AgFirst Farm Credit Bank

2008

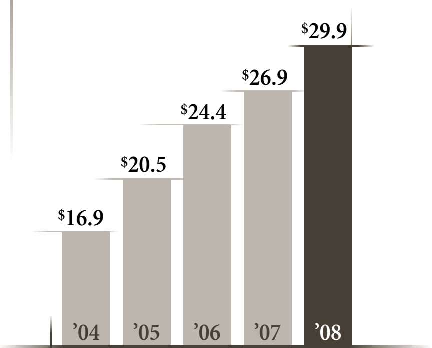
Annual Report

Strong. Stable. Committed.

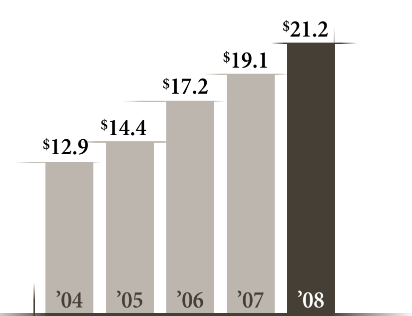
Contents

Five-Year Summary of Selected Consolidated Financial Data

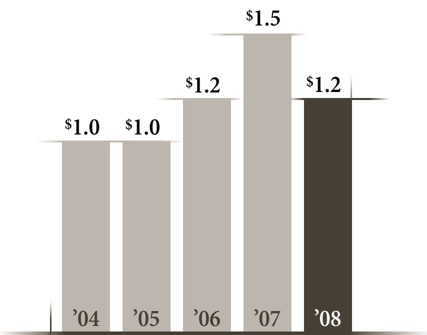
(dollars in thousands)	2008	2007	2006	2005	2004
	As of or for the year ended December 31,				
Consolidated Balance Sheet Data					
Cash and cash equivalents	$ 277,003	$ 558,770	$ 582,764	$ 557,882	$ 470,258
Investment securities	7,993,157	6,908,797	6,358,682	5,255,745	3,278,414
Loans	21,239,330	19,114,517	17,152,337	14,411,050	12,908,249
Less: allowance for loan losses	44,565	2,816	463	10,114	14,800
Net loans	21,194,765	19,111,701	17,151,874	14,400,936	12,893,449
Other assets	446,126	347,353	318,844	268,468	245,402
Total assets	$ 29,911,051	$ 26,926,621	$ 24,412,164	$ 20,483,031	$ 16,887,523
Obligations with maturities of one year or less	$ 14,037,745	$ 11,353,878	$ 10,005,004	$ 7,613,499	$ 6,533,020
Obligations with maturities greater than one year	14,407,214	13,890,262	13,001,073	11,607,104	9,105,207
Mandatorily redeemable preferred stock	225,000	225,000	225,000	225,000	225,000
Total liabilities	28,669,959	25,469,140	23,231,077	19,445,603	15,863,227
Perpetual preferred stock	400,000	400,000	150,000	150,000	150,000
Capital stock and participation certificates	434,929	364,759	313,353	224,554	226,200
Retained earnings	763,355	731,429	715,753	665,445	644,366
Accumulated other comprehensive income (loss)	(357,192)	(38,707)	1,981	(2,571)	3,730
Total shareholders' equity	1,241,092	1,457,481	1,181,087	1,037,428	1,024,296
Total liabilities and shareholders' equity	$ 29,911,051	$ 26,926,621	$ 24,412,164	$ 20,483,031	$ 16,887,523



Total Assets
in billions

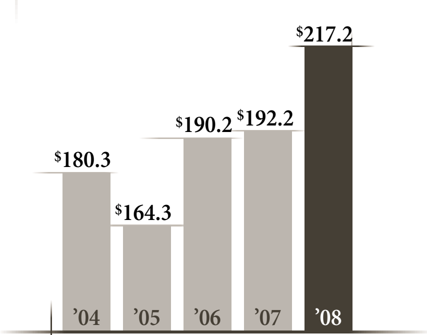


Loans
in Billions

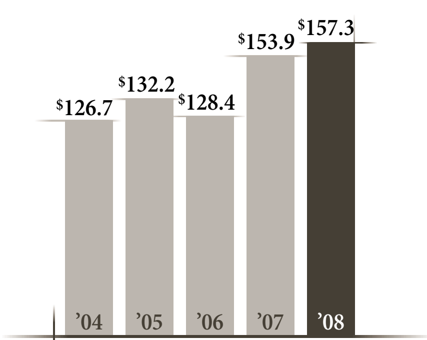


Total Shareholders' Equity
in Billions

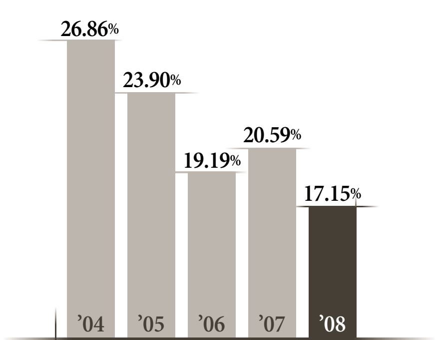
(dollars in thousands)	2008	2007	2006	2005	2004
	As of or for the year ended December 31,				
Consolidated Statement of Income Data					
Net interest income	$ 366,521	$ 260,878	$ 227,512	$ 204,201	$ 211,595
Provision for (reversal of allowance for) loan losses	43,342	2,481	(7,337)	(4,995)	(15,292)
Noninterest income (expense), net	(106,012)	(66,188)	(44,656)	(44,937)	(46,581)
Net income	$ 217,167	$ 192,209	$ 190,193	$ 164,259	$ 180,306
Consolidated Key Financial Ratios					
Rate of return on average:					
Total assets	0.76%	0.76%	0.86%	0.91%	1.11%
Total shareholders' equity	14.59%	13.58%	16.74%	14.95%	17.16%
Net interest income as a percentage of average earning assets	1.29%	1.04%	1.04%	1.14%	1.32%
Net (chargeoffs) recoveries to average loans	(0.008)%	(0.001)%	(0.015)%	0.002%	(0.033)%
Total shareholders' equity to total assets	4.15%	5.41%	4.84%	5.06%	6.07%
Debt to shareholders' equity (:1)	23.10	17.47	19.67	18.74	15.49
Allowance for loan losses to loans	0.21%	0.015%	0.003%	0.07%	0.11%
Permanent capital ratio	17.15%	20.59%	19.19%	23.90%	26.86%
Total surplus ratio	17.11%	20.54%	19.14%	23.84%	26.76%
Core surplus ratio	10.43%	13.04%	11.46%	14.15%	15.60%
Collateral ratio	105.56%	106.02%	105.28%	105.70%	106.88%
Net Income Distribution					
Cash distributions	$ 157,278	$ 153,894	$ 128,440	$ 132,230	$ 126,689
Perpetual preferred stock dividend	27,413	19,501	10,950	10,950	10,950



NET INCOME
IN MILLIONS



CASH DISTRIBUTIONS
IN MILLIONS



PERMANENT CAPITAL RATIO

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

Paul M. House
Chairman of the Board

F. A. Lowrey
Chief Executive Officer

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

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

Likewise, in the first half of 2008 we saw a significant increase in the participation opportunities created by the partnership of AgFirst's Capital Markets Unit and Associations throughout the district, as well as other lenders. Our Capital Markets Unit saw a 42 percent increase in its borrower base and added more than $1.5 billion in net participations and syndications to our portfolio during the year.

As the economy weakened in the third and fourth quarters, our credit quality weakened as well. Deterioration in a few participation loans led to the accrual of $43 million of loan loss provisions. We expect further credit deterioration in 2009, but—with our solid capital levels, experienced staff and stable base of earnings—we are prepared to manage through the adverse credit cycle in a deliberate fashion.

Growth and Credit Quality

One aspect of the downturn of the general economy is a "credit crunch," which is a scarcity of credit due to lenders being unable or unwilling to make loans. Fortunately, AgFirst continues to have the desire and capacity to continue the flow of funds to our affiliated Associations, who in turn, lend to eligible, qualified borrowers. The availability of long-term funding was disrupted for a brief period of time during the latter half of 2008, but short-term funding was readily available. With the full cooperation of our affiliated Associations, loan structures for new originations were adjusted accordingly and funds kept flowing to our Associations. In fact, our affiliated Associations saw their portfolios grow by 9.67 percent in 2008.

Earnings and Capital

Falling interest rates during 2008 enabled us to execute call options on a significant amount of fixed-rate debt and replace that called debt with less expensive funding. By calling the debt, we had to write off $27 million of unamortized concessions in 2008. However, this one-time called-debt expense was more than offset by the resulting decrease in interest expense in 2008. The improvement in interest expense will benefit 2009 earnings as well.

Our average earning assets grew by $3.2 billion in 2008. This growth, coupled with the improvement in net interest margin arising from the call activity described above and widening spreads on participations and syndications, contributed to a record $217 million of net income in 2008. This was an increase of 13 percent, or $25 million, from previous year's earnings, despite an increase of $43 million in loan loss provisions.

Our 2008 earnings level enabled us to distribute more than $153 million to the Associations we serve without compromising our strong capital position. Our capital ratios remain well above all regulatory requirements and are in line with our internal targets. We are always mindful that, as our earnings flow to the Associations and on to their borrowers, they enrich the economies of the rural communities served by the Associations.

Strategic Initiatives

Lending is only part of the AgFirst picture. Despite the year's challenges, we continued to focus on several strategic initiatives in 2008 designed to create efficiencies in association operations and enhance their ability to serve their customers. In 2008, we:

- Introduced enhancements to our key loan origination and customer service applications, including Credit Delivery, Customer Relationship Management (CRM), AgriGate, and Imaging.
- Created a new web-based training curriculum for Young, Beginning and Small (YBS) Farmers. This curriculum, a part of our Farm Credit University program, is a resource for YBS farmers across the nation to learn about farm financial management practices that will help them succeed.
- Introduced "expanded services" for our affiliated Associations. The services, provided by AgFirst, include complex loan accounting, fixed asset accounting, accounts payable services, and information management support. By taking advantage of the economies of scale that AgFirst can offer, Associations can reduce their costs without compromising quality of service.

Meeting our Mission

There is no escaping the fact that 2009 will be a challenge for lenders. We fully expect credit quality deterioration and loan losses. However, while we did not predict the timing or severity of the current economic downturn, we have always managed with the expectation that economies ebb and flow.

The conservative underwriting standards we adhere to, the robust earnings level we built into our pricing, and the strong capital levels we maintain are all designed to enable us to withstand the inevitable "bad times." Having the ability to continue through adverse conditions is important to us because our goal—moreover, our mission—is to be a reliable source of funding for our affiliated Associations in good times and bad. In turn, that enables them to meet their mission of providing sound, constructive credit to creditworthy borrowers, in good times and in bad.

Unlike many lenders, we have not "turned off the credit spigot." Associations in the AgFirst District are continuing to finance creditworthy farmers, ranchers, agribusinesses and rural homeowners. AgFirst is supporting them by providing reliable funding and superior services.

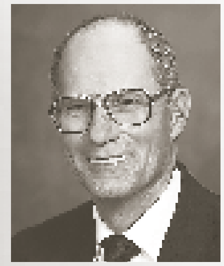
As we look forward to 2009, we know there will be challenges and that it will take time for the economy to return to normalcy. However, we are well-positioned to meet those challenges and continue to carry out our mission, which is, as it was when the System was created by Congress in 1916, to improve "the income and well-being of America's farmers and ranchers by furnishing sound, adequate, and constructive credit…to them."

Paul M. House
Chairman of the Board

F. A. Lowrey
Chief Executive Officer

February 27, 2009

BOARD OF DIRECTORS

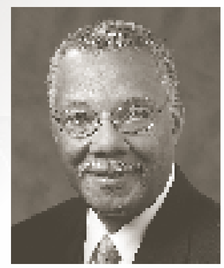

Walter L. Schmidlen, Jr.


James L. May


Robert G. Sexton


Dale R. Hershey


Eugene W. Merritt, Jr.


Kenneth A. Spearman


Gary L. Alexander

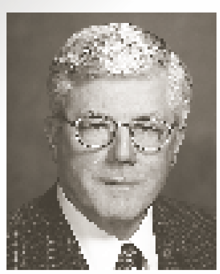

Robert L. Holden, Sr.


James M. Norsworthy, III


Robert H. Spiers, Jr.


Paul M. House
Chairman


William C. Bess, Jr.


Thomas W. Kelly


Katherine A. Pace


William H. Voss


M. Wayne Lambertson
Vice Chairman


Don W. Freeman


Lyle Ray King


J. Dan Raines, Jr.


J. Mark Wheeler

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

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 22 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 22 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.

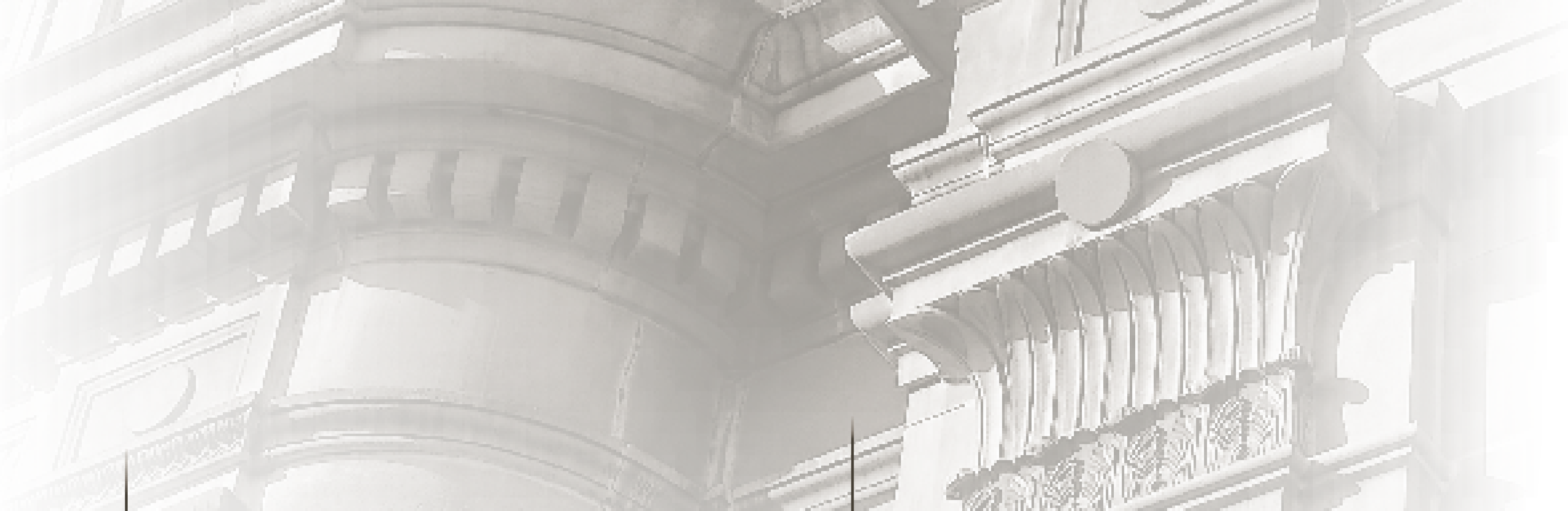
Like all banks in the Farm Credit System, AgFirst obtains its funds through the sale of notes and bonds to the investing public. Because the system issues large volumes of securities and its securities carry agency status, the Associations we serve enjoy a dependable and competitively priced source of 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 22 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.



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 we have reviewed the 2008 Annual Report of AgFirst Farm Credit Bank, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Paul M. House
Chairman of the Board

F. A. Lowrey
President & Chief Executive Officer

Charl L. Butler
Senior Vice President
& Chief Financial Officer

February 27, 2009

Report on Internal Control Over Financial Reporting

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

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

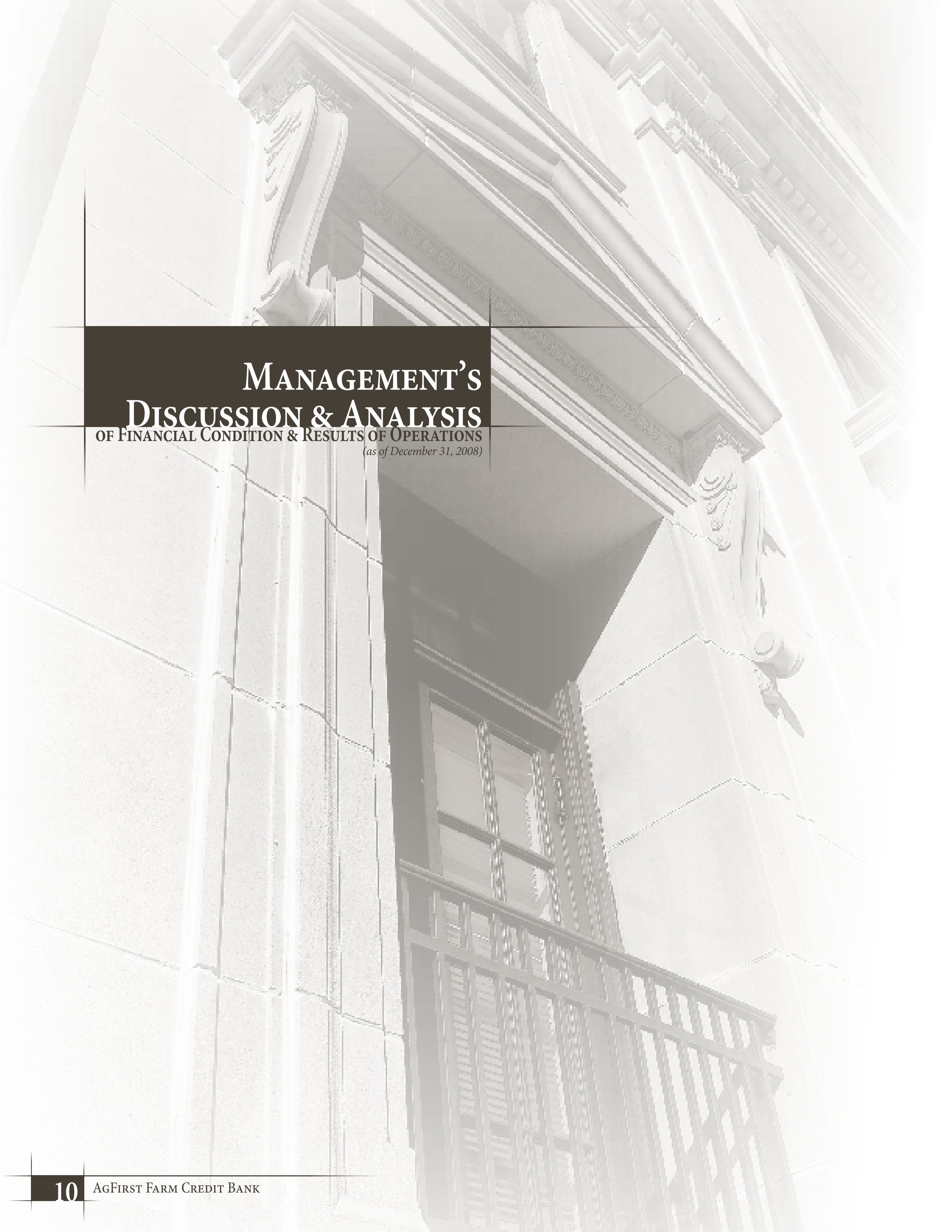
The Bank's management has completed an assessment of the effectiveness of internal control over financial reporting as of December 31, 2008. In making the assessment, management used the framework in *Internal Control — Integrated Framework*, promulgated by the Committee of Sponsoring Organizations of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

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

F.A. Lowrey
President & Chief Executive Officer

Charl L. Butler
Senior Vice President & Chief Financial Officer

February 27, 2009



Management's Discussion & Analysis

of Financial Condition & Results of Operations

(as of December 31, 2008)

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 of either 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. AgFirst also operates as a cooperative. Following the merger of Valley Farm Credit, ACA with and into MidAtlantic Farm Credit, ACA effective December 31, 2008, the District consisted of the Bank and twenty-two District Associations. All twenty-two are structured as ACA holding companies, with FLCA and PCA subsidiaries.

The following commentary reviews the Consolidated Financial Statements of condition and results of operations of AgFirst for the years ended December 31, 2008, 2007 and 2006. 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, as well as in the general economy;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry; and
- actions taken by the Federal Reserve System in implementing monetary and fiscal policy, as well as other policies and actions of the Federal government that impact the financial services industry and the debt markets.

AGRICULTURAL OUTLOOK

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

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

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

U.S. dollar depreciated against major foreign currencies in recent years resulting in greater demand for U.S. agricultural exports.

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

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

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

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

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

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

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

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

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

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

SIGNIFICANT ACCOUNTING POLICIES

The financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. Consideration of 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. In addition to the allowance for loan losses attributable to specific loans, the Bank may also establish a general allowance for loan losses based on management's assessment of risk inherent in the loans in the Bank's portfolio that were not specifically evaluated. In establishing general reserves, factors affecting certain commodity types or industries may be taken into consideration, as well as other factors previously discussed. Certain loan pools purchased from various Associations are analyzed in accordance with the selling Associations' allowance methodologies for assigning general and specific allowances, and allowances are established on those pools based on that analysis after Bank management's determination that the methodologies employed are appropriate.

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

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

- *Valuation methodologies* — Management applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets for which an observable liquid market exists, such as the majority of the Bank's investment securities. Management utilizes significant estimates and assumptions to value items for which an observable liquid market does not exist. Examples of these items include impaired loans, certain derivatives, certain investment securities and other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing, and liquidation values. The use of different assumptions could produce significantly different asset or liability values, which could have material positive or negative effects on the 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 a discount rate. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that portfolio of assets. The discount rate is used to determine the present value of future benefit obligations. The discount rate for 2008 was selected by reference to analysis and yield curves of the plans' actuary and industry norms. The yield curve selected follows the accounting guidance that the basis for discount rates should be higher-quality zero-coupon bonds with durations that match the expected cash flows of the plans that underlie the obligation.

LOAN PORTFOLIO

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)	2008		2007		2006	
Direct Notes	$ 14,997,151	70.61%	$ 14,602,548	76.39%	$ 13,877,142	80.91%
Participations/Syndications Purchased, net	4,925,744	23.19	3,470,300	18.16	2,501,453	14.58
Correspondent Lending	1,309,285	6.16	1,039,449	5.44	771,982	4.50
Loans to OFIs	7,150	0.04	2,220	0.01	1,760	0.01
Total	$ 21,239,330	100.00%	$ 19,114,517	100.00%	$ 17,152,337	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)	2008		2007		2006	
Direct Notes	$ 14,997,151	70.61 %	$ 14,602,548	76.40 %	$ 13,877,142	80.91 %
Production and Intermediate-Term	1,739,357	8.19	1,101,145	5.76	915,629	5.34
Real Estate Mortgage	1,615,851	7.61	1,125,319	5.89	750,394	4.37
Rural Residential Real Estate	1,188,843	5.60	915,874	4.79	647,610	3.77
Processing and Marketing	893,794	4.21	676,722	3.54	440,657	2.57
Loans to Cooperatives	276,987	1.30	293,009	1.53	223,264	1.30
Energy	220,361	1.04	170,932	0.90	179,613	1.05
Communication	155,813	0.73	87,912	0.46	61,769	0.36
Farm-Related Business	78,324	0.37	78,054	0.41	20,227	0.12
Water/Waste Disposal Loans	28,000	0.13	20,000	0.10	11,319	0.07
Lease Receivables	11,751	0.06	17,826	0.09	22,953	0.13
Loans to OFIs	7,150	0.03	2,220	0.01	1,760	0.01
Other	25,948	0.12	22,956	0.12	–	–
Total	$ 21,239,330	100.00 %	$ 19,114,517	100.00 %	$ 17,152,337	100.00 %

Total loans outstanding were $21.24 billion at December 31, 2008, an increase of $2.12 billion, or 11.12 percent, compared to total loans outstanding at December 31, 2007. Loans outstanding at the end of 2007 had increased $1.96 billion, or 11.44 percent, compared to December 31, 2006. Loan growth in 2008 resulted primarily from increases in participation loans purchased, including pools of loans that were purchased directly from certain District Associations. Increases in the Direct Notes that fund Association lending activity also contributed to overall loan growth. This growth in loan volume can be attributed to a number of factors. In response to growing worldwide demand for agricultural commodities, especially grains, farmers increased their production capacities. Borrowing needs have also grown because of rising costs for inputs such as fertilizer and fuel. Related capital expansion by agribusinesses has also driven up loan demand. As a result, farmers' needs for new production loans have increased dramatically, and they have also drawn more heavily on existing lines of credit.

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

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

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

Each loan is classified according to the two-tiered Uniform Classification System, which is used by all System institutions. Below are the classification definitions.

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

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

AgFirst Loans Credit Quality	2008	2007	2006
Acceptable	95.57%	98.75%	98.70%
OAEM	3.44	1.14	1.18
Adverse*	0.99	0.11	0.12
Total	100.00%	100.00%	100.00%

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

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

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

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

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. Each GFA contains minimum liquidity, capital, and earnings requirements that must be maintained by the Association. Refer to Note 1, *Organization and Operations*, in the Notes to the Consolidated Financial Statements for further discussion.

Ultimately, the Associations' ability to repay their Direct Note obligations is significantly dependent upon the 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).

Twenty of the twenty-two Associations met or exceeded the minimum GFA and regulatory requirements for liquidity, earnings, and capital as of December 31, 2008. Prior to year-end, one Association was operating under a special credit arrangement. At December 31, 2008, that Association was in violation of its liquidity requirement as measured under its Borrowing Base Formula as defined in the GFA. The same Association also failed to meet the standard earnings covenant at December 31, 2008. In early 2009, following a review of a business plan submitted by the Association, to achieve compliance with the covenants during 2009, the Bank approved a temporary waiver of the defaults and allowed the Association to continue operating under a special credit arrangement pursuant to its GFA. An additional Association also failed to meet its earnings covenant at December 31, 2008. Following review of a plan submitted in early 2009 by that Association to achieve compliance with the covenant during 2009, the Bank approved a waiver of the default. In both cases the Associations have continued to perform under the GFA, notwithstanding the covenant defaults.

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, 2008, Associations collectively had $1.46 billion under such government or government-sponsored enterprise (GSE) guarantee programs, compared to $1.25 billion at December 31, 2007.

Credit quality within the combined Associations' portfolios showed a decline during the twelve months ended December 31, 2008. At year-end, the combined Associations' loans including accrued interest were classified as follows:

District Associations Credit Quality	2008	2007	2006
Acceptable	92.26%	95.23%	96.02%
OAEM	3.66	3.01	2.53
Adverse*	4.08	1.76	1.45
Total	100.00%	100.00%	100.00%

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

Delinquencies (loans 90 days or more past due) were 0.82 percent of Association total loan assets at year-end 2008 compared to 0.39 percent and 0.28 percent at year-end 2007 and 2006, respectively. Nonperforming assets for the combined Associations represented 2.32 percent of total loan assets or $395.8 million, compared to 0.68 percent or $111.1 million for 2007, and 0.49 percent or $75.8 million for 2006. Nonperforming assets consist of nonaccrual loans, accruing restructured loans, accruing loans 90 days or more past due and other property owned.

Association net loan charge-offs of $29.2 million, $3.4 million and $12.6 million were recorded in 2008, 2007, and 2006, respectively. As a percentage of total average loan assets, net charge-offs for the combined Associations were 0.17 percent for 2008 compared to 0.02 percent and 0.08 percent in 2007 and 2006, 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, 2008.

Association	Regulatory Permanent Capital Ratio	Regulatory Core Surplus Ratio	Regulatory Total Surplus Ratio	Allowance/ Loans
AgCarolina Financial	14.72%	12.65%	12.92%	0.89%
AgChoice	11.11%	8.75%	10.27%	0.57%
Ag Credit	17.69%	14.59%	16.10%	0.46%
AgGeorgia	14.15%	10.71%	13.84%	0.71%
AgSouth	14.78%	10.88%	14.33%	0.31%
ArborOne	15.05%	12.39%	14.60%	0.57%
Cape Fear	13.03%	12.15%	12.69%	0.77%
Carolina	13.59%	10.44%	12.99%	0.75%
Central Florida	15.14%	11.70%	14.54%	1.21%
Central Kentucky	12.23%	10.32%	11.10%	0.65%
Chattanooga	13.51%	8.23%	11.43%	0.83%
Colonial	16.25%	15.50%	15.50%	0.83%
Farm Credit of the Virginias	12.11%	10.89%	10.89%	0.45%
First South	12.98%	10.55%	11.77%	0.73%
Jackson Purchase	14.45%	12.69%	13.60%	0.63%
MidAtlantic	14.11%	11.90%	13.61%	0.78%
North Florida	13.59%	12.24%	13.24%	1.38%
Northwest Florida	12.52%	11.75%	12.27%	0.62%
Puerto Rico	16.96%	16.74%	16.74%	0.46%
South Florida	15.57%	15.50%	15.50%	1.31%
Southwest Florida	12.05%	10.59%	11.83%	1.92%
Southwest Georgia	11.97%	9.06%	11.62%	0.81%

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	2008	2007	2006
North Carolina	16%	16%	15%
Florida	14	14	14
Georgia	12	12	13
Virginia	11	11	11
Pennsylvania	10	10	10
Maryland	7	7	7
South Carolina	6	6	6
Ohio	5	5	5
Alabama	3	4	3
Kentucky	3	3	3
Mississippi	2	2	2
Delaware	2	2	2
West Virginia	2	2	2
Tennessee	2	1	1
Puerto Rico	1	1	1
Louisiana	1	1	1
Texas	1	-	-
Other	2	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 the geographic concentration risk in these states.

Earnings for the combined Associations totaled $304.4 million, $381.8 million, and $348.2 million, producing an average return on assets of 1.69 percent, 2.22 percent, and 2.18 percent, and an average return on equity of 11.06 percent, 14.59 percent, and 14.00 percent for 2008, 2007, and 2006, 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 and other services, 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 Association 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	2008	2007	2006
Forestry	16%	13%	14%
Poultry	13	13	13
Fruits/Vegetables	10	10	10
Cattle	8	8	8
Other Real Estate	7	7	7
Grain	6	6	5
Dairy	5	6	6
Nursery/Greenhouse	5	5	5
Processing	3	3	4
Rural Home	3	3	3
Tobacco	3	3	3
Swine	3	3	3
Cotton	2	3	3
Corn	2	2	2
Citrus	1	2	1
Other	13	13	13
Total	100%	100%	100%

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

District Associations

	Percent of Portfolio		
Commodity Group	**2008**	**2007**	**2006**
Part-time Farmers	40%	40%	40%
Poultry	11	11	12
Forestry	5	6	6
Dairy	5	5	6
Fruits/Vegetables	5	5	5
Nursery/Greenhouse	4	4	4
Grain	4	2	2
Swine	3	3	3
Processing	3	3	2
Rural Home	3	2	1
Cotton	2	3	3
Tobacco	2	2	3
Cattle	2	2	2
Corn	2	2	1
Other Real Estate	2	1	1
Citrus	1	1	1
Other	6	8	8
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. Also, many poultry, dairy, forestry, and fruit/vegetable producers have significant secondary income from off-farm employment by a family member.

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

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

Forestry is divided principally into hardwood and softwood production and value-added processing. The timber from hardwood production is further processed into furniture, flooring, and high-grade paper and is generally located at the more northern latitudes and higher elevations. Softwood timber production is typically located in the coastal plains of the 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.

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

District Loan Volume Gross
Loans Outstanding Per Borrower

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

Loans greater than $5.0 million per borrower comprise approximately 20.03 percent of the District loan volume. 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 48.93 percent of outstanding loan volume is comprised of loans under $500 thousand, and loans less than $250 thousand make up approximately 33.51 percent of loan volume. This diversification across a large number of borrowers is another key component of the District's stable credit quality and solid financial performance over time.

Typically short-term and long-term loans to the same borrower are cross-collateralized and cross-defaulted. By law, all long-term loans must be secured by a first lien on real estate with an initial loan to appraised value not exceeding 85.00 percent. As of December 31, 2008, 40.84 percent of the District loans were identified as secured by a first lien on real estate. Exposure to losses is reduced through collateralization and other credit enhancements, including federal government guarantees.

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 and maximum hold positions.

The following table shows total participations/syndications portfolio credit exposures as of December 31.

	AgFirst Participations		
(dollars in thousands)	2008	2007	2006
Participations Purchased	$ 6,954,123	$ 4,891,381	$ 3,576,678
Less: Participations Sold	2,028,379	1,421,081	1,075,225
Net Outstanding	4,925,744	3,470,300	2,501,453
Available Commitment	2,136,119	1,697,129	1,714,215
Letters of Credit and Guarantees	210,664	177,905	258,400
Total Exposure	$ 7,272,527	$ 5,345,334	$ 4,474,068

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)	2008		2007		2006	
Florida	$ 986,651	20 %	$ 753,398	22 %	$ 656,988	26 %
Georgia	566,183	11	467,896	13	291,516	12
North Carolina	418,186	8	306,321	9	169,909	7
Pennsylvania	306,606	6	192,222	6	78,579	3
California	214,170	4	210,046	6	104,506	4
South Carolina	207,270	4	166,805	5	139,118	5
Virginia	202,490	4	72,780	2	95,256	4
Texas	191,293	4	195,611	6	115,435	5
Alabama	176,848	4	42,955	1	44,272	2
Mississippi	171,437	4	38,839	1	28,715	1
Tennessee	128,656	3	44,753	1	18,629	1
New York	112,455	2	87,133	3	64,388	2
Minnesota	109,152	2	134,056	4	98,028	4
Ohio	95,849	2	59,060	2	39,658	1
Missouri	91,696	2	47,220	1	56,104	2
Kentucky	91,073	2	36,168	1	20,033	1
Delaware	85,732	2	82,333	2	72,725	3
Louisiana	82,913	2	6,238	-	5,718	-
Connecticut	81,391	2	50,379	1	40,163	2
Oregon	72,957	1	92,517	3	46,461	2
Colorado	70,475	1	110,308	3	65,675	3
Washington	70,060	1	41,965	1	47,903	2
Arkansas	53,846	1	48,034	1	30,726	1
Iowa	48,223	1	27,513	1	144	-
Kansas	43,890	1	25,668	1	16,207	1
New Jersey	34,838	1	25,673	1	52,736	2
Puerto Rico	29,210	1	25,613	1	26,626	1
Idaho	28,286	1	11,615	-	5,515	-
Other	153,908	3	67,181	2	69,720	3
Total	$ 4,925,744	100 %	$ 3,470,300	100 %	$ 2,501,453	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 41.94 percent from 2007 year-end to 2008 year-end. The volume growth was strong in 2008 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, the food and kindred products group, and the agribusiness group which in turn represent a widely diverse group of forestry, forest products, food, food processing, and agribusiness 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	**2008**	**2007**	**2006**
Forestry	16%	17%	13%
Food and Kindred Products	13	16	19
Agribusiness	13	13	14
Lumber/Paper	6	6	8
Citrus	6	5	8
Swine	5	6	4
Cattle	5	5	3
Electric Utilities	4	5	6
Sugar Cane/Sugar Beets	3	3	4
Horticulture	4	4	6
Poultry & Eggs	4	3	2
Telephone Utilities	3	3	3
Other	18	14	10
Total	100%	100%	100%

The ethanol industry has been stressed recently due to rapidly changing commodity prices, especially corn, declining fuel consumption, and supply levels in excess of the Federal Ethanol Mandate. The Bank had $96.0 million of loans outstanding and $21.4 million of commitments to lend to ethanol related customers at December 31, 2008. The Bank had additional exposure, through the Direct Note, to the District

Associations' ethanol exposure. District Associations' total exposure to the ethanol industry at December 31, 2008 included $147.0 million of loans outstanding and $72.8 million of commitments to extend credit. At December 31 2008, the Bank had a reserve allowance of $17.7 million, which was recognized through provision expense during 2008, related to loans in its ethanol portfolio. The Associations also had total reserves of $4.4 million for loans in their ethanol portfolio at December 31, 2008.

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

Participation/Syndication Credit Quality	2008	2007	2006
Acceptable	90.17%	97.84%	97.70%
OAEM	5.56	1.57	1.53
Substandard	4.27	0.53	0.77
Doubtful	0.00	0.06	0.00
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)	2008			2007			2006		
Rural Home Loans – Guaranteed	$	1,127.7	86.14%	$	852.0	81.97%	$	605.5	78.44%
Part-time Farm Loans – Guaranteed		120.3	9.18		126.1	12.13		119.0	15.40
Agricultural Loans – Guaranteed		2.0	0.15		2.3	0.22		2.5	0.33
Non-guaranteed Loans		59.3	4.53		59.0	5.68		45.0	5.83
Total	$	1,309.3	100.00%	$	1,039.4	100.00%	$	772.0	100.00%

Rural home loans are underwritten to conform to Fannie Mae underwriting standards and are guaranteed by Fannie Mae. Part-time farm loans conform to Farmer Mac underwriting standards and are guaranteed by Farmer Mac. AgFirst classifies these loans as "held-to-maturity." During 2008, AgFirst purchased $395.9 million of rural home and part-time farm loans.

AgFirst owned $1.1 billion in rural home loans at December 31, 2008. These loans are the most significant portfolio due to the Associations' active participation in Fannie Mae home loan programs.

AgFirst owned $120.3 million in part-time farm loans at December 31, 2008. 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 $2.0 million of agricultural loans that are guaranteed by Farmer Mac at December 31, 2008. This segment is small, due primarily to the Associations' propensity to hold agricultural loans in-portfolio. Through AgFirst, a number of Associations obtain Farmer Mac guarantees for qualifying segments of their agricultural portfolios, thereby eliminating the need to sell those loans to AgFirst.

The $59.3 million of non-guaranteed loans at December 31, 2008 generally consists of loans that are being held for eventual delivery to, or 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.

The majority of loans owned and/ or serviced by AgFirst are sub-serviced through agreements with third parties. The total volume owned as of December 31, 2008 was $1.3 billion. These loans are accounted for as "held-to-maturity." The total volume serviced but not owned as of December 31, 2008 was $14.5 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 as described below.

Rural Housing Mortgage-Backed Securities

Rural Housing Mortgage-Backed Securities (RHMBS) must be fully guaranteed by a government agency or GSE. The rural housing loans backing the RHMBS must be conforming first-lien residential mortgage loans originated by non-System lenders in "rural areas" as defined by the Farm Security and Rural Investment Act of 2002, or eligible rural housing loans originated by System lenders under FCA Regulations. Investment securities at December 31, 2008 included $1.49 billion in RHMBS classified as held-to-maturity, compared to $1.12 billion at December 31, 2007. The initial time period for this pilot program has expired.

Rural America Bonds

In October 2005, the FCA approved the Rural America Bonds investment program for a three-year pilot period. In recognition of the economic interdependence between agricultural and rural communities, AgFirst and the Associations seek to safely and soundly invest in debt obligations that support farmers, ranchers, agribusinesses, and their rural communities and businesses. In doing so, AgFirst and the Associations hope to increase the well-being and prosperity of American farmers, ranchers, and rural residents. As of December 31, 2008, the District had $236.7 million in the Rural America Bond program, compared to $141.8 million at December 31, 2007. The Bank had $129.4 million invested in the program as of December 31, 2008, an increase of $55.3 million from December 31, 2007. Of the $129.4 million, the Bank had $103.5 million reflected in investment securities and $25.9 million reflected as loans on the Consolidated Balance Sheet at December 31, 2008. The FCA approved a continuation of the program at October 31, 2008 for an as yet undetermined time period.

FARMER MAC

On September 30, 2008, the Farm Credit System banks made a collective $60.0 million investment in Farmer Mac. As part of this collective investment, AgFirst purchased 11 million shares of Farmer Mac senior cumulative perpetual preferred stock, series B-1, with a par value of $1 dollar per share, for a total investment of $11.0 million. Dividends on the preferred stock are cumulative and will be payable quarterly, in cash, at an annual interest rate of 10 percent, increasing by 2 percent in each of the first three years, up to a maximum of 16 percent. The preferred stock is callable at par value after nine months, and on any quarterly dividend date thereafter. Additionally, the stock is redeemable in whole by Farmer Mac beginning nine months after the date of issuance with cash or certain qualifying assets. At December 31, 2008, AgFirst also owned $840 thousand of class B voting restricted common stock, $392 thousand of class C non-voting unrestricted stock, $15.4 million of Farmer Mac MBS investment securities and had $122.2 million of loans guaranteed by Farmer Mac. District Associations had $277.1 million of loans guaranteed by Farmer Mac at December 31, 2008

RISK MANAGEMENT

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 Officer also acts as the Chief 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)	2008	2007	2006
AgFirst High-risk Assets			
Nonaccrual loans	$ 176,411	$ 2,507	$ 15,110
Restructured loans	–	–	–
Accruing loans 90 days past due	11,325	1,356	1,759
Total high-risk loans	187,736	3,863	16,869
Other property owned	540	–	75
Total high-risk assets	$ 188,276	$ 3,863	$ 16,944
Ratios			
Nonaccrual loans to total loans	0.83%	0.01%	0.09%
High-risk assets to total assets	0.63%	0.02%	0.07%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or interest under the contractual terms of the loan. Nonaccrual loans increased $173.9 million in 2008 primarily due to three borrower relationships, which comprise 70.7 percent of the total nonaccrual loan balance at December 31, 2008.

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

Although there has been credit quality deterioration in 2008, due to the credit risk management process, the 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, District Association variable rate and adjustable rate loans are generally indexed to market rates, and fixed rate loans are priced based on market rates at closing. Loan products offered by the Associations include prime-indexed variable rate loans, LIBOR-indexed variable rate loans, one-, three- and five-year Treasury-indexed adjustable rate loans, and fixed rate loans. Variable rate and adjustable rate loans are offered with or without caps. Terms are available for up to 30 years. A variety of repayment options are offered, with the ability to pay on a monthly, quarterly, semi-annual or annual frequency. In addition, "custom" repayment plans may be negotiated to fit a borrower's unique circumstances.

The objective of interest rate risk management is to generate an adequate level of net interest income in any interest rate environment. AgFirst uses a variety of analytical techniques to manage the complexities associated with offering numerous loan options. 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, 2008.

Net Interest Income
(dollars in thousands)

Scenarios	Net Interest Income	% Change
+4.0% Shock	$463,799	19.45%
+2.0% Shock	$414,388	6.73%
Base line	$388,269	–
-50% of 3M Tbill **	$390,929	0.69%

Market Value of Equity
(dollars in thousands)

Scenarios	Assets	Liabilities	Equity*	% Change
Book Value	$29,933,601	$29,069,959	$ 863,642	–
+4.0% Shock	$28,039,423	$27,706,189	$ 333,234	(27.52)%
+2.0% Shock	$29,117,685	$28,683,336	$ 434,349	(5.53)%
Base line	$30,022,253	$29,562,472	$ 459,781	–
-50% of 3M Tbill **	$30,042,867	$29,580,938	$ 461,929	0.47%

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

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

The following table sets forth the repricing characteristics of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2008. The amount of assets and liabilities shown in the table, which reprice or mature during a particular period, were determined in accordance with the earlier of term-to-repricing or contractual maturity, anticipated prepayments, and, in the case of liabilities, the exercise of call options.

Repricing/Maturity Gap Analysis

(dollars in thousands)	0 to 6 months	6 months to 1 Year	1 to 5 Years	Over 5 Years	Total
Short and Intermediate-Term Loans					
Fixed	$ 2,956,461	$ 833,306	$ 650,859	$ 164,274	$ 4,604,900
Variable	4,281,860	–	–	–	4,281,860
Total Short and Intermediate-Term Loans	**7,238,321**	**833,306**	**650,859**	**164,274**	**8,886,760**
Long-term Real Estate Loans					
Fixed	5,762,561	2,371,447	3,648,139	504,961	12,287,108
Variable	27,502	25,857	11,983	120	65,462
Total Long-term Real Estate Loans	**5,790,063**	**2,397,304**	**3,660,122**	**505,081**	**12,352,570**
Total Loans	**13,028,384**	**3,230,610**	**4,310,981**	**669,355**	**21,239,330**
Total Investments *	**5,733,262**	**745,539**	**1,413,957**	**370,029**	**8,262,787**
TOTAL INTEREST EARNING ASSETS	**$18,761,646**	**$3,976,149**	**$5,724,938**	**$1,039,384**	**$29,502,117**
Interest-Bearing Liabilities					
Systemwide bonds and notes	$17,356,523	$4,843,000	$4,810,000	$1,043,500	$28,053,023
Other interest-bearing liabilities	–	–	–	225,000	225,000
Interest rate swaps	1,723,000	(450,000)	(1,023,000)	(250,000)	–
TOTAL INTEREST-BEARING LIABILITIES	**$19,079,523**	**$4,393,000**	**$3,787,000**	**$1,018,500**	**$28,278,023**
Interest Rate Sensitivity Gap	**$(317,877)**	**$(416,851)**	**$1,937,938**	**$20,884**	
Sensitivity Gap as % of Total Earning Assets	(1.08)%	(1.41)%	6.57%	0.07%	
Cumulative Gap	$(317,877)	$(734,728)	$1,203,210	$1,224,094	
Cumulative Gap as a % of Total Earning Assets	(1.08)%	(2.49)%	4.08%	4.15%	
Rate Sensitive Assets/Rate Sensitive Liabilities	0.98	0.91	1.51	1.02	

* *includes cash equivalents*

At December 31, 2008, the Repricing/Maturity Gap reflected the Bank is liability sensitive out to one year as repricing / maturing debt exceeded assets that mature or reprice during that time period. This position is due to declining interest rates at the end of 2008, which results in a significant portion of AgFirst's fixed-rate debt that includes call options, to reprice during the one year time period. Callable debt may be called prior to scheduled maturity and replaced at lower interest levels.

Liability sensitivity implies an increase in net interest income in falling interest rate scenarios and higher net interest income in rising 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, 2008. 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, 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, 2008, AgFirst had outstanding interest rate swaps with notional amounts totaling $2.22 billion. All of these derivative transactions were executed to create synthetic floating-rate debt to achieve a lower cost of funding. Derivatives may also be used by the Bank for asset/liability management purposes to reduce interest rate risk.

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

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

Liquidity Risk Management

One of the primary responsibilities of AgFirst is to maintain sufficient liquidity to fund the lending operations of the District Associations, in addition to its own 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 two securities repurchase agreement facilities.

Investments and Cash and Cash Equivalents

Investment securities and cash and cash equivalents outstanding as of December 31, 2008 for AgFirst totaled $8.27 billion compared to $7.47 billion and $6.94 billion at December 31, 2007 and 2006, respectively. Theses increases are due to the increases in investment securities, which are primarily related to the growth of total loans as management increased the size of the investment securities portfolio generally in line with loan growth. In addition, for 2008, growth was due to enhancing liquidity and high spread opportunities at certain points during the year.

AgFirst's investment portfolio and cash and cash equivalents consisted of the following security types as of December 31.

AgFirst Investment Securities and Cash and Cash Equivalents

(dollars in thousands)	**2008**		**2007**		**2006**	
Investment Securities						
Available for Sale						
U.S. Govt. GNMA MBS/CMOs	$ 3,245,283	40.60%	$ 1,754,553	25.40%	$ 1,267,914	19.94%
U.S. Govt. Agency MBS	2,533,993	31.70	3,051,267	44.16	2,749,985	43.25
Non-Agency Securities	404,321	5.06	636,559	9.21	776,534	12.21
Asset-Backed Securities	79,960	1.00	166,550	2.41	271,188	4.26
Total Available for Sale	6,263,557	78.36	5,608,929	81.18	5,065,621	79.66
Held to Maturity						
Rural Housing MBS	1,494,837	18.70	1,124,855	16.28	1,249,788	19.66
MBS Guaranteed by Farmer Mac	15,355	0.19	16,946	0.25	19,260	0.30
Other	219,408	2.74	158,067	2.29	24,013	0.38
Total Held to Maturity	1,729,600	21.64	1,299,868	18.82	1,293,061	20.34
Total Investment Securities	$ 7,993,157	100.00%	$ 6,908,797	100.00%	$ 6,358,682	100.00%
Cash and Cash Equivalents						
Cash	$ 7,373	2.66%	$ 14,893	2.67%	$ 70,395	12.08%
Fed Funds	–	–	183,659	32.87	55,369	9.50
Master Notes	82,000	29.60	85,218	15.25	82,000	14.07
Repos	187,630	67.74	275,000	49.21	375,000	64.35
Total Cash and Cash Equivalents	$ 277,003	100.00%	$ 558,770	100.00%	$ 582,764	100.00%
Total Investment Securities and Cash and Cash Equivalents	$ 8,270,160		$ 7,467,567		$ 6,941,446	

FCA regulations require a liquidity policy that establishes a "minimum coverage" level of 90 days for System banks. "Coverage" is defined as the number of days that maturing debt could be funded through the sale of liquid investments and Agency-guaranteed rural home loans. At December 31, 2008, AgFirst's coverage was 153 days.

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

AgFirst also maintains a portfolio of investments that are not held for liquidity purposes and are accounted for as a held-to-maturity portfolio. These investments are authorized by FCA Regulations that allow investments in Farmer Mac securities and also in specific investments approved by FCA as Mission Related Investments. The vast majority of this portfolio is comprised of Mission Related Investments for a program to purchase RHMBS, not to exceed 10.00 percent of total outstanding loans (see *Mission Related Investments* section above).

Investment securities classified as being available-for-sale totaled $6.26 billion at December 31, 2008. Total net unrealized losses relating to these securities increased $318.0 million during 2008 to a total of $355.8 million at December 31, 2008. These net unrealized losses are reflected in Accumulated Other Comprehensive Income (AOCI) in the Consolidated Financial Statements. The net unrealized losses are primarily attributed to the market dislocation and illiquidity stemming from adversity in the mortgage market. Available-for-sale investments at December 31, 2008 included $4.4 billion in Agency Collateralized Mortgage Obligations (CMOs), $1.4 billion in Agency Adjustable Rate Mortgages, $404.3 million in whole loan CMOs, and $80.0 million in asset-backed securities. The Bank also recognized a loss of $10.5 million for other-than-temporary impairment on one asset-backed security in its portfolio as discussed below, which reduced net income.

The Bank has low exposure to investments backed by subprime mortgages. Asset-backed securities with subprime exposure totaled $80.0 million, which represented 1.28 percent of the available-for-sale liquidity investment portfolio and 1.00 percent of the total investment security portfolio at December 31, 2008. The amortized cost of these investment securities totaled $124.1 million and the market value adjustment decrease for asset-backed securities of $44.1 million was included in the total $355.8 million of net unrealized losses reflected in AOCI at December 31, 2008 as discussed above. The Bank's asset-backed securities rated above the minimum for investment grade (BBB-/ Baa3) by the Nationally Recognized Statistical Rating Organizations (NRSROs) at December 31, 2008, totaled $61.9 million (amortized cost value of $85.2 million). The asset-backed securities rated at the minimum for investment grade by one of the NRSROs, totaled $18.1 million (amortized cost value of $38.9 million) at December 31, 2008. Despite the uncertainty in the mortgage securities markets, which has adversely impacted the market value of all asset-backed securities, these securities continue to perform. All of the Bank's asset-backed securities have credit enhancement features, which may include over collateralization, the subordination of other security traunches, and/ or protection provided by a monoline insurance provider.

Whole loan CMOs have also experienced significant market pricing volatility. Bank whole loan CMOs totaled $404.3 million, which represented 6.46 percent of the available-for-sale liquidity investment portfolio and 5.06 percent of the total investment security portfolio at December 31, 2008. The amortized cost of these investment securities totaled $566.8 million and the market value adjustment decrease for whole loan CMOs of $162.5 million was included in the total $355.8 million of net unrealized losses reflected in AOCI at December 31, 2008 as discussed above. The Bank's whole loan CMO securities split rated AAA/ Aaa or lower by the NRSROs at December 31, 2008 had a total amortized cost of $126.2 million and a fair value of $72.2 million.

The FCA considers asset-backed and mortgage-backed investment securities rated below AAA/Aaa by the NRSROs to be ineligible and requires System institutions to divest of such investments. However, System institutions may seek approval to continue to hold these investments. For each of the investment securities in the Bank's portfolio at December 31, 2008 rated below AAA/ Aaa (total amortized cost of $120.0 million and fair value of $69.6 million), the Bank has developed and submitted plans for approval by the FCA that provide that the securities may be held to maturity. The FCA has approved with conditions the Bank's plans for all but one, which the FCA is still in the process of reviewing. For purposes of the permanent capital, total surplus, and core surplus regulatory ratios, ineligible securities risk weighted 100 percent instead of the standard 20 percent had a fair value of $51.5 million and amortized cost of $91.5 million at year end 2008. Ineligible securities which must be deducted completely from capital and assets have fair value of $18.1 million and amortized cost of $28.5 million at year end 2008. For purposes of the net collateral ratio, all ineligible investments are stated at lower of cost or market. See the Capital section below for further discussion of the regulatory ratios. In addition, ineligible investments are excluded from liquidity coverage as defined above.

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

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

Systemwide Debt Securities

AgFirst's primary source of liquidity is its ability to issue Systemwide Debt Securities, which are the general unsecured joint and several obligations of the System banks. AgFirst continually raises funds to support its mission to provide credit and related services to the rural and agricultural sectors, to repay maturing Systemwide Debt Securities, and to meet other obligations. As a GSE, AgFirst has access to the nation's and world's debt and capital markets. This access has provided AgFirst with a dependable source of competitively priced debt that is critical to support its mission of providing funding to the rural and agricultural sectors. Moody's Investors Service and Standard & Poor's rate the System's long-term debt as Aaa and AAA, and short-term debt as P-1 and A-1+, respectively. These rating agencies base their ratings on many quantitative and qualitative factors, including the System's GSE status. Material changes to the factors considered could result in a different debt rating. Despite the recent adversity in the financial debt markets, as a result of the System's financial performance, credit quality and standing in the capital markets, AgFirst anticipates continued access to funding necessary to support the System's and Bank's needs. The U.S. government does not guarantee, directly or indirectly, Systemwide Debt Securities. AgFirst's year-to-date average balance of Systemwide Debt Securities at December 31, 2008, was $26.69 billion. At December 31, 2008, AgFirst had $28.05 billion in total System debt outstanding compared to $24.85 billion at December 31, 2007 and $22.61 billion at December 31, 2006. The year-to-year increases were primarily due to the increases in loan volume and the investment portfolio.

AgFirst's participation in outstanding Systemwide Debt Securities as of December 31, 2008 is shown in the following table.

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

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

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

Lines of Credit

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

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

Operational Risk Management

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

ALLOWANCE FOR LOAN LOSSES

The 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. The allowance for loan losses was $44.6 million at December 31, 2008, as compared with $2.8 million and $463 thousand at December 31, 2007 and 2006, respectively. The increase during 2008 was primarily due to loans moved to nonaccrual status discussed above. The allowance at December 31, 2008 included specific reserves of $31.0 million related to specific credits, $9.6 million of general reserves attributed to participation loans (timber, ethanol and meat complex) and $4.0 million of general and specific reserves on certain loan pools acquired directly from several District Associations. The market segments of the portfolio were reviewed, and particularly stressed segments were identified. Loans in those segments, excluding any loans on which specific reserves had been established, were analyzed collectively and risk rating and potential for loss given default factors were stressed. The general reserves were established based on that collective analysis and stress testing results.

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

AgFirst Allowance for Loan Losses Activity:

(dollars in thousands)	2008	2007	2006
Balance at beginning of year	$ 2,816	$ 463	$ 10,114
Charge-offs:			
Real Estate Mortgage	(322)	–	–
Agribusiness	–	–	(2,314)
Energy	–	(128)	–
Other	(1,429)	–	–
Total charge-offs	(1,751)	(128)	(2,314)
Recoveries:			
Other	158	–	–
Total recoveries	158	–	–
Net (charge-offs) recoveries	(1,593)	(128)	(2,314)
Provision for (reversal of allowance for) loan losses	43,342	2,481	(7,337)
Balance at end of year	$ 44,565	$ 2,816	$ 463
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	(0.008)%	(0.001)%	(0.015)%

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)	2008	2007	2006
Real Estate Mortgage	$ 10,972	$ 958	$ 279
Production and Intermediate Term	3,947	380	130
Agribusiness	29,641	44	26
Communication	–	–	1
Energy	–	–	3
Rural Residential Real Estate	5	5	24
Other	–	1,429	–
Total	$ 44,565	$ 2,816	$ 463

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:

	2008	2007	2006
Allowance for loan losses to loans	0.21 %	0.01 %	0.003 %
Allowance for loan losses to nonaccrual loans	25.26 %	112.33 %	3.06 %
Allowance for loan losses to participation loans and Correspondent Lending loans	0.71 %	0.06 %	0.01 %

Despite the recent negative credit quality trends, the financial positions of the Bank and District 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. However, as discussed previously, uncertainty in the general economic environment has increased the potential for additional prospective risks in the loan portfolio.

See Note 4, *Loans and Allowance for Loan Losses*, in the Notes to the 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 $217.2 million for the year ended December 31, 2008, an increase of $25.0 million over 2007. AgFirst net income totaled $192.2 million for the year ended December 31, 2007, an increase of $2.0 million over 2006. 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, 2008**	**2007**
Net income (for prior year)	$ 192,209	$ 190,193
Increase (decrease) due to:		
Total interest income	(135,525)	246,086
Total interest expense	241,168	(212,720)
Net interest income	105,643	33,366
Provision for loan losses	(40,861)	(9,818)
Noninterest income	(8,949)	(5,475)
Noninterest expense	(30,875)	(16,057)
Total increase (decrease) in net income	24,958	2,016
Net income	$ 217,167	$ 192,209

Interest Income

Total interest income for the year ended December 31, 2008 was $1.33 billion, a decrease of $135.5 million, as compared to the same period of 2007. Total interest income for 2007 was $1.47 billion, an increase of $246.1 million, as compared to the same period of 2006. The decrease from 2007 to 2008 was the result of lower earning asset yields due to the declining market interest rate environment. The volume of interest earning assets increased in 2008, with an increase in average earning assets of $3.18 billion. The average yield on interest earning assets decreased 1.14 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, 2008-2007**	**2007-2006**
Current year increase in average earning assets	$ 3,180,026	$ 3,231,118
Prior year average yield	5.84%	5.58%
Interest income variance attributed to change in volume	185,565	180,074
Current year average earning assets	28,354,848	25,174,822
Current year increase (decrease) in average yield	(1.14)%	0.26%
Interest income variance attributed to change in yield	(321,090)	66,012
Net change in interest income	$ (135,525)	$ 246,086

Interest Expense

Total interest expense for the year ended December 31, 2008 was $967.0 million, a decrease of $241.2 million, as compared to the same period of 2007. Total interest expense for the year ended December 31, 2007 was $1.21 billion, an increase of $212.7 million, as compared to the same period of 2006. The decrease in 2008 was primarily attributed to the decrease in average rates paid on System debt obligations.

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

Net Change in Interest Expense *(dollars in thousands)*	**Year Ended December 31, 2008-2007**	**2007-2006**
Current year increase in average interest-bearing liabilities	$ 3,138,322	$ 2,952,023
Prior year average rate	5.09%	4.79%
Interest expense variance attributed to change in volume	159,648	141,293
Current year average interest-bearing liabilities	26,887,916	23,749,594
Current year increase (decrease) in average rate	(1.49)%	0.30%
Interest expense variance attributed to change in rate	(400,816)	71,427
Net change in interest expense	$ (241,168)	$ 212,720

Net Interest Income

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

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

	2008			**2007**			**2006**		
	Avg. Balance	**Interest**	**Avg. Yield**	**Avg. Balance**	**Interest**	**Avg. Yield**	**Avg. Balance**	**Interest**	**Avg. Yield**
Loans	$ 20,416,963	$ 1,027,651	5.03%	$ 18,002,377	$ 1,083,668	6.02%	$ 15,568,139	$ 890,247	5.72%
Cash & investments	7,937,885	305,858	3.84%	7,172,445	385,366	5.37%	6,375,565	332,701	5.22%
Total earning assets	$ 28,354,848	$ 1,333,509	4.70%	$ 25,174,822	$ 1,469,034	5.84%	$ 21,943,704	$ 1,222,948	5.58%
Interest-bearing liabilities	$ 26,887,916	$ (966,988)	3.60%	$ 23,749,594	$ (1,208,156)	5.09%	$ 20,797,571	$ (995,436)	4.79%
Spread			1.10%			0.75%			0.79%
Impact of capital	$ 1,466,932		0.19%	$ 1,425,228		0.29%	1,146,133		0.25%
Net Interest Income (NII) & NII to average earning assets		$ 366,521	1.29%		$ 260,878	1.04%		$ 227,512	1.04%

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

Provision for Loan Losses

AgFirst assesses risks inherent in its portfolio on an ongoing basis and establishes an appropriate reserve for loan losses. The provision for loan losses for 2008 included additions to specific reserves of $31.0 million related to specific credits, $9.6 million of additions to general reserves attributed to participation loans (timber, ethanol and meat complex) and $2.7 million of additions to general and specific reserves on certain loan pools acquired directly from several District Associations. 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.

Noninterest Income

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

Noninterest Income	For the Year Ended December 31,			Increase (Decrease)	
(dollars in thousands)	2008	2007	2006	2008/ 2007	2007/ 2006
Loan fees	$ 8,626	$ 7,684	$ 6,262	$ 942	$ 1,422
Gains (losses) on investments (net)	(10,465)	–	(5)	(10,465)	5
Gains (losses) on derivatives (net)	(359)	–	6,812	(359)	(6,812)
Gains (losses) on sales of rural home loans (net)	(70)	180	(83)	(250)	263
Patronage refunds from other Farm Credit Institutions	3,164	3,161	1,746	3	1,415
Other noninterest income	3,978	2,798	4,566	1,180	(1,768)
Total noninterest income	$ 4,874	$ 13,823	$ 19,298	$ (8,949)	$ (5,475)

The increases in loan fees for 2008 and 2007 primarily represented increases in fee income on participation loans.

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

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

Patronage refunds from other Farm Credit institutions increased $4.0 million and $1.4 million in 2008 and 2007, respectively, primarily from increases in participation loans purchased from other Farm Credit institutions.

Other noninterest income was $4.0 million for the year ended December 31, 2008, or a $1.2 million increase compared to December 31, 2007. The majority of this increase was primarily for services to Associations and other Farm Credit System entities. The Bank began recognizing income from one new significant servicing arrangement in the third quarter of 2008. The $1.8 million decrease in other noninterest income for 2007 resulted from a gain booked in 2006, which was $1.5 million 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	For the Year Ended December 31,			Increase/(Decrease)	
(dollars in thousands)	2008	2007	2006	2008/ 2007	2007/ 2006
Salaries and employee benefits	$ 30,655	$ 28,853	$ 26,318	$ 1,802	$ 2,535
Occupancy and equipment	14,957	13,060	11,608	1,897	1,452
Insurance fund premiums	12,153	5,623	3,597	6,530	2,026
Other operating expense	22,174	18,776	17,529	3,398	1,247
Called debt expense	26,652	10,550	2,563	16,102	7,987
Correspondent lending servicing expense	4,017	2,071	1,656	1,946	415
Other noninterest expenses	278	1,078	683	(800)	395
Total noninterest expenses	$ 110,886	$ 80,011	$ 63,954	$ 30,875	$ 16,057

Total salaries and employee benefits generally increased over the three year period of 2006 through 2008 as a result of normal salary administration and increased benefit costs that were experienced by most employers. 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 $1.9 million and $1.4 million during 2008 and 2007, 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 $6.5 million increase in the Insurance Fund premiums in 2008 resulted primarily from a change in the assessment of the premium, as well as balance sheet growth. Effective July 1, 2008, the base on which the Insurance Fund premiums are assessed was expanded from total loans to total System debt. In addition, the annual premium rate, which was 15 basis points for the first nine months of 2008, was increased to 18 basis points the last quarter of 2008. The Insurance Fund Board increased the premium to 20 basis points in 2009. The Insurance Fund premium increased $2.0 million in 2007 due to the increase in loan volume.

Other operating expenses increased $3.4 million in 2008. The increase was primarily due to a $2.1 million increase in professional fees related to technology upgrades and Systemwide initiatives. The $1.2 million increase in other operating expenses in 2007 was primarily the result of a decrease in cost deferrals related to internal capital project development and other factors.

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

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

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

Projected Pension Expense

Pension expense for the Bank, which was $2.2 million in 2008, is expected to be $8.5 million in 2009, an increase of $6.3 million. This increase is due to a decrease in the expected return on assets and an increase in the amount of actuarial losses amortized. As previously mentioned, pension expense is determined by actuarial valuations based on certain assumptions, including expected long-term rates of return on plan assets and discount rates. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that portfolio of assets. The discount rate is used to determine the present value of future benefit obligations. Plan assets values decreased significantly in 2008 due to the decline in stock values. The long-term rate of return assumption was lowered from 8.5 percent to 8 percent for the Districtwide plan, in which the Bank participates, in response to investment return forecasts and current industry norms. The discount rate used to determine the present value of obligations decreased from 6.45 percent to 6.25 percent due to a change in the yield curve used to determine the rate to more conservatively reflect a level at which obligations could be settled. The pay increase assumption, which impacts service cost, used in the projected benefit obligation determination was increased for certain employee groups to more closely resemble actual experience over the past several years. Some of these changes in methodology may not be permanent but reflect the Bank's and Distrcit's projections based on the current financial environment.

Key Results of Operations Comparisons

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

Key Results of	For the 12 Months Ended		
Operations Comparisons	**12/31/08**	**12/31/07**	**12/31/06**
Return on average assets	0.76%	0.76%	0.86%
Return on average shareholders' equity	14.59%	13.58%	16.74%
Net interest income as a percentage of average earning assets	1.29%	1.04%	1.04%
Net (charge-offs) recoveries to average loans	(0.008)%	(0.001)%	(0.015)%

CAPITAL

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

The AgFirst Capitalization Plan (the "Plan") approved by the Bank Board of Directors establishes guidelines to ensure that adequate capital is maintained for continued financial viability, to provide for growth necessary to meet the needs of members/borrowers, and to ensure that all stockholders are treated equitably. The Bank's capital objectives are considered adequate to support inherent risk. There were no material changes to the Plan for 2008 that have an effect on the Bank's ability to retire stock and distribute earnings.

Total shareholders' equity at December 31, 2008 was $1.24 billion, compared to $1.46 billion and $1.18 billion at December 31, 2007 and 2006, respectively. The decrease in 2008 was related to the increase in accumulated other comprehensive income (loss) (AOCI). The $357.2 million negative AOCI primarily represents the unrealized losses associated with a decrease in the market value of the Bank's available-for-sale investment securities. The increase in shareholders' equity in 2007 compared to 2006 was primarily due to the issuance of $250.0 million of Perpetual Non-cumulative Subordinated Preferred Stock discussed below.

Capital stock and participation certificates totaled $434.9 million at December 31, 2008, compared to $364.8 million at December 31, 2007, an increase of $70.1 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 is 1.75 percent of Association Direct Note balances. This resulted in an $11.9 million and $20.9 million increase for 2008 and 2007, respectively, in Association owned capital stock. In addition, as of December 31, 2008, eleven Associations had purchased $114.4 million in stock to support certain loan participation pools they had sold to the Bank. This was an increase of $57.7 million, as compared to $56.7 million purchased by the end of 2007.

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

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

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

The FCA notified AgFirst that the June 2007 issuance of $250.0 million of Perpetual Non-Cumulative Subordinated Preferred Stock (as discussed above) could be included in core surplus up to an amount not to exceed 25 percent of total core surplus, inclusive of the preferred stock component. Based on this regulatory guidance, applied to the core surplus ratio at December 31, 2008, all of the $250.0 million in preferred stock has been included.

The decrease in the Bank's permanent capital, total surplus, and core surplus ratios for December 31, 2008 was attributed to the growth in assets on both a total and risk adjusted basis exceeding the increase in capital. The decrease in the collateral ratio for December 31, 2008 also was attributed to asset growth. The increase in the Bank's permanent capital, total surplus, and core surplus ratios for December 2007 was primarily attributed to the increase in capital due to the issuance of the Preferred Stock and Association owned stock.

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 its operations. For a further discussion of these risks, see the *Risk Management* section above. Due to the evolving nature of the economic capital concept, the 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, 2008.

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

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

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

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

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

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

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

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

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

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

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

LEGAL PROCEEDINGS

On the basis of information presently available, management and legal counsel are of the opinion that the ultimate liability, if any, from legal actions pending against AgFirst would be immaterial in relation to the financial position of AgFirst. Refer to Note 13, *Commitments and Contingencies*, in the Notes to the Consolidated Financial Statements for additional information.

REGULATORY MATTERS

During 2008, the FCA took no enforcement actions against the Bank or District Associations. There were no enforcement actions in effect for the Bank or District Associations at December 31, 2008.

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

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

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

Federal Legislation

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

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

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS No. 158). SFAS No. 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in that funded status in the year in which the changes occur through other comprehensive income. SFAS No. 158 further requires the determination of the fair value of plan assets at year-end and recognition of actuarial gains and losses, prior service costs or credits, and transition assets and obligations as a component of other comprehensive income. In addition, SFAS No. 158 requires that the funded status of a plan be measured as of the date of the year-end financial statements, effective for fiscal years ending after December 15, 2008. Prior to 2008, the District used a measurement date of September 30th. In 2008, the District used a measurement date of December 31st as required. See Note 10, *Employee Benefit Plans*, of the Consolidated Financial Statements, for the impact of SFAS No. 158 on the current period for the Bank's supplemental retirement plan.

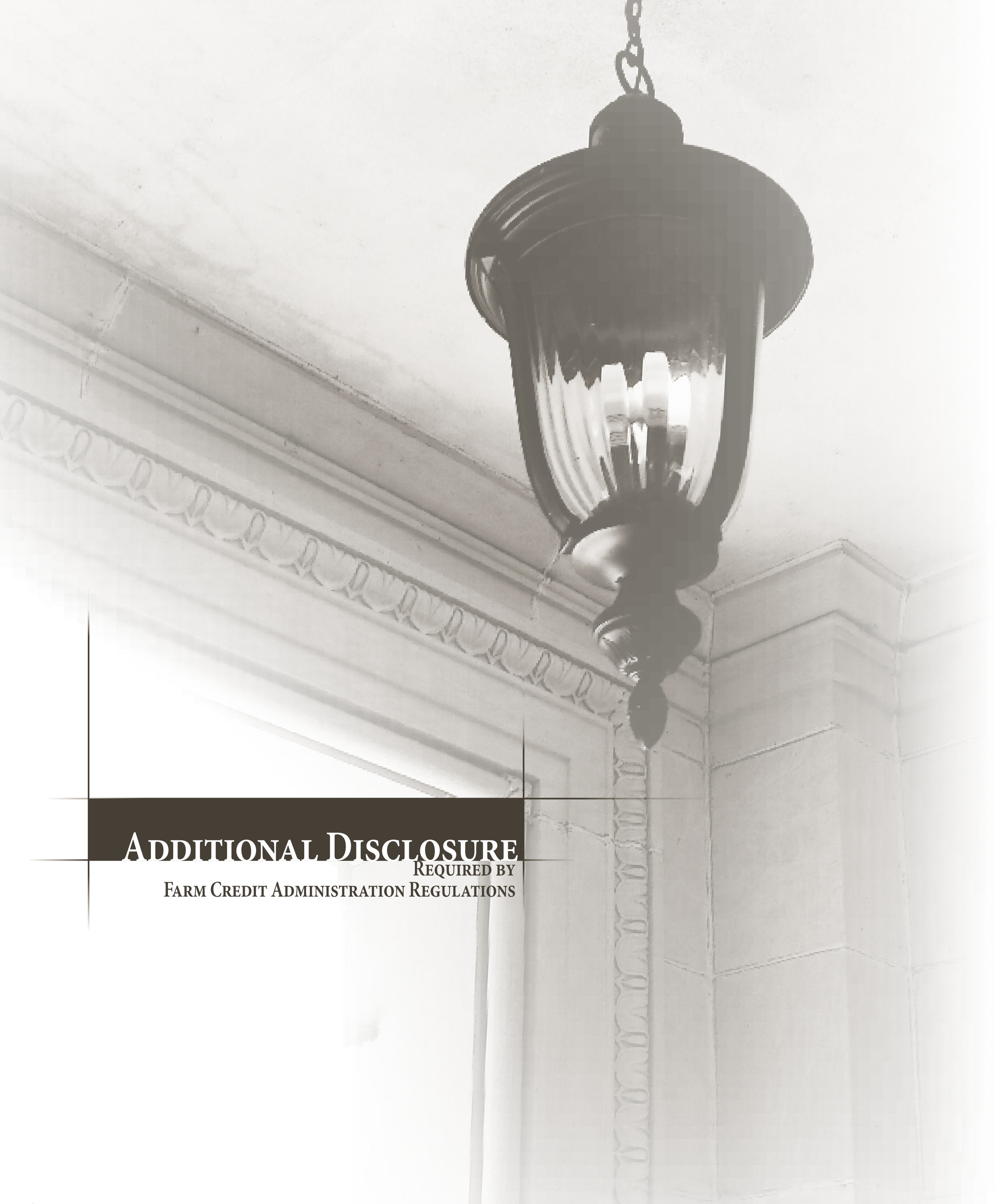
In September 2006, the FASB also issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. As a result, there is now a common definition of fair value to be used throughout generally accepted accounting principles. The FASB believes that the new standard will make the measurement of fair value more consistent and comparable and improve disclosures about those measures. SFAS No. 157 clarifies that the term fair value is intended to mean a market-based measure, not an entity-specific measure. In measuring fair value for a financial statement item, SFAS No. 157 sets forth a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The highest priority is given to quoted prices in active markets and the lowest priority to unobservable inputs. Additional disclosure requirements are required for the lowest priority level. The Bank adopted SFAS No. 157 effective January 1, 2008, on a prospective basis. See Note 14, *Fair Value Measurement*, of the Consolidated Financial Statements, for disclosures required by SFAS No. 157.

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

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

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

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



Additional Disclosure

Required by Farm Credit Administration Regulations

Description of Business

Descriptions of the territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations are incorporated herein by reference to Note 1 to the 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	Vacant
1443 Hampton Street	AgFirst Federal Credit Union
1447 Hampton Street	Vacant
1428 Taylor Street	AgFirst training center
1436 Taylor Street	Leased to a tenant

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 13 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 and contingent liabilities to be disclosed in this section is incorporated herein by reference to Notes 2, 6, 7, 8, 10 and 13 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*	11 years	CEO, Palmetto Farm Credit, ACA from April 1989 to January 1998.	He serves as: member of the Board for Federal Farm Credit Banks Funding Corporation; Council Member of the National Council of Farm Cooperatives; University of South Carolina: member of the Board of Trustees for the Business Partnership Foundation and Chairman of the Board of Directors for the Education Foundation; member of the Board of Directors for Big Brothers Big Sisters of Greater Columbia; member of the Board of Directors and Chairman of Finance Committee for National 4H Council; member of the Board of Directors for Palmetto AgriBusiness Council; member of the Board of Directors for Midlands Business Leadership Group.
Thomas S. Welsh, *Executive Vice President and Chief Administrative and Legislative Officer*	11 years	Chief Marketing and Planning Officer from January 1996 until March 1998.	He serves on the Advisory Board of the Farm Credit System Captive Insurance Company. Member of the AgFirst Plan Sponsor Committee and the AgFirst/FCBT Plan Sponsor Committee.
Leon T. Amerson, *Executive Vice President and Chief Operating Officer*	2.5 years	Chief Financial Officer from March 1998 to September 2006.	He serves on the AgFirst/FCBT Plan Fiduciary Committee.
Charl L. Butler, *Senior Vice President and Chief Financial Officer*	1.8 years	Chief Financial Officer and Secretary at The National Bank of South Carolina from 1991 until 2007.	He serves on the Board of Directors of the S.C. Council on Economic Education.
William L. Melton, *Senior Vice President and Chief Lending Officer*	5.5 years	Senior Executive Officer/Bank Lending from January to July 2003, prior to that Lending Services Manager.	.
Benjamin F. Blakewood, *Senior Vice President and Chief Information Officer*	10.5 years	Director of Information Technology from 1996 to 1998 at Affinity Technology Group.	
Frederick T. Mickler, III, *Senior Vice President and General Counsel*	11 years	Assistant General Counsel July 1989 until April 1998.	

The total amount of compensation earned by the CEO and the senior officers as a group during the years ended December 31, 2008, 2007 and 2006, is as follows:

Name of Individual or Number in Group	Year	Annual Salary	Annual Bonus	Deferred Comp.	Perq./ Other*	Total
F. A. Lowrey	2008	$ 577,192	$ 263,584	$ 12,265	$ 21,357	$ 874,398
F. A. Lowrey	2007	$ 524,720	$ 176,642	$ 44,160	$ 21,731	$ 767,253
F. A. Lowrey	2006	$ 467,018	$ 175,161	$ 10,000	$ 17,983	$ 670,162
6 Officers	2008	$ 1,456,242	$ 440,498	$ 80,196	$ 98,651	$ 2,075,587
6 Officers	2007	$ 1,284,000	$ 439,220	$ 81,030	$ 112,060	$ 1,916,310
5 Officers	2006	$ 1,029,845	$ 226,314	$ 65,522	$ 63,821	$ 1,385,502

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

In addition to a base salary, senior officers may earn additional compensation under the Bank's Corporate Bonus Plan. The plan is designed to motivate employees to exceed specific performance targets, including financial measures and customer satisfaction rating. Those covered by the plan include all employees. Bonuses are shown in the year earned. Payment of the 2008 bonus was made in the first quarter of 2009.

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

Bank compensation plans are reviewed by the Board Compensation Committee.

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

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

AgFirst Farm Credit Bank Board of Directors for 2008

Name	Position	Term of Office
Thomas W. Kelly	Chairman	December 31, 2012*
Paul M. House	Vice Chairman	December 31, 2011
Gary L. Alexander	Director	December 31, 2011
William C. Bess, Jr.	Director	December 31, 2009
Henry M. Frazee	Director	December 31, 2008
Don W. Freeman	Director	December 31, 2009
Dale R. Hershey	Director	December 31, 2011
Robert L. Holden, Sr.	Director	December 31, 2010
Lyle Ray King	Director	December 31, 2012*
M. Wayne Lambertson	Director	December 31, 2009
James L. May	Director	December 31, 2009
Eugene W. Merritt, Jr.	Director	December 31, 2010
James M. Norsworthy, III	Director	December 31, 2011
Katherine A. Pace	Director	December 31, 2011
J. Dan Raines, Jr.	Director	December 31, 2009
Walter L. Schmidlen, Jr.	Director	December 31, 2012*
Robert G. Sexton	Director	December 31, 2011
Kenneth A. Spearman	Director	December 31, 2009
Robert H. Spiers, Jr.	Director	December 31, 2009
William H. Voss	Director	December 31, 2010
J. Mark Wheeler	Director	December 31, 2012**

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

Thomas W. Kelly, Chairman of the Board, is a farmer from Tyrone, Pennsylvania. A former dairyman and breeder of Registered Holsteins, his farming operation now includes raising dairy heifers and growing corn, soybeans and hay. Along with his son, he handles land management for Spring Lane Hunt Club. He currently is an elected delegate to the Penn State Agricultural Council and a director of Mid-Atlantic Master Farmer Association and is a former director of Holstein Association, USA. Mr. Kelly currently serves as Chairman of the Board Governance Committee.

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

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

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

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

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

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

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

Association of Georgia, and First United Ethanol, LLC. Mr. Holden serves on the Board Governance Committee.

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

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

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

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

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

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

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

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

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

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

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

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

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

Committees

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

Compensation of Directors

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

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

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

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

*** *Does not include 6.25 days served on AgFirst and AgFirst/FCBT Plan Sponsor Committees.*

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

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was $259,345 for 2008, $251,988 for 2007, and $258,943 for 2006.

Transactions with Senior Officers and Directors

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section, are incorporated herein by reference to Note 11 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, 2008 were as follows:

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

Audit fees were for the annual audits of financial statements.

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

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

Consolidated Financial Statements

The Consolidated Financial Statements, together with the report thereon of PricewaterhouseCoopers LLP, dated February 27, 2009, and the Report of Management, which appear in this Annual Report to shareholders are incorporated herein by reference.

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

Report of the Audit Committee

The Audit Committee of the 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 2008, 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 2008. The foregoing report is provided by the following independent directors, who constitute the Committee:

Katherine A. Pace
Chairman of the Audit Committee

Members of Audit Committee

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

February 27, 2009

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, 2008, 2007 and 2006, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the 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 27, 2009

Consolidated Financial Statements

(dollars in thousands)	As of December 31, 2008	2007	2006
Assets			
Cash and cash equivalents	$ 277,003	$ 558,770	$ 582,764
Investment securities:			
Available for sale (amortized cost of $6,619,348 $5,646,683 and $5,063,640 respectively)	6,263,557	5,608,929	5,065,621
Held to maturity (fair value of $1,763,185 and $1,277,999 and $1,259,879 respectively)	1,729,600	1,299,868	1,293,061
Total investment securities	7,993,157	6,908,797	6,358,682
Loans	21,239,330	19,114,517	17,152,337
Less: allowance for loan losses	44,565	2,816	463
Net loans	21,194,765	19,111,701	17,151,874
Accrued interest receivable	106,593	114,508	104,925
Investments in other Farm Credit System institutions	75,055	64,221	65,066
Premises and equipment, net	18,061	20,750	25,698
Due from associations	40,671	42,701	41,692
Other assets	205,746	105,173	81,463
Total assets	$ 29,911,051	$ 26,926,621	$ 24,412,164
Liabilities			
Bonds and notes	$ 28,053,023	$ 24,847,248	$ 22,613,379
Mandatorily redeemable preferred stock	225,000	225,000	225,000
Accrued interest and dividends payable	154,143	179,578	188,028
Patronage distribution payable	157,017	153,103	128,347
Other liabilities	80,776	64,211	76,323
Total liabilities	28,669,959	25,469,140	23,231,077
Commitments and contingencies (Note 13)			
Shareholders' Equity			
Perpetual preferred stock	400,000	400,000	150,000
Capital stock and participation certificates	434,929	364,759	313,353
Retained earnings			
Allocated	805	705	—
Unallocated	762,550	730,724	715,753
Accumulated other comprehensive income (loss)	(357,192)	(38,707)	1,981
Total shareholders' equity	1,241,092	1,457,481	1,181,087
Total liabilities and shareholders' equity	$ 29,911,051	$ 26,926,621	$ 24,412,164

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

(dollars in thousands)	For the year ended December 31, 2008	2007	2006
Interest Income			
Investment securities and other	$ 305,858	$ 385,366	$ 332,701
Loans	1,027,651	1,083,668	890,247
Total interest income	1,333,509	1,469,034	1,222,948
Interest Expense	966,988	1,208,156	995,436
Net interest income	366,521	260,878	227,512
Provision for (reversal of allowance) for loan losses	43,342	2,481	(7,337)
Net interest income after provision for (reversal of allowance) for loan losses	323,179	258,397	234,849
Noninterest Income			
Loan fees	8,626	7,684	6,262
Gains (losses) on investments, net (Note 3)	(10,465)	—	(5)
Gains (losses) on derivatives, net	(359)	—	6,812
Gains (losses) on sales of rural home loans, net	(70)	180	(83)
Patronage refunds from other Farm Credit institutions	3,164	3,161	1,746
Other noninterest income	3,978	2,798	4,566
Total noninterest income	4,874	13,823	19,298
Noninterest Expense			
Salaries and employee benefits	30,655	28,853	26,318
Occupancy and equipment	14,957	13,060	11,608
Insurance fund premiums	12,153	5,623	3,597
Other operating expense	22,174	18,776	17,529
Called debt expense	26,652	10,550	2,563
Correspondent lending servicing expense	4,017	2,071	1,656
Other noninterest expense	278	1,078	683
Total noninterest expense	110,886	80,011	63,954
Net income	$ 217,167	$ 192,209	$ 190,193

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, 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					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 (Note 10)					(953)	(953)
Balance at December 31, 2007	400,000	364,759	705	730,724	(38,707)	1,457,481
Comprehensive income						
Net income				217,167		217,167
Unrealized gains (losses) on investments available for sale					(318,037)	(318,037)
Employee benefit plan adjustments (Note 10)				(138)	(448)	(586)
Total comprehensive loss						(101,456)
Capital stock/participation certificates issued/(retired), net		69,586				69,586
Stock dividends declared/(paid)		584		(584)		—
Patronage distribution						
Nonqualified allocated retained earnings			188	(188)		—
Perpetual preferred stock dividends paid				(27,413)		(27,413)
Cash distributions declared				(157,278)		(157,278)
Patronage distribution adjustment			(88)	260		172
Balance at December 31, 2008	$ 400,000	$ 434,929	$ 805	$ 762,550	$ (357,192)	$ 1,241,092

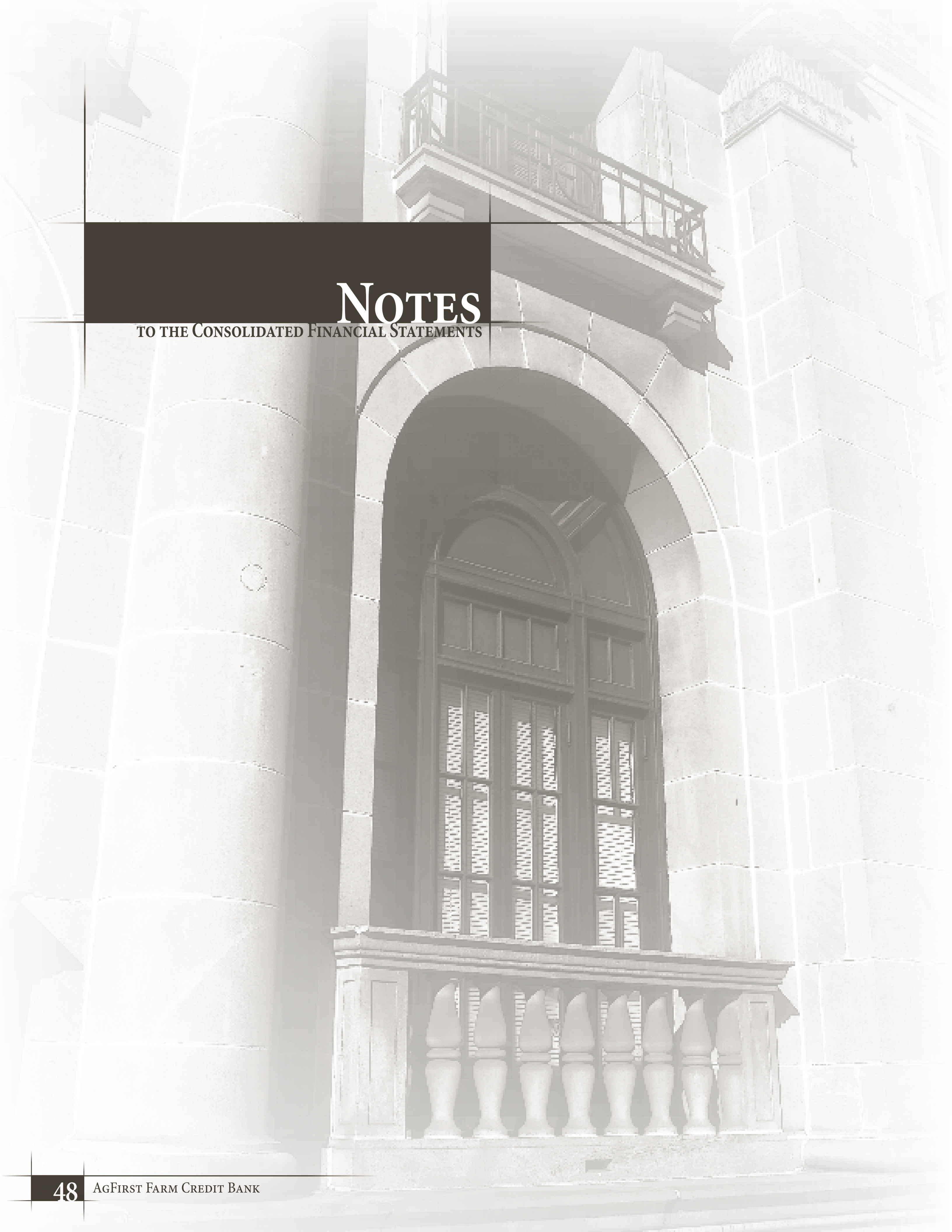
The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows

(dollars in thousands)	For the year ended December 31, 2008	2007	2006
Cash flows from operating activities:			
Net income	$ 217,167	$ 192,209	$ 190,193
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	9,192	8,452	7,642
(Premium amortization) discount accretion on investment securities	5,789	(3,502)	(7,304)
Premium amortization (discount accretion) on bonds and notes	6,820	7,343	18,420
Provision for (reversal of allowance for) loan losses	43,342	2,481	(7,337)
(Gains) losses on investments, net	10,465	—	5
(Gains) losses on derivatives, net	359	—	(6,812)
(Gains) losses on sales of rural home loans, net	70	(180)	83
Net change in loans held for sale	25,992	25,712	35,420
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	7,915	(9,583)	(29,515)
(Increase) decrease in due from associations	2,030	(1,009)	(12,884)
(Increase) decrease in other assets	(8,778)	6,003	(8,650)
Increase (decrease) in accrued interest and dividends payable	(25,435)	(8,450)	54,173
Increase (decrease) in other liabilities	18,324	7,889	17,352
Total adjustments	96,085	35,156	60,593
Net cash provided by operating activities	313,252	227,365	250,786
Cash flows from investing activities:			
Investment securities purchased	(3,076,950)	(2,155,803)	(3,245,248)
Investment securities sold or matured	1,658,299	1,569,455	2,154,162
Proceeds from sale of derivatives	—	—	6,812
Net (increase) decrease in loans	(2,152,468)	(1,987,840)	(2,779,186)
(Increase) decrease in investments in other Farm Credit System institutions	(10,834)	845	2,073
Purchase of premises and equipment, net	(6,503)	(3,504)	(7,489)
Net cash used in investing activities	(3,588,456)	(2,576,847)	(3,868,876)
Cash flows from financing activities:			
Bonds and notes issued	111,550,964	66,559,204	49,104,767
Bonds and notes retired	(108,446,508)	(64,383,204)	(45,406,904)
Perpetual preferred stock issued net of issuance cost	—	247,257	—
Capital stock and participation certificates issued/(retired), net	69,586	51,011	88,304
Cash distributions to shareholders	(153,192)	(129,279)	(132,245)
Dividends paid on perpetual preferred stock	(27,413)	(19,501)	(10,950)
Net cash provided by financing activities	2,993,437	2,325,488	3,642,972
Net increase (decrease) in cash and cash equivalents	(281,767)	(23,994)	24,882
Cash and cash equivalents, beginning of period	558,770	582,764	557,882
Cash and cash equivalents, end of period	$ 277,003	$ 558,770	$ 582,764
Supplemental schedule of non-cash investing and financing activities:			
Change in unrealized gains (losses) on investments and derivative instruments, net	$ (318,037)	$ (39,735)	$ 4,552
Increase in liability resulting from adoption of SFAS No. 158 (Note 10)	—	953	—
Employee benefit plan adjustments (Note 10)	586	—	—
Non-cash changes related to hedging activities:			
Decrease (increase) in loans	$ —	$ —	$ 7
Increase (decrease) in bonds and notes	94,499	50,526	17,132
Decrease (increase) in other assets	(91,795)	(29,572)	(1,553)
Increase (decrease) in other liabilities	(2,091)	(20,954)	(15,586)
Supplemental information:			
Interest paid	$ 985,603	$ 1,209,263	$ 927,889

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, 2008, the District consisted of the Bank and twenty-two District ACAs following the merger of Valley Farm Credit, ACA with and into MidAtlantic Farm Credit, ACA effective December 31, 2008. All twenty-two ACAs are structured as holding companies, which include FLCA and PCA subsidiaries.

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

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

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (insured debt), (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary use by the Insurance Corporation to provide assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank has been required to pay premiums, which may be passed on to the associations, into the Insurance Fund until such time as the assets in the Insurance Fund reach the "secure base amount," which is defined in the Farm Credit Act as 2.00 percent of the aggregate insured obligations (Systemwide debt obligations) or such other percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums, but it still must ensure that the reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

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

B. **Operations:** The Farm Credit Act sets forth the types of authorized lending activity 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 and operations. These lines of credit (or Direct Notes) are collateralized by a pledge of substantially all of each Association's assets. The terms of the Direct Notes 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.

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

In addition to providing loan funds to District Associations, the Bank provides the District Associations with 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, or in some cases billed directly to certain Associations that use a specific service.

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 may 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 on the trade date. Investment securities which management has the intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost. Investment securities classified as available-for sale (AFS) are carried at fair market value with net unrealized gains and losses included in other comprehensive income (OCI) in Shareholders' Equity.

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

C. **Loans and Allowance for Loan Losses:** Long-term real estate mortgage loans generally have original maturities up to 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 adjusted for charge-offs and deferred loan fees or costs adjusted for Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, valuation adjustments, if any. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. The difference in the investment in a purchased loan and its principal amount is deferred as part of the carrying amount of the loan and the net difference is amortized over the life of the related loan as an adjustment to interest income using the effective interest method.

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

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

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

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

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through allowance for loan losses reversals and loan charge-offs. A review of all individual loans in each respective portfolio is performed periodically to determine the appropriateness of risk ratings and to assure loss exposure to the 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.

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

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

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

D. **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 service cost as a percentage of the total eligible service cost 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 and in the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' 2008 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 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) (AOCI) depending on the use of the derivative and whether it qualifies for hedge accounting. For fair-value hedge transactions which hedge changes in the fair value of assets, liabilities, or firm commitments, changes in the fair value of the derivative will generally be offset by changes in the hedged item's fair value. For cash-flow hedge transactions, which hedge the variability of future cash flows related to a variable-rate asset, liability, or a forecasted transaction, changes in the fair value of the derivative will generally be deferred and reported in AOCI. The gains and losses on the derivative that are deferred and reported in AOCI will be reclassified into earnings in the periods in which earnings are impacted by the variability of the cash flows of the hedged item. The ineffective portion of all hedges is recorded in current period earnings. For derivatives not designated as a hedging instrument, the related change in fair value is recorded in current period earnings.

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

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

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

Effective January 1, 2008, the Bank adopted Statement of Financial Accounting Standards No. 157, *Fair Value Measurement.* (SFAS No. 157). This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. SFAS No. 157 establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. It describes three levels of inputs that may be used to measure fair value as discussed in Note 14.

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* (SFAS No. 158). SFAS No. 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in that funded status in the year in which the changes occur through other comprehensive income. SFAS No. 158 further requires the determination of the fair value of plan assets at year-end and recognition of actuarial gains and losses, prior service costs or credits, and transition assets and obligations as a component of other comprehensive income. In addition, SFAS No. 158 requires that the funded status of a plan be measured as of the date of the year-end financial statements, effective for fiscal years ending after December 15, 2008. Prior to 2008, the District used a measurement date of September 30th. In 2008, the District used a measurement date of December 31st as required. See Note 10 for the impact of SFAS No. 158 on the current period for the Bank's supplemental retirement plan.

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

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

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

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

Note 3 — Investment Securities

Available-for-sale

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

	December 31, 2008				
(dollars in thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**	**Yield**
U.S. Govt. GNMA MBS/CMOs	$ 3,296,293	$ 6,497	$ (57,508)	$ 3,245,282	2.25%
U.S. Govt. Agency MBS	2,632,141	5,161	(103,309)	2,533,993	2.27
Non-Agency Securities	566,777	275	(162,731)	404,321	1.63
Asset-Backed Securities	124,137	–	(44,176)	79,961	3.42
Total	$ 6,619,348	$ 11,933	$ (367,724)	$ 6,263,557	2.23%

	December 31, 2007				
(dollars in thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**	**Yield**
U.S. Govt. GNMA MBS/CMOs	$ 1,754,693	$ 3,393	$ (3,533)	$ 1,754,553	4.99%
U.S. Govt. Agency MBS	3,055,524	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%

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

Held-to-maturity

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

	December 31, 2008				
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Govt. Agency MBS	$ 1,510,192	$ 45,341	$ (341)	$ 1,555,192	5.17%
Other	219,408	6,760	(18,175)	207,993	6.13
Total	$ 1,729,600	$ 52,101	$ (18,516)	$ 1,763,185	5.29%

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

	December 31, 2006				
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
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%

AgFirst's investments include mortgage-backed securities (MBSs), asset backed securities (ABSs), and short-term money market securities. MBSs are collateralized by U.S. government or U.S. agency guaranteed residential mortgages and all but $1.9 million (fair value) was rated or split rated in the top category (AAA/ Aaa) by at least one of the Nationally Recognized Statistical Organizations (NRSROs) at December 31, 2008. All but three of the ABSs are rated above the minimum for investment grade (BBB-/ Baa3) by the NRSROs at December 31, 2008. All ABSs have credit enhancement features including senior/subordinate structure and/or are backed by a bond insurer. Money market securities are short term in nature (from overnight maturities to maturities that range from 30 to 90 days) and are only purchased from financial institutions that carry sound credit ratings.

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

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

	Less than 12 Months		Greater than 12 Months	
(dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Govt. GNMA MBS/CMOs	$ 2,378,988	$ 41,030	$ 317,983	$ 16,477
U.S. Govt. Agency MBS	1,209,922	47,272	925,178	56,378
Non-Agency Securities	35,707	12,349	350,151	150,383
Asset-Backed Securities	–	–	70,608	44,176
Other	91,240	12,337	23,248	5,838
Total	$ 3,715,857	$ 112,988	$ 1,687,168	$ 273,252

On December 31, 2008, 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 $273.3 million. The Bank performs periodic credit reviews, including other-than-temporary impairment analyses, on its investment securities portfolio. The objective is to quantify any future possible loss of principal or interest due on each security identified for additional analysis. Based on the results of all analyses, the Bank has recognized other-than-temporary impairment in connection of $10.5 million in connection with one ABS in its portfolio in 2008, which is included in Losses on Investments in the Consolidated Statements of Income.

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

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

Available-for-sale

	Due in 1 year or less		Due after 1 year through 5 years		Due after 5 years through 10 years		Due after 10 years		Total	
(dollars in thousands)	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield
U.S. Govt. GNMA MBS/CMOs	$ –	–%	$ –	–%	$ 308	1.33%	$ 3,244,974	2.28%	$ 3,245,282	2.28%
U.S. Govt. Agency MBS	17	3.14	–	–	217,702	2.30	2,316,274	2.36	2,533,993	2.36
Non-Agency Securities	–	–	–	–	–	–	404,321	2.28	404,321	2.28
Asset-Backed Securities	–	–	–	–	–	–	79,961	5.31	79,961	5.31
Total fair value	$ 17	3.14%	$ –	–%	$ 218,010	2.30%	$ 6,045,530	2.35%	$ 6,263,557	2.35%
Total amortized cost	$ 17		$ –		$ 223,120		$ 6,396,210		$ 6,619,348	

Held-to-maturity

	Due in 1 year or less		Due after 1 year through 5 years		Due after 5 years through 10 years		Due after 10 years		Total	
(dollars in thousands)	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield
U.S. Govt. Agency MBS	$ –	–%	$ –	–%	$ –	–%	$ 1,510,192	5.17%	$ 1,510,192	5.17%
Other			65,770	6.38	73,645	5.75	79,993	6.27	219,408	6.13
Total amortized cost	$ –	–%	$ 65,770	6.38%	$ 73,645	5.75%	$ 1,590,185	5.23%	$ 1,729,600	5.29%
Total fair value	$ –		$ 65,970		$ 75,329		$ 1,621,887		$ 1,763,185	

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

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

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

Note 4 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31,		
(dollars in thousands)	2008	2007	2006
Direct notes receivable from District Associations	$ 14,997,151	$ 14,602,548	$ 13,877,142
Participations/syndications, net	4,925,744	3,470,300	2,501,453
Mortgage loans purchased in the secondary market	1,309,285	1,039,449	771,982
Loans to Other Financing Institutions	7,150	2,220	1,760
Total	$ 21,239,330	$ 19,114,517	$ 17,152,337

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.

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

	December 31,		
(dollars in thousands)	2008	2007	2006
Impaired nonaccrual loans:			
Current as to principal and interest	$ 174,926	$ 2,068	$ 14,659
Past due	1,485	439	451
Impaired accrual loans:			
Restructured	–	–	–
90 days or more past due	11,325	1,356	1,759
Total impaired loans	$ 187,736	$ 3,863	$ 16,869

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

The average recorded investment in impaired loans during 2008, 2007 and 2006 was $43.3 million, $5.3 million and $8.4 million, respectively. Interest income is recognized and cash payments are applied on nonaccrual impaired loans as described in Note 2. The following table presents interest income recognized on impaired loans.

	Year Ended December 31,		
(dollars in thousands)	2008	2007	2006
Interest income recognized on impaired nonaccrual loans	$ 126	$ 276	$ 4,605
Interest income on impaired accrual loans	96	19	5
Interest income recognized on impaired loans	$ 222	$ 295	$ 4,610

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

	Year Ended December 31,		
(dollars in thousands)	2008	2007	2006
Interest income which would have been recognized under the original loan terms	$ 5,246	$ 321	$ 5,383
Less: interest income recognized	126	275	4,606
Foregone interest income	$ 5,120	$ 46	$ 777

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

	Year Ended December 31,		
(dollars in thousands)	2008	2007	2006
Balance at beginning of year	$ 2,816	$ 463	$ 10,114
Provision for (reversal of) loan losses	43,342	2,481	(7,337)
Loans charged off	(1,751)	(128)	(2,314)
Recoveries	158	–	–
Balance at end of year	$ 44,565	$ 2,816	$ 463

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

(dollars in thousands)	2008	2007	2006
Impaired loans with related allowance	$ 36,918	$ 1,429	$ –
Impaired loans with no related allowance	150,818	2,434	16,869
Total impaired loans	$ 187,736	$ 3,863	$ 16,869
Allowance on impaired loans	$ 32,409	$ 1,429	$ –

In addition, the following is a breakdown of the allowance for loan losses for the end of the last three fiscal years:

(dollars in thousands)	December 31, 2008		December 31, 2007	
	Amount	%	Amount	%
Real estate mortgage	$ 10,972	25%	$ 958	34%
Production and intermediate term	3,947	9	380	13
Agribusiness	29,641	66	44	2
Rural residential real estate	5	–	5	–
Other	–	–	1,429	51
Total	$ 44,565	100%	$ 2,816	100%

(dollars in thousands)	December 31, 2006	
	Amount	%
Real estate mortgage	$ 279	60%
Production and intermediate term	130	28
Agribusiness	26	6
Rural residential real estate	24	5
Other	4	1
Total	$ 463	100%

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 $260.8 million at December 31, 2008. 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 $3.2 million, $1.5 million, and $1.0 million for 2008, 2007, and 2006, respectively.

Note 5 — Premises and Equipment

Premises and equipment consisted of the following:

	December 31,		
(dollars in thousands)	2008	2007	2006
Land	$ 896	$ 896	$ 896
Buildings and improvements	6,375	5,921	5,871
Furniture and equipment	59,701	53,771	51,763
Work in progress	2,115	2,280	1,341
	69,087	62,868	59,871
Less: accumulated depreciation	51,026	42,118	34,173
Total	$ 18,061	$ 20,750	$ 25,698

Note 6 — Other Assets and Other Liabilities

A summary of other assets and other liabilities follows:

	December 31,		
(dollars in thousands)	2008	2007	2006
Other assets:			
Unamortized debt issue costs	$ 20,647	$ 18,637	$ 15,098
Prepaid retirement expenses	21,073	18,653	21,301
Deferred issuance costs – preferred stock	662	940	2,017
Derivative assets	124,982	33,187	3,615
Receivable from third party sub-servicer	19,179	12,567	8,495
Other	19,203	21,189	30,937
Total	$ 205,746	$ 105,173	$ 81,463
Other liabilities:			
Accounts payable	$ 5,710	$ 3,315	$ 2,513
Farm Credit System Ins. Corp. payable	35,197	28,211	24,613
Derivative liabilities	469	2,560	23,514
Postretirement benefits other than pensions	15,509	15,445	15,266
Other	23,891	14,680	10,417
Total	$ 80,776	$ 64,211	$ 76,323

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

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

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

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

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

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

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

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

Discount notes are issued with maturities ranging from 1 to 365 days. The average maturity of discount notes at December 31, 2008, was 159 days.

Systemwide debt includes callable bonds consisting of the following:

Amortized Cost	First Call Date	Year of Maturity
(dollars in thousands)		
$ 11,112,998	2009	2009 – 2023
57,000	2010	2012 – 2023
25,000	2011	2013 – 2016
10,000	2012	2017
10,000	2013	2018
$ 11,214,998	Total	

Callable debt may be called on the first call date and any 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, 2008 the assets of the Insurance Fund aggregated $2.915 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.

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, 2008:

		Shares Outstanding (dollars in thousands)	
Class	Protected Status	Number	Aggregate Par Value
B Common/Nonvoting	No	1,600,000	$ 8,000
C Common/Voting	No	83,585,391	417,927
D Common/Nonvoting	No	1,774,358	8,872
Participation Certificates/Nonvoting	No	26,051	130
Total Capital Stock and Participation Certificates		86,985,800	$ 434,929

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 Class 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. **Order of Priority Upon Impairment or Liquidation:**

Impairment

Net losses, to the extent they exceed unallocated surplus, shall, except as otherwise provided in the Act, be treated as impairing Stock in the following order:

First, Class B Common Stock, Class C Common Stock, Class D Common Stock, and Participation Certificates, pro rata, in proportion to the number of shares or units of each such class of Stock then issued and outstanding, until such Stock is fully impaired; and

Second, Preferred Stock in proportion to the number of shares of each class and series thereof then issued and outstanding (applied, as among series that rank differently upon liquidation or dissolution of AgFirst, in reverse order of priority first to the most junior ranking series and then successively to each next most junior ranking series) and consistent with the terms of each such class or series until such Stock is fully impaired; and

Third, subject to the Act, as amended, and the regulations thereunder, in such manner as shall be determined by the Board.

Liquidation

In the event of liquidation or dissolution of AgFirst, any assets of AgFirst remaining after payment or retirement of all liabilities shall be distributed in the following order or priority:

First, to the holders of Preferred Stock, in proportion to the number of shares of each class and series thereof then issued and outstanding and consistent with the terms of each such series until an amount equal to the liquidation preference provided for in the terms of such series of Preferred Stock has been distributed to such holders (applied, as among series that rank differently upon liquidation or dissolution of AgFirst, in order of priority first to the most senior ranking series and then successively to each next most senior ranking series); and

Second, to the holders of Class B Common Stock, Class C Common Stock, Class D Common Stock, and Participation Certificates, pro rata, in proportion to the number of shares or units of each such class of Stock then issued and outstanding, until an amount equal to the aggregate par or face value of all such shares or units has been distributed to such holders; and

Third, in accordance with the memorandum accounting established in the Agreement and Plan of Consolidation between The Farm Credit Bank of Columbia and the Farm Credit Bank of Baltimore, dated as of October 31, 1994; and

Fourth, all remaining assets of AgFirst after such distributions shall be to the extent practicable distributed to all Stockholders and holders of Participation Certificates on a patronage basis.

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 operations and 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, 2008 were 17.15 percent, 17.11

percent and 10.43 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. At December 31, 2008, the full amount of this preferred stock issuance could be included in core surplus.

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

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 was comprised of the following components:

(dollars in thousands)	2008	2007	2006
Unrealized (losses) gains on investments available-for-sale	$ (355,791)	$ (37,754)	$ 1,981
Employee benefit plan adjustments	(1,401)	(953)	–
Total accumulated other comprehensive income (loss)	$ (357,192)	$ (38,707)	$ 1,981

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 service cost as a percentage of the total eligible service cost for all Plan participants. As a participant in the Plan, the Bank funded $4.1 million for 2008 and provided no funding in 2007 and 2006. Plan expenses included in employee benefit costs were $2.2 million for 2008, $3.1 million for 2007, and $3.8 million for 2006. 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 $862 thousand for 2008, $999 thousand for 2007, and $1.1 million for 2006. 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 $939 thousand, $761 thousand, and $578 thousand for the years ended December 31, 2008, 2007, and 2006, respectively.

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 2008, 2007, and 2006 for the defined benefit supplemental retirement plan. The expenses of these nonqualified plans included in the Bank's employee benefit costs were $48 thousand, $6 thousand, and $33 thousand for the years ended December 31, 2008, 2007, and 2006, 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 AOCI. 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 AOCI of $953 thousand in the Bank's Consolidated Statement of Changes in Shareholders' Equity at December 31, 2007.

SFAS No. 158 also requires that employers measure the benefit obligation and plan assets as of the fiscal year end for fiscal years ending after December 15, 2008. In fiscal 2007 and earlier, a September 30 measurement date was used for pension and other postretirement benefit plans. The Standard provides two approaches for an employer to transition to a fiscal year end measurement date. The approach applied by the Bank allows for the use of the measurements determined for the prior year end. Under this alternative, pension and other postretirement benefit expense measured for the three-month period October 1, 2007 to December 31, 2007 (determined using the September 30, 2007 measurement date) is reflected as an adjustment to beginning 2008 unallocated retained earnings. As a result, the Bank decreased unallocated retained earnings by $138 thousand for the single employer defined benefit supplemental plan.

Upon adoption, SFAS No. 158 further required the determination of the fair value of plan assets and recognition of actuarial gains and losses, prior service costs or credits, and transition assets or obligations as a component of AOCI. Previous to adoption of SFAS No. 158, these amounts were netted against the plan's funded status in the Bank's Consolidated Balance Sheets pursuant to the provisions of SFAS No. 87. Under SFAS No. 158, these amounts are subsequently recognized as components of net periodic benefit costs over time. For 2008, $448 thousand has been recognized as a net debit to AOCI to reflect these elements.

The supplemental retirement plan is unfunded and had a projected benefit obligation of $5.8 million and a net under-funded status of $5.8 million at December 31, 2008. Net periodic pension cost for the period was $551 thousand. Assumptions used to determine the projected benefit obligation as of December 31, 2008 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' 2008 Annual Report.

Note 11 — Related Party Transactions

As discussed in Note 1, the Bank lends funds to the District Associations primarily to fund their loan portfolios. Further disclosure regarding these related party transactions is found in Notes 4, 9 and 13.

Interest income recognized on direct notes receivable from District Associations was $709.0 million, $830.9 million and $729.1 million for 2008, 2007, and 2006, 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 unaffiliated 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 12 — Regulatory Enforcement Matters

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

Note 13 — 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, 2008, were $178.365 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, 2008, the Bank had outstanding $190.3 million of standby letters of credit issued on behalf of District and non-district customers, with expiration dates ranging from January 2009 to October 2018. The maximum potential amount of future payments the Bank may be required to make under these existing guarantees is $190.3 million.

A guarantor is required to recognize at the inception of a guarantee, a liability for the fair value of the guarantee commitment. The 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, 2008, 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 $7.3 million expiring in less than one year and $13.0 million expiring in one to three years. The notional amounts of these guarantees represent the maximum amount of exposure the Bank has related to these instruments as of December 31, 2008.

At December 31, 2008, $5.57 billion of commitments to extend credit were outstanding. Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these financial instruments have off-balance-sheet credit risk because their amounts could be drawn upon at the option of the borrower. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and the same credit policies are applied by management. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the loan collateral is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

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

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 14 — Fair Value Measurement

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

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

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

Level 1

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

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

Level 2

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

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

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

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

Level 3

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

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

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

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis

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

	December 31, 2008			
	Level 1	Level 2	Level 3	Total Fair Value
Assets:				
Investments available-for-sale	$ -	$ 6,183,596	$ 79,961	$ 6,263,557
Federal funds sold, securities purchased under resale agreements, and other	-	187,630	-	187,630
Interest rate swaps and other financial instruments	-	124,982	-	124,982
Assets held in trust funds	2,435	-	-	2,435
Total Assets	$ 2,435	$ 6,496,208	$ 79,961	$ 6,578,604
Liabilities:				
Interest rate swaps and other financial instruments	$ -	$ 469	$ -	$ 469
Standby letters of credit	-	-	2,301	2,301
Total Liabilities	$ -	$ 469	$ 2,301	$ 2,770

The following table presents the changes in Level 3 assets and liabilities measured at fair value on a recurring basis:

	Asset-Backed Investment Securities	Standby Letters Of Credit
Balance at January 1, 2008	$ 166,551	$ 2,322
Total gains or (losses) realized/unrealized:		
Included in earnings	(10,465)	-
Included in other comprehensive loss	(26,028)	-
Purchases, sales, issuances and settlements, net	(50,097)	(21)
Transfers in and/or out of level 3	-	-
Balance at December 31, 2008	$ 79,961	$ 2,301

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

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

	December 31, 2008				
	Level 1	Level 2	Level 3	Total Fair Value	Total Gains (Losses)
Assets:					
Impaired loans	$ -	$ -	$ 4,509	$ 4,509	$ (32,409)

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, 2008, 2007 and 2006.

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, 2008		December 31, 2007		December 31, 2006	
(dollars in thousands)	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:						
Loans, net of allowance	$ 21,194,765	$ 21,604,573	$ 19,111,701	$ 19,323,045	$ 17,151,874	$ 17,040,739
Derivative assets	$ 124,982	$ 124,982	$ 33,187	$ 33,187	$ 3,615	$ 3,615
Cash and cash equivalents	$ 277,003	$ 227,003	$ 558,770	$ 558,770	$ 582,764	$ 582,764
Investment securities	$ 8,015,707	$ 8,026,742	$ 6,908,797	$ 6,886,928	$ 6,358,682	$ 6,325,500
Assets held in trust funds	$ 2,435	$ 2,435	$ 3,612	$ 3,612	$ 3,679	$ 3,679
Financial liabilities:						
Systemwide Debt Securities	$ 28,053,023	$ 28,266,307	$ 24,847,248	$ 24,908,245	$ 22,613,379	$ 22,531,191
Derivative liabilities	$ 469	$ 469	$ 2,560	$ 2,560	$ 23,514	$ 23,514

A description of the methods and assumptions used to estimate the fair value of each class of the 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.

   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. See additional information in Note 14.

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. See additional information in Note 14.

F. **Assets Held In Trust Funds:** See Note 14 for discussion of estimation of fair value for this instrument.

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, 2008 of $125.0 million with nine counterparties represents approximately 5.62 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, 2008, the Bank had not posted collateral with respect to these arrangements but has required one counterparty to post a total of $8.0 million in interest bearing cash 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, 2008 (dollars in millions)	Maturities of 2008 Derivative Products and Other Financial Instruments							
	2009	2010	2011	2012	2013	2014 and after	Total	Fair Value
Systemwide Debt Securities:								
Fixed rate	$ 8,835	$ 3,292	$ 2,625	$ 666	$ 1,986	$ 4,996	$ 22,400	$ 22,703
Weighted average interest rate	2.14%	2.91%	3.61%	4.14%	4.22%	5.04%	3.32%	
Variable rate	4,811	742	38	8	5	49	5,653	5,563
Weighted average interest rate	0.87%	1.06%	0.71%	0.82%	1.86%	0.64%	0.89%	
Derivative Instruments:								
Receive fixed swaps								
Notional value	$ 750	$ 488	$ 600	$ 75	$ 60	$ 250	$ 2,223	$ 125
Weighted average receive rate	4.17%	4.20%	4.10%	4.62%	3.99%	5.07%	4.27%	
Weighted average pay rate	1.21%	1.90%	2.19%	2.54%	2.69%	2.94%	1.90%	
Total notional value	$ 750	$ 488	$ 600	$ 75	$ 60	$ 250	$ 2,223	$ 125
Total weighted average rates on swaps:								
Receive rate	4.17%	4.20%	4.10%	4.62%	3.99%	5.07%	4.27%	
Pay rate	1.21%	1.90%	2.19%	2.54%	2.69%	2.94%	1.90%	

Note 18 — Quarterly Financial Information (Unaudited)

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

(dollars in thousands)	2008				
	First	Second	Third	Fourth	Total
Net interest income	$ 97,955	$ 86,546	$ 78,440	$ 103,580	$ 366,521
Provision for (reversal of allowance for) loan losses	2,799	6,065	660	33,818	43,342
Noninterest income (expense), net	(17,002)	(23,432)	(28,790)	(36,788)	(106,012)
Net income	$ 78,154	$ 57,049	$ 48,990	$ 32,974	$ 217,167
	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	$ 0,835	$ 190,193

AgFirst
Farm Credit Bank

1401 Hampton Street | Columbia, SC 29201 | www.AgFirst.com