



 **FARM CREDIT**
Country Mortgages 

ANNUAL **2 0 0 8** REPORT

FINANCING RURAL AMERICA



FARM CREDIT OF THE VIRGINIAS, ACA

2008 ANNUAL REPORT

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Management

David E. Lawrence.....	President and Chief Executive Officer
Bette B. Brand.....	Chief Sales Officer
Dennis K. Carpenter.....	Chief Lending Officer
David G. Sauer.....	Chief Financial Officer

Board of Directors

John E. Wells	Chairman
Alfred W. Stephens, Jr.	Vice Chairman
James H. Addington.....	Director
Ronald L. Bennett	Director
Donna M. Brooke – Alt	Director
William J. Franklin, Jr.....	Director
Paul M. House.....	Director
Melody S. Jones	Director
James A. Kinsey.....	Director
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Ralph L. Puckett.....	Director
Donald W. Reese	Director
Wallace W. Sanford, III.....	Director
Walter L. Schmidlen, Jr.	Director
Barry W. Shelor	Director
Raymond L. Simms.....	Director
Thomas V. Thacker.....	Director
Joseph W. Wampler.....	Director

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Message from the Chief Executive Officer

I am pleased to report your association made a profit for 2008 and it will pay its owners/customers a patronage dividend. Most businesses including our customers are facing a convergence of risk from volatile markets. Your Association is experiencing the same volatile market place as its customers. Yes, we are experiencing an increase in the cost of doing business, but this is not any different than our customers stating their cash flow is tighter than previous years.

2008 was a mixed year. The association experienced good loan growth through the first half of the year. The last half of the year was another scenario especially the downturn in the general economy and debt market “meltdown.” The agricultural commodities served by the association are primarily in the meat complex and were negatively impacted with increased costs of inputs (feed and fuel) and mixed revenues that resulted in a stressed situation for several customers as compared to previous years.

The association remains in a strong financial position and it is positioned to take care of your lending needs. The financial performance is not at the level we have come to expect during the past “boom” years but the Board approved a plan to distribute over \$10 million of its 2008 earnings in cash to the customer/stockholders. As in previous years, the customer/shareholders who were active borrowers during 2008 are receiving checks.

In 2008 your association directors, employees and many customers continued to participate in visits with elected officials as part of the initiative to tell how Farm Credit is conservatively lending to rural America. The goal remains to ensure Farm Credit has the authority to continue providing farmers access to capital.

We thank you for your business and trust. Please let me assure you, that your association continues to believe when conditions get tough, we should work to understand the ever-changing lending needs of the customers/owners it serves.

The annual report is inherently full of numbers and in-depth explanations of our 2008 financial results and how they were achieved. I hope you will read through the financial information and contact me or the CFO, David Sauer, if you have any questions pertaining to your association. I believe that your support and input are vital keys to the association’s success.



David E. Lawrence
Chief Executive Officer

February 27, 2009

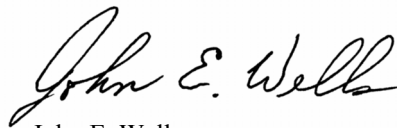
Report of Management

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



John E. Wells
Chairman of the Board



David E. Lawrence
Chief Executive Officer



David G. Sauer
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.



David E. Lawrence
Chief Executive Officer



David G. Sauer
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	\$ 3,677	\$ 3,627	\$ 2,716	\$ 2,757	\$ 2,039
Loans	1,467,970	1,503,453	1,331,317	1,193,351	1,130,862
Less: allowance for loan losses	6,779	3,694	2,445	2,736	2,947
Net loans	1,461,191	1,499,759	1,328,872	1,190,615	1,127,915
Investments in other Farm Credit institutions	37,545	21,022	18,304	13,489	13,524
Other property owned	2,507	796	—	—	—
Other assets	51,186	48,887	43,236	37,881	28,621
Total assets	<u>\$ 1,556,106</u>	<u>\$ 1,574,091</u>	<u>\$ 1,393,128</u>	<u>\$ 1,244,742</u>	<u>\$ 1,172,099</u>
Notes payable to AgFirst Farm Credit Bank*	\$ 1,318,784	\$ 1,341,684	\$ 1,168,915	\$ 1,025,160	\$ 959,297
Accrued interest payable and other liabilities with maturities of less than one year	31,581	40,751	44,470	36,449	31,140
Total liabilities	<u>1,350,365</u>	<u>1,382,435</u>	<u>1,213,385</u>	<u>1,061,609</u>	<u>990,437</u>
Capital stock and participation certificates	18,430	18,517	18,318	18,568	19,094
Retained earnings					
Allocated	71,860	63,629	54,845	60,085	58,640
Unallocated	115,444	109,502	106,580	104,480	103,928
Accumulated other comprehensive income (loss)	7	8	—	—	—
Total members' equity	<u>205,741</u>	<u>191,656</u>	<u>179,743</u>	<u>183,133</u>	<u>181,662</u>
Total liabilities and members' equity	<u>\$ 1,556,106</u>	<u>\$ 1,574,091</u>	<u>\$ 1,393,128</u>	<u>\$ 1,244,742</u>	<u>\$ 1,172,099</u>
Statement of Income Data					
Net interest income	\$ 36,563	\$ 35,450	\$ 33,661	\$ 29,708	\$ 25,271
Provision for (reversal of allowance for) loan losses	5,213	1,400	—	(78)	(20,858)
Noninterest income (expense), net	(6,246)	(4,140)	(5,864)	(2,006)	(1,163)
Net income	<u>\$ 25,104</u>	<u>\$ 29,910</u>	<u>\$ 27,797</u>	<u>\$ 27,780</u>	<u>\$ 44,966</u>
Key Financial Ratios					
Rate of return on average:					
Total assets	1.56%	2.02%	2.13%	2.33%	4.06%
Total members' equity	12.29%	15.34%	14.30%	14.48%	27.63%
Net interest income as a percentage of					
average earning assets	2.37%	2.49%	2.67%	2.57%	2.31%
Net (chargeoffs) recoveries to average loans	(0.138)%	(0.011)%	(0.023)%	(0.012)%	0.046%
Total members' equity to total assets	13.22%	12.18%	12.90%	14.71%	15.50%
Debt to members' equity (:1)	6.56	7.21	6.75	5.80	5.45
Allowance for loan losses to loans	0.46%	0.25%	0.18%	0.23%	0.26%
Permanent capital ratio	12.11%	12.68%	13.57%	15.08%	14.68%
Total surplus ratio	10.89%	11.38%	12.19%	13.49%	12.89%
Core surplus ratio	10.89%	11.38%	11.73%	12.00%	10.36%
Net Income Distribution					
Estimated patronage refunds:					
Cash	\$ 10,551	\$ 18,210	\$ 18,062	\$ 14,360	\$ 10,011
Nonqualified retained earnings	9,078	8,413	7,741	11,749	10,011

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

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

(dollars in thousands, except as noted)

GENERAL OVERVIEW

The following commentary summarizes the financial condition and results of operations of Farm Credit of the Virginias, 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 Virginia, West Virginia and Maryland. 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.farmcreditofvirginias.com, or by calling 1-540-886-3435, extension 5020, or writing David Sauer, Farm Credit of the Virginias, P.O. Box 899, Staunton, VA 24402-0899. 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

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.

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

After several years of economic growth and a favorable business climate in our region, 2008 was a challenging year. The weakening of the housing market, which started in 2007, began to impact the overall economy in 2008. In addition to the slowing housing market, energy and commodity prices increased dramatically during the first half of 2008, then prices dropped just as dramatically during the second half of the year. The volatility in prices and demand during 2008 created a challenging business environment. For the most part, farm land in our region has not experienced the decline in values like the housing market. During first half of 2008, the Association experienced a high demand for loans. For real estate loans, this demand was fueled by lower interest rates and better prices for real estate. For commercial and operating loans, the demand was driven mainly by higher input costs. During the second half of 2008, the demand for loans decreased as turmoil in the financial markets led to lower consumer spending and lower consumer confidence.

The agricultural economy had a number of challenges this year. Higher cost for fertilizer, fuel, and other inputs was one of the biggest challenges. Many agricultural producers could not pass these higher costs on which resulted in a weakening of their operating margins. Slowing demand for agricultural products during the year was another challenge. The Timber industry continued to be impacted by the slow down in the housing market. The slowing demand caused prices for our producers' products to decline especially during the fourth quarter of the year.

The credit quality of the loan portfolio continued to be good with only slight adverse movements in some quality measures compared to earlier reporting periods. The increased volatility in the financial markets and the generally weaker economy

experienced over the past twelve months have not affected either the overall farm sector or the Association's customers in a substantially negative way.

To the extent there has been any recent credit quality deterioration, that deterioration is largely driven by rapidly increasing input costs. Higher fuel costs have adversely impacted all producers. Higher feed costs have been problematic for the livestock and poultry industries. Industries tied to housing such as forestry, sawmills, sod, and landscape nurseries saw demand plummet and profitability compromised. Over time, the higher inputs will either be passed on to the consumer or production will be cut to ensure the supply produced will clear the market at prices that will generate a profit. Although the credit quality of the Association loan portfolio has been only slightly negatively impacted to date by the factors mentioned above, the risk of future deterioration is increasing.

During 2008, the Association targeted certain areas of our business with hopes of increasing market share. Continued efforts are being made to expand services, increase public knowledge of our services and streamline our current delivery of products to enhance our existing portfolio.

LOAN PORTFOLIO

The Association loan volume was \$1,467,469 at December 31, 2008 compared to \$1,503,010 at December 31, 2007, a decrease of \$35,541 or 2.36%. The decrease in loan volume was primarily due to the Association's decision to sell loans into the Bank's capitalized participation pool program, which is an income neutral transaction that benefits both the Association's and Bank's capital position. As of December 31, 2008, loans sold under this program totaled \$168,039. Under this program the Association also increased its investment in the Bank.

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	\$ 922,357	62.85%	\$ 1,008,774	67.12%	\$ 879,204	66.12%
Production and intermediate-term	374,506	25.52	329,683	21.93	314,180	23.63
Processing and marketing	86,546	5.90	81,154	5.40	68,420	5.15
Farm-related business	22,688	1.55	23,679	1.58	17,177	1.29
Communication	4,458	0.30	2,794	0.19	-	-
Rural residential real estate	56,914	3.88	56,926	3.78	50,801	3.81
Total	\$ 1,467,469	100.00%	\$ 1,503,010	100.00%	\$ 1,329,782	100.00%

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

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

Branch/State	December 31,		
	2008	2007	2006
Abingdon, VA	5%	5%	5%
Bedford, VA	3	3	3
Charlottesville, VA	4	4	4
Chatham, VA	3	3	2
Clarksburg, WV	2	2	2
Culpeper, VA	6	6	6
Elkins, WV	2	2	2
Gate City, VA	1	1	1
Halifax, VA	2	2	2
Harrisonburg, VA	13	11	13
Leesburg, VA	7	7	7
Lewisburg, WV	2	2	2
Lexington, VA	3	3	3
Oakland, MD	4	4	3
Orange, VA	7	6	6
Petersburg, WV	4	4	4
Ripley, WV	4	4	4
Roanoke, VA	2	2	2
Rocky Mount, VA	4	4	4
Romney, WV	1	1	1
Verona, VA	5	5	5
Warrenton, VA	8	7	8
Wytheville, VA	6	5	5
Agribusiness	8	3	1
Participation Loans Purchased	8	6	6
Participation Loans Sold	(14)	(2)	(1)
	100%	100%	100%

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 livestock, field crops, and timber, which constitute over 61 percent of the entire portfolio.

Commodity Group	December 31,					
	2008	2007	2006			
	<i>(dollars in thousands)</i>					
Livestock	\$ 484,265	33%	\$ 495,993	33%	\$ 452,126	34%
Field Crops	220,120	15	240,482	16	199,467	15
Timber	190,771	13	195,391	13	172,872	13
Dairy	117,398	8	120,241	8	106,383	8
Poultry	132,072	9	105,211	7	93,085	7
Rural Home	58,699	4	60,120	4	53,191	4
Tobacco	14,674	1	15,030	1	26,596	2
Other	249,470	17	270,542	18	226,062	17
Total	\$ 1,467,469	100%	\$ 1,503,010	100%	\$ 1,329,782	100%

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The Association's loan portfolio contains a concentration of livestock producers. Although a large percentage of the loan portfolio is concentrated in these enterprises, many of these operations are diversified within their enterprise and/or with crop production that reduces overall risk exposure. Demand for beef, prices of field grains, and international trade are some of the factors affecting the price of these commodities. Even though the concentration of large

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

During 2008, the Association continued to buy and sell loan participations within the System. This provides a means for the Association to spread credit concentration risk and realize non-patronage sourced interest and fee income, which may strengthen its capital position. The large increase in loan participations sold was due to loans sold into the Bank's capitalized participation pool program.

Loan Participations:	December 31,		
	2008	2007	2006
	<i>(dollars in thousands)</i>		
Participations Purchased			
– FCS Institutions	\$ 94,132	\$ 96,087	\$ 75,156
Participations Purchased			
– Non-FCS Institutions	309	318	1,033
Participations Sold	(179,507)	(24,147)	(8,221)
Total	\$ (85,066)	\$ 72,258	\$ 67,968

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 \$37,529, which were sold into the secondary market. The Association also participates in the Farmer Mac Long Term Stand-By program. Farmer Mac was established by Congress to provide liquidity to agricultural lenders. At December 31, 2008, the Association had loans amounting to \$101,353 which were 100 percent guaranteed by Farmer Mac. 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 \$309, compared to \$318 at December 31, 2007 and \$1,033 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, 2007, and 2006, the Association had \$1,312, \$1,312, and \$0, respectively, in Rural America Bonds, and they are classified as Loans on the Consolidated Balance Sheets.

On October 22, 2004, Congress enacted the "Fair and Equitable Tobacco Reform Act of 2004" (Tobacco Act) as part of the "American Jobs Creation Act of 2004." The Tobacco Act repealed the Federal tobacco price support and quota programs, provided for payments to tobacco "quota owners" and producers for the elimination of the quota and included an assessment mechanism for tobacco manufacturers and importers to pay for the buyout. Tobacco quota holders and producers will receive equal annual payments under a contract with the Secretary of Agriculture. The Tobacco Act also includes a provision that allows the quota holders and producers to assign to a "financial institution" the right to receive the contract payments (Successor-in-Interest Contracts (SIIC)) so that they may obtain a lump sum or other payment. On April 4, 2005, the United States Department of Agriculture (USDA) issued a Final Rule implementing the "Tobacco Transition Payment Program" (Tobacco Buyout). At December 31, 2008, 2007, and 2006, the Association had \$15,850, \$15,065, and \$10,401, respectively, in SIIC outstanding and these are classified as Other Investments on the Consolidated Balance Sheets.

CREDIT RISK MANAGEMENT

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

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

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

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

- Acceptable – Assets are expected to be fully collectible and represent the highest quality.
- Other Assets Especially Mentioned (OAEM) – Assets are currently collectible but exhibit some potential weakness.
- Substandard – Assets exhibit some serious weakness in repayment capacity, equity, and/or collateral pledged on the loan.
- Doubtful – Assets exhibit similar weaknesses to substandard assets. However, doubtful assets have additional weaknesses in existing facts, conditions and values that make collection in full highly questionable.
- Loss – Assets are considered uncollectible.

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

Credit Quality	2008	2007	2006
Acceptable & OAEM	96.36%	98.30%	98.44%
Substandard	3.61%	1.67%	1.56%
Doubtful	0.03%	.03%	–%
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	\$ 37,181	\$ 8,211	\$ 3,886
Restructured loans	–	–	–
Accruing loans 90 days past due	612	–	3
Total high-risk loans	37,793	8,211	3,889
Other property owned	2,507	796	–
Total high-risk assets	<u>\$ 40,300</u>	<u>\$ 9,007</u>	<u>\$ 3,889</u>
Ratios			
Nonaccrual loans to total loans	2.53%	0.55%	0.29%
High-risk assets to total assets	2.59%	0.57%	0.28%

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 \$28,970 or 352.82% percent in 2008. This large increase was mainly due to four large accounts being downgraded to nonaccrual status. Of the \$37,181 in nonaccrual volume at December 31, 2008, \$18,002 or 48.42%, compared to 17.45 percent and 52.86 percent at December 31, 2007 and 2006, respectively, was current as to scheduled principal and interest payments, but did not meet all regulatory requirements to be transferred into accrual status.

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	\$ 3,694	\$ 2,445	\$ 2,736
Charge-offs:			
Real estate mortgage	(1,807)	(3)	—
Production and intermediate-term	(324)	(141)	(205)
Agribusiness	—	—	(98)
Rural residential real estate	(8)	(11)	—
Total charge-offs	(2,139)	(155)	(303)
Recoveries:			
Real estate mortgage	—	1	—
Production and intermediate-term	11	3	12
Total recoveries	11	4	12
Net (charge-offs) recoveries	(2,128)	(151)	(291)
Provision for (reversal of allowance for) loan losses	5,213	1,400	—
Balance at end of year	\$ 6,779	\$ 3,694	\$ 2,445
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	(0.138)%	(0.011)%	(0.023)%

The net loan charge-offs were primarily associated with real estate mortgages and operating loans.

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

Allowance for Loan Losses by Type	December 31,		
	2008	2007	2006
	<i>(dollars in thousands)</i>		
Real estate mortgage	\$ 1,637	\$ 1,834	\$ 1,047
Production and intermediate-term	2,879	1,400	1,216
Agribusiness	1,721	150	97
Rural residential real estate	525	310	85
Communication	17	—	—
Total Allowance	\$ 6,779	\$ 3,694	\$ 2,445

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	0.46%	0.25%	.18%
Nonaccrual loans	18.23%	44.99%	62.92%

Please refer to Note 3, "Loans and Allowance for Loan Losses," of the Notes to the Consolidated Financial Statements, for further information concerning the allowance for loan losses.

RESULTS OF OPERATIONS

Net income for the year ended December 31, 2008, totaled \$25,104, a decrease of \$4,806 or 16.07 percent, as compared to \$29,910 for the same period of 2007. Net income for the year ended December 31, 2007, totaled \$29,910, an increase of

\$2,113 or 7.60 percent, as compared to \$27,797 for the same period of 2006. Interest income for the year ended December 31, 2008, was \$109,077, a decrease of \$664 or 0.61 percent as compared to \$109,741 for the same period of 2007. Interest income increased by \$15,738 or 16.74 percent for the period ended December 31, 2007, as compared to the same period of 2006.

Net Interest Income

Net interest income was \$36,563, \$35,450 and \$33,661 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	\$ 8,912	\$ (9,732)	\$ 156	\$ (664)
Interest expense	6,951	(8,728)	—	(1,777)
Change in net interest income	\$ 1,961	\$ (1,004)	\$ 156	\$ 1,113
12/31/07 - 12/31/06				
Interest income	\$ 12,158	\$ 3,687	\$ (107)	\$ 15,738
Interest expense	9,450	4,499	—	13,949
Change in net interest income	\$ 2,708	\$ (812)	\$ (107)	\$ 1,789

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

Noninterest Income

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

Noninterest Income	For the Year Ended			Percentage Increase/(Decrease)	
	December 31,			2008/	2007/
	2008	2007	2006	2007	2006
	<i>(dollars in thousands)</i>				
Loan fees	\$ 1,330	\$ 1,095	\$ 933	21%	17%
Fees for financially related services	217	219	112	(1)	96
Patronage refund from other Farm Credit Institutions	11,611	11,302	9,844	3	15
Gains (losses) on other property owned, net	(293)	(32)	35	(816)	(191)
Gains (losses) on sales of rural home loans	428	645	528	(34)	22
Gains (losses) on sales of premises and equipment, net	(4)	(4)	(16)	—	75
Other noninterest income	59	709	223	(92)	218
Total noninterest income	\$ 13,348	\$ 13,934	\$ 11,659	(4)	20%

Loan fees income increased mainly due to an increase in late charges and fees collected on loan participations purchased.

Other noninterest income decreased in 2008 primarily due to the Association in 2007 receiving interest income on a refund of state income taxes, a non-reoccurring event.

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	\$ 10,844	\$ 10,944	\$ 10,420	(1)%	5%
Occupancy and equipment	1,372	1,389	1,345	(1)	3
Insurance Fund premiums	2,268	2,100	1,858	8	13
Other operating expenses	5,070	4,215	3,830	20	10
Total noninterest income	\$ 19,554	\$ 18,648	\$ 17,453	5%	7%

Salaries and employee benefits decreased in 2008, as compared with 2007, primarily due to decreased costs associated with employee benefits.

Insurance Fund premiums increased 8.00 percent for the twelve months ended December 31, 2008, compared to the same period of 2007. The Farm Credit System Insurance Corporation (FCSIC) changed the methodology in assessing the insurance premiums as a result of the 2008 Farm Bill. Please refer to the "Regulatory Matters" section of this management's discussion and analysis for details concerning the 2008 Farm Bill. The FCSIC set premiums at 15 basis points on adjusted insured debt outstanding for the third quarter of 2008 and 18 basis points on adjusted insured debt outstanding for the fourth quarter of 2008. In addition, for the second half of 2008, there was a 10 basis point premium on the average principal outstanding of nonaccrual loans and any other-than-temporarily impaired investments. Previously, premiums of up to 15 basis points could be charged on accruing loans and up to 25 basis points for nonaccrual loans.

Other operating expenses increase mainly due an increase fees paid to the Federal Agricultural Mortgage Corporation for long-term standby "commitment to purchase" agreements on certain loans. Long-term standby commitments were used as a capital management tool and to reduce credit risk.

Income Taxes

The Association recorded a provision for income taxes of \$40 for the year ended December 31, 2008, as compared to a benefit for income taxes of \$574 for 2007 and a provision of \$70 for 2006. Refer to Note 2, "Summary of Significant Accounting Policies", and Note 10, "Income Taxes," of the Notes to the Consolidated Financial Statements, for more information concerning Association income taxes.

Key Results of Operations Comparisons

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

Key Results of Operations Comparisons	For the 12 Months Ended		
	12/31/08	12/31/07	12/31/06
Return on average assets	1.56%	2.02%	2.13%
Return on average members' equity	12.29%	15.34%	14.30%
Net interest income as a percentage of average earning assets	2.37%	2.49%	2.67%
Net (charge-offs) recoveries to average loans	(0.138)%	(0.011)%	(0.023)%

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 \$1,318,784 as compared to \$1,341,684 at December 31, 2007 and \$1,168,915 at December 31, 2006. The decrease of 1.71 percent compared to December 31, 2007 was attributable to the decrease in loan volume. The increase of 14.78 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 \$1,379,758 and \$1,261,713 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 did not have any lines of credit from third party financial institutions as of December 31, 2008.

Funds Management

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

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

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

Relationship with the Bank

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

The Bank's ability to access capital of the Association is discussed in Note 5 of the Notes to the Consolidated Financial Statements.

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

CAPITAL RESOURCES

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

The Association Board of Directors establishes, adopts, and maintains a formal written capital adequacy plan to ensure that adequate capital is maintained for continued financial viability, to provide for growth necessary to meet the needs of members/borrowers, and to ensure that all stockholders are treated equitably. There were no material changes to the capital plan for 2008 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 7.35 percent to \$205,741 from the December 31, 2007, total of \$191,656. At December 31, 2007, total members' equity increased 6.63 percent from the December 31, 2006 total of \$179,743. The increase was primarily attributed to the earnings of the Association offset by the cash profit-sharing distribution (patronage dividend) to the Association's member-stockholders. The Association plans to distribute more than \$10 million of the 2008 net income in cash to its member-stockholders in April of 2009.

Total capital stock and participation certificates were \$18,430 on December 31, 2008, compared to \$18,517 on December 31, 2007 and \$18,318 on December 31, 2006. The decrease was attributed to the retirement of stock.

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	12.11%	12.68%	13.57%	7.00%
Total surplus ratio	10.89%	11.38%	12.19%	7.00%
Core surplus ratio	10.89%	11.38%	11.73%	3.50%

The decrease in the Association's permanent capital, total surplus, and core surplus for December 31, 2008 and December 31, 2007 was the result of an increase in loan volume growth during the year offset by loans sold into the Bank's capitalized participation pool. The decline in the capital ratios was lessened by selling loans into the Bank capitalized participation pool program. 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.

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

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

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

	As of December 31, 2008	
	Number of Loans	Amount of Loans
Young	2,517	\$ 171,448
Beginning	3,715	362,146
Small	13,116	1,013,126

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 Association currently has a high penetration in the young, beginning, and small farm market. As of December 31, 2008, the Association was doing business with 74.5 percent of the young farmers, 21.6 percent of the beginning farmers, and 17.5 percent of small farmers identified by the 2002 Ag census.

The following strategies and outreach programs have been conducted which allowed the Association to meet its objectives and goals in the young, beginning, and small farmer program:

- Support of 4-H, FFA, and young farmer organizations through sponsorships and donations.
- Sponsor and host seminars on farm transition planning and financial management.
- Sponsor a one-day Young Farmer Institute facilitated by nationally recognized agricultural business consultant, Dr. David Kohl.
- Sponsor and host Dairy Management seminars.
- Support young and beginning farmers through a Youth Loan program.

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 Virginia, West Virginia and Maryland:

<u>Location</u>	<u>Description</u>	<u>Form of Ownership</u>
106 Sangers Lane Augusta County, VA	Administrative	Owned
1237 W. Main Street Abingdon, VA	Branch	Owned
801-B Blue Ridge Ave. Bedford, VA	Branch	Rented <i>(\$1,236 per month)</i>
1445 E. Rio Road Suite 103 Charlottesville, VA	Branch	Rented <i>(\$1,838 per month)</i>
29 Military Drive Chatham, VA	Branch	Owned
1-79, Exit 115, Rt. 20 S. Clarksburg, WV	Branch	Rented <i>(\$2,230 per month)</i>
409 James Madison Hwy. Culpeper, VA	Branch	Rented <i>(\$3,700 per month)</i>
308 Railroad Ave. Elkins, WV	Branch	Rented <i>(\$650 per month)</i>
241 E. Jackson Street Gate City, VA	Branch	Owned
161 South Main St. Halifax, VA	Branch	Rented <i>(\$531 per month)</i>
4646 South Valley Pike. Harrisonburg, VA	Branch	Owned
27 Fort Evans Rd., NE Leesburg, VA	Branch	Owned
880 North Jefferson St. Lewisburg, WV	Branch	Owned
Rt. 39 Lexington, VA	Branch	Owned
Rt. 219 North Oakland, MD	Branch	Owned
Colonial Shopping Center Orange, VA	Branch	Rented <i>(\$1,575 per month)</i>

<u>Location</u>	<u>Description</u>	<u>Form of Ownership</u>
106 North Main Street Petersburg, WV	Branch	Owned
Route 33 West Ripley, WV	Branch	Rented <i>(\$2,570 per month)</i>
38 Murray Farm Road Roanoke, VA	Branch	Owned
670 Old Franklin Turnpike Rocky Mount, VA	Branch	Owned
452 North High Street Romney, WV	Branch	Owned
1557 Commerce Road Suite 202 Verona, VA	Branch	Rented <i>(\$1,806 per month)</i>
516 Fauquier Road Warrenton, VA	Branch	Owned
660 Pepper's Ferry Road Wytheville, VA	Branch	Owned

Legal Proceedings

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

Description of Capital Structure

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

Description of Liabilities

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

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

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

Senior Officers

The following represents certain information regarding the senior officers of the Association and their business experience for the past 5 years.

<u>Senior Officer</u>	<u>Position</u>
David E. Lawrence	<i>Chief Executive Officer</i> since April, 2003 and had previously served as Chief Lending Officer since January 1993.
Bette B. Brand	<i>Chief Sales Officer</i> since October 2005 and had previously served as a Regional Sales and Lending Manager since January 2001. She currently serves on the Boards of Directors of the Virginia Agribusiness Council, Virginia Horse Council, Virginia Council of Farmer Cooperatives, and Virginia Foundation for Agriculture in the Classroom.
Dennis K. Carpenter	<i>Chief Lending Officer</i> since January 2006 and had previously served as Senior Policy Analyst at Farm Credit Administration in McLean, Virginia.
David G. Sauer	<i>Chief Financial Officer</i> since January 1998.

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

Name of Individual or Number in Group	Year	Annual			Perq/ Other*	Total
		Salary	Bonus	Deferred Comp.		
David E. Lawrence	2008	\$258,129	–	–	\$9,150	\$267,279
David E. Lawrence	2007	\$251,099	–	\$50,220	\$7,955	\$309,274
David E. Lawrence	2006	\$244,260	–	\$48,850	\$5,267	\$298,377
5	2008	\$619,479	\$53,822	\$81,145	\$17,540	\$771,986
5	2007	\$592,930	\$64,177	\$88,249	\$ 5,595	\$750,951
5	2006	\$567,559	\$55,116	\$68,487	–	\$691,162

* Amounts in the above table classified as Perquisites include group life insurance, automobile compensation, and spousal travel.

In addition to a base salary, all employees, except the CEO and internal reviewers, can earn additional compensation under an incentive plan. The incentive plan for 2008 is designed to motivate employees to stimulate new business development, increase loan volume, and increase Association’s earnings. The incentive plan is based on a combination of individual and association goals. The 2008 incentive plan includes a deferred settlement feature. The deferred settlement feature means that part of the incentive amount will not be paid to employees until 2012. The total incentive amount, including both current and deferred, was expensed in 2008. Payment of the incentive, not including the deferred settlement, will be made in the first quarter of 2009.

The CEO and internal reviewers can receive a bonus at the discretion of the Board of Directors. This bonus has a deferred settlement feature.

Defined Benefit-Type

The Association sponsors a non-qualified defined benefit supplemental executive retirement plan for Donald L. Shiflet, retired CEO. The purpose of the non-qualified plan is to provide benefits that supplement the qualified defined benefit plan in which the Association’s employees participate. For Mr. Shiflet, Compensation in excess of the 401(a)(17) limit and benefits in excess of the 415(b) limit in the qualified defined

benefit plan will be made up through the non-qualified plan. As a non-qualified plan, assets have been allocated and separately invested for this plan, but are not isolated from the general creditors of the Association.

Defined Contribution-Type

The Association sponsors a non-qualified supplemental deferred compensation plan for certain key 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.

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

Directors

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

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was \$111,485 for 2008, \$117,256 for 2007, and \$105,265 for 2006.

Subject to approval by the board, the Association may allow directors honorarium of \$400 for attendance at meetings, committee meetings, or special assignments, and \$100 for telephone conferences. In addition to the honoraria, the board chairman was paid a quarterly retainer fee of \$1,000 and the directors were paid a quarterly retainer fee of \$750. Total compensation paid to directors as a group was \$227,900. The following represents certain information regarding the directors of the Association, including their principal occupation for the past five years:

John E. Wells, Chairman, is a full-time beef farmer. He is a member of the West Virginia Cattlemen’s Association, Wirt County Farm Bureau, and is vice president of Jackson County Calf Pool Cooperative. During 2008, he served 13 days at Association board meetings and 40 days in other official activities and was paid \$23,400. His term of office is 2008-2011.

Alfred W. Stephens, Jr., Vice Chairman, is a dairy farmer. He serves as secretary on the Wythe/Bland DHIA and serves on the Wythe County Farm Bureau Board. During 2008, he served 13 days at Association board meetings and 14 days in other official activities and was paid \$12,600. His term of office is 2005-2008.

James H. Addington is the outside director. He is president of Addington Oil Corporation. During 2008, he served 13 days at Association board meetings and 7 days in other official activities and was paid \$10,400. His term of office is 2006-2008.

Ronald L. Bennett operates a dairy farm. He serves on the Alleghany County Farm Bureau Board and on the Alleghany, Bath and Rockbridge FSA Committee. During 2008, he served 13 days at Association board meetings and 10 days in other official activities and was paid \$11,900. His term of office is 2006-2009.

Donna M. Brooke-Alt is President of Brookedale Dairy Farm and also operates a greenhouse and Agri-tainment. She serves as the FSA County Committee advisor and is on the Mineral County Farm Preservation Board. During 2008, she served 13 days at Association board meetings and 17 days in other official activities and was paid \$14,100. Her term of office is 2006-2009.

William J. Franklin, Jr., is a livestock producer in Scott County, Va. He also produces hay and corn for his 75 brood cows. Bill is employed off the farm at Scott County Telephone Cooperative and serves as their Chief Executive Officer. He serves on the Carolina-Virginia's Telephone Membership Association Board, the Board of the Tennessee Independent Telecommunications Group, LLC and the TECO Board of the National Telecommunications Cooperative Association. During 2008, he served 13 days at Association board meetings and 9 days in other official activities and was paid \$10,900. His term of office is 2007-2010.

Paul M. House is president of Kettle Wind Farm, LLC., a dairy, grain, and sod farm. He is also a shareholder in Dutchland Farm Inc., a family dairy farm. He serves on the AgFirst Farm Credit Bank Board. During 2008, he served 13 days at Association board meetings and 1 day in other official activities and was paid \$8,300. His term of office is 2005-2008.

Melody S. Jones is the outside director. She is a self-employed sole practitioner Certified Public Accountant. During 2008, she served 13 days at Association board meetings and 13 days in other official activities and was paid \$11,800. Her term of office is 2007-2010.

James A. Kinsey operates a forage based purebred angus cattle operation. He serves on the CoBank, ACB Board and the Federal Farm Credit Funding Corporation Board. During 2008, he served 13 days at Association board meetings and 1 day in other official activities and was paid \$8,700. His term of office is 2006-2009.

Charles B. Leech, IV is an owner-operator with his family of a dairy farm. He serves on the Virginia State Dairymen's Association Board and Rockbridge Farmers Cooperative Board. During 2008, he served 13 days at Association board meetings and 11 days in other official activities and was paid \$12,300. His term of office is 2008-2011.

Ralph L. Puckett operates a cow/calf and feeder cattle operation. He is a field sales associate for Southern States, Inc. He serves on the Washington County Farm Bureau Board, the Southwest VA Agricultural Association and the Smyth-Washington Cattlemen Association. During 2008, he served 13 days at Association board meetings and 9 days in other official activities and was paid \$11,500. His term of office is 2007-2010.

Donald W. Reese is a partner in Reese's Farm Fresh Produce, a retail produce operation and a partner and manager of Reese Farms, Inc., a family owned vegetable farm. He is a member of the Halifax County Agricultural Education Advisory Committee and the Halifax County Farm Bureau. During 2008, he served 13 days at Association board meetings and 18 days in other official activities and was paid \$14,500. His term of office is 2006-2009.

Wallace W. Sanford, III, is a dairy and beef farmer in partnership with his family. He serves on the Maryland-Virginia Milk Producers Board and is director for the Orange County Fair and for Battlefield DHIA as well as director for the Orange Madison Coop and director for the VA State Dairymen Association. During 2008, he served 13 days at Association board meetings and 10 days in other official activities and was paid \$11,000. His term of office is 2007-2010.

Walter L. Schmidlen, Jr. is a dairy and beef farmer and owns a farm machinery dealership. He serves on the AgFirst Farm Credit Bank Board. During 2008, he served 13 days at Association board meetings and 2 days in other official activities and was paid \$8,700. His term of office is 2008-2011.

Barry W. Shelor operates a dairy farm. He serves on the Patrick County Farm Bureau Board. During 2008, he served 13 days at Association board meetings and 22 days in other official activities and was paid \$15,400. His term of office is 2006-2008.

Raymond L. Simms is a beef cattle farmer. He serves on the Spotsylvania County Farm Bureau Board, the Virginia Cattlemen's Association Board, the Tri-County/City Soil and Water Conservation District, Virginia Soil and Water Conservation Board and the Fredericksburg Feeder Calf Association. During 2008, he served 13 days at Association board meetings and 22 days in other official activities and was paid \$15,800. His term of office is 2007-2010.

Thomas V. Thacker is a poultry farmer. He serves on the Weyers Cave Recreation Association Board and the Weyers Cave Community Center Board. During 2008, he served 13 days at Association board meetings and 27 days in other official activities and was paid \$17,800. His term of office is 2006-2009.

Joseph W. Wampler is a general livestock and poultry farmer. During 2008, he served 10 days at Association board meetings and 6 days in other official activities and was paid \$8,800. His term of office is 2006-2008.

Transactions with Senior Officers and Directors

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 12 of the Consolidated Financial Statements, "Related Party Transactions," included in this Annual Report.

Transactions Other Than Loans

There have been no transactions that occurred at any time during the year ended December 31, 2008, between the Association and senior officers or directors, their immediate family members or any organizations with which they are affiliated, which require reporting per FCA regulations. There were no transactions with any senior officer or director related to the purchase or retirement of preferred stock of the Association, for the year ended December 31, 2008.

Involvement in Certain Legal Proceedings

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

Relationship with Independent Auditor

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

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

<i>(dollars in thousands)</i>	2008
Independent Auditor	
PricewaterhouseCoopers LLP	
Audit services	\$ 63,304
Total	\$ 63,304

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 1-540-886-3435, extension 5020, or writing David Sauer, Farm Credit of the Virginias, P.O. Box 899, Staunton, VA 24402-0899 or accessing the web site, www.farmcreditofvirginias.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 which is available on the Association’s website 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 the Virginias, 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:



Melody S. Jones
Chairman of the Audit Committee

Members of Audit Committee

James A. Kinsey
Donald W. Reese
Wallace W. Sanford, III
Barry W. Shelor

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 the Virginias, 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 the Virginias, 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	\$ 3,677	\$ 3,627	\$ 2,716
Loans	1,467,469	1,503,010	1,329,782
Less: allowance for loan losses	6,779	3,694	2,445
Net loans	1,460,690	1,499,316	1,327,337
Loans held for sale	501	443	1,535
Other investments	15,850	15,065	10,401
Accrued interest receivable	10,076	10,661	10,645
Investments in other Farm Credit institutions	37,545	21,022	18,304
Premises and equipment, net	7,448	5,908	6,247
Other property owned, net	2,507	796	—
Deferred tax asset, net	—	—	9
Due from AgFirst Farm Credit Bank	11,611	11,240	9,844
Other assets	6,201	6,013	6,090
Total assets	\$ 1,556,106	\$ 1,574,091	\$ 1,393,128
Liabilities			
Notes payable to AgFirst Farm Credit Bank	\$ 1,318,784	\$ 1,341,684	\$ 1,168,915
Accrued interest payable	5,347	6,565	5,587
Patronage refund payable	10,649	18,306	18,204
Other liabilities	15,585	15,880	20,679
Total liabilities	1,350,365	1,382,435	1,213,385
Commitments and contingencies			
Members' Equity			
Capital stock and participation certificates	18,430	18,517	18,318
Retained earnings			
Allocated	71,860	63,629	54,845
Unallocated	115,444	109,502	106,580
Accumulated other comprehensive income (loss)	7	8	—
Total members' equity	205,741	191,656	179,743
Total liabilities and members' equity	\$ 1,556,106	\$ 1,574,091	\$ 1,393,128

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			
Loans	\$ 108,282	\$ 108,988	\$ 93,416
Other investments	795	753	587
Total interest income	109,077	109,741	94,003
Interest Expense			
Notes payable to AgFirst Farm Credit Bank	72,514	74,291	60,342
Net interest income	36,563	35,450	33,661
Provision for (reversal of allowance for) loan losses	5,213	1,400	—
Net interest income after provision for (reversal of allowance for) loan losses	31,350	34,050	33,661
Noninterest Income			
Loan fees	1,330	1,095	933
Fees for financially related services	217	219	112
Patronage refund from other Farm Credit institutions	11,611	11,302	9,844
Gains (losses) on other property owned, net	(293)	(32)	35
Gains (losses) on sales of rural home loans, net	428	645	528
Gains (losses) on sales of premises and equipment, net	(4)	(4)	(16)
Other noninterest income	59	709	223
Total noninterest income	13,348	13,934	11,659
Noninterest Expense			
Salaries and employee benefits	10,844	10,944	10,420
Occupancy and equipment	1,372	1,389	1,345
Insurance Fund premiums	2,268	2,100	1,858
Other operating expenses	5,070	4,215	3,830
Total noninterest expense	19,554	18,648	17,453
Income before income taxes	25,144	29,336	27,867
Provision (benefit) for income taxes	40	(574)	70
Net income	\$ 25,104	\$ 29,910	\$ 27,797

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

Consolidated Statements of Changes in Members' Equity

<i>(dollars in thousands)</i>	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income	Total Members' Equity
		Allocated	Unallocated		
Balance at December 31, 2005	\$ 18,568	\$ 60,085	\$ 104,480	\$ —	\$183,133
Net income			27,797		27,797
Capital stock/participation certificates issued/(retired), net	(250)				(250)
Patronage distribution					
Cash			(18,062)		(18,062)
Nonqualified retained earnings		7,741	(7,741)		—
Retained earnings retired		(12,089)			(12,089)
Patronage distribution adjustment		(892)	106		(786)
Balance at December 31, 2006	18,318	54,845	106,580	—	179,743
Net income			29,910		29,910
Capital stock/participation certificates issued/(retired), net	199				199
Patronage distribution					
Cash			(18,210)		(18,210)
Nonqualified retained earnings		8,413	(8,413)		—
Patronage distribution adjustment		371	(365)		6
Adjustment to initially apply FAS No. 158 (Note 11)				8	8
Balance at December 31, 2007	18,517	63,629	109,502	8	191,656
Net income			25,104		25,104
Capital stock/participation certificates issued/(retired), net	(87)				(87)
Patronage distribution					
Cash			(10,551)		(10,551)
Nonqualified retained earnings		9,078	(9,078)		—
Patronage distribution adjustment		(847)	469		(378)
Employee benefit plans adjustments (Note 11)			(2)	(1)	(3)
Balance at December 31, 2008	\$ 18,430	\$ 71,860	\$ 115,444	\$ 7	\$205,741

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	\$ 25,104	\$ 29,910	\$ 27,797
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	662	689	636
Amortization of net deferred loan origination (fees) costs	(1,370)	(685)	(369)
Premium amortization/discount accretion on investments	(795)	(753)	(588)
Provision for (reversal of allowance for) loan losses	5,213	1,400	—
(Gains) losses on other property owned, net	293	32	(35)
(Gains) losses on sales of premises and equipment, net	4	4	16
(Gains) losses on sales of rural home loans, net	(428)	(645)	(528)
Changes in operating assets and liabilities:			
(Increase) decrease in loans held for sale, net	370	1,737	(536)
(Increase) decrease in accrued interest receivable	585	(16)	(2,748)
(Increase) decrease in deferred tax asset, net	—	9	3
(Increase) decrease in due from AgFirst Farm Credit Bank	(371)	(1,396)	1,054
(Increase) decrease in other assets	(188)	77	984
Increase (decrease) in accrued interest payable	(1,218)	978	1,149
Increase (decrease) in other liabilities	(298)	(4,791)	3,132
Total adjustments	2,459	(3,360)	2,170
Net cash provided by (used in) operating activities	27,563	26,550	29,967
Cash flows from investing activities:			
Net (increase) decrease in loans	32,589	(173,525)	(136,894)
(Increase) decrease in investment in other Farm Credit institutions	(16,523)	(2,718)	(4,815)
Purchases of other investments	(2,496)	(5,481)	(3,456)
Proceeds from payments received on other investments	2,506	1,570	1,058
Purchases of premises and equipment	(2,226)	(377)	(2,345)
Proceeds from sales of premises and equipment	20	23	31
Proceeds from sales of other property owned	190	3	105
Net cash provided by (used in) investing activities	14,060	(180,505)	(146,316)
Cash flows from financing activities:			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	(22,900)	172,769	143,755
Capital stock and participation certificates issued/(retired), net	(87)	199	(250)
Patronage refunds and dividends paid	(18,586)	(18,102)	(15,108)
Retained earnings retired	—	—	(12,089)
Net cash provided by (used in) financing activities	(41,573)	154,866	116,308
Net increase (decrease) in cash	50	911	(41)
Cash, beginning of period	3,627	2,716	2,757
Cash, end of period	\$ 3,677	\$ 3,627	\$ 2,716
Supplemental schedule of non-cash activities:			
Loans transferred to other property owned	\$ 2,194	\$ 831	\$ 70
Cash dividends or patronage distributions declared or payable	10,551	18,210	18,062
Increase in liability resulting from adoption of FAS 158 (Note 11)	—	(8)	—
Employee benefit plans adjustments (Note 11)	3	—	—
Supplemental information:			
Interest paid	\$ 73,732	\$ 73,313	\$ 59,193
Taxes (refunded) paid, net	60	(496)	42

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 the Virginias, ACA (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 forty-six counties in the state of Virginia, forty-eight counties in the state of West Virginia, and two counties in the state of Maryland as follows:

Virginia: Counties of Albemarle, Alleghany, Arlington, Augusta, Bath, Bedford, Bland, Botetourt, Buchanan, Carroll, Craig, Culpeper, Dickenson, Fairfax, Fauquier, Floyd, Franklin, Giles, Grayson, Greene, Halifax, Henry, Highland, Lee, Loudoun, Madison, Montgomery, Nelson, Orange, Patrick, Pittsylvania, Prince William, Pulaski, Rappahannock, Roanoke, Rockbridge, Rockingham, Russell, Scott, Smyth, Spotsylvania, Stafford, Tazewell, Washington, Wise, and Wythe;

West Virginia: Counties of Barbour, Boone, Braxton, Cabell, Calhoun, Clay, Doodridge, Fayette, Gilmer, Grant, Greenbrier, Hampshire, Hardy, Harrison, Jackson, Kanawha, Lewis, Lincoln, Logan, Marion, Mason, McDowell, Mercer, Mineral, Mingo, Monongalia, Monroe, Nicholas, Pendleton, Pleasants, Pocahontas, Preston, Putnam, Raleigh, Randolph, Ritchie, Roane, Summers, Taylor, Tucker, Tyler, Upshur, Wayne, Webster, Wetzel, Wirt, Wood, and Wyoming; and

Maryland: Counties of Allegany and Garrett.

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. **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 adjusted for charge-offs and deferred loan fees or costs.

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

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

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

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

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

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

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

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

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

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

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

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

- C. **Gains/(Losses) on Rural Home Loans Held for Sale:** Certain rural home mortgage loans originated by the Association are sold on a servicing released basis primarily to the Bank or into the secondary market to unrelated third parties. Gains or losses on sales of rural home mortgage loans are recognized based on the difference between the selling price and the carrying value of the related rural home mortgage loans sold.
- D. **Other Investments:** Other investments include Tobacco Buyout Successor-in-Interest Contracts (SIIC), which qualify as mission related investments under FCA regulations. Under the SIIC, the tobacco quota holders and producers may sell their rights to receive SIIC contract payments to a third party. The successor purchases the entire contract and all related rights and obligations associated with the contract. These investments in SIIC are purchased at a discount. Contract payments are made by the United States Department of Agriculture (USDA) in equal annual payments. Interest income is recognized from the accretion of discounts using the effective interest method.
- E. **Investment in AgFirst Farm Credit Bank:** The Association is required to maintain ownership in the Bank in the form of Class C stock. Accounting for this investment is on the cost plus allocated equities basis. Patronage refunds from the Bank are accrued as earned. The receivable for such patronage refunds is classified as due from AgFirst Farm Credit Bank.
- F. **Other Property Owned:** Other property owned, consisting of real and personal property acquired through a collection action, is recorded upon acquisition at fair value less estimated selling costs. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income, expenses, and carrying value adjustments related to other property owned are included in gains (losses) on other property owned, net.
- G. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Gains and losses on dispositions are reflected in current earnings. Maintenance and repairs are charged to expense and improvements are capitalized.
- H. **Advanced Conditional Payments:** The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, the advanced conditional payments are netted against the borrower's related loan balance. Advanced conditional payments are not insured. Interest is generally paid by the Association on such accounts.

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

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.

- J. **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 basis of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled.

The Association records a valuation allowance at the balance sheet dates against that portion of the Association's deferred tax assets that, based on management's best estimates of future events and circumstances, more likely than not (a likelihood of more than 50 percent) will not be realized. The consideration of valuation allowances involves various estimates and

assumptions as to future taxable earnings, including the effects of our expected patronage program, which reduces taxable earnings.

K. **Patronage Refund from AgFirst:** The Association records patronage refunds from the Bank on an accrual basis.

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

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

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

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

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

M. **Recently Issued Accounting Pronouncements:** In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (SFAS No. 158). SFAS No. 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in that

funded status in the year in which the changes occur through other comprehensive income. SFAS No. 158 further requires the determination of the fair value of plan assets at year-end and recognition of actuarial gains and losses, prior service costs or credits, and transition assets and obligations as a component of other comprehensive income. In addition, SFAS No. 158 requires that the funded status of a plan be measured as of the date of the year-end financial statements, effective for fiscal years ending after December 15, 2008. Prior to 2008, the District used a measurement date of September 30th. In 2008, the District used a measurement date of December 31st as required. See Note 11 for the impact of SFAS No. 158 on the current period.

In December 2007, the 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 — Loans and Allowance for Loan Losses

A summary of loans follows:

	2008	December 31, 2007	2006
Real estate mortgage	\$ 922,357	\$ 1,008,774	\$ 879,204
Production and intermediate term	374,506	329,683	314,180
Processing and marketing	86,546	81,154	68,420
Farm related business	22,688	23,679	17,177
Communication	4,458	2,794	-
Rural residential real estate	56,914	56,926	50,801
Total loans	<u>\$ 1,467,469</u>	<u>\$ 1,503,010</u>	<u>\$ 1,329,782</u>

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

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

advances, or other actions necessary to protect the financial interest of the Association in the collateral, may result in the loan to value ratios in excess of the regulatory maximum.

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

	December 31,		
	2008	2007	2006
Impaired nonaccrual loans:			
Current as to principal and interest	\$18,002	\$ 1,432	\$ 2,053
Past due	19,179	6,779	1,833
Total impaired nonaccrual loans	<u>37,181</u>	<u>8,211</u>	<u>3,886</u>
Impaired accrual loans:			
Restructured accrual loans	-	-	-
Accrual loans 90 days or more past due	612	-	3
Total impaired accrual loans	<u>612</u>	<u>-</u>	<u>3</u>
Total impaired loans	<u>\$37,793</u>	<u>\$ 8,211</u>	<u>\$ 3,889</u>

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

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

	Year Ended December 31,		
	2008	2007	2006
Interest income recognized on impaired nonaccrual loans	\$ 427	\$ 271	\$ 378
Interest income on impaired accrual loans	42	36	23
Interest income recognized on impaired loans	<u>\$ 469</u>	<u>\$ 307</u>	<u>\$ 401</u>

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

	2008	2007	2006
	Impaired loans with related allowance	\$10,780	\$ 4,670
Impaired loans with no related allowance	27,013	3,541	3,432
Total impaired loans	<u>\$37,793</u>	<u>\$ 8,211</u>	<u>\$ 3,889</u>
Allowance on impaired loans	<u>\$ 2,984</u>	<u>\$ 1,395</u>	<u>\$ 220</u>

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

	2008	2007	2006
	Average impaired loans	<u>\$11,515</u>	<u>\$ 6,030</u>

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

	Year Ended December 31,		
	2008	2007	2006
Interest income which would have been recognized under the original loan terms	\$ 1,062	\$ 722	\$ 682
Less: interest income recognized	427	271	378
Foregone interest income	<u>\$ 635</u>	<u>\$ 451</u>	<u>\$ 304</u>

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

	Year Ended December 31,		
	2008	2007	2006
Balance at beginning of year	\$ 3,694	\$ 2,445	\$ 2,736
Charge-offs:			
Real estate mortgage	(1,807)	(3)	-
Production and intermediate term	(324)	(141)	(205)
Agribusiness	-	-	(98)
Rural residential real estate	(8)	(11)	-
Total charge-offs	<u>(2,139)</u>	<u>(155)</u>	<u>(303)</u>
Recoveries:			
Real estate mortgage	-	1	-
Production and intermediate term	11	3	12
Total recoveries	<u>11</u>	<u>4</u>	<u>12</u>
Net (charge-offs) recoveries	<u>(2,128)</u>	<u>(151)</u>	<u>(291)</u>
Provision for (reversal of allowance for) loan losses	5,213	1,400	-
Balance at end of year	<u>\$ 6,779</u>	<u>\$ 3,694</u>	<u>\$ 2,445</u>
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	<u>(0.138)%</u>	<u>(0.011)%</u>	<u>(0.023)%</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	\$ 1,637	24%	\$ 1,834	50%
Production and intermediate term	2,879	43	1,400	38
Agribusiness	1,721	25	150	4
Rural residential real estate	525	8	310	8
Communication	17	-	-	-
Total	<u>\$ 6,779</u>	<u>100%</u>	<u>\$ 3,694</u>	<u>100%</u>
	December 31, 2006			
	Amount	%		
Real estate mortgage	\$ 1,047	43%		
Production and intermediate term	1,216	50		
Agribusiness	97	4		
Rural residential real estate	85	3		
Communication	-	-		
Total	<u>\$ 2,445</u>	<u>100%</u>		

To mitigate the risk of loan losses, the Association may enter into long-term standby "commitment to purchase" agreements with the Federal Agricultural Mortgage Corporation (Farmer Mac). The agreements, which are effectively credit guarantees that will remain in place until the loans are paid in full, give the Association the right to sell the loans identified in the agreements to Farmer Mac in the event of default (typically four months past

due), subject to certain conditions. The balance of loans under long-term standby commitments was \$101,353, \$97,895 and \$11,938 at December 31, 2008, 2007 and 2006, respectively. Fees paid to Farmer Mac for such commitments totaled \$493, \$57 and \$74 for the years ended December 31, 2008, 2007 and 2006, respectively. These amounts are classified as noninterest expense.

Note 4 — Other Investments

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

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

For the years ended December 31, 2008, 2007 and 2006, the Association held Tobacco Buyout SIIC of \$15,850, \$15,065 and \$10,401, respectively, net of discount.

Note 5 — Investment in AgFirst Farm Credit Bank

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

Note 6 — Premises and Equipment

Premises and equipment consists of the following:

	December 31,		
	2008	2007	2006
Land	\$ 2,756	\$ 2,736	\$ 2,731
Buildings and improvements	5,663	3,953	3,920
Furniture and equipment	3,868	4,087	3,970
	<u>12,287</u>	<u>10,776</u>	<u>10,621</u>
Less: accumulated depreciation	4,839	4,868	4,374
Total	<u>\$ 7,448</u>	<u>\$ 5,908</u>	<u>\$ 6,247</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	\$ (40)	\$ 1	\$ 37
Carrying value unrealized gains (losses)	(146)	11	–
Operating income (expense), net	<u>(107)</u>	<u>(44)</u>	<u>(2)</u>
Gains (losses) on other property owned, net	<u>\$ (293)</u>	<u>\$ (32)</u>	<u>\$ 35</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 6.1 years and 4.7 years, respectively, at December 31, 2008. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) notes payable which are match funded by the Bank was 5.23 percent and the weighted average remaining maturity was 11.7 years at December 31, 2008. The weighted average interest rate on all interest-bearing notes payable was 4.71 percent and the weighted average remaining maturity was 10.4 years at December 31, 2008.

Variable rate and fixed rate notes payable represent approximately 18.10 percent and 81.90 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. 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 Common 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 a minimum of two percent of the loan amount or \$1 thousand, or such higher amount as determined by the Board. 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.

B. Regulatory Capitalization Requirements and Restrictions

FCA's capital adequacy regulations require the Association to achieve permanent capital of 7.00 percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the 7.00 percent capital requirement can initiate certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Association's financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless prescribed capital standards are met. FCA regulations also require that additional minimum standards for capital be achieved. These standards require all System institutions to achieve and maintain ratios as defined by FCA regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of seven percent and of core surplus as a percentage of risk-adjusted assets of 3.50 percent. The Association's permanent capital, total surplus and core surplus ratios at December 31, 2008 were 12.11 percent, 10.89 percent and 10.89 percent, respectively.

A 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.

C. Description of Equities

The Association is authorized to issue or have outstanding Class D Preferred Stock, Classes A and C Common Stock, 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	No	529,820	\$ 2,649
C Common/Voting	No	2,939,061	14,695
Participation Certificates/Nonvoting	No	217,114	1,086
Total Capital Stock and Participation Certificates		3,685,995	\$ 18,430

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

Retained Earnings

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

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

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

Allocated equities shall be retired solely at the discretion of the Board; provided, however, that minimum capital standards established by the FCA and the Board are met. Nonqualified retained surplus is considered to be permanently invested in the Association and as such, there is no plan to revolve or retire this surplus. All nonqualified distributions are tax deductible only when redeemed.

At December 31, 2008, allocated members' equity consisted of \$71,860 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.

The patronage distributions accrued at year-end are based on estimates. The actual amounts distributed may vary from these estimates. Differences are reflected as distribution adjustments in the Consolidated Statements of Changes in Members' Equity.

Dividends

Dividends may be paid on stock and participation certificates as determined by the Board's resolution. Dividends may not be paid on common stock and participation certificates during any fiscal year with respect to which the Association has obligated itself to distribute earnings on a patronage basis pursuant to the bylaws. The rate of dividend paid on Class D Preferred Stock for any fiscal year may not be less than the rate of dividend paid on common stock or participation certificates for such year. All dividends shall be paid on a per share basis. Dividends on common stock and participation certificates shall be noncumulative without preference between classes.

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

Common stocks and participation certificates may be transferred to persons or entities eligible to purchase or hold such equities under the bylaws. Class D Preferred Stock may be transferred in the manner set forth in the resolution authorizing its issuance.

Impairment

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

1. Nonqualified allocated members equity beginning with the most recent allocation
2. Qualified allocated members equity beginning with the most recent allocation
3. Classes A and C Common Stock and Participation Certificates
4. Class D Preferred Stock

Liquidation

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

1. Holders of Class D Preferred Stock until an amount equal to the aggregate par value of shares of Class D Preferred Stock then outstanding has been distributed to the holders;
2. Holders of Class A Stock, Class C Stock, and Participation Certificates pro rata in proportion to the number of shares or units each such class of stock and participation certificates then outstanding until an amount equal to the aggregate par value (or face value) of such shares or units has been distributed to the holders;
3. Holders of Allocated Surplus to the extent evidenced by qualified written notices of allocation, pro rata, on the basis of the oldest allocations first, until an amount equal to the total account has been distributed to such holders;
4. Holders of Allocated Surplus to the extent evidenced by nonqualified written notice of allocation, pro rata, on the basis of the oldest allocations first, until an amount equal to the total account has been distributed to such holders;
5. Any remaining assets of the Association after such distributions shall be distributed to Patron, past and present, in proportion to which the aggregate patronage of each such Patron bears to the total patronage of all such parties insofar as practicable, unless as otherwise provided by law.

D. Other Comprehensive Income (Loss)

The Association reports other comprehensive income (loss) (OCI) in its Consolidated Statements of Changes in Members' Equity. The Association recognized OCI of \$(1) and \$8 in 2008 and 2007, respectively, due to SFAS No. 158 (see Note 11 for further information).

Note 10 — Income Taxes

The provision (benefit) for income taxes follows:

	Year Ended December 31,		
	2008	2007	2006
Current:			
Federal	\$ 33	\$ 12	\$ 58
State	7	6	10
State refunds related to long-term lending	—	(601)	—
	<u>40</u>	<u>(583)</u>	<u>68</u>
Deferred:			
Federal	—	9	2
State	—	—	—
	<u>—</u>	<u>9</u>	<u>2</u>
Total provision (benefit) for income taxes	<u>\$ 40</u>	<u>\$ (574)</u>	<u>\$ 70</u>

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

	December 31,		
	2008	2007	2006
Federal tax at statutory rate	\$ 8,549	\$ 9,974	\$ 9,475
State tax, net	3	6	7
Patronage distributions	(3,587)	(6,191)	(6,141)
Tax-exempt FLCA earnings	(5,152)	(5,330)	(3,625)
Long-term lending related refunds	—	(601)	—
Change in valuation allowance	203	1,750	145
Other	24	(182)	209
Provision (benefit) for income taxes	<u>\$ 40</u>	<u>\$ (574)</u>	<u>\$ 70</u>

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

	December 31,		
	2008	2007	2006
Deferred income tax assets:			
Allowance for loan losses	\$ 726	\$ 532	\$ 437
Annual leave	351	332	142
Nonaccrual loan interest	205	120	99
Pensions and other postretirement benefits	2763	2,567	1,058
Deferred incentive	792	737	159
Other	—	—	8
Gross deferred tax assets	<u>4,837</u>	<u>4,288</u>	<u>1,903</u>
Less: valuation allowance	<u>(2,846)</u>	<u>(2,643)</u>	<u>(893)</u>
Gross deferred tax assets, net of valuation allowance	<u>1,991</u>	<u>1,645</u>	<u>1,010</u>
Deferred income tax liabilities:			
Loan origination fees	—	(51)	(100)
Pensions and other postretirement benefits	(1,824)	(1,568)	(832)
Depreciation	(101)	(26)	(69)
Other	(66)	—	—
Gross deferred tax liability	<u>(1,991)</u>	<u>(1,645)</u>	<u>(1,001)</u>
Net deferred tax asset (liability)	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 9</u>

At December 31, 2008, deferred income taxes have not been provided by the Association on approximately \$1.6 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 \$2,846, \$2,643 and \$893 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 \$1,283 for 2008, and \$0 for 2007 and 2006, through its note payable to the Bank. Plan expenses included in salaries and employee benefits were \$615 for 2008, \$991 for 2007, and \$1,121 for 2006.

The District sponsors a plan providing certain benefits (primarily health care) to its retirees. Certain Association charges related to this plan are an allocation of District charges based on the Association's proportional share of the plan liability. Postretirement benefits other than pensions (primarily health care benefits) included in salaries and employee benefits were \$518 for 2008, \$584 for 2007 and \$590 for 2006.

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

In addition, supplemental retirement benefits and deferred compensation options are provided to certain key employees under supplemental defined benefit executive plans and supplemental deferred compensation plans. Assets have been allocated and separately invested for these plans, but are not isolated from the general creditors of the Association.

The supplemental defined benefit executive plan is unfunded and had a projected benefit obligation of \$110 and a net under-funded status of \$110 at December 31, 2008. Net periodic pension cost for the period was \$7. The assumptions used to determine the projected benefit obligation included a discount rate of 6.30 percent.

SFAS No. 158 requires the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. The balance sheet recognition provisions of SFAS No. 158 were adopted at December 31, 2007 by the Association for the single employer supplemental nonqualified plan, resulting in an adjustment of \$8 to accumulated other comprehensive income (AOCI).

SFAS No. 158 also requires that employers measure the benefit obligation and plan assets as of the fiscal year end for fiscal years ending after December 15, 2008. In fiscal 2007 and earlier, a September 30 measurement date was used for pension and other postretirement benefit plans. SFAS No. 158 provides two approaches for an employer to transition to a fiscal year end measurement date. The approach applied by the Association allows for the use of the measurements determined for the prior year end. Under this alternative, pension and other postretirement benefit expense measured for the three-month period October 1, 2007 to December 31, 2007 (determined using the September 30, 2007 measurement date) is reflected as an adjustment to beginning 2008 unallocated retained earnings. As a result, the Association decreased unallocated retained earnings by \$2.

SFAS No. 158 further requires the determination of the fair value of plan assets and recognition of actuarial gains and losses, prior service costs or credits, and transition assets or obligations as a component of AOCI. These amounts are subsequently recognized as components of net periodic benefit costs over time. For 2008, \$1 has been recognized as a net debit to AOCI to reflect these elements.

The Association participates in a defined contribution Districtwide 401(k) plan, which qualifies as a 401(k) plan as defined by the Internal Revenue Code. For employees hired on or prior to December 31, 2002, the Association will contribute \$.50 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. For employees hired on or after January 1, 2003, the Association will contribute \$1.00 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service. Employer contributions to this plan were \$298, \$274, and \$259 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 \$4,131. During 2008, \$1,761 of new loans were made and repayments totaled \$2,272. In the opinion of management, none of these loans outstanding at December 31, 2008 involved more than a normal risk of collectibility.

Note 13 — Commitments and Contingencies

The Association has various commitments outstanding and contingent liabilities.

The Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers and to manage their exposure to interest-rate risk. These financial instruments include commitments to extend credit and/or commercial letters of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2008, \$224,185 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 \$9,204 of standby letters of credit, with expiration dates ranging from January 1, 2009 to April 12, 2012. The maximum potential amount of future payments the Association may be required to make under these existing guarantees is \$9,204.

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 \$223 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 and supplemental retirement 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 principle 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	\$ 391	\$ -	\$ -	\$ 391
Total Assets	\$ 391	\$ -	\$ -	\$ 391
Liabilities:				
Standby letters of credit	\$ -	\$ -	\$ 223	\$ 223
Total Liabilities	\$ -	\$ -	\$ 223	\$ 223

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	\$ 225
Total gains or (losses) realized/unrealized:	
Included in earnings	-
Included in other comprehensive loss	-
Purchases, sales, issuances and settlements, net	(2)
Transfers in and/or out of level 3	-
Balance at December 31, 2008	\$ 223

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	\$	\$	\$ 7,796	\$ 7,796	\$ (2,984)

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	\$ 3,677	\$ 3,677	\$ 3,627	\$ 3,627
Loans, net of allowance	\$ 1,460,690	\$ 1,496,017	\$ 1,499,316	\$ 1,510,648
Tobacco Buyout SIIC	\$ 15,850	\$ 16,537	\$ 15,065	\$ 15,143
Assets held in trust funds	\$ 391	\$ 391	\$ 467	\$ 467
Financial liabilities:				
Notes payable to AgFirst Farm Credit Bank	\$ 1,318,784	\$ 1,350,230	\$ 1,341,684	\$ 1,346,607

	December 31, 2006	
	Carrying Amount	Estimated Fair Value
Financial assets:		
Cash	\$ 2,716	\$ 2,716
Loans, net of allowance	\$ 1,327,337	\$ 1,330,815
Tobacco Buyout SIIC	\$ 10,401	\$ 10,262
Assets held in trust funds	\$ 392	\$ 392
Financial liabilities:		
Notes payable to AgFirst Farm Credit Bank	\$ 1,168,915	\$ 1,150,881

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

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

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

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

The carrying value of accrued interest approximates its fair value.

- C. **Investment in AgFirst Farm Credit Bank:** Estimating the fair value of the Association's investment in the Bank 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 9.88 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.
- D. **Notes Payable to AgFirst Farm Credit Bank:** The notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association's loan receivables plus accrued interest on the notes payable. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.
- E. **Commitments to Extend Credit and Standby Letters of Credit:** The estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics and since the related credit risk is not significant.
- F. **Tobacco Buyout SIIC:** Fair value is determined by discounting the expected future cash flows using current interest rates for similar assets.
- 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	\$ 9,254	\$ 9,230	\$ 9,647	\$ 8,432	\$ 36,563
Provision for (reversal of allowance for) loan losses	2,250	493	660	1,810	5,213
Noninterest income (expense), net	(2,167)	(1,775)	(1,484)	(820)	(6,246)
Net income (loss)	<u>\$ 4,837</u>	<u>\$ 6,962</u>	<u>\$ 7,503</u>	<u>\$ 5,802</u>	<u>\$ 25,104</u>
	2007				
	First	Second	Third	Fourth	Total
Net interest income	\$ 8,580	\$ 8,830	\$ 8,759	\$ 9,281	\$ 35,450
Provision for (reversal of allowance for) loan losses	-	150	100	1,150	1,400
Noninterest income (expense), net	(1,794)	(620)	(2,013)	287	(4,140)
Net income (loss)	<u>\$ 6,786</u>	<u>\$ 8,060</u>	<u>\$ 6,646</u>	<u>\$ 8,418</u>	<u>\$ 29,910</u>
	2006				
	First	Second	Third	Fourth	Total
Net interest income	\$ 7,983	\$ 8,327	\$ 8,568	\$ 8,783	\$ 33,661
Provision for (reversal of allowance for) loan losses	-	-	-	-	-
Noninterest income (expense), net	(1,892)	(1,939)	(1,708)	(325)	(5,864)
Net income (loss)	<u>\$ 6,091</u>	<u>\$ 6,388</u>	<u>\$ 6,860</u>	<u>\$ 8,458</u>	<u>\$ 27,797</u>