AgFirst Farm Credit Bank and District Associations

FARM CREDIT

2009 Annual Report

Lending support to rural America™

AgFirst Farm Credit Bank and District Associations

2009 Annual Report

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Management

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Thomas S. Welsh .... Executive Vice President and Chief Administrative and Legislative Officer
Leon T. Amerson .... Executive Vice President and Chief Operating Officer
Charl L. Butler .... Senior Vice President and Chief Financial Officer
William L. Melton .... Senior Vice President and Chief Lending Officer
Benjamin F. Blakewood .... Senior Vice President and Chief Information Officer
Frederick T. Mickler, III .... Senior Vice President and General Counsel

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Message from the Chairman of the Board and the Chief Executive Officer

In 2009, the nation's economy struggled through one of the worst recessions since the Great Depression. A drop in consumer demand for goods and services weakened the economy, resulting in high unemployment. Banks and other financial institutions suffered tremendous losses, contributing to a "credit crunch" that further slowed economic growth.

While AgFirst and its affiliated Associations experienced deterioration in credit quality in 2009, our District was positioned much better than most financial institutions to cope with the weak economy. Collectively, we maintained our strong capital levels and earnings were slightly higher than the previous year. As always, we shared a significant part of our earnings with our customers in the form of patronage distributions.

Growth and Credit Quality

Farm net cash income declined from its record level in 2008 to an estimated $71 billion in 2009, a drop of $27 billion. While crop farmers generally experienced an excellent year with high yields and satisfactory prices, conditions were not so favorable for dairy, livestock, and poultry producers. High feed costs and low commodity prices caused significant losses for dairy and swine operations. Weak demand for new housing also adversely affected the timber industry.

As the economy slowed during 2009, demand for loans slowed as well. District loan volume grew by only 1 percent in 2009, as compared to 11 percent the previous year. We expect that farmers and consumers will remain cautious in 2010, and their caution will dampen loan demand. Associations report that many farmers who had good earnings in 2009 are "banking" their profits, instead of buying land or new equipment to grow their operations.

During 2009, our credit quality weakened as expected. Deterioration, largely in a handful of participation loans led to provisions for loan loss of $163 million and net charge-offs of $137 million. We expect some further credit deterioration before any improvement in 2010, but—with our solid capital levels, experienced staff and stable base of earnings—we are well positioned to effectively manage this adversity.

The fact that we maintained sound underwriting practices throughout the "good times" makes us confident that we will be able to weather the current financial storm. That is important to us because our Bank's goal—moreover, our mission—is to be a reliable source of funding for our affiliated Associations in good times and bad. This enables our Associations to meet their mission of providing sound, constructive credit to creditworthy borrowers on a consistent basis.

Earnings and Capital

As was true the previous year, falling interest rates in 2009 enabled us to call a significant amount of fixed-rate debt and replace that called debt with less expensive funding. This, combined with moderate balance sheet growth, resulted in net interest income of $937 million in 2009, a 15 percent or $120 million increase compared to 2008. Net income was $365 million in 2009, compared to $364 million in 2008.

Our 2009 earnings level enabled us to distribute patronage of $207 million to our borrowers without adversely affecting our capital position. As those earnings flowed to our borrowers, they enriched the economies of rural communities throughout our 15 states and Puerto Rico.

Strategic Initiatives

Despite the year's challenges, we maintained the focus on several strategic initiatives. These initiatives are designed to improve the Bank's service and performance levels and create efficiencies in Association operations. In 2009, we:

- Introduced enhancements to our key loan origination and customer service applications, including Credit Delivery, Customer Relation Management (CRM), AgriGate, and Imaging.
- Implemented enhancements to AccountAccess and our Online Loan Application.
- Implemented a new web-based training curriculum for Young, Beginning, and Small (YBS) Farmers. This curriculum, a part of our Farm Credit University program, will enable YBS farmers across the nation to learn farm financial management practices that will help their operations succeed.

- Increased the number of affiliated Associations that are using AgFirst's "expanded services." These services range from loan and general accounting to information and technology management. By taking advantage of the economies of scale that AgFirst can offer, Associations can reduce their costs and improve service to their members.

Meeting our Mission

Despite the challenges of the current economic and financial climate, Associations in the AgFirst District continue to fulfill their primary mission to finance creditworthy farmers, ranchers, agribusinesses, and rural homeowners. AgFirst is supporting this mission by providing reliable funding and superior services to the Associations.

As we look forward to 2010, we see the economy beginning to strengthen. In the meantime, we are well-positioned to meet the challenges that will continue into 2010. We will continue to "keep it rural," meeting our mission to furnish sound, adequate, and constructive credit to those who live and work in rural America.

Paul M. House
Chairman of the Board

F. A. Lowrey
Chief Executive Officer

March 12, 2010

Report of Management

The accompanying Combined Financial Statements and related financial information appearing throughout this annual report have been prepared by management of AgFirst Farm Credit Bank (Bank) 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 Combined 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 Combined Financial Statements, and that the assets of the Bank are safeguarded. The design and implementation of all systems of internal control are based on judgments required to evaluate the costs of controls in relation to the expected benefits and to determine the appropriate balance between these costs and benefits. The Bank and each affiliated District Agricultural Credit Association (District Association) maintain 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 Audit Committee of the Board of Directors and to the Chief Executive Officer.

The Bank has 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 Bank 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 and each District Association are also subject to examination by the Farm Credit Administration.

The Combined Financial Statements, in the opinion of management, fairly present the combined financial condition of the Bank and District Associations. The undersigned certify that we have reviewed the 2009 Annual Report of the Bank and District Associations, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Paul M House

Paul M. House
Chairman of the Board

F. A. Lowrey

F. A. Lowrey
President & Chief Executive Officer

Charl L Butler

Charl L. Butler
Senior Vice President & Chief Financial Officer

March 12, 2010

Report on Internal Control Over Financial Reporting

AgFirst Farm Credit Bank (Bank) and each affiliated District Agricultural Credit Association's (District Association) principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Bank and each District Association's respective Consolidated Financial Statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by or under the supervision of the Bank and each District Association's principal executives and principal financial officers, or persons performing similar functions, and affected by its Board of Directors, management and other personnel. This process provides reasonable assurance regarding the reliability of financial reporting information and the preparation of the respective Consolidated Financial Statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Bank and each District Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Bank and each District Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Bank and each District Association's assets that could have a material effect on its Consolidated Financial Statements.

The Bank and each District Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of December 31, 2009. In making the assessment, management used the framework in *Internal Control — Integrated Framework*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Bank's and each District Association's management concluded that as of December 31, 2009, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Bank's and each District Association's management determined that there were no material weaknesses in the internal control over financial reporting as of December 31, 2009.

F.A. Lowrey
President & Chief Executive Officer

Charl L. Butler
Senior Vice President & Chief Financial Officer

March 12, 2010

Five-Year Summary of Selected Combined Financial Data

	As of or for the year ended December 31,				
(dollars in thousands)	2009	2008	2007	2006	2005
Combined Balance Sheet Data					
Cash and cash equivalents	$ 981,041	$ 316,010	$ 612,841	$ 651,268	$ 640,830
Investment securities	8,442,230	8,167,026	7,060,801	6,492,102	5,302,965
Loans	23,208,189	23,077,736	20,728,296	18,669,616	16,171,572
Less: allowance for loan losses	195,132	169,090	78,874	71,915	87,551
Net loans	23,013,057	22,908,646	20,649,422	18,597,701	16,084,021
Other property owned	73,354	14,228	8,504	5,122	3,646
Other assets	895,815	1,006,520	929,583	1,014,525	743,098
Total assets	$ 33,405,497	$ 32,412,430	$ 29,261,151	$ 26,760,718	$ 22,774,560
Obligations with maturities of one year or less	$ 14,473,270	$ 14,284,135	$ 11,451,400	$ 10,134,550	$ 7,710,389
Obligations with maturities greater than one year	15,080,200	14,781,569	14,018,677	13,092,985	11,694,786
Mandatorily redeemable preferred stock	225,000	225,000	225,000	225,000	225,000
Total liabilities	29,778,470	29,290,704	25,695,077	23,452,535	19,630,175
Perpetual preferred stock	400,000	400,000	400,000	150,000	150,000
Protected borrower equity	4,205	4,670	5,369	6,208	7,628
Capital stock and participation certificates	138,504	129,529	127,147	118,817	120,370
Retained earnings					
Allocated	1,199,441	1,126,994	1,068,756	992,227	925,919
Unallocated	2,323,523	2,191,324	2,118,390	2,039,308	1,943,444
Accumulated other comprehensive income (loss)	(438,646)	(730,791)	(153,588)	1,623	(2,976)
Total shareholders' equity	3,627,027	3,121,726	3,566,074	3,308,183	3,144,385
Total liabilities and shareholders' equity	$ 33,405,497	$ 32,412,430	$ 29,261,151	$ 26,760,718	$ 22,774,560
Combined Statement of Income Data					
Net interest income	$ 937,439	$ 817,864	$ 722,190	$ 673,836	$ 610,501
Provision for (reversal of allowance for) loan losses	162,893	121,023	8,284	(717)	(6,492)
Noninterest income (expense), net	(409,679)	(333,321)	(301,989)	(264,184)	(239,816)
Net income	$ 364,867	$ 363,520	$ 411,917	$ 410,369	$ 377,177
Combined Key Financial Ratios					
Rate of return on average:					
Total assets	1.12%	1.17%	1.48%	1.67%	1.86%
Total shareholders' equity	10.79%	10.07%	11.42%	12.40%	12.05%
Net interest income as a percentage of average earning assets	2.93%	2.66%	2.64%	2.80%	3.07%
Net (chargeoffs) recoveries to average loans	(0.59)%	(0.14)%	(0.01)%	(0.09)%	(0.01)%
Total shareholders' equity to total assets	10.86%	9.63%	12.19%	12.36%	13.81%
Debt to shareholders' equity (:1)	8.21	9.38	7.21	7.09	6.24
Allowance for loan losses to loans	0.84%	0.73%	0.38%	0.39%	0.54%
Net Income Distribution					
Estimated patronage refunds and dividends:					
Cash	$ 78,191	$ 101,203	$ 129,698	$ 114,325	$ 98,354
Qualified allocated surplus	20,779	20,734	18,202	27,798	26,391
Nonqualified allocated surplus	45,462	67,605	90,743	92,988	83,420
Nonqualified retained surplus	62,269	65,449	71,700	62,038	73,653
Stock dividends	1,168	1,202	1,133	916	311
Perpetual preferred stock dividend	27,413	27,413	19,501	10,950	10,950

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

The following commentary reviews the Combined Financial Statements of 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, for the years ended December 31, 2009, 2008, and 2007. 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. The accompanying Combined Financial Statements were prepared under the oversight of the Audit Committee of the Bank's Board of Directors. For a list of the Audit Committee members, refer to the "Report of the Audit Committee" included in this Annual Report. See Note 1, *Organization and Operations*, in the Notes to the Combined Financial Statements for a discussion of the operations of the District.

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, and each Association is owned by its borrowers. AgFirst also operates as a cooperative. The District Associations jointly own all of AgFirst's voting stock. 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 District's structure is discussed in Note 1, *Organization and Operations,* in the Notes to the Combined Financial Statements in this Annual Report to shareholders.

As of December 31, 2009, the District consists of the Bank and twenty-two District Associations. All twenty-two are structured as Agricultural Credit Association (ACA) holding companies, with Federal Land Credit Association (FLCA) and Production Credit Association (PCA) subsidiaries. PCAs originate and service short- and intermediate-term loans; FLCAs originate and service long-term real estate mortgage loans; and ACAs originate both long-term and short- and intermediate-term loans. AgFirst provides funding and related services to the District Associations, which, in turn, provide loans and related services to agricultural and rural borrowers. AgFirst has in place with each of the District Associations, a revolving line of credit, referred to as a "Direct Note." Each Association primarily funds its lending and general corporate activities by borrowing through its Direct Note. All assets of the Associations secure the Direct Notes. Lending terms are specified in a separate General Financing Agreement (GFA) between AgFirst and each Association, including the subsidiaries of the 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. The ACB is owned by its related associations as well as other agricultural and rural institutions, including agricultural cooperatives. 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 its Associations, 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 (electronic version of which is available on AgFirst's website at **www.agfirst.com**) that may be referred to for a more complete analysis of AgFirst's financial condition and results of operations.

FORWARD-LOOKING INFORMATION

This Annual Report 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 the District'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, as well as in the general economy;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry and the System as a government-sponsored enterprise, as well as investor and rating agency reactions to events involving other government-sponsored enterprises and other financial institutions; and
- actions taken by the Federal Reserve System in implementing monetary and fiscal policy, as well as other policies and actions of the Federal government that impact the financial services industry and the debt markets.

AGRICULTURAL OUTLOOK

The following United States Department of Agriculture (USDA) analysis provides a general understanding of the U.S. agricultural economic outlook. However, this outlook does not take into account all aspects of the District's business. References to the USDA information in this section refer to the entire U.S. agricultural market and are not limited to the District.

The February 2010 USDA forecast estimates that 2009 farmers' net cash income, which is a measure of the cash income after payment of business expenses, decreased to $70.8 billion, down $26.7 billion from

2008, but only down $2.1 billion from its 10-year average of $72.9 billion. The USDA forecasts 2010 farmer's net cash income to increase to $76.3 billion, a $5.5 billion increase from 2009, and $3.4 billion above the 10-year average. Contributing to this increase in farmers' net cash income are increases in livestock receipts of $11.5 billion and in farm-related income of $900 million, offset by a decrease in crop receipts of $6.0 billion, an increase in cash expenses of $400 million, and a decline in direct government payments of $500 million.

During 2009, crop prices and prices for livestock animals and products declined from 2008 levels. Demand for exports was curtailed and farmers were forced to accept prices lower than previously anticipated. The USDA's 2010 forecast reflects expected improvement in economic conditions for livestock producers. During a recession, consumers limit their consumption of higher cost items such as meat, milk, and eggs, or buy lower priced products. With the U.S. economy stabilizing or showing signs of improvement, consumers are expected to increase consumption of animal products, thus improving earnings of livestock producers.

The following table sets forth the commodity prices per bushel for certain crops and by hundredweight for beef cattle from December 31, 2006 to December 31, 2009:

Commodity	**12/31/09**	**12/31/08**	**12/31/07**	**12/31/06**
Corn	$3.59	$4.11	$3.76	$3.01
Soybeans	$9.80	$9.24	$10.00	$6.18
Wheat	$4.85	$5.95	$7.74	$4.52
Beef Cattle	$78.60	$79.70	$88.90	$83.10

The USDA's February 2010 income outlook shows a great deal of variation depending on farm size, geographic location, and commodity specialties. The USDA classifies all farms into three primary categories: commercial farms, intermediate farms, and rural residential farms. Commercial farms represent about 10 percent of U.S. farms by number and represent 80 percent of total U.S. farm production. Commercial farms are expected to have an 11 percent increase in average net cash income in 2010. Intermediate farms, defined as ones in which the primary occupation is farming and gross sales are between $10 thousand and $250 thousand, represent 30 percent of U.S. farms by number and account for 18 percent of total production. The remaining 60 percent of U.S. farms are classified as rural residential farms where the primary occupation is not farming and the farms produce less than $10 thousand in products. Rural residential farms only account for 2 percent of total production.

In addition to farmers' net cash income, off-farm income is an important source of income for the repayment of farm debt obligations and is less subject to cycles in agriculture. However, off-farm income can be directly affected by conditions in the general economy. The USDA measures farm household income, which is defined as earnings from farming activities plus off-farm income. Nearly 100 percent of farm household income for operators of rural residential farms and more than 90 percent of farm household income for intermediate farms is generated from off-farm sources. Further, USDA data suggests that approximately 25 percent of farm household income for commercial farms is generated from off-farm income. The USDA predicts 2009 farm household income to decrease 15 percent for commercial farms and 19 percent for intermediate farms.

According to the USDA February 2010 forecast, farm sector asset values are expected to decline 3.5 percent from $1.944 trillion in 2009 to $1.876 trillion for 2010, reflecting lower expected returns on farm investments. The values of land, machinery/equipment, and crop inventories are expected to decline in 2010, while the values of financial assets and of purchased input inventories are expected to rise. Farmers' equity (farm business assets minus debt) is expected to decline 3 percent from $1.694 trillion in 2009 to $1.643 trillion in 2010, largely due to the declines in asset values.

One measure of the financial health of the agricultural sector used by the USDA is the assessment of farmers' utilization of their capacity to repay debt (actual debt as a percentage of maximum debt that can be supported by farmers' current income). Higher capacity utilization rates indicate tighter cash flow positions and, consequently, higher exposure to financial risk. These estimates do not take into account, however, off-farm income sources. Since 1970, debt repayment capacity utilization has ranged from a low of 35.8 percent in 1973 to a high of 104.1 percent in 1981, and has remained relatively stable since 1987, averaging about 50.0 percent. During 2009, repayment capacity utilization increased significantly above the 50.0 percent average due to the decline in farmers' net cash income. The USDA suggests a decrease in the use of repayment capacity from 70.0 percent in 2009 to 60.9 percent in 2010.

As estimated by the USDA, the Farm Credit System's market share of farm business debt, defined as debt incurred by those involved in on-farm agricultural production, grew to 39.0 percent at December 31, 2008, as compared with 28.3 percent at December 31, 2000. Farm business debt is forecasted to fall in 2010 from the 2009 level by approximately 6.8 percent. The USDA's forecast of declining debt is due to continued softening of farmland values due to lower expected earnings on farm investments, tighter credit, and greater overall market uncertainty.

In general, agriculture has experienced a sustained period of favorable economic conditions, due to stronger commodity prices, higher land values, and, to a lesser extent, government support programs. To date, the District's financial results have remained favorable as a result of these conditions. Production agriculture, however, remains a cyclical business that is heavily influenced by commodity prices. In an environment of less favorable economic conditions in agriculture and without sufficient government support programs, the District's financial performance and credit quality measures would likely be negatively impacted. Conditions in the general and agricultural economy have become more volatile with the recent instability in the global financial markets and recent declines in commodity prices. Certain agriculture sectors, as described more fully in this *Management Discussion and Analysis*, experienced significant financial stress during 2009 and could continue to experience financial stress in 2010. Any negative impact from these less favorable conditions should be lessened by geographic and commodity diversification and the influence of off-farm income sources supporting agricultural-related debt. However, agricultural borrowers who are more reliant on off-farm income sources may be more adversely impacted by a weakened general economy.

SIGNIFICANT ACCOUNTING POLICIES

The financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. Consideration of the District's significant accounting policies is 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 as well as the recognition of certain income and expense items. In many instances, 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 accounting 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 District's 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.

  Significant individual loans are evaluated based on the borrower's overall financial condition, resources, and payment record; the prospects for support from any financially responsible guarantor; and, if appropriate, the estimated net realizable value of any collateral. The allowance for loan losses 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, and geographic, industry, and other factors. In addition to the allowance for loan losses attributable to specific loans, the District may also establish a general allowance for loan losses based on management's assessment of risk inherent in the loans in the District's portfolio that were not specifically evaluated. In establishing general reserves, factors affecting certain commodity types or industries may be taken into consideration, as well as other factors previously discussed. Certain loan pools purchased by the Bank from various Associations are analyzed in accordance with the selling Associations' allowance methodologies for assigning general and specific allowances. Allowances are established on these pools based on that analysis after Bank management's determination that the methodologies employed are appropriate.

Assessing the appropriateness of the allowance for loan losses is a dynamic process. Changes in the factors considered by management in the evaluation of losses in the loan portfolios could result in a change in the level of the allowance for loan losses and have a direct impact on the provision for loan losses and the results of operations.

The overall adequacy of the allowance for loan losses is validated further based on periodic evaluations of the loan portfolio, which generally consider recent historical charge-off experiences 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.

- *Valuation methodologies* — Management applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when active 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 active market exists. Management utilizes third party valuation services to obtain fair value prices for the majority of the District's investment securities. Management also utilizes significant estimates and assumptions to value items for which an observable active market does not exist. Examples of these items include: impaired loans, certain derivatives, certain investment securities 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 asset or liability values, which could have material positive or negative effects on the District's results of operations.

- *Pensions* — The Bank and its related Associations participate in defined benefit retirement plans. These plans are noncontributory and benefits are based on salary and years of service. In addition, the Bank and its related Associations also participate in defined contribution retirement savings plans. Pension expense for all plans is recorded as part of salaries and employee benefits. Pension expense for the defined benefit retirement plans is determined by actuarial valuations based on certain assumptions, including the expected long-term rate of return on plan assets and a discount rate. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that portfolio of assets. The discount rate is used to determine the present value of future benefit obligations. The discount rate for 2009 was selected by reference to analysis and yield curves developed by the plans' actuary and industry norms. The yield curve selected follows the accounting guidance that the basis for discount rates should be higher-quality zero-coupon bonds with durations that match the expected cash flows of the plans that underlie the obligation.

LOAN PORTFOLIO

The District's aggregate loan portfolio consists primarily of direct loans made by the Associations to eligible borrowers located within their chartered territories. Diversification of the loan volume by type for each of the past three years at December 31 is illustrated in the following table:

Loan Types *(dollars in thousands)*	**2009**		**2008**		**2007**	
Real Estate Mortgage	$ 9,870,486	43%	$ 9,425,181	41%	$ 8,740,114	42%
Production and Intermediate-Term	8,270,399	36	8,556,501	37	7,817,587	38
Rural Residential Real Estate	2,007,563	9	1,682,845	7	1,407,501	7
Processing and Marketing	1,652,286	7	1,945,207	8	1,510,538	7
Loans to Cooperatives	355,392	2	318,817	2	320,154	2
Farm-Related Business	353,353	2	492,446	2	481,404	2
Energy	352,446	2	241,956	1	199,096	1
Communication	185,261	1	247,364	1	122,825	1
Water and Waste Disposal	28,000	–	28,000	–	19,999	–
Lease Receivables	15,871	–	13,385	–	19,721	–
Loans to OFIs	7,000	–	7,150	–	2,220	–
Other (including Mission Related)	110,132	–	118,884	1	87,137	–
Total	$ 23,208,189	100%	$ 23,077,736	100%	$ 20,728,296	100%

Total loans outstanding were $23.21 billion at December 31, 2009, an increase of $130.5 million, or 0.56 percent, compared to total loans outstanding at December 31, 2008. Loans outstanding at the end of 2008 had increased $2.35 billion, or 11.33 percent, compared to December 31, 2007. In late 2008, the District's loan demand, which had been very strong for several years, slowed dramatically. This trend continued into 2009, resulting in no material change in total loans outstanding over the latest twelve month period.

The downturn in the general economy that started in 2008 continued into 2009 and served to weaken overall loan demand with borrowers limiting capital spending and preserving capital. Lower commodity price levels coupled with cost cutting measures have also resulted in lesser loan demand in several segments. Future loan demand is difficult to predict. However, the growth rate of the loan portfolio is expected to remain at a moderate level through the first half of 2010.

Credit quality deterioration, which began in the second quarter 2008 and continued in 2009, was caused by a number of factors. The primary factors were: higher input costs for the meat and ethanol sectors which began moderating in 2009, over supply for the pork and dairy sectors, and the restrictive effects of the recession on the general economy, including housing and employment. The ethanol sector is improving due to lower input costs. However, the pork and housing-related industries (timber, sawmills, nurseries, etc.) remain stressed. Oversupply in the pork and dairy sectors seems to be easing, and conditions are expected to improve in 2010 after a very difficult 2009.

Declining real estate values in 2009 negatively impacted the credit quality of certain loans secured by transitional agricultural real estate. Transitional agricultural real estate is defined as agricultural land, usually lying in the path of economic development, where the land value cannot be supported solely by agricultural activity.

The District employs a number of risk management techniques to limit credit exposures. The District has adopted underwriting standards, individual borrower exposure limits, commodity exposure limits, and other risk management techniques. AgFirst and the Associations actively purchase and sell loan participations to achieve diversified portfolios. The District utilizes guarantees from U.S. government agencies/departments, including the Federal Agricultural Mortgage Corporation (Farmer Mac), the Farm Service Agency, and the Small Business Administration to further limit credit exposures. At December 31, 2009, the District collectively had $2.94 billion under such government or government-sponsored enterprise (GSE) guarantee programs, compared to $2.57 billion at December 31, 2008.

Each loan in the District's portfolio is classified according to a 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 of District loans showed a decline during the twelve months ended December 31, 2009. The following table presents selected statistics related to the credit quality of District loans including accrued interest at December 31:

Credit Quality	2009	2008	2007
Acceptable	87.17%	92.23%	95.89%
OAEM	5.98	3.88	2.63
Adverse*	6.85	3.89	1.48
Total	100.00%	100.00%	100.00%

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

Weakness continues in the housing related segments of the portfolio which includes: lumber and building product companies, timber producers, landscape and sod nurseries, and borrowers with significant real estate debt. Significant increases in housing starts and a sustained recovery in the general economy are needed to improve the financial capacity of these borrowers.

The ethanol industry experienced stress due to rapidly changing commodity prices, especially corn, declining fuel consumption, and excess production capacity. This combination of factors forced a number of ethanol producers into bankruptcy resulting in consolidation in the industry. Much of the District's ethanol exposure that was previously distressed has now been sold to new buyers and the debt refinanced or restructured. The trend is positive. However, some weakness will remain in this segment until these borrowers rebuild the strength of their balance sheets. The District's total exposure to the ethanol industry at December 31, 2009 included $240.7 million of loans outstanding and $31.8 million of commitments to extend credit. At December 31, 2009, the District had a loan loss reserve allowance of $21.5 million related to loans in its ethanol portfolio.

Loan portfolio credit quality was adversely affected by deteriorating economic conditions, including lower real estate values, in certain geographic areas within the District's footprint, particularly in Florida. The Florida economy slowed after an extended period of significant growth for many years led by increasing real estate values and net population inflows. In 2008 and continuing into 2009, real estate values declined, population growth slowed, and housing foreclosures increased. Sales of real estate in Florida, even at greatly reduced values, have been slow in 2009 and foreclosures have been high. Other areas of the District have fared better with less reduction in real estate values but sales continue to be slow throughout.

Continued weakness in the general economy and the resulting high rate of unemployment could further compromise the credit quality of part-time farmers and certain other segments of the loan portfolio. Many borrowers who have historically had stable income from non-farm sources such as stock portfolios and capital gains income from traded assets have seen reductions in these income sources. The District is routinely reevaluating the credit-worthiness of its borrowers and anticipates that credit quality in 2010 will continue to be negatively impacted by general economic conditions.

Other major segments of the District loan portfolio continue to perform well, including the sugar, poultry, and row crop segments.

Delinquencies (loans 90 days or more past due) were 1.42 percent of total loan assets at year-end 2009 compared to 0.65 percent and 0.31 percent at year-end 2008 and 2007, respectively.

Nonperforming assets for the District represented 3.66 percent of total loan assets or $860.0 million, compared to 2.51 percent or $584.1 million for 2008, and 0.55 percent or $115.0 million for 2007. Nonperforming assets consist of nonaccrual loans, accruing restructured loans, accruing loans 90 days or more past due, and other property owned.

District net loan charge-offs of $136.9 million, $30.8 million and $1.3 million were recognized in 2009, 2008 and 2007, respectively. As a percentage of total average loan assets, net charge-offs for the District were 0.58 percent for 2009, compared to 0.14 percent and 0.01 percent in 2008 and 2007, respectively. The Bank and each Association maintains an allowance for loan losses, determined by its management, based upon its unique situation.

The Associations primarily serve all or a portion of fifteen states and Puerto Rico. Additionally, AgFirst and the Associations actively purchase and sell 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 District's loan volume outstanding by state for the past three years at December 31:

District Loan Volume by State

State	2009	2008	2007
North Carolina	15%	14%	15%
Florida	14	15	15
Georgia	12	12	12
Virginia	9	10	10
Pennsylvania	9	9	9
Maryland	6	6	6
South Carolina	5	5	6
Ohio	5	4	4
Alabama	3	3	3
Kentucky	3	3	2
Delaware	2	2	2
Mississippi	2	2	2
West Virginia	2	2	2
California	2	2	2
Texas	2	2	2
Tennessee	1	2	1
Louisiana	1	1	1
Vermont	1	-	-
Puerto Rico	1	1	1
Minnesota	1	1	1
New York	1	1	1
Colorado	1	1	1
Missouri	1	1	–
Other	1	1	2
Total	100%	100%	100%

Only three states have 10.00 percent or more of the total volume. Commodity diversification, guarantees, and borrowers with significant reliance on non-farm income further mitigate the geographic concentration risk in these states.

The diversity of commodity types and income sources supporting loan repayment mitigates credit risk to the District. The District's credit portfolios are comprised of a number of segments having varying, and in some cases complementary, 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 illustrates the aggregate credit portfolio of the District by major commodity segments at December 31:

	Percent of Portfolio		
Commodity Group	**2009**	**2008**	**2007**
Forestry	12%	13%	13%
Poultry	10	10	11
Fruits and Vegetables	9	9	9
Rural Home	9	7	7
Cattle	7	7	7
Processing	6	7	7
Other Real Estate	6	6	6
Dairy	5	5	5
Grain	5	4	4
Nursery/Greenhouse	4	5	5
Lumber	4	4	4
Swine	3	3	3
Tobacco	2	2	2
Cotton	2	2	2
Citrus	2	2	2
Corn	2	2	2
Other	12	12	11
Total	100%	100%	100%

Diversification is further enhanced by a prevalence of non-farm income among the borrowers, as demonstrated by the following table as of December 31 of each year, which segregates part-time farm loans into a unique segment. Part-time farming is defined as farming not being the primary business or vocation of the applicant with agricultural operations representing less than 50 percent of their total business income.

	Percent of Portfolio		
Commodity Group	**2009**	**2008**	**2007**
Part-time Farmers	30%	31%	33%
Poultry	9	9	9
Rural Home	8	7	6
Forestry	7	6	5
Fruits and Vegetables	5	5	5
Dairy	5	5	5
Processing	4	4	5
Nursery/Greenhouse	4	4	4
Grain	4	3	2
Swine	3	3	3
Cattle	3	3	3
Cotton	2	2	2
Tobacco	2	2	2
Citrus	2	2	2
Other Real Estate	2	2	1
Corn	2	2	1
Lumber	1	1	3
Other	7	9	9
Total	100%	100%	100%

As illustrated in the above chart, the District had concentrations of *full-time farmers* of 5.00 percent or greater in only five commodities at December 31, 2009: poultry, rural home, forestry, fruits/vegetables, and dairy. All five commodities have a large geographic dispersion with production over the entire District footprint. Also, many poultry, dairy, forestry, and fruit/vegetable producers have significant secondary income from off-farm employment by a family member.

Concentrations within the District are further limited 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 dispersed as production is segregated between chicken, turkey, and egg production. Dairy herds range in size from less than one hundred cows to approximately ten thousand.

Associations also manage credit and concentration risk through participations, guarantees, and direct payment assignments from the poultry integrators and milk processing facilities. Most recently, certain commodity prices, including oil and grain, have moderated and should prove beneficial to meat complex producers, including poultry, going forward.

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 District footprint and is utilized as 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.

The fruits/vegetables portion of the aggregate Association portfolio is made up of a diverse group of many different fruits and vegetables grown throughout the District footprint. The volume is spread broadly over the base of Associations.

The following table illustrates the District loan volume outstanding based on the dollar size of the borrower relationships at December 31, 2009:

District Loan Volume Gross Loans Outstanding Per Borrower

$ Range (in thousands)	% of Total
$1-$250	34.05 %
$251-$500	16.24
$501-$1,000	13.52
$1,001-$5,000	22.56
$5,001-$25,000	11.69
$25,001-$100,000	1.94
Over $100,000	0.00
Total	**100.00 %**

Loans greater than $5.0 million per borrower comprise only 13.63 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 Association's own lending staff prior to the Association committing to such loans.

Loans under $500 thousand comprise 50.29 percent of outstanding loan volume, and loans less than $250 thousand make up approximately 34.05 percent of loan volume. This diversification across a large number of borrowers is another key component of the District's credit risk diversification and solid financial performance over time.

Typically, multiple 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, 2009, 42.53 percent of the District loans were identified as secured by a first lien on real estate. Exposure to losses is reduced through collateralization and other credit enhancements, including federal government guarantees.

MISSION RELATED INVESTMENTS

The FCA initiated a program in 2005 to allow System institutions to make and hold investments that stimulate economic growth and development in rural areas. The investments are subject to approval by the FCA on a case-by-case basis. FCA approved the Rural Housing Mortgage-Backed Securities pilot program and the Rural America Bonds pilot program as described below. The FCA also approved System participation in the Tobacco Buyout Program as described below.

Rural Housing Mortgage-Backed Securities

Rural Housing Mortgage-Backed Securities (RHMS) must be fully guaranteed by a government agency or GSE. The rural housing loans backing the RHMS 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, or eligible rural housing loans originated by System lenders under FCA Regulations. Investment securities at December 31, 2009 included $1.24 billion in RHMS classified as held-to-maturity, compared to $1.49 billion at December 31, 2008. In November 2009, the FCA approved a continuation of the RHMS program for another three years.

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 residents. As of December 31, 2009, the District had $289.6 million in the Rural America Bond program, compared to $236.7 million at December 31, 2008. Of the $289.6 million, the District had $189.9 million reflected in investment securities and $99.7 million reflected as loans on the Combined Balance Sheets at December 31, 2009. The FCA approved a continuation of the program at October 31, 2008 for an as yet undetermined time period.

Tobacco Buyout Program

On October 22, 2005, Congress enacted the "Fair and Equitable Tobacco Reform Act of 2005" (Tobacco Act) as part of the "American Jobs Creation Act of 2005." 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, 2006, 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, 2009, District Associations held Tobacco Buyout loan assignments of $64.3 million, which are reflected as loans on the Combined Balance Sheets, compared to $73.5 million at December 31, 2008. The District Associations also purchased Successor-in-Interest Contracts (SIIC) which totaled $367.5 million, and were reflected as other investments on the Combined Balance Sheets at December 31, 2009, compared to $410.3 million at December 31, 2008.

FARMER MAC

At December 31, 2009, AgFirst owned $11 million of Farmer Mac senior cumulative perpetual preferred stock, series B-1, which was redeemed in full by Farmer Mac in January 2010. Also at December 31, 2009, AgFirst owned $840 thousand of class B voting restricted common stock, $392 thousand of class C non-voting unrestricted stock, $12.8 million of Farmer Mac MBS investment securities and had $133.4 million of loans guaranteed by Farmer Mac. District Associations had $203.1 million of loans guaranteed by Farmer Mac at December 31, 2009.

RISK MANAGEMENT

Overview

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

Types of risks to which the District has exposure include:

- *structural risk* — risk inherent in the business and related to the System structures comprised of interdependent networks of cooperative 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 District's 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 federal and state governments.

Structural Risk Management

Structural risk results from the fact that AgFirst, along with its related 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. Although capital at the association level reduces the banks' credit exposures with respect to their related associations, that capital may not be available to support the payment of principal and interest on Systemwide Debt Securities.

In order to mitigate this risk, the System utilizes two integrated contractual agreements executed by and among the banks— the Amended and Restated Contractual Interbank Performance Agreement (CIPA) and the Amended and Restated Market Access Agreement (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 each district's and bank's 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 oversight 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, the investment portfolio and derivative counterparty credit exposures. The District manages credit risk associated with lending activities through an assessment of the credit risk profile of an individual obligor. The Bank and Associations set their own underwriting standards and lending policies that provide direction to loan officers and are approved by the respective boards of directors.

The credit risk management process begins with an analysis of the obligor's credit history, repayment capacity and financial position. Repayment capacity focuses on the obligor's ability to repay the obligation 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.

The credit risk rating process for loans 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).

Through their participation in loans or interests in loans to/from other institutions within the System and outside the System, the Bank and District Associations limit their exposure to both borrower and commodity concentrations. This also allows the Bank and District Associations 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's loan portfolio is divided into performing and high-risk categories. Although there was credit quality deterioration in 2009, due to the credit risk management process, the District's high-risk assets continue to be a small percentage of the total loan volume and total assets. The high-risk assets, including accrued interest, at December 31 are detailed in the following table:

(dollars in thousands)	2009	2008	2007
High-risk Assets			
Nonaccrual loans	$ 769,651	$ 551,455	$ 98,052
Restructured loans	3,922	1,040	5,508
Accruing loans 90 days past due	13,119	17,387	2,946
Total high-risk loans	786,692	569,882	106,506
Other property owned	73,354	14,228	8,504
Total high-risk assets	$ 860,046	$ 584,110	$ 115,010
Ratios			
Nonaccrual loans to total loans	3.29%	2.37%	0.47%
High-risk assets to total assets	2.57%	1.80%	0.39%

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 increased $218.2 million, net of charge-offs and transfers to other property owned, in 2009 primarily due to nine borrower relationships in the ethanol, other real estate, forestry, and swine industries, which in total comprise 26.37 percent of the total nonaccrual loan balance at December 31, 2009. The ten largest nonaccrual loan relationships accounted for 36.21 percent of the total nonaccrual balance at December 31, 2009. These ten largest nonaccrual relationships were in the forestry (20.78 percent of the ten largest total), ethanol (18.92 percent), other real estate (14.55 percent), swine (13.33 percent), cattle (12.16 percent), winery (11.30 percent), and citrus (8.96 percent) industries. Some of these nonaccrual loans are secured by transitional agricultural real estate, which has been negatively impacted by declining real estate values as discussed above. Nonaccrual loans were 3.29 percent of total loans outstanding at December 31, 2009. District management reviews, on an ongoing basis, the District's acceptable level of risk tolerance at the individual loan and portfolio levels. Management makes adjustments to credit policy and underwriting standards when appropriate as a part of the ongoing risk management process.

Restructuring of loans occurs when concessions are granted to borrowers based on either a court order or assessment of the borrower's ability to return to financial viability. The concessions can be in the form of a modification of terms, rates, or a compromise of amounts owed. Acceptance of other assets and/or equity as payment may also be considered a concession. The type of alternative financing structure chosen is based on minimizing the loss incurred by both the lender and the borrower.

Other property owned (OPO) consists primarily of assets once held as loan collateral that were acquired through foreclosure or deeded to the Bank and District Associations (or a lender group) in satisfaction of secured loans. Traditionally, OPO is primarily in the form of real estate. However, it can also include equipment and equity interests in companies or partnerships. OPO increased $59.1 million during 2009 and totaled $73.4 million at December 31, 2009. This increase is primarily due to $139.1 million of properties that were transferred into OPO from nonaccrual loans, offset by OPO sales of $75.7 million (primarily $44.3 million of ethanol assets). Ethanol production facilities account for $7.7 million (10.45 percent) of the District's total OPO holdings at December 31, 2009. Total gains of $12.7 million from six ethanol production facilities disposed of through financed sales during 2009 were deferred and will be recognized in future periods in accordance with accounting guidance. See discussion of OPO expense in the Noninterest Income section below.

Although neither the Bank nor any other System institution receives any direct government support, credit quality is indirectly enhanced by government support in the form of program payments to borrowers, which improve 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 District Associations.

Interest Rate Risk Management

The objective of interest rate risk management is to generate an adequate level of net interest income in any interest rate environment. AgFirst uses a variety of analytical techniques to manage the complexities associated with offering numerous loan options. Interest rate sensitivity gap analysis is used to monitor the repricing characteristics of the District's interest-earning assets and interest-bearing liabilities. Simulation analysis is used to determine the potential change in net interest income and in the market value of equity under various possible future market interest rate environments.

The District adheres to a philosophy that 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, District Association variable rate and adjustable rate loans are generally 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 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, 2009:

Net Interest Income
(dollars in thousands)

Scenarios	Net Interest Income	% Change
+4.0% Shock	$875,156	16.90%
+2.0% Shock	$846,741	13.10%
Base line	$748,634	– %
-50% of 3M Tbill **	$745,344	(0.44)%

Market Value of Equity
(dollars in thousands)

Scenarios	Assets	Liabilities	Equity*	% Change
Book Value	$33,363,836	$30,333,900	$3,029,936	– %
+4.0% Shock	$31,037,591	$28,726,776	$2,310,815	(21.45) %
+2.0% Shock	$32,255,555	$29,583,915	$2,671,640	(9.18) %
Base line	$33,442,674	$30,500,901	$2,941,773	– %
-50% of 3M Tbill**	$33,455,073	$30,514,206	$2,940,867	(0.03) %

* *For interest rate risk management, the $400.0 million in perpetual preferred stock is included in liabilities rather than equity.*

** *When the three-month Treasury bill interest rate is less than 4 percent, both the minus 200 and minus 400 basis point shocks are replaced with a downward shock equal to one-half of the three-month Treasury bill rate.*

The following table sets forth the repricing characteristics of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2009. The amount of assets and liabilities shown in the table, 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
Floating Rate Loans					
Adjustable/Indexed Loans	$ 6,686,207	$ 119,660	$ 149,693	$ 33,919	$ 6,989,479
Fixed Rate Loans					
Fixed Rate Loans	275,307	137,498	290,432	17,709	720,946
Fixed Rate Prepayable	6,011,454	2,786,988	4,890,894	1,808,428	15,497,764
Total Loans	12,972,968	3,044,146	5,331,019	1,860,056	23,208,189
Total Investments *	4,524,681	935,774	2,130,550	1,084,116	8,675,121
Other Earning Assets	73,492	–	293,969	–	367,461
TOTAL INTEREST EARNING ASSETS	**$17,571,141**	**$ 3,979,920**	**$7,755,538**	**$2,944,172**	**$32,250,771**
Interest-Bearing Liabilities					
Systemwide bonds and notes	$ 16,611,677	$ 5,031,836	$ 6,022,000	$ 1,028,500	$ 28,694,013
Other interest-bearing liabilities	208,089	–	–	225,000	433,089
Interest Rate Swaps	1,273,000	(188,000)	(835,000)	(250,000)	–
TOTAL INTEREST-BEARING LIABILITIES	**$18,092,766**	**$ 4,843,836**	**$5,187,000**	**$1,003,500**	**$29,127,102**
Interest Rate Sensitivity Gap	**$ (521,625)**	**$ (863,916)**	**$2,568,538**	**$1,940,672**	
Sensitivity Gap as % of Total Earning Assets	(1.62)%	(2.68)%	7.96%	6.02%	
Cumulative Gap	$ 521,625	$(1,385,541)	$1,182,997	$3,123,669	
Cumulative Gap as a % of Total Earning Assets	(1.62)%	(4.30)%	3.67%	9.69%	
Rate Sensitive Assets/Rate Sensitive Liabilities	0.97	0.82	1.50	2.93	

** includes cash equivalents*

At December 31, 2009, the Repricing/Maturity Gap showed the District is liability sensitive out to one year as repricing/maturing debt exceeded assets that mature or reprice during that time period. However, the Gap position reflected indicates the District has a low level of interest rate sensitivity. This liability sensitive position is due in part to the low interest rate environment at the end of 2009, which resulted in a significant portion of the District's fixed-rate debt, including debt with call options, subject to repricing during the one year time period. Callable debt may be called prior to scheduled maturity and replaced at lower interest levels. Liability sensitivity implies an increase in net interest income in falling interest rate scenarios and lower net interest income in rising interest rate scenarios.

The Repricing/Maturity Gap Analysis is a "point in time" view and is representative of the interest rate environment at December 31, 2009. This limitation of the Repricing/Maturity Gap Analysis is recognized as the maturity and repricing attributes of balance sheet accounts react differently to changing interest rate environments. During a period of rising interest rates, call options on fixed rate debt are not exercised and the debt terms extend to reflect the longer original maturity dates. Prepayment optionality on fixed rate assets also slows as the economic incentive for borrowers to refinance decreases and extends the asset's term. The results of simulation analysis on the District balance sheet as shown in the table above for projected change in net interest income indicates that the extension of debt maturity/repricing occurs at a faster pace than the extension of assets. This resulted in the balance sheet having a projected asset sensitive position in a rising interest rate scenario and subsequently an increase in net interest income. In a falling interest rate scenario, the balance sheet maturity/repricing position is relatively neutral with a small increase in net interest income.

At December 31, 2009, AgFirst had outstanding interest rate swaps with notional amounts totaling $1.4 billion. All of these derivative transactions were executed to create synthetic floating-rate debt to achieve a lower cost of funding. Derivatives may also be used by the Bank for asset/liability management purposes to reduce interest rate risk.

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, 2009:

Notional amounts *(dollars in millions)*	**Receive Fixed**
Balance at December 31, 2008	$ 2,223
Additions	100
Maturities/amortizations	(750)
Terminations	(200)
Balance at December 31, 2009	$ 1,373

Liquidity Risk Management

AgFirst and the District Associations maintain adequate liquidity to satisfy the District's daily cash needs. Along with normal cash flow associated with lending operations, the District has two primary sources of liquidity: investments, including its available-for-sale portfolio; and the capacity to issue Systemwide Debt Securities. The Bank also maintains several lines of credit with commercial banks, as well as three securities repurchase agreement facilities. Providing liquidity for the District's operations is primarily the responsibility of the Bank.

Investments and Cash and Cash Equivalents

Investment securities and cash and cash equivalents outstanding as of December 31, 2009 for the District totaled $9.42 billion compared to $8.48 billion and $7.67 billion at December 31, 2008 and 2007, respectively. The increase in 2009 was primarily due to efforts to enhance liquidity. Some of the increase in both years was due to management's decision to increase the size of the investment securities portfolio in line with loan growth.

Cash and cash equivalents, which increased $665.0 million from December 31, 2008 to a total of $981.0 million at December 31, 2009, are primarily cash on deposit and money market securities that are short term in nature (from overnight maturities to maturities that range up to 90 days). Money market securities must carry one of the two highest short-term ratings from a rating agency. Cash balances were increased to improve the liquidity position of the Bank.

Investment securities totaled $8.44 billion, or 25.27 percent of total assets at December 31, 2009, compared to $8.17 billion, or 25.20 percent, as of December 31, 2008. Investment securities increased $275.2 million, 3.37 percent, compared to December 31, 2008 primarily as management maintained the investment securities portfolio size proportionate with that of the loan portfolio in order to maintain adequate liquidity.

The District's investment portfolio and cash and cash equivalents consisted of the following security types as of December 31:

District Investment Securities and Cash and Cash Equivalents

(dollars in thousands)	**2009**		**2008**		**2007**	
Investment Securities						
Available for Sale						
U.S. Govt. GNMA MBS/CMOs	$ 3,857,159	45.69%	$ 3,245,283	39.73%	$ 1,754,553	24.85%
U.S. Govt. Agency MBS	2,573,375	30.48	2,533,993	31.03	3,062,041	43.37
Non-Agency Securities	360,026	4.26	404,321	4.95	636,559	9.02
Asset-Backed Securities	85,896	1.02	95,963	1.18	183,680	2.60
Commercial MBS	9,814	.12	11,767	0.14	4,597	0.06
Total Available for Sale	$ 6,886,270	81.57	$ 6,291,327	77.03	$ 5,641,430	79.90
Held to Maturity						
Rural Housing MBS	$ 1,237,233	14.66	$ 1,494,837	18.30	$ 1,124,855	15.93
MBS Guaranteed by Farmer Mac	12,818	0.15	15,355	0.19	16,946	0.24
Other Asset-Backed Securities	96,580	1.14	131,877	1.62	115,983	1.64
Mission Related Investments	209,329	2.48	233,630	2.86	161,587	2.29
Total Held to Maturity	1,555,960	18.43	1,875,699	22.97	1,419,371	20.10
Total Investment Securities	$ 8,442,230	100.00%	$ 8,167,026	100.00%	$ 7,060,801	100.00%
Cash and Cash Equivalents						
Cash	$ 748,150	76.26%	$ 46,380	14.68%	$ 68,964	11.25%
Fed Funds	–	–	–	–	183,659	29.97
Master Notes	86,690	8.84	82,000	25.95	85,218	13.91
Repos	146,201	14.90	187,630	59.37	275,000	44.87
Total Cash and Cash Equivalents	$ 981,041	100.00%	$ 316,010	100.00%	$ 612,841	100.00%
Total Investment Securities and Cash and Cash Equivalents	$ 9,423,271		$ 8,483,036		$ 7,673,642	

As of December 31, 2009, AgFirst exceeded all applicable regulatory liquidity requirements. 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 eligible available-for-sale investments, cash, and other highly liquid assets maintained by the Bank. At December 31, 2009, AgFirst's coverage was 151 days. Cash provided by the Bank's operating activities, primarily generated from net interest income in excess of operating expenses and maturities in the loan portfolio, is an additional source of liquidity for the Bank that is not reflected in the coverage calculation of 151 days.

FCA regulations also provide that a System bank may hold certain eligible investments in an amount not to exceed 35.00 percent of its total loans outstanding. These investments serve to provide liquidity to the Bank's operations, to manage short-term funds, and to manage interest rate risk. AgFirst maintains an investment portfolio for these purposes comprised primarily of short-duration, high-quality investments. At year-end 2009, the Bank's eligible investments were 33.60 percent of the total loans outstanding.

The District also 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 the FCA as Mission Related Investments. The vast majority of this portfolio is comprised of Mission Related Investments for a program to purchase RHMS, not to exceed 10.00 percent of total outstanding loans (see *Mission Related Investments* section above). Certain Associations also hold investment securities in AAA-rated asset-backed securities guaranteed by the United States Government or a United States Government agency. District investment securities classified as being held-to-maturity totaled $1.56 billion at December 31, 2009.

Investment securities classified as being available-for-sale totaled $6.89 billion at December 31, 2009. Available-for-sale investments at December 31 2009 included $3.86 billion in Agency Collateralized Mortgage Obligations (CMOs), $2.57 billion in Agency Adjustable Rate Mortgages, $360.0 million in non-agency CMOs, $85.9 million in asset-backed securities, and $9.8 million in commercial mortgage backed securities. Since the majority of the portfolio is invested in agency securities, the portfolio is highly liquid and potential credit loss exposure is limited.

Total net unrealized losses relating to the available-for-sale securities decreased $235.7 million during the twelve months ended December 31, 2009 to a total of $121.9 million at December 31, 2009. These net unrealized losses are reflected in Accumulated Other Comprehensive Income (AOCI) in the Financial Statements. The net unrealized losses stem from both normal market factors such as the current interest rate environment and some continued illiquidity in certain mortgage debt security markets. The District also recognized credit-related losses of $26.5 million for other-than-temporary impairment during the twelve months ended December 31, 2009 on asset-backed securities and non-agency CMO securities in its portfolio as discussed below, which reduced net income.

District available-for-sale asset-backed securities totaled $85.9 million at December 31, 2009. The District has low exposure to investments backed by subprime mortgages. Asset-backed securities with subprime exposure were in the Bank's portfolio only and totaled $47.5 million, which represented 0.69 percent of the available-for-sale liquidity investment portfolio and 0.56 percent of the total investment security portfolio at December 31, 2009. The amortized cost of these particular investment securities totaled $67.2 million and the negative market value adjustment for asset-backed securities of $19.9 million was included in the total $121.9 million of net unrealized losses reflected in AOCI at December 31, 2009. The District's asset-backed securities not rated in the highest category (AAA/Aaa) by at least one of the Nationally Recognized Statistical Rating Organizations (NRSROs) at December 31, 2009, totaled $35.8 million (amortized cost value of $54.2 million). Despite the uncertainty in the mortgage securities markets, which has adversely impacted the market value of all asset-backed securities, all but three of these securities, on which there were $5.7 million in payment shortfalls during 2009, continue to perform.

Non-agency CMOs have also experienced significant market pricing volatility. District non-agency CMOs totaled $360.0 million, which represented 5.23 percent of the available-for-sale liquidity investment portfolio and 4.26 percent of the total investment security portfolio at December 31, 2009. The amortized cost of these investment securities totaled $460.9 million and the negative market value adjustment for non-agency CMOs of $100.9 million was included in the total $121.9 million of net unrealized losses reflected in AOCI at December 31, 2009 as discussed above. The District's non-agency CMO securities not rated in the highest category (AAA/Aaa) by at least one of the NRSROs at December 31, 2009 had a total fair value of $185.7 million and an amortized cost of $243.8 million.

The FCA considers asset-backed and mortgage-backed investment securities rated below AAA/Aaa by the NRSROs to be ineligible and requires System institutions to divest their portfolios of such investments. However, System institutions may seek approval to continue to hold these investments. For each of the investment securities in the District's portfolio at December 31, 2009 rated below AAA/Aaa (total fair value of $221.5 million and amortized cost of $298.0 million), the District has developed and submitted plans for approval by the FCA that provide that the securities may continue to be held. The FCA has approved with conditions the District's plans for all except those investments that have most recently become ineligible, which the FCA is still in the process of reviewing. For purposes of the permanent capital, total surplus, and core surplus regulatory ratios, certain Bank ineligible securities at December 31, 2009 are risk weighted 200 percent, 100 percent or 50 percent instead of the standard 20 percent in calculating the risk adjusted assets amount. These ineligible securities had a fair value of $82.2 million and amortized cost of $107.1 million. Other ineligible securities, including one held by an Association, must be deducted completely from both capital and risk adjusted assets, based on the extent of their below investment grade rating from NRSROs. These securities had a fair value of $139.3 million and amortized cost of $190.9 million at December 31, 2009. For purposes of the net collateral ratio, all ineligible investments are stated at lower of cost or market. See the *Capital* section below for further discussion of the regulatory ratios. In addition, all ineligible investments are excluded from liquidity coverage as defined above.

District institutions perform periodic credit reviews, including other-than-temporary impairment analysis, on their entire investment securities portfolios. Additional analysis for each security not rated in the top category by the NRSROs is performed using a cash flow model with key assumptions and performance factors which may include credit default rate, prepayment rate, and loss severity. The objective is to quantify any future possible loss of principal or interest due on each identified security. The credit enhancements specific to the individual security are considered as appropriate, and may include monoline credit insurance, subordination, over-collateralization and excess interest spread. Asset-backed securities covered by insurers are analyzed with insurance and without, to quantify the extent of reliance on their guarantee. Based on the results of all analyses, the District recognized other-than-temporary credit related impairment of $26.5 million on asset-backed securities and non-agency CMOs in its portfolio during the twelve months ended December 31, 2009, which was included in Net Impairment Losses on Investments in the Statements of Income. Credit loss is defined as the shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis.

For all other investments, the District has not recognized any other-than-temporary impairment as it has determined that the decline in market value was caused primarily by reduced liquidity in the mortgage securities markets or other normal market factors. The District has the ability and intent to hold these investments until a recovery of unrealized losses occurs, which may be at maturity, and at this time expects to collect the full principal amount and interest due on these securities.

For purposes of determining the fair values of the modeled securities and the resulting unrealized gain/loss impact through AOCI, the Bank considers both a price or "mark" provided by a third party pricing service and also a value determined using the results of a modeling process. The Bank reviews and periodically discusses with the third party pricing service and valuation experts the assumptions used in their pricing models for the asset-backed and non-agency CMO securities impacted by inactive trading or distressed sales. This process ensures that, when relevant observable inputs are not available, the fair value reported for each security fairly reflects the price expected to be received in an orderly transaction that is not a forced liquidation or distressed sale at the measurement date. The modeling process was factored into the pricing for the asset-backed and non-agency CMO security portfolios of the Bank.

New accounting guidance issued by the Financial Accounting Standards Board (FASB) in April 2009 impacted the amount of security impairment exposure and the overall valuation of the District's security portfolio at

December 31, 2009. See Note 2, *Summary of Significant Accounting Policies*; Note 3, *Investment Securities*; and Note 17, *Fair Value Measurement* in the Notes to the Financial Statements for further information.

Systemwide Debt Securities

AgFirst's primary source of liquidity comes from its 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 its mission to provide credit and related services to the rural and agricultural sectors, to repay maturing Systemwide Debt Securities, and to meet other obligations. As a GSE, AgFirst has access to the nation's and world's debt and capital markets. This access has provided AgFirst with a dependable source of competitively priced debt that is critical to support its mission. 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+, respectively. These rating agencies base their ratings on many quantitative and qualitative factors, including the System's GSE status. Material changes to the factors considered could result in a different debt rating. Despite some continuing adversity in the financial debt markets, 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 the System's, District's, and Bank's needs. The U.S. government does not guarantee, directly or indirectly, Systemwide Debt Securities.

AgFirst's year-to-date average balance of Systemwide Debt Securities at December 31, 2009, was $27.96 billion. At December 31, 2009, AgFirst had $28.69 billion in total System debt outstanding compared to $28.05 billion at December 31, 2008 and $24.85 billion at December 31, 2007. The year-to-year increases were primarily due to the increases in loan volume and the investment portfolio.

AgFirst's participation in outstanding Systemwide Debt Securities as of December 31, 2009 is shown in the following table:

	Bonds		Discount Notes		Total	
Maturities	Amortized Cost	Weighted Average Interest Rate	Amortized Cost	Weighted Average Interest Rate	Amortized Cost	Weighted Average Interest Rate
			(dollars in thousands)			
2010	$ 9,421,011	0.87%	$ 4,517,536	0.41%	$ 13,938,547	0.72%
2011	5,973,495	1.20	-	-	5,973,495	1.20
2012	2,114,199	1.96	-	-	2,114,199	1.96
2013	1,967,189	2.83	-	-	1,967,189	2.83
2014	1,076,936	3.19	-	-	1,076,936	3.19
2015 and after	3,623,647	4.19	-	-	3,623,647	4.19
Total	$ 24,176,477	1.81%	$ 4,517,536	0.41%	$ 28,694,013	1.59%

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

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

Notes Payable to Other System Banks

In 2008, the Bank sold a total of $200.0 million of participations in its direct note receivable from a District Association to another System Bank. The $200.0 million at December 31, 2009 is included in Bonds and Notes in the Combined Balance Sheets and bears interest at an annual variable rate of one month LIBOR plus 47 basis points with maturity on December 31, 2010.

Lines of Credit

AgFirst maintains a $150.0 million unsecured committed line of credit facility from its primary commercial depository bank. The line of credit is tied to AgFirst's master cash management clearing account. This facility allows AgFirst to better manage its exposure to the commercial bank and short term funding activity. AgFirst pays unused commitment fees for this credit facility. The facility has a one-year term with renewal provisions. The current period maturity date is September 30, 2010.

The Bank has securities repurchase agreement facilities with three commercial banks that can range in terms from overnight to six months. Also, AgFirst has overnight Fed Funds lines of credit with three commercial banks. Both the repurchase agreements and Fed Funds lines are maintained on an uncommitted basis.

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's and the Associations' boards of directors are required, by regulation, to adopt internal control policies that provide adequate direction to their respective institutions in establishing effective control over and accountability for operations, programs, and resources. The policies 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 an institution's 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 organizations' internal frameworks under the supervision of the internal auditors. Exposure to operational risk is typically identified with the assistance of senior management. Internal audit plans are developed under the oversight of the respective Board Audit Committees to ensure an appropriate level of review based on a particular area's or department's level of inherent risk.

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 impacts 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 addresses 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

Each District institution maintains an allowance for loan losses at a level management considers adequate to provide for probable and estimable credit losses within its respective 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 and serve to decrease the allowance when management determines that any portion of a 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 general economic conditions.

The allowance for loan losses was $195.1 million at December 31, 2009, as compared with $169.1 million and $78.9 million at December 31, 2008 and 2007, respectively. The increase during 2009 was primarily due to provision expense of $162.9 million (see discussion of provision expense in the *Provision for Loan Losses* section below) off-set by charge-offs of $142.1 million for loan amounts determined to be uncollectable. Charge-offs were primarily related to the ethanol (21.79 percent of the total), forestry (21.04 percent), citrus (16.61 percent) and cattle (10.34 percent) industries. The allowance at December 31, 2009 included specific reserves of $91.5 million primarily related to specific credits for six borrower relationships and $103.6 million of general reserves. Impaired and certain other significant loans were reviewed individually to determine that appropriate reserves were in place at year end. All other loans were analyzed collectively and general reserves were established based on that collective analysis including the risk rating and potential for loss given default of the underlying loans. The total allowance at December 31, 2009 is comprised primarily of reserves for the forestry (22.17 percent of the total), ethanol (11.03 percent) and swine (6.64 percent) industries. Declining transitional agricultural real estate values impacted charge-offs and reserves in several of the loan classification industries, including forestry, cattle, and citrus.

The following table presents the activity in the allowance for loan losses for the most recent three years at December 31:

Allowance for Loan Losses Activity *(dollars in thousands)*	**Year Ended December 31,** 2009	2008	2007
Balance at beginning of year	$ 169,090	$ 78,874	$ 71,915
Charge-offs:			
Real estate mortgage	(52,457)	(23,736)	(1,702)
Production and intermediate-term	(30,070)	(5,232)	(1,461)
Agribusiness	(56,324)	(1,418)	(130)
Energy	–	–	(128)
Rural residential real estate	(3,296)	(170)	(86)
Other (including Mission Related)	–	(1,429)	–
Total charge-offs	(142,147)	(31,985)	(3,507)
Recoveries:			
Real estate mortgage	809	180	1,254
Production and intermediate-term	3,716	801	769
Agribusiness	744	33	145
Energy	12	–	–
Rural residential real estate	11	6	14
Other (including Mission Related)	4	158	–
Total recoveries	5,296	1,178	2,182
Net (charge-offs) recoveries	(136,851)	(30,807)	(1,325)
Provision for (reversal of allowance for) loan losses	162,893	121,023	8,284
Balance at end of year	$ 195,132	$ 169,090	$ 78,874
Ratio of net (charge-offs) recoveries during the period to average loans Outstanding during the period	(0.59)%	(0.14)%	(0.01)%

The allowance for loan losses by loan type for the most recent three years at December 31 is presented in the following table:

Allowance for Loan Losses by Type *(dollars in thousands)*	**December 31,** 2009	2008	2007
Real Estate Mortgage	$ 66,642	$ 52,021	$ 25,476
Production and Intermediate-Term	88,851	69,684	41,485
Agribusiness	33,148	44,472	5,937
Communication	1,822	369	123
Energy	479	219	63
Water and Waste Disposal	39	–	–
Rural Residential Real Estate	3,598	2,314	1,831
Leases	7	11	5
Other (including Mission Related)	546	–	3,954
Total	$ 195,132	$ 169,090	$ 78,874

The allowance for loan losses as a percentage of loans outstanding and as a percentage of nonaccrual loans at December 31 is shown below:

	2009	2008	2007
Allowance for loan losses to loans	0.84%	0.73%	0.38%
Allowance for loan losses to nonaccrual loans	25.35%	30.66%	80.44%

Despite the recent negative credit quality trends, the financial positions of the District's borrowers have generally remained strong as farmers' net cash income has been at favorable levels. This has been due, in part, to increases in commodity prices and direct federal government payments. With borrowers' generally strong financial positions and the continued management emphasis on underwriting standards, the credit quality of the District loan portfolio has remained sound despite recent trends. However, as discussed previously, uncertainty in the general economic environment has increased the potential for additional prospective risks in the loan portfolio.

See Note 4, *Loans and Allowance for Loan Losses,* in the Notes to the Combined Financial Statements and the *Significant Accounting Policies* section above for further information concerning the allowance for loan losses.

RESULTS OF OPERATIONS

Net Income

District net income totaled $364.9 million for the year ended December 31, 2009, an increase of $1.4 million over 2008. District net income totaled $363.5 million for the year ended December 31, 2008, a decrease of $48.4 million over 2007. 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,** 2009	2008
Net income (for prior year)	$ 363,520	$ 411,917
Increase (decrease) due to:		
Total interest income	(309,235)	(141,551)
Total interest expense	428,810	237,225
Net interest income	119,575	95,674
Provision for loan losses	(41,870)	(112,739)
Noninterest income	(1,883)	2,630
Noninterest expense	(70,650)	(34,309)
Provision for income taxes	(3,825)	347
Total increase (decrease) in net income	1,347	(48,397)
Net income	$ 364,867	$ 363,520

Interest Income

Total interest income for the year ended December 31, 2009 was $1.48 billion, a decrease of $309.2 million, as compared to the same period of 2008. Total interest income for the year ended December 31, 2008 was $1.79 billion, a decrease of $141.6 million, as compared to the same period of 2007. The decrease in both years was primarily the result of lower earning asset yields due to the declining market interest rate environment. The volume of interest earning assets increased in 2009, with an increase in average earning assets of $1.30 billion. The average yield on interest earning assets decreased 1.21 percent.

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

Net Change in Interest Income *(dollars in thousands)*	**Year Ended December 31, 2009-2008**	**2008-2007**
Current year increase in average earning assets	$ 1,301,337	$ 3,409,061
Prior year average yield	5.83%	7.07%
Interest income variance attributed to change in volume	75,819	241,071
Current year average earning assets	32,028,266	30,726,965
Current year increase (decrease) in average yield	(1.21)%	(1.24)%
Interest income variance attributed to change in yield	(385,054)	(382,622)
Net change in interest income	$ (309,235)	$ (141,551)

Interest Expense

Total interest expense for the year ended December 31, 2009 was $543.6 million, a decrease of $428.8 million, as compared to the same period of 2008. Total interest expense for the year ended December 31, 2008 was $972.4 million, a decrease of $237.2 million, as compared to the same period of 2007. The decrease in 2009 was primarily attributed to the decrease in average rates paid on System debt obligations.

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

Net Change in Interest Expense *(dollars in thousands)*	**Year Ended December 31, 2009-2008**	**2008-2007**
Current year increase in average interest-bearing liabilities	$ 1,492,779	$ 3,250,301
Prior year average rate	3.60%	5.08%
Interest expense variance attributed to change in volume	53,702	165,336
Current year average interest-bearing liabilities	28,522,089	27,029,310
Current year increase (decrease) in average rate	(1.70)%	(1.48)%
Interest expense variance attributed to change in rate	(482,512)	(402,561)
Net change in interest expense	$ (428,810)	$ (237,225)

Net Interest Income

Net interest income increased from 2008 to 2009 and from 2007 to 2008, as illustrated by the following table:

District Analysis of Net Interest Income
Year Ended December 31,
(dollars in thousands)

	2009			**2008**			**2007**		
	Avg. Balance	**Interest**	**Avg. Yield**	**Avg. Balance**	**Interest**	**Avg. Yield**	**Avg. Balance**	**Interest**	**Avg. Yield**
Loans	$ 23,159,772	$ 1,255,616	5.42%	$ 22,234,800	$ 1,456,566	6.55%	$ 19,611,569	$ 1,516,587	7.73%
Cash & investments	8,868,494	225,374	2.54%	8,492,129	333,659	3.93%	7,706,335	415,189	5.39%
Total earning assets	$ 32,028,266	$ 1,480,990	4.62%	$ 30,726,929	$ 1,790,225	5.83%	$ 27,317,904	$ 1,931,776	7.07%
Interest-bearing liabilities	$ 28,522,089	$ (543,551)	1.90%	$ 27,029,310	$ (972,361)	3.60%	$ 23,779,009	$ (1,209,586)	5.08%
Spread			2.72%			2.23%			1.99%
Impact of capital	$ 3,506,177		0.21%	$ 3,697,619		0.43%	$ 3,538,895		0.65%
Net Interest Income (NII) & NII to average earning assets		$ 937,439	2.93%		$ 817,864	2.66%		$ 722,190	2.64%

Net interest income for the year ended December 31, 2009 was $937.4 million compared to $817.9 million for the same period of 2008, an increase of $119.5 million or 14.62 percent. The net interest margin was 2.93 percent and 2.66 percent in the current year and previous year, respectively, an improvement of 27 basis points. Spreads improved for several reasons, but primarily as called debt was replaced by new debt issued at a lower rate of interest, decreasing funding costs. Loan pricing compared to the underlying cost of funds also improved during the 2009 period, reflecting increased credit risks and liquidity premiums in the lending markets. Change in net interest income due to the change in balance sheet volume was very minimal as a result of the limited loan growth previously discussed. Prospectively, as assets reprice in the lower interest rate environment, spreads and margins will narrow, which can negatively affect net interest income.

Provision for Loan Losses

AgFirst and the Associations assess risks inherent in their individual portfolios on an ongoing basis and establish appropriate reserves for loan losses. The provision for loan losses was $162.9 million and $121.0 million for the twelve months ended December 31, 2009 and 2008, respectively. Provision expense for the twelve months ended December 31, 2009 was primarily specific reserve increases for eight borrower relationships, a reversal of a specific reserve for one borrower relationship, and general reserve increases for the forestry, dairy and ethanol industries. The net provision expense of $162.9 million was primarily due to loans classified in the forestry (23.10 percent of the total), ethanol (18.31 percent), other real estate (7.79 percent), citrus (6.61 percent) and swine (6.37 percent) industries. As mentioned previously, declining transitional agricultural real estate values were, in part, the reason for some of the provision expense recognized by the District. See Note 4, *Loans and Allowance for Loan Losses*, in the Notes to the Financial Statements for further information.

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,** 2009	2008	2007	**Increase (Decrease)** 2009/ 2008	2008/ 2007
Loan fees	$ 46,512	$ 38,705	$ 29,996	$ 7,807	$ 8,709
Fees for financially related services	10,710	11,353	9,228	(643)	2,125
Gains (losses) from other property owned, net	(10,184)	(1,102)	(999)	(9,082)	(103)
Gains (losses) on investments, net	9,918	–	1	9,918	(1)
Net impairment losses on investments	(26,454)	(10,465)	–	(15,989)	(10,465)
Gains (losses) on derivatives, net	469	(359)	–	828	(359)
Gains (losses) on sale of rural home loans	2,601	2,142	147	459	1,995
Gains from sale of premises and equipment, net	1,706	4,613	2,016	(2,907)	2,597
Patronage refunds from other Farm Credit Institutions	5,493	4,084	1,790	1,409	2,294
Other noninterest income	8,900	2,583	6,745	6,317	(4,162)
Total noninterest income	$ 49,671	$ 51,554	$ 48,924	$ (1,883)	$ 2,630

The primary reason for the 2009 and 2008 increases in loan fees of $7.8 million and $8.7 million, respectively, was due to the increases in fee income on participation loans and in loan origination fees from secondary mortgage market loans.

The majority of the decrease in fees for financially related services in 2009 was the result of decreases of $402 thousand in crop hail insurance income and $237 thousand in multi-peril insurance income. The increase in 2008 was from increases of $522 thousand in crop hail insurance income and $1.3 million in multi-peril insurance income.

Expenses associated with other property owned have increased significantly during 2009 due to the acquisition of such properties by the District as discussed previously. The gains on investments in 2009 arose from sales to achieve certain portfolio limits and liquidity parameters.

The net impairment losses on investments of $26.5 million were due to the recognition of credit related other-than-temporary impairment on several of the District's investment securities, as described previously. During 2008, net impairment losses were due to the determination that an individual asset-backed security was other-than-temporarily impaired, and a related loss of $10.5 million was recognized to adjust to fair value.

Gains from sale of premises and equipment, net were $1.7 million, $4.6 million, and $2.0 million for 2009, 2008, and 2007, respectively. The primary reason for the 2008 increase was the $2.7 million gain recorded in 2008 on the sale of one Association's office building.

Patronage refunds from other Farm Credit institutions increased $1.4 million in 2009 due primarily to increases in participation loans purchased from other Farm Credit institutions.

Other noninterest income increased $6.3 million during 2009 due primarily to a 2008 captive insurance company allocated savings, based on claims experience, recorded in the first quarter of 2009, gains incurred on investments which fund the non-qualified pension plans, higher income from outside sources for services to other Farm Credit System entities, and a gain from the Bank's termination of its captive mortgage insurance program. Other noninterest income decreased $4.2 million during 2008 due primarily to losses on investments which fund the non-qualified pension plans.

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,** 2009	2008	2007	**Increase (Decrease)** 2009/ 2008	2008/ 2007
Salaries and employee benefits	$ 249,917	$ 198,657	$ 198,539	$ 51,260	$ 118
Occupancy and equipment	36,757	36,665	33,771	92	2,894
Insurance Fund premiums	48,243	35,337	28,200	12,906	7,137
Other operating expense	77,430	83,204	76,293	(5,774)	6,911
Called debt expense	36,532	26,652	10,550	9,880	16,102
Correspondent lending service expense	6,303	4,017	2,071	2,286	1,946
Other noninterest expense	278	278	1,077	–	(799)
Total noninterest expenses	$ 455,460	$ 384,810	$ 350,501	$ 70,650	$ 34,309

Salaries and employee benefits increased over the three year period of 2007 through 2009 as a result of normal salary administration and increased benefit costs. Pension expense for the District was $54.3 million in 2009 and $10.8 million in 2008, an increase of $43.5 million. This increase was primarily due to a reduction in the expected total return on plan assets and an increase in the amount of actuarial losses amortized for the Districtwide plan. Pension expense is determined by actuarial valuations based on certain assumptions, including expected long-term rates of return on plan assets and discount rates. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that portfolio of assets. The discount rate is used to determine the present value of future benefit obligations. Plan assets values decreased significantly in 2008 due to the decline in stock values. The long-term rate of return assumption was lowered from 8.50 percent to 8.00 percent in 2008 and remained at that rate in 2009, for the Districtwide plan. These rates are determined based on investment return forecasts and current industry norms. The discount rate used to determine the present value of obligations decreased from 6.25 percent in 2008 to 6.00 percent in 2009. The yield curve used to determine the rate was changed for 2009 to reflect a more conservative level at which obligations could be settled. The pay increase assumption, which impacts service cost, used in the projected benefit obligation determination was increased for certain employee groups to more closely resemble actual experience over the past several years. Some of these assumption changes may not be permanent but reflect the Bank's and District's projections based on the current financial environment.

The $12.9 million and $7.1 million increases in the Insurance Fund premiums in 2009 and 2008, respectively, resulted primarily from a change in the premium assessment methodology and the premium rate. Effective July 1, 2008, the base on which the Insurance Fund premiums are assessed was expanded from total loans to total System debt. In addition, the annual premium rate, which was 15 basis points for the first nine months of 2008, was increased to 18 basis points for the last quarter of 2008. The Insurance Fund Board increased the premium to 20 basis points for 2009.

Other operating expense was $77.4 million, $83.2 million, and $76.3 million for 2009, 2008, and 2007, respectively. The higher amount of other operating expense in 2008 was primarily due to a $2.9 million increase in professional fees related to technology upgrades and Systemwide initiatives.

Concession or debt issuance expense is amortized over the life of the underlying debt security. When debt securities are called prior to maturity, any unamortized concession is expensed. Called debt expense increased $9.9 million and $16.1 million for the years ended December 31, 2009 and 2008, respectively. Call options were exercised on bonds totaling $25.84 billion in 2009 and $19.90 billion in 2008. The called debt expense is more than offset by interest expense savings realized as called debt is replaced by new debt issued at a lower rate of interest. Over time, the favorable effect on net interest income is diminished as earning assets reprice downward.

The increases in correspondent lending servicing expense for 2009 and 2008 are primarily due to guarantee fees from increased volume in the correspondent lending portfolio.

Other noninterest expense primarily consists of amortization of mandatorily redeemable preferred stock issuance costs.

Provision for Income Taxes

Provision for income taxes increased $3.8 million in 2009 compared to 2008. This increase resulted primarily from one Association paying $1.5 million to settle prior years' tax obligations; another Association increasing its tax provision expense $1.2 million in 2009; and a third association paying a $587 thousand tax liability related to its 2008 tax extension. 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	**For the 12 Months Ended**		
Operations Comparisons	**12/31/09**	**12/31/08**	**12/31/07**
Return on average assets	1.12%	1.17 %	1.48 %
Return on average shareholders' equity	10.79%	10.07 %	11.42 %
Net interest income as a percentage of average earning assets	2.93%	2.66 %	2.64 %
Net (charge-offs) recoveries to average loans	(0.59)%	(0.14) %	(0.01) %

CAPITAL

Capital serves to support future asset growth, investment in new products and services, and to provide protection against credit, interest rate and other risks, and operating losses. A sound capital position is critical to provide protection to investors in Systemwide Debt Securities and to ensure long-term financial success.

The AgFirst Capitalization Plan (the "Plan") approved by the Bank's board of directors establishes guidelines to ensure that adequate capital is maintained for continued financial viability, to provide for growth necessary to meet the needs of members/borrowers, and to ensure that all stockholders are treated equitably. The Bank's capital objectives are considered adequate to support inherent risk. There were no material changes to the Plan for 2009 that have an effect on the Bank's ability to retire stock and distribute earnings. Similarly, association boards of directors periodically review the capital adequacy and potential future capital needs of their respective institutions.

Total District shareholders' equity at December 31, 2009 was $3.63 billion, compared to $3.12 billion and $3.57 billion at December 31, 2008 and 2007, respectively. The $505.3 million increase in 2009 was related primarily to net income of $364.9 million, a decrease of $239.1 million in unrealized losses on investments available for sale, a component of AOCI, and a decrease of $56.5 million in AOCI related to FASB guidance on employee benefit plans. These increases in shareholders' equity were offset by decreases from retained earnings retired of $59.3 million, cash distribution of $78.2 million, and stock dividends paid of $27.4 million. The $444.3 million decrease in 2008 was related primarily to the increase in AOCI of $577.2 million. The 2008 AOCI increase was due to increases in unrealized losses associated with a decrease in the market value of the District's available-for-sale investment securities of $319.7 million and due to employee benefit plans adjustments based on FASB guidance of $257.5 million (see Note 13, *Employee Benefit Plans*, in the Notes to the Combined Financial Statement for further information).

On June 8, 2007, AgFirst issued $250.0 million of Class B Perpetual Non-Cumulative Fixed-to-Floating Rate Subordinated Preferred Stock, Series 1. On October 14, 2003, AgFirst issued $150.0 million of Perpetual Non-Cumulative Preferred Stock at a par value of $1 thousand per share. On May 17, 2001, AgFirst issued $225.0 million of Mandatorily Redeemable Cumulative Preferred Stock at a par value of $1 thousand per share. The Mandatorily Redeemable Preferred Stock is reported as a liability and the related dividends reported as interest expense. Although the Mandatorily Redeemable Preferred Stock is required to be reported as a liability under GAAP, it qualifies as capital for certain regulatory purposes. See Note 10, *Mandatorily Redeemable Preferred Stock*, and Note 11, *Protected Borrower Equity and Shareholders' Equity*, in the Notes to the Combined Financial Statements for further information concerning the preferred stock issuances.

FCA sets minimum regulatory capital requirements for System banks and associations. Capital adequacy is evaluated using a number of regulatory ratios. According to the FCA regulations, each institution's permanent capital ratio is calculated by dividing permanent capital by a risk-adjusted asset base. Risk-adjusted assets refer to the total dollar amount of the institution's assets adjusted by an appropriate credit conversion factor as defined by regulation. Generally, higher credit conversion factors are applied to assets with more inherent risk. For all periods presented, AgFirst exceeded minimum regulatory standards for all of the ratios. The FCA notified AgFirst that the June 2007 issuance of $250.0 million of Perpetual Non-Cumulative Subordinated Preferred Stock (as discussed above) could be included in core surplus up to an amount not to exceed 25.00 percent of total core surplus, inclusive of the preferred stock component. Based on this regulatory guidance, applied to the Bank's core surplus ratio at December 31, 2009, all of the $250.0 million in preferred stock has been included. Also in conjunction with 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 System 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-adjusted weighting of assets. The collateral ratio is calculated by dividing the Bank's collateral, as defined by FCA regulations, by total liabilities. The net collateral ratio is not applicable to the Associations.

The Bank's regulatory ratios at December 31 are shown in the following table:

	Regulatory Minimum	AgFirst Ratio as of 12/31/09	12/31/08	12/31/07
Permanent Capital Ratio	7.00%	16.86%	17.15%	20.59%
Total Surplus Ratio	7.00%	16.83%	17.11%	20.54%
Core Surplus Ratio	3.50%	9.85%	10.43%	13.04%
Net Collateral Ratio	104.00%	105.66%	105.56%	106.02%

The Bank's permanent capital, total surplus, and core surplus ratios declined at December 31, 2009 as compared to December 31, 2008. These ratios are calculated using three month average daily balances for both capital and assets. Deductions for ineligible investment securities were higher in the 2009 period. The impairment in AOCI, as discussed above, does not affect the reported capital ratios because the affect of AOCI is excluded entirely from the risk-based capital ratios. The decrease in the Bank's permanent capital, total surplus, and core surplus ratios at December 31, 2008 as compared to December 31, 2007 was attributed to the growth in assets on both a total and risk adjusted basis exceeding the increase in capital. The decrease in the collateral ratio for this same time period also was attributed to asset growth.

The following table illustrates the risk bearing capacity of the District Associations at December 31, 2009:

Association	Regulatory Permanent Capital Ratio	Regulatory Core Surplus Ratio	Regulatory Total Surplus Ratio	Allowance/ Loans
AgCarolina Financial	15.54%	13.22%	13.22%	1.16%
AgChoice	12.47%	10.30%	11.61%	0.87%
Ag Credit	17.19%	13.89%	15.51%	0.84%
AgGeorgia	13.75%	10.47%	13.50%	0.84%
AgSouth	14.55%	10.35%	14.12%	0.63%
ArborOne	15.01%	11.55%	14.75%	0.43%
Cape Fear	13.20%	12.84%	12.84%	1.36%
Carolina	14.54%	11.71%	13.88%	0.79%
Central Florida	15.89%	13.05%	15.23%	1.61%
Central Kentucky	11.73%	9.82%	10.58%	1.05%
Chattanooga *	12.96%	3.44%	10.91%	1.13%
Colonial	16.27%	15.54%	15.54%	1.08%
Farm Credit of the Virginias	12.08%	10.79%	10.79%	0.75%
First South	12.52%	10.21%	11.37%	0.64%
Jackson Purchase	14.84%	12.92%	13.95%	1.15%
MidAtlantic	13.96%	12.93%	13.50%	0.92%
North Florida	13.50%	12.88%	13.16%	0.78%
Northwest Florida	13.26%	12.45%	13.02%	1.98%
Puerto Rico	17.39%	17.06%	17.06%	1.15%
South Florida	15.63%	15.58%	15.58%	2.03%
Southwest Florida	14.44%	10.85%	14.17%	1.30%
Southwest Georgia	13.93%	10.74%	13.53%	1.45%

* This Association did not meet the regulatory minimum core surplus ratio of 3.50 percent as of December 31, 2009. The Association's board of directors elected to retain the 2009 net income of the Association in the form of unallocated equity to address the violation of the minimum core surplus ratio. The Association's board of directors was required to submit a capital restoration plan to FCA. The plan included monitoring, reporting, and possible retention of additional unallocated surplus in future periods to ensure the minimum ratio is achieved and maintained. The capital restoration plan is expected to return the Association to full compliance with required regulatory minimum capital standards and there are no trends, commitments, contingencies, or events that are likely to affect the Association's ability to meet regulatory minimum capital standards and capital adequacy requirements. All other Associations met all of the regulatory minimum capital requirements at December 31, 2009.

AgFirst and each Association maintain an allowance for loan losses determined by its management and are capitalized to serve their unique markets. The minimum regulatory capital ratios for System banks and associations are 7.00 percent for the permanent capital ratio, 3.50 percent for the core surplus ratio, and 7.00 percent for the total surplus ratio.

See Note 11, *Protected Borrower Equity and Shareholders' Equity*, in the Notes to the Consolidated Financial Statements for additional information regarding regulatory capitalization requirements and restrictions.

ECONOMIC CAPITAL

As discussed previously (see Risk Management section above), risk is an inherent part of the District's business activities. The District's capital management framework is intended to ensure there is sufficient capital to support the underlying risks of our business activities, exceed all regulatory capital requirements, and achieve certain capital adequacy objectives. The District has implemented an economic capital measurement process including appropriate methodologies and assumptions, to quantify the capital requirements related to our primary areas of risk. The District periodically quantifies its economic capital requirements, based on the credit risk, interest rate risk, operational risk, and market risk inherent in its operations. For a further discussion of these risks, see the *Risk Management* section above. Due to the evolving nature of the economic capital concept, the District anticipates these methodologies and assumptions will continue to be refined.

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

The District 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 the combined District's loans outstanding to Young and Beginning Farmers and Ranchers as of December 31, 2009:

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

Category	Number of Loans	Percent of Total	Volume Outstanding	Percent of Total
1. Total loans and commitments outstanding at year-end	138,211	–%	$ 30,841,820	–%
2. Young farmers and ranchers	21,645	15.66%	$ 2,224,762	7.21%
3. Beginning farmers and ranchers	32,793	23.73%	$ 4,510,765	14.63%

The following table summarizes information regarding the combined District's loans outstanding to Small Farmers and Ranchers as of December 31, 2009:

Small Farmers and Ranchers
Number/Volume of Loans Outstanding by Loan Size
(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	79,824	21,715	21,133	15,539
2. Total number of loans to small farmers and ranchers	53,864	14,108	12,598	6,178
3. Number of loans to small farmers and ranchers as a % of total number of loans	67.48%	64.97%	59.61%	39.76%
4. Total loan volume outstanding at year-end	$ 1,519,007	$ 1,836,577	$ 3,894,622	$ 23,591,614
5. Total loan volume to small farmers and ranchers	$ 1,034,903	$ 1,086,254	$ 2,023,344	$ 3,556,527
6. Loan volume to small farmers and ranchers as a % of total loan volume	68.13%	59.15%	51.95%	15.08%

The following table summarizes information regarding the combined District's new loans made to Young, and Beginning Farmers and Ranchers for the year ended December 31, 2009:

Young, and Beginning Farmers and Ranchers
Gross New Business During 2009, Number/Volume of Loans
(dollars in thousands)

Category	Number of Loans	Percent of Total	Volume Outstanding	Percent of Total
1. Total gross new loans and commitments made during 2009	62,216	–%	$ 15,200,381	–%
2. Total loans and commitments made during 2009 to young farmers and ranchers	9,414	15.13%	$ 1,177,082	7.74%
3. Total loans and commitments made during 2009 to beginning farmers and ranchers	12,793	20.56%	$ 2,126,696	13.99%

The following table summarizes information regarding the combined District's new loans made to Small Farmers and Ranchers for the year ended December 31, 2009:

Small Farmers and Ranchers
Gross New Business by Loan Size, Number/Volume of Loans
(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 2009	25,834	12,153	12,758	11,471
2. Total number of loans made to small farmers and ranchers during 2009	18,297	6,650	6,170	3,643
3. Number of loans to small farmers and ranchers as a % of total number of loans	70.83%	54.72%	48.36%	31.76%
4. Total gross loan volume of all new loans and commitments made during 2009	$ 524,608	$ 875,502	$ 2,091,202	$ 11,709,069
5. Total gross loan volume to small farmers and ranchers	$ 355,427	$ 469,369	$ 992,621	$ 1,973,908
6. Loan volume to small farmers and ranchers as a % of total gross new loan volume	67.75%	53.61%	47.47%	16.86%

LEGAL PROCEEDINGS

On the basis of information presently available, management and legal counsel are of the opinion that the ultimate liability, if any, from legal actions pending against the District would be immaterial in relation to the combined financial position of AgFirst and the District Associations. Refer to Note 16, *Commitments and Contingencies*, in the Notes to the Combined Financial Statements for additional information.

REGULATORY MATTERS

During 2009, the FCA took no enforcement actions against the Bank or District Associations and no enforcement actions were in effect for the Bank or District Associations at December 31, 2009. Subsequent to year-end 2009, the FCA entered into written agreements with two District Associations whose assets totaled less than $935.0 million at December 31, 2009. The written agreements require those District Associations to take corrective actions with respect to certain areas of their operations, including capital, portfolio management, and asset quality. These enforcement actions will not have a significant impact on the Bank's or District's financial condition or results of operations.

DISTRICT MERGER ACTIVITY

Please refer to Note 23, *District Merger Activity*, in the Notes to the Consolidated Financial Statements for information regarding merger activity in the District.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Please refer to Note 2, *Summary of Significant Accounting Policies*, in the Notes to the Consolidated Financial Statements for recently issued accounting pronouncements.

Additional 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 & Analysis of Financial Condition & Results of Operations* included in this Annual Report to shareholders.

Description of Property

The Bank and the Associations own land and buildings throughout the District. The various facilities owned or leased by the Associations are described in the individual Association annual reports. The following table sets forth certain information regarding the properties owned by the reporting entity, AgFirst Farm Credit Bank, all of which are located in Columbia, South Carolina:

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

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 16 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 and contingent liabilities to be disclosed in this section is incorporated herein by reference to Notes 2, 8, 9, 10, 13, and 16 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 & Analysis of Financial Condition & 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 chief executive officer and all other senior officers of the Bank, together with their length of service at their present position, as well as positions held during the last five years, are as follows:

Name and Title	Time in Position	Prior Experience	Other Business Interests
F.A. Lowrey, *President and Chief Executive Officer*	12 years	CEO, Palmetto Farm Credit, ACA from April 1989 to January 1998.	He serves as: member of the Board for Federal Farm Credit Banks Funding Corporation; Council Member of the National Council of Farm Cooperatives; University of South Carolina: member of the Board of Trustees for the Business Partnership Foundation and Chairman of the Board of Directors for the Education Foundation; member of the Board of Directors for Big Brothers Big Sisters of Greater Columbia; member of the Board of Directors and Chairman of Finance Committee for National 4H Council; member of the Board of Directors for Palmetto AgriBusiness Council; member of the Board of Directors for Midlands Business Leadership Group.
Thomas S. Welsh, *Executive Vice President and Chief Administrative and Legislative Officer*	12 years	Chief Marketing and Planning Officer from January 1996 until March 1998.	He serves on the Advisory Board of the Farm Credit System Captive Insurance Company. Member of the AgFirst Plan Sponsor Committee and the AgFirst/FCBT Plan Sponsor Committee.
Leon T. Amerson, *Executive Vice President and Chief Operating Officer*	3 years	Chief Financial Officer from March 1998 to September 2006.	He serves on the AgFirst/FCBT Plan Fiduciary Committee.
Charl L. Butler, *Senior Vice President and Chief Financial Officer*	3 years	Chief Financial Officer and Secretary at The National Bank of South Carolina from 1991 until 2007.	
William L. Melton, *Senior Vice President and Chief Lending Officer*	6 years	Senior Executive Officer/Bank Lending from January to July 2003, prior to that Lending Services Manager.	He serves as an at-large director of the National Chicken Council.
Benjamin F. Blakewood, *Senior Vice President and Chief Information Officer*	11 years	Director of Information Technology from 1996 to 1998 at Affinity Technology Group.	
Frederick T. Mickler, III, *Senior Vice President and General Counsel*	12 years	Assistant General Counsel July 1989 until April 1998.	

The total amount of compensation earned by the CEO and the senior officers as a group during the years ended December 31, 2009, 2008 and 2007, is as follows:

Name of Individual or Number in Group	Year	Annual Salary	Annual Bonus	Deferred Comp.	Perq./ Other*	Total
F. A. Lowrey	2009	$ 600,279	$ 338,619	$ 14,654	$ 21,448	$ 975,000
F. A. Lowrey	2008	$ 577,192	$ 263,584	$ 12,265	$ 21,357	$ 874,398
F. A. Lowrey	2007	$ 524,720	$ 176,642	$ 44,160	$ 21,731	$ 767,253
6 Officers	2009	$ 1,554,648	$ 556,293	$ 84,973	$ 109,211	$ 2,305,125
6 Officers	2008	$ 1,456,242	$ 440,498	$ 80,196	$ 98,651	$ 2,075,587
5 Officers	2007	$ 1,284,000	$ 439,220	$ 81,030	$ 112,060	$ 1,916,310

* *Primarily comprised of company contributions to thrift plan (see Note 13 to the Combined Financial Statements, Employee Benefit Plans), group life insurance premiums and bank-provided automobile. Amount for other senior officers in 2007 also includes sign-on bonus.*

In addition to a base salary, senior officers may earn additional compensation under the Bank's Corporate Bonus Plan. The plan payments are based upon the Bank's achievement of financial targets and employee's achievement of performance targets. Those covered by the plan include all employees. Bonuses are shown in the year earned. Payment of the 2009 bonus was made in the first quarter of 2010.

Senior officers may also participate in the Bank's Long Term Bonus Plan which is designed to attract, recognize, and maintain senior officers and other key employees. Participation in the plan is at the sole discretion of the CEO. Bonuses are shown in year accrued. Payments will be made when earned.

Bank compensation plans are reviewed by the Board Compensation Committee.

Additionally, senior officers as well as all employees are reimbursed for all direct travel expenses incurred when traveling on Bank business. A copy of the travel policy is available to shareholders upon written request.

Disclosure of information on the total compensation paid during 2009 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 for 2009

Name	Position	Term of Office
Paul M. House	Chairman	December 31, 2011
M. Wayne Lambertson	Vice Chairman	December 31, 2013*
Gary L. Alexander	Director	December 31, 2011
Jack W. Bentley Jr.	Director	December 31, 2013**
William C. Bess, Jr.	Director	December 31, 2009
Don W. Freeman	Director	December 31, 2009
Bonnie V. Hancock	Director	December 31, 2013***
Dale R. Hershey	Director	December 31, 2011
Robert L. Holden, Sr.	Director	December 31, 2010
Thomas W. Kelly	Director	December 31, 2012
Lyle Ray King	Director	December 31, 2012
S. Alan Marsh	Director	December 31, 2013**
James L. May	Director	December 31, 2013*
Bobby E. McCollum, Jr.	Director	December 31, 2013**
Eugene W. Merritt, Jr.	Director	December 31, 2010
James M. Norsworthy, III	Director	December 31, 2011
Katherine A. Pace	Director	December 31, 2011
J. Dan Raines, Jr.	Director	December 31, 2009
Walter L. Schmidlen, Jr.	Director	December 31, 2012
Robert G. Sexton	Director	December 31, 2011
Kenneth A. Spearman	Director	December 31, 2009****
Robert H. Spiers, Jr.	Director	December 31, 2013*
William H. Voss	Director	December 31, 2010
J. Mark Wheeler	Director	December 31, 2012

* *These directors were re-elected in 2009 to a new 4-year term commencing 1/1/10.*

** *These directors were newly elected in 2009 to a 4-year term commencing 1/1/10.*

*** *This director was appointed as one of the board's outside directors for a 4-year term commencing 1/1/10.*

*****Resigned from the Bank Board effective October 9, 2009, following appointment to the FCA board.*

Paul M. House, Chairman of the Board, is from Nokesville, Virginia, where he grows corn, soybeans, wheat, hay and turf grass on 4,000 acres. He also operates a dairy and milks 340 cows. He serves as a director of the Farm Credit of the Virginias, ACA.

M. Wayne Lambertson, Vice Chairman of the Board, from Pocomoke City, Maryland, owns and operates with his son 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 boards of the national Farm Credit Council (the Farm Credit System's national trade organization), MidAtlantic Farm Credit, ACA, and the Delmarva Poultry Industry (DPI), a trade organization. Mr. Lambertson serves on the Board Compensation Committee.

Gary L. Alexander from Westminster, South Carolina is owner and operator of Alexander Farms, Inc., a poultry production and property development business. He markets 3.2 million broilers a year through his 18-broiler house farm and develops residential properties. He currently serves on the board of directors of AgSouth Farm Credit, ACA, and is a director of The Outdoor Dream Foundation, an organization providing outdoor adventures for children with life threatening illnesses and also a member of the S. C. Poultry Federation. Mr. Alexander serves on the Board Audit Committee.

Jack W. Bentley, Jr., a dairy farmer in Tignall, Georgia, owns and operates A&J Dairy, a 270-cow dairy that includes 583 acres of pasture, crops and timberland, and an additional 500 acres of leased farmland. Mr. Bentley is a director of AgGeorgia Farm Credit, ACA, Southeast United Dairy Industry Association, and the Wilkes County Farm Bureau. He is also a member of the Wilkes County Board of Tax Assessors and is past board chair for Farm Service Agency. Mr. Bentley serves on the Board Governance Committee.

William C. Bess, Jr., from Lincolnton, North Carolina, is owner of Bess Farms Inc., a grain and hay production operation and has a 70-head cow-calf operation. He served on the boards of the national Farm Credit Council Board and Farm Credit Council Services. He is also a member of Carolina Farm Credit, ACA as well as the Cleveland County and Catawba Cattlemen's Associations. Mr. Bess served on the Board Governance Committee.

Don W. Freeman of Montgomery, Alabama, manages a 400-acre cow-calf operation and an 80 unit river rental business near Lowndesboro, Alabama. He served on the national Farm Credit Council Board and is a member of 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. He is a member of First South Farm Credit, ACA. Mr. Freeman served on the Board Compensation Committee.

Bonnie V. Hancock is Executive Director of the Enterprise Risk Management Initiative at North Carolina State University (NCSU). She also lectures and teaches courses in financial management, enterprise risk management, strategy and financial statement analysis. Prior to joining NCSU, she worked with Progress Energy, as senior vice president of finance and information technology and later as president of Progress Fuels, a subsidiary that produces and markets gas, coal and synthetic fuels, and operates fuel terminals and ash management facilities. Ms. Hancock is a graduate of Georgetown University with a master's degree in taxation. She is also a graduate of the College of William and Mary with a bachelor's degree in business administration with an accounting major. She lives in Wake Forest, North Carolina, and is a member of the boards of the Marble Kids Museum and the North Carolina Coastal Pines Girl Scout Council, where she serves as a finance committee member for each respective board. Ms. Hancock serves on the Board Credit Committee.

Dale R. Hershey from Manheim, Pennsylvania is a partner in Hershey Brothers Dairy Farms, a dairy operation which milks 285 cows, raises 250 dairy replacements, and grows 650 acres of corn, alfalfa, soybeans, barley, rye and hay. He serves on the board of directors of MidAtlantic Farm Credit, ACA, and is a delegate on the Leadership Council for Land O'Lakes. He also is a member of Pennsylvania Farm Bureau, Pennsylvania Dairy Stakeholders, the Pennsylvania Holstein Association, Lancaster County Blue Ribbon Commission for Agriculture and the Penn Township Ag Advisory Committee. Mr. Hershey serves on the Board Credit Committee.

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. Mr. Holden serves on the Board Governance Committee.

Thomas W. Kelly from Tyrone, Pennsylvania, is owner and manager of a livestock and crop farm, raising dairy heifers and growing corn and soybeans. Along with his son, he handles land management for Spring Lane Hunt Club. He currently is an elected delegate to the Penn State Agricultural Council and a director of Mid-Atlantic Master Farmer Association and is a former director of Holstein Association, USA. He is a member of AgChoice Farm Credit, ACA. Mr. Kelly serves as Chairman on the Board Governance Committee.

Lyle Ray King of Ash, North Carolina, owns and operates a farm where he grows timber, 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. Mr. King serves on the Board Credit Committee.

S. Alan Marsh, a third-generation farmer, is owner and operator of Marsh Farms in Madison, Alabama. His operation consists of 3,000 acres of row crops, including cotton, soybeans, wheat and corn. Mr. Marsh is a director of First South Farm Credit, ACA and Limestone County Farmers Federation, and is president and stockholder of South Limestone Co-op Gin. He is also a delegate on the national Cotton Council, a member of the Alabama Cattlemen's Association and an advisory board member for Staplecotn, a cotton cooperative association. Mr. Marsh serves on the Board Governance Committee.

James L. May is owner and operator of Mayhaven Farm in Waynesburg, Kentucky, where he owns 330 acres and leases another 700 acres. He is involved in the development and marketing of 500 heifers for replacement cows and embryo transfer. Mr. 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 Board. Mr. May serves as chairman of the Board Credit Committee.

Bobby E. McCollum, Jr., is a poultry operator in Polkton, North Carolina. His operation includes eight broiler houses that produce 750,000 heavy broilers per year. Mr. McCollum also has a 100-head brood cow/calf commercial herd, and grows 100 acres of timber as well as hay, soybeans, wheat and corn. He is a director of Anson County Farm Bureau, and a member of Anson County Cattlemen's Association and the North Carolina Farm Bureau, serving on their Poultry Advisory Committee. He is a member of Carolina Farm Credit, ACA. Mr. McCollum serves on the Board Audit Committee.

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. Mr. Merritt served as chairman and is currently a member of the Board Compensation Committee and is a member of the AgFirst/FCBT Plan Fiduciary Committee.

James M. Norsworthy, III, from Jackson, Louisiana runs 100 Cedars Cattle Farm, a 175-head cow-calf operation. He also has a commercial hay operation with 125 acres in Alicia Bermuda hay and 150 acres in Bahia Grass hay and manages a 375-acre pine and hardwood timber operation. He is a member of the board of directors of First South Farm Credit, ACA, serves on the board of Feliciana Farm Bureau and is a past president of that organization. He is a member of East Feliciana Cattlemen's Association, American Angus Association and the Feliciana Forestry Association. Mr. Norsworthy served as a former mayor of the town of Jackson, Louisiana. Mr. Norsworthy serves on the Board Audit Committee.

Katherine A. Pace from Orlando, Florida, is a certified public accountant. Prior to forming her company, Family Business Consulting, LLC, she was a tax partner with KPMG, LLP, an audit, tax and advisory service firm, from 1985-2005. While at KPMG, 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. Ms. Pace obtained her B.S. degree in accounting from Furman University. She is a member of the American Institute of Certified Public Accountants, the Florida Institute of Certified Public Accountants and current and past member and director of numerous trade and charitable organizations. In addition to the AgFirst Bank, she serves as a director on an advisory board for a private for profit organization involved in agriculture. Ms. Pace serves as Chairman of and is the board designated financial expert on the Board Audit Committee.

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). Mr. Raines served on the Board Credit Committee.

Walter L. Schmidlen, Jr., from Elkins, West Virginia, is a past dairy farmer and now continues his cow-calf operation along with growing hay and corn on a 700 acre farm with lease/rented land. He is owner/operator of a farm equipment business. He presently serves on the board of Farm Credit of the Virginias, ACA, and was a former director of Southern States Cooperative and Sire Power. Mr. Schmidlen serves on the Board Governance Committee.

Robert G. Sexton is from Vero Beach, Florida. He is President of Oslo Citrus Growers Association and co-owner of Lost Legend, LLC, and owner of Orchid Island Juice Company. He serves as a director of Farm Credit of South Florida, ACA; Oslo Citrus Growers Association; Lost Legend, LLC; 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. He obtained both his B.S. degree in business administration and his MBA finance from the University of Florida. Mr. Sexton served on the Board Audit Committee, and currently serves on the Board Compensation Committee. He is a board designated financial expert. Mr. Sexton is also a member of the AgFirst/ FCBT Plan Sponsor Committee.

Kenneth A. Spearman from Winter Haven, Florida, is a retired Director of Internal Audit for Florida's Natural Growers, Inc. who served 28 years with the citrus industry. He is a former Controller of Citrus Central, Inc. in Orlando, Florida, co-founder of a public accounting firm in Chicago, Illinois and was employed 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 a past National President. Mr. Spearman served on the Board Governance Committee. Mr. Spearman resigned from the Bank Board effective October 9, 2009, following appointment to the FCA board.

Robert H. Spiers, Jr., is a full-time farmer, with a tobacco, corn, wheat, and soybean operation on 1,100 acres in Dinwiddie County, Virginia. He currently serves on the boards of Colonial Farm Credit, ACA, Tobacco Associates, Inc. and Dinwiddie County Farm Bureau. He is also director and treasurer of the Old Hickory Hunt Club and a director on the Virginia Flue-cured Tobacco Board. He has been active on a number of Virginia Farm Bureau advisory committees. Mr. Spiers served on the Board Compensation Committee and currently serves as Chairman of that Committee. He is chairman of the AgFirst/FCBT Plan Sponsor Committee.

William H. Voss is from McComb, Mississippi. He has commercial cattle and timber operations in Southwest Mississippi and is involved in land and commercial property management. His career includes production agriculture, agribusiness and real estate. He currently serves on the board of directors of First South Farm Credit, ACA. He is a former agricultural commodities and securities broker and has served as Chairman of the Mississippi Real Estate Commission and Chairman of the Pike County Farm Service Committee. Mr. Voss serves on the

Board Compensation Committee and is a member of the AgFirst/FCBT Plan Sponsor Committee.

J. Mark Wheeler from Bradenton, Florida is chief financial officer of Wheeler Farms, Inc., which grows citrus in several counties in Florida. He serves on the boards of Farm Credit of Southwest Florida, ACA, Florida Citrus Mutual, an industry trade association, and Wheeler Brothers, Inc., a family-held citrus contract harvesting corporation. Mr. Wheeler is president of Hardee Livestock Market, Inc., a beef cattle operation, and Boston Mining Company, a citrus, real estate and cash investment organization. Mr. Wheeler serves on the Board Audit Committee and is a member of the AgFirst/FCBT Plan Sponsor Committee.

Committees

The board has established an audit committee, compensation committee, credit committee and governance committee. All members of the board, other than the chairman, serve on a committee. The chairman of the board serves as an ex officio member of all board committees, and the vice chairman serves as a member of the board compensation committee. The Board has two designated financial experts one of which serves on the audit committee. The responsibilities for each committee are set forth in its respective board approved charter.

Compensation of Directors

Directors were compensated in 2009 in cash at the rate of $50,205 per year, payable at $4,183 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. Total cash compensation paid to all directors as a group during 2009 was $993,965. Directors received no non-cash compensation during 2009. Additional information for each director who served during 2009 is provided below.

	Number of Days Served			
Name of Director	Board Meetings	Other Official Activities*	Farm Credit Council Bd. Activities	Total Comp. Paid During 2009
Gary L. Alexander	25.50	10.50	7.75	$50,205
William C. Bess, Jr.	24.50	10.00	5.50	50,205
Don W. Freeman	25.50	9.00	7.75	50,205
Dale R. Hershey	25.50	12.75	7.75	50,205
Robert L. Holden, Sr.	22.50	13.00	7.75	50,205
Paul M. House	24.00	13.75	7.75	50,205
Thomas W. Kelly	25.50	13.25	7.75	50,205
Lyle Ray King	24.50	12.50	5.50	50,205
M. Wayne Lambertson	25.50	13.00	7.75	50,205
James L. May	25.50	13.50	7.75	50,205
Eugene W. Merritt, Jr.	25.50	8.75**	7.75	50,205
James M. Norsworthy	25.50	13.75	7.75	50,205
Katherine A. Pace	25.50	10.75	7.75	50,205
J. Dan Raines, Jr.	23.00	9.50	7.25	50,205
Walter L. Schmidlen, Jr.	25.50	13.25	7.75	50,205
Robert G. Sexton	25.50	13.75***	7.75	51,405 ****
Kenneth A. Spearman	17.00	13.00	7.25	38,870
Robert H. Spiers, Jr.	25.50	12.00	7.75	50,205
William H. Voss	25.50	9.00	7.75	50,205
J. Mark Wheeler	25.50	13.50	7.75	50,205
Total				$993,965

* *Other official activities include board committee meetings and board training.*

** *Does not include 10.50 days served on AgFirst/FCBT Plan Fiduciary Committee.*

*** *Does not include 6.00 days served on AgFirst and AgFirst/FCBT Plan Sponsor Committees.*

**** *Includes compensation for attending a Federal Farm Credit Banks Funding Corporation Board meeting.*

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 $236,458 for 2009, $259,345 for 2008, and $251,988 for 2007.

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 14 to the Combined Financial Statements, *Related Party Transactions,* included in this Annual Report to shareholders. There have been no transactions between the Bank and senior officers or directors which require reporting per FCA regulations.

Involvement in Certain Legal Proceedings

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

Relationship with Independent Auditor

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

Aggregate fees expensed by the Bank for services rendered by its independent auditor for the year ended December 31, 2009 were as follows. Independent auditor fees expensed by District Associations are disclosed in each respective Association's Annual Report.

	2009
Independent Auditor	
PricewaterhouseCoopers LLP	
Audit services	$ 458,788
Non-audit services	81,382
Total	$ 540,170

Audit fees were for the annual audits of financial statements.

Non-audit fees were for agreed upon procedures for Financial Institution Shared Assessments Program readiness, agreed upon procedures for Board of Directors elections, and accounting guidance.

All non-audit service engagements of $50,000 or more for the Bank require pre-approval by the Audit Committee.

Combined Financial Statements

The Combined Financial Statements, together with the report thereon of PricewaterhouseCoopers LLP, dated March 12, 2010, and the Report of Management, which appear in this Annual Report to shareholders are incorporated herein by reference.

Borrower Information Regulations

Farm Credit Administration (FCA) regulations require 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 Farm Credit 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. 378, or writing Stephen Gilbert, Controller, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst's web site at ***www.agfirst.com***. The Bank prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Report to shareholders within 90 days after the end of the fiscal year. The Bank prepares an electronic version of each Quarterly Report within 40 days after the end of each fiscal quarter, except that no report is prepared for the fiscal quarter that coincides with the end of the fiscal year of the Bank.

Report of the Audit Committee

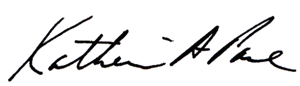
The Audit Committee of the Bank's Board of Directors (the Committee) is comprised of the directors named below. None of the directors who serve on the Committee is an employee of AgFirst Farm Credit Bank (the Bank) and in the opinion of the Board of Directors, each is free of any relationship with the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

PricewaterhouseCoopers LLP (PwC), the Bank and District Associations combined independent auditor for 2009, is responsible for expressing an opinion on the conformity of the Bank and District Associations combined audited financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 114 *(The Auditor's Communication With Those Charged With Governance)*. PwC has provided to the Committee the written disclosures and the letter required by Independence Standards Board Standard No. 1 *(Independence Discussions with Audit Committees)*, and the Committee has discussed with PwC that firm's independence.

The Committee has also concluded that PwC's provision of non-audit services 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 Bank and District Associations combined Annual Report for 2009. The foregoing report is provided by the following independent directors, who constitute the Committee:



Katherine A. Pace
Chairman of the Audit Committee

Members of Audit Committee

Gary L. Alexander
Bobby E. McCollum, Jr.
James M. Norsworthy, III
J. Mark Wheeler

March 12, 2010

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, 2009, 2008 and 2007, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the 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

March 12, 2010

Combined Balance Sheets

(dollars in thousands)	As of December 31, 2009	2008	2007
Assets			
Cash and cash equivalents	$ 981,041	$ 316,010	$ 612,841
Investment securities:			
Available for sale (amortized cost of $7,008,151 $6,648,869 and $5,679,228 respectively)	6,886,270	6,291,327	5,641,430
Held to maturity (fair value of $1,585,825, $1,907,489 and $1,397,015 respectively)	1,555,960	1,875,699	1,419,371
Total investment securities	8,442,230	8,167,026	7,060,801
Loans	23,208,189	23,077,736	20,728,296
Less: allowance for loan losses	195,132	169,090	78,874
Net loans	23,013,057	22,908,646	20,649,422
Loans held for sale	4,974	1,831	1,904
Other investments	367,461	410,249	430,812
Accrued interest receivable	206,470	235,080	252,838
Investments in other Farm Credit System institutions	22,074	19,822	8,374
Premises and equipment, net	126,850	126,850	123,012
Other property owned	73,354	14,228	8,504
Deferred tax assets, net	1	—	5
Other assets	167,985	212,688	112,638
Total assets	$33,405,497	$32,412,430	$29,261,151
Liabilities			
Bonds and notes	$28,894,013	$28,253,023	$24,847,248
Mandatorily redeemable preferred stock	225,000	225,000	225,000
Accrued interest and dividends payable	83,164	154,555	179,578
Dividends and patronage refunds payable	79,622	103,187	132,146
Pension and other postretirement benefits liability	324,734	374,355	128,415
Advanced conditional payments	7,962	21,177	31,574
Deferred tax liability, net	—	7	—
Other liabilities	163,975	159,400	151,116
Total liabilities	29,778,470	29,290,704	25,695,077
Commitments and contingencies (Note 16)			
Shareholders' Equity			
Perpetual preferred stock	400,000	400,000	400,000
Protected borrower equity	4,205	4,670	5,369
Capital stock and participation certificates	138,504	129,529	127,147
Retained earnings			
Allocated	1,199,441	1,126,994	1,068,756
Unallocated	2,323,523	2,191,324	2,118,390
Accumulated other comprehensive income (loss)	(438,646)	(730,791)	(153,588)
Total shareholders' equity	3,627,027	3,121,726	3,566,074
Total liabilities and shareholders' equity	$33,405,497	$32,412,430	$29,261,151

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, 2009	2008	2007
Interest Income			
Investment securities	$ 206,339	$ 311,787	$ 392,113
Loans	1,255,616	1,456,566	1,516,587
Other investments	19,035	21,872	23,076
Total interest income	1,480,990	1,790,225	1,931,776
Interest Expense	543,551	972,361	1,209,586
Net interest income	937,439	817,864	722,190
Provision for (reversal of allowance) for loan losses	162,893	121,023	8,284
Net interest income after provision for (reversal of allowance) for loan losses	774,546	696,841	713,906
Noninterest Income			
Loan fees	46,512	38,705	29,996
Fees for financially related services	10,710	11,353	9,228
Gains (losses) from other property owned, net	(10,184)	(1,102)	(999)
Gains (losses) on investments, net (Note 3)	9,918	—	1
Impairment losses on investments (Note 3)	(61,001)	(10,465)	—
Noncredit-related losses on investments not expected to be sold (recognized in other comprehensive income) (Note 3)	34,547	—	—
Net impairment losses on investments	(26,454)	(10,465)	—
Gains (losses) on derivatives, net	469	(359)	—
Gains (losses) on sale of rural home loans	2,601	2,142	147
Gains from sale of premises and equipment, net	1,706	4,613	2,016
Patronage refunds from other Farm Credit institutions	5,493	4,084	1,790
Other noninterest income	8,900	2,583	6,745
Total noninterest income	49,671	51,554	48,924
Noninterest Expense			
Salaries and employee benefits	249,917	198,657	198,539
Occupancy and equipment	36,757	36,665	33,771
Insurance Fund premiums	48,243	35,337	28,200
Other operating expense	77,430	83,204	76,293
Called debt expense	36,532	26,652	10,550
Correspondent lending servicing expense	6,303	4,017	2,071
Other noninterest expense	278	278	1,077
Total noninterest expense	455,460	384,810	350,501
Income before income taxes	368,757	363,585	412,329
Provision for income taxes	3,890	65	412
Net income	$ 364,867	$ 363,520	$ 411,917

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, 2006	$ 150,000	$ 6,208	$ 118,817	$ 992,227	$ 2,039,308	$ 1,623	$ 3,308,183
Comprehensive income							
Net income					411,917		411,917
Unrealized gains (losses) on investments available for sale						(39,780)	(39,780)
Minimum pension liability adjustment						21	21
Total comprehensive income							372,158
Protected borrower equity retired		(839)					(839)
Preferred stock issued	250,000						250,000
Issuance cost on preferred stock					(2,742)		(2,742)
Capital stock/participation certificates issued/(retired), net			7,197				7,197
Stock dividends declared/paid			1,133		(1,133)		—
Perpetual preferred stock dividends paid					(19,501)		(19,501)
Patronage distribution							
Cash					(129,698)		(129,698)
Qualified allocated surplus				18,202	(18,202)		—
Nonqualified allocated surplus				90,743	(90,743)		—
Nonqualified retained surplus				71,700	(71,700)		—
Retained earnings retired				(105,020)			(105,020)
Patronage distribution adjustment				904	884		1,788
Adjustment to initially apply accounting guidance for employee benefit plans (Note 13)						(115,452)	(115,452)
Balance at December 31, 2007	400,000	5,369	127,147	1,068,756	2,118,390	(153,588)	3,566,074
Comprehensive income							
Net income					363,520		363,520
Unrealized gains (losses) on investments available for sale						(319,744)	(319,744)
Employee benefit plans adjustments (Note 13)					(5,013)	(257,459)	(262,472)
Total comprehensive income							(218,696)
Protected borrower equity retired		(699)					(699)
Capital stock/participation certificates issued/(retired), net			1,180				1,180
Stock dividends declared/paid			1,202		(1,202)		—
Perpetual preferred stock dividends paid					(27,413)		(27,413)
Patronage distribution							
Cash					(101,203)		(101,203)
Qualified allocated surplus				20,734	(20,734)		—
Nonqualified allocated surplus				67,605	(67,605)		—
Nonqualified retained surplus				65,449	(65,449)		—
Retained earnings retired				(94,813)			(94,813)
Patronage distribution adjustment				(737)	(1,967)		(2,704)
Balance at December 31, 2008	400,000	4,670	129,529	1,126,994	2,191,324	(730,791)	3,121,726
Cumulative-effect adjustment for investment impairment accounting change (Note 3)					3,474	(3,474)	—
Comprehensive income							
Net income					364,867		364,867
Unrealized gains (losses) on investments available for sale:							
Other-than-temporarily impaired (Note 3)						(31,909)	
Temporarily impaired (Note 3)						271,043	
Total unrealized gains (losses) on investments available for sale							239,134
Employee benefit plans adjustments (Note 13)						56,485	56,485
Total comprehensive loss							660,486
Protected borrower equity retired		(465)					(465)
Capital stock/participation certificates issued/(retired), net			7,807				7,807
Stock dividends declared/paid			1,168		(1,168)		—
Perpetual preferred stock dividends paid					(27,413)		(27,413)
Patronage distribution							
Cash					(78,191)		(78,191)
Qualified allocated surplus				20,779	(20,779)		—
Nonqualified allocated surplus				45,462	(45,462)		—
Nonqualified retained surplus				62,269	(62,269)		—
Retained earnings retired				(59,329)			(59,329)
Patronage distribution adjustment				3,266	(860)		2,406
Balance at December 31, 2009	$ 400,000	$ 4,205	$ 138,504	$1,199,441	$ 2,323,523	$ (438,646)	$ 3,627,027

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

Combined Statements of Cash Flows

(dollars in thousands)	For the year ended December 31, 2009	2008	2007
Cash flows from operating activities:			
Net income	$ 364,867	$ 363,520	$ 411,917
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation on premises and equipment	18,665	19,091	18,090
Amortization (accretion) of net deferred loan origination costs (fees)	(11,048)	(9,638)	(5,110)
(Premium amortization) discount accretion on investment securities	38,605	(13,386)	(23,617)
Premium amortization (discount accretion) on bonds and notes	(4,631)	7,820	7,343
Provision for (reversal of allowance for) loan losses	162,893	121,023	8,284
Net impairment losses on investments	26,454	10,465	—
(Gains) losses on other property owned, net	10,184	1,102	999
(Gains) losses from sale of premises and equipment, net	(1,706)	(4,613)	(2,016)
(Gains) losses on investments, net	(9,918)	—	(1)
(Gains) losses on derivatives, net	(469)	359	—
Gains (losses) on sales of rural home loans, net	(2,601)	(2,142)	(147)
Net change in loans held for sale	(43,609)	(22,181)	28,220
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	28,610	17,758	(6,654)
(Increase) decrease in deferred tax assets, net	(8)	12	158
(Increase) decrease in other assets	(10,238)	(8,255)	123,801
Increase (decrease) in accrued interest and dividends payable	(71,391)	(25,023)	(8,450)
Increase (decrease) in pension and other postretirement benefits liability	(49,621)	245,940	14,352
Increase (decrease) in other liabilities	38,177	(251,843)	(116,506)
Total adjustments	118,348	86,489	38,746
Net cash provided by operating activities	483,215	450,009	450,663
Cash flows from investing activities:			
Investment securities purchased	(2,656,732)	(3,149,180)	(2,223,352)
Investment securities sold or matured	2,535,083	1,704,260	1,615,415
Net (increase) decrease in loans	(240,156)	(2,356,801)	(2,089,074)
(Increase) decrease in investments in other Farm Credit System institutions	(2,252)	(11,448)	364
Purchases of other investments	(54,065)	(29,666)	(44,110)
Proceeds from payments received on other investments	77,818	72,101	64,379
Purchase of premises and equipment	(19,554)	(24,997)	(22,082)
Proceeds from sale of premises and equipment	2,595	6,681	3,119
Proceeds from sale of other property owned	30,110	3,762	4,266
Net cash used in investing activities	(327,153)	(3,785,288)	(2,691,075)
Cash flows from financing activities:			
Bonds and notes issued	108,805,294	111,749,964	66,559,204
Bonds and notes retired	(108,104,360)	(108,446,508)	(64,383,204)
Net increase (decrease) in advanced conditional payments	(13,215)	(10,397)	8,547
Perpetual preferred stock issued net of issuance cost	—	—	247,258
Protected borrower equity retired	(465)	(699)	(839)
Capital stock and participation certificates issued/(retired), net	7,807	1,180	7,197
Patronage refunds and dividends paid	(99,350)	(132,866)	(111,657)
Dividends paid on perpetual preferred stock	(27,413)	(27,413)	(19,501)
Retained earnings retired	(59,329)	(94,813)	(105,020)
Net cash provided by financing activities	508,969	3,038,448	2,201,985
Net increase (decrease) in cash and cash equivalents	665,031	(296,831)	(38,427)
Cash and cash equivalents, beginning of period	316,010	612,841	651,268
Cash and cash equivalents, end of period	$ 981,041	$ 316,010	$ 612,841
Supplemental schedule of non-cash investing and financing activities:			
Financed sales of other property owned	$ 39,636	$ 5,428	$ 355
Loans transferred to other property owned	139,056	16,016	9,002
Investments transferred to loans (Note 2)	91,353	—	—
Loans transferred to investments (Note 3)	18,900	—	—
Change in unrealized gains (losses) on investments	239,134	(319,744)	(39,780)
Change in pension liability related to other comprehensive income	—	—	(21)
Decrease in other assets resulting from adoption of accounting guidance for employee benefit plans (Note 13)	—	—	105,047
Increase in liability resulting from adoption of accounting guidance for employee benefit plans (Note 13)	—	—	10,405
Employee benefit plans adjustments (Note 13)	(56,485)	262,472	—
Non-cash changes related to hedging activities:			
Increase (decrease) in bonds and notes	$ (55,313)	$ 94,499	$ 50,526
Decrease (increase) in other assets	54,941	(91,795)	(29,572)
Increase (decrease) in other liabilities	(240)	(2,091)	(20,954)
Supplemental information:			
Interest paid	619,573	$ 989,564	$ 1,210,693
Taxes paid, net	3,803	556	(2,675)

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

Notes to the 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 and related service organizations. 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. AgFirst is chartered to serve 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, 2009, the District consisted of the Bank and twenty-two District ACAs. All twenty-two ACAs are structured as holding companies, which include FLCA and PCA subsidiaries.

Each FCB and the ACB are responsible for supervising the activities of the Associations within their districts. The FCBs and/or Associations make loans to or for the benefit of eligible borrowers/shareholders for qualified agricultural and rural purposes. District Associations borrow the majority of their funds from their related bank. The FCBs and the ACB obtain a substantial majority of funds for their lending operations through the sale of consolidated Systemwide bonds and notes to the public, but also obtain a portion of their funds from internally generated earnings, from the issuance of common and preferred stock and, to a lesser extent, from the issuance of subordinated debt.

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 discretionary uses by the Insurance Corporation to provide assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank has been required to pay premiums, which may be passed on to the Associations, into the Insurance Fund, based on its annual average adjusted outstanding Insured Debt until the assets in the Insurance Fund reach the "secure base amount." The secure base amount is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments) 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 must still ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

The basis for assessing premiums was changed, beginning with the second half of 2008, to reflect each bank's pro rata share of outstanding Insured Debt. Prior to that, premiums had been based primarily on loans outstanding. Premiums of up to 20 basis points on adjusted Insured Debt obligations can be assessed along with a risk surcharge of 10 basis points on nonaccrual loans and other-than-temporarily impaired investments. Premiums for the third and fourth quarters of 2008 were 15 and 18 basis points, respectively. For 2009, the premium was 20 basis points. Effective January 1, 2010, the premium was decreased to 10 basis points.

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 other financial institutions qualified to engage 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* — being a reciprocal insurer, 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. Significant estimates are discussed in these footnotes, as applicable. Actual results can differ from these estimates.

Certain amounts in prior years' financial statements have been reclassified to conform to the current year's presentation. Also, during the second quarter of 2009, the Bank reclassified from investments to loans certain financial instruments which totaled $91.4 million. These instruments were secondary market acquisitions of either private placement or senior secured notes transacted under the scope of the Bank's lending authority. The reclassification better reflects the nature of these notes and provides for consistent presentation across the Farm Credit System. This reclassification of $91.4 million is reflected as a non-cash item in the Combined Statements of Cash Flows and did not have a significant impact on the Combined Financial Statements or the regulatory ratios.

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 on 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 value with net unrealized gains and losses included in Other Comprehensive Income (OCI) in Shareholders' Equity.

   Interest on investment securities, including amortization of premiums and accretion of discounts, is included in Interest Income. Realized gains and losses from the sales of investment securities are recognized in current earnings 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 carrying value of the security is written down to fair value, the credit-related impairment loss is recognized through earnings in the period of impairment and the non-credit related portion of impairment loss is recognized in other comprehensive income. Credit related loss is defined as the shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis.

C. **Loans and Allowance for Loan Losses**: Long-term real estate mortgage loans generally have original maturities up to thirty 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 adjusted for charge-offs, premiums, discounts, deferred loan fees or costs and derivative instruments and hedging valuation adjustments, if any.

   Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. The difference in the total investment in a loan and its principal amount is deferred as part of the carrying amount of the loan and the net difference is amortized over the life of the related loan as an adjustment to interest income using the effective interest method.

   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, 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, the interest portion of payments received in cash is generally recognized as interest income. Otherwise, loan payments are applied against the recorded investment in the loan asset. Nonaccrual loans may be returned to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected, and the loan is not classified "doubtful" or "loss."

   Loans are charged-off at the time they are determined to be uncollectible.

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

   The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through allowance for loan losses reversals and loan charge-offs. A review of individual loans in each respective portfolio is performed periodically to determine the appropriateness of risk ratings and to assure loss exposure to the District has been identified. 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 loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss.

   The District considers the following factors, among others, when determining the allowance for loan losses:

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

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

   A specific allowance may be established for impaired loans under Financial Accounting Standards Board (FASB) guidance on accounting by creditors for impairment of a loan. 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 at the loan's observable market price or fair value of the collateral if the loan is collateral dependent.

A general allowance may also be established under FASB guidance on accounting for contingencies, to reflect estimated probable credit losses incurred in the remainder of the loan portfolio at the financial statement date, which excludes loans included under the specific allowance discussed above. A general allowance can be evaluated on a pool basis for those loans with similar characteristics. The level of the general allowance may be based on management's best estimate of the likelihood of default adjusted for other relevant factors reflecting the current environment.

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 actions, is recorded upon acquisition at fair value less estimated selling costs. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income and expenses from operations and carrying value adjustments related to other property owned are included in net gains (losses) from other property owned in the Combined Statement of Income.

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. **Debt Issuance Cost:** 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 or 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 loan 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, 2009, 2008 and 2007 were $135.7 million, $160.7 million, and $180.5 million, respectively. The outstanding gross balances of advance conditional payments classified as other liabilities at December 31, 2009, 2008 and 2007 were $8.0 million, $31.0 million, and $31.6 million, respectively.

I. **Employee Benefit Plans:** The employees of the District may participate in one of four defined benefit retirement plans. The first plan (the District Plan) is the AgFirst Farm Credit Retirement Plan (FAP) and covers most eligible employees of eighteen Associations and AgFirst hired prior to January 1, 2003. The second plan is the Independent Associations' Retirement Plan (IAR) and covers eligible employees of four ACAs whose employment date is prior to January 1, 2009. The third plan is the First South Farm Credit, ACA Retirement Plan (FS Plan) and covers eligible employees of a single ACA whose employment date is prior to January 1, 2009. The fourth plan is the AgFirst Farm Credit Cash Balance Plan and covers eligible employees who were either hired on or after January 1, 2003 (for institutions in the FAP Plan) or hired on or after January 1, 2009 for institutions in the IAR Plan or FS Plan. 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. Pension benefits are primarily based on eligible compensation and years of service.

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) through two other postretirement benefit plans. Substantially all employees may become eligible for these benefits if they reach early retirement age, as defined by the plans, while working for the Bank or District Association. The plans are unfunded with expenses paid as incurred.

Substantially all District employees are eligible to participate in the defined contribution AgFirst/ FCBT (Farm Credit Bank of Texas) 401(k) Employee Benefit Plan (401(k) Plan), which qualifies as a 401(k) plan as defined by Internal Revenue Code. The 401(k) 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. The 401(k) Plan costs are expensed as funded.

AgFirst and certain District Associations also individually sponsor supplemental defined benefit and defined contribution retirement plans and offer deferred compensation plans for certain key employees. These plans are nonqualified; therefore, the associated liabilities are included in the District's combined balance sheets in other liabilities.

In accordance with FASB guidance, defined benefit plans covering more than one entity within the District represent multi-employer plans. See Note 13, *Employee Benefit Plans*, for additional financial information for these plans, including the impact of this guidance on the current period.

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.

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, 2009, deferred income taxes had not been provided by certain District Associations on approximately $125.1 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.

There were no uncertain positions for income taxes at December 31, 2009.

K. **Derivative Instruments and Hedging Activity:** The Bank is party to derivative financial instruments, primarily interest rate swaps and caps, which are used principally to reduce funding costs. Derivatives are included in the Combined Balance Sheets 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) (AOCI) depending on the risk being hedged. 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 and changes reported in earnings. 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 AOCI. The gains and losses on the derivative that are deferred and reported in AOCI will be reclassified into 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, if any, 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 at the hedge's inception whether the derivatives that are used in hedging transactions will be 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 on an ongoing basis. 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 AOCI 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 derivative 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 may be 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.

See *Recent Accounting Developments* section below for additional information regarding expanded disclosure requirements for derivative instruments.

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 for which an observable liquid market exists, such as the majority of the District's 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, certain derivatives, certain investment securities 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 asset or liability values, which could have material positive or negative effects on the District's results of operations.

Effective January 1, 2008, the Bank adopted FASB guidance on fair value measurements. This guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. This guidance also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. It describes three levels of inputs that may be used to measure fair value as discussed in Note 17.

M. **Recent Accounting Developments:** Effective January 1, 2009, the District adopted FASB guidance which amended and expanded disclosures about derivative instruments and hedging activities. The guidance requires that an entity with derivative instruments shall disclose information to enable users of the financial statements to understand:

a. How and why an entity uses derivative instruments
b. How derivative instruments and related hedged items are accounted for under appropriate guidance
c. How derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows.

The adoption of this guidance did not have an impact on the financial statements. However, the derivative instruments disclosures have been expanded (see Note 18).

Effective January 1, 2009, the Bank adopted accounting guidance for fair value measurement of nonfinancial assets and liabilities. The impact of adoption resulted in additional fair value disclosures (see Note 17), primarily regarding other property owned, but did not have an impact on the Bank's financial condition or results of operations.

In April 2009, the FASB issued guidance, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly." The guidance emphasized that even if there has been a significant decrease in the volume and level of market activity for the asset or liability and regardless of the valuation technique and inputs used, the objective for the fair value measurement is unchanged from what it would be if markets were operating at normal activity levels or transactions were orderly; that is, to determine the current exit price. It sets forth additional factors that should be considered to determine whether there has been a significant decrease in volume and level of activity when compared with normal market activity. The reporting entity shall evaluate the significance and relevance of the factors to determine whether, based on the weight of evidence, there has been a significant decrease in activity and volume. The guidance indicates that if an entity determines that either the volume or level of activity for an asset or liability has significantly decreased (from normal conditions for that asset or liability) or price quotations or observable inputs are not associated with orderly transactions, increased analysis and management judgment will be required to estimate fair value. It is further noted that a fair value measurement should include a risk adjustment to reflect the amount market participants would demand because of the risk (uncertainty) in the cash flows.

This guidance also requires a reporting entity to make additional disclosures in interim and annual periods. Revisions resulting from a change in valuation techniques or their application are accounted for as a change in accounting estimate. The District adopted this guidance effective March 31, 2009 (see Note 3 and Note 17).

In April 2009, the FASB issued guidance, "Recognition and Presentation of Other-Than-Temporary Impairments," which amends the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt securities in the financial statements. It does not change existing recognition and measurement guidance related to other-than-temporary impairments of equity securities.

This guidance changes existing impairment guidance related to accounting for certain investments in debt and equity securities by eliminating the "ability and intent to hold" provision. In addition, impairment is now considered to be other than temporary if an entity 1) intends to sell the security, 2) more likely than not will be required to sell the security before recovering its cost, or 3) does not expect to recover the security's entire amortized cost basis (even if the entity does not intend to sell). The "probability" standard relating to the collectability of cash flows is also eliminated, and impairment is now considered to be other-than-temporary if the present value of cash flows expected to be collected from the debt security is less than the amortized cost basis of the security (any such shortfall is referred to as a "credit loss"). If an entity intends to sell an impaired debt security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the impairment is other-than-temporary and should be recognized currently in earnings in an amount equal to the entire difference between fair value and amortized cost. If a credit loss exists, but an entity does not intend to sell the impaired debt security and it is not more likely than not to be required to sell before recovery, the impairment is other-than-temporary and should be separated into 1) the estimated amount relating to credit loss and 2) the amount relating to all other factors. Only the estimated credit loss amount is recognized currently in earnings, with the remainder of the loss amount recognized in other comprehensive income. For held-to-maturity securities, the portion of the other-than-temporary impairment not related to a credit loss will be recognized in a new category of other comprehensive income and amortized over the remaining life of the debt security as an increase in the security's carrying amount. Disclosure requirements for impaired debt and equity securities are expanded and will now be required quarterly, as well as annually (see Note 3).

The District adopted this guidance effective March 31, 2009. For securities held at the beginning of the interim period of adoption for which an other-than-temporary impairment was previously recognized, if an entity does not intend to sell and it is not more likely than not that it will be required to sell before recovery of its amortized cost basis, the entity shall recognize the cumulative effect of initially applying this guidance as an adjustment to the opening balance of retained earnings with a corresponding adjustment to AOCI. The Bank recognized an adjustment to beginning retained earnings in the amount of $3.5 million, and a corresponding adjustment to AOCI of $3.5 million in the first quarter of 2009.

In April 2009, the FASB issued guidance, "Interim Disclosures about Fair Value of Financial Instruments," which requires disclosures about fair value of financial instruments for interim reporting periods as well as in annual financial statements. The Bank adopted this guidance effective March 31, 2009 (see Note 18).

In May 2009, the FASB issued guidance, "Subsequent Events," which sets forth general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. There are two types of subsequent events: the first type consists of events or transactions that provide additional evidence about conditions that existed at the balance sheet date (recognized subsequent events) and the second type consists of events that provide evidence about conditions that did not exist at the balance sheet date but arose after that date (nonrecognized subsequent events). Recognized subsequent events should be reflected in the financial statements since the conditions existed at the date of the balance sheet. Nonrecognized subsequent events are not reflected in the financial statements since the conditions arose after the balance sheet date but before the financial statements are issued or are available to be issued. This guidance, which includes a required disclosure of the date through which an entity has evaluated subsequent events, was adopted by the Bank effective June 30, 2009 (see Note 24).

In June 2009, the FASB issued guidance, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles." This Codification became the source of authoritative U.S. generally accepted accounting principles recognized by the FASB. This guidance was adopted by the Bank effective July 1, 2009 and had no impact on the Bank's financial condition or results of operations. However, it results in disclosure modifications to eliminate pre-codification references.

In June 2009, the FASB issued guidance "Accounting for Transfers of Financial Assets," which amends previous guidance by improving the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets.

This guidance is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application is prohibited. This guidance must be applied to transfers occurring on or after the effective date. Additionally, on and after the effective date, the concept of a qualifying special purpose entity is no longer relevant for accounting purposes. Therefore, formerly qualifying special-purpose entities (as defined under previous accounting guidance) should be evaluated for consolidation by reporting entities on and after the effective date in accordance with the applicable consolidation guidance. If the evaluation on the effective date results in consolidation, the reporting entity should apply the transition guidance that requires consolidation. The Bank is currently evaluating the impact of adoption on its loan participation agreements to ensure that participations would meet the requirements for sales treatment. The impact of adoption is expected to be immaterial to the District's financial condition and results of operations.

In June 2009, the FASB also issued guidance to improve financial reporting for those enterprises involved with variable interest entities, which amends previous guidance by requiring an enterprise to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity.

Additionally, an enterprise is required to assess whether it has an implicit financial responsibility to ensure that a variable interest entity operates as designed when determining whether it has the power to direct the activities of the variable interest entity that most significantly impact the entity's economic performance.

This guidance is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Bank is currently evaluating the impact of adoption on its financial condition and results of operations but expects transactions that are included in the scope of this guidance, if any, to be immaterial to the District's financial condition and results of operations.

In January 2010, the FASB issued guidance "Fair Value Measurements and Disclosures," which is to improve disclosures about fair value measurement by increasing transparency in financial reporting. The changes will provide a greater level of disaggregated information and more detail disclosures of valuation techniques and inputs to fair value measurement. The new disclosures and clarification of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the rollforward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this guidance will have no impact on the Bank's financial condition and results of operations but will result in additional disclosures.

Note 3 — Investment Securities

Available-for-Sale

A summary of the amortized cost and fair value of District debt securities held as available-for-sale investments at December 31, 2009, 2008 and 2007, follows. At December 31, 2009, the amortized cost and fair value of Bank debt securities held as available-for sale investments were $6.96 billion (99.3 percent) and $6.84 billion (99.3 percent), respectively, of the District total amounts.

	December 31, 2009				
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Govt. GNMA MBS/CMOs	$ 3,835,831	$ 34,286	$ (12,958)	$ 3,857,159	2.04%
U.S. Govt. Agency MBS	2,595,257	22,374	(44,256)	2,573,375	1.58
Non-Agency Securities	460,865	–	(100,839)	360,026	0.56
Commercial MBS	10,353	–	(539)	9,814	1.34
Asset-Backed Securities	105,845	55	(20,004)	85,896	0.79
Total	$ 7,008,151	$ 56,715	$ (178,596)	$ 6,886,270	1.75%

	December 31, 2008				
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Govt. GNMA MBS/CMOs	$ 3,296,293	$ 6,497	$ (57,508)	$ 3,245,282	2.25%
U.S. Govt. Agency MBS	2,632,141	5,161	(103,309)	2,533,993	2.27
Non-Agency Securities	566,777	275	(162,731)	404,321	1.63
Commercial MBS	13,272	–	(1,505)	11,767	1.89
Asset-Backed Securities	140,386	–	(44,422)	95,964	3.32
Total	$ 6,648,869	$ 11,933	$ (369,475)	$ 6,291,327	2.23%

	December 31, 2007				
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Govt. GNMA MBS/CMOs	$ 1,754,693	$ 3,393	$ (3,533)	$ 1,754,553	4.99%
U.S. Govt. Agency MBS	3,066,315	10,595	(14,869)	3,062,041	5.03
Non-Agency Securities	651,767	718	(15,926)	636,559	5.23
Commercial MBS	4,632	–	(35)	4,597	5.53
Asset-Backed Securities	201,821	9	(18,150)	183,680	5.13
Total	$ 5,679,228	$ 14,715	$ (52,513)	$ 5,641,430	5.05%

Held-to-Maturity

A summary of the amortized cost and fair value of District debt securities held as held-to-maturity investments at December 31, 2009, 2008 and 2007, follows. At December 31, 2009, the amortized cost and fair value of Bank debt securities held as held-to-maturity investments were $1.39 billion (89.2 percent) and $1.43 billion (90.0 percent), respectively, of the District total amounts.

	December 31, 2009				
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Govt. Agency MBS	$ 1,250,051	$ 47,751	$ (289)	$ 1,297,513	5.19%
Asset-Backed Securities	96,580	555	(912)	96,223	1.60
Mission Related Investments	209,329	2,329	(19,569)	192,089	6.13
Total	$ 1,555,960	$ 50,635	$ (20,770)	$ 1,585,825	5.10%

	December 31, 2008				
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Govt. Agency MBS	$ 1,510,192	$ 45,341	$ (341)	$ 1,555,192	5.17%
Asset-Backed Securities	131,877	471	(1,380)	130,968	3.06
Mission Related Investments	233,630	7,038	(19,339)	221,329	6.15
Total	$ 1,875,699	$ 52,850	$ (21,060)	$ 1,907,489	5.15%

	December 31, 2007				
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Govt. Agency MBS	$ 1,141,801	$ 224	$ (20,469)	$ 1,121,556	5.08%
Asset-Backed Securities	115,983	263	(806)	115,440	5.37
Mission Related Investments	161,587	1,805	(3,373)	160,019	6.42
Total	$ 1,419,371	$ 2,292	$ (24,648)	$ 1,397,015	5.26%

A summary of the expected maturity, estimated fair value, and amortized cost of investment securities at December 31, 2009 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 MBS/CMOs	$ -	- %	$ -	- %	$ 1,625	0.65 %	$ 3,855,534	2.04%	$ 3,857,159	2.04%
U.S. Govt. Agency MBS	-		670	0.88	138,105	1.68	2,434,600	1.57	2,573,375	1.58
Non-Agency CMOs	-	-	-	-	-	-	360,026	0.56	360,026	0.56
Commercial MBS	-	-	-	-	-	-	9,814	1.34	9,814	1.34
Asset-Backed Securities	553	1.37	26,437	1.66	11,441	1.21	47,465	0.48	85,896	0.79
Total fair value	$ 553	1.37 %	$ 27,107	1.35 %	$ 151,171	1.64 %	$ 6,707,439	1.75%	$ 6,886,270	1.75%
Total amortized cost	$ 550		$ 27,247		$ 150,439		$ 6,829,915		$ 7,008,151	

Held-to-maturity

(dollars in thousands)	Due in 1 year or less Amount	Weighted Average Yield	Due after 1 year through 5 years Amount	Weighted Average Yield	Due after 5 years through 10 years Amount	Weighted Average Yield	Due after 10 years Amount	Weighted Average Yield	Total Amount	Weighted Average Yield
U.S. Govt. Agency MBS	$ -	- %	$ -	- %	$ 2,900	5.00 %	$ 1,247,151	5.19 %	$ 1,250,051	5.19 %
Asset-Backed Securities	1,985	1.96	11,746	1.65	50,198	1.50	32,651	1.71	96,580	1.60
Mission Related Investments	5,522	6.13	9,807	3.34	41,353	6.51	152,647	6.20	209,329	6.13
Total amortized cost	$ 7,507	5.03 %	$ 21,553	2.42 %	$ 94,451	3.80 %	$ 1,432,449	5.22 %	$ 1,555,960	5.10 %
Total fair value	$ 7,675		$ 21,864		$ 93,058		$ 1,463,228		$ 1,585,825	

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

Proceeds from sales and realized gains and losses on sales of investment securities are as follows:

(dollars in thousands)	Year Ended December 31, 2009	2008	2007
Proceeds from sales	$ 167,262	$ –	$ 7,976
Realized gains	9,918	–	1
Realized losses	–	–	–

AgFirst's and certain District Association investments include primarily mortgage-backed securities (MBSs) and asset backed securities (ABSs). These securities are held to maintain a liquidity reserve, manage short-term surplus funds, and manage interest rate risk. These securities must meet the applicable Farm Credit Administration (FCA) regulatory guidelines, which require these securities to be high quality, senior class, and rated in the top category (AAA/Aaa) by Nationally Recognized Statistical Rating Organizations (NRSROs) at the time of purchase. To achieve the ratings, these securities have a guarantee of timely payment of principal and interest or credit enhancement achieved through over collateralization or other means and the priority of payments of senior classes over junior classes. All ABSs have credit enhancement features including senior/subordinate structure and/or are backed by a bond insurer.

The FCA considers a MBS or ABS ineligible if it falls below the AAA/Aaa credit rating criteria and requires System institutions to divest of such an investment unless the FCA grants specific approval to continue to hold an ineligible security.

MBSs are collateralized by U.S. government or U.S. agency guaranteed residential mortgages and all were rated AAA/Aaa at December 31, 2009. Non-agency CMO securities not rated in the top category by at least one of the NRSROs at December 31, 2009 had a fair value of $185.7 million. ABSs not rated in the top category by at least one of the NRSROs at December 31, 2009 had a fair value of $35.8 million. For each of these investment securities in the District's portfolio rated below AAA/Aaa, the District has developed and submitted plans for approval by the FCA that provide that the securities may be held to maturity. The FCA has approved, with conditions, the District's plans for all except those investments that have recently become ineligible, which the FCA is still in the process of reviewing.

The fair value of all investments at December 31, 2009 split rated AAA/Aaa or lower by the NRSROs totaled $393.0 million (amortized cost of $512.0 million). This represents approximately 4.64 percent (and 5.98 percent) of total fair value (and amortized cost) of the District's total investment portfolio at December 31, 2009. Split rated AAA/Aaa is defined as a security maintaining different ratings by the NRSROs with at least one NRSRO rating the security AAA/Aaa.

Rural America Bonds consist of private placement securities purchased under the Mission Related Program approved by the FCA. In 2009, certain District Associations reclassified mission-related investments purchased in 2008, which totaled $18.9 million from loans to investments. The reclassification better reflects the nature of these financial instruments and provides for consistent presentation across the District.

An investment is considered impaired if its fair value is less than its cost. A continuous unrealized loss position for an investment is based on the date the impairment was first identified. This also applies to those securities other-than-temporarily impaired for which a credit loss has been recognized but noncredit-related losses continue to remain unrealized. The following table shows the fair value and gross unrealized losses for investments that have been in a continuous unrealized loss position aggregated by investment category at December 31, 2009.

(dollars in thousands)	Less than 12 Months Fair Value	Unrealized Losses	Greater than 12 Months Fair Value	Unrealized Losses
U.S. Govt. GNMA MBS/CMOs	$ 186,492	$ 1,242	$ 1,269,486	$ 11,716
U.S. Govt. Agency MBS	213,231	2,014	1,369,665	42,531
Non-Agency CMOs	12,042	2,395	347,984	98,444
Asset-Backed Securities	18,897	153	97,021	20,763
Mortgage-Backed Securities	–	–	9,814	539
Mission Related Investments	67,072	11,949	75,690	7,620
Total	$ 497,734	$ 17,753	$ 3,169,660	$ 181,613

(dollars in thousands)	Total Fair Value	Unrealized Losses
U.S. Govt. GNMA MBS/CMOs	$ 1,455,978	$ 12,958
U.S. Govt. Agency MBS	1,582,896	44,545
Non-Agency CMOs	360,026	100,839
Asset-Backed Securities	115,918	20,916
Mortgage-Backed Securities	9,814	539
Mission Related Investments	142,762	19,569
Total	$ 3,667,394	$ 199,366

On December 31, 2009, the District held certain investments having continuous unrealized loss positions for more than 12 months with a fair value totaling $3.2 billion and an unrealized loss position totaling $181.6 million. As more fully discussed in Note 2, the new FASB guidance for other-than-temporary impairment contemplates numerous factors in determining whether an impairment is other-than-temporary including: (1) whether or not management intends to sell the security, (2) whether it is more likely than not that management would be required to sell the security before recovering its costs, or (3) whether management expects to recover the security's entire amortized cost basis (even if there is no intention to sell). If the District intends to sell the security or it is more likely than not that it would be required to sell the security, the impairment loss equals the full difference between amortized cost and fair value of the security. When the District does not intend to sell securities in an unrealized loss position and it is not more likely than not that it would be required to sell the securities, other-than-temporary impairment loss is separated into credit loss and non-credit loss. Credit loss is defined as the shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis.

The District performs periodic credit reviews, including other-than-temporary impairment analyses, on its investment securities portfolio. The objective is to quantify any future possible loss of principal or interest due on securities in the portfolio. Factors considered in determining whether an impairment is other-than-temporary include among others: 1) the length of time and the extent to which the fair value is less than cost, 2) adverse conditions specifically related to the industry, 3) geographic area and the condition of the underlying collateral, 4) payment structure of the security, 5) ratings by rating agencies, 6) the credit worthiness of bond insurers, and 7) volatility of the fair value changes. Based on the results of all analyses, the District has recognized total other-than-temporary impairment during 2009 of $61.0 million in connection with ABS securities and non-agency CMO securities in its portfolio, which is included in Impairment Losses on Investments in the Combined Statements of Income.

Since the District does not intend to sell these other-than-temporarily impaired debt securities and is not more likely than not to be required to sell before recovery, the other-than temporary impairment of $61.0 million is separated into: 1) the estimated amount relating to credit loss ($26.5 million reflected in Net Income in the Combined Statements of Income), and 2) the amount relating to all other factors ($34.5 million reflected in other comprehensive income in the Combined Statement of Changes in Shareholders' Equity).

In determining the amount of credit loss, the District uses the expected present value technique as its best estimate of the present value of cash flows expected to be collected from the debt security. This technique requires key assumptions related to the underlying collateral, including default rates, degree and timing of prepayments, and loss severity. Assumptions can vary widely from security to security and are influenced by such factors as loan interest rate, geographical location of the borrower, borrower characteristics and collateral type.

Significant inputs used in this technique to measure the amount related to the credit loss include, but are not limited to: performance indicators of the underlying assets in the security (including default rates, delinquency rates, and percentage of nonperforming assets), loan to collateral value ratios, third-party guarantees, current levels of subordination, vintage, geographic concentration, and credit ratings. The District obtains assumptions for the default rate, prepayment rate, and loss severity rate from an independent third party. Default rate assumptions are generally estimated using historical loss and performance information to estimate future defaults and the forecasted cumulative default rates used at December 31, 2009 ranged from 1% to 22% for non-agency CMO securities and from 13% to 62% for ABS securities. Prepayment rate assumptions are based on forecasted prepayments and resulted in prepayment rates that ranged from 9% to 15% for non-agency CMO securities and from 11% to 22% for ABS securities at December 31, 2009. At December 31, 2009, the loss severity rates estimated from assumptions ranged from 3% to 55% for non-agency CMO securities and from 52% to 100% for ABS securities.

Due to the adoption of FASB guidance, "Recognition and Presentation of Other-Than-Temporary Impairments,, the District recognized the cumulative effect of initially applying this guidance in 2009 as an adjustment to the opening balance of unallocated retained earnings of $3.5 million with the corresponding adjustment amount to AOCI. The $3.5 million represents the noncredit-related amount of the previous other-than-temporary impairment recognized by the District in 2008 of $10.5 million on one ABS security in the Bank's portfolio.

For all investments other than the other-than-temporarily impaired securities discussed above, the District has not recognized any other-than-temporary impairment as the unrealized losses resulted from non-credit related factors. The District has the ability and intent to hold these investments until a recovery of unrealized losses occurs, which may be at maturity, and at this time expects to collect the full principal amount and interest due on these securities. Substantially all of these investments were in U. S. government agency securities and the District expects these securities would not be settled at a price less than their amortized cost. For the year ended December 31, 2009, net unrealized gains of $271.0 million were recognized in other comprehensive income for temporarily impaired available-for-sale investments.

The following schedule details the activity related to cumulative credit losses on investments recognized in earnings as of December 31, 2009:

(dollars in thousands)	**For the twelve months ended December 31, 2009**
Beginning balance at January 1, 2009	$ –
Adjustment to beginning balance due to application of investment impairment accounting change	6,991
Adjusted beginning balance at January 1, 2009	6,991
Additions for the amount related to credit loss for which other-than-temporary impairment was not previously recognized	24,372
Increases to the amount related to credit loss for which other-than-temporary impairment was previously recognized when the Bank does not intend to sell and it is not more likely than not that it will be required to sell before recovery of its amortized cost basis	2,082
Ending balance at December 31, 2009	$ 33,445

Note 4 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31,		
(dollars in thousands)	2009	2008	2007
Real estate mortgage	$ 9,870,486	$ 9,425,180	$ 8,792,463
Production and intermediate-term	8,270,399	8,556,501	7,820,724
Loans to cooperatives	355,392	318,818	320,154
Processing and marketing	1,652,286	1,945,207	1,517,944
Farm-related business	353,353	492,446	481,940
Communication	185,261	247,364	122,825
Energy	352,446	241,956	199,096
Water and waste disposal	28,000	28,000	20,752
Rural residential real estate	2,007,563	1,682,845	1,407,501
Lease receivables	15,871	13,385	19,721
Loans to other financial institutions	7,000	7,150	2,220
Other (including Mission Related)	110,132	118,884	22,956
Total	$ 23,208,189	$ 23,077,736	$ 20,728,296

The District's concentration of credit risk is spread among various agricultural commodities. 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.

The following table presents information relating to the District's impaired loans as defined in Note 2:

	December 31,		
(dollars in thousands)	2009	2008	2007
Impaired nonaccrual loans:			
Current as to principal and interest	$ 390,650	$ 376,955	$ 21,219
Past due	379,003	174,503	76,833
Impaired accrual loans:			
Restructured	9,286	1,057	5,508
90 days or more past due	13,118	17,387	2,946
Less than 90 days past due	10,134	14,199	–
Total impaired loans	$ 802,191	$ 584,101	$ 106,506

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2009.

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

(dollars in thousands)	Year Ended December 31, 2009	2008	2007
Interest income recognized on impaired nonaccrual loans	$ 13,537	$ 4,930	$ 6,520
Interest income on impaired accrual loans	2,457	1,214	901
Interest income recognized on impaired loans	$ 15,994	$ 6,144	$ 7,421

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

(dollars in thousands)	Year Ended December 31, 2009	2008	2007
Interest income which would have been recognized under the original loan terms	$ 49,970	$ 22,346	$ 12,992
Less: interest income recognized	13,969	5,243	6,920
Foregone interest income	$ 36,001	$ 17,103	$ 6,072

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

(dollars in thousands)	Year Ended December 31, 2009	2008	2007
Balance at beginning of year	$ 169,090	$ 78,874	$ 71,915
Provision for (reversal of allowance for) loan losses	162,893	121,023	8,284
Loans charged off	(142,147)	(31,985)	(3,507)
Recoveries	5,296	1,178	2,182
Balance at end of year	$ 195,132	$ 169,090	$ 78,874

The following table presents information concerning impaired loans and related allowance for loan losses as of December 31:

(dollars in thousands)	2009	2008	2007
Impaired loans with related allowance	$ 383,393	$ 313,028	$ 34,606
Impaired loans with no related allowance	418,798	271,073	71,900
Total impaired loans	$ 802,191	$ 584,101	$ 106,506
Average impaired loans	$ 706,081	$ 220,677	$ 86,026
Allowance on impaired loans	$ 90,769	$ 82,673	$ 12,603

To mitigate the risk of loan losses, District institutions have entered into Long-Term Standby Commitments 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 at "par" to Farmer Mac in the event of default, subject to certain restrictions. The balance of loans under Long-Term Standby Commitments to Purchase was $1.82 billion, $1.51 billion, and $1.26 billion at December 31, 2009, 2008 and 2007, respectively. Fees paid to Farmer Mac for such commitments totaled $1.8 million, $2.0 million, and $1.8 million for the years ended December 31, 2009, 2008 and 2007, respectively. Fees paid to government sponsored enterprises (GSEs) other than Farmer Mac were $5.3 million, $2.1 million, and $1.5 million for 2009, 2008 and 2007, respectively. These amounts are classified as noninterest expense.

Note 5 — 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, 2009, eleven District Associations held investments in Tobacco Buyout Successor-in-Interest Contracts (SIICs) of $367.5 million.

Note 6 — Premises and Equipment

Premises and equipment consisted of the following:

(dollars in thousands)	December 31, 2009	2008	2007
Land	$ 25,730	$ 24,432	$ 23,682
Buildings and improvements	114,426	106,938	98,822
Furniture and equipment	121,547	114,807	107,188
Work in progress	395	3,577	5,546
	262,098	249,754	235,238
Less: accumulated depreciation	135,248	122,904	112,226
Total	$ 126,850	$ 126,850	$ 123,012

Note 7 — Other Property Owned

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

(dollars in thousands)	December 31, 2009	2008	2007
Gains (losses) on sale, net	$ (1,758)	$ 29	$ 169
Carrying value adjustments	(3,758)	(365)	(723)
Operating income (expense), net	(4,668)	(766)	(445)
Total	$ (10,184)	$ (1,102)	$ (999)

Deferred gains on sales of other property owned totaled $12.7 million for 2009 and $0 for 2008 and 2007. Gains were deferred as the sales involved financing from the Bank and/or District Associations. The deferred gains are included in Loans in the Consolidated Balance Sheets.

Note 8 — Other Assets and Other Liabilities

A summary of other assets and other liabilities follows:

	December 31,		
(dollars in thousands)	2009	2008	2007
Other assets:			
Prepaid pension costs	$ 1,134	$ –	$ –
Derivative assets	70,041	124,982	33,187
Unamortized debt issue costs	17,832	20,647	18,637
Deferred preferred stock costs	383	662	940
Third party subservicer receivable	25,749	19,179	12,567
Prepaid expenses	4,880	3,733	2,051
Other	47,966	43,485	45,256
Total	$ 167,985	$ 212,688	$ 112,638
Other liabilities:			
Accounts payable	$ 22,117	$ 23,002	$ 22,659
Derivative liabilities	229	469	2,560
Farm Credit System Ins. Corp. payable	48,029	35,197	28,211
Bank draft payable	40,835	44,708	56,799
Payroll	20,821	20,624	22,601
Short-term funds held	–	9,822	–
Cash collateral pledged from derivative counterparties	14,065	7,963	–
Other	17,879	17,615	18,286
Total	$ 163,975	$ 159,400	$ 151,116

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. The System banks and the Funding Corporation have entered into the Market Access Agreement (MAA), which establishes 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 liabilities. The MAA was amended and restated in July 2003. At December 31, 2009, 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.

Additional information regarding Systemwide Debt Securities can be found in their respective offerings circulars.

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

	Bonds		Discount Notes		Total	
Maturities	Amortized Cost	Weighted Average Interest Rate	Amortized Cost	Weighted Average Interest Rate	Amortized Cost	Weighted Average Interest Rate
			(dollars in thousands)			
2010	$ 9,421,011	0.87%	$ 4,517,536	0.41%	$ 13,938,547	0.72%
2011	5,973,495	1.20	-	-	5,973,495	1.20
2012	2,114,199	1.96	-	-	2,114,199	1.96
2013	1,967,189	2.83	-	-	1,967,189	2.83
2014	1,076,936	3.19	-	-	1,076,936	3.19
2015 and after	3,623,647	4.19	-	-	3,623,647	4.19
Total	$ 24,176,477	1.81%	$ 4,517,536	0.41%	$ 28,694,013	1.59%

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, 2009, was 102 days.

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

Amortized Cost	First Call Date	Year of Maturity
(dollars in thousands)		
$ 10,371,000	2010	2010 - 2024
31,000	2011	2013 - 2024
10,000	2012	2017
10,000	2013	2018
$ 10,422,000	Total	

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, 2009 the assets of the Insurance Fund aggregated $3.29 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.

In 2008, the Bank sold a total of $200.0 million of participations in its direct note receivable from a District Association to another System Bank. The $200.0 million note payable at December 31, 2009 is included in Bonds and Notes in the Combined Balance Sheets and bears interest at an annual variable rate of one month LIBOR plus 47 basis points with maturity on December 31, 2010.

Note 10 — Mandatorily Redeemable Preferred Stock

On May 17, 2001, AgFirst issued $225.0 million 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 8.393 percent until December 15, 2011, with dividends paid semi-annually in arrears on June 15th and December 15th. Commencing March 15, 2012, dividends are paid at a floating rate per annum equal to 3 month LIBOR plus 3.615 percent with dividends payable quarterly. 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 par value of $1 thousand per share together with accrued and unpaid dividends to the redemption date. The Mandatorily Redeemable Preferred Stock is reported as a liability and the related dividends reported as interest expense. 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 DistrictAssociations 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. **Perpetual Preferred Stock:** On October 14, 2003, AgFirst issued $150.0 million 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 15th 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 cumulate 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.

   On June 8, 2007, AgFirst issued $250.0 million of Class B Perpetual Non-Cumulative Fixed-to-Floating Rate Subordinated Preferred Stock, Series 1. Dividends on the stock are non-cumulative and will be payable semi-annually in arrears on the 15th day of June and December in each year, commencing December 15, 2007, and ending on June 15, 2012, at an annual rate equal to 6.585 percent of the par value of $1 thousand per share, and will thereafter, commencing September 15, 2012, be payable quarterly in arrears on the 15th day of March, June, September, and December in each year, at an annual rate equal to 3-Month USD LIBOR plus 1.13 percent. In the event dividends are not declared on the Class B, Series 1 Preferred Stock for payment on any dividend payment date, then such dividends shall not cumulate and shall cease to accrue and be payable.

   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 Preferred stock, Common stock, Participation Certificates, and such other classes of equity as may be provided for in amendments to the bylaws in such amounts as may be necessary to conduct 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, 2009:

		Shares Outstanding (dollars in thousands)	
Class	**Protected Status**	**Number**	**Aggregate Par Value**
Common Nonvoting	Yes	819,200	$ 4,096
Common Voting	No	17,581,200	87,906
Participation Certificates	Yes	21,600	108
Participation Certificates	No	1,514,600	7,573
Preferred	No	6,686,800	33,434
Total Association Capital Stock, Participation Certificates and Protected Borrower Equity		26,623,400	$ 133,117

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, 2009, combined allocated retained earnings consisted of $171.7 million of qualified surplus, $494.9 million of nonqualified allocated surplus and $533.8 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, 2009, AgFirst had $146 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' operations and Combined 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.

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, 2009, AgFirst's net collateral ratio was 105.66 percent. For purposes of calculating this ratio, net collateral is not risk adjusted.

All twenty-two District Associations are organized as ACAs with 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.

One Association did not meet the regulatory minimum core surplus ratio as of December 31, 2009. The Association's board of directors elected to retain the 2009 net income of the Association in the form of unallocated equity to address the violation of the minimum core surplus ratio. The Association's board of directors was required to submit a capital restoration plan to FCA. The plan included monitoring, reporting, and possible retention of additional unallocated surplus in future periods to ensure the minimum ratio is achieved and maintained. The Association was in compliance with the other required minimum capital ratios and all other District entities were in compliance with required minimum capital standards at December 31, 2009.

An FCA regulation empowers it to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. 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. The balance at December 31 was comprised of the following components:

(dollars in thousands)	2009	2008	2007
Unrealized (losses) gains on investments available-for-sale	$ (121,881)	$ (357,542)	$ (37,798)
Employee benefit plan adjustments	(316,765)	(373,249)	(115,790)
Total accumulated other comprehensive income (loss)	$ (438,646)	$ (730,791)	$ (153,588)

Note 12 — Income Taxes

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

	Year Ended December 31,		
(dollars in thousands)	2009	2008	2007
Current:			
Federal	$ 3,272	$ (17)	$ 964
State	626	70	(710)
	3,898	53	254
Deferred:			
Federal	(8)	12	156
State	–	–	2
	(8)	12	158
Total provision (benefit) for income taxes	$ 3,890	$ 65	$ 412

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)	2009	2008	2007
Federal tax at statutory rate	$ 125,377	$ 123,619	$ 140,192
State tax, net	262	185	3
Tax-exempt FLCA earnings	(60,170)	(66,048)	(86,118)
Association patronage distributions	(34,789)	(42,934)	(52,809)
Nontaxable Bank income	(43,088)	(20,282)	(9,250)
Change in valuation allowance	13,621	9,883	13,230
Other	2,677	(4,358)	(4,836)
Provision for income taxes	$ 3,890	$ 65	$ 412

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

	December 31,		
(dollars in thousands)	2009	2008	2007
Allowance for loan losses	$ 29,566	$ 19,662	$ 16,119
Nonaccrual loan interest	8,098	4,690	3,410
Postretirement benefits other than pensions	19,544	19,566	15,856
Nonqualified patronage distributions	–	–	97
Loss carryforwards	12,447	11,684	8,962
Other	3,821	2,827	2,314
Gross deferred tax asset	73,476	58,429	46,758
Less: valuation allowance	(52,368)	(38,747)	(28,864)
Gross deferred tax assets, net of valuation allowance	21,108	19,682	17,894
Bank patronage	(5,500)	(4,112)	(4,571)
Pensions	(13,595)	(13,483)	(10,492)
Depreciation	(401)	(323)	(348)
Other	(1,611)	(1,771)	(2,478)
Gross deferred tax liability	(21,107)	(19,689)	(17,889)
Net deferred tax asset (liability)	$ 1	$ (7)	$ 5

In evaluating the ability to recover its deferred income tax asset, an Association 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.

At December 31, 2009, deferred income taxes have not been provided by District Associations on approximately $125.1 million of patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

There were no uncertain tax positions identified related to the current year, and the District has no unrecognized tax benefits at December 31, 2009 for which liabilities have been established. The District recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense. The tax years that remain open for federal and major state income tax jurisdictions are 2005 and forward.

Note 13 — Employee Benefit Plans

The employees of the District may participate in one of four defined benefit retirement plans. The first plan is the AgFirst Farm Credit Retirement Plan (FAP) and covers eligible employees of eighteen Associations and AgFirst hired prior to January 1, 2003. The second plan is the Independent Associations' Retirement Plan (IAR) and covers eligible employees of four ACAs whose employment date is prior to January 1, 2009. The third plan is the First South Farm Credit, ACA Retirement Plan (FS Plan) and covers eligible employees of a single ACA whose employment date is prior to January 1, 2009. The fourth plan is the AgFirst Farm Credit Cash Balance Plan and covers eligible employees who were either hired on or after January 1, 2003 (for institutions in the FAP Plan) or hired on or after January 1, 2009 for institutions in the IAR Plan or FS Plan. Each plan is noncontributory and collectively the plans cover substantially all employees of the participating entities. The "Projected Unit Credit" actuarial method is used for financial reporting purposes. Pension benefits are primarily based on eligible compensation and years of service. The District entities funded $53.1 million, $30.8 million, and $759 thousand into these retirement plans for each of the three years ended December 31, 2009, 2008 and 2007, respectively. The expenses of these retirement plans included in salaries and employee benefits were $55.1 million for 2009, $10.8 million for 2008, and $16.9 million for 2007.

In addition to providing pension benefits, the Bank and District Associations provide certain health care and life insurance benefits for eligible retired employees (other postretirement benefits) through two other postretirement benefit plans. Life insurance benefits are no longer provided to previously eligible employees who retired subsequent to December 1, 2007. The first plan covers most employees of twenty-two Associations and AgFirst. Under this plan, employees hired after December 31, 2002, and employees who separate from service between age 50 and age 55, are required to pay the full cost of their retiree health insurance coverage. The second plan covers employees of a single ACA. Substantially all employees may become eligible for the benefits if they reach early retirement age, as defined by the plans, while working for the Bank or District Associations. The plans are unfunded with expenses paid as incurred. Postretirement benefits other than pensions included in salaries and employee benefits were $8.7 million for 2009, $7.8 million for 2008, and $8.7 million for 2007.

The District participates in the defined contribution AgFirst/ FCBT 401(k) Employee Benefit Plan (401(k) Plan), which qualifies as a 401(k) plan as defined by the Internal Revenue Code. For employees hired on or prior to December 31, 2002, the Bank and Associations contribute $0.50 for each $1.00 of the employee's first 6.00 percent of contribution (based on total compensation) 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 contribute $1.00 for each $1.00 of the employee's first 6.00 percent of 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. The 401(k) Plan costs are expensed as funded. Employer contributions to this plan were $5.9 million, $5.7 million, and $5.3 million for the years ended December 31, 2009, 2008 and 2007, respectively.

AgFirst and certain District Associations individually sponsor defined benefit and defined contribution supplemental retirement plans and offer deferred compensation plans for certain key compensated employees. These plans are nonqualified; therefore, the associated liabilities are included in the District's combined balance sheets in other liabilities. The District entities funded $495 thousand for the year ended December 31, 2009, and $489 and $436 thousand for the years ended December 31, 2008 and 2007 into these supplemental retirement plans. The expenses of these supplemental plans included in the District's retirement costs were $1.4 million, $1.6 million, and $662 thousand for the years ended December 31, 2009, 2008 and 2007, respectively.

In September 2006, FASB issued guidance, which required the recognition of the overfunded or underfunded status of defined benefit pension and other postretirement benefit plans on the balance sheet. On December 31, 2007, the District adopted the balance sheet recognition provisions of this guidance for all defined benefit pension and other postretirement benefit plans. Adoption for these plans covering more than one entity, considered multi-employer plans, was recorded at the District level only and not reflected directly in the Bank's or Associations' Consolidated Financial Statements. Adoption for these plans covering one entity, considered single employer plans, was recorded directly in the Bank's or Associations' Consolidated Financial Statements as well as the District's Combined Financial Statements. The adoption of this guidance is reflected as an adjustment to AOCI of $115.5 million in the District's Combined Statement of Changes in Shareholders' equity at December 31, 2007.

FASB guidance requires that employers measure the benefit obligation and plan assets as of the fiscal year end for fiscal years ending after December 15, 2008. In fiscal 2007 and earlier, a September 30 measurement date was used for pension and other postretirement benefit plans. The Standard provides two approaches for an employer to transition to a fiscal year end measurement date. The approach applied by the District allows for the use of the measurements determined for the prior year end. Under this alternative, pension and other postretirement benefit expense measured for the three-month period October 1, 2007 to December 31, 2007 (determined using the September 30, 2007 measurement date) is reflected as an adjustment to beginning 2008 unallocated retained earnings. As a result, the District decreased unallocated retained earnings and increased the pension liability by $5.0 million.

FASB guidance further required the determination of the fair value of plan assets and recognition of actuarial gains and losses, prior service costs or credits, and transition assets or obligations as a component of accumulated other comprehensive income (AOCI). These amounts are subsequently recognized as components of net periodic benefit costs over time. For 2009 and 2008, $56.5 million and $257.5 million has been recognized as a net credit and debit, respectively, to AOCI to reflect these elements.

The funding status and the amounts recognized in the District's Combined Balance Sheets for all defined benefit retirement plans follows:

	Pension Benefits		
(dollars in thousands)	**2009**	**2008**	**2007**
Change in projected benefit obligation			
Projected benefit obligation at beginning of Year	$ 609,459	$ 525,810	$ 516,455
Service cost	16,671	18,503	14,747
Interest cost	37,182	41,423	30,298
Plan amendments	814	–	–
Actuarial loss (gain)	23,066	59,104	(13,473)
Benefits paid	(25,323)	(35,349)	(23,944)
Other	97	(32)	1,727
Projected benefit obligation at end of year	$ 661,966	$ 609,459	$ 525,810
Change in plan assets			
Fair value of plan assets at beginning of year	$ 359,782	$ 511,269	$ 465,914
Actual return on plan assets	80,248	(147,083)	68,398
Employer contributions	53,608	31,451	1,195
Transfers	(321)	(506)	(295)
Benefits and premiums paid	(25,323)	(35,349)	(23,944)
Fair value of plan assets at end of year	$ 467,994	$ 359,782	$ 511,268
Funded Status	$ (193,972)	$ (249,677)	$ (14,541)
Fourth quarter contributions	–	–	109
Net amount recognized	$ (193,972)	$ (249,677)	$ (14,432)
Amounts recognized in the balance sheet consist of:			
Pension assets	$ 1,134	$ –	–
Pension liabilities	(195,106)	(249,677)	(14,432)
Net amount recognized	$ (193,972)	$ (249,677)	(14,432)

The following represents the amounts included in accumulated other comprehensive income (pre-tax) at December 31:

	Pension Benefits	
(dollars in thousands)	**2009**	**2008**
Net actuarial loss (gain)	$ 295,317	352,951
Prior service costs (credit)	10,480	11,375
Net transition obligation (asset)	–	–
Total amount recognized in AOCI	$ 305,797	364,326

The accumulated benefit obligation for all defined benefit pension plans was $576,918 at December 31, 2009 and $527,427 and $453,857 at December, 2008 and 2007, respectively.

Information for pension plans with benefit obligation in excess of plan assets follows:

	Pension Benefits		
(dollars in thousands)	**2009**	**2008**	**2007**
Aggregate PBO > FV plan assets			
Projected benefit obligation	$ 661,966	$ 609,459	$ 525,810
Fair value of plan assets	467,994	359,783	511,268
Aggregate ABO > FV plan assets			
Accumulated benefit obligation	$ 574,132	$ 527,427	$ 7,069
Fair value of plan assets	464,340	359,897	–

Components of net periodic benefit cost and other amounts for all defined benefit pension plans recognized in the District's other comprehensive income as of December 31 are as follows:

	Pension Benefits		
(dollars in thousands)	**2009**	**2008**	**2007**
Net periodic benefit cost			
Service cost	$ 16,671	$ 14,803	$ 14,747
Interest cost	37,182	33,141	30,298
Expected return on plan assets	(27,597)	(42,320)	(38,440)
Amortization of net (gain) loss	–	(12)	(338)
Amortization of prior service cost	1,709	2,163	1,664
Recognized net actuarial (gain) loss	28,371	4,682	9,645
Other	96	–	(28)
Net periodic benefit cost	$ 56,432	$ 12,457	$ 17,548
Other changes in plan assets and projected benefit obligation recognized in OCI			
Net actuarial loss (gain)	$ (29,263)	$ 259,528	
Amortization of net actuarial loss (gain)	(28,371)	(5,852)	
Prior service cost (credit)	814	–	
Amortization of prior service cost	(1,709)	(2,657)	
Amortization of transition obligation (asset)	–	11	
Net periodic benefit cost	$ (58,529)	$ 251,030	
Total recognized in net periodic pension cost and OCI	$ (2,097)	$ 266,551	

The estimated net loss and prior service cost for the defined benefit pension plans that will be amortized from accumulated other comprehensive income into net periodic benefit cost during 2010 are $23.5 million and $2.0 million, respectively.

Weighted average assumptions used to determine benefit obligations at December 31, 2009 and September 30, 2008 and 2007:

	Pension Benefits		
	2009	**2008**	**2007**
Discount rate	6.04%	6.26%	6.45%
Rate of compensation increase	4.73%	5.33%	4.42%

Weighted average assumptions used to determine net periodic benefit cost for the years ended December 31:

	Pension Benefits		
	2009	**2008**	**2007**
Discount rate	6.26%	6.45%	6.00%
Expected long-term return on plan assets	8.00%	8.46%	8.46%
Rate of compensation increase	4.73%	4.46%	4.50%

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.

Plan Assets

Plan assets are invested in a number of different asset classes, with each asset class further diversified though the engagement of a number of independent investment managers. This approach lowers the likelihood of a significant credit concentration. To further ensure that excessive risk concentrations are avoided, holding of fund managers are monitored. There were no significant concentrations of credit risk in plan assets as of December 31, 2009. The target asset allocation is 45.00 percent U.S. equities, 20.00 percent non-U.S. equities, 5.00 percent real estate and 30.00 percent fixed income. The plans strategic asset allocation was determined by the Plan Fiduciary Committee after review and evaluation of an asset/liability study. Performance is monitored quarterly by both the Plan Fiduciary Committee and an outside pension consulting firm.

The weighted-average allowable asset allocations by category as of December 31 are as follows:

PLAN ASSETS	2009	2008	2007
Allowable Asset Category			
Equity securities	66.6%	61.4%	65.3%
Debt securities	29.4	30.4	29.4
Real Estate	3.0	7.1	4.9
Other	1.0	1.1	0.4
Total	100.0%	100.0%	100.0%

Target allocation for allowable asset categories for 2010 are as follows:

Allowable Asset Category	
Equity securities	62.3%–66.8%
Debt securities	28.0%–32.5%
Real Estate	2.7%–6.3%

The following table presents the fair values of the District's pension plan assets at December 31, 2009 by asset category. See note 17 regarding a description of the three levels of inputs and the classification within the fair value hierarchy.

Fair Value Measurements at December 31, 2009	Level 1	Level 2	Level 3	Total Fair Value
Asset Category				
Cash and cash equivalents	$ 1,647	$ 2,909	$ –	$ 4,556
Mutual funds:				
Domestic funds	–	195,299	–	195,299
International funds	–	86,900	–	86,900
Bond funds	–	1,079	–	1,079
Real estate equity funds	–	14,712	–	14,712
Fixed income funds	–	126,308	–	126,308
Equity securities funds	14,300	14,759	–	29,059
Fixed income securities:				
U.S. Treasuries	–	1,940	–	1,940
Corporate bonds	–	3,250	–	3,250
Mortgage-backed securities	–	831	–	831
Collateralized mortgage obligations	–	4,042	–	4,042
Foreign bonds	–	18	–	18
Total	$ 15,947	$ 452,047	$ –	$ 467,994

Contributions

The total District expects to contribute $44.8 million to the various pension plans in 2010.

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

	Pension Benefits
2010	$ 32,842
2011	34,090
2012	37,890
2013	40,756
2014	43,740
Years 2015 — 2019	255,357

The funding status and the amounts recognized in the District's Combined Balance Sheets for all other postretirement benefit plans follows:

(dollars in thousands)	Other Postretirement Benefits 2009	2008	2007
Change in benefit obligation			
Benefit obligation at beginning of year	$ 124,680	$ 114,511	$ 119,245
Service cost	2,440	2,938	2,364
Interest cost	7,599	9,029	6,997
Plan participants' contributions	995	1,174	789
Actuarial loss (gain)	662	4,212	(9,244)
Benefits paid	(6,749)	(7,184)	(5,640)
Plan amendments/other	–	–	–
Benefit obligation at end of year	$ 129,627	$ 124,680	$ 114,511
Change in plan assets			
Fair value of plan assets at beginning of year	$ –	$ –	$ –
Actual return on plan assets	–	–	–
Plan participants' contributions	5,754	1,173	789
Employer contributions	995	6,011	4,851
Benefits and premiums paid	(6,749)	(7,184)	(5,640)
Fair value of plan assets at end of year	$ –	$ –	$ –
Funded status	$ (129,627)	$ (124,679)	$ (114,511)
Fourth quarter contributions	–	–	1,032
Net other postretirement liability	$ (129,627)	$ (124,679)	$ (113,479)
Amounts recognized in the balance sheet consist of:			
Pension assets	$ –	$ –	–
Pension liabilities	(129,627)	(124,679)	(113,479)
Net amount recognized	$ (129,627)	$ (124,679)	$ (113,479)

The following represent the amounts included in accumulated other comprehensive income (pre-tax) at December 31:

(dollars in thousands)	Other Postretirement Benefits 2009	2008
Net actuarial loss (gain)	$ 23,481	24,035
Prior service costs (credit)	(12,638)	(15,270)
Net transition obligation (asset)	125	158
Total amount recognized in AOCI	$ 10,968	8,923

Components of net periodic benefit cost and other amounts for all other postretirements benefits plans recognized in the District's other comprehensive income as of December 31 are as follows:

(dollars in thousands)	Other Postretirement Benefits 2009	2008	2007
Service cost	$ 2,440	$ 2,350	$ 2,364
Interest cost	7,599	7,223	6,997
Amortization of prior service cost	(2,631)	(2,787)	(2,787)
Amortization of transition obligation (asset)	34	34	34
Amortization of net (gain)loss	1,216	979	2,096
Net periodic benefit (income) cost	$ 8,658	$ 7,799	$ 8,704
Adjustment to retained earnings for 2008 due to change in measurement date	$ –	$ 1,949	
Other changes in plan assets and projected benefit obligation recognized in OCI			
Net actuarial loss (gain)	663	4,212	
Amortization of net actuarial loss (gain)	(1,216)	(1,224)	
Prior service cost (credit)	–	–	
Amortization of prior service cost	2,631	3,484	
Amortization of transition obligation (asset)	(34)	(42)	
Net periodic benefit cost	$ 2,044	$ 6,430	
Total recognized in expenses and OCI	$ 10,702	$ 16,178	

The estimated prior service credit for the other postretirement benefit plans that will be amortized from accumulated other comprehensive income into periodic benefit cost during 2010 is $1.3 million.

Weighted average assumptions used to determine benefit obligations at December 31, 2009 and September 30, 2008 and 2007:

	Other Postretirement Benefits		
	2009	2008	2007
Discount rate	6.00%	6.25%	6.45%

Weighted average assumptions used to determine net periodic benefit cost for the years ended December 31:

	Other Postretirement Benefits		
	2009	2008	2007
Discount rate	6.25%	6.45%	6.00%

For measurement purposes, annual rates of increase of 7.00 percent through 8.00 percent in the per capita cost of covered health benefits were assumed for 2010. The rates were assumed to step down to 5.00 percent in 2020, and remain at that level thereafter.

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	$ 1,579	$ (1,286)
Effect on postretirement benefit obligation	18,358	(15,163)

Contributions

The District expects to contribute $6.4 million to other post retirement benefit plans in 2010.

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

	Other Postretirement Benefits
2010	$ 6,397
2011	6,896
2012	7,247
2013	7,587
2014	7,897
Years 2015 — 2019	43,574

Note 14 — 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 affiliated. Such loans are subject to special approval requirements contained in the FCA regulations and were made on the same terms, including interest rates, amortization schedule, and collateral, as those prevailing at the time for comparable transactions with unaffiliated persons.

Total loans to such persons at December 31, 2009, amounted to $335.5 million, as compared with $283.5 million and $241.3 million for the years ended December 31, 2008 and 2007, respectively. During 2009, 2008, and 2007, $249.1 million, $210.8 million, and $158.2 million of new loans were made and repayments totaled $197.1 million, $168.6 million, and $149.7 million, respectively. In the opinion of management, no material amounts outstanding at December 31, 2009 involved more than a normal risk of collectibility.

Note 15 — Regulatory Enforcement Matters

During 2009, the FCA took no enforcement actions against the Bank or District Associations and no enforcement actions were in effect for the Bank or District Associations at December 31, 2009. Subsequent to year-end 2009, the FCA entered into written agreements with two District Associations whose assets totaled less than $935.0 million at December 31, 2009. The written agreements require those District Associations to take corrective actions with respect to certain areas of their operations, including capital, portfolio management, and asset quality. These enforcement actions will not have a significant impact on the Bank's or District's financial condition or results of operations.

Note 16 — 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 System 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, 2009 were $177.30 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.

The Bank and District participate in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. At December 31, 2009, the Bank had outstanding $221.5 million of standby letters of credit issued on behalf of District and non-district customers, with expiration dates ranging from February 2010 to February 2018. The maximum potential amount of future payments the Bank may be required to make under these existing guarantees is $221.5 million.

A guarantor is required to recognize at the inception of a guarantee, a liability for the fair value of the guarantee commitment. The District has determined the fair value of the guarantee commitment based upon the fees to be earned over the life of the guarantee. The fair value is updated periodically to reflect changes in individual guarantee amounts and the remaining life to maturity of the individual guarantees in the District's inventory. At December 31, 2009, the District's inventory of standby letters of credit had a fair value of $5.2 million and was included in other liabilities.

The Bank also guarantees certain loans held by District Associations in the amount of $16.4 million expiring in less than one year and $1.8 million expiring in 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, 2009.

At December 31, 2009, $4.15 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.

Legal 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 17 — Fair Value Measurement

As discussed in Note 2, effective January 1, 2008, the District adopted FASB guidance on fair value measurements. This guidance defines fair value, establishes a framework for measuring fair value and expands the District's fair value disclosure for certain assets and liabilities measured at fair value on a recurring and non-recurring basis. These assets and liabilities primarily consist of investments available-for-sale, highly-liquid funds, derivative assets and liabilities, assets held in trust funds, standby letters of credit, impaired loans, other property owned, and collateral liabilities.

This guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability.

This guidance establishes a fair value hierarchy for disclosure of fair value measurements to maximize the use of observable inputs, that is, inputs that reflect the assumptions market participants would use in pricing an asset or liability based on market data obtained from sources independent of the reporting entity. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

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

Level 1

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets. Level 1 assets and liabilities could include investment securities and derivative contracts that are traded in an active exchange market, in addition to certain U.S. Treasury securities that are highly-liquid and are actively traded in over-the-counter markets.

The District's Level 1 assets at December 31, 2009 consist of assets held in trust funds related to deferred compensation and supplemental retirement plans. The trust funds include investments in securities that are actively traded and have quoted net asset value prices that are directly observable in the marketplace.

Level 2

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability. Level 2 assets and liabilities could include investment securities that are traded in active, non-exchange markets and derivative contracts that are traded in active, over-the-counter markets.

The fair value of substantially all of the District's investment securities is determined from third-party valuation services that estimate current market prices. Inputs and assumptions related to third-party market valuation services are typically observable in the marketplace. Such services incorporate prepayment assumptions and underlying mortgage- or asset-backed collateral information to generate cash flows that are discounted using appropriate benchmark interest rate curves and volatilities. Third-party valuations also incorporate information regarding broker/dealer quotes, available trade information, historical cash flows, credit ratings, and other market information. Such valuations represent an estimated exit price, or price to be received by a seller in active markets to sell the investment securities to a willing participant.

The fair value of the District's derivative financial instruments is the estimated amount to be received to sell a derivative asset or paid to transfer a derivative liability in active markets among willing participants at the reporting date. Estimated fair values are determined through internal market valuation models. These models incorporate benchmark interest rate curves, volatilities, and other inputs which are observable directly or indirectly in the marketplace. The District compares internally calculated derivative valuations to broker/dealer quotes to substantiate the results.

The District's Level 2 assets and liabilities at December 31, 2009 include derivative contracts and investment securities in U.S. government and agency mortgage-backed securities, and U.S. agency debt securities, all of which have unadjusted values from third-party or internal pricing models. Level 2 assets also include federal funds sold, securities purchased under resale agreements and other highly-liquid funds, all of which are non-exchange-traded instruments. The market value of these federal funds sold and other instruments is generally their face value, plus accrued interest, as these instruments are highly-liquid, readily convertible to cash, and short-term in nature.

The District's Level 2 liabilities also include collateral liabilities. The majority of derivative contracts are supported by bilateral collateral agreements with counterparties requiring the posting of collateral in the event certain dollar thresholds of credit exposure are reached. The market value of collateral liabilities is its face value plus accrued interest that approximates fair value.

Level 3

Level 3 inputs to the valuation methodology are unobservable and supported by little or no market activity. Level 3 assets and liabilities could include investments and derivative contracts whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, and other instruments for which the determination of fair value requires significant management judgment or estimation. Level 3 assets and liabilities also could include investments and derivative contracts whose price has been adjusted based on dealer quoted pricing that is different than the third-party valuation or internal model pricing.

Level 3 assets at December 31, 2009 include certain loans evaluated for impairment under FASB guidance, which have fair values based upon the underlying collateral as the loans were collateral-dependent loans. Since the value of the collateral, less estimated cost to sell, was less than the principle balance of the loan, specific reserves were established for these loans. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the hierarchy.

Level 3 assets at December 31, 2009 also include the Bank's mortgage-related asset-backed investment portfolio and non-agency CMO investment portfolio. Based on the currently illiquid marketplace for these investments and the lack of marketplace information available as inputs and assumptions to the valuation process, the Bank classified the mortgage-related asset-backed investment portfolio and non-agency CMO investment portfolio as Level 3 assets. The fair value measurement of these assets involved management's judgment and was based on multiple factors including information obtained from third-party valuation services using both Level 2 and Level 3 inputs.

Other property owned is classified as a Level 3 asset at December 31, 2009. The fair value for other property owned is based upon the collateral fair value. Costs to sell represent transaction costs and are not included as a component of the fair value of other property owned.

Level 3 liabilities at December 31, 2009 include standby letters of credit whose market value is internally calculated based on information that is not observable either directly or indirectly in the marketplace.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following tables present the assets and liabilities that are measured at fair value on a recurring basis at December 31, 2009 and 2008 for each of the fair value hierarchy levels. As discussed in Note 2, the requirement for a more detailed fair value disclosure of investments available-for-sale began in 2009.

	December 31, 2009			
	Level 1	Level 2	Level 3	Total Fair Value
Assets:				
Investments available-for-sale:				
U.S. Govt. GNMA MBS/CMOs	$ –	$ 3,857,159	$ –	$ 3,857,159
U.S. Govt. Agency MBS	–	2,573,375	–	2,573,375
Non-Agency CMOs	–	–	360,026	360,026
Commercial MBS	–	9,814	–	9,814
Asset-Backed Securities	–	38,431	47,465	85,896
Commercial paper, Bankers' Acceptances, CD's & Others	–	86,690	–	86,690
Federal funds sold, securities purchased under resale agreements, and other	–	146,201	–	146,201
Interest rate swaps and other financial instruments	–	70,041	–	70,041
Assets held in trust funds	10,144	–	–	10,144
Total Assets	$ 10,144	$ 6,781,711	$ 407,491	$ 7,199,346
Interest rate swaps and other financial instruments	$ –	$ 229	$ –	$ 229
Collateral liabilities	–	14,065	–	14,065
Standby letters of credit	–	–	5,236	5,236
Total Liabilities	$ –	$ 14,294	$ 5,236	$ 19,530

	December 31, 2008			
	Level 1	Level 2	Level 3	Total Fair Value
Assets:				
Investments available-for-sale	$ –	$ 6,183,596	$ 79,961	$ 6,263,557
Federal funds sold, securities purchased under resale agreements, and other	–	187,630	–	187,630
Interest rate swaps and other financial instruments	–	124,982	–	124,982
Assets held in trust funds	7,919	–	–	7,919
Total Assets	$ 7,919	$ 6,496,208	$ 79,961	$ 6,584,088
Liabilities:				
Interest rate swaps and other financial instruments	$ –	$ 469	$ –	$ 469
Collateral liabilities	–	7,963	–	7,963
Standby letters of credit	–	–	5,262	5,262
Total Liabilities	$ –	$ 8,432	$ 5,262	$ 13,694

The following tables present the changes in Level 3 assets and liabilities measured at fair value on a recurring basis for 2009 and 2008. Bank non-agency CMO securities were transferred from Level 2 to Level 3 assets effective March 31, 2009 as the Bank began adjusting the valuation obtained from a third party pricing service for this portfolio to reflect, in part, the valuation obtained from a cash flow modeling process. Total credit losses of $1.4 million were included in earnings for the first quarter of 2009 for non-agency CMOs determined to be other-than-temporarily impaired.

	Asset-Backed Investment Securities	Non-Agency CMOs	Standby Letters Of Credit
Balance at January 1, 2009	$ 79,961	$ –	$ 5,262
Total gains or (losses) realized/unrealized:			
Included in earnings	(20,949)	(3,775)	–
Included in other comprehensive loss	27,955	46,108	–
Purchases, sales, issuances and settlements, net	(39,502)	(79,627)	(26)
Transfers in and/or out of level 3	–	397,320	
Balance at December 31, 2009	$ 47,465	$ 360,026	$ 5,236

	Asset-Backed Investment Securities	Non-Agency CMOs	Standby Letters Of Credit
Balance at January 1, 2008	$ 166,551	$ –	$ 5,205
Total gains or (losses) realized/unrealized:			
Included in earnings	(10,465)	–	–
Included in other comprehensive loss	(26,028)	–	–
Purchases, sales, issuances and settlements, net	(50,097)	–	57
Transfers in and/or out of level 3	–	–	–
Balance at December 31, 2008	$ 79,961	$ –	$ 5,262

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

Assets and liabilities measured at fair value on a non-recurring basis at December 31, 2009 and 2008 for each of the fair value hierarchy values are summarized below. As discussed in Note 2, the requirement for fair value disclosure of nonfinancial instruments, such as other property owned, began in 2009.

	December 31, 2009				
	Level 1	Level 2	Level 3	Total Fair Value	Total Gains (Losses)
Assets:					
Impaired loans	$ –	$ –	$ 292,624	$ 292,624	$ (144,942)
OPO	$ –	$ –	$ 79,237	$ 79,237	$ (5,515)

	December 31, 2008				
	Level 1	Level 2	Level 3	Total Fair Value	Total Gains (Losses)
Assets:					
Impaired loans	$ –	$ –	$ 230,355	$ 230,355	$ (100,874)

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, 2009, 2008, and 2007.

Quoted market prices are generally not available for certain Systemwide 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.

	December 31, 2009		December 31, 2008		December 31, 2007	
(dollars in thousands)	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:						
Loans, net of allowance	$ 23,013,057	$ 23,280,763	$ 22,908,646	$ 23,345,531	$ 20,649,422	$ 20,908,947
Derivative assets	$ 70,041	$ 70,041	$ 124,982	$ 124,982	$ 33,187	$ 33,187
Cash & cash equivalents	$ 981,041	$ 981,041	$ 316,010	$ 316,010	$ 612,841	$ 612,841
Investment securities	$ 8,442,230	$ 8,472,095	$ 8,167,026	$ 8,198,816	$ 7,060,801	$ 7,038,445
Other investments	$ 367,461	$ 391,103	$ 410,249	$ 429,791	$ 430,812	$ 435,361
Assets held in trust funds	$ 10,144	$ 10,144	$ 7,919	$ 7,919	$ 10,626	$ 10,626
Financial liabilities:						
Bonds and notes	$ 28,894,013	$ 28,913,520	$ 28,253,023	$ 28,462,808	$ 24,847,248	$ 24,908,245
Derivative liabilities	$ 229	$ 229	$ 469	$ 469	$ 2,560	$ 2,560

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.

   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 and Cash Equivalents:** The carrying value is primarily utilized as a reasonable estimate of fair value.

C. **Investment Securities:** Fair value is primarily based upon prices obtained from a third party valuation service. See additional information in Note 17.

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

E. **Bonds and Notes:** Systemwide 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 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 internal market valuation models. See additional information in Note 17.

G. **Assets Held In Trust Funds:** See Note 17 for discussion of estimation of fair value for these assets.

Note 19 — Derivative Instruments and Hedging Activities

Effective January 1, 2009, the District adopted FASB guidance, "Disclosures about Derivative Instruments and Hedging Activities," which amends and expands the disclosure requirements for derivative instruments and for hedging activities previously required.

The District maintains an overall interest rate risk management strategy that may incorporate the use of derivative instruments to lower cost of funding or to reduce interest rate risk. The District's goal is to manage interest rate sensitivity by modifying the repricing 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, interest income and interest expense related to hedged variable-rate assets and liabilities, respectively, will increase or decrease. Another result of interest rate fluctuations is that hedged fixed-rate assets and liabilities will appreciate or depreciate in market value. The effects of any earnings variability or unrealized changes in market value are 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. 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, to allow it to diversify sources of funding, or to 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 also purchase interest rate derivatives 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 its floating-rate assets.

The primary type of derivative instrument used and the amount of activity for the year ended December 31, 2009 is summarized in the following table:

(dollars in millions)	Receive-Fixed Swaps
Balance at beginning of period	$2,223
Additions	100
Maturities/amortization	(750)
Terminations	(200)
Balance at end of period	$1,373

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 credit rating from a major rating agency, and also monitors the credit standing of and levels of exposure to individual counterparties. The estimated gross credit risk exposure at December 31, 2009 of $70.0 million was with eight counterparties and represented approximately 5.08 percent of the total notional amount of interest rate swaps. The District held $14.1 million of interest-bearing cash collateral posted by one counterparty related to these swaps. The District does not anticipate nonperformance by any of these counterparties. The estimated gross credit risk exposure at December 31, 2008 of $117.0 million was with eight counterparties and represented approximately 5.26 percent of the total notional amount of interest rate swaps. The District held $8.0 million of interest-bearing cash collateral posted by one counterparty related to these swaps. 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, 2009, the District had not posted collateral with respect to these arrangements.

All of the District's derivative activities are performed by the Bank, which 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 Bank's ALCO is responsible for approving hedging strategies that are developed within parameters established by the Bank's board of directors through the Bank's 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.

Fair-Value Hedges

For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in current earnings. The District includes the gain or loss on the hedged items in the same line item (interest expense) as the offsetting loss or gain on the related interest rate swaps. The amount of the gain on interest rate swaps recognized in interest expense for the year ended December 31, 2009 was $55.2 million, while the amount of the loss on the Systemwide Debt Securities was ($55.2) million. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings.

(dollars in thousands)	**Balance Sheet Classification - Assets**	**12/31/09 Fair Value**	**Balance Sheet Classification - Liabilities**	**12/31/09 Fair Value**
Derivatives designated as hedging instruments:				
Receive-fixed swaps	Other Assets	$70,041	Other Liabilities	$229
Total		$70,041		$229

The following table sets forth the effect of derivative instruments on the Statement of Income for the year ended December 31, 2009. Amount presented is net.

(dollars in thousands)	**Location of Gain or (Loss) Recognized in the Statement of Income**	**Amount of Gain or (Loss) Recognized in the Statement of Income**
Derivatives – Fair Value Hedging Relationships:		
Receive-fixed swaps	Noninterest Income	$469
Total		$469

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, 2009 *(dollars in millions)*	Maturities of 2009 Derivative Products and Other Financial Instruments 2010	2011	2012	2013	2014	2015 and after	Total	Fair Value
Bonds and Notes:								
Fixed rate	$ 7,906	$ 3,496	$ 2,034	$ 1,964	$ 1,077	$ 3,597	$ 20,074	$ 20,145
Weighted average interest rate	0.97%	1.86%	2.03%	2.83%	3.19%	4.22%	2.12%	
Variable rate	6,232	2,477	81	3	–	27	8,820	8,769
Weighted average interest rate	0.40%	0.27%	0.22%	0.22%	–	0.80%	0.36%	
Derivative Instruments:								
Receive fixed swaps								
Notional value	$ 288	$ 600	$ 175	$ 60	$ –	$ 250	$ 1,373	$ 70
Weighted average receive rate	4.71%	4.10%	3.07%	3.99%	–	5.07%	4.27%	
Weighted average pay rate	1.30%	2.63%	3.62%	4.30%	–	4.78%	2.95%	
Total notional value	$ 288	$ 600	$ 175	$ 60	$ –	$ 250	$ 1,373	$ 70
Total weighted average rates on swaps:								
Receive rate	4.71%	4.10%	3.07%	3.99%	–	5.07%	4.27%	
Pay rate	1.30%	2.63%	3.62%	4.30%	–	4.78%	2.95%	

Note 21 — Quarterly Financial Information (Unaudited)

Quarterly results of operations for the years ended December 31, 2009, 2008 and 2007 follow:

(dollars in thousands)	2009 First	Second	Third	Fourth	Total
Net interest income	$ 214,149	$ 228,037	$ 237,317	$ 257,936	$ 937,439
Provision for (reversal of allowance for) loan losses	36,927	61,872	50,071	14,023	162,893
Noninterest income (expense), net	(102,452)	(103,617)	(90,560)	(109,160)	(405,789)
(Provision) benefit for income taxes	(815)	(276)	(2,058)	(741)	(3,890)
Net income	$ 73,955	$ 62,272	$ 94,628	$ 134,012	$ 364,867

	2008 First	Second	Third	Fourth	Total
Net interest income	$ 193,258	$ 198,050	$ 210,501	$ 216,055	$ 817,864
Provision for (reversal of allowance for) loan losses	20,077	16,227	18,736	65,983	121,023
Noninterest income (expense), net	(80,243)	(80,596)	(71,778)	(100,639)	(333,256)
(Provision) benefit for income taxes	(203)	(405)	752	(209)	(65)
Net income	$ 92,735	$ 100,822	$ 120,739	$ 49,224	$ 363,520

	2007 First	Second	Third	Fourth	Total
Net interest income	$ 173,198	$ 175,815	$ 185,633	$ 187,544	$ 722,190
Provision for (reversal of allowance for) loan losses	587	1,053	3,001	3,643	8,284
Noninterest income (expense), net	(73,714)	(69,311)	(68,163)	(90,389)	(301,577)
(Provision) benefit for income taxes	(289)	922	(390)	(655)	(412)
Net income	$ 98,608	$ 106,373	$ 114,079	$ 92,857	$ 411,917

Note 22 — Bank Only Financial Data

Condensed financial information of the Bank follows:

Balance Sheet

(dollars in thousands)	December 31, 2009	2008	2007
Cash, cash equivalents and investment securities	$ 9,165,093	$ 8,270,160	$ 7,467,567
Loans			
To District Associations	14,890,794	14,997,151	14,602,548
To others	6,436,525	6,242,179	4,511,969
Total loans	21,327,319	21,239,330	19,114,517
Less: allowance for loan losses	32,292	44,565	2,816
Net loans	21,295,027	21,194,765	19,111,701
Other assets	407,424	446,126	347,353
Total assets	$ 30,867,544	$ 29,911,051	$ 26,926,621
Bonds and notes	$ 28,694,013	$ 28,053,023	$ 24,847,248
Mandatorily redeemable preferred stock	225,000	225,000	225,000
Other liabilities	368,201	391,936	396,892
Total liabilities	29,287,214	28,669,959	25,469,140
Perpetual preferred stock	400,000	400,000	400,000
Capital stock and participation certificates	438,707	434,929	364,759
Retained earnings	864,827	763,355	731,429
Accumulated other comprehensive income (loss)	(123,204)	(357,192)	(38,707)
Total shareholders' equity	1,580,330	1,241,091	1,457,481
Total liabilities and shareholders' equity	$ 30,867,544	$ 29,911,051	$ 26,926,621

Statement of Income

(dollars in thousands)	Year Ended December 31, 2009	2008	2007
Interest income	$ 1,031,563	$ 1,333,509	$ 1,469,034
Interest expense	541,902	966,988	1,208,156
Net interest income	489,661	366,521	260,878
Provision for (reversal of) loan losses	46,648	43,342	2,481
Net interest income after provision for loan losses	443,013	323,179	258,397
Noninterest income	7,401	4,874	13,823
Noninterest expenses			
Salaries and employee benefits	40,960	30,655	28,853
Occupancy and equipment	14,720	14,957	13,060
Insurance Fund premium	20,605	12,153	5,623
Other operating expenses	21,873	22,174	18,776
Called debt expense	36,531	26,652	10,550
Corresponding lending servicing expense	6,303	4,017	2,071
Other noninterest expenses	279	278	1,078
Total noninterest expenses	141,271	110,886	80,011
Net income	$ 309,143	$ 217,167	$ 192,209

Note 23 – District Merger Activity

During September 2009, the Board of Directors of Farm Credit of the Virginias, ACA, and AgChoice Farm Credit, ACA entered into a letter of intent to merge. The letter of intent to merge allowed Farm Credit of the Virginias, ACA, and AgChoice Farm Credit, ACA to explore the benefits of a merger. During February 2010, the Board of Directors of both these associations mutually concluded that the proposed merger was not in the best interest of their respective stockholders.

Note 24 - Subsequent Events

The District has evaluated subsequent events and has determined there are none requiring disclosure through March 12, 2010, which is the date the financial statements were issued.

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