*Puerto Rico Farm Credit, ACA*

# SECOND QUARTER 2009

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## CERTIFICATION

The undersigned certify that we have reviewed the June 30, 2009 quarterly report of Puerto Rico Farm Credit, ACA, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Juan A. Santiago
Chairman of the Board

William A. Garrahan
Chief Executive Officer

Antonio Marichal
Member of Board of Directors
Chairman of the Audit Committee

Bruce M. Hoffman
Chief Financial Officer

July 23, 2009

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

*(dollars in thousands)*

The following commentary reviews the consolidated financial condition and results of operations of Puerto Rico Farm Credit, ACA (Association) for the six months ended June 30, 2009. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements, and the 2008 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 business for financing short and intermediate-term loans and long-term real estate mortgage loans. The Association also maintains a portfolio of purchased loans, originated by other Farm Credit System entities and non-system entities. The Association's predominant chartered territory agricultural commodities were dairy, livestock, field crops and fruits which totaled approximately $115.4 million or 46.7 percent of all outstanding loan volume at June 30, 2009.

The loan volume of the Association at June 30, 2009 was $245,877, a decrease of $15,028 or 5.8 percent as compared to $260,905 at December 31, 2008. Loans originated within the Association's chartered territory were lower by approximately $7,049, while participation loans purchased decreased by approximately $7,979.

Net loans outstanding at June 30, 2009 totaled $244,383 as compared to $259,651 at December 31, 2008. Net loans at June 30, 2009 made up 92.8 percent of total assets as compared to 92.8 percent at December 31, 2008.

As a percentage of loans, nonaccrual loans equaled 7.95 percent at June 30, 2009, compared with 4.84 percent at December 31, 2008. The increase in nonaccrual loan volume during the first six months of 2009 resulted primarily from the transfer of one large chartered territory credit into nonaccrual status. Borrowers have found it increasingly difficult to maintain a current repayment status, given the island's four years of recessionary economic status. However, the overall delinquency rate for the chartered territory accruing loan portfolio has remained favorable, supported by the lower interest rate environment. Conversely, the participation purchased portfolio has shown an increasing delinquency rate during the first six months of 2009. The significant increase in loans transferred to nonaccrual and the increase in the participation portfolio delinquency rate has resulted in a decline in the loan portfolio's overall credit quality. Management expects to see a leveling off of the deterioration in credit quality during the second half of the year.

The allowance for loan losses increased to $1,494 at June 30, 2009, from $1,254 at December 31, 2008. The increase related primarily to the net change in the specific reserves established for purchased participation loans in nonaccrual status. The ratio of allowance to outstanding loan volume increased to .61 percent at June 30, 2009 from .48 percent at December 31, 2008 as a result of the higher level of nonaccrual loan volume. During the first six months of 2009, charge-offs totaled $1,846 and there were no recoveries. The majority of the chargeoffs, $1,764, were from the participation purchased portfolio segment and only $82 was from the chartered territory portfolio segment. Management anticipates additional provision expense and increased charge-off activity during the balance of 2009, both of which will exceed historical trends.

## RESULTS OF OPERATIONS

For the six months ended June 30, 2009, the Association incurred a net loss which totaled $1,084. This was a decrease of $2,837 as compared to net income of $1,753 for the first six months of 2008. The decrease primarily resulted from provision expense to increase the allowance for loan losses which totaled $2,085 and a decrease in net interest income of $803 from lending activities, mostly as a result of the lower interest rate environment. Management projects that the Association will incur a net operating loss for the year.

During the first six months of 2009, interest income, primarily from accruing loans, decreased by $2,371 or 32.2 percent. Interest expense related to the notes payable to AgFirst FCB (the Bank) decreased by $1,699 or 37.6 percent. Thus, net interest income decreased by $672 or 23.6 percent. The decrease in net interest income was due primarily to the significant decline in market interest rates, which negatively impacted by $643 the interest credit earned on loanable funds invested with the Bank. Additionally, the Association's investment in notes receivable/sub-debt from two AgFirst District associations resulted in an increase in net interest income for the first six months of $132.

For the first six months of 2009 the Association recorded provisions for loan losses expense which totaled $2,085. This compared to no provision expense for the first six months of 2008.

Noninterest income for the first half of 2009 was $1,231 or 20.5 percent higher than the $1,022 recognized during the first half of 2008. The increase was primarily attributable to gains from the acquisition of collateral property through foreclosure. Additionally, the Association realized increased accrued patronage earnings from the AgFirst FCB. Also, higher patronage rebate fees were earned from various Puerto Rico investment funds.

Noninterest expense for the six months ended June 30, 2009 increased by $289 or 13.6 percent compared to the same six month period of 2008. The increase was primarily related to salaries and employee benefits, for which a revised actuarial analyses materially increased the 2009 pension benefit expense under SFAS 87 by $439, which was partially offset by a decrease in salaries expense which totaled $184.

Although the Association is subject to federal income tax, the Association does not expect to incur a federal tax liability as a tax credit for paying patronage dividends to the Association eligible borrowers is available. As it is the Association's intent to pay out 100 percent of taxable income as patronage dividends, no provision for income taxes was made.

**For the three months ended June 30, 2009**

For the second quarter of 2009, the Association incurred a net loss from operations of $1,090 a decrease of $1,887 when compared to net income of $797 for the second quarter of 2008. The primary driver of this decrease were second quarter provisions for loan losses which totaled $1,501. This compared to the second quarter of 2008 when the Association recorded no provision expense. Charge-offs for the second quarter of 2009 totaled $1,439, as compared to none during the second quarter of 2008.

Net interest income for the three months ended June 30, 2009 was $1,035 compared to $1,322 for the three months ended June 30, 2008. Again, the lower interest rate environment had a negative impact on the interest credit earned on the Association's loanable funds invested with AgFirst FCB.

Noninterest income for the second quarter of 2009 was $533 compared to $504 for the second quarter of 2008. The year-over-year change was primarily related to accounting for other property owned.

For the second quarter of 2009, noninterest expense increased by $128 to total $1,157 as compared to the second quarter of 2008 for which noninterest expense totaled $1,029. The increase for the quarter was primarily related to employee benefits pension expense under SFAS 87.

**Key Results of Operations Ratios**

| | Annualized for the six months ended 6/30/09 | For the year ended 12/31/08 |
|---|---|---|
| Return on Average Assets | (0.80)% | 1.00% |
| Return on Average Members' Equity | (3.88)% | 4.67% |
| Net Interest Income as a Percentage of Average Earning Assets | 1.82% | 2.18% |

## LIQUIDITY AND FUNDING SOURCES

*Liquidity*

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. 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 funds are advanced by the Bank to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate notes are utilized by the Association to fund variable rate loan advances and operating funds requirements. The total notes payable to the Bank at June 30, 2009 were $205,907 as compared with $219,092 at December 31, 2008. The decrease of $13,185 or 6.0 percent corresponded closely to the decrease in outstanding loan volume of $15,028 and the decrease in the patronage refund paid to the Association's borrowers during the second quarter of 2009.

The Association had no lines of credit outstanding with third parties as of June 30, 2009.

*Funds Management*

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers variable and fixed rate loan products which are competitively priced according to local market rates. Variable rate loans may be indexed to either the Prime rate or the London Interbank Offered Rate (LIBOR). 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 interest rate risk associated with the loan portfolio.

## CAPITAL RESOURCES

Total members' equity at June 30, 2009 decreased 1.8 percent to $55,247 from December 31, 2008 when total members' equity was $56,269. The decrease of $1,022 was primarily attributable to the year-to-date net loss from operations which totaled $1,084 at June 30, 2009. The operating loss was partially offset by the annual adjustment made to unallocated retained earnings to reconcile the year end 2008 estimated patronage dividend payable to the Association's 2008 federal taxable income.

Total capital stock and participation certificates were $749 on June 30, 2009 compared to $779 on December 31, 2008. The decrease of $30 was the net result of refunding more stock to non-borrowing stockholders than new stockholders purchasing capital stock or participation certificates.

Unallocated retained earnings decreased $979 or 1.8 percent from December 31, 2008 when unallocated retained earnings totaled $54,577. The decrease was from the net loss from operations of $1,084 incurred during the first six months of 2009 and a patronage dividend adjustment of $105 to reconcile the year-end estimated dividend payable to the Association's 2008 federal taxable income.

The Board of directors intends to continue its policy of declaring cash patronage dividends. 2008 was the sixteenth consecutive year of paying dividends. The table below sets forth the recent amount of patronage dividends declared:

| Year | Amount Declared |
|---|---|
| 2008 | $2,000 |
| 2007 | $3,250 |
| 2006 | $3,200 |

The amount of dividends, as always, will depend upon continued strong earnings, the amount of taxable income, the overall financial condition of the Association and credit-related factors.

The Association's regulatory permanent capital ratio at June 30, 2009 was 17.24 percent compared to 16.96 percent at December 31, 2008. The Association's total surplus and core surplus ratios were both 16.93 percent at June 30, 2009. 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.

***Key financial condition ratios were as follows:***

| | 6/30/09 | 12/31/08 |
|---|---|---|
| Total Members' Equity to Asset | 20.98% | 20.11% |
| Debt to Total Members' Equity | 3.77:1 | 3.97:1 |

### Recently Issued Accounting Pronouncements

Please refer to Note 1, *"Organization, Significant Accounting Policies, and Recently Issued Accounting Pronouncements",* in the Notes to the Financial Statements, and the 2008 Annual Report to Shareholders for recently issued accounting pronouncements.

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**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 Stephen Gilbert, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at its website, *www.agfirst.com*. Copies of the Association's annual and quarterly reports are also available upon request free of charge by calling 1-800-981-3323, or writing Bruce M. Hoffman, CFO, Puerto Rico Farm Credit, ACA, PO Box 363649, San Juan, PR 00936-3649, or accessing the website, *www.puertoricofarmcredit.com*. The Association prepares a quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Association.

Puerto Rico Farm Credit, ACA

# Consolidated Balance Sheets

| *(dollars in thousands)* | June 30, 2009 | June 30, 2008 | December 31, 2008 |
|---|---|---|---|
| | *(unaudited)* | *(unaudited)* | *(audited)* |
| **Assets** | | | |
| Cash | $ 170 | $ 22 | $ 290 |
| Loans | 245,877 | 258,688 | 260,905 |
| Less: allowance for loan losses | 1,494 | 330 | 1,254 |
| Net loans | 244,383 | 258,358 | 259,651 |
| Notes receivable from other Farm Credit institutions (Note 5) | 10,000 | – | 10,000 |
| Accrued interest receivable | 1,031 | 1,340 | 1,244 |
| Investment in other Farm Credit institutions | 3,517 | 3,399 | 3,517 |
| Premises and equipment, net | 1,190 | 1,138 | 1,241 |
| Other property owned | 432 | – | – |
| Due from AgFirst Farm Credit Bank | 826 | 780 | 1,605 |
| Other assets | 1,835 | 1,857 | 2,286 |
| Total assets | $ 263,384 | $ 266,894 | $ 279,834 |
| **Liabilities** | | | |
| Notes payable to AgFirst Farm Credit Bank | $ 205,907 | $ 206,830 | $ 219,092 |
| Accrued interest payable | 442 | 641 | 551 |
| Patronage refund payable | – | – | 2,000 |
| Other liabilities | 1,788 | 2,108 | 1,922 |
| Total liabilities | 208,137 | 209,579 | 223,565 |
| Commitments and contingencies | | | |
| **Members' Equity** | | | |
| Capital stock and participation certificates | 749 | 802 | 779 |
| Unallocated retained earnings | 53,598 | 55,663 | 54,577 |
| Accumulated other comprehensive income (loss) | 900 | 850 | 913 |
| Total members' equity | 55,247 | 57,315 | 56,269 |
| Total liabilities and members' equity | $ 263,384 | $ 266,894 | $ 279,834 |

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

Puerto Rico Farm Credit, ACA

# Consolidated Statements of Operations

*(unaudited)*

| *(dollars in thousands)* | For the three months ended June 30, 2009 | For the three months ended June 30, 2008 | For the six months ended June 30, 2009 | For the six months ended June 30, 2008 |
|---|---|---|---|---|
| **Interest Income** | | | | |
| Loans | $ 2,165 | $ 3,338 | $ 4,545 | $ 7,366 |
| Notes receivable from other Farm Credit institutions (Note 5) | 225 | — | 450 | — |
| Total interest income | 2,390 | 3,338 | 4,995 | 7,366 |
| **Interest Expense** | | | | |
| Notes payable to AgFirst Farm Credit Bank | 1,355 | 2,016 | 2,816 | 4,515 |
| Net interest income | 1,035 | 1,322 | 2,179 | 2,851 |
| Provision for (reversal of allowance for) loan losses | 1,501 | — | 2,085 | — |
| Net interest income (loss) after provision for (reversal of allowance for) loan losses | (466) | 1,322 | 94 | 2,851 |
| **Noninterest Income** | | | | |
| Loan fees | 70 | 129 | 192 | 206 |
| Patronage rebate fees | 57 | 27 | 111 | 64 |
| Equity in earnings of other Farm Credit institutions | 408 | 396 | 826 | 780 |
| Gains (losses) on other property owned, net | — | (49) | 82 | (50) |
| Other noninterest income | (2) | 1 | 20 | 22 |
| Total noninterest income | 533 | 504 | 1,231 | 1,022 |
| **Noninterest Expense** | | | | |
| Salaries and employee benefits | 771 | 641 | 1,633 | 1,326 |
| Occupancy and equipment | 64 | 71 | 135 | 143 |
| Insurance Fund premium | 101 | 89 | 201 | 175 |
| Other operating expenses | 221 | 228 | 440 | 476 |
| Total noninterest expense | 1,157 | 1,029 | 2,409 | 2,120 |
| Income (loss) before income taxes | (1,090) | 797 | (1,084) | 1,753 |
| Provision (benefit) for income taxes | — | — | — | — |
| Net income (loss) | $ (1,090) | $ 797 | $ (1,084) | $ 1,753 |

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

Puerto Rico Farm Credit, ACA

# Consolidated Statements of Changes in Members' Equity

*(unaudited)*

| *(dollars in thousands)* | Capital Stock and Participation Certificates | Retained Earnings Unallocated | Accumulated Other Comprehensive Income | Total Members' Equity |
|---|---|---|---|---|
| Balance at December 31, 2007 | $ 819 | $ 53,880 | $ 862 | $ 55,561 |
| Comprehensive income | | | | |
| Net income | | 1,753 | | 1,753 |
| Employee benefit plans adjustments | | (17) | (12) | (29) |
| Total comprehensive income | | | | 1,724 |
| Capital stock/participation certificates issued/(retired), net | (17) | | | (17) |
| Patronage distribution adjustment | | 47 | | 47 |
| Balance at June 30, 2008 | $ 802 | $ 55,663 | $ 850 | $ 57,315 |
| Balance at December 31, 2008 | $ 779 | $ 54,577 | $ 913 | $ 56,269 |
| Comprehensive income | | | | |
| Net income | | (1,084) | | (1,084) |
| Employee benefit plans adjustments | | | (13) | (13) |
| Total comprehensive income | | | | (1,097) |
| Capital stock/participation certificates issued/(retired), net | (30) | | | (30) |
| Patronage distribution adjustment | | 105 | | 105 |
| Balance at June 30, 2009 | $ 749 | $ 53,598 | $ 900 | $ 55,247 |

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

# Notes to the Consolidated Financial Statements

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

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

The accompanying financial statements include the accounts of Puerto Rico Farm Credit, ACA (the Association). A description of the organization and operations of the Association, the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2008, are contained in the 2008 Annual Report of the Association. These unaudited second quarter 2009 consolidated financial statements should be read in conjunction with the 2008 Annual Report of the Association.

The accompanying consolidated financial statements contain all necessary adjustments for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles (GAAP) and prevailing practices within the banking industry. The results for the six months ended June 30, 2009 are not necessarily indicative of the results to be expected for the year ending December 31, 2009.

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

The Association maintains an allowance for loan losses in accordance with GAAP. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of June 30, 2009, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

In addition to the recently issued accounting pronouncements discussed in the 2008 Annual Report to Shareholders, effective January 1, 2009, the Association adopted Financial Accounting Standards Board (FASB) Statement of Position (FSP) No. 157-2, "Effective Date of FASB Statement No. 157." This FSP delayed the effective date of Statement No. 157 for nonfinancial assets and nonfinancial liabilities until fiscal years beginning after November 15, 2008. The impact of adoption requires additional fair value disclosures (see Note 6), primarily regarding other property owned, but does not have an impact on the Association's financial condition or results of operations.

In April 2009, the FASB issued FSP No. 107-1 and Accounting Principles Board (APB) No. 28-1, "Interim Disclosures about Fair Value of Financial Instruments." This FSP requires disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. The FSP is effective for interim periods ending after June 15, 2009 (see Note 7).

In May 2009, the FASB issued SFAS No. 165, "Subsequent Events," which sets forth general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Recognized subsequent events should be recognized in the financial statements since the conditions existed at the date of the balance sheet. Nonrecognized subsequent events are not recognized in the financial statements since the conditions arose after the balance sheet date but before the financial statements are issued or are available to be issued. This Standard, which includes a required disclosure of the date through which an entity has evaluated subsequent events, is effective for interim or annual periods ending after June 15, 2009 (see Note 8).

## NOTE 2 – ALLOWANCE FOR LOAN LOSSES AND IMPAIRED LOANS

An analysis of the allowance for loan losses follows:

| | For the six months ended June 30, | |
|---|---|---|
| | **2009** | **2008** |
| Balance at beginning of period | $ 1,254 | $ 330 |
| Provision for (reversal of) loan losses | 2,085 | – |
| Charge-offs | (1,845) | – |
| Recoveries | – | – |
| Balance at end of period | $ 1,494 | $ 330 |

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

| | **2009** | **2008** |
|---|---|---|
| Impaired loans with related allowance | $ 2.056 | $ – |
| Impaired loans with no related allowance | 17,557 | 5,164 |
| Total impaired loans | $ 19,613 | $ 5,164 |
| Allowance on impaired loans | $ 438 | $ – |

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

| | 2009 | 2008 |
|---|---|---|
| Average impaired loans | $ 16,970 | $ 5,028 |
| Interest income recognized on impaired loans | 41 | 47 |

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

| | For the six months ended June 30, | |
|---|---|---|
| | 2009 | 2008 |
| Pension | $ 518 | $ 79 |
| 401(k)/1165(e) | 34 | 35 |
| Other postretirement benefits | 31 | 34 |
| Total | $ 583 | $ 148 |

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

| | Actual YTD Through 6/30/09 | Projected Contributions For Remainder of 2009 | Projected Total Contributions 2009 |
|---|---|---|---|
| Pension | $ - | $ - | $ - |
| Other postretirement benefits | 39 | 39 | 78 |
| Total | $ 39 | $ 39 | $ 78 |

Actuarial calculations as of the last plan measurement date (December 31, 2008) projected no contributions to the pension plan for 2009. However, market conditions could impact discount rates and return on plan assets which could make additional contributions necessary before the next plan measurement date of December 31, 2009.

Further details regarding employee benefit plans are contained in the 2008 Annual Report to Shareholders.

## NOTE 5 — NOTES RECEIVABLE FROM OTHER FARM CREDT INSTITUTIONS

In September 2008, the Association used capital reserves to purchase $10,000 total of fixed rate unsecured subordinated notes issued by two other associations in the Farm Credit System (System) due in 2018. The notes are subordinate to all other categories of creditors of the issuing associations, including any claims of the Bank and general creditors, but are senior to all classes of shareholders of the issuing associations. The notes receivable are not considered System debt, and thus are not guaranteed by the System and not insured by the Farm Credit System Insurance Corporation. Since the notes receivable are only guaranteed by the issuing associations, repayment could be negatively impacted by funding, credit, interest rate, and/or counterparty risks encountered by the two issuing associations in their business operations.

The notes receivable bear interest at an annual fixed rate of 9 percent, payable on the fifteenth day of each month. Interest will be deferred if, as of the fifth business day prior to an interest payment date, any applicable minimum regulatory capital ratios are not satisfied by the issuing association(s). A deferral period may not last for more than five consecutive years or beyond the maturity date of the note(s). During such a period, the issuing association(s) may not declare or pay any dividends or patronage refunds, among other certain restrictions, until interest payments are resumed and all deferred interest has been paid. The note(s) may be redeemed, at the issuing association's(s') option, on October 15, 2013, or upon the occurrence of certain defined regulatory events, at a redemption price of 100 percent of the principal amount, plus any accrued but unpaid interest to the date of redemption, provided the issuing association(s) have made payment in full of all amount then due in respect of their senior indebtedness.

## NOTE 6 — FAIR VALUE MEASUREMENT

Effective January 1, 2008, the Association adopted Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (SFAS No. 157). This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements for certain assets and liabilities measured at fair value on a recurring and non-recurring basis. These assets and liabilities primarily consist of standby letters of credit, impaired loans and other property owned.

SFAS No. 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability.

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

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

**Level 1**
Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets. The Association had no Level 1 assets or liabilities at June 30, 2009.

**Level 2**
Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability. The Association had no Level 2 assets and liabilities measured at fair value on a recurring basis at June 30, 2009.

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

Level 3 assets at June 30, 2009 included impaired loans which represent the fair value of certain loans that were evaluated for impairment under SFAS No. 114. The fair value considered the underlying collateral since these were collateral-dependent loans. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established. Other property owned was classified as a level 3 asset at June 30, 2009. The fair value for other property owned is based upon the collateral less estimated costs to sell. Level 3 liabilities at June 30, 2009 included standby letters of credit whose market value is internally calculated based on information that is not observable either directly or indirectly in the marketplace.

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

The following table presents the assets and liabilities that are measured at fair value on a recurring basis at June 30, 2009 for each of the fair value hierarchy levels:

| | June 30, 2009 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total Fair Value |
| **Liabilities:** | | | | |
| Standby letters of credit | $ - | $ - | $ 47 | $ 47 |
| Total Liabilities | $ - | $ - | $ 47 | $ 47 |

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

| | Standby Letters Of Credit |
|---|---|
| Balance at January 1, 2009 | $ 45 |
| **Total gains or (losses) realized/unrealized:** | |
| Included in earnings | - |
| Included in other comprehensive loss | - |
| Purchases, sales, issuances and settlements, net | 2 |
| Transfers in and/or out of level 3 | - |
| Balance at June 30, 2009 | $ 47 |

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

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

| | June 30, 2009 | | | | |
|---|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total Fair Value | YTD Total Gains (Losses) |
| **Assets:** | | | | | |
| Impaired loans | $ - | $ - | $ 1,618 | $ 1,618 | $ (2,130) |
| Other property owned | $ - | $ - | $ 432 | $ 432 | $ 82 |

## NOTE 7 – DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the carrying amounts and fair values of the Association's financial instruments at June 30, 2009.

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

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

| | June 30, 2009 | |
|---|---|---|
| | **Carrying Amount** | **Estimated Fair Value** |
| **Financial assets:** | | |
| Cash | $ 170 | $ 170 |
| Loans, net of allowance | $ 244,383 | $ 255,068 |
| Notes receivable from other Farm Credit Institutions | $ 10,000 | $ 10,608 |
| **Financial liabilities**: | | |
| Notes payable to AgFirst Farm Credit Bank | $ 205,907 | $ 206,454 |

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:** Estimating the fair value of the Association's investment in the Bank is not practicable because the stock is not traded. The net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying balance sheet. The Association owns 0.91 percent of the issued stock of the Bank as of June 30, 2009 net of any reciprocal investment. As of that date, the Bank's assets totaled $30.0 billion and shareholders' equity totaled $1.5 billion. The Bank's earnings were $116 million during the first six month of 2009.

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

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

F. **Notes Receivable from Other Farm Credit Institutions:** Fair value is determined by discounting the expected future cash flows using appropriate interest rates for similar assets

## NOTE 8 – SUBSEQUENT EVENTS

The Association has evaluated subsequent events through July 23, 2009, which is the date the financial statements were available to be issued.