



FARM CREDIT

AgFirst Farm Credit Bank & District Associations

2007 ANNUAL REPORT



RURAL AMERICA'S CUSTOMER-OWNED PARTNER

AgFirst Farm Credit Bank and District Associations

2007 ANNUAL REPORT

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Management

F. A. (Andy) Lowrey	President and Chief Executive Officer
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

Board of Directors

Thomas W. Kelly	Chairman
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Message from the Chairman of the Board and the Chief Executive Officer

Dear Shareholders:

The AgFirst District continued to grow in 2007 as demand from commercial and lifestyle farmers increased. The result was an increase in net income, which made possible significant distributions to our borrowers.

Growth — Loan volume reached a record \$20.7 billion at 2007 year-end. Our loan portfolios increased \$2.06 billion during the year, up 11.03 percent from the previous year. This compares to growth rates of 15.4 percent and 9.0 percent in 2006 and 2005, respectively.

Despite a severe drought in parts of AgFirst's territory, crop and livestock farmers experienced a generally favorable year in 2007. Buoyed by worldwide demand, corn prices increased to their highest levels in years. As acreage shifted from wheat and soybeans to corn, prices for those crops also increased. While high corn and soybean prices increased feed costs for poultry and livestock farmers, prices for their commodities rose as exports increased due to a weaker dollar and increased foreign demand for U.S. protein.

These factors, along with a generally steady market in rural real estate and capital expansion by agribusinesses, contributed to the growth we saw in 2007. Also contributing to our growth in 2007 were the participation/syndication opportunities created by the partnership of AgFirst's Capital Markets Unit and Associations throughout the District. Working together, they marketed commercial banks and other Farm Credit institutions aggressively to garner new business from agribusiness companies within the District and throughout the United States.

Credit Quality — Credit quality remains high throughout the District. The District reported 95.89 percent acceptable loans at year-end, as compared to 96.39 the previous year. Delinquencies were only 0.31 percent of the District's total loans at the close of the year, down from 0.79 percent at 2006 year-end.

Earnings — Net income increased as a result of the growth in loan and other interest-earning assets. Final net income totaled \$412 million in 2007, up 0.4 percent from the previous year.

Distributions — Estimated patronage refunds and other distributions to borrowers totaled \$310 million at December 31, 2007, up more than 4 percent from the previous year.

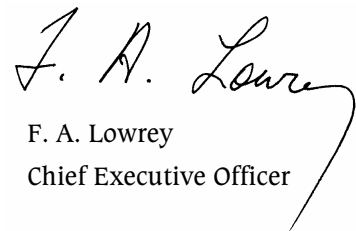
Strategic Initiatives — We continue to focus on several strategic initiatives designed to improve the District's performance and create efficiencies in Association operations. In 2007, we:

- Continued the implementation of our Customer Relationship Management (CRM) system which has been provided to 11 Associations. The response to the integrated CRM system we delivered has been very favorable, and we are already making plans for new features and enhancements.
- Introduced a document imaging solution, which enables Associations to share files between offices and reduce their paper-based files.
- Delivered a new workflow management tool called "AgriGate," and introduced several enhancements to our Credit Delivery products.
- Expanded the curriculum of Farm Credit University (FCU), an AgFirst-based training program for new loan officers and credit analysts. In 2008, we will begin developing a new curriculum for Young, Beginning, Small and Minority farmers. This program will help participants improve their business and financial management skills and will be delivered "on-demand" via the Internet.

The investments our District has made in staff and technology positioned us for the success we experienced in 2007. These investments will continue to bear fruit in 2008 and beyond and will ensure that we fulfill our mission of being the lenders of choice to agriculture and those who live and work in rural America.



Thomas W. Kelly
Chairman of the Board



F. A. Lowrey
Chief Executive Officer

February 28, 2008

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.

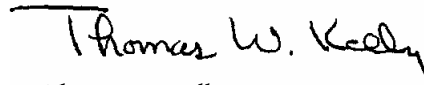
Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all combined financial statements, and that the assets 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 the 2007 Annual Report has been prepared in accordance with all applicable statutory or regulatory requirements and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

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



Thomas W. Kelly
Chairman of the Board



F. A. Lowrey
President & Chief Executive Officer



Charl L. Butler
Senior Vice President
& Chief Financial Officer

February 28, 2008

Five-Year Summary of Selected Combined Financial Data

<i>(dollars in thousands)</i>	December 31,				
	2007	2006	2005	2004	2003
Combined Balance Sheet Data					
Cash and cash equivalents	\$ 612,841	\$ 651,268	\$ 640,830	\$ 522,862	\$ 527,250
Investment securities	7,060,801	6,492,102	5,302,965	3,290,967	2,832,716
Loans	20,728,296	18,669,616	16,171,572	14,836,278	14,336,779
Less: allowance for loan losses	78,874	71,915	87,551	95,419	316,735
Net loans	20,649,422	18,597,701	16,084,021	14,740,859	14,020,044
Other property owned	8,504	5,122	3,646	3,433	2,253
Other assets	929,583	1,014,525	743,098	437,295	313,654
Total assets	\$ 29,261,151	\$ 26,760,718	\$ 22,774,560	\$ 18,995,416	\$ 17,695,917
Obligations with maturities of one year or less	\$ 11,451,400	\$ 10,134,550	\$ 7,710,389	\$ 6,586,537	\$ 6,482,632
Obligations with maturities greater than one year	14,018,677	13,092,985	11,694,786	9,184,234	8,426,554
Mandatorily redeemable preferred stock	225,000	225,000	225,000	225,000	225,000
Total liabilities	25,695,077	23,452,535	19,630,175	15,995,771	15,134,186
Perpetual preferred stock	400,000	150,000	150,000	150,000	150,000
Protected borrower equity	5,369	6,208	7,628	10,123	12,453
Capital stock and participation certificates	127,147	118,817	120,370	125,089	128,099
Retained earnings					
Allocated	1,068,756	992,227	925,919	849,626	792,168
Unallocated	2,118,390	2,039,308	1,943,444	1,861,476	1,587,934
Accumulated other comprehensive income (loss)	(153,588)	1,623	(2,976)	3,331	(108,923)
Total shareholders' equity	3,566,074	3,308,183	3,144,385	2,999,645	2,561,731
Total liabilities and shareholders' equity	\$ 29,261,151	\$ 26,760,718	\$ 22,774,560	\$ 18,995,416	\$ 17,695,917
Combined Statement of Income Data					
Net interest income	\$ 722,190	\$ 673,836	\$ 610,501	\$ 568,826	\$ 575,913
Provision for (reversal of allowance for) loan losses	8,284	(717)	(6,492)	(213,388)	8,153
Noninterest income (expense), net	(301,989)	(264,184)	(239,816)	(247,003)	(248,129)
Net income	\$ 411,917	\$ 410,369	\$ 377,177	\$ 535,211	\$ 319,631
Combined Key Financial Ratios					
Rate of return on average:					
Total assets	1.48%	1.67%	1.86%	2.96%	1.88%
Total shareholders' equity	11.42%	12.40%	12.05%	19.31%	13.03%
Net interest income as a percentage of average earning assets	2.64%	2.80%	3.07%	3.16%	3.40%
Net chargeoffs (recoveries) to average loans	0.01%	0.09%	0.01%	0.05%	0.02%
Total shareholders' equity to total assets	12.19%	12.36%	13.81%	15.79%	14.48%
Debt to shareholders' equity (:1)	7.21	7.09	6.24	5.33	5.91
Allowance for loan losses to loans	0.38%	0.39%	0.54%	0.64%	2.21%
Net Income Distribution					
Estimated patronage refunds and dividends:					
Cash	\$ 129,698	\$ 114,325	\$ 98,354	\$ 80,466	\$ 67,792
Qualified allocated surplus	18,202	27,798	26,391	28,684	46,636
Nonqualified allocated surplus	90,743	92,988	83,420	65,666	47,154
Nonqualified retained surplus	71,700	62,038	73,653	74,467	48,391
Stock dividends	1,133	916	311	60	84
Mandatorily redeemable preferred stock dividend	—	—	—	—	10,282
Perpetual preferred stock dividend	19,501	10,950	10,950	10,950	1,851

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

The following commentary reviews the combined financial condition and results of operations of AgFirst Farm Credit Bank (AgFirst or the Bank) and the District Agricultural Credit Associations (Associations or District Associations), collectively referred to as the District, for the years ended December 31, 2007, 2006, and 2005. 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; that is, each Association is owned by its borrowers. The District Associations jointly own all of AgFirst's voting stock, which also operates as a cooperative. 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*, of the Notes to the Combined Financial Statements in this Annual Report to shareholders.

As of December 31, 2007, the District was comprised of AgFirst and twenty-three Associations. 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 the 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 21, *Bank Only Financial Data*, in the Notes to the Combined Financial Statements for the purposes of additional analysis. In addition, AgFirst publishes a Bank-only financial report that may be referred to for a more complete analysis of AgFirst'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;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry; and
- actions taken by the Federal Reserve System in implementing monetary policy.

AGRICULTURAL OUTLOOK

In November 2007, the United States Department of Agriculture (USDA) estimated that 2007 farmers' net cash income (a measure of cash income after payment of business expenses) increased to \$85.7 billion, up \$17.8 billion from the 2006 forecast and up \$20.3 billion from its 10 year average. Contributing to this sizeable increase in net cash income were increases in cash receipts for crops and livestock of \$22.6 billion and \$20.3 billion, respectively, an increase in farm-related income of \$300 million,

offset in part by an increase in cash expenses of \$21.7 billion and a decrease in direct government payments of \$3.7 billion. Corn prices have risen as a result of a combination of continued food and feed demand and expanding ethanol demand. Other crop prices, in general, were positively impacted by increased acreage used to plant corn, decreasing the amount of acreage available for other crops. Wheat and soybeans compete with corn as a feed source so both wheat and soybean prices have risen since late 2006. Livestock cash receipts increased as domestic and export demand for beef has risen. The following table, which is based on information published by the USDA, sets forth the commodity prices per bushel for certain crops and by hundredweight for beef cattle from December 31, 2004 to December 31, 2007:

Commodity	12/31/04	12/31/05	12/31/06	12/31/07
Corn	\$2.04	\$1.92	\$3.01	\$3.76
Soybeans	\$5.45	\$5.77	\$6.18	\$10.00
Wheat	\$3.39	\$3.54	\$4.52	\$7.74
Beef Cattle	\$86.80	\$93.30	\$83.10	\$88.90

Rising commodity prices can have both positive and negative impacts on the District, as a lender to the agricultural and rural sectors. Higher commodity prices have resulted in increased seasonal demand for agribusiness loans. Higher grain prices positively impact grain farmers. However, higher feed costs negatively impact the profitability of livestock producers, as well as those who use corn or other grains as ingredients in processed foods. To date, this has not significantly affected the District's credit quality. In addition to higher feed costs, most other production cash expenses, such as fertilizer, seed, energy and labor costs, are forecast to rise further in 2008.

The USDA's 2007 income outlook showed a great deal of variation depending on farm size, geographic location, and commodity specialties. While we utilized the USDA analysis to provide a general understanding of the U.S. agricultural economic outlook, this outlook does not take into account all aspects of our business.

The USDA classifies all farms into three primary categories: commercial farms, intermediate farms, and rural residential farms. Commercial farms represent about 11 percent of U.S. farms by number and represent 75 percent of total U.S. farm production. Intermediate farms (where the primary occupation is farming and gross sales are below \$250,000) represent 26 percent of U.S. farms by number and account for 16 percent of total production. The remaining 63 percent of U.S. farms are classified as rural residential farms and only account for 9 percent of total production.

In addition to farmers' net cash income, off-farm income is an important source of repayment for farm debt obligations and is less subject to cycles in agriculture. The USDA measures farm household income, which is defined as earnings from farming activities plus off-farm income. Nearly 100 percent of farm household income for operators of rural residential farms and more than 80 percent of farm household income for intermediate farms is generated from off-farm sources. Further, USDA data suggests that about 30 percent of farm household income for commercial farms is generated from off-farm income. USDA estimated 2007 farm household income to have increased 21 percent for commercial farms, 8 percent for intermediate farms, and 4 percent for rural residential farms.

According to the USDA, farm business balance sheets have shown improvement over the last few years, as measured by debt relative to assets and equity levels. Farmers' equity (farm business assets less farm business debt) is expected to have increased in 2007. One measure of the financial health of the agricultural sector used by the USDA is the assessment of farmers' utilization of their capacity to repay debt (actual debt as a percentage of maximum debt that can be supported by farmers' current income). Higher

capacity utilization rates indicate tighter cash flow positions and, consequently, higher exposure to financial risk. These estimates do not take into account, however, off-farm income sources. Since 1970, debt repayment capacity utilization has ranged from a low of 35.8 percent in 1973 to 104.1 percent in 1981, and has remained relatively stable since 1987, averaging about 50 percent. The USDA suggests a decrease in the use of repayment capacity from 57 percent in 2006 to 48 percent in 2007.

Farm business debt, defined by the USDA as debt incurred by those involved in on-farm agricultural production, is estimated to have grown 3.8 percent in 2007, the fourth consecutive year of rising farm debt, following a rise of 7.3 percent in 2006. The recent rise in debt can be at least partially attributed to farmers' positive view of the sector's future. Farm real estate debt accounted for approximately 53 percent of all farm debt for 2007 and 2006.

In general, agriculture has experienced a long 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 and credit quality have been positively impacted by these conditions. Production agriculture, however, remains a cyclical business that is heavily influenced by commodity prices. In some areas, land values recently have been negatively affected by less favorable economic conditions. Economic conditions in agriculture may not be as favorable in the near future. In an environment of adverse economic conditions in agriculture and without sufficient government support programs, the District's financial performance and credit quality measures would likely be negatively impacted. However, any negative impacts should be lessened by geographic and commodity diversification and the substantial influence of off-farm income sources supporting agricultural-related debt.

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 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 our 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. 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, and allowances are established on those 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 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 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, 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 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. Hewitt Associates is the actuary for the Bank and all but one of the Associations. The District selected the discount rate by reference to Hewitt's corporate bond index, actuarial analyses, and industry norms. Hewitt's corporate bond index follows the accounting guidance that the basis for discount rates should be high-quality zero-coupon bonds with durations that match the expected cash flows of the plans that underlie the obligation.

LOAN PORTFOLIO

Loans

The District's aggregate loan portfolio primarily consists of direct loans made by the Associations to eligible borrowers located within their chartered territories. 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)	2007		2006		2005	
Real Estate Mortgage	\$ 8,740,114	42%	\$ 8,019,808	43%	\$ 7,401,816	46%
Production and Intermediate-Term	7,817,587	38	7,398,749	40	6,378,740	40
Processing and Marketing	1,510,538	7	1,145,416	6	682,709	4
Rural Residential Real Estate	1,407,501	7	1,152,266	6	959,353	6
Farm-Related Business	481,404	2	392,153	2	369,574	2
Loans to Cooperatives	320,154	2	250,364	1	164,776	1
Energy	199,096	1	198,198	1	156,006	1
Communication	122,825	1	74,126	1	33,423	—
Water and Waste Disposal	19,999	—	12,688	—	—	—
Lease Receivables	19,721	—	24,088	—	22,525	—
Discounted loans to OFIs	2,220	—	1,760	—	2,650	—
Other	87,137	—	—	—	—	—
Total	\$ 20,728,296	100%	\$ 18,669,616	100%	\$ 16,171,572	100%

Loans outstanding as of December 31, 2007 and 2006 totaled \$20.7 billion and \$18.7 billion, respectively, an increase of 11.03 percent and 15.45 percent compared to loans outstanding at December 31, 2006 and 2005, respectively. District loan growth is attributable to a seasoned lending staff, the inherent value of patronage paid under the cooperative structure, a stronger world demand for commodities coupled with a weaker U.S. dollar that helped boost agricultural exports, an active agricultural real estate market, borrowers seizing low interest rate opportunities, greater utilization of lines of credit by farm supply and livestock borrowers, and capital expansion by agribusinesses.

The District employs a number of risk management techniques to limit credit exposures. AgFirst and each Association have adopted underwriting standards, individual borrower exposure limits, commodity exposure limits, and other risk management

techniques. AgFirst and the Associations actively purchase and sell participations to achieve diversified portfolios and utilize guarantees from other agencies, including Fannie Mae, Federal Agricultural Mortgage Corporation (Farmer Mac), the Farm Services Agency, and the Small Business Administration to further limit credit exposures. At December 31, 2007, the District collectively had \$2.12 billion of guaranteed principal under various government or GSE guarantee programs, compared to \$1.82 billion at December 31, 2006.

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

District's loan volume outstanding by state for the past three years at December 31.

District Loan Volume by State			
State	2007	2006	2005
Florida	15%	16%	15%
North Carolina	15	15	15
Georgia	12	13	12
Virginia	10	10	11
Pennsylvania	9	9	10
Maryland	6	6	7
South Carolina	6	6	6
Ohio	4	4	4
Alabama	3	3	3
Kentucky	2	2	3
Delaware	2	2	2
Mississippi	2	2	2
West Virginia	2	2	2
California	2	1	1
Texas	2	1	1
Tennessee	1	1	1
Louisiana	1	1	1
Puerto Rico	1	1	1
Minnesota	1	1	—
New York	1	1	1
Colorado	1	1	—
Missouri	—	—	1
Other	2	2	1
Total	100%	100%	100%

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

During 2007, the mid-Atlantic and Southeast states experienced various levels of drought. During the third quarter of 2005, hurricane activity caused damage across a significant portion of the District with the areas of Louisiana, Mississippi, Alabama, and southern Florida most impacted. These weather related events caused severe crop and commodity damage in limited areas but the impact on repayment of loans and risk of loss was mitigated by insurance proceeds, disaster relief, and the overall financial health of the borrowers' balance sheets.

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 under the mission related investments umbrella, as described below.

Rural Housing Mortgage Backed Securities

Rural Housing Mortgage-Backed Securities (RHMBs) must be fully guaranteed by a government agency or GSE. The rural housing loans backing the RHMBs must be conforming first-lien residential mortgage loans originated by non-System lenders in "rural areas" as defined by the Farm Security and Rural Investment Act of 2002 (2002 Farm Bill), or eligible rural housing loans originated by System lenders under FCA Regulation section 613.3030. Investment securities at December 31, 2007 included \$1.12 billion in RHMBs classified as held-to-maturity, compared to \$1.25 billion at December 31, 2006.

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, 2007, the District had \$141.8 million in the Rural America Bond program, compared to \$45.6 million at December 31, 2006. Of this amount, \$54.7 million is reflected in investment securities and \$87.1 million is reflected as loans on the Combined Balance Sheets at December 31, 2007.

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, 2007, District Associations held Tobacco Buyout loan assignments of \$84.1 million, which are reflected as loans on the Combined Balance Sheets, compared to \$87.6 million at December 31, 2006. The District Associations purchased Successor-in-Interest Contracts (SIIC) of \$430.8 million, which are reflected as other investments on the Combined Balance Sheets, compared to \$428.0 million at December 31, 2006.

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.

The types of risk 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 the 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 8, *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, investment portfolio and derivative counterparty credit exposures. The District manages credit risk associated with retail lending activities through an assessment of the credit risk profile of an individual borrower. The Bank and Associations establish underwriting standards and lending policies that provide direction to loan officers and are approved by the boards of directors.

The 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.

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 loan portfolio is divided into performing and high-risk categories. The high-risk assets, including accrued interest, at December 31 are detailed below:

<i>(dollars in thousands)</i>	2007	2006	2005
High-risk Assets			
Nonaccrual loans	\$ 98,052	\$ 77,552	\$ 82,812
Restructured loans	5,508	2,619	3,151
Accruing loans 90 days past due	2,946	7,418	2,353
Total high-risk loans	106,506	87,589	88,316
Other property owned	8,504	5,122	3,646
Total high-risk assets	\$ 115,010	\$ 92,711	\$ 91,962
Ratios			
Nonaccrual loans to total loans	0.47%	0.41%	0.51%
High-risk assets to total assets	0.39%	0.35%	0.40%

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.

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 or rates or a compromise of amounts owed. Other receipts of assets and/or equity to pay toward the loan are also considered restructured loans. The type of alternative financing structure chosen is based on minimizing the loss incurred by both the lender and the borrower.

Due to the credit risk management process, the overall combined amounts for the District's high-risk assets continue to be a small percentage of the total loan volume and total assets.

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). AgFirst and the District Associations review the credit quality of the loan portfolio on an on-going basis as part of risk management practices. Each loan is classified according to the Uniform Classification System, which is used by all System institutions. Below are the classification definitions.

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

Credit quality within the District portfolio decreased slightly during the twelve months ended December 31, 2007. At year-end, the District's loans including interest were classified as follows:

Credit Quality	2007	2006	2005
Acceptable	95.89%	96.39%	95.75%
OAEM	2.63	2.31	2.67
Adverse*	1.48	1.30	1.58
Total	100.00%	100.00%	100.00%

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

Delinquencies were 0.31 percent of total loan assets at year-end 2007 compared to 0.79 percent and 0.63 percent at year-end 2006 and 2005, respectively. Nonperforming assets for the District represented 0.39 percent of total assets or \$115.0 million, compared to 0.35 percent or \$92.7 million for 2006, and 0.40 percent or \$92.0 million for 2005. Nonperforming assets consist of nonaccrual loans, accruing restructured loans, accruing loans 90 days or more past due, and other property owned.

District net charge-offs of \$1.3 million, \$14.9 million and \$1.4 million were recorded in 2007, 2006, and 2005, respectively. As a percentage of total loan assets, net charge-offs for the District were 0.01 percent for 2007, compared to 0.09 percent for 2006 and 0.01 percent in 2005.

As of December 31, 2007, the portfolio continued to reflect good credit quality supported by a sound farm sector. To date, the increased volatility in the financial markets experienced in the later part of 2007 has not affected either the overall farm sector or District customers in a substantially negative way. However, the future performance of the economy is uncertain and risk factors having the potential to affect the overall farm economy, certain segments, or individual borrowers in a negative way are increasing. Although the credit quality of the District loan portfolio has not been negatively impacted to date, the risk of future deterioration is increasing.

Although neither the District nor any other System institution receives any direct government support, credit quality is indirectly enhanced by government support as government program payments to borrowers 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. Also, the diversified nature and significant non-farm influence on the District's portfolio mitigate any impact of the lesser level of government support.

The diversity of income sources supporting loan repayment mitigates credit risk to the District. The District's credit portfolio is comprised of a number of segments having varying agricultural characteristics. Commodity and industry categories are based on the Standard Industrial Classification system published by the federal government. This system is used to assign commodity or industry categories based on the largest agricultural commodity of the customer. The following table illustrates the aggregate credit portfolio of the District by major commodity segments at December 31:

Commodity Group	Percent of Portfolio		
	2007	2006	2005
Forestry	13%	13%	12%
Poultry	11	11	13
Fruits and Vegetables	9	9	9
Cattle	7	7	8
Rural Home	7	6	6
Processing	7	6	5
Other Real Estate	6	7	6
Dairy	5	5	6
Nursery/Greenhouse	5	5	5
Grain	4	4	5
Lumber/Paper	4	4	3
Swine	3	3	3
Tobacco	2	3	3
Cotton	2	2	3
Citrus	2	2	2
Corn	2	2	2
Other	11	11	9
Total	100%	100%	100%

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

Commodity Group	Percent of Portfolio		
	2007	2006	2005
Part-time Farmers	33%	34%	35%
Poultry	9	10	11
Fruits and Vegetables	6	5	6
Dairy	5	5	6
Processing	5	4	3
Forestry	5	5	4
Nursery/Greenhouse	4	4	4
Lumber	3	4	3
Cotton	3	3	3
Swine	3	3	3
Cattle	3	3	3
Grain	3	1	2
Tobacco	2	2	2
Citrus	2	2	2
Rural Home	2	1	1
Corn	1	1	1
Other Real Estate	1	1	1
Other	10	12	10
Total	100%	100%	100%

The District has concentrations of full-time farmers greater than 5.00 percent in only five commodities: poultry, fruits and vegetables, dairy, processing, and forestry. All five commodities have a large geographic dispersion with production over the entire AgFirst footprint. Concentrations within the Associations are further dispersed through the number of farm units producing poultry or dairy products. Poultry production is almost exclusively done through a network of contract growers whose income remains stable as variable costs are absorbed by the contracting integrators. Poultry concentration is further dispersed as production is segregated between chicken, turkey, and egg

production. The fruits/vegetables portion of the portfolio is made up of a diverse group of many different fruits and vegetables grown throughout the AgFirst District footprint. The volume is spread broadly over the base of Associations. The fruits/vegetables commodity category is not the top commodity concentration for any Association and is in one of the top four commodity concentrations for only one Association.

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. Forestry is divided principally into hardwood and softwood production and value-added processing. The timber from hardwood production is further processed into furniture, flooring, and high-grade paper and is generally located at the more northern latitudes and higher elevations. Softwood timber production is typically located in the coastal plains of the AgFirst footprint and is utilized for building material for the housing market and pulp to make paper and hygiene products. Forestry production at the Associations ranges from less than fifty acres to thousands of acres, with value-added processing being conducted at sawmills and planer mills. Also, many poultry, dairy, forestry, and fruit/vegetable producers have significant secondary income from off-farm employment by a family member.

District exposure to the ethanol industry has grown during the year but still remains a very small percentage of the total loan portfolio, 0.62 percent (or \$128.8 million), at December 31, 2007. Higher corn prices caused by a number of factors, including expanding economies in the world's developing countries and increased ethanol production, will increase the cost of production of the meat production companies in the portfolio. Most meat production borrowers within the portfolio are well capitalized and have significant ability to manage through increases in feed ingredient costs.

The following table illustrates the District loan volume outstanding per borrower at December 31, 2007.

District Loan Volume Gross Loans Outstanding Per Borrower	
\$ Range	% of Total
\$1,000-\$250,000	35.80 %
\$251,000-\$500,000	15.27
\$501,000-\$1,000,000	12.60
\$1,001,000-\$5,000,000	18.90
\$5,001,000-\$25,000,000	10.84
\$25,001,000-\$100,000,000	5.88
Over \$100,000,000	0.71
Total	100.00 %

Loans greater than \$5.0 million per borrower comprise approximately 17.43 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 an Association's committing to such loans.

Approximately 51.07 percent of outstanding loan volume is comprised of loans under \$500 thousand, and loans less than \$250 thousand make up approximately 35.80 percent of loan volume. This diversification among borrowers is another key component of the District's stable credit quality and solid financial performance over time.

Typically short-term and long-term loans to the same borrower are cross-collateralized and cross-defaulted. By law, all long-term loans must be secured by a first lien on real estate with an initial loan to appraised value not exceeding 85.00 percent. As of December 31, 2007, 42.42 percent of the District loans were identified as real estate loans. Exposure to losses is reduced through collateralization.

AgFirst and each Association maintains an allowance for loan losses determined by its management and is capitalized to serve its unique market. The minimum regulatory capital ratios for System banks and associations are 7.00 percent for the permanent capital ratio, 3.50 percent for the core surplus ratio, and 7.00 percent for the total surplus ratio. The following table illustrates the risk bearing capacity of the District at December 31, 2007:

Association	Regulatory Permanent Capital Ratio	Regulatory Core Surplus Ratio	Regulatory Total Surplus Ratio	Allowance/ Loans
AgFirst Farm Credit Bank	20.59%	13.04%	20.54%	0.01%
AgCarolina Financial	15.46%	12.77%	13.84%	0.88%
AgChoice	12.13%	9.78%	11.19%	0.33%
Ag Credit	18.96%	15.66%	17.50%	0.45%
AgGeorgia	14.81%	10.71%	14.54%	0.80%
AgSouth	15.52%	11.81%	15.03%	0.30%
ArborOne	11.43%	8.89%	11.07%	0.02%
Cape Fear	13.58%	11.86%	13.23%	0.57%
Carolina	14.32%	11.24%	13.68%	0.33%
Central Florida	15.49%	11.67%	14.49%	0.40%
Central Kentucky	14.72%	12.84%	13.44%	0.63%
Chattanooga	12.17%	9.05%	10.37%	0.44%
Colonial	17.03%	16.19%	16.19%	0.41%
Farm Credit of the Virginias	12.68%	11.38%	11.38%	0.25%
First South	12.54%	10.40%	11.51%	0.56%
Jackson Purchase	13.64%	12.26%	12.88%	0.37%
MidAtlantic	15.39%	13.24%	14.98%	0.60%
North Florida	14.32%	11.25%	13.93%	0.46%
Northwest Florida	12.22%	11.46%	11.96%	0.85%
Puerto Rico	23.48%	23.11%	23.11%	0.13%
South Florida	17.04%	16.33%	16.93%	0.94%
Southwest Florida	15.19%	10.67%	15.13%	0.09%
Southwest Georgia	12.37%	10.20%	12.08%	0.13%
Valley	13.68%	10.53%	11.17%	0.32%

Interest Rate Risk Management

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

The objective of the interest rate risk management process is to generate a stable and adequate level of net interest income in any interest rate environment. AgFirst uses a variety of sophisticated analytical techniques to manage the complexities associated with offering numerous loan options. These include interest rate sensitivity gap analysis to monitor the repricing characteristics of

interest-earning assets and interest-bearing liabilities and simulation analysis to determine the potential change in net interest income and in the market value of equity due to changes in interest rates. The following tables represent the District's projected change in net interest income and market value of equity for various rate movements as of December 31, 2007.

Net Interest Income (dollars in thousands)				
Scenarios	Net Interest Income	% Change		
+2.0% Shock	\$781,541	11.51%		
+1.0% Shock	\$747,923	6.71%		
Base line	\$700,895	-		
-1.0% Shock	\$755,312	7.76%		
-50% of 3M Tbill **	\$755,021	7.72%		

Market Value of Equity (dollars in thousands)				
Scenarios	Assets	Liabilities	Equity*	% Change
Book Value	\$29,261,824	\$26,094,952	\$3,166,872	-
+2.0% Shock	\$28,573,550	\$25,556,643	\$3,016,907	(4.82%)
+1.0% Shock	\$29,049,542	\$25,966,387	\$3,083,155	(2.73%)
Base line	\$29,472,241	\$26,302,586	\$3,169,655	-
-1.0% Shock	\$29,795,618	\$26,505,652	\$3,289,965	3.80%
-50% of 3M Tbill**	\$29,956,187	\$26,614,382	\$3,341,805	5.43%

* 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, 2007. The amount of assets and liabilities shown, which reprice or mature during a particular period, were determined in accordance with the earlier of term-to-repricing or contractual maturity, anticipated prepayments, and, in the case of liabilities, the exercise of call options.

(dollars in thousands)	Repricing/Maturity Gap Analysis				
	0 to 6 months	6 months to 1 Year	1 to 5 Years	Over 5 Years	Total
Fixed Loans					
Total Fixed Loans	\$ 6,050,492	\$ 2,386,470	\$ 5,586,886	\$ 1,564,206	\$ 15,588,054
Variable Loans					
Total Variable Loans	4,998,402	34,725	8,985	78	5,042,190
Nonaccrual Loans					
Total Nonaccrual Loans	-	-	-	98,052	98,052
Total Loans	11,048,894	2,421,195	5,595,871	1,662,336	20,728,296
Total Investments *	5,791,228	458,094	736,563	618,793	7,604,678
Other Interest-Earning Assets	-	-	-	430,812	430,812
TOTAL INTEREST-EARNING ASSETS	\$16,840,122	\$ 2,879,289	\$ 6,332,434	\$ 2,711,941	\$28,763,786
Interest-Bearing Liabilities					
Systemwide bonds and notes	\$ 10,871,248	\$ 2,531,000	\$ 9,795,000	\$ 1,650,000	\$ 24,847,248
Other interest-bearing liabilities	-	-	-	225,000	225,000
Interest rate swaps	1,803,000	(340,000)	(1,213,000)	(250,000)	-
TOTAL INTEREST-BEARING LIABILITIES	\$12,674,248	\$ 2,191,000	\$ 8,582,000	\$ 1,625,000	\$25,072,248
Interest Rate Sensitivity Gap	\$ 4,165,874	\$ 688,289	\$(2,249,566)	\$ 1,086,941	
Sensitivity Gap as % of Total Earning Assets	14.48%	2.39%	(7.82%)	3.79%	
Cumulative Gap	\$ 4,165,874	\$ 4,854,163	\$ 2,604,597	\$ 3,693,719	
Cumulative Gap as a % of Total Earning Assets	14.48%	16.87%	9.05%	12.84%	
Rate Sensitive Assets/Rate Sensitive Liabilities	1.33	1.31	0.74	1.67	

* includes cash equivalents

At December 31, 2007, the Repricing/Maturity Gap reflected an asset sensitive position due to anticipated accelerated prepayment activity in fixed-rate loans. Short- and intermediate-term interest rates decreased during the last half of 2007, which also resulted in higher anticipated prepayments and exercise of options on callable fixed rate debt. Asset sensitivity implies an increase in net interest income in rising interest rate scenarios and lower net interest income in falling interest rate scenarios. However, the Repricing/Maturity Gap Analysis is a "point in time" view and is representative of the interest rate environment at December 31. The repricing attributes of the balance sheet are dynamic. Therefore, either increasing or decreasing interest rates alter the balance sheet's interest rate sensitivity position due to options in both assets and debt.

The impact of changing market interest rates on Net Interest Income (NII) is better shown in the sensitivity analysis above which indicates that NII increases in both rising and falling interest rate environments. The favorable improvement in NII for rising rates is due to the asset sensitive repricing/maturity position in those scenarios. In a falling interest rate environment, however, AgFirst becomes liability sensitive due to the exercise of call options on debt, which exceed the impact of increasing asset prepayment speeds. This results in an increase in NII in a decreasing interest rate environment.

At December 31, 2007, AgFirst had outstanding interest rate swaps with notional amounts totaling \$1.93 billion. Substantially all of these derivative transactions were executed to create synthetic floating-rate debt to achieve a lower cost of funding. Derivatives are also 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 18, *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, 2007.

Notional amounts (dollars in millions)	Receive Fixed
Balance at December 31, 2006	\$ 1,765
Additions	513
Maturities/amortizations	(350)
Terminations	—
Balance at December 31, 2007	\$ 1,928

Liquidity Risk Management

AgFirst and the District Associations maintain adequate liquidity to satisfy the District's daily cash needs. In addition to 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 a securities repurchase agreement facility. Providing liquidity for the District's operations is primarily the responsibility of the Bank.

Investments and Cash Equivalents

FCA Regulations provide that a System bank may hold certain eligible investments, in an amount not to exceed 35.00 percent of its total loans outstanding to satisfy FCA's liquidity reserve requirement, manage short-term funds, and manage interest rate risk. AgFirst maintains an investment portfolio for this purpose comprised primarily of short-duration, high-quality investments. Until recently, AgFirst generally has attempted to maintain its available-for-sale portfolio at a level near the regulatory limit of 35.00 percent of loans outstanding. In the current investment environment, spreads on investment securities have narrowed, making it more difficult for the bank to obtain viable securities. This may result in a lower mix of investment securities on the balance sheet in the future.

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

The District has low exposure to investments impacted by recent adversity in the subprime borrower mortgage market. Asset-backed securities with subprime exposure totaled \$166.6 million (2.95 percent) of the available-for-sale liquidity investment portfolio and 2.36 percent of the total investment security portfolio at December 31, 2007. The amortized cost of these investment securities was \$184.7 million and a market value adjustment of \$18.1 million was reflected in Other Comprehensive Income (OCI) in the Financial Statements at December 31, 2007. All asset-backed securities were rated in one of the two top ratings categories by at least one of the Nationally Recognized Statistical Rating Organizations at December 31, 2007 and all have credit enhancement features. However, the uncertainty in the mortgage securities markets has adversely impacted the market value of these securities as reflected in OCI. Since the decline in market value was not credit related and was caused by changes in interest rates and market conditions, and because the District has the ability and intent to hold these investments until a recovery of unrealized losses occurs, which may be maturity, the District has not recognized any other-than-temporary impairment in connection with these investments.

Investment securities and cash equivalents outstanding as of December 31, 2007 for the District totaled \$7.60 billion compared to \$7.00 billion and \$5.85 billion at December 31, 2006 and 2005, respectively. The increases in investment securities are primarily related to the growth of total loans as management increased the size of the portfolio generally in line with loan growth.

The District's investment portfolio consisted of the following security types as of December 31, 2007:

(dollars in thousands)	District Investment Securities					
	2007		2006		2005	
Investment Securities						
<i>Available for Sale</i>						
Commercial Paper	\$ —	—%	\$ —	—%	\$ 69,796	1.32%
U.S. Govt. GNMA MBS/CMOs	1,754,553	24.85	1,267,914	19.53	1,056,283	19.92
U.S. Govt. Agency MBS	3,062,041	43.37	2,749,985	42.36	2,029,961	38.28
Non-Agency Securities	636,559	9.02	776,534	11.96	597,670	11.27
Asset-Backed Securities	183,680	2.60	271,188	4.18	132,608	2.50
Commercial MBS	4,597	0.06	—	—	—	—
<i>Total Available for Sale</i>	<u>5,641,430</u>	<u>79.90</u>	<u>5,065,621</u>	<u>78.03</u>	<u>3,886,318</u>	<u>73.29</u>
<i>Held to Maturity</i>						
Rural Housing MBS	1,124,855	15.93	1,249,788	19.25	1,347,266	25.41
Commercial MBS	—	—	2,260	0.03	2,762	0.05
MBS Guaranteed by Farmer Mac	16,946	0.24	27,107	0.42	31,937	0.60
Other Asset-Backed Securities	115,983	1.64	123,313	1.90	34,682	0.65
Other	161,587	2.29	24,013	0.37	—	—
<i>Total Held to Maturity</i>	<u>1,419,371</u>	<u>20.10</u>	<u>1,426,481</u>	<u>21.97</u>	<u>1,416,647</u>	<u>26.71</u>
Total Investment Securities	<u>\$ 7,060,801</u>	<u>100.00%</u>	<u>\$ 6,492,102</u>	<u>100.00%</u>	<u>\$ 5,302,965</u>	<u>100.00%</u>
Cash Equivalents						
Fed Funds	\$ 183,659	33.77%	\$ 55,369	10.81%	\$ 168,428	30.54%
Master Notes	85,218	15.67	82,000	16.00	108,048	19.59
Repos	275,000	50.56	375,000	73.19	275,000	49.87
Total Cash Equivalents	<u>\$ 543,877</u>	<u>100.00%</u>	<u>\$ 512,369</u>	<u>100.00%</u>	<u>\$ 551,476</u>	<u>100.00%</u>

FCA regulations require a liquidity policy that establishes a "minimum coverage" level of 90 days. "Coverage" is defined as the number of days that maturing debt could be funded through the sale of liquid investments and Agency-guaranteed rural home loans. At December 31, 2007, AgFirst's coverage was 165 days.

Systemwide Debt Securities

AgFirst's primary source of liquidity is 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 the 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 had 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 the mission of providing funding to the rural and

agricultural sectors. Moody's Investors Service and Standard & Poor's rate the System's long-term debt as Aaa and AAA, and short-term debt as P-1 and A-1+, 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. However, as a result of the System's financial performance, credit quality and standing in the capital markets, AgFirst anticipates continued access to funding necessary to support the System'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, 2007, was \$23.52 billion. At December 31, 2007, AgFirst had \$24.85 billion in total debt outstanding compared to \$22.61 billion at December 31, 2006 and \$18.88 billion at December 31, 2005. 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, 2007 is shown in the following table.

Maturities	Bonds		Discount Notes		Total	
	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate
			(dollars in thousands)			
2008	\$ 8,152,307	4.53%	\$ 2,804,679	4.28%	\$ 10,956,986	4.47%
2009	4,933,329	4.56	—	—	4,933,329	4.56
2010	1,783,688	4.58	—	—	1,783,688	4.58
2011	1,437,911	4.88	—	—	1,437,911	4.88
2012	933,603	4.94	—	—	933,603	4.94
2013	4,801,731	5.46	—	—	4,801,731	5.46
Total	<u>\$ 22,042,569</u>	<u>4.78%</u>	<u>\$ 2,804,679</u>	<u>4.28%</u>	<u>\$ 24,847,248</u>	<u>4.73%</u>

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

See Note 8, *Bonds and Notes*, in the Notes to the Combined Financial Statements, for additional information related to debt.

Operational Risk Management

Operational risk is the risk of loss resulting from inadequate or failed processes or systems, human factors or external events, including the execution of unauthorized transactions by employees, errors relating to transaction processing and technology, breaches of the internal control system and the risk of fraud by employees or persons outside the System. AgFirst's and the Associations' boards of directors are required, by regulation, to adopt an internal control policy that provides adequate direction to the institution in establishing effective control over and accountability for operations, programs, and resources. The 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 manages political risk by actively supporting the Farm Credit Council, which is a full-service, federal trade association representing the System before Congress, the Executive Branch, and others. The Council provides the mechanism for "grassroots" involvement in the development of System positions and policies with respect to federal legislation and government actions that impact the System. Additionally, the District takes an active role in representing the individual interests of System institutions and their borrowers before Congress. In addition to the Farm Credit Council, each district has its own Council, which is a member of the Farm Credit Council. The district Councils represent the interests of their members on a local and state level, as well as on a federal level.

ALLOWANCE FOR LOAN LOSSES

The District maintains an allowance for loan losses at a level considered adequate to provide for probable and estimable credit losses within the loan and finance lease portfolios. The District increases the allowance by recording a provision for loan losses in the income statement. Loan losses are recorded against 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 \$78.9 million at December 31, 2007, as compared with \$71.9 million and \$87.6 million at December 31, 2006 and 2005, respectively.

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,		
	2007	2006	2005
Balance at beginning of year	\$ 71,915	\$ 87,551	\$ 95,419
Charge-offs:			
Real estate mortgage	(1,702)	(877)	(158)
Production and intermediate-term	(1,461)	(1,562)	(2,267)
Agribusiness	(130)	(13,466)	(161)
Communication loans	—	—	(13)
Energy	(128)	—	—
Rural home loans	(86)	(8)	(16)
Total charge-offs	(3,507)	(15,913)	(2,615)
Recoveries:			
Real estate mortgage	1,254	32	43
Production and intermediate-term	769	824	777
Agribusiness	145	127	44
Communication loans	—	—	363
Rural home loans	14	11	12
Total recoveries	2,182	994	1,239
Net (charge-offs) recoveries	(1,325)	(14,919)	(1,376)
Provision for (reversal of allowance for) loan losses	8,284	(717)	(6,492)
Balance at end of year	\$ 78,874	\$ 71,915	\$ 87,551
Ratio of net (charge-offs) recoveries during the period to average loans Outstanding during the period	(0.01)%	(0.09)%	(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,		
	2007	2006	2005
Real Estate Mortgage	\$ 25,476	\$ 24,804	\$ 35,676
Production and Intermediate-Term	41,485	40,395	43,490
Agribusiness	5,937	5,005	6,289
Communication	123	73	80
Energy	63	75	55
Rural Residential Real Estate	1,831	1,563	1,956
Leases	5	—	5
Other	3,954	—	—
Total	\$ 78,874	\$ 71,915	\$ 87,551

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

	2007	2006	2005
Allowance for loan losses to loans	0.38%	0.39%	0.54%
Allowance for loan losses to nonaccrual loans	80.44%	92.73%	105.72%

The financial positions of the District's borrowers have generally strengthened during the past decade as farmers' net cash income has been at favorable levels due, in part, to increases in commodity prices and direct federal government payments. With borrowers' strengthened financial positions and the continued emphasis on sound underwriting standards, the credit quality of the District

Net interest income benefited as both loans and investments increased significantly in 2007 and the Bank's preferred stock issue (see *Preferred Stock* section below) reduced debt and shifted interest expense to dividend payments. However, the positive impact on net interest income was partially offset by the compression of spread between asset yield and debt cost. The decrease in spread is attributable to the negative impact of flat to inverted yield curves on funding costs during 2007. In addition, investments continued to increase as a percent of interest earning assets. Investments have lower spreads to debt costs than loans due to their higher credit quality and liquidity.

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 allowance for loan losses was \$8.3 million for the twelve months ended December 31, 2007. Reversals of the allowance for loan losses of \$717 thousand and \$6.5 million in 2006 and 2005, respectively, primarily resulted from the net decrease in the risk exposure across the District.

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,			Increase (Decrease)	
	2007	2006	2005	2007/ 2006	2006/ 2005
Loan fees	\$ 29,996	\$ 33,434	\$ 35,931	\$ (3,438)	\$ (2,497)
Fees for financially related services	9,228	6,887	6,347	2,341	540
Realized gains (losses) on investments (net)	1	(5)	466	6	(471)
Realized gains on derivatives (net)	—	6,812	94	(6,812)	6,718
Gains (losses) on sale of rural home loans	147	3,172	2,935	(3,025)	237
Gains on sale of mortgage servicing assets	—	—	1,078	—	(1,078)
Gains from sale of premises and equipment, net	2,016	1,521	3,004	495	(1,483)
Patronage refunds from other Farm Credit Institutions	1,790	1,172	1,298	618	(126)
Other noninterest income	5,746	5,677	4,400	69	1,277
Total noninterest income	\$ 48,924	\$ 58,670	\$ 55,553	\$ 9,746	\$ 3,117

The primary reason for the 2007 decrease in loan fees was due to a reduction of \$5.9 million in correspondent lending (primarily, first lien residential mortgages) fees. The majority of the increase in fees for financially related services represented increases of \$1.0 million in crop hail insurance income and \$1.3 million in multi-peril insurance income. The 2007 decrease in realized gains on derivatives was due to the \$6.7 million gain that was recorded in 2006, as discussed below. There was a \$3.0 million reduction in 2007 in gains on sales of rural home loans.

The primary reason for the 2006 increase in noninterest income was the \$6.7 million increase in gains on derivatives which represented the gain realized on liquidating a derivative strategy and putting permanent financing in place. In addition, the \$1.2 million increase in other noninterest income for 2006 primarily resulted from a \$1.5 million gain allocated to AgFirst from the sale of .75 acres and all existing development rights related to the Farm Credit System Building Association property in McLean, Virginia. Offsetting these increases were the decrease in loan fees of \$2.5 million, \$1.1 million decrease in gains from the sale of mortgage servicing assets, and \$1.5 million decrease in gains on sale of premises and equipment.

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,			Increase (Decrease)	
	2007	2006	2005	2007/ 2006	2006/ 2005
Salaries and employee benefits	\$ 198,539	\$ 190,597	\$ 188,191	\$ 7,942	\$ 2,406
Occupancy and equipment expense	33,771	30,953	29,071	2,818	1,882
Insurance fund premiums	28,200	24,615	7,447	3,585	17,168
Other operating expenses	76,293	71,491	66,937	4,802	4,554
Intra-System financial assistance expenses	—	—	3,221	—	(3,221)
Called debt expense	10,550	2,563	656	7,987	1,907
Correspondent lending service expense	2,071	1,656	1,294	415	362
Other noninterest expenses	1,077	683	684	394	(1)
Total noninterest expenses	\$ 350,501	\$ 322,558	\$ 297,501	\$ 27,943	\$ 25,057

Total salaries and employee benefits generally increased over the three year period of 2005 through 2007 as a result of normal salary increases, retention of a highly qualified staff, and increased benefit costs that were experienced by most employers. The Insurance Fund premium increased \$2.0 million in 2007 due to the increase in loan volume. The Insurance Fund premium increased \$2.7 million in 2006 primarily due to an increase in premium rates from 5 basis points to 15 basis points on accrual loans beginning January 1, 2006. Intra-System financial assistance expense ceased when AgFirst fully extinguished its obligations in 2005 with the maturity of the last Financial Assistance Corporation bonds. The Financial Assistance Corporation dissolved effective as of December 31, 2006. See Note 13, *Intra-System Financial Assistance*, in the Notes to the Combined Financial Statements for further information.

Other operating expenses increased \$4.8 million from 2006 to 2007 and \$4.6 million from 2005 to 2006. The \$4.8 million increase in 2007 primarily resulted from increases of \$916 thousand in directors' expenses, \$1.8 million in purchased services, and \$1.3 million in advertising expenses. The \$4.6 million increase in other operating expenses from 2005 to 2006 resulted primarily from increases of \$826 thousand in FCA supervisory and examination expense, \$770 thousand in advertising expenses, and a special assessment from the Farm Credit Council of \$870 thousand.

Concession (debt issuance expense) is amortized over the life of the underlying debt security. When securities are called prior to maturity, any unamortized concession is expensed. Called debt expense increased \$8.0 million in 2007, compared to 2006. Call options were exercised on bonds totaling \$7.02 billion in 2007. For 2006, the called debt expense increased \$1.9 million, compared to 2005. Called debt volume was \$1.55 billion and \$352.0 million for 2006, and 2005, respectively. The called debt expense is more than offset by interest expense savings realized over time as called debt is replaced by new debt issued at a lower rate of interest.

Provision for Income Taxes

Provision for income taxes increased \$116 thousand in 2007 compared to 2006. Provision for income taxes increased \$2.4 million in 2006 compared to 2005. This variation from 2005 to 2006 was primarily attributable to the reversal of the allowance for loan losses recorded in 2005. See Note 11, *Income Taxes*, in the Notes to the Combined Financial Statements for further details.

Key Results of Operations Comparisons

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

Key Results of Operations Comparisons	For the 12 Months Ended 12/31/07	For the 12 Months Ended 12/31/06	For the 12 Months Ended 12/31/05
Return on average assets	1.48%	1.67%	1.86%
Return on average shareholders' equity	11.42%	12.40%	12.05%
Net interest income as a percentage of average earning assets	2.64%	2.80%	3.07%
Net charge-offs (recoveries) to average loans	0.01%	0.09%	0.01%

PREFERRED STOCK

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 are 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.

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 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.

See Note 9, *Mandatorily Redeemable Preferred Stock*, and Note 10, *Protected Borrower Equity and Shareholders' Equity*, in the Notes to the Combined Financial Statements for further information concerning the preferred stock issuances.

CAPITAL

Capital serves to support asset growth and provide protection against unexpected credit and interest rate risk and operating losses. Capital is also needed for future growth and investment in new products and services. A sound capital position is critical to providing protection to investors in Systemwide Debt Securities and to long-term financial success.

The AgFirst Capitalization Plan (the "Plan") approved by the Bank 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 2007 that have an effect on the Bank's ability to retire stock and distribute earnings.

Total District shareholders' equity at December 31, 2007 was \$3.57 billion, compared to \$3.31 billion and \$3.14 billion at December 31, 2006 and 2005, respectively. The increase in 2007 was primarily due to the Bank issuance of \$250.0 million of Perpetual Non-cumulative Subordinated Preferred Stock discussed in the *Preferred Stock* section above. Also, the increasing trend in shareholders' equity is attributed to the increases in retained earnings.

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, and each of the District Associations individually exceeded minimum regulatory standards for all of the ratios. 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 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-weighting of assets. The collateral ratio is calculated by dividing the Bank's collateral, as defined by FCA regulations, by total liabilities.

Regulatory ratios at December 31 for AgFirst are shown in the following table:

	Regulatory Minimum	AgFirst Ratio as of		
		12/31/07	12/31/06	12/31/05
Permanent Capital Ratio	7.00%	20.59%	19.19%	23.90%
Total Surplus Ratio	7.00%	20.54%	19.14%	23.84%
Core Surplus Ratio	3.50%	13.04%	11.46%	14.15%
Net Collateral Ratio	104.00%	106.02%	105.28%	105.70%

Regulatory ratios for each District Association at December 31 are presented in the *Credit Risk Management* section above.

The FCA notified AgFirst that the June 2007 issuance of \$250.0 million of Perpetual Non-Cumulative Subordinated Preferred Stock (see *Preferred Stock* section above) could be included in core surplus up to an amount not to exceed 25 percent of total core surplus, inclusive of the preferred stock component. Based on this regulatory guidance, applied to the core surplus ratio at December 31, 2007, all of the \$250.0 million in preferred stock has been included.

The increase in the Bank's permanent capital, total surplus, and core surplus ratios for December 2007 was primarily attributed to the increase in capital due to the issuance of the Preferred Stock and Association owned stock, as referenced above. The decrease in the Bank's permanent capital, total surplus, and core surplus

ratios for December 31, 2006 was attributed to the increase in assets on both a total and risk adjusted basis exceeding the increase in capital. The decrease in the collateral ratio for December 31, 2006 also was attributed to asset growth.

See Note 10, *Protected Borrower Equity and Shareholders' Equity*, in the Notes to the Combined 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 economic capital software, methodologies, and assumptions to quantify the capital requirements related to our primary areas of risk. The District periodically quantifies the economic capital requirements, based on the credit risk, interest rate risk, operational risk, and market risk inherent in 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 loans outstanding to Young, and Beginning Farmers and Ranchers as of December 31, 2007.

Young, and Beginning Farmers and Ranchers Number/Volume of Loans Outstanding <i>(dollars in thousands)</i>				
Category	Number of Loans	Percent of Total	Volume Outstanding	Percent of Total
1. Total loans and commitments outstanding at year-end	136,674	—	\$ 26,597,445	—
2. Young farmers and ranchers	21,933	16.05%	\$ 2,232,410	8.39%
3. Beginning farmers and ranchers	33,182	24.28%	\$ 4,599,062	17.29%

The following table summarizes information regarding loans outstanding to Small Farmers and Ranchers as of December 31, 2007.

Small Farmers and Ranchers Number/Volume of Loans Outstanding by Loan Size <i>(dollars in thousands)</i>				
Number/Volume Outstanding	\$0-\$50,000	\$50,001 - \$100,000	\$100,001-\$250,000	\$250,001-and greater
1. Total number of loans and commitments outstanding at year-end	80,407	21,780	20,563	13,924
2. Total number of loans to small farmers and ranchers	57,439	14,370	12,500	5,828
3. Number of loans to small farmers and ranchers as a % of total number of loans	71.44%	65.98%	60.79%	41.86%
4. Total loan volume outstanding at year-end	\$ 1,556,622	\$ 1,841,582	\$ 3,797,006	\$ 19,402,235
5. Total loan volume to small farmers and ranchers	\$ 1,087,500	\$ 1,106,684	\$ 2,020,566	\$ 3,340,919
6. Loan volume to small farmers and ranchers as a % of total loan volume	69.86%	60.09%	53.21%	17.22%

The following table summarizes information regarding the new loans made to Young, and Beginning Farmers and Ranchers for the year ended December 31, 2007.

Young, and Beginning Farmers and Ranchers Gross New Business During 2007, Number/Volume of Loans <i>(dollars in thousands)</i>				
Category	Number of Loans	Percent of Total	Volume Outstanding	Percent of Total
1. Total gross new loans and commitments made during 2007	57,758	—	\$ 13,167,791	—
2. Total loans and commitments made during 2007 to young farmers and ranchers	8,673	15.02%	\$ 1,054,450	8.01%
3. Total loans and commitments made during 2007 to beginning farmers and ranchers	11,604	20.09%	\$ 1,968,978	14.95%

The following table summarizes information regarding new loans made to Small Farmers and Ranchers for the year ended December 31, 2007.

Small Farmers and Ranchers Gross New Business by Loan Size, Number/Volume of Loans <i>(dollars in thousands)</i>				
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 2007	26,776	11,114	10,268	9,600
2. Total number of loans made to small farmers and ranchers during 2007	18,946	6,008	4,772	2,842
3. Number of loans to small farmers and ranchers as a % of total number of loans	70.76%	54.06%	46.47%	29.60%
4. Total gross loan volume of all new loans and commitments made during 2007	\$ 533,352	\$ 785,711	\$ 1,644,751	\$ 10,203,977
5. Total gross loan volume to small farmers and ranchers	\$ 354,473	\$ 420,812	\$ 767,043	\$ 1,652,599
6. Loan volume to small farmers and ranchers as a % of total gross new loan volume	66.46%	53.56%	46.64%	16.20%

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 2007, the Farm Credit Administration took no enforcement actions against the Bank or District Associations. There were no enforcement actions in effect for the Bank or District Associations at December 31, 2007.

In September 2007, the Farm Credit Administration issued a final rule and direct final rule amending the priority of claims regulations. The final rule amended the priority of claims regulations to provide Banks that make payments under a written agreement to holders of Systemwide Debt Securities on behalf of a Bank unable to make its debt payments the same subrogation rights as payments made under a statutory joint and several call.

The Farm Credit Administration must approve the written agreement. The direct final rule amended the priority of claims regulations to clarify that subordinated claims are to be paid after the claims of general creditors are paid in full.

Proposed Federal Legislation

The current Farm Bill expired on September 30, 2007. In July 2007, the House of Representatives passed its version of a new Farm Bill, the Farm, Nutrition, and Bioenergy Act of 2007. Under the Farm Bill as passed by the House of Representatives, the Congressional Budget Office estimated that payments to farmers under the commodity programs (i.e., direct and countercycle payments and loan deficiency payments) would be reduced by an estimated \$825 million in total over the next 10 years, as compared with a current services baseline of approximately \$75 billion for commodities. However, the specific provisions of the Farm Bill may increase payments for certain commodities or increase them in certain years and reduce them in others. This Farm Bill would also revise certain income payment limitations.

The Farm Bill as passed by the House of Representatives also contains provisions that would expand certain authorities of the Farm Credit System Insurance Corporation. The proposed changes generally would authorize the Insurance Corporation to collect higher levels of premiums and expand the base upon which premiums are charged. Premiums of up to 20 basis points could be charged against insured debt, adjusted to exclude an amount equal to government-guaranteed loans and investment securities. Up to an additional 10 basis points could be charged for any loan volume that is nonaccrual or investments that are other-than-temporarily impaired. Currently, premiums of up to 15 basis points may be charged on accruing loans and up to 25 basis points on nonaccrual loans.

In December 2007, the Senate passed its version of the Farm Bill, the Food and Energy Security Act of 2007. As reported, the bill proposes adjustments to current farm policy while maintaining the basic safety net structure of current law. The bill, when combined with tax provisions previously reported by the Senate Finance Committee, would provide for a permanent disaster fund and provide new incentives for farmers to engage in soil conservation activities. Before these changes are enacted into law, the Senate must conference their actions with the bill earlier approved by the House. It is premature to predict the final outcome of this process. The Senate Farm Bill contains the same expanded authorities with respect to the Insurance Corporation as noted above.

The Senate has named conferees. Conference Committee deliberation, however, awaits the naming of House conferees before it can move forward.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109* (FIN 48 or Interpretation) that was effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies how an enterprise should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the enterprise has taken or expects to take on a tax return. Under the Interpretation, the financial statements reflect expected future tax consequences of income tax positions presuming the relevant taxing authority's full knowledge of the position and all relevant facts, but without considering time values. FIN 48 is applicable to all uncertain positions for taxes accounted for under FASB Statement No. 109. The District adopted FIN 48 on January 1, 2007 and determined that interest and penalties would be classified as a component of income taxes. There were no uncertain positions for income taxes at January 1, 2007, identified as a result of the adoption and therefore no cumulative adjustment to beginning members' equity was required. The tax years that remain open for federal and major state income tax jurisdictions are 2004 and forward.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. The Standard requires an employer to recognize the overfunded or underfunded status of defined benefit pension and other postretirement benefit plans as an asset or liability in its statement of financial position and recognize changes in that funded status through accumulated other comprehensive income as of December 31, 2007. The Standard further requires the determination of the fair value of plan assets at December 31, 2007 and recognition of actuarial gains and losses, prior service costs or credits, and transition assets and obligations as a component of accumulated other comprehensive income. In addition, this Standard requires a change for the funded status of a plan to be measured as of the date of the year-end financial statements. Currently, the District uses a measurement date of September 30 but will be required in 2008 to measure the funded status of the plans as of the fiscal year end, which is December 31. The Bank and certain District Associations have single employer defined benefit plans and participate in multi-employer defined benefit plans. Under FAS 158, accounting for the impact of the adoption of the standard follows the plan sponsor, which for multi-employer plans in which the Bank and Associations participate is at the District entity level. Therefore, the impact for the adoption of FAS 158 for multi-employer defined benefit plans is reflected as an adjustment to accumulated other comprehensive income only in the District's Combined Statement of Changes in Shareholders' Equity. For single employer defined benefit plans sponsored by the Bank or Association, adoption of FAS 158 is recorded in the Bank's or Association's financial statements as well as the District's Combined Financial Statements. See Note 12, *Employee Benefit Plans*, of the Combined Financial Statements, for further information regarding the impact of the adoption of FAS 158 on the current period.

In September 2006, the FASB also issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. As a result, there is now a common definition of fair value to be used throughout generally accepted accounting principles. The FASB believes that the new standard will make the measurement of fair value more consistent and comparable and improve disclosures about those measures. This Statement clarifies that the term "fair value" is intended to mean a market-based measure, not an entity-specific measure. In measuring fair value for a financial statement item, the Statement sets forth a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The highest priority is given to quoted prices in active markets and the lowest priority to unobservable inputs. Additional disclosure requirements will be required for the lowest priority level. The Statement became effective as of January 1, 2008, and will be applied to the District Combined Financial Statements on a prospective basis. The District is currently analyzing the impact of FAS 157 on its financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *Fair Value Option for Financial Assets and Financial Liabilities*. The Standard permits entities to choose on an instrument-by-instrument basis, at specified election dates, to measure financial assets and liabilities and certain other items at fair value (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected must be reported in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. This Standard became effective as of January 1, 2008. The District has not made any elections under the fair value option, thus there will be no impact of the initial adoption of the Standard. However, the District may elect to apply the fair value option to financial instruments acquired in future periods.

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	Leased to a tenant
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 10 to the Combined Financial Statements, *Protected Borrower Equity and Shareholders' Equity*, included in this Annual Report to shareholders.

Description of Liabilities

The description of liabilities, contingent liabilities and intra-system financial assistance rights and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 7, 8, 9, 12, 13, and 16 to the Combined Financial Statements included in this Annual Report to shareholders.

Management's Discussion & Analysis of Financial Condition & 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, <i>President and Chief Executive Officer</i>	10 years	CEO, Palmetto Farm Credit, ACA from April 1989 to January 1998.	He serves as: Chairman of the Board for Federal Farm Credit Banks Funding Corporation; Council Member of the National Council of Farm Cooperatives; University of South Carolina; Board of Trustees for the Business Partnership Foundation and the Board of Directors for the Education Foundation; Board of Directors for Big Brothers Big Sisters of Greater Columbia; Board of Directors and Chairman of Finance Committee for National 4H Council; Board of Directors for Palmetto AgriBusiness Council; Board of Directors for Midlands Business Leadership Group.
Thomas S. Welsh, <i>Executive Vice President and Chief Administrative and Legislative Officer</i>	10 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, <i>Executive Vice President and Chief Operating Officer</i>	1.5 years	Chief Financial Officer from March 1998 to September 2006.	He serves on the AgFirst/FCBT Plan Fiduciary Committee.
Charl L. Butler, <i>Senior Vice President and Chief Financial Officer</i>	9 months	Chief Financial Officer and Secretary at The National Bank of South Carolina from 1991 until 2007.	He serves on the Board of Directors and as Treasurer of the S.C. Council on Economic Education.
William L. Melton, <i>Senior Vice President and Chief Lending Officer</i>	4.5 years	Senior Executive Officer/Bank Lending from January to July 2003, prior to that Lending Services Manager.	He served as Director-at-Large for the National Chicken Council, a trade organization.
Benjamin F. Blakewood, <i>Senior Vice President and Chief Information Officer</i>	9.5 years	Director of Information Technology from 1996 to 1998 at Affinity Technology Group.	
Frederick T. Mickler, III, <i>Senior Vice President and General Counsel</i>	10 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, 2007, 2006 and 2005, is as follows:

Name of Individual or Number in Group	Year	Annual		Deferred Comp.	Perq./ Other*	Total
		Salary	Bonus			
F. A. Lowrey	2007	\$ 524,720	\$ 176,642	\$ 44,160	\$ 21,731	\$ 767,253
F. A. Lowrey	2006	\$ 467,018	\$ 175,161	\$ 10,000	\$ 17,983	\$ 670,162
F. A. Lowrey	2005	\$ 444,017	\$ 162,332	\$ 6,000	\$ 16,779	\$ 629,128
6 Officers	2007	\$ 1,284,000	\$ 439,220	\$ 81,030	\$ 112,060	\$ 1,916,310
5 Officers	2006	\$ 1,029,845	\$ 226,314	\$ 65,522	\$ 63,821	\$ 1,385,502
5 Officers	2005**	\$ 1,251,913	\$ 311,804	\$ 58,502	\$ 65,204	\$ 1,687,423

* Primarily comprised of company contributions to thrift plan (see Note 12 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.

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

In addition to a base salary, senior officers may earn additional compensation under the Bank's Corporate Bonus Plan. The plan is designed to motivate employees to exceed specific performance targets, including financial measures and customer satisfaction rating. Those covered by the plan include all employees. Bonuses are shown in the year earned. Payment of the 2007 bonus was made in the first quarter of 2008.

Bank compensation plans are reviewed by the Board Compensation Committee.

Disclosure of information on the total compensation paid during 2007 to any senior officer, or to any other individual included in the aggregate, is available to shareholders upon request.

Name	Position	Term of Office
Thomas W. Kelly	Chairman	December 31, 2008
Paul M. House	Vice Chairman	December 31, 2011*
Gary L. Alexander	Director	December 31, 2011**
William C. Bess, Jr.	Director	December 31, 2009
Henry M. Frazee	Director	December 31, 2008
Don W. Freeman	Director	December 31, 2009
Dale R. Hershey	Director	December 31, 2011**
Robert L. Holden, Sr.	Director	December 31, 2010
Lyle Ray King	Director	December 31, 2008
Richard Kriebel	Director	December 31, 2007
M. Wayne Lambertson	Director	December 31, 2009
Paul Lemoine	Director	December 31, 2007
James L. May	Director	December 31, 2009
Eugene W. Merritt, Jr.	Director	December 31, 2010
James M. Norsworthy, III	Director	December 31, 2011**
Katherine A. Pace	Director	December 31, 2011***
Dale W. Player	Director	December 31, 2007
J. Dan Raines, Jr.	Director	December 31, 2009
Walter L. Schmidlen, Jr.	Director	December 31, 2008
Robert G. Sexton	Director	December 31, 2011*
Kenneth A. Spearman	Director	December 31, 2009
Robert H. Spiers, Jr.	Director	December 31, 2009
William H. Voss	Director	December 31, 2010

* These directors were re-elected to a new 4-year term ending 12/31/11.

** These directors were newly elected in 2007 to 4-year terms commencing 1/1/08.

*** Re-appointed to 4-year term ending 12/31/11.

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

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

Gary L. Alexander from Seneca, 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.

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 serves on the boards of the National Farm Credit Council Board, the Farm Credit System's national trade organization, Farm Credit Council Services, and Carolina Farm Credit, ACA. He is also a member of the Cleveland County and Catawba Cattlemen's Associations. Mr. Bess is a member of the Board Governance Committee.

Henry M. (Buddy) Frazee of Alachua, Florida, is a retired managing partner of a large cow-calf beef cattle operation, and is President of West Putnam Lakes, Inc. and H&P Frazee Enterprises, Inc., timber and land development companies. He is also managing partner, trustee of Ashley Lake Plantation and West Putnam Enterprises, land development partnerships. In addition, along with his son, he manages a 2,000-acre game preserve and deer hound kennel. He currently serves on the board of Farm Credit of North Florida, ACA. Mr. Frazee is a member of 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 is a member of the national Farm Credit Council Board, Lowndes County Farmers Federation Board, and the Lowndes County Cattlemen's Association Board. He is also past president of the Alabama Chapter of the American Society of Farm Managers and Rural Appraisers. Mr. Freeman is a member of the Board Audit 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 and the Pennsylvania Holstein Association, Lancaster County Blue Ribbon Commission for Agriculture and the Penn Township Ag Advisory Committee. Mr. Hershey serves on the Board Compensation 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 is a member of 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 is a member of the Board Governance Committee.

Richard Kriebel is a contract farmer from Benton, Pennsylvania, raising contract vegetables, forage and grain. His cropland consists of owned-and-leased acres of corn, hay and vegetables. He is a former member of the Columbia County ASCS, Columbia County Extension and the Columbia County Planning Commission. Mr. Kriebel served as a member of the Board Audit Committee.

M. Wayne Lambertson of Pokomoke 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 national Farm Credit Council Board, MidAtlantic Farm Credit, ACA board of directors and the board of the Delmarva Poultry Industry DPI, a trade organization. Mr. Lambertson serves as chairman of the Board Governance Committee.

Paul Lemoine is a cattle and row crop farmer from Plaucheville, Louisiana. He is active in a number of organizations related to farming and is employed as a crop sales consultant with Agrilience Chemical Co. He is a member of the Louisiana Cattlemen's Association and the Avoyelles Parish Farm Bureau. Mr. Lemoine served as a member of the Board Audit 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. 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 a member of 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 serves as chairman of the Board Compensation Committee and is a member of the AgFirst/FCBT Plan Fiduciary Committee.

James M. Norsworthy, III, from Jackson, Louisiana has been involved in production agriculture for 38 years. Mr. Norsworthy runs 100 Cedars Cattle Farm, a 175-head cow-calf operation near Jackson, La. 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, and serves on the board of Feliciana Farm Bureau and was president of that organization from 1984 to 1996. He is a member of East Feliciana Cattlemen's Association, American Angus Association and the Feliciana Forestry Association. Mr. Norsworthy served as mayor of the town of Jackson, La., from 1979 to 1996. 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 is a member of the Board Audit Committee and is a board designated financial expert.

Dale W. Player, from Bishopville, SC, is co-owner of a 1,850-acre row crop operation, with cotton being the primary crop. He is a member of the South Carolina Cotton Board of Directors, and director of the Carolinas Cotton Cooperative. He also serves as a delegate to the National Cotton Council and alternate director to the National Cotton Board. Mr. Player served on the Board Compensation Committee and was a member of the AgFirst Plan Sponsor Committee and the AgFirst/FCBT Plan Sponsor 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 serves as a member of the Board Compensation 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 the Farm Credit of the Virginias, ACA, and was a former director of Southern States Cooperative and Sire Power. Mr. Schmidlen serves as a member of the Board Governance Committee.

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

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 was Controller of Citrus Central, Inc. in Orlando, Florida from 1980-1991, was 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 serves as a member of the Board Compensation Committee.

Robert H. Spiers, Jr., is a full-time farmer, with a tobacco, corn, wheat, soybean, and cotton 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 director on the Virginia Flue-cured Tobacco Board. He has been active on a number of Virginia Farm Bureau advisory committees. Mr. Spiers serves as a member of the Board Compensation 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 as a member of the Board Compensation Committee.

Committees

The board has established an audit committee, compensation committee, and governance committee. All members of the board, other than the chairman, served 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 responsibilities for each committee are set forth in its respective board approved charter.

Compensation of Directors

Directors were compensated in 2007 in cash at the rate of \$43,200 per year, payable at \$3,600 per month. This is compensation for attendance at board meetings, board committee meetings, certain other meetings pre-approved by the board, and other duties as assigned. FCA regulations also allow additional compensation to be paid to a director in exceptional circumstances where extraordinary time and effort are involved. Amounts paid in excess of \$3,600 per month to board officers and board members was \$400 monthly in 2007 and represented compensation for extraordinary time and effort expended for Farm Credit Council (FCC) activities, including FCC board meetings, meetings with other district and national FCC representatives, congressional visitations, and other FCC board activities and issues. Total cash compensation paid to all directors as a group during 2007 was \$960,000. Additional information for each director who served during 2007 is provided below.

Name of Director	Number of Days Served			Total Comp. Paid During 2007*
	Board Meetings	Other Official Activities*	Farm Credit Council Bd. Activities	
William C. Bess, Jr.	25.50	11.50	8.50	\$ 48,000
Henry M. Frazee	25.50	12.50	9.00	48,000
Don W. Freeman	25.50	16.50	9.00	48,000
Robert L. Holden, Sr.	25.00	11.50	9.00	48,000
Paul M. House	25.50	16.25	9.00	48,000
Thomas W. Kelly	25.50	13.00	9.00	48,000
Lyle Ray King	25.50	16.50	9.00	48,000
Richard Kriebel	20.00	12.50	8.50	48,000
M. Wayne Lambertson	25.50	15.25	8.50	48,000
Paul Lemoine	25.00	14.75	9.00	48,000
James L. May	25.50	12.50	9.00	48,000
Eugene W. Merritt, Jr.	25.50	12.00 ***	9.50	48,000
Katherine A. Pace	25.00	15.75	9.00	48,000
Dale W. Player	25.50	12.00 ****	9.00	48,000
J. Dan Raines, Jr.	24.50	11.75	10.00	48,000
Walter L. Schmidlen, Jr.	25.50	12.25	9.00	48,000
Robert G. Sexton	25.50	16.50	9.00	48,000
Kenneth A. Spearman	25.50	27.00 **	9.00	48,000
Robert H. Spiers, Jr.	25.50	15.00	9.00	48,000
William H. Voss	25.50	12.00	9.00	48,000
Total				<u>\$960,000</u>

* Other official activities includes board committee meetings and board training. Total compensation adjusted pursuant to FCA Bookletter 51.

** Includes 8 days for System Workgroup trip to Armenia.

*** Does not include 8 days served on AgFirst/FCBT Plan Fiduciary Committee.

**** Does not include 6 days served on AgFirst and AgFirst/FCBT Plan Sponsor Committees.

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 \$251,988 for 2007, \$258,943 for 2006, and \$202,283 for 2005.

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, 2007 were as follows:

	2007
Independent Auditor	
PricewaterhouseCoopers LLP	
Audit services	\$ 632,389
Non-audit services	137,159
Total	<u>\$ 769,548</u>

Audit fees were for the annual audits of financial statements.

Non-audit fees were for services rendered related to a comfort letter issuance for a preferred stock offering,

Farmer Mac minimum servicing standards attestation, agreed upon procedures for Board of Directors elections, and accounting consultation.

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

The fees expensed by the Associations for independent auditors are disclosed in the individual Association annual reports.

Combined Financial Statements

The Combined Financial Statements, together with the report thereon of PricewaterhouseCoopers LLP, dated February 28, 2008, 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, Financial Reporting Manager, 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 the Quarterly Report within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Bank.

Report of the Audit Committee

The Audit Committee of the 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 2007, 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 2007. The foregoing report is provided by the following independent directors, who constitute the Committee:



Robert G. Sexton
Chairman of the Audit Committee

Members of Audit Committee

Gary L. Alexander
Don W. Freeman
James L. May
James M. Norsworthy, III
Katherine A. Pace

February 28, 2008

Report of Independent Auditors



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

Report of Independent Auditors

To the Board of Directors and 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, 2007, 2006 and 2005, 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

February 28, 2008

Combined Balance Sheets

<i>(dollars in thousands)</i>	December 31, 2007	December 31, 2006	December 31, 2005
Assets			
Cash and cash equivalents	\$ 612,841	\$ 651,268	\$ 640,830
Investment securities:			
Available for sale (amortized cost of \$5,679,228, \$5,063,640 and \$3,888,889 respectively)	5,641,430	5,065,621	3,886,318
Held to maturity (fair value of \$1,397,015, \$1,392,499 and \$1,384,390 respectively)	1,419,371	1,426,481	1,416,647
Total investment securities	7,060,801	6,492,102	5,302,965
Loans	20,728,296	18,669,616	16,171,572
Less: allowance for loan losses	78,874	71,915	87,551
Net loans	20,649,422	18,597,701	16,084,021
Loans held for sale	1,904	4,445	882
Other investments	430,812	428,005	237,239
Accrued interest receivable	252,838	246,184	179,970
Investments in other Farm Credit System institutions	8,374	8,738	8,756
Premises and equipment, net	123,012	120,123	107,063
Other property owned	8,504	5,122	3,646
Deferred tax assets, net	5	163	1,691
Other assets	112,638	206,867	207,497
Total assets	\$ 29,261,151	\$ 26,760,718	\$ 22,774,560
Liabilities			
Bonds and notes	\$ 24,847,248	\$ 22,613,379	\$ 18,879,964
Mandatorily redeemable preferred stock	225,000	225,000	225,000
Accrued interest and dividends payable	179,578	188,028	133,855
Dividends and patronage refunds payable	132,146	115,893	99,665
Pension and other postretirement benefits liability	128,415	114,063	109,807
Advanced conditional payments	31,574	23,027	23,749
Other liabilities	151,116	173,145	158,135
Total liabilities	25,695,077	23,452,535	19,630,175
Commitments and contingencies (Note 16)			
Shareholders' Equity			
Perpetual preferred stock	400,000	150,000	150,000
Protected borrower equity	5,369	6,208	7,628
Capital stock and participation certificates	127,147	118,817	120,370
Retained earnings			
Allocated	1,068,756	992,227	925,919
Unallocated	2,118,390	2,039,308	1,943,444
Accumulated other comprehensive income (loss)	(153,588)	1,623	(2,976)
Total shareholders' equity	3,566,074	3,308,183	3,144,385
Total liabilities and shareholders' equity	\$ 29,261,151	\$ 26,760,718	\$ 22,774,560

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,		
	2007	2006	2005
Interest Income			
Investment securities	\$ 392,113	\$ 338,314	\$ 169,034
Loans	1,516,587	1,309,291	1,028,563
Other investments	23,076	22,643	1,677
Total interest income	1,931,776	1,670,248	1,199,274
Interest Expense	1,209,586	996,412	588,773
Net interest income	722,190	673,836	610,501
Provision for (reversal of allowance) for loan losses	8,284	(717)	(6,492)
Net interest income after provision for (reversal of allowance) for loan losses	713,906	674,553	616,993
Noninterest Income			
Loan fees	29,996	33,434	35,931
Fees for financially related services	9,228	6,887	6,347
Realized gains (losses) on investments, net	1	(5)	466
Realized gains on derivatives, net	—	6,812	94
Gains (losses) on sale of rural home loans	147	3,172	2,935
Gains on sale of mortgage servicing assets	—	—	1,078
Gains from sale of premises and equipment, net	2,016	1,521	3,004
Patronage refunds from other Farm Credit institutions	1,790	1,172	1,298
Other noninterest income	5,746	5,677	4,400
Total noninterest income	48,924	58,670	55,553
Noninterest Expense			
Salaries and employee benefits	198,539	190,597	188,191
Occupancy and equipment	33,771	30,953	29,071
Insurance fund premiums	28,200	24,615	7,447
Other operating expense	76,293	71,491	66,937
Intra-System financial assistance expenses	—	—	3,221
Called debt expense	10,550	2,563	656
Correspondent lending servicing expense	2,071	1,656	1,294
Other noninterest expense	1,077	683	684
Total noninterest expense	350,501	322,558	297,501
Income before income taxes	412,329	410,665	375,045
Provision (benefit) for income taxes	412	296	(2,132)
Net income	\$ 411,917	\$ 410,369	\$ 377,177

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

Combined Statements of Changes in Shareholders' Equity

<i>(dollars in thousands)</i>	Perpetual Preferred Stock	Protected Borrower Equity	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income	Total Shareholders' Equity
				Allocated	Unallocated		
Balance at December 31, 2004	\$ 150,000	\$ 10,123	\$ 125,089	\$ 849,626	\$ 1,861,476	\$ 3,331	\$ 2,999,645
Comprehensive income							
Net income					377,177		377,177
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of \$466						(12,944)	(12,944)
Change in fair value of derivative instruments, includes reclassification adjustments of \$94						6,643	6,643
Minimum pension liability adjustment						(6)	(6)
Total comprehensive income							370,870
Protected borrower equity retired		(2,495)					(2,495)
Capital stock/participation certificates issued/(retired), net			(5,030)				(5,030)
Dividends declared/paid			311		(3,311)		(3,000)
Perpetual preferred stock dividends paid					(10,950)		(10,950)
Patronage distribution							
Cash					(95,354)		(95,354)
Qualified allocated surplus				26,391	(26,391)		—
Nonqualified allocated surplus				83,420	(83,420)		—
Nonqualified retained surplus				73,653	(73,653)		—
Retained earnings retired				(109,254)			(109,254)
Patronage distribution adjustment				2,083	(2,130)		(47)
Balance at December 31, 2005	150,000	7,628	120,370	925,919	1,943,444	(2,976)	3,144,385
Comprehensive income							
Net income					410,369		410,369
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of \$(5)						4,552	4,552
Minimum pension liability adjustment						47	47
Total comprehensive income							414,968
Protected borrower equity retired		(1,420)					(1,420)
Capital stock/participation certificates issued/(retired), net			(2,469)				(2,469)
Stock dividends declared/paid			916		(916)		—
Perpetual preferred stock dividends paid					(10,950)		(10,950)
Patronage distribution							
Cash					(114,325)		(114,325)
Qualified allocated surplus				27,798	(27,798)		—
Nonqualified allocated surplus				92,988	(92,988)		—
Nonqualified retained surplus				62,038	(62,038)		—
Retained earnings retired				(118,414)			(118,414)
Patronage distribution adjustment				1,898	(5,490)		(3,592)
Balance at December 31, 2006	150,000	6,208	118,817	992,227	2,039,308	1,623	3,308,183
Comprehensive income							
Net income					411,917		411,917
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of \$1						(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 SFAS No. 158						(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

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

Combined Statements of Cash Flows

For the year ended December 31,

<i>(dollars in thousands)</i>	2007	2006	2005
Cash flows from operating activities:			
Net income	\$ 411,917	\$ 410,369	\$ 377,177
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation on premises and equipment	18,090	16,670	14,695
Amortization of net deferred loan origination (fees) costs	(5,110)	(7,639)	(7,524)
Premium amortization/discount accretion on investment securities	(23,617)	(28,069)	1,197
Premium amortization/discount accretion on bonds and notes	7,343	18,420	14,930
Provision for (reversal of allowance for) loan losses	8,284	(717)	(6,492)
(Gains) losses on other property owned, net	999	1,300	203
(Gains) losses from sale of premises and equipment, net	(2,016)	(1,521)	(3,004)
Realized (gains) losses on investments, net	(1)	5	(466)
Realized (gains) losses on derivatives, net	—	(6,812)	(94)
Realized (gains) losses on sale of mortgage servicing assets	—	—	(1,078)
Gains (losses) on sales of rural home loans, net	(147)	(3,172)	(2,935)
Proceeds from sale of mortgage servicing assets	—	—	10,039
Net change in loans held for sale	28,220	31,857	(255,454)
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	(6,654)	(66,214)	(48,568)
(Increase) decrease in deferred tax assets, net	158	1,528	538
(Increase) decrease in other assets	123,801	(1,380)	(18,649)
Increase (decrease) in accrued interest and dividends payable	(8,450)	54,173	68,001
Increase (decrease) in pension and other postretirement benefits liability	14,352	4,256	10,697
Increase (decrease) in other liabilities	(116,506)	30,725	22,885
Total adjustments	38,746	43,410	(201,079)
Net cash provided by (used in) operating activities	450,663	453,779	176,098
Cash flows from investing activities:			
Investment securities purchased	(2,223,352)	(3,357,019)	(4,161,518)
Investment securities sold or matured	1,615,415	2,177,855	2,135,845
Proceeds from sale of derivatives	—	6,812	—
Net (increase) decrease in loans	(2,089,074)	(2,538,021)	(1,073,867)
(Increase) decrease in investments in other Farm Credit System institutions	364	18	(527)
Purchases of other investments	(44,110)	(215,335)	(237,239)
Proceeds from payments received on other investments	64,379	47,212	—
Purchase of premises and equipment	(22,082)	(30,601)	(27,774)
Proceeds from sale of premises and equipment	3,119	2,392	5,623
Proceeds from sale of other property owned	4,266	1,229	3,717
Net cash used in investing activities	(2,691,075)	(3,905,458)	(3,355,740)
Cash flows from financing activities:			
Bonds and notes issued	66,559,204	49,104,767	38,025,506
Bonds and notes retired	(64,383,204)	(45,406,904)	(34,529,195)
Net increase (decrease) in advanced conditional payments	8,547	(722)	10,615
Perpetual preferred stock issued net of issuance cost	247,258	—	—
Protected borrower equity retired	(839)	(1,420)	(2,495)
Capital stock and participation certificates issued/(retired), net	7,197	(2,469)	(5,030)
Patronage refunds and dividends paid	(111,657)	(101,771)	(81,587)
Dividends paid on perpetual preferred stock	(19,501)	(10,950)	(10,950)
Retained earnings retired	(105,020)	(118,414)	(109,254)
Net cash provided by financing activities	2,201,985	3,462,117	3,297,610
Net increase (decrease) in cash and cash equivalents	(38,427)	10,438	117,968
Cash and cash equivalents, beginning of period	651,268	640,830	522,862
Cash and cash equivalents, end of period	\$ 612,841	\$ 651,268	\$ 640,830
Supplemental schedule of non-cash investing and financing activities:			
Financed sales of other property owned	\$ 355	\$ 718	\$ 1,284
Loans transferred to other property owned	9,002	4,723	5,417
Change in unrealized gains (losses) on investments	(39,780)	4,552	(12,944)
Change in fair value of derivative instruments	—	—	6,643
Change in pension liability related to other comprehensive income	(21)	(47)	6
Decrease in other assets resulting from adoption of SFAS No. 158	105,047	—	—
Increase in pension and other postretirement benefits liability resulting from adoption of SFAS No. 158	10,405	—	—
Non-cash changes related to hedging activities:			
Decrease (increase) in loans	\$ —	\$ 7	\$ 55
Increase (decrease) in bonds and notes	50,526	17,132	(33,662)
Decrease (increase) in other assets	(29,572)	(1,553)	(937)
Increase (decrease) in other liabilities	(20,954)	(15,586)	27,807
Supplemental information:			
Interest paid	\$ 1,210,693	\$ 928,865	\$ 520,772
Taxes paid, net	(2,675)	352	1,350

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. The Bank is chartered to service the states of Pennsylvania, Delaware, Maryland, Virginia, West Virginia, North Carolina, South Carolina, Georgia, Florida, Alabama, Mississippi, the Commonwealth of Puerto Rico and portions of the states of Ohio, Tennessee, Kentucky and Louisiana.

Each FCB and the ACB serves one or more Production Credit Associations (PCAs) that originate and service short- and intermediate-term loans, Federal Land Credit Associations (FLCAs) that originate and service long-term real estate mortgage loans, and/or Agricultural Credit Associations (ACAs) that originate both long-term and short- and intermediate-term loans. PCAs, FLCAs, and ACAs are collectively referred to as associations. AgFirst and its related associations (Associations or District Associations) are collectively referred to as the District. The District Associations jointly own all of AgFirst's voting stock. As of December 31, 2007, the District consisted of the Bank and twenty-three District ACAs. All twenty-three are structured as holding companies, which include FLCA and PCA subsidiaries.

Each FCB and the ACB is responsible for supervising the activities of the associations within its district. The FCBs and/or associations make loans to or for the benefit of eligible borrowers/shareholders for qualified 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 the discretionary uses by the Insurance Corporation of providing assistance to certain troubled System institutions

and to cover the operating expenses of the Insurance Corporation. Each System bank is required to pay premiums into the Insurance Fund based on its average annual District loans outstanding until the assets in the Insurance Fund reach the "secure base amount," which is defined in the Farm Credit Act as 2.00 percent of the aggregate insured obligations (Systemwide debt obligations) or such other percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums, but it still must ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

- B. **Operations:** The Farm Credit Act sets forth the types of authorized lending activity, persons eligible to borrow and financial services which can be offered by AgFirst and the District Associations.

AgFirst and/or the District Associations are authorized to provide, either directly or in participation with other lenders, credit, credit commitments, and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, their cooperatives, rural residents, and farm-related businesses. AgFirst may also lend to financial institutions engaged in lending to eligible borrowers. The District Associations may also serve as an intermediary in offering credit life insurance and multi-peril crop insurance, and in providing additional services to borrowers.

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

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

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

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

Note 2 — Summary of Significant Accounting Policies

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

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

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

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, which are included in Realized Gains/(Losses) on Investments, Net, are determined using the specific identification method.

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

- C. **Loans and Allowance for Loan Losses:** Long-term real estate mortgage loans generally have original maturities ranging up to 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 less unearned income adjusted for Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, valuation adjustments. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days or more (unless adequately secured and in the process of collection) or

circumstances indicate that collection of principal and/or interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is reversed (if accrued in the current year) and/or charged against the allowance for loan losses (if accrued in prior years).

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

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

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition, and prior loan loss experience. The allowance for loan losses encompasses various judgments, evaluations, and appraisals with respect to the loans and their underlying security that, by their nature, contain elements of uncertainty and imprecision. Changes in the agricultural economy and their impact on borrower repayment capacity will cause these various judgments, evaluations and appraisals to change over time. Accordingly, actual circumstances could vary significantly from the institutions' expectations and predictions of those circumstances. Managements consider the following factors in determining and supporting the levels of allowances for loan losses: the concentration of lending in agriculture, combined with uncertainties associated with farmland values, commodity prices, exports, government assistance programs, regional economic effects, and weather-related influences.

The allowance for loan losses is a valuation account used to reasonably estimate loan and lease losses as of the financial statement date. Determining the appropriate allowance for the loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss. The determination of the allowance for loan losses is based on management's current judgments about the credit quality of its loan and lease portfolio. A specific allowance may be established for impaired loans under SFAS No. 114. Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent.

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

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

- D. **Other Investments:** Other Investments include Tobacco Buyout Successor-in-Interest Contracts (SIIC) which qualify as Mission-Related Investments under FCA regulations. Under the SIIC, the Tobacco quota holders and producers may sell their rights to receive SIIC contract payments to a third party. The successor purchases the entire contract and all related rights and obligations associated with the contract. These investments in SIIC are purchased at a discount. Contract payments are made by the United States Department of Agriculture (USDA) in equal annual payments. Interest income is recognized from the accretion of discounts using the effective interest method.
- E. **Other Property Owned:** Other property owned, consisting of real and personal property acquired through collection action, is recorded at fair value less estimated selling costs upon acquisition. Revised estimates to the fair value less costs to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income and expenses from operations and carrying value adjustments are included in net gains (losses) on other property owned.
- F. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. Depreciation is generally provided on the straight-line method over the estimated useful lives of the assets, which range from 3 to 40 years. Gains and losses on dispositions are reflected in current operating results. Maintenance and repairs are charged to operating expense and improvements that extend the useful life of the asset are capitalized.
- G. **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, 2007, 2006 and 2005 were \$180.5 million, \$202.5 million, and \$212.9 million, respectively. The outstanding gross balances of advance conditional payments classified as other liabilities at December 31, 2007, 2006 and 2005 were \$31.6 million, \$23.0 million, and \$23.7 million, respectively.
- I. **Employee Benefit Plans:** Substantially all of the District may be eligible to participate in one of three defined benefit retirement plans within the District. The "Projected Unit Credit" actuarial method is used for financial reporting purposes. For participants hired before January 1, 2003, benefits are determined based on a final average pay formula. For those participants hired on or after January 1, 2003, benefits are determined using a cash balance formula.

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 SFAS No. 87, *Employers' Accounting for Pensions*, and SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, and related implementation guidance, defined benefit plans covering more than one entity within the District represent multi-employer plans. See Note 12, *Employee Benefit Plans*, for additional financial information for these plans, including the impact of the adoption of SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, 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. Puerto Rico Farm Credit, ACA received a credit for taxes payable on Puerto Rico sourced income in accordance with Section 936 of the Internal Revenue Code of 1986, as amended. However, Section 936 was terminated effective December 31, 2005 (see Note 1).

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, 2007, deferred income taxes had not been provided by certain District Associations on approximately \$125.4 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 January 1, 2007 identified as a result of the adoption of Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109* (see *Recent Accounting Developments* section below).

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

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

The Bank formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as fair value or cash flow hedges to (1) specific assets or liabilities on the balance sheet or (2) firm commitments or forecasted transactions.

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

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

- L. Valuation Methodologies:** Management of the District applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets, such as investment securities. However, for those items for which an observable liquid market does not exist, management utilizes significant estimates and assumptions to value those items. Examples of these items include impaired loans, certain derivatives, and other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing, and liquidation values. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on the District's results of operations.
- M. Recent Accounting Developments:** In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109* (FIN 48 or Interpretation) that was effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies how an enterprise should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the enterprise has taken or expects to take on a tax return. Under the Interpretation, the financial statements reflect expected future tax consequences of income tax positions presuming the relevant taxing authority's full knowledge of the position and all relevant facts, but without considering time values. FIN 48 is applicable to all uncertain positions for taxes accounted for under FASB Statement No. 109. The District adopted FIN 48 on January 1, 2007 and determined that interest and penalties would be classified as a component of income taxes. There were no uncertain positions for income taxes at January 1, 2007 identified as a result of the adoption and therefore no cumulative adjustment to beginning retained earnings was required. The tax years that remain open for federal and major state income tax jurisdictions are 2004 and forward.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. The Standard requires an employer to recognize the overfunded or underfunded status of defined benefit pension and other postretirement benefit plans as an

asset or liability in its statement of financial position and recognize changes in that funded status through accumulated other comprehensive income as of December 31, 2007. The Standard further requires the determination of the fair value of plan assets at December 31, 2007 and recognition of actuarial gains and losses, prior service costs or credits, and transition assets and obligations as a component of accumulated other comprehensive income. In addition, this Standard requires a change for the funded status of a plan to be measured as of the date of the year-end financial statements. Currently, the District uses a measurement date of September 30 but will be required in 2008 to measure the funded status of the plans as of the fiscal year end, which is December 31. The Bank and certain District Associations have single employer defined benefit plans and participate in multi-employer defined benefit plans. Under SFAS No. 158, accounting for the impact of the adoption of the standard follows the plan sponsor, which for multi-employer plans in which the Bank and Associations participate is at the District entity level. Therefore, the impact for the adoption of SFAS No. 158 for multi-employer defined benefit plans is reflected as an adjustment to accumulated other comprehensive income only in the District's Combined Statement of Changes in Shareholders' Equity. For single employer defined benefit plans sponsored by the Bank or Association, adoption of SFAS No. 158 is recorded in the Bank's or Association's financial statements as well as the District's Combined Financial Statements. See Note 12, *Employee Benefit Plans*, of the Combined Financial Statements, for further information regarding the impact of the adoption of SFAS No. 158 on the current period.

In September 2006, the FASB also issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. As a result, there is now a common definition of fair value to be used throughout generally accepted accounting principles. The FASB believes that the new standard will make the measurement of fair value more consistent and comparable and improve disclosures about those measures. This Statement clarifies that the term fair value is intended to mean a market-based measure, not an entity-specific measure. In measuring fair value for a financial statement item, the Statement sets forth a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The highest priority is given to quoted prices in active markets and the lowest priority to unobservable inputs. Additional disclosure requirements will be required for the lowest priority level. The Statement became effective as of January 1, 2008, and will be applied to the District's Consolidated Financial Statements on a prospective basis. The District is currently analyzing the impact of SFAS No. 157 on its financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *Fair Value Option for Financial Assets and Financial Liabilities*. The Standard permits entities to choose on an instrument-by-instrument basis, at specified election dates, to measure financial assets and liabilities and certain other items at fair value (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected must be reported in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. This Standard became effective as of January 1, 2008. The District has not made any elections under the fair value option, thus there will be no impact of the initial adoption of the Standard. However, the District may elect to apply the fair value option to financial instruments acquired in future periods.

Note 3 — Investment Securities

Available-for-Sale

A summary of the amortized cost and fair value of debt securities held as available-for-sale investments at December 31, 2007, 2006 and 2005, follows:

(dollars in thousands)	December 31, 2007				
	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%

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

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

Held-to-Maturity

A summary of the amortized cost and fair value of debt securities held as held-to-maturity investments at December 31, 2007, 2006 and 2005 follows:

(dollars in thousands)	December 31, 2007				
	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
Other	161,587	1,805	(3,373)	160,019	6.42
Total	\$ 1,419,371	\$ 2,292	\$ (24,648)	\$ 1,397,015	5.26%

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

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

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

The following table shows the fair value and gross unrealized losses for investments in a loss position aggregated by investment category at December 31, 2007. The unrealized losses on these investments resulted from interest rate volatility and are not credit related. AgFirst and certain District Associations have both the ability and the intent to recover substantially all of the cost in these investments.

	Less than 12 Months		Greater than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<i>(dollars in thousands)</i>				
U.S. Govt. GNMA				
MBS/CMOs	\$ 484,186	\$ 1,862	\$ 118,232	\$ 1,672
U.S. Govt. Agency MBS	1,301,290	10,021	1,456,853	25,301
Non-Agency Securities	442,494	13,555	130,528	2,370
Asset-Backed Securities	197,919	18,290	1,034	13
Mortgage-Backed Securities	14,549	39	45,878	665
Other	78,965	3,373	—	—
Total	\$ 2,519,403	\$ 47,140	\$ 1,752,525	\$ 30,021

On December 31, 2007, the District held certain investments having continuous unrealized loss positions for more than 12 months with a fair value totaling \$1.75 billion and an unrealized loss position totaling \$30.0 million. Substantially all of these investments were in U. S. Government Agency securities and AgFirst expects these securities would not be settled at a price less than their amortized cost. Because the decline in market value was caused by interest rate volatility and, in certain instances, market uncertainty, and because AgFirst has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, AgFirst has not recognized any other-than-temporary impairment in connection with these investments.

A summary of the expected maturity, amortized cost and estimated fair value of investment securities at December 31, 2007, 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	
	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield
<i>(dollars in thousands)</i>										
U.S. Govt. GNMA MBS/CMO's	\$ —	—%	\$ —	—%	\$ 441	5.04%	\$ 1,754,112	4.99%	\$ 1,754,553	4.99%
U.S. Govt. Agency MBS	306	4.73	256	5.00	156,366	5.12	2,905,113	5.03	3,062,041	5.04
Non-Agency Securities	—	—	—	—	—	—	636,559	5.36	636,559	5.36
Commercial MBS	—	—	—	—	—	—	4,597	5.57	4,597	5.57
Asset-Backed Securities	—	—	—	—	14,954	5.75	168,726	5.63	183,680	5.64
Total fair value	\$ 306	4.73%	\$ 256	5.00%	\$ 171,761	5.18%	\$ 5,469,107	5.08%	\$ 5,641,430	5.08%
Total amortized cost	\$ 307		\$ 257		\$ 171,188		\$ 5,507,476		\$ 5,679,228	

Held-to-maturity

	Due in 1 year or less		Due after 1 year through 5 years		Due after 5 years through 10 years		Due after 10 years		Total	
	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield
<i>(dollars in thousands)</i>										
U.S. Govt. Agency MBS	\$ —	—%	\$ —	—%	\$ —	—%	\$ 1,141,801	5.08%	\$ 1,141,801	5.08%
Asset-Backed Securities	19	5.22	9,535	5.39	55,213	5.39	51,216	5.35	115,983	5.37
Other	10,023	7.16	15,639	6.06	98,299	6.25	37,626	6.84	161,587	6.42
Total amortized cost	\$ 10,042	7.16%	\$ 25,174	5.80%	\$ 153,512	5.94%	\$ 1,230,643	5.15%	\$ 1,419,371	5.26%
Total fair cost	\$ 10,152		\$ 25,293		\$ 150,636		\$ 1,210,934		\$ 1,397,015	

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

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

	Year Ended December 31,		
	2007	2006	2005
<i>(dollars in thousands)</i>			
Proceeds on sales	\$ 7,976	\$ 54,834	\$ 383,676
Realized gains	1	—	908
Realized losses	—	5	442

Note 4 — Loans and Allowance for Loan Losses

A summary of loans follows:

(dollars in thousands)	December 31,		
	2007	2006	2005
Real estate mortgage	\$ 8,792,463	\$ 8,019,808	\$ 7,401,816
Production and intermediate-term	7,820,724	7,398,749	6,378,740
Loans to cooperatives	320,154	250,364	164,776
Processing and marketing	1,517,944	1,145,416	682,709
Farm-related business	481,940	392,153	369,574
Communication	122,825	74,126	33,423
Energy	199,096	198,198	156,006
Water and waste disposal	20,752	12,688	—
Rural residential real estate	1,407,501	1,152,266	959,353
Lease receivables	19,721	24,088	22,525
Loans to other financial institutions	2,220	1,760	2,650
Other	22,956	—	—
Total	\$ 20,728,296	\$ 18,669,616	\$ 16,171,572

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.

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

The following table presents information relating to impaired loans.

(dollars in thousands)	December 31,		
	2007	2006	2005
Nonaccrual:			
Current as to principal and interest	\$ 21,219	\$ 29,438	\$ 51,830
Past due	76,833	48,114	30,982
Accrual:			
Restructured	5,508	2,619	3,151
90 days or more past due	2,946	7,418	2,353
Total impaired loans	\$ 106,506	\$ 87,589	\$ 88,316

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2007.

The following table presents interest income recognized on impaired loans.

(dollars in thousands)	Year Ended December 31,		
	2007	2006	2005
Interest income recognized on nonaccrual loans	\$ 6,520	\$ 12,012	\$ 8,802
Interest income on impaired accrual loans	901	529	727
Interest income recognized on impaired loans	\$ 7,421	\$ 12,541	\$ 9,529

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

(dollars in thousands)	2007	2006	2005
Impaired loans with related allowance	\$ 34,606	\$ 18,169	\$ 38,326
Impaired loans with no related allowance	71,900	69,420	49,990
Total impaired loans	\$ 106,506	\$ 87,589	\$ 88,316
Average impaired loans	\$ 86,026	\$ 78,835	\$ 93,917
Allowance on impaired loans	\$ 2,605	\$ 6,194	\$ 20,642

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

(dollars in thousands)	Year Ended December 31,		
	2007	2006	2005
Balance at beginning of year	\$ 71,915	\$ 87,551	\$ 95,419
Provision for (reversal of allowance for) loan losses	8,284	(717)	(6,492)
Loans charged off	(3,507)	(15,913)	(2,615)
Recoveries	2,182	994	1,239
Balance at end of year	\$ 78,874	\$ 71,915	\$ 87,551

To mitigate the risk of loans being placed in nonaccrual status, System institutions may enter into long-term-standby-commitment-to-purchase agreements with the Federal Agricultural Mortgage Corporation (Farmer Mac). The agreements, which are effectively credit guarantees that will remain in place until the loans are paid in full, give the Bank or Association the right to sell the loans identified in the agreements for "par" to Farmer Mac in the event a delinquency of four months occurs. The balance of loans under long-term standby commitments was \$1.26 billion, \$953.8 million, and \$825.6 million at December 31, 2007, 2006, and 2005, respectively. Fees paid to Farmer Mac for such commitments totaled \$1.8 million, \$1.9 million, and \$2.3 million for the years ended December 31, 2007, 2006, and 2005, respectively. Fees paid to government sponsored enterprises (GSEs) other than Farmer Mac were \$1.5 million, \$1.0 million, and \$581 thousand for 2007, 2006, and 2005, 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, 2007, eleven District Associations held investments in Tobacco Buyout SIICs of \$430.8 million.

Note 6 — Premises and Equipment

Premises and equipment consisted of the following:

(dollars in thousands)	December 31,		
	2007	2006	2005
Land	\$ 23,682	\$ 21,939	\$ 19,399
Buildings and improvements	98,822	92,799	77,977
Furniture and equipment	107,188	102,257	92,152
Work in progress	5,546	3,685	9,919
	235,238	220,680	199,447
Less: accumulated depreciation	112,226	100,557	92,384
Total	\$ 123,012	\$ 120,123	\$ 107,063

Note 7 — Other Assets and Other Liabilities

A summary of other assets and other liabilities follows:

(dollars in thousands)	December 31,		
	2007	2006	2005
Other assets:			
Prepaid pension costs	\$ —	\$ 121,114	\$ 141,580
Derivative assets	33,187	3,615	2,066
Unamortized debt issue costs	18,637	15,098	12,038
Deferred preferred stock costs	940	2,017	2,701
Third party subservicer receivable	12,567	8,495	6,128
Prepaid expenses	2,051	3,282	3,145
Other	45,256	53,246	39,839
Total	\$ 112,638	\$ 206,867	\$ 207,497
Other liabilities:			
Accounts payable	\$ 22,659	\$ 21,859	\$ 23,444
Derivative liabilities	2,560	23,514	39,100
Farm Credit System Ins. Corp. payable	28,211	24,613	7,475
Bank draft payable	56,799	66,774	55,628
Payroll	22,601	21,474	20,733
Other	18,286	14,911	11,755
Total	\$ 151,116	\$ 173,145	\$ 158,135

Note 8 — 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 liability. The MAA was amended and restated in July 2003. At December 31, 2007, AgFirst was in compliance with the conditions of participation for the issuances of Systemwide Debt Securities.

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

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

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

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

Bonds			Discount Notes		Total	
Maturities	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate
(dollars in thousands)						
2008	\$ 8,152,307	4.53%	\$ 2,804,679	4.28%	\$ 10,956,986	4.47%
2009	4,933,329	4.56	—	—	4,933,329	4.56
2010	1,783,688	4.58	—	—	1,783,688	4.58
2011	1,437,911	4.88	—	—	1,437,911	4.88
2012	933,603	4.94	—	—	933,603	4.94
2013	4,801,731	5.46	—	—	4,801,731	5.46
Total	\$ 22,042,569	4.78%	\$ 2,804,679	4.28%	\$ 24,847,248	4.73%

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, 2007, was 64 days.

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

Amount	First Call Date	Year of Maturity
(dollars in thousands)		
\$ 10,670,000	2008	2008 – 2022
235,000	2009	2011 – 2021
2,000	2010	2012
25,000	2011	2013 – 2016
10,000	2012	2017
\$ 10,942,000	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, 2007 the assets of the Insurance Fund aggregated \$2.60 billion; however, due to the other authorized uses of the Insurance Fund there is no assurance that any available amount in the Insurance Fund will be sufficient to fund the timely payment of principal or interest on an insured debt obligation in the event of a default by any System bank having primary liability thereon. Amounts available in the Insurance Fund were used in June 2005 to repay the Financial Assistance Corporation debt issued to fund the purchase of \$374 million of Federal Land Bank of Jackson preferred stock.

Note 9 — 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 10 — Protected Borrower Equity and Shareholders' Equity

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

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

B. **Preferred Stock:** On October 14, 2003, AgFirst issued \$150.0 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, 2007:

Class	Protected Status	Shares Outstanding (dollars in thousands)	
		Number	Aggregate Par Value
Common Nonvoting	Yes	1,017,800	\$ 5,089
Common Voting	No	17,585,600	87,928
Participation Certificates	Yes	55,800	279
Participation Certificates	No	1,632,400	8,162
Preferred	No	4,516,000	22,580
Total Association Capital Stock, Participation Certificates and Protected Borrower Equity		24,807,600	\$ 124,038

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, 2007, combined allocated retained earnings consisted of \$229.1 million of qualified surplus, \$437.0 million of nonqualified allocated surplus and \$403.4 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, 2007, AgFirst had \$130 thousand of participation certificates outstanding to OFIs at a face value of \$5.00 per share.

Regulatory Capitalization Requirements and Restrictions

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

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, 2007, AgFirst's net collateral ratio was 106.02 percent.

Included in the above table as of December 31, 2007, are all twenty-three Associations that have reorganized through the creation of FLCA and PCA subsidiaries. These subsidiaries and the ACA operate under a common board of directors and joint management. As a result, these District Associations are jointly obligated on each other's liabilities and are evaluated on a consolidated basis for capital adequacy and other regulatory purposes.

All District entities were in compliance with the required minimum capital standards at December 31, 2007.

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

An additional component of retained earnings is accumulated other comprehensive income (loss), which is reported net of taxes. The balance at December 31 was comprised of the following components:

<i>(dollars in thousands)</i>	2007	2006	2005
Unrealized (losses) gains on investments available-for-sale	\$ (37,798)	\$ 1,982	\$ (2,571)
Minimum pension liability adjustment	—	(359)	(405)
Postretirement benefits obligation adjustment	(115,790)	—	—
Total accumulated other comprehensive income (loss)	<u>\$ (153,588)</u>	<u>\$ 1,623</u>	<u>\$ (2,976)</u>

Note 11 — Income Taxes

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

	Year Ended December 31,		
<i>(dollars in thousands)</i>	2007	2006	2005
Current:			
Federal	\$ 964	\$ (1,329)	\$ (2,203)
State	(710)	154	(467)
	<u>254</u>	<u>(1,175)</u>	<u>(2,670)</u>
Deferred:			
Federal	156	1,260	320
State	2	211	218
	<u>158</u>	<u>1,471</u>	<u>538</u>
Total provision (benefit) for income taxes	<u>\$ 412</u>	<u>\$ 296</u>	<u>\$ (2,132)</u>

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,		
<i>(dollars in thousands)</i>	2007	2006	2005
Federal tax at statutory rate	\$138,501	\$ 139,592	\$ 127,418
State tax, net	3	227	(249)
Tax-exempt FLCA earnings	(84,761)	(71,937)	(78,471)
Association patronage distributions	(53,081)	(49,284)	(40,273)
Nontaxable Bank income	(7,269)	(19,413)	(11,258)
Possessions credit (Puerto Rico)	—	—	(594)
Change in valuation allowance	11,692	(1,397)	2,402
Other	(4,673)	2,508	(1,107)
Provision for income taxes	<u>\$ 412</u>	<u>\$ 296</u>	<u>\$ (2,132)</u>

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

	December 31,		
<i>(dollars in thousands)</i>	2007	2006	2005
Allowance for loan losses	\$ 16,119	\$ 14,763	\$ 18,533
Nonaccrual loan interest	2,695	3,645	2,235
Postretirement benefits other than pensions	17,561	11,549	7,846
Nonqualified patronage distributions	97	97	6,318
Loss carryforwards	8,954	3,300	5,420
Other	1,285	2,428	1,666
Gross deferred tax asset	<u>46,711</u>	<u>35,782</u>	<u>42,018</u>
Less: valuation allowance	<u>(26,711)</u>	<u>(15,613)</u>	<u>(18,772)</u>
Gross deferred tax assets, net of valuation allowance	<u>20,000</u>	<u>20,169</u>	<u>23,246</u>
Bank patronage	(4,571)	(5,658)	(9,256)
Pensions	(10,492)	(11,195)	(8,877)
Depreciation	(301)	(356)	(261)
Other	(4,631)	(2,797)	(3,161)
Gross deferred tax liability	<u>(19,995)</u>	<u>(20,006)</u>	<u>(21,555)</u>
Net deferred tax asset	<u>\$ 5</u>	<u>\$ 163</u>	<u>\$ 1,691</u>

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, 2007, deferred income taxes have not been provided by District Associations on approximately \$125.4 million of patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

The District Associations adopted the provisions of FIN 48 on January 1, 2007. As a result of the adoption, there were no uncertain positions for income taxes identified and therefore the District recognized no change in the liability for unrecognized tax benefits and no reduction to the January 1, 2007 balance of retained earnings. The District recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense. There were no uncertain tax positions identified related to the current year. The tax years that remain open for federal and major state income tax jurisdictions are 2004 and forward.

Note 12 — Employee Benefit Plans

The employees of the District may participate in one of three defined benefit retirement plans. The first plan (the District Plan) covers most employees of eighteen Associations and AgFirst. The second plan covers employees of four ACAs. The third plan covers employees of a single ACA. Each plan is noncontributory and covers substantially all employees of the participating entities. The "Projected Unit Credit" actuarial method is used for financial reporting purposes. Pension benefits are primarily based on eligible compensation and years of service. The District entities funded \$759 thousand, \$765 thousand, and \$28.0 million into these retirement plans for each of the three years ended December 31, 2007, 2006, and 2005, respectively. The expenses of these retirement plans included in salaries and employee benefits were \$16.9 million for 2007, \$21.2 million for 2006, and \$20.2 million for 2005.

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 retire subsequent to December 31, 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 2007, \$9.3 million for 2006, and \$15.0 million for 2005.

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 \$5.3 million, \$4.7 million, and \$4.2 million for the years ended December 31, 2007, 2006, and 2005, respectively.

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

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 \$436 thousand into these supplemental retirement plans for each of the three years ended December 31, 2007, 2006, and 2005, respectively. The expenses of these supplemental plans included in the District's retirement costs were \$662 thousand, \$603 thousand, and \$722 thousand for the years ended December 31, 2007, 2006, and 2005, respectively.

On December 31, 2007, the District adopted SFAS No. 158 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. SFAS No. 158 requires the recognition of a plan's over-funded or under-funded status of defined benefit pension and other postretirement benefit plans as an asset or liability in the statement of financial position and recognize changes in that funded status through accumulated other comprehensive income, net of tax, as of December 31, 2007. The standard further requires the determination of the fair value of plan assets at December 31, 2007 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, net of tax. These amounts were previously netted against the plan's funded status in the District's Combined Balance Sheets pursuant to the provisions of SFAS No. 87 and SFAS No. 106. These amounts will be subsequently recognized as components of net periodic benefit costs. Further, actuarial gains and losses that arise in subsequent periods that are not initially recognized as a component of net periodic benefit cost will be recognized as a component of accumulated other comprehensive income, net of tax. Those amounts will subsequently be recognized as a component of net periodic benefit cost as they are amortized during future periods.

The total incremental effects of adopting the provisions of SFAS No. 158 on the District's Combined Balance Sheets at December 31, 2007 are presented in the following table. The adoption of SFAS No. 158 had no effect on the District's Combined Statements of Income for the year ended December 31, 2007, or for any year presented.

Adoption of SFAS No. 158			
(dollars in thousands)	Before	Adjustments	After
	Application of SFAS No. 158		Application of SFAS No. 158
Other assets	\$ 217,685	\$ (105,047)	\$ 112,638
Total assets	29,366,198	(105,047)	29,261,151
Pension and other postretirement benefits liability	118,010	10,405	128,415
Total liabilities	25,684,672	10,405	25,695,077
Accumulated other comprehensive income (loss), net of tax	(38,136)	(115,452)	(153,588)
Total shareholders' equity	3,681,526	(115,452)	3,566,074
Total liabilities and shareholders' equity	\$ 29,366,198	\$ (105,047)	\$ 29,261,151

The estimated net actuarial loss, transition obligation and prior service cost for the pension plans that will be amortized into income during 2008 are \$4.3 million, \$11 thousand, and \$2.3 million, respectively. Also amortized into income will be \$1.0 million of net actuarial losses, transition obligations of \$34 thousand, and \$2.8 million of prior service credit related to other postretirement benefit plans.

SFAS No. 158 also requires that the funded status of a plan be measured as of the date of the year-end for fiscal years ending after December 15, 2008. The current measurement date of September 30 will be changed to December 31 beginning in 2008.

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)	2007	2006	2005
Change in projected benefit obligation			
Projected benefit obligation at beginning of year	\$ 516,455	\$ 531,010	\$ 442,887
Service cost	14,747	16,332	13,517
Interest cost	30,298	27,340	26,141
Actuarial loss (gain)	(13,473)	(42,575)	58,688
Benefits paid	(23,944)	(21,802)	(17,325)
Other	1,727	6,150	7,102
Projected benefit obligation at end of year	\$ 525,810	\$ 516,455	\$ 531,010
Change in plan assets			
Fair value of plan assets at beginning of year	\$ 465,914	\$ 444,381	\$ 381,577
Actual return on plan assets	68,398	42,453	51,962
Employer contributions	1,195	1,201	28,439
Transfers	(295)	(319)	(272)
Benefits and premiums paid	(23,944)	(21,802)	(17,325)
Fair value of plan assets at end of year	\$ 511,268	\$ 465,914	\$ 444,381
Reconciliation of funded status			
Funded Status	\$ (14,541)	\$ (50,541)	\$ (86,629)
Unrecognized net actuarial loss (gain)	–	152,058	214,039
Unamortized prior service cost	–	13,941	9,018
Unrecognized net transition (asset) or obligation	–	(241)	(578)
Net amount recognized – September 30	(14,541)	115,217	135,850
Fourth quarter contributions	109	–	–
Net amount recognized	\$ (14,432)	\$ 115,217	\$ 135,850
Amounts recognized consist of:			
Noncurrent assets	\$ –		
Current liabilities	(475)		
Noncurrent liabilities	(13,957)		
Net amount recognized	\$ (14,432)		

The following represents the amounts included in accumulated other comprehensive income (pre-tax) at December 31, 2007:

(dollars in thousands)	Pension Benefits
Net actuarial loss (gain)	\$ 98,938
Prior service costs (credit)	14,032
Net transition obligation (asset)	(12)
Total amount recognized in AOCI	\$ 112,958

The accumulated benefit obligation for all defined benefit pension plans was \$453,857, \$442,707, and \$445,459 at September 30, 2007, 2006, and 2005, respectively.

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

(dollars in thousands)	Pension Benefits		
	2007	2006	2005
Aggregate PBO > FV plan assets			
Projected benefit obligation	\$ 525,810	\$ 516,455	\$ 531,010
Fair value of plan assets	511,268	465,914	444,381
Aggregate ABO > FV plan assets			
Accumulated benefit obligation	\$ 7,069	\$ 6,293	\$ 6,664
Fair value of plan assets	–	–	–

The net periodic benefit expense for all defined benefit pension plans included in the District's Combined Statements of Income is comprised of the following:

(dollars in thousands)	Pension Benefits		
	2007	2006	2005
Components of net periodic benefit (income) cost			
Service cost	\$ 14,747	\$ 16,332	\$ 13,517
Interest cost	30,298	27,340	26,141
Expected return on plan assets	(38,440)	(36,737)	(31,673)
Amortization of net (gain) loss	(338)	(338)	(338)
Amortization of prior service cost	1,664	1,261	634
Recognized net actuarial (gain) loss	9,645	14,008	12,515
Other	(28)	(78)	123
Net periodic benefit cost	\$ 17,548	\$ 21,788	\$ 20,919

	Pension Benefits		
(dollars in thousands)	2007	2006	2005
Increase/(Decrease) in minimum liability included in other comprehensive income	\$ (21)	\$ (47)	\$ 6

Weighted average assumptions used to determine benefit obligations at September 30:

	Pension Benefits		
	2007	2006	2005
Discount rate	6.45%	6.00%	5.25%
Rate of compensation increase	4.42%	4.44%	4.48%

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

	Pension Benefits		
	2007	2006	2005
Discount rate	6.00%	5.25%	6.00%
Expected long-term return on plan assets	8.46%	8.46%	8.46%
Rate of compensation increase	4.50%	4.50%	4.55%

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 using active investment strategies utilizing multiple investment management firms. Risk is controlled through diversification among multiple asset classes, managers, styles and securities. 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 September 30 are as follows:

PLAN ASSETS	2007	2006	2005
Allowable Asset Category			
Equity securities	65.3%	64.4%	65.1%
Debt securities	29.4	30.3	30.1
Real Estate	4.9	4.6	4.1
Other	0.4	0.7	0.7
Total	100.0%	100.0%	100.0%

Target allocation for allowable asset categories for 2008 are as follows:

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

The total District expects to contribute \$1.3 million to the various pension plans in 2008.

Estimated Future Benefit Payments

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

	Pension Benefits
2008	\$ 26,582
2009	28,411
2010	30,411
2011	32,501
2012	35,564
Years 2013 — 2017	213,336

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

<i>(dollars in thousands)</i>	Other Postretirement Benefits		
	2007	2006	2005
Change in benefit obligation			
Benefit obligation at beginning of year	\$ 119,245	\$ 126,048	\$ 145,903
Service cost	2,364	2,681	2,908
Interest cost	6,997	6,484	8,574
Plan participants' contributions	789	880	1,348
Actuarial loss (gain)	(9,244)	(11,812)	9,081
Benefits paid	(5,640)	(5,390)	(5,957)
Plan amendments/other	—	354	(35,809)
Benefit obligation at end of year	\$ 114,511	\$ 119,245	\$ 126,048

Change in plan assets

Fair value of plan assets at beginning of year	\$ —	\$ —	\$ —
Actual return on plan assets	—	—	—
Plan participants' contributions	789	880	1,348
Employer contributions	4,851	4,510	4,609
Benefits and premiums paid	(5,640)	(5,390)	(5,957)
Fair value of plan assets at end of year	\$ —	\$ —	\$ —

Reconciliation of funded status

Funded status	\$ (114,511)	\$ (119,245)	\$ (126,048)
Unrecognized net actuarial loss (gain)	—	32,387	47,088
Unrecognized prior service cost	—	(21,540)	(24,730)
Net amount recognized – September 30		(108,398)	(103,690)
Fourth quarter contributions	1,032	1,220	1,009
Net other postretirement liability	\$ (113,479)	\$ (107,178)	\$ (102,681)

Amounts recognized consist of:

Current liabilities	\$ (5,637)
Noncurrent liabilities	(107,842)
Net amount recognized	\$ (113,479)

The following represent the amounts included in accumulated other comprehensive income (pre-tax) at December 31, 2007:

<i>(dollars in thousands)</i>	Other Postretirement Benefits
Net actuarial loss (gain)	\$ 21,047
Prior service costs (credit)	(18,753)
Net transition obligation (asset)	200
Total amount recognized in AOCI	\$ 2,494

The net periodic benefit expense for all other postretirement benefit plans included in the District's Combined Statements of Income is comprised of the following:

<i>(dollars in thousands)</i>	Other Postretirement Benefits		
	2007	2006	2005
Service cost	\$ 2,364	\$ 2,681	\$ 2,908
Interest cost	6,997	6,484	8,574
Net amortization and deferral	(657)	87	3,526
Net periodic benefit (income) cost	\$ 8,704	\$ 9,252	\$ 15,008

Weighted average assumptions used to determine benefit obligations at September 30:

	Other Postretirement Benefits		
	2007	2006	2005
Discount rate	6.45%	6.00%	5.25%

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

	Other Postretirement Benefits		
	2007	2006	2005
Discount rate	6.00%	5.25%	6.00%

For measurement purposes, annual rates of increase of 6.75 percent through 9 percent in the per capita cost of covered health benefits were assumed for 2008. The rates were assumed to step down to between 9.00 percent and 4.75 percent in various years beginning in 2009 through 2016, 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:

<i>(dollars in thousands)</i>	1 Percentage Point Increase	1 Percentage Point Decrease
Effect on total of service and interest cost	\$ 1,433	\$ (1,144)
Effect on postretirement benefit obligation	17,601	(11,258)

The District expects to contribute \$5.6 million to their other post retirement benefit plans in 2008.

Estimated Future Benefit Payments

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

	Other Postretirement Benefits
2008	\$ 5,640
2009	6,184
2010	6,724
2011	7,288
2012	7,661
Years 2013 — 2017	43,396

The Retiree and Disabled Medical Plan was amended effective January 1, 2006 to change the medical and prescription drug coverage for Medicare-eligible retirees and/or eligible spouses 65 years and older. Beginning in 2006, the AgFirst/FCBT Retiree and Disabled Medical Plan provides medical and prescription drug coverage to Medicare-eligible retirees and/or eligible spouses 65 years and older through fully-insured AARP endorsed Medicare Supplement policies and subsidized basic Medicare D coverage through a selected Prescription Drug Plan. Dental coverage was not changed. Retirees of the Puerto Farm Credit Association and certain other retirees who are grandfathered under insured arrangements were not impacted by the change. The benefit obligation valuation as of December 31, 2007 reflects the impact of this plan amendment.

Effective January 1, 2008, the Puerto Rico Farm Credit Association adopted a Medicare Advantage Plan which includes prescription drug coverage. As the Medicare Advantage Plan receives subsidies from the government for prescription drug coverage, participating employers are not eligible for direct reimbursements. Accordingly, in determining the benefit obligation for the Puerto Rico Farm Credit Association as of December 31, 2007, there is no impact due to direct government reimbursement of prescription drug benefits.

Note 13 — Intra-System Financial Assistance

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

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

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

Note 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 associated. Such loans are subject to special approval requirements contained in the FCA regulations and are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

Total loans to such persons at December 31, 2007, amounted to \$241.3 million, as compared with \$ 232.9 million and \$257.5 million for the years ended December 31, 2006 and 2005, respectively. During 2007, 2006, and 2005, \$158.2 million, \$150.8 million, and \$369.1 million of new loans were made and repayments totaled \$149.7 million, \$175.4 million, and \$347.0 million, respectively. In the opinion of management, no material amounts outstanding at December 31, 2007, involved more than a normal risk of collectibility.

Note 15 — Regulatory Enforcement Matters

At December 31, 2007, there were no regulatory enforcement matters or agreements in place with the FCA.

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 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, 2007 were \$154.44 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, 2007, the Bank had outstanding \$154.7 million of standby letters of credit issued on behalf of District and non-district customers, with expiration dates ranging from January 2008 to December 2012. The maximum potential amount of future payments the Bank may be required to make under these existing guarantees is \$154.7 million.

A guarantor is required to recognize at the inception of a guarantee, a liability for the fair value of the guarantee commitment. The Bank 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 Bank's inventory. At December 31, 2007, 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 \$12.0 million expiring in less than one year and \$9.7 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, 2007.

At December 31, 2007, \$6.51 billion of commitments to extend credit were outstanding. Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these financial instruments have off-balance-sheet credit risk because their amounts could be drawn upon at the option of the borrower. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and the same credit policies are applied by management. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the loan collateral is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

As of December 31, 2007, AgFirst also indemnifies leases in the amount of \$1.5 million on behalf of Farm Credit Leasing Services Corporation (FCLSC) with lease terms expiring in 2009.

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

Note 17 — 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, 2007, 2006 and 2005. The fair value of a financial instrument is generally defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Quoted market prices are generally not available for certain System financial instruments, as described below. Accordingly, fair values are based on judgments regarding anticipated cash flows, future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The estimated fair values of the District's financial instruments are as follows:

	December 31, 2007		December 31, 2006		December 31, 2005	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<i>(dollars in thousands)</i>						
Financial assets:						
Loans	\$20,728,296	\$20,987,821	\$18,669,616	\$18,695,454	\$16,171,572	\$16,154,949
Allowance for loan losses	(78,874)	(78,874)	(71,915)	(71,915)	(87,551)	(87,551)
Loans, net	\$20,649,422	\$20,908,947	\$18,597,701	\$18,623,539	\$16,084,021	\$16,067,398
Derivative assets	\$ 33,187	\$ 33,187	\$ 3,615	\$ 3,615	\$ 2,066	\$ 2,066
Cash & cash equivalents	\$ 612,841	\$ 612,841	\$ 651,268	\$ 651,268	\$ 640,830	\$ 640,830
Investment securities	\$ 7,060,801	\$ 7,038,445	\$ 6,492,102	\$ 6,458,120	\$ 5,302,965	\$ 5,270,708
Other investments	\$ 430,812	\$ 435,361	\$ 428,005	\$ 420,512	\$ 237,239	\$ 234,391
Financial liabilities:						
Systemwide Debt Securities	\$24,847,248	\$24,908,245	\$22,613,379	\$22,531,191	\$18,879,964	\$18,753,747
Derivative liabilities	\$ 2,560	\$ 2,560	\$ 23,514	\$ 23,514	\$ 39,100	\$ 39,100

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

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

For purposes of determining fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics based upon repricing and credit risk. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool. Fair value of loans in a nonaccrual status are estimated to be the carrying amount of the loan less specific reserves. The carrying value of accrued interest approximates its fair value.

- B. **Cash, Federal Funds and Securities Purchased Under Resale Agreements:** The carrying value is a reasonable estimate of fair value.
- C. **Investment Securities:** Fair value is primarily based upon prices obtained from a third party valuation service.
- D. **Other Investments:** Fair value is estimated by discounting future annual cash flows using prevailing rates for similar instruments at year-end.
- E. **Systemwide Debt Securities:** Bonds and notes are not regularly traded; thus, quoted market prices are not available. Fair value of these instruments is estimated by discounting expected future cash flows based on the quoted market price of similar maturity Treasury notes, assuming a constant estimated yield spread relationship between Systemwide bonds and notes and comparable Treasury notes.
- F. **Derivative Instruments:** The fair value of derivatives is the estimated amount to be received or paid to replace the instruments at the reporting date, considering current and projected interest rates. Where actively quoted market prices do not exist, estimated fair values are determined through dealer quotes.

Note 18 — Derivative Instruments and Hedging Activities

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

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

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

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

To minimize the risk of credit losses, the District deals with counterparties that have an investment grade or better credit rating from a major rating agency, and also monitors the credit standing of and levels of exposure to individual counterparties. The estimated credit risk exposure of \$33.2 million with ten counterparties represents approximately 1.72 percent of the total notional amount of interest rate swaps. The District does not anticipate nonperformance by any of these counterparties. The District typically enters into master agreements that contain netting provisions. These provisions allow the District to require the net settlement of covered contracts with the same counterparty in the event of default by the counterparty on one

or more contracts. A number of swaps are supported by collateral arrangements with counterparties. At December 31, 2007, the District had not posted collateral with respect to these arrangements.

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

Note 19 — 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, 2007 (dollars in millions)	Maturities of 2007 Derivative Products and Other Financial Instruments							
	2008	2009	2010	2011	2012	After 2013	Total	Fair Value
Systemwide Debt Securities:								
Fixed rate	\$ 7,123	\$ 2,829	\$ 1,678	\$ 1,429	\$ 932	\$ 4,790	\$ 18,781	\$ 18,865
Weighted average interest rate	4.34%	4.46%	4.55%	4.88%	4.94%	5.46%	4.73%	
Variable rate	3,834	2,105	106	8	2	11	6,066	6,043
Weighted average interest rate	4.70%	4.70%	5.05%	4.85%	4.88%	4.80%	4.71%	
Derivative Instruments:								
Receive fixed swaps								
Notional value	\$ 465	\$ 650	\$ 288	\$ 200	\$ 75	\$ 250	\$ 1,928	\$ 31
Weighted average receive rate	3.72%	4.38%	4.71%	5.22%	4.62%	5.07%	4.46%	
Weighted average pay rate	3.50%	3.77%	4.15%	4.38%	4.69%	5.15%	4.04%	
Total notional value	\$ 465	\$ 650	\$ 288	\$ 200	\$ 75	\$ 250	\$ 1,928	\$ 31
Total weighted average rates on swaps:								
Receive rate	3.72%	4.38%	4.71%	5.22%	4.62%	5.07%	4.46%	
Pay rate	3.50%	3.77%	4.15%	4.38%	4.69%	5.15%	4.04%	

Note 20 — Quarterly Financial Information (Unaudited)

Quarterly results of operations for the years ended December 31, 2007, 2006 and 2005 follow:

(dollars in thousands)	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
	2006				
	First	Second	Third	Fourth	Total
Net interest income	\$ 161,271	\$ 164,323	\$ 176,131	\$ 172,111	\$ 673,836
Provision for (reversal of allowance for) loan losses	101	(14,975)	2,146	12,011	(717)
Noninterest income (expense), net	(62,610)	(57,303)	(67,090)	(76,885)	(263,888)
(Provision) benefit for income taxes	(284)	(157)	(126)	271	(296)
Net income	\$ 98,276	\$ 121,838	\$ 106,769	\$ 83,486	\$ 410,369
	2005				
	First	Second	Third	Fourth	Total
Net interest income	\$ 144,329	\$ 149,955	\$ 156,096	\$ 160,121	\$ 610,501
Provision for (reversal of allowance for) loan losses	(1,265)	283	(349)	(5,161)	(6,492)
Noninterest income (expense), net	(56,901)	(54,560)	(60,119)	(70,368)	(241,948)
(Provision) benefit for income taxes	(70)	(186)	196	2,192	2,132
Net income	\$ 88,623	\$ 94,926	\$ 96,522	\$ 97,106	\$ 377,177

Note 21 — Bank Only Financial Data

Condensed financial information of the Bank follows:

Balance Sheet

<i>(dollars in thousands)</i>	December 31,		
	2007	2006	2005
Cash, cash equivalents and investment securities	\$ 7,467,567	\$ 6,941,446	\$ 5,813,627
Loans			
To District Associations	14,602,548	13,877,141	12,441,170
To others	4,511,969	3,275,196	1,969,880
Total loans	19,114,517	17,152,337	14,411,050
Less: allowance for loan losses	2,816	463	10,114
Net loans	19,111,701	17,151,874	14,400,936
Other assets	347,353	318,844	268,468
Total assets	\$ 26,926,621	\$ 24,412,164	\$ 20,483,031
Bonds and notes	\$ 24,847,248	\$ 22,613,379	\$ 18,879,964
Mandatorily redeemable preferred stock	225,000	225,000	225,000
Other liabilities	396,892	392,698	340,639
Total liabilities	25,469,140	23,231,077	19,445,603
Perpetual preferred stock	400,000	150,000	150,000
Capital stock and participation certificates	364,759	313,353	224,554
Retained earnings	731,429	715,753	665,445
Accumulated other comprehensive income (loss)	(38,707)	1,981	(2,571)
Total shareholders' equity	1,457,481	1,181,087	1,037,428
Total liabilities and shareholders' equity	\$ 26,926,621	\$ 24,412,164	\$ 20,483,031

Statement of Income

<i>(dollars in thousands)</i>	Year Ended December 31,		
	2007	2006	2005
Interest income	\$ 1,469,034	\$ 1,222,948	\$ 792,673
Interest expense	1,208,156	995,436	588,472
Net interest income	260,878	227,512	204,201
Provision for (reversal of) loan losses	2,481	(7,337)	(4,995)
Net interest income after provision for loan losses	258,397	234,849	209,196
Noninterest income	13,823	19,298	16,749
Noninterest expenses			
Salaries and employee benefits	28,853	26,318	27,957
Occupancy and equipment	13,060	11,608	11,108
Insurance Fund premium	5,623	3,597	884
Other operating expenses	18,776	17,529	15,882
Intra-System financial assistance expenses	—	—	3,221
Called debt expense	10,550	2,563	656
Corresponding lending servicing expense	2,071	1,656	1,294
Other noninterest expenses	1,078	683	684
Total noninterest expenses	80,011	63,954	61,686
Net income	\$ 192,209	\$ 190,193	\$ 164,259