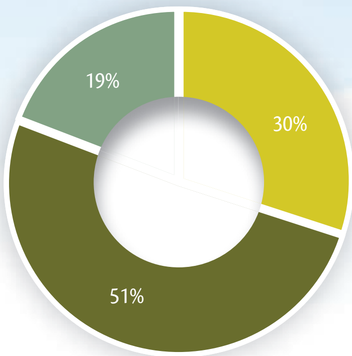
2012 ANNUAL REPORT | CoBANK | SHARED SUCCESS

LOAN PORTFOLIO

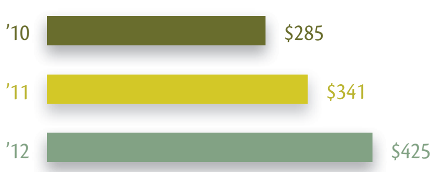


$72 billion
at 12/31/12

Agribusiness 30%
Strategic Relationships 51%
Rural Infrastructure 19%

Total Assets
($ in billions)

Net Income
($ in millions)



Patronage Distribution
($ in millions)

Permanent Capital Ratio

2012 FINANCIAL HIGHLIGHTS

FOR THE YEAR	2012	2011	2010
($ IN MILLIONS)			
Net Interest Income	$ 1,238	$ 1,071	$ 951
Provision for Loan Losses	70	58	60
Net Income	854	707	614
Patronage Distribution	425	341	285
AT YEAR END	**2012**	**2011**	**2010**
($ IN MILLIONS)			
Agribusiness	$ 21,394	$ 18,869	$ 22,676
Strategic Relationships	36,707	15,236	15,392
Rural Infrastructure	13,879	12,180	11,924
Total Loans	71,980	46,285	49,992
Allowance for Credit Losses	595	542	501
Total Assets	92,478	63,290	65,826
Total Shareholders' Equity	6,441	4,896	4,406
FINANCIAL RATIOS	**2012**	**2011**	**2010**
FOR THE YEAR			
Return on Average Common Equity	15.16 %	16.05 %	15.31 %
Return on Average Assets	0.94	1.07	1.03
Return on Active Patron Investment	18.41	22.65	19.77
Net Interest Margin	1.41	1.69	1.66
Permanent Capital Ratio	16.14	16.37	14.30

OUR MISSION, AS AN INTEGRAL MEMBER OF THE FARM CREDIT SYSTEM, IS TO SERVE AS A DEPENDABLE PROVIDER OF CREDIT AND OTHER VALUE-ADDED FINANCIAL SERVICES TO AGRICULTURE AND RURAL INFRASTRUCTURE BUSINESSES FOR THE BENEFIT OF RURAL AMERICA.

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EVERETT DOBRINSKI
Chairman
ROBERT B. ENGEL
President & Chief Executive Officer

TO OUR SHAREHOLDERS

In the broader U.S. economy, 2012 is apt to be remembered much more for weakness and uncertainty than it will be for strength and success. GDP growth remained much weaker than normally associated with recovery, reflecting the severity of economic dislocation produced by the 2008 financial crisis. The long-lasting process of deleveraging by households, businesses and banks continued to place a drag on demand, output and overall economic confidence. Employment and wage metrics remained weak despite repeated doses of monetary stimulus from the Federal Reserve. All the while, political dysfunction in Washington continued to be the norm, as leaders failed to address long-term fiscal imbalances that threaten our nation's long-term solvency and future.

At CoBank, by contrast, the year 2012 was one of very strong performance on behalf of our customers in the nation's agribusiness and rural infrastructure industries. We began the year with a historic business transaction—the close of our merger with U.S. AgBank. We ended it by recording our 13th consecutive period of annual net earnings growth. Throughout the year, we remained dedicated to serving the needs of our customers, providing them with the dependable credit and other financial services they count on from CoBank as their trusted financial partner.

Today, few if any other financial institutions in the world can claim a track record of continuous success as long as CoBank's. Credit for that fact rests squarely with our cooperative customers, affiliated Farm Credit associations and the other businesses we serve across rural America, who have consistently found ways to thrive despite the ongoing challenges of the economic environment. Collectively, our customers form the backbone of the U.S. rural economy, and they continue to create value for their members, invest in the future, and compete effectively in an increasingly globalized marketplace.

The theme of our annual report this year—"Shared Success"—is meant to celebrate the beauty of this mutually beneficial relationship. As a cooperative, CoBank succeeds when we collaborate with our customers to provide financial solutions to meet their growth and strategic objectives. Our customers benefit from the dependability of our financial services, the value of our patronage program, and the enduring commitment of the bank to support communities and institutions of importance to them across rural America.

With the economy as volatile as ever, we cannot predict with certainty what lies ahead for CoBank or any of the vital rural industries we serve. We do know, however, that our mission and sense of higher purpose will remain

AT COBANK, THE YEAR 2012 WAS ONE OF EXCEPTIONAL PERFORMANCE ON BEHALF OF OUR CUSTOMERS IN THE NATION'S AGRIBUSINESS AND RURAL INFRASTRUCTURE INDUSTRIES.

unchanged. We continue to focus on building the financial strength and flexibility of the bank so we will be able to share success with our customers and other stakeholders throughout rural America—today and for generations to come.

MERGER WITH U.S. AGBANK

The most significant event of the year for CoBank was our merger with Wichita-based U.S. AgBank, one of the other funding banks in the Farm Credit System. The close of the merger on January 1, 2012 was the culmination of almost two years of planning, work and negotiation by the boards and management teams of both organizations. The goal of the merger was straightforward: to create a stronger, more durable financial institution that would be in a better position to withstand market volatility and serve customers over the long term. With over $90 billion in assets, the combined bank is now the largest institution in the Farm Credit System and one of the top 10 commercial and industrial lenders in the United States.

The merger significantly diversified CoBank's loan portfolio by adding $20 billion of wholesale loans to 25 newly affiliated Farm Credit associations in the West, Southwest and Mid-Plains regions of the country. It also increased our overall lending capacity and enhanced our profitability, credit quality and other key measures of financial performance. Finally, it enabled us to bring on board AgBank's highly experienced work force of banking professionals, who deeply understand the needs of our new affiliated association customers and the challenges and opportunities they face inside their individual service territories.

From a customer service standpoint, it's difficult to imagine a smoother transition than the one we had when we combined the two banks at

the beginning of the year. Thanks to a well-designed integration plan, we were able to bring together people, systems and business processes without any noticeable disruption to our borrowers. Since then, we have carefully managed the ongoing integration process while maintaining a strong focus on customer value and experience.

We did not allow ourselves to take the success of the merger for granted. We fully recognized that the history of corporate mergers is replete with examples of transactions that failed to live up to expectations. Fortunately, this one was well planned, and the business rationale for bringing the banks together was fundamentally sound. We also enjoyed solid support and alignment from our board of directors, and a sincere commitment from the employees of both banks to ensure the merger was a success. Today, we are confident that the merger is living up to its full potential, and that it will deliver meaningful benefits to the bank and its customers for many years to come.

The merger could not have been accomplished without the strong support we received from all our customers. We especially appreciate the time our customers invested to understand the merger, and the backing and patience they demonstrated both before and after the transaction close.

2012 FINANCIAL RESULTS

CoBank's financial performance in 2012 was very strong. Net income grew 21 percent to $853.9 million, an all-time high. Average loan volume for the year was $70.3 billion, an increase of 40 percent.

The performance of the bank's individual operating segments varied considerably in 2012 due to the merger as well as external economic and market conditions. Loans to affiliated Farm Credit associations increased substantially due to the addition of AgBank's association loans to our Strategic Relationships portfolio. In our agribusiness operating segment, average loan volume actually declined from 2011 due to lower prices for commodities earlier in the year, shifting farmer delivery patterns, and the strong financial position of agricultural cooperatives. Meanwhile, the bank continued to experience solid growth in lending to rural infrastructure customers, particularly in the power supply and electric distribution industries.

TODAY, WE ARE CONFIDENT THAT THE MERGER IS LIVING UP TO ITS FULL POTENTIAL, AND THAT IT WILL DELIVER MEANINGFUL BENEFITS TO THE BANK AND ITS CUSTOMERS FOR MANY YEARS TO COME.

Overall credit quality for CoBank remained very strong throughout 2012. At year-end, 1.01 percent of the bank's loans were classified as adverse assets, compared to 1.25 percent at December 31, 2011. Nonaccrual loans totaled $170.2 million, compared to $134.9 million at the end of 2011. Our provision for loan losses increased to $70.0 million in 2012 compared to $58.0 million for 2011, primarily due to credit challenges impacting a small number of rural infrastructure customers as well as continued weakness and uncertainty in the economy. The bank's allowance for credit losses totaled $595.1 million—a strong source of protection for the bank and its capital base against loan losses. CoBank finished the year with $6.4 billion of shareholders' equity, and our capital and liquidity levels remained well in excess of regulatory minimums.

As we move into 2013, we're very pleased with the overall financial condition of the bank and its ongoing ability to fulfill its mission and meet the borrowing needs of our customers.

PATRONAGE

CoBank's strong financial performance will once again enable us to return a significant portion of our earnings to our customers. In March, the bank will distribute a total of $425.0 million in cash and stock to qualified borrowers, bringing the total amount of patronage distributed by the bank to more than $1.6 billion for the past five years.

Reliable, formula-based patronage is an essential part of the CoBank value proposition. Cooperatives and other eligible borrowers receive 100 basis points of their average qualifying loan balance during the year, while affiliated Farm Credit associations receive 45 basis points. The cash patronage returned to customers effectively lowers their net cost of borrowing from CoBank, and it is especially significant in the current low interest rate environment. In addition, the equity component of our cooperative plan provides customers with an equity stake that grows in accordance with their usage of the bank's financial services. Patronage is one of the most important ways we share success with our customers, and it helps drive the alignment of interests between bank and borrower that is such a powerful feature of the cooperative business model.

In December, our board of directors approved a significant enhancement to our cooperative patronage program, raising the cash portion to 75 percent from the previous level of 65 percent. It was the latest in a series of improvements adopted over the past decade that have included increases in the percentage of cash patronage paid as well as reductions in target equity requirements. The latest adjustment will be effective for the 2012 fiscal year, meaning eligible customers will see the higher cash payout in their March 2013 patronage distributions. We're delighted to be in a position to make this change, which we expect will deliver real value to our customer-owners in 2013 and future years.

GOVERNANCE

Beyond financial success, the year 2012 also saw important changes in governance at CoBank. At the beginning of the year, the CoBank and AgBank boards were combined to form a 32-member board of directors for the first year after the merger close. Then, on January 1, 2013, we transitioned

ANYONE WHO LOOKS AT THE MAKEUP OF OUR BOARD IS BOUND TO BE IMPRESSED BY THE BREADTH AND DEPTH OF ITS TIES TO RURAL AMERICA AND THE INDUSTRIES WE SERVE.

to the governance structure called for under the CoBank-AgBank merger agreement, with 24 elected directors from six voting regions across the country. Half our board seats continue to be chosen on a one-member-one-vote basis, and half are chosen on the basis of modified equity—a balanced approach that helps assure fairness and equitability for all borrowers. We will also continue to have up to five appointed board members, including at least two who are "outside independent" directors with no affiliation with any organization that does business with CoBank.

All of our customer constituencies—agribusinesses, rural infrastructure providers and affiliated Farm Credit associations—are well represented on our board and will continue to have a strong voice in the future direction of CoBank. And, as always, each director is expected to represent the broad interests of the entire CoBank customer base, rather than the parochial concerns of any particular industry or region of the country.

Anyone who looks at the makeup of our board is bound to be impressed by the breadth and depth of its ties to rural America and the industries we serve. The vast majority of our directors are actively engaged in the business of production agriculture, agribusiness or rural infrastructure, and all have a profound appreciation for the role that CoBank and the Farm Credit System play in supporting the U.S. rural economy. The collective knowledge and experience of our directors has always been a major competitive advantage for CoBank, and our strong governance structure ensures it will remain so going forward.

CORPORATE SOCIAL RESPONSIBILITY

Another way CoBank shares success is through our various corporate social responsibility programs. As a mission-based lender, we believe we have a responsibility to support civic, charitable and industry organizations in the rural communities served by our customers, as well as those where our directors and associates live and work.

Over the past few years, we have made a concerted effort to increase our focus in this regard. We're proud of the fact that, during 2012, the bank contributed $6.7 million to non-profit organizations throughout the country. We also made significant investments in cooperative and rural economic development programs, contributed to cooperative and industry associations, supported the advancement of local food systems, funded research and higher education, and provided financing for a wide array of renewable energy projects in the area of environmental sustainability.

Detailed information about these programs is available in our first-ever corporate social responsibility report, which is being published and distributed to customers as a companion to our annual report. That document, entitled "Growing Rural America," is one we hope you will take time to review in detail. Our board continues to be extremely supportive of our activities in this area, and we're pleased to be in a position to give back when the overall level of need across the nation remains so high.

SERVING OUR CUSTOMERS: AN OPPORTUNITY AND A PRIVILEGE

Following this letter is a series of profiles of CoBank customers operating in many of the industries we serve. Taken together, they offer a wonderful portrait of the way our borrowers enhance the quality of life in America's rural communities. One example is Ohio-based Buckeye Power, which is investing over $100 million to improve the environmental performance of its generation facilities. Another is Tillamook County Creamery Association in Oregon, which is building a new plant to increase its operating efficiency and tap into new markets. In rural Tea, South Dakota, the Lewis & Clark Regional Water System is ensuring the availability of clean water and fostering economic development in the surrounding area. And in Monroe, Louisiana, CenturyLink continues to build a leadership position as one of the largest and most advanced communications service providers in the country.

The opportunity and privilege of working with these and thousands of other customers across rural America gives us enormous optimism about the future. Despite continued weakness in the economy, we draw a great deal of confidence from the strength of our customer base and the essential nature of the services our borrowers provide.

As always, we remain mindful of the enormous trust our customers place in CoBank as their financial partner. We thank you for your ongoing support and look forward to reporting back to you on our future progress.

EVERETT DOBRINSKI
Chairman

ROBERT B. ENGEL
President & Chief Executive Officer

CoBANK
BOARD OF DIRECTORS

CoBANK 2013 BOARD OF DIRECTORS

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HOMETOWN: MAKOTI, ND

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• 1ST VICE CHAIRMAN
OCCUPATION: FARMING
HOMETOWN: NORMAL, IL

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OCCUPATION: FARMING AND RANCHING
HOMETOWN: CHESTER, MT

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HOMETOWN: YAKIMA, WA

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HOMETOWN: LAKELAND, FL

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HOMETOWN: REDVALE, CO

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OCCUPATION: FARMING AND RANCHING
HOMETOWN: TUTTLE, OK

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HOMETOWN: CHICAGO, IL

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HOMETOWN: PORTERVILLE, CA

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HOMETOWN: DECATUR, AL

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HOMETOWN: FELTON, MN

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Catherine Moyer
OCCUPATION: RURAL COMMUNICATIONS MANAGEMENT
HOMETOWN: ULYSSES, KS

Alarik Myrin
OCCUPATION: FARMING AND RANCHING
HOMETOWN: ALTAMONT, UT

David S. Phippen
OCCUPATION: FARMING
HOMETOWN: RIPON, CA

Ronald J. Rahjes
OCCUPATION: FARMING
HOMETOWN: KENSINGTON, KS

David L. Reinders
OCCUPATION: AGRIBUSINESS COOPERATIVE MANAGEMENT
HOMETOWN: SUNRAY, TX

Clint E. Roush
OCCUPATION: FARMING AND LIVESTOCK
HOMETOWN: ARAPAHO, OK

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OCCUPATION: RETIRED, COMMERCIAL BANKING
HOMETOWN: WINNETKA, IL

Richard W. Sitman
OCCUPATION: RETAIL SERVICES
HOMETOWN: KENTWOOD, LA

Kevin A. Still
OCCUPATION: AGRIBUSINESS COOPERATIVE MANAGEMENT
HOMETOWN: DANVILLE, IN

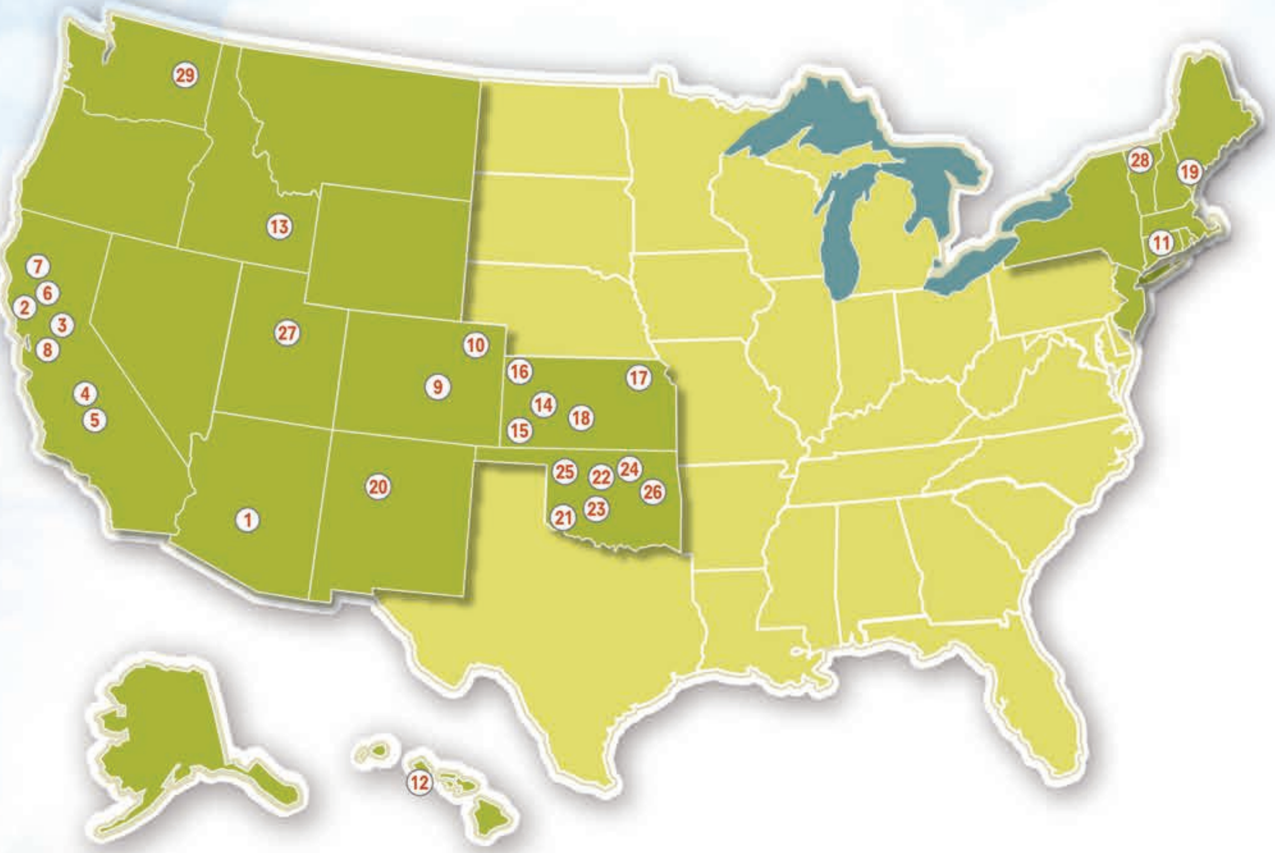
Scott H. Whittington
OCCUPATION: ELECTRIC COOPERATIVE MANAGEMENT
HOMETOWN: BURLINGTON, KS

"OUR DIRECTORS HAVE A PROFOUND APPRECIATION FOR THE ROLE COBANK PLAYS IN THE U.S. RURAL ECONOMY."

EVERETT DOBRINSKI
CoBank Chairman

STRATEGIC RELATIONSHIPS

PORTFOLIO



ARIZONA
1 FCS Southwest — TEMPE

CALIFORNIA
2 American AgCredit — SANTA ROSA
3 Farm Credit West — ROSEVILLE
4 Kingsburg Land Bank — KINGSBURG
5 Fresno Madera Farm Credit — FRESNO
6 FCS of Colusa-Glenn — COLUSA
7 Northern California Farm Credit — CHICO
8 Yosemite Farm Credit — TURLOCK

COLORADO
9 FC of Southern Colorado — COLORADO SPRINGS
10 Premier Farm Credit — STERLING

CONNECTICUT
11 Farm Credit East — ENFIELD

HAWAII
12 FCS of Hawaii — HONOLULU

IDAHO
13 Idaho, ACA — BLACKFOOT

KANSAS
14 FC of Ness City — NESS CITY
15 FC of Southwest Kansas — GARDEN CITY
16 FC of Western Kansas — COLBY
17 Frontier Farm Credit — MANHATTAN
18 High Plains Farm Credit — LARNED

MAINE
19 Farm Credit of Maine — AUBURN

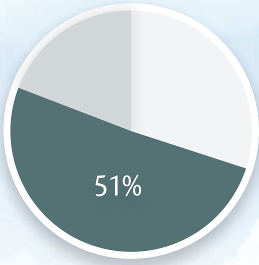
NEW MEXICO
20 FC of New Mexico — ALBUQUERQUE

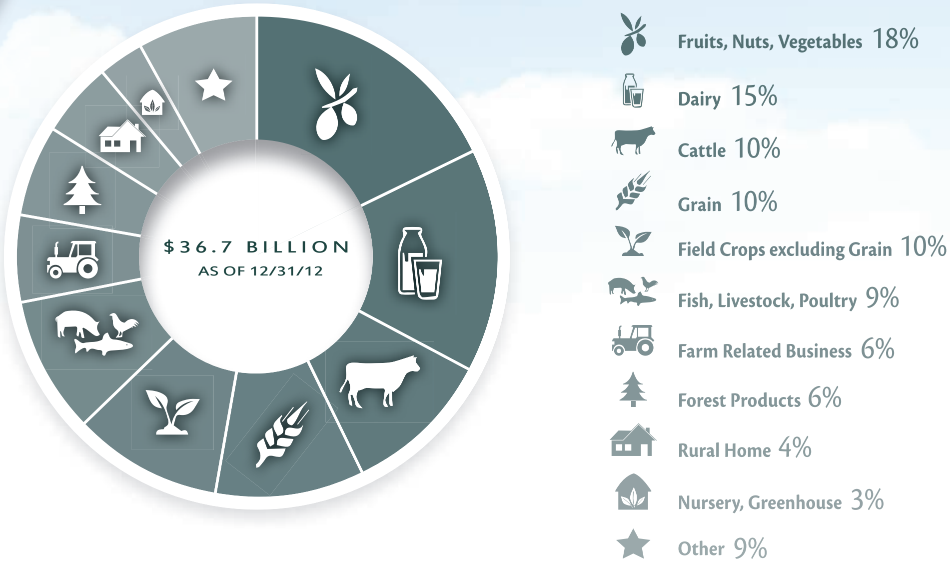
OKLAHOMA
21 AgPreference — ALTUS
22 Chisholm Trail Farm Credit — ENID
23 FC of Central Oklahoma — ANADARKO
24 FC of Enid — ENID
25 FC of Western Oklahoma — WOODWARD
26 FCS of East Central Oklahoma — BROKEN ARROW

UTAH
27 Western AgCredit — SOUTH JORDAN

VERMONT
28 Yankee Farm Credit — WILLISTON

WASHINGTON
29 Northwest Farm Credit Services — SPOKANE





FOR THE YEAR	2012	2011	2010
($ IN MILLIONS)			
Period-End Loans	*$ 36,707*	*$ 15,236*	*$ 15,392*
Average Loans	*34,976*	*15,215*	*15,118*
Net Income	*246*	*81*	*80*

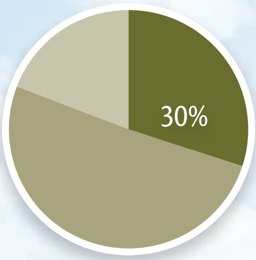
In addition to providing loans to retail customers and cooperatives in all 50 states, CoBank also serves as a funding bank for 29 affiliated Farm Credit associations across the country. Those associations provide loans and financial services to approximately 70,000 farmers, ranchers and other rural borrowers in 23 states. They serve a diverse array of industries, from fruits, nuts and vegetables to dairy, beef, poultry and forest products.

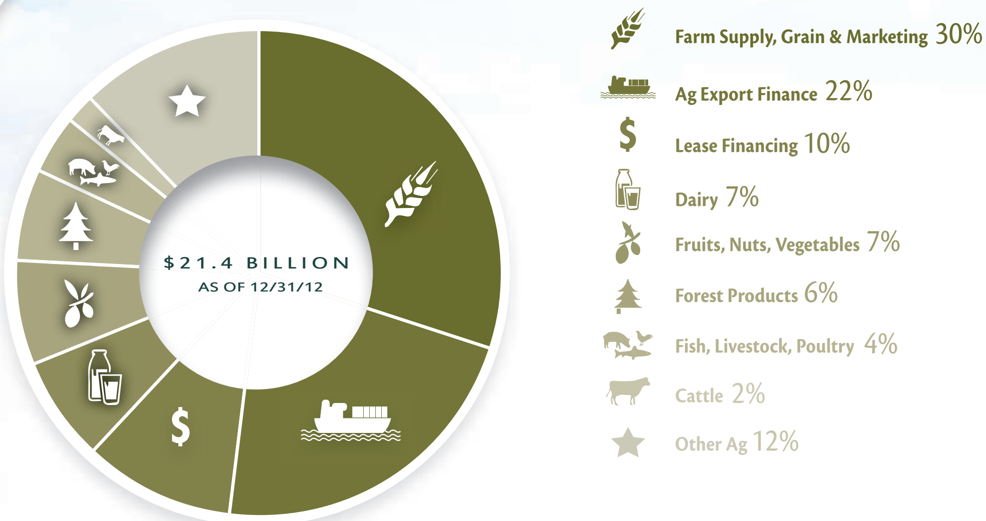
CoBank provides these association customers with wholesale financing as well as other value-added products and services. In turn, the associations provide the bank with added lending capacity by serving as participation partners on large credit transactions.

CoBank also serves as a partner of choice for a number of non-affiliated Farm Credit associations throughout the country on loan participations and syndications, as well as non-credit services.

AGRIBUSINESS

PORTFOLIO



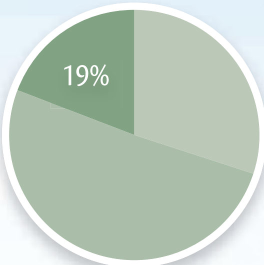


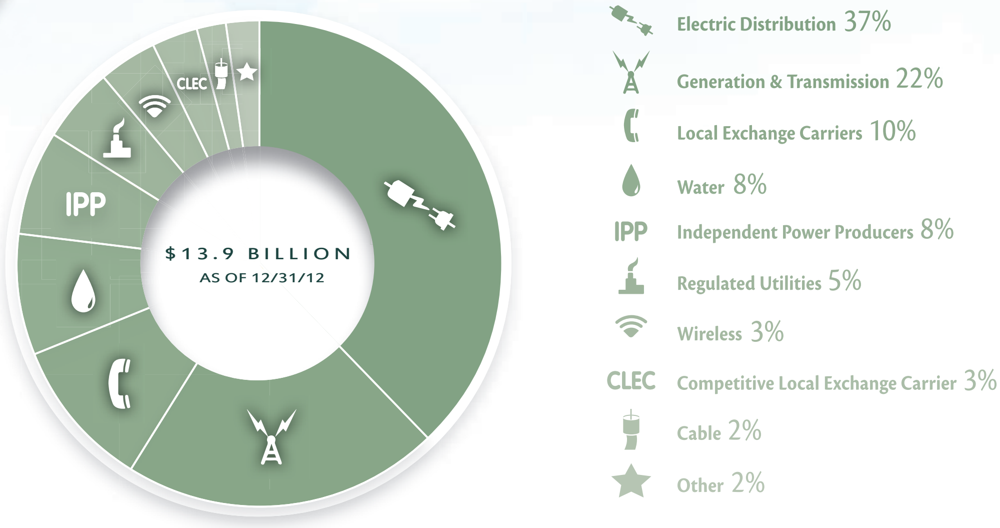
FOR THE YEAR ($ IN MILLIONS)	2012	2011	2010
Period-End Loans	$21,394	$18,869	$22,676
Average Loans	22,209	23,104	18,896
Net Income	410	438	365

CoBank's Agribusiness operating segment includes the Regional Agribusiness Banking Group, Corporate Agribusiness Banking Group, Agricultural Export Finance Division and Banking Services Group, which includes Farm Credit Leasing. It serves cooperatives and other customers involved in a wide variety of industries, including grain handling and marketing, farm supply, food processing, dairy, livestock, fruits, nuts, vegetables, cotton, biofuels and forest products. Average loan volume in the Agribusiness portfolio was $22.2 billion in 2012.

RURAL INFRASTRUCTURE

PORTFOLIO





FOR THE YEAR ($ IN MILLIONS)	2012	2011	2010
Period-End Loans	*$13,879*	*$12,180*	*$11,924*
Average Loans	*13,086*	*11,880*	*11,524*
Net Income	*208*	*194*	*176*

CoBank's Rural Infrastructure operating segment includes the following banking divisions: Electric Distribution, Energy & Water Services, Power Supply and Communications. It serves rural utilities and other customers across a wide variety of industries, including electric generation, transmission and distribution cooperatives; water and wastewater companies; and wireline, cable and wireless communications service providers. Average loan volume in CoBank's Rural Infrastructure portfolio was $13.1 billion in 2012.

REGIONAL AGRIBUSINESS

BANKING GROUP

Mark Hocking	**Keith Murfield**	**Gary Dyer**	**Jacob AcMoody**
CHIEF FINANCIAL OFFICER, UDA	*CHIEF EXECUTIVE OFFICER, UDA*	*PRESIDENT AND CEO, FARM CREDIT SERVICES SOUTHWEST*	*RELATIONSHIP MANAGER, COBANK*

Huge silver tanker trucks filled with milk arrive each day at United Dairymen of Arizona's manufacturing plant in Tempe, Arizona. The plant, which operates around the clock, processes up to 10 million pounds of milk per day. It produces dry milk along with cream, butter, lactose powder and other milk products.

In 2012, the 52-year-old cooperative undertook an expansion of the Tempe facility in order to enhance capacity on behalf of its 68 member milk producers, which provide 90 percent of the state's milk supply. With a new term loan and increased line of credit from CoBank, UDA acquired additional evaporator equipment to expand milk powder production and build additional powder storage silos. It also allowed them to expand their milk holding capacity, enhance their skimming ability and make plant improvements to strengthen food security.

"These new facilities will allow us to grow and continue to meet our customers' needs," said Keith Murfield, the co-op's CEO. "The whole process was made easier, though, because of our relationship with CoBank. We're both cooperatives so we share the same principles."

Amy Gales, executive vice president of CoBank's Regional Agribusiness Banking Group, said the UDA transaction is a great example of teamwork within the Farm Credit System. Many of the cooperative's individual producers are longstanding customers of Farm Credit Services Southwest, one of CoBank's affiliated associations, and FCSSW purchased a participation interest in the UDA loan package. Over the past several years, CoBank also has purchased participation interests in a number of loans from FCSSW to UDA-member milk producers.

"Strong partnerships and common goals made this transaction very easy to complete," Gales said. "It's a great example of the cooperative banking model in action."

Peter Rudeen
RELATIONSHIP MANAGER, COBANK

Joe Stelzig
CHAIRMAN, WEST-CON

Dean Isaacson
GENERAL MANAGER, WEST-CON

Western Consolidated Cooperative likes to take a far-sighted approach to managing its business.

In recent years, storage capacity limits have sometimes forced the co-op to sell grain when it didn't necessarily want to. So in 2012, West-Con decided to add an additional 4.1 million bushels of grain storage at its facility in Twin Brooks, South Dakota—despite dry conditions nationwide that ultimately became a severe drought impacting crop yields all over the country.

"Given the conditions, it was a bit of a gamble," acknowledges Dean Isaacson, general manager, West-Con. "But we knew this was an investment in the long-term."

Isaacson adds with a laugh that, with a good local crop, "we'd look like geniuses." As it turned out, West-Con's leaders were right, and the co-op's members produced an excellent crop with above-average yields.

As it has for nearly 30 years, West-Con turned to CoBank to help finance the project, securing a $9.5 million term loan that also financed an upgrade of the co-op's liquid fertilizer storage.

"West-Con has been working with CoBank since day one and they've been pretty good to us," said Joe Stelzig, chairman of West-Con's board of directors. "They work hard to understand our needs. It takes a lot of short- and long-term capital to run this business, and some people just don't get it. But CoBank understands."

"We have a history with CoBank," said Isaacson. "At times we've been leveraged pretty highly because of large projects, but CoBank has stuck by us. Having a financial partner we can depend on makes a big difference. It gives us the flexibility we need to make the right decisions for the future."

CORPORATE AGRIBUSINESS

BANKING GROUP

Jim Allen
SENIOR VICE PRESIDENT, NORTHWEST FARM CREDIT SERVICES

Laura B. Smith
VICE PRESIDENT AND TREASURER, PLUM CREEK

David W. Lambert
SENIOR VICE PRESIDENT, CHIEF FINANCIAL OFFICER, PLUM CREEK

Michael Tousignant
RELATIONSHIP MANAGER, COBANK

In late 2011, Plum Creek Timber Company reached out to its local Farm Credit association, Northwest Farm Credit Services, to discuss refinancing an existing $600 million revolving line of credit and a maturing $350 million term loan.

Plum Creek is the largest and most geographically diverse private timberland owner in the nation and a longtime NWFCS customer. Given the size and scope of the transaction, NWFCS brought in CoBank as a joint lead arranger on the transaction.

“Plum Creek is one of the premier land and timber companies in the country and a core customer for Northwest,” said Jim Allen, senior vice president of Capital Markets for Northwest Farm Credit Services. “While we were confident in the strength of our relationship and our own industry expertise, we knew that the addition of CoBank’s balance sheet and strong capital markets capabilities would add to the success of the transaction and help to ensure the satisfaction of a great customer.”

In a highly collaborative transaction, CoBank and Northwest became joint lead arrangers for credit facilities that eventually totaled $1.15 billion. In total, 19 Farm Credit institutions participated in the transaction, which included a $700 million revolver syndicated to several commercial banks as well as Farm Credit entities. A patronage-based $450 million term loan with a delayed draw feature was syndicated exclusively within the Farm Credit System.

“When we compared the features that CoBank and Northwest were able to offer relative to those offered by commercial banks, the difference was substantial,” said Laura B. Smith, vice president and treasurer at Plum Creek. “The transaction allowed us to lower our overall debt cost, making us more cost effective and capital competitive.”

“This was a complicated transaction, but the execution was very smooth,” continued Smith. “CoBank and Northwest delivered exactly what they promised and just what we needed.”

Tillamook

Don Desjarlais
CHIEF FINANCIAL OFFICER, TILLAMOOK

Scott Trauth
RELATIONSHIP MANAGER, COBANK

Patrick Criteser
CHIEF EXECUTIVE OFFICER, TILLAMOOK

Patrick Sauer
CAPITAL MARKETS DIVISION, COBANK

Each day, the Tillamook County Creamery Association churns out more than 500,000 pounds of high-quality cheese at their factories in Tillamook and Boardman, Oregon, which is then sold across the country. That's about 180 million pounds of cheese each year.

Today, some cheese-making byproducts, notably whey and lactose, are not being further processed into higher value products, particularly at the plant in Boardman. But with a new, $66 million term loan from CoBank, Tillamook is planning to build a new facility there that will enable the whey and lactose to be further re-processed and then sold for use in other food products and pharmaceuticals.

Tillamook CEO Patrick Criteser said the project will enable the farmer-owned dairy cooperative to be more efficient and tap into new markets.

"We're excited about this new capability and the promise it brings to Tillamook," Criteser said. "This investment represents a significant commitment by our farmer owners to the continued growth of our company."

Tillamook, which has been around for more than 100 years, is owned by approximately 110 dairy farming families, many of whom are third-generation co-op members. The co-op makes the No. 1 selling brand of natural chunk cheese in the West, in addition to offering a variety of other cheeses and dairy products. Tillamook has been doing business with CoBank for decades.

"As a cooperative, our profits go back to our farmer-owners to help ensure economic sustainability and preserve a way of life for future generations," said Don Desjarlais, Tillamook's chief financial officer. "We like the fact that CoBank is a cooperative, too. That's important to us. CoBank understands our business, and as customer-owners we know they are committed to our success."

ELECTRIC DISTRIBUTION

BANKING DIVISION

Wilbur Rollins
SENIOR VICE PRESIDENT, NOVEC

Stan Feuerberg
PRESIDENT AND CEO, NOVEC

Lee Earhart
RELATIONSHIP MANAGER, COBANK

In 2013, a portion of the power flowing to homes and businesses across northern Virginia will come from an unlikely source: burned wood.

To help bolster its renewable energy portfolio, Northern Virginia Electric Cooperative, or NOVEC, is building a 49.9-megawatt "green" biomass power plant near South Boston, Virginia. The $175 million project, expected to be completed in 2013, eventually will satisfy over 6 percent of the cooperative's energy requirements—enough to meet the needs of about 16,000 residential customers.

The plant will burn "slash," which is the wood that's left behind after construction projects or in furniture manufacturing. In addition, the plant will be carbon neutral, meaning it will not add any more carbon dioxide to the environment beyond what's already released through natural decomposition of the wood. Better yet, no methane gas, sulfur or mercury will be emitted by the plant.

The project is being financed largely through a $90 million loan from the USDA's Rural Utilities Service and state and federal grants, but CoBank provided an interim construction line of credit to provide liquidity.

"Being a good steward of the environment has always been a priority at NOVEC," said company President and CEO Stan Feuerberg. "Having a strong financial partner such as CoBank, who shares our commitment to the environment, certainly helped make the project possible."

Feuerberg added that the interim financing provided by CoBank was critical to getting the project off the ground.

"Not only is this plant meeting the needs and wants of NOVEC's customers by providing cleaner and reliable energy, it's a great example of corporate citizenship and the cooperative spirit," said Candace Roper, senior vice president and manager of CoBank's Electric Distribution Banking Division.

NOVEC was recognized by J.D. Power & Associates for ranking highest in customer satisfaction among 30 mid-size electric utilities in the South.

ENERGY & WATER SERVICES

BANKING DIVISION

Dan Zulkosky
CONSTRUCTION ADMINISTRATOR, LEWIS & CLARK

Troy Larson
EXECUTIVE DIRECTOR, LEWIS & CLARK

James Maras
RELATIONSHIP MANAGER, COBANK

It has taken more than two decades for the Lewis & Clark Regional Water System to move from an idea on paper to reality.

The South Dakota-based water service provider was first incorporated in 1990, with a plan to serve rural communities in South Dakota, Iowa and Minnesota. But more than 10 years went by before enough government funding was in hand to begin construction.

In July 2012, the company finally began delivering water in a portion of its 5,000-square-mile service territory. When the system is completed, it will provide drinking water to over 300,000 people.

"That's the reality of funding a project like this," said Troy Larson, Lewis & Clark's executive director. "Unfortunately, just because the government approves the project and commits to the funding, it doesn't mean that you actually receive the cash."

CoBank has been another key source of financing for the utility. The bank provided Lewis & Clark with a loan for the purchase of its administrative building in Tea, South Dakota, as well as a line of credit that can be used for short-term financing on an as-needed basis, which Larson says gives him "peace of mind."

"We had never worked with CoBank before and were pleasantly surprised at what they could offer," Larson said. "They provided attractive terms and a degree of flexibility that you just don't get with other lenders. Now, we wouldn't make a financial move without at least checking with CoBank first."

Larson says turning on the taps at Lewis & Clark is already making a difference in terms of economic development in the communities it serves. "We've seen several examples of companies that have chosen to bring their businesses into our service territory because of the reliable water service we are able to provide," Larson said. "That's good for our customers, their local economies and, ultimately, the people who call those communities home."

COMMUNICATIONS

BANKING DIVISION

Stewart Ewing
CHIEF FINANCIAL OFFICER, CENTURYLINK

Tom Meyer
RELATIONSHIP MANAGER, COBANK

CenturyLink's founder, Clarke M. Williams, literally grew up in the communications industry when he began delivering hand-written phone bills for the family business to rural Louisiana subscribers at the age of eight.

Today the now-public company, based in Monroe, Louisiana, is one of the three largest telecommunications service providers in the U.S. and is a global leader in cloud infrastructure and hosted IT solutions for enterprise customers.

Thanks to a continuous series of acquisitions—including its 2011 transaction with Denver-based Qwest—it now has more than $18 billion in annual revenue and millions of customers across the United States and internationally. Despite its scale, CenturyLink has never lost sight of its rural roots, and it remains one of the nation's dominant rural carriers.

"The service we provide to rural America is still an incredibly important part of our business," said Stewart Ewing, CenturyLink's executive vice president and chief financial officer.

A longtime CoBank customer, CenturyLink turned to CoBank in early 2012 for a $440 million financing package. CoBank put together a medium-term loan that was syndicated throughout the Farm Credit System.

Ewing notes that CenturyLink had a number of different financing options at its disposal. "We could have issued bonds to institutional or retail investors," said Ewing. "But we already had a great relationship with CoBank. They are a good, stable bank that hasn't gone through all the ups and downs of other institutions, and they were able to bring us a unique financing vehicle from the strength of the whole Farm Credit System."

Rob West, senior vice president and manager of CoBank's Communications Banking Division, said: "In order to thrive and compete in a world market, rural communities depend heavily on reliable and affordable communications services like voice and broadband. CenturyLink is an important provider of these essential services and a true partner to rural America."

POWER SUPPLY

BANKING DIVISION

Bill Roberts
CHIEF FINANCIAL OFFICER, BUCKEYE

Josh Batchelder
RELATIONSHIP MANAGER, COBANK

Pat O'Loughlin
CHIEF OPERATIONS OFFICER, BUCKEYE

Tony Ahern
CHIEF EXECUTIVE OFFICER, BUCKEYE

Buckeye Power knows the importance of dependability. Twenty-five electric distribution cooperatives rely on Buckeye every day to supply power to more than 400,000 homes and businesses they serve in rural communities across the state of Ohio.

As it plans to meet future demand, Buckeye is also taking steps to protect the environment. In recent years, the company has added to its capacity by investing in a variety of renewable energy sources, including wind, hydro-electric and biogas. It also continues to make its traditional coal-fired plants, which provide the bulk of its power supply, even cleaner.

In 2012, a $125 million financing package from CoBank helped Buckeye fund capital expenditures needed to keep older plants in compliance with increasingly stringent environmental laws. Buckeye's flagship power plant, the Cardinal Power Station, will emerge from the upgrade as a best-in-class facility, with new flue gas desulfurization systems that significantly reduce greenhouse gas emissions.

"This project is an important part of our overall plan to continually improve our environmental performance," said Tony Ahern, Buckeye's CEO. "The debt capital provided by CoBank was essential, and we really appreciate having a provider of financing like CoBank that knows us well and understands our industry."

"Buckeye Power's progressive approach is enabling them to meet the demands of their customers for reliable, affordable electricity while reducing environmental impacts at the same time," said Todd Telesz, senior vice president and manager of CoBank's Power Supply Banking Division. "We're delighted to be working with Buckeye on this initiative and value the trust they place in our relationship as their long-term financial partner."

OUR VALUE PROPOSITION

CoBank is a financially strong, **DEPENDABLE,** cooperative bank that provides credit and financial solutions to rural America. We are **KNOWLEDGEABLE**, responsive and committed to enhancing our **CAPACITY** to deliver a superior customer experience and competitively priced products, while maintaining the safety and soundness of the bank for future generations. We consistently demonstrate our **FOCUS** on rural America, repeatedly strive to be a trusted advisor for our customers and provide a consistent return on their investment and **OWNERSHIP** in CoBank.

COBANK 2012 FINANCIAL REPORT

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SHARED SUCCESS

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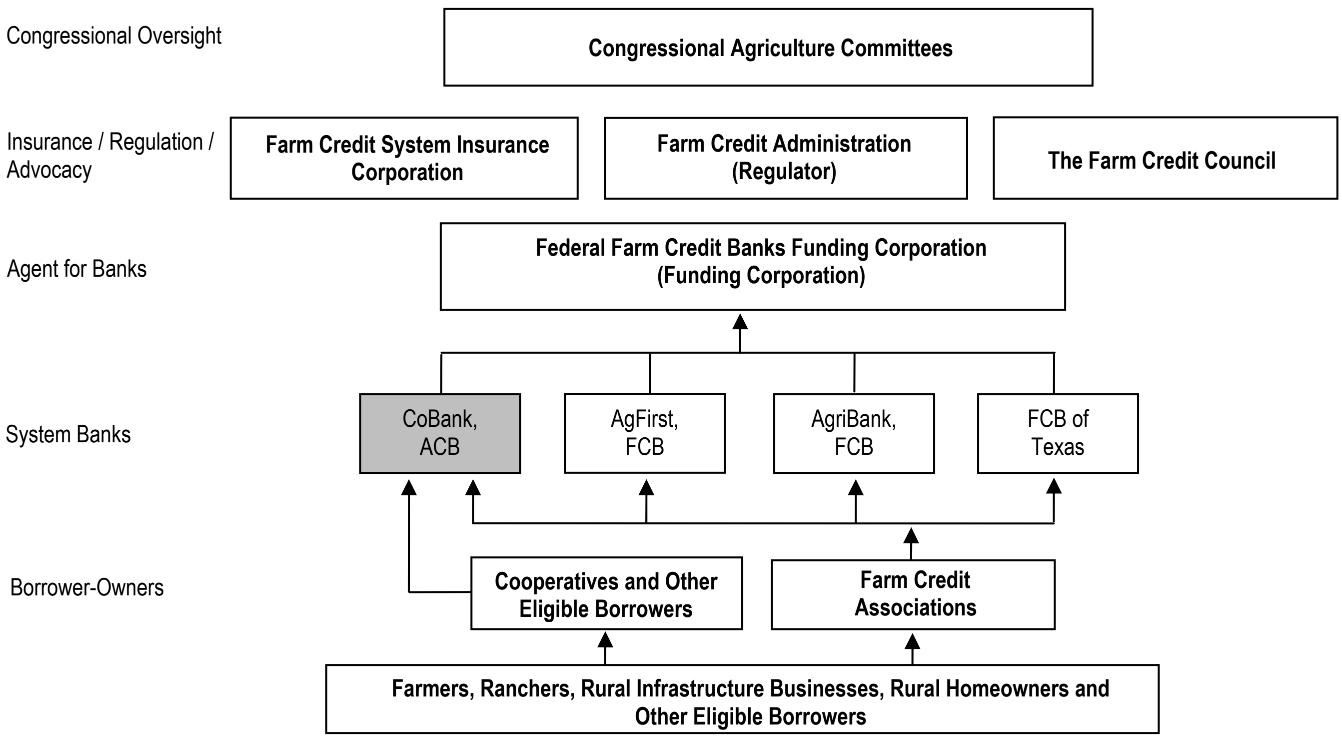
Company Introduction

CoBank, ACB (CoBank or the Bank) is one of the four banks of the Farm Credit System (System) and provides loans, leases and other financial services to vital industries across rural America. The System is a federally chartered network of borrower-owned lending institutions composed of cooperatives and related service organizations.

Cooperatives are organizations that are owned and governed by their members who use the cooperative's products or services. The System was established in 1916 by the U.S. Congress, and is a Government Sponsored Enterprise (GSE).

The following chart depicts the structure and ownership of the System.



CoBank is federally chartered under the Farm Credit Act of 1971, as amended (the Farm Credit Act), and is subject to supervision, examination, and safety and soundness regulation by an independent federal agency, the Farm Credit Administration (FCA). We are a mission-based lender with authority to make loans and provide related financial services to eligible borrowers in the agribusiness and rural utility industries, and to certain related entities, as defined by the Farm Credit Act. We are not legally authorized to accept deposits. We raise funds for our operations primarily by issuing debt securities through the System's agent, the Federal Farm Credit Banks Funding Corporation (Funding Corporation). Such securities are the joint and several obligations of the four System banks.

We are cooperatively owned by our U.S. customers. Our customers consist of agricultural cooperatives, rural energy, communications and water companies, farmer-owned financial institutions including Agricultural Credit Associations and Federal Land Credit Associations (Associations) and other businesses that serve rural America. We are the primary funding source for certain Associations serving specified geographic regions in the United States (which are regulated financial institutions and members of the System). We collectively refer to these entities as our affiliated Associations.

We provide a broad range of loans and other financial services to vital industries through three operating segments: Agribusiness, Strategic Relationships and Rural Infrastructure.

The information and disclosures contained in this Annual Report to Shareholders primarily relate to CoBank. System annual and quarterly information statements and press releases for the current fiscal year and the two preceding fiscal years, as well as offering circulars relating to Federal Farm Credit Banks Consolidated Systemwide bonds, medium term notes and discount notes (collectively referred to as Systemwide Debt Securities), are available for inspection at, or will be furnished without charge upon request to, the Federal Farm Credit Banks Funding Corporation, 10 Exchange Place, Suite 1401, Jersey City, New Jersey 07302; telephone (201) 200-8000. These documents are also available online through the Federal Farm Credit Banks Funding Corporation website at www.farmcreditfunding.com. This website also provides a link to each System bank's website where financial and other information of each bank can be found. Similar links are also available at the CoBank website at www.cobank.com.

Farmer Mac

The Federal Agricultural Mortgage Corporation (Farmer Mac) is a federally chartered corporation that was formed to provide a secondary market for a variety of loans made to borrowers in rural America. Although Farmer Mac is an institution of the System and is examined and regulated by the FCA, it is an entirely separate entity. As provided by law, neither CoBank nor any other System entity, other than Farmer Mac itself, is liable for any debt or obligation of Farmer Mac. Likewise, Farmer Mac is not liable for any debt or obligation of any other System entity, including Systemwide debt securities, either directly or on a joint and several basis. For more information on Farmer Mac and its relationship with other System entities, please see 'Relationship with the Federal Agricultural Mortgage Corporation' on page 52.

Merger with U.S. AgBank, FCB

U.S. AgBank, FCB (AgBank), which was also a System bank, merged with and into CoBank effective January 1, 2012. Upon the date of the merger, CoBank became the funding bank for the 25 Farm Credit Associations previously affiliated with AgBank. The merger with AgBank diversified CoBank's loan portfolio and enhanced our capital base and overall lending capacity.

Beginning in 2012, our financial position, results of operations, cash flows and related metrics include the effects of the merger with AgBank. Prior year results have not been restated to reflect the impact of the merger.

Overview

In 2012, we recorded our 13th consecutive year of growth in net income, as our merger with AgBank delivered significant financial benefits. Earnings grew to $853.9 million in 2012, a 21 percent increase compared to 2011 earnings. The increase in net income was largely driven by greater net interest income, a refund from the Farm Credit System Insurance Corporation (Insurance Corporation) and a lower level of income tax expense. Partially offsetting these items were a greater level of losses on the early extinguishment of debt, including losses related to the extinguishment of a portion of our subordinated debt, and higher operating expenses. Net interest income grew 16 percent, primarily reflecting the impact of the merger with AgBank, which increased loan volume by $20.2 billion and our investment securities by $4.8 billion as of the merger date. We also experienced loan growth in our Rural Infrastructure operating segment. Our total loans outstanding were $72.0 billion at December 31, 2012.

Overall loan quality measures improved in 2012 due to the merger, as the substantial majority of the acquired loan portfolio were wholesale loans to Associations, all of which were classified as 'Acceptable' credit quality. Adversely classified loans decreased to 1.01 percent of total loans and related accrued interest at December 31, 2012, compared to 1.25 percent at December 31, 2011. Notwithstanding the improvement in overall loan quality measures, nonaccrual loans increased to $170.2 million at December 31, 2012 from $134.9 million at December 31, 2011, due to an increased level of nonaccrual loans in our Rural Infrastructure operating segment. Our provision for loan losses increased to $70.0 million in 2012 compared to $58.0 million for 2011.

Our financial position remains strong as of December 31, 2012, reflecting capital and liquidity levels well above regulatory minimums. With $6.4 billion in shareholders' equity, our permanent capital and core surplus ratios were 16.14 percent and 10.06 percent, respectively, as of December 31, 2012, compared to the regulatory minimum requirements of 7.00 and 3.50 percent, respectively. As of year-end 2012, we held $19.3 billion in investments and cash as a liquidity reserve and our days liquidity was 204 days.

In the fourth quarter of 2012, we completed a series of debt and equity transactions that enhanced the Bank's overall capital position and lowered our cost of regulatory capital. In October 2012, we redeemed all of our outstanding Series A and Series B cumulative perpetual preferred stock totaling $363.3 million, and we issued $400.0 million of Series F non-cumulative perpetual preferred stock. These preferred stock transactions lowered our dividend costs and enhanced the quality and durability of our regulatory capital. In December 2012, we purchased $95.3 million of our outstanding Series 2008A subordinated debt through a cash tender offer, which reduced the overall cost of our indebtedness.

A five-year summary of selected consolidated financial data is shown in the following table.

Five-Year Summary of Selected CoBank Consolidated Financial Data

($ in Thousands)	2012	2011	2010	2009	2008
Consolidated Statement of Income Data					
Net Interest Income	**$ 1,238,170**	$ 1,071,027	$ 950,845	$ 945,963	$ 862,609
Provision for Loan Losses	**70,000**	58,000	60,000	80,000	55,000
Noninterest Income	**113,321**	117,936	98,559	84,961	68,411
Operating Expenses	**263,883**	228,270	216,210	219,231	215,181
Provision for Income Taxes	**163,691**	196,106	159,427	166,277	127,406
Net Income	**$ 853,917**	$ 706,587	$ 613,767	$ 565,416	$ 533,433
Net Income Distributed					
Patronage Distributions:					
Common Stock	**$ 80,472**	$ 109,900	$ 90,450	$ 85,067	$ 106,681
Cash	**344,516**	230,751	194,110	183,828	207,216
Total Patronage Distributions	**424,988**	340,651	284,560	268,895	313,897
Preferred Stock Dividends	**72,065**	63,799	63,799	60,955	48,075
Total Net Income Distributed	**$ 497,053**	$ 404,450	$ 348,359	$ 329,850	$ 361,972
Consolidated Balance Sheet Data					
Total Loans	**$ 71,980,458**	$ 46,285,142	$ 49,992,338	$ 44,174,464	$ 44,550,121
Less: Allowance for Loan Losses	**437,376**	388,056	400,744	369,817	329,198
Net Loans	**71,543,082**	45,897,086	49,591,594	43,804,647	44,220,923
Investment Securities	**17,999,191**	12,995,458	12,616,696	11,808,207	11,536,848
Cash	**1,253,509**	2,771,842	1,922,586	923,083	3,127,204
Other Assets	**1,681,976**	1,625,829	1,695,014	1,624,765	2,277,082
Total Assets	**$ 92,477,758**	$ 63,290,215	$ 65,825,890	$ 58,160,702	$ 61,162,057
Debt Obligations with Maturities ≤ 1Year	**$ 27,796,639**	$ 22,019,899	$ 22,271,349	$ 16,593,682	$ 19,404,201
Debt Obligations with Maturities > 1Year	**56,715,165**	35,084,587	38,052,964	36,317,632	36,961,221
Reserve for Unfunded Commitments	**157,703**	153,919	99,799	128,373	154,223
Other Liabilities	**1,367,107**	1,136,277	995,581	1,063,386	1,047,563
Total Liabilities	**86,036,614**	58,394,682	61,419,693	54,103,073	57,567,208
Preferred Stock	**961,750**	700,000	700,000	700,000	700,000
Common Stock	**2,605,933**	1,654,314	1,568,989	1,520,054	1,401,192
Unallocated Retained Earnings	**2,729,031**	2,439,531	2,137,394	1,871,986	1,638,596
Accumulated Other Comprehensive Income (Loss)	**144,430**	101,688	(186)	(34,411)	(144,939)
Total Shareholders' Equity	**6,441,144**	4,895,533	4,406,197	4,057,629	3,594,849
Total Liabilities and Shareholders' Equity	**$ 92,477,758**	$ 63,290,215	$ 65,825,890	$ 58,160,702	$ 61,162,057
Key Financial Ratios					
For the Year:					
Return on Average Common Shareholders' Equity	**15.16 %**	16.05 %	15.31 %	15.96 %	17.32 %
Return on Average Total Shareholders' Equity	**14.03**	15.02	14.30	14.65	15.65
Return on Average Assets	**0.94**	1.07	1.03	0.93	0.91
Net Interest Margin	**1.41**	1.69	1.66	1.66	1.51
Net Charge-offs / Average Loans	**(0.02)**	(0.03)	(0.13)	(0.15)	(0.04)
Patronage Distributions / Total Average Common Stock Owned by Active Borrowers	**18.41**	22.65	19.77	19.68	25.10
At Year-end:					
Debt / Total Shareholders' Equity (: 1)	**13.36**	11.93	13.94	13.33	16.01
Total Shareholders' Equity / Total Assets	**6.97 %**	7.74 %	6.69 %	6.98 %	5.88 %
Allowance for Credit Losses* / Total Loans	**0.83**	1.17	1.00	1.13	1.09
Permanent Capital Ratio	**16.14**	16.37	14.30	15.29	14.75
Total Surplus Ratio	**15.22**	16.01	13.96	15.01	14.61
Core Surplus Ratio	**10.06**	10.02	8.42	8.77	7.98
Net Collateral Ratio	**107.08**	109.05	108.03	108.67	107.75

* Includes the allowance for loan losses and the reserve for unfunded commitments

Financial Condition and Results of Operations

Net income grew to $853.9 million in 2012 compared to $706.6 million in 2011. Increased earnings largely resulted from a $167.1 million increase in net interest income, primarily reflective of the positive impact of the merger with AgBank. In addition, we recorded a refund from the Insurance Corporation totaling $44.6 million and our income tax expense declined by $32.4 million. Partially offsetting the increase in earnings was $37.3 million of losses on early extinguishment of debt, net of prepayment income, as compared to net losses on early extinguishment of debt in 2011 of $25.7 million. This increase included the impact of asset/liability measures taken to better position our balance sheet in the low interest rate environment and to reduce future interest expense. In addition, we incurred $28.5 million in losses on the December 2012 purchase of $95.3 million of our Series 2008A subordinated debt through a cash tender offer. The provision for loan losses increased by $12.0 million, reflecting specific credit challenges related to a small number of customers, further assessment of risk associated with loan concentrations, and continued economic weakness. Operating expenses increased by $35.6 million and included the impact of the merger.

Our annualized return on average common shareholders' equity decreased to 15.16 percent in 2012 from 16.05 percent in 2011, and our annualized return on average assets decreased to 0.94 percent in 2012 compared to 1.07 percent in 2011. These decreases primarily reflect the increase in lower-spread, lower-risk loans to Associations resulting from the merger, a decline in the return on our invested capital, and a decline in average loan volume in our Agribusiness operating segment.

Our 2011 net income increased to $706.6 million, or by 15 percent, from $613.8 million in 2010. The 2011 increase was principally driven by greater net interest income resulting from strong loan growth in our Agribusiness operating segment in 2011. To a lesser extent, earnings also increased due to reduced impairment losses on investment securities and greater fee income. Our provision for income taxes, losses on early extinguishment of debt and operating expenses were each higher in 2011 than in 2010 and somewhat offset those favorable factors.

Net Interest Income

Interest income and interest expense for the major categories of interest-earning assets and interest-bearing liabilities are shown in the following table.

Average Balances and Rates

Year Ended December 31,	2012			2011			2010		
($ in Millions)	Average Balance	Average Rate	Interest Income/ Expense	Average Balance	Average Rate	Interest Income/ Expense	Average Balance	Average Rate	Interest Income/ Expense
Interest-earning Assets									
Total Loans	$ 70,271	2.42 %	$ 1,704	$ 50,199	3.02 %	$ 1,518	$ 45,538	3.09 %	$ 1,408
Investment Securities	17,655	1.82	322	13,051	2.08	271	11,618	2.22	258
Total Interest-earning Assets	$ 87,926	2.30	$ 2,026	$ 63,250	2.83	$ 1,789	$ 57,156	2.91	$ 1,666
Interest-bearing Liabilities									
Bonds and Notes	$ 72,741	1.00 %	$ 730	$ 50,942	1.28 %	$ 651	$ 48,804	1.35 %	$ 660
Discount Notes	7,687	0.18	14	7,113	0.27	19	3,009	0.27	8
Subordinated Debt	995	4.52	45	1,000	4.40	44	1,000	4.50	45
Other Notes Payable	1,408	(0.07) *	(1) *	1,354	0.30	4	1,525	0.13	2
Total Interest-bearing Liabilities	$ 82,831	0.95	$ 788	$ 60,409	1.19	$ 718	$ 54,338	1.31	$ 715
Interest Rate Spread		1.35			1.64			1.60	
Impact of Equity Financing	$ 6,218	0.06		$ 4,705	0.05		$ 4,292	0.06	
Net Interest Margin and Net Interest Income		1.41 %	$ 1,238		1.69 %	$ 1,071		1.66 %	$ 951

* Average rate was favorably impacted by $5.0 million of derivative-related fair value accretion resulting from merger accounting

Changes in our interest income, interest expense and net interest income due to volume and rate variances for interest-earning assets and interest-bearing liabilities are summarized in the table below.

Changes in Net Interest Income Due to Changes in Average Volume and Interest Rates*

($ in Millions)	2012 Increase (Decrease) From Previous Year Due To			2011 Increase (Decrease) From Previous Year Due To		
	Volume	Yield/Rate	Total	Volume	Yield/Rate	Total
Total Loans	$ 544	$ (358)	$ 186	$ 142	$ (32)	$ 110
Investment Securities	94	(44)	50	31	(18)	13
Total Interest Income	638	(402)	236	173	(50)	123
Total Interest Expense	265	(196)	69	75	(72)	3
Changes in Net Interest Income	$ 373	$ (206)	$ 167	$ 98	$ 22	$ 120

* The change in interest income or expense not solely due to changes in volume or rate has been allocated in proportion to the absolute dollar amount of the change in volume and rate

Net interest income increased $167.1 million, or 16 percent, to $1,238 million in 2012, compared to $1,071 million in 2011. Growth in net interest income includes the positive impact of the merger with AgBank, which increased our loan volume by $20.2 billion and our investment securities by $4.8 billion as of the merger date. The substantial majority of this loan volume is included in our Strategic Relationships operating segment. As a result of the merger, net interest income in our Strategic Relationships segment increased by $180.4 million in 2012. The increase in Strategic Relationships net interest income includes the benefit of greater loan volume, increased earnings on investment securities and $90.0 million of net accretion of merger-related asset and liability fair value adjustments which resulted from the application of business combination accounting standards. The majority of the accretion/amortization of these fair value adjustments will be recognized in net interest income in diminishing amounts in the first five years following the merger. The accounting for the merger is described in Note 3 to the accompanying consolidated financial statements.

Growth in lending in our Rural Infrastructure operating segment also contributed to greater net interest income. Rural Infrastructure net interest income increased by $37.2 million in 2012. Net interest income in our Agribusiness operating segment decreased $49.6 million in 2012, due to a decline in average loan volume driven by a lower level of seasonal lending.

Our overall net interest margin declined to 1.41 percent in 2012 from 1.69 percent in 2011, and interest rate spread decreased to 1.35 percent in 2012 from 1.64 percent in 2011. These decreases largely reflect the effects of the merger, as the substantial majority of AgBank's loan portfolio consisted of wholesale loans to Associations, which carry a lower spread than loans to retail customers, commensurate with a lower risk profile and lower regulatory capital requirements. Increased competition from commercial banks and other lenders in many of the industries we serve continued to put pressure on retail lending margins in 2012. In addition, a decline in the return on our invested capital due to lower intermediate-term interest rates and lower average loan volume in our Agribusiness operating segment further contributed to the lower overall net interest margin and spread in 2012.

Average investment securities increased to $17.7 billion in 2012 from $13.1 billion in 2011. The increase in our average investments primarily reflects the impact of the merger and the greater liquidity requirements associated with higher average loan volume.

In 2011, our net interest income increased 13 percent to $1,071 million, compared to $950.8 million in 2010. The increase in net interest income primarily resulted from an increase in average loan volume, particularly in loans to customers in our Agribusiness operating segment, as increased prices and volatility for grains and certain other agricultural commodities led to greater customer financing requirements. Our 2011 net interest margin increased to 1.69 percent from 1.66 percent in 2010, and interest rate spread increased to 1.64 percent in 2011 from 1.60 percent in 2010. These increases were primarily due to a greater level of average Agribusiness loan volume in 2011. Agribusiness loan volume generally carries a higher spread and higher risk than certain other portfolios, including lending to Associations. Lower returns on our invested capital due to the low interest rate environment partially offset the benefit of increased Agribusiness loan volume.

Provision for Loan Losses and Allowance for Credit Losses

The provision for loan losses reflects our expense estimates for credit losses inherent in our loan and finance lease portfolios, including unfunded commitments. The allowance for loan losses covers the funded portion of our loans outstanding, while the reserve for unfunded commitments is held to cover losses on unfunded lending commitments. The sum of the allowance for loan losses and the reserve for unfunded commitments is referred to as the allowance for credit losses. We base our allowance for probable and estimable losses on the factors discussed in "Critical Accounting Estimates – Allowance for Credit Losses" on page 58. The tables on page 34 summarize the activity in our allowance for credit losses, by operating segment, for the past five years.

Our provision for loan losses increased to $70.0 million in 2012 compared to $58.0 million for 2011. The higher provision primarily reflects specific credit challenges related to a small number of customers, further assessment of risk associated with loan concentrations, and continued economic weakness. The 2012 provision includes a higher level of provision in our Rural Infrastructure segment, primarily due to specific credit challenges facing a small number of communications and rural energy customers, and a lower provision in our Agribusiness segment primarily due to improved credit quality in 2012.

Overall loan quality measures improved in 2012. Adversely classified assets decreased to 1.01 percent of total loans and related accrued interest at December 31, 2012, compared to 1.25 percent at December 31, 2011. The improvement reflects the addition of the high quality wholesale portfolio acquired from AgBank.

Notwithstanding the improvement in overall credit quality measures, our nonaccrual loans increased to $170.2 million (0.24 percent of total loans) at December 31, 2012 from $134.9 million (0.29 percent of total loans) at December 31, 2011 due largely to credit deterioration related to a small number of Rural Infrastructure customers. Loan charge-offs, net of recoveries, increased slightly to $16.9 million in 2012 from $16.6 million in 2011.

In 2010, we recorded a $60.0 million provision for loan losses, largely reflective of credit challenges facing a limited number of rural energy customers in our Rural Infrastructure operating segment. Net charge-offs were $57.6 million in 2010, and nonaccrual loans at December 31, 2010 were $167.0 million, or 0.33 percent of total loans.

Our allowance for credit losses was $595.1 million at December 31, 2012, compared to $542.0 million and $500.5 million as of December 31, 2011 and 2010, respectively. The allowance for credit losses represented 0.83 percent of total loans as of the end of 2012, compared to 1.17 percent and 1.00 percent of total loans at December 31, 2011 and 2010, respectively. The decline as a percent of total loans resulted from the impact of the merger. At December 31, 2012, our allowance for credit losses represented 1.87 percent of non-guaranteed loans excluding loans to Associations, compared to 1.92 percent at December 31, 2011.

Refer to "Corporate Risk Profile – Credit Risk Management" beginning on page 38 for further information on nonperforming loans, charge-offs, loan quality trends and the factors considered in determining the levels of our provision for loan losses and overall allowance for credit losses.

Noninterest Income

The following table details our noninterest income for each of the last three years.

Noninterest Income ($ in Thousands)

Year Ended December 31,	2012	2011	2010
Net Fee Income	**$ 116,801**	$ 117,741	$ 102,620
Prepayment Income	**49,379**	24,691	18,820
Losses on Early Extinguishment of Debt	**(86,718)**	(50,421)	(26,537)
Loss on Tender Offer for Subordinated Debt	**(28,460)**	-	-
Other-Than-Temporary Impairment Losses, Net	**(17,000)**	(10,000)	(44,000)
Other, Net	**79,319**	35,925	47,656
Total Noninterest Income	**$ 113,321**	$ 117,936	$ 98,559

Noninterest income is primarily composed of net fee income, loan prepayment fee income and miscellaneous gains and losses, reduced by losses on early extinguishment of debt (including subordinated debt) and impairment losses on investment securities.

Net noninterest income decreased in 2012 to $113.3 million from $117.9 million in 2011. The decrease includes a greater level of losses on early extinguishment of debt, net of prepayment income, losses related to a tender offer to purchase a portion of our subordinated debt, and increased impairment losses on investment securities. These items were partially offset by a $44.6 million refund from the Insurance Corporation.

In December 2012, we purchased $95.3 million of our 7.875 percent fixed rate Series 2008A subordinated notes through a cash tender offer. We incurred a loss of $28.5 million related to this transaction, which will reduce future interest expense.

Prepayment income increased to $49.4 million in 2012 from $24.7 million in 2011 due to a higher level of customer refinancing resulting from the low interest rate environment. We extinguish debt early to offset the current and prospective impact of prepayments in our loan and investment portfolios and to maintain a desired mix of interest-earning assets and interest-bearing liabilities. During 2012, we early extinguished $371.5 million of Systemwide Debt Securities compared to $649.3 million in 2011. Losses on early extinguishment of Systemwide Debt Securities were $86.7 million in 2012 compared to $50.4 million in 2011. The increase resulted from a greater level of debt buyback losses incurred to better position our balance sheet in the low interest rate environment and to reduce future interest expense.

We recorded $17.0 million of other-than-temporary impairment losses on investment securities in 2012 compared to $10.0 million in 2011. The impairments in 2012 resulted from credit quality deterioration of certain investment securities and changes to assumptions in our credit loss models to better reflect current cash flow expectations surrounding certain of our residential mortgage- and asset-backed securities. Certain of the securities impaired in 2012 were non-agency residential mortgage-backed investment securities and were among those identified as credit-impaired investment securities acquired as part of the AgBank merger (discussed further in Note 3 to the accompanying consolidated financial statements). The 2011 impairment losses resulted from weakness in the U.S. housing market and broader economy and the related impact on our non-agency residential mortgage-backed and asset-backed investment securities. The credit quality of our investment portfolio is discussed in "Liquidity and Capital Resources" beginning on page 53.

"Other, net" noninterest income in 2012 includes a $44.6 million refund from the Insurance Corporation related to the Farm Credit Insurance Fund (Insurance Fund). As described in Note 6 to the accompanying consolidated financial statements, when the Insurance Fund exceeds the statutory 2 percent secure base amount (SBA), the Insurance Corporation is required to reduce premiums and may refund excess amounts. The Insurance Fund ended 2011 above the SBA. In April 2012, the Insurance Corporation approved the distribution of the excess amounts and in May of 2012, such amounts were distributed to the System banks.

Our net fee income, which includes arrangement fees and unused commitment fees, among others, was relatively flat at $116.8 million compared to $117.7 million in 2011.

Total noninterest income increased by $19.4 million, or 20 percent, in 2011 from $98.6 million in 2010. The 2011 period reflected a $34.0 million decrease in other-than-temporary impairment losses on investment securities and a $15.1 million improvement in net fee income, primarily driven by increased arrangement fees earned on loan transactions in our agribusiness and rural energy portfolios. Other noninterest income for 2011 also included a $10.0 million increase in customer derivative income driven by customers locking-in or protecting their term funding costs and a $4.5 million gain on the sale of one of our previously impaired investment securities. Partially offsetting these increases were losses on early extinguishment of Systemwide Debt Securities, net of prepayment income, of $25.7 million in 2011, compared to $7.7 million in 2010.

Operating Expenses

The following table details our operating expenses for each of the last three years.

Analysis of Operating Expenses ($ in Thousands)

Year Ended December 31,	2012	2011	2010
Employee Compensation	**$ 145,999**	$ 117,531	$ 98,971
General and Administrative	**32,228**	24,446	41,589
Information Technology	**22,227**	18,846	16,115
Insurance Fund Premium	**18,349**	20,245	13,281
Travel and Entertainment	**15,767**	12,425	10,922
Farm Credit System Related	**13,279**	8,415	8,294
Occupancy and Equipment	**9,012**	7,404	6,479
Purchased Services	**7,022**	18,958	20,559
Total Operating Expenses	**$ 263,883**	$ 228,270	$ 216,210
Total Operating Expenses/ (Net Interest Income + Net Fee Income)	**19.5 %**	19.2 %	20.5 %
Operating Expenses, Excluding Insurance Fund Premium/ (Net Interest Income + Net Fee Income)	**18.1**	17.5	19.3

Total operating expenses increased 16 percent in 2012 to $263.9 million, compared to $228.3 million for 2011, largely due to the impact of the merger.

Employee compensation expense, which primarily includes salaries, incentive compensation and employee benefits, increased 24 percent in 2012 to $146.0 million, largely due to the addition of 72 former AgBank employees, other staffing increases and the impact of changes in the design of certain elements of our compensation program. These design changes were made to ensure the Bank's incentive programs align with market practices and include the appropriate performance measures while balancing our risk profile with total compensation. As of December 31, 2012, we had 865 employees, compared to 762 and 719 at December 31, 2011 and 2010, respectively.

General and administrative expenses increased to $32.2 million in 2012 from $24.4 million in 2011, largely due to increases in contributions to universities and charitable organizations, as well as increases in support provided to organizations that advance the mission of the System, the industries we serve, and rural America. General and administrative expenses in 2011 included $3.2 million in one-time merger-related expenses.

Information technology expense increased to $22.2 million in 2012 from $18.8 million in 2011 due largely to merger integration efforts.

Insurance Fund premium expense decreased to $18.3 million primarily due to a decrease in premium rates, which were five basis points of average outstanding adjusted insured debt obligations for 2012, compared to six basis points for 2011. The merger with AgBank did not significantly change the level of Insurance Fund premium expense as the substantial majority of the acquired loan portfolio were wholesale loans to Associations, where the Insurance Fund premiums are passed on to Associations.

Our travel and entertainment expenses increased to $15.8 million in 2012 from $12.4 million in 2011, due primarily to a greater level of expenditures on customer meetings and other customer-facing activities, which in part reflect the expanded customer base following the merger.

Farm Credit System related expenses increased to $13.3 million in 2012 from $8.4 million in 2011, and include our share of costs to fund the operations of the FCA, our regulator, and the Farm Credit Council (FCC), a national trade organization that represents System entities. Each System institution is assessed a pro rata share of the FCA's total expenses based primarily on each institution's average risk-adjusted assets. FCC costs are generally allocated based on the number of directors that represent each district (a System bank and its affiliated associations) and the level of bank assets. The increase in Farm Credit System related expenses in 2012 reflects a higher level of all of these cost allocation drivers, which resulted due to the merger.

Occupancy and equipment expenses increased to $9.0 million in 2012 from $7.4 million in 2011 due largely to the merger. Purchased services expense decreased to $7.0 million in 2012 from $19.0 million in 2011. The 2011 period included $9.8 million of merger-related expenses which largely related to outside advisors and consultants who assisted with transaction analysis and integration activities.

Total operating expenses as a percent of net interest income plus net fee income were 19.5 percent in 2012 compared to 19.2 percent in 2011 and 20.5 percent in 2010. Excluding the impact of Insurance Fund premium expense, operating expenses as a percent of net interest income plus net fee income were 18.1 percent in 2012, compared to 17.5 percent in 2011 and 19.3 percent in 2010.

The $12.1 million increase in total operating expenses in 2011 from 2010 resulted principally from an $18.6 million increase in employee compensation expense, a $7.0 million increase in Insurance Fund premiums, a $2.7 million increase in information technology expense and a $1.5 million increase in travel and entertainment. These items were partially offset by a $17.4 million decrease in general and administrative expenses. Employee compensation expense was higher in 2011 due to increased incentive compensation expense related to stronger financial performance and increased employee staffing levels. The increase in Insurance Fund premiums in 2011 reflected an increase in premium rates, which were six basis points of average outstanding adjusted insured debt obligations for 2011, compared to five basis points for 2010. The increase in information technology and travel and entertainment expenses in 2011 largely related to the merger efforts. General and administrative expenses in 2010 included the settlement of a business dispute in our Rural Infrastructure operating segment.

Provision for Income Taxes

Our provision for income taxes decreased to $163.7 million in 2012 from $196.1 million in 2011, and our effective tax rate decreased to 16.1 percent for 2012 from 21.7 percent for 2011. As more fully discussed in Note 1 to the accompanying consolidated financial statements, a significant portion of CoBank's activities are exempt from income taxes. These tax-exempt activities primarily include lending to Farm Credit Associations. The merger with U.S. AgBank significantly increased the earnings in the tax-exempt portion of our business. In addition, the decline in average loan volume in our Agribusiness operating segment in 2012 led to an overall decrease in earnings in the taxable portion of our lending activities. Our effective tax rates are less than the applicable federal and state statutory income tax rates due to tax-deductible patronage distributions as well as the tax-exempt business activities.

Our effective tax rate increased to 21.7 percent for 2011 compared to 20.6 percent for 2010. The increase reflected a change in estimated taxes applicable to certain deferred tax items and a higher level of earnings in the taxable portion of our business activities.

Operating Segment Financial Review

We conduct lending operations through three operating segments: Agribusiness, Strategic Relationships and Rural Infrastructure.

We hold investment securities primarily as a liquidity reserve to support our core lending operations. Net interest income on investment securities and gains or losses on investment securities are allocated to all operating segments, whereas the underlying investment assets are not allocated to the operating segments.

In addition to the operating segments described below, our Banking Services Group (BSG) provides capital markets services and non-credit products and services. As part of its capital markets services, which support our lending divisions, BSG manages syndications and loan sales with approximately 130 financial institutions. In 2012, we syndicated or sold approximately $16.5 billion of loan commitments to System entities and other financial institutions to help meet customers' credit needs and to effectively manage our risk diversification and capital.

BSG's non-credit products and services include cash management as well as, commercial credit card and merchant card processing solutions. Revenues generated from non-credit products and services, as well as BSG's operating expenses, are allocated to the appropriate operating segments. BSG's Knowledge Exchange Division provides the Bank and our customers industry specific research and strategic insight to enhance understanding of emerging trends, business opportunities, and risks.

Net income by operating segment is summarized in the accompanying table and is more fully disclosed in Note 15 to the accompanying consolidated financial statements. The following tables also provide period-end and average loan amounts.

Net Income by Operating Segment ($ in Thousands)

Year Ended December 31,	2012	2011	2010
Operating Segment:			
Agribusiness	**$ 409,886**	$ 438,082	$ 365,247
Strategic Relationships	**245,638**	80,806	80,446
Rural Infrastructure	**208,199**	194,418	175,596
Total Operating Segments	**863,723**	713,306	621,289
Corporate/Other	**(9,806)**	(6,719)	(7,522)
Total	**$ 853,917**	$ 706,587	$ 613,767

Period-end Loan Portfolio by Operating Segment ($ in Millions)

December 31,	2012	2011	2010	2009	2008
Agribusiness	**$ 21,394**	$ 18,869	$ 22,676	$ 17,469	$ 18,498
Strategic Relationships	**36,707**	15,236	15,392	15,271	15,026
Rural Infrastructure	**13,879**	12,180	11,924	11,434	11,026
Total Loans	**$ 71,980**	$ 46,285	$ 49,992	$ 44,174	$ 44,550

Average Loan Portfolio by Operating Segment ($ in Millions)

Year Ended December 31,	2012	2011	2010	2009	2008
Agribusiness	**$ 22,209**	$ 23,104	$ 18,896	$ 18,229	$ 21,843
Strategic Relationships	**34,976**	15,215	15,118	15,062	13,670
Rural Infrastructure	**13,086**	11,880	11,524	11,236	9,861
Total Average Loans	**$ 70,271**	$ 50,199	$ 45,538	$ 44,527	$ 45,374

The following table presents activity in the allowance for credit losses by operating segment.

Analysis of the Allowance for Credit Losses ($ in Thousands)

	2012	2011	2010	2009	2008
Beginning of Year	$ 541,975	$ 500,543	$ 498,190	$ 483,421	$ 447,226
Charge-offs:					
Agribusiness	(29,069)	(10,559)	(25,893)	(36,958)	(17,574)
Strategic Relationships	-	-	-	-	-
Rural Infrastructure	(1,556)	(12,956)	(50,502)	(33,240)	(8,000)
Total Charge-offs	(30,625)	(23,515)	(76,395)	(70,198)	(25,574)
Recoveries:					
Agribusiness	11,022	6,527	4,234	4,850	3,916
Strategic Relationships	-	-	-	-	-
Rural Infrastructure	2,707	420	14,514	117	2,853
Total Recoveries	13,729	6,947	18,748	4,967	6,769
Net Charge-offs	(16,896)	(16,568)	(57,647)	(65,231)	(18,805)
Provision (Reversal) Charged (Credited) to Earnings:					
Agribusiness	16,550	37,000	7,167	39,000	70,000
Strategic Relationships	-	-	-	-	-
Rural Infrastructure	53,450	21,000	52,833	41,000	(15,000)
Total Provision Charged to Earnings	70,000	58,000	60,000	80,000	55,000
End of Year	$ 595,079	$ 541,975	$ 500,543	$ 498,190	$ 483,421
Components:					
Allowance for Loan Losses	$ 437,376	$ 388,056	$ 400,744	$ 369,817	$ 329,198
Reserve for Unfunded Commitments	157,703	153,919	99,799	128,373	154,223
Total Allowance for Credit Losses (ACL)	$ 595,079	$ 541,975	$ 500,543	$ 498,190	$ 483,421
ACL/Total Loans	0.83 %	1.17 %	1.00 %	1.13 %	1.09 %
ACL/Non-guaranteed Loans (Excluding Loans to Associations)	1.87	1.92	1.60	1.98	1.85
ACL/Impaired Loans	345	402	299	154	218
ACL/Nonaccrual Loans	350	402	300	162	222
Net Charge-offs/Average Loans	(0.02)	(0.03)	(0.13)	(0.15)	(0.04)

Allowance for Credit Losses by Operating Segment ($ in Thousands)

December 31,	2012	2011	2010	2009	2008
Agribusiness	$ 384,287	$ 385,784	$ 352,816	$ 367,308	$ 360,416
Strategic Relationships	-	-	-	-	-
Rural Infrastructure	210,792	156,191	147,727	130,882	123,005
Total Allowance for Credit Losses	$ 595,079	$ 541,975	$ 500,543	$ 498,190	$ 483,421

Agribusiness

Overview

The Agribusiness operating segment includes loans and other financial services provided to cooperatives and other businesses in various agricultural sectors such as grain handling and marketing, farm supply, food processing, dairy, livestock, fruits, nuts, vegetables, cotton, biofuels and forest products. Primary products and services include term loans, revolving lines of credit, trade finance, leasing, tax-exempt bond issuances, capital markets services, and cash management and investment products. To enhance portfolio diversification, and to assist System partners in meeting the needs of their customers, we purchase participations in agribusiness loans from other System entities and financial institutions.

A significant level of Agribusiness loan volume relates to the seasonal financing of grain inventories through the use of lines of credit at our grain cooperative customers. This seasonal volume is affected by a number of factors, including commodity prices, selling patterns, transportation availability, grain volume and the relationship between cash and futures prices in the grain commodities markets. Agribusiness loan volume generally reaches a seasonal low in late summer or early fall. Harvest financing demands result in loan volume increases beginning in the late fall of each year. Peak loan volume typically occurs early in the year when producers' deferred payments are redeemed by our cooperative customers. Agribusiness loans outstanding totaled $21.4 billion at December 31, 2012, compared to $18.9 billion at December 31, 2011. The increase in year-end loan volume was due in part to higher commodity prices resulting from the impact of the drought which affected many parts of the United States throughout 2012.

Our Agribusiness customers face evolving globalization of markets, changing market demands and increasing regulation. These trends are leading some of our cooperative customers to consolidate and merge, enter into joint ventures, or form alliances while developing new markets. This consolidation trend has, in some cases, resulted in larger individual and attributed credit commitments, consistent with our mission. We have met our customers' financing needs while maintaining appropriate credit exposure to individual customers by partnering with System entities and commercial banks in loan syndications and sales.

The Agribusiness segment includes our Agricultural Export Finance Division, which provides short- and medium-term trade finance to support the export of U.S. agricultural products. Borrowers consist primarily of commercial banks in foreign countries (generally emerging markets) which support our domestic customers in selling and shipping U.S. agricultural products to international markets. In financing the export of U.S. agricultural products, the Agricultural Export Finance Division places emphasis on supporting the U.S. government-sponsored export loan guarantee General Sales Manager program. As of December 31, 2012, the Agricultural Export Finance Division had $4.6 billion in loans outstanding, 76 percent of which were guaranteed by the U.S. government. The Agricultural Export Finance Division maintains a representative office in Singapore.

The Agribusiness segment also includes Farm Credit Leasing Services Corporation (FCL), a wholly-owned subsidiary which provides lease-related products and financial services to Association partners, agribusinesses, agricultural producers and rural infrastructure companies. As of December 31, 2012, FCL had $2.1 billion in leases outstanding.

2012 Performance

Our Agribusiness segment generated $409.9 million in net income for 2012, a 6 percent decrease from the $438.1 million in net income for 2011. The decrease in earnings resulted primarily from a $49.6 million decline in net interest income due to lower average loan volume and low returns on the Bank's invested capital. In addition, lending spreads declined as a result of improved asset quality and increased competition from commercial banks and other lenders.

Agribusiness average loan volume decreased 4 percent to $22.2 billion in 2012 from $23.1 billion in 2011. The decline in average loan volume reflected a decrease in seasonal lending early in 2012, when lower grain commodity prices, changing farmer delivery patterns, and overall strong financial positions reduced working capital financing needs at many of our grain cooperative customers. Generally, lower prices for agricultural commodities, reduced grain contracting, and delayed delivery of inventory from farmers lead to a reduction in financing requirements for many Agribusiness customers, particularly those in the farm supply and grain marketing sectors who borrow to finance inventory purchases and receivables. Agribusiness loan volume was positively impacted in the latter half of 2012 by higher commodity prices due to drought conditions in many parts of the United States.

The following table shows five-year price trends for certain commodities. Prices represent the yearly high and low "nearby" futures price per bushel for corn, soybeans and wheat. Nearby futures contracts represent those contracts with the nearest settlement date.

Year Ended December 31,	2012	2011	2010	2009	2008
Commodity					
Corn:					
High	**$ 8.44**	$ 8.00	$ 6.30	$ 4.50	$ 7.61
Low	**5.51**	5.95	3.25	3.06	3.09
Soybeans:					
High	**17.89**	14.56	13.84	12.67	16.49
Low	**11.50**	12.70	9.00	6.28	7.76
Wheat:					
High	**9.47**	8.93	8.08	6.74	12.53
Low	**5.90**	5.80	4.26	4.40	4.76

Notwithstanding the overall decline in average Agribusiness loan volume, average loan volume within the Agricultural Export Finance Division increased $470.9 million to $4.3 billion during 2012 as compared to 2011, due primarily to global market volatility and a higher level of export demand. Our lending spreads on Agricultural Export Finance loans are generally lower than other portions of our Agribusiness portfolio due to their lower risk profile.

Agribusiness recorded a $16.6 million provision for loan losses in 2012 compared to $37.0 million for 2011. The decline in the provision primarily reflected improved credit quality. Additionally, the 2011 provision reflected credit challenges facing a small number of customers. Nonaccrual loans decreased to $70.5 million at December 31, 2012 from $80.3 million at December 31, 2011 due in part to the return to accruing status of two Agribusiness customers whose financial performance had improved and the sale of an Agribusiness nonaccrual loan. Partially offsetting the decline in nonaccrual loan volume was the movement of a small number of Agribusiness loans to nonaccrual status due to credit concerns. Net charge-offs increased to $18.0 million in 2012 compared to $4.0 million for 2011 and also related to a small number of Agribusiness customers.

Noninterest income in our Agribusiness segment decreased by $12.5 million in 2012 largely due to allocated losses from the purchase of a portion of our subordinated debt through a cash tender offer, a greater level of losses on early extinguishment of debt, net of prepayment income, a lower level of arrangement fees and lower customer derivative income. These decreases were partially offset by a refund from the Insurance Corporation. Operating expenses in our Agribusiness segment increased by $8.8 million in 2012 primarily due to higher employee compensation expense resulting from changes in the design of certain elements of our compensation program and a higher level of contributions to universities and charitable and industry organizations. Partially offsetting this increase were lower Insurance Fund premiums and the reduction in merger-related expenses in 2012. Income tax expense in the Agribusiness operating segment decreased $22.2 million due to the decline in pretax earnings.

Strategic Relationships

Overview

The Strategic Relationships operating segment includes loans from the direct funding relationships we have with our affiliated Association customer-owners and our funding relationships with other System institutions. Establishing partnerships with Associations allows us to provide credit and non-credit services to a more diverse set of customers. The Associations' strong market presence and local relationship management, combined with our product suite and lending capacity, provide a competitive advantage in attracting and retaining customers. As a result, developing and maintaining strong relationships with Farm Credit Associations and banks is an important strategic focus.

As a result of the merger with AgBank, the number of our affiliated Associations increased from four to 29 on January 1, 2012 and now includes Associations operating in 23 states serving the Northwest, West, Southwest, Rocky Mountains, Mid-Plains, and Northeast regions of the United States. The merger resulted in a $19.5 billion increase in Strategic Relationships loan volume as of January 1, 2012, including $18.9 billion in loans outstanding and $530.9 million in fair value adjustments recorded pursuant to business combination accounting standards. For additional information on the accounting impacts of the merger, refer to Note 3 of the accompanying consolidated financial statements.

As of December 31, 2012, the Strategic Relationships portfolio totaled $36.7 billion, including $33.1 billion in wholesale loans to our affiliated Associations and $3.6 billion of participations in wholesale loans made by other System banks to certain of their affiliated Associations, $3.4 billion of which are participations in loans made by the Farm Credit Bank of Texas.

2012 Performance

Strategic Relationships average loan volume was $35.0 billion in 2012 compared to $15.2 billion in 2011. The significant increase was the direct result of the merger with AgBank. Excluding the impact of the merger, average loan volume increased modestly. Strategic Relationships net income increased to $245.6 million for 2012 from $80.8 million for 2011 due primarily to a $180.4 million increase in net interest income largely resulting from the merger. The merger-related increase in net interest income includes spread earned on the acquired Association loan volume and an allocated portion of the acquired investment securities, as well as the net accretion of asset and liability fair value adjustments resulting from the merger. Operating expenses increased to $31.3 million in 2012 from $15.2 million in 2011 due to the merger and, to a lesser extent, the aforementioned changes to certain elements of our compensation program and the greater level of contributions to universities and charitable and industry organizations.

Overall loan quality in our Strategic Relationships portfolio is very strong. As a wholesale lender to Associations, we benefit from the diversification of the Association loan portfolios and a strong collateral position. In addition, the earnings, capital and loan loss reserves of the Associations provide us a buffer from losses in their respective loan portfolios. Lower margins in the Strategic Relationships operating segment are commensurate with the lower risk profile and lower regulatory capital requirements. No provisions for loan losses or allowance for credit losses have been recorded related to any Association loan.

Strategic Relationships current period operating results did not benefit from the previously mentioned Insurance Corporation refund because such amounts were passed on directly to our Association customers. Strategic Relationships has no income tax expense as the earnings on its business activities are tax exempt.

Rural Infrastructure

Overview

The Rural Infrastructure operating segment includes loans and other financial services provided to companies in the power, communications and water industries. Primary products and services include term loans, revolving lines of credit, project financing, leasing, tax-exempt bond issuances, capital markets services and cash management and investment products. Rural Infrastructure loan volume increased $1.7 billion to $13.9 billion at December 31, 2012 from $12.2 billion at December 31, 2011.

Power industry customers include rural electric generation and transmission cooperatives, electric distribution cooperatives, renewable energy providers, independent power producers, and investor-owned utilities. Loan demand from power supply customers has generally declined as a result of continued weakness in the economy and regulatory uncertainty. Nonetheless, customers undertaking infrastructure enhancements to meet long-term requirements or to comply with environmental regulations continue to demand debt capital. Growth in renewable energy projects also contributes to loan demand from power supply customers. Loan growth has also resulted from opportunities to refinance borrowings from other lenders, particularly in the electric distribution sector.

Communications industry customers include rural local exchange carriers, wireless providers, data transport networks, cable television systems, and data centers. We focus on rural communications companies that are positioned to provide a range of services, including voice (both wireline and wireless), broadband and video. Growth opportunities may arise from merger and acquisition activity, as consolidation could result from carriers seeking to improve operating efficiencies and gain market share in this highly competitive industry. Capital spending may provide additional growth opportunities as wireline carriers enhance their networks with fiber optics and wireless carriers continue to upgrade to fourth generation (4G) data technology.

Water industry customers include rural water and waste water companies. Capital expenditure growth in this industry continues primarily as a result of the need to replace aging infrastructure and to meet higher standards for water quality. While much of this need has been filled by financing from government programs, some private lending opportunities for construction/interim financing have been created as a bridge to government grants or loans. With the continuing need for plant upgrades and expected limitations on the availability of government funds, we expect private lending to this industry to continue to grow.

2012 Performance

Rural Infrastructure average loan volume increased to $13.1 billion in 2012 compared to $11.9 billion in 2011. Growth in average loan volume resulted primarily from increased lending activity in the power supply industry and greater market penetration in the electric distribution industry. The merger with AgBank did not have a significant impact on loan volume in Rural Infrastructure.

Rural Infrastructure net income increased 7 percent to $208.2 million for 2012 from $194.4 million for 2011. The increase in earnings was primarily due to a $37.2 million increase in net interest income driven by the growth in loan volume as well as increased lending spreads in our communications portfolio. Noninterest income increased by $7.2 million primarily due to a refund from the Insurance Corporation and greater arrangement fee income. Partially offsetting these items were allocated losses from the purchase of a portion of our subordinated debt through a cash tender offer and a greater level of losses on the early extinguishment of debt, net of prepayment income.

Rural Infrastructure recorded a provision for loan losses of $53.5 million in 2012 compared to $21.0 million in 2011. The 2012 provision for loan losses reflects an overall higher level of average Rural Infrastructure commitments as well as specific credit challenges facing a small number of communications and rural energy customers. Nonaccrual loans in the Rural Infrastructure segment increased to $99.7 million at December 31, 2012 from $54.5 million at December 31, 2011, also largely due to credit concerns surrounding a small number of our communications and rural energy customers. As a result, overall loan quality in our Rural Infrastructure operating segment deteriorated modestly from the prior year end. However, loan quality in this operating segment remains strong. Rural Infrastructure recorded net recoveries of $1.2 million in 2012 as compared to net charge-offs of $12.5 million in 2011. The 2011 net charge-offs related to a small number of communications customers.

Rural Infrastructure operating expenses increased by $9.6 million in 2012, due primarily to an increase in employee compensation expense resulting from an increase in staffing and changes in the design of certain elements of our compensation program, and a higher level of contributions to universities and charitable and industry organizations. These increases were partially offset by lower Insurance Fund premiums and the reduction in merger-related expenses in 2012. Rural Infrastructure income tax expense decreased $11.4 million due to a higher level of tax-deductible patronage refunds resulting from loan growth as well as the impact of the higher provision for loan losses.

Corporate Risk Profile

Managing risk is an essential part of successfully operating our Bank. Our primary risk exposures are credit, interest rate, liquidity, operational and reputation. Credit risk is the risk of not collecting the amounts due on loans, investments or derivatives. Interest rate risk is the potential reduction of net interest income and the market value of equity as a result of changes in interest rates. Liquidity risk is the potential inability to repay obligations or fund borrowers on a timely basis. Operational risk is the risk of loss resulting from inadequate or failed processes or systems, breaches of internal controls or compliance requirements, the risk of fraud, and other operational matters. Reputation risk is the risk of loss arising from negative public opinion.

Business segments and support units have the responsibility of identifying, controlling and monitoring risks. Our Risk Management Group provides oversight of the Bank's enterprise risk management through measurement and control processes addressing the Bank's primary risk exposures, including credit, interest rate, liquidity, operational and reputation. The following is a discussion of these risks, and our approach to managing them.

Credit Risk Management

Credit risk exists in our lending, leasing, investing and derivatives activities. Credit risk in lending, leasing and derivatives activities arises from changes in a borrower's or counterparty's ability or willingness to repay funds borrowed or to meet agreed-upon obligations. Credit risk may be further impacted by changes in collateral values, changes in the prevailing economic environment, fraud, defaults on mortgages or other obligations which collateralize mortgage- and asset-backed investment securities, changes in the credit-worthiness of bond insurers and other counterparties who insure or guarantee certain investment securities, and declines in the value of underlying collateral securing investment securities, primarily residential real estate.

We actively manage credit risk through a well-defined, Board-approved loan portfolio strategy, a structured and centralized credit approval process, a disciplined risk management process, and a sound credit administration program. We have established comprehensive credit guidelines and procedures to ensure consistency and integrity of information related to the credit risk in our loan, investment and derivatives portfolios.

Various groups and committees within CoBank, including our Board of Directors, have a role in managing credit risk, as described below. Our Board of Directors establishes overall lending, investment, derivatives and reserve policies. It also approves the portfolio strategy and reviews loan volume, loan quality trends, significant high-concern or troubled loans, and the credit quality of our investment and derivatives portfolios.

The CoBank Loan Committee (CLC), which is appointed by the President and CEO, and includes the Chief Credit Officer and senior management of the Credit Group and the lending groups, holds ultimate credit authority as authorized by Board policy. The CLC delegates lending authorities to specific committees or groups of individuals based on size of exposure and risk rating, and approves certain limits for investment obligors and derivative counterparties. It acts on individual credit actions or administrative matters and approves exceptions to exposure limits if conditions warrant.

The Credit Group is led by the Chief Credit Officer, who reports to the President and CEO. The Credit Group manages the credit approval process within concentration limits established for the loan portfolio pursuant to Board policies. As part of the credit approval process, it reviews assigned risk ratings for accuracy and conformity with our established guidelines, and approves limits with respect to investment obligors and derivative counterparties. It also manages significant high-risk or troubled loans.

The Risk Management Group is led by the Chief Risk Officer, who reports to the President and CEO. Certain individuals within the Risk Management group have direct reporting responsibility to the Audit Committee and the Board of Directors. The Risk Management Group oversees development of the loan portfolio strategy, the analysis of the allowance for credit losses, and economic capital. It provides independent reporting to the Board of Directors on the quality of the Bank's assets, the Bank's system of internal controls, and material findings of the Asset Review and Internal Audit Divisions.

The Asset and Liability Committee (ALCO), which includes the President and CEO, Chief Banking Officer, Chief Operating Officer, Chief Financial Officer, Chief Risk Officer, Chief Credit Officer and Treasurer, oversees, among other things, credit risk within the investment portfolio. It also reviews counterparty credit risk arising from derivative transactions.

The Country Risk Committee (CRC) is appointed by the President and CEO, and includes the Chief Risk Officer, the Chief Credit Officer and the Chief Banking Officer. It oversees the methodologies for setting country risk grades and establishing maximum country limits, as well as the approval of individual country risk grades and limits.

Credit Risk Related to Loans

The key elements of our credit risk management related to lending include our portfolio strategy, the credit approval process, and the use of exposure and concentration limits, each of which is explained below.

Portfolio Strategy

The portfolio strategy provides overall guidance on lending activities and strategies over a three year planning horizon. The objectives of our portfolio strategy are to safely fulfill our lending mission, ensure appropriate portfolio diversification, and optimize returns based on risk and profitability, all within established capital parameters. As part of the annual business and financial planning process, the Board of Directors reviews and approves the Bank's portfolio strategy. Management regularly analyzes performance with respect to the portfolio strategy and reports the results to the Board of Directors.

Credit Approval

The most critical element in managing and controlling risk in the extension of credit is the initial decision to make a loan and the resulting structure and terms of the relationship with the borrower.

We place significant emphasis on the evaluation and understanding of a borrower's business and management in the initial credit analysis and the approval process. We emphasize cash flow and repayment capacity as primary sources for repayment of loans, while collateral is normally considered a secondary source of repayment. In circumstances where the credit decision places substantial reliance on collateral to repay the loans, independent appraisals may be used to assist in the collateral valuation. Such appraisals are conducted in accordance with FCA regulations and professional appraisal standards.

For wholesale lending within our Strategic Relationships operating segment, the earnings, capital and loan loss reserves of the Associations provide us a buffer from losses in their respective loan portfolios. Loans to our affiliated Associations are governed by a General Financing Agreement, as described on page 107.

With the exception of certain small-dollar lease transactions, no single individual is granted credit approval authority within CoBank. All approvals or credit actions require formal documentation. Management assigns a risk rating to each borrower based on two measurements: probability of default (PD) and loss given default (LGD). The PD rating system uses a 14-point scale of 1 (highest quality) to 14 (lowest quality). The PD rating is primarily determined by the financial characteristics of the borrower and reflects the probability of default driven by several factors, including business risk, industry risk, management capability and financial condition. The LGD rating is intended to approximate the degree of potential loss in the event the borrower defaults.

Exposure and Concentration Limits

We make extensive use of exposure limits to manage risk and volatility in the loan portfolio. Exposure to individual borrowers and related entities is managed through a risk matrix that considers the dollar exposure, type of exposure and risk rating of the borrower. Individual borrower exposures are examined at the time of each borrower's formal review, which occurs at least annually. The dollar exposure, risk rating and type of credit extended further determine the delegated level of authority required to approve the credit. These individual borrower exposures are then further subject to total portfolio limits on exposure to different industries and/or countries. Exposure limits for different industries are reviewed quarterly while exposure limits for different countries are reviewed annually. We allow for more frequent evaluation when necessary. Exceptions to these exposure limits may be granted by the CLC or the CRC if conditions warrant.

We also manage lending credit exposures and concentrations by selling and purchasing loans. Our capabilities in selling and purchasing loans will continue to be critical to dynamically managing the portfolio, maintaining market discipline, and meeting our mission.

While we believe these standards, processes and tools are appropriate to manage our credit risk, there is no assurance that significant deterioration in loan quality will not occur, which could reduce our future earnings.

We are limited to making loans and providing related financial services to eligible borrowers in certain specified industries, as mandated by the Farm Credit Act. As a result, we have a concentration of loans to the agricultural and rural infrastructure industries. The significant risk factors affecting credit conditions in these industries within each of our operating segments are described below.

Agribusiness

The relationship of demand for and supply of U.S. agricultural products in a global marketplace can significantly impact the volume, earnings and loan quality of our Agribusiness portfolio.

Changes in the prices of agricultural commodities can impact the profitability and loan quality of a portion of our Agribusiness customers. Changes in prices for agricultural commodities result from, among other factors, seasonal and cyclical weather conditions; global production levels; changes in the production levels of ethanol, which can be impacted by legislative initiatives, the price of oil and other commodities; financial investment in the commodity futures markets by non-agricultural interests; and changing export markets. Market prices for food products also have a significant effect on a number of customer sectors within our Agribusiness portfolio.

Major international events, including military conflicts, terrorism, political disruptions or trade agreements can affect, among other things, the price of commodities or products used or sold by our borrowers or their access to markets. In addition, biological or disease risk in human or livestock populations can impact the supply of and demand for agricultural products. Certain of our customers also have exposure to counterparties in the commodities exchange markets.

U.S. agriculture receives financial support from the U.S. government through direct payments, crop insurance and other benefits. While U.S. government support for agriculture has been consistent, there is no assurance that such financial support will remain at current levels, especially given the current debate surrounding the need to reduce federal government spending. Although most of our customers do not generally receive direct support from federal programs, a significant reduction or elimination of such support could have a negative impact on the loan quality of certain borrowers, including Associations, who derive a significant share of their earnings from farmers and other producers who may be affected by such a reduction. Other political, legislative and regulatory activities may also impact the level or existence of certain government programs.

Strategic Relationships

Approximately $36.7 billion, or 51 percent, of our total loan portfolio at December 31, 2012, represented direct loans to our affiliated Associations and participations in the direct loans of nonaffiliated Associations. The risk factors previously discussed in the "Agribusiness" section can also affect loan quality at Associations; however, the impact of such factors on farmers and other producers served by Associations may not be the same as the impact on cooperatives and other customers served by our Agribusiness operating segment. The loan quality of our Strategic Relationships portfolio is enhanced by our strong collateral position and the earnings, capital and loan loss reserves of the Associations, which provide us a buffer from losses in their respective loan portfolios.

Rural Infrastructure

A general slowdown in the U.S. economy can reduce industrial and residential demand for services and negatively affect customers in our Rural Infrastructure portfolio.

Fluctuating weather conditions and protracted low levels of electricity demand can adversely affect our customers in the energy industry. The pace and degree of the restructuring of the electric energy industry in the United States, including the lack of open access transmission, may also impact future loan quality. Further, constraints on carbon emissions and other environmental standards could adversely impact energy customers.

The communications industry is affected by significant competition. Regulatory, legislative and technological changes may impact the future competitive position and markets for the communications industry. These factors may place downward pressure on the loan quality of certain sectors of the communications industry. In addition, decreased cash flows and the resultant impact on asset valuation, the inability to successfully integrate merged or acquired companies, or the lack of availability of debt and equity capital could adversely affect certain communications customers.

The water industry faces high capital expenditure requirements due to environmental regulation and aging infrastructure. While per capita residential water usage is declining due to conservation measures and increased use of water efficient appliances, rates continue to rise. Heavy reliance on user fees to build and maintain water infrastructure could adversely affect certain water customers.

Credit Quality Conditions and Measurements in Our Loan Portfolio

The following table presents loans and related accrued interest receivable classified by management pursuant to our regulator's Uniform Loan Classification System, as a percent of total loans and related accrued interest.

Loan Quality Ratios

	December 31, 2012			December 31, 2011		
	Wholesale Loans (1)	Retail Loans (2)	Total Bank	Wholesale Loans (1)	Retail Loans (2)	Total Bank
Acceptable	**100.00 %**	**95.73 %**	**97.91 %**	100.00 %	95.07 %	96.68 %
Special Mention	**-**	**2.20**	**1.08**	-	3.07	2.07
Substandard	**-**	**1.90**	**0.93**	-	1.79	1.20
Doubtful	**-**	**0.17**	**0.08**	-	0.07	0.05
Loss	**-**	**-**	**-**	-	-	-
Total	**100.00 %**	**100.00 %**	**100.00 %**	100.00 %	100.00 %	100.00 %

(1) Represents loans in our Strategic Relationships operating segment

(2) Represents loans in our Agribusiness and Rural Infrastructure operating segments

Our overall credit quality measures improved in 2012 due to the merger, as the substantial majority of the loans in the acquired loan portfolio were wholesale loans to Associations, all of which were classified as 'Acceptable' credit quality. Included in the acquired retail loans were $113.3 million of loans classified as 'Special Mention.' None of the loans acquired were adversely classified loans ('Substandard' and 'Doubtful') or in nonaccrual status.

Notwithstanding the overall improvement in loan quality measures, the total amount of adversely classified loans and related accrued interest increased to $732.1 million at December 31, 2012, compared to $581.4 million at December 31, 2011, primarily due to downgrades of a limited number of rural energy, communications and agribusiness customers.

Summary of High-Risk Assets ($ in Millions)

December 31,	2012	2011	2010	2009	2008
Nonaccrual Loans	**$ 170**	$ 135	$ 167	$ 308	$ 218
Accruing Loans 90 Days or More Past Due	**3**	-	1	15	4
Restructured Loans	**-**	-	-	-	-
Total Impaired Loans	**173**	135	168	323	222
Other Property Owned	**-**	1	7	-	-
Total High-Risk Assets	**$ 173**	$ 136	$ 175	$ 323	$ 222

Total nonaccrual loans were $170.2 million at December 31, 2012 compared to $134.9 million and $167.0 million at December 31, 2011 and 2010, respectively. The increase from 2011 to 2012 was due largely to credit concerns surrounding a limited number of rural energy and communications customers. The increase in nonaccrual loans was partially offset by the return to accruing status of certain communications and agribusiness customers whose financial performance improved, the sale of a limited number of agribusiness and communications nonaccrual loans and charge-offs related primarily to a small number of agribusiness customers. The decrease in nonaccruals from 2010 to 2011 reflected the pay down of balances as well as charge-offs related to a small number of agribusiness and communications customers. Nonaccrual loans as a percent of our total loan portfolio were 0.24 percent as of December 31, 2012 compared to 0.29 percent at December 31, 2011. Over the past 10 years, nonaccrual loans have averaged 0.48 percent of the total loan portfolio.

Net loan charge-offs totaled $16.9 million in 2012 and $16.6 million in 2011. Gross charge-offs in 2012 were $30.6 million compared to $23.5 million in 2011. Gross charge-offs in 2012 were primarily associated with a limited number of agribusiness customers, whereas the 2011 gross charge-offs related to a small number of agribusiness, communications and rural energy customers.

Our allowance for credit losses totaled $595.1 million and represented 0.83 percent of total outstanding loans as of the end of 2012, compared to 1.17 percent and 1.00 percent of total loans at December 31, 2011 and 2010, respectively. At December 31, 2012, our allowance for credit losses represented 1.87 percent of non-guaranteed loans outstanding, excluding loans to Associations.

As part of our overall assessment of risk in the loan portfolio and the allowance for credit losses as of December 31, 2012, we have considered a wide variety of factors impacting the industries we serve. These factors include ongoing weakness and uncertainty in the U.S. and global economies; the continuing European sovereign debt crisis; higher commodity prices, resulting in part from the drought that has impacted a significant portion of the United States, which could further weaken the livestock, ethanol and dairy sectors; a constrained ability by the U.S. and other governments to respond to additional geopolitical or economic shocks; U.S. budget deficit actions that will likely place increasing pressure on various tax incentives and subsidies, including those related to ethanol, renewable energy and agricultural commodity programs; a decline in the value of poorly-positioned power generation assets in the wake of low natural gas prices, uncertain environmental policy and soft industrial and commercial demand for power; continuing technological and business model changes related to the communications industry; operational and documentation risks; biological and disease risks and the attendant threats to livestock sectors; and a significant level of industry and individual borrower concentration risk resulting from our defined mission of service to rural America.

See "Critical Accounting Estimates – Allowance for Credit Losses" on page 58 for a more complete description of our process to determine the adequacy of our allowance for credit losses.

Credit Risk Related to Investments and Derivatives

We minimize credit risk in our investment portfolio by investing primarily in securities issued or guaranteed by the U.S. government or one of its agencies. At year-end 2012, 40 percent of our $18.0 billion investment portfolio consisted of securities that carry a full faith and credit guarantee of the U.S. government. Such securities include mortgage-backed securities (MBS) issued by the Government National Mortgage Association, Export-Import Bank of the United States securities and U.S. Treasury and other debt securities, including loans backed by the Small Business Administration. Approximately 55 percent of our investment portfolio consisted of securities issued by government agencies that carry the implicit backing of the U.S. government, including MBS issued by the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac) and Farmer Mac. Government actions since mid-2008 to strengthen the capital of, and improve the liquidity of, securities issued by Fannie Mae and Freddie Mac indicate a strong level of support by the U.S. government regarding the obligations of the housing GSEs.

The remaining 5 percent of our investment portfolio represented investments in FHA/VA non-wrapped 'reperformer' MBS not further insured by Fannie Mae or Freddie Mac, non-agency MBS, asset-backed securities (ABS) and corporate bonds.

Certain of the investment securities acquired in the merger with AgBank included FHA/VA wrapped and non-wrapped 'reperformer' MBS, which are investment securities where residential mortgage loans serving as collateral were cured after a default. The underlying loans supporting the FHA/VA wrapped 'reperformer' MBS are approximately 90 percent government guaranteed or insured, and are further supported by guarantees from either Fannie Mae or Freddie Mac. These investment securities are included within the acquired U.S. agency MBS portfolio. The underlying loans supporting the FHA/VA non-wrapped reperformer MBS are also approximately 90 percent government guaranteed or insured but have no guarantees from Fannie Mae or Freddie Mac.

The most significant credit risk in our investment portfolio relates to FHA/VA non-wrapped reperformer MBS, non-agency MBS and ABS. The acquired portfolio of FHA/VA non-wrapped reperformer MBS carry unique credit risks, which stem from any potential deficiencies in documentation or lack of compliance with servicing requirements on underlying loans that could make such loans ineligible for guarantees or insurance.

Credit risk in our investment portfolio also arises from the inability of guarantors and third-party providers of other credit enhancements, such as bond insurers or Farmer Mac, to meet their contractual obligations to us. With the exception of Farmer Mac, all of our private sector investment counterparties are rated by a Nationally Recognized Statistical Rating Organization (NRSRO).

We recorded $17.0 million of other-than-temporary impairment losses on investment securities in 2012, compared to $10.0 million in 2011 and $44.0 million in 2010. The credit quality of our investment portfolio as of December 31, 2012 and impairment losses on investment securities are more fully discussed in "Liquidity and Capital Resources" beginning on page 53.

Our counterparty credit risk arising from derivative transactions is managed within credit methodologies and limits approved by the CLC. Managing counterparty exposure is more fully discussed in "Counterparty Exposure" beginning on page 47.

Interest Rate Risk Management

We are subject to interest rate risk, which is defined as the risk of changes to future earnings and long-term market value of equity due to changes in interest rates. This risk primarily arises from our equity positioning and differences in the timing between the contractual maturities, repricing characteristics, and prepayments of our assets and the liabilities funding these assets. This risk can also arise from embedded caps in certain of our investments and differences between the interest rate indices used to price and fund our assets. Our asset/liability management objective is to manage the mix of interest-earning assets and interest-bearing liabilities to reduce interest rate risk and stabilize our net interest income while optimizing profitability and insulating shareholders' equity from significant adverse fluctuations in market interest rates. While we actively manage our interest rate risk position within policy limits approved by the Board of Directors using strategies established by our ALCO, there can be no assurance that changes in interest rates will not adversely impact our earnings and capital.

The following is a more detailed description of our primary interest rate risks and strategies used to mitigate those risks.

Equity Positioning Risk

The existence of shareholders' equity that serves as an interest-free source of funding for the balance sheet requires us to make decisions about the maturity mix of the assets funded by this equity. Using equity to fund short-term assets results in increased volatility of net interest income, whereas using equity to fund long-term assets results in increased volatility in the market value of our equity. During 2012, 2011 and 2010, we chose to use this equity to fund intermediate-term assets (generally, maturing equally over the next five years) to balance the risks to net interest income and market value of equity.

Repricing Risk

Mismatches in interest rate repricing of assets and liabilities arise from the interaction of customer business needs, and our investment portfolio. In addition, we may also undertake funding strategies designed to maximize earnings on our asset/liability position in certain interest rate environments, including using short-term liabilities to fund longer-term assets. Any such strategies are managed within the established sensitivity limits discussed beginning on page 45.

Exposure to changes in the level and direction of interest rates is managed by adjusting the Bank's mix of interest-sensitive assets and liabilities through various strategies and through the utilization of interest rate risk management products, including interest rate swaps and other financial instruments (derivatives). We do not use derivatives for speculative or trading purposes. Refer to page 46 for additional information related to derivatives.

Prepayment/Extension Risk

Prepayment risk in our loan portfolio exists in loans that are considered fully prepayable, which represents approximately 19 percent of fixed-rate loans that can be prepaid without a fee. Prepayment risk in this portfolio results when longer-term fixed interest rates fall and prepayments increase as borrowers refinance to a lower rate. Prepayments can adversely impact loan portfolio income to the extent prepayments exceed the level of fixed-rate callable debt in the portfolio. This funding can be called in lower-rate environments, thus allowing liabilities to reprice to a lower rate. Approximately 61 percent of our fully prepayable loan portfolio is funded with callable debt, which lowers prepayment risk.

The remaining 81 percent of fixed-rate loans contain, at a minimum, make-whole prepayment penalties. These provisions require a borrower to compensate us for the cost we incur in retiring debt funding associated with loan prepayments. This allows us to generally fund our loan assets with debt of similar maturities to manage the risk of prepayments in the loan portfolio.

Extension risk in the loan portfolio occurs when long-term interest rates rise and prepayments decrease more than expected causing the underlying loans to pay down at a slower rate than initially expected. In this scenario, loan portfolio income will be negatively impacted as additional higher-rate term funding is required to continue to fund extended loans.

Prepayment risk in the investment portfolio results when long-term interest rates fall and prepayments increase as underlying borrowers refinance their mortgages to a lower rate. Prepayments adversely affect investment portfolio income in a falling interest rate environment because investments are partially funded with non-callable debt and any proceeds from prepaid investments will be reinvested at a lower interest rate. Prepayment risk in our investment portfolio is moderate based on the type and average life of securities. Purchases of MBS are currently subject to a price risk eligibility test based on a stressed interest rate environment. The test is designed to manage our exposure to prepayment risk at the time of investment purchase. In addition, our fixed-rate MBS (other than hybrid adjustable-rate mortgage securities), generally contain some embedded prepayment protection in the form of PAC (planned amortization class) bands. These PAC securities are structured so that principal payments are expected to follow a predetermined schedule as long as the prepayments of the underlying collateral fall within a prescribed band. Over time, these bands may erode resulting in an incremental increase in prepayment risk within the investment portfolio.

We also fund a portion of our fixed-rate prepayable investment portfolio with short-term liabilities and term fixed-rate callable debt that provide a partial hedge against investment prepayments in certain falling interest rate scenarios. The rate we pay on these liabilities reprices downward with a drop in short-term and intermediate-term interest rates. In addition, we are able to retire the short-term liabilities if prepayments increase on the funded assets independent of movements in interest rates.

Extension risk in the investment portfolio occurs when long-term interest rates rise and prepayments decrease more than expected causing the underlying investment securities to pay down at a slower rate than initially expected. In this scenario, investment portfolio income will be negatively impacted as additional higher-rate term funding is required to continue to fund extended securities. Extension risk in the investment portfolio is moderate based on the type and average life of securities purchased. In the same way PAC bands protect against prepayment risk, they also serve to limit extension risk as the amortization of these securities is defined as long as prepayments of the underlying collateral fall within a prescribed band.

Cap Risk

Cap risk is embedded in the floating-rate MBS in our investment portfolio. When short-term interest rates rise, the interest rate paid by the floating-rate MBS may become capped and limit the amount of income paid by the securities while underlying funding costs are not capped. Exposure to cap risk is managed by monitoring the concentration of strike levels in our floating-rate MBS and related interest rate shock sensitivities. We also purchase interest rate caps and other derivatives to manage cap risk. In addition, we have the ability to reduce cap risk by selling our floating-rate investment securities.

Basis Risk

Basis risk arises due to the differences between the interest rate indices used to price our assets and the indices used to fund those assets. We manage our basis risk through match funding, when possible, and using derivatives (primarily interest rate swaps) and other funding strategies. However, some basis risk will always exist as unanticipated loan volume changes cause an excess or shortage of some forms of funding.

Measurement and Monitoring of Interest Rate Risk

We utilize several key risk measurement and monitoring tools to assist in the management of interest rate risk. These include interest rate gap analysis, duration gap analysis, sensitivity analysis of net interest income and market value of equity, and net interest income forecasting, each of which is described in further detail in the following pages.

<u>Interest Rate Gap Analysis</u>

The interest rate gap analysis shown in the following table presents a comparison of interest-earning assets and interest-bearing liabilities in defined repricing timeframes as of December 31, 2012. The interest rate gap analysis is a static indicator that does not reflect future changes in repricing characteristics and may not necessarily indicate the sensitivity of net interest income in a changing interest rate environment.

Interest Rate Sensitivity Analysis at December 31, 2012 ($ in Millions)

	One Month or Less	Over One Month Through Six Months	Over Six Months Through One Year	Over One Year Through Five Years	Over Five Years and Not Rate Sensitive	Total
Interest-earning Assets:						
Floating-rate Loans:						
Adjustable-rate/Indexed-rate Loans	$ 17,627	$ 3,054	$ 109	$ 105	$ -	$ 20,895
Administered-rate Loans	12,459	-	-	-	-	12,459
Fixed-rate Loans:						
Fixed-rate Loans [(1)]	6,851	4,821	2,445	8,691	8,266	31,074
Fixed-rate Loans, Prepayable [(2)]	583	1,238	1,226	3,243	1,092	7,382
Nonaccrual Loans	-	-	-	-	170	170
Total Loans	37,520	9,113	3,780	12,039	9,528	71,980
Investment Securities	6,539	2,619	1,045	6,212	1,584	17,999
Total Interest-earning Assets [(3)]	$ 44,059	$ 11,732	$ 4,825	$ 18,251	$ 11,112	$ 89,979
Interest-bearing Liabilities:						
Callable Bonds and Notes	$ 238	$ 1,349	$ 134	$ 1,792	$ 2,264	$ 5,777
Noncallable Bonds and Notes [(4)]	29,605	9,312	6,919	21,135	9,580	76,551
Bonds, Medium Term Notes and Discount Notes [(4)]	29,843	10,661	7,053	22,927	11,844	82,328
Effect of Interest Rate Swaps, Forwards, Futures, etc.	15,233	(1,458)	(1,495)	(12,280)	-	-
Cash Investment Services Payable and Other Interest-bearing Liabilities	2,184	-	-	-	-	2,184
Total Interest-bearing Liabilities	$ 47,260	$ 9,203	$ 5,558	$ 10,647	$ 11,844	$ 84,512
Interest Rate Sensitivity Gap (Total Interest-earning Assets less Total Interest-bearing Liabilities)	$ (3,201)	$ 2,529	$ (733)	$ 7,604	$ (732)	$ 5,467
Cumulative Gap	$ (3,201)	$ (672)	$ (1,405)	$ 6,199	$ 5,467	
Cumulative Gap/Total Interest-earning Assets	(3.56) %	(0.75) %	(1.56) %	6.89 %	6.08 %	

(1) Prepayment penalties apply that compensate CoBank for economic losses

(2) Freely prepayable or only minimal prepayment penalties apply

(3) Does not include $1.3 billion in cash as of December 31, 2012

(4) Includes subordinated debt

The previous table excludes $1.3 billion of cash as of December 31, 2012. While cash is not considered an interest-earning asset, we include our cash balance in the sensitivity analysis discussed below, as we would invest such funds in overnight or other highly-liquid investments if market rates increased. Our interest rate sensitivity position at December 31, 2012 may be characterized as slightly "liability sensitive." Typically, when our position is liability-sensitive, our net interest income will be favorably impacted in a stable or declining interest rate environment or when the slope of the yield curve is positive. This position will be unfavorably impacted in a rising interest rate environment or when the slope of the yield curve is negative. We have adjusted our position to be slightly liability-sensitive in anticipation of stable short-term rates and a positively sloped yield curve over the near term.

We continually monitor interest rates and have the ability to reposition our balance sheet as a result of anticipated interest rate changes. For example, if we expected a more immediate and meaningful increase in short-term interest rates, we could shift our position to an asset-sensitive position in short order.

Duration Gap Analysis

The duration gap is the difference between the estimated durations of assets and liabilities, which is calculated using an asset/liability model. The duration gap summarizes the extent to which estimated cash flows for assets and liabilities are matched, on average, over time. A positive duration gap means there is increased market value exposure to rising interest rates over the long-term because it indicates that the duration of our assets exceeds the duration of our liabilities. A negative duration gap indicates increased exposure to declining interest rates over the long-term because the duration of our assets is less than the duration of our liabilities. We apply the same interest rate process, prepayment models, and volatility assumptions to generate the portfolio duration gap that we use in our sensitivity analysis, which is discussed below. The duration gap provides a relatively concise and simple measure of the interest rate risk inherent in our balance sheet, but it is not directly linked to expected future earnings performance. Our aggregate positive duration gap was 2.6 months at December 31, 2012 and 2.1 months at December 31, 2011.

Sensitivity Analysis

We use asset/liability models to evaluate the dynamics of our balance sheet and to estimate earnings volatility under different interest rate scenarios. Our analysis includes calculating the impact of significant increases or decreases in interest rates on net interest income, over a twelve month period, and the estimated market value of equity. Our modeling practices have been consistently applied in each of the three years presented in this report.

Our analysis estimates the effect of immediate and sustained parallel shifts in the yield curve (called "shocks") of 100, 200 and 300 basis points. Pursuant to regulation and our Board policy, when the three-month Treasury rate is below 4 percent, as it was for each of the periods presented, we perform a shock equal to one-half the three-month Treasury rate. This resulted in downward shocks of -3 basis points, -1 basis point, and -6 basis points at December 31, 2012, 2011, and 2010, respectively. Due to extremely low short-term interest rates, these downward shock scenarios, while required by policy, are not considered meaningful. When analyzing net interest income at risk, we also estimate the effect of gradual upward or downward changes in market rates (called "ramps") over a one year period of 100, 200 and 300 basis points, where possible.

The following table summarizes the impact of interest rate changes on net interest income and the market value of equity. Market value of equity is the net present value of all future cash flows discounted to a valuation date, using discounting factors derived from observed market rates on the same valuation date. In all cases, the underlying assumptions and hedging strategies are held constant so that results are comparable from scenario to scenario. However, actual results would differ to the extent changes in strategy were undertaken to mitigate the unfavorable impact of interest rate changes.

Net Interest Income at Risk

December 31,	2012	2011	2010
Scenario:			
- 300 bp shock	**n/a**	n/a	n/a
- 200 bp shock	**n/a**	n/a	n/a
- 100 bp shock	**n/a**	n/a	n/a
- 6 bp shock	**n/a**	n/a	-
- 3 bp shock	**(0.1) %**	n/a	n/a
- 1 bp shock	**n/a**	-	n/a
+ 100 bp shock	**0.6**	-	0.2 %
+ 200 bp shock	**(0.7)**	(0.3) %	0.7
+ 300 bp shock	**(2.0)**	(0.9)	1.1
- 300 bp ramp	**n/a**	n/a	n/a
- 200 bp ramp	**n/a**	n/a	n/a
- 100 bp ramp	**n/a**	n/a	n/a
+ 100 bp ramp	**1.2**	0.6	0.1
+ 200 bp ramp	**1.5**	1.3	0.7
+ 300 bp ramp	**1.4**	1.9	1.4

Market Value of Equity at Risk

December 31,	2012	2011	2010
Scenario:			
- 300 bp shock	**n/a**	n/a	n/a
- 200 bp shock	**n/a**	n/a	n/a
- 100 bp shock	**n/a**	n/a	n/a
- 6 bp shock	**n/a**	n/a	0.2 %
- 3 bp shock	**0.3 %**	n/a	n/a
- 1 bp shock	**n/a**	-	n/a
+ 100 bp shock	**(4.7)**	(4.1) %	(3.7)
+ 200 bp shock	**(10.0)**	(8.8)	(7.2)
+ 300 bp shock	**(15.4)**	(13.3)	(10.7)

Our net interest income is lower in the rising interest rate scenarios due to our liability-sensitive position. Our Board limits the amount of adverse change to net interest income and market value of equity under a 200 basis point rate shock. The limit for market value of equity was 15 percent and the limit for net interest income was 10 percent for all three years presented. At December 31, 2012, 2011 and 2010, we were within our policy limits as detailed in the preceding table.

Forecasting

We update our asset/liability model monthly with information on loans, investment securities, borrowings and derivatives. This "current position" is the starting point for all analysis. The current position data is then combined with base case business plan assumptions and independent, third-party economic forecasts to derive our estimates of future net interest income. Generally, we set assumptions on pricing, maturity characteristics and funding mix using trend analysis of actual asset and liability data.

Net interest income forecasts are derived utilizing different interest rate scenarios. As noted previously, we obtain independent market interest rate projections when preparing our forecasts. These interest rate projections are designed around economic forecasts that are meant to estimate the most likely path of interest rates for the planning horizon and alternate views of a rapidly expanding economy, and a dramatically slowing economy. In addition, we review scenarios based on the market's implied forward rates and unchanged rates. We also review the impact on net interest income of parallel and nonparallel shifts in the yield curve over different time horizons using stochastic processes, or those involving a randomly determined sequence of observations.

Use of Derivatives

We use derivatives as an integral part of our interest rate risk management activities. To achieve risk management objectives and satisfy the financing needs of our borrowers, we execute various derivative transactions with other financial institutions. Derivatives (primarily interest rate swaps) are used to manage liquidity and the interest rate risk arising from maturity and repricing mismatches between assets and liabilities. In addition, we execute foreign exchange spot and forward contracts to manage currency risk on our relatively nominal amount of loans denominated in foreign currencies. The notional amounts of derivatives, weighted average interest rates to be received and paid, and fair values at December 31, 2012, are shown in the following table. We also discuss derivatives in Note 12 to the accompanying consolidated financial statements.

Derivative Financial Instruments at December 31, 2012 ($ in Millions)

Derivative Product	Notional Amount	Weighted Average Receive Rate	Weighted Average Pay Rate	Fair Value
Receive Fixed Swaps	$ 17,672	2.32 %	0.22 %	$ 876
Receive Fixed Amortizing Swaps	1,735	2.33	0.30	104
Pay Fixed Swaps	1,878	0.28	1.81	(74)
Pay Fixed Amortizing Swaps	1,735	0.30	2.05	(76)
Interest Rate Options	3,049	-	-	19
Foreign Currency Spots and Forwards	292	-	-	(2)
Total	$ 26,361	2.00 %	0.49 %	$ 847

The following section includes a summary of our derivatives portfolio by strategy and further explanation of each strategy.

Notional Amounts of Derivative Financial Instruments by Strategy ($ in Millions)

December 31,	2012	2011	2010
Liquidity Management	**$ 13,304**	$ 14,364	$ 21,474
Equity Positioning	**2,489**	2,903	3,088
Options Risk Management [1]	**2,880**	1,850	1,850
Customer Transactions	**7,445**	6,193	4,411
Foreign Currency Risk Management [2]	**243**	243	131
Total	**$ 26,361**	$ 25,553	$ 30,954

[1] Excludes $169.0 million, $149.0 million and $206.0 million of interest rate options at December 31, 2012, 2011 and 2010, respectively, which are classified as customer transactions.

[2] Excludes $49.0 million, $56.0 million and $68.0 million of foreign currency spots and forwards at December 31, 2012, 2011 and 2010, respectively, which are classified as customer transactions.

The total notional amount of our derivatives portfolio increased by $808.0 million in 2012 due to a greater level of customer transactions and increased usage of derivatives to hedge cap risk in our investment portfolio. The total notional amount of derivatives decreased by $5.4 billion in 2011 due to reduced usage of derivatives for purposes of managing liquidity. Over the past two years, market conditions have allowed for better execution of outright term floating-rate debt instead of issuing term fixed-rate debt and using interest rate swaps to transform such debt to a floating rate.

Liquidity Management

Interest rate swaps are executed to improve liquidity, primarily by effectively converting specific longer-term fixed-rate bonds and notes into floating-rate debt indexed to LIBOR or similar short-term rates. The fixed rate received on the swap largely offsets the fixed rate paid on the associated debt leaving a net floating rate payment on the swap. This allows us to issue longer-term debt and still match fund the predominantly short-term repricing nature of our interest-sensitive asset portfolio. Liquidity risk management is discussed further beginning on page 48.

Equity Positioning

We also use interest rate swaps to manage interest rate risk as it relates to investment of our equity. If the cash flows of loans and investments on the balance sheet do not create the targeted maturity for the investment of our equity, we enter into receive-fixed interest rate swaps to produce the desired equity investment maturity profile.

Options Risk Management

In the course of managing risk in the investment portfolio, we periodically hedge cap risk embedded within our floating-rate investment securities that do not meet our current risk management objectives. We enter into offsetting derivative transactions to hedge this risk.

Customer Transactions

Derivatives are offered to customers as a service to enable them to modify or reduce their interest rate and foreign exchange risk by transferring such risk to us. We substantially offset this risk transference by concurrently entering into offsetting agreements with counterparties.

Foreign Currency Risk Management

We enter into foreign exchange spot and forward contracts to manage currency risk on our relatively nominal amount of loans denominated in foreign currencies. Typically, foreign currency contracts are purchased to fund the principal cash flows of the loan and simultaneously sold to lock in the principal and interest cash flows upon the repricing or maturity date of the loan.

Counterparty Exposure

The use of derivative instruments exposes us to counterparty credit risk. Credit risk associated with derivatives is measured based on the replacement cost that would be incurred should the counterparties with contracts in a net gain position with respect to CoBank fail to perform. We minimize this risk by diversifying our derivative positions among various counterparties using master netting agreements, and requiring collateral with zero thresholds and daily posting to support credit exposures with active counterparties. We evaluate the creditworthiness of each counterparty, establishing individual credit exposure limits, and deal exclusively with derivative counterparties that have an investment grade credit rating from a major credit rating agency. In addition, we monitor counterparty credit default swap spreads and other market-related information which may indicate reduced creditworthiness of a counterparty. Credit default swap spreads are taken into account in establishing counterparty limits.

We measure counterparty credit risk daily based on the current fair market values of our derivative positions. Personnel who are independent of the derivative portfolio management function monitor the derivative exposures against approved limits. Exceptions to approved limits, along with a plan detailing actions to address limit overages, are reported to the CLC. Changes to the counterparty limits must be approved by the CLC.

We also perform stress tests on the derivative portfolio using asset/liability models to analyze the potential effects of market rate changes on fair value, including extreme rate changes. The forward interest rate curves used to project the future expected cash flows for the derivative positions are modeled under potential scenarios which increase and decrease interest rates within a 99 percent confidence interval. These extreme rate scenarios are then used to further evaluate potential counterparty credit risk and to establish placement limits.

Notwithstanding our credit evaluation process and the maintenance of collateral agreements with our derivative counterparties, the failure of a counterparty to perform on its obligations could negatively impact our earnings. Furthermore, although our credit evaluations consider the possibility of default by a counterparty, our ultimate exposure to default by a counterparty could be greater than expected.

The following table details the notional amount of our derivatives and related exposure to dealer counterparties classified by their Standard & Poor's credit rating as of December 31, 2012.

Derivative Counterparty Exposure ($ in Millions)

	AAA	AA	A	Below A
Exposure to Counterparties in Net Gain Position	$ -	$ 286	$ 475	$ -
Collateral Held	-	281	467	-
Exposure, Net of Collateral	$ -	$ 5	$ 8	$ -
Total Notional Amount	$ -	$ 9,716	$ 12,932	$ -
Total Number of Counterparties	-	6	12	-

The notional amount of our derivatives and related exposure to customer counterparties were $3.7 billion and $189.0 million, respectively, at December 31, 2012 compared to $3.1 billion and $152.5 million, respectively, at December 31, 2011. Customer derivative agreements are secured through our loan agreements.

Liquidity Risk Management

We must continually raise funds to provide credit and related services to customers, repay maturing debt obligations and meet other obligations.

Our primary source of liquidity is the ability to issue Systemwide Debt Securities, as well as the use of available cash. Additionally, if necessary, we could convert high credit quality, liquid investments to cash. We and other System banks maintain a liquidity framework wherein U.S. Treasury and other U.S. government-guaranteed securities are maintained. Pursuant to these requirements, the first 15 days of maturing debt coverage must be maintained with cash, cash equivalents and/or U.S. Treasury securities with maturities of less than three years. The next 30 days of debt coverage is generated from investment securities with an explicit guarantee from the U.S. government, and highly-rated commercial paper that matures in 45 days or less. We were in compliance with the 15 and 45 day liquidity requirements throughout 2012.

As a result of the System's credit quality and standing in the capital markets as a GSE, we have traditionally maintained ready access to debt-funding, notwithstanding volatility in the credit markets and the 2011 downgrades of the long-term U.S. sovereign credit rating and the System's long-term debt rating, as discussed in "Other Risk Factors" beginning on page 50.

Our liquidity management objectives are to meet maturing debt obligations, provide a reliable source of funding to borrowers, provide additional liquidity if market conditions deteriorate for a period of time and fund operations on a cost-effective basis. Approximately 67 percent of our interest-earning assets mature or reprice in one year or less with 49 percent maturing or repricing in one month or less. Match-funding these assets from a maturity perspective would create an unacceptable concentration of short-term liabilities. Instead, we manage this risk by issuing longer-term debt and swapping this debt from a fixed to floating rate using derivative transactions, as previously described, or with the issuance of term floating-rate debt. By so doing, we reduce the need to fund maturing liabilities on any given business day to a more manageable level. While we believe that sufficient resources are available to meet liquidity management objectives through our debt maturity structure, holdings of liquid assets and access to the capital markets via the Funding Corporation, the volatility of our loan volume causes our liquidity needs to vary significantly from day to day.

The amounts and maturities of our debt obligations are set forth in the table below.

Debt Maturities as of December 31, 2012 ($ in Millions)

	Book	Par
1 Day [(1)]	$ 2,184	$ 2,184
2-7 Days	269	269
8-30 Days	2,253	2,253
31-90 Days	4,664	4,662
91-180 Days	6,756	6,750
181-365 Days	11,671	11,508
1-5 Years	43,557	42,567
Over 5 Years	13,158	13,065
Total	$ 84,512	$ 83,258

[(1)] Includes $555.9 million of cash collateral payable to derivative counterparties that does not have a stated maturity date.

See Notes 6 and 16 to the accompanying consolidated financial statements for information regarding interest rates and maturities of Systemwide Debt Securities, and contingencies.

Due to the often volatile funding needs of certain customer sectors, in particular Agribusiness customer sectors impacted by seasonal borrowing requirements and changing commodity prices, we provide a significant amount of revolving loan commitments. At December 31, 2012, commitments to extend credit and commercial letters of credit were $30.4 billion and $287.1 million, respectively. In addition, we provide standby letters of credit, which guarantee payment or performance of an obligation. As of December 31, 2012, the maximum potential amount of future payments that we may be required to make under standby letters of credit was $1.4 billion. Since many of these commitments may expire without being drawn, the total commitments do not necessarily represent future cash requirements. Our exposure to many of these commitments is mitigated by borrowing base requirements contained in loan agreements. See Note 11 to the accompanying consolidated financial statements for a full discussion of financial instruments with off-balance sheet risk.

We monitor our liquidity position by assuming no ability to issue debt and calculating the number of days into the future we could meet maturing debt obligations by using available cash and liquidating eligible investments. System banks are required by regulation to maintain a minimum of 90 days of liquidity (cash and readily marketable investments generally discounted by 5 to 10 percent of market value) on a continuous basis. However, as a result of the merger with AgBank, we maintain a higher minimum of 130 days liquidity. Additionally, through December 31, 2014, if days liquidity were to fall below 150 for five consecutive days, the Bank must notify the FCA and submit to them a written plan to restore and maintain the 150 days level. At December 31, 2012, our liquidity was 204 days, compared to 234 days at December 31, 2011. During 2012, we averaged 190 days of liquidity compared to an average of 199 days in 2011. Our days liquidity declined from 2011 as we have managed our liquidity closer to our target level of 180 days.

An additional source of liquidity is cash provided by our operating activities (primarily generated from net interest income in excess of operating expenses), which totaled $884.0 million, $952.7 million and $598.1 million in 2012, 2011 and 2010, respectively. Further, assets of the Insurance Fund would be used to repay maturing Systemwide Debt Securities, to the extent available, if no other sources existed to repay such debt.

Our liquidity plan covers certain contingencies in the event our access to normal funding sources is disrupted. We purchase only high credit quality investments to ensure our investment portfolio is readily marketable and available to serve as a source of contingent funding. Our investment portfolio may also be used as collateral to borrow funds to cover maturing liabilities. Pursuant to FCA regulations, non-agency mortgage- and asset-backed securities, which include our FHA/VA non-wrapped reperformer MBS, that are no longer rated AAA by at least one major rating agency must be excluded from our liquidity reserve. Approximately $877.0 million of these investment securities have been downgraded to ratings below AAA and are no longer included in our liquidity reserve as of December 31, 2012. Another $222.6 million of investment securities, primarily representing Farmer Mac MBS, are also excluded from our liquidity reserve.

We have identified certain portions of our loan portfolio that we believe could be sold or participated in the event our access to normal funding mechanisms is disrupted. These loans serve as an additional source of contingent funding. We also maintain uncommitted lines of credit with various financial institutions that could provide liquidity during unanticipated short-term disruptions in funding. However, it is uncertain whether we would be able to sell or participate loans or fully utilize uncommitted lines of credit in the event of a systemic funding disruption.

Operational Risk Management

Operational risk is inherent in all business activities and the management of such risk is important to the achievement of our objectives. Operational risk represents the risk of loss resulting from conducting our operations, including the execution of unauthorized transactions by employees; errors relating to loan documentation, transaction processing and technology; the inability to perfect liens on collateral; breaches of internal control systems; and the risk of fraud by employees or persons outside the Bank. This risk of loss also includes potential legal actions that could arise as a result of operational deficiencies, noncompliance with regulatory standards, employee misconduct or adverse business decisions. In the event of a breakdown in the internal control system, improper access to or operation of systems or improper employee actions, the Bank could incur financial loss or face regulatory action.

We utilize a risk management framework, business policies and processes, and employee training to manage operational risk. Under this framework, business segments and support units have direct and primary responsibility and accountability for identifying, controlling and monitoring operational risk. Business managers maintain controls with the objective of providing proper transaction authorization and execution, proper system operations, safeguarding of assets from misuse or theft and ensuring the reliability of financial and other data. Employees receive regular training on business ethics, fraud identification and prevention, compliance with laws and regulations, and information security. We also mitigate operational risk through the use of insurance coverages.

Business continuity and disaster recovery planning is also important to effectively manage our operational risks. Each critical business unit, as well as our Information Technology Division, is required to develop, maintain and test such plans at least annually to ensure that continuity and recovery activities, if needed, could sustain critical functions including systems and information supporting customers and business operations. While we believe that we have designed effective business continuity policies and procedures, there is no absolute assurance that business disruption or operational losses would not occur in the event of a disaster.

Our Risk Management Group is responsible for, among other matters, coordinating the completion of ongoing risk assessments and ensuring that operational risk management is integrated into business decision-making activities. In addition, this group, in coordination with the Audit Committee of the Board of Directors, determines the scope and level of review performed by the internal audit function. Our internal audit function validates the system of internal controls through risk-based, regular and ongoing audit procedures, and reports on the effectiveness of internal controls to executive management and the Audit Committee of the Board of Directors. In addition, the president and CEO reports annually to the Audit Committee of the Board of Directors on the current state of the Bank's risks and controls.

To enhance our governance and internal controls, we apply policies and procedures that mirror the material provisions of the Sarbanes-Oxley Act of 2002, including section 404, *Management Assessment of Internal Controls Over Financial Reporting.*

Reputation Risk Management

Reputation risk is the risk to earnings and capital arising from the loss of confidence, trust and esteem among customers, investors, partners, policymakers, shareholders and other key stakeholders. Like all businesses, the Bank is subject to a wide variety of reputation risks both within and outside its control, including credit difficulties with individual customers or industries, business disputes, lawsuits, credit market disruptions, regulatory events and public allegations of misconduct against employees. As a member of the Farm Credit System, the Bank could be indirectly impacted by events that damage the reputation of another System entity.

The Board of Directors and management regard the Bank's reputation as a critical asset and have implemented a number of policies, procedures and programs to ensure it is well protected. The controls and processes surrounding credit risk, interest rate risk, liquidity risk and operational risk also mitigate reputation risk by lowering the likelihood of significant problems in each of those areas. In addition, the Bank has a formal crisis communications plan in place in order to help it manage communications with stakeholders if an unplanned, reputation-impacting event occurs. The Bank also has a variety of initiatives in place to ensure that customer-owners are communicated with openly and have access to the information they need to accurately evaluate the Bank's overall business and financial performance. Furthermore, customers, Farm Credit partners and others have regular access to members of the Board of Directors and management through numerous meetings and events held by the Bank throughout the year.

We place considerable emphasis on ethical behavior and ensure that our directors and employees receive regular training related to business ethics, fraud identification and prevention, compliance with laws and regulations, and information security. In addition, as discussed on page 150, each year all employees certify their compliance with our Associate Responsibilities and Conduct Policy. Finally, the Bank actively supports and participates in the System's reputation management committee, which consists of representatives from Farm Credit Banks and Associations.

Other Risk Factors

Joint and Several Liability for the Debt of the Farm Credit System

Farm Credit System Banks and Associations are not authorized to accept deposits and therefore cannot use deposits as a funding source. Instead, Banks raise funds for their operations primarily through Systemwide Debt Securities issued on the Banks' behalf by the Funding Corporation. Systemwide Debt Securities are the joint and several liabilities of the System banks and are not obligations of, nor are they guaranteed by, the U.S. government or any agency or instrumentality thereof, other than the System banks. Under the Farm Credit Act, each System bank is primarily liable for the portion of the Systemwide Debt Securities issued on its behalf. At December 31, 2012, we were primarily liable for $81.4 billion of Systemwide Debt Securities. Additionally, each System bank is contingently liable for Systemwide Debt Securities of the other System banks. At December 31, 2012, the total aggregate principal amount of the outstanding Systemwide Debt Securities was $198.0 billion.

Although the System banks have established mutual covenants and measures, which are monitored on a quarterly basis, there is no assurance that these would be sufficient to protect a System bank from liability should another System bank default and the Insurance Fund be insufficient to cure the default. See Note 16 to the accompanying consolidated financial statements for a more complete description of the interbank agreements among the System banks.

The Insurance Fund, which totaled $3.3 billion as of December 31, 2012, is available from the Insurance Corporation to ensure the timely payment by each System bank of its primary obligations on Systemwide Debt Securities and can also be used by the Insurance Corporation for its operating expenses and for other mandatory and permissive purposes. Under the Farm Credit Act, before joint and several liability can be invoked, available amounts in the Insurance Fund would first be exhausted. There is no assurance, however, that the Insurance Fund would have sufficient resources to fund a System bank's defaulted obligations. If the Insurance Fund was insufficient, then the remaining System banks would be required to pay the default amount in proportion to their respective available collateral positions. Available collateral approximates the amount of total shareholders' equity of the System banks.

To the extent we must fund our allocated portion of another System bank's portion of the Systemwide Debt Securities due to a default, our earnings and total shareholders' equity would be reduced, possibly materially. The Insurance Corporation does not insure any payments on our subordinated debt, preferred stock or common stock. See Note 6 to the accompanying consolidated financial statements for more information about the Insurance Fund.

Our Funding Costs Would Increase if the Farm Credit System Lost its Status as a Government Sponsored Enterprise

The System is a GSE and, as a member of the System, CoBank benefits from favorable debt-funding costs. Additionally, our individual credit ratings are positively impacted by the GSE status of the System.

The two largest housing GSEs, Fannie Mae and Freddie Mac, have been under increased public and congressional scrutiny as a result of their significant operating losses and U.S. government efforts to strengthen their capital and provide liquidity for securities they issue. Congressional deliberations over structural reform related to these housing GSEs are likely to continue for a number of years. The Farm Credit System has not been the subject of this specific congressional scrutiny, nor is it subject to the jurisdiction of the same congressional committees as the housing GSEs. However, we believe there is at least some risk that further efforts to regulate GSEs could impact the System's status or erode some of the GSE-related benefits that it currently enjoys, including favorable funding costs and funding flexibility.

Our Funding Costs Could Be Negatively Impacted by Downgrades of the Long-Term U.S. Sovereign Credit Rating and the System's Long-Term Debt Rating

As a member of the System, we have historically benefited from the favorable funding costs and funding flexibility associated with the debt securities issued through the Funding Corporation. In August 2011, Standard & Poor's Ratings Services (S&P) downgraded the long-term sovereign credit rating of the United States from AAA to AA+ with a negative outlook. The credit ratings of GSEs, including the System, are influenced by the sovereign credit rating of the United States. As a result, S&P also lowered its long-term debt rating of the System from AAA to AA+. The ratings of individual System banks rated by S&P, including CoBank, were not affected. Notwithstanding these actions, to date we have continued to access the funding necessary to support our lending and business operations. However, the risk of further downgrades by S&P, Moody's, and Fitch is heightened given the current debate around U.S. government deficits and the debt ceiling. Any future downgrades could negatively impact funding costs, earnings and funding flexibility for CoBank and other System institutions.

Our Funding is Dependent Upon the System's Ability to Access the Capital Markets

The primary source of liquidity for CoBank and the other System institutions is the ability to issue Systemwide Debt Securities. This access has provided the System with a dependable source of low cost debt. The System's ability to continue to issue Systemwide Debt Securities depends, in part, on the conditions in the capital markets at that time, which is outside the System's control and creates a funding risk for all System banks. As a result, the System cannot make any assurances that it will be able to issue on CoBank's behalf low cost debt or any debt at all. If the System cannot issue low cost debt or cannot access the capital markets, CoBank's funding would be negatively impacted, which would have a negative effect on our financial condition and results of operations, possibly materially.

We are Subject to Liquidity Risk with Respect to Certain Investments and Derivatives

We are subject to liquidity risk in the course of our investing activities, particularly with respect to our investments in non-agency MBS and ABS, and FHA/VA non-wrapped reperformer MBS, which together represent approximately 5 percent of our investment securities held for liquidity. As a result of volatile market conditions, it could be difficult to sell such investments, if the need arises, and the discounts from face value would likely be significant. In addition, because of the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of our investments may differ significantly from the values that would have been used had a ready market existed for the investments.

Our derivative contracts require the Bank or its counterparties to post cash or securities as collateral when the fair values of the derivatives change based on changes in interest rates. The collateral exchanged between parties occurs daily with zero posting thresholds for all dealer counterparties. As a result of these derivative contracts, we are exposed to liquidity risk when changes in interest rates require us to post collateral to our counterparties. As of December 31, 2012, our counterparties had posted $555.9 million in cash and $195.3 million in securities as collateral with us. At December 31, 2012, a parallel increase of 2.0 percentage points in the U.S. dollar LIBOR/swap curve would have required us to return approximately half of the collateral currently posted with us by our counterparties. Further, cash collateral we have posted at December 31, 2012 of $17.0 million would more than double in such a scenario.

CoBank and its Affiliated Associations Face Intense Competition

CoBank and its affiliated Associations face intense competition, primarily from mortgage banking companies, commercial banks, thrift institutions, insurance companies and finance companies. CoBank's and its affiliated Associations' future results may become increasingly sensitive to fluctuations in the volume and cost of their retail lending activities as well as wholesale loan purchases resulting from competition from other lenders and purchasers of loans. There can be no assurance that CoBank and its affiliated Associations will be able to continue to compete successfully in the markets they serve.

Regulatory Reforms Could Adversely Impact System Banks, Including CoBank, and Associations

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) was signed into law on July 21, 2010. Under the Dodd-Frank Act, the federal banking agencies, the U.S. Securities and Exchange Commission, the Commodity Futures Trading Commission and a variety of other regulatory agencies are required to adopt a broad range of new rules and regulations that will significantly reform the supervision and regulation of the financial services industry. These federal agencies have been given significant discretion in drafting and implementing rules and regulations, and consequently, much of the impact of the Dodd-Frank Act may not be known for many more months or years. The Dodd-Frank Act largely preserves the authority of the FCA as the System's regulator by excluding System institutions from certain of the law's provisions. It is possible that the FCA might choose to adopt by regulation some reforms for System institutions that are similar to those provided for other financial institutions in the Dodd-Frank Act. Should the FCA adopt similar reforms, it is not clear to what extent, if any, such reforms would impact us.

Additionally, the Basel Committee on Banking Supervision (the Basel Committee) released consultative proposals in December 2009 aimed at strengthening global capital and liquidity regulations. The Basel Committee adopted revised versions of the consultative proposals as definitive frameworks in December 2010, and made further revisions in June 2011. This framework is often referred to as "Basel III." On July 8, 2010, the FCA published an Advance Notice of Proposed Rulemaking (ANPR) in the Federal Register, requesting comments as to whether the FCA should replace the existing regulatory capital requirements with a capital tier framework similar to the capital tiers and related requirements set forth in the Basel Accord (Basel I) that other federal financial regulatory agencies have adopted. In the capital ANPR, the FCA stated that it was important for the agency to consider the Basel III framework because the other federal financial regulatory agencies were members of the Basel Committee and had encouraged the public to review and comment on the Basel III proposal. The FCA asked commenters on the ANPR to review and consider the Basel III proposal. The FCA has not published any further rules related to the implementation of a capital tier framework since 2010.

Relationship with the Federal Agricultural Mortgage Corporation

Farmer Mac is a federally chartered corporation that was established to create a secondary market for agricultural mortgages and other loans. Since its formation, Farmer Mac's business model has evolved such that it now retains on its balance sheet agricultural mortgages and other loans similar to other System entities. Although Farmer Mac is statutorily defined as an institution of the System and is examined and regulated by the FCA, it is financially and operationally separate and distinct from the System, and neither CoBank nor any other System entity, other than Farmer Mac itself, is liable for any debt or obligation of Farmer Mac. Further, the assets of the Insurance Fund do not support any debt or obligation of Farmer Mac. Except for contractual obligations arising from business transactions between Farmer Mac and certain System institutions, Farmer Mac is not liable for any debt or obligation of any other System entity, including Systemwide Debt Securities, either directly or on a joint and several basis.

Unlike Systemwide Debt Securities and the System banks, including CoBank, neither Farmer Mac's debt obligations nor its corporate entity are currently rated by a NRSRO. The System's independent credit ratings do not apply to Farmer Mac and it should not be assumed that Farmer Mac would receive comparable ratings if it were rated by a NRSRO.

Unlike other System entities, Farmer Mac is not organized as a cooperative. By statute, the Farmer Mac board of directors consists of 15 members, of which five are representatives of the System, five are representatives of the commercial banking community and five are political appointees. Farmer Mac is stockholder-owned and certain series of its common shares are publicly traded. System entities, including CoBank, have a non-controlling ownership interest in Farmer Mac in the form of a non-publicly traded series of common stock. However, due to the lack of a liquid market for the Farmer Mac common stock we own, as well as our internal analysis of the risks inherent in Farmer Mac's overall business model and risk profile, such stock has no carrying value on CoBank's balance sheet. At December 31, 2012, we held $215.5 million in MBS guaranteed by Farmer Mac, which we obtained in the merger with AgBank. We place no reliance on such guarantee when determining the fair value of these MBS. Instead, we look solely at the underlying agricultural mortgage loans which were originated by and continue to be serviced by other System entities.

In 2008, CoBank and the other System banks provided Farmer Mac with a capital infusion, in the form of preferred stock, to strengthen Farmer Mac's capital position following the recognition of significant losses in its investment portfolio. The System's capital infusion allowed Farmer Mac to continue to comply with its statutory capital requirements, which are significantly lower than the regulatory capital requirements for other System entities. Farmer Mac redeemed all such preferred stock in 2010.

As an institution of the System, we believe that if Farmer Mac were to again experience financial difficulty, it could create financial, reputational and political risk to other System entities, including CoBank and its affiliated Associations, and the System as a whole. Notwithstanding, CoBank and the other System entities are not statutorily obligated to make any further investment in Farmer Mac.

Liquidity and Capital Resources

Funding

We use our capital in addition to short-term and long-term debt to fund our assets. Our debt consists primarily of Systemwide Debt Securities issued on CoBank's behalf by the Funding Corporation. Refer to Notes 6 and 7 to the accompanying consolidated financial statements for additional information regarding our debt obligations.

As a member of the System, CoBank has traditionally maintained ready access to debt funding. As of December 31, 2012, Systemwide Debt Securities were rated AAA by Moody's Investors Service and Fitch Ratings, and AA+ by Standard & Poor's Ratings Services.

Investment Securities and Cash

Investment securities and cash are primarily held for the purposes of maintaining a liquidity reserve and managing short-term surplus funds. In accordance with Board-approved policies, we purchase high credit quality investment securities to ensure that the investment portfolio is readily marketable and available to serve as a source of liquidity in the event of disruption to our normal funding sources.

Investment securities totaled $18.0 billion at December 31, 2012, and increased from $13.0 billion at December 31, 2011 primarily due to the merger. Our cash balances were $1.3 billion and $2.8 billion at December 31, 2012 and 2011, respectively.

As a result of our merger with AgBank, we acquired investment securities totaling $4.8 billion (fair value) on January 1, 2012, which consisted of U.S. Treasury and agency debt securities of $643.9 million, U.S. agency MBS of $3.2 billion, Farmer Mac MBS of $252.9 million, FHA/VA non-wrapped reperformer MBS of $554.1 million, non-agency MBS of $132.7 million and ABS of $58.5 million. Included within the acquired U.S. agency MBS portfolio of $3.2 billion are $296.7 million of certain FHA/VA reperformer MBS where the underlying loans are approximately 90 percent government guaranteed or insured, and which are further supported by guarantees from either Fannie Mae or Freddie Mac. The $554.1 million of FHA/VA non-wrapped reperformer MBS noted above are MBS where the underlying loans are also approximately 90 percent government guaranteed or insured but which have no guarantees from Fannie Mae or Freddie Mac. These securities carry unique credit risks, as previously discussed on page 41.

As part of business combination accounting, the fair value of all acquired investment securities became the carrying value as of the merger date. We do not expect to collect the full contractual amounts due on certain FHA/VA non-wrapped reperformer MBS, non-agency MBS and ABS acquired in the merger. For these investment securities, differences between the contractual amounts due and merger date fair value are classified into two categories: amounts expected to be collected ('accretable amounts') and amounts not expected to be collected ('non-accretable amounts'). Accretable amounts, which totaled $261.1 million for all acquired investment securities as of the merger date, will be recognized in income over the remaining life of the investment securities. Non-accretable amounts totaled $102.5 million as of the merger date, and related to $739.7 million (fair value) of the acquired investment securities.

The following table summarizes our investment securities and related unrealized gains/losses by asset class.

Investment Securities ($ in Millions)

December 31, 2012	Amortized Cost	Fair Value	Unrealized Gains (Losses)
U.S. Treasury and Agency Debt	$ 6,380	$ 6,491	$ 111
Mortgage-Backed:			
U.S. Agency	10,237	10,353	116
Farmer Mac	217	215	(2)
FHA/VA Non-Wrapped Reperformer	507	506	(1)
Non-Agency	271	292	21
Asset-Backed	97	121	24
Corporate Bonds	21	21	-
Total	$ 17,730	$ 17,999	$ 269
December 31, 2011			
U.S. Treasury and Agency Debt	$ 3,549	$ 3,638	$ 89
Mortgage-Backed:			
U.S. Agency	8,899	9,061	162
Non-Agency	265	242	(23)
Asset-Backed	78	54	(24)
Total	$ 12,791	$ 12,995	$ 204

At each reporting period, we perform impairment assessments of our investment securities based on evaluations of both current and future market and credit conditions and expected cash flows of these securities. Subsequent changes in market and credit conditions or expected cash flows could change these evaluations.

As all of our investment securities are classified as "available for sale", we recognize changes in the fair value of our investment securities in accumulated other comprehensive income (loss), a component of shareholders' equity, unless losses are credit-related and considered other-than-temporary, in which case that portion of the loss is recorded in earnings. We recorded unrealized gains on our investment securities of $65.7 million and $138.8 million in 2012 and 2011, respectively. The unrealized gains in 2012 primarily related to improved valuations for certain non-agency MBS and ABS, while the unrealized gains in 2011 were primarily driven by the impact of interest rate changes on the values of certain fixed-rate investment securities.

The most significant credit risk in our investment portfolio relates to the 5 percent of investment securities that do not contain either an implicit or explicit guarantee of the U.S. government, consisting of FHA/VA non-wrapped reperformer MBS, non-agency MBS, and ABS. These investment securities collectively totaled $918.6 million as of December 31, 2012. Credit risks associated with the acquired portfolio of FHA/VA non-wrapped reperformer MBS and certain other investment securities are discussed on page 41.

Credit risk in our investment portfolio also arises from the inability of guarantors and third-party providers of other credit enhancements, such as bond insurers or Farmer Mac, to meet their contractual obligations to us. As of December 31, 2012, we held $215.5 million of Farmer Mac MBS.

We recorded impairment losses in earnings of $17.0 million in 2012 and $10.0 million in 2011. The 2012 impairment losses related to five non-agency MBS and five ABS and included the impact of changes to assumptions in our loss models to better reflect current cash flow expectations. Five of the investment securities impaired in the current year (four MBS and one ABS) were among those identified as credit-impaired investment securities acquired as part of the AgBank merger. For additional discussion concerning these investment securities, refer to Note 3 to the accompanying consolidated financial statements. Increasing levels of defaults and foreclosures on residential mortgages, continued high unemployment, a decline in home prices or continued weak economic conditions may result in further downward adjustments to the fair value of certain investment securities and the need to record future impairment losses.

Derivatives

As described previously, we use derivatives in part to manage our liquidity position. Derivatives are recorded at fair value as assets or liabilities in the accompanying consolidated balance sheets. Changes in the fair value of these derivatives are accounted for as gains or losses through current period earnings or as a component of accumulated other comprehensive income (loss), depending on the use of the derivatives and whether they qualify for hedge accounting treatment. Net changes in the fair value of derivatives and hedged items recorded in the accompanying consolidated statements of income totaled gains of $4.0 million and $12.3 million for 2012 and 2011, respectively. Changes in the fair value of derivatives recorded as other comprehensive income (loss) totaled losses of $5.5 million and $0.5 million in 2012 and 2011, respectively.

Capital

We believe that a sound capital position is critical to our long-term financial success and future growth. We are primarily capitalized by common and preferred stock and by unallocated retained earnings. Our shareholders' equity totaled $6.4 billion and $4.9 billion at December 31, 2012 and 2011, respectively. The $1.5 billion increase was due to a $1.1 billion increase in common and preferred stock related to our merger with AgBank, $853.9 million of earnings, a $42.7 million increase in accumulated other comprehensive income, and a net $36.7 million increase in preferred stock, as further described below. These factors were partially offset by $344.5 million in cash patronage, $72.1 million in preferred stock dividends, $61.6 million in net fair value adjustments related to the merger, and $7.1 million of common stock retirements, net of common stock issuances.

On January 1, 2012, as part of the AgBank merger, each share of outstanding common stock of AgBank (Class A Common Stock, $5 par value, 177,162,554 shares outstanding; Class B Common Stock, $5 par value, 200 shares outstanding; Class C Common Stock, $5 par value, 200 shares outstanding) was exchanged for one-twentieth of a share of common stock of CoBank ($100 par value, 8,858,148 shares outstanding). In addition, AgBank's $225 million of preferred stock ($1,000 par value, 225,000 shares outstanding) was exchanged for $225 million of a new series (Series E) of CoBank non-cumulative perpetual preferred stock ($1,000 par value, 225,000 shares outstanding) with substantially the same terms and conditions.

On October 1, 2012, we redeemed all of our outstanding Series A and Series B cumulative perpetual preferred stock totaling $363.3 million. We used cash on hand to effectuate these redemptions. The dividend rates for our Series A and Series B preferred stock were 7.814 percent and 7.0 percent, respectively. On October 4, 2012, we issued $400 million of Series F non-cumulative perpetual preferred stock. We used the proceeds from the Series F preferred stock to increase our regulatory capital pursuant to current FCA regulations and for general corporate purposes. For regulatory capital purposes, our Series F preferred stock is included in permanent capital, total surplus and core surplus, whereas our Series A and Series B preferred stock were only included in permanent capital and total surplus. Further, our Series A preferred stock was not fully includable in our permanent capital and total surplus due to its dividend step-up feature. In addition to improving the quality of our capital, these preferred stock transactions resulted in lower dividend costs. Dividends on Series F preferred stock, if declared by the Board of Directors in its sole discretion, are non-cumulative and are payable quarterly at a fixed annual rate equal to 6.25 percent from the date of issuance up to, but excluding, October 1, 2022. Thereafter, dividends will accrue at an annual rate equal to 3-month USD LIBOR plus 4.557 percent.

In 2008, our shareholders approved a measure allowing CoBank to issue preferred stock, subject to FCA approval, up to the then bylaw limit of $1.0 billion outstanding, at any time through September 2018. In September 2011, in connection with the merger with AgBank, shareholders approved an increase to the preferred stock authorization and the bylaw limit to $1.5 billion outstanding. Such measures allow us to access outside capital more quickly and efficiently in response to dynamic market conditions, without the necessity of obtaining shareholder approval for each issuance. As of December 31, 2012, we had $961.8 million of preferred stock outstanding.

We had $904.7 million and $1.0 billion of subordinated debt outstanding at December 31, 2012 and 2011, respectively. In December 2012, we purchased $95.3 million of our 7.875 percent fixed rate Series 2008A subordinated notes through a cash tender offer. As a result, we incurred a loss of $28.5 million, which is recorded as a component of noninterest income in the consolidated statement of income for the year ended December 31, 2012. For regulatory capital purposes, subject to certain limitations, subordinated debt is included in permanent capital and total surplus and excluded from liabilities in the net collateral ratio. Our subordinated debt is discussed in Note 7 to the accompanying consolidated financial statements.

We may from time to time seek to retire our outstanding debt or equity securities through calls, cash purchases and/or exchanges, in open market purchases, privately negotiated transactions or otherwise. Such repurchases or exchanges, if any, will depend on prevailing market conditions, the Bank's capital position and liquidity requirements, contractual restrictions and other factors. The amounts involved may be material.

FCA regulations include requirements to maintain regulatory capital at or above minimum levels for our permanent capital ratio, total surplus ratio, core surplus ratio, and net collateral ratio. The calculation of these ratios is summarized in Note 8 to the accompanying consolidated financial statements. If these standards are not met, the FCA could impose restrictions, including limiting our ability to pay patronage distributions, retire equities and pay preferred stock dividends. As displayed in the following table, at December 31, 2012, 2011 and 2010, we exceeded the minimum regulatory requirements, which are noted parenthetically. The fair value adjustments recorded as a result of the merger with AgBank had an initial unfavorable effect on our regulatory capital ratios. This effect will diminish over time as the acquired assets and liabilities are repaid and the fair value adjustments accrete into income. The pro forma column in the following table reflects our capital ratios excluding the effects of the fair value adjustments resulting from the merger. Effective January 1, 2013, the FCA granted us permission to exclude the impact of merger-related fair value adjustments when determining our net collateral ratio.

Selected Capital Information ($ in Millions)

December 31,	2012	Pro Forma 2012 [(1)]	2011	2010
Total Shareholders' Equity	**$ 6,441**	**n/a**	$ 4,896	$ 4,406
Total Shareholders' Equity/Total Assets	**6.97 %**	**n/a**	7.74 %	6.69 %
Permanent Capital Ratio (7.0%)	**16.14**	**16.83 %**	16.37	14.30
Total Surplus Ratio (7.0%)	**15.22**	**15.91**	16.01	13.96
Core Surplus Ratio (3.5%)	**10.06**	**10.74**	10.02	8.42
Net Collateral Ratio (104.0%)[(2)(3)]	**107.08**	**107.67**	109.05	108.03

(1) The pro forma column reflects regulatory capital ratios excluding the effects of the fair value adjustments resulting from the merger with AgBank effective January 1, 2012.

(2) The regulatory minimum net collateral ratio is 103.0 percent, but the FCA requires the higher 104.0 percent during a period in which we have Series A preferred stock or subordinated debt outstanding. Our Series A preferred stock was fully redeemed on October 1, 2012.

(3) As a condition of the merger with AgBank, from January 1, 2012 through December 31, 2014, if the net collateral ratio falls below 105.0 percent, the Bank must notify the FCA and submit to them a written plan to restore and maintain a level of at least 105.0 percent.

Pursuant to FCA guidance, a portion of our common stock is included in core surplus, subject to certain conditions. This inclusion will continue on a temporary basis until December 31, 2014 or the point at which the FCA changes its capital regulations in a manner that would be inconsistent with this treatment. The FCA requires that we also calculate our core surplus ratio excluding common stock and has established a 3.0 percent minimum for such ratio. In addition, as a condition of the merger with AgBank, from January 1, 2012 through December 31, 2014, if our core surplus ratio excluding common stock falls below 5.59 percent, the Bank must notify the FCA and submit to them a written plan to restore and maintain the ratio to at least that level. As of December 31, 2012, our core surplus ratio excluding common stock was 8.32 percent.

The FCA issued Advance Notices of Proposed Rulemaking on capital adequacy in 2007 and 2010 which could ultimately lead to significant changes in the System's regulatory capital rules, as more fully discussed on page 52 within "Other Risk Factors."

In accordance with the Farm Credit Act, cooperatives and other eligible borrowers are required to purchase equity in CoBank as a condition of borrowing. Eligible borrowers that borrow on a patronage basis have voting rights while they are active borrowers. Generally, for borrowers other than affiliated Associations, the minimum initial borrower investment is equal to the lesser of one thousand dollars or 2 percent of the amount of the loan. The minimum initial investment is generally received by CoBank in cash at the time the borrower receives the loan proceeds. Affiliated Associations provide an initial and ongoing voting stock investment of 4 percent of their average outstanding loan balance. Collectively, the customer-owners that hold voting stock elect our Board of Directors. We operate on a cooperative basis and return a portion of our earnings to our customer-owners in the form of patronage distributions.

In conjunction with the annual business and financial planning process, the Board of Directors reviews and approves a capital adequacy plan which includes capital targets and capital ratio baselines. The Board determines a targeted equity level based on projected asset levels, earnings, economic conditions, possible credit losses and other contingencies. The Board also balances the amount required to properly capitalize the Bank with the desire to distribute a level of patronage that provides appropriate returns to our customer-owners. The Board may increase or decrease these patronage levels (provided we remain within the regulatory capital minimums) based on its ongoing evaluation of the Bank's business. As a result, there is no assurance that patronage will remain at current levels.

When reviewing the capital adequacy plan, the Board considers the following: risk diversification of the loan portfolio, loan seasonality, anticipated future capital needs, equity levels required by the Bank's proprietary economic capital model, the Bank's capital levels in comparison to commercial banks and the regulatory minimum capital standards. As of December 31, 2012, the Board-established capital ratio baselines were 10 percent for the permanent capital and total surplus ratios, 5 percent for the core surplus ratio, and 3.75 percent for the core surplus ratio excluding common stock. As part of our business planning process, we perform stress tests to examine the Bank's financial condition and performance under a variety of market and economic environments, including unanticipated loan growth and prolonged periods of financial and loan quality stress. These tests, which include severe scenarios, illustrate the Bank's ability to continue to maintain compliance with regulatory requirements and board baselines while continuing to meet commitments to our stakeholders. Results of these tests are reviewed with the Board of Directors.

Capital Plans

We have four capital plans that govern the level of capital investment required by customer-owners. These include a plan for cooperative customers, a plan for affiliated Associations, a plan for nonaffiliated entities and a plan for loan participations purchased from System entities.

The targeted equity level for the cooperative capital plan is 8 percent of the 10-year historical average loan volume. Additionally, when a borrower's loans are paid in full, stock is retired over a 10-year loan base period beginning in the year following loan payoff, subject to Board approval and compliance with minimum regulatory capital requirements. The targeted patronage rate for the cooperative capital plan is 100 basis points of the current year average loan volume. For the 2012 patronage to be distributed in 2013, the cash portion of patronage will be 75 percent for all cooperative capital plan members, compared to 65 percent for 2011 and 2010. The remaining portion is paid in common stock.

The capital plan for loan participations purchased from System entities is similar to the cooperative capital plan described above.

The targeted equity level for the affiliated Association capital plan is 4 percent of the one-year historical average loan volume. There is no stock retirement feature for this capital plan. The targeted patronage rate for the affiliated Association capital plan is 45 basis points of the current year average loan volume, with all patronage being paid in cash.

The targeted equity level for the nonaffiliated entities capital plan is 4 percent of the five-year historical average loan volume. Additionally, when these borrower's loans are paid in full, stock is retired over a five-year loan base period beginning in the year following loan payoff, subject to Board approval and compliance with minimum regulatory capital requirements. The targeted patronage rate for the nonaffiliated entity capital plan is 45 basis points of the current year average loan volume. The cash portion of patronage is 20 percent for all nonaffiliated entity capital plan members, with the remaining portion paid in common stock.

All patronage payments and retirements of equity require the prior approval of our Board of Directors, which may increase or decrease such payments based upon the Bank's current or projected business performance and capital levels. In addition, patronage payments can only be made if the Bank is in compliance with minimum regulatory capital requirements.

Patronage distributions are made in the form of cash and common stock, as shown in the following table. Eligible shareholders will receive patronage distributions from CoBank for 2012 in the first quarter of 2013. Patronage distributions for 2012 were higher than 2011 primarily as a result of the inclusion of the patronage-based loan portfolio acquired in the AgBank merger.

Patronage Distributions ($ in Thousands)			
Year Ended December 31,	**2012**	**2011**	**2010**
Common Stock	**$ 80,472**	$ 109,900	$ 90,450
Cash	**344,516**	230,751	194,110
Total Patronage Distributions	**$ 424,988**	$ 340,651	$ 284,560
Patronage Distributions/ Total Average Common Stock Owned by Active Borrowers	**18.41 %**	22.65 %	19.77 %

Economic Capital

Economic capital is a measure of risk and is defined as the amount of capital required to absorb potential losses resulting from extremely severe events over a one-year time period. "Unexpected losses" are the difference between potential extremely severe losses and the expected (average) loss over a one-year time period. The amount of economic capital required is based on our risk profile and a targeted solvency standard. We attribute economic capital to credit risk, interest rate risk, operational risk and market risk. Credit risk, interest rate risk and operational risk are described under "Corporate Risk Profile" beginning on page 37. Market risk represents exposure to asset residual values related to our leasing activity. These risks are measured and aggregated to estimate the exposure to potential extremely severe events and any impact to our capital.

The economic capital model considers the economic capital requirements of our affiliated Associations through the evaluation of the Associations' retail credit risk, operational risk and interest rate risk. An economic capital shortfall (which is the difference between available capital and required economic capital) at any affiliated Association is included in our economic capital requirements.

For economic capital modeling purposes, we have targeted a "AA" solvency standard, which equates to a 99.97 percent confidence level. In other words, the likelihood of incurring losses greater than the required economic capital amount is estimated to be similar to the likelihood of a AA-rated bond defaulting, which is a 0.03 percent probability. At December 31, 2012, the Bank held capital in excess of the amount calculated by its economic capital model.

Credit Risk Capital

Credit risk capital requirements are based on the risk profile of the borrower or counterparty, repayment sources, the nature of underlying collateral and other support, given current events and conditions. Our credit risk ratings process uses a two dimensional loan rating structure, incorporating our 14-point risk-rating scale to identify and track the probability of borrower default and a separate scale addressing loss given default.

In assigning credit risk capital, our economic capital model considers retail borrower probability of default, loss given default, and portfolio concentrations. Other principal drivers of credit risk that differentiate capital allocation include exposure at default, asset maturity, and asset and inter-commodity correlations. We have developed standards for probability of borrower default and loss given default, based on external benchmarks.

Interest Rate Risk Capital

The amount of capital attributed to interest rate risk is based on potential changes in our market value of equity, calculated under randomly generated interest rate scenarios. We utilize widely accepted, third-party models to quantify the interest rate risk and related risk capital requirement.

Operational Risk Capital

Our approach to quantifying operational risk capital is based on the capital of non-financial companies with similar business risks. These non-financial companies hold capital primarily for operational risk. Their level of capital and credit rating yields an inferred estimate of the level of capital to be held for operational risk. Capital as a percent of operating expenses is the primary methodology used in determining operational risk capital.

Market Risk Capital

Market risk arises primarily from the volatility in the residual value of leased assets at the maturity of lease contracts. This risk exists because of the mismatch between the present value of future cash flows, the present value of the returned leased asset, and the underlying value of the equipment over time. This is because default can occur when the inherent value of the leased asset is below that of the present value of all future payments. This difference is used to calculate the exposure.

Other Risks

Other areas of risk in which we may have exposure are structural, liquidity, regulatory, reputation, and political risk. While capital is not specifically attributed to these risks, some of the excess capital – the amount by which book capital exceeds economic capital – is held for these other risks.

Critical Accounting Estimates

Management's discussion and analysis of the financial condition and results of operations are based on the Bank's consolidated financial statements, which we prepare in accordance with accounting principles generally accepted in the United States of America. In preparing these financial statements, we make estimates and assumptions. Our financial position and results of operations are affected by these estimates and assumptions, which are integral to understanding reported results.

Note 1 to the accompanying consolidated financial statements contains a summary of our significant accounting policies. We consider certain of these policies to be critical to the presentation of our financial condition, as they require us to make complex or subjective judgments that affect the value of certain assets and liabilities. Some of these estimates relate to matters that are inherently uncertain. Most accounting policies are not, however, considered critical. Our critical accounting policies relate to determining the level of our allowance for credit losses, the valuation of financial instruments with no ready markets (primarily derivatives and certain investment securities) and accounting for the merger with AgBank. Management has reviewed these critical accounting policies with the Audit Committee of the Board of Directors.

Certain of the statements below contain forward-looking statements, which are more fully discussed on page 61.

Allowance for Credit Losses

Our allowance for loan losses reflects an adjustment to the value of our total loan and finance lease portfolio for inherent credit losses related to outstanding balances. We provide line of credit financing to customers to cover short-term and variable needs, the usage of which, particularly for farm supply and grain marketing customers, is influenced by volatility in agricultural commodity prices. As a result, we have significant unfunded commitments for which we maintain a separate reserve. This reserve is reported as a liability on the Bank's consolidated balance sheet. We refer to the combined amounts of the allowance for loan losses and the reserve for unfunded commitments as the "allowance for credit losses."

Our allowance for credit losses reflects our assessment of the risk of probable and estimable loss related to outstanding balances and unfunded commitments in our loan and finance lease portfolio. The allowance for credit losses is maintained at a level consistent with this assessment, considering such factors as loss experience, portfolio quality, portfolio concentrations, current and historical production conditions, our mission, and economic and environmental factors specific to our business segments.

The allowance for credit losses is based on our regular evaluation of our loan and finance lease portfolio. We establish the allowance for credit losses via a process that begins with estimates of probable loss within the portfolio. Our methodology consists of analysis of specific individual credits and evaluation of the remaining portfolio. We evaluate significant individual credit exposures, including adversely classified loans, based upon the borrower's overall financial condition, resources, payment record and projected viability. We also evaluate the prospects for support from any financially viable guarantors and the estimated net realizable value of any collateral. Senior-level committees approve specific credit and reserve-related activities. The Audit and Risk Committees of the Board of Directors review and approve the allowance for credit losses on a quarterly basis, including year-end. In addition, the Board of Directors approves the year-end allowance.

Our determination of the allowance for credit losses is sensitive to the assigned risk ratings and probabilities of default, as well as assumptions surrounding loss given default. Changes in these components underlying this critical accounting estimate could increase or decrease our provision for loan losses. Such a change would increase or decrease net income and the related allowance for loan losses and reserve for unfunded commitments, which could have a material effect on the Bank's financial position and results of operations.

To analyze the impact of assumptions on our provision expense and the related allowance for credit losses, we changed a critical assumption to reflect the impact of deterioration or improvement in loan quality. In the event that 10 percent of loans (calculated on a pro-rata basis across all risk ratings), excluding loans to Associations and guaranteed loans, experienced downgrades or upgrades of one risk rating category, the provision for loan losses and related allowance for credit losses would have increased or decreased by $15.9 million at December 31, 2012.

Valuation of Financial Instruments with No Ready Markets

We use fair value measurements to record fair value adjustments to certain financial instruments and to determine fair value disclosures. All of our investment securities and derivative instruments are reported at their estimated fair value on the accompanying consolidated balance sheets.

As discussed in Note 13 to the accompanying consolidated financial statements, we maximize the use of observable inputs when measuring fair value. Observable inputs reflect market-derived or market-based information obtained from independent sources, while unobservable inputs primarily reflect our estimates about market data.

The fair value of 96 percent of our investment securities is determined by a third-party pricing service that uses valuation models to estimate current market prices. For the remainder of our investment securities, market value is calculated internally using third-party models. Inputs and assumptions related to all of these models are typically observable in the marketplace. Such models incorporate prepayment assumptions and underlying mortgage- or asset-backed collateral information to generate cash flows that are discounted using appropriate benchmark interest rate curves and volatilities. These third-party valuation models also incorporate information regarding broker/dealer quotes, available trade information, historical cash flows, credit ratings, and other market information. Such valuations represent an estimated exit price, or price to be received by a seller in active markets to sell the investment securities to a willing participant.

The fair value of our derivative financial instruments is the estimated amount to be received to sell a derivative asset or paid to transfer or extinguish a derivative liability in active markets among willing participants at the reporting date. Estimated fair value is determined through internal market valuation models. These models use an income approach and incorporate benchmark interest rate curves, volatilities, counterparty credit quality, and other inputs that are observable directly or indirectly in the marketplace. We compare internally calculated derivative valuations to broker/dealer quotes to substantiate the results. The fair value of collateral assets and liabilities related to derivative contracts is their face value, plus accrued interest, as these instruments are cash balances; therefore, fair value approximates face value.

All financial models used for the determination of the fair value of financial instruments in the financial statements or for independent risk monitoring purposes are periodically reviewed and validated in accordance with our policies.

The degree of management judgment involved in determining the fair value of a financial instrument is dependent upon the availability of observable market inputs. For financial instruments that trade actively and have observable market prices and inputs, there is minimal subjectivity involved in measuring fair value. When observable market prices and inputs are not fully available, management judgment is necessary to estimate fair value. In addition, changes in market conditions may reduce the availability of market prices or observable data. For example, reduced liquidity in the capital markets or changes in secondary market activities could result in observable market inputs becoming unavailable. When market data is not available, we use valuation techniques requiring more management judgment to estimate the appropriate fair value measurement. Changes in assumptions could affect the fair values.

At December 31, 2012, approximately 21 percent of total assets, or $19.1 billion, consisted of financial instruments recorded at fair value. Approximately 96 percent of these financial instruments used valuation methodologies involving market-based or market-derived information to measure fair value. The remaining 4 percent of these financial instruments was measured using model-based techniques, consisting of our Farmer Mac MBS, FHA/VA non-wrapped reperformer MBS, and a small portion of agency MBS. At December 31, 2012, approximately 1 percent of total liabilities, or $723.6 million, consisted of financial instruments recorded at fair value, the substantial majority of which are valued using methodologies involving market-based or market-derived information.

Merger Accounting

Business combination accounting standards, which we applied in relation to our merger with AgBank, required the use of significant estimates and assumptions. The acquisition method of accounting for business combinations requires a company to estimate the assets acquired and liabilities assumed at their acquisition-date fair value. In some instances, assumptions with respect to the timing and amount of future revenues and expenses associated with assets and liabilities are used in determining its fair value. Actual timing and amount of net cash flows from revenues and expenses related to assets and liabilities over time may differ materially from those initial estimates, and if the timing is delayed significantly or if the net cash flows decline significantly, assets could become impaired. Our estimates are based upon assumptions we believed to be reasonable, but which are inherently uncertain and unpredictable. Our merger is discussed further in Note 3 to the accompanying consolidated financial statements.

Recent Accounting Pronouncements

In December 2011 and in January 2013, the Financial Accounting Standards Board (FASB) issued guidance creating new disclosure requirements about the nature of an entity's rights of setoff and related arrangements associated with its financial instruments and derivative instruments. The requirements are effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods, with retrospective application required. We will adopt these provisions in 2013. The adoption will not impact our consolidated financial position, results of operations or cash flows, but will expand our disclosure associated with certain financial instruments.

In February 2013, the FASB issued guidance on reclassifications out of accumulated other comprehensive income (AOCI) and changes in AOCI balances. The requirements are effective for annual reporting periods beginning on or after December 15, 2012, and interim periods within those annual periods, with prospective application required and early adoption permitted. We will adopt these provisions in 2013. The adoption will not impact our consolidated financial position, results of operations or cash flows.

Business Outlook

The January 1, 2012 merger with AgBank has created opportunities to increase market share in the geographic regions covered by our new 25 affiliated Associations, has significantly enhanced the geographic and industry diversification of our loan portfolio, and has provided us with greater capacity to fulfill our mission, especially in volatile markets. It also provides us with the opportunity to further strengthen business operations and enhance market opportunities for CoBank's products and services. We believe the merger has created a stronger, more durable financial institution with an enhanced ability to fulfill its mission, both today and for future generations of rural borrowers.

We continue to face challenges that could make the lending and earnings environment less favorable for CoBank. Agricultural commodity prices remain volatile and growth is weak in the broader economy. Customers in certain of the industries we serve are impacted by unpredictable and volatile agricultural commodity prices, and regulatory and political uncertainty. Although the Food, Conservation, and Energy Act of 2008 (commonly referred to as the 2008 Farm Bill) was recently extended until September 30, 2013, there is considerable uncertainty as to the content and timing of the next farm bill. Additionally, many areas in the United States continue to be impacted by drought conditions. Grain and farm supply cooperatives in affected regions may be impacted by revenue loss from lower throughput and a smaller revenue base received from providing ancillary services to farmers. In addition, borrowers in the protein and biofuels sectors may be negatively impacted by higher input prices. These challenges could reduce the credit quality and influence the level of loan demand in certain sectors of our loan portfolio. Weakness in the housing market and/or persistently high unemployment could also lead to further losses on certain of our investment securities. Greater liquidity in debt funding markets and a renewed focus by banks on commercial lending has intensified competition across many of the industries we serve. In addition, a continued low interest rate environment negatively impacts the return on our invested capital.

We are focused on preserving the strength of our balance sheet, completing the integration of the former U.S. AgBank operations and enhancing our enterprise risk management capabilities. We believe that our strong capital, liquidity and earnings will continue to provide the capacity to serve customers in volatile market conditions and to effectively lower the net cost of borrowing for our customers through consistent and reliable patronage payments. We will continue our disciplined approach to managing risk and will closely monitor asset quality. We will also continue to enhance our financial condition through appropriate expense discipline while retaining a significant portion of our earnings. Nevertheless, we will seek opportunities to invest in people, processes, systems and activities that enhance our value proposition and allow us to better fulfill our mission in rural America.

Our continued success will be achieved by delivering on our value proposition, creating mutually beneficial partnerships with other System institutions, increasing market share, maintaining effective access to the agency debt capital markets, optimizing current lending authorities and pursuing various strategic alliances with other financial services organizations.

Under the guidance of our Board of Directors and through the focus of a proven executive management team, we look forward to continuing to deliver on our value proposition on behalf of our customers and to fulfilling our mission as a dependable and strategic source of credit and financial services to the nation's rural economy.

Forward Looking Statements

Certain of the statements contained in the 2012 Annual Report that are not historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Our actual results may differ materially from those included in the forward-looking statements that relate to our plans, projections, expectations and intentions. Forward-looking statements are typically identified by words such as "believe," "expect," "anticipate," "intend," "estimate," "plan," "project," "may," "will," "should," "would," "could" or similar expressions. Although we believe that the information expressed or implied in such forward-looking statements is reasonable, we can give no assurance that such projections and expectations will be realized or the extent to which a particular plan, projection or expectation may be realized. These forward-looking statements are based on current knowledge and are subject to various risks and uncertainties, including, but not limited to:

- Potential deterioration in the agricultural, energy, communications, and water industries;
- Weather-related, disease and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income, including the impact of drought in many parts of the United States which may negatively affect certain customer sectors;
- Credit performance of the loan portfolio;
- Loan portfolio growth and seasonal factors;
- Weak U.S. and global economic conditions;
- Government policies and political developments in the United States and other countries in which we make loans;
- The European sovereign debt crisis and its potential impact on funding markets and LIBOR rates;
- Legislative actions and the effect of banking and financial services reforms;
- Regulatory actions, including possible amendments to, and interpretations of, risk-based capital guidelines;
- Changes in the U.S. government's support of the agriculture industry and agricultural exports;
- Changes in levels of global crop production and ending stocks;
- Actions taken by the U.S. Congress relative to Government Sponsored Enterprises (GSEs), including the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Agricultural Mortgage Corporation (Farmer Mac);
- Actions taken by the U.S. government to manage U.S. fiscal policy;
- Actions taken by the Federal Reserve to manage the U.S. monetary policy;
- A decrease in the credit outlook or ratings of U.S. government debt and agency debt, including Systemwide Debt Securities;
- The level of interest rates;
- Relationships between various interest rate indices;
- Changes in assumptions underlying the valuations of financial instruments;
- Changes in the basis for our estimates underlying the allowance for credit losses;
- Failure of our investment portfolio to perform as expected or deterioration in the credit quality of such investments;
- The resolution of legal proceedings and related matters;
- Environmental-related conditions or laws impacting our lending activities;
- Nonperformance by counterparties to our investment and derivative positions; and
- Our ability to successfully execute and integrate any future business combinations or strategic alliances.

We expressly disclaim any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

Consolidated Statements of Income

CoBank, ACB

($ in Thousands)

Year Ended December 31,	2012	2011	2010
Interest Income			
Loans	**$ 1,703,877**	$ 1,518,073	$ 1,408,565
Investment Securities	**321,730**	271,074	257,740
Total Interest Income	**2,025,607**	1,789,147	1,666,305
Interest Expense	**787,437**	718,120	715,460
Net Interest Income	**1,238,170**	1,071,027	950,845
Provision for Loan Losses	**70,000**	58,000	60,000
Net Interest Income After Provision for Loan Losses	**1,168,170**	1,013,027	890,845
Noninterest Income/ Expense			
Net Fee Income	**116,801**	117,741	102,620
Prepayment Income	**49,379**	24,691	18,820
Losses on Early Extinguishment of Debt	**(86,718)**	(50,421)	(26,537)
Loss on Tender Offer for Subordinated Debt	**(28,460)**	-	-
Total Other-Than-Temporary Impairment Losses	**(972)**	(8,756)	(49,851)
Portion Recognized in Other Comprehensive Income/Loss	**(16,028)**	(1,244)	5,851
Net Other-Than-Temporary Impairment Losses Included in Earnings	**(17,000)**	(10,000)	(44,000)
Other, Net	**79,319**	35,925	47,656
Total Noninterest Income	**113,321**	117,936	98,559
Operating Expenses			
Employee Compensation	**145,999**	117,531	98,971
General and Administrative	**32,228**	24,446	41,589
Information Technology	**22,227**	18,846	16,115
Insurance Fund Premium	**18,349**	20,245	13,281
Travel and Entertainment	**15,767**	12,425	10,922
Farm Credit System Related	**13,279**	8,415	8,294
Occupancy and Equipment	**9,012**	7,404	6,479
Purchased Services	**7,022**	18,958	20,559
Total Operating Expenses	**263,883**	228,270	216,210
Income Before Income Taxes	**1,017,608**	902,693	773,194
Provision for Income Taxes	**163,691**	196,106	159,427
Net Income	**$ 853,917**	$ 706,587	$ 613,767

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

Consolidated Statements of Comprehensive Income

CoBank, ACB

($ in Thousands)

Year Ended December 31,	2012	2011	2010
Net Income	**$ 853,917**	$ 706,587	$ 613,767
Other Comprehensive Income, Net of Tax (Note 2):			
Net Change in Unrealized Losses/Gains on Investment Securities Not Other-Than-Temporarily Impaired	**6,060**	123,863	42,010
Net Change in Unrealized Losses/Gains on Other-Than-Temporarily Impaired Investment Securities	**43,118**	(7,034)	1,147
Net Change in Unrealized Losses/Gains on Interest Rate Swaps and Other Financial Instruments	**(5,301)**	(1,460)	(3,893)
Net Pension Adjustment	**(1,135)**	(13,495)	(5,039)
Other Comprehensive Income	**42,742**	101,874	34,225
Comprehensive Income	**$ 896,659**	$ 808,461	$ 647,992

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

Consolidated Balance Sheets
CoBank, ACB

($ in Thousands)

As of December 31,	2012	2011	2010
Assets			
Total Loans	**$ 71,980,458**	$ 46,285,142	$ 49,992,338
Less: Allowance for Loan Losses	**437,376**	388,056	400,744
Net Loans	**71,543,082**	45,897,086	49,591,594
Cash	**1,253,509**	2,771,842	1,922,586
Investment Securities	**17,999,191**	12,995,458	12,616,696
Accrued Interest Receivable	**360,839**	277,528	386,401
Interest Rate Swaps and Other Financial Instruments	**1,005,115**	1,048,629	1,001,365
Other Assets	**316,022**	299,672	307,248
Total Assets	**$ 92,477,758**	$ 63,290,215	$ 65,825,890
Liabilities			
Bonds and Notes	**$ 83,607,119**	$ 56,104,486	$ 59,324,313
Subordinated Debt	**904,685**	1,000,000	1,000,000
Accrued Interest Payable	**295,776**	255,021	351,235
Interest Rate Swaps and Other Financial Instruments	**157,880**	136,945	92,580
Reserve for Unfunded Commitments	**157,703**	153,919	99,799
Other Liabilities	**913,451**	744,311	551,766
Total Liabilities	**86,036,614**	58,394,682	61,419,693
Commitments and Contingent Liabilities (Note 16)			
Shareholders' Equity			
Preferred Stock	**961,750**	700,000	700,000
Common Stock	**2,605,933**	1,654,314	1,568,989
Unallocated Retained Earnings	**2,729,031**	2,439,531	2,137,394
Accumulated Other Comprehensive Income (Loss)	**144,430**	101,688	(186)
Total Shareholders' Equity	**6,441,144**	4,895,533	4,406,197
Total Liabilities and Shareholders' Equity	**$ 92,477,758**	$ 63,290,215	$ 65,825,890

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

Consolidated Statements of Cash Flows

CoBank, ACB

($ in Thousands)

Year Ended December 31,	2012	2011	2010
Cash Flows Provided by Operating Activities			
Net Income	$ **853,917**	$ 706,587	$ 613,767
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:			
Provision for Loan Losses	**70,000**	58,000	60,000
Deferred Income Taxes	**(30,639)**	101,674	27,237
Depreciation and Amortization/Accretion, Net	**(37,123)**	10,520	3,568
Losses on Impairments of Investments Available-for-Sale	**17,000**	10,000	44,000
Net Gain on Sale of Investment Securities	**-**	(4,451)	-
Decrease in Accrued Interest Receivable	**29,992**	108,873	20,299
Decrease (Increase) in Other Assets	**117,099**	20,376	(67,906)
Decrease in Accrued Interest Payable	**(40,217)**	(96,214)	(43,063)
(Decrease) Increase in Other Liabilities	**(60,253)**	17,284	(50,495)
Net Gains on Interest Rate Swaps and Other Financial Instruments	**(8,513)**	(9,943)	(1,448)
Proceeds from Termination of Interest Rate Swaps	**-**	31,788	-
Purchase of Interest Rate Caps	**(15,120)**	-	(6,715)
Other	**(12,102)**	(1,758)	(1,181)
Net Cash Provided by Operating Activities	**884,041**	952,736	598,063
Cash Flows (Used in) Provided by Investing Activities			
Net (Increase) Decrease in Loans	**(5,823,665)**	3,688,075	(5,871,365)
Net Cash Acquired in Business Combination	**225,859**	-	-
Investment Securities:			
Purchases	**(12,276,503)**	(6,128,705)	(14,332,036)
Proceeds from Maturities and Prepayments	**12,190,661**	5,841,874	13,547,385
Proceeds from Sales	**-**	41,345	-
Net Cash (Used in) Provided by Investing Activities	**(5,683,648)**	3,442,589	(6,656,016)
Cash Flows Provided by (Used in) Financing Activities			
Bonds and Notes Proceeds	**63,645,063**	35,881,933	40,122,110
Bonds and Notes Retired	**(59,857,913)**	(40,119,400)	(32,487,178)
Net (Decrease) Increase in Notes Payable and Other Interest-bearing Liabilities	**(132,556)**	974,492	(286,222)
Subordinated Debt Retired	**(95,315)**	-	-
Preferred Stock Issued, Net	**394,196**	-	-
Preferred Stock Redemptions	**(363,250)**	-	-
Preferred Stock Dividends Paid	**(71,938)**	(63,799)	(63,799)
Common Stock Issued	**27,011**	5,324	2,465
Common Stock Retired	**(34,124)**	(29,899)	(43,980)
Cash Patronage Distribution Paid	**(229,900)**	(194,720)	(185,940)
Net Cash Provided by (Used In) Financing Activities	**3,281,274**	(3,546,069)	7,057,456
Net (Decrease) Increase in Cash	**(1,518,333)**	849,256	999,503
Cash at Beginning of Year	**2,771,842**	1,922,586	923,083
Cash at End of Year	$ **1,253,509**	$ 2,771,842	$ 1,922,586
Supplemental Noncash Investing and Financing Activities			
Net Change in Accrued Purchases of Securities	$ **-**	$ -	$ 6,002
Change in Unrealized Gains/Losses on Investment Securities, Before Taxes	**65,689**	138,817	69,608
Patronage in Common Stock	**80,472**	109,900	90,450
Issuance of Preferred Stock Related to Merger	**225,000**	-	-
Issuance of Common Stock Related to Merger	**878,260**	-	-
Supplemental Noncash Fair Value Changes Related to Hedging Activities			
Decrease (Increase) in Interest Rate Swaps and Other Financial Instrument Assets	$ **43,514**	$ (47,264)	$ (17,291)
(Decrease) Increase in Bonds and Notes Related to Hedging Activities	**(171,359)**	(10,878)	49,182
Increase (Decrease) in Interest Rate Swaps and Other Financial Instrument Liabilities	**20,935**	44,365	(30,799)
Supplemental Disclosure of Cash Flow Information			
Interest Paid	$ **743,578**	$ 815,746	$ 755,518
Income Taxes Paid	**93,880**	95,225	213,793

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

Consolidated Statements of Changes in Shareholders' Equity
CoBank, ACB

($ in Thousands)

	Preferred Stock	Common Stock	Unallocated Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2009	$ 700,000	$ 1,520,054	$ 1,871,986	$ (34,411)	$ 4,057,629
Comprehensive Income			613,767	34,225	647,992
Preferred Stock Dividends			(63,799)		(63,799)
Common Stock:					
Issuances		2,465			2,465
Redemptions		(43,980)			(43,980)
Patronage Distribution:					
Cash			(194,110)		(194,110)
Common Stock		90,450	(90,450)		-
Balance at December 31, 2010	$ 700,000	$ 1,568,989	$ 2,137,394	$ (186)	$ 4,406,197
Comprehensive Income			706,587	101,874	808,461
Preferred Stock Dividends			(63,799)		(63,799)
Common Stock:					
Issuances		5,325			5,325
Redemptions		(29,900)			(29,900)
Patronage Distribution:					
Cash			(230,751)		(230,751)
Common Stock		109,900	(109,900)		-
Balance at December 31, 2011	$ 700,000	$ 1,654,314	$ 2,439,531	$ 101,688	$ 4,895,533
Comprehensive Income			**853,917**	**42,742**	**896,659**
Preferred Stock:					
Dividends			**(72,065)**		**(72,065)**
Issuance in Connection with Merger	**225,000**				**225,000**
Other Issuance	**400,000**		**(5,804)**		**394,196**
Redemptions	**(363,250)**				**(363,250)**
Common Stock:					
Issuance in Connection with Merger		**878,260**			**878,260**
Other Issuances		**27,011**			**27,011**
Redemptions		**(34,124)**			**(34,124)**
Patronage Distribution:					
Cash			**(344,516)**		**(344,516)**
Common Stock		**80,472**	**(80,472)**		**-**
Net Fair Value Adjustments Related to Merger (Note 3)			**(61,560)**		**(61,560)**
Balance at December 31, 2012	**$ 961,750**	**$ 2,605,933**	**$ 2,729,031**	**$ 144,430**	**$ 6,441,144**

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

Note 1 – Description of Business and Summary of Significant Accounting Policies

Description of Business

CoBank, ACB (CoBank or the Bank) is one of the four banks of the Farm Credit System (System). CoBank provides loans, leases and other financial services to vital industries across rural America. The System is a federally chartered network of borrower-owned lending institutions comprised of cooperatives and related service organizations. The System was established in 1916 by the U.S. Congress and is a Government Sponsored Enterprise (GSE). We are federally chartered under the Farm Credit Act of 1971, as amended (the Farm Credit Act), and are subject to supervision, examination and safety and soundness regulation by an independent federal agency, the Farm Credit Administration (FCA).

On January 1, 2012, U.S. AgBank, FCB (AgBank) merged with and into CoBank, FCB, a wholly-owned subsidiary of CoBank. CoBank, FCB was formed in connection with the merger and preserves the statutory tax exemption applicable to Farm Credit Banks. Effective January 1, 2012, CoBank transferred its nontaxable activities to CoBank, FCB and began conducting its Title I lending business (primarily funding of Farm Credit Associations) through CoBank, FCB. Refer to Note 3 for additional information on the merger with AgBank.

We are cooperatively owned by our domestic customers, which consist of agricultural cooperatives, rural energy, communications and water companies, farmer-owned financial institutions (including FCA-chartered organizations of the System such as Agricultural Credit Associations and Federal Land Credit Associations, both referred to as Associations) and other businesses that serve vital industries in rural America.

Our wholly-owned leasing subsidiary, Farm Credit Leasing Services Corporation (FCL), specializes in lease financing and related services for a broad range of equipment, machinery, vehicles and facilities.

In conjunction with other System entities, the Bank jointly owns three service organizations: the Federal Farm Credit Banks Funding Corporation (Funding Corporation), the FCS Building Association and the Farm Credit Association Captive Insurance Corporation. The Funding Corporation issues, markets and processes Federal Farm Credit Banks Consolidated Systemwide bonds, medium term notes and discount notes (collectively referred to as Systemwide Debt Securities) and also provides financial management and reporting services for the combined entities of the System. The FCS Building Association leases premises and equipment to the FCA as required by the Farm Credit Act. The Farm Credit Association Captive Insurance Company is a reciprocal insurer that provides insurance services such as directors and officers liability, fiduciary liability and a bankers bond to System organizations.

We have a minority ownership interest in Farm Credit Financial Partners, Inc., chartered under the Farm Credit Act as a service organization providing a range of support and technology services to certain Associations. Effective January 1, 2012, in connection with the merger of AgBank, we obtained a minority ownership interest in AgVantis, Inc., also chartered under the Farm Credit Act as a service organization providing a range of support and technology services to certain Associations formerly affiliated with AgBank. Additionally, we have a small equity interest in other System banks as required in connection with the purchase and sale of participation loans.

Copies of CoBank's financial reports are available on request by calling or visiting one of our banking center locations and through our website at www.cobank.com. Copies of financial reports of our affiliated Associations and the System are available on their respective websites.

Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

The consolidated financial statements include the accounts of CoBank, CoBank, FCB and FCL. All significant intercompany accounts and transactions have been eliminated.

The accompanying consolidated financial statements exclude financial information of 29 Associations to whom we provide direct wholesale funding, which are collectively referred to as our affiliated Associations. CoBank and our affiliated Associations are collectively referred to as the "District." The supplemental information on pages 107 to 117 includes certain unaudited combined financial information of our affiliated Associations and the District.

We prepare our financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the financial services industry. These principles require us to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results may differ from those estimates. Significant estimates are discussed in these notes to the consolidated financial statements, as applicable. Certain reclassifications have been made to amounts reported in previous years to conform to the 2012 presentation.

Loans

We report loans, excluding leases, at their principal amount outstanding and accrue interest income based upon the daily principal amount outstanding. For loans purchased at a discount, we amortize unearned income using the straight-line method, which approximates the interest method. We defer loan origination fees and costs, and amortize them over the life of the related loan as an adjustment to yield.

The accounting for loans obtained in the merger with AgBank is described in Note 3.

Except as otherwise noted, leases are included with loans in the consolidated financial statements and related notes. We record leases as either direct financing or operating leases. Under direct financing leases, unearned finance income from lease contracts represents the excess of gross lease receivables over the cost of leased equipment, net of estimated residual values. Residual values, which are reviewed at least annually, represent the estimated amount to be received at lease termination from the disposition of leased assets. We amortize net unearned finance income to interest income using the interest method. Under operating leases, property is recorded at cost and depreciated on a straight-line basis over the lease term to an estimated residual or salvage value. We recognize revenue as earned ratably over the term of the operating lease.

In the normal course of business, we manage lending credit exposures by selling or syndicating loans to System entities and other financial institutions. Such transactions include the transfer of participating interests, as defined pursuant to GAAP. We account for these transactions as sales and, accordingly, the assets transferred are not recognized in our consolidated balance sheets.

Impaired Loans

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms of the loans. Impaired loans include loans that are in nonaccrual status, restructured, or past due 90 days or more and still accruing interest.

We do not accrue interest income on impaired loans unless they are adequately secured and in the process of collection. When interest accruals are suspended, accrued and unpaid interest income is reversed with current year accruals charged to earnings and prior year amounts charged off against the allowance for loan losses.

For nonaccrual loans, we primarily apply cash receipts against the outstanding principal balance. If collectibility of the loan balance is fully expected and certain other criteria are met, we recognize interest payments as interest income. We may return such loans to accrual status when the borrower is current, has demonstrated payment performance, collection of future payments is fully expected and there are no unrecovered charge-offs.

Accruing restructured loans are those for which the contractual terms and conditions have been amended or otherwise revised to incorporate certain monetary concessions because the borrower is experiencing financial difficulty. We place the loan in nonaccrual status if the borrower's ability to meet the revised contractual terms is uncertain.

We establish an impairment reserve if the fair value of assets held for operating leases decreases to below book value and such difference is not recoverable.

Allowance for Loan Losses and Reserve for Unfunded Commitments

Our allowance for loan losses reflects an adjustment to the value of our total loan and finance lease portfolio for inherent credit losses, while we also maintain a separate reserve for unfunded commitments which is reported as a liability on the Bank's consolidated balance sheet. The reserve for unfunded commitments represents an additional reserve for binding commitments to extend credit and for commercial letters of credit. We had $30.4 billion and $287.1 million of commitments to extend credit and commercial letters of credit at December 31, 2012. The amount of our allowance for loan losses and reserve for unfunded commitments can fluctuate based on the seasonal nature of borrowings in the agriculture industry, which is impacted by various factors including volatility in commodity prices. We refer to the combined amounts of the allowance for loan losses and the reserve for unfunded commitments as the "allowance for credit losses." At December 31, 2012, our allowance for credit losses totaled $595.1 million, of which $437.4 million related to the allowance for loan losses and $157.7 million related to the reserve for unfunded commitments.

The allowance for credit losses is maintained at a level we consider sufficient to absorb losses inherent in the loan and finance lease portfolio and in unfunded commitments. We base the allowance for credit losses on our regular evaluation of these portfolios.

To determine our allowance for credit losses, we divide our loans and finance leases into two broad categories: those that are impaired and those that are not. A loan or finance lease is impaired when, based on current information and events, it is probable that we will not collect all amounts due under the contractual terms. Impairment of loans and finance leases is measured based on the fair value of the collateral, if the loan or finance lease is collateral dependent, or the present value of expected future cash flows discounted at the effective interest rate of the contract. In limited cases, we base the impairment on observable market prices. Changes in the financial condition of our borrowers and in the general economy will cause these estimates, appraisals and evaluations to change.

For loans and finance leases that are not individually assessed for impairment, we establish an allowance for credit losses for losses that are both probable and estimable as of the balance sheet date. The evaluation of this portion of our portfolio generally considers default rates from industry data, internal risk ratings, loss given default assumptions, historical recovery rates, specific industry conditions, weather conditions, general economic and political conditions, and changes in the character, composition and performance of the portfolio, among other factors. We also consider overall portfolio indicators, including trends in internally risk-rated exposures, classified exposures, and historical charge-offs and recoveries. Additionally, we consider industry, geographic and portfolio concentrations, including current developments within operating segments. Changes in these factors, or our assumptions and estimates thereof, could result in a change in the allowance and could have a direct and material impact on the provision for loan losses and our results of operations. The total allowance for credit losses is available to absorb probable and estimable credit losses within our entire portfolio.

We increase or decrease the allowance for credit losses by recording a provision or reversal for loan losses in the statement of income. We record loan losses against the allowance for loan losses when management determines that any portion of the loan or finance lease is uncollectible. We add subsequent recoveries, if any, to the allowance for loan losses. Transfers between the allowance for loan losses and the reserve for unfunded commitments can occur in conjunction with funding a seasonal line of credit or other loan and decreasing a related unfunded commitment or, conversely, receiving a loan payment and increasing a related unfunded commitment. Newly-executed loan commitments will also increase this liability.

We also assess the credit risk associated with off-balance sheet loan commitments and letters of credit and determine the appropriate level of reserve for unfunded commitments that should be recorded.

Cash

For purposes of these financial statements, cash represents deposits at banks and cash on hand which are used for operating or liquidity purposes.

Investment Securities

We classify investment securities as available-for-sale and report them at their estimated fair value. We have no trading or held-to-maturity securities. We amortize or accrete purchased premiums and discounts using the constant yield method, which approximates the interest method, over the terms of the respective securities. We report unrealized gains and losses, net of applicable income taxes and credit losses, in the accumulated other comprehensive income (loss) component of shareholders' equity on the consolidated balance sheets. We use the specific identification method for determining cost in computing realized gains and losses on sales of investment securities.

The accounting for investment securities obtained in the merger with AgBank is described in Note 3.

We evaluate investments in a loss position to determine if such a loss is other-than-temporary. If losses are deemed to be other-than-temporary, we record the portion related to credit losses in earnings and the portion related to all other factors in other comprehensive income (loss). For additional information, refer to Note 5.

Premises and Equipment

We carry premises and equipment at cost less accumulated depreciation and amortization. We provide for depreciation and amortization on the straight-line method over the estimated useful lives of the assets. We record gains and losses on dispositions in current operating results. We record maintenance and repairs to operating expenses when incurred and capitalize improvements.

We capitalize leased property and equipment meeting certain criteria and depreciate such assets using the straight-line method over the terms of the respective leases.

Mineral Rights

As a result of our merger with AgBank, we own mineral rights in Arizona, California, Colorado, Kansas, Nevada, New Mexico, Oklahoma and Utah. As required by the merger agreement, the net earnings from these mineral rights are passed on directly to certain Associations formerly affiliated with AgBank. Mineral income is primarily generated from royalties on natural gas and crude oil production, leasing bonuses and rental payments. This income may vary from year to year based on fluctuations in energy demand, prices and production. In 2012, net mineral income passed directly to these Associations totaled $13.7 million. As a result of the agreement to pass the net earnings from mineral rights to certain Associations, these mineral rights have no carrying value in our consolidated balance sheet.

Derivative Financial Instruments and Hedging Activities

We record derivatives as assets or liabilities at their fair value on the consolidated balance sheets. We record changes in the fair value of a derivative in current period earnings or accumulated other comprehensive income (loss), depending on the use of the derivative and whether it qualifies for fair value or cash flow hedge accounting. For derivatives not designated as hedging instruments, we record the related change in fair value in current period earnings.

We formally document all relationships between derivatives and hedged items, as well as risk management objectives and strategies for undertaking various hedge transactions. This process includes linking all derivatives that are designated as fair value or cash flow hedges to assets and liabilities on the consolidated balance sheets or to forecasted transactions.

We also formally assess (both at the hedge's inception and on an ongoing basis) whether the derivatives that are used in hedging transactions have been effective in offsetting changes in the fair value or cash flows of hedged items and whether those derivatives are expected to remain effective in future periods. We typically use regression analyses or other statistical analyses to assess the effectiveness of hedges. Hedge accounting is discontinued prospectively if: (i) it is determined that the derivative is no longer effective in offsetting changes in the fair value or cash flows of a hedged item; (ii) the derivative expires or is sold, terminated or exercised; or (iii) management determines that the fair value or cash flow hedge designation is no longer appropriate.

If we determine that a derivative no longer qualifies as an effective fair value or cash flow hedge, or if management removes the hedge designation, we continue to carry the derivative on the balance sheet at fair value, with changes in fair value recognized in current period earnings as part of noninterest income. For discontinued cash flow hedges, we amortize the component of other comprehensive income (loss) to net interest income over the original term of the hedge contract. For additional information, refer to Note 12.

Fair Value Measurements

Our fair value measurements represent the estimated amount to be received to sell an asset or paid to transfer or extinguish a liability (an exit price) in active markets among willing participants at the reporting date. We maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The classification of assets and liabilities measured at fair value within the disclosure hierarchy is based on three levels of inputs to the fair value measurement process, which are described in Note 13.

Fair Value of Guarantor's Obligations

We provide standby letters of credit, which are irrevocable undertakings to guarantee payment of a specified financial obligation. As a guarantor, we recognize a liability for the fair value of the obligation undertaken in issuing the guarantee. Our liability for the fair value of these obligations is determined by applying a risk-adjusted spread percentage to those obligations.

Employee Benefit Plans

Our employee benefit plans are described in Note 9. The net expense for employee benefit plans is recorded as employee compensation expense. For defined benefit pension plans, we use the "Projected Unit Credit" actuarial method for financial reporting and funding purposes.

The anticipated costs of benefits related to postretirement health care and life insurance are accrued during the period of the employees' active service and are classified as employee compensation expense.

Income Taxes

CoBank, ACB operates as a non-exempt cooperative, which qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, amounts distributed as qualified patronage distributions to borrowers in the form of cash or stock may be deducted from taxable income. We base provisions for income taxes for financial reporting purposes only on those taxable earnings that will not be distributed as qualified patronage distributions.

CoBank, FCB is a wholly owned subsidiary of CoBank, ACB. Beginning in 2012, the Bank's tax-exempt activities primarily reside in CoBank, FCB.

We record deferred tax assets and liabilities for temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases except for our nontaxable entity. We measure these deferred amounts using the current marginal statutory tax rate on the taxable portion of our business activities. Calculating deferred tax assets and liabilities involves various management estimates and assumptions as to future taxable earnings. We expect to fully realize deferred tax assets based on the projected level of future taxable income and other factors.

See Note 10 for further information regarding income taxes.

Subsequent Events

We have evaluated subsequent events through March 1, 2013, which is the date the financial statements were issued.

Note 2 – Recently Issued or Adopted Accounting Pronouncements

In April 2011, the Financial Accounting Standards Board (FASB) issued guidance on troubled debt restructurings, including criteria to determine whether a loan modification represents a concession and whether the debtor is experiencing financial difficulties. We adopted the new requirements in the first quarter of 2012. The adoption did not have a material effect on our consolidated financial position, results of operations or cash flows. Troubled debt restructurings are discussed further in Note 4.

In May 2011, the FASB issued guidance clarifying certain aspects of fair value measurement and disclosure requirements. We adopted the new requirements in the first quarter of 2012. The adoption did not have a material effect on our consolidated financial position, results of operations or cash flows; however, we have expanded our disclosure related to our Level 2 and Level 3 valuation techniques and inputs in Note 13.

In June and December 2011, the FASB issued guidance which revises the manner in which entities present comprehensive income in their financial statements. The new guidance requires entities to report components of comprehensive income in either a continuous statement of comprehensive income or two separate but consecutive statements. The guidance does not change the items that must be reported in other comprehensive income. These provisions were effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The new guidance must be applied retrospectively. We adopted the new requirements in the first quarter of 2012. The adoption did not have a material effect on our consolidated financial position, results of operations or cash flows; however, it did result in changes to the presentation of comprehensive income, which is now displayed in two separate but consecutive statements on pages 62 and 63.

In December 2011, the FASB issued guidance creating new disclosure requirements about the nature of an entity's rights of setoff and related arrangements associated with its financial instruments and derivative instruments. The requirements are effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods, with retrospective application required. We will adopt these provisions in 2013. The adoption will not impact our consolidated financial position, results of operations or cash flows, but will expand our disclosure associated with certain financial instruments.

Note 3 – Merger with U.S. AgBank, FCB

Effective January 1, 2012, AgBank was merged with and into CoBank. As a result of the merger, the number of our affiliated Associations increased from four to 29 and now includes Associations in 23 states serving the Northwest, West, Southwest, Rocky Mountains, Mid-Plains, and Northeast regions of the United States. The merger with AgBank diversifies CoBank's loan portfolio, builds our capital base and enhances our overall lending capacity. The effects of the merger are included in our results of operations, balance sheet, average balances and related metrics beginning in 2012.

On January 1, 2012, in connection with the merger, each share of outstanding common stock of AgBank was exchanged for one-twentieth of a share of common stock of CoBank. In addition, AgBank's preferred stock was exchanged for a new series of CoBank preferred stock with substantially the same terms and conditions. These transactions are further explained in Note 8.

The merger was accounted for under the acquisition method of accounting, as prescribed by Accounting Standards Codification (ASC) 805, Business Combinations (ASC 805). Pursuant to these rules, CoBank acquired the assets and assumed the liabilities of AgBank at their acquisition-date fair value. The fair value of the net identifiable assets acquired ($1.04 billion) was substantially equal to the fair value of the equity interests exchanged in the merger. As a result, no goodwill was recorded. In addition, no material amounts of intangible assets were acquired. A net decrease of $61.6 million was recorded in retained earnings related to the merger.

The following condensed statement of net assets acquired reflects the fair value assigned to AgBank's net assets as of the acquisition date. There were no subsequent changes to these fair values.

($ in Millions)

Condensed Statement of Net Assets Acquired

		January 1, 2012
Assets		
Net Loans	$	20,200
Cash		226
Investment Securities		4,832
Accrued Interest Receivable		113
Interest Rate Swaps and Other Financial Instruments		85
Other Assets		100
Total Assets	$	25,556
Liabilities		
Bonds and Notes	$	24,306
Accrued Interest Payable		81
Other Liabilities		127
Total Liabilities	$	24,514
Fair Value of Net Assets Acquired	$	1,042

Fair value adjustments to AgBank's assets and liabilities included a $553.0 million increase to loans and a $700.4 million increase to bonds and notes to reflect changes in interest rates and other market conditions since the time these instruments were issued. These differences will be accreted or amortized into net interest income over the remaining life of the respective loans and debt instruments on an effective yield basis, with the majority being recognized in diminishing amounts in the first five years following the merger. We expect to collect the substantial majority of the contractual amounts of the acquired loans, which totaled $19.7 billion at January 1, 2012.

In connection with the merger, we acquired investment securities with a contractual outstanding principal and interest balance of $5.2 billion. We recorded these investments on our consolidated balance sheet at an estimated fair value of $4.8 billion, consisting of U.S. Treasury and agency debt securities of $643.9 million, U.S. agency mortgage-backed securities (MBS) of $3.2 billion, Federal Agricultural Mortgage Corporation (Farmer Mac) MBS of $252.9 million, FHA/VA non-wrapped reperformer MBS (i.e., investment securities where residential mortgage loans serving as collateral were cured after a default) of $554.1 million, non-agency MBS of $132.7 million, and asset-backed securities (ABS) of $58.5 million.

We determined that certain of the acquired FHA/VA non-wrapped reperformer MBS, non-agency MBS and ABS had evidence of credit quality deterioration such that it is probable that we will be unable to collect all contractually required payments. These investments, which we refer to as acquired credit-impaired investment securities, are subject to the provisions of ASC 310-30, Accounting for Certain Loans or Debt Securities Acquired in a Transfer, pursuant to which the difference between contractually required payments and the cash flows expected to be collected at acquisition is considered a 'non-accretable amount.' This difference is neither accreted into income nor recorded on our consolidated balance sheet. The excess of cash flows expected to be collected over fair value is referred to as 'accretable amounts' and is recognized in interest income over the remaining life of the investment using the effective yield method, with the majority being recognized in diminishing amounts in the first five years following the merger. The following table displays information related to the acquired credit-impaired investment securities.

($ in Millions)

Information for Acquired Credit-Impaired Investment Securities as of January 1, 2012		
Contractually Required Payments Including Interest	$	1,104
Non-accretable Amount		(103)
Cash Flows Expected to be Collected*		1,001
Accretable Amounts		(261)
Fair Value of Acquired Credit-Impaired Investment Securities	**$**	**740**

* Represents the undiscounted expected principal and interest cash flows

At each reporting period we evaluate estimated cash flows expected to be collected from acquired credit-impaired investment securities. Increases in expected cash flows will generally result in an increase in interest income over the remaining life of the investment. Decreases in expected cash flows due to credit deterioration will generally result in other-than-temporary impairment charges recognized in earnings. During 2012, we recorded $7.0 million in impairment losses related to four non-agency MBS and one ABS that were among those identified as credit-impaired investment securities acquired as part of the AgBank merger.

($ in Millions)

Changes in Accretable Amounts of Acquired Credit-Impaired Investment Securities		
Balance at January 1, 2012	$	(261)
Interest Recognized in Earnings		44
Reclassifications from Nonaccretable Amount for Investments with Improvements in Expected Cash Flows		-
Total Other-Than-Temporary Impairment Losses Included in Earnings		7
Balance at December 31, 2012	**$**	**(210)**

The carrying amount of acquired credit-impaired investment securities was $678.0 million at December 31, 2012.

Note 4 – Loans, Loan Quality and Allowance for Credit Losses

Loans Outstanding

Loans outstanding by operating segment are shown below.

($ in Millions)

December 31,	2012		2011		2010	
	Amount	%	Amount	%	Amount	%
Agribusiness	**$ 21,394**	**30 %**	$ 18,869	41 %	$ 22,676	45 %
Strategic Relationships	**36,707**	**51**	15,236	33	15,392	31
Rural Infrastructure	**13,879**	**19**	12,180	26	11,924	24
Total	**$ 71,980**	**100 %**	$ 46,285	100 %	$ 49,992	100 %
Loans Purchased	**$ 9,574**		$ 8,600		$ 8,403	
Loans Sold	**10,915**		8,617		8,291	

We have loans outstanding in all 50 states as well as 29 foreign countries and a limited number of U.S. territories. Our agricultural export finance loan portfolio, which is included in our Agribusiness operating segment, reflects significant concentration in U.S. government-sponsored trade financing programs which guarantee payment in the event of default by the borrower of generally 98 percent of loan principal outstanding and varying percentages of interest due. Of the $4.6 billion in agricultural export finance loans outstanding as of December 31, 2012, 76 percent were guaranteed by the U.S. government under one of these trade financing programs, primarily the General Sales Manager program of the U.S. Department of Agriculture's Commodity Credit Corporation.

We make loans to customers in various industries. Industries that represent 10 percent or more of total loans outstanding (excluding direct wholesale loans to Associations) for any of the periods presented below are as follows:

December 31,	2012	2011	2010
Farm Supply and Grain Marketing	**9 %**	16 %	22 %
Electric Distribution	**7**	11	10

Loans to our affiliated Associations represented 46 percent, 24 percent, and 23 percent of total loans outstanding at December 31, 2012, 2011 and 2010, respectively. As of December 31, 2012, our 29 affiliated Associations provided financing and other financial services to farmer-owners for rural real estate, equipment, working capital, agricultural production and operating purposes in the Northwest, West, Southwest, Rocky Mountains, Mid-Plains, and Northeast regions of the United States. Participations in loans made by other System banks to their affiliated Associations represented 5 percent, 9 percent, and 8 percent of our total loans outstanding at December 31, 2012, 2011 and 2010, respectively.

Unamortized loan premiums and discounts, and unamortized deferred loan fees and costs totaled $63.2 million, $70.0 million and $69.0 million as of December 31, 2012, 2011 and 2010, respectively.

Allowance for Credit Losses

The following tables present the changes in the components of our allowance for credit losses and the details of the ending balances. The allowance for credit losses includes the allowance for loan losses and the reserve for unfunded commitments. The elements of our allowance for credit losses are presented by operating segment.

	Agribusiness	Strategic Relationships[1]	Rural Infrastructure	Total
December 31, 2012				
Allowance for Loan Losses				
Beginning Balance	$ 269,317	$ -	$ 118,739	$ 388,056
Charge-offs	(29,069)	-	(1,556)	(30,625)
Recoveries	11,022	-	2,707	13,729
Provision for Loan Losses	16,550	-	53,450	70,000
Transfers (to) from Reserve for Unfunded Commitments[2]	9,775	-	(13,559)	(3,784)
Ending Balance	277,595	-	159,781	437,376
Reserve for Unfunded Commitments				
Beginning Balance	116,467	-	37,452	153,919
Transfers (to) from Allowance for Loan Losses[2]	(9,775)	-	13,559	3,784
Ending Balance	106,692	-	51,011	157,703
Allowance for Credit Losses	$ 384,287	$ -	$ 210,792	$ 595,079
Allowance for Credit Losses				
Ending Balance, Allowance for Credit Losses Related to Loans:				
Individually Evaluated for Impairment	$ 10,656	$ -	$ 32,700	$ 43,356
Collectively Evaluated for Impairment	373,631	-	178,092	551,723
Total	$ 384,287	$ -	$ 210,792	$ 595,079
Loans				
Ending Balance for Loans and Related Accrued Interest:				
Individually Evaluated for Impairment	$ 70,476	$ 36,831,056	$ 99,731	$ 37,001,263
Collectively Evaluated for Impairment	21,381,372	-	13,837,987	35,219,359
Total	$ 21,451,848	$ 36,831,056	$ 13,937,718	$ 72,220,622
December 31, 2011				
Allowance for Loan Losses				
Beginning Balance	$ 284,217	$ -	$ 116,527	$ 400,744
Charge-offs	(10,559)	-	(12,956)	(23,515)
Recoveries	6,527	-	420	6,947
Provision for Loan Losses	37,000	-	21,000	58,000
Transfers to Reserve for Unfunded Commitments[2]	(47,868)	-	(6,252)	(54,120)
Ending Balance	269,317	-	118,739	388,056
Reserve for Unfunded Commitments				
Beginning Balance	68,599	-	31,200	99,799
Transfers from Allowance for Loan Losses[2]	47,868	-	6,252	54,120
Ending Balance	116,467	-	37,452	153,919
Allowance for Credit Losses	$ 385,784	$ -	$ 156,191	$ 541,975
Allowance for Credit Losses				
Ending Balance, Allowance for Credit Losses Related to Loans:				
Individually Evaluated for Impairment	$ 16,254	$ -	$ 7,500	$ 23,754
Collectively Evaluated for Impairment	369,530	-	148,691	518,221
Total	$ 385,784	$ -	$ 156,191	$ 541,975
Loans				
Ending Balance for Loans and Related Accrued Interest:				
Individually Evaluated for Impairment	$ 80,351	$ 15,275,708	$ 54,511	$ 15,410,570
Collectively Evaluated for Impairment	18,837,654	-	12,191,938	31,029,592
Total	$ 18,918,005	$ 15,275,708	$ 12,246,449	$ 46,440,162

	Agribusiness	Strategic Relationships[1]	Rural Infrastructure	Total
December 31, 2010				
Allowance for Loan Losses				
Beginning Balance	$ 264,540	$ -	$ 105,277	$ 369,817
Charge-offs	(25,893)	-	(50,502)	(76,395)
Recoveries	4,234	-	14,514	18,748
Provision for Loan Losses	7,167	-	52,833	60,000
Transfers from (to) Reserve for Unfunded Commitments[2]	34,169	-	(5,595)	28,574
Ending Balance	284,217	-	116,527	400,744
Reserve for Unfunded Commitments				
Beginning Balance	102,768	-	25,605	128,373
Transfers from (to) Allowance for Loan Losses[2]	(34,169)	-	5,595	(28,574)
Ending Balance	68,599	-	31,200	99,799
Allowance for Credit Losses	$ 352,816	$ -	$ 147,727	$ 500,543
Allowance for Credit Losses				
Ending Balance, Allowance for Credit Losses Related to Loans:				
Individually Evaluated for Impairment	$ 16,918	$ -	$ 23,200	$ 40,118
Collectively Evaluated for Impairment	335,898	-	124,527	460,425
Total	$ 352,816	$ -	$ 147,727	$ 500,543
Loans				
Ending Balance for Loans and Related Accrued Interest:				
Individually Evaluated for Impairment	$ 93,373	$ 15,435,194	$ 73,600	$ 15,602,167
Collectively Evaluated for Impairment	22,644,294	-	11,917,340	34,561,634
Total	$ 22,737,667	$ 15,435,194	$ 11,990,940	$ 50,163,801

(1) As a result of our strong collateral position with respect to loans to Associations, along with the earnings, capital and loss reserves of Associations that serve as an additional layer of protection against losses, no allowance for credit losses is recorded in our Strategic Relationships operating segment.

(2) These transfers generally occur as a result of advances on or repayments of seasonal lines of credit or other loans.

The information in the tables under the Credit Quality, Aging Analysis and Impaired Loans captions is presented by operating segment, with guaranteed and non-guaranteed loans in our Agribusiness segment separately identified.

Credit Quality

The following table presents our loans and related accrued interest classified, by management, pursuant to our regulator's Uniform Loan Classification System.

December 31, 2012	Agribusiness Non-Guaranteed	Agribusiness Guaranteed	Strategic Relationships	Rural Infrastructure	Total
Acceptable	$ 16,786,810	$ 3,512,387	$ 36,831,056	$ 13,579,205	$ 70,709,458
Special Mention	618,149	4	-	160,913	779,066
Substandard	520,928	-	-	150,528	671,456
Doubtful	13,570	-	-	47,072	60,642
Loss	-	-	-	-	-
Total	$ 17,939,457	$ 3,512,391	$ 36,831,056	$ 13,937,718	$ 72,220,622
December 31, 2011					
Acceptable	$ 14,753,661	$ 2,850,689	$ 15,275,708	$ 12,019,166	$ 44,899,224
Special Mention	824,133	43	-	135,331	959,507
Substandard	473,432	-	-	84,452	557,884
Doubtful	16,047	-	-	7,500	23,547
Loss	-	-	-	-	-
Total	$ 16,067,273	$ 2,850,732	$ 15,275,708	$ 12,246,449	$ 46,440,162
December 31, 2010					
Acceptable	$ 17,577,545	$ 3,385,473	$ 14,885,307	$ 11,688,197	$ 47,536,522
Special Mention	1,192,436	208	399,787	177,407	1,769,838
Substandard	564,926	266	150,100	99,416	814,708
Doubtful	16,813	-	-	25,920	42,733
Loss	-	-	-	-	-
Total	$ 19,351,720	$ 3,385,947	$ 15,435,194	$ 11,990,940	$ 50,163,801

Aging Analysis

The following tables present an aging of past due loans and related accrued interest.

December 31, 2012	Agribusiness Non-Guaranteed	Agribusiness Guaranteed	Strategic Relationships	Rural Infrastructure	Total
30-89 Days Past Due	$ 7,609	$ -	$ -	$ -	$ 7,609
90 Days Past Due	21,608	-	-	5,296	26,904
Total Past Due	$ 29,217	$ -	$ -	$ 5,296	$ 34,513
Current	17,910,240	3,512,391	36,831,056	13,932,422	72,186,109
Total	$ 17,939,457	$ 3,512,391	$ 36,831,056	$ 13,937,718	$ 72,220,622
Accruing Loans 90 Days or More Past Due	$ 2,513	$ -	$ -	$ -	$ 2,513
December 31, 2011					
30-89 Days Past Due	$ 68,847	$ -	$ -	$ -	$ 68,847
90 Days Past Due	20,126	-	-	-	20,126
Total Past Due	$ 88,973	$ -	$ -	$ -	$ 88,973
Current	15,978,300	2,850,732	15,275,708	12,246,449	46,351,189
Total	$ 16,067,273	$ 2,850,732	$ 15,275,708	$ 12,246,449	$ 46,440,162
Accruing Loans 90 Days or More Past Due	$ 114	$ -	$ -	$ -	$ 114

December 31, 2010	Agribusiness Non-Guaranteed	Agribusiness Guaranteed	Strategic Relationships	Rural Infrastructure	Total
30-89 Days Past Due	$ 8,606	$ -	$ -	$ -	$ 8,606
90 Days Past Due	5,664	-	-	33,716	39,380
Total Past Due	$ 14,270	$ -	$ -	$ 33,716	$ 47,986
Current	19,337,450	3,385,947	15,435,194	11,957,224	50,115,815
Total Loans Outstanding	$ 19,351,720	$ 3,385,947	$ 15,435,194	$ 11,990,940	$ 50,163,801
Accruing Loans 90 Days or More Past Due	$ 681	$ -	$ -	$ -	$ 681

Impaired Loans

Impaired loan information is shown in the following tables. Loans past due 90 days or more and still accruing interest are adequately secured and in the process of collection.

December 31, 2012	Agribusiness Non-Guaranteed	Agribusiness Guaranteed(1)	Strategic Relationships(1)	Rural Infrastructure	Total
Nonaccrual Loans(2)	**$ 70,476**	**$ -**	**$ -**	**$ 99,731**	**$ 170,207**
Accruing Loans 90 Days or More Past Due	**2,513**	**-**	**-**	**-**	**2,513**
Accruing Restructured Loans	**-**	**-**	**-**	**-**	**-**
Total Impaired Loans	**$ 72,989**	**$ -**	**$ -**	**$ 99,731**	**$ 172,720**
December 31, 2011					
Nonaccrual Loans(2)	$ 80,350	$ -	$ -	$ 54,512	$ 134,862
Accruing Loans 90 Days or More Past Due	114	-	-	-	114
Accruing Restructured Loans	-	-	-	-	-
Total Impaired Loans	$ 80,464	$ -	$ -	$ 54,512	$ 134,976
December 31, 2010					
Nonaccrual Loans	$ 93,373	$ -	$ -	$ 73,600	$ 166,973
Accruing Loans 90 Days or More Past Due	681	-	-	-	681
Accruing Restructured Loans	-	-	-	-	-
Total Impaired Loans	$ 94,054	$ -	$ -	$ 73,600	$ 167,654

(1) There were no impaired loans in our Agribusiness Guaranteed or Strategic Relationships portfolios for any of the periods presented.

(2) Included in nonaccrual loans at December 31, 2012 are $24.7 million of loans that qualify as troubled debt restructurings. Included in nonaccrual loans at December 31, 2011 are $17.3 million of loans that qualify as troubled debt restructurings.

The following tables present information on impaired loans and related amounts in the allowance for loan losses.

December 31, 2012	Agribusiness Non-Guaranteed	Agribusiness Guaranteed[1]	Strategic Relationships[1]	Rural Infrastructure	Total
Impaired Loans With No Related Allowance for Loan Losses					
Carrying Amount	$ 52,902	$ -	$ -	$ 6,907	$ 59,809
Unpaid Principal	97,720	-	-	15,744	113,464
Average Balance	56,076	-	-	24,333	80,409
Interest Income Recognized	1,674	-	-	1,702	3,376
Impaired Loans With Related Allowance for Loan Losses					
Carrying Amount	20,087	-	-	92,824	112,911
Unpaid Principal	23,058	-	-	96,747	119,805
Allowance for Loan Losses	10,656	-	-	32,700	43,356
Average Balance	15,528	-	-	37,584	53,112
Interest Income Recognized	4,351	-	-	-	4,351
Total Impaired Loans					
Carrying Amount	72,989	-	-	99,731	172,720
Unpaid Principal	120,778	-	-	112,491	233,269
Allowance for Loan Losses	10,656	-	-	32,700	43,356
Average Balance	71,604	-	-	61,917	133,521
Interest Income Recognized	6,025	-	-	1,702	7,727
December 31, 2011					
Impaired Loans With No Related Allowance for Loan Losses					
Carrying Amount	$ 25,589	$ -	$ -	$ 39,328	$ 64,917
Unpaid Principal	37,584	-	-	50,344	87,928
Average Balance	39,996	-	-	42,547	82,543
Interest Income Recognized	4,888	-	-	32	4,920
Impaired Loans With Related Allowance for Loan Losses					
Carrying Amount	54,875	-	-	15,184	70,059
Unpaid Principal	75,761	-	-	16,893	92,654
Allowance for Loan Losses	16,254	-	-	7,500	23,754
Average Balance	65,783	-	-	17,450	83,233
Interest Income Recognized	-	-	-	-	-
Total Impaired Loans					
Carrying Amount	80,464	-	-	54,512	134,976
Unpaid Principal	113,345	-	-	67,237	180,582
Allowance for Loan Losses	16,254	-	-	7,500	23,754
Average Balance	105,779	-	-	59,997	165,776
Interest Income Recognized	4,888	-	-	32	4,920

December 31, 2010	Agribusiness Non-Guaranteed	Agribusiness Guaranteed[(1)]	Strategic Relationships[(1)]	Rural Infrastructure	Total
Impaired Loans With No Related Allowance for Loan Losses					
Carrying Amount	$ 34,866	$ -	$ -	$ 20,952	$ 55,818
Unpaid Principal	47,004	-	-	39,939	86,943
Average Balance	106,480	-	-	28,357	134,837
Interest Income Recognized	4,405	-	-	1,059	5,464
Impaired Loans With Related Allowance for Loan Losses					
Carrying Amount	59,188	-	-	52,648	111,836
Unpaid Principal	76,519	-	-	65,223	141,742
Allowance for Loan Losses	16,918	-	-	23,200	40,118
Average Balance	65,001	-	-	61,777	126,778
Interest Income Recognized	-	-	-	-	-
Total Impaired Loans					
Carrying Amount	94,054	-	-	73,600	167,654
Unpaid Principal	123,523	-	-	105,162	228,685
Allowance for Loan Losses	16,918	-	-	23,200	40,118
Average Balance	171,481	-	-	90,134	261,615
Interest Income Recognized	4,405	-	-	1,059	5,464

(1) There were no impaired loans in our Agribusiness Guaranteed or Strategic Relationships portfolios for any of the periods presented.

Interest income forgone on nonaccrual and accruing restructured loans is as follows:

Year Ended December 31, 2012	
Interest Income Which Would Have Been Recognized Per Original Terms	$ 15,849
Less: Interest Income Recognized	(7,611)
Forgone Interest Income	$ 8,238

Commitments on Impaired Loans

There were $12.3 million in commitments available to be drawn by borrowers whose loans were classified as impaired at December 31, 2012.

Troubled Debt Restructurings

Troubled debt restructurings (TDRs) are loans in which we have granted a concession because the borrower is experiencing financial difficulty. Concessions may include payment deferrals, term extensions and/or interest rate reductions. As of December 31, 2012, all TDRs are classified as nonaccrual loans. TDRs classified as nonaccrual loans, along with other impaired loans, may be returned to accruing status upon meeting specific criteria, as more fully described in Note 1. During the year ended December 31, 2012, there was one modification that qualified as a TDR. This loan totaled $25.5 million before and after modification. During the year ended December 31, 2011, we modified two loans to customers that qualified as TDRs. These loans totaled $11.6 million before and after modification. Subsequent to their restructuring, there have been no payment defaults on our TDR-classified loans.

Leases Outstanding

A summary of the components of FCL's net investment in direct financing leases and property on operating leases is as follows:

($ in Millions)

December 31,	2012	2011	2010
Net Investment in Direct Financing Leases:			
Minimum Lease Payments to be Received, Net of Participation Interests	**$ 1,382**	$ 1,293	$ 1,232
Estimated Residual Values of Leased Property (Unguaranteed)	**384**	344	311
Initial Direct Costs	**12**	11	10
Less: Unearned Finance Income	**(184)**	(196)	(212)
Net Investment in Direct Financing Leases	**$ 1,594**	$ 1,452	$ 1,341
Property on Operating Leases:			
Vehicles and Other Equipment	**$ 793**	$ 750	$ 750
Initial Direct Costs	**3**	2	2
Total	**796**	752	752
Less: Accumulated Depreciation	**(327)**	(327)	(339)
Net Property on Operating Leases	**$ 469**	$ 425	$ 413
Year Ended December 31,	**2012**	**2011**	**2010**
Depreciation Expense	**$ 136**	$ 124	$ 123

At December 31, 2012, gross minimum lease payments to be received for direct financing leases and minimum future rental revenue for noncancelable operating leases are as follows:

($ in Millions)

Year	Minimum Lease Payments	Minimum Future Rental Revenue
2013	$ 396	$ 104
2014	370	74
2015	244	41
2016	154	24
2017	93	4
Subsequent Years	125	1

Note 5 – Investment Securities

A summary of investment securities available-for-sale follows. See Note 13 for disclosures about estimated fair values of financial instruments, including investments.

($ in Millions)

December 31, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury and Agency Debt	$ 6,380	$ 112	$ (1)	$ 6,491
Mortgage-Backed:				
U.S. Agency	10,237	122	(6)	10,353
Farmer Mac	217	-	(2)	215
FHA/VA Non-Wrapped Reperformer	507	5	(6)	506
Non-Agency	271	26	(5)	292
Asset-Backed	97	27	(3)	121
Corporate Bonds	21	-	-	21
Total	$ 17,730	$ 292	$ (23)	$ 17,999

($ in Millions)

December 31, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury and Agency Debt	$ 3,549	$ 89	$ -	$ 3,638
Mortgage-Backed:				
U.S. Agency	8,899	166	(4)	9,061
Non-Agency	265	-	(23)	242
Asset-Backed	78	-	(24)	54
Total	$ 12,791	$ 255	$ (51)	$ 12,995

($ in Millions)

December 31, 2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury and Agency Debt	$ 3,311	$ 47	$ -	$ 3,358
Mortgage-Backed:				
U.S. Agency	8,673	124	(58)	8,739
Non-Agency	424	2	(24)	402
Asset-Backed	143	-	(25)	118
Total	$ 12,551	$ 173	$ (107)	$ 12,617

A summary of the contractual maturity, amortized cost, fair value and weighted average yield of investment securities by type at December 31, 2012 is as follows:

U.S. Treasury and Agency Debt Securities

($ in Millions)

Contractual Maturity	Amortized Cost	Fair Value	Weighted Average Yield
In One Year or Less	$ 1,450	$ 1,451	0.52 %
One to Five Years	3,542	3,561	0.73
Five to Ten Years	707	792	3.44
After Ten Years	681	687	1.76
Total	$ 6,380	$ 6,491	1.09

U.S. Agency Mortgage-Backed Securities

($ in Millions)

Contractual Maturity	Amortized Cost	Fair Value	Weighted Average Yield
In One Year or Less	$ -	$ -	- %
One to Five Years	12	12	3.53
Five to Ten Years	302	308	2.52
After Ten Years	9,923	10,033	1.62
Total	$ 10,237	$ 10,353	1.65

Farmer Mac Mortgage-Backed Securities

($ in Millions)

Contractual Maturity	Amortized Cost	Fair Value	Weighted Average Yield
In One Year or Less	$ -	$ -	- %
One to Five Years	-	-	-
Five to Ten Years	-	-	-
After Ten Years	217	215	2.14
Total	$ 217	$ 215	2.14

FHA/VA Non-Wrapped Reperformer Mortgage-Backed Securities

($ in Millions)

Contractual Maturity	Amortized Cost	Fair Value	Weighted Average Yield
In One Year or Less	$ -	$ -	- %
One to Five Years	-	-	-
Five to Ten Years	-	-	-
After Ten Years	507	506	6.13
Total	$ 507	$ 506	6.13

Non-Agency Mortgage-Backed Securities

($ in Millions)

Contractual Maturity	Amortized Cost	Fair Value	Weighted Average Yield
In One Year or Less	$ -	$ -	- %
One to Five Years	-	-	-
Five to Ten Years	12	12	0.67
After Ten Years	259	280	4.25
Total	$ 271	$ 292	4.09

Asset-Backed Securities

($ in Millions)

Contractual Maturity	Amortized Cost	Fair Value	Weighted Average Yield
In One Year or Less	$ -	$ -	- %
One to Five Years	-	-	-
Five to Ten Years	-	-	-
After Ten Years	97	121	7.83
Total	$ 97	$ 121	7.83

Corporate Bonds

($ in Millions)

Contractual Maturity	Amortized Cost	Fair Value	Weighted Average Yield
In One Year or Less	$ -	$ -	- %
One to Five Years	21	21	1.27
Five to Ten Years	-	-	-
After Ten Years	-	-	-
Total	$ 21	$ 21	1.27

While the substantial majority of our MBS and all of our ABS have contractual maturities in excess of 10 years, expected maturities for these securities are shorter than contractual maturities because of structured cash flow features and because borrowers have the right to call or prepay obligations.

The following table shows the fair value and gross unrealized losses for investments in a loss position aggregated by security type, and the length of time the securities have been in a continuous unrealized loss position at December 31, 2012, 2011 and 2010, respectively. The continuous loss position is based on the date the impairment first occurred. Unrealized loss positions related to these securities, including those impaired for longer than 12 months, are primarily from widened credit spreads.

($ in Millions)	Less Than 12 Months		Greater Than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2012				
U.S. Treasury and Agency Debt	**$ 1,191**	**$ (1)**	**$ -**	**$ -**
Mortgage-Backed:				
U.S. Agency	**764**	**(6)**	**67**	**-**
Farmer Mac	**143**	**(2)**	**-**	**-**
FHA/VA Non-Wrapped Reperformer	**283**	**(5)**	**15**	**(1)**
Non-Agency	**6**	**-**	**83**	**(5)**
Asset-Backed	**-**	**-**	**10**	**(3)**
Corporate Bonds	**21**	**-**	**-**	**-**
Total	**$ 2,408**	**$ (14)**	**$ 175**	**$ (9)**
December 31, 2011				
U.S. Treasury and Agency Debt	$ -	$ -	$ -	$ -
Mortgage-Backed:				
U.S. Agency	1,297	(3)	275	(1)
Non-Agency	57	(1)	143	(22)
Asset-Backed	-	-	54	(24)
Total	$ 1,354	$ (4)	$ 472	$ (47)
December 31, 2010				
U.S. Treasury and Agency Debt	$ -	$ -	$ -	$ -
Mortgage-Backed:				
U.S. Agency	3,188	(56)	641	(2)
Non-Agency	-	-	315	(24)
Asset-Backed	-	-	115	(25)
Total	$ 3,188	$ (56)	$ 1,071	$ (51)

As of December 31, 2012, with the exception of the securities in the following table, we expect to collect all principal and interest payments on our investment securities. We do not intend to sell the securities in unrealized loss positions, and it is not likely that we will be required to sell such securities, for regulatory, liquidity or other purposes before an anticipated recovery of our cost basis occurs.

The following table summarizes other-than-temporary impairment (OTTI) losses recorded in earnings by security type for the periods presented.

($ in Millions)	Number of Securities		OTTI	
December 31, 2012				
Asset-Backed	**5**	**$**	**12**	
Non-Agency Mortgage-Backed	**5**		**5**	
Total	**10**	**$**	**17**	
December 31, 2011				
Asset-Backed	4	$	5	(1)
Non-Agency Mortgage-Backed	4		5	
Total	8	$	10	
December 31, 2010				
Asset-Backed	7	$	35	(1)
Non-Agency Mortgage-Backed	3		9	
Total	10	$	44	

(1) During 2011, we sold a previously impaired asset-backed security for proceeds of $41.3 million and recorded a gain on disposition of $4.5 million. Impairment losses related to this security were $11.7 million in 2010.

The fair value of our securities with OTTI losses was $196.3 million, $129.8 million, and $184.3 million at December 31, 2012, 2011, and 2010, respectively.

The following table details the activity related to the credit loss component of investment securities that have been written down for OTTI.

Credit Losses on Impaired Investments ($ in Millions)

	2012	2011	2010
Beginning of Year	$ 48	$ 59	$ 15
Additional Credit Impairments Related to Securities Previously Impaired	9	7	18
Initial Credit Impairments Related to Securities Not Previously Impaired	8	3	26
Sales of Investments with Credit Impairments	-	(20)	-
Subsequent Accretion for Increases in Cash Flows Expected to be Collected	(1)	(1)	-
End of Year	$ 64	$ 48	$ 59

For impaired investment securities, we estimate the component of unrealized losses attributable to credit losses primarily using a third-party cash flow model. The model requires key assumptions related to underlying collateral, including the degree and timing of prepayments and defaults and loss severity. Assumptions used are influenced by such factors as interest rates and the performance, type and age of collateral. For prepayment assumptions, we use the lower of the three- or six-month historical voluntary prepayment rate. Prepayment rates used ranged from zero to 22 percent for impaired investment securities at December 31, 2012. We apply historical performance information to estimate future defaults using a default timing curve. Lifetime default rates ranged from 4 percent to 36 percent for impaired investment securities at December 31, 2012. Loss severity assumptions are based on actual performance, where available, or are obtained from an independent third-party. Loss severity ranged from 36 percent to 100 percent for impaired investment securities at December 31, 2012.

Note 6 – Bonds and Notes

We are primarily liable for the following bonds and notes:

($ in Millions)

December 31,	2012	2011	2010
Bonds	**$ 74,154**	$ 49,174	$ 50,416
Medium-term Notes	**342**	340	376
Discount Notes	**6,927**	4,278	7,194
Total Systemwide Debt Securities	**81,423**	53,792	57,986
Cash Investment Services Payable	**1,614**	1,515	439
Other	**570**	797	899
Total Bonds and Notes	**$ 83,607**	$ 56,104	$ 59,324

Systemwide Debt Securities

We, along with the other System banks, obtain funds for lending activities and operations primarily from the sale of debt securities issued by System banks through the Funding Corporation. These debt securities are composed of bonds, medium-term notes and discount notes and are collectively referred to as Systemwide Debt Securities. Pursuant to the Farm Credit Act, Systemwide Debt Securities are the general unsecured joint and several obligations of the System banks. Systemwide Debt Securities are not obligations of, and are not guaranteed by, the U.S. government or any agency or instrumentality thereof, other than the System banks.

Bonds and medium-term notes are issued at fixed or floating interest rates. Bonds have original maturities of three months to 30 years, while medium-term notes have original maturities ranging from one to 30 years. Discount notes are issued with maturities ranging from one to 365 days. The weighted average remaining maturity of CoBank's discount notes outstanding at December 31, 2012 was 166 days.

Cash investment services payable mature within one year. Other bonds and notes primarily represent cash collateral payable to derivative counterparties that have posted collateral to us.

The aggregate maturities and the weighted average interest rates of CoBank's Systemwide Debt Securities at December 31, 2012 are shown in the accompanying table. Weighted average interest rates include the effect of related derivative financial instruments.

($ in Millions)

Maturities and Rates of Systemwide Debt Securities

	Bonds		Medium-term Notes		Discount Notes		Total	
Year of Maturity	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate
2013	$ 18,516	0.72	$ 169	5.84	$ 6,927	0.21	$ 25,612	0.62 %
2014	17,479	0.66	9	8.20	-	-	17,488	0.67
2015	16,978	0.65	9	6.93	-	-	16,987	0.65
2016	4,605	1.42	17	6.30	-	-	4,622	1.44
2017	4,461	1.57	-	-	-	-	4,461	1.57
2018 and thereafter	12,115	3.34	138	5.86	-	-	12,253	3.36
Total	$ 74,154	1.21	$ 342	5.96	$ 6,927	0.21	$ 81,423	1.15

Certain Systemwide Debt Securities include debt which may be called on the first call date and, subsequently, called daily or on each interest payment date thereafter. At December 31, 2012, callable debt was $5.8 billion, with the range of first call dates being from January 2013 through June 2015.

Conditions for Issuing Systemwide Debt

Certain conditions must be met before we can participate in the issuance of Systemwide Debt Securities. One such condition of participation, required by the Farm Credit Act and FCA regulations, is that we must maintain specified, eligible, unencumbered assets at least equal in value to the total amount of debt obligations outstanding for which we are primarily liable. Such assets exceeded applicable debt by $7.3 billion at December 31, 2012. This requirement does not provide holders of Systemwide Debt Securities with a security interest in any of our assets.

In addition, because System banks are contingently liable for Systemwide Debt Securities of the other System banks, the banks have entered into agreements to provide for mutual protection. The System banks and the Funding Corporation operate under a Second Amended and Restated Market Access Agreement (MAA) designed to address certain Funding Corporation statutory responsibilities. The MAA financial conditions establish mechanisms for monitoring, limiting and ultimately denying a troubled System bank's access to and participation in Systemwide debt issuances, thereby limiting other System banks' exposure to statutory joint and several liabilities. The MAA promotes the identification and resolution of financial problems of individual System banks in a timely manner. The System banks and the Funding Corporation have also entered into an Amended and Restated Contractual Interbank Performance Agreement (CIPA). The CIPA establishes an agreed-upon standard of financial condition and performance for the System banks and their affiliated Associations (the Districts). The CIPA measures various ratios taking into account the capital, asset quality, earnings, interest rate risk and liquidity of the Districts and System banks. Periodically, the ratios in the CIPA model are reviewed to take into consideration current performance standards in the financial services industry. In connection with the most recent review, effective June 30, 2011, certain ratios were revised. At December 31, 2012, 2011 and 2010, all System banks, including CoBank, were in compliance with all of the conditions of participation for the issuance of Systemwide Debt Securities.

Insurance Fund

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Corporation insures the timely payment of principal and interest on Systemwide Debt Securities and carries out various other responsibilities.

The primary sources of funds for the Insurance Fund are premiums paid by the System banks and earnings on the Insurance Corporation assets. Premiums are determined and assessed to System banks semi-annually by the Insurance Corporation.

Each System bank is required to pay premiums into the Insurance Fund until the assets in the Insurance Fund reach the "secure base amount" (SBA), which is defined in the Farm Credit Act as 2 percent of the aggregate outstanding insured Systemwide Debt Securities (adjusted to reflect the reduced risk on loans or investments guaranteed by the U.S. or state governments) or such other percentage of the aggregate outstanding insured Systemwide Debt Securities as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the SBA, the Insurance Corporation is required to reduce premiums, and, in some instances, may refund excess amounts, but must still ensure that premiums are sufficient to maintain the level of the Insurance Fund at the SBA.

The Insurance Fund ended 2011 above the SBA. In 2012, the Insurance Corporation approved and distributed the excess amounts to the System banks, and, as a result, in 2012, CoBank recorded a $44.6 million refund from the Insurance Corporation. We recorded no premium refund from the Insurance Corporation in the year ended December 31, 2011. For the year ended December 31, 2010, we recorded a $33.3 million premium refund from the Insurance Corporation, which resulted from the Insurance Fund ending 2009 above the SBA. The premium refunds recorded in 2012 and 2010 are classified in 'Other, Net' within the 'Noninterest Income/Expense' section of the consolidated statements of income for the years ended December 31, 2012 and 2010, respectively.

The Insurance Corporation premium rates were 5 basis points, 6 basis points, and 5 basis points of adjusted insured debt obligations for the years ended December 31, 2012, 2011 and 2010, respectively.

The Insurance Fund is available to assist with the timely payment of principal and interest on Systemwide Debt Securities, in the event of a default by a System bank, to the extent that net assets are available in the Insurance Fund. No other liabilities reflected in our financial statements are insured by the Insurance Corporation.

In addition, the Insurance Fund could be used to ensure the retirement of System entities' protected borrower equity at par or stated value and for other specified purposes. The Insurance Fund is also available for discretionary uses of providing assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. As discussed on page 52, the Insurance Fund does not insure the obligations of Farmer Mac.

At December 31, 2012, the assets of the Insurance Fund aggregated $3.3 billion. However, due to the other authorized uses of the Insurance Fund, there is no assurance that any available amount in the Insurance Fund will be sufficient to fund the timely payment of principal or interest on Systemwide Debt Securities in the event of a default by any System bank having primary liability thereon.

Early Extinguishment of Debt

During 2012, we recorded losses of $86.7 million on the early extinguishment of $371.5 million of Systemwide Debt Securities. During 2011 and 2010, we recorded losses of $50.4 million and $26.5 million, respectively, on the early extinguishment of $649.3 million and $235.7 million of Systemwide Debt Securities, respectively. All losses on early extinguishment of debt are reported as a component of noninterest income.

Note 7 – Subordinated Debt

We had subordinated debt outstanding of $904.7 million and $1.0 billion at December 31, 2012 and 2011, respectively. In December 2012, we purchased $95.3 million of our 7.875 percent fixed rate Series 2008A subordinated notes through a cash tender offer. As a result, we incurred losses of $28.5 million, which are recorded as a component of noninterest income. Our subordinated debt was issued in April 2008 and June 2007, as summarized in the table below.

Subordinated Debt as of December 31, 2012

	Series 2008A	Series 2007A
Type	Unsecured subordinated notes	Unsecured subordinated notes
Issue Date	April 2008	June 2007
Maturity Date	April 2018	June 2022
Amount Outstanding (000)	$404,685	$500,000
Interest Rate (%)	7.875%	3-month USD LIBOR + 0.60% (0.908% at December 31, 2012)
Interest Payment Date	Semi-annually in cash on 15th day of April and October	Quarterly in cash on 15th day of March June, September and December

The 2007 issuance of subordinated debt may be redeemed, in whole or in part, at our option, on June 15, 2017, and each of the 2007 and 2008 issuances of subordinated debt may be redeemed, in whole, at our option at any time upon the occurrence of certain defined regulatory conditions. Any redemption of subordinated debt shall be at a redemption price of 100 percent of the principal amount, plus any accrued but unpaid interest to the date of redemption, provided we have made payment in full of all amounts then due in respect of our senior indebtedness.

Our subordinated debt is unsecured and junior to all other categories of creditors, including general creditors, and senior to all classes of shareholders. Interest on subordinated debt will be deferred if, as of the fifth business day prior to an interest payment date, any applicable minimum regulatory capital ratios are not satisfied. A deferral period may not last for more than the shorter of five consecutive years or the maturity date of the subordinated debt. We may not declare or pay any dividends or patronage distributions until interest payments are resumed and all deferred interest has been paid.

Our subordinated debt is not considered Systemwide debt and is not an obligation of, or guaranteed by, the Farm Credit System or any banks in the System, other than CoBank. Payments on our subordinated debt are not insured by the Insurance Corporation.

Note 8 – Shareholders' Equity

Description of Equities

As of December 31, 2012, we had $961.8 million of preferred stock and $2.6 billion in common stock outstanding, as summarized in the table below.

Preferred and Common Stock

	Stock		
	Preferred	Class A	Class A
Shares Authorized (000)	n/a [1]	Unlimited	Unlimited
Shares Outstanding (000)	10,960	1,019	25,041
Voting or Nonvoting	Nonvoting	Nonvoting	Voting
Par / Face Value (per share)	n/a [1]	$ 100	$ 100

[1] Shares authorized and par/face value can vary by issuance. Refer to table on page 86.

Pursuant to our bylaws, we have a single class of common equity – Class A common stock. Class A shareholders that are directly eligible to borrow from CoBank, that borrow on a patronage basis and that are active borrowers, have voting rights. No other class of shareholders has voting rights.

On January 1, 2012, in conjunction with the merger, each share of outstanding common stock of AgBank (Class A Common Stock, $5 par value, 177,162,554 shares outstanding; Class B Common Stock, $5 par value, 200 shares outstanding; Class C Common Stock, $5 par value, 200 shares outstanding) was exchanged for one-twentieth of a share of Class A common stock of CoBank ($100 par value, 8,858,148 shares outstanding). In addition, AgBank's $225 million of preferred stock ($1,000 par value, 225,000 shares outstanding) was exchanged for $225 million of a new series (Series E) of CoBank non-cumulative perpetual preferred stock ($1,000 par value, 225,000 shares outstanding) with substantially the same terms and conditions.

In 2008, our shareholders approved a measure allowing CoBank to issue preferred stock, subject to FCA approval, up to the then bylaw limit of $1.0 billion outstanding, at any time through September 2018. In September 2011, in connection with the merger with AgBank, shareholders approved an increase to the authorized level and bylaw limit of preferred stock to $1.5 billion outstanding. Such measures allow us to access third party capital more quickly and efficiently in response to dynamic market conditions, without the necessity of obtaining shareholder approval for each issuance.

Holders of common equities may not pledge, hypothecate or otherwise grant a security interest in such equities except as consented to by the Bank under FCA regulations. We have a statutory first lien on CoBank common stock. We pay dividends only on preferred stock.

In case of liquidation or dissolution, preferred stock, common stock and unallocated retained earnings would be distributed to shareholders, after the payment of all liabilities pursuant to FCA regulations, in the following order: (1) retirement of all Series C, Series D, Series E and Series F preferred stock at par plus all accrued but unpaid dividends for the then current dividend period; (2) retirement of all common stock at par; (3) retirement of all patronage surplus (a component of unallocated retained earnings) in amounts equal to the face amount of the applicable nonqualified written notices of allocation or such other notice; and (4) remaining unallocated retained earnings and reserves shall be paid to the holders of common stock in proportion to patronage to the extent possible.

Preferred Stock

The following table summarizes our outstanding preferred stock as of December 31, 2012.

Preferred Stock as of December 31, 2012

	Series C	Series D	Series E	Series F
Type	Non-Cumulative Perpetual	Non-Cumulative Perpetual	Non-Cumulative Perpetual	Non-Cumulative Perpetual
Issue Date	July 2008	August 2009	January 2012	October 2012
Shares Outstanding (000)	4,000	2,735	225	4,000
Amount Outstanding (000)	$200,000	$136,750	$225,000	$400,000
Par Value (per share)	$50	$50	$1,000	$100
Current Dividend Rate (%)	11.00%	11.00%	3-month USD LIBOR + 1.18% beginning on July 10, 2012 (1.530% at December 31, 2012)	6.25%
Next Change in Dividend Rate (% and dates)	3-month USD LIBOR + 6.79% on July 1, 2013	n/a	n/a	3-month USD LIBOR + 4.557% on October 1, 2022
Dividend Frequency	Quarterly	Quarterly	Quarterly	Quarterly
Optional Redemption Begins (date)	Annual calls on or after July 1, 2013 at par plus accrued dividends	Quarterly calls on or after October 1, 2014 at par plus accrued dividends	July 2012 and each five year anniversary thereafter at par plus accrued dividends	Quarterly calls on or after October 1, 2022 at par plus accrued dividends

On October 1, 2012, we redeemed our Series A and Series B cumulative perpetual preferred stock, totaling $363.3 million. We used cash on hand to effectuate these redemptions. The dividend rates for our Series A and Series B preferred stock were 7.814 percent and 7.0 percent, respectively. Also in October 2012, we issued $400 million of Series F non-cumulative perpetual preferred stock, representing four million shares at $100 per share par value. We used the proceeds from the Series F preferred stock to increase our regulatory capital pursuant to current FCA regulations and for general corporate purposes.

If preferred stock dividends are not paid for 18 months on any of our preferred stock, holders of all series of outstanding preferred stock, voting as a single class, will have the right to appoint two non-voting observers to attend our Board of Directors meetings until full dividends for a one year period are paid. In addition, other than pursuant to an order issued by our regulator, we may not enter into agreements restricting our ability to declare or pay preferred stock dividends.

All stock retirements, including preferred stock redemptions, require the approval of our Board of Directors. Payments of preferred stock dividends also require the approval of our Board of Directors.

Capitalization Requirements

In accordance with the Farm Credit Act, eligible borrowers are required to purchase common stock in CoBank as a condition of borrowing. The minimum initial borrower investment is equal to the lesser of one thousand dollars or 2 percent of the amount of the loan. The minimum initial investment is generally received in cash at the time the borrower receives the loan proceeds.

Association customers are required to invest in our common stock, as discussed on page 107.

Most agricultural export finance customers, customers of FCL and certain other borrowers are not required to purchase, nor do they own, common stock in CoBank. Likewise, they do not participate in patronage distributions.

Retirements of common stock, if any, are determined annually after the Board of Directors sets the target equity level. Net cash retirements are made at the sole discretion of the Board of Directors and are at book value not to exceed par or face value.

Patronage

As a customer-owned bank, we return a portion of our earnings to eligible common shareholders in the form of patronage distributions. Eligible common shareholders will receive total patronage for 2012 of $425.0 million, of which $344.5 million will be paid in cash in 2013 and the balance will be paid in common stock. For 2011 and 2010, total patronage was $340.7 million and $284.6 million, respectively, of which $230.8 million and $194.1 million, respectively, was paid in cash in the subsequent year. All patronage distributions require the approval of our Board of Directors.

Regulatory Capitalization Requirements and Restrictions

The FCA's capital adequacy regulations require us to maintain certain minimum capital requirements and collateral standards.

We are prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless prescribed capital standards are met. All such minimum regulatory capital requirements and collateral standards were met as of December 31, 2012.

At December 31, 2012, our permanent capital, total surplus, core surplus and net collateral ratios exceeded the regulatory minimums as noted in the following table.

Capital Ratios as of December 31,

	Regulatory Minimums	2012	2011	2010
Permanent Capital Ratio	7.0 %	**16.14 %**	16.37 %	14.30 %
Total Surplus Ratio	7.0	**15.22**	16.01	13.96
Core Surplus Ratio	3.5	**10.06**	10.02	8.42
Net Collateral Ratio	104.0 (1)(2)	**107.08**	109.05	108.03

(1) The regulatory minimum net collateral ratio is 103.0 percent, but the FCA requires the higher 104.0 percent during a period in which we have Series A preferred stock or subordinated debt outstanding. Our Series A preferred stock was fully redeemed on October 1, 2012.

(2) As a condition of the merger with AgBank, from January 1, 2012 through December 31, 2014, if the net collateral ratio falls below 105.0 percent, the Bank must notify the FCA and submit to them a written plan to restore and maintain a level of at least 105.0 percent.

Our capital and collateral ratios are calculated in accordance with FCA regulations, as summarized below.

- The permanent capital ratio is quarterly average permanent capital (generally shareholders' equity and subordinated debt subject to certain limitations, excluding accumulated other comprehensive income and other deductions) as a percentage of quarterly average risk-adjusted assets.
- The total surplus ratio is quarterly average total surplus (quarterly average permanent capital, net of purchased stock) as a percentage of quarterly average risk-adjusted assets.
- The core surplus ratio is quarterly average core surplus (generally unallocated retained earnings, non-cumulative preferred stock and a portion of common stock) as a percentage of quarterly average risk-adjusted assets.
- The net collateral ratio is net collateral (generally net loans and investments) divided by total liabilities, as adjusted to exclude subordinated debt (subject to certain limitations) and the fair value of certain derivatives.

Pursuant to FCA guidance, a portion of our common stock is included in core surplus, subject to certain conditions. This inclusion will continue on a temporary basis until December 31, 2014 or the point at which the FCA changes its capital regulations in a manner that would be inconsistent with this treatment. The FCA requires that we also calculate our core surplus ratio excluding common stock and has established a 3.0 percent minimum for such ratio. In addition, as a condition of the merger with AgBank, from January 1, 2012 through December 31, 2014, if our core surplus ratio excluding common stock falls below 5.59 percent, the Bank must notify the FCA and submit to them a written plan to restore and maintain the ratio to at least that level. As of December 31, 2012, our core surplus ratio excluding common stock was 8.32 percent.

Note 9 – Employee Benefit Plans and Incentive Compensation Plans

Employee Benefit Plans

We have employer-funded, qualified defined benefit pension plans, which are noncontributory and cover employees hired prior to January 1, 2007. Depending on the date of hire, benefits are determined either by a formula based on years of service and final average pay, or by the accumulation of a cash balance with interest credits and contribution credits based on years of service and eligible compensation. Effective January 1, 2007, the Bank closed the remaining qualified defined benefit pension plan to new participants.

We also have noncontributory, unfunded nonqualified supplemental executive retirement plans (SERPs) covering certain senior officers and specified other senior managers. In addition, we have a noncontributory, unfunded nonqualified executive retirement plan (ERP) designed to provide enhanced retirement benefits to two senior officers employed pursuant to employment agreements. The defined benefit pension plans, SERPs and ERP are collectively referred to as Retirement Plans. We hold assets in a trust fund related to our SERPs and ERP; however, such funds remain Bank assets and are not included as plan assets in the accompanying disclosures.

We have a 401(k) retirement savings plan pursuant to which we match a certain percentage of employees' elective contributions. In addition, under this plan, employees hired on or after January 1, 2007 receive additional, non-elective employer defined contributions. Our contributions to the 401(k) retirement savings plan, which are recorded as employee compensation expense, were $6.5 million, $4.7 million and $3.9 million for 2012, 2011 and 2010, respectively. For eligible senior managers, including our senior officers, we also have a nonqualified deferred compensation plan, which includes benefits not provided under the employee savings plan due to certain Internal Revenue Code limitations.

All retirement-eligible employees are also currently eligible for other postretirement benefits, which primarily include access to health care benefits. Substantially all participants pay the full premiums associated with these other postretirement health care benefits. Participant contributions are adjusted annually.

Pursuant to the terms of the merger agreement, assets and obligations related to bank participants in AgBank's legacy defined benefit pension plans were transferred into CoBank's defined benefit pension plan as of the merger date. The merger agreement also required AgBank to make a $17.2 million funding contribution effective with the transfer of the participants into the CoBank plan. In addition, we assumed certain nonqualified retirement plans as a result of the merger.

The following table provides a summary of the changes in the plans' projected benefit obligations and fair values of assets over the three-year period ended December 31, 2012, as well as a statement of funded status as of December 31 of each year.

	Retirement Plans			Other Postretirement Benefits		
	2012	2011	2010	2012	2011	2010
Change in Projected Benefit Obligation:						
Benefit Obligation at Beginning of Year	$ **205,704**	$ 179,292	$ 161,616	$ **5,596**	$ 5,342	$ 4,171
Service Cost	**6,920**	6,113	6,117	**252**	402	178
Interest Cost on Benefit Obligation	**12,787**	9,327	8,960	**257**	272	228
Plan Participant Contributions	**-**	-	-	**486**	482	468
Plan Amendments	**-**	4,043	-	**-**	-	-
Curtailment[(1)]	**-**	-	(629)	**-**	-	-
Merger Impact	**71,236**	-	-	**657**	-	-
Actuarial Loss (Gain)	**19,250**	14,482	10,538	**(320)**	7	782
Transfers	**-**	-	140	**-**	-	-
Benefits Paid	**(17,949)**	(7,553)	(7,450)	**(958)**	(909)	(485)
Projected Benefit Obligation at End of Year	**297,948**	205,704	179,292	**5,970**	5,596	5,342
Change in Plan Assets:						
Fair Value of Plan Assets at Beginning of Year	**171,361**	167,796	156,645	**-**	-	-
Actual Return on Plan Assets	**29,090**	6,980	14,201	**-**	-	-
Employer Contributions	**12,021**	4,138	4,260	**472**	427	17
Contribution Required by Merger	**17,200**	-	-	**-**	-	-
Asset Transfer Related to Merger	**44,450**	-	-	**-**	-	-
Transfers	**-**	-	140	-	-	-
Benefits Paid	**(17,949)**	(7,553)	(7,450)	**(958)**	(909)	(485)
Plan Participant Contributions	**-**	-	-	**486**	482	468
Fair Value of Plan Assets at End of Year	**256,173**	171,361	167,796	**-**	-	-
Funded Status – Fair Value of Plan Assets Less Than Projected Benefit Obligation	**(41,775)**	(34,343)	(11,496)	**(5,970)**	(5,596)	(5,342)
Net Amount Recognized - December 31	$ **(41,775)**	$ (34,343)	$ (11,496)	$ **(5,970)**	$ (5,596)	$ (5,342)

(1) Curtailment resulted from the departure of senior officers from the ERP in 2010.

The projected benefit obligation and the accumulated benefit obligation for the Retirement Plans as of December 31 of each year are as follows.

	2012	2011	2010
Projected Benefit Obligation:			
Funded Plans	$ **266,443**	$ 177,216	$ 154,366
Unfunded SERP/ERP	**31,505**	28,488	24,926
Total	$ **297,948**	$ 205,704	$ 179,292
Accumulated Benefit Obligation:			
Funded Plans	$ **238,811**	$ 159,497	$ 135,881
Unfunded SERP/ERP	**26,829**	24,050	19,132
Total	$ **265,640**	$ 183,547	$ 155,013

The $256.2 million in fair value of plan assets shown in the table above relates only to the qualified retirement plans. As depicted in the preceding table, such plans had a projected benefit obligation and an accumulated benefit obligation of $266.4 million and $238.8 million, respectively, as of December 31, 2012.

We hold assets in trust accounts related to our SERPs and ERP. Such assets had a fair value of $23.9 million as of December 31, 2012, which is included in "Other Assets" in the consolidated balance sheet. Unlike the assets related to the qualified plans, those funds remain Bank assets and would be subject to general creditors in a bankruptcy or liquidation. Accordingly, they are not included as part of the assets in the table above. As depicted in the preceding table, our SERPs and ERP had a projected benefit obligation and an accumulated benefit obligation of $31.5 million and $26.8 million, respectively, as of December 31, 2012.

The following table provides the amounts recognized in the consolidated balance sheets as of December 31 of each year.

	Retirement Plans			Other Postretirement Benefits		
	2012	2011	2010	2012	2011	2010
Prepaid Pension Assets	$ **-**	$ -	$ 13,430	$ **-**	$ -	$ -
Accrued Benefit Liabilities	**(41,775)**	(34,343)	(24,926)	**(5,970)**	(5,596)	(5,342)
Net Amounts Recognized	$ **(41,775)**	$ (34,343)	$ (11,496)	$ **(5,970)**	$ (5,596)	$ (5,342)

The following table presents the components of net periodic benefit cost for the plans.

	Retirement Plans			Other Postretirement Benefits		
	2012	2011	2010	2012	2011	2010
Service Cost	$ **6,920**	$ 6,113	$ 6,117	$ **252**	$ 402	$ 178
Interest Cost on Benefit Obligation	**12,787**	9,327	8,960	**257**	272	228
Expected Return on Plan Assets	**(16,765)**	(13,463)	(12,902)	**-**	-	-
Amortization of Prior Service Cost	**235**	(133)	284	**-**	-	(12)
Curtailment Gain[1]	**-**	-	(351)	**-**	-	-
Recognized Actuarial Loss (Gain)	**4,351**	3,482	1,496	**189**	(52)	(152)
Net Periodic Benefit Cost	$ **7,528**	$ 5,326	$ 3,604	$ **698**	$ 622	$ 242

[1] Curtailment gain resulted from the departure of senior officers from the ERP in 2010.

We anticipate that our total pension expense for the Retirement Plans will be approximately $7.0 million in 2013, as compared to $7.5 million in 2012.

The following table displays the amounts included in accumulated other comprehensive income (OCI), a component of shareholders' equity, related to our pension and other postretirement benefit plans.

Amounts Included in Accumulated OCI (Pre-Tax) at December 31, 2012	Qualified Retirement Plans	Nonqualified Retirement Plans	Other Postretirement Benefits	Total
Net Actuarial Loss (Gain)	$ 71,931	$ 11,207	$ (1,916)	$ 81,222
Prior Service Cost (Credit)	2,289	598	-	2,887
Amount Recognized in Accumulated OCI [1]	$ 74,220	$ 11,805	$ (1,916)	$ 84,109

[1] Amount recognized in accumulated OCI, net of tax, is a loss of $52.1 million as of December 31, 2012. Approximately $3.3 million, net of tax, will be amortized from OCI into net periodic cost in 2013.

Assumptions

We measure plan obligations and annual expense using assumptions designed to reflect future economic conditions. As the bulk of pension benefits will not be paid for many years, the computations of pension expenses and benefits are based on assumptions about discount rates, estimates of annual increases in compensation levels and expected rates of return on plan assets.

The weighted average rate assumptions used in the measurement of our benefit obligations are as follows:

	2012	2011	2010
Discount Rate	**4.05 %**	4.80 %	5.35 %
Rate of Compensation Increase	**4.75**	4.75	5.00

The weighted average rate assumptions used in the measurement of our net periodic benefit cost are as follows:

	2012	2011	2010
Discount Rate	**4.80 %**	5.35 %	5.70 %
Expected Rate of Return on Plan Assets (Qualified Plans Only)	**7.25**	8.00	8.00
Rate of Compensation Increase	**4.75**	5.00	5.00

The discount rates are calculated using a spot yield curve method developed by an independent actuary. The approach maps a high-quality bond yield curve to the duration of the plans' liabilities, thus approximating each cash flow of the liability stream to be discounted at an interest rate specifically applicable to its respective period in time.

We establish the expected rate of return on plan assets based on a review of past and expected future anticipated returns on plan assets. The expected rate of return on plan assets assumption also matches the pension plans' long-term interest rate assumption used for funding purposes.

Assumed health care cost trend rates have an effect on the amounts reported for other postretirement benefits. For measurement purposes, an 8 percent annual rate of increase in the per capita cost of covered health care benefits was assumed for 2012. The rate was assumed to decrease by 0.5 percent each year through 2018 to 5.0 percent and remain at that level thereafter. A 1-percentage-point increase in the assumed health care cost trend rate would increase total annual service and interest cost by $75 and total other postretirement benefit obligations by $440 as of January 1, 2012. Conversely, a 1-percentage-point decrease in the assumed health care cost trend rate would decrease total annual service and interest cost by $63 and total other postretirement benefit obligations by $384.

Plan Assets

The asset allocation target ranges for the pension plans follow the investment policy adopted by our retirement trust committee. This policy provides for a certain level of trustee flexibility in selecting target allocation percentages. The actual asset allocations at December 31, 2012, 2011 and 2010 are shown in the following table, along with the adopted range for target allocation percentages by asset class. The actual allocation percentages reflect the quoted market values at year-end and may vary during the course of the year. Plan assets are generally rebalanced to a level within the target range each year at the direction of the trustees.

Retirement Benefit Plan Assets

	Target Allocation Range	Percentage of Plan Assets at December 31,		
		2012	2011	2010
Asset Category				
Domestic Equity	40-50 %	**43 %**	46 %	43 %
Domestic Fixed Income	35-50	**37**	36	37
International Equity	0-10	**10**	8	10
Emerging Markets Equity and Fixed Income	0-10	**5**	4	4
Real Assets	0-5	**5**	6	6
Total	100 %	**100 %**	100 %	100 %

The assets of the pension plans consist primarily of investments in various domestic equity, international equity and bond funds. These funds do not contain any significant investments in a single entity, industry, country or commodity, thereby mitigating concentration risk. No CoBank stock or debt, or that of any other System institution, is included in these investments.

The following table presents major categories of plan assets that are measured at fair value at December 31, 2012 for each of the fair value hierarchy levels as defined in Note 13.

Fair Value Measurements

December 31, 2012

	Level 1	Level 2	Total
Asset Category			
Cash	$ 727	$ -	$ 727
Domestic Equity:			
Large-cap Growth Funds (1)	53,324	43,431	96,755
Small-cap Growth Fund (1)	-	12,727	12,727
International Equity:			
International Fund (2)	26,454	-	26,454
Fixed Income:			
Total Return Fund (3)	93,546	-	93,546
Emerging Markets:			
Equity and Fixed Income Fund (4)	-	13,642	13,642
Real Assets: Gold Fund (5)	12,322	-	12,322
Total	$ 186,373	$ 69,800	$ 256,173

(1) Funds invest primarily in diversified portfolios of common stocks of U.S. companies in various industries, including information technology, consumer goods and services, healthcare, financial services and energy.

(2) Fund invests primarily in a diversified portfolio of equities of non-U.S. companies in various industries, including financial services, healthcare, information technology, telecommunications, energy and consumer goods.

(3) Fund invests primarily in a diversified portfolio of investment grade debt securities and cash instruments.

(4) Fund invests in equities and corporate debt securities of companies located in emerging international markets. Industries include financial services, energy, and information technology. Fund also invests in the sovereign debt of various countries.

(5) Fund invests in gold bullion.

Level 1 plan assets are funds with quoted daily net asset values that are directly observable by market participants. The fair value of these funds is the net asset value at close of business on the reporting date. Level 2 plan assets are funds with quoted net asset values that are not directly observable by market participants. A significant portion of the underlying investments in these funds have individually observable market prices, which are utilized by the plan's trustee to determine a net asset value at close of business on the reporting date. There were no Level 3 plan assets at December 31, 2012.

Investment strategy and objectives are described in the pension plans' formal investment policy document. The basic strategy and objectives are to manage portfolio assets with a long-term time horizon appropriate for the participant demographics and cash flow requirements; to optimize long-term funding requirements by generating rates of return sufficient to fund liabilities and exceed the long-term rate of inflation; and to provide competitive investment returns as measured against appropriate benchmarks.

Expected Contributions

We expect to contribute approximately $4.1 million to our funded, qualified defined benefit pension plans in 2013 and a net $0.5 million, after reflecting collected retiree premiums, to our other postretirement benefit plans in 2013. We also expect to contribute approximately $2.2 million to our trust fund related to our SERPs and ERP in 2013. Our actual 2013 contributions could differ from the estimates noted above.

Estimated Future Benefit Payments

We expect to make the following benefit payments, which reflect expected future service, as appropriate.

Estimated Benefit Payments

Year:	Retirement Benefits	Other Postretirement Benefits
2013	$ 16,392	$ 449
2014	16,841	481
2015	18,050	484
2016	18,664	462
2017	20,302	471
2018 to 2022	111,721	2,216

Incentive Compensation Plans

We have a broad-based, Board-approved short-term incentive compensation plan covering substantially all employees pursuant to which annual cash awards may be earned. Criteria used to determine amounts payable include the achievement of specified financial measures and strategic business objectives, which are approved annually by the Compensation Committee of the Board of Directors. Individual performance is also considered in the determination of the amounts payable.

We also have a Board-approved long-term incentive compensation plan, pursuant to which cash awards may be earned by senior officers and specified other senior managers who have a significant impact on long-term financial performance. Criteria used to determine amounts payable include achievement of certain Bank financial targets and strategic business objectives over a three-year performance period. Cash awards are to be paid subsequent to completion of each three-year period, subject to approval by the Compensation Committee of the Board of Directors.

Under the terms of the short-term incentive compensation plan, a minimum return on active patron stock investment must be achieved in order for a payout to be approved. Likewise, a minimum return on active patron stock investment must be achieved in each year within the three-year performance period for a full payout under the long-term incentive plan. The required minimum return on active patron stock investment was 11 percent for all performance periods disclosed herein.

Note 10 – Income Taxes

The components of the provision for income taxes are as follows:

Year Ended December 31,	2012	2011	2010
Current:			
Federal	**$ 162,968**	$ 79,914	$ 117,056
State	**31,362**	14,518	15,134
Total Current	**194,330**	94,432	132,190
Deferred:			
Federal	**(20,633)**	90,246	24,209
State	**(10,006)**	11,428	3,028
Total Deferred	**(30,639)**	101,674	27,237
Total	**$ 163,691**	$ 196,106	$ 159,427
Comprehensive Tax Provision			
Allocable to:			
Pre-Tax Income	**$ 163,691**	$ 196,106	$ 159,427
Shareholders' Equity -			
Amounts Allocated to:			
Investment Securities	**16,511**	21,988	26,451
Derivatives	**(168)**	981	(2,386)
Pension Liability	**(695)**	(8,271)	(3,089)
Total	**$ 179,339**	$ 210,804	$ 180,403

The components of deferred tax assets and liabilities are shown below.

December 31,	2012	2011	2010
Allowance for Credit Losses	**$ 200,576**	$ 176,334	$ 159,930
Employee Benefits	**51,719**	41,436	30,447
Loan Origination Fees	**15,941**	19,851	19,701
Other Deferred Tax Assets	**48,116**	43,539	51,921
Gross Deferred Tax Assets	**316,352**	281,160	261,999
Leasing	**482,191**	480,418	367,603
Unrealized Net Gains on Investment Securities and Derivatives	**62,192**	45,851	22,881
Other Deferred Tax Liabilities	**16,801**	14,714	14,966
Gross Deferred Tax Liabilities	**561,184**	540,983	405,450
Net Deferred Tax Liabilities	**$ (244,832)**	$ (259,823)	$ (143,451)

Deferred income taxes are provided for the change in temporary differences between the basis of certain assets and liabilities for financial reporting and income tax reporting purposes except for our nontaxable entity. The expected future tax rates are based upon enacted tax laws.

We have concluded that it is more likely than not that the deferred tax assets will be realized based on our history of earnings, sources of taxable income in carry back periods, and our ability to implement tax planning strategies.

The effective tax rates for the years ended December 31, 2012, 2011 and 2010 of 16.1 percent, 21.7 percent and 20.6 percent, respectively, were less than the statutory income tax rate primarily due to the impact of our non-taxable entity and activities, and $425.0 million, $340.7 million and $284.6 million, respectively, of patronage distributions which are tax deductible, if made by our taxable entity, as permitted by Subchapter T of the Internal Revenue Code.

Year Ended December 31,	2012	2011	2010
Federal Tax at Statutory Rate	**$ 356,162**	$ 315,943	$ 270,618
State Tax, Net	**14,478**	17,196	11,120
Patronage Distributions Allocated by Taxable Entity	**(80,801)**	(118,434)	(99,130)
Effect of Nontaxable Entity	**(122,518)**	-	-
Tax-Exempt Activities	**(55)**	(20,546)	(21,348)
Other	**(3,575)**	1,947	(1,833)
Provision for Income Taxes	**$ 163,691**	$ 196,106	$ 159,427

We will distribute 42 percent of income before income taxes to our shareholders as patronage distributions related to 2012, compared to 38 percent for 2011 and 37 percent for 2010.

A reconciliation of the beginning and ending amount of unrecognized tax benefits, excluding interest and penalties, is as follows:

Year Ended December 31, 2012	
Balance at Beginning of Year	**$ 5,244**
Additions Based on Tax Positions Related to the Current Year	**1,455**
Additions for Tax Positions of Prior Years	**973**
Reductions for Tax Positions of Prior Years	**(279)**
Lapse of Applicable Statute of Limitations	**(746)**
Balance at End of Year	**$ 6,647**
Year Ended December 31, 2011	
Balance at Beginning of Year	$ 4,102
Additions Based on Tax Positions Related to the Current Year	1,102
Additions for Tax Positions of Prior Years	430
Reductions for Tax Positions of Prior Years	(29)
Settlements	(115)
Lapse of Applicable Statute of Limitations	(246)
Balance at End of Year	$ 5,244
Year Ended December 31, 2010	
Balance at Beginning of Year	$ 5,761
Additions Based on Tax Positions Related to the Current Year	757
Additions for Tax Positions of Prior Years	325
Reductions for Tax Positions of Prior Years	(2,515)
Lapse of Applicable Statute of Limitations	(226)
Balance at End of Year	$ 4,102

The total amount of unrecognized tax benefits that, if recognized, would impact the effective tax rate is $6.0 million. We do not currently believe that the unrecognized tax benefits will change significantly within the next 12 months.

CoBank is no longer subject to federal tax examination for periods before 2009.

CoBank files tax returns in most states each year and is under continuous examination by various state taxing authorities. With few exceptions, we are no longer subject to state and local income tax examinations by taxing authorities for periods before 2009. For all open audits, any potential adjustments have been considered in establishing our reserve for uncertain tax positions as of December 31, 2012.

We recognize interest and penalties accrued related to unrecognized tax benefits as a component of the provision for income taxes. During the year ended December 31, 2012, we recognized an increase of approximately $0.5 million in interest and penalties. We had approximately $2.7 million and $2.2 million of interest and penalties accrued at December 31, 2012 and 2011, respectively.

Note 11 – Financial Instruments With Off-Balance Sheet Risk

We utilize various financial instruments with off-balance sheet risk to satisfy the financing needs of our borrowers and to manage our exposure to interest rate risk. Such financial instruments include commitments to extend credit and commercial letters of credit. Commitments to extend credit are agreements to lend to a borrower provided that certain contractual conditions are met. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2012, outstanding commitments to extend credit and commercial letters of credit were $30.4 billion and $287.1 million, respectively.

Since many of these commitments may expire without being drawn, the total commitments do not necessarily represent future cash requirements. Our exposure to many of these commitments is mitigated by borrowing base requirements contained in loan agreements. However, these credit-related financial instruments have off-balance sheet credit risk because their amounts are not reflected on the consolidated balance sheets until funded or drawn upon. The credit risk associated with issuing commitments and commercial letters of credit is substantially the same as that involved in extending loans to borrowers. Therefore, management applies the same credit policies to these commitments. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. As discussed in Note 1, we maintain a reserve for unfunded commitments.

For a fee, we provide financial standby letters of credit for borrowers, which are irrevocable commitments to guarantee payment of a specified financial obligation. We also provide performance standby letters of credit which are irrevocable agreements by us, as a guarantor, to make payments to the guaranteed party in the event a specified third-party fails to perform under a nonfinancial contractual obligation, such as a third-party failing to timely deliver certain commodities at a specified time and place. We also issue indemnification agreements that function like guarantees. These indemnification agreements contingently require us, as the indemnifying party (guarantor), to make payments to an indemnified party under certain specified circumstances. Certain recourse provisions would enable us, as a guarantor, to recover from third parties any of the amounts paid under guarantees, thereby limiting our maximum potential exposure.

As of December 31, 2012, the maximum potential amount of future payments that we may be required to make under our outstanding standby letters of credit was $1.4 billion, with a fair value of $9.8 million, which is included in other liabilities in the consolidated balance sheet. Payment/performance risk of the standby letters of credit guarantee is assessed using the same internal customer credit ratings that we use to manage credit risk in our loan portfolio. These outstanding standby letters of credit have expiration dates ranging from January 2013 to February 2033.

Note 12 – Derivative Financial Instruments and Hedging Activities

Risk Management Objectives and Strategies

We maintain an overall interest rate risk management strategy that incorporates the use of derivative financial instruments to manage liquidity and to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. Our goal is to manage interest rate sensitivity by modifying the repricing frequency or effective maturity of certain balance sheet assets and liabilities. We also maintain a foreign exchange risk management strategy to reduce the impact of currency fluctuations on our relatively nominal amount of foreign currency-denominated loans. As a result of interest rate and foreign exchange rate fluctuations, fixed-rate assets and liabilities will appreciate or depreciate in market value. The effect of this unrealized appreciation or depreciation is expected to be substantially offset by gains and losses on the derivative instruments that are linked to these assets and liabilities. Interest rate and foreign exchange fluctuations also cause interest income and interest expense of variable-rate assets and liabilities to increase or decrease. The effect of this variability in earnings is expected to be substantially offset by gains and losses on the derivative instruments that are linked to these assets and liabilities.

Uses of Derivatives

To achieve risk management objectives and satisfy the financing needs of our borrowers, we execute various derivative transactions with other financial institutions. Derivatives (primarily interest rate swaps) are used to manage liquidity and the interest rate risk arising from maturity and repricing mismatches between assets and liabilities. Under interest rate swap arrangements, we agree with a third-party to exchange, at specified intervals, payment streams calculated on a specified notional amount, with at least one payment stream based on a specified floating-rate index. We use a variety of interest rate swaps including the exchange of floating-rate for fixed-rate swaps and fixed-rate for floating-rate swaps with payment obligations tied to specific indices. In addition, we execute foreign exchange spot and forward contracts to manage currency risk on loans denominated in foreign currencies. We also enter into derivatives for our customers as a service to enable them to transfer, modify or reduce their interest rate risk and foreign exchange risk by transferring such risk to us. We substantially offset this risk transference by concurrently entering into offsetting agreements with counterparties.

The notional amounts and related activity of derivatives at December 31, 2012, 2011 and 2010 are shown in the following table.

Activity in the Notional Amounts of Derivative Financial Instruments

($ in Millions)	Swaps	Caps	Spots and Forwards	Total
December 31, 2011	**$ 23,255**	**$ 1,999**	**$ 299**	**$ 25,553**
Acquired Related to Merger	**1,280**	**1,465**	**-**	**2,745**
Additions /Accretion	**4,955**	**820**	**2,603**	**8,378**
Maturities /Amortization	**(6,434)**	**(1,130)**	**(2,610)**	**(10,174)**
Terminations	**(36)**	**(105)**	**-**	**(141)**
December 31, 2012	**$ 23,020**	**$ 3,049**	**$ 292**	**$ 26,361**
December 31, 2010	$ 28,699	$ 2,056	$ 199	$ 30,954
Additions /Accretion	6,226	-	5,271	11,497
Maturities /Amortization	(8,937)	(38)	(5,171)	(14,146)
Terminations	(2,733)	(19)	-	(2,752)
December 31, 2011	$ 23,255	$ 1,999	$ 299	$ 25,553
December 31, 2009	$ 30,748	$ 1,600	$ 218	$ 32,566
Additions /Accretion	4,700	528	2,699	7,927
Maturities /Amortization	(6,489)	(72)	(2,718)	(9,279)
Terminations	(260)	-	-	(260)
December 31, 2010	$ 28,699	$ 2,056	$ 199	$ 30,954

Accounting for Derivative Instruments and Hedging Activities

We record derivatives as assets or liabilities at their fair value on the consolidated balance sheets. We record changes in the fair value of a derivative in current period earnings or accumulated other comprehensive income (loss), depending on the use of the derivative and whether it qualifies for hedge accounting. For fair value hedge transactions that hedge changes in the fair value of assets or liabilities, changes in the fair value of the derivative will generally be offset in the statement of income by changes in the hedged item’s fair value attributable to the risk being hedged. For cash flow hedge transactions, in which we hedge the variability of future cash flows related to a variable-rate asset or liability, changes in the fair value of the derivative are reported in accumulated other comprehensive income (loss). The gains and losses on the derivatives that we report in accumulated other comprehensive income (loss) will be reclassified as earnings in the periods in which earnings are affected by the variability of the cash flows of the hedged item. We record the ineffective portion of all hedges in current period earnings.

For our customer transactions, which are not designated as hedging instruments, we record the related changes in fair value in current period earnings. We substantially offset this risk transference by concurrently entering into offsetting agreements with counterparties, with the changes in fair value of these transactions also recorded in current period earnings.

Fair Value Hedges

The majority of the fair value hedging activity relates to entering into interest rate swaps primarily to convert our non-prepayable fixed-rate debt to floating-rate debt to achieve our liquidity management strategy. The amount converted depends on contractual interest rates and maturities. For the remaining fair value hedges, we enter into receive-fixed, pay-floating swaps to align our equity positioning strategy with our risk management strategy. For fair value hedges, the amount of hedge ineffectiveness is recognized as net interest income in current period earnings.

Cash Flow Hedges

We purchase interest rate caps to hedge cap risk embedded within a portion of our floating-rate investment securities. The interest rate caps hedge floating-rate debt cash flows that fund the cash flows from floating-rate investment securities. If the strike rates in the purchased interest rate caps are exceeded, we receive cash flows on the derivative to hedge our floating-rate funding exposure above such strike levels. We also enter into foreign exchange spot and forward contracts to manage currency risk on loans denominated in foreign currencies. Typically, foreign currency contracts are purchased to fund the principal cash flows of the loan and simultaneously sold to lock in the principal and interest cash flows upon repricing or maturity date of the loan. For cash flow hedges, the amount of hedge ineffectiveness, the amount excluded from effectiveness assessment, and the amounts reclassified from accumulated other comprehensive income (loss) into current period earnings are all reflected in net interest income. At December 31, 2012, we expect that $1.2 million of expense will be reclassified from other comprehensive income into earnings in the next 12 months, based on the anticipated cash flows of existing financial instruments. The maximum term over which we are hedging our exposure to the variability of future cash flows for all forecasted transactions is approximately 10 years.

Derivatives Not Designated As Hedges

Derivative agreements with our customers and the related offsetting derivative agreements with counterparties are not designated as hedging instruments and do not receive hedge accounting treatment. Accordingly, any changes in the fair value of these customer related derivatives are recognized immediately as noninterest income/expense in current period earnings.

Counterparty Credit Risk

The use of derivatives for risk management introduces credit risk related to counterparties and market risk related to movements in interest rates. Generally, when the fair value of a derivative contract is positive, we are exposed to counterparty credit risk.

To minimize the risk of credit losses, all derivative transactions are governed by master swap agreements, which include bilateral collateral arrangements, requiring the Bank or our counterparties to post collateral on a daily basis with thresholds set at zero for all active dealer counterparties. The master swap agreements also include netting agreements requiring the net settlement of covered contracts with the same counterparty in the event of default by the other party. The "net" mark-to-market exposure represents the netting of the positive and negative exposures with that counterparty. Notwithstanding these protections, we are exposed to intra-day credit risk with these counterparties. Derivative transactions with our customers are secured through our loan agreements. We record derivative exposures and related cash collateral balances at gross amounts in our consolidated balance sheets. As of December 31, 2012, our counterparties had posted $555.9 million in cash and $195.3 million in securities as collateral with us. The maximum amount of losses we could be exposed to in the event of nonperformance by dealer counterparties to our derivative positions, net of collateral held by us, was $12.8 million, $18.6 million and $10.6 million at December 31, 2012, 2011 and 2010, respectively.

Hedge Terminations

During 2012, we terminated interest rate caps of $105.0 million in notional value to reduce our credit exposure to a counterparty. These caps had been accounted for as cash flow hedges. During 2011, we terminated approximately $2.6 billion in notional value of interest rate swaps for asset-liability management purposes. These swaps were accounted for as fair value hedges. We received proceeds of $31.8 million as a result of the 2011 hedge contract terminations, which were reflected under operating activities in the consolidated statement of cash flows for 2011. The previous fair value adjustments to the fixed-rate debt that was hedged by these contracts will be amortized over the remaining life of the debt.

We terminated interest rate swaps with customers and offsetting dealer counterparties totaling notional value of $36.0 million, $190.0 million, and $260.0 million in 2012, 2011 and 2010, respectively. Proceeds from the customer terminations were offset by proceeds from the offsetting dealer terminations.

A summary of the impact of derivative financial instruments on our consolidated balance sheets as of December 31, 2012, 2011 and 2010 is shown below.

Fair Value of Derivative Financial Instruments

As of December 31, 2012	Fair Value of Derivative Assets[1]	Fair Value of Derivative Liabilities[2]
Derivatives Designated as Hedging Instruments		
Interest Rate Contracts	$ 810,295	$ -
Foreign Exchange Contracts	319	2,108
Total Derivatives Designated as Hedging Instruments	$ 810,614	$ 2,108
Derivatives Not Designated as Hedging Instruments		
Interest Rate Contracts	$ 192,377	$ 153,774
Foreign Exchange Contracts	2,124	1,998
Total Derivatives Not Designated as Hedging Instruments	$ 194,501	$ 155,772
Total Derivatives	$ 1,005,115	$ 157,880

[1] These assets make up the "Interest Rate Swaps and Other Financial Instruments" assets in the consolidated balance sheet as of December 31, 2012

[2] These liabilities make up the "Interest Rate Swaps and Other Financial Instruments" liabilities in the consolidated balance sheet as of December 31, 2012

A summary of the impact of derivative financial instruments on our consolidated statements of income and comprehensive income for the years ended December 31, 2012, 2011 and 2010 is shown below.

Fair Value of Derivative Financial Instruments

As of December 31, 2011		Fair Value of Derivative Assets[1]		Fair Value of Derivative Liabilities[2]
Derivatives Designated as Hedging Instruments				
Interest Rate Contracts	$	884,219	$	14
Foreign Exchange Contracts		3,980		180
Total Derivatives Designated as Hedging Instruments	$	888,199	$	194
Derivatives Not Designated as Hedging Instruments				
Interest Rate Contracts	$	157,052	$	133,602
Foreign Exchange Contracts		3,378		3,149
Total Derivatives Not Designated as Hedging Instruments	$	160,430	$	136,751
Total Derivatives	$	1,048,629	$	136,945

[1] These assets make up the "Interest Rate Swaps and Other Financial Instruments" assets in the consolidated balance sheet as of December 31, 2011

[2] These liabilities make up the "Interest Rate Swaps and Other Financial Instruments" liabilities in the consolidated balance sheet as of December 31, 2011

Fair Value of Derivative Financial Instruments

As of December 31, 2010		Fair Value of Derivative Assets[1]		Fair Value of Derivative Liabilities[2]
Derivatives Designated as Hedging Instruments				
Interest Rate Contracts	$	917,346	$	19,017
Foreign Exchange Contracts		566		1,838
Total Derivatives Designated as Hedging Instruments	$	917,912	$	20,855
Derivatives Not Designated as Hedging Instruments				
Interest Rate Contracts	$	80,433	$	68,913
Foreign Exchange Contracts		3,020		2,812
Total Derivatives Not Designated as Hedging Instruments	$	83,453	$	71,725
Total Derivatives	$	1,001,365	$	92,580

[1] These assets make up the "Interest Rate Swaps and Other Financial Instruments" assets in the consolidated balance sheet as of December 31, 2010

[2] These liabilities make up the "Interest Rate Swaps and Other Financial Instruments" liabilities in the consolidated balance sheet as of December 31, 2010

Derivative Financial Instruments in Fair Value Hedging Relationships

	Net Amount of Gain or (Loss) Recognized in Income on Derivative and Hedged Item [1]					
Year Ended December 31,		**2012**		**2011**		**2010**
Interest Rate Contracts	**$**	**4,204**	$	394	$	2,151
Total	**$**	**4,204**	$	394	$	2,151

[1] Located in Interest Expense in the consolidated statements of income for the years ended December 31, 2012, 2011 and 2010

Derivative Financial Instruments in Cash Flow Hedging Relationships

Year Ended December 31, 2012		**Amount of Gain or (Loss) Recognized in OCI on Derivative[1]**		**Amount of Gain or (Loss) Reclassified from OCI to Income on Derivative[1]**		**Amount of Gain or (Loss) Recognized in Income on Derivative[2]**
Interest Rate Contracts	**$**	**(6,917)**	**$**	**(1,465)** [3]	**$**	**-**
Foreign Exchange Contracts		**(5,589)**		**(5,571)** [4] [5]		**(216)** [4]
Total	**$**	**(12,506)**	**$**	**(7,036)**	**$**	**(216)**

[1] Effective portion

[2] Ineffective portion and amount excluded from effectiveness assessment

[3] Located in Interest Expense in the consolidated statement of income for the year ended December 31, 2012

[4] Located in Interest Income – Loans in the consolidated statement of income for the year ended December 31, 2012

[5] Fully offset by a $5,571 gain on foreign currency denominated loans (hedged items) which is also located in Interest Income - Loans in the consolidated statement of income for the year ended December 31, 2012

Derivative Financial Instruments in Cash Flow Hedging Relationships

Year Ended December 31, 2011	Amount of Gain or (Loss) Recognized in OCI on Derivative[1]	Amount of Gain or (Loss) Reclassified from OCI to Income on Derivative[1]	Amount of Gain or (Loss) Recognized in Income on Derivative[2]
Interest Rate Contracts	$ (3,640)	$ (2,401) [3]	$ -
Foreign Exchange Contracts	(5,072)	(4,311) [4] [5]	(2,178) [4]
Total	$ (8,712)	$ (6,712)	$ (2,178)

[1] Effective portion

[2] Ineffective portion and amount excluded from effectiveness assessment

[3] Located in Interest Expense in the consolidated income statement for the year ended December 31, 2011

[4] Located in Interest Income – Loans in the consolidated statement of income for the year ended December 31, 2011

[5] Fully offset by a $4,311 gain on foreign currency denominated loans (hedged items) which is also located in Interest Income - Loans in the consolidated statement of income for the year ended December 31, 2011

Derivative Financial Instruments in Cash Flow Hedging Relationships

Year Ended December 31, 2010	Amount of Gain or (Loss) Recognized in OCI on Derivative[1]	Amount of Gain or (Loss) Reclassified from OCI to Income on Derivative[1]	Amount of Gain or (Loss) Recognized in Income on Derivative[2]
Interest Rate Contracts	$ (7,171)	$ (1,311) [3]	$ -
Foreign Exchange Contracts	(3,393)	(2,974) [4] [5]	(459) [4]
Total	$ (10,564)	$ (4,285)	$ (459)

[1] Effective portion

[2] Ineffective portion and amount excluded from effectiveness assessment

[3] Located in Interest Expense in the consolidated statement of income for the year ended December 31, 2010

[4] Located in Interest Income – Loans in the consolidated statement of income for the year ended December 31, 2010

[5] Fully offset by a $2,974 gain on foreign currency denominated loans (hedged items) which is also located in Interest Income - Loans in the consolidated statement of income for the year ended December 31, 2010

Derivative Financial Instruments not Designated as Hedging Relationships

	Net Amount of Gain or (Loss) Recognized in Income On Derivative[1]		
Year Ended December 31,	**2012**	**2011**	**2010**
Interest Rate Contracts	**$ 8,269**	$ 11,930	$ 537
Foreign Exchange Contracts	**(102)**	20	(29)
Total	**$ 8,167**	$ 11,950	$ 508

[1] Located in Other Noninterest Income/Expense in the consolidated statements of income for the years ended December 31, 2012, 2011 and 2010

Note 13 – Disclosure About Estimated Fair Value of Financial Instruments

The fair value of financial instruments represents the estimated amount to be received to sell an asset or paid to transfer or extinguish a liability (an exit price) in active markets among willing participants at the reporting date. The FASB has established a three-level fair value hierarchy aimed at maximizing the use of observable inputs – that is, inputs that reflect the assumptions market participants would use in pricing an asset or liability. Observable inputs are based on market data obtained from sources independent of the reporting entity. Unobservable inputs are supported by limited or no market activity and require significant management judgment or estimation.

Due to the uncertainty of expected cash flows resulting from financial instruments, the use of different assumptions and valuation methodologies could significantly affect the estimated fair value amounts. Accordingly, certain estimated fair values may not be indicative of the amounts for which the financial instruments could be exchanged in a current or future market transaction.

A description of the methods, assumptions and inputs to the valuation process used to determine or estimate the fair value of each class of financial instruments within the three-level hierarchy follows.

Level 1

Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Our Level 1 assets at December 31, 2012 consist of assets held in a trust fund related to deferred compensation and our SERPs and ERP. The trust fund includes investments in securities that are actively traded and have quoted net asset value prices that are directly observable in the marketplace.

Level 2

Level 2 inputs include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability. Our Level 2 assets and liabilities at December 31, 2012 include our derivative contracts, collateral balances related to derivative contracts, U.S. Treasury and agency debt investment securities, non-agency MBS, the substantial majority of agency MBS, and corporate bonds.

The fair value of our derivative financial instruments is the estimated amount to be received to sell a derivative asset or paid to transfer or extinguish a derivative liability in active markets among willing participants at the reporting date. Estimated fair value is determined through internal market valuation models. These models use an income approach and incorporate benchmark interest rate curves (primarily the USD LIBOR/swap curve), volatilities, counterparty credit quality and other inputs that are observable directly or indirectly in the marketplace. We compare internally calculated derivative valuations to broker/dealer quotes to substantiate the results. The fair value of collateral assets and liabilities related to derivative contracts is their face value, plus accrued interest, as these instruments are cash balances; therefore, fair value approximates face value.

The fair value of our investment securities classified as Level 2 is determined by a third-party pricing service that uses valuation models to estimate current market prices. Inputs and assumptions related to these models are typically observable in the marketplace. Such models incorporate prepayment assumptions and underlying collateral information to generate cash flows that are discounted using appropriate benchmark interest rate curves and volatilities. These third-party valuation models also incorporate information regarding broker/dealer quotes, available trade information, historical cash flows, credit ratings, and other market information. Such valuations represent an estimated exit price, or price to be received by a seller in active markets to sell the investment securities to a willing participant. The estimated fair values of investment securities also appear in Note 5.

The following table presents information about valuation techniques and inputs to Level 2 fair value measurements.

Information About Valuation Techniques and Inputs to Level 2 Fair Value Measurements

	Valuation Technique	Inputs
Investment Securities	Third-Party Pricing Service	Prepayment Rate Lifetime Default Rate Loss Severity Benchmark Yield Curve Quoted Prices
Interest Rate Swaps and Other Financial Instruments	Discounted Cash Flow	Benchmark Yield Curve Counterparty Credit Risk Volatility
Collateral Assets and Collateral Liabilities	Carrying Value	Par/Principal

Level 3

Level 3 inputs are unobservable and supported by limited or no market activity. Our Level 3 assets at December 31, 2012 include our Farmer Mac MBS, FHA/VA non-wrapped reperformer MBS, ABS and a small portion of our agency MBS. Based on the lack of active trading volume and an orderly market for these securities, we classified these securities as Level 3. Market value for all Farmer Mac MBS and FHA/VA non-wrapped reperformer MBS is calculated internally using third-party models. Market value for ABS and Level 3 agency MBS is determined by a third-party pricing service that uses valuation models to estimate current market prices. Inputs into all of these valuation models include underlying collateral data and projected losses as well as information for prepayment speeds and discounting spreads. Due to the lack of marketplace information, the inputs into these valuation models primarily represent management assumptions, with some corroboration to market inputs where information is available.

Level 3 assets at December 31, 2012 also include $47.0 million of loans originally measured at cost, which were written down to fair value as a result of impairment. The valuation of these assets requires a determination of the fair value of the underlying collateral, which may include the use of independent appraisals or other market-based information to develop a management estimate of fair value. As a result, these fair value measurements fall under Level 3 in the fair value hierarchy; however, they are excluded from the following tables because they are not measured on a recurring basis.

Our Level 3 liabilities at December 31, 2012 include standby letters of credit whose market value is internally calculated based on information that is not observable either directly or indirectly in the marketplace.

The following table presents quantitative information about Level 3 fair value measurements as of December 31, 2012.

Quantitative Information About Valuation Techniques and Unobservable Inputs to Level 3 Fair Value Measurements

($ in Millions)	Fair Value	Valuation Technique	Unobservable Inputs	Range
Assets				
Investment Securities:				
U.S. Agency Mortgage-Backed	$ 78	Third-Party Pricing Service	Prepayment Rate	*
Farmer Mac Mortgage-Backed	215	Discounted Cash Flow	Prepayment Rate	8-14 percent
			Mark-to-Market Spread	1 percent
FHA/VA Non-Wrapped Reperformer Mortgage-Backed	506	Discounted Cash Flow	Prepayment Rate	6-10 percent
			Lifetime Default Rate	1-21 percent
			Loss Severity	11-13 percent
Asset-Backed	121	Third-Party Pricing Service	Prepayment Rate	*
			Lifetime Default Rate	*
			Loss Severity	*
Impaired Loans	47	Appraisal	Income/Expense Data	**
			Comparable Sales	**
			Replacement Cost	**
Liabilities				
Standby Letters of Credit	$ 10	Discounted Cash Flow	Mark-to-Market Spread	0.2-2 percent

* Excludes ranges for Level 3 U.S. Agency MBS and all ABS which are determined by a third-party pricing service

** Range of inputs are unique to each collateral property

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following tables present the assets and liabilities that are measured at fair value on a recurring basis at December 31, 2012, 2011 and 2010 for each of the fair value hierarchy levels

Assets and Liabilities Measured at Fair Value on a Recurring Basis

December 31, 2012

($ in Millions)	Level 1	Level 2	Level 3	Total
Assets				
Investment Securities:				
U.S. Treasury and				
Agency Debt	$ -	$ 6,491	$ -	$ 6,491
Mortgage-Backed:				
U.S. Agency	-	10,275	78	10,353
Farmer Mac	-	-	215	215
FHA/VA Non-Wrapped				
Reperformer	-	-	506	506
Non-Agency	-	292	-	292
Asset-Backed	-	-	121	121
Corporate Bonds	-	21	-	21
Interest Rate Swaps and				
Other Financial Instruments	-	1,005	-	1,005
Assets Held in Trust				
(included in Other Assets)	51	-	-	51
Collateral Assets (included				
in Other Assets)	-	17	-	17
Total Assets	$ 51	$ 18,101	$ 920	$ 19,072
Liabilities				
Interest Rate Swaps and				
Other Financial Instruments	$ -	$ 158	$ -	$ 158
Collateral Liabilities				
(included in Bonds and Notes)	-	556	-	556
Standby Letters of Credit				
(included in Other Liabilities)	-	-	10	10
Total Liabilities	$ -	$ 714	$ 10	$ 724

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Assets and Liabilities Measured at Fair Value on a Recurring Basis

December 31, 2011

($ in Millions)	Level 1	Level 2	Level 3	Total
Assets				
Investment Securities:				
U.S. Treasury and				
Agency Debt	$ -	$ 3,638	$ -	$ 3,638
Mortgage-Backed:				
U.S. Agency	-	9,061	-	9,061
Non-Agency	-	242	-	242
Asset-Backed	-	-	54	54
Interest Rate Swaps and				
Other Financial Instruments	-	1,049	-	1,049
Assets Held in Trust				
(included in Other Assets)	36	-	-	36
Collateral Assets (included				
in Other Assets)	-	15	-	15
Total Assets	$ 36	$ 14,005	$ 54	$ 14,095
Liabilities				
Interest Rate Swaps and				
Other Financial Instruments	$ -	$ 137	$ -	$ 137
Collateral Liabilities				
(included in Bonds and Notes)	-	792	-	792
Standby Letters of Credit				
(included in Other Liabilities)	-	-	10	10
Total Liabilities	$ -	$ 929	$ 10	$ 939

Assets and Liabilities Measured at Fair Value on a Recurring Basis

December 31, 2010

($ in Millions)	Level 1	Level 2	Level 3	Total
Assets				
Investment Securities:				
U.S. Treasury and				
Agency Debt	$ -	$ 3,358	$ -	$ 3,358
Mortgage-Backed:				
U.S. Agency	-	8,739	-	8,739
Non-Agency	-	402	-	402
Asset-Backed	-	-	118	118
Interest Rate Swaps and				
Other Financial Instruments	-	1,001	-	1,001
Assets Held in Trust				
(included in Other Assets)	34	-	-	34
Collateral Assets (included				
in Other Assets)	-	7	-	7
Total Assets	$ 34	$ 13,507	$ 118	$ 13,659
Liabilities				
Interest Rate Swaps and				
Other Financial Instruments	$ -	$ 93	$ -	$ 93
Collateral Liabilities				
(included in Bonds and Notes)	-	891	-	891
Standby Letters of Credit				
(included in Other Liabilities)	-	-	11	11
Total Liabilities	$ -	$ 984	$ 11	$ 995

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The following table presents the changes in Level 3 assets and liabilities measured at fair value on a recurring basis:

Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis

($ in Millions)	U.S. Agency Mortgage-Backed Securities	Farmer Mac Mortgage-Backed Securities	FHA/VA Non-Wrapped Reperformer Mortgage-Backed Securities	Asset-Backed Securities	Standby Letters of Credit
Balance at December 31, 2011	**$ -**	**$ -**	**$ -**	**$ 54**	**$ 10**
Level 3 Assets Acquired in Merger	**89**	**253**	**554**	**59**	**-**
Total Gains or Losses (Realized/Unrealized):					
Included in Other Noninterest Expense	**-**	**-**	**-**	**(12)**	**-**
Included in Other Comprehensive Income	**-**	**(1)**	**(1)**	**43**	**-**
Issuances	**-**	**-**	**-**	**-**	**7**
Settlements	**(12)**	**(36)**	**(77)**	**(26)**	**(7)**
Accretion	**1**	**(1)**	**30**	**3**	**-**
Balance at December 31, 2012	**$ 78**	**$ 215**	**$ 506**	**$ 121**	**$ 10**
Balance at December 31, 2010	$ -	$ -	$ -	$ 118	$ 11
Total Gains or Losses (Realized/Unrealized):					
Included in Other Noninterest Expense	-	-	-	(5)	-
Included in Other Comprehensive Income	-	-	-	1	-
Sales	-	-	-	(41)	-
Issuances	-	-	-	-	7
Settlements	-	-	-	(19)	(8)
Balance at December 31, 2011	$ -	$ -	$ -	$ 54	$ 10
Balance at December 31, 2009	$ -	$ -	$ -	$ 173	$ 10
Total Gains or Losses (Realized/Unrealized):					
Included in Other Noninterest Expense	-	-	-	(35)	-
Included in Other Comprehensive Income	-	-	-	27	-
Issuances	-	-	-	-	5
Settlements	-	-	-	(47)	(4)
Balance at December 31, 2010	$ -	$ -	$ -	$ 118	$ 11

Estimated Fair Value of Certain Other Financial Instruments

The following table presents the estimated fair values of financial instruments that are recorded in the consolidated balance sheets at cost, as well as certain off-balance sheet financial instruments, as of December 31, 2012, 2011 and 2010.

($ in Millions)

	December 31, 2012			December 31, 2011			December 31, 2010		
	Carrying Amount	Estimated Fair Value	Fair Value Hierarchy	Carrying Amount	Estimated Fair Value	Fair Value Hierarchy	Carrying Amount	Estimated Fair Value	Fair Value Hierarchy
Financial Assets:									
Net Loans	**$ 71,543**	**$ 73,800**	**Level 3**	$ 45,897	$ 47,647	Level 3	$ 49,592	$ 50,613	Level 3
Financial Liabilities:									
Bonds and Notes	**$ 83,607**	**$ 85,183**	**Level 3**	$ 56,104	$ 57,678	Level 3	$ 59,324	$ 60,094	Level 3
Subordinated Debt	**905**	**990**	**Level 3**	1,000	955	Level 3	1,000	953	Level 3
Off-Balance Sheet Financial Instruments:									
Commitments to Extend Credit	**$ -**	**$ (100)**	**Level 3**	$ -	$ (102)	Level 3	$ -	$ (80)	Level 3

Net Loans

Our loan portfolio includes fixed- and floating-rate loans. Since no active trading market exists for most of our loans, fair value is estimated by discounting the expected future cash flows using current interest rates at which similar loans would be made to borrowers with similar credit risk.

Bonds and Notes

Bonds and notes are not all traded in the secondary market and those that are traded may not have readily available quoted market prices. Therefore, the fair value of the instruments is estimated by calculating the discounted value of the expected future cash flows. The discount rates used are based on the sum of quoted market yields for the U.S. Treasury yield curve and an estimated yield-spread relationship between Farm Credit debt securities and U.S. Treasury securities. We estimate an appropriate yield-spread taking into consideration bank and security dealer yield indications, observed new Government Sponsored Enterprise debt security pricing, and pricing levels in the related USD interest rate swap market.

Subordinated Debt

The fair value of subordinated debt is estimated based upon quotes obtained from a broker/dealer.

Commitments to Extend Credit

The fair value of commitments to extend credit is estimated by applying a risk-adjusted spread percentage to these obligations.

The following table presents information about valuation techniques and inputs to other fair value measurements.

Information About Valuation Techniques and Inputs to Other Fair Value Measurements

	Valuation Technique	Input
Loans	Discounted Cash Flow	Prepayment Rate Mark-to-Market Spread Benchmark Yield Curve Probability of Default Loss Given Default
Bonds and Notes	Discounted Cash Flow	Benchmark Yield Curve Farm Credit Spread
Subordinated Debt	Broker/Dealer Quote	Price for Similar Security
Commitments to Extend Credit	Discounted Cash Flow	Mark-to-Market Spread

Note 14 – Related Party Transactions

In the ordinary course of business, we enter into loan transactions with customers, the officers or directors of which may also serve on our Board of Directors. Such loans are subject to special review and reporting requirements contained in the FCA regulations, are reviewed and approved only at the most senior loan committee level within the Bank and are regularly reported to the Board of Directors. Except as noted below, all related party loans are made in accordance with established policies on substantially the same terms, including interest rates and collateral requirements, as those prevailing at the time for comparable transactions with unrelated borrowers.

During 2010, we made a $4.0 million loan to Dixie Electric Membership Corporation (DEMCO), with which Richard W. Sitman, a member of our Board of Directors, is affiliated. The loan was made to refinance a portion of DEMCO's existing long-term indebtedness. CoBank's pricing policy was unintentionally misapplied to this loan and the loan was closed with an interest rate of 3.25 percent, which is lower than rates on similar loans to unrelated borrowers. As of December 31, 2012, there was $3.2 million outstanding on this loan, which is less than 10 percent of the Bank's total exposure to DEMCO.

Total loans outstanding to customers whose officers or directors serve on our Board of Directors amounted to $390.5 million at December 31, 2012. During 2012, $3.0 billion of advances on loans were made and repayments totaled $2.9 billion. None of these loans outstanding at December 31, 2012 were delinquent, in nonaccrual or accruing restructured status or, in the opinion of management, involved more than a normal risk of collectibility.

Note 15 – Segment Financial Information

We conduct lending operations through three operating segments: Agribusiness, Strategic Relationships and Rural Infrastructure.

The following table presents condensed disaggregated information for the segments. Allocations of resources and corporate items, as well as measurement of financial performance, are made at these operating segment levels. We also allocate net interest income on investment securities to our segments. Information to reconcile the total reportable segments to the total CoBank financial statements is shown as "other." Intersegment transactions are insignificant.

We do not hold significant assets in any foreign country. Substantially all of our agricultural export finance loans are U.S. dollar-denominated and the majority of these loans are guaranteed by a U.S. government-sponsored loan guarantee program. For the two years ended December 31, 2012 and 2011, no customer made up 10 percent or more of our gross or net interest income. For the year ended December 31, 2010, interest earned from an affiliated Association, Northwest Farm Credit Services, represented 10 percent of our gross interest income and less than 10 percent of our net interest income. No other customer made up 10 percent or more of our gross or net interest income for 2010.

Segment Financial Information

	Agribusiness	Strategic Relationships	Rural Infrastructure	Subtotal	Other	Total CoBank
2012 Results of Operations ($ in Thousands):						
Net Interest Income	**$ 631,737**	**$ 275,679**	**$ 338,156**	**$ 1,245,572**	**$ (7,402)**	**$ 1,238,170**
Provision for Loan Losses	**16,550**	**-**	**53,450**	**70,000**	**-**	**70,000**
Noninterest Income	**64,708**	**1,220**	**49,335**	**115,263**	**(1,942)**	**113,321**
Operating Expenses	**154,521**	**31,261**	**76,766**	**262,548**	**1,335**	**263,883**
Provision for Income Taxes	**115,488**	**-**	**49,076**	**164,564**	**(873)**	**163,691**
Net Income	**$ 409,886**	**$ 245,638**	**$ 208,199**	**$ 863,723**	**$ (9,806)**	**$ 853,917**
Selected Financial Information at December 31, 2012 ($ in Millions):						
Loans	**$ 21,394**	**$ 36,707**	**$ 13,879**	**$ 71,980**	**$ -**	**$ 71,980**
Less: Allowance for Loan Losses	**(277)**	**-**	**(160)**	**(437)**	**-**	**(437)**
Net Loans	**$ 21,117**	**$ 36,707**	**$ 13,719**	**$ 71,543**	**$ -**	**$ 71,543**
Total Assets	**$ 21,447**	**$ 36,849**	**$ 13,776**	**$ 72,072**	**$ 20,406 ***	**$ 92,478**
*Other assets are comprised of:						
Investment Securities						**$ 17,999**
Other Assets						**2,407**
2011 Results of Operations ($ in Thousands):						
Net Interest Income	$ 681,370	$ 95,232	$ 300,911	$ 1,077,513	$ (6,486)	$ 1,071,027
Provision for Loan Losses	37,000	-	21,000	58,000	-	58,000
Noninterest Income	77,178	752	42,109	120,039	(2,103)	117,936
Operating Expenses	145,752	15,178	67,174	228,104	166	228,270
Provision for Income Taxes	137,714	-	60,428	198,142	(2,036)	196,106
Net Income	$ 438,082	$ 80,806	$ 194,418	$ 713,306	$ (6,719)	$ 706,587
Selected Financial Information at December 31, 2011 ($ in Millions):						
Loans	$ 18,869	$ 15,236	$ 12,180	$ 46,285	$ -	$ 46,285
Less: Allowance for Loan Losses	(269)	-	(119)	(388)	-	(388)
Net Loans	$ 18,600	$ 15,236	$ 12,061	$ 45,897	$ -	$ 45,897
Total Assets	$ 18,690	$ 15,281	$ 12,121	$ 46,092	$ 17,198 *	$ 63,290
*Other assets are comprised of:						
Investment Securities						$ 12,995
Other Assets						4,203
2010 Results of Operations ($ in Thousands):						
Net Interest Income	$ 547,102	$ 93,071	$ 315,645	$ 955,818	$ (4,973)	$ 950,845
Provision for Loan Losses	7,167	-	52,833	60,000	-	60,000
Noninterest Income	57,336	801	41,816	99,953	(1,394)	98,559
Operating Expenses	117,798	13,426	81,877	213,101	3,109	216,210
Provision for Income Taxes	114,226	-	47,155	161,381	(1,954)	159,427
Net Income	$ 365,247	$ 80,446	$ 175,596	$ 621,289	$ (7,522)	$ 613,767
Selected Financial Information at December 31, 2010 ($ in Millions):						
Loans	$ 22,676	$ 15,392	$ 11,924	$ 49,992	$ -	$ 49,992
Less: Allowance for Loan Losses	(284)	-	(116)	(400)	-	(400)
Net Loans	$ 22,392	$ 15,392	$ 11,808	$ 49,592	$ -	$ 49,592
Total Assets	$ 22,513	$ 15,439	$ 11,869	$ 49,821	$ 16,005 *	$ 65,826
*Other assets are comprised of:						
Investment Securities						$ 12,617
Other Assets						3,388

Note 16 – Commitments and Contingent Liabilities

Under the Farm Credit Act of 1971, as amended, we are primarily liable for the portion of outstanding Systemwide Debt Securities issued by CoBank. We are also contingently liable, as defined in statutory joint and several liability provisions, for the outstanding Systemwide Debt Securities issued by the other System banks. Total Systemwide Debt Securities of the System were $198.0 billion at December 31, 2012.

There are several mechanisms in place affecting exposure to statutory joint and several liabilities. System banks are statutorily required to maintain eligible assets at a level at least equal in value to the total amount of debt for which such System bank is primarily liable. In addition, in the event of a default by a System bank, the Insurance Fund would be required to make timely payment of principal and interest on Systemwide Debt Securities, to the extent that net assets are available in the Insurance Fund, before the joint and several liability of the System banks would be triggered. At December 31, 2012, the aggregated assets of the Insurance Fund totaled $3.3 billion. Finally, System banks must maintain certain financial criteria in order to participate in Systemwide debt issuances. If these criteria are not met, a troubled System bank's access to and participation in Systemwide debt issuances could be limited or denied.

We have entered into employment agreements with two of our senior officers which will provide specified payments, as well as certain enhanced retirement benefits, in the event of a termination, except in the case of a termination for cause. These employment agreements also provide for enhanced payments in the event of a change in control, as further discussed on page 144. In addition, as part of the merger with AgBank, we assumed severance and retention agreements that provide for payments to certain employees in the event of termination.

On at least a quarterly basis, we assess our liabilities and contingencies in connection with outstanding legal proceedings utilizing the latest information available. For those matters where it is probable that we will incur a loss, and the amount of the loss can be reasonably estimated, we record a liability in our consolidated financial statements. For other matters, where a loss is not probable or the amount of the loss is not estimable, we will not accrue a liability. While the outcome of legal proceedings is inherently uncertain, based on information currently available, advice of legal counsel and available insurance coverage, we believe that our established legal reserves are adequate as of December 31, 2012 and the liabilities arising from our legal proceedings will not have a material adverse effect on our consolidated financial position, results of operations or cash flows. However, in the event of unexpected future developments, it is possible that the ultimate resolution of these matters, if unfavorable, may be material to the Bank's consolidated financial position, results of operations or cash flows.

We have various other commitments outstanding and contingent liabilities as discussed elsewhere in these notes to consolidated financial statements, including commitments to extend credit as discussed in Note 11.

Note 17 – Quarterly Financial Information

Unaudited quarterly results of operations for the years ended December 31, 2012, 2011 and 2010, are shown in the table below.

Quarterly Financial Information (Unaudited)

2012		First		Second		Third		Fourth		Total
Net Interest Income	$	**313,076**	$	**307,080**	$	**305,082**	$	**312,932**	$	**1,238,170**
Provision for Loan Losses		**5,000**		**5,000**		**10,000**		**50,000**		**70,000**
Noninterest Income and Expenses, Net		**26,186**		**(9,117)**		**41,503**		**91,990**		**150,562**
Provision for Income Taxes		**51,391**		**58,809**		**35,925**		**17,566**		**163,691**
Net Income	$	**230,499**	$	**252,388**	$	**217,654**	$	**153,376**	$	**853,917**

2011		First		Second		Third		Fourth		Total
Net Interest Income	$	301,204	$	276,537	$	251,995	$	241,291	$	1,071,027
Provision for Loan Losses		12,500		25,000		12,500		8,000		58,000
Noninterest Income and Expenses, Net		19,694		25,519		27,872		37,249		110,334
Provision for Income Taxes		56,949		45,290		41,706		52,161		196,106
Net Income	$	212,061	$	180,728	$	169,917	$	143,881	$	706,587

2010		First		Second		Third		Fourth		Total
Net Interest Income	$	230,720	$	217,903	$	226,276	$	275,946	$	950,845
Provision for Loan Losses		12,500		4,000		21,000		22,500		60,000
Noninterest Income and Expenses, Net		8,018		26,688		39,979		42,966		117,651
Provision for Income Taxes		41,543		36,843		33,339		47,702		159,427
Net Income	$	168,659	$	150,372	$	131,958	$	162,778	$	613,767

District Overview

CoBank is chartered by the FCA to serve the Associations that provide credit and financially related services to or for the benefit of eligible borrowers/shareholders. The Associations are not authorized by the Farm Credit Act to participate in the issuance of Systemwide Debt Securities. Therefore, we are the primary funding source for our affiliated Associations. As a result of the merger with AgBank, on January 1, 2012, the number of our affiliated Associations increased from four to 29 and now includes Associations in 23 states serving the Northwest, West, Southwest, Rocky Mountains, Mid-Plains, and Northeast regions of the United States.

The Associations originate and service long-term real estate mortgage loans as well as short- and intermediate-term loans for agricultural purposes. The Associations may also purchase eligible loan participations from System entities and other lending institutions. Additionally, the Associations serve as an intermediary in offering multi-peril crop insurance and credit life insurance, and providing additional financial services to borrowers.

The Farm Credit Act as well as FCA regulations require us to exercise limited supervision over the operating activities of our affiliated Associations. These Associations and CoBank operate under a debtor-creditor relationship evidenced by a General Financing Agreement (GFA) entered into separately with each Association. The GFA sets forth the business relationship between us and each Association and also references certain requirements contained in the Farm Credit Act and FCA regulations. The Associations' respective boards of directors are expected to establish and monitor the necessary policies and procedures to comply with all FCA regulations. In all other respects, the lending relationship with the Associations is substantially similar to that with our other borrowers.

We make loans to the Associations, which, in turn, make loans to their eligible borrowers. We have senior secured interests in substantially all of the Associations' assets, which extend to the underlying collateral of the Associations' loans to their customers. Total loans outstanding and related accrued interest to our affiliated Associations was $32.9 billion at December 31, 2012. During 2012, $93.8 billion of advances on loans were made to our affiliated Associations and repayments totaled $91.2 billion.

We have no direct access to Association capital. Our bylaws permit our Board of Directors to set the target equity level for Association investment in the Bank within a range of 4 to 6 percent of the one-year historical average of Association borrowings. In 2012, the required investment level was 4 percent. There are no capital sharing agreements between us and our affiliated Associations.

Our affiliated Associations are considered customers and thus operate independently and maintain an arms-length relationship with us, except to the limited extent that the Farm Credit Act requires us, as the funding bank, to monitor and approve certain activities of these Associations. Accordingly, the financial information of affiliated Associations is not included in our condensed consolidated financial statements. However, because of the interdependent manner in which CoBank and our affiliated Associations operate, we believe that presenting combined Bank and Association financial information is meaningful for purposes of additional analysis.

The Financial Highlights, Management's Discussion and Analysis and the Condensed Combined Income Statements and Balance Sheets included in the supplemental information on pages 108 to 117 present unaudited combined financial information and related analysis of CoBank and its affiliated Associations, which are collectively referred to as the "District." As part of the combining process, all significant transactions between CoBank and the Associations, including loans made by the Bank to the affiliated Associations and the interest income/interest expense related thereto, and investments of the affiliated Associations in the Bank and the earnings related thereto, have been eliminated.

Supplemental District Financial Information
CoBank, ACB and Affiliated Associations

Financial Highlights[1]

($ in Thousands)

As of December 31,		2012		2011
Total Loans	$	**79,076,558**	$	48,336,198
Less: Allowance for Loan Losses		**759,626**		588,879
Net Loans		**78,316,932**		47,747,319
Total Assets		**100,374,523**		65,376,682
Total Shareholders' Equity		**12,942,545**		6,790,284

Year Ended December 31,		2012		2011
Net Interest Income	$	**2,362,465**	$	1,495,994
Provision for Loan Losses		**147,167**		122,280
Net Fee Income		**147,384**		129,795
Net Income		**1,500,678**		922,108
Net Interest Margin		**2.48 %**		2.29 %
Return on Average Assets		**1.53**		1.35
Return on Average Total Shareholders' Equity		**11.89**		14.06
Average Loans	$	**77,210,644**	$	52,178,631
Average Earning Assets		**95,201,132**		65,253,937
Average Assets		**98,045,339**		68,208,556

[1] On January 1, 2012, AgBank was merged into CoBank, FCB and CoBank became the funding bank for the 25 Farm Credit Associations previously affiliated with AgBank. The effects of the merger are included in the District's condensed combined statement of income, balance sheet, average balances and related metrics beginning in 2012.

Management's Discussion and Analysis of District Results of Operations and Financial Condition

The following discussion summarizes the combined results of operations and financial position of the CoBank District (District) as of and for the year ended December 31, 2012. Comparisons with prior-year periods are included. Affiliated Agricultural Credit Associations and Federal Land Credit Associations are together referred to as "affiliated Associations."

Merger with AgBank

On January 1, 2012, AgBank was merged into CoBank, and CoBank became the funding bank for the 25 Associations formerly affiliated with AgBank. Beginning in 2012, the District's statement of income, balance sheet, average balances and related metrics include the effects of the merger with AgBank. Prior year results have not been restated to reflect the impact of the merger.

Upon the closing of the merger, the District's total loans, investment securities, other assets, liabilities and shareholders' equity increased by $24.9 billion, $5.2 billion, $0.9 billion, $25.8 billion, and $5.2 billion, respectively. These amounts include adjustments to fair value, as required by accounting standards for business combinations.

Also on January 1, 2012, Mountain Plains Farm Credit Services merged with American AgCredit, both of which are former AgBank affiliated Associations.

Combined Results of Operations

District net income increased 63 percent to $1.5 billion for 2012 compared to $922.1 million for 2011, and included the impact of the merger and an $86.2 million refund from the Farm Credit System Insurance Corporation (Insurance Corporation). Stronger earnings primarily reflect an increase in net interest income and noninterest income, partially offset by an increase in operating expenses.

Net interest income increased 58 percent to $2.4 billion for 2012 from $1.5 billion for 2011. The significant increase in net interest income was due to the merger-related addition of 25 affiliated Associations to the District. The merger drove an increase in average loan volume in the District, which grew to $77.2 billion for 2012 compared to $52.2 billion for 2011. The merger impact was somewhat offset by lower average agribusiness loan volume in the Bank's retail portfolio. Excluding the impact of the merger, average loan volume at the Associations increased modestly.

The District's overall net interest margin increased to 2.48 percent for 2012 as compared to 2.29 percent for 2011. The merger with AgBank increased the District's overall net interest margin due to the resulting shift in the mix of total District loans. The significant majority of the loan portfolios of the 25 new affiliated Associations consist of long-term real estate mortgage loans and production and intermediate-term loans, which generally carry higher margins than portions of CoBank's retail loan portfolio, including guaranteed agricultural export finance loans and most rural energy loans. Lower spreads on guaranteed agricultural export finance loans and most rural energy loans are commensurate with their lower risk and lower regulatory capital requirements. In addition, CoBank's loans to non-affiliated Associations also carry lower margins, consistent with their lower risk and capital profile.

The District's combined provision for loan losses was $147.2 million for 2012, compared to $122.3 million for 2011. The Associations' combined provision was $77.2 million for 2012, compared to $64.3 million for 2011. The District's loan quality is discussed beginning on page 112.

Noninterest income increased significantly to $265.5 million for 2012 from $165.0 million for 2011, driven primarily by a refund from the Insurance Corporation. CoBank and its affiliated Association customers received a refund of $86.2 million, with $44.6 million related to CoBank and $41.6 million related to affiliated Associations. The increase in noninterest income also included a higher level of fee income due to the addition of fee income generated by the 25 new affiliated Associations. These favorable items were partially offset by a greater level of losses on the early extinguishment of debt, net of prepayment income, at the Bank and the loss on the extinguishment of a portion of the Bank's subordinated debt.

Total District operating expenses were also significantly impacted by the merger, increasing 93 percent to $799.3 million for 2012 from $413.2 million for 2011. Employee compensation increased to $496.9 million from $226.6 million for 2011. The total number of employees in the District more than doubled to approximately 3,600 primarily as a result of the merger, which was the largest contributing factor to the increase in employee compensation expense. In addition, assets and obligations related to bank participants in AgBank's legacy defined benefit pension plans were transferred into CoBank's defined benefit pension plan effective with the merger. This transfer resulted in a $14.1 million one-time expense to the plans from which these assets and obligations were transferred, which was recognized in the District financial statements in 2012. The increases in substantially all other operating expense categories, including general and administrative, information technology, occupancy and equipment, Farm Credit System related and other expenses, were also primarily the result of the merger with the addition of 25 Associations. Purchased services expenses were $38.6 million for 2012 compared to $36.0 million for the same period in 2011. The 2011 period reflected merger-related costs at the bank, while current period expenses include costs resulting from the addition of expenses incurred by the 25 newly affiliated Associations following the merger.

Income tax expense decreased to $180.9 million from $203.3 million. Because the substantial majority of the business activities at Associations, including those Associations previously affiliated with AgBank, are exempt from federal income tax, the income tax expense at the District predominantly relates to CoBank. The decrease in income tax expense at CoBank is discussed on page 32.

Loan Portfolio

The following table presents the District's outstanding loans classified in accordance with the FCA's loan types.

($ in Thousands)

District Loans by Loan Type

December 31,	2012	2011
Real Estate Mortgage	$ 23,403,897	$ 6,451,948
Non-affiliated Associations	3,590,169	4,047,861
Production and Intermediate-term	12,976,059	6,746,375
Agribusiness:		
Loans to Cooperatives	11,197,967	10,095,904
Processing and Marketing Operations	3,786,031	1,503,068
Farm Related Businesses	1,489,009	732,585
Communications	2,854,413	2,640,289
Energy	10,740,816	8,695,046
Water/Wastewater	1,119,923	986,082
Agricultural Export Finance	4,660,523	3,757,667
Rural Residential Real Estate	870,060	784,887
Lease Receivables	2,308,251	1,873,321
Other	79,440	21,165
Total	$ 79,076,558	$ 48,336,198

District loan volume at December 31, 2012 was $79.1 billion compared to $48.3 billion at December 31, 2011. The significant increase resulted from the merger with AgBank. In particular, real estate mortgage, production and intermediate-term, and agribusiness processing and marketing loans increased significantly due to the addition of the 25 Associations formerly affiliated with AgBank. The increase in period-end agribusiness loans to cooperatives was primarily due to the merger and higher commodity prices in the latter half of 2012 resulting from the impact of the drought which affected many parts of the United States. The increase in energy loans primarily relates to growth in CoBank's retail portfolio. The increase in agricultural export finance loans relates to CoBank's retail portfolio and resulted from global market volatility and a higher level of export demand.

Portfolio Diversification

The following tables present the District's combined loan portfolio by primary business/commodity and geographic distribution, as a percent of total loans for the periods presented.

Distribution by Primary Business / Commodity

	2012	2011
Farm Supply and Grain Marketing	**14 %**	18 %
Fruits, Nuts and Vegetables	**12**	9
Dairy	**10**	8
Cattle	**6**	2
Electric Distribution	**6**	11
International Lending	**6**	8
Field Crops Except Grains	**5**	3
Generation and Transmission	**4**	5
Livestock, Fish and Poultry	**4**	4
Other Farm Credit Entities	**4**	8
Forest Products	**4**	5
Farm Related Business Services	**3**	3
Leasing	**3**	4
Local Telephone Exchange Carriers	**2**	3
Nursery, Greenhouse	**2**	2
Rural Home	**2**	2
Other	**13**	5
Total	**100 %**	100 %

Geographic Distribution

	2012	2011
California	**21 %**	6 %
Texas	**7**	10
Kansas	**6**	2
Washington	**5**	7
New York	**4**	6
Oregon	**4**	5
Colorado	**4**	2
Idaho	**3**	4
Oklahoma	**3**	1
Iowa	**2**	4
Minnesota	**2**	3
Other (less than 2 percent each for the current year)	**33**	42
Total States	**94 %**	92 %
Latin America	**2**	3
Europe, Mideast and Africa	**2**	3
Other International	**2**	2
Total International	**6 %**	8 %
Total	**100 %**	100 %

Loan Quality

The following table presents loans and related accrued interest receivable, classified by management at the various District entities pursuant to the FCA's Uniform Loan Classification System, as a percent of total loans and related accrued interest.

District Loan Quality

December 31,	2012	2011
Acceptable	**94.86 %**	93.82 %
Special Mention	**2.29**	3.23
Substandard	**2.71**	2.81
Doubtful	**0.14**	0.14
Loss	**-**	-
Total	**100.00 %**	100.00 %

Loan quality within the District is very favorable, with over 94 percent of all loans and related accrued interest in the highest category of credit quality. While the merger with AgBank did not significantly change the loan quality measures at the District level, it did enhance industry and geographic diversification within the CoBank District. Credit risk in the District's loan portfolio is spread broadly among customers, industries and geographic territory. The District serves a diversified spectrum of borrowers up and down the agricultural value chain. Association retail loans in the District loan portfolio are concentrated in the Northwest, West, Southwest, Rocky Mountains, Mid-Plains, and Northeast regions of the United States. CoBank's retail loan portfolio extends across the United States, with moderate levels of concentration in the Midwest region of the country and in the farm supply and grain marketing, electric distribution, and generation and transmission sectors.

Nonperforming assets (which consist of nonaccrual loans, accruing restructured loans, accruing loans 90 days or more past due and other property owned) totaled $857.8 million as of December 31, 2012 compared to $500.2 million at December 31, 2011, and increased primarily as a result of the additional Associations included due to the merger. Nonperforming assets represented 1.08 percent of total District loan volume and other property owned at December 31, 2012 compared to 1.03 percent at December 31, 2011. Nonaccrual loan volume, the largest component of nonperforming assets, was 0.92 percent of total loans at December 31, 2012 compared to 0.89 percent at December 31, 2011. Changes in the level of nonaccrual loans in CoBank's retail loan portfolio are discussed on page 41. Other property owned increased to $47.8 million at December 31, 2012 from $10.0 million at December 31, 2011, mostly due to other property owned by Associations in the former AgBank district. The properties in other property owned are primarily related to the livestock/cattle and energy industries.

The following table displays the District's nonperforming assets for the periods presented.

($ in Thousands)

Nonperforming Assets

December 31,	2012	2011
Nonaccrual Loans:		
Real Estate Mortgage	**$ 350,187**	$ 128,719
Production and Intermediate-term	**224,217**	183,141
Agribusiness	**36,119**	41,154
Communications	**79,493**	54,512
Energy	**22,141**	201
Water/Waste Water	**200**	-
Rural Residential Real Estate	**12,360**	15,287
Lease Receivables	**5,116**	9,549
Total Nonaccrual Loans	**729,833**	432,563
Accruing Restructured Loans:		
Real Estate Mortgage	**35,098**	18,481
Production and Intermediate-term	**26,091**	18,639
Agribusiness	**3,709**	2,123
Energy	**3,145**	3,228
Rural Residential Real Estate	**316**	409
Total Accruing Restructured Loans	**68,359**	42,880
Accruing Loans 90 Days or More Past Due:		
Real Estate Mortgage	**4,474**	2,554
Production and Intermediate-term	**6,750**	10,783
Agribusiness	**-**	188
Rural Residential Real Estate	**77**	1,056
Lease Receivables	**479**	114
Total Accruing Loans 90 Days or More Past Due	**11,780**	14,695
Total Nonperforming Loans	**809,972**	490,138
Other Property Owned	**47,826**	10,031
Total Nonperforming Assets	**$ 857,798**	$ 500,169
Nonaccrual Loans as a Percentage of Total Loans	**0.92 %**	0.89 %
Nonperforming Assets as a Percentage of Total Loans and Other Property Owned	**1.08**	1.03
Nonperforming Assets as a Percentage of Capital	**6.63**	7.37

The following tables present an aging of past due loans and related accrued interest in the District for the periods presented.

($ in Thousands)

Aging of Past Due Loans

December 31, 2012	30-90 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans and Accrued Interest	Recorded Investment >90 Days and Accruing
Real Estate Mortgage	$ 75,130	$ 127,289	$ 202,419	$ 23,421,193	$ 23,623,612	$ 4,474
Production and Intermediate Term	51,905	64,382	116,287	12,941,245	13,057,532	6,750
Agribusiness	12,870	7,562	20,432	16,512,149	16,532,581	-
Communications	-	5,296	5,296	2,855,692	2,860,988	-
Energy	-	71	71	10,784,164	10,784,235	-
Water/Wastewater	-	-	-	1,126,483	1,126,483	-
Agricultural Export Finance	-	-	-	4,672,186	4,672,186	-
Rural Residential Real Estate	5,089	6,961	12,050	862,087	874,137	77
Lease Receivables	8,854	1,400	10,254	2,298,462	2,308,716	479
Non-affiliated Associations	-	-	-	3,592,333	3,592,333	-
Other	-	-	-	79,580	79,580	-
Total	$ 153,848	$ 212,961	$ 366,809	$ 79,145,574	$ 79,512,383	$ 11,780

($ in Thousands)

Aging of Past Due Loans

December 31, 2011	30-90 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans and Accrued Interest	Recorded Investment >90 Days and Accruing
Real Estate Mortgage	$ 34,802	$ 49,821	$ 84,623	$ 6,425,403	$ 6,510,026	$ 2,554
Production and Intermediate Term	36,186	57,901	94,087	6,688,311	6,782,398	10,783
Agribusiness	6,264	7,886	14,150	12,362,121	12,376,271	188
Communications	-	-	-	2,648,194	2,648,194	-
Energy	-	-	-	8,740,596	8,740,596	-
Water/Wastewater	-	-	-	992,051	992,051	-
Agricultural Export Finance	-	-	-	3,766,204	3,766,204	-
Rural Residential Real Estate	6,363	7,710	14,073	775,341	789,414	1,056
Lease Receivables	56,100	4,916	61,016	1,812,304	1,873,320	114
Non-affiliated Associations	-	-	-	4,050,481	4,050,481	-
Other	-	-	-	21,223	21,223	-
Total	$ 139,715	$ 128,234	$ 267,949	$ 48,282,229	$ 48,550,178	$ 14,695

District entities maintain an allowance for loan losses at a level consistent with the probable losses identified by management of each institution, considering such factors as current agricultural and economic conditions, loan loss experience, portfolio quality, and loan portfolio composition and concentrations. CoBank and certain Associations also maintain a reserve for unfunded commitments, which totaled $171.2 million at December 31, 2012.

Although aggregated in the District's combined financial statements, the allowance for loan losses for each District entity is particular to that institution and is not available to absorb losses realized by other District entities. The allowance for loan losses at December 31, 2012 totaled $759.6 million compared to $588.9 million at December 31, 2011.

The following presents detailed changes in the allowance for loan losses in the District for the periods presented.

($ in Thousands)

Changes in Allowance for Loan Losses

	Balance at December 31, 2011	Charge-offs	Recoveries	Provision for Loan Losses/ (Loan Loss Reversal)	Transfers from (to) Reserve for Unfunded Commitments	Merger Impact	Balance at December 31, 2012
Real Estate Mortgage	$ 52,628	$ (14,148)	$ 8,066	$ 4,183	$ 294	$ 38,720	$ 89,743
Production and Intermediate Term	143,613	(72,081)	8,887	72,162	1,173	47,644	201,398
Agribusiness	232,396	(15,319)	1,921	14,478	6,575	14,976	255,027
Communications	46,498	(1,556)	2,343	17,800	715	465	66,265
Energy	68,204	-	364	35,491	(12,895)	2,239	93,403
Water/Wastewater	7,518	-	45	3,664	(1,378)	4	9,853
Agricultural Export Finance	12,073	-	412	(7,964)	1,701	16	6,238
Rural Residential Real Estate	4,123	(711)	45	2,007	-	55	5,519
Lease Receivables	21,761	(3,062)	7,340	5,217	-	902	32,158
Other	65	(177)	5	129	-	-	22
Total	$ 588,879	$ (107,054)	$ 29,428	$ 147,167	$ (3,815)	$ 105,021	$ 759,626

($ in Thousands)

Changes in Allowance for Loan Losses

	Balance at December 31, 2010	Charge-offs	Recoveries	Provision for Loan Losses/ (Loan Loss Reversal)	Transfers from (to) Reserve for Unfunded Commitments	Balance at December 31, 2011
Real Estate Mortgage	$ 42,077	$ (3,609)	$ 9	$ 17,215	$ (3,064)	$ 52,628
Production and Intermediate Term	129,381	(30,999)	5,158	50,302	(10,229)	143,613
Agribusiness	253,776	(7,441)	2,736	22,506	(39,181)	232,396
Communications	60,824	(6,333)	185	(7,805)	(373)	46,498
Energy	51,292	(6,623)	235	28,625	(5,325)	68,204
Water/Wastewater	5,616	(1,265)	-	3,774	(607)	7,518
Agricultural Export Finance	10,732	(127)	3,147	-	(1,679)	12,073
Rural Residential Real Estate	2,878	(2,245)	-	3,631	(141)	4,123
Lease Receivables	19,852	(2,446)	355	4,000	-	21,761
Other	37	-	-	33	(5)	65
Total	$ 576,465	$ (61,088)	$ 11,825	$ 122,281	$ (60,604)	$ 588,879

District Capital Resources

Combined District shareholders' equity at December 31, 2012 totaled $12.9 billion, a net increase of $6.1 billion as compared to $6.8 billion at December 31, 2011. The merger with AgBank accounted for $5.2 billion of the increase, net of merger-related fair value adjustments. The additional increase resulted from District net income of $1.5 billion, partially offset by net stock retirements, patronage distributions, preferred stock dividends, and other comprehensive loss, which collectively totaled $694.2 million. The components of the District's accumulated other comprehensive income (loss) are detailed in the following table.

($ in Thousands)

Accumulated Other Comprehensive Income (Loss)

December 31,	2012	2011
Unrealized Gains on Investment Securities	**$ 213,983**	$ 158,662
Net Pension Adjustment	**(303,628)**	(115,156)
Unrealized Losses on Interest Rate Swaps and Other Financial Instruments	**(11,261)**	(5,960)
Accumulated Other Comprehensive (Loss) Income	**$ (100,906)**	$ 37,546

The following table presents regulatory capital ratios for CoBank and the range of ratios at the affiliated Associations.

District Capital Ratios

	December 31, 2012			December 31, 2011		
	Permanent Capital Ratio	Total Surplus Ratio	Core Surplus Ratio	Permanent Capital Ratio	Total Surplus Ratio	Core Surplus Ratio
CoBank	**16.14%**	**15.22%**	**10.06%**	16.37%	16.01%	10.02%
Associations	**13.43% - 35.45%**	**13.27% - 35.02%**	**13.07% - 29.78%**	13.81% - 20.59%	13.65% - 20.26%	13.65% - 20.26%
Regulatory Minimum	**7.00%**	**7.00%**	**3.50%**	7.00%	7.00%	3.50%

As depicted in the table above, at December 31, 2012, CoBank and all affiliated Associations exceeded the FCA's regulatory minimum capital ratios.

Although aggregated in the District's condensed financial statements, capital for each District entity is particular to that institution. In addition, the provisions of joint and several liability for Systemwide Debt Securities are applicable only to System banks and do not include Associations.

Condensed Combined Statements of Income

($ in Thousands)

Year Ended December 31,	2012	2011
Interest Income		
Loans	$ **2,814,611**	$ 1,937,425
Investment Securities	**336,590**	276,350
Total Interest Income	**3,151,201**	2,213,775
Interest Expense	**788,736**	717,781
Net Interest Income	**2,362,465**	1,495,994
Provision for Loan Losses	**147,167**	122,280
Net Interest Income After Provision for Loan Losses	**2,215,298**	1,373,714
Noninterest Income/ Expense		
Net Fee Income	**147,384**	129,795
Prepayment Income	**49,510**	24,683
Losses on Early Extinguishment of Debt	**(86,718)**	(50,421)
Loss on Tender Offer for Subordinated Debt	**(28,460)**	-
Total Other-Than-Temporary Impairment Losses	**(972)**	(8,756)
Portion Recognized in Other Comprehensive Loss	**(16,028)**	(1,244)
Net Other-Than-Temporary Impairment Losses Included in Earnings	**(17,000)**	(10,000)
Other, Net	**200,827**	70,909
Total Noninterest Income	**265,543**	164,966
Operating Expenses		
Employee Compensation	**496,898**	226,627
General and Administrative	**73,955**	46,681
Information Technology	**50,412**	25,829
Insurance Fund Premium	**33,397**	26,699
Farm Credit System Related	**23,253**	10,697
Occupancy and Equipment	**41,615**	21,326
Purchased Services	**38,583**	35,981
Other	**41,160**	19,399
Total Operating Expenses	**799,273**	413,239
Income Before Income Taxes	**1,681,568**	1,125,441
Provision for Income Taxes	**180,890**	203,333
Net Income	$ **1,500,678**	$ 922,108

Supplemental District Financial Information

CoBank, ACB and Affiliated Associations

Condensed Combined Balance Sheets

($ in Thousands)

As of December 31,	2012	2011
Assets		
Total Loans	$ 79,076,558	$ 48,336,198
Less: Allowance for Loan Losses	759,626	588,879
Net Loans	78,316,932	47,747,319
Cash	1,538,820	2,849,697
Investment Securities	18,287,845	12,995,458
Interest Rate Swaps and Other Financial Instruments	1,005,044	1,047,897
Accrued Interest Receivable and Other Assets	1,225,882	736,311
Total Assets	$ 100,374,523	$ 65,376,682
Liabilities		
Bonds and Notes	$ 84,490,027	$ 56,168,289
Subordinated Debt	904,685	1,000,000
Interest Rate Swaps and Other Financial Instruments	157,008	136,062
Reserve for Unfunded Commitments	171,246	167,404
Accrued Interest Payable and Other Liabilities	1,709,012	1,114,643
Total Liabilities	87,431,978	58,586,398
Shareholders' Equity		
Preferred Stock Issued by Bank	961,750	700,000
Preferred Stock Issued by Associations	338,371	-
Common Stock	1,240,695	1,201,116
Paid In Capital	654,933	164,369
Unallocated Retained Earnings	9,847,702	4,687,253
Accumulated Other Comprehensive (Loss) Income	(100,906)	37,546
Total Shareholders' Equity	12,942,545	6,790,284
Total Liabilities and Shareholders' Equity	$ 100,374,523	$ 65,376,682

Report of Management

CoBank, ACB

March 1, 2013

To our Shareholders:

The consolidated financial statements of CoBank, ACB (CoBank) are prepared by management, which is responsible for their integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as appropriate in the circumstances. The consolidated financial statements, in the opinion of management, fairly present, in all material respects, the consolidated financial position of CoBank. Other consolidated financial information included in the Annual Report to Shareholders is consistent with that in the financial statements.

To meet its responsibility for reliable consolidated financial information, management depends on accounting and internal control systems which have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded and transactions are properly authorized and recorded. The systems have been designed to recognize that the cost must be related to the benefits derived. To monitor compliance, CoBank's internal audit staff performs audits of the accounting records, reviews accounting systems and internal controls, and recommends improvements as deemed appropriate. CoBank's 2012, 2011 and 2010 consolidated financial statements have been audited by PricewaterhouseCoopers LLP, independent auditors. In addition, our independent auditors have audited our internal control over financial reporting as of December 31, 2012, 2011 and 2010. CoBank is also examined by the Farm Credit Administration.

The president and chief executive officer, as delegated by the Board of Directors, has overall responsibility for CoBank's system of internal controls and financial reporting, subject to the review of the audit committee of the Board of Directors. The president and chief executive officer reports periodically on those matters to the audit committee. The audit committee consults regularly with management and meets periodically with the independent auditors and internal auditors to review the scope and results of their work. The audit committee reports regularly to the Board of Directors. Both the independent auditors and the internal auditors have direct access to the audit committee, which is composed solely of directors who are not officers or employees of CoBank.

The undersigned certify that this CoBank Annual Report to Shareholders has been reviewed by the undersigned and has been prepared in accordance with all applicable statutory or regulatory requirements and that the information contained herein is true, accurate and complete to the best of their knowledge.

Everett M. Dobrinski	Robert B. Engel	David P. Burlage
Chairman of the Board	President and Chief Executive Officer	Chief Financial Officer

Report of Independent Auditors
CoBank, ACB

To the Board of Directors and Shareholders of CoBank, ACB:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of comprehensive income, of changes in shareholders' equity and of cash flows appearing on pages 62 through 66 of the CoBank 2012 Annual Report to Shareholders present fairly, in all material respects, the financial position of CoBank, ACB and its subsidiaries (CoBank) at December 31, 2012, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, CoBank maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). CoBank's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assertion of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing on page 121 of the CoBank 2012 Annual Report to Shareholders. Our responsibility is to express opinions on these consolidated financial statements and on CoBank's internal control over financial reporting based on our integrated audits. We conducted our integrated audits in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States) and in accordance with the auditing and attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Report of Independent Auditors
CoBank, ACB

A company's internal control over financial reporting is a process effected by those charged with governance, management and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and those charged with governance; and (iii) provide reasonable assurance regarding prevention or timely detection and correction of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect and correct misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

Denver, Colorado
March 1, 2013

Management's Report on Internal Control Over Financial Reporting

CoBank, ACB

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. CoBank's internal control over financial reporting is a process designed under the supervision of our president and chief executive officer and our chief financial officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Bank's financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles. As of the end of the Bank's 2012 fiscal year, management conducted an assessment of the effectiveness of the Bank's internal control over financial reporting based on the framework established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, our management concluded that the Bank's internal control over financial reporting is effective as of December 31, 2012.

Our internal control over financial reporting includes policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and the directors of CoBank; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Bank's assets that could have a material effect on our financial statements.

The effectiveness of the Bank's internal control over financial reporting as of December 31, 2012 has been audited by PricewaterhouseCoopers LLP, independent auditors, as stated in their report appearing on pages 119 and 120, which expresses an unqualified opinion on the effectiveness of the Bank's internal control over financial reporting as of December 31, 2012. There have been no changes in the Bank's internal control over financial reporting that occurred during our most recent fiscal quarter (i.e., the fourth quarter of 2012) that have materially affected, or are reasonably likely to materially affect, the Bank's internal control over financial reporting.

Controls and Procedures
CoBank, ACB

We maintain a system of disclosure controls and procedures. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information disclosed by us in our quarterly and annual reports is accumulated and communicated to our management, including our principal executive officer and our principal financial officer, as appropriate, to allow timely decisions to be made regarding disclosure. The president and chief executive officer and the chief financial officer have evaluated our disclosure controls and procedures as of the end of the period covered by this annual report and have concluded that our disclosure controls and procedures are effective as of that date.

We also maintain a system of internal controls. The term “internal controls,” as defined by the American Institute of Certified Public Accountants’ Codification of Statement on Auditing Standards, AU-C Section 315, means a process effected by those charged with governance, management and other personnel that is designed to provide reasonable assurance about the achievement of the entity’s objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. We continually assess the adequacy of our internal controls over financial reporting and enhance our controls in response to internal control assessments and internal and external audit and regulatory recommendations. There have been no significant changes in our internal controls or in other factors that could significantly affect such controls subsequent to the date we carried out our evaluations. In accordance with our internal control procedures, these financial statements were prepared under the oversight of the Audit Committee of our Board of Directors.

Annual Report to Shareholders Disclosure Information Required by Farm Credit Administration Regulations

CoBank, ACB

In accordance with Farm Credit Administration (FCA) regulations, CoBank has prepared this Annual Report to Shareholders for the year ended December 31, 2012, in accordance with all applicable statutory or regulatory requirements.

	Section	Location
Description of Business		
Territory served, eligible borrowers, types of lending activities engaged in, financial services offered, and related Farm Credit organizations.	Notes to Financial Statements...................... Supplemental District Financial Information	Note 1 Page 107
Significant developments within the last 5 years that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting business, seasonal characteristics, concentration of assets, and dependence, if any, upon a single customer or a few customers.	Notes to Financial Statements......................	Note 1 Note 2 Note 3 Note 4 Note 5 Note 6 Note 7 Note 8 Note 14 Note 15 Note 16 Note 17
	Management's Discussion and Analysis	Pages 25 to 61
Description of Property		
Location of Property CoBank leases its national office building which is located in Greenwood Village, Colorado. CoBank also leases various facilities which are described on the inside back cover of this Annual Report to Shareholders. CoBank leases banking center offices in Ames, IA; Atlanta, GA; Austin, TX; Enfield, CT; Fargo, ND; Louisville, KY; Lubbock, TX; Minneapolis, MN; Omaha, NE; Sacramento, CA; Spokane, WA; Sterling, CO; and St. Louis, MO. CoBank leases office space in Washington D.C. and Singapore. CoBank owns its Wichita Banking Center facilities in Wichita, KS. CoBank leases the majority of this building to various unrelated tenants. Farm Credit Leasing Services Corporation leases its headquarters office in Minneapolis, MN, as well as outside sales offices in Atlanta, GA; Enfield, CT; Louisville, KY; Lubbock, TX; Celina, OH; Omaha, NE; Sacramento, CA; St. Louis, MO; and Stockton, CA, some of which are located in CoBank banking centers. CoBank has a national charter and, as a result, serves customers across rural America. Travel to customer locations may be difficult due to the rural nature of many of our customers' operations. In order to provide the appropriate level of customer contact and to optimize the efficiency of management travel, CoBank utilizes a variety of transportation to serve its customers, including aircraft (both commercial and fractional interest). The use of fractional interest aircraft is strictly limited to business use.	Office Locations..	Inside Back Cover
Legal Proceedings and Enforcement Actions	Notes to Financial Statements......................	Note 16
Description of Capital Structure	Notes to Financial Statements......................	Note 8
Description of Liabilities		
Debt Outstanding	Notes to Financial Statements......................	Notes 6 and 7
Contingent Liabilities	Notes to Financial Statements......................	Note 16
Selected Financial Data for the Five Years Ended December 31, 2012	Five-Year Summary of Selected Consolidated Financial Data	Page 27
Management's Discussion and Analysis of Financial Condition and Results of Operations	Management's Discussion and Analysis	Pages 28 to 61
Directors and Senior Officers		
Directors' Information	Board of Directors Disclosure	Pages 125 to 135
Senior Officers' Information	Senior Officers	Pages 136 to 148
Transactions with Directors and Senior Officers	Notes to Financial Statements......................	Note 14

Annual Report to Shareholders Disclosure Information Required by Farm Credit Administration Regulations

CoBank, ACB

	Section	Location
Involvement in Certain Legal Proceedings There were no matters that came to the attention of the Board of Directors or management regarding the involvement of current directors or senior officers in specified legal proceedings which are required to be disclosed.		
Relationship with Independent Auditors There has been no change in independent auditors or no disagreements on any matters of accounting principle or financial statement disclosure during the period.		
Financial Statements Financial Statements and Footnotes	Financial Information..................................	Pages 62 to 106
Report of Management	Report of Management	Page 118
Report of Independent Auditors	Report of Independent Auditors	Pages 119 to 120
Aggregate Fees Incurred for Services Rendered by Independent Auditors	Board of Directors Disclosure	Page 127
Credit and Services to Young, Beginning and Small Farmers and Ranchers and Producers or Harvesters of Aquatic Products	Young, Beginning and Small Farmers.........	Page 151

Board of Directors Disclosure as of December 31, 2012

CoBank, ACB

Directors

During 2012 and as a result of the merger with U.S. AgBank, FCB, CoBank was governed by a 32-member board of directors, the majority of which were elected by our customers. On January 1, 2013, the board transitioned to a board of directors consisting of 24 directors elected by customers from six different geographic regions. The board has elected two outside directors (independent of any customer or Farm Credit System affiliation) and has appointed two directors to complement the expertise of the customer-elected board members (customer affiliation permitted) resulting in a current board of 28 members.

Director terms run for four years. Employees of Farm Credit System institutions, including CoBank, cannot serve on CoBank's Board of Directors within one year of employment.

Director Independence

The Board must be composed at all times of at least 75 percent of directors who are deemed to be independent. The Board has adopted standards to assist it in making the annual affirmative determination of each director's independence status. A director will be considered "independent" if he or she meets the 14 criteria for independence set forth by the Board, which were established based upon leading industry practice and the listing standards of the New York Stock Exchange. For example, the loans from CoBank to an affiliated Association or Title III customer, as defined by the Farm Credit Act, where a CoBank director is also a director must not comprise more than 15 percent of the total loans of CoBank. In addition, the Board has made a determination as to each independent director that no relationship exists which, in the opinion of the Board, would interfere with the exercise of independent judgment in carrying out the director's responsibilities. In making these determinations, the Board reviewed and discussed information provided by the directors and by CoBank with regard to each director's business and personal activities as they may relate to CoBank and CoBank's management. As of December 31, 2012, 31 directors were considered to be independent.

Information About Committees of the Board of Directors

The standing Board committees consist of the following: an Audit Committee, a Compensation Committee, an Executive Committee, a Governance Committee and a Risk Committee. The Board has adopted written charters for each of these committees. The full text of each charter is available on our website at www.cobank.com.

All standing Board committees report on their meetings at the regular meeting of the full Board. Minutes of each committee meeting are signed by the committee chair and secretary, or another individual acting in their place at the meeting.

In 2012, the Board of Directors held six regular meetings and standing committees of the Board of Directors held a total of 28 meetings. The primary responsibilities of each committee are described on the following pages.

Committee Responsibilities

<u>Audit Committee</u>

The Audit Committee members are appointed by the Board chair in consultation with the Board officers and committee chairs. The Audit Committee is governed by a formal charter and chaired by one of the Board's outside directors. All members of the Audit Committee are independent of management of the Bank and any other System entity. During 2012, the Audit Committee met during four of the regular meetings of the Board of Directors, including regular meetings in executive session with senior management, the Chief Risk Officer, the head of the Internal Audit Division, the head of the Asset Review Division, and the Bank's independent auditors. The Audit Committee reviews and approves the quarterly and annual financial statements.

Mr. Barry M. Sabloff serves as Chairman of the Audit Committee. The Board of Directors has determined that Mr. Sabloff has the qualifications and experience necessary to serve as the "board financial expert," as defined by the rules of the Securities and Exchange Commission and the Farm Credit Administration, and he was so designated.

The primary purpose of the Audit Committee is to assist the Board in fulfilling its oversight responsibilities by carrying out the following responsibilities:

(1) Overseeing management's conduct of the Bank's financial reporting process and systems of internal accounting and financial controls;

(2) Monitoring the independence and performance of the Bank's internal audit function, the risk assessment process, and the independent auditors;

(3) Ensuring the Bank's compliance with legal and regulatory requirements; and

(4) Providing an avenue of communication among the outside auditors, management and the Board.

Management has the primary responsibility for the consolidated financial statements and the financial reporting process, including the system of internal controls. The Audit Committee oversees the Bank's independent auditors, systems of internal accounting and financial controls, and financial reporting process on behalf of the Board of Directors. In this regard, the Audit Committee helps to ensure independence of the Bank's independent auditors, the integrity of management and the adequacy of disclosure to shareholders. The Audit Committee has unrestricted access to representatives of the Internal Audit Division, independent auditors and financial management.

The Audit Committee preapproves all audit and audit-related services and permitted nonaudit services (including the fees and terms thereof) to be performed for the Bank by its independent auditors, as negotiated by management. The Audit Committee may form and delegate authority to the chairman of the Audit Committee, or a subcommittee of the Audit Committee (consisting of one or more members), when appropriate, including the authority to grant preapprovals of audit and permitted nonaudit services, provided that decisions of the chairman or any subcommittee to grant preapprovals are presented to the full Audit Committee at its next scheduled meeting.

The Audit Committee reviewed the audited consolidated financial statements in the Annual Report for the year ended December 31, 2012, with management and the Bank's independent auditors. The independent auditors are responsible for expressing an opinion on the conformity of the Bank's audited consolidated financial statements with accounting principles generally accepted in the United States of America, including a discussion of the quality of the Bank's accounting principles, the reasonableness of significant judgments, the clarity of disclosures in the consolidated financial statements and the adequacy of internal controls. The Audit Committee discussed with the independent auditors the results of the 2012 audit and all other matters required to be discussed by Statements on Auditing Standards. In addition, the Audit Committee received, reviewed and discussed the written disclosures from the independent auditors required by Independence Standards Board Standard No. 1, "Independence Discussions with Audit Committees." Based on the review and discussions described above, the Audit Committee recommended to the Board of Directors that the audited consolidated financial statements be included in the Bank's Annual Report for the year ended December 31, 2012 and for filing with the FCA.

Board of Directors Disclosure as of December 31, 2012
CoBank, ACB

Aggregate fees incurred by the Bank for services rendered by its independent auditors, PricewaterhouseCoopers LLP, for the years ended December 31, 2012 and 2011 were as follows:

Year Ended December 31,	2012	2011
Audit	**$ 761,000**	$ 563,497
Audit-related	**227,500**	73,000
All Other	**140,309**	1,500
Total	**$ 1,128,809**	$ 637,997

Audit fees were for the annual audit of the consolidated financial statements, including merger-related procedures.

Audit-related fees were for assurance and related services primarily in connection with the merger with AgBank in both 2012 and 2011, and a preferred stock offering in 2012.

For 2012, other fees include consulting fees related to an assessment of data management and reporting, as well as fees for accounting research software. For 2011, other fees are exclusively for accounting research software.

Compensation Committee

The Compensation Committee members are appointed by the Board chair in consultation with the Board officers and committee chairs. All members of the Compensation Committee are independent of management. The committee is primarily responsible for representing the Board in matters related to compensation programs for the Bank, including salary, incentive and benefits programs, and in facilitating the terms of employment, compensation and evaluation of the President and Chief Executive Officer. The committee also reviews the results of the Bank's affirmative action program and encourages programs to support diversity and inclusion.

Executive Committee

The Executive Committee members are appointed by the Board chair in consultation with the Board officers and committee chairs. The committee is primarily responsible for developing for Board consideration recommendations surrounding the design and implementation of the Bank's strategic plan. It acts on behalf of the Board between Board meetings when necessary. The Executive Committee is responsible for reviewing the Bank's budget and reports of operations, and for reviewing the capital adequacy plan and portfolio strategy. The committee reviews the Bank's annual business and financial plan and recommends such plan for approval by the Board. The committee also provides advice and counsel to the Board and management on policy matters related to capital and finance.

Governance Committee

The Governance Committee members are appointed by the Board chair in consultation with the Board officers and committee chairs. The committee is primarily responsible for monitoring and recommending for Board consideration corporate governance processes and structures that are consistent with leading practices. The committee coordinates the annual Board self-evaluation and a periodic director peer evaluation. The committee also oversees the Bank's director nomination process, which is conducted by the Nominating Committee (see page 128), and director election process. In addition, the committee annually assesses the needs of the Board – taking into account the experience and background of current directors – and also recommends prospective outside and appointed directors to the full Board.

Risk Committee

The Risk Committee members are appointed by the Board chair in consultation with the Board officers and committee chairs. The committee is primarily responsible for overseeing the enterprise risk management practices of the Bank, including management's ability to assess and manage the Bank's credit, market, interest rate, liquidity, legal and compliance, reputational, technology and operational risks. The committee also provides an open avenue of communication between management and the Board in order to effectively manage risks.

Other Committees

Nominating Committee

The Nominating Committee for 2012 consisted of 24 customer-owner representatives, all of whom were elected by the Bank's stockholders. No member of the Board or management served on the Nominating Committee. This committee is charged with the responsibility to identify qualified candidates for Board membership and to review director nominations, helping to ensure that the Bank continues to attract a highly qualified and diverse Board. The Nominating Committee seeks candidates who are recognized leaders and who fulfill specific needs for industry and geographic diversity on the Board. Customers are encouraged to submit resumes of candidates for elected positions. The Nominating Committee makes a best effort to recommend at least two candidates for each position up for election. Shareholders and interested candidates may gather signatures for petitions to run for the Board following the conclusion of the Nominating Committee's work. A nominee must not have reached age 70 on or prior to the date the term of office is to begin and must meet other eligibility requirements established by Bank bylaws and federal regulations.

Audit Subcommittee

The Audit Subcommittee (ASC) was appointed in March 2012 by the chairman of the Board, in consultation with the Board officers, to provide independent oversight and review of an internal investigation being conducted by the Bank in connection with certain business practices. The ASC was also responsible for the Bank's responses to the regulatory requirements related to those business practices. The ASC consisted of three members of the Audit Committee, including the chairman of the Audit Committee. The ASC completed its work in July 2012.

Board of Directors Disclosure as of December 31, 2012

CoBank, ACB

The following represents certain information regarding the directors as of December 31, 2012, including business experience during the past five years. The terms of directors are scheduled to expire as of December 31 of the years indicated.

1 - Audit Committee	5 - Risk Committee	9 - Governance Committee Chair
2 - Compensation Committee	6 - Audit Committee Chair	10 - Risk Committee Chair
3 - Executive Committee	7 - Compensation Committee Chair	11 - Audit Sub Committee
4 - Governance Committee	8 - Executive Committee Chair	

Name	Term Expires	Principal Occupation and Other Affiliations
Wayne S. Allen [5] Age: 71 Year Service Began: 2012	2012	**Principal Occupation:** Owner/Operator: Allen Farms, a rice growing operation, Nevada City, CA; Partner: Bread Store, L.P., a commercial property management company, Nevada City, CA. **Other Affiliations:** Director: The Farm Credit Council, a trade organization, Washington, DC.
Gene J. Batali [5] Age: 71 Year Service Began: 2007 Also Served: 2003-2005	2013	**Principal Occupation:** Retired President: Batali Ranch, Inc., Yakima, WA.
Wesley D. Brantley [1] Age: 72 Year Service Began: 2012	2012	**Principal Occupation:** Retired Certified Public Accountant, Ada, OK. **Other Affiliations:** Director: Kiwanis Club of Greater Ada, OK, a service organization.
Robert W. Bray [4] Age: 57 Year Service Began: 2012	2014	**Principal Occupation:** Owner/Operator: Bray Ranches, a farming and ranching operation and big game hunting business, Redvale, CO. **Other Affiliations:** Director: Colorado Agricultural Development Authority, a trade organization, Lakewood, CO; Director: Club 20, a coalition of county business interests; Commissioner: Colorado Parks and Wildlife Commission, a state regulatory agency, Colorado.
John J. Breen [5] Age: 70 Year Service Began: 2012	2012	**Principal Occupation:** Retired Banking Executive, Middletown, NJ.
Oghi A. DeGiusti, Jr. [2, 3] Age: 60 Year Service Began: 2012	2014	**Principal Occupation:** Owner/Operator: DeGiusti Farms, an alfalfa, grass, hay, wheat and cow/calf stocker operation, Tuttle, OK. **Other Affiliations:** Director: The Farm Credit Council, a trade organization, Washington, DC; Chairman: Grady County Farm Services Agency, Chickasha, OK; Director: Grady County Alfalfa Hay Growers Association, Chickasha, OK.
Everett M. Dobrinski [2, 3, 7, 8] Chairman Age: 66 Year Service Began: 1999	2015	**Principal Occupation:** Owner/Operator: Dobrinski Farm, a cereal grain and oilseed farm, Makoti, ND. **Other Affiliations:** Director: North Dakota Coordinating Council for Cooperatives, a trade association, Jamestown, ND; Director: The Farm Credit Council, a trade organization, Washington, DC.

Board of Directors Disclosure as of December 31, 2012

CoBank, ACB

Name	Term Expires	Principal Occupation and Other Affiliations
John C. Eisenhut [2, 3] First Vice Chairman Age: 67 Year Service Began: 2012	2012	**Principal Occupation:** Owner/Operator: Eisenhut Farms,, an almond orchard, Turlock, CA; Owner/Operator: Eisenhut Properties, a commercial and residential real estate company, Turlock, CA; Manager: Hilltop Ranch, an almond processor, Ballico, CA. **Other Affiliations:** Director: Delta Blood Bank, a community blood center, Turlock, CA.
William M. Farrow III [5] Age: 57 Year Service Began: 2007	2014	**Principal Occupation:** Director, President and CEO: Urban Partnership Bank, a commercial bank, Chicago, IL; Owner: Winston and Wolfe LLC, a technology development company, Chicago, IL. **Other Affiliations:** Director: Federal Reserve Bank of Chicago, a federal depository bank, Chicago, IL (as of January 1, 2013); Member: Community Depository Institutions Advisory Council, promoting communication with the Federal Reserve System, Chicago, IL; Trustee: Illinois Institute of Technology, a PhD granting technological university, Chicago, IL; Former Chief Executive Officer and Managing Partner: F.C. Partners Group, LLC, business advisor, Chicago, IL.
Mary E. Fritz [2, 3] Third Vice Chairman Age: 63 Year Service Began: 2003	2015	**Principal Occupation:** Owner/Operator: Quarter Circle JF Ranch, Inc., a dry land grain and cow/calf operation, Chester, MT. **Other Affiliations:** Vice Chair: The Farm Credit Council, a trade organization, Washington, DC.
John L. Guthrie [2, 3] Age: 68 Year Service Began: 2012	2013	**Principal Occupation:** Owner/Operator: cow/calf and stocker cattle ranch and diversified farming operation, Porterville, CA; Director: Guthrie Investment Co., managing farming and investments, Porterville, CA. **Other Affiliations:** Chair: Federal Farm Credit Banks Funding Corporation, the issuer of Systemwide debt, Jersey City, NJ; Director: F&T Financial Services, a financial institution for consumer loans and debt collections, Porterville, CA; Director: California Cattlemen's Association, a trade association, Sacramento, CA.
William H. Harris [4] Age: 63 Year Service Began: 2001	2015	**Principal Occupation:** Owner/Operator: Harris Farms, a cash crop farming operation, LeRoy, NY; Partner: HR&W Harvesting, a processing vegetable farm, LeRoy, NY; President: Eatwell Farms, Inc., a custom field work operation, LeRoy, NY. **Other Affiliations:** Director: ACDI/VOCA, international agricultural development, Washington, DC.
Daniel T. Kelley [2, 3] Second Vice Chairman Age: 64 Year Service Began: 2004	2013	**Principal Occupation:** Owner/Operator: Kelley Farms, a diversified corn and soybean operation, Normal, IL. **Other Affiliations:** Chairman and President: GROWMARK, Inc., farm supply and grain marketing, Bloomington, IL; Chairman: Illinois Agricultural Leadership Foundation, agricultural leadership development, Macomb, IL; Director: Evergreen FS, Inc., a farm supply and grain marketing operation, Bloomington, IL; Director: Midwest Grain, LLC, grain merchandising, Bloomington, IL; Director: Nationwide Mutual Insurance Company, an insurance company, Columbus, OH; Director: Nationwide Bank, a federal savings bank, Columbus, OH.

Board of Directors Disclosure as of December 31, 2012

CoBank, ACB

Name	Term Expires	Principal Occupation and Other Affiliations
James A. Kinsey [2, 3] Age: 63 Year Service Began: 2001	2016	**Principal Occupation:** Owner/Operator: Kinsey's Oak Front Farms, a purebred angus seed-stock producer, Flemington, WV. **Other Affiliations:** Director: Farm Credit of the Virginias, ACA, agriculture finance, Staunton, VA.
David J. Kragnes [4] Age: 60 Year Service Began: 2009	2016	**Principal Occupation:** Owner/Operator of a wheat, sugar beet, soybean and corn farm in Felton, MN. **Other Affiliations:** Director: Quentin Burdick Center for Cooperatives, an advisory board, Fargo, ND.
J. Scott Markham [1] Age: 62 Year Service Began: 2010	2013	**Principal Occupation:** Owner/Operator: Markham Farms, Inc., a dairy, diversified corn, dairy heifer and beef operation, Constableville, NY.
Gary A. Miller [1, 11] Age: 52 Year Service Began: 2006	2013	**Principal Occupation:** President and Chief Executive Officer: GreyStone Power Corporation, an electric membership corporation, Douglasville, GA. **Other Affiliations:** Director: Wellstar Health System, health care, Marietta, GA; Director: GRESCO Utility Supply, Inc., electric material supplier, Smarr, GA; Treasurer: Douglas County Development Authority, an economic development agency, Douglasville, GA.
Catherine Moyer [5] Age: 37 Year Service Began: 2010	2014	**Principal Occupation:** CEO and General Manager: Pioneer Communications, a rural telephone and communications company, Ulysses, KS. **Other Affiliations:** Director: Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO), a trade organization, Washington, D.C.; Director: Leadership Kansas, leadership program for Kansas civic and business leaders, Topeka, KS; Director: Kan-ed Advisory Committee, an educational interactive network, Topeka, KS; Commissioner: Kansas Lottery Commission, Topeka, KS; Director: Telcom Insurance Group, provider of property and casualty coverage to small telecommunications providers, Greenbelt, MD.
Alarik Myrin [5] Age: 66 Year Service Began: 2012	2014	**Principal Occupation:** President: Myrin Ranch, a ranching and farming operation, Altamont, UT; Manager: Myrin Livestock Co., LLC, a family cattle ranch, Altamont, UT; General Partner: Myrin Investment Co., Ltd., real estate rental management, Altamont, UT. **Other Affiliations:** Director: Lakefork Irrigation Co., a water irrigation company, Altamont, UT.
Robert D. Nattier [4, 9] Age: 69 Year Service Began: 2003	2012	**Principal Occupation:** Co-Operator: 4-N, Inc., a grain and livestock operation, Newton, KS; Owner: Foxridge Golf Club, Newton, KS. **Other Affiliations:** Director: North Newton Housing Authority, HUD development, North Newton, KS; Director: Wheatland Homes, HUD development, Newton, KS.
David S. Phippen [4] Age: 62 Year Service Began: 2012	2015	**Principal Occupation:** Partner: Travaille & Phippen, Inc., an almond grower and processing company, and additional partnerships related to almonds and farm management, Manteca, CA. **Other Affiliations:** Director: Almond Board of California, a trade organization, Modesto, CA; Director: San Joaquin County Farm Bureau, a trade organization, Stockton, CA.

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CoBank, ACB

Name	Term Expires	Principal Occupation and Other Affiliations
Ronald J. Rahjes [1] Age: 61 Year Service Began: 2012	2015	**Principal Occupation:** Member: Wesley J. Rahjes and Sons, Inc., a diversified family farming corporation producing wheat, corn, soybeans and grain sorghum, Kensington, KS; Owner: R&C Tax Service, an accounting and tax firm, Kensington, KS. **Other Affiliations:** Director: Rural Telephone/Nextech, Inc., a telecommunications company, Lenora, KS.
David L. Reinders [1] Age: 56 Year Service Began: 2011	2014	**Principal Occupation:** Chief Executive Officer**:** Sunray Co-op, a diversified farmer owned grain cooperative, Sunray, TX. **Other Affiliations:** Director: Texas Agricultural Cooperative Council, a statewide industry association for cooperatives, Austin, TX; Associate Director: Happy State Bank, a commercial bank, Amarillo, TX.
Clint E. Roush [5] Age: 65 Year Service Began: 2012	2014	**Principal Occupation:** President: Clint Roush Farms, Inc., a family farming operation producing wheat, alfalfa and feeder cattle, Arapaho, OK. **Other Affiliations:** Director: Farmers Cooperative Association of Clinton, OK, a grain and fertilizer cooperative, Clinton, OK; Director: Custer County Cattlemen's Association, a trade organization, Arapaho, OK.
Barry M. Sabloff [1, 6, 11] Age: 66 Year Service Began: 2005	2016	**Principal Occupation:** General Partner: Sabloff Family Limited Partnership, L.P., a partnership managing investments in Marquette National Corporation common stock, Winnetka, IL; Retired Executive Vice President, Bank One, N.A. (now merged with JPMorgan Chase & Co.). **Other Affiliations:** Vice Chairman/Director: Marquette National Corporation, a bank holding company, Chicago, IL; Vice Chairman/Director: Marquette Bank, a community bank, Chicago, IL; Director: Calypso Technology, Inc., a provider of trading systems to financial institutions, San Francisco, CA; Trustee: Columbia College Chicago, a private arts and media college, Chicago, IL; Director: The American School in London Foundation, an educational foundation, Princeton, NJ.
Kenneth W. Shaw [2, 3] Fourth Vice Chairman Age: 62 Year Service Began: 2012	2012	**Principal Occupation:** Owner: Rancher/Stockman, a cow/calf/yearling operation, Mountainair, NM. **Other Affiliations:** Director: Central New Mexico Electric Cooperative, an electric distribution cooperative, Mountainair, NM.
Richard W. Sitman [4] Age: 59 Year Service Began: 1999 Also Served: 1995-1996	2015	**Principal Occupation:** Owner/Operator: Jos. M. Sitman, Inc., a retail rental and storage company, Greensburg, LA. **Other Affiliations:** Chairman: Dixie Electric Membership Corporation, an electric distribution cooperative, Baton Rouge, LA; Chairman: DEMCO Energy Services, LLC, an electric service supplier, Baton Rouge, LA; Chairman: Dixie Business Center, a business incubator, Denham Springs, LA; Director: First Guaranty Bank, a commercial bank, Hammond, LA; Director: The Farm Credit Council, a trade organization, Washington, DC.

Board of Directors Disclosure as of December 31, 2012
CoBank, ACB

Name	Term Expires	Principal Occupation and Other Affiliations
Donnell Spencer [1] Age: 78 Year Service Began: 2012	2012	**Principal Occupation:** President/Director: Diversified Spencer, Inc., raising alfalfa and livestock, Richfield, UT.
Kevin A. Still [5, 10] Age: 55 Year Service Began: 2002	2014	**Principal Occupation:** President and Chief Executive Officer: Co-Alliance, LLP, a partnership of five cooperatives supplying energy, agronomy and animal nutrition, producing swine and marketing grain, Avon, IN; Chief Executive Officer and Treasurer: Midland Co-op, Inc., Frontier Co-op, Inc., LaPorte County Farm Bureau Cooperative Association, IMPACT Co-op, Inc., and Excel Co-op, Inc., agricultural retail cooperatives, Avon, IN. **Other Affiliations:** Vice President/Director: Connexities, LLC, a technology provider, Danville, IN; President and Owner: Still Farms LLC, a grain farm, Galesburg, IL.
David V. Vanni [1] Age: 71 Year Service Began: 2012	2012	**Principal Occupation:** Owner/Operator: Rancho de Solis Winery, Inc., a grape growing and wine making operation, Gilroy, CA; Owner/Operator: Fratelli Ranch, LLC, a vineyard, Gilroy, CA; Partner: Vanni Business Partners, LLC, developing investments, Gilroy, CA. **Other Affiliations:** Vice Chairman: Santa Clara Water District Public Facility Finance Committee, financing operations of a water district, San Jose, CA.
Robert J. Wietharn [4] Age: 51 Year Service Began: 2012	2012	**Principal Occupation:** Director/Manager, Wietharn Farms, Inc.: a family farm corporation raising corn and soybeans, Clay Center, KS; Director/Officer, Valley Pork Ranch, Inc.: a family farm corporation marketing farrow-to-finish hogs, Clay Center, KS; Director/Officer, Riverscreen Inc.: manufacturing irrigation equipment, Clay Center, KS; Director/Officer, Valley Farmers, Inc.: a grain facility and irrigation equipment dealership, Clay Center, KS.
Leland T. Willeke [4] Age: 62 Year Service Began: 2012	2012	**Principal Occupation:** President: Wheatland Industries, Inc., a family farm corporation producing wheat and millet, Otis, CO.

Compensation of Directors

For 2012, directors were compensated in cash at an annual rate of $54,467, paid in quarterly installments, which was the maximum amount permitted by the FCA for CoBank directors. Directors may elect to defer payment of all or part of their director compensation in accordance with agreements and applicable law. Compensation is for attendance at Board meetings, certain other meetings preapproved by the Board, and special duties as assigned. Directors' compensation is reduced by $2,500 for an unexcused absence at any regular Board meeting. FCA regulations also allow additional compensation to be paid to a director in exceptional circumstances where extraordinary time and effort are involved. In 2012, the Board approved additional compensation in excess of $54,467 to the Board and Audit Committee chairmen, and to other directors in recognition of greater than normal involvement in connection with special assignments. Additional information for each director who served during 2012 is provided below. Current CoBank policy regarding reimbursements for travel, subsistence and other related expenses states that for meetings designated by the Board and approved special assignments, Board members shall be reimbursed for reasonable travel and related expenses that are necessary and that support CoBank's business interests. As may be appropriate, CoBank may share in the reimbursement of expenses with other organizations. A copy of CoBank's policy is available to shareholders upon request. The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was $720,081, $402,028 and $366,263 for the years ended December 31, 2012, 2011 and 2010, respectively.

Board of Directors Disclosure as of December 31, 2012

CoBank, ACB

The following table presents the number of days served at Board meetings and other official CoBank activities, and compensation paid to each director for the year ended December 31, 2012.

Name of Director	Number of Days Served at Board Meetings	Number of Days Served in Other Official CoBank Activities	Total Compensation Paid During 2012
Wayne S. Allen*	17	16	$ 56,367
Gene J. Batali	18	37	54,867
Wesley D. Brantley, Jr.	18	21	55,967
Robert W. Bray	18	30	56,767
John J. Breen	18	15	56,367
Oghi A. DeGiusti, Jr.*	18	34	55,967
Everett M. Dobrinski*	18	59	70,807
John C. Eisenhut	16	30	58,967
William M. Farrow III	18	11	54,867
Mary E. Fritz*	18	39	55,967
John L. Guthrie*	18	26	55,967
William H. Harris	17	20	55,267
Daniel T. Kelley	16	24	54,717
James A. Kinsey	14	13	54,467
David J. Kragnes	18	24	55,267
J. Scott Markham	18	27	54,867
Gary A. Miller	18	37	58,067
Catherine Moyer	18	6	54,867
Alarik Myrin	18	32	56,367
Robert D. Nattier	18	30	62,467
David S. Phippen	17	23	54,267
Ronald J. Rahjes	18	44	59,967
David L. Reinders	18	24	54,867
Clint E. Roush	18	39	57,867
Barry M. Sabloff	18	29	70,807
Kenneth W. Shaw	18	29	55,967
Richard W. Sitman*	18	22	54,867
Donnell Spencer	18	28	56,367
Kevin A. Still	18	13	57,867
David V. Vanni	15	18	53,867
Robert J. Wietharn	18	19	56,767
Leland T. Willeke	17	17	56,767
Total	561	836	$ 1,829,474

* In 2012, these directors represented CoBank's interests by serving on the Boards of various trade groups and other organizations important to the Bank. Days of service related to these activities and compensation received (if any) are not included in this report.

Senior Officers

CoBank, ACB

Robert B. Engel,
President and Chief Executive Officer

Mr. Engel was appointed president and chief executive officer effective July 1, 2006. Mr. Engel is responsible for implementing the Bank's strategic and business direction as set by the Board of Directors. He serves as chairman of the Board of Directors of Farm Credit Leasing Services Corporation (FCL). Mr. Engel also serves as the vice chairman of the Board of Directors of the Federal Farm Credit Banks Funding Corporation. Prior to joining CoBank in 2000 as president and chief operating officer, he was chief banking officer at HSBC Bank USA. During his 14-year tenure at HSBC, Mr. Engel served in a variety of management and credit positions. Mr. Engel has 28 years of banking experience, and eight years of accounting experience with KPMG and Deloitte & Touche. He serves on the Boards of Trustees of Niagara University, Regis University, New Ventures in Higher Education, Inc., and the Graduate Institute of Cooperative Leadership. He also serves as vice chairman of the National Council of Farmer Cooperatives.

Mary E. McBride,
Chief Banking Officer

Ms. McBride was appointed chief banking officer effective September 7, 2010. Ms. McBride manages all of CoBank's banking groups that are included in the Agribusiness, Strategic Relationships and Rural Infrastructure operating segments. Prior to her current position, Ms. McBride was CoBank's chief operating officer. Previous to that, she was executive vice president for the Bank's Rural Infrastructure Banking Group (formerly known as the Communications and Energy Banking Group). Before joining CoBank in 1993, Ms. McBride worked as senior vice president of Wells Fargo/First Interstate Bank of Denver, N.A. Prior to that, she was assistant vice president at Bank of Boston. In total, Ms. McBride has more than 30 years of financial services experience. She serves on the Board of Directors of Farm Credit Financial Partners, Inc. Ms. McBride was a member of the USDA and DOE Biomass Research and Development Technical Advisory Committee from 2006 through 2012. She also serves on the Board of Directors for the Denver Metropolitan Affiliate of Susan G. Komen for the Cure.

Ann E. Trakimas,
Chief Operating Officer

Ms. Trakimas was appointed chief operating officer effective January 3, 2011. Ms. Trakimas oversees the Finance, Business Support Services, Legal, Human Resources, and Regulatory, Legislative and Compliance areas. Before joining CoBank, Ms. Trakimas served as a director on the board of the Federal Farm Credit Banks Funding Corporation for six years. She also served as chairman of the Funding Corporation's Audit Committee and as a member of the Systemwide Audit Committee. Prior to that, she worked for Goldman Sachs, where she held numerous executive positions including head of the firm's Financial Institutions Credit Risk Management and Advisory team. Ms. Trakimas has more than 30 years of experience in the financial services industry.

David P. Burlage,
Chief Financial Officer

Mr. Burlage was appointed chief financial officer effective November 16, 2009. Mr. Burlage oversees the Controller and Treasury areas of the Bank, which include the funding, asset/liability management, financial planning, capital, accounting, tax and reporting functions of the Bank. Prior to his current position, Mr. Burlage served as senior vice president of the Finance Division. Before joining CoBank in 2002, Mr. Burlage was the chief financial officer at Interlink Group, Inc., an IT professional services company. Earlier, Mr. Burlage was with Titanium Metals Corporation and Arthur Andersen & Co. Mr. Burlage has over 27 years of financial experience. He serves on the Board of Governors of the Farm Credit System Association Captive Insurance Company. He is a CPA and member of the American Institute of Certified Public Accountants.

Lori L. O'Flaherty,
Chief Credit Officer

Ms. O'Flaherty was appointed chief credit officer effective August 9, 2010. Ms. O'Flaherty is responsible for credit approval functions, as well as credit support and analysis, credit guidelines and training, loan compliance and monitoring and special assets. Prior to her current position, Ms. O'Flaherty was executive vice president of credit approval and administration, and, prior to that, she managed CoBank's Corporate Finance Division. Before joining CoBank in 1997, Ms. O'Flaherty was vice president of Wells Fargo/First Interstate Bank, N.A. Ms. O'Flaherty has over 30 years of experience in commercial banking. She serves on the Board of Directors of Big Brothers Big Sisters of Colorado, Inc.

Gregory E. Somerhalder,
Chief Risk Officer

Mr. Somerhalder was appointed chief risk officer effective April 1, 2012. Mr. Somerhalder oversees the Bank's enterprise risk management through measurement and capital processes addressing the Bank's primary risk exposures, including credit, interest rate, liquidity, operational and reputation. Immediately prior to his current position, Mr. Somerhalder was appointed deputy chief risk officer at the closing of our merger with AgBank and served from January 2012 to April 2012. Prior to rejoining CoBank, Mr. Somerhalder held various risk management, credit and lending positions for 10 years with AgBank, most recently as the senior vice president-risk management. Previously, he held various lending positions for 19 years with CoBank or its predecessors. Mr. Somerhalder has over 30 years of System experience.

John Svisco,
Chief Administrative Officer

Mr. Svisco was appointed chief administrative officer effective September 7, 2010. Mr. Svisco is responsible for directing the Bank's information technology, operations, and corporate communications areas. Prior to his current position, Mr. Svisco was senior vice president of human resources and administrative services divisions. Mr. Svisco joined CoBank in August 2002 and managed lease and loan operations during his first seven years at the Bank. Prior to joining CoBank, Mr. Svisco spent 20 years with HSBC Bank USA, where his last position was senior vice president of operations services. He serves on the Board of Directors of AgVantis, Inc.

Gregory J. Buehne,
General Counsel

Mr. Buehne was appointed general counsel effective June 16, 2011. Mr. Buehne is responsible for providing legal counsel to all areas of the Bank's business operations. Prior to joining CoBank, Mr. Buehne served as senior vice president for legal and legislative services at U.S. AgBank, with responsibility for the bank's legal, government affairs and strategic planning functions. With more than 28 years of experience in the Farm Credit System, Mr. Buehne has served in executive legal roles at AgAmerica, FCB, Western Farm Credit Bank and the Farm Credit Bank of Spokane. He serves on the Board of Governors of the Farm Credit System Association Captive Insurance Company.

Senior Officers Compensation Discussion and Analysis
CoBank, ACB

Overview

This section describes the compensation programs for CoBank's President and Chief Executive Officer (President and CEO) and other senior officers, as defined by FCA regulations (collectively, senior officers), as well as those programs for any highly compensated employees as defined by FCA regulations. This section also presents the compensation earned by our President and CEO, as well as aggregate compensation earned by our other senior officers and any highly compensated employees, for the years ended December 31, 2012, 2011 and 2010. For the 2012 period, information is included for one employee who became employed by CoBank on January 1, 2012 as a result of the merger with U.S. AgBank, and who meets the regulatory definition of a "highly compensated employee" due to previous contractual agreements between the employee and U.S. AgBank.

The Board of Directors, through its Compensation Committee (Committee), has adopted a total compensation philosophy for the Bank. Our total compensation philosophy is intended to align the interests of our senior officers with those of our shareholders and is more fully described below. We accomplish this by providing incentive compensation that rewards performance in relation to the business plan established by our Board of Directors.

In 2012, CoBank made modifications to its compensation program to reflect changes in market compensation practices. The modifications included a reduction in the maximum award that may be earned under the Bank's short-term incentive program and a shift in the mix of fixed and variable pay. In 2013, an additional modification will be introduced to require an incentive compensation recovery policy for the Bank's most senior officers. We believe these changes more fully align our compensation program with our shareholders' long-term interests and best practices in governance of executive compensation. These changes were also made to ensure our incentive plans align with market practices while balancing our risk profile with total compensation.

As described in the 'Overview' section of Management's Discussion and Analysis on page 26 of this Annual Report, in 2012 CoBank reported record financial performance. As a result of our performance, our short-term incentive plan for 2012 was funded between the target and maximum award levels. In addition, based on strong performance in the 2010 to 2012 period, our long-term incentive plan was also funded between the target and maximum award levels. These and other elements of our senior officers' compensation are explained below.

Compensation Philosophy and Objectives

The Bank's total compensation philosophy is designed to maintain a compensation program that will:

- Attract, retain and reward associates with the skills required to accomplish the Bank's strategic business objectives;
- Provide accountability and incentives for achievement of those objectives;
- Link compensation to Bank performance and increased shareholder value;
- Properly balance the risk profile of the Bank with both short- and long-term incentives;
- Be designed within a consistent philosophy and framework;
- Create a culture of adherence to core values and strong ethical behavior; and
- Be integrated with the Bank's business processes, including business planning, performance management and succession planning.

The total compensation philosophy seeks to achieve the appropriate balance among market-based salaries, variable incentive compensation and benefits designed to incent and reward both the current and long-term achievement of our strategic business objectives, business and financial plans and mission fulfillment. It also seeks to incent prudent risk taking within Board-established parameters with the proper balance and accountabilities between short- and long-term business performance. For senior officers, CoBank strives to deliver a significant portion of total target compensation through performance-based pay, with the actual proportion of total compensation provided through both short- and long-term incentives varying with actual financial performance, the achievement of Board-approved strategic business objectives and each senior officer's individual performance. We believe this philosophy fosters a performance-oriented, results-based culture wherein compensation varies from one year to the next on the basis of actual results achieved. We also find that this variable performance-based compensation approach is significantly and properly aligned with an acceptable risk profile and shareholder returns.

Process for Compensation Decisions

The Board of Directors has established the Committee to oversee the design, implementation and administration of compensation and benefits programs for CoBank. The Committee meets regularly to execute the responsibilities of its charter. The Committee reviews the performance of the Bank's President and CEO semi-annually, and the Board of Directors annually approves the compensation level of the President and CEO, including salary and short- and long-term incentive compensation. The President and CEO is responsible for setting the compensation levels of the senior officers directly reporting to him, with the Committee reviewing the compensation of the most senior of those officers who, in turn, are responsible for the compensation of all other employees.

The Committee generally makes a final decision regarding the President and CEO's incentive compensation in its February meeting to fully take into consideration the prior year's Bank and individual performance. Decisions about salary and performance also occur at other meetings in the year, as considered appropriate. The Committee utilizes an independent executive compensation consultant, Pay Governance LLC (Consultant), to annually compare the President and CEO's compensation level to a select peer group of financial institutions. This evaluation helps ensure that such compensation is competitive with positions of similar scope and complexity at relevant financial institutions. The comparative peer group is composed of companies with significant corporate and commercial lending activities, and which have other similar characteristics such as asset size, net income or significant customer relationships.

Components of CoBank Total Compensation Program

Given the cooperative ownership structure of CoBank, no equity or stock-based plans are used to compensate any employee, including senior officers. Senior officers' compensation primarily consists of four components – salary, short-term incentive plan, long-term incentive plan and retirement benefits – as described below. All employees participate in salary, the short-term incentive plan and retirement benefits, while senior officers and specified other senior leaders are also eligible to participate in the long-term incentive plan. All senior officers can elect to defer certain incentive payments through a nonqualified deferred compensation plan. In addition, senior officers are eligible for supplemental retirement benefits, as discussed beginning on page 144.

Overview of Senior Officers' Compensation		
Component	**CoBank Philosophy**	**Design Characteristics**
Salary	• Market-based compensation • Provides a foundation for other components • Competitive relative to positions of similar scope at a select peer group of financial institutions • Reflects individual performance, competencies and responsibilities	
Short-Term Incentive Plan	• Links rewards to achievement of annual goals • Recognizes corporate and individual performance • Aligns the interests of shareholders and senior officers through bankwide financial and strategic business objectives • Balances short-term results with the risk profile of the Bank	• Multiple corporate financial and non-financial goals • Awards are capped • Minimum performance for each goal required • Minimum return on active patron stock investment of 11% required in year of payout • Individual and corporate performance weighted equally, although a minimum level of individual performance must be achieved
Long-Term Incentive Plan	• Provides opportunity for wealth accumulation tied to CoBank's sustained performance • Reinforces accountability and balance for the annual outcomes embodied in the short-term incentive plan • Balances short-term results and long-term value creation • Encourages longer-term retention of plan participants • Promotes the creation of profitable growth in shareholder and customer value, and enhances the sustainability of CoBank to serve its customers while providing proper balance to the risk profile of the Bank • Aligns the interests of shareholders and senior officers through bankwide financial and strategic business objectives	• Multiple corporate financial and non-financial goals • Awards are capped • Three-year performance periods • New plan starts each year (plans overlap) • Minimum performance for each goal required • Minimum return on active patron stock investment of 11% must be achieved in each year of the plan for a full payout • No individual performance factor although a minimum level of individual performance must be achieved; corporate performance determines level of payout.

Overview of Senior Officers' Compensation (continued)		
Component	**CoBank Philosophy**	**Design Characteristics**
Retirement Benefits	• Provides for a source of income subsequent to retirement • Encourages longer-term retention of plan participants	• Benefits vary based on date of hire • Senior officers hired prior to January 1, 2007 participate in a defined benefit plan and supplemental retirement plan • Senior officers hired on or after January 1, 2007 receive additional, non-elective employer contributions to the 401(k) retirement savings plan • Other retirement benefits include a 401(k) retirement savings plan and access to health care benefits. Substantially all participants pay the full premiums associated with postretirement health care benefits

Salary

Overview

Salary Considerations

- Individual performance and competencies
- Maintenance or expansion of responsibilities and scope of position
- Peer group data and internal equity
- Overall CoBank merit budget

Salaries represent a foundational component of CoBank's total compensation program as the amounts of other components are determined in relation to base salary. Senior officer salaries are market-based and established taking into consideration individual performance, the specific competencies and experience the senior officer brings to CoBank, the responsibilities and scope of the position, peer group data and internal equity. Salaries for senior officers are generally adjusted annually.

Short-Term Incentives

Overview

Short-Term Incentive Plan (STIP)

- Corporate and individual performance weighted equally
- Corporate financial performance measures are balanced: profitability, loan quality and operating efficiency
- Board of Directors also provides subjective evaluation related to achievement of corporate strategic business objectives
- All associates are eligible to participate
- For 2012, CoBank performed at or above maximum award levels on two corporate performance goals and between the target and maximum award levels on the other three corporate performance goals

Annual short-term incentive payments are based on a combination of annual corporate and individual performance. The short-term incentive plan, which has the same design for all employees, including the President and CEO and other senior officers, aligns the interests of shareholders and employees through the establishment of a balanced scorecard of bankwide financial and strategic business objectives. Under the terms of the plan, a minimum return on active patron stock investment must be achieved for the plan year in order for a payout to be approved, ensuring that shareholders are rewarded first. The return minimum was 11 percent for the years ended December 31, 2012, 2011 and 2010.

The actual short-term incentive award is determined as follows:

Salary × Annual Short-Term Incentive Target × Corporate Performance Factor × Individual Performance Factor

Based on corporate and individual performance factors, participants can earn from zero to 225 percent of their individual annual short-term incentive target (zero to 400 percent for 2011 and 2010). Payments are typically made during March, but always following the end of the year to which the award is applicable. Participants are not eligible to receive a short-term payout if they are no longer employed by CoBank at the time of the scheduled payout, unless otherwise provided for in an employment agreement. The key elements of the actual payout are described below.

- *Annual Short-Term Incentive Target* — Annual short-term incentive targets are set for all employees at the beginning of the year. For the 2012 performance period, the target short-term incentive level for the President and CEO was 75 percent of salary. For the other senior officers, the targets ranged from 40 to 70 percent.

- *Corporate Performance Factor* — Corporate performance is determined at the end of the year based on annual actual business results relative to a balanced scorecard of bankwide financial and strategic business objectives, as established at the beginning of each year by the Board of Directors, and is the same for all employees, including the President and CEO and other senior officers. The Board of Directors retains the right to make adjustments to the corporate performance factor, where appropriate, in addition to providing a subjective performance metric for the achievement of strategic business objectives.

  CoBank utilizes a balanced scorecard for measuring short-term corporate performance to emphasize overall success in executing our strategy and managing risks. The short-term corporate scorecard establishes certain key performance indicators, of which 80 percent focus on the achievement of specified financial measures related to profitability, loan quality and operating efficiency, and 20 percent focus on the achievement of strategic business objectives, as determined at the beginning of each year by the Board of Directors. The final performance result, or corporate performance factor, is determined by comparing the actual performance of each measure to the targets established at the beginning of the year. Each scorecard performance measure is weighted separately, and the factor is set such that if performance of each measure exactly meets the established target, the result is a performance factor of 100 percent. The corporate performance factor can vary from zero to 150 percent (zero to 200 percent for 2011 and 2010), depending on performance against the targets. The 2012 Short-Term Corporate Scorecard is as follows:

2012 Short-Term Corporate Scorecard

Performance Measure	Weight
Net Income	25 %
Return on Common Equity	20 %
Strategic Business Objectives	20 %
Loan Quality (Adverse Loans to Risk Funds)	25 %
Operating Expense Ratio	10 %

- *Individual Performance Factor* — At the beginning of each year, all CoBank employees, including the President and CEO and other senior officers, establish individual goals they seek to achieve that year in support of the business. These individual goals are anchored to the Bank's business and financial plan, as well as the Bank's strategic business objectives and also include key behavioral competencies appropriate for that employee. The President and CEO is responsible for administering the short-term incentive plan and approves the individual performance factors of the other senior officers. The Board of Directors approves the goals and individual performance factor of the President and CEO. The assessment of an individual's actual performance with respect to his or her annual goals is reflected as an individual performance factor and ranges from zero to 150 percent (zero to 200 percent for 2011 and 2010).

The actual short-term incentive awards for 2012, 2011 and 2010 for the President and CEO, other senior officers and any highly compensated employees are presented in the Summary Compensation Table on page 147.

Long-Term Incentives

Overview

Long-Term Incentive Plan (LTIP)
- Awards based upon corporate performance for overlapping three-year periods
- Corporate financial performance measures are balanced: profitability, loan quality and capital adequacy
- Board of Directors also provides subjective evaluation related to the achievement of corporate strategic business objectives
- For the 2010 to 2012 performance period, CoBank performed at or above maximum award levels on three corporate performance goals and between target and maximum award levels on the other two corporate performance goals

CoBank utilizes a long-term incentive compensation plan that provides senior officers and specified other senior leaders with the opportunity for wealth accumulation tied to CoBank's sustained success. The long-term incentive plan provides the accountability and balance for the annual outcomes embodied in the short-term plan. Participants in the long-term plan directly influence the longer-term outcomes of actions and risks taken during each annual employment period, which provides the proper balance between short-term results and long-term value creation. Eligibility for participation is limited to those individuals who clearly have the ability to drive the success of strategies critical to long-term value creation for shareholders. The purpose of this plan is to encourage longer-term retention of plan participants, to promote the creation of profitable growth in shareholder and customer value, and to enhance the sustainability of CoBank to serve its customers while providing proper balance to the risk profile of the Bank. The long-term incentive plan aligns the interests of shareholders and senior officers through the establishment of bankwide financial and strategic business objectives, and reinforces a long-term focus on financial performance, strategic positioning and risk management.

Long-term incentive plan payouts are based on corporate performance in the achievement of key financial metrics and strategic business objectives over a three-year performance period, as defined by CoBank's long-term corporate scorecard. These three-year performance metrics and objectives are established at the beginning of each three-year performance period by the Board of Directors in connection with the annual business and financial plan. A minimum return on active patron stock investment must be achieved in each year of the three-year performance period for a full payout to be approved, ensuring that shareholders are rewarded first. The return minimum is 11 percent for the 2010 through 2012, 2011 through 2013, and 2012 through 2014 performance periods.

The actual long-term incentive award is determined as follows:

Salary × Long-Term Incentive Target × Corporate Performance Factor

Based on the corporate performance factor, participants can earn from zero to 200 percent of their individual long-term incentive target. Payments are typically made during March of each year following the end of the three-year performance period to which the award is applicable. Participants are not eligible to receive a full payment at the time of the scheduled payout if their performance did not meet expectations during the performance period, or if their employment terminated for reason of retirement, death or disability during the performance period. Participants are not eligible to receive any payment at the time of the scheduled payout if they are no longer employed by CoBank for reasons other than retirement, death or disability, unless otherwise provided for in an employment agreement. The key elements of the actual payout are described below.

- *Long-Term Incentive Target* — For the 2010 through 2012 performance period, the long-term incentive target for the President and CEO was 140 percent of salary. For the remaining senior officers, the targets ranged from 40 to 80 percent.

- *Corporate Performance Factor* — Corporate performance is determined at the end of a designated three-year period based on actual business results relative to a balanced scorecard of bankwide financial and strategic business objectives, as established at the beginning of the three-year performance period by the Board of Directors. The Board of Directors retains the right to make adjustments to the corporate performance factor, where appropriate, in addition to providing a subjective performance result for the achievement of strategic business objectives.

  CoBank utilizes a balanced scorecard for measuring long-term corporate performance to emphasize overall success in executing our strategy and managing risks. The long-term corporate scorecard establishes certain key performance indicators, of which 80 percent focus on the achievement of specified financial measures related to profitability, loan quality and capital adequacy, and 20 percent focus on the achievement of strategic business objectives, as determined at the beginning of each three-year performance period by the Board of Directors. The final performance result, or corporate performance factor, is determined by comparing the actual performance of each measure to the targets established at the beginning of each three-year performance period. Each scorecard performance measure is weighted separately, and the factor is set such that if performance of each measure exactly meets the established target, the result is a performance factor of 100 percent. The corporate performance factor can vary from zero to a maximum of 200 percent, depending on performance against the targets. The Long-Term Corporate Scorecards for the three-year performance periods 2010 through 2012, 2011 through 2013 and 2012 through 2014 are as follows:

Long-Term Corporate Scorecards:
2010 – 2012, 2011 – 2013 and 2012 – 2014 Periods

Performance Measure	Weight
Net Income	20 %
Permanent Capital Ratio	20 %
Return on Common Equity	20 %
Strategic Business Objectives	20 %
Loan Quality (Adverse Loans to Risk Funds)	20 %

The actual long-term incentive awards for 2012, 2011 and 2010 for the President and CEO and other senior officers are presented in the Summary Compensation Table on page 147.

Terms of Senior Officers' Employment Agreements

As of December 31, 2012, two of our senior officers, including the President and CEO, are employed pursuant to employment agreements, which provide specified compensation and related benefits to these senior officers in the event their employment is terminated, except for termination for cause. In the event of termination except for cause, the employment agreements provide for (a) payment of the officer's prorated salary and incentives through the date of the termination, (b) semi-monthly payments aggregating two to three times the sum of the officer's base compensation and short-term incentives at target, (c) enhanced retirement benefits if the termination results from a change in control, (d) the continued participation in the Bank's health and welfare benefits over a two or three year period, and (e) certain other benefits over a two or three year period to the same extent as such benefits were being provided on the date of termination. The employment agreements also provide certain limited payments upon death or disability of the officer. To receive payments and other benefits under the agreements, the officer must sign a release agreeing to give up any claims, actions or lawsuits against the Bank that relate to his or her employment with the Bank. The agreements also provide for non-competition and non-solicitation by the officers over the term of the payments, and the payments are considered taxable income, without any consideration or provision for "gross-up" for tax purposes.

Retirement Benefits

Overview

We have employer-funded qualified defined benefit pension plans, which are noncontributory and cover employees hired prior to January 1, 2007. Depending on the date of hire, benefits are determined either by a formula based on years of service and final average pay, or by the accumulation of a cash balance with interest credits and contribution credits based on years of service and eligible compensation. We also have noncontributory, unfunded, nonqualified supplemental executive retirement plans (SERPs) covering the one highly compensated employee and all but two senior officers employed at December 31, 2012, as well as specified other senior managers. In addition, as more fully discussed below, we have a noncontributory, unfunded nonqualified executive retirement plan (ERP) designed to provide enhanced retirement benefits to the two senior officers employed pursuant to employment agreements, including the President and CEO. All employees are also eligible to participate in a 401(k) retirement savings plan, which includes employer matching contributions. Employees hired on or after January 1, 2007, receive additional, non-elective employer contributions to the 401(k) retirement savings plan. All retirement-eligible employees, including senior officers, are also currently eligible for other postretirement benefits, which primarily include access to health care benefits. Substantially all participants pay the full premiums associated with these other postretirement health care benefits.

Defined Benefit Pension Plans

Senior officers hired prior to January 1, 2007 and the one highly compensated employee are participants in the defined benefit pension plans. Pursuant to these plans, the benefits, including those of the President and CEO, are determined based on years of service and final average pay. Eligible compensation for senior officers, as defined under the final average pay formula, is the highest 60 consecutive-month average, which includes salary and incentive compensation measured over a period of one year or less, and excludes long-term incentive awards, expense reimbursements, taxable fringe benefits, relocation allowance, short- and long-term disability payments, nonqualified deferred compensation distributions, lump sum vacation payouts and all severance payments. Eligible compensation for the one highly compensated employee is defined the same as that for senior officers, except that the long-term incentive awards are included in the calculation. Retirement benefits for senior officers are calculated assuming payment in the form of a single life annuity with five years certain and retirement at age 65. The one highly compensated employee's retirement benefits are calculated assuming payment in the form of a 50% joint and survivor annuity and retirement at the earliest unreduced retirement age, which could be prior to age 65. However, the actual form and timing of retirement benefit payments are based on participant elections. The plans require five years of service to become vested. The one highly compensated employee and all senior officers participating in the defined benefit pension plans have been employed for more than five years and, as such, are fully vested in the plans. The benefit formula is the sum of 1.5 percent of eligible compensation up to Social Security covered compensation plus 1.75 percent of eligible compensation in excess of Social Security covered compensation, multiplied by the years of eligible benefit service. Social Security covered compensation is the 35 year average of the Social Security taxable wage bases up to the participant's Social Security retirement age.

Federal laws limit the amount of compensation we may consider when determining benefits payable under the qualified defined benefit pension plans. We maintain SERPs that pay the excess pension benefits that would have been payable under our qualified defined benefit pension plans.

Executive Retirement Plan

As noted previously, an ERP has been adopted for the President and CEO and one of the other senior officers subject to their respective employment agreements. The President and CEO's agreement provides for a minimum retirement benefit of 47 percent of eligible compensation as of December 31, 2012, increasing to a maximum of 55 percent of eligible compensation as of December 31, 2015, with no reduction for early retirement. The ERP is limited such that benefits provided under that plan are payable only if total retirement benefits payable per year from the three retirement plans do not exceed $850,000, expressed as a single life annuity with five years certain. The ERP is integrated with the existing final average pay defined benefit retirement plan and the existing SERP. It provides the required additional retirement benefits to the extent such benefits are not covered by the other two plans, but only up to the maximum total retirement benefits noted above. If benefits exceed this maximum, no benefits are payable from the ERP. In the event of the death of the President and CEO during the term of his employment with the Bank, the plan provides a death benefit to a surviving spouse equal to the minimum retirement benefit described above. The benefits provided to the other senior officer under the ERP are the same as those provided to the President and CEO, but at reduced levels.

Nonqualified Deferred Compensation Plan

We have a nonqualified deferred compensation plan that allows senior officers and other eligible senior managers to defer all or a portion of their incentive compensation. Additionally, the Bank makes contributions to this plan on behalf of participants whose benefits under the 401(k) plan are limited due to federal tax laws. Contributions are made at the same percentages as available under the 401(k) plan. The compensation that is deferred is invested in any number of investment options selected by the participants. These investment options are either identical or substantially similar to those available to all participants in the Bank's 401(k) plan. The participant is subject to all risks and returns of amounts invested. The election to defer is irrevocable and the deferred amounts cannot be paid except in accordance with specified elections as permitted by law. At that time, the participant will receive payment of the amounts credited to his or her account under the plan in a manner that has been specified by the participant. If a participant dies before the entire amount has been distributed, the undistributed portion will be paid to the participant's beneficiary.

Compensation Risk Management

The Committee considers potential risks when reviewing and approving compensation programs. The Board of Directors approves the total compensation philosophy and programs to ensure there is a proper balance and alignment between the overall acceptable risk profile of the Bank and the manner in which prudent risk taking is reflected in the design of the underlying program. We have designed our compensation programs, including our incentive compensation plans, with specific features to address potential risks while rewarding employees for achieving short-term and long-term financial and strategic objectives through prudent business judgment and appropriate risk taking. The objective is to motivate employees to take prudent risk within Board-approved parameters while ensuring employees are also accountable for the long-term outcomes of their actions. The following elements have been incorporated in our compensation programs available for our senior officers:

- *A Balanced Mix of Compensation Components* – The target compensation mix for our senior officers is composed of salary, short-term incentive, long-term incentive and retirement benefits, representing a mix that is weighted toward long-term performance and service with CoBank.

- *Multiple Performance Factors* – Our incentive compensation plans include balanced scorecards of organization-wide financial performance and integration with individual performance assessments through our performance management system.

    - Incentive plans include a Board-determined subjective evaluation of our achievement of strategic objectives
    - The short-term incentive is dependent on multiple performance metrics, including a subjective measure of performance against strategic business objectives and an assessment of individual performance
    - The long-term incentives are cash-based, with three-year performance metrics to complement our annual short-term incentives
    - Board of Directors retains the right to adjust performance factors
    - Targets and ranges of performance for each metric are approved by the Board prior to the beginning of the performance period

- *Multiple Year Performance Measurement* – Our long-term incentives include a three-year performance measurement period that requires sustained corporate performance complemented by required minimum level of shareholder return in order for the plan to be fully funded.

- *Caps on Incentive Payments* – Our incentive compensation plan payments are subject to caps that limit the maximum award that may be paid.

- *Minimum Performance Requirements for Each Metric* – Our incentive compensation plan payments are contingent upon achieving minimum performance levels for each financial performance goal.

- *Minimum Individual Performance Requirements* – Our incentive compensation plans require a minimum individual performance level before a payment may be made for any given performance year.

- *Compensation Committee Discretion* – The Committee subjectively evaluates the Bank's achievement of strategic business objectives and approves all incentive plan funding following a review of the Bank's performance against plan performance criteria established and approved prior to the beginning of the incentive plan performance period.

- *Shareholder Return* – A minimum return on active patron stock investment must be achieved for incentive compensation payments to be approved.

Additionally, the Compensation Committee annually considers an assessment of compensation-related risks for all of our employees. Our assessment includes a review of multiple facets of our compensation program including governance practices, program documentation, incentive plan design, processes, employment practices, benefits program, and cultural considerations. Reviews of various aspects of our programs are also conducted by external audit partners, and audit reports are provided to our Board of Directors. Based on this assessment, the Compensation Committee concluded that our compensation plans do not create risks that are reasonably likely to have a material adverse effect on CoBank. In making this conclusion, the Compensation Committee reviewed the key design elements of our compensation programs in relation to industry “best practices” as presented by the Consultant, as well as the design features and administrative processes that mitigate any potential risks, such as through our internal controls and oversight by management and the Board of Directors. In 2012, as previously discussed, compensation program design changes were made to further ensure incentive plans do not encourage excessive risk-taking. Further, in 2013, an additional modification will be introduced to require an incentive compensation recovery policy for the Bank’s most senior officers.

The President and CEO has elected to receive retirement benefits payable pursuant to the SERP and ERP in the form of an annuity, as opposed to a lump sum. The Committee believes this arrangement enhances the focus on overall risk management and the long-term success of the Bank.

Senior Officers Compensation Discussion and Analysis
CoBank, ACB

Summary Compensation Table

Compensation earned by our President and CEO and aggregate compensation of other senior officers and the one highly compensated employee for the years ended December 31, 2012, 2011 and 2010 is disclosed in the accompanying table. Our current Board policy regarding reimbursements for travel, subsistence and other related expenses states that all employees, including senior officers, shall be reimbursed for actual reasonable travel and related expenses that are necessary and that support our business interests. A copy of our policy is available to shareholders of CoBank and of our affiliated Farm Credit Associations upon request.

Summary Compensation Table[1] ($ in Thousands)

		Annual						
Name of Individual or Number in Group[2]	Year	Salary	Short-Term Incentive Compensation[3]	Long-Term Incentive Compensation[3]	Change in Pension Value[4]	Deferred/ Perquisites[5]	Other[6]	Total
President & CEO:								
Robert B. Engel	2012	$ 775	$ 1,256	$ 1,596	$ 1,127	$ 208	$ -	$ 4,962
Robert B. Engel	2011	662	1,676	1,301	1,636	113	-	5,388
Robert B. Engel	2010	596	1,148	1,409	1,008	93	-	4,254
Aggregate Number of Senior Officers and the Highly Compensated Employee (excluding the CEO):								
9	2012	$ 2,827	$ 2,867	$ 1,855	$ 4,162	$ 723	$ 2,060	$ 14,494
7	2011	2,078	3,208	1,428	2,212	407	-	9,333
8	2010	2,271	1,934	1,587	1,473	276	1,417	8,958

[1] Disclosure of the total compensation paid during 2012 to any designated senior officer or highly compensated employee is available to shareholders of CoBank and of our affiliated Farm Credit Associations upon request. Compensation amounts do not include earnings on nonqualified deferred compensation, as such earnings are not considered above-market or preferential.

[2] The senior officers and the one highly compensated employee included in the summary compensation disclosure are those officers defined by FCA regulations §619.9310 and §620.6.

[3] Incentive compensation amounts represent amounts earned in the reported fiscal year, which are paid in March of the subsequent year to persons who continue to be employed by CoBank or unless otherwise provided for in an employment agreement. The short-term incentive compensation amounts are calculated based on relevant performance factors for the reported fiscal year, while the long-term incentive compensation amounts are calculated based on the relevant performance factors for the three-year performance period ended in the reported fiscal year.

[4] The Change in Pension Value increased in 2012 primarily due to the final compensation level and the form of pension benefit payment elected by a senior officer who retired during the year.

[5] Represents company contributions to a 401(k) retirement savings plan and nonqualified deferred compensation plan, as well as payment of tax return preparation and financial planning expenses, relocation, certain travel-related costs, wellness benefits, life insurance benefits and associated income tax impact. For 2012, also includes the Board-approved payout of vacation over a certain threshold that was earned but not used in 2011, due to exceptional work demands related to the merger.

[6] For 2012, includes $1,727 paid and anticipated to be paid to the one highly compensated employee (who will leave the Bank in 2013) for salary, salary continuance, incentive compensation and certain other benefits, all pursuant to the terms of previous contractual agreements between the employee and U.S. AgBank; $213 for sign-on payments for two senior officers who joined the Bank in 2011 and 2012; and $120 for payments that were awarded by U.S. AgBank and assumed by CoBank as a result of the merger. For 2010, represents amounts paid or payable to two senior officers (who left the Bank in 2010) for employment transition and separation pay, salary continuance and certain other benefits.

Pension Benefits

The table below shows certain pension benefit information by plan for the President and CEO and the senior officer group, including the one highly compensated employee as of December 31, 2012.

Pension Benefits Table ($ in Thousands)

Name of Individual or Number in Group[1]	Plan Name	Number of Years of Credited Service[2]	Actuarial Present Value of Accumulated Benefits	Payments During Last Fiscal Year[3]
President & CEO:				
Robert B. Engel	CoBank, ACB Retirement Plan	12.58	$ 421	$ -
	Supplemental Executive Retirement Plan	12.58	3,068	-
	Executive Retirement Plan	12.58	5,861	-
Total			$ 9,350	$ -
Aggregate Number of Senior Officers and the Highly Compensated Employee (excluding the CEO):				
6	CoBank, ACB Retirement Plan	21.78	$ 7,083	$ 98
	Supplemental Executive Retirement Plan	21.78	2,757	2,895
	Executive Retirement Plan	19.67	1,366	-
Total			$ 11,206	$ 2,993

[1] The senior officers and the one highly compensated employee included in the pension benefits disclosure are those defined by FCA regulations §619.9310 and §620.6.
[2] For the Retirement Plan and the SERP, represents an average for the aggregate senior officer and the highly compensated employee group.
[3] Represents post-retirement benefit payments made during the last fiscal year.

Report on Compensation
CoBank, ACB

Members of the Compensation Committee of the Board of Directors are appointed by the Board chair in consultation with the Board officers and committee chairs. All members of the Compensation Committee qualify as independent directors as defined by Board policy.

The Compensation Committee (Committee) approves the overall compensation philosophy at the Bank utilizing an independent, Committee-appointed, executive compensation consultant, which includes establishing the compensation philosophy which guides program design including pay mix comprised of base pay, short- and long-term incentive compensation plans and employee benefits. In so doing, the Committee has developed and implemented compensation policies and programs that support the Bank's core values and links compensation to overall Bank and individual performance, ensuring a proper balance with the risk profile of the Bank, thereby contributing to the value of the shareholders' investment in the Bank.

The Committee is responsible for establishing the performance standards for the President and Chief Executive Officer and the compensation structure for other Bank associates. The Committee reviews the Board's performance evaluation of the President and Chief Executive Officer, approves an overall performance rating, and recommends for full Board approval all aspects of compensation (base salary, short- and long-term incentives, benefits, and perquisites) for the President and Chief Executive Officer, consistent with the business and financial objectives of the Bank, the results achieved by the executive, and competitive compensation practices. The Committee carefully evaluates incentive-based compensation programs and payments thereunder to ensure they are reasonable and appropriate to the services performed by senior officers. The Committee monitors the terms and provisions of the incentive-based compensation programs for senior officers and assesses the balance of financial rewards to senior officers against the risks to the institution. The Committee carefully evaluates whether senior officer compensation, incentive, and benefit programs are designed to support the Bank's long-term business strategy and mission as well as promote safe and sound business practices. The Committee reviews the institution's projected long-term obligations for compensation and retirement benefits. The Committee operates under a written charter, adopted by the Committee and the Board of Directors, which more fully describes the Committee's responsibilities.

The Committee has reviewed and discussed the Senior Officers Compensation Discussion and Analysis with management. Based on this review and discussion, the Committee recommended to the Board of Directors, and the Board approved, that the Senior Officers Compensation Discussion and Analysis be included in the Annual Report for the year ended December 31, 2012.

Members of the 2013 Compensation Committee:

Oghi A. DeGiusti, Jr., Chair
Gene J. Batali
Daniel T. Kelley
David S. Phippen
David L. Reinders

March 1, 2013

Code of Ethics
CoBank, ACB

CoBank sets high standards for honesty, ethics, integrity, impartiality and conduct. Each year, every associate certifies compliance with the letter, intent and spirit of our Associate Responsibilities and Conduct Policy, which establishes the ethical standards of our organization, and each senior officer is required to disclose additional information. Additionally, our president and chief executive officer, chief operating officer, chief risk officer, chief credit officer, general counsel, chief financial officer and other senior financial professionals certify compliance with the letter, intent and spirit of our Code of Ethics. Our Code of Ethics supplements our Associate Responsibilities and Conduct Policy and establishes additional responsibilities specifically related to the preparation and distribution of our financial statements and related disclosures. Details about our Code of Ethics are available at www.cobank.com. At your request, we will provide you with a copy of our Code of Ethics, free of charge. Please contact:

Corporate Communications Division
P. O. Box 5110
Denver, CO 80217
(303) 740-4061

Young, Beginning, and Small Farmers

CoBank, ACB

Under the Farm Credit Act, CoBank does not have authority to lend directly to young, beginning, and small farmers. Rather, we recognize that Associations serve young, beginning, and small farmers, which we support through wholesale funding, partnering on Association programs as they deem appropriate, and completing reporting required by regulations. We believe the future of agriculture and rural America is well served when loan programs are developed by Associations to aid ambitious and capable young, beginning, and small farmers. Therefore, we have adopted a written policy that encourages the board of directors at each of our affiliated Associations to establish a program to provide sound and constructive credit and other services to young, beginning, and small farmers and ranchers and producers or harvesters of aquatic products (YBS farmers and ranchers). Each affiliated Association provides us annually with a report measuring achievement with respect to these programs for YBS farmers and ranchers. A summary of the combined reports for our affiliated Associations and certain participations CoBank purchased from Associations follows.

YBS Farmers and Ranchers ($ in Thousands)

	Loan Numbers		Loan Volume	
	Number	Percent of Portfolio	Dollars	Percent of Portfolio
Loans and Commitments Outstanding at December 31, 2012:				
Young	20,446	15.75 %	$ 5,469,243	9.34 %
Beginning	28,803	22.19	7,471,607	12.76
Small	46,953	36.18	6,129,203	10.47
Gross New Loans and Commitments Made During 2012:				
Young	5,713	14.92 %	$ 1,725,644	8.21 %
Beginning	7,028	18.35	1,967,292	9.36
Small	10,379	27.10	1,392,190	6.62

Small Farmers and Ranchers

Number / Volume of Loans Outstanding by Loan Size at December 31, 2012

Number / Volume	$0 – $50,000	$50,001 – $100,000	$100,001 – $250,000	$250,001 and greater
Total Number of Loans to Small Farmers and Ranchers	19,165	11,044	11,345	5,399
Total Loan Volume to Small Farmers and Ranchers ($ in Thousands)	$ 457,406	$ 831,093	$ 1,809,510	$ 3,031,194

Key definitions are as follows:

Young Farmer or Rancher – A farmer, rancher or producer or harvester of aquatic products who is age 35 or younger as of the date the loan was originally made.

Beginning Farmer or Rancher – A farmer, rancher or producer or harvester of aquatic products who had 10 years or less of experience at farming, ranching or producing or harvesting aquatic products as of the date the loan was originally made.

Small Farmer or Rancher – A farmer, rancher or producer or harvester of aquatic products who normally generated less than $250,000 in annual gross sales of agricultural or aquatic products at the date the loan was originally made.

The Young, Beginning, and Small farmer and rancher categories are not mutually exclusive, therefore, certain farmers and ranchers may be classified in more than one category in the tables above.

Beyond providing appropriate wholesale lending for Association YBS farmers and ranchers programs and submitting reports to our regulator, CoBank has partnered with Associations on successful financing programs designed to attract quality farm operations, meeting the intended purpose of providing vital capital to start-up farming operations and promoting the flow of capital into rural areas. CoBank also has its own programs to serve the credit needs of agribusiness cooperatives and rural infrastructure providers of all sizes as well as rural communities using our mission-related investments authorities. CoBank has also reached out to non-traditional forms of agricultural production, such as local foods, community supported agriculture, and urban agriculture, to better understand their financing needs within the legal constraints of CoBank lending authorities.

CERTIFICATION

I, Robert B. Engel, President and Chief Executive Officer of CoBank, ACB (CoBank or the Bank), a federally chartered instrumentality under the Farm Credit Act of 1971, as amended, certify that:

(1) I have reviewed this annual report of CoBank;

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of CoBank as of, and for, the periods presented in this report;

(4) CoBank's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for CoBank and have:

   a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Bank, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. evaluated the effectiveness of the Bank's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. disclosed in this report any change in the Bank's internal control over financial reporting that occurred during the Bank's most recent fiscal quarter (the Bank's fourth fiscal quarter in the case of this annual report) that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting; and

(5) CoBank's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Bank's auditors and the audit committee of the Bank's Board of Directors (or persons performing the equivalent functions):

   a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize, and report financial information; and

   b. any fraud, whether or not material, that involves management or other employees who have a significant role in the Bank's internal control over financial reporting.

/s/ ROBERT B. ENGEL

Robert B. Engel
President and Chief Executive Officer

Dated: March 1, 2013

CERTIFICATION

I, David P. Burlage, Chief Financial Officer of CoBank, ACB (CoBank or the Bank), a federally chartered instrumentality under the Farm Credit Act of 1971, as amended, certify that:

(1) I have reviewed this annual report of CoBank;

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of CoBank as of, and for, the periods presented in this report;

(4) CoBank's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for CoBank and have:

a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Bank, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c. evaluated the effectiveness of the Bank's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d. disclosed in this report any change in the Bank's internal control over financial reporting that occurred during the Bank's most recent fiscal quarter (the Bank's fourth fiscal quarter in the case of this annual report) that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting; and

(5) CoBank's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Bank's auditors and the audit committee of the Bank's Board of Directors (or persons performing the equivalent functions):

a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize, and report financial information; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the Bank's internal control over financial reporting.

/s/ DAVID P. BURLAGE

David P. Burlage
Chief Financial Officer

Dated: March 1, 2013

Leadership
CoBank, ACB

Robert B. Engel, President and Chief Executive Officer

Mary E. McBride, Chief Banking Officer
Agribusiness
Amy H. Gales, Regional Agribusiness Banking Group*
Leili Ghazi, Agribusiness Division – West
Michael W. Hechtner, Agribusiness Division – Central
Lynn M. Scherler, Agribusiness Division – South
G. David Sparks, Agribusiness Division – East
Jonathan B. Logan, Corporate Agribusiness Banking Group
Karen S. Lowe, Agricultural Export Finance Division

Rural Infrastructure
Paul A. Narduzzo, Rural Infrastructure Banking Group
Brett A. Challenger, Energy and Water Services Banking Division
Candace A. Roper, Electric Distribution Banking Division
Todd E. Telesz, Power Supply Banking Division
Robert F. West, Communications Banking Division

Banking Services
Antony M. Bahr, Banking Services Group
Brian J. Klatt, Capital Markets Division
Russell D. Nelson, Farm Credit Leasing Services Corporation**
Leonard G. Sahling, Knowledge Exchange Division
Richard A. Scholz, Non-Credit Services Division

Ann E. Trakimas, Chief Operating Officer
Finance
David P. Burlage, Chief Financial Officer
Timothy D. Steidle, Treasury Division
Michael R. Vestal, Controller Division

Business Support Services
John Svisco, Chief Administrative Officer
James R. Bernsten, Chief Information Officer
Arthur C. Hodges, Jr., Corporate Communications Division
Stephen B. Secor, Operations Division
Todd E. Wilson, Enterprise Solutions and Services Division

Regulatory, Legislative and Compliance
Andrew D. Jacob, Regulatory, Legislative and Compliance
L. Todd Van Hoose, Government Affairs

Legal
Gregory J. Buehne, General Counsel

Human Resources
Robert L. O'Toole, Senior Vice President

Gregory E. Somerhalder, Chief Risk Officer
Rodney A. Brown, Asset Review Division
Katia V. Hoffer, Enterprise Risk Management Division
Steven W. Wittbecker, Internal Audit Division

Lori L. O'Flaherty, Chief Credit Officer
Daniel L. Key, Credit Approval Division
Ronald P. Seigley, Special Assets Division

* The Strategic Relationships operating segment is included in the Regional Agribusiness Banking Group.
** Farm Credit Leasing Services Corporation is included in our Agribusiness operating segment.

Customer Privacy

Your financial privacy and the security of your other non-public information are important to us. We, therefore, hold your financial and other non-public information in strictest confidence. Federal regulations allow disclosure of such information by us only in certain situations. Examples of these situations include law enforcement or legal proceedings or when such information is requested by a Farm Credit System institution with which you do business. In addition, as required by Federal laws targeting terrorism funding and money laundering activities, we collect information and take actions necessary to verify your identity.

CoBank's 2013 Quarterly and Annual Reports to Shareholders are available free of charge on request by calling or visiting one of our banking center locations and through our website at www.cobank.com on approximately May 10, 2013, August 9, 2013, November 9, 2013, and March 1, 2014 (Annual Report).

OFFICE LOCATIONS

COBANK NATIONAL OFFICE

5500 South Quebec Street
Greenwood Village, CO 80111
(303) 740-4000
(800) 542-8072

FARM CREDIT LEASING SERVICES CORPORATION

600 Highway 169 South, Suite 300
Minneapolis, MN 55426
(952) 417-7800
(800) 444-2929

WASHINGTON, D.C. OFFICE

50 F Street, N.W., Suite 900
Washington, DC 20001
(202) 650-5860

U.S. REGIONAL OFFICES

Ames Banking Center

2515 University Boulevard, Suite 104
Ames, IA 50010
(515) 292-8828

Atlanta Banking Center **

900 Circle 75 Parkway, Suite 1400
Atlanta, GA 30339-5946
(770) 618-3200
(800) 255-7429
FCL: (770) 618-3226

Austin Banking Center

4801 Plaza on the Lake Drive
Austin, TX 78746
(512) 483-9273

California Farm Credit Leasing Office *

2345 East Earhart Avenue
Stockton, CA 95206
(209) 944-7478

Enfield Banking Center **

240B South Road
Enfield, CT 06082-4451
(860) 814-4043
(800) 876-3227
FCL: (860) 814-4049

Fargo Banking Center

Goldmark Office Park
1711 Gold Drive South, Suite 230
Fargo, ND 58103
(701) 277-5007
(866) 280-2892

Louisville Banking Center **

1601 UPS Drive, Suite 102
Louisville, KY 40223
(502) 423-5650
(800) 262-6599
FCL: (800) 942-3309

Lubbock Banking Center **

5715 West 50th
Lubbock, TX 79414
(806) 788-3700
FCL: (806) 788-3705

Minneapolis Banking Center **

600 Highway 169 South, Suite 300
Minneapolis, MN 55426
(952) 417-7900
(800) 282-4150
FCL: (800) 444-2929

Ohio Farm Credit Leasing Office *

1220 Irmscher Blvd.
Celina, OH 45822
(855) 838-9961 ext. 23969

Omaha Banking Center **

11422 Miracle Hills Drive, Suite 300
Omaha, NE 68154-4404
(402) 492-2000
(800) 346-5717

Sacramento Banking Center **

1478 Stone Point Drive, Suite 450
Roseville, CA 95661
(916) 380-3524
(800) 457-0942
FCL: (800) 289-7080

Spokane Banking Center

1700 South Assembly Street, Suite 103
Spokane, WA 99224-2121
(509) 363-8700
(800) 378-5577

Sterling Banking Center

229 South 3rd Street
Sterling, CO 80751
(970) 521-2774

St. Louis Banking Center **

1650 Des Peres Road, Suite 120
St. Louis, MO 63131
(314) 835-4200
(800) 806-4144
FCL: (800) 853-5480

Wichita Banking Center **

245 North Waco
Wichita, KS 67202
(316) 290-2000
(800) 322-3654
FCL: (800) 322-6558

* Farm Credit Leasing office only
** Farm Credit Leasing office within this CoBank location

INTERNATIONAL REPRESENTATIVE OFFICE

10 Hoe Chiang Road
#05-01 Keppel Towers
Singapore 089315
(65) 6534-5261

COBANK
COOPERATIVE. CONNECTED. COMMITTED.

5500 SOUTH QUEBEC STREET
GREENWOOD VILLAGE, CO 80111
800-542-8072