

2010

Annual Report



JACKSON PURCHASE ACA

Lending Support for Generations

JACKSON PURCHASE AGRICULTURAL CREDIT ASSOCIATION

2010 ANNUAL REPORT

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Management

Stan Brunston	Chief Executive Officer
Stan Grief	Senior Vice President
Kevin Brown	Assistant Vice President
Barbara Davis.....	Chief Financial Officer

Board of Directors

Curtis Hancock, Jr.	Chairman
Joe Forrest Campbell	Vice Chairman
Darren Grogan.....	Director
Randall Heath.....	Director
Dr. Buddy Ray	Outside Director
Aaron Wilson	Director
Eddie Workman	Director

Message from the President

We at Jackson Purchase wish everyone a prosperous New Year. This past year has not been as good for our farm borrowers yield and earnings wise. The dry hot weather hampered corn and soybean yields yet as a whole our farm borrowers were still profitable thanks to crop insurance and increased prices for crops. Commodity prices for 2011 are very good at present and some are taking advantage of this with hedges and/or forward contracting. It will definitely cost more for inputs in 2011 with oil prices once again pushing the \$90 per barrel range. We are still expecting 2011 to be an exceptional earnings year for our farm borrowers with average yields.

It would appear the economy is improving based on an improving stock market. The unemployment rate is still at or above 9%. Many companies are showing good profits for year-end 2010. You have your economists who are predicting a great recovery by year-end 2011 and those who are predicting a doomsday scenario. Therefore, your guess would be as good as mine and we will just have to stick around to see which economist is right. I would say there is a better attitude among consumers at present and the country as a whole toward spending, savings, and debt reduction. Home prices in our territory are still very affordable especially with the current interest rate environment. Term rates are beginning to tick up a bit yet they are still very low and are expected to stay in the 5% range for most home borrowers in 2011. We are experiencing an increase in land prices. This is one area that is of a concern and is being watched closely by the Association. We do not need a return of huge increases in land values that gives all a false sense of security in the net worth area of the balance sheet. The best method of increasing equity is through debt reduction from earnings not through appreciation of land values.

The financial condition of the Association continues to be stable. Credit quality remains strong with Acceptable and OAEM classifications for 2010 at 95.98% as compared to 2009 at 95.22% and 98.35% in 2008. Nonaccrual accounts have decreased to approximately 1.4% of volume with year-end 2009 at 2.2% of volume. The Association did experience losses of .458% in 2010 and .322% in 2009 as compared to no losses in 2008. We historically have not had much, if any, losses yet due to the downturn in the economy in 2009 they surfaced on the participation portfolio. The losses taken in 2010 were booked from 2009 earnings thus not affecting the earnings in 2010. The Association experienced an increase in net volume at year-end 2010 of 2.13% as compared to 2009 of 1.64%. This was excellent, considering the huge agricultural pay downs we had at the beginning of 2010. Gross loan volume at December 31, 2010 was \$273,790,000 as compared to 2009 of \$268,074,000 and to \$263,736,000 for 2008. Net income for 2010 is approximately \$5.4 million as compared to 2009 of \$2.8 million, \$4.8 million in 2008, and \$4.6 million in 2007. We will pay a strong patronage in 2011 from the earnings in 2010. The patronage is estimated to be approximately \$4.7 million or \$1 million greater than 2009. Our permanent capital ratio at year-end 2010 was 16.94% as compared to 14.84% in 2009 and 14.45% in 2008. The 16.94% is above our optimum range of 15% to 20%, yet it exceeds the regulatory level of 7%. Utilizing the 2011 business plan model, projected future earnings will continue to build the permanent capital ratio and keep it within the target range over the next four years. The Association continues to strive toward greater economic efficiencies as the operating cost per hundred currently is \$.86 as compared to \$.95 in 2009, \$.88 in 2008 and \$1.35 in 2007.

Your board and management are excited and thankful for the continued success of the organization. They continue to establish business objectives, which will endure the financial strength and prosperity of your Association. In 2011, these objectives continue to pursue the vision of being the premiere lender, not just in agriculture, but in the entire rural area we serve. Some of these objectives continue to include:

- **Remain committed to agriculture as the core of our vision**
- **Priority emphasis on programs and products to increase young, beginning, and small farmers**
- **Greater involvement in the financing and improvement of rural communities for their future needs**
- **Continue to reduce the operating rate through greater efficiency, increased volume, and improved fee income**
- **Manage succession planning to ensure the quality of management and leadership to fulfill the goals and vision**
- **Improve the return to the borrowers equity**
- **Maintain the quality of credit within the Association, which will minimize the risk to capital.**

We continue to see tremendous opportunities before us. Our Cooperative structure allows a patronage refund and local governance which should become the benchmark for all financial institutions. With local authority to approve borrower needs and strong internal Farm Credit funding sources, the association brings a major contribution to the overall economy of a community. With opportunities always come challenges: challenges to maintain a quality staff, challenges of adequate capital to grow, and challenges to provide the right products to serve a changing rural economy. The 2011 year will be fraught with additional challenges as we continue to face tremendous obstacles with the current economic downturn. We were blessed in 2010 with sufficient earnings to cover all reserves and pay a great patronage to our members. We are continuing to build reserves to better protect the Association from unforeseen catastrophic losses. We placed an additional \$1.4 million in reserves from 2010 earnings. We plan to continue with this trend in 2011.

The Association is managing change within the organization before it manages us. We are analyzing and moving forward with a strategic move that will change the structure of the organization. This will be completed by the Fall of 2011 should the change be economically and structurally feasible and approved by the Board of Directors. This will definitely enhance our ability to better serve our borrowers. We are finding it easier to come up with new ideas than letting go of the old ones. As with most organizations, we state we embrace change, yet we want others to go first. We ask that you, our borrowers, assist us in the days, weeks, and months ahead as we strive to improve the organization that will improve our service to you, improve our efficiencies, and bottom line add more dollars back to you with the patronage refund.

As with challenges in the past, your Board will continue to rely on the promise of God's wisdom to address each challenge as we position the Association to serve the future needs of agriculture and rural America.

May you continue to be blessed in 2011.



Stan Brunston
President/CEO

March 14, 2011

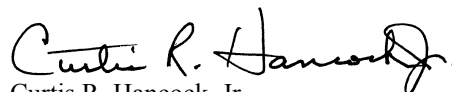
Report of Management

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

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

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

The Consolidated Financial Statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that we have reviewed the 2010 Annual Report of Jackson Purchase Agricultural Credit Association that the report has been prepared under the oversight of the audit committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.



Curtis R. Hancock, Jr.
Chairman of the Board



Joe F. Campbell
Member of Board of Directors
Chairman of the Audit Committee



Stan Brunston
Chief Executive Officer



Barbara Davis
Chief Financial Officer

March 14, 2011

Report on Internal Control Over Financial Reporting

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

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

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



Stan Brunston
Chief Executive Officer



Barbara Davis
Chief Financial Officer

March 14, 2011

Consolidated Five - Year Summary of Selected Financial Data

<i>(dollars in thousands)</i>	2010	2009	December 31, 2008	2007	2006
Balance Sheet Data					
Cash	\$ 1,926	\$ 2,503	\$ 2,860	\$ 3,536	\$ 4,253
Investment securities	4,702	7,145	9,889	13,627	19,427
Loans	273,790	268,074	263,736	283,759	252,739
Less: allowance for loan losses	2,436	3,070	1,771	1,039	1,052
Net loans	271,354	265,004	261,965	282,720	251,687
Investments in other Farm Credit institutions	6,001	6,539	7,881	4,067	3,685
Other property owned	669	77	—	—	—
Other assets	11,706	12,476	12,328	12,194	11,911
Total assets	\$ 296,358	\$ 293,744	\$ 294,923	\$ 316,144	\$ 290,963
Notes payable to AgFirst Farm Credit Bank*	\$ 242,185	\$ 241,378	\$ 237,734	\$ 261,974	\$ 243,292
Accrued interest payable and other liabilities with maturities of less than one year	8,956	9,441	14,817	14,459	9,849
Total liabilities	251,141	250,819	252,551	276,433	253,141
Capital stock and participation certificates	2,010	2,009	2,015	1,988	1,947
Retained earnings					
Allocated	19,973	18,231	16,553	14,541	12,776
Unallocated	23,234	22,685	23,804	23,182	23,099
Total members' equity	45,217	42,925	42,372	39,711	37,822
Total liabilities and members' equity	\$ 296,358	\$ 293,744	\$ 294,923	\$ 316,144	\$ 290,963
Statement of Income Data					
Net interest income	\$ 6,729	\$ 6,255	\$ 6,829	\$ 6,361	\$ 6,119
Provision for (reversal of allowance for) loan losses	510	2,089	731	—	(104)
Noninterest income (expense), net	(809)	(1,341)	(1,261)	(1,777)	(1,610)
Net income	\$ 5,410	\$ 2,825	\$ 4,837	\$ 4,584	\$ 4,613
Key Financial Ratios					
Rate of return on average:					
Total assets	2.00%	1.05%	1.60%	1.63%	1.76%
Total members' equity	12.04%	6.56%	11.53%	11.68%	12.14%
Net interest income as a percentage of					
average earning assets	2.64%	2.48%	2.37%	2.38%	2.46%
Net (chargeoffs) recoveries to average loans	(0.458)%	(0.322)%	—%	(0.005)%	0.003%
Total members' equity to total assets	15.26%	14.61%	14.37%	12.56%	13.00%
Debt to members' equity (:1)	5.55	5.84	5.96	6.96	6.69
Allowance for loan losses to loans	0.89%	1.15%	0.67%	0.37%	0.42%
Permanent capital ratio	16.94%	14.84%	14.45%	13.64%	14.83%
Total surplus ratio	16.04%	13.95%	13.60%	12.88%	14.00%
Core surplus ratio	14.95%	12.92%	12.69%	12.26%	13.23%
Net Income Distribution					
Estimated patronage refunds:					
Cash	\$ 1,870	\$ 1,360	\$ 1,443	\$ 1,508	\$ 1,364
Qualified allocated retained earnings	—	—	—	445	518
Nonqualified allocated retained earnings	1,329	1,166	1,237	847	845
Nonqualified retained earnings	1,722	1,360	1,443	1,508	1,169

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

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

(dollars in thousands, except as noted)

GENERAL OVERVIEW

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

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

The Association is a cooperative, which is owned by the members (also referred to throughout this Annual Report as stockholders or shareholders) served. The territory of the Association extends across a diverse agricultural region of Western Kentucky. 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, or may be obtained at no charge by calling 1-800-845-1745, extension 2832, or writing Susanne Coughman, 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, jacksonpurchaseaca.com, or by calling 1-270-247-5613, extension 12, or writing Barbara Davis, Jackson Purchase ACA, PO Box 309, Mayfield, KY 42066. The Association prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days

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

FORWARD LOOKING INFORMATION

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

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

AGRICULTURAL OUTLOOK

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

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

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

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

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

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

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

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

plus off-farm income. Nearly 100 percent of farm household income for operators of rural residential farms and more than 90 percent of farm household income for intermediate farms is generated from off-farm sources. Further, USDA data suggests that approximately 25 percent of farm household income for commercial farms is generated from off-farm income.

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

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

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

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

agricultural-related debt. However, agricultural borrowers who are more reliant on off-farm income sources may be more adversely impacted by a weakened general economy.

CRITICAL ACCOUNTING POLICIES

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

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

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

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

- *Valuation methodologies* — Management applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating

fair values for certain assets for which an observable liquid market exists, such as most investment securities. Management utilizes significant estimates and assumptions to value items for which an observable liquid market does not exist. Examples of these items include impaired loans, pension and other postretirement benefit obligations, and certain other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing and liquidation values. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on the Association's results of operations.

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

ECONOMIC CONDITIONS

The economy of the Purchase area is greatly affected by the US and world economy. We presently are beginning another era of extremely high grain prices that will affect each of us financially. The grain producers will be able to generate sufficient income to support their operations while the users of grains in livestock production and food consumption will find higher cost at the market place. I recently read an article by Fed Chairman, Ben Bernanke concerning our economic outlook and the following is his comments on the economy:

"The economic recovery that began in the middle of 2009 appears to have strengthened in recent months, although, to date, growth has not been fast enough to bring about a significant improvement in the job market. The early phase of the recovery, in the second half of 2009 and in early 2010, was largely attributable to the stabilization of the financial system, the effects of expansionary monetary and fiscal policies, and a strong boost to production from businesses rebuilding their depleted inventories. But economic growth slowed significantly last spring as the impetus from inventory building and fiscal stimulus diminished and as Europe's debt problems roiled global financial markets.

More recently, however, we have seen increased evidence that a self-sustaining recovery in consumer and business spending may be taking hold. Notably, we learned last week that households increased their spending in the fourth quarter, in real terms, at an annual rate of more than 4 percent. Although a significant portion of this pickup reflected strong sales of motor vehicles, the recent

gains in consumer spending look to have been reasonably broad based. Businesses' investments in new equipment and software grew robustly over most of last year, as firms replaced aging equipment and as the demand for their products and services expanded. In contrast, in the housing sector, the overhang of vacant and foreclosed homes continues to weigh heavily on both home prices and residential construction. Overall, however, improving household and business confidence, accommodative monetary policy, and more-supportive financial conditions, including an apparent increase in the willingness of banks to make loans, seems likely to lead to a more rapid pace of economic recovery in 2011 than we saw last year.

While indicators of spending and production have, on balance, been encouraging, the job market has improved only slowly. Following the loss of about 8-1/2 million jobs in 2008 and 2009, private-sector employment showed gains in 2010. However, these gains were barely sufficient to accommodate the inflow of recent graduates and other new entrants to the labor force and, therefore, not enough to significantly reduce the overall unemployment rate. Recent data do provide some grounds for optimism on the employment front; for example, initial claims for unemployment insurance have generally been trending down, and indicators of job openings and firms' hiring plans have improved. Even so, with output growth likely to be moderate for awhile and with employers reportedly still reluctant to add to their payrolls, it will be several years before the unemployment rate has returned to a more normal level. Until we see a sustained period of stronger job creation, we cannot consider the recovery to be truly established.

On the inflation front, we have recently seen significant increases in some highly visible prices, notably for gasoline. Indeed, prices of many commodities have risen lately, largely as a result of the very strong demand from fast-growing emerging market economies, coupled, in some cases, with constraints on supply. Nevertheless, overall inflation remains quite low: Over the 12 months ending in December, prices for all the goods and services purchased by households increased by only 1.2 percent, down from 2.4 percent over the prior 12 months.¹ To assess underlying trends in inflation, economists also follow several alternative measures of inflation; one such measure is so-called core inflation, which excludes the more volatile food and energy components and therefore can be a better predictor of where overall inflation is headed. Core inflation was only 0.7 percent in 2010, compared with around 2-1/2 percent in 2007, the year before the recession began. Wage growth has slowed as well, with average hourly earnings increasing only 1.8 percent last year. These downward trends in wage and price inflation are not surprising, given the substantial slack in the economy.

Economic growth will probably increase this year, we expect the unemployment rate to remain stubbornly above, and inflation to remain persistently below, the levels that Federal Reserve policymakers have judged to be consistent over the longer term with our mandate from the Congress to foster maximum employment and price stability. Under such conditions, the Federal Reserve would typically ease monetary policy by reducing the target for its short-term policy interest rate, the federal funds rate. However, the target range for the funds rate has been near zero since December 2008, and the Federal Reserve has indicated that economic conditions are likely to warrant an exceptionally low target rate for an extended period. As a result, for the past two years we have been using alternative

tools to provide additional monetary accommodation.

In particular, over the past two years the Federal Reserve has further eased monetary conditions by purchasing longer-term securities on the open market. From December 2008 through March 2010, we purchased about \$1.7 trillion in longer-term Treasury, agency, and agency mortgage-backed securities. In August 2010, we began reinvesting the proceeds from all securities that matured or were redeemed in longer-term Treasury securities, so as to keep the size of our securities holdings roughly constant. Around the same time, we began to signal to financial markets that we were considering providing additional monetary policy accommodation by conducting further asset purchases. And in early November, we announced a plan to purchase an additional \$600 billion in longer-term Treasury securities by the middle of this year. All these purchases are settled through the banking system, with the result that depository institutions now hold a very high level of reserve balances with the Federal Reserve.

Although large-scale purchases of longer-term securities are a different monetary policy tool than the more familiar approach of targeting the federal funds rate, the two types of policies affect the economy in similar ways. Conventional monetary policy easing works by lowering market expectations for the future path of short-term interest rates, which, in turn, reduces the current level of longer-term interest rates and contributes to an easing in broader financial conditions. These changes, by reducing borrowing costs and raising asset prices, bolster household and business spending and thus increase economic activity. By comparison, the Federal Reserve's purchases of longer-term securities have not affected very short-term interest rates, which remain close to zero, but instead put downward pressure directly on longer-term interest rates. By easing conditions in credit and financial markets, these actions encourage spending by households and businesses through essentially the same channels as conventional monetary policy, thereby supporting the economic recovery.

A wide range of market indicators supports the view that the Federal Reserve's securities purchases have been effective at easing financial conditions. For example, since August, when we announced our policy of reinvesting maturing securities and signaled we were considering more purchases, equity prices have risen significantly, volatility in the equity market has fallen, corporate bond spreads have narrowed, and inflation compensation as measured in the market for inflation-indexed securities has risen from low to more normal levels. Yields on 5- to 10-year Treasury securities initially declined markedly as markets priced in prospective Fed purchases; these yields subsequently rose, however, as investors became more optimistic about economic growth and as traders scaled back their expectations of future securities purchases. All of these developments are what one would expect to see when monetary policy becomes more accommodative, whether through conventional or less conventional means. Interestingly, these developments are also remarkably similar to those that occurred during the earlier episode of policy easing, notably in the months following our March 2009 announcement of a significant expansion in securities purchases. The fact that financial markets responded in very similar ways to each of these policy actions lends credence to the view that these actions had the expected effects on markets and are thereby providing significant support to job creation and the economy.

My colleagues and I have said that we will review the asset purchase program regularly in light of incoming information and will adjust it as needed to promote maximum employment and stable prices. In particular, it bears emphasizing that we have the necessary tools to smoothly and effectively exit from the asset purchase program at the appropriate time. In particular, our ability to pay interest on reserve balances held at the Federal Reserve Banks will allow us to put upward pressure on short-term market interest rates and thus to tighten monetary policy when required, even if bank reserves remain high. Moreover, we have developed additional tools that will allow us to drain or immobilize bank reserves as required to facilitate the smooth withdrawal of policy accommodation when conditions warrant. If needed, we could also tighten policy by redeeming or selling securities.

Fiscal policymakers also face significant challenges. The federal budget deficit has expanded to an average of more than 9 percent of gross domestic product (GDP) over the past two years, up from an average of about 2 percent of GDP during the three years prior to the recession. The extraordinarily wide deficit largely reflects the weakness of the economy along with the actions that the Administration and the Congress took to ease the recession and steady financial markets. However, even after economic and financial conditions have returned to normal, the federal budget will remain on an unsustainable path, with the budget gap becoming increasingly large over time, unless the Congress enacts significant changes in fiscal programs.

For example, under plausible assumptions about how fiscal policies might evolve in the absence of major legislative changes, the Congressional Budget Office (CBO) projects the deficit to fall from around 9 percent of GDP currently to roughly 5 percent of GDP by 2015, but then to rise to about 6-1/2 percent of GDP by the end of the decade.² After that, it projects the budget outlook to deteriorate even more rapidly, with federal debt held by the public reaching almost 90 percent of GDP by 2020 and 150 percent of GDP by 2030, up from about 60 percent at the end of fiscal year 2010.

The long-term fiscal challenges confronting the nation are especially daunting because they are mostly the product of powerful underlying trends, not short-term or temporary factors. The two most important driving forces for the federal budget are the aging of the U.S. population and rapidly rising health-care costs. Indeed, the CBO projects that federal spending for health-care programs--which includes Medicare, Medicaid, and subsidies to purchase health insurance through new insurance exchanges--will roughly double as a percentage of GDP over the next 25 years.³ The ability to control health-care costs, while still providing high-quality care to those who need it, will be critical for bringing the federal budget onto a sustainable path.

The retirement of the baby-boom generation will also strain Social Security, as the number of workers paying taxes into the system rises more slowly than the number of people receiving benefits. Currently, there are about five individuals between the ages of 20 and 64 for each person aged 65 and older. By 2030, when most of the baby boomers will have retired, this ratio is projected to decline to around 3.⁴ Overall, the projected fiscal pressures associated with Social Security are considerably smaller than the pressures associated with federal health programs, but they are still notable.

The CBO's long-term budget projections, by design, do not account for the likely adverse economic effects of such high debt and deficits. But if government debt and deficits were actually to grow at the pace envisioned, the economic and financial effects would be severe. Sustained high rates of government borrowing would both drain funds away from private investment and increase our debt to foreigners, with adverse long-run effects on U.S. output, incomes, and standards of living. Moreover, diminishing investor confidence that deficits will be brought under control would ultimately lead to sharply rising interest rates on government debt and, potentially, to broader financial turmoil. In a vicious circle, high and rising interest rates would cause debt-service payments on the federal debt to grow even faster, causing further increases in the debt-to-GDP ratio and making fiscal adjustment all the more difficult.

How much adjustment is needed to restore fiscal sustainability in the United States? To help answer this question, it is useful to apply the concept of the primary budget deficit, which is the government budget deficit excluding interest payments on the national debt. To stabilize the ratio of federal debt to the GDP--a convenient benchmark for assessing fiscal sustainability--the primary budget deficit must be reduced to zero.⁵ Under the CBO projection that I noted earlier, the primary budget deficit is expected to be 2 percent of GDP in 2015 and then rise to almost 3 percent of GDP in 2020 and 6 percent of GDP in 2030. These projections provide a gauge of the adjustments that will be necessary to attain fiscal sustainability. To put the budget on a sustainable trajectory, policy actions--either reductions in spending or increases in revenues or some combination of the two--will have to be taken to eventually close these primary budget gaps.

By definition, the unsustainable trajectories of deficits and debt that the CBO outlines cannot actually happen, because creditors would never be willing to lend to a government with debt, relative to national income, that is rising without limit. The economist Herbert Stein succinctly described this type of situation: 'If something cannot go on forever, it will stop.'⁶ One way or the other, fiscal adjustments sufficient to stabilize the federal budget must occur at some point. The question is whether these adjustments will take place through a careful and deliberative process that weighs priorities and gives people adequate time to adjust to changes in government programs or tax policies, or whether the needed fiscal adjustments will be a rapid and painful response to a looming or actual fiscal crisis. Acting now to develop a credible program to reduce future deficits would not only enhance economic growth and stability in the long run, but could also yield substantial near-term benefits in terms of lower long-term interest rates and increased consumer and business confidence. Plans recently put forward by the President's National Commission on Fiscal Responsibility and Reform and other prominent groups provide useful starting points for a much-needed national conversation. Although these proposals differ on many details, they demonstrate that realistic solutions to our fiscal problems are available.

Of course, economic growth is affected not only by the levels of taxes and spending, but also by their composition and structure. I hope that, in addressing our long-term fiscal challenges, the Congress and the Administration will seek reforms to the government's tax policies and spending priorities that serve not only to reduce the deficit, but also to enhance the long-term growth potential of our economy--for example, by reducing

disincentives to work and to save, by encouraging investment in the skills of our workforce as well as in new machinery and equipment, by promoting research and development, and by providing necessary public infrastructure. Our nation cannot reasonably expect to grow its way out of our fiscal imbalances, but a more productive economy will ease the tradeoffs that we face.”

In conclusion to Mr. Bernanke’s comments, I would add that each of us realizes as home owners and businessmen that we cannot borrower our way out of the deficits our government has created. None of you as well as this organization can run our households nor businesses on deficits. The government must adopt a fiscal wellness policy. One that promotes debt reduction not tax increases. Tax increases will only lessen the responsibility of congress to cut cost. Congress has proven that once they get their hands on your money they rarely let go of it. They will find new irresponsible ways to spend it. We need to continue to speak to our congressmen and representatives that we want government smaller and government cost brought into line with income tax revenue. To continue as we are is not an option.

- 1) *Inflation data are derived using the price index for personal consumption expenditures.*
- 2) *The so-called alternative fiscal policy scenario, which assumes, among other things, that most of the tax cuts enacted in 2001 and 2003 are made permanent and that discretionary federal outlays rise at the same rate as GDP, is presented in Congressional Budget Office (2010), The Long-Term Budget Outlook (Washington: CBO, June (revised August)).*
- 3) *See the two long-term scenarios for mandatory federal spending on health care shown in figure 2-3, p. 39, in CBO, and The Long-Term Budget Outlook, in Note 2.*
- 4) *These figures are the inverse of the ratio of the population age 65 or older as a percentage of the population ages 20 to 64 shown in figure 3-2, p. 47, in CBO, The Long-Term Budget Outlook, in Note 2.*
- 5) *This result requires that the nominal rate of interest paid on government debt equal the rate of growth of nominal GDP, a condition which usually serves as a reasonable approximation. If the rate of interest on government debt is higher than the growth rate of nominal GDP, as might happen if creditors become wary of lending, then a primary budget surplus rather than primary balance is needed to stabilize the ratio of debt to GDP.*
- 6) *Herbert Stein (1997), "Herb Stein's Unfamiliar Quotations," Slate, May 16, www.slate.com/id/2561.*

Read more: <http://www.businessinsider.com/bernanke-national-press-club-speech-2011-2#ixzz1EEAulbZv>

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	December 31,					
	2010		2009		2008	
	<i>(dollars in thousands)</i>					
Production and intermediate-term	\$ 133,078	48.60	\$ 128,354	47.88%	\$ 126,282	47.88%
Real estate mortgage	94,729	34.60	78,028	29.11	81,239	30.80
Processing and marketing	13,947	5.09	19,849	7.40	20,863	7.91
Other	12,044	4.40	13,015	4.86	-	-
Rural residential real estate	9,165	3.35	14,325	5.34	22,523	8.54
Cooperatives	6,403	2.34	7,271	2.71	-	-
Farm-related business	4,424	1.62	7,232	2.70	12,829	4.87
Total	\$ 273,790	100.00%	\$ 268,074	100.00%	\$ 263,736	100.00%

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

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

Branch	December 31,		
	2010	2009	2008
Bardwell	9.37%	9.73%	8.56%
Clinton	15.12	11.70	10.61
Hickman	9.41	9.66	8.81
Kevil	10.20	9.16	9.46
Murray	16.50	15.21	14.77
Lone Oak	2.40	2.18	2.11
Mayfield	19.17	20.90	20.44
Marshall County	3.11	2.70	2.36
Special Assets Unit	14.72	18.76	22.88
	100.00%	100.00%	100.00%

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

The major commodities in the Association loan portfolio are shown below. The predominant commodities are row crops, poultry, and tobacco, which constitute 68 percent of the entire portfolio.

Commodity Group	December 31,					
	2010		2009		2008	
	<i>(dollars in thousands)</i>					
Row Crops	\$ 142,973	52%	\$ 124,512	46%	\$ 113,607	43%
Other	37,288	14	39,751	15	44,662	17
Poultry	25,048	9	25,301	9	26,190	10
Tobacco	18,515	7	16,135	6	17,889	7
Livestock	15,837	6	19,986	8	12,875	5
Rural Home	13,418	5	17,448	7	23,434	9
Animal Specialties	14,136	5	13,273	5	10,033	4
Sawmills, Paper and Forestry	6,575	2	11,668	4	15,046	5
Total	\$ 273,790	100%	\$ 268,074	100%	\$ 263,736	100%

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The Association’s loan portfolio contains a concentration of corn and soybean 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. Demand for beef, prices of field grains, and international trade are some of the factors affecting the price of these commodities. 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 increase in gross loan volume for the twelve months ended December 31, 2010 and December 31, 2009, is primarily attributed to the increased input costs of farm production, new loans in real estate, and equipment.

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

Loan Participations:	December 31,		
	2010	2009	2008
	<i>(dollars in thousands)</i>		
Participations Purchased			
– FCS Institutions	\$ 36,526	\$ 47,596	\$ 59,133
Participations Purchased			
– Non-FCS Institutions	24,959	30,675	39,740
Participations Sold	(60,178)	(76,842)	(100,043)
Total	\$ 1,307	\$ 1,429	\$ (1,170)

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

The Association sells qualified long-term mortgage loans into the secondary market. For the period ended December 31, 2010, the Association originated loans for resale totaling \$15,962, which were sold into the secondary market as compared to \$20,240 for December 31, 2009 and \$13,321 for December 31, 2008.

The Association purchased portions of loans that are guaranteed by the United States Department of Agriculture and the Small Business Administration. 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, 2010, the balance of these loans, including the unamortized premium, was \$19,007, compared to \$21,719 at December 31, 2009 and \$24,956 at December 31, 2008. These loans are included as participations purchased stated above.

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, 2010 and December 31, 2009, the Association had no investments in Rural America Bonds. However, the Association is actively planning to evaluate such opportunities in the future.

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, 2010, the Association had \$2,312 in SIIC outstanding, compared to \$2,821 and \$2,901 for the years ended December 31, 2009 and 2008, respectively, and these are classified as Other Investments on the Consolidated Balance Sheets. In addition, at December 31, 2010, December 31, 2009 and December 31, 2008, the Association had \$133 and \$448, and \$539, respectively, in loans outstanding collateralized by assignments of contract payments.

INVESTMENT SECURITIES

As permitted under FCA regulations, the Association is authorized to hold eligible investments for the purposes of reducing interest rate risk and managing surplus short-term funds. The Bank is responsible for approving the investment policies of the Association. The Bank annually reviews the investment portfolio of every Association that it funds. The Association's investments consist primarily of asset-backed securities (ABS). The ABSs amounted to \$4,702, \$7,145, and \$9,889 at December 31, 2010, December 31, 2009, and December 31, 2008, respectively. 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 our regulator to dispose of the security.

Investment securities classified as being held-to-maturity totaled \$4,702 at December 31, 2010. These held-to-maturity investments primarily consisted of Small Business Administration loan participation pools.

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. The actual loan to appraised value when loans are made is generally lower than the statutory

maximum percentage. In addition, each loan is assigned a credit risk rating based upon the underwriting standards. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses, and risks in a particular relationship.

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

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

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

Credit Quality	2010	2009	2008
Acceptable & OAEM	95.98%	95.22%	98.35%
Substandard	3.98%	4.72%	1.58%
Doubtful	0.04%	0.06%	0.07%
Loss	–%	–%	–%
Total	100.00%	100.00%	100.00%

Nonperforming Assets

The Association's loan portfolio is divided into performing and high-risk categories. The Credit 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,		
	2010	2009	2008
	<i>(dollars in thousands)</i>		
Nonaccrual loans	\$ 3,947	\$ 5,870	\$ 2,017
Restructured loans	–	4	9
Accruing loans 90 days past due	565	–	–
Total high-risk loans	4,512	5,874	2,026
Other property owned	669	77	–
Total high-risk assets	\$ 5,181	\$ 5,951	\$ 2,026
Ratios			
Nonaccrual loans to total loans	1.44%	2.19%	0.76%
High-risk assets to total assets	1.75%	2.03%	0.69%

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 decreased \$1,923 or 32.76

percent in 2010. This decrease primarily resulted from normal nonaccrual collections and loan reinstatements to accrual status. Of the \$3,947 in nonaccrual volume at December 31, 2010, 3,833 or 97.11%, compared to 93.95% and 91.32% at December 31, 2009 and 2008, respectively, was current as to scheduled principal and interest payments, but did not meet all regulatory requirements to be transferred into accrual status.

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

Allowance for Loan Losses

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

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

Allowance for Loan Losses Activity:	Year Ended December 31,		
	2010	2009	2008
	<i>(dollars in thousands)</i>		
Balance at beginning of year	\$ 3,070	\$ 1,771	\$ 1,039
Charge-offs:			
Agribusiness		(768)	
Production and intermediate-term	(53)	(21)	(1)
Rural Residential Real Estate	(3)	-	-
Real estate mortgage	(1,138)	(2)	-
Total charge-offs	<u>(1,194)</u>	<u>(791)</u>	<u>(1)</u>
Recoveries:			
Agribusiness	50	-	-
Production and intermediate-term	-	1	2
Total recoveries	<u>50</u>	<u>1</u>	<u>2</u>
Net (charge-offs) recoveries	<u>(1,144)</u>	<u>(790)</u>	<u>1</u>
Provision for (reversal of allowance for) loan losses	<u>510</u>	<u>2,089</u>	<u>731</u>
Balance at end of year	<u>\$ 2,436</u>	<u>\$ 3,070</u>	<u>\$ 1,771</u>
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	<u>(0.458)%</u>	<u>(0.322)%</u>	<u>-%</u>

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

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

Allowance for Loan Losses by Type	December 31,		
	2010	2009	2008
	<i>(dollars in thousands)</i>		
Real estate mortgage	\$ 339	\$ 1,507	\$ 152
Production and intermediate-term	361	301	758
Agribusiness	1,705	1,208	774
Rural residential real estate	31	54	87
Total Allowance	<u>\$ 2,436</u>	<u>\$ 3,070</u>	<u>\$ 1,771</u>

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:	2010	2009	2008
Total loans	.89%	1.15%	.67%
Nonperforming loans	47.02%	51.59%	87.41%
Nonaccrual loans	61.72%	52.30%	87.80%

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 \$6,729, \$6,255 and \$6,829 in 2010, 2009 and 2008, respectively. Net interest income is the difference between interest income and interest expense. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets and cost of debt. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following table:

Change in Net Interest Income:

	Volume*	Nonaccrual		Total
		Rate	Income	
	<i>(dollars in thousands)</i>			
12/31/10 - 12/31/09				
Interest income	\$ 101	\$ 179	\$ (231)	\$ 49
Interest expense	(46)	(379)	-	(425)
Change in net interest income	<u>\$ 147</u>	<u>\$ 558</u>	<u>\$ (231)</u>	<u>\$ 474</u>
12/31/09 - 12/31/08				
Interest income	\$(2,295)	\$(2,937)	\$ 268	\$(4,964)
Interest expense	(1,145)	(3,245)	-	(4,390)
Change in net interest income	<u>\$(1,150)</u>	<u>\$ 308</u>	<u>\$ 268</u>	<u>\$ (574)</u>

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

Noninterest Income

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

Noninterest Income	For the Year Ended December 31,			Percentage Increase/(Decrease)	
	2010	2009	2008	2010/ 2009	2009/ 2008
	<i>(dollars in thousands)</i>				
Loan fees	\$ 246	\$ 269	\$ 372	(8.55)%	(27.69)%
Fees for financially related services	422	563	890	(25.04)	(36.74)
Patronage refund from other Farm Credit Institutions	3,425	3,248	2,525	5.45	28.63
Gains (losses) on other Property owned, net	(240)	(4)	—	5900.00	(400.00)
Gains (losses) on sales of rural home loans	272	200	79	36.00	153.16
Insurance Fund refund	647	—	—	—	—
Other noninterest income	36	43	54	(16.28)	(20.37)
Total noninterest income	\$ 4,808	\$ 4,319	\$ 3,920	11.32%	10.18%

The increase in Patronage Refund from other Farm Credit Institutions included \$1,084 fee income from the sale of assets to AgFirst Farm Credit Bank and a special patronage of \$615.

Noninterest Expense

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

Noninterest Expense	For the Year Ended December 31,			Percentage Increase/(Decrease)	
	2010	2009	2008	2010/ 2009	2009/ 2008
	<i>(dollars in thousands)</i>				
Salaries and employee benefits	\$ 4,051	\$ 3,742	\$ 3,331	8.26%	12.34%
Occupancy and equipment	359	384	319	(6.51)	20.38
Insurance Fund premiums	93	354	352	(73.73)	0.57
Other operating expenses	1,085	1,178	1,178	(7.89)	—
Total noninterest expense	\$ 5,588	\$ 5,658	\$ 5,180	(1.24)%	9.23

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

Insurance Fund premiums decreased 73.73 percent for the twelve months ended December 31, 2010, compared to the same period of 2009. The Farm Credit System Insurance Corporation (FCSIC) changed the methodology in assessing the insurance premiums as a result of the 2008 Farm Bill. Please refer to the “Regulatory Matters” section of this management’s discussion and analysis for details concerning the 2008 Farm Bill. The FCSIC set premiums at 5 basis points on adjusted insured debt outstanding reduced by guaranteed investments for 2010 as compared to 20 basis points for 2009. In addition, for 2010 and 2009, there was a 10 basis point premium on the average principal outstanding of nonaccrual loans and any other-than-temporarily impaired investments. Previously, in 2008, premiums of up to 18 basis points could be charged on accruing loans and up to 25 basis points for nonaccrual loans.

Noninterest expense decreased \$70 or 1.24 percent for December 31, 2010, as compared to the same period of 2009 and increased \$478 or 9.23 percent compared to December 31, 2008. The primary reason for the decrease in total noninterest expense is attributable primarily to a decrease of 73.73% in Insurance Fund premiums. The primary reason for the increase in total noninterest expense for the period ended December 31, 2009 was attributable primarily to an increase of 12.34% in salaries and employee benefits and an increase of 20.38% in occupancy and equipment.

Income Taxes

The Association recorded a provision for income taxes of \$29 for the year ended December 31, 2010, as compared to a provision of \$2 for 2009 and a provision of \$1 for 2008. Refer to Note 2, “Summary of Significant Accounting Policies, Income Taxes,” of the Notes to the Consolidated Financial Statements, for more information concerning Association income taxes.

Key Results of Operations Comparisons

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

Key Results of Operations Comparisons	For the 12 Months Ended		
	12/31/10	12/31/09	12/31/08
Return on average assets	2.00%	1.05%	1.60%
Return on average members’ equity	12.04%	6.56%	11.53%
Net interest income as a percentage of average earning assets	2.64%	2.48%	2.37%
Net (charge-offs) recoveries to average loans	(0.458)%	(0.322)%	—%

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".

Total notes payable to the Bank at December 31, 2010, was \$242,185 as compared to \$241,378 at December 31, 2009 and \$237,734 at December 31, 2008. The increase of 0.33 percent compared to December 31, 2009, and the increase of 1.53 percent compared to December 31, 2008, was attributable to loan growth in the Association. The average volume of outstanding notes payable to the Bank was \$220,412 and \$218,884 for the years ended December 31, 2010 and 2009, respectively. Refer to Note 9, "Notes Payable to AgFirst Farm Credit Bank," of the Notes to the Consolidated Financial Statements, for weighted average interest rates and maturities, and additional information concerning the Association's notes payable.

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

The Association had no lines of credit from third party financial institutions as of December 31, 2010.

Funds Management

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

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers fixed, adjustable and variable rate loan products that are marginally priced according to financial market rates. Variable rate loans may be indexed to market indices such as the Prime Rate or the 30-day London Interbank Offered Rate (LIBOR). Adjustable rate mortgages are indexed to U.S. Treasury Rates. Fixed rate loans are priced based on the current cost of System debt of similar terms to maturity.

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

Relationship with the Bank

The Association's statutory obligation to borrow only from the Bank is discussed in Note 9, "Notes Payable to AgFirst Farm Credit Bank" of the Notes to the Consolidated Financial Statements in this annual report.

The Bank's ability to access capital of the Association is discussed in Note 6 of the Notes to the Consolidated Financial Statements.

The Bank's role in mitigating the Association's exposure to interest rate risk is described in the "Liquidity and Funding Sources" section of this Management's Discussion and Analysis and in Note 9, "Notes Payable to AgFirst Farm Credit Bank" included in this Annual Report.

CAPITAL RESOURCES

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

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

Total members' equity at December 31, 2010, increased 5.34 percent to \$45,217 from the December 31, 2009, total of \$42,925. At December 31, 2009, total members' equity increased 1.31 percent from the December 31, 2008 total of \$42,372. The increase was primarily attributed to association earnings.

Total capital stock and participation certificates were \$2,010 on December 31, 2010, compared to \$2,009 on December 31, 2009 and \$2,015 on December 31, 2008.

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

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

	2010	2009	2008	Regulatory Minimum
Permanent capital ratio	16.94%	14.84%	14.45%	7.00%
Total surplus ratio	16.04%	13.95%	13.60%	7.00%
Core surplus ratio	14.95%	12.92%	12.69%	3.50%

The increase in the Association’s permanent capital, total surplus, and core surplus for December 31, 2010 is attributed to a decrease in off balance sheet commitments and participation loans. The increase in the Association’s permanent capital, total surplus, and core surplus for December 31, 2009 was attributed to a decrease in off balance sheet commitments. 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 10, “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 10, “Members’ Equity,” of the Notes to the Consolidated Financial Statements, for more information concerning the patronage distributions. The Association declared patronage distributions of \$4,921 in 2010, \$3,886 in 2009, and \$4,123 in 2008.

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, 2010 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, 2010	
	Number of Loans	Amount of Loans
Young	620	\$55,191
Beginning	670	\$56,667
Small	1,793	\$89,589

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 2007 USDA Ag census data is the latest data available. It 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 5335 reported farmers of which by definition 296 or 5.5 percent were Young, 1259 or 23.6 percent were Beginning and 4875 or 91.4 percent were Small. Comparatively, as of April 2009, the demographics of the Association’s agricultural portfolio contained 2036 farmers, of which by definition 407 or 20 percent were Young, 428 or 21 percent were Beginning and 1170 or 57.5 percent were Small.

ACA’s goals are to maintain our YBS percentages at the 2010 level, but in no case slip below the goals set in the Business Plan of 14% for Young, 12% for Beginning and 40% for Small farmers. Unfortunately, ACA did not reach the YBS goals for 2010, due to limited number of young people beginning in agriculture. The differences in the census data and the Association data are primarily in the definition differences in Young, Beginning and Small farmers. The Association assigns Young, Beginning and Small based on the age, years of experience and income of the youngest individual involved in the operation. Our numbers also include farmers that do not own farmland but rent all of their land.

The Association addresses the specific credit programs and partnerships that have been developed to help small farmers, young farmers, and farmers just starting out. It comprises programs offered by:

1. The Farm Service Agency (FSA), which includes guaranteed and direct loans to qualifying borrowers. The Association is a Certified Lender, a status designated by the FSA.
2. KAFC Beginning Farmer Program – the state of Kentucky has special interest rates for loans up to \$100,000 for YBS in combination with ACA direct loans, with ACA as servicer of the account.
3. Agricultural Infrastructure Loan Program – the state of Kentucky has developed this program for past Tobacco Producers. The program gives a low interest rate on loans up to \$100,000 in combination with ACA direct loans on any infrastructure on their farms. ACA is the servicer of the account.

The Association sponsors local events (such as 4-H and FFA fairs), or events where the Association is an exhibitor (such as industry or trade shows).

The Association is committed to the future success of Young, Beginning and Small farmers.

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

REGULATORY MATTERS

For the twelve months ended December 31, 2010, the FCA took no enforcement action against the Association.

**RECENTLY ISSUED ACCOUNTING
PRONOUNCEMENTS**

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

Disclosure Required by Farm Credit Administration Regulations

Description of Business

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

The description of significant developments that had or could have a material impact on earnings, interest rates to borrowers, borrower patronage or dividends, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, concentrations of assets, and changes in patronage policies or practices, 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 Kentucky:

<u>Location</u>	<u>Description</u>	<u>Form of Ownership</u>
328 E. Broadway Mayfield	Administrative	Owned
1401 N. 12th St. Murray	Branch	Owned
1514 Union City Hwy. Hickman	Branch	Owned
12350 Highway 60 West Kevil	Branch	Owned
102 N Washington Clinton	Branch	Owned
196 US Hwy 51 North Bardwell	Branch	Leased*
3565 Lone Oak Rd, Suite 2 Paducah	Branch	Leased**
2730 U S Hwy. 641 N Benton	Branch	Owned
545 Dick Castleman Bypass Mayfield	Branch	Owned

*Five year lease beginning 2/1/09 & expiring 2/1/14. Monthly payment \$1,500.00

**Five-year lease beginning 5/13/08 &, terminating 5/13/13. Monthly payment \$1,500.00.

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 10 of the Consolidated Financial Statements, "Members' Equity," included in this Annual Report.

Description of Liabilities

The description of liabilities, contingent liabilities and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 9 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 and their business experience for the past five years:

<u>Name and Title</u>	<u>Term of Office</u>	<u>Prior Experience</u>
Stan Brunston, Chief Executive Officer	3/1/2008- present	Chief Lending Officer/Senior Vice President of Credit from June 1986 to March 2008.
Stan Grief, Chief Lending Officer/Senior Vice President	3/1/2008 - present	Branch Manager/Assistant Vice President from 1987 to 2005. Senior Credit Administrator/Vice President of Credit from January 2006 to March 2008.
Kevin Brown, Assistant Vice President	4/16/2008 - present	Branch Manager from February 1993 to April 2008.
Barbara Davis, Chief Financial Officer	1985 - present	

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

Name of Individual or Number in Group	Year	Annual				Total
		Salary	Bonus	Perquisites	Other	
Stan Brunston	2010	\$170,007	\$ 24,165	\$ 4,204	–	\$198,376
Stan Brunston	2009	\$170,007	\$ –	\$ 2,503	–	\$172,510
Stan Brunston	2008	\$146,256	\$ 20,227	\$ 2,504	–	\$168,987
Tommy Murphey	2008*	\$ 43,752	\$ 14,233	\$ 926	\$14,584	\$ 73,495
5	2010	\$467,392	\$ 70,719	\$ 3,895	–	\$542,006
5	2009	\$467,768	\$ 3,675	\$ 3,649	–	\$475,092
5	2008	\$408,572	\$ 64,138	\$ –	–	\$472,710

- *Tommy Murphey retired March 31, 2008.

*Amounts in the above table classified as Perquisites include group life insurance, and automobile compensation.

**Amounts in the above table classified as Other include severance pay at retirement.

In addition to a base salary, senior officers earn additional compensation under an incentive plan which is tied to the overall business performance and the individual's performance appraisal rating. The Association incentive plan is designed to motivate employees to exceed the business plan goals during the fiscal year. These goals typically include return on assets, credit quality, credit administration, loan volume, nonaccrual loan volume, permanent capital and other key ratios. Those covered by the plan include all employees. Also all employees except Administrative staff participate in insurance and lease incentive plans designed to motivate employees to increase insurance sales and leasing fee income to benefit the member as well as the Association. Additional incentive plans available to all employees include member referral incentives designed to encourage employees to promote new business through personal contacts. Bonuses are shown in the year earned, which may be different than the year of payment. Additionally, all employees are reimbursed for all direct travel expenses incurred when traveling on Association business. A copy of the travel policy is available to shareholders upon written request.

Disclosure of information on the total compensation paid during 2010 to any senior officer, or to any other individual included in the total, is available to shareholders upon request.

Directors

The following chart details the year the director began serving on the board, the current term of expiration, current committee assignments and total cash compensation paid:

DIRECTOR	ORIGINAL YEAR OF ELECTION OR APPOINTMENT	CURRENT TERM EXPIRATION	TOTAL COMP. PAID DURING 2010
Curtis Hancock, Jr., <i>Chairman</i>	1991	2012	\$10,135
Joe Forrest Campbell, <i>Vice-Chairman</i>	2000	2013	12,805
Darren Grogan	2008	2011	8,135
Randall Heath	2006	2013	6,270
Aaron Wilson	2009	2012	10,535
Eddie Workman	2005	2011	9,335
Buddy D. Ray, <i>Outside Dir</i>	2003	2013	9,735
			\$66,950

The following represents certain information regarding the directors of the Association, including their principal occupation and employment for the past five years. Unless specifically listed, the principal occupation of the board member for the past five years has been as a self-employed farmer.

Mr. Curtis Hancock, Jr., Chairman, operates a row crop program. He serves as State Treasurer for Kentucky Farm Business Analysis Group, serves on the AgFirst District Farm Credit Council Board, serves on the National Farm Credit Council Board in Washington DC, and serves on the Farm Credit Council Services Board in Denver.

Mr. Joe Forrest Campbell, Vice Chairman, operates a row crop farming operation. He is a member of the Kentucky and Tennessee Society of Farm Managers and Rural Appraisers and is owner and operator of Campbell Appraisal Services.

Mr. Darren Grogan operates a row crop farming operation. He also serves as President of the Carlisle County FFA Alumni.

Mr. Randall Heath operates a row crop farming operation. Mr. Heath serves on the Kentucky Farm Bureau Board, as Chairman on the Graves County Soil Association Board, and also serves on the Kentucky Soybean Promotion Board.

Mr. Aaron Wilson operates a row crop and tobacco program. He also has a cow/calf operation. He serves as Chairman of the Ballard County Soil Conservation Department, and is a member of the UST/MSU Agriculture Leadership Development Class.

Mr. Eddie Workman operates a row crop and tobacco program. Mr. Workman serves on the Calloway County Farm Bureau Board and also serves on a Natural Resources Conservation Service Committee.

Mr. Buddy D. Ray, DVM, Outside Director, is a veterinarian at the Mayfield Veterinary Clinic and Bovine Consulting Associates, LLC. He also serves on the Professional Veterinary Products LLC. Board and Bayer Animal Large Animal Advisory Board.

Subject to approval by the board, the Association may allow directors honoraria of \$400 for attendance at meetings, committee meetings, or special assignments. Directors are paid a quarterly retainer fee of \$500. Total compensation paid to directors as a group was \$66,950.

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

Name of Director	Days Serve		Committee Assignments	Comp. Paid for other Activities*
	Regular Board Meetings	Other Official Activities*		
Curtis Hancock, Jr., <i>Chairman</i>	10	11	Executive, Audit, Compensation	\$4,135
Joe Forrest Campbell, <i>Vice-Chairman</i>	10	19	Credit Review, Audit-Chairman, Compensation	6,805
Darren Grogan	10	6	Audit	2,135
Randall Heath	8	4	Audit, Governance	1,070
Aaron Wilson	10	12	Audit, Governance	4,535
Eddie Workman	10	9	Audit, Governance	3,335
Buddy D. Ray, <i>Outside Director</i>	10	10	Credit Review, Audit, Compensation	3,735
				\$25,750

* Includes board committee meetings and other board activities other than regular board meetings and quarterly retainer fees.

Directors and senior officers are reimbursed on an actual cost basis for all expenses incurred in the performance of official duties. Such expenses may include transportation, lodging, meals, tips, tolls, parking of cars, laundry, registration fees, and other expenses associated with travel on official business. A copy of the 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 \$28,426 for 2010, \$22,124 for 2009 and \$35,778 for 2008.

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 Auditor

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

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

	2010
<i>Independent Auditor</i>	
PricewaterhouseCoopers LLP	
Audit services	\$ 48,604
Total	<u>\$ 48,604</u>

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

Consolidated Financial Statements

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

Copies of the Association's quarterly reports are available upon request free of charge by calling 1-270-247-5613 or writing Barbara Davis, Jackson Purchase Agricultural Credit Association, P. O. Box 309, Mayfield, KY 42066 or accessing the website, www.jacksonpurchaseaca.com. The Association prepares an electronic version of the Annual Report which is available on the Association's web site within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

Borrower Information Regulations

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

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

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

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

Shareholder Investment

Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank (Bank or AgFirst). Copies of the Bank's Annual and Quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Susanne Caughman, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst's web site at www.agfirst.com. 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 Jackson Purchase Agricultural Credit Association (Association) and in the opinion of the Board of Directors, each is free of any relationship with the Association or management that would interfere with the director's independent judgment on the Committee.

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

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

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

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



Joe F. Campbell

Chairman of the Audit Committee

Members of Audit Committee

Darren Grogan
Curtis Hancock
Randall Heath
Dr. Buddy Ray
Aaron Wilson
Eddie Workman

March 14, 2011

Report of Independent Auditors



Report of Independent Auditors

To the Board of Directors and Members
of Jackson Purchase Agricultural Credit Association

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

PricewaterhouseCoopers LLP

March 14, 2011

*PricewaterhouseCoopers LLP, 10 Tenth Street, Suite 1400, Atlanta, GA 30309-3851
T: (678) 419 1000, F: (678) 419 1239, www.pwc.com/us*

Consolidated Balance Sheets

<i>(dollars in thousands)</i>	December 31, 2010	December 31, 2009	December 31, 2008
Assets			
Cash	\$ 1,926	\$ 2,503	\$ 2,860
Investment securities:			
Held to maturity (fair value of \$4,693, \$7,143 and \$9,816 respectively)	4,702	7,145	9,889
Loans	273,790	268,074	263,736
Less: allowance for loan losses	2,436	3,070	1,771
Net loans	271,354	265,004	261,965
Loans held for sale	250	533	352
Other investments	2,312	2,821	2,901
Accrued interest receivable	3,106	3,067	4,290
Investments in other Farm Credit institutions	6,001	6,539	7,881
Premises and equipment, net	1,665	1,783	1,415
Other property owned	669	77	—
Due from AgFirst Farm Credit Bank	3,273	3,250	2,510
Other assets	1,100	1,022	860
Total assets	\$ 296,358	\$ 293,744	\$ 294,923
Liabilities			
Notes payable to AgFirst Farm Credit Bank	\$ 242,185	\$ 241,378	\$ 237,734
Accrued interest payable	540	598	741
Patronage refund payable	1,902	1,383	1,460
Advanced conditional payments	2,429	2,543	5,716
Other liabilities	4,085	4,917	6,900
Total liabilities	251,141	250,819	252,551
Commitments and contingencies			
Members' Equity			
Capital stock and participation certificates	2,010	2,009	2,015
Retained earnings			
Allocated	19,973	18,231	16,553
Unallocated	23,234	22,685	23,804
Total members' equity	45,217	42,925	42,372
Total liabilities and members' equity	\$ 296,358	\$ 293,744	\$ 294,923

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

Consolidated Statements of Income

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2010	2009	2008
Interest Income			
Investment securities	\$ 101	\$ 132	\$ 381
Loans	13,186	13,081	17,785
Other investments	115	140	151
Total interest income	<u>13,402</u>	<u>13,353</u>	<u>18,317</u>
Interest Expense			
Notes payable to AgFirst Farm Credit Bank	6,646	7,039	11,211
Other	27	59	277
Total interest expense	<u>6,673</u>	<u>7,098</u>	<u>11,488</u>
Net interest income	6,729	6,255	6,829
Provision for loan losses	510	2,089	731
Net interest income after provision for loan losses	<u>6,219</u>	<u>4,166</u>	<u>6,098</u>
Noninterest Income			
Loan fees	246	269	372
Fees for financially related services	422	563	890
Patronage refund from other Farm Credit institutions	3,425	3,248	2,525
Gains (losses) on other property owned, net	(240)	(4)	—
Gains (losses) on sales of rural home loans, net	272	200	79
Insurance Fund refund	647	—	—
Other noninterest income	36	43	54
Total noninterest income	<u>4,808</u>	<u>4,319</u>	<u>3,920</u>
Noninterest Expense			
Salaries and employee benefits	4,051	3,742	3,331
Occupancy and equipment	359	384	319
Insurance Fund premiums	93	354	352
Other operating expenses	1,085	1,178	1,178
Total noninterest expense	<u>5,588</u>	<u>5,658</u>	<u>5,180</u>
Income before income taxes	5,439	2,827	4,838
Provision for income taxes	29	2	1
Net income	<u>\$ 5,410</u>	<u>\$ 2,825</u>	<u>\$ 4,837</u>

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

Consolidated Statements of Changes in Members' Equity

<i>(dollars in thousands)</i>	Capital Stock and Participation Certificates	Retained Earnings		Total Members' Equity
		Allocated	Unallocated	
Balance at December 31, 2007	\$ 1,988	\$ 14,541	\$ 23,182	\$ 39,711
Net income			4,837	4,837
Capital stock/participation certificates issued/(retired), net	27			27
Patronage distribution				
Cash			(1,443)	(1,443)
Nonqualified allocated retained earnings		1,237	(1,237)	—
Nonqualified retained earnings		1,443	(1,443)	—
Retained earnings retired		(725)		(725)
Patronage distribution adjustment		57	(92)	(35)
Balance at December 31, 2008	2,015	16,553	23,804	42,372
Net income			2,825	2,825
Capital stock/participation certificates issued/(retired), net	(6)			(6)
Patronage distribution				
Cash			(1,360)	(1,360)
Nonqualified allocated retained earnings		1,166	(1,166)	—
Nonqualified retained earnings		1,360	(1,360)	—
Retained earnings retired		(885)		(885)
Patronage distribution adjustment		37	(58)	(21)
Balance at December 31, 2009	2,009	18,231	22,685	42,925
Net income			5,410	5,410
Capital stock/participation certificates issued/(retired), net	1			1
Patronage distribution				
Cash			(1,870)	(1,870)
Nonqualified allocated retained earnings		1,329	(1,329)	—
Nonqualified retained earnings		1,722	(1,722)	—
Retained earnings retired		(1,270)		(1,270)
Patronage distribution adjustment		(39)	60	21
Balance at December 31, 2010	\$ 2,010	\$ 19,973	\$ 23,234	\$ 45,217

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

Consolidated Statements of Cash Flows

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2010	2009	2008
Cash flows from operating activities:			
Net income	\$ 5,410	\$ 2,825	\$ 4,837
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	152	148	126
Amortization of premiums on purchased loans	259	395	383
Premium amortization (discount accretion) on investments	(17)	16	129
Provision for (reversal of allowance for) loan losses	510	2,089	731
(Gains) losses on other property owned, net	240	4	—
Changes in operating assets and liabilities:			
(Increase) decrease in loans held for sale, net	283	(181)	(431)
(Increase) decrease in accrued interest receivable	(39)	1,223	1,323
(Increase) decrease in due from AgFirst Farm Credit Bank	(23)	(740)	(395)
(Increase) decrease in other assets	(78)	(162)	95
Increase (decrease) in accrued interest payable	(58)	(143)	(489)
Increase (decrease) in other liabilities	(832)	(1,983)	1,465
Total adjustments	397	666	2,937
Net cash provided by (used in) operating activities	5,807	3,491	7,774
Cash flows from investing activities:			
Proceeds from maturities of or principal payments received on investment securities, held to maturity	2,345	2,588	3,458
Net (increase) decrease in loans	(7,951)	(6,445)	19,641
(Increase) decrease in investment in other Farm Credit institutions	538	1,342	(3,814)
Purchases of other investments	—	(331)	(875)
Proceeds from payments received on other investments	624	551	384
Purchases of premises and equipment	(34)	(516)	(210)
Proceeds from sales of other property owned	—	841	—
Net cash provided by (used in) investing activities	(4,478)	(1,970)	18,584
Cash flows from financing activities:			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	807	3,644	(24,240)
Net increase (decrease) in advanced conditional payments	(114)	(3,173)	(547)
Capital stock and participation certificates issued/(retired), net	1	(6)	27
Patronage refunds and dividends paid	(1,330)	(1,458)	(1,549)
Retained earnings retired	(1,270)	(885)	(725)
Net cash provided by (used in) financing activities	(1,906)	(1,878)	(27,034)
Net increase (decrease) in cash	(577)	(357)	(676)
Cash, beginning of period	2,503	2,860	3,536
Cash, end of period	\$ 1,926	\$ 2,503	\$ 2,860
Supplemental schedule of non-cash activities:			
Loans transferred to other property owned	\$ 832	\$ 922	\$ —
Cash dividends or patronage distributions declared or payable	1,870	1,360	1,443
Supplemental information:			
Interest paid	6,731	7,241	11,977
Taxes (refunded) paid, net	27	—	4

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

Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

Note 1 — Organization and Operations

A. **Organization:** Jackson Purchase Agricultural Credit Association (Association) is a member-owned cooperative which provides credit and credit-related services to or for the benefit of eligible borrowers/shareholders for qualified purposes in the counties of Ballard, Calloway, Carlisle, Fulton, Graves, Hickman, Marshall and McCracken in the state of Kentucky.

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

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

The ACA holding company holds a charter for the two wholly-owned subsidiaries, although the Association is operating its short- and intermediate-term business through the ACA instead of the PCA.

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

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

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

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

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

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

Note 2 — Summary of Significant Accounting Policies

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

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

- A. **Cash:** Cash, as included in the statements of cash flows, represents cash on hand and on deposit at banks.
- B. **Investment Securities:** The Association, as permitted under the FCA regulations, holds investments for purposes of maintaining a liquidity reserve, managing short-term surplus funds and managing interest rate risk. The Association's investments are classified as held-to-maturity and accordingly have been reported at amortized cost. Purchase premiums and discounts are amortized by a two-step method using constant yield methodologies over a projected cash flow stream.

The Association reviews all investments that are in a loss position in order to determine whether the unrealized loss, which is considered an impairment, is temporary or other-than-temporary. In the event of other-than-temporary impairment, the carrying value of the security would be written down to fair value, the credit-related loss would be included in earnings in the period of impairment and the non-credit related portion would be recognized in other comprehensive income. Credit related loss is defined as the shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis.

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

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

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

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

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

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

The Association uses a two-dimensional loan rating model based on an internally generated combined system risk rating guidance that incorporates a 14-point risk-rating scale to identify and track the probability of borrower default and a separate scale addressing loss given default over a period of time. Probability of default is the probability that a borrower will experience a default within 12 months from the date of the determination of the risk rating. A default is considered to have occurred if the lender believes the borrower will not be able to pay its obligation in full or the borrower is past due more than 90 days. The loss given default is management's estimate as to the anticipated economic loss on a specific loan assuming default has occurred or is expected to occur within the next 12 months.

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

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

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

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

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

A specific allowance may be established for impaired loans under Financial Accounting Standards Board (FASB) guidance on accounting by creditors for impairment of a loan. Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent.

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

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

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

Substantially all employees of the Association may also be eligible to participate in a defined contribution Districtwide 401(k) plan, which qualifies as a 401(k) plan as defined by the Internal Revenue Code; a percentage of employee contributions is matched by the Association. 401(k) plan costs are expensed as funded.

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

- J. **Income Taxes:** The Association is generally subject to Federal income taxes. As previously described, the ACA

holding company has two wholly-owned subsidiaries, a PCA and a FLCA. The FLCA subsidiary is exempt from federal and state income taxes as provided in the Farm Credit Act. The ACA holding company and the PCA subsidiary are subject to federal, state and certain other income taxes.

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

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

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

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. Patronage receivable is included in Due from AgFirst Farm Credit Bank.

L. Fair Value Measurement: Effective January 1, 2008, the Association adopted FASB guidance on fair value measurements. This guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. This guidance also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. It describes three levels of inputs that may be used to measure fair value as discussed in Note 15.

M. Recently Issued Accounting Pronouncements: The Financial Accounting Standards Board (FASB) issued guidance "Accounting for Transfers of Financial Assets," which amended previous guidance by improving the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and

cash flows; and a transferor's continuing involvement, if any, in transferred financial assets.

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

In June 2009, the FASB also issued guidance to improve financial reporting for those enterprises involved with variable interest entities, which amends previous guidance by requiring an enterprise to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity. Additionally, an enterprise is required to assess whether it has an implicit financial responsibility to ensure that a variable interest entity operates as designed when determining whether it has the power to direct the activities of the variable interest entity that most significantly impact the entity's economic performance. This guidance was effective January 1, 2010. The Association does not have any variable interest or controlling interest in a variable entity. Therefore, there was no impact of adoption of the guidance for the Association.

Effective January 1, 2010, the Association adopted FASB guidance "Fair Value Measurements and Disclosures," which is intended to improve disclosures about fair value measurement by increasing transparency in financial reporting. The changes provide a greater level of disaggregated information and more detailed disclosures of valuation techniques and inputs to fair value measurement. The new disclosures and clarification of existing disclosures were effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the rollforward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this guidance had no impact on the Association's financial condition and results of operations but resulted in additional disclosures (see Note 15).

In July 2010, the FASB issued guidance on "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses." This guidance provides additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of its allowance for credit losses. Existing disclosures were amended to include additional disclosures of financing receivables on both a portfolio segment and class of financing receivable basis. This includes a

rollforward schedule of the allowance for credit losses from the beginning of the reporting period to the end of the period on a portfolio segment basis, with the ending balance further disclosed on the basis of the method of impairment (individually or collectively evaluated). The guidance also calls for new disclosures including but not limited to credit quality indicators at the end of the reporting period by class of financing receivables, the aging of past due financing receivables, nature and extent of financing receivables modified as troubled debt restructurings by class and the effect on the allowance for credit losses. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The adoption of this guidance should have no impact on the Association's financial condition or results of operations, but it will result in additional disclosures.

Note 3 — Investment Securities

A summary of the amortized cost and fair value of investment securities held-to-maturity at December 31, 2010, 2009 and 2008 follows:

December 31, 2010					
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Asset backed securities	\$ 4,702	\$ 3	\$ (12)	\$ 4,693	1.98%

December 31, 2009					
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Asset backed securities	\$ 7,145	\$ 9	\$ (11)	\$ 7,143	2.00%

December 31, 2008					
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Asset backed securities	\$ 9,889	\$ —	\$ (73)	\$ 9,816	2.92%

A summary of the expected maturity, amortized cost and estimated fair value of investment securities held-to-maturity at December 31, 2010 follows:

	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	\$ 1,700	\$ 1,698	1.93%
After one year through five years	2,929	2,924	2.02
After five years through ten years	73	71	1.79
After ten years	—	—	—
Total	\$ 4,702	\$ 4,693	1.98%

The Association's investments consist primarily of asset-backed securities (ABSs). These ABSs are rated AAA and they are guaranteed by the full faith and credit of the United States government. Asset-backed securities are held for maintaining a liquidity reserve, managing short-term surplus funds and managing interest rate risk. These securities must meet the applicable Farm Credit Administration (FCA) regulatory

guidelines, which require these securities to be high quality, senior class, and rated AAA at the time of purchase. To achieve the ratings, these securities have a guarantee of timely payment of principal and interest or credit enhancement achieved through over collateralization and the priority of payments of senior classes over junior classes. The FCA considers an asset-backed security investment ineligible if it falls below the AAA credit rating criteria and requires System institutions to divest of such an investment unless approval is granted to continue to hold by the FCA. All of the Association's asset-backed securities at December 31, 2010 are considered eligible under FCA regulatory guidelines.

An investment is considered impaired if its fair value is less than its cost. A continuous unrealized loss position for an investment is based on the date the impairment was first identified. The following table shows the fair value and gross unrealized losses for investments that were in a continuous unrealized loss position aggregated by investment category at December 31, 2010, 2009 and 2008:

	December 31, 2010			
	Less than 12 Months		Greater than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Asset-backed securities	\$ 1,681	\$ (5)	\$ 1,453	\$ (7)

	December 31, 2009			
	Less than 12 Months		Greater than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Asset-backed securities	\$ 1,740	\$ (1)	\$ 1,633	\$ (10)

	December 31, 2008			
	Less than 12 Months		Greater than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Asset-backed securities	\$ 2,692	\$ 9	\$ 6,808	\$ 64

The Association performs periodic credit reviews, including other-than-temporary impairment analyses, on its investment securities portfolio. The objective is to quantify any future possible loss of principal or interest due on each security identified for additional analysis. Factors considered in determining whether an impairment is other-than-temporary include among others as applicable: 1) the length of time and the extent to which the fair value is less than cost, 2) adverse conditions specifically related to the industry, 3) geographic area and the condition of the underlying collateral, 4) payment structure of the security, 5) ratings by rating agencies, 6) the credit worthiness of bond insurers, and 7) volatility of the fair value changes. Based on the results of all analyses, the Association has not recognized any other-than-temporary impairment as the unrealized losses resulted primarily from reduced liquidity in the securities markets stemming from general adversity in the financial markets. The Association has the ability and intent to hold these investments until a recovery of unrealized losses occurs, which may be at maturity, and at this time expects to collect the full principal amount and interest due on these securities, especially after considering credit enhancements. The Association does not intend

to sell these investments and it is not more likely than not that the Association would be required to sell these investments before recovering its costs. Substantially all of these investments were in U. S. government agency securities and the Association expects

these securities would not be settled at a price less than their amortized cost. All securities continue to perform.

Note 4 — Loans and Allowance for Loan Losses

A summary of loans follows:

<i>(dollars in thousands)</i>	December 31,		
	2010	2009	2008
Real estate mortgage	\$ 94,729	\$ 78,028	\$ 81,239
Production and intermediate-term	133,078	128,354	126,282
Agribusiness			
Loans to cooperatives	6,403	7,271	—
Processing and marketing	13,947	19,849	20,863
Farm-related business	4,424	7,232	12,829
Total agribusiness	24,774	34,352	33,692
Rural residential real estate	9,165	14,325	22,523
Other (including mission-related)	12,044	13,015	—
Total Loans	\$ 273,790	\$ 268,074	\$ 263,736

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

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

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

<i>(dollars in thousands)</i>	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	\$ —	\$ 20,570	\$ —	\$ —	\$ 2,609	\$ 390	\$ 2,609	\$ 20,960
Production and intermediate term	2,053	14,276	—	—	923	1,163	2,976	15,439
Agribusiness								
Loans to cooperatives	1,293	—	—	—	4,995	—	6,288	—
Processing and marketing	21,485	16,447	11,702	6,896	4,123	—	37,310	23,343
Farm-related business	—	436	—	—	—	—	—	436
Total agribusiness	22,778	16,883	11,702	6,896	9,118	—	43,598	23,779
Other (including mission-related)	—	—	—	—	11,759	—	11,759	—
Total	\$ 24,831	\$ 51,729	\$ 11,702	\$ 6,896	\$ 24,409	\$ 1,553	\$ 60,942	\$ 60,178

A significant source of liquidity for the Association is the repayments and maturities of loans. The following table presents the contractual maturity distribution of loans by loan type at December 31, 2010 and indicates that approximately 35.38 percent of loans had maturities of one year or less:

<i>(dollars in thousands)</i>	Due less than 1 year	Due 1 Through 5 years	Due after 5 years	Total
Real estate mortgage	\$ 6,198	\$ 8,381	\$ 80,150	\$ 94,729
Production and intermediate term Agribusiness	76,752	28,981	27,345	133,078
Loans to cooperatives	1,293	—	5,110	6,403
Processing and marketing	10,962	793	2,192	13,947
Farm-related business	1,550	509	2,365	4,424
Total agribusiness	13,805	1,302	9,667	24,774
Rural residential real estate	118	1,360	7,687	9,165
Other (including mission related)	—	2,384	9,660	12,044
Total Loans	\$ 96,873	\$ 42,408	\$ 134,509	\$ 273,790

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

	2010	2009	2008		2010	2009	2008
Real estate mortgage:				Farm-related business			
Acceptable	94.63%	89.54%	95.32%	Acceptable	100.00%	93.45%	99.85%
OAEM	2.43	6.35	4.33	OAEM	—	—	—
Substandard/doubtful/loss	2.94	4.11	.35	Substandard/doubtful/loss	—	6.55	0.15
	100.00%	100.00%	100.00%		100.00%	100.00%	100.00%
Production and intermediate-term:				Total agribusiness			
Acceptable	95.82%	95.88%	94.05%	Acceptable	69.98%	68.03%	97.36%
OAEM	2.51	2.90	3.79	OAEM	6.82	9.52	—
Substandard/doubtful/loss	1.67	1.22	2.16	Substandard/doubtful/loss	23.20	22.45	2.64
	100.00%	100.00%	100.00%		100.00%	100.00%	100.00%
Agribusiness:				Rural residential real estate:			
Loans to cooperatives:				Acceptable	93.35%	97.67%	97.28%
Acceptable	87.46%	88.36%	—%	OAEM	3.61	0.01	0.78
OAEM	12.54	—	—	Substandard/doubtful/loss	3.04	2.32	1.94
Substandard/doubtful/loss	—	11.64	—		100.00%	100.00%	100.00%
	100.00%	100.00%	100.00%	Other (including mission-related)			
Processing and marketing				Acceptable	100.00%	100.00%	—%
Acceptable	52.32%	51.20%	95.81%	OAEM	—	—	—
OAEM	6.33	16.54	—	Substandard/doubtful/loss	—	—	—
Substandard/doubtful/loss	41.35	32.26	4.19		100.00%	100.00%	100.00%
	100.00%	100.00%	100.00%	Total Loans:			
				Acceptable	93.18%	90.77%	95.14%
				OAEM	2.80	4.46	3.22
				Substandard/doubtful/loss	4.02	4.77	1.64
					100.00%	100.00%	100.00%

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

<i>(dollars in thousands)</i>	30 Through 89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans	Recorded Investment 90 Days or More Past Due and Accruing Interest
Real estate mortgage	\$ 411	\$ 86	\$ 497	\$ 95,238	\$ 95,735	\$ —
Production and intermediate-term Agribusiness	116	23	139	134,743	134,882	—
Loans to cooperatives	—	—	—	6,482	6,482	—
Processing and marketing	167	—	167	13,815	13,982	—
Farm-related business	—	—	—	4,455	4,455	—
Total agribusiness	167	—	167	24,752	24,919	—
Rural residential real estate	48	5	53	9,149	9,202	—
Other (including mission-related)	—	565	565	11,564	12,129	565
Total	\$ 742	\$ 679	\$ 1,421	\$ 275,446	\$ 276,867	\$ 565

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

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

<i>(dollars in thousands)</i>	December 31,		
	2010	2009	2008
Nonaccrual loans:			
Real estate mortgage	\$ 226	\$ 2,252	\$ 226
Production and intermediate-term Agribusiness	44	192	1,676
Loans to cooperatives	-	859	-
Processing and marketing	3,612	2,468	-
Farm-related business	-	10	14
Total agribusiness	3,612	3,337	14
Rural residential real estate	65	89	101
Total nonaccrual loans	<u>\$ 3,947</u>	<u>\$ 5,870</u>	<u>\$ 2,017</u>
Accruing restructured loans:			
Real estate mortgage	\$ -	\$ 4	\$ 9
Total accruing restructured loans	<u>\$ -</u>	<u>\$ 4</u>	<u>\$ 9</u>
Accruing loans 90 days or more past due:			
Other (including mission-related)	\$ 565	\$ -	\$ -
Total accruing loans 90 days or more past due	<u>\$ 565</u>	<u>\$ -</u>	<u>\$ -</u>
Total nonperforming loans	\$ 4,512	\$ 5,874	\$ 2,026
Other property owned	669	77	-
Total nonperforming assets	<u>\$ 5,181</u>	<u>\$ 5,951</u>	<u>\$ 2,026</u>
Nonaccrual loans as a percentage of total loans	1.44%	2.19%	0.76%
Nonperforming assets as a percentage of total loans and other property owned	1.89%	2.22%	0.77%
Nonperforming assets as a percentage of capital	<u>11.46%</u>	<u>13.86%</u>	<u>4.78%</u>

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

<i>(dollars in thousands)</i>	December 31,		
	2010	2009	2008
Impaired nonaccrual loans:			
Current as to principal and interest	\$ 3,833	\$ 5,515	\$ 1,843
Past due	114	355	174
Total impaired nonaccrual loans	<u>3,947</u>	<u>5,870</u>	<u>2,017</u>
Impaired accrual loans:			
Restructured	-	4	9
90 days or more past due	565	-	-
Total impaired accrual loans	<u>565</u>	<u>4</u>	<u>9</u>
Total impaired loans	<u>\$ 4,512</u>	<u>\$ 5,874</u>	<u>\$ 2,026</u>

Additional impaired loan information is as follows:

<i>(dollars in thousands)</i>	December 31, 2010			Year Ended December 31, 2010	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans
Impaired loans with a related allowance for credit losses:					
Real estate mortgage	\$ 141	\$ 156	\$ 86	\$ 111	\$ 3
Production and intermediate-term Agribusiness	23	22	22	18	-
Processing and marketing	1,677	1,736	240	1,319	32
Total agribusiness	1,677	1,736	240	1,319	32
Total	\$ 1,841	\$ 1,914	\$ 348	\$ 1,448	\$ 35
Impaired loans with no related allowance for credit losses:					
Real estate mortgage	\$ 85	\$ 190	\$ -	\$ 67	\$ 1
Production and intermediate-term Agribusiness	21	21	-	17	1
Processing and marketing	1,935	1,935	-	-	-
Total agribusiness	1,935	1,935	-	1,522	38
Rural residential real estate	65	63	-	51	1
Other (including mission-related)	565	534	-	444	11
Total	\$ 2,671	\$ 2,743	\$ -	\$ 2,101	\$ 52
Total impaired loans:					
Real estate mortgage	\$ 226	\$ 346	\$ 86	\$ 178	\$ 4
Production and intermediate-term Agribusiness	44	43	22	35	1
Processing and marketing	3,612	3,671	240	2,841	70
Total agribusiness	3,612	3,671	240	2,841	70
Rural residential real estate	65	63	-	51	1
Other (including mission-related)	565	534	-	444	11
Total	\$ 4,512	\$ 4,657	\$ 348	\$ 3,549	\$ 87

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

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

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

<i>(dollars in thousands)</i>	Year Ended December 31,		
	2010	2009	2008
Interest income which would have been recognized under the original loan terms	\$ 203	\$ 470	\$ 103
Less: interest income recognized	84	315	48
Foregone interest income	\$ 119	\$ 155	\$ 55

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

<i>(dollars in thousands)</i>	Real Estate Mortgage	Production and Intermediate- term	Agribusiness	Rural Residential Real Estate	Other Loans (including mission-related)	Total
Allowance for credit losses:						
Balance at December 31, 2009	\$ 1,507	\$ 301	\$ 1,208	\$ 54	\$ —	\$ 3,070
Charge-offs	(1,138)	(53)	—	(3)	—	(1,194)
Recoveries	—	—	50	—	—	50
Provision for loan losses	(30)	113	447	(20)	—	510
Balance at December 31, 2010	\$ 339	\$ 361	\$ 1,705	\$ 31	\$ —	\$ 2,436
2010 allowance ending balance:						
Individually evaluated for impairment	\$ 86	\$ 22	\$ 240	\$ —	\$ —	\$ 348
Collectively evaluated for impairment	\$ 253	\$ 339	\$ 1,465	\$ 31	\$ —	\$ 2,088
Recorded investment in loans outstanding:						
Ending Balance at December 31, 2010	\$ 95,735	\$ 134,882	\$ 24,919	\$ 9,202	\$ 12,129	\$ 276,867
2010 recorded investment ending balance:						
Loans individually evaluated for impairment	\$ 227	\$ 43	\$ 3,612	\$ 65	\$ 565	\$ 4,512
Loans collectively evaluated for impairment	\$ 95,508	\$ 134,839	\$ 21,307	\$ 9,137	\$ 11,564	\$ 272,355

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, 2010, 2009 and 2008, the Association held Tobacco Buyout SIIC of \$2,312, \$2,821 and \$2,901, respectively, net of discount.

Note 6 — Investment in AgFirst Farm Credit Bank

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

Note 7 — Premises and Equipment

Premises and equipment consists of the following:

	December 31,		
	2010	2009	2008
Land	\$ 315	\$ 310	\$ 297
Buildings and improvements	1,899	1,896	1,571
Furniture and equipment	861	871	875
	<u>3,075</u>	<u>3,077</u>	<u>2,743</u>
Less: accumulated depreciation	1,410	1,294	1,328
Total	<u>\$ 1,665</u>	<u>\$ 1,783</u>	<u>\$ 1,415</u>

Note 8 — Other Property Owned

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

	December 31,		
	2010	2009	2008
Gains (losses) on sale, net	\$ 2	\$ -	\$ -
Carrying value unrealized gains (losses)	(237)	-	-
Operating income (expense), net	(5)	(4)	-
Gains (losses) on other property owned, net	<u>\$ (240)</u>	<u>\$ (4)</u>	<u>\$ -</u>

Note 9 — 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 the Association. The weighted average interest rates on the variable rate notes were 1.57 percent for LIBOR-based loans, 1.95 percent for Prime-based loans, and the weighted average remaining maturities were 1.0 years and 2.8 years, respectively, at December 31, 2010. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) loans which are match funded by the Bank was 3.21 percent and the weighted average remaining maturity was 9.1 years at December 31, 2010. The weighted average interest rate on all interest-bearing notes payable was 2.76 percent and the weighted average remaining maturity was 6.8 years at December 31, 2010.

Variable rate and fixed rate notes payable represent approximately 29.00 percent and 71.00 percent, respectively, of total notes payable at December 31, 2010.

Under the Farm Credit Act, the Association is obligated to borrow only from the Bank, unless the Bank approves borrowing from other funding sources. The Bank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2010, the Association's notes payable were within the specified limitations.

Note 10 — Members' Equity

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

A. 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 Common 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 loan amount. 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.

B. Regulatory Capitalization Requirements and Restrictions

The FCA's capital adequacy regulations require all system institutions to achieve permanent capital of 7.00 percent of risk adjusted assets and off-balance-sheet commitments. Failure to meet the 7.00 percent capital requirement can initiate certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Association's financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless prescribed capital standards are met. FCA regulations also require that additional minimum standards for capital be achieved. These standards require all System institutions to achieve and maintain ratios as defined by FCA regulations. These required ratios are total surplus as a percentage of risk adjusted assets of 7.00 percent and of core surplus as a percentage of risk adjusted assets of 3.50 percent. The Association's permanent capital, total surplus and core surplus ratios at December 31, 2010 were 16.94 percent, 16.04 percent and 14.95 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.

C. Description of Equities

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

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

Class	Protected	Shares Outstanding	
		Number	Aggregate Par Value
B Common/Nonvoting	No	10,000	\$ 50
C Common/Voting	No	364,600	1,823
C Participation Certificates/Nonvoting	No	27,400	137
Total Capital Stock and Participation Certificates		402,000	\$ 2,010

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

Retained Earnings

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

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

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

Allocated equities shall be retired solely at the discretion of the Board; provided, however, that minimum capital standards established by the FCA and the Board are met. Nonqualified retained surplus is considered to be permanently invested in the Association and as such, there is no plan to revolve or retire this surplus. All nonqualified distributions are tax deductible only when redeemed.

At December 31, 2010, allocated members' equity consisted of \$474 of qualified surplus, \$7,010 of nonqualified allocated surplus and \$12,489 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 member's 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 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, or C Common Stock and participation certificates shall be at the same rate per share.

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

Transfer

Classes B and C Common Stocks and Participation Certificates may be transferred to persons or entities eligible to purchase or hold such Stock or Participation Certificates as provided in Section 830 of the Association's bylaws. Class A Preferred Stock may be transferred in the manner set forth in the resolution authorizing the issuance of each Stock.

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. Classes B and C Common Stock and Participation Certificates
2. Class A 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. Holders of Class A Preferred Stock
2. Holders of Classes B and C Common Stock and Participation Certificates
3. Holders of allocated surplus evidenced by qualified written notices of allocation, in the order of the year of issuance, until the total amount of such account has been distributed
4. Holders of nonqualified allocated surplus evidenced by written notices of allocation in the order of the year of issuance, until the total amount of such account has been distributed
5. All unallocated surplus issued after December 12, 1996, shall be distributed to present and former patrons from said date through the date of liquidation on a patronage basis
6. Any remaining assets of the Association after such distribution shall be distributed ratably to the holders of all classes of stock and participation certificates in proportion to the number or shares or units of such class of stock or participation certificates held by such holders

Note 11 — Income Taxes

The provision (benefit) for income taxes follows:

	Year Ended December 31,		
	2010	2009	2008
Current:			
Federal	\$ 29	\$ 2	\$ 1
	<u>29</u>	<u>2</u>	<u>1</u>
Deferred:	-	-	-
Total provision (benefit) for income taxes	<u>\$ 29</u>	<u>\$ 2</u>	<u>\$ 1</u>

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

	December 31,		
	2010	2009	2008
Federal tax at statutory rate	\$ 1,849	\$ 961	\$ 1,645
Patronage distributions	(636)	(462)	(490)
Tax-exempt FLCA earnings	(1,187)	(448)	(958)
Change in deferred tax asset valuation allowance	(29)	(48)	(188)
Other	32	(1)	(8)
Provision (benefit) for income taxes	<u>\$ 29</u>	<u>\$ 2</u>	<u>\$ 1</u>

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

	December 31,		
	2010	2009	2008
Deferred income tax assets:			
Allowance for loan losses	\$ 126	\$ 132	\$ 142
Annual leave	51	54	45
Pensions and other postretirement benefits	34	28	31
Depreciation	4	14	7
Gross deferred tax assets	<u>215</u>	<u>228</u>	<u>225</u>
Less: valuation allowance	<u>(22)</u>	<u>(51)</u>	<u>(99)</u>
Gross deferred tax assets, net of valuation allowance	<u>193</u>	<u>177</u>	<u>126</u>
Deferred income tax liabilities:			
Pensions and other postretirement benefits	(193)	(177)	(126)
Depreciation	-	-	-
Gross deferred tax liability	<u>(193)</u>	<u>(177)</u>	<u>(126)</u>
Net deferred tax asset (liability)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

At December 31, 2010, deferred income taxes have not been provided by the Association on approximately \$2.9 million of its investment in the Bank. Management expects that these earnings will not be converted to cash.

The Association recorded a valuation allowance of \$22, \$51 and \$99 during 2010, 2009 and 2008, respectively. The Association will continue to evaluate the realizability of these deferred tax assets and adjust the valuation allowance accordingly.

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

Note 12 — Employee Benefit Plans

The Association participates in multi-employer sponsored benefit plans. These plans include a defined benefit final average pay retirement plan with three other associations, a Districtwide defined benefit cash balance retirement plan, a defined benefit

other postretirement benefits plan, and a defined contribution 401(k) plan. Financial information regarding each of these plans follows.

Substantially all employees of the Association are eligible to participate in either the defined benefit Independent Associations' Retirement Plan (the IAR Plan) with three other District associations or the Districtwide defined benefit AgFirst Farm Credit Cash Balance Retirement Plan (the CB Plan.) These two plans are noncontributory and include eligible District employees. For participants hired prior to January 1, 2009, benefits are provided under the IAR Plan and are based on eligible compensation and years of service. For participants hired on or after January 1, 2009, benefits are provided under the CB Plan and are determined using a percent of eligible compensation formula. The employer contribution under the CB Plan is based on a formula of 3.00 - 5.00 percent of eligible compensation (depending on years of service) and interest credits as allocated to an employee's theoretical account balance. As a participant in these defined benefit retirement plans, the Association funded \$713 for 2010, \$737 for 2009, and \$632 for 2008, through its note payable to the Bank. Plan expenses included in salaries and employee benefits were \$604 for 2010, \$567 for 2009, and \$152 for 2008. Additional financial information for the Plans may be found in the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' 2010 Annual Report.

The District sponsors a plan providing certain benefits (primarily health care) to its retirees. Certain Association charges related to this plan are an allocation of District charges based on the Association's proportional share of the plan liability. This plan is unfunded with expenses paid as incurred. Postretirement benefits other than pensions (primarily health care benefits) included in salaries and employee benefits were \$0 for 2010, \$(12) for 2009 and \$(11) for 2008. Additional financial information for the Plan may be found in the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' 2010 Annual Report.

The Association also participates in a defined contribution Districtwide 401(k) plan, which qualifies as a 401(k) plan as defined by the Internal Revenue Code. This 401(k) plan requires the Association to match 100 percent of employee optional contributions up to a 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 \$153, \$141 and \$142 for the years ended December 31, 2010, 2009 and 2008, respectively.

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, amortization schedule, and collateral, as those prevailing at the time for comparable transactions with unaffiliated borrowers.

Total loans to such persons at December 31, 2010 amounted to \$18,562. During 2010, \$16,602 of new loans were made and repayments totaled \$16,272. In the opinion of management, none of these loans outstanding at December 31, 2010 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, 2010, \$67,529 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, 2010, the Association had outstanding \$1,383 of standby letters of credit, with expiration dates ranging from January 4, 2011 to May 1, 2019. The maximum potential amount of future payments the Association may be required to make under these existing guarantees is \$1,383.

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, 2010, the Association's inventory of standby letters of credit had a fair value of \$17 and was included in other liabilities.

Note 15 — Fair Value Measurement

As described in Note 2, effective January 1, 2008, the Association adopted FASB guidance on fair value measurements. This guidance defines fair value, establishes a framework for measuring fair value and expands the Association's fair value disclosures for certain assets and liabilities measured at fair value on a recurring and non-recurring basis. These assets and liabilities consist primarily of standby letters of credit, impaired loans and other property owned.

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

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

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

Level 1

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets. The Association has no Level 1 assets or liabilities measured at fair value on a recurring basis at December 31, 2010.

Level 2

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability. The Association has no Level 2 assets and liabilities measured at fair value on a recurring basis at December 31, 2010.

Level 3

Level 3 inputs to the valuation methodology are unobservable and supported by little or no market activity. Valuation is determined using pricing models, discounted cash flow methodologies, or similar techniques, and could include significant management judgment or estimation. Level 3 assets and liabilities include instruments whose price has been adjusted based on dealer quoted pricing that is different than the third-party valuation or internal model pricing.

Level 3 assets at December 31, 2010 include impaired loans which represent the fair value of certain loans that were evaluated for impairment under FASB guidance. The fair value was based upon the underlying collateral since these were collateral-dependent loans. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established. Other property owned is classified as a Level 3 asset at December 31, 2010. The fair value for other property owned is based upon the collateral value. Costs to sell represent transaction costs and are not included as a component of the fair value of other property owned. Level 3 liabilities at December 31, 2010 include standby letters of credit whose market value is internally calculated based on information that is not observable either directly or indirectly in the marketplace.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following tables present the assets and liabilities that are measured at fair value on a recurring basis at December 31, 2010, 2009 and 2008 for each of the fair value hierarchy levels:

December 31, 2010				
	Level 1	Level 2	Level 3	Total Fair Value
Liabilities:				
Standby letters of credit	\$ —	\$ —	\$ 17	\$ 17
Total Liabilities	\$ —	\$ —	\$ 17	\$ 17

December 31, 2009				
	Level 1	Level 2	Level 3	Total Fair Value
Liabilities:				
Standby letters of credit	\$ —	\$ —	\$ 28	\$ 28
Total Liabilities	\$ —	\$ —	\$ 28	\$ 28

December 31, 2008				
	Level 1	Level 2	Level 3	Total Fair Value
Liabilities:				
Standby letters of credit	\$ —	\$ —	\$ 46	\$ 46
Total Liabilities	\$ —	\$ —	\$ 46	\$ 46

The Association had no transfers of assets or liabilities into or out of Level 1 or Level 2 during 2010 or 2009. The following tables present the changes in Level 3 assets and liabilities measured at fair value on a recurring basis for 2010, 2009 and 2008:

	Standby Letters Of Credit
Balance at January 1, 2010	\$ 28
Total gains or (losses) realized/unrealized:	
Included in earnings	-
Included in other comprehensive loss	-
Purchases, sales, issuances and settlements, net	(11)
Transfers in and/or out of level 3	-
Balance at December 31, 2010	\$ 17

	Standby Letters Of Credit
Balance at January 1, 2009	\$ 46
Total gains or (losses) realized/unrealized:	
Included in earnings	-
Included in other comprehensive loss	-
Purchases, sales, issuances and settlements, net	(18)
Transfers in and/or out of level 3	-
Balance at December 31, 2009	\$ 28

	Standby Letters Of Credit
Balance at January 1, 2008	\$ 53
Total gains or (losses) realized/unrealized:	
Included in earnings	-
Included in other comprehensive loss	-
Purchases, sales, issuances and settlements, net	(7)
Transfers in and/or out of level 3	-
Balance at December 31, 2008	\$ 46

Assets and Liabilities Measured at Fair Value on a Non-recurring Basis

Assets and liabilities measured at fair value on a non-recurring basis at December 31, 2010, 2009 and 2008 for each of the fair value hierarchy values are summarized below. As discussed in Note 2, fair value disclosure of nonfinancial instruments, such as other property owned, began in 2009.

	December 31, 2010				YTD Total Gains (Losses)
	Level 1	Level 2	Level 3	Total Fair Value	
Assets:					
Impaired loans	\$ -	\$ -	\$ 1,493	\$ 1,493	\$ 335
Other property owned	\$ -	\$ -	\$ 721	\$ 721	\$ (235)

	December 31, 2009				YTD Total Gains (Losses)
	Level 1	Level 2	Level 3	Total Fair Value	
Assets:					
Impaired loans	\$ -	\$ -	\$ 2,345	\$ 2,345	\$ (2,200)
Other property owned	\$ -	\$ -	\$ 77	\$ 77	\$ -

	December 31, 2008				YTD Total Gains (Losses)
	Level 1	Level 2	Level 3	Total Fair Value	
Assets:					
Impaired loans	\$ -	\$ -	\$ 1,141	\$ 1,141	\$ (411)

Note 16 — Disclosures About Fair Value Of Financial Instruments

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

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

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

	December 31, 2010		December 31, 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash	\$ 1,926	\$ 1,926	\$ 2,503	\$ 2,503
Loans, net of allowance	\$ 274,432	\$ 272,131	\$ 268,024	\$ 269,404
Investment securities	\$ 4,730	\$ 4,693	\$ 7,192	\$ 7,143
Tobacco Buyout SIIC	\$ 2,312	\$ 2,410	\$ 2,821	\$ 2,997
Financial liabilities:				
Notes payable to AgFirst Farm Credit Bank	\$ 242,725	\$ 241,764	\$ 241,976	\$ 243,773

	December 31, 2008	
	Carrying Amount	Estimated Fair Value
Financial assets:		
Cash	\$ 2,860	\$ 2,860
Loans, net of allowance	\$ 266,172	\$ 267,601
Investment securities	\$ 9,972	\$ 9,816
Tobacco Buyout SIIC	\$ 2,901	\$ 3,046
Financial liabilities:		
Notes payable to AgFirst Farm Credit Bank	\$ 238,475	\$ 241,978

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

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

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

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

The carrying value of accrued interest approximates its fair value.

- C. **Investment Securities:** Fair value is primarily based upon prices obtained from a third party valuation service.
- 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 1.63 percent of the issued stock of the Bank as of December 31, 2010 net of any reciprocal investment. As of that date, the Bank's assets totaled \$30.8 billion and shareholders' equity totaled \$1.9 billion. The Bank's earnings were \$417 million during 2010.

In addition, the Association has an investment of \$79 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:** 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 17 — Quarterly Financial Information (Unaudited)

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

	2010				
	First	Second	Third	Fourth	Total
Net interest income	\$ 1,583	\$ 1,623	\$ 1,679	\$ 1,844	\$ 6,729
Provision for (reversal of allowance for) loan losses	—	—	175	335	510
Noninterest income (expense), net	174	(347)	(261)	(375)	(809)
Net income (loss)	\$ 1,757	\$ 1,276	\$ 1,243	\$ 1,134	\$ 5,410

	2009				
	First	Second	Third	Fourth	Total
Net interest income	\$ 1,457	\$ 1,657	\$ 1,517	\$ 1,624	\$ 6,255
Provision for (reversal of allowance for) loan losses	—	1,486	664	(61)	2,089
Noninterest income (expense), net	(377)	(543)	(329)	(92)	(1,341)
Net income (loss)	\$ 1,080	\$ (372)	\$ 524	\$ 1,593	\$ 2,825

	2008				
	First	Second	Third	Fourth	Total
Net interest income	\$ 1,742	\$ 1,779	\$ 1,703	\$ 1,605	\$ 6,829
Provision for (reversal of allowance for) loan losses	—	—	232	499	731
Noninterest income (expense), net	(411)	(573)	(23)	(254)	(1,261)
Net income (loss)	\$ 1,331	\$ 1,206	\$ 1,448	\$ 852	\$ 4,837

Note 18 – Subsequent Events

The Association has evaluated subsequent events and has determined there are none requiring disclosure through March 14, 2011, which is the date the financial statements were issued.