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# SOUTHWEST GEORGIA FARM CREDIT, ACA

# 2007 ANNUAL REPORT

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## Management

Richard S. Monson.....	President/Chief Executive Officer
Larry J. Malone.....	Chief Lending Officer
Belinda Robertson.....	Chief Financial Officer

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## *Message from the President*

Economics has always been my “thing.” I enjoy the complexity of number systems, and the simplicity of the numbers themselves. And while I consider myself to be a “numbers person,” I value the English language and the words we use every day. Which is why, as I listened to a recent news story, I was amazed that the word “sub prime” had been designated the 2007 word of the year. Not surprisingly, it’s taken on a new context — as a verb nonetheless — as when one would describe less than spectacular performance. As a high school student might say about a below average grade on a test — “I sub-primed that.”

There are words that trickle into our every day speech. As I contemplate how to describe our 2007 performance, I want to be sure to avoid clichés. The one thing I can say for sure about 2007 is that the realities of the national economy found their way to the southwest corner of Georgia. Yet, with a disciplined approach and a sound business strategy, our team was successful in meeting our targets. In short, it was a very good year.

### **Leadership, focus and determination**

Our Board of Directors and senior management team are committed to a better rural America. In the 21 counties we serve in southwest Georgia, we have developed a solid reputation as a financial partner you know and trust. We don’t take this lightly. If the words we choose to describe ourselves are important, our actions mean even more. We recognize that rural America is changing. The influences of a global economy and 24/7 communication are being felt right here — from Bainbridge to Leesburg and everywhere in between. As our nation’s farmers and agribusinesses struggle to compete, access to competitive credit becomes all that more important. We spent a good deal of time in 2007 reaching out to rural America — in our own backyard and beyond — in an effort to help these special places provide the kinds of services their residents rely on.

One example is our mission-related investments, the work we do through a consortium of three Farm Credit associations. We call this consortium Rural America Capital Group. This past year Rural America Capital Group, working closely with the United States Department of Agriculture, financed three critical access hospitals, in communities where there was a dire need for health care services. One of these hospitals, St. James Health Services in St. James, Minnesota, is in a small town about three hours from the twin cities. It sits at the intersection of two major highways, and prides itself on its small town appeal. The town is, in fact, a “Mayberry” of sorts, and there is no doubt among its residents that without a vibrant health care system, their community could not flourish.

St. James’ 50-year old structure was outdated. It could no longer accommodate the needs of the region. Today, with tremendous community support and the strength of a financial partner like Rural America Capital Group, the residents of St. James, Minnesota can rest assured that their newly opened hospital will meet their health care needs today, and in the future.

## **Trust, Experience and Accountability**

Though the headlines were shouting of a mortgage crisis, a gloomy housing forecast, increased inflation and unemployment, local farmers benefited from excellent corn, peanut and cotton crops, despite less than adequate rainfall. Land prices remained steady, making the purchase of a recreational tract for hobby farming or hunting, attractive. With an abundance of quality land available, those in the market are finding southwest Georgia to be a prime location. Quality public schools, exceptional health care and true southern culture are all attractive to buyers.

And as more people find southwest Georgia, our Association is uniquely positioned to accommodate their needs. Managed growth is our goal. Innovation is the key. As much as agriculture and rural America have changed over the course of the past 90 years, our Association must remain mission-focused and highly motivated to meet the ever growing needs of America's farmers, agri-businesses and rural communities.

Two words defined 2007 for our Association — trust and accountability. The credit crisis we experienced this year opened the eyes of our nation. Borrowers need a financial partner they know and trust. In turn, it is our responsibility to manage our Association to the best of our abilities, ever-vigilant that we are accountable to our owners. Our promise is of a bright future for those who entrust us to be their lender of choice.

Thank you for your continued support of Southwest Georgia Farm Credit. We look forward to serving you in 2008.

Respectfully,



Richard S. Monson  
President

February 28, 2008

## *Report of Management*

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

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

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

The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that the 2007 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.

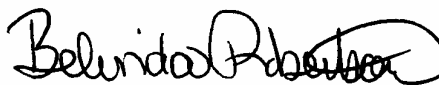
The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.



Bobby J. Brooks  
Chairman of the Board



Richard S. Monson  
Chief Executive Officer



Belinda Robertson  
Chief Financial Officer

February 28, 2008



# 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, 2007 with comparisons to the years ended December 31, 2006 and December 31, 2005. This information should be read in conjunction with the Consolidated Financial Statements, Notes to the Consolidated Financial Statements and other sections in this Annual Report. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors. For a list of the Audit Committee members, refer to the "Report of the Audit Committee" reflected in this Annual Report. Information in any part of this Annual Report may be incorporated by reference in answer or partial answer to any other item of the Annual Report.

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

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

The Association obtains funding from AgFirst Farm Credit Bank (AgFirst or Bank). The Association is materially affected and shareholder investment in the Association could be affected by the financial condition and results of operations of the Bank. Copies of the Bank's Annual and Quarterly Reports are on the AgFirst website, [www.agfirst.com](http://www.agfirst.com), or may be obtained at no charge by calling 1-800-845-1745, extension 378, or writing Stephen Gilbert, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202.

Copies of the Association's Annual and Quarterly reports are also available upon request free of charge on the Association's website, [www.svgafarmcredit.com](http://www.svgafarmcredit.com), or by calling 1-800-844-2645, extension 114, or writing Belinda Robertson, Southwest Georgia Farm Credit, ACA, P.O. Box 790, Bainbridge, Georgia 39818-0790. The Association prepares an electronic version of

the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Association.

## FORWARD LOOKING INFORMATION

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

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international, and farm-related business sectors;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry; and
- actions taken by the Federal Reserve System in implementing monetary policy.

## AGRICULTURAL OUTLOOK

In November 2007, the United States Department of Agriculture (USDA) estimated that 2007 farmers' net cash income (a measure of cash income after payment of business expenses) increased to \$85.7 billion, up \$17.8 billion from the 2006 forecast and up \$20.3 billion from its 10 year average. Contributing to this sizeable increase in net cash income were increases in cash receipts for crops and livestock of \$22.6 billion and \$20.3 billion, respectively, an increase in farm-related income of \$300 million, offset in part by an increase in cash expenses of \$21.7 billion and a decrease in direct government payments of \$3.7 billion. Corn prices have risen as a result of a

combination of continued food and feed demand and expanding ethanol demand. Other crop prices, in general, were positively impacted by increased acreage used to plant corn, decreasing the amount of acreage available for other crops. Wheat and soybeans compete with corn as a feed source so both wheat and soybean prices have risen since late 2006. Livestock cash receipts increased as domestic and export demand for beef have risen. The following table, which is based on information published by the USDA, sets forth the commodity prices per bushel for certain crops and by hundredweight for beef cattle from December 31, 2004 to December 31, 2007:

Commodity	12/31/04	12/31/05	12/31/06	12/31/07
Corn	\$2.04	\$1.92	\$3.01	\$3.76
Soybeans	\$5.45	\$5.77	\$6.18	\$10.00
Wheat	\$3.39	\$3.54	\$4.52	\$7.74
Beef Cattle	\$86.80	\$93.30	\$83.10	\$88.90

Rising commodity prices can have both positive and negative impacts on the Association, as a lender to the agricultural and rural sectors. Higher commodity prices have resulted in increased seasonal demand for agribusiness loans. Higher grain prices positively impact grain farmers. However, higher feed costs negatively impact the profitability of livestock producers, as well as those who use corn or other grains as ingredients in processed foods. To date, this has not significantly affected the Association's credit quality. In addition to higher feed costs, most other production cash expenses, such as fertilizer, seed, energy and labor costs, are forecast to rise further in 2008.

The USDA's 2007 income outlook showed a great deal of variation depending on farm size, geographic location and commodity specialties. While we utilized the USDA analysis to provide a general understanding of the U.S. agricultural economic outlook, this outlook does not take into account all aspects of our business.

The USDA classifies all farms into three primary categories: commercial farms, intermediate farms and rural residential farms. Commercial farms represent about 11 percent of U.S. farms by number and represent 75 percent of total U.S. farm production. Intermediate farms (where the primary occupation is farming and gross sales are below \$250,000) represent 26 percent of U.S. farms by number and account for 16 percent of total production. The remaining 63 percent of U.S. farms are classified as rural residential farms and only account for 9 percent of total production.

In addition to farmers' net cash income, off-farm income is an important source of repayment for farm debt obligations and is less subject to cycles in agriculture. The USDA measures farm household income, which is defined as earnings from farming activities plus off-farm income. Nearly 100 percent of farm household income for operators of rural residential farms and more than 80 percent of farm household income for intermediate farms is generated from off-farm sources. Further, USDA data suggests that about 30 percent of farm household income for commercial farms is generated from off-farm income. USDA estimated 2007 farm household income to increase 21 percent for commercial farms, 8 percent for intermediate farms and 4 percent for rural residential farms.

According to the USDA, farm business balance sheets have shown improvement over the last few years, as measured by debt relative to assets and equity levels. Farmers' equity (farm business assets less farm business debt) is expected to have

increased in 2007. One measure of the financial health of the agricultural sector used by the USDA is the assessment of farmers' utilization of their capacity to repay debt (actual debt as a percentage of maximum debt that can be supported by farmers' current income). Higher capacity utilization rates indicate tighter cash flow positions and, consequently, higher exposure to financial risk. These estimates do not take into account, however, off-farm income sources. Since 1970, debt repayment capacity utilization has ranged from a low of 35.8 percent in 1973 to 104.1 percent in 1981, and has remained relatively stable since 1987, averaging about 50 percent. The USDA suggests a decrease in the use of repayment capacity from 57 percent in 2006 to 48 percent in 2007.

Farm business debt, defined by the USDA as debt incurred by those involved in on-farm agricultural production, is estimated to have grown 3.8 percent in 2007, the fourth consecutive year of rising farm debt, following a rise of 7.3 percent in 2006. The recent rise in debt can be at least partially attributed to farmers' positive view of the sector's future. Farm real estate debt accounted for approximately 53 percent of all farm debt for 2007 and 2006.

In general, agriculture has experienced a long period of favorable economic conditions, due to stronger commodity prices, higher land values, and, to a lesser extent, government support programs. To date, the Association's financial results and credit quality have been positively impacted by these conditions. Production agriculture, however, remains a cyclical business that is heavily influenced by commodity prices. In some areas, land values recently have been negatively affected by less favorable economic conditions. Economic conditions in agriculture may not be as favorable in the near future. In an environment of adverse economic conditions in agriculture and without sufficient government support programs, the Association's financial performance and credit quality measures would likely be negatively impacted. However, any negative impacts should be lessened by geographic and commodity diversification and the substantial influence of off-farm income sources supporting agricultural-related debt.

### CRITICAL ACCOUNTING POLICIES

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

- *Allowance for loan losses* — The allowance for loan losses is management's best estimate of the amount of probable losses existing in and inherent in our loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs. The allowance for loan losses is determined based on a periodic evaluation of the loan portfolio, which generally considers relevant historical charge-

off experience adjusted for relevant factors. These factors include 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, and 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 other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing and liquidation values. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on the Association's results of operations.
- **Pensions** — The Bank and its related Associations participate in defined benefit retirement plans. These plans are noncontributory and benefits are based on salary and years of service. In addition, the Bank and its related Associations also participate in defined contribution retirement savings plans. Pension expense for all plans is recorded as part of salaries and employee benefits. Pension expense for the defined benefit retirement plans is determined by actuarial valuations based on certain assumptions, including expected long-term rate of return on plan assets and discount rate. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that portfolio of assets. The discount rate is used to determine the present value of our future benefit obligations. The discount rate was selected by reference to Hewitt Associates' (a global human resource services provider) corporate bond index, actuarial analysis and industry norms.

## ECONOMIC CONDITIONS

During 2007 many of the positive forces influencing Georgia and the U.S. are the same. Businesses have continued to hire and make capital investments. The global economy expanded, and its growth outpaced domestic economic growth. The dollar has weakened, boosting prospects for Georgia's export-oriented businesses.

Nonresidential construction in Georgia is expected to reach its cyclical peak in 2008 and the housing and manufacturing recessions will continue to deepen. However, because home price bubbles did not develop in any of Georgia's MSAs, existing home prices remain relatively steady in Georgia. Tight credit standards and considerable uncertainty in the financial markets restrained lending and therefore dampened sales of consumer items typically bought on credit.

As the U.S. business cycle becomes less conducive to economic growth, Georgia's above average population growth has become a more important driver of the state's overall economy. The state's population is expected to grow by 1.9 percent in 2008, more than double the 0.9 percent gain expected for the nation. The main impetus is in-migration from other states. Newcomers span the age spectrum to include an influx of relatively well-heeled retirees seeking affordable amenities as well as young, single, college-educated people. Such diversity ensures an adequate supply of talented young workers as well as a consumer base less exposed to the ups and downs of the business cycle.

There has been significant change in our market base over the past year, with the Association buying and selling loan participations as well as the Association's involvement in government guarantee programs. During 2007, the Association targeted certain areas of our business with hopes of increasing market share. Continued efforts are being made to expand services, increase public knowledge of our services and streamline our current delivery of products to enhance our existing portfolio.

## LOAN PORTFOLIO

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

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

Loan Type	2007		December 31, 2006		2005	
			<i>(dollars in thousands)</i>			
Real estate mortgage	\$ 199,989	50.8%	\$ 245,856	51.5%	\$ 244,941	53.8%
Production and intermediate-term	144,185	36.6	156,002	32.7	115,676	25.4
Loans to cooperatives	993	.3	1,152	.2	2,124	.5
Processing and marketing	19,780	5.0	18,389	3.9	17,907	3.9
Farm-related business	21,783	5.5	47,255	9.9	63,374	13.9
Communication	-	-	-	-	334	.1
Energy	913	.2	897	.2	626	.1
Rural residential real estate	6,378	1.6	7,857	1.6	10,342	2.3
Total	\$ 394,021	100.0%	\$ 477,408	100.0%	\$ 455,324	100.0%

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

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

County/Branch	December 31,		
	2007	2006	2005
Baker	4.40%	3.56%	3.81%
Calhoun	.63	.57	.62
Chattahoochee	.17	.16	1.83
Clay	.70	.64	.79
Decatur*	13.13	20.14	19.73
Dougherty	5.61	3.69	5.43
Early*	1.90	2.46	3.15
Grady*	3.46	3.43	4.44
Lee	1.06	1.56	1.73
Marion	2.18	2.24	2.85
Miller	1.94	2.29	2.18
Mitchell	9.07	8.16	7.77
Quitman	-	-	.01
Randolf	1.10	1.15	1.22
Schley	.50	.39	.45
Seminole*	1.63	1.79	2.46
Stewart	1.27	.78	.69
Sumter*	3.58	3.52	3.90
Terrell*	1.40	1.51	2.01
Thomas	4.07	5.89	5.58
Webster	.40	.51	.59
Other**	41.80	35.56	28.76
	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>

\* Branch Locations

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

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, landlords, poultry, cotton, livestock and peanuts, which constitute over 72 percent of the entire portfolio.

Commodity Group	December 31,					
	2007		2006		2005	
	<i>(dollars in thousands)</i>					
Timber	\$ 108,118	27%	\$ 142,846	30%	\$ 120,867	26%
Landlords	53,890	14	70,334	15	64,208	14
Poultry	40,498	10	43,186	9	47,161	10
Cotton	26,193	7	36,703	7	34,385	8
Livestock	28,006	7	29,222	6	29,793	7
Peanuts	26,940	7	24,794	5	21,499	5
Fruit & Nut	21,011	5	15,351	3	14,793	3
Vegetables	9,131	2	13,021	3	12,744	2
Dairy	5,666	1	4,102	1	3,238	1
Horticulture	3,321	1	2,522	1	5,803	1
Row Crops	7,934	2	7,789	2	11,460	3
Rural Home	6,498	2	6,892	1	8,068	2
Other	60,744	15	81,819	17	82,643	18
Total	<u>\$ 397,950</u>	<u>100%</u>	<u>\$ 478,581</u>	<u>100%</u>	<u>\$ 456,662</u>	<u>100%</u>

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The Association's loan portfolio contains a concentration of timber, landlords, poultry, cotton, livestock and peanut producers. Although a large percentage of the loan portfolio is concentrated in these enterprises, many of these operations are diversified within their enterprise and/or with crop production that reduces overall risk exposure. Within the timber commodity group there are 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. Even though the concentration of large loans has increased over the past several years, the agricultural enterprise mix of these loans is diversified and similar to that of the overall portfolio. The risk in the portfolio associated with commodity concentration and large loans is reduced by the range of diversity of enterprises in the Association's territory.

The decrease in gross loan volume for the twelve months ended December 31, 2007, is primarily attributed to the divestiture of \$29 million in USDA loans as well as the sale of \$102 million into the AgFirst capital participation pool. The capital participation pool is a tool AgFirst has made available to assist the associations in managing their capital positions. Although total earning assets were reduced on the balance sheet the sale to the AgFirst capital participation pool did not negatively impact the income statement since AgFirst distributes back to the association any income generated from these loans as patronage.

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

During 2007, the Association increased activity in the buying and selling of loan participations within and outside of the System. This provides a means for the Association to spread credit concentration risk and realize non-patronage sourced interest and fee income, which is intended to strengthen our capital position.

Loan Participations:	December 31,		
	2007	2006	2005
	<i>(dollars in thousands)</i>		
Participations Purchased			
- FCS Institutions	\$ 97,263	\$ 101,303	\$ 81,818
Participations Purchased			
- Non-FCS Institutions	21,449	20,492	10,250
Participations Sold	<u>(168,668)</u>	<u>(103,639)</u>	<u>(54,158)</u>
Total	<u>\$ (49,956)</u>	<u>\$ 18,156</u>	<u>\$ 37,910</u>

The Association did not have any loans sold with recourse, retained subordinated participation interests in loans sold, or interests in pools of subordinated participation interests for the year ended December 31, 2007.

The Association sells qualified long-term mortgage loans into the secondary market. For the year ended December 31, 2007, the Association originated loans for resale totaling \$15,812, which were sold into the secondary market. This compares to \$11,982 and \$14,880 for 2006 and 2005 respectively. The Association additionally purchased portions of loans that are guaranteed by the United States Department of Agriculture. These loans are held for the purposes of reducing interest rate risk and managing surplus short-term funds as allowable under FCA regulations. At December 31, 2007, the balance of these loans, including the unamortized premium, was \$2,467, compared to \$31,364 at December 31, 2006 and \$41,871 at December 31, 2005.

## MISSION-RELATED INVESTMENTS

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

In October 2005, the FCA authorized AgFirst and the Associations to make investments in Rural America Bonds under a three-year pilot period. Rural America Bonds may include debt obligations issued by public and private enterprises, corporations, cooperatives, other financing institutions, or rural lenders where the proceeds would be used to support agriculture, agribusiness, rural housing, or economic development, infrastructure, or community development and revitalization projects in rural areas. Examples include investments that fund value-added food and fiber processors and marketers, agribusinesses, commercial enterprises that create and maintain employment opportunities in rural areas, community services, such as schools, hospitals, and government facilities, and other activities that sustain or revitalize rural communities and their economies. The objective of this pilot program is to help meet the growing and diverse financing needs of agricultural enterprises, agribusinesses, and rural communities by providing a flexible flow of money to rural areas through bond financing. These bonds may be classified as Loans or Investments on the Consolidated Balance Sheets depending on the nature of the investment. As of December 31, 2007, December 31, 2006, and December 31, 2005 the Association had \$12,894, \$6,447, and 1,502 respectively, in Rural America Bonds, and they are classified as either Loans or Investments on the Consolidated Balance Sheets.

On October 22, 2004, Congress enacted the "Fair and Equitable Tobacco Reform Act of 2004" (Tobacco Act) as part of the "American Jobs Creation Act of 2004." The Tobacco Act repealed the Federal tobacco price support and quota programs, provided for payments to tobacco "quota owners" and producers for the elimination of the quota and included an assessment mechanism for tobacco manufacturers and importers to pay for the buyout. Tobacco quota holders and producers will receive equal annual payments under a contract with the Secretary of Agriculture. The Tobacco Act also includes a provision that allows the quota holders and producers to assign to a "financial institution" the right to receive the contract payments (Successor-in-Interest Contracts (SIIC)) so that they may obtain a lump sum or other payment. On April 4, 2005, the United States Department of Agriculture (USDA) issued a Final Rule implementing the "Tobacco Transition Payment Program" (Tobacco Buyout). At December 31, 2007, December 31, 2006, and December 31, 2005, the Association had \$78,342, \$84,426, and \$58,851, respectively, in SIIC outstanding and these are classified as Other Investments on the Consolidated Balance Sheets.

## INVESTMENT SECURITIES

As permitted under FCA regulations, the Association is authorized to hold eligible investments for the purposes of reducing interest rate risk and managing surplus short-term funds. The Bank is responsible for approving the investment policies of the Association. The Bank annually reviews the investment portfolio of every Association that it funds. The Association's investments consist primarily of asset-backed securities (ABS). The ABSs and other investments amounted to \$35,868 at December 31, 2007, \$32,006 at December 31, 2006, and none at December 31, 2005. These ABSs are rated AAA, as they are guaranteed by the full faith and credit of the United States government.

In view of the recent economic conditions and volatility related to these types of securities, the Association is actively monitoring the creditworthiness of these securities. These securities are supported by various forms of credit enhancements including insurance guarantees from AAA rated insurers, over-collateralization and favorable priority of payments. Based on our evaluations, we believe these securities do not pose a significant risk of loss given the credit enhancements and relatively short weighted average lives. However, in the event a security is downgraded, we may be required by The Farm Credit Administration, our regulator, to dispose of the security.

## CREDIT RISK MANAGEMENT

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

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

The credit risk management process begins with an analysis of the borrower's credit history, repayment capacity, and financial position. Repayment capacity focuses on the borrower's ability to repay the loan based upon cash flows from operations or other sources of income, including non-farm income. Real estate loans must be collateralized by first liens on the real estate (collateral). As required by FCA regulations, each institution that makes loans on a collateralized basis must have collateral evaluation policies and procedures. Real estate mortgage loans may be made only in amounts up to 85 percent of the original appraised value of the property taken as collateral or up to 97 percent of the appraised value if guaranteed by a state, federal, or other governmental agency. The actual loan to appraised value when loans are made is generally lower than the statutory maximum percentage.

Appraisals are required for loans of more than \$250. In addition, each loan is assigned a credit risk rating based upon the underwriting standards. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses, and risks in a particular relationship.

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

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

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

Credit Quality	2007	2006	2005
Acceptable & OAEM	99.23%	99.83%	99.42%
Substandard	.77%	.17%	.58%
Doubtful	–%	–%	–%
Loss	–%	–%	–%
Total	100.00%	100.00%	100.00%

#### Nonperforming Assets

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

High-risk Assets	December 31,		
	2007	2006	2005
	<i>(dollars in thousands)</i>		
Nonaccrual loans	\$ 2,136	\$ 102	\$ 131
Restructured loans	3,494	354	362
Accruing loans 90 days past due	–	126	–
Total high-risk loans	–	582	493
Other property owned	–	7	7
Total high-risk assets	\$ 5,630	\$ 589	\$ 500
<b>Ratios</b>			
Nonaccrual loans to total loans	.5%	.02%	.03%
High-risk assets to total assets	1.0%	.09%	.09%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or future interest accruals, under the contractual terms of the loan. In substance, nonaccrual loans reflect loans where the accrual of interest has been suspended. Nonaccrual loans increased \$2,034 or over 1900 percent in 2007. This increase resulted from one large loan transferred to nonaccrual during the year. The loan is well collateralized and management does not expect a significant loss in relation to this loan. Of the \$2,136 in nonaccrual volume at

December 31, 2007, \$95 or 4.4%, compared to 100.00% at December 31, 2006 and 2005 was current as to scheduled principal and interest payments, but did not meet all regulatory requirements to be transferred into accrual status.

Loan restructuring is available to financially distressed borrowers. Restructuring of loans occurs when the Association grants a concession to a borrower based on either a court order or good faith in a borrower's ability to return to financial viability. The concessions can be in the form of a modification of terms or rates, a compromise of amounts owed, or deed in lieu of foreclosure. Other receipts of assets and/or equity to pay the loan in full or in part are also considered restructured loans. The type of alternative financing structure chosen is based on minimizing the loss incurred by both the Association and the borrower. Restructured loans increased \$3,140 or over 887 percent in 2007. This increase primarily resulted from restructuring one large loan during the year. The loan is adequately collateralized and management does not expect a significant loss in relation to this loan.

#### Allowance for Loan Losses

The allowance for loan losses at each period end was considered by Association management to be adequate to absorb probable losses existing in and inherent to its loan portfolio.

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

Allowance for Loan Losses Activity:	Year Ended December 31,		
	2007	2006	2005
	<i>(dollars in thousands)</i>		
Balance at beginning of year	\$ 427	\$ 844	\$ 843
Charge-offs:			
Real estate mortgage	–	(1)	(5)
Total charge-offs	–	(1)	(5)
Recoveries:			
Real estate mortgage	2	2	5
Total recoveries	2	2	5
Net (charge-offs) recoveries	2	1	–
Provision for (reversal of allowance for) loan losses	91	(418)	1
Balance at end of year	\$ 520	\$ 427	\$ 844
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	–%	–%	–%

The net loan recoveries were primarily associated with payments in the normal course of business.

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,		
	2007	2006	2005
	<i>(dollars in thousands)</i>		
Real estate mortgage	\$ 264	\$ 221	\$ 456
Production and intermediate-term	191	140	217
Agribusiness	56	58	150
Communication	–	–	1
Energy	1	1	1
Rural residential real estate	8	7	19
Total allowance	\$ 520	\$ 427	\$ 844

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

Allowance for Loan Losses as a Percentage of:	December 31,		
	2007	2006	2005
Total loans	.13%	.09%	.19%
Nonperforming loans	9.2%	73.37%	171.20%
Nonaccrual loans	24.3%	418.63%	644.27%

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," of the Notes to the Consolidated Financial Statements, for further information concerning the allowance for loan losses.

## RESULTS OF OPERATIONS

### Net Interest Income

Net interest income was \$11.81 million, \$12.58 million and \$11.44 million in 2007, 2006 and 2005, respectively. Net interest income is the difference between interest income and interest expense. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets and cost of debt. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following table:

#### Change in Net Interest Income:

	Volume*	Rate	Nonaccrual Income	Total
<b>12/31/07 - 12/31/06</b>				
Interest income	\$ (1,173)	\$ 782	\$ 40	\$ (351)
Interest expense	(611)	1,028	-	417
Change in net interest income	\$ (562)	\$ (246)	\$ 40	\$ (768)
<b>12/31/06 - 12/31/05</b>				
Interest income	\$ 9,208	\$ 4,541	\$ -	\$ 13,749
Interest expense	6,254	6,362	-	12,616
Change in net interest income	\$ 2,954	\$ (1,821)	\$ -	\$ 1,133

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

### Noninterest Income

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

Noninterest Income	For the Year Ended			Percentage	
	December 31,			2007/	2006/
	2007	2006	2005	2006	2005
<i>(dollars in thousands)</i>					
Loan fees	\$ 1,194	\$ 1,734	\$ 950	(31.14)%	82.53%
Fees for financially related services	11	12	11	(8.33)	9.09
Patronage refund from other Farm Credit Institutions	7,326	5,780	4,622	26.75	25.05
Gains (losses) on sales of rural home loans	97	96	129	1.04	(25.58)
Gains (losses) on sales of premises and equipment, net	(6)	1	(1)	(500.00)	(200.00)
Other noninterest income	45	89	94	(49.44)	(5.32)
Total noninterest income	\$ 8,667	\$ 7,712	\$ 5,805	12.38%	32.8%

### Noninterest Expense

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

Noninterest Expense	For the Year Ended			Percentage	
	December 31,			2007/	2006/
	2007	2006	2005	2006	2005
<i>(dollars in thousands)</i>					
Salaries and employee benefits	\$ 4,602	\$ 4,059	\$ 4,002	13.38%	1.42%
Occupancy and equipment	459	467	489	(1.71)	(4.50)
Insurance Fund premiums	616	620	181	(2.60)	242.54
Other operating expenses	2,061	1,960	1,720	5.15	13.95
Total noninterest expense	\$ 7,738	\$ 7,106	\$ 6,392	8.89%	11.17%

Salaries and employee benefits increased in 2007, as compared with 2006, primarily due to increased costs associated with employee benefit plans, merit and incentive compensation, and employee staffing levels. Noninterest expense increased \$632 or 8.89 percent for December 31, 2007, as compared to the same period of 2006 and increased \$714 or 11.17 percent compared to December 31, 2005. The increase in Insurance fund premium in 2006 of \$439 or 242.54% was due to increase in premium in 2006 to 15 basis points compared to 5 basis points in 2005, along with increased loan volume.

### Income Taxes

The Association recorded a benefit for income taxes of \$14 for the year ended December 31, 2007, as compared to a benefit of \$1 for 2006 and a provision of \$21 for 2005.

### Key Results of Operations Comparisons

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

Key Results of Operations Comparisons	For the 12 Months Ended		
	12/31/07	12/31/06	12/31/05
Return on average assets	2.13%	2.27%	2.38%
Return on average members' equity	18.18%	21.57%	18.44%
Net interest income as a percentage of average earning assets	2.10%	2.18%	2.61%
Net charge-offs (recoveries) to average loans	-%	-%	-%

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

## LIQUIDITY AND FUNDING SOURCES

### Liquidity and Funding

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement (GFA). The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw

funds. The Bank advances the funds to the Association, creating notes payable (or direct loans) to the Bank. The Bank manages interest rate risk through direct loan pricing and asset/liability management. The notes payable are segmented into variable rate and fixed rate components. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. Association capital levels effectively create a borrowing margin between the amount of loans outstanding and the amount of notes payable outstanding. This margin is commonly referred to as "Loanable Funds."

Liquidity management is the process whereby funds are made available to meet all financial commitments including the extension of credit, payment of operating expenses and payment of debt obligations. The Association receives access to funds through its borrowing relationship with the Bank and from income generated by operations. The liquidity policy of the Association is to manage cash balances to maximize debt reduction and to increase loan volume. As borrower payments are received, they are applied to the Association's note payable to the Bank. The Association's participation in the Farmer Mac, investments, and other secondary market programs provides additional liquidity. Sufficient liquid funds have been available to meet all financial obligations. There are no known trends likely to result in a liquidity deficiency for the Association.

Total notes payable to the Bank at December 31, 2007, was \$462,596 as compared to \$547,249 at December 31, 2006 and \$465,789 at December 31, 2005. The decrease of 15.47 percent compared to December 31, 2006 was primarily attributed to the \$29 million divestiture of USDA assets early in 2007 and the sale of loan assets to the AgFirst capital participation pool while the increase of 17.49 percent compared to December 31, 2005, was attributable to continued loan growth in the Association. The average volume of outstanding notes payable to the Bank was \$518,701 and \$529,395 for the years ended December 31, 2007 and 2006, respectively. Refer to Note 8, "Notes Payable to AgFirst Farm Credit Bank," of the Notes to the Consolidated Financial Statements, for weighted average interest rates and maturities, and additional information concerning the Association's notes payable.

The Association had no lines of credit from third party financial institutions as of December 31, 2007.

#### *Funds Management*

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

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

are priced based on the current cost of System debt of similar terms to maturity.

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

#### **CAPITAL RESOURCES**

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

The Association Board of Directors establishes, adopts, and maintains a formal written capital adequacy plan to ensure that adequate capital is maintained for continued financial viability, to provide for growth necessary to meet the needs of members/borrowers, and to ensure that all stockholders are treated equitably. There were no material changes to the capital plan for 2007 that would affect minimum stock purchases or would have an effect on the Association's ability to retire stock and distribute earnings.

Total members' equity at December 31, 2007, increased 9.7 percent to \$72,947 from the December 31, 2006, total of \$66,497. At December 31, 2006, total members' equity increased 8.15 percent from the December 31, 2005 total of \$61,487. The increase was primarily attributed to net income partially offset by patronage and the retirement of equities for those years.

Total capital stock and participation certificates were \$1,523 on December 31, 2007, compared to \$1,543 on December 31, 2006 and \$1,606 on December 31, 2005. 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.

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

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

	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>Regulatory Minimum</b>
Permanent capital ratio	12.37%	12.42%	13.04%	7.00%
Total surplus ratio	12.08%	12.16%	12.77%	7.00%
Core surplus ratio	10.20%	10.39%	10.54%	3.50%

The decrease in the Association's permanent capital, total surplus, and core surplus for December 31, 2007 and December 31, 2006 was attributed to an increase in the risk adjusted asset base. There are no trends, commitments, contingencies, or events that are likely to affect the Association's ability to meet regulatory minimum capital standards and capital adequacy requirements.

See Note 9, "Members' Equity," of the Consolidated Financial Statements, for further information concerning capital resources.

**PATRONAGE PROGRAM**

Prior to the beginning of any fiscal year, the Association's Board of Directors, by adoption of a resolution, may establish a Patronage Allocation Program to distribute its available consolidated net earnings. This resolution provides for the application of net earnings in the manner described in the Association's Bylaws. This includes the setting aside of funds to increase surplus to meet minimum capital adequacy standards established by FCA Regulations, to increase surplus to meet Association capital adequacy standards to a level necessary to support competitive pricing at targeted earnings levels, and for reasonable reserves for necessary purposes of the Association. After excluding net earnings attributable to (a) the portion of loans participated to another institution, and (b) participation loans purchased, remaining consolidated net earnings are eligible for allocation to borrowers. Refer to Note 9, "Members' Equity," of the Notes to the Consolidated Financial Statements, for more information concerning the patronage distributions. The Association declared patronage distributions of \$5,875 in 2007, \$8,450 in 2006, and \$7,916 in 2005.

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

The Association's mission is to provide financial services to agriculture and the rural community, which includes providing credit to young\*, beginning\*\* and small\*\*\* farmers. Because of the unique needs of these individuals, and their importance to the future growth of the Association, the Association has established annual marketing goals to increase our market share of loans to YBS farmers. Specific marketing plans have been developed to target these groups, and resources have been designated to help ensure YBS borrowers have access to a stable source of credit. As a result, 2007 goals were established and met.

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

	As of December 31, 2007	
	Number of Loans	Amount of Loans
Young	215	\$ 42,392
Beginning	531	110,235
Small	1,019	115,926

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

The 2002 USDA (2002 is the latest USDA Ag census data available; next census will be available in 2008.) Ag census data has been used as a benchmark to measure penetration of the Association's marketing efforts. The census data indicated that within the Association's chartered territory (counties) there were 4,585 reported farmers of which by definition 173 or 3.77 percent were Young, 1,356 or 29.57 percent were Beginning, and 4,057 or 88.48 percent were Small. Comparatively, as of December 31, 2007, the demographics of the Association's agricultural portfolio contained 2,082 farmers, of which by definition 215 or 10.33 percent were Young, 531 or 25.50 percent were Beginning and 1,019 or 48.94 percent were Small.

In addition to our marketing strategies, in 2007 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.

**2007 Activities**

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

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

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

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

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

- \* **Young farmers** are defined as those farmers, ranchers, producers or harvesters of aquatic products who are age 35 or younger as of the date the loan is originally made.
- \*\* **Beginning farmers** are defined as those farmers, ranchers, producers or harvesters of aquatic products who have 10 years or less farming or ranching experience as of the date the loan is originally made.
- \*\*\* **Small farmers** are defined as those farmers, ranchers, producers or harvesters of aquatic products who normally generate less than \$250 in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

## REGULATORY MATTERS

### *Proposed Federal Legislation*

The current Farm Bill expired on September 30, 2007. In July 2007, the House of Representatives passed its version of a new Farm Bill, the Farm, Nutrition, and Bioenergy Act of 2007. Under the Farm Bill as passed by the House of Representatives, the Congressional Budget Office estimated that payments to farmers under the commodity programs (i.e., direct and countercycle payments and loan deficiency payments) would be reduced by an estimated \$825 million in total over the next 10 years, as compared with a current services baseline of approximately \$75 billion for commodities. However, the specific provisions of the Farm Bill may increase payments for certain commodities or increase them in certain years and reduce them in others. This Farm Bill would also revise certain income payment limitations.

The Farm Bill as passed by the House of Representatives also contains provisions that would expand certain authorities of the Farm Credit System Insurance Corporation. The proposed changes generally would authorize the Insurance Corporation to collect higher levels of premiums and expand the base upon which premiums are charged. Premiums of up to 20 basis points could be charged against insured debt, adjusted to exclude an amount equal to government-guaranteed loans and investment securities. Up to an additional 10 basis points could be charged for any loan volume that is nonaccrual or investments that are other-than-temporarily impaired. Currently, premiums of up to 15 basis points may be charged on accruing loans and up to 25 basis points on nonaccrual loans.

In December 2007, the Senate passed its version of the Farm Bill, the Food and Energy Security Act of 2007. As reported, the bill proposes adjustments to current farm policy while maintaining the basic safety net structure of current law. The bill, when combined with tax provisions previously reported by the Senate Finance Committee, would provide for a permanent disaster fund and provide new incentives for farmers to engage in soil conservation activities. Before these changes are enacted into law, the Senate must conference their actions with the bill earlier approved by the House. It is premature to predict the final outcome of this process. The Senate Farm Bill contains the same expanded authorities with respect to the Insurance Corporation as noted above.

The Senate has named conferees. Conference Committee deliberation, however, awaits the naming of House conferees before it can move forward.

## RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109*" (FIN 48 or Interpretation) that was effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies how an enterprise should recognize, measure, present and disclose in its financial statements uncertain tax positions that the enterprise has taken or expects to take on a tax return. Under the Interpretation, the financial statements reflect expected future tax consequences of income tax positions presuming the relevant taxing authority's

full knowledge of the position and all relevant facts, but without considering time values. FIN 48 is applicable to all uncertain positions for taxes accounted for under FASB Statement No. 109. The Association adopted FIN 48 on January 1, 2007 and determined that interest and penalties would be classified as a component of income taxes.

There were no uncertain positions for income taxes at January 1, 2007 therefore no cumulative adjustment to beginning members' equity was required. The Association recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense. There were no uncertain tax positions identified related to the current year. The tax years that remain open for federal and major state income tax jurisdictions are 2004 and forward

In September 2006, the FASB also issued Statement of Financial Accounting Standards No. 157, "*Fair Value Measurements*." This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. As a result, there is now a common definition of fair value to be used throughout generally accepted accounting principles. The FASB believes that the new standard will make the measurement of fair value more consistent and comparable and improve disclosures about those measures. This Statement clarifies that the term fair value is intended to mean a market-based measure, not an entity-specific measure. In measuring fair value for a financial statement item, the Statement sets forth a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The highest priority is given to quoted prices in active markets and the lowest priority to unobservable inputs. Additional disclosure requirements will be required for the lowest priority level. The Statement became effective as of January 1, 2008, and will be applied to our consolidated financial statements on a prospective basis.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "*Fair Value Option for Financial Assets and Financial Liabilities*." The Standard permits entities to choose on an instrument-by-instrument basis, at specified election dates, to measure financial assets and liabilities and certain other items at fair value (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected must be reported in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. This Standard became effective as of January 1, 2008. The Association has not made any elections under the fair value option, thus there will be no impact of the initial adoption of the Standard. However, the Association may elect to apply the fair value option to financial instruments acquired in future periods.

# *Disclosure Required by Farm Credit Administration Regulations*

## Description of Business

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

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

## Description of Property

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

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

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

\*\* The Leesburg outpost is leased by the Association on a year-by-year basis. Lease payments are \$350 per month.

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

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

## Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 14 of the Consolidated Financial Statements, “*Commitments and Contingencies*,” included in this Annual Report.

## Description of Capital Structure

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

## Description of Liabilities

The description of liabilities, contingent liabilities and intrasystem financial assistance rights and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 8, 12 and 14 of the Consolidated Financial Statements included in this Annual Report.

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

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

## Senior Officers

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

<u>Senior Officer</u>	<u>Position</u>
Richard S. Monson	President/Chief Executive Officer
Larry J. Malone	Chief Lending Officer
Belinda Robertson	Chief Financial Officer

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

**Larry J. Malone, Chief Lending Officer:** The business experience for the past five years for Larry J. Malone is with the Farm Credit System. Mr. Malone has been with the Farm Credit System since October 1978.

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

The total amount of compensation earned by the CEO and the highest paid officers as a group during the years ended December 31, 2007, 2006 and 2005, is as follows:

Name of Individual or Number in Group	Year	Annual		Deferred/Comp.	Perq./Other	Total
		Salary	Bonus			
Richard S. Monson	2007	\$228,289	\$ 64,375	-	\$ 5,936	\$298,600
Richard S. Monson	2006*	\$193,482	\$ 74,199	-	\$ 2,928	\$270,609
Richard S. Monson	2005	\$176,971	\$ 60,170	-	-	\$237,141
6	2007	\$558,368	\$160,129	-	\$31,351	\$749,848
6	2006*	\$478,896	\$330,001	-	\$ 1,972	\$810,869
5	2005	\$477,392	\$196,303	-	-	\$673,695

\* Beginning with year-end 2006, CEO compensation must be disclosed as a separate line item and is not included in the aggregate amount. The CEO salary is included in the aggregate amount for 2005 as well as listed as a separate line item. The aggregate amounts shown above include the top highest paid officers and/or senior officers as a group.

Regulatory reporting changes have affected the content of the compensation reported for 2006 and those changes may not be reflected in the 2005 amounts.

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 achieving or exceeding a net income goal as set by management and approved by the Board.

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

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

The Board of Directors approved this Employee Profit Sharing Plan January 31, 2007, effective January 1, 2007.

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 January 31, 2007, effective as of January 1, 2007.

The Associations 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 six 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 six other categories are: (1) Guaranteed Loans, (2) Rural Home Loans closed, (3) Participation/Lease Origination, (4) Leases, (5) Charge-Offs and (6) AutoDraft/Online Payments. Each goal is assigned a separate rate of compensation and is aggregated for a total payment. However no award will be paid unless the new loan sales volume minimum requirement is exceeded as set by management. The minimum requirement is less than the actual new loan sales volume goal. Additionally, payments from the Employee Profit Sharing Plan will not be paid to the officer until he/she meets or exceeds their new loan volume goal set by management.

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

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

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 January 31, 2007, effective as of January 1, 2007.

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

The board approved the Country Home Mortgage incentive plan January 31, 2007, effective January 1, 2007.

Disclosure of information on the total compensation paid during 2007 to any senior officer, or to any other individual included in the total, is available to shareholders upon request.

**Directors**

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

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was \$68,038 for 2007, \$64,032 for 2006, and \$61,635 for 2005.

Subject to approval by the board, the Association may allow directors honoraria of \$400 for attendance at meetings, committee meetings, or special assignments and \$100 honoraria for participation in teleconference calls. In addition, directors on the Executive Committee (Chairman and Vice Chairman) receive a quarterly fee up to \$150 for incidental services. Expenses incurred in connection with the attendance of the spouse of a director at a compensable function may be reimbursable upon a determination by the board chairman that the attendance of the spouse was or will be beneficial to the purpose of the meeting, and such reimbursement will not be reported as compensation. Total compensation paid to directors, as a group was \$136,800.

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

**Bobby J. Brooks**, Chairman, is a peanut and cotton farmer. He is presently serving a three-year term, which will expire in 2009. During 2007 he served 12 days at association board meetings, 11 days at Executive Committee meetings, and 16 days in other official activities and was paid \$16,200. 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 2007, he served 12 days at association board meetings, 12 days at Executive Committee meetings and 12 days in other official activities and was paid \$15,000.

**T. E. Allen, III** is a peanut and cotton farmer. He is presently serving a three-year term, which will expire in 2009. During 2007, he served 11 days at association board meetings, 2 days at Building Committee meetings, 7 days at Compensation Committee meetings, 5 days at RIMCO (Risk Management Committee) meetings and 13 days in other official activities and was paid \$14,600. Mr. Allen also serves on the boards of Quality Gin, a cotton gin; People's Warehouse, a warehouse facility and First United Ethanol, LLC a facility that produces and sells ethanol.

**Jeffrey A. Clark** is a Professor of Finance at Florida State University. He was appointed as an association outside director. He is serving a three-year term, which will expire in 2008. During 2007, Mr. Clark served 12 days at association board meetings, 14 days at Audit Committee meetings, 2 days at Special Loan Committee meetings and 10 days in other official activities and was paid \$13,700.

**Clifford Dollar, Jr.** is a peanut, cotton and cattle farmer. He is presently serving a three-year term, which will expire in 2009. During 2007, he served 12 days at association board meetings, 2 days at Building Committee meetings, 4 days at Special Loan Committee meetings and 13 days in other official activities and was paid \$11,800. Mr. Dollar also serves as Board President of Sowege 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 2007, he served 12 days at association board meetings, 4 days at Audit Committee meetings, 6 days at Compensation Committee meetings and 13 days in other official activities and was paid \$13,100. Mr. Fendley also serves on the boards of Clay County Farm Bureau; an insurance and farm related services provider and 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 2010. During 2007, he served 12 days at association board meetings, 2 days at Building Committee meetings, 7 days at Compensation Committee meetings, 5 days at RIMCO meetings and 6 days in other official activities and was paid \$12,200. Mr. Holden also serves on the boards of the Grady County Farm Bureau; an insurance and farm related services provider, AgFirst Farm Credit Bank; an association owned district agriculture cooperative discount and member services bank, as Board Vice-President of Georgia Milk Producers Association; an organization for promoting milk and other interest of Georgia Dairymen, American Dairy Association of Georgia; an organization for committed to promoting milk and consumer education and First United Ethanol, LLC; a facility that produces and sells ethanol.

**Robert B. Moss** was reappointed as an association outside director. He is presently serving a three-year term, which will expire in 2010. During 2007, Mr. Moss served 12 days at association board meetings, 4 days at Audit Committee meetings, 1 day at Building Committee meeting, 4 days at RIMCO meetings, 2 days at Special Loan Committee meetings and 12 days in other official activities and was paid \$12,500. Mr. Moss is a retired Superintendent of the University of Georgia College of Agricultural and Environmental Sciences, Southwest Georgia Branch Experiment Station, Plains, Georgia. Mr. Moss served as a part-time coordinator of the Georgia Branch Experiment Station for five years. Currently Mr. Moss is a part-time farm management consultant. Mr. Moss is a member of the Plains Lions Club; a civic organization and Director of the Plains Better Home Town Board; an organization committed to local improvement for future growth.

**T. E. Moyer, Jr.** is a cotton, peanut and cattle farmer. He is presently serving a three-year term, which will expire in 2010. During 2007, Mr. Moyer served 11 days at association board meetings, 6 days at Audit Committee meetings, 2 days at Building Committee meetings, 7 days at Compensation Committee meetings, 1 day at RIMCO meeting and 12 days in other official activities and was paid \$15,000. Mr. Moyer serves as Board President of the Baker County Farm Bureau; an insurance and farm related services provider. He also serves as Chairman of the Baker County Board of Commissioners; a county government.

**B. E. Powell** is a farmer. He is presently serving a three-year term, which will expire in 2010. During 2007, he served 12 days at association board meetings, 10 days at Audit Committee

meetings and 12 days in other official activities and was paid \$12,700. 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 of the Consolidated Financial Statements, “Related Party Transactions,” included in this Annual Report. There have been no transactions between the Association and senior officers or directors which require reporting per FCA regulations.

**Involvement in Certain Legal Proceedings**

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

**Relationship with Independent Auditors and Other Qualified Public Accountants**

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

Aggregate fees incurred by the Association for services rendered by its independent auditors and other qualified public accountants for the year ended December 31, 2007 were as follows:

	<u>2007</u>
<b>Independent Auditor</b>	
PricewaterhouseCoopers LLP	
Audit services	\$ 67,152
<b>Qualified Public Accountant</b>	
Harper, Rains, Knight & Company	
Nonaudit services	92,391
Tax services	<u>14,950</u>
Total	<u>\$ 174,493</u>

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

Nonaudit fees were for Quarterly Internal Credit Review, Internal Operations Review, Sarbanes-Oxley and Spreadsheet Testing.

All nonaudit service fees incurred by the Association were approved by the Audit Committee.

**Consolidated Financial Statements**

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated February 28, 2008 and the report of management, which appear in this Annual Report are incorporated herein by reference.

Copies of the Association’s Annual and Quarterly reports are available upon request free of charge by calling 1-229-246-8032

or 1-800-844-2615, or writing Southwest Georgia Farm Credit, ACA, P. O. Box 790, Bainbridge, Georgia 39818-0790, Attention: Chief Financial Officer, or accessing the website, [www.swgafarmcredit.com](http://www.swgafarmcredit.com). The Association prepares an electronic version of the Annual Report which is available on the Association’s web site within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

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. The implementation of these measures ensures that new and existing borrowers are aware of the privacy protections afforded them through FCA regulations and Farm Credit System institution efforts.

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

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

**Shareholder Investment**

Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank (Bank or AgFirst). Copies of the Bank’s Annual and Quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Stephen Gilbert, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst’s web site at [www.agfirst.com](http://www.agfirst.com). The Bank prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Bank prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Bank.

## *Report of the Audit Committee*

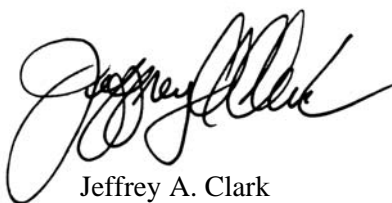
The Audit Committee of the Board of Directors (Committee) is comprised of the directors named below. None of the directors who serve on the Committee is an employee of Southwest Georgia Farm Credit (Association) and in the opinion of the Board of Directors, each is free of any relationship with the Association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

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

PricewaterhouseCoopers LLP (PwC), the Association's independent auditor for 2007, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 114 (*The Auditor's Communication With Those Charged With Governance*). PwC has provided to the Committee the written disclosures and the letter required by Independence Standards Board Standard No. 1 (*Independence Discussions with Audit Committees*), and the Committee has discussed with PwC that firm's independence.

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

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



Jeffrey A. Clark  
Chairman of the Audit Committee

### **Members of the Audit Committee**

T. E. Moye, Jr.  
Billy E. Powell

February 28, 2008

# 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, 2007, 2006 and 2005, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

*PricewaterhouseCoopers* LLP

February 28, 2008









# Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

## Note 1 — Organization and Operations

A. **Organization:** Southwest Georgia Farm Credit, ACA (the Association or ACA) is a member-owned cooperative which provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified purposes in the counties of Baker, Calhoun, Chattahoochee, Clay, Decatur, Dougherty, Early, Grady, Lee, Marion, Miller, Mitchell, Quitman, Randolph, Schley, Seminole, Stewart, Sumter, Terrell, Thomas, and Webster in the state of Georgia.

The Association is a lending institution of the Farm Credit System (System), a nationwide system of cooperatively owned banks and associations, which was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (Farm Credit Act). The most recent significant amendment to the Farm Credit Act was the Agricultural Credit Act of 1987. At December 31, 2007, the System was comprised of four Farm Credit Banks, one Agricultural Credit Bank and ninety-four Associations.

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

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

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

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the

timely payment of principal and interest on Systemwide debt obligations (Insured debt), (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary uses by the Insurance Corporation to provide assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank is required to pay premiums, which may be passed on to the Association, into the Insurance Fund, based on its annual average loan principal outstanding until the monies in the Insurance Fund reach the "secure base amount." The secure base amount is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (Systemwide debt obligations) or such other percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums, but it still must ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

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

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

## Note 2 — Summary of Significant Accounting Policies

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

Certain amounts in prior years' financial statements have been reclassified to conform to the current year's presentation. Such reclassifications had no effect on net income or total members'

equity of prior years. The Consolidated Financial Statements include the accounts of the FLCA and the PCA. All significant inter-company transactions have been eliminated in consolidation.

- A. **Cash:** Cash, as included in the statements of cash flows, represents cash on hand and on deposit at banks.
- B. **Investment Securities:** The Association, as permitted under the FCA regulations, holds investments for purposes of maintaining a liquidity reserve, managing short-term surplus funds and managing interest rate risk. The Association's investments are classified as held-to-maturity and accordingly have been reported at amortized cost. Purchased premiums and discounts are amortized or accreted ratably over the term of the respective security.

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

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

- C. **Loans and Allowance for Loan Losses:** Long-term real estate mortgage loans generally have original maturities ranging from 5 to 40 years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less. Loans are carried at their principal amount outstanding less unearned income. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding.

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

When loans are in nonaccrual status, the interest portion of payments received in cash is recognized as interest income if collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it. Otherwise, loan payments are applied against the recorded investment in the loan.

Nonaccrual loans may be returned to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected and the loan is not classified "doubtful" or "loss."

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

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

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

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

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

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

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

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

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

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

E. **Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** The Association is required to maintain ownership in the Bank in the form of Class B and Class C stock. Accounting for this investment is on the cost plus allocated equities basis. Patronage refunds from the Bank are accrued as earned. The receivable for such patronage refunds is classified as due from AgFirst Farm Credit Bank.

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

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

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

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

Substantially all employees of the Association may also be eligible to participate in 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 contributes \$.50 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. For employees hired on or after January 1, 2003, the Association contributes \$1.00 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service. 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.

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

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

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

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

L. **Recently Issued Accounting Pronouncements:** In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109" (FIN 48 or Interpretation) that was effective for fiscal years beginning after December 15,

2006. FIN 48 clarifies how an enterprise should recognize, measure, present and disclose in its financial statements uncertain tax positions that the enterprise has taken or expects to take on a tax return. Under the Interpretation, the financial statements reflect expected future tax consequences of income tax positions presuming the relevant taxing authority's full knowledge of the position and all relevant facts, but without considering time values. FIN 48 is applicable to all uncertain positions for taxes accounted for under FASB Statement No. 109. The Association adopted FIN 48 on January 1, 2007 and determined that interest and penalties would be classified as a component of income taxes.

There were no uncertain positions for income taxes at January 1, 2007 identified as a result of the adoption and therefore no cumulative adjustment to beginning members' equity was required. The tax years that remain open for federal and major state income tax jurisdictions are 2004 and forward.

In September 2006, the FASB also issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements." This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. As a result, there is now a common definition of fair value to be used throughout generally accepted accounting principles. The FASB believes that the new standard will make the measurement of fair value more consistent and comparable and improve disclosures about those measures. This Statement clarifies that the term fair value is intended to mean a market-based measure, not an entity-specific measure. In measuring fair value for a financial statement item, the Statement sets forth a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The highest priority is given to quoted prices in active markets and the lowest priority to unobservable inputs. Additional disclosure requirements will be required for the lowest priority level. The Statement became effective as of January 1, 2008, and will be applied to the Association's Consolidated Financial Statements on a prospective basis.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "Fair Value Option for Financial Assets and Financial Liabilities." The Standard permits entities to choose on an instrument-by-instrument basis, at specified election dates, to measure financial assets and liabilities and certain other items at fair value (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected must be reported in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. This Standard became effective as of January 1, 2008. The Association has not made any elections under the fair value option, thus there will be no impact of the initial adoption of the Standard. However, the Association may elect to apply the fair value option to financial instruments acquired in future periods.

### Note 3 — Investment Securities

A summary of the amortized cost and fair value of investment securities held-to-maturity at December 31, 2007, 2006 and 2005 follows:

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

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

	December 31, 2005				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Asset backed securities	\$ —	\$ —	\$ —	\$ —	—%
Other	—	—	—	—	—
Total	\$ —	\$ —	\$ —	\$ —	—%

The Association's investments consist primarily of asset-backed securities (ABSs). These ABSs are rated AAA, as they are guaranteed by the full faith and credit of the United States government. All unrealized losses referenced above are related to changes in interest rates and are not credit related.

The following table shows the fair value and gross unrealized losses for investments in a loss position by the length of time the securities have been in a continuous unrealized loss position at December 31, 2007. The continuous loss position is based on the date the impairment occurred. The unrealized losses on these investments resulted from interest rate volatility and are not credit related. The Association expects to recover substantially all of our cost in these investments. Substantially all of these investments were in U. S. government securities and we expect that these securities would not be settled at a price less than their amortized cost. Because the decline in market value was caused by interest rate increases and not credit quality, and because the Association has the ability and intent to hold these investments to maturity, the Association has not recognized any other-than-temporary impairment in connection with these investments.

	Less than 12 Months		Greater than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Asset-backed securities	\$ 3	\$ —	\$ 34,333	\$ 89
Other	25	—	1,519	—
Total	\$ 28	\$ —	\$ 35,852	\$ 89

A summary of the expected maturity, amortized cost and estimated fair value of investment securities at December 31, 2007, follows:

	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	\$ 28	\$ 28	.33%
After one year through five years	2,151	2,145	5.03
After five years through ten years	12,429	12,416	5.36
After ten years	21,260	21,291	5.58
Total	\$ 35,868	\$ 35,880	5.47%

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

A summary of loans follows:

	December 31,		
	2007	2006	2005
Real estate mortgage	\$ 199,989	\$ 245,856	\$ 244,941
Production and intermediate term	144,185	156,002	115,676
Loans to cooperatives	993	1,152	2,124
Processing and marketing	19,780	18,389	17,907
Farm related business	21,783	47,255	63,374
Communication	—	—	334
Energy	913	897	626
Rural residential real estate	6,378	7,857	10,342
Total loans	\$ 394,021	\$ 477,408	\$ 455,324

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, 2007, 2006 and 2005 consisted of the following commodity types:

Commodity Type	December 31,		
	2007	2006	2005
Timber	27%	30%	26%
Landlords	14	15	14
Poultry	10	9	10
Cotton	7	8	8
Livestock	7	5	5
Peanuts	7	6	7
Fruit and Nut	5	3	3
Row Crops	2	1	3
Rural Home	2	1	2
Vegetables	2	3	2
Dairy	1	1	1
Horticulture	1	1	1
Other	15	17	18
Total	100%	100%	100%

The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but typically includes farmland and income-producing property, such as crops and livestock, as well as receivables. Long-term real estate loans are collateralized by the first liens on the

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

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,		
	2007	2006	2005
Nonaccrual loans:			
Current as to principal and interest	\$ 95	\$ 102	\$ 131
Past due	2,041	—	—
Total nonaccrual loans	2,136	102	131
Impaired accrual loans:			
Restructured accrual loans	3,494	354	362
Accrual loans 90 days or more past due	—	126	—
Total impaired accrual loans	3,494	480	362
Total impaired loans	\$5,630	\$ 582	\$ 493

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2007.

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,		
	2007	2006	2005
Interest income recognized on nonaccrual loans	\$ 41	\$ —	\$ 1
Interest income on impaired accrual loans	138	31	119
Interest income recognized on impaired loans	\$ 179	\$ 31	\$ 120

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

	2007	2006	2005
	Impaired loans with related allowance	\$ 223	\$ —
Impaired loans with no related allowance	5,407	582	493
Total impaired loans	\$ 5,630	\$ 582	\$ 493
Allowance on impaired loans	\$ 20	\$ —	\$ —

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

	2007	2006	2005
	Average impaired loans	\$ 2,129	\$ 447

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

	<b>Year Ended December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Interest income which would have been recognized under the original loan terms	\$ 93	\$ 20	\$ 21
Less: interest income recognized	41	-	1
Foregone interest income	<u>\$ 52</u>	<u>\$ 20</u>	<u>\$ 20</u>

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

	<b>Year Ended December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Balance at beginning of year	\$ 427	\$ 844	\$ 843
Charge-offs:			
Real estate mortgage	-	(1)	(5)
Total charge-offs	<u>-</u>	<u>(1)</u>	<u>(5)</u>
Recoveries:			
Real estate mortgage	2	2	5
Total recoveries	<u>2</u>	<u>2</u>	<u>5</u>
Net (charge-offs) recoveries	<u>2</u>	<u>1</u>	<u>0</u>
Provision for (reversal of allowance for) loan losses	91	(418)	1
Balance at end of year	<u>\$ 520</u>	<u>\$ 427</u>	<u>\$ 844</u>
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	<u>-%</u>	<u>-%</u>	<u>-%</u>

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

	<b>December 31, 2007</b>		<b>December 31, 2006</b>	
	<b>Amount</b>	<b>%</b>	<b>Amount</b>	<b>%</b>
Real estate mortgage	\$ 264	50.8%	\$ 221	51.7%
Production and intermediate term	191	36.6	140	32.8
Agribusiness	56	10.8	58	13.6
Communication	-	-	-	-
Energy	1	0.2	1	0.2
Rural residential real estate	8	1.6	7	1.7
Total	<u>\$ 520</u>	<u>100.0%</u>	<u>\$ 427</u>	<u>100.0%</u>

	<b>December 31, 2005</b>	
	<b>Amount</b>	<b>%</b>
Real estate mortgage	\$ 456	54.0%
Production and intermediate term	217	25.7
Agribusiness	150	17.8
Communication	1	0.1
Energy	1	0.1
Rural residential real estate	19	2.3
Total	<u>\$ 844</u>	<u>100.0%</u>

**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 years ended December 31, 2007, 2006 and 2005, the Association held Tobacco Buyout SIIC of \$78,342, \$84,426 and \$58,851, respectively, 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:

	<b>December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Land	\$ 748	\$ 746	\$ 372
Buildings and improvements	1,631	1,556	1,556
Furniture and equipment	796	785	824
	<u>3,175</u>	<u>3,087</u>	<u>2,752</u>
Less: accumulated depreciation	1,819	1,774	1,704
Total	<u>\$ 1,356</u>	<u>\$ 1,313</u>	<u>\$ 1,048</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 5.81 percent for LIBOR-based loans, 5.74 percent for Prime-based loans, and the weighted average remaining maturities were 3.9 years and 4.6 years, respectively, at December 31, 2007. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) loans which are match funded by the Bank was 5.64 percent and the weighted average remaining maturity was 6.7 years at December 31, 2007. The weighted average interest rate on all interest-bearing notes payable was 5.70 percent and the weighted average remaining maturity was 5.6 years at December 31, 2007.

Variable rate and fixed rate notes payable represent approximately 27.32 percent and 72.68 percent, respectively, of total notes payable at December 31, 2007.

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, 2007, 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, 2007 were 12.37 percent, 12.08 percent and 10.20 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, 2007:

Class	Protected	Shares Outstanding	
		Number	Aggregate Par Value
A Common/Nonvoting	No	76	\$ —
B Common/Nonvoting	Yes	68,738	344
C Common/Voting	No	213,606	1,068
B Participation Certificates/Nonvoting	Yes	1,759	9
C Participation Certificates/Nonvoting	No	20,493	102
Total Capital Stock and Participation Certificates		304,672	\$ 1,523

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

*Retained Earnings*

The Association maintains an unallocated retained earnings account and an allocated retained earnings account. The minimum aggregate amount of these two accounts is determined by the Board. At the end of any fiscal year, if the retained earnings accounts otherwise would be less than the minimum amount determined by the Board as necessary to maintain adequate capital reserves to meet the commitments of the Association, the Association shall apply earnings for the year to the unallocated retained earnings account in such

amounts as may be determined necessary by the Board. 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, 2007, allocated members' equity consisted of \$17,407 of nonqualified allocated surplus and \$9,708 of nonqualified retained surplus.

#### *Patronage Distributions*

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

If the Association meets its capital adequacy standards after making the patronage distributions, the patronage distributions may be in cash, authorized stock of the Association, allocations of earnings retained in an allocated members' equity account, or any one or more of such forms of distribution. Patronage distributions of the Association's earnings may be paid on either a qualified or nonqualified basis, or a combination of both, as determined by the Board. A minimum of 20 percent of the total qualified patronage distribution to any borrower for any fiscal year shall always be paid in cash. Amounts not distributed are retained as unallocated members' equity.

#### *Dividends*

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

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

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

#### *Transfer*

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

#### *Impairment*

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

1. Assistance preferred Stock
2. Allocated Retained Earnings in its entirety
3. Class C Common Stock and Class C Participation Certificates
4. Classes A and B Common Stock and Class B Participation Certificates
5. Classes A and D Preferred Stock

#### *Liquidation*

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

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

**Note 10 — Income Taxes**

The provision (benefit) for income taxes follows:

	<b>Year Ended December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Current:			
Federal	\$ 4	\$ (4)	\$ 9
State	2	(1)	3
	<u>6</u>	<u>(5)</u>	<u>12</u>
Deferred:			
Federal	(17)	3	8
State	(3)	1	1
	<u>(20)</u>	<u>4</u>	<u>9</u>
Total provision (benefit) for income taxes	<u>\$ (14)</u>	<u>\$ (1)</u>	<u>\$ 21</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:

	<b>December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Federal tax at statutory rate	\$ 4,299	\$ 4,624	\$ 3,691
State tax, net	-	-	2
Patronage distributions	(1,198)	(3,371)	(1,077)
Tax-exempt FLCA earnings	(3,189)	(1,352)	(2,562)
Change in valuation allowance	67	-	-
Other	7	98	(33)
Provision (benefit) for income taxes	<u>\$ (14)</u>	<u>\$ (1)</u>	<u>\$ 21</u>

Deferred tax assets and liabilities result from the following at:

	<b>December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Deferred income tax assets:			
Allowance for loan losses	\$ 103	\$ 44	\$ 159
Annual leave	-	-	54
Nonaccrual loan interest	-	-	8
Pensions and other postretirement benefits	355	220	295
Depreciation	25	26	57
Other	-	-	2
Gross deferred tax assets	<u>483</u>	<u>290</u>	<u>575</u>
Less: valuation allowance	<u>(67)</u>	<u>-</u>	<u>-</u>
Gross deferred tax assets, net of valuation allowance	<u>416</u>	<u>290</u>	<u>575</u>
Deferred income tax liabilities:			
Loan fees	(5)	(6)	(8)
Pensions and other postretirement benefits	(411)	(304)	(583)
Gross deferred tax liability	<u>(416)</u>	<u>(310)</u>	<u>(591)</u>
Net deferred tax asset (liability)	<u>\$ -</u>	<u>\$ (20)</u>	<u>\$ (16)</u>

At December 31, 2007, deferred income taxes have not been provided by the Association on approximately \$2.0 million of patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

The Association recorded a valuation allowance of \$67 during 2007. The Association will continue to evaluate the realizability of these deferred tax assets and adjust the valuation allowance accordingly.

The Association adopted the provisions of the Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," on January 1, 2007. As a result of the adoption, there were no uncertain positions for income taxes identified and therefore the Association recognized no change in the liability for unrecognized tax benefits and no reduction to the January 1, 2007 balance of retained earnings. The Association recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense. There were no uncertain tax positions identified related to the current year. The tax years that remain open for federal and major state income tax jurisdictions are 2004 and forward.

**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. As a participant in the District's defined benefit plan, the Association funded \$0 for 2007 and 2006, and \$554 for 2005, through its note payable to the Bank. Plan expenses included in salaries and employee benefits were \$355 for 2007, \$388 for 2006, and \$391 for 2005. Additional financial information for the Plan may be found in the District's Annual Report.

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. Employer contributions to this plan were \$119, \$88, and \$62 for the years ended December 31, 2007, 2006 and 2005, respectively.

The District sponsors a plan providing certain benefits (primarily health care) to its retirees. Certain Association charges related to this plan are an allocation of District charges based on the Association's proportional share of the plan liability. Postretirement benefits other than pensions (primarily health care benefits) included in salaries and employee benefits were \$125 for 2007, \$123 for 2006 and \$220 for 2005. Additional financial information for the Plan may be found in the District's Annual Report.

**Note 12 — Intra-System Financial Assistance**

The Farm Credit Act provided for capital assistance to System institutions experiencing severe financial stress through the issuance, prior to October 1, 1992, by the Financial Assistance Corporation of U.S. Treasury-guaranteed 15-year bonds, of which \$1.261 billion in principal amount was originally issued. The last remaining Financial Assistance Corporation bonds matured and were repaid on June 10, 2005.

Pursuant to the Farm Credit Act, the U.S. Treasury paid \$440 million, on behalf of the System, in interest costs on \$844 million of the Financial Assistance Corporation bonds issued for purposes other than funding Capital Preservation Agreement accruals. The Banks had irrevocably set aside funds, including interest earned, that totaled the \$440 million needed to repay the interest advanced by the U.S. Treasury. On June 10, 2005, the Banks repaid the U.S. Treasury the interest advanced. The Farm Credit Administrative Board cancelled the Financial Assistance Corporation's charter as of December 31, 2006.

**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, 2007 amounted to \$8,623. During 2007, \$4,934 of new loans were made and repayments totaled \$5,548. In the opinion of management, none of these loans outstanding at December 31, 2007 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, 2007, \$76,396 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 Consolidated Balance Sheets until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending

loans to borrowers and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. At December 31, 2007, the Association had outstanding \$5,448 of standby letters of credit, with expiration dates ranging from January 7, 2008 to April 2, 2012. The maximum potential amount of future payments the Association may be required to make under these existing guarantees is \$5,448.

A guarantor is required to recognize at the inception of a guarantee, a liability for the fair value of the guarantee commitment. The Association has determined the fair value of the guarantee commitment based upon the fees to be earned over the life of the guarantee. The fair value is updated periodically to reflect changes in individual guarantee amounts and the remaining life to maturity of the individual guarantees in the Association's inventory. At December 31, 2007, the Association's inventory of standby letters of credit had a fair value of \$80 and was included in other liabilities.

As of December 31, 2007, the Association had commitments to purchase \$248 in additional Tobacco Buyout SIIC in 2008.

During 2006, the Association agreed to become one of several investors in a USDA approved Rural Business Investments Company (RBIC). At December 31, 2007, there was an outstanding commitment of \$331 to make additional equity purchases.

**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, 2007, 2006 and 2005. 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, 2007		December 31, 2006	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>				
Cash	\$ 1,310	\$ 1,310	\$ 2,885	\$ 2,885
Loans	\$ 394,021	\$ 401,434	\$ 477,408	\$ 484,526
Allowance for loan losses	520	—	427	—
Loans, net	\$ 393,501	\$ 401,434	\$ 476,981	\$ 484,526
Investment securities	\$ 35,868	\$ 35,880	\$ 32,006	\$ 31,803
Tobacco Buyout SIIC	\$ 78,342	\$ 78,856	\$ 84,426	\$ 82,612
<b>Financial liabilities:</b>				
Notes payable to AgFirst Farm Credit Bank	\$ 462,596	\$ 472,188	\$ 547,249	\$ 549,214

	December 31, 2005	
	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>		
Cash	\$ 3,358	\$ 3,358
Loans	\$ 455,324	\$ 457,404
Allowance for loan losses	844	—
Loans, net	\$ 454,480	\$ 457,404
Investment securities	\$ —	\$ —
Tobacco Buyout SIIC	\$ 58,851	\$ 57,760
<b>Financial liabilities:</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 465,789	\$ 463,162

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

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

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

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

The carrying value of accrued interest approximates its fair value.

- C. **Investment Securities:** Fair value is based upon quoted market price.
- D. **Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** Estimating the fair value of the Association's investment in the Bank and Other Farm Credit Institutions is not practicable because the stock is not traded.

As described in Note 6, the net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying Consolidated Balance Sheets. The Association owns 6.50 percent of the issued stock of the Bank as of December 31, 2007 net of any reciprocal investment. As of that date, the Bank's assets totaled \$26.9 billion and shareholders' equity totaled \$1,457 million. The Bank's earnings were \$192 million during 2007.

In addition, the Association has an investment of \$1,072 related to other Farm Credit institutions.

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

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

Quarterly results of operations for the years ended December 31, 2007, 2006 and 2005 follow:

	2007				
	First	Second	Third	Fourth	Total
Net interest income	\$ 2,955	\$ 3,127	\$ 3,088	\$ 2,637	\$ 11,807
Provision for (reversal of allowance for) loan losses	—	—	91	—	91
Noninterest income (expense), net	(3)	(221)	5	1,162	943
Net income (loss)	\$ 2,952	\$ 2,906	\$ 3,002	\$ 3,799	\$ 12,659
	2006				
	First	Second	Third	Fourth	Total
Net interest income	\$ 3,037	\$ 3,227	\$ 3,373	\$ 2,938	\$ 12,575
Provision for (reversal of allowance for) loan losses	—	—	—	(418)	(418)
Noninterest income (expense), net	(377)	(151)	(171)	1,306	607
Net income (loss)	\$ 2,660	\$ 3,076	\$ 3,202	\$ 4,662	\$ 13,600
	2005				
	First	Second	Third	Fourth	Total
Net interest income	\$ 2,584	\$ 2,797	\$ 2,981	\$ 3,080	\$ 11,442
Provision for (reversal of allowance for) 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