

2008

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



Financing Rural America

FARM CREDIT OF SOUTH FLORIDA, ACA

2008 ANNUAL REPORT

Contents

Message from the President	3-4
Report of Management	5
Report on Internal Control Over Financial Reporting	6
Consolidated Five-Year Summary of Selected Financial Data	7
Management's Discussion & Analysis of Financial Condition & Results of Operations.....	8-19
Disclosure Required by FCA Regulations	20-23
Report of the Audit Committee	24
Report of Independent Auditors	25
Consolidated Financial Statements	26-29
Notes to the Consolidated Financial Statements	30-42

Management

Don Rice.....	President/Chief Executive Officer
C. Robert Pendleton	Chief Lending Officer
Linda Rusciano	Chief Financial Officer
Esther Morales	Chief Credit Officer

Board of Directors

Jack C. Coker	Chairman
Louis E. Larson, Jr.	Vice Chairman
John L. Alger.....	Director
William E. Bowman, Jr.....	Director
Robert J. Callaway	Outside Director
Sherwood J. Johnson.....	Director
Charles F. Martin	Director
John D. Martin, Jr.	Director
Robert G. Sexton.....	Director
Andrea Thurn	Outside Director

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Message from the President

The real story of 2008 is certainly not about Farm Credit. However, like every person and business in the country, Farm Credit was certainly drawn into the drama. This past year was perhaps the most difficult year for the US and the world economy since the Great Depression. All the other recessions since the Great Depression have been characterized by downturns in consumption, employment and GDP. However, this past year's recession became a full-blown financial crisis and almost reached the level of the financial panic of the 1930s. While deposit insurance and more rapid government intervention prevented mass withdrawals and failures of banks, the credit markets did seize-up and credit, for many fundamentally sound companies, dried up. Lack of confidence between banks stopped even very short-term lending between financial institutions, as banks with excess cash wouldn't lend that cash to other banks needing cash, even for very brief periods. This flow of funds between financial institutions is almost as essential to funding the economy as the bank depositors' confidence that they can get their money back from the bank at anytime. The US stock market declined almost 50 percent in the first 11 months of the year and all interest rates for borrowing, with the exception of the rate paid by the US Treasury, increased dramatically. Iconic financial institutions collapsed, some forced into liquidation or merger and others were "bailed out" by billions of Treasury dollars poured into the company to prevent it from complete failure.

Fortunately, the US Treasury and other Central Banks around the world flooded the financial system with trillions of Dollars, Euros, Francs, and Yen. It is now estimated that over \$2 trillion was pumped into the US monetary system alone. In addition to this flood of liquidity, the US Treasury reduced interest rates to historic lows, made direct investments in financial institutions and actually began to fund individual corporations through direct purchases of commercial paper. The yield on 90 day US government obligations declined to essentially zero and actually traded negatively a few times during the crisis. This means that some investors loaned the US government cash and will actually receive less cash back at the end of 90 days than they initially invested. For short term funds, the US Treasury essentially become a safer place to hold money than between the mattresses or in a coffee can buried in the back yard.

What precipitated this mess and who is responsible? Greed created the crisis but the most culpable parties were the bankers and investment experts on Wall Street who thought they had devised a system where housing values would continue to increase forever by allowing consumers to borrow far more on those houses than they could repay. However, that same greed existed at the consumer level where there was no reluctance to purchase far more house than that consumer could repay because the value of the house would always go up and the house could be sold for a big profit at anytime. Greedy land developers and builders scooped up available land for future building. Greedy realtors and mortgage brokers received larger and larger commissions from home sales and loans that the home buyers had no reasonable way to repay. In retrospect, this "land value boom" was identical to all the bubbles that have ever occurred in the past. The only difference was that the financial community had created new financing vehicles, claimed to be essentially risk free. However, these new financial instruments simply multiplied the problem many times over.

We are truly blessed that Farm Credit did not participate in this type of lending or investment activity. However, like the innocent bystander at a major auto accident, we have also been impacted by the actions of others. We have been struck by some of the accident's flying debris and we are going to be stuck in the traffic jam that follows for months and perhaps years as the financial system and the country work through the crisis.

The severe downturn in the economy has impacted producers of almost every agricultural commodity we finance, as consumers and businesses slow down consumption. Most impacted are our nursery, sod and tree producers who have seen their businesses decline dramatically as the home building industry collapsed. All our borrowers have seen dramatic declines in the value of their farms, other assets and savings/investments. This stress at the borrowers' operations has resulted in a substantial decline in the performance of our loan portfolio, perhaps the worst we have seen in over a decade.

This financial and housing market bubble was created by the other more "modern" and "progressive" institutions using the newly created lending products. They approved loans on the spot with little or no documentation and no analysis. However, we at Farm Credit stuck to our "old fashioned" lending philosophy and products. We continued to require "too much" financial information, took "too long" to analyze that information just as we had for 90 years. Unlike most other lenders, we wanted to be sure that our borrowers were making prudent decisions and that loans could be paid from recurring income produced by their operation. This conservatism served us well. Our capital and earnings have thus far remained very strong, despite the financial crisis. However, our funding costs and the availability of funds for long-term commitments have been impacted. Ironically our funding costs, relative to other GSEs (government sponsored enterprises) like Fannie Mae and Freddie Mac, increased. These entities that required the biggest government bail-outs of all now borrow at lower costs than Farm Credit, because the investing public views them as being fully backed by the government.

While we faced a great deal of stress in 2008, we are very pleased that our earnings for 2008 were sufficient to cover the increases in capital and loan loss reserves that are needed due to recession. Earnings were sufficient for the Board to declare patronage refunds at essentially the same level as in prior years.

We at Farm Credit saw this economic crisis developing some four or five years ago. We began at that time to increase capital, diversify our income sources and improve our underwriting standards as well as improve our operating efficiencies. Here in South Florida, we know how to prepare for an approaching hurricane and we have tried very hard to prepare and position the association for the storm we now face. However, regardless of the level of preparation, we will still have to ride out the storm and make the necessary repairs after the recovery begins. We believe that we have built a strong institution on the very firm foundation of our cooperative structure. We believe that working hand in hand with our members, as we have for over 90 years, we will continue to be the very best source of funds for farmers, ranchers, rural residents, and the farm related businesses. Any success we enjoy today, or have seen at any time in our long history, is attributed to the loyalty of our members and the dedication of our staff. Together we can weather this financial and economic storm, just as together, we have weathered every storm since Farm Credit was founded in 1916.

I hope you will take the time to review this Annual Report and the accompanying financial statements and audit. Please feel free to contact me or any staff member with any questions you may have regarding the report.



Don Rice
President/Chief Executive Officer

February 27, 2009

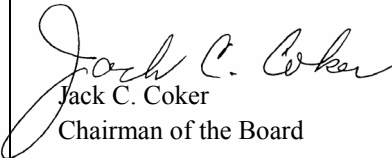
Report of Management


The accompanying consolidated financial statements and related financial information appearing throughout this annual report have been prepared by management of Farm Credit of South 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 South 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.


Jack C. Coker
Chairman of the Board


Don Rice
Chief Executive Officer


Linda Rusciano
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.



Don Rice
Chief Executive Officer



Linda Rusciano
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
Balance Sheet Data					
Cash	\$ 408	\$ 2,072	\$ 667	\$ 904	\$ 1,090
Investment securities	3,221	1,803	—	—	—
Loans	589,244	529,972	514,258	467,557	480,183
Less: allowance for loan losses	8,051	4,978	5,198	5,106	5,100
Net loans	581,193	524,994	509,060	462,451	475,083
Investments in other Farm Credit institutions	7,857	7,552	6,773	5,411	5,642
Other property owned	—	—	—	—	—
Other assets	16,412	17,850	18,914	13,264	11,769
Total assets	\$ 609,091	\$ 554,271	\$ 535,414	\$ 482,030	\$ 493,584
Notes payable to AgFirst Farm Credit Bank*	\$ 484,670	\$ 428,586	\$ 420,609	\$ 372,272	\$ 399,589
Accrued interest payable and other liabilities with maturities of less than one year	19,294	26,493	23,378	23,852	17,638
Total liabilities	503,964	455,079	443,987	396,124	417,227
Protected borrower stock	2,538	2,682	2,739	2,898	3,135
Capital stock and participation certificates	697	725	777	808	810
Retained earnings					
Allocated	22,550	22,483	21,752	22,550	21,277
Unallocated	79,342	73,302	66,159	59,650	51,135
Total members' equity	105,127	99,192	91,427	85,906	76,357
Total liabilities and members' equity	\$ 609,091	\$ 554,271	\$ 535,414	\$ 482,030	\$ 493,584
Statement of Income Data					
Net interest income	\$ 16,107	\$ 17,319	\$ 16,702	\$ 14,898	\$ 12,768
Provision for (reversal of allowance for) loan losses	5,525	—	—	—	(9,823)
Noninterest income (expense), net	3,656	(290)	(489)	2,052	861
Net income	\$ 14,238	\$ 17,029	\$ 16,213	\$ 16,950	\$ 23,452
Key Financial Ratios					
Rate of return on average:					
Total assets	2.47%	3.15%	3.20%	3.56%	5.02%
Total members' equity	13.55%	17.38%	17.97%	20.98%	38.29%
Net interest income as a percentage of average earning assets	2.91%	3.32%	3.41%	3.20%	2.72%
Net (chargeoffs) recoveries to average loans	(0.442)%	(0.042)%	0.019%	0.001%	0.01%
Total members' equity to total assets	17.26%	17.90%	17.08%	17.82%	15.47%
Debt to members' equity (:1)	4.79	4.59	4.86	4.61	5.46
Allowance for loan losses to loans	1.37%	0.94%	1.01%	1.09%	1.06%
Permanent capital ratio	15.57%	17.04%	16.31%	16.76%	12.76%
Total surplus ratio	15.50%	16.93%	16.18%	16.58%	12.58%
Core surplus ratio	15.50%	16.33%	14.94%	14.44%	10.86%
Net Income Distribution					
Estimated patronage refunds:					
Cash	\$ 5,071	\$ 6,006	\$ 5,147	\$ 4,007	\$ 3,502
Nonqualified retained earnings	3,470	3,834	4,383	4,173	3,692

* General financing agreement is renewable on three-year cycles. The next renewal date is December 31, 2009.

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 South 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 southeast 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, 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.farmcreditsfl.com or by calling 1-800-432-4156, extension 240, or writing Linda Rusciano, Farm Credit of South Florida, ACA, P. O. Box 213069, Royal Palm Beach, FL

33421. 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:

Commodity	12/31/08	12/31/07	12/31/06	12/31/05
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

The U.S. and the world currently face the most serious economic recession in three decades, perhaps the worst since the Great Depression. The economy of Florida has declined more than any other state in most economic measures.

The economy of the area served by the Association began a significant decline during 2007 and continued to decline rapidly in 2008. New construction, the leading economic driver in the South Florida economy for almost 10 years, essentially stopped. Inventories of unsold houses reached record highs and prices began to fall in 2006 and continued through 2008. Across our territory, the median price of a home is down more than 40% from the peak of 2005. Builders mothballed or abandoned projects. Some attempted to sell other land held for future development and some of the oldest, most prominent names in the construction business closed, liquidated or filed bankruptcy. Excess inventory and declining sales has resulted in downward pressure on new and existing home prices. Foreclosures in South Florida are among the highest in the U.S. and new filings continue to grow each month. Unemployment has risen sharply across the region and now exceeds 10 percent in some counties.

The 2008 farm operating year was relatively stable for most industries financed by the association with the exception of those directly tied to the housing industry like nursery, sod and tree growers. Production conditions were good with no significant storms, freezes or drought as had been faced in the previous four or five growing seasons. Nursery, sod and tree growers are experiencing the worst economic conditions in history. Many tree and sod growers report sales being off 80-90 percent since the peak in 2005. Nursery growers' results are mixed based on the products and the marketing sources. Foliage sales to large retailers have seen some decline but not nearly as dramatic as landscape plants. The serious recession, which fully developed in 2008, has materially slowed and will continue to slow discretionary consumer purchases of plants.

Citrus growers continued to lose very significant acres of producing groves to diseases in 2008. Citrus canker, citrus greening and other diseases have resulted in the loss of thousands of acres of groves over the past few years. Prices for citrus products are currently fair due to the reduced crop, but the long-term prospects of keeping sufficient acres in production to operate the industry efficiently are bleak. The industry should be able to continue to produce at some level. However, the industry's infrastructure capacity will greatly exceed producer needs. Not only will the industry be forced to adopt new practices to produce crops threatened by these diseases, it will also face dramatic changes in the way it harvests, processes and markets the crops. Many packing houses, processors, and others who provide services to the industry will be forced out of business due to the decreased volume of acres and fruit. Export levels of the 2008-2009 citrus crop are anticipated to decline due to the worldwide recession.

The slowing general economy has also resulted in lower demand for beef which has lowered prices for feeder calves grown in our territory. Dairy prices, which had been strong for a significantly long cycle, began to fall dramatically in late 2008 and are now at levels below breakeven for most producers. Vegetable prices and production in 2008 were average for most producers financed by the Association.

Performance of the Association's portfolio saw significant decline in quality and performance in 2008. However, the year-end levels of non-performing loans are not below the long-term average for distressed assets and are manageable based on the Association's strong capital and earnings position. Most of the distressed borrowers are attempting to sell land to reduce debt but are unable to do so in the current market. Few sales are being reported and those that have occurred indicate that prices received for land will be significantly lower than the peak prices seen over the first five years of the decade. The staff is aggressively working to assist these borrowers. The management team and board of directors have taken steps to adjust the Association's loan underwriting and servicing practices. They have also grown both capital and the allowance for loan loss reserves to better position the Association's ability to deal with additional performance stress in the loan portfolio that may result in 2009. As in past economic downturns and natural disasters, Farm Credit stands ready to work with our members who have long-term viable operations even though they are currently experiencing cash flow and profitability problems.

LOAN PORTFOLIO

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

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

Loan Type	2008		December 31, 2007		2006	
			<i>(dollars in thousands)</i>			
Real estate mortgage	\$ 388,652	65.96%	\$ 374,068	70.58%	\$ 389,254	75.69%
Production and intermediate-term	72,121	12.24	70,093	13.23	63,749	12.40
Processing and marketing	90,194	15.31	53,585	10.11	45,791	8.90
Farm-related business	26,620	4.52	24,796	4.68	8,890	1.73
Communication	11,501	1.95	7,256	1.37	6,401	1.25
Rural residential real estate	156	0.02	174	0.03	173	0.03
Total	\$ 589,244	100.00%	\$ 529,972	100.00%	\$ 514,258	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.

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 nursery, livestock, equine, sugar, citrus and vegetables, which constitute over 48 percent of the entire portfolio.

Commodity Group	2008		December 31, 2007		2006	
			<i>(dollars in thousands)</i>			
Nursery/Greenhouse	\$ 160,501	27%	\$ 157,927	30%	\$ 148,047	29%
Participations Purchased	134,213	23	103,795	20	81,646	16
Other Real Estate	67,743	11	57,779	11	63,662	12
Livestock	29,744	5	37,747	7	41,259	8
Equine	42,424	7	28,491	5	28,821	6
Sugar Cane	20,190	3	28,091	5	29,250	6
Vegetables	23,329	4	26,799	5	27,866	5
Other	40,785	7	24,862	5	13,978	1
Citrus Fruits	26,551	5	23,413	4	24,319	5
Dairy	17,796	3	15,711	3	18,529	4
Farm Related Business	16,548	3	15,201	3	17,929	4
Fruits	9,420	2	10,156	2	18,952	4
Total	\$ 589,244	100%	\$ 529,972	100%	\$ 514,258	100%

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The Association enjoys a diverse commodity portfolio with no significant single concentration in any one commodity. The Nursery/Greenhouse group represents 27% of the portfolio, it should be noted this group is a broad classification covering both interior foliage and exterior landscape plant products with very different market characteristics and credit risk profiles. Other concentrations, such as sugar and vegetables contain operations that are vertically integrated with processing, sales and marketing which increases their profitability and reduces credit risks to the Association. For purposes of calculating concentration risks, each loan is classified by the principal product grown. However, many operations produce a number of products in addition to the principal product, thus reducing overall risks to the operation and the Association.

The increase in gross loan volume for the twelve months ended December 31, 2008, is primarily attributed to increased activity in participations purchased with other Farm Credit institutions. Fluctuations in volume can also be influenced by usage of borrower SmartCash accounts, a voluntary additional conditional payment fund, which are offset against the related loans outstanding in the portfolio. SmartCash balances at December 31, 2008 were \$7,645, compared to \$13,653 at December 31, 2007 and \$8,314 at December 31, 2006. Additional SmartCash funds, held in Other Liabilities against commitment balances, totaled \$7,387 as of December 31, 2008 as compared to \$10,525 and \$8,354, at 2007 and 2006, respectively.

For the past few years, the Association has experienced a shift in loan assets. The short and intermediate-term volume trend has been downward while the long-term loan volume trend is upward. The short-term portfolio, which is heavily influenced by operating-type loans, normally reaches a peak balance in the fall and rapidly declines in the spring and early summer months as commodities are marketed and proceeds are applied to repay operating loans.

During 2007 and 2008, the Association increased activity in the buying and selling of loan participations within and outside of the System. This provides a means for the Association to spread credit concentration risk and realize non-patronage sourced interest and fee income, which may strengthen their capital position.

Loan Participations:	December 31,		
	2008	2007	2006
	<i>(dollars in thousands)</i>		
Participations Purchased			
– FCS Institutions	\$ 117,437	\$ 114,111	\$ 85,903
Participations Purchased			
– Non-FCS Institutions	13,608	16,719	19,330
Participations Sold	(87,926)	(90,290)	(90,693)
Total	\$ 43,119	\$ 40,540	\$ 14,540

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 \$1,839, which were sold into the secondary market. The Association additionally purchased portions of loans that are guaranteed by the United States Department of Agriculture. These loans are held for the purposes of reducing interest rate risk and managing surplus short-term funds as allowable under FCA regulations. At December 31, 2008, the balance of these loans, including the unamortized premium, was \$13,608, compared to \$16,719 at December 31, 2007 and \$18,152 at December 31, 2006.

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 and December 31, 2007, the Association had no investments in Rural America Bonds. The Association is

actively seeking opportunities in the Rural America Bond Program; however, very limited opportunities exist within the Association's largely urban territory.

INVESTMENT SECURITIES

As permitted under FCA regulations, the Association is authorized to hold eligible investments for the purposes of reducing interest rate risk and managing surplus short-term funds. The Bank is responsible for approving the investment policies of the Association. The Bank annually reviews the investment portfolio of every Association that it funds. The Association's investments consist primarily of asset-backed securities (ABS). The ABS investments amounted to \$3,221 at December 31, 2008 and \$1,803 at December 31, 2007. These investments are rated AAA, as they are guaranteed by the full faith and credit of the United States government.

In view of the recent economic conditions and volatility related to these types of securities, the Association is actively monitoring the creditworthiness of these securities. These securities are supported by various forms of credit enhancements including insurance guarantees from AAA rated insurers, over-collateralization and favorable priority of payments. Based on our evaluations, we believe these securities do not pose a significant risk of loss given the credit enhancements and relatively short weighted average lives. However, in the event a security is downgraded, we may be required by our regulator to dispose of the security.

Investment securities classified as being held-to-maturity totaled \$3,221 at December 31, 2008 and \$1,803 at December 31, 2007. These held-to-maturity investments consist of pools of loans with United States government guarantees.

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 \$1 million. 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	94.18 %	97.85 %	98.21 %
Substandard	5.82 %	2.15 %	1.79 %
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	\$ 14,384	\$ —	\$ 138
Impaired accrual loans			
Restructured loans	—	—	—
Current as to principal and interest	—	805	4,286
Accruing loans 90 days past due	—	—	267
Total high-risk loans	14,384	805	4,691
Other property owned	—	—	—
Total high-risk assets	<u>\$ 14,384</u>	<u>\$ 805</u>	<u>\$ 4,691</u>
Ratios			
Nonaccrual loans to total loans	2.44%	—%	0.03%
High-risk assets to total assets	2.36%	0.15%	0.08%

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 \$14,384 or 100.00 percent in 2008. This increase resulted from credit quality deterioration and decline of collateral values resulting from the current economic downturn. Of the \$14,384 in nonaccrual volume at December 31, 2008, \$5,403 or 37.56%, was current as to scheduled principal and interest payments, but did not meet all regulatory requirements to be transferred into accrual status.

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	\$ 4,978	\$ 5,198	\$ 5,106
Charge-offs:			
Real estate mortgage	(1,605)	(1,400)	(2)
Production and intermediate-term	(581)	(13)	—
Agribusiness	(278)	—	—
Total charge-offs	<u>(2,464)</u>	<u>(1,413)</u>	<u>(2)</u>
Recoveries:			
Real estate mortgage	—	1,187	—
Production and intermediate-term	12	6	94
Total recoveries	<u>12</u>	<u>1,193</u>	<u>94</u>
Net (charge-offs) recoveries	<u>(2,452)</u>	<u>(220)</u>	<u>92</u>
Provision for (reversal of allowance for) loan losses	5,525	—	—
Balance at end of year	<u>\$ 8,051</u>	<u>\$ 4,978</u>	<u>\$ 5,198</u>
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	<u>(0.442)%</u>	<u>(0.042)%</u>	<u>0.019%</u>

The net loan charge-offs were primarily associated with transfers to nonaccrual status where the outstanding balance of the loan exceeded the net realizable value of the collateral.

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	\$ 6,382	\$ 3,384	\$ 3,597
Production and intermediate-term	975	1,393	1,400
Agribusiness	637	136	136
Communication	57	59	59
Rural residential real estate	—	6	6
Total Allowance for Loan Losses	<u>\$ 8,051</u>	<u>\$ 4,978</u>	<u>\$ 5,198</u>

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	1.37%	0.94%	1.01%
Nonperforming loans	55.97%	618.39%	1283.5%
Nonaccrual loans	55.97%	—%	3766.7%

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

RESULTS OF OPERATIONS

Net income for the year ended December 31, 2008, totaled \$14,238, a decrease of \$2,791 or 16.39 percent, as compared to \$17,029 for the same period of 2007 and a decrease of \$1,975

or 12.18 percent, as compared to \$16,213 for the same period of 2006. The decline in net income for the year ending 2008 is primarily attributed to provisions to the allowance for loan losses of \$5,525 to offset the current year charge-offs and provide for additional charge-offs anticipated in the portfolio.

Interest income for the year ended December 31, 2008 was \$37,719, a decrease of \$5,032 or 11.77 percent as compared to \$42,751 for the same period of 2007. Interest income increased by \$3,446 or 8.77 percent for the percent for the period ended December 31, 2007, compared to the same period of 2006. The significant decline in interest income during 2008 is a result of the continued decline in variable rates during the period offset by loan volume growth.

Net Interest Income

Net interest income was \$16,107, \$17,319 and \$16,702 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 Income	Total
	<i>(dollars in thousands)</i>			
12/31/08 - 12/31/07				
Interest income	\$ 2,556	\$ (7,476)	\$ (112)	\$ (5,032)
Interest expense	(1,712)	5,532	-	3,820
Change in net interest income	\$ 844	\$ (1,944)	\$ (112)	\$ (1,212)
12/31/07 - 12/31/06				
Interest income	\$ 2,482	\$ 845	\$ 119	\$ 3,446
Interest expense	(1,628)	(1,201)	-	(2,829)
Change in net interest income	\$ 854	\$ (356)	\$ 119	\$ 617

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

Net interest income decreased by \$1,212 or 7.00 percent in 2008 compared to 2007 and decreased by \$595 or 3.56 percent, compared to 2006. The primary reason for the decline is the reduction in the variable interest rate market offset by growth in the loan portfolio and increased yields on new loans. A comparison of 2008 and 2007 reveals the change in rate accounted for \$1,944 of the decrease while the change in volume accounted for the offsetting increase of \$844. Interest income on nonaccrual loans for 2008 totaled \$7, a decrease of \$112 compared to the \$119 during 2007. When comparing 2007 and 2006, an increase in volume accounted for \$854 of the increase while decline in interest rates accounted for the \$356 offsetting decrease. Nonaccrual interest income was \$119 in 2007, an increase of \$119 compared to \$0 in 2006. The Association's net interest income as a percentage of average earning assets was 2.91 percent on December 31, 2008, compared to 3.32 percent and 3.41 percent on December 31, 2007 and December 31, 2006, respectively. The continued decline in this ratio is attributed to the declining variable rates which significantly impacts interest earned on the Association's loanable funds.

Noninterest Income

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

Noninterest Income	For the Year Ended December 31,			Percentage Increase/(Decrease)	
	2008	2007	2006	2008/ 2007	2007/ 2006
	<i>(dollars in thousands)</i>				
Loan fees	\$ 2,573	\$ 1,555	\$ 1,999	65.47%	(22.21)%
Fees for financially related services	1,203	909	419	32.34	116.95
Patronage refund from other Farm Credit Institutions	3,805	4,124	3,866	(7.74)	6.67
Gains (losses) on other property owned, net	407	27	27	1,407.41	-
Gains (losses) on sales of premises and equipment, net	2,721	16	36	16,906.25	(55.56)
Other noninterest income	(127)	220	88	(157.73)	150.00
Total noninterest income	\$10,582	\$ 6,851	\$ 6,435	54.46%	6.46%

Loan fees increased \$1,018 or 65.47 percent during the period ending December 31, 2008 when compared to \$1,555 in 2007. This increase is a result of increased activity in loan originations and participation loans during the period. Fees for financially related services were \$1,203 in 2008 compared to \$909 in 2007, an increase of \$294 or 32.34 percent. Gains on other property owned of \$407 resulted from the recognition of a deferred gain from other property owned sold in a prior period. The Association also realized gains from sales of premises and equipment of \$2,721. This gain is primarily attributed to the gain on sale of the former administrative office in Lake Worth of \$2,811.

Noninterest Expense

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

Noninterest Expense	For the Year Ended December 31,			Percentage Increase/(Decrease)	
	2008	2007	2006	2008/ 2007	2007/ 2006
	<i>(dollars in thousands)</i>				
Salaries and employee benefits	\$ 4,260	\$ 4,377	\$ 4,419	(2.67)%	(0.95)%
Occupancy and equipment expense	658	714	608	(7.84)	17.43
Insurance Fund premium	747	730	681	2.33	7.20
Other operating expense	1,285	1,296	1,209	(0.85)	7.20
Total noninterest expense	\$ 6,950	\$ 7,117	\$ 6,917	(2.35)%	2.89%

Non-interest expense decreased \$167 or 2.35 percent for December 31, 2008, as compared to the same period in 2007, and increased \$33 or 0.48 percent compared to December 31, 2006.

Salaries and employee benefits decreased \$117 or 2.67% in 2008, as compared with 2007, primarily due to decreased costs associated with employee benefit plans, merit and incentive compensation, and employee staffing levels. The decrease in occupancy and equipment expense is related to reductions in real estate taxes and other building expenses resulting from the sale of the former administrative office in Lake Worth. Other operating expenses decreased \$11 or 0.85% resulting from decreases in areas such as travel expense, employee training, advertising and public/member relations expense offset by increases in director costs, purchased services and communications.

Insurance Fund premiums increased \$17 or 2.33 percent for the twelve months ended December 31, 2008, compared to the same period of 2007. The Farm Credit System Insurance Corporation (FCSIC) changed the methodology in assessing the insurance premiums as a result of the 2008 Farm Bill. Please refer to the "Regulatory Matters" section of this management's discussion and analysis for details concerning the 2008 Farm Bill. The FCSIC set premiums at 15 basis points on adjusted insured debt outstanding for the third quarter of 2008 and 18 basis points on adjusted insured debt outstanding for the fourth quarter of 2008. In addition, for the second half of 2008, there was a 10 basis point premium on the average principal outstanding of nonaccrual loans and any other-than-temporarily impaired investments. Previously, premiums of up to 15 basis points could be charged on accruing loans and up to 25 basis points for nonaccrual loans.

Income Taxes

The Association recorded a benefit for income taxes of \$24 for the year ended December 31, 2008, as compared to a provision of \$24 for 2007 and a provision of \$7 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	2.47%	3.15%	3.20%
Return on average members' equity	13.55%	17.38%	17.97%
Net interest income as a percentage of average earning assets	2.91%	3.32%	3.41%
Net (charge-offs) recoveries to average loans	(0.442)%	(0.042)%	0.019%

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 \$484,670 as compared to \$428,586 at December 31, 2007 and \$420,609 at December 31, 2006. The increase of 13.09 percent compared to December 31, 2007 and the increase of 15.23 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 \$452,143 and \$423,619 for the years ended December 31, 2008 and 2007, respectively. Refer to Note 8, "Notes Payable to AgFirst Farm Credit Bank," of the Notes to the Consolidated Financial Statements, for weighted average interest rates and maturities, and additional information concerning the Association's notes payable.

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

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

Funds Management

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

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

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

Relationship with the Bank

The Association's statutory obligation to borrow only from the Bank and the Bank's ability to access capital of the Association is discussed in Note 5, "Investment in AgFirst Farm Credit Bank" and Notes 7 "Notes Payable to AgFirst Farm Credit Bank" of the Notes to the Consolidated Financial Statements included in this Annual Report

The Bank's role in mitigating the Association's exposure to interest rate risk is described in the "Liquidity and Funding" section of this Management's Discussion and Analysis and in Note 7, "Notes Payable to AgFirst Farm Credit Bank included in this annual report.

CAPITAL RESOURCES

Capital serves to support asset growth and provide protection against unexpected credit and interest rate risk and operating losses. Capital is also needed for future growth and investment in new products and services.

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

Total members' equity at December 31, 2008, increased 5.98 percent to \$105,127 from the December 31, 2007, total of \$99,192. At December 31, 2007, total members' equity increased 8.49 percent from the December 31, 2006 total of \$91,427. The increase was primarily attributed to continued growth in net income offset by distribution of cash patronage and revolvment of allocated surplus.

Total capital stock and participation certificates were \$3,235 on December 31, 2008, compared to \$3,407 on December 31, 2007 and \$3,516 on December 31, 2006. The decrease was attributed to the retirement of protected stock and participation certificates on loans liquidated in the normal course of business, retirement of excess stock through revolvment. FCA sets minimum regulatory capital requirements for System banks and associations. Capital adequacy is evaluated using a number of regulatory ratios. According to the FCA regulations, each institution's permanent capital ratio is calculated by dividing permanent capital by a risk-adjusted asset base. Risk adjusted assets mean the total dollar amount of the institution's assets adjusted by an appropriate credit conversion factor as defined by regulation. For all periods represented, the Association exceeded minimum regulatory standard for all the ratios.

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

	2008	2007	2006	Regulatory Minimum
Permanent capital ratio	15.57%	17.04%	16.31%	7.00%
Total surplus ratio	15.50%	16.93%	16.18%	7.00%
Core surplus ratio	15.50%	16.33%	14.94%	3.50%

The decrease in the Association's permanent capital, total surplus, and core surplus for December 31, 2008 was attributed to the Association's growth in loan volume. 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 \$8,541 in 2008, \$9,840 in 2007, and \$9,530 in 2006.

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

The Association's mission is to provide financial services to agriculture and the rural community, which includes providing credit to young*, beginning** and small*** farmers. The Association has further expanded this mission to include minority 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&M farmers. Specific marketing plans have been developed to target these groups, and resources have been designated to help ensure YBS&M 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&M loans in the loan portfolio for the Association.

	As of December 31, 2008	
	Number of Loans	Amount of Loans
Young	167	\$ 68,792
Beginning	472	216,725
Small	430	140,436

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 5,879 reported farmers of which by definition 256 or 4.4 percent were Young, 2,095 or 35.6 percent were Beginning, and 5,144 or 87.5 percent were Small. Comparatively, as of December 31, 2007, the demographics of the Association's agricultural portfolio contained 719 farmers, of which by definition 111 or 15.44 percent were Young, 322 or 44.78 percent were Beginning and 312 or 43.39 percent were Small.

In addition to the Association's overall marketing plan, the Association has developed and implemented a specific YBS&M plan to better identify and serve this unique and important segment of the agriculture in South Florida.

The YBS&M plan contains several components including staffing, identification, education, development, and direct financial support. Staffing represents the foundation of the program. The Association recognizes that to serve this community, its staff must understand the culture and needs of each group. The Association has focused on diversity in its employment practices for several years because we believe strongly that our staff should reflect the diversity of the community we serve. The Association currently has Credit, Lending and Operational staff fully capable of conducting business in four languages. The Association also has specialized programs and specially trained staff to serve the YBS&M community. Specific quantitative and qualitative goals have been set for the Association and specific staff members ensure their focus on the program as well as measure our performance in reaching these segments of our market.

Identification and outreach are also critical components of the program. The Association constantly monitors any public record databases, organizational membership roles, etc. available that could assist in identification of YBS&M potential customers. In addition, staff members are active in community, trade and cultural organizations felt to have membership that might include YBS&M farmers with other agricultural trade organizations and agencies such as the Federal, State and county agricultural agencies to ensure they understand our programs and would refer YBS&M farmers with financial or credit needs to Farm Credit. The Association has also worked closely with these agencies in providing training and development opportunities for YBS&M farmers. The Association aggressively attempts to partner with these agencies in joint programs. The Association is a "Preferred Lender" in USDA guaranteed lending programs.

A final component of the program is in the area of youth development programs. The Association actively supports those organizations such as FFA, 4-H, NAYFE and other youth based programs that are training and developing the farmers and ranchers of the future.

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

- * Young farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who are age 35 or younger as of the date the loan is originally made.
- ** Beginning farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who have 10 years or less farming or ranching experience as of the date the loan is originally made.
- *** Small farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who normally generate less than \$250 in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

REGULATORY MATTERS

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

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

Federal Legislation

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

other-than-temporarily impaired. Previously, premiums of up to 15 basis points could be charged on accruing loans and up to 25 basis points for nonaccrual loans.

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

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

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

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

Disclosure Required by Farm Credit Administration Regulations

Description of Business

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

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

Description of Property

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

<u>Location</u>	<u>Description</u>	<u>Form of Ownership</u>
11903 Southern Blvd. Royal Palm Beach	Administrative/ Branch	Owned
7150 20th Street Vero Beach	Branch	Leased
403 NW 6th Street Okeechobee	Branch	Owned
24700 SW 177th Avenue Homestead	Branch	Owned

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 12 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 8 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, 7 and 12 of the Consolidated Financial Statements included in this Annual Report.

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

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

Senior Officers

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

<u>Senior Officer</u>	<u>Position & Other Business Interests</u>
Donald A. Rice	<i>President and Chief Executive Officer</i> since November 1995. He serves on the boards of the Florida Council of Cooperatives (promotes cooperatives in Florida), Palm Beach County Overall Economic Development Program and the Palm Beach County Ag Enhancement Council.
C. Robert Pendleton	<i>Executive Vice President and Chief Lending Officer</i> since 1991, with Farm Credit since 1979. Serves as director on the board of the South Florida Fair.
Linda Rusciano	<i>Executive Vice President and Chief Financial Officer</i> since 1986, with Farm Credit since 1981.
Esther Morales	<i>Senior Vice President & Chief Credit Officer</i> since 2000, with Farm Credit since 1989.

The total amount of compensation earned by the CEO and five most highly paid officers as a group is disclosed in the Association's 2009 Annual Meeting Information Statement (AMIS). The AMIS is available for public inspection at the reporting association office. Disclosure of information on 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 a base salary, all employees earn additional compensation under an incentive plan. The Association incentive plan is designed to motivate employees to exceed the business plan goals during the fiscal year. These goals typically include return on assets, credit quality, credit administration, loan volume, nonaccrual loan volume, permanent capital and other key ratios. The goals incorporated in the current plan include return on assets, return on equity, credit quality, credit administration, high-risk loans, nonaccrual loan volume and operating efficiencies. Payment of the incentive is in the first quarter 2009. 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 sponsors a non-qualified supplemental deferred compensation plan for eligible employees. The purpose of the non-qualified plan is to provide supplemental deferred compensation options to eligible key employees. As a non-qualified plan, assets have been allocated and separately invested for this plan, but are not isolated from the general creditors of the Association.

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
Jack C. Coker, <i>Chairman</i>	1982	2011	\$ 19,200
Louis E. Larson, Jr., <i>Vice-Chairman</i>	1989	2010	18,900
John L. Alger	2007	2011	18,300
William E. Bowman, Jr.	1976	2010	16,200
Robert J. Callaway, <i>Outside Director</i>	1990	2009	18,600
Sherwood J. Johnson	1982	2009	19,200
Charles F. Martin	1987	2010	16,800
John D. Martin, Jr.	1994	2009	15,600
Robert G. Sexton	1995	2011	14,700
Andrea Thurn, <i>Outside Director</i>	2007	2010	17,100
			\$ 174,600

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.

Jack C. Coker, Chairman, is a beef cattle rancher and real estate developer in Okeechobee County. He currently serves on the boards of B and J Investments, Inc., J & M Investments, Inc. and Coker Cattle Corporation.

Louis E. Larson, Jr., Vice Chairman, is a dairy farmer and rancher in Okeechobee County. He serves as director on the boards of Larson Dairy, Inc., SunTrust of Mid-Florida, Dairy Feeds, Inc., Okeechobee Cattleman’s Association, and Southeast Milk, Inc. Mr. Larson also serves as Secretary to the Florida Cattlemen’s Association.

John L. Alger is a vegetable grower and nurseryman in Miami-Dade County. He serves on the boards of directors of Alger Farms, Inc. and Florida Fruit and Vegetable Association. Mr. Alger also serves as Vice President of S. M. Jones and Company, a produce sales company in Belle Glade; Vice President of Dade County Farm Bureau and is a member of the Executive Advisory Board of First National Bank of South Florida.

William E. Bowman, Jr. is a cattle rancher with his farming operations based in Okeechobee and eastern Palm Beach Counties. He currently serves on the boards of Bowman & Sons, Inc., Florida State Fair, South Florida Fair, McArthur Dairy, Triple Ranch, Inc., Taylor Creek Ranch, Inc., Dairy Feeds, Inc., the Law Enforcement Assistance Foundation and Flamingo Hills, a boat marina.

Robert J. Callaway serves as an Outside Director for the Association. He is a co-founder of Callaway and Price, Inc., a real estate appraisal and consulting firm. Mr. Callaway serves on the boards of Callaway Realty, Inc., the West Palm Beach Fishing Club & Foundation and Law Enforcement Assistance Foundation, a fund raising organization.

Sherwood J. Johnson is a citrus grower in the Indian River area. He currently serves as a director on the boards of Delta Farms Water Control District, University of Florida Share Council, Treasure Coast Agriculture Research Foundation, and Treasure Coast Research and Education Authority, a research center. Mr. Johnson also serves on the AgFirst Farm Credit Bank Nominating Committee.

Charles F. Martin is a nurseryman in Miami-Dade County. He serves as secretary/treasurer of Harold B. Martin, Inc.

John D. Martin, Jr., was a retired vegetable farmer and nurseryman in Palm Beach County and a citrus grower in St. Lucie County. He served on the boards of Martin Properties of Palm Beach County, Inc., and Palm Beach Community Bank. Regrettably, Mr. Martin passed away in January, 2009.

Robert G. Sexton is a citrus grower in Indian River County. He is President of Oslo Citrus Growers Association and co-owner of Orchid Island Juice Company. He serves as a director and chairman of the Audit Committee of AgFirst Farm Credit Bank. Mr. Sexton also serves as director on the boards of Oslo Citrus Growers Association, McArthur Management Company, a management company for a large dairy, cattle and citrus agribusiness; Lost Legend, LLC, owner of Orchid Island Juice Company; Sexton Grove Holdings, a family citrus company; Sexton Properties, Oslo Packing Company, Indian River Citrus League, Florida Citrus Packers, Highlands Exchange Service Co-op, a packinghouse supply cooperative; Patio Restaurant of Vero Beach and Sexton, Inc., family owned commercial real estate companies; and Dancing Pigs, LLC, which owns Red, Hot and Blue BBQ restaurants.

Andrea Thurn serves as an Outside Director for the Association. She is a Certified Public Accountant and a Partner/Owner in Morgan, Jacoby, Thurn, Boyle and Associates, P.A. in Vero Beach. Ms. Thurn has many years of experience with financial institutions, cooperatives and agribusinesses. She serves as Secretary/Treasurer of Vero Chemical Distributors, a janitorial paper and chemical supplier.

Subject to approval by the board, the Association may allow directors honoraria of \$300 for attendance at meetings, committee meetings, or special assignments. Directors are paid a monthly retainer fee of \$900, except for the chairman of the board who receives \$1,000. Total compensation paid to directors as a group was \$174,600 for 2008. No director received more than \$5,000 in non-cash compensation during the year.

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

Name of Director	Days Served		Committee Assignments	Comp. Paid for other Activities*
	Regular Board Meetings	Other Official Activities*		
Jack C. Coker, <i>Chairman</i>	10	17	Compensation, Governance, Executive, Loan	\$ 7,200
Louis E. Larson, Jr., <i>Vice-Chairman</i>	9	13	Compensation, Executive, Loan	8,100
John L. Alger	10	14	Compensation, Loan	7,500
William E. Bowman, Jr.	8	9	Compensation, Governance, Loan	5,400
Robert J. Callaway	10	21	Audit, Compensation, Loan	7,800
Sherwood J. Johnson	9	23	Audit, Governance, Compensation, Executive, Loan	8,400
Charles F. Martin	10	15	Compensation, Governance, Loan	6,000
John D. Martin	8	7	Compensation, Loan	4,800
Robert G. Sexton	8	13	Compensation, Loan	3,900
Andrea Thurn	9	20	Audit, Compensation, Loan	6,300
				\$ 65,400

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

Directors are reimbursed on an actual cost basis for all expenses incurred in the performance of official duties. Such expenses may include transportation, lodging, meals, tips, tolls, parking of cars, laundry, registration fees, and other expenses associated with travel on official business. A copy of the policy is available to shareholders of the Association upon request.

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was \$55,015 for 2008, \$40,938 for 2007 and \$26,247 for 2006.

Transactions with Senior Officers and Directors

The reporting entity’s policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 11 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 paid by the Association for services rendered by its independent auditor for the year ended December 31, 2008 were as follows:

	<u>2008</u>
<i>Independent Auditor</i> PricewaterhouseCoopers LLP	
Audit services	\$ 49,543
Total	<u>\$ 49,543</u>

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

Consolidated Financial Statements

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

Copies of the Association’s Annual and Quarterly reports are available upon request free of charge by calling 1-800-432-4156 or writing Linda Rusciano, Farm Credit of South Florida, ACA, P. O. Box 213069, Royal Palm Beach, FL 33421 or accessing the web site, www.farmcreditsfl.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. 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 South 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:



Sherwood J. Johnson
Chairman of the Audit Committee

Members of Audit Committee

Robert J. Callaway
Andrea Thurn

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 South 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 South 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
Assets			
Cash	\$ 408	\$ 2,072	\$ 667
Investment securities:			
Held to maturity (fair value of \$3,215 \$1,802 and \$0 respectively)	3,221	1,803	—
Total investment securities	3,221	1,803	—
Loans	589,244	529,972	514,258
Less: allowance for loan losses	8,051	4,978	5,198
Net loans	581,193	524,994	509,060
Accrued interest receivable	3,112	3,362	3,572
Investments in other Farm Credit institutions	7,857	7,552	6,773
Premises and equipment, net	5,793	6,693	6,777
Due from AgFirst Farm Credit Bank	3,614	3,978	3,782
Other assets	3,893	3,817	4,783
Total assets	\$ 609,091	\$ 554,271	\$ 535,414
Liabilities			
Notes payable to AgFirst Farm Credit Bank	\$ 484,670	\$ 428,586	\$ 420,609
Accrued interest payable	1,579	2,107	2,071
Patronage refund payable	5,349	6,227	5,307
Advanced conditional payments	7,387	10,525	8,354
Other liabilities	4,979	7,634	7,646
Total liabilities	503,964	455,079	443,987
Members' Equity			
Protected borrower stock	2,538	2,682	2,739
Capital stock and participation certificates	697	725	777
Retained earnings			
Allocated	22,550	22,483	21,752
Unallocated	79,342	73,302	66,159
Total members' equity	105,127	99,192	91,427
Total liabilities and members' equity	\$ 609,091	\$ 554,271	\$ 535,414

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
Interest Income			
Investment securities	\$ 126	\$ 88	\$ —
Loans	37,593	42,663	39,305
Total interest income	37,719	42,751	39,305
Interest Expense			
Notes payable to AgFirst Farm Credit Bank	21,612	25,432	22,603
Net interest income	16,107	17,319	16,702
Provision for (reversal of allowance for) loan losses	5,525	—	—
Net interest income after provision for (reversal of allowance for) loan losses	10,582	17,319	16,702
Noninterest Income			
Loan fees	2,573	1,555	1,999
Fees for financially related services	1,203	909	419
Patronage refund from other Farm Credit institutions	3,805	4,124	3,866
Gains (losses) on other property owned, net	407	27	27
Gains (losses) on sales of premises and equipment, net	2,721	16	36
Other noninterest income	(127)	220	88
Total noninterest income	10,582	6,851	6,435
Noninterest Expense			
Salaries and employee benefits	4,260	4,377	4,419
Occupancy and equipment	658	714	608
Insurance Fund premiums	747	730	681
Other operating expenses	1,285	1,296	1,209
Total noninterest expense	6,950	7,117	6,917
Income before income taxes	14,214	17,053	16,220
Provision (benefit) for income taxes	(24)	24	7
Net income	\$ 14,238	\$ 17,029	\$ 16,213

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		Total Members' Equity
			Allocated	Unallocated	
Balance at December 31, 2005	\$ 2,898	\$ 808	\$ 22,550	\$ 59,650	\$ 85,906
Net income				16,213	16,213
Protected borrower stock retired	(159)				(159)
Capital stock/participation certificates issued/(retired), net		(31)			(31)
Patronage distribution					
Cash				(5,147)	(5,147)
Nonqualified retained earnings			4,383	(4,383)	—
Retained earnings retired			(5,292)		(5,292)
Patronage distribution adjustment			111	(174)	(63)
Balance at December 31, 2006	2,739	777	21,752	66,159	91,427
Net income				17,029	17,029
Protected borrower stock retired	(57)				(57)
Capital stock/participation certificates issued/(retired), net		(52)			(52)
Patronage distribution					
Cash				(6,006)	(6,006)
Nonqualified retained earnings			3,834	(3,834)	—
Retained earnings retired			(3,135)		(3,135)
Patronage distribution adjustment			32	(46)	(14)
Balance at December 31, 2007	2,682	725	22,483	73,302	99,192
Net income				14,238	14,238
Protected borrower stock retired	(144)				(144)
Capital stock/participation certificates issued/(retired), net		(28)			(28)
Patronage distribution					
Cash				(5,071)	(5,071)
Nonqualified retained earnings			3,470	(3,470)	—
Retained earnings retired			(3,237)		(3,237)
Patronage distribution adjustment			(166)	343	177
Balance at December 31, 2008	\$ 2,538	\$ 697	\$ 22,550	\$ 79,342	\$ 105,127

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
Cash flows from operating activities:			
Net income	\$ 14,238	\$ 17,029	\$ 16,213
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	345	354	288
Premium amortization/discount accretion on investments	74	37	—
Provision for (reversal of allowance for) loan losses	5,525	—	—
(Gains) losses on other property owned, net	(407)	(27)	(27)
(Gains) losses on sales of premises and equipment, net	(2,721)	(16)	(36)
(Increase) decrease in accrued interest receivable	250	210	(194)
(Increase) decrease in due from AgFirst Farm Credit Bank	364	(196)	503
(Increase) decrease in other assets	(76)	966	(378)
Increase (decrease) in accrued interest payable	(528)	36	504
Increase (decrease) in other liabilities	(2,248)	15	(4,297)
Total adjustments	578	1,379	(3,637)
Net cash provided by (used in) operating activities	14,816	18,408	12,576
Cash flows from investing activities:			
Purchases of investment securities, held to maturity	(2,133)	(2,129)	—
Proceeds from maturities of or principal payments received on investment securities, held to maturity	641	289	—
Net (increase) decrease in loans	(61,724)	(15,934)	(46,609)
(Increase) decrease in investment in other Farm Credit institutions	(305)	(779)	(1,362)
Purchases of premises and equipment	(316)	(703)	(5,887)
Proceeds from sales of premises and equipment	3,592	449	54
Proceeds from sales of other property owned	—	—	27
Net cash provided by (used in) investing activities	(60,245)	(18,807)	(53,777)
Cash flows from financing activities:			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	56,084	7,977	48,337
Net increase (decrease) in advanced conditional payments	(3,138)	2,171	2,171
Protected borrower stock retired	(144)	(57)	(159)
Capital stock and participation certificates issued/(retired), net	(28)	(52)	(31)
Patronage refunds and dividends paid	(5,772)	(5,100)	(4,062)
Retained earnings retired	(3,237)	(3,135)	(5,292)
Net cash provided by (used in) financing activities	43,765	1,804	40,964
Net increase (decrease) in cash	(1,664)	1,405	(237)
Cash, beginning of period	2,072	667	904
Cash, end of period	\$ 408	\$ 2,072	\$ 667
Supplemental schedule of non-cash activities:			
Cash dividends or patronage distributions declared or payable	\$ 5,071	\$ 6,006	\$ 5,147
Supplemental information:			
Interest paid	\$ 22,140	\$ 25,396	\$ 22,099
Taxes (refunded) paid, net	4	(687)	(5)

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 South 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 Broward, Dade, Indian River, Martin, Monroe, Okeechobee, Palm Beach, and St. Lucie 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). The sale of other insurance necessary to protect a member's farm or aquatic unit is permitted, but limited to hail and multi-peril crop insurance, and insurance necessary to protect the facilities and equipment of aquatic borrowers.

Note 2 — Summary of Significant Accounting Policies

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

in the Consolidated Financial Statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results may differ from these estimates.

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

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

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

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

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

Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days (unless adequately collateralized and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in the prior year).

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

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

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

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

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

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

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

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

interest, and penalty interest incurred as the result of past due status, is collected or otherwise discharged in full.

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

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

- D. 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. 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 Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards No. 141R, "Business Combinations" (SFAS No. 141R). SFAS No. 141R requires business combinations to be accounted for under the acquisition method of accounting (previously called the purchase method). The acquisition method requires (a)

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

Note 3 — Investment Securities

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

	December 31, 2008				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Asset backed securities	\$ 3,221	\$ 3	\$ (9)	\$ 3,215	3.20%

	December 31, 2007				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Asset backed securities	\$ 1,803	\$ 1	\$ (2)	\$ 1,802	5.38%

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

The following table shows the fair value and gross unrealized losses for investments in a loss position by the length of time the securities have been in a continuous unrealized loss position at December 31, 2008. The continuous loss position is based on the date the impairment occurred. The Association performs periodic credit reviews, including other-than-temporary impairment analysis, on its investment securities portfolio. The objective is to quantify any future possible loss of principal or interest due on each security identified for additional analysis. Based on the results of all analyses, the Association has not recognized any other-than-temporary impairment in connection with these investments. The unrealized losses on these investments resulted primarily from reduced liquidity in the securities markets stemming from general adversity in the financial markets and are not credit related. The Association has the ability and intent to hold these investments until a recovery of unrealized losses occurs, which may be at maturity, and at this time expects to collect the full principal amount and interest due on these securities. All securities continue to perform. Substantially all of these investments were in U. S. government securities and the Association expects that these securities would not be settled at a price less than their amortized cost.

	Less than 12 Months		Greater than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Asset-backed securities	\$ 683	\$ 6	\$ 618	\$ 3

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

	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	\$ —	\$ —	—%
After one year through five years	—	—	—
After five years through ten years	1,310	1,301	1.88
After ten years	1,911	1,914	4.10
Total	\$ 3,221	\$ 3,215	3.20%

Note 4 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31,		
	2008	2007	2006
Real estate mortgage	\$ 388,652	\$ 374,068	\$ 389,254
Production and intermediate term	72,121	70,093	63,749
Processing and marketing	90,194	53,585	45,791
Farm related business	26,620	24,796	8,890
Communication	11,501	7,256	6,401
Rural residential real estate	156	174	173
Total loans	\$ 589,244	\$ 529,972	\$ 514,258

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	\$ 5,403	\$ —	\$ 59
Past due	8,981	—	79
Total impaired nonaccrual loans	14,384	—	138
Impaired accrual loans:			
Restructured accrual loans	—	—	—
Current as to principal and interest	—	805	4,286
Accrual loans 90 days or more past due	—	—	267
Total impaired accrual loans	—	805	4,553
Total impaired loans	\$14,384	\$ 805	\$4,691

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	\$ 7	\$ 119	\$ —
Interest income on impaired accrual loans	65	141	352
Interest income recognized on impaired loans	\$ 72	\$ 260	\$ 352

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

	2008	2007	2006
Impaired loans with related allowance	\$ 2,642	\$ 805	\$ 4,286
Impaired loans with no related allowance	11,742	—	405
Total impaired loans	\$14,384	\$ 805	\$ 4,691
Allowance on impaired loans	\$ 524	\$ 324	\$ 2,134

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

	2008	2007	2006
Average impaired loans	\$ 5,855	\$ 2,917	\$ 496

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	\$ 875	\$ 120	\$ 10
Less: interest income recognized	7	119	—
Foregone interest income	<u>\$ 868</u>	<u>\$ 1</u>	<u>\$ 10</u>

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

	Year Ended December 31,		
	2008	2007	2006
Balance at beginning of year	\$ 4,978	\$ 5,198	\$ 5,106
Charge-offs:			
Real estate mortgage	(1,605)	(1,400)	(2)
Production and intermediate term	(581)	(13)	—
Agribusiness	(278)	—	—
Total charge-offs	<u>(2,464)</u>	<u>(1,413)</u>	<u>(2)</u>
Recoveries:			
Real estate mortgage	—	1,187	—
Production and intermediate term	12	6	94
Total recoveries	<u>12</u>	<u>1,193</u>	<u>94</u>
Net (charge-offs) recoveries	<u>(2,452)</u>	<u>(220)</u>	<u>92</u>
Provision for (reversal of allowance for) loan losses	<u>5,525</u>	<u>—</u>	<u>—</u>
Balance at end of year	<u>\$ 8,051</u>	<u>\$ 4,978</u>	<u>\$ 5,198</u>

	2008	2007	2006
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	<u>(0.442)%</u>	<u>(0.042)%</u>	<u>0.019%</u>

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

	December 31, 2008		December 31, 2007	
	Amount	%	Amount	%
Real estate mortgage	\$ 6,382	79%	\$ 3,384	68%
Production and intermediate term	975	12	1,393	28
Agribusiness	637	8	136	3
Communication	57	1	59	1
Total	<u>\$ 8,051</u>	<u>100%</u>	<u>\$ 4,978</u>	<u>100%</u>

	December 31, 2006	
	Amount	%
Real estate mortgage	\$ 3,597	69%
Production and intermediate term	1,400	27
Agribusiness	136	3
Communication	59	1
Rural residential real estate	6	—
Total	<u>\$ 5,198</u>	<u>100%</u>

Note 5 — Investment in AgFirst Farm Credit Bank

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

Note 6 — Premises and Equipment

Premises and equipment consists of the following:

	December 31,		
	2008	2007	2006
Land	\$ 149	\$ 439	\$ 439
Buildings and improvements	5,419	6,299	6,810
Furniture and equipment	1,780	2,124	1,395
	<u>7,348</u>	<u>8,862</u>	<u>8,644</u>
Less: accumulated depreciation	<u>1,555</u>	<u>2,169</u>	<u>1,867</u>
Total	<u>\$ 5,793</u>	<u>\$ 6,693</u>	<u>\$ 6,777</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	\$ 407	\$ 27	\$ 27
Carrying value unrealized gains (losses)	—	—	—
Operating income (expense), net	<u>—</u>	<u>—</u>	<u>—</u>
Gains (losses) on other property owned, net	<u>\$ 407</u>	<u>\$ 27</u>	<u>\$ 27</u>

Note 8 — Notes Payable to AgFirst Farm Credit Bank

The Association's indebtedness to the Bank represents borrowings by the Association to fund its loan portfolio. This indebtedness is collateralized by a pledge of substantially all of the Association's assets and the terms of the revolving lines of credit are governed by a general financing agreement. Interest rates on both variable and fixed rate notes payable are generally established loan-by-loan based on the Bank's marginal cost of funds, capital position, operating costs and return objectives. The interest rate is periodically adjusted by the Bank based upon agreement between the Bank and the Association. The weighted average interest rates on the variable rate notes were 3.34 percent for LIBOR-based loans, 2.30 percent for Prime-based loans, and the weighted average remaining maturities were 1.8 years and 3.0 years, respectively, at December 31, 2008. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) loans which are match funded by the Bank was 4.21 percent and the weighted average remaining maturity was 3.0 years at December 31, 2008. The weighted average interest rate on all interest-bearing notes payable was 3.60 percent and the weighted average remaining maturity was 2.9 years at December 31, 2008.

Variable rate and fixed rate notes payable represent approximately 29.24 percent and 70.76 percent, respectively, of total notes payable at December 31, 2008.

Under the Farm Credit Act, the Association is obligated to borrow only from the Bank, unless the Bank approves borrowing from other funding sources. The Bank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas

relating primarily to credit quality and financial condition. At December 31, 2008, the Association's notes payable were within the specified limitations.

Note 9 — Members' Equity

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

A. Protected Borrower Equity

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

B. Capital Stock and Participation Certificates

In accordance with the Farm Credit Act and the Association's capitalization bylaws, each borrower is required to invest in Class C stock for agricultural loans, or participation certificates in the case of rural home and farm related business loans, as a condition of borrowing. The initial borrower investment, through either purchase or transfer, must be in an amount equal to the lessor of two percent of the loan amount or \$1,000. The Board of Directors may increase the amount of investment if necessary to meet the Association's capital needs. Loans designated for sale or sold into the Secondary Market on or after April 16, 1996 will have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation.

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

C. Regulatory Capitalization Requirements and Restrictions

FCA's capital adequacy regulations require the Association to achieve permanent capital of seven percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the seven percent capital requirement can initiate certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Association's financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless

prescribed capital standards are met. FCA regulations also require that additional minimum standards for capital be achieved. These standards require all System institutions to achieve and maintain ratios as defined by FCA regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of seven percent and core surplus as a percentage of risk-adjusted assets of three and one-half percent. The Association's permanent capital, total surplus and core surplus ratios at December 31, 2008 were 15.57 percent, 15.50 percent and 15.50 percent, respectively.

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

D. Description of Equities

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

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

Class	Protected	Shares Outstanding	
		Number	Aggregate Par Value
A Common/Nonvoting	Yes	86,051	\$ 430
B Common/Nonvoting	Yes	416,127	2,081
C Common/Voting	No	135,282	676
B Participation Certificates/Nonvoting	Yes	5,400	27
C Participation Certificates/Nonvoting	No	4,139	21
Total Capital Stock and Participation Certificates		646,999	\$ 3,235

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 Board determines the minimum aggregate amount of these two accounts. 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. All nonqualified distributions are tax deductible only when redeemed.

At December 31, 2008, allocated members' equity consisted of \$22,550 of nonqualified retained surplus.

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.

Dividends

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

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

Transfer

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

Impairment

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

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

Distribution on Liquidation

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities, shall be distributed in the following order of priority:

- a) **First**, to the holders of Class D Preferred Stock until an amount equal to the aggregate par value of all shares of said stock then issued and outstanding has been distributed to such holders,
- b) **Second**, to the holders of Class A Common Stock, Class B Common Stock, Class C Common Stock and Participation Certificates, pro rata in proportion to the

number of shares or units of each such class of stock or participation certificates then issued and outstanding, until an amount equal to the aggregate par value or face amount of all such shares or units has been distributed to such holders;

- c) **Third**, to the holders of allocated surplus evidenced by qualified written notices of allocation, in the order of the year of issuance, until the total amount of such account has been distributed;
- d) **Fourth**, to the holders of allocated surplus evidenced by nonqualified written notices of allocation, in the order of the year of issuance, until the total amount of such account has been distributed;
- e) **Fifth**, all unallocated surplus accrued or issued after April 22, 1995, shall be distributed to present and former Patrons from said date through the date of liquidation on a patronage basis to the extent practicable; and
- f) **Sixth**, any remaining assets of the Association after such distribution shall be distributed ratably to the holders of all classes of Common Stock and Participation Certificates in proportion to the number or shares or units of such class of Common Stock or participation certificates held by such holders.

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

Note 10 — Income Taxes

The provision (benefit) for income taxes follows:

	Year Ended December 31,		
	2008	2007	2006
Current:			
Federal	\$ (24)	\$ 24	\$ 7
	(24)	24	7
Deferred:	-	-	-
Total provision (benefit) for income taxes	\$ (24)	\$ 24	\$ 7

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

	December 31,		
	2008	2007	2006
Federal tax at statutory rate	\$ 4,833	\$ 5,798	\$ 5,515
Patronage distributions	(1,724)	(2,042)	(1,750)
Nonqualified written notices	-	-	-
Tax-exempt FLCA earnings	(4,081)	(4,221)	(3,784)
Change in deferred tax asset valuation allowance	983	394	16
Other	(35)	95	10
Provision (benefit) for income taxes	\$ (24)	\$ 24	\$ 7

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

	December 31,		
	2008	2007	2006
Deferred income tax assets:			
Allowance for loan losses	\$ 367	\$ 524	\$ 527
Net operating loss – carryforward	1,877	787	382
Nonaccrual loan interest	47	-	2
Gross deferred tax assets	2,291	1,311	911
Less: valuation allowance	(2,065)	(1,082)	(688)
Gross deferred tax assets, net of valuation allowance	226	229	223
Deferred income tax liabilities:			
Bank patronage allocation	(226)	(229)	(223)
Other	-	-	-
Gross deferred tax liability	(226)	(229)	(223)
Net deferred tax asset (liability)	\$ -	\$ -	\$ -

At December 31, 2008, deferred income taxes have not been provided by the Association on approximately \$1.1 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 \$2,065, \$1,082 and \$688 during 2008, 2007 and 2006, respectively. The Association will continue to evaluate the realizability of these deferred tax assets and adjust the valuation allowance accordingly.

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

Note 11 — Employee Benefit Plans

The employees of the Association may participate in a Districtwide defined benefit retirement plan. This plan is noncontributory and covers substantially all Association employees. Benefits are based on salary and years of service. As a participant in the District's defined benefit plan, the Association funded \$505 for 2008 and \$0 for 2007 and 2006, through its note payable to the Bank. Plan expenses included in salaries and employee benefits were \$218 for 2008, \$343 for 2007, and \$416 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 \$80 for 2008, \$84 for 2007 and \$117 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 \$124, \$111, and \$99 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 \$11,168. During 2008, \$7,689 of new loans were made and repayments totaled \$6,771.

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, \$145,238 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 \$10,588 of standby letters of credit, with expiration dates ranging from January 9, 2009 to March 31, 2014. The maximum potential amount of future payments the Association may be required to make under these existing guarantees is \$10,588.

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 \$191 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 assets held in trust funds, standby letters of credit, and impaired loans.

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

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

Level 1

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

Level 2

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

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 also 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	
Assets:				
Assets held in trust funds	\$ 895	\$ -	\$ -	\$ 895
Total Assets	\$ 895	\$ -	\$ -	\$ 895
Liabilities:				
Standby letters of credit	\$ -	\$ -	\$ 191	\$ 191
Total Liabilities	\$ -	\$ -	\$ 191	\$ 191

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	\$ 184
Total gains or (losses) realized/unrealized:	
Included in earnings	-
Included in other comprehensive loss	-
Purchases, sales, issuances and settlements, net	7
Transfers in and/or out of level 3	-
Balance at December 31, 2008	\$ 191

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		
Assets:					
Impaired loans	\$ -	\$ -	\$ 2,118	\$ 2,118	\$ (524)

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
Financial assets:				
Cash	\$ 408	\$ 408	\$ 2,072	\$ 2,072
Loans, net of allowance	\$ 581,193	\$ 592,318	\$ 524,994	\$ 535,868
Investment securities	\$ 3,221	\$ 3,215	\$ 1,803	\$ 1,802
Assets held in trust funds	\$ 895	\$ 895	\$ 1,068	\$ 1,068
Financial liabilities:				
Notes payable to AgFirst Farm Credit Bank	\$ 484,670	\$ 492,050	\$ 428,586	\$ 435,522

	December 31, 2006	
	Carrying Amount	Estimated Fair Value
Financial assets:		
Cash	\$ 667	\$ 667
Loans, net of allowance	\$ 509,060	\$ 516,585
Investment securities	\$ -	\$ -
Assets held in trust funds	\$ 788	\$ 788
Financial liabilities:		
Notes payable to AgFirst Farm Credit Bank	\$ 420,609	\$ 422,532

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

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

For purposes of determining fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics based upon repricing and credit risk. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

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

The carrying value of accrued interest approximates its fair value.

C. **Investment Securities:** Fair value is based upon quoted market price.

D. **Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** Estimating the fair value of the Association's investment in the Bank and Other Farm Credit Institutions is not practicable because the stock is not traded. As described in Note 5, the net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying Consolidated Balance Sheets. The Association owns 2.0 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 \$7,857 related to other Farm Credit institutions.

E. **Notes Payable to AgFirst Farm Credit Bank:** The notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association's loan receivables plus accrued interest on the notes payable. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.

F. **Commitments to Extend Credit and Standby Letters of Credit:** The estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics and since the related credit risk is not significant.

G. **Assets Held in Trust Funds:** See Note 14 for discussion of estimation of fair value for this instrument.

Note 16 — Quarterly Financial Information (Unaudited)

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

	2008				
	First	Second	Third	Fourth	Total
Net interest income	\$ 4,163	\$ 4,033	\$ 3,839	\$ 4,072	\$ 16,107
Provision for (reversal of allowance for) loan losses	—	525	2,000	3,000	5,525
Noninterest income (expense), net	667	204	515	2,270	3,656
Net income (loss)	\$ 4,830	\$ 3,712	\$ 2,354	\$ 3,342	\$ 14,238

	2007				
	First	Second	Third	Fourth	Total
Net interest income	\$ 4,291	\$ 4,314	\$ 4,339	\$ 4,375	\$ 17,319
Provision for (reversal of allowance for) loan losses	—	—	—	—	—
Noninterest income (expense), net	(37)	154	(521)	114	(290)
Net income (loss)	\$ 4,254	\$ 4,468	\$ 3,818	\$ 4,489	\$ 17,029

	2006				
	First	Second	Third	Fourth	Total
Net interest income	\$ 4,086	\$ 4,100	\$ 4,236	\$ 4,280	\$ 16,702
Provision for (reversal of allowance for) loan losses	—	—	—	—	—
Noninterest income (expense), net	189	(417)	(224)	(37)	(489)
Net income (loss)	\$ 4,275	\$ 3,683	\$ 4,012	\$ 4,243	\$ 16,213