

FARMER MAC II LLC

FINANCIAL REPORT

FOR THE YEAR ENDED DECEMBER 31, 2012

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### Financial Statements

The following information concerning Farmer Mac II LLC's audited financial statements is included in this report beginning on the pages listed below:

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## INDEPENDENT AUDITOR'S REPORT



### Independent Auditor's Report

To the Board of Directors and Members  
of Farmer Mac II LLC:

We have audited the accompanying financial statements of Farmer Mac II LLC (the "Company"), which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of income, comprehensive income, members' equity and cash flows for each of the three years in the period ended December 31, 2012.

#### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on the financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

#### *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company at December 31, 2012 and 2011, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2012 in accordance with accounting principles generally accepted in the United States of America.

*PricewaterhouseCoopers LLP*

April 1, 2013

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**FARMER MAC II LLC  
BALANCE SHEETS**

	As of December 31,	
	2012	2011
	<i>(in thousands)</i>	
<b>Assets:</b>		
Cash and cash equivalents	\$ 22,610	\$ 1,267
<b>Farmer Mac Guaranteed Securities:</b>		
Available-for-sale, at fair value	26,036	34,890
<b>USDA Guaranteed Securities:</b>		
Available-for-sale, at fair value	1,486,595	1,279,546
Trading, at fair value	104,188	212,359
Total USDA Guaranteed Securities	1,590,783	1,491,905
Interest receivable	23,226	24,178
Other assets	277	322
Total Assets	\$ 1,662,932	\$ 1,552,562
<b>Liabilities and Members' Equity:</b>		
<b>Liabilities:</b>		
Intercompany borrowings	\$ 328,000	\$ 218,000
Accounts payable and accrued expenses	247	178
Total Liabilities	328,247	218,178
<b>Members' Equity:</b>		
Preferred stock, par value \$1,000 per share, 250,000 shares authorized and outstanding (redemption value \$250,000,000)	241,853	241,853
Common stock, no par value	1,020,168	1,020,168
Accumulated other comprehensive income related to available-for-sale securities	20,341	35,951
Retained earnings	52,323	36,412
Total Members' Equity	1,334,685	1,334,384
Total Liabilities and Members' Equity	\$ 1,662,932	\$ 1,552,562

See accompanying notes to financial statements.

**FARMER MAC II LLC**  
**STATEMENTS OF OPERATIONS**

	For the Year Ended December 31,		
	2012	2011	2010
	<i>(in thousands)</i>		
Interest income:			
USDA and Farmer Mac Guaranteed Securities	\$ 47,529	\$ 48,140	\$ 41,367
Interest expense	9,014	5,495	2,066
Net interest income	38,515	42,645	39,301
Non-interest income/(loss):			
Gains/(losses) on trading assets	44	3,119	(3,890)
Other income	579	283	4
Non-interest income/(loss)	623	3,402	(3,886)
Non-interest expense:			
General and administrative	1,040	944	1,212
Non-interest expense	1,040	944	1,212
Net income	38,098	45,103	34,203
Preferred stock dividends	(22,187)	(22,187)	(20,707)
Net income attributable to common stockholders	\$ 15,911	\$ 22,916	\$ 13,496

See accompanying notes to financial statements.

**FARMER MAC II LLC**  
**STATEMENTS OF COMPREHENSIVE INCOME**

	For the Year Ended December 31,		
	2012	2011	2010
	<i>(in thousands)</i>		
Net income	\$ 38,098	\$ 45,103	\$ 34,203
Other comprehensive income:			
Unrealized holding (losses)/gains on securities	(15,610)	44,070	(8,119)
Comprehensive income	\$ 22,488	\$ 89,173	\$ 26,084

See accompanying notes to financial statements.

**FARMER MAC II LLC**  
**STATEMENTS OF MEMBERS' EQUITY**

	For the Year Ended December 31,					
	2012		2011		2010	
	Shares	Amount	Shares	Amount	Shares	Amount
	<i>(in thousands)</i>					
Preferred stock:						
Balance, beginning of period	250	\$ 241,853	250	\$ 241,853	-	\$ -
Issuance of preferred stock	-	-	-	-	250	241,853
Balance, end of period	250	\$ 241,853	250	\$ 241,853	250	\$ 241,853
Common stock:						
Balance, beginning of period		\$ 1,020,168		\$ 1,020,168		\$ 10
Issuance of common stock		-		-		1,020,158
Balance, end of period		\$ 1,020,168		\$ 1,020,168		\$ 1,020,168
Retained earnings:						
Balance, beginning of period		\$ 36,412		\$ 13,496		\$ -
Net income		38,098		45,103		34,203
Preferred stock dividends		(22,187)		(22,187)		(20,707)
Balance, end of period		\$ 52,323		\$ 36,412		\$ 13,496
Accumulated other comprehensive income/(loss):						
Balance, beginning of period		\$ 35,951		\$ (8,119)		\$ -
Other comprehensive (loss)/income		(15,610)		44,070		(8,119)
Balance, end of period		\$ 20,341		\$ 35,951		\$ (8,119)
Total Members' Equity		\$ 1,334,685		\$ 1,334,384		\$ 1,267,398

See accompanying notes to financial statements.

**FARMER MAC II LLC**  
**STATEMENTS OF CASH FLOWS**

	For the Year Ended December 31,		
	2012	2011	2010
	<i>(in thousands)</i>		
<b>Cash flows from operating activities:</b>			
Net income	\$ 38,098	\$ 45,103	\$ 34,203
Adjustments to reconcile net income to net cash provided by operating activities:			
Net amortization of premiums and discounts on USDA and Farmer Mac Guaranteed Securities	9,307	8,601	9,410
Net change in fair value of trading securities	(44)	(3,119)	3,890
Net change in:			
Interest receivable	952	(1,489)	(4,677)
Other assets	45	76	672
Other liabilities	69	(459)	576
Net cash provided by operating activities	<u>48,427</u>	<u>48,713</u>	<u>44,074</u>
<b>Cash flows from investing activities:</b>			
Purchases of USDA and Farmer Mac Guaranteed Securities	(479,324)	(404,836)	(407,070)
Proceeds from repayment of USDA and Farmer Mac Guaranteed Securities	364,427	270,189	273,166
Net cash used in investing activities	<u>(114,897)</u>	<u>(134,647)</u>	<u>(133,904)</u>
<b>Cash flows from financing activities:</b>			
Issuance cost of preferred stock	-	-	(8,147)
Proceeds from common stock issuance	-	-	10,000
Dividends paid on preferred stock	(22,187)	(22,187)	(20,645)
Proceeds from intercompany borrowings	110,000	94,000	124,000
Net cash provided by financing activities	<u>87,813</u>	<u>71,813</u>	<u>105,208</u>
Net increase/(decrease) in cash and cash equivalents	<u>21,343</u>	<u>(14,121)</u>	<u>15,378</u>
Cash and cash equivalents at beginning of period	1,267	15,388	10
Cash and cash equivalents at end of period	<u>\$ 22,610</u>	<u>\$ 1,267</u>	<u>\$ 15,388</u>

See accompanying notes to financial statements.



**FARMER MAC II LLC**  
**NOTES TO FINANCIAL STATEMENTS**  
**YEARS ENDED DECEMBER 31, 2012, 2011, AND 2010**

1. Basis of Presentation

The accounting and reporting policies of Farmer Mac II LLC (the “Company”) conform to accounting principles generally accepted in the United States of America (“generally accepted accounting principles” or “GAAP”). The preparation of financial statements in conformity with generally accepted accounting principles requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of income and expense during the reporting period. Actual results could differ from those estimates. These financial statements reflect all normal and recurring adjustments that are, in the opinion of management, necessary to present a fair statement of the financial position and the results of operations and cash flows of Farmer Mac II LLC for the periods presented.

2. Description of the Business

On December 10, 2009, Farmer Mac II LLC was formed as a Delaware limited liability company. The Company was established to operate the Farmer Mac II program. Under the Farmer Mac II program, the Company purchases the portion of loans guaranteed by the United States Department of Agriculture (the “USDA Guaranteed Securities”) pursuant to the Consolidated Farm and Rural Development Act (7 U.S.C. §§ 1921 et. seq.). The Company’s principal source of revenue is net interest income earned on the portfolios of USDA Guaranteed Securities and Farmer Mac Guaranteed Securities that have Farmer Mac’s guarantee of timely payment of principal and interest in addition to the USDA Guarantee (“Farmer Mac Guaranteed Securities”), together referred to as “USDA and Farmer Mac Guaranteed Securities.”

3. Related Party Transactions

Farmer Mac II LLC is an operating subsidiary of the Federal Agricultural Mortgage Corporation (“Farmer Mac”). In December 2009, the Company issued common stock to Farmer Mac, the sole Member of the Company as of December 31, 2009, in exchange for cash, as the initial transaction after formation of the Company. On January 25, 2010, Farmer Mac transferred substantially all of the Farmer Mac II program business, including \$1.2 billion of USDA and Farmer Mac Guaranteed Securities and \$19.1 million in accrued interest receivable and other assets, to Farmer Mac II LLC in exchange for all of the preferred stock and \$1.0 billion of additional common stock in the Company. Farmer Mac simultaneously sold the preferred stock to third party investors.

The Company has an uncommitted intercompany borrowing facility with Farmer Mac in the aggregate principal amount of up to \$500.0 million and pays an administrative fee to Farmer Mac in connection with each borrowing under the facility. As of December 31, 2012 and 2011, there were \$328.0 million and \$218.0 million, respectively, of borrowings outstanding under the facility. During 2012, the Company incurred interest expense of \$9.0 million for borrowings

under this facility, compared to \$5.5 million for 2011 and \$2.1 million for 2010. Principal on loans under the facility is payable on the last business day of each calendar month but, with Farmer Mac approval, may be refinanced in whole or in part, on a month-by-month basis, provided that no event of default under the facility has occurred and is continuing. The interest rate on loans is Farmer Mac's estimated cost of funds plus a credit spread capped at 0.50 percent. Farmer Mac earned \$0.1 million in guarantee fees during each of the years ended December 31, 2012, 2011, and 2010, which reduced interest income related to the Farmer Mac II Guaranteed Securities owned by Farmer Mac II LLC.

Pursuant to a Secondment Agreement and a Management and Administrative Services Agreement, Farmer Mac provides various services to the Company, including management of the day-to-day business and marketing, administrative, accounting and reporting, risk management and other activities of the Company, including access to and use of office space within Farmer Mac's corporate offices and information technology services. During 2012, 2011, and 2010, the cost of these services was \$0.7 million, and \$0.7 million, and \$0.6 million, respectively.

The Company has agreed to reimburse Farmer Mac for all expenses reasonably incurred by or on its behalf by Farmer Mac in the course of the performance by Farmer Mac employees under the Secondment and Management and Administrative Services Agreements, subject to certain caps. The Company has agreed to indemnify Farmer Mac and its respective officers, directors, and employees against any and all out of pocket liabilities, losses, damages, costs, and expenses incurred by them arising out of a claim against any of them to the extent that it directly results from the provision under the Secondment or Management and Administrative Services Agreements.

The Company has an Administrator Agreement with Zions First National Bank ("Zions"). Zions is the largest holder of Farmer Mac's outstanding Class A voting stock and a large holder of Farmer Mac's outstanding Class C non-voting common stock as of December 31, 2012 and 2011. Farmer Mac from time to time enters into or engages in various business transactions with Zions. Zions retained fees of \$0.3 million, netted out of interest income, in connection with the Administrator Agreement during the years ended December 31, 2012, 2011, and 2010.

Transactions between Farmer Mac II LLC and Farmer Mac are conducted on an arms-length basis.

#### 4. Significant Accounting Policies

##### *Cash and cash equivalents and Statement of Cash Flows*

The Company considers highly liquid investment securities with original maturities of three months or less to be cash equivalents. The carrying value of cash and cash equivalents is a reasonable estimate of their approximate fair value. Changes in the balance of cash and cash equivalents are reported in the statement of cash flows. There was no material non-cash activity for the years ended December 31, 2012 and 2011. Non-cash activity for the year ended December 31, 2010 included the transfer, at fair value, of \$1.3 billion of USDA and Farmer Mac

Guaranteed Securities and related accrued interest from Farmer Mac in exchange for Company common and preferred stock. Interest paid during the years ended December 31, 2012, 2011, and 2010 totaled \$9.0 million, \$5.9 million, and \$1.7 million, respectively.

### *Income Taxes*

Effective January 25, 2010, the Company became a multi-member LLC and is treated as a partnership for federal and state income tax purposes. As such, the taxable income that results from the Company's operations is passed through to its members who are responsible for paying the taxes on that income. Accordingly, the Company makes no tax payments and has no accrual for income taxes. Prior to January 25, 2010, the Company was a single member LLC and was treated as a disregarded entity for federal and state income tax purposes. The Company, by virtue of its relationship with Farmer Mac, is exempt from state and local income taxes.

### *Fair Value Measurements*

The Company accounts for all USDA and Farmer Mac Guaranteed Securities at fair value on a recurring basis. The Company categorizes these securities into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the security. The three levels used to classify fair value measurements are described as follows:

- |         |   |
|---------|---|
| Level 1 | Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.             |
| Level 2 | Quoted prices in markets that are not active or financial instruments for which all significant inputs are observable, either directly or indirectly. |
| Level 3 | Prices or valuations that require unobservable inputs that are significant to the fair value measurement.   |

The Company estimates the fair value of its USDA and Farmer Mac Guaranteed Securities by discounting the projected cash flows of these instruments. The fair values are based on the present value of expected cash flows using management's best estimate of certain key assumptions, which include prepayment speeds, forward yield curves and discount rates commensurate with the risks involved. As of December 31, 2012 and 2011, the Company classified all its assets measured at fair value as Level 3 because there is limited market activity and therefore little or no price transparency. On a sample basis, the Company corroborates the fair value of its securities by obtaining a secondary valuation from an independent third party pricing service.

## *New Accounting Standards*

### Offsetting Assets and Liabilities

On December 16, 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2011-11, *Disclosures about Offsetting Assets and Liabilities*, which creates new disclosure requirements designed to make financial statements prepared under GAAP more comparable to those prepared under International Financial Reporting Standards. The new guidance requires entities to disclose net and gross information for certain derivative instruments and financial instruments and information about the impact of collateral on offsetting arrangements and other amounts subject to a master netting agreement that are not offset on the balance sheet.

On January 31, 2013, the FASB issued ASU 2013-01, *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*, addressing the implementation of ASU 2011-11. The amendment clarifies that the scope of ASU 2011-11 applies to recognized derivative instruments, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are offset in the financial statements or are subject to enforceable master netting arrangements or similar agreements. ASU 2013-01 was effective concurrently with ASU 2011-11, which applies for interim and annual periods beginning on or after January 1, 2013. Because these standards only require additional disclosure, the adoption of ASU 2011-11 and ASU 2013-01 did not have a material effect on Farmer Mac II LLC's financial position, results of operations or cash flows.

### Comprehensive Income

On February 5, 2013, the FASB issued ASU 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income* ("AOCI"). The new guidance requires entities to disclose additional information about reclassification adjustments, including changes in AOCI balances by component and significant items reclassified out of AOCI. An entity would disaggregate the total change of each component of other comprehensive income and separately present reclassification adjustments and current period other comprehensive income.

ASU 2013-02 also requires significant items reclassified out of AOCI to be presented either on the face of the statement where net income is presented or as a separate disclosure in the notes to the financial statements. The income tax benefit or expense attributed to each component of other comprehensive income and reclassification adjustments must be presented in the financial statement or notes to the financial statements. The amendments in ASU 2013-02 did not change the current requirement for reporting net income or other comprehensive income in the financial statements. ASU 2013-02 was effective for all reporting periods beginning after December 15, 2012. The adoption of this new guidance did not have a material effect on Farmer Mac II LLC's financial position, results of operations or cash flows because it only requires additional disclosure.

## 5. USDA and Farmer Mac Guaranteed Securities

The following table sets forth information about USDA and Farmer Mac Guaranteed Securities as of December 31, 2012 and 2011:

	December 31, 2012			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
	<i>(in thousands)</i>			
Available-for-sale:				
USDA Guaranteed Securities	\$ 1,467,159	\$ 19,605	\$ (169)	\$ 1,486,595
Farmer Mac Guaranteed Securities	25,131	909	(4)	26,036
Total available-for-sale	<u>\$ 1,492,290</u>	<u>\$ 20,514</u>	<u>\$ (173)</u>	<u>\$ 1,512,631</u>
Trading:				
USDA Guaranteed Securities	104,914	624	(1,350)	104,188
Total USDA and Farmer Mac Guaranteed Securities	<u>\$ 1,597,204</u>	<u>\$ 21,138</u>	<u>\$ (1,523)</u>	<u>\$ 1,616,819</u>
	December 31, 2011			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	<i>(in thousands)</i>			
Available-for-sale:				
USDA Guaranteed Securities	\$ 1,244,519	\$ 35,149	\$ (122)	\$ 1,279,546
Farmer Mac Guaranteed Securities	33,966	924	-	34,890
Total available-for-sale	<u>\$ 1,278,485</u>	<u>\$ 36,073</u>	<u>\$ (122)</u>	<u>\$ 1,314,436</u>
Trading:				
USDA Guaranteed Securities	213,130	1,804	(2,575)	212,359
Total USDA and Farmer Mac Guaranteed Securities	<u>\$ 1,491,615</u>	<u>\$ 37,877</u>	<u>\$ (2,697)</u>	<u>\$ 1,526,795</u>

The USDA Guaranteed Securities classified as trading relate to securities for which the fair value option was elected by Farmer Mac prior to transfer of the securities to the Company. Farmer Mac II LLC maintained the fair value option election for these securities.

The unrealized losses presented above are principally due to wider spreads on mortgage securities and changes in interest rates from the date of acquisition to December 31, 2012 and 2011, as applicable. The USDA and Farmer Mac Guaranteed Securities are backed by the full faith and credit of the United States. Therefore, Farmer Mac II LLC has concluded that none of the unrealized losses on its available-for-sale securities represents other-than-temporary impairment as of December 31, 2012 and 2011. Farmer Mac II LLC does not intend to sell these securities and it is not more likely than not that Farmer Mac II LLC will be required to sell the securities before recovery of the amortized cost basis. Farmer Mac II LLC did not sell any USDA and Farmer Mac Guaranteed Securities during the years ended December 31, 2012, 2011, and 2010.

The amortized cost, fair value and weighted average yield of available-for-sale USDA and Farmer Mac Guaranteed Securities by remaining contractual maturity as of December 31, 2012 are set forth below. The balances presented are based on their final maturities, although the actual maturities may differ due to prepayments of the underlying assets.

USDA and Farmer Mac Guaranteed Securities Available-for-Sale as of December 31, 2012			
	Amortized Cost	Fair Value <i>(dollars in thousands)</i>	Weighted- Average Yield
Due within one year	\$ 8,952	\$ 8,969	1.62 %
Due after one year through five years	80,978	81,964	3.48 %
Due after five years through ten years	113,986	115,527	2.74 %
Due after ten years	1,288,374	1,306,171	3.45 %
Total	<u>\$ 1,492,290</u>	<u>\$ 1,512,631</u>	3.38 %

Farmer Mac II LLC did not own any held-to-maturity USDA and Farmer Mac Guaranteed Securities as of December 31, 2012 and 2011. As of December 31, 2012, the Company owned trading USDA Guaranteed Securities with an amortized cost of \$104.9 million, a fair value of \$104.2 million and a weighted average yield of 5.77 percent. As of December 31, 2011, the Company owned trading USDA Guaranteed Securities with an amortized cost of \$213.1 million, a fair value of \$212.4 million and a weighted average yield of 5.83 percent.

## 6. Fair Value Disclosures

The following tables present information about the Company's securities measured at fair value on a recurring basis.

Level 3 Assets Measured at Fair Value for the Year Ended December 31, 2012

	Beginning Balance	Purchases	Settlements	Unrealized Gains included in Income	Unrealized Losses included in Other Comprehensive Income	Ending Balance
<i>(in thousands)</i>						
Recurring:						
Assets:						
Farmer Mac Guaranteed Securities:						
Available-for-sale	\$ 34,890	\$ -	\$ (8,834)	\$ -	\$ (20)	\$ 26,036
Total Farmer Mac Guaranteed Securities	34,890	-	(8,834)	-	(20)	26,036
USDA Guaranteed Securities:						
Available-for-sale	1,279,546	479,324	(256,685)	-	(15,590)	1,486,595
Trading (1)	212,359	-	(108,215)	44	-	104,188
Total USDA Guaranteed Securities	1,491,905	479,324	(364,900)	44	(15,590)	1,590,783
Total Assets at fair value	\$ 1,526,795	\$ 479,324	\$ (373,734)	\$ 44	\$ (15,610)	\$ 1,616,819

(1) Includes unrealized gains of \$0.3 million attributable to assets still held as of December 31, 2012 that are recorded in Gains/(losses) on trading assets.

Level 3 Assets Measured at Fair Value for the Year Ended December 31, 2011

	Beginning Balance	Purchases	Settlements	Unrealized Gains included in Income	Unrealized Gains included in Other Comprehensive Income	Ending Balance
<i>(in thousands)</i>						
Recurring:						
Assets:						
Farmer Mac Guaranteed Securities:						
Available-for-sale	\$ 36,117	\$ -	\$ (3,481)	\$ -	\$ 2,254	\$ 34,890
Total Farmer Mac Guaranteed Securities	36,117	-	(3,481)	-	2,254	34,890
USDA Guaranteed Securities:						
Available-for-sale	1,005,679	404,836	(172,785)	-	41,816	1,279,546
Trading (1)	311,765	-	(102,525)	3,119	-	212,359
Total USDA Guaranteed Securities	1,317,444	404,836	(275,310)	3,119	41,816	1,491,905
Total Assets at fair value	\$ 1,353,561	\$ 404,836	\$ (278,791)	\$ 3,119	\$ 44,070	\$ 1,526,795

(1) Includes unrealized losses of \$1.8 million attributable to assets still held as of December 31, 2011 that are recorded in Gains/(losses) on trading assets.

Level 3 Assets Measured at Fair Value for the Year Ended December 31, 2010

	Beginning Balance	Net Transfers In	Purchases and Settlements, net	Unrealized Losses included in Income	Unrealized Losses included in Other Comprehensive Income/(loss)	Ending Balance
<i>(in thousands)</i>						
Recurring:						
Assets:						
Farmer Mac Guaranteed Securities:						
Available-for-sale	\$ -	\$ 37,630	\$ (183)	\$ -	\$ (1,330)	\$ 36,117
Total Farmer Mac Guaranteed Securities	-	37,630	(183)	-	(1,330)	36,117
USDA Guaranteed Securities:						
Available-for-sale	-	756,113	256,355	-	(6,789)	1,005,679
Trading (1)	-	421,279	(105,624)	(3,890)	-	311,765
Total USDA Guaranteed Securities	-	1,177,392	150,731	(3,890)	(6,789)	1,317,444
Total Assets at fair value	\$ -	\$ 1,215,022	\$ 150,548	\$ (3,890)	\$ (8,119)	\$ 1,353,561

(1) Unrealized losses are attributable to assets still held as of December 31, 2010 and are recorded in Gains/(losses) on trading assets.

The following table presents additional information about the significant unobservable inputs used in the fair value measurements categorized in level 3 of the fair value hierarchy:

Financial Instruments	Fair Value as of December 31, 2012 <i>(in thousands)</i>	Valuation Technique	Unobservable Inputs	Range (Weighted-Average)
Farmer Mac Guaranteed Securities	\$ 26,036	Discounted cash flow	Discount rate Constant prepayment rate	1.0% - 2.7% (2.0%) 8% - 17% (15%)
USDA Guaranteed Securities	1,590,783	Discounted cash flow	Discount rate Constant prepayment rate	1.4% - 5.3% (3.4%) 0% - 26% (10%)

The significant unobservable inputs used in the fair value measurements of USDA and Farmer Mac Guaranteed Securities are prepayment rates and discount rates commensurate with the risks involved. Typically, significant increases (decreases) in any of these inputs in isolation may result in materially lower (higher) fair value measurements. Generally, in a rising interest rate environment, Farmer Mac would expect average discount rates to increase and would likely expect a corresponding decrease in forecasted prepayment rates. Conversely, in a declining interest rate environment, Farmer Mac would expect average discount rates to decrease and would likely expect a corresponding increase in forecasted prepayment rates.

The following table sets forth the estimated fair values and the carrying amounts for financial assets and liabilities as of December 31, 2012 and 2011:

	December 31, 2012		December 31, 2011	
	Fair Value	Carrying Amount	Fair Value	Carrying Amount
	<i>(in thousands)</i>			
Financial assets:				
Cash and cash equivalents	\$ 22,610	\$ 22,610	\$ 1,267	\$ 1,267
Farmer Mac Guaranteed Securities	26,036	26,036	34,890	34,890
USDA Guaranteed Securities	1,590,783	1,590,783	1,491,905	1,491,905
Financial liabilities:				
Intercompany Borrowings	328,000	328,000	218,000	218,000

The carrying amount of cash and cash equivalents is a reasonable estimate of their approximate fair value and is categorized as level 1 in the fair value hierarchy. The Company believes that the carrying amount of the intercompany borrowings also is a reasonable estimate of their approximate fair value due to their thirty day maturity. This line item is categorized as level 2 within the fair value hierarchy.



## 7. Members' Equity

As of December 31, 2012 and 2011, there were 250,000 shares of preferred stock issued and outstanding. The preferred stock is non-cumulative perpetual preferred stock. The dividend rate is 8.875% per annum up to but excluding the payment in first quarter 2015, adjusts at that time to 10.875% up to but excluding the payment in first quarter 2020, then adjusts to its perpetual rate of three-month LIBOR plus 8.211%.

The following table presents the dividends declared on the preferred stock during 2012 and the first quarter of 2013:

<u>Date Dividend Declared</u>	<u>Per Share Amount</u>	<u>For Period Beginning</u>	<u>For Period Ending</u>	<u>Date Paid</u>
February 2, 2012	\$ 22.1875	December 30, 2011	March 29, 2012	March 30, 2012
June 7, 2012	22.1875	March 30, 2012	June 29, 2012	June 30, 2012
August 3, 2012	22.1875	June 30, 2012	September 29, 2012	October 1, 2012
December 6, 2012	22.1875	September 30, 2012	December 29, 2012	December 31, 2012
February 6, 2013	22.1875	December 30, 2012	March 29, 2013	*

\* The dividend declared on February 6, 2013 is scheduled to be paid on April 1, 2013.

The holders of the preferred stock generally have no voting rights; however, under certain circumstances, including non-payment of dividends for four quarterly periods, the holders of the preferred stock are entitled to elect a total of two of the five directors of Farmer Mac II LLC. There was \$1.0 billion of no-par value common stock outstanding as of December 31, 2012 and 2011. To date, no common stock dividends have been declared.



## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

This discussion and analysis of financial condition and results of operations should be read together with the financial statements and related notes to the financial statements that appear elsewhere in this report. The discussion below is not necessarily indicative of future results.

### **OVERVIEW**

In January 2010, Farmer Mac II LLC initiated operations upon the issuance of its preferred stock and common stock to Farmer Mac as consideration for the contribution by Farmer Mac to Farmer Mac II LLC of substantially all of the assets, totaling \$1.3 billion, comprising the Farmer Mac II program business. Through its Farmer Mac II program, Farmer Mac II LLC purchases USDA-guaranteed portions of farm ownership loans, farm operating loans, business and industry loans, community facilities loans and other portions of loans that are fully guaranteed as to principal and interest by the USDA ("USDA Guaranteed Securities"). Farmer Mac II LLC also holds USDA Guaranteed Securities that have Farmer Mac's guarantee of timely payment of principal and interest in addition to the USDA guarantee ("Farmer Mac Guaranteed Securities"). During 2012, the Company purchased \$479.3 million of USDA Guaranteed Securities, compared to \$404.8 million during 2011. As of December 31, 2012, the Farmer Mac II LLC portfolio consisted of \$26.0 million in Farmer Mac Guaranteed Securities and \$1.6 billion of USDA Guaranteed Securities, compared to \$34.9 million and \$1.5 billion, respectively, as of December 31, 2011.

### **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The preparation of Farmer Mac II LLC's financial statements in accordance with GAAP requires the use of estimates and assumptions that affect the amounts reported in the financial statements and related notes for the periods presented. Actual results could differ from those estimates. The critical accounting policy that is both important to the portrayal of Farmer Mac II LLC's financial condition and results of operations and requires complex, subjective judgments is the accounting policy for fair value measurement. For a discussion of Farmer Mac II LLC's accounting policy on fair value measurement, see Note 4 to the financial statements.

### **RESULTS OF OPERATIONS**

Net interest income was \$38.5 million for the year ended December 31, 2012, compared to \$42.6 million for 2011 and \$39.3 million for 2010. As of December 31, 2012, Farmer Mac II LLC had outstanding borrowings of \$328.0 million under the uncommitted Farmer Mac borrowing facility, compared to \$218.0 million as of December 31, 2011. Interest expense for the year ended December 31, 2012 was \$9.0 million, compared to \$5.5 million and \$2.1 million for the years ended December 31, 2011 and 2010, respectively.

Non-interest income was \$0.6 million for the year ended December 31, 2012, compared to \$3.4 million for the year ended December 31, 2011, and losses of \$3.9 million for the year ended

December 31, 2010. The fluctuations in non-interest income for these periods were primarily due to changes in the fair value of USDA Guaranteed Securities classified as trading.

Non-interest expense was \$1.0 million for the year ended December 31, 2012, compared to \$0.9 million and \$1.2 million for the same periods in 2011 and 2010, respectively. This expense primarily related to legal fees, independent accountant fees and contract services provided by Farmer Mac under Secondment and Management and Administrative Services Agreements.

## **BALANCE SHEET ANALYSIS**

The primary assets related to the Farmer Mac II line of business are the USDA Guaranteed Securities and Farmer Mac Guaranteed Securities. During 2012, these assets increased by \$90.0 million due to the purchase of \$479.3 million of USDA Guaranteed Securities, partially offset by principal pay downs of \$364.4 million on USDA and Farmer Mac Guaranteed Securities, and net of adjustments for premium amortization and changes in fair value.

## **LIQUIDITY AND CAPITAL RESOURCES**

The funding and liquidity needs of the Farmer Mac II program business are driven by the purchase and retention of USDA Guaranteed Securities. The primary sources of funds to meet these needs are principal and interest payments received on those securities and net interest income earned from holding these securities on balance sheet. Farmer Mac II LLC also has access to a \$500.0 million uncommitted borrowing facility from Farmer Mac, against which the Company had \$328.0 million in outstanding borrowings as of December 31, 2012, compared to \$218.0 million as of December 31, 2011. Principal on loans under the facility is payable on the last business day of each calendar month but, with Farmer Mac approval, may be refinanced in whole or in part, on a month-by-month basis, provided that no event of default under the facility has occurred and is continuing. The interest rate on loans is Farmer Mac's estimated cost of funds plus a credit spread capped at 0.50 percent.

Farmer Mac II LLC had \$22.6 million in cash and cash equivalents as of December 31, 2012, compared to \$1.3 million as of December 31, 2011.

As of December 31, 2012 and 2011, Farmer Mac II LLC had members' equity of \$1.3 billion comprised primarily of \$241.9 million of preferred stock and \$1.0 billion of common stock.