



# ANNUAL 2008 REPORT

FINANCING RURAL AMERICA



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# FARM CREDIT OF NORTH FLORIDA, ACA

## 2008 ANNUAL REPORT

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### Management

J. Charles Thompson.....	President
Bernie Krauth.....	Vice President – Chief Credit Manager
Roger Scarborough.....	Vice President – Chief Financial Officer
Bobby Carnley.....	Vice President – Chief Relationship Manager
Julius Davenport.....	Vice President – Loan Policy Manager
Jeffrey Spencer.....	Vice President – Relationship Manager

### Board of Directors

Henry M. Frazee .....	Chairman
Ron St. John .....	Vice Chairman
T. Richard Barber, Jr. ....	Director
Shepherd E. Colledge.....	Director
Roger W. Davis.....	Director
Joseph C. Joyce .....	Director
Douglas Moore.....	Director
Lloyd Register.....	Director
Stanford Robertson .....	Director
Hansel C. Ross.....	Director
Arthur Sandlin.....	Director

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

The most difficult part of writing any message is the beginning and considering all that happened during 2008 knowing where to start is especially challenging. One year ago I wrote about the outlook for 2008, "We all recognize we have come through a period of feverish real estate investment that led to unsustainable increases in prices and growth, and now what? Inventories are high, sales are slow, and prices have declined, or property just hasn't sold. Depending on to whom you listen, the recovery will begin a month ago or 18 months from now. Who really knows? We do know that interest rates are projected to decline, the stock market has taken a hit, and we will be electing congressmen, senators, and a new president in November. To say the least, it should be interesting." Today I can think of much better terms to describe the economy, past and present, than "interesting", but I'd better not use them. It was easy to predict the things I did a year ago, but in no way did I, or anyone else, see the severity of the economic decline that has occurred. Result - economic risk for our customers and the Association has increased. When you examine the information in our report you will find that during 2008 delinquency rates increased, asset quality decreased, and earnings decreased significantly from previous years. The primary causes for the decline in earnings was the lower interest rate environment and the need to increase our allowance for loan losses. The association was profitable in 2008, even with the adversity.

Yes, 2008 was a difficult year, the first since the late '80's and early '90's. Yet, as stated above, the association was profitable, remains adequately capitalized, and has declared a patronage to its membership for the 20<sup>th</sup> consecutive year. Yes, the patronage will be smaller than planned, but as far as I know we are still the only lending institution in our area that will pay any patronage back to our stockholder/borrowers.

It's good to get 2008 behind us, now on to 2009.

### **2009 Outlook**

I don't dare describe the outlook for 2009 as 'interesting'. Extremely uncertain might be a better term, new president, new congress, national and world recession, stock market up one day down the next, financial markets in turmoil, and real estate, no one seems to know. We believe interest rates will remain at present levels throughout the year and some of our borrowers will continue to experience stress. We don't know what the government will do with the trillion plus in economic stimulus or when it will reach its way to North Florida. I can only pray our leaders will make wise decisions and manage our resources for the long term benefit of our country.

What I do know: I know that, Farm Credit of North Florida, has over \$600 million in loans to properly manage and over \$60 million of our stockholders' capital to protect. I also know that we have an outstanding board and staff that are dedicated to serving our customers and community while protecting our investors and stockholders. We will do everything possible to work with our distressed customers to find solutions that are win-win for the customer and association alike. No one really knows when our economy will improve and stabilize. In times like these opportunity for one is adversity for another. Farm Credit was born out of tough economic conditions; yet we've been around since 1916. We're not sure what 2009 will bring, but I am sure Farm Credit will be here to provide sound financial products to our customers and our community.

### **Goals for 2009**

We will continue to seek out good, new business while continuing to provide outstanding service to our existing customers. Included in our service will be our commitment to help financially distressed customers find solutions that are acceptable to both the customer and the association. I strongly urge anyone who is beginning to have difficulties to see their account officer as soon as possible. The earlier problems are identified the higher the probability solutions can be found.

Our **Young, Beginning, and Small Farmer** outreach program is being enhanced. We have formed and budgeted a YBS Action Team for the specific purpose of raising the bar for this very important program.

We will continue our involvement in community service activities throughout our 18 counties. This is who we are, this our community, the place we call home.

In closing, during planning sessions with staff and board, and privately, many times the question of how we could have avoided some of the adversity we have experienced has been asked. I am sure some of you have thought the same thing about your own business. Even if we had stayed on the sideline the economic downturn would have impacted us. Farm Credit of North Florida and the Farm Credit System continue to be solid financial institutions. 2009 will present adversity and opportunity; we are here to serve you.

February 27, 2009



J. Charles Thompson  
President and Chief Executive Officer

## *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 North 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 North 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.



Henry M. Frazee  
Chairman of the Board



J. Charles Thompson  
Chief Executive Officer



Roger Scarborough  
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.



J. Charles Thompson  
Chief Executive Officer



Roger Scarborough  
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	\$ 59	\$ 13	\$ 940	\$ 845	\$ 781
Loans	475,687	470,186	449,836	412,784	378,638
Less: allowance for loan losses	6,877	2,146	1,629	1,622	1,626
Net loans	468,810	468,040	448,207	411,162	377,012
Investments in other Farm Credit institutions	9,804	9,741	9,084	7,018	6,636
Other property owned	2,487	—	—	—	—
Other assets	26,353	29,100	28,758	17,073	11,742
Total assets	<u>\$ 507,513</u>	<u>\$ 506,894</u>	<u>\$ 486,989</u>	<u>\$ 436,098</u>	<u>\$ 396,171</u>
Notes payable to AgFirst Farm Credit Bank*	\$ 421,771	\$ 408,613	\$ 395,346	\$ 352,485	\$ 323,182
Accrued interest payable and other liabilities with maturities of less than one year	14,386	25,762	23,833	21,070	15,381
Total liabilities	<u>436,157</u>	<u>434,375</u>	<u>419,179</u>	<u>373,555</u>	<u>338,563</u>
Protected borrower stock	71	96	143	191	319
Capital stock and participation certificates	1,609	1,713	1,792	1,910	1,839
Retained earnings					
Allocated	40,688	42,708	39,158	33,938	29,566
Unallocated	28,988	28,002	26,717	26,504	25,884
Total members' equity	<u>71,356</u>	<u>72,519</u>	<u>67,810</u>	<u>62,543</u>	<u>57,608</u>
Total liabilities and members' equity	<u>\$ 507,513</u>	<u>\$ 506,894</u>	<u>\$ 486,989</u>	<u>\$ 436,098</u>	<u>\$ 396,171</u>
<b>Statement of Income Data</b>					
Net interest income	\$ 11,041	\$ 13,001	\$ 12,681	\$ 11,037	\$ 9,587
Provision for (reversal of allowance for) loan losses	5,542	512	—	—	(5,190)
Noninterest income (expense), net	(2,944)	(1,963)	(1,741)	(519)	(744)
Net income	<u>\$ 2,555</u>	<u>\$ 10,526</u>	<u>\$ 10,940</u>	<u>\$ 10,518</u>	<u>\$ 14,033</u>
<b>Key Financial Ratios</b>					
Rate of return on average:					
Total assets	0.50%	2.14%	2.38%	2.54%	3.73%
Total members' equity	3.51%	14.81%	16.62%	17.49%	29.54%
Net interest income as a percentage of					
average earning assets	2.27%	2.76%	2.88%	2.78%	2.60%
Net (chargeoffs) recoveries to average loans	(0.169)%	0.001%	0.002%	(0.001)%	(0.004)%
Total members' equity to total assets	14.06%	14.31%	13.92%	14.34%	14.54%
Debt to members' equity (:1)	6.11	5.99	6.18	5.97	5.88
Allowance for loan losses to loans	1.45%	0.46%	0.36%	0.39%	0.43%
Permanent capital ratio	13.59%	14.32%	14.19%	13.81%	12.93%
Total surplus ratio	13.24%	13.93%	13.77%	13.33%	12.40%
Core surplus ratio	12.24%	11.25%	11.53%	11.53%	10.36%
<b>Net Income Distribution</b>					
Estimated patronage refunds:					
Cash	\$ 880	\$ 3,272	\$ 3,267	\$ 3,174	\$ 2,662
Qualified allocated retained earnings	—	—	—	—	154
Nonqualified allocated retained earnings	733	6,348	6,796	5,534	3,989
Nonqualified retained earnings	—	—	572	1,163	1,347

\* General financing agreement is renewable on three-year cycles. The next renewal date is December 31, 2011.

# *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 North 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 North 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, P. O. 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.fcnf.com](http://www.fcnf.com), or by calling 1-800-342-3795, or writing Roger Scarborough, Farm Credit of North Florida, ACA, 12300 NW US HWY 441, Alachua, FL 32615. 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.

### ECONOMIC CONDITIONS

During 2008, economic conditions in our region were slightly unstable.

As agricultural loan demand has increased, turmoil in the overall financial markets, and the banking sector in particular, has caused commercial banks to reduce the amount of available credit to farmers and related businesses. This also has contributed to increased loan demand in the Association and throughout the Farm

Credit System. A seasoned, knowledgeable lending staff and the inherent value of patronage paid under the cooperative structure have positioned the Association to compete effectively for this expanded business while retaining current members and their business relationships.

For the year December 31, 2008, the credit quality of the loan portfolio continued to be good with only slight adverse movements in some quality measures compared to earlier reporting periods. The increased volatility in the financial markets and the generally weaker economy experienced over the past twelve months have not affected either the overall farm sector or the Association's customers in a substantially negative way.

To the extent there has been any recent credit quality deterioration, that deterioration is largely driven by rapidly increasing input costs. Higher fuel costs have adversely impacted all producers. Higher feed costs have been problematic for the livestock and poultry industries. Industries tied to housing such as forestry, sawmills, sod, and landscape nurseries saw demand plummet and profitability compromised. Over time, the higher inputs will either be passed on to the consumer or production will be cut to ensure the supply produced will clear the market at prices that will generate a profit. Although the credit quality of the Association loan portfolio has been only slightly negatively impacted to date by the factors mentioned above, the risk of future deterioration is increasing. During 2008, the Association targeted certain areas of our business with hopes of increasing market share. Continued efforts are being made to expand services, increase public knowledge of our services and streamline our current delivery of products to enhance our existing portfolio.

### 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	December 31,					
	2008		2007		2006	
	<i>(dollars in thousands)</i>					
Real estate mortgage	\$ 327,088	68.76%	\$ 326,391	69.42%	\$ 307,172	68.29%
Production and intermediate-term	98,721	20.75	102,829	21.87	113,401	25.20
Processing and marketing	10,895	2.29	8,327	1.77	2,310	0.52
Farm-related business	26,816	5.64	22,572	4.80	16,051	3.57
Energy	599	0.13	609	0.13	598	0.14
Rural residential real estate	11,568	2.43	9,458	2.01	10,304	2.28
Total	\$ 475,687	100.00%	\$ 470,186	100.00%	\$ 449,836	100.00%

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
Alachua	53.15%	52.22%	52.42%
Lake City	1.88	2.08	2.35
Live Oak	13.49	13.68	13.35
Ocala	9.68	10.01	10.49
Palatka	17.85	17.60	15.83
Trenton	3.95	4.41	5.56
	100.00%	100.00%	100.00%

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 forestry, equine, and livestock, which constitute over 61 percent of the entire portfolio.

Commodity Group	December 31,					
	2008		2007		2006	
	<i>(dollars in thousands)</i>					
Forestry	\$ 191,225	40%	\$ 196,020	42%	\$ 183,834	41%
Equine	54,119	11	54,852	12	50,710	11
Livestock	49,408	10	56,746	12	57,180	13
Other	43,381	9	28,620	6	26,234	6
Horticulture/Nurseries	32,010	7	35,328	8	29,121	6
Field/Grain	29,690	6	30,118	6	26,778	6
Dairy	26,729	6	23,697	5	28,585	6
Fruit, Nut and Vegetable	25,551	5	20,715	4	22,799	5
Rural Home	8,805	2	9,266	2	9,967	2
Potatoes	4,989	1	5,200	1	5,235	1
Poultry	6,810	1	6,239	1	5,437	1
Tobacco	2,970	1	3,385	1	3,956	1
Total	\$ 475,687	100%	\$ 470,186	100%	\$ 449,836	100%

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 forestry producers. Although a large percentage of the loan portfolio is concentrated in these enterprises, many of these operations are diversified within their enterprise and/or with crop production that reduces overall risk exposure. Demand for beef, prices of field grains, and international trade are some of the factors affecting the price of these commodities. 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 real estate financing. The association continues to attract large real estate loans in addition to normal business.

For the past few years, the Association has experienced a shift in loan assets. 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 heavily influenced by

operating-type loans, normally reaches a peak balance in August and rapidly declines in the fall months as commodities are marketed and proceeds are applied to repay operating loans.

During 2008, the Association continued 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 is intended to strengthen our capital position.

Loan Participations:	December 31,		
	2008	2007	2006
	<i>(dollars in thousands)</i>		
Participations Purchased			
– FCS Institutions	\$ 33,012	\$ 33,264	\$ 31,789
Participations Purchased			
– Non-FCS Institutions	83	480	432
Participations Sold	(200,188)	(163,276)	(135,420)
Total	<u>\$(167,093)</u>	<u>\$(129,532)</u>	<u>\$(103,199)</u>

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 for the period ended December 31, 2008.

The Association sells qualified long-term mortgage loans into the secondary market. For the period ended December 31, 2008, the Association originated loans for resale totaling \$7,772, which were sold into the secondary market. The Association also participates in the Farmer Mac Long Term Stand-By Commitment program. Farmer Mac was established by Congress to provide liquidity to agricultural lenders. At December 31, 2008, December 31, 2007, and December 31, 2006 the Association had loans amounting to \$27,203, \$27,406 and \$22,845, respectively, that were 100 percent guaranteed by Farmer Mac.

### MISSION-RELATED INVESTMENTS

During 2005, the FCA initiated an investment program to stimulate economic growth and development in rural areas. The FCA outlined a program to allow System institutions to hold such investments, subject to approval by the FCA on a case-by-case basis. FCA approved the Rural America Bonds pilot and the Tobacco Buyout Program under the mission-related investments umbrella, as described below.

In October 2005, the FCA authorized AgFirst and the Associations to make investments in Rural America Bonds under a three-year pilot period. Rural America Bonds may include debt obligations issued by public and private enterprises, corporations, cooperatives, other financing institutions, or rural lenders where the proceeds would be used to support agriculture, agribusiness, rural housing, or economic development, infrastructure, or community development and revitalization projects in rural areas. Examples include investments that fund value-added food and fiber processors and marketers, agribusinesses, commercial enterprises that create and maintain employment opportunities in rural areas, community services, such as schools, hospitals, and government facilities, and other activities that sustain or revitalize rural communities and their economies. The objective of this pilot program is to help meet the growing and diverse

financing needs of agricultural enterprises, agribusinesses, and rural communities by providing a flexible flow of money to rural areas through bond financing. These bonds may be classified as Loans or Investments on the Consolidated Balance Sheets depending on the nature of the investment. As of December 31, 2008, December 31, 2007, and December 31, 2006 the Association had \$941, \$1,053 and \$235, respectively, in Rural America Bonds, and they are classified as Loans on the Consolidated Balance Sheets.

On October 22, 2004, Congress enacted the “Fair and Equitable Tobacco Reform Act of 2004” (Tobacco Act) as part of the “American Jobs Creation Act of 2004.” The Tobacco Act repealed the Federal tobacco price support and quota programs, provided for payments to tobacco “quota owners” and producers for the elimination of the quota and included an assessment mechanism for tobacco manufacturers and importers to pay for the buyout. Tobacco quota holders and producers will receive equal annual payments under a contract with the Secretary of Agriculture. The Tobacco Act also includes a provision that allows the quota holders and producers to assign to a “financial institution” the right to receive the contract payments (Successor-in-Interest Contracts (SIIC)) so that they may obtain a lump sum or other payment. On April 4, 2005, the United States Department of Agriculture (USDA) issued a Final Rule implementing the “Tobacco Transition Payment Program” (Tobacco Buyout). At December 31, 2008, December 31, 2007, and December 31, 2006 the Association had \$12,650, \$14,199 and \$14,054, respectively, in SIIC outstanding net of discount and these are classified as Other Investments on the Consolidated Balance Sheets.

### 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. 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	96.00%	98.74%	99.63%
Substandard	4.00%	1.26%	0.37%
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	\$ 11,283	\$ 2,128	\$ 1,091
Restructured loans	579	–	–
Accruing loans 90 days past due	363	–	–
Accruing loans less than 90 days past due	–	1,177	–
Total high-risk loans	12,225	3,305	1,091
Other property owned	2,487	–	–
Total high-risk assets	\$ 14,712	\$ 3,305	\$ 1,091
<b>Ratios</b>			
Nonaccrual loans to total loans	2.37%	0.44%	0.24%
High-risk assets to total assets	2.90%	0.42%	0.22%

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 \$9,155 or 430.22 percent in 2008. This increase resulted from primarily from a slowdown in the general economy, particularly a decline in real estate sale activity. Of the \$11,283 in nonaccrual volume at December 31, 2008, \$411 or 3.64 percent, compared to 12.73 percent and 38.22 percent 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 increase in other property owned is the result of one large borrower who defaulted and chose to provide the association a deed-in-lieu of foreclosure.

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	\$ 2,146	\$ 1,629	\$ 1,622
Charge-offs:			
Real estate mortgage	(749)	–	(2)
Production and intermediate-term	(4)	–	(2)
Rural residential real estate	(64)	–	–
Total charge-offs	(817)	–	(4)
Recoveries:			
Real estate mortgage	2	3	2
Production and intermediate-term	4	2	9
Total recoveries	6	5	11
Net (charge-offs) recoveries	(811)	5	7
Provision for (reversal of allowance for) loan losses	5,542	512	–
Balance at end of year	\$ 6,877	\$ 2,146	\$ 1,629
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	(0.169)%	0.001%	0.002%

The net charge-offs are the result of loan restructuring activity. Of the net charge offs, the majority involved deeds in lieu of foreclosure where the collateral value decreased from the time of the loan origination, resulting in inadequately secured loans.

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	\$ 5,429	\$ 1,496	\$ 1,110
Production and intermediate-term	912	422	416
Agribusiness	466	191	67
Energy	3	2	2
Rural residential real estate	67	35	34
<b>Total loans</b>	<b>\$ 6,877</b>	<b>\$ 2,146</b>	<b>\$ 1,629</b>

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	1.45%	0.46%	0.36%
Nonperforming loans	60.06%	101%	149%
Nonaccrual loans	60.95%	101%	149%

Please refer to Note 3, "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 \$11,041 million, \$13,001 million and \$12,681 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:

	Volume*	Rate	Nonaccrual		Total
			Income		
	<i>(dollars in thousands)</i>				
<b>12/31/08 - 12/31/07</b>					
Interest income	\$ 1,265	\$ (8,362)	\$ 108		\$ (6,989)
Interest expense	1,252	(6,281)	-		(5,029)
Change in net interest income	\$ 13	\$ (2,081)	\$ 108		\$ (1,960)
<b>12/31/07 - 12/31/06</b>					
Interest income	\$ 2,392	\$ 563	\$ (80)		\$ 2,875
Interest expense	1,599	957	-		2,556
Change in net interest income	\$ 793	\$ (394)	\$ (80)		\$ 319

- *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			Percentage	
	December 31,			2008/	2007/
	2008	2007	2006	2007	2006
	<i>(dollars in thousands)</i>				
Loan fees	\$ 1,108	\$ 1,397	\$ 1,412	(20.69)%	(1.06)%
Fees for financially related services	20	17	25	17.65	(32.00)
Patronage refund from other Farm Credit Institutions	3,959	4,837	4,376	(18.15)	10.53
Gains (losses) on other property owned, net	(96)	-	-	-	-
Gains (losses) on sales of rural home loans	75	39	59	92.31	(33.89)
Gains (losses) from sales of premises and equipment, net	(11)	(12)	(2)	(8.33)	5.00
Other noninterest income	116	122	255	(4.92)	(52.15)
<b>Total noninterest income</b>	<b>\$ 5,171</b>	<b>\$ 6,400</b>	<b>\$ 6,125</b>	<b>(19.20)</b>	<b>4.49%</b>

The decrease in loans fees is primarily due to a decline in residential lending activity involving loans originated and then sold into the secondary market. Fee income on loan participations sold also declined.

The decrease in patronage refunds from other Farm Credit institutions is a result of reduced patronage declared by the buying institutions on loan participations originated and sold by Farm Credit of North Florida.

### 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			Percentage	
	December 31,			2008/	2007/
	2008	2007	2006	2007	2006
	<i>(dollars in thousands)</i>				
Salaries and employee benefits	\$ 4,685	\$ 5,074	\$ 4,927	(7.67)%	2.98%
Occupancy and equipment expense	707	705	640	0.28	10.15
Insurance Fund premium	699	681	633	2.64	7.58
Other operating expense	1,970	1,888	1,700	4.34	11.06
<b>Total noninterest expense</b>	<b>\$ 8,061</b>	<b>\$ 8,348</b>	<b>\$ 7,900</b>	<b>(3.44)</b>	<b>5.67%</b>

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.

Insurance Fund premiums increased 2.64 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.

Other operating expense increased 4.34 percent for the twelve months ended December 31, 2008, compared to the same period of 2007. This increase is primarily due to increased data processing expense and increased advertising and public and member relations expense.

*Income Taxes*

The Association recorded a provision for income taxes of \$54 for the year ended December 31, 2008, as compared to a provision of \$15 for 2007 and a benefit of (\$34) 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	0.50%	2.14%	2.38%
Return on average members' equity	3.51%	14.81%	16.62%
Net interest income as a percentage of average earning assets	2.27%	2.76%	2.88%
Net (charge-offs) recoveries to average loans	(0.169)%	0.001%	0.002%

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 \$421,771 as compared to \$408,613 at December 31, 2007 and \$395,346 at December 31, 2006. The increase of 3.22 percent compared to December 31, 2007 and the increase of 6.68 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 \$421,004, \$401,000 and \$374,449 for the years ended December 31, 2008, 2007, and 2006, 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 participation in the Farmer Mac Long-term Standby Commitment program, 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.

*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 8 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 Sources" 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, decreased (1.60) percent to \$71,356 from the December 31, 2007, total of \$72,519. The decrease from 2007 to 2008 was primarily attributed to net income being less than the total retirement of allocated retained earnings in 2008 and estimated cash patronage to be distributed in 2009.

At December 31, 2007, total members' equity increased to \$72,519 or 6.94 percent from the December 31, 2006 total of \$67,810. The increase is the result of net income being more than the total retirement of allocated retained earnings in 2007 and estimated cash patronage to be distributed in 2008.

Total capital stock and participation certificates were \$1,609 on December 31, 2008, compared to \$1,713 on December 31, 2007 and \$1,792 on December 31, 2006. The decrease was attributed to more capital stock and participation certificates being retired than issued.

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 standards 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	13.59%	14.32%	14.19%	7.00%
Total surplus ratio	13.24%	13.93%	13.77%	7.00%
Core surplus ratio	12.24%	11.25%	11.53%	3.50%

The decrease in the Association's permanent capital and total surplus ratios for December 31, 2008 was attributed to insufficient earnings to capitalize the growth in risk adjusted assets. The core surplus ratio increased as a result of the association increasing the revolvment cycle of allocated surplus. This allowed the surplus to be counted as a part of core surplus in the capital calculations. 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, and (b) participation loans purchased, 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 \$1,613 in 2008, \$9,620 in 2007, and \$10,635 in 2006. The significant decrease in patronage distributions from 2007 to 2008 is attributed to a decrease in earnings primarily because of provisions made to the allowance for loan losses.

**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 were established and met.

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	168	\$24,066
Beginning	499	76,637
Small	1,053	125,237

*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 15,566 reported farmers of which by definition 2,505 or 16.00 percent were Young, 3,951 or 25.00 percent were Beginning, and 9,110 or 59.00 percent were Small. Comparatively, as of December 31, 2008, the demographics of the Association's agricultural portfolio contained 1,720 YBS farmers, of which by definition 168 or 9.77 percent were Young, 499 or 29.01 percent were Beginning and 1,053 or 61.22 percent were Small.

The Association is committed to the future success of young, beginning and small farmers. In addition to our marketing strategies, in 2008 the Association continued to promote and operate a YBS program assisting young, beginning and small farmers through marketing, outreach and financial support programs.

The YBS Committee, coordinates the Association's program, including setting YBS goals in the annual strategic plan, and reporting on those goals and achievements to the Board of Directors on a quarterly basis. Additional staff members in each of the Association's regions have been designated to be a part of the Association YBS Program, bringing additional knowledge about their respective communities. The Association is committed to the future success of young, beginning and small farmers.

Educational experiences are made available to YBS farmers through programs both in-house and events held outside the association. Outside speakers and educational materials are provided in some cases. YBS topics are included in all industry and tradeshow activities conducted by the Association. The team has a goal to expand our relationship with IFAS and the University of Florida by helping sponsor programs that reach YBS farmers in our area. The Association website, [www.fcfnf.com](http://www.fcfnf.com), includes an entire section of information and resources for YBS visitors.

The Association sponsors many activities involving youth groups, including 4-H and FFA organizations. The YBS Team is preparing "classroom" presentations for various FFA chapters in our territory. For 2009 the Board of Directors approved a Scholarship program. We will be granting five \$1,000 scholarships to individuals attending college that plan to pursue a degree in agriculture or agribusiness.

The Association also offers flexible financing options in-house for qualified YBS borrowers. Special lending programs have been set-up to assist YBS farmers including Farm Service

Agency (FSA) guaranteed programs. For 2009 the Board of Directors approved the implementation of a Youth Fair Livestock loan program to assist youth in 4-H and FFA purchase animals for youth fair projects. The goal of the loan program is to not only help the youth with financing, but also to teach them about borrowing money and repaying a loan.

- \* 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 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>
12300 U. S. Highway 441 Alachua	Administrative	Owned
1606 Canyon Avenue Live Oak	Branch	Owned
5075 N.W. U.S. Highway 27 Ocala	Branch	Owned
309 North 2nd Street Palatka	Branch	Owned
511 South Main Street Trenton	Branch	Owned
826 SW Main Blvd., Suite 102 Lake City	Branch	Leased*

\* *During January 2003, the association signed a five-year lease agreement. January 1, 2008, the association signed a lease extension agreement. The term will be month to month, with the right of either party to terminate the lease at anytime, upon 60 days written notice.*

## **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:

<u>Senior Officer</u>	<u>Position</u>
J. Charles Thompson	<i>President and Chief Executive Officer since January 1989</i>
Bernie Krauth	<i>Vice President and Chief Lending Officer since April 2004</i>
Roger Scarborough	<i>Vice President and Chief Financial Officer since November 1998</i>
Bobby W. Carnley	<i>Vice President and Chief Relationship Manager since March 2004</i>
Julius Davenport	<i>Vice President and Director of Credit Administration since April 2001</i>
Jeffrey Spencer	<i>Vice President and Relationship Manager since September 1997</i>

The business experience for the past five years for senior officers is with the Farm Credit System.

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*	
J. Charles Thompson	2008	\$206,046	\$ -	-	\$5,104	\$211,150
J. Charles Thompson	2007	\$198,122	\$ 50,000	-	-	\$248,122
J. Charles Thompson	2006	\$188,687	\$ 55,000	-	-	\$243,687
5	2008	\$519,882	\$ -	-	-	\$519,882
5	2007	\$486,253	\$ 93,559	-	-	\$579,812
5	2006	\$459,510	\$ 85,017	-	-	\$552,109

\* Amounts in the above table classified as Perquisites include travel incentives, group life insurance, automobile compensation, purchased automobile, spousal travel, relocation and tuition reimbursement. Amounts in the above table classified as other include amounts contributed by the Association on behalf of the senior officer to a defined contribution plan unless the plan is made available to all employees on the same basis. FCA regulations do not require disclosure of the amounts contributed to a 401K that is applicable to all employees. For the year ended December 31, 2008, our Association has no contributions of this type other than the 401K plan made available to all employees.

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, employees and senior officers can earn additional bonus compensation under an annual incentive plan which is tied to the overall business performance and the individual's performance appraisal rating. The incentive plan is based on a fiscal year and is designed to motivate employees to exceed performance targets established by the Board of Directors. 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.

The Association has in place an incentive bonus plan that rewards employees for outstanding performance. All employees, but the President, Chief Lending Officer and Chief Financial Officer are covered by the plan.

The plan requires the Association exceed its business plan projected earnings and meet minimum performance levels in the areas of (1) Asset Growth, (2) Asset Quality, (3) Work Quality (Credit Administration), and (4) Efficiency, as measured by the relationship of operating expense to net interest income. These scores are calculated on an Association and loan officer basis. The plan is calculated on a calendar year and is paid after year-end results are tabulated.

The percentage award is a fraction of the amount by which earnings exceed the target and the number of points earned in all performance categories.

The Association also has a discretionary bonus award program which covers all employees. It is awarded on an individual basis, is based on measured contribution to the Association, and must be approved by the Board of Directors or the Board's Compensation Committee. Awards may be in the form of cash, gifts, or recognition.

Bonuses are shown in the year earned, which may be different than the year of payment.

### 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
Henry M. Frazee, <i>Chairman</i>	1976	2009	\$ 16,106
Ron St. John, <i>Vice Chairman</i>	1992	2010	10,076
T. Richard Barber	2005	2011	13,368
Shepherd C. Colledge, <i>Outside Director</i>	1990		31,527
Roger W. Davis	1998	2010	11,362
Joseph C. Joyce	2008		5,884
Douglas Moore	2001	2011	13,390
Lloyd Register	1997	2009	18,346
Stanford Robertson	2001	2009	10,339
Hansel C. Ross	1993	2011	11,890
Arthur Sandlin	1995	2010	<u>20,650</u>
			\$ 162,938

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.

### Directors

Directors and senior officers 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 \$44,592 for 2008, \$43,221 for 2007 and \$49,267 for 2006.

Subject to approval by the board, the Association may allow directors honoraria of \$400 for attendance at meetings, committee meetings, or special assignments. However, committees meeting prior to or after a board meeting or another committee meeting, compensation for those meetings will be compensated at a rate of \$200, the board chairman and each regular member of the Executive Committee also receive during the first month of each quarter a \$1,000 retainer fee and all directors receive a \$500 quarterly retainer fee. Independent Directors receive an additional \$1,000 quarterly retainer fee in addition to other compensation they may receive. Total compensation paid to directors as a group was \$162,938.

The following represents certain information, as required by Federal Regulation, regarding the directors of the Association:

**Henry M. Frazee**, Chairman, is a Real Estate sales consultant, and has been involved in timberland and real estate development and sales for the past five years and serves on the West Putnam Lakes, Inc. and H & P Enterprize boards. During 2008, he served 11 days at Association board meetings and 16 days in other official activities and was paid \$16,106. His term of office is 2006 – 2009.

**Ron St. John**, Vice Chairman, has been a dairy farmer for the past five years and serves on the Southeast Milk Cooperative board (agriculture organization), and serves on the board of the Trenton Medical Center (medical). During 2008, he served 8 days at Association board meetings and 9 days in other official activities and was paid \$10,076. His term of office is 2007 – 2010.

**T. Richard Barber, Jr.** has been a peanut, melon, and cattle rancher for the past five years and serves on the SouthTrust Bank Board. During 2008, he served 11 days at Association board meetings and 15 days in other official activities and was paid \$13,368. His term of office is 2008 – 2011.

**Shepherd E. Colledge** has been a real estate developer for the past five years. During 2008, he served 11 days at Association board meetings and 46 days in other official activities and was paid \$31,527. Mr. Colledge is currently an appointed director.

**Roger W. Davis** has been a tobacco and cattle farmer for the past five years. During 2008, he served 10 days at Association board meetings and 13 days in other official activities and was paid \$11,362. His term of office is 2007 – 2010.

**Joseph C. Joyce** has been an Associate Vice President for internal affairs at the University of Florida for the past five years. He serves on the board of the Florida Aquatic Plant Management Society Foundation (education). During 2008, he served 5 days at Association board meetings and 2 days in other official activities and was paid \$5,884. Mr. Joyce is currently an appointed director.

**Douglas Moore** has been a dairy, forestry, and cattle farmer for the past five years and serves on the boards of Northpoint Services (construction), T. M. Livestock (real estate), South Prong Hunt Club (hunt club). During 2008, he served 11 days at Association board meetings and 15 days in other official activities and was paid \$13,390. His term of office is 2008 – 2011.

**Lloyd Register** has been a dairy, beef, hay, and timber farmer for the past five years and serves on the board of the Baker County Farm Bureau Association (agriculture organization). During 2008, he served 11 days at Association board meetings and 27 days in other official activities and was paid \$18,346. His term of office is 2006 – 2009.

**Stanford Robertson** has been a potato farmer for the past five years and serves on the Flagler County Farm Bureau board (agriculture organization). During 2008, he served 9 days at Association board meetings and 10 days in other official activities and was paid \$10,339. His term of office is 2006 – 2009.

**Hansel C. Ross** has been a peanut and tree farmer for the past five years. During 2008, he served 11 days at Association board meetings and 14 days in other official activities and was paid \$11,890. His term of office is 2008 – 2011.

**Arthur Sandlin** has been a peanut farmer and cattle rancher for the past five years and serves on the board of the Perkins State Bank. During 2008, he served 9 days at Association board meetings and 30 days in other official activities and was paid \$20,650. His term of office is 2007 – 2010.

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*		
Henry M. Frazee, <i>Chairman</i>	11	16	Audit, Compensation	\$ 5,400
Ron St. John, <i>Vice-Chairman</i>	8	9	Audit	3,800
T. Richard Barber, Jr.	11	15	Audit	5,400
Shepherd C. Colledge	11	46	Audit, Compensation, Executive, Governance	14,200
Roger W. Davis	10	13	Audit	4,600
Joseph C. Joyce	5	2	Audit	800
Douglas Moore	11	15	Compensation, Governance	5,000
Lloyd Register**	11	27	Compensation	10,400
Stanford Robertson	9	10	Compensation	3,400
Hansel Ross	11	14	Governance	4,600
Arthur Sandlin	9	30	Executive, Governance	10,000
				\$ 67,600

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

\*\* Lloyd Register serves on the Horizons Committee as one of the association representatives and is a member of the District Advisory Committee which meets annually.

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.

#### 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 incurred by the Association for services rendered by its independent auditor for the year ended December 31, 2008 were as follows:

<i>(dollars in thousands)</i>	<b>2008</b>
<b><i>Independent Auditor</i></b>	
PricewaterhouseCoopers LLP	
Audit services	\$ 55,068
Nonaudit services	<u>1,467</u>
 Total	 <u>\$ 56,535</u>

Audit fees were for the annual audit of the consolidated financial statements.

Nonaudit services were for the training of association staff on high risk accounting guidelines.

**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 1-800-342-3795 or writing Roger Scarborough at Farm Credit of North Florida, 12300 NW US Highway 441, Alachua, FL 32615 or accessing the web site, [www.fcncf.com](http://www.fcncf.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 North Florida, ACA (Association) 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:



Shepherd E. Colledge  
Chairman of the Audit Committee

### **Members of Audit Committee**

T. Richard Barber  
Shepherd E. Colledge  
Roger W. Davis  
Henry M. Frazee  
Joseph C. Joyce  
Ron St. John

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 North 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 North 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	\$ 59	\$ 13	\$ 940
Loans	475,687	470,186	449,836
Less: allowance for loan losses	6,877	2,146	1,629
Net loans	468,810	468,040	448,207
Other investments	12,650	14,199	14,054
Accrued interest receivable	3,293	4,167	4,050
Investments in other Farm Credit institutions	9,804	9,741	9,084
Premises and equipment, net	2,855	2,984	3,009
Other property owned, net	2,487	—	—
Due from AgFirst Farm Credit Bank	3,688	4,051	3,642
Other assets	3,867	3,699	4,003
Total assets	\$ 507,513	\$ 506,894	\$ 486,989
<b>Liabilities</b>			
Notes payable to AgFirst Farm Credit Bank	\$ 421,771	\$ 408,613	\$ 395,346
Accrued interest payable	1,387	1,991	1,990
Patronage refund payable	929	3,313	3,300
Advanced conditional payments	8,074	14,444	11,389
Other liabilities	3,996	6,014	7,154
Total liabilities	436,157	434,375	419,179
Commitments and contingencies			
<b>Members' Equity</b>			
Protected borrower stock	71	96	143
Capital stock and participation certificates	1,609	1,713	1,792
Retained earnings			
Allocated	40,688	42,708	39,158
Unallocated	28,988	28,002	26,717
Total members' equity	71,356	72,519	67,810
Total liabilities and members' equity	\$ 507,513	\$ 506,894	\$ 486,989

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>			
Loans	\$ 30,438	\$ 37,362	\$ 34,514
Other investments	674	739	712
Total interest income	31,112	38,101	35,226
<b>Interest Expense</b>			
Notes payable to AgFirst Farm Credit Bank	19,758	24,437	21,962
Other	313	663	583
Total interest expense	20,071	25,100	22,545
Net interest income	11,041	13,001	12,681
Provision for (reversal of allowance for) loan losses	5,542	512	—
Net interest income after provision for (reversal of allowance for) loan losses	5,499	12,489	12,681
<b>Noninterest Income</b>			
Loan fees	1,108	1,397	1,412
Fees for financially related services	20	17	25
Patronage refund from other Farm Credit institutions	3,959	4,837	4,376
Gains (losses) on other property owned, net	(96)	—	—
Gains (losses) on sales of rural home loans, net	75	39	59
Gains (losses) on sales of premises and equipment, net	(11)	(12)	(2)
Other noninterest income	116	122	255
Total noninterest income	5,171	6,400	6,125
<b>Noninterest Expense</b>			
Salaries and employee benefits	4,685	5,074	4,927
Occupancy and equipment	707	705	640
Insurance Fund premiums	699	681	633
Other operating expenses	1,970	1,888	1,700
Total noninterest expense	8,061	8,348	7,900
Income before income taxes	2,609	10,541	10,906
Provision (benefit) for income taxes	54	15	(34)
Net income	\$ 2,555	\$ 10,526	\$ 10,940

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

# Consolidated Statements of Changes in Members' Equity

<i>(dollars in thousands)</i>	Protected Borrower Stock	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2005	\$ 191	\$ 1,910	\$ 33,938	\$ 26,504		\$ 62,543
Net income				10,940		10,940
Protected borrower stock retired	(48)					(48)
Capital stock/participation certificates issued/(retired), net		(118)				(118)
Patronage distribution						
Cash				(3,267)		(3,267)
Nonqualified allocated retained earnings			6,796	(6,796)		—
Nonqualified retained earnings			572	(572)		—
Retained earnings retired			(2,193)			(2,193)
Patronage distribution adjustment			45	(92)		(47)
Balance at December 31, 2006	143	1,792	39,158	26,717	—	67,810
Net income				10,526		10,526
Protected borrower stock retired	(47)					(47)
Capital stock/participation certificates issued/(retired), net		(79)				(79)
Patronage distribution						
Cash				(3,272)		(3,272)
Nonqualified allocated retained earnings			6,348	(6,348)		—
Retained earnings retired			(2,455)			(2,455)
Patronage distribution adjustment			(343)	379		36
Balance at December 31, 2007	96	1,713	42,708	28,002	—	72,519
Net income				2,555		2,555
Protected borrower stock retired	(25)					(25)
Capital stock/participation certificates issued/(retired), net		(104)				(104)
Patronage distribution						
Cash				(880)		(880)
Nonqualified allocated retained earnings			733	(733)		—
Retained earnings retired			(2,455)			(2,455)
Patronage distribution adjustment			(298)	44		(254)
Balance at December 31, 2008	\$ 71	\$ 1,609	\$ 40,688	\$ 28,988	\$ —	\$ 71,356

*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	\$ 2,555	\$ 10,526	\$ 10,940
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	397	386	341
Premium amortization/discount accretion on other investments	(674)	(739)	(712)
Provision for (reversal of allowance for) loan losses	5,542	512	—
(Gains) losses on other property owned, net	96	—	—
(Gains) losses on sales of premises and equipment, net	11	12	2
(Gains) losses on sales of rural home loans, net	(75)	(39)	(59)
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	874	(117)	(897)
(Increase) decrease in due from AgFirst Farm Credit Bank	363	(409)	259
(Increase) decrease in other assets	(93)	343	390
Increase (decrease) in accrued interest payable	(604)	1	474
Increase (decrease) in other liabilities	(2,018)	(1,140)	1,338
Total adjustments	3,819	(1,190)	1,136
Net cash provided by (used in) operating activities	6,374	9,336	12,076
<b>Cash flows from investing activities:</b>			
Net (increase) decrease in loans	(8,905)	(20,345)	(37,045)
(Increase) decrease in investment in other Farm Credit institutions	(63)	(657)	(2,066)
Purchases of other investments	(142)	(1,506)	(12,575)
Proceeds from payments received on other investments	2,365	2,100	1,833
Purchases of premises and equipment	(288)	(378)	(269)
Proceeds from sales of premises and equipment	9	5	2
Proceeds from sales of other property owned	10	—	—
Net cash provided by (used in) investing activities	(7,014)	(20,781)	(50,120)
<b>Cash flows from financing activities:</b>			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	13,158	13,267	42,861
Net increase (decrease) in advanced conditional payments	(6,370)	3,055	874
Protected borrower stock retired	(25)	(47)	(48)
Capital stock and participation certificates issued/(retired), net	(104)	(79)	(118)
Patronage refunds and dividends paid	(3,518)	(3,223)	(3,237)
Retained earnings retired	(2,455)	(2,455)	(2,193)
Net cash provided by (used in) financing activities	686	10,518	38,139
Net increase (decrease) in cash	46	(927)	95
Cash, beginning of period	13	940	845
Cash, end of period	\$ 59	\$ 13	\$ 940
<b>Supplemental schedule of non-cash activities:</b>			
Financed sales of other property owned	\$ 704	\$ —	\$ —
Loans transferred to other property owned	3,297	—	—
Cash dividends or patronage distributions declared or payable	880	3,272	3,267
<b>Supplemental information:</b>			
Interest paid	\$ 20,675	\$ 25,099	\$ 22,071
Taxes (refunded) paid, net	42	26	—

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 North Florida, ACA (the Association) 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 Alachua, Baker, Bradford, Clay, Columbia, Dixie, Duval, Flagler, Gilchrist, Hamilton, Lafayette, Levy, Marion, Nassau, Putnam, St. Johns, Suwannee and Union 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.

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).

## 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 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. **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.

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.

- C. **Other Investments:** Other investments include Tobacco Buyout Successor-in-Interest Contracts (SIIC), which qualify as mission related investments under FCA regulations. Under the SIIC, the tobacco quota holders and producers may sell their rights to receive SIIC contract payments to a third party. The successor purchases the entire contract and all related rights and obligations associated with the contract. These investments in SIIC are purchased at a discount. Contract payments are made by the United States Department of Agriculture (USDA) in equal annual payments. Interest income is recognized from the accretion of discounts using the effective interest method.
- D. **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.

- E. **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.
- F. **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. The estimated useful lives of buildings and improvements primarily range from 10 to 40 years, with the majority in the range of 15 to 40 years. The estimated useful lives of furniture and equipment primarily range from three to 10 years, with the majority in the range of five to 10 years. Gains and losses on dispositions are reflected in current earnings. Maintenance and repairs are charged to expense and improvements are capitalized.
- G. **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.
- H. **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.

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. Substantially all employees may become eligible for these benefits if they reach early retirement age while working for the Association.

- I. **Income Taxes:** 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.

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

**L. Recently Issued Accounting Pronouncements:**

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 — Loans and Allowance for Loan Losses**

A summary of loans follows:

	December 31,		
	2008	2007	2006
Real estate mortgage	\$ 327,088	\$ 326,391	\$ 307,172
Production and intermediate term	98,721	102,829	113,401
Processing and marketing	10,895	8,327	2,310
Farm related business	26,816	22,572	16,051
Energy	599	609	598
Rural residential real estate	11,568	9,458	10,304
Total loans	<u>\$ 475,687</u>	<u>\$ 470,186</u>	<u>\$ 449,836</u>

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	\$ 411	\$ 271	\$ 417
Past due	11,451	1,857	674
Total impaired nonaccrual loans	<u>11,862</u>	<u>2,128</u>	<u>1,091</u>
Impaired accrual loans:			
Restructured accrual loans		-	-
Accrual loans 90 days or more past due	363	-	-
Accrual loans less than 90 days past due	-	1,177	-
Total impaired accrual loans	<u>363</u>	<u>1,177</u>	<u>-</u>
Total impaired loans	<u>\$ 12,225</u>	<u>\$ 3,305</u>	<u>\$ 1,091</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	\$ 133	\$ 25	\$ 105
Interest income on impaired accrual loans	92	9	2
Interest income recognized on impaired loans	\$ 225	\$ 34	\$ 107

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

	2008	2007	2006
Impaired loans with related allowance	\$ 9,613	\$ 2,403	\$ 128
Impaired loans with no related allowance	2,612	902	963
Total impaired loans	\$12,225	\$ 3,305	\$ 1,091
Allowance on impaired loans	\$ 3,348	\$ 401	\$ 72

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

	2008	2007	2006
Average impaired loans	\$ 7,490	\$ 1,470	\$ 428

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	\$ 342	\$ 131	\$ 111
Less: interest income recognized	133	25	105
Foregone interest income	\$ 209	\$ 106	\$ 6

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

	Year Ended December 31,		
	2008	2007	2006
Balance at beginning of year	\$ 2,146	\$ 1,629	\$ 1,622
Charge-offs:			
Real estate mortgage	(749)	–	(2)
Production and intermediate term	(4)	–	(2)
Rural residential real estate	(64)	–	–
Total charge-offs	(817)	–	(4)
Recoveries:			
Real estate mortgage	2	3	2
Production and intermediate term	4	2	9
Total recoveries	6	5	11
Net (charge-offs) recoveries	(811)	5	7
Provision for (reversal of allowance for) loan losses	5,542	512	–
Balance at end of year	\$ 6,877	\$ 2,146	\$ 1,629
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	(0.169)%	0.001%	0.002%

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	\$ 5,429	78.93%	\$ 1,496	69.72%
Production and intermediate term	912	13.27	422	19.66
Agribusiness	466	6.78	191	8.90
Energy	3	0.05	2	0.09
Rural residential real estate	67	0.97	35	1.63
Total	\$ 6,877	100.00%	\$ 2,146	100.00%

	December 31, 2006	
	Amount	%
Real estate mortgage	\$ 1,110	68.14%
Production and intermediate term	416	25.54
Agribusiness	67	4.11
Energy	2	0.12
Rural residential real estate	34	2.09
Total	\$ 1,629	100.00%

To mitigate the risk of loan losses, the Association may enter into long-term standby “commitment to purchase” agreements with the Federal Agricultural Mortgage Corporation (Farmer Mac). The agreements, which are effectively credit guarantees that will remain in place until the loans are paid in full, give the Association the right to sell the loans identified in the agreements to Farmer Mac in the event of default (typically four months past due), subject to certain conditions. The balance of loans under long-term standby commitments was \$27,203, \$27,406 and \$22,845 at December 31, 2008, 2007 and 2006, respectively. Fees paid to Farmer Mac for such commitments totaled \$124, \$123 and \$128 for the years ended December 31, 2008, 2007 and 2006, respectively. These amounts are classified as noninterest expense.

#### Note 4 — Other Investments

On October 22, 2004, Congress enacted the “Fair and Equitable Tobacco Reform Act of 2004” (Tobacco Act) as part of the “American Jobs Creation Act of 2004.” The Tobacco Act repealed the Federal tobacco price support and quota programs, provides for payments to tobacco “quota owners” and producers for the elimination of the quota, and provides an assessment mechanism for tobacco manufacturers and importers to pay for the buyout. Tobacco quota holders and producers will receive 10 equal annual payments under a contract with the Secretary of Agriculture. The Tobacco Act also includes a provision that allows the quota holders and producers to assign to a “financial institution” the right to receive the contract payments so that they may obtain a lump sum or other payment. On April 4, 2005, the USDA issued a Final Rule implementing the “Tobacco Transition Payment Program” (Tobacco Buyout).

The FCA determined that System institutions are “financial institutions” within the meaning of the Tobacco Act and are, therefore, eligible to participate in the Tobacco Buyout. The FCA recognized that the Tobacco Buyout has significant implications for some System institutions and the tobacco quota holders and producers they serve. The FCA’s goal is to provide System institution borrowers with the option to immediately receive Tobacco Buyout contract payments and reinvest them in future business opportunities.

For the years ended December 31, 2008, 2007 and 2006, the Association held Tobacco Buyout SIIC of \$12,650, \$14,199 and \$14,054, respectively, net of discount.

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

The Association is required to maintain ownership in the Bank of 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	\$ 416	\$ 414	\$ 409
Buildings and improvements	2,437	2,429	2,394
Furniture and equipment	1,864	1,863	1,671
	<u>4,717</u>	<u>4,706</u>	<u>4,474</u>
Less: accumulated depreciation	1,862	1,722	1,465
Total	<u>\$ 2,855</u>	<u>\$ 2,984</u>	<u>\$ 3,009</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	\$ (96)	\$ -	\$ -
Carrying value unrealized gains (losses)	-	-	-
Operating income (expense), net	<u>(37)</u>	<u>-</u>	<u>-</u>
Gains (losses) on other property owned, net	<u>\$ (133)</u>	<u>\$ -</u>	<u>\$ -</u>

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

The Association's indebtedness to the Bank represents borrowings by the Association primarily 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 line of credit are governed by the General Financing Agreement (GFA). The GFA defines Association performance criteria for borrowing from the Bank, which included in 2008 liquidity, earnings and solvency covenants. The Association failed to meet its earning covenant at December 31, 2008. The default allows the Bank to accelerate repayment of all indebtedness. In early 2009, following review of a plan submitted by the Association to achieve compliance with the covenant during 2009, the Bank approved a waiver of the default. The Association has continued to perform its obligations under the GFA, notwithstanding its covenant default.

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 3.7 years and 4.5 years, respectively, at December 31, 2008. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) notes payable which are match funded by the Bank was 5.03 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 3.62 percent and the weighted average remaining maturity was 6.2 years at December 31, 2008.

Variable rate and fixed rate notes payable represent approximately 49.03 percent and 50.97 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.

**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 Stock**

Protection of certain borrower stock is provided under the Farm Credit Act, which requires the Association, when retiring protected borrower stock, to retire such stock at par or stated value regardless of its book value. Protected borrower stock includes capital stock and participation certificates, 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 stock 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 \$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**

The 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 the FCA that, if undertaken, could have a direct material effect on the Association’s financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless prescribed capital standards are met. The 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 13.59 percent, 13.24 percent and 12.24 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 Class 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	12,356	\$ 62
C Common/Voting	No	297,005	1,485
B Participation Certificates/Nonvoting	Yes	1,783	9
C Participation Certificates/Nonvoting	No	24,826	124
Total Capital Stock and Participation Certificates		335,970	\$ 1,680

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. Nonqualified retained surplus is considered to be permanently invested in the Association and as such, there is no plan to revolve or retire this surplus. All nonqualified distributions are tax deductible only when redeemed.

At December 31, 2008, allocated members’ equity consisted of \$5,506 of qualified surplus, \$31,499 of nonqualified surplus and \$3,683 of nonqualified retained surplus.

*Dividends*

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

The rate of dividends on Classes A, B or 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*

Class 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:

1. 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
2. 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
3. Classes A, B and C Common Stock and Classes B and C Participation Certificates
4. Class D Preferred Stock

*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:

1. Holders of Class D Preferred Stock
2. Holders of Classes A, B and C Common Stock and Classes B and C Participation Certificates
3. 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
4. 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
5. All unallocated surplus accrued after April 4, 1995 shall be distributed to patrons (i.e., those who receive patronage distributions pursuant to section 860) of the Association from the period beginning April 4, 1995 through the date of liquidation on a patronage basis
6. Any remaining assets of the Association after such distribution shall be distributed ratably to the holders of all classes of stock and participation certificates

**Note 10 — Income Taxes**

The provision (benefit) for income taxes follows:

	<b>Year Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Current:			
Federal	\$ 54	\$ 19	\$ 9
State	-	(4)	-
	<u>54</u>	<u>15</u>	<u>9</u>
Deferred:			
Federal	-	-	(37)
State	-	-	(6)
	<u>-</u>	<u>-</u>	<u>(43)</u>
Total provision (benefit) for income taxes	<u>\$ 54</u>	<u>\$ 15</u>	<u>\$ (34)</u>

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:

	<b>December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Federal tax at statutory rate	\$ 887	\$ 3,584	\$ 3,708
State tax, net	-	(3)	(4)
Patronage distributions	(370)	(1,112)	(1,111)
Tax-exempt FLCA earnings	(575)	(2,703)	(2,323)
Change in valuation allowance	(176)	605	(322)
Other	288	(356)	18
Provision (benefit) for income taxes	<u>\$ 54</u>	<u>\$ 15</u>	<u>\$ (34)</u>

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

	December 31,		
	2008	2007	2006
Deferred income tax assets:			
Allowance for loan losses	\$ 570	\$ 189	\$ 146
Net operating loss – carryforward	–	519	27
Nonaccrual loan interest	19	57	30
Depreciation	–	–	–
Gross deferred tax assets	589	765	203
Less: valuation allowance	(589)	(765)	(160)
Gross deferred tax assets, net of valuation allowance	–	–	43
Deferred income tax liabilities:			
Future Bank equity redemption	–	–	(43)
Gross deferred tax liability	–	–	(43)
Net deferred tax asset (liability)	\$ –	\$ –	\$ –

At December 31, 2008, deferred income taxes have not been provided by the Association on approximately \$2.2 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 \$589, \$765 and \$160 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. This plan is considered a multi-employer plan and, therefore, there is no impact to the Association’s financial statements due to Statement of Financial Accounting Standards No. 158, “Employers’ Accounting for Defined Benefit and Other Postretirement Plans.” Benefits are based on salary and years of service. As a participant in the District’s defined benefit plan, the Association funded \$645 for 2008, and \$0 for 2007 and 2006, through its note payable to the Bank. Plan expenses included in salaries and employee benefits were \$279 for 2008, \$444 for 2007, \$526 for 2006. Additional financial information for the Plan may be found in the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations’ 2008 Annual Report.

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 \$155 for 2008, \$163 for 2007 and \$167 for 2006. Additional financial information for the Plan may be found in the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations’ 2008 Annual Report.

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 \$118, \$126 and \$120 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 \$28,297. During 2008, \$30,091 of new loans were made and repayments totaled \$23,740. 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, \$78,339 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 \$673 of standby letters of credit, with expiration dates ranging from February 18, 2009 to March 31, 2012. The maximum potential amount of future payments the Association may be required to make under these existing guarantees is \$673.

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 \$25 and was included in other liabilities.

#### 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 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 has no Level 1 assets or liabilities measured at fair value on a recurring basis at December 31, 2008.

#### 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>Liabilities:</b>				
Standby letters of credit	\$ -	\$ -	\$ 25	\$ 25
Total Liabilities	\$ -	\$ -	\$ 25	\$ 25

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	\$ 40
<b>Total gains or (losses) realized/unrealized:</b>	
Included in earnings	-
Included in other comprehensive loss	-
Purchases, sales, issuances and settlements, net	(15)
Transfers in and/or out of level 3	-
Balance at December 31, 2008	<u>\$ 25</u>

**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	\$ -	\$ -	\$ 6,265	\$ 6,265	\$ (3,348)

**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	\$ 59	\$ 59	\$ 13	\$ 13
Loans, net of allowance	<u>\$ 468,810</u>	<u>\$ 474,871</u>	<u>\$ 468,040</u>	<u>\$ 472,166</u>
Tobacco Buyout SIIC	<u>\$ 12,650</u>	<u>\$ 13,216</u>	<u>\$ 14,199</u>	<u>\$ 14,289</u>
<b>Financial liabilities:</b>				
Notes payable to AgFirst Farm Credit Bank	<u>\$ 421,771</u>	<u>\$ 428,170</u>	<u>\$ 408,613</u>	<u>\$ 412,384</u>

	December 31, 2006	
	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>		
Cash	<u>\$ 940</u>	<u>\$ 940</u>
Loans, net of allowance	<u>\$ 448,207</u>	<u>\$ 451,168</u>
Tobacco Buyout SIIC	<u>\$ 14,054</u>	<u>\$ 13,729</u>
<b>Financial liabilities:</b>		
Notes payable to AgFirst Farm Credit Bank	<u>\$ 395,346</u>	<u>\$ 394,586</u>

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 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 1.90 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 \$9,804 related to other Farm Credit institutions.

D. **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.

E. **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.

F. **Tobacco Buyout SIIC:** Fair value is determined by discounting the expected future cash flows using current interest rates for similar assets.

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

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

	2008				
	First	Second	Third	Fourth	Total
Net interest income	\$ 3,125	\$ 2,798	\$ 2,673	\$ 2,445	\$ 11,041
Provision for (reversal of allowance for) loan losses	800	1,450	254	3,038	5,542
Noninterest income (expense), net	(487)	(665)	(896)	(896)	(2,944)
Net income (loss)	\$ 1,838	\$ 683	\$ 1,523	\$ (1,489)	\$ 2,555

	2007				
	First	Second	Third	Fourth	Total
Net interest income	\$ 3,288	\$ 3,283	\$ 3,249	\$ 3,181	\$ 13,001
Provision for (reversal of allowance for) loan losses	-	-	312	200	512
Noninterest income (expense), net	(507)	(439)	(440)	(577)	(1,963)
Net income (loss)	\$ 2,781	\$ 2,844	\$ 2,497	\$ 2,404	\$ 10,526

	2006				
	First	Second	Third	Fourth	Total
Net interest income	\$ 3,071	\$ 3,134	\$ 3,204	\$ 3,272	\$ 12,681
Provision for (reversal of allowance for) loan losses	-	-	-	-	-
Noninterest income (expense), net	(390)	(529)	(537)	(285)	(1,741)
Net income (loss)	\$ 2,681	\$ 2,605	\$ 2,667	\$ 2,987	\$ 10,940