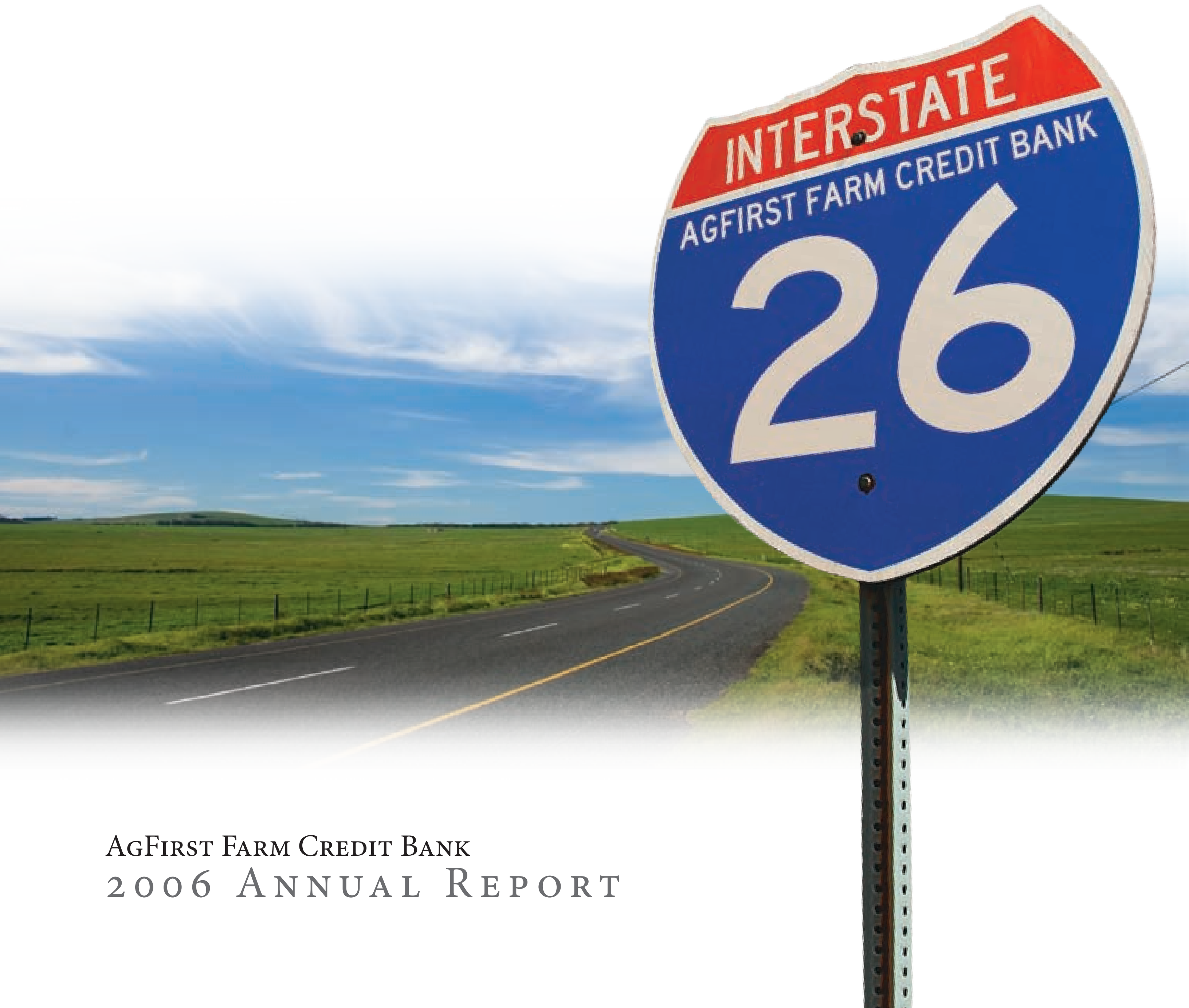
Going the Extra Mile



AgFirst Farm Credit Bank
2006 Annual Report

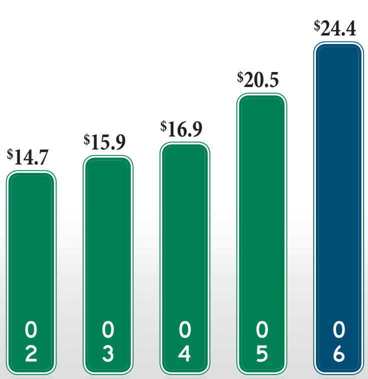
AgFirst Farm Credit Bank

2006 Annual Report

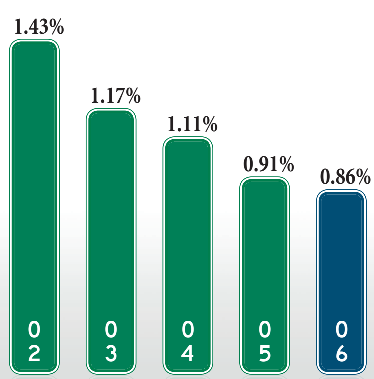
Five-Year Summary
of Selected Consolidated Financial Data

(dollars in thousands)	December 31, 2006	2005	2004	2003	2002
Consolidated Balance Sheet Data					
Cash and cash equivalents	$ 582,764	$ 557,882	$ 470,258	$ 469,945	$ 359,819
Investment securities	6,358,682	5,255,745	3,278,414	2,832,716	2,153,118
Loans	17,152,337	14,411,050	12,908,249	12,375,351	12,008,041
Less: allowance for loan losses	463	10,114	14,800	34,168	31,155
Net loans	17,151,874	14,400,936	12,893,449	12,341,183	11,976,886
Other assets	318,844	268,468	245,402	235,704	211,367
Total assets	$ 24,412,164	$ 20,483,031	$ 16,887,523	$ 15,879,548	$ 14,701,190
Obligations with maturities of one year or less	$ 10,005,004	$ 7,613,499	$ 6,533,020	$ 6,384,790	$ 6,273,546
Obligations with maturities greater than one year	13,001,073	11,607,104	9,105,207	8,315,226	7,444,960
Mandatorily redeemable preferred stock	225,000	225,000	225,000	225,000	—
Total liabilities	23,231,077	19,445,603	15,863,227	14,925,016	13,718,506
Mandatorily redeemable preferred stock	—	—	—	—	225,839
Perpetual preferred stock	150,000	150,000	150,000	150,000	—
Capital stock and participation certificates	313,353	224,554	226,200	229,083	249,444
Retained earnings	715,753	665,445	644,366	601,699	527,673
Accumulated other comprehensive income (loss)	1,981	(2,571)	3,730	(26,250)	(20,272)
Total shareholders' equity	1,181,087	1,037,428	1,024,296	954,532	756,845
Total liabilities and shareholders' equity	$ 24,412,164	$ 20,483,031	$ 16,887,523	$ 15,879,548	$ 14,701,190

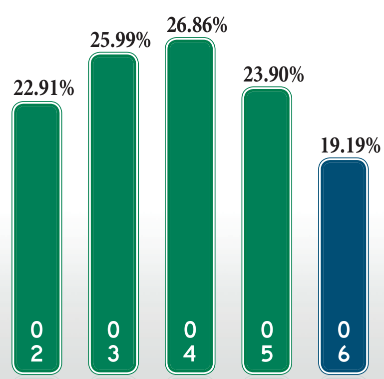
Total Assets
(in billions)



Return on Assets

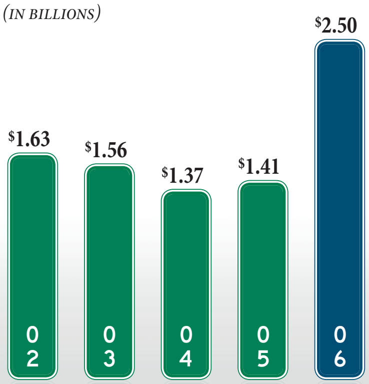


Permanent Capital Ratio

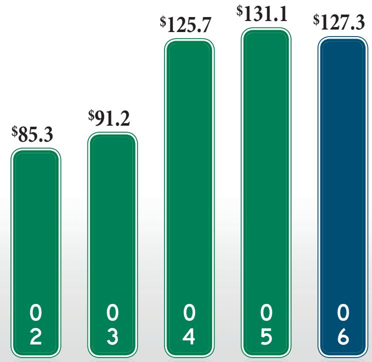


(dollars in thousands)	December 31, 2006	2005	2004	2003	2002
Consolidated Statement of Income Data					
Net interest income	$ 227,512	$ 204,201	$ 211,595	$ 244,057	$ 255,660
Provision for (reversal of allowance for) loan losses	(7,337)	(4,995)	(15,292)	2,500	8,000
Noninterest income (expense), net	(44,656)	(44,937)	(46,581)	(64,108)	(53,527)
Net income	$ 190,193	$ 164,259	$ 180,306	$ 177,449	$ 194,133
Consolidated Key Financial Ratios					
Rate of return on average:					
Total assets	0.86%	0.91%	1.11%	1.17%	1.43%
Total shareholders' equity	16.74%	14.95%	17.16%	20.37%	23.75%
Net interest income as a percentage of average earning assets	1.04%	1.14%	1.32%	1.62%	1.91%
Net chargeoffs (recoveries) to average loans	0.015%	(0.002)%	0.033%	(0.004)%	0.021%
Total shareholders' equity to total assets	4.84%	5.06%	6.07%	6.01%	5.15%
Debt to shareholders' equity (:1)	19.67	18.74	15.49	15.64	18.13
Allowance for loan losses to loans	0.003%	0.07%	0.11%	0.28%	0.26%
Permanent capital ratio	19.19%	23.90%	26.86%	25.99%	22.91%
Total surplus ratio	19.14%	23.84%	26.76%	25.79%	22.69%
Core surplus ratio	11.46%	14.15%	15.60%	14.45%	13.20%
Collateral ratio	105.28%	105.70%	106.88%	106.94%	105.94%
Net Income Distribution					
Cash distributions	$ 128,440	$ 132,230	$ 126,689	$ 92,129	$ 86,677
Mandatorily redeemable preferred stock dividend	—	—	—	10,282	18,887
Perpetual preferred stock dividend	10,950	10,950	10,950	1,851	—

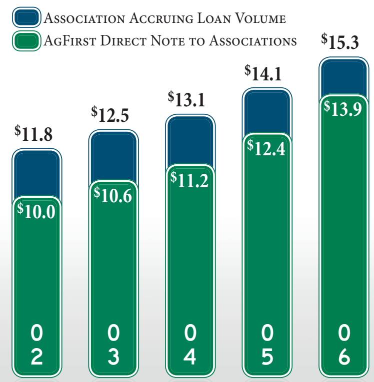
Participations/Syndications Year-End Volume
(in billions)



Distributions to Associations
(in millions)



Trends
(in billions)



2006 Board of Directors

This page, from the left:

Robert L. Holden, Sr., *Whigham, Georgia*

Robert A. Carson, *Marks, Mississippi*

J. Dan Raines, Jr., *Ashburn, Georgia*

Henry M. "Buddy" Frazee, *Alachua, Florida*

Don W. Freeman, *Montgomery, Alabama*

Thomas W. Kelly, Chairman, *Tyrone, Pennsylvania*

Lyle Ray King, *Ash, North Carolina*

Paul Lemoine, *Plaucheville, Louisiana*

Robert G. Sexton, *Vero Beach, Florida*

Katherine A. Pace, *Orlando, Florida*

Opposite page, from the left:

Paul M. House, Vice Chairman, *Nokesville, Virginia*

M. Wayne Lambertson, *Pocomoke City, Maryland*

Richard Kriebel, *Benton, Pennsylvania*

Dale W. Player, *Bishopville, South Carolina*

James L. May, *Waynesburg, Kentucky*

Kenneth A. Spearman, *Winter Haven, Florida*

Walter L. Schmidlen, Jr., *Elkins, West Virginia*

William C. Bess, Jr., *Lincolnton, North Carolina*

Eugene W. Merritt, Jr., *Easley, South Carolina*

Robert H. Spiers, Jr., *Stony Creek, Virginia*

What we deliver

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

- Lines of credit that enable borrowers to take advances at their choice of Prime, LIBOR or fixed rate.
- Credit Delivery, a loan origination system developed by AgFirst and used by all 23 of our member-associations.
- AgScore, a secure, web-based credit scoring product developed by AgFirst and used by 21 associations and 32 other financial institutions.
- 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 enables borrowers to make payments, transfer funds and obtain current account information on a secure Internet site.
- LoanLine, a service that provides loan and payment 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 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.

To Our Stockholders

Like most businesses, we plan for success. In fact, when we prepared our business plan for 2006, we planned for a very successful year. Our "most likely" scenario called for a healthy 8.5 percent growth in loan volume. We projected that our net income would grow by 9 percent in 2006, ending the year at $179 million. All in all, we planned for an exceptional year.

As you'll see in this report, we exceeded our expectations. Certainly, a healthy agricultural and general economy helped, but it was the extraordinary performance of our employees, both at AgFirst and its affiliated associations, that made the difference. Every day, they go the extra mile. Every day, they strive to exceed the expectations of their customers. Because of them, we have exceeded our own expectations.

Growth and Credit Quality

Over the past several years, AgFirst's affiliated associations have grown increasingly sophisticated in serving all of their available markets. As surveys and market share numbers show, associations in the AgFirst District have always done an outstanding job originating and servicing loans to the commercial farm market. However, this traditional market has changed in recent years and, as predicted, farms have grown both larger and smaller.

Large commercial operations and small "lifestyle" farms demand distinctly different approaches to lending. Our associations have had to make many changes over the last ten years to adapt to these new markets. By implementing new organizational structures, marketing techniques and origination methodologies, they have positioned themselves for success and are now enjoying the fruits of those efforts. Their success in meeting the needs of new and existing customers contributed to a significant increase in their loan volume in 2006 and a $1.4 billion increase in AgFirst's direct note volume.

Also contributing to our growth in 2006 were participation opportunities created by the partnership of AgFirst's Capital Markets Unit and associations throughout the district. Working together, they marketed aggressively to garner new business from agribusiness companies within the district and throughout the United States. As a result, associations' portfolios and earnings grew, and the Capital Markets Unit saw a 200 percent increase in its borrower base, while adding more than $1.0 billion in net participations and syndications to its portfolio during the year.

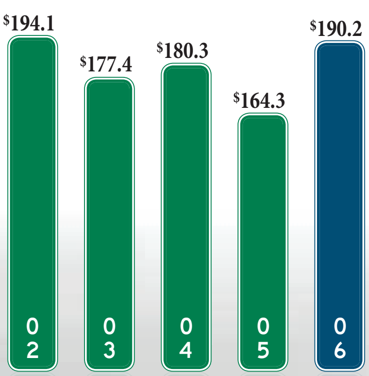
While growth is always welcome, we always strive for "quality growth," because that is the foundation of stable earnings. The credit quality of AgFirst's participation loan portfolio is strong, with acceptable loans reported at 97.70 percent at 2006 year-end, as compared to 96.01 percent the previous year. Our affiliated associations believe the same and continue to maintain high credit quality in their portfolios. Associations reported 96.02 percent acceptable loans at year-end, up from 95.58 percent the previous year.

Earnings

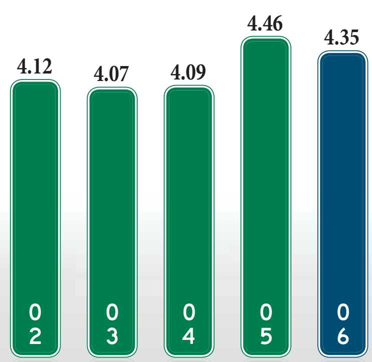
With the growth of loan portfolio, our average earning assets grew by $4.09 billion in 2006. This growth contributed to a near-record year of earnings. Our net income totaled $190.2 million in 2006, up 15.8 percent, or $25.9 million from previous year's earnings.

Our 2006 earnings level enabled us to distribute $128.4 million to the 23 associations we serve. As our earnings flowed to the associations and on to their borrowers, they enriched the economies of rural communities throughout our 15 states and Puerto Rico.

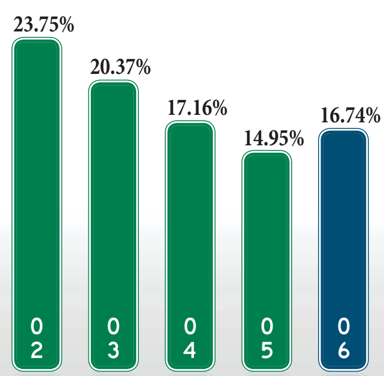
Net Income
(in millions)



Customer Satisfaction
(1 to 5 scale)



Return on Shareholders' Equity



Strategic Initiatives

We continue to focus on several strategic initiatives designed to improve the bank's performance and create efficiencies in association operations. In 2006, we:

- Implemented a Microsoft®-based Customer Relationship Management (CRM) system. Because we knew our associations needed more than an "out-of-the-box" CRM solution, we invested time and money to integrate Microsoft's® CRM with our own loan and customer systems.

- Introduced an imaging solution, which enables associations to share files between offices and reduce their paper-based files.

- Moved forward with other "Business Integration Projects," including AgriGate, a workflow management tool, and introduced enhancements to our Credit Delivery and E-Commerce products. Now, association customers can view their Annual Loan History Statements and tax forms online, saving them and our associations time and money.

- Expanded the curriculum of Farm Credit University (FCU), an AgFirst-based training program for new loan officers and credit analysts. In 2006, we introduced a "Commercial Agricultural Lending" module and began development of a self-paced, online orientation program for new employees. Since 2004, more than 350 students have enrolled in FCU, including employees outside the AgFirst family of associations, and we have trained more than 200 association mentors/coaches to work with these new lenders.

- Continued enhancing our risk management efforts. With ERisk and other tools in development, our Risk Management department continues to monitor the integrity of our data and assess our portfolio risk, as well as financial disclosure controls.

Ninety Years of Service to Agriculture and Rural America

On July 17, 1916, President Woodrow Wilson signed into law the Federal Farm Loan Act, which authorized the establishment of the Farm Credit System. To celebrate our 90th anniversary, representatives of AgFirst, together with association representatives and members of Congress, gathered at President Wilson's birthplace in Staunton, Virginia in July 17, 2006. It was truly a memorable moment as Congressman Bob Goodlatte of Virginia, using a replica of Wilson's pen, signed a resolution recognizing the contributions of the Farm Credit System to American agriculture.

AgFirst is proud to have played a part in the success of the Farm Credit System. Our business model, with its foundation in patronage distributions and other cooperative principles, has helped us grow and prosper, as it has the associations we serve and the farmers they serve. We know that the success we realized in 2006 is the result, not only of our hard work, but that of all the people who have served Farm Credit since its birth. In 2006, as in 1916, we have all been driven by a common mission: improving the quality of life on the farm and throughout our part of rural America. That responsibility—and its importance to our nation—will continue to guide us for years to come.

Thomas W. Kelly
Chairman of the Board

F. A. Lowrey
Chief Executive Officer

February 28, 2007

2006 Financial Results

Report of Management

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

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

In 2004, AgFirst adopted 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 public auditors, whose report appears elsewhere in this annual report. The Bank is also subject to examination by the Farm Credit Administration.

The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Bank. The undersigned certify that the 2006 Annual Report has been prepared in accordance with all applicable statutory or regulatory requirements and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

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

Thomas W. Kelly
Chairman of the Board

F. A. Lowrey
President & Chief Executive Officer

Leon T. Amerson
Executive Vice President,
Chief Operating Officer
& Chief Financial Officer

February 28, 2007

Management's Discussion & Analysis of Financial Condition & Results of Operation
(as of december 31, 2006)

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

Each FCB and the ACB serves one or more Production Credit Associations (PCAs) that originate and service short- and intermediate-term loans, Federal Land Credit Associations (FLCAs) that originate and service long-term real estate mortgage loans and/or Agricultural Credit Associations (ACAs) that originate both long-term and short- and intermediate-term loans. PCAs, FLCAs and ACAs are collectively referred to as associations. AgFirst and its related associations (Associations or District Associations) are collectively referred to as the District (District). The District Associations jointly own all of AgFirst's voting stock. As of December 31, 2006, the District consisted of the Bank and twenty-three District ACAs. All twenty-three are structured as holding companies, which include FLCA and PCA subsidiaries.

The following commentary reviews the consolidated financial condition and results of operations of AgFirst for the years ended December 31, 2006, 2005 and 2004. 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. See Note 1, *Organization and Operations*, in the Notes to the Consolidated Financial Statements for a discussion of the operations of AgFirst.

FINANCIAL OVERVIEW

The following information provides an overview, in capsule form, of AgFirst's financial results for 2006 as compared to 2005 and 2004:

- The aggregate principal amount of loans outstanding at December 31, 2006 was $17.15 billion compared to $14.41 billion at December 31, 2005, and $12.91 billion at December 31, 2004, reflecting increases of 19.02 percent and 32.88 percent compared to 2005 and 2004, respectively.

- Net income totaled $190.2 million for the twelve months ended December 31, 2006, reflecting a 15.79 percent increase and a 5.48 percent increase compared to the years ended December 31, 2005 and 2004, respectively.

- The 2006 net income included a $10.1 million reversal of the allowance for loan losses, offset by a $2.3 million charge-off on one participation loan. The 2005 and 2004 net income included reversals of the allowance for loan losses, amounting to $5.0 million and $15.3 million, respectively. These reversals positively affected income. The 2004 reversal was the result of the completion of previously announced studies to refine AgFirst's methodology for determining the allowance for loan losses.

- AgFirst's ratio of total shareholders' equity to total assets decreased from 5.06 percent at December 31, 2005 and 6.07 percent at December 31, 2004 to 4.84 percent at December 31, 2006.

- AgFirst's return on average total assets and return on average shareholders' equity for the year ended December 31, 2006 were 0.86 percent and 16.74 percent, respectively, compared to 0.91 percent and 14.95 percent for the year ended December 31, 2005, and 1.11 percent and 17.16 percent for the year ended December 31, 2004.

CRITICAL ACCOUNTING POLICIES

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. AgFirst considers significant accounting policies to be critical to the understanding of AgFirst'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. AgFirst considers these policies to be critical because 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 AgFirst's loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs.

  Significant individual loans are evaluated based on the borrower's overall financial condition, repayment capacity and historical 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, geographic, industry and other factors. Capitalized participation pool loans are analyzed in accordance with the selling Associations' allowance methodologies for assigning general and specific allowances.

  Assessing the appropriateness of the allowance for loan losses is a dynamic process. Increases or decreases in the allowance level will occur as conditions warrant. Material changes could have a direct impact on the provision for loan losses and create volatility in the results of operations.

- *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 most 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, pension and other postretirement benefit obligations, and certain derivative and other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing and liquidation values. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on AgFirst's results of operations.

- *Pensions* — The Bank and 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 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 is determined by actuarial valuations based on certain assumptions, including expected long-term rate of return on plan assets and discount rate. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that portfolio of assets. At September 30, 2006, the discount rate used to determine the pension plan obligations was 6.00 percent, compared to 5.25 percent at September 30, 2005. The discount rate is used to determine the present value of future benefit obligations. AgFirst selected the discount rate by reference to Moody's Investors Service Aa long-term corporate bond index, actuarial analyses and industry norms.

MISSION-RELATED INVESTMENTS

During 2005, the Farm Credit Administration (FCA) initiated a program to stimulate economic growth and development in rural areas. Recognizing that different investment strategies are needed for agricultural and rural communities, the FCA outlined a program to allow System institutions to hold investments, 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 Bond pilot programs under the mission-related investments umbrella, as described below.

Rural Housing Mortgage-Backed Securities

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

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 areas and residents. As of December 31, 2006, the District had $45.6 million in the Rural America Bond program. AgFirst alone had $26.1 million invested in the program. Of the $26.1 million, AgFirst had $24.0 million reflected in investment securities and $2.1 million reflected as loans on the Consolidated Balance Sheets at December 31, 2006.

LOAN PORTFOLIO

AgFirst's loan portfolio primarily consists of direct loans to District Associations (Direct Notes), loan participations/syndications purchased, residential loans, part-time farmer loans, and loans to Other Financing Institutions (OFIs) as shown below:

AgFirst Loan Portfolio

(dollars in thousands)	2006		2005		2004	
Direct Notes	$ 13,877,142	80.91%	$ 12,441,170	86.33%	$ 11,229,197	86.99%
Participations/Syndications Purchased, net	2,501,453	14.58	1,411,802	9.80	1,374,863	10.65
Correspondent Lending	771,982	4.50	555,421	3.85	302,226	2.34
SFAS No. 133 Adjustment	–	–	7	–	63	–
Loans to OFIs	1,760	0.01	2,650	0.02	1,900	0.02
Total	$ 17,152,337	100.00%	$ 14,411,050	100.00%	$ 12,908,249	100.00%

The diversification of AgFirst loan volume by type is shown below:

(dollars in thousands)	2006		2005		2004	
Production Agriculture						
Real Estate Mortgage	$ 750,394	4.37%	$ 411,707	2.86%	$ 441,113	3.42%
Production and Intermediate-Term	915,629	5.34	490,057	3.40	412,240	3.19
Agribusiness:						
Loans to Cooperatives	223,264	1.30	142,947	0.99	91,638	0.71
Processing and Marketing	440,657	2.57	280,932	1.95	282,359	2.19
Farm-Related Business	20,227	0.12	7,278	0.05	23,654	0.18
Communication	61,769	0.36	27,717	0.19	68,291	0.53
Energy	179,613	1.05	142,593	0.99	160,926	1.25
Water/Waste Disposal Loans	11,319	0.07	–	–	–	–
Rural Residential Real Estate	647,610	3.77	442,692	3.07	183,206	1.42
Lease Receivables	22,953	0.13	21,307	0.15	13,725	0.10
Direct Loans to Associations	13,877,142	80.91	12,441,170	86.33	11,229,197	86.99
Discounted Loans to OFIs	1,760	0.01	2,650	0.02	1,900	0.02
Total	$ 17,152,337	100.00%	$ 14,411,050	100.00%	$ 12,908,249	100.00%

Loan growth resulted from growth of the Direct Notes that fund Association lending activity and increases in participation loans purchased. Association growth in originations is attributable to a seasoned lending staff, the value inherent to patronage paid under their cooperative structure, the direct and indirect payments on Program Crops under the current Farm Bill, an improving world economy coupled with a weaker U.S. dollar that helped boost agricultural exports, borrowers seizing low interest rate opportunities, and capital expenditures by borrowers for property, plant and equipment.

Credit quality at year-end 2006 reflected improvement over previous years. Each loan is classified according to the Uniform Classification System, which is used by all System institutions. Below are the classification definitions.

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

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

AgFirst Loans Credit Quality	2006	2005	2004
Acceptable	98.70%	98.55%	98.06%
OAEM	1.18	1.21	1.54
Adverse*	0.12	0.24	0.40
Total	100.00%	100.00%	100.00%

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

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 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 funds most of its lending and general corporate activities by borrowing under its Direct Note. All assets of the Associations secure the Direct Notes and lending terms are specified in a separate General Financing Agreement (GFA) between AgFirst and each Association, including the subsidiaries of the Associations. Refer to Note 1, *Organization and Operations*, in the Notes to the Consolidated Financial Statements for further discussion. Each GFA contains minimum liquidity, capital, and earnings requirements that must be maintained by the Association.

Although AgFirst's loans to the Associations are evidenced by Direct Notes that are with full recourse to the borrowing Associations, the Associations' ability to repay is significantly dependent upon repayment of loans made to their borrowers. Accordingly, AgFirst's direct and indirect credit exposure depends upon the creditworthiness of both the Associations that are direct borrowers and the underlying borrowers of the Associations as indirect borrowers of AgFirst.

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

All Associations exceeded the minimum GFA and regulatory requirements for liquidity, earnings, and capital as of December 31, 2006. No Association is operating under a supervisory action and the 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 dynamic 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 participations to achieve diversified portfolios and the 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, 2006, Associations collectively had $1.19 billion under such government or GSE guarantee programs.

Credit quality within the combined Associations' portfolios improved during the twelve months ended December 31, 2006. At year-end, the combined Associations' loans including accrued interest were classified as follows:

District Associations Credit Quality	2006	2005	2004
Acceptable	96.02%	95.58%	94.50%
OAEM	2.53	2.86	3.43
Adverse*	1.45	1.56	2.07
Total	100.00%	100.00%	100.00%

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

Delinquencies were 0.28 percent of Association total loan assets at year-end 2006 compared to 0.45 percent and 0.59 percent at year-end 2005 and 2004, respectively. Nonperforming assets for the combined Associations represented 0.49 percent of total loan assets or $75.8 million, compared to 0.50 percent or $72.1 million for 2005, and 0.63 percent or $84.1 million for 2004. Nonperforming assets consist of nonaccrual loans, accruing restructured loans, accruing loans 90 days or more past due and other property owned.

Association net charge-offs of $12.6 million, $1.7 million and $3.9 million were recorded in 2006, 2005, and 2004, respectively. As a percentage of total loan assets, net charge-offs for the combined Associations were 0.08 percent for 2006 compared to 0.01 percent and 0.03 percent in 2005 and 2004, respectively.

Each Association maintains an allowance for loan losses determined by its management and is capitalized based upon its unique situation. The minimum regulatory capital ratios for System banks and associations are 7.00 percent for the permanent capital ratio, 7.00 percent for the total surplus ratio, and 3.50 percent for the core surplus ratio. The following table illustrates the risk bearing capacity of the Associations.

Association	Regulatory Permanent Capital Ratio	Regulatory Core Surplus Ratio	Regulatory Total Surplus Ratio	Allowance/ Loans
AgChoice	13.59%	11.17%	12.55%	0.31%
Ag Credit	19.15%	15.71%	17.54%	0.48%
AgGeorgia	15.04%	10.60%	14.66%	0.78%
AgSouth	15.94%	12.15%	15.56%	0.30%
ArborOne	13.29%	8.70%	12.89%	0.08%
Cape Fear	15.08%	12.20%	14.72%	0.57%
Carolina	16.00%	12.44%	15.29%	0.29%
Central Florida	16.55%	13.46%	15.88%	0.47%
Central Kentucky	15.65%	13.32%	14.27%	0.64%
Chattanooga	13.71%	10.56%	11.85%	0.41%
Colonial	16.95%	15.96%	16.00%	0.44%
East Carolina	15.63%	13.21%	15.19%	1.52%
Farm Credit of the Virginias	13.57%	11.73%	12.19%	0.18%
First South	13.50%	10.77%	12.33%	0.53%
Jackson Purchase	14.83%	13.23%	14.00%	0.42%
MidAtlantic	15.87%	12.90%	15.35%	0.52%
North Florida	14.19%	11.53%	13.77%	0.36%
Northwest Florida	11.54%	10.78%	11.28%	0.32%
Puerto Rico	24.31%	23.90%	23.90%	0.11%
South Florida	16.31%	14.94%	16.18%	1.01%
Southwest Florida	17.08%	14.27%	16.85%	0.08%
Southwest Georgia	12.42%	10.39%	12.16%	0.09%
Valley	14.19%	10.63%	11.54%	0.34%

Affiliated Associations serve all or a portion of fifteen states and Puerto Rico. This wide geographic dispersion is a natural risk-reducing factor for AgFirst. The following table illustrates the geographic distribution of the loan volume originated by the Associations.

District Associations State	2006	2005	2004
North Carolina	16%	16 %	16%
Florida	14	15	14
Georgia	13	13	13
Virginia	11	11	11
Pennsylvania	11	11	11
Maryland	7	7	7
South Carolina	6	6	6
Ohio	5	5	5
Alabama	4	3	3
Kentucky	3	3	3
Mississippi	2	2	2
West Virginia	2	2	2
Delaware	2	2	2
Louisiana	2	2	2
Puerto Rico	1	1	2
Tennessee	1	1	1
Total	100%	100%	100%

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

During the third quarter of 2005, hurricane activity caused damage across a significant portion of the District. Louisiana, Mississippi, Alabama, and southern Florida were the areas most impacted. Crop and commodity damage in certain areas was severe, but the impact on repayment of loans and risk of loss was mitigated by insurance proceeds, disaster relief, and the overall financial health of the borrowers' balance sheets.

Earnings for the combined Associations totaled $348.2 million, $343.8 million, and $478.4 million, producing an average return on assets of 2.18 percent, 2.40 percent, and 3.65 percent, and an average return on equity of 14.0 percent, 14.68 percent, and 24.35 percent for 2006, 2005, and 2004, respectively. Included in the 2004 results was a one-time reversal of the allowance for loan losses of $188.9 million, net of $11.2 million tax impact, in connection with completion of previously announced studies to refine the System institutions' methodologies for determining the allowance for loan losses. Excluding the impact of the one-time reversal of the allowance for loan losses, net income for the combined Associations would have been $289.5 million for 2004.

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

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

District Associations

	Percent of Portfolio		
Commodity Group	**2006**	**2005**	**2004**
Forestry	14%	13%	12%
Poultry	13	14	13
Fruits/Vegetables	10	10	9
Cattle	8	9	9
Grain	7	7	8
Dairy	6	7	8
Nursery/Greenhouse	5	5	5
Processing	4	3	4
Rural Home	3	4	4
Tobacco	3	3	4
Swine	3	3	3
Cotton	3	3	3
Citrus	1	2	2
Other	20	17	16
Total	100%	100%	100%

The table illustrates that 2006 commodity concentrations were 5.00 percent or more in only seven segments. The concentration in these segments is mitigated by a prevalence of non-farm income among the borrowers as demonstrated by the following table, which segregates part-time farm loans into a unique segment.

District Associations

	Percent of Portfolio		
Commodity Group	**2006**	**2005**	**2004**
Part-time Farmers	40%	41%	40%
Poultry	12	11	11
Forestry	7	6	6
Dairy	6	7	8
Nursery/Greenhouse	4	4	4
Cotton	3	3	3
Swine	3	3	3
Tobacco	3	3	3
Cattle	3	3	3
Corn	2	2	2
Other	17	17	17
Total	100%	100%	100%

Associations have concentrations of full-time farmers greater than 5.00 percent in only three commodities - poultry, forestry, and dairy. All three commodities have a large geographic dispersion with production over the entire AgFirst footprint. Concentrations within the Associations are further dispersed through the number of farm units producing poultry or dairy products. Poultry production is almost exclusively done through a network of contract growers whose income remains stable as variable costs are absorbed by the contracting integrators. Poultry concentration is further disbursed as production is segregated between chicken, turkey, and egg production. Dairy herds range in size from less than 100 cows to approximately 10 thousand. Associations also manage credit and concentration risk through participations, guarantees, and direct payment assignments from the poultry integrators and milk processing facilities. Forestry is divided principally into hardwood and softwood production and value-added processing. The timber from hardwood production is further processed into furniture, flooring, and high-grade paper and is generally located at the more northern latitudes and higher elevations. Softwood timber production is typically located in the coastal plains of the AgFirst footprint and is utilized for building material for the housing market and pulp to make paper and hygiene products. Forestry production at the Associations ranges from less than fifty acres to thousands of acres with value-added processing being conducted at sawmills and planer mills. Also, many poultry, dairy, and forestry producers have significant secondary income from off-farm employment by a family member. AgFirst exposure to the ethanol industry has grown during the year but still remains a very small percentage of the portfolio. AgFirst maintains a conservative maximum hold position in this industry. AgFirst also continues to watch the impact of increasing United States ethanol production on corn prices. Higher corn prices caused by increased ethanol production will increase the cost of production of the meat production companies in the portfolio. Most meat production borrowers within the portfolio are well capitalized and have significant ability to manage through increases in feed ingredient costs.

District Loan Volume
Gross Loans Per Borrower

$ Range	**% of Total**
$1,000-$250,000	30.53 %
$251,000-$500,000	15.33
$501,000-$1,000,000	13.47
$1,001,000-$5,000,000	21.02
$5,001,000-$25,000,000	10.82
$25,001,000-$100,000,000	6.12
Over $100,000,000	2.71
	100.00 %

Loans greater than $5.0 million comprise approximately 19.65 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 Associations' own lending staff prior to an Association committing to such loans.

Approximately 45.86 percent of outstanding loan volume is comprised of loans under $500 thousand, and loans less than $250 thousand make up approximately 30.53 percent of loan volume. This diversification among borrowers is another key component of the District's stable credit quality and solid financial performance over time.

Typically short 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, 2006, 42.96 percent of the District loans were identified as real estate loans. Exposure to losses is reduced through collateralization.

Participations/Syndications

AgFirst has an active Capital Markets Unit that purchases and sells loan participations and syndications. The Capital Markets Loan Officers and Relationship Managers work with the Associations to originate loans within the District's territory, providing commercial loan expertise to augment the Associations' staffs, as needed, as well as providing an outlet for loans that exceed an Association's limits. Additionally, the Capital Markets Unit actively pursues the purchase of participations and syndications originated outside of the District's territory. 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 its own concentrations.

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

	AgFirst Participations		
(dollars in thousands)	2006	2005	2004
Participations Purchased	$ 3,576,678	$ 1,906,665	$ 1,676,940
Less: Participations Sold	1,075,225	494,863	302,077
Net Outstanding	2,501,453	1,411,802	1,374,863
Available Commitment	1,714,215	1,486,601	1,086,958
Letters of Credit and Guarantees	258,400	127,662	146,579
Total Exposure	$ 4,474,068	$ 3,026,065	$ 2,608,400

Like the Associations, AgFirst employs a number of 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:

	AgFirst Participations					
(dollars in thousands)	2006		2005		2004	
Florida	$ 656,988	26%	$ 325,528	23%	$ 291,437	21%
Georgia	291,516	12	80,432	6	84,864	6
North Carolina	169,909	7	85,543	6	149,917	11
South Carolina	139,118	5	154,780	11	108,621	8
Texas	115,435	5	81,992	6	72,553	5
California	104,506	4	34,280	2	30,608	2
Minnesota	98,028	4	40,716	3	59,544	4
Virginia	95,256	4	64,895	5	70,733	5
Pennsylvania	78,579	3	80,147	6	64,792	5
Delaware	72,725	3	78,453	6	47,854	4
Colorado	65,675	3	57,431	4	23,076	2
New York	64,388	2	43,705	3	60,450	4
Missouri	56,104	2	61,637	4	65,944	5
Kansas	52,736	2	20,752	1	18,425	1
Washington	47,903	2	27,360	2	13,738	1
Oregon	46,461	2	16,592	1	19,823	1
Alabama	44,272	2	–	-	157	1
Connecticut	40,164	2	8,837	1	–	–
Ohio	39,658	1	35,151	2	27,146	2
Illinois	5,256	–	24,842	2	24,759	2
Other	216,776	9	88,729	6	140,422	10
Total	$ 2,501,453	100%	$ 1,411,802	100%	$ 1,374,863	100%

The higher geographic concentrations in Florida and Georgia are attributed to large commodity concentrations in the sugar and citrus industries in Florida and in the poultry and timberland loans in Georgia. Concentration risk is mitigated through established hold positions to a single borrower and to a single commodity/industry.

Volume outstanding in AgFirst's participation/syndication portfolio increased by 77.18 percent from 2005 year-end to 2006 year-end. The volume growth was strong in 2006 due to increased utilization of committed lines of credit by borrowers, increased loan activity in the agribusiness sector, and increased participations from affiliated Associations. A large percentage of the increase in number of borrowers is related to the establishment of the capitalized participation pools that are comprised of small to moderate sized loans. AgFirst's calling program continues to generate opportunities to purchase new credits as well as to maintain allocations in existing credits. The portfolio is well-diversified with volume spread out into many different commodity groups.

The largest major commodity concentration is food and kindred products, which represents a widely diverse group of food and food processing companies. The following shows the various major commodity groups in the portfolio and their percentage of the portfolio's outstanding volume.

AgFirst Participations	Percent of Portfolio		
Commodity Group	2006	2005	2004
Food and Kindred Products	19%	24%	22%
Agribusiness	14	10	7
Forestry	13	7	9
Lumber/Paper	8	8	7
Citrus	8	7	6
Electric Utilities	6	10	11
Horticulture	6	6	5
Sugar Cane/Sugar Beets	4	7	9
Swine	4	3	5
Telephone Utilities	3	2	5
Poultry & Eggs	2	5	7
Other	13	11	7
Total	100%	100%	100%

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

Participation/Syndication Credit Quality	2006	2005	2004
Acceptable	97.70%	96.01%	93.82%
OAEM	1.53	1.65	2.75
Substandard	0.77	1.67	2.66
Doubtful	0.00	0.67	0.77
Total	100.00%	100.00%	100.00%

Correspondent Lending

The Correspondent Lending Unit (Correspondent Lending) formerly referred to as a Secondary Mortgage Market Unit (SMMU) purchases residential and part-time farm loans from a network of correspondents including the affiliated Associations. The majority of loans purchased by Correspondent Lending to be "held to maturity" are guaranteed by Fannie Mae and/or Farmer Mac, thereby exposing AgFirst to limited credit risk. 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, 2006, 2005 and 2004.

	AgFirst Correspondent Lending					
(dollars in millions)	2006		2005		2004	
Rural Home Loans - Guaranteed	$ 605.5	78.44%	$ 411.6	74.11%	$ 145.3	48.08%
Part-time Farm Loans - Guaranteed	119.0	15.40	110.0	19.80	115.7	38.29
Agricultural Loans - Guaranteed	2.5	0.33	3.2	0.58	3.5	1.16
Non-guaranteed Loans	45.0	5.83	30.6	5.51	37.7	12.47
Total	$ 772.0	100.00%	$ 555.4	100.00%	$ 302.2	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 2006, AgFirst purchased $300.8 million of rural home and part-time farm loans. Purchases of rural home and part-time farm loans averaged $25.1 million per month for 2006.

AgFirst owns $605.5 million in rural home loans. These loans are the most significant portfolio due to the Associations' active participation in Fannie Mae home loan programs.

AgFirst owns $119.0 million in part-time farm loans. 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 owns $2.5 million of agricultural loans that are guaranteed by Farmer Mac. 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 $45.0 million of non-guaranteed loans 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, 2006 was $772.0 million. These loans are accounted for as "held-to-maturity." The total volume serviced but not owned as of December 31, 2006 was $16.4 million. These loans were not "held-to-maturity" by AgFirst; they were sold with servicing rights maintained by AgFirst.

RISK MANAGEMENT

AgFirst has implemented an enterprise risk management organization, through the appointment of a Chief Risk Officer (CRO) who reports to the Executive Vice President, Chief Operating Officer and Chief Financial Officer.

In general, the office of the CRO 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;
- Developing 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;
- Providing 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; and
- Developing analytical systems and data management capabilities to support the risk management function.

Overview

The Bank is in the business of making agricultural and other loans that requires taking certain risks in exchange for compensation for the risks undertaken. Management of risks inherent in AgFirst business is essential for current and long-term financial performance. The goal is to identify and assess risk, and to properly and effectively mitigate, measure, price, monitor and report risks in the business activities.

The major types of risks are:

- *structural risk* — risk inherent in the business and related to the District structure (an interdependent network of 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 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 the Associations, is part of the System, which is comprised of banks and associations that are cooperatively owned, directly or indirectly, by their borrowers. While System institutions are financially and operationally interdependent, this structure at times requires action by consensus or contractual agreement. The Federal Farm Credit Banks Funding Corporation (Funding Corporation) provides for the issuance, marketing and processing of Systemwide Debt Securities using a network of investment dealers and dealer banks. The System banks fund association loans with Systemwide debt. Refer to Note 8, *Bonds and Notes*, in the Notes to the 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.

In order to mitigate this risk, the System utilizes two integrated contractual agreements — 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 the district and bank 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 oversite and control over a bank's access to System funding if the creditworthiness of the bank declines below certain agreed-upon levels. The MAA promotes the identification and resolution of individual bank financial problems in a timely manner and discharges the Funding Corporation's statutory responsibility for determining conditions for each bank's participation in each issuance of Systemwide Debt Securities.

Credit Risk Management

Credit risk arises from the potential inability of an obligor to meet its repayment obligation and exists in outstanding loans, letters of credit, unfunded loan commitments, investment portfolio and derivative counterparty credit exposures. The Bank manages credit risk associated with retail lending activities through an assessment of the credit risk profile of an individual borrower. 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 retail credit risk management process begins with an analysis of the borrower's credit history, repayment capacity and financial position. Repayment capacity focuses on the borrower's ability to repay the loan 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 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 its participation in loans or interests in loans to/from other institutions within the System or outside the System, the District limits its exposure to either a borrower or commodity concentration. This also allows the Bank 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, are detailed below:

(dollars in thousands)	2006	2005	2004
AgFirst High-risk Assets			
Nonaccrual loans	$ 15,110	$ 19,197	$ 26,428
Restructured loans	–	–	–
Accruing loans 90 days past due	1,759	653	245
Total high-risk loans	16,869	19,850	26,673
Other property owned	75	–	–
Total high-risk assets	$ 16,944	$ 19,850	$ 26,673
Ratios			
Nonaccrual loans to total loans	0.09%	0.13%	0.20%
High-risk assets to total assets	0.07%	0.10%	0.16%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or interest under the contractual terms of the loan. Nonaccrual loans decreased $4.1 million, or 21.29 percent in 2006.

Restructuring of loans occurs when a concession is granted to a borrower based on either a court order or good faith in a borrower's ability to return to financial viability. The concessions can be in the form of a modification of terms or rates, a compromise of amounts owed, or deed in lieu of foreclosure. 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 Association and the borrower.

Although the System receives no direct government support, credit quality is an indirect beneficiary of government support as government program payments to borrowers enhance 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 Associations. In addition, the diversified nature and significant non-farm influence on the District's portfolio mitigate the impact of government support for program crops.

Interest Rate Risk Management

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

The objective of interest rate risk management is to generate a stable and adequate level of net interest income in any interest rate environment.

AgFirst uses a variety of sophisticated analytical techniques to manage the complexities associated with offering numerous loan options. These include interest rate sensitivity gap analysis to monitor the repricing characteristics of AgFirst's interest-earning assets and interest-bearing liabilities and simulation analysis to determine the change in net interest income and in the market value of equity due to changes in interest rates.

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, 2006.

Net Interest Income
(dollars in thousands)

Scenarios	Net Interest Income	% Change
+4.0% Shock	$231,482	4.0%
+2.0% Shock	$233,878	5.08%
Base line	$222,572	–
-2.0% Shock	$285,847	28.43%

Market Value of Equity
(dollars in thousands)

Scenarios	Assets	Liabilities	Equity*	% Change
Book Value	$24,412,164	$23,381,077	$1,031,087	–
+4.0% Shock	$22,580,498	$22,018,051	$ 562,447	(34.79)%
+2.0% Shock	$23,429,412	$22,722,544	$ 706,868	(18.05)%
Base line	$24,264,797	$23,402,246	$ 862,551	–
-2.0% Shock	$24,835,225	$23,789,558	$1,045,667	21.23%

* *For interest rate risk management, the $150.0 million in perpetual preferred stock is included in liabilities rather than equity.*

The following table sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2006. The amount of assets and liabilities shown, which reprice or mature during a particular period, were determined in accordance with the earlier of term-to-repricing or contractual maturity, anticipated prepayments, and, in the case of liabilities, the exercise of call options.

Repricing/Maturity Gap Analysis

(dollars in thousands)	Less than or Equal to 1 Year	Greater than 1 Year Less than 5 Years	Greater than or Equal to 5 Years	Total
Short- and Intermediate-Term Loans				
Fixed	$ 1,804,005	$ 677,676	$ 640,507	$ 3,122,188
Variable	3,927,653	–	–	3,927,653
Total Short- and Intermediate-Term Loans	5,731,658	677,676	640,507	7,049,841
Long-Term Real Estate Loans				
Fixed	4,138,712	4,231,451	1,615,642	9,985,805
Variable	105,265	11,341	85	116,691
Total Long-Term Real Estate Loans	4,243,977	4,242,792	1,615,727	10,102,496
Total Loans	9,975,635	4,920,468	2,256,234	17,152,337
Total Investments	5,257,130	805,769	808,152	6,871,051 *
TOTAL INTEREST EARNING ASSETS	$ 15,232,765	$ 5,726,237	$ 3,064,386	$ 24,023,388
Interest Bearing Liabilities				
Systemwide Bonds and Notes	$ 11,689,379	$ 7,211,000	$ 3,713,000	$ 22,613,379
Other Interest Bearing Liabilities	–	–	225,000	225,000
Interest Rate Swaps	1,415,000	(1,215,000)	(200,000)	–
TOTAL INTEREST BEARING LIABILITIES	$ 13,104,379	$ 5,996,000	$ 3,738,000	$ 22,838,379
Interest Rate Sensitivity Gap	$ 2,128,386	$ (269,763)	$ (673,614)	
Sensitivity Gap as a % of Total Earning Assets	8.86%	(1.12%)	(2.80%)	
Cumulative Gap	$ 2,128,386	$ 1,858,623	$ 1,185,009	
Cumulative Gap as a % of Total Earning Assets	8.86%	7.74%	4.93%	
Rate Sensitive Assets/Rate Sensitive Liabilities	1.16	0.96	0.82	

* *includes cash equivalents*

At December 31, 2006, the Repricing/Maturity Gap reflected an asset sensitive position due to the extension of liabilities. Short- and intermediate-term interest rates increased during the year and resulted in the majority of call options on fixed rate debt to be "out of the money." This extension and the asset sensitive repricing position imply an increase in net interest income given rising interest rates. However, the Repricing/Maturity Gap Analysis is a "point in time" view and is representative of the interest rate environment at December 31. Increasing or decreasing interest rates alter this position due to options in both assets and debt.

The Net Interest Income (NII) sensitivity analysis as shown above indicates that NII increases in both rising and falling interest rate environments. The modest improvement in NII for rising rates is due to an asset sensitive repricing / maturity position in those scenarios. In a falling interest rate environment, 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 for the decreasing interest rate environment.

At December 31, 2006, AgFirst had outstanding interest rate swaps with notional amounts totaling $1.77 billion. These derivative transactions were executed to reduce interest rate risk and/or reduce funding costs.

AgFirst policy prohibits the use of derivatives for speculative purposes. See Note 17, *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, 2006.

Disclosures for Derivative Financial Instruments

Notional amounts *(dollars in millions)*	**Receive Fixed**	**Amortizing Pay Fixed**	**Amortizing Floating for Floating**	**Interest Rate Caps**	**Total**
Balance at December 31, 2005	$ 1,930	$ 440	$ 264	$ 239	$ 2,873
Additions	450	–	–	–	450
Maturities/amortizations	(615)	(440)	(264)	(239)	(1,558)
Terminations	–	–	–	–	–
Balance at December 31, 2006	$ 1,765	$ –	$ –	$ –	$ 1,765

Various Uses of Derivative Instruments at December 31, 2006

(dollars in millions)

Derivatives utilized to create synthetic floating-rate debt to achieve a lower cost of funding	$ 1,765
Asset/liability management purposes	–
Other purposes	–
Total derivatives outstanding	$ 1,765

Liability Risk Management

AgFirst maintains adequate liquidity to satisfy its daily cash needs. In addition to normal cash flow associated with lending operations, AgFirst has two primary sources of liquidity: investments and the issuance of Systemwide Debt Securities.

Investments and Cash Equivalents

FCA Regulations provide that a System bank may hold certain eligible investments, in an amount not to exceed 35.00 percent of its total loans outstanding to satisfy FCA's liquidity reserve requirement, manage short-term funds, and manage interest rate risk. AgFirst maintains an investment portfolio for this purpose comprised primarily of short-duration, high-quality investments. The nature of this portfolio guarantees that investments can be converted to cash quickly and without significant risk of loss.

In addition, AgFirst maintains a portfolio of investments that are not held for liquidity purposes and are accounted for as a held-to-maturity portfolio. These investments are authorized by FCA Regulations that allow investments in Farmer Mac securities and also in specific investments approved by FCA as a Mission Related Investment. 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).

Investment securities and cash equivalents outstanding as of December 31, 2006 for AgFirst totaled $6.87 billion compared to $5.81 billion and $3.72 billion at December 31, 2005 and 2004, respectively. The increases in 2006 and 2005 are due to the revision of FCA Regulations during 2005 to increase the maximum level of liquidity investments from 30.00 percent to 35.00 percent of total loans outstanding, growth of total loans outstanding and AgFirst's participation in the Mission Related Investment program for rural housing.

AgFirst's investment portfolio consisted of the following security types as of December 31, 2006:

AgFirst Investment Securities

(dollars in thousands)	2006		2005		2004	
Investment Securities						
Available for Sale						
Commercial Paper	$ –	–%	$ 69,796	1.33%	$ 29,957	0.91%
U.S. Govt. GNMA MBS/CMOs	1,267,914	19.94	1,056,283	20.10	1,080,843	32.97
U.S. Govt. Agency MBS	2,749,985	43.25	2,029,961	38.62	1,853,148	56.53
Non-Agency Securities	776,534	12.21	597,670	11.37	292,545	8.92
Asset-Backed Securities	271,188	4.26	132,608	2.52	21,921	0.67
Total Available for Sale	5,065,621	79.66	3,886,318	73.94	3,278,414	100.00
Held to Maturity						
Rural Housing MBS	1,249,788	19.66	1,347,266	25.64	–	–
MBS Guaranteed by Farmer Mac	19,260	0.30	22,161	0.42	–	–
Other	24,013	0.38	–	–	–	–
Total Held to Maturity	1,293,061	20.34	1,369,427	26.06	–	–
Total Investment Securities	$ 6,358,682	100.00%	$ 5,255,745	100.00%	$ 3,278,414	100.00%
Cash Equivalents						
Fed Funds	$ 55,369	10.81%	$ 168,428	30.54%	$ 58,691	13.32%
Master Notes	82,000	16.00	108,048	19.59	107,000	24.28
Repos	375,000	73.19	275,000	49.87	275,000	62.40
Total Cash Equivalents	$ 512,369	100.00%	$ 551,476	100.00%	$ 440,691	100.00%

FCA regulations require a liquidity policy that establishes a "minimum coverage" level of 90 days. "Coverage" is defined as the number of days that maturing debt could be funded through the sale of liquid investments and Agency-guaranteed rural home loans. At December 31, 2006, AgFirst's coverage was 170 days.

Systemwide Debt Securities

AgFirst's primary source of liquidity is the ability to issue Systemwide Debt Securities, which are the general unsecured joint and several obligations of the System banks. AgFirst continually raises funds to support the mission to provide credit and related services to the rural and agricultural sectors, repay maturing Systemwide Debt Securities, and meet other obligations. As a government-sponsored enterprise, AgFirst has had access to the nation's and world's capital markets. This access has provided AgFirst with a dependable source of competitively priced debt that is critical to support the mission of providing funding to the rural and agricultural sectors. Moody's Investors Service and Standard & Poor's rate the System's long-term debt as Aaa and AAA, and short-term debt as P-1 and A-1+. These rating agencies base their ratings on many quantitative and qualitative factors, including the System's government-sponsored enterprise status. Material changes to the factors considered could result in a different debt rating. However, as a result of the System's financial performance, credit quality and standing in the capital markets, AgFirst anticipates continued access to funding necessary to support System needs. The U.S. government does not guarantee, directly or indirectly, Systemwide Debt Securities. The year-to-date average balance of Systemwide Debt Securities at December 31, 2006, was $20.57 billion. At December 31, 2006, AgFirst had $22.61 billion in total debt outstanding compared to $18.88 billion at December 31, 2005 and $15.40 billion at December 31, 2004. The year-to-year increases were primarily due to the increases in loan volume and investments.

AgFirst's participation in outstanding Systemwide Debt Securities as of December 31, 2006 is as follows:

Systemwide Debt Securities

(dollars in thousands)	Bonds		Medium-Term Notes		Discount Notes		Total	
Maturities	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate
2007	$ 7,041,289	4.65%	$ –	– %	$ 2,586,284	5.12 %	$ 9,627,573	4.78%
2008	4,539,046	4.64	–	–	–	–	4,539,046	4.64
2009	2,329,510	4.61	–	–	–	–	2,329,510	4.61
2010	1,255,027	4.76	–	–	–	–	1,255,027	4.76
2011	1,003,414	5.00	–	–	–	–	1,003,414	5.00
2012	3,858,809	5.52	–	–	–	–	3,858,809	5.52
Total	$ 20,027,095	4.84%	$ –	– %	$ 2,586,284	5.12 %	$ 22,613,379	4.87%

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

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

Operational Risk Management

Operational risk is the risk of loss resulting from inadequate or failed processes or systems, human factors or external events, including the execution of unauthorized transactions by employees, errors relating to transaction processing and technology, breaches of the internal control system and the risk of fraud by employees or persons outside the System. AgFirst and the Associations' board of directors are required, by regulation, to adopt an internal control policy that provides adequate direction to the institution in establishing effective control over and accountability for operations, programs and resources. The policy 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 its 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 Department exists 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 and internal audit plans developed with higher risk areas receiving more review.

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 affects the System directly, such as changes to the Farm Credit Act, or indirectly, such as agricultural appropriations bills. Political risk to the System is the risk of loss of support for the System or agriculture by the U.S. government.

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

ALLOWANCE FOR LOAN LOSSES

The Bank maintains an allowance for loan losses at a level management considers adequate to provide for probable and estimable credit losses within the loan and finance lease portfolios. The Bank increases the allowance by recording a provision for loan losses in the income statement. Loan losses are recorded against the allowance when management determines that any portion of the loan or lease is uncollectible. Any subsequent recoveries are added to the allowance. Analysis indicates that an allowance for losses for AgFirst's direct note and correspondent lending portfolios is not justified. All of AgFirst's allowance for losses reflects reserves for risks identified in the participations/syndications portfolio. The allowance for loan losses was $463 thousand at December 31, 2006, as compared with $10.1 million and $14.8 million at December 31, 2005 and 2004, respectively.

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

AgFirst Allowance for Loan Losses Activity:

(dollars in thousands)	2006	2005	2004
Balance at beginning of year	$ 10,114	$ 14,800	$ 34,168
Charge-offs:			
Real estate mortgage	–	–	(225)
Agribusiness	(2,314)	(41)	(673)
Communication	–	(13)	(3,200)
Total charge-offs	(2,314)	(54)	(4,098)
Recoveries:			
Production and intermediate term	–	–	22
Communication	–	363	–
Total recoveries	–	363	22
Net (charge-offs) recoveries	(2,314)	(309)	(4,076)
(Reversal of) provision for loan losses	(7,337)	(4,995)	–
Nonrecurring reversal of allowance for loan losses*	–	–	(15,292)
Balance at end of year	$ 463	$ 10,114	$ 14,800
Ratio of net charge-offs (recoveries) during the period to average loans outstanding during the period	0.015%	(0.002)%	(0.033)%

* *Represents the amount of allowance reversal due to the refinement in methodology.*

The allowance for loan losses by loan type for the most recent three years is as follows:

AgFirst Allowance for Loan Losses by Loan Type

(dollars in thousands)	2006	2005	2004
Real estate mortgage	$ 279	$ 10,100	$ 13,400
Production and intermediate term	130	–	–
Agribusiness	26	–	–
Communication	1	–	1,400
Energy	3	–	–
Rural residential real estate	24	14	–
Total loans	$ 463	$ 10,114	$ 14,800

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

	2006	2005	2004
Allowance for loan losses to loans	0.003 %	0.07 %	0.11 %
Allowance for loan losses to nonaccrual loans	3.06 %	52.68 %	56.00 %
Allowance for loan losses to participation loans and Correspondent Lending loans	0.01 %	0.51 %	0.88 %

The financial positions of the Associations' borrowers have generally strengthened during the past decade as farmers' net cash income has been at a favorable level due, in part, to direct federal government payments and steady increases in land values over the period. With borrowers' strengthened financial positions and the continued emphasis on sound underwriting standards, the credit quality of the District loan portfolio has remained healthy. This trend is anticipated to continue as long as financial conditions remain unchanged.

See Note 5, *Loans and Allowance for Loan Losses* in the Notes to the Consolidated Financial Statements for further information concerning the allowance for loan losses.

RESULTS OF OPERATIONS

Net Income

AgFirst net income totaled $190.2 million for the year ended December 31, 2006, an increase of $25.9 million over 2005 and a decrease of $16.0 million from December 2005 to December 2004. 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, 2006**	**2005**
Net income (for prior year)	$ 164,259	$ 180,306
Increase (decrease) due to:		
Total interest income	430,275	248,334
Total interest expense	(406,964)	(255,728)
Net interest income	23,311	(7,394)
Provision for loan losses	2,342	(10,297)
Noninterest income	2,549	(1,272)
Noninterest expense	(2,268)	2,916
Total increase (decrease) in net income	25,934	(16,047)
Net income	$ 190,193	$ 164,259

Interest Income

Total interest income for the year ended December 31, 2006 was $1.22 billion, an increase of $430.3 million, as compared to the same period of 2005. Total interest income for 2005 was $792.7 million, an increase of $248.3 million, as compared to the same period of 2004. The increase from 2005 to 2006 resulted from increases related to volume and rate. The volume of interest earning assets increased in 2006, with an increase in average earning assets of $4.09 billion. In 2006, interest rates increased in comparison to 2005 and as a result, the average yield on interest earning assets increased 1.13 percent.

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

Net Change in Interest Income *(dollars in thousands)*	**Year Ended December 31, 2006-2005**	**2005-2004**
Increase in average earning assets	$ 4,089,252	$ 1,834,873
Average yield (prior year)	4.44%	3.40%
Interest income variance attributed to change in volume	181,548	62,348
Average earning assets (current year)	21,943,704	17,854,452
Increase (decrease) in average yield	1.13%	1.04%
Interest income variance attributed to change in yield	248,727	185,986
Net change in interest income	$ 430,275	$ 248,334

Interest Expense

Total interest expense for the year ended December 31, 2006 was $995.4 million, an increase of $407.0 million, as compared to the same period of 2005. Total interest expense for the year ended December 31, 2005 was $588.5 million, an increase of $255.7 million, as compared to the same period of 2004. The increases were primarily attributed to an increase in interest-bearing liabilities supporting asset growth, and an increase in rates.

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

Net Change in Interest Expense *(dollars in thousands)*	**Year Ended December 31, 2006-2005**	**2005-2004**
Increase in average interest-bearing liabilities	$ 3,988,090	$ 1,775,396
Average rate (prior year)	3.50%	2.21%
Interest expense variance attributed to change in volume of interest-bearing liabilities	139,616	39,293
Average interest-bearing liabilities (current year)	20,797,571	16,809,481
Increase (decrease) in average rate	1.28%	1.29%
Interest expense variance attributed to change in rate	267,348	216,435
Net change in interest expense	$ 406,964	$ 255,728

Net Interest Income

Net interest income increased from 2005 to 2006, while the 2005 level was below 2004, as illustrated by the following table:

AgFirst Analysis of Net Interest Income

	2006		**2005**		**2004**	
(dollars in thousands)	**Avg. Balance**	**Interest**	**Avg. Balance**	**Interest**	**Avg. Balance**	**Interest**
Loans	$ 15,568,139	$ 890,247	$ 13,448,845	$ 624,945	$ 12,464,633	$ 469,774
Cash & investments	6,375,565	332,701	4,405,607	167,728	3,554,946	74,565
Total earning assets	$ 21,943,704	$ 1,222,948	$ 17,854,452	$ 792,673	$ 16,019,579	$ 544,339
Interest-bearing liabilities	$ 20,797,571	$ (995,436)	$ 16,809,481	$ (588,472)	$ 15,034,085	$ (332,744)
Impact of capital	$ 1,146,133		$ 1,044,971		$ 985,494	
Net interest income		$ 227,512		$ 204,201		$ 211,595

	2006 Average Yield	**2005 Average Yield**	**2004 Average Yield**
Yield on loans	5.72%	4.65%	3.77%
Yield on cash & investments	5.22%	3.81%	2.10%
Yield on earning assets	5.57%	4.44%	3.40%
Cost of interest-bearing liabilities	4.78%	3.50%	2.21%
Spread	0.79%	0.94%	1.19%
Impact of capital	0.25%	0.20%	0.13%
Net interest income/avg. earning assets	1.04%	1.14%	1.32%

The increase in net interest income is attributed to the positive variance in interest earning assets, offset by the decrease in spread between asset and funding costs. Both loans and investments increased significantly in 2006, but the positive impact on net interest income was partially offset by compression of spread between asset yield and debt cost. The decreases in spread are attributed to an increase in short-term rates that resulted in a narrower spread on short-term and variable rate Direct Notes to Associations. In addition, investments increased as a percent of interest earning assets. Investments have lower spreads to debt costs than loans due to their high credit quality and liquidity.

Provision for Loan Losses

AgFirst assesses risks inherent in its portfolio on an ongoing basis and establishes an appropriate reserve for loan losses. A reversal of the provision for the twelve months ended December 31, 2006 and 2005 of $7.3 million and $5.0 million, respectively, resulted from decreased exposure and payments related to loans in the Participation/Syndication portfolio. As referenced above, the $15.3 million reversal in 2004 resulted from the AgFirst study and the resulting refinements in methodology completed during the fourth quarter of 2004.

Noninterest Income

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

Noninterest Income *(dollars in thousands)*	**For the Year Ended December 31, 2006**	**2005**	**2004**	**Increase (Decrease) 2006/ 2005**	**2005/ 2004**
Loan fees	$ 6,262	$ 11,441	$ 11,751	$ (5,179)	$ (310)
Realized gains (losses) on investments (net)	(5)	466	(17)	(471)	483
Realized gains on derivatives (net)	6,812	94	96	6,718	(2)
Other noninterest income	6,229	4,748	6,191	1,481	(1,443)
Total noninterest income	$ 19,298	$ 16,749	$ 18,021	$ 2,549	$ (1,272)

The decrease in loan fees was primarily due to reductions of $3.5 million in net participations/syndications fee income, as lines of credit were more fully advanced and generated less un-advanced commitment fees. In addition, prepayment penalty income was $1.3 million lower between periods as refinance activity slowed in a higher interest rate environment. The $6.7 million increase in gains on derivatives in 2006 represents the gain realized on liquidating a derivative strategy and putting permanent financing in place. The $1.5 million increase in other noninterest income for 2006 primarily resulted from a $1.5 million gain allocated to AgFirst from the sale of .75 acres and all existing development rights related to the Farm Credit System Building Association property in McLean, Virginia.

Noninterest Expense

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

Noninterest Expense *(dollars in thousands)*	**For the Year Ended December 31, 2006**	**2005**	**2004**	**Increase (Decrease) 2006/ 2005**	**2005/ 2004**
Salaries and employee benefits	$ 26,318	$ 27,957	$ 26,172	$ (1,639)	$ 1,785
Occupancy and equipment expense	11,608	11,108	9,823	500	1,285
Insurance fund premium	3,597	884	845	2,713	39
Other operating expense	17,529	15,882	15,448	1,647	434
Intra-System financial assistance expenses	–	3,221	6,794	(3,221)	(3,573)
Called debt expense	2,563	656	3,360	1,907	(2,704)
Other noninterest expenses	2,339	1,978	2,160	361	(182)
Total noninterest expense	$ 63,954	$ 61,686	$ 64,602	$ 2,268	$ (2,916)

Occupancy and equipment expenses increased during 2006 and 2005, primarily as the result of a technology renovation aimed at improving AgFirst's technical infrastructure and updating various systems. The Insurance fund premium increased $2.7 million for the twelve months ended December 31, 2006, compared to the comparable period in 2005, due to an increase in premium rates from 5 basis points to 15 basis points on accrual loans beginning January 1, 2006.

Financial assistance expense declined due to the retirement of several Financial Assistance Corporation bonds. See Note 12, *Intra-System Financial Assistance,* in the Notes to the Consolidated Financial Statements for further information. AgFirst fully extinguished its obligations in 2005 with the maturity of the last Financial Assistance Corporation bonds. The Financial Assistance Corporation dissolved effective as of December 31, 2006.

Concession (debt issuance expense) is amortized over the life of the underlying debt security. When securities are called prior to maturity, any unamortized concession is expensed. Called debt expense increased $1.9 million in 2006, compared to 2005. For 2005, the called debt decreased $2.7 million, compared to 2004. Called debt volume was $1.55 billion, $352.0 million, and $2.53 billion for 2006, 2005, and 2004, respectively.

Key Results of Operations Comparisons

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

Key Results of Operations Comparisons	**For the 12 Months Ended 12/31/06**	**For the 12 Months Ended 12/31/05**	**For the 12 Months Ended 12/31/04**
Return on average assets	0.86%	0.91%	1.11%
Return on average shareholders' equity	16.74%	14.95%	17.16%
Net interest income as a percentage of average earning assets	1.04%	1.14%	1.32%
Net chargeoffs (recoveries) to average loans	0.015%	(0.002)%	0.033%

Employee Retirement Plans

For the years ended December 31, 2006, 2005 and 2004, AgFirst had contributed $0, $4.6 million and $18.9 million, respectively, to the Districtwide defined benefit retirement plan. The Districtwide funding in 2004, 2005, and 2006 brought the retirement plan's assets to an amount that exceeded the Accumulated Benefit Obligation as of the Plan's measurement date, eliminating the minimum pension liability and the charge to accumulated other comprehensive income. The funding in 2005 and 2006 maintained the Plan's assets to exceed the Accumulated Benefit Obligation. See Note 11, *Employee Benefit Plans*, in the Notes to the Consolidated Financial Statements of this report for further information.

PREFERRED STOCK

On May 17, 2001, AgFirst issued 225 thousand shares 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 (1) 8.393 percent until December 15, 2011, with dividends paid semi-annually on June 15th and December 15th: and (2) thereafter at a floating rate per annum equal to 3 month LIBOR plus 3.615 percent with dividends payable quarterly commencing March 15, 2012. 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 its par value of $1 thousand per share.

On October 14, 2003, AgFirst issued 150 thousand shares 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 be cumulative 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 then current dividend period to the date of redemption.

See Note 9, *Mandatorily Redeemable Preferred Stock,* and Note 10, *Shareholders' Equity,* of the Notes to the Consolidated Financial Statements of this annual report for more detailed information concerning the preferred stock issuances.

CAPITAL

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

The AgFirst Capitalization Plan (the "Plan") approved by the Bank Board of Directors establishes guidelines to ensure that adequate capital is maintained for continued financial viability, to provide for growth necessary to meet the needs of members/borrowers, and to assure 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 2006 that have an effect on the Bank's ability to retire stock and distribute earnings.

Total shareholders' equity at December 31, 2006 was $1.18 billion, compared to $1.04 billion and $1.02 billion at December 31, 2005 and 2004, respectively. The increasing trend in shareholders' equity is attributed to the increases in retained earnings and increased levels of Association owned stock. Capital stock and participation certificates totaled $313. 4 million at December 31, 2006, compared to $224.6 million at December 31, 2005, an increase of $88.8 million. The Associations are required to maintain ownership in the Bank in the form of Class B and Class C stock. The Associations' minimum stock requirement increased from 1.40 percent of Association Direct Note balances to 1.75 percent effective December 31, 2006, as a means to support the strong growth in Bank assets. This resulted in a $61.1 million increase in Association owned capital stock. In addition, the Associations purchased $26.6 million in stock as a result of the capitalized participation pool established in 2006.

FCA sets minimum regulatory capital requirements for System banks and associations. Capital adequacy is evaluated using a number of regulatory ratios. According to the FCA regulations, each institution's permanent capital ratio is calculated by dividing permanent capital by a risk-adjusted asset base. Risk-adjusted assets mean the total dollar amount of the institution's assets adjusted by an appropriate credit conversion factor as defined by regulation. For all periods presented, AgFirst exceeded minimum regulatory standards for all of the ratios. Subsequent to the issuance of the mandatorily redeemable preferred stock, FCA now requires AgFirst to maintain a minimum net collateral ratio of 104.00 percent compared to the System regulatory minimum of 103.00 percent. Unlike the permanent capital, total surplus and core surplus ratios, the net collateral ratio does not incorporate any risk-weighting of assets. The collateral ratio is calculated by dividing the Bank's collateral as defined by FCA regulations, by total liabilities.

At December 31, regulatory ratios were:

	Regulatory Minimum	AgFirst Ratio as of 12/31/06	12/31/05	12/31/04
Permanent Capital Ratio	7.00%	19.19%	23.90%	26.86%
Total Surplus Ratio	7.00%	19.14%	23.84%	26.76%
Core Surplus Ratio	3.50%	11.46%	14.15%	15.60%
Collateral Ratio	104.00%	105.28%	105.70%	106.88%

The decrease in the Bank's permanent capital, total surplus, and core surplus ratios for December 31, 2006 and December 31, 2005 was attributed to the increase in assets for both years exceeding the increase in capital. The decrease in the collateral ratios for the years ended December 31, 2006 and 2005 was attributed to asset growth.

Refer to Note 10, *Shareholders' Equity*, in the Notes to the Consolidated Financial Statements for additional information.

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 year-end 2006:

Young, and Beginning Farmers and Ranchers
Number/Volume of Loans Outstanding
December 31, 2006
(dollars in thousands)

Category	Number of Loans	Percent of Total	Volume Outstanding	Percent of Total
1. Total loans and commitments outstanding at year-end	134,515	–	$ 23,981,790	–
2. Young farmers and ranchers	21,387	15.90%	$ 2,008,429	8.37%
3. Beginning farmers and ranchers	32,393	24.08%	$ 4,209,076	17.55%

The following table summarizes information regarding loans outstanding to Small Farmers and Ranchers as of year-end 2006:

Small Farmers and Ranchers
Number/Volume of Loans Outstanding by Loan Size
December 31, 2006
(dollars in thousands)

Number/Volume Outstanding	$0- $50,000	$50,001 - $100,000	$100,001- $250,000	$250,001- and greater
1. Total number of loans and commitments outstanding at year-end	80,626	21,200	19,750	12,939
2. Total number of loans to small farmers and ranchers	58,381	14,093	11,901	5,324
3. Number of loans to small farmers and ranchers as a % of total number of loans (line 2/ line 1 * 100 = 00.00%)	72.41%	66.48%	60.26%	41.15%
4. Total loan volume outstanding at year-end	$ 1,535,098	$ 1,761,301	$ 3,580,258	$ 17,105,133
5. Total loan volume to small farmers and ranchers	$ 1,076,172	$ 1,065,984	$ 1,897,262	$ 2,959,686
6. Loan volume to small farmers and ranchers as a % of total loan volume (line 5/ line 4 * 100 = 00.00%)	70.10%	60.52%	52.99%	17.30%

The following table summarizes information regarding the new loans made to Young and Beginning Farmers and Ranchers as of year-end 2006:

Young, and Beginning Farmers and Ranchers
Gross New Business During 2006, Number/Volume of Loans
December 31, 2006
(dollars in thousands)

Category	Number of Loans	Percent of Total	Volume Outstanding	Percent of Total
1. Total gross new loans and commitments made during 2006	59,861	–	$ 12,392,681	-
2. Total loans and commitments made to young farmers and ranchers	8,781	14.67%	$ 973,789	7.86%
3. Total loans and commitments made to beginning farmers and ranchers	11,538	19.27%	$ 1,944,541	15.69%

The following table summarizes information regarding new loans made to Small Farmers and Ranchers as of year-end 2006:

Small Farmers and Ranchers
Gross New Business by Loan Size, Number/Volume of Loans
December 31, 2006
(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 2006	30,144	10,880	9,796	9,041
2. Total number of loans made to small farmers and ranchers during 2006	20,842	5,779	4,199	2,402
3. Number of loans to small farmers and ranchers as a % of total number of loans (line 2/ line 1 * 100 = 00.00%)	69.14%	53.12%	42.86%	26.57%
4. Total gross loan volume of all new loans and commitments made during 2006	$ 574,657	$ 727,007	$ 1,503,187	$ 9,587,830
5. Total gross loan volume to small farmers and ranchers	$ 355,456	$ 381,459	$ 639,352	$ 1,480,690
6. Loan volume to small farmers and ranchers as a % of total gross new loan volume (line 5/ line 4 * 100 = 00.00%)	61.86%	52.47%	42.53%	15.44%

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

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Accounting for Certain Hybrid Financial Instruments

In February 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 155, *Accounting for Certain Hybrid Financial Instruments* (SFAS 155), an amendment of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133) and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SFAS 140.) This Statement resolves certain issues addressed in the implementation of SFAS 133 concerning beneficial interests in securitized financial assets. SFAS 155 permits fair value measurement for any hybrid financial instrument that contains an embedded derivative, clarifies which interest-only strips and principal-only strips are not subject to the requirement of SFAS 133, establishes a requirement to evaluate interests in securitized financial assets, clarifies the concentrations of credit risk, and eliminates the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument. The Statement is effective for all financial instruments acquired or issued in fiscal years beginning after September 15, 2006. The Bank is currently analyzing the impact of SFAS 155 on its financial statements. The adoption of this standard is not expected to have a material effect on the Bank's Consolidated Balance Sheets or Statements of Income.

Accounting for Servicing of Financial Assets

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets* (SFAS 156), which amends the accounting for separately recognized servicing assets and servicing liabilities. SFAS 156 permits the choice of the amortization method or the fair value measurement method, with changes in fair value recorded in income, for the subsequent measurement for each class of separately recognized servicing assets and servicing liabilities. The Statement is effective for years beginning after September 15, 2006, with earlier adoption permitted. The Bank is currently analyzing the impact of SFAS 156 on its financial statements. The adoption of this standard is not expected to have a material effect on the Bank's Consolidated Balance Sheets or Statements of Income.

Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which provides enhanced guidance for using fair value to measure assets and liabilities. The standard applies whenever other standards require or permit assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. Early adoption is permitted. The Bank is currently analyzing the impact of SFAS 157 on its financial statements.

Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS 158). SFAS 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 through comprehensive income changes in that funded status in the year in which the changes occur. SFAS 158 also provides guidance relating to the discount rate, which may require the Bank to adjust its basis for selecting the discount rate for its pension and non-pension postretirement benefit plans. The Bank will be required to implement SFAS 158 for the year ended December 31, 2007. In addition, SFAS 158 requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the Bank uses a measurement date of September 30th. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. The Bank is currently evaluating the impact of implementing SFAS 158.

Fair Value Option for Financial Assets and Financial Liabilities

In February 2007, the FASB issued SFAS No. 159, *Fair Value Option for Financial Assets and Financial Liabilities*. The standard permits entities to choose on an instrument-by-instrument basis, at specified election dates, to measure eligible items at fair value (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected shall be reported in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. This standard is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Bank is currently evaluating the impact of implementing SFAS 159.

RECENT REGULATORY MATTERS

In January 2006, FCA approved final governance regulations for System banks and associations. The regulations are intended to promote the continued safety and soundness of the System by establishing governance standards and improving transparency in public disclosures. While the regulation will require changes to governance processes/disclosures, it is not expected to materially impact Bank operations.

FORWARD LOOKING INFORMATION

This annual information statement contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Words such as "anticipates," "believes," "could," "estimates," "may," "should," "will," or other variations of these terms are intended to identify the forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions, and expected future developments. However, actual results and developments may differ materially from AgFirst's expectations and predictions due to a number of risks and uncertainties, many of which are beyond AgFirst's control. These risks and uncertainties include, but are not limited to:

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

Additional Disclosures 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 and Analysis of Financial Condition and Results of Operations* included in this annual report to shareholders.

Description of Property

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

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

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 15 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 10 to the consolidated financial statements, *Shareholders' Equity,* included in this annual report to shareholders.

Description of Liabilities

The description of liabilities, contingent liabilities and intrasystem financial assistance rights and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 7, 8, 9, 11, 12 and 15 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 and Analysis of Financial Condition and 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 business experience for the past five years for senior officers is with the Farm Credit System.

Senior Officer	Position & Other Business Interests
F. A. (Andy) Lowrey	***President & Chief Executive Officer.*** He serves as: Chairman of the Board for Federal Farm Credit Banks Funding Corporation; Council Member of the National Council of Farm Cooperatives; University of South Carolina: Board of Trustees for Darla Moore School of Business, Board of Trustees for Education Foundation, Moore School of Business Dean Search Committee, Envisioning Moore Capital Campaign Executive Committee; Board of Directors for Big Brothers Big Sisters of Greater Columbia; Board of Directors for National 4H: Chairman of Finance Committee; Board of Directors for Palmetto AgriBusiness Council; Board of Directors for Midlands Business Leadership Group.
Thomas S. Welsh	***Executive Vice President, Chief Administrative & Legislative Officer & Corporate Secretary.*** He serves on the Advisory Board of the Farm Credit System Captive Insurance Company.
Leon T. Amerson	***Executive Vice President, Chief Operating Officer & Chief Financial Officer***
Benjamin F. Blakewood	***Senior Vice President & Chief Technology & Operations Officer***
William L. Melton	***Senior Vice President & Chief Lending Officer.*** He serves as Director-at-Large for the National Chicken Council, a trade organization.
Frederick T. Mickler, III	***Senior Vice President & General Counsel***

The total amount of compensation earned by the CEO and the senior officers as a group during the years ended December 31, 2006, 2005 and 2004, is as follows:

Name of Individual or Number in Group	Year	Annual Salary	Annual Bonus	Deferred Comp.	Perq./ Other*	Total
F. A. Lowrey	2006	$ 467,018	$ 175,161	$ 10,000	$ 17,983	$ 670,162
F. A. Lowrey	2005	$ 444,017	$ 162,332	$ 6,000	$ 16,779	$ 629,128
F. A. Lowrey	2004	$ 415,286	$ 116,280	$ 29,070	$ 15,120	$ 575,756
5 Officers	2006**	$ 1,029,845	$ 226,314	$ 65,522	$ 63,821	$ 1,385,502
5 Officers	2005	$ 1,251,913	$ 311,804	$ 58,502	$ 65,204	$ 1,687,423
5 Officers	2004	$ 1,183,639	$ 190,409	$ 99,122	$ 64,389	$ 1,537,559

* *Primarily comprised of company contributions to thrift plan, group life insurance premiums and automobile compensation.*

** *Beginning with the year ending December 31, 2006, FCA requires CEO compensation to be disclosed separately from other senior officers (i.e. not included in the senior officer group), and re-defines the senior officer group. The new requirement is to be applied prospectively, so senior officer compensation for 2004 and 2005 have not been re-stated to reflect the change.*

In addition to a base salary, senior officers 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 2006 bonus was made in the first quarter of 2007.

Disclosure of information on the total compensation paid during 2006 to any senior officer, or to any other individual included in the aggregate, is available to shareholders upon request.

AgFirst Farm Credit Bank Board of Directors

Name	Position	Term of Office
Thomas W. Kelly	Chairman	December 31, 2008
Paul M. House	Vice Chairman	December 31, 2007
William C. Bess, Jr.	Director	December 31, 2009
Robert A. Carson	Director	December 31, 2006
Henry M. Frazee	Director	December 31, 2008
Don W. Freeman	Director	December 31, 2009
Robert L. Holden, Sr.	Director	December 31, 2010*
Lyle Ray King	Director	December 31, 2008
Richard Kriebel	Director	December 31, 2007
M. Wayne Lambertson	Director	December 31, 2009
Paul Lemoine	Director	December 31, 2007
James L. May	Director	December 31, 2009
Eugene W. Merritt, Jr.	Director	December 31, 2010*
Katherine A. Pace	Director	December 31, 2007
Dale W. Player	Director	December 31, 2007
J. Dan Raines, Jr.	Director	December 31, 2009
Walter L. Schmidlen, Jr.	Director	December 31, 2008
Robert G. Sexton	Director	December 31, 2007
Kenneth A. Spearman	Director	December 31, 2009
Robert H. Spiers, Jr.	Director	December 31, 2009
William H. Voss	Director	December 31, 2010**

* *These directors were re-elected to a new 4-year term ending 12/31/10.*

** *These directors were newly elected in 2006 to 4-year terms commencing 1/1/07.*

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

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

William C. Bess, Jr., from Lincolnton, North Carolina, is co-owner of Farmers & Builders Supply Co., a retail farm equipment business, and serves as Secretary/Treasurer. In addition, he 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.

Robert A. Carson, a row crop farmer in the Mississippi Delta, is active in a number of agricultural organizations. He is a director of the Delta Council.

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.

Don W. Freeman of Montgomery, Alabama, manages a 400-acre cow-calf operation and a 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.

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.

Lyle Ray King of Ash, North Carolina, owns and operates a farm where he grows tobacco, 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.

Richard Kriebel is a contract farmer from Benton, Pennsylvania, raising contract vegetables, forage and grain. His cropland consists of owned-and-leased acres of corn, hay and vegetables. He is a director of AgChoice Farm Credit, ACA, and a former member of the Columbia County ASCS, Columbia County Extension and the Columbia County Planning Commission.

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

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

James L. May is owner and operator of Mayhaven Farm in Waynesburg, Kentucky, where he owns 250 acres and leases another 700 acres. He is involved in the development and marketing of 500 heifers for replacement cows and embryo transfer. May's operation also includes 150 acres of alfalfa hay, 500 acres of corn and soybeans, and 100 acres of wheat. He currently serves as a member of the Central Kentucky Ag Credit board, Lincoln County Extension Council, Lincoln County Ag Development Board, and is a member of the Lincoln County Farm Bureau.

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.

Katherine A. Pace, from Orlando, Florida, is a certified public accountant with 22 years in public accounting. She provides consulting services to family owned businesses through her company Family Business Consulting, LLC. Previously, she was a tax partner with KPMG, LLP, an audit, tax and advisory service firm, from 1985-2005 where 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. She is a member of the American Institute of Certified Public Accountants and currently serves on the boards of several charitable organizations as well as on an advisory board for a private for profit organization involved in agriculture.

Dale W. Player, from Bishopville, SC, is co-owner of a 1,850-acre row crop operation, with cotton being the primary crop. He is a director of ArborOne, ACA, member of the South Carolina Cotton Board of Directors, and director of the Carolinas Cotton Cooperative. He also serves as a delegate to the National Cotton Council and alternate director to the National Cotton Board.

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). He also serves as director and president of Raines Commercial Group, Inc., which is primarily engaged in employee leasing.

Walter L. Schmidlen, Jr., from Elkins, West Virginia, is a dairy and beef farmer. He is owner and operator of a farm machinery business and grows hay and corn on a 700-acre farm. 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.

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

Kenneth A. Spearman, from Winter Haven, Florida, currently serves as Director of Internal Audit for Florida's Natural Growers, Inc. Prior to this, he was Controller for Citrus Central, Inc. in Orlando, Florida from 1980-1991, and was co-founder of a public accounting firm in Chicago, Illinois after employment 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 also past National President.

Robert H. Spiers, Jr., is a full-time farmer, with a tobacco, peanut, soybean and cotton operation on 1,100 acres in Dinwiddie County, Virginia. He currently serves on the boards of Colonial Farm Credit, ACA, and Dinwiddie County Farm Bureau. He is also director and treasurer of the Old Hickory Hunt Club. He has been active in several farming organizations, including the Virginia Cotton Growers Association, Virginia Flue-Cured Tobacco Board and Virginia Farm Bureau.

William H. Voss, is from McComb, Mississippi. He owns a cattle and timber operation in Southwest Mississippi. He currently serves as Chairman of the Board of directors of First South Farm Credit, headquartered in Ridgeland, Miss., and is a member of the Pike County Economic Development District Board. Previously, Voss has served as chairman of the Mississippi Real Estate Commission and the Pike County Farm Service Committee.

Committees

The board has established an audit committee, compensation committee and governance committee. All members of the board, other than the chairman and vice chairman, serve on a committee.

Compensation of Directors

Directors were compensated in 2006 in cash at the rate of $40,332 per year, payable at $3,361.00 per month. This is compensation for attendance at board meetings, board committee meetings, certain other meetings pre-approved by the board, and other duties as assigned. FCA regulations also allow additional compensation to be paid to a director in exceptional circumstances where extraordinary time and effort are involved. Amounts paid in excess of $40,332 to board officers and board members represented compensation for service for Farm Credit Council (FCC) activities, including FCC board meetings, meetings with other district and national FCC representatives, congressional visitations, and other FCC board activities and issues. Total cash compensation paid to all directors as a group during 2006 was $902,640. Additional information for each director who served during 2006 is provided in the following table.

	Number of Days Served			
Name of Director	Board Meetings	Other Official Activities*	Farm Credit Council Bd. Activities	Total Comp. Paid During 2006
William C. Bess, Jr.	23	14.50	8.75	$ 45,132
Robert A. Carson	23	16.25	9.00	45,132
Henry M. Frazee	23	9.25	8.75	45,132
Don W. Freeman	23	13.25	8.75	45,132
Robert L. Holden, Sr.	20	13.00	8.75	45,132
Paul M. House	20	17.00	8.75	45,132
Thomas W. Kelly	23	14.00	8.75	45,132
Lyle Ray King	23	13.25	8.75	45,132
Richard Kriebel	20	17.00	8.75	45,132
M. Wayne Lambertson	17	13.00	8.75	45,132
Paul Lemoine	23	16.00	8.75	45,132
James L. May	23	17.25	8.75	45,132
Eugene W. Merritt, Jr.	23	23.25	8.75	45,132
Katherine A. Pace	23	16.25	8.75	45,132
Dale W. Player	20	15.75	6.00	45,132
J. Dan Raines, Jr.	21	10.00	8.75	45,132
Walter L. Schmidlen, Jr.	23	19.00	8.75	45,132
Robert G. Sexton	23	19.00	8.75	45,132
Kenneth A. Spearman	23	12.50	8.75	45,132
Robert H. Spiers, Jr.	23	15.50	8.75	45,132
Total				$ 902,640

* *Includes board committee meetings and board training.*

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 $258,943 for 2006, $202,283 for 2005, and $183,164 for 2004.

Transactions with Senior Officers and Directors

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 13 to the consolidated financial statements, *Related Party Transactions,* included in this annual report to shareholders.

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.

Relationship with Independent Auditors

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

Consolidated Financial Statements

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP, dated February 28, 2007, and the Report of Management, which appear in this annual report to shareholders are incorporated herein by reference.

Copies of AgFirst's annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 316, or writing Wanda Martin, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, ***www.agfirst.com***. AgFirst prepares a quarterly report within 45 days after the end of each fiscal quarter, except that no quarterly report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

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 2006, 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. 61 *(Communication With Audit Committees)*. 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 2006. The foregoing report is provided by the following independent directors, who constitute the Committee:

Robert G. Sexton
Chairman of the Audit Committee

Members of Audit Committee

Don W. Freeman
Richard Kriebel
Paul Lemoine
Katherine A. Pace
Walter L. Schmidlen, Jr.

February 28, 2007

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, 2006, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

February 28, 2007

Consolidated Balance Sheets

(dollars in thousands)	December 31, 2006	December 31, 2005	December 31, 2004
Assets			
Cash and cash equivalents	$ 582,764	$ 557,882	$ 470,258
Investment securities:			
Available for sale (amortized cost of $5,063,640 $3,888,889 and $3,268,041 respectively)	5,065,621	3,886,318	3,278,414
Held to maturity (fair value of $1,259,879 and $1,337,860 respectively)	1,293,061	1,369,427	—
Total Investment securities	6,358,682	5,255,745	3,278,414
Loans	17,152,337	14,411,050	12,908,249
Less: allowance for loan losses	463	10,114	14,800
Net loans	17,151,874	14,400,936	12,893,449
Accrued interest receivable	104,925	75,410	50,630
Investments in other Farm Credit System institutions	65,066	67,139	66,646
Premises and equipment, net	25,698	25,851	27,920
Due from associations	41,692	28,808	30,385
Other assets	81,463	71,260	69,821
Total assets	$ 24,412,164	$ 20,483,031	$ 16,887,523
Liabilities			
Bonds and notes	$ 22,613,379	$ 18,879,964	$ 15,402,385
Mandatorily redeemable preferred stock (Note 9)	225,000	225,000	225,000
Accrued interest and dividends payable	188,028	133,855	65,854
Patronage distribution payable	128,347	132,226	126,689
Postretirement benefits other than pensions	15,266	14,999	13,943
Other liabilities	61,057	59,559	29,356
Total liabilities	23,231,077	19,445,603	15,863,227
Commitments and contingencies (Note 15)			
Shareholders' Equity			
Perpetual preferred stock (Note 10)	150,000	150,000	150,000
Capital stock and participation certificates	313,353	224,554	226,200
Retained earnings	715,753	665,445	644,366
Accumulated other comprehensive income (loss)	1,981	(2,571)	3,730
Total shareholders' equity	1,181,087	1,037,428	1,024,296
Total liabilities and shareholders' equity	$ 24,412,164	$ 20,483,031	$ 16,887,523

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

Consolidated Statements of Income

(dollars in thousands)	For the year ended December 31, 2006	2005	2004
Interest Income			
Investment securities and other	$ 332,701	$ 167,728	$ 74,565
Loans	890,247	624,945	469,774
Total interest income	1,222,948	792,673	544,339
Interest Expense	995,436	588,472	332,744
Net interest income	227,512	204,201	211,595
Reversal of allowance for loan losses	(7,337)	(4,995)	(15,292)
Net interest income after reversal of allowance for loan losses	234,849	209,196	226,887
Noninterest Income			
Loan fees	6,262	11,441	11,751
Realized gains (losses) on investments, net	(5)	466	(17)
Realized gains on derivatives, net	6,812	94	96
Other noninterest income	6,229	4,748	6,191
Total noninterest income	19,298	16,749	18,021
Noninterest Expenses			
Salaries and employee benefits	26,318	27,957	26,172
Occupancy and equipment	11,608	11,108	9,823
Insurance fund premium	3,597	884	845
Other operating expenses	17,529	15,882	15,448
Intra-System financial assistance expenses	—	3,221	6,794
Called debt expense	2,563	656	3,360
Other noninterest expenses	2,339	1,978	2,160
Total noninterest expenses	63,954	61,686	64,602
Net income	$ 190,193	$ 164,259	$ 180,306

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	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at December 31, 2003	$ 150,000	$ 229,083	$ 601,699	$ (26,250)	$ 954,532
Comprehensive income					
Net income			180,306		180,306
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of $(17)				1,859	1,859
Change in fair value of derivative instruments, includes reclassification adjustments of $96				12,120	12,120
Minimum pension liability adjustment				16,001	16,001
Total comprehensive income					210,286
Capital stock/participation certificates issued/retired, net		(2,883)			(2,883)
Perpetual preferred stock dividends paid			(10,950)		(10,950)
Cash distributions declared			(126,689)		(126,689)
Balance at December 31, 2004	150,000	226,200	644,366	3,730	1,024,296
Comprehensive income					
Net income			164,259		164,259
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of $466				(12,944)	(12,944)
Change in fair value of derivative instruments, includes reclassification adjustments of $94				6,643	6,643
Total comprehensive income					157,958
Capital stock/participation certificates issued/retired, net		(1,646)			(1,646)
Perpetual preferred stock dividends paid			(10,950)		(10,950)
Cash distributions declared			(132,230)		(132,230)
Balance at December 31, 2005	150,000	224,554	665,445	(2,571)	1,037,428
Comprehensive income					
Net income			190,193		190,193
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of $(5)				4,552	4,552
Total comprehensive income					194,745
Capital stock/participation certificates issued/retired, net		88,304			88,304
Stock dividends declared/paid		495	(495)		—
Perpetual preferred stock dividends paid			(10,950)		(10,950)
Cash distributions declared			(128,440)		(128,440)
Balance at December 31, 2006	$ 150,000	$ 313,353	$ 715,753	$ 1,981	$ 1,181,087

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

Consolidated Statements of Cash Flow

(dollars in thousands)	For the year ended December 31, 2006	2005	2004
Cash flows from operating activities:			
Net income	$ 190,193	$ 164,259	$ 180,306
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	7,642	6,491	6,016
Provision for (reversal of allowance for) loan losses	(7,337)	(4,995)	(15,292)
Realized (gains) losses on investments, net	5	(466)	17
Realized (gains) losses on derivatives, net	(6,812)	(94)	(96)
Realized (gains) losses on mortgage loans held for sale	83	32	2,445
Realized (gains) losses on sales of servicing assets	—	(1,078)	—
Proceeds from sale of mortgage servicing assets	—	10,039	—
Purchases of mortgage loans held for sale (net of principal repayment)	—	(264,032)	(329,939)
Proceeds from sale of mortgage loans held for sale	10,807	6,664	255,951
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	(29,515)	(24,780)	(5,652)
(Increase) decrease in amortized discount on notes	13,374	4,321	(1,754)
(Increase) decrease in due from associations	(12,884)	1,577	9,454
(Increase) decrease in other assets	(8,650)	(10,541)	(8,958)
Increase (decrease) in accrued interest and dividend payable	54,173	68,001	13,830
Increase (decrease) in postretirement benefits other than pensions	267	1,056	2,255
Increase (decrease) in minimum pension liability	—	—	(8,751)
Increase (decrease) in other liabilities	17,085	2,396	(7,053)
Total adjustments	38,238	(205,409)	(87,527)
Net cash provided by (used in) operating activities	228,431	(41,150)	92,779
Cash flows from investing activities:			
Investment securities purchased	(3,252,552)	(4,118,358)	(4,091,449)
Investment securities sold or matured	2,154,162	2,128,549	3,647,593
Proceeds from sale of derivatives	6,812	—	—
Net (increase) decrease in loans	(2,754,573)	(1,244,133)	(465,088)
(Increase) decrease in investments in other Farm Credit System institutions	2,073	(493)	12,026
Purchase of premises and equipment, net	(7,489)	(4,422)	(8,941)
Net cash used in investing activities	(3,851,567)	(3,238,857)	(905,859)
Cash flows from financing activities:			
Bonds and notes issued	49,109,813	38,036,115	41,593,667
Bonds and notes retired	(45,406,904)	(34,529,195)	(40,674,312)
Capital stock and participation certificates issued/retired, net	88,304	(1,646)	(2,883)
Cash distributions to shareholders	(132,245)	(126,693)	(92,129)
Dividends paid on perpetual preferred stock	(10,950)	(10,950)	(10,950)
Net cash provided by financing activities	3,648,018	3,367,631	813,393
Net increase (decrease) in cash and cash equivalents	24,882	87,624	313
Cash and cash equivalents, beginning of period	557,882	470,258	469,945
Cash and cash equivalents, end of period	$ 582,764	$ 557,882	$ 470,258
Supplemental schedule of non-cash investing and financing activities:			
Change in unrealized gains (losses) on investments	$ 4,552	$ (12,944)	$ 1,859
Change in fair value of derivative instruments	—	6,643	12,120
Change in pension liability related to other comprehensive income	—	—	16,001
Non-cash changes related to hedging activities:			
Decrease (increase) in loans	$ 7	$ 55	$ (344)
Increase (decrease) in bonds and notes	17,132	(33,662)	(22,225)
Decrease (increase) in other assets	(1,553)	(937)	2,359
Increase (decrease) in other liabilities	(15,586)	27,807	8,090
Supplemental information:			
Interest paid	$ 941,263	$ 520,471	$ 318,914

The accompanying notes are an integral part of these 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. The System was established by Acts of Congress and is subject to the provisions of the Farm Credit Act of 1971, as amended (the Farm Credit Act).

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

Each FCB and the ACB serves one or more Production Credit Associations (PCAs) that originate and service short- and intermediate-term loans, Federal Land Credit Associations (FLCAs) that originate and service long-term real estate mortgage loans and/or Agricultural Credit Associations (ACAs) that originate both long-term and short- and intermediate-term loans. PCAs, FLCAs and ACAs are collectively referred to as associations. AgFirst and its related associations (Associations or District Associations) are collectively referred to as the District. The District Associations jointly own all of AgFirst's voting stock. As of December 31, 2006, the District consisted of the Bank and twenty-three District ACAs. All twenty-three are structured as holding companies, which include FLCA and PCA subsidiaries.

Each FCB and the ACB is responsible for supervising the activities of the Associations within its district. The FCBs and/or Associations make loans to or for the benefit of eligible borrowers/shareholders for qualified purposes. Funds for the FCBs and the ACB are raised principally through the sale of consolidated Systemwide bonds and notes to the public.

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

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

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

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

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

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

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

The Bank owns the Farm Credit Finance Corporation of Puerto Rico (the Finance Corporation). The Finance Corporation borrowed funds from the Bank and eligible funds from qualified companies doing business in Puerto Rico under Section 2(j) of the Puerto Rico Tax Incentive Act of 1987, as amended, or the Puerto Rico Tax Incentive Act of 1998, including corporations that had elections under Section 936 and 30(A) of the Internal Revenue Code of 1986, as amended (Code). The funds so 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 Bank, in conjunction with other System banks, jointly owns service organizations, which were created to provide a variety of services for the System:

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

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

Note 2 — Summary of Significant Accounting Policies

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

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

A. **Cash and Cash Equivalents:** Cash and Cash Equivalents include cash on hand and short-term investments with original maturities of three months or less.

B. **Investment Securities**: The Bank, as permitted under the FCA regulations, holds investments for purposes of maintaining a liquidity reserve, managing short-term surplus funds, managing interest rate risk and, in the case of certain Mission-Related Investments, to stimulate economic growth and development in rural areas. Investments are classified based on management's intention on the date of purchase and recorded on the consolidated balance sheets as securities as of the trade date. Investment securities which management has the intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost. Investment securities classified as available-for sale (AFS) are carried at fair market value with net unrealized gains and losses included in accumulated other comprehensive income (OCI).

   Interest on investment securities, including amortization of premiums and accretion of discounts, is included in Interest Income. Realized gains and losses from the sales of investment securities, which are included in Realized Gains/ (Losses) on Investments, Net, are determined using the specific identification method.

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

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

   Loans are carried at their principal amount outstanding less unearned income adjusted for Statement of Financial Accounting Standards (SFAS) No. 133 valuation adjustments, if any. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days or more (unless adequately secured and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is reversed (if accrued in the current year) and/or charged against the allowance for loan losses (if accrued in prior years).

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

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

   The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. A review of all individual loans in each respective portfolio is performed to determine the appropriateness of risk ratings and to assure loss exposure to the Bank has been identified. Capitalized participation pool loans 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 the loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss.

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

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

D. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. Depreciation is provided on the straight-line method over the estimated useful lives of the asset, 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. **Other Assets and Liabilities:** Direct expenses incurred in issuing debt and preferred stock are deferred and amortized using the straight-line method (which approximates the interest method) over the term of the related indebtedness and term of the preferred stock.

F. **Employee Benefit Plans:** Substantially all Bank employees may be eligible to participate in a districtwide defined benefit retirement plan (the Plan) within the District. The "Projected Unit Credit" actuarial method is used for financial reporting purposes. Based on the funded status at the Plan's measurement date (September 30) of the underlying Plan, the Bank may record a minimum liability, an intangible asset relating to unrecognized prior service cost and an adjustment to other comprehensive income (loss). 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. Pension costs are allocated by multiplying the District's net pension expense times each institution's salary expense as a percentage of the District's salary expense.

   Substantially all Bank employees are also eligible to participate in the thrift/deferred compensation plan (Thrift 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 total compensation. For employees hired 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. Thrift Plan costs are expensed as funded.

In addition to providing pension benefits, the Bank provides certain health care and life insurance benefits for retired employees (other postretirement benefits). 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 55 and 10 years of service. Employees hired after December 31, 2002 are required to pay the full cost of their retiree health insurance coverage.

The Bank also sponsors supplemental retirement and deferred compensation plans for certain key employees. The plans are nonqualified: therefore, the associated liabilities are included in the Bank's consolidated balance sheets in other liabilities.

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 manage interest rate risk on assets, liabilities and anticipated transactions. Derivatives are included in the consolidated balance sheets as assets and liabilities and reflected at fair value.

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

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

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

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

J. **Recent Accounting Developments:** In February 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments* (SFAS 155), an amendment of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133) and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SFAS 140.) This Statement resolves certain issues addressed in the implementation of SFAS 133 concerning beneficial interests in securitized financial assets. SFAS 155 permits fair value measurement for any hybrid financial instrument that contains an embedded derivative, clarifies which interest-only strips and principal-only strips are not subject to the requirement of SFAS 133, establishes a requirement to evaluate interests in securitized financial assets, clarifies the concentrations of credit risk, and eliminates the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument. The Statement is effective for all financial instruments acquired or issued in fiscal years beginning after September 15, 2006. The Bank is currently analyzing the impact of SFAS 155 on its financial statements. The adoption of this standard is not expected to have a material effect on the Bank's consolidated balance sheets or statements of income.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets* (SFAS 156), which amends the accounting for separately recognized servicing assets and servicing liabilities. SFAS 156 permits the choice of the amortization method or the fair value measurement method, with changes in fair value recorded in income, for the subsequent measurement for each class of separately recognized servicing assets and servicing liabilities. The Statement is effective for years beginning after September 15, 2006, with earlier adoption permitted. The Bank is currently analyzing the impact of SFAS 156 on its financial statements. The adoption of this standard is not expected to have a material effect on the Bank's consolidated balance sheets or statements of income.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which provides enhanced guidance for using fair value to measure assets and liabilities. The standard applies whenever other standards require or permit assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. Early adoption is permitted. The Bank is currently analyzing the impact of SFAS 157 on its financial statements.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS 158). SFAS 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 through comprehensive income changes in that funded status in the year in which the changes occur. The Bank and its related Associations will be required to implement SFAS 158 for the year ended December 31, 2007. In addition, SFAS 158 requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the Bank and its related Associations use a measurement date of September 30th. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. The Bank and its related Associations are currently evaluating the impact of implementing SFAS 158.

In February 2007, the FASB issued SFAS No. 159, *Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). The standard permits entities to choose on an instrument-by-instrument basis, at specified election dates, to measure eligible items at fair value (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected shall be reported in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. This standard is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Bank is currently analyzing the impact of implementing SFAS 159.

Note 3 — Refinement of the Allowance for Loan Losses Methodology

The Bank's allowance for loan losses methodology was adjusted and revised in the late 1980s to take into account unusually adverse economic factors affecting American agriculture. Subsequent estimates continued to reflect, to some extent, the loss history of the mid-to-late 1980s. Accordingly, the reserves provided in the mid-to-late 1980s, in effect, remained part of the allowance for loan losses.

The Bank's allowance for loan losses methodology has consistently adhered to proper accounting policies, under the regulatory supervision of the FCA in its role as a "safety and soundness" regulator. It was the FCA's view that the allowance for loan losses should include among others, an assessment of probable losses, economic conditions and historical loss experience keeping in mind the potentially long agricultural credit cycle.

In April 2004, the FCA issued an "Informational Memorandum" to System institutions regarding the criteria and methodologies that would be used in evaluating the adequacy of a System institution's allowance for loan losses. The FCA endorsed the direction provided by other bank regulators and the SEC and indicated the conceptual framework addressed in their guidance would be included as part of their examination process.

During 2004, the Bank completed a study to further refine its allowance for loan losses methodology taking into account recently issued guidance by the FCA, the System's regulator, as well as the Securities and Exchange Commission (SEC) and Federal Financial Institutions Examination Council guidelines. The refinement in methodology resulted in a calculated allowance for loan losses that was significantly less than the previously recorded balance due to revised loss factors that are more indicative of actual loss experience in recent years and current borrower analysis.

Note 4 — 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, 2006, 2005 and 2004, follows:

	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%

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

	December 31, 2004				
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Commercial Paper	$ 29,957	$ –	$ –	$ 29,957	2.35%
U.S. Govt. GNMA MBS/CMOs	1,079,707	3,047	(1,911)	1,080,843	2.47
U.S. Govt. Agency MBS	1,843,914	10,720	(1,486)	1,853,148	3.02
Non-Agency Securities	292,537	9	(1)	292,545	2.68
Asset-Backed Securities	21,926	3	(8)	21,921	2.60
Total	$ 3,268,041	$ 13,779	$ (3,406)	$ 3,278,414	2.80%

Held-to-maturity

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

	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%

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

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

The following table shows the fair value and gross unrealized losses for investments in a loss position aggregated by investment category at December 31, 2006. The unrealized losses on these investments resulted from interest rate volatility and are not credit related. AgFirst expects to recover substantially all of our cost in these investments.

	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	$ 165,458	$ 304	$ 317,958	$ 2,587
U.S. Govt. Agency MBS	1,005,039	3,534	1,410,461	36,327
Non-Agency Securities	449,162	499	–	–
Total	$ 1,619,659	$ 4,337	$ 1,728,419	$ 38,914

On December 31, 2006, 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 $38.9 million. Substantially all of these investments were in U. S. government agency securities and the Bank expects these securities would not be settled at a price less than their amortized cost. Because the decline in market value was caused by interest rate increases and not credit quality, and because the Bank has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, the Bank has not recognized any other-than-temporary impairment in connection with these investments.

A summary of the expected maturity, estimated fair value and amortized cost of investment securities at December 31, 2006 follows:

Available-for-sale

	Due in 1 year or less		Due after 1 year through 5 years		Due after 5 years through 10 years		Due after 10 years		Total	
(dollars in thousands)	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield
U.S. Govt. GNMA MBS/CMOs	$ –	– %	$ –	– %	$ –	– %	$ 1,267,914	5.43 %	$ 1,267,914	5.43 %
U.S. Govt. Agency MBS	363	4.80	6,438	4.37	26,808	5.71	2,716,376	5.59	2,749,985	5.59
Non-Agency Securities	–	–	–	–	–	–	776,534	5.77	776,534	5.77
Asset-Backed Securities	–	–	–	–	3,750	6.09	267,438	5.55	271,188	5.56
Total fair value	$ 363	4.80 %	$ 6,438	4.37 %	$ 30,558	5.76 %	$ 5,028,262	5.58 %	$ 5,065,621	5.58 %
Total amortized cost	$ 365		$ 6,481		$ 30,458		$ 5,026,336		$ 5,063,640	

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	$ –	– %	$ –	– %	$ –	– %	$ 1,269,048	5.23 %	$ 1,269,048	5.23 %
Other	–	–	–	–	–	–	24,013	7.45	24,013	7.45
Total amortized cost	$ –	– %	$ –	– %	$ –	– %	$ 1,293,061	5.28 %	$ 1,293,061	5.28 %
Total fair value	$ –		$ –		$ –		$ 1,259,879		$ 1,259,879	

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)	2006	2005	2004
Proceeds on sales	$ 54,834	$ 383,676	$ 197,340
Realized gains	–	908	6
Realized losses	5	442	23

Note 5 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31,		
(dollars in thousands)	2006	2005	2004
Direct notes receivable from District Associations	$ 13,877,142	$ 12,441,170	$ 11,229,197
Participations/Syndications, net	2,501,453	1,411,802	1,374,863
Mortgage loans purchased in the secondary market	771,982	555,421	302,226
SFAS No. 133 adjustment	–	7	63
Loans to Other Financing Institutions	1,760	2,650	1,900
Total	$ 17,152,337	$ 14,411,050	$ 12,908,249

A substantial portion of the Bank's loan portfolio consists of notes receivable from District Associations. As described in Note 1(B) — *Operations*, 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. While the amounts below represent the Associations' maximum potential credit risk as it relates to recorded loan principal, 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.

Total Association loans consisted of the following commodity types:

	Percent of Portfolio		
Commodity Group	**2006**	**2005**	**2004**
Forestry	14%	13%	12%
Poultry	13	14	13
Fruits/Vegetables	10	10	9
Cattle	8	9	9
Grain	7	7	8
Dairy	6	7	8
Nursery/Greenhouse	5	5	5
Processing	4	3	4
Rural Home	3	4	4
Tobacco	3	3	4
Swine	3	3	3
Cotton	3	3	3
Citrus	1	2	2
Other	20	17	16
Total	100%	100%	100%

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

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

	December 31,		
(dollars in thousands)	**2006**	**2005**	**2004**
Nonaccrual:			
Current as to principal and interest	$14,659	$18,448	$26,077
Past due	451	749	351
Accrual:			
Restructured	–	–	–
90 days or more past due	1,759	653	245
Total impaired loans	$16,869	$19,850	$26,673

The average recorded investment in impaired loans during 2006, 2005 and 2004 was $8.4 million, $20.4 million and $29.9 million, respectively. Impaired loans of $15.1 million, $19.2 million and $26.4 million at December 31, 2006, 2005 and 2004 had a specific allowance for loan losses totaling $0.5 million, $10.1 million and $14.8 million, respectively.

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2006.

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

	Year Ended December 31,		
(dollars in thousands)	**2006**	**2005**	**2004**
Balance at beginning of year	$ 10,114	$ 14,800	$ 34,168
Provision for (reversal of) loan losses	(7,337)	(4,995)	–
Nonrecurring reversal of allowance for loan losses*	–	–	(15,292)
Loans charged off	(2,314)	(54)	(4,098)
Recoveries	–	363	22
Balance at end of year	$ 463	$ 10,114	$ 14,800

* *Represents the amount of allowance reversal due to the refinement in methodology.*

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. The balance of loans under Long-Term Standby Commitments to Purchase was $226.8 million at December 31, 2006. Fees paid to Farmer Mac for such commitments are paid by the Associations. Fees paid to government sponsored enterprises (GSEs) other than Farmer Mac were $1.0 million, $581 thousand and $628 thousand for 2006, 2005 and 2004, respectively.

Note 6 — Premises and Equipment

Premises and equipment consisted of the following:

	December 31,		
(dollars in thousands)	**2006**	**2005**	**2004**
Land	$ 896	$ 896	$ 896
Buildings and improvements	5,871	5,853	5,707
Furniture and equipment	51,763	43,147	37,844
Work in progress	1,341	4,331	7,760
	59,871	54,227	52,207
Less: accumulated depreciation	34,173	28,376	24,287
Total	$ 25,698	$ 25,851	$ 27,920

Note 7 — Other Assets and Other Liabilities

A summary of other assets and other liabilities follows:

	December 31,		
	2006	**2005**	**2004**
Other assets:			
Unamortized debt issue costs	$ 15,098	$ 12,038	$ 9,054
Prepaid retirement expenses	21,301	24,664	23,259
Deferred issuance costs – preferred stock	2,017	2,701	3,385
Derivative assets	3,615	2,066	1,125
Receivable from third party sub-servicer	8,495	6,128	–
Receivables and other	30,937	23,663	32,998
Total	$ 81,463	$ 71,260	$ 69,821
Other liabilities:			
Accounts payable	$ 2,513	$ 2,717	$ 3,030
Farm Credit System Ins. Corp. payable	24,613	7,475	7,058
Derivative liabilities	23,514	39,100	11,278
Other	10,417	10,267	7,990
Total	$ 61,057	$ 59,559	$ 29,356

Note 8 — Bonds and Notes

The System, unlike commercial banks and other depository institutions, obtains funds for its lending operations primarily from the sale of Systemwide Debt Securities issued by the banks through the Funding Corporation. Certain conditions must be met before AgFirst can participate in the issuance of Systemwide Debt Securities. As one condition of participation, AgFirst is required by the Farm Credit Act and FCA regulations to maintain specified eligible assets, at least equal in value to the total amount of debt obligations outstanding for which it is primarily liable. This requirement does not provide holders of Systemwide Debt Securities with a security interest in any assets of the banks. In 1994, the System banks and the Funding Corporation entered into the Market Access Agreement (MAA), which established 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, 2006, 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.

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

	Bonds		Medium-Term Notes		Discount Notes		Total	
Maturities	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate
				(dollars in thousands)				
2007	$ 7,041,289	4.65%	$ –	–%	$ 2,586,284	5.12%	$ 9,627,573	4.78%
2008	4,539,046	4.64	–	–	–	–	4,539,046	4.64
2009	2,329,510	4.61	–	–	–	–	2,329,510	4.61
2010	1,255,027	4.76	–	–	–	–	1,255,027	4.76
2011	1,003,414	5.00	–	–	–	–	1,003,414	5.00
2012	3,858,809	5.52	–	–	–	–	3,858,809	5.52
Total	$ 20,027,095	4.84%	$ –	–%	$ 2,586,284	5.12%	$ 22,613,379	4.87%

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, 2006, was 71 days.

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

Amount	First Call Date	Year of Maturity
(dollars in thousands)		
$ 9,684,000	2007	2007-2020
18,000	2008	2015-2020
160,000	2009	2013-2021
2,000	2010	2012
25,000	2011	2013-2016
$ 9,889,000		

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, 2006 the assets of the Insurance Fund aggregated $2.31 billion; however, due to the other authorized uses of the Insurance Fund there is no assurance that any available amount in the Insurance Fund will be sufficient to fund the timely payment of principal or interest on an insured debt obligation in the event of a default by any System bank having primary liability thereon. Amounts available in the Insurance Fund were used in June 2005 to repay the Financial Assistance Corporation debt issued to fund the purchase of $374 million of Federal Land Bank of Jackson preferred stock.

Note 9 — Mandatorily Redeemable Preferred Stock

As of December 31, 2006, AgFirst had 225 thousand shares issued and outstanding of Mandatorily Redeemable Cumulative Preferred Stock at a par value of $1 thousand per share that is redeemable on December 15, 2016. Dividends on the preferred stock are payable semi-annually in arrears on the 15th day of June and December of each year at an annual rate equal to 8.393 percent of the $1 thousand per share par value. Beginning March 15, 2012, the rate will change to a floating rate indexed to the 3-month LIBOR. On or after the dividend payment date in December 15, 2011, the preferred stock will be redeemable in whole or in part at the option of the Bank on any dividend payment date at its par value of $1 thousand per share together with accrued and unpaid dividends to the redemption date. Beginning in July 1, 2003, the Mandatorily Redeemable Preferred Stock was required to be reported prospectively as a liability and the related dividends reported prospectively as interest expense in accordance with SFAS No. 150. Although the Mandatorily Redeemable Preferred Stock is required to be reported as a liability under GAAP, it qualifies as capital for certain regulatory purposes.

Note 10 — 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, 2006:

		Shares Outstanding (dollars in thousands)	
Class	Protected Status	Number	Aggregate Par Value
B Common/Nonvoting	No	1,920,800	$ 9,604
C Common/Voting	No	59,117,437	295,588
D Common/Nonvoting	No	1,609,483	8,047
Participation Certificates/Nonvoting	No	22,880	114
Total Capital Stock and Participation Certificates		62,670,600	$ 313,353

B. **Perpetual Preferred Stock:** On October 14, 2003, AgFirst issued 150 thousand shares of Perpetual Non-Cumulative Preferred Stock. Dividends on the stock are payable 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 and after the dividend payment date in December 2008, the Bank 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.

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

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

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

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

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

E. **Regulatory Capitalization Requirements and Restrictions:** FCA's capital adequacy regulations require the Bank to achieve permanent capital of seven percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the seven percent capital requirement can initiate certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Bank's consolidated financial statements. The Bank is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless the prescribed capital standard is met. FCA Regulations also require all System institutions to achieve and maintain additional capital adequacy ratios as defined by FCA Regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of seven percent and core surplus as a percentage of risk-adjusted assets of three and one-half percent. The Bank's permanent capital, total surplus and core surplus ratios at December 31, 2006 were 19.19 percent, 19.14 percent and 11.46 percent, respectively.

Capital adequacy is also evaluated using a ratio of net collateral to total liabilities. Subsequent to the issuance of the 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, 2006, the Bank's net collateral ratio was 105.28 percent.

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

F. **Accumulated Other Comprehensive Income (Loss):** Accumulated other comprehensive income (loss) at December 31, 2006, 2005 and 2004 was comprised of the following components:

(dollars in thousands)	2006	2005	2004
Unrealized gains (losses) on investments available-for-sale	$ 1,981	$ (2,571)	$ 10,373
Unrealized (losses) on cash flow hedges	–	–	(6,643)
Total	$ 1,981	$ (2,571)	$ 3,730

Note 11 — Employee Benefit Plans

The employees of the Bank may participate in a Districtwide defined benefit retirement plan. This plan is noncontributory and covers most Bank employees. For participants hired prior to January 1, 2003, benefits are based on eligible compensation and years of service. The assets, liabilities and costs of the plan are not segregated by participating entities but are allocated among the participating entities. Pension costs are allocated by multiplying the District's net pension expense times each institution's salary expense as a percentage of the District's salary expense. 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 measurement date for the plan is September 30.

The Bank also sponsors supplemental retirement and deferred compensation plans for certain key employees. The plans are nonqualified; therefore, the associated liabilities are included in the Bank's consolidated balance sheets in other liabilities. The expenses of these plans included in the Bank's retirement costs were $33 thousand, $237 thousand and $283 thousand for the years ended December 31, 2006, 2005 and 2004, respectively.

The Bank also participates in a Districtwide Thrift Plan, which qualifies as a 401(k) plan as defined by 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 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.

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

In addition to providing pension benefits, the Bank provides certain health care and life insurance benefits for the retired employees (other postretirement benefits). Substantially all 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 55 and 10 years of service. Employees hired after December 31, 2002 are required to pay the full cost of their retiree health insurance coverage.

For further information on postretirement costs, see "Postretirement Benefits" section in the Notes to the Combined Financial Statements for AgFirst Farm Credit Bank and District Associations 2006 Annual Report.

The following is a table of retirement and postretirement benefit expenses:

(dollars in thousands)	2006	2005	2004
Pension	$ 3,784	$ 3,614	$ 3,858
Thrift/deferred compensation	578	820	500
Other postretirement benefits	1,109	1,991	2,631
Total	$ 5,471	$ 6,425	$ 6,989

Note 12 — Intra-System Financial Assistance

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

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

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

Note 13 — Related Party Transactions

As discussed in Note 1, the Bank lends funds to the District Associations to fund their loan portfolios. Further disclosure regarding these related party transactions is found in Notes 5, 10 and 15.

Interest income recognized on direct notes receivable from District Associations was $729.1 million, $532.6 million and $400.2 million for 2006, 2005 and 2004, respectively.

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

Note 14 — Regulatory Enforcement Matters

At December 31, 2006, there were no regulatory enforcement matters or agreements in place with the FCA.

Note 15 — 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 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, 2006, were $133.63 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.

Standby letters of credit are unconditional commitments issued by the Bank to guarantee the performance of a customer to a third party. As of December 31, 2006, the Bank had $38.5 million letters of credit issued on behalf of Association customers. Of the outstanding amount, $4.8 million will expire in less than one year, $7.7 million are due to expire in one to three years, $11.1 million are due to expire in three to five years and the remaining $14.8 million have terms that will expire in 2013.

In addition, the Bank had $120.6 million in letters of credit issued on behalf of non-district entities with $18.0 million expiring in less than one year, $40.2 million due to expire in one to three years, $61.1 million expiring in three to five years and the remaining $1.3 million have terms that will expire from 2012 to 2015.

The Bank also guarantees certain loans held by District Associations in the amount of $97.1 million with $92.5 million expiring in less than one year and the remaining $4.6 million will expire in 2016. The notional amounts of these guarantees represent the maximum amount of exposure the Bank has related to these instruments as of December 31, 2006.

At December 31, 2006, $3.15 billion of commitments to extend credit were outstanding. Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these financial instruments have off-balance-sheet credit risk because their amounts could be drawn upon at the option of the borrower. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and the same credit policies are applied by management. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the loan collateral is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

As of December 31, 2006, AgFirst also indemnifies leases in the amount of $2.2 million on behalf of the Farm Credit Leasing Services Corporation (FCLSC) with lease terms expiring in 2009.

Other 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 other actions, would not be material in relation to the financial position of the Bank.

Note 16 — 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, 2006, 2005 and 2004. The fair value of a financial instrument is generally defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Quoted market prices are generally not available for certain System financial instruments, as described in the following table. 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.

(dollars in thousands)	December 31, 2006 Carrying Amount	December 31, 2006 Estimated Fair Value	December 31, 2005 Carrying Amount	December 31, 2005 Estimated Fair Value	December 31, 2004 Carrying Amount	December 31, 2004 Estimated Fair Value
Financial assets:						
Loans	$ 17,152,337	$ 17,040,739	$ 14,411,050	$ 14,270,616	$ 12,908,249	$ 12,519,613
Allowance for loan losses	(463)	–	(10,114)	–	(14,800)	–
Loans, net	$ 17,151,874	$ 17,040,739	$ 14,400,936	$ 14,270,616	$ 12,893,449	$ 12,519,613
Derivative assets	$ 3,615	$ 3,615	$ 2,066	$ 2,066	$ 1,125	$ 1,125
Cash and cash equivalents	$ 582,764	$ 582,764	$ 557,882	$ 557,882	$ 470,258	$ 470,258
Investment securities	$ 6,358,682	$ 6,325,500	$ 5,255,745	$ 5,224,178	$ 3,278,414	$ 3,278,414
Financial liabilities:						
Systemwide Debt Securities	$ 22,613,379	$ 22,531,191	$ 18,879,964	$ 18,753,747	$ 15,402,385	$ 15,206,435
Derivative liabilities	$ 23,514	$ 23,514	$ 39,100	$ 39,100	$ 11,278	$ 11,278

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

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

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

B. **Cash, Federal Funds and Securities Purchased Under Resale Agreements:** The carrying value is a reasonable estimate of fair value.

C. **Investment Securities:** Fair value is based upon currently quoted market prices.

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

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

Note 17 — Derivative Instruments and Hedging Activities

The Bank maintains an overall interest rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. 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, 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 options such as caps, in order to reduce the impact of rising interest rates on its floating-rate debt, and floors, in order to reduce the impact of falling interest rates on its floating-rate assets.

By using derivative instruments, the 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 of $3.6 million with nine counterparties represents approximately 0.20 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, 2006, the Bank had not posted collateral with respect to these arrangements.

Note 18 — 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, 2006 *(dollars in millions)*	Maturities of 2006 Derivative Products and Other Financial Instruments 2007	2008	2009	2010	2011	After 2012	Total	Fair Value
Systemwide Debt Securities:								
Fixed rate	$ 6,008	$ 2,623	$ 2,113	$ 1,155	$ 1,001	$ 3,858	$ 16,758	$ 16,650
Weighted average interest rate	4.51%	4.20%	4.54%	4.72%	5.00%	5.52%	4.75%	
Variable rate	3,620	1,916	216	100	2	1	5,855	5,881
Weighted average interest rate	5.23%	5.23%	5.28%	5.26%	5.19%	5.19%	5.23%	
Derivative Instruments:								
Receive fixed swaps								
Notional value	$ 350	$ 465	$ 550	$ –	$ 200	$ 200	$ 1,765	$ (20)
Weighted average receive rate	2.99%	3.72%	4.22%	–	5.22%	5.10%	4.06%	
Weighted average pay rate	4.86%	4.73%	4.84%	–	4.98%	4.93%	4.84%	
Total notional value	$ 350	$ 465	$ 550	$ –	$ 200	$ 200	$ 1,765	$ (20)
Total weighted average rates on swaps:								
Receive rate	2.99%	3.72%	4.22%	–	5.22%	5.10%	4.06%	
Pay rate	4.86%	4.73%	4.84%	–	4.98%	4.93%	4.84%	

Note 19 — Quarterly Financial Information (Unaudited)

Quarterly results of operations for the years ended December 31, 2006, 2005 and 2004 follow:

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

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

	2004 First	Second	Third	Fourth	Total
Net interest income	$ 54,801	$ 54,781	$ 53,340	$ 48,673	$ 211,595
Provision for (reversal of allowance for) loan losses	–	–	–	(15,292)	(15,292)
Noninterest income (expense), net	(7,948)	(11,625)	(12,987)	(14,021)	(46,581)
Net income	$ 46,853	$ 43,156	$ 40,353	$ 49,944	$ 180,306

Management

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

Thomas S. Welsh ....Executive Vice President, Chief Administrative & Legislative Officer & Corporate Secretary

Leon T. Amerson ....Executive Vice President, Chief Operating Officer & Chief Financial Officer

Benjamin F. Blakewood.................Senior Vice President & Technology & Operations Officer

William L. Melton......................Senior Vice President & Chief Lending Officer

Frederick T. Mickler, III.................Senior Vice President & General Counsel

Board of Directors as of January 1, 2007

Thomas W. Kelly.......................Chariman

Paul M. House.........................Vice Chairman

William C. Bess, Jr.....................Director

Henry M. "Buddy" Frazee..............Director

Don W. Freeman.......................Director

Robert L. Holden, Sr...................Director

Lyle Ray King ....Director

Richard Kriebel........................Director

M. Wayne Lambertson.................Director

Paul Lemoine..........................Director

James L. May..........................Director

Eugene W. Merritt, Jr...................Director

Katherine A. Pace......................Director

Dale W. Player.........................Director

J. Dan Raines, Jr. ....Director

Walter L. Schmidlen Jr. ....Director

Robert G. Sexton.......................Director

Kenneth A. Spearman ....Director

Robert H. Spiers, Jr. ....Director

William H. Voss ....Director

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