

# **THIRD QUARTER 2006**

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James R. Alberts  
Chief Executive Officer



James G. Ditty  
Chairman of the Board

October 27, 2006

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

*(dollars in thousands)*

The following commentary reviews the financial condition and results of operations of Farm Credit of Northwest Florida, ACA (Association) for the period ended September 30, 2006.

These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2005 Annual Report of the Association. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

## **LOAN PORTFOLIO**

The Association provides funds to farmers, rural homeowners and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans. The Association's loan portfolio is diversified over a range of agricultural commodities including forestry, row crops, livestock peanuts, horticulture, dairies and rural homes. Farm size varies and many of the borrowers in the region have diversified farming operations. This factor, along with the numerous opportunities for non-farm income in the area, somewhat reduces the level of dependency on any single commodity.

The gross loan volume of the Association as of September 30, 2006, was \$530,988, an increase of \$111,677, as compared to \$419,311 at December 31, 2005. Net loans outstanding at September 30, 2006, were \$529,414 as compared to \$417,902 at December 31, 2005. Net loans accounted for 96.65 percent of total assets at September 30, 2006, as compared to 96.25 percent of total assets at December 31, 2005. This increase in loan volume is mostly due to continued desire for ownership of timberland, recreational/hunting land and lifestyle farms. Continued sale of timberland by large corporations has resulted in extraordinary availability of land for acquisition.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level, however, and credit administration remains satisfactory. Nonaccrual loans were \$940 at September 30, 2006 and were also \$940 at December 31, 2005.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions. The allowance for loan losses at September 30, 2006 was \$1,574, an increase of \$165, as compared to \$1,409 at December 31, 2005. The Association recorded a \$12 charge off against the allowance for loan loss since December 31, 2005. The allowance for loan loss of \$1,574 at September 30, 2006 was considered by management to be adequate to cover possible losses.

## **RESULTS OF OPERATIONS**

### ***For the three months ended September 30, 2006***

Net income for the three months ended September 30, 2006, totaled \$3,516, as compared to \$2,643 for the same period in 2005. Net interest income increased \$684 for the three months ended September 30, 2006, as compared to the same period in 2005. Increased loan volume was the primary reason for this increase in net interest income.

Noninterest income for the three months ended September 30, 2006, totaled \$1,157, as compared to \$838 for the same period of 2005, an increase of \$319. The increase is primarily the result of an increase of \$252 in Equity in Earnings of other Farm Credit institutions and an increase of \$104 in loan fee income. Noninterest expense for the three months ended September 30, 2006, increased \$221 compared to the same period of 2005. The primary reasons for the increase in noninterest expense were an increase of \$130 in Insurance Fund premiums, an increase of \$28 in salaries and employee benefits and an increase of \$52 in other operating expenses.

### ***For the nine months ended September 30, 2006***

Net income for the nine months ended September 30, 2006, totaled \$9,627, as compared to \$7,151 for the same period in 2005. At September 30, 2006, net interest income increased by \$2,564 or 30.81 percent compared to September 30, 2005. Interest income on loans increased by \$11,013 and interest expense increased by \$8,449. This change in net interest income is the result of increased loan volume.

The Association recorded a provision for loan loss of \$177 for the nine months ended September 30, 2006, as compared to \$0 (none) for the same period in 2005.

Noninterest income for the nine months ended September 30, 2006, totaled \$3,109, as compared to \$2,238 for the same period of 2005, an increase of \$871. The increase is primarily the result of an increase of \$694 in Equity in Earnings of other Farm Credit institutions and an increase of \$214 in loan fee income. Noninterest expense for the nine months ended September 30, 2006, increased \$747 compared to the same period of 2005. The primary reasons for the decrease in noninterest expense were an increase of \$403 in Insurance Fund premiums, an increase in salaries and benefits of \$199 and an increase of \$122 in other operating expenses.

## FUNDING SOURCES

The principal source of funds for the Association is the borrowing relationship established with AgFirst Farm Credit Bank (the Bank) through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances funds to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at September 30, 2006, was \$476 as compared to \$370 at December 31, 2005.

## CAPITAL RESOURCES

Total members' equity at September 30, 2006, increased to \$64,984 from the December 31, 2005, total of \$56,022. The increase is primarily attributed to year-to-date 2006 earnings less allocated surplus revolvment.

Total capital stock and participation certificates were \$1,383 on September 30, 2006, compared to \$1,464 on December 31, 2005. This decrease is attributed to capital stock and participation certificates retirements of \$241 and issuances of \$160.

Farm Credit Administration (FCA) regulations require all Farm Credit institutions to maintain minimum permanent capital, total surplus and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus and core surplus as defined in FCA regulations, by a risk-adjusted asset base. As of September 30, 2006, the Association's total surplus ratio and core surplus ratio were 10.83 percent and 10.33 percent, respectively, and the permanent capital ratio was 11.08 percent. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

## ACCOUNTING FOR DEFINED BENEFIT PENSION AND OTHER POSTRETIREMENT PLANS

On September 29, 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 158 – Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans. The Standard requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in that funded status in the year in which the changes occur through comprehensive income. The Standard is effective for employers with publicly traded securities for the fiscal year ending after December 15, 2006 and for employers without publicly traded securities for the fiscal year ending after September 15, 2007. The Association will be required to implement the Standard for the year ended December 31, 2007. In addition, this Standard requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the Association uses a measurement date of September 30th. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. The Association is currently evaluating the impact of implementing this Standard. It is anticipated that the impact from the implementation of this Standard will have no impact on the income statement and, based on the current funded status of the defined benefit plans, it is not expected to have a material or significant impact on the balance sheet.

**NOTE:** Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst's annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Wanda Martin, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, [www.agfirst.com](http://www.agfirst.com). Copies of the Association's annual and quarterly reports are also available 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, or accessing the website, [www.farmcredit-fl.com](http://www.farmcredit-fl.com). The Association prepares a quarterly report within 45 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.

*Farm Credit of Northwest Florida, ACA*  
**Consolidated Balance Sheets**

<i>(dollars in thousands)</i>	<b>September 30, 2006</b> <i>(unaudited)</i>	<b>December 31, 2005</b> <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 710	\$ 360
Loans	530,988	419,311
Less: allowance for loan losses	1,574	1,409
Net loans	529,414	417,902
Accrued interest receivable	6,174	3,707
Investment in other Farm Credit institutions	4,417	4,418
Premises and equipment, net	1,669	1,337
Other property owned	313	—
Prepaid retirement expense	2,160	2,425
Due from AgFirst Farm Credit Bank	2,603	3,680
Other assets	298	369
Total assets	<u>\$ 547,758</u>	<u>\$ 434,198</u>
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 476,134	\$ 370,114
Accrued interest payable	2,330	1,564
Patronage refund payable	21	2,995
Other liabilities	4,289	3,503
Total liabilities	<u>482,774</u>	<u>378,176</u>
Commitments and contingencies		
<b>Members' Equity</b>		
Protected borrower equity	33	45
Capital stock and participation certificates	1,350	1,419
Retained earnings		
Allocated	36,535	37,394
Unallocated	27,066	17,164
Total members' equity	<u>64,984</u>	<u>56,022</u>
Total liabilities and members' equity	<u>\$ 547,758</u>	<u>\$ 434,198</u>

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

*Farm Credit of Northwest Florida, ACA*  
**Consolidated Statements of Income**

(unaudited)

<i>(dollars in thousands)</i>	<b>For the three months ended September 30,</b>		<b>For the nine months ended September 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>Interest Income</b>				
Loans	\$ 10,947	\$ 7,173	\$ 29,246	\$ 18,233
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	7,034	3,988	18,202	9,884
Other	57	13	158	27
Total interest expense	7,091	4,001	18,360	9,911
Net interest income	3,856	3,172	10,886	8,322
Provision for (reversal of) loan losses	—	—	177	—
Net interest income after provision for (reversal of) loan losses	3,856	3,172	10,709	8,322
<b>Noninterest Income</b>				
Loan fees	197	93	506	292
Fees for financially related services	—	2	1	3
Equity in earnings of other Farm Credit institutions	956	704	2,569	1,875
Other noninterest income	4	39	33	68
Total noninterest income	1,157	838	3,109	2,238
<b>Noninterest Expense</b>				
Salaries and employee benefits	808	780	2,396	2,197
Occupancy and equipment	84	73	234	211
Insurance Fund premium	197	67	537	134
Other operating expenses	322	270	921	799
Total noninterest expense	1,411	1,190	4,088	3,341
Income before income taxes	3,602	2,820	9,730	7,219
Provision (benefit) for income taxes	86	177	103	68
Net income	\$ 3,516	\$ 2,643	\$ 9,627	\$ 7,151

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

*Farm Credit of Northwest Florida, ACA*

# Consolidated Statements of Changes in Members' Equity

*(unaudited)*

*(dollars in thousands)*

	Protected Borrower Capital	Capital Stock and Participation Certificates	Retained Earnings		Total Members' Equity
			Allocated	Unallocated	
Balance at December 31, 2004	\$ 66	\$ 1,376	\$ 29,843	\$ 17,009	\$ 48,294
Net income				7,151	7,151
Protected borrower equity retired	(16)				(16)
Capital stock/participation certificates issued		165			165
Capital stock/participation certificates retired		(167)			(167)
Retained earnings retired			(536)		(536)
Distribution adjustment			158	(226)	(68)
Balance at September 30, 2005	\$ 50	\$ 1,374	\$ 29,465	\$ 23,934	\$ 54,823
Balance at December 31, 2005	\$ 45	\$ 1,419	\$ 37,394	\$ 17,164	\$ 56,022
Net income				9,627	9,627
Protected borrower equity retired	(12)				(12)
Capital stock/participation certificates issued		160			160
Capital stock/participation certificates retired		(229)			(229)
Retained earnings retired			(665)		(665)
Distribution adjustment			(194)	275	81
Balance at September 30, 2006	\$ 33	\$ 1,350	\$ 36,535	\$ 27,066	\$ 64,984

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

# Notes to the Consolidated Financial Statements

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

## NOTE 1 – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

A description of the organization and operations of Farm Credit of Northwest Florida, ACA (the Association), the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2005, are contained in the 2005 Annual Report to Shareholders. These unaudited third quarter 2006 consolidated financial statements should be read in conjunction with the 2005 Annual Report to Shareholders.

On September 29, 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 158 – Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans. The Standard requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in that funded status in the year in which the changes occur through comprehensive income. The Standard is effective for employers with publicly traded securities for the fiscal year ending after December 15, 2006 and for employers without publicly traded securities for the fiscal year ending after June 15, 2007. The Association will be required to implement the Standard for the year ended December 31, 2007. In addition, this Standard requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the Association uses a measurement date of September 30th. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. The Association is currently evaluating the impact of implementing this Standard. It is anticipated that the impact from the implementation of this Standard will have no impact on the consolidated income statement and, based on the current funded status of the defined benefit plans, it is not expected to have a material or significant impact on the consolidated balance sheet.

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles. The results for the nine months ended September 30, 2006, are not necessarily indicative of the results to be expected for the year ending December 31, 2006.

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

The Association maintains an allowance for loan losses in accordance with generally accepted accounting principles.

The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of September 30, 2006, the allowance for losses is adequate in management’s opinion to provide for possible losses on existing loans.

## NOTE 2 – ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses follows:

	<b>For the nine months ended September 30,</b>	
	<b>2006</b>	<b>2005</b>
Balance at beginning of period	\$ 1,409	\$ 1,409
Provision for (reversal of) loan losses	177	–
Loans (charged off), net of recoveries	(12)	–
Balance at end of period	<u>\$ 1,574</u>	<u>\$ 1,409</u>

## NOTE 3 – COMMITMENTS AND CONTINGENT LIABILITIES

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 4 – EMPLOYEE BENEFIT PLANS

The Association participates in a Districtwide defined benefit retirement plan. The costs of the plan are not segregated by participating entities but are allocated among the participating entities. Pension costs are allocated by multiplying the District’s net pension expense times each institution’s salary expense as a percentage of the District’s salary expense. The Association also participates in Districtwide Thrift and other postretirement benefit plans.

The following is a table of retirement and postretirement benefit expense for the nine months ended September 30, 2006:

	<b>For the nine months ended September 30,</b>	
	<b>2006</b>	<b>2005</b>
Pension	\$ 265	\$ 226
Thrift/deferred compensation	57	38
Other postretirement benefits	59	131
Total	<u>\$ 381</u>	<u>\$ 395</u>

As of September 30, 2006, no contributions have been made to the pension plan for 2006. The Association does not anticipate making additional contributions for the remainder of 2006.