

# 2008

A N N U A L R E P O R T

**FARM CREDIT**



of Central Florida

Financing Rural America

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# FARM CREDIT OF CENTRAL FLORIDA, ACA

## 2008 ANNUAL REPORT

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### Management

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Gregory D. Ellis.....	Executive Vice President & Treasurer
Courtney A. Eelman.....	Senior Vice President
Jeffrey T. Phillips.....	Senior Vice President
Regina W. Thomas.....	Senior Vice President

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## *Message from the President & Chief Executive Officer*

The Farm Credit System was established by Congress because it recognized that a **“prosperous, productive agriculture is essential to a free nation.”** The objective of the system is to **“improve the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit and closely related services to them, their cooperatives, and to selected farm-related businesses necessary for efficient farm operations.”**

Farm Credit of Central Florida, ACA, its Board of Directors and staff are focused on meeting the objective and mission of the Farm Credit System for its members. We believe in cooperative principles and strive to see that they are always applied to our business practices. Our track record speaks for itself, but we will not rest on the past, only use it to help us improve the future. Agriculture and rural America are our business. Our Association’s Mission is *“To be the lender of Choice to agriculture and rural communities of Central Florida.”* We do not take that lightly. When you need credit, we want your first thought to be **“FARM CREDIT.”**

As you are aware, issues with the “sub prime” housing market that resulted in significant stress on our nation’s financial system have rippled through our economy causing significant stress throughout most sectors, especially the central Florida housing and real estate markets. While your Association was not involved in the “sub prime” debacle, its effects on the general, regional, and agricultural economies have impacted our credit quality and 2008 earnings. The region’s economic dependence on the housing and real estate markets has been obvious as its significant decline has adversely affected many members’ farm and nonfarm income along with real estate values. This has been especially apparent in the nursery industry, which is highly dependent on the housing markets and the general economy.

You will see as you read the report, the Association continues to be in sound financial position. While earnings and credit quality have both declined from last year’s record levels they are still strong. Final net earnings as of December 31, 2008 were \$6.96 million. The Association is well capitalized and your Board of Directors has again approved the payment of a patronage refund on 2008 earnings to be paid in the form of cash and allocated surplus. The estimated patronage refund will be \$6.2 million. As President and Chief Executive Officer of your Association, I want to assure you that honesty and integrity comes foremost in operating the Association and reporting to you the stockholder.

New loan demand was strong in the first half of 2008, but slowed in the second half as economic uncertainty increased. However, the Association experienced growth in loan volume as many borrowers increased their funding levels on their credit lines to meet rising input costs, especially energy, fertilizer, and feed costs.

It is obvious 2009 will present even more challenges and opportunities. Many growers will face lower commodity prices as a result of decreased demand, which will be coupled with increased input costs from higher energy costs and higher costs associated with protection from evasive disease and pests.

I am confident your Association is positioned to meet the challenges of the future. The diversity, expertise, and experience of your Board of Directors provide valuable insight into the directing and policy making of your Association to make sure your cooperative remains strong and viable. You can be assured the Board is focused on your interests and understands your challenges. The Board has approved a business plan and budget that will allow our very capable staff to continue to provide the level of products and services you

have come to expect. The Board continues to direct the staff to assist members facing adversity with all due consideration and reasonable avenues to work through difficult times.

We continue to stress the importance of member service and will continue to send you surveys to obtain your feedback regarding our products and services. We ask that you please continue to take time to complete and return these surveys so we know how we are doing.

On behalf of the Board, Senior Management and Staff, I hope each of you have a prosperous and productive year. Thank you for patronizing your cooperative. Remember to tell your friends and neighbors of its advantages.



Reginald T. Holt  
Chief Executive Officer

February 27, 2009

## Report of Management

The accompanying Consolidated Financial Statements and related financial information appearing throughout this annual report have been prepared by management of Farm Credit of Central Florida, ACA (Association) in accordance with generally accepted accounting principles appropriate in the circumstances. Amounts which must be based on estimates represent the best estimates and judgments of management. Management is responsible for the integrity, objectivity, consistency, and fair presentation of the consolidated financial statements and financial information contained in this report.

Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all financial statements, and that the assets of the Association are safeguarded. The design and implementation of all systems of internal control are based on judgments required to evaluate the costs of controls in relation to the expected benefits and to determine the appropriate balance between these costs and benefits. The Association maintains an internal audit program to monitor compliance with the systems of internal accounting control. Audits of the accounting records, accounting systems and internal controls are performed and internal audit reports, including appropriate recommendations for improvement, are submitted to the Board of Directors.

The Consolidated Financial Statements have been examined by independent public auditors, whose report appears elsewhere in this annual report. The Association is also subject to examination by the Farm Credit Administration.

The Consolidated Financial Statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that we have reviewed the 2008 Annual Report of Farm Credit of Central Florida, ACA, that the report has been prepared under the oversight of the audit committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.



Al Bellotto  
Chairman of the Board



Reginald T. Holt  
Chief Executive Officer



Gregory D. Ellis  
Chief Financial Officer

February 27, 2009

# *Report on Internal Control Over Financial Reporting*

The Association's principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association's Consolidated Financial Statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by, or under the supervision of the Association's principal executives and principal financial officers, or persons performing similar functions, and effected by its Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting information and the preparation of the Consolidated Financial Statements for external purposes in accordance with accounting principles generally accepted in the United States of America and includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Association's assets that could have a material effect on its Consolidated Financial Statements.

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of December 31, 2008. In making the assessment, management used the framework in *Internal Control — Integrated Framework*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association concluded that as of December 31, 2008, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of December 31, 2008.



Reginald T. Holt  
Chief Executive Officer



Gregory D. Ellis  
Chief Financial Officer

February 27, 2009

## Consolidated Five - Year Summary of Selected Financial Data

<i>(dollars in thousands)</i>	2008	2007	December 31, 2006	2005	2004
<b>Balance Sheet Data</b>					
Cash	\$ 36	\$ 72	\$ 63	\$ 799	\$ 203
Investment securities	50,376	30,247	38,704	34,682	—
Loans	422,431	369,663	349,172	400,399	348,753
Less: allowance for loan losses	5,243	1,473	1,639	2,133	1,954
Net loans	417,188	368,190	347,533	398,266	346,799
Investments in other Farm Credit institutions	14,043	15,114	15,822	4,034	3,951
Other property owned	504	1,061	—	—	—
Other assets	14,801	15,355	14,322	13,494	11,273
Total assets	\$ 496,948	\$ 430,039	\$ 416,444	\$ 451,275	\$ 362,226
Notes payable to AgFirst Farm Credit Bank*	\$ 412,134	\$ 343,677	\$ 334,575	\$ 374,294	\$ 288,746
Accrued interest payable and other liabilities with maturities of less than one year	8,475	12,609	12,769	10,524	9,143
Total liabilities	420,609	356,286	347,344	384,818	297,889
Protected borrower stock	39	64	97	146	275
Capital stock and participation certificates	1,259	1,267	1,209	1,169	1,229
Retained earnings					
Allocated	34,758	33,511	28,995	27,008	26,153
Unallocated	40,252	39,214	38,799	38,134	36,680
Accumulated other comprehensive income (loss)	31	(303)	—	—	—
Total members' equity	76,339	73,753	69,100	66,457	64,337
Total liabilities and members' equity	\$ 496,948	\$ 430,039	\$ 416,444	\$ 451,275	\$ 362,226
<b>Statement of Income Data</b>					
Net interest income	\$ 10,503	\$ 10,536	\$ 11,871	\$ 10,614	\$ 8,797
Provision for (reversal of allowance for) loan losses	3,975	(120)	(612)	68	(8,815)
Noninterest income (expense), net	428	1,734	(1,019)	(829)	(1,551)
Net income	\$ 6,956	\$ 12,390	\$ 11,464	\$ 9,717	\$ 16,061
<b>Key Financial Ratios</b>					
Rate of return on average:					
Total assets	1.57%	3.04%	2.63%	2.56%	4.96%
Total members' equity	8.98%	16.97%	16.71%	14.73%	30.06%
Net interest income as a percentage of average earning assets	2.54%	2.78%	2.84%	2.89%	2.71%
Net (chargeoffs) recoveries to average loans	(0.05)%	(0.01)%	0.03 %	0.03 %	0.04 %
Total members' equity to total assets	15.36%	17.15%	16.59%	14.73%	17.76%
Debt to members' equity (:1)	5.51	4.83	5.03	5.79	4.63
Allowance for loan losses to loans	1.24%	0.40%	0.47%	0.53%	0.56%
Permanent capital ratio	15.14%	15.49%	16.55%	15.36%	15.40%
Total surplus ratio	14.54%	14.49%	15.88%	15.06%	15.15%
Core surplus ratio	11.70%	11.67%	13.46%	12.70%	12.13%
<b>Net Income Distribution</b>					
Cash dividends declared/paid	\$ —	\$ —	\$ —	\$ —	\$ 1,000
Estimated patronage refunds:					
Cash	\$ 2,619	\$ 4,666	\$ 3,554	\$ 2,808	\$ 1,727
Qualified allocated retained earnings	2,690	—	59	—	3,208
Nonqualified allocated retained earnings	899	6,998	6,541	4,658	—
Nonqualified retained earnings	—	—	—	558	—

\* General financing agreement is renewable on three-year cycles. The next renewal date is December 31, 2010.

# Management's Discussion & Analysis of Financial Condition & Results of Operations

(dollars in thousands, except as noted)

## GENERAL OVERVIEW

The following commentary summarizes the financial condition and results of operations of Farm Credit of Central Florida, ACA, (Association) for the year ended December 31, 2008 with comparisons to the years ended December 31, 2007 and December 31, 2006. This information should be read in conjunction with the Consolidated Financial Statements, Notes to the Consolidated Financial Statements and other sections in this Annual Report. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors. For a list of the Audit Committee members, refer to the "Report of the Audit Committee" reflected in this Annual Report. Information in any part of this Annual Report may be incorporated by reference in answer or partial answer to any other item of the Annual Report.

The Association is an institution of the Farm Credit System (System), which was created by Congress in 1916 and has served agricultural producers for over 90 years. The System's mission is to maintain and improve the income and well-being of American farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses. The System is the largest agricultural lending organization in the United States. The System is regulated by the Farm Credit Administration, (FCA), which is an independent safety and soundness regulator.

The Association is a cooperative, which is owned by the members (also referred to throughout this Annual Report as stockholders or shareholders) served. The territory of the Association extends across a diverse agricultural region of central Florida. Refer to Note 1, "Organization and Operations," of the Notes to the Consolidated Financial Statements for counties in the Association's territory. The Association provides credit to farmers, ranchers, rural residents, and agribusinesses. Our success begins with our extensive agricultural experience and knowledge of the market.

The Association obtains funding from AgFirst Farm Credit Bank (AgFirst or Bank). The Association is materially affected and shareholder investment in the Association could be affected by the financial condition and results of operations of the Bank. Copies of the Bank's Annual and Quarterly Reports are on the AgFirst website, [www.agfirst.com](http://www.agfirst.com), or may be obtained at no charge by calling 1-800-845-1745, extension 378, or writing Stephen Gilbert, AgFirst Farm Credit Bank, Post Office Box 1499, Columbia, SC 29202.

Copies of the Association's Annual and Quarterly reports are also available upon request free of charge on the Association's website, [www.FarmCreditCFL.com](http://www.FarmCreditCFL.com), or by calling 1-800-533-2773, or writing Greg Ellis, Chief Financial Officer, Farm Credit of Central Florida, ACA, Post Office Box 8009, Lakeland, FL 33802-8009. The Association prepares an electronic version of the Annual Report, which is available on the website, within

75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report, which is available on the internet, within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Association.

## FORWARD LOOKING INFORMATION

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

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international, and farm-related business sectors;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry and the Farm Credit System, as a government-sponsored enterprise, as well as investor and rating-agency reactions to events involving other government-sponsored enterprises and other financial institutions; and
- actions taken by the Federal Reserve System in implementing monetary policy.

## AGRICULTURAL OUTLOOK

The February 2009 United States Department of Agriculture (USDA) forecast estimates that 2009 farmers' net cash income, which is a measure of the cash income after payment of business expenses, will decrease to \$77.3 billion, down \$16.1 billion from 2008 and up \$5.5 billion from its 10-year average.

Contributing to this decrease in farmers' net cash income are decreases in cash receipts for crops and livestock of \$18.7 billion and \$10.9 billion, respectively, and a decrease in direct government payments of \$1.0 billion, offset in part by a decrease in cash expenses of \$14.1 billion and an increase in farm-related income of \$400 million.

In general, 2008 has been an excellent year for U.S. crop producers, particularly for feed crops, oilseeds and food grains. The high level of farmers' net cash income is primarily the result of high commodity prices during the first half of the year. These higher prices were principally due to strong demand from foreign buyers and the domestic biofuels industry. Corn producers were the primary beneficiaries of the increased demand that has been putting pressure on prices. Other crop prices, in general, increased due to increased acreage to plant corn, decreasing the acreage available for other crops, and to consumers seeking lower cost alternatives to corn. Inadequate rainfall in competitor countries and increased international consumption, from growth in population and rising incomes, reduced world supplies of corn and soybeans, which has translated into rising demand for farm commodities. In addition, the U.S. dollar has depreciated against major foreign currencies in recent years resulting in greater demand for U.S. agricultural exports. However, during the latter half of 2008, many of these factors shifted. A dramatic downturn in the global economy decreased international consumption. Oil prices dropped dampening the demand for ethanol. Crop production outlook improved in certain regions of the world. Further, the dollar strengthened in the latter half of 2008. The combination of these events resulted in a dramatic drop in commodity prices in late 2008 to levels more in line with commodity prices at December 31, 2007. The following table sets forth the commodity prices per bushel for certain crops and by hundredweight for beef cattle from December 31, 2005 to December 31, 2008:

<b>Commodity</b>	<b>12/31/08</b>	<b>12/31/07</b>	<b>12/31/06</b>	<b>12/31/05</b>
Corn	\$4.10	\$3.76	\$3.01	\$1.92
Soybeans	\$9.24	\$10.00	\$6.18	\$5.77
Wheat	\$5.97	\$7.74	\$4.52	\$3.54
Beef Cattle	\$79.80	\$88.90	\$83.10	\$93.30

Elevated crop prices, particularly in early 2008, and the resulting volatility from a dramatic drop in crop prices in the latter half of 2008 had both positive and negative impacts on the Association, as a lender to the agricultural and rural sectors. Elevated commodity prices and increased prices and demand for farm inputs generally result in an increase in average agribusiness loans outstanding. While higher commodity prices have positively impacted grain farmers through the first nine months of 2008, a continuation of recent declines in grain prices could have an unfavorable impact in the near future. The volatility of these prices has resulted in higher risk profiles for Association borrowers, particularly borrowers who purchased at elevated crop prices for future production purposes.

The USDA's February 2009 income outlook shows a great deal of variation depending on farm size, geographic location, and commodity specialties. While the Association utilized the USDA analysis to provide a general understanding of the U.S. agricultural economic outlook, this outlook does not take into account all aspects of the Association's business.

The USDA classifies all farms into three primary categories: commercial farms, intermediate farms and rural residential farms. Commercial farms represent about 11 percent of U.S. farms by number and represent 75 percent of total U.S. farm production. Intermediate farms, defined as the primary occupation is farming and gross sales are below \$250,000, represent 26 percent of U.S. farms by number and account for 16 percent of total production. The remaining 63 percent of U.S. farms are classified as rural residential farms where the primary occupation is not farming and the farms produce less than \$250,000 in products and only account for 9 percent of total production.

In addition to farmers' net cash income, off-farm income is an important source of income for the repayment of farm debt obligations and is less subject to cycles in agriculture. The USDA measures farm household income, which is defined as earnings from farming activities plus off-farm income. Nearly 100 percent of farm household income for operators of rural residential farms and more than 80 percent of farm household income for intermediate farms is generated from off-farm sources. Further, USDA data suggests that approximately 25 percent of farm household income for commercial farms is generated from off-farm income. The USDA forecasts 2009 farm household income to decrease 15 percent for commercial farms and 19 percent for intermediate farms.

According to the USDA February 2009 forecast, farm business balance sheets continued to strengthen in the last few years, as measured by debt relative to assets and equity levels. Farm debt to farm assets is forecasted to decline from 10.0 percent for 2008 to 9.1 percent for 2009. Farmers' equity (farm business assets less farm business debt) is expected to continue to rise by 0.9 percent in 2009, after increasing 6.9 percent in 2008.

One measure of the financial health of the agricultural sector used by the USDA is the assessment of farmers' utilization of their capacity to repay debt (actual debt as a percentage of maximum debt that can be supported by farmers' current income). Higher capacity utilization rates indicate tighter cash flow positions and, consequently, higher exposure to financial risk. These estimates do not take into account, however, off-farm income sources. Since 1970, debt repayment capacity utilization has ranged from a low of 35.8 percent in 1973 to 104.1 percent in 1981, and has remained relatively stable since 1987, averaging about 50.0 percent. The USDA suggests an increase in the use of repayment capacity from 43.0 percent in 2008 to 50.0 percent in 2009.

As estimated by the USDA, the Farm Credit System's market share of farm business debt, defined as debt incurred by those involved in on-farm agricultural production, had grown to 36.7 percent at December 31, 2007, as compared with 28.3 percent at December 31, 2000. Farm business debt is forecasted to grow only 0.9 percent in 2009. The USDA's forecast of slow moderation in debt growth is due to decreases in agricultural production costs and to high levels of earnings during the past two years that may enable certain producers to self finance crop production.

In general, agriculture has experienced a sustained period of favorable economic conditions, due to stronger commodity prices, higher land values, and, to a lesser extent, government

support programs. To date, the Association's financial results have been positively impacted as a result of these conditions. Production agriculture, however, remains a cyclical business that is heavily influenced by commodity prices. In an environment of less favorable economic conditions in agriculture and without sufficient government support programs, the Association's financial performance and credit quality measures would likely be negatively impacted. Conditions in the general and agricultural economy have become more volatile with the recent instability in the global financial markets and recent declines in commodity prices. Any negative impact from these less favorable conditions should be lessened by geographic and commodity diversification and the influence of off-farm income sources supporting agricultural-related debt. However, agricultural borrowers who are more reliant on off-farm income sources may be more adversely impacted by a weakened general economy.

### CRITICAL ACCOUNTING POLICIES

The financial statements are reported in conformity with accounting principles generally accepted in the United States of America. Our significant accounting policies are critical to the understanding of our results of operations and financial position because some accounting policies require us to make complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. We consider these policies critical because management must make judgments about matters that are inherently uncertain. For a complete discussion of significant accounting policies, see Note 2, "Summary of Significant Accounting Policies," of the Notes to the Consolidated Financial Statements. The following is a summary of certain critical policies.

- *Allowance for loan losses* — The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs. The allowance for loan losses is determined based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic and political conditions, loan portfolio composition, credit quality and prior loan loss experience.

Significant individual loans are evaluated based on the borrower's overall financial condition, resources, and payment record, the prospects for support from any financially responsible guarantor, and, if appropriate, the estimated net realizable value of any collateral. The allowance for loan losses encompasses various judgments, evaluations and appraisals with respect to the loans and their underlying security that, by nature, contains elements of uncertainty and imprecision. Changes in the agricultural economy and their borrower repayment capacity will cause these various judgments, evaluations and appraisals to change over time. Accordingly, actual circumstances could vary from the Association's expectations and predictions of those circumstances.

Management considers the following factors in determining and supporting the levels of allowance for loan losses: the concentration of lending in agriculture, combined with uncertainties in farmland values, commodity prices, exports, government assistance programs, regional economic effects and weather-related influences. Changes in the factors considered by management in the evaluation of losses in the loan portfolios could result in a change in the allowance for loan losses and could have a direct impact on the provision for loan losses and the results of operations.

- *Valuation methodologies* — Management applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets for which an observable liquid market exists, such as most investment securities. Management utilizes significant estimates and assumptions to value items for which an observable liquid market does not exist. Examples of these items include impaired loans, pension and other postretirement benefit obligations, and certain other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing and liquidation values. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on the Association's results of operations.
- *Pensions* — The Bank and its related Associations participate in defined benefit retirement plans. These plans are noncontributory and benefits are based on salary and years of service. In addition, the Bank and its related Associations also participate in defined contribution retirement savings plans. Pension expense for all plans is recorded as part of salaries and employee benefits. Pension expense for the defined benefit retirement plans is determined by actuarial valuations based on certain assumptions, including expected long-term rate of return on plan assets and discount rate. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that portfolio of assets. The discount rate is used to determine the present value of our future benefit obligations. The discount rate for 2008 was selected by reference to analysis and yield curves of the plans' actuary and industry norms.

### REGIONAL ECONOMICS

Both the Florida and National economies continue to be in a recession that officially started at the end of 2007. Florida has been particularly impacted by the stressed housing and real estate markets, and ranked second in the number of foreclosures for 2008. Reduced availability of credit has exacerbated the real estate market weakness. Unemployment has increased significantly over the past year, reaching 8.1% in December 2008, which was .9% above the National rate of 7.2%. The

current unemployment rate is the highest since 1992. Construction activity in the State slowed considerably in 2008 with the value of new contracts estimated at \$33.2 billion. The 2008 estimate is 54% less than the \$71.7 billion of construction contracts in 2005. 2009 is expected to be another weak year for the Florida construction industry, with declines projected in both residential and nonresidential projects. While construction is projected to be lower overall in 2009 compared to 2008, nonbuilding construction for public works and infrastructure projects are expected to increase. Florida horticultural growers of construction dependent products such as trees, woody ornamentals and shrubs have been particularly hard hit by the current recession.

In the housing area, privately owned housing units authorized declined in 2008 to 61,958 from 104,292 in 2007. A large inventory of homes for sale has pushed values lower in the state. Florida's House Price Index declined from 467 at July 1, 2007 to 392 at July 1, 2008, and is expected to move lower in 2009. This measure of single-family property repeat sales is indexed to 1980 prices that are given a value of 100. Most Florida real estate declined in value over the past twelve months with some exceptions for property with strong income generating capacity. Florida's population growth is correlated with the condition of the National economy. Over the past twelve years, population growth has been as high as almost 450,000 net new residents in 2004. Growth in 2006 and 2007 exceeded 300,000, but fell to an estimated 126,000 in 2008. Current estimates are that population growth will further decline in 2009 to approximately 75,000 new residents. Population growth fuels construction, real estate sales and other industries, so the further declines expected will likely prolong Florida's recession into 2010. Higher insurance premiums and real estate taxes impact the cost of living, particularly to new residents. These issues will continue to add an economic hurdle to the state's economy over the next several years despite political efforts to slow the increases.

Higher gasoline and jet fuel prices have increased travel costs over the past several years. However, fuel prices have abated since mid-2008, which should strengthen regional travel somewhat. Florida hotels began to experience significantly reduced occupancy rates and revenues beginning in September 2008. Overseas visitors, especially from Europe, had provided some cushion to the softening domestic tourism market until recently. With the spread of the global financial difficulties coupled with strengthening of the dollar relative to European currencies, international travel to Florida will likely be curbed. Major attractions in the Orlando area report that attendance and revenues slowed in the third and fourth quarters of 2008.

Agriculture, agribusiness, and food processing and manufacturing are still a significant economic driver to the local and state economy. These business segments provided significant jobs and revenues to the state and local economies.

The agricultural industry in the Central Florida region produces a wide variety of farm commodities with horticulture, citrus, and fruit and vegetables the largest market segments. None of the commodities produced in the region are included in any USDA government support programs and not materially impacted by U.S. farm bill legislation. Other significant factors that continue to affect the agricultural economy include the introduction of

pest and plant diseases, weather-related risks, water-use regulations, environmental rules and regulations, and competition for agricultural lands. All Florida producers, particularly fruit and vegetable producers are concerned about foreign trade issues, primarily the Free Trade of the America's Agreement (FTAA) and World Trade Organization initiatives. State agencies continue to pursue the purchase of significant parcels of agricultural property for water resource protection and environmental protection purposes. Florida rural property owners are now facing new challenges as special interest groups and government officials attempt to limit their future land use through growth management regulations.

The region served by the Association was spared any natural disaster in 2008. There were no material impacts by hurricanes and the region has enjoyed generally favorable weather conditions. The region continues to experience below average rainfall and water authorities are continuing to maintain restrictions.

The citrus industry is currently being impacted by high volumes of juice. These supplies have caused a reduction in 2008/09 season cash prices for round oranges. Some growers, however, are receiving prices exceeding the cash market through multi-year contracts or fruit participation arrangements. All crop producers are facing higher input costs resulting primarily from increased prices for energy and fertilizer. Furthermore, citrus growers are dealing with the added cost of dealing with canker and greening diseases. A majority of the Association's citrus growers were able to significantly reduce leverage over the past several years because of strong fruit prices. Strawberry growers experienced good growing conditions and favorable operating results over the past three seasons. Cow-calf operators have enjoyed good prices and returns over the past two years, but are now faced with some price softening. Most of the Association's cow-calf operators have diversified income sources. As noted above, construction dependent horticulture has been most affected by the recession. In response to economic conditions, nursery operators have instituted significant cost cutting measures while focusing on marketing efforts. Association management continually reviews its loan portfolio, and while some deterioration is noted, credit quality remains satisfactory with 92% of loan assets rated Acceptable at December 31, 2008. Association delinquencies increased in 2008, and the rolling twelve month average delinquency rate was .79% at December 31, 2008 compared to .36% at December 31, 2007.

There has been little change in the Association's market region over the past year. The Association's Commercial and Corporate Lending Group continues to serve and target large high-quality farm and agribusiness customers. The group continues to report good growth in 2007 and 2008. The Lifestyle and Small Business Lending Group has maintained a consistent market presence in consumer and middle market lending and is also reporting growth. The Association continues to maintain its marketing efforts and activity in the lifestyle farm and rural residential market segments. The Association also continues to serve young, beginning and small farm customers in this lending group.

**LOAN PORTFOLIO**

The Association provides funds to farmers, rural homeowners, and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans through numerous product types.

The diversification of the Association loan volume by type for each of the past three years is shown below.

Loan Type	2008		December 31, 2007		2006	
	<i>(dollars in thousands)</i>					
Real estate mortgage	\$ 201,237	47.63%	\$ 191,299	51.75%	\$ 189,594	54.28%
Production and intermediate-term	167,294	39.60	128,366	34.73	103,307	29.59
Loans to cooperatives	—	—	2,482	.67	1,879	.54
Processing and marketing	17,106	4.05	9,885	2.67	20,200	5.79
Farm-related business	4,133	0.98	3,335	.90	2,998	.86
Communication	—	—	—	—	975	.28
Energy	3,359	0.80	3,586	.97	3,827	1.10
Rural residential real estate	29,302	6.94	30,710	8.31	26,392	7.56
<b>Total</b>	<b>\$ 422,431</b>	<b>100.00%</b>	<b>\$ 369,663</b>	<b>100.00%</b>	<b>\$ 349,172</b>	<b>100.00%</b>

While we make loans and provide financially related services to qualified borrowers in the agricultural and rural sectors and to certain related entities, our loan portfolio is diversified.

The geographic distribution of the loan volume by branch for the past three years is as follows:

Branch	December 31,		
	2008	2007	2006
Apopka	10.57%	10.89%	12.17%
Plant City	6.07	6.97	6.73
Brooksville	4.76	5.46	5.81
Lake Wales	4.90	5.07	5.22
Lakeland	3.57	4.14	3.92
Agribusiness Lending Group	66.99	65.98	64.84
Residential Lending Group	0.16	—	.07
Special Assets	2.98	1.49	1.24
	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

Commodity and industry categories are based upon the Standard Industrial Classification system published by the federal government. The system is used to assign commodity or industry categories based upon the largest agricultural commodity of the customer.

The major commodities in the Association loan portfolio are shown below. The predominant commodities are horticulture (predominately nurseries), fruits & vegetables, livestock, and citrus, which constitute over 83 percent of the entire portfolio.

Commodity Group	2008		December 31, 2007		2006	
	<i>(dollars in thousands)</i>					
Horticulture	\$ 134,469	31.84%	\$ 114,249	30.90%	\$ 110,791	31.73%
Fruits & Vegetables	91,683	21.70	68,134	18.43	68,089	19.50
Livestock	63,251	14.97	53,671	14.52	51,643	14.79
Citrus	63,004	14.91	54,254	14.68	47,068	13.48
Rural Home	22,080	5.23	22,440	6.07	20,357	5.83
Dairy	7,078	1.68	4,847	1.31	3,038	.87
Other	40,866	9.67	52,068	14.09	48,186	13.80
<b>Total</b>	<b>\$ 422,431</b>	<b>100.00%</b>	<b>\$ 369,663</b>	<b>100.00%</b>	<b>\$ 349,172</b>	<b>100.00%</b>

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The Association's loan portfolio contains a concentration of fruit & vegetable producers, nursery

operations, and citrus growers. Even though the concentration of large loans has increased over the past several years, the agricultural enterprise mix of these loans is diversified and similar to that of the overall portfolio. The risk in the portfolio associated with commodity concentration and large loans is reduced by the range of diversity of enterprises in the Association's territory.

The increase in gross loan volume for the twelve months ended December 31, 2008, is primarily attributed to increased demand for loans from within the Association's chartered territory. Increased loan volume is partly attributed to financing opportunities in certain agricultural commodity segments experiencing growth. Also contributing to higher volumes is additional demand for loan refinancings due to agricultural lending retrenchment by some local commercial banks.

For the past few years, the Association has experienced a shift in loan assets. Expressed as a percentage of net loans, the long-term volume trend has been downward while the short-and intermediate-term loan volume trend is upward. The short-term portfolio, which is cyclical in nature and heavily influenced by operating-type loans, normally reaches a minimum balance in August or September and rapidly increases in the fall months as strawberry and other winter vegetable growers increase their borrowings to prepare for the next crop season. The Association has grown the long-term portfolio through increased mortgage lending on real estate and facilities used for agriculture production.

During 2008, the Association increased activity in the buying and selling of loan participations within and outside of the System. This provides a means for the Association to spread credit concentration risk and realize non-patronage sourced interest and fee income, which may strengthen its capital position.

Loan Participations:	December 31,		
	2008	2007	2006
	<i>(dollars in thousands)</i>		
Participations Purchased			
– FCS Institutions	\$ 36,842	\$ 32,470	\$ 34,929
Participations Sold	(341,733)	(281,704)	(239,249)
<b>Total</b>	<b>\$(304,891)</b>	<b>\$(249,234)</b>	<b>\$(204,320)</b>

For the years ended December 31, 2008, 2007, and 2006, the Association did not have any loans sold with recourse, retained subordinated participation interests in loans sold, or interests in pools of subordinated participation interests.

The Association sells qualified long-term residential mortgage loans into the secondary market. For the years ended December 31, 2008, 2007, and 2006, the Association originated loans for resale totaling \$10,848, \$14,089, and \$4,754, respectively, which were sold into the secondary market.

**INVESTMENT SECURITIES**

As permitted under FCA regulations, the Association is authorized to hold eligible investments for the purposes of reducing interest rate risk and managing surplus short-term funds. The Bank is responsible for approving the investment policies of the Association. The Bank annually reviews the

investment portfolio of every Association that it funds. The Association's investments consist of pools of Small Business Administration (SBA) guaranteed loans. These investments carry the full faith and credit of the United States government. The balance of these SBA investments, classified as being held-to-maturity, amounted to \$50,376 at December 31, 2008, \$30,247 at December 31, 2007, and \$38,704 at December 31, 2006.

### CREDIT RISK MANAGEMENT

Credit risk arises from the potential inability of an obligor to meet its repayment obligation. As part of the process to evaluate the success of a loan, the Association continues to review the credit quality of the loan portfolio on an ongoing basis. With the approval of the Association Board of Directors, the Association establishes underwriting standards and lending policies that provide direction to loan officers. Underwriting standards include, among other things, an evaluation of:

- Character – borrower integrity and credit history
- Capacity – repayment capacity of the borrower based on cash flows from operations or other sources of income
- Collateral – protection for the lender in the event of default and a potential secondary source of repayment
- Capital – ability of the operation to survive unanticipated risks
- Conditions – intended use of the loan funds

The credit risk management process begins with an analysis of the borrower's credit history, repayment capacity, and financial position. Repayment capacity focuses on the borrower's ability to repay the loan based upon cash flows from operations or other sources of income, including non-farm income. Real estate loans must be collateralized by first liens on the real estate (collateral). As required by FCA regulations, each institution that makes loans on a collateralized basis must have collateral evaluation policies and procedures. Real estate mortgage loans may be made only in amounts up to 85 percent of the original appraised value of the property taken as collateral or up to 97 percent of the appraised value if guaranteed by a state, federal, or other governmental agency. The actual loan to appraised value when loans are made is generally lower than the statutory maximum percentage. With certain exceptions identified in Association policy, appraisals are required for loans of more than \$250,000. In addition, each loan is assigned a credit risk rating based upon the underwriting standards. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses, and risks in a particular relationship.

We review the credit quality of the loan portfolio on an ongoing basis as part of our risk management practices. Each loan is classified according to the Uniform Classification System, which is used by all Farm Credit System institutions. Below are the classification definitions.

- Acceptable – Assets are expected to be fully collectible and represent the highest quality.
- Other Assets Especially Mentioned (OAEM) – Assets are currently collectible but exhibit some potential weakness.

- Substandard – Assets exhibit some serious weakness in repayment capacity, equity, and/or collateral pledged on the loan.
- Doubtful – Assets exhibit similar weaknesses to substandard assets. However, doubtful assets have additional weaknesses in existing facts, conditions and values that make collection in full highly questionable.
- Loss – Assets are considered uncollectible.

The following table presents selected statistics related to the credit quality of loans including accrued interest at December 31.

Credit Quality	2008	2007	2006
Acceptable & OAEM	95.87%	98.67%	98.87%
Substandard	4.13%	1.33%	1.13%
Doubtful	–%	–%	–%
Loss	–%	–%	–%
Total	100.00%	100.00%	100.00%

### Nonperforming Assets

The Association's loan portfolio is divided into performing and high-risk categories. A Special Assets Management Department is responsible for servicing loans classified as high-risk. The high-risk assets, including accrued interest, are detailed below:

High-risk Assets	December 31,		
	2008	2007	2006
	<i>(dollars in thousands)</i>		
Nonaccrual loans	\$ 11,963	\$ 4,810	\$ 3,519
Restructured loans	146	172	199
Accruing loans 90 days past due	796	–	–
Total high-risk loans	12,905	4,982	3,718
Other property owned	504	1,061	–
Total high-risk assets	\$ 13,409	\$ 6,043	\$ 3,718
<b>Ratios</b>			
Nonaccrual loans to total loans	2.83%	1.30%	1.01%
High-risk assets to total assets	2.70%	1.41%	.89%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or future interest accruals, under the contractual terms of the loan. In substance, nonaccrual loans reflect loans where the accrual of interest has been suspended. Nonaccrual loans increased \$7,153 or 148.71 percent in 2008. This increase resulted primarily from the transfer of 20 real estate loans due to the weakness associated with the individual borrower's repayment capacity. Of the \$11,963 in nonaccrual volume at December 31, 2008, \$3,235 or 27.04%, compared to 9.44% and 1.28% at December 31, 2007 and 2006, respectively, was current as to scheduled principal and interest payments, but did not meet all regulatory requirements to be transferred into accrual status. The 2008 other property owned balance consists of 3 real estate parcels obtained through foreclosure action.

Loan restructuring is available to financially distressed borrowers. Restructuring of loans occurs when the Association grants a concession to a borrower based on either a court order or good faith in a borrower's ability to return to financial viability. The

concessions can be in the form of a modification of terms or rates, a compromise of amounts owed, or deed in lieu of foreclosure. Other receipts of assets and/or equity to pay the loan in full or in part are also considered restructured loans. The type of alternative financing structure chosen is based on minimizing the loss incurred by both the Association and the borrower.

*Allowance for Loan Losses*

The allowance for loan losses at each period end was considered by Association management to be adequate to absorb probable losses existing in and inherent to its loan portfolio.

The following table presents the activity in the allowance for loan losses for the most recent three years:

Allowance for Loan Losses Activity:	Year Ended December 31,		
	2008	2007	2006
	<i>(dollars in thousands)</i>		
Balance at beginning of year	\$ 1,473	\$ 1,639	\$ 2,133
Charge-offs:			
Real estate mortgage	(134)	—	—
Production and intermediate-term	(44)	(73)	(3)
Agribusiness	—	—	(6)
Rural residential real estate	(77)	—	—
Total charge-offs	(255)	(73)	(9)
Recoveries:			
Production and intermediate-term	50	15	18
Agribusiness	—	12	109
Total recoveries	50	27	127
Net (charge-offs) recoveries	(205)	(46)	118
Provision for (reversal of allowance for) loan losses	(3,975)	120	612
Balance at end of year	\$ 5,243	\$ 1,473	\$ 1,639
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	(0.05)%	(0.01)%	0.03%

The net loan charge-offs were primarily associated with the increased nonaccrual transfers and the write-down to the net realizable value upon acquisition and transfer on three real estate loans to other property owned.

The allowance for loan losses by loan type for the most recent three years is as follows:

Allowance for Loan Losses by Type	December 31,		
	2008	2007	2006
	<i>(dollars in thousands)</i>		
Real estate mortgage	\$ 2,501	\$ 763	\$ 891
Production and intermediate-term	2,074	512	485
Agribusiness	263	62	117
Communication	—	—	5
Energy	41	14	18
Rural residential real estate	364	122	123
Total loans	\$ 5,243	\$ 1,473	\$ 1,639

The allowance for loan losses as a percentage of loans outstanding and as a percentage of certain other credit quality indicators is shown below:

Allowance for Loan Losses as a Percentage of:	December 31,		
	2008	2007	2006
Total loans	1.24%	.40%	.47%
Nonperforming loans	40.63%	29.57%	44.08%
Nonaccrual loans	43.83%	30.62%	46.58%

Please refer to Note 4, "Loans and Allowance for Loan Losses," of the Notes to the Consolidated Financial Statements, for further information concerning the allowance for loan losses.

**RESULTS OF OPERATIONS**

*Net Interest Income*

Net interest income was \$10,503 million, \$10,536 million and \$11,871 million in 2008, 2007 and 2006, respectively. Net interest income is the difference between interest income and interest expense. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets and cost of debt. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following table:

Change in Net Interest Income:	Nonaccrual			
	Volume*	Rate	Income	Total
	<i>(dollars in thousands)</i>			
<b>12/31/08 - 12/31/07</b>				
Interest income	\$ 2,789	\$ (5,605)	\$ 13	\$ (2,803)
Interest expense	1,965	(4,735)	—	(2,770)
Change in net interest income	\$ 824	\$ (870)	\$ 13	\$ (33)
<b>12/31/07 - 12/31/06</b>				
Interest income	\$ (3,046)	\$ 752	\$ 6	\$ (2,288)
Interest expense	(1,803)	850	—	(953)
Change in net interest income	\$ (1,243)	\$ (98)	\$ 6	\$ (1,335)

\* *Volume variances can be the result of increased/decreased loan volume or from changes in the percentage composition of assets and liabilities between periods.*

*Noninterest Income*

Noninterest income for each of the three years ended December 31 is shown in the following table:

Noninterest Income	For the Year Ended December 31,			Percentage Increase/(Decrease)	
	2008	2007	2006	2008/2007	2007/2006
	<i>(dollars in thousands)</i>				
Loan fees	\$ 1,049	\$ 900	\$ 1,050	16.56%	(14.29)%
Fees for financially related services	440	376	9	17.02	4,077.78
Patronage refund from other Farm Credit Institutions	6,398	7,533	4,646	(15.07)	62.14
Gains (losses) on other property owned, net	(348)	—	—	—	—
Gains (losses) on sales of rural home loans, net	185	118	5	56.78	2,260.00
Gains (losses) from sales of premises and equipment, net	—	—	38	—	(100.00)
Other noninterest income	85	103	48	(17.48)	114.58
Total noninterest income	\$ 7,809	\$ 9,030	\$ 5,796	(13.52)%	55.80

Noninterest income decreased \$1,221 or 13.52% for December 31, 2008, as compared to the same period of 2007.

December 31, 2007 noninterest income increased \$3,234 or 55.80% when compared to the same period of 2006. The decline in noninterest income for 2008 is attributed to the increase in loan fees, fees for financially related services and gain on sales of rural home loans being more than offset by the reduction in patronage refunds from other Farm Credit institutions and reductions in other noninterest income.

*Noninterest Expense*

Noninterest expense for each of the three years ended December 31 is shown in the following table:

Noninterest Expense	For the Year Ended December 31,			Percentage Increase/(Decrease)	
	2008	2007	2006	2008/ 2007	2007/ 2006
	<i>(dollars in thousands)</i>				
Salaries and employee benefits	\$ 4,516	\$ 4,582	\$ 4,170	(1.44)%	9.88%
Occupancy and equipment	683	692	675	(1.30)	2.52
Insurance Fund premium	554	522	572	6.13	(8.74)
Other operating expense	1,628	1,500	1,385	8.53	8.30
Total noninterest expense	\$ 7,381	\$ 7,296	\$ 6,802	1.17%	7.26%

Noninterest expense increased \$85 or 1.17 percent for December 31, 2008, as compared to the same period of 2007 and increased \$494 or 7.26 percent compared to December 31, 2006. Salaries and employee benefits decreased in 2008, as compared with 2007, primarily due to decreased costs associated with employee benefit plans, merit and incentive compensation, and employee staffing levels. The reduction in salaries and employee benefits and occupancy and equipment expense were more than offset by increases in the insurance fund premium and other operating expense.

Insurance Fund premiums increased 06.13 percent for the twelve months ended December 31, 2008, compared to the same period of 2007. The Farm Credit System Insurance Corporation (FCSIC) changed the methodology in assessing the insurance premiums as a result of the 2008 Farm Bill. Please refer to the "Regulatory Matters" section of this management's discussion and analysis for details concerning the 2008 Farm Bill. The FCSIC set premiums at 15 basis points on adjusted insured debt outstanding for the third quarter of 2008 and 18 basis points on adjusted insured debt outstanding for the fourth quarter of 2008. In addition, for the second half of 2008, there was a 10 basis point premium on the average principal outstanding of nonaccrual loans and any other-than-temporarily impaired investments. Previously, premiums of up to 15 basis points could be charged on accruing loans and up to 25 basis points for nonaccrual loans.

*Income Taxes*

The Association did not record a provision or benefit for income taxes for the year ended December 31, 2008, or 2007, as compared to a provision of \$13 for 2006. Refer to Note 2, "Summary of Significant Accounting Policies, Income Taxes," of the Notes to the Consolidated Financial Statements, for more information concerning Association income taxes.

*Key Results of Operations Comparisons*

Key results of operations comparisons for each of the twelve months ended December 31 are shown in the following table:

Key Results of Operations Comparisons	For the 12 Months Ended		
	12/31/08	12/31/07	12/31/06
Return on average assets	1.57%	3.04%	2.63 %
Return on average members' equity	8.98%	16.97%	16.71 %
Net interest income as a percentage of average earning assets	2.54%	2.78%	2.84 %
Net (charge-offs) recoveries to average loans	(0.05)%	(0.01)%	0.03%

A key factor in the growth of net income for future years will be continued improvement in net interest and noninterest income. Our goal is to generate earnings sufficient to fund operations, adequately capitalize the Association, and achieve an adequate rate of return for our members. To meet this goal, the agricultural economy must continue the improvement shown in recent years and the Association must meet certain objectives. These objectives are to attract and maintain high quality loan volume priced at competitive rates and to manage credit risk in our entire portfolio, while efficiently meeting the credit needs of our members.

**LIQUIDITY AND FUNDING SOURCES**

*Liquidity and Funding*

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement (GFA). The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association, creating notes payable (or direct loans) to the Bank. The Bank manages interest rate risk through direct loan pricing and asset/liability management. The notes payable are segmented into variable rate and fixed rate components. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. Association capital levels effectively create a borrowing margin between the amount of loans outstanding and the amount of notes payable outstanding. This margin is commonly referred to as "Loanable Funds".

Total notes payable to the Bank at December 31, 2008, was \$412,134 as compared to \$343,677 at December 31, 2007 and \$334,575 at December 31, 2006. The increase of 19.92 percent compared to December 31, 2007 and the increase of 2.72 percent compared to December 31, 2006, was attributable to continued loan growth in the Association. The average volume of outstanding notes payable to the Bank was \$362,563 and \$327,375 for the years ended December 31, 2008 and 2007, respectively. Refer to Note 8, "Notes Payable to AgFirst Farm Credit Bank," of the Notes to the Consolidated Financial Statements, for weighted average interest rates and maturities, and additional information concerning the Association's notes payable.

Liquidity management is the process whereby funds are made available to meet all financial commitments including the extension of credit, payment of operating expenses and payment

of debt obligations. The Association receives access to funds through its borrowing relationship with the Bank and from income generated by operations. The liquidity policy of the Association is to manage cash balances to maximize debt reduction and to increase loan volume. As borrower payments are received, they are applied to the Association's note payable to the Bank. The Association's investments and other secondary market programs provide additional liquidity. Sufficient liquid funds have been available to meet all financial obligations. There are no known trends likely to result in a liquidity deficiency for the Association.

The Association had no lines of credit from third party financial institutions as of December 31, 2008.

*Funds Management*

The Bank and the Association manage assets and liabilities to provide a broad range of loan products and funding options, which are designed to allow the Association to be competitive in all interest rate environments. The primary objective of the asset/liability management process is to provide stable and rising earnings, while maintaining adequate capital levels by managing exposure to credit and interest rate risks.

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers fixed, adjustable and variable rate loan products that are marginally priced according to financial market rates. Variable rate loans may be indexed to market indices such as the Prime Rate or the 90-day London Interbank Offered Rate (LIBOR). Adjustable rate mortgages are indexed to U.S. Treasury Rates. Fixed rate loans are priced based on the current cost of System debt of similar terms to maturity.

The majority of the interest rate risk in the Association's Consolidated Balance Sheets is transferred to the Bank through the notes payable structure. The Bank, in turn, actively utilizes funds management techniques to identify, quantify and control risk associated with the loan portfolio.

*Relationship with the Bank*

The Association's statutory obligation to borrow only from the Bank is discussed in Note 8, "Notes Payable to AgFirst Farm Credit Bank" of the Notes to the Consolidated Financial Statements in this annual report.

The Bank's ability to access capital of the Association is discussed in Note 5, "Investment in AgFirst Farm Credit Bank" of the Notes to the Consolidated Financial Statements.

The Bank's role in mitigating the Association's exposure to interest rate risk is described in the "Liquidity and Funding" section of this Management's Discussion and Analysis and in Note 8, "Notes Payable to AgFirst Farm Credit Bank included in this annual report.

**CAPITAL RESOURCES**

Capital serves to support asset growth and provide protection against unexpected credit and interest rate risk and operating

losses. Capital is also needed for future growth and investment in new products and services.

The Association Board of Directors establishes, adopts, and maintains a formal written capital adequacy plan to ensure that adequate capital is maintained for continued financial viability, to provide for growth necessary to meet the needs of members/borrowers, and to ensure that all stockholders are treated equitably. There were no material changes to the capital plan for 2007 that would affect minimum stock purchases or would have an effect on the Association's ability to retire stock and distribute earnings.

Total members' equity at December 31, 2008, increased 3.51 percent to \$76,339 from the December 31, 2007, total of \$73,753. At December 31, 2007, total members' equity increased 6.73 percent from the December 31, 2006 total of \$69,100. The increase was primarily attributed to the increase in retained earnings (allocated surplus and unallocated surplus) being partially offset by the reduction in capital stock and participation certificates.

Total capital stock and participation certificates were \$1,298 on December 31, 2008, compared to \$1,331 on December 31, 2007 and \$1,306 on December 31, 2006. The 2008 decrease from 2007 was attributed to the retirement of protected borrower stock and participation certificates on loans liquidated in the normal course of business and the retirement of excess stock through revolvment. The 2007 increase from 2006 was attributed to capital stock purchases being greater than the reduction of protected borrower stock and participation certificates on loans liquidated in the normal course of business.

FCA sets minimum regulatory capital requirements for System banks and associations. Capital adequacy is evaluated using a number of regulatory ratios. According to the FCA regulations, each institution's permanent capital ratio is calculated by dividing permanent capital by a risk-adjusted asset base. Risk adjusted assets mean the total dollar amount of the institution's assets adjusted by an appropriate credit conversion factor as defined by regulation. For all periods represented, the Association exceeded minimum regulatory standard for all the ratios.

The Association's capital ratios as of December 31 and the FCA minimum requirements follow:

	2008	2007	2006	Regulatory Minimum
Permanent capital ratio	15.14%	15.49%	16.55%	7.00%
Total surplus ratio	14.54%	14.49%	15.88%	7.00%
Core surplus ratio	11.70%	11.67%	13.46%	3.50%

The decrease in the Association's Permanent Capital for December 31, 2008 and December 31, 2007 was attributed to the increase in risk-adjusted assets (primarily loans originated). This increase in risk-adjusted assets also caused the decrease in the Association's Total Surplus Ratio and Core Surplus Ratio for 2007. The nominal increase in the Association's 2008 Total Surplus and Core Surplus ratios results from the increase in allocated surplus as compared to 2007. There are no trends, commitments, contingencies, or events that are likely to affect

the Association's ability to meet regulatory minimum capital standards and capital adequacy requirements.

See Note 9, "Members' Equity," of the Consolidated Financial Statements, for further information concerning capital resources.

**PATRONAGE PROGRAM**

Prior to the beginning of any fiscal year, the Association's Board of Directors, by adoption of a resolution, may establish a Patronage Allocation Program to distribute its available consolidated net earnings. This resolution provides for the application of net earnings in the manner described in the

Association's Bylaws. This includes the setting aside of funds to increase surplus to meet minimum capital adequacy standards established by FCA Regulations, to increase surplus to meet Association capital adequacy standards to a level necessary to support competitive pricing at targeted earnings levels, and for reasonable reserves for necessary purposes of the Association. After excluding net earnings attributable to (a) the portion of loans participated to another institution, (b) participation loans purchased, and (c) other non-patronage sourced activities, the remaining consolidated net earnings are eligible for allocation to borrowers. Refer to Note 9, "Members' Equity," of the Notes to the Consolidated Financial Statements, for more information concerning the patronage distributions. The Association declared patronage distributions of \$6,208 in 2008, \$11,664 in 2007, and \$10,154 in 2006.

**YOUNG, BEGINNING AND SMALL (YBS) FARMERS AND RANCHERS PROGRAM**

The Association's mission is to provide financial services to agriculture and the rural community, which includes providing credit to young\*, beginning\*\* and small\*\*\* farmers. Because of the unique needs of these individuals, and their importance to the future growth of the Association, the Association has established annual marketing goals to increase our market share of loans to YBS farmers. Specific marketing plans have been developed to target these groups, and resources have been designated to help ensure YBS borrowers have access to a stable source of credit. As a result, 2008 goals for new volume were established and exceeded.

The following table outlines the loan volume and number of YBS loans in the loan portfolio for the Association.

	As of December 31, 2008	
	Number of Loans	Amount of Loans
Young	172	\$ 14,730
Beginning	481	78,779
Small	813	89,522

Note: For purposes of the above table, a loan could be classified in more than one category, depending upon the characteristics of the underlying borrower.

The 2002 USDA (2002 is the latest USDA Ag census data available; next census will be available in February, 2009.) Ag census data has been used as a benchmark to measure

penetration of the Association's marketing efforts. The census data indicated that within the Association's chartered territory (counties) there were 14,630 reported farmers of which by definition 574 or 3.92 percent were Young, 4,660 or 31.85 percent were Beginning, and 13,759 or 94.05 percent were Small. Comparatively, as of December 31, 2008, the demographics of the Association's agricultural portfolio contained 1,466 YBS farmers, of which by definition 172 or 11.73 percent were Young, 481 or 32.81 percent were Beginning and 813 or 55.46 percent were Small.

The Association Board of Directors has adopted a Young, Beginning, and Small Farmer Plan with specific goals for the number of loans and new volume closed for 2009 and two succeeding years. The association will continue to review the demographics of its territory during 2009 utilizing 2009 Ag census data.

The following strategies and outreach programs have been conducted which assists and supports the Association's efforts to meet its objectives and goals for financing to the young, beginning, and small farmers.

- Support of 4-H, FFA, and young farmer organizations through sponsorships and donations.
- Sponsor seminars on farm transition planning and financial management.
- Youth livestock financing program for Youth Steer and Swine Shows. Available territory wide.
- Financial Training in cooperation with Florida Southern College, Citrus and Horticulture Dept.
- Employees serve as judges for youth livestock project record books.
- Sponsor participants and participate in Florida Council of Coops, Young Cooperator Conference.
- Sponsor Florida Nursery Growers Young Professional Award.

In addition, the association's lending personnel actively participate in various commodity trade group conferences and continuing education programs.

Association lenders have established performance goals to provide informational and financial training to agricultural youth groups and industry trade associations.

The Association is committed to the future success of young, beginning and small farmers.

\* Young farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who are age 35 or younger as of the date the loan is originally made.

\*\* Beginning farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who have 10 years or less farming or ranching experience as of the date the loan is originally made.

\*\*\* Small farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who normally generate less than \$250 in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

## REGULATORY MATTERS

For the twelve months ended December 31, 2008, the FCA took no enforcement action against the Association.

On June 16, 2008, FCA published a proposed rule in the Federal Register that would authorize Banks, Associations, or service corporations to invest in rural communities, i.e., communities that have fewer than 50,000 residents and are outside of an urbanized area, under certain conditions. The proposed rule would authorize two types of rural community investments: (1) investment in debt securities that would involve projects or programs that benefit the public in rural communities, and (2) equity investment in venture capital funds, which funds create economic opportunities and jobs in rural communities by providing capital to small or start-up businesses. Under the proposed rule, these investments would be limited to 150 percent of the institution's total surplus. The comment period closed August 15, 2008.

### *Federal Legislation*

In June, 2008, Congress passed the 2008 Farm Bill. This 2008 Farm Bill governs farm commodity, conservation, and other USDA programs for five years, from 2008 through 2012. The 2008 Farm Bill includes significant federal financial support for wheat, feed grains, cotton, rice, oilseeds, and dairy. It also contains new, expanded assistance for certain specialty crops. Overall, the 2008 Farm Bill maintains the government payments to farmers that had been in place under the previous farm bill. It also amended the Farm Credit Act to allow the FCSIC to assess insurance premiums based on each Bank's prorata share of adjusted outstanding insured debt (rather than loans), aligning premiums with the risk that is being insured. Premiums of up to 20 basis points could be charged against insured debt adjusted for loans and investments guaranteed by U.S. or state governments, and up to an additional 10 basis points could be charged for any nonaccrual loan volume or investments that are other-than-temporarily impaired. Previously, premiums of up to 15 basis points could be charged on accruing loans and up to 25 basis points for nonaccrual loans.

Using the new authorities contained in the 2008 Farm Bill, in June 2008, the FCSIC set premiums at 15 basis points on adjusted insured debt outstanding for the third quarter of 2008 and 18 basis points on adjusted insured debt outstanding for the fourth quarter of 2008. In addition, for the second half of 2008, there was a 10 basis point premium on the average principal outstanding for nonaccrual loans and on the average amount of any other-than-temporarily impaired investments. The FCSIC has provided guidance to System institutions that the premium rates will be increased to 20 basis points in 2009.

## RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, "*Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans.*" The Standard requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in that funded status in the year in which the changes occur through accumulated other comprehensive income. The Standard further requires the determination of the fair value of plan assets at year-end and recognition of actuarial gains and losses, prior service costs or credits, and transition assets and obligations as a component of accumulated other comprehensive income. In addition, this Standard requires that the funded status of a plan be measured as of the date of the year-end financial statements, effective for fiscal years ending after December 15, 2008. Prior to 2008, the District used a measurement date of September 30th. In 2008, the District used a measurement date of December 31st as required. See Note 11, Employee Benefit Plans, for the impact of the adoption of FAS 158 on the current period.

In December 2007, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141R, "*Business Combinations*" (SFAS 141R). SFAS 141R requires business combinations to be accounted for under the acquisition method of accounting (previously called the purchase method). The acquisition method requires (a) identifying the acquirer, (b) determining the acquisition date, (c) recognizing and measuring the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, at their acquisition date fair values, and (d) recognizing and measuring goodwill or a gain from a bargain purchase. SFAS 141R should be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Early application is prohibited. The Association is still evaluating the provisions of SFAS 141R, but believes that its adoption will significantly impact its accounting for combinations/acquisitions that may occur in 2009 and beyond.

# *Disclosure Required by Farm Credit Administration Regulations*

## Description of Business

Descriptions of the territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations are incorporated herein by reference to Note 1 of the Consolidated Financial Statements, "Organization and Operations," included in this Annual Report to shareholders.

The description of significant developments that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, and concentrations of assets, if any, is incorporated in "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in this Annual Report.

## Description of Property

The following table sets forth certain information regarding the properties of the reporting entity, all of which are located in Florida:

<u>Location</u>	<u>Description</u>	<u>Form of Ownership</u>
115 S. Missouri Ave.* Lakeland	Administrative/ Branch	Leased
507 E. Third Street Apopka	Branch	Owned
36 W. Polk Avenue Lake Wales	Branch	Owned
2301 Thonotosassa Road Plant City	Branch	Owned
31081 Cortez Blvd.** Brooksville	Branch	Leased

\* The Administrative / branch office located at 115 S. Missouri Ave. is leased through December 31, 2016 with a 4-year option to renew.

\*\*The branch office located at 31081 Cortez Blvd. is leased through November 30, 2009 with a 3-year option to renew.

## Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 13 of the Consolidated Financial Statements, "Commitments and Contingencies," included in this Annual Report.

## Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 9 of the Consolidated Financial Statements, "Members' Equity," included in this Annual Report.

## Description of Liabilities

The description of liabilities, contingent liabilities and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 8 and 13 of the Consolidated Financial Statements included in this Annual Report.

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

"Management's Discussion and Analysis of Financial Condition and Results of Operations," which appears in this Annual Report and is to be disclosed in this section, is incorporated herein by reference.

## Senior Officers

The following represents certain information regarding the senior officers of the Association and their business experience for the past five years:

<u>Senior Officer</u>	<u>Time in Position</u>	<u>Prior Experience</u>
Reginald T. Holt, <i>President &amp; Chief Executive Officer</i>	9 months	Sr. VP & Director of Agribusiness Lending from October 1997 to April 2008. Area VP from June 1992 to October 1997. Also serves on the Executive Committee of the AgFirst Farm Credit Council.
Craig A. Register, <i>Executive Vice President / Chief Lending Officer</i>	9 months	Director of Credit Administration at AgFirst from December 2004 to February 2008. Various positions of increasing responsibilities in the Association's Credit Department from January 1986 to November 2004.
Gregory D. Ellis, <i>Executive Vice President &amp; Corporate Treasurer / CFO</i>	16 years	Various positions of increasing responsibilities in the Association's Finance and Operations Department since 1985.
Courtney A. Eelman <i>Sr. Vice President Director of Loan Administration</i>	9 months	Association Credit Administrator from December 2003 to March 2008. Credit Analyst with AmSouth Bank from November 2001 to December 2003. Association Credit Analyst from December 1999 to October 2001.

<u>Senior Officer</u>	<u>Time in Position</u>	<u>Prior Experience</u>
Jeffery T. Phillips, Sr. Vice President / Chief Relationship Manager	9 months	Association Sr. Relationship Manager from January 2001 to March 2008, Association Credit Analyst from August 1997 to January 2001.
Regina W. Thomas, Sr. Vice President / Chief Business Development Officer	9 months	Association Relationship Manager from November 1999 to March 2008. Branch Manager at Carolina Farm Credit from April 1994 to November 1999. Also serves on the Executive Committee of the University of Florida IFAS Share Council, the FNGLA State Board of Directors, Treasurer of Florida Agri- Women, Inc., and past President and Treasurer of the FNGLA Action Chapter.

The total amount of compensation earned by the CEO and the highest paid officers as a group during the years ended December 31, 2008, 2007 and 2006, is as follows:

Name of Individual or Number in Group	Year	Annual				Total
		Salary	Bonus	Deferred Comp.	Perq./ Other*	
Reginald T. Holt	2008	\$192,007	-	-	-	\$192,007
Richard W. Joyner	2008	\$ 81,253	-	-	-	\$ 81,253
Richard W. Joyner	2007	\$325,012	-	-	\$7,830	\$332,842
Richard W. Joyner	2006	\$242,010	-	-	\$5,764	\$247,774
8**	2008	\$653,955	\$ 2,000	-	-	\$655,955
5	2007	\$601,523	\$162,963	-	\$5,290	\$769,776
5	2006	\$538,354	\$131,092	-	\$5,235	\$674,681

\* Amounts in the above table classified as Perquisites include travel incentives, group life insurance, automobile compensation, purchased automobile, spousal travel, relocation and tuition reimbursement.

\*\* Includes information for 2 Association Officers that retired effective February 28, and April 30, 2008. Information for CEO Holt is for nine months of 2008 with first three months of 2008 included with other Association Officers.

Disclosure of information on the total compensation paid during 2008 to any senior officer, or to any other individual included in the total, is available to shareholders upon request.

In addition to base salary, all Association employees (except the CEO and Chief ACA Reviewer) may earn additional compensation under a corporate bonus plan. The Association bonus plan is designed to motivate employees to exceed business plan goals established by the Board of Directors during the fiscal year. Level 1 of the Association plan covers all non-exempt employees (for wage and salary administration purposes) and is based on increasing budgeted final net income. Payments under Level 1 are calculated at year-end with eligible employees receiving up to 5 percent of their annual salary in cash.

Level 2 of the Association plan covers all exempt employees (except the CEO, other Senior Officers, the Chief ACA Reviewer, Residential Lending Group employees, and employees

identified as “lenders”) and is based on increasing loan volume and fee income. This portion of the plan is divided into three categories; percent increase (over budget) in Average Gross Accruing Volume outstanding (33.33 percent), percent increase (over budget) in Dollar Volume of New Loans Closed (33.33 percent), and percent increase (over budget) in Final Net Income (33.33 percent). Payments at this level are calculated at year-end based on the weighted average performance in each category, paid 100 percent in cash. The maximum award at this level shall not exceed 12 percent of their annual salary and requires a certain minimum individual employee evaluation score.

Level 3 of the Association plan covers all employees identified as “lenders” and is based upon their personal performance relative to their individual standards of performance. Award percentage points are earned for Marketing and Business Development and deductions for Asset Quality and Delinquencies. Payments at this level are calculated at year-end based on the weighted average performance in each category and also requires a certain minimum individual employee evaluation score. The maximum award at this level shall not exceed 50% of their annual salary with amounts up to 25% paid in cash and amounts greater than 25% deferred for 5 years.

Level 4 of the Association plan covers all employees in the Residential Lending Group. Underwriters and Sales Coordinators earn awards based upon their personal performance relative to their individual standards of performance. Processors and Closers earn a set dollar amount on each loan originated. Payments are made quarterly and require a certain minimum individual employee evaluation score.

Level 5 of the Association plan covers the senior officers listed above with the exception of the CEO. The Association must meet certain objectives for Shareholder Value (measured by the Return on Equity ratio; weighted 20 percent), Safety & Soundness (measured by FCA “CAMELS” rating and CIPA Score; weighted 20 percent), Growth, (measured by increase in Gross Volume, and New Loans Closed; weighted 20 percent), Credit Quality (measured by Acceptable & OAEM volume, Nonaccrual loan volume, Other Property Owned, and Delinquencies; weighted 20 percent), and Operating Efficiency (measured by the ratio of Operating Expenses to Final Net Interest Income, Noninterest Income to Operating Expenses ratio and the Return on Assets ratio; weighted 20 percent). Payments at this level are calculated at year-end based on the weighted average performance in each category, paid 75 percent in cash and 25 percent deferred for 5 years. The maximum award at this level shall not exceed 25 percent of their annual salary and requires a certain minimum individual employee evaluation score.

An overall plan restriction limits the total of all payments to a maximum of 25 percent of the total gain over budget. Payment of the Corporate Bonus is in the first quarter of 2009. Bonuses are shown in the year earned, which may be different than the year of payment.

The Association also sponsors a non-qualified defined benefit supplemental executive retirement plan for the Association’s former CEO. The purpose of the non-qualified plan is to provide benefits that supplement the qualified defined benefit plan in which the Association’s employees participate. For the former CEO, compensation in excess of the 401(a)(17) limit and benefits in excess of the 415(b) limit in the qualified defined benefit plan will be made up through the non-qualified plan. As a non-

qualified plan, assets have been allocated and separately invested for this plan, but are not isolated from the general creditors of the Association. Additionally, all employees are reimbursed for all direct travel expenses incurred when traveling on Association business. A copy of the travel policy is available to shareholders upon written request.

**Directors**

The following chart details the year the director began serving on the board, the current term of expiration, current committee assignments and total cash compensation paid:

DIRECTOR	ORIGINAL YEAR OF ELECTION OR APPOINTMENT	CURRENT TERM EXPIRATION	TOTAL COMP. PAID DURING 2008
Al Bellotto, <i>Chairman</i>	1991	2009	\$ 42,100
David J. Stanford, <i>Vice-Chairman</i>	1992	2011	35,600
W.T. Bice, Sr.*	1991	2008	1,550
C. Dennis Carlton, Sr.	2004	2010	12,100
L. Baylis Carnes, III	2008	2011	9,250
W. Rex Clonts, Jr.	1997	2009	13,600
Homer E. Hunnicutt, Jr.	1991	2010	17,400
John S. Langford	2005	2009	16,600
Robert R. Roberson	1997	2010	16,000
Lewis S. Stidham, <i>Outside Director</i>	1995	2010	17,300
Ronald R. Wetherington	1993	2011	14,500
			\$ 196,000

\* Director Bice's term expired in March 2008

The following represents certain information regarding the directors of the Association, including their principal occupation and employment for the past five years. Unless specifically listed, the principal occupation of the board member for the past five years has been as a self-employed farmer.

**Al Bellotto, Chairman**, is a cattleman and citrus grower and serves on the boards of the Florida Cattlemen's Association and the Polk County Cattlemen's Association (Beef Promotion). His principal occupation and employment for the past 5 years was with Al Bellotto, Inc.

**David J. Stanford, Vice-Chairman**, is a citrus grower and now retired citrus processor and serves on the board of South Lake Apopka Citrus Growers Association (citrus cooperative).

**W. T. Bice, Sr.** is a citrus grower and serves on the board and as President of Star Lake, Inc. (investments). His principal occupation and employment for the past 5 years was with W.T. Bice Groves. Mr. Bice's term expired in March 2008.

**C. Dennis Carlton, Sr.** is a cattleman, citrus grower and real estate broker and serves on the boards of Valrico State Bank, Center State Bank, Agricultural Economic Development Council of Hillsborough County, and the Soil and Water Conservation Council.

**L. Baylis Carnes, III** operates sand and gravel plants and is a timber and citrus producer and serves on the board of Standard Sand and Silica Company. His principal occupation for the past 5 years was with Standard Sand and Silica Company.

**W. Rex Clonts, Jr.** is a citrus grower and serves on the board of Florida Citrus Mutual and the Florida Fruit and Vegetable Association. His principal occupation and employment for the past 5 years was with Clonts Groves, Inc.

**Homer E. Hunnicutt, Jr.** is a cattle producer and serves on the boards of Hillandale Farms, Inc., SunTrust Bank – Nature Coast, and the Hernando County Farm Bureau. His principal occupation and employment for the past 5 years was with Finest Farms.

**John S. Langford** is a citrus grower, citrus fruit dealer and real estate agent and serves on the boards of Community Southern Bank (Lakeland, FL), the Polk County Farm Bureau, and is Vice-Chairman of the Polk County Planning Commission. His principal occupation and employment for the past 5 years was with John Langford, Inc.

**Robert R. Roberson** is a nurseryman and serves on the boards of Bank First (Apopka, FL) and the Orange County Farm Bureau. His principal occupation and employment for the past 5 years was with Foliage Factory Too, Inc. Mr. Roberson also owns Less Energy Systems LLC in Apopka, FL and has an active real estate license with Lou Haubner Realty.

**Lewis S. Stidham** is a former commercial banker from Citrus & Chemical Bank. His principal occupation for the past 5 years has been self-employment.

**Ronald R. Wetherington** is a strawberry and citrus grower and serves on the boards of the Hillsborough County Farm Bureau, Florida Farm Bureau Insurance Company, Florida Farm Bureau Federation, and Hillsborough County Law Enforcement Association.

Subject to approval by the board, the Association may allow directors an annual retainer of \$3,000 to be paid monthly and honoraria of \$400 for attendance at meetings and committee meetings, \$300 for special assignments, \$200 for telephone conference calls and \$200 for travel days that include an overnight stay. Total compensation paid to directors as a group was \$196,000 for 2008. No director received more than \$5,000 in non-cash compensation during the year.

The following chart details the number of meetings, other activities and additional compensation paid for other activities (if applicable) for each director:

Name of Director	Days Served		Committee Assignments	Comp. Paid for Other Activities*
	Regular Board Meetings	Other Official Activities*		
Al Bellotto, <i>Chairman</i>	12	92	Executive, Compensation, Legislative	\$ 37,300
David J. Stanford, <i>Vice-Chairman</i>	12	76	Executive, Compensation, Risk Management	30,800
W.T. Bice, Sr.	2	0	Compensation	750
C. Dennis Carlton, Sr.	11	14	Risk Management, Legislative	7,700
L. Baylis Carnes, III	9	9	Compensation, Risk Management	5,650
W. Rex Clonts, Jr.	10	19	Audit, Legislative	9,600
Homer E. Hunnicutt, Jr.	12	28	Audit, Risk Management	12,600
John S. Langford	11	27	Audit, Risk Management	12,200
Robert R. Roberson	12	26	Audit, Legislative	11,200
Lewis S. Stidham	11	30	Audit, Risk Management	12,900
Ronald R. Wetherington	11	22	Audit, Legislative	10,100
				\$ 150,800

\* Includes board committee meetings and other board activities other than regular board meetings.

Directors are reimbursed on an actual cost basis for all expenses incurred in the performance of official duties. Such expenses may include transportation, lodging, meals, tips, tolls, parking of cars, laundry, registration fees, and other expenses

associated with travel on official business. A copy of the policy is available to shareholders of the Association upon request.

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was \$69,756 for 2008, \$55,655 for 2007 and \$39,064 for 2006.

**Transactions with Senior Officers and Directors**

The reporting entity’s policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 12 of the Consolidated Financial Statements, “*Related Party Transactions*,” included in this Annual Report. There have been no transactions between the Association and senior officers or directors which require reporting per FCA regulations.

**Involvement in Certain Legal Proceedings**

There were no matters which came to the attention of management or the board of directors regarding involvement of current directors or senior officers in specified legal proceedings which should be disclosed in this section. No directors or senior officers have been involved in any legal proceedings during the last five years which require reporting per FCA regulations.

**Relationship with Independent Auditor**

There were no changes in or material disagreements with our independent auditor on any matter of accounting principles or financial statement disclosure during this period.

Aggregate fees for services rendered by its independent auditor for the year ended December 31, 2008 were as follows:

	2008
<b>Independent Auditor</b>	
PricewaterhouseCoopers LLP	
Audit services	\$ 58,200
Total	<u>\$ 58,200</u>

PricewaterhouseCoopers audit fees were for the annual audit of and for rendering an opinion on the Association’s consolidated financial statements.

**Consolidated Financial Statements**

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated February 27, 2009 and the report of management, which appear in this Annual Report are incorporated herein by reference.

Copies of the Association’s Annual and Quarterly reports are available upon request free of charge by calling 1-800-533-2773 or writing Gregory D. Ellis, Chief Financial Officer, Farm Credit of Central Florida, ACA, P.O. Box 8009, Lakeland, FL 33802 or accessing the web site, [www.farmcreditcf.com](http://www.farmcreditcf.com). The Association prepares an electronic version of the Annual Report which is available on the Association’s web site within 75 days after the end of the fiscal year and distributes the Annual

Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

**Borrower Information Regulations**

Since 1972, Farm Credit Administration (FCA) regulations have required that borrower information be held in strict confidence by Farm Credit System (FCS) institutions, their directors, officers and employees. These regulations provide Farm Credit institutions clear guidelines for protecting their borrowers’ nonpublic personal information.

On November 10, 1999, the FCA Board adopted a policy that requires FCS institutions to formally inform new borrowers at loan closing of the FCA regulations on releasing borrower information and to address this information in the Annual Report. The implementation of these measures ensures that new and existing borrowers are aware of the privacy protections afforded them through FCA regulations and Farm Credit System institution efforts.

**Credit and Services to Young, Beginning, and Small Farmers and Ranchers and Producers or Harvesters of Aquatic Products**

Information to be disclosed in this section is incorporated herein by reference to the similarly named section in the Management’s Discussion and Analysis of Financial Condition and Results of Operations section included in this annual report to the shareholders.

**Shareholder Investment**

Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank (Bank or AgFirst). Copies of the Bank’s Annual and Quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Stephen Gilbert, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst’s web site at [www.agfirst.com](http://www.agfirst.com). The Bank prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Bank prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Bank.

## *Report of the Audit Committee*

The Audit Committee of the Board of Directors (Committee) is comprised of the directors named below. None of the directors who serve on the Committee is an employee of Farm Credit of Central Florida, ACA and in the opinion of the Board of Directors, each is free of any relationship with the Association or management that would interfere with the director's independent judgment on the Committee.

The Committee has adopted a written charter that has been approved by the Board of Directors. The Committee has reviewed and discussed the Association's audited financial statements with management, which has primary responsibility for the financial statements.

PricewaterhouseCoopers LLP (PwC), the Association's independent auditor for 2008, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 114 (*The Auditor's Communication With Those Charged With Governance*). PwC has provided to the Committee the written disclosures and the letter required by Independence Standards Board Standard No. 1 (*Independence Discussions with Audit Committees*), and the Committee has discussed with PwC that firm's independence.

The Committee has also concluded that PwC's provision of non-audit services, if any, to the Association is compatible with PwC's independence.

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Association's Annual Report for 2008. The foregoing report is provided by the following independent directors, who constitute the Committee:



Lewis S. Stidham  
Chairman of the Audit Committee

### **Members of Audit Committee**

W. Rex Clonts, Jr.  
Homer E. Hunnicutt, Jr.  
John S. Langford  
Robert R. Roberson  
Ronald R. Wetherington

February 27, 2009

# Report of Independent Auditors



PricewaterhouseCoopers LLP  
10 Tenth Street, Suite 1400  
Atlanta, GA 30309  
Telephone (678) 419 1000

## Report of Independent Auditors

To the Board of Directors and Members  
of Farm Credit of Central Florida, ACA

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of changes in members' equity and of cash flows present fairly, in all material respects, the financial position of Farm Credit of Central Florida, ACA (the Association) and its subsidiaries at December 31, 2008, 2007 and 2006, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

*PricewaterhouseCoopers* LLP

February 27, 2009

# Consolidated Balance Sheets

<i>(dollars in thousands)</i>	December 31, 2008	December 31, 2007	December 31, 2006
<b>Assets</b>			
Cash	\$ 36	\$ 72	\$ 63
Investment securities:			
Held to maturity (fair value of \$50,540 \$30,148 and \$38,387 respectively)	50,376	30,247	38,704
Total investment securities	50,376	30,247	38,704
Loans	422,431	369,663	349,172
Less: allowance for loan losses	5,243	1,473	1,639
Net loans	417,188	368,190	347,533
Accrued interest receivable	2,624	2,699	3,582
Investments in other Farm Credit institutions	14,043	15,114	15,822
Premises and equipment, net	1,032	999	1,139
Other property owned, net	504	1,061	—
Due from AgFirst Farm Credit Bank	6,017	7,360	4,523
Other assets	5,128	4,297	5,078
Total assets	\$ 496,948	\$ 430,039	\$ 416,444
<b>Liabilities</b>			
Notes payable to AgFirst Farm Credit Bank	\$ 412,134	\$ 343,677	\$ 334,575
Accrued interest payable	1,253	1,688	1,680
Patronage refund payable	2,648	4,703	3,603
Other liabilities	4,574	6,218	7,486
Total liabilities	420,609	356,286	347,344
Commitments and contingencies			
<b>Members' Equity</b>			
Protected borrower stock	39	64	97
Capital stock and participation certificates	1,259	1,267	1,209
Retained earnings			
Allocated	34,758	33,511	28,995
Unallocated	40,252	39,214	38,799
Accumulated other comprehensive income (loss)	31	(303)	—
Total members' equity	76,339	73,753	69,100
Total liabilities and members' equity	\$ 496,948	\$ 430,039	\$ 416,444

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

# Consolidated Statements of Income

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2008	2007	2006
<b>Interest Income</b>			
Investment securities	\$ 1,441	\$ 1,706	\$ 1,911
Loans	26,162	28,700	30,783
Total interest income	27,603	30,406	32,694
<b>Interest Expense</b>			
Notes payable to AgFirst Farm Credit Bank	17,100	19,870	20,823
Net interest income	10,503	10,536	11,871
Provision for (reversal of allowance for) loan losses	3,975	(120)	(612)
Net interest income after provision for (reversal of allowance for) loan losses	6,528	10,656	12,483
<b>Noninterest Income</b>			
Loan fees	1,049	900	1,050
Fees for financially related services	440	376	9
Patronage refund from other Farm Credit institutions	6,398	7,533	4,646
Gains (losses) on other property owned, net	(348)	—	—
Gains (losses) on sales of rural home loans, net	185	118	5
Gains (losses) on sales of premises and equipment, net	—	—	38
Other noninterest income	85	103	48
Total noninterest income	7,809	9,030	5,796
<b>Noninterest Expense</b>			
Salaries and employee benefits	4,516	4,582	4,170
Occupancy and equipment	683	692	675
Insurance Fund premiums	554	522	572
Other operating expenses	1,628	1,500	1,385
Total noninterest expense	7,381	7,296	6,802
Income before income taxes	6,956	12,390	11,477
Provision (benefit) for income taxes	—	—	13
Net income	\$ 6,956	\$ 12,390	\$ 11,464

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

# Consolidated Statements of Changes in Members' Equity

<i>(dollars in thousands)</i>	Capital		Retained Earnings		Accumulated Other Comprehensive Income	Total Members' Equity
	Protected Borrower Stock	Stock and Participation Certificates	Allocated	Unallocated		
Balance at December 31, 2005	\$ 146	\$ 1,169	\$ 27,008	\$ 38,134	—	\$ 66,457
Net income				11,464		11,464
Protected borrower stock retired	(49)					(49)
Capital stock/participation certificates issued/(retired), net		40				40
Patronage distribution						
Cash				(3,554)		(3,554)
Qualified allocated retained earnings			59	(59)		—
Nonqualified allocated retained earnings			6,541	(6,541)		—
Retained earnings retired			(5,037)			(5,037)
Patronage distribution adjustment			424	(645)		(221)
Balance at December 31, 2006	97	1,209	28,995	38,799	—	69,100
Net income				12,390		12,390
Protected borrower stock retired	(33)					(33)
Capital stock/participation certificates issued/(retired), net		58				58
Patronage distribution						
Cash				(4,666)		(4,666)
Nonqualified allocated retained earnings			6,998	(6,998)		—
Retained earnings retired			(2,178)			(2,178)
Patronage distribution adjustment			(304)	(311)		(615)
Adjustment to initially apply FAS No. 158 (Note 11)					(303)	(303)
Balance at December 31, 2007	64	1,267	33,511	39,214	(303)	73,753
Net income				6,956		6,956
Protected borrower stock retired	(25)					(25)
Capital stock/participation certificates issued/(retired), net		(8)				(8)
Patronage distribution						
Cash				(2,619)		(2,619)
Qualified allocated retained earnings			2,690	(2,690)		—
Nonqualified allocated retained earnings			899	(899)		—
Retained earnings retired			(2,178)			(2,178)
Patronage distribution adjustment			(164)	315		151
Employee benefit plans adjustments (Note 11)				(25)	334	309
Balance at December 31, 2008	\$ 39	\$ 1,259	\$ 34,758	\$ 40,252	\$ 31	\$ 76,339

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

# Consolidated Statements of Cash Flows

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2008	2007	2006
<b>Cash flows from operating activities:</b>			
Net income	\$ 6,956	\$ 12,390	\$ 11,464
provided by (used in) operating activities:			
Depreciation on premises and equipment	172	189	193
Amortization of net deferred loan origination (fees) costs	(225)	(201)	(583)
Premium amortization/discount accretion on investments	627	805	903
Provision for (reversal of allowance for) loan losses	3,975	(120)	(612)
(Gains) losses on other property owned, net	348	—	—
(Gains) losses on sales of premises and equipment, net	—	—	(38)
(Gains) losses on sales of rural home loans, net	(185)	(118)	(5)
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	75	883	(386)
(Increase) decrease in due from AgFirst Farm Credit Bank	1,343	(2,837)	(733)
(Increase) decrease in other assets	(646)	899	328
Increase (decrease) in accrued interest payable	(435)	8	28
Increase (decrease) in other liabilities	(1,335)	(1,571)	1,480
Total adjustments	3,714	(2,063)	575
Net cash provided by (used in) operating activities	10,670	10,327	12,039
<b>Cash flows from investing activities:</b>			
Purchases of investment securities, held to maturity	(28,119)	(3,201)	(17,708)
Proceeds from maturities of or principal payments received on investment securities, held to maturity	7,363	10,853	12,783
Net (increase) decrease in loans	(53,053)	(21,397)	51,928
(Increase) decrease in investment in other Farm Credit institutions	1,071	708	(11,788)
Purchases of premises and equipment	(205)	(49)	(187)
Proceeds from sales of other property owned	514	—	—
Net cash provided by (used in) investing activities	(72,429)	(13,086)	35,028
<b>Cash flows from financing activities:</b>			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	68,457	9,102	(39,719)
Protected borrower stock retired	(25)	(33)	(49)
Capital stock and participation certificates issued/(retired), net	(8)	58	40
Patronage refunds and dividends paid	(4,523)	(4,181)	(3,038)
Retained earnings retired	(2,178)	(2,178)	(5,037)
Net cash provided by (used in) financing activities	61,723	2,768	(47,803)
Net increase (decrease) in cash	(36)	9	(736)
Cash, beginning of period	72	63	799
Cash, end of period	\$ 36	\$ 72	\$ 63
<b>Supplemental schedule of non-cash activities:</b>			
Loans transferred to other property owned	\$ 305	\$ 1,061	\$ —
Cash dividends or patronage distributions declared or payable	2,619	4,666	3,554
Increase in liability resulting from adoption of FAS 158 (Note 11)	—	303	—
Employee benefit plans adjustments (Note 11)	(309)	—	—
<b>Supplemental information:</b>			
Interest paid	\$ 17,535	\$ 19,862	\$ 20,795
Taxes (refunded) paid, net	—	(132)	4

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

# Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

## Note 1 — Organization and Operations

A. **Organization:** Farm Credit of Central Florida, ACA (the Association or ACA) is a member-owned cooperative which provides credit and credit-related services to or for the benefit of eligible borrowers/shareholders for qualified purposes in the counties of Brevard, Citrus, Hernando, Hillsborough, Lake, Orange, Osceola, Pasco, Pinellas, Polk, Seminole, Sumter, and Volusia in the state of Florida.

The Association is a lending institution of the Farm Credit System (System), a nationwide system of cooperatively owned banks and associations, which was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (Farm Credit Act). The most recent significant amendment to the Farm Credit Act was the Agricultural Credit Act of 1987. At December 31, 2008, the System was comprised of four Farm Credit Banks, one Agricultural Credit Bank and ninety associations.

AgFirst Farm Credit Bank (Bank) and its related associations are collectively referred to as the "District." The Bank provides funding to associations within the District and is responsible for supervising certain activities of the Association, as well as the other associations operating within the District. The District consists of the Bank and twenty-two Agricultural Credit Associations (ACAs), all of which are structured as ACA parent-companies, which have two wholly owned subsidiaries, a Federal Land Credit Association (FLCA) and a Production Credit Association (PCA). FLCAs are tax-exempt while ACAs and PCAs are taxable.

ACA parent-companies provide financing and related services through its FLCA and PCA subsidiaries. The FLCA makes collateralized long-term agricultural real estate and rural home mortgage loans. The PCA makes short- and intermediate-term loans for agricultural production or operating purposes; however, the Association is operating its short- and intermediate-term business through the ACA instead of the PCA.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System banks and associations. The FCA examines the activities of the associations and certain actions by the associations are subject to the prior approval of the FCA and the supervising bank.

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (Insured debt), (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance

Fund is also available for discretionary uses by the Insurance Corporation to provide assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank has been required to pay premiums, which may be passed on to the Association, into the Insurance Fund, based on its annual average loan principal outstanding until the monies in the Insurance Fund reach the "secure base amount." The secure base amount is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (Systemwide debt obligations) or such other percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums, but it still must ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount. In June 2008, with the passage of the Food, Conservation, and Energy Act of 2008 (Farm Bill), the basis for assessing premiums was changed, beginning with the second half of 2008, to reflect each association's pro rata share of outstanding insured debt. The Farm Bill imposes premiums of up to 20 basis points on adjusted insured debt obligations, with the Insurance Corporation Board having the ability to reduce the amount, and a risk surcharge of 10 basis points on nonaccrual loans and other-than-temporarily impaired investments. Premiums for the third and fourth quarters of 2008 were 15 and 18 basis points, respectively.

B. **Operations:** The Farm Credit Act sets forth the types of authorized lending activity, persons eligible to borrow, and financial services which can be offered by the Association. The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related businesses.

The Association may sell to any System borrowing member, on an optional basis, credit or term life insurance appropriate to protect the loan commitment in the event of death of the debtor(s). The sale of other insurance necessary to protect a member's farm or aquatic unit is permitted, but limited to hail and multi-peril crop insurance, and insurance necessary to protect the facilities and equipment of aquatic borrowers.

## Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the Association conform with accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of financial statements in conformity with GAAP requires management to

make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results may differ from these estimates.

Certain amounts in prior years' financial statements may have been reclassified to conform to the current year's presentation. Such reclassifications had no effect on net income or total members' equity of prior years. The Consolidated Financial Statements include the accounts of the FLCA and the PCA. All significant inter-company transactions have been eliminated in consolidation.

- A. **Cash:** Cash, as included in the statements of cash flows, represents cash on hand and on deposit at banks.
- B. **Investment Securities:** The Association, as permitted under the FCA regulations, holds investments for purposes of maintaining a liquidity reserve, managing short-term surplus funds and managing interest rate risk. The Association's investments are classified as held-to-maturity and accordingly have been reported at amortized cost. Purchase premiums and discounts are amortized or accreted ratably over the term of the respective security which approximates the effective interest method.

The Association may also hold additional investments in accordance with mission-related investment and other investment programs, approved by the Farm Credit Administration. These programs allow the Association to make investments that further the System's mission to serve rural America. Mortgage-backed securities issued by Farmer Mac are considered other investments. Mission-related investments for which the Association has the intent and ability to hold to maturity are classified as held-to-maturity and carried at cost, adjusted for the amortization of premiums and accretion of discounts. Farmer Mac investments are classified either as held-to-maturity or available-for-sale depending on the institution's ability and intent to hold the investment to maturity.

The Association reviews all investments that are in a loss position in order to determine whether the unrealized loss, which is considered an impairment, is temporary or other-than-temporary. In the event of other-than-temporary impairment, the cost basis of the investment would be written down to its fair value, and the realized impairment loss would be included in earnings in the period of impairment.

- C. **Loans and Allowance for Loan Losses:** Long-term real estate mortgage loans generally have original maturities ranging from 5 to 40 years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less. Loans are carried at their principal amount outstanding adjusted for charge-offs and deferred loan fees or costs.

Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days (unless adequately collateralized and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. When a loan is placed in nonaccrual

status, accrued interest deemed uncollectible is reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in the prior year).

When loans are in nonaccrual status, the interest portion of payments received in cash is recognized as interest income if collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it. Otherwise, loan payments are applied against the recorded investment in the loan. Nonaccrual loans may be returned to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected and the loan is not classified "doubtful" or "loss."

Loans are charged-off, wholly or partially, as appropriate, at the time they are determined to be uncollectible.

In cases where a borrower experiences financial difficulties and the Association makes certain monetary concessions to the borrower through modifications to the contractual terms of the loan, the loan is classified as a restructured loan. If the borrower's ability to meet the revised payment schedule is uncertain, the loan is classified as a nonaccrual loan.

Loan origination fees and direct loan origination costs are deferred as part of the carrying amount of the loan and the net fee or cost is amortized over the life of the related loan as an adjustment to interest income using the effective interest method.

The allowance for loan losses is a valuation account used to reasonably estimate loan and lease losses existing as of the financial statement date. Determining the appropriate allowance for loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss.

The allowance for loan losses is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition and prior loan loss experience. It is based on estimates, appraisals and evaluations of loans which, by their nature, contain elements of uncertainty and imprecision. The possibility exists that changes in the economy and its impact on borrower repayment capacity will cause these estimates, appraisals and evaluations to change.

The level of allowance for loan losses is generally based on recent charge-off experience adjusted for relevant environmental factors. The Association considers the following factors when adjusting the historical charge-offs experience:

- Changes in credit risk classifications,
- Changes in collateral values,
- Changes in risk concentrations,
- Changes in weather related conditions, and
- Changes in economic conditions.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms of the loan. Impaired loans include nonaccrual loans, restructured loans, and loans past due 90 days or more and still accruing interest. A loan is considered contractually past due when any principal repayment or interest payment required by the loan instrument is not received on or before the due date. A loan shall remain contractually past due until it is formally restructured or until the entire amount past due, including principal, accrued interest, and penalty interest incurred as the result of past due status, is collected or otherwise discharged in full.

A specific allowance may be established for impaired loans under Statement of Financial Accounting Standards No. 114. Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent.

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through allowance for loan losses reversals and loan charge-offs.

**D. Gains/(Losses) on Rural Home Loans Held for Sale:**

Certain rural home mortgage loans originated by the Association are sold on a servicing released basis primarily to the Bank or into the secondary market to unrelated third parties. Gains or losses on sales of rural home mortgage loans are recognized based on the difference between the selling price and the carrying value of the related rural home mortgage loans sold.

**E. Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** The Association is required to maintain ownership in the Bank in the form of Class B and Class C stock. Accounting for this investment is on the cost plus allocated equities basis. Patronage refunds from the Bank are accrued as earned. The receivable for such patronage refunds is classified as due from AgFirst Farm Credit Bank.

**F. Other Property Owned:** Other property owned, consisting of real and personal property acquired through a collection action, is recorded upon acquisition at fair value less estimated selling costs. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income, expenses, and carrying value adjustments related to other property owned are included in gains (losses) on other property owned, net.

**G. Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Useful life ranges from 3 to 10 years for furniture, equipment, and automobiles and up to 40 years for buildings and leasehold

improvements. Gains and losses on dispositions are reflected in current earnings. Maintenance and repairs are charged to expense and improvements are capitalized.

**H. Advanced Conditional Payments:** The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, the advanced conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as interest-bearing liabilities in the accompanying Consolidated Balance Sheets. Advanced conditional payments are not insured. Interest is generally paid by the Association on such accounts.

**I. Employee Benefit Plans:** Substantially all employees of the Association may participate in the AgFirst Farm Credit Retirement Plan (Plan), which is a defined benefit plan and is considered a multi-employer plan. The Plan is noncontributory and includes eligible District employees. The "Projected Unit Credit" actuarial method is used for financial reporting purposes. The cost of the Plan is allocated based on a percentage of each institution's salary expense to the total salary expense for all Plan participants. Additional financial information for the Plan may be found in Note 11 and in the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' 2008 Annual Report.

Substantially all employees of the Association may also be eligible to participate in a defined contribution Districtwide 401(k) plan, which qualifies as a 401(k) plan as defined by the Internal Revenue Code. For employees hired on or prior to December 31, 2002, the Association contributes \$.50 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. For employees hired on or after January 1, 2003, the Association contributes \$1.00 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service. 401(k) plan costs are expensed as funded.

The Association may provide certain health care and life insurance benefits to eligible retired employees (other postretirement benefits) through a District multi-employer plan. Substantially all employees may become eligible for these benefits if they reach early retirement age while working for the Association. Additional financial information for the plan may be found in Note 11 and in the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' 2008 Annual Report.

The Association also sponsors a single employer supplemental retirement plan for certain key employees. The plans are nonqualified; therefore, the associated liabilities are included in the Association's Consolidated Balance Sheets in other liabilities. See Note 11 for the impact of SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans", on the current period for the defined benefit supplemental retirement plan.

**J. Income Taxes:** Effective January 1, 2005, the Association formed a tax exempt subsidiary as described in Note 1. The Association is generally subject to Federal and certain other income taxes. As previously described, the ACA holding company has two wholly-owned subsidiaries, a PCA and a FLCA. The FLCA subsidiary is exempt from federal and state income taxes as provided in the Farm Credit Act. The ACA holding company and the PCA subsidiary are subject to federal, state and certain other income taxes.

The Association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the Association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those taxable earnings that will not be distributed as qualified patronage refunds. The Association distributes patronage on the basis of book income.

The Association accounts for income taxes under the asset and liability method, recognizing deferred tax assets and liabilities for the expected future tax consequences of the temporary differences between the carrying amounts and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled.

The Association records a valuation allowance at the balance sheet dates against that portion of the Association's deferred tax assets that, based on management's best estimates of future events and circumstances, more likely than not (a likelihood of more than 50 percent) will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of our expected patronage program, which reduces taxable earnings.

**K. Patronage Refund from AgFirst and Other Financial Institutions:** The Association records patronage refunds from the Bank and certain District Associations on an accrual basis.

**L. Fair Value Measurement:** Effective January 1, 2008, the Association adopted Statement of Financial Accounting Standards No. 157, "*Fair Value Measurements*" (SFAS No. 157). This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. SFAS No. 157 establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. It describes three levels of inputs that may be used to measure fair value:

Level 1 — Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 — Observable inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly or indirectly. Level 2 inputs include the following: (a) quoted prices for similar assets or liabilities in active markets; (b) quoted prices for identical or similar assets or liabilities in markets that are not active so that they are traded less frequently than exchange-traded instruments, the prices are not current or principal market information is not released publicly; (c) inputs other than quoted prices that are observable such as interest rates and yield curves, prepayment speeds, credit risks and default rates and (d) inputs derived principally from or corroborated by observable market data by correlation or other means.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. These unobservable inputs reflect the reporting entity's own assumptions about assumptions that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

See Note 14 for disclosures required by SFAS No. 157.

**M. Recently Issued Accounting Pronouncements:** In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 158, "*Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*" (SFAS No. 158). SFAS No. 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in that funded status in the year in which the changes occur through other comprehensive income. SFAS No. 158 further requires the determination of the fair value of plan assets at year-end and recognition of actuarial gains and losses, prior service costs or credits, and transition assets and obligations as a component of other comprehensive income. In addition, SFAS No. 158 requires that the funded status of a plan be measured as of the date of the year-end financial statements, effective for fiscal years ending after December 15, 2008. Prior to 2008, the District used a measurement date of September 30th. In 2008, the District used a measurement date of December 31st as required. The Association has various defined benefit pension and other postretirement benefit plans. These plans are classified as either single employer plans or multi-employer plans. For single employer defined benefit Association plans, adoption of SFAS No. 158 impacted the Association's Consolidated Financial Statements. For multi-employer Association plans in which the Association participates, adoption of SFAS No. 158 and corresponding impact was recorded at a District level and is not reflected directly in the Association's Consolidated Financial Statements. See Note 11 for further information regarding the impact of SFAS No. 158 on the current period for the Association's supplemental retirement plan.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141R, "Business Combinations" (SFAS No. 141R). SFAS No. 141R requires business combinations to be accounted for under the acquisition method of accounting (previously called the purchase method). The acquisition method requires (a) identifying the acquirer, (b) determining the acquisition date, (c) recognizing and measuring the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, at their acquisition date fair values, and (d) recognizing and measuring goodwill or a gain from a bargain purchase. SFAS No. 141R will be applied to business combinations on or after January 1, 2009. The Association is still evaluating the provisions of SFAS No. 141R, but believes that its adoption will significantly impact its accounting for combinations/acquisitions that may occur in 2009 and beyond.

### Note 3 — Investment Securities

A summary of the amortized cost and fair value of investment securities held-to-maturity at December 31, 2008, 2007 and 2006 follows:

December 31, 2008					
Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield	
Asset backed securities	\$ 50,367	\$ 324	\$ (151)	\$ 50,540	3.64%

  

December 31, 2007					
Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield	
Asset backed securities	\$ 30,247	\$ 177	\$ (276)	\$ 30,148	5.30%

  

December 31, 2006					
Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield	
Asset backed securities	\$ 38,704	\$ 167	\$ (484)	\$ 38,387	8.51%

The Association's investments consist primarily of asset-backed securities (ABSs). These ABSs are rated AAA, as they are guaranteed by the full faith and credit of the United States government. All unrealized losses referenced above are primarily due to reduced liquidity in the securities markets stemming from general adversity in the financial markets and are not credit related.

The following table shows the fair value and gross unrealized losses for investments in a loss position by the length of time the securities have been in a continuous unrealized loss position at December 31, 2008. The continuous loss position is based on the date the impairment occurred. The Association performs periodic credit reviews, including other-than-temporary impairment analysis, on its investment securities portfolio. The objective is to quantify any future possible loss of principal or interest due on each security identified for additional analysis. Based on the results of all analyses, the Association has not recognized any other-than-temporary impairment in connection with these investments. The unrealized losses on these investments resulted primarily from reduced liquidity in the securities markets stemming from general adversity in the financial markets and are not credit related. The Association has the ability and intent to hold these investments until a recovery of unrealized losses

occurs, which may be at maturity, and at this time expects to collect the full principal amount and interest due on these securities. All securities continue to perform. Substantially all of these investments were in U. S. government securities and the Association expects that these securities would not be settled at a price less than their amortized cost.

	Less than 12 Months		Greater than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Asset-backed securities	\$ 1,029	\$ 3	\$ 5,670	\$ 148

A summary of the expected maturity, amortized cost and estimated fair value of investment securities at December 31, 2008 follows:

	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	\$ 22	\$ 23	2.58%
After one year through five years	2,291	2,303	5.08
After five years through ten years	14,233	14,313	7.54
After ten years	33,830	33,901	2.67
Total	\$ 50,376	\$ 50,540	3.64%

### Note 4 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31,		
	2008	2007	2006
Real estate mortgage	\$ 201,237	\$ 191,299	\$ 189,594
Production and intermediate term	167,294	128,366	103,307
Loans to cooperatives	—	2,482	1,879
Processing and marketing	17,106	9,885	20,200
Farm related business	4,133	3,335	2,998
Communication	—	—	975
Energy	3,359	3,586	3,827
Rural residential real estate	29,302	30,710	26,392
Total loans	\$ 422,431	\$ 369,663	\$ 349,172

A substantial portion of the Association's lending activities is collateralized and the Association's exposure to credit loss associated with lending activities is reduced accordingly. An estimate of the Association's credit risk exposure is considered in the determination of the allowance for loan losses.

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

The following table presents information relating to impaired loans as defined in Note 2.

	December 31,		
	2008	2007	2006
Impaired nonaccrual loans:			
Current as to principal and interest	\$ 3,235	\$ 454	\$ 45
Past due	8,728	4,356	3,474
Total impaired nonaccrual loans	<u>11,963</u>	<u>4,810</u>	<u>3,519</u>
Impaired accrual loans:			
Restructured accrual loans	146	172	199
Accrual loans 90 days or more past due	796	—	—
Total impaired accrual loans	<u>942</u>	<u>172</u>	<u>199</u>
Total impaired loans	<u>\$ 12,905</u>	<u>\$ 4,982</u>	<u>\$ 3,718</u>

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2008.

Interest income is recognized and cash payments are applied on nonaccrual impaired loans as described in Note 2. The following table presents interest income recognized on impaired loans.

	Year Ended December 31,		
	2008	2007	2006
Interest income recognized on impaired nonaccrual loans	\$ 47	\$ 34	\$ 28
Interest income on impaired accrual loans	4	3	1
Interest income recognized on impaired loans	<u>\$ 51</u>	<u>\$ 37</u>	<u>\$ 29</u>

The following table presents information concerning impaired loans as of December 31,

	2008	2007	2006
	Impaired loans with related allowance	\$ 9,607	\$ 903
Impaired loans with no related allowance	3,298	4,079	2,862
Total impaired loans	<u>\$ 12,905</u>	<u>\$ 4,982</u>	<u>\$ 3,718</u>
Allowance on impaired loans	<u>\$ 3,177</u>	<u>\$ 139</u>	<u>\$ 105</u>

The following table summarizes impaired loan information for the year ended December 31,

	2008	2007	2006
Average impaired loans	<u>\$ 8,015</u>	<u>\$ 4,251</u>	<u>\$ 2,852</u>

The following table summarizes interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans:

	Year Ended December 31,		
	2008	2007	2006
Interest income which would have been recognized under the original loan terms	\$ 683	\$ 341	\$ 265
Less: interest income recognized	47	34	28
Foregone interest income	<u>\$ 636</u>	<u>\$ 307</u>	<u>\$ 237</u>

The changes in the allowance for loan losses are as follows:

	Year Ended December 31,		
	2008	2007	2006
Balance at beginning of year	\$ 1,473	\$ 1,639	\$ 2,133
Charge-offs:			
Real estate mortgage	(134)	—	—
Production and intermediate term	(44)	(73)	(3)
Agribusiness	—	—	(6)
Rural residential real estate	(77)	—	—
Total charge-offs	<u>(255)</u>	<u>(73)</u>	<u>(9)</u>
Recoveries:			
Production and intermediate term	50	15	18
Agribusiness	—	12	109
Total recoveries	<u>50</u>	<u>27</u>	<u>127</u>
Net (charge-offs) recoveries	<u>(205)</u>	<u>(46)</u>	<u>118</u>
Provision for (reversal of allowance for) loan losses	<u>(3,975)</u>	<u>(120)</u>	<u>(612)</u>
Balance at end of year	<u>\$ 5,243</u>	<u>\$ 1,473</u>	<u>\$ 1,639</u>
Ratio of net charge-offs (recoveries) during the period to average loans outstanding during the period	<u>(0.05%)</u>	<u>(0.01%)</u>	<u>0.03%</u>

In addition, the following is a breakdown of the allowance for loan losses for the end of the last three fiscal years:

	December 31, 2008		December 31, 2007	
	Amount	%	Amount	%
Real estate mortgage	\$ 2,501	47%	\$ 763	51%
Production and intermediate term	2,074	40	512	35
Agribusiness	263	5	62	5
Communication	—	—	—	—
Energy	41	1	14	1
Rural residential real estate	364	7	122	8
Total	<u>\$ 5,243</u>	<u>100%</u>	<u>\$ 1,473</u>	<u>100%</u>
	December 31, 2006			
	Amount	%		
Real estate mortgage	\$ 891	54%		
Production and intermediate term	485	30		
Agribusiness	117	7		
Communication	5	—		
Energy	18	1		
Rural residential real estate	123	8		
Total	<u>\$ 1,639</u>	<u>100%</u>		

#### Note 5 — Investment in AgFirst Farm Credit Bank

The Association is required to maintain ownership in the Bank of Class B and Class C stock as determined by the Bank. The Bank may require additional capital contributions to maintain its capital requirements.

**Note 6 — Premises and Equipment**

Premises and equipment consists of the following:

	December 31,		
	2008	2007	2006
Land	\$ 224	\$ 224	\$ 224
Buildings and improvements	871	842	831
Furniture and equipment	1,208	1,263	1,261
	<u>2,303</u>	<u>2,329</u>	<u>2,316</u>
Less: accumulated depreciation	1,271	1,330	1,177
Total	<u>\$ 1,032</u>	<u>\$ 999</u>	<u>\$ 1,139</u>

The Association is obligated under various noncancellable operating leases for offices. At December 31, 2008 future minimum lease payments for all noncancellable operating leases are as follows:

2009	341
2010	328
2011	338
2012	348
2013	358
Subsequent years	<u>1,140</u>
Total minimum lease payments	<u>\$ 2,853</u>

**Note 7 — Other Property Owned**

Net gains (losses) on other property owned consist of the following:

	December 31,		
	2008	2007	2006
Gains (losses) on sale, net	\$ (70)	\$ -	\$ -
Carrying value unrealized gains (losses)	(264)	-	-
Operating income (expense), net	<u>(14)</u>	<u>(1)</u>	<u>-</u>
Gains (losses) on other property owned, net	<u>\$(348)</u>	<u>\$ (1)</u>	<u>\$ -</u>

**Note 8 — Notes Payable to AgFirst Farm Credit Bank**

The Association's indebtedness to the Bank represents borrowings by the Association to fund its loan portfolio. This indebtedness is collateralized by a pledge of substantially all of the Association's assets and the terms of the revolving lines of credit are governed by a general financing agreement. Interest rates on both variable and fixed rate notes payable are generally established loan-by-loan based on the Bank's marginal cost of funds, capital position, operating costs and return objectives. The interest rate is periodically adjusted by the Bank based upon agreement between the Bank and the Association. The weighted average interest rates on the variable rate notes were 3.34 percent for LIBOR-based loans, 2.30 percent for Prime-based loans, and the weighted average remaining maturities were 4.1 years and 3.2 years, respectively, at December 31, 2008. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) loans which are match funded by the Bank was 5.05 percent and the weighted average remaining maturity was 8.7 years at December 31, 2008. The

weighted average interest rate on all interest-bearing notes payable was 3.94 percent and the weighted average remaining maturity was 6.3 years at December 31, 2008.

Variable rate and fixed rate notes payable represent approximately 42.70 percent and 57.30 percent, respectively, of total notes payable at December 31, 2008.

Under the Farm Credit Act, the Association is obligated to borrow only from the Bank, unless the Bank approves borrowing from other funding sources. The Bank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2008, the Association's notes payable were within the specified limitations.

**Note 9 — Members' Equity**

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

**A. Protected Borrower Equity**

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

**B. Capital Stock and Participation Certificates**

In accordance with the Farm Credit Act and the Association's capitalization bylaws, each borrower is required to invest in Class C stock for agricultural loans, or participation certificates in the case of rural home and farm related business loans, as a condition of borrowing. The initial borrower investment, through either purchase or transfer, must be in an amount equal to the lesser of \$1 thousand or two percent of the amount of the loan. The Board of Directors may increase the amount of investment if necessary to meet the Association's capital needs. Loans designated for sale or sold into the Secondary Market on or after April 16, 1996 will have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation.

The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, but usually does not make a cash investment. The aggregate par value is generally added to the principal amount of the related loan obligation. The Association retains a first lien on the stock or participation certificates owned by borrowers. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding stock or participation certificates.

**C. Regulatory Capitalization Requirements and Restrictions**

FCA’s capital adequacy regulations require the Association to achieve permanent capital of 7.00 percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the 7.00 percent capital requirement can initiate certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Association’s financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless prescribed capital standards are met. FCA regulations also require that additional minimum standards for capital be achieved. These standards require all System institutions to achieve and maintain ratios as defined by FCA regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of 7.00 percent and of core surplus as a percentage of risk-adjusted assets of 3.50 percent. The Association’s permanent capital, total surplus and core surplus ratios at December 31, 2008 were 15.14 percent, 14.54 percent and 11.70 percent, respectively.

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

**D. Description of Equities**

The Association is authorized to issue or have outstanding Classes A and D Preferred Stock, Classes A, B and C Common Stock, Classes B and C Participation Certificates and such other classes of equity as may be provided for in amendments to the bylaws in such amounts as may be necessary to conduct the Association’s business. All stock and participation certificates have a par or face value of five dollars (\$5.00) per share.

The Association had the following shares outstanding at December 31, 2008:

Class	Protected	Shares Outstanding	
		Number	Aggregate Par Value
B Common/Nonvoting	Yes	6,998	\$ 35
C Common/Voting	No	208,523	1,043
B Participation Certificates/Nonvoting	Yes	740	4
C Participation Certificates/Nonvoting	No	43,252	216
Total Capital Stock and Participation Certificates		259,513	\$ 1,298

Protected common stock and participation certificates are retired at par or face value in the normal course of business. At-risk common stock and participation certificates are retired at the sole discretion of the Board at book value not to exceed par or face amounts, provided the minimum capital adequacy standards established by the Board are met.

*Retained Earnings*

The Association maintains an unallocated retained earnings account and an allocated retained earnings account. The minimum aggregate amount of these two accounts is determined by the Board. At the end of any fiscal year, if the retained earnings accounts otherwise would be less than the minimum amount determined by the Board as necessary to maintain adequate capital reserves to meet the commitments of the Association, the Association shall apply earnings for the year to the unallocated retained earnings account in such amounts as may be determined necessary by the Board. Unallocated retained earnings are maintained for each borrower to permit liquidation on a patronage basis.

The Association maintains an allocated retained earnings account consisting of earnings held and allocated to borrowers on a patronage basis. In the event of a net loss for any fiscal year, such allocated retained earnings account will be subject to full impairment in the order specified in the bylaws beginning with the most recent allocation.

The Association has a first lien and security interest on all retained earnings account allocations owned by any borrowers, and all distributions thereof, as additional collateral for their indebtedness to the Association. When the debt of a borrower is in default or is in the process of final liquidation by payment or otherwise, the Association, upon approval of the Board, may order any and all retained earnings account allocations owned by such borrower to be applied on the indebtedness.

Allocated equities shall be retired solely at the discretion of the Board; provided, however, that minimum capital standards established by the FCA and the Board are met.

At December 31, 2008, allocated members’ equity consisted of \$15,149 of qualified and \$19,608 of nonqualified allocated surplus distributions. Nonqualified distributions are tax deductible only when redeemed.

*Dividends*

The Association may declare noncumulative dividends on its capital stock and participation certificates provided the dividend rate does not exceed 20 percent of the par value of the respective capital stock and participation certificates. Such dividends may be paid solely on Classes A and D Preferred Stock or on all classes of stock and participation certificates.

The rate of dividends paid on Class A Preferred Stock for any fiscal year may not be less than the rate of dividends paid on Classes A, B or C Common Stock or participation certificates for such year. The rate of dividends on Classes A, B and C Common Stock and participation certificates shall be at the same rate per share.

Dividends may not be declared if, after recording the liability, the Association would not meet its capital adequacy standards. No dividends were declared by the Association for any of the periods included in these Consolidated Financial Statements.

*Patronage Distributions*

Prior to the beginning of any fiscal year, the Board, by adoption of a resolution, may obligate the Association to distribute to borrowers on a patronage basis all or any portion of available net earnings for such fiscal year or for that and subsequent fiscal years. Patronage distributions are based on the proportion of the borrower's interest to the amount of interest earned by the Association on its total loans unless another proportionate patronage basis is approved by the Board.

If the Association meets its capital adequacy standards after making the patronage distributions, the patronage distributions may be in cash, authorized stock of the Association, allocations of earnings retained in an allocated members' equity account, or any one or more of such forms of distribution. Patronage distributions of the Association's earnings may be paid on either a qualified or nonqualified basis, or a combination of both, as determined by the Board. A minimum of 20 percent of the total qualified patronage distribution to any borrower for any fiscal year shall always be paid in cash.

*Transfer*

Classes A and D Preferred, Classes A, B and C Common Stocks, and Classes B and C Participation Certificates may be transferred to persons or entities eligible to purchase or hold such equities.

*Impairment*

Any net losses recorded by the Association shall first be applied against unallocated members' equity. To the extent that such losses would exceed unallocated members' equity, such losses would be applied consistent with the Association's bylaws and distributed pro rata to each share and/or unit outstanding in the class, in the following order:

- a) **First**, Assistance Preferred Stock issued and outstanding (if any);
- b) **Second**, allocated surplus evidenced by nonqualified written notices of allocation, in its entirety, with application to most recent allocation first and then in reverse order until all such allocated surplus has been exhausted;
- c) **Third**, allocated surplus evidenced by qualified written notices of allocation, in its entirety, with application to most recent allocation first and then in reverse order until all such allocated surplus has been exhausted;
- d) **Fourth**, Class A Common and Class B Common Stock, Class C Common Stock, Class E Common Stock, Class C Participation Certificates and Class B Participation Certificates issued and outstanding, pro rata until such stock is fully impaired;
- e) **Fifth**, Class A Preferred and Class D Preferred Stock issued and outstanding, if any.

*Liquidation*

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities should be distributed to the holders of the outstanding stock and participation certificates in the following order:

- a) **First**, to the holders of Class A Preferred and Class D Preferred Stock until an amount equal to the aggregate par value of all shares of said stock then issued and outstanding has been distributed to such holders;
- b) **Second**, to the holders of Class A Common, Class B Common, Class C Common Stock, Class E Common Stock, and Class B Participation Certificates and Class C Participation Certificates, pro rata in proportion to the number of shares or units of each such class of stock or participation certificate then issued and outstanding, until an amount equal to the aggregate par value or face amount of all such shares or units has been distributed to such holders;
- c) **Third**, to the holders of allocated surplus evidenced by qualified written notices of allocation, in the order of year of issuance and pro rata by year of issuance, until the total amount of such allocated surplus has been distributed;
- d) **Fourth**, to the holders of allocated surplus evidenced by nonqualified written notices of allocation, in the order of year of issuance and pro rata by year of issuance, until the total amount of such allocated surplus has been distributed;
- e) **Fifth**, in so far as practicable, all unallocated surplus issued after April 15, 1999, shall be distributed to Patrons of the Association from the period beginning April 15, 1999, through the date of liquidation, on a patronage basis; and
- f) **Sixth**, any remaining assets of the Association after such distributions shall be distributed ratably to the holders of all classes of stock and participation certificates in proportion to the number of shares or units of such class of stock or participation certificates held by such holders.

All distributions to the holders of any class of stock and/or participation certificate holders shall be made pro rata in proportion to the number of shares or units of such class of stock or participation certificates held by such holders.

**E. Other Comprehensive Income (Loss)**

The Association reports other comprehensive income (loss) (OCI) in its consolidated statements of changes in members' equity. The Association recognized OCI of \$334 and \$(303) in 2008 and 2007, respectively, due to SFAS No. 158 (see Note 11 for further information).

**Note 10 — Income Taxes**

The provision (benefit) for income taxes follows:

	Year Ended December 31,		
	2008	2007	2006
Current:			
Federal	\$ -	\$ -	\$ -
State	-	-	-
	-	-	-
Deferred:			
Federal	-	-	12
State	-	-	1
	-	-	13
Total provision (benefit) for income taxes	\$ -	\$ -	\$ 13

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

	December 31,		
	2008	2007	2006
Federal tax at statutory rate	\$ 2,365	\$ 4,213	\$ 3,902
State tax, net	-	-	1
Effect of non-taxable FLCA subsidiary	840	(3,948)	(3,127)
Patronage distributions	(1,805)	(1,586)	(1,228)
Change in valuation allowance	(1,412)	2,724	530
Other	12	(1,403)	(65)
Provision (benefit) for income taxes	\$ -	\$ -	\$ 13

Deferred tax assets and liabilities are comprised of the following at:

	December 31,		
	2008	2007	2006
Deferred income tax assets:			
Allowance for loan losses	\$ 387	\$ 220	\$ 274
Net operating loss – carryforward	1,501	3,064	334
Annual leave	-	-	-
Nonaccrual loan interest	(2)	4	6
Pensions and other postretirement benefits	-	-	-
Deferred incentive	-	-	-
Other	-	-	-
Gross deferred tax assets	1,886	3,288	614
Less: valuation allowance	(1,866)	(3,278)	(554)
Gross deferred tax assets, net of valuation allowance	20	10	60
Deferred income tax liabilities:			
Loan origination fees	(20)	(10)	(60)
Pensions and other postretirement benefits	-	-	-
Gross deferred tax liability	(20)	(60)	(60)
Net deferred tax asset (liability)	\$ -	\$ -	\$ -

At December 31, 2008, deferred income taxes have not been provided by the Association on approximately \$1.2 million of

patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

The Association recorded a valuation allowance of \$1,866, \$3,278 and \$554 during 2008, 2007 and 2006, respectively. The Association will continue to evaluate the realizability of these deferred tax assets and adjust the valuation allowance accordingly.

There were no uncertain tax positions identified related to the current year and the Association has no unrecognized tax benefits at December 31, 2008 for which liabilities have been established. The Association recognizes interest and penalties, if any, related to unrecognized tax benefits as a component of income tax expense. The tax years that remain open for federal and major state income tax jurisdictions are 2005 and forward.

**Note 11 — Employee Benefit Plans**

The employees of the Association may participate in a Districtwide defined benefit retirement plan. This plan is noncontributory and covers substantially all Association employees. Benefits are based on salary and years of service. As a participant in the District's defined benefit plan, the Association funded \$900 for 2008, \$0 for 2007, and \$1 for 2006, through its note payable to the Bank. Plan expenses included in salaries and employee benefits were \$594 for 2008, \$462 for 2007, and \$527 for 2006.

The District sponsors a plan providing certain benefits (primarily health care) to its retirees. Certain Association charges related to this plan are an allocation of District charges based on the Association's proportional share of the plan liability. Postretirement benefits other than pensions (primarily health care benefits) included in salaries and employee benefits were \$169 for 2008, \$162 for 2007 and \$173 for 2006.

Under SFAS No. 158, accounting for the standard follows the plan sponsor, which is at the District entity level for the Districtwide benefit plans in which the Association participates. Therefore, there is no impact to the Association's financial statements due to SFAS No. 158 for the two defined benefit plans discussed above. Additional financial information for the District sponsored plans, including the impact of SFAS No. 158, may be found in Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' 2008 Annual Report.

In addition, supplemental retirement benefits are provided to certain key employees under a supplemental defined benefit executive plan adopted during 2007. Assets have been allocated and separately invested for this plan but are not isolated from the general creditors of the Association.

The supplemental defined benefit executive plan is unfunded and had a projected benefit obligation of \$279 and a net underfunded status of \$279 at December 31, 2008. Net periodic pension cost for the period was \$302. The assumptions used to determine the projected benefit obligation included a discount rate of 6.30 percent.

SFAS No. 158 requires the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. The balance sheet recognition provisions of SFAS No. 158 were adopted at December 31, 2007 by the Association for the single employer supplemental nonqualified plan, resulting in an adjustment of \$303 to accumulated other comprehensive income (AOCI).

SFAS No. 158 also requires that employers measure the benefit obligation and plan assets as of the fiscal year end for fiscal years ending after December 15, 2008. In fiscal 2007 and earlier, a September 30 measurement date was used for pension and other postretirement benefit plans. SFAS No. 158 provides two approaches for an employer to transition to a fiscal year end measurement date. The approach applied by the Association allows for the use of the measurements determined for the prior year end. Under this alternative, pension and other postretirement benefit expense measured for the three-month period October 1, 2007 to December 31, 2007 (determined using the September 30, 2007 measurement date) is reflected as an adjustment to beginning 2008 unallocated retained earnings. As a result, the Association decreased unallocated retained earnings by \$25.

SFAS No. 158 further requires the determination of the fair value of plan assets and recognition of actuarial gains and losses, prior service costs or credits, and transition assets or obligations as a component of AOCI. These amounts are subsequently recognized as components of net periodic benefit costs over time. For 2008, \$334 has been recognized as a net credit to AOCI to reflect these elements.

The Association participates in a defined contribution Districtwide 401(k) plan, which qualifies as a 401(k) plan as defined by the Internal Revenue Code. For employees hired on or prior to December 31, 2002, the Association will contribute \$.50 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. For employees hired on or after January 1, 2003, the Association will contribute \$1.00 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service. Employer contributions to this plan were \$133, \$189, and \$175 for the years ended December 31, 2008, 2007 and 2006, respectively.

#### **Note 12 — Related Party Transactions**

In the ordinary course of business, the Association enters into loan transactions with officers and directors of the Association, their immediate families and other organizations with which such persons may be associated. Such loans are subject to special approval requirements contained in the FCA regulations and are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

Total loans to such persons at December 31, 2008 amounted to \$47,729. During 2008, \$18,605 of new loans were made and repayments totaled \$5,395. In the opinion of management, none of these loans outstanding at December 31, 2008 involved more than a normal risk of collectibility.

#### **Note 13 — Commitments and Contingencies**

The Association has various commitments outstanding and contingent liabilities.

The Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers and to manage their exposure to interest-rate risk. These financial instruments include commitments to extend credit and/or commercial letters of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2008, \$66,663 of commitments to extend credit and \$0 of commercial letters of credit were outstanding.

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the Consolidated Balance Sheets until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. At December 31, 2008, the Association had outstanding \$5,960 of standby letters of credit, with expiration dates ranging from January 5, 2009 to June 5, 2011. The maximum potential amount of future payments the Association may be required to make under these existing guarantees is \$5,960.

A guarantor is required to recognize at the inception of a guarantee, a liability for the fair value of the guarantee commitment. The Association has determined the fair value of the guarantee commitment based upon the fees to be earned over the life of the guarantee. The fair value is updated periodically to reflect changes in individual guarantee amounts and the remaining life to maturity of the individual guarantees in the Association's inventory. At December 31, 2008, the Association's inventory of standby letters of credit had a fair value of \$110.

**Note 14 — Fair Value Measurement**

As described in Note 2, the Association adopted SFAS No. 157 effective January 1, 2008 which expanded the Association's fair value disclosure for certain assets and liabilities measured at fair value on a recurring and non-recurring basis. These assets and liabilities primarily consist of assets held in trust funds, standby letters of credit, and impaired loans.

SFAS No. 157 establishes a fair value hierarchy for disclosure of fair value measurements to maximize the use of observable inputs, that is, inputs that reflect the assumptions market participants would use in pricing an asset or liability based on market data obtained from sources independent of the reporting entity. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The three levels of inputs and the classification of the Association's financial instruments within the fair value hierarchy are as follows:

**Level 1**

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets. The Association's Level 1 assets at December 31, 2008 consist of assets held in trust funds related to a supplemental retirement plan. The trust funds include investments in securities that are actively traded and have quoted net asset value prices that are directly observable in the marketplace.

**Level 2**

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability. The Association has no Level 2 assets or liabilities measured at fair value on a recurring basis at December 31, 2008.

**Level 3**

Level 3 inputs to the valuation methodology are unobservable and supported by little or no market activity. Valuation is determined using pricing models, discounted cash flow methodologies, or similar techniques, and could include significant management judgment or estimation. Level 3 assets and liabilities include instruments whose price has been adjusted based on dealer quoted pricing that is different than the third-party valuation or internal model pricing. Level 3 assets at December 31, 2008 include impaired loans which represent the fair value of certain loans that were evaluated for impairment under SFAS No. 114. The fair value was based upon the underlying collateral since these were collateral-dependent loans. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other

matters. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established. Level 3 liabilities at December 31, 2008 include standby letters of credit whose market value is internally calculated based on information that is not observable either directly or indirectly in the marketplace.

**Assets and Liabilities Measured at Fair Value on a Recurring Basis**

The following table presents the assets and liabilities that are measured at fair value on a recurring basis at December 31, 2008 for each of the fair value hierarchy levels:

	December 31, 2008			Total Fair Value
	Level 1	Level 2	Level 3	
<b>Assets:</b>				
Assets held in trust funds	\$ 143	\$ -	\$ -	\$ 143
Total Assets	\$ 143	\$ -	\$ -	\$ 143
<b>Liabilities:</b>				
Standby letters of credit	\$ -	\$ -	\$ 110	\$ 110
Total Liabilities	\$ -	\$ -	\$ 110	\$ 110

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

	Standby Letters Of Credit
Balance at January 1, 2008	\$ 143
<b>Total gains or (losses) realized/unrealized:</b>	
Included in earnings	-
Included in other comprehensive loss	-
Purchases, sales, issuances and settlements, net	(33)
Transfers in and/or out of level 3	-
Balance at December 31, 2008	\$ 110

**Assets and Liabilities Measured at Fair Value on a Non-recurring Basis**

Assets and liabilities measured at fair value on a non-recurring basis at December 31, 2008 for each of the fair value hierarchy values are summarized below:

	December 31, 2008			Total Fair Value	Total Gains (Losses)
	Level 1	Level 2	Level 3		
<b>Assets:</b>					
Impaired loans	\$ -	\$ -	\$ 6,430	\$ 6,430	\$ (3,177)

**Note 15 — Disclosures About Fair Value of Financial Instruments**

The following table presents the carrying amounts and fair values of the Association's financial instruments at December 31, 2008, 2007 and 2006.

Quoted market prices are generally not available for certain System financial instruments, as described below. Accordingly fair values are based on judgments regarding anticipated cash flows, future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The estimated fair values of the Association's financial instruments are as follows:

	December 31, 2008		December 31, 2007	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>				
Cash	\$ 36	\$ 36	\$ 72	\$ 72
Loans, net of allowance	\$ 417,188	\$ 424,861	\$ 368,190	\$ 373,333
Investment securities	\$ 50,376	\$ 50,540	\$ 30,247	\$ 30,148
Assets held in trust funds	\$ 143	\$ 143	\$ 234	\$ 234
<b>Financial liabilities:</b>				
Notes payable to AgFirst Farm Credit Bank	\$ 412,134	\$ 417,955	\$ 343,677	\$ 346,600

	December 31, 2006	
	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>		
Cash	\$ 63	\$ 63
Loans, net of allowance	\$ 347,533	\$ 350,871
Investment securities	\$ 38,704	\$ 38,387
Assets held in trust funds	\$ -	\$ -
<b>Financial liabilities:</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 334,575	\$ 333,609

A description of the methods and assumptions used to estimate the fair value of each class of the Association's financial instruments for which it is practicable to estimate that value follows:

- A. **Cash:** The carrying value is a reasonable estimate of fair value.
- B. **Loans:** Because no active market exists for the Association's loans, fair value is estimated by discounting the expected future cash flows using the Association's current interest rates at which similar loans would be made to borrowers with similar credit risk. As the discount rates are based on the Bank's loan rates, as well as management estimates, management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale.

For purposes of determining fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics based upon repricing and credit

risk. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

Fair value of loans in a nonaccrual status is estimated to be the carrying amount less specific reserves.

The carrying value of accrued interest approximates its fair value.

- C. **Investment Securities:** Fair value is based upon quoted market price.
- D. **Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** Estimating the fair value of the Association's investment in the Bank and Other Farm Credit Institutions is not practicable because the stock is not traded. As described in Note 5, the net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying Consolidated Balance Sheets. The Association owns 3.60 percent of the issued stock of the Bank as of December 31, 2008 net of any reciprocal investment. As of that date, the Bank's assets totaled \$29.9 billion and shareholders' equity totaled \$1.2 billion. The Bank's earnings were \$217 million during 2008.

In addition, the Association has an investment of \$14,043 related to other Farm Credit institutions.

- E. **Notes Payable to AgFirst Farm Credit Bank:** The notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association's loan receivables plus accrued interest on the notes payable. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.
- F. **Commitments to Extend Credit and Standby Letters of Credit:** The estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics and since the related credit risk is not significant.
- G. **Assets Held in Trust Funds:** See Note 14 for discussion of estimation of fair value for this instrument.

**Note 16 — Quarterly Financial Information (Unaudited)**

Quarterly results of operations for the years ended December 31, 2008, 2007 and 2006 follow:

	<b>2008</b>				
	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth</b>	<b>Total</b>
Net interest income	\$ 2,792	\$ 2,476	\$ 2,341	\$ 2,894	\$ 10,503
Provision for (reversal of allowance for) loan losses	600	460	1,460	1,455	3,975
Noninterest income (expense), net	383	175	513	(643)	428
Net income (loss)	<u>\$ 2,575</u>	<u>\$ 2,191</u>	<u>\$ 1,394</u>	<u>\$ 796</u>	<u>\$ 6,956</u>
	<b>2007</b>				
	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth</b>	<b>Total</b>
Net interest income	\$ 2,666	\$ 2,534	\$ 2,691	\$ 2,645	\$ 10,536
Provision for (reversal of allowance for) loan losses	-	(100)	(150)	130	(120)
Noninterest income (expense), net	179	282	143	1,130	1,734
Net income (loss)	<u>\$ 2,845</u>	<u>\$ 2,916</u>	<u>\$ 2,984</u>	<u>\$ 3,645</u>	<u>\$ 12,390</u>
	<b>2006</b>				
	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth</b>	<b>Total</b>
Net interest income	\$ 2,857	\$ 3,044	\$ 3,088	\$ 2,882	\$ 11,871
Provision for (reversal of allowance for) loan losses	-	-	(112)	(500)	(612)
Noninterest income (expense), net	(592)	(558)	(377)	508	(1,019)
Net income (loss)	<u>\$ 2,265</u>	<u>\$ 2,486</u>	<u>\$ 2,823</u>	<u>\$ 3,890</u>	<u>\$ 11,464</u>

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