

# THIRD QUARTER 2011

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## CERTIFICATION

The undersigned certify that we have reviewed the September 30, 2011 quarterly report of Cape Fear Farm Credit, ACA, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.



Michael R. Jackson  
Chief Executive Officer



Matthew J. Currin  
Chief Financial Officer



Ronald J. Allen  
Chairman of the Board

November 7, 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. This process provides 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.

Internal control over financial reporting 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 September 30, 2011. 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 September 30, 2011, 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 September 30, 2011.



Michael R. Jackson  
Chief Executive Officer



Matthew J. Currin  
Chief Financial Officer

November 7, 2011

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

*(dollars in thousands)*

The following commentary reviews the financial condition and results of operations of Cape Fear Farm Credit ACA, (Association) for the period ended September 30, 2011. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2010 Annual Report of the Association. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

## **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. The Association's loan portfolio is diversified over a range of agricultural commodities in our region, including swine, poultry, tobacco, and row-crop operations. Farm size varies and many of the borrowers in the region have diversified farming operations. This factor, along with the opportunities for non-farm income in the area, lessens the level of dependency on any single given commodity. Concentration risk is further mitigated by a portfolio of participation loans purchased or originated and sold.

The gross loan volume of the Association as of September 30, 2011 was \$750,443, an increase of \$32,967 as compared to \$717,476 at December 31, 2010. Net loans outstanding at September 30, 2011, were \$743,273 as compared to \$709,525 at December 31, 2010. Net loans accounted for 92.44 percent of total assets at September 30, 2011, as compared to 91.03 percent of total assets at December 31, 2010.

The increase in gross and net loan volume during the reporting period is attributed to increased demand for credit, particularly within the poultry sector as some expansion has taken place in that industry. The increased demand in poultry was offset by reduced demand in other industries in our portfolio due to some uncertainty within these industries and the general economy as a whole. The short-term portfolio, which is heavily influenced by operating-type loans, normally reaches a peak in August and declines in the fall months as farm commodities are marketed and proceeds are applied to the operating loans.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level and credit administration remains satisfactory. Nonaccrual loans increased from \$26,152 at December 31, 2010 to \$30,730 at September 30, 2011. This increase is mainly due to the transfer of certain large credits into nonaccrual throughout 2011.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions. The allowance for loan losses at September 30, 2011 was \$7,170, which was less than the December 31, 2010 amount of \$7,951 by \$781. The decrease in the overall allowance was mainly due to charge-offs that occurred on several large nonaccrual credits. The amounts on these larger credits that were deemed uncollectible were charged off, therefore eliminating the need for specific reserves on these accounts.

## **RESULTS OF OPERATIONS**

### ***For the three months ended September 30, 2011***

Net income for the three months ended September 30, 2011 totaled \$4,266 as compared to \$4,388 for the same period in 2010. The decrease of \$122 or 2.78 percent is attributed to a decrease in noninterest income of \$187, an increase in allowance for loan loss provisions of \$178 and an increase in noninterest expense of \$64. These items were offset by increases in net interest income of \$279 and a decrease in provision for income tax of \$28.

Net interest income for the three months ended September 30, 2011 increased \$279 or 4.85 percent compared to September 30, 2010. Interest income on loans decreased by \$244 and interest income from other investments decreased increased by \$71, while interest income from investment securities increased by \$3. Interest expense decreased \$591 compared to the same period last year. The increase in net interest income was mainly a result of increased margins on loans that was improved by additional earnings on the Association's fixed loanable funds credit with AgFirst Farm Credit Bank (Bank). Nonaccrual income was \$2 for the three months ended September 30, 2011, as compared to \$134 for the same period in 2010.

Noninterest income for the three months ended September 30, 2011 totaled \$1,782 as compared to \$1,969 for the same period of 2010, a decrease of \$187. This decrease was mainly due to a decrease in loan fees of \$122 and an increase in losses on other property owned of \$37.

Noninterest expense for the three months ended September 30, 2011 increased \$64 compared to the same period of 2010. This increase is due to an increase in other operating expenses by \$134 and in Insurance Fund premiums of \$15 and is offset by a decrease in salaries and employee benefits of \$52 and in occupancy and equipment expense of \$33.

#### ***For the nine months ended September 30, 2011***

Net income for the nine months ended September 30, 2011 totaled \$10,940 as compared to \$15,104 for the same period in 2010. The decrease of \$4,164 or 27.57 percent is attributed primarily to increased allowance for loan loss provisions of \$4,169.

At September 30, 2011, net interest income increased \$945 or 5.73 percent compared to September 30, 2010. Interest income on loans decreased by \$1,600 and interest income from other sources decreased by \$231, while interest expense decreased \$2,776 compared to the same period last year. These decreases are both due to a lower interest rate environment on loan products as well as notes payable to the Bank. Nonaccrual income was \$119 for the nine months ended September 30, 2011, as compared to \$324 for the same period in 2010.

Noninterest income for the nine months ended September 30, 2011 totaled \$6,693 as compared to \$7,289 for the same period of 2010, a decrease of \$596. This decrease primarily resulted from the non-recurring Insurance Fund refunds of \$788 in 2010 that were not present in 2011. This decrease also included decreases of \$115 in equity earnings of other Farm Credit institutions, \$25 in fees for financially related services, \$62 in other noninterest income and \$17 in gains on sale of rural home loans, net. These decreases were offset by increases in gains on other property owned, net in the amount of \$188, an increase in loan fees of \$64 and an increase in gains on the sale of premises and equipment, net of \$159.

Noninterest expense for the nine months ended September 30, 2011 increased \$372 compared to the same period of 2010. This increase resulted primarily from increases of \$300 in salaries and employee benefits, other operating expenses of \$126 and \$35 in Insurance Fund premiums. These increases were offset by a decrease of \$89 in occupancy and equipment expenses.

## **FUNDING SOURCES**

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The funds are advanced by the Bank to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at September 30, 2011, were \$659,035 as compared to \$636,329 at December 31, 2010.

## **CAPITAL RESOURCES**

Total members' equity at September 30, 2011 increased to \$135,883 from the December 31, 2010 total of \$124,802. The increase is primarily due to recognition of net income retained as unallocated surplus through the third quarter.

Farm Credit Administration (FCA) regulations require all Farm Credit institutions to maintain minimum permanent capital, total surplus and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus and core surplus as defined in FCA regulations, by a risk-adjusted asset base. As of September 30, 2011, the Association's permanent capital ratio was 16.65 percent and the total surplus ratio and core surplus ratios were both 16.28 percent. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

## **REGULATORY MATTERS**

On August 18, 2011, the FCA published for comment an amendment to the regulations governing investments held by institutions of the System. The stated objectives of the proposed rule are to:

- ensure that the Banks hold sufficient high quality, readily marketable investments to provide sufficient liquidity to continue operations and pay maturing obligations in the event of market disruption;
- strengthen the safety and soundness of System institutions;
- seek comments on how the FCA can comply with section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which requires the FCA to remove all references to and requirements relating to credit ratings and to substitute other appropriate standards of creditworthiness;

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- reduce regulatory burden with respect to investments that fail to meet eligibility criteria after purchase or are unsuitable; and
  - enhance the ability of the System to supply credit to agriculture and aquatic producers by ensuring adequate availability to funds.

The System is in the process of developing a response to the proposed amendment to the investment regulations. Comments are due by November 16, 2011.

**NOTE:** Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst's annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 2832, or writing Susanne Caughman, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, [www.agfirst.com](http://www.agfirst.com). Copies of the Association's annual and quarterly reports are also available upon request free of charge by calling 1-800-368-5819 ext. 3243, writing Matthew J. Currin, Cape Fear Farm Credit, P. O. Box 2405, Fayetteville, NC 28302, or accessing the website, [www.capefearfarmcredit.com](http://www.capefearfarmcredit.com). The Association prepares a 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.

Cape Fear Farm Credit, ACA

# Consolidated Balance Sheets

<i>(dollars in thousands)</i>	<b>September 30, 2011</b> <i>(unaudited)</i>	<b>December 31, 2010</b> <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 3,184	\$ 4,416
Investment securities:		
Held to maturity (fair value of \$6,606 and \$5,712 respectively)	5,656	5,690
Loans	750,443	717,476
Less: allowance for loan losses	7,170	7,951
Net loans	743,273	709,525
Loans held for sale	382	393
Other investments	15,476	20,356
Accrued interest receivable	7,577	6,134
Investments in other Farm Credit institutions	11,630	11,630
Premises and equipment, net	2,728	2,931
Other property owned	5,862	5,626
Due from AgFirst Farm Credit Bank	4,089	6,641
Other assets	4,231	6,125
Total assets	<u>\$ 804,088</u>	<u>\$ 779,467</u>
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 659,035	\$ 636,329
Accrued interest payable	1,386	1,476
Patronage refund payable	28	7,464
Other liabilities	7,756	9,396
Total liabilities	<u>668,205</u>	<u>654,665</u>
Commitments and contingencies		
<b>Members' Equity</b>		
Protected borrower stock	36	50
Capital stock and participation certificates	2,653	2,634
Retained earnings		
Allocated	34,662	34,552
Unallocated	98,842	87,883
Accumulated other comprehensive income (loss)	(310)	(317)
Total members' equity	<u>135,883</u>	<u>124,802</u>
Total liabilities and members' equity	<u>\$ 804,088</u>	<u>\$ 779,467</u>

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

Cape Fear Farm Credit, ACA

# Consolidated Statements of Income

*(unaudited)*

<i>(dollars in thousands)</i>	<b>For the three months ended September 30,</b>		<b>For the nine months ended September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
<b>Interest Income</b>				
Investment securities	\$ 82	\$ 79	\$ 225	\$ 245
Loans	10,046	10,290	29,244	30,844
Other investments	213	284	642	853
Total interest income	<u>10,341</u>	<u>10,653</u>	<u>30,111</u>	<u>31,942</u>
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	4,306	4,897	12,680	15,456
Net interest income	6,035	5,756	17,431	16,486
Provision for loan losses	407	229	4,398	229
Net interest income after provision for loan losses	<u>5,628</u>	<u>5,527</u>	<u>13,033</u>	<u>16,257</u>
<b>Noninterest Income</b>				
Loan fees	409	531	1,726	1,662
Fees for financially related services	14	9	40	65
Patronage refund from other Farm Credit institutions	1,367	1,362	4,485	4,600
Gains (losses) on other property owned, net	(37)	—	188	—
Gains (losses) on sale of rural home loans, net	15	27	49	66
Gains (losses) on sales of premises and equipment, net	22	(2)	157	(2)
Insurance Fund refunds	—	—	—	788
Other noninterest income (expense)	(8)	42	48	110
Total noninterest income	<u>1,782</u>	<u>1,969</u>	<u>6,693</u>	<u>7,289</u>
<b>Noninterest Expense</b>				
Salaries and employee benefits	2,158	2,210	6,254	5,954
Occupancy and equipment	244	277	593	682
Insurance Fund premium	97	82	277	242
Other operating expenses	480	346	1,497	1,371
Total noninterest expense	<u>2,979</u>	<u>2,915</u>	<u>8,621</u>	<u>8,249</u>
Income before income taxes	4,431	4,581	11,105	15,297
Provision for income taxes	165	193	165	193
Net income	<u>\$ 4,266</u>	<u>\$ 4,388</u>	<u>\$ 10,940</u>	<u>\$ 15,104</u>

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

Cape Fear Farm Credit, ACA

# Consolidated Statements of Changes in Members' Equity

*(unaudited)*

*(dollars in thousands)*

	Protected Borrower Capital	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2009	\$ 56	\$ 2,645	\$ 21,739	\$ 87,041	\$ (319)	\$ 111,162
Comprehensive income						
Net income				15,104		15,104
Employee benefit plans adjustments					13	13
Total comprehensive income						15,117
Protected borrower equity retired	(6)					(6)
Capital stock/participation certificates issued/(retired), net		(15)				(15)
Patronage distribution adjustment			(114)	154		40
Balance at September 30, 2010	\$ 50	\$ 2,630	\$ 21,625	\$ 102,299	\$ (306)	\$ 126,298
Balance at December 31, 2010	\$ 50	\$ 2,634	\$ 34,552	\$ 87,883	\$ (317)	\$ 124,802
Comprehensive income						
Net income				10,940		10,940
Employee benefit plans adjustments					7	7
Total comprehensive income						10,947
Protected borrower equity retired	(14)					(14)
Capital stock/participation certificates issued/(retired), net		19				19
Patronage distribution adjustment			110	19		129
Balance at September 30, 2011	\$ 36	\$ 2,653	\$ 34,662	\$ 98,842	\$ (310)	\$ 135,883

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

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## Cape Fear Farm Credit, ACA

# Notes to the Consolidated Financial Statements

*(dollars in thousands, except as noted)  
(unaudited)*

### **NOTE 1 – ORGANIZATION, SIGNIFICANT ACCOUNTING POLICIES, AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

The accompanying financial statements include the accounts of Cape Fear Farm Credit, ACA (the Association). A description of the organization and operations of the Association, the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2010, are contained in the 2010 Annual Report to Shareholders. These unaudited third quarter 2011 consolidated financial statements should be read in conjunction with the 2010 Annual Report to Shareholders.

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles (GAAP) and prevailing practices within the banking industry. The results for the nine months ended September 30, 2011, are not necessarily indicative of the results to be expected for the year ending December 31, 2011.

Certain amounts in the prior period's consolidated financial statements may have been reclassified to conform to the current period's consolidated financial statement presentation. Such reclassifications had no effect on the prior period net income or total capital as previously reported.

The Association maintains an allowance for loan losses in accordance with GAAP. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of September 30, 2011, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

#### **Recently Issued Accounting Pronouncements**

In September 2011, the Financial Accounting Standards Board (FASB) issued guidance entitled, "Compensation – Retirement Benefits – Multiemployer Plans." The amendment is intended to provide for more information about an employer's financial obligations to multiemployer pension and other postretirement benefit plans, which should help financial statement users better understand the financial health of significant plans in which the employer participates. The additional disclosures include: a) a description of the nature of plan benefits, b) a qualitative description of the extent to which the employer could be responsible for the

obligations of the plan, including benefits earned by employees during employment with another employer, and c) other quantitative information to help users understand the financial information about the plan. The amendments are effective for annual periods for fiscal years ending after December 15, 2011 for public entities. The amendments should be applied retrospectively for all prior periods presented.

In June 2011, the FASB issued guidance entitled, "Comprehensive Income – Presentation of Comprehensive Income." This amendment is intended to increase the prominence of other comprehensive income in financial statements. The current option that permits the presentation of other comprehensive income in the statement of changes in equity has been eliminated. The main provisions of the guidance provides that an entity that reports items of other comprehensive income has the option to present comprehensive income in either one or two consecutive financial statements: (1) A single statement must present the components of net income and total net income, the components of other comprehensive income and total other comprehensive income, and a total for comprehensive income; (2) In a two-statement approach, an entity must present the components of net income and total net income in the first statement. That statement must be immediately followed by a financial statement that presents the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income. This guidance is to be applied retrospectively. For public entities, it is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this guidance will not impact financial condition or results of operations, but will result in changes to the presentation of comprehensive income.

In May 2011, the FASB issued guidance entitled, "Fair Value Measurement – Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs." The amendments change the wording used to describe the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The amendments include the following: (1) Application of the highest and best use and valuation premise is only relevant when measuring the fair value of nonfinancial assets (does not apply to financial assets and liabilities); (2) Aligns the fair value measurement of instruments classified within an entity's shareholders' equity with the guidance for liabilities. As a result, an entity should measure the fair value of its own equity instruments from the perspective of a

market participant that holds the instruments as assets; (3) Clarifies that a reporting entity should disclose quantitative information about the unobservable inputs used in a fair value measurement that is categorized within Level 3 of the fair value hierarchy; (4) An exception to the requirement for measuring fair value when a reporting entity manages its financial instruments on the basis of its net exposure, rather than its gross exposure, to those risks; (5) Clarifies that the application of premiums and discounts in a fair value measurement is related to the unit of account for the asset or liability being measured at fair value. Premiums or discounts related to size as a characteristic of the entity's holding (that is, a blockage factor) instead of as a characteristic of the asset or liability (for example, a control premium), are not permitted. A fair value measurement that is not a Level 1 measurement may include premiums or discounts other than blockage factors when market participants would incorporate the premium or discount into the measurement at the level of the unit of account specified in other guidance; (6) Expansion of the disclosures about fair value measurements. The most significant change will require entities, for their recurring Level 3 fair value measurements, to disclose quantitative information about unobservable inputs used, a description of the valuation processes used by the entity, and a qualitative discussion about the sensitivity of the measurements. New disclosures are required about the use of a nonfinancial asset measured or disclosed at fair value if its use differs from its highest and best use. In addition, entities must report the level in the fair value hierarchy of assets and liabilities not recorded at fair value but where fair value is disclosed. The amendments are to be applied prospectively. The amendments are effective during interim and annual periods beginning after December 15, 2011. Early application is not permitted.

In April 2011, the FASB issued guidance entitled, "A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring," which provides for clarification on whether a restructuring constitutes a troubled debt restructuring (TDR). In evaluating whether a restructuring is a TDR, a creditor must separately conclude that both of the following exists: (1) the restructuring constitutes a concession, and (2) the debtor is experiencing financial difficulties. The guidance is effective for nonpublic entities, including the Association, for annual periods ending on or after December 15, 2012, including interim periods within those annual periods. The guidance should be applied retrospectively to the beginning of the annual period of adoption. The new disclosures about TDR activity required by the guidance on "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses," as discussed below, are effective for annual reporting periods ending after December 15, 2011. The impact of adoption of this guidance, if any, is expected to be immaterial to the Association's financial condition and results of operations, but it will result in additional disclosures.

In January 2011, the FASB issued guidance entitled, "Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings." This amendment temporarily delayed the

effective date of the disclosures about TDRs required by the guidance previously issued on "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses." The effective date of the new disclosures about TDRs coincides with the guidance for determining what constitutes a TDR as described above.

In July 2010, the FASB issued guidance on "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses." This amendment 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 were effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period were effective for interim and annual reporting periods beginning on or after December 15, 2010. The adoption of this guidance had no impact on the Association's financial condition and results of operations but resulted in significant additional disclosures (see Note 3).

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 were 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 5).

Other recently issued accounting pronouncements are discussed in the 2010 Annual Report to Shareholders.

## NOTE 2 – INVESTMENT SECURITIES

A summary of the amortized cost and fair value of investment securities held-to-maturity at September 30, 2011 and December 31, 2010 follows:

	September 30, 2011				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Mission-related investments	\$ 5,656	\$ 950	\$ -	\$ 6,606	4.98%

  

	December 31, 2010				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Mission-related investments	\$ 5,690	\$ 22	\$ -	\$ 5,712	5.06%

A summary of the expected maturity, amortized cost and estimated fair value of investment securities held-to-maturity at September 30, 2011 follows:

	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	\$ -	\$ -	-%
After one year through five years	-	-	-
After five years through ten years	-	-	-
After ten years	5,656	6,606	4.98
Total	\$ 5,656	\$ 6,606	4.98%

The Association's mission-related investments consist of private placement securities purchased under the Rural America Bond Program approved by the FCA.

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 Association had no investments that have been in a continuous unrealized loss position at September 30, 2011 or December 31, 2010.

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 non-credit related factors. 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. 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. All securities continue to perform.

## NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES

A summary of loans as of September 30, 2011 and December 31, 2010, follows:

	September 30, 2011	December 31, 2010
Real estate mortgage	\$ 274,658	\$ 254,585
Production and intermediate-term Agribusiness:	431,063	404,299
Loans to cooperatives	1,963	929
Processing and marketing	13,233	22,113
Farm-related business	13,147	14,756
Total agribusiness	28,343	37,798
Communication	3,355	3,358
Energy	7,283	10,988
Rural residential real estate	5,741	6,448
Total Loans	\$ 750,443	\$ 717,476

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 tables present participations purchased and sold balances at September 30, 2011 and December 31, 2010:

	September 30, 2011							
	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	\$ -	\$ 56,093	\$ -	\$ -	\$ -	\$ 21,857	\$ -	\$ 77,950
Production and intermediate-term Agribusiness	12,703	5,752	-	-	5,300	-	18,003	5,752
Loans to cooperatives	1,963	-	-	-	-	-	1,963	-
Processing and marketing	10,437	-	-	-	-	-	10,437	-
Farm-related business	926	-	-	-	-	-	926	-
Total agribusiness	13,326	-	-	-	-	-	13,326	-
Communication	3,356	-	-	-	-	-	3,356	-
Energy	1,461	36,388	-	-	-	-	1,461	36,388
Total	\$ 30,846	\$ 98,233	\$ -	\$ -	\$ 5,300	\$ 21,857	\$ 36,146	\$ 120,090

	December 31, 2010							
	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	\$ 593	\$ 37,085	\$ -	\$ 1,429	\$ -	\$ 24,750	\$ 593	\$ 63,264
Production and intermediate-term Agribusiness	15,087	101,861	-	-	6,064	-	21,151	101,861
Loans to cooperatives	930	-	-	-	-	-	930	-
Processing and marketing	17,841	-	-	-	-	-	17,841	-
Farm-related business	1,072	-	-	-	-	-	1,072	-
Total agribusiness	19,843	-	-	-	-	-	19,843	-
Communication	3,358	-	-	-	-	-	3,358	-
Energy	1,461	56,230	-	-	-	-	1,461	56,230
Total	\$ 40,342	\$ 195,176	\$ -	\$ 1,429	\$ 6,064	\$ 24,750	\$ 46,406	\$ 221,355

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 September 30, 2011 and indicates that approximately 21.92 percent of loans had maturities of less than one year:

	Due less than 1 year	Due 1 Through 5 years	Due after 5 years	Total
Real estate mortgage	\$ 9,668	\$ 71,421	\$ 193,569	\$ 274,658
Production and intermediate-term Agribusiness	129,641	111,177	190,245	431,063
Loans to cooperatives	1,565	-	398	1,963
Processing and marketing	9,147	2,401	1,685	13,233
Farm-related business	3,356	6,547	3,244	13,147
Total agribusiness	14,068	8,948	5,327	28,343
Communication	3,353	2	-	3,355
Energy	7,283	-	-	7,283
Rural residential real estate	464	277	5,000	5,741
Total Loans	\$ 164,477	\$ 191,825	\$ 394,141	\$ 750,443

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 September 30, 2011 and December 31, 2010:

	September 30, 2011	December 31, 2010		September 30, 2011	December 31, 2010
<b>Real estate mortgage:</b>			<b>Total agribusiness:</b>		
Acceptable	93.19%	91.48%	Acceptable	86.77%	81.16%
OAEM	2.14	3.45	OAEM	8.50	8.67
Substandard/doubtful/loss	4.67	5.07	Substandard/doubtful/loss	4.73	10.17
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>
<b>Production and intermediate-term:</b>			<b>Communication:</b>		
Acceptable	89.05%	86.58%	Acceptable	100.00%	100.00%
OAEM	5.56	7.81	OAEM	-	-
Substandard/doubtful/loss	5.39	5.61	Substandard/doubtful/loss	-	-
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>
<b>Agribusiness:</b>			<b>Energy and water/waste disposal:</b>		
<b>Loans to cooperatives:</b>			Acceptable	20.02%	13.25%
Acceptable	79.64%	52.28%	OAEM	-	86.75
OAEM	20.36	47.72	Substandard/doubtful/loss	79.98	-
Substandard/doubtful/loss	-	-		<u>100.00%</u>	<u>100.00%</u>
	<u>100.00%</u>	<u>100.00%</u>			
<b>Processing and marketing:</b>			<b>Rural residential real estate:</b>		
Acceptable	75.55%	70.02%	Acceptable	94.34%	89.14%
OAEM	15.01	12.74	OAEM	1.54	2.26
Substandard/doubtful/loss	9.44	17.24	Substandard/doubtful/loss	4.12	8.60
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>
<b>Farm-related business:</b>			<b>Total Loans:</b>		
Acceptable	99.13%	99.72%	Acceptable	89.90%	87.01%
OAEM	0.17	0.10	OAEM	4.31	7.42
Substandard/doubtful/loss	0.70	0.18	Substandard/doubtful/loss	5.79	5.57
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>

The following tables provide an age analysis of past due loans and related accrued interest as of September 30, 2011 and December 31, 2010:

	September 30, 2011					
	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	\$ 528	\$ 4,065	\$ 4,593	\$ 272,525	\$ 277,118	\$ -
Production and intermediate-term	4,200	6,187	10,387	425,574	435,961	-
Agribusiness						
Loans to cooperatives	-	-	-	1,968	1,968	-
Processing and marketing	-	-	-	13,311	13,311	-
Farm-related business	-	-	-	13,221	13,221	-
Total agribusiness	-	-	-	28,500	28,500	-
Communication	-	-	-	3,355	3,355	-
Energy and water/waste disposal	-	5,826	5,826	1,458	7,284	-
Rural residential real estate	22	75	97	5,675	5,772	-
Total	<u>\$ 4,750</u>	<u>\$ 16,153</u>	<u>\$ 20,903</u>	<u>\$ 737,087</u>	<u>\$ 757,990</u>	<u>\$ -</u>

**December 31, 2010**

	<b>30 Through 89 Days Past Due</b>	<b>90 Days or More Past Due</b>	<b>Total Past Due</b>	<b>Not Past Due or Less Than 30 Days Past Due</b>	<b>Total Loans</b>	<b>Recorded Investment 90 Days or More Past Due and Accruing Interest</b>
Real estate mortgage	\$ 553	\$ 1,971	\$ 2,524	\$ 254,023	\$ 256,547	\$ -
Production and intermediate-term Agribusiness	3,865	4,565	8,430	399,744	408,174	-
Loans to cooperatives	-	-	-	934	934	-
Processing and marketing	-	-	-	22,250	22,250	-
Farm-related business	-	-	-	14,819	14,819	-
Total agribusiness	-	-	-	38,003	38,003	-
Communication	-	-	-	3,359	3,359	-
Energy and water/waste disposal	-	-	-	11,020	11,020	-
Rural residential real estate	99	78	177	6,305	6,482	-
Total	<u>\$ 4,517</u>	<u>\$ 6,614</u>	<u>\$ 11,131</u>	<u>\$ 712,454</u>	<u>\$ 723,585</u>	<u>\$ -</u>

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

Nonperforming assets (including related accrued interest) and related credit quality statistics at September 30, 2011 and December 31, 2010 are as follows:

	<b>September 30, 2011</b>	<b>December 31, 2010</b>
<b>Nonaccrual loans:</b>		
Real estate mortgage	\$ 11,671	\$ 11,635
Production and intermediate-term Agribusiness	13,005	11,774
Loans to cooperatives	-	-
Processing and marketing	-	2,514
Farm-related business	86	27
Total agribusiness	86	2,541
Energy and water/waste disposal	5,826	-
Rural residential real estate	142	202
Total nonaccrual loans	<u>\$ 30,730</u>	<u>\$ 26,152</u>
<b>Accruing restructured loans:</b>		
Real estate mortgage	\$ -	\$ 16
Production and intermediate-term Agribusiness	-	-
Loans to cooperatives	-	-
Processing and marketing	-	-
Farm-related business	-	-
Total agribusiness	-	-
Energy and water/waste disposal	-	-
Rural residential real estate	-	-
Total accruing restructured loans	<u>\$ -</u>	<u>\$ 16</u>
Total nonperforming loans	\$ 30,730	\$ 26,168
Other property owned	5,862	5,626
Total nonperforming assets	<u>\$ 36,592</u>	<u>\$ 31,794</u>
Nonaccrual loans as a percentage of total loans	4.09%	3.64%
Nonperforming assets as a percentage of total loans and other property owned	4.84%	4.40%
Nonperforming assets as a percentage of capital	<u>26.93%</u>	<u>25.48%</u>

There were no loans accruing and 90 days past due at September 30, 2011 and December 31, 2010.

The following table presents information relating to impaired loans (including accrued interest) at September 30, 2011 and December 31, 2010. Impaired loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms of the loan.

	September 30, 2011	December 31, 2010
Impaired nonaccrual loans:		
Current as to principal and interest	\$ 13,408	\$ 18,623
Past due	17,322	7,529
Total impaired nonaccrual loans	30,730	26,152
Impaired accrual loans:		
Restructured	-	16
90 days or more past due	-	-
Total impaired accrual loans	-	16
Total impaired loans	\$ 30,730	\$ 26,168

Additional impaired loan information as of September 30, 2011 and December 31, 2010 is as follows:

	September 30, 2011			Quarter Ended September 30, 2011		Nine Months Ended September 30, 2011	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans	Average Impaired Loans	Interest Income Recognized on Impaired Loans
<b>Impaired loans with a related allowance for credit losses:</b>							
Real estate mortgage	\$ 5,766	\$ 6,315	\$ 1,104	\$ 5,783	\$ -	\$ 6,055	\$ 23
Production and intermediate-term Agribusiness	7,178	7,306	2,651	7,200	1	7,538	28
Processing and marketing Farm-related business	-	-	-	-	-	-	-
Total agribusiness	-	-	-	-	-	-	-
Energy and water/waste disposal	-	-	-	-	-	-	-
Rural residential real estate	15	18	1	15	-	16	-
Total	\$ 12,959	\$ 13,639	\$ 3,756	\$ 12,998	\$ 1	\$ 13,609	\$ 51
<b>Impaired loans with no related allowance for credit losses:</b>							
Real estate mortgage	\$ 5,905	\$ 6,783	\$ -	\$ 5,923	\$ 1	\$ 6,201	\$ 23
Production and intermediate-term Agribusiness	5,827	6,353	-	5,845	-	6,120	23
Processing and marketing Farm-related business	-	-	-	-	-	-	-
Total agribusiness	86	90	-	86	-	90	-
Energy and water/waste disposal	5,826	11,293	-	5,843	1	6,118	23
Rural residential real estate	127	149	-	128	-	134	-
Total	\$ 17,771	\$ 24,668	\$ -	\$ 17,825	\$ 2	\$ 18,663	\$ 69
<b>Total impaired loans:</b>							
Real estate mortgage	\$ 11,671	\$ 13,098	\$ 1,104	\$ 11,706	\$ 1	\$ 12,256	\$ 46
Production and intermediate-term Agribusiness	13,005	13,659	2,651	13,045	1	13,658	51
Processing and marketing Farm-related business	-	-	-	-	-	-	-
Total agribusiness	86	90	-	86	-	90	-
Energy and water/waste disposal	5,826	11,293	-	5,843	1	6,118	23
Rural residential real estate	142	167	1	143	-	150	-
Total	\$ 30,730	\$ 38,307	\$ 3,756	\$ 30,823	\$ 3	\$ 32,272	\$ 120

	December 31, 2010			Year Ended December 31, 2010	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans
<b>Impaired loans with a related allowance for credit losses:</b>					
Real estate mortgage	\$ 7,754	\$ 7,544	\$ 1,106	\$ 9,055	\$ 274
Production and intermediate-term	6,527	6,065	2,287	7,622	230
Processing and marketing	2,514	2,605	317	2,936	92
Farm-related business	27	31	-	31	1
Total agribusiness	2,541	2,636	317	2,967	93
Rural residential real estate	81	79	1	94	3
Total	\$ 16,903	\$ 16,324	\$ 3,711	\$ 19,738	\$ 600
<b>Impaired loans with no related allowance for credit losses:</b>					
Real estate mortgage	\$ 3,897	\$ 5,151	\$ -	\$ 4,552	\$ 137
Production and intermediate-term	5,247	6,076	-	6,129	186
Processing and marketing	-	1,301	-	-	(3)
Farm-related business	-	-	-	-	-
Total agribusiness	-	1,301	-	-	(3)
Rural residential real estate	121	152	-	142	4
Total	\$ 9,265	\$ 12,680	\$ -	\$ 10,823	\$ 324
<b>Total impaired loans:</b>					
Real estate mortgage	\$ 11,651	\$ 12,695	\$ 1,106	\$ 13,607	\$ 411
Production and intermediate-term	11,774	12,141	2,287	13,751	416
Processing and marketing	2,514	3,906	317	2,936	89
Farm-related business	27	31	-	31	1
Total agribusiness	2,541	3,937	317	2,967	90
Rural residential real estate	202	231	1	236	7
Total	\$ 26,168	\$ 29,004	\$ 3,711	\$ 30,561	\$ 924

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

The Association had \$8 and \$781 in commitments to lend additional funds to debtors whose loans were classified as impaired at September 30, 2011 and December 31, 2010, respectively.

A summary of changes in the allowance for loan losses and period end recorded investment in loans at September 30, 2011 and December 31, 2010 follows:

	September 30, 2011						
	Real Estate Mortgage	Production and Intermediate-term	Agribusiness	Communication	Energy and Water/Waste Disposal	Rural Residential Real Estate	Total
<b>Allowance for credit losses:</b>							
Balance at December 31, 2010	\$ 2,611	\$ 4,675	\$ 541	\$ 20	\$ 65	\$ 39	\$ 7,951
Charge-offs	(10)	(435)	(900)	-	(3,850)	(50)	(5,245)
Recoveries	58	8	-	-	-	-	66
Provision for loan losses	(308)	359	488	(5)	3,826	38	4,398
Balance at September 30, 2011	\$ 2,351	\$ 4,607	\$ 129	\$ 15	\$ 41	\$ 27	\$ 7,170
September 30, 2011 allowance ending balance:							
Loans individually evaluated for impairment	\$ 1,104	\$ 2,651	\$ -	\$ -	\$ -	\$ 1	\$ 3,756
Loans collectively evaluated for impairment	\$ 1,247	\$ 1,956	\$ 129	\$ 15	\$ 41	\$ 26	\$ 3,414
<b>Recorded investment in loans outstanding:</b>							
Ending Balance at September 30, 2011	\$ 277,118	\$ 435,961	\$ 28,500	\$ 3,355	\$ 7,284	\$ 5,772	\$ 757,990
September 30, 2011 recorded investment ending balance:							
Loans individually evaluated for impairment	\$ 11,673	\$ 13,006	\$ 86	\$ -	\$ 5,826	\$ 142	\$ 30,733
Loans collectively evaluated for impairment	\$ 265,445	\$ 422,955	\$ 28,414	\$ 3,355	\$ 1,458	\$ 5,630	\$ 727,257

December 31, 2010

	Real Estate Mortgage	Production and Intermediate- term	Agribusiness	Communication	Energy and Water/Waste Disposal	Rural Residential Real Estate	Total
<b>Allowance for credit losses:</b>							
Balance at December 31, 2009	\$ 1,932	\$ 6,818	\$ 1,170	\$ 15	\$ 39	\$ 102	\$ 10,076
Charge-offs	(156)	(344)	-	-	-	-	(500)
Recoveries	119	104	-	-	-	-	223
Provision for loan losses	716	(1,903)	(629)	5	26	(63)	(1,848)
Balance at December 31, 2010	\$ 2,611	\$ 4,675	\$ 541	\$ 20	\$ 65	\$ 39	\$ 7,951
December 31, 2010 allowance ending balance:							
Loans individually evaluated for impairment	\$ 1,106	\$ 2,287	\$ 317	\$ -	\$ -	\$ 1	\$ 3,711
Loans collectively evaluated for impairment	\$ 1,505	\$ 2,388	\$ 224	\$ 20	\$ 65	\$ 38	\$ 4,240
<b>Recorded investment in loans outstanding:</b>							
Ending Balance at December 31, 2010	\$ 256,547	\$ 408,174	\$ 38,003	\$ 3,359	\$ 11,020	\$ 6,482	\$ 723,585
December 31, 2010 recorded investment ending balance:							
Loans individually evaluated for impairment	\$ 12,795	\$ 12,769	\$ 2,638	\$ -	\$ -	\$ 223	\$ 28,425
Loans collectively evaluated for impairment	\$ 243,752	\$ 395,405	\$ 35,365	\$ 3,359	\$ 11,020	\$ 6,259	\$ 695,160

#### NOTE 4 – EMPLOYEE BENEFIT PLANS

The following is a table of retirement and other postretirement benefit expenses for the Association:

	For the nine months ended September 30,	
	2011	2010
Pension	\$ 1,664	\$ 1,573
401(k)	140	102
Other postretirement benefits	300	244
Total	\$ 2,104	\$ 1,919

The following is a table of retirement and other postretirement benefit contributions for the Association:

	Actual YTD Through 9/30/11	Projected Contributions For Remainder of 2011	Projected Total Contributions 2011
Pension	\$ 21	\$ 1,786	\$ 1,807
Other postretirement benefits	193	103	296
Total	\$ 214	\$ 1,889	\$ 2,103

Contributions in the above table include allocated estimates of funding for multi-employer plans in which the Association participates. These amounts may change when a total funding amount and allocation is determined by the respective Plan's Sponsor Committee. Also, market conditions could impact discount rates and return on plan assets which could change contributions necessary before the next plan measurement date of December 31, 2011.

Further details regarding employee benefit plans are contained in the 2010 Annual Report to Shareholders.

#### NOTE 5 – 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 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 assets held in trust funds, 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's Level 1 assets at September 30, 2011 consist of assets held in trust funds related to deferred compensation and supplemental retirement plans. The trust funds include investments in securities that are actively traded and have quoted net asset value prices that are directly observable in the marketplace.

### 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 September 30, 2011.

### Level 3

Level 3 inputs to the valuation methodology are unobservable and supported by little or no market activity. Valuation is determined using pricing models, discounted cash flow methodologies, or similar techniques, and could include significant management judgment or estimation. Level 3 assets and liabilities also could include 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 September 30, 2011 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 September 30, 2011. 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 September 30, 2011 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 September 30, 2011 and December 31, 2010 for each of the fair value hierarchy levels:

September 30, 2011				
	Level 1	Level 2	Level 3	Total Fair Value
<b>Assets:</b>				
Assets held in trust funds	\$ 140	\$ -	\$ -	\$ 140
Total Assets	\$ 140	\$ -	\$ -	\$ 140

<b>Liabilities:</b>				
Standby letters of credit	\$ -	\$ -	\$ 14	\$ 14
Total Liabilities	\$ -	\$ -	\$ 14	\$ 14

December 31, 2010				
	Level 1	Level 2	Level 3	Total Fair Value
<b>Assets:</b>				
Assets held in trust funds	\$ 157	\$ -	\$ -	\$ 157
Total Assets	\$ 157	\$ -	\$ -	\$ 157

<b>Liabilities:</b>				
Standby letters of credit	\$ -	\$ -	\$ 61	\$ 61
Total Liabilities	\$ -	\$ -	\$ 61	\$ 61

The following tables present the changes in Level 3 assets and liabilities measured at fair value on a recurring basis for the nine months ended September 30, 2011 and 2010. The Association had no transfer of assets or liabilities into or out of Level 1 or Level 2 during the first nine months of 2011 and 2010.

	<b>Standby Letters Of Credit</b>
Balance at January 1, 2011	\$ 61
<b>Total gains or (losses) realized/unrealized:</b>	
Included in earnings	-
Included in other comprehensive loss	-
Purchases	-
Sales	-
Issuances	-
Settlements	(47)
Transfers in and/or out of level 3	-
Balance at September 30, 2011	<u>\$ 14</u>

	<b>Standby Letters Of Credit</b>
Balance at January 1, 2010	\$ 97
<b>Total gains or (losses) realized/unrealized:</b>	
Included in earnings	-
Included in other comprehensive loss	-
Purchases, sales, issuances and settlements, net	(25)
Transfers in and/or out of level 3	-
Balance at September 30, 2010	<u>\$ 72</u>

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

Assets and liabilities measured at fair value on a non-recurring basis during the period at September 30, 2011 and December 31, 2010 for each of the fair value hierarchy values are summarized below:

	September 30, 2011				YTD Total Gains (Losses)
	Level 1	Level 2	Level 3	Total Fair Value	
<b>Assets:</b>					
Impaired loans	\$ -	\$ -	\$ 4,602	\$ 4,602	\$ (5,224)
Other property owned	\$ -	\$ -	\$ 5,959	\$ 5,959	\$ 303
	December 31, 2010				YTD Total Gains (Losses)
	Level 1	Level 2	Level 3	Total Fair Value	
<b>Assets:</b>					
Impaired loans	\$ -	\$ -	\$ 11,107	\$ 11,107	\$ 2,692
Other property owned	\$ -	\$ -	\$ 5,974	\$ 5,974	\$ (1,923)

### NOTE 6 — DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the carrying amounts and fair values of the Association's financial instruments at September 30, 2011 and December 31, 2010.

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:

	September 30, 2011		December 31, 2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>				
Cash	\$ 3,184	\$ 3,184	\$ 4,416	\$ 4,416
Loans, net of allowance	\$ 750,821	\$ 766,358	\$ 715,635	\$ 720,654
Investment securities	\$ 5,685	\$ 6,606	\$ 5,714	\$ 5,712
Tobacco Buyout SIC	\$ 15,476	\$ 16,209	\$ 20,356	\$ 21,354
Assets held in trust funds	\$ 140	\$ 140	\$ 157	\$ 157
<b>Financial liabilities:</b>				
Notes payable to AgFirst				
Farm Credit Bank	\$ 660,421	\$ 667,091	\$ 637,805	\$ 641,497

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.

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The book value of accrued interest, which has been included in the carrying amount of loans, approximates its fair value.

- C. **Investment in AgFirst Farm Credit Bank:** Estimating the fair value of the Association's investment in the Bank is not practicable because the stock is not traded. The net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying Consolidated Balance Sheets. The Association owns 3.27 percent of the issued stock of the Bank as of September 30, 2011 net of any reciprocal investment. As of that date, the Bank's assets totaled \$30.3 billion and shareholders' equity totaled \$2.2 billion. The Bank's earnings were \$295 million during the first nine months of 2011.
- D. **Notes Payable to AgFirst Farm Credit Bank:** The notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association's loan receivables plus accrued interest on the notes payable. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.

The book value of accrued interest, which has been included in the carrying amount of notes payable, approximates its fair value.

- E. **Commitments to Extend Credit:** The estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics and since the related credit risk is not significant.
- F. **Tobacco Buyout SIIC:** Fair value is determined by discounting the expected future cash flows using current interest rates for similar assets.
- G. **Assets Held in Trust Funds:** See Note 5 for discussion of estimation of fair value for this instrument.
- H. **Investment Securities:** Fair value is determined by discounting the expected future cash flows using appropriate interest rates for similar assets.

## NOTE 7 – SUBSEQUENT EVENTS

The Association has evaluated subsequent events and has determined there are none requiring disclosure through November 7, 2011, which is the date the financial statements were issued.