2008

Annual Report

Farm Credit

AgFirst Farm Credit Bank & District Associations

Financing Rural America

AgFirst Farm Credit Bank and District Associations

2008 ANNUAL REPORT

Contents

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

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

Dear Shareholders:

The U.S. economy is mired in what is commonly described as nothing less than a crisis. This economic downturn has challenged all financial institutions. During 2008, we witnessed a sharp increase in the number of troubled banks and were stunned by the collapse of several large, well-respected Wall Street giants. While the U.S. government has initiated aggressive actions in an effort to provide relief to the troubled banking sector and reverse the economic downturn, the grim reality is that there are few signs suggesting a turnaround is imminent.

While AgFirst and the District Associations were certainly not immune from the economic forces at play, we were very well-positioned for the economic downturn, entering 2008 with historically high credit quality, a strong capital position, and robust earnings.

Growth — Net farm income in 2007 was at a record level of $86.8 billion. Exports were strong, as the weak dollar made U.S. commodities more competitive in international markets, and year ending stocks of many commodities were low. Demand for land, machinery, and equipment grew as prices for corn, soybeans, and other crops climbed to their highest levels in 20 years. While crop farmers experienced an increase in the value of farm production in 2008, profits were squeezed by rising costs of fuel, fertilizer, feed, and other input costs. High feed costs dampened profits for the meat complex, which experienced falling consumer demand for the first time in many years. As a result, demand for new and larger operating lines of credit increased.

Loan volume reached a record $23.1 billion at 2008 year-end. Our loan portfolios increased $2.3 billion during the year, up 11.3 percent from the previous year. This compares to growth rates of 11.03 percent and 15.4 percent in 2007 and 2006, respectively.

Credit Quality — As the economy weakened in the third and fourth quarters, the District saw its credit quality weaken as well. Deterioration in loan quality led to our making $121 million in provisions for loan loss by year end. We expect further credit deterioration in 2009, but—with our solid capital levels, experienced staff, and stable base of earnings—we are prepared to manage that in a deliberate fashion.
In addition, the fact that we maintained responsible underwriting practices throughout the "good times" makes us confident we will be able to weather the current financial storm. That is important to us because our goal—moreover, our mission—is to be a reliable source of credit in good times and bad.

Earnings — Final net income totaled $364 million in 2008, a decrease of $48 million, or 11.75 percent from the previous year. This decrease was primarily related to the additional provision for loan losses recorded in 2008, as referenced above. Net interest income increased $96 million, as a result of the growth in loan and other interest-earning assets and improving spreads.

Distributions — Our 2008 earnings level enabled us to distribute $255 million to our borrowers without compromising our strong capital position. We are always mindful that, as our earnings flow to the Associations and on to their borrowers, they enrich the economies of the rural communities served by the Associations.

Strategic Initiatives — We continue to focus on several strategic initiatives designed to create efficiencies and enhance our ability to serve our customers. In 2008, we:

- Introduced enhancements to our key loan origination and customer service applications, including Credit Delivery, Customer Relationship Management (CRM), AgriGate, and Imaging.

- Created a new web-based training curriculum for Young, Beginning and Small (YBS) farmers. This curriculum, a part of our Farm Credit University program, is a resource for YBS farmers across the nation to learn about farm financial management practices that will help them succeed.

- Expanded the services provided by AgFirst to the District Associations, including complex loan accounting, fixed asset accounting, accounts payable services, and information management support. By taking advantage of the economies of scale that AgFirst can offer, Associations can reduce their costs without compromising quality of service.

Meeting our Mission

Unlike many lenders, we have not "turned off the spigot." We continue to finance creditworthy farmers, ranchers, agribusinesses and rural homeowners. As we look forward to 2009, we know there will be challenges and that it will take time for the economy to return to normalcy. However, we are well-positioned to meet those challenges and continue to carry out our mission, which is, as it was when the System was created by Congress in 1916, to improve "the income and well-being of America's farmers and ranchers by furnishing sound, adequate, and constructive credit…to them."

Paul M. House
Chairman of the Board

F. A. Lowrey
Chief Executive Officer

February 27, 2009

Report of Management

The accompanying Combined Financial Statements and related financial information appearing throughout this annual report have been prepared by management of AgFirst Farm Credit Bank (Bank) in accordance with generally accepted accounting principles appropriate in the circumstances. Amounts which must be based on estimates represent the best estimates and judgments of management. Management is responsible for the integrity, objectivity, consistency, and fair presentation of the Combined Financial Statements and financial information contained in this report.

Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all Combined Financial Statements, and that the assets of the Bank are safeguarded. The design and implementation of all systems of internal control are based on judgments required to evaluate the costs of controls in relation to the expected benefits and to determine the appropriate balance between these costs and benefits. The Bank and each affiliated District Agricultural Credit Association (District Association) maintain an internal audit program to monitor compliance with the systems of internal accounting control. Audits of the accounting records, accounting systems and internal controls are performed and internal audit reports, including appropriate recommendations for improvement, are submitted to the Audit Committee of the Board of Directors and to the Chief Executive Officer.

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

The Combined Financial Statements have been examined by independent auditors, whose report appears elsewhere in this Annual Report. The Bank and each District Association are also subject to examination by the Farm Credit Administration.

The Combined Financial Statements, in the opinion of management, fairly present the combined financial condition of the Bank and District Associations. The undersigned certify that we have reviewed the 2008 Annual Report of the Bank and District Associations, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Paul M. House
Chairman of the Board

F. A. Lowrey
President & Chief Executive Officer

Charl L. Butler
Senior Vice President
& Chief Financial Officer

February 27, 2009

Report on Internal Control Over Financial Reporting

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

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

The Bank and each District Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of December 31, 2008. In making the assessment, management used the framework in *Internal Control — Integrated Framework*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Bank and each District Association concluded that as of December 31, 2008, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Bank and each District Association determined that there were no material weaknesses in the internal control over financial reporting as of December 31, 2008.

F.A. Lowrey
President & Chief Executive Officer

Charl L. Butler
Senior Vice President & Chief Financial Officer

February 27, 2009

Five-Year Summary of Selected Combined Financial Data

(dollars in thousands)	2008	2007	2006	2005	2004
	As of or for the year ended December 31,				
Combined Balance Sheet Data					
Cash and cash equivalents	$ 316,010	$ 612,841	$ 651,268	$ 640,830	$ 522,862
Investment securities	8,167,026	7,060,801	6,492,102	5,302,965	3,290,967
Loans	23,077,736	20,728,296	18,669,616	16,171,572	14,836,278
Less: allowance for loan losses	169,090	78,874	71,915	87,551	95,419
Net loans	22,908,646	20,649,422	18,597,701	16,084,021	14,740,859
Other property owned	14,228	8,504	5,122	3,646	3,433
Other assets	1,006,520	929,583	1,014,525	743,098	437,295
Total assets	$32,412,430	$29,261,151	$26,760,718	$22,774,560	$18,995,416
Obligations with maturities of one year or less	$14,284,135	$11,451,400	$10,134,550	$ 7,710,389	$ 6,586,537
Obligations with maturities greater than one year	14,781,569	14,018,677	13,092,985	11,694,786	9,184,234
Mandatorily redeemable preferred stock	225,000	225,000	225,000	225,000	225,000
Total liabilities	29,290,704	25,695,077	23,452,535	19,630,175	15,995,771
Perpetual preferred stock	400,000	400,000	150,000	150,000	150,000
Protected borrower equity	4,670	5,369	6,208	7,628	10,123
Capital stock and participation certificates	129,529	127,147	118,817	120,370	125,089
Retained earnings					
Allocated	1,126,994	1,068,756	992,227	925,919	849,626
Unallocated	2,191,324	2,118,390	2,039,308	1,943,444	1,861,476
Accumulated other comprehensive income (loss)	(730,791)	(153,588)	1,623	(2,976)	3,331
Total shareholders' equity	3,121,726	3,566,074	3,308,183	3,144,385	2,999,645
Total liabilities and shareholders' equity	$32,412,430	$29,261,151	$26,760,718	$22,774,560	$18,995,416
Combined Statement of Income Data					
Net interest income	$ 817,864	$ 722,190	$ 673,836	$ 610,501	$ 568,826
Provision for (reversal of allowance for) loan losses	121,023	8,284	(717)	(6,492)	(213,388)
Noninterest income (expense), net	(333,321)	(301,989)	(264,184)	(239,816)	(247,003)
Net income	$ 363,520	$ 411,917	$ 410,369	$ 377,177	$ 535,211
Combined Key Financial Ratios					
Rate of return on average:					
Total assets	1.17%	1.48%	1.67%	1.86%	2.96%
Total shareholders' equity	10.07%	11.42%	12.40%	12.05%	19.31%
Net interest income as a percentage of average earning assets	2.66%	2.64%	2.80%	3.07%	3.16%
Net (chargeoffs) recoveries to average loans	(0.14)%	(0.01)%	(0.09)%	(0.01)%	(0.05)%
Total shareholders' equity to total assets	9.63%	12.19%	12.36%	13.81%	15.79%
Debt to shareholders' equity (:1)	9.38	7.21	7.09	6.24	5.33
Allowance for loan losses to loans	0.73%	0.38%	0.39%	0.54%	0.64%
Net Income Distribution					
Estimated patronage refunds and dividends:					
Cash	$ 101,203	$ 129,698	$ 114,325	$ 98,354	$ 80,466
Qualified allocated surplus	20,734	18,202	27,798	26,391	28,684
Nonqualified allocated surplus	67,605	90,743	92,988	83,420	65,666
Nonqualified retained surplus	65,449	71,700	62,038	73,653	74,467
Stock dividends	1,202	1,133	916	311	60
Perpetual preferred stock dividend	27,413	19,501	10,950	10,950	10,950

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

The following commentary reviews the Combined Financial Statements of condition and results of operations of AgFirst Farm Credit Bank (AgFirst or the Bank) and the District Agricultural Credit Associations (Associations or District Associations), collectively referred to as the District, for the years ended December 31, 2008, 2007, and 2006. 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. AgFirst 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,* in the Notes to the Combined Financial Statements in this Annual Report to shareholders.

Following the merger of Valley Farm Credit, ACA with and into MidAtlantic Farm Credit, ACA effective December 31, 2008, the District consisted of the Bank and twenty-two District Associations. All twenty-two are structured as Agricultural Credit Association (ACA) holding companies, with Federal Land Credit Association (FLCA) and Production Credit Association (PCA) subsidiaries. PCAs originate and service short- and intermediate-term loans, FLCAs originate and service long-term real estate mortgage loans, and ACAs originate both long-term and short- and intermediate-term loans. AgFirst provides funding and related services to the District Associations, which, in turn, provide loans and related services to agricultural and rural borrowers. AgFirst has in place with each of the District Associations, a revolving line of credit, referred to as a "direct note". Each Association primarily funds its lending and general corporate activities by borrowing through its direct note. All assets of the Associations secure the direct notes. Lending terms are specified in a separate General Financing Agreement (GFA) between AgFirst and each Association, including the subsidiaries of the Associations.

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

While combined District statements reflect the financial and operational interdependence of AgFirst and 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, as well as in the general economy;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry; and
- actions taken by the Federal Reserve System in implementing monetary and fiscal policy, as well as other policies and actions of the Federal government that impact the financial services industry and the debt markets.

AGRICULTURAL OUTLOOK

The following USDA analysis provides a general understanding of the U.S. agricultural economic outlook. However, this outlook does not take into account all aspects of the District's business. References to the USADA information in this section refer to the U.S. agricultural market and not the District.

The February 2009 United States Department of Agriculture (USDA) forecast estimates that 2009 farmers' net cash income, which is a measure of the cash income after payment of business expenses, will decrease to $77.3 billion, down $16.1 billion from 2008 and up $5.5 billion from its 10-year average. Contributing to this decrease in farmers' net cash income are decreases in cash receipts for crops and livestock of $18.7 billion and $10.9 billion, respectively, and a decrease in direct government payments of $1.0 billion, offset in part by a decrease in cash expenses of $14.1 billion and an increase in farm-related income of $400 million.

In general, 2008 was an excellent year for U.S. crop producers, particularly for feed crops, oilseeds and food grains. The high level of farmers' net cash income was primarily the result of high commodity prices during the first half of the year. Prices for corn, soybeans, and wheat peaked at levels close to $8.00, $16.50, and $12.50 per bushel during 2008 before significantly declining in the fourth quarter. These higher prices were principally due to strong demand from foreign buyers and the domestic biofuels industry. Corn producers were the primary beneficiaries of the increased demand. Other crop prices, in general, increased due to increased acreage to plant corn, decreasing the acreage available for other crops, and to consumers seeking lower cost alternatives to corn. Inadequate rainfall in competitor countries and increased international consumption, from growth in population and rising incomes, reduced world supplies of corn and soybeans, which translated into rising demand for farm commodities. In addition, the U.S. dollar depreciated against major foreign currencies in recent years resulting in greater demand for U.S. agricultural exports.

However, during the latter half of 2008, many of these factors shifted. A dramatic downturn in the global economy decreased international consumption. Oil prices dropped, which dampened the demand for ethanol. Crop production outlook improved in certain regions of the world. Further, the dollar strengthened in the latter half of 2008. The combination of these events resulted in a dramatic drop in commodity prices in late 2008 to levels more in line with commodity prices at December 31, 2007.

The following table sets forth the commodity prices per bushel for certain crops and by hundredweight for beef cattle from December 31, 2005 to December 31, 2008:

Commodity	12/31/08	12/31/07	12/31/06	12/31/05
Corn	$4.10	$3.76	$3.01	$1.92
Soybeans	$9.24	$10.00	$6.18	$5.77
Wheat	$5.97	$7.74	$4.52	$3.54
Beef Cattle	$79.80	$88.90	$83.10	$93.30

Elevated crop prices, particularly in early 2008, and the resulting volatility from a dramatic drop in crop prices in the latter half of 2008 had both positive and negative impacts on the District, as a lender to the agricultural and rural sectors. Elevated commodity prices and increased prices and demand for farm inputs generally result in an increase in average agribusiness loans outstanding. While higher commodity prices positively impacted grain farmers through the first nine months of 2008, a continuation of recent declines in grain prices could have an unfavorable impact in the near future. The volatility of these prices has resulted in higher risk profiles for District borrowers, particularly borrowers who purchased at elevated crop prices for future production purposes.

The USDA's February 2009 income outlook shows a great deal of variation depending on farm size, geographic location, and commodity specialties. The USDA classifies all farms into three primary categories: commercial farms, intermediate farms and rural residential farms. Commercial farms represent about 11 percent of U.S. farms by number and represent 75 percent of total U.S. farm production. Intermediate farms, defined as ones in which the primary occupation is farming and gross sales are below $250 thousand, represent 26 percent of U.S. farms by number and account for 16 percent of total production. The remaining 63 percent of U.S. farms are classified as rural residential farms where the primary occupation is not farming and the farms produce less than $250 thousand in products and only account for 9 percent of total production.

In addition to farmers' net cash income, off-farm income is an important source of income for the repayment of farm debt obligations and is less subject to cycles in agriculture. The USDA measures farm household income, which is defined as earnings from farming activities plus off-farm income. Nearly 100 percent of farm household income for operators of rural residential farms and more than 80 percent of farm household income for intermediate farms is generated from off-farm sources. Further, USDA data suggests that approximately 25 percent of farm household income for commercial farms is generated from off-farm income. The USDA forecasts 2009 farm household income to decrease 15 percent for commercial farms and 19 percent for intermediate farms.

According to the USDA February 2009 forecast, farm business balance sheets continued to strengthen in the last few years, as measured by debt relative to assets and equity levels. U.S. farm debt to farm assets is forecasted to remain relatively unchanged from 9.2 percent for 2008 to 9.1 percent for 2009. Farmers' equity (farm business assets less farm business debt) is expected to continue to rise by 1.7 percent in 2009, after increasing 6.8 percent in 2008.

One measure of the financial health of the agricultural sector used by the USDA is the assessment of farmers' utilization of their capacity to repay debt (actual debt as a percentage of maximum debt that can be supported by farmers' current income). Higher capacity utilization rates indicate tighter cash flow positions and, consequently, higher exposure to financial risk. These estimates do not take into account, however, off-farm income sources. Since 1970, debt repayment capacity utilization has ranged from a low of 35.8 percent in 1973 to a high of 104.1 percent in 1981, and has remained relatively stable since 1987, averaging about 50.0 percent. The USDA suggests an increase in the use of repayment capacity from 44.1 percent in 2008 to 50.2 percent in 2009.

As estimated by the USDA, the Farm Credit System's market share of farm business debt, defined as debt incurred by those involved in on-farm agricultural production, grew to 36.7 percent at December 31, 2007, as compared with 28.3 percent at December 31, 2000. Farm business debt is forecasted to grow but slow to only 0.9 percent in 2009. The USDA's forecast of slow moderation in debt growth is due to decreases in agricultural production costs and to high levels of earnings during the past two years that may enable certain producers to self finance crop production.

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

SIGNIFICANT ACCOUNTING POLICIES

The financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. Consideration of the District's significant accounting policies is critical to the understanding of the District's results of operations and financial position because some accounting policies require complex or subjective judgments and estimates that may affect the value of certain assets or liabilities as well as the recognition of certain income and expense items. In many instances, management has to make judgments about matters that are inherently uncertain. For a complete discussion of significant accounting policies, see Note 2, *Summary of Significant Accounting Policies,* in 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. In addition to the allowance for loan losses attributable to specific loans, the District may also establish a general allowance for loan losses based on management's assessment of risk inherent in the loans in the District's portfolio that were not specifically evaluated. In establishing general reserves, factors affecting certain commodity types or industries may be taken into consideration, as well as other factors not previously discussed. Certain loan pools purchased by the Bank from various Associations are analyzed in accordance with the selling Associations' allowance methodologies for assigning general and specific allowances, 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 the majority of the District's investment securities. Management utilizes significant estimates and assumptions to value items for which an observable liquid market does not exist. Examples of these items include impaired loans, certain derivatives, certain investment securities and other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing, and liquidation values. The use of different assumptions could produce significantly different asset or liability values, which could have material positive or negative effects on the District's results of operations.

- *Pensions* — The Bank and its related Associations participate in defined benefit retirement plans. These plans are noncontributory and benefits are based on salary and years of service. In addition, the Bank and its related Associations also participate in defined contribution retirement savings plans. Pension expense for all plans is recorded as part of salaries and employee benefits. Pension expense for the defined benefit retirement plans is determined by actuarial valuations based on certain assumptions, including the expected long-term rate of return on plan assets and a discount rate. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that portfolio of assets. The discount rate is used to determine the present value of future benefit obligations. The discount rate for 2008 was selected by reference to analysis and yield curves of the plans' actuary and industry norms. The yield curve selected follows the accounting guidance that the basis for discount rates should be higher-quality zero-coupon bonds with durations that match the expected cash flows of the plans that underlie the obligation.

LOAN PORTFOLIO

The District's aggregate loan portfolio 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)*	**2008**		**2007**		**2006**	
Real Estate Mortgage	$ 9,425,181	41%	$ 8,740,114	42%	$ 8,019,808	43%
Production and Intermediate-Term	8,556,501	37	7,817,587	38	7,398,749	40
Processing and Marketing	1,945,207	8	1,510,538	7	1,145,416	6
Rural Residential Real Estate	1,682,845	7	1,407,501	7	1,152,266	6
Farm-Related Business	492,446	2	481,404	2	392,153	2
Loans to Cooperatives	318,817	2	320,154	2	250,364	1
Communication	247,364	1	122,825	1	74,126	1
Energy	241,956	1	199,096	1	198,198	1
Water and Waste Disposal	28,000	–	19,999	–	12,688	–
Lease Receivables	13,385	–	19,721	–	24,088	–
Loans to OFIs	7,150	–	2,220	–	1,760	–
Other	118,884	1	87,137	–	–	–
Total	$ 23,077,736	100%	$ 20,728,296	100%	$ 18,669,616	100%

Total loans outstanding were $23.08 billion at December 31, 2008, an increase of $2.35 billion, or 11.33 percent, compared to total loans outstanding at December 31, 2007 of $20.73 billion. Total loans outstanding at the end of 2007 had increased $2.06 billion, or 11.03 percent, compared to December 31, 2006. This growth in loan volume can be attributed to a number of factors. In response to growing worldwide demand for agricultural commodities, especially grains, farmers increased their production capacities. Borrowing needs have also grown because of rising costs for inputs such as fertilizer and fuel. Related capital expansion by agribusinesses has also driven up loan demand. As a result, farmers' needs for new production loans have increased dramatically, and they have also drawn more heavily on existing lines of credit.

As agricultural loan demand has increased, turmoil in the overall financial markets in general, and the banking sector in particular, has caused commercial banks to reduce the amount of available credit to farmers and related businesses. A seasoned, knowledgeable lending staff and a strong financial position have positioned the Bank and its District Associations to effectively meet the financing needs of eligible borrowers.

Future loan demand is difficult to predict, although moderation in the growth rate of the loan portfolio is anticipated. Commodity prices have declined significantly from their peaks, which has already caused some softening in loan demand. The current downturn in the general economy also has served to weaken overall loan demand. However, the future availability of credit from the commercial banking sector for farmers and related operations is very uncertain, and the ultimate effect on loan demand at the Bank and its District Associations cannot be determined.

The District employs a number of risk management techniques to limit credit exposures. Each Association has adopted underwriting standards, individual borrower exposure limits, commodity exposure limits, and other risk management techniques. AgFirst and the Associations actively purchase and sell loan participations to achieve diversified portfolios. Some Associations utilize guarantees from U.S. government agencies/departments, including the Federal Agricultural Mortgage Corporation (Farmer Mac), the Farm Services Agency, and the Small Business Administration to further limit credit exposures. At December 31, 2008, the District collectively had $2.57 billion under such government or government-sponsored enterprise (GSE) guarantee programs, compared to $2.12 billion at December 31, 2007.

The Associations primarily 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	2008	2007	2006
Florida	15%	15%	16%
North Carolina	14	15	15
Georgia	12	12	13
Virginia	10	10	10
Pennsylvania	9	9	9
Maryland	6	6	6
South Carolina	5	6	6
Ohio	4	4	4
Alabama	3	3	3
Kentucky	3	2	2
Delaware	2	2	2
Mississippi	2	2	2
West Virginia	2	2	2
California	2	2	1
Texas	2	2	1
Tennessee	2	1	1
Louisiana	1	1	1
Puerto Rico	1	1	1
Minnesota	1	1	1
New York	1	1	1
Colorado	1	1	1
Missouri	1	–	–
Other	1	2	2
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 geographic concentration risk in these states.

MISSION RELATED INVESTMENTS

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

Rural Housing Mortgage-Backed Securities

Rural Housing Mortgage-Backed Securities (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, or eligible rural housing loans originated by System lenders under FCA Regulations. Investment securities at December 31, 2008 included $1.49 billion in RHMBS classified as held-to-maturity, compared to $1.12 billion at December 31, 2007. The initial time period for this pilot program has expired.

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, 2008, the District had $236.7 million in the Rural America Bond program, compared to $141.8 million at December 31, 2007. Of the $236.7 million, the District had $117.8 million reflected in investment securities and $118.9 million reflected as loans on the Combined Balance Sheets at December 31, 2008. The FCA approved a continuation of the program at October 31, 2008 for an as yet undetermined time period.

Tobacco Buyout Program

On October 22, 2005, Congress enacted the "Fair and Equitable Tobacco Reform Act of 2005" (Tobacco Act) as part of the "American Jobs Creation Act of 2005." The Tobacco Act repealed the federal tobacco price support and quota programs, provided for payments to tobacco "quota owners" and producers for the elimination of the quota, and provided an assessment mechanism for tobacco manufacturers and importers to pay for the buyout. Tobacco quota holders and producers receive equal annual payments under a contract with the Secretary of Agriculture. The Tobacco Act also includes a provision that allows the quota holders and producers to assign to a "financial institution" the right to receive the contract payments so that they may obtain a lump sum or other payment. On April 4, 2006, the United States Department of Agriculture (USDA) issued a Final Rule implementing the "Tobacco Transition Payment Program" (Tobacco Buyout).

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

As of December 31, 2008, District Associations held Tobacco Buyout loan assignments of $73.5 million, which are reflected as loans on the Combined Balance Sheets, compared to $84.1 million at December 31, 2007. The District Associations purchased Successor-in-Interest Contracts (SIIC) of $410.3 million, which are reflected as other investments on the Combined Balance Sheets at December 31, 2008, compared to $430.8 million at December 31, 2007.

FARMER MAC

On September 30, 2008, the Farm Credit System banks made a collective $60.0 million investment in Farmer Mac. As part of this collective investment, AgFirst purchased 11 thousand shares of Farmer Mac senior cumulative perpetual preferred stock, series B-1, with a par value of $1 thousand per share, for a total investment of $11.0 million. Dividends on the preferred stock are cumulative and will be payable quarterly, in cash, at an annual interest rate of 10 percent, increasing by 2 percent in each of the first three years, up to a maximum of 16 percent. The preferred stock is callable at par value after nine months, and on any quarterly dividend date thereafter. Additionally, the stock is redeemable in whole by Farmer Mac beginning nine months after the date of issuance with cash or certain qualifying assets. At December 31, 2008, AgFirst also owned $840 thousand of class B voting restricted common stock, $392 thousand of class C non-voting unrestricted stock, $15.4 million of Farmer Mac MBS investment securities and had $122.2 million of loans guaranteed by Farmer Mac.

District Associations had $277.1 million of loans guaranteed by Farmer Mac at December 31, 2008

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 lending activities through an assessment of the credit risk profile of an individual obligor. The Bank and Associations set their own underwriting standards and lending policies that provide direction to loan officers and are approved by the 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 in the following table:

(dollars in thousands)	2008	2007	2006
High-risk Assets			
Nonaccrual loans	$ 551,455	$ 98,052	$ 77,552
Restructured loans	1,040	5,508	2,619
Accruing loans 90 days past due	17,387	2,946	7,418
Total high-risk loans	569,882	106,506	87,589
Other property owned	14,228	8,504	5,122
Total high-risk assets	$ 584,110	$ 115,010	$ 92,711
Ratios			
Nonaccrual loans to total loans	2.37%	0.47%	0.41%
High-risk assets to total assets	1.80%	0.39%	0.35%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or interest under the contractual terms of the loan. Nonaccrual loans increased $453.4 million in 2008 primarily due to six borrower relationships, which comprise 60.7 percent of the total nonaccrual loan balance at December 31, 2008.

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.

Although there has been credit quality deterioration in 2008, due to the credit risk management process, the Districts high-risk assets continue to be a small percentage of the total loan volume and total assets.

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 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 two-tiered 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 at year-end 2008 reflected some deterioration compared to recent years. At December 31, 2008, the credit quality of the loan portfolio continued to be satisfactory but with adverse movements in some quality measures compared to earlier reporting periods. The increased volatility in the financial markets and the generally weaker economy have affected the overall farm sector and some of the District's customers. The pace of loans migrating to more adverse classifications increased in the second half of 2008, and some additional deterioration is expected to occur in 2009.

At year-end, the District's loans including accrued interest were classified as follows:

Credit Quality	2008	2007	2006
Acceptable	92.23%	95.89%	96.39%
OAEM	3.88	2.63	2.31
Adverse*	3.89	1.48	1.30
Total	100.00%	100.00%	100.00%

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

Delinquencies (loans 90 days or more past due) were 0.65 percent of total loan assets at year-end 2008 compared to 0.31 percent and 0.79 percent at year-end 2007 and 2006, respectively. Nonperforming assets for the District represented 2.51 percent of total loan assets or $584.1 million, compared to 0.55 percent or $115.0 million for 2007, and 0.49 percent or $92.7 million for 2006. Nonperforming assets consist of nonaccrual loans, accruing restructured loans, accruing loans 90 days or more past due, and other property owned.

District net loan charge-offs of $30.8 million, $1.3 million and $14.9 million were recorded in 2008, 2007, and 2006, respectively. As a percentage of total average loan assets, net charge-offs for the District were 0.14 percent for 2008, compared to 0.01 percent and 0.09 percent in 2007 and 2006, respectively The Bank and each Association maintains an allowance for loan losses determined by its management based upon it unique situation.

To a large degree, the recent credit quality deterioration has been driven by generally higher input costs for meat production and ethanol customers, as well as continued slowness of the general economy. Higher fuel costs in early 2008 adversely impacted all producers. Higher feed costs have been problematic for the livestock and poultry industries, causing significant stress. Most recently, certain commodity prices, including oil and grain, have declined substantially providing better opportunity for positive earnings in the meat production segments in 2009. Industries tied to housing such as forestry, sawmills, sod, and landscape nurseries continue to be impacted by the declining housing market and slowness of the general economy. The global economic slowdown could create less demand for agricultural exports, which would have a negative impact on the profitability of production agriculture.

Loan portfolio credit quality was also adversely affected in 2008 by deteriorating economic conditions in Florida. The Florida economy slowed after significant growth for many years led by increasing real estate values and population growth. In 2008, real estate values declined, population growth slowed, and housing foreclosures increased. Loans where repayment is dependent on investment income or real estate sales in Florida demonstrated weakening repayment ability and therefore poorer credit quality.

Given the general economy is widely recognized to be in a recession, combined with higher unemployment, credit quality of part-time farmers potentially will also be compromised. Borrowers who have historically had stable income from non-farm sources such as stock portfolios and capital gains income from traded assets sometimes find themselves without either. As a result, the District is routinely reevaluating the credit-worthiness of borrowers who have depleted their liquidity and have difficulty getting access to credit because their equity has been reduced and their cash flow is dependent on a turnaround in the general economy. Based on the above factors, the risk of future credit quality deterioration is increasing.

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, and in some cases complimentary, agricultural characteristics. Commodity and industry categories are based on the Standard Industrial Classification system published by the federal government. This system is used to assign commodity or industry categories based on the largest agricultural commodity of the customer. The following table illustrates the aggregate credit portfolio of the District by major commodity segments at December 31:

	Percent of Portfolio		
Commodity Group	**2008**	**2007**	**2006**
Forestry	13%	13%	13%
Poultry	10	11	11
Fruits and Vegetables	9	9	9
Cattle	7	7	7
Rural Home	7	7	6
Processing	7	7	6
Other Real Estate	6	6	7
Dairy	5	5	5
Nursery/Greenhouse	5	5	5
Grain	4	4	4
Lumber	4	4	4
Swine	3	3	3
Tobacco	2	2	3
Cotton	2	2	2
Citrus	2	2	2
Corn	2	2	2
Other	12	11	11
Total	100%	100%	100%

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

Commodity Group	Percent of Portfolio 2008	2007	2006
Part-time Farmers	31%	33%	34%
Poultry	9	9	10
Rural Home	7	6	6
Forestry	6	5	5
Fruits and Vegetables	5	5	5
Dairy	5	5	5
Processing	4	5	4
Nursery/Greenhouse	4	4	4
Swine	3	3	3
Cattle	3	3	3
Grain	3	2	1
Cotton	2	2	3
Tobacco	2	2	2
Citrus	2	2	2
Other Real Estate	2	1	1
Corn	2	1	1
Lumber	1	3	4
Other	9	9	7
Total	100%	100%	100%

The District has concentrations of full-time farmers of 5.00 percent or greater in only five commodities at December 31, 2008: poultry, rural home, forestry, fruits/vegetables, and dairy. All five commodities have a large geographic dispersion with production over the entire District footprint. Also, many poultry, dairy, forestry, and fruit/vegetable producers have significant secondary income from off-farm employment by a family member.

Concentrations within the District are further limited through the number of farm units producing poultry or dairy products. Poultry production is almost exclusively done through a network of contract growers whose income remains stable as variable costs are absorbed by the contracting integrators. Poultry concentration is further dispersed as production is segregated between chicken, turkey, and egg production. Dairy herds range in size from less than one hundred cows to approximately ten thousand.

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

Forestry is divided principally into hardwood and softwood production and value-added processing. The timber from hardwood production is further processed into furniture, flooring, and high-grade paper and is generally located at the more northern latitudes and higher elevations. Softwood timber production is typically located in the coastal plains of the District footprint and is utilized 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. The fruits/vegetables portion of the aggregate Association portfolio is made up of a diverse group of many different fruits and vegetables grown throughout the District footprint. The volume is spread broadly over the base of Associations.

The ethanol industry has been stressed recently due to rapidly changing commodity prices, especially corn, declining fuel consumption, and supply levels in excess of the Federal Ethanol Mandate. The Bank had $96.0 million of loans outstanding and $21.4 million of commitments to lend to ethanol related customers at December 31, 2008. District Associations' total exposure to the ethanol industry at December 31, 2008 included $147.0 million of loans outstanding and $72.8 million of commitments to extend credit. At December 31, 2008, the Bank had a reserve allowance of $17.7 million, which was recognized through provision expense during 2008, related to loans in its ethanol portfolio. The Associations also had total reserves of $4.4 million for loans in their ethanol portfolio at December 31, 2008.

The following table illustrates the District loan volume outstanding per borrower at December 31, 2008.

District Loan Volume Gross Loans Outstanding Per Borrower

$ Range (in thousands)	% of Total
$1-$250	33.51 %
$251-$500	15.42
$501-$1,000	12.82
$1,001-$5,000	18.22
$5,001-$25,000	11.25
$25,001-$100,000	8.19
Over $100,000	0.59
Total	100.00 %

Loans greater than $5.0 million per borrower comprise approximately 20.03 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 48.93 percent of outstanding loan volume is comprised of loans under $500 thousand, and loans less than $250 thousand make up approximately 33.51 percent of loan volume. This diversification across a large number of 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, 2008, 40.84 percent of the District loans were identified as secured by a first lien on real estate. Exposure to losses is reduced through collateralization and other credit enhancements, including federal government guarantees.

AgFirst and each Association maintain an allowance for loan losses determined by its management and are capitalized to serve their unique markets. The minimum regulatory capital ratios for System banks and associations are 7.00 percent for the permanent capital ratio, 3.50 percent for the core surplus ratio, and 7.00 percent for the total surplus ratio. The following table illustrates the risk bearing capacity of the District at December 31, 2008:

Association	Regulatory Permanent Capital Ratio	Regulatory Core Surplus Ratio	Regulatory Total Surplus Ratio	Allowance/ Loans
AgFirst Farm Credit Bank	17.15%	17.11%	10.43%	0.21%
AgCarolina Financial	14.72%	12.65%	12.92%	0.89%
AgChoice	11.11%	8.75%	10.27%	0.57%
Ag Credit	17.69%	14.59%	16.10%	0.46%
AgGeorgia	14.15%	10.17%	13.84%	0.71%
AgSouth	14.78%	10.88%	14.33%	0.31%
ArborOne	15.05%	12.39%	14.60%	0.57%
Cape Fear	13.03%	12.15%	12.69%	0.77%
Carolina	13.59%	10.44%	12.99%	0.75%
Central Florida	15.14%	11.70%	14.54%	1.21%
Central Kentucky	12.23%	10.32%	11.10%	0.65%
Chattanooga	13.51%	8.23%	11.43%	0.83%
Colonial	16.25%	15.50%	15.50%	0.83%
Farm Credit of the Virginias	12.11%	10.89%	10.89%	0.45%
First South	12.98%	10.55%	11.77%	0.73%
Jackson Purchase	14.45%	12.69%	13.60%	0.63%
MidAtlantic	14.11%	11.90%	13.61%	0.78%
North Florida	13.59%	12.24%	13.24%	1.38%
Northwest Florida	12.52%	11.75%	12.27%	0.62%
Puerto Rico	16.96%	16.74%	16.74%	0.46%
South Florida	15.57%	15.50%	15.50%	1.31%
Southwest Florida	12.05%	10.59%	11.83%	1.92%
Southwest Georgia	11.97%	9.06%	11.62%	0.81%

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, District Association variable rate and adjustable rate loans generally 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 an adequate level of net interest income in any interest rate environment. AgFirst uses a variety of analytical techniques to manage the complexities associated with offering numerous loan options. These include interest rate sensitivity gap analysis to monitor the repricing characteristics of the District's 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 under various possible future market interest rate environments.

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, 2008.

Net Interest Income
(dollars in thousands)

Scenarios	Net Interest Income	% Change
+4.0% Shock	$842,257	29.03%
+2.0% Shock	$751,274	15.09%
Base line	$652,770	– %
-50% of 3M Tbill **	$653,516	0.11%

Market Value of Equity
(dollars in thousands)

Scenarios	Assets	Liabilities	Equity*	% Change
Book Value	$32,425,485	$29,815,074	$2,610,411	– %
+4.0% Shock	$30,542,983	$28,451,304	$2,091,679	(4.98)%
+2.0% Shock	$31,616,068	$29,428,451	$2,187,617	(0.62)%
Base line	$32,508,835	$30,307,586	$2,201,248	– %
-50% of 3M Tbill**	$32,529,594	$30,326,053	$2,203,541	0.10%

* *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, 2008. The amount of assets and liabilities shown in the table, which reprice or mature during a particular period, were determined in accordance with the earlier of term-to-repricing or contractual maturity, anticipated prepayments, and, in the case of liabilities, the exercise of call options.

Repricing/Maturity Gap Analysis

(dollars in thousands)	0 to 6 months	6 months to 1 Year	1 to 5 Years	Over 5 Years	Total
Short and Intermediate-Term Loans					
Fixed	$ 3,018,095	$ 809,370	$1,523,658	$ 170,979	$ 5,522,102
Variable	5,036,571	–	–	–	5,036,571
Total Short and Intermediate-Term Loans	8,054,666	809,370	1,523,658	170,979	10,558,673
Long-term Real Estate Loans					
Fixed	5,620,505	2,339,185	3,615,679	879,526	12,454,895
Variable	26,672	25,637	11,739	120	64,168
Total Long-term Real Estate Loans	5,647,177	2,364,822	3,627,418	879,646	12,519,063
Total Loans	13,701,843	3,174,192	5,151,076	1,050,625	23,077,736
Total Investments *	5,883,949	746,424	1,418,821	387,462	8,436,656
TOTAL INTEREST-EARNING ASSETS	**$19,585,792**	**$3,920,616**	**$6,569,897**	**$1,438,087**	**$31,514,392**
Interest-Bearing Liabilities					
Systemwide bonds and notes	$17,356,523	$4,843,000	$4,810,000	$1,043,500	$28,053,023
Other interest-bearing liabilities	–	–	200,000	225,000	425,000
Interest rate swaps	1,723,000	(450,000)	(1,023,000)	(250,000)	–
TOTAL INTEREST-BEARING LIABILITIES	**$19,079,523**	**$4,393,000**	**$3,987,000**	**$1,018,500**	**$28,478,023**
Interest Rate Sensitivity Gap	**$ 506,269**	**$ (472,384)**	**$2,582,897**	**$ 419,587**	
Sensitivity Gap as % of Total Earning Assets	1.61%	(1.50)%	8.19%	1.33%	
Cumulative Gap	$ 506,269	$ 33,885	$2,616,781	$3,036,368	
Cumulative Gap as a % of Total Earning Assets	1.61%	0.11%	8.30	9.63%	
Rate Sensitive Assets/Rate Sensitive Liabilities	1.03	0.89	1.65	1.41	

* *includes cash equivalents*

At December 31, 2008, the Repricing / Maturity Gap reflected an asset sensitive position out to six months due in part to accelerated prepayment speeds in fixed-rate loans. Short-and intermediate-term interest rates decreased during the year which resulted in the higher loan prepayments and also enabled the Bank to exercise options on callable fixed-rate debt. The asset sensitivity position of the Balance Sheet implies an increase in net interest income in rising interest rates scenarios. However, the Repricing / Maturity Gap Analysis is a point in time view and is representative of the interest rate environment at December 31. Increasing or decreasing interest rates alter this position due to options in both assets and debt.

The Net Interest Income (NII) sensitivity analysis shown above indicates the change in District NII is positive in both rising and falling interest rate scenarios. The NII result for rising interest rates illustrated in the +2.00 and +4.00 percent shocks is consistent with the asset sensitive position explained above and reflected in the Repricing / Maturity Gap schedule. While the majority of equity funding is applied to variable and short-term assets, falling interest rates cause call options in fixed rate debt to be "in the money" and eligible for exercise. As rates fall, the volume of fixed rate debt call options exercised exceeds refinancing activity or prepayment speeds on fixed-rate assets causing the District to become liability sensitive in falling interest rate environments. The volume of liabilities repricing within the 12-month period is greater than assets and the cost of debt declines at a faster rate, widening spreads and increasing NII for the District.

At December 31, 2008, AgFirst had outstanding interest rate swaps with notional amounts totaling $2.22 billion. All of these derivative transactions were executed to create synthetic floating-rate debt to achieve a lower cost of funding. Derivatives may also be used by the Bank for asset/liability management purposes to reduce interest rate risk.

AgFirst policy prohibits the use of derivatives for speculative purposes. See Note 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, 2008.

Notional amounts *(dollars in millions)*	**Receive Fixed**
Balance at December 31, 2007	$ 1,928
Additions	760
Maturities/amortizations	(400)
Terminations	(65)
Balance at December 31, 2008	$ 2,223

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 two securities repurchase agreement facilities. Providing liquidity for the District's operations is primarily the responsibility of the Bank.

Investments and Cash and Cash Equivalents

Investment securities and cash and cash equivalents outstanding as of December 31, 2008 for the District totaled $8.48 billion compared to $7.67 billion and $7.14 billion at December 31, 2007 and 2006, respectively. These increases are due to the increases in investment securities, which are primarily related to the growth of total loans as Bank management increased the size of the investment securities portfolio generally in line with loan growth. In addition, for 2008, growth was due to enhancing liquidity and high spread opportunities at certain points during the year.

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

District Investment Securities and Cash and Cash Equivalents

(dollars in thousands)	2008		2007		2006	
Investment Securities						
Available for Sale						
U.S. Govt. GNMA MBS/CMOs	$ 3,245,283	39.73%	$ 1,754,553	24.85%	$ 1,267,914	19.53%
U.S. Govt. Agency MBS	2,533,993	31.03	3,062,041	43.37	2,749,985	42.36
Non-Agency Securities	404,321	4.95	636,559	9.02	776,534	11.96
Asset-Backed Securities	95,963	1.18	183,680	2.60	271,188	4.18
Commercial MBS	11,767	0.14	4,597	0.06	–	–
Total Available for Sale	6,291,327	77.03	5,641,430	79.90	5,065,621	78.03
Held to Maturity						
Rural Housing MBS	1,494,837	18.30	1,124,855	15.93	1,249,788	19.25
Commercial MBS	–	–	–	–	2,260	0.03
MBS Guaranteed by Farmer Mac	15,355	0.19	16,946	0.24	27,107	0.42
Other Asset-Backed Securities	131,877	1.62	115,983	1.64	123,313	1.90
Other	233,630	2.86	161,587	2.29	24,013	0.37
Total Held to Maturity	1,875,699	22.97	1,419,371	20.10	1,426,481	21.97
Total Investment Securities	$ 8,167,026	100.00%	$ 7,060,801	100.00%	$ 6,492,102	100.00%
Cash and Cash Equivalents						
Cash	$ 46,380	14.68%	$ 68,964	11.25%	$ 138,899	21.33%
Fed Funds	–	–	183,659	29.97	55,369	8.50
Master Notes	82,000	25.95	85,218	13.91	82,000	12.59
Repos	187,630	59.37	275,000	44.87	375,000	57.58
Total Cash and Cash Equivalents	$ 316,010	100.00%	$ 612,841	100.00%	$ 651,268	100.00%
Total Investment Securities and Cash and Cash Equivalents	$ 8,483,036		$ 7,673,642		$ 7,143,370	

FCA regulations require a liquidity policy that establishes a "minimum coverage" level of 90 days for System banks. "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, 2008, AgFirst's coverage was 153 days.

FCA regulations further provide that a System bank may hold certain eligible investments in an amount not to exceed 35.00 percent of its total loans outstanding. These investments serve to provide liquidity to the Bank's operations, to manage short-term funds, and to manage interest rate risk. AgFirst maintains an investment portfolio for these purposes comprised primarily of short-duration, high-quality investments. At year-end, the Bank's eligible investments were 29.49 percent of its total loans outstanding.

The District also maintains a portfolio of investments that are not held for liquidity purposes and are accounted for as a held-to-maturity portfolio. These investments are authorized by FCA Regulations that allow investments in Farmer Mac securities and also in specific investments approved by 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). Certain Associations also hold investment securities in AAA-rated asset-backed securities guaranteed by the United States Government or a United States Government agency.

Investment securities classified as being available-for-sale totaled $6.29 billion at December 31, 2008. Total net unrealized losses relating to these securities increased $319.7 million during 2008 to a total of $357.5 million at December 31, 2008. These net unrealized losses are reflected in Accumulated Other Comprehensive Income (AOCI) in the Combined Financial Statements. The net unrealized losses are primarily attributed to the market dislocation and illiquidity stemming from adversity in the mortgage market. Available-for-sale investments at December 31, 2008 included $4.40 billion in Agency Collateralized Mortgage Obligations (CMOs), $1.39 billion in Agency Adjustable Rate Mortgages, $407.2 million in whole loan CMOs, and $96.0 million in asset-backed securities. The Bank also recognized a loss of $10.5 million for other-than-temporary impairment on one asset-backed security in its portfolio as discussed below, which reduced net income.

District available- for-sale asset-backed securities totaled $96.0 million at December 31, 2008. The District has low exposure to investments backed by subprime mortgages. Asset-backed securities with subprime exposure were in the Bank's portfolio only and totaled $80.0 million, which represented 1.27 percent of the District's available-for-sale liquidity investment portfolio and 0.98 percent of the total investment security portfolio at December 31, 2008. The amortized cost of these particular investment securities totaled $124.1 million and the market value adjustment decrease for asset-backed securities of $44.1 million was included in the total $357.5 million of net unrealized losses reflected in AOCI at December 31, 2008 as discussed above. The District's total asset-backed securities rated above the minimum for investment grade (BBB-/ Baa3) by the Nationally Recognized Statistical Rating Organizations (NRSROs) at December 31, 2008, totaled $77.9 million (amortized cost value of $100.9 million). The District's asset-backed securities rated at the minimum for investment grade by one of the NRSROs were in the Bank's portfolio only and totaled $18.1 million (amortized cost value of $38.9 million) at December 31, 2008. Despite the uncertainty in the mortgage securities markets, which has adversely impacted the market value of all asset-backed securities, these securities continue to perform. All of the District's asset-backed securities have credit enhancement features, which may include over collateralization, the subordination of other security traunches, and/ or protection provided by a monoline insurance provider.

Whole loan CMOs have also experienced significant market pricing volatility. District whole loan CMOs totaled $407.2 million, which represented 6.47 percent of the available-for-sale liquidity investment portfolio and 4.99 percent of the total investment security portfolio at December 31, 2008. The amortized cost of these investment securities totaled $570.4 million and the market value adjustment decrease for whole loan CMOs of $163.2 million was included in the total $357.5 million of net unrealized losses reflected in AOCI at December 31, 2008 as discussed above. The District's whole loan CMO securities split rated AAA/ Aaa or lower by the NRSROs at December 31, 2008 were in the Bank's portfolio only and had a total amortized cost of $126.2 million and a fair value of $72.2 million.

The FCA considers asset-backed and mortgage-backed investment securities rated below AAA/Aaa by the NRSROs to be ineligible and requires System institutions to divest of such investments. However, System institutions may seek approval to continue to hold these investments. There were no ineligible securities held by the Associations at December 31, 2008. For each of the investment securities in the Bank's portfolio at December 31, 2008 rated below AAA/ Aaa (total amortized cost of $120.0 million and fair value of $69.6 million), the Bank has developed and submitted plans for approval by the FCA that provide that the securities may be held to maturity. The FCA has approved with conditions the Bank's plans for all but one, which the FCA is still in the process of reviewing. For purposes of the permanent capital, total surplus, and core surplus regulatory ratios, ineligible securities risk weighted 100 percent instead of the standard 20 percent had a fair value of $51.5 million and amortized cost of $91.5 million at year end 2008. Ineligible securities which must be deducted completely from capital and assets have fair value of $18.1 million and amortized cost of $28.5 million at year end 2008. For purposes of the net collateral ratio, all ineligible investments are stated at lower of cost or market. See the Capital section below for further discussion of the regulatory ratios. In addition, ineligible investments are excluded from liquidity coverage as defined above.

The District performs periodic credit reviews, including other-than-temporary impairment analysis, on its entire investment securities portfolio, including asset-backed securities and whole loan CMOs, placing special emphasis on those investments not rated in the top category by the NRSROs. Additional analysis for each security identified is performed using a cash flow model with key assumptions and performance factors which may include credit default rate, prepayment rate, and loss severity. The objective is to quantify any future possible loss of principal or interest due on each identified security. For each of the cash flow analyses, the credit enhancements specific to the individual security are considered as appropriate, and may include monoline credit insurance, subordination, over-collateralization and excess interest spread. Asset-backed securities covered by insurers are analyzed with insurance and without, to quantify the extent of reliance on their guarantee. Based on the results of all analyses, the Bank has recognized other-than-temporary impairment of $10.5 million related to one asset-backed security in its portfolio at December 31, 2008, which is included in Losses on Investments in the Combined Statements of Income.

For all other investments, the District has not recognized any other-than-temporary impairment as it has determined that the decline in market value was caused primarily by reduced liquidity in the securities markets stemming from the general adversity in the financial and mortgage markets. The District has the ability and intent to hold these investments until a recovery of unrealized losses occurs, which may be at maturity, and at this time expects to collect the full principal amount and interest due on these securities, especially after considering insurance guarantees. All securities continue to perform. For purposes of determining the fair values of the modeled securities and the resulting unrealized gain/ loss impact through AOCI, the Bank considers both a price or "mark" provided by third party pricing services and also a value determined using the results of the modeling process. The Bank reviews and discusses with the third party pricing services and valuations experts the assumptions used in their pricing models, particularly for the asset-backed securities impacted by inactive trading or distressed sales, to ensure when relevant observable inputs are not available, that the price is fairly reflective of the price expected to be received in an orderly transaction that is not a forced liquidation or distressed sale at the measurement date.

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 its mission to provide credit and related services to the rural and agricultural sectors, to repay maturing Systemwide Debt Securities, and to meet other obligations. As a GSE, AgFirst has access to the nation's and world's debt and capital markets. This access has provided AgFirst with a dependable source of competitively priced debt that is critical to support its mission 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. Despite the recent adversity in the financial debt markets, as a result of the System's financial performance, credit quality and standing in the capital markets, AgFirst anticipates continued access to funding necessary to support the System's 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, 2008, was $26.69 billion. At December 31, 2008, AgFirst had $28.05 billion in total System debt outstanding compared to $24.85 billion at December 31, 2007 and $22.61 billion at December 31, 2006. 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, 2008 is shown in the following table.

	Bonds		Discount Notes		Total	
Maturities	Amortized Cost	Weighted Average Interest Rate	Amortized Cost	Weighted Average Interest Rate	Amortized Cost	Weighted Average Interest Rate
			(dollars in thousands)			
2009	$ 7,620,912	1.91%	$ 6,024,896	1.42%	$ 13,645,808	1.69%
2010	4,033,986	2.57	–	–	4,033,986	2.57
2011	2,663,407	3.57	–	–	2,663,407	3.57
2012	673,468	4.11	–	–	673,468	4.11
2013	1,991,002	4.21	–	–	1,991,002	4.21
2014 and after	5,045,352	4.99	–	–	5,045,352	4.99
Total	$ 22,028,127	3.21%	$ 6,024,896	1.42%	$ 28,053,023	2.83%

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 Systemwide debt.

Notes Payable to Other System Bank

In 2008, the Bank sold a total of $200 million of participations in its direct note receivable from a District Association to another System Bank. These sales enhance the composition of the Bank's capital and liquidity position and facilitate the District's diversification and opportunities for growth. The $200 million at December 31, 2008 is included in Bonds and Notes in the Combined Balance Sheets and bears interest at an annual variable rate of one month LIBOR plus 47 basis points with maturity on December 31, 2010.

Lines of Credit

AgFirst has obtained a $150.0 million unsecured committed line of credit facility from its primary commercial depository bank. The line of credit is tied to AgFirst's master cash management clearing account. This facility will allow AgFirst to better manage its exposure to the commercial bank and short term funding activity. AgFirst pays unused commitment fees for this credit facility. The facility has a one-year term with renewal provisions. The current period maturity date is September 1, 2009.

The Bank has securities repurchase agreement facilities with two commercial banks for $300 million and $800 million that can range in terms from overnight to six months. Also, AgFirst has overnight Fed Funds lines of credit with three commercial banks. Both the repurchase agreements and Fed Funds lines are maintained on an uncommitted basis.

Operational Risk Management

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

ALLOWANCE FOR LOAN LOSSES

The District maintains an allowance for loan losses at a level management considers 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 $169.1 million at December 31, 2008, as compared with $78.9 million and $71.9 million at December 31, 2007 and 2006, respectively. The increase during 2008 was primarily due to loans moved to nonaccrual status discussed above. The allowance at December 31, 2008 included specific reserves and general reserves. The market segments of the portfolio were reviewed, and particularly stressed segments were identified. Loans in those segments, excluding any loans on which specific reserves had been established, were analyzed collectively and risk rating and potential for loss given default factors were stressed. The general reserves were established based on that collective analysis and stress testing results.

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, 2008**	**2007**	**2006**
Balance at beginning of year	$ 78,874	$ 71,915	$ 87,551
Charge-offs:			
Real estate mortgage	(23,736)	(1,702)	(877)
Production and intermediate-term	(5,232)	(1,461)	(1,562)
Agribusiness	(1,418)	(130)	(13,466)
Energy	–	(128)	–
Rural residential real estate	(170)	(86)	(8)
Other	(1,429)	–	–
Total charge-offs	(31,985)	(3,507)	(15,913)
Recoveries:			
Real estate mortgage	180	1,254	32
Production and intermediate-term	801	769	824
Agribusiness	33	145	127
Rural residential real estate	6	14	11
Other	158	–	–
Total recoveries	1,178	2,182	994
Net (charge-offs) recoveries	(30,807)	(1,325)	(14,919)
Provision for (reversal of allowance for) loan losses	121,023	8,284	717
Balance at end of year	$ 169,090	$ 78,874	$ 71,915
Ratio of net (charge-offs) recoveries during the period to average loans Outstanding during the period	(0.14)%	(0.01)%	(0.09)%

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, 2008**	**2007**	**2006**
Real Estate Mortgage	$ 52,021	$ 25,476	$ 24,804
Production and Intermediate-Term	69,684	41,485	40,395
Agribusiness	44,472	5,937	5,005
Communication	369	123	73
Energy	219	63	75
Rural Residential Real Estate	2,314	1,831	1,563
Leases	11	5	–
Other	–	3,954	–
Total	$ 169,090	$ 78,874	$ 71,915

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

	2008	**2007**	**2006**
Allowance for loan losses to loans	0.73%	0.38%	0.39%
Allowance for loan losses to nonaccrual loans	30.66%	80.44%	92.73%

Despite the recent declining credit quality trends, 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 loan portfolio has remained healthy. However, as discussed previously, uncertainty in the general economic environment has increased the potential for additional prospective risks in the loan portfolio.

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

RESULTS OF OPERATIONS

Net Income

District net income totaled $363.5 million for the year ended December 31, 2008, a decrease of $48.4 million over 2007. District net income totaled $411.9 million for the year ended December 31, 2007, an increase of $1.5 million over 2006. Major components of the changes in net income for the referenced periods are outlined in the following table and discussion.

Change in Net Income *(dollars in thousands)*	**Year Ended December 31, 2008**	**2007**
Net income (for prior year)	$ 411,917	$ 410,369
Increase (decrease) due to:		
Total interest income	(141,551)	261,528
Total interest expense	237,225	(213,174)
Net interest income	95,674	48,354
Provision for loan losses	(112,739)	(9,001)
Noninterest income	2,630	(9,746)
Noninterest expense	(34,309)	(27,943)
Provision for income taxes	347	(116)
Total increase (decrease) in net income	(48,397)	1,548
Net income	$ 363,520	$ 411,917

Interest Income

Total interest income for the year ended December 31, 2008 was $1.79 billion, a decrease of $141.6 million, as compared to the same period of 2007. Total interest income for the year ended December 31, 2007 was $1.93 billion, an increase of $261.5 million, as compared to the same period of 2006. The decrease from 2007 to 2008 was the result of lower earning asset yields due to the declining market interest rate environment. The volume of interest earning assets increased in 2008, with an increase in average earning assets of $3.41 billion. The average yield on interest earning assets decreased 1.24 percent.

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

Net Change in Interest Income *(dollars in thousands)*	**Year Ended December 31, 2008-2007**	**2007-2006**
Current year increase in average earning assets	$ 3,409,061	$ 3,246,208
Prior year average yield	7.07%	6.94%
Interest income variance attributed to change in volume	241,071	225,243
Current year average earning assets	30,726,965	27,317,904
Current year increase (decrease) in average yield	(1.24)%	0.13%
Interest income variance attributed to change in yield	(382,622)	36,285
Net change in interest income	$ (141,551)	$ 261,528

Interest Expense

Total interest expense for the year ended December 31, 2008 was $972.4 million, a decrease of $237.2 million, as compared to the same period of 2007. Total interest expense for the year ended December 31, 2007 was $1.21 billion, an increase of $213.2 million, as compared to the same period of 2006. The decrease in 2008 was primarily attributed to the decrease in average rates paid on System debt obligations.

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

Net Change in Interest Expense *(dollars in thousands)*	**Year Ended December 31, 2008-2007**	**2007-2006**
Current year increase in average interest-bearing liabilities	$ 3,250,301	$ 2,955,112
Prior year average rate	5.08%	4.79%
Interest expense variance attributed to change in volume	165,336	141,400
Current year average interest-bearing liabilities	27,029,310	23,779,009
Current year increase (decrease) in average rate	(1.48)%	0.29%
Interest expense variance attributed to change in rate	(402,561)	71,774
Net change in interest expense	$ (237,225)	$ 213,174

Net Interest Income

Net interest income increased from 2007 to 2008 and from 2006 to 2007, as illustrated by the following table:

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

	2008 Avg. Balance	**2008 Interest**	**2008 Avg. Yield**	**2007 Avg. Balance**	**2007 Interest**	**2007 Avg. Yield**	**2006 Avg. Balance**	**2006 Interest**	**2006 Avg. Yield**
Loans	$ 22,234,800	$ 1,456,566	6.55%	$ 19,611,569	$ 1,516,587	7.73%	$ 17,215,100	$ 1,309,291	7.60%
Cash & investments	8,492,129	333,659	3.93%	7,706,335	415,189	5.39%	6,856,596	360,957	5.26%
Total earning assets	$ 30,726,929	$ 1,790,225	5.83%	$ 27,317,904	$ 1,931,776	7.07%	$ 24,071,696	$ 1,670,248	6.94%
Interest-bearing liabilities	$ 27,029,310	$ (972,361)	3.60%	$ 23,779,009	$ (1,209,586)	5.08%	$ 20,823,897	$ (996,412)	4.79%
Spread			2.23%			1.99%			2.15%
Impact of capital	$ 3,697,619		0.43%	$ 3,538,895		0.65%	$ 3,247,799		0.65%
Net Interest Income (NII) & NII to average earning assets		$ 817,864	2.66%		$ 722,190	2.64%		$ 673,836	2.80%

Net interest income benefited as both loans and investments outstanding increased significantly in 2008 and the preferred stock issue (see Preferred Stock section below) reduced debt and shifted interest expense to dividend payments in the second quarter of 2007. Also, spreads improved as called debt was replaced with new debt issued at a lower rate of interest, thereby increasing net interest income. However, the benefit of lower debt costs was substantially offset by lower earning asset yields.

Provision for Loan Losses

AgFirst and the Associations assess risks inherent in their individual portfolios on an ongoing basis and establish appropriate reserves for loan losses. The provision for loan losses was $121.0 million and $8.3 million for the twelve months ended December 31, 2008 and 2007, respectively. The provisions for loan losses in 2008 and 2007 were primarily due to specific reserves for borrower relationships moved to nonaccrual. Reversals of the allowance for loan losses of $717 thousand in 2006 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, 2008**	**2007**	**2006**	**Increase (Decrease) 2008/ 2007**	**2007/ 2006**
Loan fees	$ 38,705	$ 29,996	$ 33,434	$ 8,709	$ (3,438)
Fees for financially related services	11,353	9,228	6,887	2,125	2,341
Gains (losses) on investments, net	(10,465)	1	(5)	(10,466)	6
Gains (losses) on derivatives, net	(359)	–	6,812	(359)	(6,812)
Gains (losses) on sale of rural home loans	2,142	147	3,172	1,995	(3,025)
Gains from sale of premises and equipment, net	4,613	2,016	1,521	2,597	495
Patronage refunds from other Farm Credit Institutions	4,084	1,790	1,172	2,294	618
Other noninterest income	1,481	5,746	5,677	(4,265)	69
Total noninterest income	$ 51,554	$ 48,924	$ 58,670	$ 2,630	$ (9,746)

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

The majority of the increase in fees for financially related services in 2008 was the result of increases of $522 thousand in crop hail insurance income and $1.3 million in multi-peril insurance income. The increase in 2007 was from increases of $1.0 million in crop hail insurance income and $1.3 million in multi-peril insurance income.

The increase in losses on investments in 2008 was due to the determination that an individual asset-backed security was other-than-temporarily impaired, as discussed above, and a related loss of $10.5 million was recognized to adjust to fair value.

The increase in the losses on derivatives in 2008 of $359 thousand was due to the early termination of an interest rate swap in September 2008. The decrease in the realized gains on derivatives in 2007 was due to the $6.8 million gain on derivatives recorded in 2006. The realized gains on derivatives in 2006 were attributed to liquidating a derivative strategy and putting permanent financing in place.

Patronage refunds from other Farm Credit institutions increased $2.3 million in 2008 primarily from increases in participation loans purchased from other Farm Credit institutions.

Other noninterest income decreased $4.3 million during 2008 primarily due to losses incurred on investments which fund the non-qualified pension plans.

Noninterest Expense

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

Noninterest Expense	**For the Year Ended December 31,**			**Increase (Decrease)**	
(dollars in thousands)	**2008**	**2007**	**2006**	**2008/ 2007**	**2007/ 2006**
Salaries and employee benefits	$ 198,657	$ 198,539	$ 190,597	$ 118	$ 7,942
Occupancy and equipment	36,665	33,771	30,953	2,894	2,818
Insurance Fund premiums	35,337	28,200	24,615	7,137	3,585
Other operating expense	83,204	76,293	71,491	6,911	4,802
Called debt expense	26,652	10,550	2,563	16,102	7,987
Correspondent lending service expense	4,017	2,071	1,656	1,946	415
Other noninterest expense	278	1,077	683	(799)	394
Total noninterest expenses	$ 384,810	$ 350,501	$ 322,558	$ 34,309	$ 27,943

Total salaries and employee benefits generally increased over the three year period of 2006 through 2008 as a result of normal salary administration and increased benefit costs that were experienced by most employers.

The $7.1 million increase in the Insurance Fund premiums in 2008 resulted primarily from a change in the assessment of the premium, as well as balance sheet growth. Effective July 1, 2008, the base on which the Insurance Fund premiums are assessed was expanded from total loans to total System debt. In addition, the annual premium rate which was 15 basis points for the first nine months of 2008 was increased to 18 basis points the last quarter of 2008. The Insurance Fund Board increased the premium to 20 basis points in 2009. The Insurance Fund premium increased $3.6 million in 2007 due to the increase in loan volume.

Occupancy and equipment expenses increased $2.9 million and $2.8 million during 2008 and 2007, respectively, primarily as the result of technology upgrading and renovation aimed at improving the Bank's technical infrastructure and updating various systems and related higher depreciation expense

Other operating expenses increased $6.9 million from 2007 to 2008 and $4.8 million from 2006 to 2007. The $6.9 million increase in 2008 primarily resulted from increases of $2.9 million in purchased services for technology upgrades and Systemwide initiatives, $936 thousand in travel expenses, $759 thousand in public and member relation expenses, and $528 thousand in directors' expenses. The $4.8 million increase in other operating expenses from 2006 to 2007 resulted from increases of $916 thousand in directors' expenses, $1.8 million in purchased services, and $1.3 million in advertising expenses.

Concession (debt issuance expense) is amortized over the life of the underlying debt security. When debt securities are called prior to maturity, any unamortized concession is expensed. Called debt expense increased $16.1 million and $8.0 million for the twelve months ended December 31, 2008 and 2007, respectively. Call options were exercised on bonds totaling $19.9 billion in 2008 and $7.02 billion in 2007. The called debt expense is more than offset by interest expense savings realized as called debt is replaced by new debt issued at a lower rate of interest. Over time, the favorable effect on net interest income is diminished as earning assets reprice downward.

The increases in correspondent lending servicing expense for 2008 and 2007 are primarily due to guarantee fees from increased volume in the correspondent lending portfolio.

Other noninterest expense primarily consists of amortization of mandatorily redeemable preferred stock issuance costs. Certain of these costs were completely amortized into expense in the latter part of 2007.

Projected Pension Expense

Pension expense for the District, which was $12.4 million in 2008, is expected to be $56.3 million in 2009, an increase of $43.9 million. This increase is due to a decrease in the expected return on assets and an increase in the amount of actuarial losses amortized. As previously mentioned, pension expense is determined by actuarial valuations based on certain assumptions, including expected long-term rates of return on plan assets and discount rates. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that portfolio of assets. The discount rate is used to determine the present value of future benefit obligations. Plan assets values decreased significantly in 2008 due to the decline in stock values. The long-term rate of return assumption was lowered from 8.5 percent to 8 percent for the two primary Districtwide plans in response to investment return forecasts and current industry norms. The discount rate used to determine the present value of obligations decreased from 6.45 percent to 6.25 percent due to a change in the yield curve used to determine the rate to more conservatively reflect a level at which obligations could be settled. The pay increase assumption, which impacts service cost, used in the projected benefit obligation determination was increased for certain employee groups to more closely resemble actual experience over the past several years. Some of these changes in methodology may not be permanent but reflect the District's projections based on the current financial environment.

Provision for Income Taxes

Provision for income taxes decreased $347 thousand in 2008 compared to 2007. Provision for income taxes increased $116 thousand in 2007 compared to 2006. The decrease in 2008 is due to federal and state tax refunds recorded through the provision. 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 12/31/08	12/31/07	12/31/06
Return on average assets	1.17%	1.48%	1.67%
Return on average shareholders' equity	10.07%	11.42%	12.40%
Net interest income as a percentage of average earning assets	2.66%	2.64%	2.80%
Net (charge-offs) recoveries to average loans	(0.14)%	(0.01)%	(0.09)%

CAPITAL

Capital serves to support asset growth and provide protection against unexpected credit and interest rate risk and operating losses. Capital is also needed to support 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 2008 that have an effect on the Bank's ability to retire stock and distribute earnings.

Total District shareholders' equity at December 31, 2008 was $3.12 billion, compared to $3.57 billion and $3.31 billion at December 31, 2007 and 2006, respectively. The decrease in 2008 was related to the increase in AOCI of $577.2 million. The AOCI increase was due to an increase in unrealized losses associated with a decrease in the market value of the District's available-for-sale investment securities of $319.7 million. Also, AOCI increased $257.5 in 2008 due to FAS No. 158 employee benefit plan adjustments (see *Recently Issued Accounting Pronouncements* section below and Note 12, *Employee Benefit Plans*, in the Notes to the Combined Financial Statement for further information). The increase in shareholders' equity in 2007 compared to 2006 was primarily due to the issuance of $250.0 million of Perpetual Non-cumulative Subordinated Preferred Stock discussed below.

On June 8, 2007, AgFirst issued $250.0 million of Class B Perpetual Non-Cumulative Fixed-to-Floating Rate Subordinated Preferred Stock, Series 1. On October 14, 2003, AgFirst issued $150.0 million of Perpetual Non-Cumulative Preferred Stock at a par value of $1 thousand per share. On May 17, 2001, AgFirst issued $225.0 million of Mandatorily Redeemable Cumulative Preferred Stock at a par value of $1 thousand per share. The Mandatorily Redeemable Preferred Stock is reported as a liability and the related dividends reported as interest expense. Although the Mandatorily Redeemable Preferred Stock is required to be reported as a liability under GAAP, it qualifies as capital for certain regulatory purposes. See Note 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.

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 12/31/08	12/31/07	12/31/06
Permanent Capital Ratio	7.00%	17.15%	20.59%	19.19%
Total Surplus Ratio	7.00%	17.11%	20.54%	19.14%
Core Surplus Ratio	3.50%	10.43%	13.04%	11.46%
Net Collateral Ratio	104.00%	105.56%	106.02%	105.28%

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 (as discussed 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, 2008, all of the $250.0 million in preferred stock has been included.

The decrease in the Bank's permanent capital, total surplus, and core surplus ratios for December 31, 2008 was attributed to the growth in assets on both a total and risk adjusted basis exceeding the increase in capital. The decrease in the collateral ratio for December 31, 2008 also was attributed to asset growth. 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.

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 its operations. For a further discussion of these risks, see the *Risk Management* section above. Due to the evolving nature of the economic capital concept, the

District anticipates these methodologies and assumptions will continue to be refined.

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

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

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

Young Farmer – A farmer, rancher, or producer or harvester of aquatic products who was age 35 or younger as of the date the loan was originally made.

Beginning Farmer – A farmer, rancher, or producer or harvester of aquatic products who had 10 years or less farming or ranching experience as of the date the loan was originally made.

Small Farmer – A farmer, rancher, or producer or harvester of aquatic products who normally generated less than $250 thousand in annual gross sales of agricultural or aquatic products at the date the loan was originally made.

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

The following table summarizes information regarding loans outstanding to Young, and Beginning Farmers and Ranchers as of December 31, 2008.

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

Category	Number of Loans	Percent of Total	Volume Outstanding	Percent of Total
1. Total loans and commitments outstanding at year-end	140,003	–	$ 30,303,641	–
2. Young farmers and ranchers	22,079	15.77%	$ 2,313,572	7.63%
3. Beginning farmers and ranchers	33,599	24.00%	$ 4,738,653	15.64%

The following table summarizes information regarding loans outstanding to Small Farmers and Ranchers as of December 31, 2008.

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

Number/Volume Outstanding	$0-$50,000	$50,001-$100,000	$100,001-$250,000	$250,001-and greater
1. Total number of loans and commitments outstanding at year-end	81,162	22,032	21,413	15,396
2. Total number of loans to small farmers and ranchers	55,563	14,461	12,899	6,316
3. Number of loans to small farmers and ranchers as a % of total number of loans	68.46%	65.64%	60.24%	41.02%
4. Total loan volume outstanding at year-end	$ 1,549,892	$ 1,866,970	$ 3,941,003	$ 22,945,776
5. Total loan volume to small farmers and ranchers	$ 1,062,910	$ 1,112,506	$ 2,077,789	$ 3,716,876
6. Loan volume to small farmers and ranchers as a % of total loan volume	68.58%	59.59%	52.72%	16.20%

The following table summarizes information regarding the new loans made to Young, and Beginning Farmers and Ranchers for the year ended December 31, 2008.

Young, and Beginning Farmers and Ranchers
Gross New Business During 2008, Number/Volume of Loans
(dollars in thousands)

Category	Number of Loans	Percent of Total	Volume Outstanding	Percent of Total
1. Total gross new loans and commitments made during 2008	66,679	–	$ 17,468,329	–
2. Total loans and commitments made during 2008 to young farmers and ranchers	9,848	14.77%	$ 1,359,298	7.78%
3. Total loans and commitments made during 2008 to beginning farmers and ranchers	13,523	20.28%	$ 2,514,954	14.40%

The following table summarizes information regarding new loans made to Small Farmers and Ranchers for the year ended December 31, 2008.

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

Number/Volume	$0-$50,000	$50,001 -$100,000	$100,001-$250,000	$250,001-and greater
1. Total number of new loans and commitments made during 2008	27,421	12,392	13,300	13,566
2. Total number of loans made to small farmers and ranchers during 2008	18,840	6,647	6,123	4,159
3. Number of loans to small farmers and ranchers as a % of total number of loans	68.71%	53.64%	46.04%	30.66%
4. Total gross loan volume of all new loans and commitments made during 2008	$ 552,614	$ 884,356	$ 2,146,341	$ 13,885,018
5. Total gross loan volume to small farmers and ranchers	$ 361,732	$ 469,856	$ 986,711	$ 2,472,622
6. Loan volume to small farmers and ranchers as a % of total gross new loan volume	65.46%	53.13%	45.97%	17.81%

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 15, *Commitments and Contingencies*, in the Notes to the Combined Financial Statements for additional information.

REGULATORY MATTERS

During 2008, the FCA 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, 2008.

On October 31, 2007, the FCA published an advance notice of proposed rulemaking in the Federal Register with respect to the consideration of possible modifications to the FCA's risk-based capital rules for Farm Credit System institutions that are similar to the standardized approach delineated in the Basel II Framework. The FCA sought comments to facilitate the development of a proposed rule that would enhance its regulatory capital framework and more closely align minimum capital requirements with risks taken by System institutions. Comments on the advance notice of proposed rulemaking were due no later than December 31, 2008.

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

In November 2008, the FCA adopted the Market Emergency Standby Resolution. The resolution authorizes a waiver of the liquidity reserve requirement whenever a financial, economic, agricultural, or national defense emergency is deemed to exist. After certain conditions are met and the resolution goes into effect, the resolution temporarily allows the Banks to fund their assets with discount notes even if doing so would cause the liquidity reserve of one or more of the Banks to drop below the regulatory minimum. The resolution grants the Banks a temporary waiver, subject to certain conditions, of the liquidity reserve requirement for no more than 14 calendar days. It also contemplates that any affected Bank would develop a plan for quickly restoring its liquidity reserve to the minimum regulatory level.

Federal Legislation

In June, 2008, Congress passed the 2008 Farm Bill. This 2008 Farm Bill governs farm commodity, conservation, and other USDA programs for five years, from 2008 through 2012. The 2008 Farm Bill includes significant federal financial support for wheat, feed grains, cotton, rice, oilseeds, and dairy. It also contains new, expanded assistance for certain specialty crops. Overall, the 2008 Farm Bill maintains the government payments to farmers that had been in place under the previous farm bill. It also amended the Farm Credit Act to allow the FCSIC to assess insurance premiums based on each Bank's prorata share of adjusted outstanding insured debt (rather than loans), aligning premiums with the risk that is being insured. Premiums of up to 20 basis points can be charged against insured debt adjusted for loans and investments guaranteed by U.S. or state governments, and up to an additional 10 basis points could be charged for any nonaccrual loan volume or investments that are other-than-temporarily impaired. Previously, premiums of up to 15 basis points could be charged on accruing loans and up to 25 basis points for nonaccrual loans.

Using the new authorities contained in the 2008 Farm Bill, in June 2008, the FCSIC set premiums at 15 basis points on adjusted insured debt outstanding for the third quarter of 2008 and 18 basis points on adjusted insured debt outstanding for the fourth quarter of 2008. There remains a 10 basis point premium on the average principal outstanding for nonaccrual loans and on the average amount of any other-than-temporarily impaired investments. The FCSIC has increased the premium rates to 20 basis points in 2009.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS No. 158). SFAS No. 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in that funded status in the year in which the changes occur through other comprehensive income. SFAS No. 158 further requires the determination of the fair value of plan assets at year-end and recognition of actuarial gains and losses, prior service costs or credits, and transition assets and obligations as a component of other comprehensive income. In addition, SFAS No. 158 requires that the funded status of a plan be measured as of the date of the year-end financial statements, effective for fiscal years ending after December 15, 2008. Prior to 2008, the District used a measurement date of September 30th. In 2008, the District used a measurement date of December 31st as required. See Note 12, *Employee Benefit Plans*, of the Combined Financial Statements, for the impact of SFAS No. 158 on the current period for the District.

In September 2006, the FASB also issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 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. SFAS No. 157 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, SFAS No. 157 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 are required for the lowest priority level. The District adopted SFAS No. 157 effective January 1, 2008, on a prospective basis. See Note 16, *Fair Value Measurement*, of the Combined Financial Statements, for disclosures required by SFAS No. 157.

In December 2007, the FASB issued Statements of Financial Accounting Standards No. 141R, *Business Combinations* (SFAS No. 141R). SFAS No. 141R requires business combinations to be accounted for under the acquisition method of accounting (previously called the purchase method). The acquisition method requires (a) identifying the acquirer, (b) determining the acquisition date, (c) recognizing and measuring the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, at their acquisition date fair values, and (d) recognizing and measuring goodwill or a gain from a bargain purchase. SFAS No. 141R will be applied to business combinations on or after January 1, 2009. The District's adoption of SFAS No. 141R will significantly impact its accounting for combinations/acquisitions that may occur in 2009 and beyond.

In February 2008, the FASB issued Staff Interpretation (FSP) No. 157-2, *Effective Date of FASB Statement No. 157*. This FSP delayed the effective date of the Statement for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008.

The District is currently evaluating the impact of adoption of this Interpretation.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133* (SFAS No. 161), which amends and expands the disclosure requirements for derivative instruments and for hedging activities previously required by SFAS No. 133. It states that an entity with derivative instruments shall disclose information to enable users of the financial statements to understand (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 161, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. SFAS No. 161 encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The adoption of this Statement will result in additional disclosures, but will not have an impact on the District's financial condition or results of operation.

In October 2008, the FASB issued Staff Interpretation (FSP) No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active.* This FSP clarifies the application of FASB Statement No. 157, *Fair Value Measurements*, in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. It became effective upon issuance, and included prior periods for which financial statements have not been issued. Revisions resulting from a change in valuation techniques or their application shall be accounted for as a change in accounting estimate. The District has considered the interpretation in determining the fair value of its financial assets at December 31, 2008.

Additional Disclosure Required by Farm Credit Administration Regulations

Description of Business

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

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

Description of Property

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

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

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 15 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 and contingent liabilities to be disclosed in this section is incorporated herein by reference to Notes 2, 7, 8, 9, 12, and 15 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, *President and Chief Executive Officer*	11 years	CEO, Palmetto Farm Credit, ACA from April 1989 to January 1998.	He serves as: member of the Board for Federal Farm Credit Banks Funding Corporation; Council Member of the National Council of Farm Cooperatives; University of South Carolina: member of the Board of Trustees for the Business Partnership Foundation and Chairman of the Board of Directors for the Education Foundation; member of the Board of Directors for Big Brothers Big Sisters of Greater Columbia; member of the Board of Directors and Chairman of Finance Committee for National 4H Council; member of the Board of Directors for Palmetto AgriBusiness Council; member of the Board of Directors for Midlands Business Leadership Group.
Thomas S. Welsh, *Executive Vice President and Chief Administrative and Legislative Officer*	11 years	Chief Marketing and Planning Officer from January 1996 until March 1998.	He serves on the Advisory Board of the Farm Credit System Captive Insurance Company. Member of the AgFirst Plan Sponsor Committee and the AgFirst/FCBT Plan Sponsor Committee.
Leon T. Amerson, *Executive Vice President and Chief Operating Officer*	2.5 years	Chief Financial Officer from March 1998 to September 2006.	He serves on the AgFirst/FCBT Plan Fiduciary Committee.
Charl L. Butler, *Senior Vice President and Chief Financial Officer*	1.8 years	Chief Financial Officer and Secretary at The National Bank of South Carolina from 1991 until 2007.	He serves on the Board of Directors of the S.C. Council on Economic Education.
William L. Melton, *Senior Vice President and Chief Lending Officer*	5.5 years	Senior Executive Officer/Bank Lending from January to July 2003, prior to that Lending Services Manager.	.
Benjamin F. Blakewood, *Senior Vice President and Chief Information Officer*	10.5 years	Director of Information Technology from 1996 to 1998 at Affinity Technology Group.	
Frederick T. Mickler, III, *Senior Vice President and General Counsel*	11 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, 2008, 2007 and 2006, is as follows:

Name of Individual or Number in Group	Year	Annual Salary	Annual Bonus	Deferred Comp.	Perq./ Other*	Total
F. A. Lowrey	2008	$ 577,192	$ 263,584	$ 12,265	$ 21,357	$ 874,398
F. A. Lowrey	2007	$ 524,720	$ 176,642	$ 44,160	$ 21,731	$ 767,253
F. A. Lowrey	2006	$ 467,018	$ 175,161	$ 10,000	$ 17,983	$ 670,162
6 Officers	2008	$ 1,456,242	$ 440,498	$ 80,196	$ 98,651	$ 2,075,587
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

* *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.*

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 2008 bonus was made in the first quarter of 2009.

Beginning in 2008, senior officers may also participate in the Bank's Long Term Bonus Plan which is designed to attract, recognize, and maintain senior officers and other key employees. Participation in the plan is at the sole discretion of the CEO. Bonuses are shown in year accrued. Payments will be made when earned.

Bank compensation plans are reviewed by the Board Compensation Committee.

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

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

AgFirst Farm Credit Bank Board of Directors for 2008

Name	Position	Term of Office
Thomas W. Kelly	Chairman	December 31, 2012*
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, 2012*
M. Wayne Lambertson	Director	December 31, 2009
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
J. Dan Raines, Jr.	Director	December 31, 2009
Walter L. Schmidlen, Jr.	Director	December 31, 2012*
Robert G. Sexton	Director	December 31, 2011
Kenneth A. Spearman	Director	December 31, 2009
Robert H. Spiers, Jr.	Director	December 31, 2009
William H. Voss	Director	December 31, 2010
J. Mark Wheeler	Director	December 31, 2012**

* *These directors were re-elected to a new 4-year term ending 12/31/12.*
** *This director was newly elected in 2008 to 4-year terms commencing 1/1/09.*

Thomas W. Kelly, Chairman of the Board, is a farmer from Tyrone, Pennsylvania. A former dairyman and breeder of Registered Holsteins, his farming operation now 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 an elected delegate to the Penn State Agricultural Council and a director of Mid-Atlantic Master Farmer Association and is a former director of Holstein Association, USA. Mr. Kelly currently serves as Chairman of the Board Governance Committee.

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 served on the Board Compensation Committee. He currently serves as Chairman of the Board.

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

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 serves on 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 served on the Board Governance Committee.

Don W. Freeman of Montgomery, Alabama, manages a 400-acre cow-calf operation and an 80 unit river rental business near Lowndesboro, Alabama. He 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 served on the Board Audit Committee and currently serves on the Board Compensation 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 served on the Board Compensation Committee, and currently serves on the Board Credit Committee.

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

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 served on the Board Governance Committee, and currently serves on the Board Credit 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 boards of the national Farm Credit Council, MidAtlantic Farm Credit, ACA, and the Delmarva Poultry Industry DPI, a trade organization. Mr.

Lambertson served as chairman of the Board Governance Committee and currently serves on the Board Compensation Committee. He also is currently Vice Chairman of the Board.

James L. May is owner and operator of Mayhaven Farm in Waynesburg, Kentucky, where he owns 330 acres and leases another 700 acres. He is involved in the development and marketing of 500 heifers for replacement cows and embryo transfer. Mr. May's operation also includes 150 acres of alfalfa hay, 500 acres of corn and soybeans, and 100 acres of wheat. He currently serves as a member of the Central Kentucky Ag Credit board, Lincoln County Extension Council, Lincoln County Ag Development Board, and is a member of the Lincoln County Farm Bureau Board. Mr. May served on the Board Audit Committee, and currently serves as chairman of the Board Credit 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 runs 100 Cedars Cattle Farm, a 175-head cow-calf operation. He also has a commercial hay operation with 125 acres in Alicia Bermuda hay and 150 acres in Bahia Grass hay and manages a 375-acre pine and hardwood timber operation. He is a member of the board of directors of First South Farm Credit, ACA, serves on the board of Feliciana Farm Bureau and is a past president of that organization. He is a member of East Feliciana Cattlemen's Association, American Angus Association and the Feliciana Forestry Association. Mr. Norsworthy served as a former mayor of the town of Jackson, La. 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 served on the Board Audit Committee and currently serves as Chairman of that Committee. She is a board designated financial expert.

J. Dan Raines, Jr. is a beef producer from Ashburn, Georgia. His operations include commercial beef cattle, registered Angus cattle and timber. He serves as a director on the boards of AgGeorgia Farm Credit, ACA and the Federal Agricultural Mortgage Corporation (Farmer Mac). Mr. Raines served on the Board Compensation Committee, and currently serves on the Board Credit Committee.

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

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

Kenneth A. Spearman, from Winter Haven, Florida, is a retired Director of Internal Audit for Florida's Natural Growers, Inc. who served 28 years with the citrus industry. He is a former Controller of Citrus Central, Inc. in Orlando, Florida, co-founder of a public accounting firm in Chicago, Illinois and was employed with Arthur Andersen & Co. He obtained his Masters Degree in Business Administration from Governors State University in University Park, Illinois, and his B. S. degree in accounting from Indiana University. He served as chairman of the board of trustees for the Lake Wales Medical Center. He is a member of the Institute of Internal Auditors, and the National Society of Accountants for Cooperatives, where he was a past National President. Mr. Spearman served on the Board Compensation Committee and currently serves on the Board Governance 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 on the Board Compensation Committee, and is a member of the AgFirst/FCBT Plan Sponsor Committee.

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

J. Mark Wheeler, from Brandenton, Florida is chief financial officer of Wheeler Farms, inc., which grows citrus in Brevard, Desoto, Glades and Polk Counties in Florida. He serves on the boards of Farm Credit of Southwest Florida, ACA, Florida Citrus Mutual, an industry trade association, and Wheeler Brothers, Inc., a family-held citrus contract harvesting corporation. Mr. Wheeler is president of Hardee Livestock Market, Inc., a beef cattle operation, and Boston Mining Company, a citrus, real estate and cash investment organization. Mr. Wheeler serves on the Board Audit Committee.

Committees

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

Compensation of Directors

Directors were compensated in 2008 in cash at the rate of $50,205 per year, payable at $4,183 per month. This is compensation for attendance at board meetings, board committee meetings, certain other meetings pre-approved by the board, and other duties as assigned. FCA regulations also allow additional compensation to be paid to a director in exceptional circumstances where extraordinary time and effort are involved. Total cash compensation paid to all directors as a group during 2008 was $1,004,100. Additional information for each director who served during 2008 is provided below.

	Number of Days Served			
Name of Director	Board Meetings	Other Official Activities*	Farm Credit Council Bd. Activities	Total Comp. Paid During 2008*
Gary L. Alexander	24.50	15.00	8.25	$ 50,205
William C. Bess, Jr.	24.50	9.00	7.75	50,205
Henry M. Frazee	24.50	14.00	8.25	50,205
Don W. Freeman	24.50	15.75	8.25	50,205
Dale R. Hershey	25.00	13.50	8.25	50,205
Robert L. Holden, Sr.	25.00	11.00	8.25	50,205
Paul M. House	24.50	11.25	8.25	50,205
Thomas W. Kelly	25.00	14.25	8.25	50,205
Lyle Ray King	25.00	14.00	8.25	50,205
M. Wayne Lambertson	24.50	11.00	7.75	50,205
James L. May	24.50	15.75	8.25	50,205
Eugene W. Merritt, Jr.	24.00	12.00 **	8.25	50,205
James M. Norsworthy	25.00	15.50	8.25	50,205
Katherine A. Pace	25.00	18.00	8.25	50,205
J. Dan Raines, Jr.	20.75	10.50	8.25	50,205
Walter L. Schmidlen, Jr.	24.50	14.00	8.25	50,205
Robert G. Sexton	25.00	18.00 ***	8.25	50,205
Kenneth A. Spearman	25.00	14.25	8.25	50,205
Robert H. Spiers, Jr.	25.00	14.25	8.25	50,205
William H. Voss	25.00	14.25	8.25	50,205
Total				$1,004,100

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

** *Does not include 8.75 days served on AgFirst/FCBT Plan Fiduciary Committee.*

*** *Does not include 6.25 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 $259,345 for 2008, $251,988 for 2007, and $258,943 for 2006.

Transactions with Senior Officers and Directors

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section, are incorporated herein by reference to Note 13 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, 2008 were as follows:

	2008
Independent Auditor	
PricewaterhouseCoopers LLP	
Audit services	$ 491,512
Non-audit services	108,863
Total	$ 600,375

Audit fees were for the annual audits of financial statements.

Non-audit fees were for services rendered related to Farmer Mac minimum servicing standards attestation, agreed upon procedures for Board of Directors elections, and accounting training.

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

Combined Financial Statements

The Combined Financial Statements, together with the report thereon of PricewaterhouseCoopers LLP, dated February 27, 2009, 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, Director of Financial Reporting, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst's web site at ***www.agfirst.com***. The Bank prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Report to shareholders within 90 days after the end of the fiscal year. The Bank prepares an electronic version of each Quarterly Report within 40 days after the end of each fiscal quarter, except that no report is prepared for the fiscal quarter that coincides with the end of the fiscal year of the Bank.

Report of the Audit Committee

The Audit Committee of the Bank's Board of Directors (the Committee) is comprised of the directors named below. None of the directors who serve on the Committee is an employee of AgFirst Farm Credit Bank (the Bank) and in the opinion of the Board of Directors, each is free of any relationship with the Bank or management that would interfere with the director's independent judgment on the Committee.

The Committee has adopted a written charter that has been approved by the Board of Directors. The Committee has reviewed and discussed the audited financial statements with management, which has primary responsibility for the financial statements.

PricewaterhouseCoopers LLP (PwC), the Bank and District Associations combined independent auditor for 2008, 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 2008. The foregoing report is provided by the following independent directors, who constitute the Committee:

Katherine A. Pace
Chairman of the Audit Committee

Members of Audit Committee

Gary L. Alexander
James M. Norsworthy, III
Robert G. Sexton
J. Mark Wheeler

February 27, 2009

Report of Independent Auditors

PRICEWATERHOUSECOOPERS

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

Report of Independent Auditors

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

In our opinion, the accompanying combined balance sheets and the related combined statements of income, of changes in shareholders' equity and of cash flows present fairly, in all material respects, the financial position of AgFirst Farm Credit Bank (the Bank) and District Associations (together, the District) at December 31, 2008, 2007 and 2006, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the 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 27, 2009

Combined Balance Sheets

(dollars in thousands)	As of December 31, 2008	2007	2006
Assets			
Cash and cash equivalents	$ 316,010	$ 612,841	$ 651,268
Investment securities:			
Available for sale (amortized cost of $6,648,869, $5,679,228 and $5,063,640 respectively)	6,291,327	5,641,430	5,065,621
Held to maturity (fair value of $1,907,489, $1,397,015 and $1,392,499 respectively)	1,875,699	1,419,371	1,426,481
Total investment securities	8,167,026	7,060,801	6,492,102
Loans	23,077,736	20,728,296	18,669,616
Less: allowance for loan losses	169,090	78,874	71,915
Net loans	22,908,646	20,649,422	18,597,701
Loans held for sale	1,831	1,904	4,445
Other investments	410,249	430,812	428,005
Accrued interest receivable	235,080	252,838	246,184
Investments in other Farm Credit System institutions	19,822	8,374	8,738
Premises and equipment, net	126,850	123,012	120,123
Other property owned	14,228	8,504	5,122
Deferred tax assets, net	—	5	163
Other assets	212,688	112,638	206,867
Total assets	$32,412,430	$29,261,151	$26,760,718
Liabilities			
Bonds and notes	$28,253,023	$24,847,248	$22,613,379
Mandatorily redeemable preferred stock	225,000	225,000	225,000
Accrued interest and dividends payable	154,555	179,578	188,028
Dividends and patronage refunds payable	103,187	132,146	115,893
Pension and other postretirement benefits liability	374,355	128,415	114,063
Advanced conditional payments	21,177	31,574	23,027
Deferred tax liability, net	7	—	—
Other liabilities	159,400	151,116	173,145
Total liabilities	29,290,704	25,695,077	23,452,535
Commitments and contingencies (Note 15)			
Shareholders' Equity			
Perpetual preferred stock	400,000	400,000	150,000
Protected borrower equity	4,670	5,369	6,208
Capital stock and participation certificates	129,529	127,147	118,817
Retained earnings			
Allocated	1,126,994	1,068,756	992,227
Unallocated	2,191,324	2,118,390	2,039,308
Accumulated other comprehensive income (loss)	(730,791)	(153,588)	1,623
Total shareholders' equity	3,121,726	3,566,074	3,308,183
Total liabilities and shareholders' equity	$32,412,430	$29,261,151	$26,760,718

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, 2008	2007	2006
Interest Income			
Investment securities	$ 311,787	$ 392,113	$ 338,314
Loans	1,456,566	1,516,587	1,309,291
Other investments	21,872	23,076	22,643
Total interest income	1,790,225	1,931,776	1,670,248
Interest Expense	972,361	1,209,586	996,412
Net interest income	817,864	722,190	673,836
Provision for (reversal of allowance) for loan losses	121,023	8,284	(717)
Net interest income after provision for (reversal of allowance) for loan losses	696,841	713,906	674,553
Noninterest Income			
Loan fees	38,705	29,996	33,434
Fees for financially related services	11,353	9,228	6,887
Gains (losses) on investments, net (Note 3)	(10,465)	1	(5)
Gains (losses) on derivatives, net	(359)	—	6,812
Gains (losses) on sale of rural home loans	2,142	147	3,172
Gains from sale of premises and equipment, net	4,613	2,016	1,521
Patronage refunds from other Farm Credit institutions	4,084	1,790	1,172
Other noninterest income	1,481	5,746	5,677
Total noninterest income	51,554	48,924	58,670
Noninterest Expense			
Salaries and employee benefits	198,657	198,539	190,597
Occupancy and equipment	36,665	33,771	30,953
Insurance Fund premiums	35,337	28,200	24,615
Other operating expense	83,204	76,293	71,491
Called debt expense	26,652	10,550	2,563
Correspondent lending servicing expense	4,017	2,071	1,656
Other noninterest expense	278	1,077	683
Total noninterest expense	384,810	350,501	322,558
Income before income taxes	363,585	412,329	410,665
Provision for income taxes	65	412	296
Net income	$ 363,520	$ 411,917	$ 410,369

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

Combined Statements of Changes in Shareholders' Equity

(dollars in thousands)	Perpetual Preferred Stock	Protected Borrower Equity	Capital Stock and Participation Certificates	Retained Earnings Allocated	Retained Earnings Unallocated	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at December 31, 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						4,552	4,552
Minimum pension liability adjustment						47	47
Total comprehensive income							414,968
Protected borrower equity retired		(1,420)					(1,420)
Capital stock/participation certificates issued/(retired), net			(2,469)				(2,469)
Dividends declared/paid			916		(916)		—
Perpetual preferred stock dividends paid					(10,950)		(10,950)
Patronage distribution							
Cash					(114,325)		(114,325)
Qualified allocated surplus				27,798	(27,798)		—
Nonqualified allocated surplus				92,988	(92,988)		—
Nonqualified retained surplus				62,038	(62,038)		—
Retained earnings retired				(118,414)			(118,414)
Patronage distribution adjustment				1,898	(5,490)		(3,592)
Balance at December 31, 2006	150,000	6,208	118,817	992,227	2,039,308	1,623	3,308,183
Comprehensive income							
Net income					411,917		411,917
Unrealized gains (losses) on investments available for sale						(39,780)	(39,780)
Minimum pension liability adjustment						21	21
Total comprehensive income							372,158
Protected borrower equity retired		(839)					(839)
Preferred stock issued	250,000						250,000
Issuance cost on preferred stock					(2,742)		(2,742)
Capital stock/participation certificates issued/(retired), net			7,197				7,197
Stock dividends declared/paid			1,133		(1,133)		—
Perpetual preferred stock dividends paid					(19,501)		(19,501)
Patronage distribution							
Cash					(129,698)		(129,698)
Qualified allocated surplus				18,202	(18,202)		—
Nonqualified allocated surplus				90,743	(90,743)		—
Nonqualified retained surplus				71,700	(71,700)		—
Retained earnings retired				(105,020)			(105,020)
Patronage distribution adjustment				904	884		1,788
Adjustment to initially apply SFAS No. 158 (Note 12)						(115,452)	(115,452)
Balance at December 31, 2007	400,000	5,369	127,147	1,068,756	2,118,390	(153,588)	3,566,074
Comprehensive income							
Net income					363,520		363,520
Unrealized gains (losses) on investments available for sale						(319,744)	(319,744)
Employee benefit plans adjustments (Note 12)					(5,013)	(257,459)	(262,472)
Total comprehensive loss							(218,696)
Protected borrower equity retired		(699)					(699)
Capital stock/participation certificates issued/(retired), net			1,180				1,180
Stock dividends declared/paid			1,202		(1,202)		—
Perpetual preferred stock dividends paid					(27,413)		(27,413)
Patronage distribution							
Cash					(101,203)		(101,203)
Qualified allocated surplus				20,734	(20,734)		—
Nonqualified allocated surplus				67,605	(67,605)		—
Nonqualified retained surplus				65,449	(65,449)		—
Retained earnings retired				(94,813)			(94,813)
Patronage distribution adjustment				(737)	(1,967)		(2,704)
Balance at December 31, 2008	$ 400,000	$4,670	$129,529	$1,126,994	$ 2,191,324	$ (730,791)	$ 3,121,726

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

Combined Statements of Cash Flows

(dollars in thousands)	For the year ended December 31, 2008	2007	2006
Cash flows from operating activities:			
Net income	$ 363,520	$ 411,917	$ 410,369
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation on premises and equipment	19,091	18,090	16,670
Amortization of net deferred loan origination (fees) costs	(9,638)	(5,110)	(7,639)
(Premium amortization) discount accretion on investment securities	(13,386)	(23,617)	(28,069)
Premium amortization (discount accretion) on bonds and notes	7,820	7,343	18,420
Provision for (reversal of allowance for) loan losses	121,023	8,284	(717)
(Gains) losses on other property owned, net	1,102	999	1,300
(Gains) losses from sale of premises and equipment, net	(4,613)	(2,016)	(1,521)
(Gains) losses on investments, net	10,465	(1)	5
(Gains) losses on derivatives, net	359	—	(6,812)
Gains (losses) on sales of rural home loans, net	(2,142)	(147)	(3,172)
Net change in loans held for sale	(22,181)	28,220	31,857
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	17,758	(6,654)	(66,214)
(Increase) decrease in deferred tax assets, net	12	158	1,528
(Increase) decrease in other assets	(8,255)	123,801	(1,380)
Increase (decrease) in accrued interest and dividends payable	(25,023)	(8,450)	54,173
Increase (decrease) in pension and other postretirement benefits liability	245,940	14,352	4,256
Increase (decrease) in other liabilities	(251,843)	(116,506)	30,725
Total adjustments	86,489	38,746	43,410
Net cash provided by operating activities	450,009	450,663	453,779
Cash flows from investing activities:			
Investment securities purchased	(3,149,180)	(2,223,352)	(3,357,019)
Investment securities sold or matured	1,704,260	1,615,415	2,177,855
Proceeds from sale of derivatives	—	—	6,812
Net (increase) decrease in loans	(2,356,801)	(2,089,074)	(2,538,021)
(Increase) decrease in investments in other Farm Credit System institutions	(11,448)	364	18
Purchases of other investments	(29,666)	(44,110)	(215,335)
Proceeds from payments received on other investments	72,101	64,379	47,212
Purchase of premises and equipment	(24,997)	(22,082)	(30,601)
Proceeds from sale of premises and equipment	6,681	3,119	2,392
Proceeds from sale of other property owned	3,762	4,266	1,229
Net cash used in investing activities	(3,785,288)	(2,691,075)	(3,905,458)
Cash flows from financing activities:			
Bonds and notes issued	111,749,964	66,559,204	49,104,767
Bonds and notes retired	(108,446,508)	(64,383,204)	(45,406,904)
Net increase (decrease) in advanced conditional payments	(10,397)	8,547	(722)
Perpetual preferred stock issued net of issuance cost	—	247,258	—
Protected borrower equity retired	(699)	(839)	(1,420)
Capital stock and participation certificates issued/(retired), net	1,180	7,197	(2,469)
Patronage refunds and dividends paid	(132,866)	(111,657)	(101,771)
Dividends paid on perpetual preferred stock	(27,413)	(19,501)	(10,950)
Retained earnings retired	(94,813)	(105,020)	(118,414)
Net cash provided by financing activities	3,038,448	2,201,985	3,462,117
Net increase (decrease) in cash and cash equivalents	(296,831)	(38,427)	10,438
Cash and cash equivalents, beginning of period	612,841	651,268	640,830
Cash and cash equivalents, end of period	$ 316,010	$ 612,841	$ 651,268
Supplemental schedule of non-cash investing and financing activities:			
Financed sales of other property owned	$ 5,428	$ 355	$ 718
Loans transferred to other property owned	16,016	9,002	4,723
Change in unrealized gains (losses) on investments	(319,744)	(39,780)	4,552
Change in pension liability related to other comprehensive income	—	(21)	(47)
Decrease in other assets resulting from adoption of SFAS No. 158 (Note 12)	—	105,047	—
Increase in pension and other postretirement benefits liability resulting from adoption of SFAS No. 158 (Note 12)	—	10,405	—
Employee benefit plans adjustments (Note 12)	262,472	—	—
Non-cash changes related to hedging activities:			
Decrease (increase) in loans	$ —	$ —	$ 7
Increase (decrease) in bonds and notes	94,499	50,526	17,132
Decrease (increase) in other assets	(91,795)	(29,572)	(1,553)
Increase (decrease) in other liabilities	(2,091)	(20,954)	(15,586)
Supplemental information:			
Interest paid	$ 989,564	$ 1,210,693	$ 928,865
Taxes paid, net	556	(2,675)	352

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

Notes to the Combined Financial Statements

Note 1 — Organization and Operations

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

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

Each FCB and the ACB serves one or more Production Credit Associations (PCAs) that originate and service short- and intermediate-term loans, Federal Land Credit Associations (FLCAs) that originate and service long-term real estate mortgage loans, and/or Agricultural Credit Associations (ACAs) that originate both long-term and short- and intermediate-term loans. PCAs, FLCAs, and ACAs are collectively referred to as associations. AgFirst and its related associations (Associations or District Associations) are collectively referred to as the District. The District Associations jointly own all of AgFirst's voting stock. As of December 31, 2008, the District consisted of the Bank and twenty-two District ACAs following the merger of Valley Farm Credit, ACA with and into MidAtlantic Farm Credit, ACA effective December 31, 2008. All twenty-two ACAs are structured as holding companies, which include FLCA and PCA subsidiaries.

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

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

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (insured debt), (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary use by the Insurance Corporation to provide assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank has been required to pay premiums, which may be passed on to the associations, into the Insurance Fund until such time as 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 the reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

In June 2008, with the passage of the Food, Conservation, and Energy Act of 2008 (Farm Bill), the basis for assessing premiums was changed, beginning with the second half of 2008, to reflect each Bank's pro rata share of outstanding insured debt. Prior to that, premiums had been based primarily on loans outstanding. The Farm Bill imposes premiums of up to 20 basis points on adjusted insured debt obligations, with the Insurance Corporation Board having the ability to reduce the amount, and a risk surcharge of 10 basis points on nonaccrual loans and other-than-temporarily impaired investments. Premiums for the third and fourth quarters of 2008 were 15 and 18 basis points, respectively. Effective January 1, 2009, the premium was increased to 20 basis points.

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

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

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

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

- *Federal Farm Credit Banks Funding Corporation (Funding Corporation)* — provides for the issuance, marketing and processing of Systemwide Debt Securities using a network of investment dealers and dealer banks. The Funding Corporation also provides financial management and reporting services.

- *FCS Building Association* — leases premises and equipment to the FCA, as required by the Farm Credit Act.

- *Farm Credit System Association Captive Insurance Company* — being a reciprocal insurer, provides insurance services to its member organizations.

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

Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the District conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of combined financial statements in conformity with GAAP requires the managements of AgFirst and District Associations to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results can differ from these estimates. Certain amounts in prior years' financial statements may 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 on the trade date. Investment securities which management has the intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost. Investment securities classified as available-for sale (AFS) are carried at fair market value with net unrealized gains and losses included in Other Comprehensive Income (OCI) in Shareholders' Equity.

   Interest on investment securities, including amortization of premiums and accretion of discounts, is included in Interest Income. Realized gains and losses from the sales of investment securities, 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 is written down to its fair value, and the impairment loss is included in earnings in the period of impairment.

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

   Loans are carried at their principal amount outstanding adjusted for charge-offs and deferred loan fees or costs adjusted for Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, valuation adjustments, if any. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. The difference in the investment in a purchased loan and its principal amount is deferred as part of the carrying amount of the loan and the net difference is amortized over the life of the related loan as an adjustment to interest income using the effective interest method.

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

   When loans are in nonaccrual status, 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 returned to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected, and the loan is not classified "doubtful" or "loss."

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

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

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

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

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

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

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

   A general allowance may also be established under Statement of Financial Accounting Standards No. 5 to reflect estimated probable credit losses inherent in the remainder of the loan portfolio which excludes impaired loans considered under the specific allowance discussed above. A general allowance can be evaluated on a pool basis for those loans with similar characteristics. The level of the general allowance may be based on management's best estimate of the likelihood of default adjusted for other relevant factors reflecting the current environment.

D. **Other Investments:** Other Investments include Tobacco Buyout Successor-in-Interest Contracts (SIIC) which qualify as Mission-Related Investments under FCA regulations. Under the SIIC, the Tobacco quota holders and producers may sell their rights to receive SIIC contract payments to a third party. The successor purchases the entire contract and all related rights and obligations associated with the contract. These investments in SIIC are purchased at a discount. Contract payments are made by the United States Department of Agriculture (USDA) in equal annual payments. Interest income is recognized from the accretion of discounts using the effective interest method.

E. **Other Property Owned:** Other property owned, consisting of real and personal property acquired through collection 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, 2008, 2007 and 2006 were $160.7 million, $180.5 million, and $202.5 million, respectively. The outstanding gross balances of advance conditional payments classified as other liabilities at December 31, 2008, 2007 and 2006 were $31.0 million, $31.6 million, and $23.0 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 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.

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, 2008, deferred income taxes had not been provided by certain District Associations on approximately $125.1 million of patronage refunds received prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. Under GAAP, deferred taxes must be provided on all patronage refunds made to taxable District Associations after December 31, 1992, except to the extent that a portion of these amounts will be distributed in the form of patronage to District Association members.

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

There were no uncertain positions for income taxes at December 31, 2008.

K. **Derivative Instruments and Hedging Activity:** The Bank is party to derivative financial instruments, primarily interest rate swaps and caps, which are principally used to reduce funding costs. Derivatives are included in the Combined Balance Sheets as assets and liabilities and reflected at fair value.

Changes in the fair value of a derivative are recorded in current period earnings or accumulated other comprehensive income (loss) (AOCI) depending on the 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 AOCI. The gains and losses on the derivative that are deferred and reported in AOCI will be reclassified into earnings in the periods in which earnings are impacted by the variability of the cash flows of the hedged item. The ineffective portion of all hedges is recorded in current period earnings. For derivatives not designated as a hedging instrument, the related change in fair value is recorded in current period earnings.

The Bank formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as fair value or cash flow hedges to (1) specific assets or liabilities on the balance sheet or (2) firm commitments or forecasted transactions. The Bank also formally assesses at the hedge's inception whether the derivatives that are used in hedging transactions 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 AOCI would be amortized into earnings over the remaining life of the original hedged item. For fair value hedges, changes in the fair value of the derivative will be recorded in current period earnings. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, the Bank will carry the derivative at its fair value on the balance sheet, recognizing changes in fair value in current period earnings.

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

L. **Valuation Methodologies:** Management of the District applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets for which an observable liquid market exists, such as the majority of the District's investment securities. Management utilizes significant estimates and assumptions to value items for which an observable liquid market does not exist. Examples of these items include impaired loans, certain derivatives, certain investment securities and other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing, and liquidation values. The use of different assumptions could produce significantly different asset or liability values, which could have material positive or negative effects on the District's results of operations.

Effective January 1, 2008, the District adopted Statement of Financial Accounting Standards No. 157, Fair Value Measurement. (SFAS No. 157). This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. SFAS No. 157 establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. It describes three levels of inputs that may be used to measure fair value as discussed in Note 16.

M. **Recent Accounting Developments**: In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS No. 158). SFAS No. 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in that funded status in the year in which the changes occur through other comprehensive income. SFAS No. 158 further requires the determination of the fair value of plan assets at year-end and recognition of actuarial gains and losses, prior service costs or credits, and transition assets and obligations as a component of other comprehensive income. In addition, SFAS No. 158 requires that the funded status of a plan be measured as of the date of the year-end financial statements, effective for fiscal years ending after December 15, 2008. Prior to 2008, the District used a measurement date of September 30th. In 2008, the District used a measurement date of December 31st as required. See Note 12, Employee Benefit Plans, of the Combined Financial Statements, for the impact of SFAS No. 158 on the current period for the District.

In September 2006, the FASB also issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 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. SFAS No. 157 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, SFAS No. 157 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 are required for the lowest priority level. The District adopted SFAS No. 157 effective January 1, 2008, on a prospective basis. See Note 16, Fair Value Measurement, of the Combined Financial Statements, for disclosures required by SFAS No. 157.

In December 2007, the FASB issued Statements of Financial Accounting Standards No. 141R, *Business Combinations* (SFAS No. 141R). SFAS No. 141R requires business combinations to be accounted for under the acquisition method of accounting (previously called the purchase method). The acquisition method requires (a) identifying the acquirer, (b) determining the acquisition date, (c) recognizing and measuring the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, at their acquisition date fair values, and (d) recognizing and measuring goodwill or a gain from a bargain purchase. SFAS No. 141R will be applied to business combinations on or after January 1, 2009. The District's adoption of SFAS No. 141R will significantly impact its accounting for combinations/acquisitions that may occur in 2009 and beyond.

In February 2008, the FASB issued Staff Interpretation (FSP) No. 157-2, *Effective Date of FASB Statement No. 157*. This FSP delayed the effective date of the Statement for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008. The District is currently evaluating the impact of adoption of this Interpretation.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133* (SFAS No. 161), which amends and expands the disclosure requirements for derivative instruments and for hedging activities previously required by SFAS No. 133. It states that an entity with derivative instruments shall disclose information to enable users of the financial statements to understand (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 161, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. SFAS No. 161 encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The adoption of this Statement will result in additional disclosures, but will not have an impact on the District's financial condition or results of operation.

In October 2008, the FASB issued Staff Interpretation (FSP) No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*. This FSP clarifies the application of FASB Statement No. 157, Fair Value Measurements, in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. It became effective upon issuance, and included prior periods for which financial statements have not been issued. Revisions resulting from a change in valuation techniques or their application shall be accounted for as a change in accounting estimate. The District has considered the interpretation in determining the fair value of its financial assets at December 31, 2008.

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, 2008, 2007 and 2006, follows:

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

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

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

Held-to-Maturity

A summary of the amortized cost and fair value of debt securities held as held-to-maturity investments at December 31, 2008, 2007 and 2006 follows:

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

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

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

AgFirst's and certain District Association's investments include 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 all but $1.9 million (fair value) was rated or split rated in the top category (AAA/ Aaa) by at least one of the Nationally Recognized Statistical Organizations (NRSROs) at December 31, 2008. All but three of the ABSs are rated above the minimum for investment grade (BBB-/ Baa3) by the NRSROs at December 31, 2008. All ABSs have credit enhancement features including senior/subordinate structure and/or are backed 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 that carry sound credit ratings.

The amortized cost of all investments at December 31, 2008 split rated AAA/Aaa or lower by the NRSROs totaled $235.5 million (fair value of $139.8 million), which represents approximately 2.8% (and 1.7%) of total amortized cost (and fair value) of the District's total investment portfolio at December 31, 2008.

The following table shows the fair value and gross unrealized losses for investments that have been in a continuous unrealized loss position aggregated by investment category at December 31, 2008. An investment is considered impaired if its fair value is less than its cost. The continuous loss position is based on the date the impairment was first identified.

	Less than 12 Months		Greater than 12 Months	
(dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Govt. GNMA MBS/CMOs	$ 2,378,988	$ 41,030	$ 317,983	$ 16,478
U.S. Govt. Agency MBS	1,209,921	47,272	925,178	56,378
Non-Agency Securities	35,707	12,349	350,151	150,383
Asset-Backed Securities	45,753	606	111,168	45,196
Mortgage-Backed Securities	1,626	492	10,141	1,012
Other	100,338	13,501	23,248	5,838
Total	$ 3,772,333	$ 115,250	$ 1,737,869	$ 275,285

On December 31, 2008, the District held certain investments having continuous unrealized loss positions for more than 12 months with a fair value totaling $1.7 billion and an unrealized loss position totaling $275.3 million. The District performs periodic credit reviews, including other-than-temporary impairment analyses, on its investment securities portfolio. The objective is to quantify any future possible loss of principal or interest due on each security identified for additional analysis. Based on the results of all analyses, the District has recognized other-than-temporary impairment of $10.5 million in connection with one ABS in 2008, which is included in Losses on Investments in the Combined Statements of Income.

For all other investments, the District has not recognized any other-than-temporary impairment as the unrealized losses resulted primarily from reduced liquidity in the securities markets stemming from general adversity in the financial markets and full payment of principal and interest is expected. The District has the ability and intent to hold these investments until a recovery of unrealized losses occurs, which may be at maturity, and at this time expects to collect the full principal amount and interest due on these securities, especially after considering credit enhancements. All securities, including the one security that has been determined to be other-than-temporarily impaired, continue to perform. Substantially all of these investments were in U. S. government agency securities and the District expects these securities would not be settled at a price less than their amortized cost.

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

Available-for-sale

	Due in 1 year or less		Due after 1 year through 5 years		Due after 5 years through 10 years		Due after 10 years		Total	
(dollars in thousands)	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield
U.S. Govt. GNMA MBS/CMOs	$ –	–%	$ –	–%	$ 308	1.33%	$ 3,244,974	2.28%	$ 3,245,282	2.28%
U.S. Govt. Agency MBS	17	3.14	–	–	217,702	2.30	2,316,274	2.36	2,533,993	2.36
Non-Agency Securities	–	–	–	–	–	–	404,321	2.28	404,321	2.28
Commercial MBS	–	–	–	–	–	–	11,767	2.13	11,767	2.13
Asset-Backed Securities	–	–	–	–	10,711	2.63	85,253	5.14	95,964	4.86
Total fair value	$ 17	3.14%	$ –	–%	$ 228,721	2.31%	$ 6,062,589	2.35%	$ 6,291,327	2.35%
Total amortized cost	$ 18		$ –		$ 233,994		$ 6,414,857		$ 6,648,869	

Held-to-maturity

	Due in 1 year or less		Due after 1 year through 5 years		Due after 5 years through 10 years		Due after 10 years		Total	
(dollars in thousands)	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield
U.S. Govt. Agency MBS	$ –	– %	$ –	–%	$ –	–%	$ 1,510,192	5.17%	$ 1,510,192	5.17%
Asset-Backed Securities	1,693	2.56	38,084	2.83	45,436	2.95	46,664	3.37	131,877	3.06
Other	25	4.50	65,770	6.38	75,632	5.77	92,203	6.30	233,630	6.15
Total amortized cost	$ 1,718	2.59%	$ 103,854	5.08%	$ 121,068	4.71%	$ 1,649,059	5.19%	$ 1,875,699	5.15%
Total fair cost	$ 1,664		$ 104,048		$ 122,096		$ 1,679,681		$ 1,907,489	

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

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

	Year Ended December 31,		
(dollars in thousands)	2008	2007	2006
Proceeds on sales	$ –	$ 7,976	$ 54,834
Realized gains	–	1	–
Realized losses	–	–	5

Note 4 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31,		
(dollars in thousands)	2008	2007	2006
Real estate mortgage	$ 9,425,180	$ 8,792,463	$ 8,019,808
Production and intermediate-term	8,556,501	7,820,724	7,398,749
Loans to cooperatives	318,818	320,154	250,364
Processing and marketing	1,945,207	1,517,944	1,145,416
Farm-related business	492,446	481,940	392,153
Communication	247,364	122,825	74,126
Energy	241,956	199,096	198,198
Water and waste disposal	28,000	20,752	12,688
Rural residential real estate	1,682,845	1,407,501	1,152,266
Lease receivables	13,385	19,721	24,088
Loans to other financial institutions	7,150	2,220	1,760
Other	118,884	22,956	–
Total	$ 23,077,736	$ 20,728,296	$ 18,669,616

The District's concentration of credit risk is spread among various agricultural commodities. A substantial portion of the District's lending activities is collateralized and, accordingly, the credit risk associated with lending activities is considerably less than the recorded loan principal and is considered in the allowance for loan losses.

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

(dollars in thousands)	December 31, 2008	2007	2006
Impaired nonaccrual loans:			
Current as to principal and interest	$ 377,929	$ 21,219	$ 29,438
Past due	173,526	76,833	48,114
Impaired accrual loans:			
Restructured	1,040	5,508	2,619
90 days or more past due	17,387	2,946	7,418
Total impaired loans	$ 569,882	$ 106,506	$ 87,589

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

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

(dollars in thousands)	Year Ended December 31, 2008	2007	2006
Interest income recognized on impaired nonaccrual loans	$ 4,930	$ 6,520	$ 12,012
Interest income on impaired accrual loans	1,214	901	529
Interest income recognized on impaired loans	$ 6,144	$ 7,421	$ 12,541

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

(dollars in thousands)	Year Ended December 31, 2008	2007	2006
Interest income which would have been recognized under the original loan terms	$ 22,346	$ 12,992	$ 17,826
Less: interest income recognized	5,243	6,920	12,178
Foregone interest income	$ 17,103	$ 6,072	$ 5,648

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

(dollars in thousands)	Year Ended December 31, 2008	2007	2006
Balance at beginning of year	$ 78,874	$ 71,915	$ 87,551
Provision for (reversal of allowance for) loan losses	121,023	8,284	(717)
Loans charged off	(31,985)	(3,507)	(15,913)
Recoveries	1,178	2,182	994
Balance at end of year	$ 169,090	$ 78,874	$ 71,915

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

(dollars in thousands)	2008	2007	2006
Impaired loans with related allowance	$ 192,120	$ 34,606	$ 18,169
Impaired loans with no related allowance	377,762	71,900	69,420
Total impaired loans	$ 569,882	$ 106,506	$ 87,589
Average impaired loans	$ 220,677	$ 86,026	$ 78,835
Allowance on impaired loans	$ 80,238	$ 2,605	$ 6,194

To mitigate the risk of loan losses, District institutions have entered into Long-Term Standby Commitments to Purchase agreements with the Federal Agricultural Mortgage Corporation (Farmer Mac). The agreements, which are effectively credit guarantees that will remain in place until the loans are paid in full, give the Bank or Association the right to sell the loans identified in the agreements for "par" to Farmer Mac in the event of default, subject to certain restrictions.. The balance of loans under Long-Term Standby Commitments to Purchase was $1.51 billion, $1.26 billion, and $953.8 million at December 31, 2008, 2007, and 2006, respectively. Fees paid to Farmer Mac for such commitments totaled $2.0 million, $1.8 million, and $1.9 million for the years ended December 31, 2008, 2007, and 2006, respectively. Fees paid to government sponsored enterprises (GSEs) other than Farmer Mac were $2.1 million, $1.5 million, and $1.0 million for 2008, 2007, and 2006, 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, 2008, eleven District Associations held investments in Tobacco Buyout SIICs of $410.2 million.

Note 6 — Premises and Equipment

Premises and equipment consisted of the following:

(dollars in thousands)	December 31, 2008	2007	2006
Land	$ 24,432	$ 23,682	$ 21,939
Buildings and improvements	106,938	98,822	92,799
Furniture and equipment	114,807	107,188	102,257
Work in progress	3,577	5,546	3,685
	249,754	235,238	220,680
Less: accumulated depreciation	122,904	112,226	100,557
Total	$ 126,850	$ 123,012	$ 120,123

Note 7 — Other Assets and Other Liabilities

A summary of other assets and other liabilities follows:

(dollars in thousands)	December 31, 2008	2007	2006
Other assets:			
Prepaid pension costs	$ –	$ –	$ 121,114
Derivative assets	124,982	33,187	3,615
Unamortized debt issue costs	20,647	18,637	15,098
Deferred preferred stock costs	662	940	2,017
Third party subservicer receivable	19,179	12,567	8,495
Prepaid expenses	3,733	2,051	3,282
Other	43,485	45,256	53,246
Total	$ 212,688	$ 112,638	$ 206,867
Other liabilities:			
Accounts payable	$ 23,002	$ 22,659	$ 21,859
Derivative liabilities	469	2,560	23,514
Farm Credit System Ins. Corp. payable	35,197	28,211	24,613
Bank draft payable	44,708	56,799	66,774
Payroll	20,624	22,601	21,474
Short-term funds held	17,785	–	–
Other	17,615	18,286	14,911
Total	$ 159,400	$ 151,116	$ 173,145

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, 2008, AgFirst was in compliance with the conditions of participation for the issuances of Systemwide Debt Securities.

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

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

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

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

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

	Bonds		Discount Notes		Total	
Maturities	Amortized Cost	Weighted Average Interest Rate	Amortized Cost	Weighted Average Interest Rate	Amortized Cost	Weighted Average Interest Rate
			(dollars in thousands)			
2009	$ 7,620,912	1.91%	$ 6,024,896	1.42%	$ 13,645,808	1.69%
2010	4,033,986	2.57	–	–	4,033,986	2.57
2011	2,663,407	3.57	–	–	2,663,407	3.57
2012	673,468	4.11	–	–	673,468	4.11
2013	1,991,002	4.21	–	–	1,991,002	4.21
2014 and after	5,045,352	4.99	–	–	5,045,352	4.99
Total	$ 22,028,127	3.21%	$ 6,024,896	1.42%	$ 28,053,023	2.83%

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, 2008, was 159 days.

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

Amortized Cost	First Call Date	Year of Maturity
(dollars in thousands)		
$ 11,112,998	2009	2009 – 2023
57,000	2010	2012 – 2023
25,000	2011	2013 – 2016
10,000	2012	2017
10,000	2013	2018
$ 11,214,998	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, 2008 the assets of the Insurance Fund aggregated $2.92 billion; however, due to the other authorized uses of the Insurance Fund there is no assurance that any available amount in the Insurance Fund will be sufficient to fund the timely payment of principal or interest on an insured debt obligation in the event of a default by any System bank having primary liability thereon.

In 2008, the Bank sold a total of $200 million of participations in its direct note receivable from a District Association to another System Bank. The $200 million note payable at December 31, 2008 is included in Bonds and Notes in the Combined Balance Sheets and bears interest at an annual variable rate of one month LIBOR plus 47 basis points with maturity on December 31, 2010.

Note 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 DistrictAssociations to retire such capital at par or stated value regardless of its book value. Protected borrower equity includes capital stock, participation certificates, and allocated equities which were outstanding as of January 6, 1988, or were issued or allocated prior to October 6, 1988. If a Bank or an Association is unable to retire protected borrower stock at par value or stated value, amounts required to retire this stock would be obtained from the Insurance Fund.

B. **Perpetual Preferred Stock:** On October 14, 2003, AgFirst issued $150.0 million of Perpetual Non-Cumulative Preferred Stock at a par value of $1 thousand per share. Dividends on the stock are non-cumulative and payable on the 15th day of June and December in each year, commencing December 15, 2003, at an annual rate equal to 7.30 percent. In the event dividends are not declared on the preferred stock for payment on any dividend payment date, then such dividends shall not cumulate and shall cease to accrue and be payable. On or after the dividend payment date in December 2008, AgFirst may, at its option, redeem the preferred stock in whole or in part at any time at the redemption price of $1 thousand per share plus accrued and unpaid dividends for the then current dividend period to the date of redemption.

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

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

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

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

District Associations:

The District Associations are generally authorized to issue or have outstanding Preferred stock, Common stock, Participation Certificates, and such other classes of equity as may be provided for in amendments to the bylaws in such amounts as may be necessary to conduct business. All classes of stock and participation certificates have a par or face value of five dollars ($5.00) per share.

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

		Shares Outstanding (dollars in thousands)	
Class	**Protected Status**	**Number**	**Aggregate Par Value**
Common Nonvoting	Yes	903,400	$ 4,517
Common Voting	No	17,681,400	88,407
Participation Certificates	Yes	30,600	153
Participation Certificates	No	1,552,400	7,762
Preferred	No	4,871,400	24,357
Total Association Capital Stock, Participation Certificates and Protected Borrower Equity		25,039,200	$ 125,196

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, 2008, combined allocated retained earnings consisted of $189.9 million of qualified surplus, $468.4 million of nonqualified allocated surplus and $468.7 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, 2008, 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' operations and Combined Financial Statements. AgFirst and District Associations are prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless the prescribed capital standard is met. FCA regulations also require all System institutions to achieve and maintain additional ratios as defined by FCA regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of seven percent and core surplus as a percentage of risk-adjusted assets of three and one-half percent.

AgFirst's capital adequacy is also evaluated using a ratio of net collateral to total liabilities. Subsequent to the issuance of the mandatorily redeemable preferred stock, FCA now requires AgFirst to maintain a minimum net collateral ratio of 104.00 percent compared to the regulatory minimum of 103.00 percent. At December 31, 2008, AgFirst's net collateral ratio was 105.56 percent. For purposes of calculating this ratio, net collateral is not risk adjusted.

All twenty-two District Associations 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, 2008.

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

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

(dollars in thousands)	2008	2007	2006
Unrealized (losses) gains on investments available-for-sale	$ (357,542)	$ (37,798)	$ 1,982
Minimum pension liability adjustment	–	–	(359)
Employee benefit plan adjustments	(373,249)	(115,790)	–
Total accumulated other comprehensive income (loss)	$ (730,791)	$ (153,588)	$ 1,623

Note 11 — Income Taxes

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

	Year Ended December 31,		
(dollars in thousands)	2008	2007	2006
Current:			
Federal	$ (162)	$ 964	$ (1,329)
State	215	(710)	154
	53	254	(1,175)
Deferred:			
Federal	133	156	1,260
State	(121)	2	211
	12	158	1,471
Total provision (benefit) for income taxes	$ 65	$ 412	$ 296

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

	Year Ended December 31,		
(dollars in thousands)	2008	2007	2006
Federal tax at statutory rate	$ 123,619	$ 138,501	$ 139,592
State tax, net	185	3	227
Tax-exempt FLCA earnings	(62,872)	(84,761)	(71,937)
Association patronage distributions	(42,934)	(53,081)	(49,284)
Nontaxable Bank income	(20,282)	(7,269)	(19,413)
Change in valuation allowance	4,340	11,692	(1,397)
Other	(1,991)	(4,673)	2,508
Provision for income taxes	$ 65	$ 412	$ 296

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

	December 31,		
(dollars in thousands)	2008	2007	2006
Allowance for loan losses	$ 19,662	$ 16,119	$ 14,763
Nonaccrual loan interest	4,690	2,695	3,645
Postretirement benefits other Than pensions	19,566	17,561	11,549
Nonqualified patronage distributions	–	97	97
Loss carryforwards	11,684	8,954	3,300
Other	2,787	1,285	2,428
Gross deferred tax asset	58,389	46,711	35,782
Less: valuation allowance	(36,030)	(26,711)	(15,613)
Gross deferred tax assets, net of valuation allowance	22,359	20,000	20,169
Bank patronage	(4,112)	(4,571)	(5,658)
Pensions	(15,581)	(10,492)	(11,195)
Depreciation	(323)	(301)	(356)
Other	(2,350)	(4,631)	(2,797)
Gross deferred tax liability	(22,366)	(19,995)	(20,006)
Net deferred tax (liability) asset	$ (7)	$ 5	$ 163

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, 2008, deferred income taxes have not been provided by District Associations on approximately $125.1 million of patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

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

Note 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 $30.8 million, $759 thousand, and $765 thousand into these retirement plans for each of the three years ended December 31, 2008, 2007, and 2006, respectively. The expenses of these retirement plans included in salaries and employee benefits were $10.8 million for 2008, $16.9 million for 2007, and $21.2 million for 2006.

In addition to providing pension benefits, the Bank and District Associations provide certain health care and life insurance benefits for eligible retired employees (other postretirement benefits) through two other postretirement benefit plans. Life insurance benefits are no longer provided to previously eligible employees who retired subsequent to December 1, 2007. The first plan covers most employees of twenty-two Associations and AgFirst. Under this plan, employees hired after December 31, 2002, and employees who separate from service between age 50 and age 55, are required to pay the full cost of their retiree health insurance coverage. The second plan covers employees of a single ACA. Substantially all employees may become eligible for the benefits if they reach early retirement age, as defined by the plans, while working for the Bank or District Associations. The plans are unfunded with expenses paid as incurred. Postretirement benefits other than pensions included in salaries and employee benefits were $7.8 million for 2008, $8.7 million for 2007, and $9.3 million for 2006.

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 $5.7 million, $5.3 million, and $4.7 million for the years ended December 31, 2008, 2007, and 2006, respectively.

AgFirst and certain District Associations individually sponsor defined benefit and defined contribution supplemental retirement plans and offer deferred compensation plans for certain key compensated employees. These plans are nonqualified; therefore, the associated liabilities are included in the District's combined balance sheets in other liabilities. The District entities funded $489 thousand for the year ended December 31, 2008, and $436 thousand for the years ended December 31, 2007 and 2006 into these supplemental retirement plans. The expenses of these supplemental plans included in the District's retirement costs were $1.6 million, $662 thousand, and $603 thousand for the years ended December 31, 2008, 2007, and 2006, respectively.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (SFAS No. 158), which required the recognition of the overfunded or underfunded status of defined benefit pension and other postretirement benefit plans on the balance sheet. On December 31, 2007, the District adopted the balance sheet recognition provisions of 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. The adoption of SFAS No. 158 is reflected as an adjustment to AOCI of $115.5 million in the District's Combined Statement of Changes in Shareholders' equity at December 31, 2007.

SFAS No. 158 also requires that employers measure the benefit obligation and plan assets as of the fiscal year end for fiscal years ending after December 15, 2008. In fiscal 2007 and earlier, a September 30 measurement date was used for pension and other postretirement benefit plans. The Standard provides two approaches for an employer to transition to a fiscal year end measurement date. The approach applied by the District allows for the use of the measurements determined for the prior year end. Under this alternative, pension and other postretirement benefit expense measured for the three-month period October 1, 2007 to December 31, 2007 (determined using the September 30, 2007 measurement date) is reflected as an adjustment to beginning 2008 unallocated retained earnings. As a result, the District decreased unallocated retained earnings and increased the pension liability by $5.0 million.

Upon adoption, SFAS No. 158 further required the determination of the fair value of plan assets and recognition of actuarial gains and losses, prior service costs or credits, and transition assets or obligations as a component of accumulated other comprehensive income (AOCI). These amounts are subsequently recognized as components of net periodic benefit costs over time. For 2008, $257.5 million has been recognized as a net debit to AOCI to reflect these elements.

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

(dollars in thousands)	Pension Benefits 2008	2007	2006
Change in projected benefit obligation			
Projected benefit obligation at beginning of Year	$ 525,810	$ 516,455	$ 531,010
Service cost	18,503	14,747	16,332
Interest cost	41,423	30,298	27,340
Actuarial loss (gain)	59,104	(13,473)	(42,575)
Benefits paid	(35,349)	(23,944)	(21,802)
Other	(32)	1,727	6,150
Projected benefit obligation at end of year	$ 609,459	$ 525,810	$ 516,455
Change in plan assets			
Fair value of plan assets at beginning of year	$ 511,269	$ 465,914	$ 444,381
Actual return on plan assets	(147,083)	68,398	42,453
Employer contributions	31,451	1,195	1,201
Transfers	(506)	(295)	(319)
Benefits and premiums paid	(35,349)	(23,944)	(21,802)
Fair value of plan assets at end of year	$ 359,782	$ 511,268	$ 465,914
Reconciliation of funded status			
Funded Status	$ (249,677)	$ (14,541)	$ (50,541)
Unrecognized net actuarial loss (gain)	–	–	152,058
Unamortized prior service cost	–	–	13,941
Unrecognized net transition (asset) or obligation	–	–	(241)
Net amount recognized – September 30	(249,677)	(14,541)	115,217
Fourth quarter contributions	–	109	–
Net amount recognized – December 31	$ (249,677)	$ (14,432)	$ 115,217
Amounts recognized consist of:			
Noncurrent assets	$ –	$ –	
Current liabilities	(482)	(475)	
Noncurrent liabilities	(249,195)	(13,957)	
Net amount recognized	$ (249,677)	$ (14,432)	

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

(dollars in thousands)	Pension Benefits 2008	2007
Net actuarial loss (gain)	$ 352,951	98,398
Prior service costs (credit)	11,375	14,032
Net transition obligation (asset)	–	(12)
Total amount recognized in AOCI	$ 364,326	112,958

The accumulated benefit obligation for all defined benefit pension plans was $527,427 at December 31, 2008 and $453,857 and $442,707 at September 30, 2007, and 2006, respectively.

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

(dollars in thousands)	Pension Benefits 2008	2007	2006
Aggregate PBO > FV plan assets			
Projected benefit obligation	$ 609,459	$ 525,810	$ 516,455
Fair value of plan assets	359,783	511,268	465,914
Aggregate ABO > FV plan assets			
Accumulated benefit obligation	$ 527,427	$ 7,069	$ 6,293
Fair value of plan assets	359,897	–	–

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 2008	2007	2006
Components of net periodic benefit (income) cost			
Service cost	$ 14,803	$ 14,747	$ 16,332
Interest cost	33,141	30,298	27,340
Expected return on plan assets	(42,320)	(38,440)	(36,737)
Amortization of net (gain) loss	(12)	(338)	(338)
Amortization of prior service cost	2,163	1,664	1,261
Recognized net actuarial (gain) loss	4,682	9,645	14,008
Other	–	(28)	(78)
Net periodic benefit cost	$ 12,457	$ 17,548	$ 21,788
Adjustment to retained earnings for 2008 due to change in measurement date	$ 3,064		
Other changes in plan assets and projected benefit obligation recognized in OCI			
Net actuarial loss (gain)	$ 259,528		
Amortization of net actuarial loss (gain)	(5,852)		
Prior service cost (credit)	–		
Amortization of prior service cost	(2,657)		
Amortization of transition obligation (asset)	11		
Net periodic benefit cost	$ 251,030		
Total recognized in net periodic pension cost and OCI	$ 266,551		

The estimated net loss and prior service cost for the defined benefit pension plans that will be amortized from accumulated other comprehensive income into net periodic benefit cost during 2009 are $24.9 million and $1.8 million, respectively.

(dollars in thousands)	Pension Benefits 2008	2007	2006
Increase/(Decrease) in minimum liability included in other comprehensive income	$ –	$ (21)	$ (47)

Weighted average assumptions used to determine benefit obligations at December 31, 2008 and September 30, 2007 and 2006:

	Pension Benefits 2008	2007	2006
Discount rate	6.26%	6.45%	6.00%
Rate of compensation increase	5.33%	4.42%	4.44%

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

	Pension Benefits 2008	2007	2006
Discount rate	6.45%	6.00%	5.25%
Expected long-term return on plan assets	8.46%	8.46%	8.46%
Rate of compensation increase	4.46%	4.50%	4.50%

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

Plan Assets

Plan assets are invested 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 December 31 are as follows:

PLAN ASSETS	2008	2007	2006
Allowable Asset Category			
Equity securities	61.4%	65.3%	64.4%
Debt securities	30.4	29.4	30.3
Real Estate	7.1	4.9	4.6
Other	1.1	0.4	0.7
Total	100.0%	100.0%	100.0%

Target allocation for allowable asset categories for 2009 are as follows:

Allowable Asset Category	
Equity securities	62.8% –67.3%
Debt securities	28.2% –32.7%
Real Estate	2.7% –6.4%

The total District expects to contribute $61.9 million to the various pension plans in 2009.

Estimated Future Benefit Payments

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

	Pension Benefits
2009	$ 30,541
2010	31,399
2011	33,583
2012	37,205
2012	39,732
Years 2014 — 2018	238,380

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

(dollars in thousands)	Other Postretirement Benefits 2008	2007	2006
Change in benefit obligation			
Benefit obligation at beginning of year	$ 114,511	$ 119,245	$ 126,048
Service cost	2,938	2,364	2,681
Interest cost	9,029	6,997	6,484
Plan participants' contributions	1,174	789	880
Actuarial loss (gain)	4,212	(9,244)	(11,812)
Benefits paid	(7,184)	(5,640)	(5,390)
Plan amendments/other	–	–	354
Benefit obligation at end of year	$ 124,680	$ 114,511	$ 119,245
Change in plan assets			
Fair value of plan assets at beginning of year	$ –	$ –	$ –
Actual return on plan assets	–	–	–
Plan participants' contributions	1,173	789	880
Employer contributions	6,011	4,851	4,510
Benefits and premiums paid	(7,184)	(5,640)	(5,390)
Fair value of plan assets at end of year	$ –	$ –	$ –
Reconciliation of funded status			
Funded status	$ (124,679)	$ (114,511)	$ (119,245)
Unrecognized net actuarial loss (gain)	–	–	32,387
Unrecognized prior service cost	–	–	(21,540)
Net amount recognized – September 30			(108,398)
Fourth quarter contributions	–	1,032	1,220
Net other postretirement liability	$ (124,679)	$ (113,479)	$ (107,178)
Amounts recognized consist of:			
Current liabilities	$ (6,075)	$ (5,637)	
Noncurrent liabilities	(118,604)	(107,842)	
Net amount recognized	$ (124,679)	$ (113,479)	

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

(dollars in thousands)	Other Postretirement Benefits 2008	2007
Net actuarial loss (gain)	$ 24,035	21,047
Prior service costs (credit)	(15,270)	(18,753)
Net transition obligation (asset)	158	200
Total amount recognized in AOCI	$ 8,923	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:

(dollars in thousands)	Other Postretirement Benefits 2008	2007	2006
Service cost	$ 2,350	$ 2,364	$ 2,681
Interest cost	7,223	6,997	6,484
Net amortization and deferral	(1,774)	(657)	87
Net periodic benefit (income) cost	$ 7,799	$ 8,704	$ 9,252
Adjustment to retained earnings for 2008 due to change in measurement date	$ 1,949		
Other changes in plan assets and projected benefit obligation recognized in OCI			
Net actuarial loss (gain)	4,212		
Amortization of net actuarial loss (gain)	(1,224)		
Prior service cost (credit)	–		
Amortization of prior service cost	3,484		
Amortization of transition obligation (asset)	(42)		
Net periodic benefit cost	$ 6,430		
Total recognized in expenses and OCI	$ 16,178		

The estimated prior service credit for the other postretirement benefit plans that will be amortized from accumulated other comprehensive income into periodic benefit cost during 2009 is $8.9 million.

Weighted average assumptions used to determine benefit obligations at December 31, 2008 and September 30, 2007 and 2006:

	Other Postretirement Benefits 2008	2007	2006
Discount rate	6.25%	6.45%	6.00%

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

	Other Postretirement Benefits 2008	2007	2006
Discount rate	6.45%	6.00%	5.25%

For measurement purposes, annual rates of increase of 6.50 percent through 8.50 percent in the per capita cost of covered health benefits were assumed for 2009. The rates were assumed to step down to 5.0 percent in 2015, and remain at that level thereafter.

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

(dollars in thousands)	1 Percentage Point Increase	1 Percentage Point Decrease
Effect on total of service and interest cost	$ 1,588	$ (1,294)
Effect on postretirement benefit obligation	17,443	(14,421)

The District expects to contribute $6.3 million to their other post retirement benefit plans in 2009.

Estimated Future Benefit Payments

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

	Other Postretirement Benefits
2009	$ 6,277
2010	6,803
2011	7,341
2012	7,708
2013	8,045
Years 2014 — 2018	44,628

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, 2008 reflects the impact of this plan amendment.

Note 13 — Related Party Transactions

In the ordinary course of business, the District enters into loan transactions with officers and directors of AgFirst or Associations, their immediate families and other organizations with which such persons may be affiliated. Such loans are subject to special approval requirements contained in the FCA regulations and were made on the same terms, including interest rates, amortization schedule, and collateral, as those prevailing at the time for comparable transactions with unaffiliated persons.

Total loans to such persons at December 31, 2008, amounted to $283.5 million, as compared with $241.3 million and $232.9 million for the years ended December 31, 2007 and 2006, respectively. During 2008, 2007, and 2006, $210.8 million, $158.2 million, and $150.8 million of new loans were made and repayments totaled $168.6 million, $149.7 million, and $175.4 million, respectively. In the opinion of management, no material amounts outstanding at December 31, 2008, involved more than a normal risk of collectibility.

Note 14 — Regulatory Enforcement Matters

At December 31, 2008, there were no regulatory enforcement matters or agreements in place with the FCA.

Note 15 — Commitments and Contingencies

The District has various contingent liabilities and commitments outstanding as discussed elsewhere in these notes to Combined Financial Statements. While primarily liable for its portion of System bonds and notes, AgFirst is jointly and severally liable for the bonds and notes of the other System banks. The total bonds and notes of the System at December 31, 2008 were $178.37 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, 2008, the Bank had outstanding $190.3 million of standby letters of credit issued on behalf of District and non-district customers, with expiration dates ranging from January 2008 to October 2018. The maximum potential amount of future payments the Bank may be required to make under these existing guarantees is $190.3 million.

A guarantor is required to recognize at the inception of a guarantee, a liability for the fair value of the guarantee commitment. The District has determined the fair value of the guarantee commitment based upon the fees to be earned over the life of the guarantee. The fair value is updated periodically to reflect changes in individual guarantee amounts and the remaining life to maturity of the individual guarantees in the District's inventory. At December 31, 2008, the District's inventory of standby letters of credit had a fair value of $5.3 million and was included in other liabilities.

The Bank also guarantees certain loans held by District Associations in the amount of $7.3 million expiring in less than one year and $13.0 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, 2008.

At December 31, 2008, $9.08 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, 2008, AgFirst also indemnifies leases in the amount of $732 thousand on behalf of Farm Credit Leasing Services Corporation (FCLSC) with lease terms expiring in 2009.

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

Note 16 — Fair Value Measurement

As described in Note 2, the District adopted SFAS No. 157 effective January 1, 2008 which expanded the District's fair value disclosure for certain assets and liabilities measured at fair value on a recurring and non-recurring basis. These assets and liabilities primarily consist of investments available-for-sale, highly-liquid funds, derivative assets and liabilities, assets held in trust funds, standby letters of credit, and impaired loans.

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

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

Level 1

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

The District's Level 1 assets at December 31, 2008 consist of assets held in trust funds related to deferred compensation and supplemental retirement plans. The trust funds include investments in securities that are actively traded and have quoted net asset value prices that are directly observable in the marketplace.

Level 2

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

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

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

The District's Level 2 assets and liabilities at December 31, 2008 include derivative contracts and investment securities in U.S. government and agency mortgage-backed securities, non-agency mortgage-backed securities, and U.S. agency debt securities, all of which have unadjusted values from third-party or internal pricing models. Level 2 assets also include federal funds sold, securities purchased under resale agreements and other highly-liquid funds, all of which are non-exchange-traded instruments. The market value of these federal funds sold and other instruments is generally their face value, plus accrued interest, as these instruments are highly-liquid, readily convertible to cash, and short-term in nature.

Level 3

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

Level 3 assets at December 31, 2008 include impaired loans which represent the fair value of certain loans that were evaluated for impairment under SFAS No. 114. The fair value was based upon the underlying collateral since these were collateral-dependent loans. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the collateral, less estimated costs to sell, is less than the principle balance of the loan, a specific reserve is established.

Level 3 assets at December 31, 2008 also include the District's mortgage-related asset-backed investment portfolio. Based on the currently illiquid marketplace for mortgage-related asset-backed investments and the lack of marketplace information available as inputs and assumptions to the valuation process, the District classified the mortgage-related asset-backed investment portfolio as Level 3 assets. The fair value measurement of these assets involved management's judgment and was based on multiple factors including information obtained from third-party valuation services using both level 2 and level 3 inputs.

Level 3 liabilities at December 31, 2008 include standby letters of credit whose market value is internally calculated based on information that is not observable either directly or indirectly in the marketplace.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents the assets and liabilities that are measured at fair value on a recurring basis at December 31, 2008 for each of the fair value hierarchy levels:

	December 31, 2008			
	Level 1	Level 2	Level 3	Total Fair Value
Assets:				
Investments available-for-sale	$ -	$ 6,183,596	$ 79,961	$ 6,263,557
Federal funds sold, securities purchased under resale agreements, and other	-	187,630	-	187,630
Interest rate swaps and other financial instruments	-	124,982	-	124,982
Assets held in trust funds	7,919	-	-	7,919
Total Assets	$ 7,919	$ 6,496,208	$ 79,961	$ 6,584,088
Liabilities:				
Interest rate swaps and other financial instruments	$ -	$ 469	$ -	$ 469
Standby letters of credit	-	-	5,262	5,262
Total Liabilities	$ -	$ 469	$ 5,262	$ 5,731

The following table presents the changes in Level 3 assets and liabilities measured at fair value on a recurring basis. The total loss of $10,465 is included in earnings as a Loss on Investments in the Combined Statements of Income.

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

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

Assets and liabilities measured at fair value on a non-recurring basis at December 31, 2008 for each of the fair value hierarchy values are summarized below:

	December 31, 2008				
	Level 1	Level 2	Level 3	Total Fair Value	Total Gains (Losses)
Assets:					
Impaired loans	$ -	$ -	$ 111,882	$ 111,882	$ (80,238)

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, 2008, 2007 and 2006.

Quoted market prices are generally not available for certain Systemwide financial instruments, as described below. Accordingly, fair values are based on judgments regarding anticipated cash flows, future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

	December 31, 2008		December 31, 2007		December 31, 2006	
(dollars in thousands)	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:						
Loans, net of allowance	$ 22,908,646	$ 23,345,531	$ 20,649,422	$ 20,908,947	$ 18,597,701	$ 18,623,539
Derivative assets	$ 124,982	$ 124,982	$ 33,187	$ 33,187	$ 3,615	$ 3,615
Cash & cash equivalents	$ 316,010	$ 316,010	$ 612,841	$ 612,841	$ 651,268	$ 651,268
Investment securities	$ 8,167,026	$ 8,198,816	$ 7,060,801	$ 7,038,445	$ 6,492,102	$ 6,458,120
Other investments	$ 410,249	$ 429,791	$ 430,812	$ 435,361	$ 428,005	$ 420,512
Assets held in trust funds	$ 7,919	$ 7,919	$ 10,626	$ 10,626	$ 9,104	$ 9,104
Financial liabilities:						
Bonds and notes	$ 28,253,023	$ 28,462,808	$ 24,847,248	$ 24,908,245	$ 22,613,379	$ 22,531,191
Derivative liabilities	$ 469	$ 469	$ 2,560	$ 2,560	$ 23,514	$ 23,514

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

A. **Loans:** Because no active market exists for the District's loans, fair value is estimated by discounting the expected future cash flows using the District's current interest rates at which similar loans would be made to borrowers with similar credit risk.

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

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

C. **Investment Securities:** Fair value is primarily based upon prices obtained from a third party valuation service. See additional information in Note 16.

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

E. **Bonds and Notes:** Systemwide bonds and notes are not regularly traded; thus, quoted market prices are not available. Fair value of these instruments is estimated by discounting expected future cash flows based on the quoted market price of similar maturity Treasury notes, assuming a constant estimated 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. See additional information in Note 16.

G. **Assets Held in Trust Funds:** See Note 16 for discussion of estimation of fair value for this instrument.

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 lower cost of funding or to reduce interest rate risk. 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 its floating-rate assets.

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 $125.0 million with ten counterparties represents approximately 5.62 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, 2008, the District had not posted collateral with respect to these arrangements but has required on counterparty to post a total of $8.0 million in interest bearing cash collateral.

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, 2008 *(dollars in millions)*	Maturities of 2008 Derivative Products and Other Financial Instruments 2009	2010	2011	2012	2013	2014 and after	Total	Fair Value
Bonds and Notes:								
Fixed rate	$ 8,835	$ 3,292	$ 2,625	$ 666	$ 1,986	$ 4,996	$ 22,400	$ 22,703
Weighted average interest rate	2.14%	2.91%	3.61%	4.14%	4.22%	5.04%	3.32%	
Variable rate	4,811	942	38	8	5	49	5,853	5,760
Weighted average interest rate	0.87%	1.35%	0.71%	0.82%	1.86%	0.64%	0.94%	
Derivative Instruments:								
Receive fixed swaps								
Notional value	$ 750	$ 488	$ 600	$ 75	$ 60	$ 250	$ 2,223	$ 125
Weighted average receive rate	4.17%	4.20%	4.10%	4.62%	3.99%	5.07%	4.27%	
Weighted average pay rate	1.21%	1.90%	2.19%	2.54%	2.69%	2.94%	1.90%	
Total notional value	$ 750	$ 488	$ 600	$ 75	$ 60	$ 250	$ 2,223	$ 125
Total weighted average rates on swaps:								
Receive rate	4.17%	4.20%	4.10%	4.62%	3.99%	5.07%	4.27%	
Pay rate	1.21%	1.90%	2.19%	2.54%	2.69%	2.94%	1.90%	

Note 20 — Quarterly Financial Information (Unaudited)

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

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

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

	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

Note 21 — Bank Only Financial Data

Condensed financial information of the Bank follows:

Balance Sheet

(dollars in thousands)	December 31, 2008	2007	2006
Cash, cash equivalents and investment securities	$ 8,270,160	$ 7,467,567	$ 6,941,446
Loans			
To District Associations	14,997,151	14,602,548	13,877,141
To others	6,242,179	4,511,969	3,275,196
Total loans	21,239,330	19,114,517	17,152,337
Less: allowance for loan losses	44,565	2,816	463
Net loans	21,194,765	19,111,701	17,151,874
Other assets	446,126	347,353	318,844
Total assets	$ 29,911,051	$ 26,926,621	$ 24,412,164
Bonds and notes	$ 28,053,023	$ 24,847,248	$ 22,613,379
Mandatorily redeemable preferred stock	225,000	225,000	225,000
Other liabilities	391,936	396,892	392,698
Total liabilities	28,669,959	25,469,140	23,231,077
Perpetual preferred stock	400,000	400,000	150,000
Capital stock and participation certificates	434,929	364,759	313,353
Retained earnings	763,355	731,429	715,753
Accumulated other comprehensive income (loss)	(357,192)	(38,707)	1,981
Total shareholders' equity	1,241,091	1,457,481	1,181,087
Total liabilities and shareholders' equity	$ 29,911,051	$ 26,926,621	$ 24,412,164

Statement of Income

(dollars in thousands)	Year Ended December 31, 2008	2007	2006
Interest income	$ 1,333,509	$ 1,469,034	$ 1,222,948
Interest expense	966,988	1,208,156	995,436
Net interest income	366,521	260,878	227,512
Provision for (reversal of) loan losses	43,342	2,481	(7,337)
Net interest income after provision for loan losses	323,179	258,397	234,849
Noninterest income	4,874	13,823	19,298
Noninterest expenses			
Salaries and employee benefits	30,655	28,853	26,318
Occupancy and equipment	14,957	13,060	11,608
Insurance Fund premium	12,153	5,623	3,597
Other operating expenses	22,174	18,776	17,529
Called debt expense	26,652	10,550	2,563
Corresponding lending servicing expense	4,017	2,071	1,656
Other noninterest expenses	278	1,078	683
Total noninterest expenses	110,886	80,011	63,954
Net income	$ 217,167	$ 192,209	$ 190,193

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