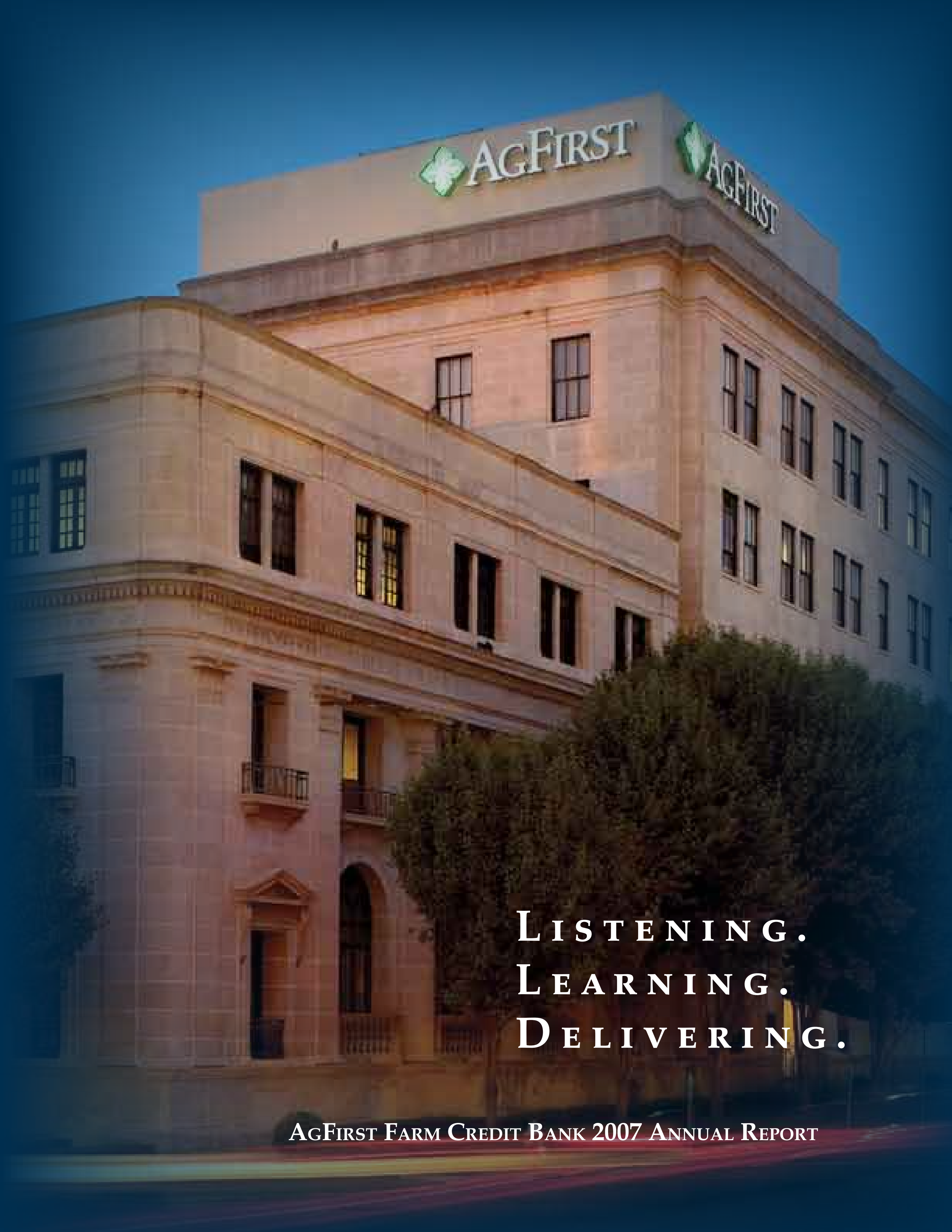


LISTENING.
LEARNING.
DELIVERING.

AGFIRST FARM CREDIT BANK 2007 ANNUAL REPORT

Building on a Dynamic Dialogue

Dialogue. It may be the most important aspect of successful business-to-business relationships. Listen, and customers will tell you what they need. Ask, and they will tell you what you need to know. Respond, and they will tell others how well you know your business.

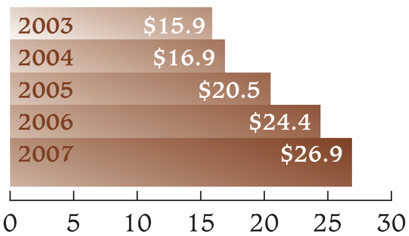
Our mission is to enable our associations to be the lender of choice to rural America. To do that, we must build a dynamic and productive dialogue with them. We know that our associations know their business needs best. So, before we lend a hand, we lend an ear.

Contents

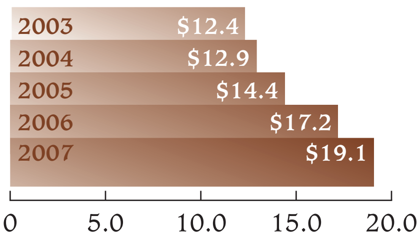
Five-Year Summary of Selected Consolidated Financial Data

(dollars in thousands)	2007	2006	2005	2004	2003
	As of or for the year ended December 31,				
Consolidated Balance Sheet Data					
Cash and cash equivalents	$ 558,770	$ 582,764	$ 557,882	$ 470,258	$ 469,945
Investment securities	6,908,797	6,358,682	5,255,745	3,278,414	2,832,716
Loans	19,114,517	17,152,337	14,411,050	12,908,249	12,375,351
Less: allowance for loan losses	2,816	463	10,114	14,800	34,168
Net loans	19,111,701	17,151,874	14,400,936	12,893,449	12,341,183
Other assets	347,353	318,844	268,468	245,402	235,704
Total assets	$26,926,621	$24,412,164	$20,483,031	$16,887,523	$15,879,548
Obligations with maturities of one year or less	$11,353,878	$10,005,004	$7,613,499	$6,533,020	$6,384,790
Obligations with maturities greater than one year	13,890,262	13,001,073	11,607,104	9,105,207	8,315,226
Mandatorily redeemable preferred stock	225,000	225,000	225,000	225,000	225,000
Total liabilities	25,469,140	23,231,077	19,445,603	15,863,227	14,925,016
Perpetual preferred stock	400,000	150,000	150,000	150,000	150,000
Capital stock and participation certificates	364,759	313,353	224,554	226,200	229,083
Retained earnings	731,429	715,753	665,445	644,366	601,699
Accumulated other comprehensive income (loss)	(38,707)	1,981	(2,571)	3,730	(26,250)
Total shareholders' equity	1,457,481	1,181,087	1,037,428	1,024,296	954,532
Total liabilities and shareholders' equity	$26,926,621	$24,412,164	$20,483,031	$16,887,523	$15,879,548

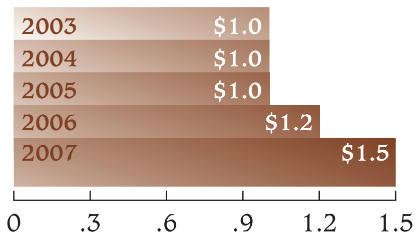
Total Assets
(in billions)



Loans
(in billions)

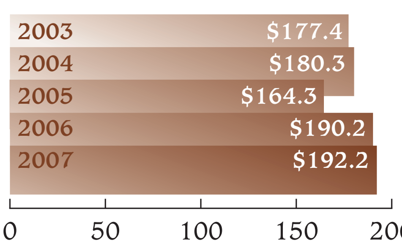


Total Shareholders' Equity
(in billions)

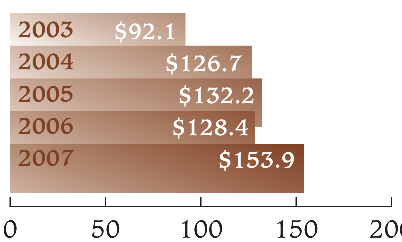


(dollars in thousands)	As of or for the year ended December 31, 2007	2006	2005	2004	2003
Consolidated Statement of Income Data					
Net interest income	$ 260,878	$ 227,512	$ 204,201	$ 211,595	$ 244,057
Provision for (reversal of allowance for) loan losses	2,481	(7,337)	(4,995)	(15,292)	2,500
Noninterest income (expense), net	(66,188)	(44,656)	(44,937)	(46,581)	(64,108)
Net income	$ 192,209	$ 190,193	$ 164,259	$ 180,306	$ 177,449
Consolidated Key Financial Ratios					
Rate of return on average:					
Total assets	0.76%	0.86%	0.91%	1.11%	1.17%
Total shareholders' equity	13.58%	16.74%	14.95%	17.16%	20.37%
Net interest income as a percentage of average earning assets	1.04%	1.04%	1.14%	1.32%	1.62%
Net chargeoffs (recoveries) to average loans	0.001%	0.015%	(0.002)%	0.033%	(0.004)%
Total shareholders' equity to total assets	5.41%	4.84%	5.06%	6.07%	6.01%
Debt to shareholders' equity (:1)	17.47	19.67	18.74	15.49	15.64
Allowance for loan losses to loans	0.015%	0.003%	0.07%	0.11%	0.28%
Permanent capital ratio	20.59%	19.19%	23.90%	26.86%	25.99%
Total surplus ratio	20.54%	19.14%	23.84%	26.76%	25.79%
Core surplus ratio	13.04%	11.46%	14.15%	15.60%	14.45%
Collateral ratio	106.02%	105.28%	105.70%	106.88%	106.94%
Net Income Distribution					
Cash distributions	$ 153,894	$ 128,440	$ 132,230	$ 126,689	$ 92,129
Mandatorily redeemable preferred stock dividend	—	—	—	—	10,282
Perpetual preferred stock dividend	19,501	10,950	10,950	10,950	1,851

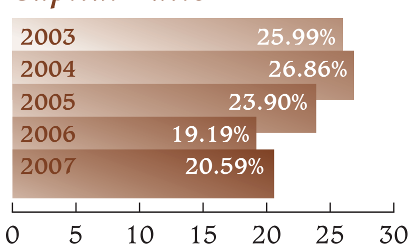
Net Income
(in millions)



Cash Distributions
(in millions)



Permanent Capital Ratio



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

Thomas W. Kelly
Chairman of the Board

F. A. Lowrey
Chief Executive Officer

During 2007, we focused on executing our strategy. What had been plans on paper just two or three years ago has now come to fruition. We have delivered new products and services to our affiliated Associations, helping them generate revenue and manage their businesses more efficiently.

At the same time, we have managed our business effectively. Our total loans outstanding increased by 11 percent in 2007, led by the growth in our Capital Markets portfolio. Our total assets increased by more than 10 percent, ending the year at $26.9 billion. In addition, we enjoyed another near record year of earnings, and, again, distributed a significant portion of those earnings to our Association-stockholders.

Growth and Credit Quality

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

These factors, along with a generally steady market in rural real estate and capital expansion by agribusinesses, led to an increase in Association loan volume. As a result, AgFirst's direct note portfolio increased by 5.2 percent, or $725 million.

Also contributing to our growth in 2007 were participation opportunities created by the partnership of AgFirst's Capital Markets Unit and Associations throughout the district. Working together, they obtained new business from agribusiness companies within the district and throughout the United States. As a result, Associations' portfolios and earnings grew, and the Capital Markets Unit added more than $565 million in net participations and syndications (excluding certain participation loan pools purchased from District Associations) to its portfolio during the year.

While growth is always welcome, we always strive for "quality growth," because that is the foundation of stable earnings. The credit quality of AgFirst's participation loan portfolio is strong, with acceptable loans reported at 97.84 percent at 2007 year-end, as compared to 97.70 percent the previous year. Our affiliated Associations believe the same and continue to maintain high credit quality in their portfolios. Associations reported 95.23 percent acceptable loans at year-end, as compared to 96.02 percent the previous year.

Earnings and Capital

With the growth of the loan portfolio, our average earning assets grew by $3.23 billion in 2007. This growth contributed to a near record year of earnings of $192.2 million in 2007.

Our 2007 earnings level enabled us to distribute a record $148.8 million to the 23 Associations we serve. As our earnings flowed to the Associations and on to their borrowers, they enriched the economies of rural communities throughout our 15 states and Puerto Rico.

In June 2007, we successfully issued $250 million of preferred stock, which was our third such issuance of preferred stock. Proceeds from this issuance were used for general corporate purposes, including pay off of debt, to enhance shareholder value with the goal of ultimately increasing distributions back to our Associations.

Strategic Initiatives

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

- Continued the implementation of our Customer Relationship Management (CRM) system, which has been provided to 11 Associations. Responses to the integrated CRM system we delivered have been very favorable, and we are already making plans for new features and enhancements.

- Introduced a document imaging solution, which enables Associations to share files between offices and reduce their paper-based files.

- Delivered a new workflow management tool called "AgriGate," and introduced several enhancements to our Credit Delivery products.

- Expanded the curriculum of Farm Credit University (FCU), an AgFirst-based training program for new loan officers and credit analysts. In 2008, we will begin developing a new curriculum for Young, Beginning, Small and Minority farmers. This program will help participants improve their business and financial management skills and will be delivered "on-demand" via the Internet.

AgFirst:
A Great Place to Work

In October 2007, AgFirst was named as one of the top 20 "Best Places to Work" in South Carolina by the S.C. Chamber of Commerce and the Society for Human Resource Management. Among large companies (250 or more employees), we were selected as the sixth "best place to work" in South Carolina. This achievement is especially significant to our stockholders because research shows that companies that rank as "best places to work" are also some of the highest performing companies.

The Great Places to Work® Institute defines "a great place to work" as one where you trust the people you work for, have pride in what you do, and enjoy the people you work with. It's very evident that AgFirst meets the criteria of this definition, judging by the high scores our employees gave AgFirst for the following statements:

- The work of this organization is important and makes a difference.
- I'm proud to be part of this organization.
- I understand how my job contributes to this organization's success.
- In my workgroup, we actively seek to understand customers' needs.
- I would recommend our products and services to my family and friends.

We are very proud of our employees, our customers, and our performance, and we will always strive to be "the best."

Thomas W. Kelly

Thomas W. Kelly
Chairman of the Board

F. A. Lowrey

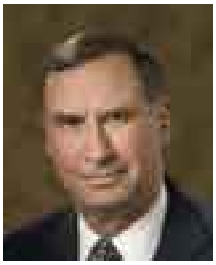
F. A. Lowrey
Chief Executive Officer

February 28, 2008

Board of Directors


Thomas W. Kelly
Chairman


Don W. Freeman


James L. May

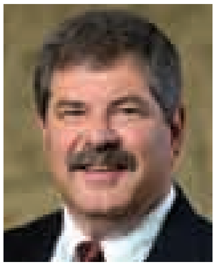

Walter L. Schmidlen, Jr.


Paul M. House
Vice Chairman


Dale R. Hershey


Eugene W. Merritt, Jr.


Robert G. Sexton


Gary L. Alexander


Robert L. Holden, Sr.


James M. Norsworthy, III


Kenneth A. Spearman


William C. Bess, Jr.

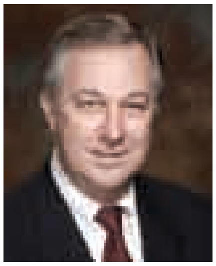

Lyle Ray King


Katherine A. Pace


Robert H. Spiers, Jr.


Henry M. Frazee


M. Wayne Lambertson


J. Dan Raines, Jr.


William H. Voss

AgFirst Profile

Who we are and what we do

AgFirst is a member of the Farm Credit System, the largest agricultural lending organization in the United States. We provide funding and services to 23 Agricultural Credit Associations (ACAs or associations) in 15 eastern states and Puerto Rico. The ACAs, in turn, provide financing to more than 80,000 farmers, ranchers, rural homeowners and agribusinesses. We also operate a Capital Markets Unit, which arranges and participates in loans for agribusinesses, and a Correspondent Lending division, which buys, sells and services rural home and agricultural loans throughout the United States.

How we are organized and funded

AgFirst is owned by its affiliated ACAs. The ACAs benefit from their ownership of AgFirst in two important ways. In the delivery of funding and services to all 23 ACAs, AgFirst achieves economies of scale that could not be achieved by the associations individually. In addition, AgFirst shares its profits with the associations through patronage refunds. The patronage refunds we pay our associations reduce their cost of borrowing and, ultimately, their borrowers' cost of borrowing.

Like all banks in the Farm Credit System, AgFirst obtains its funds through the sale of notes and bonds to the investing public. Because the system issues large volumes of securities and its securities carry agency status, the associations we serve enjoy a dependable and competitively priced source of funding.

What we deliver

Through their affiliation with AgFirst, the ACAs have access to a broad range of financial tools that allows them to compete in today's global economy. These tools include:

- Lines of credit that enable borrowers to take advances at their choice of Prime, LIBOR or fixed rate.
- Credit Delivery, a loan origination system developed by AgFirst and used by all 23 of our member-associations.
- AgriLine®, an automated system that enables borrowers to write their own loan advances by check.
- FastCash, a product that enables associations to send loan advances to their borrowers' checking accounts overnight through the Automated Clearing House system.
- AutoDraft, a service that automatically drafts borrowers' loan payments.
- AccountAccess, an online service that provides loan and payment information to borrowers via a secure Internet site, and LoanLine, a service that provides the same information by telephone.
- AutoBorrow, a cash management product for commercial borrowers developed by AgFirst in partnership with Bank of America.
- AgSweep, a cash management product for commercial borrowers developed by AgFirst in partnership with Wachovia.

These products and services have helped our associations grow and gain market share throughout their chartered territories.

AgFirst Farm Credit Bank is located in downtown Columbia, S.C.

John Burnside, director of capital markets, and his team have invested years of effort to establish a strong network of relationships and contacts throughout the United States. "Through our network, we're able to tap into potential opportunities and make them available for the good of the district."

"We've been able to aggressively pursue some lending opportunities that we might have passed by a few years ago," comments Randy Pope, capital markets manager with Cape Fear Farm Credit. "By working with AgFirst's capital markets department, we've been able to meet the needs of growing businesses like Prestage Farms."

Bringing Resources Together

Modern agribusinesses require complex financial solutions to keep their operations running smoothly and to take advantage of emerging growth opportunities. Capital demands can easily exceed the limits of traditional resources and without other options AgFirst associations could lose significant business.

AgFirst's Capital Markets department helps member-associations better serve their largest clients. Capital Markets brings together several lenders as partners in a single large transaction, which often entails working with commercial banks and other Farm Credit institutions. On the flip side of the equation, Capital Markets may find opportunities for AgFirst and its associations to participate in agribusiness loans generated outside our shareholder group.

Creating a New Level of Teamwork

Arranging complex financial transactions requires a high level of coordination and expertise. AgFirst's Relationship Management team is a key element in making these transactions work. Relationship Managers work closely with association Capital Markets staff throughout all stages of the process, from business development to loan closing.

As a financial package develops, Capital Markets becomes a central coordinating office that can leverage specialized capabilities. They provide assistance to associations in loan structuring, loan distribution as well as guidance in multi-lender transactions. To our associations, this means they have the tools, talent, and financial resources necessary to keep meeting the needs of their borrowers, however large and diversified their operations.

In addition to serving multi-lender needs, Capital Markets looks for commercial agribusiness opportunities in the secondary loan market. They bring these opportunities to associations as potential investments. This is just one more way our expanding network of contacts yields benefits for our associations.

"Cape Fear Farm Credit and AgFirst are great business partners to have because they understand the volatility of the commodity business," says Bill Prestage, President and CEO of Prestage Farms, headquartered in Clinton, N.C. "They're professional people with a long-range vision, and that's what attracted me to do business with them."

Cape Fear and AgFirst have worked with Marsha and Bill Prestage for more than 16 years as they have grown their business into one of the largest poultry and swine operations in the United States.

Over the past several years, the correspondent lending department has worked to improve its processes to bring associations a level of service that is second to none. “We know our communications are better and our underwriting is superior,” comments Beth Anderson, director of correspondent lending. “Add to that our competitive rates and we’re able to exceed our customers’ expectations.”

Making Rural Living Affordable

At AgFirst, we believe that people who live in the country deserve the same rates as those who live in urban areas. That's why AgFirst established its Corresponding Lending department, which buys rural home and part-time farm loans from Farm Credit associations and other lenders throughout the nation. Because of AgFirst's partnership with Fannie Mae and Farmer Mac, these originators can offer competitive, affordable rates to people who live in rural areas, even if their house sits on a ten-acre tract of land located on a dirt road.

Listening and Delivering

Change is a constant in the mortgage business. To help their originators stay abreast of current topics, Correspondent Lending offers Webinars for them each month and supplements that by posting information on its Web site. And, every year, AgFirst hosts a Correspondent Lending Conference to provide in-depth training for association staff and other originators. Throughout the year, Correspondent Lending staff listen to their customers to learn about their challenges and how to meet them.

It was listening to its customers that led Correspondent Lending to introduce a new front-end loan confirmation and underwriting system for its customers in 2007. The new system, called Avista, replaces two previous systems and streamlines several steps in the process. Avista provides a portal for originators that enables them to lock in a loan commitment to AgFirst in just a few seconds, a process that previously took several minutes to accomplish with numerous steps in the back-office at AgFirst. And, it provides an automated system that gives instant results based on Fannie Mae standards and the assistance of Fannie Mae's desktop underwriting system.

To be competitive in their marketplaces, our customers and associations have to provide quick responses to their borrowers. By listening and learning from our customers and associations, the Correspondent Lending department helps the them provide the quick responses their borrowers demand.

AgFirst looked at off-the-shelf software solutions for CRM. But we chose to customize the software for our district, enabling it to pull information from our various back-end systems. "Buying the software, setting up the servers and getting CRM installed was the easy part," says Mike Craft, CRM business system owner. "There's a lot of integration work and development of custom reports. But, at the payoff, all of the information about a customer or prospect is right there."

At MidAtlantic Farm Credit, nothing is more important than their members. "As we've continued to grow, it has been critical to us that we don't lose our personal connection to our customers," remarks Sandy Wieber, Senior Vice President of Marketing at MidAtlantic Farm Credit. "AgFirst's support of a district-wide CRM system has allowed us to keep that level of service, and it's allowed us to do it in a way that is integrated with our existing credit and loan systems. CRM lets us treat our customers as if they're the only customer that we have—and that's the definition of great customer service."

Focusing on Relationships

George Dunning, Loan Officer, MidAtlantic Farm Credit

Customer Relationship Management (CRM) brings a new approach to developing sales opportunities, enhancing customer support, and growing existing business. Like traditional sales tools, CRM provides software to enter and track essential customer data, but it goes several steps further in helping to build and strengthen relationships with prospects and current customers. As with many AgFirst initiatives, the impetus to create CRM came from listening to association leaders about their business needs.

While CRM offers numerous reporting and sales management features, it would have taken years before these features were useful if AgFirst had not chosen to customize the software. As an off-the-shelf product, CRM required countless hours of data entry and would have had limited or incomplete reporting capability. With the generous input, direction, and field testing provided by several of our associations, AgFirst went to work on customizing the software to make it more usable for our district.

Maggie Johnson, Loan Specialist, MidAtlantic Farm Credit

Ways to import existing customer information from our other back-end systems had to be created. By populating CRM with current customer information from our other systems, associations save hours of initial data entry and the information in CRM is more complete. There is also the added feature of having all of the customer's information in one place, no matter where the customer information resides.

We then went a step further by allowing each association to add specialized functionality. In addition, custom reports were developed to add to the information CRM was now capable of giving the association about their customers and prospects. This level of development required additional resources, but associations are seeing benefits from CRM now, instead of years from now.

Creating a New Mindset

CRM encourages a highly proactive and personal approach to marketing loan products. It isn't just about making enough phone calls and meeting a monthly quota. Instead, CRM helps associations focus on finding out about individual needs that can best be met with Farm Credit financing. It gets sales people thinking about the customer-prospect and how to help them achieve their business and financial goals.

Used properly, CRM can create a different mindset and change the business culture of an association. As employees gain experience with the program, they begin to understand that today's loan closing is tomorrow's servicing and follow-up activity. A loan pays association income, but a relationship brings repeat loans over the long term–and CRM is about the long term.

Donna Gantt, manager of business analysis services, knows that people learn faster, become more efficient and provide better customer service when the systems they need to use are intuitive and easily navigated. "That's what AgriGate is all about," she said. "We wanted the system to be quick and easy to get through without a lot of re-keying and screen navigation."

As a pilot association for AgriGate, Farm Credit of Central Florida, headquartered in Lakeland, Fla., was instrumental in helping AgFirst make the system work smoothly. "From the very beginning, the AgriGate team worked quickly to resolve any issues we discovered during the pilot phase. They even went so far as to make some recommended enhancements the same day we asked!" said Glenda Tomlinson, assistant vice president, information and training at Central Florida. "The biggest benefit of AgriGate is the ease of access to all applications and the seamless transition from one to the other."

Doorway to Cybertasking

Thomas Dalton,
Credit Analyst,
Farm Credit of
Central Florida

High-speed data transfer, multi-tasking, networking, the Internet–these features of computer technology all make our jobs easier. But in a multifaceted financial services industry, the staggering amount of data and the different systems we use to access it often seem to hamper efficiency rather than enhance it. Our associations asked AgFirst to find a solution for this problem. To develop the solution, AgFirst needed to work closely with its associations to clear a way through the maze.

As a first step, we visited six associations to fully understand how technology impacted their working environment–positively and negatively. We spent time with each and followed up with ideas, feedback, and potential solutions. Out of all of this, over several years, came AgriGate–a portal that provides a single access point for software applications shared among AgFirst and the associations, some thirty different programs.

Dawn Tuten, Paralegal,
Farm Credit of Central Florida

AgriGate is being implemented in a series of phases and we are currently in Phase I. Even at this early date, our associations report that the process is proving itself much quicker and easier to use than its predecessor.

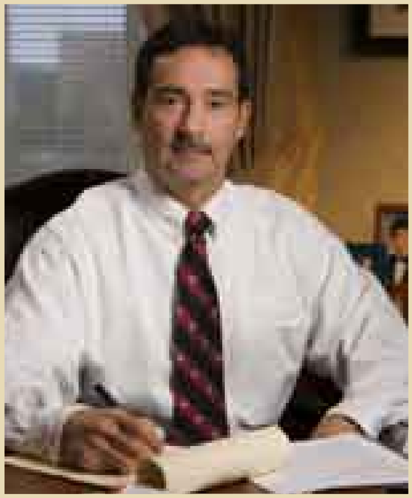
How It Works

When a user enters AgriGate, all the programs for which they have approved access appear in the portal and can be opened with a single click. The portal gives the user shortcuts to all available applications, including standard programs and rate sheets. With only a few exceptions, separate security protocols become unnecessary. What's more, users can open and have access to multiple mainframe applications at once, rather than switching between them one at a time.

Consider this scenario, common in many association offices: A customer service representative is working on a customer's file when another customer calls with a question about accelerating an account payoff on their loan balance. Before answering the customer, the customer service representative would have to close out screens on one account to open another. Not anymore. AgriGate makes it possible to keep multiple customer accounts open simultaneously, switching back and forth to perform different functions in each. By itself this is a tremendous time-saver that comes into play many times in the course of a single day.

Brittany Lopez,
Credit Analyst,
Farm Credit of
Central Florida

While systems and procedures will continue to evolve, AgriGate establishes the framework to smoothly accommodate change.



Similar to many enterprise-level initiatives, providing a solution to electronically capture, store, manage and distribute documents across the enterprise was an initiative that began by listening to our customers. “The biggest benefit is the efficiencies gained by being able to easily and securely access business information, regardless of geographic location,” said Robert Zeman, Vice President, Information Technology.

Southwest Georgia Farm Credit was the first association in the district to use electronic filing. “In fact, we’ve tried it all. What this new Imaging system does is offer us access to a loan file with the click of a button.” We had a good imaging system in place called ELF, but the problem was that everyone used it differently,” says Shannon Crawford, branch operations coordinator for the association. “The new Imaging system is very user-friendly and is a logical system. AgFirst asked for our input as they developed it, which told us they were committed to turning out a program that met our needs.”

Making Documents Accessible

Mandy Johnson (left), Loan Closing Coordinator with Kirk Whitaker (right), Senior Information Systems Specialist, Southwest Georgia Farm Credit

Whether large or small, every loan requires extensive documentation and paperwork that must remain available for years after a deal closes. Retrieving, exchanging, and filing all this paper during and after the loan process creates a major burden for any office. The burden is even greater when offices are spread throughout multiple counties in the state and sometimes even crossing state lines. Getting important documents in the hands of the people who need them could mean hours of driving, or risking possible loss by mailing or shipping. That's why AgFirst began the Imaging project.

Imaging technology is not new, but until recently it often seemed to create as many problems as it solved, to take more time than it saved. To get beyond these hurdles, the AgFirst approach began with the belief that the business need should drive the technology. The need expressed by our associations was for a system that would allow fast, easy retrieval of loan documents from anywhere at any time–an accessible central repository. Our solution is Imaging.

Patrick Deen, Corporate Financial Analyst, Southwest Georgia Farm Credit

No More Paper File Searches

AgFirst's Imaging system creates a digital record of an original document and then automatically files it under an appropriate category. The automatic filing feature may be its most important element. Although different individuals may each have their own filing system, Imaging makes it possible for anyone involved at any stage of the loan process to easily access a record, regardless of who filed it or where. The system recognizes and classifies documents based on content. This saves a lot of searching through physical files.

The system also eliminates the need to transport paper documents between offices to verify signatures or other requirements–another major savings in time and money. Even faxes become unnecessary. Because documents need not travel back and forth, security risks are minimized as well.

Renee Ausley, Accountant, Southwest Georgia Farm Credit

With digital images stored in a single repository, any employee who needs to access loan documents can do so from any location. In fact, two or more people in different offices can look at the same file simultaneously while discussing case particulars, which can eliminate any potential confusion or miscommunication. This helps ensure more accurate and timely processing.

While Imaging technology will never totally replace paper documents, it certainly makes critical information more manageable and readily available to those who need it. AgFirst Imaging is another example of a solution that arose from the ongoing dialogue with our member-associations.

To help our associations remain competitive, AgFirst is committed to offering products and services that associations can use to retain existing customers and attract new business. Mike Mooney, product development analyst at AgFirst, says, "Our goal in developing new loan products is not just to stay in step with our competitors, but to stay ahead of them. Offering a fixed-rate, construction-to-permanent financing product gives our associations another tool to meet the needs of agricultural and consumer borrowers."

With fluctuating interest rates, a poultry producer like Townsend Hare from Saluda, S.C. (right), may find it difficult to make long-range financial plans. "The construction-to-permanent fixed-rate financing appealed to me because it enabled me to lock in my interest rate for the long-term, with just one closing. But it also let me determine what my payments were going to be for the entire term of the loan."

Ben Skelley, regional vice president, AgSouth Farm Credit (left), knows that fluctuating interest rates can cause concern for borrowers when beginning a large construction project. "With interest rates as low as they are now, borrowers will find this new option for fixed-rate construction-to-permanent financing attractive and convenient. It's a win-win situation for AgSouth and our customers," he said.

Eliminating Guesswork

Fluctuating costs and volatile interest rates can make anyone a little uneasy when contemplating a large construction project such as building poultry houses. Like Townsend Hare, borrowers need the security while building that they are not going to face higher interest rates once they obtain permanent financing. AgFirst recently introduced its Fixed-Rate Construction-to-Permanent (FRCP) financing product, which gives associations' customers much greater security and helps associations better compete with commercial banks. Obviously, the key feature is the fixed interest rate, but it offers many other benefits.

Because there is only one application, one closing, and one set of closing costs, the entire process is streamlined to save time and money. Borrowers can lock in a rate before construction begins and be assured it will remain the same throughout the term of the loan. Furthermore, FRCP lets customers choose up to a thirty-year term, subject to sound credit underwriting guidelines, to provide maximum economy and flexibility in structuring payments. All of this also means FRCP eliminates guesswork at every step. Everything is specified up front and never changes after that, regardless of a long or short construction period.

Such features make FRCP particularly attractive to agribusinesses engaged in major capital expansions or improvements–dairy barns, poultry houses, grain silos, and other production facilities. These customers will be better able to maintain consistent cash flow throughout the construction process.

Gaining Peace of Mind

Our new FRCP financing can be applied to residential loans as well. While the construction periods may be shorter, removing the guesswork from the process is just as important to prospective homeowners as it is to business owners. Once the interest rate and terms are locked in, customers can have complete peace of mind knowing there are no surprises with FRCP financing.

Associations will undoubtedly gain some peace of mind too. They have an opportunity to expand loan volume by competing more aggressively with other lenders, which is always a major concern. FRCP financing has gained immediate and enthusiastic acceptance, because it meets genuine needs in the marketplace–for associations and their customers.

At Your Convenience

Cash Management

Giving association credit officers an additional way to close a deal is one reason we develop tools like our cash management services. "This is just one more way we're able to assist our associations in competing with the major commercial banks throughout our district," said Pam Larsen, manager of cash services at AgFirst.

Maximum efficiency. All successful business owners strive to achieve it. This is true in the financial industry and especially true for those in the agricultural industry. Those who achieve it take full advantage of every available resource—land, labor, equipment, and time. But even successful managers sometimes overlook the importance of managing one of their most valuable assets: their cash.

Like any other asset or resource, cash must be properly managed to ensure that it generates the maximum returns for your business. Each day, business managers have to ask themselves: Is my cash in the right place today? How much do I need in my checking account to cover incoming checks? Will I have excess cash at the end of the day? If so, should I pay down my line of credit to reduce my interest expense? So many questions, and often the decisions they make are based on best guesses of the situation that day. Managing cash can be a time-consuming process, full of guesswork and wrong decisions.

That's why AgFirst developed two products to give associations a choice of tools to meet their borrowers' cash management needs. AutoBorrow, developed in 2001 in partnership with Bank of America®, was designed solely for Farm Credit's borrowers to help them manage their cash for optimal efficiency. AgSweep, developed with Wachovia Bank, was recently added to the lineup of cash management tools to ensure these tools were available to everyone throughout the district.

Jo Riser from Jobo Holstein Farms in Gettysburg, Penn., realizes the tremendous time-savings that come from using AgSweep. "AgSweep is a win-win situation for us. Not only are we saving a ton on interest, we save a twenty-five minute trip, one way, to the bank," she says.

Like AutoBorrow, AgSweep automatically tracks the user's cash position and transfers funds between loan and business checking accounts as needed. Customers can also choose one of three investment options so that idle funds earn maximum returns. Both AutoBorrow and AgSweep save time, reduce interest expense, and provide a clear and comprehensive snapshot of each day's financial operations. These are features that modern business managers cannot be without.

Taken together, AgSweep and AutoBorrow give associations greater reach and presence in their service areas. For their customers, this means greater convenience.

Keeping Customers Better Informed

Since AgFirst first introduced it in 1998 as an online information tool, AccountAccess has increasingly grown to include more information that borrowers and associations said they wanted and needed. Starting as an easy way for district members to get up-to-date loan information, AccountAccess now lets them make online payments and initiate FastCash transactions. From 2005 to 2007, first-time users of the service grew by 49 percent.

According to the latest customer satisfaction survey of association customers, more than 58 percent regularly use the Internet. To help us improve AccountAccess, we wanted to know how well it was meeting user expectations. During a three-week period in January 2008, we asked AccountAccess users to complete a short survey. Survey questions measured overall satisfaction with AccountAccess and the features it offered, as well as its importance to users. Interest in four potential new features was also measured. More than 500 users throughout the district completed the survey.

The results indicated AccountAccess has been well received by our associations' members, with 98 percent of respondents indicating they were satisfied or very satisfied with the service and 96 percent saying that it was important or very important to them.

We asked users about new features that we're considering adding to AccountAccess and the response was favorable. Of the four new features we're considering, users rated getting their billing statements online the highest. They also gave high ratings to access to a message center and the ability to set up recurring payments as well as making payments with credit and debit cards.

Activity on AccountAccess continues to increase, with log-ins alone up 39 percent from 2006 to 2007. Use of both Online Payment and FastCash transfers increased 69 percent and 34 percent, respectively, over the previous year.

The Internet is constantly changing and growing to adapt to what people need and want. What seems impossible today, becomes the standard tomorrow. AccountAccess will continue to change and grow along with the technology to continue to be an important service associations can offer to their customers.

AccountAccess will continue to evolve to meet association customers' changing needs. Gregg Steinmeyer, director of marketing research and product development at AgFirst, sees it this way: "AccountAccess will never be finished. As technology changes and grows, so will AccountAccess. In the 10 years since we've launched the system, we've seen it transition from a simple way for an association customer to view their account information, to an interactive tool that adds convenience and real value for the borrower."

2007 Financial Results

Report of Management

The accompanying consolidated 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 consolidated financial statements and financial information contained in this report.

Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all consolidated 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 maintains an internal audit program to monitor compliance with the systems of internal accounting control. Audits of the accounting records, accounting systems and internal controls are performed and internal audit reports, including appropriate recommendations for improvement, are submitted to the Audit Committee of the Board of Directors and to the Chief Executive Officer.

AgFirst 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 AgFirst Code of Ethics may be viewed on the Bank's website at *www.agfirst.com*.

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

The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Bank. The undersigned certify that the 2007 Annual Report has been prepared in accordance with all applicable statutory or regulatory requirements and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

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

Thomas W. Kelly
Chairman of the Board

F. A. Lowrey
President and Chief Executive Officer

Charl L. Butler
Senior Vice President
and Chief Financial Officer

February 28, 2008

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

(As of December 31, 2007)

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

The nation is currently served by four Farm Credit Banks (FCBs) and one Agricultural Credit Bank (ACB), each of which has specific lending authorities within its chartered territory. The ACB also has certain 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 serve 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 (District). The Associations are structured as cooperatives; that is, each Association is owned by its borrowers. The District Associations jointly own all of AgFirst's voting stock, which also operates as a cooperative. As of December 31, 2007, the District consisted of the Bank and twenty-three District Associations. All twenty-three are structured as ACA holding companies, with FLCA and PCA subsidiaries.

The following commentary reviews the consolidated financial condition and results of operations of AgFirst for the years ended December 31, 2007, 2006 and 2005. This information should be read in conjunction with the accompanying Consolidated Financial Statements, the Notes to the Consolidated Financial Statements and other sections of this Annual Report. The accompanying Consolidated 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 Consolidated Financial Statements for a discussion of the operations of AgFirst.

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 AgFirst's expectations and predictions due to a number of risks and uncertainties, many of which are beyond AgFirst's control. These risks and uncertainties include, but are not limited to:

- political, legal, regulatory, and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international, and farm-related business sectors;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry; and
- actions taken by the Federal Reserve System in implementing monetary policy.

AGRICULTURAL OUTLOOK

In November 2007, the United States Department of Agriculture (USDA) estimated that 2007 farmers' net cash income (a measure of cash income after payment of business expenses) increased to $85.7 billion, up $17.8 billion from the 2006 forecast and up $20.3 billion from its 10 year average. Contributing to this sizeable increase in net cash income were increases in cash receipts for crops and livestock of $22.6 billion and $20.3 billion, respectively, an increase in farm-related income of $300 million, offset in part by an increase in cash expenses of $21.7 billion and a decrease in direct government payments of $3.7 billion. Corn prices have risen as a result of a combination of continued food and feed demand and expanding ethanol demand. Other crop prices, in general, were positively impacted by increased acreage used to plant corn, decreasing the amount of acreage available for other crops. Wheat and soybeans compete with corn as a feed source so both wheat and soybean prices have risen since late 2006. Livestock cash receipts increased as domestic and export demand for beef has risen. The following table, which is based on information published by the USDA, sets forth the commodity prices per bushel for certain crops and by hundredweight for beef cattle from December 31, 2004 to December 31, 2007:

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

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

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

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

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

According to the USDA, farm business balance sheets have shown improvement over the last few years, as measured by debt relative to assets and equity levels. Farmers' equity (farm business assets less farm business debt) is expected to have increased in 2007. One measure of the financial health of the agricultural sector used by the USDA is the assessment of farmers' utilization of their capacity to repay debt (actual debt as a percentage of maximum debt that can be supported by farmers' current income). Higher capacity utilization rates indicate tighter cash flow positions and, consequently, higher exposure to financial risk. These estimates do not take into account, however, off-farm income sources. Since 1970, debt repayment capacity utilization has ranged from a low of 35.8 percent in 1973 to 104.1 percent in 1981, and has remained relatively stable since 1987, averaging about 50 percent. The USDA suggests a decrease in the use of repayment capacity from 57 percent in 2006 to 48 percent in 2007.

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

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

SIGNIFICANT ACCOUNTING POLICIES

The financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. Consideration of AgFirst's significant accounting policies is critical to the understanding of the Bank's results of operations and financial position because some accounting policies require complex or subjective judgments and estimates that may affect the value of certain assets or liabilities as well as the recognition of certain income and expense items. In many instances, management has to make judgments about matters that are inherently uncertain. For a complete discussion of significant accounting policies, see Note 2, *Summary of Significant Accounting Policies,* of the Notes to the Consolidated Financial Statements. The following is a summary of certain critical policies.

- *Allowance for loan losses* — The allowance for loan losses is management's best estimate of the amount of probable losses existing in and inherent in our loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs.

  Significant individual loans are evaluated based on the borrower's overall financial condition, resources, and payment record; the prospects for support from any financially responsible guarantor; and, if appropriate, the estimated net realizable value of any collateral. The allowance for loan losses attributable to these loans is established by a process that estimates the probable loss inherent in the loans, taking into account various historical and projected factors, internal risk ratings, regulatory oversight, and geographic, industry, and other factors. Certain loan pools purchased from various Associations are analyzed in accordance with the selling Associations' allowance methodologies for assigning general and specific allowances, and allowances are established on those pools based on that analysis after Bank management's determination that the methodologies employed are appropriate.

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

  The overall adequacy of the allowance for loan losses is validated further based on periodic evaluations of the loan portfolio, which generally consider recent historical charge-off experiences adjusted for relevant factors. These factors include types of loans, credit quality, specific industry conditions, general economic and political conditions, and changes in the character, composition, and performance of the portfolio, among other factors.

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

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

LOAN PORTFOLIO

AgFirst's loan portfolio primarily consists of direct loans to District Associations (Direct Notes), loan participations/syndications purchased, Correspondent Lending loans (primarily, first lien residential mortgages), and loans to Other Financing Institutions (OFIs) as shown below at December 31:

AgFirst Loan Portfolio

(dollars in thousands)	2007		2006		2005	
Direct Notes	$ 14,602,548	76.39%	$ 13,877,142	80.91%	$ 12,441,170	86.33%
Participations/Syndications Purchased, net	3,470,300	18.16	2,501,453	14.58	1,411,802	9.80
Correspondent Lending	1,039,449	5.44	771,982	4.50	555,428	3.85
Loans to OFIs	2,220	0.01	1,760	0.01	2,650	0.02
Total	$ 19,114,517	100.00%	$ 17,152,337	100.00%	$ 14,411,050	100.00%

The diversification of the AgFirst loan volume by type for each of the past three years at December 31 is shown below:

(dollars in thousands)	2007		2006		2005	
Direct Loans to Associations	$ 14,602,548	76.40 %	$ 13,877,142	80.91 %	$ 12,441,170	86.33 %
Real Estate Mortgage	1,125,319	5.89	750,394	4.37	411,707	2.86
Production and Intermediate-Term	1,101,145	5.76	915,629	5.34	490,057	3.40
Rural Residential Real Estate	915,874	4.79	647,610	3.77	442,692	3.07
Processing and Marketing	676,722	3.54	440,657	2.57	280,932	1.95
Loans to Cooperatives	293,009	1.53	223,264	1.30	142,947	0.99
Energy	170,932	0.90	179,613	1.05	142,593	0.99
Communication	87,912	0.46	61,769	0.36	27,717	0.19
Farm-Related Business	78,054	0.41	20,227	0.12	7,278	0.05
Water/Waste Disposal Loans	20,000	0.10	11,319	0.07	–	–
Lease Receivables	17,826	0.09	22,953	0.13	21,307	0.15
Discounted Loans to OFIs	2,220	0.01	1,760	0.01	2,650	0.02
Other	22,956	0.12	–	–	–	–
Total	$ 19,114,517	100.00 %	$ 17,152,337	100.00 %	$ 14,411,050	100.00 %

Loan growth resulted primarily from growth of the Direct Notes that fund Association lending activity and increases in participation loans purchased. Association growth is attributable to a seasoned lending staff, the inherent value of patronage paid under the cooperative structure, a stronger world demand for commodities coupled with a weaker U.S. dollar that helped boost agricultural exports, an active agricultural real estate market, borrowers seizing low interest rate opportunities, greater utilization of lines of credit by farm supply and livestock borrowers, and capital expansion by agribusinesses.

Credit quality at year-end 2007 reflected improvement over previous years. Each loan is classified according to the two-tiered Uniform Classification System, which is used by all System institutions and assigns a probability of default and a loss given default. Below are the classification definitions.

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

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

AgFirst Loans Credit Quality	2007	2006	2005
Acceptable	98.75%	98.70%	98.55%
OAEM	1.14	1.18	1.21
Adverse*	0.11	0.12	0.24
Total	100.00%	100.00%	100.00%

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

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

Direct Notes

AgFirst's primary line of business is to provide funds to District Associations. Each Association is a federally chartered instrumentality of the United States and is regulated by the Farm Credit Administration (FCA). AgFirst has a revolving line of credit, referred to as a Direct Note, in place with each of the Associations. Each of the Associations primarily funds its lending and general corporate activities by borrowing under 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. Refer to Note 1, *Organization and Operations*, in the Notes to the Consolidated Financial Statements for further discussion. Each GFA contains minimum liquidity, capital, and earnings requirements that must be maintained by the Association.

Ultimately, the Associations' ability to repay their direct note obligations is significantly dependent upon repayment of loans made to their borrowers. Accordingly, AgFirst's direct and indirect credit exposure depends upon the creditworthiness of both the Associations that are direct borrowers and the underlying borrowers of the Associations as indirect borrowers of AgFirst.

AgFirst continually monitors the risk-bearing capacity of each Association through a variety of mechanisms, including testing of the reliability of the Association's risk ratings assigned to each of their loans, periodic meetings with Association Managements and Boards, semi-annual formalized risk assessments, and prior-approval of loan transactions that exceed the Association's delegated lending authority (which is determined by AgFirst).

All Associations met or exceeded the minimum GFA and regulatory requirements for liquidity, earnings, and capital as of December 31, 2007. No Association is operating under a supervisory action. Litigation in which Associations are involved is typically loan related and poses no material threat to their viability. All Associations are subject to an annual audit by independent auditors and periodic examination by FCA. Each Association is required by regulatory mandate to perform continuous internal credit, appraisal, and audit reviews.

Associations employ 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 Service Agency, and the Small Business Administration to further limit credit exposures. At December 31, 2007, Associations collectively had $1.25 billion under such government or government-sponsored enterprise (GSE) guarantee programs, compared to $1.19 billion at December 31, 2006.

Credit quality within the combined Associations' portfolios showed a very minimal decline during the twelve months ended December 31, 2007. At year-end, the combined Associations' loans including accrued interest were classified as follows:

District Associations Credit Quality	2007	2006	2005
Acceptable	95.23%	96.02%	95.58%
OAEM	3.01	2.53	2.86
Adverse*	1.76	1.45	1.56
Total	100.00%	100.00%	100.00%

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

Delinquencies (loans 90 days or more past due) were 0.39 percent of Association total loan assets at year-end 2007 compared to 0.28 percent and 0.45 percent at year-end 2006 and 2005, respectively. Nonperforming assets for the combined Associations represented 0.68 percent of total loan assets or $111.1 million, compared to 0.49 percent or $75.8 million for 2006, and 0.50 percent or $72.1 million for 2005. Nonperforming assets consist of nonaccrual loans, accruing restructured loans, accruing loans 90 days or more past due and other property owned.

Association net charge-offs of $3.4 million, $12.6 million and $1.7 million were recorded in 2007, 2006, and 2005, respectively. As a percentage of total average loan assets, net charge-offs for the combined Associations were 0.02 percent for 2007 compared to 0.08 percent and 0.01 percent in 2006 and 2005, respectively. Each Association maintains an allowance for loan losses determined by its management based upon its unique situation.

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 Associations at December 31, 2007.

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

Affiliated Associations primarily serve all or a portion of fifteen states and Puerto Rico. This large geographic area results in geographic diversity, which is a natural risk-reducing factor for AgFirst. The following table illustrates the geographic distribution of the Associations' loan volume outstanding by state for the past three years at December 31.

District Associations

State	2007	2006	2005
North Carolina	16%	15%	16%
Florida	14	14	15
Georgia	12	13	13
Virginia	11	11	11
Pennsylvania	10	10	11
Maryland	7	7	7
South Carolina	6	6	6
Ohio	5	5	5
Alabama	4	3	3
Kentucky	3	3	3
Mississippi	2	2	2
West Virginia	2	2	2
Delaware	2	2	2
Louisiana	1	1	2
Puerto Rico	1	1	1
Tennessee	1	1	1
Other	3	4	–
Total	100%	100%	100%

Only five states have loan volume representing 10.00 percent or more of the total. Commodity diversification, guarantees, and borrowers with relatively high levels of non-farm income mitigate any geographic concentration risk in these states.

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

Earnings for the combined Associations totaled $381.8 million, $348.2 million, and $343.8 million, producing an average return on assets of 2.22 percent, 2.18 percent, and 2.40 percent, and an average return on equity of 14.59 percent, 14.00 percent, and 14.68 percent for 2007, 2006, and 2005, respectively.

AgFirst provides each Association with core operating systems and support, including a loan origination system, loan accounting and servicing systems, general ledger and related financial accounting systems, and a human resources/payroll system. With AgFirst providing such systems, the Associations are able to achieve operating efficiencies ordinarily afforded to only much larger organizations. In addition, having common systems supported by AgFirst provides an opportunity to automate the AgFirst/Association lending process. One of the most significant advantages of this is a match-funding mechanism that automatically creates Direct Note advances that match the repricing and maturity characteristics of each underlying loan. The Association's interest rate risk is significantly reduced by employing this system.

The diversity of income sources supporting Association loan repayment further mitigates credit risk to AgFirst. The Associations' credit portfolios are 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 Associations by major commodity segments at December 31.

District Associations

	Percent of Portfolio		
Commodity Group	2007	2006	2005
Forestry	13%	14%	13%
Poultry	13	13	14
Fruits/Vegetables	10	10	10
Cattle	8	8	9
Other Real Estate	7	7	6
Dairy	6	6	7
Grain	6	5	5
Nursery/Greenhouse	5	5	5
Processing	3	4	3
Rural Home	3	3	4
Tobacco	3	3	3
Swine	3	3	3
Cotton	3	3	3
Corn	2	2	2
Citrus	2	1	2
Other	13	13	11
Total	100%	100%	100%

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

District Associations

	Percent of Portfolio		
Commodity Group	**2007**	**2006**	**2005**
Part-time Farmers	40%	40%	39%
Poultry	11	12	12
Forestry	6	6	7
Dairy	5	6	7
Fruits/Vegetables	5	5	5
Nursery/Greenhouse	4	4	4
Cotton	3	3	3
Swine	3	3	3
Processing	3	2	1
Tobacco	2	3	3
Cattle	2	2	3
Corn	2	1	2
Grain	2	2	2
Rural Home	2	1	1
Citrus	1	1	1
Other Real Estate	1	1	1
Other	8	8	6
Total	100%	100%	100%

Associations have concentrations of *full-time farmers* of 5.00 percent or greater in only four commodities: poultry, forestry, dairy, and fruits/vegetables. All four commodities have a large geographic dispersion with production over the entire AgFirst footprint. Concentrations within the Associations are further dispersed through the number of farm units producing poultry or dairy products. Poultry production is almost exclusively done through a network of contract growers whose income remains stable as variable costs are absorbed by the contracting integrators. Poultry concentration is further dispersed as production is segregated between chicken, turkey, and egg production. Dairy herds range in size from less than one hundred cows to approximately ten thousand. Associations also manage credit and concentration risk through participations, guarantees, and direct payment assignments from the poultry integrators and milk processing facilities.

Forestry is divided principally into hardwood and softwood production and value-added processing. The timber from hardwood production is further processed into furniture, flooring, and high-grade paper and is generally located at the more northern latitudes and higher elevations. Softwood timber production is typically located in the coastal plains of the AgFirst footprint and is utilized for building material for the housing market and pulp to make paper and hygiene products. Forestry production at the Associations ranges from less than fifty acres to thousands of acres, with value-added processing being conducted at sawmills and planer mills. 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 AgFirst District footprint. The volume is spread broadly over the base of Associations. Fruits/vegetables commodity category is not the top commodity concentration for any Association and is in one of the top four commodity concentrations for only one Association. Also, many poultry, dairy, forestry, and fruit/vegetable producers have significant secondary income from off-farm employment by a family member.

District Association exposure to the ethanol industry has grown during the year but still remains a very small percentage of their total loan portfolios, 0.43 percent (or $69.3 million), at December 31, 2007. AgFirst also maintains a conservative maximum hold position for this industry in its loan portfolio. In the Bank's portfolio at December 31, 2007, ethanol exposure totaled $59.4 million, representing 0.31 percent of the portfolio. Higher corn prices caused by a number of factors, including expanding economies in the world's developing countries and increased ethanol production, will increase the cost of production of the meat production companies in the portfolio. Most meat production borrowers within the portfolio are well capitalized and have significant ability to manage through increases in feed ingredient costs.

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

District Loan Volume Gross
Loans Outstanding Per Borrower

$ Range	**% of Total**
$1,000-$250,000	35.80 %
$251,000-$500,000	15.27
$501,000-$1,000,000	12.60
$1,001,000-$5,000,000	18.90
$5,001,000-$25,000,000	10.84
$25,001,000-$100,000,000	5.88
Over $100,000,000	0.71
Total	100.00 %

Loans greater than $5.0 million per borrower comprise approximately 17.43 percent of the District loan volume. As mentioned above, loans exceeding an Association's delegated lending authority must be pre-approved by AgFirst. As a result, larger agribusiness loans are typically analyzed by AgFirst's commercial lending staff as well as the Association's own lending staff prior to an Association's committing to such loans.

Approximately 51.07 percent of outstanding loan volume is comprised of loans under $500 thousand, and loans less than $250 thousand make up approximately 35.80 percent of loan volume. This diversification 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, 2007, 42.42 percent of the District loans were identified as real estate loans. Exposure to losses is reduced through collateralization.

Participations/Syndications

AgFirst has an active Capital Markets Unit that purchases and sells loan participations and syndications. The Capital Markets Loan Officers and Association Relationship Managers work with the Associations to originate loans within the District's territory, provide commercial loan expertise to augment the Associations' staff, as needed, and provide an outlet for loans that exceed Associations' various hold limits. Additionally, the Capital Markets Unit actively pursues the purchase of participations and syndications originated outside of the District's territory by other System institutions, commercial banks, and other lenders. These loans may be held as earning assets of AgFirst or sub-participated to the Associations. The Capital Markets Unit also sells participations outside of the District to manage AgFirst's and the District Associations' loan concentrations.

The following table shows portfolio credit exposures as of December 31.

	AgFirst Participations		
(dollars in thousands)	**2007**	**2006**	**2005**
Participations Purchased	$ 4,891,381	$ 3,576,678	$ 1,906,665
Less: Participations Sold	1,421,081	1,075,225	494,863
Net Outstanding	3,470,300	2,501,453	1,411,802
Available Commitment	1,697,129	1,714,215	1,486,601
Letters of Credit and Guarantees	177,905	258,400	127,662
Total Exposure	$ 5,345,334	$ 4,474,068	$ 3,026,065

Like the Associations, AgFirst employs risk management techniques to limit credit exposures, such as the adoption of underwriting standards, individual borrower exposure limits based on risk ratings, and commodity exposure limits.

The following table illustrates AgFirst's participation/syndication portfolio by geographic distribution at December 31.

	AgFirst Participations					
(dollars in thousands)	2007		2006		2005	
Florida	$ 753,398	22 %	$ 656,988	26 %	$ 325,528	23 %
Georgia	467,896	13	291,516	12	80,432	6
North Carolina	306,321	9	169,909	7	85,543	6
California	210,046	6	104,506	4	34,280	2
Texas	195,611	6	115,435	5	81,992	6
Pennsylvania	192,222	6	78,579	3	80,147	6
South Carolina	166,805	5	139,118	5	154,780	11
Minnesota	134,056	4	98,028	4	40,716	3
Colorado	110,308	3	65,675	3	57,431	4
Oregon	92,517	3	46,461	2	16,592	1
New York	87,133	3	64,388	2	43,705	3
Delaware	82,333	2	72,725	3	78,453	6
Virginia	72,780	2	95,256	4	64,895	5
Ohio	59,060	1	39,658	1	35,151	2
Connecticut	50,379	1	40,163	2	8,837	–
Arkansas	48,034	1	30,726	1	10,006	1
Missouri	47,220	1	56,104	2	61,637	4
Tennessee	44,753	1	18,629	1	4,963	–
Alabama	42,955	1	44,272	2	–	–
Washington	41,965	1	47,903	2	27,360	2
Mississippi	38,839	1	28,715	1	9,710	1
Kentucky	36,168	1	20,033	1	10,360	1
Iowa	27,513	1	144	–	9,125	1
New Jersey	25,673	1	52,736	2	20,752	1
Kansas	25,668	1	16,207	1	–	–
Puerto Rico	25,613	1	26,626	1	–	–
Other	85,034	3	80,953	3	69,407	5
Total	$ 3,470,300	100 %	$ 2,501,453	100 %	$ 1,411,802	100 %

The customer bases in the Florida and Georgia markets, AgFirst's two largest markets by state, contain commodity concentrations in the sugar and citrus industries in Florida and in the poultry and timberland industries in Georgia. Concentration risk in these states, and throughout the portfolio, is mitigated through established maximum hold positions to a single borrower and to a single commodity/industry.

AgFirst's participation volume outstanding increased by 38.73 percent from 2006 year-end to 2007 year-end. The volume growth was strong in 2007 due to increased utilization of committed lines of credit by borrowers, increased loan activity in the agribusiness sector, and increased participations purchased from affiliated Associations. The portfolio is well-diversified with volume attributed to many different commodity groups.

The largest major commodity concentrations are in the forestry group and the food and kindred products group, which in turn represent a widely diverse group of forestry, forest products, food, and food processing companies. The following shows the various major commodity groups in the portfolio and their percentage of the portfolio's outstanding volume at December 31.

AgFirst Participations	Percent of Portfolio		
Commodity Group	2007	2006	2005
Forestry	17%	13%	7%
Food and Kindred Products	16	19	24
Agribusiness	13	14	10
Swine	6	4	3
Lumber/Paper	6	8	8
Citrus	5	8	7
Electric Utilities	5	6	10
Cattle	5	3	2
Horticulture	4	6	6
Sugar Cane/Sugar Beets	3	4	7
Telephone Utilities	3	3	2
Poultry & Eggs	3	2	5
Other	14	10	9
Total	100%	100%	100%

The following table represents the Participation/Syndication credit quality as of December 31.

Participation/Syndication Credit Quality	2007	2006	2005
Acceptable	97.84%	97.70%	96.01%
OAEM	1.57	1.53	1.65
Substandard	0.53	0.77	1.67
Doubtful	0.06	0.00	0.67
Total	100.00%	100.00%	100.00%

Correspondent Lending

The Correspondent Lending Unit (Correspondent Lending) purchases residential loans, including part-time farm loans, from a network of correspondents including the affiliated Associations. Essentially all loans purchased by Correspondent Lending are guaranteed by Fannie Mae and/or Farmer Mac, thereby limiting credit risk to AgFirst. Technically, the guarantees are in the form of Long-Term Standby Commitments to Purchase, which give AgFirst the right to deliver delinquent loans to the "guarantor" at par.

The table below illustrates the Correspondent Lending gross unpaid principal balance of loans outstanding at December 31.

	AgFirst Correspondent Lending					
(dollars in millions)	2007		2006		2005	
Rural Home Loans – Guaranteed	$ 852.0	81.97%	$ 605.5	78.44%	$ 411.6	74.11%
Part-time Farm Loans – Guaranteed	126.1	12.13	119.0	15.40	110.0	19.80
Agricultural Loans – Guaranteed	2.3	0.22	2.5	0.33	3.2	0.58
Non-guaranteed Loans	59.0	5.68	45.0	5.83	30.6	5.51
Total	$ 1,039.4	100.00%	$ 772.0	100.00%	$ 555.4	100.00%

Rural home loans are underwritten to conform to Fannie Mae standards and are guaranteed by Fannie Mae. Part-time farm loans conform to Farmer Mac standards and are guaranteed by Farmer Mac. During 2007, AgFirst purchased $360.8 million of rural home and part-time farm loans, averaging $30.1 million per month.

AgFirst owned $852.0 million in rural home loans at December 31, 2007. These loans are the most significant segment of the correspondent lending portfolio due to the Associations' active participation in Fannie Mae home loan programs.

AgFirst owned $126.1 million in part-time farm loans at December 31, 2007. Part-time farm loans represent first lien mortgages on homes with property characteristics (such as acreage or agricultural improvements) that may not conform to Fannie Mae standards. These loans are guaranteed by Farmer Mac.

AgFirst owned $2.3 million of agricultural loans that are guaranteed by Farmer Mac at December 31, 2007. This segment is small, due primarily to the Associations' propensity to hold agricultural loans in their own portfolios. Through AgFirst, a number of Associations obtain Farmer Mac guarantees for qualifying segments of their agricultural portfolios, thereby reducing the need to sell those loans to AgFirst.

The $59.0 million of non-guaranteed loans at December 31, 2007 generally consists of loans that are awaiting confirmation of guarantee by Fannie Mae or Farmer Mac. Such loans are secured by first-lien mortgages and are considered high quality assets at time of purchase.

Essentially all loans owned and/ or serviced by AgFirst are sub-serviced through agreements with third parties. The total volume owned as of December 31, 2007 was $1.04 billion. The total volume serviced but not owned as of December 31, 2007 was $13.8 million.

MISSION RELATED INVESTMENTS

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

Rural Housing Mortgage-Backed Securities

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

Rural America Bonds

In October 2005, the FCA approved the Rural America Bonds investment program for a three-year pilot period. In recognition of the economic interdependence between agricultural and rural communities, AgFirst and the Associations seek to safely and soundly invest in debt obligations that support farmers, ranchers, agribusinesses, and their rural communities and businesses. In doing so, AgFirst and the Associations hope to increase the well-being and prosperity of American farmers, ranchers, and rural residents. As of December 31, 2007, the District had $141.8 million in the Rural America Bond program, compared to $45.6 million at December 31, 2006. The Bank had $74.1 million invested in the program as of December 31, 2007, an increase of $48.0 million from December 31, 2006. Of the $74.1 million, the Bank had $51.2 million reflected in investment securities and $22.9 million reflected as loans on the Consolidated Balance Sheet at December 31, 2007.

RISK MANAGEMENT

The organizational structure of AgFirst facilitates communication of operational and risk management issues throughout all layers of management and across all functional areas. AgFirst's Chief Operating and Risk Officer, who reports directly to the President and Chief Executive Officer of the Bank, is responsible for:

- Providing overall leadership, vision, and direction for enterprise risk management;
- Establishing an integrated risk management framework for all aspects of risk across the organization;
- Ensuring development of risk management policies, including the quantification of management's risk appetite through specific risk limits;
- Implementing a set of risk metrics and reports, including key risk exposures and early warning indicators;
- Reviewing and approving recommendations for the allocation of economic capital to business activities based on risk, and optimizing the Bank's risk portfolio through business activities and risk transfer strategies;
- Improving the Bank's risk management readiness through coordination of communication and training programs, risk-based performance measurement and incentives, and other change management programs;
- Assigning responsibility for development of analytical systems and data management capabilities to support the risk management program; and
- Reporting periodically to the Audit Committee of the Board of Directors on actions taken to strengthen the Bank's system of internal controls.

Overview

The Bank 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 AgFirst'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 Bank's business activities.

Types of risks to which the Bank 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 Bank's operating results and financial condition,
- *liquidity risk* — risk of loss arising from the inability to meet obligations when they come due without incurring unacceptable losses,
- *operational risk* — risk of loss resulting from inadequate or failed internal processes or systems, errors by employees or external events, and
- *political risk* — risk of loss of support for the System and agriculture by federal and state governments.

Structural Risk Management

Structural risk results from the fact that AgFirst, along with its related Associations, is part of the System, which is comprised of banks and associations that are cooperatively owned, directly or indirectly, by their borrowers. While System institutions are financially and operationally interdependent, this structure at times requires action by consensus or contractual agreement. The Federal Farm Credit Banks Funding Corporation (Funding Corporation) provides for the issuance, marketing, and processing of Systemwide Debt Securities using a network of investment dealers and dealer banks. The System banks fund association loans with Systemwide debt. Refer to Note 7, *Bonds and Notes*, in the Notes to the Consolidated Financial Statements for further discussion. The banks are jointly and severally liable for the payments of Systemwide Debt Securities, exposing each bank to the risk of default of the others.

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

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

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

Credit Risk Management

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

The credit risk management process begins with an analysis of the obligor's credit history, repayment capacity and financial position. Repayment capacity focuses on the obligor's ability to repay the obligation based on cash flows from operations or other sources of income, including non-farm income. Real estate mortgage loans must be secured by first liens on the real estate (collateral). As required by FCA regulations, each institution that makes loans on a secured basis must have collateral evaluation policies and procedures.

The credit risk rating process for loans uses a two-dimensional loan rating structure, incorporating a 14-point risk-rating scale to identify and track a borrower's probability of default and a separate scale addressing loss given default. The loan rating structure calculates estimates of loss through two components, borrower risk and transaction risk. Borrower risk is the risk of loss driven by factors intrinsic to the borrower. The transaction risk or facility risk is related to the structure of a credit (tenor, terms, and collateral).

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

AgFirst's 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)	2007	2006	2005
AgFirst High-risk Assets			
Nonaccrual loans	$ 2,507	$ 15,110	$ 19,197
Restructured loans	–	–	–
Accruing loans 90 days past due	1,356	1,759	653
Total high-risk loans	3,863	16,869	19,850
Other property owned	–	75	–
Total high-risk assets	$ 3,863	$ 16,944	$ 19,850
Ratios			
Nonaccrual loans to total loans	0.01%	0.09%	0.13%
High-risk assets to total assets	0.02%	0.07%	0.10%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or interest under the contractual terms of the loan. Nonaccrual loans decreased $12.6 million, or 83.41 percent in 2007.

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

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

Although neither the Bank 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.

Interest Rate Risk Management

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

The objective of interest rate risk management is to generate a stable and adequate level of net interest income in any interest rate environment. AgFirst uses a variety of sophisticated analytical techniques to manage the complexities associated with offering numerous loan options. These include interest rate sensitivity gap analysis to monitor the repricing characteristics of AgFirst'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 AgFirst's projected change in net interest income and market value of equity for various rate movements as of December 31, 2007.

Net Interest Income
(dollars in thousands)

Scenarios	Net Interest Income	% Change
+4.0% Shock	$300,147	12.26%
+2.0% Shock	$291,037	8.86%
Base line	$267,362	–
-50% of 3M Tbill **	$367,258	37.36%

Market Value of Equity
(dollars in thousands)

Scenarios	Assets	Liabilities	Equity*	% Change
Book Value	$26,926,621	$25,869,140	$1,057,481	–
+4.0% Shock	$25,191,013	$24,484,558	$ 706,455	(29.55)%
+2.0% Shock	$26,160,570	$25,331,199	$ 829,371	(17.30)%
Base line	$27,079,984	$26,077,143	$1,002,841	–
-50% of 3M Tbill **	$27,570,393	$26,388,938	$1,181,455	17.81%

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

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

The following table sets forth the repricing characteristics of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2007. The amount of assets and liabilities shown 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	$ 2,401,883	$ 334,755	$ 929,596	$ 508,642	$ 4,174,876
Variable	3,508,397	–	–	–	3,508,397
Total Short and Intermediate-Term Loans	5,910,280	334,755	929,596	508,642	7,683,273
Long-term Real Estate Loans					
Fixed	3,838,608	1,926,551	4,401,003	1,175,418	11,341,580
Variable	45,078	35,126	9,383	77	89,664
Total Long-term Real Estate Loans	3,883,686	1,961,677	4,410,386	1,175,495	11,431,244
Total Loans	9,793,966	2,296,432	5,339,982	1,684,137	19,114,517
Total Investments *	5,655,212	456,474	731,697	609,291	7,452,674
TOTAL INTEREST EARNING ASSETS	$15,449,178	$2,752,906	$6,071,679	$2,293,428	$26,567,191
Interest-Bearing Liabilities					
Systemwide bonds and notes	$ 10,871,248	$ 2,531,000	$ 9,795,000	$ 1,650,000	$ 24,847,248
Other interest-bearing liabilities	–	–	–	225,000	225,000
Interest rate swaps	1,803,000	(340,000)	(1,213,000)	(250,000)	–
TOTAL INTEREST-BEARING LIABILITIES	$12,674,248	$2,191,000	$8,582,000	$1,625,000	$25,072,248
Interest Rate Sensitivity Gap	$2,774,930	$561,906	$(2,510,321)	$668,428	
Sensitivity Gap as % of Total Earning Assets	10.44%	2.12%	(9.45%)	2.52%	
Cumulative Gap	$2,774,930	$3,336,835	$826,514	$1,494,942	
Cumulative Gap as a % of Total Earning Assets	10.44%	12.56%	3.11%	5.63%	
Rate Sensitive Assets/Rate Sensitive Liabilities	1.22	1.26	0.71	1.41	

* *includes cash equivalents*

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

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

At December 31, 2007, AgFirst had outstanding interest rate swaps with notional amounts totaling $1.93 billion. Substantially all of these derivative transactions were executed to create synthetic floating-rate debt to achieve a lower cost of funding. Derivatives are also used by the Bank for asset/liability management purposes to reduce interest rate risk.

AgFirst policy prohibits the use of derivatives for speculative purposes. See Note 16, *Derivative Instruments and Hedging Activities*, in the Notes to the Consolidated Financial Statements for additional information. The following table shows the activity in derivatives during the year ended December 31, 2007.

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

Liquidity Risk Management

AgFirst maintains adequate liquidity to satisfy its daily cash needs. In addition to normal cash flow associated with lending operations, AgFirst has two primary sources of liquidity: investments, including its available-for-sale portfolio, and the capacity to issue Systemwide Debt Securities. The Bank also maintains several lines of credit with commercial banks, as well as a securities repurchase agreement facility.

Investments and Cash Equivalents

FCA Regulations provide that a System bank may hold certain eligible investments, in an amount not to exceed 35.00 percent of its total loans outstanding. These investments serve to provide liquidity to the Bank's operations which meet and generally exceed the FCA's liquidity reserve requirement, 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. Until recently, AgFirst generally has attempted to maintain its available-for-sale portfolio at a level near the regulatory limit of 35.00 percent of loans outstanding. In the current investment environment, spreads on investment securities have narrowed, making it more difficult for the bank to obtain viable securities. This may result in a lower mix of investment securities on the balance sheet in the future.

In addition, AgFirst 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).

The Bank has low exposure to investments impacted by recent adversity in the subprime borrower mortgage market. Asset-backed securities with subprime exposure totaled $166.6 million (2.97 percent) of the available-for-sale liquidity investment portfolio and 2.41 percent of the total investment security portfolio at December 31, 2007. The amortized cost of these investment securities was $184.7 million and a market value adjustment of $18.1 million was reflected in Other Comprehensive Income (OCI) in the Financial Statements at December 31, 2007. All asset-backed securities were rated in one of the two top ratings categories by at least one of the Nationally Recognized Statistical Rating Organizations at December 31, 2007 and all have credit enhancement features. However, the uncertainty in the mortgage securities markets has adversely impacted the market value of these securities as reflected in OCI. Since the decline in market value was not credit related and was caused by changes in interest rates and market conditions, and because the Bank has the ability and intent to hold these investments until a recovery of unrealized losses occurs, which may be maturity, the Bank has not recognized any other-than-temporary impairment in connection with these investments.

Investment securities and cash equivalents outstanding as of December 31, 2007 for AgFirst totaled $7.45 billion compared to $6.87 billion and $5.81 billion at December 31, 2006 and 2005, respectively. The increases in investment securities are primarily related to the growth of total loans as management increased the size of the portfolio generally in line with loan growth.

AgFirst's investment portfolio consisted of the following security types as of December 31, 2007.

	AgFirst Investment Securities					
(dollars in thousands)	**2007**		**2006**		**2005**	
Investment Securities Available for Sale						
Commercial Paper	$ –	–%	$ –	–%	$ 69,796	1.33%
U.S. Govt. GNMA MBS/CMOs	1,754,553	25.40	1,267,914	19.94	1,056,283	20.10
U.S. Govt. Agency MBS	3,051,267	44.16	2,749,985	43.25	2,029,961	38.62
Non-Agency Securities	636,559	9.21	776,534	12.21	597,670	11.37
Asset-Backed Securities	166,550	2.41	271,188	4.26	132,608	2.52
Total Available for Sale	5,608,929	81.18	5,065,621	79.66	3,886,318	73.94
Held to Maturity						
Rural Housing MBS	1,124,855	16.28	1,249,788	19.66	1,347,266	25.64
MBS Guaranteed by Farmer Mac	16,946	0.25	19,260	0.30	22,161	0.42
Other	158,067	2.29	24,013	0.38	–	–
Total Held to Maturity	1,299,868	18.82	1,293,061	20.34	1,369,427	26.06
Total Investment Securities	$ 6,908,797	100.00%	$ 6,358,682	100.00%	$ 5,255,745	100.00%
Cash Equivalents						
Fed Funds	$ 183,659	33.77%	$ 55,369	10.81%	$ 168,428	30.54%
Master Notes	85,218	15.67	82,000	16.00	108,048	19.59
Repos	275,000	50.56	375,000	73.19	275,000	49.87
Total Cash Equivalents	$ 543,877	100.00%	$ 512,369	100.00%	$ 551,476	100.00%

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

Systemwide Debt Securities

AgFirst's primary source of liquidity is its ability to issue Systemwide Debt Securities, which are the general unsecured joint and several obligations of the System banks. AgFirst continually raises funds to support 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 had access to the nation's and world's debt and capital markets. This access has provided AgFirst with a dependable source of competitively priced debt that is critical to support 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. However, as a result of the System's financial performance, credit quality and standing in the capital markets, AgFirst anticipates continued access to funding necessary to support the System's and Bank's needs. The U.S. government does not guarantee, directly or indirectly, Systemwide Debt Securities. AgFirst's year-to-date average balance of Systemwide Debt Securities at December 31, 2007, was $23.52 billion. At December 31, 2007, AgFirst had $24.85 billion in total debt outstanding compared to $22.61 billion at December 31, 2006 and $18.88 billion at December 31, 2005. The year-to-year increases were primarily due to the increases in loan volume and the investment portfolio.

AgFirst's participation in outstanding Systemwide Debt Securities as of December 31, 2007 is shown in the following table.

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

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

Refer to Note 7, *Bonds and Notes,* in the Notes to the Consolidated Financial Statements, for additional information related to debt.

Operational Risk Management

Operational risk is the risk of loss resulting from inadequate or failed processes or systems, human factors or external events, including the execution of unauthorized transactions by employees, errors relating to transaction processing and technology, breaches of the internal control system and the risk of fraud by employees or persons outside the System. AgFirst's and the Associations' boards of directors are required, by regulation, to adopt internal control policies that provide adequate direction to the institutions in establishing effective controls 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 addition, AgFirst has implemented a Risk Management Policy to ensure that business exposures to risk are identified, measured and controlled, using the most effective and efficient methods to eliminate, reduce, or transfer such exposures. AgFirst's risk management structure was designed to ensure that an effective enterprise-wide risk management program is in place. Exposure to operational risk is typically identified with the assistance of senior management. Internal audit plans are developed under the oversight of the AgFirst's Board Audit Committee to ensure an appropriate level of review based on a particular area's or department's level of inherent risk.

Political Risk Management

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

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

ALLOWANCE FOR LOAN LOSSES

The Bank 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 Bank 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. Analysis indicates that a general allowance for losses related to AgFirst's direct note, correspondent lending and the primary components of its participations/syndication portfolios is not justified. AgFirst's allowance for loan losses reflects reserves for risks identified related to specific loans in those portfolios and a general reserve for certain pools of loans acquired directly from several District Associations. The allowance for loan losses was $2.8 million at December 31, 2007, as compared with $463 thousand and $10.1 million at December 31, 2006 and 2005, respectively. The allowance at

December 31, 2007 included a specific reserve of $1.4 million related to a specific credit and general reserves on certain loan pools of $1.4 million.

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

AgFirst Allowance for Loan Losses Activity:

(dollars in thousands)	2007	2006	2005
Balance at beginning of year	$ 463	$ 10,114	$ 14,800
Charge-offs:			
Agribusiness	–	(2,314)	(41)
Communication	–	–	(13)
Energy	(128)	–	–
Total charge-offs	(128)	(2,314)	(54)
Recoveries:			
Communication	–	–	363
Total recoveries	–	–	363
Net (charge-offs) recoveries	(128)	(2,314)	309
Provision for (reversal of allowance for) loan losses	2,481	(7,337)	(4,995)
Balance at end of year	$ 2,816	$ 463	$ 10,114
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	(0.001)%	(0.015)%	0.002%

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

AgFirst Allowance for Loan Losses by Loan Type

(dollars in thousands)	2007	2006	2005
Real Estate Mortgage	$ 958	$ 279	$10,100
Production and Intermediate Term	380	130	–
Agribusiness	44	26	–
Communication	–	1	–
Energy	–	3	–
Rural Residential Real Estate	5	24	14
Other	1,429	–	–
Total	$ 2,816	$ 463	$10,114

The allowance for loan losses as a percentage of loans outstanding and as a percentage of certain other credit quality indicators at December 31 is shown below:

	2007	2006	2005
Allowance for loan losses to loans	0.01%	0.003%	0.07%
Allowance for loan losses to nonaccrual loans	112.33%	3.06%	52.68%
Allowance for loan losses to participation loans and Correspondent Lending loans	0.06%	0.01%	0.51%

The financial positions of the Associations' 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. As discussed previously, uncertainty in the general economic environment has increased the potential for prospective risks in the loan portfolio.

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

RESULTS OF OPERATIONS

Net Income

AgFirst net income totaled $192.2 million for the year ended December 31, 2007, an increase of $2.0 million over 2006. AgFirst net income totaled $190.2 million for the year ended December 31, 2006, an increase of $25.9 million over 2005. Major components of the changes in net income for the referenced periods are outlined in the following table and discussion.

Changes in Net Income *(dollars in thousands)*	Year Ended December 31, 2007	2006
Net income (for prior year)	$ 190,193	$ 164,259
Increase (decrease) due to:		
Total interest income	246,086	430,275
Total interest expense	(212,720)	(406,964)
Net interest income	33,366	23,311
Provision for loan losses	(9,818)	2,342
Noninterest income	(5,475)	2,549
Noninterest expense	(16,057)	(2,268)
Total increase (decrease) in net income	2,016	25,934
Net income	$ 192,209	$ 190,193

Interest Income

Total interest income for the year ended December 31, 2007 was $1.47 billion, an increase of $246.1 million, as compared to the same period of 2006. Total interest income for 2006 was $1.22 billion, an increase of $430.3 million, as compared to the same period of 2005. The increase from 2006 to 2007 resulted from increases related to volume and rate. The volume of interest earning assets increased in 2007, with an increase in average earning assets of $3.23 billion. In 2007, interest rates increased in comparison to 2006 and as a result, the average yield on interest earning assets increased 0.26 percent.

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

Net Change in Interest Income *(dollars in thousands)*	Year Ended December 31, 2007-2006	2006-2005
Current year increase in average earning assets	$ 3,231,118	$ 4,089,252
Prior year average yield	5.58%	4.44%
Interest income variance attributed to change in volume	180,074	181,548
Current year average earning assets	25,174,822	21,943,704
Current year increase (decrease) in average yield	0.26%	1.14%
Interest income variance attributed to change in yield	66,012	248,727
Net change in interest income	$ 246,086	$ 430,275

Interest Expense

Total interest expense for the year ended December 31, 2007 was $1.21 billion, an increase of $212.7 million, as compared to the same period of 2006. Total interest expense for the year ended December 31, 2006 was $995.4 million, an increase of $407.0 million, as compared to the same period of 2005. The increases were primarily attributed to an increase in interest-bearing liabilities supporting asset growth, and an increase in average rates.

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

Net Change in Interest Expense *(dollars in thousands)*	Year Ended December 31, 2007-2006	2006-2005
Current year increase in average interest-bearing liabilities	$ 2,952,023	$ 3,988,090
Prior year average rate	4.79%	3.50%
Interest expense variance attributed to change in volume	141,293	139,616
Current year average interest-bearing liabilities	23,749,594	20,797,571
Current year increase (decrease) in average rate	0.30%	1.29%
Interest expense variance attributed to change in rate	71,427	267,348
Net change in interest expense	$ 212,720	$ 406,964

Net Interest Income

Net interest income increased from 2006 to 2007 and from 2005 to 2006, as illustrated by the following table.

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

	2007			2006			2005		
	Avg. Balance	Interest	Avg. Yield	Avg. Balance	Interest	Avg. Yield	Avg. Balance	Interest	Avg. Yield
Loans	$ 18,002,377	$ 1,083,668	6.02%	$ 15,568,139	$ 890,247	5.72%	$ 13,448,845	$ 624,945	4.65%
Cash & investments	7,172,445	385,366	5.37%	6,375,565	332,701	5.22%	4,405,607	167,728	3.81%
Total earning assets	$ 25,174,822	$ 1,469,034	5.84%	$ 21,943,704	$ 1,222,948	5.58%	$ 17,854,452	$ 792,673	4.44%
Interest-bearing liabilities	$ 23,749,594	$ (1,208,156)	5.09%	$ 20,797,571	$ (995,436)	4.79%	$ 16,809,481	$ (588,472)	3.50%
Spread			0.75%			0.79%			0.94%
Impact of capital	$ 1,425,228		0.29%	$ 1,146,133		0.25%	$ 1,044,971		0.20%
Net Interest Income (NII) & NII to average earning assets		$ 260,878	1.04%		$ 227,512	1.04%		$ 204,201	1.14%

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

Provision for Loan Losses

AgFirst assesses risks inherent in its portfolio on an ongoing basis and establishes an appropriate reserve for loan losses. The net provision for loan losses in 2007 of $2.5 million resulted from a $1.4 million addition for a specific reserve related to one credit and a $1.1 million addition for general reserves for certain loan pools purchased directly from several Associations. The net reversal of allowance for loan losses in 2006 of $7.3 million resulted from decreased exposure and payments related to loans in the Participation/Syndication portfolio.

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, 2007	2006	2005	Increase (Decrease) 2007/2006	2006/2005
Loan fees	$ 7,684	$ 6,262	$ 11,441	$ 1,422	$ (5,179)
Realized gains (losses) on investments (net)	–	(5)	466	5	(471)
Realized gains on derivatives (net)	–	6,812	94	(6,812)	6,718
Gains (losses) on sales of rural home loans (net)	180	(83)	1,046	263	(1,129)
Patronage refunds from other Farm Credit Institutions	3,161	1,746	943	1,415	803
Other noninterest income	2,798	4,566	2,759	(1,768)	1,807
Total noninterest income	$ 13,823	$ 19,298	$ 16,749	$ (5,475)	$ 2,549

The increase in loan fees for 2007 primarily represented increases in fee income on participation loans. The decrease in loan fees from 2006 to 2005 was primarily due to reductions of $3.5 million in net participations/syndications fee income, as lines of credit were more fully advanced and generated less un-advanced commitment fees. In addition, prepayment penalty income was $1.3 million lower in 2006 as compared to 2005 as refinance activity slowed in a higher interest rate environment.

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 $1.4 million and $0.8 million in 2007 and 2006, respectively, primarily from increases in participation loans purchased from other Farm Credit institutions.

The $1.8 million increase in other noninterest income for 2006 primarily resulted from a $1.5 million gain allocated to AgFirst from the sale of the Farm Credit System Building Association property in McLean, Virginia.

Noninterest Expense

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

Noninterest Expense *(dollars in thousands)*	For the Year Ended December 31, 2007	 2006	 2005	Increase/(Decrease) 2007/ 2006	 2006/ 2005
Salaries and employee benefits	$ 28,853	$ 26,318	$ 27,957	$ 2,535	$ (1,639)
Occupancy and equipment	13,060	11,608	11,108	1,452	500
Insurance fund premiums	5,623	3,597	884	2,026	2,713
Other operating expense	18,776	17,529	15,882	1,247	1,647
Intra-System financial assistance expense	–	–	3,221	–	(3,221)
Called debt expense	10,550	2,563	656	7,987	1,907
Correspondent lending servicing expense	2,071	1,656	1,294	415	362
Other noninterest expenses	1,078	683	684	395	(1)
Total noninterest expenses	$ 80,011	$ 63,954	$ 61,686	$ 16,057	$ 2,268

Total salaries and employee benefits generally increased over the three year period of 2005 through 2007 as a result of normal salary increases, retention of a highly qualified staff, and increased benefit costs that were experienced by most employers. From year to year, the level of reported personnel costs was also affected by deferrals reflecting the cost of internal capital project development and other factors.

Occupancy and equipment expenses increased $1.4 million and $0.5 million during 2007 and 2006, respectively, primarily as the result of technology upgrading and renovation aimed at improving AgFirst's technical infrastructure and updating various systems and related higher depreciation expense.

The Insurance Fund premium increased $2.0 million in 2007 due to the increase in loan volume. The Insurance Fund premium increased $2.7 million in 2006 primarily due to an increase in premium rates from 5 basis points to 15 basis points on accrual loans beginning January 1, 2006.

Other operating expenses increased $1.2 million in 2007. This increase in reported expenses was primarily the result of a decrease in cost deferrals related to internal capital project development and other factors. The increase in 2006 is primarily due to an increase in purchased services and a special assessment from the Farm Credit Council.

Intra-System financial assistance expense ceased when AgFirst fully extinguished its obligations in 2005 with the maturity of the last Financial Assistance Corporation bonds. The Financial Assistance Corporation dissolved effective as of December 31, 2006. See Note 11, *Intra-System Financial Assistance*, in the Notes to the Consolidated Financial Statements for further information.

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 $8.0 million in 2007, compared to 2006. Call options were exercised on bonds totaling $7.02 billion in 2007. For 2006, the called debt expense increased $1.9 million, compared to 2005. Called debt volume was $1.55 billion and $352.0 million for 2006, and 2005, respectively. The called debt expense is more than offset by interest expense savings realized over time as called debt is replaced by new debt issued at a lower rate of interest.

The increases in correspondent lending servicing expense for 2007 and 2006 are primarily due to higher guarantee fees from increased volume in the correspondent lending portfolio.

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

Key Results of Operations Comparisons

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

Key Results of Operations Comparisons	For the 12 Months Ended 12/31/07	For the 12 Months Ended 12/31/06	For the 12 Months Ended 12/31/05
Return on average assets	0.76%	0.86%	0.91%
Return on average shareholders' equity	13.58%	16.74%	14.95%
Net interest income as a percentage of average earning assets	1.04%	1.04%	1.14%
Net chargeoffs (recoveries) to average loans	0.001%	0.015%	(0.002)%

The June 2007 issuance of the Perpetual Preferred Stock (see Preferred Stock section below) affected certain ratios in the table above. Return on equity was lowered because the additional equity was not fully leveraged during 2007. Also, the issued stock, while increasing shareholders' equity, served to reduce interest bearing liabilities as proceeds from the issuance were used to pay off debt. This also had a related income statement impact as interest expense decreased which had a positive affect on net interest margin and return on assets.

PREFERRED STOCK

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

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

On May 17, 2001, AgFirst issued $225.0 million of Mandatorily Redeemable Cumulative Preferred Stock at a par value of $1 thousand per share. This stock is mandatorily redeemable on December 15, 2016 and carries a stated annual dividend rate of 8.393 percent until December 15, 2011, with dividends paid semi-annually in arrears on June 15th and December 15th. Commencing March 15, 2012, dividends are paid at a floating rate per annum equal to 3 month LIBOR plus 3.615 percent with dividends payable quarterly.

On or after the dividend payment date in December 2011, the preferred stock will be redeemable in whole or in part at the option of AgFirst on any dividend payment date at par value of $1 thousand per share together with accrued and unpaid dividends to the redemption date. The Mandatorily Redeemable Preferred Stock is reported as a liability and the related dividends reported as interest expense. Although the Mandatorily Redeemable Preferred Stock is required to be reported as a liability under GAAP, it qualifies as capital for certain regulatory purposes.

See Note 8, *Mandatorily Redeemable Preferred Stock,* and Note 9, *Shareholders' Equity*, in the Notes to the Consolidated Financial Statements for further information concerning the preferred stock issuances.

CAPITAL

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

The AgFirst Capitalization Plan (the "Plan") approved by the Bank Board of Directors establishes guidelines to ensure that adequate capital is maintained for continued financial viability, to provide for growth necessary to meet the needs of members/borrowers, and to ensure that all stockholders are treated equitably. The Bank's capital objectives are considered adequate to support inherent risk. There were no material changes to the Plan for 2007 that have an effect on the Bank's ability to retire stock and distribute earnings.

Total shareholders' equity at December 31, 2007 was $1.46 billion, compared to $1.18 billion and $1.04 billion at December 31, 2006 and 2005, respectively. The increase in 2007 of $276.4 million was primarily due to the issuance of $250.0 million of Perpetual Non-cumulative Subordinated Preferred Stock discussed in the *Preferred Stock* section above. Also, the increasing trend in shareholders' equity is attributed to the increases in retained earnings and increased levels of Association owned stock. Capital stock and participation certificates totaled $364.8 million at December 31, 2007, compared to $313.4 million at December 31, 2006, an increase of $51.4 million. The Associations are required to maintain ownership in the Bank in the form of Class B and Class C stock. The Associations' minimum stock requirement increased from 1.40 percent of Association Direct Note balances to 1.75 percent effective December 31, 2006, as a means to support the strong growth in Bank assets. This resulted in a $20.9 million and $61.1 million increase for 2007 and 2006, respectively, in Association owned capital stock. In addition, as of December 31, 2007, ten Associations had purchased $56.7 million in stock to support certain loan participation pools they had sold to the Bank. This was an increase of $30.1 million, as compared to $26.6 million purchased in 2006.

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 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 are shown in the following table.

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

Regulatory ratios for each District Association at December 31 are presented in the *Direct Notes* section above.

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

The increase in the Bank's permanent capital, total surplus, and core surplus ratios for December 2007 was primarily attributed to the increase in capital due to the issuance of the Preferred Stock and Association owned stock, as referenced above. The decrease in the Bank's permanent capital, total surplus, and core surplus ratios for December 31, 2006 was attributed to the increase in assets on both a total and risk adjusted basis exceeding the increase in capital. The decrease in the collateral ratio for December 31, 2006 also was attributed to asset growth.

Refer to Note 9, *Shareholders' Equity*, in the Notes to the Consolidated Financial Statements for additional information regarding regulatory capitalization requirements and restrictions.

ECONOMIC CAPITAL

As discussed previously (see Risk Management section above), risk is an inherent part of the Bank's business activities. The Bank'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 Bank has implemented economic capital software, methodologies, and assumptions to quantify the capital requirements related to our primary areas of risk. The Bank periodically quantifies the economic capital requirements, based on the credit risk, interest rate risk, operational risk, and market risk inherent in operations. For a further discussion of these risks, see the *Risk Management* section above. Due to the evolving nature of the economic capital concept, the Bank anticipates these methodologies and assumptions will continue to be refined.

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

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

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

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

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

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

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

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

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	136,674	–	$ 26,597,445	–
2. Young farmers and ranchers	21,933	16.05%	$ 2,232,410	8.39%
3. Beginning farmers and ranchers	33,182	24.28%	$ 4,599,062	17.29%

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

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

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

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

Young, and Beginning Farmers and Ranchers
Gross New Business During 2007, Number/Volume of Loans
(dollars in thousands)

Category	Number of Loans	Percent of Total	Volume Outstanding	Percent of Total
1. Total gross new loans and commitments made during 2007	57,758	–	$ 13,167,791	–
2. Total loans and commitments made during 2007 to young farmers and ranchers	8,673	15.02%	$ 1,054,450	8.01%
3. Total loans and commitments made during 2007 to beginning farmers and ranchers	11,604	20.09%	$ 1,968,978	14.95%

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

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

LEGAL PROCEEDINGS

On the basis of information presently available, management and legal counsel are of the opinion that the ultimate liability, if any, from legal actions pending against AgFirst would be immaterial in relation to the financial position of AgFirst. Refer to Note 14, *Commitments and Contingencies*, in the Notes to the Consolidated Financial Statements for additional information.

REGULATORY MATTERS

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

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

Proposed Federal Legislation

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

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

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

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

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans.* The Standard requires an employer to recognize the overfunded or underfunded status of defined benefit pension and other postretirement benefit plans as an asset or liability in its statement of financial position and recognize changes in that funded status through accumulated other comprehensive income as of December 31, 2007. The Standard further requires the determination of the fair value of plan assets at December 31, 2007 and recognition of actuarial gains and losses, prior service costs or credits, and transition assets and obligations as a component of accumulated other comprehensive income. In addition, this Standard requires a change for the funded status of a plan to be measured as of the date of the year-end financial statements. Currently, the Bank and District Associations use a measurement date of September 30 but will be required in 2008 to measure the funded status of the plans as of the fiscal year end, which is December 31. The Bank has one single employer defined benefit plan and participates in multi-employer defined benefit pension and other postretirement benefit plans. Under FAS 158, accounting for the impact of the adoption of the standard follows the plan sponsor, which for multi-employer plans in which the Bank participates is at the District entity level. Therefore, there is no impact to the Bank's financial statements for the adoption of FAS 158 for multi-employer plans. For the one single employer defined benefit plan sponsored by the Bank, a supplemental retirement plan, adoption of FAS 158 is reflected as an adjustment to accumulated other comprehensive income in the Bank's Consolidated Statement of Changes in Shareholders' Equity. See Note 10, *Employee Benefit Plans,* of the Consolidated Financial Statements, for further information regarding the impact of the adoption of FAS 158 on the current period for the Bank's supplemental retirement plan.

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

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

Additional Disclosure Required by Farm Credit Administration Regulations

Description of Business

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

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

Description of Property

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

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

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 14 to the Consolidated 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 9 to the Consolidated Financial Statements, *Shareholders' Equity,* included in this Annual Report to shareholders.

Description of Liabilities

The description of liabilities, contingent liabilities and intra-system financial assistance rights and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 6, 7, 8, 10, 11 and 14 to the Consolidated Financial Statements included in this Annual Report to shareholders.

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

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

Senior Officers

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

The chief executive officer and all other senior officers of the Bank, together with their length of service at their present position, as well as positions held during the last five years, are as follows:

Name and Title	Time in Position	Prior Experience	Other Business Interests
F.A. Lowrey, *President and Chief Executive Officer*	10 years	CEO, Palmetto Farm Credit, ACA from April 1989 to January 1998.	He serves as: Chairman of the Board for Federal Farm Credit Banks Funding Corporation; Council Member of the National Council of Farm Cooperatives; University of South Carolina: Board of Trustees for the Business Partnership Foundation and the Board of Directors for the Education Foundation; Board of Directors for Big Brothers Big Sisters of Greater Columbia; Board of Directors and Chairman of Finance Committee for National 4H Council; Board of Directors for Palmetto AgriBusiness Council; Board of Directors for Midlands Business Leadership Group.
Thomas S. Welsh, *Executive Vice President and Chief Administrative and Legislative Officer*	10 years	Chief Marketing and Planning Officer from January 1996 until March 1998.	He serves on the Advisory Board of the Farm Credit System Captive Insurance Company. Member of the AgFirst Plan Sponsor Committee and the AgFirst/FCBT Plan Sponsor Committee.
Leon T. Amerson, *Executive Vice President and Chief Operating Officer*	1.5 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*	9 months	Chief Financial Officer and Secretary at The National Bank of South Carolina from 1991 until 2007.	He serves on the Board of Directors and as Treasurer of the S.C. Council on Economic Education.
William L. Melton, *Senior Vice President and Chief Lending Officer*	4.5 years	Senior Executive Officer/Bank Lending from January to July 2003, prior to that Lending Services Manager.	He served as Director-at-Large for the National Chicken Council, a trade organization.
Benjamin F. Blakewood, *Senior Vice President and Chief Information Officer*	9.5 years	Director of Information Technology from 1996 to 1998 at Affinity Technology Group.	
Frederick T. Mickler, III, *Senior Vice President and General Counsel*	10 years	Assistant General Counsel July 1989 until April 1998.	

The total amount of compensation earned by the CEO and the senior officers as a group during the years ended December 31, 2007, 2006 and 2005, is as follows:

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

* *Primarily comprised of company contributions to thrift plan (see Note 10 to the Consolidated Financial Statements – Employee Benefit Plans), group life insurance premiums and bank-provided automobile. Amount for other senior officers in 2007 also includes sign-on bonus.*

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

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

Bank compensation plans are reviewed by the Board Compensation Committee.

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

AgFirst Farm Credit Bank Board of Directors

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

* *These directors were re-elected to a new 4-year term ending 12/31/11.*
** *These directors were newly elected in 2007 to 4-year terms commencing 1/1/08.*
*** *Re-appointed to 4-year term ending 12/31/11.*

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

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

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

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

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

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

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

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

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

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

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

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

James L. May is owner and operator of Mayhaven Farm in Waynesburg, Kentucky, where he owns 330 acres and leases another 700 acres. He is involved in the development and marketing of 500 heifers for replacement cows and embryo transfer. May's operation also includes 150 acres of alfalfa hay, 500 acres of corn and soybeans, and 100 acres of wheat. He currently serves as a member of the Central Kentucky Ag Credit board, Lincoln County Extension Council, Lincoln County Ag Development Board, and is a member of the Lincoln County Farm Bureau Board. Mr. May serves as a member of the Board Audit Committee.

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

James M. Norsworthy, III, from Jackson, Louisiana has been involved in production agriculture for 38 years. Mr. Norsworthy runs 100 Cedars Cattle Farm, a 175-head cow-calf operation near Jackson, La. He also has a commercial hay operation with 125 acres in Alicia Bermuda hay and 150 acres in Bahia Grass hay and manages a 375-acre pine and hardwood timber operation. He is a member of the board of directors of First South Farm Credit, ACA, and serves on the board of Feliciana Farm Bureau and was president of that organization from 1984 to 1996. He is a member of East Feliciana Cattlemen's Association, American Angus Association and the Feliciana Forestry Association. Mr. Norsworthy served as mayor of the town of Jackson, La., from 1979 to 1996. Mr. Norsworthy serves on the Board Audit Committee.

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

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

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

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

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

Kenneth A. Spearman, from Winter Haven, Florida, is a retired Director of Internal Audit for Florida's Natural Growers, Inc. who served 28 years with the citrus industry. He was Controller of Citrus Central, Inc. in Orlando, Florida from 1980-1991, was co-founder of a public accounting firm in Chicago, Illinois and was employed with Arthur Andersen & Co. He obtained his Masters Degree in Business Administration from Governors State University in University Park, Illinois, and his B. S. degree in accounting from Indiana University. He served as chairman of the board of trustees for the Lake Wales Medical Center. He is a member of the Institute of Internal Auditors, and the National Society of Accountants for Cooperatives, where he was a past National President. Mr. Spearman serves as a member of the Board Compensation Committee.

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

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

Committees

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

Compensation of Directors

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

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

* *Other official activities includes board committee meetings and board training. Total compensation adjusted pursuant to FCA Bookletter 51.*
** *Includes 8 days for System Workgroup trip to Armenia.*
*** *Does not include 8 days served on AgFirst/FCBT Plan Fiduciary Committee.*
**** *Does not include 6 days served on AgFirst and AgFirst/FCBT Plan Sponsor Committees.*

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

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was $251,988 for 2007, $258,943 for 2006, and $202,283 for 2005.

Transactions with Senior Officers and Directors

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section, are incorporated herein by reference to Note 12 to the Consolidated Financial Statements, *Related Party Transactions,* included in this Annual Report to shareholders. There have been no transactions between the Bank and senior officers or directors which require reporting per FCA regulations.

Involvement in Certain Legal Proceedings

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

Relationship with Independent Auditor

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

Aggregate fees expensed by the Bank for services rendered by its independent auditor for the year ended December 31, 2007 were as follows:

	2007
Independent Auditor	
PricewaterhouseCoopers LLP	
Audit services	$ 632,389
Non-audit services	137,159
Total	$ 769,548

Audit fees were for the annual audits of financial statements.

Non-audit fees were for services rendered related to a comfort letter issuance for a preferred stock offering, Farmer Mac minimum servicing standards attestation, agreed upon procedures for Board of Directors elections, and accounting consultation.

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

Consolidated Financial Statements

The Consolidated Financial Statements, together with the report thereon of PricewaterhouseCoopers LLP, dated February 28, 2008, and the Report of Management, which appear in this Annual Report to shareholders are incorporated herein by reference.

Shareholder Investment

Copies of AgFirst's Annual and Quarterly Reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Stephen Gilbert, Financial Reporting Manager, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst's web site at ***www.agfirst.com***. The Bank prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Report to shareholders within 90 days after the end of the fiscal year. The Bank prepares an electronic version of the Quarterly Report within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Bank.

Report of the Audit Committee

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

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

PricewaterhouseCoopers LLP (PwC), the Bank's independent auditor for 2007, is responsible for expressing an opinion on the conformity of the Bank's audited financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 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 Company's Annual Report for 2007. The foregoing report is provided by the following independent directors, who constitute the Committee:

Robert G. Sexton

Robert G. Sexton
Chairman of the Audit Committee

Members of Audit Committee

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

February 28, 2008

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated 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 its subsidiary at December 31, 2007, 2006 and 2005, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

February 28, 2008

Consolidated Balance Sheets

(dollars in thousands)	As of December 31, 2007	2006	2005
Assets			
Cash and cash equivalents	$ 558,770	$ 582,764	$ 557,882
Investment securities:			
Available for sale (amortized cost of $5,646,683 $5,063,640 and $3,888,889 respectively)	5,608,929	5,065,621	3,886,318
Held to maturity (fair value of $1,277,999 and $1,259,879 and $1,337,860 respectively)	1,299,868	1,293,061	1,369,427
Total investment securities	6,908,797	6,358,682	5,255,745
Loans	19,114,517	17,152,337	14,411,050
Less: allowance for loan losses	2,816	463	10,114
Net loans	19,111,701	17,151,874	14,400,936
Accrued interest receivable	114,508	104,925	75,410
Investments in other Farm Credit System institutions	64,221	65,066	67,139
Premises and equipment, net	20,750	25,698	25,851
Due from associations	42,701	41,692	28,808
Other assets	105,173	81,463	71,260
Total assets	$ 26,926,621	$ 24,412,164	$ 20,483,031
Liabilities			
Bonds and notes	$ 24,847,248	$ 22,613,379	$ 18,879,964
Mandatorily redeemable preferred stock	225,000	225,000	225,000
Accrued interest and dividends payable	179,578	188,028	133,855
Patronage distribution payable	153,103	128,347	132,226
Other liabilities	64,211	76,323	74,558
Total liabilities	25,469,140	23,231,077	19,445,603
Commitments and contingencies (Note 14)			
Shareholders' Equity			
Perpetual preferred stock	400,000	150,000	150,000
Capital stock and participation certificates	364,759	313,353	224,554
Retained earnings			
Allocated	705	—	—
Unallocated	730,724	715,753	665,445
Accumulated other comprehensive income (loss)	(38,707)	1,981	(2,571)
Total shareholders' equity	1,457,481	1,181,087	1,037,428
Total liabilities and shareholders' equity	$ 26,926,621	$ 24,412,164	$ 20,483,031

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

Consolidated Statements of Income

(dollars in thousands)	For the year ended December 31, 2007	2006	2005
Interest Income			
Investment securities and other	$ 385,366	$ 332,701	$ 167,728
Loans	1,083,668	890,247	624,945
Total interest income	1,469,034	1,222,948	792,673
Interest Expense	1,208,156	995,436	588,472
Net interest income	260,878	227,512	204,201
Provision for (reversal of allowance) for loan losses	2,481	(7,337)	(4,995)
Net interest income after provision for (reversal of allowance) for loan losses	258,397	234,849	209,196
Noninterest Income			
Loan fees	7,684	6,262	11,441
Realized gains (losses) on investments, net	—	(5)	466
Realized gains on derivatives, net	—	6,812	94
Gains (losses) on sales of rural home loans, net	180	(83)	1,046
Patronage refunds from other Farm Credit institutions	3,161	1,746	943
Other noninterest income	2,798	4,566	2,759
Total noninterest income	13,823	19,298	16,749
Noninterest Expense			
Salaries and employee benefits	28,853	26,318	27,957
Occupancy and equipment	13,060	11,608	11,108
Insurance fund premiums	5,623	3,597	884
Other operating expense	18,776	17,529	15,882
Intra-System financial assistance expense	—	—	3,221
Called debt expense	10,550	2,563	656
Correspondent lending servicing expense	2,071	1,656	1,294
Other noninterest expense	1,078	683	684
Total noninterest expense	80,011	63,954	61,686
Net income	$ 192,209	$ 190,193	$ 164,259

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

Consolidated Statements of Changes in Shareholders' Equity

(dollars in thousands)	Perpetual Preferred Stock	Capital Stock and Participation Certificates	Retained Earnings Allocated	Retained Earnings Unallocated	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at December 31, 2004	$ 150,000	$ 226,200	$ —	$ 644,366	$ 3,730	$ 1,024,296
Comprehensive income						
Net income				164,259		164,259
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of $466					(12,944)	(12,944)
Change in fair value of derivative instruments, includes reclassification adjustments of $94					6,643	6,643
Total comprehensive income						157,958
Capital stock/participation certificates issued/(retired), net		(1,646)				(1,646)
Perpetual preferred stock dividends paid				(10,950)		(10,950)
Cash distributions declared				(132,230)		(132,230)
Balance at December 31, 2005	150,000	224,554	—	665,445	(2,571)	1,037,428
Comprehensive income						
Net income				190,193		190,193
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of $(5)					4,552	4,552
Total comprehensive income						194,745
Capital stock/participation certificates issued/(retired), net		88,304				88,304
Stock dividends declared/(paid)		495		(495)		—
Perpetual preferred stock dividends paid				(10,950)		(10,950)
Cash distributions declared				(128,440)		(128,440)
Balance at December 31, 2006	150,000	313,353	—	715,753	1,981	1,181,087
Comprehensive income						
Net income				192,209		192,209
Unrealized gains (losses) on investments available for sale					(39,735)	(39,735)
Total comprehensive income						152,474
Preferred stock issued	250,000					250,000
Issuance cost on preferred stock				(2,743)		(2,743)
Capital stock/participation certificates issued/(retired), net		51,011				51,011
Stock dividends declared/(paid)		395		(395)		—
Patronage distribution						
Nonqualified allocated retained earnings			705	(705)		—
Perpetual preferred stock dividends paid				(19,501)		(19,501)
Cash distributions declared				(153,894)		(153,894)
Adjustment to initially apply SFAS No. 158					(953)	(953)
Balance at December 31, 2007	$ 400,000	$ 364,759	$ 705	$ 730,724	$ (38,707)	$ 1,457,481

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

Consolidated Statements of Cash Flows

(dollars in thousands)	For the year ended December 31, 2007	2006	2005
Cash flows from operating activities:			
Net income	$ 192,209	$ 190,193	$ 164,259
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	8,452	7,642	6,491
Premium amortization/discount accretion on investment securities	(3,502)	(7,304)	982
Premium amortization/discount accretion on bonds and notes	7,343	18,420	14,930
Provision for (reversal of allowance for) loan losses	2,481	(7,337)	(4,995)
Realized (gains) losses on investments, net	—	5	(466)
Realized (gains) losses on derivatives, net	—	(6,812)	(94)
(Gains) losses on sales of rural home loans, net	(180)	83	(1,046)
Realized (gains) losses on sales of servicing assets	—	—	(1,078)
Proceeds from sale of mortgage servicing assets	—	—	10,039
Net change in loans held for sale	25,712	35,420	(257,368)
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	(9,583)	(29,515)	(24,780)
(Increase) decrease in due from associations	(1,009)	(12,884)	1,577
(Increase) decrease in other assets	6,003	(8,650)	(10,541)
Increase (decrease) in accrued interest and dividends payable	(8,450)	54,173	68,001
Increase (decrease) in other liabilities	7,889	17,352	3,452
Total adjustments	35,156	60,593	(194,896)
Net cash provided by (used in) operating activities	227,365	250,786	(30,637)
Cash flows from investing activities:			
Investment securities purchased	(2,155,803)	(3,245,248)	(4,119,340)
Investment securities sold or matured	1,569,455	2,154,162	2,128,549
Proceeds from sale of derivatives	—	6,812	—
Net (increase) decrease in loans	(1,987,840)	(2,779,186)	(1,243,055)
(Increase) decrease in investments in other Farm Credit System institutions	845	2,073	(493)
Purchase of premises and equipment, net	(3,504)	(7,489)	(4,422)
Net cash used in investing activities	(2,576,847)	(3,868,876)	(3,238,761)
Cash flows from financing activities:			
Bonds and notes issued	66,559,204	49,104,767	38,025,506
Bonds and notes retired	(64,383,204)	(45,406,904)	(34,529,195)
Perpetual preferred stock issued net of issuance cost	247,257	—	—
Capital stock and participation certificates issued/(retired), net	51,011	88,304	(1,646)
Cash distributions to shareholders	(129,279)	(132,245)	(126,693)
Dividends paid on perpetual preferred stock	(19,501)	(10,950)	(10,950)
Net cash provided by financing activities	2,325,488	3,642,972	3,357,022
Net increase (decrease) in cash and cash equivalents	(23,994)	24,882	87,624
Cash and cash equivalents, beginning of period	582,764	557,882	470,258
Cash and cash equivalents, end of period	$ 558,770	$ 582,764	$ 557,882
Supplemental schedule of non-cash investing and financing activities:			
Change in unrealized gains (losses) on investments	$ (39,735)	$ 4,552	$ (12,944)
Change in fair value of derivative instruments related to other comprehensive income	—	—	6,643
Increase in liability resulting from adoption of SFAS No. 158	953	—	—
Non-cash changes related to hedging activities:			
Decrease (increase) in loans	$ —	$ 7	$ 55
Increase (decrease) in bonds and notes	50,526	17,132	(33,662)
Decrease (increase) in other assets	(29,572)	(1,553)	(937)
Increase (decrease) in other liabilities	(20,954)	(15,586)	27,807
Supplemental information:			
Interest paid	$ 1,209,263	$ 927,889	$ 520,471

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

Notes to the Consolidated 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, 2007, the District consisted of the Bank and twenty-three District ACAs. All twenty-three are structured as holding companies, which include FLCA and PCA subsidiaries.

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

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

The Bank primarily lends to the District Associations in the form of a line of credit to fund the Associations' loan portfolios. These lines of credit are collateralized by a pledge of substantially all of each Association's assets. The terms of the revolving lines of credit are governed by a general financing agreement between the Bank and each Association. Each advance is structured such that the principal cash flow, repricing characteristics, and underlying index (if any) of the advance match those of the assets being funded. By match-funding the Association loans, the Associations' exposure to interest rate risk is minimized. Advances are also made to fund general operating expenses of the Associations.

The Associations borrow from the Bank and in turn may originate and service both long-term real estate mortgage and short-term and intermediate-term loans to their members.

In addition to providing loan funds to District Associations, the Bank provides to the District Associations banking and support services such as accounting, human resources, information systems, and marketing. The costs of these support services are included in the interest charges to the Associations.

The Bank is also authorized to provide, in participation with other lenders and the secondary market, credit, credit commitments, and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related businesses. The Bank may also lend to other financial institutions qualified to engage in lending to eligible borrowers.

The Bank owns the Farm Credit Finance Corporation of Puerto Rico (the Finance Corporation). The Finance Corporation borrowed funds from the Bank and eligible funds from qualified companies doing business in Puerto Rico under Section 2(j) of the Puerto Rico Tax Incentive Act of 1987, as amended, or the Puerto Rico Tax Incentive Act of 1998, including corporations that had elections under Section 936 and 30(A) of the Internal Revenue Code of 1986, as amended (Code). The funds borrowed were primarily used to acquire from AgFirst the note receivable from Puerto Rico Farm Credit, ACA, and to acquire eligible loans originated by other System institutions. Savings in interest costs were, in part, passed along to borrowers in Puerto Rico who met certain eligibility requirements. The operations of the Finance Corporation were suspended and placed into inactive status effective December 31, 2005. All assets and liabilities of the Finance Corporation were transferred to its sole shareholder, AgFirst, on December 31, 2005.

The Bank, 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.
- *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 Bank conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of consolidated financial statements in conformity with GAAP requires the management of the Bank to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results can differ from these estimates. Certain amounts in prior years' financial statements have been reclassified to conform to the current year's presentation.

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

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 Bank, 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 consolidated balance sheets as securities as of the trade date. Investment securities which management has the intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost. Investment securities classified as available-for sale (AFS) are carried at fair market value with net unrealized gains and losses included in accumulated other comprehensive income (OCI) in shareholders' equity.

   Interest on investment securities, including amortization of premiums and accretion of discounts, is included in Interest Income. Realized gains and losses from the sales of investment securities are recognized in current earnings using the specific identification method.

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

C. **Loans and Allowance for Loan Losses:** Long-term real estate mortgage loans generally have original maturities ranging up to 30 years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less.

   Loans are carried at their principal amount outstanding less unearned income 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.

   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. A review of all individual loans in each respective portfolio is performed to determine the appropriateness of risk ratings and to assure loss exposure to the Bank has been identified. Certain loan pools acquired from several of the District Associations are analyzed in accordance with the selling Association's allowance methodologies for assigning general and specific allowances. 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 Bank 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.

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

E. **Debt Issuance Cost:** Direct expenses incurred in issuing debt and mandatorily redeemable preferred stock 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 mandatorily redeemable preferred stock.

F. **Employee Benefit Plans:** The Bank participates in three District sponsored benefit plans. These plans include a defined benefit retirement plan, a defined benefit other postretirement benefits plan, and a defined contribution 401(k) plan.

   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, the two District defined benefit plans represent multi-employer plans.

Substantially all Bank employees are eligible to participate in the District defined benefit retirement plan (the Plan). The Plan is noncontributory and includes eligible District employees. 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. The actuarially-determined cost of the Plan is allocated to each participating entity, including the Bank, by multiplying the Plan's net pension expense by each participating institution's eligible compensation as a percentage of the total eligible compensation for all Plan participants. The cumulative excess of amounts funded by the Bank over the cost allocated to the Bank is reflected as prepaid retirement expense, a component of other assets in the Bank's Consolidated Balance Sheets.

In addition to providing pension benefits, the Bank provides certain health care and life insurance benefits for retired employees (other postretirement benefits) through a District plan. Substantially all of the Bank's employees are eligible for those benefits when they reach early retirement age while working for the Bank. Early retirement age is defined as a minimum of age 50 and 10 years of service. 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. Employees who retire subsequent to December 1, 2007 are no longer provided life insurance benefits under the plan. Certain Bank charges related to this plan are an allocation of District charges based on the Bank's proportional share of the plan liability. The cumulative excess of cost allocated to the Bank over the amounts funded by the Bank is reflected as postretirement benefits other than pensions, a component of other liabilities in the Bank's Consolidated Balance Sheets.

Since the foregoing two defined benefit plans are multi-employer plans, the Bank does not apply the provisions of SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, in its stand-alone financial statements. Rather, the effects of SFAS No. 158 are reflected in the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations. See *Recent Accounting Developments* section below for additional information regarding SFAS No. 158.

Substantially all Bank 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 the Internal Revenue Code. For employees hired on or prior to December 31, 2002, the Bank contributes $0.50 for each $1.00 of the employee's first 6.00 percent of contribution up to the maximum employer contribution of 3.00 percent of eligible compensation. For employees hired on or after January 1, 2003, the Bank contributes $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 eligible 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.

Additional financial information for the above three plans may be found in Note 10, *Employee Benefit Plans*, and in the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' 2007 Annual Report.

In addition to the multi-employer plans above, the Bank sponsors a single employer defined benefit supplemental retirement plan, two defined contribution supplemental retirement plans, and offers a deferred compensation plan for certain key employees. These plans are nonqualified; therefore, the associated liabilities are included in the Bank's consolidated balance sheets in other liabilities. See Note 10, *Employee Benefit Plans*, for additional financial information for these plans, including the impact of the adoption of SFAS No. 158 on the current period for the defined benefit supplemental retirement plan.

G. **Income Taxes:** The Bank is exempt from federal and other income taxes as provided in the Farm Credit Act.

H. **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 consolidated 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) depending on the use of the derivative and whether it qualifies for hedge accounting. For fair-value hedge transactions which hedge changes in the fair value of assets, liabilities, or firm commitments, changes in the fair value of the derivative will generally be offset by changes in the hedged item's fair value. For cash-flow hedge transactions, which hedge the variability of future cash flows related to a variable-rate asset, liability, or a forecasted transaction, changes in the fair value of the derivative will generally be deferred and reported in accumulated other comprehensive income (loss). The gains and losses on the derivative that are deferred and reported in accumulated other comprehensive income (loss) will be reclassified 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 accumulated other comprehensive income (loss) would be amortized into earnings over the remaining life of the original hedged item. For fair value hedges, changes in the fair value of the derivative will be recorded in current period earnings. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, the Bank will carry the derivative at its fair value on the balance sheet, recognizing changes in fair value in current period earnings.

The Bank may occasionally purchase a financial instrument in which a derivative instrument is "embedded." Upon purchasing the financial instrument, the Bank assesses whether the economic characteristics of the embedded derivative are clearly and closely related to the economic characteristics of the remaining component of the financial instrument and whether a separate, non-embedded instrument with the same terms as the embedded instrument would meet the definition of a derivative instrument. When it is determined that (1) the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract and (2) a separate, stand-alone instrument with the same terms would qualify as a derivative instrument, the embedded derivative is separated from the host contract, carried at fair value, and 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.

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

J. **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.* The Standard requires an employer to recognize the overfunded or underfunded status of defined benefit pension and other postretirement benefit plans as an asset or liability in its statement of financial position and recognize changes in that funded status through accumulated other comprehensive income as of December 31, 2007. The Standard further requires the determination of the fair value of plan assets at December 31, 2007 and recognition of actuarial gains and losses, prior service costs or credits, and transition assets and obligations as a component of accumulated other comprehensive income. In addition, this Standard requires a change for the funded status of a plan to be measured as of the date of the year-end financial statements. Currently, the Bank and District Associations use a measurement date of September 30 but will be required in 2008 to measure the funded status of the plans as of the fiscal year end, which is December 31. The Bank has one single employer defined benefit plan and participates in multi-employer defined benefit pension and other postretirement benefit plans. Under SFAS No. 158, accounting for the impact of the adoption of the standard follows the plan sponsor, which for multi-employer plans in which the Bank participates is at the District entity level. Therefore, there is no impact to the Bank's financial statements for the adoption of SFAS No. 158 for multi-employer plans. For the one single employer defined benefit plan sponsored by the Bank, a supplemental retirement plan, adoption of SFAS No. 158 is reflected as an adjustment to accumulated other comprehensive income in the Bank's Consolidated Statement of Changes in Shareholders' Equity. See Note 10, *Employee Benefit Plans,* of the Consolidated Financial Statements, for further information regarding the impact of the adoption of SFAS No. 158 on the current period for the Bank's supplemental retirement plan.

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

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

Note 3 — Investment Securities

Available-for-sale

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

(dollars in thousands)	December 31, 2007 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Govt. GNMA MBS/CMOs	$ 1,754,693	$ 3,393	$ (3,533)	$ 1,754,553	4.99%
U.S. Govt. Agency MBS	3,055,524	10,595	(14,853)	3,051,266	5.03
Non-Agency Securities	651,767	718	(15,926)	636,559	5.26
Asset-Backed Securities	184,699	–	(18,148)	166,551	5.07
Total	$ 5,646,683	$ 14,706	$ (52,460)	$ 5,608,929	5.04%

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

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

Held-to-maturity

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

(dollars in thousands)	December 31, 2007 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Govt. Agency MBS	$ 1,141,801	$ 224	$ (20,469)	$ 1,121,556	5.08%
Other	158,067	1,749	(3,373)	156,443	6.39
Total	$ 1,299,868	$ 1,973	$ (23,842)	$ 1,277,999	5.24%

(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
	December 31, 2006				
U.S. Govt. Agency MBS	$ 1,269,048	$ –	$ (33,367)	$ 1,235,681	5.23%
Other	24,013	185	–	24,198	7.45
Total	$ 1,293,061	$ 185	$ (33,367)	$ 1,259,879	5.28%

(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
	December 31, 2005				
U.S. Govt. Agency MBS	$ 1,369,427	$ 110	$ (31,677)	$ 1,337,860	5.29%
Total	$ 1,369,427	$ 110	$ (31,677)	$ 1,337,860	5.29%

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

The following table shows the fair value and gross unrealized losses for investments in a loss position aggregated by investment category at December 31, 2007. The unrealized losses on these investments resulted from interest rate volatility and, in certain instances, market uncertainty. AgFirst expects to recover substantially all of our cost in these investments.

(dollars in thousands)	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	Greater than 12 Months Fair Value	Greater than 12 Months Unrealized Losses
U.S. Govt. GNMA MBS/CMOs	$ 484,186	$ 1,862	$ 118,232	$ 1,672
U.S. Govt. Agency MBS	1,301,290	10,021	1,456,853	25,301
Non-Agency Securities	442,494	13,555	130,528	2,370
Asset-Backed Securities	166,551	18,149	–	–
Other	78,965	3,372	–	–
Total	$ 2,473,486	$ 46,959	$ 1,705,613	$ 29,343

On December 31, 2007, the Bank 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 $29.3 million. Substantially all of these investments were in U. S. government agency securities and the Bank expects these securities would not be settled at a price less than their amortized cost. Because the decline in market value was caused by interest rate volatility and, in certain instances, market uncertainty, and because the Bank has the ability and intent to hold these investments until a recovery of unrealized losses occurs, which may be maturity, the Bank has not recognized any other-than-temporary impairment in connection with these investments.

A summary of the expected maturity, estimated fair value and amortized cost of investment securities at December 31, 2007 follows:

Available-for-sale

(dollars in thousands)	Due in 1 year or less Amount	Due in 1 year or less Weighted Average Yield	Due after 1 year through 5 years Amount	Due after 1 year through 5 years Weighted Average Yield	Due after 5 years through 10 years Amount	Due after 5 years through 10 years Weighted Average Yield	Due after 10 years Amount	Due after 10 years Weighted Average Yield	Total Amount	Total Weighted Average Yield
U.S. Govt. GNMA MBS/CMO's	$ –	–%	$ –	–%	$ 441	5.04%	$ 1,754,112	4.99%	$ 1,754,553	4.99%
U.S. Govt. Agency MBS	306	4.73	256	5.00	156,366	5.12	2,894,338	5.03	3,051,266	5.04
Non-Agency Securities	–	–	–	–	–	–	636,559	5.36	636,559	5.36
Asset-Backed Securities	–	–	–	–	–	–	166,551	5.63	166,551	5.63
Total fair value	$ 306	4.73%	$ 256	5.00%	$ 156,807	5.12%	$ 5,451,560	5.08%	$ 5,608,929	5.08%
Total amortized cost	$ 307		$ 257		$ 156,241		$ 5,489,878		$ 5,646,683	

Held-to-maturity

(dollars in thousands)	Due in 1 year or less Amount	Due in 1 year or less Weighted Average Yield	Due after 1 year through 5 years Amount	Due after 1 year through 5 years Weighted Average Yield	Due after 5 years through 10 years Amount	Due after 5 years through 10 years Weighted Average Yield	Due after 10 years Amount	Due after 10 years Weighted Average Yield	Total Amount	Total Weighted Average Yield
U.S. Govt. Agency MBS	$ –	– %	$ –	–%	$ –	–%	$ 1,141,801	5.08%	$ 1,141,801	5.08%
Other	9,998	7.16	15,640	6.06	94,804	6.19	37,625	6.84	158,067	6.39
Total amortized cost	$ 9,998	7.16%	$ 15,640	6.06%	$ 94,804	6.19%	$ 1,179,426	5.14%	$ 1,299,868	5.24%
Total fair cost	$ 10,108		$ 15,834		$ 92,114		$ 1,159,943		$ 1,277,999	

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:

(dollars in thousands)	Year Ended December 31, 2007	2006	2005
Proceeds on sales	$ –	$ 54,834	$ 383,676
Realized gains	–	–	908
Realized losses	–	5	442

Note 4 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31,		
(dollars in thousands)	2007	2006	2005
Direct notes receivable from District Associations	$ 14,602,548	$ 13,877,142	$ 12,441,170
Participations/syndications, net	3,470,300	2,501,453	1,411,802
Mortgage loans purchased in the secondary market	1,039,449	771,982	555,421
Loans to Other Financing Institutions	2,220	1,760	2,657
Total	$ 19,114,517	$ 17,152,337	$ 14,411,050

A substantial portion of the Bank's loan portfolio consists of notes receivable from District Associations. As described in Note 1, these notes are used by the Associations to fund their loan portfolios, and therefore, the Bank's concentration of credit risk in various agricultural commodities approximates that of the District as a whole. Loan concentrations are considered to exist when there are amounts loaned to a multiple number of borrowers engaged in similar activities, which would cause them to be similarly impacted by economic or other conditions. A substantial portion of the Associations' lending activities is collateralized and the Associations' exposure to credit loss associated with lending activities is reduced accordingly. An estimate of the Bank's credit risk exposure is considered in the Bank's allowance for loan losses.

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

The following table presents information relating to the Bank's impaired loans.

	December 31,		
(dollars in thousands)	2007	2006	2005
Nonaccrual:			
Current as to principal and interest	$ 2,068	$ 14,659	$ 18,448
Past due	439	451	749
Accrual:			
Restructured	–	–	–
90 days or more past due	1,356	1,759	653
Total impaired loans	$ 3,863	$ 16,869	$ 19,850

The average recorded investment in impaired loans during 2007, 2006 and 2005 was $5.3 million, $8.4 million and $20.4 million, respectively. Total impaired loans of $3.9 million, $16.9 million and $19.9 million at December 31, 2007, 2006 and 2005 are considered in the allowance for loan losses totaling $2.8 million, $0.5 million and $10.1 million, respectively.

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

A summary of changes in the allowance for loan losses, all of which relates to the Bank's participation loan portfolio, follows:

	Year Ended December 31,		
(dollars in thousands)	2007	2006	2005
Balance at beginning of year	$ 463	$ 10,114	$ 14,800
Provision for (reversal of) loan losses	2,481	(7,337)	(4,995)
Loans charged off	(128)	(2,314)	(54)
Recoveries	–	–	363
Balance at end of year	$ 2,816	$ 463	$ 10,114

To mitigate risk of loan losses, District Associations have entered into Long-Term Standby Commitments to Purchase agreements with the Federal Agricultural Mortgage Corporation (Farmer Mac) through an arrangement with the Bank. The agreements, which are effectively credit guarantees that will remain in place until the loans are paid in full, give the Associations the right to sell the loans identified in the agreements to the Bank, which can, in turn, sell them to Farmer Mac in the event of default, subject to certain conditions. Loans under Long-Term Standby Commitments to Purchase held by the Associations were $289.7 million at December 31, 2007. Fees paid to Farmer Mac for such commitments are paid by the Associations. Fees paid to government sponsored enterprises (GSEs) other than Farmer Mac were $1.5 million, $1.0 million, and $581 thousand for 2007, 2006, and 2005, respectively.

Note 5 — Premises and Equipment

Premises and equipment consisted of the following:

	December 31,		
(dollars in thousands)	2007	2006	2005
Land	$ 896	$ 896	$ 896
Buildings and improvements	5,921	5,871	5,853
Furniture and equipment	53,771	51,763	43,147
Work in progress	2,280	1,341	4,331
	62,868	59,871	54,227
Less: accumulated depreciation	42,118	34,173	28,376
Total	$ 20,750	$ 25,698	$ 25,851

Note 6 — Other Assets and Other Liabilities

A summary of other assets and other liabilities follows:

	December 31,		
(dollars in thousands)	2007	2006	2005
Other assets:			
Unamortized debt issue costs	$ 18,637	$ 15,098	$ 12,038
Prepaid retirement expenses	18,653	21,301	24,664
Deferred issuance costs – preferred stock	940	2,017	2,701
Derivative assets	33,187	3,615	2,066
Receivable from third party sub-servicer	12,567	8,495	6,128
Receivables and other	21,189	30,937	23,663
Total	$ 105,173	$ 81,463	$ 71,260
Other liabilities:			
Accounts payable	$ 3,315	$ 2,513	$ 2,717
Farm Credit System Ins. Corp. payable	28,211	24,613	7,475
Derivative liabilities	2,560	23,514	39,100
Postretirement benefits other than pensions	15,445	15,266	14,999
Other	14,680	10,417	10,267
Total	$ 64,211	$ 76,323	$ 74,558

Note 7 — Bonds and Notes

The System, unlike commercial banks and other depository institutions, obtains funds for its lending operations primarily from the sale of Systemwide Debt Securities issued by the Banks through the Funding Corporation. Certain conditions must be met before AgFirst can participate in the issuance of Systemwide Debt Securities. As one condition of participation, AgFirst is required by the Farm Credit Act and FCA regulations to maintain specified eligible assets, at least equal in value to the total amount of debt obligations outstanding for which it is primarily liable. This requirement does not provide holders of Systemwide Debt Securities with a security interest in any assets of the banks. The System banks and the Funding Corporation have entered into the Market Access Agreement (MAA), which establishes criteria and procedures for the banks to provide certain information and, under certain circumstances, for restricting or prohibiting an individual bank's participation in Systemwide debt issuances, thereby reducing other System banks' exposure to statutory joint and several liability. The MAA was amended and restated in July 2003. At December 31, 2007, AgFirst was in compliance with the conditions of participation for the issuances of Systemwide Debt Securities.

Each issuance of Systemwide Debt Securities ranks equally, in accordance with the FCA regulations, with other unsecured System-wide 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 offering circulars.

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

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

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

Discount notes are issued with maturities ranging from 1 to 365 days. The average maturity of discount notes at December 31, 2007, was 64 days.

Systemwide debt includes callable bonds consisting of the following:

Amount	First Call Date	Year of Maturity
(dollars in thousands)		
$ 10,670,000	2008	2008 – 2022
235,000	2009	2011 – 2021
2,000	2010	2012
25,000	2011	2013 – 2016
10,000	2012	2017
$ 10,942,000	Total	

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

As described in Note 1, the Insurance Fund is available to ensure the timely payment of principal and interest on Systemwide Debt Securities (insured debt) of System banks to the extent net assets are available in the Insurance Fund and not designated for specific use. All other liabilities on the financial statements are uninsured. At December 31, 2007 the assets of the Insurance Fund aggregated $2.60 billion; however, due to the other authorized uses of the Insurance Fund there is no assurance that any available amount in the Insurance Fund will be sufficient to fund the timely payment of principal or interest on an insured debt obligation in the event of a default by any System bank having primary liability thereon. Amounts available in the Insurance Fund were used in June 2005 to repay the Financial Assistance Corporation debt issued to fund the purchase of $374 million of Federal Land Bank of Jackson preferred stock.

Note 8 — 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 9 — Shareholders' Equity

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

A. **Description of Equities:** In accordance with the Farm Credit Act and the Bank's capitalization bylaws, the Bank is authorized to issue and have outstanding Classes B, C and D Common Stock, Participation Certificates, Preferred Stock and other classes of equity as may be provided for in amendments to the bylaws in such amounts as may be necessary to conduct the Bank's business. All Common Stock and Participation Certificates have a par or face value of five dollars ($5.00) per share.

   The Bank had the following shares of common equities outstanding at December 31, 2007:

		Shares Outstanding *(dollars in thousands)*	
Class	Protected Status	Number	Aggregate Par Value
B Common/Nonvoting	No	1,793,200	$ 8,966
C Common/Voting	No	69,462,997	347,315
D Common/Nonvoting	No	1,669,552	8,348
Participation Certificates/Nonvoting	No	26,051	130
Total Capital Stock and Participation Certificates		72,951,800	$ 364,759

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

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:** District Associations are required to maintain ownership in the Bank in the form of Class B or C Common Stock as determined by the Bank. The Bank may require additional capital contributions to maintain its capital levels.

Additionally, the Bank has issued Class D Common Stock in connection with participations purchased by the Bank from other System institutions. Class D Common Stock issued in connection with participations has no voting rights. Such Stock may be retired at the discretion of the Board, and, if retired, shall be retired at book value, not to exceed its par value.

Class D Common Stock shall also be purchased by borrowers eligible to hold it as a condition for obtaining a loan in an amount as may be determined by the Board at its discretion within a range between a minimum of two percent (2.00%) of the loan amount or $1 thousand, whichever is less, and a maximum not to exceed ten percent (10.00%) of the loan amount. The Bank currently has no such loans outstanding.

D. **Other Equity:** At the inception of each Other Financing Institution (OFI) loan, the Bank requires OFIs to make cash purchases of participation certificates in the Bank. The Bank has a first lien on these equities for the repayment of any indebtedness to the Bank.

E. **Regulatory Capitalization Requirements and Restrictions:** FCA's capital adequacy regulations require the Bank 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 lead to the initiation of certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Bank's consolidated financial statements. The Bank is 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 capital adequacy ratios as defined by FCA Regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of seven percent and core surplus as a percentage of risk-adjusted assets of three and one-half percent. The Bank's permanent capital, total surplus and core surplus ratios at December 31, 2007 were 20.59 percent, 20.54 percent and 13.04 percent, respectively. The FCA notified AgFirst that the June 2007 issuance of $250.0 million of Perpetual Non-Cumulative Subordinated Preferred Stock 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.

Capital adequacy is also evaluated using a ratio of net collateral to total liabilities. Subsequent to the issuance of the mandatorily redeemable preferred stock, FCA now requires AgFirst to maintain a minimum net collateral ratio of 104.00 percent compared to the regulatory minimum of 103.00 percent. At December 31, 2007, the Bank's net collateral ratio was 106.02 percent.

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. The Bank has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

F. **Accumulated Other Comprehensive Income (Loss):** Accumulated other comprehensive income (loss) at December 31, 2007, 2006 and 2005 was comprised of the following components:

(dollars in thousands)	2007	2006	2005
Unrealized (losses) gains on investments available-for-sale	$ (37,754)	$ 1,981	$ (2,571)
Postretirement benefits obligation adjustment	(953)	–	–
Total accumulated other comprehensive income (loss)	$ (38,707)	$ 1,981	$ (2,571)

Note 10 — Employee Benefit Plans

The Bank participates in three District sponsored benefit plans. These plans include a defined benefit retirement plan, a defined benefit other postretirement benefits plan, and a defined contribution 401(k) plan. Financial information regarding each of these plans follows.

Substantially all employees of the Bank are eligible to participate in the District defined benefit retirement plan (the Plan). This Plan is noncontributory and includes eligible District employees. For participants hired prior to January 1, 2003, benefits are based on eligible compensation and years of service. For participants hired on or after January 1, 2003, benefits are determined using a cash balance formula. This formula is based on employer contributions (3.00-5.00 percent of eligible compensation depending on years of service) and interest credits as allocated to an employee's theoretical account balance. The actuarially-determined cost of the Plan is allocated to each participating entity including the Bank by multiplying the Plan's net pension expense by each institution's eligible compensation as a percentage of the total eligible compensation for all Plan participants. As a participant in the Plan, the Bank funded $0 for 2007 and 2006 and $4.6 million for 2005. Plan expenses included in employee benefit costs were $3.1 million for 2007, $3.8 million for 2006, and $3.6 million for 2005. The cumulative excess of amounts funded by the Bank over the cost allocated to the Bank is reflected as prepaid retirement expense, a component of other assets in the Consolidated Balance Sheets.

In addition to providing pension benefits, the Bank provides certain health care benefits for eligible retired employees (other postretirement benefits) through a District benefit plan. Substantially all of the Bank employees may become eligible for the benefits if they reach early retirement age while working for the Bank. Early retirement age is defined as a minimum of age 50 and 10 years of service. 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. Employees who retire subsequent to December 1, 2007 are no longer provided life insurance benefits under the plan. Certain Bank charges related to this plan are an allocation of District charges based on the Bank's proportional share of the plan liability. This plan is unfunded with expenses paid as incurred. Postretirement benefits other than pensions included in employee benefit costs were $999 thousand for 2007, $1.1 million for 2006, and $2.0 million for 2005. The cumulative excess of cost allocated to the Bank over the amounts funded by the Bank is reflected as postretirement benefits other than pensions, a component of other liabilities in the Bank's Consolidated Balance Sheets.

The Bank also 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 contributes $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 contributes $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 included in salaries and employee benefit costs were $761 thousand, $578 thousand, and $820 thousand for the years ended December 31, 2007, 2006, and 2005, respectively.

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

In addition to the multi-employer plans above, the Bank sponsors a single employer defined benefit supplemental retirement plan, two defined contribution supplemental retirement plans, and offers a deferred compensation plan for certain key employees. These plans are nonqualified; therefore, the associated liabilities are included in the Bank's consolidated balance sheets in other liabilities. The Bank funded the benefit payments of $252 thousand for each of the years of 2007, 2006, and 2005 for the defined benefit supplemental retirement plan. The expenses of these nonqualified plans included in the Bank's employee benefit costs were $6 thousand, $33 thousand, and $237 thousand for the years ended December 31, 2007, 2006, and 2005, respectively.

On December 31, 2007, the Bank adopted SFAS No. 158 for the single employer defined benefit supplemental retirement plan. Under SFAS No. 158, accounting for the impact of the adoption of the standard follows the plan sponsor, which for multi-employer plans in which the Bank participates is at the District entity level. Therefore, there is no impact to the Bank's financial statements for the adoption of SFAS No. 158 for the two defined benefit multi-employer plans discussed above. SFAS No. 158 requires an employer to recognize the overfunded or underfunded status of defined benefit pension and other postretirement benefit plans as an asset or liability in its statement of financial position and recognize changes in that funded status through accumulated other comprehensive income as of December 31, 2007. The Standard further requires the determination of the fair value of plan assets at December 31, 2007 and recognition of actuarial gains and losses, prior service costs or credits, and transition assets and obligations as a component of accumulated other comprehensive income. These amounts were previously netted against the plan's funded status in the Bank's Consolidated Balance Sheets pursuant to the provisions of SFAS No. 87. In addition, this Standard requires a change for the funded status of a plan to be measured as of the date of the year-end financial statements. Currently, the Bank uses a measurement date of September 30 but will be required in 2008 to measure the funded status of the supplemental retirement plan as of the fiscal year end, which is December 31. For the one single employer supplemental retirement defined benefit plan sponsored by the Bank, adoption of SFAS No. 158 is reflected as an adjustment to accumulated other comprehensive income of $953 thousand in the Bank's Consolidated Statement of Changes in Shareholders' Equity. The supplemental retirement plan is unfunded and had a projected benefit obligation of $5.01 million and a net under-funded status of $4.95 million at December 31, 2007. Net periodic pension cost for the period was $427 thousand. The weighted average assumption used to determine the projected benefit obligation as of December 31, 2007 included a discount rate of 6.40 percent and a rate of compensation increase of 4.50 percent. Additional financial information for the three District sponsored multi-employer plans may be found in the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' 2007 Annual Report.

Note 11 — Intra-System Financial Assistance

The Farm Credit Act provided for capital assistance to System institutions experiencing severe financial stress through the issuance, prior to October 1, 1992, by the Financial Assistance Corporation of U.S. Treasury-guaranteed 15-year bonds, of which $1.261 billion in principal amount was originally issued. The last remaining Financial Assistance Corporation bonds matured and were repaid on June 10, 2005.

Pursuant to the Farm Credit Act, the U.S. Treasury paid $440 million, on behalf of the System, in interest costs on $844 million of the Financial Assistance Corporation bonds issued for purposes other than funding Capital Preservation Agreement accruals. The Banks had irrevocably set aside funds, including interest earned, that totaled the $440 million needed to repay the interest advanced by the U.S. Treasury. On June 10, 2005, the Banks repaid the U.S. Treasury the interest advanced. The Farm Credit Administration Board cancelled the Financial Assistance Corporation's charter as of December 31, 2006.

Note 12 — Related Party Transactions

As discussed in Note 1, the Bank lends funds to the District Associations to fund their loan portfolios. Further disclosure regarding these related party transactions is found in Notes 4, 9 and 14.

Interest income recognized on direct notes receivable from District Associations was $830.9 million, $729.1 million and $532.6 million for 2007, 2006, and 2005, respectively.

The Bank has had participation loans outstanding during the last year to certain of its directors, their immediate family members and organizations with which the directors are affiliated. These loans were made in the ordinary course of business, and were made on the same terms, including interest rate, amortization schedule and collateral, as those prevailing at the time for comparable transactions with other persons. No loan to a director, or to any organization affiliated with such person, or to any immediate family member who resides in the same household as such person or in whose loan or business operation such person has a material financial or legal interest, involved more than the normal risk of collectibility.

Note 13 — Regulatory Enforcement Matters

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

Note 14 — Commitments and Contingencies

The Bank has various contingent liabilities and commitments outstanding as discussed elsewhere in these notes to the consolidated financial statements. While primarily liable for its portion of System bonds and notes, the Bank is jointly and severally liable for the bonds and notes of the other System banks. The total bonds and notes of the System at December 31, 2007, were $154.44 billion.

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

The Bank participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. At December 31, 2007, the Bank had outstanding $154.7 million of standby letters of credit issued on behalf of District and non-district customers, with expiration dates ranging from January 2008 to December 2012. The maximum potential amount of future payments the Bank may be required to make under these existing guarantees is $154.7 million.

A guarantor is required to recognize at the inception of a guarantee, a liability for the fair value of the guarantee commitment. The Bank has determined the fair value of the guarantee commitment based upon the fees to be earned over the life of the guarantee. The fair value is updated periodically to reflect changes in individual guarantee amounts and the remaining life to maturity of the individual guarantees in the Bank's inventory. At December 31, 2007, the Bank's inventory of standby letters of credit had a fair value of $2.3 million and was included in other liabilities.

The Bank also guarantees certain loans held by District Associations in the amount of $12.0 million expiring in less than one year and $9.7 million expiring in one to three years. The notional amounts of these guarantees represent the maximum amount of exposure the Bank has related to these instruments as of December 31, 2007.

At December 31, 2007, $3.80 billion of commitments to extend credit were outstanding. Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these financial instruments have off-balance-sheet credit risk because their amounts could be drawn upon at the option of the borrower. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and the same credit policies are applied by management. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the loan collateral is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

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

Other legal actions are pending against the Bank 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 financial position of the Bank.

Note 15 — Disclosures about Fair Value of Financial Instruments

The following table presents the carrying amounts and fair values of the Bank's financial instruments at December 31, 2007, 2006 and 2005. The fair value of a financial instrument is generally defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Quoted market prices are generally not available for certain Systemwide Debt securities, 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, 2007		December 31, 2006		December 31, 2005	
(dollars in thousands)	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:						
Loans	$ 19,114,517	$ 19,325,861	$ 17,152,337	$ 17,041,202	$ 14,411,050	$ 14,280,730
Allowance for loan losses	(2,816)	(2,816)	(463)	(463)	(10,114)	(10,114)
Loans, net	$ 19,111,701	$ 19,323,045	$ 17,151,874	$ 17,040,739	$ 14,400,936	$ 14,270,616
Derivative assets	$ 33,187	$ 33,187	$ 3,615	$ 3,615	$ 2,066	$ 2,066
Cash and cash equivalents	$ 558,770	$ 558,770	$ 582,764	$ 582,764	$ 557,882	$ 557,882
Investment securities	$ 6,908,797	$ 6,886,928	$ 6,358,682	$ 6,325,500	$ 5,255,745	$ 5,224,178
Financial liabilities:						
Systemwide Debt Securities	$ 24,847,248	$ 24,908,245	$ 22,613,379	$ 22,531,191	$ 18,879,964	$ 18,753,747
Derivative liabilities	$ 2,560	$ 2,560	$ 23,514	$ 23,514	$ 39,100	$ 39,100

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

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

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

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

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

Note 16 — Derivative Instruments and Hedging Activities

The Bank 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 Bank'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 Bank'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 Bank's gains and losses on the derivative instruments that are linked to these hedged assets and liabilities. The Bank 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 Bank enters into derivatives, particularly interest rate swaps, to lower funding costs, allow it to diversify sources of funding, or alter interest rate exposures arising from mismatches between assets and liabilities. Interest rate swaps allow the Bank to raise long-term borrowings at fixed rates and swap them into floating rates that are lower than those available to the Bank if floating rate borrowings were made directly. Under interest rate swap arrangements, the Bank 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 Bank may purchase interest rate derivatives such as caps in order to reduce the impact of rising interest rates on its floating-rate debt and floors in order to reduce the impact of falling interest rates on its floating-rate assets.

By using derivative instruments, the Bank exposes itself to credit and market risk. If a counterparty fails to fulfill its performance obligations under a derivative contract, the Bank'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 Bank, thus creating a repayment risk for the Bank. When the fair value of the derivative contract is negative, the Bank owes the counterparty and, therefore, assumes no repayment risk.

To minimize the risk of credit losses, the Bank deals with counterparties that have an investment grade credit rating from a major rating agency, and also monitors the credit standing of and levels of exposure to individual counterparties. The estimated credit risk exposure at December 31, 2007 of $33.2 million with ten counterparties represents approximately 1.72 percent of the total notional amount of interest rate swaps. The Bank does not anticipate nonperformance by any of these counterparties. The Bank typically enters into master agreements that contain netting provisions. These provisions allow the Bank to require the net settlement of covered contracts with the same counterparty in the event of default by the counterparty on one or more contracts. A number of swaps are supported by collateral arrangements with counterparties. At December 31, 2007, the Bank had not posted collateral with respect to these arrangements nor required the counterparties to post collateral.

Note 17 — Additional Derivative Financial Instruments and Other Financial Instruments Disclosures

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

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

Note 18 — Quarterly Financial Information (Unaudited)

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

(dollars in thousands)	2007 First	Second	Third	Fourth	Total
Net interest income	$ 59,246	$ 60,053	$ 67,680	$ 73,899	$ 260,878
Provision for (reversal of allowance for) loan losses	262	(114)	557	1,776	2,481
Noninterest income (expense), net	(13,569)	(12,758)	(14,942)	(24,919)	(66,188)
Net income	$ 45,415	$ 47,409	$ 52,181	$ 47,204	$ 192,209

	2006 First	Second	Third	Fourth	Total
Net interest income	$ 54,438	$ 54,144	$ 60,101	$ 58,829	$ 227,512
Provision for (reversal of allowance for) loan losses	–	(10,114)	54	2,723	(7,337)
Noninterest income (expense), net	(10,953)	(3,138)	(15,294)	(15,271)	(44,656)
Net income	$ 43,485	$ 61,120	$ 44,753	$ 40,835	$ 190,193

	2005 First	Second	Third	Fourth	Total
Net interest income	$ 49,140	$ 50,424	$ 51,302	$ 53,335	$ 204,201
Provision for (reversal of allowance for) loan losses	(571)	(39)	(1,300)	(3,085)	(4,995)
Noninterest income (expense), net	(11,385)	(7,401)	(12,525)	(13,626)	(44,937)
Net income	$ 38,326	$ 43,062	$ 40,077	$ 42,794	$ 164,259

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