investment in AgriBank, all required stock, was $101.9 million at March 31, 2014 and $157.9 million at December 31, 2013.

Effective January 1, 2014, we entered into a contractual agreement with AgriBank whereby our required investment in AgriBank was reduced by $40.0 million. In return for this lower required investment amount, we agreed to pay an additional spread on a portion of our note payable with AgriBank equal to the reduction in our required investment.

## NOTE 4: INVESTMENT SECURITIES

We held investment securities of $30.6 million at March 31, 2014 and $32.2 million at December 31, 2013. Our investment securities consisted of loans guaranteed by the Small Business Administration. These securities have been classified as held-to-maturity. The investment portfolio is evaluated for other-than-temporary impairment. To date, we have not recognized any impairment on our investment portfolio.

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

| As of: | **March 31 2014** | December 31 2013 |
|---|---|---|
| Amortized cost | **$30,601** | $32,233 |
| Unrealized gains | **720** | 666 |
| Unrealized losses | **--** | -- |
| Fair value | **$31,321** | $32,899 |
| Weighted average yield | **0.9%** | 1.3% |

Investment income is recorded in "Interest income" in the Consolidated Statements of Income and totaled $67 thousand and $140 thousand for the three months ended March 31, 2014 and 2013, respectively.

## NOTE 5: 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 accompanying 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.

## 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. Accounting 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 13 in our 2013 Annual Report for a more complete description of the three input levels.

### Non-Recurring Basis

We did not have any assets or liabilities measured at fair value on a recurring basis at March 31, 2014 or December 31, 2013. 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 March 31, 2014** | | | | | |
| **Loans** | **$ --** | **$11,075** | **$12,892** | **$23,967** | **($2,140)** |
| **Acquired property** | **--** | **2,868** | **12,465** | **15,333** | **195** |
| **Unfunded loan commitments** | **--** | **--** | **1,102** | **1,102** | **1,306** |
| As of December 31, 2013 | | | | | |
| Loans | $ -- | $11,142 | $11,812 | $22,954 | ($1,156) |
| Acquired property | -- | 1,746 | 11,005 | 12,751 | (10,507) |
| Unfunded loan commitments | -- | -- | 2,408 | 2,408 | (2,408) |

### 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.

**Acquired property:** 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.

**Unfunded loan commitments:** Estimating the fair value of unfunded loan commitments is determined by the inherent credit loss in such instruments.

## NOTE 7: SUBSEQUENT EVENTS

We have evaluated subsequent events through May 6, 2014, 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.