2006

ANNUAL REPORT

Rural America's Customer-Owned Partner

AgFirst Farm Credit Bank and District Associations

AgFirst Farm Credit Bank and District Associations

2006 Annual Report

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Management

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Thomas S. Welsh .... Executive Vice President, Chief Administrative and Legislative Officer & Corporate Secretary
Leon T. Amerson .... Executive Vice President, Chief Operating Officer & Chief Financial Officer
William L. Melton .... Senior Vice President & Chief Lending Officer
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Message from the Chairman of the Board and Chief Executive Officer

Dear Shareholders:

Associations in the AgFirst District experienced tremendous growth in 2006 as demand from commercial and lifestyle farmers increased. The result was a substantial increase in net income, which made possible significant distributions to our borrowers.

Growth — Loan volume reached a record $18.7 billion at 2006 year-end. Our loan portfolios increased $2.5 billion during the year, up 15.45 percent from the previous year. This compares to growth rates of 9.0 percent and 3.5 percent in 2005 and 2004, respectively.

Loan demand increased in almost all sectors during the past year. Contributing to the demand were higher farm input costs and new investments in property, plant and equipment. Our strong marketing and advertising efforts fueled continued growth in the lifestyle and "Country Mortgages" markets, and borrowers increasingly turned to Farm Credit for financing to take advantage of its patronage programs, which can significantly reduce the borrowers' interest costs.

Also contributing to our growth in 2006 were the participation/syndication opportunities created by the partnership of AgFirst's Capital Markets Unit and Associations throughout the District. Working together, they marketed commercial banks and other Farm Credit institutions aggressively to garner new business from agribusiness companies within the District and throughout the United States.

Credit Quality — Although U.S. net farm income in 2006 was down from the record levels set in 2004 and 2005, District Associations have seen no deterioration in their loan portfolios. In fact, credit quality improved in 2006. Associations reported 96.02 percent acceptable loans at year-end, up from 95.58 percent the previous year. Delinquencies were only 0.28 percent of associations' total loans at the close of the year, down from 0.45 percent at 2005 year-end and the lowest level reported in four years.

Earnings — Net income increased as a result of the growth in loan and other interest-earning assets. Final net income totaled $410 million in 2006, up 8.8 percent from the previous year.

Distributions — Patronage refunds and other distributions to borrowers totaled **$297 million in 2006, up more than 7 percent** from the previous year.

Strategic Initiatives — As a district, we continue to focus on initiatives that create efficiencies in association operations. In 2006, AgFirst worked closely with several Associations to implement a Microsoft®-based Customer Relationship Management (CRM) system which is integrated with our own loan and customer systems.

Throughout 2006, Associations in the AgFirst District celebrated the 90th anniversary of the Farm Credit System. The System was "born" on July 17, 1916, when President Woodrow Wilson signed into law the Federal Farm Loan Act. Ninety years later, on July 17, 2006, Association representatives, together with representatives of AgFirst, the Farm Credit Administration and members of Congress, gathered at President Wilson's birthplace in Staunton, Virginia. On that historic day, we watched as Congressman Bob Goodlatte of Virginia, using a replica of Wilson's pen, signed a resolution recognizing the contributions of the Farm Credit System to American agriculture.

The AgFirst District has played an important role in the success of the Farm Credit System. Our business model, with its foundation in patronage and other cooperative principles, has helped us grow and prosper, as it has the farmers we serve. Since 1916, we have been driven by an important mission: improving the quality of life on the farm and throughout our part of rural America. That responsibility — and its importance to our nation — will continue to drive us and guide us for years to come.

Thomas W. Kelly
Chairman of the Board

F. A. Lowrey
Chief Executive Officer

February 28, 2007

Report of Management

The accompanying financial statements and related financial information appearing throughout this annual report have been prepared by management of AgFirst Farm Credit Bank (AgFirst) 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 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 AgFirst 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. AgFirst and each District 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 Chief Executive Officer.

In 2004, AgFirst adopted a Code of Ethics for its Chief Executive Officer, Senior Financial Officers, and other Senior Officers who are involved with preparation and distribution of financial statements and maintenance of the records supporting the financial statements. A copy of the AgFirst Code of Ethics may be viewed on the Bank's website at *www.agfirst.com*.

The combined financial statements have been examined by independent auditors, whose report appears elsewhere in this annual report. The Bank is also subject to examination by the Farm Credit Administration.

The combined financial statements, in the opinion of management, fairly present the financial condition of the Bank. The undersigned certify that the 2006 Annual Report has been prepared 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.

The accompanying combined financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

Thomas W. Kelly
Chairman of the Board

F. A. Lowrey
President & Chief Executive Officer

Leon T. Amerson
Executive Vice President,
Chief Operating Officer
& Chief Financial Officer

February 28, 2007

Five-Year Summary of Selected Combined Financial Data

(dollars in thousands)	December 31, 2006	2005	2004	2003	2002
Combined Balance Sheet Data					
Cash and cash equivalents	$ 651,268	$ 640,830	$ 522,862	$ 527,250	$ 444,457
Investment securities	6,492,102	5,302,965	3,290,967	2,832,716	2,153,118
Loans	18,669,616	16,171,572	14,836,278	14,336,779	13,823,089
Less: allowance for loan losses	71,915	87,551	95,419	316,735	311,180
Net loans	18,597,701	16,084,021	14,740,859	14,020,044	13,511,909
Other property owned	5,122	3,646	3,433	2,253	4,828
Other assets	1,014,525	743,098	437,295	313,654	312,689
Total assets	$ 26,760,718	$ 22,774,560	$ 18,995,416	$ 17,695,917	$ 16,427,001
Obligations with maturities of one year or less	$ 10,134,550	$ 7,710,389	$ 6,586,537	$ 6,482,632	$ 6,357,834
Obligations with maturities greater than one year	13,092,985	11,694,786	9,184,234	8,426,554	7,562,772
Mandatorily redeemable preferred stock	225,000	225,000	225,000	225,000	—
Total liabilities	23,452,535	19,630,175	15,995,771	15,134,186	13,920,606
Mandatorily redeemable preferred stock	—	—	—	—	225,839
Perpetual preferred stock	150,000	150,000	150,000	150,000	—
Protected borrower equity	6,208	7,628	10,123	12,453	15,486
Capital stock and participation certificates	118,817	120,370	125,089	128,099	124,541
Retained earnings					
Allocated	992,227	925,919	849,626	792,168	756,525
Unallocated	2,039,308	1,943,444	1,861,476	1,587,934	1,494,659
Accumulated other comprehensive income (loss)	1,623	(2,976)	3,331	(108,923)	(110,655)
Total shareholders' equity	3,308,183	3,144,385	2,999,645	2,561,731	2,280,556
Total liabilities and shareholders' equity	$ 26,760,718	$ 22,774,560	$ 18,995,416	$ 17,695,917	$ 16,427,001
Combined Statement of Income Data					
Net interest income	$ 673,836	$ 610,501	$ 568,826	$ 575,913	$ 553,058
Provision for (reversal of allowance for) loan losses	(717)	(6,492)	(213,388)	8,153	25,263
Noninterest income (expense), net	(264,184)	(239,816)	(247,003)	(248,129)	(215,248)
Net income	$ 410,369	$ 377,177	$ 535,211	$ 319,631	$ 312,547
Combined Key Financial Ratios					
Rate of return on average:					
Total assets	1.67%	1.86%	2.96%	1.88%	2.04%
Total shareholders' equity	12.40%	12.05%	19.31%	13.03%	13.28%
Net interest income as a percentage of average earning assets	2.80%	3.07%	3.16%	3.40%	3.63%
Net chargeoffs (recoveries) to average loans	0.09%	0.01%	0.05%	0.02%	0.12%
Total shareholders' equity to total assets	12.36%	13.81%	15.79%	14.48%	13.88%
Debt to shareholders' equity (:1)	7.09	6.24	5.33	5.91	6.10
Allowance for loan losses to loans	0.39%	0.54%	0.64%	2.21%	2.25%
Net Income Distribution					
Estimated patronage refunds and dividends:					
Cash	$ 114,325	$ 98,354	$ 80,466	$ 67,792	$ 64,846
Qualified allocated surplus	27,798	26,391	28,684	46,636	50,936
Nonqualified allocated surplus	92,988	83,420	65,666	47,154	42,261
Nonqualified retained surplus	62,038	73,653	74,467	48,391	32,402
Stock dividends	916	311	60	84	90
Mandatorily redeemable preferred stock dividend	—	—	—	10,282	18,887
Perpetual preferred stock dividend	10,950	10,950	10,950	1,851	—

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

This commentary reviews the combined financial condition and results of operations of AgFirst Farm Credit Bank (AgFirst or the Bank) and the District Agricultural Credit Associations (Associations or District Associations), collectively referred to as the District. This information should be read in conjunction with the accompanying combined financial statements, the notes to the combined financial statements, and other sections of this annual report.

OPERATING STRUCTURE

The District is part of the Farm Credit System (the System), the country's oldest Government Sponsored Enterprise (GSE), created by Congress to provide sound, adequate, and constructive credit and closely related services to agriculture and rural America.

AgFirst and each Association are federally chartered instrumentalities of the United States and are individually regulated by the Farm Credit Administration (the FCA). In creating the System, it was the stated objective of Congress to "*encourage farmer- and rancher-borrowers' participation in the management, control, and ownership of a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit, and to modernize and improve the authorizations and means for furnishing such credit and credit for housing in rural areas made available through the institutions constituting the Farm Credit System.*" Consequently, the Associations are structured as cooperatives; that is, each Association is owned by its borrowers. As such, the benefits of ownership flow to the same farmer/rancher-borrowers that the System was created to serve. Additional information related to the Associations' structure is discussed in Note 1, *Organization and Operations,* of the Notes to the Combined Financial Statements in this annual report to shareholders.

As of December 31, 2006, the District was comprised of AgFirst and twenty-three Agricultural Credit Associations (the Associations). AgFirst provides funding and related services to the twenty-three Associations, which, in turn, provide loans and related services to agricultural and rural borrowers. AgFirst has in place with each of the twenty-three Associations, a revolving line of credit, referred to as a *direct note*. Each Association funds its lending and general corporate activities by borrowing through its direct note. All assets of the Associations secure the direct notes and lending terms are specified in a separate General Financing Agreement between AgFirst and each Association. AgFirst also operates as a cooperative and is owned by the twenty-three Associations.

AgFirst and the Associations are chartered to serve eligible borrowers in Alabama, Delaware, Florida, Georgia, Maryland, Mississippi, North Carolina, Pennsylvania, South Carolina, Virginia, West Virginia, Puerto Rico, and portions of Kentucky, Louisiana, Ohio, and Tennessee. Three other Farm Credit Banks (FCBs) and an Agricultural Credit Bank (ACB), through a number of associations, provide loans and related services to eligible borrowers in the remaining portion of the United States. While owned by its related associations, each FCB manages and controls its own business activities and operations. Likewise, associations are not commonly owned or controlled and each manages and controls its own business activities and operations. Nevertheless, each FCB and its related associations operate in such an interdependent manner that the financial results of each bank are generally viewed on a combined basis with its related associations.

While combined District statements reflect the financial and operational interdependence of AgFirst and the Associations, it is recognized that AgFirst does not own or control the Associations and has limited access to Association capital. Therefore, Bank-only financial information (e.g. not combined with the Associations) has been set forth in Note 22, *Bank Only Financial Data,* in the Notes to the Combined Financial Statements for the purposes of additional analysis. In addition, AgFirst publishes a Bank-only financial report that may be referred to for a more complete analysis of AgFirst Bank-only financial condition and results of operations.

CRITICAL ACCOUNTING POLICIES

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. The District considers significant accounting policies to be critical to the understanding of the District's results of operations and financial position because some accounting policies require complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. The District considers these policies to be critical because management has to 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 Combined Financial Statements. The following is a summary of certain critical policies.

- *Allowance for loan losses* — The allowance for loan losses is management's best estimate of the amount of probable losses existing in and 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, which generally considers recent historical charge-off experience adjusted for relevant factors. These factors include types of loans, credit quality, specific industry conditions, general economic and political conditions, and changes in the character, composition, and performance of the portfolio, among other factors.

  Significant individual loans are evaluated based on the borrower's overall financial condition, repayment capacity and historical 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 attributable to these loans is established by a process that estimates the probable loss inherent in the loans, taking into account various historical and projected factors, internal risk ratings, regulatory oversight, geographic, industry and other factors.

Assessing the appropriateness of the allowance for loan losses is a dynamic process. Increases or decreases in the allowance level will occur as conditions warrant. Material changes could have a direct impact on the provision for loan losses and create volatility in 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 derivative and 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 District's results of operations.
- *Pensions* — The Bank and the 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 the 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 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. At September 30, 2006, the discount rate used to determine the pension plan obligations was 6.00 percent, compared to 5.25 percent at September 30, 2005. The discount rate is used to determine the present value of the future benefit obligations. The Bank selected the discount rate by reference to Moody's Investors Service Aa long-term corporate bond index, actuarial analyses and industry norms.

MISSION-RELATED INVESTMENTS

During 2005, FCA initiated a program to stimulate economic growth and development in rural areas. Recognizing that different investment strategies are needed for agricultural and rural communities, the FCA outlined a program to allow System institutions to hold investments, subject to approval by the FCA on a case-by-case basis. FCA approved the Rural Housing Mortgage-Backed Securities pilot program, the Rural America Bond pilot and the Tobacco Buyout programs under the mission-related investments umbrella, as described below.

Rural Housing Mortgage Backed Securities

Rural Housing Mortgage-Backed Securities (RHMBS) must be fully guaranteed by a government agency or government-sponsored enterprise (GSE). The rural housing loans backing the RHMBS must be conforming first-lien residential mortgage loans originated by non-System lenders in "rural areas" as defined by the Farm Security and Rural Investment Act of 2002 (2002 Farm Bill), or eligible rural housing loans originated by System lenders under FCA Regulation section 613.3030. Investment securities at December 31, 2006 included $1.25 billion in RHMBS classified as held-to-maturity.

Rural America Bonds

In October 2005, the FCA approved the Rural America Bonds investment program for a three-year pilot period. In recognition of the economic interdependence between agricultural and rural communities, AgFirst and the Associations seek to safely and soundly invest in debt obligations that support farmers, ranchers, agribusinesses, and their rural communities and businesses. In doing so, AgFirst and the Associations hope to increase the well-being and prosperity of American farmers, ranchers, and rural areas and residents. As of December 31, 2006, the District had $45.6 million in the Rural America Bond program. Of this amount, $24.0 million are reflected in investment securities and $21.6 million are reflected as loans on the Combined Balance Sheets at December 31, 2006.

Tobacco Buyout Program

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 provided an assessment mechanism for tobacco manufacturers and importers to pay for the buyout. Tobacco quota holders and producers 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 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).

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

As of December 31, 2006, District Associations held Tobacco Buyout loan assignments of $87.6 million, which are reflected as loans on the Combined Balance Sheets. The District Associations purchased Successor-in-Interest Contracts (SIIC) of $428.0 million, which are reflected as other investments on the Combined Balance Sheets.

LOAN PORTFOLIO

Loans

The District's aggregate loan portfolio primarily consists of direct loans made by the Associations to eligible borrowers located within their chartered territories, as illustrated in the following table.

Loan Types
(dollars in thousands)

	2006		2005		2004	
Production Agriculture						
Real Estate Mortgage	$ 8,019,808	43%	$ 7,401,816	46%	$ 6,890,364	46%
Production and Intermediate-Term	7,398,749	40	6,378,740	40	5,868,713	40
Agribusiness:						
Loans to Cooperatives	250,364	1	164,776	1	137,474	1
Processing and Marketing	1,145,416	6	682,709	4	603,081	4
Farm-Related Business	392,153	2	369,574	2	336,434	2
Communication	74,126	1	33,423	–	85,269	1
Energy	198,198	1	156,006	1	176,397	1
Rural Residential Real Estate	1,152,266	6	959,353	6	720,740	5
Lease Receivables	24,088	–	22,525	–	15,906	–
Water and Waste Disposal	12,688	–	–	–	–	–
Discounted loans to OFIs	1,760	–	2,650	–	1,900	–
Total	$ 18,669,616	100%	$ 16,171,572	100%	$ 14,836,278	100%

Loans outstanding as of December 31, 2006 totaled $18.7 billion, an increase of 15.45 percent and 25.84 percent compared to December 31, 2005 and 2004, respectively. District loan growth in originations is attributable to a seasoned lending staff, the value inherent to patronage paid under their cooperative structure, the direct and indirect payments on Program Crops under the current Farm Bill, an improving world economy coupled with a weaker U.S. dollar that helped boost agricultural exports, borrowers seizing low interest rate opportunities, and capital expenditures by borrowers for property, plant and equipment.

The District employs a number of risk management techniques to limit credit exposures. AgFirst and each Association have adopted underwriting standards, individual borrower exposure limits, commodity exposure limits, and other risk management techniques. AgFirst and the Associations actively purchase and sell participations to achieve diversified portfolios and utilize guarantees from other agencies, including Fannie Mae, Federal Agricultural Mortgage Corporation (Farmer Mac), the Farm Services Agency, and the Small Business Administration to further limit credit exposures. At December 31, 2006, the District collectively had $1.82 billion of guaranteed principal under various government or GSE guarantee programs.

The Associations serve all or a portion of fifteen states and Puerto Rico. Additionally, AgFirst and the Associations actively participate in the purchase and sale of loans and loan participations with non-District institutions. The resulting geographic dispersion is a natural risk-reducing factor. The following table illustrates the geographic distribution of the aggregate District portfolio.

District Associations

State	2006	2005	2004
Florida	16%	15%	15%
North Carolina	14	15	15
Georgia	13	12	12
Virginia	10	11	11
Pennsylvania	9	10	10
Maryland	6	7	7
South Carolina	6	6	6
Ohio	4	4	4
Alabama	3	3	3
Kentucky	2	3	3
Delaware	2	2	2
Mississippi	2	2	2
West Virginia	2	2	2
Louisiana	1	1	1
Texas	1	1	1
California	1	–	–
Tennessee	1	1	1
Puerto Rico	1	1	1
New York	1	1	1
Minnesota	1	–	–
Colorado	1	–	–
Other	3	3	3
Total	100%	100%	100%

Only four states have 10 percent or more of the total volume. Commodity diversification, guarantees, and borrowers with relatively high levels of non-farm income mitigate the concentration risk in these states.

During the third quarter of 2005, hurricane activity caused damage across a significant portion of the District. Louisiana, Mississippi, Alabama, and southern Florida were the areas most impacted. Crop and commodity damage in certain areas was severe, but the impact on repayment of loans and risk of loss was mitigated by insurance proceeds, disaster relief, and the overall financial health of the borrowers' balance sheets.

RISK MANAGEMENT

Overview

The District is in the business of making agricultural and other loans that requires taking certain risks in exchange for compensation for the risks undertaken. Management of risks inherent in District business is essential for current and long-term financial performance. The goal is to identify and assess risk, and to properly and effectively mitigate, measure, price, monitor and report risks in the business activities.

The major types of risks are:

- *structural risk* — risk inherent in the business and related to the District structure (an interdependent network of lending institutions),
- *credit risk* — risk of loss arising from an obligor's failure to meet the terms of its contract or failure to perform as agreed,
- *interest rate risk* — risk that changes in interest rates may adversely affect the operating results and financial condition,
- *liquidity risk* — risk of loss arising from the inability to meet obligations when they come due without incurring unacceptable losses,
- *operational risk* — risk of loss resulting from inadequate or failed internal processes or systems, errors by employees or external events, and
- *political risk* — risk of loss of support for the System and agriculture by the federal and state governments.

Structural Risk Management

Structural risk results from the fact that AgFirst, along with the Associations is part of the System, which is comprised of banks and associations that are cooperatively owned, directly or indirectly, by their borrowers. While System institutions are financially and operationally interdependent, this structure at times requires action by consensus or contractual agreement. The Federal Farm Credit Banks Funding Corporation (Funding Corporation) provides for the issuance, marketing and processing of Systemwide Debt Securities using a network of investment dealers and dealer banks. The System banks fund association loans, with Systemwide debt. Refer to Note 9, *Bonds and Notes*, in the Notes to the Combined Financial Statements for further discussion. The banks are jointly and severally liable for the payments of Systemwide Debt Securities, exposing each bank to the risk of default of the others.

In order to mitigate this risk, the System utilizes two integrated contractual agreements — the Amended and Restated Contractual Interbank Performance Agreement, or CIPA, and the Amended and Restated Market Access Agreement, or MAA. Under provisions of the CIPA, a score is calculated that measures the financial condition and performance of each district using various ratios that take into account the district and bank capital, asset quality, earnings, interest-rate risk and liquidity. Based on these measures, the CIPA establishes an agreed-upon standard of financial condition and performance that each district must achieve and maintain. The CIPA also establishes economic incentives whereby monetary penalties are applied if the performance standard is not met. These penalties will occur at the same point at which a bank would be required to provide additional monitoring information under the MAA.

The MAA establishes criteria and procedures for the banks that provide operational oversite and control over a bank's access to System funding if the creditworthiness of the bank declines below certain agreed-upon levels. The MAA promotes the identification and resolution of individual bank financial problems in a timely manner and discharges the Funding Corporation's statutory responsibility for determining conditions for each bank's participation in each issuance of Systemwide Debt Securities.

Credit Risk Management

Credit risk arises from the potential inability of an obligor to meet its repayment obligation and exists in outstanding loans, letters of credit, unfunded loan commitments, investment portfolio and derivative counterparty credit exposures. The District manages credit risk associated with retail lending activities through an assessment of the credit risk profile of an individual borrower. The Bank and Associations establish underwriting standards and lending policies that provide direction to loan officers and are approved by the boards of directors.

The retail 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 on cash flows from operations or other sources of income, including non-farm income. Real estate mortgage loans must be secured by first liens on the real estate (collateral). As required by FCA regulations, each institution that makes loans on a secured basis must have collateral evaluation policies and procedures. Real estate mortgage loans may be made in amounts up to 85.00 percent of the original appraised value of the property taken as security or up to 97.00 percent of the appraised value if guaranteed by a state, federal or other governmental agency. The actual loan appraised value when loans are made is generally lower than the statutory maximum percentage. In addition, each loan is assigned a credit risk rating based on the underwriting standards. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths and weaknesses and risks in a particular relationship. In addition, borrower and commodity concentration lending limits have been established to manage credit exposure.

Through its participation in loans or interests in loans to/from other institutions within the System or outside the System, the District limits its exposure to either a borrower or commodity concentration. This also allows the District to manage growth and capital, and to improve geographic diversification. Concentration risk is reviewed and measured by industry, product, geography and customer limits.

The District loan portfolio is divided into performing and high-risk categories. The high-risk assets, including accrued interest, are detailed below:

(dollars in thousands)	2006	2005	2004
High-risk Assets			
Nonaccrual loans	$ 77,552	$ 82,812	$ 101,749
Restructured loans	2,619	3,151	3,556
Accruing loans 90 days past due	7,418	2,353	2,034
Total high-risk loans	87,589	88,316	107,339
Other property owned	5,122	3,646	3,433
Total high-risk assets	$ 92,711	$ 91,962	$ 110,772
Ratios			
Nonaccrual loans to total loans	0.41%	0.51%	0.69%
High-risk assets to total assets	0.35%	0.40%	0.58%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or interest under the contractual terms of the loan. Nonaccrual loans decreased $5.3 million, or 6.35 percent in 2006.

Restructuring of loans occurs when a concession is granted 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 toward the loan 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.

The credit risk rating process uses a two-dimensional loan rating structure, incorporating a 14-point risk-rating scale to identify and track a borrower's probability of default and a separate scale addressing loss given default. The loan rating structure calculates estimates of loss through two components, borrower risk and transaction risk. Borrower risk is the risk of loss driven by factors intrinsic to the borrower. The transaction risk or facility risk is related to the structure of a credit (tenor, terms, and collateral). AgFirst and the District Associations review the credit quality of the loan portfolio on an on-going basis as part of risk management practices. Each loan is classified according to the Uniform Classification System, which is used by all 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.

Credit quality within the District portfolio improved during the twelve months ended December 31, 2006. At year-end, the District's loans including interest were classified as follows:

Credit Quality	2006	2005	2004
Acceptable	96.39%	95.75%	94.50%
OAEM	2.31	2.67	3.32
Adverse*	1.30	1.58	2.18
Total	100.00%	100.00%	100.00%

* *Adverse loans include substandard, doubtful, and loss loans.*

Delinquencies were 0.79 percent of total loan assets at year-end 2006 compared to 0.63 percent and 0.42 percent at year-end 2005 and 2004, respectively. Nonperforming assets for the District represented 0.35 percent of total assets or $92.7 million, compared to 0.40 percent or $92.0 million for 2005, and 0.58 percent or $110.8 million for 2004. Nonperforming assets consist of nonaccrual loans, accruing restructured loans, accruing loans 90 days or more past due, and other property owned.

District net chargeoffs of $14.9 million, $1.4 million and $7.9 million were recorded in 2006, 2005, and 2004, respectively. As a percentage of total loan assets, net chargeoffs for the District were 0.09 percent for 2006, compared to 0.01 percent for 2005 and 0.05 percent in 2004.

Although the System receives no direct government support, credit quality is an indirect beneficiary of government support as government program payments to borrowers enhance their ability to honor their commitments. However, due to the geographic location of the District and the resulting types of agriculture, government programs account for a relatively small percentage of net farm income in the territory served by the Associations. In addition, the diversified nature and significant non-farm influence on the District's portfolio mitigate the impact of government support for program crops.

The diversity of income sources supporting loan repayment mitigates credit risk to the District. The District's credit portfolio is comprised of a number of segments having varying agricultural characteristics. Commodity and industry categories are based on the Standard Industrial Classification system published by the federal government. This system is used to assign commodity or industry categories based on the largest agricultural commodity of the customer. The following table/chart illustrates the aggregate credit portfolio of the District by major commodity segments.

	Percent of Portfolio		
Commodity Group	2006	2005	2004
Forestry	13%	12%	11%
Rural home	13	7	5
Poultry	11	13	12
Cattle	7	8	8
Grain	6	7	7
Dairy	5	6	7
Nursery/Greenhouse	5	5	5
Lumber/Paper	4	3	4
Swine	3	3	3
Tobacco	3	3	3
Cotton	2	3	3
Citrus	2	2	2
Utilities	1	1	2
Other	25	27	28
Total	100%	100%	100%

The table illustrates that 2006 commodity concentrations were 5.00 percent or more in only seven segments. The concentration in these segments is mitigated by a prevalence of non-farm income among the borrowers as demonstrated by the following table, which segregates part-time farm loans into a unique segment.

	Percent of Portfolio		
Commodity Group	2006	2005	2004
Part-time Farmers	34%	37%	36%
Poultry	10	10	10
Dairy	7	6	7
Forestry	7	6	7
Nursery/Greenhouse	5	4	4
Cotton	3	3	3
Swine	3	3	3
Cattle	3	3	2
Tobacco	2	2	2
Corn	1	1	1
Other	25	25	25
Total	100%	100%	100%

The District has concentrations of full-time farmers greater than 5.00 percent in only three commodities - poultry, forestry, and dairy. All three commodities have a large geographic dispersion with production over the entire AgFirst footprint. Concentrations within the Associations are further dispersed through the number of farm units producing poultry or dairy products. Poultry production is almost exclusively done through a network of contract growers whose income remains stable as variable costs are absorbed by the contracting integrators. Poultry concentration is further disbursed as production is segregated between chicken, turkey, and egg production. Dairy herds range in size from less than 100 cows to approximately 10 thousand. Associations also manage credit and concentration risk through participations, guarantees, and direct payment assignments from the poultry integrators and milk processing facilities. Forestry is divided principally into hardwood and softwood production and value-added processing. The timber from hardwood production is further processed into furniture, flooring, and high-grade paper and is generally located at the more northern latitudes and higher elevations. Softwood timber production is typically located in the coastal plains of the AgFirst footprint and is utilized for building material for the housing market and pulp to make paper and hygiene products. Forestry production at the Associations ranges from less than fifty acres to thousands of acres with value-added processing being conducted at sawmills and planer mills. Also, many poultry, dairy, and forestry producers have significant secondary income from off-farm employment by a family member. AgFirst exposure to the ethanol industry has grown during the year but still remains a very small percentage of the portfolio. AgFirst maintains a conservative maximum hold position in this industry. AgFirst also continues to watch the impact of increasing United States ethanol production on corn prices. Higher corn prices caused by increased ethanol production will increase the cost of production of the meat production companies in the portfolio. Most meat production borrowers within the portfolio are well capitalized and have significant ability to manage through increases in feed ingredient costs.

Loans greater than $5.0 million comprise approximately 19.65 percent of the District loan volume. Loans exceeding an Association's delegated lending authority must be pre-approved by AgFirst. As a result, larger agribusiness loans are typically analyzed by AgFirst's commercial lending staff as well as the Associations' own lending staff prior to an Association committing to such loans.

Approximately 45.86 percent of outstanding loan volume is comprised of loans under $500 thousand, and loans less than $250 thousand make up approximately 30.53 percent of loan volume. This diversification among borrowers is another key component of the District's stable credit quality and solid financial performance over time.

Typically short and long term loans to the same borrower are cross-collateralized and cross-defaulted. By law, all long-term loans must be secured by a first lien on real estate with an initial loan to appraised value not exceeding 85.00 percent. As of December 31, 2006, 42.96 percent of the District loans were identified as real estate loans. Exposure to losses is reduced through collateralization.

District Loan Volume
Gross Loans Per Borrower

$ Range	% of Total
$1,000-$250,000	30.53 %
$251,000-$500,000	15.33
$501,000-$1,000,000	13.47
$1,001,000-$5,000,000	21.02
$5,001,000-$25,000,000	10.82
$25,001,000-$100,000,000	6.12
Over $100,000,000	2.71
	100.00 %

AgFirst and each Association maintain an allowance for loan losses determined by its management and is capitalized to serve its unique market. The minimum regulatory capital ratios for System banks and associations are 7.00 percent for the permanent capital ratio, 7.00 percent for the total surplus ratio, and 3.50 percent for the core surplus ratio. The following table illustrates the risk bearing capacity of the District.

District Entity	Regulatory Permanent Capital Ratio	Regulatory Core Surplus Ratio	Regulatory Total Surplus Ratio	Allowance/ Loans
AgFirst Farm Credit Bank	19.19%	11.46%	19.14%	0.39%
AgChoice	13.59%	11.17%	12.55%	0.31%
Ag Credit	19.15%	15.71%	17.54%	0.48%
AgGeorgia	15.04%	10.60%	14.66%	0.78%
AgSouth	15.94%	12.15%	15.56%	0.30%
ArborOne	13.29%	8.70%	12.89%	0.08%
Cape Fear	15.08%	12.20%	14.72%	0.57%
Carolina	16.00%	12.44%	15.29%	0.29%
Central Florida	16.55%	13.46%	15.88%	0.47%
Central Kentucky	15.65%	13.32%	14.27%	0.64%
Chattanooga	13.71%	10.56%	11.85%	0.41%
Colonial	16.95%	15.96%	16.00%	0.44%
East Carolina	15.63%	13.21%	15.19%	1.52%
Farm Credit of the Virginias	13.57%	11.73%	12.19%	0.18%
First South	13.50%	10.77%	12.33%	0.53%
Jackson Purchase	14.83%	13.23%	14.00%	0.42%
MidAtlantic	15.87%	12.90%	15.35%	0.52%
North Florida	14.19%	11.53%	13.77%	0.36%
Northwest Florida	11.54%	10.78%	11.28%	0.32%
Puerto Rico	24.31%	23.90%	23.90%	0.11%
South Florida	16.31%	14.94%	16.18%	1.01%
Southwest Florida	17.08%	14.27%	16.85%	0.08%
Southwest Georgia	12.42%	10.39%	12.16%	0.09%
Valley	14.19%	10.63%	11.54%	0.34%

Interest Rate Risk Management

The District adheres to a philosophy that all loans should be priced competitively in the market and that loan rates and spreads should be contractually established at loan closing such that a borrower is not subject to rate changes at the discretion of management or boards of directors. Therefore, all District Association variable rate and adjustable rate loans are indexed to market rates, and fixed rate loans are priced based on market rates at closing. Loan products offered by the Associations include prime-indexed variable rate loans, LIBOR-indexed variable rate loans, one-, three- and five-year Treasury-indexed adjustable rate loans, and fixed rate loans. Variable rate and adjustable rate loans are offered with or without caps. Terms are available for up to 30 years. A variety of repayment options are offered, with the ability to pay on a monthly, quarterly, semi-annual or annual frequency. In addition, "custom" repayment plans may be negotiated to fit a borrower's unique circumstances.

The objective of the interest rate risk management process is to generate a stable and adequate level of net interest income in any interest rate environment. AgFirst uses a variety of sophisticated analytical techniques to manage the complexities associated with offering numerous loan options. These include interest rate sensitivity gap analysis to monitor the repricing characteristics of interest-earning assets and interest-bearing liabilities and simulation analysis to determine the change in net interest income and in the market value of equity due to changes in interest rates. The following tables represent the District's projected change in net interest income and market value of equity for various rate movements as of December 31, 2006.

Net Interest Income
(dollars in thousands)

Scenarios	Net Interest Income	% Change
+2.0% Shock	$682,842	8.19%
+1.0% Shock	$660,058	4.58%
Base line	$631,137	–
-1.0% Shock	$631,988	0.13%
-2.0% Shock	$637,555	1.02%

Market Value of Equity
(dollars in thousands)

Scenarios	Assets	Liabilities	Equity	% Change
Book Value	$26,760,311	$23,602,128	$3,158,183	–
+2.0% Shock	$25,934,228	$22,943,595	$2,990,633	(4.58%)
+1.0% Shock	$26,362,845	$23,300,322	$3,062,523	(2.29%)
Base line	$26,757,499	$23,623,297	$3,134,202	–
-1.0% Shock	$27,070,642	$23,853,401	$3,217,241	2.65%
-2.0% Shock	$27,276,036	$24,010,609	$3,265,427	4.19%

* *For interest rate risk management, the $150.0 million in perpetual preferred stock is included in liabilities rather than equity.*

The following table sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2006. The amount of assets and liabilities shown, which reprice or mature during a particular period, were determined in accordance with the earlier of term-to-repricing or contractual maturity, anticipated prepayments, and, in the case of liabilities, the exercise of call options.

Repricing/Maturity Gap Analysis
(dollars in thousands)

	0 to 6 Months	6 months to 1 Year	1 to 5 Years	Over 5 Years	Total
Loans					
Fixed	$ 4,185,879	$ 1,734,492	$ 5,191,231	$ 2,091,943	$ 13,203,545
Variable	5,331,413	46,198	10,692	216	5,388,519
Nonaccrual	–	–	–	77,552	77,552
Total Loans	9,517,292	1,780,690	5,201,923	2,169,711	18,669,616
Total Investments	4,918,020	470,886	807,083	808,482	7,004,471 *
TOTAL INTEREST EARNING ASSETS	$ 14,435,312	$ 2,251,576	$ 6,009,006	$ 2,978,193	$ 25,674,087
Interest Bearing Liabilities					
Systemwide Bonds and Notes	$ 9,536,379	$ 2,153,000	$ 7,211,000	$ 3,713,000	$ 22,613,379
Other Interest Bearing Liabilities	–	–	–	225,000	225,000
Interest Rate Swaps	1,640,000	(225,000)	(1,215,000)	(200,000)	–
TOTAL INTEREST BEARING LIABILITIES	$ 11,176,379	$ 1,928,000	$ 5,996,000	$ 3,738,000	$ 22,838,379
Interest Rate Sensitivity Gap	$ 3,258,933	$ 323,576	$ 13,006	$ (759,807)	
Sensitivity Gap as a % of Total Earning Assets	12.69%	1.26%	0.05%	(2.96%)	
Cumulative Gap	$ 3,258,933	$ 3,582,509	$ 3,595,515	$ 2,835,708	
Cumulative Gap as a % of Total Earning Assets	12.69%	13.95%	14.00%	11.05%	
Rate Sensitive Assets/Rate Sensitive Liabilities	1.29	1.17	1.00	0.80	

** includes cash equivalents*

At December 31, 2006, the Repricing / Maturity Gap reflected an asset sensitive position due to allocation of equity funding for variable and short-term assets at the District level and extension of options in liabilities. Short- and intermediate-term interest rates increased during the year and resulted in the majority of call options on fixed rate debt to be "out of the money". This gap position implies an increase in net interest income given rising interest rates scenario. However, the Repricing / Maturity Gap Analysis is a point in time view and is representative of the interest rate environment at December 31. Increasing or decreasing interest rates alter this position due to options in both assets and debt.

The Net Interest Income (NII) sensitivity analysis shown above indicates the change in District NII is positive in both rising and falling interest rate scenarios. The NII result for rising interest rates illustrated in the +1.00 and +2.00 percent shocks is consistent with the asset sensitive position explained above and reflected in the Repricing / Maturity Gap schedule. NII in the falling interest rate scenarios is also positive, due to a lesser extent. While the majority of equity funding is applied to variable and short-term assets, falling interest rates cause call options in fixed rate debt to be "in the money" and eligible for exercise. As rates fall, the volume of fixed rate debt call options exercised exceeds refinancing activity or prepayment speeds on fixed rate assets causing the District to become liability sensitive in falling interest rate environments. The volume of liabilities repricing within the 12-month period is greater than assets and the cost of debt declines at a faster rate, widening margins and increasing NII for the District.

At December 31, 2006, AgFirst had outstanding interest rate swaps with notional amounts totaling $1.77 billion. These derivative transactions were executed to reduce interest rate risk and/or reduce funding costs.

AgFirst policy prohibits the use of derivatives for speculative purposes. See Note 19, *Derivative Instruments and Hedging Activities*, in the Notes to the Combined Financial Statements for additional information. The following table shows the activity in derivatives during the year ended December 31, 2006.

Disclosures for Derivative Financial Instruments

Notional amounts *(dollars in millions)*	**Receive Fixed**	**Amortizing Pay Fixed**	**Amortizing Floating for Floating**	**Interest Rate Caps**	**Total**
Balance at December 31, 2005	$ 1,930	$ 440	$ 264	$ 239	$ 2,873
Additions	450	–	–	–	450
Maturities/amortizations	(615)	(440)	(264)	(239)	(1,558)
Terminations	–	–	–	–	–
Balance at December 31, 2006	$ 1,765	$ –	$ –	$ –	$ 1,765

Various Uses of Derivative Instruments at December 31, 2006
(dollars in millions)

Derivatives utilized to create synthetic floating-rate debt to achieve a lower cost of funding	$ 1,765
Asset/liability management purposes	–
Other purposes	–
Total derivatives outstanding	$ 1,765

Liability Risk Management

AgFirst maintains adequate liquidity to satisfy the District's daily cash needs. In addition to normal cash flow associated with lending operations, AgFirst has two primary sources of liquidity: investments and the issuance of Systemwide Debt Securities.

Investments and Cash Equivalents

FCA Regulations provide that a System bank may hold certain eligible investments, in an amount not to exceed 35.00 percent of its total loans outstanding to satisfy FCA's liquidity reserve requirement, manage short-term funds, and manage interest rate risk. AgFirst maintains an investment portfolio for this purpose comprised primarily of short-duration, high-quality investments. The nature of this portfolio guarantees that investments can be converted to cash quickly and without significant risk of loss.

In addition, the District maintains a portfolio of investments that are not held for liquidity purposes and are accounted for as a held-to-maturity portfolio. These investments are authorized by FCA Regulations that allow investments in Farmer Mac securities and also in specific investments approved by FCA as a Mission-Related Investment. The vast majority of this portfolio is comprised of Mission-Related Investments for a program to purchase RHMBS, not to exceed 10.00 percent of total outstanding loans (see *Mission-Related Investments* section). Six Associations also holds investment securities in AAA-rated asset-backed securities (ABSs) guaranteed by the United States Government or a United States Government agency.

Investment securities and cash equivalents outstanding as of December 31, 2006 for the District totaled $7.00 billion compared to $5.85 billion and $3.73 billion at December 31, 2005 and 2004, respectively. The increases in 2006 and 2005 are due to revision of FCA Regulations during 2005 to increase the maximum level of liquidity investments from 30.00 to 35.00 percent of total loans outstanding, growth of total loans outstanding and AgFirst participation in the Mission-Related Investment program for rural housing.

The District's investment portfolio consisted of the following security types as of December 31, 2006:

District Investment Securities

(dollars in thousands)	2006		2005		2004	
Investment Securities						
Available for Sale						
Commercial Paper	$ –	–%	$ 69,796	1.32%	$ 29,957	0.91%
U.S. Govt. GNMA MBS/CMOs	1,267,914	19.53	1,056,283	19.92	1,080,843	32.84
U.S. Govt. Agency MBS	2,749,985	42.36	2,029,961	38.28	1,853,148	56.31
Non-Agency Securities	776,534	11.96	597,670	11.27	292,545	8.89
Asset-Backed Securities	271,188	4.18	132,608	2.50	21,921	0.67
Total Available for Sale	5,065,621	78.03	3,886,318	73.29	3,278,414	99.62
Held to Maturity						
Rural Housing MBS	1,249,788	19.25	1,347,266	25.41	–	–
Commercial MBS	2,260	0.03	2,762	0.05	–	–
MBS Guaranteed by Farmer Mac	27,107	0.42	31,937	0.60	12,553	0.38
Other Asset-Backed Securities	123,313	1.90	34,682	0.65	–	–
Other	24,013	0.37	–	–	–	–
Total Held to Maturity	1,426,481	21.97	1,416,647	26.71	12,553	0.38
Total Investment Securities	$ 6,492,102	100.00%	$ 5,302,965	100.00%	$ 3,290,967	100.00%
Cash Equivalents						
Fed Funds	$ 55,369	10.81%	$ 168,428	30.54%	$ 58,691	13.32%
Master Notes	82,000	16.00	108,048	19.59	107,000	24.28
Repos	375,000	73.19	275,000	49.87	275,000	62.40
Total Cash Equivalents	$ 512,369	100.00%	$ 551,476	100.00%	$ 440,691	100.00%

FCA regulations require a liquidity policy that establishes a "minimum coverage" level of 90 days. "Coverage" is defined as the number of days that maturing debt could be funded through the sale of liquid investments and Agency-guaranteed rural home loans. At December 31, 2006, AgFirst's coverage was 170 days.

Systemwide Debt Securities

AgFirst's primary source of liquidity is the ability to issue Systemwide Debt Securities, which are the general unsecured joint and several obligations of the System banks. AgFirst continually raises funds to support the mission to provide credit and related services to the rural and agricultural sectors, repay maturing Systemwide Debt Securities, and meet other obligations. As a government-sponsored enterprise, AgFirst has had access to the nation's and world's capital markets. This access has provided AgFirst with a dependable source of competitively priced debt that is critical to support the mission of providing funding to the rural and agricultural sectors. Moody's Investors Service and Standard & Poor's rate the System's long-term debt as Aaa and AAA, and short-term debt as P-1 and A-1+. These rating agencies base their ratings on many quantitative and qualitative factors, including the System's government-sponsored enterprise status. Material changes to the factors considered could result in a different debt rating. However, as a result of the System's financial performance, credit quality and standing in the capital markets, AgFirst anticipates continued access to funding necessary to support System needs. The U.S. government does not guarantee, directly or indirectly, Systemwide Debt Securities. The year-to-date average balance of Systemwide Debt Securities at December 31, 2006, was $20.57 billion. At December 31, 2006, AgFirst had $22.61 billion in total debt outstanding compared to $18.88 billion at December 31, 2005 and $15.40 billion at December 31, 2004. The year-to-year increases were primarily due to the increases in loan volume and investments.

AgFirst's participation in outstanding Systemwide Debt Securities as of December 31, 2006 is as follows:

Systemwide Debt Securities

(dollars in thousands)

	Bonds		Medium-Term Notes		Discount Notes		Total	
Maturities	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate
2006	$ 7,041,289	4.65%	$ –	–%	$ 2,586,284	5.12%	$ 9,627,573	4.78%
2007	4,539,046	4.64	–	–	–	–	4,539,046	4.64
2008	2,329,510	4.61	–	–	–	–	2,329,510	4.61
2009	1,255,027	4.76	–	–	–	–	1,255,027	4.76
2010	1,003,414	5.00	–	–	–	–	1,003,414	5.00
2011	3,858,809	5.52	–	–	–	–	3,858,809	5.52
Total	$ 20,027,095	4.84%	$ –	–%	$ 2,586,284	5.12%	$22,613,379	4.87%

In the preceding table, weighted average interest rates include the effect of related derivative financial instruments.

See Note 9, *Bonds and Notes,* in the Notes to the Combined Financial Statements, for additional information related to debt.

Operational Risk Management

Operational risk is the risk of loss resulting from inadequate or failed processes or systems, human factors or external events, including the execution of unauthorized transactions by employees, errors relating to transaction processing and technology, breaches of the internal control system and the risk of fraud by employees or persons outside the System. AgFirst and the Associations' board of directors are required, by regulation, to adopt an internal control policy that provides adequate direction to the institution in establishing effective control over and accountability for operations, programs and resources. The policy must include, at a minimum, the following items:

- direction to management that assigns responsibility for the internal control function to an officer of the institution,
- adoption of internal audit and control procedures,
- direction for the operation of a program to review and assess its assets,
- adoption of loan, loan-related assets and appraisal review standards, including standards for scope of review selection and standards for work papers and supporting documentation,
- adoption of asset quality classification standards,
- adoption of standards for assessing credit administration, including the appraisal of collateral, and
- adoption of standards for the training required to initiate a program.

In general, System institutions address operational risk through the organization's internal framework under the supervision of the internal auditors. Exposure to operational risk is typically identified with the assistance of senior management and internal audit plans developed with higher risk areas receiving more review.

Political Risk Management

System institutions are instrumentalities of the federal government and are intended to further governmental policy concerning the extension of credit to or for the benefit of agricultural and rural America. The System and its borrowers may be significantly affected by federal legislation that affects the System directly, such as changes to the Farm Credit Act, or indirectly, such as agricultural appropriations bills. Political risk to the System is the risk of loss of support for the System or agriculture by the U.S. government.

The District manages political risk by actively supporting the Farm Credit Council, which is a full-service, federal trade association representing the System before Congress, the Executive Branch, and others. The Council provides the mechanism for "grassroots'' involvement in the development of System positions and policies with respect to federal legislation and government actions that impact the System. Additionally, the District takes an active role in representing the individual interests of System institutions and their borrowers before Congress. In addition to the Farm Credit Council, each district has its own Council, which is a member of the Farm Credit Council. The district Councils represent the interests of their members on a local and state level, as well as on a federal level.

ALLOWANCE FOR LOAN LOSSES

The District maintains an allowance for loan losses at a level considered adequate to provide for probable and estimable credit losses within the loan and finance lease portfolios. The District increases the allowance by recording a provision for loan losses in the income statement. Loan losses are recorded against the allowance when management determines that any portion of the loan or lease is uncollectible. Any subsequent recoveries are added to the allowance. Managements' evaluations consider factors which include, among other things, loan loss experience, portfolio quality, loan portfolio composition, current agricultural production conditions and economic conditions. The allowance for loan losses was $71.9 million at December 31, 2006, as compared with $87.6 million and $95.4 million at December 31, 2005 and 2004, respectively.

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,**		
(dollars in thousands)	**2006**	**2005**	**2004**
Balance at beginning of year	$ 87,551	$ 95,419	$ 316,735
Charge-offs:			
Real estate mortgage	(877)	(158)	(301)
Production and intermediate-term	(1,562)	(2,267)	(5,102)
Agribusiness	(13,466)	(161)	(1,248)
Communication loans	–	(13)	(3,200)
Rural home loans	(8)	(16)	(36)
Total charge-offs	(15,913)	(2,615)	(9,887)
Recoveries:			
Real estate mortgage	32	43	34
Production and intermediate-term	824	777	1,905
Agribusiness	127	44	14
Communication loans	–	363	–
Rural home loans	11	12	6
Total recoveries	994	1,239	1,959
Net (charge-offs) recoveries	(14,919)	(1,376)	(7,928)
(Reversal of) provision for loan losses	(717)	(6,492)	2,037
Nonrecurring reversal of allowance for loan losses*	–	–	(215,425)
Balance at end of year	$ 71,915	$ 87,551	$ 95,419
Ratio of net charge-offs (recoveries) during the period to average loans outstanding during the period	0.09%	0.01%	0.05%

* *Represents the amount of allowance reversal due to the refinement in methodology.*

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

Allowance for Loan Losses by Type *(dollars in thousands)*	December 31, 2006	2005	2004
Real Estate Mortgage	$ 24,804	$ 35,676	$ 40,515
Production and Intermediate-Term	40,395	43,490	44,891
Agribusiness	5,005	6,289	6,487
Communication	73	80	1,504
Energy	75	55	76
Rural Residential Real Estate	1,563	1,956	1,928
Leases	–	5	18
Total	$ 71,915	$ 87,551	$ 95,419

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

	2006	2005	2004
Allowance for loan losses to loans	0.39%	0.54%	0.64%
Allowance for loan losses to nonaccrual loans	92.73%	105.72%	93.78%
Allowance for loan losses to participation loans and correspondent lending loans	2.20%	5.29%	8.13%

The financial positions of the District borrowers have generally strengthened during the past decade as farmers' net cash income has been at a favorable level, due, in part, to direct federal government payments and steady increases in land values over the period. With borrowers' strengthened financial positions and the continued emphasis on sound underwriting standards, the credit quality of the District loan portfolio has remained healthy.

See Note 3, *Refinement of the Allowance for Loan Loss Methodologies* and Note 5, *Loans and Allowance for Loan Losses,* in the Notes to the Combined Financial Statements for further information concerning the allowance for loan losses.

RESULTS OF OPERATIONS

Net Income

District net income totaled $410.4 million for the year ended December 31, 2006, an increase of $33.2 million over 2005, while 2005 net income decreased $158.0 million compared to 2004. Major components of the changes in net income for the referenced periods are outlined in the following table and discussion.

Change in Net Income *(dollars in thousands)*	Year Ended December 31, 2006	2005
Net income (for prior year)	$ 377,177	$ 535,211
Increase (decrease) due to:		
Total interest income	470,974	297,591
Total interest expense	(407,639)	(255,916)
Net interest income	63,335	41,675
Provision for loan losses	(5,775)	(206,896)
Noninterest income	3,117	1,850
Noninterest expense	(25,057)	(7,158)
Provision for income taxes	(2,428)	12,495
Total increase (decrease) in net income	33,192	(158,034)
Net income	$ 410,369	$ 377,177

Interest Income

Total interest income for the year ended December 31, 2006 was $1.67 billion, an increase of $471.0 million, as compared to the same period of 2005. Total interest income for the year ended December 31, 2005 was $1.20 billion, an increase of $297.6 million, as compared to the same period of 2004.

The following table illustrates the impact volume and yield changes had on interest income over these periods.

Net Change in Interest Income *(dollars in thousands)*	Year Ended December 31, 2006-2005	2005-2004
Increase in average earning assets	$ 4,197,034	$ 1,864,089
Average yield (prior year)	6.04%	5.01%
Interest income variance attributed to change in volume	253,257	93,324
Average earning assets (current year)	24,071,696	19,874,662
Increase (decrease) in average yield	0.90%	1.02%
Interest income variance attributed to change in yield	217,717	204,267
Net change in interest income	$ 470,974	$ 297,591

The increase from 2005 to 2006 was primarily attributable to the increase in average earning assets of $4.20 billion. In 2006, interest rates increased in comparison to 2005 and as a result, the average yield on interest earning assets increased by 0.90 percent.

Interest Expense

Total interest expense for the year ended December 31, 2006 was $996.4 million, an increase of $407.6 million, as compared to the same period of 2005. Total interest expense for the year ended December 31, 2005 was $588.8 million, an increase of $255.9 million, as compared to the same period of 2004. The increases in interest expense were primarily attributed to rising interest rates, and an increase in interest-bearing liabilities to support asset growth.

The following table illustrates the impact volume and rate changes had on interest expense over these periods.

Net Change in Interest Expense *(dollars in thousands)*	Year Ended December 31, 2006-2005	2005-2004
Increase in average interest-bearing liabilities	$ 3,996,877	$ 1,792,935
Average rate (prior year)	3.50%	2.21%
Interest expense variance attributed to change in volume of average interest-bearing liabilities	139,850	39,696
Average interest-bearing liabilities (current year)	20,823,897	16,827,020
Increase (decrease) in average rate	1.29%	1.29%
Interest expense variance attributed to change in rate	267,789	216,220
Net change in interest expense	$ 407,639	$ 255,916

Net Interest Income

Net interest income increased from 2005 to 2006 and from 2004 to 2005, as illustrated by the following table:

Analysis of Net Interest Income
(dollars in thousands)

	2006		2005		2004	
	Avg. Balance	**Interest**	**Avg. Balance**	**Interest**	**Avg. Balance**	**Interest**
Loans	$ 17,215,100	$ 1,309,291	$ 15,414,929	$ 1,028,563	$ 14,429,728	$ 826,926
Cash & investments	6,856,596	360,957	4,459,733	170,711	3,580,845	74,757
Total earning assets	$ 24,071,696	$ 1,670,248	$ 19,874,662	$ 1,199,274	$ 18,010,573	$ 901,683
Interest-bearing liabilities	$ 20,823,897	$ (996,412)	$ 16,827,020	$ (588,773)	$ 15,034,085	$ (332,857)
Impact of capital	$ 3,247,799		$ 3,047,642		$ 2,976,488	
Net interest income		$ 673,836		$ 610,501		$ 568,826

	2006 Average Yield	2005 Average Yield	2004 Average Yield
Yield on loans	7.61%	6.67%	5.73%
Yield on cash & investments	5.26%	3.83%	2.08%
Yield on earning assets	6.94%	6.03%	5.00%
Cost of interest-bearing liabilities	4.79%	3.50%	2.21%
Spread	2.15%	2.53%	2.79%
Impact of capital	0.65%	0.54%	0.37%
Net interest income/avg. earning assets	2.80%	3.07%	3.16%

The increase in net interest income is attributed to the positive variance in interest earning assets, offset by the decrease in spread between asset and funding costs. Both loans and investments increased significantly in 2006, but the positive impact on net interest income was partially offset by compression of spread between asset yield and debt cost. The decreases in spread are primarily due to increased competitive pressures and a shift in balance sheet composition where investments increased as a percentage of total assets. Investments have lower spreads to debt costs than loans due to their high credit quality and liquidity. The percentage of average investments relative to total average earning assets for 2004, 2005 and 2006 was 19.88 percent, 22.44 percent and 28.48 percent, respectively.

Provision for Loan Losses

AgFirst and each Association assess risks inherent in their individual portfolios on an ongoing basis and establish an appropriate reserve for loan losses. A reversal of $717 thousand in 2006 primarily resulted from the net decrease in the risk exposure across the District. In 2005, a net reversal of $6.5 million in provision for loan losses was recorded by the District. The $213.4 million net reversal in 2004 resulted from the District's studies and the resulting refinements in methodologies completed during the fourth quarter of 2004.

Noninterest Income

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

Noninterest Income *(dollars in thousands)*	For the Year Ended December 31, **2006**	**2005**	**2004**	Increase (Decrease) **2006/ 2005**	**2005/ 2004**
Loan fees	$ 33,434	$ 35,931	$ 34,317	$ (2,497)	$ 1,614
Fees for financially related services	6,887	6,347	6,544	540	(197)
Realized gains (losses) on investments (net)	(5)	466	(17)	(471)	483
Realized gains on derivatives (net)	6,812	94	96	6,718	(2)
Gains (losses) on sale of rural home loans	3,172	2,935	(717)	237	3,652
Gains on sale of mortgage servicing assets	–	1,078	–	(1,078)	1,078
Gains from sale of premises and equipment, net	1,521	3,004	–	(1,483)	3,004
Other noninterest income	6,849	5,698	13,480	1,151	(7,782)
Total noninterest income	$ 58,670	$ 55,553	$ 53,703	$ 3,117	$ 1,850

The primary reason for the 2006 increase in noninterest income was the $6.7 million increase in gains on derivatives which represented the gain realized on liquidating a derivative strategy and putting permanent financing in place. In addition, the $1.2 million increase in other noninterest income for 2006 primarily resulted from a $1.5 million gain allocated to AgFirst from the sale of .75 acres and all existing development rights related to the Farm Credit System Building Association property in McLean, Virginia. Offsetting these increases were the decrease in loan fees of $2.5 million, $1.1 million decrease in gains from the sale of mortgage servicing assets, and $1.5 million decrease in gains on sale of premises and equipment. For the year ended December 31, 2004, other noninterest income was $7.8 million greater than December 31, 2005. Other noninterest income for 2004 included a recovery recorded by AgFirst of $3.4 million on an investment previously charged-off and the $3.8 million gain on the sale of stock in the Farm Credit Leasing Corporation.

Noninterest Expense

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

Noninterest Expense *(dollars in thousands)*	**For the Year Ended December 31,** 2006	2005	2004	**Increase (Decrease)** 2006/ 2005	2005/ 2004
Salaries and employee benefits	$190,597	$ 188,191	$ 179,907	$ 2,406	$ 8,284
Occupancy and equipment expense	30,953	29,071	26,441	1,882	2,630
Insurance fund premium	24,615	7,447	7,088	17,168	359
Other operating expenses	71,491	66,937	60,895	4,554	6,042
Intra-System financial assistance expenses	–	3,221	6,794	(3,221)	(3,573)
Restructuring charge	–	–	3,697	–	(3,697)
Called debt expense	2,563	656	3,360	1,907	(2,704)
Other noninterest expenses	2,339	1,978	2,161	361	(183)
Total noninterest expenses	$322,558	$ 297,501	$ 290,343	$ 25,057	$ 7,158

Salaries and employee benefits increased in 2006 due to normal increases in employee compensation. The Insurance fund premium increased $17.2 million for the twelve months ended December 31, 2006, compared to the comparable period in 2005, due to an increase in premium rates from 5 basis points to 15 basis points on accrual loans beginning January 1, 2006. Financial assistance expense declined in 2005 due to the retirement of several Financial Assistance Corporation bonds. AgFirst fully extinguished its obligations in 2005 with the maturity of the last Financial Assistance Corporation bonds. The Financial Assistance Corporation dissolved effective December 31, 2006. See Note 14, *Intra-System Financial Assistance,* in the Notes to the Combined Financial Statements for further information.

Other operating expenses increased $4.6 million from 2005 to 2006 and increased $6.0 million from 2004 to 2005. The $4.5 million increase in other operating expenses from 2006 to 2005 resulted primarily from increases of $826 thousand in FCA supervisory and examination expense, $770 thousand in advertising expenses, and $964 thousand in allocated committee expense. The $6.0 million increase in other operating expenses from 2004 to 2005 resulted primarily from increases of $1.3 million in directors' expenses, $1.1 million in advertising expense, $1.0 million in communications expense, $590 thousand in purchased services expense, and $507 thousand in public and member relations expense.

Concession (debt issuance expense) is amortized over the life of the underlying debt security. When securities are called prior to maturity, any unamortized concession is expensed. Called debt expense increased $1.9 million in 2006, compared to 2005. For 2005, the called debt decreased $2.7 million, compared to 2004. Called debt volume was $1.55 billion, $352.0 million, and $2.53 billion for 2006, 2005, and 2004, respectively.

The restructuring charges of $3.7 million recorded in 2004 were the nonrecurring costs related to an Association consolidation. Effective January 1, 2004, AgSouth Farm Credit, ACA merged with Palmetto Farm Credit, ACA. The merged Association is called AgSouth Farm Credit, ACA, and is headquartered in Statesboro, Georgia.

Provision for Income Taxes

Provision for income taxes increased $2.4 million in 2006 compared to 2005. Provision for income taxes decreased $12.5 million in 2005 compared to 2004. These variations are primarily attributable to the reversal of the allowance for loan losses recorded in 2004. In connection with the reversal of the allowance for loan losses due to the refinement of methodologies, $11.2 million in tax provision was recognized in 2004. See Note 12, *Income Taxes*, in the Notes to the Combined Financial Statements for further details.

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 12/31/06**	**For the 12 Months Ended 12/31/05**	**For the 12 Months Ended 12/31/04**
Return on average assets	1.67%	1.86%	2.96%
Return on average shareholders' equity	12.40%	12.05%	19.31%
Net interest income as a percentage of average earning assets	2.84%	3.07%	3.16%
Net chargeoffs (recoveries) to average loans	0.09%	0.01%	0.05%

EMPLOYEE RETIREMENT PLANS

As of December 31, 2006, the District had contributed $765 thousand to the Districtwide defined benefit retirement plans. As of December 31, 2005, the District had contributed $28.0 million to the Districtwide defined benefit retirement plans. The Districtwide funding in 2005 and 2006 brought the retirement plans' assets to an amount that exceeded the Accumulated Benefit Obligation as of the plans' measurement date, eliminating the minimum pension liability and the charge to accumulated other comprehensive income. See Note 13, *Employee Benefit Plans*, in the Notes to the Combined Financial Statements of this report for further information.

PREFERRED STOCK

On May 17, 2001, AgFirst issued 225 thousand shares of Mandatorily Redeemable Cumulative Preferred Stock at a par value of $1 thousand per share. This stock is mandatorily redeemable on December 15, 2016 and carries a stated annual dividend rate of (1) 8.393 percent until December 15, 2011, with dividends paid semi-annually on June 15th and December 15th: and (2) thereafter at a floating rate per annum equal to 3 month LIBOR plus 3.615 percent with dividends payable quarterly commencing March 15, 2012. On or after the dividend payment date in December 2011, the preferred stock will be redeemable in whole or in part at the option of AgFirst on any dividend payment date at its par value of $1 thousand per share.

On October 14, 2003, AgFirst issued 150 thousand shares of Perpetual Non-Cumulative Preferred Stock at a par value of $1 thousand per share. Dividends on the stock are non-cumulative and payable on the fifteenth day of June and December in each year, commencing December 15, 2003, at an annual rate equal to 7.30 percent. In the event dividends are not declared on the preferred stock for payment on any dividend payment date, then such dividends shall not accumulate and shall cease to accrue and be payable. On or after the dividend payment date in December 2008, AgFirst may, at its option, redeem the preferred stock in whole or in part at any time at the redemption price of $1 thousand per share plus accrued and unpaid dividends for the then current dividend period to the date of redemption.

See Note 10, *Mandatorily Redeemable Preferred Stock,* and Note 11, *Protected Borrower Equity and Shareholders' Equity,* in the Notes to the Combined Financial Statements of this annual report for more detailed information concerning the preferred stock issuances.

CAPITAL

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. A sound capital position is critical to providing protection to investors in Systemwide Debt Securities and to long-term financial success.

Total shareholders' equity at December 31, 2006 was $3.31 billion, compared to $3.14 billion and $3.00 billion at December 31, 2005 and 2004, respectively. The increases in shareholders' equity are primarily attributed to increases in retained earnings.

FCA sets minimum regulatory capital requirements for 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. System banks are also required to maintain a minimum collateral ratio of 103.00 percent. Subsequent to the issuance of the mandatorily redeemable preferred stock, FCA now requires AgFirst to maintain a minimum net collateral ratio of 104.00 percent compared to the regulatory minimum of 103.00 percent. Unlike the permanent capital, total surplus and core surplus ratios, the net collateral ratio does not incorporate any risk-weighting of assets. The collateral ratio is calculated by dividing the Bank's collateral as defined by FCA regulations, by total liabilities. The collateral ratios for AgFirst were 105.28 percent, 105.70 percent, and 106.88 percent at December 31, 2006, 2005, and 2004, respectively. The decrease in the collateral ratios for the years ended December 31, 2006 and 2005 was attributed to asset growth.

See Note 11, *Protected Borrower Equity and Shareholders' Equity*, in the Notes to the Combined Financial Statements for additional information.

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

AgFirst is committed to providing sound and dependable credit to young, beginning, and small (YBS) farmers and ranchers. Because of the unique needs of these individuals, and their importance to the future growth of the Associations, the Associations have established annual marketing goals to increase market shares 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' access to a stable source of credit. AgFirst and the District Associations recognize that YBS farmers are vitally important to the future of agriculture and are committed to continue offering programs to help educate, assist, and provide quality financial services to YBS farmers.

The FCA regulatory definitions for YBS farmers and ranchers are as follows:

> ***Young Farmer –*** A farmer, rancher, or producer or harvester of aquatic products who was age 35 or younger as of the date the loan was originally made.
>
> ***Beginning Farmer –*** A farmer, rancher, or producer or harvester of aquatic products who had 10 years or less farming or ranching experience as of the date the loan was originally made.
>
> ***Small Farmer*** – A farmer, rancher, or producer or harvester of aquatic products who normally generated less than $250 thousand in annual gross sales of agricultural or aquatic products at the date the loan was originally made.

It is important to note that due to the regulatory definitions a farmer/rancher may be included in multiple categories as they would be included in each category in which the definition was met.

The following table summarizes information regarding loans outstanding to Young and Beginning Farmers and Ranchers as of year-end 2006:

Young, and Beginning Farmers and Ranchers
Number/Volume of Loans Outstanding
December 31, 2006
(dollars in thousands)

Category	Number of Loans	Percent of Total	Volume Outstanding	Percent of Total
1. Total loans and commitments outstanding at year-end	134,515	–	$ 23,981,790	–
2. Young farmers and ranchers	21,387	15.90%	$ 2,008,429	8.37%
3. Beginning farmers and ranchers	32,393	24.08%	$ 4,209,076	17.55%

The following table summarizes information regarding loans outstanding to Small Farmers and Ranchers as of year-end 2006:

Small Farmers and Ranchers
Number/Volume of Loans Outstanding by Loan Size
December 31, 2006
(dollars in thousands)

Number/Volume Outstanding	$0– $50,000	$50,001– $100,000	$100,001– $250,000	$250,001– and greater
1. Total number of loans and commitments outstanding at year-end	80,626	21,200	19,750	12,939
2. Total number of loans to small farmers and ranchers	58,381	14,093	11,901	5,324
3. Number of loans to small farmers and ranchers as a % of total number of loans (line 2/ line 1 * 100 = 00.00%)	72.41%	66.48%	60.26%	41.15%
4. Total loan volume outstanding at year-end	$1,535,098	$1,761,301	$ 3,580,258	$ 17,105,133
5. Total loan volume to small farmers and ranchers	$1,076,172	$1,065,984	$ 1,897,262	$ 2,959,686
6. Loan volume to small farmers and ranchers as a % of total loan volume (line 5/ line 4 * 100 = 00.00%)	70.10%	60.52%	52.99%	17.30%

The following table summarizes information regarding the new loans made to Young and Beginning Farmers and Ranchers as of year-end 2006:

Young, and Beginning Farmers and Ranchers
Gross New Business During 2006, Number/Volume of Loans
December 31, 2006
(dollars in thousands)

Category	Number of Loans	Percent of Total	Volume Outstanding	Percent of Total
1. Total gross new loans and commitments made during 2006	59,861	–	$ 12,392,681	–
2. Total loans and commitments made to young farmers and ranchers	8,781	14.67%	$ 973,789	7.86%
3. Total loans and commitments made to beginning farmers and ranchers	11,538	19.27%	$ 1,944,541	15.69%

The following table summarizes information regarding new loans made to Small Farmers and Ranchers as of year-end 2006:

Small Farmers and Ranchers
Gross New Business by Loan Size, Number/Volume of Loans
December 31, 2006
(dollars in thousands)

Number/Volume	$0– $50,000	$50,001– $100,000	$100,001– $250,000	$250,001– and greater
1. Total number of new loans and commitments made during 2006	30,144	10,880	9,796	9,041
2. Total number of loans made to small farmers and ranchers during 2006	20,842	5,779	4,199	2,402
3. Number of loans to small farmers and ranchers as a % of total number of loans (line 2/ line 1 * 100 = 00.00%)	69.14%	53.12%	42.86%	26.57%
4. Total gross loan volume of all new loans and commitments made during 2006	$ 574,657	$ 727,007	$ 1,503,187	$ 9,587,830
5. Total gross loan volume to small farmers and ranchers	$ 355,456	$ 381,459	$ 639,352	$ 1,480,690
6. Loan volume to small farmers and ranchers as a % of total gross new loan volume (line 5/ line 4 * 100 = 00.00%)	61.86%	52.47%	42.53%	15.44%

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Accounting for Certain Hybrid Financial Instruments

In February 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 155, *Accounting for Certain Hybrid Financial Instruments* (SFAS 155), an amendment of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133) and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SFAS 140.) This Statement resolves certain issues addressed in the implementation of SFAS 133 concerning beneficial interests in securitized financial assets. SFAS 155 permits fair value measurement for any hybrid financial instrument that contains an embedded derivative, clarifies which interest-only strips and principal-only strips are not subject to the requirement of SFAS 133, establishes a requirement to evaluate interests in securitized financial assets, clarifies the concentrations of credit risk, and eliminates the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument. The Statement is effective for all financial instruments acquired or issued in fiscal years beginning after September 15, 2006. The District is currently analyzing the impact of SFAS 155 on its financial statements. The adoption of this standard is not expected to have a material effect on the District's Combined Balance Sheets or Statements of Income.

Accounting for Servicing of Financial Assets

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets* (SFAS 156), which amends the accounting for separately recognized servicing assets and servicing liabilities. SFAS 156 permits the choice of the amortization method or the fair value measurement method, with changes in fair value recorded in income, for the subsequent measurement for each class of separately recognized servicing assets and servicing liabilities. The Statement is effective for years beginning after September 15, 2006, with earlier adoption permitted. The District is currently analyzing the impact of SFAS 156 on its financial statements. The adoption of this standard is not expected to have a material effect on the District's Combined Balance Sheets or Statements of Income.

Accounting for Uncertainty in Income Taxes

In June 2006, the SFASB released Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. The District is currently analyzing the impact of FIN 48 on its financial statements. Adoption of FIN 48 is not expected to have a material impact on the District's Combined Balance Sheet or Combined Statement of Income.

Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which provides enhanced guidance for using fair value to measure assets and liabilities. The standard applies whenever other standards require or permit assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. Early adoption is permitted. The District is currently analyzing the impact of SFAS 157 on its financial statements.

Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS 158). SFAS 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 through comprehensive income changes in that funded status in the year in which the changes occur. SFAS 158 also provides guidance relating to the discount rate, which may require the District to adjust its basis for selecting the discount rate for its pension and non-pension postretirement benefit plans. The District will be required to implement SFAS 158 for the year ended December 31, 2007. In addition, SFAS 158 requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the District uses a measurement date of September 30th. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. The District is currently evaluating the impact of implementing SFAS 158.

Fair Value Option for Financial Assets and Financial Liabilities

In February 2007, the FASB issued SFAS No. 159, *Fair Value Option for Financial Assets and Financial Liabilities*. The standard permits entities to choose on an instrument-by-instrument basis, at specified election dates, to measure eligible items at fair value (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected shall be reported in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. This standard is effective for financial statements issued for fiscal years beginning after November 15, 2007. The District is currently evaluating the impact of implementing SFAS 159.

RECENT REGULATORY MATTERS

In January 2006, FCA approved final governance regulations for System banks and associations. The regulations are intended to promote the continued safety and soundness of the System by establishing governance standards and improving transparency in public disclosures. While the regulation will require changes to governance processes/disclosures, it is not expected to materially impact District operations.

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 AgFirst’s expectations and predictions due to a number of risks and uncertainties, many of which are beyond the District’s 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
- actions taken by the Federal Reserve System in implementing monetary policy.

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 to the combined 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 to shareholders.

Description of Property

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

Location	Description
1401 Hampton Street	Bank building and adjacent parking
1441 Hampton Street	Leased
1443 Hampton Street	AgFirst Federal Credit Union
1447 Hampton Street	Vacant
1428 Taylor Street	AgFirst training center
1436 Taylor Street	Leased

The District Associations own land and buildings throughout the District, in numerous Association headquarters and branch locations. These properties are, for the most part, small and midsized office structures which are generally typical of property in the local area.

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 17 to the combined financial statements, *Commitments and Contingencies,* included in this annual report to shareholders.

Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 11 to the combined financial statements, *Protected Borrower Equity and Shareholders' Equity,* included in this annual report to shareholders.

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, 9, 10, 13, 14 and 17 to the combined financial statements included in this annual report to shareholders.

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 to shareholders and is to be disclosed in this section, is incorporated herein by reference.

Senior Officers

The following represents certain information regarding the directors and senior officers of the reporting entity.

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

Senior Officer	Position & Other Business Interests
F. A. (Andy) Lowrey	*President & Chief Executive Officer.* He serves as: Chairman of the Board for Federal Farm Credit Banks Funding Corporation; Council Member of the National Council of Farm Cooperatives; University of South Carolina: Board of Trustees for Darla Moore School of Business, Board of Trustees for Education Foundation, Moore School of Business Dean Search Committee, Envisioning Moore Capital Campaign Executive Committee; Board of Directors for Big Brothers Big Sisters of Greater Columbia; Board of Directors for National 4H; Chairman of Finance Committee; Board of Directors for Palmetto AgriBusiness Council; Board of Directors for Midlands Business Leadership Group.
Thomas S. Welsh	*Executive Vice President, Chief Administrative & Legislative Officer & Corporate Secretary.* He serves on the Advisory Board of the Farm Credit System Captive Insurance Company.
Leon T. Amerson	*Executive Vice President, Chief Operating Officer & Chief Financial Officer*
Benjamin F. Blakewood	*Senior Vice President & Chief Technology & Operations Officer*
William L. Melton	*Senior Vice President & Chief Lending Officer.* He serves as Director-at-Large for the National Chicken Council, a trade organization.
Frederick T. Mickler, III	*Senior Vice President & General Counsel*

The total amount of compensation earned by the CEO and the senior officers as a group during the years ended December 31, 2006, 2005 and 2004, is as follows:

Name of Individual or Number in Group	Year	Annual Salary	Annual Bonus	Deferred Comp.	Perq./ Other*	Total
F. A. Lowrey	2006	$ 467,018	$ 175,161	$ 10,000	$ 17,983	$ 670,162
F. A. Lowrey	2005	$ 444,017	$ 162,332	$ 6,000	$ 16,779	$ 629,128
F. A. Lowrey	2004	$ 415,286	$ 116,280	$ 29,070	$ 15,120	$ 575,756
5 Officers	2006**	$ 1,029,845	$ 226,314	$ 65,522	$ 63,821	$ 1,385,502
5 Officers	2005	$ 1,251,913	$ 311,804	$ 58,502	$ 65,204	$ 1,687,423
5 Officers	2004	$ 1,183,639	$ 190,409	$ 99,122	$ 64,389	$ 1,537,559

** Primarily comprised of company contributions to thrift plan, group life insurance premiums and automobile compensation.*

*** Beginning with the year ending December 31, 2006, FCA requires CEO compensation to be disclosed separately from other senior officers (i.e. not included in the senior officer group), and re-defines the senior officer group. The new requirement is to be applied prospectively, so senior officer compensation for 2004 and 2005 have not been re-stated to reflect the change.*

In addition to a base salary, senior officers earn additional compensation under the Bank's Corporate Bonus Plan. The plan is designed to motivate employees to exceed specific performance targets, including financial measures and customer satisfaction rating. Those covered by the plan include all employees. Bonuses are shown in the year earned. Payment of the 2006 bonus was made in the first quarter of 2007.

Disclosure of information on the total compensation paid during 2006 to any senior officer, or to any other individual included in the aggregate, is available to shareholders upon request.

AgFirst Farm Credit Bank Board of Directors

Name	Position	Term of Office
Thomas W. Kelly	Chairman	December 31, 2008
Paul M. House	Vice Chairman	December 31, 2007
William C. Bess, Jr.	Director	December 31, 2009
Robert A. Carson	Director	December 31, 2006
Henry M. Frazee	Director	December 31, 2008
Don W. Freeman	Director	December 31, 2009
Robert L. Holden, Sr.	Director	December 31, 2010*
Lyle Ray King	Director	December 31, 2008
Richard Kriebel	Director	December 31, 2007
M. Wayne Lambertson	Director	December 31, 2009
Paul Lemoine	Director	December 31, 2007
James L. May	Director	December 31, 2009
Eugene W. Merritt, Jr.	Director	December 31, 2010*
Katherine A. Pace	Director	December 31, 2007
Dale W. Player	Director	December 31, 2007
J. Dan Raines, Jr.	Director	December 31, 2009
Walter L. Schmidlen, Jr.	Director	December 31, 2008
Robert G. Sexton	Director	December 31, 2007
Kenneth A. Spearman	Director	December 31, 2009
Robert H. Spiers, Jr.	Director	December 31, 2009
William H. Voss	Director	December 31, 2010**

* *These directors were re-elected to a new 4-year term ending 12/31/10.*
** *These directors were newly elected in 2006 to 4-year terms commencing 1/1/07.*

Thomas W. Kelly, Chairman of the Board, is a farmer from Tyrone, Pennsylvania. His farming operation includes raising dairy heifers and growing corn, soybeans and hay. Along with his son, he handles land management for Spring Lane Hunt Club. He currently is a director of AgChoice Farm Credit, ACA and Mid-Atlantic Master Farmer Association; and is a former director of Holstein Association, USA.

Paul M. House, Vice Chairman of the Board, is from Nokesville, Virginia, where he grows corn, soybeans, wheat, hay and turf grass. He also operates a dairy. He serves as a director of the Farm Credit of the Virginias, ACA.

William C. Bess, Jr., from Lincolnton, North Carolina, is co-owner of Farmers & Builders Supply Co., a retail farm equipment business, and serves as Secretary/Treasurer. In addition, he has a 70-head cow-calf operation. He serves on the boards of the national Farm Credit Council Board, the Farm Credit System's national trade organization, Farm Credit Council Services, and Carolina Farm Credit, ACA. He is also a member of the Cleveland County and Catawba Cattlemen's Associations.

Robert A. Carson, a row crop farmer in the Mississippi Delta, is active in a number of agricultural organizations. He is a director of the Delta Council.

Henry M. (Buddy) Frazee of Alachua, Florida, is a retired managing partner of a large cow-calf beef cattle operation, and is President of West Putnam Lakes, Inc. and H&P Frazee Enterprises, Inc., timber and land development companies. He is also managing partner, trustee of Ashley Lake Plantation and West Putnam Enterprises, land development partnerships. In addition, along with his son, he manages a 2,000-acre game preserve and deer hound kennel. He currently serves on the board of Farm Credit of North Florida, ACA.

Don W. Freeman of Montgomery, Alabama, manages a 400-acre cow-calf operation and an 80 unit river rental business near Lowndesboro, Alabama. He is a member of the national Farm Credit Council Board, Lowndes County Farmers Federation Board, and the Lowndes County Cattlemen's Association Board. He is also past president of the Alabama Chapter of the American Society of Farm Managers and Rural Appraisers.

Robert L. Holden, Sr. is co-owner and operator of a dairy, a 900-acre row-crop farm, and a 200,000 broiler operation in Whigham, Georgia. He is a director of the Southwest Georgia Farm Credit, ACA, Georgia Milk Producers, Grady County Farm Bureau, American Dairy Association of Georgia, and First United Ethanol, LLC.

Lyle Ray King of Ash, North Carolina, owns and operates a farm where he grows tobacco, corn, soybeans and wheat. He currently serves on the boards of Cape Fear Farm Credit, ACA, Atlantic Telephone Membership Cooperative, and Landbank Resource Management, a real estate company.

Richard Kriebel is a contract farmer from Benton, Pennsylvania, raising contract vegetables, forage and grain. His cropland consists of owned-and-leased acres of corn, hay and vegetables. He is a director of AgChoice Farm Credit, ACA, and a former member of the Columbia County ASCS, Columbia County Extension and the Columbia County Planning Commission.

M. Wayne Lambertson of Pokomoke City, Maryland, owns and operates with his two sons a 2,700-acre farm of corn, soybeans, and wheat, and a 300,000 capacity broiler operation. He is co-owner of a restaurant, Green Turtle, and partner in a development and construction company, J.W.L. Enterprise, LLC. He currently serves on the national Farm Credit Council Board, MidAtlantic Farm Credit, ACA board of directors and the board of the Delmarva Poultry Industry DPI, a trade organization.

Paul Lemoine is a cattle and row crop farmer from Plaucheville, Louisiana. He is active in a number of organizations related to farming and is employed as a crop sales consultant with Agriliance Chemical Co. He is a member of the Louisiana Cattlemen's Association and the Avoyelles Parish Farm Bureau.

James L. May is owner and operator of Mayhaven Farm in Waynesburg, Kentucky, where he owns 250 acres and leases another 700 acres. He is involved in the development and marketing of 500 heifers for replacement cows and embryo transfer. May's operation also includes 150 acres of alfalfa hay, 500 acres of corn and soybeans, and 100 acres of wheat. He currently serves as a member of the Central Kentucky Ag Credit board, Lincoln County Extension Council, Lincoln County Ag Development Board, and is a member of the Lincoln County Farm Bureau.

Eugene W. Merritt, Jr., from Easley, South Carolina, is co-owner of an ornamental tree farm and is a landscape contractor. He also operates a 400-acre timber and grass farm. He serves on the boards of AgSouth Farm Credit, ACA; People Bancorp, a commercial bank holding company; Peoples National Bank, a commercial bank; and Jackson Companies, a recreational company.

Katherine A. Pace, from Orlando, Florida, is a certified public accountant with 22 years in public accounting. She provides consulting services to family owned businesses through her company Family Business Consulting, LLC. Previously, she was a tax partner with KPMG, LLP, an audit, tax and advisory service firm, from 1985-2005 where her practice included a variety of cooperative and agribusiness clients as well as participation in trade associations such as the National Society of Accountants for Cooperatives. She is a member of the American Institute of Certified Public Accountants and currently serves on the boards of several charitable organizations as well as on an advisory board for a private for profit organization involved in agriculture.

Dale W. Player, from Bishopville, SC, is co-owner of a 1,850-acre row crop operation, with cotton being the primary crop. He is a director of ArborOne, ACA, member of the South Carolina Cotton Board of Directors, and director of the Carolinas Cotton Cooperative. He also serves as a delegate to the National Cotton Council and alternate director to the National Cotton Board.

J. Dan Raines, Jr. is a beef producer from Ashburn, Georgia. His operations include commercial beef cattle, registered Angus cattle and timber. He serves as a director on the boards of AgGeorgia Farm Credit, ACA and the Federal Agricultural Mortgage Corporation (Farmer Mac). He also serves as director and president of Raines Commercial Group, Inc., which is primarily engaged in employee leasing.

Walter L. Schmidlen, Jr., from Elkins, West Virginia, is a dairy and beef farmer. He is owner and operator of a farm machinery business and grows hay and corn on a 700-acre farm. He presently serves on the board of the Farm Credit of the Virginias, ACA, and was a former director of Southern States Cooperative and Sire Power.

Robert G. Sexton is from Vero Beach, Florida. He is President of Oslo Citrus Growers Association and co-owner of Orchid Island Juice Company. He serves as a director of Farm Credit of South Florida, ACA; Florida Citrus Packers; Indian River Citrus League; Highland Exchange Service Co-op, a packinghouse supply cooperative; McArthur Management Company, a management company for a large dairy, cattle and citrus agribusiness; Sexton Grove Holdings, a family citrus company; Sexton Properties, Oslo Packing Company, Patio Restaurant and Sexton, Inc., family commercial real estate companies; and Dancing Pigs, LLC, which owns Red, Hot and Blue BBQ restaurants. In addition, he is a member of the Indian River Farm Bureau.

Kenneth A. Spearman, from Winter Haven, Florida, currently serves as Director of Internal Audit for Florida's Natural Growers, Inc. Prior to this, he was Controller for Citrus Central, Inc. in Orlando, Florida from 1980-1991, and was co-founder of a public accounting firm in Chicago, Illinois after employment with Arthur Andersen & Co. He obtained his Masters Degree in Business Administration from Governors State University in University Park, Illinois, and his B.S. degree in accounting from Indiana University. He served as chairman of the board of trustees for the Lake Wales Medical Center. He is a member of the Institute of Internal Auditors, and the National Society of Accountants for Cooperatives, where he was also past National President.

Robert H. Spiers, Jr., is a full-time farmer, with a tobacco, peanut, soybean and cotton operation on 1,100 acres in Dinwiddie County, Virginia. He currently serves on the boards of Colonial Farm Credit, ACA, and Dinwiddie County Farm Bureau. He is also director and treasurer of the Old Hickory Hunt Club. He has been active in several farming organizations, including the Virginia Cotton Growers Association, Virginia Flue-Cured Tobacco Board and Virginia Farm Bureau.

William H. Voss, is from McComb, Mississippi. He owns a cattle and timber operation in Southwest Mississippi. He currently serves as Chairman of the Board of directors of First South Farm Credit, headquartered in Ridgeland, Miss., and is a member of the Pike County Economic Development District Board. Previously, Voss has served as chairman of the Mississippi Real Estate Commission and the Pike County Farm Service Committee.

Committees

The board has established an audit committee, compensation committee and governance committee. All members of the board, other than the chairman and vice chairman, serve on a committee.

Compensation of Directors

Directors were compensated in 2006 in cash at the rate of $40,332 per year, payable at $3,361.00 per month. This is compensation for attendance at board meetings, board committee meetings, certain other meetings pre-approved by the board, and other duties as assigned. FCA regulations also allow additional compensation to be paid to a director in exceptional circumstances where extraordinary time and effort are involved. Amounts paid in excess of $40,332 to board officers and board members represented compensation for service for Farm Credit Council (FCC) activities, including FCC board meetings, meetings with other district and national FCC representatives, congressional visitations, and other FCC board activities and issues. Total cash compensation paid to all directors as a group during 2006 was $902,640. Additional information for each director who served during 2006 is provided below.

	Number of Days Served			
Name of Director	Board Meetings	Other Official Activities**	Farm Credit Council Bd. Activities	Total Comp. Paid During 2006
William C. Bess, Jr.	23	14.50	8.75	$ 45,132
Robert A. Carson	23	16.25	9.00	45,132
Henry M. Frazee	23	9.25	8.75	45,132
Don W. Freeman	23	13.25	8.75	45,132
Robert L. Holden, Sr.	20	13.00	8.75	45,132
Paul M. House	20	17.00	8.75	45,132
Thomas W. Kelly	23	14.00	8.75	45,132
Lyle Ray King	23	13.25	8.75	45,132
Richard Kriebel	20	17.00	8.75	45,132
M. Wayne Lambertson	17	13.00	8.75	45,132
Paul Lemoine	23	16.00	8.75	45,132
James L. May	23	17.75	8.75	45,132
Eugene W. Merritt, Jr.	23	23.25	8.75	45,132
Katherine A. Pace	23	16.25	8.75	45,132
Dale W. Player	20	15.75	6.00	45,132
J. Dan Raines, Jr.	21	10.00	8.75	45,132
Walter L. Schmidlen, Jr.	23	19.00	8.75	45,132
Robert G. Sexton	23	19.00	8.75	45,132
Kenneth A. Spearman	23	13.50	8.75	45,132
Robert H. Spiers, Jr.	23	15.50	8.75	45,132
Total				$ 902,640

** *Includes board committee meetings and board training.*

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

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was $258,943 for 2006, $202,283 for 2005, and $183,164 for 2004.

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 15 to the combined financial statements, *Related Party Transactions,* included in this annual report to shareholders.

Involvement in Certain Legal Proceedings

There were no matters which came to the attention of management or the board of directors regarding involvement of current directors or senior officers in specified legal proceedings which should be disclosed in this section.

Relationship with Independent Auditors

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

Combined Financial Statements

The combined financial statements, together with the report thereon of PricewaterhouseCoopers LLP, dated February 28, 2007, and the Report of Management, which appear in this annual report to shareholders are incorporated herein by reference.

Borrower Information Regulations

Since 1972, Farm Credit Administration (FCA) regulations have required that borrower information be held in strict confidence by Farm Credit 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 to shareholders. 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.

Shareholder Investment

Shareholder investment in a District Association is materially affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst's annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 316, or writing Wanda Martin, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, ***www.agfirst.com***. AgFirst prepares a quarterly report within 45 days after the end of each fiscal quarter, except that no quarterly report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

Report of the Audit Committee

The Audit Committee of the Board of Directors (the Committee) is comprised of the directors named below. None of the directors who serve on the Committee is an employee of AgFirst Farm Credit Bank (the Bank) and in the opinion of the Board of Directors, each is free of any relationship with the Bank 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 Bank's audited financial statements with management, which has primary responsibility for the financial statements.

PricewaterhouseCoopers LLP (PwC), the Bank's independent auditor for 2006, is responsible for expressing an opinion on the conformity of the Bank'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. 61 *(Communication With Audit Committees)*. 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 to the Bank 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 Company's Annual Report for 2006. The foregoing report is provided by the following independent directors, who constitute the Committee:

Robert G. Sexton

Robert G. Sexton
Chairman of the Audit Committee

Members of Audit Committee

Don W. Freeman
Richard Kriebel
Paul Lemoine
Katherine A. Pace
Walter L. Schmidlen, Jr.

February 28, 2007

Report of Independent Auditors

PRICEWATERHOUSECOOPERS

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

Report of Independent Auditors

To the Board of Directors and Shareholders
of AgFirst Farm Credit Bank and District Associations

In our opinion, the accompanying combined balance sheets and the related combined statements of income, of changes in shareholders' equity and of cash flows present fairly, in all material respects, the financial position of AgFirst Farm Credit Bank (the Bank) and District Associations (together, the District) at December 31, 2006, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the District'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 28, 2007

Combined Balance Sheets

(dollars in thousands)	December 31, 2006	December 31, 2005	December 31, 2004
Assets			
Cash and cash equivalents	$ 651,268	$ 640,830	$ 522,862
Investment securities:			
Available for sale (amortized cost of $5,063,640, $3,888,889 and $3,268,041 respectively)	5,065,621	3,886,318	3,278,414
Held to maturity (fair value of $1,392,499 $1,384,390 and $12,816 respectively)	1,426,481	1,416,647	12,553
Total Investment securities	6,492,102	5,302,965	3,290,967
Loans	18,669,616	16,171,572	14,836,278
Less: allowance for loan losses	71,915	87,551	95,419
Net loans	18,597,701	16,084,021	14,740,859
Other investments	428,005	237,239	—
Accrued interest receivable	246,184	179,970	131,402
Investments in other Farm Credit System institutions	8,738	8,756	8,229
Premises and equipment, net	120,123	107,063	96,603
Other property owned	5,122	3,646	3,433
Deferred tax assets, net	163	1,691	2,229
Other assets	211,312	208,379	198,832
Total assets	$26,760,718	$22,774,560	$18,995,416
Liabilities			
Bonds and notes	$22,613,379	$18,879,964	$15,402,385
Mandatorily redeemable preferred stock (Note10)	225,000	225,000	225,000
Accrued interest and dividends payable	188,028	133,855	65,854
Dividends and patronage refunds payable	115,893	99,665	81,607
Postretirement benefits other than pensions	107,178	102,681	92,970
Other liabilities	203,057	189,010	127,955
Total liabilities	23,452,535	19,630,175	15,995,771
Commitments and contingencies (Note 17)			
Shareholders' Equity			
Perpetual preferred stock (Note 11)	150,000	150,000	150,000
Protected borrower equity	6,208	7,628	10,123
Capital stock and participation certificates	118,817	120,370	125,089
Retained earnings			
Allocated	992,227	925,919	849,626
Unallocated	2,039,308	1,943,444	1,861,476
Accumulated other comprehensive income (loss)	1,623	(2,976)	3,331
Total shareholders' equity	3,308,183	3,144,385	2,999,645
Total liabilities and shareholders' equity	$26,760,718	$22,774,560	$18,995,416

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

Combined Statements of Income

(dollars in thousands)	For the year ended December 31, 2006	2005	2004
Interest Income			
Investment securities	$ 338,314	$ 169,034	$ 74,757
Loans	1,309,291	1,028,563	826,926
Other investments	22,643	1,677	—
Total interest income	1,670,248	1,199,274	901,683
Interest Expense	996,412	588,773	332,857
Net interest income	673,836	610,501	568,826
Reversal of allowance for loan losses	(717)	(6,492)	(213,388)
Net interest income after reversal of allowance for loan losses	674,553	616,993	782,214
Noninterest Income			
Loan fees	33,434	35,931	34,317
Fees for financially related services	6,887	6,347	6,544
Realized gains (losses) on investments, net	(5)	466	(17)
Realized gains on derivatives, net	6,812	94	96
Gains (losses) on sale of rural home loans	3,172	2,935	(717)
Gains on sale of mortgage servicing assets	—	1,078	—
Gains from sale of premises and equipment, net	1,521	3,004	—
Other noninterest income	6,849	5,698	13,480
Total noninterest income	58,670	55,553	53,703
Noninterest Expenses			
Salaries and employee benefits	190,597	188,191	179,907
Occupancy and equipment	30,953	29,071	26,441
Insurance Fund premium	24,615	7,447	7,088
Other operating expenses	71,491	66,937	60,895
Intra-System financial assistance expenses	—	3,221	6,794
Restructuring charge	—	—	3,697
Called debt expense	2,563	656	3,360
Other noninterest expenses	2,339	1,978	2,161
Total noninterest expenses	322,558	297,501	290,343
Income before income taxes	410,665	375,045	545,574
Provision (benefit) for income taxes (Note 12)	296	(2,132)	10,363
Net income	$ 410,369	$ 377,177	$ 535,211

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

Combined Statements of Changes in Shareholders' Equity

(dollars in thousands)	Perpetual Preferred Stock	Protected Borrower Equity	Capital Stock and Participation Certificates	Retained Earnings Allocated	Retained Earnings Unallocated	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at December 31, 2003	$ 150,000	$ 12,453	$ 128,099	$ 792,168	$ 1,587,934	$ (108,923)	$ 2,561,731
Comprehensive income							
Net income					535,211		535,211
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of ($17)						1,859	1,859
Change in fair value of derivative instruments, includes reclassification adjustments of $96						12,120	12,120
Minimum pension liability adjustment						98,275	98,275
Total comprehensive income							647,465
Protected borrower equity retired		(2,330)					(2,330)
Capital stock/participation certificates issued/retired, net			(3,070)				(3,070)
Dividends declared/paid			60		(3,840)		(3,780)
Perpetual preferred stock dividends paid					(10,950)		(10,950)
Patronage distribution							
Cash					(76,686)		(76,686)
Qualified allocated surplus				28,684	(28,684)		—
Nonqualified allocated surplus				65,666	(65,666)		—
Nonqualified retained surplus				74,467	(74,467)		—
Retained earnings retired				(111,010)			(111,010)
Patronage distribution adjustment				(349)	(1,376)		(1,725)
Balance at December 31, 2004	150,000	10,123	125,089	849,626	1,861,476	3,331	2,999,645
Comprehensive income							
Net income					377,177		377,177
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of $466						(12,944)	(12,944)
Change in fair value of derivative instruments, includes reclassification adjustments of $94						6,643	6,643
Minimum pension liability adjustment						(6)	(6)
Total comprehensive income							370,870
Protected borrower equity retired		(2,495)					(2,495)
Capital stock/participation certificates issued/retired, net			(5,030)				(5,030)
Dividends declared/paid			311		(3,311)		(3,000)
Perpetual preferred stock dividends paid					(10,950)		(10,950)
Patronage distribution							
Cash					(95,354)		(95,354)
Qualified allocated surplus				26,391	(26,391)		—
Nonqualified allocated surplus				83,420	(83,420)		—
Nonqualified retained surplus				73,653	(73,653)		—
Retained earnings retired				(109,254)			(109,254)
Patronage distribution adjustment				2,083	(2,130)		(47)
Balance at December 31, 2005	150,000	7,628	120,370	925,919	1,943,444	(2,976)	3,144,385
Comprehensive income							
Net income					410,369		410,369
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of ($5)						4,552	4,552
Minimum pension liability adjustment						47	47
Total comprehensive income							414,968
Protected borrower equity retired		(1,420)					(1,420)
Capital stock/participation certificates issued/retired, net			(2,469)				(2,469)
Dividends declared/paid			916		(916)		—
Perpetual preferred stock dividends paid					(10,950)		(10,950)
Patronage distribution							
Cash					(114,325)		(114,325)
Qualified allocated surplus				27,798	(27,798)		—
Nonqualified allocated surplus				92,988	(92,988)		—
Nonqualified retained surplus				62,038	(62,038)		—
Retained earnings retired				(118,414)			(118,414)
Patronage distribution adjustment				1,898	(5,490)		(3,592)
Balance at December 31, 2006	$ 150,000	$ 6,208	$ 118,817	$ 992,227	$ 2,039,308	$ 1,623	$ 3,308,183

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

Combined Statements of Cash Flows

	For the year ended December 31,		
(dollars in thousands)	**2006**	**2005**	**2004**
Cash flows from operating activities:			
Net income	$ 410,369	$ 377,177	$ 535,211
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation on premises and equipment	16,670	14,695	13,997
Amortization of discount on other investments	(22,643)	—	—
Provision for (reversal of allowance for) loan losses	(717)	(6,492)	(213,388)
(Gains) losses on other property owned, net	1,300	203	479
(Gains) losses from sale of premises and equipment, net	(1,521)	(3,004)	—
Realized (gains) losses on investments, net	5	(466)	17
Realized (gains) losses on derivatives, net	(6,812)	(94)	(96)
Realized (gains) losses on sale of servicing assets	—	(1,078)	—
Realized (gains) losses on mortgage loans held for sale	(3,172)	(2,935)	717
Proceeds from sale of mortgage servicing assets	—	10,039	—
Purchases of mortgage loans held for sale (net of principal repayment)	—	(264,032)	(329,939)
Proceeds from sale of mortgage loans held for sale	10,807	6,664	255,951
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	(66,214)	(48,568)	(9,395)
(Increase) decrease in amortized discount on notes	13,374	4,321	(1,754)
(Increase) decrease in deferred tax assets, net	1,528	538	11,074
(Increase) decrease in other assets	(1,380)	(18,649)	(126,559)
Increase (decrease) in accrued interest and dividend payable	54,173	68,001	13,829
Increase (decrease) in postretirement benefits other than pensions	4,497	9,711	13,721
Increase (decrease) in minimum pension liability	—	—	(52,519)
Increase (decrease) in other liabilities	29,762	34,486	63,688
Total adjustments	29,657	(196,660)	(360,177)
Net cash provided by (used in) operating activities	440,026	180,517	175,034
Cash flows from investing activities:			
Investment securities purchased	(3,362,445)	(4,160,321)	(4,091,449)
Investment securities sold or matured	2,177,855	2,135,845	3,647,593
Proceeds from sale of derivatives	6,812	—	—
Net (increase) decrease in loans	(2,524,610)	(1,079,477)	(451,223)
(Increase) decrease in investments in other Farm Credit System institutions	18	(527)	10,928
Purchases of other investments	(215,335)	(237,239)	—
Proceeds from payments received on other investments	47,212	—	—
Purchase of premises and equipment, net	(30,601)	(27,774)	(23,686)
Proceeds from sale of premises and equipment, net	2,392	5,623	—
Proceeds from sale of other property owned	1,229	3,717	2,855
Net cash used in investing activities	(3,897,473)	(3,360,153)	(904,982)
Cash flows from financing activities:			
Bonds and notes issued	49,109,813	38,036,115	41,593,667
Bonds and notes retired	(45,406,904)	(34,529,195)	(40,674,312)
Protected borrower equity retired	(1,420)	(2,495)	(2,330)
Capital stock and participation certificates issued/retired, net	(2,469)	(5,030)	(3,070)
Patronage refunds and dividends paid	(101,771)	(81,587)	(66,435)
Dividends paid on perpetual preferred stock	(10,950)	(10,950)	(10,950)
Retained earnings retired	(118,414)	(109,254)	(111,010)
Net cash provided by financing activities	3,467,885	3,297,604	725,560
Net increase (decrease) in cash and cash equivalents	10,438	117,968	(4,388)
Cash and cash equivalents, beginning of period	640,830	522,862	527,250
Cash and cash equivalents, end of period	$ 651,268	$ 640,830	$ 522,862
Supplemental schedule of non-cash investing and financing activities:			
Financed sales of other property owned	$ 718	$ 1,284	$ 627
Loans transferred to other property owned	4,723	5,417	5,141
Change in unrealized gains (losses) on investments	4,552	(12,944)	1,859
Change in fair value of derivative instruments	—	6,643	12,120
Change in pension liability related to other comprehensive income	47	(6)	98,275
Non-cash changes related to hedging activities:			
Decrease (increase) in loans	$ 7	$ 55	$ (344)
Increase (decrease) in bonds and notes	17,132	(33,662)	(22,225)
Decrease (increase) in other assets	(1,553)	(937)	2,359
Increase (decrease) in other liabilities	(15,586)	27,807	8,090
Supplemental information:			
Interest paid	$ 928,865	$ 520,772	$ 319,028
Taxes paid, net	352	1,350	1,772
Federal tax refunds related to long-term lending operations (Note 12)	—	—	816

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

Notes to Combined Financial Statements

Note 1 — Organization and Operations

A. **Organization:** AgFirst Farm Credit Bank (the Bank or AgFirst) is one of the banks of the Farm Credit System (the System), a nationwide system of cooperatively owned banks and associations. The System was established by Acts of Congress and is subject to the provisions of the Farm Credit Act of 1971, as amended (the Farm Credit Act).

The nation is currently served by four Farm Credit Banks (FCBs) and one Agricultural Credit Bank (ACB), each of which has specific lending authorities within its chartered territory. The ACB also has additional specific nationwide lending authorities. The Bank is chartered to service the states of Pennsylvania, Delaware, Maryland, Virginia, West Virginia, North Carolina, South Carolina, Georgia, Florida, Alabama, Mississippi, the Commonwealth of Puerto Rico and portions of the states of Ohio, Tennessee, Kentucky and Louisiana.

Each FCB and the ACB serves one or more Production Credit Associations (PCAs) that originate and service short- and intermediate-term loans, Federal Land Credit Associations (FLCAs) that originate and service long-term real estate mortgage loans and/or Agricultural Credit Associations (ACAs) that originate both long-term and short- and intermediate-term loans. PCAs, FLCAs and ACAs are collectively referred to as associations. AgFirst and its related associations (Associations or District Associations) are collectively referred to as the District. The District Associations jointly own all of AgFirst's voting stock. As of December 31, 2006, the District consisted of the Bank and twenty-three District ACAs. All twenty-three are structured as holding companies, which include FLCA and PCA subsidiaries.

Each FCB and the ACB is responsible for supervising the activities of the associations within its district. The FCBs and/or associations make loans to or for the benefit of eligible borrowers/shareholders for qualified purposes. All District Associations borrow funds from the Bank. Funds for the FCBs and the ACB are raised principally through the sale of consolidated Systemwide bonds and notes to the public.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System banks and associations. The activities of the banks and associations are examined by the FCA and certain actions by these entities are subject to the FCA's prior approval.

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 the discretionary uses by the Insurance Corporation of providing assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank is required to pay premiums into the Insurance Fund based on its average annual District loans outstanding until the assets in the Insurance Fund reach the "secure base amount," which is defined in the Farm Credit Act as 2.00 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.

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 AgFirst and the District Associations.

AgFirst and/or the District Associations are 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, their cooperatives, rural residents and farm-related businesses. AgFirst may also lend to financial institutions engaged in lending to eligible borrowers. The District Associations may also serve as an intermediary in offering credit life insurance and multi-peril crop insurance, and in providing additional services to borrowers.

The District Associations borrow from AgFirst and in turn may originate and service both long-term real estate mortgage and short- and intermediate-term loans to their members. As noted above, as of January 1, 2006, all Associations have reorganized into parent-subsidiary structures and operate their long-term mortgage activities through FLCA subsidiaries and their short- and intermediate-term lending activities through PCA subsidiaries or the ACA.

AgFirst, in conjunction with other System banks, jointly owns service organizations, which were created to provide a variety of services for the System:

- *Federal Farm Credit Banks Funding Corporation (Funding Corporation)* — provides for the issuance, marketing and processing of Systemwide Debt Securities using a network of investment dealers and dealer banks. The Funding Corporation also provides financial management and reporting services.
- *FCS Building Association* — leases premises and equipment to the FCA, as required by the Farm Credit Act.
- *Farm Credit System Association Captive Insurance Company* — a reciprocal insurer that provides insurance services to its member organizations.

These investments are accounted for using the cost method. In addition, the Farm Credit Council acts as a full-service federated trade association which represents the System before Congress, the Executive Branch and others, and provides support services to System institutions on a fee basis.

Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the District conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of combined financial statements in conformity with GAAP requires the managements of AgFirst and District Associations to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates. Significant estimates are discussed in these footnotes, as applicable. Actual results may differ from these estimates. Certain amounts in prior years' financial statements have been reclassified to conform to the current year's financial statement presentation.

The accompanying combined financial statements include the accounts of AgFirst (including the Finance Corporation) and the District Associations, and reflect the investments in and allocated earnings of the service organizations in which AgFirst and Associations have partial ownership interests. All significant transactions and balances between AgFirst and District Associations have been eliminated in combination.

A. **Cash and Cash Equivalents:** Cash and Cash Equivalents include cash on hand and short-term investments with original maturities of three months or less.

B. **Investment Securities:** The District, as permitted under the FCA regulations, holds investments for purposes of maintaining a liquidity reserve, managing short-term surplus funds, managing interest rate risk and, in the case of certain Mission-Related Investments, to stimulate economic growth and development in rural areas. Investments are classified based on management's intention on the date of purchase and recorded on the Combined Balance Sheet as securities as of the trade date. Investment securities which management has the intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost. Investment securities classified as available-for sale (AFS) are carried at fair market value with net unrealized gains and losses included in Accumulated Other Comprehensive Income (OCI).

   Interest on investment securities, including amortization of premiums and accretion of discounts, are included in Interest Income. Realized gains and losses from the sales of investment securities, which are included in Realized Gains/(Losses) on Investments, Net, are determined using the specific identification method.

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

C. **Loans and Allowance for Loan Losses**: Long-term real estate mortgage loans generally have original maturities ranging up to forty years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of ten years or less.

   Loans are carried at their principal amount outstanding less unearned income adjusted for Statement of Financial Accounting Standards (SFAS) No. 133 valuation adjustments. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days or more (unless adequately secured 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) and/or charged against the allowance for loan losses (if accrued in prior years).

   When loans are in nonaccrual status, the interest portion of payments received in cash is generally 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 asset. Nonaccrual loans may be transferred 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.

   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 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 allowance for loan losses is a valuation account used to reasonably estimate loan and lease losses as of the financial statement date. Determining the appropriate allowance for the loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss. The determination of the allowance for loan losses is based on management's current judgments about the credit quality of its loan and lease portfolio. A specific allowance may be established for impaired loans under SFAS 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. See Note 3 for a discussion on the refinement of the allowance for loan losses methodologies.

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

- Credit risk classifications,
- Collateral values,
- Risk concentrations,
- Weather related conditions, and
- Economic conditions.

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. **Other Property Owned:** Other property owned, consisting of real and personal property acquired through collection action, is recorded at fair value less estimated selling costs upon acquisition. Revised estimates to the fair value less costs 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 and expenses from operations and carrying value adjustments are included in net gains (losses) on other property owned.

F. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. Depreciation is generally provided on the straight-line method over the estimated useful lives of the assets, which range from 3 to 40 years. Gains and losses on dispositions are reflected in current operating results. Maintenance and repairs are charged to operating expense and improvements that extend the useful life of the asset are capitalized.

G. **Other Assets and Other Liabilities:** Direct expenses incurred in issuing debt are deferred and amortized using the straight-line method (which approximates the interest method) over the term of the related indebtedness and term of the preferred stock.

H. **Advanced Conditional Payments:** The District Associations are 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, those advanced conditional payments (ACPs) are netted against the borrower's related loan balance. ACPs which are held by the District but cannot be used to reduce outstanding loans balances, except at the direction of the borrower, are classified as other liabilities in the combined balance sheets. ACPs are not insured, and interest is generally paid by the associations on such balances. The outstanding gross balances of advance conditional payments netted against loans at December 31, 2006, 2005 and 2004 were $202.5 million, $212.9 million and $165.5 million, respectively. The outstanding gross balances of advance conditional payments classified as other liabilities at December 31, 2006, 2005 and 2004 were $23.0 million, $23.7 million and $13.1 million, respectively.

I. **Employee Benefit Plans:** Substantially all of the District may be eligible to participate in one of three defined benefit retirement plans within the District. The "Projected Unit Credit" actuarial method is used for financial reporting purposes. Based on the funded status of the District's defined benefit retirement plan (the Plan) at the measurement date (September 30), the District may record a minimum liability, an intangible asset relating to unrecognized prior service cost and an adjustment to other comprehensive income (loss). The adjustment to other comprehensive income (loss) would be net of deferred taxes, if significant. For participants hired before January 1, 2003, benefits are determined based on a final average pay formula. For those participants hired on or after January 1, 2003, benefits are determined using a cash balance formula.

Substantially all District employees are eligible to participate in the thrift/deferred compensation plan (Thrift Plan), which qualifies as a 401(k) plan as defined by Internal Revenue Code. The Thrift Plan requires AgFirst and Associations to match a percentage up to a maximum employee contribution of 6.00 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service. Thrift Plan costs are expensed as funded.

In addition to providing pension benefits, the Bank and District Association may provide certain health care and life insurance benefits for the retired employees (other postretirement benefits). Substantially all employees may become eligible for these benefits if they reach early retirement age while working for the Bank or District Association.

The District also sponsors supplemental retirement and deferred compensation plans for certain key employees. The plans are nonqualified; therefore, the associated liabilities are included in the District's combined balance sheets in other liabilities.

J. **Income Taxes:** AgFirst and FLCA subsidiaries of ACA parent companies are exempt from federal and other income taxes as provided in the Farm Credit Act. Puerto Rico Farm Credit, ACA received a credit for taxes payable on Puerto Rico sourced income in accordance with Section 936 of the Internal Revenue Code of 1986, as amended. However, the Section 936 noted was terminated effective December 31, 2005. See Note 1(B) — *Operations*.

The ACAs provide for federal and certain other income taxes and are eligible to operate as cooperatives that qualify for tax treatment under Subchapter T of the Internal Revenue Code. Most District Associations operate as cooperatives under Subchapter T and can deduct from taxable income, amounts distributed as qualified patronage refunds to borrowers in the form of cash, stock or allocated retained earnings. Amounts distributed as nonqualified patronage refunds are tax deductible by the ACAs only when redeemed. Income taxes are provided only on the earnings not distributed or not expected to be distributed as qualified patronage refunds or those earnings that are exempt from tax due to the long-term lending exemption.

District Associations recognize deferred tax assets and liabilities for the expected future tax consequences of the temporary differences between the carrying amounts and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled. District Associations may provide a valuation allowance for deferred tax assets to the extent that it is more likely than not that they will not be realized.

At December 31, 2006, deferred income taxes had not been provided by certain District Associations on approximately $125 million of patronage refunds received prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. Under GAAP, deferred taxes must be provided on all patronage refunds made to taxable District Associations after December 31, 1992, except to the extent that a portion of these amounts will be distributed in the form of patronage to District Association members.

No deferred taxes have been provided on AgFirst's unallocated earnings. AgFirst currently has no plans to distribute unallocated AgFirst earnings and does not contemplate circumstances, which, if distributions were made, would result in taxes being paid at the Association level.

K. **Derivative Instruments and Hedging Activity:** The Bank is party to derivative financial instruments, primarily interest rate swaps, which are principally used to manage interest rate risk on assets, liabilities and anticipated transactions. Derivatives are recorded on the balance sheet as assets and liabilities, and reflected at fair value.

Changes in the fair value of a derivative are recorded in current period earnings or accumulated other comprehensive income (loss) depending on the use of the derivative and whether it qualifies for hedge accounting. For fair-value hedge transactions, which hedge changes in the fair value of assets, liabilities, or firm commitments, changes in the fair value of the derivative will generally be offset by changes in the hedged item's fair value. For cash-flow hedge transactions, which hedge the variability of future cash flows related to a variable-rate asset, liability, or a forecasted transaction, changes in the fair value of the derivative will generally be deferred and reported in accumulated other comprehensive income (loss). The gains and losses on the derivative that are deferred and reported in accumulated other comprehensive income (loss) will be reclassified as earnings in the periods in which earnings are impacted by the variability of the cash flows of the hedged item. The ineffective portion of all hedges is recorded in current period earnings. For derivatives not designated as a hedging instrument, the related change in fair value is recorded in current period earnings.

The Bank formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as fair value or cash flow hedges to (1) specific assets or liabilities on the balance sheet or (2) firm commitments or forecasted transactions. The Bank also formally assesses (both at the hedge's inception and on an ongoing basis) whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the fair value or cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. The Bank uses regression analysis (or other statistical analysis) to assess the effectiveness of its hedges. The Bank discontinues hedge accounting prospectively when the Bank determines that a hedge has not been or is not expected to be effective as a hedge. For cash flow hedges, any remaining accumulated other comprehensive income (loss) would be amortized into earnings over the remaining life of the original hedged item. For fair value hedges, changes in the fair value of the derivative will be recorded in current period earnings. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, the Bank will carry the derivative at its fair value on the balance sheet, recognizing changes in fair value in current period earnings.

The Bank may occasionally purchase a financial instrument in which a derivative instrument is "embedded." Upon purchasing the financial instrument, the Bank assesses whether the economic characteristics of the embedded derivative are clearly and closely related to the economic characteristics of the remaining component of the financial instrument and whether a separate, non-embedded instrument with the same terms as the embedded instrument would meet the definition of a derivate instrument. When it is determined that (1) the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract and (2) a separate, stand-alone instrument with the same terms would qualify as a derivative instrument, the embedded derivative is separated from the host contract, carried at fair value and designated as either a fair value or cash flow hedge. However, if the entire contract were to be measured at fair value, with changes in fair value reported in current earnings, or if the Bank could not reliably identify and measure the embedded derivative for purposes of separating that derivative from its host contract, the entire contract would be carried on the balance sheet at fair value and not be designated as a hedging instrument.

L. **Valuation Methodologies:** Management of the District 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, such as most investment securities. However, for those items for which an observable liquid market does not exist, management utilizes significant estimates and assumptions to value those items. Examples of these items include impaired loans, pension and other postretirement benefit obligations, and certain derivative and 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 District's results of operations.

M. **Recent Accounting Developments:** In February 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments* (SFAS 155), an amendment of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133) and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SFAS 140.) This Statement resolves certain issues addressed in the implementation of SFAS 133 concerning beneficial interests in securitized financial assets. SFAS 155 permits fair value measurement for any hybrid financial instrument that contains an embedded derivative, clarifies which interest-only strips and principal-only strips are not subject to the requirement of SFAS 133, establishes a requirement to evaluate interests in securitized financial assets, clarifies the concentrations of credit risk, and eliminates the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument. The Statement is effective for all financial instruments acquired or issued in fiscal years beginning after September 15, 2006. The District is currently analyzing the impact of SFAS 155 on its financial statements. The adoption of this standard is not expected to have a material effect on the District's combined balance sheets or statements of income.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets* (SFAS 156), which amends the accounting for separately recognized servicing assets and servicing liabilities. SFAS 156 permits the choice of the amortization method or the fair value measurement method, with changes in fair value recorded in income, for the subsequent measurement for each class of separately recognized servicing assets and servicing liabilities. The Statement is effective for years beginning after September 15, 2006, with earlier adoption permitted. The District is currently analyzing the impact of SFAS 156 on its financial statements. The adoption of this standard is not expected to have a material effect on the District's combined balance sheets or statements of income.

In June 2006, the FASB released Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. The District is currently analyzing the impact of FIN 48 on its financial statements. Adoption of FIN 48 is not expected to have a material effect on the District's combined balance sheets or combined statements of income.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which provides enhanced guidance for using fair value to measure assets and liabilities. The standard applies whenever other standards require or permit assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. Early adoption is permitted. The District is currently analyzing the impact of SFAS 157 on its financial statements.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS 158). SFAS 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 through comprehensive income changes in that funded status in the year in which the changes occur. The Bank and its related Associations will be required to implement SFAS 158 for the year ended December 31, 2007. In addition, SFAS 158 requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the District uses a measurement date of September 30th. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. The District is currently evaluating the impact of implementing SFAS 158.

In February 2007, the FASB issued SFAS No. 159, *Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). The standard permits entities to choose on an instrument-by-instrument basis, at specified election dates, to measure eligible items at fair value (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected shall be reported in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. This standard is effective for financial statements issued for fiscal years beginning after November 15, 2007. The District is currently evaluating the impact of implementing SFAS 159.

Note 3 — Refinement of the Allowance for Loan Losses Methodologies

During 2004, the District conducted studies to further refine the allowance for loan losses methodologies taking into account recently issued guidance by the FCA, the System's regulator, as well as the Securities and Exchange Commission (SEC) and Federal Financial Institutions Examination Council guidelines.

The District's allowance for loan losses methodology was adjusted and revised in the late 1980s to take into account unusually adverse economic factors affecting American agriculture. Subsequent estimates continued to reflect, to some extent, the loss history of the mid-to-late 1980s. Accordingly, the reserves provided in the mid-to-late 1980s, in effect, remained part of the allowance for loan losses.

The District's allowance for loan losses methodology has consistently adhered to proper accounting policies, under the regulatory supervision of the FCA in its role as a "safety and soundness" regulator. It was the FCA's view that the allowance for loan losses should include among others, an assessment of probable losses, economic conditions and historical loss experience keeping in mind the potentially long agricultural credit cycle.

In April 2004, the FCA issued an "Informational Memorandum" to System institutions regarding the criteria and methodologies that would be used in evaluating the adequacy of a System institution's allowance for loan losses. The FCA endorsed the direction provided by other bank regulators and the SEC and indicated the conceptual framework addressed in their guidance would be included as part of their examination process.

During the fourth quarter of 2004, the District completed its studies and refined its methodologies to be in compliance with the guidance discussed in the previous paragraph. The refinement in methodologies resulted in a calculated allowance for loan losses that was significantly less than the previously recorded balance due to revised loss factors that are more indicative of actual loss experience in recent years and current borrower analysis.

While the $215.4 million reversal had a significant impact on 2004 results of operations and the previously recorded allowance for loan losses, the refinement in methodologies did not have a significant impact on comparative results of operations in future periods. Additionally, the refinement in methodology did not have a significant impact on the level of the risk bearing capacity of the District, generally referred to as "risk funds" (capital plus the allowance for loan losses), which totaled $3.10 billion at December 31, 2004 (20.86 percent of District loans).

Note 4 — Investment Securities

Available-for-Sale

A summary of the amortized cost and fair value of debt securities held as available-for-sale investments at December 31, 2006, 2005 and 2004, follows:

	December 31, 2006				
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Govt. GNMA MBS/CMOs	$ 1,268,345	$ 2,321	$ (2,752)	$ 1,267,914	5.43%
U.S. Govt. Agency MBS	2,748,072	8,546	(6,633)	2,749,985	5.59
Non-Agency Securities	776,159	874	(499)	776,534	5.77
Asset-Backed Securities	271,064	124	–	271,188	5.56
Total	$ 5,063,640	$ 11,865	$ (9,884)	$ 5,065,621	5.58%

	December 31, 2005				
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Commercial Paper	$ 69,813	$ –	$ (17)	$ 69,796	4.37%
U.S. Govt. GNMA MBS/CMOs	1,060,168	1,779	(5,664)	1,056,283	4.39
U.S. Govt. Agency MBS	2,029,368	5,714	(5,121)	2,029,961	4.50
Non-Agency Securities	596,956	899	(185)	597,670	4.74
Asset-Backed Securities	132,584	31	(7)	132,608	5.43
Total	$ 3,888,889	$ 8,423	$ (10,994)	$ 3,886,318	4.54%

	December 31, 2004				
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Commercial Paper	$ 29,957	$ –	$ –	$ 29,957	2.35%
U.S. Govt. GNMA MBS/CMOs	1,079,707	3,047	(1,911)	1,080,843	2.47
U.S. Govt. Agency MBS	1,843,914	10,720	(1,486)	1,853,148	3.02
Non-Agency Securities	292,537	9	(1)	292,545	2.68
Commercial MBS	–	–	–	–	–
Asset-Backed Securities	21,926	3	(8)	21,921	2.60
Total	$ 3,268,041	$ 13,779	$ (3,406)	$ 3,278,414	2.80%

Held-to-Maturity

A summary of the amortized cost and fair value of debt securities held as held-to-maturity investments at December 31, 2006, 2005 and 2004 follows:

	December 31, 2006				
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Govt. Agency MBS	$ 1,276,895	$ 84	$ (33,367)	$ 1,243,612	5.26%
Commercial MBS	2,260	–	(65)	2,195	4.89
Asset-Backed Securities	123,313	186	(1,005)	122,494	7.32
Other	24,013	185	–	24,198	7.45
Total	$ 1,426,481	$ 455	$ (34,437)	$ 1,392,499	5.47%

	December 31, 2005				
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Govt. Agency MBS	$ 1,379,203	$ 111	$ (31,700)	$ 1,347,614	5.31%
Commercial MBS	2,762	5	–	2,767	4.86
Asset-Backed Securities	34,682	161	(834)	34,009	7.00
Total	$ 1,416,647	$ 277	$ (32,534)	$ 1,384,390	5.35%

	December 31, 2004				
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Govt. Agency MBS	$ 12,553	$ 263	$ –	$ 12,816	5.79%
Total	$ 12,553	$ 263	$ –	$ 12,816	5.79%

AgFirst's and certain District Association's investments consist primarily of mortgage-backed securities (MBSs), asset-backed securities (ABSs), and short-term money market securities. MBSs are collateralized by U.S. Government or U.S. agency guaranteed residential mortgages and have a AAA credit rating. ABSs are also rated AAA either due to the senior/subordinate structure and/or a credit wrap by a bond insurer. Money market securities are short term in nature (from overnight maturities to maturities that range from 30 to 90 days) and are only purchased from financial institutions which carry sound credit ratings. All unrealized losses referenced above are related to changes in interest rates and are not credit related.

The following table shows the fair value and gross unrealized losses for investments in a loss position aggregated by investment category at December 31, 2006. The unrealized losses on these investments resulted from interest rate volatility and are not credit related. AgFirst and certain District Associations have both the ability and the intent to recover substantially all of the cost in these investments.

	Less than 12 Months		Greater than 12 Months	
(dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Govt. GNMA MBS/CMOs	$ 165,458	$ 304	$ 317,958	$ 2,587
U.S. Govt. Agency MBS	1,005,040	3,534	1,410,461	36,327
Non-Agency Securities	449,161	498	–	–
Commercial MBS	–	–	2,195	65
Asset-Backed Securities	48,819	303	50,891	703
Total	$ 1,668,478	$ 4,639	$ 1,781,505	$ 39,682

On December 31, 2006, AgFirst held certain investments having continuous unrealized loss positions for more than 12 months with a fair value totaling $1.78 billion and an unrealized loss position totaling $39.7 million. Substantially all of these investments were in U. S. Government Agency securities and AgFirst expects these securities would not be settled at a price less than their amortized cost. Because the decline in market value was caused by interest rate increases and not credit quality, and because AgFirst has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, AgFirst has not recognized any other-than-temporary impairment in connection with these investments.

A summary of the expected maturity, amortized cost and estimated fair value of investment securities at December 31, 2006, follows:

Available-for-sale

	Due in 1 year or less		Due after 1 year through 5 years		Due after 5 years through 10 years		Due after 10 years		Total	
(dollars in thousands)	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield
U.S. Govt. GNMA	$ –	–%	$ –	–%	$ –	–%	$ 1,267,914	5.43%	$ 1,267,914	5.43%
U.S. Govt. Agency MBS	363	4.80	6,438	4.37	26,808	5.71	2,716,376	5.59	2,749,985	5.59
Non-Agency Securities	–	–	–	–	–	–	776,534	5.77	776,534	5.77
Asset-Backed Securities	–	–	–	–	3,750	6.09	267,438	5.55	271,188	5.56
Total fair value	$ 363	4.80%	$ 6,438	4.37%	$ 30,558	5.76%	$ 5,028,262	5.58%	$ 5,065,621	5.58%
Total amortized cost	$ 365		$ 6,481		$ 30,458		$ 5,026,336		$ 5,063,640	

Held-to-maturity

	Due in 1 year or less		Due after 1 year through 5 years		Due after 5 years through 10 years		Due after 10 years		Total	
(dollars in thousands)	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield
U.S. Govt. Agency MBS	$ –	–%	$ –	–%	$ –	–%	$ 1,276,895	5.23%	$ 1,276,895	5.26%
Commercial MBS	–	–	855	4.75	1,405	4.97	–	–	2,260	4.89
Asset-Backed Securities	283	8.71	40,394	8.15	40,605	6.35	42,031	7.46	123,313	7.34
Other	–	–	–	–	–	–	24,013	7.45	24,013	7.45
Total amortized cost	$ 283	8.71%	$ 41,249	8.07%	$ 42,010	6.30%	$ 1,342,939	5.36%	$ 1,426,481	5.47%
Total fair value	$ 284		$ 40,945		$ 41,708		$ 1,309,562		$ 1,392,499	

Included in the available-for-sale investments are collateralized mortgage obligations. Substantially all collateralized mortgage obligations have contractual maturities in excess of ten years. However, expected maturities for collateralized mortgage obligations will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Proceeds from and realized gains and losses on investments in debt securities are as follows:

	Year Ended December 31,		
(dollars in thousands)	2006	2005	2004
Proceeds on sales	$ 54,834	$ 383,676	$ 197,340
Realized gains	–	908	6
Realized losses	5	442	23

Note 5 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31,		
(dollars in thousands)	2006	2005	2004
Real estate mortgage	$ 8,019,808	$ 7,401,816	$ 6,890,364
Production and intermediate-term	7,398,749	6,378,740	5,868,713
Agribusiness:			
Loans to cooperatives	250,364	164,776	137,474
Processing and marketing	1,145,416	682,709	603,081
Farm-related business	392,153	369,574	336,434
Communication	74,126	33,423	85,269
Energy	198,198	156,006	176,397
Water and waste disposal	12,688	–	–
Rural residential real estate	1,152,266	959,353	720,740
Lease receivables	24,088	22,525	15,906
Loans to other financial institutions	1,760	2,650	1,900
Total	$ 18,669,616	$ 16,171,572	$ 14,836,278

The District's concentration of credit risk in various agricultural commodities is shown in the following table. While the amounts represent the maximum potential credit risk as it relates to recorded loan principal, a substantial portion of the District's lending activities is collateralized and, accordingly, the credit risk associated with lending activities is considerably less than the recorded loan principal and is considered in the allowance for loan losses.

Total loans consisted of the following commodity types:

	Percent of Portfolio		
Commodity Group	**2006**	**2005**	**2004**
Forestry	13 %	12 %	11 %
Rural home	13	7	5
Poultry	11	13	12
Cattle	7	8	8
Grain	6	7	7
Dairy	5	6	7
Nursery/Greenhouse	5	5	5
Lumber/Paper	4	3	4
Swine	3	3	3
Tobacco	3	3	3
Cotton	2	3	3
Citrus	2	2	2
Utilities	1	1	2
Other	25	27	28
Total	100 %	100 %	100 %

Impaired loans are loans in which it is probable that principal and interest will not be collected according to the contractual terms. Interest income recognized and cash payments received on nonaccrual impaired loans are applied as described in Note 2.

The following table presents information relating to impaired loans.

	December 31,		
(dollars in thousands)	**2006**	**2005**	**2004**
Nonaccrual:			
Current as to principal and interest	$ 29,438	$ 51,830	$ 59,967
Past due	48,114	30,982	41,782
Accrual:			
Restructured	2,619	3,151	3,556
90 days or more past due	7,418	2,353	2,034
Total impaired loans	$ 87,589	$ 88,316	$ 107,339

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2006.

The following table presents interest income recognized on impaired loans.

	Year Ended December 31,		
(dollars in thousands)	**2006**	**2005**	**2004**
Interest income recognized on nonaccrual loans	$ 12,012	$ 8,802	$ 9,826
Interest income on impaired accrual loans	529	727	1,543
Interest income recognized on impaired loans	$ 12,541	$ 9,529	$ 11,369

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

(dollars in thousands)	**2006**	**2005**	**2004**
Impaired loans with related allowance	$ 18,169	$ 38,326	$ 39,597
Impaired loans with no related allowance	69,420	49,990	67,742
Total impaired loans	$ 87,589	$ 88,316	$ 107,339
Average impaired loans	$ 78,835	$ 93,917	$ 120,899
Allowance on impaired loans	$ 6,194	$ 20,642	$ 26,473

A summary of changes in the allowance for loan losses follows:

	Year Ended December 31,		
(dollars in thousands)	**2006**	**2005**	**2004**
Balance at beginning of year	$ 87,551	$ 95,419	$ 316,735
Provision for (reversal of allowance for) loan losses	(717)	(6,492)	2,037
Reversal of provision due to change in methodology	–	–	(215,425)
Loans charged off	(15,913)	(2,615)	(9,887)
Recoveries	994	1,239	1,959
Balance at end of year	$ 71,915	$ 87,551	$ 95,419

To mitigate the risk of loans being placed in nonaccrual status, System institutions 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 Bank or Association the right to sell the loans identified in the agreements for "par" to Farmer Mac in the event a delinquency of four months occurs. The balance of loans under long-term standby commitments was $953.8 million, $825.6 million and $662.1 million at December 31, 2006, 2005 and 2004, respectively. Fees paid to Farmer Mac for such commitments totaled $1.9 million, $2.3 million and $2.6 million for the years ended December 31, 2006, 2005 and 2004, respectively. Fees paid to government sponsored enterprises (GSEs) other than Farmer Mac were $1.0 million, $581 thousand and $628 thousand for 2006, 2005 and 2004, respectively. These amounts are classified as noninterest expense.

Note 6 — 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 equal annual payments under a contract with the Secretary of Agriculture. The Tobacco Act also includes a provision that allows the quota holders and producers to assign to a "financial institution" the right to receive the contract payments so that they may obtain a lump sum or other payment. On April 4, 2005, the USDA issued a Final Rule implementing the "Tobacco Transition Payment Program" (Tobacco Buyout).

The FCA determined that System institutions are "financial institutions" within the meaning of the Tobacco Act and are, therefore, eligible to participate in the Tobacco Buyout. The FCA recognized that the Tobacco Buyout has significant implications for some System institutions and the tobacco quota holders and producers they serve. The FCA's goal is to provide System institution borrowers with the option to immediately receive Tobacco Buyout contract payments and reinvest them in future business opportunities. As of December 31, 2006, eleven District Associations held investments in Tobacco Buyout SIICs of $428.0 million.

Note 7 — Premises and Equipment

Premises and equipment consisted of the following:

(dollars in thousands)	December 31, 2006	2005	2004
Land	$ 21,939	$ 19,399	$ 17,938
Buildings and improvements	92,799	77,977	70,483
Furniture and equipment	102,257	92,152	84,891
Work in progress	3,685	9,919	10,553
	220,680	199,447	183,865
Less: accumulated depreciation	100,557	92,384	87,262
Total	$ 120,123	$ 107,063	$ 96,603

Note 8 — Other Assets and Other Liabilities

A summary of other assets and other liabilities follows:

(dollars in thousands)	December 31, 2006	2005	2004
Other assets:			
Prepaid pension costs	$ 121,114	$ 141,580	$ 133,774
Derivative assets	3,615	2,066	1,125
Unamortized debt issue costs	15,098	12,038	9,054
Deferred preferred stock costs	2,017	2,701	3,385
Third party subservicer receivable	8,495	6,128	–
Prepaid expenses	3,282	3,145	3,265
Other	57,691	40,721	48,229
Total	$ 211,312	$ 208,379	$ 198,832
Other liabilities:			
Accounts payable	$ 21,859	$ 23,444	$ 24,221
Derivative liabilities	23,514	39,100	11,278
Farm Credit System Ins. Corp. payable	24,613	7,475	7,057
Bank draft payable	66,774	55,628	38,574
Payroll	21,474	20,733	19,016
Short-term funds held	23,027	23,749	13,134
Nonqualified pension liability	6,885	7,126	6,140
Other	14,911	11,755	8,535
Total	$ 203,057	$ 189,010	$ 127,955

Note 9 — Bonds and Notes

The System, unlike commercial banks and other depository institutions, obtains funds for its lending operations primarily from the sale of Systemwide Debt Securities issued by the banks through the Funding Corporation. Certain conditions must be met before AgFirst can participate in the issuance of Systemwide Debt Securities. As one condition of participation, AgFirst is required by the Farm Credit Act and FCA regulations to maintain specified eligible assets, at least equal in value to the total amount of debt obligations outstanding for which it is primarily liable. This requirement does not provide holders of Systemwide Debt Securities with a security interest in any assets of the banks. In 1994, the System banks and the Funding Corporation entered into the Market Access Agreement (MAA), which established criteria and procedures for the banks to provide certain information and, under certain circumstances, for restricting or prohibiting an individual bank's participation in Systemwide debt issuances, thereby reducing other System banks' exposure to statutory joint and several liability. The MAA was amended and restated in July 2003. At December 31, 2006, AgFirst was in compliance with the conditions of participation for the issuances of Systemwide Debt Securities.

Each issuance of Systemwide Debt Securities ranks equally, in accordance with the FCA regulations, with other unsecured Systemwide Debt Securities. Systemwide Debt Securities are not issued under an indenture and no trustee is provided with respect to these securities. Systemwide Debt Securities are not subject to acceleration prior to maturity upon the occurrence of any default or similar event.

The System may issue the following types of Systemwide Debt Securities:

- Federal Farm Credit Banks Consolidated Systemwide Bonds,
- Federal Farm Credit Banks Consolidated Systemwide Discount Notes,
- Federal Farm Credit Banks Consolidated Systemwide Master Notes,
- Federal Farm Credit Banks Global Debt Securities, and
- Federal Farm Credit Banks Consolidated Systemwide Medium-Term Notes.

The District's participation in outstanding Systemwide Debt Securities is as follows:

	Bonds		Medium-Term Notes		Discount Notes		Total	
Maturities	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate
				(dollars in thousands)				
2007	$ 7,041,289	4.65%	$ –	–%	$ 2,586,284	5.12%	$ 9,627,573	4.78%
2008	4,539,046	4.64	–	–	–	–	4,539,046	4.64
2009	2,329,510	4.61	–	–	–	–	2,329,510	4.61
2010	1,255,027	4.76	–	–	–	–	1,255,027	4.76
2011	1,003,414	5.00	–	–	–	–	1,003,414	5.00
2012	3,858,809	5.52	–	–	–	–	3,858,809	5.52
Total	$ 20,027,095	4.84%	$ –	–%	$ 2,586,284	5.12%	$ 22,613,379	4.87%

In the preceding table, weighted average interest rates include the effect of related derivative financial instruments.

Discount notes are issued with maturities ranging from 1 to 365 days. The average maturity of discount notes at December 31, 2006, was 71 days.

Systemwide Debt includes callable bonds and medium-term notes consisting of the following:

Amount	First Call Date	Year of Maturity
(dollars in thousands)		
$ 9,684,000	2007	2007-2020
18,000	2008	2015-2020
160,000	2009	2013-2021
2,000	2010	2012
25,000	2011	2013-2016
$ 9,889,000		

Callable debt may be called on the first call date and, any date thereafter.

As described in Note 1, the Insurance Fund is available to ensure the timely payment of principal and interest on Systemwide Debt Securities (insured debt) of System banks to the extent net assets are available in the Insurance Fund and not designated for specific use. All other liabilities on the financial statements are uninsured. At December 31, 2006 the assets of the Insurance Fund aggregated $2.31 billion; however, due to the other authorized uses of the Insurance Fund there is no assurance that any available amount in the Insurance Fund will be sufficient to fund the timely payment of principal or interest on an insured debt obligation in the event of a default by any System bank having primary liability thereon. Amounts available in the Insurance Fund were used in June 2005 to repay the Financial Assistance Corporation debt issued to fund the purchase of $374 million of Federal Land Bank of Jackson preferred stock.

Note 10 — Mandatorily Redeemable Preferred Stock

As of December 31, 2006, AgFirst had 225 thousand shares issued and outstanding of Mandatorily Redeemable Cumulative Preferred Stock at a par value of $1 thousand per share that is redeemable on December 15, 2016. Dividends on the preferred stock are payable semi-annually in arrears on the 15th day of June and December of each year at an annual rate equal to 8.393 percent of the $1 thousand per share par value. Beginning March 15, 2012, the rate will change to a floating rate indexed to the 3-month LIBOR. On or after the dividend payment date in December 15, 2011, the preferred stock will be redeemable in whole or in part at the option of the Bank on any dividend payment date at its par value of $1 thousand per share together with accrued and unpaid dividends to the redemption date. Beginning in July 1, 2003, the Mandatorily Redeemable Preferred Stock was required to be reported prospectively as a liability and the related dividends reported prospectively as interest expense in accordance with SFAS No. 150. Although the Mandatorily Redeemable Preferred Stock is required to be reported as a liability under GAAP, it qualifies as capital for certain regulatory purposes.

Note 11 — Protected Borrower Equity and Shareholders' Equity

Descriptions of the District's capitalization requirements, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below.

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

B. **Preferred Stock:** On October 14, 2003, AgFirst issued 150 thousand shares of Perpetual Non-Cumulative Preferred Stock. Dividends on the stock are payable at an annual rate equal to 7.30 percent. In the event dividends are not declared on the Preferred Stock for payment on any dividend Payment Date, then such dividends shall not cumulate and shall cease to accrue and be payable. On and after the Dividend Payment Date in December 2008, the Bank may, at its option, redeem the Preferred Stock in whole or in part at any time at the redemption price of $1 thousand per share plus accrued and unpaid dividends for then current dividend period to the date of redemption.

   Payment of dividends or redemption price on the Preferred Stock may be restricted if the Bank fails to satisfy applicable minimum capital adequacy, surplus and collateral requirements.

C. **Capital Stock, Participation Certificates and Retained Earnings:** In accordance with the Farm Credit Act, borrowers are generally required to invest in their respective associations as a condition of borrowing. The District Associations' capital stock requirements are generally the lesser of 2.00 percent of the amount of the loan or $1 thousand. Some District Associations have dollar maximums, which range from $1 thousand to $5 thousand. Loans designated for sale or sold into the Secondary Market have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation. Association capitalization plans presently establish stock requirements in accordance with the Farm Credit Act and their respective bylaws.

   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 added to the principal amount of the related loan obligation. AgFirst and the Association have a first lien on the stock or participation certificates owned by their respective borrowers. Retirement of such equities will generally be at the lower of par or book value and repayment of a loan cannot automatically result in retirement of the corresponding stock or participation certificates.

District Associations:

The District Associations are generally authorized to issue or have outstanding Classes A, C and D Preferred stock, Classes A, B, C and D Common stock, Classes A, B and C Participation Certificates, Assistance Preferred Stock 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 business. All classes of stock and participation certificates have a par or face value of five dollars ($5.00) per share.

The District Associations had the following shares outstanding at December 31, 2006:

		Shares Outstanding (dollars in thousands)	
Class	Protected Status	Number	Aggregate Par Value
A Common Nonvoting	Yes	141,400	$ 707
A Common Nonvoting	No	–	–
B Common Nonvoting	Yes	1,027,400	5,137
B Common Nonvoting	No	–	–
B Common Voting	No	–	–
C Common Voting	No	17,532,000	87,660
B Participation Certificates	Yes	72,800	364
C Participation Certificates	No	1,678,400	8,392
Participation Certificates	No	–	–
A Preferred	No	2,777,000	13,885
C Preferred	No	143,800	719
Total Association Capital Stock and Participation Certificates		23,372,800	$ 116,864

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

Participation Certificates are nonvoting and may be issued as a condition for obtaining a loan to rural home borrowers, to persons or organizations furnishing farm-related services, to persons or organizations who are eligible to borrow or participate in loans, but who are not eligible to hold voting stock, and to persons or organizations eligible to borrow for the purpose of qualifying them for technical assistance, financially related services, and/or leasing services offered by the Association.

Preferred Stock may be issued to such persons or investors as may be permitted under a plan adopted by each Board. Retirement will be at the sole discretion of each Board provided that the minimum capital adequacy standards established by the Board are met. If retired, Preferred Stock will be retired at its book value, not to exceed its par value. Preferred Stock is nonvoting and generally has preference over common stock and participation certificates as to dividends, and priority in the event of liquidation of an Association.

Retained Earnings

The Associations maintain unallocated retained earnings accounts and allocated retained earnings accounts. The minimum aggregate amounts of these two accounts are determined by each 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 an 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 Associations maintain allocated retained earnings accounts consisting of earnings held and allocated to borrowers on a patronage basis. In the event of a net loss by an Association 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 Associations have 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, an Association, upon approval of its 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 FCA and the Board are met. All nonqualified distributions are tax deductible only when redeemed.

At December 31, 2006, combined allocated retained earnings consisted of $292.0 million of qualified surplus, $372.7 million of nonqualified allocated surplus and $327.5 million of nonqualified retained surplus.

Dividends

An Association may declare dividends on its capital stock and participation certificates. Such dividends generally may be paid solely on Preferred Stock, or on all classes of stock and participation certificates.

Patronage Distributions

Prior to the beginning of any fiscal year, each Board, by adoption of a resolution, may obligate its 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, if made by that Association, are based on the proportion of the borrower's interest to the amount of interest earned by that Association on its total loans unless another proportionate patronage basis is approved by the Board.

If an Association will meet 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 retained earnings account, or combinations 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.

Amounts not distributed are retained as unallocated retained earnings.

Transfer

Equities may generally be transferred to persons or entities eligible to purchase or hold such equities under an Association's bylaws.

Impairment

Any net losses recorded by an Association shall first be applied against unallocated retained earnings. To the extent that such losses would exceed unallocated retained earnings, resulting in impairment of the Association's allocated retained earnings or capital stock, such losses would be applied pro rata to each share and/or unit outstanding, provided applications shall be made to allocated retained earnings by annual series, with the most recent allocations applied first.

Liquidation

In the event of the liquidation or dissolution of an Association, any assets of the Association remaining after payment or retirement of all liabilities may be distributed either to the holders of the outstanding stock and participation certificates or on a patronage basis, dependent upon the bylaws of the Association.

AgFirst:

Capital Stock and Allocated Retained Earnings — District Associations are required to invest in the capital stock of AgFirst. These intercompany balances and transactions are eliminated in combination. Additionally, AgFirst has issued and has outstanding $8.0 million in Class D Common stock, which is a nonvoting class of stock with a $5.00 par value.

Other Equity — At the inception of each other financing institutions (OFI) loan, AgFirst requires OFIs to make cash purchases of participation certificates in AgFirst. AgFirst has a first lien on these equities for the repayment of any indebtedness to AgFirst. At December 31, 2006, AgFirst had $114 thousand of participation certificates outstanding to OFIs at a face value of $5.00 per share.

Regulatory Capitalization Requirements and Restrictions

FCA's capital adequacy regulations require AgFirst and District Associations to achieve permanent capital of seven percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the seven percent capital requirement can initiate certain mandatory and possibly additional discretionary actions by the FCA that, if undertaken, could have a direct material effect on AgFirst's or District Associations' financial statements. AgFirst and District Associations are prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless the prescribed capital standard is met. FCA regulations also require all System institutions to achieve and maintain additional ratios as defined by FCA regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of seven percent and core surplus as a percentage of risk-adjusted assets of three and one-half percent. The following table shows the ranges of capital standards for the entities within the District at December 31, 2006.

	Permanent Capital Ratio Ranges	Core Surplus Ratio Ranges	Total Surplus Ratio Ranges
AgFirst	19.19%	11.46%	19.14%
District Associations	11.54% – 24.31%	8.70% – 23.90%	11.28% – 23.90%

AgFirst's capital adequacy is also evaluated using a ratio of net collateral to total liabilities. Subsequent to the issuance of the mandatorily redeemable preferred stock, FCA now requires AgFirst to maintain a minimum net collateral ratio of 104.00 percent compared to the regulatory minimum of 103.00 percent. At December 31, 2006, AgFirst's net collateral ratio was 105.28 percent.

Included in the above table as of December 31, 2006, are all twenty-three Associations that have reorganized through the creation of FLCA and PCA subsidiaries. These subsidiaries and the ACA operate under a common board of directors and joint management. As a result, these District Associations are jointly obligated on each other's liabilities and are evaluated on a consolidated basis for capital adequacy and other regulatory purposes.

All District entities were in compliance with the required minimum capital standards at December 31, 2006.

A regulation empowers the FCA to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. AgFirst and District Associations have not been called upon to initiate any transfers and are not aware of any proposed action under this regulation.

An additional component of retained earnings is accumulated other comprehensive income/loss, which is reported net of taxes as follows:

(dollars in thousands)	2006	2005	2004
Unrealized (losses) gains on investments available-for-sale	$ 1,982	$ (2,571)	$ 10,373
Unrealized (losses) on cash flow hedges	–	–	(6,643)
Minimum pension liability adjustment	(359)	(405)	(399)
	$ 1,623	$ (2,976)	$ 3,331

Note 12 — Income Taxes

The provision (benefit) for income taxes follows for the year ended December 31:

	Year Ended December 31,		
(dollars in thousands)	2006	2005	2004
Current:			
Federal	$ (1,329)	$ (2,203)	$ 116
State	154	(467)	527
ACA tax refunds	–	–	(1,159)
	(1,175)	(2,670)	(516)
Deferred:			
Federal	1,260	320	6,530
State	211	218	1,382
Write-off deferred tax assets	–	–	2,967
	1,471	538	10,879
Total provision (benefit) for income taxes	$ 296	$ (2,132)	$ 10,363

In connection with the reversal of the allowance for loan losses due to the refinement of methodologies, $11.2 million in tax provision was recognized in 2004. This tax provision was partially offset by other tax adjustments. Additionally, from 2000 through 2002, Associations signed settlement agreements with the IRS resolving the taxability of the prior years' earnings from its long-term mortgage lending activities. This settlement agreement was modeled after one used by another System ACA to reach a settlement agreement with the IRS in August 2000. As a result of this settlement, the Associations recorded tax refunds of $816 thousand in 2004 which is included as a component of the 2004 current income tax provision.

The provision 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:

	Year Ended December 31,		
(dollars in thousands)	2006	2005	2004
Federal tax at statutory rate	$139,592	$ 127,418	$ 185,495
State tax, net	227	(249)	1,126
Tax-exempt FLCA earnings	(71,937)	(78,471)	(91,370)
Association patronage distributions	(49,284)	(40,273)	(43,364)
Nontaxable Bank income	(19,413)	(11,258)	(18,230)
Possessions credit (Puerto Rico)	–	(594)	(785)
ACA tax refunds	–	–	(1,489)
Write-off of deferred tax assets	–	–	2,967
Allowance for loan loss reversal	–	–	(26,154)
Other	1,111	1,295	2,167
Provision for income taxes	$ 296	$ (2,132)	$ 10,363

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

	December 31,		
(dollars in thousands)	2006	2005	2004
Allowance for loan losses	$ 14,763	$ 18,533	$ 10,671
Nonaccrual loan interest	3,645	2,235	1,359
Postretirement benefits other than pensions	11,549	7,846	1,106
Nonqualified patronage distributions	97	6,318	29,987
Loss carryforwards	3,300	5,420	–
Other	2,428	1,666	4,479
Gross deferred tax asset	35,782	42,018	47,602
Less: valuation allowance	(15,613)	(18,772)	(21,350)
Gross deferred tax assets, net of valuation allowance	20,169	23,246	26,252
Future Bank stock redemptions	–	–	(2,787)
Bank patronage	(5,658)	(9,256)	(4,315)
State income tax	–	–	(653)
Loan fees	–	–	(1,444)
Pensions	(11,195)	(8,877)	(1,090)
Depreciation	(356)	(261)	(134)
Other	(2,797)	(3,161)	(13,600)
Gross deferred tax liability	(20,006)	(21,555)	(24,023)
Net deferred tax asset	$ 163	$ 1,691	$ 2,229

In evaluating the ability to recover its deferred income tax asset the company considers all available positive and negative evidence, including operating results, ongoing tax planning and forecasts of future taxable income on a jurisdiction-by-jurisdiction basis. The valuation allowance has been provided due to the uncertainty regarding the realizability of certain deferred assets in excess of deferred liabilities. The valuation allowance decreased approximately $3.2 million primarily due to the reduction of deferred tax assets related to future non-qualifying patronage distributions.

At December 31, 2006, deferred income taxes have not been provided by District Associations on approximately $125 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.

Note 13 — Employee Benefit Plans

The employees of the District may participate in one of three defined benefit retirement plans. The first plan (the District Plan) covers most employees of eighteen Associations and AgFirst. The second plan covers employees of four ACAs, and the third plan covers employees of a single ACA. Each plan is noncontributory and covers substantially all employees of the participating entities. The "Projected Unit Credit" actuarial method is used for financial reporting purposes. Based on the funded status of the defined benefit retirement plans at the measurement date (September 30) of the underlying Plan, the District may record a minimum liability, an intangible asset relating to unrecognized prior service cost and an adjustment to other comprehensive income (loss). The adjustment to other comprehensive income (loss) would be net of deferred taxes, if significant.

The following table set forth the obligations and funded status of the retirement plans:

	PENSION BENEFITS As of December 31,		
(dollars in thousands)	2006	2005	2004
Change in benefit obligation			
Benefit obligation at beginning of year	$ 531,010	$ 442,887	$ 372,158
Service cost	16,332	13,517	13,937
Interest cost	27,340	26,141	22,888
Actuarial loss (gain)	(42,575)	58,688	43,502
Benefits paid	(21,802)	(17,325)	(16,753)
Other	6,150	7,102	7,155
Benefit obligation at end of year	$ 516,455	$ 531,010	$ 442,887
Change in plan assets			
Fair value of plan assets at beginning of year	$ 444,381	$ 381,577	$ 258,673
Actual return on plan assets	42,453	51,962	33,212
Employer contributions	1,201	28,439	106,618
Transfers	(319)	(272)	(173)
Benefits and premiums paid	(21,802)	(17,325)	(16,753)
Fair value of plan assets at end of year	$ 465,914	$ 444,381	$ 381,577
Funded Status	$ (50,541)	$ (86,629)	$ (61,310)
Unrecognized net actuarial loss (gain)	152,058	214,039	186,610
Unamortized prior service cost	13,941	9,018	3,946
Unrecognized net (asset) or obligation	(241)	(578)	(917)
Net amount recognized	$ 115,217	$ 135,850	$ 128,329
Amounts recognized in the statement of financial position consisted of:			
Prepaid benefit costs	$ 121,114	$ 141,580	$ 133,774
Accrued benefit liability	(6,386)	(6,593)	(5,843)
Intangible asset	131	459	–
Accumulated other comprehensive income	358	404	398
Net amount recognized	$ 115,217	$ 135,850	$ 128,329
Components of net periodic benefit cost			
Service cost	$ 16,332	$ 13,517	$ 13,937
Interest cost	27,340	26,141	22,888
Expected return on plan assets	(36,737)	(31,673)	(23,278)
Amortization of net (gain) loss	(338)	(338)	(338)
Amortization of prior service cost	1,261	634	839
Recognized net actuarial (gain) loss	14,008	12,515	9,190
FAS 88 – special termination benefits	–	–	1,552
Other	(78)	123	286
Net periodic benefit cost	$ 21,788	$ 20,919	$ 25,076

The FAS 88 – special termination benefits in 2004 were related to the merger of two Associations.

The following table summarizes the District sponsored pension plans that have projected benefit obligations in excess of plan assets and the accumulated benefit obligation of the unfunded executive supplemental retirement plans in which the accumulated benefit obligation exceeds plan assets. The liability for the supplemental retirement plans for certain key employees is included in other liabilities on the combined balance sheets. During 2004, the District entities funded $106.6 million into the pension plans, eliminating the minimum pension liability. During 2006 and 2005, the District entities funded an additional $1.2 million and $28.4 million, respectively, into the pension plans. The District had prepaid pension costs of $121.1 million included in other assets on the combined balance sheets as of December 31, 2006.

	As of December 31,		
(dollars in thousands)	**2006**	**2005**	**2004**
Aggregate PBO > FV plan assets			
Projected benefit obligation	$ 516,455	$ 531,010	$ 442,887
Fair value of plan assets	465,914	444,381	381,577
Aggregate ABO > FV plan assets			
Accumulated benefit obligation	$ 6,293	$ 6,664	$ 5,729
Fair value of plan assets	–	–	–
Additional Information			
Increase/(decrease) in minimum liability included in other comprehensive income	$ 47	$ (6)	$ 98,275

	As of December 31,		
	2006	**2005**	**2004**
ASSUMPTIONS:			
Weighted average assumptions used to determine benefit obligations at December 31			
Discount rate	6.00%	5.25%	6.00%
Rate of compensation increase	4.44%	4.48%	4.47%
Weighted average assumptions used to determine net periodic benefit cost for years ended December 31			
Discount rate	5.25%	6.00%	6.25%
Expected return on plan assets	8.46%	8.46%	8.92%
Rate of compensation increase	4.50%	4.55%	4.54%

Plan assets are invested using active investment strategies utilizing multiple investment management firms. Managers within each asset class cover a range of investment styles and approaches are combined in a way that controls for capitalization, and style biases (equities), and interest rate anticipation strategies (fixed income) vs. benchmark indices while focusing primarily on issue selection as a means to add value. Risk is controlled through diversification among multiple asset classes, managers, styles, and securities. Risk is further controlled both at the manager and asset class level by assigning excess return and tracking error targets. Monitoring activities take place to evaluate performance against these targets. The target asset allocation is 45.00 percent U.S. equity, 20.00 percent non-U.S. equity, 5.00 percent real estate, and 30.00 percent fixed income. The plan's strategic asset allocation was determined by the AgFirst Plan Sponsor Committee after review and evaluation of an asset/liability study.

Allowable investment types include:

U.S. Equity: Common stocks of large, medium, and small companies, which are predominantly U.S. based.

Non-U.S. Equity: Equity securities issued by companies domiciled outside the U.S. and in depository receipts, which represent ownership of securities of non-U.S. companies.

Fixed Income: Fixed income securities issued or guaranteed by the U.S. government, and to a lesser extent by non-U.S. governments, or by their respective agencies and instrumentalities, mortgage backed securities, including collateralized mortgage obligations, corporate debt obligations and dollar-denominated obligations issued in the U.S. by non-U.S. banks and corporations (Yankee bonds).

Real Estate: The real estate portfolio participates in private market investments representing a diversified portfolio of high-quality, operating and substantially leased properties.

The strategic role of real estate is to:

- Provide diversification relative to stocks and bonds, thereby lowering the overall return volatility of the entire Plan.
- Provide a long-term return between those of stocks and bonds.

PLAN ASSETS	**2006**	**2005**	**2004**
Asset Category			
Equity securities	64.4%	65.1%	67.1%
Debt securities	30.3	30.1	28.3
Real Estate	4.6	4.1	3.9
Other	.7	.7	.7
	100.0%	100.0%	100.0%

Target allocation for asset categories for 2007 are as follows:

Asset Category	
Equity securities	62.8% – 67.3%
Debt securities	28.2% – 32.7%
Real Estate	2.8% – 6.4%

Cash Flows

Contributions: The total District contribution expected during 2007 is $1.2 million.

Estimated Benefit Payments: Estimated future benefit payments are as follows:

	(dollars in thousands)
2007	$ 23,709
2008	25,369
2009	27,528
2010	29,626
2011	31,838
2012-2016	195,948

The overall expected long-term rate of return on assets assumption is based on the target asset allocation for Plan assets, capital markets forecasts for asset classes employed, and active management excess return expectations. The total return for bonds is based on an equilibrium yield assumed to be 6.00 percent for government bonds plus an additional 0.50 percent due to the exposure of corporate debt in an aggregate benchmark, for a total return of 6.50 percent. A 3.00 percent equity premium is added to arrive at the forecast for equity returns, both foreign and domestic. Equilibrium forecasts are used to reflect long-term expectations for the asset classes employed. To the extent asset classes are actively managed, an excess return premium is added.

The District also sponsors supplemental retirement and deferred compensation plans for certain key compensated employees. The plans are nonqualified; therefore, the associated liabilities are included in the District's combined balance sheets in other liabilities. The expenses of these plans included in the District's retirement costs were $570 thousand, $959 thousand and $956 thousand for the years ended December 31, 2006, 2005 and 2004, respectively.

The District also participates in a Districtwide defined contribution Thrift 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 Bank and Associations will contribute $0.50 for each $1.00 of the employee's contribution up to the maximum employer contribution of 3.00 percent of total compensation. For employees hired on or after January 1, 2003, the Bank and Associations will contribute $1.00 for each $1.00 of the employee's contribution up to the maximum employer contribution of 6.00 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as determined and adjusted by the Internal Revenue Service. Employer contributions were $4.7 million, $4.2 million and $3.9 million for 2006, 2005 and 2004, respectively.

Effective January 1, 2006 the Districtwide 401(k) Plan known as the AgFirst Farm Credit Employee Thrift Plan merged with the Farm Credit Bank of Texas Thrift Plus Plan. The new plan is known as the AgFirst/FCBT 401 (k) Employee Benefit Plan.

In addition to providing pension benefits, the Bank and District Associations provide certain health care and life insurance benefits for the retired employees (other postretirement benefits). Substantially all employees may become eligible for the benefits if they reach early retirement age while working for the Bank or District Associations.

The following is a table of other postretirement benefits expenses:

	OTHER POSTRETIREMENT BENEFITS As of December 31,		
(dollars in thousands)	**2006**	**2005**	**2004**
Change in benefit obligation			
Benefit obligation at beginning of year	$ 126,048	$ 145,903	$ 150,152
Service cost	2,681	2,908	3,719
Interest cost	6,484	8,574	9,272
Plan participant contributions	880	1,348	767
Actuarial loss (gain)	(11,812)	9,081	(12,505)
Benefits paid	(5,390)	(5,957)	(5,329)
Plan amendments/other	354	(35,809)	(173)
Benefit obligation at end of year	$ 119,245	$ 126,048	$ 145,903
Change in plan assets			
Fair value of plan assets at beginning of year	$ –	$ –	$ –
Actual return on plan assets	–	–	–
Plan participant contributions	880	1,348	767
Employer contributions	4,510	4,609	4,562
Benefits and premiums paid	(5,390)	(5,957)	(5,329)
Fair value of plan assets at end of year	$ –	$ –	$ –
Funded Status	$ (119,245)	$ (126,048)	$ (145,903)
Unrecognized net actuarial loss (gain)	32,387	47,088	40,028
Unrecognized prior service cost	(21,540)	(24,730)	(1,932)
Unrecognized net obligation and 4th Qtr contributions	1,220	1,009	14,837
Net amount recognized	$ (107,178)	$ (102,681)	$ (92,970)
Amounts recognized in the statement of financial position consisted of:			
Prepaid benefit costs	$ –	$ –	$ –
Accrued benefit liability	(107,178)	(102,681)	(92,970)
Intangible asset	–	–	–
Accumulated other comprehensive	–	–	–
Net amount recognized	$ (107,178)	$ (102,681)	$ (92,970)
Components of net periodic postretirement benefit costs			
Service cost	$ 2,681	$ 2,908	$ 3,719
Interest cost	6,484	8,574	9,272
Amortization of net (gain) loss	34	1,786	1,786
Amortization of prior service cost	(2,836)	(281)	(184)
Recognized net actuarial (gain) loss	2,889	2,021	3,353
Net periodic benefit (income) cost	$ 9,252	$ 15,008	$ 17,946
EXPECTED FUTURE CASH FLOWS			
Expected contributions			
Fiscal 2007	$ 5,351		
Expected benefit payments (net of employee contributions)			
Fiscal 2007	$ 5,351		
Fiscal 2008	5,814		
Fiscal 2009	6,347		
Fiscal 2010	6,929		
Fiscal 2011	7,502		
Fiscal 2012-2016	43,157		
ASSUMPTIONS:			
Weighted average assumptions used to determine benefit obligations at December 31			
Discount rate	6.00%	5.25%	6.00%
Weighted average assumptions used to determine net periodic benefit cost for years ended December 31			
Discount rate	5.25%	6.00%	6.25%
Expected return on plan assets	N/A	N/A	N/A
Assumed health care cost trend rates:			
Health care cost trend rate assumed for next year	6.75%–9.00%	7.0%–9.50%	9.75%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	4.75%	4.75%	5.00%
Year that the rate reaches the ultimate trend rate	2016	2015	2012

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

(dollars in thousands)	1 Percentage Point Increase	1 Percentage Point Decrease
Effect on total of service and interest cost	$ 1,555	$ (1,255)
Effect on postretirement benefit obligation	15,654	(13,019)

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Act) was signed into law. This act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. In May 2004, the FASB issued FASB Staff Position (FSP) 106-2, *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003* (the Act). This Staff Position provides guidance on the accounting for the effects of the Act for employers that sponsor postretirement health care plans that provide prescription drug benefits. The District sponsored plan adopted FSP 106-2 effective July 1, 2004 (measured as of March 31, 2004). The benefit obligation valuation as of December 31, 2004 reflects the impact of the Medicare Act.

In determining the benefit obligation as of December, 31, 2004, the expected per capita claims cost was estimated to be reduced by 12.00 percent beginning in 2006, for Medicare-eligible participants receiving actuarially equivalent drug benefits, due to a government reimbursement of a portion of prescription drug benefits. The District reduced its accumulated postretirement benefit obligation (APBO) for the subsidy related to benefits attributed to past service. The effect of the subsidy on the measurement of net periodic postretirement cost for 2005 was a reduction of 2005 expense. The effect included lower amortization of actuarial losses, lower service costs and lower interest costs on the APBO.

The Retiree and Disabled Medical Plan was amended effective January 1, 2006 to change the medical and prescription drug coverage for Medicare-eligible retirees and/or eligible spouses 65 years and older. Beginning in 2006, the AgFirst/FCBT Retiree and Disabled Medical Plan will provide medical and prescription drug coverage to Medicare-eligible retirees and/or eligible spouses 65 years and older through fully-insured AARP endorsed Medicare Supplement policies and subsidized basic Medicare D coverage through a selected Prescription Drug Plan. Dental coverage was not changed. Retirees of the Puerto Farm Credit Association and certain other retirees who are grandfathered under insured arrangements were not impacted by the change. The benefit obligation valuation as of December 31, 2005 reflects the impact of this plan amendment.

In determining the benefit obligation as of December 31, 2005, there was no impact due to government reimbursement of prescription drug benefits, except for Medicare-eligible and/or eligible spouses of the Puerto Rico Farm Credit Association. After the plan amendment, the plan no longer provides prescription drug benefits directly for retirees and/or eligible spouses 65 years and older. Instead, the District subsidizes the cost of coverage obtained under the Medicare D program through the selected Prescription Drug Provider.

Note 14 — Intra-System Financial Assistance

The Farm Credit Act provided for capital assistance to System institutions experiencing severe financial stress through the issuance, prior to October 1, 1992, by the Farm Credit System Financial Assistance Corporation, (Financial Assistance Corporation) of U.S. Treasury-guaranteed 15-year bonds, of which $1.26 billion in principal amount was originally issued. The last remaining Financial Assistance Corporation bonds matured and were repaid on June 10, 2005.

Pursuant to the Farm Credit Act, the U.S. Treasury paid $440 million, on behalf of the System, in interest costs on $844 million of the Financial Assistance Corporation bonds issued for purposes other than funding Capital Preservation Agreement accruals. The Banks had irrevocably set aside funds, including interest earned, that totaled the $440 million needed to repay the interest advanced by the U.S. Treasury. On June 10, 2005, the Banks repaid the U.S. Treasury the interest advanced. As provided in the Farm Credit Act, the Financial Assistance Corporation will continue in existence no longer than two years following the maturity of the debt in June 2005.

The Financial Assistance Corporation was dissolved effective as of December 31, 2006.

Note 15 — Related Party Transactions

In the ordinary course of business, the District enters into loan transactions with officers and directors of AgFirst or Associations, 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, 2006, amounted to $232.9 million, as compared with $ 257.5 million and $235.3 million for the years ended December 31, 2005 and 2004, respectively. During 2006, 2005 and 2004, $150.8 million, $369.1 million and $230.0 million of new loans were made and repayments totaled $175.4 million, $347.0 million and $220.9 million, respectively. In the opinion of management, no material amounts outstanding at December 31, 2006, involved more than a normal risk of collectibility.

Note 16 — Regulatory Enforcement Matters

At December 31, 2006, there were no regulatory enforcement matters or agreements in place with the FCA.

Note 17 — Commitments and Contingencies

The District has various contingent liabilities and commitments outstanding as discussed elsewhere in these notes to combined financial statements. While primarily liable for its portion of bonds and notes, AgFirst is jointly and severally liable for the bonds and notes of the other System banks. The total bonds and notes of the System at December 31, 2006 were $133.63 billion.

In the normal course of business, the Bank and Associations may participate in credit related financial instruments with off-balance-sheet risk to satisfy the financing needs of their borrowers. These financial instruments include standby letters of credit, various guarantees and commitments to extend credit.

Standby letters of credit are unconditional commitments issued by the Bank and District Associations to guarantee the performance of a customer to a third party. As of December 31, 2006, the Bank had $120.6 million in letters of credit with non-District entities with $18.0 million expiring in less than one year, $40.2 million due to expire in one to three, $61.1 million expiring in five years and the remaining $1.3 million have terms that will expire from 2012 to 2015. As of December 31, 2006, the District Associations had $146.9 million in letters of credit with terms predominantly of one to three years. The notional amounts of these guarantees represent the maximum amount of exposure the Bank and the District Associations have related to these instruments as of December 31, 2006.

At December 31, 2006, $5.6 billion of commitments to extend 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 financial instruments have off-balance-sheet credit risk because their amounts could be drawn upon at the option of the borrower. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and the same credit policies are applied by management. 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 loan collateral 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.

As of December 31, 2006, AgFirst also indemnifies leases in the amount of $2.2 million on behalf of Farm Credit Leasing Services Corporation (FCLSC) with lease terms expiring in 2009.

Actions are pending against AgFirst and certain District Associations in which claims for money damages are asserted. On the basis of information presently available, management and legal counsel are of the opinion that the ultimate liability, if any, from these actions, would not be material in relation to the combined financial position of AgFirst and District Associations.

Note 18 — Disclosures about Fair Value of Financial Instruments

The following table presents the carrying amounts and fair values of the District's financial instruments at December 31, 2006, 2005 and 2004. The fair value of a financial instrument is generally defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. 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 District's financial instruments are as follows:

	December 31, 2006		December 31, 2005		December 31, 2004	
(dollars in thousands)	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:						
Loans	$18,669,616	$18,695,454	$16,171,572	$16,154,949	$14,836,278	$15,130,575
Allowance for loan losses	(71,915)	–	(87,551)	–	(95,419)	–
Loans, net	$18,597,701	$18,695,454	$16,084,021	$16,154,949	$14,740,859	$15,130,575
Derivative assets	$ 3,615	$ 3,615	$ 2,066	$ 2,066	$ 1,125	$ 1,125
Cash & cash equivalents	$ 651,268	$ 651,268	$ 640,830	$ 640,830	$ 522,862	$ 522,862
Investment securities	$ 6,492,102	$ 6,458,120	$ 5,302,965	$ 5,270,708	$ 3,290,967	$ 3,291,230
Other investments	$ 428,005	$ 420,512	$ 237,239	$ 234,391	$ –	$ –
Financial liabilities:						
Systemwide Debt Securities	$22,613,379	$22,531,191	$18,879,964	$18,753,747	$15,402,385	$15,206,435
Derivative liabilities	$ 23,514	$ 23,514	$ 39,100	$ 39,100	$ 11,278	$ 11,278

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

A. **Loans:** Because no active market exists for the District's loans, fair value is estimated by discounting the expected future cash flows using the District's current interest rates at which similar loans would be made to borrowers with similar credit risk. Since the discount rates are based on the District'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 are estimated to be the carrying amount of the loan less specific reserves. The carrying value of accrued interest approximates its fair value.

B. **Cash, Federal Funds and Securities Purchased Under Resale Agreements:** The carrying value is a reasonable estimate of fair value.

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

D. **Other Investments:** Fair value is estimated by discounting future annual cash flows using prevailing rates for similar instruments at year-end.

E. **Systemwide Debt Securities:** Bonds and notes are not regularly traded; thus, quoted market prices are not available. Fair value of these instruments is estimated by discounting expected future cash flows based on the quoted market price of similar maturity Treasury notes, assuming a constant estimated yield spread relationship between Systemwide bonds and notes and comparable Treasury notes.

F. **Derivative Instruments:** The fair value of derivatives is the estimated amount to be received or paid to replace the instruments at the reporting date, considering current and projected interest rates. Where actively quoted market prices do not exist, estimated fair values are determined through dealer quotes.

Note 19 — Derivative Instruments and Hedging Activities

The District maintains an overall interest rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. The District's goal is to manage interest rate sensitivity by modifying the repricing or maturity characteristics of certain balance sheet assets and liabilities so that the net interest margin is not adversely affected by movements in interest rates. As a result of interest rate fluctuations, hedged fixed-rate assets and liabilities will appreciate or depreciate in market value. The effect of this unrealized appreciation or depreciation is expected to be substantially offset by the District's gains or losses on the derivative instruments that are linked to these hedged assets and liabilities. Another result of interest rate fluctuations is that the interest income and interest expense of hedged variable-rate assets and liabilities, respectively, will increase or decrease. The effect of this variability in earnings is expected to be substantially offset by the District's gains and losses on the derivative instruments that are linked to these hedged assets and liabilities. The District considers its strategic use of derivatives to be a prudent method of managing interest rate sensitivity, as it prevents earnings from being exposed to undue risk posed by changes in interest rates.

The District enters into derivatives, particularly interest rate swaps, to lower funding costs, diversify sources of funding, or alter interest rate exposures arising from mismatches between assets and liabilities. Interest rate swaps allow the District to raise long-term borrowings at fixed rates and swap them into floating rates that are lower than those available to the District if floating rate borrowings were made directly. Under interest rate swap arrangements, the District agrees with other parties to exchange, at specified intervals, payment streams calculated on a specified notional principal amount, with at least one stream based on a specified floating rate index.

The District may purchase interest rate options such as caps, in order to reduce the impact of rising interest rates on its floating-rate debt, and floors, in order to reduce the impact of falling interest rates on their floating-rate assets. There are no floors outstanding currently.

By using derivative instruments, the District exposes itself to credit and market risk. If a counterparty fails to fulfill its performance obligations under a derivative contract, the District's credit risk will equal the fair value gain in the derivative. Generally, when the fair value of a derivative contract is positive, this indicates that the counterparty owes the District, thus creating a repayment risk for the District. When the fair value of the derivative contract is negative, the District owes the counterparty and, therefore, assumes no repayment risk.

To minimize the risk of credit losses, the District deals with counterparties that have an investment grade or better credit rating from a major rating agency, and also monitors the credit standing of and levels of exposure to individual counterparties. The estimated credit risk exposure of $3.6 million with nine counterparties represents approximately 0.20 percent of the total notional amount of interest rate swaps. The District does not anticipate nonperformance by any of these counterparties. The District typically enters into master agreements that contain netting provisions. These provisions allow the District to require the net settlement of covered contracts with the same counterparty in the event of default by the counterparty on one or more contracts. A number of swaps are supported by collateral arrangements with counterparties. At December 31, 2006, the District had not posted collateral with respect to these arrangements.

The District's derivative activities are monitored by its Asset-Liability Management Committee (ALCO) as part of the Committee's oversight of the District's asset/liability and treasury functions. The District's ALCO is responsible for approving hedging strategies that are developed through its analysis of data derived from financial simulation models and other internal and industry sources. The resulting hedging strategies are then incorporated into the District's overall interest rate risk-management strategies.

Note 20 — Additional Derivative Financial Instruments and Other Financial Instruments Disclosure

The table below provides information about derivative financial instruments and other financial instruments that are sensitive to changes in interest rates, including debt obligations and interest rate swaps. The debt information below represents the principal cash flows and related weighted average interest rates by expected maturity dates. The derivative information below represents the notional amounts and weighted average interest rates by expected maturity dates.

December 31, 2006 *(dollars in millions)*	Maturities of 2006 Derivative Products and Other Financial Instruments 2007	2008	2009	2010	2011	After 2012	Total	Fair Value
Systemwide Debt Securities:								
Fixed rate	$ 6,008	$ 2,623	$ 2,113	$ 1,155	$ 1,001	$ 3,858	$ 16,758	$ 16,650
Weighted average interest rate	4.51%	4.20%	4.54%	4.72%	5.00%	5.52%	4.75%	
Variable rate	3,620	1,916	216	100	2	1	5,855	5,881
Weighted average interest rate	5.23%	5.23%	5.28%	5.26%	5.19%	5.19%	5.23%	
Derivative Instruments:								
Receive fixed swaps								
Notional value	$ 350	$ 465	$ 550	$ –	$ 200	$ 200	$ 1,765	$ (20)
Weighted average receive rate	2.99%	3.72%	4.22%	–	5.22%	5.10%	4.06%	
Weighted average pay rate	4.86%	4.73%	4.84%	–	4.98%	4.93%	4.84%	
Total notional value	$ 350	$ 465	$ 550	$ –	$ 200	$ 200	$ 1,765	$ (20)
Total weighted average rates on swaps:								
Receive rate	2.99%	3.72%	4.22%	–	5.22%	5.10%	4.06%	
Pay rate	4.86%	4.73%	4.84%	–	4.98%	4.93%	4.84%	

Note 21 — Quarterly Financial Information (Unaudited)

Quarterly results of operations for the years ended December 31, 2006, 2005 and 2004 follow:

(dollars in thousands)	2006 First	Second	Third	Fourth	Total
Net interest income	$ 161,271	$ 164,323	$ 176,131	$ 172,111	$ 673,836
Provision for (reversal of allowance for) loan losses	101	(14,975)	2,146	12,011	(717)
Noninterest income (expense), net	(62,610)	(57,303)	(67,090)	(76,885)	(263,888)
(Provision) benefit for income taxes	(284)	(157)	(126)	271	(296)
Net income	$ 98,276	$ 121,838	$ 106,769	$ 83,486	$ 410,369

	2005 First	Second	Third	Fourth	Total
Net interest income	$ 144,329	$ 149,955	$ 156,096	$ 160,121	$ 610,501
Provision for (reversal of allowance for) loan losses	(1,265)	283	(349)	(5,161)	(6,492)
Noninterest income (expense), net	(56,901)	(54,560)	(60,119)	(70,368)	(241,948)
(Provision) benefit for income taxes	(70)	(186)	196	2,192	2,132
Net income	$ 88,623	$ 94,926	$ 96,522	$ 97,106	$ 377,177

	2004 First	Second	Third	Fourth	Total
Net interest income	$ 139,553	$ 141,788	$ 144,117	$ 143,368	$ 568,826
Provision for (reversal of allowance for) loan losses	150	112	1,775	(215,425)	(213,388)
Noninterest income (expense), net	(54,500)	(60,117)	(55,143)	(66,880)	(236,640)
(Provision) benefit for income taxes	(337)	(79)	1,607	(11,554)	(10,363)
Net income	$ 84,566	$ 81,480	$ 88,806	$ 280,359	$ 535,211

Note 22 — Bank Only Financial Data

Condensed financial information of the Bank follows:

Balance Sheet

(dollars in thousands)	December 31, 2006	2005	2004
Cash, cash equivalents and investment securities	$ 6,941,446	$ 5,813,627	$ 3,748,672
Loans			
To District Associations	13,877,141	12,441,170	11,229,197
To others	3,275,196	1,969,880	1,679,052
Total loans	17,152,337	14,411,050	12,908,249
Less: allowance for loan losses	463	10,114	14,800
Net loans	17,151,874	14,400,936	12,893,449
Other assets	318,844	268,468	245,402
Total assets	$ 24,412,164	$ 20,483,031	$ 16,887,523
Bonds and notes	$ 22,613,379	$ 18,879,964	$ 15,402,385
Mandatorily redeemable preferred stock	225,000	225,000	225,000
Other liabilities	392,698	340,639	235,842
Total liabilities	23,231,077	19,445,603	15,863,227
Perpetual preferred stock	150,000	150,000	150,000
Capital stock and participation certificates	313,353	224,554	226,200
Retained earnings	715,753	665,445	644,366
Accumulated other comprehensive income (loss)	1,981	(2,571)	3,730
Total shareholders' equity	1,181,087	1,037,428	1,024,296
Total liabilities and equity	$ 24,412,164	$ 20,483,031	$ 16,887,523

Statement of Income

(dollars in thousands)	Year Ended December 31, 2006	2005	2004
Interest income	$ 1,222,948	$ 792,673	$ 544,339
Interest expense	995,436	588,472	332,744
Net interest income	227,512	204,201	211,595
Provision for (reversal of) loan losses	(7,337)	(4,995)	(15,292)
Net interest income after provision for loan losses	234,849	209,196	226,887
Noninterest income	19,298	16,749	18,021
Noninterest expenses			
Salaries and employee benefits	26,318	27,957	26,172
Occupancy and equipment	11,608	11,108	9,823
Insurance Fund premium	3,597	884	845
Other operating expenses	17,529	15,882	15,448
Intra-System financial assistance expenses	–	3,221	6,794
Called debt expense	2,563	656	3,360
Other expenses	2,339	1,978	2,160
Total noninterest expenses	63,954	61,686	64,602
Net income	$ 190,193	$ 164,259	$ 180,306

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