Lone Star, ACA

2012 Annual Report

December 31, 2012

Part of the Farm Credit System

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Letter from the CEO

Dear Stockholder:

What a great year! I am honored to write this letter as your CEO and to announce all of the extraordinary things going on at Lone Star, ACA. Our team has worked extremely hard to form an exceptional association over the past several years. A better, brighter day arrived in 2012!

Lone Star, ACA is proud to announce that your board of directors approved to pay $7 million in a cash patronage dividend to our eligible members! This is three and a half times the amount of patronage compared to last year, and we thank you, our loyal stockholders. Returning earnings to our patrons has always been the core principle of your association. Since 2001, your association has returned more than $40 million in patronage and we look forward to growing in the future.

Our net income improved from $10.1 million in 2011 to $19.8 million in 2012, acceptable credit quality increased from 85.3 percent to 90.9 percent and our return on assets improved from 1.0 percent to 2.3 percent. By any measure, the financial performance of Lone Star, ACA improved dramatically in 2012. Your association is positioned to meet challenges now and in the future. We are well capitalized and possess a talented and devoted staff with a knowledgeable and committed board of directors. We are stronger today than ever before.

We are proud of the opportunities to serve our rural community for more than 90 years and to provide financing needs for you and your fellow stockholders. Lone Star, ACA offers a wide variety of loan programs at competitive rates including purchasing real estate, farm or ranch operating expenses, purchasing equipment, buying, refinancing or building a country home, purchasing recreational property or financing for an agribusiness.

We take pride in who we are and what we do. Please stop by and visit your local office or join us at one of our nine stockholder appreciation dinners throughout the year. We enjoy taking the time to talk face to face and value the relationships we have with you.

Sincerely,

Steve H. Fowlkes
Chief Executive Officer

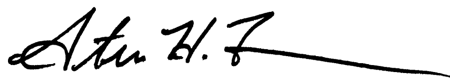
REPORT OF MANAGEMENT

The consolidated financial statements of Lone Star, ACA (association) are prepared by management, who is responsible for the statements' 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 appropriate in the circumstances. Other financial information included in the annual report is consistent with that in the consolidated financial statements.

To meet its responsibility for reliable financial information, management depends on the Farm Credit Bank of Texas' and the association's 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 of controls must be related to the benefits derived. The consolidated financial statements are audited by PricewaterhouseCoopers LLP, independent accountants, who conduct a review of internal controls solely for the purpose of establishing a basis for reliance thereon in determining the nature, extent and timing of audit tests applied in the audit of the consolidated financial statements in accordance with auditing standards generally accepted in the United States of America. The association is also examined by the Farm Credit Administration.

The board of directors has overall responsibility for the association's systems of internal control and financial reporting. The board consults regularly with management and reviews the results of the audits and examinations referred to previously.

The undersigned certify that we have reviewed this annual report, that it 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 his or her knowledge or belief.

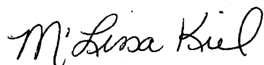


Steve Fowlkes, Chief Executive Officer

March 12, 2013

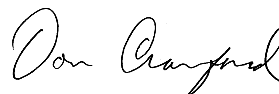
Bruce Duncan, Chairman, Board of Directors

March 12, 2013



M'Lissa Kiel, Chief Financial Officer

March 12, 2013



Don Crawford, Chairman, Audit Committee

March 12, 2013

REPORT OF AUDIT COMMITTEE

The Audit Committee (committee) is composed of four members from the board of directors of Lone Star, ACA. Don Crawford, CPA, serves as the chairman of the committee, and Bert Pruett, David Harris and Lonnie Hammonds are also members of the Audit Committee. In 2012, 12 committee meetings were held. The committee oversees the scope of Lone Star, ACA's system of internal controls and procedures, and the adequacy of management's action with respect to recommendations arising from those auditing activities. The committee's approved responsibilities are described more fully in the Audit Committee Charter, which is available on request or on Lone Star, ACA's website. The committee approved the appointment of PricewaterhouseCoopers LLP, independent auditors, to perform the outside audit for 2012.

Management is responsible for Lone Star, ACA's internal controls and the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. The consolidated financial statements are prepared under the oversight of the committee. PricewaterhouseCoopers LLP, is responsible for performing an independent audit of Lone Star, ACA's consolidated financial statements in accordance with auditing standards generally accepted in the United States of America and for issuing a report thereon. The committee's responsibilities include monitoring and overseeing the processes.

In this context, the committee reviewed and discussed Lone Star, ACA's audited consolidated financial statements for the year ended December 31, 2012 (audited consolidated financial statements) with management and PricewaterhouseCoopers LLP. The committee also reviews with PricewaterhouseCoopers LLP the matters required to be discussed by authoritative guidance "The Auditor's Communication With Those Charged With Governance," and both PricewaterhouseCoopers LLP and Lone Star, ACA's internal auditors directly provide reports on significant matters to the committee.

The committee discussed with PricewaterhouseCoopers LLP its independence from Lone Star, ACA. The committee also reviewed the nonaudit services provided by PricewaterhouseCoopers LLP and concluded that these services were not incompatible with maintaining the independent accountant's independence. The committee has discussed with management and PricewaterhouseCoopers LLP such other matters and received such assurances from them as the committee deemed appropriate.

Based on the foregoing review and discussions and relying thereon, the committee recommended that the board of directors include the audited consolidated financial statements in Lone Star, ACA's Annual Report to Stockholders for the year ended December 31, 2012.

Audit Committee Members

Don Crawford, CPA
David Harris
Lonnie Hammonds
Bert Pruett

March 12, 2013

LONE STAR, ACA

FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA
(unaudited)
(dollars in thousands)

	2012	2011	2010	2009	2008
Balance Sheet Data					
Assets					
Cash	**$ 77**	$ 64	$ 66	$ 47	$ 380
Investments	**-**	35,689	45,232	-	-
Loans	**831,335**	872,046	958,023	1,123,923	1,155,381
Less: allowance for loan losses	**(10,234)**	(12,463)	(19,068)	(7,387)	(917)
Net loans	**821,101**	859,583	938,955	1,116,536	1,154,464
Investment in and receivable from the Farm Credit Bank of Texas	**15,391**	17,628	20,427	23,255	21,327
Other property owned, net	**1,061**	5,487	9,472	11,567	92
Other assets	**7,064**	9,185	10,079	12,546	14,441
Total assets	**$ 844,694**	$ 927,636	$ 1,024,231	$ 1,163,951	$ 1,190,704
Liabilities					
Obligations with maturities of one year or less	**$ 11,460**	$ 6,034	$ 3,294	$ 5,844	$ 10,972
Obligations with maturities greater than one year	**644,820**	745,310	852,113	987,424	1,019,556
Total liabilities	**656,280**	751,344	855,407	993,268	1,030,528
Members' Equity					
Capital stock and participation certificates	**3,772**	4,043	4,417	4,725	4,752
Unallocated retained earnings	**185,513**	172,748	164,672	165,951	155,237
Accumulated other comprehensive income (loss)	**(871)**	(499)	(265)	7	187
Total members' equity	**188,414**	176,292	168,824	170,683	160,176
Total liabilities and members' equity	**$ 844,694**	$ 927,636	$ 1,024,231	$ 1,163,951	$ 1,190,704
Statement of Income Data					
Net interest income	**$ 26,439**	$ 28,032	$ 28,295	$ 32,320	$ 30,576
Provision for loan losses	**(666)**	(5,669)	(21,871)	(14,856)	(1,342)
Income from the Farm Credit Bank of Texas	**4,059**	3,863	5,214	4,789	3,736
Other noninterest income	**3,975**	909	2,024	2,176	3,422
Noninterest expense	**(13,995)**	(17,046)	(14,804)	(13,715)	(12,525)
Benefit from income taxes	**(48)**	(13)	(15)	-	-
Net income (loss)	**$ 19,764**	$ 10,076	$ (1,157)	$ 10,714	$ 23,867
Key Financial Ratios for the Year					
Return on average assets	**2.3%**	1.0%	-0.1%	0.9%	2.1%
Return on average members' equity	**10.5%**	5.8%	-0.7%	6.3%	15.5%
Net interest income as a percentage of average earning assets	**3.1%**	2.9%	2.7%	2.8%	2.8%
Net charge-offs (recoveries) as a percentage of average loans	**0.3%**	1.3%	1.0%	0.7%	0.1%

LONE STAR, ACA

FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA
(unaudited)
(dollars in thousands)

	2012	2011	2010	2009	2008
Key Financial Ratios at Year End					
Members' equity as a percentage of total assets	**22.3%**	19.0%	16.5%	14.7%	13.5%
Debt as a percentage of members' equity	**348.3%**	426.2%	506.7%	581.9%	643.4%
Allowance for loan losses as a percentage of loans	**1.2%**	1.4%	2.0%	0.7%	0.1%
Permanent capital ratio	**20.7%**	17.3%	15.2%	13.4%	13.2%
Core surplus ratio	**20.2%**	16.9%	14.7%	13.0%	12.8%
Total surplus ratio	**20.2%**	16.9%	14.7%	13.0%	12.8%
Net Income Distribution					
Cash dividends paid	**$ 2,000**	$ -	$ 122	$ 5,430	$ 5,000

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

The following commentary explains management's assessment of the principal aspects of the consolidated financial condition and results of operations of Lone Star, ACA, including its wholly-owned subsidiaries, Lone Star, PCA and Lone Star, FLCA (association) for the years ended December 31, 2012, 2011 and 2010, and should be read in conjunction with the accompanying consolidated financial statements. The accompanying financial statements were prepared under the oversight of the association's audit committee.

Forward-Looking Information:

This annual information statement contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Words such as "anticipates," "believes," "could," "estimates," "may," "should," "will" or other variations of these terms are intended to identify the forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions and expected future developments. However, actual results and developments may differ materially from our expectations and predictions due to a number of risks and uncertainties, many of which are beyond our control. These risks and uncertainties include, but are not limited to:

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international and farm-related business sectors;
- weather-related, disease-related and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry; and
- actions taken by the Federal Reserve System in implementing monetary policy.

Significant Events:

Effective February 27, 2013, the Association entered into a Letter of Intent in order to memorialize its intent to pursue a mutually beneficial merger transaction with Texas Land Bank, ACA, pending completion of due diligence of each other's operations. This is the first step in a process for developing definitive terms and conditions for a plan of merger. The proposed effective date for merger is January 1, 2014, or as soon as practicable thereafter. Additional disclosures will be provided to stockholders during 2013 under timelines dictated by Farm Credit regulations.

In December 2012, the Lone Star, ACA board declared a $7,000,000 cash patronage to be paid in April of 2013, based on 2012 earnings. The association's capital position continued to improve and is above 20 percent for the year ending December 2012.

In December 2012, the association received a direct loan patronage of $2,883,552 from the bank, representing 43 basis points on the average daily balance of the association's direct loan with the bank. During 2012, the association received $803,813 representing income that would have been earned based on the AMBS investment discussed in Note 3 to the consolidated financial statements, Investment Securities, included in this annual report. The association also received $312,536 in patronage payments from the bank, based on the association's stock investment in the bank. Also, the association received a capital markets patronage of $58,788 from the bank, representing 65 basis points on the association's average balance of participations in the bank's patronage pool program.

The Farm Credit System Insurance Corporation Board approved the refund of over $220 million to the holders of Allocated Insurance Reserve Accounts (AIRAs). That amount represents the excess in the insurance fund over the 2% secure base amount, after making adjustments for FCSIC's 2012 budgeted operating expenses (approximately $4 million) and its estimate for losses in the fund (zero $). In May, Lone Star received $1,001,628 of this refund. This is considered a nonrecurring event and the association does not anticipate receiving additional refunds in the future.

For over 95 years, the association has continued to provide its members with quality financial services. The board of directors and management remain committed to maintaining the financial integrity of the association while offering competitive loan products that meet the financial needs of agricultural producers.

Loan Portfolio:

The association makes and services loans to farmers, ranchers, rural homeowners and certain farm-related businesses. The association's core loan volume consists of long-term farm mortgage loans, production and intermediate-term loans, and farm-related business loans. These loan products are available to eligible borrowers with competitive variable, fixed and adjustable interest rates. Loan maturities range from one to 40 years, with annual operating loans comprising the majority of the commercial loans and 15- to 20-year maturities comprising the majority of the mortgage loans. Loans serviced by the association offer several installment payment cycles, the timing of which usually coincides with the seasonal cash-flow capabilities of the borrower.

The composition of the association's loan portfolio, including principal less funds held of $831,334,481, $872,045,989 and $958,022,787 as of December 31, 2012, 2011 and 2010, respectively, is described more fully in detailed tables in Note 4 to the consolidated financial statements, "Loans and Allowance for Loan Losses," included in this annual report.

The loan portfolio decrease between December 31, 2011 and December 31, 2012 of $40,711,508 or 4.7 percent is attributed to normal amortization of loan assets and collection of adverse loans combined with decreased demand for real estate transactions during 2012 and tightened underwriting standards and practices. Although economic conditions remain uncertain the association anticipates slight growth in loan volume during 2013.

Purchase and Sales of Loans:

During 2012, 2011 and 2010, the association was participating in loans with other lenders. As of December 31, 2012, 2011 and 2010, these participations totaled $125,599,389, $92,377,919 and $53,358,687, or 15.1 percent, 10.6 percent and 5.6 percent of loans, respectively. The association had no participation with entities outside the district for the years ended 2012, 2011 and 2010. The association has also sold participations of $13,474,394, $16,450,296 and $14,031,256 as of December 31, 2012, 2011 and 2010, respectively.

Effective January 26, 2012 the Farm Credit Bank of Texas (the bank) purchased Lone Star's securitized Farmer Mac Agricultural Mortgage Backed Securities (AMBS) investments. The purchase of $35,459,508 included outstanding principal and accrued interest as of that date. There was no gain or loss recognized by the association on this transaction. The association will continue to service the underlying loans that were included in this security. Also, there should be no effect to Lone Star's income based on this transaction as it is expected that the bank will be able to pay the association a patronage equivalent to the net interest that would have been earned on the AMBS investment. However, the bank's payment of patronage is at the discretion of the bank's board of directors.

Risk Exposure:

High-risk assets include nonaccrual loans, loans that are past due 90 days or more and still accruing interest, formally restructured loans, and other property owned, net. The following table illustrates the association's components and trends of high-risk assets serviced (including related accrued interest) for the prior three years as of December 31:

	2012		2011		2010	
	Amount	**%**	Amount	%	Amount	%
Nonaccrual	**$ 24,276,925**	**95.5%**	$ 59,597,315	91.6%	$ 90,870,374	90.6%
90 days past due and still accruing interest	**-**	**0.0%**	11,113	0.0%	-	0.0%
Formally restructured	**67,657**	**0.3%**	-	0.0%	-	0.0%
Other property owned, net	**1,060,973**	**4.2%**	5,487,529	8.4%	9,471,968	9.4%
Total	**$ 25,405,555**	**100.0%**	$ 65,095,957	100.0%	$ 100,342,342	100.0%

At December 31, 2012, 2011 and 2010, loans that were considered impaired were $24,344,582, $59,608,428 and $90,870,374, representing 2.9 percent, 6.8 percent and 9.5 percent of loan volume, respectively. Impaired loans consist of all high-risk assets except other property owned, net.

The association experienced a $35,320,390 decrease in nonaccrual loan volume during 2012 for total outstanding volume of $24,276,925 as of December 31, 2012. Of the $24,276,925, dairy loans comprised $10,310,221, general livestock comprised $7,056,858 and general farms comprised $1,985,951, with the remaining balance of nonaccrual volume being comprised by other various commodities.

Except for the relationship between installment due date and seasonal cash-flow capabilities of the borrower, the association is not affected by any seasonal characteristics. The factors affecting the operations of the association are the same factors that would affect any agricultural real estate lender.

Allowance for Loan Losses:

The following table provides relevant information regarding the allowance for loan losses as of, or for the year ended, December 31:

	2012	2011	2010
Allowance for loan losses	**$ 10,233,598**	$ 12,463,151	$ 19,067,611
Provision for loan losses	**665,992**	5,669,112	21,871,350
Loans charged off	**(3,915,121)**	(12,380,211)	(10,635,878)
Recoveries	**1,019,576**	106,639	445,646
Allowance for loan losses to total loans	**1.2%**	1.4%	2.0%
Allowance for loan losses to nonaccrual loans	**42.2%**	20.9%	21.0%
Allowance for loan losses to impaired loans	**42.0%**	20.9%	21.0%
Net charge-offs to average loans	**0.3%**	1.3%	1.0%

The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition, collateral value, portfolio quality, current production conditions and economic conditions, and prior loan loss experience.

Based upon ongoing risk assessment and the allowance for loan losses procedures outlined above, the allowance for loan losses of $10,233,598, $12,463,151 and $19,067,611 at December 31, 2012, 2011 and 2010, respectively, is considered adequate by management to compensate for inherent losses in the loan portfolio at such dates. Management's process for the evaluation of allowance for loan losses includes a portfolio analysis, peer comparison with similar Farm Credit institutions and similar commercial banks, and historical loss experience. In addition, during 2012 management implemented an additional allowance pool to address the need for additional allowance for under-secured loans, should they deteriorate, and ultimately require a specific allowance. In view of portfolio analysis, historical trends, projected needs, and the implementation of the additional allowance pool, management believes that the allowance is adequate.

Results of Operations:

The association's net income for the year ended December 31, 2012, was $19,764,483 as compared to $10,076,234 for the year ended December 31, 2011, reflecting an increase of $9,688,249, or 96.2 percent. The association's net loss for the year ended December 31, 2010 was $1,156,606. Net income reflected an absolute increase of $11,232,840, or 971.2 percent, in 2011 versus 2010.

Net interest income for 2012, 2011 and 2010 was $26,439,176, $28,031,961 and $28,295,149, respectively, reflecting decreases of $1,592,785, or 5.7 percent, for 2012 versus 2011 and $263,188, or 0.9 percent, for 2011 versus 2010. Net interest income is the principal source of earnings for the association and is impacted by volume, yields on assets and cost of debt. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following tables:

	2012		2011		2010	
	Average Balance	**Interest**	Average Balance	Interest	Average Balance	Interest
Loans	**$ 843,602,912**	**$ 40,144,277**	$ 913,882,657	$ 46,549,195	$ 1,018,509,560	$ 52,167,261
Investments	**2,421,791**	**211,055**	41,091,250	2,168,367	41,791,644	2,315,894
Total interest-earning assets	**846,024,703**	**40,355,332**	954,973,907	48,717,562	1,060,301,204	54,483,155
Interest-bearing liabilities	**671,237,817**	**13,916,156**	797,698,646	20,685,601	915,964,536	26,188,006
Impact of capital	**$ 174,786,886**		$ 157,275,261		$ 144,336,668	
Net interest income		**$ 26,439,176**		$ 28,031,961		$ 28,295,149

	2012 Average Yield	2011 Average Yield	2010 Average Yield
Yield on loans	**4.76%**	5.09%	5.12%
Yield on investments	**8.71%**	5.28%	5.54%
Total yield on interest-earning assets	**4.77%**	5.10%	5.14%
Cost of interest-bearing liabilities	**2.07%**	2.59%	2.86%
Interest rate spread	**2.70%**	2.51%	2.28%
Net interest income as a percentage of average earning assets	**3.13%**	2.94%	2.67%

	2012 vs. 2011			2011 vs. 2010		
	Increase (decrease) due to			Increase (decrease) due to		
	Volume	**Rate**	**Total**	Volume	Rate	Total
Interest income - loans	**$ (3,579,769)**	**$ (2,825,149)**	**$ (6,404,918)**	$ (5,358,885)	$ (259,181)	$ (5,618,066)
Interest income - investments	**(2,040,587)**	**83,275**	**(1,957,312)**	(38,812)	(108,715)	(147,527)
Total interest income	**(5,620,356)**	**(2,741,874)**	**(8,362,230)**	(5,397,697)	(367,896)	(5,765,593)
Interest expense	**(3,279,382)**	**(3,490,063)**	**(6,769,445)**	(3,381,340)	(2,121,065)	(5,502,405)
Net interest income	**$ (2,340,974)**	**$ 748,189**	**$ (1,592,785)**	$ (2,016,357)	$ 1,753,169	$ (263,188)

Interest income for 2012 decreased by $8,362,230, or 17.2 percent, compared to 2011, with a majority of the decrease due to a decrease in average accruing loan volume. Interest expense for 2012 decreased by $6,769,445, or 32.7 percent, compared to 2011 due to a decrease in both the average interest-bearing liabilities and the average rate. The interest rate spread increased by 19 basis points to 2.70 percent in 2012 from 2.51 percent in 2011, primarily because the association's rate of borrowing from its lender was very favorable in 2012 relative to prior years, giving it the ability to capitalize on the interest rate environment and increase spreads on loans. Also contributing to this increase is the decline in non-earning assets, which acts as a drag on the association's interest rate spread. The association offers a number of different interest rate programs including fixed rate products lasting for a set period up to the term of a loan, products indexed to prime or LIBOR, and a variety of adjustable interest rate products. The association's control over interest rate margins resides in its ability to add a spread over cost of funds, the goal of which is to achieve an acceptable level of revenue to fund operations and generate a return for shareholders. Net interest margin for year end 2012 was 3.13, versus 2.94 for the same period in 2011. This can be attributed to the aforementioned increase in net interest spread, coupled with increasing association capital levels that drive down the need to borrow monies to fund loans and therefore increase interest income. In 2010, the association implemented authoritative accounting guidance that requires loan origination fees and costs to be capitalized and amortized over the life of the loans as an adjustment to yield. The resulting adjustment to loan yield for 2010 was a decrease of $96,962. The interest rate spread increased by 23 basis points to 2.51 percent in 2011 from 2.28 percent in 2010, primarily for the same reasons the interest rate spread increased in 2012.

Noninterest income for 2012 increased by $3,262,744, or 68.4 percent, compared to 2011, due primarily to an increase in gains on other property owned and an increase in other noninterest income which included a $1,001,628 refund from the Farm Credit System Insurance Corporation (FCSIC or Insurance Fund). The distributions from the FCSIC included reserves it held in excess of its secure base amount in 2003 which had been previously allocated to its Allocated Insurance Reserves Accounts, and also included reserves in excess of its secure base amount in 2009 which were likewise allocated. The 2008 Farm Bill amended the Farm Credit Act and simplified the formula for payments from the Allocated Insurance Reserves Accounts to allow more immediate distribution of excess Insurance Fund balances to System banks. Authoritative accounting guidance requiring the capitalization and amortization of loan origination fees and costs was implemented during 2010 for loans closed in 2010, resulting in the capitalization of $551,008, $763,575 and $959,896 for 2012, 2011 and 2010 respectively, in origination fees, which will be amortized over the life of the loans as an adjustment to yield in net interest income. Noninterest income for 2011 decreased by $2,466,327, or 34.1 percent, compared to 2010, due primarily to a decrease in patronage income received from the bank and a decrease in other income which included a refund from FCSIC in 2010. The $2,466,327 decrease in noninterest income included

$1,151,797 in refund distributions of excess reserves from prior years from the Farm Credit System Insurance Corporation (FCSIC or Insurance Fund).

Provisions for loan losses decreased by $5,003,120, or 88.3 percent, compared to 2011, due primarily to fewer loans being identified with the need for specific allowances.

Operating expenses consist primarily of salaries, employee benefits, purchased services and provision for acquired property losses. Expenses for purchased services may include administrative services, marketing, accounting and loan processing, audit and credit review fees, and legal fees, among others. Net operating expense for 2012, 2011 and 2010 was $13,995,492, $17,045,487 and $14,804,015, respectively, reflecting a decrease of $3,049,995 or 17.9 percent for 2012 and an increase of $2,241,472 or 15.1 percent for 2011. The decrease in operating expenses for 2012 was driven primarily by a $4,049,538 decrease in acquired property provisions. The decrease in operating expenses was slightly offset by a $1,207,533 increase in salaries and benefits which was the result of the implementation of an incentive payment by the association in 2012. Authoritative accounting guidance requiring the capitalization and amortization of loan origination fees and costs resulted in the capitalization of $932,752, $876,905 and $862,934 for 2012, 2011 and 2010, respectively, in origination costs, which will be amortized over the life of the loans as an adjustment to yield in net interest income. The capitalized costs consisted of salaries and benefits totaling $932,752 related to the origination of loans in 2012.

For the year ended December 31, 2012, the association's return on average assets was 2.3 percent, as compared to 1.0 percent and -0.1 percent for the years ended December 31, 2011 and 2010, respectively. For the year ended December 31, 2012, the association's return on average members' equity was 10.5 percent, as compared to 5.8 percent and -0.7 percent for the years ended December 31, 2011 and 2010, respectively. The association experienced an increase in return on average assets and return on average member's equity due to the increase in net income and decrease in average loan volume compared to 2011.

Because the association depends on the bank for funding, any significant positive or negative factors affecting the operations of the bank would have a similar effect on the operations of the association.

Liquidity and Funding Sources:

The interest rate risk inherent in the association's loan portfolio is substantially mitigated through the funding relationship with the bank. The bank manages interest rate risk through its direct loan pricing and asset/liability management process.

The association operates under a general financing agreement (GFA) with the bank. The current GFA is effective through September 30, 2015. The primary source of liquidity and funding for the association is a direct loan from the bank. The outstanding balance of $643,933,881, $743,775,358 and $850,095,961 as of December 31, 2012, 2011 and 2010, respectively, is recorded as a liability on the association's balance sheet. The note carried a weighted average interest rate of 1.86 percent, 2.38 percent and 2.74 percent at December 31, 2012, 2011 and 2010, respectively. The indebtedness is collateralized by a pledge of substantially all of the association's assets to the bank and is governed by a general financing agreement. The decrease in note payable to the bank and related accrued interest payable since December 31, 2011, is due to the association's decrease in average earning assets. The association's own funds, which represent the amount of the association's loan portfolio funded by the association's equity, were $187,566,837, $165,747,475 and $153,386,700 at December 31, 2012, 2011 and 2010, respectively. The maximum amount the association may borrow from the bank as of December 31, 2012, was $813,879,592 as defined by the general financing agreement. The indebtedness continues in effect until the expiration date of the general financing agreement, which is September 30, 2015, unless sooner terminated by the bank upon the occurrence of an event of default, or by the association, in the event of a breach of this agreement by the bank, upon giving the bank 30 calendar days prior written notice, or in all other circumstances, upon giving the bank 120 days prior written notice.

The liquidity policy of the association is to manage cash balances to maximize debt reduction and to increase accrual loan volume. This policy will continue to be pursued during 2013. As borrower payments are received, they are applied to the association's note payable to the bank.

The association will continue to fund its operations through direct borrowings from the bank, capital surplus from prior years and borrower stock. It is management's opinion that funds available to the association are sufficient to fund its operations for the coming year.

Capital Resources:

The association's capital position remains strong, with total members' equity of $188,414,171, $176,292,864 and $168,824,267 at December 31, 2012, 2011 and 2010, respectively. Under regulations governing minimum permanent capital adequacy and other capitalization issues, the association is required to maintain a minimum adjusted permanent capital of 7.0 percent of risk-adjusted

assets as defined by the FCA. The permanent capital ratio measures available at-risk capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the institution's financial capacity to absorb potential losses beyond that provided in the allowance for loan losses accounts. The association's permanent capital ratio at December 31, 2012, 2011 and 2010 was 20.7 percent, 17.3 percent and 15.2 percent, respectively.

The core surplus ratio measures available core surplus capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the quality of capital that exists to maintain stable earnings and financial strength. The association's core surplus ratio at December 31, 2012, 2011 and 2010 was 20.2 percent, 16.9 percent and 14.7 percent, respectively, which is in compliance with the FCA's minimum ratio requirement of 3.5 percent. The total surplus ratio measures available surplus capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the reserves existing to protect borrowers' investments in the association. The association's total surplus ratio at December 31, 2012, 2011 and 2010 was 20.2 percent, 16.9 percent and 14.7 percent, respectively, which is in compliance with the FCA's minimum ratio requirement of 7.0 percent.

In 2012, 2011 and 2010, the association paid patronage of $2,000,000, $0 and $121,801, respectively. In December 2012, the board of directors approved a $7,000,000 patronage distribution to be paid in April 2013. As a result of deterioration in the loan portfolio and the impact on 2010 financial results, the association did not pay patronage in 2011 based on 2010 earnings. The $121,801 patronage distribution that was paid in 2010 was due to an erroneously omitted patronage payment in 2009. See Note 10 to the consolidated financial statements, "Members' Equity," included in this annual report, for further information.

Relationship With the Bank:

The association operates under a general financing agreement (GFA) with the bank. The current GFA is effective through September 30, 2015.

The association's statutory obligation to borrow only from the bank is discussed in Note 9 to the consolidated financial statements, "Note Payable to the Bank," included in this annual report.

The bank's ability to access capital of the association is discussed in Note 2 to the consolidated financial statements, "Summary of Significant Accounting Policies," included in this annual report, within the section "Capital Stock Investment in the Bank."

The bank's role in mitigating the association's exposure to interest rate risk is described in the section "Liquidity and Funding Sources" of Management's Discussion and Analysis and in Note 9 to the consolidated financial statements, "Note Payable to the Bank," included in this annual report.

The bank provides computer systems to support the critical operations of all district associations. In addition, each association has operating systems and facility-based systems that are not supported by the bank. As disclosed in Note 13 to the consolidated financial statements, "Related Party Transactions," included in this annual report, the bank provides many services that the association can utilize, such as administrative, marketing, information systems and accounting services. Additionally, the bank bills district expenses to the associations, such as the Farm Credit System Insurance Corporation insurance premiums. As of April 2011, the bank only bills associations for direct pass-through expenses and no longer bills for allocated expenses.

Summary:

Over the past 95 years, regardless of the state of the agricultural economy, your association's board of directors and management, as well as the board of directors and management of the bank, have been committed to offering their borrowers a ready source of financing at a competitive price. Your continued support will be critical to the success of this association.

Independent Auditor's Report

To the Board of Directors and Members of
Lone Star, ACA:

We have audited the accompanying consolidated financial statements of Lone Star, ACA and its subsidiaries (the Association), which comprise the consolidated balance sheets as of December 31, 2012, 2011 and 2010, and the related consolidated statements of comprehensive income, of changes in members' equity and of cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Association's preparation and fair presentation of the consolidated 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 Association'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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Lone Star, ACA and its subsidiaries at December 31, 2012, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

March 12, 2013

PricewaterhouseCoopers LLP, 300 West 6th Street, Suite 1800, Austin, Texas 78701
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LONE STAR, ACA

CONSOLIDATED BALANCE SHEETS

	December 31,		
	2012	2011	2010
Assets			
Cash	**$ 77,431**	$ 63,794	$ 66,243
Investments	**-**	35,688,875	45,231,568
Loans	**831,334,481**	872,045,989	958,022,787
Less: allowance for loan losses	**(10,233,598)**	(12,463,151)	(19,067,611)
Net loans	**821,100,883**	859,582,838	938,955,176
Accrued interest receivable	**4,873,843**	7,088,527	8,159,279
Investment in and receivable from the Farm Credit Bank of Texas:			
Capital stock	**13,922,385**	16,129,205	18,570,550
Other	**1,468,168**	1,498,683	1,856,461
Other property owned, net	**1,060,973**	5,487,529	9,471,968
Premises and equipment	**1,615,834**	1,666,071	1,532,386
Other assets	**574,206**	430,069	387,341
Total assets	**$ 844,693,723**	$ 927,635,591	$ 1,024,230,972
Liabilities			
Note payable to the Farm Credit Bank of Texas	**$ 643,933,881**	$ 743,775,358	$ 850,095,961
Accrued interest payable	**1,036,026**	1,534,543	2,016,598
Drafts outstanding	**142,345**	44,532	23,786
Dividends payable	**7,000,000**	2,000,000	-
Other liabilities	**4,167,300**	3,988,294	3,270,360
Total liabilities	**656,279,552**	751,342,727	855,406,705
Members' Equity			
Capital stock and participation certificates	**3,772,180**	4,043,055	4,417,400
Unallocated retained earnings	**185,512,981**	172,748,498	164,672,264
Accumulated other comprehensive income (loss)	**(870,990)**	(498,689)	(265,397)
Total members' equity	**188,414,171**	176,292,864	168,824,267
Total liabilities and members' equity	**$ 844,693,723**	$ 927,635,591	$ 1,024,230,972

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

LONE STAR, ACA

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Year Ended December 31,		
	2012	2011	2010
Interest Income			
Loans	**$ 40,144,277**	$ 46,549,195	$ 52,167,261
Investments	**211,055**	2,168,367	2,315,894
Total interest income	**40,355,332**	48,717,562	54,483,155
Interest Expense			
Note payable to the Farm Credit Bank of Texas	**13,916,071**	20,685,577	26,187,974
Advance conditional payments	**85**	24	32
Total interest expense	**13,916,156**	20,685,601	26,188,006
Net interest income	**26,439,176**	28,031,961	28,295,149
Provision for Loan Losses	**665,992**	5,669,112	21,871,350
Net interest income after provision for losses	**25,773,184**	22,362,849	6,423,799
Noninterest Income			
Income from the Farm Credit Bank of Texas:			
Patronage income	**4,058,689**	3,862,745	5,214,086
Loan fees	**808,788**	330,369	979,920
Financially related services income (expense)	**(1,274)**	51,796	85,668
Gain (loss) on other property owned, net	**2,060,825**	340,326	(234,936)
Gain on sale of premises and equipment, net	**-**	122,400	1,025
Other noninterest income	**1,108,016**	64,664	1,192,864
Total noninterest income	**8,035,044**	4,772,300	7,238,627
Noninterest Expenses			
Salaries and employee benefits	**7,998,366**	6,790,833	5,333,985
Directors' expense	**345,297**	363,785	332,047
Purchased services	**908,446**	936,861	1,518,114
Travel	**682,396**	543,749	466,154
Occupancy and equipment	**680,849**	743,671	819,723
Communications	**172,067**	182,526	194,530
Advertising	**437,996**	217,660	311,289
Public and member relations	**471,183**	495,299	418,501
Supervisory and exam expense	**349,796**	417,305	394,982
Insurance Fund premiums	**509,116**	688,624	655,448
Provisions for acquired property losses	**1,133,902**	5,183,440	3,836,989
Other noninterest expense	**306,078**	481,734	522,253
Total noninterest expenses	**13,995,492**	17,045,487	14,804,015
Income before income taxes	**19,812,736**	10,089,662	(1,141,589)
Provision for income taxes	**48,253**	13,428	15,017
NET INCOME	**19,764,483**	10,076,234	(1,156,606)
Other comprehensive income:			
Change in postretirement benefit plans	**(372,301)**	(233,292)	(272,773)
Other comprehensive income, net of tax	**(372,301)**	(233,292)	(272,773)
COMPREHENSIVE INCOME	**$ 19,392,182**	$ 9,842,942	$ (1,429,379)

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

LONE STAR, ACA

CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

	Capital Stock/ Participation Certificates	Retained Earnings Unallocated	Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
Balance at December 31, 2009	$ 4,726,260	$ 165,950,671	$ 7,376	$ 170,684,307
Comprehensive income	-	(1,156,606)	(272,773)	(1,429,379)
Capital stock/participation certificates issued	397,195	-	-	397,195
Capital stock/participation certificates and allocated retained earnings retired	(706,055)	-	-	(706,055)
Patronage dividends:				
Declared	-	(121,801)	-	(121,801)
Balance at December 31, 2010	4,417,400	164,672,264	(265,397)	168,824,267
Comprehensive income	-	10,076,234	(233,292)	9,842,942
Capital stock/participation certificates issued	319,725	-	-	319,725
Capital stock/participation certificates and allocated retained earnings retired	(694,070)	-	-	(694,070)
Patronage dividends:				
Declared	-	(2,000,000)	-	(2,000,000)
Balance at December 31, 2011	4,043,055	172,748,498	(498,689)	176,292,864
Comprehensive income	-	19,764,483	(372,301)	19,392,182
Capital stock/participation certificates issued	384,170	-	-	384,170
Capital stock/participation certificates and allocated retained earnings retired	(655,045)	-	-	(655,045)
Patronage dividends:				
Declared	-	(7,000,000)	-	(7,000,000)
Balance at December 31, 2012	**$ 3,772,180**	**$ 185,512,981**	**$ (870,990)**	**$ 188,414,171**

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

LONE STAR, ACA

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2012	2011	2010
Cash flows from operating activities:			
Net income	**$ 19,764,483**	$ 10,076,234	$ (1,156,606)
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses or (loan loss reversal)	**665,992**	5,669,112	21,871,350
(Gain) loss on sale of other property owned, net	**(926,923)**	4,843,114	4,071,925
Depreciation and amortization	**555,368**	470,353	402,114
Gain on sale of premises and equipment, net	**-**	(122,400)	(1,025)
Decrease in accrued interest receivable	**2,214,684**	900,248	2,751,861
Decrease in other receivables from the Farm Credit Bank of Texas	**30,515**	357,778	755,233
(Increase) decrease in other assets	**(144,137)**	127,776	(426,707)
Decrease in accrued interest payable	**(498,517)**	(482,055)	(423,174)
(Decrease) increase in other liabilities	**(193,295)**	484,645	(2,699,929)
Net cash provided by operating activities	**21,468,170**	22,324,805	25,145,042
Cash flows from investing activities:			
Decrease in loans, net	**30,696,173**	66,068,007	105,652,573
Cash recoveries of loans previously charged off	**1,019,576**	106,639	445,646
Proceeds from redemption of investment in the Farm Credit Bank of Texas	**2,206,820**	2,441,345	2,072,755
Investment securities held-to-maturity			
Proceeds from sales, maturities, calls and prepayments	**35,688,875**	9,542,693	-
Purchases of premises and equipment	**(346,979)**	(552,851)	(273,736)
Proceeds from sales of premises and equipment	**(68,511)**	106,394	13,824
Proceeds from sales of other property owned	**11,364,052**	6,634,724	2,403,288
Net cash provided by investing activities	**80,560,006**	84,346,951	110,314,350

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

CONSOLIDATED STATEMENT OF CASH FLOWS

	Year Ended December 31,		
	2012	2011	2010
Cash flows from financing activities:			
Net repayment of note payable to the Farm Credit Bank of Texas	**(99,841,477)**	(106,320,603)	(134,888,097)
Increase (decrease) in drafts outstanding	**97,813**	20,746	(107,970)
Decrease in advance conditional payments	**-**	-	(13,836)
Issuance of capital stock and participation certificates	**384,170**	319,725	397,195
Retirement of capital stock and participation certificates	**(655,045)**	(694,070)	(706,055)
Cash dividends paid	**(2,000,000)**	-	(121,801)
Net cash used in financing activities	**(102,014,539)**	(106,674,202)	(135,440,564)
Net increase (decrease) in cash	**13,637**	(2,449)	18,828
Cash at the beginning of the year	**63,794**	66,243	47,415
Cash at the end of the year	**$ 77,431**	$ 63,794	$ 66,243
Supplemental schedule of noncash investing and financing activities:			
Financed sales of other property owned	**$ -**	$ -	$ 901,800
Loans exchanged for agricultural mortgage-backed securities	**-**	-	59,616,146
Loans transferred to other property owned	**6,010,573**	7,493,399	4,380,254
Loans charged off	**3,915,121**	12,380,211	10,635,878
Dividends declared	**-**	-	-
Patronage distributions declared	**7,000,000**	2,000,000	-
Supplemental cash information:			
Cash paid during the year for:			
Interest	**$ 14,414,673**	$ 21,167,656	$ 26,611,180

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

LONE STAR, ACA
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 — ORGANIZATION AND OPERATIONS:

A. Organization: Lone Star, ACA, including its wholly-owned subsidiaries, Lone Star, PCA and Lone Star, FLCA (collectively called "the association"), is a member-owned cooperative which provides credit and credit-related services to, or for the benefit of, eligible borrowers/stockholders for qualified agricultural purposes in the counties of Hood, Johnson, Somervell, Tarrant, Denton, Wise, Dallas, Bowie, Camp, Cass, Morris, Titus, Delta, Lamar, Red River, Cooke, Fannin, Grayson, Eastland, Erath, Palo Pinto, Parker, Shackelford, Stephens, Throckmorton, Young, Borden, Fisher, Kent, Mitchell, Nolan, Scurry and Taylor in the state of Texas.

   The association is a lending institution of the Farm Credit System (System), a nationwide system of cooperatively owned banks and associations that was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (Act). At December 31, 2012, the System consisted of three Farm Credit Banks (FCBs) and their affiliated associations, one Agricultural Credit Bank (ACB) and its affiliated associations, the Federal Farm Credit Banks Funding Corporation (Funding Corporation), and various service and other organizations.

   The Farm Credit Bank of Texas (bank) and its related associations are collectively referred to as the "district." The bank provides funding to all associations within the district and is responsible for supervising certain activities of the district associations. At December 31, 2012, the district consisted of the bank, one FLCA and 16 ACA parent companies, which have two wholly-owned subsidiaries, a FLCA and a PCA, operating in or servicing the states of Alabama, Louisiana, Mississippi, New Mexico and Texas. ACA parent companies provide financing and related services through their FLCA and PCA subsidiaries. The FLCA makes secured long-term agricultural real estate and rural home mortgage loans. The PCA makes short- and intermediate-term loans for agricultural production or operating purposes.

   The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System banks and associations. The FCA examines the activities of System associations to ensure their compliance with the Farm Credit Act, FCA regulations, and safe and sound banking practices.

   The Act established the Farm Credit System Insurance Corporation (FCSIC) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations, (2) to ensure the retirement of protected borrower capital at par or stated value and (3) for other specified purposes. The Insurance Fund is also available for the discretionary uses by the FCSIC of providing assistance to certain troubled System institutions and to cover the operating expenses of the FCSIC. Each System bank has been required to pay premiums, which may be passed on to the association, into the Insurance Fund, based on its annual average adjusted outstanding insured debt until the monies in the Insurance Fund reach the "secure base amount," which is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments) or other such percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the FCSIC is required to reduce premiums as necessary to maintain the Insurance Fund at the 2 percent level. As required by the Farm Credit Act, as amended, the Insurance Corporation may return excess funds above the secure base amount to System institutions.

   FCA regulations require borrower information to be held in strict confidence by Farm Credit institutions, their directors, officers and employees. Directors and employees of the Farm Credit institutions are prohibited, except under specified circumstances, from disclosing nonpublic personal information about members.

B. Operations: The Act sets forth the types of authorized lending activity, persons eligible to borrow and financial services that can be offered by the association. The association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents and farm-related businesses. The association makes and services short- and intermediate-term loans for agricultural production or operating purposes, and secured long-term real estate mortgage loans, with funding from the bank.

   The association provides a service facilitating the origination of residential loans that are funded by other lenders as well as acting as an intermediary in offering credit life insurance.

The association's financial condition may be affected by factors that affect the bank. The financial condition and results of operations of the bank may materially affect stockholders' investments in the association. Upon request, stockholders of the association will be provided with the Farm Credit Bank of Texas and District Associations' Annual Report to Stockholders, which includes the combined financial statements of the bank and all of the district associations. The district's annual report discusses the material aspects of the financial condition, changes in financial condition, and results of operations for the bank and the district. In addition, the district's annual report identifies favorable and unfavorable trends, significant events, uncertainties and the impact of activities of the Insurance Fund.

The lending and financial services offered by the bank are described in Note 1, "Organization and Operations," of the district's annual report to stockholders.

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The accounting and reporting policies of the association conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results could differ from those estimates. Certain amounts in prior years' consolidated financial statements have been reclassified to conform to current financial statement presentation. The consolidated financial statements include the accounts of Lone Star, PCA and Lone Star, FLCA. All significant intercompany transactions have been eliminated in consolidation.

A. Recently Issued or Adopted Accounting Pronouncements:

In December 2011, the Financial Accounting Standards Board (FASB) issued guidance entitled "Balance Sheet – Disclosures about Offsetting Assets and Liabilities." The guidance requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. This includes the effect or potential effect of rights of setoff associated with an entity's recognized assets and recognized liabilities. The requirements apply to recognized financial instruments and derivative instruments that are offset in accordance with the rights of offset set forth in accounting guidance and for those recognized financial instruments and derivative instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset or not. This guidance is to be applied retrospectively for all comparative periods and is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The adoption of this guidance will not impact the association's financial condition or its results of operations, but will result in additional disclosures.

In September 2011, the FASB issued guidance entitled "Compensation – Retirement Benefits – Multi-employer Plans." The guidance is intended to provide more information about an employer's financial obligations to a multi-employer pension plan, which should help financial statement users better understand the financial health of significant plans in which the employer participates. The additional disclosures include: a) a description of the nature of plan benefits, b) a qualitative description of the extent to which the employer could be responsible for the obligations of the plan, including benefits earned by employees during employment with another employer and c) other quantitative information to help users understand the financial information about the plan. The amendments are effective for annual periods for fiscal years ending after December 15, 2012 for nonpublic entities. The amendments should be applied retrospectively for all prior periods presented. The adoption did not impact the association's financial condition or results of operations.

In June and December 2011, the FASB issued guidance entitled "Comprehensive Income – Presentation of Comprehensive Income." This guidance is intended to increase the prominence of other comprehensive income in financial statements. The main provisions of the guidance provide that an entity that reports items of other comprehensive income has the option to present comprehensive income in either one or two consecutive financial statements. This guidance did not change the items that must be reported in other comprehensive income. With either approach, an entity is required to present reclassification adjustments for items reclassified from other comprehensive income to net income in the statement(s). The December 2011 guidance deferred the effective date for the presentation of reclassification adjustments.

This guidance is applied retrospectively and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this guidance did not impact financial condition or results of operations, but resulted in changes to the presentation of comprehensive income.

B. Cash and Cash Equivalents: Cash and cash equivalents, as included in the statement of cash flows, represent cash on hand and on deposit at local banks.

C. Investment Securities: The association's investments include mortgage-backed securities issued by Federal Agricultural Mortgage Corporation (Farmer Mac) for which the association has the intent and ability to hold to maturity and which are consequently classified as held-to-maturity. Held-to-maturity investments are carried at cost, adjusted for the amortization of premiums and accretion of discounts. Changes in the fair value of these investments are not recorded unless the investment is deemed to be other-than-temporarily impaired. Impairment is considered to be other-than-temporary if the present value of cash flows expected to be collected from the debt security is less than the amortized cost basis of the security (any such shortfall is referred to as a "credit loss"). If an entity intends to sell an impaired debt security or is more likely than not to be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the impairment is other-than-temporary and should be recognized currently in earnings in an amount equal to the entire difference between fair value and amortized cost. If a credit loss exists, but an entity does not intend to sell the impaired debt security and is not more likely than not to be required to sell before recovery, the impairment is other-than-temporary and should be separated into (i) the estimated amount relating to credit loss and (ii) the amount relating to all other factors. Only the estimated credit loss amount is recognized currently in earnings, with the remainder of the loss amount recognized in other comprehensive income.

   Gains and losses on the sales of investments available-for-sale are determined using the specific identification method. Premiums and discounts are amortized or accreted into interest income over the term of the respective issues. The association does not hold investments for trading purposes.

D. Loans and Allowance for Loan Losses: Long-term real estate mortgage loans generally have original maturities ranging from five to 40 years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less. Loans are carried at their principal amount outstanding adjusted for charge-offs and deferred loan fees or costs. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. Authoritative accounting guidance requires loan origination fees and direct loan origination costs, if material, to be capitalized and the net fee or cost to be amortized over the life of the related loan as an adjustment to yield. Prior to 2010, this guidance was not implemented due to its immaterial effect on the association's financial position or results of operation for any year presented. The guidance was implemented in 2010 for loans closed in 2010 and subsequent years, resulting in the capitalization of $551,008, $763,575 and $959,896 for 2012, 2011 and 2010, respectively, in origination fees and $932,752, $876,905 and $862,934 for 2012, 2011 and 2010, respectively, in origination costs, primarily salaries and benefits related to the origination of 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 loan and are generally considered substandard or doubtful, which is in accordance with the loan rating model, as described below. Impaired loans include nonaccrual loans, restructured loans and loans past due 90 days or more and still accruing interest. A loan is considered contractually past due when any principal repayment or interest payment required by the loan instrument is not received on or before the due date. A loan shall remain contractually past due until it is formally restructured or until the entire amount past due, including principal, accrued interest and penalty interest incurred as a result of past-due status, is collected or otherwise discharged in full.

   Impaired loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days (unless adequately secured and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. Additionally, all loans over 180 days past due are placed in nonaccrual status. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is either reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in prior years). Loans are charged off at the time they are determined to be uncollectible.

   A restructured loan constitutes a troubled debt restructuring if for economic or legal reasons related to the debtor's financial difficulties the association grants a concession to the debtor that it would not otherwise consider. A concession is generally granted in order to minimize the association's economic loss and avoid foreclosure. Concessions vary by program and are borrower-specific and may include interest rate reductions, term extensions, payment deferrals or the acceptance of additional collateral in lieu of payments. In limited circumstances, principal may be forgiven. A loan restricted in a troubled debt restructuring is an impaired loan.

   Payments received on nonaccrual loans are generally applied to the recorded investment in the loan asset. If collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it, the interest portion of payments is recognized as current interest income. Nonaccrual loans may be returned to accrual status when principal and interest are current, the borrower has demonstrated payment performance, there are no unrecovered prior charge-offs, and collection of future payments is no longer in doubt. If previously unrecognized interest income exists at the time the loan is transferred to accrual status, cash received at the time of or subsequent to the transfer is first recorded as interest income until such time as the recorded balance equals the contractual indebtedness of the borrower.

The bank and related associations use a two-dimensional loan rating model based on an internally generated combined system risk-rating guidance that incorporates a 14-point risk-rating scale to identify and track the probability of borrower default and a separate scale addressing loss given default over a period of time. Probability of default is the probability that a borrower will experience a default within 12 months from the date of the determination of the risk rating. A default is considered to have occurred if the lender believes the borrower will not be able to pay its obligation in full or the borrower is past due more than 90 days. The loss given default is management's estimate as to the anticipated economic loss on a specific loan, assuming default has occurred or is expected to occur within the next 12 months.

Each of the probability of default categories carries a distinct percentage of default probability. The 14-point risk-rating scale provides for granularity of the probability of default, especially in the acceptable ratings. There are nine acceptable categories that range from a borrower of the highest quality to a borrower of minimally acceptable quality. The probability of default between 1 and 9 is very narrow and would reflect almost no default to a minimal default percentage. The probability of default grows more rapidly as a loan moves from a "9" to other assets especially mentioned (OAEM) and grows significantly as a loan moves to a substandard (viable) level. A substandard (nonviable) rating indicates that the probability of default is almost certain.

The credit risk-rating methodology is a key component of the association's allowance for loan losses evaluation, and is generally incorporated into its loan underwriting standards and internal lending limit. The allowance for loan losses is maintained at a level considered adequate by management to provide for probable losses inherent in the loan portfolio.

The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including agricultural economy, loan portfolio composition, collateral value, management's process for classification of risk of the loans within the portfolio and the portfolio's prior loss experience. The allowance for loan losses encompasses various judgments, evaluations and appraisals with respect to the loans and their underlying security that, by their nature, contain elements of uncertainty and imprecision. Changes in the agricultural economy and their impact on borrower repayment capacity will cause these various judgments, evaluations and appraisals to change over time. Accordingly, actual circumstances could vary significantly from the institutions' expectations and predictions of those circumstances. The allowance for loan losses process is supported by loan portfolio stress testing, which simulates stress in the current portfolio and the correlating allowance that would be needed.

The allowance for loan losses includes components for loans individually evaluated for impairment and loans collectively evaluated for impairment. Generally, for loans individually evaluated the allowance for loan losses represents the difference between the recorded investment in the loan and the present value of the cash flows expected to be collected discounted at the loan's effective interest rate, or at the fair value of the collateral, less estimated costs to sell, if the loan is collateral-dependent. For those loans collectively evaluated for impairment, the allowance for loan losses is determined using the risk-rating model.

E. Capital Stock Investment in the Farm Credit Bank of Texas: The association's investment in the bank is in the form of Class A voting capital stock and allocated retained earnings. This investment is adjusted periodically based on the association's proportional utilization of the bank compared to other district associations. The bank requires a minimum stock investment of 2 percent of the association's average borrowing from the bank. This investment is carried at cost plus allocated equities in the accompanying consolidated balance sheet.

   If needed to meet regulatory capital adequacy requirements, the board of directors of the bank may increase the percentage of stock held by an association from 2 percent of the average outstanding balance of borrowings from the bank to a maximum of 5 percent of the average outstanding balance of borrowings from the bank.

F. Other Property Owned, Net: Other property owned, net, consists of real and personal property acquired through foreclosure or deed in lieu of foreclosure, is recorded at fair value less estimated selling costs upon acquisition. Any initial reduction in the carrying amount of a loan to the fair value of the collateral received is charged to the allowance for loan losses. On at least an annual basis, revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income and expenses from operations and carrying value adjustments are included in net gains (losses) on other property owned in the statements of comprehensive income.

G. Premises and Equipment: Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. Depreciation is provided on the straight-line method using estimated useful lives of the assets. Gains and losses on dispositions are reflected in current operations. Maintenance and repairs are charged to operating expense, and improvements are capitalized.

H. Advance Conditional Payments: The association is authorized under the Act to accept advance payments from borrowers. To the extent that the borrower's access to such funds is restricted, the advance conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as liabilities in the accompanying consolidated balance sheet. Advance conditional payments are not insured. Interest is generally paid by the association on such accounts at rates established by the board of directors.

I. Employee Benefit Plans: Employees of the association participate in either the district defined benefit retirement plan (DB Plan) or the defined contribution plan (DC Plan). All eligible employees may participate in the Farm Credit Benefits Alliance 401(k) Plan. Also, the association sponsored a nonqualified defined contribution 401(k) plan in 2009; this plan was not sponsored in 2012, 2011, or 2010. The DB Plan is closed to new participants. Participants generally include employees hired prior to January 1, 1996. The DB Plan is noncontributory and provides benefits based on salary and years of service. The "projected unit credit" actuarial method is used for financial reporting and funding purposes for the DB Plan.

   Participants in the DC Plan generally include employees who elected to transfer from the DB Plan prior to January 1, 1996, and employees hired on or after January 1, 1996. Participants in the DC Plan direct the placement of their employers' contributions, 5.0 percent of eligible pay for the year ended December 31, 2012, made on their behalf into various investment alternatives.

   The structure of the district's DB Plan is characterized as multi-employer, since neither the assets, liabilities nor costs of the plan are segregated or separately accounted for by the associations. No portion of any surplus assets is available to the associations, nor are the associations required to pay for plan liabilities upon withdrawal from the plans. As a result, the associations recognize as pension cost the required contribution to the plans for the year. Contributions due and unpaid are recognized as a liability. The association recognized pension costs for the DC Plan of $241,608, $182,774 and $156,132 for the years ended December 31, 2012, 2011 and 2010, respectively. For the DB Plan, the association recognized pension costs of $460,568, $890,942 and $755,812 for the years ended December 31, 2012, 2011 and 2010, respectively.

   The association also participates in the Farm Credit Benefits Alliance 401(k) Plan, which requires the associations to match 100 percent of employee contributions up to 3.0 percent of eligible earnings and to match 50 percent of employee contributions for the next 2.0 percent of employee contributions, up to a maximum employer contribution of 4.0 percent of eligible earnings. Association 401(k) plan costs are expensed as incurred. The association's contributions to the 401(k) plan were $228,546, $181,239 and $152,541 for the years ended December 31, 2012, 2011 and 2010, respectively.

   In addition to pension benefits, the association provides certain health care and life insurance benefits to qualifying retired employees (other postretirement benefits). These benefits are not characterized as multi-employer and, consequently, the liability for these benefits is included in other liabilities. No association employees hired on or after January 1, 2004 will be eligible for these health care and life insurance benefits upon retirement.

J. Income Taxes: The ACA holding company conducts its business activities through two wholly-owned subsidiaries. Long-term mortgage lending activities are operated through the wholly-owned FLCA subsidiary, which is exempt from federal and state income tax. Short- and intermediate-term lending activities are operated through the wholly-owned PCA subsidiary. Operating expenses are allocated to each subsidiary based on estimated relative service. All significant transactions between the subsidiaries and the parent company have been eliminated in consolidation. The ACA, along with the PCA subsidiary, is subject to income tax. The association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated retained earnings. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage refunds. Deferred taxes are provided on the association's taxable income on the basis of a proportionate share of the tax effect of temporary differences not allocated in patronage form. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (over 50 percent probability), based on management's estimate, that they will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of the association's expected patronage program, which reduces taxable earnings.

K. Patronage Refunds From the Farm Credit Bank of Texas: The association records patronage refunds from the bank on an accrual basis.

L. Fair Value Measurement: The FASB guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. It describes three levels of inputs that may be used to measure fair value:

Level 1 — Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury, other U.S. government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets. Also included in Level 1 are assets held in trust funds, which relate to deferred compensation and our supplemental retirement plan. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace. Pension plan assets that are invested in equity securities, including mutual funds and fixed-income securities that are actively traded, are also included in Level 1.

Level 2 — Observable inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly or indirectly. Level 2 inputs include the following: (a) quoted prices for similar assets or liabilities in active markets; (b) quoted prices for identical or similar assets or liabilities in markets that are not active so that they are traded less frequently than exchange-traded instruments, the prices are not current or principal market information is not released publicly; (c) inputs other than quoted prices that are observable such as interest rates and yield curves, prepayment speeds, credit risks and default rates; and (d) inputs derived principally from or corroborated by observable market data by correlation or other means. This category generally includes certain U.S. government and agency mortgage-backed debt securities, corporate debt securities, and derivative contracts. Pension plan assets that are derived from observable inputs, including corporate bonds and mortgage-backed securities, are reported in Level 2.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities are considered Level 3. These unobservable inputs reflect the reporting entity's own assumptions about assumptions that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain private equity investments, retained residual interests in securitizations, asset-backed securities, highly structured or long-term derivative contracts, certain loans and other property owned. Pension plan assets such as certain mortgage-backed securities that are supported by little or no market data in determining the fair value are included in Level 3.

The fair value disclosures are presented in Note 14, "Fair Value Measurements."

M. Off-balance-sheet credit exposures: Commitments to extend credit are agreements to lend to customers, generally having fixed expiration dates or other termination clauses that may require payment of a fee. Commercial letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. These letters of credit are issued to facilitate commerce and typically result in the commitment being funded when the underlying transaction is consummated between the customer and third party. The credit risk associated with commitments to extend credit and commercial letters of credit is essentially the same as that involved with extending loans to customers and is subject to normal credit policies. Collateral may be obtained based on management's assessment of the customer's creditworthiness. The association's exposure in off balance-balance-sheet credit exposures is further disclosed in Note 15 "Commitments and Contingencies."

NOTE 3 — INVESTMENT SECURITIES:

The association may hold mission-related and other investments. The Farm Credit Administration approves mission-related programs and other mission-related investments. The following is a summary of mission-related and other investments that are held to maturity:

During 2010, the association exchanged loans totaling $59,626,146 million for Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed mortgage-backed securities (AMBS). The loans were previously covered under the Long-Term Standby Commitment to Purchase Agreements with Farmer Mac. No gain or loss was recognized in the financial statements upon completion of the exchange transactions.

Effective January 26, 2012, The Farm Credit Bank of Texas (the bank) purchased Lone Star's securitized Farmer Mac Agricultural Mortgage Backed Securities (AMBS) investments. The purchase of $35,459,508 included outstanding principal and accrued interest as of that date. There was no gain or loss recognized by the association on this transaction. The association will continue to service the underlying loans that were included in this security. Also, for 2012 there was no effect to Lone Star's income based on this transaction as the bank was able to pay the association a patronage equivalent to the net interest that it would have earned on

the AMBS investment. The amount of patronage received in 2012 was $803,813. However, for future years, the bank's payment of patronage is at the discretion of the bank's board of directors.

The following is a summary of Farmer Mac agricultural mortgage-backed securities:

	December 31, 2012			
	Amortized Cost	**Gross Unrealized Gains**	**Fair Value**	**Weighted Average Yield**
Agricultural mortgage-backed securities	**$ -**	**$ -**	**$ -**	**- %**

	December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	$35,688,875	$ 597,892	$36,286,767	5.39 %

	December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	$45,231,568	$ 284,022	$45,515,590	5.42 %

NOTE 4 — LOANS AND ALLOWANCE FOR LOAN LOSSES:

A summary of loans as of December 31 follows:

	2012		2011		2010	
Loan Type	**Amount**	**%**	Amount	%	Amount	%
Real estate mortgage	**$ 641,681,563**	**77.1%**	$ 681,576,375	78.2%	$ 760,723,914	79.4%
Production and intermediate term	**77,797,798**	**9.4%**	96,692,376	11.1%	139,139,347	14.5%
Agribusiness:						
Loans to cooperatives	**156,067**	**0.0%**	515,414	0.1%	2,988,302	0.3%
Processing and marketing	**57,413,674**	**6.9%**	56,797,700	6.5%	30,430,889	3.2%
Farm-related business	**4,848,876**	**0.6%**	5,645,373	0.6%	4,509,956	0.5%
Communication	**1,676,270**	**0.2%**	6,089,587	0.7%	1,699,955	0.2%
Energy	**33,441,681**	**4.0%**	8,336,568	1.0%	753,480	0.1%
Water and waste water	**548,300**	**0.1%**	1,316,020	0.2%	-	0.0%
Rural residential real estate	**13,770,252**	**1.7%**	15,076,576	1.7%	17,776,944	1.9%
Total	**$ 831,334,481**	**100%**	$ 872,045,989	100%	$ 958,022,787	100%

The association may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration regulations. The following table presents information regarding participations purchased and sold as of December 31, 2012:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	$ 7,892,553	$ 13,276,772	$ -	$ -	$ 7,892,553	$ 13,276,772
Production and intermediate term	25,033,984	-	-	-	25,033,984	-
Agribusiness	57,006,601	197,622	-	-	57,006,601	197,622
Communication	1,676,270	-	-	-	1,676,270	-
Energy	33,441,681	-	-	-	33,441,681	-
Water and waste water	548,300	-	-	-	548,300	-
Total	$ 125,599,389	$ 13,474,394	$ -	$ -	$ 125,599,389	$ 13,474,394

Loan Volume by Office or Geographic Location:

Branch	**2012**	2011	2010
Sherman	**20.6%**	20.3%	19.3%
Stephenville	**20.2%**	23.5%	27.0%
Capital Markets	**15.1%**	10.6%	5.8%
Denton	**11.4%**	10.9%	11.2%
Cleburne	**9.5%**	10.0%	10.4%
New Boston	**7.4%**	7.8%	6.5%
Paris	**6.9%**	7.1%	7.2%
Abilene	**4.5%**	5.8%	6.2%
Sweetwater	**3.0%**	2.5%	3.2%
Weatherford	**1.4%**	1.5%	1.4%
Fort Worth	**0.0%**	0.0%	0.0%
Mount Pleasant	**0.0%**	0.0%	2.0%
Totals	**100.0%**	100.0%	100.0%

The association's concentration of credit risk in various agricultural commodities is shown in the following table. While the amounts represent the association's maximum potential credit risk as it relates to recorded loan principal, a substantial portion of the association's lending activities is collateralized, and the association's exposure to credit loss associated with lending activities is reduced accordingly. An estimate of the association's credit risk exposure is considered in the determination of the allowance for loan losses.

	2012		2011		2010	
Operation/Commodity	**Amount**	**%**	Amount	%	Amount	%
Livestock, except dairy and poultry	**$ 535,071,420**	**64.1%**	$ 569,828,799	65.4%	$ 646,620,518	67.5%
General farms, primarily crops	**47,216,455**	**5.7%**	47,280,827	5.4%	52,161,535	5.4%
Electric services	**33,989,981**	**4.1%**	9,652,588	1.1%	753,480	0.1%
Field crops except cash grains	**32,040,210**	**3.9%**	32,174,882	3.7%	41,464,158	4.3%
Timber	**28,949,828**	**3.5%**	26,266,089	3.0%	27,129,546	2.8%
Wholesale trade - nondurable goods	**27,900,805**	**3.4%**	25,318,579	2.9%	16,585,916	1.7%
Dairy farms	**25,360,712**	**3.1%**	54,292,919	6.2%	91,985,370	9.6%
Paper and allied products	**16,428,635**	**2.0%**	13,452,403	1.5%	1,087,491	0.1%
Cash grains	**15,959,167**	**1.9%**	16,140,193	1.9%	9,377,605	1.0%
Rural home loans	**14,327,522**	**1.7%**	15,779,242	1.8%	17,186,006	1.8%
Hunting, trapping and game propagation	**13,949,237**	**1.7%**	6,837,998	0.8%	5,767,719	0.6%
Animal specialties	**12,926,629**	**1.6%**	13,112,190	1.5%	13,976,547	1.5%
Food and kindred products	**10,619,160**	**1.3%**	13,283,184	1.5%	16,488,106	1.7%
Other	**6,819,166**	**0.8%**	6,846,664	0.8%	68,936	0.0%
Poultry and eggs	**3,065,567**	**0.4%**	5,423,457	0.6%	6,437,923	0.7%
Communication	**1,676,270**	**0.2%**	6,089,587	0.7%	1,699,955	0.2%
Farm and garden machinery equipment	**1,520,405**	**0.2%**	3,198,890	0.4%	1,115,290	0.1%
Chemical and allied products	**1,414,532**	**0.2%**	1,466,353	0.2%	2,037,111	0.2%
Lumber and wood products, except furniture	**1,121,751**	**0.1%**	1,221,491	0.1%	1,127,664	0.1%
Agricultural services	**855,934**	**0.1%**	1,649,831	0.2%	1,726,121	0.2%
Fruit and tree nuts	**48,552**	**0.0%**	-	0.0%	-	0.0%
Building materials, hardware and garden supplies	**37,334**	**0.0%**	54,621	0.0%	70,132	0.0%
General farms, primarily livestock	**35,209**	**0.0%**	64,049	0.0%	8,844	0.0%
Food stores	**-**	**0.0%**	2,611,153	0.3%	2,638,639	0.3%
Public warehousing and storage	**-**	**0.0%**	-	0.0%	508,175	0.1%
Total	**$ 831,334,481**	**100.0%**	$ 872,045,989	100.0%	$ 958,022,787	100.0%

The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies but typically includes farmland and income-producing property, such as crops and livestock, as well as receivables. Long-term real estate loans are secured by the first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (or 97 percent if guaranteed by a government agency) of the property's appraised value. However, a decline in a property's market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the association in the collateral, may result in the loan-to-value ratios in excess of the regulatory maximum.

To mitigate the risk of loan losses, the association has obtained loan guarantees from Farmer Mac through an arrangement with the bank, in the form of standby commitments to purchase qualifying loans. The agreements, which will remain in place until the loans are paid in full, give the association the right to sell the loans identified in the agreements to Farmer Mac in the event of defaults (typically four months past due), subject to certain conditions. At December 31, 2012, 2011 and 2010, loans totaling $1,273,028, $37,113,178 and $47,749,172, respectively, were guaranteed by these commitments. Fees paid for these guarantees totaled $25,587, $167,036 and $228,562 in 2012, 2011 and 2010, respectively, and are included in "other noninterest expense.

Nonperforming assets (including related accrued interest) and related credit quality statistics are as follows:

	December 31, 2012	December 31, 2011	December 31, 2010
Nonaccrual loans:			
Real estate mortgage	**$ 17,821,115**	$ 34,312,846	$ 49,122,711
Production and intermediate term	**3,838,693**	17,903,808	32,030,880
Agribusiness	**588,546**	6,965,867	9,292,522
Communication	**1,676,270**	-	-
Rural residential real estate	**352,301**	414,794	424,261
Total nonaccrual loans	**24,276,925**	59,597,315	90,870,374
Accruing restructured loans:			
Real estate mortgage	**35,233**	-	-
Production and intermediate term	**32,424**	-	-
Total accruing restructured loans	**67,657**	-	-
Accruing loans 90 days or more past due:			
Real estate mortgage	**-**	11,113	-
Total accruing loans 90 days or more past due	**-**	11,113	-
Total nonperforming loans	**24,344,582**	59,608,428	90,870,374
Other property owned	**1,060,973**	5,487,529	9,471,968
Total nonperforming assets	**$ 25,405,555**	$ 65,095,957	$ 100,342,342

One credit quality indicator utilized by the bank and association is the Farm Credit Administration's Uniform Loan Classification System that categorizes loans into five categories. The categories are defined as follows:

- Acceptable – assets are expected to be fully collectible and represent the highest quality,
- Other assets especially mentioned (OAEM) – assets are currently collectible but exhibit some potential weakness,
- Substandard – assets exhibit some serious weakness in repayment capacity, equity and/or collateral pledged on the loan,
- Doubtful – assets exhibit similar weaknesses to substandard assets; however, doubtful assets have additional weaknesses in existing factors, conditions and values that make collection in full highly questionable, and
- Loss – assets are considered uncollectible.

The following table shows loans and related accrued interest classified under the Farm Credit Administration's Uniform Loan Classification System as a percentage of total loans and related accrued interest receivable by loan type as of December 31:

	2012	2011	2010
Real estate mortgage			
Acceptable	**90%**	88%	86%
OAEM	**5%**	3%	2%
Substandard/doubtful	**5%**	9%	12%
	100%	100%	100%
Production and intermediate term			
Acceptable	**92%**	63%	50%
OAEM	**1%**	8%	10%
Substandard/doubtful	**7%**	29%	40%
	100%	100%	100%
Loans to cooperatives			
Acceptable	**100%**	100%	100%
OAEM	**0%**	0%	0%
Substandard/doubtful	**0%**	0%	0%
	100%	100%	100%
Processing and marketing			
Acceptable	**99%**	90%	66%
OAEM	**0%**	0%	8%
Substandard/doubtful	**1%**	10%	26%
	100%	100%	100%
Farm-related business			
Acceptable	**95%**	75%	63%
OAEM	**0%**	2%	0%
Substandard/doubtful	**5%**	23%	37%
	100%	100%	100%
Communication			
Acceptable	**0%**	100%	100%
OAEM	**0%**	0%	0%
Substandard/doubtful	**100%**	0%	0%
	100%	100%	100%
Energy			
Acceptable	**100%**	100%	100%
OAEM	**0%**	0%	0%
Substandard/doubtful	**0%**	0%	0%
	100%	100%	100%
Water and waste water			
Acceptable	**100%**	100%	0%
OAEM	**0%**	0%	0%
Substandard/doubtful	**0%**	0%	0%
	100%	100%	0%
Rural residential real estate			
Acceptable	**86%**	87%	90%
OAEM	**4%**	2%	6%
Substandard/doubtful	**10%**	11%	4%
	100%	100%	100%
Lease receivables			
Acceptable	**0%**	0%	100%
OAEM	**0%**	0%	0%
Substandard/doubtful	**0%**	0%	0%
	0%	0%	100%
Total Loans			
Acceptable	**91%**	85%	80%
OAEM	**4%**	4%	4%
Substandard/doubtful	**5%**	11%	16%
	100%	100%	100%

The following tables provide an age analysis of past due loans (including accrued interest) as of December 31, 2012 and 2011:

December 31, 2012:	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less than 30 Days Past Due	Total Loans	Recorded Investment >90 Days and Accruing
Real estate mortgage	$ 1,280,010	$ 3,630,666	$ 4,910,676	$ 641,145,513	$ 646,056,189	$ -
Production and intermediate-term	99,221	2,163,830	2,263,051	75,877,324	78,140,375	-
Loans to cooperatives	-	-	-	157,146	157,146	-
Processing and marketing	-	588,546	588,546	56,870,041	57,458,587	-
Farm-related business	-	-	-	4,851,038	4,851,038	-
Communication	-	-	-	1,676,270	1,676,270	-
Energy	-	-	-	33,510,829	33,510,829	-
Water and waste water	-	-	-	549,010	549,010	-
Rural residential real estate	47,315	-	47,315	13,761,565	13,808,880	-
Total	$ 1,426,546	$ 6,383,042	$ 7,809,588	$ 828,398,736	$ 836,208,324	$ -

December 31, 2011:	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less than 30 Days Past Due	Total Loans	Recorded Investment >90 Days and Accruing
Real estate mortgage	$ 2,672,169	$ 10,387,717	$ 13,059,886	$ 674,593,495	$ 687,653,381	$ 11,113
Production and intermediate-term	718,740	8,774,590	9,493,330	87,787,538	97,280,868	-
Loans to cooperatives	-	-	-	516,158	516,158	-
Processing and marketing	-	5,219,353	5,219,353	51,632,051	56,851,404	-
Farm-related business	-	-	-	5,650,293	5,650,293	-
Communication	-	-	-	6,096,406	6,096,406	-
Energy	-	-	-	8,402,110	8,402,110	-
Water and waste water	-	-	-	1,317,185	1,317,185	-
Rural residential real estate	332,262	35,271	367,533	14,759,029	15,126,562	-
Total	$ 3,723,171	$ 24,416,931	$ 28,140,102	$ 850,754,265	$ 878,894,367	$ 11,113

Note: The recorded investment in the receivable is the face amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges or acquisition costs, and may also reflect a previous direct write-down of the investment.

Troubled Debt Restructuring: A restructuring of a debt constitutes a troubled debt restructuring if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Troubled debt restructurings are undertaken in order to improve the likelihood of recovery on the loan and may include, but are not limited to, forgiveness of principal or interest, interest rate reductions that are lower than the current market rate for new debt with similar risk, or significant term or payment extensions.

As of December 31, 2012, the total recorded investment of troubled debt restructured loans was $11,118,892, including $11,051,235 classified as nonaccrual and $67,657 classified as accrual, with specific allowance for loan losses of $1,540,222. The specific allowance is determined quarterly through a net realizable value analysis for each individual loan asset. As of December 31, 2012, commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring were $0.

The following tables present additional information regarding troubled debt restructurings, which includes both accrual and nonaccrual loans with troubled debt restructuring designation, that occurred during the year ended December 31, 2012 and December 31, 2011. The pre-modification outstanding recorded investment represents the recorded investment of the loans as of the quarter end prior to the restructuring. The post modification outstanding recorded investment represents the recorded investment of the loans as of the quarter end the restructuring occurred. Loans formally restructured prior to January 1, 2012, were $12,690,421.

December 31, 2012:	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	$ 326,765	$ 497,027
Production and intermediate term	122,524	147,358
Total	$ 449,289	$ 644,385

December 31, 2011:	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	$ 12,578,548	$ 11,719,726
Production and intermediate term	2,267,063	1,517,200
Total	$ 14,845,611	$ 13,236,926

In restructurings where principal is forgiven, the amount of the forgiveness is immediately charged off. In restructurings where accrued interest is forgiven, the interest is reversed (if current year interest) or charged off (if prior year interest). There were no restructurings where principal was forgiven that required a charge-off at the modification date, for the year ended December 31, 2012.

The predominant form of concession granted for troubled debt restructuring includes a delay in the repayment of principal. At times these terms might be offset with incremental payments, collateral or new borrower guarantees, in which case the association assesses all of the modified terms to determine if the overall modification qualifies as a troubled debt restructuring.

There were no loans that met the accounting criteria as a troubled debt restructuring and that occurred within the previous 12 months of that year and for which there was a payment default during the period. A payment default is defined as a payment that is 30 days past due after the date the loan was restructured.

There were no additional commitments to lend to borrowers whose loans have been modified in TDRs at December 31, 2012 and December 31, 2011.

Note: In addition to the disclosures specified above, it is important to ensure that the TDR disclosures are transparent and provide sufficient detail for a reader of the financial statements to understand the details of loan modifications. Additional details of the loan modifications may include quantification of the different types of concessions granted and classification of TDRs by accrual or nonaccrual status.

The following table provides information on outstanding loans restructured in troubled debt restructurings at period end. These loans are included as impaired loans in the impaired loan table:

	Loans Modified as TDRs		TDRs on Nonaccrrual Status*	
	December 31, 2012	December 31, 2011	December 31, 2012	December 31, 2011
Troubled debt restructurings:				
Real estate mortgage	$ 35,233	$ -	$ 9,941,242	$ 11,249,437
Production and intermediate term	32,424	-	1,109,993	1,440,984
Total	$ 67,657	$ -	$ 11,051,235	$ 12,690,421

* represents the portion of loans modified as TDRs (first column) that are in nonaccrual status

Additional impaired loan information is as follows:

	Recorded Investment at 12/31/2012	Unpaid Principal Balance[a]	Related Allowance	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:					
Real estate mortgage	$ 12,723,644	$ 12,859,757	$ 2,233,786	$ 13,366,960	$ 6,023
Production and intermediate term	3,020,104	3,245,869	1,177,535	2,847,661	4,529
Processing and marketing	-	-	-	-	-
Farm-related business	-	-	-	-	-
Communication	1,676,270	1,676,270	741,182	1,340,920	(3,163)
Rural residential real estate	208,721	208,721	21,341	164,528	-
Total	$ 17,628,739	$ 17,990,617	$ 4,173,844	$ 17,720,069	$ 7,389
Impaired loans with no related allowance for credit losses:					
Real estate mortgage	$ 5,132,705	$ 5,200,475	$ -	$ 4,099,340	$ 41,359
Production and intermediate term	851,013	4,628,619	-	4,432,900	31,423
Processing and marketing	588,546	588,546	-	1,449,838	-
Farm-related business	-	-	-	-	9,160
Communication	-	-	-	-	-
Rural residential real estate	143,579	143,581	-	154,335	-
Total	$ 6,715,843	$ 10,561,221	$ -	$ 10,136,413	$ 81,942
Total impaired loans:					
Real estate mortgage	$ 17,856,349	$ 18,060,232	$ 2,233,786	$ 17,466,300	$ 47,382
Production and intermediate term	3,871,117	7,874,488	1,177,535	7,280,561	35,952
Processing and marketing	588,546	588,546	-	1,449,838	-
Farm-related business	-	-	-	-	9,160
Communication	1,676,270	1,676,270	741,182	1,340,920	(3,163)
Rural residential real estate	352,300	352,302	21,341	318,863	-
Total	$ 24,344,582	$ 28,551,838	$ 4,173,844	$ 27,856,482	$ 89,331

[a] Unpaid principal balance represents the contractual obligations of the loans.

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2012.

Interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans at December 31:

	2012	2011	2010
Interest income which would have been recognized under the original terms	**$ 2,792,575**	$ 4,831,493	$ 6,320,348
Less: interest income recognized	**(89,331)**	(578,698)	(421,824)
Foregone interest income	**$ 2,703,244**	$ 4,252,795	$ 5,898,524

A summary of the changes in the allowance for credit losses and the ending balance of loans outstanding are as follows:

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communication	Energy	Water and Waste Water	Rural Residential Real Estate	Total
Allowance for Credit Losses:								
Balance at December 31, 2011	$ 1,528,527	$ 10,316,634	$ 602,903	$ 4,180	$ 4,764	$ -	$ 6,143	$ 12,463,151
Charge-offs	(2,831,321)	(1,338,596)	279,849	-	-	-	(25,053)	(3,915,121)
Recoveries	-	1,019,576	-	-	-	-	-	1,019,576
Provision for loan losses	81,680	551,289	32,217	223	255	-	328	665,992
Balance at December 31, 2012	$ (1,221,114)	$ 10,548,903	$ 914,969	$ 4,403	$ 5,019	$ -	$ (18,582)	$ 10,233,598
Ending Balance: individually evaluated for impairment	$ 2,233,786	$ 1,177,535	$ -	$ 741,182	$ -	$ -	$ 21,341	$ 4,173,844
Ending Balance: collectively evaluated for impairment	$ (3,454,900)	$ 9,371,368	$ 914,969	$ (736,779)	$ 5,018	$ -	$ (39,922)	$ 6,059,754
Recorded Investment in Loans Outstanding:								
Ending Balance at December 31, 2012	$ 646,056,189	$ 78,140,375	$ 62,466,771	$ 1,676,270	$ 33,510,829	$ 549,010	$ 13,808,880	$ 836,208,324
Ending balance for loans individually evaluated for impairment	$ 17,856,232	$ 3,870,958	$ 588,546	$ 1,676,270	$ -	$ -	$ 352,300	$ 24,344,306
Ending balance for loans collectively evaluated for impairment	$ 628,199,957	$ 74,269,417	$ 61,878,225	$ -	$ 33,510,829	$ 549,010	$ 13,456,580	$ 811,864,018

A summary of the allowance for loan losses as of December 31 follows:

	2011	2010
Beginning balance	$ 19,067,611	$ 7,386,493
Provision for loan losses	5,669,112	21,871,350
Loans charged off	(12,380,211)	(10,635,878)
Recoveries	106,639	445,646
Allowance for loan losses	$ 12,463,151	$ 19,067,611

NOTE 5 — INVESTMENT IN THE FARM CREDIT BANK OF TEXAS:

The association operates under a general financing agreement (GFA) with the bank. The current GFA is effective through September 30, 2015. The investment in the Farm Credit Bank of Texas is a requirement of borrowing from the bank and is carried at cost plus allocated equities, not fair value, in the accompanying balance sheet. Estimating the fair value of the association's investment in the Farm Credit Bank of Texas is not practicable because the stock is not traded. The association owns 6.50% of the issued stock of the bank as of December 31, 2012. As of that date, the bank's assets totaled $15.4 billion and members' equity totaled $1.274 billion. The bank's earnings were $174.6 million during 2012.

NOTE 6 — PREMISES AND EQUIPMENT:

Premises and equipment consisted of the following at December 31:

	2012	2011	2010
Land and improvements	**$ 208,268**	$ 208,268	$ 208,268
Building and improvements	**1,715,873**	1,645,734	1,633,472
Furniture and equipment	**424,806**	433,691	437,383
Computer equipment and software	**378,248**	419,526	393,011
Automobiles	**953,468**	996,473	817,861
	3,680,663	3,703,692	3,489,995
Accumulated depreciation	**(2,064,829)**	(2,037,621)	(1,957,609)
Total	**$ 1,615,834**	$ 1,666,071	$ 1,532,386

The association leases office space in Fort Worth, Sherman, Abilene, Weatherford and Clarksville. Lease expense was $341,863, $352,323 and $374,540 for 2012, 2011 and 2010, respectively. Minimum annual lease payments for the next five years are as follows:

	Operating
2013	$ 347,646
2014	308,695
2015	305,511
2016	267,596
2017	221,766
Thereafter	285,651
Total	$ 1,736,865

NOTE 7 — OTHER PROPERTY OWNED, NET:

Net gain (loss) on other property owned, net consists of the following for the years ended December 31:

	2012	2011	2010
Gain (loss) on sale, net	**$ 2,261,068**	$ 1,005,698	$ 227,710
Operating income (expense), net	**(200,243)**	(665,372)	(462,646)
Net gain (loss) on other property owned	**$ 2,060,825**	$ 340,326	$ (234,936)

NOTE 8 — OTHER ASSETS AND OTHER LIABILITIES:

Other assets comprised the following at December 31:

	2012	2011	2010
Accounts receivable (other than members) - Other	**$ 424,401**	$ 384,296	$ 313,351
Other Assets - Other	**149,805**	45,773	73,990
Total	**$ 574,206**	$ 430,069	$ 387,341

Other liabilities comprised the following at December 31:

	2012	2011	2010
Accounts payable - Total	**$ 801,603**	$ 1,146,260	$ 764,485
Accumlated post retirement obligation	**2,836,361**	2,391,932	2,116,908
Funds held/advanced conditional payments	**40,188**	36,701	851
Other liabilities	**489,148**	413,401	388,116
Total	**$ 4,167,300**	$ 3,988,294	$ 3,270,360

NOTE 9 — NOTE PAYABLE TO THE BANK:

The interest rate risk inherent in the association's loan portfolio is substantially mitigated through the funding relationship with the bank. The bank manages interest rate risk through its direct loan pricing and asset/liability management process. The association's indebtedness to the bank represents borrowings by the association to fund the majority of its loan portfolio. The indebtedness is collateralized by a pledge of substantially all of the association's assets, and is governed by a general financing agreement. The interest rate on the direct loan is based upon the bank's cost of funding the loans the association has outstanding to its borrowers. The indebtedness continues in effect until the expiration date of the general financing agreement, which is September 30, 2015, unless sooner terminated by the bank upon the occurrence of an event of default, or by the association, in the event of a breach of this agreement by the bank, upon giving the bank 30 calendar days prior written notice, or in all other circumstances, upon giving the bank 120 days prior written notice.

The total amount and the weighted average interest rate of the association's direct loan from the bank at December 31, 2012, 2011 and 2010, were $643,933,881 at 1.86 percent, $743,775,358 at 2.38 percent and $850,095,961 at 2.74 percent, respectively.

Under the Act, the association is obligated to borrow only from the bank unless the bank approves borrowing from other funding sources. The bank and FCA regulations have established limitations on the association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2012, 2011 and 2010, the association's note payable was within the specified limitations. The maximum amount the association may borrow from the bank as of December 31, 2012, was $813,879,592, as defined by the general financing agreement.

In addition to borrowing limits, the financing agreement establishes certain covenants including limits on leases, investments, other debt, and dividend and patronage distributions; minimum standards for return on assets and for liquidity; and provisions for conducting business, maintaining records, reporting financial information, and establishing policies and procedures. Remedies specified in the general financing agreement associated with the covenants include additional reporting requirements, development of action plans, increases in interest rates on indebtedness, reduction of lending limits or repayment of indebtedness. As of and for the year ended December 31, 2012 the association was not subject to remedies associated with the covenants in the general financing agreements. As of and for the years ended December 31, 2011 and 2010, the association was subject to remedies associated with the covenants in the general financing agreement and was in compliance with those remedies.

NOTE 10 — MEMBERS' EQUITY:

A description of the association's capitalization requirements, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below.

Protection of certain borrower equity is provided under the Act that requires the association, when retiring protected borrower equity, to retire such equity at par or stated value regardless of its book value. Protected borrower equity includes capital stock, participation certificates and allocated equities that were outstanding as of January 6, 1988, or were issued or allocated prior to October 6, 1988. If an association is unable to retire protected borrower equity at par value or stated value, amounts required to retire this equity would be obtained from the Insurance Fund.

In accordance with the Act and the association's capitalization bylaws, each borrower is required to invest in the association as a condition of borrowing. The investment in Class B capital stock (for farm loans), or participation certificates (for rural home loans) is equal to 2 percent of the loan amount, up to a maximum amount of $1,000. The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, usually by adding the aggregate par value of the capital stock or participation certificates to the principal amount of the related loan obligation. The capital stock or participation certificates are subject to a first lien by the association. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding capital stock or participation certificates.

If needed to meet regulatory capital adequacy requirements, the board of directors of the association may increase the percentage of stock requirement for each borrower up to a maximum of 10 percent of the loan amount.

Each owner of Class B capital stock is entitled to a single vote, while participation certificates provide no voting rights to their owners.

Within two years of repayment of a loan, the association capital bylaws require the conversion of any borrower's outstanding Class B to Class A stock. Class A stock has no voting rights except in a case where a new issuance of preferred stock has been submitted to stockholders affected by the preference. Redemption of Class A shares is made solely at the discretion of the association's board of directors.

All borrower stock is at risk. As such, losses that result in impairment of capital stock or participation certificates shall be borne on a pro rata basis by all holders of Class A capital stock, Class B capital stock and participation certificates. In the event of liquidation of the association, capital stock and participation certificates would be utilized as necessary to satisfy any remaining obligations in excess of the amounts realized on the sale or liquidation of assets. Any excess of the amounts realized on the sale or liquidation of assets over the association's obligations to external parties and to the bank would be distributed to the association's stockholders.

Dividends and patronage distributions may be paid on the capital stock and participation certificates of the association, as the board of directors may determine by resolution subject to capitalization requirements as defined by the FCA. Amounts not distributed are retained as unallocated retained earnings. The following dividends and patronage distributions were declared and paid in 20112, 2011 and 2010, respectively:

Date Declared	Date Paid (to be Paid)	Patronage
December 2012	**April 2013**	**$ 7,000,000**
December 2011	April 2012	$ 2,000,000
December 2008	August 2010	$ 121,801

The FCA's capital adequacy regulations require the association to achieve permanent capital and total surplus of at least 7.0 percent and core surplus of at least 3.5 percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the ratio requirements can initiate certain mandatory and possibly additional discretionary actions by the FCA that, if undertaken, could have a direct material effect on the association's financial statements. The association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to stockholders unless prescribed capital standards are met. As of December 31, 2012, the association is not prohibited from retiring stock or distributing earnings; furthermore, neither the board nor senior management knows of any such prohibitions that may apply during the subsequent fiscal year. The association's permanent capital ratio, core surplus ratio and total surplus ratio at December 31, 2012, were 20.7 percent, 20.2 percent and 20.2 percent, respectively.

The association Capital Adequacy Plan directs association management to manage the capital position in a manner which:

- Permits the association to operate profitably over the long term;
- Provides reasonable protection against risks inherent in association operations;
- Meets all regulatory requirements;
- Recognizes the cost to stockholders related to investing capital in the association; and
- Is an integral part of the association's business plan.

An FCA regulation empowers the FCA to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. The association has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

At December 31, the association had the following shares of Class B stock and participation certificates outstanding at a par value of $5 per share:

	2012	2011	2010
Class B stock	**710,731**	762,956	833,270
Participation certificates	**43,705**	45,655	50,210
Total	**754,436**	808,611	883,480

An additional component of equity is accumulated other comprehensive income (loss) on nonpension postretirement benefits which totaled $372,301, $233,292 and $272,773 for the years ended December 31, 2012, 2011 and 2010, respectively.

NOTE 11 — INCOME TAXES:

The association's provision for (benefit from) income taxes follows for the years ended December 31, 2012, 2011 and 2010.

	2012	2011	2010
Current:			
Federal	**$ 48,253**	$ 13,428	$ 15,017
Total provision for (benefit from) income taxes	**$ 48,253**	$ 13,428	$ 15,017

The association had no deferred provision for (benefit from) income taxes for the years ending December 31, 2012, 2011 and 2010.

The provision for (benefit from) income tax differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as follows for the years ended December 31:

	2012	2011	2010
Federal tax at statutory rate	**$ 6,736,330**	$ 3,425,919	$ (388,139)
State tax, net	**(4,699,630)**	(5,784,476)	(7,639,430)
Change in valuation allowance	**(1,821,246)**	2,375,052	6,600,291
Other	**(167,201)**	(3,067)	1,442,295
Provision for (benefit from) income taxes	**$ 48,253**	$ 13,428	$ 15,017

Deferred tax assets and liabilities in accordance with accounting guidance, "Accounting for Income Taxes," are comprised of the following at December 31:

	2012	2011	2010
Deferred Tax Assets			
Allowance for loan losses	**$ 480,526**	$ 3,121,815	$ 4,906,047
Allowance for acquired properties	**-**	560,665	-
Loss carryforwards	**11,494,489**	10,280,980	6,680,326
Other	**4,079**	4,079	6,114
Gross deferred tax assets	**11,979,094**	13,967,539	11,592,487
Deferred tax asset valuation allowance	**(11,979,094)**	(13,967,539)	(11,592,487)
Deferred Tax Liabilities			
Other	**(76,698)**	(28,445)	(15,017)
Gross deferred tax liabilities	**(76,698)**	(28,445)	(15,017)
Net deferred tax asset (liability)	**$ (76,698)**	$ (28,445)	$ (15,017)

The association recorded valuation allowances of $11,979,094, $13,967,539 and $11,592,487 during 2012, 2011 and 2010, respectively. The association will continue to evaluate the realizability of the deferred tax assets and adjust the valuation allowance accordingly.

NOTE 12 — EMPLOYEE BENEFIT PLANS:

Employee Retirement Plans: Employees of the association participate in either the defined benefit retirement plan (DB Plan) or the defined contributions plan (DC Plan) and are eligible to participate in the Farm Credit Benefits Alliance 401(k) Plan. These plans are described more fully in section I of Note 2, "Summary of Significant Accounting Policies." The structure of the district's DB plan is characterized as multi-employer, since neither the assets, liabilities nor cost of any plan is segregated or separately accounted for by participating employers (bank and associations). No portion of any surplus assets is available to any participating employer. As a result, participating employers of the plan only recognize as cost the required contributions for the period and a liability for any unpaid contributions required for the period of their financial statements. Plan obligations, assets and the components of annual benefit expenses are recorded and reported upon district combination only. The association records current contributions to the DB plan as an expense in the current year.

The DB plan is noncontributory and benefits are based on salary and years of service. The legal name of the plan is Farm Credit Bank of Texas Pension Plan; its employer identification number is 74-1110170. The DB plan is not subject to any contractual expiration dates. The DB plan's funding policy is to fund current year benefits expected to be earned by covered employees plus an amount to improve the accumulated benefit obligation funded status by a percentage approved by the plan sponsor. The plan sponsor is the board of the Farm Credit Bank of Texas. The "projected unit credit" actuarial method is used for both financial reporting and funding purposes. District employers have the option of providing enhanced retirement benefits, under certain conditions, within the DB plan, to facilitate reorganization and/or restructuring. Actuarial information regarding the DB pension plan accumulated benefit obligation and plan asset is calculated for the district as a whole and is presented in the district's Annual Report to Stockholders. The actuarial present value of vested and nonvested accumulated benefit obligation exceeded the net assets of the DB plan as of December 31, 2012.

The risks of participating in these multi-employer plans are different from single-employer plans in the following aspects:

a. Assets contributed to the multi-employer plan by one employer may be used to provide benefits to employees of other participating employers.
b. If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.
c. If the association chooses to stop participating in some of its multi-employer plans, it may be required to pay the plan an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

The following table includes additional information regarding the funded status of the plan, the association's contributions, and the percentage of association contribution to total plan contributions for the years ended December 31, 2012, 2011 and 2010:

	2012	2011	2010
Funded status of plan	**65.0** %	64.9 %	71.6 %
Association's contribution	**$ 460,568**	$ 890,942	$ 755,812
Percentage of association's contribution to total contributions	**2.9** %	3.9 %	3.8 %

The funded status presented above is based on the percentage of plan assets to projected benefit obligations. DB plan funding is based on the percentage of plan assets to the accumulated benefit obligation, which was 72.7 percent, 72.6 percent and 78.8 percent at December 31, 2012, 2011 and 2010, respectively.

Other Postretirement Benefits: In addition to pension benefits, the association provides certain health care benefits to qualifying retired employees (other postretirement benefits). These benefits are not characterized as multi-employer and, consequently, the liability for these benefits is included in other liabilities.

In September 2006, the FASB issued guidance, which required the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. The balance sheet recognition provisions of this guidance were adopted at December 31, 2007. The guidance also required that employers measure the benefit obligation and plan assets as of the fiscal year end for fiscal years ending after December 15, 2008. In fiscal 2007 and earlier, the System used a September 30 measurement date for pension and other postretirement benefit plans. The guidance provided two approaches for an employer to transition to a fiscal year-end measurement date. The System has applied the second approach, which allows for the use of the measurements determined for the prior year end.

The following table reflects the benefit obligation, cost and actuarial assumptions for the association's other postretirement benefits:

Retiree Welfare Benefit Plans

Disclosure Information Related to Retirement Benefits	2012	2011	2010
Change in Accumulated Postretirement Benefit Obligation			
Accumulated postretirement benefit obligation, beginning of year	**$ 2,391,932**	$ 2,116,908	$ 1,822,879
Service cost	**61,789**	63,428	60,376
Interest cost	**120,440**	119,127	108,715
Plan participants' contributions	**13,690**	19,987	21,114
Plan amendments	**-**	-	-
Special termination benefits	**-**	-	-
Actuarial loss (gain)	**319,115**	156,164	179,974
Benefits paid	**(70,605)**	(83,682)	(76,150)
Accumulated postretirement benefit obligation, end of year	**$ 2,836,361**	$ 2,391,932	$ 2,116,908
Change in Plan Assets			
Plan assets at fair value, beginning of year	**$ -**	$ -	$ -
Actual return on plan assets	**-**	-	-
Company contributions	**56,915**	63,695	55,036
Plan participants' contributions	**13,690**	19,987	21,114
Benefits paid	**(70,605)**	(83,682)	(76,150)
Plan assets at fair value, end of year	**$ -**	$ -	$ -
Funded status of the plan	**$ (2,836,361)**	$ (2,391,932)	$ (2,116,908)
Amounts Recognized in Statement of Financial Position			
Other liabilities	**$ (2,836,361)**	$ (2,391,932)	$ (2,116,908)
Amounts Recognized in Accumulated Other Comprehensive Income			
Net actuarial loss (gain)	**$ 1,274,763**	$ 1,032,192	$ 938,584
Prior service cost (credit)	**(403,773)**	(533,503)	(673,187)
Net transition obligation (asset)	**-**	-	-
Total	**$ 870,990**	$ 498,689	$ 265,397
Weighted-Average Assumptions Used to Determine Obligations at Year End			
Measurement date	**12/31/2012**	12/31/2011	12/31/2010
Discount rate	**4.40%**	5.10%	5.70%
Health care cost trend rate assumed for next year (pre-/post-65) - medical	**7.25%/6.50%**	8.5%/6.75%	7.5%/6.5%
Health care cost trend rate assumed for next year - Rx	**7.75%**	8.00%	10.00%
Ultimate health care cost trend rate	**5.00%**	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	**2023**	2018	2017

Total Cost	2012	2011	2010
Service cost	**$ 61,789**	$ 63,428	$ 60,376
Interest cost	**120,440**	119,127	108,715
Expected return on plan assets	**-**	-	-
Amortization of:			
Unrecognized net transition obligation (asset)	**-**	-	-
Unrecognized prior service cost	**(129,730)**	(139,684)	(141,639)
Unrecognized net loss (gain)	**76,544**	62,556	48,840
Net postretirement benefit cost	**$ 129,043**	$ 105,427	$ 76,292
Accounting for settlements/curtailments/special termination benefits	**$ -**	$ -	$ -
Other Changes in Plan Assets and Projected Benefit Obligation Recognized in Other Comprehensive Income			
Net actuarial loss (gain)	**$ 319,115**	$ 156,164	$ 179,974
Amortization of net actuarial loss (gain)	**(76,544)**	(62,556)	(48,840)
Prior service cost (credit)	**-**	-	-
Amortization of prior service cost	**129,730**	139,684	141,639
Recognition of prior service cost	**-**	-	-
Amortization of transition liability (asset)	**-**	-	-
Total recognized in other comprehensive income	**$ 372,301**	$ 233,292	$ 272,773
AOCI Amounts Expected to be Amortized Into Expense in 2013			
Unrecognized net transition obligation (asset)	**$ -**	$ -	$ -
Unrecognized prior service cost	**(121,736)**	(129,730)	(139,684)
Unrecognized net loss (gain)	**104,065**	76,544	62,556
Total	**$ (17,671)**	$ (53,186)	$ (77,128)
Weighted-Average Assumptions Used to Determine Benefit Cost			
Measurement date	**12/31/2011**	12/31/2010	12/31/2009
Discount rate	**5.10%**	5.70%	6.05%
Health care cost trend rate assumed for next year (pre-/post-65) - medical	**8.5%/6.75%**	7.50%/6.50%	8.0%/7.0%
Health care cost trend rate assumed for next year - Rx	**8.00%**	10.00%	10.50%
Ultimate health care cost trend rate	**5.00%**	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	**2018**	2017	2017

Expected Future Cash Flows

Expected Benefit Payments (net of employee contributions)			
Fiscal 2013	**$ 83,731**	$ 68,609	$ 64,351
Fiscal 2014	**100,439**	79,303	68,796
Fiscal 2015	**111,518**	94,193	76,950
Fiscal 2016	**127,951**	104,309	90,041
Fiscal 2017	**131,443**	119,272	97,191
Fiscal 2018–2022	**785,921**	712,198	644,322
Expected Contributions			
Fiscal 2013	**$ 83,731**	$ 68,609	$ 64,351

NOTE 13 — RELATED PARTY TRANSACTIONS:

Directors of the association, except for any director-elected directors, are required to be borrowers/stockholders of the association. Also, in the ordinary course of business, the association may enter into loan origination or servicing transactions with its officers, relatives of officers and directors, or with organizations with which such persons are associated. Such loans are subject to special approval requirements contained in FCA regulations and are made on the same terms, including interest rates, amortization schedule and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

Total loans to such persons for the association amounted to $18,288,302, $18,833,176 and $17,604,242 at December 31, 2012, 2011 and 2010, respectively. During 2012, $25,365,649 of new loans were made, and repayments totaled $24,973,112. In the opinion of management, no such loans outstanding at December 31, 2012, 2011 and 2010 involved more than a normal risk of collectibility.

Expenses included in purchased services may include purchased services such as administrative services, marketing, information systems and accounting services and allocations of expenses incurred by the bank and passed through to the associations, such as FCSIC expenses. The bank charges the individual associations directly for these services based on each association's proportionate usage. These expenses totaled $94,724, $202,940 and $495,369 in 2012, 2011 and 2010, respectively. As of April 2011, the bank only bills associations for direct pass-through expenses and no longer bills for allocated expenses.

The association received patronage payments from the bank totaling $4,058,689, $3,862,745 and $5,214,086 during 2012, 2011 and 2010, respectively. Of the $4,058,689 patronage received for 2012, $803,813 or 19.8% represented income that would have been earned based on the AMBS investment discusses in Note 3, "Investment Securities."

NOTE 14 — FAIR VALUE MEASUREMENTS:

Accounting guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. See Note 2, "Summary of Significant Accounting Policies," for additional information.

Quantitative Information about Recurring and Nonrecurring Level 3 Fair Value Measurements

	Fair Value at December 31, 2012	Valuation Technique(s)	Unobservable Input
Standby letters of credit	$ 2,558,198	Discounted cash flow	Rate of funding Risk-adjusted spread

With regard to impaired loans and other property owned, it is not practicable to provide specific information on inputs as each collateral property is unique. System institutions utilize appraisals to value these loans and other property owned and take into account unobservable inputs such as, income and expense, comparable sales, replacement cost and comparability adjustments.

Information about Other Financial Instrument Fair Value Measurements

	Valuation Technique(s)	Input
Cash	Carrying value	Par/principal and appropriate interest yield
Loans	Discounted cash flow	Prepayment forecasts Probability of default Loss severity
Other interest-bearing liabilities	Carrying value	Par/principal and appropriate interest yield

Assets and liabilities measured at fair value on a recurring basis at December 31, 2012, 2011 and 2010 for each of the fair value hierarchy values are summarized below:

December 31, 2012	**Fair Value Measurement Using**			**Total Fair Value**
	Level 1	**Level 2**	**Level 3**	
Assets:				
Assets held in nonqualified benefit trusts	**38,984**	**-**	**-**	**38,984**
Total assets	**$ 38,984**	**$ -**	**$ -**	**$ 38,984**
Liabilities:				
Standby letters of credit	**2,558,198**	**-**	**-**	**2,558,198**
Total liabilities	**$ 2,558,198**	**$ -**	**$ -**	**$ 2,558,198**

December 31, 2011	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Assets held in nonqualified benefit trusts	26,171	-	-	26,171
Total assets	$ 26,171	$ -	$ -	$ 26,171
Liabilities:				
Standby letters of credit	4,105,365	-	-	4,105,365
Total liabilities	$ 4,105,365	$ -	$ -	$ 4,105,365

December 31, 2010	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Assets held in nonqualified benefit trusts	51,280	-	-	51,280
Total assets	$ 51,280	$ -	$ -	$ 51,280
Liabilities:				
Standby letters of credit	2,855,356	-	-	2,855,356
Total liabilities	$ 2,855,356	$ -	$ -	$ 2,855,356

Assets and liabilities measured at fair value on a nonrecurring basis at December 31, 2012, 2011 and 2010 for each of the fair value hierarchy values are summarized below:

December 31, 2012	**Fair Value Measurement Using**			**Total Fair Value**
	Level 1	**Level 2**	**Level 3**	
Assets:				
Loans	**$ -**	**$ -**	**$ 13,454,295**	**$ 13,454,295**
Other property owned	**-**	**-**	**1,060,973**	**1,060,973**

December 31, 2011	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Loans	$ -	$ -	$ 51,039,216	$ 51,039,216
Other property owned	-	-	5,487,529	5,487,529

December 31, 2010	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Loans	$ -	$ -	$ 74,759,265	$ 74,759,265
Other property owned	-	-	9,471,878	9,471,878

Financial assets and financial liabilities measured at carrying amounts and not measured at fair value on the balance sheet for each of the fair value hierarchy values are summarized as follows:

	December 31, 2012 Fair Value Measurement Using				December 31, 2011		December 31, 2010	
	Total Carrying Amount	**Level 1**	**Level 3**	**Total Fair Value**	Total Carrying Amount	Total Fair Value	Total Carrying Amount	Total Fair Value
Assets:								
Cash	**$ 77,431**	**$ 77,431**	**$ -**	**$ 77,431**	$ 63,794	$ 63,794	$ 66,243	$ 66,243
Net loans	**807,645,987**	**-**	**804,883,092**	**804,883,092**	860,944,495	855,449,848	938,955,176	927,475,826
Investments	**-**	**-**	**-**	**-**	35,688,875	36,286,767	45,231,568	45,515,590
Total Assets	**$ 807,723,418**	**$ 77,431**	**$ 804,883,092**	**$ 804,960,523**	$ 896,697,164	$ 891,800,409	$ 984,252,987	$ 973,057,659
Liabilities:								
Note payable to the bank	**643,933,880**	**-**	**641,793,801**	**641,793,801**	743,775,358	739,028,498	850,095,961	839,702,974

Valuation Techniques

As more fully discussed in Note 2, "Summary of Significant Accounting Policies," accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following represent a brief summary of the valuation techniques used by the bank and associations for assets and liabilities:

Investment Securities

Where quoted prices are available in an active market, available-for-sale securities would be classified as Level 1. If quoted prices are not available in an active market, the fair value of securities is estimated using pricing models that utilize observable inputs, quoted prices for similar securities received from pricing services or discounted cash flows. Generally, these securities would be classified as Level 2. This would include certain mortgage-backed and asset-backed securities. Where there is limited activity or less transparency around inputs to the valuation, the securities are classified as Level 3. Securities classified within Level 3 include asset-based securities and certain mortgage-backed securities, including private label-FHA/VA securities and those issued by Farmer Mac.

Assets Held in Nonqualified Benefits Trusts

Assets held in trust funds related to deferred compensation and supplemental retirement plans are classified within Level 1. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace.

Standby Letters of Credit

The fair value of letters of credit approximate the fees currently charged for similar agreements or the estimated cost to terminate or otherwise settle similar obligations.

Loans

For certain loans evaluated for impairment under impairment guidance, the fair value is based upon the underlying collateral since the loans are collateral-dependent loans for which real estate is the collateral. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the real estate, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established.

Other Property Owned

Other property owned is generally classified as Level 3. The process for measuring the fair value of other property owned involves the use of appraisals or other market-based information. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. As a result, these fair value measurements fall within Level 3 of the hierarchy.

NOTE 15 — COMMITMENTS AND CONTINGENCIES:

In addition to those commitments and contingencies discussed in Note 2, “Summary of Significant Accounting Policies,” the association is involved in various legal proceedings in the ordinary course of business. In the opinion of legal counsel and management, there are no legal proceedings at this time that are likely to materially affect the association.

The association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers in the form of commitments to extend credit and commercial letters of credit. These financial instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. 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, the association had outstanding commitments of $106,788,253 to extend credit.

The association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financing obligations. Standby letters of credit are recorded, at fair value, on the balance sheet by the association. At December 31, 2012, $2,558,198 of standby letters of credit were included in other liabilities. Outstanding standby letters of credit have expiration dates ranging from January1, 2013 to September 27, 2017. The fair value of these obligations at December 31, 2012 is based on the fees for the unexpired period remaining, which are negligible. The maximum potential amount of future payments the association is required to make under the guarantees is $2,558,198.

NOTE 16 — QUARTERLY FINANCIAL INFORMATION (UNAUDITED):

Quarterly results of operations for the years ended December 31 (in thousands) follow:

	2012				
	First	**Second**	**Third**	**Fourth**	**Total**
Net interest income	**$ 6,872**	**$ 6,233**	**$ 6,498**	**$ 6,836**	**$ 26,439**
(Provision for) reversal of loan losses	**(645)**	**1,957**	**(1,695)**	**(283)**	**(666)**
Noninterest income (expense), net	**(401)**	**(1,229)**	**(2,540)**	**(1,839)**	**(6,009)**
Net income	**$ 5,826**	**$ 6,961**	**$ 2,263**	**$ 4,714**	**$ 19,764**

	2011				
	First	Second	Third	Fourth	Total
Net interest income	$ 6,809	$ 6,786	$ 6,807	$ 7,630	$ 28,032
(Provision for) reversal of loan losses	(2,787)	(112)	(1,812)	(958)	(5,669)
Noninterest income (expense), net	(2,750)	(4,030)	(3,294)	(2,213)	(12,287)
Net income	$ 1,272	$ 2,644	$ 1,701	$ 4,459	$ 10,076

	2010				
	First	Second	Third	Fourth	Total
Net interest income	$ 7,747	$ 7,219	$ 6,728	$ 6,600	$ 28,294
(Provision for) reversal of loan losses	(9,071)	(5,519)	(2,271)	(5,010)	(21,871)
Noninterest income (expense), net	(3,668)	(900)	(2,722)	(290)	(7,580)
Net income	$ (4,992)	$ 800	$ 1,735	$ 1,300	$ (1,157)

NOTE 17 — SUBSEQUENT EVENTS:

The association has evaluated subsequent events through March 12, 2013, which is the date the financial statements were issued or available to be issued.

Effective February 27, 2013, the Association entered into a Letter of Intent in order to memorialize its intent to pursue a mutually beneficial merger transaction with Texas Land Bank, ACA, pending completion of due diligence of each other's operations. This is the first step in a process for developing definitive terms and conditions for a plan of merger. The proposed effective date for merger is January 1, 2014, or as soon as practicable thereafter. Additional disclosures will be provided to stockholders during 2013 under timelines dictated by Farm Credit regulations.

Pursuant to FCA Regulation §620.6(e)(2), Lone Star, ACA discloses that after fiscal year end 2012, but prior to publication of this annual report, the family member of a director purchased an acquired property from Lone Star, ACA under market terms and conditions, and Lone Star partially financed the purchase of that acquired property at market rates and terms in its ordinary course of business.

DISCLOSURE INFORMATION AND INDEX

Disclosures Required by Farm Credit Administration Regulations

DESCRIPTION OF BUSINESS

The description of the territory served, the persons eligible to borrow, the types of lending activities engaged in and the financial services offered, and related Farm Credit organizations required to be disclosed in this section is incorporated herein by reference from Note 1 to the consolidated financial statements, “Organization and Operations,” included in this annual report.

The descriptions of significant developments that had or could have a material impact on earnings, interest rates to borrowers, patronage, or dividends and acquisitions or dispositions of material assets, changes in the reporting entity, changes in patronage policies or practices and financial assistance provided by or to the association through loss sharing or capital preservation agreements or from any other source, if any, required to be disclosed in this section are incorporated herein by reference from “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” included in this annual report.

DESCRIPTION OF PROPERTY

Lone Star, ACA (association) serves its 33-county territory through its main administrative and lending office at 1612 Summit Avenue, Suite 300, Fort Worth, Texas 76102. Additionally, there are nine branch lending offices and two contact points located throughout the territory. The association owns the office buildings in Paris, New Boston, Denton, Cleburne, Stephenville and Sweetwater, free of debt. The association leases office space in Sherman, Decatur, Gainesville, Abilene, Weatherford and Fort Worth.

LEGAL PROCEEDINGS

In the ordinary course of business, the association is involved in various legal proceedings. In the opinion of legal counsel and management, there are no legal proceedings at this time that are likely to materially affect the consolidated financial statements of the association.

DESCRIPTION OF CAPITAL STRUCTURE

The information required to be disclosed in this section is incorporated herein by reference from Note 10 to the consolidated financial statements, “Members’ Equity,” included in this annual report.

DESCRIPTION OF LIABILITIES

The description of liabilities required to be disclosed in this section is incorporated herein by reference from Note 9 to the consolidated statements, “Note Payable to the Bank,” and in “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” included in this annual report.

The description of contingent liabilities required to be disclosed in this section is incorporated herein by reference from Notes 2 and 15 to the consolidated financial statements, “Summary of Significant Accounting Policies” and “Commitments and Contingencies,” respectively, included in this annual report.

RELATIONSHIP WITH THE FARM CREDIT BANK OF TEXAS

The association’s financial condition may be impacted by factors that affect the Farm Credit Bank of Texas (bank), as discussed in Note 1 to the consolidated financial statements, “Organization and Operations,” included in this annual report. The financial condition and results of operations of the bank may materially affect the stockholders’ investment in the association.

The Farm Credit Bank of Texas and District Associations’ (district) annual and quarterly stockholder reports are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, The Ag Agency, P.O. Box 202590, Austin, Texas 78720-2590 or calling (512) 483-9204. Copies of the district’s annual and quarterly stockholder reports can also be requested by e-mailing *fcb@farmcreditbank.com*. The district’s annual and quarterly stockholder reports are also available on its website at *www.farmcreditbank.com*.

The association’s quarterly stockholder reports are also available free of charge, upon request. These reports will be available approximately 40 days after quarter end and can be obtained by writing to Lone Star, ACA 1612 Summit Avenue Suite 300, Fort

Worth, Texas 76102 or calling (817)332-6565. Copies of the association's quarterly stockholder reports can also be requested by e-mailing *Selita.Sprunger@lonestaragcredit.com.* The association's annual stockholder report is available on its website at *www.lonestaragcredit.com.* 75 days after the fiscal year end. Copies of the association's annual stockholder report can also be requested 90 days after the fiscal year end.

SELECTED FINANCIAL DATA

The selected financial data for the five years ended December 31, 2012, required to be disclosed, is incorporated herein by reference to the "Five-Year Summary of Selected Consolidated Financial Data" included in this annual report to stockholders.

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

"Management's Discussion and Analysis," which precedes the consolidated financial statements in this annual report, is incorporated herein by reference.

BOARD OF DIRECTORS

CORPORATE GOVERNANCE

The board of directors at Lone Star, ACA is comprised of 13 director positions. Ten directors are elected by the voting membership. Each represents one of five geographic regions that comprise Lone Star, ACA's lending territory. One director is appointed by the other members of the board and is a current stockholder of the association. Two directors are appointed by the other members of the board and cannot be customers, stockholders, employees or agents of any Farm Credit institution. One of these appointed outside directors brings specific financial, accounting and audit expertise to the board and chairs the board's Audit Committee. The other appointed outside director position is used to bring outside perspective and other areas of expertise to enhance board oversight capabilities.

AUDIT COMMITTEE

This Committee is made up of four board members including at least one appointed outside director. All members of the committee are expected to have practical knowledge of finance and accounting, be able to read and have a working understanding of the financial statements, or develop that understanding within a reasonable period of time after being appointed to the committee. The outside director appointed to this committee has significant financial and audit expertise and chairs this committee. Don Crawford serves in this position. The board of directors has determined that Mr. Crawford has the qualifications and experience necessary to serve as an Audit Committee "financial expert" as defined by FCA regulation, and has been designated as such. Other current Audit Committee members are David Harris, Lonnie Hammonds and Bert Pruett.

The Audit Committee members are appointed by the board. All members of the Audit Committee are independent of management for Lone Star, ACA or any system entity. The Audit Committee has unrestricted access to representatives of the internal audit firm, independent public accountants, internal credit review firms and financial management.

The committee assists the board in fulfilling its oversight responsibility related to accounting policies, internal controls, financial reporting practices and regulatory requirements. This committee has a charter detailing its purpose and key objectives, authority, composition, meeting requirements and responsibilities. The charter among other things gives the committee the authority to hire and compensate the internal and external auditors and credit reviewers, approve all audit and permitted non-audit services, review the audited financial statements and all public financial disclosures, meet privately with internal and external auditors and credit reviewers and review any complaints regarding accounting irregularities and fraud. The charter is posted on Lone Star, ACA's website at *www.lonestaragcredit.com*.

COMPENSATION COMMITTEE

The Compensation Committee consists of three board members selected by the board of directors. Neither the CEO nor management can have any involvement in the selection of committee members nor can they participate in any deliberations of the committee on matters relating to their own compensation. The committee is presently chaired by the board of directors' vice chairman, Tom Johnson. Mr. Johnson also currently serves as vice chairman of the Texas District Benefits Administration Committee and is a member of the AgFirst/FCBT Joint Plan Sponsor Committee. Other current Compensation Committee members are David Stubblefield and Larry Stewart.

The committee is responsible for reviewing and recommending for full board approval, the performance standards of the CEO and the evaluation of the CEO's performance against those standards. It also recommends to the board all actions necessary to administer the CEO's compensation plan. The board has delegated to the CEO the responsibility to administer the base salaries of senior officers and all other staff of Lone Star, ACA, within board approved guidelines. However, the CEO must review the base salary administration with the Compensation Committee, and the committee recommends for board approval the overall compensation program for senior officers. The committee is also responsible for director compensation and for oversight of Lone Star, ACA's employee's salary and benefits plans and all board policies applicable to those plans.

DIRECTORS AND SENIOR OFFICERS

The association's member-elected and director-elected board of directors and senior officers are as follows:

NAME	POSITION	DATE ELECTED/ EMPLOYED	TERM EXPIRES
Bruce Duncan	Chairman	1986	2013
Tom Johnson	Vice Chairman	2000	2013
Richard Gaona	Director	2000	2015
Bobby Mathiews	Director	2006	2015
Don Crawford	Director-Elected Outside Director	2002	2014
Wallace E. Kraft II	Director	1993	2014
Lonnie Hammonds	Director-Elected Stockholder Director	2002	2014
Bert Pruett	Director	1984	2014
David Harris	Director	2001	2013
Larry Stewart	Director	1984	2015
David Stubblefield	Director	1994	2015
Tony Ballinger	Director	2011	2014
Chad Lee	Director-Elected Outside Director	2011	2014
Steve Fowlkes	Chief Executive Officer	2010	-
Troy Bussmeir	Chief Operating Officer	2010	-
M'Lissa Kiel	Chief Financial Officer	1997	-
Jim Bob Reynolds	Chief Credit Officer	2010	-
Ronald J. Carlock	Sr Regional President	1979	-
Thomas Keith	Regional President	1982	-
James Welch	Regional President	1997	-
Matthew James	Regional President and Branch Manager	1998	-
James Bearden	SVP Policy and Compliance	1997	-
Jeff Royal	Chief Appraisal Officer	1999	-

A brief statement of the business and employment background, for at least, the last five years, of each director and senior officer is provided for informational purposes.

Bruce Duncan, 69, currently serves as chairman of the board of Lone Star and is from Avery, Texas. He is a building contractor working under the business name of Bruce Duncan Construction Company, specializing in custom homes with some commercial remodeling. He has been in the construction business since the 1960s. Mr. Duncan maintains a cow/calf operation, and also raises and sells hybrid Bermuda grass and hay. He was elected to the board in 1986.

Tom Johnson, 61, was elected to serve on the Lone Star board in 2001, and he currently serves as vice chairman of the board and as chairman of the Compensation Committee. Additionally, he serves on the 10th District Benefits Advisory Committee and the Ag-First/Farm Credit Bank of Texas Joint Benefits Committee. Mr. Johnson has been active in the communications industry for more than 25 years and is currently the president and director for the following telecommunications and media businesses: First American Communications Enterprise, Inc., First American Holdings, Inc., North Texas Telephone Company, Inc., TLJ Limited Partnership, and United Media, Inc., and as CEO and director for BEMA Media, LLC and Christian.TV, Inc., and is an officer and director for Oklahoma Telephone and Telegraph, Inc. He also serves as president or officer and director for TLJ Management Inc., a management consulting business, and Johnson River LLC, River Creek LTD, North Star LLC, TPJ Properties LTD, GYI Hanger LLC, and Covenant Denison Holdings LLC, which are ranching and real estate investment businesses. Mr. Johnson is a director for First United Bank and Trust Company of Durant, Oklahoma and serves on various committees. Mr. Johnson serves as a director for

Texoma Medical Center Hospital and Varitronics LLC, an education hardware and software business. Mr. Johnson also serves as a director or vice president for various other nonprofit ministries. Mr. Johnson maintains a Black Angus cow/calf operation specializing in producing Waygu-Black Angus calves.

Richard Gaona, 54, is a full-time farmer growing cotton, wheat and hay, and maintains a beef cattle operation in Fisher County. Mr. Gaona serves as board chairman of the Fisher County Appraisal District Board. He is currently board secretary for Rolling Plains Cotton Growers and also serves as a board member for Cotton, Inc. and Universal Cotton Standards. Mr. Gaona was elected to serve on the association's board in 2000.

Bobby Mathiews, 65, was elected to the board in 2006. He is a small independent oil company operator and stock farmer in Throckmorton County. Mr. Mathiews has served as mayor of Woodson for the past 20 years. Mr. Mathiews serves as president of the board of the Brazos Telephone Co-op. He also serves on the Throckmorton Central Appraisal District Board. Mr. Mathiews is a wheat producer and maintains a cow-calf operation.

Don Crawford, 65, serves as a director-elected director and resides in Palo Pinto County. Mr. Crawford was elected to serve on the board in 2002 and currently serves as chairman of the Audit Committee. He is a director and chairman of the Audit Committee of Titan Bank, N.A. of Mineral Wells, Texas. Mr. Crawford is a certified public accountant (CPA) and a partner with Crawford, Carter and Thompson CPAs of Mineral Wells. He is also a partner in Crawford Brothers Ranch of Strawn, Texas, a commercial beef cattle operation, and he is a general partner in Crawford Cross LLP, a land holding company. Mr. Crawford serves as a board member for the Palo Pinto Municipal Water District, and he serves as Treasurer on the Board of Mineral Wells Industrial Foundation, a non-profit foundation. Mr. Crawford serves as chairman of the Finance Committee of Our Lady of Lourdes Catholic Church.

Wallace E. Kraft II, 68, lives in Lamar County. Dr. Kraft was elected to the board in 1993 and he currently serves as the association representative on the District Farm Credit Council. Dr. Kraft is a general veterinary practitioner in Paris, Texas and owns Animal Health Center, a mixed animal practice. Dr. Kraft serves on the Lamar County Farm Bureau Board. Dr. Kraft serves as treasurer of the Veterinary PAC of the American Veterinary Medical Association (AMVA). He also serves on the Legislative Committee of the Texas Veterinary Medical Association (TVMA). Dr. Kraft serves on the liaison committee for the TVMA/AVMA. He is also on the board of directors for Sulphur River Basin Water Authority. Dr. Kraft is chairman of the board of trustees for 1st Methodist Church, Paris, Texas. Dr. Kraft maintains a cow-calf operation and hay production operation.

Lonnie Hammonds, 72, was elected to the board in 2002 and currently serves on the association Audit Committee. Mr. Hammonds is retired from the banking industry, as well as dairy farming. Mr. Hammonds is self-employed in the ranching industry in Erath and Hamilton counties.

Bert Pruett, 60, was elected to the board in 1984 and currently serves on the Audit Committee. Mr. Pruett lives in Slidell in northwest Denton County. Mr. Pruett serves as treasurer of the Greenwood-Slidell Volunteer Fire Department. Mr. Pruett is president of the Denton-Wise County Farmers Union. Mr. Pruett is chairman of the deacons of the First Baptist Church. He is a self-employed grain farmer who maintains an operation of cattle, wheat, milo, corn and hay.

David Harris, 53, lives in Johnson County and owns property in Somervell County. He was elected to the board in 2001 and currently serves on the Audit Committee. Mr. Harris is the president of Bob Harris Oil Company, a wholesale and retail fuel distributor. Mr. Harris is managing partner in Alvarado Joint Venture, a real estate development partnership, and he is also managing partner in Harco Cattle. Mr. Harris is a member of the Santa Gertrudis Association Breed Improvement Committee and a Performance Committee member. He formerly served as president of the Premier Santa Gertrudis Association and former vice president of Marketing for Santa Gertrudis Breeders International. Mr. Harris is a member of the Cleburne Economic Development Board and is manager of Harris Farms. He also maintains a purebred and commercial cow-calf operation.

Larry Stewart, 63, lives between Granbury and Lipan in Hood County. Mr. Stewart was elected to the board in 1984 and currently serves on the Compensation Committee. Mr. Stewart's primary operation is beef cattle and he also participates in hay production. Mr. Stewart also serves as a director on the F.N.B. Granbury Bank Board, and as a director on the Hood County Action Cemetary Board and Cancer Care Board.

David Stubblefield, 61, is a farmer-stockman in the Colorado City area of Mitchell County. He was elected to the board in 1994 and currently serves on the Compensation Committee. Mr. Stubblefield is president of the board for the Producers Co-op Gin and is a state director serving as vice president of the Texas Farm Bureau. Mr. Stubblefield is chairman of the Lone Wolf Groundwater Conservation District. He also serves as director for Rolling Plains Cotton Growers and a director for Southern Farm Bureau Life.

Mr. Stubblefield operates the Gas 'n' Grub convenience store featuring a deli, catering and Western Union services. Mr. Stubblefield grows cotton, milo and wheat, and maintains a beef cow operation.

Tony Ballinger, 39, was elected to the board in 2011. Mr. Ballinger is a beef cattle specialist for ADM Alliance Nutrition, a producer of livestock feed ingredients. Mr. Ballinger currently serves as president of the Texas Red Angus Association. Mr. Ballinger is on the board of trustees of the Morgan Mill ISD. Mr. Ballinger maintains a commercial and purebred cow-calf operation, a hay production and small grains operation, as well as a horse-breeding program.

Chad Lee, 41, a director-elected director, was elected to serve on the board in 2011. Mr. Lee is a private practice attorney, with an emphasis on criminal defense, employment and various agricultural issues, including contracts, oil and gas leasing and real property disputes. Mr. Lee also maintains an operation of commercial cattle, wheat and hay.

Steve Fowlkes, 60, became interim CEO of Lone Star in February 2010. In May of 2010 the board named Mr. Fowlkes permanent CEO. Mr. Fowlkes had served as the senior vice president/chief credit officer of the Farm Credit Bank of Texas in Austin, Texas, for the preceding six and a half years. Mr. Fowlkes began his career as a credit examiner with the Farm Credit Administration. He was assistant manager of the Federal Land Bank Association of Cleburne prior to joining the Federal Land Bank (FLB) of Texas in 1979 as a management analyst. Subsequently, he held the positions of associate vice president of internal review for the FLB of Texas, vice president of review for the Farm Credit Banks of Texas, and vice president, special assets, for the Farm Credit Bank of Texas. In 1998, Fowlkes was promoted to senior vice president of bank administration with responsibility for human resources, building operations and the bank's in-house marketing agency. He also was vice chairman of the bank's executive committee. From January to March 2003, he served as interim chief executive officer of the bank. Fowlkes, who is a native of Fort Worth, earned his bachelor's and master's degrees in agricultural economics from Texas A&M University.

Troy Bussmeir, 40, joined Lone Star May of 2010 as the chief credit officer, and was later appointed as chief operating officer in March 2012. Prior to Lone Star, he served five years as a relationship manager at the Farm Credit Bank of Texas in Austin, and as a Capital Markets analyst for one year prior to that. Mr. Bussmeir began his banking career in 1999 with Farm Credit of South Florida, serving as a credit analyst and later as a senior commercial loan officer. He left South Florida to work at AgFirst Farm Credit Bank in Columbia, S.C., as a commercial credit analyst in their Capital Markets group. Mr. Bussmeir is a native of Seattle, Washington and earned his bachelor's degree in finance and accounting from Palm Beach Atlantic University in West Palm Beach, Florida.

M'Lissa Kiel, 50, joined the Farm Credit Bank of Texas in 1986 and served in various accounting and financial capacities before assuming the role of chief financial officer of Lone Star in December 1997.

Jim Bob Reynolds, 49, was appointed chief credit officer in March 2012. Jim Bob began his Farm Credit career with Lone Star, ACA on September 1, 2010 serving as senior vice president of commercial credit. Prior to joining Lone Star, ACA Jim Bob worked for First State Bank in Dalhart, Texas for the preceding 11 years, serving as senior vice president of commercial lending. Jim Bob is a native of Dalhart, Texas where he grew up on his family's farming/cattle operation. He earned his BS in Ag Economics from Texas Tech University and his MBA from UTSA.

Ronald J. Carlock, 55, is a graduate of Texas A&M University. He began his career with the Federal Land Bank Association of Denton in 1979. Mr. Carlock served as president of the association prior to the merger forming Lone Star on December 31, 1997. Mr. Carlock currently serves as a senior regional president for the association.

Thomas Keith, 53, was named regional president in January 2007. Prior to his promotion, Mr. Keith served as credit office president of the Stephenville office. Mr. Keith, a graduate of Tarleton State University, began his Farm Credit career as a loan officer trainee at Farm Credit Bank of Texas in June 1982.

James Welch, 39, began his Farm Credit career in 1997 with North Texas PCA. From May 2002 through January 2006, Mr. Welch was a credit office president for Lone Star in Paris. Mr. Welch transferred to AgriLand Farm Credit in February 2006 as a joint branch manager of the Paris and Clarksville offices. Mr. Welch returned to Lone Star in December 2006 in his current capacity as a regional president.

Matthew James, 37, was named regional president of the Stephenville region in July of 2010. Prior to his promotion, Mr. James served as branch president of the Stephenville office. Mr. James graduated from Tarleton State University with a bachelor of science degree in agriculture and a minor in business. He began his Farm Credit career as an intern with Lone Star Federal Land Bank in Stephenville in spring of 1998 and accepted a full-time position in August of 1998.

James Bearden, 58, has been employed by Lone Star since 1997. He has served the Farm Credit System since 1980 in several capacities. Mr. Bearden is a native of Hillsboro, Texas, and a graduate of Texas A&M University. Mr. Bearden currently serves as senior vice president of policy and compliance.

Jeff Royal, 50, began his career with Farm Credit as a staff appraiser for Farm Credit Bank of Texas in 1998. Mr. Royal assumed the duties of appraisal operations for Lone Star in 1999 and currently serves as the chief appraisal officer for the association. He is a graduate of Texas A&M University, earning a bachelor's degree in agricultural economics and a master's degree in land economics and real estate.

COMPENSATION OF DIRECTORS

Directors were compensated for their service to the association in the form of an honorarium at the rate of $600 per day for director meetings and special meetings, except for the board chairman and vice chairman. Effective May 2011 the board chairman and vice chairman rate has been increased from $700 and $600 to $800 and $700, respectively. Also effective May 2011 the Audit chairman receives an additional honorarium of $500 per month. Directors also receive an annual retention fee of $600 per month. Committee meetings that are held in conjunction with another meeting are paid at the rate of $150 per meeting, except for Audit Committee meetings as of May 2011 directors are compensated for their service at the rate or $200 per meeting. Directors are paid honorarium for conference calls less than an hour at the rate of $100 per hour and for calls in excess of an hour they are compensated $200 per hour. Directors were reimbursed for certain expenses incurred while representing the association in an official capacity. Mileage for attending official meetings during 2012 was paid at the IRS-approved rate of 55.5 cents per mile. A copy of the travel policy is available to stockholders of the association upon request.

	Number of Days Served Associated With		
DIRECTOR	**Board Meeting**	**Other Official Activities**	**Total Compensation in 2012**
Tony Ballinger	13	5	$ 18,000
Don Crawford	13	7	28,100
Bruce Duncan	12	12	24,200
Richard Gaona	13	5	18,000
Lonnie Hammonds	13	7	22,100
David Harris	12	7	21,300
Tom Johnson	13	9	23,150
Wallace E Kraft II	13	8	19,800
Chad Lee	12	5	17,400
Bobby Mathiews	13	5	18,000
Bert Pruett	12	11	23,800
Larry Stewart	13	5	19,300
David Stubblefield	12	2	16,750
			$ 269,900

The aggregate compensation paid to directors in 2012, 2011 and 2010 was $269,900, $283,600 and $257,500, respectively. Additional detail regarding director compensation paid for committee service (which is included in the table above) is as follows:

	Committee			
DIRECTOR	**Audit Committee**	**Compensation Committee**	**Credit Review Committee**	**Total**
Don Crawford	$ 8,200	$ -	$ -	$ 8,200
Lonnie Hammonds	2,200	-	-	2,200
David Harris	2,000	-	-	2,000
Tom Johnson	-	1,050	-	1,050
Bert Pruett	2,000	-	-	2,000
Larry Stewart	-	1,050	150	1,200
David Stubblefield	-	1,050	-	1,050
	$ 14,400	$ 3,150	$ 150	$ 17,700

The aggregate amount of reimbursement for travel, subsistence and other related expenses paid to directors and on their behalf was $75,397, $79,645 and $74,547 in 2012, 2011 and 2010, respectively.

COMPENSATION OF SENIOR OFFICERS

Compensation Discussion and Analysis – Senior Officers

Overview

The objective of the association's salary administration program is to attract, develop, retain and motivate staff that is knowledgeable and efficient in the ability to support the association in the executions of its strategic objectives and delivery of association results that maximize the value received by its membership. The association operates utilizing a compensation program which focuses on the performance and contributions of its employees in achieving the association's financial and operational objectives, all for the ultimate benefit of its membership. The Association's board of directors, through its Compensation Committee, establishes annual salary and incentive programs utilizing the services of the Human Resources Compensation Team at the bank to compile "Compensation Market Data" annually that is used by the board and management in establishing salary levels. Data sources used include the Federal Reserve Bank of Dallas 11th District survey, Texas Community Bank survey (Independent Bankers Association of Texas), Watson Wyatt Financial Institution surveys, Mercer Financial Services Commercial Lending survey and CompData surveys. The Compensation Market Data reveals salary and incentive levels for similar sized institutions operating in our geographic area. Studies provided by third-party compensation specialists form the foundation for the association's evaluation and establishment of annual salary plans used by the association.

Chief Executive Officer (CEO) Compensation Table and Policy

Name of Individual	Year	Salary (a)	Bonus (b)	Change in Pension Value (c)	Deferred/ Perquisite (d)	Other (e)	Total
Steve Fowlkes	2012	**$ 405,000**	**$ 352,500**	**$ 391,115**	**$ 11,091**	**$**	**$ 1,159,706**
CEO	2011	370,000	116,100	229,892	11,062	37,355	764,409
	2010	233,340			3,016	58,424	294,780
Daron Gates CEO	2010	18,570			2,300		20,870

(a) Gross Salary
(b) Bonus earned and paid
(c) Change in pension value (noncash)
(d) Automobile benefits
(e) Other includes: 2011 & 2010 relocation costs.

Daron Gates resigned effective January 27, 2010.

The Farm Credit Administration (FCA) approved an amendment to regulations regarding senior officer compensation disclosures. One provision of the rule requires associations to hold nonbinding, advisory votes on senior officer compensation. In accordance with the rule, associations must hold a vote on senior officer compensation when 5 percent of the voting stockholders petition for the vote. Also, associations must hold a vote on CEO compensation or senior officer compensation or both if compensation increases by 15 percent or more from the previous reporting period as provided in the rule. This amendment does not become effective until the 2013 fiscal year, and the additional disclosures required by the amendment will be incorporated in the 2013 Annual Report to Stockholders.

The CEO's salary is established for the period January 1 through December 31 of each year, and is set by the board using the Compensation Market Data as a guideline to arrive at a fair and competitive salary. As previously discussed, Mr. Fowlkes was employed in May of 2010 with the charge of correcting weaknesses in the association's management and internal control weaknesses in credit operations and credit administration. The CEO's 2012 bonus was at board discretion and based upon its assessment of the association's financial performance, credit administration and credit quality improvements, and attainment of other goals and objectives as established in the association's 2012 Business Plan. This incentive was based on the period from May 2011 through December of 2012. Factors contributing to the award were the size and complexity of the association coupled with the challenges it faced, considered in context with the costs and consequences of previously cited weaknesses by FCA in their December 2009 Report of Examination. The financial condition of the association has notably improved and credits adversely

affecting the association have been identified and materially reduced. Third-party examinations and credit reviews have validated significant improvement.

The CEO of the association participates in the Farm Credit of Texas Pension Plan (the "Pension Plan"), which is a qualified defined benefit retirement plan. Compensation, as defined in the Pension Plan, includes wages, incentive compensation, and deferrals to the 401(k) and flexible spending account plans, but excludes annual leave or sick leave that may be paid in cash at the time of termination, retirement, or transfer of employment, severance payments, retention bonuses, taxable fringe benefits, and any other payments. Pension Plan benefits are based on the average of monthly eligible compensation over the 60 consecutive months that produce the highest average after 1996 ("FAC60"). The Pension Plan's benefit formula for a Normal Retirement Pension is the sum of (a) 1.65 percent of FAC60 times "Years of Benefit Service" and (b) 0.50 percent of (i) FAC60 in excess of Social Security covered compensation items (ii) "Years of Benefit Service" (not to exceed 35). The CEO's Pension Plan benefit is offset by the CEO's pension benefits from another Farm Credit System institution. The present value of the CEO's accumulated Pension Plan is calculated assuming retirement had occurred at the measurement date used for financial reporting purposes with the retirement at age 65. The Pension Plan's benefit formula for the Normal Retirement Pension assumes that the CEO is married on the date the annuity begins, that the spouse is exactly two years younger than the CEO, and that the benefit is payable in the form of a 50 percent joint and survivor annuity. If any of those assumptions are incorrect, the benefit is recalculated to be the actuarial equivalent benefit. The CEO's pension plan was funded by a previous Farm Credit Institution and has reached the maximum contribution level. All costs prior to 2012 were borne by the previous employer.

Compensation of Other Senior Officers

Officers and employees are evaluated and compensated based on the market compensation data as previously described. The following table summarizes the compensation paid to the five highest compensated senior officers (excluding the CEO) of the association during 2012, 2011 and 2010. Amounts reflected in the table are presented in the year the compensation was earned.

Name of Group	Year	Salary (a)	Bonus (b)	Deferred/ Perquisite (c)	Other (d)	Total
Aggregate No. of Five Highest Compensated Senior Officers in Year Excluding CEO						
(5)	**2012**	**870,935**	**174,187**	**38,933**		**1,084,055**
(5)	2011	809,394		30,191	6,476	846,061
(5)	2010	641,608		26,297	60,051	727,956

(a) Gross Salary
(b) Bonus earned and paid
(c) Automobile benefits
(d) Other includes: 2011 & 2010 relocation costs

Disclosure of information on the total compensation paid and the arrangements of the compensation plans during the last fiscal year to any senior officer or to any other officer included in the aggregate are available and will be disclosed to shareholders of the institution upon request.

The Farm Credit Administration (FCA) approved an amendment to regulations regarding senior officer compensation disclosures. One provision of the rule requires associations to hold nonbinding, advisory votes on senior officer compensation. In accordance with the rule, associations must hold a vote on senior officer compensation when 5 percent of the voting stockholders petition for the vote. Also, associations must hold a vote on CEO compensation or senior officer compensation or both if compensation increases by 15 percent or more from the previous reporting period as provided in the rule. This amendment does not become effective until the 2013 fiscal year, and the additional disclosures required by the amendment will be incorporated in the 2013 Annual Report to Stockholders.

As a result of the continued improvement in operations and in an effort to maintain it's competitiveness in the marketplace, during 2012, the association board's Compensation Committee (Committee) approved an incentive plan for Lone Star senior officers and staff to be implemented in 2012. The incentive plan was based on Association performance goals and objectives, including credit administration and the related correlation of credit administration with the FCA, association Internal Credit Review and the FCBT reviews, Permanent Capital Ratio goals, ratio of adverse assets and ability of the association to declare a patronage for 2013 based

on 2012 earnings reflective of improved financial performance, as defined by the board. All employees were eligible to participate except for the CEO, who was not a participant in this incentive program. The association did not have an incentive plan nor did it pay an incentive to staff during 2011 or 2010. The association underwent an examination by the Farm Credit Administration (FCA) during the third quarter of 2009. The examination report, dated December 22, 2009, cited a severe management and internal control weakness in credit operations and credit administration. In early 2010 the board made changes in the association senior management. Under new management, the weaknesses identified have been corrected.

Personal mileage on association automobiles is reported as taxable income to employees and reported in the deferred/perquisite column in the table above. Employees who use their personal automobile for business purposes were reimbursed during 2012 at the IRS-approved rate of 55.5 cents per mile.

Neither the CEO nor any other senior officer received non-cash compensation exceeding $5,000, other than disclosed previously in 2012, 2011 or 2010.

Senior officers, including the CEO, are reimbursed for reasonable travel, subsistence and other related expenses while conducting association business. A copy of the association's travel policy is available to shareholders upon request.

TRANSACTIONS WITH DIRECTORS AND SENIOR OFFICERS

The association's policies on loans to and transactions with its officers and directors, required to be disclosed in this section, are incorporated herein by reference from Note 13 to the consolidated financial statements, "Related Party Transactions," included in this annual report.

DIRECTORS' AND SENIOR OFFICERS' INVOLVEMENT IN CERTAIN LEGAL PROCEEDINGS

During the past five years, none of the association's officers or directors has been involved in legal proceedings that are material to an evaluation of the ability or integrity of any person who served as director or senior officer on January 1, 2011, or any time during the year just ended.

RELATIONSHIP WITH INDEPENDENT AUDITOR

No change in auditors has taken place since the last annual report to stockholders and no disagreements with auditors has occurred that the association is required to report to the Farm Credit Administration under part 621 of the FCA regulations governing this disclosure.

Fees for professional services rendered for the association by PricewaterhouseCoopers for the year ending December 31, 2012 were $66,200 and were comprised of audit services for $60,000 and tax services for $6,200.

FINANCIAL STATEMENTS

The financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 12, 2013, and the report of management in this annual report to stockholders, are incorporated herein by reference.

MEMBER/SHAREHOLDER PRIVACY

Members' nonpublic personal financial information is protected by Farm Credit Administration regulation. Our directors and employees are restricted from disclosing information not normally contained in published reports or press releases about the association or its members.

CREDIT AND SERVICES TO YOUNG, BEGINNING AND SMALL FARMERS AND RANCHERS, AND PRODUCERS OR HARVESTERS OF AQUATIC PRODUCTS

Lone Star, ACA is obligated to establish programs that respond to the credit and related service needs of Young, Beginning and Small (YBS) farmers and ranchers. It is the association's responsibility to fulfill its public policy role by extending credit and related services to this important sector of our customer base. YBS farmers and ranchers face continuing challenges in agriculture, including access to capital and credit needs, limited financial resources for land and equipment, urbanization demands and increasing competition from larger and highly capitalized operations.

The board of directors and management are committed to providing programs that facilitate meeting the needs of this group of customers. These programs also address other issues, including the aging of agricultural landowners and customers, the need to transfer assets to another generation of potential landowners and a recognition that many young, beginning and small operators will need to supplement their farm income by seeking off-farm employment. Additionally, demographic trends indicate that agricultural landowners make decisions regarding land or agricultural endeavors based on lifestyle choices, recreational utility or as an alternative investment in a major financial asset.

Definitions for YBS Farmers and Ranchers

Young Farmer or Rancher- a farmer, rancher or producer/harvester of aquatic products who was age 35 or younger as of the date when the loan was originally made.

Beginning Farmer or Rancher- a farmer, rancher or producer/harvester of aquatic products who had ten years or less of experience at farming or ranching as of the date the loan was originally made.

Small Farmer or Rancher- a farmer, rancher or producer/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. An individual loan to a small borrower will be reported in one of four loan size categories: $0-$50,000; $50,001-$100,000; $100,001-$250,000; and $250,001 and greater.

In order to address the specific needs of these customers, and to be responsive to the credit needs of young, beginning and small farmers, the association utilizes all existing loan programs to the maximum benefit of young, beginning and small farmers. The association has also developed specific loan programs to meet the credit needs of this group. Qualifying young, beginning, and small farmers who are involved or becoming more involved in agriculture may be eligible for loans with more flexible rates and fees.

The association's YBS loans, as a percentage of total loans outstanding on December 31, 2012, 2011 and 2010, respectively, are reflected in the table below:

	2012		2011		2010	
	% loans	% volume	% loans	% volume	% loans	% volume
Young	18.62	10.74	19.32	11.78	19.80	12.33
Beginning	55.57	47.49	54.87	49.23	54.06	51.99
Small	79.15	59.68	78.20	54.40	77.17	64.36

The association's YBS loans, as a percentage of all loans closed each year, are reflected in the table below for the past three years:

	2012		2011		2010	
	% loans	% volume	% loans	% volume	% loans	% volume
Young	15.78	12.35	13.76	12.38	16.20	11.81
Beginning	48.06	36.98	36.55	32.17	36.64	23.76
Small	72.02	44.15	61.23	31.79	65.11	36.87

The board has established quantitative targets within the operational and strategic business plan to measure and evaluate progress toward serving young, beginning and small customers. These volume-based targets for 2012 performance included credit to young farmers at 14 percent, credit to beginning farmers at 37 percent and credit to small farmers at 40 percent. While new credit to young farmers did not meet expectations, beginning and small farmer activity met objectives for 2012, especially for smaller loans, primarily due to the overall level of loan activity for the year. Goals were also established by the board for loans outstanding to young, beginning and small farmers. Volume based performance goals for outstanding loans included young borrowers at 12.5 percent, beginning borrowers at 50.0 percent and small borrowers at 60.0 percent of loans outstanding. Performance mirrored that of new business, with volume outstanding to young farmers less than expected and beginning and small farmers near expectations.

The United States Department of Agriculture's NASS Census of Agriculture-2007 Census provides data regarding the actual market for YBS farmers and ranchers within the 33-county area served by Lone Star. This census data indicated 4.2 percent of

farm operators are “young,” 34.4 percent of operators are “beginning” and 97.7 percent of farm units are categorized as “small.” There are differences in the method by which association YBS data and demographic census data is described. Census data is based on the number of farms, and association data is based on the number of customers. Additionally, census dates do not coincide with an annual analysis of association data, and calculations for young and beginning farmers are slightly different. Annual performance data and goals established also include lending activity outside the association’s territory. However, a comparison does offer a quantitative measure of the association’s performance in fulfilling its mission of service to young, beginning and small farmers.

The association coordinates its young, beginning and small farmer loan program activities with other lenders. This includes the purchase and sale of loan participations, loan guarantees and joint lending. Related services including appraisal, credit life insurance, life and disability products and leasing programs are available to assist YBS borrowers in their credit and related service needs.

Important components of the association’s YBS efforts include the emphasis placed on outreach programs. The association has held a long-standing belief that an investment in agricultural students and youth activities is important to the long-term success of the cooperative. The association develops a comprehensive array of marketing efforts to include youth activities and events including livestock shows, 4-H and FFA events, young professional groups and agricultural leadership opportunities.

The association offers a scholarship program for area seniors, and four scholarships are awarded in the lending area. The association also sponsors youth activities in the local area and at the state level through support of 4-H and FFA activities.

A YBS advisory board was formed to generate ideas and methods on how Lone Star, ACA can better serve the YBS demographic in our area. The advisory board minutes are reported to the board of directors.

In summary, the association fulfills its mission of providing agricultural credit, and meeting the specific credit and related service needs of young, beginning and small farmers, ranchers and producers/harvesters of aquatic products through specific lending programs, quantitative performance measures and broad-based objectives.