

FEDERAL AGRICULTURAL MORTGAGE CORP
Form 10-Q
August 09, 2012
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As filed with the Securities and Exchange Commission on August 9, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2012
Commission File Number 001-14951

FEDERAL AGRICULTURAL MORTGAGE CORPORATION

(Exact name of registrant as specified in its charter)

Federally chartered instrumentality of the United States (State or other jurisdiction of incorporation or organization) 52-1578738 (I.R.S. employer identification number)

1999 K Street, N.W., 4th Floor, Washington, D.C. (Address of principal executive offices) 20006 (Zip code)
(202) 872-7700 (Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer x
Non-accelerated filer o Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

As of August 1, 2012, the registrant had outstanding 1,030,780 shares of Class A voting common stock, 500,301 shares of Class B voting common stock and 8,960,906 shares of Class C non-voting common stock.

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PART I - FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

FEDERAL AGRICULTURAL MORTGAGE CORPORATION AND SUBSIDIARIES
 CONSOLIDATED BALANCE SHEETS
 (unaudited)

	June 30, 2012 (in thousands)	December 31, 2011
Assets:		
Cash and cash equivalents	\$752,502	\$817,046
Investment securities:		
Available-for-sale, at fair value	2,495,021	2,182,694
Trading, at fair value	1,430	1,796
Total investment securities	2,496,451	2,184,490
Farmer Mac Guaranteed Securities:		
Available-for-sale, at fair value	4,444,467	4,289,272
USDA Guaranteed Securities:		
Available-for-sale, at fair value	1,418,638	1,279,546
Trading, at fair value	146,825	212,359
Total USDA Guaranteed Securities	1,565,463	1,491,905
Loans:		
Loans held for sale, at lower of cost or fair value	612,795	541,447
Loans held for investment, at amortized cost	1,341,250	1,241,311
Loans held for investment in consolidated trusts, at amortized cost	596,218	1,121,559
Allowance for loan losses	(9,361)	(10,161)
Total loans, net of allowance	2,540,902	2,894,156
Real estate owned, at lower of cost or fair value	2,460	3,136
Financial derivatives, at fair value	36,894	40,250
Interest receivable (includes \$10,726 and \$15,578, respectively, related to consolidated trusts)	96,049	110,339
Guarantee and commitment fees receivable	38,122	31,384
Prepaid expenses and other assets	77,104	21,530
Total Assets	\$12,050,414	\$11,883,508
Liabilities and Equity:		
Liabilities:		
Notes payable:		
Due within one year	\$6,482,817	\$6,087,879
Due after one year	4,519,192	4,104,882
Total notes payable	11,002,009	10,192,761
Debt securities of consolidated trusts held by third parties	184,499	701,583
Financial derivatives, at fair value	162,591	160,024
Accrued interest payable (includes \$3,154 and \$7,659, respectively, related to consolidated trusts)	54,997	60,854
Guarantee and commitment obligation	34,051	27,440
Accounts payable and accrued expenses	18,533	178,708
Deferred tax liability, net	2,927	250

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Reserve for losses	8,779	7,355
Total Liabilities	11,468,386	11,328,975
Commitments and Contingencies (Note 6)		
Equity:		
Preferred stock:		
Series C, par value \$1,000 per share, 100,000 shares authorized, 57,578 shares issued and outstanding	57,578	57,578
Common stock:		
Class A Voting, \$1 par value, no maximum authorization, 1,030,780 shares outstanding	1,031	1,031
Class B Voting, \$1 par value, no maximum authorization, 500,301 shares outstanding	500	500
Class C Non-Voting, \$1 par value, no maximum authorization, 8,952,428 shares and 8,825,794 shares outstanding, respectively	8,952	8,826
Additional paid-in capital	104,019	102,821
Accumulated other comprehensive income, net of tax, related to available-for-sale securities	89,713	79,370
Retained earnings	78,382	62,554
Total Stockholders' Equity	340,175	312,680
Non-controlling interest - preferred stock	241,853	241,853
Total Equity	582,028	554,533
Total Liabilities and Equity	\$12,050,414	\$11,883,508
See accompanying notes to consolidated financial statements.		

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FEDERAL AGRICULTURAL MORTGAGE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
	(in thousands, except per share amounts)			
Interest income:				
Investments and cash equivalents	\$6,024	\$7,033	\$12,256	\$14,220
Farmer Mac Guaranteed Securities and USDA Guaranteed Securities	37,523	29,358	75,269	57,133
Loans	28,031	30,461	57,184	59,571
Total interest income	71,578	66,852	144,709	130,924
Total interest expense	36,961	37,640	75,884	74,693
Net interest income	34,617	29,212	68,825	56,231
Release of/(provision for) loan losses	1,220	(160)	) 800	(1,441)
Net interest income after release of/(provision for) loan losses	35,837	29,052	69,625	54,790
Non-interest (loss)/income:				
Guarantee and commitment fees	6,064	6,320	11,994	12,707
Losses on financial derivatives	(31,292)	) (17,806)	) (24,892)	) (13,801)
(Losses)/gains on trading assets	(3,086)	) 1,968	(1,987)	) 3,279
Gains on sale of available-for-sale investment securities	—	38	28	195
Gains on sale of real estate owned	262	627	262	724
Lower of cost or fair value adjustment on loans held for sale	—	(156)	) —	(964)
Other income	771	1,124	1,492	5,022
Non-interest (loss)/income	(27,281)	) (7,885)	) (13,103)	) 7,162
Non-interest expense:				
Compensation and employee benefits	4,574	4,666	9,059	9,163
General and administrative	2,664	2,656	5,422	4,912
Regulatory fees	562	573	1,125	1,164
Real estate owned operating costs, net	15	231	21	599
Provision for/(release of) losses	1,394	(935)	) 1,424	(2,869)
Other expense	—	—	—	900
Non-interest expense	9,209	7,191	17,051	13,869
(Loss)/income before income taxes	(653)	) 13,976	39,471	48,083
Income tax (benefit)/expense	(2,629)	) 2,539	9,025	12,056
Net income	1,976	11,437	30,446	36,027
Less: Net income attributable to non-controlling interest - preferred stock dividends	(5,547)	) (5,547)	) (11,094)	) (11,094)
Net (loss)/income attributable to Farmer Mac	(3,571)	) 5,890	19,352	24,933
Preferred stock dividends	(720)	) (720)	) (1,440)	) (1,440)
Net (loss)/income attributable to common stockholders	\$(4,291)	) \$5,170	\$17,912	\$23,493
(Loss)/earnings per common share and dividends:				
Basic (loss)/earnings per common share	\$(0.41)	) \$0.50	\$1.72	\$2.28
Diluted (loss)/earnings per common share	\$(0.41)	) \$0.48	\$1.63	\$2.20
Common stock dividends per common share	\$0.10	\$0.05	\$0.20	\$0.10

See accompanying notes to consolidated financial statements.

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FEDERAL AGRICULTURAL MORTGAGE CORPORATION AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (unaudited)

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
	(in thousands)			
Net income	\$ 1,976	\$ 11,437	\$ 30,446	\$ 36,027
Other comprehensive income, net of tax:				
Unrealized holding gains on securities (1)	10,827	27,466	10,863	20,911
Less: Reclassification adjustment for gains included in net income (2)	(237	) (645	) (520	) (2,750
Other comprehensive income	10,590	26,821	10,343	18,161
Comprehensive income	12,566	38,258	40,789	54,188
Less: Comprehensive income attributable to noncontrolling interest - preferred stock dividends	(5,547	) (5,547	) (11,094	) (11,094
Comprehensive income attributable to Farmer Mac	\$ 7,019	\$ 32,711	\$ 29,695	\$ 43,094

(1) Presented net of income tax expense of \$5.8 million and \$14.8 million for the three months ended June 30, 2012 and 2011, respectively, and income tax expense of \$5.8 million and \$11.3 million for the six months ended June 30, 2012 and 2011, respectively.

(2) Presented net of income tax benefit of \$0.1 million and \$0.3 million for the three months ended June 30, 2012 and 2011, respectively, and income tax benefit of \$0.3 million and \$1.5 million for the six months ended June 30, 2012 and 2011, respectively.

See accompanying notes to consolidated financial statements.

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FEDERAL AGRICULTURAL MORTGAGE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EQUITY
(unaudited)

	For the Six Months Ended			
	June 30, 2012		June 30, 2011	
	Shares	Amount	Shares	Amount
	(in thousands)			
Preferred stock:				
Balance, beginning of period	58	\$57,578	58	\$57,578
Issuance of Series C preferred stock	—	—	—	—
Balance, end of period	58	\$57,578	58	\$57,578
Common stock:				
Balance, beginning of period	10,357	\$10,357	10,284	\$10,284
Issuance of Class C common stock	43	43	58	58
Exercise of stock options and SARs	83	83	2	2
Balance, end of period	10,483	\$10,483	10,344	\$10,344
Additional paid-in capital:				
Balance, beginning of period		\$102,821		\$100,050
Stock-based compensation expense		1,800		1,490
Issuance of Class C common stock		7		15
Tax effect of stock-based awards		(609)		(458)
Balance, end of period		\$104,019		\$101,097
Retained earnings:				
Balance, beginning of period		\$62,554		\$50,837
Net income attributable to Farmer Mac		19,352		24,933
Cash dividends:				
Preferred stock, Series C (\$25.00 per share)		(1,440)		(1,440)
Common stock (\$0.20 per share and \$0.10 per share, respectively)		(2,084)		(1,031)
Balance, end of period		\$78,382		\$73,299
Accumulated other comprehensive income:				
Balance, beginning of period		\$79,370		\$18,275
Other comprehensive income, net of tax		10,343		18,161
Balance, end of period		\$89,713		\$36,436
Total Stockholders' Equity		\$340,175		\$278,754
Non-controlling interest - preferred stock:				
Balance, beginning of period		\$241,853		\$241,853
Issuance of Preferred stock - Farmer Mac II LLC		—		—
Balance, end of period		\$241,853		\$241,853
Total Equity		\$582,028		\$520,607
See accompanying notes to consolidated financial statements.				

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FEDERAL AGRICULTURAL MORTGAGE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	For the Six Months Ended	
	June 30, 2012	June 30, 2011
	(in thousands)	
Cash flows from operating activities:		
Net income	\$30,446	\$36,027
Adjustments to reconcile net income to net cash used in operating activities:		
Net amortization of deferred gains, premiums and discounts on loans, investments, Farmer Mac Guaranteed Securities and USDA Guaranteed Securities	6,998	5,329
Amortization of debt premiums, discounts and issuance costs	6,934	5,765
Net change in fair value of trading securities, financial derivatives and loans held for sale	7,911	(10,299)
Gains on the sale of available-for-sale investment securities	(28	) (195)
Gains on the sale of real estate owned	(262	) (724)
Total provision for/(release of) losses	624	(1,428)
Deferred income taxes	(3,657	) 393
Stock-based compensation expense	1,800	1,490
Proceeds from repayment and sale of trading investment securities	527	550
Purchases of loans held for sale	(86,963	) (119,410)
Proceeds from repayment of loans purchased as held for sale	78,156	51,012
Net change in:		
Interest receivable	14,290	1,434
Guarantee and commitment fees receivable	(6,738	) 2,928
Other assets	(54,632	) 12,650
Accrued interest payable	(5,857	) (979)
Other liabilities	4,409	(3,976)
Net cash used in operating activities	(6,042	) (19,433)
Cash flows from investing activities:		
Purchases of available-for-sale investment securities	(1,058,206	) (990,568)
Purchases of Farmer Mac Guaranteed Securities and USDA Guaranteed Securities	(667,338	) (1,016,815)
Purchases of loans held for investment	(251,583	) (329,782)
Purchases of defaulted loans	(3,857	) (18,345)
Proceeds from repayment of available-for-sale investment securities	581,672	511,562
Proceeds from repayment of Farmer Mac Guaranteed Securities and USDA Guaranteed Securities	437,375	647,701
Proceeds from repayment of loans purchased as held for investment	159,666	181,792
Proceeds from sale of available-for-sale investment securities	5,028	153,609
Proceeds from sale of Farmer Mac Guaranteed Securities	17,628	10,734
Proceeds from sale of real estate owned	938	1,279
Net cash used in investing activities	(778,677	) (848,833)
Cash flows from financing activities:		
Proceeds from issuance of discount notes	34,231,830	34,663,582
Proceeds from issuance of medium-term notes	1,315,854	991,849
Payments to redeem discount notes	(34,013,370	) (34,114,562)
Payments to redeem medium-term notes	(732,000) (540,000)
Excess tax benefits related to stock-based awards	856	144

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Payments to third parties on debt securities of consolidated trusts	(69,124)	(80,783)
Proceeds from common stock issuance	27		16	
Dividends paid - Non-controlling interest - preferred stock	(11,094	)	(11,094)
Dividends paid on common and preferred stock	(2,804	)	(2,471)
Net cash provided by financing activities	720,175		906,681	
Net (decrease)/increase in cash and cash equivalents	(64,544	)	38,415	
Cash and cash equivalents at beginning of period	817,046		729,920	
Cash and cash equivalents at end of period	\$752,502		\$768,335	
See accompanying notes to consolidated financial statements.				

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FEDERAL AGRICULTURAL MORTGAGE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. ACCOUNTING POLICIES

The interim unaudited consolidated financial statements of the Federal Agricultural Mortgage Corporation ("Farmer Mac" or the "Corporation") and subsidiaries have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). These interim unaudited consolidated financial statements reflect all normal and recurring adjustments that are, in the opinion of management, necessary to present a fair statement of the financial position and the results of operations and cash flows of Farmer Mac and subsidiaries for the interim periods presented. Certain information and footnote disclosures normally included in the annual consolidated financial statements have been omitted as permitted by SEC rules and regulations. The December 31, 2011 consolidated balance sheet presented in this report has been derived from the Corporation's audited 2011 consolidated financial statements. Management believes that the disclosures are adequate to present fairly the consolidated financial statements as of the dates and for the periods presented. These interim unaudited consolidated financial statements should be read in conjunction with the 2011 consolidated financial statements of Farmer Mac and subsidiaries included in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2011 filed with the SEC on March 15, 2012. Results for interim periods are not necessarily indicative of those that may be expected for the fiscal year. Below is a summary of Farmer Mac's significant accounting policies.

Principles of Consolidation

The consolidated financial statements include the accounts of Farmer Mac and its two subsidiaries: (1) Farmer Mac Mortgage Securities Corporation ("FMMSC"), whose principal activities are to facilitate the purchase and issuance of Farmer Mac Guaranteed Securities and to act as a registrant under registration statements filed with the Securities and Exchange Commission, and (2) Farmer Mac II LLC, whose principal activity is the operation of substantially all of the business related to the Farmer Mac II program – primarily the acquisition of USDA-guaranteed portions. The consolidated financial statements also include the accounts of variable interest entities ("VIEs") in which Farmer Mac determined itself to be the primary beneficiary. See Note 1(f) for more information on consolidated VIEs.

A Farmer Mac guarantee of timely payment of principal and interest is an explicit element of the terms of all Farmer Mac Guaranteed Securities. When Farmer Mac retains such securities in its portfolio, that guarantee is not extinguished. For Farmer Mac Guaranteed Securities in the Corporation's portfolio, Farmer Mac has entered into guarantee arrangements with FMMSC. The guarantee fee rate established between Farmer Mac and FMMSC is an element in determining the fair value of these Farmer Mac Guaranteed Securities, and guarantee fees related to these securities are reflected in guarantee and commitment fees in the consolidated statements of operations. These guarantee fees totaled \$2.5 million and \$5.1 million for the three and six months ended June 30, 2012, respectively, compared to \$2.0 million and \$4.1 million for the same periods in 2011. The corresponding expense of FMMSC has been eliminated against interest income in consolidation. All other inter-company balances and transactions have been eliminated in consolidation.

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(a) Cash and Cash Equivalents and Statements of Cash Flows

Farmer Mac considers highly liquid investment securities with maturities at the time of purchase of three months or less to be cash equivalents. The carrying value of cash and cash equivalents is a reasonable estimate of their approximate fair value. Changes in the balance of cash and cash equivalents are reported in the consolidated statements of cash flows.

The following table sets forth information regarding certain cash and non-cash transactions for the six months ended June 30, 2012 and 2011:

	For the Six Months Ended	
	June 30, 2012	June 30, 2011
	(in thousands)	
Cash paid during the period for:		
Interest	\$55,131	\$49,261
Income taxes	13,500	11,500
Non-cash activity:		
Real estate owned acquired through loan liquidation	—	2,639
Loans acquired and securitized as Farmer Mac Guaranteed Securities	12,301	8,729
Consolidation of Farmer Mac I Guaranteed Securities from off-balance sheet to loans held for investment in consolidated trusts and to debt securities of consolidated trusts held by third parties	12,301	8,729
Deconsolidation of loans held for investment in consolidated trusts and debt securities of consolidated trusts held by third parties - transferred to off-balance sheet Farmer Mac I Guaranteed Securities	460,261	—
Transfers of loans held for sale to loans held for investment	—	878,798

During second quarter 2012, Farmer Mac deconsolidated \$460.3 million of Farmer Mac I Guaranteed Securities owned by Farm Credit West ("FCW") from loans held for investment in consolidated trusts and debt securities of consolidated trusts held by third parties to off-balance sheet Farmer Mac I Guaranteed Securities because FCW was no longer a related party as of June 30, 2012.

Effective January 1, 2011, Farmer Mac transferred \$878.8 million of loans in the Farmer Mac I program from held for sale to held for investment because Farmer Mac no longer has the intent to securitize or sell these loans in the foreseeable future. Farmer Mac transferred these loans at their cost, which was lower than the estimated fair value at the time of transfer. At the time of purchase, loans are classified as either held for sale or held for investment depending upon management's intent and ability to hold the loans for the foreseeable future. Cash receipts from the repayment of loans are classified within the statements of cash flows based on management's intent upon purchase of the loan, as prescribed by accounting guidance related to the statement of cash flows.

(b) Allowance for Losses

Farmer Mac maintains an allowance for losses to cover estimated probable losses incurred as of the balance sheet date on loans held ("allowance for loan losses") and loans underlying LTSPCs and Farmer Mac Guaranteed Securities ("reserve for losses") based on available information. Farmer Mac's methodology for determining the allowance for losses separately considers its portfolio segments – Farmer Mac I, Farmer Mac II, and Rural Utilities, and disaggregates its analysis, where relevant, into classes of financing receivables, which currently include loans and AgVantage securities. Further disaggregation by commodity type is performed, where appropriate, in analyzing the need for an allowance for losses.

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The allowance for losses is increased through periodic provisions for loan losses that are charged against net interest income and provisions for losses that are charged to non-interest expense, and is reduced by charge-offs for actual losses, net of recoveries. Negative provisions, or a release of allowance for losses, generally are recorded in the event that the estimate of probable losses as of the end of a period is lower than the estimate at the beginning of the period.

The total allowance for losses consists of a general allowance for losses and a specific allowance for impaired loans.

General Allowance for Losses

Farmer Mac I

Farmer Mac's methodology for determining its allowance for losses incorporates the Corporation's automated loan classification system. That system scores loans based on criteria such as historical repayment performance, indicators of current financial condition, loan seasoning, loan size and loan-to-value ratio. For purposes of the loss allowance methodology, the loans in Farmer Mac's portfolio of loans and loans underlying Farmer Mac I Guaranteed Securities and LTSPCs have been scored and classified for each calendar quarter since first quarter 2000. The allowance methodology captures the migration of loan scores across concurrent and overlapping three-year time horizons and calculates loss rates separately within each loan classification for (1) loans underlying LTSPCs and (2) loans held and loans underlying Farmer Mac I Guaranteed Securities. The calculated loss rates are applied to the current classification distribution of unimpaired loans in Farmer Mac's portfolio to estimate inherent losses, on the assumption that the historical credit losses and trends used to calculate loss rates will continue in the future. Management evaluates this assumption by taking into consideration several factors, including:

- economic conditions;
- geographic and agricultural commodity/product concentrations in the portfolio;
- the credit profile of the portfolio;
- delinquency trends of the portfolio;
- historical charge-off and recovery activities of the portfolio; and
- other factors to capture current portfolio trends and characteristics that differ from historical experience.

Management believes that its use of this methodology produces a reasonable estimate of probable losses, as of the balance sheet date, for all loans held in the Farmer Mac I portfolio and loans underlying Farmer Mac I Guaranteed Securities and LTSPCs. There were no purchases or sales during the first half of 2012 that materially affected the credit profile of the Farmer Mac I portfolio.

Farmer Mac has not provided an allowance for losses for loans underlying Farmer Mac I AgVantage securities. Each AgVantage security is a general obligation of an issuing institution approved by Farmer Mac and is secured by eligible loans in an amount at least equal to the outstanding principal amount of the security, with some level of overcollateralization required for Farmer Mac I AgVantage securities. Farmer Mac excludes the loans that secure AgVantage securities from the credit risk metrics it discloses because of the credit quality of the issuing institutions, the collateralization level for the securities, and because delinquent loans are required to be removed from the pool of pledged loans and replaced with current eligible loans. AgVantage® is a registered trademark of Farmer Mac.

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Farmer Mac II

No allowance for losses has been provided for USDA Guaranteed Securities or Farmer Mac II Guaranteed Securities. The USDA-guaranteed portions presented as "USDA Guaranteed Securities" on the consolidated balance sheets, as well as those that collateralize Farmer Mac II Guaranteed Securities, are guaranteed by the USDA. Each USDA guarantee is an obligation backed by the full faith and credit of the United States. Farmer Mac excludes these guaranteed portions from the credit risk metrics it discloses because of the USDA guarantee.

Rural Utilities

Farmer Mac separately evaluates the rural utilities loans it owns, as well as the lender obligations and loans underlying or securing its Farmer Mac Guaranteed Securities – Rural Utilities, including AgVantage securities, to determine if there are any probable losses inherent in those assets. Each AgVantage security is a general obligation of an issuing institution approved by Farmer Mac and is secured by eligible loans in an amount at least equal to the outstanding principal amount of the security. No allowance for losses has been provided for this portfolio segment based on the credit quality of the collateral supporting rural utilities assets and Farmer Mac's counterparty risk analysis. As of June 30, 2012, there were no delinquencies and no probable losses inherent in Farmer Mac's rural utilities loans held or in any Farmer Mac Guaranteed Securities – Rural Utilities.

Specific Allowance for Impaired Loans

Farmer Mac also analyzes certain loans in its portfolio for impairment in accordance with accounting guidance on measuring individual impairment of a loan. Farmer Mac's impaired loans generally include loans 90 days or more past due, in foreclosure, restructured, in bankruptcy and certain performing loans that have previously been delinquent or are secured by real estate that produces agricultural commodities or products currently under stress.

For loans with an updated appraised value, other updated collateral valuation or management's estimate of discounted collateral value, this analysis includes the measurement of the fair value of the underlying collateral for individual loans relative to the total recorded investment, including principal, interest and advances and net of any charge-offs. In the event that the collateral value does not support the total recorded investment, Farmer Mac specifically provides an allowance for the loan for the difference between the recorded investment and its fair value, less estimated costs to liquidate the collateral. Estimated selling costs are based on historical selling costs incurred by Farmer Mac or management's best estimate of selling costs for a particular property. For the remaining impaired assets without updated valuations, this analysis is performed in the aggregate in consideration of the similar risk characteristics of the assets and historical statistics.

A modification to the contractual terms of a loan that results in granting a concession to a borrower experiencing financial difficulties is considered a troubled debt restructuring ("TDR"). Farmer Mac has granted a concession when, as a result of the restructuring, it does not expect to collect all amounts due, including interest accrued at the original contract rate. In making its determination of whether a borrower is experiencing financial difficulties, Farmer Mac considers several factors, including whether (1) the borrower has declared or is in the process of declaring bankruptcy, (2) there is substantial doubt as to whether the borrower will continue to be a going concern, and (3) the borrower can obtain funds from other sources at an effective interest rate at or near a current market interest rate for debt with similar risk

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characteristics. Farmer Mac evaluates TDRs similarly to other impaired loans for purposes of the allowance for losses. For the three and six months ended June 30, 2012, the recorded investment of loans determined to be TDRs was \$0.1 million and \$1.1 million, respectively, before restructuring and \$0.1 million and \$1.3 million, respectively, after restructuring. As of June 30, 2012, there was one TDR identified during the previous 12 months that was in default, under the modified terms, with a recorded investment of \$0.1 million. The impact of TDRs on Farmer Mac's allowance for loan losses for both the three and six months ended June 30, 2012 was a partial release of \$0.2 million. See Note 5 for more information related to the allowance for losses.

(c) Financial Derivatives

Farmer Mac enters into financial derivative transactions principally to protect against risk from the effects of market price or interest rate movements on the value of certain assets, future cash flows or debt issuance, not for trading or speculative purposes. Farmer Mac enters into interest rate swap contracts principally to adjust the characteristics of its short-term debt to match more closely the cash flow and duration characteristics of its longer-term loans and other assets, and also to adjust the characteristics of its long-term debt to match more closely the cash flow and duration characteristics of its short-term assets, thereby reducing interest rate risk and often times deriving an overall lower effective cost of borrowing than would otherwise be available to Farmer Mac in the conventional debt market. Farmer Mac is required to recognize certain contracts and commitments as derivatives when the characteristics of those contracts and commitments meet the definition of a derivative.

Financial derivatives are recorded on the consolidated balance sheets at fair value as a freestanding asset or liability. Through second quarter 2012, Farmer Mac did not designate its financial derivatives as fair value hedges or cash flow hedges; therefore, the changes in the fair values of financial derivatives were reported as gains or losses on financial derivatives in the consolidated statements of operations. Effective July 1, 2012, Farmer Mac designated \$950.0 million notional amount of interest rate swaps in fair value hedge relationships. These interest rate swaps are used to hedge against the risk of changes in fair values of certain fixed rate AgVantage securities due to changes in the benchmark interest rate (i.e., LIBOR). Beginning in third quarter 2012, Farmer Mac will record in earnings offsetting fair value adjustments on the hedged items attributable to the risk being hedged. Any differences arising from fair value changes that are not offset will result in hedge ineffectiveness and affect GAAP earnings.

In accordance with applicable fair value measurement guidance, Farmer Mac made an accounting policy election to measure the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio, consistent with how the Corporation previously has been measuring credit risk for these instruments. See Notes 4 and 8 for more information on financial derivatives.

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(d) Loss/Earnings Per Common Share

Basic loss/earnings per common share ("EPS") is based on the weighted-average number of shares of common stock outstanding. Diluted earnings per common share is based on the weighted-average number of shares of common stock outstanding adjusted to include all potentially dilutive common stock options, stock appreciation rights ("SARs") and non-vested restricted stock awards. The following schedules reconcile basic and diluted EPS for the three and six months ended June 30, 2012 and 2011:

	For the Three Months Ended			June 30, 2011		
	June 30, 2012	Weighted-average	\$ per	Net	Weighted-average	\$ per
	Net Loss	Shares	Share	Income	Shares	Share
	(in thousands, except per share amounts)					
Basic EPS						
Net (loss)/income attributable to common stockholders	\$ (4,291)	10,468	\$ (0.41)	\$ 5,170	10,343	\$ 0.50
Effect of dilutive securities(1):						
Stock options, SARs and restricted stock		—	—		376	(0.02)
Diluted EPS	\$ (4,291)	10,468	\$ (0.41)	\$ 5,170	10,719	\$ 0.48

For the three months ended June 30, 2012 and 2011, stock options and SARs of 1,270,777 and 652,234, respectively, were outstanding but not included in the computation of diluted earnings per share of common stock (1) because they were anti-dilutive. For the three months ended June 30, 2012 and 2011, contingent shares of non-vested restricted stock of 146,311 and 170,760, respectively, were outstanding but not included in the computation of diluted earnings per share of common stock because performance conditions were not met.

	For the Six Months Ended			June 30, 2011		
	June 30, 2012	Weighted-average	\$ per	Net	Weighted-average	\$ per
	Net	Shares	Share	Income	Shares	Share
	(in thousands, except per share amounts)					
Basic EPS						
Net income attributable to common stockholders	\$ 17,912	10,417	\$ 1.72	\$ 23,493	10,314	\$ 2.28
Effect of dilutive securities(1):						
Stock options, SARs and restricted stock		545	(0.09)		378	(0.08)
Diluted EPS	\$ 17,912	10,962	\$ 1.63	\$ 23,493	10,692	\$ 2.20

For the six months ended June 30, 2012 and 2011, stock options and SARs of 469,577 and 705,515, respectively, were outstanding but not included in the computation of diluted earnings per share of common stock because they (1) were anti-dilutive. For the six months ended June 30, 2012 and 2011, contingent shares of non-vested restricted stock of 92,800 and 148,380, respectively, were outstanding but not included in the computation of diluted earnings per share of common stock because performance conditions were not met.

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(e) Fair Value Measurement

Farmer Mac follows accounting guidance for fair value measurements that defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and establishes a fair value hierarchy that ranks the quality and reliability of the inputs to valuation techniques used to measure fair value. The hierarchy gives highest rank to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest rank to unobservable inputs (level 3 measurements).

Farmer Mac's assessment of the significance of the input to the fair value measurement requires judgment and considers factors specific to the financial instrument. Both observable and unobservable inputs may be used to determine the fair value of financial instruments that Farmer Mac has classified within the level 3 category. As a result, the unrealized gains and losses for assets and liabilities within the level 3 category may include changes in fair value that were attributable to both observable (e.g., changes in market interest rates) and unobservable (e.g., changes in projected prepayment rates) inputs. See Note 8 for more information regarding fair value measurement.

(f) Consolidation of Variable Interest Entities

Farmer Mac has interests in various entities that are considered to be VIEs. These interests include investments in securities issued by VIEs, such as Farmer Mac agricultural mortgage-backed securities created pursuant to Farmer Mac's securitization transactions and mortgage and asset-backed trusts that Farmer Mac did not create. The consolidation model uses a qualitative evaluation that requires consolidation of an entity when the reporting enterprise both (1) has the power to direct matters which significantly impact the activities and success of the entity, and (2) has exposure to benefits and/or losses that could potentially be significant to the entity. The reporting enterprise that meets both these conditions is deemed the primary beneficiary of the VIE.

The VIEs in which Farmer Mac has a variable interest are limited to securitization trusts. The major judgment in determining if Farmer Mac is the primary beneficiary is whether Farmer Mac has the power to direct the activities of the trust that potentially have the most significant impact on the economic performance of the trust. Generally, the ability to make decisions regarding default mitigation is evidence of that power. Farmer Mac determined that it is the primary beneficiary for the securitization trusts related to most Farmer Mac I and all Rural Utilities securitization transactions because of its rights as guarantor under both programs to control the default mitigation activities of the trusts. For certain securitization trusts created when loans subject to LTSPCs were converted to Farmer Mac I Guaranteed Securities, Farmer Mac determined that it is not the primary beneficiary since the power to make decisions regarding default mitigation was shared among unrelated parties. For similar securitization transactions where the power to make decisions regarding default mitigation is shared with a related party, Farmer Mac determined that it is the primary beneficiary because the applicable accounting guidance does not permit parties within a related party group to conclude that the power is shared. In the event that a related party status changes, consolidation or deconsolidation of these securitization trusts could occur.

For those trusts that Farmer Mac is the primary beneficiary, the assets and liabilities are presented on the consolidated balance sheets as "Loans held for investment in consolidated trusts" and "Debt securities of consolidated trusts held by third parties," respectively. These assets can only be used to satisfy the obligations of the related trust.

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For those trusts where Farmer Mac has a variable interest but has not been determined to be the primary beneficiary, Farmer Mac's interests are presented as either "Farmer Mac Guaranteed Securities" or "Investment securities" on the consolidated balance sheets. Farmer Mac's involvement in VIEs classified as Farmer Mac Guaranteed Securities include securitization trusts under the Farmer Mac II program and trusts related to AgVantage securities. In the case of Farmer Mac II trusts, Farmer Mac is not determined to be the primary beneficiary because it does not have the decision-making power over default mitigation activities. For the AgVantage trusts, Farmer Mac currently does not have the power to direct the activities that have the most significant economic impact to the trust unless, as guarantor, there is a default by the issuer of the trust securities. Should there be a default, Farmer Mac would reassess whether it is the primary beneficiary of those trusts. For VIEs classified as investment securities, which include auction-rate certificates, asset-backed securities and government-sponsored enterprise ("GSE")-guaranteed mortgage-backed securities, Farmer Mac is determined not to be the primary beneficiary because of the lack of voting rights or other powers to direct the activities of the trust. As of June 30, 2012, the Farmer Mac Guaranteed Securities trusts and investment securities trusts have carrying amounts on the consolidated balance sheets totaling \$61.2 million and \$1.0 billion, respectively, and Farmer Mac's maximum exposure to loss, based on principal outstanding, was \$59.3 million and \$1.0 billion, respectively. As of December 31, 2011, the Farmer Mac Guaranteed Securities trusts and investment securities trusts had carrying amounts on the consolidated balance sheets totaling \$66.6 million and \$1.0 billion, respectively, and Farmer Mac's maximum exposure to loss was \$65.4 million and \$1.0 billion, respectively. In addition, Farmer Mac had a variable interest in unconsolidated VIEs, which include a guarantee of timely payment of principal and interest, totaling \$2.0 billion and \$1.6 billion, respectively, as of June 30, 2012 and December 31, 2011.

(g) New Accounting Standards

Offsetting Assets and Liabilities

On December 16, 2011, the FASB issued ASU 2011-11, Disclosures about Offsetting Assets and Liabilities, which creates new disclosure requirements designed to make financial statements prepared under U.S. GAAP more comparable to those prepared under International Financial Reporting Standards. The new guidance requires entities to disclose net and gross information for certain derivative instruments and financial instruments and information about the impact of collateral on offsetting arrangements and other amounts subject to a master netting agreement that are not offset on the balance sheet. ASU 2011-11 is effective in first quarter 2013. Farmer Mac does not expect the adoption of the new guidance to have a material effect on its financial position, results or operations or cash flows.

(h) Reclassifications

Certain reclassifications of prior period information were made to conform to the current period presentation.

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2. INVESTMENT SECURITIES

The following tables present the amortized cost and fair values of Farmer Mac's investment securities as of June 30, 2012 and December 31, 2011:

	June 30, 2012			
	Amortized Cost (in thousands)	Unrealized Gains	Unrealized Losses	Fair Value
Available-for-sale:				
Floating rate auction-rate certificates backed by Government guaranteed student loans	\$74,100	\$—	\$(14,393)	) \$59,707
Floating rate asset-backed securities	173,101	265	(67)	) 173,299
Floating rate corporate debt securities	86,293	360	(26)	) 86,627
Fixed rate corporate debt securities	57,723	64	(30)	) 57,757
Floating rate Government/GSE guaranteed mortgage-backed securities	755,343	7,212	(188)	) 762,367
Fixed rate GSE guaranteed mortgage-backed securities	2,483	203	—	) 2,686
Floating rate GSE subordinated debt	70,000	—	(14,161)	) 55,839
Fixed rate GSE preferred stock	79,478	7,314	—	) 86,792
Floating rate senior agency debt	25,000	66	—	) 25,066
Fixed rate senior agency debt	178,853	122	—	) 178,975
Fixed rate U.S. Treasuries	1,005,995	33	(122)	) 1,005,906
Total available-for-sale	2,508,369	15,639	(28,987)	) 2,495,021
Trading:				
Floating rate asset-backed securities	4,611	—	(3,181)	) 1,430
Total investment securities	\$2,512,980	\$15,639	\$(32,168)	) \$2,496,451
	December 31, 2011			
	Amortized Cost (in thousands)	Unrealized Gains	Unrealized Losses	Fair Value
Available-for-sale:				
Floating rate auction-rate certificates backed by Government guaranteed student loans	\$74,100	\$—	\$(13,887)	) \$60,213
Floating rate asset-backed securities	178,443	219	(102)	) 178,560
Floating rate corporate debt securities	74,152	69	(388)	) 73,833
Fixed rate corporate debt securities	38,678	27	(6)	) 38,699
Floating rate Government/GSE guaranteed mortgage-backed securities	759,567	4,852	(381)	) 764,038
Fixed rate GSE guaranteed mortgage-backed securities	3,106	254	—	) 3,360
Floating rate GSE subordinated debt	70,000	—	(17,438)	) 52,562
Fixed rate commercial paper	9,999	1	—	) 10,000
Fixed rate GSE preferred stock	79,662	5,216	—	) 84,878
Floating rate senior agency debt	38,000	32	—	) 38,032
Fixed rate senior agency debt	79,255	19	(21)	) 79,253
Fixed rate U.S. Treasuries	798,966	304	(4)) 799,266
Total available-for-sale	2,203,928	10,993	(32,227)) 2,182,694
Trading:				

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Floating rate asset-backed securities	5,138	—	(3,342) 1,796
Total investment securities	\$2,209,066	\$10,993	\$(35,569) \$2,184,490

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During the three months ended June 30, 2012, Farmer Mac did not sell any securities from its available-for-sale investment portfolio, compared to the same period in 2011, when Farmer Mac received proceeds of \$75.1 million from the sale of securities from its available-for-sale investment portfolio, resulting in gross realized gains of \$38,000. During the six months ended June 30, 2012, Farmer Mac received proceeds of \$5.0 million from the sale of securities from its available-for-sale investment portfolio, resulting in gross realized gains of \$28,000, compared to proceeds of \$153.6 million, for the same period in 2011, resulting in gross realized gains of \$0.2 million.

As of June 30, 2012 and December 31, 2011, unrealized losses on available-for-sale investment securities were as follows:

	June 30, 2012			
	Available-for-Sale Securities Unrealized loss position for less than 12 months		Unrealized loss position for more than 12 months	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(in thousands)			
Floating rate auction-rate certificates backed by Government guaranteed student loans	\$—	\$—	\$59,707	\$(14,393)
Floating rate asset-backed securities	24,304	(51)	5,910	(16)
Floating rate corporate debt securities	16,975	(26)	—	—
Fixed rate corporate debt securities	25,287	(30)	—	—
Floating rate Government/GSE guaranteed mortgage-backed securities	91,149	(177)	846	(11)
Floating rate GSE subordinated debt	—	—	55,839	(14,161)
Fixed rate U.S. Treasuries	721,627	(122)	—	—
Total	\$879,342	\$(406)	\$122,302	\$(28,581)
	December 31, 2011			
	Available-for-Sale Securities Unrealized loss position for less than 12 months		Unrealized loss position for more than 12 months	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(in thousands)			
Floating rate auction-rate certificates backed by Government guaranteed student loans	\$—	\$—	\$60,213	\$(13,887)
Floating rate asset-backed securities	63,496	(102)	—	—
Floating rate corporate debt securities	41,061	(388)	—	—
Fixed rate corporate debt securities	18,189	(6)	—	—
Floating rate Government/GSE guaranteed mortgage-backed securities	235,454	(359)	17,409	(22)
Floating rate GSE subordinated debt	—	—	52,562	(17,438)
Fixed rate senior agency debt	44,976	(21)	—	—
Fixed rate U.S. Treasuries	50,160	(4)	—	—
Total	\$453,336	\$(880)	\$130,184	\$(31,347)

The unrealized losses presented above are principally due to a general widening of credit spreads from the dates of acquisition to June 30, 2012 and December 31, 2011, as applicable. The resulting decreases in fair values reflect an

increase in the perceived risk by the financial markets related to those securities. As of June 30, 2012, all of the investment securities in an unrealized loss position had credit ratings of at least

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"A" except one that was rated "BBB+". As of December 31, 2011, all of the investment securities in an unrealized loss position had credit ratings of at least "A" except one that was rated "A-" and one that was rated "BBB+". The unrealized losses were on 36 and 44 individual investment securities, respectively, as of June 30, 2012 and December 31, 2011.

As of June 30, 2012, 9 of the securities in loss positions had been in loss positions for more than 12 months and had a total unrealized loss of \$28.6 million. As of December 31, 2011, 10 of the securities in loss positions had been in loss positions for more than 12 months and had a total unrealized loss of \$31.3 million. The unrealized losses on those securities are principally due to a general widening of credit spreads from the dates of acquisition. Securities in unrealized loss positions 12 months or more have a fair value as of June 30, 2012 that is, on average, approximately 81.1 percent of their amortized cost basis. Farmer Mac believes that all of these unrealized losses are recoverable within a reasonable period of time by way of changes in credit spreads or maturity. Accordingly, Farmer Mac has concluded that none of the unrealized losses on these available-for-sale investment securities represent other-than-temporary impairment as of June 30, 2012 and December 31, 2011. Farmer Mac does not intend to sell these securities and it is not more likely than not that Farmer Mac will be required to sell the securities before recovery of the amortized cost basis.

Farmer Mac did not own any held-to-maturity investment securities as of June 30, 2012 and December 31, 2011. As of June 30, 2012, Farmer Mac owned trading investment securities with an amortized cost of \$4.6 million, a fair value of \$1.4 million and a weighted average yield of 4.33 percent. As of December 31, 2011, Farmer Mac owned trading investment securities with an amortized cost of \$5.1 million, a fair value of \$1.8 million and a weighted average yield of 4.36 percent.

The amortized cost, fair value and weighted average yield of available-for-sale investment securities by remaining contractual maturity as of June 30, 2012 are set forth below. Asset-backed and mortgage-backed securities are included based on their final maturities, although the actual maturities may differ due to prepayments of the underlying assets or mortgages.

	Investment Securities Available-for-Sale as of June 30, 2012		
	Amortized Cost	Fair Value	Weighted- Average Yield
	(dollars in thousands)		
Due within one year	\$1,147,970	\$1,147,937	0.75%
Due after one year through five years	224,333	224,849	0.78%
Due after five years through ten years	445,894	433,913	1.14%
Due after ten years	690,172	688,322	2.44%
Total	\$2,508,369	\$2,495,021	1.29%

