Puerto Rico Farm Credit, ACA

THIRD QUARTER 2010

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CERTIFICATION

The undersigned certify that we have reviewed the September 30, 2010 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.

Bruce M. Hoffman
President/Chief Executive Officer
Chief Financial Officer

Juan A. Santiago
Chairman of the Board

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

November 5, 2010

Puerto Rico Farm Credit, ACA

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 nine months ended September 30, 2010. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements, and the 2009 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 $97,665 or 48.7 percent of all outstanding loan volume at September 30, 2010.

The outstanding loan volume of the Association at September 30, 2010 was $200,353, a decrease of $26,873 or 11.8 percent as compared to $227,226 at December 31, 2009. Loans originated within the Association's chartered territory were lower by approximately $10,481, while participation loans purchased decreased by approximately $16,392.

Net loans outstanding at September 30, 2010 totaled $197,730 as compared to $224,506 at December 31, 2009. Net loans at September 30, 2010 made up 90.5 percent of total assets, lower than the 91.7 percent at December 31, 2009.

As a percentage of outstanding loans, nonaccrual loans equaled 10.6 percent at September 30, 2010, compared with 8.41 percent at December 31, 2009. The increase in the percentage of nonaccrual loan volume during the first nine months of 2010 occurred primarily as a result of transferring chartered territory loans into nonaccrual. Specific borrowers have continued to find it 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. The significant increase in both the number of loans and the volume of loans transferred to nonaccrual during the past eighteen months has resulted in a decline in the loan portfolio's overall credit quality. Management continues to see a slight deterioration in credit quality through the end of 2010.

The allowance for loan losses decreased by $97 to $2,623 at September 30, 2010, from $2,720 at December 31, 2009. The decrease related primarily to the net change in the specific reserves established for loans continuing in nonaccrual status. During the third quarter, one large chartered territory loan required a material increase in the assigned specific reserve. The ratio of allowance to outstanding loan volume increased to 1.31 percent at September 30, 2010 from 1.20 percent at December 31, 2009 as a result of the level of nonaccrual loan volume that required related specific reserves. During the first nine months of 2010, charge-offs net of recoveries totaled $293. Management anticipates minimal provision expense and limited charge-off activity during the balance of 2010, rather than the significant provision and charge-off activity of the first nine months of 2010.

RESULTS OF OPERATIONS

For the nine months ended September 30, 2010

For the nine months ended September 30, 2010, the Association recognized net income of $1,509. This was an increase of $3,075 as compared to a net loss of $1,566 for the first nine months of 2009. The increase primarily resulted from a decrease in provision expense related to the allowance for loan losses which totaled $2,857 year-over-year. Additionally, stock and premium refunds received from the Farm Credit System Insurance Corporation (FCSIC) which totaled $704 offset decreases in net interest income and other noninterest income, and an increase in noninterest expense.

During the first nine months of 2010, interest income, primarily from accruing loans, decreased by $918 or 12.7 percent. Interest expense related to the notes payable to AgFirst FCB (the Bank) decreased by $778 or 19.3 percent. Thus, net interest income decreased by $140 or 4.4 percent. The decrease in net interest income was due primarily to the significant decline in accruing loan volume, partially offset by an increase in the recognition of memo interest income from nonaccrual loans.

For the first nine months of 2010 the Association recorded provision for loan losses expense which totaled $197. This compared to provision expense for the first nine months of 2009 which totaled $3,054

Noninterest income for the first nine months of 2010 was $2,422 or 33.7 percent higher than the $1,811 recognized during the first nine months of 2009. The increase was primarily attributable to the refund distributions received from the FCSIC. It is not anticipated that the Association will receive any additional refunds from the FCSIC during 2010. These refunds more than offset decreases in other noninterest income categories compared to the first nine months of 2009.

Noninterest expense for the nine months ended September 30, 2010 increased by $251 or 7.1 percent compared to the same nine month period of 2009. The increase was primarily related to unbudgeted salaries and employee benefits expense of $304 and unbudgeted other operating expenses of $121. Both of these were partially offset by a decrease in the FCSIC premium expense which totaled $222.

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's eligible borrowers is available. It continues to be the Association's intent to pay out 100 percent of taxable income as patronage dividends. Thus, no provision for income taxes has been recognized during 2010. However, for 2009 not all eligible patronage sourced income was distributed and the Association incurred a $2 tax expense.

For the three months ended September 30, 2010

For the third quarter of 2010, the Association recognized net income of $122 an increase of $604 when compared to a net loss from operations of $482 for the third quarter of 2009. The primary driver of this increase was a reduction of $539 in the quarterly provision expense for loan losses, year-over-year.

Net interest income for the three months ended September 30, 2010 was $990 compared to $1,009 for the three months ended September 30, 2009. Again, the decrease in net interest income was primarily related to the year-over-year decrease in accruing loan volume.

Noninterest income for the third quarter of 2010 was $640 compared to $580 for the third quarter of 2009. The year-over-year increase was primarily related to a gain on the acquisition of other property through the foreclosure process.

For the third quarter of 2010, noninterest expense decreased by $24 to total $1,078 as compared to the third quarter of 2009 for which noninterest expense totaled $1,102. The decrease for the third quarter of 2010 was primarily related to reductions in salaries and benefits expense and a material decrease in the accrued FCSIC insurance fund premium, partially offset by increased unbudgeted other operating expenses.

Key Results of Operations Ratios

	Annualized for the nine months ended 9/30/10	**For the year ended 12/31/09**
Return on Average Assets	.87%	(0.33)%
Return on Average Members' Equity	3.61%	(1.54)%
Net Interest Income as a Percentage of Average Earning Assets	2.00%	1.93%

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 September 30, 2010 were $160,284 as compared with $187,237 at December 31, 2009. The decrease of $26,953 or 14.4 percent corresponded closely to the decrease in outstanding loan volume of $26,873.

The Association had no lines of credit outstanding with third parties as of September 30, 2010.

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 are generally 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 September 30, 2010 increased 2.7 percent to $56,161 from December 31, 2009 when total members' equity was $54,674. The increase of $1,487 was primarily attributable to the year-to-date net income which totaled $1,509 at September 30, 2010.

Total capital stock and participation certificates were $687 on September 30, 2010 compared to $721 on December 31, 2009. The decrease of $34 was the net result of refunding more stock to non-borrowing stockholders than new stockholders purchasing capital stock or participation certificates.

Unallocated retained earnings increased $1,523 or 2.7 percent from December 31, 2009 when unallocated retained earnings totaled $53,208. The increase was from net income of $1,509 earned during the first nine months of 2010 and a patronage dividend adjustment of $14 to reconcile the year-end estimated dividend payable to the Association's 2009 federal taxable income.

The Board of directors intends to continue its policy of declaring cash patronage dividends. 2009 was the twentieth consecutive year of paying dividends. The table below sets forth the recent amount of patronage dividends declared:

Year	Amount Declared
2009	$615
2008	$2,000

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

The Association's regulatory permanent capital ratio at September 30, 2010 was 20.33 percent compared to 17.39 percent at December 31, 2009. The Association's total surplus and core surplus ratios were both 19.99 percent at September 30, 2010. 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:

	9/30/10	12/31/09
Total Members' Equity to Asset	25.70%	22.32%
Debt to Total Members' Equity	2.89:1	3.48 : 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 2009 Annual Report to Shareholders for recently issued accounting pronouncements.

REGULATORY MATTERS

On July 8, 2010, the Farm Credit Administration issued an advance notice of proposed rulemaking (ANPRM) to gather public comments on the promulgation of Tier 1 and Tier 2 capital standards for Farm Credit System institutions. The Tier 1/Tier 2 capital standards would be similar to the capital tiers delineated in the Basel Accord that other Federal financial regulatory agencies have adopted for the banking organizations they regulate. The Farm Credit Administration is seeking comments to facilitate the development of this regulatory capital framework, including new minimum risk-based and leverage ratio capital requirements that take into consideration both the System's cooperative structure of primarily wholesale banks owned by retail lender Associations that are, in turn, owned by their member borrowers, and the System's status as a Government-sponsored enterprise. The comment period for the ANPRM ends November 5, 2010.

Financial Regulatory Reform

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) was signed into law on July 21, 2010. While the Dodd-Frank Act represents a significant overhaul of many aspects of the regulation of the financial services industry, many of the rules and regulations are not applicable to the System. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new implementing rules and regulations, and to prepare numerous studies and reports for Congress. The federal agencies are given significant discretion in drafting the implementing rules and regulations, and consequently, many of the details and much of the impact of the Dodd-Frank Act may not be known for many months or years.

The Dodd-Frank Act creates new regulators and expands the authority of the Federal Reserve Board over non-bank financial companies previously not subject to its or other bank regulators' direct jurisdiction, particularly those that are important to the U.S. financial system. Nevertheless, the Dodd-Frank Act largely preserves the authority of the Farm Credit Administration as the System's independent federal regulator by excluding System institutions from being a non-bank financial company and providing other exemptions and exclusions from certain of the law's provisions. Also, the rules prohibiting banking entities from engaging in proprietary trading under the so-called Volcker Rule will not apply to the debt securities issued by the System.

The provisions of the Dodd-Frank Act pertaining to the regulation of over-the-counter derivatives will require more of these transactions to be cleared through a third-party central clearinghouse and traded on regulated exchanges. These requirements have the potential of making derivative transactions more costly and less attractive as risk management tools for System institutions. The Dodd-Frank Act requires the Commodities Futures Trading Commission to consider an end-user exemption from the mandatory clearing and trading requirements for derivative transactions entered into by certain System institutions.

Among the studies called for under the Act are two that will examine Fannie Mae, Freddie Mac, and federal home loan finance. One provision expressed Congress' sense of importance of GSE reform to residential mortgage credit. The other calls for the Treasury department to conduct a study on ending the conservatorship of Fannie Mae and Freddie Mac and reforming the federal housing finance system. A potential risk for the Farm Credit System is that the System is also a GSE and may directly or indirectly be impacted by the decisions made as Congress addresses Fannie Mae and Freddie Mac.

In light of the foregoing, it is difficult to predict at this time the extent to which the Dodd-Frank Act or the forthcoming implementing rules and regulations will have on the System. However, it is possible they could affect funding strategies and increase funding costs.

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. 2832, or writing Susanne Caughman, 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)	September 30, 2010	September 30, 2009	December 31, 2009
	(unaudited)	*(unaudited)*	*(audited)*
Assets			
Cash	$ 113	$ 201	$ 162
Loans	200,353	234,590	227,226
Less: allowance for loan losses	2,624	2,463	2,720
Net loans	197,729	232,127	224,506
Notes receivable from other Farm Credit institutions (Note 5)	10,000	10,000	10,000
Accrued interest receivable	803	1,096	864
Investment in other Farm Credit institutions	3,679	3,517	3,679
Premises and equipment, net	1,028	1,156	1,116
Other property owned	2,694	530	521
Due from AgFirst Farm Credit Bank	1,022	1,217	1,845
Other assets	1,468	1,562	2,261
Total assets	$ 218,536	$ 251,406	$ 244,954
Liabilities			
Notes payable to AgFirst Farm Credit Bank	$ 160,284	$ 194,431	$ 187,237
Accrued interest payable	343	385	375
Patronage refund payable	—	—	615
Other liabilities	1,748	1,848	2,053
Total liabilities	162,375	196,664	190,280
Commitments and contingencies			
Members' Equity			
Capital stock and participation certificates	687	733	721
Retained earnings			
Unallocated	54,731	53,116	53,208
Accumulated other comprehensive income	743	893	745
Total members' equity	56,161	54,742	54,674
Total liabilities and members' equity	$ 218,536	$ 251,406	$ 244,954

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 September 30, 2010	For the three months ended September 30, 2009	For the nine months ended September 30, 2010	For the nine months ended September 30, 2009
Interest Income				
Loans	$ 1,817	$ 1,991	$ 5,618	$ 6,536
Notes receivable from other Farm Credit institutions (Note 5)	225	225	675	675
Total interest income	2,042	2,216	6,293	7,211
Interest Expense				
Notes payable to AgFirst Farm Credit Bank	1,052	1,207	3,245	4,023
Net interest income	990	1,009	3,048	3,188
Provision for loan losses	430	969	197	3,054
Net interest income after provision for loan losses	560	40	2,851	134
Noninterest Income				
Loan fees	119	90	261	282
Patronage Rebate Fees	54	59	179	170
Equity in earnings of other Farm Credit institutions	328	391	1,132	1,217
Gains (losses) on other property owned, net	138	16	136	98
FCSIC FAC stock refund	–	–	451	–
Insurance Fund refund	–	–	253	–
Other noninterest income	1	24	10	44
Total noninterest income	640	580	2,422	1,811
Noninterest Expense				
Salaries and employee benefits	687	774	2,697	2,407
Occupancy and equipment	62	67	189	202
Insurance Fund premium	25	97	76	298
Other operating expenses	304	164	800	604
Total noninterest expense	1,078	1,102	3,762	3,511
Income (loss) before income taxes	122	(482)	1,511	(1,566)
Provision for income taxes	–	–	2	–
Net income (loss)	$ 122	$ (482)	$ 1,509	$ (1,566)

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	Unallocated Retained Earnings	Accumulated Other Comprehensive Income	Total Members' Equity
Balance at December 31, 2008	$ 779	$ 54,577	$ 913	$ 56,269
Comprehensive income				
Net income (loss)		(1,566)		(1,566)
Employee benefit plans adjustments			(20)	(20)
Total comprehensive income				(1,586)
Capital stock/participation certificates issued/(retired), net	(46)			(46)
Patronage distribution adjustment		105		105
Balance at September 30, 2009	$ 733	$ 53,116	$ 893	$ 54,742
Balance at December 31, 2009	$ 721	$ 53,208	$ 745	$ 54,674
Comprehensive income				
Net income		1,509		1,509
Employee benefit plans adjustments			(2)	(2)
Total comprehensive income				1,507
Capital stock/participation certificates issued/(retired), net	(34)			(34)
Patronage distribution adjustment		14		14
Balance at September 30, 2010	$ 687	$ 54,731	$ 743	$ 56,161

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

Puerto Rico Farm Credit, ACA

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, 2009, are contained in the 2009 Annual Report of the Association. These unaudited third quarter 2010 consolidated financial statements should be read in conjunction with the 2009 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 nine months ended September 30, 2010 are not indicative of the results to be expected for the year ending December 31, 2010.

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

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

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

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

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

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

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

In January 2010, the FASB issued guidance "Fair Value Measurements and Disclosures," which is to improve disclosures about fair value measurement by increasing transparency in financial reporting. The changes will provide a greater level of disaggregated information and more detailed disclosures of valuation techniques and inputs to fair value measurement. The new disclosures and clarification of existing disclosures were effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the rollforward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this guidance had no impact on the Association's financial condition and results of operations but resulted in additional disclosures (see Note 7).

In July 2010, the FASB issued guidance on "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses." This guidance is intended to provide additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of its allowance for credit losses. Existing disclosures will be amended to include additional disclosures of financing receivables on both a portfolio segment and class of financing receivable basis. This will include a rollforward schedule of the allowance for credit losses from the beginning of the reporting period to the end of the period on a portfolio segment basis, with the ending balance further disclosed on the basis of the method of impairment (individually or collectively evaluated). The guidance also calls for new disclosures including but not limited to credit quality indicators at the end of the reporting period by class of financing receivables, the aging of past due financing receivables, nature and extent of financing receivables modified as troubled debt restructurings by class and the effect on the allowance for credit losses. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The adoption of this guidance should have no impact on the Association's financial condition or results of operations, but it will result in additional disclosures.

NOTE 2 — ALLOWANCE FOR LOAN LOSSES AND IMPAIRED LOANS

An analysis of the allowance for loan losses follows:

	For the nine months ended September 30,	
	2010	2009
Balance at beginning of period	$ 2,720	$ 1,254
Provision for (reversal of) loan losses	197	3,054
Charge-offs	(302)	(1,845)
Recoveries	9	–
Balance at end of period	$ 2,624	$ 2,463

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

	2010	2009
Impaired loans with related allowance	$10,703	$ 5,016
Impaired loans with no related allowance	10,562	17,679
Total impaired loans	21,265	22,695
Allowance on impaired loans	$ 1,397	$ 1,686

The following table summarizes impaired loan information for the nine months ended September 30,

	2010	2009
Average impaired loans	$ 21,482	$ 17,872
Interest income recognized on impaired loans	390	118

NOTE 3 — COMMITMENTS AND CONTINGENT LIABILITIES

An action is 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 nine months ended September 30,	
	2010	2009
Pension	$ 810	$ 777
401(k)/1165(e)	51	51
Other postretirement benefits	68	46
Total	$ 929	$ 874

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

	Actual YTD Through 9/30/10	Projected Contributions For Remainder of 2010	Projected Total Contributions 2010
Pension	$ –	$ 913	$ 913
Other postretirement benefits	84	26	110
Total	$ 84	$ 939	$ 1,023

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

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

NOTE 5 – 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 AgFirst District, both notes due in 2018. The notes receivable 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 Insurance Corporation. Since the notes receivable are only guaranteed by the issuing associations, repayment could be negatively impacted by funding, credit, 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 9.00 percent, payable on the fifteenth day of each month, beginning on October 15, 2008. 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 amounts then due in respect of their senior indebtedness.

NOTE 6 – NOTES PAYABLE TO AGFIRST FARM CREDIT BANK

The Association's indebtedness to the Bank represents borrowings by the Association primarily 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 line of credit are governed by the General Financing Agreement (GFA). The GFA defines Association performance criteria for borrowing from the Bank, which for 2009 included borrowing base margin, earnings and capital covenants. The Association failed to meet its earning covenant at December 31, 2009. The default allowed the Bank, in conjunction with the FCA, to accelerate repayment of all indebtedness. The Bank has approved a temporary waiver of the default and allowed the Association to operate under a special credit arrangement with several extensions pursuant to its GFA through December 31, 2010, at which time the Bank will assess the Association's compliance with the terms of the GFA and special credit arrangement. The Association has continued to perform its obligations under the special credit arrangement.

NOTE 7 – FAIR VALUE MEASUREMENT

Effective January 1, 2008, the Association adopted FASB guidance on fair value measurements. This guidance defines fair value, establishes a framework for measuring fair value and expands the Association's fair value disclosures for certain assets and liabilities measured at fair value on a recurring and non-recurring basis. These assets and liabilities consist primarily of standby letters of credit, impaired loans and other property owned.

This guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability.

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

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

Level 1

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets. The Association had no Level 1 assets or liabilities at September 30, 2010.

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 or liabilities measured at fair value on a recurring basis at September 30, 2010.

Level 3

Level 3 inputs to the valuation methodology are unobservable and supported by little or no market activity. Valuation is determined using pricing models, discounted cash flow methodologies, or similar techniques, and could include significant management judgment or estimation. Level 3 assets and liabilities also could 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 September 30, 2010 included impaired loans which represent the fair value of certain loans that were evaluated for impairment under FASB guidance. 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 September 30, 2010. The fair value for other property owned is based upon the collateral value. Costs to sell represent transaction costs and are not included as a component of the fair value of other property owned. Level 3 liabilities at September 30, 2010 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 tables present the assets and liabilities that are measured at fair value on a recurring basis at September 30, 2010 and December 31, 2009 for each of the fair value hierarchy levels:

	September 30, 2010			
	Level 1	Level 2	Level 3	Total Fair Value
Liabilities:				
Standby letters of credit	$ –	$ –	$ 35	$ 35
Total Liabilities	$ –	$ –	$ 35	$ 35

	December 31, 2009			
	Level 1	Level 2	Level 3	Total Fair Value
Liabilities:				
Standby letters of credit	$ –	$ –	$ 40	$ 40
Total Liabilities	$ –	$ –	$ 40	$ 40

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

	Standby Letters Of Credit
Balance at January 1, 2010	$ 40
Total gains or (losses) realized/unrealized:	
Included in earnings	–
Included in other comprehensive loss	–
Purchases, sales, issuances and settlements, net	(5)
Transfers in and/or out of level 3	–
Balance at September 30, 2010	$ 35

	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	3
Transfers in and/or out of level 3	–
Balance at September 30, 2009	$ 48

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 September 30, 2010 and December 31, 2009 for each of the fair value hierarchy values are summarized below:

	September 30, 2010				
	Level 1	Level 2	Level 3	Total Fair Value	YTD Total Gains (Losses)
Assets:					
Impaired loans	$ –	$ –	$ 8,901	$ 8,901	$ (274)
Other property owned	$ –	$ –	$ 2,272	$ 2,272	$ 140

	December 31, 2009				
	Level 1	Level 2	Level 3	Total Fair Value	YTD Total Gains (Losses)
Assets:					
Impaired loans	$ –	$ –	$ 2,614	$ 2,614	$ (2,319)
Other property owned	$ –	$ –	$ 600	$ 600	$ 89

NOTE 8 — DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the carrying amounts and fair values of the Association's financial instruments at September 30, 2010 and December 31, 2009.

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

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

	September 30, 2010		December 31, 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash	$ 113	$ 113	$ 162	$ 162
Loans, net of allowance	$ 198,458	$ 194,092	$ 225,295	$ 224,989
Notes receivable from other Farm Credit Institutions	$ 10,075	$ 11,189	$ 10,075	$ 10,617
Financial liabilities:				
Notes payable to AgFirst Farm Credit Bank	$ 160,627	$ 160,694	$ 187,612	$ 187,910

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

A. **Cash:** The carrying value is primarily a reasonable estimate of fair value.

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

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

   Fair value of loans in a nonaccrual status is estimated to be the carrying amount of the loan less specific reserves.

   The book value of accrued interest, which has been included in the carrying amount of loans, 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 0.93 percent of the issued stock of the Bank as of September 30, 2010 net of any reciprocal investment. As of that date, the Bank's assets totaled $30.0 billion and shareholders' equity totaled $2.0 billion. The Bank's earnings were $307.2 million during the first nine months of 2010.

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.

The book value of accrued interest, which has been included in the carrying amount of notes payable, approximates its fair value.

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 9 – SUBSEQUENT EVENTS

The Association has evaluated subsequent events and has determined there are none requiring disclosure through November 5, 2010, which is the date the financial statements were issued.