FEDERAL AGRICULTURAL MORTGAGE CORP
Form 10-Q
August 09, 2006

As filed with the Securities and Exchange Commission on
August 9, 2006

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

FORM 10-Q

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

For the quarterly period ended June 30, 2006

Commission File Number 0-17440

FEDERAL AGRICULTURAL MORTGAGE CORPORATION
(Exact name of registrant as specified in its charter)

Federally chartered instrumentality of the United States (State or other jurisdiction of incorporation or organization)	52-1578738 (I.R.S. employer identification number)
1133 Twenty-First Street, N.W., Suite 600 Washington, D.C. (Address of principal executive offices)	20036 (Zip code)

(202) 872-7700
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer [ ] Accelerated filer [X] Non-accelerated filer [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b 2 of the Exchange Act).
Yes [ ] No [X]

As of August 1, 2006, the registrant had 1,030,780 shares of Class A Voting Common Stock, 500,301 shares of Class B Voting Common Stock and 9,205,695 shares of Class C Non Voting Common Stock outstanding.

PART I - FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

The following interim unauditedcondensed consolidated financial statements of the Federal Agricultural Mortgage Corporation ("Farmer Mac" or the "Corporation") have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). These interim unaudited condensed consolidated financial statements reflect all normal and recurring adjustments that are, in the opinion of management, necessary to present a fair statement of the financial condition and the results of operations and cash flows of Farmer Mac for the interim periods presented. Certain information and footnote disclosures normally included in annual consolidated financial statements have been condensed or omitted as permitted by SEC rules and regulations. The December 31, 2005 consolidated balance sheet presented in this report has been derived from the Corporation's audited 2005 consolidated financial statements. Management believes that the disclosures are adequate to present fairly the condensed consolidated financial position, condensed consolidated results of operations and condensed consolidated cash flows as of the dates and for the periods presented. These interim unaudited condensed consolidated financial statements should be read in conjunction with the audited 2005 consolidated financial statements of Farmer Mac included in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2005. Results for interim periods are not necessarily indicative of those that may be expected for the fiscal year.

The following information concerning Farmer Mac's interim unaudited condensed consolidated financial statements is included in this report beginning on the pages listed below:

FEDERAL AGRICULTURAL MORTGAGE CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)
(in thousands, except share data)

	June 30, 2006	December 31, 2005
Assets:		
Cash and cash equivalents	$ 348,951	$ 458,852
Investment securities	2,007,895	1,621,941
Farmer Mac Guaranteed Securities	1,303,921	1,330,976
Loans held for sale	54,801	41,956
Loans held for investment	732,334	762,436
Allowance for loan losses	(2,734)	(4,876)
Loans held for investment, net	729,600	757,560
Real estate owned	1,039	3,532
Financial derivatives	23,040	8,751
Interest receivable	63,652	67,509
Guarantee and commitment fees receivable	25,784	22,170
Deferred tax asset, net	950	2,397
Prepaid expenses and other assets	6,321	24,975
Total Assets	$ 4,565,954	$ 4,340,619 c
Liabilities and Stockholders' Equity:		
Liabilities:		
Notes payable:		
Due within one year	$ 3,040,620	$ 2,587,704
Due after one year	1,181,875	1,403,598
Total notes payable	4,222,495	3,991,302
Financial derivatives	21,039	29,162
Accrued interest payable	29,034	29,250
Guarantee and commitment obligation	21,685	17,625
Accounts payable and accrued expenses	13,277	21,371
Reserve for losses	3,518	3,777
Total Liabilities	4,311,048	4,092,487
Stockholders' Equity:		
Preferred stock:		
Series A, stated at redemption/liquidation value, $50 per share, 700,000 shares authorized, issued and outstanding	35,000	35,000
Common stock:		
Class A Voting, $1 par value, no maximum authorization, 1,030,780 shares issued and outstanding	1,031	1,031
Class B Voting, $1 par value, no maximum authorization,		

500,301 shares issued and outstanding	500	500
Class C Non-Voting, $1 par value, no maximum authorization,		
9,361,305 and 9,559,554 shares issued and outstanding as of June 30, 2006 and December 31, 2005, respectively	9,361	9,560
Additional paid-in capital	83,740	83,058
Accumulated other comprehensive income	5,075	3,339
Retained earnings	120,199	115,644
Total Stockholders' Equity	254,906	248,132
Total Liabilities and Stockholders' Equity	$ 4,565,954	$ 4,340,619

See accompanying notes to condensed consolidated financial statements.

FEDERAL AGRICULTURAL MORTGAGE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)
(in thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
Interest income:				
Investments and cash equivalents	$ 30,298	$ 14,765	$ 56,996	$ 27,352
Farmer Mac Guaranteed Securities	19,417	17,773	37,512	34,854
Loans	11,847	11,470	23,230	23,591
Total interest income	61,562	44,008	117,738	85,797
Interest expense	52,461	35,886	99,737	69,869
Net interest income	9,101	8,122	18,001	15,928
Recovery/(provision) for loan losses	594	203	1,606	787
Net interest income after recovery/(provision) for loan losses	9,695	8,325	19,607	16,715
Guarantee and commitment fees	5,288	4,889	10,337	9,845
Gains on financial derivatives and trading assets	2,026	3,755	25	2,045
Gains/(losses) on the sale of real estate owned	304	(67)	514	(80)
Representation and warranty claims income	718	-	718	79
Other income	58	367	227	687
Total revenues	18,089	17,269	31,428	29,291
Expenses:				
Compensation and employee benefits	2,673	1,899	5,577	3,675
General and administrative	2,577	2,275	5,335	4,264
Regulatory fees	588	576	1,175	1,152
Real estate owned operating costs, net	22	59	137	37
Provision/(recovery) for losses	592	(91)	(104)	(192)
Total operating expenses	6,452	4,718	12,120	8,936
Income before income taxes	11,637	12,551	19,308	20,355
Income tax expense	3,458	3,780	5,532	6,112
Net income	8,179	8,771	13,776	14,243
Preferred stock dividends	(560)	(560)	(1,120)	(1,120)
Net income available to common stockholders	$ 7,619	$ 8,211	$ 12,656	$ 13,123

Earnings per common share:								
Basic earnings per common share	$	0.69	$	0.72	$	1.14	$	1.14
Diluted earnings per common share	$	0.67	$	0.72	$	1.11	$	1.13
Common stock dividends per common share	$	0.10	$	0.10	$	0.20	$	0.20

See accompanying notes to condensed consolidated financial statements.

FEDERAL AGRICULTURAL MORTGAGE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
(in thousands)

	Six Months Ended	
	June 30, 2006	June 30, 2005
Cash flows from operating activities:		
Net income	$ 13,776	$ 14,243
Adjustments to reconcile net income to net cash provided by operating activities:		
Net (accretion)/amortization of investment premiums and discounts	(1,237)	1,267
Net amortization of debt premiums, discounts and issuance costs	58,220	26,960
Proceeds from repayment of trading investment securities	1,001	1,525
Purchases of loans held for sale	(31,316)	(27,781)
Proceeds from repayment of loans held for sale	5,344	6,643
Net change in fair value of trading securities and financial derivatives	2,150	(1,454)
Amortization of settled financial derivatives contracts	138	932
(Gains)/losses on the sale of real estate owned	(514)	80
Total (recovery)/provision for losses	(1,711)	(979)
Deferred income taxes	501	316
Stock-based compensation expense	955	-
Decrease in interest receivable	3,857	8,323
Decrease/(increase) in guarantee and commitment fees receivable	(3,614)	759
Decrease/(increase) in other assets	21,210	(2,016)
Increase in accrued interest payable	(216)	(2,747)
Decrease in other liabilities	(9,086)	(3,436)
Net cash provided by operating activities	59,458	22,635
Cash flows from investing activities:		
Purchases of available-for-sale investment securities	(1,913,573)	(1,026,241)
Purchases of Farmer Mac II Guaranteed Securities and AgVantage Farmer Mac Guaranteed Securities	(108,600)	(92,834)
Purchases of loans held for investment	(25,058)	(11,141)
Purchases of defaulted loans	(4,565)	(3,804)
Proceeds from repayment of investment securities	1,524,967	899,988
Proceeds from repayment of Farmer Mac Guaranteed Securities	117,990	127,460
Proceeds from repayment of loans	68,426	69,781
Proceeds from sale of loans and Farmer Mac Guaranteed Securities	3,033	22,012
Proceeds from sale of real estate owned	2,819	572

Net cash used in investing activities	(334,561)	(14,207)
Cash flows from financing activities:		
Proceeds from issuance of discount notes	37,272,236	22,405,440
Proceeds from issuance of medium-term notes	117,200	204,183
Payments to redeem discount notes	(37,100,394)	(22,304,773)
Payments to redeem medium-term notes	(114,000)	(339,840)
Settlement of financial derivatives	13	(136)
Tax benefit from tax deductions in excess of compensation cost recognized	348	-
Proceeds from common stock issuance	2,112	650
Purchases of common stock	(8,974)	(10,965)
Dividends paid	(3,339)	(3,416)
Net cash provided by/(used in) financing activities	165,202	(48,857)
Net decrease in cash and cash equivalents	(109,901)	(40,429)
Cash and cash equivalents at beginning of period	458,852	430,504
Cash and cash equivalents at end of period	$ 348,951	$ 390,075

See accompanying notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Note 1. Accounting Policies

(a) Cash and Cash Equivalents

Farmer Mac considers highly liquid investment securities with maturities of three months or less at the time of purchase to be cash equivalents. Changes in the balance of cash and cash equivalents are reported in the condensed consolidated statements of cash flows. The following table sets forth information regarding certain cash and non-cash transactions for the six months ended June 30, 2006 and 2005.

	Six Months Ended	
	June 30, 2006	June 30, 2005
	(in thousands)	
Cash paid for:		
Interest	$ 40,360	$ 33,295
Income taxes	4,500	6,700
Non-cash activity:		
Real estate owned acquired through foreclosure	-	460
Loans acquired and securitized as Farmer Mac Guaranteed Securities	3,033	22,012
Loans previously under LTSPCs exchanged for Farmer Mac Guaranteed Securities	550,114	-

(b) Allowance for Losses

As of June 30, 2006, Farmer Mac maintained an allowance for losses to cover estimated probable losses on loans held for investment, real estate owned, and loans underlying long-term standby purchase commitments (“LTSPCs”) and Farmer Mac I Guaranteed Securities issued after the Farm Credit System Reform Act of 1996 (the “1996 Act”) in accordance with Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies* (“SFAS 5”) and Statement of Financial Accounting Standards No. 114, *Accounting by Creditors for Impairment of a Loan*, as amended (“SFAS 114”).

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

Historically, Farmer Mac estimated probable losses using a systematic process that began with management’s evaluation of the results of a proprietary loan pool simulation and guarantee fee model. That model drew upon historical information from a data set of agricultural mortgage loans screened to include only those loans with credit characteristics similar to those eligible for Farmer Mac’s programs. The results generated by that model were then modified, as necessary, by the application of management’s judgment.

During 2005, Farmer Mac completed the planned migration of its methodology for determining its allowance for losses away from one based on its loan pool simulation and guarantee fee model to one based on its own historical portfolio loss experience and credit trends. Farmer Mac recorded the effects of that change as a change in accounting estimate as of September 30, 2005.

Farmer Mac's current methodology for determining its allowance for losses incorporates the Corporation's proprietary automated loan classification system. That system scores loans based on criteria such as historical repayment performance, loan seasoning, loan size and loan-to-value ratio. For the purposes of the loss allowance methodology, the loans in Farmer Mac's portfolio of loans and loans underlying post-1996 Act Farmer Mac I Guaranteed Securities and LTSPCs have been scored and classified for each calendar quarter since first quarter 2000. The allowance methodology captures the migration of loan scores across concurrent and overlapping 3-year time horizons and calculates loss rates separately within each loan classification for (1) loans underlying LTSPCs and (2) loans held and loans underlying post-1996 Act Farmer Mac I Guaranteed Securities. The calculated loss rates are applied to the current classification distribution of Farmer Mac's portfolio to estimate inherent probable losses, on the assumption that the historical credit losses and trends used to calculate loss rates will continue in the future. Management evaluates this assumption by taking into consideration several factors, including:

- economic conditions;
- geographic and agricultural commodity/product concentrations in the portfolio;
- the credit profile of the portfolio;
- delinquency trends of the portfolio; and
- historical charge-off and recovery activities of the portfolio.

If, based on that evaluation, management concludes that the assumption is not valid due to other more compelling indicators, the loss allowance calculation is modified by the addition of further assumptions to capture current portfolio trends and characteristics that differ from historical experience.

As of June 30, 2006, Farmer Mac concluded that the credit profile of its portfolio was consistent with Farmer Mac's historical credit profile and trends. Management believes that its use of this methodology produces a reliable estimate of inherent probable losses, as of the balance sheet date, for all loans held, real estate owned and loans underlying post-1996 Act Farmer Mac I Guaranteed Securities and LTSPCs in accordance with SFAS 5 and SFAS 114.

The following table summarizes the changes in the components of Farmer Mac's allowance for losses for the three and six months ended June 30, 2006 and 2005:

	June 30, 2006			
	Allowance for Loan Losses	REO Valuation Allowance	Reserve for Losses	Total Allowance for Losses
		(in thousands)		
Three Months Ended:				
Beginning balance	$ 3,883	$ -	$ 2,931	$ 6,814
Provision/(recovery) for losses	(594)	5	587	(2)
Net charge-offs	(555)	(5)	-	(560)
Ending balance	$ 2,734	$ -	$ 3,518	$ 6,252
Six Months Ended:				
Beginning balance	$ 4,876	$ -	$ 3,777	$ 8,653
Provision/(recovery) for losses	(1,606)	155	(259)	(1,710)
Net charge-offs	(536)	(155)	-	(691)
Ending balance	$ 2,734	$ -	$ 3,518	$ 6,252

	June 30, 2005			
	Allowance for Loan Losses	REO Valuation Allowance	Reserve for Losses	Total Allowance for Losses
		(in thousands)		
Three Months Ended:				
Beginning balance	$ 3,846	$ -	$ 12,485	$ 16,331
Provision for losses	(203)	-	(91)	(294)
Net recoveries	27	-	-	27
-				
Ending balance	$ 3,670	$ -	$ 12,394	$ 16,064
Six Months Ended:				
Beginning balance	$ 4,395	$ -	$ 12,706	$ 17,101
Provision/(recovery) for losses	(787)	120	(312)	(979)
Net (charge-offs)/recoveries	62	(120)	-	(58)
-				
Ending balance	$ 3,670	$ -	$ 12,394	$ 16,064

The table below summarizes the components of Farmer Mac's allowance for losses as of June 30, 2006 and December 31, 2005:

	June 30, 2006	December 31, 2005
	(in thousands)	
Allowance for loan losses	$ 2,734	$ 4,876
Real estate owned valuation allowance	-	-
Reserve for losses:		
On-balance sheet Farmer Mac I Guaranteed Securities	1,505	2,068
Off-balance sheet Farmer Mac I Guaranteed Securities	1,324	1,078
LTSPCs	689	631
Total	$ 6,252	$ 8,653

No allowance for losses has been made for loans underlying Farmer Mac I Guaranteed Securities issued prior to the 1996 Act, AgVantage securities or securities issued under the Farmer Mac II program ("Farmer Mac II Guaranteed Securities"). Farmer Mac I Guaranteed Securities issued prior to the 1996 Act are supported by unguaranteed first loss subordinated interests, which are expected to exceed the estimated credit losses on those loans. Each AgVantage security is a general obligation of an issuing institution approved by Farmer Mac and is collateralized by eligible mortgage loans. As of June 30, 2006, there were no probable losses inherent in Farmer Mac's AgVantage securities. The guaranteed portions collateralizing Farmer Mac II Guaranteed Securities are guaranteed by the United States Department of Agriculture ("USDA"). Each USDA guarantee is an obligation backed by the full faith and credit of the United States. As of June 30, 2006, Farmer Mac had not experienced any credit losses on any Farmer Mac I Guaranteed Securities issued prior to the 1996 Act, AgVantage securities or Farmer Mac II Guaranteed Securities and does not expect to incur any such losses in the future.

As of June 30, 2006, Farmer Mac individually analyzed $30.8 million of its $68.8 million of impaired assets for collateral shortfalls against updated appraised values, other updated collateral valuations or discounted values. Farmer Mac evaluated the remaining $38.0 million of impaired assets for which updated valuations were not available in the aggregate in consideration of their similar risk characteristics and historical statistics. Of the $30.8 million of assets analyzed individually, $29.4 million were adequately collateralized. For the $1.4 million of assets that were not adequately collateralized, individual collateral shortfalls totaled $15,000. Accordingly, Farmer Mac recorded specific allowances of $15,000 for those under-collateralized assets as of June 30, 2006. In addition to the specific allowances provided, Farmer Mac's non-specific or general allowances were $6.2 million as of June 30, 2006.

The balance of impaired assets, both on- and off-balance sheet, and the related allowance specifically allocated to those impaired assets as of June 30, 2006 and December 31, 2005 are summarized in the following table:

	June 30, 2006			December 31, 2005		
	Balance	Specific Allowance	Net Balance	Balance	Specific Allowance	Net Balance
			(in thousands)			
Impaired assets:						
Specific allowance for losses	$ 1,360	$ (15)	$ 1,345	$ 2,445	$ (161)	$ 2,284
No specific allowance for losses	67,412	-	67,412	71,177	-	71,177
Total	$ 68,772	$ (15)	$ 68,757	$ 73,622	$ (161)	$ 73,461

(c) Financial Derivatives

Farmer Mac enters into financial derivative transactions principally to protect against risk from the effects of market price or interest rate movements on the value of certain assets and future cash flows or debt issuance, not for trading or speculative purposes. Farmer Mac enters into interest rate swap contracts principally to adjust the characteristics of its short-term debt to match more closely the cash flow and duration characteristics of its longer-term mortgage and other assets, and also to adjust the characteristics of its long-term debt to match more closely the cash flow and duration characteristics of its short-term assets, thereby reducing interest rate risk. These transactions also may provide an overall lower effective cost of borrowing than would otherwise be available in the conventional debt market.

All financial derivatives are recorded on the balance sheet at fair value as a free-standing asset or liability. Financial derivatives in hedging relationships that mitigate exposure to changes in the fair value of assets are considered fair value hedges. Financial derivatives in hedging relationships that mitigate the exposure to the variability in expected future cash flows or other forecasted transactions are considered cash flow hedges. Financial derivatives that do not satisfy the hedging criteria of Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities,* as amended (“SFAS 133”) are not accounted for as hedges, and changes in the fair values of those financial derivatives are reported as gains or losses on financial derivatives and trading assets in the condensed consolidated statements of operations.

The following table summarizes information related to Farmer Mac's financial derivatives as of June 30, 2006 and December 31, 2005:

	June 30, 2006							
	Cash Flow Hedges		Fair Value Hedges		No Hedge Designation		Total	
	Notional Amount	Fair Value	Notional Amount	Fair Value	Notional Amount	Fair Value	Notional Amount	Fair Value
	(in thousands)							
Interest rate swaps:								
Pay-fixed	$ 655,612	$ 3,624	$ -	$ -	$ 119,057	$ 2,713	$ 774,669	$ 6,337
Receive-fixed	-	-	45,000	(4,998)	234,000	(7,804)	279,000	(12,802)
Basis	-	-	-	-	372,899	8,525	372,899	8,525
Treasury futures	-	-	-	-	11	(4)	11	(4)
Agency forwards	84,666	(289)	-	-	25,360	234	110,026	(55)
Total	$ 740,278	$ 3,335	$ 45,000	$ (4,998)	$ 751,327	$ 3,664	$ 1,536,605	$ 2,001

	December 31, 2005							
	Cash Flow Hedges		Fair Value Hedges		No Hedge Designation		Total	
	Notional Amount	Fair Value	Notional Amount	Fair Value	Notional Amount	Fair Value	Notional Amount	Fair Value
	(in thousands)							
Interest rate swaps:								
Pay-fixed	$ 633,939	$ (17,999)	$ -	$ -	$ 76,739	$ 771	$ 710,678	$ (17,228)
Receive-fixed	-	-	45,000	(2,930)	160,000	(2,823)	205,000	(5,753)
Basis	225,629	3,721	-	-	163,867	(920)	389,496	2,801
Treasury futures	-	-	-	-	99	32	99	32
Agency forwards	41,514	(201)	-	-	49,664	(62)	91,178	(263)
Total	$ 901,082	$ (14,479)	$ 45,000	$ (2,930)	$ 450,369	$ (3,002)	$ 1,396,451	$ (20,411)

As of June 30, 2006, Farmer Mac had approximately $2.8 million of net after-tax unrealized gains on cash flow hedges included in accumulated other comprehensive income. These amounts will be reclassified into earnings in the same period or periods during which the hedged forecasted transactions (either the payment of interest or the issuance of discount notes) affect earnings or immediately when it becomes probable that the original hedged forecasted transaction will not occur within two months of the originally specified date. Over the next twelve months, Farmer Mac estimates that $0.3 million of the amount currently reported in accumulated other comprehensive income will be reclassified into earnings. For the quarter ended June 30, 2006, Farmer Mac recorded a loss of less than $0.1 million for ineffectiveness related to Farmer Mac's designated hedges.

As of June 30, 2006, Farmer Mac had outstanding basis swaps with a related party with a notional mount of $210.0 million and a fair value of $9.1 million. See Note 3 "Related Party Transactions" in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2005, as filed with the SEC on March 16, 2006 for additional information on these related party transactions. As of December 31, 2005, these swaps were designated cash flow hedges and had an outstanding notional amount of $225.6 million and a fair value of $3.7 million. During second quarter 2006, Farmer Mac discontinued hedge accounting treatment for these swaps.

Accordingly, the Corporation recognized a $2.6 million gain on financial derivatives and trading assets in the condensed consolidated financial statements related to the change in fair value of these swaps. As of June 30, 2006, Farmer Mac had $4.1 million of net after-tax unrealized gains remaining in accumulated other comprehensive income related to these swaps. In accordance with SFAS 133, this amount will be reclassified into earnings during the periods which the hedged forecasted transactions affect earnings.

(d) Earnings Per Common Share

Basic earnings per common share are based on the weighted-average number of shares of common stock outstanding. Diluted earnings per common share are based on the weighted-average number of shares of common stock outstanding adjusted to include all potentially dilutive common stock options. The following schedule reconciles basic and diluted earnings per common share ("EPS") for the three and six months ended June 30, 2006 and 2005:

	June 30, 2006			June 30, 2005		
	Basic EPS	Dilutive stock options	Diluted EPS	Basic EPS	Dilutive stock options	Diluted EPS
	(in thousands, except per share amounts)					
Three Months Ended:						
Net income available to common stockholders	$ 7,619		$ 7,619	$ 8,211		$ 8,211
Weighted-average shares	11,083	256	11,339	11,409	42	11,451
Earnings per common share	$ 0.69		$ 0.67	$ 0.72		$ 0.72
Six Months Ended:						
Net income available to common stockholders	$ 12,656		$ 12,656	$ 13,123		$ 13,123
Weighted average shares	11,095	287	11,382	11,548	56	11,604
Earnings per common share	$ 1.14		$ 1.11	$ 1.14		$ 1.13

During second quarter 2006, Farmer Mac repurchased 282,500 shares of its Class C Non-Voting Common Stock at an average price of $26.55 per share pursuant to the Corporation's previously announced stock repurchase program. These repurchases reduced the Corporation's capital by approximately $7.5 million.

(e) Stock-Based Compensation

In 1997, Farmer Mac adopted a stock option plan for directors, officers and other employees to acquire shares of Class C Non-Voting Common Stock. Under the plan, stock option awards vest annually in thirds, with the first third vesting one year after the date of grant. If not exercised, any options granted under the 1997 plan expire ten years from the date of grant, except options issued to directors since June 1, 1998, if not exercised, expire five years from the date of grant. Of the 3,750,000 shares authorized to be issued under the plan, 490,923 remain available for future issuance. For all stock options granted, the exercise price is equal to the closing price of the Class C Non-Voting Common Stock on or immediately preceding the date of grant.

Effective January 1, 2006, Farmer Mac adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payments* ("SFAS 123(R)") using the modified prospective method of transition, which requires (1) the recordation of compensation expense for the non-vested portion of previously issued awards that remain outstanding as of the initial date of adoption and (2) the recordation of compensation expense for any awards issued or modified after December 31, 2005. Accordingly, prior period amounts have not been retrospectively adjusted for this change. The adoption resulted in the recognition of $0.4 million and $0.9 million of compensation expense during the three-month and six-month periods ended June 30, 2006, respectively, related to the non-vested portion of previously issued stock option awards that were outstanding as of the initial date of adoption. Additionally, Farmer Mac recognized $0.1 million of compensation expense related to stock options awarded during second quarter 2006. The effect of the recognition of compensation expense resulting from stock options on diluted EPS for the three-month and six-month periods ended June 30, 2006 was a reduction of $0.03 and $0.05, respectively, per diluted share. Prior to the adoption of SFAS 123(R), Farmer Mac accounted for its stock-based employee compensation plans under the intrinsic value method of accounting for employee stock options pursuant to Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25"), and had adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation*, as amended ("SFAS 123"). Accordingly, no compensation expense was recognized in 2005 for employee stock option plans. Had Farmer Mac elected to use the fair value method of accounting for employee stock options, net income available to common stockholders and earnings per share for the three and six months ended June 30, 2005 would have been reduced to the pro forma amounts indicated in the following table:

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
	(in thousands, except per share amounts)	
Net income available to common stockholders, as reported	$ 8,211	$ 13,123
Deduct: Total stock-based employee compensation expense determined under fair value-based method for all awards, net of tax	(1,663)	(1,663)
Pro forma net income available to common stockholders	$ 6,548	$ 11,460
Earnings per common share:		
Basic - as reported	$ 0.72	$ 1.14
Basic - pro forma	$ 0.57	$ 0.99
Diluted - as reported	$ 0.72	$ 1.13
Diluted - pro forma	$ 0.57	$ 0.99

As of June 30, 2006, there was $2.8 million of total unrecognized compensation cost related to stock options outstanding and unvested as of December 31, 2005. Of that cost, $0.9 million and $1.4 million is expected to be recognized in the remainder of 2006 and 2007, respectively.

The following table summarizes stock option activity for the three and six months ended June 30, 2006 and 2005:

	June 30, 2006		June 30, 2005	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Three Months Ended:				
Outstanding, beginning of period	2,091,208	$ 22.68	1,803,484	$ 22.72
Granted	358,928	26.35	432,561	20.59
Exercised	(75,111)	17.26	(38,066)	14.01
Canceled	(75,091)	28.82	(56,679)	26.59
Outstanding, end of period	2,299,934	23.23	2,141,300	22.30
Options exercisable at end of period	1,431,465		1,397,755	
Six Months Ended:				
Outstanding, beginning of period	2,153,008	$ 22.41	1,812,222	$ 22.67
Granted	358,928	26.35	432,561	20.59
Exercised	(136,911)	15.40	(39,803)	14.11
Canceled	(75,091)	28.82	(63,680)	26.34
Outstanding, end of period	2,299,934	23.23	2,141,300	22.30
Options exercisable at end of period	1,431,465		1,397,755	

Stock options cancellations during the six months ended June 30, 2006 and June 30, 2005 were due either to unvested options terminating in accordance with the provisions of the applicable stock option plans upon directors' or employees' departures from Farmer Mac or vested options terminating unexercised on their expiration date. For the three-month and the six-month periods ended June 30, 2006, the additional paid-in capital received from stock option exercises was $1.2 million and $2.0 million, respectively, compared to $0.5 million and $0.5 million for the comparable periods in the prior year. For the three-month and the six-month periods ended June 30, 2006, the reduction of income taxes to be paid as a result of the deduction for stock option exercises was $0.3 million and $0.7 million, respectively, compared to $0.1 million and $0.1 million for the comparable periods in the prior year.

The following table summarizes information regarding options outstanding as of June 30, 2006:

	Options Outstanding		Options Exercisable
Range of Exercise Prices	Number of Shares	Weighted-Average Remaining Contractual Life	Number of Shares
$10.00 - $19.99	401,609	6.2 years	254,270
20.00 - 24.99	1,100,058	5.9 years	743,856
25.00 - 29.99	607,349	7.3 years	242,421
30.00 - 34.99	190,418	4.9 years	190,418
35.00 - 39.99	-	-	-
40.00 - 44.99	-	-	-
45.00 - 50.00	500	5.8 years	500
	2,299,934		1,431,465

The weighted-average grant date fair values of options granted in 2006, 2005 and 2004 were $10.05, $7.53 and $7.34 per share, respectively. The fair values were estimated using the Black-Scholes option pricing model based on the following assumptions:

	2006	2005	2004
Risk-free interest rate	5.0%	3.9%	4.3%
Expected years until exercise	6 years	7 years	5 years
Expected stock volatility	36.9%	46.3%	47.8%
Dividend yield	1.6%	0.0%	0.0%

(f) Reclassifications

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

(g) New Accounting Standards

In March 2004, the Emerging Issues Task Force ("EITF") amended EITF 03-1, *The Meaning of Other-Than-Temporary Impairment*. This amendment, which was originally effective for financial periods beginning after June 15, 2004, introduced qualitative and quantitative guidance for determining whether securities are other-than-temporarily impaired. In November 2005, the Financial Accounting Standards Board ("FASB") issued Staff Position No. 115-1 and No. 124-1 ("FSP"), which supersedes the guidance in paragraphs 10-18 of EITF 03-1 and references existing other-than-temporary impairment guidance. The FSP clarifies that an investor should recognize an impairment loss no later than when the impairment is deemed other-than-temporary, even if a decision to sell the security has not been made, and also provides guidance on the subsequent accounting for impaired debt securities. The FSP is effective for reporting periods beginning after December 15, 2005. Farmer Mac's adoption of the FSP effective January 1, 2006 did not have a material effect on Farmer Mac's results of operations or financial position.

In May 2005, FASB issued Statement of Financial Accounting Standards No. 154, *Accounting Changes and Error Corrections* ("SFAS 154"), which replaced Accounting Principles Board Opinion No. 20, *Accounting Changes*, and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*. SFAS 154 requires retrospective application to prior periods' financial statements for changes in accounting principles, unless determination of either the period specific effects or the cumulative effect of the change is impracticable or otherwise promulgated. SFAS 154 is effective for fiscal years beginning after December 15, 2005. Farmer Mac's adoption of SFAS 154 effective January 1, 2006 did not have a material effect on Farmer Mac's results of operations or financial position.

In February 2006, FASB issued Statement of Financial Accounting Standards No. 155, *Accounting for Certain Hybrid Financial Instruments - an Amendment of FASB Statements No. 133 and 140* ("SFAS 155"), which resolves issues addressed in Statement 133 Implementation Issue No. D1, *Application of Statement 133 to Beneficial Interests in Securitized Financial Assets*. SFAS 155, among other things, permits the fair value re-measurement of any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation; clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS 133; and establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. SFAS 155 is effective for all financial instruments acquired or issued in a fiscal year beginning after September 15, 2006. SFAS 155 is not expected to have a material effect on Farmer Mac's results of operations and financial position.

In March 2006, FASB issued Statement of Financial Accounting Standards No. 156, *Accounting for Servicing of Financial Assets* ("SFAS 156"), which requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable and permits the entities to elect either fair value measurement with changes in fair value reflected in earnings or the amortization and impairment requirements of Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, for subsequent measurement. SFAS 156 is effective on January 1, 2007. The adoption of SFAS 156 is not expected to have a material effect on Farmer Mac's results of operations or financial position.

In July 2006, FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109* ("FIN 48"), which clarifies the accounting for uncertainty in tax positions. This Interpretation requires the recognition in financial statements of the impact of a tax position if that position is more likely than not to be sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective for fiscal years beginning after December 31, 2006, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. Farmer Mac is currently evaluating the impact, if any, that FIN 48 will have on its financial statements.

Note 2. Farmer Mac Guaranteed Securities

The following table sets forth information about Farmer Mac Guaranteed Securities retained by Farmer Mac as of June 30, 2006 and December 31, 2005.

	June 30, 2006			December 31, 2005		
	Available-for-Sale	Held-to-Maturity	Total	Available-for-Sale	Held-to-Maturity	Total
			(in thousands)			
Farmer Mac I	$ 433,493	$ 40,351	$ 473,844	$ 492,158	$ 41,573	$ 533,731
Farmer Mac II	-	830,077	830,077	-	797,245	797,245
Total	$ 433,493	$ 870,428	$ 1,303,921	$ 492,158	$ 838,818	$ 1,330,976
Amortized cost	$ 428,325	$ 870,428	$ 1,298,753	$ 477,561	$ 838,818	$ 1,316,379
Unrealized gains	8,921	268	9,189	18,395	448	18,843
Unrealized losses	(3,753)	(13,594)	(17,347)	(3,798)	(8,339)	(12,137)
Fair value	$ 433,493	$ 857,102	$ 1,290,595	$ 492,158	$ 830,927	$ 1,323,085

The table below presents a sensitivity analysis for Farmer Mac's retained Farmer Mac Guaranteed Securities as of June 30, 2006.

	June 30,2006 *(dollars in thousands)*
Fair value of beneficial interests retained in Farmer Mac Guaranteed Securities	$ 1,290,595
Weighted-average remaining life (in years)	4.8
Weighted-average prepayment speed (annual rate)	10.1%
Effect on fair value of a 10%	$ (53)

adverse change		
Effect on fair value of a 20% adverse change	$	(80)
Weighted-average discount rate		5.7%
Effect on fair value of a 10% adverse change	$	(17,912)
Effect on fair value of a 20% adverse change	$	(35,802)

These sensitivities are hypothetical. Changes in fair value based on 10 percent or 20 percent variations in assumptions generally cannot be extrapolated because the relationship of the change in assumptions to the change in fair value may not be linear. Also, in this table the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption. In fact, changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower prepayments), which might amplify or counteract the sensitivities.

The table below presents the outstanding principal balances as of the periods indicated for Farmer Mac Guaranteed Securities, loans, and LTSPCs.

	June 30, 2006	December 31, 2005
	(in thousands)	
On-balance sheet assets:		
Farmer Mac I:		
Loans	$ 778,304	$ 784,422
Guaranteed Securities	467,944	518,250
Farmer Mac II:		
Guaranteed Securities	828,939	796,224
Total on-balance sheet	$ 2,075,187	$ 2,098,896
Off-balance sheet assets:		
Farmer Mac I:		
LTSPCs	$ 2,149,677	$ 2,329,798
Guaranteed Securities	1,778,288	804,785
Farmer Mac II:		
Guaranteed Securities	34,839	39,508
Total off-balance sheet	$ 3,962,804	$ 3,174,091
Total	$ 6,037,991	$ 5,272,987

Net credit losses and 90-day delinquencies as of and for the periods indicated for Farmer Mac Guaranteed Securities, loans and LTSPCs are presented in the table below. Information is not presented for loans underlying Farmer Mac I Guaranteed Securities issued prior to the 1996 Act or Farmer Mac II Guaranteed Securities. Farmer Mac I Guaranteed Securities issued prior to the 1996 Act are supported by unguaranteed first loss subordinated interests, which are expected to exceed the estimated credit losses on those loans. The guaranteed portions collateralizing Farmer Mac II Guaranteed Securities are guaranteed by the USDA. Each USDA guarantee is an obligation backed by the full faith and credit of the United States. As of June 30, 2006, Farmer Mac had not experienced any credit losses on any Farmer Mac I Guaranteed Securities issued prior to the 1996 Act or on any Farmer Mac II Guaranteed Securities and does not expect to incur any such losses in the future.

	90-Day Delinquencies (1)		Net Credit Losses/(Recoveries) For the Six Months Ended	
	As of June 30, 2006	As of December 31, 2005	June 30, 2006	2005
	(in thousands)			
On-balance sheet assets:				
Farmer Mac I:				
Loans	$ 18,599	$ 23,308	$ 536	$ (62)
Guaranteed Securities	-	-	-	-
Total on-balance sheet	$ 18,599	$ 23,308	$ 536	$ (62)
Off-balance sheet assets:				
Farmer Mac I:				
LTSPCs	$ 2,409	$ 2,153	$ -	$ -
Guaranteed Securities	-	-	-	-
Total off-balance sheet	$ 2,409	$ 2,153	$ -	$ -
Total	$ 21,008	$ 25,461	$ 536	$ (62)

(1) Includes loans and loans underlying post-1996 Act Farmer Mac I Guaranteed Securities and LTSPCs that are 90 days or more past due, in foreclosure, restructured after delinquency, and in bankruptcy, excluding loans performing under either their original loan terms or a court-approved bankruptcy plan.

Note 3. Off-Balance Sheet Guarantees and Long-Term Standby Purchase Commitments

Overview

Farmer Mac offers approved agricultural and rural residential mortgage lenders two off-balance sheet alternatives to increase their liquidity or lending capacity while retaining the cash flow benefits of their loans: (1) Farmer Mac

Guaranteed Securities, which are available through either the Farmer Mac I program or the Farmer Mac II program; and (2) LTSPCs, which are available only through the Farmer Mac I program. Both of these alternatives result in the creation of off-balance sheet obligations for Farmer Mac in the ordinary course of its business.

Off-Balance Sheet Farmer Mac Guaranteed Securities

Periodically Farmer Mac transfers agricultural mortgage loans into trusts that are used as vehicles for the securitization of the transferred assets and the beneficial interests in the trusts are sold to third party investors. The following table summarizes certain cash flows received from and paid to these trusts:

	Six Months Ended	
	June 30, 2006	June 30, 2005
	(in thousands)	
Proceeds from new securitizations	$ 3,033	$ 22,012
Guarantee fees received	761	776
Purchases of assets from the trusts	506	1,595
Servicing advances	10	5
Repayment of servicing advances	8	21

The following table presents the outstanding balance of off-balance sheet Farmer Mac Guaranteed Securities, which represents the maximum principal amount of potential undiscounted future payments that Farmer Mac could be required to make with respect to those securities as of June 30, 2006 and December 31, 2005, not including offsets provided by any recourse provisions, recoveries from third parties or collateral for the underlying loans.

Outstanding Balance of Off-Balance Sheet Farmer Mac Guaranteed Securities

	June 30, 2006	December 31, 2005
	(in thousands)	
Farmer Mac I Guaranteed Securities	$ 1,778,288	$ 804,785
Farmer Mac II Guaranteed Securities	34,839	39,508
Total Farmer Mac I and II	$ 1,813,127	$ 844,293

As of June 30, 2006, the weighted-average remaining maturity of all loans underlying off-balance sheet Farmer Mac Guaranteed Securities, excluding AgVantage securities, was 17.1 years. For those securities issued or modified on or after January 1, 2003, Farmer Mac has recorded a liability for its obligation to stand ready under the guarantee in the guarantee and commitment obligation on the condensed consolidated balance sheet. This liability approximated $4.8 million as of June 30, 2006 and $5.2 million as of December 31, 2005.

Long-Term Standby Purchase Commitments (LTSPCs)

An LTSPC is a commitment by Farmer Mac to purchase eligible loans from a segregated pool of loans, either for cash or in exchange for Farmer Mac I Guaranteed Securities, on one or more undetermined future dates.

As of June 30, 2006 and December 31, 2005, the maximum principal amount of potential undiscounted future payments that Farmer Mac could be requested to make under LTSPCs, not including offsets provided by any recourse provisions, recoveries from third parties or collateral for the underlying loans, was $2.1 billion and $2.3 billion, respectively.

As of June 30, 2006, the weighted-average remaining maturity of all loans underlying LTSPCs was 14.1 years. For those LTSPCs issued or modified on or after January 1, 2003, Farmer Mac has recorded a liability for its obligation to stand ready under the commitment in the guarantee and commitment obligation on the condensed consolidated balance sheet. This liability approximated $16.9 million as of June 30, 2006 and $12.4 million as of December 31, 2005.

Note 4. Comprehensive Income

Comprehensive income is comprised of net income plus other changes in stockholders' equity not resulting from investments by or distributions to stockholders. The following table sets forth Farmer Mac's other comprehensive income for the three and six months ended June 30, 2006 and 2005:

	Three Months Ended		Six Months Ended	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
	(in thousands)			
Net income available to common stockholders	$ 7,619	$ 8,211	$ 12,656	$ 13,123
Unrealized gains/(losses) on securities	(10,275)	14,702	(24,184)	(1,655)
Cash flow hedging instruments:				
Unrealized gains/(losses)	9,617	(15,574)	26,238	2,762
Amortization of losses on forward sale contracts into interest expense	327	452	617	905
Cash flow hedging instruments	9,944	(15,122)	26,855	3,667
Other compehensive income, before tax	(331)	(420)	2,671	2,012
Income tax related to items of other comprehensive income	(116)	(146)	935	705
Other comprehensive income/(loss), net of tax	(215)	(274)	1,736	1,307
Comprehensive income available to common stockholders	$ 7,404	$ 7,937	$ 14,392	$ 14,430

Note 5. Investments

As of the dates indicated below, Farmer Mac's investment portfolio was comprised of the following investment securities:

	June 30, 2006	December 31, 2005
	(in thousands)	
Held-to-maturity	$ 10,602	$ 10,602
Available-for-sale	1,991,398	1,604,419
Trading	5,895	6,920
	$ 2,007,895	$ 1,621,941

The amortized cost and estimated fair values of investments as of June 30, 2006 and December 31, 2005 were as follows:

	As of June 30, 2006				As of December 31, 2005			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
				(in thousands)				
Held-to-maturity:								
Cash investment in fixed rate guaranteed investment contract	$ 10,602	$ 262	$ -	$ 10,864	$ 10,602	$ 18	$ -	$ 10,620
Total held-to-maturity	$ 10,602	$ 262	$ -	$ 10,864	$ 10,602	$ 18	$ -	$ 10,620
Available-for-sale:								
Floating rate asset-backed securities	$ 448,098	$ 720	$ -	$ 448,818	$ 336,647	$ 941	$ -	$ 337,588
Floating rate corporate debt securities	407,496	507	(91)	407,912	231,168	515	(10)	231,673
Fixed rate corporate debt securities	544,484	-	(9,254)	535,230	520,000	-	(1,950)	518,050
Fixed rate preferred stock	237,918	4,947	(446)	242,419	239,033	11,687	(304)	250,416
Fixed rate commercial paper	184,153	-	-	184,153	90,848	-	-	90,848
Floating rate mortgage-backed securities	162,710	576	(11)	163,275	175,441	481	(78)	175,844
Fixed rate mortgage-backed securities	10,014	-	(423)	9,591	-	-	-	-
Total available-for-sale	$ 1,994,873	$ 6,750	$ (10,225)	$ 1,991,398	$ 1,593,137	$ 13,624	$ (2,342)	$ 1,604,419
Trading:								
Adjustable rate mortgage-backed securities	$ 5,866	$ 29	$ -	$ 5,895	$ 6,867	$ 53	$ -	$ 6,920
Total trading	$ 5,866	$ 29	$ -	$ 5,895	$ 6,867	$ 53	$ -	$ 6,920

The temporary unrealized losses presented above are principally due to changes in interest rates from the date of acquisition to June 30, 2006 and December 31, 2005, as applicable. Farmer

Mac has the intent and ability to hold its investment securities until either the market value recovers or the securities mature.

As of June 30, 2006, Farmer Mac owned one held-to-maturity investment that matures in 2006 with an amortized cost of $10.6 million, a fair value of $10.9 million, and a yield of 6.5 percent. As of June 30, 2006, Farmer Mac owned trading investment securities that mature after 10 years with an amortized cost of $5.9 million, a fair value of $5.9 million, and a weighted average yield of 5.38 percent. The amortized cost, fair value and yield of investments by remaining contractual maturity for available-for-sale investment securities as of June 30, 2006 are set forth below. Asset- and mortgage-backed securities are included based on their final maturities, although the actual maturities may differ due to prepayments of the underlying assets or mortgages.

	Investment Securities Available-for-Sale as of June 30, 2006		
	Amortized Cost	Fair Value	Yield
	(dollars in thousands)		
Due within one year	$ 253,008	$ 252,955	4.95%
Due after one year through five years	946,390	937,159	5.14%
Due after five years through ten years	112,886	116,576	7.41%
Due after ten years	682,589	684,708	5.81%
Total	$ 1,994,873	$ 1,991,398	5.47%

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Please read the following Management's Discussion and Analysis of Financial Condition and Results of Operations in conjunction with: (1) the interim unaudited condensed consolidated financial statements and the related notes that appear elsewhere in this report; and (2) Farmer Mac's Annual Report on Form 10 K for the fiscal year ended December 31, 2005.

Special Note Regarding Forward-Looking Statements

Some statements made in this report are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 pertaining to management's current expectations as to Farmer Mac's future financial results, business prospects and business developments. Forward-looking statements include, without limitation, any statement that may predict, forecast, indicate or imply future results, performance or achievements, and typically are accompanied by, and identified with, such terms as "anticipates," "believes," "expects," "intends," "should" and similar phrase
The following management's discussion and analysis of financial condition and results of operations includes forward-looking statements addressing Farmer Mac's:

· prospects for earnings;
· prospects for growth in loan purchase, guarantee, securitization and LTSPC volume;
· trends in net interest income;
· trends in provisions for losses;
· trends in expenses;
· changes in capital position; and
· other business and financial matters.

Management's expectations for Farmer Mac's future necessarily involve a number of assumptions and estimates and the evaluation of risks and uncertainties. Various factors could cause Farmer Mac's actual results to differ materially from the expectations as expressed or implied by the forward-looking statements, including the factors discussed under "Risk Factors" in Part I, Item 1A of Farmer Mac's Annual Report on Form 10-K for the year ended December 31, 2005, as filed with the Securities and Exchange Commission ("SEC") on March 16, 2006 and uncertainties regarding:

· the possible establishment of additional statutory or regulatory restrictions or constraints on Farmer Mac that could hamper its growth or diminish its profitability;
· the general rate of growth in agricultural mortgage indebtedness;
· the rate and direction of development of the secondary market for agricultural mortgage loans, particularly lender interest in the Farmer Mac secondary market and Farmer Mac credit products;
· borrower preferences for fixed-rate agricultural mortgage indebtedness;
· the willingness of investors to invest in Farmer Mac Guaranteed Securities; and
· possible reaction in the financial markets to events involving government-sponsored enterprises other than Farmer Mac.

In light of these potential risks and uncertainties, no undue reliance should be placed on any forward-looking statements expressed in this report. Furthermore, Farmer Mac undertakes no obligation to release publicly the results of revisions to any forward-looking statements that may be made to reflect new information or any future events or circumstances, except as otherwise mandated by law.

Critical Accounting Policy and Estimates

The critical accounting policy that is both important to the portrayal of Farmer Mac's financial condition and results of operations and requires complex, subjective judgments is the accounting policy for the allowance for losses. For a discussion of Farmer Mac's critical accounting policy, changes implemented in its methodology for determining its allowance for losses as of September 30, 2005, as well as Farmer Mac's use of estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and related notes for the periods presented, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policy and Estimates" in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2005, as filed with the SEC on March 16, 2006.

Results of Operations

Overview. Net income available to common stockholders for second quarter 2006 was $7.6 million or $0.67 per diluted common share, compared to $8.2 million or $0.72 per diluted common share for second quarter 2005. The decrease was due principally to the after-tax effects of increased compensation costs resulting from the expense related to the vesting of stock options pursuant to Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payments* ("SFAS 123(R)"), which was adopted January 1, 2006. Net income available to common stockholders for the six months ended June 30, 2006 was $12.7 million or $1.11 per diluted common share, compared to $13.1 million or $1.13 per diluted common share for the six months ended June 30, 2005.

As part of Farmer Mac's continuing evaluation of the overall credit quality of its portfolio, the state of the U.S. agricultural economy, the recent upward trends in agricultural land values, and the level of Farmer Mac's outstanding guarantees and commitments, Farmer Mac determined that the appropriate allowance for losses as of June 30, 2006 was $6.3 million. This resulted in the release of $2,000 from the allowance for losses in second quarter 2006. As of June 30, 2006, the allowance for losses was $6.3 million and 13 basis points relative to the outstanding post-1996 Act Farmer Mac I portfolio, compared to $8.7 million and 20 basis points as of December 31, 2005.

As of June 30, 2006, Farmer Mac's 90 day delinquencies (Farmer Mac I loans purchased or placed under Farmer Mac I Guaranteed Securities or long-term standby purchase commitments ("LTSPCs") after changes to Farmer Mac's statutory charter in 1996 that were 90 days or more past due, in foreclosure, restructured after delinquency, or in bankruptcy, excluding loans performing under either their original loan terms or a court-approved bankruptcy plan) were $21.0 million, representing 0.46 percent of the principal balance of all loans held and loans underlying post-1996 Act Farmer Mac I Guaranteed Securities and LTSPCs, down from $36.8 million (0.85 percent) as of June 30, 2005.

During second quarter 2006, Farmer Mac:
- added $570.6 million of Farmer Mac I loans under LTSPCs;
- purchased $26.1 million of newly originated and current seasoned Farmer Mac I loans;
- purchased $61.2 million of Farmer Mac II USDA-guaranteed portions of loans; and
- converted $550.1 million of pre-existing LTSPCs into Farmer Mac I Guaranteed Securities.

As of June 30, 2006, Farmer Mac's outstanding program volume was $6.0 billion, which represented approximately 12.5 percent of management's estimate of a $48.0 billion market of eligible agricultural mortgage loans. In addition, Farmer Mac guaranteed $1.0 billion of AgVantage securities on July 20, 2006, bringing Farmer Mac's outstanding program volume to approximately $7.0 billion at that time.

Farmer Mac's ongoing guarantee and commitment fee income is earned on the cumulative outstanding principal balance of Farmer Mac Guaranteed Securities and loans underlying LTSPCs. Accordingly, guarantee and commitment fees increase or decrease through changes in periodic business volume in proportion to the change in that cumulative outstanding principal balance, not in proportion to the change in periodic volume.

Set forth below is a more detailed discussion of Farmer Mac's results of operations.

Net Interest Income. Net interest income was $9.1 million for second quarter 2006, compared to $8.1 million for second quarter 2005. The net interest yield was 83 basis points for the six months ended June 30, 2006, compared to 87 basis points for the six months ended June 30, 2005. Net interest income includes guarantee fees for loans purchased after April 1, 2001 (the effective date of Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* ("SFAS 140")), but not for loans purchased prior to that date. The effect of SFAS 140 was the classification of approximately $1.7 million (8 basis points) of guarantee fee income as interest income for the six months ended June 30, 2006, compared to $1.9 million (10 basis points) for the six months ended June 30, 2005.

Farmer Mac classifies the net interest income and expense realized on financial derivatives that are not in fair value or cash flow hedge relationships as gains and losses on financial derivatives and trading assets. For the six months ended June 30, 2006 and 2005, this classification resulted in no effect on the net interest yield and a decrease of the net interest yield of 3 basis points, respectively.

The net interest yields for the six months ended June 30, 2006 and 2005 included the benefits of yield maintenance payments of 11 basis points and 17 basis points, respectively. Yield maintenance payments represent the present value of expected future interest income streams and accelerate the recognition of interest income from the related loans. Because the timing and size of these payments vary greatly, variations do not necessarily indicate positive or negative trends to gauge future financial results. For the six months ended June 30, 2006 and 2005, the after tax effects of yield maintenance payments on net income and diluted earnings per share were $1.5 million or $0.13 per diluted share and $2.0 million or $0.17 per diluted share, respectively.

The following table provides information regarding interest-earning assets and funding for the six months ended June 30, 2006 and 2005. The balance of non-accruing loans is included in the average balance of interest-earning loans presented, though no related income is included in the income figures presented. Therefore, as the balance of non-accruing loans increases or decreases, the net interest yield will decrease or increase accordingly. Net interest income and the yield will also fluctuate due to the uncertainty of the timing and size of yield maintenance payments. The average rate earned on cash and cash equivalents reflects the increase in short-term market rates during the latter part of 2005 and the first six months of 2006. The increase in the average rate for investments reflects the general increase in short-term rates and the short-term or floating rate nature of most investments acquired or reset during 2005 and the first six months of 2006 and outstanding during 2006. The higher average rate on loans and Farmer Mac Guaranteed Securities during the first six months of 2006 reflects the increase in market rates during the latter part of 2005 and first part of 2006, which affected the rates on loans acquired or reset during that period and outstanding during the first six months of 2006. The higher average rate on Farmer Mac's notes payable due within one year is consistent with general trends in average short-term rates during the periods presented. The upward trend in the average rate on notes payable due after one year reflects the retirement of older debt and the issuance of new debt at higher market rates during the latter part of 2005 and first six months of 2006 and outstanding during 2006.

	Six Months Ended					
	June 30, 2006			June 30, 2005		
	Average Balance	Income/ Expense	Average Rate	Average Balance	Income/ Expense	Average Rate
	(dollars in thousands)					
Interest-earning assets:						
Cash and cash equivalents	$ 614,978	$ 14,413	4.69%	$ 467,504	$ 6,330	2.71%
Investments	1,681,448	42,581	5.06%	1,062,979	21,022	3.96%
Loans and Farmer Mac Guaranteed Securities	2,056,083	60,744	5.91%	2,138,226	58,445	5.47%
Total interest-earning assets	4,352,509	117,738	5.41%	3,668,709	85,797	4.68%
Funding:						
Notes payable due within one year	2,471,175	59,658	4.83%	1,860,505	34,027	3.66%
Notes payable due after one year	1,669,947	40,079	4.80%	1,608,066	35,842	4.46%
Total interest-bearing liabilities	4,141,122	99,737	4.82%	3,468,571	69,869	4.03%
Net non-interest-bearing funding	211,387			200,138		
Total funding	$ 4,352,509	99,737	4.58%	$ 3,668,709	69,869	3.81%
Net interest income/yield		$ 18,001	0.83%		$ 15,928	0.87%

The following table sets forth information regarding the changes in the components of Farmer Mac's net interest income for the periods indicated. For each category, information is provided on changes attributable to changes in volume (change in volume multiplied by old rate) and changes in rate (change in rate multiplied by old volume). Combined rate/volume variances, the third element of the calculation, are allocated based on their relative size. The increases in income due to changes in rate reflect the short-term or adjustable-rate nature of the assets or liabilities and the general increases in short-term market rates.

	Six Months Ended June 30, 2006 Compared to Six Months Ended June 30, 2005 Increase/(Decrease) Due to		
	Rate	Volume	Total
	(in thousands)		
Income from interest-earning assets:			
Cash and cash equivalents	$ 5,646	$ 2,437	$ 8,083
Investments	7,014	14,545	21,559
Loans and Farmer Mac Guaranteed Securities	13,734	(11,435)	2,299
Total	26,394	5,547	31,941
Expense from interest-bearing liabilities	15,001	14,867	29,868
Change in net interest income	$ 11,393	$ (9,320)	$ 2,073

Guarantee and Commitment Fees. Guarantee and commitment fees, which compensate Farmer Mac for assuming the credit risk on loans underlying Farmer Mac Guaranteed Securities and LTSPCs, were $5.3 million for second quarter 2006 and $10.3 million for the six months ended June 30, 2006, compared to $4.9 million and $9.8 million, respectively, for the same periods in 2005. The effect of SFAS 140 was the classification as interest income of guarantee fees of $0.9 million for second quarter 2006 and $1.7 million for the six months ended June 30, 2006, compared to $0.9 million and $1.9 million, respectively, for the same periods in 2005, although management considers the amounts to have been earned in consideration for the assumption of credit risk. That portion of the difference or "spread" between the cost of Farmer Mac's debt funding for loans and the yield on post-1996 Act Farmer Mac I Guaranteed Securities held on its books compensates for credit risk. When a post-1996 Act Farmer Mac I Guaranteed Security is sold to a third party, Farmer Mac continues to receive the guarantee fee component of that spread, which continues to compensate Farmer Mac for its assumption of credit risk. The portion of the spread that compensates for interest rate risk would not typically continue to be received by Farmer Mac if the asset were sold, except to the extent attributable to any retained interest-only strip.

Expenses. General and administrative expenses were $2.6 million for second quarter 2006 and $5.3 million for the six months ended June 30, 2006, compared to $2.3 million and $4.3 million, respectively, for the same periods in 2005. The increase was largely attributable to increased legal fees related to mortgage securitizations and compliance matters. Compensation and employee benefits were $2.7 million for second quarter 2006 and $5.6 million for the six months ended June 30, 2006, compared to $1.9 million and $3.7 million, respectively, for the same periods in 2005. For second quarter 2006 and the six months ended June 30, 2006, compensation costs were higher due to expense related to stock options of $0.4 million and $1.0 million, respectively. The comparable periods in the prior year did not include expense related to stock options. For more information on stock option expense and the adoption of SFAS 123(R) on January 1, 2006, see Note 1(e). The remainder of the increase was due to a general increase in staffing during 2005.

Regulatory fee expense for each of the six-month periods ended June 30, 2006 and 2005 was $1.2 million. The Farm Credit Administration ("FCA") has advised the Corporation that its estimated fees for the federal fiscal year ended September 30, 2006 will be $2.4 million. After the end of a federal government fiscal year, FCA may revise its prior year estimated assessments to reflect actual costs incurred, and has issued both additional assessments and refunds in the past. Farmer Mac expects all of the above-mentioned expenses and regulatory fees to continue at approximately the same levels through 2006.

During second quarter 2006, Farmer Mac released $2,000 from the allowance for losses, compared to a release of $0.3 million for second quarter 2005. During the six months ended June 30, 2006, Farmer Mac released $1.7 million from the allowance for losses, compared to a release of $1.0 million for the six months ended June 30, 2005. See "—Quantitative and Qualitative Disclosures About Market Risk Management—Credit Risk" for additional information regarding Farmer Mac's provision for losses, provision for loan losses and Farmer Mac's methodology for determining its allowance for losses. As of June 30, 2006, Farmer Mac's total allowance for losses was $6.3 million, or 13 basis points of outstanding loans held or loans underlying post-1996 Act Farmer Mac I Guaranteed Securities (excluding AgVantage securities) and LTSPCs, compared to $8.7 million and 20 basis points as of December 31, 2005.

Gains and Losses on Financial Derivatives and Trading Assets. The gain on financial derivatives and trading assets was $2.0 million for second quarter 2006 and $25,000 for the six months ended June 30, 2006, compared to gains of $3.8 million and $2.0 million, respectively, for the same periods in 2005. The gains and losses resulted primarily from fluctuations in the fair values of financial derivatives that were not designated as either fair value hedges or cash flow hedges in accordance with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities,* as amended ("SFAS 133"), which fluctuations resulted from movements in interest rates. During second quarter 2006, Farmer Mac discontinued hedge accounting treatment for basis swaps with a notional mount of $210.0 million and a fair value of $9.1 million. Accordingly, the Corporation recognized a $2.6 million gain on financial derivatives and trading assets in the condensed consolidated financial statements during second quarter 2006 related to the change in fair value of these swaps. As of June 30, 2006, Farmer Mac had $4.1 million of net after-tax unrealized gains remaining in accumulated other comprehensive income related to these swaps. In accordance with SFAS 133, this amount will be reclassified into earnings during the periods which the hedged forecasted transactions affect earnings.

Non-GAAP Performance Measures. Farmer Mac reports its financial results in accordance with accounting principles generally accepted in the United States of America ("GAAP"). In addition to GAAP measures, Farmer Mac presents certain non-GAAP performance measures. Farmer Mac uses these non-GAAP performance measures to develop financial plans, to measure corporate economic performance, and to set incentive compensation because, in management's view, the non-GAAP measures more accurately represent Farmer Mac's economic performance, transaction economics and business trends. Investors and the investment analyst community have previously relied upon similar measures to evaluate Farmer Mac's historical and future performance. Farmer Mac's disclosure of non-GAAP measures is not intended to replace GAAP information but, rather, it is intended to supplement it.

Farmer Mac developed non-GAAP core earnings to present net income less the after-tax effects of SFAS 133. Core earnings for the three and six months ended June 30, 2006 were $6.3 million and $12.5 million, respectively, compared to $6.0 million and $12.2 million for the three and six months ended June 30, 2005. The reconciliation of GAAP net income available to common stockholders to core earnings is presented in the following table:

Reconciliation of GAAP Net Income Available to Common Stockholders to Core Earnings

	Three Months Ended		Six Months Ended	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
	(in thousands)			
GAAP net income available to common stockholders	$ 7,619	$ 8,211	$ 12,656	$ 13,123
Less the effects of SFAS 133:				
Unrealized gains/(losses) on financial derivatives and trading assets, net of tax	1,290	2,251	157	898
Core earnings	$ 6,329	$ 5,960	$ 12,499	$ 12,225

Business Volume. New business volume for second quarter 2006 was $657.9 million, up from $648.5 million in first quarter 2006. That new business volume included an LTSPC issued to a Farm Credit System ("FCS") institution on $486.7 million of agricultural real estate mortgage loans. During second quarter 2006, the loans underlying that LTSPC were converted into a Farmer Mac Guaranteed Security. In addition to the new business volume in first and second quarters of 2006, in July 2006, Farmer Mac guaranteed $1.0 billion of AgVantage securities supported by a five-year mortgage-backed obligation of Metropolitan Life Insurance Company ("MetLife") backed by agricultural real estate mortgage loans. This transaction was in addition to the similar first quarter transaction in which Farmer Mac guaranteed $500.0 million of AgVantage securities supported by a MetLife agricultural mortgage-backed obligation.

All of the above-referenced transactions were products of Farmer Mac's ongoing efforts to diversify its marketing focus to include large program transactions that emphasize high asset quality, with greater protection against adverse credit performance and commensurately lower compensation for the assumption of credit risk and administrative costs. While Farmer Mac's new business volume has improved as a result of those efforts, its future business with agricultural mortgage lenders may still be constrained by:

- high levels of available capital and liquidity of agricultural lenders;
- alternative sources of funding and credit enhancement for agricultural lenders;
- increased competition in the secondary market for agricultural mortgage loans; and
- reduced growth rates in the agricultural mortgage market.

Management believes that legislative or regulatory developments or interpretations of Farmer Mac's statutory charter could adversely affect Farmer Mac, its ability to offer new products, the ability or motivation of certain lenders to participate in its programs or the terms of any such participation, or increase the cost of regulation and related corporate activities. See

"Risk Factors" in Part I, Item 1A of Farmer Mac's Annual Report on Form 10-K for the year ended December 31, 2005, as filed with the SEC on March 16, 2006.

For a more detailed discussion of the above factors and the related effects on Farmer Mac's business volume, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Outlook for 2006" in the Corporation's Annual Report on Form 10 K for the year ended December 31, 2005, as filed with the SEC on March 16, 2006.

Looking ahead, Farmer Mac is developing innovative ways to serve the financing needs of rural America, and remains confident of opportunities for increased business volume and income growth as a result of the Corporation's product development and customer service efforts. Farmer Mac's marketing initiatives are generating business opportunities for 2006 and, it believes, beyond. Current initiatives include:

- an alliance with the American Bankers Association, entered into in October 2005, under which Farmer Mac agreed to facilitate access and improve pricing to ABA member institutions and the ABA agreed to promote member participation in the Farmer Mac I program;
- new and expanded business relationships that will serve a cross-section of agricultural lenders in many areas of the nation;
- expanded use of AgVantage transactions, targeting highly-rated financial institutions with large agricultural mortgage portfolios;
- product enhancements, such as open prepayment loan structures;
- agribusiness and rural development loans associated with agriculture, in fulfillment of Farmer Mac's Congressional mission;
- federal and state agricultural finance programs;
- new loan securitization structures; and
- increased efforts to adjust the pricing of products to reflect with greater precision the risks assumed by Farmer Mac and the creditworthiness of the obligors on obligations guaranteed by Farmer Mac.

Some of the agribusiness and rural development initiatives will require Farmer Mac to consider credit risks that expand upon or differ from those the Corporation has accepted previously. Farmer Mac will use underwriting standards appropriate to those credit risks, and likely will draw upon outside expertise to analyze and evaluate the credit and funding aspects of loans submitted pursuant to those initiatives. While Farmer Mac is seeking to expand its mix of loan types within the scope of its Congressional charter, it is too early to assess the probability of success of these efforts. Farmer Mac believes that prospects for large portfolio transactions similar to those that have accounted for a significant portion of Farmer Mac's previous growth, including the previously mentioned January and July 2006 AgVantage transactions and the April 2006 LTSPC transaction, continue to exist. No assurance can be given at this time as to the certainty or timing of similar transactions in the future.

The following tables set forth the amount of all Farmer Mac I and Farmer Mac II loan purchase and guarantee activities for newly originated and current seasoned loans during the periods indicated:

	Three Months Ended		Six Months Ended	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
	(in thousands)			
Loan purchase and guarantee and commitment activity:				
Farmer Mac I:				
Loans	$ 26,114	$ 20,382	$ 56,374	$ 38,922
LTSPCs	570,595	96,419	643,750	129,701
AgVantage	-	-	500,000	-
Farmer Mac II Guaranteed Securities	61,204	45,123	106,331	88,757
Total purchases, guarantees and commitments	$ 657,913	$ 161,924	$ 1,306,455	$ 257,380
Farmer Mac I Guaranteed Securities issuances:				
Retained	$ -	$ -	$ -	$ -
Sold	1,548	20,098	3,033	22,012
Loans previously under LTSPCs exchanged for Farmer Mac Guaranteed Securities	550,114	-	550,114	-
Total	$ 551,662	$ 20,098	$ 553,147	$ 22,012

To fulfill its guarantee and commitment obligations, Farmer Mac purchases defaulted loans underlying Farmer Mac Guaranteed Securities and LTSPCs, all of which are at least 90 days delinquent at the time of purchase. The following table presents Farmer Mac's loan purchases of newly originated and current seasoned loans and defaulted loans purchased underlying Farmer Mac I Guaranteed Securities and LTSPCs:

	Three Months Ended		Six Months Ended	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
	(in thousands)			
Farmer Mac I newly originated and current seasoned loan purchases	$ 26,114	$ 20,382	$ 56,374	$ 38,922
Defaulted loans purchased underlying off-balance sheet Farmer Mac I Guaranteed Securities	-	-	506	1,595
Defaulted loans underlying on-balance sheet Farmer Mac I Guaranteed Securities transferred to loans	214	-	813	1,174
Defaulted loans purchased underlying LTSPCs	297	405	3,246	1,035
Total loan purchases	$ 26,625	$ 20,787	$ 60,939	$ 42,726

The weighted-average age of the Farmer Mac I newly originated and current seasoned loans purchased during second quarter 2006 was two months and during second quarter 2005, the weighted-average age was less than one month. Of the Farmer Mac I newly originated and current seasoned loans purchased during second quarter 2006 and second quarter 2005, 76 percent and 77 percent, respectively, had principal amortization periods longer than the maturity date, resulting in balloon payments at maturity, with a weighted-average remaining term to maturity of 16.9 years and 14.6 years, respectively. The weighted-average age of delinquent loans purchased out of securitized pools and LTSPCs during second quarter 2006 and second quarter 2005 was 9.8 years and 13.7 years, respectively.

As of June 30, 2006, Farmer Mac had 165 approved loan sellers eligible to participate in the Farmer Mac I program, ranging from single-office to multi-branch institutions, spanning community banks, FCS institutions, mortgage companies, commercial banks and insurance companies. The increase in the number of approved Farmer Mac I loan sellers from 95 as of June 30, 2005 is principally a result of two factors: (1) an increase in the number of new Farmer Mac Sellers precipitated largely by the new American Bankers Association/Farmer Mac Alliance; and (2) a new, customized seller recertification process that is conducted quarterly instead of annually. In addition to participating directly in the Farmer Mac I program, some of the approved loan sellers enable other lenders to participate indirectly in the Farmer Mac I program by managing correspondent networks of lenders from which they purchase loans to sell to Farmer Mac. As of June 30, 2006, approximately 100 lenders were participating in those networks.

Sellers in the Farmer Mac II program consist mostly of community and regional banks. As of June 30, 2006, more than 300 lenders were participating, directly or indirectly, in one or both of the Farmer Mac I or Farmer Mac II programs.

USDA's most recent publications (as available on USDA's website as of August 8, 2006) forecast:

- 2006 net cash farm income to be $64.8 billion, following record years of $82.8 billion in 2005 and $85.5 billion in 2004.
- 2006 net farm income to be $56.2 billion, which is a decrease of $16.4 billion from 2005 but still slightly above the 10 year average net farm income of $55.7 billion.
- Total direct U.S. government payments to be $18.5 billion in 2006, down from the forecast of $23.0 billion for 2005, but still higher than the estimate of $13.3 billion for 2004.
- Countercyclical payments are forecast to increase from $4.1 billion in 2005 to $5.3 billion in 2006.
- Marketing loan benefits including loan deficiency payments, marketing loan gains, and certificate exchange gains are projected to be down from $6.2 billion in 2005 to $4.1 billion in 2006.
- The value of U.S. farm real estate to increase 6.5 percent in 2006 to $1.4 trillion, as compared to the 2005 increase of 6.8 percent, and the general economy to support further growth in farmland values.
- The amount of farm real estate debt to increase by 3.1 percent in 2006 to $122.9 billion, compared to $119.2 billion in 2005.

The USDA forecasts referenced above relate to U.S. agriculture generally, but should be favorable for Farmer Mac's financial condition relative to its exposure to outstanding guarantees and commitments, as they indicate above-average borrower cash flows and generally increased values in U.S. farm real estate.

Balance Sheet Review

During the six months ended June 30, 2006, there were $44.7 million of net principal paydowns in program assets (Farmer Mac Guaranteed Securities and loans) offset by a $276.1 million increase in the portfolio of investment securities and cash and cash equivalents. Consistent with the net increase in assets during the period, total liabilities increased $218.6 million from December 31, 2005 to June 30, 2006. For further information regarding off-balance sheet program activities, see "—Off-Balance Sheet Program Activities" below.

During the six months ended June 30, 2006, accumulated other comprehensive income increased $1.7 million, which is the net effect of a $15.7 million decrease in after-tax unrealized gains on securities available for sale and a $17.4 million increase in the after-tax fair value of financial derivatives classified as cash flow hedges. Accumulated other comprehensive income is not a component of Farmer Mac's core capital or regulatory capital.

Farmer Mac is required to hold capital at the higher of the statutory minimum capital requirement or the amount required by the risk-based capital stress test. As of June 30, 2006, Farmer Mac's core capital totaled $249.8 million, compared to $244.8 million as of December 31,

2005. As of June 30, 2006, core capital exceeded Farmer Mac's statutory minimum capital requirement of $158.5 million by $91.3 million.

Farmer Mac was in compliance with its risk-based capital standards as of June 30, 2006. As of June 30, 2006, the risk-based capital stress test generated a regulatory capital requirement of $67.7 million, up from the $32.4 million requirement as of December 31, 2005. The increase in the risk-based capital requirement from December 31, 2005 to June 30, 2006 was attributable to an increase in Farmer Mac's outstanding business volume and changes in the interest rate environment during that period. As of June 30, 2006, Farmer Mac's regulatory capital of $256.1 million exceeded the risk-based capital requirement by approximately $188.4 million. On November 17, 2005, FCA published in the Federal Register a proposed rule that would revise the risk-based capital regulation. For further discussion of that proposed rule, see "Regulatory Matters."

Off-Balance Sheet Program Activities

Farmer Mac offers approved agricultural and rural residential mortgage lenders two off balance sheet alternatives to increase their liquidity or lending capacity while retaining the cash flow benefits of their loans: (1) Farmer Mac Guaranteed Securities, which are available through either the Farmer Mac I program or the Farmer Mac II program; and (2) LTSPCs, which are available only through the Farmer Mac I program. Both of these alternatives result in the creation of off-balance sheet obligations for Farmer Mac in the ordinary course of its business. See Note 3 to the interim unaudited condensed consolidated financial statements for further information regarding Farmer Mac's off-balance sheet program activities.

Quantitative and Qualitative Disclosures About Market Risk Management

Interest Rate Risk. Farmer Mac is subject to interest rate risk on all assets held for investment because of possible timing differences in the cash flows of the assets and related liabilities. This risk is primarily related to loans held and on-balance sheet Farmer Mac Guaranteed Securities due to the ability of borrowers to prepay their mortgages before the scheduled maturities, thereby increasing the risk of asset and liability cash flow mismatches. Cash flow mismatches in a changing interest rate environment can reduce the earnings of the Corporation if assets repay sooner than expected and the resulting cash flows must be reinvested in lower-yielding investments when Farmer Mac's funding costs cannot be correspondingly reduced, or if assets repay more slowly than expected and the associated debt must be replaced by higher-cost debt.

Yield maintenance provisions and other prepayment penalties contained in many agricultural mortgage loans reduce, but do not eliminate, prepayment risk, particularly in the case of a defaulted loan where yield maintenance may not be collected. Those provisions require borrowers to make an additional payment when they prepay their loans so that, when reinvested with the prepaid principal, yield maintenance payments generate substantially the same cash flows that would have been generated had the loan not prepaid. Those provisions create a disincentive to prepayment and compensate the Corporation for its interest rate risks to a large degree. As of June 30, 2006, 55 percent of the outstanding balance of all loans held and loans underlying on-balance sheet Farmer Mac I Guaranteed Securities (including 80 percent of all loans with fixed interest rates) were covered by yield maintenance provisions and other prepayment penalties. Of the Farmer Mac I fixed rate loans purchased in second quarter 2006, 14 percent had yield maintenance or another form of prepayment protection. As of June 30, 2006, none of the USDA-guaranteed portions underlying Farmer Mac II Guaranteed Securities had yield maintenance provisions; however, 14 percent contained prepayment penalties. Of the USDA guaranteed portions purchased in second quarter 2006, less than one percent contained other forms of prepayment penalties.

As of June 30, 2006, Farmer Mac had $349.0 million of cash and cash equivalents and $2.0 billion of investment securities. Cash equivalents and investment securities pose only limited interest rate risk to Farmer Mac, due to their closely matched funding. Farmer Mac's cash equivalents mature within three months and are match-funded with discount notes having similar maturities. As of June 30, 2006, Farmer Mac's investment securities consisted of $956.5 million of floating rate securities that have rates that adjust within one year. These floating rate investments are funded using:

- a series of discount note issuances in which each successive discount note is issued and matures on or about the corresponding interest rate reset date of the related investment;
- floating-rate notes having similar rate reset provisions as the related investment; or
- fixed-rate notes swapped to floating rates having similar reset provisions as the related investment.

An important "stress test" of Farmer Mac's exposure to long-term interest rate risk is the measurement of the sensitivity of its market value of equity ("MVE") to yield curve shocks. MVE represents the present value of all future cash flows from on- and off-balance sheet assets, liabilities and financial derivatives, discounted at current interest rates and spreads. The following schedule summarizes the results of Farmer Mac's MVE sensitivity analysis as of June 30, 2006 and December 31, 2005 to an immediate and instantaneous parallel shift in the yield curve.

	Percentage Change in MVE from Base Case	
Interest Rate Scenario	June 30, 2006	December 31, 2005
+ 300 bp	-9.2%	-6.2%
+ 200 bp	-5.8%	-3.6%
+ 100 bp	-2.6%	-1.4%
- 100 bp	1.0%	0.0%
- 200 bp	0.4%	-0.7%
- 300 bp	-0.7%	-1.5%

During second quarter 2006, Farmer Mac maintained a low level of interest rate sensitivity through ongoing asset and liability management activities. As of June 30, 2006, a uniform or "parallel" increase of 100 basis points would have increased Farmer Mac's net interest income ("NII"), a shorter-term measure of interest rate risk, by 3.1 percent, while a parallel decrease of 100 basis points would have decreased NII by 5.1 percent. Farmer Mac also measures the sensitivity of both MVE and NII to a variety of non-parallel interest rate shocks, including flattening and steepening yield curve scenarios. As of June 30, 2006, both MVE and NII showed similar or lesser sensitivity to non-parallel shocks as to the parallel shocks. As of June 30, 2006, Farmer Mac's effective duration gap, another standard measure of interest rate risk that measures the difference between the sensitivities of assets compared to that of liabilities, was plus 1.4 months, compared to plus 0.5 months as of December 31, 2005. Duration matching helps to maintain the correlation of cash flows and stable portfolio earnings even when interest rates are not stable. Farmer Mac believes the relative insensitivity of its MVE and NII to both parallel and non-parallel interest rate shocks, and its duration gap, indicate that Farmer Mac's approach to managing its interest rate risk exposures is effective.

As of June 30, 2006, Farmer Mac had $1.4 billion combined notional amount of interest rate swaps with terms ranging from 1 to 15 years. Of those interest rate swaps, $774.7 million were floating-to-fixed rate interest rate swaps, $279.0 million were fixed-to-floating interest rate swaps and $372.9 million were basis swaps.

Farmer Mac uses financial derivatives as an end-user for hedging purposes, not for trading or speculative purposes. When financial derivatives meet the specific hedge criteria under SFAS 133, they are accounted for as either fair value hedges or cash flow hedges. Financial derivatives that do not satisfy those hedge criteria are not accounted for as hedges and changes in the fair value of those financial derivatives are reported as a gain or loss on financial derivatives and trading assets in the consolidated statements of operations. All of Farmer Mac's financial derivative transactions are conducted under standard collateralized agreements that limit Farmer Mac's potential credit exposure to any counterparty. As of June 30, 2006, Farmer Mac had uncollateralized net exposure of $2.6 million to two counterparties.

Credit Risk. Farmer Mac's primary exposure to credit risk is the risk of loss resulting from the inability of borrowers to repay their mortgages in conjunction with a deficiency in the value of the collateral relative to the amount outstanding on the mortgage and the costs of liquidation. Farmer Mac has established underwriting, appraisal and documentation standards for Farmer Mac I agricultural mortgage loans to mitigate the risk of loss from borrower defaults and to provide guidance concerning the management, administration and conduct of underwriting and appraisals to all participating sellers and potential sellers in its programs.

Farmer Mac's allowance for losses is presented in three components on its consolidated balance sheet:

- an "Allowance for loan losses" on loans held for investment;
- a valuation allowance on real estate owned, which is included in the balance sheet under "Real estate owned";
- an allowance for losses on loans underlying post-1996 Act Farmer Mac I Guaranteed Securities and LTSPCs, which is included in the balance sheet under "Reserve for losses."

Farmer Mac's provision for losses is presented in two components on its consolidated statement of operations:

- a "Provision for loan losses," which represents losses on Farmer Mac's loans held for investment; and
- a "Provision for losses," which represents losses on loans underlying post-1996 Act Farmer Mac I Guaranteed Securities and LTSPCs and real estate owned.

Historically, Farmer Mac estimated probable losses using a systematic process that began with management's evaluation of the results of a proprietary loan pool simulation and guarantee fee model. That model drew upon historical information from a data set of agricultural mortgage loans screened to include only those loans with credit characteristics similar to those eligible for Farmer Mac's programs. The results generated by that model were then modified, as necessary, by the application of management's judgment.

During 2005, Farmer Mac completed the planned migration of its methodology for determining its allowance for losses away from one based on its loan pool simulation and guarantee fee model to one based on its own historical portfolio loss experience and credit trends. Farmer Mac recorded the effects of that change as a change in accounting estimate as of September 30, 2005.

Farmer Mac's current methodology for determining its allowance for losses incorporates the Corporation's proprietary automated loan classification system. That system scores loans based on criteria such as historical repayment performance, loan seasoning, loan size and loan-to-value ratio. For the purposes of the loss allowance methodology, the loans in Farmer Mac's portfolio of loans and loans underlying post-1996 Act Farmer Mac I Guaranteed Securities and LTSPCs have been scored and classified for each calendar quarter since first quarter 2000. The new allowance methodology captures the migration of loan scores across concurrent and overlapping 3-year time horizons and calculates loss rates separately within each loan classification for (1) loans underlying LTSPCs and (2) loans held and loans underlying post-1996 Act Farmer Mac I Guaranteed Securities. The calculated loss rates are applied to the current classification distribution of Farmer Mac's portfolio to estimate inherent losses, on the assumption that the historical credit losses and trends used to calculate loss rates will continue in the future. Management evaluates this assumption by taking into consideration several factors, including:

- economic conditions;
- geographic and agricultural commodity/product concentrations in the portfolio;
- the credit profile of the portfolio;
- delinquency trends of the portfolio; and
- historical charge-off and recovery activities of the portfolio.

If, based on that evaluation, management concludes that the assumption is not valid due to other more compelling indicators, the loss allowance calculation is modified by the addition of further assumptions to capture current portfolio trends and characteristics that differ from historical experience.

As of June 30, 2006, Farmer Mac concluded that the credit profile of its portfolio was consistent with Farmer Mac's historical credit profile and trends. Management believes that its use of this methodology produces a reliable estimate of inherent probable losses, as of the balance sheet date, for all loans held, real estate owned and loans underlying post-1996 Act Farmer Mac I

Guaranteed Securities and LTSPCs in accordance with Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies* and Statement of Financial Accounting Standards No. 114, *Accounting by Creditors for Impairment of a Loan*, as amended.

No allowance for losses has been made for loans underlying Farmer Mac I Guaranteed Securities issued prior to the 1996 Act, AgVantage securities or Farmer Mac II Guaranteed Securities. Farmer Mac I Guaranteed Securities issued prior to the 1996 Act are supported by unguaranteed first loss subordinated interests, which are expected to exceed the estimated credit losses on those loans. Each AgVantage security is a general obligation of an issuing institution approved by Farmer Mac and is collateralized by eligible mortgage loans. As of June 30, 2006, there were no probable losses inherent in Farmer Mac's AgVantage securities. The guaranteed portions collateralizing Farmer Mac II Guaranteed Securities are guaranteed by the USDA. Each USDA guarantee is an obligation backed by the full faith and credit of the United States. As of June 30, 2006, Farmer Mac had not experienced any credit losses on any Farmer Mac I Guaranteed Securities issued prior to the 1996 Act, AgVantage securities or Farmer Mac II Guaranteed Securities and does not expect to incur any such losses in the future.

The following table summarizes the changes in the components of Farmer Mac's allowance for losses for the three and six months ended June 30, 2006 and 2005:

	June 30, 2006			
	Allowance for Loan Losses	REO Valuation Allowance	Reserve for Losses	Total Allowance for Losses
	(in thousands)			
Three Months Ended:				
Beginning balance	$ 3,883	$ -	$ 2,931	$ 6,814
Provision/(recovery) for losses	(594)	5	587	(2)
Net charge-offs	(555)	(5)	-	(560)
Ending balance	$ 2,734	$ -	$ 3,518	$ 6,252
Six Months Ended:				
Beginning balance	$ 4,876	$ -	$ 3,777	$ 8,653
Provision/(recovery) for losses	(1,606)	155	(259)	(1,710)
Net charge-offs	(536)	(155)	-	(691)
Ending balance	$ 2,734	$ -	$ 3,518	$ 6,252

	June 30, 2005			
	Allowance for Loan Losses	REO Valuation Allowance	Reserve for Losses	Total Allowance for Losses
	(in thousands)			
Three Months Ended:				
Beginning balance	$ 3,846	$ -	$ 12,485	$ 16,331
Provision for losses	(203)	-	(91)	(294)
Net recoveries	27	-	-	27
Ending balance	$ 3,670	$ -	$ 12,394	$ 16,064
Six Months Ended:				
Beginning balance	$ 4,395	$ -	$ 12,706	$ 17,101
Provision/(recovery) for losses	(787)	120	(312)	(979)
Net (charge-offs)/recoveries	62	(120)	-	(58)
Ending balance	$ 3,670	$ -	$ 12,394	$ 16,064

During second quarter 2006, Farmer Mac released $2,000 from the allowance for losses, compared to the release of $0.3 million in second quarter 2005. During second quarter 2006, Farmer Mac charged off $0.9 million in losses against the allowance for losses and had $0.3 million in recoveries for net charge-offs of $0.6 million. During second quarter 2005, Farmer Mac charged off $15,000 in losses against the allowance for losses and had $42,000 in recoveries for net charge-offs of $27,000. There was no previously accrued or advanced interest on loans or Farmer Mac I Guaranteed Securities that was charged off in second quarter 2006 or second quarter 2005. As of June 30, 2006, Farmer Mac's allowance for losses totaled

$6.3 million, or 13 basis points of the outstanding principal balance of loans held and loans underlying post-1996 Act Farmer Mac I Guaranteed Securities (excluding AgVantage securities) and LTSPCs, compared to $8.7 million (20 basis points) as of December 31, 2005.

As of June 30, 2006, Farmer Mac's 90 day delinquencies totaled $21.0 million and represented 0.46 percent of the principal balance of all loans held and loans underlying post-1996 Act Farmer Mac I Guaranteed Securities (excluding AgVantage securities) and LTSPCs, compared to $36.8 million (0.85 percent) as of June 30, 2005. As of June 30, 2006, Farmer Mac's non-performing assets (which includes 90-day delinquencies, loans performing under either their original loan terms or a court-approved bankruptcy plan, and real estate owned) totaled $40.0 million and represented 0.87 percent of the principal balance of all loans held and loans underlying post-1996 Act Farmer Mac I Guaranteed Securities (excluding AgVantage securities) and LTSPCs, compared to $60.7 million (1.39 percent) as of June 30, 2005. Loans that have been restructured after delinquency were insignificant and are included within the reported 90 day delinquency and non-performing asset disclosures. From quarter to quarter, Farmer Mac anticipates that 90-day delinquencies and non-performing assets will fluctuate, both in dollars and as a percentage of the outstanding portfolio, with higher levels likely at the end of the first and third quarters of each year corresponding to the semi-annual (January 1st and July 1st) payment characteristics of most Farmer Mac I loans.

The following table presents historical information regarding Farmer Mac's non-performing assets and 90-day delinquencies:

	Outstanding Post-1996 Act Loans, Guarantees (1), LTSPCs, and REO	Non-performing Assets	Percentage	Less: REO and Performing Bankruptcies	90-Day Delinquencies	Percentage
			(dollars in thousands)			
As of:						
June 30, 2006	$ 4,633,841	$ 40,083	0.87%	$ 19,075	$ 21,008	0.46%
March 31, 2006	4,224,669	49,475	1.17%	20,713	28,762	0.68%
December 31, 2005	4,399,189	48,764	1.11%	23,303	25,461	0.58%
September 30, 2005	4,273,268	64,186	1.50%	23,602	40,584	0.95%
June 30, 2005	4,360,670	60,696	1.39%	23,925	36,771	0.85%
March 31, 2005	4,433,087	70,349	1.59%	24,561	45,788	1.04%
December 31, 2004	4,642,208	50,636	1.09%	25,353	25,283	0.55%
September 30, 2004	4,756,839	75,022	1.58%	27,438	47,584	1.01%
June 30, 2004	4,882,505	69,751	1.43%	36,978	32,773	0.68%

(1) Excludes loans underlying AgVantage securities.

As of June 30, 2006, approximately $1.3 billion (29.1 percent) of Farmer Mac's outstanding loans held and loans underlying post-1996 Act Farmer Mac I Guaranteed Securities (excluding AgVantage securities) and LTSPCs were in their peak delinquency and default years (approximately years three through five after origination), compared to $1.2 billion (28.4 percent) as of June 30, 2005.

As of June 30, 2006, Farmer Mac individually analyzed $30.8 million of its $68.8 million of impaired assets for collateral shortfalls against updated appraised values, other updated collateral valuations or discounted values. Farmer Mac evaluated the remaining $38.0 million of impaired assets for which updated valuations were not available in the aggregate in consideration of their similar risk characteristics and historical statistics. Of the $30.8 million of assets analyzed individually, $29.4 million were adequately collateralized. For the $1.4 million of assets that were not adequately collateralized, individual collateral shortfalls totaled $15,000. Accordingly, Farmer Mac recorded specific allowances of $15,000 for those under-collateralized assets as of June 30, 2006. In addition to the specific allowances provided, Farmer Mac's non-specific or general allowances were $6.2 million as of June 30, 2006.

As of June 30, 2006, the weighted-average original loan-to-value ("LTV") ratio for all loans held and loans underlying post-1996 Act Farmer Mac I Guaranteed Securities and LTSPCs was 50.1 percent, and the weighted-average original LTV ratio for all post-1996 Act non performing assets was 56.1 percent. The following table summarizes the post-1996 Act non-performing assets by original LTV ratio:

Distribution of Post-1996 Act Non-performing
Assets by Original LTV Ratio
as of June 30, 2006
(dollars in thousands)

Original LTV Ratio	Post-1996 Act Non-performing Assets	Percentage
0.00% to 40.00%	$ 4,147	10%
40.01% to 50.00%	6,329	16%
50.01% to 60.00%	17,120	43%
60.01% to 70.00%	12,185	30%
70.01% to 80.00%	302	1%
80.01% +	-	0%
Total	$ 40,083	100%

The following table presents outstanding loans held and loans underlying post-1996 Act Farmer Mac I Guaranteed Securities and LTSPCs, post-1996 Act non-performing assets and specific allowances for losses as of June 30, 2006 by year of origination, geographic region and commodity/collateral type:

Farmer Mac I Post-1996 Act Non-performing Assets and Specific Allowance for Losses

	Distribution of Outstanding Loans, Guarantees and LTSPCs	Outstanding Loans, Guarantees and LTSPCs (1)	Post-1996 Act Non-performing Assets (2)	Non-performing Asset Rate	Specific Allowance for Losses
		(dollars in thousands)			
By year of origination:					
Before 1996	12%	$ 562,756	$ 3,619	0.64 %	$ -
1996	5%	222,025	7,053	3.18%	-
1997	6%	280,529	3,270	1.17%	-
1998	10%	462,138	8,668	1.88%	15
1999	10%	481,517	6,946	1.44%	-
2000	6%	277,814	4,239	1.53%	-
2001	9%	416,876	4,082	0.98%	-
2002	11%	523,406	369	0.07%	-
2003	11%	493,231	-	0.00%	-
2004	8%	353,116	1,184	0.34%	-
2005	10%	450,804	653	0.14%	-
2006	2%	109,629	-	0.00%	-
-					
Total	100%	$ 4,633,841	$ 40,083	0.87%	$ 15
By geographic region (3):					
Northwest	19%	$ 863,845	$ 27,066	3.13%	$ -
Southwest	46%	2,204,629	5,727	0.26%	-
Mid-North	16%	723,383	2,168	0.30%	15
Mid-South	7%	307,183	2,315	0.75%	-
Northeast	7%	319,752	1,354	0.42%	-
Southeast	5%	215,049	1,453	0.68%	-
Total	100%	$ 4,633,841	$ 40,083	0.87%	$ 15
By commodity/collateral type:					
Crops	41%	$ 1,894,824	$ 16,978	0.90%	$ -
Permanent plantings	27%	1,208,917	18,531	1.53%	15
Livestock	24%	1,113,776	3,564	0.32%	-
Part-time farm/rural housing	6%	294,356	1,010	0.34%	-

Ag storage and processing	2%	100,127	-	0.00%	-
Other	0%	21,841	-	0.00%	