

2005

ANNUAL REPORT



Southwest Georgia Farm Credit

Rural America's Customer-Owned Partner

SOUTHWEST GEORGIA FARM CREDIT, ACA

2005 ANNUAL REPORT

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Management

| | |
|------------------------|-----------------------------------|
| Richard S. Monson..... | President/Chief Executive Officer |
| Larry J. Malone..... | Chief Lending Officer |

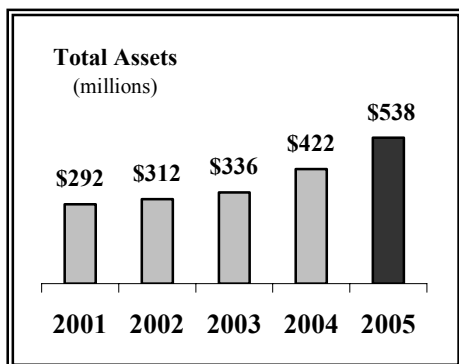
Board of Directors

| | |
|---------------------------|---------------|
| Bobby J. Brooks..... | Chairman |
| Charlie Burch | Vice Chairman |
| T. E. Allen, III..... | Director |
| Jeffrey A. Clark..... | Director |
| Clifford Dollar, Jr..... | Director |
| Alton H. Fendley, Jr..... | Director |
| Robert L. Holden, Sr..... | Director |
| Robert B. Moss | Director |
| T. E. Moye, Jr..... | Director |
| B. E. Powell..... | Director |

Message from the Chief Executive Officer

Message to Our Stockholders

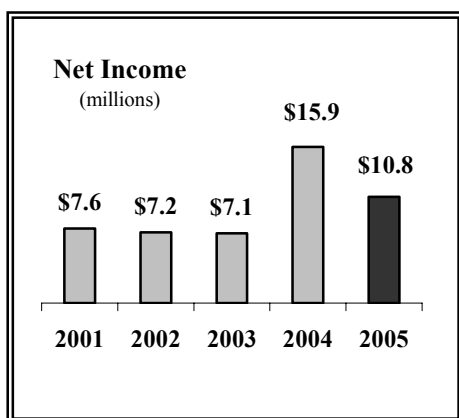
Southwest Georgia Farm Credit is committed to providing its members with a reliable and competitive source of financing and improving the quality of life and economic condition of rural consumers in southwest Georgia. This commitment has never been more evident than in 2005.



I am very pleased to report that our Association achieved an exceptional level of performance in 2005 as a result of our board and staff's unrelenting dedication to be responsive to the needs of its members and in the development of new business.

2005 Financial Performance

Net income in 2005 totaled \$10.8 million, up from \$9.3 million the previous year, excluding the large reversal of loan loss reserves of prior year. This favorable level of earnings resulted in a return on average assets of 2.38% (ROA) and return on average equity by (ROE) of 18.44%.



Despite weak demand for financing in certain sectors of the Agricultural Market and rising interest rates, a strong demand for unimproved farm and timberland, along with an increase in participations in the Capital Markets sector, resulted in new loan volume of \$200 million. This exceptional loan growth, contributed to the Association's increase in total assets to \$538 million, which is 27% higher than 2004.

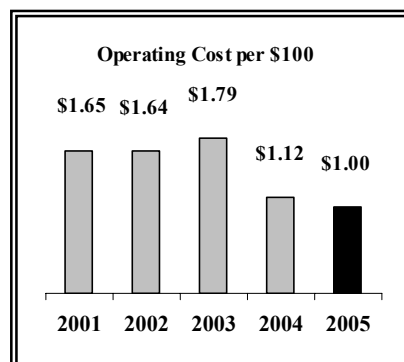
Increasing off balance sheet income continues to be one of the association's strategic objectives. In 2005, the Country Home Mortgages residential housing line of business closed the year with \$14.8 million in originations sold into the secondary market. This is an increase from the 2004 total originations of \$7.2 million. The association is committed to growing this sector and will continue to employ aggressive marketing tactics to increase its presence in the residential loan market throughout southwest Georgia.

Delinquencies and non-performing loans continue to remain at historically low levels, even as farming related costs like fuel, fertilizer and chemicals continue to rise. Overall, the quality of the loan portfolio remained very favorable throughout the year with 99.42% of the loans classified acceptable. In addition, non-accrual loans and other property owned obtained through foreclosure were at negligible levels.

Strategic Initiatives

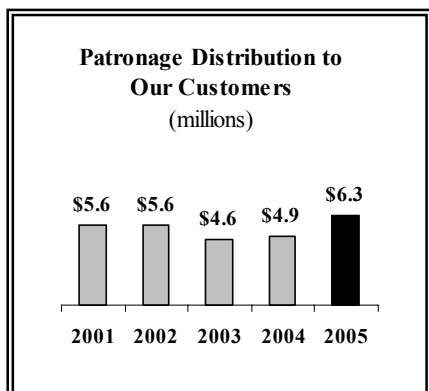
A true cooperative is defined as being an organization that is owned by and operated for the benefit of those using its services. Therefore, our role is to continue to operate the association in a manner that provides you with a dependable source of financing at an exceptional level of value. Furthermore, it is our obligation to seek ways to maximize stockholder return, while simultaneously meeting our congressionally mandated mission. And, both of these objectives must be accomplished being mindful of maintaining investor confidence in the system's joint and several obligation on debt issuances.

Efforts to employ capital in a safe and profitable manner have allowed the association to grow significantly without adding staff. Since 2001, Southwest Georgia Farm Credit has increased earning assets by more than \$180 million or 66%, while maintaining a relatively unchanged number of staff. The efficiencies we've gained in recent years are the result of a number of focused strategies designed to stimulate loan and investment growth. This means more money is available to pay back to you in the form of patronage and continue to fund the needs of rural southwest Georgia.



Strategically, we are focused on providing an even greater benefit to our borrowers. Therefore in 2006 we will employ the following business objectives:

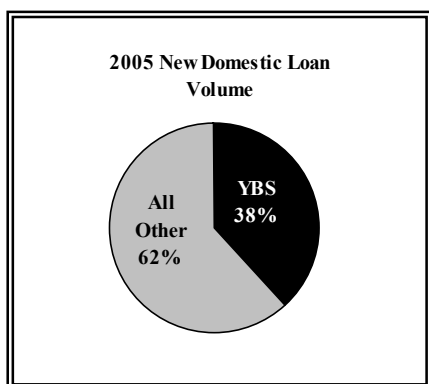
- ❖ Improve mission related performance through targeted marketing and focused sales practices.
- ❖ Achieve strong asset growth through loans and investments.
- ❖ Diversify revenue through off balance sheet sources and new products or services.
- ❖ Develop a personnel recruitment and development program that generates an increasingly productive and efficient workforce.
- ❖ Ensure portfolio risk is managed for long-term profitability and maximization of stockholder wealth.



Mission Related Performance

We are very excited about our achievement of mission related objectives in 2005. We accomplished our goal of offering a reliable and competitive source of financing to our customers. We generated \$200 million of new financing throughout southwest Georgia, and will distribute an estimated \$6.3 million in patronage to our borrowers.

In addition to providing the previously mentioned benefits to our customers, the Association's existence runs much deeper to the heart of southwest Georgia. In 2005, we also met our more specific goals, like providing tailored services and products to Young, Beginning, and Small farmers (YBS). In 2005, approximately 38% of our new domestic loan volume was originated for a YBS farmer. Therefore, we can continue to proudly claim that we maintain a competitive influence within this segment of our chartered territory. We can also declare that our presence within our chartered territory provides a source of competition to other financial institutions, further benefiting all of the residents of southwest Georgia.



The upcoming year will once again present an abundance of challenges. How will the real estate market react to increasing interest rates? How will rising crop production costs affect the backbone of our portfolio? It takes a lot of forethought and dedication from your board and management staff to foresee and overcome such adverse circumstances, but we take pride in arising to the challenge. We look forward to serving you in 2006 and will continue to strive to make you feel proud to be a member of a high performing cooperative for years to come.

We ask that you review our annual report as it will better reflect on our accomplishments. We believe you will find the results very favorable. We welcome your questions or concerns.

As always we thank you for your loyalty and hope that we have served you well.

Respectfully,

Richard S. Monson
President

March 6, 2006

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 (the 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.

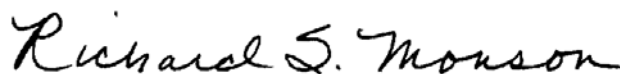
Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all financial statements, and that the assets of the 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 the 2005 Annual Report has been prepared 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

March 6, 2006

Consolidated Five - Year Summary of Selected Financial Data

(UNAUDITED)

| <i>(dollars in thousands)</i> | 2005 | 2004 | December 31, 2003 | 2002 | 2001 |
|---|-------------------|-------------------|----------------------|-------------------|-------------------|
| Balance Sheet Data | | | | | |
| Cash | \$ 3,358 | \$ 2,514 | \$ 1,606 | \$ 3,008 | \$ 2,794 |
| Loans | 455,324 | 401,497 | 328,715 | 302,314 | 281,174 |
| Less: allowance for loan losses | 844 | 843 | 7,587 | 7,601 | 8,440 |
| Net loans | 454,480 | 400,654 | 321,128 | 294,713 | 272,734 |
| Investment in other Farm Credit institutions | 5,503 | 4,726 | 4,212 | 4,822 | 5,553 |
| Other property owned | 7 | — | — | — | 43 |
| Other assets | 74,837 | 13,957 | 8,572 | 9,241 | 11,302 |
| Total assets | <u>\$ 538,185</u> | <u>\$ 421,851</u> | <u>\$ 335,518</u> | <u>\$ 311,784</u> | <u>\$ 292,426</u> |
| Notes payable to AgFirst Farm Credit Bank* | \$ 465,789 | \$ 355,722 | \$ 281,553 | \$ 255,286 | \$ 235,486 |
| Accrued interest payable and other liabilities with maturities of less than one year | 10,909 | 8,160 | 7,859 | 11,200 | 9,125 |
| Total liabilities | <u>476,698</u> | <u>363,882</u> | <u>289,412</u> | <u>266,486</u> | <u>244,611</u> |
| Protected borrower equity | 481 | 568 | 707 | 912 | 1,273 |
| Capital stock and participation certificates | 1,125 | 1,140 | 1,139 | 1,204 | 1,212 |
| Retained earnings | | | | | |
| Allocated | 24,744 | 23,949 | 24,326 | 23,639 | 23,403 |
| Unallocated | 35,137 | 32,312 | 22,308 | 22,109 | 21,927 |
| Accumulated other comprehensive income (loss) | — | — | (2,374) | (2,566) | — |
| Total members' equity | <u>61,487</u> | <u>57,969</u> | <u>46,106</u> | <u>45,298</u> | <u>47,815</u> |
| Total liabilities and members' equity | <u>\$ 538,185</u> | <u>\$ 421,851</u> | <u>\$ 335,518</u> | <u>\$ 311,784</u> | <u>\$ 292,426</u> |
| Statement of Income Data | | | | | |
| Net interest income | \$ 11,442 | \$ 10,162 | \$ 9,415 | \$ 8,734 | \$ 9,224 |
| Provision for (reversal of allowance for) loan losses | 1 | (6,701) | — | — | — |
| Noninterest income (expense), net | (608) | (867) | (2,305) | (1,489) | (1,547) |
| Net income | <u>\$ 10,833</u> | <u>\$ 15,996</u> | <u>\$ 7,110</u> | <u>\$ 7,245</u> | <u>\$ 7,677</u> |
| Key Financial Ratios | | | | | |
| Rate of return on average: | | | | | |
| Total assets | 2.38% | 4.18% | 2.22% | 2.41% | 2.91% |
| Total members' equity | 18.44% | 34.40% | 15.76% | 15.12% | 16.21% |
| Net interest income as a percentage of average earning assets | 2.61% | 2.69% | 2.99% | 2.98% | 3.60% |
| Net chargeoffs (recoveries) to average loans | — | 0.011% | 0.004% | 0.29% | — |
| Total members' equity to total assets | 11.42% | 13.74% | 13.74% | 14.53% | 16.35% |
| Debt to members' equity (:1) | 7.75 | 6.28 | 6.28 | 5.88 | 5.12 |
| Allowance for loan losses to loans | 0.19% | 0.21% | 2.31% | 2.51% | 3.00% |
| Permanent capital ratio | 13.04% | 15.04% | 14.70% | 15.13% | 16.59% |
| Total surplus ratio | 12.77% | 14.66% | 14.30% | 14.70% | 16.11% |
| Core surplus ratio | 10.54% | 11.10% | 10.30% | 10.60% | 11.62% |
| Net Income Distribution | | | | | |
| Estimated patronage refunds: | | | | | |
| Cash dividend | \$ 3,169 | \$ 2,459 | \$ 2,333 | \$ 3,177 | \$ 2,805 |
| Nonqualified allocated retained earnings | 3,169 | 2,459 | 2,333 | 2,471 | 2,805 |
| Nonqualified retained earnings | 1,578 | 1,229 | 2,298 | 1,412 | 1,402 |

* General financing agreement is renewable on three-year cycles. The next renewal date is December 31, 2007.

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

(dollars in thousands, except as noted)

GENERAL OVERVIEW

The following commentary summarizes the financial condition and results of operations of Southwest Georgia Farm Credit, ACA, (Association) for the year ended December 31, 2005 with comparisons to the years ended December 31, 2004 and December 31, 2003. 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 Association is an institution of the Farm Credit System, (System), which was created by Congress in 1916 and has served agricultural producers for almost 90 years. The System 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 Farm Credit 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 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 (the Bank). The Association is materially affected by the financial condition and results of operations of the Bank. Copies of the AgFirst Farm Credit Bank's Quarterly and Annual Reports are on the AgFirst website, www.agfirst.com, or may be obtained at no charge by calling 1-800-845-1745, extension 378, or writing Jay Wise, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. Copies of the Association's Annual and Quarterly reports are also on the Association's website, www.swgafarmcredit.com, or may be obtained upon request free of charge by calling 1-800-844-2615 or writing Southwest Georgia Farm Credit, ACA, P.O. Box 790, Bainbridge, Georgia 39818-0790, Attention: Controller.

CRITICAL ACCOUNTING POLICIES

The financial statements are reported in conformity with accounting principles generally accepted in the United States of America. We consider our significant accounting policies to be 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. These policies are considered critical because we have to 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 management's best estimate of the amount of probable losses inherent in its loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through loan loss reversals and loan charge-offs. The allowance for loan losses is determined based on a periodic evaluation of the loan portfolio, which generally considers types of loans, credit quality, specific industry conditions, general economic and political conditions, and changes in the character, composition, and performance of the portfolio, among other factors.

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 attributable to these loans is established by a process that estimates the probable loss inherent in the loans, taking into account various historical and projected factors, internal risk ratings, regulatory oversight, geographic, industry and other factors.

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 derivative and 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.

ECONOMIC CONDITIONS

During 2005, economic conditions in our region were favorable with good weather conditions and crop yields. The favorable economy had a positive impact on the Association's financial performance. The Association has continued to buy and sell loan participations and its involvement in government guarantee programs.

During 2005, the Association continued to focus on marketing the Country Home Mortgage line of business to take advantage of the market share in the home sector. Interest rates were very attractive and resulted in strong new home and existing home sales. During the last half of the year, interest rates began to increase and resulted in a decrease of homes being refinanced.

Likewise in 2005, the Association began to focus on marketing to rural lifestyle and unimproved timberland. Demand in these lines of business has escalated in recent years resulting in expanded market potential. It is anticipated the results of this new focus may take several years for the Association to fully recognize the benefit.

TOBACCO BUYOUT PROGRAM

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, provides for payments to tobacco “quota owners” and producers for the elimination of the quota, and provides an assessment mechanism for tobacco manufacturers and importers to pay for the buyout. Tobacco quota holders and producers will receive 10 years of equal 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 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).

The FCA determined that System institutions are “financial institutions” within the meaning of the Tobacco Act and are therefore eligible to participate in the Tobacco Buyout. FCA recognized that the Tobacco Buyout has significant implications for some System institutions and the tobacco quota holders and producers they serve. The FCA’s goal is to provide System institution borrowers with the option to immediately receive Tobacco Buyout contract payments and reinvest them in future business opportunities.

For the year ended December 31, 2005, the Association had loan assignments for Tobacco Buyout borrowers and also entered into commitments to acquire Successor-in-Interest Contracts (SIIC), beginning in the fourth quarter 2005. As of December 31, 2005, the Association had loan assignments of \$327 and SIIC of \$58,851. The loan assignments are included with Loans and the SIIC as Other Investments on the Consolidated Balance Sheets.

RURAL AMERICA BONDS

In October, 2005, FCA approved a Rural America Bonds investment program for the Bank and its related associations. This investment program is consistent with the stated objectives of FCA’s January 11, 2005, Informational Memorandum regarding pilot investment programs that support the financing needs of agriculture and rural America. The objectives of these pilot programs are to enable Farm Credit System institutions to better meet the changing financing needs of agricultural enterprises, agribusinesses, and rural communities by creating an additional source of dependable, affordable, and flexible financing through investments and partnerships. As indicated in the proposal, in recognition of the economic interdependence between agricultural and rural communities, AgFirst institutions seek to safely and soundly invest in debt obligations that support farmers, ranchers, agribusinesses, and their rural communities and businesses. In doing so, AgFirst institutions hope to increase the well-being and prosperity of American farmers, ranchers, and rural areas and residents.

As of December 31, 2005, the Association had \$1,502 in investments in the Rural America Bond program. For financial reporting purposes these bonds are included in Loans on the Consolidated Balance Sheets.

LOAN PORTFOLIO

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

The gross loan volume of the Association as of December 31, 2005, was \$455,324, an increase of \$53,827 or 13.41 percent as compared to \$401,497 at December 31, 2004 and an increase of \$72,782 or 22.14 percent as compared to \$328,715 at December 31, 2003. Net loans outstanding (gross loans net of the allowance for loan losses) on December 31, 2005, were \$454,480 as compared to \$400,654 at December 31, 2004 and \$321,128 at December 31, 2003. Net loans accounted for 84.45 percent of total assets on December 31, 2005 as compared to 94.98 percent of total assets at December 31, 2004 and 95.71 percent of total assets at December 31, 2003.

The diversification of the Association loan volume by type for each of the past three years is shown below. See Note 4, “Loans and Allowance for Loan Losses” of the Notes to the Consolidated Financial Statements, for the loans outstanding amounts.

| Loan Type | 12/31/05 | 12/31/04 | 12/31/03 |
|----------------------------------|-----------------|-----------------|-----------------|
| Production agriculture: | | | |
| Real estate mortgage | 46.72% | 48.03% | 46.82% |
| Production and intermediate term | 18.76 | 20.22 | 19.79 |
| Agribusiness: | | | |
| Processing and marketing | 2.03 | 2.47 | 3.34 |
| Farm related business | 4.12 | 2.92 | 2.72 |
| Rural residential real estate | 2.27 | 2.84 | 2.53 |
| Participations | 16.57 | 12.06 | 16.86 |
| Rural America Bonds | .33 | ----- | ----- |
| USDA Notes Receivables | 9.20 | 11.46 | 7.94 |
| Total | 100.00% | 100.00% | 100.00% |

The following table presents the contractual maturity distribution of loans at December 31, 2005:

| Loan Type | Due after | | | Total |
|----------------------------------|------------------------------|-------------------------------|--------------------------|-------------------|
| | Due in 1 year or less | 1 year through 5 years | Due after 5 years | |
| Production agriculture: | | | | |
| Real estate mortgage | \$ 17,716 | \$ 63,337 | \$ 131,687 | \$ 212,740 |
| Production and intermediate term | 56,860 | 19,587 | 8,951 | 85,399 |
| Agribusiness: | | | | |
| Processing and marketing | 2,645 | 5,766 | 822 | 9,233 |
| Farm related business | 8,440 | 9,809 | 528 | 18,777 |
| Rural residential real estate | 208 | 1,462 | 8,671 | 10,342 |
| Participations | 11,950 | 43,358 | 20,154 | 75,461 |
| Rural America Bond | | | 1,502 | 1,502 |
| USDA Notes Receivables | | | 41,870 | 41,870 |
| Total | \$ 97,820 | \$ 143,318 | \$ 214,186 | \$ 455,324 |

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 following tables reflect the commodities financed and the geographic locations served.

The geographic distribution of the loans by branch/state for the past three years is as follows:

| Branch | 12/31/05 | 12/31/04 | 12/31/03 |
|---------------|----------|----------|----------|
| Baker | 3.81% | 3.28% | 2.51% |
| Calhoun | .62 | .66 | .72 |
| Chattahoochee | 1.83 | 1.27 | 1.00 |
| Clay | .79 | .98 | .86 |
| Decatur | 19.73 | 22.17 | 17.16 |
| Dougherty | 5.43 | 3.25 | 3.03 |
| Early | 3.15 | 2.51 | 3.21 |
| Grady | 4.44 | 5.24 | 6.30 |
| Lee | 1.73 | 1.59 | 1.85 |
| Marion | 2.85 | 2.79 | 2.97 |
| Miller | 2.18 | 2.54 | 3.32 |
| Mitchell | 7.77 | 9.43 | 10.69 |
| Quitman | .01 | .14 | .19 |
| Randolf | 1.22 | 1.90 | 2.14 |
| Schley | .45 | .48 | .52 |
| Seminole | 2.46 | 2.33 | 3.22 |
| Stewart | .69 | 1.00 | 1.12 |
| Sumter | 3.90 | 4.63 | 5.21 |
| Terrell | 2.01 | 2.60 | 2.25 |
| Thomas | 5.58 | 5.73 | 4.23 |
| Webster | .59 | .68 | .55 |
| Other | 28.76 | 24.80 | 26.95 |
| Total | 100.00% | 100.00% | 100.00% |

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

The major commodities in the Association loan portfolio are shown below. The predominant commodities are timber, participations purchased, landlords, poultry, cotton, peanuts, which constitute over 73 percent of the entire portfolio.

| Commodity Group | Percent of Portfolio | | |
|--------------------------|----------------------|------|------|
| | 2005 | 2004 | 2003 |
| Timber | 19% | 8% | 11% |
| Participations Purchased | 17 | 23 | 25 |
| Landlords | 13 | 15 | 16 |
| Poultry | 10 | 11 | 14 |
| Cotton | 8 | 9 | 8 |
| Peanuts | 6 | 7 | 8 |
| Livestock | 3 | 4 | 4 |
| Row Crops | 2 | 1 | 1 |
| Rural Home | 2 | 2 | 3 |
| Vegetables | 2 | 2 | 2 |
| Fruit and Nut | 1 | 1 | 1 |
| Horticulture | 1 | 1 | 2 |
| Other | 16 | 16 | 5 |
| Total | 100% | 100% | 100% |

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, participations purchased, landlords, poultry, cotton, and peanuts. 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 a significant number of less than full time timber producers. As such, the risk in this group is more diversified than appears from the

nominal percentage. Strong real estate demand by non-traditional farmers has led to loan growth in the domestic business. The increase in gross and net loan volume for the twelve months ended December 31, 2005, is primarily attributed to loans to purchase real estate and participations purchased.

For the past few years, the Association has experienced a shift in loan assets. The long-term volume trend has been upward while the short and intermediate-term loan volume trend is downward. 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 loans.

During 2005, the Association continued activity in the buying and selling of loan participations within and outside of the Farm Credit System (FCS). This provides a means for the Association to spread credit concentration risk and realize non-patronage sourced interest and fee income, which may strengthen the capital position.

| Loan Participations | 2005 | 2004 | 2003 |
|--------------------------|-----------|-----------|-----------|
| Participations Purchased | | | |
| – FCS Institutions | \$ 81,818 | \$ 78,944 | \$ 59,639 |
| Participations Purchased | | | |
| – Non-FCS Institutions | 10,250 | 11,477 | – |
| Participations Sold | (54,158) | (41,988) | (4,231) |
| Total | \$ 37,910 | \$ 48,433 | \$ 55,408 |

The Association sells qualified long-term mortgage loans into the secondary market. For the period ended December 31, 2005, the Association originated loans for resale totaling \$14,880, which were sold into the secondary market. The Association purchased guaranteed 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, 2005, the balance of these loans (including the unamortized premium) was \$41,871, compared to \$46,010 at December 31, 2004 and \$26,098 at December 31, 2003.

RISK EXPOSURE

Credit risk arises from the potential inability of an obligator to meet its repayment obligation. As a part of a system 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 – protects the lender in the event of default and represents 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. Long-term real estate loans must be secured by first liens on the real estate (collateral). As required by regulation, each institution that makes loans on a secured basis must have collateral evaluation policies and

procedures. Appraisals are required for loans more than \$250,000. In addition, each loan is assigned a credit risk weighting 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.

The Association's loan portfolio is divided into performing and high-risk categories. Specific personnel within the Association are responsible for servicing loans classified as high-risk. The high-risk assets, including accrued interest, are detailed below:

| | 12/31/05 | 12/31/04 | 12/31/03 |
|----------------------------------|----------|----------|----------|
| High-risk Assets | | | |
| Nonaccrual loans | \$ 131 | \$ 153 | \$ 444 |
| Restructured loans | 362 | 758 | 806 |
| Accruing loans 90 days past due | — | — | — |
| Total high-risk loans | 493 | 911 | 1,250 |
| Other property owned | 7 | 21 | — |
| Total high-risk assets | \$ 500 | \$ 932 | \$ 1,250 |
| Ratios | | | |
| Nonaccrual loans to total loans | 0.03% | 0.04% | 0.14% |
| High-risk assets to total assets | 0.09% | 0.22% | 0.37% |

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or interest under the contractual terms of the loan. Nonaccrual loans decreased \$22, or 14.38 percent in 2005. This decrease resulted from payments and liquidations. Of the \$131 in nonaccrual volume at December 31, 2005, \$131 or 100% was current as to scheduled principal and interest payments, compared to \$153 or 100% at December 31, 2004 and \$304 or 68.47% at December 31, 2003, 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.

Credit Quality

The credit quality of the loan portfolio is reviewed on an on-going 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 | 2005 | 2004 | 2003 |
|-------------------|---------|---------|---------|
| Acceptable & OAEM | 99.42% | 99.55% | 97.73% |
| Substandard | .58 | .45 | 2.27 |
| Doubtful | — | — | — |
| Loss | — | — | — |
| Total | 100.00% | 100.00% | 100.00% |

Allowance for Loan Losses

During 2004, the Association completed its study to further refine the allowance for loan losses methodology, taking into account recently issued guidance by the Farm Credit Administration (FCA), the System's regulator, as well as the Securities and Exchange Commission (SEC) and Federal Financial Institutions Examination Council. As a result of this study and resulting refinements in methodology, during the fourth quarter of 2004, the Association recorded a reversal of the allowance for loan losses of \$6,701.

The Association's allowance for loan losses methodology was adjusted and revised in the late 1980s to take into account the credit losses experienced in the mid-to-late 1980s, as a result of unusually adverse economic factors affecting American agriculture. Given the long cyclical nature of the agricultural economy, loss factors utilized to determine the allowance for loan losses subsequent to 1989 continued to reflect, to some extent, the loss history of the mid-to-late 1980s, which resulted in conservative estimates of the allowance for loan losses. The Association's allowance for loan losses methodology utilized throughout the period was in accordance with generally accepted accounting principles and was consistently applied.

While conservative in estimating the allowance for loan losses, the methodology used resulted in annual provisions for loan losses over the periods that reflected changes in credit quality and loss experience. Accordingly, the reserves provided in the mid-to-late 1980s have, in effect, remained part of the allowance for loan losses. The Association's allowance for loan loss methodology has consistently adhered to proper accounting policies, under the regulatory supervision of the FCA in its role as a "safety and soundness" regulator. It was the FCA's view that the allowance for loan losses should include, among others, an assessment of probable losses, historical loss experience and economic conditions.

In April 2004, the FCA issued an Informational Memorandum to System institutions regarding the criteria and methodologies that would be used in evaluating the adequacy of a System institution's allowance for loan losses. The FCA endorsed the direction provided by other bank regulators and the SEC and indicated that the conceptual framework addressed in their guidelines would be included as part of their examination process.

The refinement in methodology resulted in a calculated allowance for loan losses that was significantly less than the previously recorded balance due to revised loss factors that are more indicative of actual loss experience in recent years and current borrower analysis. The factors considered in determining the revised level of allowance for loan losses were generally based on recent historical charge-off experience adjusted for relevant environmental factors. The Association considered the following 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.

While the reversal had a significant impact on 2004 results of operations and the previously recorded allowance for loan losses, the refinement in methodology is not expected to have a significant impact on comparative results of operations in future periods. Additionally, the refinement in methodology did not have a significant impact on the level of risk bearing capacity of the Association, generally referred to as "risk funds" (capital plus the allowance for loan losses), which totaled \$62,331 at December 31, 2005 (13.69 percent of Association loans), as compared with \$58,812 at December 31, 2004 (14.65 percent of Association loans) and \$53,693 at December 31, 2003 (16.33 of Association loans).

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. Management's evaluations consider factors including loan loss experience, portfolio quality, loan portfolio composition, current agricultural production conditions and economic conditions. The allowance for loan losses was \$844 at December 31, 2005, as compared with \$843 and \$7,587 at December 31, 2004 and 2003, respectively.

Net loan charge-offs of \$1, \$43 and \$14 were recorded in 2005, 2004 and 2003, respectively. Net loan charge-offs as a percentage of average loans remained at low levels of 0 percent, .011 percent, and .004 percent for 2005, 2004 and 2003, respectively. The net loan charge-offs were primarily associated with the charge-off of one loan during 2005.

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

| Allowance for Loan Loss Activity | 2005 | 2004 | 2003 |
|---|-------------|-------------|-------------|
| Balance at beginning of year | \$ 843 | \$ 7,587 | \$ 7,601 |
| Provision for (reversal of allowance for) loan losses | 1 | - | - |
| Nonrecurring provision for loan losses reversal** | - | (6,701) | - |
| Charge-offs: | | | |
| Production agriculture: | | | |
| Real estate mortgage | (5) | (66) | (22) |
| Total charge-offs | (5) | (66) | (22) |
| Recoveries | | | |
| Production agriculture: | | | |
| Real estate mortgage | 5 | 23 | 8 |
| Total recoveries | 5 | 23 | 8 |
| Net (charge-offs) recoveries | -- | (43) | (14) |
| Balance at end of year | \$ 844 | \$ 843 | \$ 7,587 |
| Ratio of net charge-offs during the period to average loans outstanding during the period | -% | .011% | .004% |

** Represents the amount of provision reversal due to the change in methodology.

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, | | |
|--|---------------------|-------------|-------------|
| | 2005 | 2004 | 2003 |
| Production agriculture: | | | |
| Real estate mortgage | \$ 456 | \$ 455 | \$ 4,099 |
| Production and intermediate term | 217 | 216 | 1,948 |
| Agribusiness | 150 | 150 | 1,366 |
| Communication | 1 | 1 | - |
| Energy | 1 | 1 | - |
| Rural residential real estate | 19 | 19 | 174 |
| Total loans | \$ 844 | \$ 843 | \$ 7,587 |

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: | 2005 | December 31, 2004 | 2003 |
|--|-------------|--------------------------|-------------|
| Total loans | .19% | .21% | 2.31% |
| Nonperforming loans | 171.20% | 92.54% | 606.96% |
| Nonaccrual loans | 644.27% | 550.98% | 1,708.78% |

The financial positions of our borrowers have generally strengthened during the past decade as farmers' net cash income has been at a favorable level due, in part, to direct federal government payments and steady increases in land values over the period. With borrowers' strengthened financial positions and the continued emphasis on sound underwriting standards, the credit quality of our loan portfolio has remained healthy. Please refer to Note 4, "Loans and Allowance for Loan Losses", in the Notes to the Consolidated Financial Statements, for further information concerning the allowance for loan losses.

EMPLOYEE RETIREMENT PLANS

For the years ended December 31, 2005 and 2004, the Association contributed \$554 and \$2,357 respectively, to the District-wide defined benefit retirement plan. The District-wide funding brings the retirement plan's assets to an amount exceeding the accumulated benefit obligation. The contributions in 2004 eliminated the minimum pension liability. Assuming that interest rates and returns on investments remain relatively constant, benefits to the Association in subsequent periods should include improved net income due to lower retirement expense and the elimination of the pension-related change in accumulated other comprehensive income in the members' equity. See Note 11, "Employee Benefit Plans," in the Notes to the Consolidated Financial Statements for further information.

RESULTS OF OPERATIONS

Net income for the year ended December 31, 2005, totaled \$10,833, a decrease of \$5,163 or 32.28 percent, as compared to \$15,996 for the same period of 2004 and an increase of \$8,886 or 124.98 percent, as compared to \$7,110 for the same period of 2003. Interest income for the year ended December 31, 2005, was \$29,089, an increase of \$7,795 or 36.61 percent as compared to \$21,294 for the same period of 2004. Interest income increased by \$2,472 or 13.13 percent for the period ended December 31, 2004, compared to December 31, 2003. Major components of the changes in net income for the past two years are outlined in the following table.

Changes in Net Income:

| | 2005-2004 | 2004-2003 |
|--|------------------|------------------|
| Net income (prior year) | \$ 15,996 | \$ 7,110 |
| Increase (decrease) in net income due to: | | |
| Interest income | 7,795 | 2,472 |
| Interest expense | (6,515) | (1,725) |
| Net interest income | 1,280 | 747 |
| Provision for loan losses | (6,702) | 6,701 |
| Noninterest income | 669 | 1,682 |
| Noninterest expense | (402) | (267) |
| Provision for income taxes | (8) | 23 |
| Total changes in income | (5,163) | 8,886 |
| Net income | \$ 10,833 | \$ 15,996 |

Net Interest Income

Net interest income increased by \$1,280 or 12.60 percent in 2005, and increased by \$747 or 7.93 percent, compared to 2004 and 2003, respectively. The primary reason for the increase compared to 2004 was the result of increased volume during 2005. The increase compared to 2003 was likewise the result of increased volume. The Association's net interest income as a percentage of average earning assets was 2.67 percent on December 31, 2005, compared to 2.69 percent on December 31, 2004 and 2.99 percent on December 31, 2003.

Interest income on nonaccrual loans for 2005 totaled \$1, a decrease of \$14, compared to \$15 for 2004 and a decrease of \$248 compared to \$263 for 2003. Please refer to the Consolidated Five-Year Summary of Selected Financial Data in this Annual Report to review key financial ratios pertaining to earnings and net interest income. The sources of change in net interest income are illustrated, as follows:

Change in Net Interest Income:

| | Volume* | Rate | Nonaccrual Income | Total |
|-------------------------------|----------------|-------------|------------------------------|--------------|
| 12/31/05 - 12/31/04 | | | | |
| Interest income | \$ 4,378 | \$ 3,431 | \$ (14) | \$ 7,795 |
| Interest expense | 2,184 | 4,331 | - | 6,515 |
| Change in net interest income | \$ 2,194 | \$ (900) | \$ (14) | \$ 1,280 |
| 12/31/04 - 12/31/03 | | | | |
| Interest income | \$ 3,672 | \$ (952) | \$ (248) | \$ 2,472 |
| Interest expense | 2,155 | (430) | - | 1,725 |
| Change in net interest income | \$ 1,517 | \$ (522) | \$ (248) | \$ 747 |

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

A reversal of a portion of the allowance for loan losses at December 31, 2004 resulted in a negative provision of \$(6,701), compared to provision expense of \$1 and \$0 at December 31, 2005 and 2003, respectively. Please refer to the Allowance for Loan Losses section discussed above.

Noninterest Income

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

| Noninterest Income | For the Year Ended December 31, | | | Percentage Increase/(Decrease) | |
|---|--|-------------|-------------|---|-----------------------|
| | 2005 | 2004 | 2003 | 2005/ 2004 | 2004/ 2003 |
| Loan fees | \$ 950 | \$ 1,122 | \$ 967 | (15.33)% | 16.03% |
| Fees for financially related services | 11 | 16 | 15 | (31.25) | 6.67 |
| Patronage refund from other Farm Credit Institutions | 4,622 | 3,840 | 2,364 | 20.36 | 62.44 |
| Gains (losses) on sale of rural homes | 129 | 92 | 9 | 40.22 | 922.22 |
| Gains (losses) from sale of other property owned, net | (1) | (1) | 46 | - | (97.83) |
| Other noninterest income | 94 | 67 | 53 | 40.30 | 26.42 |
| Total noninterest income | \$ 5,805 | \$ 5,136 | \$ 3,454 | 13.03% | 48.70% |

Patronage refunds from other Farm Credit Institutions increased \$782 in 2005 compared to 2004 and increased \$1,476 in 2004 compared to 2003. The Association received \$2,932 in a patronage refund and \$1,271 in a special distribution from the Bank for the year ended December 31, 2005, compared to \$2,484 and \$1,173 for 2004, and \$2,068 and \$295 for 2003. Loan fees decreased \$172 and increased \$155 for the period ended December 31, 2005, compared to the comparable periods in 2004 and 2003, respectively.

Noninterest Expense

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

| Noninterest Expense | For the Year Ended December 31, | | | Percentage Increase/(Decrease) | |
|---------------------------------|--|-------------|-------------|---|-----------------------|
| | 2005 | 2004 | 2003 | 2005/ 2004 | 2004/ 2003 |
| Salaries and employee benefits | \$ 4,002 | \$ 3,756 | \$ 3,562 | 6.55% | 5.45% |
| Occupancy and equipment expense | 489 | 450 | 424 | 8.67 | 6.13 |
| Insurance Fund premium | 181 | 157 | 336 | 15.29 | (5.33) |
| Other operating expense | 1,720 | 1,627 | 1,401 | 5.72 | 16.13 |
| Total noninterest expense | \$ 6,392 | \$ 5,990 | \$ 5,723 | 6.71% | 4.67% |

Noninterest expense increased \$402 or 6.71 percent for December 31, 2005, as compared to the same period of 2004 and increased \$267 or 4.67 percent compared to December 31, 2003. Salaries and employee benefits increased \$246 or 6.55 percent for December 2005, as compared to the same period of 2004 and increased \$194 or 5.45 percent compared to December 31, 2003. Benefits expense for 2005 was \$1,166 compared to \$1,250 for 2004 and \$1,238 for 2003.

The Association recorded a provision for income taxes of \$21 for the year ended December 31, 2005, as compared to a provision of \$13 for 2004 and a provision of \$36 for 2003.

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 favorable performance exhibited 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 for the entire portfolio, while efficiently meeting the credit needs of our members.

| Key Results of Operations Comparisons | For the 12 Months Ended 12/31/05 | For the 12 Months Ended 12/31/04 | For the 12 Months Ended 12/31/03 |
|---|---|---|---|
| Return on Average Assets | 2.38% | 4.18% | 2.22% |
| Return on Average Members' Equity | 18.44% | 34.40% | 15.76% |
| Net Interest Income as a Percentage of Average Earning Assets | 2.61% | 2.69% | 2.99% |
| Net Chargeoffs (Recoveries) to Average Loans | -% | 0.011% | 0.004% |

LIQUIDITY AND FUNDING SOURCES

Liquidity

Liquidity management is the process whereby funds are made available to meet all financial commitments including the extension of credit, payment of operating expenses and payment of debt obligations. The Association receives access to funds through its borrowing relationship with the Bank and from income generated by operations. The Association's participation in the Farmer Mac and other secondary market programs provides additional liquidity. Sufficient liquid funds have been available to meet all financial obligations.

Funding Sources

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association, creating notes payable to the Bank. 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. The total notes payable to the Bank at December 31, 2005, were \$465,789 as compared to \$355,722 at December 31, 2004 and \$281,553 at December 31, 2003. The increase of 30.94 percent compared to December 31, 2004 and the increase of 26.34 percent compared to December 31, 2003, is attributable to an increase in loan volume for 2005, 2004 and 2003 respectively.

The Association had no lines of credit outstanding with third parties as of December 31, 2005.

Funds Management

The Bank and the Association manage assets and liabilities to provide a broad range of loan products and funding options, which will permit 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 either 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 Farm Credit debt of similar terms to maturity.

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

CAPITAL RESOURCES

Total members' equity at December 31, 2005, increased 6.07 percent to \$61,487 from the December 31, 2004, total of \$57,969 and increased 25.73 percent from the December 31, 2003 total of \$46,106. The increase was primarily attributed to net income and partially offset by patronage and retirement of equities for 2005, 2004 and 2003 respectively.

Total capital stock and participation certificates were \$1,606 on December 31, 2005, compared to \$1,708 on December 31, 2004 and \$1,846 on December 31, 2003. The decrease was attributed to the retirement of protected stock and participation certificates on loans liquidated in the normal course of business, new loans being capitalized at lower regulatory levels and at risk capital stock and participation certificates retired.

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

| | 2005 | 2004 | 2003 | Regulatory Minimum |
|-------------------|-------------|-------------|-------------|---------------------------|
| Permanent Capital | 13.04% | 15.04% | 14.70% | 7.00% |
| Total Surplus | 12.77% | 14.66% | 14.30% | 7.00% |
| Core Surplus | 10.54% | 11.10% | 10.30% | 3.50% |

At December 31, 2005, the Association's permanent capital ratio, average at-risk capital divided by average risk adjusted assets calculated in accordance with FCA regulations, exceeded the regulatory minimum of 7.00 percent. In addition to these regulatory requirements, the Association has established a permanent capital goal in excess of the 7.00 percent FCA minimum requirement. As of December 31, 2005, the Association has met the goal.

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 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 will be allocated to borrowers. Refer to Note 9, "Members' Equity", of the Notes to the Consolidated Financial Statements, for more information concerning the patronage distributions. The Association declared patronage distributions of \$6,338 in 2005, \$4,918 in 2004, and \$4,666 in 2003.

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 access to a stable source of credit.

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

| | As of December 31, 2005 | |
|-----------|--------------------------------|------------------------|
| | Number of Loans | Amount of Loans |
| Young | 222 | \$30,819 |
| Beginning | 528 | 108,724 |
| Small | 974 | 116,530 |

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.

YBS DEMOGRAPHICS

| Category | Percentage of 4,585 Ag Farms in Territory | | | |
|-----------------|--|------------------------------------|--|--------|
| | 2002 Census | 12/31/05 Borrowing Entities | Percentage of BE's in Territory | |
| Young | 173 | 3.77% | 136 | 78.61% |
| Beginning | 1,356 | 29.57% | 358 | 25.40% |
| Small | 4,057 | 88.48% | 657 | 16.19% |

The 2002 USDA Agricultural 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 173 or 3.77 percent reported farmers of which by definition were Young, 1,356 or 29.57 percent

were Beginning, and 4,057 or 88.48 percent were Small. Using the relationship of borrowing entities to farms, the Association had 79 percent coverage for young farmers, 26 percent beginning farmers and 16 percent for small farmers. The data is not adjusted for farms that have no outstanding debt.

In addition to our marketing strategies, in 2005 the Association coordinates its YBS farmer mission accomplishment through selected tactical programs.

- ❖ 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.

2005 Activities

- ❖ Extensively supported 4-H youth, FFA youth, and young farmer organizations through sponsorships and donations and presentations both on a local and statewide basis.
- ❖ Continued heavy emphasis on Farm Credit awareness and "top of mind" through newspaper and magazine advertisements and Spotlight Page in the Wiregrass Land and Living publication directly pertaining to YBS farmers.
- ❖ Expand communications for YBS Education Reimbursement Plan to assist YBS members in obtaining approved continuing education hours and/or software programs relevant to improving their operation.
- ❖ *Rural America Bond Program* – This program, as approved by the Board of Directors, authorizes the Association to utilize its investment authority in a safe and sound manner. The program allows the association to achieve more fully its statutory mission to provide for an adequate and flexible flow of money into rural areas, such as the following:
 - To meet current and future rural capital needs.
 - To improve the income and well-being of young, beginning, and small farmers and ranchers.
 - To modernize and improve the authorizations and means for furnishing capital to such young, beginning, and small farmers and their rural community.
 - To improve the authorizations and means for furnishing capital to business enterprises, housing and infrastructure therein, all of which is in recognition of the mutual economic interdependence between agriculture and rural communities.

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, 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 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.

FORWARD LOOKING INFORMATION

Certain information included in this discussion constitutes forward-looking statements and information that are based upon management's belief as well as certain assumptions made by and information currently available to management. When used in this discussion, the words "anticipate," "project," "expect," "believe," and similar expressions are intended to identify forward-looking statements. Although management of the Association believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations and projections will prove to have been correct. Such forward-looking statements are subject to certain risks, uncertainties and assumptions. Should one or more of these risks materialize, or should such underlying assumptions prove to be incorrect, actual results may vary materially from those anticipated, projected, or expected. Among key factors that may have a direct bearing on the Association's operating results are fluctuations in the economy, the relative strengths and weaknesses in the agricultural credit sectors and in the real estate market, the actions taken by the Federal Reserve for the purpose of managing the economy, and the continued growth of the agricultural market consistent with recent historical experience.

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 to 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 to shareholders.

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 th Blvd. NW Cairo | Branch | Owned |
| 408 W. 3 rd St. Donalsonville | Branch | Owned |
| 111 6 th Avenue Buena Vista | Outpost | Leased* |
| 1046 Highway 82 West, Suite 201 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 opened in April 2005 on a year-by-year lease basis. Lease payments are \$325 per month.

*** The Thomasville outpost was opened in January 2005 on a year-by-year lease basis. Lease payments are \$1,200 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 14 to the consolidated financial statements, "Commitments and Contingencies," included in this annual report to shareholders.

Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 9 to the consolidated financial statements, "Members' Equity," included in this annual report to shareholders.

Description of Liabilities

The description of liabilities, contingent liabilities and intrasystem financial assistance rights and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 8, 12 and 14 to the consolidated financial statements included in this annual report to shareholders.

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 to shareholders 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 |
| Larry J. Malone | Chief Lending Officer |

The business experience for the past five years for senior officers is with the Farm Credit System.

The total amount of compensation earned by the top five officers as a group, including the CEO, during the years ended December 31, 2005, 2004 and 2003, is as follows:

| <u>Senior Officers</u> | <u>Year</u> | <u>Annual</u> | | | | | <u>Total</u> |
|------------------------|-------------|---------------|--------------|-----------------------------------|--------------|-----------|--------------|
| | | <u>Salary</u> | <u>Bonus</u> | <u>Deferred/- Perquisites</u> | <u>Other</u> | | |
| CEO | 2005 | \$176,971 | \$ 60,170 | — | — | \$237,141 | |
| CEO | 2004 | \$169,231 | \$ 49,200 | — | — | \$218,431 | |
| 5 | 2005 | \$477,392 | \$196,303 | — | — | \$673,695 | |
| 5 | 2004 | \$440,668 | \$187,658 | — | — | \$628,326 | |
| 5 | 2003 | \$402,167 | \$ 79,857 | — | — | \$482,024 | |

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 board of directors reviews the compensation plans for approval and funding. A committee with board representation administers the profit sharing and incentive plans.

The Association's Employee Profit Sharing Plan is based on rewarding from profits generated that compare actual net income to 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 Board of Directors approved this Employee Profit Sharing Plan November 24, 2004, effective January 1, 2005.

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 board approved the Discretionary Plan on November 24, 2004, effective as of January 1, 2005.

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: (4) Credit Quality/Administration, (5) Participation Loan Origination, (6) Leases, (7) Charge-Offs and (8) SMMU Referrals. 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.

Employees that score unsatisfactory on their performance evaluation or are on probation may not be eligible to participate. Incentive payments are paid in the first quarter of the year following the fiscal year in which they are earned.

The board approved the Sales Performance incentive plan November 24, 2004, effective as of January 1, 2005.

The Association's Country Home Mortgage incentive plan is designed to reward employees for referrals of prospects to the Country Mortgage Unit. Each employee who obtains three referrals that close, will be paid an incentive with the second payroll following quarter-end.

The board approved the Country Home Mortgage incentive plan November 24, 2004 effective January 1, 2005.

The Association's Money Concepts incentive plan is designed to reward employees for referrals of prospects to the Money Concepts representative. A referral fee will be paid for each contact made that results in an appointment. Payments will be paid with the second payroll following quarter-end.

The board approved the Money Concepts incentive plan December 22, 2004 effective January 1, 2005.

Disclosure of the total compensation earned in 2005 by any senior officer, or to any other individual included in the total whose compensation exceeds \$50,000, is available to stockholders 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 \$61,635 for 2005, \$49,678 for 2004, and \$59,917 for 2003.

Subject to approval by the board, the Association may allow directors honoraria of \$300 for attendance at meetings, committee meetings, or special assignments. 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 \$143,135.

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 2006. During 2005 he served 13 days at Association board meetings and 25 days in other official activities and was paid \$11,600. Mr. Brooks also serves 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 2008. During 2005, he served 13 days at Association board meetings and 25 days in other official activities and was paid \$11,800.

T. E. Allen, III is a peanut and cotton farmer. He is presently serving a three-year term, which will expire in 2006. During 2005, he served 13 days at Association board meetings and 18 days in other official activities and was paid \$9,100. Mr. Allen also serves on the boards of the Quality Gin, a cotton gin, on the board of People's Warehouse, a warehouse facility and on the board of First United Ethanol, LLC a facility that produces and sells ethanol.

Jeffrey A. Clark was appointed as an Association outside director in September 2005. He is serving a three-year term, which will expire in 2008. During 2005, Mr. Clark served 2 days at Association board meetings and was paid \$600. Mr. Clark is a Professor of Finance at Florida State University.

Clifford Dollar, Jr. is a peanut, cotton and cattle farmer. He is presently serving a three-year term, which will expire in 2006. During 2005, he served 13 days at Association board meetings and 17 days in other official activities and was paid \$8,800. Mr. Dollar also serves as the secretary/treasurer of the board of Sowega Cotton, Inc., a cotton gin.

Alton H. Fendley, Jr. is a peanut and cotton farmer. He is presently serving a three-year term, which will expire in 2008. During 2005, he served 12 days at Association board meetings and 16 days in other official activities and was paid \$7,600. Mr. Fendley also serves on the Clay County Farm Bureau Board, an insurance and farm related services provider and on the board of Southern States of Cuthbert, a farm supply provider.

Robert L. Holden, Sr. is a dairy, poultry and row crop farmer. He is presently serving a three-year term, which will expire in 2007. During 2005, he served 12 days at Association board meetings and 9 days in other official activities and was paid \$6,100. Mr. Holden also serves on the boards of the Grady County Farm Bureau, an insurance and farm related services provider; on the AgFirst Farm Credit Bank, an association owned district agriculture cooperative discount and member services bank; on the board of the Georgia Milk Producers Association, an organization for promoting milk and other interest of Georgia Dairymen, on the board of the American Dairy Association of Georgia, an organization for promoting milk and educating consumers and on the board of 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 2007. During 2005, Mr. Moss served 13 days at Association board meetings and 21 days in other official activities and was paid \$9,400. 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.

T. E. Moye, Jr. is a cotton, peanut and cattle farmer. He is presently serving a three-year term, which will expire in 2007. During 2005, Mr. Moye served 13 days at Association board meetings and 16 days in other official activities and was paid \$8,500. Mr. Moye serves on the board of the Baker County Farm Bureau, an insurance and farm related services provider.

B. E. Powell is a farmer. He is presently serving a three-year term, which will expire in 2007. During 2005, he served 12 days at Association board meetings and 16 days in other official activities and was paid \$8,000. Mr. Powell also serves 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 13 to the consolidated financial statements, "Related Party Transactions," included in this annual report to shareholders.

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.

Relationship with Independent Public Accountants

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

Consolidated Financial Statements

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 6, 2006, and the report of management, which appear in this annual report to shareholders are incorporated herein by reference.

Copies of the Association's quarterly reports are available upon request free of charge by calling 1-229-246-8032 or 1-800-844-2615, or writing Southwest Georgia Farm Credit, ACA, P. O. Box 790, Bainbridge, Georgia 39818-0790, Attention: Controller, or accessing the website, www.swgafarmcredit.com. The Association prepares a quarterly report within 45 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

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 1-800-844-2615, extension 113.

Borrower Information Regulations

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

On November 10, 1999, the FCA Board adopted a policy that requires FCS institutions to formally inform new borrowers at loan closing of the FCA regulations on releasing borrower information and to address this information in the annual report to shareholders. 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.

Stockholder Investment

Stockholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of the District annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Jay Wise, 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.

Report of the Audit Committee

The Audit Committee of the Board of Directors (the Committee) is comprised of the directors named below. None of the directors who serve on the Audit Committee is an employee of Southwest Georgia Farm Credit, ACA (the 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 2005, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with generally accepted accounting principles. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 61 (*Communication with Audit Committees*). 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 the PwC's provision of non-audit services 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 2005. The foregoing report is provided by the following independent directors, who constitute the Audit Committee:



Robert B. Moss
Chairman of the Audit Committee

Members of the Audit Committee

Alton H. Fendley
Billy E. Powell

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, 2005, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

March 6, 2006

Consolidated Balance Sheets

| <i>(dollars in thousands)</i> | December 31, 2005 | December 31, 2004 | December 31, 2003 |
|---|----------------------|----------------------|----------------------|
| Assets | | | |
| Cash | \$ 3,358 | \$ 2,514 | \$ 1,606 |
| Loans | 455,324 | 401,497 | 328,715 |
| Less: allowance for loan losses | 844 | 843 | 7,587 |
| Net loans | 454,480 | 400,654 | 321,128 |
| Other investments | 58,851 | — | — |
| Accrued interest receivable | 7,176 | 5,794 | 4,955 |
| Investment in other Farm Credit institutions | 5,503 | 4,726 | 4,212 |
| Premises and equipment, net | 1,048 | 1,100 | 1,152 |
| Other property owned | 7 | — | — |
| Prepaid retirement expense | 3,279 | 3,116 | — |
| Due from AgFirst Farm Credit Bank | 4,203 | 3,657 | 2,319 |
| Other assets | 280 | 290 | 146 |
| Total assets | \$ 538,185 | \$ 421,851 | \$ 335,518 |
| Liabilities | | | |
| Notes payable to AgFirst Farm Credit Bank | \$ 465,789 | \$ 355,722 | \$ 281,553 |
| Accrued interest payable | 1,981 | 1,112 | 794 |
| Patronage refund payable | 3,182 | 2,483 | 2,361 |
| Minimum pension liability | — | — | 1,178 |
| Other liabilities | 5,746 | 4,565 | 3,526 |
| Total liabilities | 476,698 | 363,882 | 289,412 |
| Commitments and contingencies | | | |
| Members' Equity | | | |
| Protected borrower equity | 481 | 568 | 707 |
| Capital stock and participation certificates | 1,125 | 1,140 | 1,139 |
| Retained earnings | | | |
| Allocated | 24,744 | 23,949 | 24,326 |
| Unallocated | 35,137 | 32,312 | 22,308 |
| Accumulated other comprehensive income (loss) | — | — | (2,374) |
| Total members' equity | 61,487 | 57,969 | 46,106 |
| Total liabilities and members' equity | \$ 538,185 | \$ 421,851 | \$ 335,518 |

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

Consolidated Statements of Income

| <i>(dollars in thousands)</i> | For the year ended December 31, | | |
|---|--|-------------|-------------|
| | 2005 | 2004 | 2003 |
| Interest Income | | | |
| Loans | \$ 28,593 | \$ 21,294 | \$ 18,822 |
| Other | 496 | — | — |
| Total interest income | 29,089 | 21,294 | 18,822 |
| Interest Expense | | | |
| Notes payable to AgFirst Farm Credit Bank | 17,647 | 11,132 | 9,407 |
| Net interest income | 11,442 | 10,162 | 9,415 |
| Provision for (reversal of allowance for) loan losses | 1 | (6,701) | — |
| Net interest income after provision for (reversal of allowance for) loan losses | 11,441 | 16,863 | 9,415 |
| Noninterest Income | | | |
| Loan fees | 950 | 1,122 | 967 |
| Fees for financially related services | 11 | 16 | 15 |
| Patronage refund from other Farm Credit institutions | 4,622 | 3,840 | 2,364 |
| Gains (losses) on other property owned, net | (1) | (1) | 46 |
| Other noninterest income | 223 | 159 | 62 |
| Total noninterest income | 5,805 | 5,136 | 3,454 |
| Noninterest Expense | | | |
| Salaries and employee benefits | 4,002 | 3,756 | 3,562 |
| Occupancy and equipment | 489 | 450 | 424 |
| Insurance Fund premium | 181 | 157 | 336 |
| Other operating expenses | 1,720 | 1,627 | 1,401 |
| Total noninterest expense | 6,392 | 5,990 | 5,723 |
| Income before income taxes | 10,854 | 16,009 | 7,146 |
| Provision (benefit) for income taxes | 21 | 13 | 36 |
| Net income | \$ 10,833 | \$ 15,996 | \$ 7,110 |

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 Equity | Capital Stock and Participation Certificates | Retained Earnings | | Accumulated Other Comprehensive Income | Total Members' Equity |
|--|---------------------------------|---|-------------------|-------------|---|-----------------------------|
| | | | Allocated | Unallocated | | |
| Balance at December 31, 2002 | \$ 912 | \$ 1,204 | \$ 23,639 | \$ 22,109 | \$ (2,566) | \$ 45,298 |
| Comprehensive income | | | | | | |
| Net income | | | | 7,110 | | 7,110 |
| Minimum pension liability adjustment | | | | | 192 | 192 |
| Total comprehensive income | | | | | | 7,302 |
| Protected borrower equity retired | (205) | | | | | (205) |
| Capital stock/participation certificates issued | | 118 | | | | 118 |
| Capital stock/participation certificates retired | | (183) | | | | (183) |
| Patronage distribution | | | | | | |
| Cash | | | | (2,333) | | (2,333) |
| Nonqualified allocated retained earnings | | | 2,333 | (2,333) | | — |
| Nonqualified retained earnings | | | 2,298 | (2,298) | | — |
| Retained earnings retired | | | (3,915) | | | (3,915) |
| Distribution adjustment | | | (29) | 53 | | 24 |
| Balance at December 31, 2003 | 707 | 1,139 | 24,326 | 22,308 | (2,374) | 46,106 |
| Comprehensive income | | | | | | |
| Net income | | | | 15,996 | | 15,996 |
| Minimum pension liability adjustment | | | | | 2,374 | 2,374 |
| Total comprehensive income | | | | | | 18,370 |
| Protected borrower equity retired | (139) | | | | | (139) |
| Capital stock/participation certificates issued | | 127 | | | | 127 |
| Capital stock/participation certificates retired | | (126) | | | | (126) |
| Patronage distribution | | | | | | |
| Cash | | | | (2,459) | | (2,459) |
| Nonqualified allocated retained earnings | | | 2,459 | (2,459) | | — |
| Nonqualified retained earnings | | | 1,229 | (1,229) | | — |
| Retained earnings retired | | | (3,780) | | | (3,780) |
| Distribution adjustment | | | (285) | 155 | | (130) |
| Balance at December 31, 2004 | 568 | 1,140 | 23,949 | 32,312 | — | 57,969 |
| Net income | | | | 10,833 | | 10,833 |
| Protected borrower equity retired | (87) | | | | | (87) |
| Capital stock/participation certificates issued | | 121 | | | | 121 |
| Capital stock/participation certificates retired | | (136) | | | | (136) |
| Patronage distribution | | | | | | |
| Cash | | | | (3,169) | | (3,169) |
| Nonqualified allocated retained earnings | | | 3,169 | (3,169) | | — |
| Nonqualified retained earnings | | | 1,578 | (1,578) | | — |
| Retained earnings retired | | | (3,786) | | | (3,786) |
| Distribution adjustment | | | (166) | (92) | | (258) |
| Balance at December 31, 2005 | \$ 481 | \$ 1,125 | \$ 24,744 | \$ 35,137 | \$ — | \$ 61,487 |

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, | | |
|--|--|-------------|-------------|
| | 2005 | 2004 | 2003 |
| Cash flows from operating activities: | | | |
| Net income | \$ 10,833 | \$ 15,996 | \$ 7,110 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | |
| Depreciation on premises and equipment | 157 | 158 | 172 |
| Provision for (reversal of allowance for) loan losses | 1 | (6,701) | — |
| (Gains) losses on other property owned, net | 1 | 1 | (46) |
| Changes in operating assets and liabilities: | | | |
| (Increase) decrease in accrued interest receivable | (1,382) | (839) | 810 |
| (Increase) decrease in prepaid retirement expense | (163) | (3,116) | — |
| (Increase) decrease in due from AgFirst Farm Credit Bank | (546) | (1,338) | (153) |
| (Increase) decrease in other assets | 10 | (144) | (23) |
| Increase (decrease) in accrued interest payable | 869 | 318 | (38) |
| Increase (decrease) in minimum pension liability | — | (1,178) | (92) |
| Increase (decrease) in other liabilities | 1,181 | 3,413 | (2,153) |
| Total adjustments | 128 | (9,426) | (1,523) |
| Net cash provided by (used in) operating activities | 10,961 | 6,570 | 5,587 |
| Cash flows from investing activities: | | | |
| Net (increase) decrease in loans | (53,827) | (72,878) | (26,487) |
| (Increase) decrease in investment in other Farm Credit institutions | (777) | (514) | 610 |
| (Increase) decrease in other investments | (58,851) | — | — |
| Purchase of premises and equipment, net | (105) | (106) | (137) |
| Proceeds from sale of other property owned | (8) | 52 | 84 |
| Net cash provided by (used in) investing activities | (113,568) | (73,446) | (25,930) |
| Cash flows from financing activities: | | | |
| Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net | 110,067 | 74,169 | 26,267 |
| Protected borrower equity retired | (87) | (139) | (205) |
| Capital stock and participation certificates issued | 121 | 127 | 118 |
| Capital stock and participation certificates retired | (136) | (126) | (183) |
| Patronage refunds paid | (2,728) | (2,467) | (3,141) |
| Retained earnings retired | (3,786) | (3,780) | (3,915) |
| Net cash provided by (used in) financing activities | 103,451 | 67,784 | 18,941 |
| Net increase (decrease) in cash | 844 | 908 | (1,402) |
| Cash, beginning of period | 2,514 | 1,606 | 3,008 |
| Cash, end of period | \$ 3,358 | \$ 2,514 | \$ 1,606 |
| Supplemental schedule of non-cash activities: | | | |
| Financed sales of other property owned | \$ — | \$ — | \$ 229 |
| Loans transferred to other property owned | — | 53 | 301 |
| Cash dividends or patronage distributions declared or payable | 3,169 | 2,459 | 2,333 |
| Decrease (increase) in accumulated other comprehensive income related to minimum pension liability | — | 2,374 | 192 |
| Supplemental information: | | | |
| Interest paid | \$ 16,778 | \$ 10,814 | \$ 9,445 |
| Taxes paid, net | 4 | — | 62 |

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 (the 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 (the Farm Credit Act). The most recent significant amendment to the Farm Credit Act was the Agricultural Credit Act of 1987. At December 31, 2005, the System was comprised of four Farm Credit Banks and one Agricultural Credit Bank and ninety-six Associations.

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

ACA parent-companies provide financing and related services through its FLCA and PCA subsidiaries. The FLCA makes secured long-term agricultural real estate and rural home mortgage loans. The PCA makes short-and intermediate-term loans for agricultural production or operating purposes.

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 of providing assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank is required to pay premiums into the Insurance Fund, based on its annual average loan principal outstanding until the monies in the Insurance Fund reach the "secure base amount," which 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.

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 Farm Credit 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.

The AgFirst Annual Report to Shareholders, the AgFirst District Annual Report to Shareholders, and the AgFirst District's quarterly reports are available on its web site, www.agfirst.com. Upon request, shareholders of the Association will be provided with copies of these reports at no charge by calling 1-800-845-1745, Ext. 378. The Association's financial condition may be impacted by factors that affect the Bank. The Bank's Annual Report discusses the material aspects of the District's financial condition, changes in financial condition, and results of operations. In addition, the District's Annual Report identifies favorable and unfavorable trends, significant events, uncertainties and the impact of activities of the Insurance Corporation.

The lending and financial services offered by the Bank are described in Note 1 of the Bank's Annual Report to Shareholders.

Note 2 — Summary of Significant Accounting Policies

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

Certain amounts in prior years' financial statements have been reclassified to conform to current consolidated financial statement 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 intercompany transactions have been eliminated in consolidation.

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

B. Loans and Allowance for Loan Losses: Long-term real estate mortgage loans generally have original maturities ranging from five to 30 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 less unearned income. The premiums associated with the USDA notes receivables are amortized over the life of the loan. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding.

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.

Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days (unless adequately secured 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 determination of the allowance for loan losses is based on management's current judgments about the credit quality of its loan and lease portfolio. A specific allowance may be established for impaired loans. 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. See Note 3 for a discussion on the refinement of the allowance for loan losses methodology.

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 is increased through provisions for loan losses and loan recoveries and is decreased through reversals of provisions for loan losses and loan charge-offs.

The allowance 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.

C. 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 purchases 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.

D. Investment in AgFirst Farm Credit Bank: 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 included in Due from AgFirst Farm Credit Bank.

E. Other Property Owned: Other property owned, consisting of real and personal property acquired through a collection action, is recorded at fair value less estimated selling costs upon acquisition. 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 and expenses from operations and carrying value adjustments are included in gains (losses) on other property owned.

F. 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 operations. Maintenance and repairs are charged to operating expense and improvements are capitalized.

G. 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 Balance Sheet. Advanced conditional payments are not insured. Interest is generally paid by the Association on such accounts.

H. Employee Benefit Plans: The employees of the Association may participate in the Retirement Plan (the Plan) of the AgFirst District, which is a defined benefit plan. The District utilizes the "Projected Unit Credit" actuarial method for financial reporting purposes and for funding purposes. As a result of the funded status at the Plan's measurement date (September 30) of the underlying Plan, the Association may record a minimum liability, an intangible asset relating to unrecognized prior service cost and other comprehensive income (loss). The adjustment to other comprehensive income (loss) would be net of deferred taxes, if significant. For participants hired before January 1, 2003, benefits are determined based on a final average pay formula. For those participants hired on or after January 1, 2003, benefits are determined using a cash balance formula.

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

Effective January 1, 2006 the Districtwide 401(k) Plan known as the AgFirst Farm Credit Employee Thrift Plan merged with the Farm Credit Bank of Texas Thrift Plus Plan. The new plan is known as the AgFirst/FCBT 401(k) Employee Benefit Plan.

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.

I. Income Taxes: The Association is generally subject to Federal 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 recognizes deferred tax assets and liabilities for the expected future tax consequences of the temporary differences between the carrying amounts and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled.

As previously described, the ACA holding company operates through two wholly-owned subsidiaries. The FLCA subsidiary is

exempt from federal and other income taxes as provided in the Farm Credit Act. The ACA and the PCA subsidiary are subject to federal and state income taxes. The Association accounts for income taxes under the asset and liability method. Accordingly, deferred taxes are recognized for estimated taxes ultimately payable or recoverable based on federal, state or local laws.

J. Patronage Refund from AgFirst: The Association records patronage refunds from the Bank on an accrual basis.

Note 3 — Refinement of the Allowance for Loan Losses Methodology

During 2004, the Association conducted a study to further refine its allowance for loan losses methodology taking into account recently issued guidance by FCA, the System's regulator, as well as the Securities and Exchange Commission (SEC) and Federal Financial Institutions Examination Council guidelines.

The Association's allowance for loan losses methodology was adjusted and revised in the late 1980s to take into account credit losses in that period. Given the long cyclical nature of the agricultural economy, loss factors utilized to determine the allowance for loan losses subsequent to 1989 continued to reflect, to some extent, the loss history of the mid-to-late 1980s, which resulted in conservative estimates of the allowance for loan losses. The Association's allowance for loan losses methodology utilized throughout the period was in accordance with generally accepted accounting principles and was consistently applied.

While conservative in estimating the allowance for loan losses, the methodology used resulted in annual provisions for loan losses over the periods that reflected changes in credit quality and loss experience. Accordingly, the reserves provided in the mid-to-late 1980s have, in effect, remained part of the allowance for loan losses. The Association's allowance for loan losses methodology has consistently adhered to proper accounting policies, under the regulatory supervision of FCA in its role as a "safety and soundness" regulator. It was FCA's view that the allowance for loan losses should include among others, an assessment of: probable losses, historical loss experience and economic conditions.

In April 2004, FCA issued an "Informational Memorandum" to System institutions regarding the criteria and methodologies that would be used in evaluating the adequacy of a System institution's allowance for loan losses. FCA endorsed the direction provided by other bank regulators and the SEC and indicated the conceptual framework addressed in their guidance would be included as part of their examination process.

During the fourth quarter of 2004, the Association completed its study and refined its methodology to be in compliance with the guidance discussed in the previous paragraph. The refinement in methodology resulted in a calculated allowance for loan losses that was significantly less than the previously recorded balance due to revised loss factors that are more indicative of actual loss experience in recent years and current borrower analysis.

While the \$6,701 reversal had a significant impact on 2004 results of operations and the previously recorded allowance for loan losses, the refinement in methodology did not have a significant impact on 2005 comparative results of operations and is not expected to have a significant impact in future periods. Additionally, the refinement in methodology did not have a significant impact on the level of the risk bearing capacity of the Association, generally referred to as "risk funds" (capital plus the allowance for loan losses), which totaled \$62,330 at December 31, 2005 (13.69 percent of Association loans), as compared with \$58,812 at December 31, 2004 (14.65 percent of Association loans), and \$53,693 at December 31, 2003 (16.33 percent of Association loans).

Note 4 — Loans and Allowance for Loan Losses

A summary of loans follows:

| | December 31, | | |
|----------------------------------|-------------------|-------------------|-------------------|
| | 2005 | 2004 | 2003 |
| Production agriculture: | | | |
| Real estate mortgage | \$ 212,740 | \$ 192,838 | \$ 153,891 |
| Production and intermediate term | 85,399 | 81,188 | 65,059 |
| Agribusiness: | | | |
| Processing and marketing | 9,233 | 9,919 | 10,990 |
| Farm related business | 18,777 | 11,718 | 8,941 |
| Rural residential real estate | 10,342 | 11,391 | 8,328 |
| Participations | 75,461 | 48,433 | 55,408 |
| Rural American Bond | 1,502 | — | — |
| USDA notes receivables | 41,870 | 46,010 | 26,098 |
| Total loans | \$ 455,324 | \$ 401,497 | \$ 328,715 |

The Association's concentration of credit risk in various agricultural commodities is shown in the following table. While the amounts represent the Association's maximum potential credit risk as it relates to recorded loan principal, 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.

Total loans at December 31, 2005, 2004 and 2003 consisted of the following commodity types:

| Commodity Type | December 31, | | |
|--------------------------|--------------|-------------|-------------|
| | 2005 | 2004 | 2003 |
| Timber | 19% | 8% | 11% |
| Participations Purchased | 17 | 23 | 25 |
| Landlords | 13 | 15 | 16 |
| Poultry | 10 | 11 | 14 |
| Cotton | 8 | 9 | 8 |
| Peanuts | 6 | 7 | 8 |
| Livestock | 3 | 4 | 4 |
| Row Crops | 2 | 1 | 1 |
| Rural Home | 2 | 2 | 3 |
| Vegetables | 2 | 2 | 2 |
| Fruit and Nut | 1 | 1 | 1 |
| Horticulture | 1 | 1 | 2 |
| Other | 16 | 16 | 5 |
| Total | 100% | 100% | 100% |

Listed below is a detailed breakdown of the commodities that are included in participations purchased in the table above:

| Participations Purchased | December 31, | | |
|--------------------------|---------------|---------------|---------------|
| | 2005 | 2004 | 2003 |
| Timber | 7.02% | 14.26% | 7.35% |
| Fruit and Nut | 2.47 | 2.54 | 4.37 |
| Livestock | 1.70 | .43 | .54 |
| Landlords | 1.41 | 1.33 | 1.21 |
| Dairy | .50 | 1.42 | 2.10 |
| Poultry | .48 | .21 | — |
| Row Crop | .48 | .53 | .81 |
| Horticulture | .34 | .50 | .30 |
| Vegetables/Melons | .29 | .37 | — |
| Other | 1.84 | .90 | 8.59 |
| Total | 16.53% | 22.49% | 25.27% |

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 secured by the first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (97 percent if guaranteed by a government agency) of the property's appraised value. However, a decline in a property's market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the Association in the collateral, may result in the loan to value ratios in excess of the regulatory maximum.

The Association has purchased notes receivables in the guaranteed portions of certain loans. These loans are guaranteed by the United States Department of Agriculture and are held for the purposes of reducing interest rate risk and managing surplus short-term funds as allowable under FCA regulations.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms.

The following table presents information relating to impaired loans.

| | December 31, | | |
|--|---------------|---------------|-----------------|
| | 2005 | 2004 | 2003 |
| Nonaccrual loans: | | | |
| Current as to principal and interest | \$ 131 | \$ 153 | \$ 304 |
| Past due | — | — | 140 |
| Total nonaccrual loans | 131 | 153 | 444 |
| Impaired accrual loans: | | | |
| Restructured accrual loans | 362 | 758 | 806 |
| Accrual loans 90 days or more past due | — | — | — |
| Total impaired accrual loans | 362 | 758 | 806 |
| Total impaired loans | \$ 493 | \$ 911 | \$ 1,250 |

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2005.

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, | | |
|---|-------------------------|--------------|---------------|
| | 2005 | 2004 | 2003 |
| Interest income recognized on nonaccrual loans | \$ 1 | \$ 15 | \$ 263 |
| Interest income on impaired accrual loans | 119 | 78 | 88 |
| Interest income recognized on impaired loans | \$ 120 | \$ 93 | \$ 351 |

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

| | 2005 | 2004 | 2003 |
|--|--------|--------|----------|
| Impaired loans with related allowance | \$ - | \$ 1 | \$ 86 |
| Impaired loans with no related allowance | 493 | 910 | 1,164 |
| Total impaired loans | \$ 493 | \$ 911 | \$ 1,250 |
| Allowance on impaired loans | \$ - | \$ - | \$ 23 |

The following table summarizes impaired loan information for the year ended December 31,

| | 2005 | 2004 | 2003 |
|------------------------|--------|----------|----------|
| Average impaired loans | \$ 604 | \$ 1,427 | \$ 1,571 |

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

| | Year Ended December 31 | |
|--|------------------------|-------|
| | 2005 | 2004 |
| Interest income which would have been recognized under the original loan terms | \$ 21 | \$ 36 |
| Less: interest income recognized | 1 | 15 |
| Foregone interest income | \$ 20 | \$ 21 |

The changes in the allowance for loan losses are as follows:

| | Year Ended December 31, | | |
|---|-------------------------|----------|----------|
| | 2005 | 2004 | 2003 |
| Balance at beginning of year | \$ 843 | \$ 7,587 | \$ 7,601 |
| Provision for (reversal of allowance for) loan losses | \$ 1 | \$ - | \$ - |
| Nonrecurring provision for loan losses reversal | - | (6,701) | - |
| Charge-offs: | | | |
| Production agriculture: | | | |
| Real estate mortgage | \$ (5) | \$ (66) | \$ (22) |
| Total charge-offs | (5) | (66) | (22) |
| Recoveries | | | |
| Production agriculture: | | | |
| Real estate mortgage | \$ 5 | \$ 23 | \$ 8 |
| Total recoveries | 5 | 23 | 8 |
| Net (charge-offs) recoveries | - | (43) | (14) |
| Balance at end of year | \$ 844 | \$ 843 | \$ 7,587 |
| Ratio of net charge-offs during the period to average loans outstanding during the period | -% | 0.011% | 0.004% |

As previously discussed in Note 3, the nonrecurring provision for loan losses reversal resulted from the refinement of the Association's allowance for loan losses methodology.

In addition, the following is a breakdown of the allowance for loan losses for the end of the last three fiscal years:

| | December 31, | | | | | |
|----------------------------------|--------------|---------|--------|---------|----------|---------|
| | 2005 | | 2004 | | 2003 | |
| | Amount | % | Amount | % | Amount | % |
| Production agriculture | | | | | | |
| Real estate mortgage | \$ 456 | 54.03% | \$ 456 | 54.03% | \$ 4,099 | 54.03% |
| Production and intermediate term | 217 | 25.67 | 216 | 25.67 | 1,948 | 25.67 |
| Agribusiness | 150 | 17.80 | 150 | 17.80 | 1,366 | 18.01 |
| Communication | 1 | 0.07 | 1 | 0.07 | - | - |
| Energy | 1 | 0.14 | 1 | 0.14 | - | - |
| Rural residential real estate | 19 | 2.29 | 19 | 2.29 | 174 | 2.29 |
| Total | \$ 844 | 100.00% | \$ 843 | 100.00% | \$ 7,587 | 100.00% |

Note 5 – Other Investments

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, provides for payments to tobacco "quota owners" and producers for the elimination of the quota, and provides an assessment mechanism for tobacco manufacturers and importers to pay for the buyout. Tobacco quota holders and producers will receive 10 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 so that they may obtain a lump sum or other payment. On April 4, 2005, the USDA issued a Final Rule implementing the "Tobacco Transition Payment Program" (Tobacco Buyout).

The FCA determined that System institutions are "financial institutions" within the meaning of the Tobacco Act and are, therefore, eligible to participate in the Tobacco Buyout. The FCA recognized that the Tobacco Buyout has significant implications for some System institutions and the tobacco quota holders and producers they serve. The FCA's goal is to provide System institution borrowers with the option to immediately receive Tobacco Buyout contract payments and reinvest them in future business opportunities.

For the year ended December 31, 2005, the Association held Tobacco Buyout SIIC of \$58,851, net of discount.

Note 6 — Investment in AgFirst Farm Credit Bank

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

Note 7 — Premises and Equipment

Premises and equipment consisted of the following:

| | December 31, | | |
|--------------------------------|-----------------|-----------------|-----------------|
| | 2005 | 2004 | 2003 |
| Land | \$ 372 | \$ 373 | \$ 229 |
| Buildings and improvements | 1,556 | 1,552 | 1,682 |
| Furniture and equipment | 824 | 780 | 829 |
| | <u>2,752</u> | <u>2,705</u> | <u>2,740</u> |
| Less: accumulated depreciation | 1,704 | 1,605 | 1,588 |
| Total | <u>\$ 1,048</u> | <u>\$ 1,100</u> | <u>\$ 1,152</u> |

Note 8 — Notes Payable to AgFirst Farm Credit Bank

The Association's indebtedness to the Bank represents borrowings by the Association 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 lines of credit are governed by a general financing agreement. 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 Association. The weighted average interest rates on the variable rate notes were 5.30 percent for LIBOR-based loans, 5.17 percent for Prime-based loans, and the weighted average remaining maturities were 4.9 years and 8.5 years, respectively, at December 31, 2005. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) notes payable which are match funded by the Bank was 4.90 percent and the weighted average remaining maturity was 6.1 years at December 31, 2005. The weighted average interest rate on all interest-bearing notes payable was 5.07 percent and the weighted average remaining maturity was 6.8 years at December 31, 2005.

Variable rate and fixed rate notes payable represent approximately 43.46 percent and 56.54 percent, respectively, of total notes payable at December 31, 2005.

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. At December 31, 2005, the Association's notes payable were within the specified limitations.

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 seven percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the seven 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 seven percent and of core surplus as a percentage of risk-adjusted assets of three and one-half percent. The Association's permanent capital, total surplus and core surplus ratios at December 31, 2005 were 13.04 percent, 12.77 percent and 10.54 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.

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, 2005:

| Class | Protected | Shares Outstanding | |
|--|-----------|--------------------|---------------------|
| | | Number | Aggregate Par Value |
| A Common/Nonvoting | Yes | 78 | \$ — |
| B Common/Nonvoting | Yes | 92,552 | 463 |
| C Common/Voting | No | 200,961 | 1,005 |
| B Participation Certificates/Nonvoting | Yes | 3,494 | 18 |
| C Participation Certificates/Nonvoting | Yes | 24,058 | 120 |
| Total Capital Stock and Participation Certificates | | <u>321,143</u> | <u>\$ 1,606</u> |

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

Retained Earnings

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

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

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

Allocated equities shall be retired solely at the discretion of the Board; provided, however, that minimum capital standards established by the FCA and the Board are met. 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, 2005, allocated members' equity consisted of \$4,097 of qualified surplus, \$13,582 of nonqualified allocated surplus and \$7,064 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.

E. Other Comprehensive Income (Loss)

The Association reports other comprehensive income (loss) in its Statement of Changes in Members' Equity. For the years ended December 31, 2003 and 2002, other comprehensive income (loss) was related to the minimum pension liability recorded as a result

of the funded status of the underlying plan. During 2004, the District Associations funded the pension plans sufficiently to eliminate the pension-related charge to other comprehensive income (loss) at December 31, 2004. See Note 11 for further information.

Note 10 — Income Taxes

The provision (benefit) for income taxes follows:

| | Year Ended December 31, | | |
|--|-------------------------|--------------|--------------|
| | 2005 | 2004 | 2003 |
| Current: | | | |
| Federal | \$ 9 | \$ 7 | \$ 37 |
| State | 3 | 1 | 6 |
| | <u>12</u> | <u>8</u> | <u>43</u> |
| Deferred: | | | |
| Federal | 8 | 4 | (6) |
| State | 1 | 1 | (1) |
| | <u>9</u> | <u>5</u> | <u>(7)</u> |
| Total provision (benefit) for income taxes | <u>\$ 21</u> | <u>\$ 13</u> | <u>\$ 36</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, | | |
|---------------------------------------|--------------|--------------|--------------|
| | 2005 | 2004 | 2003 |
| Federal tax at statutory rate | \$ 3,691 | \$ 5,443 | \$ 2,430 |
| State tax, net | 2 | 1 | 4 |
| Patronage distributions | (1,077) | (601) | (281) |
| Tax-exempt FLCA earnings | (2,562) | (3,921) | (2,144) |
| Reversal of allowance for loan losses | - | (895) | - |
| Other | (33) | (14) | 27 |
| Provision (benefit) for income taxes | <u>\$ 21</u> | <u>\$ 13</u> | <u>\$ 36</u> |

Deferred tax assets and liabilities result from the following at:

| | December 31, | | |
|---|----------------|---------------|---------------|
| | 2005 | 2004 | 2003 |
| Allowance for loan losses | \$ 159 | \$ - | \$ - |
| Annual leave | 54 | 4 | 4 |
| Nonaccrual loan interest | 8 | - | - |
| Postretirement benefits other than pensions | 295 | 7 | 3 |
| Depreciation | 57 | 1 | 1 |
| Other | 2 | - | - |
| Gross deferred tax assets | <u>575</u> | <u>12</u> | <u>8</u> |
| Future Bank equity redemption | - | (12) | (4) |
| Loan fees | (8) | - | - |
| Pensions | (583) | (7) | (6) |
| Gross deferred tax liability | <u>(591)</u> | <u>(19)</u> | <u>(10)</u> |
| Net deferred tax asset (liability) | <u>\$ (16)</u> | <u>\$ (7)</u> | <u>\$ (2)</u> |

At December 31, 2005, 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.

Note 11 — Employee Benefit Plans

The employees of the Association may participate in a Districtwide defined benefit retirement plan. This plan is noncontributory and covers substantially all Association employees. Benefits are based on salary and years of service. The assets, liabilities and costs of the plan are not segregated by participating entities but are allocated

among the participating entities. Pension costs are allocated by multiplying the District's net pension expense times the Association's salary expense as a percentage of the District's salary expense.

At December 31, 2005 and 2004, the fair value of the plan assets of the District's defined benefit plan exceeded the Accumulated Benefit Obligation (ABO), while at December 31, 2003, the ABO of the District's defined benefit plan exceeded the fair value of plan assets. The fair value of the plan assets and the ABO were measured as of September 30, 2005. At December 31, 2003, the Association's allocated amount of the minimum pension liability was recorded in the Consolidated Balance Sheets in the amount of the excess of the ABO over the fair value of plan assets. In conjunction with the minimum pension liability, accumulated other comprehensive loss was \$2,374 at December 31, 2003. The impact on deferred taxes was not significant.

The Association participates in a Districtwide Thrift Plan. 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.

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.

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Act) was signed into law. This act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. In May 2004, the FASB issued FASB Staff Position (FSP) 106-2, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act). This Staff Position provides guidance on the accounting for the effects of the Act for employers that sponsor postretirement health care plans that provide prescription drug benefits. The District sponsored plan adopted FSP 106-2 effective July 1, 2004 (measured as of March 31, 2004). The benefit obligation valuation as of December 31, 2004 reflects the impact of the Medicare Act.

In determining the benefit obligation as of December 31, 2004, the expected per capita claims cost were estimated to be reduced by 12 percent beginning in 2006, for Medicare-eligible participants receiving actuarially equivalent drug benefits, due to a government reimbursement of a portion of prescription drug benefits. The District reduced its accumulated postretirement benefit obligation (APBO) for the subsidy related to benefits attributed to past service. The effect of the subsidy on the measurement of net periodic postretirement cost for 2005 was a reduction of 2005 expense. The effect included lower amortization of actuarial losses, lower service costs and lower interest costs on the APBO.

The Retiree and Disabled Medical Plan was amended effective January 1, 2006 to change the medical and prescription drug coverage for Medicare-eligible retirees and/or eligible spouses 65 years and older. Beginning in 2006, the AgFirst/FCBT Retiree and Disabled Medical Plan will provide medical and prescription drug coverage to Medicare-eligible retirees and/or eligible spouses 65 years and older through fully-insured AARP endorsed Medicare Supplement policies and subsidized basic Medicare D coverage through a selected Prescription Drug Plan. Dental coverage was not changed. Certain other retirees who are grandfathered under insured arrangements were not impacted by the change. The benefit obligation valuation as of December 31, 2005 reflects the impact of this plan amendment.

In determining the benefit obligation as of December 31, 2005, there was no impact due to government reimbursement of prescription drug benefits. After the plan amendment, the plan no longer provides prescription drug benefits directly for retirees and/or eligible spouses 65 years and older. Instead, the District subsidizes the cost of coverage obtained under the Medicare D program through the selected Prescription Drug Provider.

For further information on postretirement costs, see "Postretirement Benefits" section in the Notes to the AgFirst Farm Credit District Consolidated Financial Statements.

The following is a table of retirement and postretirement benefits expenses (credits):

| | 2005 | 2004 | 2003 |
|-------------------------------|---------------|---------------|---------------|
| Pension | \$ 391 | \$ 438 | \$ 431 |
| Thrift/deferred compensation | 62 | 67 | 57 |
| Other postretirement benefits | 220 | 299 | 291 |
| Total | <u>\$ 673</u> | <u>\$ 804</u> | <u>\$ 779</u> |

For the years ended December 31, 2005 and 2004, the Association had contributed \$554 and \$2,357, respectively, to the Districtwide defined benefit retirement plan, which was sufficient to meet its accumulated benefit obligation. For 2004, the contributions eliminated the minimum pension liability and the pension-related charge to accumulated other comprehensive income (OCI) in shareholders' equity. As a result of the fundings and the reclassification of the OCI, the Association ended 2005 and 2004 with \$3,279 and \$3,116, respectively, in prepaid retirement expense on the consolidated balance sheets.

Note 12 — Intra-System Financial Assistance

The Farm Credit System Financial Assistance Corporation (Financial Assistance Corporation) was established in 1988 primarily to provide capital to institutions of the System experiencing financial difficulty. Such assistance was funded through the Financial Assistance Corporation's issuance of \$1.261 billion of 15-year U.S. Treasury-guaranteed debt. The interest rates on these issuances range from 8.80 percent to 9.45 percent. The repayment of this debt and related interest was the responsibility of System banks. In June 2005, the last outstanding Financial Assistance Corporation debt of \$325 million matured and was redeemed.

Each System bank may be required to pay premiums into the Insurance Fund based on its annual average loan principal outstanding. The Bank, in turn, may also assess the Association for insurance premiums based on the average principal outstanding of accrual and nonaccrual loans of the Association for each year. At December 31, 2005, the assets in the Insurance Fund aggregated \$2.062 billion. However, due to the authorized uses of the Insurance Fund, there is no assurance that Fund assets will be available or sufficient to ensure the payment of principal of, or interest on, insured debt securities in the event of a default by any System bank having primary liability thereon.

Note 13 — 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, 2005 amounted to \$7,794. During 2005, \$5,118 of new loans were made and repayments totaled \$4,013. In the opinion of management, none

of these loans outstanding at December 31, 2005 involved more than a normal risk of collectibility.

Note 14 — 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, 2005, \$82,933 of commitments to extend credit and \$0 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 Balance Sheet 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. Outstanding standby letters of credit have expiration dates ranging from January 1, 2006 to October 29, 2010. The maximum potential amount of future payments the Association is required to make under the guarantees is \$4,959.

As of December 31, 2005, the Association had commitments to purchase \$18,531 in additional Tobacco Buyout SIIC in 2006.

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, 2005, 2004 and 2003. The fair value of a financial instrument is generally defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

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, 2005 | | December 31, 2004 | |
|---|-------------------|----------------------|-------------------|----------------------|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Financial assets: | | | | |
| Cash | \$ 3,358 | \$ 3,358 | \$ 2,514 | \$ 2,514 |
| Loans | \$ 455,324 | \$ 457,404 | \$ 401,497 | \$ 405,487 |
| Allowance for loan losses | 844 | — | 843 | — |
| Loans, net | \$ 454,480 | \$ 457,404 | \$ 400,654 | \$ 405,487 |
| Other Investments | \$ 58,851 | \$ 57,760 | \$ — | \$ — |
| Financial liabilities: | | | | |
| Notes payable to AgFirst Farm Credit Bank | \$ 465,789 | \$ 463,162 | \$ 355,722 | \$ 355,090 |

| | December 31, 2003 | |
|---|-------------------|----------------------|
| | Carrying Amount | Estimated Fair Value |
| Financial assets: | | |
| Cash | \$ 1,606 | \$ 1,606 |
| Loans | \$ 328,715 | \$ 333,657 |
| Allowance for loan losses | 7,587 | — |
| Loans, net | \$ 321,128 | \$ 333,657 |
| Other Investments | \$ — | \$ — |
| Financial liabilities: | | |
| Notes payable to AgFirst Farm Credit Bank | \$ 281,553 | \$ 281,679 |

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

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

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

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

The carrying value of accrued interest approximates its fair value.

- C. **Investment in AgFirst Farm Credit Bank:** Estimating the fair value of the Association's investment in the Bank is not practicable because the stock is not traded. 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 balance sheet. The Association owns 3.20 percent of the issued stock of the Bank as of December 31, 2005 net of any reciprocal investment. As of that date, the

Bank's assets totaled \$20.5 billion and shareholders' equity totaled \$1,037 million. The Bank's earnings were \$164 million during 2005.

In addition, the Association has an investment of \$414 related to other Farm Credit institutions.

- D. **Notes Payable to AgFirst Farm Credit Bank:** The notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association's loan receivables plus accrued interest on the notes payable. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.
- E. **Commitments to Extend Credit 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.
- F. **Other Investments:** Other Investments includes Tobacco Buyout Successor-in-Interest Contracts (SIIC) which come under the FCA's Mission Related Investments. Under the SIIC, the tobacco quota holders and producers may assign their rights to receive Tobacco Buyout contract payments to a third party. The successor purchases the entire contract and all related rights and obligations associated with contract.

Fair value of the SIIC is estimated by discounting future annual cash flows using prevailing rates for similar instruments at year-end.

Note 16 — Quarterly Financial Information (Unaudited)

Quarterly results of operations for the years ended December 31, 2005, 2004 and 2003 follow:

| | 2005 | | | | |
|---|-------------|----------|----------|----------|-----------|
| | First | Second | Third | Fourth | Total |
| Net interest income | \$ 2,584 | \$ 2,797 | \$ 2,981 | \$ 3,080 | \$ 11,442 |
| Provision for (reversal of) loan losses | 1 | — | — | — | 1 |
| Noninterest income (expense), net | (414) | (404) | (339) | 549 | (608) |
| Net income (loss) | \$ 2,169 | \$ 2,393 | \$ 2,642 | \$ 3,629 | \$ 10,833 |
| | 2004 | | | | |
| | First | Second | Third | Fourth | Total |
| Net interest income | \$ 2,326 | \$ 2,463 | \$ 2,689 | \$ 2,684 | \$ 10,162 |
| Provision for (reversal of) loan losses | — | — | — | (6,701) | (6,701) |
| Noninterest income (expense), net | (398) | (539) | (256) | 326 | (867) |
| Net income (loss) | \$ 1,928 | \$ 1,924 | \$ 2,433 | \$ 9,711 | \$ 15,996 |
| | 2003 | | | | |
| | First | Second | Third | Fourth | Total |
| Net interest income | \$ 2,193 | \$ 2,414 | \$ 2,473 | \$ 2,335 | \$ 9,415 |
| Provision for (reversal of) loan losses | — | — | — | — | — |
| Noninterest income (expense), net | (457) | (593) | (746) | (509) | (2,305) |
| Net income (loss) | \$ 1,736 | \$ 1,821 | \$ 1,727 | \$ 1,826 | \$ 7,110 |