

2008 ANNUAL REPORT



Farm Credit

SOUTHWEST GEORGIA



On Common Ground

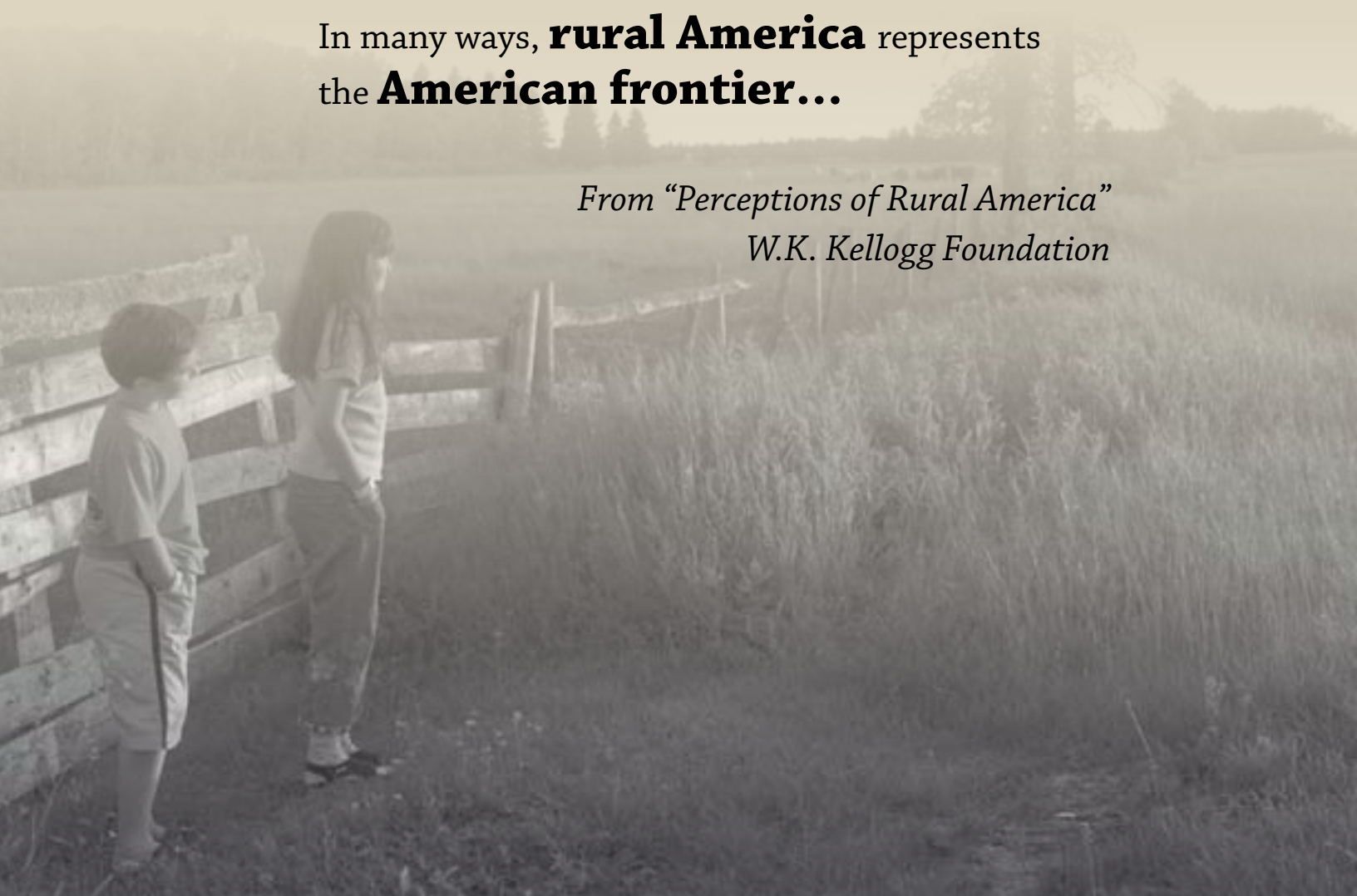
Growing, living and serving in rural America.

# Rural America...

helps perpetuate the **values that define America**, like individualism and self-sufficiency; rural Americans are the **nation's backbone** as the suppliers of food, and they represent the **last open space** in an environment with a rapidly developing suburban landscape.

In many ways, **rural America** represents the **American frontier...**

*From "Perceptions of Rural America"  
W.K. Kellogg Foundation*



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# Consolidated 5-Year Summary of Selected Financial Data

<i>(dollars in thousands)</i>	December 31,				
	2008	2007	2006	2005	2004
<b>Balance Sheet Data</b>					
Cash	\$ 2,971	\$ 1,310	\$ 2,885	\$ 3,358	\$ 2,514
Investment securities	39,707	35,868	32,006	—	—
Loans	373,754	394,021	477,408	455,324	401,497
Less: allowance for loan losses	3,359	520	427	844	843
Net loans	370,395	393,501	476,981	454,480	400,654
Investments in other Farm Credit institutions	16,246	21,196	13,473	5,503	4,726
Other property owned	3,725	—	7	7	—
Other assets	89,412	99,788	104,768	74,837	13,957
Total assets	\$ 522,456	\$ 551,663	\$ 630,120	\$ 538,185	\$ 421,851
Notes payable to AgFirst Farm Credit Bank*	\$ 450,740	\$ 462,596	\$ 547,249	\$ 465,789	\$ 355,722
Accrued interest payable and other liabilities with maturities of less than one year	8,335	16,120	16,374	10,909	8,160
Total liabilities	459,075	478,716	563,623	476,698	363,882
Protected borrower stock	297	353	402	481	568
Capital stock and participation certificates	1,201	1,170	1,141	1,125	1,140
Retained earnings					
Allocated	23,993	27,115	25,198	24,744	23,949
Unallocated	37,890	44,309	39,756	35,137	32,312
Total members' equity	63,381	72,947	66,497	61,487	57,969
Total liabilities and members' equity	\$ 522,456	\$ 551,663	\$ 630,120	\$ 538,185	\$ 421,851
<b>Statement of Operations Data</b>					
Net interest income	\$ 9,169	\$ 11,807	\$ 12,575	\$ 11,442	\$ 10,162
Provision for (reversal of allowance for) loan losses	15,558	91	(418)	1	(6,701)
Noninterest income (expense), net	(33)	943	607	(608)	(867)
Net income (loss)	\$ (6,422)	\$ 12,659	\$ 13,600	\$ 10,833	\$ 15,996
<b>Key Financial Ratios</b>					
Rate of return on average:					
Total assets	(1.16)%	2.13%	2.27%	2.38%	4.18%
Total members' equity	(9.84)%	18.18%	21.57%	18.44%	34.40%
Net interest income as a percentage of					
average earning assets	1.81%	2.10%	2.18%	2.61%	2.69%
Net (chargeoffs) recoveries to average loans	(3.08)%	—	—	—	(0.011)%
Total members' equity to total assets	12.13%	13.22%	10.55%	11.42%	13.74%
Debt to members' equity (:1)	7.24	6.56	8.48	7.75	6.28
Allowance for loan losses to loans	0.90%	0.13%	0.09%	0.19%	0.21%
Permanent capital ratio	11.97%	12.37%	12.42%	13.04%	15.04%
Total surplus ratio	11.62%	12.08%	12.16%	12.77%	14.66%
Core surplus ratio	9.06%	10.20%	10.39%	10.54%	11.10%
<b>Net Income Distribution</b>					
Estimated patronage refunds:					
Cash	\$ —	\$ 3,525	\$ 3,978	\$ 3,169	\$ 2,459
Nonqualified allocated retained earnings	—	2,350	3,978	3,169	2,459
Nonqualified retained earnings	—	—	494	1,578	1,229

\* General financing agreement is renewable on three-year cycles. The next renewal date is December 31, 2010.

## Message from the Chief Executive Officer

Nothing can prepare us for a year like we experienced in 2008. Whether you have been reading about the financial crisis in the *Albany Herald* or the *Wall Street Journal*, we have not witnessed this kind of financial upheaval in decades.

The financial services industry is being redefined each and every day as we enter uncharted territory. Commodity markets are in turmoil, unemployment is rising, the stock market has plummeted and financial institutions are failing. Rest assured, your Association is more resolved than ever to persevere and perform our mission to serve agriculture and rural America. Throughout the past year, we have been faced with a number of difficult challenges on several fronts. We have recognized large losses, seen our credit quality deteriorate and faced an increasingly disrupted financial market where there is reduced investor appetite for long-term debt.

While some losses were the result of a deteriorating real estate market, the unfortunate fact is the Association held a number of loans which deviated from our established credit policies and underwriting guidelines. Failure to comply with established policies and procedures resulted in inadequately collateralized loans which, in today's economy, quickly and dramatically deteriorated and put the Association at financial risk. In response to these circumstances, the Association engaged in an aggressive course of action to pursue recovery of losses associated with the subject loans from all available means. It is important that I stress that the Board of Directors, Audit Committee and Management Team have all taken extraordinary measures, including personnel actions, to insure our operations remain sound and the Association is adequately capitalized.

Specifically, to address our challenges we implemented a plan of action, including:

- Having a thorough internal credit review performed by a third-party firm.
- Conducting a comprehensive audit of internal controls over lending operations and disbursement procedures through a third-party firm.
- Purchasing \$21.4 million in credit enhancement from the Federal Agricultural Mortgage Corporation to increase regulatory capital ratios.
- Selling participation interests in loans of \$52.4 million to AgFirst Farm Credit Bank to improve regulatory capital ratios.
- Hiring a highly respected 27-year veteran of the Farm Credit System to serve as Chief Lending Officer.

One of the consequences related to the loss events previously described, is the Association violated two of its financial covenants under the borrowing relationship with AgFirst Farm Credit Bank, requiring that we operate under a special credit agreement as a condition for accessing funding. Fortunately, the Association managed this economic adversity with a solid capital position and resilient portfolio reflecting an extensive degree of diversification. More importantly, each of the successive audits and credit reviews undertaken during the year indicated credit supervision was, in fact, sound and properly administered.

In 2009, we will continue to emphasize the importance of staying true to our core business of providing Wall Street capital to Main Street farmers, agri-businesses, residential homeowners and investments that contribute to the quality of life for rural constituents. In order to accomplish this, we must continue to improve our capital position and effectively manage portfolio risk, to once again regain our former financial strength. Once this has been accomplished, we can begin to return our profits to our customers, as we did for so many years in the past. Regrettably, as I have described in prior communications, a declaration of patronage will not be possible in the coming year, and we will delay the distribution of the 2003 Allocated Surplus until we are more certain of economic conditions. I will assure you that we are doing all we can to achieve favorable operating results in 2009 while positioning ourselves for further uncertainty.

We will continue to work diligently to protect the integrity of our governance, build our financial position and manage the Association with a high degree of transparency. A solid commitment to our mission will serve as our compass. And the desire to have our customers prosper and the Association succeed will be our course.

Respectfully,

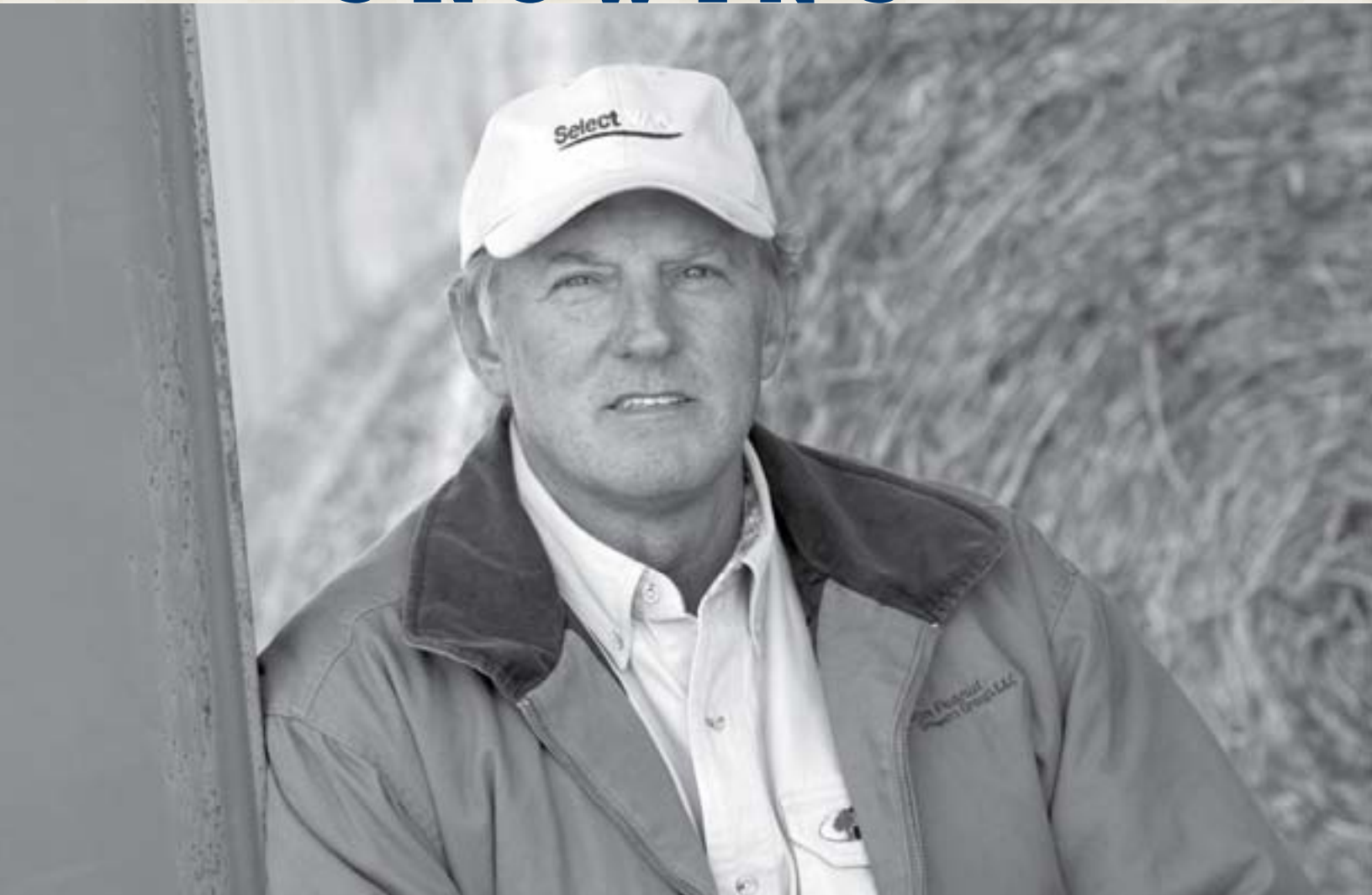


Richard S. Monson  
President and Chief Executive Officer



**Richard S. Monson**

# GROWING



*“I farm because I love the land...love having my family working by my side each and every day. There are no two days that are alike. I learned from my father early on that you have to align yourself with people who understand what you hope to accomplish in life; who know how to help you grow and prosper. Farm Credit has been by our side since long before I started riding a tractor. My father trusted Farm Credit with his family’s livelihood, and I do, too.”*

Ricky Smith, farmer, Donalsonville, Georgia

## Farm families like the Smiths never give up.

The day, and time, will stick in his mind forever. It was a Tuesday. Three years ago. March 22, 2005 at exactly 1:13 p.m.

A tornado whipped through Russell Smith's farm near Donalsonville, taking the home and farm he and his wife, Lillian, spent their lifetime together building. Though it lasted a brief 12 seconds, nature's fury unleashed \$2 million worth of damage.

"Everything we had busted wide open," Russell Smith said. "We were at a loss. We didn't know what to do. We looked around the farm—at the cows, the fences, tractors, trailers—everything was gone. We've been through a lot over the years. The 1954 drought. The economy. But there's no doubt that was the toughest thing. Financially, it was the biggest hurdle to overcome."

### Overcoming adversity is part of farm life

As Russell Smith surveyed the damage—the destruction of a lifetime of work—he remembered the fall of 1954, when he and his brother-in-law both were growing cotton. His relative's farm, just across the road from his own place, was five acres in size, just like his at the time. Both farms were so dry—it was the worst drought southwest Georgia had seen in decades—a major, prolonged drought that created dusty fields with little yield.

When all was said and done, Russell Smith and his brother-in-law had exactly one bale of cotton to show for their hard work—one bale between the two of them.

"You'll hear us old-timers talk about the '54 drought," Russell Smith said. "Sure, '77 was dry and '80 was hot and dry and of course, you remember these years. They stick out in your mind. But '54, that was different. That's the worst I've seen it in my lifetime."



*Russell and Lillian Smith take great pride in running a family farm, son and grandsons included—from the left: Mrs. Lillian, Kyle, Mr. Russell, Dusty, son Ricky and Nick.*

# G R O W I N G



*Faith, family and friends have helped the Smiths face life's challenges. "Some of the finest people live right here nearby," Russell Smith says.*

## **It was their neighbors, and their faith, that pulled them through**

It's easy for Lillian Smith to get a bit teary-eyed at the thought of what happened that afternoon three years ago. Russell, too. When they collected themselves, were assured that every family member was accounted for and unhurt, and thanked God, they surveyed the damage.

"Cows were out, fences were down, our home was destroyed; it was a pretty amazing sight," Russell Smith said. "When it happens like that—just out of nowhere—you're really just frozen. The first few days after it happened, we were just scattered. And no sooner did we feel overwhelmed than about 100 of our neighbors came by—checking on Lillian, checking on the farm, doing whatever they could do to help.

"Some of the finest people live right here nearby," Russell Smith said. "They're good people."

In fact, the entire community pitched in—bringing everything from machinery and equipment and food to strong backs and financial support. Those who couldn't work on the farm any longer stopped by to offer moral support.

Said Tarrell Bennett, Farm Credit's Relationship Manager who works with the Smiths: "Not even for one minute did they have a thought about giving up. There was a fighting spirit from the time that tornado ripped through."

Said Ricky Smith, Russell's only son: "What I know for sure is that I wouldn't want to live anywhere else."

## **Decades of a trusted relationship**

Tarrell Bennett visited the Smiths after the tornado, doing whatever he could to help them land on their feet. Their professional relationship has spanned close to four decades. But that afternoon, their friendship was what mattered most. "I got out

to the farm and it was like something I had never seen before, except maybe on TV—when you see storms come through the mid-west and tear up everything in its path,” he said.

Three years later, a new home, a lot of hard work and the strength of family and friends have gotten the Smiths back on their feet. Tarrell Bennett, for one, couldn’t have been more pleased to see Mrs. Lillian in her new home—her rose bushes lining the driveway, their granddaughter, Sutton, capturing everyone’s attention with her bright, cheerful smile.

With the entire family working on the farm—all three grandsons—Russell Smith need only look out the window to see his years of hard work paying off—for generations to come.


## Passing on the legacy

Russell Smith watches now as Ricky Smith handles most of the day-to-day operations on the farm. Like clockwork each year, he visits with Tarrell Bennett to discuss an operating loan. More often than not though, Ricky and Tarrell meet for a cup of coffee, chatting about the crops, the rain, the cost of fertilizer. Ricky says he likes to pick his brain—farmer to farmer. Tarrell enjoys the conversation.

“I guess I’ve known Tarrell for 36, 37 years, ever since he joined Farm Credit,” Ricky Smith says. “Sometimes before we take on a new project, I’ll run an idea or two past him, just to get his thoughts. I value him as a lender. I value him more as a friend.”

## Since 1916, Farm Credit has been serving farmers and rural America

Farmers throughout the 21 counties served by Southwest Georgia Farm Credit have come to rely on a safe, sound source of credit. In the past 10 years alone, this Association has made more than \$850 million in agricultural loans, serving its primary mission to improve the quality of life and economic condition of rural consumers by being Southwest Georgia’s customer-owned partner. The Association’s success lies in the hands of its member-owners. Like Russell and Ricky Smith, and his sons Nick, Dusty and Kyle.

“I guess I see Farm Credit as the place I turn to each year to keep the farm going,” Ricky said. “And I’m guessing the boys will be doing that down the road and for years to come.” 

## Brad Stovall built the perfect family home.

The first thing you notice is the front yard. All 10 acres of it—or thereabouts. His friends used to joke that he could build a driving range on it. But Brad saw something different. He'd drive by in the evenings and watch the sun set over Lumpkin from the highest point on his property. And on the weekends, he'd sit in a deer stand, and eyeball the turkeys and deer meandering through his pines on the 305-acre tract.

There's no doubt that Brad Stovall admires nature. The land surrounding the home he built in 2006 is left for all things wild. His two dogs run freely through the landscape, stopping from time-to-time to smell a berry bush or chase a squirrel. While some of us may love the city and all of its conveniences, Brad and his family cherish the rural escape—the buffer between neighbors and the ability to simply sit on the front porch and think.

“There's something special about waking up in the morning and watching the deer from your bedroom window,” Brad said. “I love the peacefulness of this place.”

### Building a home where memories can be made

Brad, Lori, and daughters, Kinsey and Bailee, each put their special mark on the design of their home. A beautiful 5-point foyer welcomes you and from there, the home is filled with

treasures, imaginatively decorated with surprises at every turn.

From the foyer, you enter a game room—full of trophies earned from hunts in faraway places. Brad wanted his girls to experience different countries and cultures. The home is filled with memories of their travels.

The kitchen is modern, bright and cheerful, with a welcoming breakfast bar. The bedrooms are elegantly decorated to each teen's tastes. Upstairs, a wonderful room spans the entire length of the house, with a view that captures all of Lumpkin—rolling hills as far as the eye can see. It's a special place, where the girls invite their friends for weekend sleepovers.

“We put a lot of thought into everything we did inside the house and out,” Brad said. “We wanted this to be a place where we could be a family, and when our friends are here, we want them to feel like family, too.”

### New experiences, frustrations and successes

To say that everything went as planned with the Stovall's home wouldn't be exactly accurate. If the land was the canvas, the home was a product of the artist's imagination, inside and out. Sometimes, Brad admits, he needed just a little inspiration, as any good artist might.

# LIVING



*“This property was nothing but pasture four years ago. When I purchased it I really had no idea what I was going to do with it. But Lumpkin is home. I grew up here. Lori grew up here. One afternoon we were out on the property and I said to Lori, ‘Why don’t we build our home here?’ The location is perfect, right on the outskirts of town. It really has been our dream come true. One phone call to Farm Credit and we were on our way. That’s how I like to do business. Easy and efficient.”*

Brad Stovall, Rural Home Owner, Lumpkin, Georgia

# LIVING

“There were a few times when I’d be contemplating this or that, maybe trying to figure out the best way to get something done, and Brian was there on the other end of the phone.”

Brian Wilson, Relationship Manager with Farm Credit in the Americus branch, had recently been through the home building process, and had worked with Brad to finance the tract and the home. He also knew a good sub-contractor or two, and helped Brad through some of the finer points of getting the house built.

“Not only did Brian handle the financing, he was a resource for me,” Brad said.

Said Brian Wilson: “I got a call from Brad one day and he told me he was ready to build the house. He told me later how he had worked with other lenders, but Farm Credit made the entire process easy. I like to tell my customers, ‘Tell us who you are, what you want and how you are going to pay for it.’ We don’t like to complicate things. As much as our customers enjoy the simplicity and comfort of country living, we want to be the lender known for an easy process and getting the job done to their satisfaction.”

## Opportunities for family and friends—for a lifetime

On any given Saturday, Brad and Lori can be found on their back patio, Brad at the grill, friends encircling the outdoor fireplace. They watch as their favorite Georgia Bulldogs face off against some SEC rival, sharing the smiles and laughter that years of friendship have afforded them.

“We love Saturdays, because our friends love coming here, love watching the game, grilling up something good to enjoy,” Lori said. “It’s a special time when we can all be together.”

Not that they have gone far from their roots. Both have spent their lives in Lumpkin, a small town of about 1,200 that’s located about 30 miles from Columbus. Lori is a kindergarten teacher at Stewart County Elementary School. Brad works in the forestry industry.




*Brad, Lori, and daughters, Bailee and Kinsey, enjoy being surrounded by nature at their country home in Lumpkin.*

“The family who previously owned the property had it in their family for three generations,” Brad said. “It’s a special place, one that we wanted to keep authentic in every way possible.”

### **Finishing touches and the satisfaction of a job well-done**

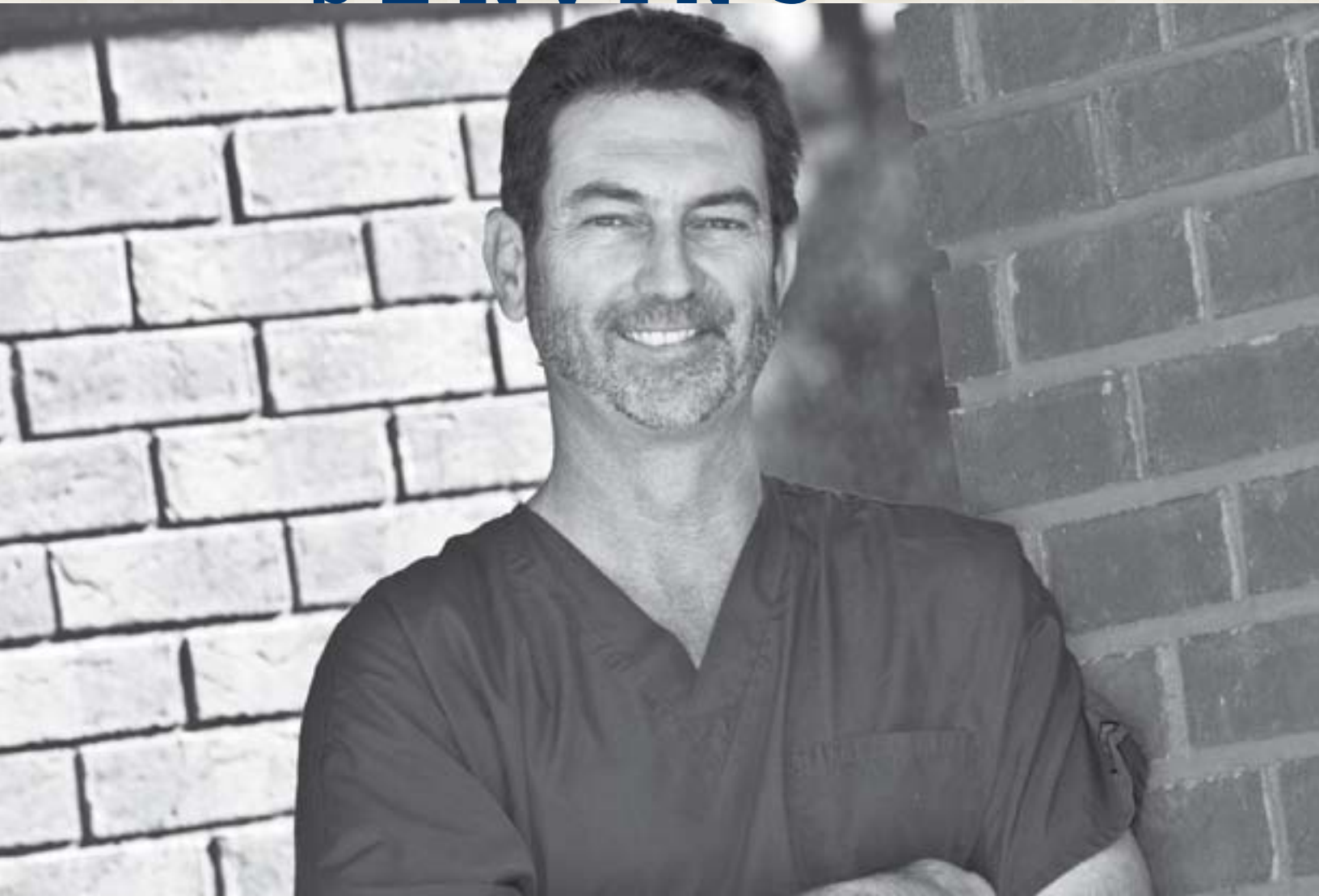
When Brad and the girls jump on their four-wheeler and ride around the property, they get the sense that their house is more than just a place they come home to each evening. It’s their retreat.

A place to stop and think if that’s what they choose, or a place where they can walk through the woods, or sit in the deer stand on a brisk winter morning. There’s a certain serenity, a connection to nature and to a community they cherish—with a sense of privacy—that connects them all to the land.

“We love this town, and we love knowing that we come home to a place that offers everything we wanted for the girls and the two of us,” Brad said. “It’s home.” 



# SERVING



*“Serving a small community means there are certain requirements—as a health care provider and as a businessman—which require us to think outside the box. Not only do I want to provide excellent service, I want to support the community and go beyond expectations whenever I can. Southwest Georgia Farm Credit and Rural America Capital Group helped me create a clear vision for the future, so we’re here for the people who need us the most.”*

Thomas K. Leggett, Jr., DMD, Dentist, Cairo, Georgia

## Dr. Leggett is a believer in solutions.

Since the day he became a dentist, Dr. Leggett has been an optimist. What might seem like a rough day or a nagging problem can usually be fixed with a certain amount of mental input, and there's no doubt that Dr. Leggett is a thinker. Give him a problem, and in a reasonable amount of time, he'll have contemplated a solution. It's how he is wired.

A few years back, Dr. Leggett realized that he had outgrown his original dental facility. He recognized that in order to put his practice at the cutting edge of dental technology he needed to completely upgrade his building and equipment. As usual, he put his mind to work. Determined to find a solution, he first went to a local bank for a loan and learned that there weren't many lenders willing to provide long-term financing at a fixed rate. That's when he turned to Southwest Georgia Farm Credit.

### Dentists need a safe, sound source of capital, too

If you've been down North Broad Street in Cairo, you've no doubt seen the beautiful brick building that now houses Dental Associates of Southwest Georgia. These days, Dr. Leggett's practice serves nearly the population of Grady County. In fact, his practice has grown to accommodate those who live in nearby Thomasville, Camilla and Bainbridge, as well.

Dr. Leggett had worked with a local commercial bank for years and wanted to continue the relationship. But the bank didn't offer a fully amortized, long-term fixed rate permanent financing product—a bond—and Farm Credit was able to help, through Rural America Capital Group.

Rural America Capital Group is a consortium of three Farm Credit System institutions, that includes Southwest Georgia Farm Credit, Farm Credit of Southwest Florida and ArborOne Financial. Rural America Capital Group provides



*Dental Associates of Southwest Georgia in downtown Cairo.*

# S E R V I N G

funding alternatives for projects in small, rural communities, where a new hospital or other medical facility, a school or a business can greatly enhance the quality of life for residents.

Rural America Capital Group's mission is to bring the right kind of financing to projects that make a difference in people's lives. Like having a dentist in the right place, at the right time.

"Health care, education, infrastructure, job creation—that's what Rural America Capital Group is all about," said Paxton Poitevint, Account Executive. "I know I have a great financing product when I can watch a community open the doors of a new critical access hospital, thanks to financing from Rural America Capital Group. These kinds of projects are the life-blood of a community."

## **An innovative, cost-effective approach for rural America**

Rural America Capital Group takes a simple approach to getting a project started. First, an eligibility study is completed. Then, a preliminary credit review is conducted, followed by a project feasibility study. In Dr. Leggett's case, it was a simple case of "doing the math."

"We needed to create a product for Dr. Leggett that was tailored to his specific needs, by matching debt service requirements with the business's cash flow," Poitevint said. "Long-term fixed rate financing through a Private Placement Bond offering was the perfect way to go."

Said Dr. Leggett: "I can worry about being a businessman, or I can worry about being a dentist. I much prefer to be thinking about my dental practice, and how we can provide the highest level of care to our patients, than to be worried about how we pay for the building each month. Rural America Capital Group helped me achieve my vision."

## **Reaching out to support critical needs**

Cairo, Georgia, is a small town in southwestern Georgia which shares a border with Florida. Its median household income is far less than the statewide average. It's nearly 9,500 residents appreciate the city's quaintness and southern charm. But there's no hiding the fact that about a quarter of the city's population lives below the poverty line.


"The fact is that small, rural communities usually don't have the kind of access they need to quality dental care," Dr. Leggett said. "Studies have shown over the years that good oral health contributes to overall good physical and mental health. A healthy smile is important to one's self-esteem, employability, etc. One study I've read found that the number one obstacle in going from welfare to work is poor oral health. We simply have to meet the need."

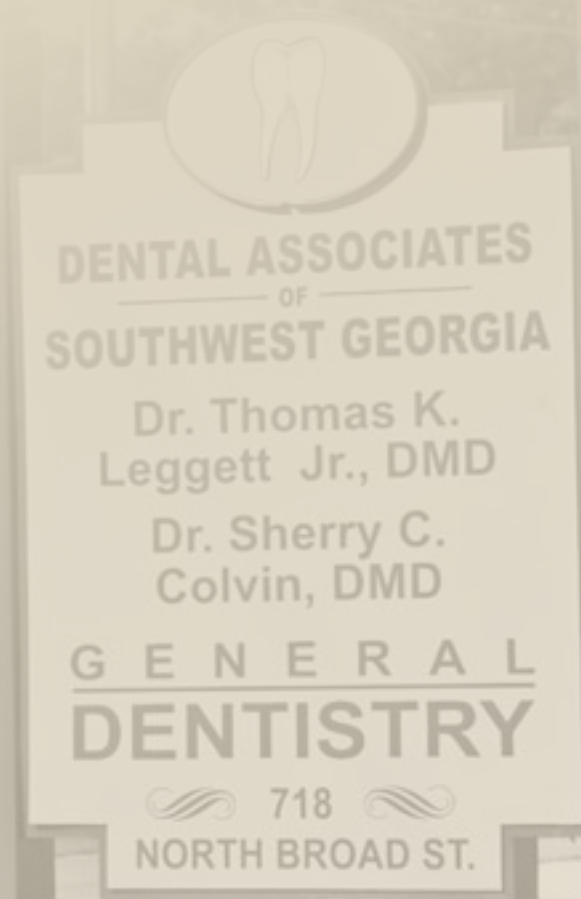
No doubt, Dr. Leggett is a businessman and health care provider who needs to make a living. His practice supports about 20 good-paying jobs in the community. There are few who are turned away because they can't pay.

“Just look at the numbers of dentists in rural America—about half that of metropolitan counties,” Dr. Leggett said. “Three-quarter’s of the nation’s dental shortage exists in rural America. And with more dentists retiring—especially in rural areas—it becomes harder and harder to care for the growing number of uninsured and underinsured.”

Rural America Capital Group understands the complex issues of serving a rural community. In Dr. Leggett’s case, he was able to hire an associate, Sherry Colvin, DMD, to help handle the patient load. In her mid-thirties, Dr. Colvin will be a valuable asset to the community for years to come.

Rural America Capital Group was also able to work with the dentists to establish a Social Enhancement Program, whereby \$2,000 is provided each year to serve those in the community who are desperately in need of dental care, but can’t afford it. In many cases, these funds supplement what a parent can pay for a child’s oral health exam, or for more urgent care.

“Access to dental care is one of the leading rural health care issues we face as a nation,” Dr. Leggett said. “At least here in Cairo, Georgia, I feel like we are able to do our part.” 



## **2008 Financial Results**

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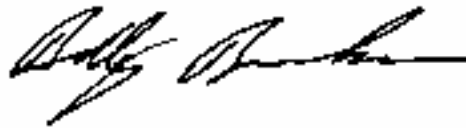
## Report of Management

The accompanying Consolidated Financial Statements and related financial information appearing throughout this annual report have been prepared by management of Southwest Georgia Farm Credit, 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 2008 Annual Report of Southwest Georgia Farm Credit, ACA, that the report has been prepared under the oversight of the audit committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.



Bobby J. Brooks  
Chairman of the Board



Richard S. Monson  
Chief Executive Officer



Belinda Robertson  
Chief Financial Officer

February 27, 2009

## Report on Internal Control Over Financial Reporting

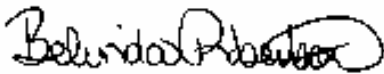
The Association's principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association's Consolidated Financial Statements. For purposes of this report, "internal 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, 2008. 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, 2008, the internal control over financial reporting was effectively 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, 2008.



Richard S. Monson  
Chief Executive Officer



Belinda Robertson  
Chief Financial Officer

February 27, 2009

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

(dollars in thousands, except as noted)

## GENERAL OVERVIEW

The following commentary summarizes the financial condition and results of operations of Southwest Georgia Farm Credit, ACA, (Association) for the year ended December 31, 2008 with comparisons to the years ended December 31, 2007 and December 31, 2006. 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 Southwest Georgia. 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 378, or writing Stephen Gilbert, 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.swgafarmcredit.com](http://www.swgafarmcredit.com), or by calling 1-866-304-3276, extension 1150, or writing Belinda Robertson, Southwest Georgia Farm Credit, ACA, 305 Colquitt Highway, Bainbridge, Georgia 39817. 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 February 2009 United States Department of Agriculture (USDA) forecast estimates that 2009 farmers' net cash income, which is a measure of the cash income after payment of business expenses, will decrease to \$77.3 billion, down \$16.1 billion from 2008 and up \$5.5 billion from its 10-year average. Contributing to this decrease in farmers' net cash income are decreases in cash receipts for crops and livestock of \$18.7 billion and \$10.9 billion,

respectively, and a decrease in direct government payments of \$1.0 billion, offset in part by a decrease in cash expenses of \$14.1 billion and an increase in farm-related income of \$400 million.

In general, 2008 has been an excellent year for U.S. crop producers, particularly for feed crops, oilseeds and food grains. The high level of farmers' net cash income is primarily the result of high commodity prices during the first half of the year. These higher prices were principally due to strong demand from foreign buyers and the domestic biofuels industry. Corn producers were the primary beneficiaries of the increased demand that has been putting pressure on prices. Other crop prices, in general, increased due to increased acreage to plant corn, decreasing the acreage available for other crops, and to consumers seeking lower cost alternatives to corn. Inadequate rainfall in competitor countries and increased international consumption, from growth in population and rising incomes, reduced world supplies of corn and soybeans, which has translated into rising demand for farm commodities. In addition, the U.S. dollar has depreciated against major foreign currencies in recent years resulting in greater demand for U.S. agricultural exports. However, during the latter half of 2008, many of these factors shifted. A dramatic downturn in the global economy decreased international consumption. Oil prices dropped dampening the demand for ethanol. Crop production outlook improved in certain regions of the world. Further, the dollar strengthened in the latter half of 2008. The combination of these events resulted in a dramatic drop in commodity prices in late 2008 to levels more in line with commodity prices at December 31, 2007. The following table sets forth the commodity prices per bushel for certain crops and by hundredweight for beef cattle from December 31, 2005 to December 31, 2008:

<b>Commodity</b>	<b>12/31/08</b>	<b>12/31/07</b>	<b>12/31/06</b>	<b>12/31/05</b>
Corn	\$4.10	\$3.76	\$3.01	\$1.92
Soybeans	\$9.24	\$10.00	\$6.18	\$5.77
Wheat	\$5.97	\$7.74	\$4.52	\$3.54
Beef Cattle	\$79.80	\$88.90	\$83.10	\$93.30

Elevated crop prices, particularly in early 2008, and the resulting volatility from a dramatic drop in crop prices in the latter half of 2008 had both positive and negative impacts on the Association, as a lender to the agricultural and rural sectors. Elevated commodity prices and increased prices and demand for farm inputs generally result in an increase in average agribusiness loans outstanding. While higher commodity prices have positively impacted grain farmers through the first nine months of 2008, a continuation of recent declines in grain prices could have an unfavorable impact in the near future. The volatility of these prices has resulted in higher risk profiles for Association borrowers, particularly borrowers who purchased at elevated crop prices for future production purposes.

The USDA's February 2009 income outlook shows a great deal of variation depending on farm size, geographic location, and commodity specialties. While the Association utilized the USDA analysis to provide a general understanding of the U.S. agricultural economic outlook, this outlook does not take into account all aspects of the Association's business.

The USDA classifies all farms into three primary categories: commercial farms, intermediate farms and rural residential farms. Commercial farms represent about 11 percent of U.S. farms by

number and represent 75 percent of total U.S. farm production. Intermediate farms, defined as the primary occupation is farming and gross sales are below \$250,000, represent 26 percent of U.S. farms by number and account for 16 percent of total production. The remaining 63 percent of U.S. farms are classified as rural residential farms where the primary occupation is not farming and the farms produce less than \$250,000 in products and only account for 9 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. The USDA measures farm household income, which is defined as earnings from farming activities plus off-farm income. Nearly 100 percent of farm household income for operators of rural residential farms and more than 80 percent of farm household income for intermediate farms is generated from off-farm sources. Further, USDA data suggests that approximately 25 percent of farm household income for commercial farms is generated from off-farm income. The USDA forecasts 2009 farm household income to decrease 15 percent for commercial farms and 19 percent for intermediate farms.

According to the USDA February 2009 forecast, farm business balance sheets continued to strengthen in the last few years, as measured by debt relative to assets and equity levels. Farm debt to farm assets is forecasted to decline from 10.0 percent for 2008 to 9.1 percent for 2009. Farmers' equity (farm business assets less farm business debt) is expected to continue to rise by 0.9 percent in 2009, after increasing 6.9 percent in 2008.

One measure of the financial health of the agricultural sector used by the USDA is the assessment of farmers' utilization of their capacity to repay debt (actual debt as a percentage of maximum debt that can be supported by farmers' current income). Higher capacity utilization rates indicate tighter cash flow positions and, consequently, higher exposure to financial risk. These estimates do not take into account, however, off-farm income sources. Since 1970, debt repayment capacity utilization has ranged from a low of 35.8 percent in 1973 to 104.1 percent in 1981, and has remained relatively stable since 1987, averaging about 50.0 percent. The USDA suggests an increase in the use of repayment capacity from 43.0 percent in 2008 to 50.0 percent in 2009.

As estimated by the USDA, the Farm Credit System's market share of farm business debt, defined as debt incurred by those involved in on-farm agricultural production, had grown to 36.7 percent at December 31, 2007, as compared with 28.3 percent at December 31, 2000. Farm business debt is forecasted to grow only 0.9 percent in 2009. The USDA's forecast of slow moderation in debt growth is due to decreases in agricultural production costs and to high levels of earnings during the past two years that may enable certain producers to self finance crop production.

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 been positively impacted 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

## Management's Discussion & Analysis of Financial Condition and Results of Operations (continued)

(dollars in thousands, except as noted)

sufficient government support programs, the Association's financial performance and credit quality measures would likely be negatively impacted. Conditions in the general and agricultural economy have become more volatile with the recent instability in the global financial markets and recent declines in commodity prices. 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 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 2008 was selected by reference to analysis and yield curves of the plans' actuary and industry norm.

### ECONOMIC CONDITIONS

During 2008, economic conditions in our region were much like most of the nations'. In late April of 2008, the gas prices increased to record heights and within a few months, the real estate meltdown set off a series of financial crises which ultimately led to government intervention in the financial system as well as a fall in the stock market.

The number of farms in the United States has grown 4 percent and the operators of those farms have become more diverse in the past five years, according to results of the 2007 Census of Agriculture released February 4<sup>th</sup> 2009, by the U.S. Department of Agriculture's National Agriculture Statistics Service (NASS).

Georgia's agribusinesses did better than expected. Corn yield was 140 bushels per harvested acre, which is a state record. Cotton's yield per harvested acre averaged 840 pounds per acre, 3 pounds less than the previous estimate, but 39 pounds more than last year's yield. Peanut and Soybeans increased production over

40%. Timely rains during the latter part of August and early September, plus irrigation made for much better crops than earlier thought.

Higher fuel costs have adversely impacted all producers. Higher feed costs have been problematic for the livestock and poultry industries. Industries tied to housing such as forestry, sawmills, sod, and landscape nurseries saw demand plummet and profitability compromised. Over time, the higher inputs will either be passed on to the consumer or production will be cut to ensure the supply produced will clear the market at prices that will generate a profit.

As agricultural loan demand has increased, turmoil in the overall financial markets, and the banking sector in particular, has caused commercial banks to reduce the amount of available credit to farmers and related businesses. This also has contributed to increased loan demand in the Association and throughout the Farm Credit System. A seasoned, knowledgeable lending staff and the inherent value of patronage paid under the cooperative structure have positioned the Association to compete effectively while retaining current members and their business relationships.

For the year December 31, 2008, the credit quality of the loan portfolio has deteriorated significantly compared to earlier reporting periods. Not only has the increased volatility in the financial markets and the generally weaker economy contributed to this decline, but audits early in the year revealed serious credit administration problems. The audit committee and leadership team took swift action to identify the scope and extent of the problems. In conjunction with the audit committee, a course of action was performed to ensure proper credit administration and thorough risk identification.

Business Plan objectives for 2008 were revised in April due to the catastrophic nature of the financial circumstances discussed above. The board approved these revised objectives and budget projections for the remainder of the year. The following reflect the revised objectives:

1. Solidify credit quality and credit administration
2. Repair and build organizational reputation
3. Strengthen the balance sheet
4. Generate non-interest income

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

Loan Type	2008		December 31, 2007		2006	
			<i>(dollars in thousands)</i>			
Real estate mortgage	\$ 196,598	52.60%	\$ 199,989	50.8%	\$ 245,856	51.5%
Production and						
intermediate-term	109,414	29.28	144,185	36.6	156,002	32.7
Loans to cooperatives	847	.23	993	.3	1,152	.2
Processing and marketing	30,890	8.26	19,780	5.0	18,389	3.9
Farm-related business	28,340	7.58	21,783	5.5	47,255	9.9
Energy	900	.24	913	.2	897	.2
Rural residential real estate	6,765	1.81	6,378	1.6	7,857	1.6
<b>Total</b>	<b>\$ 373,754</b>	<b>100.00%</b>	<b>\$ 394,021</b>	<b>100.0%</b>	<b>\$ 477,408</b>	<b>100.0%</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 loan volume by branch/state for the past three years is as follows:

County/Branch	December 31,		
	2008	2007	2006
Baker	2.35%	4.40%	3.56%
Calhoun	.60	.63	.57
Chattahoochee	.28	.17	.16
Clay	.58	.70	.64
Decatur*	13.93	13.13	20.14
Dougherty	3.35	5.61	3.69
Early*	1.40	1.90	2.46
Grady*	3.21	3.46	3.43
Lee	1.41	1.06	1.56
Marion	2.59	2.18	2.24
Miller	2.04	1.94	2.29
Mitchell	9.89	9.07	8.16
Randolf	1.03	1.10	1.15
Schley	.75	.50	.39
Seminole*	2.66	1.63	1.79
Stewart	1.23	1.27	.78
Sumter*	3.83	3.58	3.52
Terrell*	1.44	1.40	1.51
Thomas	1.11	4.07	5.89
Webster	.81	.40	.51
Other**	45.51	41.80	35.56
	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

\*Branch Locations

\*\*Note: The Other category above consists of loans originated and participated outside our territory.

The Association's efforts to strengthen its capital position by selling loans to AgFirst Farm Credit Bank during the year caused a shift of the geographic composition within the portfolio. Management does not expect this trend to continue in the long term and over the next few years should see this allocation shift back into the normal distribution.

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's loan portfolio are shown below. The predominant commodities are timber, landlords, poultry, cotton, livestock and peanuts, which constitute over 70 percent of the entire portfolio.

Commodity Group	2008		December 31, 2007		2006	
			<i>(dollars in thousands)</i>			
Timber	\$ 99,238	26%	\$ 108,118	27%	\$ 142,846	30%
Landlords	49,165	13	53,890	14	70,334	15
Poultry	44,471	12	40,498	10	43,186	9
Cotton	25,084	7	26,193	7	36,703	7
Livestock	25,040	7	28,006	7	29,222	6
Peanuts	19,172	5	26,940	7	24,794	5
Fruit & Nut	16,539	4	21,011	5	15,351	3
Vegetables	9,804	3	9,131	2	13,021	3
Dairy	6,054	2	5,666	1	4,102	1
Horticulture	1,992	1	3,321	1	2,522	1
Row Crops	8,799	2	7,934	2	7,789	2
Rural Home	5,619	1	6,498	2	6,892	1
Other	62,777	17	60,744	15	81,819	17
<b>Total</b>	<b>\$ 373,754</b>	<b>100%</b>	<b>\$ 397,950</b>	<b>100%</b>	<b>\$ 478,581</b>	<b>100%</b>

## Management's Discussion & Analysis of Financial Condition and Results of Operations (continued)

(dollars in thousands, except as noted)

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 of timber, landlords, poultry, cotton, livestock and peanut producers. Although a large percentage of the loan portfolio is concentrated in these enterprises, many of these operations are diversified within their enterprise and/or with crop production that reduces overall risk exposure. Within the timber commodity group there are significant numbers of less than full time timber producers. As such, the risk in this group is more diversified than appears from the nominal percentage. Even though the concentration of large loans has increased over the past several years, the agricultural enterprise mix of these loans is diversified and similar to that of the overall portfolio. The risk in the portfolio associated with commodity concentration and large loans is reduced by the range of diversity of enterprises in the Association's territory.

The decrease in gross loan volume for the twelve months ended December 31, 2008, is primarily attributed to the significant charge offs during the first quarter. The losses necessitated a rapid restructuring of the balance sheet. Though most of the restructuring was related to regulatory capital ratio strengthening, some of the actions greatly improved the Association's risk bearing capacity. The primary strategy was to divest the balance sheet of assets by jettisoning expendable and highly marketable loans, while simultaneously purchasing credit enhancements for improved regulatory treatment.

For the past few years, the Association has experienced a shift in loan assets. The long-term volume trend has been downward while the short and intermediate-term loan volume trend is upward. The short-term portfolio, which is heavily influenced by operating-type loans, normally reaches a peak balance in August and rapidly declines in the fall months as commodities are marketed and proceeds are applied to repay operating type loans.

During 2008, the Association continued activity in the buying and selling of loan participations within and outside of the System. This activity provides a means for the Association to spread credit concentration risk and realize non-patronage sourced interest and fee income, which helps to strengthen our capital position.

Loan Participations:	December 31,		
	2008	2007	2006
	<i>(dollars in thousands)</i>		
Participations Purchased			
– FCS Institutions	\$ 98,003	\$ 97,263	\$ 101,303
Participations Purchased			
– Non-FCS Institutions	13,792	21,449	20,492
Participations Sold	(156,080)	(168,668)	(103,639)
Total	\$ (44,285)	\$ (49,956)	\$ 18,156

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, 2008.

The Association sells qualified long-term mortgage loans into the secondary market. For the period ended December 31, 2008, the Association originated loans for resale totaling \$10,825, which were sold into the secondary market. The Association

also utilizes the Farmer Mac Long Term Stand-By repurchase agreements. Farmer Mac was established by Congress to provide liquidity to agricultural lenders. At December 31, 2008, the Association had loans amounting to \$12,439 which were 100 percent guaranteed by Farmer Mac. The Association additionally purchased portions of loans that are guaranteed by the United States Department of Agriculture. These loans are held for the purposes of reducing interest rate risk and managing surplus short-term funds as allowable under FCA regulations. At December 31, 2008, the balance of these loans, including the unamortized premium, was \$2,174, compared to \$2,467 at December 31, 2007 and \$31,364 at December 31, 2006. The association divested of large portion of its USDA loans early in 2007 in an effort to strengthen capital.

### MISSION-RELATED INVESTMENTS

During 2005, the FCA initiated an investment program to stimulate economic growth and development in rural areas. The FCA outlined a program to allow System institutions to hold such investments, subject to approval by the FCA on a case-by-case basis. FCA approved the Rural America Bonds pilot program and the Tobacco Buyout 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, 2008, December 31, 2007, and December 31, 2006, the Association had \$19,243, \$12,894, and \$6,447, respectively, in Rural America Bonds, and they are classified as Loans and Investments on the Consolidated Balance Sheets.

On October 22, 2004, Congress enacted the "Fair and Equitable Tobacco Reform Act of 2004" (Tobacco Act) as part of the "American Jobs Creation Act of 2004." The Tobacco Act repealed the Federal tobacco price support and quota programs, provided for payments to tobacco "quota owners" and producers for the elimination of the quota and included an assessment mechanism for tobacco manufacturers and importers to pay for the buyout. Tobacco quota holders and producers will receive equal annual payments under a contract with the Secretary of Agriculture. The Tobacco Act also includes a provision that allows the quota holders and producers to assign to a "financial institution" the right to receive the contract payments (Successor-in-Interest Contracts (SIIC)) so that they may obtain a lump sum

or other payment. On April 4, 2005, the United States Department of Agriculture (USDA) issued a Final Rule implementing the "Tobacco Transition Payment Program" (Tobacco Buyout). At December 31, 2008, December 31, 2007, and December 31, 2006, the Association had \$69,317, \$78,342, and \$84,426, respectively, in SIIC outstanding and these are classified as Other Investments on the Consolidated Balance Sheets.

## INVESTMENT SECURITIES

As permitted under FCA regulations, the Association is authorized to hold eligible investments for the purposes of reducing interest rate risk and managing surplus short-term funds. The Bank is responsible for approving the investment policies of the Association. The Bank annually reviews the investment portfolio of every Association that it funds. The Association's investments consist primarily of asset-backed securities (ABS). The ABSs amounted to \$31,252 at December 31, 2008, \$35,868, December 31, 2007 and \$32,006 at December 31, 2006. These ABSs are rated AAA, as they are guaranteed by the full faith and credit of the United States government.

In view of the recent economic conditions and volatility related to these types of securities, the Association is actively monitoring the creditworthiness of these securities. These securities are supported by various forms of credit enhancements including insurance guarantees from AAA rated insurers, over-collateralization and favorable priority of payments. Based on our evaluations, we believe these securities do not pose a significant risk of loss given the credit enhancements and relatively short weighted average lives. All Investment Securities held by the ACA are classified as being held-to-maturity.

## 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. 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	2008	2007	2006
Acceptable & OAEM	88.62%	99.23%	99.83%
Substandard	11.38%	.77%	.17%
Doubtful	–%	–%	–%
Loss	–%	–%	–%
Total	100.00%	100.00%	100.00%

## Management's Discussion & Analysis of Financial Condition and Results of Operations (continued)

(dollars in thousands, except as noted)

### 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:

High-risk Assets	December 31,		
	2008	2007	2006
	<i>(dollars in thousands)</i>		
Nonaccrual loans	\$ 20,358	\$ 2,136	\$ 102
Restructured loans	236	3,494	354
Accruing loans 90 days past due	2,104	–	126
Total Non-Performing Loans	22,698	5,630	582
Impaired Loans current as to			
Principal and interest	13,850	–	–
Total high-risk loans	36,548	\$ 5,630	\$ 582
Other property owned	3,725	–	7
Total high-risk assets	\$ 40,273	5,630	589
<b>Ratios</b>			
Nonaccrual loans to total loans	5.45%	.54%	0.02%
High-risk assets to total assets	7.71%	1.02%	0.09%

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 \$18,222 or 323 percent in 2008. This increase resulted primarily from two sources. First were loans related to the poor credit administration which disclosed a number of loans which were under collateralized and second the economic turmoil and deterioration of real estate values left several large participation loans which required downgrading and subsequent transfer to nonaccrual status. Of the \$20,358 in nonaccrual volume at December 31, 2008, \$9,905 or 48.65%, compared to 4.45% and 100.00% at December 31, 2007 and 2006, respectively, was current as to scheduled principal and interest payments, but did not meet all regulatory requirements to be transferred into accrual status.

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

Allowance for Loan Losses Activity:	Year Ended December 31,		
	2008	2007	2006
	<i>(dollars in thousands)</i>		
Balance at beginning of year	\$ 520	\$ 427	\$ 844
Charge-offs:			
Real estate mortgage	(12,721)	–	(1)
Total charge-offs	(12,721)	–	(1)
Recoveries:			
Real estate mortgage	2	2	2
Total recoveries	2	2	2
Net (charge-offs) recoveries	(12,719)	2	1
Provision for (reversal of allowance for) loan losses	15,558	91	(418)
Balance at end of year	\$ 3,359	\$ 520	\$ 427
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	(3.08)%	–%	–%

The net loan charge-offs were primarily associated with two large relationships that were placed into non-accrual and a provision to allowance for loan loss was made accordingly. These loans were a direct result of operational risk exposed early in 2008. Once the loans were determined to be under collateralized and uncollectible the Association processed the charge-offs.

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,		
	2008	2007	2006
	<i>(dollars in thousands)</i>		
Real estate mortgage	\$ 1,481	\$ 264	\$ 221
Production and intermediate-term	1,738	191	140
Agribusiness	124	56	58
Energy	2	1	1
Rural residential real estate	14	8	7
Total allowance	\$ 3,359	\$ 520	\$ 427

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:	2008	2007	2006
Total loans	.90%	.13%	.09%
Nonperforming loans	14.80%	9.20%	73.37%
Nonaccrual loans	16.50%	24.30%	418.63%

Please refer to Note 4, "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 Interest Income

Net interest income was \$9.2 million, \$11.8 million and \$12.6 million in 2008, 2007 and 2006, 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*	Rate	Nonaccrual Income	Total
<b>12/31/08 - 12/31/07</b>				
Interest income	\$ (4,089)	\$ (6,958)	\$ 182	\$(10,865)
Interest expense	2,230	5,997	–	8,227
Change in net interest income	<u>\$ (1,859)</u>	<u>\$ (961)</u>	<u>\$ 182</u>	<u>\$(2,638)</u>
<b>12/31/07 - 12/31/06</b>				
Interest income	\$ (1,173)	\$ 782	\$ 40	\$(351)
Interest expense	(611)	1,028	–	417
Change in net interest income	<u>\$ (562)</u>	<u>\$ (246)</u>	<u>\$ 40</u>	<u>\$(768)</u>

- 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 December 31,			Percentage Increase/(Decrease)	
	2008	2007	2006	2008/ 2007	2007/ 2006
	<i>(dollars in thousands)</i>				
Loan fees	\$ 1,453	\$ 1,194	\$ 1,734	21.69%	(31.14)%
Fees for financially related services	9	11	12	(18.18)	(8.33)
Patronage refund from other Farm Credit Institutions	6,319	7,326	5,780	(13.75)	26.75
Gains (losses) on sales of rural home loans	7	97	96	(92.78)	1.04
Gains (losses) on sales of premises and equipment, net	(3)	(6)	1	(50.00)	(700.00)
Other noninterest income	48	45	89	6.67	(49.44)
Total noninterest income	<u>\$ 7,833</u>	<u>\$ 8,667</u>	<u>\$ 7,712</u>	<u>(9.62)%</u>	<u>12.38%</u>

### 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)	
	2008	2007	2006	2008/ 2007	2007/ 2006
	<i>(dollars in thousands)</i>				
Salaries and employee benefits	\$ 4,447	\$ 4,602	\$ 4,059	(3.37)%	13.38%
Occupancy and equipment	481	459	467	4.79	(1.71)
Insurance Fund premiums	554	616	620	(10.06)	(2.60)
Other operating expenses	2,382	2,061	1,960	15.57	5.15
Total noninterest expense	<u>\$ 7,864</u>	<u>\$ 7,738</u>	<u>\$ 7,106</u>	<u>1.63%</u>	<u>8.89%</u>

Salaries and employee benefits decreased in 2008, as compared with 2007, primarily due to an open Senior Officer position for a large part of the year as well as a couple of staff positions that remained open longer than expected. Temporary and contract help was used to alleviate the work load from this shortage, however, these expenses were applied to purchased services which is included in other operating expenses.

Insurance Fund premiums decreased 10 percent for the twelve months ended December 31, 2008, compared to the same period of 2007. This decrease is primarily related to the reduction in average daily balance of the Association's direct note from the loans sold to AgFirst Farm Credit Bank during the year as well as the Association's efforts to guarantee a larger percentage of the loan portfolio. The Farm Credit System Insurance Corporation (FCSIC) changed the methodology in assessing the insurance premiums as a result of the 2008 Farm Bill. Please refer to the "Regulatory Matters" section of this management's discussion and analysis for details concerning the 2008 Farm Bill. The FCSIC set premiums at 15 basis points on adjusted insured debt outstanding for the third quarter of 2008 and 18 basis points on adjusted insured debt outstanding for the fourth quarter of 2008. In addition, for the second half of 2008, there was a 10 basis point premium on the average principal outstanding of nonaccrual loans and any other-than-temporarily impaired investments. Previously, premiums of up to 15 basis points could be charged on accruing loans and up to 25 basis points for nonaccrual loans.

### Income Taxes

The Association recorded a provision for income taxes of \$2 for the year ended December 31, 2008, as compared to a benefit of \$14 for 2007 and a benefit of \$1 for 2006. 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		
	12/31/08	12/31/07	12/31/06
Return on average assets	(1.16)%	2.13%	2.27%
Return on average members' equity	(9.84)%	18.18%	21.57%
Net interest income as a percentage of average earning assets	1.81%	2.10%	2.18%
Net (charge-offs) recoveries to average loans	(3.08)%	–%	–%

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

## Management's Discussion & Analysis of Financial Condition and Results of Operations (continued)

(dollars in thousands, except as noted)

### 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."

Total notes payable to the Bank at December 31, 2008, was \$450,740 as compared to \$462,596 at December 31, 2007 and \$547,249 at December 31, 2006. The decrease of 2.56 percent compared to December 31, 2007 and the decrease of 15.47 percent compared to December 31, 2006, was attributable to management's strategy to strengthen capital and liquidity positions in 2008 by divesting of certain low yielding assets. The average volume of outstanding notes payable to the Bank was \$480,998 and \$518,701, 529,395 for the years ended December 31, 2008, 2007, and 2006 respectively. Refer to Note 8, "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. The Association's participation in the Farmer Mac, stand by purchase program, investments, and other secondary market programs provides additional liquidity.

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 included in 2008 liquidity, earnings and solvency covenant. At December 31, 2008, the Association was operating under a special credit arrangement in connection with the Bank's waiver of a pre-existing default of its liquidity covenant. Effective December 31, 2008, the GFA was amended to measure liquidity under its Borrowing Base Formula for all associations. The Association failed to meet the revised liquidity

requirements as well as the earnings covenant at December 31, 2008. The defaults allow the Bank to accelerate repayment of all indebtedness. In early 2009, following review of a plan submitted by the Association to achieve compliance with the covenants during 2009, the Bank approved a temporary waiver of the defaults and allowed the Association to continue operating under a special credit arrangement pursuant to the GFA (until April 15, 2009). The Association has continued to perform its obligations under the GFA, notwithstanding its covenant defaults.

The Association had no lines available under lines of credit from third party financial institutions as of December 31, 2008.

#### *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 8, "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 6 "Investment in AgFirst Farm Credit Bank" 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 Sources" section of this Management's Discussion and Analysis and in Note 8, "Notes Payable to AgFirst Farm Credit Bank" included in this annual report.

### 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. As part of the Association's strategy to strengthen and restructure the balance sheet both the C-Stock retirement and 2003 Allocated Surplus revolvment were suspended. There was no patronage distribution for 2008 due to the year's negative earnings.

Total members' equity at December 31, 2008, decreased 13.1 percent to \$63,381 from the December 31, 2007, total of \$72,947. At December 31, 2007, total members' equity increased 9.7 percent from the December 31, 2006 total of \$66,497. Both the 2008 internal issues as well as the economic turmoil led to negative earnings, the primary factor attributed to the decrease for 2008.

Total capital stock and participation certificates were \$1,498 on December 31, 2008, compared to \$1,523 on December 31, 2007 and \$1543 on December 31, 2006. The decrease was attributed to the retirement of protected stock and participation certificates on loans liquidated in the normal course of business, and new loans being capitalized at lower regulatory levels.

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.

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

	2008	2007	2006	Regulatory Minimum
Permanent capital ratio	11.97%	12.37%	12.42%	7.00%
Total surplus ratio	11.62%	12.08%	12.16%	7.00%
Core surplus ratio	9.06%	10.20%	10.39%	3.50%

The decrease in the Association's permanent capital, total surplus, and core surplus for December 31, 2008 and December 31, 2007 was primarily attributed to the negative 2008 income. This year's negative earnings reduced the Association's overall equity position which has a direct impact on the capital ratios. The Association's analysis and business plan forecast does not indicate any trends, commitments, contingencies, or events that are likely to affect the Association's ability to meet regulatory minimum capital standards and capital adequacy requirements.

See Note 9, "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 9, "Members' Equity," of the Notes to the Consolidated Financial Statements, for more information concerning the patronage distributions. Due to negative income earnings for 2008, the ACA did not declare patronage distributions. For the previous year's 2007, and 2006, distributions of \$5,875 and \$8,450 were declared by the ACA.

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

The Association's mission is to provide financial services to agriculture and the rural community, which includes providing credit to young\*, beginning\*\* and small\*\*\* farmers. Because of the unique needs of these individuals, and their importance to the future growth of the Association, the Association has established annual marketing goals to increase our market share of loans to YBS farmers. Specific marketing plans have been developed to target these groups, and resources have been designated to help ensure YBS borrowers have access to a stable source of credit. As a result, 2008 goals were established and met.

The following table outlines the loan volume and number of YBS loans in the loan portfolio for the Association.

	As of December 31, 2008	
	Number of Loans	Amount of Loans
Young	213	31,642
Beginning	510	96,942
Small	987	118,227

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

The 2002 USDA (2002 is the latest USDA Ag census data available; next census will be available in February, 2009.) Ag census data has been used as a benchmark to measure penetration of the Association's marketing efforts. The census data indicated that within the Association's chartered territory (counties) there were 4,585 reported farmers of which by definition 173 or 3.77 percent were Young, 1,356 or 29.57 percent were Beginning, and 4,057 or 88.48 percent were Small. Comparatively, as of December 31, 2008, the demographics of the Association's agricultural portfolio contained 1,710 farmers, of which by definition 213 or 12.45 percent were Young, 510 or 29.82 percent were Beginning and 987 or 57.72 percent were Small.

In addition to our marketing strategies, in 2008 the Association coordinates its YBS farmer mission accomplishment through selected tactical programs.

## Management's Discussion & Analysis of Financial Condition and Results of Operations (continued)

(dollars in thousands, except as noted)

- ❖ Effectively utilize focused sales management techniques and incentive compensation to expand competitive presence within the YBS farmer mission segment.
- ❖ Build awareness and retention through targeted and consistent advertising, promotion and specifically designed public relations campaigns related to YBS farmers.
- ❖ Effectively coordinate with the USDA Farm Service Agency to fully utilize the loan guarantee program to ensure safe and sound lending practices when appropriate.
- ❖ Expand efforts within the community for outreach programs designed to promote the Association's services and commitment to agriculture for YBS farmers.

### 2008 Activities

- ❖ Extensively supported FFA, 4-H youth, and young farmer organizations through sponsorships, donations and presentations on a local and statewide basis.
- ❖ Continued Farm Credit awareness through newspaper and magazine advertising.
- ❖ Incorporated information and ads in the Association's quarterly magazine, Wiregrass Land & Living.
- ❖ Provided incentive compensation for new loans identified and originated as YBS.

A very successful component of the overall program to ensure the extension of credit to YBS farmers was the Sales Incentive Program. This program specifically allocated incentive compensation for new loans identified and originated as YBS.

In addition, the Association coordinated closely with the Farm Service Agency to utilize the loan guarantee program as an approved Farm Service Agency Preferred Lender. Utilization of loan guarantee programs with qualifying YBS borrowers, assisted in the accomplishment of the Association's mission.

In fulfilling the Corporate Mission as well as the Public Mission and Obligation Statement, the Association ensured that credit and services were offered to all eligible borrowers, including YBS farmers and ranchers, in a safe and sound manner and within the Association's risk-bearing capacity.

The Association website, [www.swgafarmcredit.com](http://www.swgafarmcredit.com), includes an entire section of information and resources for YBS visitors to the site.

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

\* Young farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who are age 35 or younger as of the date the loan is originally made.

\*\* Beginning farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who have 10 years or less farming or ranching experience as of the date the loan is originally made.

\*\*\* Small farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who normally generate less than \$250 in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

### REGULATORY MATTERS

For the twelve months ended December 31, 2008, the FCA took no enforcement action against the Association.

On June 16, 2008, FCA published a proposed rule in the Federal Register that would authorize Banks, Associations, or service corporations to invest in rural communities, i.e., communities that have fewer than 50,000 residents and are outside of an urbanized area, under certain conditions. The proposed rule would authorize two types of rural community investments: (1) investment in debt securities that would involve projects or programs that benefit the public in rural communities, and (2) equity investment in venture capital funds, which funds create economic opportunities and jobs in rural communities by providing capital to small or start-up businesses. Under the proposed rule, these investments would be limited to 150 percent of the institution's total surplus. The comment period closed August 15, 2008.

#### *Federal Legislation*

In June, 2008, Congress passed the 2008 Farm Bill. This 2008 Farm Bill governs farm commodity, conservation, and other USDA programs for five years, from 2008 through 2012. The 2008 Farm Bill includes significant federal financial support for wheat, feed grains, cotton, rice, oilseeds, and dairy. It also contains new, expanded assistance for certain specialty crops. Overall, the 2008 Farm Bill maintains the government payments to farmers that had been in place under the previous farm bill. It also amended the Farm Credit Act to allow the FCSIC to assess insurance premiums based on each Bank's prorata share of adjusted outstanding insured debt (rather than loans), aligning premiums with the risk that is being insured. Premiums of up to 20 basis points could be charged against insured debt adjusted for loans and investments guaranteed by U.S. or state governments, and up to an additional 10 basis points could be charged for any nonaccrual loan volume or investments that are other-than-temporarily impaired. Previously, premiums of up to 15 basis points could be charged on accruing loans and up to 25 basis points for nonaccrual loans.

Using the new authorities contained in the 2008 Farm Bill, in June 2008, the FCSIC set premiums at 15 basis points on adjusted insured debt outstanding for the third quarter of 2008 and 18 basis points on adjusted insured debt outstanding for the fourth quarter of 2008. In addition, for the second half of 2008, there was a 10 basis point premium on the average principal outstanding for nonaccrual loans and on the average amount of any other-than-temporarily impaired investments. The FCSIC has provided guidance to System institutions that the premium rates will be increased to 20 basis points in 2009.

### RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In December 2007, the FASB issued Statements of Financial Accounting Standards No. 141R, "Business Combinations" (SFAS 141R). SFAS 141R requires business combinations to

be accounted for under the acquisition method of accounting (previously called the purchase method). The acquisition method requires (a) identifying the acquirer, (b) determining the acquisition date, (c) recognizing and measuring the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, at their acquisition date fair values, and (d) recognizing and measuring goodwill or a gain from a bargain purchase. SFAS 141R should be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Early application is prohibited. The Association is still evaluating the provisions of SFAS 141R, but believes that its adoption will significantly impact its accounting for combinations/acquisitions that may occur in 2009 and beyond.

# 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 Georgia:

<u>Location</u>	<u>Description</u>	<u>Form of Ownership</u>
117 S. Donalson Street Bainbridge	Administrative	Owned
411 W. Broughton St. Bainbridge	Administrative Annex	Owned
33 Liberty Street Blakely	Branch	Owned
40 E. Broad Street Camilla	Branch	Owned
937 Forrester Drive S.E. Dawson	Branch	Owned
504 W. Shotwell Street Bainbridge	Branch	Owned
1037 E. Forsyth Street Americus	Branch	Owned
1230 38 <sup>th</sup> Blvd. NW Cairo	Branch	Owned
408 W. 3 <sup>rd</sup> St. Donalsonville	Branch	Owned
111 6 <sup>th</sup> Avenue Buena Vista	Outpost	Leased*
1277 Highway 82 West, Suite 220 Leesburg	Outpost	Leased**
503 North Broad Street Thomasville	Outpost	Leased***

\* The Buena Vista outpost is leased by the Association on a year-by-year basis. Lease payments are \$150 per month.

\*\* The Leesburg outpost was leased by the Association on a year-by-year basis. Lease payments were \$350 per month. Lease ended on 5-31-08.

\*\*\* The Thomasville outpost is leased by the Association on a year-by-year lease basis. Lease payments are \$2,100 per month.

NOTE The Leesburg and Thomasville outpost offices are primarily used for the Association's Secondary Mortgage Market Unit.

## Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 13 of the Consolidated Financial Statements, "Commitments and Contingencies," included in this Annual Report.

## Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 9 of the Consolidated Financial Statements, "Members' Equity," included in this Annual Report.

## Description of Liabilities

The description of liabilities, contingent liabilities and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 8 and 13 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 senior officers of the Association:

<u>Senior Officer</u>	<u>Position</u>
Richard S. Monson	President/Chief Executive Officer
Richard H. Horn	Chief Lending Officer
Belinda Robertson	Chief Financial Officer
Tarrell Bennett	Chief Relationship Officer

**Richard S. Monson, President/Chief Executive Officer:** The business experience for the past five years for Richard S. Monson is with the Farm Credit System. Mr. Monson has been with the Farm Credit System since September 1986.

**Richard H. Horn, Chief Lending Officer:** The business experience for the past five years for Richard H. Horn is with the Farm Credit System. Mr. Horn previously served as Chief Lending Officer of ArborOne from June 1993 until October 2008 and with the Farm Credit System since August 1981.

**Belinda Robertson, Chief Financial Officer:** Ms. Robertson, who has been with the Farm Credit System since June of 2006, was a Business Office Director with Bryant & Stratton College, Virginia Beach, Virginia. Ms. Robertson was previously employed with the Farm Credit System for 7½ years for Farm Credit of Northwest Florida, ACA.

**Tarrell Bennett, Chief Relationship Manager.** Mr Bennett has served Southwest Georgia Farm Credit for 36 years, most recently overseeing the Relationship Managers who serve the Association's 21-county territory. He has served as the Association's Credit Manager and worked in the Special Assets Management Department.

The total amount of compensation earned by the CEO and the highest paid officers as a group during the years ended December 31, 2008, 2007 and 2006, is as follows:

Name of Individual or Number in Group	Year	Annual				Total
		Salary	Bonus	Deferred/Comp.	Perq./Other	
Richard S. Monson	2008	\$251,117	-	-	\$ 5,765	\$ 256,882
Richard S. Monson	2007	\$228,289	\$ 64,375	-	\$ 5,936	\$ 298,600
Richard S. Monson	2006	\$193,482	\$ 74,199	-	\$ 2,928	\$ 270,609
7	2008	\$716,758	\$255,438	-	\$66,405	\$1,038,601
6	2007	\$558,368	\$160,129	-	\$31,351	\$ 749,848
6	2006	\$478,896	\$330,001	-	\$ 1,972	\$ 810,869

In addition to a base salary, certain employees may earn additional compensation under employee performance sharing and incentive plans. Employee profit sharing and incentives are shown in the year earned, which may be different than the year paid. Profits distributed under the Employee Profit Sharing Plan and Sales Performance Incentive Plan is paid in the first quarter of the year following the fiscal year in which they are earned. The Association's compensation plans are designed to motivate employees and to help the Association meet and exceed its organizational objectives and financial goals.

Annually, the Compensation Committee (board representation) reviews the compensation plans for approval and funding. All Compensation Committee minutes are reviewed by the board of directors.

The Association's Employee Profit Sharing Plan is based on rewarding from profits generated achieving or exceeding a net income goal as set by management and approved by the Board.

Full-time employees with six-months or more tenure are eligible to participate. Employees with six-months but less than one year of service participate on a prorated basis and employees who are on any extended period of paid or unpaid leave of absence will be evaluated for prorated payment on a case-by-case basis.

Annual salary plus overtime will be considered for employee performance sharing calculation of non-exempt employees that have met employment eligibility requirements and all individual performance standards are considered satisfactory. The maximum payout will not exceed three percent of net income.

The Compensation Committee approved this Employee Profit Sharing Plan March 26, 2008, effective January 1, 2008. The Association's Discretionary Plan is based on individual performance and is capped at five percent of annual base salary. Incentives earned under this plan will be paid the first pay period following approval. Discretionary incentives may be recommended at any time by any member of the management team, including supervisors of one or more employees, on the behalf of any employee who has demonstrated meritorious

performance. The plan operates on a calendar year basis and includes all supervised employees. The Compensation Committee approved the Discretionary Plan on January 17, 2008, effective as of January 1, 2008.

The Association's Sales Performance incentive plan is designed to focus on sales and marketing and recognizes each relationship manager on his or her individual sales goals as set by management. The goals set by management are designed to appropriately emphasize and recognize both quality and growth of the Association's portfolio. There are three major goals and five other categories recognized by this plan. The three major goals are: (1) new loan volume, (2) new loan and existing portfolio Risk Adjusted Return on Capital (RAROC), and (3) Young, Beginning, Small, Minority Farmers (YBSM) new loans closed. The five other categories are: (1) Guaranteed Loans, (2) Rural Home Loans closed, (3) Participation Origination, (4) Leases and (5) Auto Draft/Online Payments. Each goal is assigned a separate rate of compensation and is aggregated for a total payment. However, no award will be paid unless the new loan sales volume minimum requirement is exceeded as set by management. The minimum requirement is less than the actual new loan sales volume goal. Additionally, payments from the Employee Profit Sharing Plan will not be paid to the officer until he/she meets or exceeds their new loan volume goal set by management.

Incentive payments for YBSM loans and Leases will be made on the calendar quarters commencing on the quarter ending immediately after the relationship manager has booked 2/3 of the new loan volume goal as set forth by management.

Incentive payments for loans originated and participated with AgFirst or through the Consortium will be paid upon the closing of the loan and the payment of the fee to the Association.

The Compensation Committee approved the Sales Performance incentive plan January 17, 2008, effective as of January 1, 2008.

The Loan Analyst Group incentive plan is designed to reward Loan Analyst based on the number of loans underwritten, or off of the total gross volume underwritten, whichever is higher. All performance-based incentives will be paid annually.

The Compensation Committee approved the Loan Analyst Group incentive plan March 26, 2008, effective as of January 1, 2008.

The Loan Closing Group incentive plan is designed to reward Loan Closers based on the number of loans closed within the year. All performance-based incentives will be paid annually. The Compensation Committee approved the Loan Closing Group incentive plan March 26, 2008, effective as of January 1, 2008.

The Corporate and Public Finance Group Administrator incentive plan is calculated from new loan RAROC (Risk Adjusted Return on Capital); in addition the administrator will be eligible to receive a percentage of the origination and servicing fees generated by the group. All performance-based incentives will be paid annually.

## Disclosure Required by Farm Credit Administration Regulations (continued)

The Compensation Committee approved the Corporate and Public Finance Group Administrator incentive plan March 26, 2008, effective January 1, 2008.

The Association's Country Home Mortgage incentive plan is designed to reward employees for referrals of prospects to the Country Mortgage Unit. Rewards are based on job title and specific management set targets. Incentives are also paid to originators once fee income reaches a management set target.

The Compensation Committee approved the Country Home Mortgage incentive plan January 30, 2008, effective January 1, 2008.

The Employee Profit Sharing Plan did not distribute funds this year due to negative earnings.

Disclosure of information on the total compensation paid during 2008 to any senior officer, or to any other individual included in the total, is available to shareholders upon request.

### Directors

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

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was \$94,518 for 2008, \$68,038 for 2007 and \$64,032 for 2006.

Subject to approval by the board, the Association may allow directors honoraria of \$400 for attendance at meetings, committee meetings, or special assignments and \$100 honoraria for participation in teleconference calls. In addition, directors on the Executive Committee (Chairman and Vice Chairman) receive a quarterly fee up to \$150 for incidental services. Expenses incurred in connection with the attendance of the spouse of a director at a compensable function may be reimbursable upon a determination by the board chairman that the attendance of the spouse was or will be beneficial to the purpose of the meeting, and such reimbursement will not be reported as compensation. Total compensation paid to directors, as a group was \$155,600.

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

**Bobby J. Brooks**, Chairman, is a peanut and cotton farmer. He is presently serving a three-year term, which will expire in 2009. During 2008 he served 17 days at Association board meetings, 16 days at Executive Committee meetings, and 17 days in other official activities and was paid \$18,500. Mr. Brooks also serves as director on the boards of Clay Co. Inc., a peanut buying point; Edison Gin Company, a cotton gin, and Clay County Farm Bureau Board, an insurance and farm related services provider.

**Charlie Burch**, Vice Chairman, is a farmer. He is presently serving a three-year term, which will expire in 2011. During

2008, he served 17 days at Association board meetings, 16 days at Executive Committee meetings and 15 days in other official activities and was paid \$17,700.

**T. E. Allen, III** is a peanut and cotton farmer. He is presently serving a three-year term, which will expire in 2009. During 2008, he served 15 days at Association board meetings, 1 day at a Building Committee meeting, 9 days at Compensation Committee meetings, 9 days at RIMCO (Risk Management Committee) meetings, 4 days at Steering Committee meetings and 16 days in other official activities and was paid \$18,400. Mr. Allen also serves as director on the boards of Quality Gin, a cotton gin, and People's Warehouse, a warehouse facility.

**Jeffrey A. Clark, Ph.D.**, is a Professor of Finance at the Florida State University. He was reappointed as an Association outside director. He is serving a three-year term, which will expire in 2011. During 2008, Dr. Clark served 15 days at Association board meetings, 10 days at Audit Committee meetings, 4 days at Steering Committee meetings, 7 days at RIMCO (Risk Management Committee) meetings and 11 days in other official activities and was paid \$16,200.

**Clifford Dollar, Jr.** is a peanut, cotton and cattle farmer. He is presently serving a three-year term, which will expire in 2009. During 2008, he served 17 days at Association board meetings, 7 days at Audit Committee meetings, 1 day at a Building Committee meeting, 1 day at a Credit Review Committee meeting, 9 days at RIMCO (Risk Management Committee) meetings and 16 days in other official activities and was paid \$17,400. Mr. Dollar also serves as Board President of Sowega Cotton, Inc., a cotton gin.

**Alton H. Fendley, Jr.** was a peanut and cotton farmer. He was presently serving a three-year term, which would have expired in 2011. During 2008, he served 6 days at Association board meetings, 5 days at Compensation Committee meetings, 1 day at an Executive Committee meeting and 11 days in other official activities and was paid \$7,800. Mr. Fendley also served on the boards of Clay County Farm Bureau, an insurance and farm related services provider, and Southern States of Cuthbert, a farm supply provider.

Mr. Fendley died in July, leaving his wife, Diane Jones Fendley, and their children.

"Alton will be remembered as a man of integrity, who dearly loved his family and contributed to the well-being of our local agricultural community as a member of the Board of Directors of Southwest Georgia Farm Credit," said Board Chairman Bobby Brooks. "He will be missed."

**Robert L. Holden, Sr.** is a dairy, poultry and row crop farmer. He is presently serving a three-year term, which will expire in 2010. During 2008, he served 17 days at Association board meetings, 1 day at a Building Committee meeting, 1 day at a Credit Review Committee meeting, 9 days at Compensation Committee meetings, 9 days at RIMCO (Risk Management Committee) meetings, 5 days at Steering Committee meetings and 6 days in other official activities and was paid \$15,600. Mr. Holden also serves on the boards of the Grady County Farm Bureau, an insurance and farm related services provider; AgFirst Farm Credit Bank, an association owned district agriculture cooperative discount and member services bank; as Board President of Georgia Milk Producers Association, an organization

for promoting milk and other interests of Georgia Dairymen; American Dairy Association of Georgia, an organization committed to promoting milk and consumer education; and First United Ethanol, LLC, a facility that produces and sells ethanol.

**Robert B. Moss** was reappointed as an Association outside director. He is presently serving a three-year term, which will expire in 2010. During 2008, Mr. Moss served 17 days at association board meetings, 11 days at Audit Committee meetings, 1 day at a RIMCO (Risk Management Committee) meeting, 16 days in other official activities and was paid \$15,600. Mr. Moss is a retired Superintendent of the University of Georgia College of Agricultural and Environmental Sciences, Southwest Georgia Branch Experiment Station, Plains, Georgia. Mr. Moss served as a part-time coordinator of the Georgia Branch Experiment Station for five years. Currently Mr. Moss is a part-time farm management consultant. Mr. Moss is a member of the Plains Lions Club, a civic organization, and Director of the Plains Better Home Town Board, an organization committed to local improvement for future growth.

**T. E. Moye, Jr.** is a cotton, peanut and cattle farmer. He is presently serving a three-year term, which will expire in 2010. During 2008, Mr. Moye served 16 days at Association board meetings, 12 days at Audit Committee meetings, 1 day at a Building Committee meeting, 4 days at Compensation Committee meetings and 10 days in other official activities and was paid \$13,600. Mr. Moye serves as Board President of the Baker County Farm Bureau, an insurance and farm related services provider. He also serves as Chairman of the Baker County Board of Commissioners, a county government. Mr. Moye is a founding member and current board member of South Georgia Regional Information Technology Authority (SGRITA), an Internet provider for five South Georgia counties.

**B. E. Powell** is a farmer. He is presently serving a three-year term, which will expire in 2010. During 2008, he served 17 days at Association board meetings, 2 days at Audit Committee meetings, 5 days at Compensation Committee meetings and 16 days in other official activities and was paid \$14,800. Mr. Powell also serves as director on the Marion County Hospital Authority Board, a healthcare provider.

#### Transactions with Senior Officers and Directors

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 12 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, 2008 were as follows:

	2008
<b>Independent Auditor</b>	
PricewaterhouseCoopers LLP	
Audit services	\$ 52,139
<b>Qualified Public Accountant</b>	
Harper, Rains, Knight & Company	
Nonaudit services	125,884
Tax services	14,698
FCCServices	19,011
Total	<u>\$ 211,732</u>

Audit service 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 February 27, 2009 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 1-229-246-0384 or toll free 1-866-304-3276, or writing Southwest Georgia Farm Credit, ACA, 305 Colquitt Highway, Bainbridge, Georgia 39817, Attention: Chief Financial Officer, or accessing the website, [www.swgafarmcredit.com](http://www.swgafarmcredit.com). The Association prepares an electronic version of the Annual Report which is available on the Association's 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 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.

Should you have questions concerning the financial reports or any other information contained within this Annual Report please contact the Stockholder Relations Department by calling 1-866-304-3276, extension 1141.

#### 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.

**Disclosure Required by Farm Credit Administration Regulations (continued)**

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

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

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

**Shareholder Investment**

Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank (Bank or AgFirst). Copies of the Bank's Annual and Quarterly Reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Stephen Gilbert, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst's website 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 Southwest Georgia Farm Credit (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 2008, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 114 (*The Auditor's Communication With Those Charged With Governance*). PwC has provided to the Committee the written disclosures and the letter required by Independence Standards Board Standard No. 1 (*Independence Discussions with Audit Committees*), and the Committee has discussed with PwC that firm's independence.

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

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Association's Annual Report for 2007. The foregoing report is provided by the following independent directors, who constitute the Committee:



Jeffrey A. Clark  
Chairman of the Audit Committee

## Members of Audit Committee

Clifford Dollar, Jr.  
Robert B. Moss  
T. E. Moye, Jr.

February 27, 2009

## Report of Independent Auditors



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

### Report of Independent Auditors

To the Board of Directors and Members  
 of Southwest Georgia Farm Credit, 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 Southwest Georgia Farm Credit, ACA (the Association) and its subsidiaries at December 31, 2008, 2007 and 2006, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

*PricewaterhouseCoopers* LLP

February 27, 2009

## Consolidated Balance Sheets

<i>(dollars in thousands)</i>	December 31, 2008	December 31, 2007	December 31, 2006
<b>Assets</b>			
Cash	\$ 2,971	\$ 1,310	\$ 2,885
Investment securities:			
Held to maturity (fair value of \$39,536 \$35,880 and \$31,803 respectively)	39,707	35,868	32,006
Total investment securities	39,707	35,868	32,006
Loans	373,754	394,021	477,408
Less: allowance for loan losses	3,359	520	427
Net loans	370,395	393,501	476,981
Other investments	69,317	78,342	84,426
Accrued interest receivable	6,132	9,463	10,167
Investments in other Farm Credit institutions	16,246	21,196	13,473
Premises and equipment, net	3,382	1,356	1,313
Other property owned, net	3,725	—	7
Due from AgFirst Farm Credit Bank	6,237	6,856	5,239
Other assets	4,344	3,771	3,623
Total assets	\$ 522,456	\$ 551,663	\$ 630,120
<b>Liabilities</b>			
Notes payable to AgFirst Farm Credit Bank	\$ 450,740	\$ 462,596	\$ 547,249
Accrued interest payable	1,663	2,233	2,733
Patronage refund payable	23	3,552	4,009
Other liabilities	6,649	10,335	9,632
Total liabilities	459,075	478,716	563,623
Commitments and contingencies			
<b>Members' Equity</b>			
Protected borrower stock	297	353	402
Capital stock and participation certificates	1,201	1,170	1,141
Retained earnings			
Allocated	23,993	27,115	25,198
Unallocated	37,890	44,309	39,756
Total members' equity	63,381	72,947	66,497
Total liabilities and members' equity	\$ 522,456	\$ 551,663	\$ 630,120

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,		
	2008	2007	2006
<b>Interest Income</b>			
Investment securities	\$ 1,213	\$ 2,023	\$ 1,378
Loans	26,690	36,237	36,954
Other investments	3,719	4,227	4,506
Total interest income	31,622	42,487	42,838
<b>Interest Expense</b>			
Notes payable to AgFirst Farm Credit Bank	22,453	30,680	30,263
Net interest income	9,169	11,807	12,575
Provision for (reversal of allowance for) loan losses	15,558	91	(418)
Net interest income after provision for (reversal of allowance for) loan losses	(6,389)	11,716	12,993
<b>Noninterest Income</b>			
Loan fees	1,453	1,194	1,734
Fees for financially related services	9	11	12
Patronage refund from other Farm Credit institutions	6,319	7,326	5,780
Gains (losses) on other property owned, net	7	(6)	1
Gains (losses) on sales of rural home loans, net	(3)	97	96
Other noninterest income	48	45	89
Total noninterest income	7,833	8,667	7,712
<b>Noninterest Expense</b>			
Salaries and employee benefits	4,447	4,602	4,059
Occupancy and equipment	481	459	467
Insurance Fund premiums	554	616	620
Other operating expenses	2,382	2,061	1,960
Total noninterest expense	7,864	7,738	7,106
Income (loss) before income taxes	(6,420)	12,645	13,599
Provision (benefit) for income taxes	2	(14)	(1)
Net income (loss)	\$ (6,422)	\$ 12,659	\$ 13,600

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, 2005	\$ 481	\$ 1,125	\$ 24,744	\$ 35,137	\$ 61,487
Net income				13,600	13,600
Protected borrower stock retired	(79)				(79)
Capital stock/participation certificates issued/(retired), net		16			16
Patronage distribution					
Cash				(3,978)	(3,978)
Nonqualified allocated retained earnings			3,978	(3,978)	—
Nonqualified retained earnings			494	(494)	—
Retained earnings retired			(4,100)		(4,100)
Patronage distribution adjustment			82	(531)	(449)
Balance at December 31, 2006	402	1,141	25,198	39,756	66,497
Net income				12,659	12,659
Protected borrower stock retired	(49)				(49)
Capital stock/participation certificates issued/(retired), net		29			29
Patronage distribution					
Cash				(3,525)	(3,525)
Nonqualified allocated retained earnings			2,350	(2,350)	—
Retained earnings retired			(2,811)		(2,811)
Patronage distribution adjustment			2,378	(2,231)	147
Balance at December 31, 2007	353	1,170	27,115	44,309	72,947
Net income (loss)				(6,422)	(6,422)
Protected borrower stock retired	(56)				(56)
Capital stock/participation certificates issued/(retired), net		31			31
Retained earnings retired			(2,646)		(2,646)
Patronage distribution adjustment			(476)	3	(473)
Balance at December 31, 2008	\$ 297	\$ 1,201	\$ 23,993	\$ 37,890	\$ 63,381

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,		
	2008	2007	2006
<b>Cash flows from operating activities:</b>			
Net income (loss)	\$ (6,422)	\$ 12,659	\$ 13,600
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	105	120	137
Premium amortization/discount accretion on investments	(2,893)	(4,227)	(4,506)
Provision for (reversal of allowance for) loan losses	15,558	91	(418)
(Gains) losses on other property owned, net	(7)	6	(1)
(Gains) losses on sales of rural home loans, net	3	(97)	(96)
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	3,331	704	(2,991)
(Increase) decrease in due from AgFirst Farm Credit Bank	619	(1,617)	(1,036)
(Increase) decrease in other assets	(576)	(51)	32
Increase (decrease) in accrued interest payable	(570)	(500)	752
Increase (decrease) in other liabilities	(3,686)	703	3,886
Total adjustments	11,884	(4,868)	(4,241)
Net cash provided by (used in) operating activities	5,462	7,791	9,359
<b>Cash flows from investing activities:</b>			
Purchases of investment securities, held to maturity	(22,934)	(13,488)	(35,090)
Proceeds from maturities of or principal payments received on investment securities, held to maturity	18,269	9,626	3,084
Net (increase) decrease in loans	3,693	83,389	(22,083)
(Increase) decrease in investment in other Farm Credit institutions	4,950	(7,723)	(7,970)
Purchases of other investments	(331)	(2,326)	(31,622)
Proceeds from payments received on other investments	13,075	12,637	10,553
Purchases of premises and equipment	(2,131)	(163)	(402)
Proceeds from sales of other property owned	137	1	1
Net cash provided by (used in) investing activities	14,728	81,953	(83,529)
<b>Cash flows from financing activities:</b>			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	(11,856)	(84,653)	81,460
Protected borrower stock retired	(56)	(49)	(79)
Capital stock and participation certificates issued/(retired), net	31	29	16
Patronage refunds and dividends paid	(4,002)	(3,835)	(3,600)
Retained earnings retired	(2,646)	(2,811)	(4,100)
Net cash provided by (used in) financing activities	(18,529)	(91,319)	73,697
Net increase (decrease) in cash	1,661	(1,575)	(473)
Cash, beginning of period	1,310	2,885	3,358
Cash, end of period	\$ 2,971	\$ 1,310	\$ 2,885
<b>Supplemental schedule of non-cash activities:</b>			
Loans transferred to other property owned	\$ 3,855	\$ 3,525	\$ 3,978
<b>Supplemental information:</b>			
Interest paid	\$ 23,023	\$ 31,180	\$ 29,511
Taxes (refunded) paid, net	—	3	7

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:** Southwest Georgia Farm Credit, 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 Baker, Calhoun, Chattahoochee, Clay, Decatur, Dougherty, Early, Grady, Lee, Marion, Miller, Mitchell, Quitman, Randolph, Schley, Seminole, Stewart, Sumter, Terrell, Thomas, and Webster in the state of Georgia.

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, 2008, the System was comprised of four Farm Credit Banks, one Agricultural Credit Bank and ninety 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 is authorized to make short- and intermediate-term loans for agricultural production or operating purposes; however, the Association is operating its short- 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 loan principal outstanding until the monies in the Insurance Fund reach the "secure base amount." The secure base amount is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (Systemwide debt obligations) or such other percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums, but it still must ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount. In June 2008, with the passage of the Food, Conservation, and Energy Act of 2008 (Farm Bill), the basis for assessing premiums was changed, beginning with the second half of 2008, to reflect each association's pro rata share of outstanding insured debt. The Farm Bill imposes premiums of up to 20 basis points on adjusted insured debt obligations, with the Insurance Corporation Board having the ability to reduce the amount, and a risk surcharge of 10 basis points on nonaccrual loans and other-than-temporarily impaired investments. Premiums for the third and fourth quarters of 2008 were 15 and 18 basis points, respectively.

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

## Notes to the Consolidated Financial Statements (continued)

(dollars in thousands, except as noted)

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 may 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. **Investment Securities:** The Association, as permitted under the FCA regulations, holds investments for purposes of maintaining a liquidity reserve, managing short-term surplus funds and managing interest rate risk. The Association's investments are classified as held-to-maturity and accordingly have been reported at amortized cost. Purchase premiums and discounts are amortized or accreted ratably over the term of the respective security which approximates effective interest method.

The Association may also hold additional investments in accordance with mission-related investment and other investment programs, approved by the Farm Credit Administration. These programs allow the Association to make investments that further the System's mission to serve rural America. Mission-related investments for which the Association has the intent and ability to hold to maturity are classified as held-to-maturity and carried at cost, adjusted for the amortization of premiums and accretion of discounts.

The Association reviews all investments that are in a loss position in order to determine whether the unrealized loss, which is considered an impairment, is temporary or other-than-temporary. In the event of other-than-temporary impairment, the cost basis of the investment would be written down to its fair value, and the realized impairment loss would be included in earnings in the period of impairment.

- C. **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.

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

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

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

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

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

interest, and penalty interest incurred as the result of past due status, is collected or otherwise discharged in full.

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

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance 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.

- D. **Other Investments:** Other investments include Tobacco Buyout Successor-in-Interest Contracts (SIIC), which qualify as mission related investments under FCA regulations. Under the SIIC, the tobacco quota holders and producers may sell their rights to receive SIIC contract payments to a third party. The successor purchases the entire contract and all related rights and obligations associated with the contract. These investments in SIIC are purchased at a discount. Contract payments are made by the United States Department of Agriculture (USDA) in equal annual payments. Interest income is recognized from the accretion of discounts using the effective interest method.
- E. **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 B and 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.
- F. **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.
- G. **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.
- H. **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.

- I. **Employee Benefit Plans:** Substantially all employees of the Association may participate in the AgFirst Farm Credit Retirement Plan (Plan), which is a defined benefit plan and is considered a multi-employer plan. The Plan is noncontributory and includes eligible District employees. The "Projected Unit Credit" actuarial method is used for financial reporting purposes. The cost of the Plan is allocated based on a percentage of each institution's salary expense to the total salary expense for all Plan participants.

Substantially all employees of the Association may also be eligible to participate in 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 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.

- J. **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

## Notes to the Consolidated Financial Statements (continued)

(dollars in thousands, except as noted)

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.

**K. Patronage Refund from AgFirst and Other Financial Institutions:** The Association records patronage refunds from the Bank and certain District Associations on an accrual basis. The patronage receivable is included in the amount due from AgFirst Farm Credit Bank.

**L. Fair Value Measurement:** Effective January 1, 2008, the Association adopted Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (SFAS No. 157). This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. SFAS No. 157 establishes a fair value hierarchy, 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:

Level 1 — Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 — Observable inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly or indirectly. Level 2 inputs include the following: (a) quoted prices for similar assets or liabilities in active markets; (b) quoted prices for identical or similar assets or liabilities in markets that are not active so that they are traded less frequently than exchange-traded instruments, the prices are not current or principal market information is not released publicly; (c) inputs other than quoted prices that are observable such as interest rates and yield curves, prepayment speeds, credit risks and default rates and (d) inputs derived principally from or corroborated by observable market data by correlation or other means.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. These unobservable inputs reflect the reporting entity's own assumptions about assumptions that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include financial instruments whose value is determined using pricing

models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

See Note 14 for disclosures required by SFAS No. 157.

**M. Recently Issued Accounting Pronouncements:** In December 2007, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards No. 141R, "Business Combinations" (SFAS No. 141R). SFAS No. 141R requires business combinations to be accounted for under the acquisition method of accounting (previously called the purchase method). The acquisition method requires (a) identifying the acquirer, (b) determining the acquisition date, (c) recognizing and measuring the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, at their acquisition date fair values, and (d) recognizing and measuring goodwill or a gain from a bargain purchase. SFAS No. 141R will be applied to business combinations on or after January 1, 2009. The Association is still evaluating the provisions of SFAS 141R, but believes that its adoption will significantly impact its accounting for combinations/acquisitions that may occur in 2009 and beyond.

### Note 3 — Investment Securities

A summary of the amortized cost and fair value of investment securities held-to-maturity at December 31, 2008, 2007 and 2006 follows:

	December 31, 2008				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Asset backed securities	\$ 33,264	\$ 152	\$ (130)	\$ 33,286	2.77%
Other	6,443	234	(426)	6,250	6.71
Total	\$ 39,707	\$ 386	\$ (556)	\$ 39,536	3.41%

	December 31, 2007				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Asset backed securities	\$ 34,348	\$ 78	\$ (89)	\$ 34,336	5.36%
Other	1,520	24	—	1,544	7.70
Total	\$ 35,868	\$ 102	\$ (89)	\$ 35,880	5.20%

	December 31, 2006				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Asset backed securities	\$ 32,006	\$ 1	\$ (204)	\$ 31,803	5.61%
Other	—	—	—	—	—
Total	\$ 32,006	\$ 1	\$ (204)	\$ 31,803	5.61%

The Association's investments consist primarily of asset-backed securities (ABSs). These ABSs are rated AAA, as they are guaranteed by the full faith and credit of the United States government. All unrealized losses referenced above are primarily due to reduced liquidity in the securities markets stemming from general adversity in the financial markets and are not credit related.

The following table shows the fair value and gross unrealized losses for investments in a loss position by the length of time the

securities have been in a continuous unrealized loss position at December 31, 2008. The continuous loss position is based on the date the impairment occurred. The Association performs periodic credit reviews, including other-than-temporary impairment analysis, on its investment securities portfolio. The objective is to quantify any future possible loss of principal or interest due on each security identified for additional analysis. Based on the results of all analyses, the Association has not recognized any other-than-temporary impairment in connection with these investments. The unrealized losses on these investments resulted primarily from reduced liquidity in the securities markets stemming from general adversity in the financial markets and are not credit related. The Association has the ability and intent to hold these investments until a recovery of unrealized losses occurs, which may be at maturity, and at this time expects to collect the full principal amount and interest due on these securities. All securities continue to perform. Substantially all of these investments were in U. S. government securities and the Association expects that these securities would not be settled at a price less than their amortized cost.

	Less than 12 Months		Greater than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Asset-backed securities	\$ 12,743	80	\$ 5,925	\$ 50
Other	3,189	426	-	-
Total	\$ 15,932	506	\$ 5,925	\$ 50

A summary of the expected maturity, amortized cost and estimated fair value of investment securities at December 31, 2008 follows:

	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	\$ 903	\$ 914	1.19%
After one year through five years	31,238	31,235	2.77
After five years through ten years	36	35	4.52
After ten years	7,530	7,353	6.32
Total	\$ 39,707	\$ 39,537	3.45%

#### Note 4 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31,		
	2008	2007	2006
Real estate mortgage	\$ 196,598	\$ 199,989	\$ 245,856
Production and intermediate term	109,414	144,185	156,002
Loans to cooperatives	847	993	1,152
Processing and marketing	30,890	19,780	18,389
Farm related business	28,340	21,783	47,255
Communication	-	-	-
Energy	900	913	897
Rural residential real estate	6,765	6,378	7,857
Total loans	\$ 373,754	\$ 394,021	\$ 477,408

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 following table presents information relating to impaired loans as defined in Note 2.

	December 31,		
	2008	2007	2006
Impaired nonaccrual loans:			
Current as to principal and interest	\$ 9,905	\$ 95	\$ 102
Past due	10,453	2,041	-
Total impaired nonaccrual loans	20,358	2,136	102
Impaired accrual loans:			
Current as to principal and interest	13,850	-	-
Restructured accrual loans	236	3,494	354
Accrual loans 90 days or more past due	2,104	-	126
Total impaired accrual loans	16,190	3,494	480
Total impaired loans	\$ 36,548	\$ 5,630	\$ 582

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2008.

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

	Year Ended December 31,		
	2008	2007	2006
Interest income recognized on impaired nonaccrual loans	\$ 223	\$ 41	\$ -
Interest income on impaired accrual loans	246	138	31
Interest income recognized on impaired loans	\$ 469	\$ 179	\$ 31

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

	2008	2007	2006
	Impaired loans with related allowance	\$ 12,411	\$ 223
Impaired loans with no related allowance	24,137	5,407	582
Total impaired loans	\$ 36,548	\$ 5,630	\$ 582
Allowance on impaired loans	\$ 2,583	\$ 20	\$ -



revolving line of credit are governed by the General Financing Agreement (GFA). The GFA defines Association performance criteria for borrowing from the Bank, which, in 2008, included liquidity, earnings and solvency covenants. At December 31, 2008, the Association was operating under a special credit arrangement in connection with the Bank's waiver of a pre-existing default of its liquidity covenant. Effective December 31, 2008, the GFA for all Associations was amended to measure liquidity under its Borrowing Base Formula. The Association failed to meet the revised liquidity requirement as well as the earnings covenant at December 31, 2008. The defaults allow the Bank to accelerate repayment of all indebtedness. In early 2009, following review of a plan submitted by the Association to achieve compliance with the covenants during 2009, the Bank approved a temporary waiver of the defaults and allowed the Association to continue operating under a special credit arrangement pursuant to the GFA. The Association has continued to perform under the GFA, notwithstanding its covenant defaults.

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 3.34 percent for LIBOR-based loans, 2.30 percent for Prime-based loans, and the weighted average remaining maturities were 3.2 years and 4.5 years, respectively, at December 31, 2008. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) loans which are match funded by the Bank was 4.68 percent and the weighted average remaining maturity was 7.8 years at December 31, 2008. The weighted average interest rate on all interest-bearing notes payable was 3.88 percent and the weighted average remaining maturity was 6.4 years at December 31, 2008.

Variable rate and fixed rate notes payable represent approximately 23.81 percent and 76.19 percent, respectively, of total notes payable at December 31, 2008.

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 9 — 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 Equity**

Protection of certain borrower equity is provided under the Farm Credit Act which requires the Association, when retiring protected borrower equity, to retire such equity at par or stated value regardless of its book value. Protected borrower equity includes capital stock, participation certificates and allocated equities 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 equity 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 the lesser of \$1 thousand or two percent of the amount of the loan. 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**

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 FCA that, if undertaken, could have a direct material effect on the Association's consolidated 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. 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, 2008 were 11.97 percent, 11.62 percent and 9.06 percent, respectively.

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

**Notes to the Consolidated Financial Statements (continued)***(dollars in thousands, except as noted)***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, 2008:

Class	Protected	Shares Outstanding	
		Number	Aggregate Par Value
A Common/Nonvoting	Yes	76	\$ -
B Common/Nonvoting	Yes	58,231	291
C Common/Voting	No	220,738	1,104
B Participation Certificates/Nonvoting	Yes	1,164	6
C Participation Certificates/Nonvoting	Yes	19,415	97
Total Capital Stock and Participation Certificates		299,624	\$ 1,498

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 of Directors 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.

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. Nonqualified retained surplus is considered to be permanently invested in the Association and as such, there is no plan to revolve or retire this surplus. All nonqualified distributions are tax deductible only when redeemed.

At December 31, 2008, allocated members' equity consisted of \$14,285 of nonqualified allocated surplus and \$9,708 of nonqualified retained surplus.

*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. Amounts not distributed are retained as unallocated members' equity.

*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 dividends paid on Classes A, B or C Common Stock or participation certificates for such year. The rate of dividends on Classes A, B and 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.

### 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. Assistance preferred Stock
2. Allocated Retained Earnings in its entirety
3. Class C Common Stock and Class C Participation Certificates
4. Classes A and B Common Stock and Class B Participation Certificates
5. 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 and B Common Stock and Class B Participation Certificates
3. Class C Common Stock and Class C Participation Certificates
4. Allocated surplus evidenced by qualified written notices of allocation on the basis of oldest allocations first
5. Allocated surplus evidenced by nonqualified notices of allocation on the basis of oldest allocations first
6. All Unallocated Retained Earnings issued after January 1, 1995 shall be distributed to the holders of Class C Stock and Class C Participation Certificates from January 1, 1995 through the date of liquidation on a patronage basis; and
7. Any remaining assets of the Association after such distribution shall be distributed ratably to the holders of all classes of stock and participation certificates in proportion to the number of shares or units of such class of stock or participation certificates held by such holders.

### Note 10 — Income Taxes

The provision (benefit) for income taxes follows:

	Year Ended December 31,		
	2008	2007	2006
Current:			
Federal	\$ 2	\$ 4	\$ (4)
State	—	2	(1)
	<u>2</u>	<u>6</u>	<u>(5)</u>
Deferred:			
Federal	—	(17)	3
State	—	(3)	1
	<u>—</u>	<u>(20)</u>	<u>4</u>
Total provision (benefit) for income taxes	<u>\$ 2</u>	<u>\$ (14)</u>	<u>\$ (1)</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,		
	2008	2007	2006
Federal tax at statutory rate	\$ (2,183)	\$ 4,299	\$ 4,624
State tax, net	1	—	—
Patronage distributions	—	(1,198)	(3,371)
Tax-exempt FLCA earnings	(2,236)	(3,189)	(1,352)
Change in valuation allowance	4,892	67	—
Other	(472)	7	98
Provision (benefit) for income taxes	<u>\$ 2</u>	<u>\$ (14)</u>	<u>\$ (1)</u>

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

	December 31,		
	2008	2007	2006
Deferred income tax assets:			
Allowance for loan losses	\$ 325	\$ 103	\$ 44
Pensions and other postretirement benefits	378	355	220
Depreciation	42	25	26
Loss carryforwards	<u>4,671</u>	<u>—</u>	<u>—</u>
Gross deferred tax assets	<u>5,416</u>	<u>483</u>	<u>290</u>
Less: valuation allowance	<u>(4,959)</u>	<u>(67)</u>	<u>—</u>
Gross deferred tax assets, net of valuation allowance	<u>457</u>	<u>416</u>	<u>290</u>
Deferred income tax liabilities:			
Loan fees	(4)	(5)	(6)
Pensions and other postretirement benefits	<u>(453)</u>	<u>(411)</u>	<u>(304)</u>
Gross deferred tax liability	<u>(457)</u>	<u>(416)</u>	<u>(310)</u>
Net deferred tax asset (liability)	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (20)</u>

## Notes to the Consolidated Financial Statements (continued)

(dollars in thousands, except as noted)

At December 31, 2008, deferred income taxes have not been provided by the Association on approximately \$2.0 million 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 \$4,959 during 2008. 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, 2008 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 2005 and forward.

### Note 11 — Employee Benefit Plans

The employees of the Association may participate in a Districtwide defined benefit retirement plan. This plan is a multi-employer plan and, therefore, there is no impact to the Association's financial statements due to Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit and Other postretirement Plans." This plan is noncontributory and covers substantially all Association employees. Benefits are based on salary and years of service. As a participant in the District's defined benefit plan, the Association funded \$520 for 2008 and \$0 for 2007 and 2006, through its note payable to the Bank. Plan expenses included in salaries and employee benefits were \$238 for 2008, \$355 for 2007, and \$388 for 2006. 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' 2008 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. Postretirement benefits other than pensions (primarily health care benefits) included in salaries and employee benefits were \$121 for 2008, \$125 for 2007, and \$123 for 2006. 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' 2008 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. This plan is considered a multi-employer plan and, therefore, there is no impact to the Association's financial statements due to Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit and Other Postretirement Plans." 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 \$122, \$119, and \$88 for the years ended December 31, 2008, 2007 and 2006, respectively.

### Note 12 — Related Party Transactions

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

Total loans to such persons at December 31, 2008 amounted to \$7,853. During 2008, \$4,140 of new loans were made and repayments totaled \$4,871. In the opinion of management, none of these loans outstanding at December 31, 2008 involved more than a normal risk of collectibility.

### Note 13 — 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, 2008, \$49,451 of commitments to extend credit and \$2,261 of commercial letters of credit were outstanding.

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

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. At December 31, 2008, the Association had outstanding \$3,656 of standby letters of credit, with expiration dates ranging from December 31, 2008 to April 2, 2012. The maximum potential amount of future payments the Association may be required to make under these existing guarantees is \$3,656.

A guarantor is required to recognize at the inception of a guarantee, a liability for the fair value of the guarantee commitment. The Association has determined the fair value of the guarantee commitment based upon the fees to be earned over the life of the guarantee. The fair value is updated periodically to reflect changes in individual guarantee amounts and the remaining life to maturity of the individual guarantees in the Association's inventory. At December 31, 2008, the Association's inventory of standby letters of credit had a fair value of \$40 and was included in other liabilities.

As of December 31, 2008, the Association had commitments to purchase \$69,317 in additional Tobacco Buyout SIIC in 2008.

During 2006, the Association agreed to become one of several investors in a USDA approved Rural Business Investments Company (RBIC). At December 31, 2008, there was an outstanding commitment of \$150 to make additional equity purchases.

#### Note 14 — Fair Value Measurement

As described in Note 2, the Association adopted SFAS No. 157 effective January 1, 2008 which expanded the Association's fair value disclosure for certain assets and liabilities measured at fair value on a recurring and non-recurring basis. These assets and liabilities primarily consist of standby letters of credit and impaired loans.

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

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

#### Level 1

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets. The Association has no Level 1 assets or liabilities at December 31, 2008.

#### 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 and liabilities measured at fair value on a recurring basis.

#### Level 3

Level 3 inputs to the valuation methodology are unobservable and supported by little or no market activity. Valuation is determined using pricing models, discounted cash flow methodologies, or similar techniques, and could include significant management judgment or estimation. Level 3 assets and liabilities also could include instrument 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, 2008 include impaired loans which represent the fair value of certain loans that were evaluated for impairment under SFAS No. 114. 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 principal balance of the loan, a specific reserve is established. Level 3 liabilities at December 31, 2008 include standby letters of credit whose market value is internally calculated based on information that is not observable either directly or indirectly in the marketplace.

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

The following table presents the assets and liabilities that are measured at fair value on a recurring basis at December 31, 2008 for each of the fair value hierarchy levels:

	December 31, 2008			Total Fair Value
	Level 1	Level 2	Level 3	
<b>Liabilities:</b>				
Standby letters of credit	\$ -	\$ -	\$ 40	\$ 40
Total Liabilities	\$ -	\$ -	\$ 40	\$ 40

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

	Standby Letters Of Credit
Balance at January 1, 2008	\$ 80
<b>Total gains or (losses) realized/unrealized:</b>	
Included in earnings	-
Included in other comprehensive loss	-
Purchases, sales, issuances and settlements, net	(40)
Transfers in and/or out of level 3	-
Balance at December 31, 2008	\$ 40

## Notes to the Consolidated Financial Statements (continued)

(dollars in thousands, except as noted)

### 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, 2008 for each of the fair value hierarchy values are summarized below:

	December 31, 2008			Total Fair Value	Total Gains (Losses)
	Level 1	Level 2	Level 3		
<b>Assets:</b>					
Impaired loans	\$ -	\$ -	\$ 9,828	\$ 9,828	\$ (2,583)

### Note 15 — 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, 2008, 2007 and 2006.

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, 2008		December 31, 2007	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>				
Cash	\$ 2,971	\$ 2,971	\$ 1,310	\$ 1,310
Loans, net of allowance	\$ 370,395	\$ 379,694	\$ 393,501	\$ 400,914
Investment securities	\$ 39,707	\$ 39,536	\$ 35,868	\$ 35,880
Tobacco Buyout SIIC	\$ 69,317	\$ 72,440	\$ 78,342	\$ 78,856
<b>Financial liabilities:</b>				
Notes payable to AgFirst Farm Credit Bank	\$ 450,740	\$ 464,528	\$ 462,596	\$ 472,188
	December 31, 2006			
	Carrying Amount	Estimated Fair Value		
<b>Financial assets:</b>				
Cash	\$ 2,885	\$ 2,885		
Loans, net of allowance	\$ 476,981	\$ 484,099		
Investment securities	\$ 32,006	\$ 31,803		
Tobacco Buyout SIIC	\$ 84,426	\$ 82,612		
<b>Financial liabilities:</b>				
Notes payable to AgFirst Farm Credit Bank	\$ 547,249	\$ 549,214		

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

- A. **Cash:** The carrying value is a reasonable estimate of fair value.
- B. **Loans:** Because no active market exists for the Association's loans, fair value is estimated by discounting the expected future cash flows using the Association's current interest rates at which similar loans would be made to borrowers with similar credit risk. As the discount rates are based on the Bank's loan rates, as well as management estimates, management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale.

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

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

The carrying value of accrued interest approximates its fair value.

- C. **Investment Securities:** Fair value is based upon quoted market price.
- D. **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 6, the net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying Consolidated Balance Sheets. The Association owns 3.98 percent of the issued stock of the Bank as of December 31, 2008 net of any reciprocal investment. As of that date, the Bank's assets totaled \$29.9 billion and shareholders' equity totaled \$1.2 billion. The Bank's earnings were \$217 million during 2008.

In addition, the Association has an investment of \$16,246 related to other Farm Credit institutions.

- E. **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.

**F. Commitments to Extend Credit and Standby Letters of 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.

**G. Tobacco Buyout SIIC:** Fair value is determined by discounting the expected future cash flows using current interest rates for similar assets.

**Note 16 — Quarterly Financial Information (Unaudited)**

Quarterly results of operations for the years ended December 31, 2008, 2007 and 2006 follow:

	2008				
	First	Second	Third	Fourth	Total
Net interest income	\$ 2,712	\$ 1,984	\$ 2,299	\$ 2,174	\$ 9,169
Provision for (reversal of allowance for) loan losses	10,254	3,444	742	1,118	15,558
Noninterest income (expense), net	350	650	137	(1,170)	(33)
Net income (loss)	\$ (7,192)	\$ (810)	\$ 1,694	\$ (114)	\$ (6,422)

	2007				
	First	Second	Third	Fourth	Total
Net interest income	\$ 2,955	\$ 3,127	\$ 3,088	\$ 2,637	\$ 11,807
Provision for (reversal of allowance for) loan losses	—	—	91	—	91
Noninterest income (expense), net	(3)	(221)	5	1,162	943
Net income (loss)	\$ 2,952	\$ 2,906	\$ 3,002	\$ 3,799	\$ 12,659

	2006				
	First	Second	Third	Fourth	Total
Net interest income	\$ 3,037	\$ 3,227	\$ 3,373	\$ 2,938	\$ 12,575
Provision for (reversal of allowance for) loan losses	—	—	—	(418)	(418)
Noninterest income (expense), net	(377)	(151)	(171)	1,306	607
Net income (loss)	\$ 2,660	\$ 3,076	\$ 3,202	\$ 4,662	\$ 13,600







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