LONE STAR, ACA

2012
Quarterly Report
Third Quarter

For the Quarter Ended September 30, 2012

REPORT OF MANAGEMENT

The undersigned certify that we have reviewed this 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 and belief.

Steve Fowlkes, Chief Executive Officer

November 8, 2012

Bruce Duncan, Chairman, Board of Directors

November 8, 2012

M'Lissa Kiel, Chief Financial Officer

November 8, 2012

Don Crawford, Chairman, Audit Committee

November 8, 2012

Troy Bussmeir, Chief Operating Officer

November 8, 2012

LONE STAR, ACA
MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the financial performance of the Lone Star, ACA (Agricultural Credit Association), referred to as the association, for the quarter ended September 30, 2012. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2011 Annual Report to Stockholders.

The association is a member of the Farm Credit System (System), a nationwide network of cooperatively owned financial institutions established by and subject to the provisions of the Farm Credit Act of 1971, as amended, and the regulations of the Farm Credit Administration (FCA) promulgated thereunder.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The consolidated financial statements were prepared under the oversight of the association's audit committee.

Significant Events:

In December 2011 the Lone Star, ACA board declared a $2,000,000 cash patronage to be paid in April 2012, based on 2011 earnings. The association's capital position continued to improve and is above 20 percent for the quarter ending September 30, 2012.

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 a non-recurring event and the association does not anticipate receiving additional refunds in the future.

During the second quarter of 2012 the association recognized a recovery of $2.1 million from a nonaccrual loan.

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.

Loan Portfolio:

Total loans outstanding at September 30, 2012, including nonaccrual loans and sales contracts, were $818,471,761 compared to $872,045,989 at December 31, 2011, reflecting a decrease of 6.1 percent. Nonaccrual loans as a percentage of total loans outstanding were 4.2 percent at September 30, 2012, compared to 6.8 percent at December 31, 2011.

The association recorded $491,310 in recoveries and $1,065,654 in charge-offs for the quarter ended September 30, 2012, and $2,856 in recoveries and $2,248,564 in charge-offs for the same period in 2011. The association's allowance for loan losses was 1.4 percent and 1.4 percent of total loans outstanding as of September 30, 2012, and December 31, 2011, respectively.

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. The following table illustrates the association's components and trends of high-risk assets.

	September 30, 2012		December 31, 2011	
	Amount	**%**	Amount	%
Nonaccrual	**$ 34,277,179**	**86.8%**	$ 59,597,315	91.6%
90 days past due and still accruing interest	**131,237**	**0.3%**	11,113	0.0%
Formally restructured	**57,093**	**0.1%**	-	0.0%
Other property owned, net	**5,063,710**	**12.8%**	5,487,529	8.4%
Total	**$ 39,529,219**	**100.0%**	$ 65,095,957	100.0%

As of September 30, 2012 high risk assets have decreased by $25,568,689 or 39 percent from year end December 31, 2011. This positive decrease is a result of loan resolution efforts and continued downward trend in exposure to certain enterprise groups, along with receipt of timely payments that enabled other high risk asset loans to return to a viable accruing status.

Results of Operations:

The association had net income of $2,263,234 and $15,050,612 for the three and nine months ended September 30, 2012, as compared to net income of $1,700,868 and $5,616,864 for the same period in 2011, reflecting an increase of 33.1 and 168.0 percent, respectively. Net interest income was $6,498,461 and $19,603,645 for the three and nine months ended September 30, 2012, compared to $6,806,691 and $20,401,491 for the same period in 2011. Interest income for the three and nine months ended September 30, 2012, decreased by $1,956,334 and $6,004,837, or 16.6 and 16.5 percent, respectively, from the same period of 2011, primarily due to a decrease in average loan volume, slightly offset by an increase in interest spread. Interest expense for the three and nine months ended September 30, 2012, decreased by $1,648,104 and $5,206,991, or 33.2 and 32.5 percent, respectively, from the same period of 2011 due to a slight decrease in interest rates coupled with a decrease in average debt volume. Average loan volume for the third quarter of 2012 was $836,035,459, compared to $896,120,068 in the third quarter of 2011. The average spread on the loan portfolio for the third quarter of 2012 was 2.67 percent, compared to 2.45 percent in the third quarter of 2011.

The association's return on average assets for the nine months ended September 30, 2012, was 2.31 percent compared to 0.76 percent for the same period in 2011. The association's return on average equity for the nine months ended September 30, 2012, was 10.87 percent, compared to 4.35 percent for the same period in 2011.

	September 30 2012		September 30 2011	
	Average Balance	**Interest**	Average Balance	Interest
Loans	**$ 850,962,806**	**$ 30,232,263**	$925,964,351	$34,773,720
Investments	**3,234,947**	**211,054**	42,692,219	1,674,434
Total interest-earning assets	**854,197,753**	**30,443,317**	968,656,570	36,448,154
Interest-bearing liabilities	**680,858,118**	**10,839,623**	812,648,551	16,046,647
Impact of capital	**$ 173,339,635**		$156,008,019	
Net interest income		**$ 19,603,694**		$20,401,507

	2012 Annualized Average Yield	2011 Average Yield
Yield on loans	**4.75%**	5.02%
Yield on investments*	**8.71%**	5.24%
Total yield on interest-earning assets	**4.76%**	5.03%
Cost of interest-bearing liabilities	**2.13%**	2.64%
Interest rate spread	**2.63%**	2.39%
Net interest income as a percentage of average earning assets	**3.07%**	2.82%

* For 2012, due to FCBT purchasing the securitized AMBS Investments as referenced in Significant Events above – the annualized yield on these investments reflects interest earned for the full period versus the average balance of investments.

	September 30, 2012 vs. September 30, 2011		
	Increase (decrease) due to		
	Volume	**Rate**	**Total**
Interest income - loans	**$ (2,819,226)**	**$ (1,722,231)**	**$ (4,541,457)**
Interest income - investments	**(1,548,969)**	**85,589**	**(1,463,380)**
Total interest income	**(4,368,195)**	**(1,636,642)**	**(6,004,837)**
Interest expense	**(2,604,697)**	**(2,602,327)**	**(5,207,024)**
Net interest income	**$ (1,763,497)**	**$ 965,684**	**$ (797,813)**

	Quarter Ended September 30,		Change
	2012	**2011**	
Average Loan Volume	**$ 850,962,806**	$ 925,964,351	-8.1%
Average Loan Portfolio Spread	**2.63**	2.39	10.2%
ROA	**2.31%**	0.76%	203.9%
ROE	**10.87%**	4.35%	150.1%
Allowance for loan losses to total loans	**1.41%**	2.11%	-33.0%

Liquidity and Funding Sources:

The association secures the majority of its lendable funds from the Farm Credit Bank of Texas (the bank), which obtains its funds through the issuance of Systemwide obligations and with lendable equity. The following schedule summarizes the association's borrowings.

	September 30, 2012	December 31, 2011
Note payable to the bank	**$ 642,824,887**	$ 743,775,358
Accrued interest on note payable	**1,047,697**	1,534,542
Total	**$ 643,872,584**	$ 745,309,900

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 $642,824,887 as of September 30, 2012 is recorded as a liability on the association's balance sheet. The note carried a weighted average interest rate of 2.13 percent at September 30, 2012. The indebtedness is collateralized by a pledge of substantially all of the association's assets to the bank and is governed by the GFA. 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, was $175,795,549 at September 30, 2012. The maximum amount the association may borrow from the bank as of September 30, 2012 was $797,487,534 as defined by the GFA. The indebtedness continues in effect until the expiration date of the GFA, 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 generate adequate amounts of cash to fund operations and meet obligations while increasing accrual loan volume. This policy will continue to be pursued during the remainder of 2012. As borrower payments are received, they are applied to the association's note payable to the bank.

Capital Resources:

The association's capital position increased by $14,439,999 to $190,732,863 at September 30, 2012, compared to $176,292,864 December 31, 2011. The association's debt as a percentage of members' equity was 3.40:1 as of September 30, 2012, compared to 4.26:1 as of December 31, 2011.

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 association's permanent capital ratio at September 30, 2012, was 20.3 percent, which is in compliance with the FCA's minimum permanent capital standard. The association's core surplus ratio and total surplus ratio at September 30, 2012, were 19.9 and 19.9 percent, respectively, which is in compliance with the FCA's minimum surplus standard.

Significant Recent 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 offset 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 financial condition or results of operations, but will result in additional disclosures.

In September 2011, the FASB issued guidance entitled "Compensation – Retirement Benefits – Multiemployer Plans." The guidance is intended to provide more information about an employer's financial obligations to a multiemployer 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 will not impact the association's financial condition or results of operation.

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 disclose 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.

In May 2011, the FASB issued guidance entitled "Fair Value Measurement – Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs." The amendments clarify certain aspects of the fair value measurement and disclosure requirements. The amendments are to be applied prospectively and are effective during interim and annual periods beginning after December 31, 2011. The adoption of this guidance did not impact the financial condition or results of operations but resulted in additional disclosures.

In April 2011, the FASB issued its guidance entitled, "A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring," which provides for clarification on whether a restructuring constitutes a troubled debt restructuring. In evaluating whether a restructuring is a troubled debt restructuring, a creditor must separately conclude that both of the following exists: (1) the restructuring constitutes a concession, and (2) the debtor is experiencing financial difficulties. The guidance is effective for nonpublic entities for annual periods ending on or after December 15, 2012, including interim periods within those annual periods. The adoption of this guidance was not material to the financial condition or results of operations.

Relationship with the Farm Credit Bank of Texas:

The association's financial condition may be impacted by factors that affect the bank. The financial condition and results of operations of the bank may materially affect the stockholder's investment in the association. The Management's Discussion and Analysis and Notes to Financial Statements contained in the December 31, 2011 Annual Report of Lone Star, ACA more fully describe the association's relationship with the bank.

The Texas Farm Credit District's (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, or by calling (512) 483-9204. Copies of the district's quarterly and annual stockholder reports also can be requested by e-mail at *fcb@farmcreditbank.com*. The district makes its annual and quarterly stockholder reports available on its website at *www.farmcreditbank.com.*

The association's quarterly stockholder reports are also available free of charge, upon request. These reports 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 emailing *morgan.grall@lonestaragcredit.com*. The association makes its annual and quarterly stockholder reports available on its website at *www.lonestaragcredit.com*.

LONE STAR, ACA

CONSOLIDATED BALANCE SHEET

	September 30, 2012 (unaudited)	December 31, 2011
ASSETS		
Cash	**$ 102,010**	$ 63,794
Investments	**-**	35,688,875
Loans	**818,471,761**	872,045,989
Less: allowance for loan losses	**(11,551,110)**	(12,463,151)
Net loans	**806,920,651**	859,582,838
Accrued interest receivable	**6,841,044**	7,088,527
Investment in and receivable from the bank:		
Capital stock	**15,988,615**	16,129,205
Other	**1,589,721**	1,498,683
Other property owned, net	**5,063,710**	5,487,529
Premises and equipment	**1,711,658**	1,666,071
Other assets	**735,964**	430,069
Total assets	**$ 838,953,373**	$ 927,635,591
LIABILITIES		
Note payable to the bank	**$ 642,824,887**	$ 743,775,358
Accrued interest payable	**1,047,697**	1,534,543
Drafts outstanding	**97,750**	44,532
Dividends payable	**-**	2,000,000
Other liabilities	**4,250,176**	3,988,294
Total liabilities	**648,220,510**	751,342,727
MEMBERS' EQUITY		
Capital stock and participation certificates	**3,806,460**	4,043,055
Unallocated retained earnings	**187,799,109**	172,748,498
Accumulated other comprehensive income (loss)	**(872,706)**	(498,689)
Total members' equity	**190,732,863**	176,292,864
Total liabilities and members' equity	**$ 838,953,373**	$ 927,635,591

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

LONE STAR, ACA

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(unaudited)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
INTEREST INCOME				
Loans	**$ 9,811,795**	$ 11,301,655	**$ 30,232,263**	$ 34,773,720
Investments	**-**	466,474	**211,054**	1,674,434
Total interest income	**9,811,795**	11,768,129	**30,443,317**	36,448,154
INTEREST EXPENSE				
Note payable to the bank	**3,313,315**	4,961,428	**10,839,623**	16,046,647
Advance conditional payments	**19**	10	**49**	16
Total interest expense	**3,313,334**	4,961,438	**10,839,672**	16,046,663
Net interest income	**6,498,461**	6,806,691	**19,603,645**	20,401,491
PROVISION FOR LOAN LOSSES	**1,695,332**	1,812,245	382,614	4,711,318
Net interest income after provision for loan losses	**4,803,129**	4,994,446	**19,221,031**	15,690,173
NONINTEREST INCOME				
Income from the bank:				
Patronage income	**519,366**	402,965	**1,573,570**	1,260,537
Loan fees	**157,048**	110,993	**678,576**	390,225
Financially related services income	**1,938**	24,917	**(3,647)**	46,818
Gain (loss) on other property owned, net	**(66,697)**	207,420	**1,979,127**	437,141
Gain (loss) on sale of premises and equipment, net	**-**	122,000	**-**	122,400
Other noninterest income	**185**	482	**1,107,276**	64,388
Total noninterest income	**611,840**	868,777	**5,334,902**	2,321,509
NONINTEREST EXPENSES				
Salaries and employee benefits	**1,622,797**	1,715,170	**5,123,004**	5,013,313
Directors' expense	**60,728**	27,018	**275,969**	232,457
Purchased services	**225,402**	250,468	**667,664**	702,695
Travel	**152,218**	158,265	**486,574**	393,332
Occupancy and equipment	**129,023**	180,457	**455,746**	518,033
Communications	**41,301**	47,919	**128,552**	133,800
Advertising	**87,307**	57,448	**264,456**	128,394
Public and member relations	**106,036**	106,459	**313,829**	347,287
Supervisory and exam expense	**74,524**	100,374	**275,272**	316,931
Insurance Fund premiums	**98,080**	140,458	**428,533**	419,919
Provisions for acquired property losses	**474,735**	1,265,590	**839,283**	3,752,591
Other noninterest expense	**76,472**	129,498	**238,345**	446,239
Total noninterest expenses	**3,148,623**	4,179,124	**9,497,227**	12,404,991
Income before income taxes	**2,266,346**	1,684,099	**15,058,706**	5,606,691
Provision for (benefit from) income taxes	**3,112**	(16,769)	**8,094**	(10,173)
NET INCOME	**2,263,234**	1,700,868	**15,050,612**	5,616,864
Other comprehensive income:				
Change in postretirement benefit plans	**(124,672)**	-	**-**	-
Other comprehensive income, net of tax	**(124,672)**	-	**-**	-
COMPREHENSIVE INCOME	**$ 2,138,562**	$ 1,700,868	**$ 15,050,612**	$ 5,616,864

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

LONE STAR, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

(unaudited)

	Capital Stock/ Participation Certificates	Retained Earnings Unallocated	Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
Balance at December 31, 2010	$ 4,417,400	$ 164,672,264	$ (265,397)	$ 168,824,267
Net income	-	5,616,864	-	5,616,864
Other comprehensive income	-	-	(199,048)	(199,048)
Capital stock/participation certificates and allocated retained earnings issued	240,020	-	-	240,020
Capital stock/participation certificates and allocated retained earnings retired	(520,695)	-	-	(520,695)
Balance at September 30, 2011	$ 4,136,725	$ 170,289,128	$ (464,445)	$ 173,961,408
Balance at December 31, 2011	$ 4,043,055	$ 172,748,498	$ (498,689)	$ 176,292,864
Net income	-	15,050,612	-	15,050,612
Other comprehensive income	-	-	(374,017)	(374,017)
Capital stock/participation certificates and allocated retained earnings issued	260,865	-	-	260,865
Capital stock/participation certificates and allocated retained earnings retired	(497,460)	-	-	(497,460)
Balance at September 30, 2012	**$ 3,806,460**	**$ 187,799,110**	**$ (872,706)**	**$ 190,732,864**

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

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

The Lone Star, ACA (Agricultural Credit Association), referred to as the association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. 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 (the System), which was established by Acts of Congress to meet the needs of American agriculture.

The significant accounting policies followed and the financial condition and results of operations of the association as of and for the year ended December 31, 2011, are contained in the 2011 Annual Report to Stockholders. These unaudited third quarter 2012 financial statements should be read in conjunction with the 2011 Annual Report to Stockholders.

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 offset 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 financial condition or results of operations, but will result in additional disclosures.

In September 2011, the FASB issued guidance entitled "Compensation – Retirement Benefits – Multiemployer Plans." The guidance is intended to provide more information about an employer's financial obligations to a multiemployer 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 will not impact the association's financial condition or results of operation.

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 disclose 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.

In May 2011, the FASB issued guidance entitled "Fair Value Measurement – Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs." The amendments clarify certain aspects of the fair value measurement and disclosure requirements. The amendments are to be applied prospectively and are effective during interim and annual periods beginning after December 31, 2011. The adoption of this guidance did not impact the financial condition or results of operations but resulted in additional disclosures.

In April 2011, the FASB issued its guidance entitled, "A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring," which provides for clarification on whether a restructuring constitutes a troubled debt restructuring. In evaluating whether a restructuring is a troubled debt restructuring, a creditor must separately conclude that both of the following exists: (1) the restructuring constitutes a concession, and (2) the debtor is experiencing financial difficulties. The guidance is effective for nonpublic entities for annual periods ending on or after December 15, 2012, including interim periods within those annual periods. The adoption of this guidance was not material to the financial condition or results of operations.

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles, except for the inclusion of a statement of cash flows. Generally accepted accounting principles require a business enterprise that provides a set of financial statements reporting both financial position and results of operations to also provide a statement of cash flows for each period for which results of operations are provided. In regulations issued by FCA, associations have the option to exclude statements of cash flows in interim financial statements. Therefore, the association has elected not to include a statement of cash flows in these consolidated financial statements.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The preparation of these consolidated financial statements requires the use of management's estimates. The results for the quarter ended September 30, 2012, are not necessarily indicative of the results to be expected for the year ended December 31, 2012. Certain amounts in the prior period's financial statements have been reclassified to conform to current financial statement presentation.

NOTE 2 — INVESTMENTS:

Mission-Related and Other Investments Held-to-Maturity

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 by the association.

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.

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

	September 30, 2012				
	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**	**Weighted Average Yield**
Agricultural mortgage-backed securities	**$ -**	**$ -**	**$ -**	**$ -**	**- %**

	December 31, 2011				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	$35,688,875	$ 597,892	$ -	$36,286,767	5.00 %

NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES:

A summary of loans follows:

Loan Type	**September 30, 2012 Amount**	December 31, 2011 Amount
Production agriculture:		
Real estate mortgage	**$ 649,515,258**	$ 681,576,375
Production and intermediate term	**75,200,539**	96,692,376
Agribusiness:		
Loans to cooperatives	**68,896**	515,414
Processing and marketing	**55,482,670**	56,797,700
Farm-related business	**5,472,915**	5,645,373
Communication	**1,695,419**	6,089,587
Energy	**16,404,260**	8,336,568
Water and waste water	**577,996**	1,316,020
Rural residential real estate	**14,053,808**	15,076,576
Total	**$ 818,471,761**	$ 872,045,989

The association purchases or sells 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 the balances of participations purchased and sold at September 30, 2012:

	Other Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	$ 7,938,033	$ 13,455,903	$ 7,938,033	$ 13,455,903
Production and intermediate term	22,459,132	-	22,459,132	-
Agribusiness	55,679,655	2,524,629	55,679,655	2,524,629
Communication	1,695,419	-	1,695,419	-
Energy	16,404,260	-	16,404,260	-
Water and waste water	577,996	-	577,996	-
Total	$ 104,754,495	$ 15,980,532	$ 104,754,495	$ 15,980,532

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

	September 30, 2012	December 31, 2011
Nonaccrual loans:		
Real estate mortgage	**$ 25,277,942**	$34,312,846
Production and intermediate term	**6,517,687**	17,903,808
Agribusiness	**407,417**	6,965,867
Communication	**1,695,419**	-
Rural residential real estate	**378,714**	414,794
Total nonaccrual loans	**34,277,179**	59,597,315
Accruing restructured loans:		
Real estate mortgage	**35,233**	-
Production and intermediate term	**21,860**	-
Total accruing restructured loans	**57,093**	-
Accruing loans 90 days or more past due:		
Real estate mortgage	**-**	11,113
Agribusiness	**131,237**	-
Total accruing loans 90 days or more	**131,237**	11,113
Total nonperforming loans	**34,465,509**	59,608,428
Other property owned	**5,063,710**	5,487,529
Total nonperforming assets	**$ 39,529,219**	$65,095,957

One credit quality indicator utilized by the association is the Farm Credit Administration 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 as a percentage of total loans and related accrued interest receivable by loan type as of:

	September 30, 2012	December 31, 2011
Real estate mortgage		
Acceptable	**89.1** %	87.8 %
OAEM	**4.0**	3.5
Substandard/doubtful	**6.9**	8.7
	100.0	100.0
Production and intermediate term		
Acceptable	**87.4**	63.4
OAEM	**0.6**	7.5
Substandard/doubtful	**12.0**	29.1
	100.0	100.0
Agribusiness		
Acceptable	**98.9**	88.5
OAEM	**-**	0.2
Substandard/doubtful	**1.1**	11.3
	100.0	100.0
Energy and water/waste water		
Acceptable	**100.0**	100.0
OAEM	**-**	-
Substandard/doubtful	**-**	-
	100.0	100.0
Communication		
Acceptable	**-**	100.0
OAEM	**-**	-
Substandard/doubtful	**100.0**	-
	100.0	100.0
Rural residential real estate		
Acceptable	**85.8**	87.1
OAEM	**3.5**	2.0
Substandard/doubtful	**10.7**	10.9
	100.0	100.0
Total loans		
Acceptable	**89.7**	85.4
OAEM	**3.3**	3.6
Substandard/doubtful	**7.0**	11.0
	100.0 %	100.0 %

The following tables provide an age analysis of past due loans (including accrued interest) as of:

September 30, 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	**$ 3,780,055**	**$ 7,071,402**	**$ 10,851,457**	**$ 644,924,446**	**$ 655,775,903**	**$ -**
Production and intermediate term	**484,779**	**1,855,220**	**2,339,999**	**73,274,756**	**75,614,755**	**-**
Loans to cooperatives	**-**	**-**	**-**	**68,992**	**68,992**	**-**
Processing and marketing	**-**	**407,417**	**407,417**	**55,150,398**	**55,557,815**	**-**
Farm-related business	**-**	**131,237**	**131,237**	**5,355,668**	**5,486,905**	**131,237**
Communication	**-**	**-**	**-**	**1,695,419**	**1,695,419**	**-**
Energy	**-**	**-**	**-**	**16,422,621**	**16,422,621**	**-**
Water and waste water	**-**	**-**	**-**	**578,513**	**578,513**	**-**
Rural residential real estate	**109,743**	**36,007**	**145,750**	**13,966,132**	**14,111,882**	**-**
Total	**$ 4,374,577**	**$ 9,501,283**	**$ 13,875,860**	**$ 811,436,945**	**$ 825,312,805**	**$ 131,237**

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.

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 September 30, 2012, the total recorded investment of troubled debt restructured loans was $11,488,870, including $11,431,777 classified as nonaccrual and $57,093 classified as accrual. The individual collateral evaluation of the nonaccrual loans determined that an allowance of $27,962 was needed as of September 30, 2012. As of September 30, 2012 there were no available commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring. Loans formally restructured prior to January 1, 2012, were $12,690,424.

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 three and nine months ended September 30, 2012. The premodification outstanding recorded investment represents the recorded investment of the loans as of the quarter end prior to the restructuring. The postmodification outstanding recorded investment represents the recorded investment of the loans as of the quarter end the restructuring occurred.

For the Three Months Ended September 30, 2012	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	$ 35,116	$ 35,233
Production and intermediate term	22,644	21,860
Total	$ 57,760	$ 57,093

For the Nine Months Ended September 30, 2012	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	$ 194,073	$ 193,489
Production and intermediate term	110,721	109,937
Total	$ 304,794	$ 303,426

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 loans with Charge-offs recorded prior to or for the quarter ending September 30, 2012 on troubled debt restructured loans.

The predominant form of concession granted for troubled debt restructuring includes delay in scheduled principal payments. Other types of modifications include extension of the term, principal or accrued interest reductions, interest rate decreases, capitalized interest, and delayed payments, among others. At times, these terms might be offset with incremental payments, collateral or new borrower guarantees, in which case we assess all of the modified terms to determine if the overall modification qualifies as a troubled debt restructuring.

There were no trouble debt restructured loans for the period from October 1, 2011, through September 30, 2012, for which there was a payment default during that same period. A payment default is defined as a payment that is 30 days past due after the date the loan was restructured.

Additional impaired loan information is as follows:

	September 30, 2012			At December 31, 2011		
	Recorded Investment	**Unpaid Principal Balance[a]**	**Related Allowance**	Recorded Investment	Unpaid Principal Balance[a]	Related Allowance
Impaired loans with a related allowance for credit losses:						
Real estate mortgage	**$ 4,471,330**	**$ 5,286,920**	**$ 3,145,217**	$ 4,403,062	$ 4,537,167	$ 1,217,854
Production and intermediate term	**4,535,051**	**4,760,816**	**2,476,773**	10,216,506	15,540,075	8,223,813
Processing and marketing	**-**	**-**	**-**	-	-	282,643
Farm-related business	**-**	**-**	**-**	1,143,936	1,423,785	197,720
Communication	**1,695,419**	**1,695,419**	**753,821**	-	-	-
Rural residential real estate	**229,119**	**229,201**	**37,811**	54,736	54,736	4,895
Total	**$ 10,930,919**	**$ 11,972,356**	**$ 6,413,622**	$ 15,818,240	$ 21,555,763	$ 9,926,925
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	**$ 20,841,728**	**$ 20,951,758**	**$ -**	$ 29,920,897	$ 31,342,429	$ -
Production and intermediate term	**2,004,424**	**13,707,991**	**-**	7,687,302	14,178,285	-
Processing and marketing	**407,417**	**407,417**	**-**	5,821,931	5,821,931	-
Farm-related business	**129,475**	**129,475**	**-**	-	-	-
Communication	**-**	**-**	**-**	-	-	-
Rural residential real estate	**149,595**	**149,599**	**-**	360,058	360,058	-
Total	**$ 23,532,639**	**$ 35,346,240**	**$ -**	$ 43,790,188	$ 51,702,703	$ -
Total impaired loans:						
Real estate mortgage	**$ 25,313,058**	**$ 26,238,678**	**$ 3,145,217**	$ 34,323,959	$ 35,879,596	$ 1,217,854
Production and intermediate term	**6,539,475**	**18,468,807**	**2,476,773**	17,903,808	29,718,360	8,223,813
Processing and marketing	**407,417**	**407,417**	**-**	5,821,931	5,821,931	282,643
Farm-related business	**129,475**	**129,475**	**-**	1,143,936	1,423,785	197,720
Communication	**1,695,419**	**1,695,419**	**753,821**	-	-	-
Rural residential real estate	**378,714**	**378,800**	**37,811**	414,794	414,794	4,895
	$ 34,463,558	**$ 47,318,596**	**$ 6,413,622**	$ 59,608,428	$ 73,258,466	$ 9,926,925

[a] Unpaid principal balance represents the recorded principal balance of the loan.

For the Three Months Ended	September 30, 2012 Average Impaired Loans	September 30, 2012 Interest Income Recognized	September 30, 2011 Average Impaired Loans	September 30, 2011 Interest Income Recognized
Impaired loans with a related allowance for credit losses:				
Real estate mortgage	**$ 3,426,744**	**$ 5,768**	$ 5,361,363	$ -
Production and intermediate term	**5,056,791**	**1,355**	12,877,038	1,565
Processing and marketing	**-**	**-**	1,788,925	-
Farm-related business	**373,451**	**211**	1,167,156	29,279
Communication	**552,854**	**-**	-	-
Rural residential real estate	**108,681**	**184**	223,233	-
Total	**$ 9,518,521**	**$ 7,518**	$ 21,417,715	$ 30,844
Impaired loans with no related allowance for credit losses:				
Real estate mortgage	**$ 23,433,602**	**$ 4,725**	$ 43,166,901	$ 78,755
Production and intermediate term	**4,866,086**	**553**	21,353,081	92,924
Processing and marketing	**394,837**	**-**	5,673,942	-
Farm-related business	**42,220**	**3,488**	-	2,201
Communication	**-**	**-**	-	-
Rural residential real estate	**273,861**	**-**	108,133	221
Total	**$ 29,010,606**	**$ 8,766**	$ 70,302,057	$ 174,101
Total impaired loans:				
Real estate mortgage	**$ 26,860,346**	**$ 10,493**	$ 48,528,264	$ 78,755
Production and intermediate term	**9,922,877**	**1,908**	34,230,119	94,489
Processing and marketing	**394,837**	**-**	7,462,867	-
Farm-related business	**415,671**	**3,699**	1,167,156	31,480
Communication	**552,854**	**-**	-	-
Rural residential real estate	**382,542**	**184**	331,366	221
	$ 38,529,127	**$ 16,284**	$ 91,719,772	$ 204,945

For the Nine Months Ended	September 30, 2012 Average Impaired Loans	September 30, 2012 Interest Income Recognized	September 30, 2011 Average Impaired Loans	September 30, 2011 Interest Income Recognized
Impaired loans with a related allowance for credit losses:				
Real estate mortgage	**$ 4,767,956**	**$ 4,552**	$ 4,193,960	$ 2,920
Production and intermediate term	**5,324,901**	**4,528**	14,410,727	4,888
Processing and marketing	**-**	**-**	472,141	(1,278)
Farm-related business	**-**	**-**	1,280,582	66,510
Communication	**282,570**	**(3,163)**	-	-
Rural residential real estate	**212,939**	**-**	232,126	-
Total	**$ 10,588,366**	**$ 5,917**	$ 20,589,536	$ 73,040
Impaired loans with no related allowance for credit losses:				
Real estate mortgage	**$ 20,885,799**	**$ 15,440**	$ 44,558,617	$ 347,112
Production and intermediate term	**6,566,285**	**4,911**	16,026,866	149,020
Processing and marketing	**1,784,140**	**-**	5,305,193	(303)
Farm-related business	**134,023**	**12,776**	-	6,577
Communication	**-**	**-**	-	-
Rural residential real estate	**156,823**	**-**	83,923	722
Total	**$ 29,527,070**	**$ 33,127**	$ 65,974,599	$ 503,128
Total impaired loans:				
Real estate mortgage	**$ 25,653,755**	**$ 19,992**	$ 48,752,577	$ 350,032
Production and intermediate term	**11,891,186**	**9,439**	30,437,593	153,908
Processing and marketing	**1,784,140**	**-**	5,777,334	(1,581)
Farm-related business	**134,023**	**12,776**	1,280,582	73,087
Communication	**282,570**	**(3,163)**	-	-
Rural residential real estate	**369,762**	**-**	316,049	722
	$ 40,115,436	**$ 39,044**	$ 86,564,135	$ 576,168

A summary of changes in the allowance for loan losses and period end recorded investment in loans is as follows:

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communications	Energy and Water/Waste Water	Rural Residential Real Estate	Total
Allowance for Credit Losses:							
Balance at June 30, 2012	$ 1,311,332	$ 8,575,495	$ 539,400	$ 3,740	$ 4,262	$ (4,107)	$ 10,430,122
Charge-offs	(902,210)	(427,843)	279,849	-	-	(15,450)	(1,065,654)
Recoveries	54,988	436,322	-	-	-	-	491,310
Provision for loan losses	207,922	1,403,347	82,011	568	648	836	1,695,332
Adjustment due to merger	-	-	-	-	-	-	-
Other	-	-	-	-	-	-	-
Balance at September 30, 2012	$ 672,032	$ 9,987,321	$ 901,260	$ 4,308	$ 4,910	$ (18,721)	$ 11,551,110
Balance at December 31, 2011	$ 1,528,527	$ 10,316,634	$ 602,902	$ 4,180	$ 4,764	$ 6,143	$ 12,463,150
Charge-offs	(903,420)	(1,305,156)	279,849	-	-	(25,053)	(1,953,780)
Recoveries	-	659,126	-	-	-	-	659,126
Provision for loan losses	46,925	316,717	18,509	128	146	189	382,614
Adjustment due to merger	-	-	-	-	-	-	-
Other	-	-	-	-	-	-	-
Balance at September 30, 2012	$ 672,032	$ 9,987,321	$ 901,260	$ 4,308	$ 4,910	$ (18,721)	$ 11,551,110
Ending Balance:							
Individually evaluated for impairment	$ 3,145,216	$ 2,476,774	$ -	$ 753,821	$ -	$ 37,811	$ 6,413,622
Collectively evaluated for impairment	(2,473,184)	7,510,547	901,260	(749,513)	4,910	(56,532)	5,137,488
Loans acquired with deteriorated credit quality	-	-	-	-	-	-	-
Balance at September 30, 2012	$ 672,032	$ 9,987,321	$ 901,260	$ 4,308	$ 4,910	$ (18,721)	$ 11,551,110

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communications	Energy and Water/Waste Water	Rural Residential Real Estate	Total
Recorded Investments in Loans Outstanding:							
Ending Balance at September 30, 2012	$655,775,905	$ 75,614,755	$61,113,711	$ 1,695,419	$ 17,001,134	$ 14,111,881	$825,312,805
Individually evaluated for impairment	$ 25,313,058	$ 6,539,475	$ 536,892	$ 1,695,419	$ -	$ 378,714	$ 34,463,558
Collectively evaluated for impairment	$630,462,847	$ 69,075,280	$60,576,819	$ -	$ 17,001,134	$ 13,733,167	$790,849,247
Ending Balance at December 31, 2011	$687,682,591	$ 97,265,961	$63,007,959	$ 6,095,301	$ 9,718,320	$ 15,124,235	$878,894,367
Individually evaluated for impairment	$ 34,323,959	$ 17,903,808	$ 6,965,867	$ -	$ -	$ 414,794	$ 59,608,428
Collectively evaluated for impairment	$653,358,632	$ 79,362,153	$56,042,092	$ 6,095,301	$ 9,718,320	$ 14,709,441	$819,285,939

Prior years allowance for loan loss data was not captured by commodity and is reflected as presented in the 2011 annual report in the following table:

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communication	Energy	Water and Waste Disposal	Total
Allowance for Credit Losses:							
Balance at December 31, 2010	$3,528,497	$14,203,343	$1,232,781	$2,716	$1,204	$99,070	$ 19,067,611
Charge-offs	(3,832,765)	(6,588,424)	(1,941,802)			(17,220)	(12,380,211)
Recoveries	13,093	76,326	-	-	-	17,220	106,639
Provision for loan losses	1,819,702	2,625,389	1,311,924	1,464	3,560	(92,927)	5,669,112
Other	-	-	-	-	-	-	-
Balance at December 31, 2011	$ 1,528,527	$ 10,316,634	$ 602,903	$ 4,180	$ 4,764	$ 6,143	$ 12,463,151
Ending Balance: individually evaluated for impairment	$1,217,854	$8,226,895	$480,362	$ -	$ -	$4,895	$ 9,930,006
Ending Balance: collectively evaluated for impairment	$310,675	$2,089,737	$122,540	$4,180	$4,764	$1,249	$ 2,533,145
Recorded Investments in Loans Outstanding:							
Ending Balance at December 31, 2011	$687,682,591	$97,265,961	$63,007,959	$6,095,301	$9,718,320	$15,124,235	$ 878,894,367
Ending balance for loans individually evaluated for impairment	$34,323,959	$17,903,808	$6,965,867	$ -	$ -	$414,794	$ 59,608,428
Ending balance for loans collectively evaluated for impairment	$653,358,632	$79,362,153	$56,042,092	$6,095,301	$9,718,320	$14,709,441	$ 819,285,939

NOTE 4 — CAPITAL:

The association's board of directors has established a Capital Adequacy Plan (Plan) that includes the capital targets that are necessary to achieve the institution's capital adequacy goals as well as the minimum permanent capital standards. The Plan monitors projected dividends, equity retirements and other actions that may decrease the association's permanent capital. In addition to factors that must be considered in meeting the minimum standards, the board of directors also monitors the following factors: capability of management; quality of operating policies, procedures, and internal controls; quality and quantity of earnings; asset quality and the adequacy of the allowance for losses to absorb potential loss within the loan and lease portfolios; sufficiency of liquid funds; needs of an institution's customer base; and any other risk-oriented activities, such as funding and interest rate risk, potential obligations under joint and several liability, contingent and off-balance-sheet liabilities or other conditions warranting additional capital. At least quarterly, management reviews the association's goals and objectives with the board.

NOTE 5 — INCOME TAXES:

Lone Star, ACA and its subsidiary are subject to federal and certain other income taxes. The associations are eligible to operate as cooperatives that qualify for tax treatment under Subchapter T of the Internal Revenue code. Under specified conditions, the associations can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage refunds. During the nine months ended September 30, 2012, the association did not participate in a patronage program. Deferred taxes are recorded at the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution and will therefore impact future tax payments. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (more than 50 percent probability), based on management's estimate, that they will not be realized. For the nine months ended September 30, 2012, and 2011, net income for tax purposes the association carries a deferred tax asset of $15,227,492 and $14,173,506 respectively with full valuation allowance recorded against the asset each year.
The subsidiary, Lone Star, FLCA, is exempt from federal and other income taxes as provided in the Farm Credit Act of 1971.

NOTE 6 — FAIR VALUE MEASUREMENTS:

FASB guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 14 to the 2011 Annual Report to Stockholders for a more complete description.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

September 30, 2012	**Fair Value Measurement Using**			**Total Fair**
	Level 1	**Level 2**	**Level 3**	**Value**
Assets:				
Assets held in nonqualified benefit trusts	**38,353**	**-**	**-**	**38,353**
Total assets	**38,353**	**-**	**-**	**38,353**

December 31, 2011	Fair Value Measurement Using			Total Fair
	Level 1	Level 2	Level 3	Value
Assets:				
Assets held in nonqualified benefit trusts	35,192	-	-	35,192
Total assets	35,192	-	-	35,192

Accounting guidance requires that the fair value measurement for investments be broken out by the different types of investments held.

Assets and liabilities measured at fair value on a nonrecurring basis for each of the fair value hierarchy values are summarized below:

September 30, 2012	**Fair Value Measurement Using**			**Total Fair**
	Level 1	**Level 2**	**Level 3**	**Value**
Assets:				
Loans*	**$ -**	**$ -**	**$ 34,465,509**	**$ 34,465,509**
Other property owned	**-**	**-**	**5,063,710**	**5,063,710**

December 31, 2011	Fair Value Measurement Using			Total Fair
	Level 1	Level 2	Level 3	Value
Assets:				
Loans*	$ -	$ -	$ 59,608,428	$ 59,608,428
Other property owned	-	-	5,487,529	5,487,529

*Represents the fair value of certain loans that were evaluated for impairment under authoritative guidance "Accounting by Creditors for Impairment of a Loan." The fair value was based upon the underlying collateral since these were collateral-dependent loans for which real estate is the collateral.

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:

	September 30, 2012				December 31, 2011			
	Total Carrying Amount		**Total Fair Value**		Total Carrying Amount		Total Fair Value	
Assets:								
Cash	**$**	**102,010**	**$**	**102,010**	$	63,794	$	63,794
Mission-related and other investments held-to-maturity		-		-		35,688,875		35,688,875
Net loans		**806,920,651**		**806,920,651**		859,582,838		859,582,838
Total Assets		**807,022,661**		**807,022,661**		895,335,507		895,335,507
Liabilities:								
Other interest-bearing liabilities		**642,824,887**		**642,824,887**		743,775,358		743,775,358
Total Liabilities		**642,824,887**		**642,824,887**		743,775,358		743,775,358

Valuation Techniques

As more fully discussed in Note 14 to the 2011 Annual Report to Stockholders, authoritative 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 for the association's assets and liabilities. For a more complete description, see Notes to the 2011 Annual Report to Stockholders.

Investment Securities

Where quoted prices are available in an active market, available-for-sale securities are classified as Level 1. If quoted prices are not available in an active market, the fair value of securities is estimated using quoted prices for similar securities received from pricing services, pricing models that utilize observable inputs or discounted cash flows. Generally, these securities are classified as Level 2. This would include certain mortgage-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-backed securities and certain mortgage-backed securities, including 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.

Loans

For certain loans evaluated for impairment under authoritative guidance, the fair value is based upon the underlying collateral since the loans were 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 fair value is based upon the collateral value, which is generally determined using appraisals or other indications based on comparable sales of similar properties. Costs to sell represent transaction costs and are not included as a component of the asset's fair value.

NOTE 7 — EMPLOYEE BENEFIT PLANS:

The following table summarizes the components of net periodic benefit costs of nonpension other postretirement employee benefits for the three months ended September 30:

	Other Benefits	
	2012	2011
Service cost	**$ 15,447**	$ 15,857
Interest cost	**30,110**	29,781
Amortization of prior service (credits) costs	**(32,432)**	(34,921)
Amortizations of net actuarial (gain) loss	**19,136**	15,369
Net periodic benefit cost	**$ 32,261**	$ 26,086

The following table summarizes the components of net periodic benefit costs of nonpension other postretirement employee benefits for the nine months ended September 30:

	Other Benefits	
	2012	2011
Service cost	**$ 46,341**	$ 47,571
Interest cost	**90,330**	89,343
Amortization of prior service (credits) costs	**(97,296)**	(104,763)
Amortizations of net actuarial (gain) loss	**57,408**	46,107
Net periodic benefit cost	**$ 96,783**	$ 78,258

The association's liability for the plan's unfunded accumulated obligation at September 30, 2012, was $2,815,341 and is included in "Other Liabilities" in the balance sheet.

The structure of the district's defined benefit pension plan is characterized as multiemployer since the assets, liabilities and cost of the plan are not segregated or separately accounted for by participating employers (bank and associations). The association recognizes its amortized annual contributions to the plan as an expense. The association previously disclosed in its financial statements for the year ended December 31, 2011, that it expected to contribute $68,609 to the district's defined benefit pension plan in 2012. As of September 30, 2012, $46,700 of contributions have been made. The association presently anticipates contributing an additional $21,909 to fund the defined benefit pension plan in 2012 for a total of $68,609.

The association's accumulated other comprehensive income (loss) relates entirely to its nonpension other postretirement benefits. The following table summarizes the changes in accumulated other comprehensive income (loss) for the nine months ended September 30:

		2012		2011
Accumulated other comprehensive income (loss) at January 1		**$ (498,689)**		$ (265,397)
Amortization of prior service credit (costs) included in net periodic postretirement benefit cost	**$ 400,127**		$ 504,890	
Amortization of actuarial gain (loss) included in net periodic postretirement benefit cost	**(774,144)**		(703,938)	
Other comprehensive income (loss), net of tax		**(374,017)**		(199,048)
Accumulated other comprehensive income at September 30		**$ (872,706)**		$ (464,445)

NOTE 8 — COMMITMENTS AND CONTINGENT LIABILITIES:

The association is involved in various legal proceedings in the normal 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.

NOTE 9 — SUBSEQUENT EVENTS:

The association has evaluated subsequent events through November 8, 2012 which is the date the financial statements were issued. There were no events to report.