

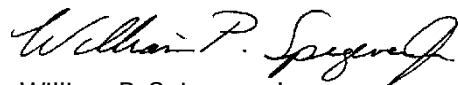
# **SECOND QUARTER 2010**

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## **CERTIFICATION**

The undersigned certify that we have reviewed the June 30, 2010 quarterly report of AgSouth Farm Credit, ACA, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.



William P. Spigener, Jr.  
Chief Executive Officer



Alisa D. Gunter  
Chief Financial Officer



A. Harvey Lemmon  
Chairman of the Board

August 6, 2010

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*AgSouth Farm Credit, ACA*

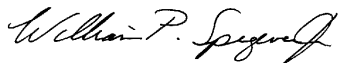
# Report on Internal Control Over Financial Reporting

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

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

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of June 30, 2010. In making the assessment, management used the framework in *Internal Control — Integrated Framework*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association concluded that as of June 30, 2010, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of June 30, 2010.



William P. Spigener  
Chief Executive Officer



Alisa D. Gunter  
Chief Financial Officer

August 6, 2010

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

*(dollars in thousands)*

The following commentary reviews the financial condition and results of operations of AgSouth Farm Credit, ACA (Association) for the period ended June 30, 2010. This information should be read in conjunction with the accompanying financial statements, notes to the financial statements, and the 2009 Annual Report of AgSouth Farm Credit. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

## **FORWARD LOOKING INFORMATION**

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

## **LOAN PORTFOLIO**

The Association provides funds to farmers, rural homeowners and farm-related businesses for financing of short and

intermediate-term loans and long-term real estate mortgage loans. The Association's loan portfolio is diversified over a wide range of agricultural commodities produced in our region, including poultry (broilers, turkeys and eggs), timber, field crops and grains, cotton, horses, and beef cattle. Loans to producers of these commodities total \$1,197,631 or 77.39 percent of the Association's portfolio. Farm size varies, and many of the Association customers have diversified farming operations. These factors, along with the numerous opportunities for non-farm income in the area, reduce to some degree the level of income dependency on any given commodity.

During the second quarter of 2010 the Association originated \$23,106 in loans for the secondary market. Originations at the same period 2009 were \$27,116. The 14.80 percent decrease is the result of the lack of buyers in the real estate market and economic pessimism. Rates continue to remain low and active marketing efforts are generating some business in most areas of the territory. As of June 30, 2010, the Association held \$689 in qualifying loans for sale.

## **Georgia Region**

The economy in the state of Georgia is beginning to show some modest signs of improvement. Since peaking in March 2010 at 10.5 percent, the unemployment rate has declined the first two months of the second quarter dropping to 10.3 percent in April and 10.2 percent in May. The improvement in home sales and building permits has slowed in the second quarter; however, both remain up relative to 2009. According to Kennesaw State University College of Business, Georgia's Purchasing Managers Index (PMI), a reading of economic activity in the state's manufacturing sector, May was 63.2, down just 0.1 from April's reading of 63.3, marking the index's first slip in the last five months. A PMI index above 50 generally indicates economic expansion. The May PMI, 7.2 points above the index's six-month average, shows that the number of manufacturers experiencing improved market conditions remains high and sustainable.

The agricultural sector in Georgia remains fairly positive with many commodities continuing to post favorable price outlooks. The poultry industry has seen significant improvement with egg sets for broiler production increasing. Several integrators within the region have announced plans to increase production and add additional growers/houses. All integrators are producing strong bottom line results at this time. The Pilgrim's Pride plant in Douglas, Georgia, which

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closed in May 2009, has been confirmed by the company to be reopening by January 2011. The process of re-establishing their shut down grower operations is presently underway, and we expect many to be receiving new flocks of birds by October. This will allow an upgrade in the classification of much of our Pilgrim's grower portfolio by year end.

The Vidalia onion crop is expected to produce very good results in 2010 as prices remained strong all season with generally fair to good yields. The 2010 blueberry crop may produce mixed results as market price for fresh berries dropped rather quickly as a substantial portion of the southeastern United States crop matured at approximately the same time from Florida to North Carolina. Cotton prices for 2010 remain favorable and acreage has increased this year over last. Other row crops appear to be in fairly good condition at the end of the second quarter with adequate rain over most of our service area through the present. Timber and forest products, while experiencing good price increases in March and April, have now fallen back, losing almost all price gains from earlier this year. The slow housing market continues to depress lumber and other building materials prices.

Loan activity has remained strong in the Georgia region. Commercial banks, for the most part, are still not lending very aggressively. This has increased our loan demand. Commercial banks in Georgia are still trying to recover from the melt down in both housing and much of their commercial loan portfolios. The number of commercial banks in Georgia has fallen from 334 in 2008 to 299 at the end of first quarter 2010. Most were forced into merger, sale, or closure by the FDIC due to failure to meet regulatory requirements.

In general, the agriculture dependant portfolio is on track to have another good year in 2010; however, there is plenty of time and challenges left to affect those final results. The general economy is showing some limited signs of improvement. This is encouraging for the non-ag dependent portion of the portfolio. We do expect some additional loans to deteriorate as we move into the third and fourth quarters; however, we hope to begin resolving many of those loans already classified, as well as, disposing of acquired properties. This will result in an overall improvement in credit quality by year end.

### **South Carolina Region**

As the second quarter of 2010 ended in South Carolina, the state's general economy remains weak even though there are some signs of improvement compared to the recent past. After unemployment peaked at 12.5 percent in January, the state's unemployment rate decreased to 11 percent as of May month end. The May unemployment level within the state continues to significantly trail the national unemployment rate of 9.7 percent.

Foreclosures within the state as of mid-second quarter have not improved as the number of distressed home loans increased by 31.4 percent in May 2010 compared to May 2009.

Housing permits year to date as of May month end compare favorably to the same time frame in 2009 with an increase of 1,130 permits, an 18.8 percent increase. Permits issued in May 2010 increased 6.0 percent compared to those issued in May 2009. Building permits remain weak compared to historical highs a few years back; however, improvement is noted over the past year.

Compared to the general economy within the state, the agricultural outlook remains relatively stable. The quarter started off with adequate moisture noted throughout most of the state as plantings were initiated and as most crop plantings concluded. As late spring and early summer approached, rainfall was insufficient to counter the extreme heat experienced in virtually all areas of the state. Fortunately, late second quarter thunderstorms continue to bring timely rain to many areas, but the excessive heat demands the need for frequent rainfall. Where rainfall is not as timely, crops are beginning to show stress.

Some corn on dry land is struggling as it is in the dough stage at quarter-end. Current corn reports indicate 79 percent of the crop is in fair to excellent condition with the majority of the crop in merely fair condition. A little more than one third of the cotton in the state has squared, but 96 percent of the state's cotton is rated fair or better at this stage. Just over one quarter of the state's peanuts are pegged, and the peanut condition has deteriorated due to moisture and excessive heat but still can be considered in good condition. Almost all the soybean plantings are completed, and about 87 percent of the crop has now emerged. Like other field crops, soybeans are in need of moisture at this time. The soybean crop continues to be rated 92 percent fair or better at this point in the growth cycle. Virtually all small grains have been harvested. Much of the wheat and oat crop are in storage to be marketed to end users as mills and livestock users are buying primarily on an as needed basis to avoid huge inventory investments. Prices for virtually all field crops remain at reasonably attractive levels.

A small portion of the region's financing is oriented toward vegetables and fruits, but tomato and cucumber harvests are progressing well. Prices for tomatoes remain depressed as of the end of June 2010. Approximately one third of the state's peaches are harvested at quarter-end, and despite declining conditions, the peach crop is considered to be mostly fair to excellent. Melons are about 50 percent harvested and prices are weak due to a large supply at quarter-end.

High temperatures are having a negative impact on both livestock and pastures within the state, which has become a challenge each summer in South Carolina. Only 29 percent of the pasture and hay within the state is rated good or better.

One of the largest commodity concentrations for AgSouth within South Carolina remains poultry, with the biggest component consisting of broilers. Recent feedback indicates some grower expansion is being considered by a few integrators based primarily on changes in bird size as larger birds continue to be the trend. Some producers are having to upgrade their older houses. Some expansion and improvement financing has been evident recently as it relates to the state's turkey houses, and this financing has been supplied using USDA guarantees to reduce risk.

The largest commodity concentration within the state continues to be the forestry industry. With above average rainfall during the first quarter and early second quarter throughout most of the southeast, prices for virtually all timber products improved and pine pulpwood prices improved significantly for a short time. The projections for pulpwood now are focused on modest but steady growth for the next few quarters. Prospects for sawtimber are much less evident. Processing units projected much improved earnings during late first quarter and throughout the second quarter, but again, the sustainability of this income is an unknown given housing data recently released.

Real estate financing within the region has slowed as the number of sales have remained minimal. Some deterioration in land values can be noted, but the reduced number of sales does not allow for a good indication of the overall valuation of real estate within the region. As has been the case historically, land values vary substantially from area to area within the state and smaller tracts continue to hold value better than larger parcels. Since a large percentage of historical financing within South Carolina has focused on real estate acquisitions, refinances, and improvement financing on tracts, real estate values will be monitored closely over the coming months to determine the impact upon the region's loan growth on a forward looking basis.

Delinquencies have increased slightly and nonearning assets remain at much higher levels since the economy has weakened beginning in 2008. In most cases, where performance has deteriorated, decreased non-farm income and the inability to sell capital assets has been noted.

## **ASSOCIATION BALANCE SHEET**

The gross loan volume of the Association as of June 30, 2010, was \$1,547,611, an increase of \$43,816 or 2.91 percent as compared to \$1,503,794 at December 31, 2009. Net loans outstanding at June 30, 2010 were \$1,536,958 as compared to \$1,494,297 at December 31, 2009. Net loans accounted for

94.17 percent of total assets at June 30, 2010, as compared to 93.74 percent of total assets at December 31, 2009.

The increase in gross and net loan volume during the reporting period is attributed to advances on operating lines during the growing season and some additional loan volume gained from commercial banks. Commercial banks have been less aggressive in the agricultural market due to capital constraints and other collection issues within their core portfolios. The Association has had some success in obtaining new, quality business from those in the marketplace looking for another lender.

At December 31, 2009, the Association held Investment securities totaling \$4,583. These investments are Rural America bonds made under the authority for Mission Related Investments granted by the Farm Credit Administration. At June 30, 2010, Investment securities totaled \$11,981, an increase of \$ 7,398. During the first quarter of 2010, the Association made a significant investment in a bond for the construction of the Range Fuels plant in Soperton, Georgia.

The Association typically structures loans to meet the needs of the borrower. Many term loans are made for ten years or less allowing the borrower to build equity faster and thus reducing the risk in the loan portfolio.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level and credit administration remains satisfactory. Nonaccrual loans increased from \$35,606 at December 31, 2009, to \$43,307 at June 30, 2010. This increase is the result of transfers to nonaccrual status exceeding payments and payoffs on existing nonaccrual accounts and includes several accounts in excess of \$1,000. The increase in nonaccrual loans can, in some instances, be tied to the general economy. Association staff is working diligently to work out this and all other nonaccrual debt situations.

Other property owned increased to \$4,409 at June 30, 2010 from \$3,489 at December 31, 2009. The increase in other property owned is the result of the acquisition of several pieces of property taken during the reporting period. Additional acquisitions are expected as nonearning assets work through the collection process. The Association is actively marketing all properties for sale. For details, please visit our website at [www.agsouthfc.com/classifieds](http://www.agsouthfc.com/classifieds).

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions. The allowance for loan losses at June 30, 2010, was \$10,653 compared to \$9,497 at December 31, 2009, and was considered by management to be adequate to cover possible losses. The increase in the allowance account came as an addition to the provision and exceeded loan charge-offs

and recoveries during the reporting period. The Asset/Liability Committee (ALCO) of the Association, which is comprised of members of senior management, corporate lenders, and staff assigned to special assets management, met in June to review the allowance account. The ALCO determined that an addition to the allowance account was needed. The Association funded the allowance through the provision for loan loss in the amount of \$1,482.

Premises and equipment, net decreased \$57 from \$15,108 at December 31, 2009 to \$15,051 at June 30, 2010. The building projects the Association had in progress in 2009 are complete and no new initiatives have begun at this point.

## RESULTS OF OPERATIONS

### *For the three months ended June 30, 2010*

Net income for the three months ended June 30, 2010, totaled \$9,218 as compared to \$5,713 for the same period in 2009. This is an increase of \$3,505 or 61.35 percent. The commentary below explains the positive variance.

Net interest income before the provision for loan loss increased \$826 for the three months ended June 30, 2010, as compared to the same period in 2009 due primarily to the increase in margin on new and existing loan volume. Net interest income after the provision for loan losses increased \$1,216 in the quarter ending June 30, 2010.

The provision for loan loss was \$1,872 in the quarter ending June 30, 2009 as compared to \$1,482 for the quarter ending June 30, 2010. The Association's ALCO made the decision that a provision entry was needed after analyzing the risk in the current portfolio. The analysis included reviewing historical trends, loan size, loan performance and credit quality reports.

At June 30, 2010, interest income on loans increased \$843 compared to the same period in 2009. The increase was due to the increase in investment interest income and an increase in interest income on loans. During the quarter ending June 30, 2009, the Association did not have any investment interest income compared to the same period in 2010 where the Association earned \$187 in investment interest income. The investment interest income is generated from several Rural America Bonds made under the Farm Credit Administration's (FCA) Mission Related Investment Program. Also, the Association had an increase in nonaccrual income between the two reporting periods. Nonaccrual income, which is included in interest income, was \$166 for the three months ended June 30, 2010, as compared to \$26 for the same period in 2009. The remainder of the increase is the result of an increase in interest income on notes and loans receivable held in the portfolio.

Interest expense increased \$17 for the three months ended June 30, 2010. The increase is tied to the slight increase in the notes payable balance.

Noninterest income increased \$911 over the same period last year. Loan fees increased \$21 or 2.26 percent. The increase in loan fees is due to late charges, servicing fees on loans sold to AgFirst Farm Credit Bank and other associations, and servicing fees on loans sold in the secondary mortgage market. Fees for financially related services increased \$30 from \$63 at June 30, 2009 compared to \$93 at June 30, 2010. The equity in earnings from other Farm Credit institutions increased \$685 from \$3,131 at June 30, 2009 to \$3,816 at June 30, 2010. This is an increase of 21.88 percent. In June, 2010, AgFirst made a special patronage distribution of \$824 due to their earnings year-to-date in 2010. No such distribution was paid in the same period of 2009. The special distribution should be considered as nonrecurring.

In the three months ending June 30, 2009, the Association experienced losses on the sale of Other Property Owned in the amount of \$64. During the same period of 2010, the Association booked gains on the sale of Other Property Owned of \$45. The gain was an accumulation of several small gains on sales of properties taken during the foreclosure process.

Gains on the sale of rural home loans increased \$28 from \$335 at June 30, 2009 compared to \$363 at June 30, 2010. The increase in gains is the result of the increased activity in the housing market as mortgage rates hit new lows during the second quarter of 2010. Other noninterest income increased \$39 from \$167 at June 30, 2009 compared to \$206 at June 30, 2010. Other noninterest income includes the Association's investment in a long-term deferred compensation account maintained for certain key employees and previous retirees and other miscellaneous income.

Noninterest expense for the three months ended June 30, 2010, decreased \$1,415 or 15.51 percent when compared to the same period of 2009. Salaries and employee benefit expense decreased \$899 between the two reporting periods. The decrease in salaries and employee benefits is tied to an increase in deferred costs for loans made during the reporting periods. Some direct costs associated with making loans are deferred under guidelines of ASC 310-20 (previously FAS 91). Deferred costs reduce salary and employee benefit expenses. The deferred amount increased in the 2010 reporting period when compared to the 2009 reporting period.

The Association booked an accrual for the 2010 incentive payment based upon plan results. The Association evaluated 2010 performance measures for incentive purposes and determined that some employees would earn incentive in 2010. Based upon this information, the Association accrued \$1,041 in incentive in June 2010. The incentive accrual is included in Salary and Benefits.

Occupancy and equipment expense at June 30, 2010 was \$555 compared to \$511 for the same period in 2009. The increase is from the normal cost of operations and some timing differences as it relates to maintenance issues.

The Insurance Fund premium decreased \$572 from \$588 at June 30, 2009 to \$16 at June 30, 2010. In June 2010, the FCSIC Insurance board elected to change the premium charged on accruing loans to 5 basis points. This change was retroactive to January 2010. As a result of this change all year-to-date expense was reversed in June and the three months of expense booked.

Other operating expenses increased \$12 from June 30, 2009, \$1,066 compared to \$1,078 at June 30, 2010. Other operating expenses includes travel, communications, advertising, public and member relations, training and all other expenses necessary to run the business.

### ***For the six months ended June 30, 2010***

Net income for the six months ended June 30, 2010, totaled \$18,974 as compared to \$13,615 for the same period in 2009. This is an increase of \$5,359 or 39.36 percent. The following narrative will explain the positive variance.

Net interest income before the provision for loan loss increased \$1,957 for the six months ended June 30, 2010, as compared to the same period in 2009 due primarily to the increase in margin on new volume and focused repricing efforts on existing loan volume. Net interest income after the provision for loan losses increased \$1,508 in the period ending June 30, 2010. This increase is the result of focused repricing efforts and a slightly higher provision expense between the two reporting periods.

The provision amounts are \$2,964 and \$2,515 for the June 30, 2010 and 2009 periods, respectively. In June 2010, the Association's ALCO made the decision that a provision entry was needed after analyzing the risk in the current portfolio. The ALCO authorized provision entries of \$1,482 in March and \$1,482 in June. The analysis included reviewing historical trends, loan size, loan performance and credit quality reports.

At June 30, 2010, interest income on loans increased \$1,145 compared to the same period in 2009. The increase was due to the increase in investment interest income and an increase in interest income on loans. During the quarter ending June 30, 2009, the Association did not have any investment interest income compared to the same period in 2010 where the Association earned \$327 in investment interest income. The investment interest income is generated from several Rural America Bonds made under the Farm Credit Administration's (FCA) Mission Related Investment Program. Also, the Association had an increase in nonaccrual income between the two reporting periods. Nonaccrual income, which is included in interest income, was \$423 for the six months

ended June 30, 2010, as compared to \$49 for the same period in 2009. The increase of \$374 or 763.27 percent is the result of the recognition of interest income when nonaccrual loans pay off.

Interest expense decreased \$812 for the six months ended June 30, 2010. The decrease is attributable to the lower interest rate environment and the ability to fix a portion of the Association's lendable equity at favorable rates which resulted in lower interest expense.

Noninterest income increased \$2,658 over the same period last year. Loan fees increased \$86 or 4.23 percent. The increase in loan fees is from late charges, servicing fees on loans sold to AgFirst Farm Credit Bank and other associations and servicing fees on loans sold in the secondary mortgage market. It also includes servicing fees earned on investment income. Fees for financially related services increased \$4 from \$266 at June 30, 2009 compared to \$270 at June 30, 2010. The 1.50 percent increase in fees for financially related services is the result of increased income earned on sales of multi-peril insurance, leasing and fee appraisal services.

The equity in earnings from other Farm Credit institutions increased \$634 from \$6,056 at June 30, 2009 to \$6,690 at June 30, 2010. In June 2010, AgFirst made a special patronage distribution of \$824 due to their earnings year-to-date 2010. No such distribution was paid in the same period of 2009. The special distribution should be considered as nonrecurring.

Gains on the sale of other property owned totaled \$46 for the six months ending June 30, 2010. When compared to the same period in 2009, losses on other property owned totaled \$68. The additional gains were from sales of some of the property held on the Association's books.

There was no material change in gains on the sale of rural home loans between the two reporting parties. Gains increased from \$632 to \$634 in the reporting periods ending June 30, 2010 and 2009, respectively.

During the first quarter of 2010, the Association recorded \$1,712 of insurance premium refunds from the Farm Credit System Insurance Corporation (FCSIC), which insures the System's debt obligations. The amount is reflected in Noninterest Income on the Consolidated Statements of Income. These payments are nonrecurring and resulted from the assets of the Farm Credit Insurance Fund exceeding the secure base amount as defined by the Farm Credit Act.

Other noninterest income increased \$106 from \$269 at June 30, 2009 compared to \$375 at June 30, 2010. The increase is the result of the sale of the Oakland Avenue office building in Rock Hill, South Carolina. The Rock Hill office relocated to Springdale Road in the fall of 2009.

Noninterest expense for the six months ended June 30, 2010, decreased \$1,148 compared to the same period of 2009. Salaries and employee benefit expense decreased \$297 between the two reporting periods. The 2.47 percent decrease in salaries and employee benefits is tied to an increase in deferred costs for loans made during the reporting periods. Some direct costs associated with making loans are deferred under guidelines of ASC 310-20 (previously FAS 91). Deferred costs reduce salary and employee benefit expenses. The deferred amount increased in the 2010 reporting period when compared to the 2009 reporting period.

The Association booked an accrual for the 2010 incentive payment based upon plan results which is included in salary and benefit expense. The Association evaluated 2010 performance measures for incentive purposes and determined that some employees would earn incentive in 2010. Based upon this information, the Association accrued \$1,041 in incentive in June 2010.

Occupancy and equipment expense at June 30, 2010 was \$1,105 compared to \$1,029 for the same period in 2009. The increase is from the normal cost of operations and some timing differences as it relates to maintenance issues.

The Insurance Fund premium decreased from \$1,153 at June 30, 2009 to \$324 at June 30, 2010. In June 2010, the FCSIC Insurance board elected to change the premium charged on accruing loans to 5 basis points. This change was retroactive to January 2010.

Other operating expenses decreased \$98 from June 30, 2009, \$2,478 compared to \$2,380 at June 30, 2010. The decrease is the result of efforts to control expenses carried over from 2009. Some of the decrease may be timing related when compared to the prior year period.

## FUNDING SOURCES

The principal source of funds for the Association is the borrowing relationship established with AgFirst Farm Credit Bank (the Bank) through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at June 30, 2010 was \$1,366,702 as compared to \$1,323,237 at December 31, 2009. The increase is related to the increase in loan volume between the two reporting periods.

As of June 30, 2010, the Association had invested \$80,000 of its lendable equity in fixed rate notes. These fixed rate notes have maturities ranging from October 2010 through January 2013.

## CAPITAL RESOURCES

Total members' equity at June 30, 2010 increased to \$239,159 from the December 31, 2009 total of \$234,833. The increase is primarily attributed to the earnings of the Association offset by revolvment of allocated equities and the retirement of capital stock and participation certificates during the reporting period. At December 31, 2009, allocated retained earnings totaled \$111,658. At June 30, 2010, the allocated retained earnings had decreased to \$96,446. During April 2010, the Association revolved the 2004 series of allocated surplus.

Total capital stock and participation certificates were \$6,565 on June 30, 2010, compared to \$6,485 on December 31, 2009. The increase is attributed to the purchase of stock in excess of retirement of protected stock and participation certificates on loans liquidated in the normal course of business, and the retirement of excess stock.

Farm Credit Administration (FCA) regulations require all Farm Credit institutions to maintain minimum permanent capital, total surplus, and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus, and core surplus, as defined in FCA regulations, by a risk-adjusted asset base. As of June 30, 2010, the Association's total surplus ratio and core surplus ratio were 13.80 percent and 9.51 percent, respectively, and the permanent capital ratio was 14.23 percent. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

The Association has a portion of the portfolio in an in-portfolio guarantee program with Farmer Mac. The purpose of these guarantees is to improve the Association's capital position. At June 30, 2010, the Association had loans totaling \$8,944 in this program. No additional placement of loans is scheduled at this time. The cost of the guarantees year to date was \$24. The use of the Farmer Mac in-portfolio guarantee has a positive effect on the Association's capital ratios.

At December 31, 2009, the Association's permanent capital ratio was 14.55 percent. The decrease to 14.23 percent permanent capital at June 30, 2010 is the result of the Association's growth on the balance sheet outpacing additions to retained earnings. Association management continues to discuss several options available to the Association to strengthen the capital position. These options include selling additional loans to AgFirst and others, placing pools of loans with Farmer Mac in the in-portfolio guarantee

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program, and participating with AgFirst in a capitalized participation pool. All options are being studied should management and the Board determine that steps are necessary to maintain the Association's strong capital position.

**NOTE:** Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst's annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 2378, or writing Stephen Gilbert, 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](http://www.agfirst.com). Copies of the Association's annual and quarterly reports are also available upon request free of charge by calling 1-800-310-4805, ext 237, writing Alisa D. Gunter, CFO, AgSouth Farm Credit, ACA, PO Box 4966, Spartanburg, SC 29305, or accessing the website [www.agsouthfc.com](http://www.agsouthfc.com). The Association prepares a quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

# AgSouth Farm Credit, ACA

## Consolidated Balance Sheets

<i>(dollars in thousands)</i>	<b>June 30, 2010</b>	<b>December 31, 2009</b>
	<i>(unaudited)</i>	<i>(audited)</i>
<b>Assets</b>		
Cash	\$ 1,962	\$ 4,119
Investment securities:		
Held to maturity (fair value of \$12,596 and \$4,768 respectively)	11,981	4,583
Loans	1,547,611	1,503,794
Less: allowance for loan losses	10,653	9,497
Net loans	1,536,958	1,494,297
Loans held for sale	689	2,209
Accrued interest receivable	16,493	15,599
Investment in other Farm Credit institutions	24,964	24,658
Premises and equipment, net	15,051	15,108
Other property owned	4,409	3,489
Due from AgFirst Farm Credit Bank	5,541	11,507
Other assets	13,996	18,579
Total assets	<u>\$ 1,632,044</u>	<u>\$ 1,594,148</u>
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 1,366,702	\$ 1,323,237
Accrued interest payable	3,810	3,922
Patronage refund payable	397	7,505
Other liabilities	21,976	24,651
Total liabilities	<u>1,392,885</u>	<u>1,359,315</u>
Commitments and contingencies		
<b>Members' Equity</b>		
Protected borrower equity	163	208
Capital stock and participation certificates	6,402	6,277
Retained earnings		
Allocated	96,446	111,658
Unallocated	136,421	116,982
Accumulated other comprehensive income (loss)	(273)	(292)
Total members' equity	<u>239,159</u>	<u>234,833</u>
Total liabilities and members' equity	<u>\$ 1,632,044</u>	<u>\$ 1,594,148</u>

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

AgSouth Farm Credit, ACA

# Consolidated Statements of Income

(unaudited)

<i>(dollars in thousands)</i>	<b>For the three months ended June 30,</b>		<b>For the six months ended June 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
<b>Interest Income</b>				
Investment securities	\$ 187	\$ —	\$ 327	\$ —
Loans	24,426	23,770	48,494	47,676
Total interest income	24,613	23,770	48,821	47,676
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	11,605	11,590	23,132	23,949
Other	4	2	10	5
Total interest expense	11,609	11,592	23,142	23,954
Net interest income	13,004	12,178	25,679	23,722
Provision for (reversal of allowance for) loan losses	1,482	1,872	2,964	2,515
Net interest income after provision for (reversal of allowance for) loan losses	11,522	10,306	22,715	21,207
<b>Noninterest Income</b>				
Loan fees	951	930	2,121	2,035
Fees for financially related services	92	63	270	266
Equity in earnings of other Farm Credit institutions	3,816	3,131	6,690	6,056
Gains (losses) on other property owned, net	45	(64)	46	(68)
Gains (losses) on sale of rural home loans, net	363	335	634	632
Insurance Fund refund	—	—	1,712	—
Other noninterest income	206	167	375	269
Total noninterest income	5,473	4,562	11,848	9,190
<b>Noninterest Expense</b>				
Salaries and employee benefits	6,057	6,956	11,705	12,002
Occupancy and equipment	555	511	1,105	1,029
Insurance Fund premium	16	588	324	1,153
Other operating expenses	1,078	1,066	2,380	2,478
Total noninterest expense	7,706	9,121	15,514	16,662
Income before income taxes	9,289	5,747	19,049	13,735
Provision (benefit) for income taxes	71	34	75	120
Net income	\$ 9,218	\$ 5,713	\$ 18,974	\$ 13,615

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

AgSouth Farm Credit, ACA  
**Consolidated Statements of Changes in  
Members' Equity**

*(unaudited)*

<i>(dollars in thousands)</i>	Protected Borrower Capital	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2008	\$ 335	\$ 6,270	\$ 109,795	\$ 112,202	\$ (213)	\$ 228,389
Comprehensive income						
Net income				13,615		13,615
Employee benefit plans adjustments					3	<u>3</u>
Total comprehensive income						13,618
Protected borrower equity retired	(78)					(78)
Capital stock/participation certificates issued/(retired), net		(118)				(118)
Retained earnings retired			(13,427)			(13,427)
Patronage distribution adjustment			530	626		<u>1,156</u>
Balance at June 30, 2009	<u>\$ 257</u>	<u>\$ 6,152</u>	<u>\$ 96,898</u>	<u>\$ 126,443</u>	<u>\$ (210)</u>	<u>\$ 229,540</u>
Balance at December 31, 2009	\$ 208	\$ 6,277	\$ 111,658	\$ 116,982	\$ (292)	\$ 234,833
Comprehensive income						
Net income				18,974		18,974
Employee benefit plans adjustments					19	<u>19</u>
Total comprehensive income						18,993
Protected borrower equity retired	(45)					(45)
Capital stock/participation certificates issued/(retired), net		125				125
Retained earnings retired			(15,006)			(15,006)
Patronage distribution adjustment			(206)	465		<u>259</u>
Balance at June 30, 2010	<u>\$ 163</u>	<u>\$ 6,402</u>	<u>\$ 96,446</u>	<u>\$ 136,421</u>	<u>\$ (273)</u>	<u>\$ 239,159</u>

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

## Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)  
(unaudited)

### **NOTE 1 – ORGANIZATION, SIGNIFICANT ACCOUNTING POLICIES, AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

The accompanying financial statements include the accounts of AgSouth Farm Credit, ACA (the Association). A description of the organization and operations of the Association, the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2009, are contained in the 2009 Annual Report to Shareholders. These unaudited second quarter 2010 consolidated financial statements should be read in conjunction with the 2009 Annual Report to Shareholders.

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles (GAAP) and prevailing practices within the banking industry. The results for the six months ended June 30, 2010, are not necessarily indicative of the results to be expected for the year ending December 31, 2010.

Certain amounts in the prior period's consolidated financial statements may have been reclassified to conform to the current period's consolidated financial statement presentation. Such reclassifications had no effect on the prior period net income or total capital as previously reported.

The Association maintains an allowance for loan losses in accordance with GAAP. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of June 30, 2010, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

In addition to the recently issued accounting pronouncements discussed in the 2009 Annual Report to Shareholders, in June 2009, the Financial Accounting Standards Board (FASB) issued guidance "Accounting for Transfers of Financial Assets," which amended previous guidance by improving the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets.

This guidance was effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application was prohibited. This guidance must be applied to transfers occurring on or after the effective date. Additionally, on and after the effective date, the concept of a qualifying special purpose entity is no longer relevant for accounting purposes. Therefore, formerly qualifying special-purpose entities (as defined under previous accounting guidance) should be evaluated for consolidation by reporting entities on and after the effective date in accordance with the applicable consolidation guidance. If the evaluation on the effective date results in consolidation, the reporting entity should apply the transition guidance that requires consolidation. The Association evaluated the impact of adoption on its loan participation agreements to ensure that participations would meet the requirements for sales treatment. The impact of adoption on January 1, 2010 was immaterial to the Association's financial condition and results of operations.

In June 2009, the FASB also issued guidance, to improve financial reporting for those enterprises involved with variable interest entities, which amends previous guidance by requiring an enterprise to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity.

Additionally, an enterprise is required to assess whether it has an implicit financial responsibility to ensure that a variable interest entity operates as designed when determining whether it has the power to direct the activities of the variable interest entity that most significantly impact the entity's economic performance.

This guidance was effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application was prohibited. The Association does not have any variable interest or controlling interest in a variable entity. Therefore, there was no impact of adoption of the guidance for the Association.

In January 2010, the FASB issued guidance "Fair Value Measurements and Disclosures," which is to improve disclosures about fair value measurement by increasing transparency in financial reporting. The changes will provide

a greater level of disaggregated information and more detailed disclosures of valuation techniques and inputs to fair value measurement. The new disclosures and clarification of existing disclosures were effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the rollforward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this guidance had no impact on the Association's financial condition and results of operations but resulted in additional disclosures (see Note 5).

## NOTE 2 – INVESTMENT SECURITIES

A summary of the amortized cost and fair value of investment securities held-to-maturity at June 30, 2010 and December 31, 2009 follows:

	June 30, 2010				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Mission related investments	\$ 11,981	\$ 615	\$ -	\$ 12,596	4.52%

	December 31, 2009				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Mission related investments	\$ 4,583	\$ 185	\$ -	\$ 4,768	7.46%

A summary of the expected maturity, amortized cost and estimated fair value of investment securities held-to-maturity at June 30, 2010 and December 31, 2009 follows:

	June 30, 2010		
	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	\$ -	\$ -	-0%
After one year through five years	-	-	-
After five years through ten years	-	-	-
After ten years	11,981	12,596	4.52
Total	\$ 11,981	\$ 12,596	4.52%

	December 31, 2009		
	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	\$ -	\$ -	-0%
After one year through five years	-	-	-
After five years through ten years	-	-	-
After ten years	4,583	4,768	7.46
Total	\$ 4,583	\$ 4,768	7.46%

The Association's mission related investments consist of private placement securities purchased under the Rural America Bond Program approved by the FCA.

An investment is considered impaired if its fair value is less than its cost. A continuous unrealized loss position for an investment is based on the date the impairment was first identified. The Association had no investments that have been in a continuous unrealized loss position at June 30, 2010.

The Association performs periodic credit reviews, including other-than-temporary impairment analyses, on its investment securities portfolio. The objective is to quantify any future possible loss of principal or interest due on each security identified for additional analysis. Factors considered in determining whether an impairment is other-than-temporary include among others as applicable: 1) the length of time and the extent to which the fair value is less than cost, 2) adverse conditions specifically related to the industry, 3) geographic area and the condition of the underlying collateral, 4) payment structure of the security, 5) ratings by rating agencies, 6) the credit worthiness of bond insurers, and 7) volatility of the fair value changes.

Based on the results of all analyses, the Association has not recognized any other-than-temporary impairment in connection with its investment securities. The Association has the ability and intent to hold these investments until maturity and at this time expects to collect the full principal amount and interest due on these securities. The Association does not intend to sell these investments and it is not more likely than not that the Association would be required to sell these investments before recovering its costs. All securities continue to perform and are in an unrealized gain position at June 30, 2010.

## NOTE 3 – ALLOWANCE FOR LOAN LOSSES AND IMPAIRED LOANS

An analysis of the allowance for loan losses follows:

	For the six months ended June 30,	
	2010	2009
Balance at beginning of period	\$ 9,497	\$ 4,467
Provision for (reversal of) loan losses	2,964	2,515
Charge-offs	(1,818)	(409)
Recoveries	9	136
Balance at end of period	\$10,652	\$ 6,709

The following table presents information concerning impaired loans as of June 30,

	2010	2009
Impaired loans with related allowance	\$18,699	\$ 2,250
Impaired loans with no related allowance	24,608	10,582
Total impaired loans	43,307	12,832
Allowance on impaired loans	\$ 2,426	\$ 933

Impaired loans increased significantly between the two reporting periods. Quarterly, impaired loans are analyzed to determine if a specific allowance for loan loss is needed. If so, the related allowance for loan loss is adjusted.

The following table summarizes impaired loan information for the six months ended June 30,

	<b>2010</b>	<b>2009</b>
Average impaired loans	\$ 38,850	\$ 9,242
Interest income recognized on impaired loans	423	53

#### **NOTE 4 – EMPLOYEE BENEFIT PLANS**

The following is a table of retirement and other postretirement benefit expenses for the Association:

	<b>For the six months ended June 30,</b>	
	<b>2010</b>	<b>2009</b>
Pension	\$ 2,841	\$3,009
401(k)	251	252
Other postretirement benefits	446	475
<b>Total</b>	<b>\$ 3,538</b>	<b>\$3,736</b>

The following is a table of retirement and other postretirement benefit contributions for the Association:

	<b>Actual YTD Through 6/30/10</b>	<b>Projected Contributions For Remainder of 2010</b>	<b>Projected Total Contributions 2010</b>
Pension	\$ 43	\$ 4,735	\$4,778
Other postretirement benefits	312	353	665
<b>Total</b>	<b>\$ 355</b>	<b>\$ 5,088</b>	<b>\$5,443</b>

Contributions in the above table include allocated estimates of funding for multi-employer plans in which the Association participates. These amounts may change when a total funding amount and allocation is determined by the respective Plan's Sponsor Committee. Also, market conditions could impact discount rates and return on plan assets which could change contributions necessary before the next plan measurement date of December 31, 2010.

Further details regarding employee benefit plans are contained in the 2009 Annual Report to Shareholders.

#### **NOTE 5 – FAIR VALUE MEASUREMENT**

Effective January 1, 2008, the Association adopted FASB guidance on fair value measurements. This guidance defines fair value, establishes a framework for measuring fair value and expands the Association's fair value disclosures for certain

assets and liabilities measured at fair value on a recurring and non-recurring basis. These assets and liabilities consist primarily of assets held in trust funds, standby letters of credit, impaired loans, and other property owned. This guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability.

This guidance establishes a fair value hierarchy for disclosure of fair value measurements to maximize the use of observable inputs, that is, inputs that reflect the assumptions market participants would use in pricing an asset or liability based on market data obtained from sources independent of the reporting entity. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

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

##### **Level 1**

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets. The Association's Level 1 assets at June 30, 2010 consist of assets held in trust funds related to deferred compensation and supplemental retirement plans. The trust funds include investments in securities that are actively traded and have quoted net asset value prices that are directly observable in the marketplace.

##### **Level 2**

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability. The Association has no Level 2 assets and liabilities measured at fair value on a recurring basis at June 30, 2010.

##### **Level 3**

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

Level 3 assets at June 30, 2010 include impaired loans which represent the fair value of certain loans that were evaluated for impairment under FASB guidance. The fair value was based upon the underlying collateral since these were collateral-dependent loans. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established.

Other property owned is classified as a Level 3 asset at June 30, 2010. The fair value for other property owned is based upon the collateral value. Costs to sell represent transaction costs and are not included as a component of the fair value of other property owned. Level 3 liabilities at June 30, 2010 include standby letters of credit whose market value is internally calculated based on information that is not observable either directly or indirectly in the marketplace.

#### Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following tables present the assets and liabilities that are measured at fair value on a recurring basis at June 30, 2010 and December 31, 2009 for each of the fair value hierarchy levels:

June 30, 2010				
	Level 1	Level 2	Level 3	Total Fair Value
<b>Assets:</b>				
Assets held in trust funds	\$ 708	\$ -	\$ -	\$ 708
Total Assets	\$ 708	\$ -	\$ -	\$ 708
<b>Liabilities:</b>				
Standby letters of credit	\$ -	\$ -	\$ 151	\$ 151
Total Liabilities	\$ -	\$ -	\$ 151	\$ 151
<b>December 31, 2009</b>				
	Level 1	Level 2	Level 3	Total Fair Value
<b>Assets:</b>				
Assets held in trust funds	\$ 735	\$ -	\$ -	\$ 735
Total Assets	\$ 735	\$ -	\$ -	\$ 735
<b>Liabilities:</b>				
Standby letters of credit	\$ -	\$ -	\$ 94	\$ 94
Total Liabilities	\$ -	\$ -	\$ 94	\$ 94

The following tables present the changes in Level 3 assets and liabilities measured at fair value on a recurring basis for the six months ended June 30, 2010 and 2009. The Association had no transfers of assets or liabilities into or out of Level 1 or Level 2 during the first six months of 2010 and 2009.

	Standby Letters Of Credit
Balance at January 1, 2010	\$ 94
<b>Total gains or (losses) realized/unrealized:</b>	
Included in earnings	-
Included in other comprehensive loss	-
Purchases, sales, issuances and settlements, net	57
Transfers in and/or out of level 3	-
Balance at June 30, 2010	\$ 151

	Standby Letters Of Credit
Balance at January 1, 2009	\$ 122
<b>Total gains or (losses) realized/unrealized:</b>	
Included in earnings	-
Included in other comprehensive loss	-
Purchases, sales, issuances and settlements, net	61
Transfers in and/or out of level 3	-
Balance at June 30, 2009	\$ 183

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

Assets and liabilities measured at fair value on a non-recurring basis at June 30, 2010 and December 31, 2009 for each of the fair value hierarchy values are summarized below:

June 30, 2010						
	Level 1	Level 2	Level 3	Total Fair Value	YTD Total Gains (Losses)	
<b>Assets:</b>						
Impaired loans	\$ -	\$ -	\$ 16,184	\$ 16,184	\$ (2,964)	
Other property owned	\$ -	\$ -	\$ 3,277	\$ 3,277	\$ 73	
<b>December 31, 2009</b>						
	Level 1	Level 2	Level 3	Total Fair Value	YTD Total Gains (Losses)	
<b>Assets:</b>						
Impaired loans	\$ -	\$ -	\$ 13,255	\$ 13,255	\$ (1,820)	
Other property owned	\$ -	\$ -	\$ 3,935	\$ 3,935	\$ (2,144)	

**NOTE 6 — DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS**

The following tables present the carrying amounts and fair values of the Association’s financial instruments at June 30, 2010 and December 31, 2009.

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

The estimated fair values of the Association’s financial instruments are as follows:

	June 30, 2010		December 31, 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>				
Cash	\$ 1,962	\$ 1,962	\$ 4,119	\$ 4,119
Investment securities	\$ 11,981	\$ 12,596	\$ 4,583	\$ 4,768
Loans, net of allowance	\$ 1,536,958	\$ 1,574,560	\$ 1,494,297	\$ 1,537,827
Assets held in trust funds	\$ 708	\$ 708	\$ 735	\$ 735
<b>Financial liabilities:</b>				
Notes payable to AgFirst Farm Credit Bank	\$ 1,366,702	\$ 1,385,354	\$ 1,323,237	\$ 1,338,028

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

**A. Cash:**

The carrying value is primarily a reasonable estimate of fair value.

**B. Loans:**

Because no active market exists for the Association’s loans, fair value is estimated by discounting the expected future cash flows using the Association’s current interest rates at which similar loans would be made to borrowers with similar credit risk. Discount rates are based on the Bank’s loan rates as well as management estimates.

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

status is estimated to be the carrying amount of the loan less specific reserves.

The carrying value of accrued interest approximates its fair value.

**C. Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:**

Estimating the fair value of the Association’s investment in the Bank and Other Farm Credit Institutions is not practicable because the stock is not traded. The net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying Consolidated Balance Sheets. The Association owns 5.83 percent of the issued stock of the Bank as of June 30, 2010 net of any reciprocal investment. As of that date, the Bank’s assets totaled \$30.7 billion and shareholders’ equity totaled \$1.9 billion. The Bank’s earnings were \$206.7 million during the first six months of 2010.

In addition, the Association has an investment of \$2,785 related to other Farm Credit institutions.

**D. Notes Payable to AgFirst Farm Credit Bank:**

The notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association’s loan receivables plus accrued interest on the notes payable. This assumption implies that earnings on the Association’s interest margin are used to fund operating expenses and capital expenditures.

**E. Commitments to Extend Credit:**

The estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics and since the related credit risk is not significant.

**F. Assets Held in Trust Funds:**

See Note 5 for discussion of estimation of fair value for this instrument.

**G. Investment Securities:**

Fair value is determined by discounting the expected future cash flows using appropriate interest rates for similar assets.

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**NOTE 7 – SUBSEQUENT EVENTS**

The Association has evaluated subsequent events and has determined there are none requiring disclosure through August 6, 2010, which is the date the financial statements were issued.