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# FARM CREDIT OF NORTHWEST FLORIDA, ACA

## *2010 ANNUAL REPORT*

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### Management

Rick Bitner .....	President & Chief Executive Officer
Bruce C. Harrison .....	Chief Financial Officer
Jay Baker .....	Relationship Manager
Chuck Thiele .....	Credit Administrator
Deandrea Barber .....	Policy and Operations Manager
John Gregory .....	Special Assets Manager

### Board of Directors

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

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## *Message from the Chief Executive Officer*

As most of you can attest, 2010 was another challenging year. Unemployment remained high, economic distress was evident, and Florida continued to struggle with a depressed real estate market. These conditions required the Association to continue investing significant resources to work with borrowers experiencing repayment difficulties. Additionally, the Association's Board and management continued to aggressively review operating policies to ensure that, to the fullest extent possible, they protect your investment in the Association.

During the year, the Association made prudent additional provisions for potential loan losses. At year-end, the Association's allowance for loan losses was approximately \$10.1 million. This continued funding for actual and potential losses resulted in an operating loss of approximately \$302,000. Losses are never acceptable to the Board and management; yet, we do note the significant improvement this represents over operations in 2009. These improved operating results, as well as other factors, hearten those entrusted with the responsibility for your Association that the worst of its credit issues, especially potential large losses, may have been recognized and accounted for properly.

At year-end, the Association was in default of its General Financing Agreement with its funding bank, AgFirst Farm Credit Bank, due to financial covenants related to Liquidity, Return on Assets, and violation of the regulatory minimum for Core Surplus. Thankfully, this Core Surplus violation was due to the Association's allocation of its surplus, which affects how Core Surplus can be reported. The capitalization of the Association remains strong and has improved with Permanent Capital at 14.03% at year-end, as opposed to 13.26% at the beginning of 2010. The Association is operating under a special credit agreement with AgFirst Farm Credit Bank and remains under heightened supervision with its regulator, the Farm Credit Administration. This year's operating loss, unfortunately, does not support the Association making a patronage distribution for 2010.

In light of this information, why be optimistic for 2011?

- ❖ The Farm Credit System remains strong with available credit at attractive terms and low interest rates. In a year when it seemed news of Florida bank failures remained the norm, your Association continued to fully fund new loans and all outstanding loan commitments as well as seek out new members.
- ❖ Your Association has a strong chartered territory with diversity of opportunity – we are currently working to expand financing options for machinery and equipment as well as developing a more robust rural home lending program.
- ❖ As we work with newly distressed borrowers, we are seeing an improved ability for them to continue to meet their debt obligations under restructure plans.
- ❖ Renewed interest in the real estate market appears evident through both increased inquiries and applications for new loans and successes we are experiencing in selling properties owned by the Association. While real estate activity is not robust, it is better than seen in 2009 and early 2010.
- ❖ Criticized assets remain much higher than desirable, but have improved overall from year-end 2009 to today. As we continue to restructure loans and liquidate Association-owned properties, barring unanticipated economic issues, this trend should continue.
- ❖ Finally, you make us optimistic. Your commitment to the Farm Credit cooperative system and continued support during this difficult period is greatly appreciated. The Board, management and staff are working hard to improve your Association and to provide you better service. We feel confident that a return to positive operations in 2011 is very likely.

While these factors provide reason for enhanced optimism, please do not mistake this for a lack of realism. Times remain difficult and the Association's Board and management understand we must remain diligent. There is continued volatility in the market and areas such as the economy and weather always provide an element of the unknown. However, there are a few very important areas where the Board and I can provide you with absolute assurances.

- 1) The Board and management of Farm Credit of Northwest Florida take our responsibility for protecting your investment in the Association very seriously. We are committed to working hard with one priority – the best interest of our Stockholders.
- 2) As a Floridian whose family has called the Panhandle “home” my entire life, I understand all that is unique and special about Northwest Florida. In addition to me, most of the Board and many of the staff also have families whose roots in Northwest Florida run deep throughout multiple generations. One of our core business values is working for the preservation of this area's rural heritage.
- 3) Your Association is committed to its public mission and cooperative principles. It has been very gratifying to receive the acknowledgement of so many of you regarding your Association's increased participation in the local agricultural community. We will continue to develop programs to meet the needs of agriculture with special emphasis on empowering Young, Beginning, and Small

Farmers and Ranchers. And, while payment of allocated surplus is unlikely this year, we will continue to communicate with you regarding revolvment plans.

4) If you are experiencing difficulty, we want to help you restore your business and finances to good health. The Association, like the entire Farm Credit System, has not requested, nor received, any federal assistance or funds. However, we will work with you to review your account to determine if restructuring your debt would be beneficial and assist you in continuing to meet your obligation. If you need assistance, please contact your Loan Officer or our Senior Relationship Manager, Jay Baker, at [jbaker@farmcredit-fl.com](mailto:jbaker@farmcredit-fl.com) or 800-527-0647.

5) You can rely on Farm Credit. Ninety-five years serving agriculture means that the Farm Credit System has overcome difficult times before. I still believe, as I expressed last year, that through a combination of accountability and hard work, we will not only endure today's difficulties, but as a result build a stronger and more diverse Association.

The Board, Management and Staff offer sincere appreciation for your support over the years. We look forward to serving you for many more years to come. Thank you for taking the time to review the information provided in this report. If you have any questions, please contact me directly at [rbitner@farmcredit-fl.com](mailto:rbitner@farmcredit-fl.com) or 800-527-0647.



Rick Bitner  
Chief Executive Officer

March 14, 2011

## *Report of Management*

The accompanying consolidated financial statements and related financial information appearing throughout this Annual Report have been prepared by management of Farm Credit of Northwest Florida, ACA (Association) in accordance with generally accepted accounting principles appropriate in the circumstances. Amounts which must be based on estimates represent the best estimates and judgments of management. Management is responsible for the integrity, objectivity, consistency, and fair presentation of the consolidated financial statements and financial information contained in this report.

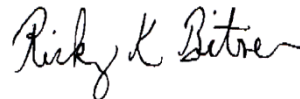
Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all financial statements, and that the assets of the Association are safeguarded. The design and implementation of all systems of internal control are based on judgments required to evaluate the costs of controls in relation to the expected benefits and to determine the appropriate balance between these costs and benefits. The Association maintains an internal audit program to monitor compliance with the systems of internal accounting control. Audits of the accounting records, accounting systems and internal controls are performed and internal audit reports, including appropriate recommendations for improvement, are submitted to the Board of Directors.

The consolidated financial statements have been examined by independent public auditors, whose report appears elsewhere in this annual report. The Association is also subject to examination by the Farm Credit Administration.

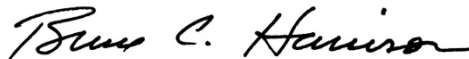
The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that we have reviewed the 2010 Annual Report of Farm Credit of Northwest Florida, ACA, that the report has been prepared under the oversight of the audit 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.



Richard Terry  
Chairman of the Board



Ricky K. Bitner  
Chief Executive Officer



Bruce C. Harrison  
Chief Financial Officer

March 14, 2011

## ***Report on Internal Control Over Financial Reporting***

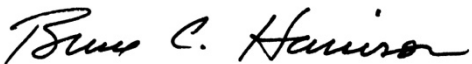
The Association's principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association's Consolidated Financial Statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by, or under the supervision of the Association's principal executives and principal financial officers, or persons performing similar functions, and effected by its Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting information and the preparation of the Consolidated Financial Statements for external purposes in accordance with accounting principles generally accepted in the United States of America and includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Association's assets that could have a material effect on its Consolidated Financial Statements.

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of December 31, 2010. In making the assessment, management used the framework in *Internal Control — Integrated Framework*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association concluded that as of December 31, 2010, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of December 31, 2010.



Ricky K. Bitner  
Chief Executive Officer



Bruce Harrison  
Chief Financial Officer

March 14, 2011

## Consolidated Five - Year Summary of Selected Financial Data

<i>(dollars in thousands)</i>	2010	2009	December 31, 2008	2007	2006
<b>Balance Sheet Data</b>					
Cash	\$ —	\$ —	\$ 537	\$ 1,375	\$ 968
Loans	385,839	441,596	494,521	516,104	497,447
Less: allowance for loan losses	10,098	8,724	3,294	4,396	1,574
Net loans	375,741	432,872	491,227	511,708	495,873
Investments in other Farm Credit institutions	8,418	9,506	10,257	10,372	9,591
Other property owned	16,930	15,464	1,355	—	—
Other assets	10,100	11,586	12,739	14,267	15,162
Total assets	\$ 411,189	\$ 469,428	\$ 516,115	\$ 537,722	\$ 521,594
Notes payable to AgFirst Farm Credit Bank*	\$ 336,920	\$ 393,791	\$ 435,228	\$ 455,811	\$ 445,110
Accrued interest payable and other liabilities with maturities of less than one year	3,864	4,719	6,014	11,053	12,212
Total liabilities	340,784	398,510	441,242	466,864	457,322
Protected borrower stock	7	14	16	24	33
Capital stock and participation certificates	1,014	1,138	1,231	1,349	1,382
Retained earnings					
Allocated	51,936	52,016	52,055	49,411	43,299
Unallocated	17,448	17,750	21,571	20,074	19,558
Total members' equity	70,405	70,918	74,873	70,858	64,272
Total liabilities and members' equity	\$ 411,189	\$ 469,428	\$ 516,115	\$ 537,722	\$ 521,594
<b>Statement of Operations</b>					
Net interest income	\$ 8,505	\$ 9,697	\$ 13,125	\$ 14,413	\$ 14,745
Provision for (reversal of allowance for) loan losses	6,109	11,296	6,907	2,822	177
Noninterest income (expense), net	(2,698)	(2,217)	(1,001)	219	(150)
Net income (loss)	\$ (302)	\$ (3,816)	\$ 5,217	\$ 11,810	\$ 14,418
<b>Key Financial Ratios</b>					
Rate of return on average:					
Total assets	(0.07)%	(0.78)%	0.99%	2.22%	2.86%
Total members' equity	(0.43)%	(5.10)%	6.93%	16.63%	23.26%
Net interest income as a percentage of average earning assets	2.25%	2.19%	2.64%	2.83%	3.02%
Net (chargeoffs) recoveries to average loans	(1.136)%	(1.242)%	(1.577)%	—%	(0.002)%
Total members' equity to total assets	17.12%	15.11%	14.51%	13.18%	12.32%
Debt to members' equity (:1)	4.84	5.62	5.89	6.59	7.12
Allowance for loan losses to loans	2.62%	1.98%	0.67%	0.85%	0.32%
Permanent capital ratio	14.03%	13.26%	12.52%	12.22%	11.54%
Total surplus ratio	13.78%	13.02%	12.27%	11.96%	11.28%
Core surplus ratio	3.06%	12.45%	11.75%	11.46%	10.78%
<b>Net Income Distribution</b>					
Estimated patronage refunds:					
Cash	\$ —	\$ —	\$ 753	\$ 4,991	\$ 5,534
Nonqualified retained earnings	—	—	3,012	6,655	6,764

\* General financing agreement is renewable on a one-year cycle. The next renewal date is December 31, 2011.

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

(dollars in thousands, except as noted)

## GENERAL OVERVIEW

The following commentary summarizes the financial condition and results of operations of Farm Credit of Northwest Florida, ACA, (Association) for the year ended December 31, 2010 with comparisons to the years ended December 31, 2009 and December 31, 2008. This information should be read in conjunction with the Consolidated Financial Statements, Notes to the Consolidated Financial Statements and other sections in this Annual Report. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors. For a list of the Audit Committee members, refer to the "Report of the Audit Committee" reflected in this Annual Report. Information in any part of this Annual Report may be incorporated by reference in answer or partial answer to any other item of the Annual Report.

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

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

The Association obtains funding from AgFirst Farm Credit Bank (AgFirst or Bank). The Association is materially affected and shareholder investment in the Association could be affected by the financial condition and results of operations of the Bank. Copies of the Bank's Annual and Quarterly Reports are on the AgFirst website, [www.agfirst.com](http://www.agfirst.com), or may be obtained at no charge by calling 1-800-845-1745, extension 2832, or writing Susanne Caughman, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202.

Copies of the Association's Annual and Quarterly reports are also available upon request free of charge on the Association's website, [www.farmcredit-fl.com](http://www.farmcredit-fl.com), or by calling 1-850-526-4910, extension 103, or writing Bruce C. Harrison, Farm Credit of Northwest Florida, P.O. Box 7000, Marianna, FL 32447. The Association prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The

Association prepares an electronic version of the Quarterly report, which is available on the internet, within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Association.

## FORWARD LOOKING INFORMATION

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

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international, and farm-related business sectors;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry and the Farm Credit System, as a government-sponsored enterprise, as well as investor and rating-agency reactions to events involving other government-sponsored enterprises and other financial institutions; and
- actions taken by the Federal Reserve System in implementing monetary policy.

## AGRICULTURAL OUTLOOK

The following United States Department of Agriculture (USDA) analysis provides a general understanding of the U.S. agricultural economic outlook. However, this outlook does not take into account all aspects of the Association's business. References to the USDA information in this section refer to the entire U.S. agricultural market and are not limited to the Association.

The February 2011 USDA forecast estimates that 2010 farmers' net cash income, which is a measure of the cash income after



payment of business expenses, increased to \$91.3 billion, up \$22.2 billion from 2009, and up \$19.5 billion from its 10-year average of \$71.8 billion. The improvement in 2010 farmers' net cash income was primarily due to an increase in livestock receipts of \$21.7 billion. The USDA forecasts 2011 farmer's net cash income to increase to \$98.6 billion, a \$7.3 billion increase from 2010, and \$26.8 billion above the 10-year average. Contributing to this forecasted increase in 2011 farmers' net cash income are increases in crop receipts of \$24.0 billion, livestock receipts of \$4.3 billion, and farm-related income of \$300 million, partially offset by an increase in cash expenses of \$19.7 billion, and a decline in direct government payments of \$1.6 billion.

During 2010, feed prices declined through the first half of the year and export demand for livestock was strong resulting in the significant increase in livestock receipts. The forecast for crop receipts for 2010 was up from 2009 but not to the same extent as livestock. For 2011, crop receipts are forecasted to rise across a number of crop categories, particularly corn, soybeans, and cotton. Continued demand for ethanol, strong exports, and tight supplies are forecasted to contribute to significant commodity price increases. These increases, as well as uncertainty regarding future commodity price increases, could significantly raise input costs and place further pressure on certain dairy and livestock producers.

The following table sets forth the commodity prices per bushel for certain crops and by hundredweight for beef cattle from December 31, 2007 to December 31, 2010:

<b>Commodity</b>	<b>12/31/10</b>	<b>12/31/09</b>	<b>12/31/08</b>	<b>12/31/07</b>
Corn	\$4.82	\$3.60	\$4.11	\$3.76
Soybeans	\$11.60	\$9.80	\$9.24	\$10.00
Wheat	\$6.45	\$4.87	\$5.95	\$7.74
Beef Cattle	\$98.10	\$78.50	\$79.70	\$88.90

The USDA's February 2011 income outlook shows a great deal of variation depending on farm size, geographic location, and commodity specialties. The USDA classifies all farms into three primary categories: commercial farms, intermediate farms, and rural residential farms. Commercial farms, large-scale farms with gross sales greater than \$250 thousand, represent about 10 percent of U.S. farms by number and represent 80 percent of total U.S. farm production. Commercial farms are expected to have a nearly 29 percent increase in average net cash income in 2010. Intermediate farms, defined as ones in which the primary occupation is farming and gross sales are between \$10 thousand and \$250 thousand, represent 30 percent of U.S. farms by number and account for 18 percent of total production. Intermediate farms are expected to have a 78 percent increase in average net cash income in 2010. The remaining 60 percent of U.S. farms are classified as rural residential farms where the primary occupation is not farming and the farms produce less than \$10 thousand in products. Rural residential farms only account for 2 percent of total production.

In addition to farmers' net cash income, off-farm income is an important source of income for the repayment of farm debt obligations and is less subject to cycles in agriculture. However, off-farm income can be directly affected by conditions in the general economy. The USDA measures farm household income, which is defined as earnings from farming activities plus off-farm income. Nearly 100 percent of farm household income for operators of rural residential farms and more than 90

percent of farm household income for intermediate farms is generated from off-farm sources. Further, USDA data suggests that approximately 25 percent of farm household income for commercial farms is generated from off-farm income.

According to the USDA February 2011 forecast, farm sector asset values are expected to increase \$64 billion or 3.1 percent to \$2.121 trillion for 2010, reflecting increased expected returns on farm investments. The values of land, machinery/equipment, and inventories of crop, livestock, and poultry are expected to rise modestly in 2010. Farmers' equity (farm business assets minus debt) is expected to rise 3.8 percent from \$1.812 trillion in 2009 to \$1.881 trillion in 2010, largely due to an expected 3.1 percent increase in farm asset values and a 2.1 percent decline in debt.

One measure of the financial health of the agricultural sector used by the USDA is the assessment of farmers' utilization of their capacity to repay debt (actual debt as a percentage of maximum debt that can be supported by farmers' current income). Higher capacity utilization rates indicate tighter cash flow positions and, consequently, higher exposure to financial risk. Lower rates indicate healthier cash flow and financial position. These estimates do not take into account, however, off-farm income sources. Since 1970, debt repayment capacity utilization has ranged from a low of 37 percent in 1973 to a high of 110 percent in 1981, and has remained relatively stable since 1987, averaging about 50 percent. During 2010, repayment capacity utilization decreased to 45 percent due to the increase in farmers' net cash income. The forecast for 2011 predicts farmers' utilization to decline from 45 percent in 2010 to approximately 43 percent for 2011.

As estimated by the USDA in February 2011, the Farm Credit System's market share of farm business debt, defined as debt incurred by those involved in on-farm agricultural production, grew to 40.1 percent at December 31, 2009 (latest available data), as compared with 39.0 percent at December 31, 2008. Farm business debt is forecasted to rise slightly in 2011 to \$241.6 billion from \$240.3 billion in 2010. The USDA's forecast of rising debt is due to rising production costs, such as energy and feed, in 2011, which will drive certain crop and livestock producers to increase their debt loads.

In general, agriculture has experienced a sustained period of favorable economic conditions, due to stronger commodity prices, higher land values, and, to a lesser extent, government support programs. To date, the Association's financial results have remained favorable as a result of these conditions. Production agriculture, however, remains a cyclical business that is heavily influenced by commodity prices. In an environment of less favorable economic conditions in agriculture and without sufficient government support programs, the Association's financial performance and credit quality measures would likely be negatively impacted. Conditions in the general and agricultural economies remain volatile. Certain agriculture sectors, as described more fully in this *Management Discussion and Analysis*, experienced significant financial stress during 2010 and could continue to experience financial stress in 2011. Any negative impact from these less favorable conditions should be lessened by geographic and commodity diversification and the influence of off-farm income sources supporting agricultural-related debt. However, agricultural borrowers who are more reliant on off-farm income sources may be more adversely impacted by a weakened general economy.

## CRITICAL ACCOUNTING POLICIES

The consolidated financial statements are reported in conformity with accounting principles generally accepted in the United States of America. Our significant accounting policies are critical to the understanding of our results of operations and financial position because some accounting policies require us to make complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. We consider these policies critical because management must make judgments about matters that are inherently uncertain. For a complete discussion of significant accounting policies, see Note 2, "Summary of Significant Accounting Policies," of the Notes to the Consolidated Financial Statements. The following is a summary of certain critical policies.

- *Allowance for loan losses* — The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs. The allowance for loan losses is determined based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic and political conditions, loan portfolio composition, credit quality and prior loan loss experience.

Significant individual loans are evaluated based on the borrower's overall financial condition, resources, and payment record, the prospects for support from any financially responsible guarantor, and, if appropriate, the estimated net realizable value of any collateral. The allowance for loan losses encompasses various judgments, evaluations and appraisals with respect to the loans and their underlying security that, by nature, contains elements of uncertainty and imprecision. Changes in the agricultural economy and their borrower repayment capacity will cause these various judgments, evaluations and appraisals to change over time. Accordingly, actual circumstances could vary from the Association's expectations and predictions of those circumstances.

Management considers the following factors in determining and supporting the levels of allowance for loan losses: the concentration of lending in agriculture, combined with uncertainties in farmland values, commodity prices, exports, government assistance programs, regional economic effects and weather-related influences. Changes in the factors considered by management in the evaluation of losses in the loan portfolios could result in a change in the allowance for loan losses and could have a direct impact on the provision for loan losses and the results of operations.

- *Valuation methodologies* — Management applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets for which an observable liquid market exists, such as most investment securities. Management utilizes significant estimates and assumptions to value items for which an observable liquid market does not exist. Examples of these items include

impaired loans, pension and other postretirement benefit obligations, and certain other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing and liquidation values. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on the Association's results of operations.

- *Pensions* — The Bank and its related Associations participate in defined benefit retirement plans. These plans are noncontributory and benefits are based on salary and years of service. In addition, the Bank and its related Associations also participate in defined contribution retirement savings plans. Pension expense for all plans is recorded as part of salaries and employee benefits. Pension expense for the defined benefit retirement plans is determined by actuarial valuations based on certain assumptions, including expected long-term rate of return on plan assets and discount rate. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that portfolio of assets. The discount rate is used to determine the present value of our future benefit obligations. The discount rate for 2009 was selected by reference to analysis and yield curves of the plans' actuary and industry norms.

## ECONOMIC CONDITIONS

The Florida economy began to show signs of stabilization in late 2010 with a vibrant health care industry, census hiring, and an industrial upswing being the catalyst for the economic improvement. At September 2010, Florida's unemployment rate was 11.9% compared to 9.6% at the national level. The University of West Florida's Haas Center for Business Research and Economic Development reported that the unemployment rate for the Northwest Florida region in 2010 was higher than in 2009; although the region continues its trend of being lower than the overall state average and is almost at the national unemployment rate.

The Association has no unacceptable agricultural concentrations. The agricultural economy had mixed results in 2010. Row crop production was favorable for most of our area with a late season drought impacting the quality and production for those without irrigation. The outlook for 2011 remains favorable for row crop prices. There are concerns around the dairy, poultry, and meat complex industry due to the anticipation of high input and operating costs in a weak economy where it may be difficult to pass on higher expenses to the consumer.

The major row crop commodities for Northwest Florida are peanuts, cotton, corn, and soybeans. The US Environmental Protection Agency's decision to allow the sale of gasoline containing 15% ethanol for certain automobiles will result in acreage shifting from soybeans to corn. The outlook for corn production and prices in 2011 is favorable. World cotton demand, after declining in 2008 and 2009, trended upward in 2010 and is expected to continue to improve in 2011. Cotton acreage held steady and will likely increase again in 2011 depending on relative prices and input costs as the planting season approaches. In 2010, Florida planted 26% more peanuts; however, the late season drought hurt producers without

irrigation. The 2011 peanut crop is estimated to be slightly larger than 2010 due to higher projected peanut prices. As the commodity markets bid for acreage in 2011, soybean prices will increase primarily as a defensive action to prevent too many acres from going to competing crops. The south will see reduced soybean acreage as cotton, peanuts, and corn has the potential to be more profitable in 2011.

The timber market is affected by many factors including the state of new housing and remodeling markets, weather, reforestation trends, and product availability. The major classes of wood products consist of pine and hardwood saw timber, pine chip-n-saw, and pine and hardwood pulp. "Stumpage prices" rebounded in mid-2010 and the Fall-Winter 2010 edition of the Florida Forest Steward (a quarterly newsletter published by the University of Florida's Institute of Food and Agricultural Sciences (IFAS) Program) showed price ranges for Florida stumpage generally up from 2009 and early 2010. Despite a declining trend in the Southeast region, Florida's average stumpage prices for products were on the increase in the last half of 2010.

In the dairy industry, milk prices in 2010 were well above 2009. The forecast for 2011, based on future prices, is for an all-milk price below the 2010 average all-milk price. Cheese and butter are driving the short-run increases. The cheese market has risen sharply with exports well ahead of last year. Butter prices also rose steadily throughout 2010. Should exports weaken; the higher milk production will be difficult for the market to absorb.

The beef market saw U.S. cattle farmers continuing to decrease their inventory of cattle and calves. The major factors responsible for cattle inventory decline include a combination of a lack of profitability by the majority of cow-calf farmers, high production costs, large levels of competing meats, and alternate uses of land. The net beef supply during 2011 is expected to decrease as a result of a decrease in domestic production, a slight increase in beef imports, and a decrease in beef exports. However, according to the Southeast Cattle Advisor (October 2010) as the economy improves there should be increased beef demand resulting in higher prices for all classes of cattle in 2011.

The Association is seeing consistent, though highly cautious interest in local real estate markets. The reduction in per acre pricing from previous investor-driven levels makes rural land more affordable. Traditional agricultural operators are selectively purchasing tracts to enhance existing operations. Recreational users evidence interest in the local market; although it is now a "buyer's market" and purchasers are highly selective. The Association is reliant on continued demand for rural property, even if the market remains sluggish. There is no anticipation of land values improving in 2011 from current levels. Consumers continue to be cautious with uncertainty in the economy and, although improvement is anticipated, increases in consumer spending will be slow as job stability or growth occurs. A level of concern over discretionary spending remains evident and stabilization or modest growth in the economy would do much to enhance confidence. The continued desire for large farmsteads offering a buffer from neighbors remains evident and inquiries for rural land financing for homesteads has increased.

Overall the outlook for 2011 is more favorable than 2010 though not overly optimistic. This is a result of the expectation that agricultural commodity prices will remain solid and that

the local real estate market may be leveling out. The Association experienced a decrease in loan volume for 2010 and due to current economic conditions minimal growth is expected during 2011.

## LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners, and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans through numerous product types.

The gross loan volume of the Association as of December 31, 2010, was \$385,839, a decrease of \$55,757 or 12.63 percent as compared to \$441,596 at December 31, 2009 and a decrease of \$108,682 or 21.98 percent as compared to \$494,521 at December 31, 2008. Net loans outstanding (gross loans net of the allowance for loan losses) at December 31, 2010, was \$375,741 as compared to \$432,872 at December 31, 2009 and \$491,227 at December 31, 2008. Net loans accounted for 91.38 percent of total assets at December 31, 2010 as compared to 92.21 percent of total assets at December 31, 2009 and 95.18 percent of total assets at December 31, 2008.

The diversification of the Association loan volume by type for each of the past three years is shown below.

Loan Type	2010		December 31, 2009		2008	
	<i>(dollars in thousands)</i>					
Real estate mortgage	\$ 245,787	63.70%	\$ 277,260	62.79%	\$ 350,190	70.82%
Production and intermediate-term	133,649	34.64	148,638	33.66	125,280	25.33
Rural residential real estate	5,569	1.44	7,460	1.69	9,017	1.82
Processing and marketing	684	.18	772	.17	9,546	1.93
Farm-related business	150	.04	259	.06	488	.10
Other	—	—	7,207	1.63	—	—
<b>Total</b>	<b>\$ 385,839</b>	<b>100.00%</b>	<b>\$ 441,596</b>	<b>100.00%</b>	<b>\$ 494,521</b>	<b>100.00%</b>

While we make loans and provide financially related services to qualified borrowers in the agricultural and rural sectors and to certain related entities, our loan portfolio is diversified.

The geographic distribution of the accruing loan volume by branch for the past three years is as follows.

Branch	12/31/10	12/31/09	12/31/08
Commercial Credits	24.51%	31.01%	42.45%
Milton	23.44	26.71	20.49
Tallahassee (new in 2007)	17.89	14.44	8.23
Marianna	14.08	14.06	15.64
Monticello	13.25	12.53	11.24
Special Assets	6.83	1.25	1.95
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

Commodity and industry categories are based upon the Standard Industrial Classification system published by the federal government. The system is used to assign commodity or industry categories based upon the largest agricultural commodity of the customer.

The major commodities in the Association loan portfolio are shown below. The predominant commodities are forestry, row

crops, livestock, peanuts and horticulture which constitute over 80 percent of the entire portfolio.

Commodity Group	December 31,					
	2010		2009		2008	
	<i>(dollars in thousands)</i>					
Forestry	\$ 189,573	49%	\$ 216,706	49%	\$ 236,247	47%
Row Crops	56,065	14	57,404	13	63,159	13
Livestock	30,224	8	35,051	8	39,181	8
Peanuts	19,077	5	24,341	5	21,842	4
Horticulture	21,726	6	23,268	5	27,441	5
Dairy	11,431	3	11,591	3	10,910	2
Rural Homes	6,428	2	7,470	2	8,907	2
Poultry	243	—	297	—	468	—
Other	52,624	13	67,282	15	93,321	19
<b>Total</b>	<b>\$ 387,391</b>	<b>100%</b>	<b>\$ 443,410</b>	<b>100%</b>	<b>\$ 501,476</b>	<b>100%</b>

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The Association’s loan portfolio contains a concentration in the forestry industry. Although a large percentage of the loan portfolio is concentrated in this industry, a high percentage of the repayment source is dependent on resources other than the commodity, which reduces overall risk exposure.

The decrease in loan volume for the twelve months ending December 31, 2010 was due to the association’s planned reduction in loan volume in an effort to increase capital, normal pay-down on loans and a decrease in financing demands.

During 2010, the Association continued activity in the buying and selling of loan participations within and outside of the System. This provides a means for the Association to spread credit concentration risk and realize non-patronage sourced interest and fee income, which strengthened our capital position.

Loan Participations	2010	2009	2008
	<i>(dollars in thousands)</i>		
Participations Purchased			
– FCS Institutions	\$ 916	\$ 955	\$ 992
Participations Purchased			
– Non-FCS Institutions	8,842	9,715	14,529
Participations Sold	<u>(93,532)</u>	<u>(103,375)</u>	<u>(121,440)</u>
<b>Total</b>	<b>\$ (83,774)</b>	<b>\$ (92,705)</b>	<b>\$(105,919)</b>

The Association did not have any loans sold with recourse, retained subordinated participation interests in loans sold, or interests in pools of subordinated participation interests for the period ended December 31, 2010.

**MISSION-RELATED INVESTMENTS**

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

In October 2005, the FCA authorized AgFirst and the Associations to make investments in Rural America Bonds under a three-year pilot period. Rural America Bonds may include debt obligations issued by public and private enterprises,

corporations, cooperatives, other financing institutions, or rural lenders where the proceeds would be used to support agriculture, agribusiness, rural housing, or economic development, infrastructure, or community development and revitalization projects in rural areas. Examples include investments that fund value-added food and fiber processors and marketers, agribusinesses, commercial enterprises that create and maintain employment opportunities in rural areas, community services, such as schools, hospitals, and government facilities, and other activities that sustain or revitalize rural communities and their economies. The objective of this pilot program is to help meet the growing and diverse financing needs of agricultural enterprises, agribusinesses, and rural communities by providing a flexible flow of money to rural areas through bond financing. These bonds may be classified as Loans or Investments on the Consolidated Balance Sheets depending on the nature of the investment. As of December 31, 2010, 2009, and 2008 the Association had \$0, \$7,237 and \$7,440 respectively, in Rural America Bonds, and they are classified as Loans on the Consolidated Balance Sheets.

**CREDIT RISK MANAGEMENT**

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

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

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

We review the credit quality of the loan portfolio on an ongoing basis as part of our risk management practices. Each loan is classified according to the Uniform Classification System, which is used by all Farm Credit System institutions. Below are the classification definitions.

- Acceptable – Assets are expected to be fully collectible and represent the highest quality.
- Other Assets Especially Mentioned (OAEM) – Assets are currently collectible but exhibit some potential weakness.
- Substandard – Assets exhibit some serious weakness in repayment capacity, equity, and/or collateral pledged on the loan.
- Doubtful – Assets exhibit similar weaknesses to substandard assets. However, doubtful assets have additional weaknesses in existing facts, conditions and values that make collection in full highly questionable.
- Loss – Assets are considered uncollectible.

The following table presents selected statistics related to the credit quality of loans including accrued interest at December 31.

Credit Quality	2010	2009	2008
Acceptable & OAEM	81.69%	88.87%	92.62%
Substandard	12.76	9.47	6.79
Doubtful	5.55	1.66	0.59
Total	100.00%	100.00%	100.00%

#### Nonperforming Assets

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

	12/31/10	12/31/09	12/31/08
	<i>(dollars in thousands)</i>		
<b>High-risk Assets</b>			
Nonaccrual loans	\$ 49,461	\$ 34,503	\$ 21,921
Accruing loans 90 days past due	–	1,188	1,217
Total high-risk loans	49,461	35,691	23,138
Other property owned	16,930	15,464	1,355
Total high-risk assets	\$ 66,391	\$ 51,155	\$ 24,493
<b>Ratios</b>			
Nonaccrual loans to total loans	12.82%	7.81%	4.43%
High-risk assets to total assets	16.15%	10.90%	4.75%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or future interest accruals, under the contractual terms of the loan. In substance, nonaccrual loans reflect loans where the accrual of interest has been suspended. Nonaccrual loans increased \$14,958 or 43.35 percent in 2010. This increase resulted from a protracted deterioration in general economic conditions both nationally and in our territory combined with continued reduction in real estate values during the same period.

The Association held "Other Property Owned" (OPO) at December 31, 2010 valued at \$16,930 compared to \$15,464 at December 31, 2009 and \$1,355 at December 31, 2008. The Association acquired OPO valued at \$11,407 during 2010, sold OPO valued at \$8,631 during 2010 and wrote down the value of OPO by \$1,310 during 2010 through direct write downs OPO values.

Loan restructuring is available to financially distressed borrowers. Restructuring of loans occurs when the Association grants a concession to a borrower based on either a court order or good faith in a borrower's ability to return to financial viability. The concessions can be in the form of a modification of terms or rates, a compromise of amounts owed, or deed in lieu of foreclosure. Other receipts of assets and/or equity to pay the loan in full or in part are also considered restructured loans. The type of alternative financing structure chosen is based on minimizing the loss incurred by both the Association and the borrower.

#### Allowance for Loan Losses

The allowance for loan losses at each period end was considered by Association management to be adequate to absorb probable losses existing in and inherent to its loan portfolio. The allowance for loan losses is determined according to generally accepted accounting principles.

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

Allowance for Loan Loss Activity:	2010	2009	2008
	<i>(dollars in thousands)</i>		
Balance at beginning of year	\$ 8,724	\$ 3,294	\$ 1,574
Charge-offs:			
Real estate mortgage	(3,278)	(2,741)	(5,584)
Production and intermediate term	(1,462)	(1,522)	(1,403)
Agribusiness	(135)	(1,360)	(939)
Rural residential real estate	(162)	(623)	(83)
Total charge-offs	(5,037)	(6,246)	(8,009)
Recoveries:			
Real estate mortgage	302	380	–
Total recoveries	302	380	–
Net (charge-offs) recoveries	(4,735)	(5,866)	(8,009)
Provision for (reversal of allowance for) loan losses	6,109	11,296	6,907
Balance at end of year	\$ 10,098	\$ 8,724	\$ 3,294
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	(1.136)%	(1.242)%	(1.577)%

The net loan charge-offs were primarily associated with real estate loans where land values had fallen significantly over the last two to three years.

The allowance for loan losses by loan type for the most recent three years is as follows:

Allowance for Loan Losses by Type	December 31,		
	2010	2009	2008
	<i>(dollars in thousands)</i>		
Real estate mortgage	\$ 5,488	\$ 4,903	\$ 1,860
Production and intermediate-term	4,026	3,162	1,389
Agribusiness	10	18	24
Rural residential real estate	574	554	21
Other	—	87	—
<b>Total loans</b>	<b>\$ 10,098</b>	<b>\$ 8,724</b>	<b>\$ 3,294</b>

The allowance for loan losses as a percentage of loans outstanding and as a percentage of certain other credit quality indicators is shown below:

Allowance for Loan Losses as a Percentage of:	December 31,		
	2010	2009	2008
Total loans	2.62%	1.98%	.67%
Nonperforming loans	20.42%	24.16%	14.01%
Nonaccrual loans	20.42%	25.28%	15.03%

Please refer to Note 3, "Loans and Allowance for Loan Losses," of the Notes to the Consolidated Financial Statements, for further information concerning the allowance for loan losses.

## RESULTS OF OPERATIONS

Net loss for the year ended December 31, 2010, totaled \$302, a decrease in net loss of \$3,514 as compared to net loss of \$3,816 for the same period of 2009 and a decrease in net income of \$5,519 as compared to \$5,217 for the same period of 2008. Interest income for the year ended December 31, 2010, was \$21,175, a decrease of \$5,384 or 20.27 percent as compared to \$26,559 for the same period of 2009. Interest income decreased by \$7,747 for the period ended December 31, 2009, compared to December 31, 2008. Net loss included the unfavorable effect of a provision for loan losses of \$6,109 as indicated in the Allowance for Loan Losses section. Major components of the changes in net income for the past two years are outlined in the following table.

Change in Net Income:	2010-2009	2009-2008
	<i>(dollars in thousands)</i>	
Net income (loss) prior year	\$ (3,816)	\$ 5,217
<b>Increase (decrease) in net income due to:</b>		
Interest income	(5,384)	(7,747)
Interest expense	4,192	4,319
Net interest income	(1,192)	(3,428)
Provision for loan losses	5,187	(4,389)
Noninterest income	332	101
Net gain or losses	(1,605)	(986)
Noninterest expense	336	(258)
Provision for income taxes	456	(73)
Total changes in income	3,514	(9,033)
<b>Net income (loss)</b>	<b>\$ (302)</b>	<b>\$ (3,816)</b>

## Net Interest Income

Net interest income was \$8,505, \$9,697 and \$13,125 in 2010, 2009 and 2008, respectively. Net interest income is the difference between interest income and interest expense. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets and cost of debt. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following table:

### Change in Net Interest Income:

	Volume*	Nonaccrual		Total
		Rate	Income	
	<i>(dollars in thousands)</i>			
<b>12/31/10 - 12/31/09</b>				
Interest income	\$(3,907)	\$(1,536)	\$ 59	\$(5,384)
Interest expense	(1,888)	(2,304)	—	(4,192)
Change in net interest income	<b>\$(2,019)</b>	<b>\$ 768</b>	<b>\$ 59</b>	<b>\$(1,192)</b>
<b>12/31/09 - 12/31/08</b>				
Interest income	\$(3,741)	\$(4,110)	\$ 104	\$(7,747)
Interest expense	(1,585)	(2,734)	—	(4,319)
Change in net interest income	<b>\$(2,156)</b>	<b>\$(1,376)</b>	<b>\$ 104</b>	<b>\$(3,428)</b>

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

## Noninterest Income

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

Noninterest Income	For the Year Ended			Percentage	
	December 31,			2010/	2009/
	2010	2009	2008	2009/	2008
	<i>(dollars in thousands)</i>				
Loan fees	\$ 319	\$ 189	\$ 200	68.78%	(5.50)%
Fees for financially related services	—	—	1	—	(100.00)
Patronage refund from other Farm Credit Institutions	4,141	4,411	4,264	(6.12)	3.45
Gains (losses) on					
Other Property Owned	(2,592)	(986)	—	162.88	(100.00)
Other noninterest income	522	50	84	944.00	(40.48)
<b>Total noninterest income</b>	<b>\$ 2,390</b>	<b>\$ 3,664</b>	<b>\$ 4,549</b>	<b>34.77%</b>	<b>(19.45)%</b>

The decrease in non-interest income of \$1,274 in 2010 compared to 2009 is primarily due to losses on Other Property Owned (OPO) of \$2,591 in 2010 compared to \$986 in 2009 (an increase in losses of \$1,605) and reductions in patronage refunds from other Farm Credit Institutions of \$270. These reductions in noninterest income were offset by increases in loan fee income \$130 and increases in other noninterest income of \$471.

Regarding the increase of \$1,605 in losses on Other Property Owned in 2010 as compared to 2009, losses on the sale of OPO increased by \$721, write downs in the value of OPO increased by \$501 and current expenses related to OPO increased by \$383.

Regarding the reductions of \$270 in patronage refunds from other Farm Credit Institutions, general patronage from AgFirst decreased by \$412 due to decreased volume and patronage related to the AgFirst Capital Participation Pool (CPP) decreased by \$295 due to losses on loans in the CPP. These reductions were offset by an increase in the Special Distribution from AgFirst of \$435 and increases in patronage from other Farm Credit Institutions of \$2.

The increase in Other noninterest income of \$471 primarily resulted from insurance refund of \$492 offset by a reduction in other noninterest income of \$21.

*Noninterest Expense*

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

Noninterest Expense	For the Year Ended December 31,			Percentage Increase/(Decrease)	
	2010	2009	2008	2010/ 2009	2009/ 2008
<i>(dollars in thousands)</i>					
Salaries and employee benefits	\$ 3,866	\$ 3,607	\$ 3,236	7.18%	12.57%
Occupancy and equipment	329	315	356	4.44	(11.52)
Insurance Fund premiums	221	847	743	(73.91)	14.00
Other operating expenses	1,129	1,112	1,288	1.53	(13.66)
Total noninterest expense	\$ 5,545	\$ 5,881	\$ 5,623	(5.71)%	4.59%

Salaries and employee benefits increased in 2010, as compared with 2009, primarily due to increased costs associated with employee benefit plans, merit increases, and employee staffing levels.

Insurance Fund premiums decreased by \$626, or 73.91%, for the year 2010 as compared to the year 2009 due primarily to a change in the premium rate charged. The 2010 base annual premium rate was 5 basis points compared to 20 basis points charged in 2009.

*Income Taxes*

The Association recorded a benefit of \$456 from income taxes for the year ended December 31, 2010, as compared to no provision or benefit for 2009 and a benefit of \$73 for 2008. The benefit was related to federal income tax refunds received due to the carryback of the 2009 net operating loss to prior years. Refer to Note 2, "Summary of Significant Accounting Policies, Income Taxes," of the Notes to the Consolidated Financial Statements, for more information concerning Association income taxes.

*Key Results of Operations Comparisons*

Key results of operations comparisons for each of the twelve months ended December 31 are shown in the following table:

Key Results of Operations Comparisons	For the 12 Months Ended 12/31/10	For the 12 Months Ended 12/31/09	For the 12 Months Ended 12/31/08
Return on Average Assets	(0.07)%	(.78)%	.99%
Return on Average Members' Equity	(0.43)%	(5.10)%	6.93%
Net Interest Income as a Percentage of Average Earning Assets	2.25%	2.19%	2.64%
Net (Charge-offs) Recoveries to Average Loans	(1.136)%	(1.242)%	(1.577)%

The return on average assets and return on average members' equity for the year ended 12/31/2010 improved as compared to the returns for the year ended 12/31/2009. The improvement was due to a decrease in the loss from \$(3,816) for the year ended 12/31/2009 to a loss of \$ (302) for the year ended 12/31/2010. This reduction in the loss was primarily due to the substantial

reduction in the provision for loan losses for the year ended 12/31/2010 as compared to the year ended 12/31/2009.

The return on average assets and return on average members' equity for the year ended 12/31/2009 decreased substantially as compared to the returns for the year ended 12/31/2008. The decrease was due to a decrease in net income from \$5,217 for the 12/31/2008 to a loss of \$ (3,816) for the year ended 12/31/2009. This reduction in net income was primarily due to the substantial increase in the provision for loan losses for the year ended 12/31/2009 as compared to the year ended 12/31/2008.

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

**LIQUIDITY AND FUNDING SOURCES**

*Liquidity and Funding*

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement (GFA). The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association, creating notes payable (or direct loans) to the Bank. The Bank manages interest rate risk through direct loan pricing and asset/liability management. The notes payable are segmented into variable rate and fixed rate components. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. Association capital levels effectively create a borrowing margin between the amount of loans outstanding and the amount of notes payable outstanding. This margin is commonly referred to as "Loanable Funds."

The total notes payable to the Bank at December 31, 2010, were \$336,920 as compared to \$393,791 at December 31, 2009 and \$435,228 at December 31, 2008. The 2010 decrease of 14.44 percent compared to December 31, 2009 was due to decreased loan volume and the 2009 decrease of 9.52 percent compared to December 31, 2008, was also attributable to decreased loan volume.

The average volume of notes payable to the Bank was \$365,765 and \$411,883 for the years ended December 31, 2010 and 2009, respectively. Refer to Note 7, "Notes Payable to AgFirst Farm Credit Bank," of the Notes to the Consolidated Financial Statements, for weighted average interest rates and maturities, and additional information concerning the Association's notes payable.

Liquidity management is the process whereby funds are made available to meet all financial commitments including the extension of credit, payment of operating expenses and payment of debt obligations. The Association receives access to funds through its borrowing relationship with the Bank and from income generated by operations. The liquidity policy of the Association is to manage cash balances to maximize debt reduction and to increase loan volume. As borrower payments are received, they are applied to the Association's note payable to the Bank.

As of December 31, 2010 the association's liquidity margin (the borrowing base) was in a negative position. The association's Return on Assets for the year ending December 31, 2010 was a negative .07 percent. The association's core surplus was at 3.06% as of December 31, 2010. These are all in violation of the association's General Financing Agreement with the Bank. The Bank has waived the violations through December 31, 2011. Funds have continued to be available for our financing activities. The association is actively marketing the other property owned by the association in an effort to increase liquidity. The association is also presently aggressively working to restructure nonaccrual loans which can also increase liquidity.

The Association had no lines of credit outstanding with third parties as of December 31, 2010.

#### *Funds Management*

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

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

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

#### *Relationship with the Bank*

The Association's statutory obligation to borrow only from the Bank is discussed in Note 7, "Notes Payable to AgFirst Farm Credit Bank" of the Notes to the Consolidated Financial Statements in this Annual Report.

The Bank's ability to access capital of the Association is discussed in Note 4 of the Notes to the Consolidated Financial Statements.

The Bank's role in mitigating the Association's exposure to interest rate risk is described in the "Liquidity and Funding" section of this Management's Discussion and Analysis and in Note 7, "Notes Payable to AgFirst Farm Credit Bank" included in this Annual Report.

The Association has an agreement with the Bank whereby the Bank may provide certain fiscal, personnel, accounting, marketing, communication, public relations, information management, computer and certain other services as requested by the Association. Specific services currently provided by the Bank to the Association, in which each service provided would constitute a material interdependent relationship, include information management, computer services/hosting, payroll processing and related payroll tax services.

#### **CAPITAL RESOURCES**

Capital serves to support asset growth and provide protection against unexpected credit and interest rate risk and operating losses. Capital is also needed for future growth and investment in new products and services.

The Association Board of Directors establishes, adopts, and maintains a formal written capital adequacy plan to ensure that adequate capital is maintained for continued financial viability, to provide for growth necessary to meet the needs of members/borrowers, and to ensure that all stockholders are treated equitably. There were no material changes to the capital plan for 2010 that would affect minimum stock purchases or would have an effect on the Association's ability to retire stock and distribute earnings.

Total members' equity at December 31, 2010, decreased .72 percent to \$70,405 from the December 31, 2009, total of \$70,918. At December 31, 2009, total members' equity decreased 5.28 percent from the December 31, 2008 total of \$74,873. The decrease for 2010 was primarily attributed to the net loss for the year ended December 31, 2010. The decrease for 2009 was primarily attributed to the net loss for the year ended December 31, 2009.

Total capital stock and participation certificates were \$1,021 on December 31, 2010, compared to \$1,152 on December 31, 2009 and \$1,247 on December 31, 2008. These decreases were attributed to the excess of stock and participations certificate retirements over the issuance of new instruments.

FCA sets minimum regulatory capital requirements for System banks and associations. Capital adequacy is evaluated using a number of regulatory ratios. According to the FCA regulations, each institution's permanent capital ratio is calculated by dividing permanent capital by a risk-adjusted asset base. Risk adjusted assets mean the total dollar amount of the institution's assets adjusted by an appropriate credit conversion factor as defined by regulation. For all periods represented, the Association exceeded minimum regulatory standard for all the ratios except for core surplus as of December 31, 2010. The association has submitted a plan to restore the core surplus to the minimum regulatory standard to the FCA.



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

	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>Regulatory Minimum</u>
Permanent Capital	14.03%	13.26%	12.52%	7.00%
Total Surplus	13.78%	13.02%	12.27%	7.00%
Core Surplus	3.06%	12.45%	11.75%	3.50%

The increase in the Association's permanent capital and total surplus for December 31, 2010 was attributable to the reduction in loan volume. The decrease in core surplus was due to unallocated surplus as a percentage of risk funds not exceeding the FCA regulatory requirement of 1.5%. The increase in permanent capital, total surplus and core surplus for December 31, 2009 was attributable to capital accumulation due to the reduction in loan volume. The association anticipates that the core surplus will meet regulatory requirements by the end of the first quarter of 2011. There are no trends, commitments, contingencies, or events that are likely to affect the Association's ability to meet regulatory minimum capital standards and capital adequacy requirements once the core surplus is restored.

See Note 8, "Members' Equity," of the Consolidated Financial Statements, for further information concerning capital resources.

**PATRONAGE PROGRAM**

Prior to the beginning of any fiscal year, the Association's Board of Directors, by adoption of a resolution, may establish a Patronage Allocation Program to distribute its available consolidated net earnings. This resolution provides for the application of net earnings in the manner described in the Association's Bylaws. This includes the setting aside of funds to increase surplus to meet minimum capital adequacy standards established by FCA Regulations, to increase surplus to meet Association capital adequacy standards to a level necessary to support competitive pricing at targeted earnings levels, and for reasonable reserves for necessary purposes of the Association. After excluding net earnings attributable to (a) the portion of loans participated to another institution, and (b) participation loans purchased, remaining consolidated net earnings are eligible for allocation to borrowers. Refer to Note 8, "Members' Equity," of the Notes to the Consolidated Financial Statements, for more information concerning the patronage distributions. The Association declared no patronage distributions in 2010 or in 2009, but did declare patronage of \$753 in 2008. No patronage distributions were declared in 2010 due to the loss incurred by the association. The loss incurred was due to the deterioration in loan quality and the resulting provision for loan losses. Future patronage distribution would be dependent upon the improvement of the association's overall financial condition. The Board of Directors has not changed the association's policies and practices related to the patronage program and the Board of Directors wishes to continue past practices of patronage distribution.

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

The Association's mission includes providing sound and constructive credit to Young, Beginning and Small (YBS) farmers and ranchers. Northwest Florida's Board and

management are responsible to ensure that the Association is making appropriate efforts to implement its YBS program. The Board approves YBS policies as well as the annual business plan which outlines strategies to accomplish Northwest Florida's YBS mission, and goals by which to measure the YBS program's performance.

**DEFINITIONS**

Young Farmer: A farmer, rancher, or producer or harvester of aquatic products who is age 35 or younger as of the date the loan is originally made.

Beginning Farmer: A farmer, rancher, or producer or harvester of aquatic products whose experience in farming or ranching as of the date the loan is originally made is 10 years or less.

Small Farmer: A farmer, rancher, or producer or harvester of aquatic products who normally generates less than \$250,000 in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

**YBS PROGRAM STRATEGIES**

The Association's Young, Beginning and Small Farmer and Rancher Program (YBS) complies with statutory and regulatory requirements which include program goals for both quantitative measurements of the number and volume of YBS loans and strategies the Association will employ to meet program objectives.

The Association's Young, Beginning and Small Farmer and Rancher (YBS) Policy provides that loans for this segment will be underwritten according to normal commodity-based standards. Since these groups may traditionally have weaker credit factors, Association staff works with otherwise qualified YBS applicants to offset these weaknesses through additional obligors, additional pledges of collateral or through obtaining FSA loan guarantees. Farm Credit of Northwest Florida is an approved FSA lender. The Association's Board and management continue to evaluate the Young, Beginning and Small Farmer and Rancher (YBS) Policy to determine if additional lending inducements can be added in a manner that still provides for safe and constructive financing.

In 2010, the Association placed a greater emphasis on "hands-on" involvement in agricultural events and affiliations in our chartered territory that have a tie to young, beginning, and small farmers and ranchers. During the year, the Association met with many of the agriculturally-focused affiliates and educational systems within the territory to identify needs and opportunities that can be addressed by the Association's Young, Beginning, and Small Farmer and Rancher Program. The Association actively participated in agricultural events through sponsorships, speaking engagements, as exhibitors, volunteers, and through staff attendance. In total, the Association participated in forty-five YBS designated events with financial sponsorship of \$12,500.

Our members can expect this level of participation to increase even further in 2011.

Other 2011 strategies for meeting program objectives include:

- 1) Implementation of additional YBS lending inducements that may provide for new program

- incentives such as pricing and fee considerations for Young, Beginning, and Small farmers and ranchers.
- 2) Development of YBS Advisory Board to provide input regarding future policy development and program planning.
  - 3) A new Internship Program in cooperation with agriculturally affiliated colleges.
  - 4) Association representation of the Farm Credit System in local college's career and job fairs.
  - 5) Hosting of Board/Staff/Student/YBS Farmer joint training initiatives.

**YBS PROGRAM QUANTITATIVE GOALS**

At year-end 2009, based on economic conditions the Association anticipated a 12.25% decrease in the number and volume of YBS loans during 2010. This was part of an overall strategy to decrease new loan production throughout the portfolio in order to preserve and increase capital. Additionally, the Association was aware of a particular segment of borrowers with larger credit exposures that met YBS program coding criteria who were distressed and it was likely that their accounts would be settled through forced liquidation. In actuality, the Association's decrease in YBS loan volume totals exceeded the 12.25% projection with a reduction of approximately 16.875%. For 2011, the Association anticipates that YBS loan volume will decrease further before stabilizing in 2012. The following charts show: Chart (1) the specific reduction in the number of loans and the volume of loans in the Young, Beginning, and Small categories during 2010; Chart (2) the 2010 year-end number and volume of loans by Young, Beginning and Small categories; and Chart (3) 2011 quantitative goals for YBS.

Chart (1) Specific Reductions in YBS Categories in 2010:

	Decrease # Loans	Decrease Loan Volume
Young	8.20%	31.44%
Beginning	10.02%	16.62%
Small	11.26%	14.92%

Chart (2) Association volume and number of YBS loans as of December 31, 2010:

	# of All YBS Loans	Volume All YBS Loans
Young	112	\$ 28,264,995
Beginning	530	\$145,872,120
Small	867	\$241,308,225

Chart (3) 2011 Quantitative Goals for YBS:

	# of All YBS Loans	Volume All YBS Loans
Young	97	\$ 22,232,122
Beginning	446	\$116,506,841
Small	761	\$203,493,542

For purposes of the above tables, a loan could be included in more than one of the categories depending on the characteristics of the underlying borrower.

**ASSOCIATION COMPARISON TO YBS TERRITORIAL DEMOGRAPHICS**

Association Comparison (12/31/2010) to 2007 Ag Census Data:

	2007 Ag Census	Association Loans "In Territory"	Market Share Percentage
Young	270	108	40.00%
Beginning	2,314	463	20.01%
Small	7,845	784	9.99%

The 2007 USDA Ag Census data has been used as a benchmark to measure penetration of the Association's YBS program efforts. The Ag Census is taken every five years by mailing report forms to farm and ranch operators. For purposes of the census, a farm is any place from which \$1,000 or more of agricultural products were produced or sold, or normally would have been sold during the census year. This is similar to how the Association defines an agricultural borrower. The Association's designation as being "in territory" is tied to the borrower having a farm operation headquartered or some agricultural involvement in one of the eighteen counties that comprises the Association's chartered territory. For purposes of the comparison above, the Ag Census data and the Association's numbers are not determined using exactly the same methodology. Market share percentages may be distorted due to a farm (that would be counted once in the census) potentially having more than one loan with the association.

**YBS PROGRAM SUMMARY**

In summary, the Association will place continued emphasis on involvement in agricultural activities occurring within its territory, in implementing additional loan inducements to help YBS farmers and ranchers receive sound and constructive credit, and in reaching out in partnership to area educational systems that have agriculturally-affiliated programs. The Association will work diligently to meet its YBS Mission statement of *Helping agriculture harvest a better tomorrow by cultivating Young, Beginning, and Small Farmers today.*

**REGULATORY MATTERS**

For the twelve months ended December 31, 2010, the FCA took no enforcement action against the Association. During the first quarter of 2010, the FCA entered into a written supervisory agreement with the Association. The written supervisory agreement required the Association to take corrective actions with respect to certain areas of its operations, including board operations, strategic planning and staffing, internal controls, asset quality, loan portfolio management, portfolio risk, capital, earnings and liquidity. The Association remained under written supervisory agreement as of the date of this report.

**RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

Please refer to Note 2, *Summary of Significant Accounting Policies*, in the Notes to the Consolidated Financial Statements for recently issued accounting pronouncements.

# *Disclosure Required by Farm Credit Administration Regulations*

## **Description of Business**

Descriptions of the territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations are incorporated herein by reference to Note 1 of the Consolidated Financial Statements, "Organization and Operations," included in this Annual Report to shareholders.

The description of significant developments that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, and concentrations of assets, if any, is incorporated in "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in this Annual Report.

## **Description of Property**

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

<u>Location</u>	<u>Description</u>	<u>Form of Ownership</u>
5052 Hwy. 90 East Marianna	Administrative/ Branch	Owned
5336 Stewart Street, SE Milton	Branch	Owned
925 W. Washington Monticello	Branch	Owned
2015 Centre Pointe Blvd. Suites 103 and 104 Tallahassee	Branch	Leased

Rented facility is leased at prevailing market rates from independent third parties not currently exceeding five years.

## **Legal Proceedings**

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 12 of the Consolidated Financial Statements, "Commitments and Contingencies," and Note 17 of the Consolidated Financial Statements, "Regulatory Enforcement Matters," included in this Annual Report.

## **Description of Capital Structure**

Information to be disclosed in this section is incorporated herein by reference to Note 8 of the Consolidated Financial Statements, "Members' Equity," included in this Annual Report.

## **Description of Liabilities**

The description of liabilities, contingent liabilities and intrasystem financial assistance rights and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 7, 9 and 12 of the Consolidated Financial Statements included in this Annual Report.

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

"Management's Discussion and Analysis of Financial Condition and Results of Operations," which appears in this Annual Report and is to be disclosed in this section, is incorporated herein by reference.

## **Senior Officers**

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

<u>Senior Officers</u>	<u>Position &amp; Other Business Interests</u>
Rick Bitner	<i>President &amp; Chief Executive Officer</i> since January 1, 2009. Mr. Bitner also serves on the Board of Directors of Florida's Great Northwest, a regional economic and workforce development association.
Bruce C. Harrison	<i>Chief Financial Officer</i> since June 2002.
Jay Baker	<i>Relationship Manager</i> since February 2009.
Chuck Thiele	<i>Credit Administrator</i> since January 2010.
Deandra Barber	<i>Policy and Operations Manager</i> since January 2010. <i>Loan Operations Manager</i> from December 2005 thru December 2009.

The business experience for the past five years for executive officers is with the Farm Credit System, except for Rick Bitner, who for the five years prior to March 2007 was a Senior Vice President of a commercial bank and Chuck Thiele who was a Vice President of a commercial bank prior to January 2010.

The total amount of compensation earned by the CEO and the highest paid officers as a group during the years ended December 31, 2010, 2009 and 2008, is as follows:

Name of Individual or Number in	Year	Annual				Total
		Salary	Bonus	Deferred Comp.	Perq./Other*	
Rick Bitner	2010	\$179,382	-	-	-	\$179,382
Rick Bitner	2009	\$175,631	-	-	-	\$175,631
Rick Bitner	2008	\$ 27,500	-	-	-	\$ 27,500
James Alberts**	2008	\$218,758	-	-	\$ 4,911	\$223,669
5	2010	\$528,153	-	-	\$ 5,079	\$533,232
6	2009	\$612,149	-	-	\$ 5,063	\$617,212
7	2008	\$690,098	\$ 16,333	-	-	\$706,431

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

\*\*During 2008 the salary for James R. Alberts for the ten months serving as CEO was \$218,758 and the salary for the two months while not serving as C.E.O. was \$43,752. During 2008 the perq./other for James R. Alberts for the ten months serving as CEO was \$4,911 and the perq./other for the two months while not serving as C.E.O. was \$1,085.

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

In addition to a base salary, officers may earn additional compensation under incentive plans. The Association's plans are designed to motivate employees to produce progressively higher levels of final net earnings from year to year and to support the Association's organizational objectives and financial goals. At the same time, these plans foster superior performance and team concepts. A copy of the policies is available to shareholders of the Association upon request. No amounts were paid or accrued to senior officers during 2010.

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

Senior officers and other association employees are reimbursed on an actual cost basis for all expenses incurred in the performance of official duties. Such expenses may include transportation, lodging, meals, tips, tolls, parking of cars, laundry, registration fees, and other expenses associated with travel on official business. Total reimbursements to senior officers for business expenses during 2010 were less than three hundred dollars. Some senior officers and other association employees are assigned association automobiles to be utilized in the performance of association duties. Personal usage of the assigned automobiles is allowed on a limited basis. Any personal usage is considered a benefit to the officer or employee and is included as income to the individual in accordance with IRS regulations. Total benefit to senior officers for the personal usage of association automobiles during 2010 was \$8,494. A copy of the expense policy is available to shareholders of the Association upon request. Disclosure of information on the total compensation paid during 2010 to any senior officer, or to any other individual included in the total, is available to shareholders upon request.

**Directors**

The following chart details the directors serving in 2010, their current term of service and total cash compensation paid:

Name of Director	Current Term	Total Compensation
James G. Ditty, <i>Chairman</i>	2010-2013	\$ 11,100
Richard Terry, <i>Vice-Chairman</i>	2008-2011	10,000
Melvin Adams	2009-2012	7,750
Fred H. Beshears	2010-2013	8,500
Bob Calvert, <i>Appointed Director</i>	2007-2010	19,250
Cindy Eade	2008-2011	9,500
Copeland Griswold	2010-2013	8,750
William Carroll Lamb, <i>Outside Director</i>	2008-2011	8,500
James C. Moulton	2009-2012	6,250
George T. Van Pelt	2008-2011	9,250
T.B. Walker	2009-2012	9,000
Al Wenstrand, <i>Outside Director</i>	2007-2010	3,250
<b>Total</b>		<b>\$ 111,100</b>

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

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

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

**Melvin T. Adams** owns and operates a farm in Jackson and Holmes Counties and has been a cattle and row crop farmer for the past five years. Mr. Adams served on the executive committee. He currently serves as vice chairman of the board.

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

**Robert A. Calvert, Jr.** is an appointed director and a Certified Management Consultant. For 29 years he has been the owner of Calvert Consulting, a Bank Management and Board Consulting firm that specializes in new bank charters, strategic planning, recruiting bank executive officers, director training, and performing management and director studies for the financial industry regulators. He is a member of the Society of Financial Examiners and has been in the banking industry for 44 years. He is a former commercial bank President, CEO, and Director. Mr. Calvert served on the audit committee.

**Cindy S. Eade** has been in dairy production for the past five years. She is the co-owner and manager of Cindale Farms LLC. She is a member of S. E. Milk Cooperative, and serves on the Board of Directors of the Jackson County Chamber of Commerce. She is a resident of Jackson County, Florida. Ms.

Eade served on the audit committee and the risk management committee. She currently serves as chairman of the audit committee.

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

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

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

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

**T. B. Walker** has been a dairy, cattle and row crop farmer for the past five years and a partner with Waukeenah Feed and Fertilizer Supply (retail). Mr. Walker served on the executive committee.

**Al Wenstrand** served as an outside director and has served as the president for Florida's Great Northwest, Inc., since 2003. From 1999 until 2003, he was appointed by Governor Mike Johanns to the cabinet level position of Director of Economic Development for Nebraska. Prior to the appointment, he was the executive director of the Sarpy County Economic Development Corporation, working in cooperation with the Omaha Chamber in a four-county, regional economic development effort. He served for five years as the chairman of the Nebraska Investment Finance Authority. He also served on the board of directors as treasurer of the Applied Information Management Institute, a not-for-profit membership organization created by a consortium of business, education and government entities to support and promote business growth related to information technology. Mr. Wenstrand served on the audit committee. Mr. Wenstrand relocated out of our territory and therefore resigned in 2010.

Subject to approval by the board, the Association currently may allow directors \$500 honoraria for attendance at meetings or special assignments with the exceptions of the chairman, who is allowed \$600 honoraria for board meetings and the appointed director, who is paid a monthly retainer of \$1,500. Executive committee members are allowed \$250 per meeting. Total compensation paid to directors as a group was \$111,100 for 2010. No director received more than \$5,000 in non-cash compensation during the year.

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

DIRECTOR	Regular Board Meeting	
	Days Served	Compensation
James G. Ditty, <i>Chairman</i>	11	\$6,600
Richard Terry, <i>Vice-Chairman</i>	12	6,000
Melvin Adams	11	5,500
Fred H. Beshears	12	6,000
Bob Calvert, <i>Appointed Director</i>	12	18,000
Cindy Eade	12	6,000
Copeland Griswold	11	5,500
William Carroll Lamb, <i>Outside Director</i>	12	6,000
James C. Moulton	11	5,500
George T. Van Pelt	12	6,000
T.B. Walker	12	6,000
Al Wenstrand, <i>Outside Director</i>	6	3,000
<b>Total</b>		\$80,100

DIRECTOR	Executive Committee	
	Days Served	Compensation
Richard Terry, <i>Vice-Chairman</i>	1	\$250
Fred H. Beshears	1	250
Bob Calvert, <i>Appointed Director</i>	1	250
Cindy Eade	1	250
Copeland Griswold	1	250
William Carroll Lamb, <i>Outside Director</i>	1	250
James C. Moulton	1	250
George T. Van Pelt	1	250
T.B. Walker	1	250
Al Wenstrand, <i>Outside Director</i>	1	250
<b>Total</b>		\$2,500

DIRECTOR	Other Official Activities	
	Days Served	Compensation
James G. Ditty, <i>Chairman</i>	11	\$4,500
Richard Terry, <i>Vice-Chairman</i>	9	3,750
Melvin Adams	6	2,250
Fred H. Beshears	6	2,250
Bob Calvert, <i>Appointed Director</i>	4	1,000
Cindy Eade	10	3,250
Copeland Griswold	8	3,000
William Carroll Lamb, <i>Outside Director</i>	6	2,250
James C. Moulton	2	500
George T. Van Pelt	7	3,000
T.B. Walker	7	2,750
<b>Total</b>		\$28,500

Directors are reimbursed on an actual cost basis for all expenses incurred in the performance of official duties. Such expenses may include transportation, lodging, meals, tips, tolls, parking of cars, laundry, registration fees, and other expenses associated with travel on official business. A copy of the expense policy is available to shareholders of the Association upon request.

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was \$41,153 for 2010, \$42,813 for 2009, and \$62,451 for 2008.

**Transactions with Senior Officers and Directors**

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

**Involvement in Certain Legal Proceedings**

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

**Relationship with Independent Auditor**

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

Aggregate fees incurred by the Association for services rendered by its independent auditor for the year ended December 31, 2010 were as follows:

<i>(dollars in thousands)</i>	<b>2010</b>
<b>Independent Auditor</b>	
PricewaterhouseCoopers LLP	
Audit services	\$ 56
Total	<u>\$ 56</u>

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

**Consolidated Financial Statements**

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 14, 2011 and the report of management, which appear in this Annual Report are incorporated herein by reference.

Copies of the Association’s Annual and Quarterly reports are available upon request free of charge by calling 1-850-526-4910 or writing Chief Financial Officer, Farm Credit of Northwest Florida, P.O. Box 7000, Marianna, Florida 32447, or accessing the web site, [www.farmcredit-fl.com](http://www.farmcredit-fl.com). The Association prepares an electronic version of the Annual Report which is available on the Association’s web site within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

**Borrower Information Regulations**

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

institutions clear guidelines for protecting their borrowers’ nonpublic personal information.

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

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

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

**Shareholder Investment**

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

## *Report of the Audit Committee*

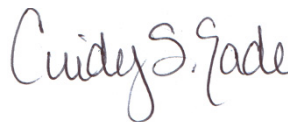
The Audit Committee of the Board of Directors (Committee) is comprised of the directors named below. None of the directors who serve on the Committee is an employee of Farm Credit of Northwest Florida (Association) and in the opinion of the Board of Directors, each is free of any relationship with the Association or management that would interfere with the director's independent judgment on the Committee.

The Committee has adopted a written charter that has been approved by the Board of Directors. The Committee has reviewed and discussed the Association's audited financial statements with management, which has primary responsibility for the financial statements.

PricewaterhouseCoopers LLP (PwC), the Association's independent auditor for 2010, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 114 (*The Auditor's Communication With Those Charged With Governance*). PwC has provided to the Committee the written disclosures and the letter required by Independence Standards Board Standard No. 1 (*Independence Discussions with Audit Committees*), and the Committee has discussed with PwC that firm's independence.

The Committee has also concluded that PwC's provision of non-audit services, if any, to the Association is compatible with PwC's independence.

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Association's Annual Report for 2010. The foregoing report is provided by the following independent directors, who constitute the Committee:



Cindy S. Eade  
Chairman of the Audit Committee

### **Members of Audit Committee**

Robert A. Calvert, Jr.  
James Moulton

March 14, 2011

# Report of Independent Auditors



## Report of Independent Auditors

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of changes in members' equity and of cash flows present fairly, in all material respects, the financial position of Farm Credit of Northwest Florida, ACA (the Association) and its subsidiaries at December 31, 2010, 2009 and 2008, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

*PricewaterhouseCoopers* LLP

March 14, 2011

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# Consolidated Balance Sheets

<i>(dollars in thousands)</i>	December 31, 2010	December 31, 2009	December 31, 2008
<b>Assets</b>			
Cash	\$ —	\$ —	\$ 537
Loans	385,839	441,596	494,521
Less: allowance for loan losses	10,098	8,724	3,294
Net loans	375,741	432,872	491,227
Accrued interest receivable	2,612	3,315	4,559
Investments in other Farm Credit institutions	8,418	9,506	10,257
Premises and equipment, net	1,322	1,430	1,564
Other property owned	16,930	15,464	1,355
Due from AgFirst Farm Credit Bank	3,788	4,337	4,243
Other assets	2,378	2,504	2,373
Total assets	\$ 411,189	\$ 469,428	\$ 516,115
<b>Liabilities</b>			
Notes payable to AgFirst Farm Credit Bank	\$ 336,920	\$ 393,791	\$ 435,228
Accrued interest payable	935	1,248	1,638
Patronage refund payable	31	31	793
Other liabilities	2,898	3,440	3,583
Total liabilities	340,784	398,510	441,242
Commitments and contingencies			
<b>Members' Equity</b>			
Protected borrower stock	7	14	16
Capital stock and participation certificates	1,014	1,138	1,231
Retained earnings			
Allocated	51,936	52,016	52,055
Unallocated	17,448	17,750	21,571
Total members' equity	70,405	70,918	74,873
Total liabilities and members' equity	\$ 411,189	\$ 469,428	\$ 516,115

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

# Consolidated Statements of Operations

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2010	2009	2008
<b>Interest Income</b>			
Loans	\$ 21,175	\$ 26,559	\$ 34,306
<b>Interest Expense</b>			
Notes payable to AgFirst Farm Credit Bank	12,669	16,849	20,912
Other	1	13	269
Total interest expense	12,670	16,862	21,181
Net interest income	8,505	9,697	13,125
Provision for loan losses	6,109	11,296	6,907
Net interest income after provision for loan losses	2,396	(1,599)	6,218
<b>Noninterest Income</b>			
Loan fees	319	189	200
Patronage refund from other Farm Credit institutions	4,141	4,411	4,264
Gains (losses) on other property owned, net	(2,592)	(986)	—
Insurance Fund refund	492	—	—
Other noninterest income	31	50	85
Total noninterest income	2,391	3,664	4,549
<b>Noninterest Expense</b>			
Salaries and employee benefits	3,866	3,607	3,236
Occupancy and equipment	329	315	356
Insurance Fund premiums	221	847	743
Other operating expenses	1,129	1,112	1,288
Total noninterest expense	5,545	5,881	5,623
Income (loss) before income taxes	(758)	(3,816)	5,144
Provision (benefit) for income taxes	(456)	—	(73)
Net income (loss)	\$ (302)	\$ (3,816)	\$ 5,217

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

## Consolidated Statements of Changes in Members' Equity

<i>(dollars in thousands)</i>	Protected Borrower Stock	Capital Stock and Participation Certificates	Retained Earnings		Total Members' Equity
			Allocated	Unallocated	
Balance at December 31, 2007	\$ 24	\$ 1,349	\$ 49,411	\$ 20,074	\$ 70,858
Net income				5,217	5,217
Protected borrower stock retired	(8)				(8)
Capital stock/participation certificates issued/(retired), net		(118)			(118)
Patronage distribution					
Cash				(753)	(753)
Nonqualified retained earnings			3,012	(3,012)	—
Retained earnings retired			(96)		(96)
Patronage distribution adjustment			(272)	45	(227)
Balance at December 31, 2008	16	1,231	52,055	21,571	74,873
Net income				(3,816)	(3,816)
Protected borrower stock retired	(2)				(2)
Capital stock/participation certificates issued/(retired), net		(93)			(93)
Retained earnings retired			(42)		(42)
Patronage distribution adjustment			3	(5)	(2)
Balance at December 31, 2009	14	1,138	52,016	17,750	70,918
Comprehensive income					
Net income				(302)	(302)
Protected borrower stock retired	(7)				(7)
Capital stock/participation certificates issued/(retired), net		(124)			(124)
Retained earnings retired			(80)		(80)
Balance at December 31, 2010	\$ 7	\$ 1,014	\$ 51,936	\$ 17,448	\$ 70,405

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

# Consolidated Statements of Cash Flows

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2010	2009	2008
<b>Cash flows from operating activities:</b>			
Net income	\$ (302)	\$ (3,816)	\$ 5,217
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	143	162	210
Amortization of net deferred loan origination (fees) costs	(96)	(270)	(565)
Provision for (reversal of allowance for) loan losses	6,109	11,296	6,907
(Gains) losses on other property owned, net	2,592	986	—
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	703	1,244	367
(Increase) decrease in due from AgFirst Farm Credit Bank	549	(94)	986
(Increase) decrease in other assets	126	(131)	12
Increase (decrease) in accrued interest payable	(313)	(390)	(578)
Increase (decrease) in other liabilities	(542)	(143)	(229)
Total adjustments	9,271	12,660	7,110
Net cash provided by (used in) operating activities	8,969	8,844	12,327
<b>Cash flows from investing activities:</b>			
Net (increase) decrease in loans	41,961	31,855	12,784
(Increase) decrease in investment in other Farm Credit institutions	1,088	751	115
Purchases of premises and equipment	(35)	(28)	(47)
Proceeds from sales of other property owned	5,099	379	—
Net cash provided by (used in) investing activities	48,113	32,957	12,852
<b>Cash flows from financing activities:</b>			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	(56,871)	(41,437)	(20,583)
Protected borrower stock retired	(7)	(2)	(8)
Capital stock and participation certificates issued/(retired), net	(124)	(93)	(118)
Patronage refunds and dividends paid	—	(764)	(5,212)
Retained earnings retired	(80)	(42)	(96)
Net cash provided by (used in) financing activities	(57,082)	(42,338)	(26,017)
Net increase (decrease) in cash	—	(537)	(838)
Cash, beginning of period	—	537	1,375
Cash, end of period	\$ —	\$ —	\$ 537
<b>Supplemental schedule of non-cash activities:</b>			
Financed sales of other property owned	\$ 2,250	\$ —	\$ —
Loans transferred to other property owned	11,407	15,474	1,355
Cash dividends or patronage distributions declared or payable	—	—	753
<b>Supplemental information:</b>			
Interest paid	12,983	17,252	21,759
Taxes (refunded) paid, net	(456)	26	130

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

# Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

## Note 1 — Organization and Operations

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

The Association is a lending institution of the Farm Credit System (System), a nationwide system of cooperatively owned banks and associations, which was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (Farm Credit Act). The most recent significant amendment to the Farm Credit Act was the Agricultural Credit Act of 1987. At December 31, 2010, the System was comprised of four Farm Credit Banks, one Agricultural Credit Bank and eighty-six associations.

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

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

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

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (Insured debt), (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also

available for discretionary uses by the Insurance Corporation to provide assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank has been required to pay premiums, which may be passed on to the Association, into the Insurance Fund, based on its annual average adjusted outstanding insured debt until the assets in the Insurance Fund reach the "secure base amount." The secure base amount is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments) or such other percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums, but it still must ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

B. **Operations:** The Farm Credit Act sets forth the types of authorized lending activity, persons eligible to borrow, and financial services which can be offered by the Association. The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related businesses.

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

## Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the Association conform with accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results may differ from these estimates.

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

inter-company transactions have been eliminated in consolidation.

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

B. **Loans and Allowance for Loan Losses:** Long-term real estate mortgage loans generally have original maturities ranging from 5 to 40 years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less. Loans are carried at their principal amount outstanding adjusted for charge-offs and deferred loan fees or costs.

Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days (unless adequately collateralized and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in the prior year).

When loans are in nonaccrual status, the interest portion of payments received in cash is recognized as interest income if collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it. Otherwise, loan payments are applied against the recorded investment in the loan. Nonaccrual loans may be returned to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected and the loan is not classified "doubtful" or "loss."

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

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

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

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

The Association uses a two-dimensional loan rating model based on an internally generated combined system risk rating guidance that incorporates a 14-point risk rating scale to identify and track the probability of borrower default and a separate scale addressing loss given default over a period of time. Probability of default is the probability that a borrower will experience a default within 12 months from the date of

the determination of the risk rating. A default is considered to have occurred if the lender believes the borrower will not be able to pay its obligation in full or the borrower is past due more than 90 days. The loss given default is management's estimate as to the anticipated economic loss on a specific loan assuming default has occurred or is expected to occur within the next 12 months.

Each of the probability of default categories carries a distinct percentage of default probability. The 14-point risk rating scale provides for granularity of the probability of default, especially in the acceptable ratings. There are nine acceptable categories that range from a borrower of the highest quality to a borrower of minimally acceptable quality. The probability of default between 1 and 9 is very narrow and would reflect almost no default to a minimal default percentage. The probability of default grows more rapidly as a loan moves from a "9" to other assets especially mentioned and grows significantly as a loan moves to a substandard (viable) level. A substandard (non-viable) rating indicates that the probability of default is almost certain.

The credit risk rating methodology is a key component of the Association's allowance for loan losses evaluation, and is generally incorporated into the institution's loan underwriting standards and internal lending limit. The allowance for loan losses is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including current production and economic conditions, loan portfolio composition, collateral value, portfolio quality, and prior loan loss experience. It is based on estimates, appraisals and evaluations of loans which, by their nature, contain elements of uncertainty and imprecision. The possibility exists that changes in the economy and its impact on borrower repayment capacity will cause these estimates, appraisals and evaluations to change.

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

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

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

A specific allowance may be established for impaired loans under Financial Accounting Standards Board (FASB) guidance on accounting by creditors for impairment of a loan.

Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent.

A general allowance may also be established under FASB guidance on accounting for contingencies, to reflect estimated probable credit losses inherent in the remainder of the loan portfolio which excludes impaired loans considered under the specific allowance discussed above. A general allowance can be evaluated on a pool basis for those loans with similar characteristics. The level of the general allowance may be based on management's best estimate of the likelihood of default adjusted for other relevant factors reflecting the current environment.

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

**C. Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** The Association is required to maintain ownership in the Bank in the form of Class C stock.

Accounting for this investment is on the cost plus allocated equities basis. Patronage refunds from the Bank are accrued as earned. The receivable for such patronage refunds is classified as due from AgFirst Farm Credit Bank.

**D. Other Property Owned:** Other property owned, consisting of real and personal property acquired through a collection action, is recorded upon acquisition at fair value less estimated selling costs. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income, expenses, and carrying value adjustments related to other property owned are included in gains (losses) on other property owned, net.

**E. Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Gains and losses on dispositions are reflected in current earnings. Maintenance and repairs are charged to expense and improvements are capitalized.

**F. Advanced Conditional Payments:** The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, the advanced conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as interest-bearing liabilities in the accompanying Consolidated Balance Sheets. Advanced conditional payments are not insured. Interest is generally paid by the Association on such accounts.

**G. Employee Benefit Plans:** Substantially all employees of the Association may participate in either the AgFirst Farm Credit

Final Average Pay Retirement Plan or the AgFirst Farm Credit Cash Balance Plan (collectively referred to as the "Plans"), which are defined benefit plans and considered multi-employer plans. These two Plans are noncontributory and include eligible District employees. The "Projected Unit Credit" actuarial method is used for financial reporting purposes. The actuarially-determined costs of these Plans are allocated to each participating entity, including the Association, by multiplying the Plans' net pension expense by each institution's eligible service cost and accumulated benefit obligation as a percentage of the total eligible service cost and total accumulated benefit obligation for all Plans' participants.

Substantially all employees of the Association may also be eligible to participate in defined contribution Districtwide 401(k) plan, which qualifies as a 401(k) plan as defined by the Internal Revenue Code. For employees hired on or prior to December 31, 2002, the Association contributes \$.50 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. For employees hired on or after January 1, 2003, the Association contributes \$1.00 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service. 401(k) plan costs are expensed as funded.

The Association may provide certain health care and life insurance benefits to eligible retired employees. Substantially all employees may become eligible for these benefits if they reach early retirement age while working for the Association. Authoritative accounting guidance requires the accrual of the expected cost of providing these benefits to an employee and an employee's beneficiaries and covered dependents during the years that the employee renders service necessary to become eligible for these benefits.

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

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

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

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

- I. **Patronage Refund from AgFirst and Other Financial Institutions:** The Association records patronage refunds from the Bank and certain District Associations on an accrual basis.
- J. **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 disclosures about fair value measurements. 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 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. It describes three levels of inputs that may be used to measure fair value as discussed in Note 13.
- K. **Recently Issued Accounting Pronouncements:** 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 January 1, 2010. This guidance must be applied to transfers occurring on or after the effective date. Additionally, 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 loan 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 January 1, 2010. The Association does not have any variable interest or controlling interest in a variable entity. Therefore, there was no impact of adoption of the guidance for the Association.

Effective January 1, 2010, the Association adopted FASB guidance "Fair Value Measurements and Disclosures," which is intended to improve disclosures about fair value measurement by increasing transparency in financial reporting. The changes 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 13).

In July 2010, the FASB issued guidance on "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses." This guidance provides 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 were amended to include additional disclosures of financing receivables on both a portfolio segment and class of financing receivable basis. This includes 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 3 — Loans and Allowance for Loan Losses**

A summary of loans follows:

<i>(dollars in thousands)</i>	December 31,		
	2010	2009	2008
Real estate mortgage	\$ 245,787	\$ 277,260	\$ 350,190
Production and intermediate-term Agribusiness	133,649	148,638	125,280
Processing and marketing	684	772	9,546
Farm-related business	150	259	488
Total agribusiness	834	1,031	10,034
Rural residential real estate	5,569	7,460	9,017
Other (including mission-related)	-	7,207	-
<b>Total Loans</b>	<b>\$ 385,839</b>	<b>\$ 441,596</b>	<b>\$ 494,521</b>

A substantial portion of the Association's lending activities is collateralized and the Association's exposure to credit loss associated with lending activities is reduced accordingly. An estimate of the Association's credit risk exposure is considered in the determination of the allowance for loan losses.

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

The Association may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume, and comply with Farm Credit Administration regulations. The following table presents participations purchased and sold balances at December 31, 2010:

<i>(dollars in thousands)</i>	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	\$ 916	\$ 50,890	\$ -	\$ 5,883	\$ 5,258	\$ 1,149	\$ 6,174	\$ 57,922
Production and intermediate-term Agribusiness	-	33,118	-	-	3,584	1,462	3,584	34,580
Processing and marketing	-	1,030	-	-	-	-	-	1,030
<b>Total</b>	<b>\$ 916</b>	<b>\$ 85,038</b>	<b>\$ -</b>	<b>\$ 5,883</b>	<b>\$ 8,842</b>	<b>\$ 2,611</b>	<b>\$ 9,758</b>	<b>\$ 93,532</b>

A significant source of liquidity for the Association is the repayments and maturities of loans. The following table presents the contractual maturity distribution of loans by loan type at December 31, 2010 and indicates that approximately 32.48 percent of loans had maturities of one year or less:

<i>(dollars in thousands)</i>	Due less than 1 year	Due 1 Through 5 years	Due after 5 years	Total
Real estate mortgage	\$ 45,443	\$ 95,110	\$ 105,234	\$ 245,787
Production and intermediate-term Agribusiness	78,871	43,723	11,055	133,649
Processing and marketing	(10)	694	-	684
Farm-related business	1	-	149	150
Total agribusiness	(9)	694	149	834
Rural residential real estate	944	1,638	2,987	5,569
Other (including mission related)	-	-	-	-
<b>Total Loans</b>	<b>\$ 125,249</b>	<b>\$ 141,165</b>	<b>\$ 119,425</b>	<b>\$ 385,839</b>

*Farm Credit of Northwest Florida, ACA*

The following table shows loans and related accrued interest classified under the Farm Credit Administration Uniform Loan Classification System as a percentage of total loans and related accrued interest receivable by loan type as of December 31, 2010, 2009, and 2008:

	2010	2009	2008		2010	2009	2008
<b>Real estate mortgage:</b>				<b>Total agribusiness</b>			
Acceptable	79.64%	84.47%	92.50%	Acceptable	100.00%	96.86%	97.53%
OAEM	5.01	6.82	2.21	OAEM	-	-	-
Substandard/doubtful/loss	15.35	8.71	5.29	Substandard/doubtful/loss	-	3.14	2.47
	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>
<b>Production and intermediate-term:</b>				<b>Rural residential real estate:</b>			
Acceptable	62.11%	58.51%	79.99%	Acceptable	78.89%	82.68%	99.82%
OAEM	13.96	25.24	5.29	OAEM	2.68	4.43	0.18
Substandard/doubtful/loss	23.93	16.25	14.72	Substandard/doubtful/loss	18.43	12.89	-
	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>
<b>Processing and marketing</b>				<b>Other (including mission-related)</b>			
Acceptable	100.00%	95.94%	100.00%	Acceptable	100.00%	100.00%	0.00%
OAEM	-	-	-	OAEM	-	-	-
Substandard/doubtful/loss	-	4.06	-	Substandard/doubtful/loss	-	-	-
	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>	<u>0.00%</u>
<b>Farm-related business</b>				<b>Total Loans:</b>			
Acceptable	99.33%	99.61%	65.58%	Acceptable	73.59%	76.04%	89.72%
OAEM	-	-	-	OAEM	8.07	12.83	2.90
Substandard/doubtful/loss	0.67	0.39	34.42	Substandard/doubtful/loss	18.34	11.13	7.38
	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>

The following table provides an age analysis of past due loans and related accrued interest as of December 31, 2010:

<i>(dollars in thousands)</i>	30 Through 89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans	Recorded Investment 90 Days or More Past Due and Accruing Interest
Real estate mortgage	\$ 3,344	\$ 21,608	\$ 24,952	\$ 222,606	\$ 247,558	\$ -
Production and intermediate-term Agribusiness	6,244	16,231	22,475	111,989	134,464	-
Processing and marketing	-	(10)	(10)	697	687	-
Farm-related business	1	-	1	149	150	-
Total agribusiness	1	(10)	(9)	846	837	-
Rural residential real estate	90	243	333	5,259	5,592	-
Total	<u>\$ 9,679</u>	<u>\$ 38,072</u>	<u>\$ 47,751</u>	<u>\$ 340,700</u>	<u>\$ 388,451</u>	<u>\$ -</u>

The recorded investment in the receivable is the face amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, or acquisition costs and may also reflect a previous direct write-down of the investment.

Nonperforming assets (including related accrued interest) and related credit quality statistics are as follows:

<i>(dollars in thousands)</i>	December 31,		
	2010	2009	2008
<b>Nonaccrual loans:</b>			
Real estate mortgage	\$ 26,624	\$ 21,277	\$ 12,779
Production and intermediate-term Agribusiness	22,135	12,230	9,141
Processing and marketing	(10)	31	-
Farm-related business	1	1	1
Total agribusiness	(9)	32	1
Rural residential real estate	711	964	-
Total nonaccrual loans	<u>\$ 49,461</u>	<u>\$ 34,503</u>	<u>\$ 21,921</u>
<b>Accruing restructured loans:</b>			
Total accruing restructured loans	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
<b>Accruing loans 90 days or more past due:</b>			
Real estate mortgage	\$ -	\$ 1,188	\$ -
Production and intermediate-term	-	-	1,217
Total accruing loans 90 days or more past due	<u>\$ -</u>	<u>\$ 1,188</u>	<u>\$ 1,217</u>
Total nonperforming loans	\$ 49,461	\$ 35,691	\$ 23,138
Other property owned	16,930	15,464	1,355
Total nonperforming assets	<u>\$ 66,391</u>	<u>\$ 51,155</u>	<u>\$ 24,493</u>
Nonaccrual loans as a percentage of total loans	12.82%	7.81%	4.43%
Nonperforming assets as a percentage of total loans and other property owned	16.48%	11.19%	4.94%
Nonperforming assets as a percentage of capital	<u>94.30%</u>	<u>72.13%</u>	<u>32.71%</u>

The following table presents information relating to impaired loans (including accrued interest) as defined in Note 2:

<i>(dollars in thousands)</i>	December 31,		
	2010	2009	2008
Impaired nonaccrual loans:			
Current as to principal and interest	\$ 11,054	\$ 6,254	\$ –
Past due	38,407	28,249	21,921
Total impaired nonaccrual loans	<u>49,461</u>	<u>34,503</u>	<u>21,921</u>
Impaired accrual loans:			
90 days or more past due	–	1,188	1,217
Total impaired accrual loans	–	1,188	1,217
Total impaired loans	<u>\$ 49,461</u>	<u>\$ 35,691</u>	<u>\$ 23,138</u>

Additional impaired loan information is as follows:

<i>(dollars in thousands)</i>	December 31, 2010			Year Ended December 31, 2010	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans
<b>Impaired loans with a related allowance for credit losses:</b>					
Real estate mortgage	\$ 16,649	\$ 19,355	\$ 2,709	\$ 14,627	\$ 166
Production and intermediate-term	15,415	16,951	2,593	13,542	153
Rural residential real estate	711	740	515	625	7
Total	<u>\$ 32,775</u>	<u>\$ 37,046</u>	<u>\$ 5,817</u>	<u>\$ 28,794</u>	<u>\$ 326</u>
<b>Impaired loans with no related allowance for credit losses:</b>					
Real estate mortgage	\$ 9,975	\$ 9,719	\$ –	\$ 8,763	\$ 99
Production and intermediate-term	6,720	7,359	–	5,904	67
Agribusiness					
Processing and marketing	(10)	1,229	–	(9)	–
Farm-related business	1	1,535	–	1	–
Total agribusiness	(9)	2,764	–	(8)	–
Total	<u>\$ 16,686</u>	<u>\$ 19,842</u>	<u>\$ –</u>	<u>\$ 14,659</u>	<u>\$ 166</u>
<b>Total impaired loans:</b>					
Real estate mortgage	\$ 26,624	\$ 29,074	\$ 2,709	\$ 23,390	\$ 265
Production and intermediate-term	22,135	24,310	2,593	19,446	220
Agribusiness					
Processing and marketing	(10)	1,229	–	(9)	–
Farm-related business	1	1,535	–	1	–
Total agribusiness	(9)	2,764	–	(8)	–
Rural residential real estate	711	740	515	625	7
Total	<u>\$ 49,461</u>	<u>\$ 56,888</u>	<u>\$ 5,817</u>	<u>\$ 43,453</u>	<u>\$ 492</u>

Unpaid principal balance represents the contractual principal balance of the loan.

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2010.

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

<i>(dollars in thousands)</i>	Year Ended December 31,		
	2010	2009	2008
Interest income which would have been recognized under the original loan terms	\$ 2,519	\$ 1,658	\$ 868
Less: interest income recognized	184	125	21
Foregone interest income	<u>\$ 2,335</u>	<u>\$ 1,533</u>	<u>\$ 847</u>

A summary of changes in the allowance for loan losses and period end recorded investment in loans is as follows:

<i>(dollars in thousands)</i>	Real Estate Mortgage	Production and Intermediate-term	Agribusiness	Rural Residential Real Estate	Other Loans (including mission- related)	Total
<b>Allowance for credit losses:</b>						
Balance at December 31, 2009	\$ 4,903	\$ 3,162	\$ 18	\$ 554	\$ 87	\$ 8,724
Charge-offs	(3,278)	(1,462)	(135)	(162)	—	(5,037)
Recoveries	302	—	—	—	—	302
Provision for loan losses	3,561	2,326	127	182	(87)	6,109
Balance at December 31, 2010	\$ 5,488	\$ 4,026	\$ 10	\$ 574	\$ —	\$ 10,098
2010 allowance ending balance:						
Individually evaluated for impairment	\$ 2,709	\$ 2,593	\$ —	\$ 515	\$ —	\$ 5,817
Collectively evaluated for impairment	\$ 2,779	\$ 1,433	\$ 10	\$ 59	\$ —	\$ 4,281
<b>Recorded investment in loans outstanding:</b>						
Ending Balance at December 31, 2010	\$ 247,558	\$ 134,464	\$ 837	\$ 5,592	\$ —	\$ 388,451
2010 recorded investment ending balance:						
Loans individually evaluated for impairment	\$ 30,497	\$ 30,844	\$ (9)	\$ 712	\$ —	\$ 62,044
Loans collectively evaluated for impairment	\$ 217,061	\$ 103,620	\$ 846	\$ 4,880	\$ —	\$ 326,407

To mitigate risk of loan losses, District Associations have entered into Long-Term Standby Commitments to Purchase agreements with the Federal Agricultural Mortgage Corporation (Farmer Mac) through an arrangement with the Association. The agreements, which are effectively credit guarantees that will remain in place until the loans are paid in full, give the Associations the right to sell the loans identified in the agreements to the Association, which can, in turn, sell them to Farmer Mac in the event of default (typically four months past due), subject to certain conditions. The balance of loans under Long-Term Standby Commitments to Purchase held by the Associations were \$800, \$951, and \$1,315 at December 31, 2010, 2009, and 2008, respectively. Fees paid to Farmer Mac for such commitments are paid by the Associations and totaled \$6, \$7, and \$12 for 2010, 2009, and 2008, respectively. These amounts are classified as noninterest expense.

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

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

**Note 5 — Premises and Equipment**

Premises and equipment consists of the following:

	December 31,		
	2010	2009	2008
Land	\$ 186	\$ 186	\$ 186
Buildings and improvements	1,978	1,979	1,970
Furniture and equipment	1,123	1,087	1,068
	<u>3,287</u>	<u>3,252</u>	<u>3,224</u>
Less: accumulated depreciation	1,965	1,822	1,660
Total	<u>\$ 1,322</u>	<u>\$ 1,430</u>	<u>\$ 1,564</u>

**Note 6 — Other Property Owned**

Net gains (losses) on other property owned consist of the following:

	December 31,		
	2010	2009	2008
Gains (losses) on sale, net	\$ (864)	\$ (143)	\$ —
Carrying value unrealized gains (losses)	(1,310)	(809)	—
Operating income (expense), net	<u>(418)</u>	<u>(34)</u>	<u>—</u>
Gains (losses) on other property owned, net	<u>\$ (2,592)</u>	<u>\$ (986)</u>	<u>\$ —</u>

**Note 7 — 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 includes borrowing base margin, earnings, and

capital covenants. The Association failed to meet its borrowing base margin and earnings covenants at December 31, 2010. The defaults allow the Bank, in conjunction with the FCA, to accelerate repayment of all indebtedness. The Bank has approved a temporary waiver of the defaults and has allowed the Association to operate under a special credit arrangement pursuant to its GFA. The Association did not meet the regulatory minimum for the core surplus ratio as of December 31, 2010 (see Note 8 below for further information), which is also a default of the GFA. The Bank has also approved a waiver of this default.

Interest rates on both variable and fixed rate notes payable are generally established loan-by-loan based on the Bank's marginal cost of funds, capital position, operating costs and return objectives. The interest rate is periodically adjusted by the Bank based upon agreement between the Bank and the Association. The weighted average interest rates on the variable rate notes were 1.58 percent for LIBOR-based loans, 1.95 percent for Prime-based loans, and the weighted average remaining maturities were 2.4 years and 9.6 years, respectively, at December 31, 2010. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) notes payable which are match funded by the Bank was 3.37 percent and the weighted average remaining maturity was 4.6 years at December 31, 2010. The weighted average interest rate on all interest-bearing notes payable was 3.10 percent and the weighted average remaining maturity was 5.2 years at December 31, 2010.

Variable rate and fixed rate notes payable represent approximately 4.98 percent and 95.02 percent, respectively, of total notes payable at December 31, 2010.

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

#### Note 8 — Members' Equity

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

##### A. Protected Borrower Stock

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

##### B. Capital Stock and Participation Certificates

In accordance with the Farm Credit Act and the Association's capitalization bylaws, each borrower is required to invest in Class C stock for agricultural loans, or participation certificates in the case of rural home and farm related business loans, as a

condition of borrowing. The initial borrower investment, through either purchase or transfer, must be in an amount equal to \$1. The Board of Directors may increase the amount of investment if necessary to meet the Association's capital needs. Loans designated for sale or sold into the Secondary Market on or after April 16, 1996 will have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation.

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

##### C. Regulatory Capitalization Requirements and Restrictions

The FCA's capital adequacy regulations require the Association to achieve permanent capital of 7.00 percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the 7.00 percent capital requirement can initiate certain mandatory and possibly additional discretionary actions by the FCA that, if undertaken, could have a direct material effect on the Association's financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless prescribed capital standards are met. The FCA regulations also require that additional minimum standards for capital be achieved. These standards require all System institutions to achieve and maintain ratios as defined by FCA regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of 7.00 percent and of core surplus as a percentage of risk-adjusted assets of 3.50 percent. The Association's permanent capital, total surplus and core surplus ratios at December 31, 2010 were 14.03 percent, 13.78 percent and 3.06 percent, respectively.

The Association did not meet the regulatory minimum core surplus ratio of 3.50 percent as of December 31, 2010. Core surplus consists of unallocated equities and certain includible allocated equities. However, in the event unallocated equities are less than 1.50 percentage points, no more than two percentage points of the minimum ratio may consist of includible allocated equities. The Association actually held 13.14 percent of includible allocated equities at December 31, 2010. The Association board of directors was required to submit a capital restoration plan to FCA. The plan included monitoring, reporting, and actions to ensure the minimum ratio is achieved and maintained. The Association was in compliance with the other required minimum capital ratios at December 31, 2010.

An FCA regulation empowers it to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. The Association has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

**D. Description of Equities**

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

The Association had the following shares outstanding at December 31, 2010

Class	Protected	Shares Outstanding	
		Number	Aggregate Par Value
B Common/Nonvoting	Yes	1,312	\$ 7
C Common/Voting	No	185,541	928
C Participation Certificates/Nonvoting	Yes	17	-
C Participation Certificates/Nonvoting	No	17,207	86
Total Capital Stock and Participation Certificates		204,077	\$ 1,021

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

*Retained Earnings*

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

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

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

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

At December 31, 2010, allocated members' equity consisted of \$9,813 of qualified surplus, \$11,683 of nonqualified allocated surplus and \$30,440 of nonqualified retained surplus.

*Dividends*

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

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

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

*Patronage Distributions*

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

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

*Transfer*

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

*Impairment*

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

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

*Liquidation*

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

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

**Note 9 — Income Taxes**

The provision (benefit) for income taxes follows:

	Year Ended December 31,		
	2010	2009	2008
Current:			
Federal	\$ (456)	\$ -	\$ (81)
State	-	-	8
	<u>(456)</u>	<u>-</u>	<u>(73)</u>
Deferred:			
Federal	-	-	-
State	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>
Total provision (benefit) for income taxes	<u>\$ (456)</u>	<u>\$ -</u>	<u>\$ (73)</u>

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

	December 31,		
	2010	2009	2008
Federal tax at statutory rate	\$ (258)	\$ (1,298)	\$ 1,749
State tax, net	-	-	-
Patronage distributions	-	-	(256)
Tax-exempt FLCA earnings	(405)	(737)	(1,702)
Change in valuation allowance	286	2,252	202
Other	(79)	(217)	(66)
Provision (benefit) for income taxes	<u>\$ (456)</u>	<u>\$ -</u>	<u>\$ (73)</u>

Deferred tax assets and liabilities are comprised of the following at:

	December 31,		
	2010	2009	2008
Deferred income tax assets:			
Allowance for loan losses	\$ 1,650	\$ 1,917	\$ 534
Net operating loss – carryforward	1,253	1,437	919
Loan origination fees	119	109	91
Nonaccrual loan interest	931	315	166
Write down of Other Property Owned	295	184	-
Gross deferred tax assets	<u>4,248</u>	<u>3,962</u>	<u>1,710</u>
Less: valuation allowance	<u>(4,248)</u>	<u>(3,962)</u>	<u>(1,710)</u>
Gross deferred tax assets, net of valuation allowance	-	-	-
Deferred income tax liabilities:			
Gross deferred tax liability	-	-	-
Net deferred tax asset (liability)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

At December 31, 2010, deferred income taxes have not been provided by the Association on approximately \$56 of patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

The Association recorded a valuation allowance of \$4,248, \$3,962 and \$1,710 during 2010, 2009 and 2008, respectively. The Association will continue to evaluate the realizability of these deferred tax assets and adjust the valuation allowance accordingly.

There were no uncertain tax positions identified related to the current year and the Association has no unrecognized tax benefits at December 31, 2010 for which liabilities have been established. The Association recognizes interest and penalties, if any, related to unrecognized tax benefits as a component of income tax expense. The tax years that remain open for federal and major state income tax jurisdictions are 2007 and forward.

**Note 10 — Employee Benefit Plans**

The Association participates in district sponsored benefit plans. These plans include a defined benefit final average pay retirement plan, a defined benefit cash balance retirement plan, a defined benefit other postretirement benefits plan, and a defined contribution 401(k) plan. Financial information regarding each of these plans follows.

Substantially all employees of the Association are eligible to participate in either the defined benefit final average pay retirement plan (the FAP Plan) or the defined benefit cash balance retirement plan (the CB Plan.) These two plans are noncontributory and include eligible District employees. For participants hired prior to January 1, 2003, benefits are provided under the FAP Plan and are based on eligible compensation and years of service. For participants hired on or after January 1, 2003, benefits are provided under the CB Plan and are determined using a percent of eligible compensation formula. The employer contribution under the CB Plan is based on a formula of 3.00 - 5.00 percent of eligible compensation (depending on years of service) and interest credits as allocated to an employee's theoretical account balance. As a participant in these District

defined benefit plans, the Association funded \$457 for 2010, \$559 for 2009, and \$303 for 2008, through its note payable to the Bank. Plan expenses included in salaries and employee benefits were \$612 for 2010, \$623 for 2009, and \$185 for 2008. Additional financial information for the Plan may be found in the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' 2010 Annual Report.

The District sponsors a plan providing certain benefits (primarily health care) to its retirees. Certain Association charges related to this plan are an allocation of District charges based on the Association's proportional share of the plan liability. This plan is unfunded with expenses paid as incurred. Postretirement benefits other than pensions (primarily health care benefits) included in salaries and employee benefits were \$101 for 2010, \$90 for 2009 and \$85 for 2008. Additional financial information for the Plan may be found in the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' 2010 Annual Report.

The Association participates in a defined contribution Districtwide 401(k) plan, which qualifies as a 401(k) plan as defined by the Internal Revenue Code. For employees hired on or prior to December 31, 2002, the Association will contribute \$.50 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. For employees hired on or after January 1, 2003, the Association will contribute \$1.00 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service. Employer contributions to this plan were \$103, \$91 and \$99 for the years ended December 31, 2010, 2009 and 2008, respectively.

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

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

Total loans to such persons at December 31, 2010 amounted to \$29,094. During 2010, \$12,853 of new loans were made and repayments totaled \$17,049. In the opinion of management, none of these loans outstanding at December 31, 2010 involved more than a normal risk of collectability, except as described below.

Mortgage loans totaling \$4.22 million at December 31, 2010 to one director of the Association, James C. Moulton, were classified substandard due to more than a normal risk of collectability as determined by the Association. This classification of substandard was the result of declining debt repayment capacity related to weakness in the general real estate economy. These loans are current and are adequately secured. The largest outstanding balance on these loans during 2010 was \$4.31 million and the balance outstanding at January 31, 2011, was \$4.21 million.

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

The Association has various commitments outstanding and contingent liabilities.

The Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers and to manage their exposure to interest-rate risk. These financial instruments include commitments to extend credit and/or commercial letters of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2010, \$12,494 of commitments to extend credit and no commercial letters of credit were outstanding.

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the Consolidated Balance Sheets until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

Actions are pending against the Association in which claims for money damages are asserted. On the basis of information presently available, management and legal counsel are of the opinion that the ultimate liability, if any, for these actions, would not be material in relation to the overall financial position of the Association.

#### **Note 13 — Fair Value Measurement**

As described in Note 2, 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 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 has no Level 1 assets or liabilities measured at fair value on a recurring basis at December 31, 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 has no Level 2 assets or liabilities measured at fair value on a recurring basis at December 31, 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 include instruments whose price has been adjusted based on dealer quoted pricing that is different than the third-party valuation or internal model pricing.

Level 3 assets at December 31, 2010 include impaired loans which represent the fair value of certain loans that were evaluated for impairment under FASB guidance. The fair value was based upon the underlying collateral since these were collateral-dependent loans. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the collateral, less estimated costs to sell, is less than the principle balance of the loan, a specific reserve is established. Other property owned is classified as a Level 3 asset at December 31, 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.

**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 December 31, 2010, 2009, and 2008 for each of the fair value hierarchy values are summarized below. As discussed in Note 2, fair value disclosures of nonfinancial assets, such as other property owned, began in 2009.

December 31, 2010					
	Level 1	Level 2	Level 3	Total Fair Value	YTD Total Gains (Losses)
<b>Assets:</b>					
Impaired Loans	\$ -	\$ -	\$ 26,958	\$ 26,958	\$ (7,322)
Other property owned	\$ -	\$ -	\$ 16,649	\$ 16,649	\$ (2,174)
<b>December 31, 2009</b>					
	Level 1	Level 2	Level 3	Total Fair Value	YTD Total Gains (Losses)
<b>Assets:</b>					
Impaired Loans	\$ -	\$ -	\$ 14,962	\$ 14,962	\$ (7,871)
Other property owned	\$ -	\$ -	\$ 15,532	\$ 15,532	\$ (952)
<b>December 31, 2008</b>					
	Level 1	Level 2	Level 3	Total Fair Value	YTD Total Gains (Losses)
<b>Assets:</b>					
Impaired Loans	\$ -	\$ -	\$ 17,365	\$ 17,365	\$ (5,793)

**Note 14 — Disclosures About Fair Value of Financial Instruments**

The following table presents the carrying amounts and fair values of the Association's financial instruments at December 31, 2010, 2009, and 2008.

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

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

	December 31, 2010		December 31, 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>				
Cash	\$ —	\$ —	\$ —	\$ —
Loans, net of allowance	\$ 378,353	\$ 376,365	\$ 436,187	\$ 441,426
<b>Financial liabilities:</b>				
Notes payable to AgFirst Farm Credit Bank	\$ 337,855	\$ 339,666	\$ 395,039	\$ 399,705

	December 31, 2008	
	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>		
Cash	\$ 537	\$ 537
Loans, net of allowance	\$ 495,786	\$ 503,566
<b>Financial liabilities:</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 436,866	\$ 443,811

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

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

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

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

The carrying value of accrued interest approximates its fair value.

- C. **Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** Estimating the fair value of the Association's investment in the Bank and Other Farm Credit Institutions is not practicable because the stock is not traded. As described in Note 4, the net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying Consolidated Balance Sheets. The Association owns 2.20 percent of the issued stock of the Bank as of December 31, 2010 net of any reciprocal investment. As of that date, the Bank's assets totaled \$30.8 billion and shareholders' equity totaled \$1.9 billion. The Bank's earnings were \$417 million during 2010.

In addition, the Association has an investment of \$418 related to other Farm Credit institutions.

- D. **Notes Payable to AgFirst Farm Credit Bank:** The notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association's loan receivables plus accrued interest on the notes payable. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.
- E. **Commitments to Extend Credit:** The estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics and since the related credit risk is not significant.

**Note 15 — Quarterly Financial Information (Unaudited)**

Quarterly results of operations for the years ended December 31, 2010, 2009, and 2008 follow:

	2010				
	First	Second	Third	Fourth	Total
Net interest income	\$ 2,133	\$ 2,011	\$ 2,226	\$ 2,135	\$ 8,505
Provision for (reversal of allowance for) loan losses	378	4,760	2,168	(1,197)	6,109
Noninterest income (expense), net	(91)	(600)	(742)	(1,265)	(2,698)
Net income (loss)	\$ 1,664	\$ (3,349)	\$ (684)	\$ 2,067	\$ (302)
	2009				
	First	Second	Third	Fourth	Total
Net interest income	\$ 2,659	\$ 2,371	\$ 2,585	\$ 2,082	\$ 9,697
Provision for (reversal of allowance for) loan losses	1,065	5,747	1,033	3,451	11,296
Noninterest income (expense), net	(317)	(419)	(506)	(975)	(2,217)
Net income (loss)	\$ 1,277	\$ (3,795)	\$ 1,046	\$ (2,344)	\$ (3,816)
	2008				
	First	Second	Third	Fourth	Total
Net interest income	\$ 3,696	\$ 3,392	\$ 3,220	\$ 2,817	\$ 13,125
Provision for (reversal of allowance for) loan losses	583	506	1,648	4,170	6,907
Noninterest income (expense), net	(238)	(308)	(409)	(46)	(1,001)
Net income (loss)	\$ 2,875	\$ 2,578	\$ 1,163	\$ (1,399)	\$ 5,217

**Note 16 – Regulatory Enforcement Matters**

During the first quarter of 2010, the FCA entered into a written supervisory agreement with the Association. The written supervisory agreement required the Association to take corrective actions with respect to certain areas of its operations, including board operations, strategic planning and staffing, internal controls, asset quality, loan portfolio management, portfolio risk, capital, earnings and liquidity. The Association remained under written supervisory agreement as of the date of this report.

**Note 17 – Subsequent Events**

The Association has evaluated subsequent events and has determined that, except as described in Note 7, there are none requiring disclosure through March 14, 2011, which is the date the financial statements were issued.

As discussed more fully in the Liquidity and Funding Sources section included in the “Management’s Discussion & Analysis of Financial Condition & Results of Operations” and in Note 8, the association was in violation of certain requirements of the General Financing Agreement with AgFirst (the Bank) as of December 31, 2010. The Bank has waived the violations through December 31, 2011.