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# FARM CREDIT OF NORTHWEST FLORIDA, ACA

# 2007 ANNUAL REPORT

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## Management

James R. Alberts.....	Chief Executive Officer
Bruce C. Harrison .....	Chief Financial Officer
Wade Hayslip.....	Chief Lending Officer
Wesley O. Pope.....	Chief Appraiser
Jay Baker .....	Western Regional Lending Manager
Rick Hemby .....	Central Regional Lending Manager
Rick Bitner .....	Eastern Regional Lending Manager
Deandrea Barber .....	Loan Operations Manager
Lesia Andrews.....	Marketing Manager

## Board of Directors

James G. Ditty .....	Chairman
Richard Terry .....	Vice Chairman
Melvin T. Adams .....	Director
Fred Beshears.....	Director
Bob Calvert .....	Director
Cindy Eade .....	Director
Copeland Griswold .....	Director
William Carroll Lamb.....	Director
James C. Moulton .....	Director
George T. VanPelt .....	Director
T. B. Walker.....	Director
Al Wenstrand .....	Director

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

The association achieved a positive financial outcome in 2007, resulting in a notably favorable year for our shareholders. The Board of Directors was pleased to distribute \$4,686,464 in patronage and \$631,797 in allocated surplus to our members during the year 2007. Further, the board remains dedicated to preserving this important membership benefit and has already declared an additional \$4,990,560 to be distributed to shareholders in 2008!

Remarkably, our executive management team maintained the association's loan volume, an impressive accomplishment in a contracting economy. Additionally, the association reports net income in excess of \$11.8 million.

Responsible expense control endures as a pragmatic component of our culture, and controllable expenses declined an impressive 5.6%.

Total members' equity to total assets increased to 13.18%, up from 12.32% in 2006. Permanent capital increased as well as core and total surplus as indicated below, which effectively creates a safety net to further intensify the stability of our organization:

	<b>As of 12/31/07</b>	<b>As of 12/31/06</b>	<b>Regulatory Required</b>
Permanent Capital	12.22 %	11.54 %	7.00 %
Core Surplus	11.46 %	11.27 %	3.50 %
Total Surplus	11.96 %	10.77 %	7.00 %

Noteworthy performance occurred in other indicators as depicted in the table below. A cursory comparison with 2006 indicates a slight decline. Deeper analysis of an objective analogy considering economic differentials between 2006 (an especially robust year) and 2007 (a year of Florida economic languish) indicates a favorable performance in 2007:

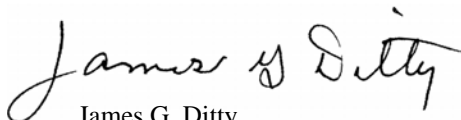
<b>Rate of return on average:</b>	<b>As of 12/31/07</b>	<b>As of 12/31/06</b>
Total assets	2.22 %	2.86 %
Total members' equity	16.63 %	23.26 %
Net interest income as a percentage of average earning assets	2.83 %	3.02 %

To further edify the above ratios, a nation-wide peer comparison was reviewed resulting in considerable discovery. When compared with similar entities, as of September 30, 2007, Farm Credit of Northwest Florida produced indicators among the top tier across our nation.

Looking toward 2008, management and the board will remain assiduous in insuring the safety and soundness of our organization with special consideration for the somber economic outlook. In deference to these conditions, it was prudent to allow a provision for loan loss in the amount of \$2,822,367.

To compensate uncontrollable economic factors, the Association's strength will be maintained through strong internal controls, diligent credit practices and continued expense containment. An infusion of talented professionals will enhance our existing dedicated, executive team. We will continue to provide for the ongoing education of our associates, with special emphasis on critical thinking skills.

Numerous goals and attainable challenges have been established for the year ahead. The year 2008 will be a year of proactive change and we will seek new methods for designing innovative solutions to ensure there are opportunities to create a flourishing Rural America.



James G. Ditty  
Chairman of the Board



James R. Alberts  
President/CEO

## YBS Update

Special emphasis was placed on our professional staff to increase our share in this market, with the following growth results for 2007:

	Volume Growth	Percentage Growth
Young	\$ 8,056,413	15.60%
Beginning	\$ 4,280,342	1.83%
Small	\$19,331,467	5.61%

Our organization remains committed to serving the credit needs of these vital segments. High quality volume growth is essential and our professional team has set significant goals to reach out to related agencies and organizations to support the perpetuation of agriculture in Rural America.

### Who is a Young, Beginning or Small Farmer?

- A young farmer is one who is 35 years of age or younger.
- A Beginning farmer is one who has 10 or fewer years farming, ranching or aquatic agriculture experience.
- A Small farmer is one who generates less than \$250,000 in annual gross agricultural or aquatic sales.

February 28, 2008

## *Report of Management*

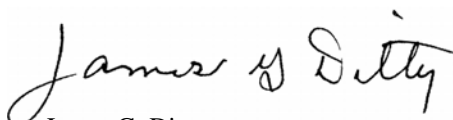
The accompanying consolidated financial statements and related financial information appearing throughout this annual report have been prepared by management of Farm Credit of Northwest Florida, ACA (Association) in accordance with generally accepted accounting principles appropriate in the circumstances. 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 financial statements, and that the assets of the Association 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 Association 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 Board of Directors.

The consolidated financial statements have been examined by independent public auditors, whose report appears elsewhere in this annual report. The Association 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 Association. The undersigned certify that the 2007 Annual Report has been prepared in accordance with all applicable statutory or regulatory requirements and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

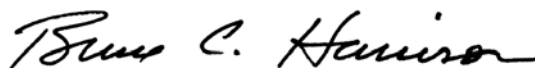
The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.



James G. Ditty  
Chairman of the Board



James R. Alberts  
Chief Executive Officer



Bruce C. Harrison  
Chief Financial Officer

February 28, 2008



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

(dollars in thousands, except as noted)

## GENERAL OVERVIEW

The following commentary summarizes the financial condition and results of operations of Farm Credit of Northwest Florida, ACA, (Association) for the year ended December 31, 2007 with comparisons to the years ended December 31, 2006 and December 31, 2005. This information should be read in conjunction with the Consolidated Financial Statements, Notes to the Consolidated Financial Statements and other sections in this Annual Report. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors. For a list of the Audit Committee members, refer to the "Report of the Audit Committee" reflected in this Annual Report. Information in any part of this Annual Report may be incorporated by reference in answer or partial answer to any other item of the Annual Report.

The Association is an institution of the Farm Credit System, (System), which was created by Congress in 1916 and has served agricultural producers for over 90 years. The System mission is to maintain and improve the income and well-being of American farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses. The Farm Credit System is the largest agricultural lending organization in the United States. The System is regulated by the Farm Credit Administration, (FCA), which is an independent safety and soundness regulator.

The Association is a cooperative, which is owned by the members served. The territory of the Association extends across a diverse agricultural region of Northwest Florida. Refer to Note 1, "Organization and Operations", of the Notes to the Consolidated Financial Statements for counties in the Association's territory. The Association provides credit to farmers, ranchers, rural residents, and agribusinesses. Our success begins with our extensive agricultural experience and knowledge of the market.

The Association obtains funding from AgFirst Farm Credit Bank (the Bank). The Association is materially affected by the financial condition and results of operations of the Bank. Copies of the AgFirst Farm Credit Bank's Quarterly and Annual Reports are on the AgFirst website, [www.agfirst.com](http://www.agfirst.com), or may be obtained at no charge by calling 1-800-845-1745, extension 316, or writing Wanda Martin, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. Copies of the Association's Annual and Quarterly reports are also on the Association's website, [www.farmcredit-fl.com](http://www.farmcredit-fl.com) or may be obtained upon request free of charge by calling 850-526-4910 ext. 103 or writing Bruce C. Harrison, Chief Financial Officer, Farm Credit of Northwest Florida, ACA, P.O. Box 7000, Marianna, FL 32447.

## 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 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.

## AGRICULTURAL OUTLOOK

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

bushel for certain crops and by hundredweight for beef cattle from December 31, 2004 to December 31, 2007:

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

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

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

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

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

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

to 104.1 percent in 1981, and has remained relatively stable since 1987, averaging about 50 percent. The USDA suggests a decrease in the use of repayment capacity from 57 percent in 2006 to 48 percent in 2007.

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

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

## CRITICAL ACCOUNTING POLICIES

The financial statements are reported in conformity with accounting principles generally accepted in the United States of America. We consider our significant accounting policies to be critical to the understanding of our results of operations and financial position because some accounting policies require us to make complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. These policies are considered critical because we have 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 inherent in its loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through loan loss reversals and loan charge-offs. The allowance for loan losses is determined based on a periodic evaluation of the loan portfolio, which generally considers types of loans, credit quality, specific industry conditions, general economic and political conditions, and changes in the character, composition, and performance of the portfolio, among other factors.

Significant individual loans are evaluated based on the borrower's overall financial condition, resources, and payment record, the prospects for support from any financially responsible guarantor, and, if appropriate, the estimated net realizable value of any collateral. The allowance for loan

losses attributable to these loans is established by a process that estimates the probable loss inherent in the loans, taking into account various historical and projected factors, internal risk ratings, regulatory oversight, geographic, industry and other factors.

Changes in the factors considered by management in the evaluation of losses in the loan portfolios could result in a change in the allowance for loan losses and could have a direct impact on the provision for loan losses and 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 the Association's results of operations. For additional information, refer to the Recently Issued Accounting Pronouncements disclosed in this Annual Report.
- *Pensions* — The Bank and its related Associations participate in defined benefit retirement plans. These plans are noncontributory and benefits are based on salary and years of service. In addition, the Bank and its related Associations also participate in defined contribution retirement savings plans. Pension expense for all plans is recorded as part of salaries and employee benefits. Pension expense 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. The discount rate is used to determine the present value of our future benefit obligations. The discount rate was selected by reference to Hewitt Associates' ( a global human resource services provider ) corporate bond index, actuarial analyses and industry norms.

## ECONOMIC CONDITIONS

A myriad of economic factors converged in our territory throughout the year 2007. The first quarter was marked by mitigated economic growth compared with the year 2006, followed by steady abatement throughout the remainder of the year.

The timber industry was somewhat impaired by modest prices, likely caused by construction decline and a languishing economic environment. Saw timber and chip-n-saw prices were down in 2007, but pulpwood prices were flat. The outlook for the forestry/timber industry in Northwest Florida is expected to

improve because of new opportunities emerging in 2008. The vast majority of the Association's timber farmers enjoy income sources from enterprises other than the forestry industry.

As prices moderate for rural properties, buyers may act upon previously suppressed demand. The Association experienced a decline in financing requests in 2007 for farmsteads, mini-plantations, lifestyle farmers, hobby farms, recreational acreage and country homes. Acquisitions for this type of property are expected to increase by the latter part of 2008.

Commodities such as row crops and livestock experienced both positive and negative outcomes due partially, to scattered drought conditions. Some knowledgeable people are of the opinion that the impact of the drought of 2007 may be felt for years to come in our water supply and farm operations.

Higher commodity prices for row crops, livestock and dairy were allayed by increased production costs such as fuel and feed. Irrigation was a critical factor for successful yields in row crops. The drought affected dry-land peanuts in Northwest Florida with some yields down as much as fifty percent. The yields of irrigated crops were adequate, but added fuel cost reduced the profits. Less acreage planted in 2007 and weather conditions caused a drop of nearly forty percent in cotton production. Overall, fewer acres were planted in peanuts and cotton for the year 2007, while corn experienced an increase from that of 2006.

The Association experienced stable loan volume for the year 2007, and due to economic conditions little or no growth is expected in 2008. Generally, the overall outlook for 2008 is cautiously optimistic.

## MISSION-RELATED INVESTMENTS

During 2005, the FCA initiated an investment program to stimulate economic growth and development in rural areas. The FCA outlined a program to allow System institutions to hold such investments, subject to approval by the FCA on a case-by-case basis. FCA has approved the Rural America Bonds pilot under the mission-related investments umbrella, as described below.

### *Rural America Bonds*

In October 2005, the FCA authorized AgFirst and the Associations to make investments in Rural America Bonds under a three-year pilot period. Rural America Bonds may include debt obligations issued by public and private enterprises, corporations, cooperatives, other financing institutions, or rural lenders where the proceeds would be used to support agriculture, agribusiness, rural housing, or economic development, infrastructure, or community development and revitalization projects in rural areas. Examples include investments that fund value-added food and fiber processors and marketers, agribusinesses, commercial enterprises that create and maintain employment opportunities in rural areas, community services, such as schools, hospitals, and government facilities, and other activities that sustain or revitalize rural communities and their economies. The objective of this pilot program is to help meet the growing and diverse financing needs of agricultural enterprises, agribusinesses, and rural communities by providing a flexible flow of money to rural areas through bond financing. These bonds may be classified as Loans or Investments on the Consolidated Balance Sheets depending on the nature of the investment. As of December 31, 2007 the Association had \$12,825 in Rural America Bonds, and

they are classified as Loans on the Consolidated Balance Sheets. As of December 31, 2006 and December 31, 2005 the Association had no Rural America Bonds.

**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 through numerous product types.

The gross loan volume of the Association as of December 31, 2007, was \$516,104, an increase of \$18,657 or 3.75 percent as compared to \$497,447 at December 31, 2006 and an increase of \$78,136 or 18.63 percent as compared to \$419,311 at December 31, 2005. Net loans outstanding (gross loans net of the allowance for loan losses) on December 31, 2007, were \$511,708 as compared to \$495,873 at December 31, 2006 and \$417,902 at December 31, 2005. Net loans accounted for 95.16 percent of total assets on December 31, 2007 as compared to 95.07 percent of total assets at December 31, 2006 and 96.25 percent of total assets at December 31, 2005.

The diversification of the Association loan volume by type for each of the past three years is shown below. See Note 3, "Loans and Allowance for Loan Losses" of the Notes to the Consolidated Financial Statements, for the loans outstanding amounts.

<b>Loan Type</b>	<b>12/31/07</b>	<b>12/31/06</b>	<b>12/31/05</b>
Production agriculture:			
Real estate mortgage	72.41%	68.99%	69.03%
Production and intermediate-term	23.83	28.78	29.14
Agribusiness:			
Processing and marketing	1.44	—	.05
Farm related business	.45	.40	.53
Rural residential real estate	1.87	1.83	1.26
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

While we make loans and provide financially related services to qualified borrowers in the agricultural and rural sectors and to certain related entities, our loan portfolio is diversified. The following tables reflect the geographic locations served and the commodities financed.

The geographic distribution of the loans by branch for the past three years is as follows:

<b>Branch</b>	<b>12/31/07</b>	<b>12/31/06</b>	<b>12/31/05</b>
Milton	20.67%	20.08%	18.25%
Monticello	14.12	16.72	15.68
Madison (closed in 2006)	—	—	6.31
Commercial Credits	43.35	42.46	39.76
Marianna	17.69	20.74	20.00
Tallahassee (new in 2007)	4.17	—	—
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

Commodity and industry categories are based upon the Standard Industrial Classification system published by the federal government. The system is used to assign commodity or industry categories based upon the primary business of the customer. Primary business is assigned if the commodity or industry accounts for 50 percent or more of the total value of the sales for its products. Otherwise, the category assigned will be considered as other.

The major commodities in the Association loan portfolio are shown below. The predominant commodities are timber, plantations, livestock, peanuts and other row crops, which constitutes 71 percent of the entire portfolio.

<b>Commodity Group</b>	<b>Percent of Portfolio</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Forestry	50%	54%	53%
Other	17	12	16
Row Crops	14	14	13
Livestock	7	7	7
Peanuts	3	4	4
Horticulture	5	4	3
Dairy	2	3	3
Rural Homes	2	2	1
Poultry	—	—	—
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

The table above presents the concentration of risk based on the commodity category only. However, another important factor for consideration is the risk based on commodity repayment sources. The table below presents the repayment source based on the commodity and the repayment source based on resources other than the commodity. The table below indicates that 84 percent of the total loans were dependent on repayment sources based on resources other than the commodity as of December 31, 2007 and 82 percent and 80 percent of the total loans were dependent on repayment resources other than the commodity as of December 31, 2006 and December 31, 2005, respectively. The non-commodity repayment resources represent a wide variety of diversified cash flows that commodity fluctuations could not affect.

<b>Commodity Type</b>	<b>12/31/07</b>	<b>Repayment Source Based on Resources Other Than the Commodity</b>	
		<b>12/31/07</b>	<b>12/31/07</b>
Forestry	50%	5%	95%
Other	17	8	92
Row Crops	14	14	86
Livestock	7	30	70
Peanuts	3	56	44
Horticulture	5	70	30
Dairy	2	100	—
Rural Homes	2	—	100
Poultry	—	100	—
<b>Total</b>	<b>100%</b>	<b>16%</b>	<b>84%</b>

<b>Commodity Type</b>	<b>12/31/06</b>	<b>Repayment Source Based on Resources Other Than the Commodity</b>	
		<b>12/31/06</b>	<b>12/31/06</b>
Forestry	54%	6%	94%
Row Crops	14	15	85
Other	12	20	80
Livestock	7	29	71
Peanuts	4	62	38
Horticulture	4	69	31
Dairy	3	100	—
Rural Homes	2	—	100
Poultry	—	81	19
<b>Total</b>	<b>100%</b>	<b>18%</b>	<b>82%</b>

Commodity Type	12/31/05	Repayment	Repayment
		Source Based on Commodity	Source Based on Resources Other Than the Commodity
Forestry	53%	8%	92%
Other	16	18	82
Row Crops	13	18	82
Livestock	7	24	76
Peanuts	4	91	9
Horticulture	3	84	16
Dairy	3	100	–
Rural Homes	1	–	100
Poultry	–	79	21
Total	100%	20%	80%

During 2007, 2006 and 2005, the Association continued to have activity in the buying and selling of loan participations within and outside of the System. This provides a means for the Association to spread credit concentration risk and strengthen capital position.

Loan Participations	2007	2006	2005
	<i>(dollars in thousands)</i>		
Participations Purchased			
– FCS Institutions	\$ –	\$ 734	\$ –
Participations Purchased			
– Non-FCS Institutions	14,283	11,354	17,213
Participations Sold	(105,864)	(146,761)	(76,455)
Total	\$ (91,581)	\$ (134,673)	\$ (59,242)

The Association participates in the Farmer Mac LTSB program. Farmer Mac was established by Congress to provide liquidity to agricultural lenders. At December 31, 2007, 2006 and 2005, the Association had loans amounting to \$3,146, \$4,866 and \$7,783, respectively, which were 100 percent guaranteed by Farmer Mac. The Association additionally purchased guaranteed portions of loans that are guaranteed by the United States Department of Agriculture. These loans are held for the purposes of reducing interest rate risk and managing surplus short-term funds as allowable under FCA regulations. At December 31, 2007, the balance of these loans (including the unamortized premium) was \$2,545, compared to \$3,006 at December 31, 2006 and \$4,115 at December 31, 2005.

### CREDIT RISK MANAGEMENT

Credit risk arises from the potential inability of an obligator to meet its repayment obligation. As a part of a system to evaluate the success of a loan, the Association continues to review the credit quality of the loan portfolio on an ongoing basis. With the approval of the Association Board of Directors, the Association establishes underwriting standards and lending policies that provide direction to loan officers. Underwriting standards include, among other things, an evaluation of:

- *Character* – borrower integrity and credit history
- *Capacity* – repayment capacity of the borrower based on cash flows from operations or other sources of income
- *Collateral* – protects the lender in the event of default and represents a potential secondary source of repayment
- *Capital* – ability of the operation to survive unanticipated risks
- *Conditions* – intended use of the loan funds

The 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 upon cash flows from operations or other sources of income, including non-farm income. Real estate loans must be collateralized by first liens on the real estate (collateral). As required by FCA regulations, each institution that makes loans on a collateralized basis must have collateral evaluation policies and procedures. Real estate mortgage loans may be made only in amounts up to 85 percent of the original appraised value of the property taken as collateral or up to 97 percent of the appraised value if guaranteed by a state, federal, or other governmental agency. The actual loan to appraised value when loans are made is generally lower than the statutory maximum percentage. Appraisals are required for loans of more than \$250,000. In addition, each loan is assigned a credit risk weighting based upon the underwriting standards. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses, and risks in a particular relationship.

The Association’s loan portfolio is divided into performing and high-risk categories. A Special Assets Management Department is responsible for servicing loans classified as high-risk. The high-risk assets, including accrued interest, are detailed below:

	12/31/07	12/31/06	12/31/05
	<i>(dollars in thousands)</i>		
<b>High-risk Assets</b>			
Nonaccrual loans	\$ 8,324	\$ 940	\$ 940
Restructured loans	–	–	–
Accruing loans 90 days past due	31	–	6
Total high-risk loans	8,355	940	946
Other property owned	–	–	–
Total high-risk assets	\$ 8,355	\$ 940	\$ 946
<b>Ratios</b>			
Nonaccrual loans to total loans	1.61%	0.19%	0.22%
High-risk assets to total assets	1.55%	0.18%	0.22%

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. The increase in non-accrual loans resulted primarily due to the non-performance of a bond from one member and non-performance on eight loans to six members. Nonaccrual loans for 2006 remained the same as 2005, that being one loan to one member in both years.

Loan restructuring is available to financially distressed borrowers. Restructuring of loans occurs when the Association grants a concession 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 the loan in full or in part 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.

### Credit Quality

We review the credit quality of the loan portfolio on an on-going basis as part of our risk management practices. Each loan is classified according to the Uniform Classification System, which is used by all Farm Credit 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 loans including accrued interest at December 31.

<b>Credit Quality</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
Acceptable & OAEM	97.65%	99.13%	98.73%
Substandard	.82	.87	1.27
Doubtful	1.53	–	–
Loss	–	–	–
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

### Allowance for Loan Losses

The allowance for loan losses at each period end was considered by Association management to be adequate to absorb probable losses existing in and inherent to its loan portfolio.

Management's evaluations consider factors including loan loss experience, portfolio quality, loan portfolio composition, current agricultural production conditions and economic conditions. The allowance for loan losses was \$4,396 at December 31, 2007, as compared with \$1,574 and \$1,409 at December 31, 2006 and 2005, respectively.

Net loan charge-offs (recoveries) of \$0, \$12 and \$0 were recorded in 2007, 2006 and 2005, respectively. Net loan charge-offs (recoveries) as a percentage of average loans remained at low levels of 0 percent, .002 percent, and 0 percent for 2007, 2006 and 2005, respectively.

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

<b>Allowance for Loan Loss Activity:</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
	<i>(dollars in thousands)</i>		
Balance at beginning of year	\$ 1,574	\$ 1,409	\$ 1,409
Charge-offs:			
Real estate mortgage	–	12	–
Total charge-offs	–	12	–
Recoveries:			
Real estate mortgage	–	–	–
Total recoveries	–	–	–
Net (charge-offs) recoveries	–	12	–
Provision for (reversal of allowance for) loan losses	2,822	177	–
Nonrecurring provision for loan losses reversal*	–	–	–
Balance at end of year	\$ 4,396	\$ 1,574	\$ 1,409
Ratio of net charge-offs during the period to average loans outstanding during the period	–%	.002%	–%

\* 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:

<b>Allowance for Loan Losses by Type</b>	<b>December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
	<i>(dollars in thousands)</i>		
Real estate mortgage	\$ 3,573	\$ 763	\$ 655
Production and intermediate-term	232	320	269
Agribusiness	487	472	473
Rural residential real estate	104	19	12
<b>Total loans</b>	<b>\$ 4,396</b>	<b>\$ 1,574</b>	<b>\$ 1,409</b>

The increase in the allowance for loan losses in the two tables above resulted primarily from a specific reserve allowance on one bond from one member. The allowance for loan losses as a percentage of loans outstanding and as a percentage of certain other credit quality indicators is shown below:

<b>Allowance for Loan Losses as a Percentage of:</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
Total loans	.85%	.32%	.34%
Nonperforming loans	–	–	–
Nonaccrual loans	44.45%	167.45%	149.89%

The financial positions of our 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 our loan portfolio has remained healthy. Please refer to Note 4, "Loans and Allowance for Loan Losses", in the Notes to the Consolidated Financial Statements, for further information concerning the allowance for loan losses.

### EMPLOYEE RETIREMENT PLANS

For the years ended December 31, 2007, 2006 and 2005, the Association contributed \$0, \$0 and \$434, respectively, to the District-wide defined benefit retirement plan. The District-wide funding brings the retirement plan's assets to an amount exceeding the accumulated benefit obligation. The contributions in 2004 eliminated the minimum pension liability. Assuming that interest rates and returns on investments remain relatively constant, benefits to the Association in subsequent periods should include improved net income due to lower retirement expense and the elimination of the pension-related change in accumulated other comprehensive income in the members' equity. See Note 9, "Employee Benefit Plans," in the Notes to the Consolidated Financial Statements for further information.

### RESULTS OF OPERATIONS

Net income for the year ended December 31, 2007, totaled \$11,810, a decrease of \$2,608 or 18.09 percent, as compared to \$14,418 for the same period of 2006 and an increase of \$537 or 4.76 percent, as compared to \$11,273 for the same period of 2005. Interest income for the year ended December 31, 2007, was \$41,925, an increase of \$1,775 or 4.42 percent as compared to \$40,150 for the same period of 2006. Interest income increased by \$14,223 for the period ended December 31, 2006, compared to December 31, 2005. Net income included the unfavorable effect of a provision for loan losses of \$ 2,822 as indicated in the Allowance for Loan Losses section. Major components of the changes in net income for the past two years are outlined in the following table.

<b>Change in Net Income:</b>	<b>2007-2006</b>	<b>2006-2005</b>
	<i>(dollars in thousands)</i>	
<b>Net income (prior year)</b>	\$ 14,418	\$ 11,273
<b>Increase (decrease) in net income due to:</b>		
Interest income	1,775	14,223
Interest expense	(2,107)	(11,005)
Net interest income	(332)	3,218
Provision for loan losses	(2,645)	(177)
Noninterest income	638	674
Net gains	(76)	31
Noninterest expense	319	(1,114)
Provision for income taxes	(512)	513
Total changes in income	(2,608)	3,145
<b>Net income</b>	<b>\$ 11,810</b>	<b>\$ 14,418</b>

*Net Interest Income*

Net interest income for the year ended December 31, 2007 decreased \$332 or 2.25 percent compared to 2006. Net interest income for the year ended December 31, 2006 increased \$3,218 or 27.92 percent compared to 2005.

Interest income on nonaccrual loans for the year ended December 31, 2007 totaled \$11, no change compared to 2006. Interest income on nonaccrual loans for the year ended December 31, 2006 totaled \$11, a decrease of \$83 compared to 2005.

**Change in Net Interest Income:**

	<b>Nonaccrual</b>			
	<b>Volume*</b>	<b>Rate</b>	<b>Income</b>	<b>Total</b>
	<i>(dollars in thousands)</i>			
<b>12/31/07 - 12/31/06</b>				
Interest income	\$ 1,639	\$ 136	\$ -	\$ 1,775
Interest expense	(1,025)	(1,082)	-	(2,107)
Change in net interest income	\$ 614	\$ (946)	\$ -	\$ (332)
<b>12/31/06 - 12/31/05</b>				
Interest income	\$ 8,376	\$ 5,930	\$ (83)	\$ 14,223
Interest expense	(4,981)	(6,024)	-	(11,006)
Change in net interest income	\$ 3,395	\$ (94)	\$ (83)	\$ 3,218

\* Volume variances can be the result of increased/decreased loan volume or from changes in the percentage composition of assets and liabilities between periods.

*Noninterest Income*

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

<b>Noninterest Income</b>	<b>For the Year Ended</b>			<b>Percentage</b>	
	<b>December 31,</b>			<b>2007/</b>	<b>2006/</b>
	<i>(dollars in thousands)</i>				
	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Loan fees	\$ 166	\$ 548	\$ 410	(69.71%)	33.66%
Fees for financially related services	1	1	3	-	(66.67)
Patronage refund from other Farm Credit Institutions	5,521	4,510	3,977	22.42	13.42
Gains (losses) on sale of rural homes	-	-	4	-	(100.00)
Gains (losses) on sale of premises & equipment, net	2	79	12	(974.68)	566.67
Other noninterest income	47	37	64	27.03	(49.19)
Total noninterest income	\$ 5,737	\$ 5,175	\$ 4,470	15.77%	18.82%

Patronage refunds from other Farm Credit Institutions increased \$1,011 and \$533 for the years ended December 31, 2007 and 2006, respectively. The Association received \$4,164 in a patronage refund and \$652 in a special distribution from the Bank for the year ended December 31, 2007, compared to \$3,273 and \$630 for 2006, and \$2,432 and \$1,054 for 2005. Loan fees decreased \$382 and increased \$138 for the period ended December 31, 2007, compared to the comparable periods in 2006 and 2005, respectively.

*Noninterest Expense*

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

<b>Noninterest Expense</b>	<b>For the Year Ended</b>			<b>Percentage</b>	
	<b>December 31,</b>			<b>2007/</b>	<b>2006/</b>
	<i>(dollars in thousands)</i>				
	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Salaries and employee benefits	\$ 2,951	\$ 3,355	\$ 2,956	(12.04%)	13.72%
Occupancy and equipment	345	304	287	13.49	5.92
Insurance Fund premiums	766	732	185	4.64	295.96
Other operating expenses	1,277	1,267	1,116	.79	13.53
Total noninterest expense	\$ 5,339	\$ 5,658	\$ 4,544	(5.64%)	24.52%

Noninterest expense for the year ended December 31, 2007 decreased \$319 or 5.64 percent compared to 2006. Noninterest expense for the year ended December 31, 2006 increased \$1,115 or 24.53 percent compared to 2005. Salaries and employee benefits expense for the year ended December 31, 2007 decreased \$404 or 12.04 percent compared to 2006. Salaries and employee benefits expense for the year ended December 31, 2006 increased \$399 or 13.50 percent compared to 2005. Insurance Fund premiums for the year ended December 31, 2007 increased \$34 or 4.71 percent compared to 2006. Insurance Fund premiums for the year ended December 31, 2006 increased \$547 or 295.96 percent compared to 2006.

The Association recorded a provision for income taxes of \$179 for the year ended December 31, 2007, as compared to a benefit for income taxes of \$(333) for 2006 and a provision of \$180 for 2005.

A key factor in the growth of net income for future years will be continued improvement in net interest and noninterest income. Our goal is to generate earnings sufficient to fund operations, adequately capitalize the Association, and achieve an adequate rate of return for our members. To meet this goal, the agricultural economy must continue the improvement shown in recent years and the Association must meet certain objectives. These objectives are to attract and maintain high quality loan volume priced at competitive rates and to manage credit risk in our entire portfolio, while efficiently meeting the credit needs of our members.

<b>Key Results of Operations Comparisons</b>	<b>For the 12 Months Ended 12/31/07</b>	<b>For the 12 Months Ended 12/31/06</b>	<b>For the 12 Months Ended 12/31/05</b>
Return on Average Assets	2.22%	2.86%	2.96%
Return on Average Members' Equity	16.63%	23.26%	21.45%
Net Interest Income as a Percentage of Average Earning Assets	2.83%	3.02%	3.12%
Net Chargeoffs (Recoveries) to Average Loans	-%	.002%	-%

## LIQUIDITY AND FUNDING SOURCES

### *Liquidity*

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement (GFA). The GFA 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, creating notes payable (or direct loans) to the Bank. The Bank manages interest rate risk through direct loan pricing and asset/liability management. The notes payable are segmented into variable rate and fixed rate components. 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. Association capital levels effectively create a borrowing margin between the amount of loans outstanding and the amount of notes payable outstanding. This margin is commonly referred to as "Loanable Funds."

Liquidity management is the process whereby funds are made available to meet all financial commitments including the extension of credit, payment of operating expenses and payment of debt obligations. The Association receives access to funds through its borrowing relationship with the Bank and from income generated by operations. The Association's participation in the Farmer Mac and other secondary market programs provides additional liquidity. Sufficient liquid funds have been available to meet all financial obligations.

### *Funding Sources*

The principal source of funds for the Association is the borrowing relationship established with 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, creating notes payable to the Bank. The notes payable are segmented into variable rate and fixed rate components. 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 December 31, 2007, were \$455,811 as compared to \$445,110 at December 31, 2006 and \$370,114 at December 31, 2005. The 2007 increase of 2.40 percent compared to December 31, 2006 and the 2006 increase of 20.26 percent compared to December 31, 2005, is attributable to increased loan volume.

The Association had no lines of credit outstanding with third parties as of December 31, 2007.

### *Funds Management*

The Bank and the Association manage assets and liabilities to provide a broad range of loan products and funding options, which will permit the Association to be competitive in all interest rate environments. The primary objective of the asset/liability management process is to provide stable and rising earnings, while maintaining adequate capital levels by managing exposure to credit and interest rate risks.

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers fixed, adjustable and variable rate loan products that are marginally priced according to financial market rates. Variable rate loans may be indexed to either the Prime Rate or the 90-day London Interbank Offered Rate (LIBOR). Adjustable rate mortgages are indexed to U.S. Treasury Rates. Fixed rate loans are priced based on the current cost of Farm Credit debt of similar terms to maturity.

The majority of the interest rate risk in the Association balance sheet is transferred to the Bank through the notes payable structure. The Bank, in turn, actively utilizes funds management techniques to identify, quantify and control risk associated with the loan portfolio.

## CAPITAL RESOURCES

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.

The Association Board of Directors establishes, adopts, and maintains a formal written capital adequacy plan to ensure that adequate capital is maintained for continued financial viability, to provide for growth necessary to meet the needs of members/borrowers, and to ensure that all stockholders are treated equitably. There were no material changes to the capital plan for 2007 that would affect minimum stock purchases or would have an effect on the Association's ability to retire stock and distribute earnings.

Total members' equity at December 31, 2007, increased 10.25 percent to \$70,858 from the December 31, 2006, total of \$64,272 and for the year ended December 31, 2006, increased 14.73 percent from the December 31, 2005 total of \$56,022. The increase was primarily attributed to the net income for the years ended December 31, 2007 and December 31, 2006.

Total capital stock and participation certificates were \$1,373 on December 31, 2007, compared to \$1,415 on December 31, 2006 and \$1,464 on December 31, 2005.

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 represented, the Association exceeded minimum regulatory standards for all the ratios.

The Association's capital ratios as of December 31 and the FCA minimum requirements follow:

	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>Regulatory Minimum</u>
Permanent Capital	12.22%	11.54%	12.54%	7.00%
Total Surplus	11.96%	11.28%	12.19%	7.00%
Core Surplus	11.46%	10.78%	11.55%	3.50%

At December 31, 2007, the Association's permanent capital ratio, average at-risk capital divided by average risk adjusted assets calculated in accordance with FCA regulations, exceeded the regulatory minimum of 7.00 percent. In addition to these

regulatory requirements, the Association has established a permanent capital goal in excess of the 7.00 percent FCA minimum requirement. As of December 31, 2007, the Association has met the goal.

**PATRONAGE PROGRAM**

Prior to the beginning of any fiscal year, the Association’s Board of Directors, by adoption of a resolution, may establish a Patronage Allocation Program to distribute its available consolidated net earnings. This resolution provides for the application of net earnings in the manner described in the Association’s Bylaws. This includes the setting aside of funds to increase surplus to meet minimum capital adequacy standards established by Regulations, to increase surplus to meet Association capital adequacy standards to a level necessary to support competitive pricing at targeted earnings levels, and for reasonable reserves for necessary purposes of the Association. After excluding net earnings attributable to (a) the portion of loans participated to another institution, and (b) participation loans purchased, remaining consolidated net earnings will be allocated to borrowers. Refer to Note 7, “Members’ Equity”, of the Notes to the Consolidated Financial Statements, for more information concerning the patronage distributions. The Association declared patronage distributions of \$4,991 in 2007, \$5,534 in 2006, and \$5,924 in 2005.

**YOUNG, BEGINNING AND SMALL (YBS) FARMERS AND RANCHERS PROGRAM**

The Association’s mission is to provide financial services to agriculture and the rural community, which includes providing credit to young\*, beginning\*\* and small\*\*\* farmers. Because of the unique needs of these individuals, and their importance to the future growth of the Association, the Association has established annual marketing goals to increase our market share 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 have access to a stable source of credit.

The following tables outline the loan volume and number of YBS loans in the loan portfolio for the Association at December 31, 2007 and December 31, 2006.

As of December 31, 2007		
	Number of Loans	Amount of Loans
Young	151	\$ 59,696
Beginning	693	\$238,451
Small	1,154	\$363,863
As of December 31, 2006		
	Number of Loans	Amount of Loans
Young	153	\$ 51,640
Beginning	690	\$234,170
Small	1,189	\$344,532

*Note: For purposes of the above table, a loan could be classified in more than one category, depending upon the characteristics of the underlying borrower.*

For 2007, the Association’s goal was to increase loan volume to young farmers by 1 percent over December 31, 2006, increase loan volume to beginning farmers by 3 percent over December 31, 2006 and increase loan volume to small farmers by 3 percent over December 31, 2006. The loan volume to young, beginning and small farmers increased by 15.60 percent, 1.83 percent and 5.61 percent, respectively. Although the Association did not obtain the goal for beginning farmers, the number of loans and the volume did increase for that segment of the portfolio. The goals for young and small farmers were obtained. The Association currently has a high penetration in the young, beginning and small farmer market. As of December 31, 2007, the Association was doing business with 48.16 percent of the young farmers identified by the 2002 agricultural census, 25.38 percent of the beginning farmers and 15.94 percent of the small farmers identified by the same census.

During 2007, the Association staff continued to receive training in services related to YBS customer needs to more effectively serve these borrowers. Partnerships were established or enhanced with local agricultural entities such as Farm Service Agency, Future Farmers of America, and the Farm Bureau. Through these partnerships the Association has sponsored numerous educational programs and activities for the purpose of promoting and supporting YBS programs. Some of those activities are:

- Sponsor – Madison County “Young Farmer of the Year”
- Sponsor – Gulf Coast Agribusiness Conference
- Sponsor – Gulf Coast Cotton Expo
- Sponsor – Florida Peanut Producers Association
- Sponsor – Farm City Day

A relationship has also been established with The University of Florida Institute of Food and Agricultural Services which will allow the Association to participate in agriculture-related conferences in 2008.

The Association remains fully committed to serving the financing needs of YBS borrowers and will continue to evaluate its programs to ensure they will be more effective in 2008. The Association includes YBS goals in the annual strategic plan and reports those achievements to the Board of Directors.

The Association is committed to the future success of young, beginning and small farmers.

- \* Young farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who are age 35 or younger as of the date the loan is originally made.
- \*\* Beginning farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who have 10 years or less farming or ranching experience as of the date the loan is originally made.
- \*\*\* Small farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who normally generate less than \$250 in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

## REGULATORY MATTERS

### *Proposed Federal Legislation*

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

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

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

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

### RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109*" (FIN 48 or Interpretation) that was effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies how an enterprise should recognize, measure, present and disclose in its financial statements uncertain tax positions that the enterprise has taken or expects to take on a tax return. Under the Interpretation, the financial statements reflect expected future tax consequences

of income tax positions presuming the relevant taxing authority's full knowledge of the position and all relevant facts, but without considering time values. FIN 48 is applicable to all uncertain positions for taxes accounted for under FASB Statement No. 109. The Association adopted FIN 48 on January 1, 2007 and determined that interest and penalties would be classified as a component of income taxes.

The total amount of uncertain positions for income taxes at January 1, 2007 was \$0 and no cumulative adjustment to beginning members' equity was required. At January 1, 2007, the total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate was \$0 and the total amount of interest and penalties as of January 1, 2007 was \$0. The Association's uncertain tax positions that may reverse within the next 12 months was \$0. The tax years that remain open for federal and major state income tax jurisdictions are 2004 and forward.

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

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

# *Disclosure Required by Farm Credit Administration Regulations*

## Description of Business

Descriptions of the territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations are incorporated herein by reference to Note 1 of 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.

## Description of Property

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

<u>Location</u>	<u>Description</u>	<u>Form of Ownership</u>
5052 Hwy. 90 East Marianna	Administrative/ Branch	Owned
5336 Stewart Street, SE Milton	Branch	Owned
925 W. Washington Monticello	Branch	Owned
2015 Centre Pointe Blvd. Suite 104 Tallahassee	Branch	Leased

## Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 12 of the Consolidated Financial Statements, "Commitments and Contingencies," included in this Annual Report.

## Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 7 of the Consolidated Financial Statements, "Members' Equity," included in this Annual Report.

## 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, 6, 10 and 12 of the Consolidated Financial Statements included in this Annual Report.

## 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 and is to be disclosed in this section, is incorporated herein by reference.

## Senior Officers

The following represents certain information regarding the executive officers of the Association:

<u>Senior Officer</u>	<u>Position</u>
James R. Alberts	Chief Executive Officer/ President
Bruce C. Harrison	Chief Financial Officer
Wade Hayslip	Chief Lending Officer
Wesley O. Pope	Chief Appraiser
Jay Baker	Western Regional Lending Manager
Rick Bitner	Eastern Regional Lending Manager
Lesia Andrews	Marketing Manager

The business experience for the past five years for executive officers is with the Farm Credit System, except for Rick Bitner, who for the preceding five years worked in commercial banking.

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

<u>Name of Individual or Number in Group</u>	<u>Year</u>	<u>Annual</u>		<u>Deferred Comp.</u>	<u>Perq./ Other*</u>	<u>Total</u>
		<u>Salary</u>	<u>Bonus</u>			
James R. Alberts	2007	\$250,012	\$ 80,000	-	\$5,378	\$335,390
James R. Alberts	2006	\$222,009	\$ 66,600	\$40,000	\$5,274	\$333,883
James R. Alberts	2005	\$200,008	\$ 57,000	-	-	\$257,008
6	2007	\$625,946	\$ 46,656	\$105,000	\$6,060	\$783,662
5	2006	\$545,663	\$ 99,915	\$86,000	\$12,651	\$744,229
5	2005	\$580,131	\$120,975	-	-	\$701,106

\* Primarily comprised of group life insurance premiums and automobile compensation.

NOTE: Regulatory reporting changes affected the content of the compensation reported for 2006 and 2007. Those changes may not be reflected in 2005.

Salary and bonus are amounts earned during the year, including 401K contributions.

In addition to a base salary, officers may earn additional compensation under incentive plans. Any incentive earned is included in the salary column of the above table. The Association's plans are designed to motivate employees to produce progressively higher levels of final net earnings from year to year and to support the Association's organizational objectives and financial goals. At the same time, these plans foster superior performance and team concepts. A copy of the policies is available to shareholders of the Association upon request.

Bonuses are shown in the year earned, which may be different than the year of payment.

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

### Directors

The following chart details the directors serving in 2007, their current term of service and total cash compensation paid:

Name of Director	Current Term	Total Compensation
James G. Ditty, <i>Chairman</i>	2007-2010	\$ 19,950
Richard Terry, <i>Vice-Chairman</i>	2005-2008	11,250
Melvin Adams	2006-2009	7,750
Fred H. Beshears	2007-2010	8,500
Bobby A. Boutwell, <i>Outside Director</i>	2004-2007	3,000
Janegale M. Boyd, <i>Outside Director</i>	2004-2007	2,500
Bob Calvert, <i>Appointed Director</i>	2007-2010	16,500
Cindy Eade	2005-2008	10,250
Copeland Griswold	2007-2010	12,900
William Carroll Lamb, <i>Outside Director</i>	2005-2008	14,650
James C. Moulton	2006-2009	8,250
George T. Van Pelt	2005-2008	9,000
T.B. Walker	2006-2009	12,500
Al Wenstrand, <i>Outside Director</i>	2007-2010	2,000
Total		\$ 139,000

The following represents certain information regarding the directors of the Association, including their principal occupation and employment for the past five years.

**James G. Ditty**, Chairman, owns, operates and rents a farm in Jackson County and has been a row crop farmer with principal commodities being peanuts and other row crops for the last five years.

**Richard Terry**, Vice Chairman, owns and operates a tobacco farm in Madison County. This has been his principal occupation for the past five years. He serves on the board for Madison County Farm Bureau, Farmers' Coop, Inc., Live Oak, Florida and Madison County Tobacco Warehouse. Mr. Terry served on the loan committee.

**Melvin T. Adams** owns and operates a farm in Jackson and Holmes Counties and has been a cattle and row crop farmer for the past five years. Mr. Adams served on the executive committee and the compensation committee.

**Fred H. Beshears'** primary occupation for the past five years has been owner and operator of Simpson Nurseries/Jefferson Growers. He has served as a Director for the Florida Pecan Growers Association. He is a resident of Jefferson County, Florida. Mr. Beshears served on the loan committee.

**Bobby A. Boutwell**, outside director, operates a farm supply and fertilizer business in Santa Rosa County, has a cattle operation and rents a farm. This has been his primary occupation for the last five years. Mr. Boutwell served on the audit committee.

**Janegale M. Boyd**, outside director, is a businesswoman, registered nurse, and served as a member of the Florida Legislature for two terms. Her occupation and employment for the last five years has been President/CEO of the Florida Association of Homes for the Aging.

She was twice recognized as the Outstanding Young Woman of the Year. She is active in several professional and community organizations including the Leadership Florida program, the Monticello Opera House, Challenger Learning Center, and serves on the Tallahassee Community College Advisory Board for the School of Nursing. Mrs. Boyd has also served as the Chairman of the City of Monticello Planning Agency (1989-1996), and Chairman of the Jefferson County United Way Campaign. She is a resident of Jefferson County, Florida. Ms. Boyd served on the audit committee.

**Robert A. Calvert, Jr.** is an appointed director and a Certified Management Consultant. For 26 years he has been the owner of Calvert Consulting, a Bank Management Consulting firm that specializes in new bank charters, strategic planning, recruiting bank executive officers, director training, and performing management and director studies for the financial industry regulators. He is a member of the Society of Financial Examiners and has been in the banking industry for 43 years. He is a former commercial bank President, CEO, and Director. Mr. Calvert served on the audit committee.

**Cindy S. Eade** has been in dairy production for the past five years. She is the co-owner and manager of Cindale Farms LLC. She is a member of S.E. Milk Women's Alliance, member of S. E. Milk Marketing Cooperative, and member of Florida Cattlewomen's Association. She is a resident of Jackson County, Florida. Ms. Eade served on the audit committee.

**Copeland Griswold** owns and operates a row crop and timber farm in Santa Rosa County, Florida and has been a farmer for the past five years. Mr. Griswold served on the loan committee.

**William Carroll Lamb** is an outside director and is a past Executive Vice President of Florida Forestry Association, Florida Agricultural Council and the Florida Society of Association Executives. He has served on the boards of Florida Future Farmers of America Foundation, Florida 4-H Foundation and the Southern Scholarship Foundation. He has been retired for the past five years. Mr. Lamb served on the executive committee and the compensation committee.

**James C. Moulton** is involved in the management of timber holdings, he is also involved in building, leasing and management of retail shopping centers and professional buildings in Northwest Florida. This has been his principal occupation for the last five years. He is President of Moulton Properties and serves on the board for Compass Bank, Pensacola (commercial banking). Mr. Moulton served on the audit committee.

**George T. VanPelt's** primary occupation for the past five years has been dairy farming. He is co-owner and operator of a dairy farm in Escambia County. Small grains are also grown for feed. He serves as 4-H Camp Trustee, Board member of Pensacola Interstate Fair and a Church Finance Committee Member. Mr. VanPelt served on the executive committee and the compensation committee.

**T. B. Walker** has been a dairy, cattle and row crop farmer for the past five years and a partner with Waukeenah Feed and Fertilizer Supply (retail). He serves on the board of Farmers and Merchants Bank in Jefferson County (commercial banking). Mr. Walker served on the executive committee and the compensation committee.

**Al Wenstrand** is an outside director and has served as the president for Florida's Great Northwest, Inc., since 2003. From 1999 until 2003, he was appointed by Governor Mike Johanns to the cabinet level position of Director of Economic Development for Nebraska. Prior to the appointment, he was the executive director of the Sarpy County Economic Development Corporation, working in cooperation with the Omaha Chamber in a four-county, regional economic development effort. He served for five years as the chairman of the Nebraska Investment Finance Authority. He also served on the board of directors as treasurer of the Applied Information Management Institute, a not-for-profit membership organization created by a consortium of business, education and government entities to support and promote business growth related to information technology. Mr. Wenstrand served on the loan committee.

Subject to approval by the board, the Association currently may allow directors \$500 honoraria for attendance at meetings or special assignments with the exceptions of the chairman, who is allowed \$600 honoraria for board meetings and the appointed director, who is paid a monthly retainer of \$1,500. Executive committee members are allowed \$250 per meeting. Total compensation paid to directors as a group was \$139,000 for 2007. No director received more than \$5,000 in non-cash compensation during the year.

The following charts detail the number of meetings, compensation for board meetings, other activities and additional compensation paid for other activities (if applicable) for each director:

DIRECTOR	Regular Board Meeting	
	Attended	Compensation
James G. Ditty, <i>Chairman</i>	12	\$ 7,200
Richard Terry, <i>Vice-Chairman</i>	12	6,000
Melvin Adams	10	5,000
Fred H. Beshears	12	6,000
Bobby A. Boutwell	6	3,000
Janegale M. Boyd	5	2,500
Bob Calvert, <i>Appointed Director</i>	11	16,500
Cindy Eade	12	6,000
Copeland Griswold	11	5,500
William Carroll Lamb, <i>Outside Director</i>	12	6,000
James C. Moulton	10	5,000
George T. Van Pelt	10	5,000
T.B. Walker	12	6,000
Al Wenstrand, <i>Outside Director</i>	4	2,000
<b>Total</b>		<b>\$83,700</b>

DIRECTOR	Executive Committee	
	Attended	Compensation
James G. Ditty, <i>Chairman</i>	11	\$ 2,750
Richard Terry, <i>Vice-Chairman</i>	3	750
Melvin Adams	9	2,250
Cindy Eade	1	250
Copeland Griswold	2	500
William Carroll Lamb, <i>Outside Director</i>	9	2,250
James C. Moulton	1	250
George T. Van Pelt	10	2,500
T.B. Walker	10	2,500
<b>Total</b>		<b>\$14,000</b>

DIRECTOR	Other Official Activities	
	Attended	Compensation
James G. Ditty, <i>Chairman</i>	21	\$10,000
Richard Terry, <i>Vice-Chairman</i>	9	4,500
Melvin Adams	1	500
Fred H. Beshears	5	2,500
Cindy Eade	8	4,000
Copeland Griswold	15	6,900
William Carroll Lamb, <i>Outside Director</i>	13	6,400
James C. Moulton	6	3,000
George T. Van Pelt	3	1,500
T.B. Walker	8	4,000
<b>Total</b>		<b>\$43,300</b>

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 of the Association upon request.

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was \$45,252 for 2007, \$50,657 for 2006, and \$54,868 for 2005.

**Transactions with Senior Officers and Directors**

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 11 of the Consolidated Financial Statements, "Related Party Transactions," included in this Annual Report. There have been no transactions between the Association and senior officers or directors which require reporting per FCA regulations.

**Involvement in Certain Legal Proceedings**

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

**Relationship with Independent Auditors and Other Qualified Public Accountants**

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

Aggregate fees incurred by the Association for services rendered by its independent auditors and other qualified public accountants for the year ended December 31, 2007 were as follows:

<i>(dollars in thousands)</i>	<u>2007</u>
<b>Independent Auditor</b>	
PricewaterhouseCoopers LLP	
Audit services	<u>\$ 59</u>

Audit services were for the annual audit of the consolidated financial statements.

**Consolidated Financial Statements**

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated February 28, 2008 and the report of management, which appear in this Annual Report are incorporated herein by reference.

Copies of the Association’s Annual and Quarterly reports are available upon request free of charge by calling 1-850-526-4910 or writing Chief Financial Officer, Farm Credit of Northwest Florida, P.O. Box 7000, Marianna, Florida 32447, or accessing the web site, [www.farmcredit-fl.com](http://www.farmcredit-fl.com). The Association prepares an electronic version of the Annual Report which is available on the Association’s web site within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the 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.

**Borrower Information Regulations**

Since 1972, Farm Credit Administration (FCA) regulations have required that borrower information be held in strict confidence by Farm Credit System (FCS) institutions, their directors, officers and employees. These regulations provide Farm Credit institutions clear guidelines for protecting their borrowers’ nonpublic personal information.

On November 10, 1999, the FCA Board adopted a policy that requires FCS institutions to formally inform new borrowers at loan closing of the FCA regulations on releasing borrower information and to address this information in the Annual Report. The implementation of these measures ensures that new and existing borrowers are aware of the privacy protections afforded them through FCA regulations and Farm Credit System institution efforts.

**Credit and Services to Young, Beginning, and Small Farmers and Ranchers and Producers or Harvesters of Aquatic Products**

Information to be disclosed in this section is incorporated herein by reference to the similarly named section in the Management’s Discussion and Analysis of Financial Condition and Results of Operations section included in this annual report to the shareholders.

**Shareholder Investment**

Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank (Bank or AgFirst). Copies of the Bank’s Annual and Quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, 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 by going to AgFirst’s web site at [www.agfirst.com](http://www.agfirst.com). The Bank prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Bank prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Bank.

## *Report of the Audit Committee*

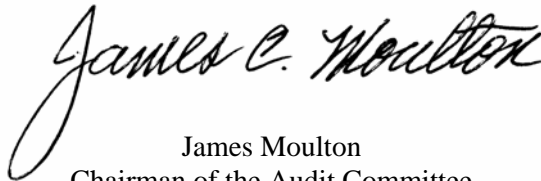
The Audit Committee of the Board of Directors (Committee) is comprised of the directors named below. None of the directors who serve on the Committee is an employee of Farm Credit of Northwest Florida, ACA (Association) and in the opinion of the Board of Directors, each is free of any relationship with the Association 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 Association's audited financial statements with management, which has primary responsibility for the financial statements.

PricewaterhouseCoopers LLP (PwC), the Association's independent auditor for 2007, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 114 (*The Auditor's Communication With Those Charged With Governance*). PwC has provided to the Committee the written disclosures and the letter required by Independence Standards Board Standard No. 1 (*Independence Discussions with Audit Committees*), and the Committee has discussed with PwC that firm's independence.

The Committee has also concluded that PwC's provision of non-audit services, if any, to the Association 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 Association's Annual Report for 2007. The foregoing report is provided by the following independent directors, who constitute the Committee:



James Moulton  
Chairman of the Audit Committee

**Members of Audit Committee**

Cindy Eade  
Robert A. Calvert, Jr.

February 28, 2008

# Report of Independent Auditors



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

## Report of Independent Auditors

To the Board of Directors and Members  
of Farm Credit of Northwest Florida, ACA

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

*PricewaterhouseCoopers* LLP

February 28, 2008









# Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

## Note 1 — Organization and Operations

A. **Organization:** Farm Credit of Northwest Florida, ACA (the Association or ACA) is a member-owned cooperative which provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified purposes in the counties of Bay, Calhoun, Escambia, Franklin, Gadsden, Gulf, Holmes, Jackson, Jefferson, Leon, Liberty, Madison, Okaloosa, Santa Rosa, Taylor, Wakulla, Walton, and Washington in the state of Florida.

The Association is a lending institution of the Farm Credit System (System), a nationwide system of cooperatively owned banks and associations, which was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (Farm Credit Act). The most recent significant amendment to the Farm Credit Act was the Agricultural Credit Act of 1987. At December 31, 2007, the System was comprised of four Farm Credit Banks, one Agricultural Credit Bank and ninety-four Associations.

AgFirst Farm Credit Bank (Bank) and its related Associations are collectively referred to as the "District." The Bank provides funding to associations within the District and is responsible for supervising certain activities of the Association, as well as the other Associations operating within the District. The District consists of the Bank and twenty-three Agricultural Credit Associations (ACAs), all of which are structured as ACA parent-companies, which have two wholly owned subsidiaries, a Federal Land Credit Association (FLCA) and a Production Credit Association (PCA). FLCAs are tax-exempt while ACAs and PCAs are taxable.

ACA parent-companies provide financing and related services through its FLCA and PCA subsidiaries. The FLCA makes collateralized long-term agricultural real estate and rural home mortgage loans. The PCA makes short- and intermediate-term loans for agricultural production or operating purposes; however the Association is operating its short-term and intermediate-term business through the ACA instead of the PCA.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System banks and associations. The FCA examines the activities of the associations and certain actions by the associations are subject to the prior approval of the FCA and the supervising Bank.

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (Insured debt), (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary uses by the Insurance Corporation to provide assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank is required to pay premiums, which may be passed on to the Association, into the Insurance Fund, based on its annual average loan principal outstanding until the monies in the Insurance Fund reach the "secure base amount." The secure base amount is defined in the Farm Credit Act as 2.0 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 Association. The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related businesses.

The Association may sell to any System borrowing member, on an optional basis, credit or term life insurance appropriate to protect the loan commitment in the event of death of the debtor(s). The sale of other insurance necessary to protect a member's farm or aquatic unit is permitted, but limited to hail and multi-peril crop insurance, and insurance necessary to protect the facilities and equipment of aquatic borrowers.

**Note 2 — Summary of Significant Accounting Policies**

The accounting and reporting policies of the Association conform with accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of financial statements in conformity with GAAP requires management 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 may differ from these estimates.

Certain amounts in prior years' financial statements have been reclassified to conform to the current year's presentation. Such reclassifications had no effect on net income or total members' equity of prior years. The Consolidated Financial Statements include the accounts of the FLCA and the PCA. All significant inter-company transactions have been eliminated in consolidation.

A. **Cash:** Cash, as included in the statements of cash flows, represents cash on hand and on deposit at banks.

B. **Loans and Allowance for Loan Losses:** Long-term real estate mortgage loans generally have original maturities ranging from 5 to 40 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. 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 (unless adequately collateralized 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) or charged against the allowance for loan losses (if accrued in the prior year).

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

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

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

Loan origination fees and direct loan origination costs are deferred as part of the carrying amount of the loan and the net fee or cost is amortized over the life of the related loan as an adjustment to interest income using the effective interest method.

The allowance for loan losses is a valuation account used to reasonably estimate loan and lease losses existing as of the financial statement date. Determining the appropriate allowance for loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss.

The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition and prior loan loss experience. It is based on estimates, appraisals and evaluations of loans which, by their nature, contain elements of uncertainty and imprecision. The possibility exists that changes in the economy and its impact on borrower repayment capacity will cause these estimates, appraisals and evaluations to change.

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

- Changes in credit risk classifications,
- Changes in collateral values,
- Changes in risk concentrations,
- Changes in weather related conditions, and
- Changes in economic conditions.

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

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

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs.

- C. Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** The Association is required to maintain ownership in the Bank in the form of Class C stock. Accounting for this investment is on the cost plus allocated equities basis. Patronage refunds from the Bank are accrued as earned. The receivable for such patronage refunds is classified as due from AgFirst Farm Credit Bank.
- D. Other Property Owned:** Other property owned, consisting of real and personal property acquired through a collection action, is recorded upon acquisition at fair value less estimated selling costs. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income, expenses, and carrying value adjustments related to other property owned are included in gains (losses) on other property owned, net.
- E. Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Gains and losses on dispositions are reflected in current earnings. Maintenance and repairs are charged to expense and improvements are capitalized.
- F. Advanced Conditional Payments:** The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, the advanced conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as interest-bearing liabilities in the accompanying Consolidated Balance Sheets. Advanced conditional payments are not insured. Interest is generally paid by the Association on such accounts.
- G. Employee Benefit Plans:** Substantially all employees of the Association may participate in the AgFirst Farm Credit Retirement Plan (Plan), which is a defined benefit plan and is considered a multi-employer plan. The Plan is noncontributory and includes eligible District employees. The "Projected Unit Credit" actuarial method is used for financial reporting purposes. For participants hired before January 1, 2003, benefits are determined based on a final average pay formula. For those participants hired on or after January 1, 2003, benefits are determined using a cash balance formula. The cost of the Plan is allocated based on a percentage of each institution's salary expense to the total salary expense for all Plan participants.

Substantially all employees of the Association may also be eligible to participate in the District's thrift 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 Association contributes \$.50 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. For employees hired on or after January 1, 2003, the Association contributes \$1.00 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. Employee deferrals are not

to exceed the maximum deferral as adjusted by the Internal Revenue Service. Thrift Plan costs are expensed as funded.

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.

The Association may provide certain health care and life insurance benefits to eligible retired employees. Substantially all employees may become eligible for these benefits if they reach early retirement age while working for the Association.

- H. Income Taxes:** The Association is generally subject to Federal and certain other income taxes. As previously described, the ACA holding company has two wholly-owned subsidiaries, a PCA and a FLCA. The FLCA subsidiary is exempt from federal and state income taxes as provided in the Farm Credit Act. The ACA holding company and the PCA subsidiary are subject to federal, state and certain other income taxes.

The Association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the Association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those taxable earnings that will not be distributed as qualified patronage refunds. The Association distributes patronage on the basis of book income.

The Association accounts for income taxes under the asset and liability method, recognizing deferred tax assets and liabilities for the expected future tax consequences of the temporary differences between the carrying amounts and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled.

The Association records a valuation allowance at the balance sheet dates against that portion of the Association's deferred tax assets that, based on management's best estimates of future events and circumstances, more likely than not (a likelihood of more than 50 percent) will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of our expected patronage program, which reduces taxable earnings.

- I. Patronage Refund from AgFirst and Other Financial Institutions:** The Association records patronage refunds from the Bank and certain District Associations on an accrual basis.
- J. Recently Issued Accounting Pronouncements:** In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes — an Interpretation of FASB

Statement No. 109” (FIN 48 or Interpretation) that was effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies how an enterprise should recognize, measure, present and disclose in its financial statements uncertain tax positions that the enterprise has taken or expects to take on a tax return. Under the Interpretation, the financial statements reflect expected future tax consequences of income tax positions presuming the relevant taxing authority’s full knowledge of the position and all relevant facts, but without considering time values. FIN 48 is applicable to all uncertain positions for taxes accounted for under FASB Statement No. 109. The Association adopted FIN 48 on January 1, 2007 and determined that interest and penalties would be classified as a component of income taxes.

There were no uncertain positions for income taxes at January 1, 2007 identified as a result of the adoption and therefore no cumulative adjustment to beginning members’ equity was required. The tax years that remain open for federal and major state income tax jurisdictions are 2004 and forward.

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

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

### Note 3 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31,		
	2007	2006	2005
Real estate mortgage	\$ 373,727	\$ 343,202	\$ 289,468
Production and intermediate term	122,999	143,171	122,173
Processing and marketing	7,405	-	167
Farm related business	2,329	1,973	2,233
Rural residential real estate	9,644	9,101	5,270
Total loans	<u>\$ 516,104</u>	<u>\$ 497,447</u>	<u>\$ 419,311</u>

The Association’s concentration of credit risk in various agricultural commodities is shown in the following table. While the amounts represent the Association’s maximum potential credit risk as it relates to recorded loan principal, a substantial portion of the Association’s lending activities is collateralized and the Association’s exposure to credit loss associated with lending activities is reduced accordingly. An estimate of the Association’s credit risk exposure is considered in the determination of the allowance for loan losses.

Total loans at December 31, 2007, 2006 and 2005 consisted of the following commodity types:

Commodity Type	December 31,		
	2007	2006	2005
Forestry	50%	54%	53%
Other	17	12	16
Row Crops	14	14	13
Livestock	7	7	7
Horticulture	5	4	3
Peanuts	3	4	4
Dairy	2	3	3
Rural Home	2	2	1
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>

The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management’s credit evaluation of the borrower. Collateral held varies, but typically includes farmland and income-producing property, such as crops and livestock, as well as receivables. Long-term real estate loans are collateralized by the first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (97 percent if guaranteed by a government agency) of the property’s appraised value. However, a decline in a property’s market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the Association in the collateral, may result in the loan to value ratios in excess of the regulatory maximum.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms.

The following table presents information relating to impaired loans.

	December 31,		
	2007	2006	2005
Nonaccrual loans:			
Current as to principal and interest	\$ 906	\$ 940	\$ 940
Past due	7,418	-	-
Total nonaccrual loans	<u>8,324</u>	<u>940</u>	<u>940</u>
Impaired accrual loans:			
Restructured accrual loans	-	-	-
Accrual loans 90 days or more past due	31	-	6
Total impaired accrual loans	<u>31</u>	<u>-</u>	<u>6</u>
Total impaired loans	<u>\$ 8,355</u>	<u>\$ 940</u>	<u>\$ 946</u>

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

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

	Year Ended December 31,		
	2007	2006	2005
Interest income recognized on nonaccrual loans	\$ 11	\$ 11	\$ 94
Interest income on impaired accrual loans	5	3	2
Interest income recognized on impaired loans	<u>\$ 16</u>	<u>\$ 14</u>	<u>\$ 96</u>

The following table presents information concerning impaired loans as of December 31,

	2007	2006	2005
	Impaired loans with related allowance	\$ 7,418	\$ 940
Impaired loans with no related allowance	937	-	6
Total impaired loans	<u>\$ 8,355</u>	<u>\$ 940</u>	<u>\$ 946</u>
Allowance on impaired loans	<u>\$ 3,441</u>	<u>\$ 470</u>	<u>\$ 470</u>

The following table summarizes impaired loan information for the year ended December 31,

	2007	2006	2005
Average impaired loans	<u>\$ 2,603</u>	<u>\$ 1,161</u>	<u>\$ 1,255</u>

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

	Year Ended December 31,		
	2007	2006	2005
Interest income which would have been recognized under the original loan terms	\$ 388	\$ 241	\$ 509
Less: interest income recognized	11	11	94
Foregone interest income	<u>\$ 377</u>	<u>\$ 230</u>	<u>\$ 415</u>

The changes in the allowance for loan losses are as follows:

	Year Ended December 31,		
	2007	2006	2005
Balance at beginning of year	\$ 1,574	\$ 1,409	\$ 1,409
Charge-offs:			
Real estate mortgage	-	(12)	-
Total charge-offs	-	(12)	-
Recoveries:			
Real estate mortgage	-	-	-
Total recoveries	-	-	-
Net (charge-offs) recoveries	-	(12)	-
Provision for (reversal of allowance for) loan losses	2,822	177	-
Balance at end of year	<u>\$ 4,396</u>	<u>\$ 1,574</u>	<u>\$ 1,409</u>
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	-%	0.002%	-%

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

	December 31, 2007		December 31, 2006	
	Amount	%	Amount	%
Real estate mortgage	\$ 3,573	81.3%	\$ 763	48.5%
Production and intermediate term	232	5.3	320	20.3
Agribusiness	487	11.1	472	30.0
Rural residential real estate	104	2.3	19	1.2
Total	<u>\$ 4,396</u>	<u>100.0%</u>	<u>\$ 1,574</u>	<u>100.0%</u>
	December 31, 2005			
	Amount	%		
Real estate mortgage	\$ 656	46.6%		
Production and intermediate term	269	19.1		
Agribusiness	473	33.6		
Rural residential real estate	11	0.8		
Total	<u>\$ 1,409</u>	<u>100.0%</u>		

To mitigate the risk of loan losses, the Association may enter into long-term standby "commitment to purchase" agreements with the Federal Agricultural Mortgage Corporation (Farmer Mac). The agreements, which are effectively credit guarantees that will remain in place until the loans are paid in full, give the Association the right to sell the loans identified in the agreements to Farmer Mac in the event of default (typically four months past due), subject to certain conditions. The balance of loans under long-term standby commitments was \$3,145, \$4,866 and \$7,783 at December 31, 2007, 2006 and 2005, respectively. Fees paid to Farmer Mac for such commitments totaled \$19, \$33 and \$45 for the years ended December 31, 2007, 2006 and 2005, respectively. These amounts are classified as noninterest expense.

**Note 4 — Investment in AgFirst Farm Credit Bank**

The Association is required to maintain ownership in the Bank of Class C stock as determined by the Bank. The Bank may require additional capital contributions to maintain its capital requirements.

**Note 5 — Premises and Equipment**

Premises and equipment consisted of the following:

	December 31,		
	2007	2006	2005
Land	\$ 186	\$ 186	\$ 187
Buildings and improvements	1,970	1,970	1,557
Furniture and equipment	1,040	933	880
	<u>3,196</u>	<u>3,089</u>	<u>2,624</u>
Less: accumulated depreciation	1,469	1,285	1,287
Total	<u>\$ 1,727</u>	<u>\$ 1,804</u>	<u>\$ 1,337</u>

**Note 6 — Notes Payable to AgFirst Farm Credit Bank**

The Association's indebtedness to the Bank represents borrowings by the Association to fund its loan portfolio. This indebtedness is collateralized by a pledge of substantially all of the Association's assets and the terms of the revolving lines of credit are governed by a general financing agreement. Interest rates on both variable and fixed rate notes payable are generally established loan-by-loan based on the Bank's marginal cost of funds, capital position, operating costs and return objectives. The interest rate is periodically adjusted by the Bank based upon agreement between the Bank and Association. The weighted average interest rates on the variable rate notes were 5.81 percent for LIBOR-based loans, 5.74 percent for Prime-based loans, and the weighted average remaining maturities were 3.8 years and 7.7 years, respectively, at December 31, 2007. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) notes payable which are match funded by the Bank was 5.73 percent and the weighted average remaining maturity was 5.0 years at December 31, 2007. The weighted average interest rate on all interest-bearing notes payable was 5.74 percent and the weighted average remaining maturity was 5.2 years at December 31, 2007.

Variable rate and fixed rate notes payable represent approximately -1.67 percent and 101.67 percent, respectively, of total notes payable at December 31, 2007.

Under the Farm Credit Act, the Association is obligated to borrow only from the Bank, unless the Bank approves borrowing from other funding sources. The Bank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2007, the Association's notes payable were within the specified limitations.

**Note 7 — Members' Equity**

A description of the Association's capitalization requirements, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below.

**A. Protected Borrower Stock**

Protection of certain borrower stock is provided under the Farm Credit Act, which requires the Association, when retiring protected borrower stock, to retire such stock at par or stated value regardless of its book value. Protected borrower stock includes capital stock and participation certificates, which were outstanding as of January 6, 1988, or were issued or allocated prior to October 6, 1988. If an Association is unable to retire protected borrower stock at par value or stated value, amounts required to retire this equity would be obtained from the Insurance Fund

**B. Capital Stock and Participation Certificates**

In accordance with the Farm Credit Act and the Association's capitalization bylaws, each borrower is required to invest in Class C stock for agricultural loans, or participation certificates in the case of rural home and farm related business loans, as a condition of borrowing. The initial borrower investment, through either purchase or transfer, must be in an amount equal to \$1. The Board of Directors may increase the amount of investment if necessary to meet the Association's capital needs. Loans designated for sale or sold into the Secondary Market on or after April 16, 1996 will have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation.

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

**C. Regulatory Capitalization Requirements and Restrictions**

The FCA's capital adequacy regulations require the Association to achieve permanent capital of seven percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the seven percent capital requirement can initiate certain mandatory and possibly additional discretionary actions by the FCA that, if undertaken, could have a direct material effect on the Association's financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless prescribed capital standards are met. The FCA regulations also require that additional minimum standards for capital be achieved.

These standards require all System institutions to achieve and maintain ratios as defined by FCA regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of seven percent and of core surplus as a percentage of risk-adjusted assets of three and one-half percent. The Association's permanent capital, total surplus and core surplus ratios at December 31, 2007 were 12.22 percent, 11.96 percent and 11.46 percent, respectively.

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

**D. Description of Equities**

The Association is authorized to issue or have outstanding Classes A and D Preferred Stock, Classes A, B, and C Common Stock, Classes B and C Participation Certificates and such other classes of equity as may be provided for in amendments to the bylaws in such amounts as may be necessary to conduct the Association's business. All stock and participation certificates have a par or face value of five dollars (\$5.00) per share.

The Association had the following shares outstanding at December 31, 2007:

Class	Protected	Shares Outstanding	
		Number	Aggregate Par Value
B Common/Nonvoting	Yes	4,440	\$ 23
C Common/Voting	No	245,296	1,227
B Participation Certificates/Nonvoting	Yes	291	1
C Participation Certificates/Nonvoting	No	24,417	122
Total Capital Stock and Participation Certificates		274,444	\$ 1,373

Protected common stock and participation certificates are retired at par or face value in the normal course of business. At-risk common stock and participation certificates are retired at the sole discretion of the Board at book value not to exceed par or face amounts, provided the minimum capital adequacy standards established by the Board are met.

*Retained Earnings*

The Association maintains an unallocated retained earnings account and an allocated retained earnings account. The minimum aggregate amount of these two accounts is determined by the Board. At the end of any fiscal year, if the retained earnings accounts otherwise would be less than the minimum amount determined by the Board as necessary to maintain adequate capital reserves to meet the commitments of the Association, the Association shall apply earnings for the year to the unallocated retained earnings account in such amounts as may be determined necessary by the Board. Unallocated retained earnings are maintained for each borrower to permit liquidation on a patronage basis.

The Association maintains an allocated retained earnings account consisting of earnings held and allocated to borrowers on a patronage basis. In the event of a net loss for any fiscal year, such allocated retained earnings account will be subject to full impairment in the order specified in the bylaws beginning with the most recent allocation.

The Association has a first lien and security interest on all retained earnings account allocations owned by any borrowers, and all distributions thereof, as additional collateral for their indebtedness to the Association. When the debt of a borrower is in default or is in the process of final liquidation by payment or otherwise, the Association, upon approval of the Board, may order any and all retained earnings account allocations owned by such borrower to be applied on the indebtedness.

Allocated equities shall be retired solely at the discretion of the Board; provided, however, that minimum capital standards established by the FCA and the Board are met.

At December 31, 2007, allocated members' equity consisted of \$ 9,859 of qualified surplus, \$ 11,855 of nonqualified allocated surplus and \$ 27,697 of nonqualified retained surplus.

*Dividends*

The Association may declare noncumulative dividends on its capital stock and participation certificates provided the dividend rate does not exceed 20 percent of the par value of the respective capital stock and participation certificates. Such dividends may be paid solely on Classes A or D Preferred Stock, or on all classes of stock and participation certificates.

The rate of dividends paid on Class A and D Preferred Stock for any fiscal year may not be less than the rate of dividend paid on Classes A, B, or C Common Stock or participation certificates for such year. The rate of dividends on Class D Preferred Stock and Class A Preferred Stock shall be determined by the Board but shall not be greater than twenty percent per annum. The rate of dividends on Classes A, B, or C Common Stock and participation certificates shall be at the same rate per share.

Dividends may not be declared if, after recording the liability, the Association would not meet its capital adequacy standards. No dividends were declared by the Association for any of the periods included in these financial statements.

*Patronage Distributions*

Prior to the beginning of any fiscal year, the Board, by adoption of a resolution, may obligate the Association to distribute to borrowers on a patronage basis all or any portion of available net earnings for such fiscal year or for that and subsequent fiscal years. Patronage distributions are based on the proportion of the borrower's interest to the amount of interest earned by the Association on its total loans unless another proportionate patronage basis is approved by the Board.

If the Association meets its capital adequacy standards after making the patronage distributions, the patronage distributions may be in cash, authorized stock of the Association, allocations of earnings retained in an allocated members' equity account, or any one or more of such forms of distribution. Patronage distributions of the Association's earnings may be paid on either a qualified or nonqualified basis, or a combination of both, as determined by the Board. A minimum of 20 percent of the total qualified patronage distribution to any borrower for any fiscal year shall always be paid in cash.

*Transfer*

Classes A and D Preferred, Classes A, B, and C Common Stocks, and Classes B and C Participation Certificates may be transferred to persons or entities eligible to purchase or hold such equities.

*Impairment*

Any net losses recorded by the Association shall first be applied against unallocated members' equity. To the extent that such losses would exceed unallocated members' equity, such losses would be applied consistent with the Association's bylaws and distributed pro rata to each share and/or unit outstanding in the class, in the following order:

1. Class C Common Stock and Class C Participation Certificates
2. Classes A and B Common Stock and Class B Participation Certificates
3. Classes A and D Preferred Stock

*Liquidation*

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities should be distributed to the holders of the outstanding stock and participation certificates in the following order:

1. Classes A and D Preferred Stock
2. Classes A, B and C Common Stock, and Classes B and C Participation Certificates
3. Holders of allocated surplus evidenced by qualified written notices of allocation
4. Holders of allocated surplus evidenced by nonqualified written notices of allocation
5. All unallocated surplus issued after January 1, 1995, shall be distributed to past and present Patrons on a patronage basis
6. Any remaining assets of the Association after such distribution shall be distributed ratably to the holders of all classes of stock and participation certificates

**Note 8 — Income Taxes**

The provision (benefit) for income taxes follows:

	Year Ended December 31,		
	2007	2006	2005
Current:			
Federal	\$ 104	\$ 255	\$ 89
State	19	58	15
	<u>123</u>	<u>313</u>	<u>104</u>
Deferred:			
Federal	56	(596)	22
State	—	(50)	54
	<u>56</u>	<u>(646)</u>	<u>76</u>
Total provision (benefit) for income taxes	<u>\$ 179</u>	<u>\$ (333)</u>	<u>\$ 180</u>

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

	December 31,		
	2007	2006	2005
Federal tax at statutory rate	\$ 4,076	\$ 4,789	\$ 3,894
State tax, net	15	5	45
Patronage distributions	(1,697)	(1,882)	(1,007)
Tax-exempt FLCA earnings	(3,073)	(2,792)	(3,080)
Change in valuation allowance	1,285	(1,513)	257
Effect of refunds - amended tax returns	—	1,497	—
Other	(427)	(437)	71
Provision (benefit) for income taxes	<u>\$ 179</u>	<u>\$ (333)</u>	<u>\$ 180</u>

Deferred tax assets and liabilities result from the following at:

	December 31,		
	2007	2006	2005
Deferred income tax assets:			
Allowance for loan losses	\$ 1,320	\$ 350	\$ 289
Net operating loss – carryforward	—	—	1,497
Loan origination fees	165	231	—
Nonaccrual loan interest	23	—	—
Depreciation	—	—	19
Gross deferred tax assets	<u>1,508</u>	<u>581</u>	<u>1,805</u>
Less: valuation allowance	<u>(1,508)</u>	<u>(223)</u>	<u>(1,736)</u>
Gross deferred tax assets, net of valuation allowance	<u>—</u>	<u>358</u>	<u>69</u>
Deferred income tax liabilities:			
Future Bank equity redemption	—	(302)	(302)
State income tax	—	—	(308)
Loan origination fees	—	—	(52)
Gross deferred tax liability	<u>—</u>	<u>(302)</u>	<u>(662)</u>
Net deferred tax asset (liability)	<u>\$ —</u>	<u>\$ 56</u>	<u>\$ (593)</u>

At December 31, 2007, deferred income taxes have not been provided by the Association on approximately \$56 of patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

The Association recorded a valuation allowance of \$1,508, \$223 and \$1,736 during 2007, 2006 and 2005, respectively. The Association will continue to evaluate the realizability of these deferred tax assets and adjust the valuation allowance accordingly.

The Association adopted the provisions of the Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," on January 1, 2007. As a result of the adoption, there were no uncertain positions for income taxes identified and therefore the Association recognized no change in the liability for unrecognized tax benefits and no reduction to the January 1, 2007 balance of retained earnings. The Association recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense. There were no uncertain tax positions identified related to the current year. The tax years that remain open for federal and major state income tax jurisdictions are 2004 and forward.

#### **Note 9 — Employee Benefit Plans**

The employees of the Association may participate in a Districtwide defined benefit retirement plan. This plan is noncontributory and covers substantially all Association employees. Benefits are based on salary and years of service. As a participant in the District's defined benefit plan, the Association funded \$0 for 2007 and 2006, and \$434 for 2005, through its note payable to the Bank. Plan expenses included in salaries and employee benefits were \$273 for 2007, \$353 for 2006, and \$302 for 2005. Additional financial information for the Plan may be found in the District's Annual Report.

The Association participates in a Districtwide Thrift Plan. For employees hired on or prior to December 31, 2002, the Association will contribute \$.50 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. For employees hired on or after January 1, 2003, the Association will contribute \$1.00 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service. Employer contributions to this plan were \$83, \$74, and \$46 for the years ended December 31, 2007, 2006 and 2005, respectively.

The District sponsors a plan providing certain benefits (primarily health care) to its retirees. Certain Association charges related to this plan are an allocation of District charges based on the Association's proportional share of the plan liability. Postretirement benefits other than pensions (primarily health care benefits) included in salaries and employee benefits were \$78 for 2007, \$79 for 2006 and \$175 for 2005. Additional financial information for the Plan may be found in the District's Annual Report.

#### **Note 10 — Intra-System Financial Assistance**

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

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

#### **Note 11 — Related Party Transactions**

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

Total loans to such persons at December 31, 2007 amounted to \$34,345. During 2007, \$11,345 of new loans were made and repayments totaled \$11,752. In the opinion of management, none of these loans outstanding at December 31, 2007 involved more than a normal risk of collectibility.

#### **Note 12 — Commitments and Contingencies**

The Association has various commitments outstanding and contingent liabilities.

The Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers and to manage their exposure to interest-rate risk. These financial instruments include commitments to extend credit and/or commercial letters of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2007, \$30,103 of commitments to extend credit and \$0 of commercial letters of 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 credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the Consolidated Balance Sheets until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and management applies the same credit policies to these commitments. 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 collateral or other security 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.

Actions are pending against the Association in which money damages are sought. However, on the basis of information now at hand, management and legal counsel are of the opinion that the ultimate liability, if any, resulting therefrom, would not be material in relation to the overall financial position of the Association.

#### Note 13 — Disclosures About Fair Value of Financial Instruments

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

Quoted market prices are generally not available for certain 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:

	December 31, 2007		December 31, 2006	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>				
Cash	\$ 1,375	\$ 1,375	\$ 968	\$ 968
Loans	\$ 516,104	\$ 526,841	\$ 497,447	\$ 506,083
Allowance for loan losses	4,396	—	1,574	—
Loans, net	\$ 511,708	\$ 526,841	\$ 495,873	\$ 506,083
<b>Financial liabilities:</b>				
Notes payable to AgFirst Farm Credit Bank	\$ 455,811	\$ 461,443	\$ 445,110	\$ 445,756

	December 31, 2005	
	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>		
Cash	\$ 360	\$ 360
Loans	\$ 419,311	\$ 419,758
Allowance for loan losses	1,409	—
Loans, net	\$ 417,902	\$ 419,758
<b>Financial liabilities:</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 370,114	\$ 366,868

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 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. As 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 value of loans in a nonaccrual status is estimated to be the carrying amount 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. As described in Note 4, 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 3.22 percent of the issued stock of the Bank as of December 31, 2007 net of any reciprocal investment. As of that date, the Bank's assets totaled \$26.9 billion and shareholders' equity totaled \$1,457 million. The Bank's earnings were \$192 million during 2007.

In addition, the Association has an investment of \$417 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.

#### Note 14 — Quarterly Financial Information (Unaudited)

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

	2007				
	First	Second	Third	Fourth	Total
Net interest income	\$ 3,674	\$ 3,667	\$ 3,555	\$ 3,517	\$ 14,413
Provision for (reversal of allowance for) loan losses	—	—	599	2,223	2,822
Noninterest income (expense), net	(143)	(93)	(335)	790	219
Net income (loss)	\$ 3,531	\$ 3,574	\$ 2,621	\$ 2,084	\$ 11,810

	2006				
	First	Second	Third	Fourth	Total
Net interest income	\$ 3,424	\$ 3,606	\$ 3,856	\$ 3,859	\$ 14,745
Provision for (reversal of allowance for) loan losses	47	130	—	—	177
Noninterest income (expense), net	(376)	(366)	(340)	932	(150)
Net income (loss)	\$ 3,001	\$ 3,110	\$ 3,516	\$ 4,791	\$ 14,418

	2005				
	First	Second	Third	Fourth	Total
Net interest income	\$ 2,408	\$ 2,742	\$ 3,172	\$ 3,205	\$ 11,527
Provision for (reversal of allowance for) loan losses	—	—	—	—	—
Noninterest income (expense), net	(187)	(455)	(529)	917	(254)
Net income (loss)	\$ 2,221	\$ 2,287	\$ 2,643	\$ 4,122	\$ 11,273