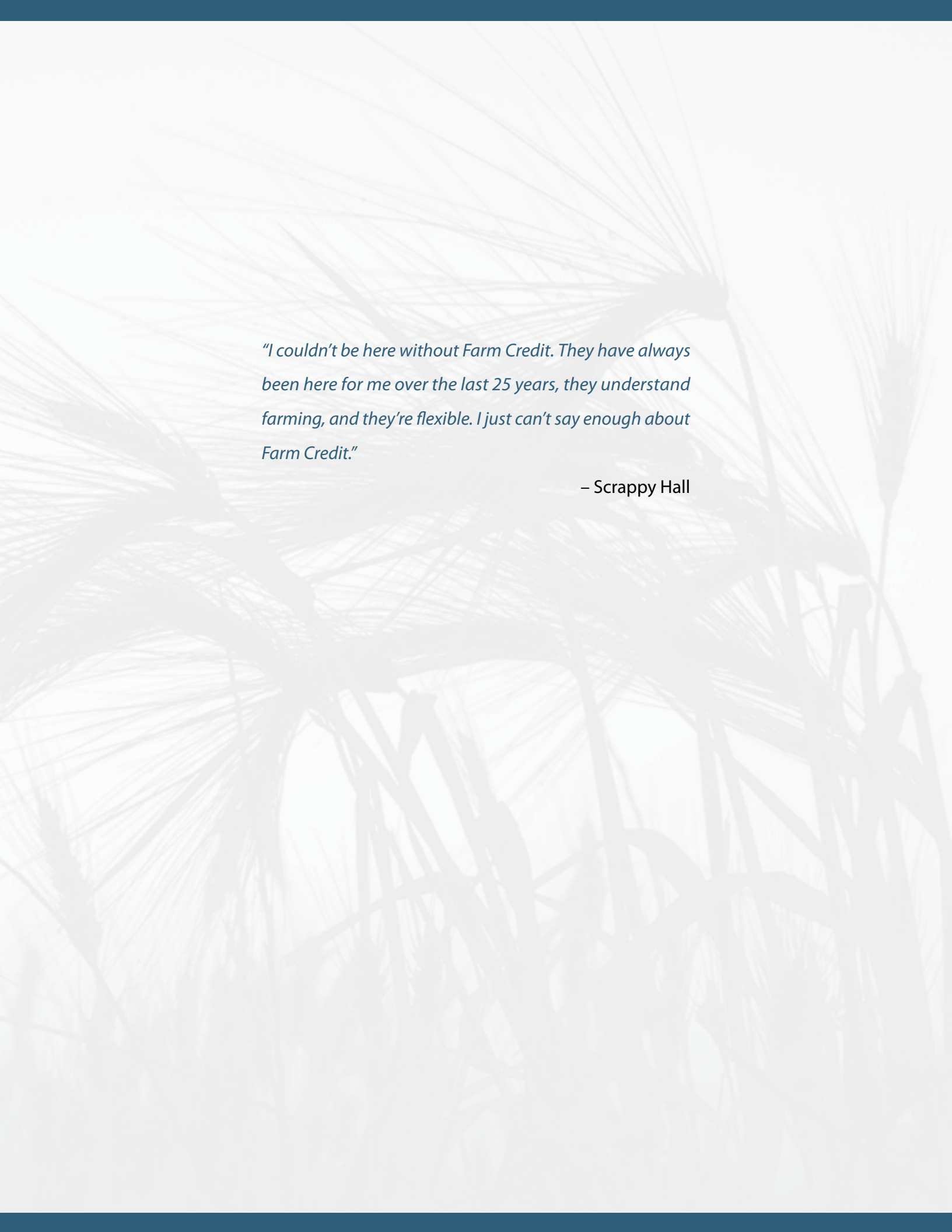




Relationship Lending at its Best

2010  
ANNUAL  
REPORT





*"I couldn't be here without Farm Credit. They have always been here for me over the last 25 years, they understand farming, and they're flexible. I just can't say enough about Farm Credit."*

– Scrappy Hall

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## On the Cover:

Top left: Al Bundy (left) with Jay Darden, Clinton branch manager

Top middle: Stuart Betts, Lillington branch manager (far right) with Duane and Kathy Byrd in front of their new composter

Top right: Brothers Mike and Glenn McPherson with Brook Hall, Elizabethtown branch manager

Center image: Phillip Strickland, Fayetteville branch manager (far right) with Mitchell Sessoms, his son, Matt, and his grandson, Tradd

# Message from the Interim Chief Executive Officer

2010 began as a challenging year for Cape Fear Farm Credit, as well as the commodities we serve, but ended as one of the most profitable years ever for the Association. Our Association has a history of providing high quality service and is a leader among lending cooperatives in the efficient delivery of credit to agriculture and the rural communities we serve. As we strive to fulfill our mission—to be the lender of choice to agriculture and our rural communities—our efforts produced the following results in 2010:

Net income.....	\$21.1 million
Return on Equity.....	17.33%
Return on Assets.....	2.71%
Efficiency Ratio.....	35.86%

The above performance allowed for the following patronage distributions in 2011:

2010 Cash Patronage.....\$7.4 Million\*  
(March 2011)

\*estimated

Even though 2010 continued to be a difficult economic environment, the Association ranked extremely high when compared to its peers in the AgFirst District in ROE, ROA, and efficiency ratios. Uncertainty in the swine, broiler, and turkey industries due to high feed costs, along with stress in all industries directly or indirectly tied to housing, once again presented challenges

to Cape Fear. Weakness in all these segments continued to affect the loan portfolio quality.

The details of the Association's financial performance are included in this annual report. The potential for unforeseen issues in the loan portfolio mandated responsible financial capital management to ensure Cape Fear's long term, sound financial condition. Even after paying a patronage dividend of nearly \$7.4 million, over \$13.6 million has been contributed to capital. As a result, Cape Fear's permanent capital ratio improved to 15.94% at year end, a year over year improvement of over 21%. This action will help ensure a sound Association for the future of all of our member-borrowers, and it will enhance Cape Fear's ability to continue to serve the commodities produced within our territory.

Volatility in the commodity markets are expected to continue and appears to be the norm in the foreseeable future. While corn, soybeans, cotton, and other commodities are experiencing historical highs, increases in input costs make good crop yields essential for generating a profit. Risk management by producers is increasingly important if they are to sustain profitability. The same historically high commodity prices that benefited row crop producers led to high input cost for swine, chicken, and turkey sectors and limited profits in 2010 as it is expected to do again in 2011.

As commercial banks recover from financial stress and again return to the market, vigorous competition for high quality loans is expected to return. To remain competitive, the Associa-



**Michael R. Jackson**  
Interim Chief Executive Officer

tion must continue to maximize efficiencies while providing excellent service, sound industry knowledge and competitive rates. The success of Cape Fear Farm Credit is dependent on the hard work and commitment of our employees to provide exceptional service to agriculture and the rural customers in the Cape Fear region.

Cape Fear Farm Credit will continue its cooperative business model which emphasizes long term vision and high performance. Cape Fear will continue to focus on its commitment to provide excellent service and unparalleled value to agriculture and the rural communities in the Cape Fear region. The Association's goal will continue to be to maintain a financially strong and healthy organization which through its efficient operation is able to return profits to its members and thus provide the most cost effective source of funding available.



# Consolidated Five-Year Summary of Selected Financial Data

<i>(dollars in thousands)</i>	2010	2009	December 31, 2008	2007	2006
<b>Balance Sheet Data</b>					
Cash	\$ 4,416	\$ 3,972	\$ 1,819	\$ 2,102	\$ 1,529
Investment securities	5,690	6,200	—	—	—
Loans	717,476	743,178	762,501	703,680	630,407
Less: allowance for loan losses	7,951	10,076	5,986	3,993	3,607
Net loans	709,525	733,102	756,515	699,687	626,800
Investments in other Farm Credit institutions	11,630	12,288	11,682	10,259	8,370
Other property owned	5,626	828	313	95	—
Other assets	42,580	49,151	54,440	57,084	52,873
Total assets	\$ 779,467	\$ 805,541	\$ 824,769	\$ 769,227	\$ 689,572
Notes payable to AgFirst Farm Credit Bank*	\$ 636,329	\$ 678,235	\$ 695,160	\$ 641,059	\$ 563,329
Accrued interest payable and other liabilities with maturities of less than one year	18,336	16,144	23,635	25,666	27,038
Total liabilities	654,665	694,379	718,795	666,725	590,367
Protected borrower stock	50	56	73	124	204
Capital stock and participation certificates	2,634	2,645	2,634	2,542	2,333
Retained earnings					
Allocated	34,552	21,739	17,699	16,631	15,881
Unallocated	87,883	87,041	85,891	83,542	81,145
Accumulated other comprehensive income (loss)	(317)	(319)	(323)	(337)	(358)
Total members' equity	124,802	111,162	105,974	102,502	99,205
Total liabilities and members' equity	\$ 779,467	\$ 805,541	\$ 824,769	\$ 769,227	\$ 689,572
<b>Statement of Income Data</b>					
Net interest income	\$ 22,696	\$ 22,211	\$ 23,913	\$ 22,301	\$ 19,621
Provision for (reversal of allowance for) loan losses	(1,848)	6,203	2,287	537	172
Noninterest income (expense), net	(3,491)	(1,730)	(1,314)	(1,146)	(1,792)
Net income	\$ 21,053	\$ 14,278	\$ 20,312	\$ 20,618	\$ 17,657
<b>Key Financial Ratios</b>					
Rate of return on average:					
Total assets	2.71%	1.75%	2.52%	2.81%	2.83%
Total members' equity	17.33%	12.97%	18.71%	19.91%	17.88%
Net interest income as a percentage of					
average earning assets	3.14%	2.87%	3.09%	3.18%	3.28%
Net (chargeoffs) recoveries to average loans	(0.038)%	(0.277)%	(0.039)%	(0.022)%	—%
Total members' equity to total assets	16.01%	13.80%	12.85%	13.33%	14.39%
Debt to members' equity (:1)	5.25	6.25	6.78	6.50	5.95
Allowance for loan losses to loans	1.11%	1.36%	0.79%	0.57%	0.57%
Permanent capital ratio	15.94%	13.20%	13.03%	13.58%	15.08%
Total surplus ratio	15.60%	12.84%	12.69%	13.23%	14.72%
Core surplus ratio	15.60%	12.84%	12.15%	11.86%	12.20%
<b>Net Income Distribution</b>					
Estimated patronage refunds:					
Cash	\$ 7,439	\$ 4,915	\$ 11,293	\$ 11,484	\$ 8,919
Nonqualified retained earnings	12,926	8,286	6,333	6,746	—

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

# RELATIONSHIP LENDING

## Relationship Lending at its Best

**H**ave you ever stopped to think about the reasons why you do business with certain people and organizations? Is it pricing? Is it the product? Is it convenience? Is it location? Is it familiarity? Is it the people?

When members are asked why they continue to do business with Cape Fear Farm Credit, time and time again, the answers are the same. Members continue to come back and do business with a team of employees that understands agriculture and the members have a valued relationship with the people at Cape Fear Farm Credit. The employees take pride in being relationship lenders and providing the best products and services to meet the needs of the borrowers across the charted territory of southeastern North Carolina.

Customer satisfaction surveys are distributed to members on a routine basis, and the feedback received continually points to relationship lending, customer service, and the people. Here are a few comments and excerpts from recent survey results:

- “Your people do a great job. Thanks for your help in my endeavors.”
- “I am more than satisfied with Cape Fear Farm Credit. I have had many loans over the years.”
- “Great personal service.”
- “Wonderful people!”
- “The staff is the best, always friendly, personable, and willing to help.”

- “Great place to do business. They always treat me and my family very well. Thanks!”
- “Excellent service all around. We have a lot to be proud of.”

Relationship lending is more than a nice, friendly face when you walk in the office door and goes beyond the loan transaction. It is about the value our members receive and the trust that is built over a period of time. Let us take a stroll through Cape Fear Country and learn about several members, their operations, and their relationship with Cape Fear Farm Credit.





Rebecca Wood, Raeford branch relationship manager (far right), with the Settharath family

## Khan and Dee Settharath

Laurel Hill, N.C. | Scotland County

Raeford branch members for three years

**Reason for becoming a CFFC member:**

Refinance poultry operation

**How did you find out about CFFC?** Referral from a friend

**Operation:** Six poultry houses on contract with Perdue Farms

**Family:** Daughter Brena (seven), son Brian (13)

*"Doing business with Cape Fear Farm Credit is an easy process, and we are glad that we decided to refinance. They are family oriented, and we like it when Rebecca hands out the patronage checks!"*

– Khan Settharath



Phillip Strickland, Fayetteville branch manager (far left) with Mitchell Sessoms, his son, Matt, and his grandson, Tradd

## Mitchell Sessoms

Roseboro, N.C. | Cumberland County

Fayetteville branch member for 11 years

**Reason for becoming a CFFC member:**

Construction of pullet houses

**How did you find out about CFFC?** Through local referrals, and several other Tyson contract growers who were already doing business with Cape Fear Farm Credit.

**Operation:** Eleven pullet houses on contract with Tyson and 140 acres of hay

**Family:** Wife, Chris; son, Matt Sessoms and his wife, Marina, and their two children, Tradd (six) and Luanna (three); daughter, Ashley Honeycutt and her husband, Brian, and their son, Zack (four); daughter Betsy Autry and her husband, Timmy, and their son, Brayden (three); stepson, Jeremy Blessing and his wife, Tammy, and their children, Malcom (three) and Cassidy (one)

*"I like the fact that I can deal one-on-one with Phillip. I'm also confident that they give me the best interest rate they can at the time. They even contacted me earlier this year when interest rates dropped, and I like saving money!"*

– Mitchell Sessoms



Shannon Bell, Burgaw branch manager (left) and Scrapy Hall with construction beginning in the background on four new poultry houses

## Donald "Scrapy" Hall

Rocky Point, N.C. | Pender County

Burgaw branch member for 27 years

**Reason for becoming a CFFC member:**

Decided to exit the tobacco business and started raising hogs

**How did you find out about us?** Local referral

**Operation:** Eight poultry houses on contract with Nash Johnson & Sons and in the process of constructing four additional houses; swine operation on contract with Murphy Brown; 1,000 acres corn, soybeans, and wheat

**Family:** Wife Lou; son, Don; grandchildren, Hannah (four) and Caroline (one)

*"I couldn't be here without Farm Credit. They have always been here for me over the last 25 years, they understand farming, and they're flexible. I just can't say enough about Farm Credit."*

– Scrapy Hall



John Patterson, Dunn branch manager (left) with Clay Gardner

## DMG Farms, DMG Turf

### Clay Gardner

Angier, N.C. | Harnett County

Dunn branch member for eight years

#### Reason for becoming a CFFC member:

Home construction loan

#### How did you find out about CFFC?

Father was a Farm Credit member and past PCA director

**Operation:** 1,700 acres of sweet potatoes, tobacco, soybeans, and sod

**Family:** Wife, Denise and their children, Lillie (seven) and Carlie (seven), David Clay (six), and Parker (one-and-a-half); parents, David and Betty Gardner

*"The people at Farm Credit have always been easy to get along with, they're competitive, and I have nothing but good things to say. Over the last several years, I've referred several people to John."*

–Clay Gardner



Al Bundy (left) with Jay Darden, Clinton branch manager

## B&B Pecans, Elizabeth's Pecan Candy

### Al Bundy

Turkey, N.C. | Sampson County

[www.elizabeths pecans.com](http://www.elizabeths pecans.com)

Clinton branch member for eight years

#### Reason for becoming a CFFC member:

To purchase a box truck for his candy business, Elizabeth's Pecan Candy

#### How did you find out about CFFC?

Father was a previous Farm Credit member and owner of Capt'n Bundy's Pecan Farm

**Operation:** Pecan farm, pecan processing company, and pecan products

**Family:** Wife, Maureen, and their daughter Elizabeth

*"I talked to Jay about the idea of getting into the chocolate coating business, and he came across a grant opportunity that he thought fit my needs exactly. I applied for the grant and was recently notified that I am a recipient and can use the grant funds towards the purchase of the new chocolate coating equipment. It's obvious that Jay cares about the success of my business."*

– Al Bundy



(From the left) Brothers Glenn and Mike McPherson with Brook Hall, Elizabethtown branch manager

## McPherson Brothers Farm, Inc.

### Mike and Glenn McPherson

Abbottsburg, N.C. | Bladen County

Elizabethtown branch member for 28 years (Mike) and 22 years (Glenn)

#### Reason for becoming a CFFC member:

Began farming with their father

#### How did you find out about CFFC?

Their parents were longtime members

**Operation:** 2,500 acres of corn, peanuts, soybeans, and wheat

**Family:** Mike McPherson: wife Martha and their children, Nicole (21), Jack (17), and Ian (15)

Glenn McPherson: wife Betty Ann and their children, Sam (18) and Meredith (12)

*"With Farm Credit, it's through thick and thin and it's an easy process. One day I was setting tobacco and Brook came out to the field so I could sign some papers."*

–Mike McPherson

*"It's a joy to do business with Farm Credit. I can pick up the phone anytime and call Brook, and I know she will help me."*

– Glenn McPherson



Stuart Betts, Lillington branch manager (far right), with Duane and Kathy Byrd in front of their new composter

## D&K Farms, Kathy's Puppies

### Kathy and Duane Byrd

Bunnlevel, N.C. | Harnett County

Lillington branch member for 13 years

**Reason for becoming a CFFC member:**

Construction of poultry houses

**How did you find out about CFFC?**

Referral from integrator and friends that were already dealing with Farm Credit

**Operation:** Four broiler houses on contract with Townsend; cattle and hay operation; small dog breeder

**Family:** Daughters, Dusty, Bethany, and Kimberly, and sons Roy, George, and Daniel; grandchildren, Trevor, Addyson, Arianna, and Brittany

*"Farm Credit is user friendly to a farmer. They know what you're talking about and the flow and process is straightforward."*

– Duane Byrd



Robin Albertson, Kenansville branch manager (right), with Mike Rabon

## Mike Rabon

Warsaw, N.C. | Duplin County

Kenansville branch member for 16 years

**Reason for becoming a CFFC member:**

Construction of nurseries on contract with Murphy Brown

**How did you find out about CFFC?**

Referral from a local business

**Operation:** Nurseries on contract with Murphy Brown; cattle operation; and owner of Rabon Car Wash

**Family:** Daughter, Kim, and son, Kevin; grandchildren, Lexus and Hailey; girlfriend, Glenna

*"Farm Credit is like family. Robin treats me great. It's the best thing that's ever happened to me. I wouldn't have what I have now if it weren't for Farm Credit. They gave me the opportunity to succeed."*

– Mike Rabon



Ginny Martin, Lumberton loan officer (left), with Madison Lytch

## Madison Lytch

Maxton, N.C. | Robeson County

Lumberton branch member for approximately 36 years

**Reason for becoming a CFFC member:**

Purchase a farm

**How did you find out about CFFC?**

His father was a longtime member

**Operation:** Row crop operation consisting of corn and soybeans; manager of Midway Gin Company

**Family:** Wife, Dina, son Adam, and daughter, Margaret

*"Farm Credit is what kept me farming. I've gotten to know everyone in the office on a one-to-one basis. It's like a family tradition; my daddy started there, and then it got passed down to me and Mama."*

– Madison Lytch



Glenn Waters, Whiteville/Shalotte branch manager (right) with JW Hardwick



Carole Piver, Shalotte branch loan assistant (right) with member Ricky Clemmons

## JW Hardwick

Whiteville, N.C. | Columbus County

Whiteville branch member for approximately 40 years

**Reason for becoming a CFFC member:** His father was a member and as JW became more involved in the operation, he began doing business with Cape Fear Farm Credit.

### How did you find out about CFFC?

His father was a past member

**Operation:** 300-head cow/calf operation; 2,400 acres of corn, soybeans, and double-crop wheat and oats; 450 acres of coastal hay

**Family:** Wife, Diana (bookkeeper for the farming operation); daughter, Freda, sons, David and Dewayne; grandchildren, Adrienne, Adam, Jonathan, Heather, Hanna, and Spencer; great grandchildren, Will, Lauren, and Chase

*"I have a good relationship with Farm Credit, and Glenn is very versed on agriculture. There's a good crew of ladies in the office, and I enjoy doing business with them."*

- JW Hardwick

## Ricky Clemmons

Bolivia, N.C. | Brunswick County

Shalotte branch member for approximately 19 years

**Reason for a becoming CFFC member:** His father was farming and doing business with Farm Credit.

### How did you find out about CFFC?

His father was a long-time member

**Operation:** Approximately 1,400 acres of corn and soybeans; 7,500-head hog operation on contract with Murphy Brown; and a trucking business (C&S Transport, Inc.)

**Family:** Wife, Christi; daughters, Melissa Sellers, Kaitlin, and son, Caleb

*"They all bend over backwards for me. Carole can do a lot over the phone, and she's very customer friendly. We even share the same birthday! I enjoy doing business with Farm Credit, and the patronage is always a plus."*

- Ricky Clemmons

# ADDITIONAL SERVICES OFFERED

## Additional Services Offered by Cape Fear Farm Credit

### For your place in the country ...

- Lots
- Homes
- Home construction
- Purchases and refinancing
- Remodeling and home improvements
- Hunting tracts
- Recreational property
- Horses, cattle, and other livestock
- Livestock and utility trailers

### For your farm ...

- Poultry and livestock facilities
- Pasture, crop, and timberland
- Barns, stables, sheds, and grain bins
- Farm residences
- Operating expenses
- Machinery, equipment, and vehicles
- Leasing of machinery, equipment, and vehicles

### For your agribusiness ...

- Nurseries and greenhouses
- Poultry and livestock operations
- Gins and processing facilities
- Timber and sawmill operations
- Farm-related businesses

## And there's more ...

Cape Fear Farm Credit has all the financial tools you need to be successful like online access to your accounts. Cape Fear Farm Credit offers the following services and conveniences:

### Financially-Related Services

Mortgage life and disability insurance

### Money Management Tools

- **Agriline** – personalized checks for your line of credit loan
- **FastCash** – transfer money from your Line of Credit loan to your commercial bank checking account with a phone call
- **AutoDraft** – automatic drafting of your loan payments saves you time and money
- **AutoBorrow** – a cash management tool that links your Cape Fear Farm Credit loan to your business checking account

### E-Commerce

- **AccountAccess** – online access to all your Cape Fear Farm Credit accounts
- **LoanLine** – 24-hour, toll-free telephone access to your loan information

### Other Services

Appraisal Services



Elizabethtown branch member Dean Hilton and daughter, Molly, at the 2010 Southern Farm Days at Lake Waccamaw



2010 Ag Biz Planner Conference in Raleigh, N.C.



2010 Annual Farm Safety Day at Fann Farms in Salemburg, N.C.

# BOARD OF DIRECTORS

## Board of Directors

As a cooperative, Cape Fear Farm Credit is controlled by a group of local directors who are also farmers in the Cape Fear Region. Our board of directors serves as the elected link between membership and management of the association.



**Ron Allen**  
Chairman  
Bladen County



**Arnold Smith**  
Vice Chairman  
Cumberland County



**Dr. James Harriss**  
PhD Finance  
Outside Director  
New Hanover County



**Gary Hendrix**  
Hoke County



**Jart Hudson**  
Sampson County



**Lyle Ray King**  
Brunswick County



**Daniel Lewis**  
Robeson County



**Jonathan Pope**  
Harnett County



**Jeff Simpson**  
Cumberland County



**Harold Smith**  
Duplin County



**Michael "Bo" Stone**  
Robeson County



**Terray Suggs, CPA**  
Outside Director  
Columbus County



**Gene West, Jr.**  
Sampson County



**Alfred Wooten**  
Pender County

# MANAGEMENT TEAM

## Management Team



(From the left): Jay Smith, chief relationship manager; Michael R. Jackson, interim chief executive officer; Matt Currin, chief financial officer



(From the left): Wayne Strickland, chief appraiser; Skipper Jones, marketing manager; George Ford, Jr., director of information technology; Betty Kay Williams, chief credit administrator

# CAPE FEAR FARM CREDIT EMPLOYEES

## Cape Fear Farm Credit Employees (as of February 1, 2011)

### Burgaw Branch

Jim Fouche  
Shannon Bell  
Debbie Bradshaw  
Gail Lee

### Clinton Branch

Jay Darden  
Sylvia Fryar  
Vickie Giddens  
Tonya Hobbs  
Nelson Powell  
David Sutton

### Dunn Branch

John Patterson  
Deneice Core  
Cale Horne  
Christy Moore  
Glenda Tew

### Elizabethtown Branch

Brook Hall  
Wesley Ackerman  
Jeanne Fields  
Jane Love  
Linda Wilson

### Fayetteville Branch

Phillip Strickland  
Cathy Keane

### Kenansville Branch

Robin Albertson  
Faye Gore  
Kim Hunter  
Cliff Kilpatrick  
Debbie Raynor  
Gerald Wilson

### Lillington Branch

Stuart Betts  
Karen Roberson  
Tracy Taylor

### Lumberton Branch

Kevin Kinlaw  
Vickie Edwards  
Shawn Hunt  
Brittany Leggette  
Ginny Martin  
Vickie Walters

### Raeford Branch

Will Maxwell  
Denise Blanton  
Sharon Nichols  
Rebecca Wood

### Shalotte Branch

Glenn Waters  
Carole Piver

### Whiteville Branch

Glenn Waters  
Mark Harritan  
Judy Prince  
Becky Thompson  
Candy Ward

### Capital Markets Department

Randy Pope  
Joel Britt  
Amy Tyndall

### Appraisers

Wayne Strickland  
Tony Dempsey  
Matthew Edwards  
Glenn Matthews

### Fayetteville Administrative

Michael Jackson  
Melissa Boney  
Nancy Byrd  
Sarah Byrd  
Gloria Chalk  
Matthew Currin  
George Ford, Jr.  
Ronda Hoffman  
Dennis Honrine  
Skipper Jones  
Roderick Lusk  
Angela McGill  
Tina Melvin-Ford  
Janet Smith  
Jay Smith  
Sharon Smith  
Courtney Stewart  
Betty Kay Williams  
Diana Winningham



2010 Lumberton Advisory Board with CFFC employees Ginny Martin, Betty Kay Williams, and Kevin Kinlaw



Ethan Caudell, 2010 Cape Fear Farm Credit  
Presidential Scholarship Recipient

# BRANCH LOCATIONS

## Branch Locations

### Burgaw

811 South Walker Street  
910-259-5481

### Clinton

1780 SE Boulevard  
910-592-8121

### Dunn

400 West Broad Street  
910-892-4065

### Elizabethtown

108 North Poplar Street  
910-862-4536

### Fayetteville

333 East Russell Street  
910-483-1404

### Kenansville

127 Beasley Street  
910-296-1776

### Lillington

105 East Front Street  
910-893-8318

### Lumberton

1902 North Cedar Street  
910-738-8181

### Raeford

331 South Main Street  
910-875-6181

### Shalotte

4631 Main Street  
910-754-6203

### Whiteville

300 Liberty Street  
910-642-8041



Whiteville branch members Mearl, Billy, and Jason Butler represent three generations doing business with Cape Fear Farm Credit



Award winning photograph taken by Chase Piercy, son of Clinton branch members Jammie and Kim Piercy. Chase submitted this photograph in the 4-H senior division in the nature's beauty category and won second place.

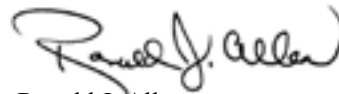
# Report of Management

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

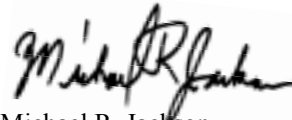
Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all financial statements, and that the assets of the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

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

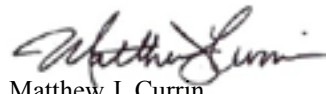
The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that we have reviewed the 2010 Annual Report of Cape Fear Farm Credit, ACA, that the report has been prepared under the oversight of the audit committee 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.



Ronald J. Allen  
Chairman of the Board



Michael R. Jackson  
Interim Chief Executive Officer



Matthew J. Currin  
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.



Michael R. Jackson  
Interim Chief Executive Officer



Matthew J. Currin  
Chief Financial Officer

March 14, 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 Cape Fear Farm Credit, ACA, (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 Southeastern North Carolina. Refer to Note 1, "Organization and Operations," of the Notes to the Consolidated Financial Statements for counties in the Association's territory. The Association provides credit to farmers, ranchers, rural residents, and agribusinesses. Our success begins with our extensive agricultural experience and knowledge of the market.

The Association obtains funding from AgFirst Farm Credit Bank (AgFirst or Bank). The Association is materially affected and shareholder investment in the Association could be affected by the financial condition and results of operations of the Bank. Copies of the Bank's Annual and Quarterly Reports are on the AgFirst website, [www.agfirst.com](http://www.agfirst.com), or may be obtained at no charge by calling 1-800-845-1745, extension 2832, or writing Susanne Caughman, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202.

Copies of the Association's Annual and Quarterly reports are also available upon request free of charge on the Association's website, [www.capefearfarmcredit.com](http://www.capefearfarmcredit.com), or by calling 1-800-368-5819, extension 3243, or writing Matthew J. Currin, Cape Fear Farm Credit, P.O. Box 2405, Fayetteville, NC, 28302. 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.

# Management's Discussion & Analysis of Financial Condition & Results of Operations (continued) dollars in thousands, except as noted

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 2010 was selected by reference to analysis and yield curves of the plans' actuary and industry norms.

## ECONOMIC CONDITIONS

During 2010, economic conditions in the Cape Fear region remained generally stable. As usual, regions dominated by agriculture generally

lag other areas when it comes to feeling the effect of a recession and the recovery that follows. Our agriculture economy is dominated by swine, broiler and turkey production. In 2010 average feed costs were lower than in the previous two years but a spike in prices in the last quarter of the year reduced profitability for the industry. In the broiler industry, producers had a generally profitable year due to reduced feed costs, lower supplies of meat and lower non-feed operational costs. However, the increase in feed costs towards the end of the year created new uncertainties. The turkey industry also experienced better results in 2010 but was also affected by increased feed costs in the fourth quarter.

Demand for transitional land in the Cape Fear region continued to drop in 2010 but at a slower pace than in 2009. This drop can be attributed to the overall uncertain economy, restricted availability to borrowed capital, low demand for housing and less discretionary income due to the wide spread stress in the swine, poultry and turkey industries. However, given all of these factors, traditional farm land values have generally held steady.

The row crop sector within the region experienced an average year. Pricing opportunities remained strong throughout the region but decreases in yields offset most potential gains that high grain prices provided. Produce, blueberries and other fruits and vegetables seemed to have an acceptable year as well. The ethanol industry continued to experience stress in 2010 but generally not to the level it experienced in 2009. While profit margins improved in 2010, stressed cash flows and lowered working capital levels continued to impact operations within the ethanol industry.

The current economic environment has continued to impact employment throughout the region. Employment has remained virtually flat throughout the Association's territory from year to year and the jobless rate has fallen slightly over that time. This trend has resulted in continued stress in all industries that are tied to housing and has led to continued delinquencies in the Association's lifestyle portfolio.

All of the factors mentioned above resulted in a slightly higher overall loan portfolio quality and decreased levels of allowance for loan losses for the Association. While the financial results were more positive for 2010 as compared to 2009, a great deal of uncertainty still exists overall. We are carefully managing through this uncertainty while at the same time aggressively looking to enhance our overall position by making high quality loan decisions and seeking attractive new loan opportunities.

## 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	\$ 404,299	56.34%	\$ 414,779	55.82%	\$ 437,369	57.36%
Real estate mortgage	254,585	35.49	253,452	34.10	241,148	31.63
Processing and marketing	22,113	3.08	34,791	4.68	46,630	6.12
Farm related business	14,756	2.06	18,537	2.49	21,916	2.87
Energy	10,988	1.53	8,460	1.14	–	–
Rural residential real estate	6,448	0.90	8,568	1.15	12,088	1.58
Communication	3,358	0.47	3,317	0.45	3,350	0.44
Loans to Cooperatives	929	0.13	1,274	0.17	–	–
<b>Total</b>	<b>\$ 717,476</b>	<b>100.00%</b>	<b>\$ 743,178</b>	<b>100.00%</b>	<b>\$ 762,501</b>	<b>100.00%</b>

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

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

Branch/State	December 31,		
	2010	2009	2008
Burgaw	4.83%	4.71%	4.76%
Clinton	13.43	11.81	12.67
Dunn	9.10	8.88	9.12
Elizabethtown	9.55	9.69	9.01
Fayetteville	4.12	4.21	4.26
Kenansville	18.30	16.67	16.66
Lillington	4.27	4.59	4.97
Lumberton	10.35	10.31	8.95
Raeford*	5.33	3.21	3.15
Shalotte	1.62	1.71	1.72
Whiteville	2.66	2.87	2.94
Capital Markets	12.53	13.78	17.37
Bonds & Investments	0.08	0.08	0.08
Special Asset Management	3.83	4.98	1.70
	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

\*Upon closure of the Lauringburg branch office in May 2010, all loan assets were transferred to the Raeford branch office.

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.

# Management's Discussion & Analysis of Financial Condition & Results of Operations (continued) dollars in thousands, except as noted

The major commodities in the Association loan portfolio are shown below. The predominant commodities are Swine, Chickens, and Field & Row Crops, which constitute 60 percent of the entire portfolio.

Commodity Group	2010		December 31, 2009		2008	
			<i>(dollars in thousands)</i>			
Swine	\$ 229,987	32%	\$ 242,890	33%	\$ 246,531	32%
Chickens	139,572	19	139,536	19	153,908	20
Field & Row Crops	64,020	9	62,843	8	58,865	8
Landlords	55,788	8	61,700	8	48,636	6
Tobacco	52,232	7	52,248	7	53,219	7
Turkeys	32,443	5	36,349	5	39,005	5
Timber, Sawmills, & Paper	29,926	4	35,187	5	43,000	6
Fruits, Vegetables, & Nuts	28,827	4	28,935	4	31,447	4
Non-Farm & Miscellaneous	25,771	4	31,366	4	23,655	3
Other	25,716	4	20,173	3	27,605	4
Cotton	19,520	2	17,751	2	19,555	3
Livestock	6,913	1	8,455	1	10,654	1
Rural Home	6,761	1	5,745	1	6,472	1
<b>Total</b>	<b>\$ 717,476</b>	<b>100%</b>	<b>\$ 743,178</b>	<b>100%</b>	<b>\$ 762,552</b>	<b>100%</b>

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 swine, chicken, and field & row crop 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 pork and chicken, 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 decrease in gross loan volume for the twelve months ended December 31, 2010, is primarily attributed to decreased demand for credit in the general loan portfolio and continued pay down from existing customers. The Association had fewer opportunities for growth in 2010 due to the reduced demand in most industries in our portfolio as a result of current economic conditions and the uncertainty that exists within these commodity groups.

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 selling of loan participations within the System. This provides a means for the Association to spread credit concentration risk and realize some non-patronage sourced interest and fee income, which may strengthen our capital position. The Association continued strict guidelines for

purchases in 2010 and as a result no new purchases were made during the year.

Loan Participations:	December 31,		
	2010	2009	2008
	<i>(dollars in thousands)</i>		
Participations Purchased			
– FCS Institutions	\$ 38,197	\$ 48,630	\$ 99,091
Participations Purchased			
– Non-FCS Institutions	8,208	13,341	20,200
Participations Sold	(221,355)	(240,453)	(280,236)
<b>Total</b>	<b>\$ (174,950)</b>	<b>\$ (178,482)</b>	<b>\$ (160,945)</b>

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 began selling qualified long-term mortgage loans into the secondary market in 2010 after dissolution of the Secondary Market Mortgage program in 2008. For the period ended December 31, 2010, the Association originated loans for resale totaling \$5,161, of which \$4,767 were sold into the secondary market and \$393 were held for sale at year end awaiting processing and funding.

The Association additionally purchased portions of loans that are guaranteed by the United States Department of Agriculture. These loans are held for the purposes of reducing interest rate risk and managing surplus short-term funds as allowable under FCA regulations. At December 31, 2010, the balance of these loans, including the unamortized premium, was \$410, compared to \$684 at December 31, 2009 and \$1,473 at December 31, 2008.

## 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 the Association had \$6,250 in Rural America Bonds. The Association had \$6,781 as of December 31, 2009 and had \$613 of Rural America Bonds as of December 31, 2008. \$560 of these instruments are classified as Loans on the Consolidated Balance Sheets and the other \$5,690 are classified as Investment Securities.

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, 2009, and 2008 the Association had \$20,356, \$24,742 and \$28,847, respectively, in SIIC outstanding. These instruments are classified as Other Investments on the Consolidated Balance Sheets.

## CREDIT RISK MANAGEMENT

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

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

The credit risk management process begins with an analysis of the borrower’s credit history, repayment capacity, and financial position. Repayment capacity focuses on the borrower’s ability to repay the loan based upon cash flows from operations or other sources of income, including non-farm income. Real estate loans must be collateralized by first liens on the real estate (collateral). As required by FCA regulations, each institution that makes loans on a collateralized basis must have collateral evaluation policies and procedures. Real estate mortgage loans may be made only in amounts up to 85 percent of the original appraised value of the property taken as collateral or up to 97 percent of the appraised value if guaranteed by a state, federal, or other governmental agency. The actual loan to appraised value when loans are made is generally lower than the statutory maximum percentage. Appraisals are required for loans of more than one million dollars. 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	94.43%	93.74%	97.74%
Substandard	5.53%	6.22%	2.22%
Doubtful	0.04%	0.04%	0.04%
Loss	–%	–%	–%
Total	100.00%	100.00%	100.00%

# Management's Discussion & Analysis of Financial Condition & Results of Operations (continued) dollars in thousands, except as noted

## Nonperforming Assets

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

High-risk Assets	December 31,		
	2010	2009	2008
	<i>(dollars in thousands)</i>		
Nonaccrual loans	\$ 26,152	\$ 31,548	\$ 11,980
Restructured loans	16	19	20
Accruing loans 90 days past due	—	—	—
Total high-risk loans	26,168	31,567	12,000
Other property owned	5,626	828	313
Total high-risk assets	\$ 31,794	\$ 32,395	\$ 12,313
<b>Ratios</b>			
Nonaccrual loans to total loans	3.64%	4.25%	1.57%
High-risk assets to total assets	4.08%	4.02%	1.49%

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 \$5,396 or 17.10 percent in 2010. This decrease resulted mainly from the transfer of two large swine loans into other property owned. This also explains the increase in other property owned. Of the \$26,152 in nonaccrual volume at December 31, 2010, \$18,636 or 71.26%, compared to 46.48% and 84.45% 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	\$ 10,076	\$ 5,986	\$ 3,993
Charge-offs:			
Real estate mortgage	(156)	(83)	—
Production and intermediate-term	(344)	(323)	(307)
Total charge-offs	(500)	(2,208)	(307)
Recoveries:			
Real estate mortgage	119	55	13
Production and intermediate-term	104	27	—
Total recoveries	223	95	13
Net (charge-offs) recoveries	(277)	(2,113)	(294)
Provision for (reversal of allowance for) loan losses	(1,848)	6,203	2,287
Balance at end of year	\$ 7,951	\$ 10,076	\$ 5,986
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	(0.038)%	(0.277)%	(0.039)%

The net loan charge-offs were primarily associated with multiple small loans that experienced continued financial difficulties.

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>		
Production and intermediate-term	\$ 4,675	\$ 6,818	\$ 3,046
Real estate mortgage	2,611	1,932	1,759
Agribusiness	541	1,170	1,079
Energy	65	39	—
Rural residential real estate	39	102	85
Communication	20	15	17
Total allowance	\$ 7,951	\$ 10,076	\$ 5,986

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

Allowance for Loan Losses as a Percentage of:	December 31,		
	2010	2009	2008
Total loans	1.11%	1.36%	0.79%
Nonperforming loans	30.38%	31.92%	49.88%
Nonaccrual loans	30.40%	31.94%	49.96%

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 \$22.7 million, \$22.2 million and \$23.9 million 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*	Rate	Nonaccrual Income	Total
	<i>(dollars in thousands)</i>			
<b>12/31/10 - 12/31/09</b>				
Interest income	\$ (3,464)	\$ (846)	\$ 451	\$ (3,859)
Interest expense	(2,008)	(2,336)	–	(4,344)
Change in net interest income	<u>\$ (1,456)</u>	<u>\$ 1,490</u>	<u>\$ 451</u>	<u>\$ 485</u>
<b>12/31/09 - 12/31/08</b>				
Interest income	\$ (28)	\$ (9,833)	\$ (137)	\$ (9,998)
Interest expense	361	(8,657)	–	(8,296)
Change in net interest income	<u>\$ (389)</u>	<u>\$ (1,176)</u>	<u>\$ (137)</u>	<u>\$ (1,702)</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	\$ 2,284	\$ 2,557	\$ 3,180	(10.67)%	(19.59)%
Fees for financially related services	86	129	204	(33.33)	(36.76)
Patronage refund from other Farm Credit Institutions	7,154	7,347	6,495	(2.63)	13.12
Gains (losses) on other property owned, net	(1,953)	(10)	(48)	19,430.00	79.17
Insurance Fund refund	788	–	–	100.00	
Other noninterest income	144	135	(1)	6.67	13,600.00
Total noninterest income	<u>\$ 8,580</u>	<u>\$ 10,158</u>	<u>\$ 9,830</u>	<u>15.53%</u>	<u>3.34%</u>

### Noninterest Expense

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

Noninterest Expense	For the Year Ended December 31,			Percentage Increase/(Decrease)	
	2010	2009	2008	2010/ 2009	2009/ 2008
	<i>(dollars in thousands)</i>				
Salaries and employee benefits	\$ 8,457	\$ 7,432	\$ 6,754	13.79 %	10.04%
Occupancy and equipment	891	891	853	–	4.45
Insurance Fund premiums	321	1,270	1,071	(74.72)	18.58
Other operating expenses	2,203	2,045	2,447	7.73	(16.43)
Total noninterest expense	<u>\$ 11,872</u>	<u>\$ 11,638</u>	<u>\$ 11,125</u>	<u>2.01%</u>	<u>4.61%</u>

Salaries and employee benefits increased in 2010, as compared with 2009, primarily due to accrual of incentive for employees in 2010 where there was no accrual of incentive in 2009.

Insurance Fund premiums decreased 74.72 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 20 basis points on adjusted insured debt outstanding for all of 2010. In addition, there was a 10 basis point premium on the average principal outstanding of nonaccrual loans and any other-than-temporarily impaired investments. Previously, premiums of up to 15 basis points could be charged on accruing loans and up to 25 basis points for nonaccrual loans.

Total noninterest expense increased \$234 or 2.01 percent for December 31, 2010, as compared to the same period of 2009 and increased \$747 or 6.71 percent compared to December 31, 2008. The increase in noninterest expense in 2010 is primarily due to the increase in salaries and employee benefits mentioned above.

### Income Taxes

The Association recorded a provision for income taxes of \$199 for the year ended December 31, 2010, as compared to a provision of \$250 for 2009 and a provision of \$19 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.

# Management's Discussion & Analysis of Financial Condition & Results of Operations (continued) dollars in thousands, except as noted

## 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	2.71%	1.75%	2.52%
Return on average members' equity	17.33%	12.75%	18.71%
Net interest income as a percentage of average earning assets	3.14%	2.87%	3.09%
Net (charge-offs) recoveries to average loans	(0.038)%	(0.277)%	(0.039)%

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 \$636,329 as compared to \$678,235 at December 31, 2009 and \$695,160 at December 31, 2008. The decrease of 6.18 percent compared to December 31, 2009 and the decrease of 8.46 percent compared to December 31, 2008, was attributable to the reduction in loan volume for the Association. The average volume of outstanding notes payable to the Bank was \$645,973 and \$693,425 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. 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 available 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 or 90-day London Interbank Offered Rate (LIBOR). Adjustable rate mortgages are indexed to U.S. Treasury Rates. Fixed rate loans are priced based on the current cost of System debt of similar terms to maturity.

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

### Relationship with the Bank

The Association's statutory obligation to borrow only from the Bank is discussed in Note 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 10, "Members' Equity" 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 12.27 percent to \$124,802 from the December 31, 2009, total of \$111,162. At December 31, 2009, total members’ equity increased 4.90 percent from the December 31, 2008 total of \$105,974. The increase was primarily attributed to the increase in retained surplus due to the amount of net income being greater than any surplus amounts revolved or redeemed in 2010.

Total capital stock and participation certificates were \$2,634 on December 31, 2010, compared to \$2,701 on December 31, 2009 and \$2,707 on December 31, 2008. The decrease was attributed to the reduction in membership related to the reduction in loan volume. FCA sets minimum regulatory capital requirements for System banks and associations. Capital adequacy is evaluated using a number of regulatory ratios. According to the FCA regulations, each institution’s permanent capital ratio is calculated by dividing permanent capital by a risk-adjusted asset base. Risk adjusted assets mean the total dollar amount of the institution’s assets adjusted by an appropriate credit conversion factor as defined by regulation. For all periods represented, the Association exceeded minimum regulatory standards for all the ratios.

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

	2010	2009	2008	Regulatory Minimum
Permanent capital ratio	15.94%	13.20%	13.03%	7.00%
Total surplus ratio	15.60%	12.84%	12.69%	7.00%
Core surplus ratio	15.60%	12.84%	12.15%	3.50%

The increase in the Association’s permanent capital and total surplus for December 31, 2010 was due to the reduction in risk adjusted assets due to a decline in loan volume plus an increase in loan guarantees that were initiated by the Association. The Association also retained more capital at year end 2009 when compared to previous years. The increase as of December 31, 2009 was related to

the reduction in loan volume and reduction in net earnings. The increase in total and core surplus is due to the fact that the Association continuing to utilize nonqualified retained surplus in 2010 for all retained patronage-based income. This type of surplus can be counted as total surplus and is also counted as core surplus because it is not scheduled to be revolved out in the next three years. The total and core surplus ratios are exactly the same because the Association no longer has any allocated surplus that is revolved on a scheduled basis. 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 \$7,439 in 2010, \$4,915 in 2009, and \$11,293 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. 2010 goals were established but not met due to the deterioration of the general economy and borrowers reduced appetite for borrowing.

# Management's Discussion & Analysis

## Management's Discussion & Analysis of Financial Condition & Results of Operations (continued) dollars in thousands, except as noted

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	852	\$110,904
Beginning	1,065	142,762
Small	2,520	165,679

*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 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 7,016 reported farmers of which by definition 339 or 4.80 percent were Young, 1,817 or 25.90 percent were Beginning, and 5,196 or 74.10 percent were Small. Comparatively, as of December 31, 2010, the demographics of the Association's agricultural portfolio contained 2,595 farmers, of which by definition 484 or 18.70 percent were Young, 670 or 25.80 percent were Beginning and 1,543 or 59.50 percent were Small.

In addition to our marketing strategies, in 2010 the Association, through marketing, outreach and financial support programs, created a three-pronged program to help young, beginning and small farmers. The following strategies and outreach programs have been conducted in 2010:

- Support of 4-H, FFA, and young farmer organizations through sponsorships and donations
- Sponsorship of seminars on farm transition planning and financial management
- At least one Young, Beginning, or Small (YBS) Farmer required on each Branch Advisory Committee
- Implementation of reduced documentation loans
- Continue to reach YBS Farmers through various forms of advertising including radio and through the association's internet presence.
- Development of a YBS Farmer retreat for certain YBS Farmers

The Chief Relationship Manager coordinates the Association's YBS efforts. The Association includes YBS goals in the annual strategic plan, and reports on those goals and achievements to the Board of Directors on a quarterly basis.

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 or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, and concentrations of assets, if any, is incorporated in “*Management’s Discussion and Analysis of Financial Condition and Results of Operations*” included in this Annual Report.

## Description of Property

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

<u>Location</u>	<u>Description</u>	<u>Form of Ownership</u>
333 East Russell Street Fayetteville	Administrative/ Branch	Owned
103 East Front Street Lillington	Branch	Owned
400 West Broad Street Dunn	Branch	Owned
1780 Southeast Boulevard Clinton	Branch	Owned
127 Beasley Street Kenansville	Branch	Owned
811 South Walker Street Burgaw	Branch	Owned
108 North Poplar Street Elizabethtown	Branch	Owned
500 South Main Street Laurinburg	Vacant Building	Owned
331 South Main Street Raeford	Branch	Owned
1902 North Cedar Street Lumberton	Branch	Owned
1407 Liberty Street Whiteville	Branch	Owned

<u>Location</u>	<u>Description</u>	<u>Form of Ownership</u>
4631 Main Street Shallotte	Branch	Owned

## 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>Senior Officer</u>	<u>Position &amp; Other Business Interests</u>
Michael R. Jackson	<i>Interim President &amp; Chief Executive Officer</i> since January 2011. He previously served as Senior Vice President/Chief Lending Officer for the Association. Mr. Jackson serves as an officer and board member for several closely held family real estate and investment companies.
Richard A. Eason*	<i>President &amp; Chief Executive Officer</i> from January 2001 to January 2011. He previously served as Chief Operating Officer for the Association.
Matthew J. Currin	<i>Senior Vice President &amp; Chief Financial Officer</i> since August 2006. He previously served as Controller for the Association.

# Disclosure Required by Farm Credit Administration Regulations (continued) dollars in thousands, except as noted

## Senior Officer

## Position & Other Business Interests

Jay R. Smith

Senior Vice President & Chief Relationship Manager since January 2007. He previously served as Credit Administrator for the Association.

\*Retired effective January 31, 2011

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	Deferred Comp.	Perq./Other*		
Richard A. Eason	2010	\$285,421	–	–	\$15,045	\$300,466	
Richard A. Eason	2009	\$281,896	–	–	\$16,740	\$298,636	
Richard A. Eason	2008	\$279,106	\$ 55,000	–	\$ 9,273	\$343,379	
5	2010	\$567,079	\$ 118,979	–	\$36,350	\$722,408	
5	2009	\$547,398	–	–	\$30,481	\$577,879	
6	2008	\$520,393	\$ 181,024	–	\$29,224	\$730,641	

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.

Regulatory reporting changes have affected the content of the compensation reported for 2008, 2009 and 2010.

\*Amounts in the above table classified as Perquisites include travel incentives, group life insurance, automobile compensation, purchased automobile, spousal travel, relocation and tuition reimbursement. Amounts in the above table classified as Other include amounts contributed by the Association on behalf of the senior officer to a defined contribution plan unless the plan is made available to all employees on the same basis.

In addition to a base salary, senior officers earn additional compensation under an incentive plan. The Association incentive plan is designed to motivate employees to exceed the business plan goals during the fiscal year. These goals include return on equity, return on assets, credit quality, credit administration, delinquencies and other key ratios. All Association employees, with the exception of the Chief Executive Officer and Risk Manager, are covered by the plan. The Chief Executive Officer's and Risk Manager's bonuses are at the discretion of the Board of Directors. Bonuses shown in previous years 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.

## Directors

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

DIRECTOR	ORIGINAL YEAR OF ELECTION OR APPOINTMENT	CURRENT TERM EXPIRATION	TOTAL COMP. PAID DURING 2010
Ronald Allen, <i>Chairman</i>	2003	2012	\$ 22,000
Arnold D. Smith, <i>Vice-Chairman</i>	2006	2013	20,000
Dr. James D. Harriss, <i>Outside Director</i>	2006	2013	23,750
Gary A. Hendrix	2007	2014	20,000
P. Jart Hudson	2003	2011	20,000
Lyle R. King	1990	2011	20,000
Daniel H. Lewis	2007	2014	20,000
Jonathan A. Pope	2009	2013	20,000
W. Jeffrey (Jeff) Simpson	2008	2011	20,000
Harold J. Smith, Jr.	1995	2013	20,000
Michael T. (Bo) Stone	2007	2014	20,000
Terray F. Suggs, <i>Outside Director</i>	2006	2011	23,750
Gene S. West	2010	2011	3,333
Alfred K. Wooten	2004	2011	20,000
Jimmy W. Frederick*	2009	2010	10,000
Total			\$282,833

\* Denotes former director who voluntarily resigned from the board in 2010.

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

**Mr. Ronald J. Allen**, Chairman, is a poultry, swine, cattle and hay farmer. His principal occupation and employment for the past five years was self-employed farming and Executive Director of Materials Management for Southeastern Regional Medical Center, a regional hospital (retired). Mr. Allen also serves on the Four County Electric Membership Corporation, an electric utility.

**Mr. Arnold D. Smith**, Vice Chairman is a tobacco and row crop farmer. His principal occupation and employment for the past five years was self-employed farming.

**Mr. Jimmy W. Frederick** is a tobacco, row crop and contract turkey farmer. His principal occupation and employment for the past five years was self-employed farming. Mr. Frederick also serves on the board of Duplin County Farm Bureau, an insurance company.

**Dr. James D. Harriss** was appointed as an Association outside director in 2006. He is an Assistant Professor of Finance at Campbell University. His principal occupation and employment for the past five years was Assistant Professor of Finance at Campbell University.

**Mr. Gary A. Hendrix** is a cotton, row crop, and swine farmer. His principal occupation and employment for the past five years was self-employed farming. Mr. Hendrix also serves on the board of FCI, an agricultural services firm.

**Mr. P. Jart Hudson, Jr.** is a cotton, row crop, tobacco and contract swine farmer. His principal occupation and employment for the past five years was self-employed farming. Mr. Hudson also serves on the board of the Tobacco Growers Association of NC, a crop promotion association and Tri-County Cotton Gin, a cotton processor.

**Mr. Lyle R. King** is a row crop, timber and tobacco farmer. His principal occupation and employment for the past five years was self-employed farming. Mr. King also serves on the boards of AgFirst Farm Credit Bank, the district Farm Credit bank, and Atlantic Telephone Coop, a telephone utility cooperative.

**Mr. Daniel H. Lewis** is a row crop, cattle, timber and poultry farmer. His principal occupation and employment for the past five years was self-employed farming.

**Mr. Jonathan (Jon) A. Pope** is a tobacco, row crop, cattle, poultry, and timber farmer. His principal occupation and employment for the past five years was self-employed farming.

**Mr. W. Jeffrey (Jeff) Simpson** is a tobacco, row crop, and watermelon farmer. His principal occupation and employment for the past five years was self-employed farming. Mr. Simpson also serves as Chairman of the Cumberland County Farm Services Agency (FSA) Board, an agricultural services agency, the FSA Advisory Board, a governmental agency, the NC Tobacco Trust Fund, a tobacco settlement agency, and Congressman Mike McIntyre's Advisory Board, a congressional advisory board.

**Mr. Harold J. Smith, Jr.** is a row crop, swine, vegetable, strawberry and cattle farmer. His principal occupation and employment for the past five years was self-employed farming.

**Mr. Michael T. (Bo) Stone** is a tobacco, row crop, hay, cattle, swine, produce and strawberry farmer, in addition to operating an agri-tourism venture. His principal occupation and employment for the past five years was self-employed farming. Mr. Stone also serves on the board of Robeson County Farm Bureau, an insurance company and on the board of Southeastern Regional Medical Center, a regional hospital.

**Mr. Terray F. Suggs** was appointed as an Association outside director in 2006. He is a Certified Public Accountant and is the sole owner of Terray Suggs, P.A. His principal occupation and employment for the past five years was as an accounting professional with Terray Suggs, P.A. Mr. Suggs also serves on the board of Columbus Regional Healthcare System, a healthcare organization and The North Carolina Community Foundation, a statewide community development organization.

**Mr. Gene S. West** is a row crop, cotton and swine producer. He also owns and operates a commercial cotton gin. His principal occupation and employment for the past five years was self-employed farming.

**Mr. Alfred K. Wooten** is a commercial producer of turf grass, blueberries and row crops. His principal occupation and employment for the past five years was self-employed farming. Mr. Wooten also serves on the board of Pender County Farm Bureau, an insurance company, and the North Carolina Sod Producer's Association, a sod and turf grass advocate.

Subject to approval by the board, the Association may allow the Chairman of the Board a quarterly retainer of \$5,500, outside directors a quarterly retainer of \$6,250 and other regular Board members a quarterly retainer of \$5,000. Total compensation paid to directors as a group during 2010 was \$282,833.

The following chart details the number of meetings and other activities as well as committee assignments during 2010 for each director:

Name of Director	Days Served		Committee Assignments
	Regular Board Meetings	Other Official Activities*	
Ronald Allen, <i>Chairman</i>	11	30	Executive
Arnold Smith, <i>Vice-Chairman</i>	12	11	Executive, Compensation, Governance
Dr. James D. Harriss, <i>Outside Director</i>	11	18	Audit, Governance
Gary A. Hendrix	12	22	Audit, Governance
P. Jart Hudson	12	9	Compensation
Lyle R. King	11	16	Compensation, Governance
Daniel H. Lewis	12	22	Audit
Jonathan A. Pope	11	14	Compensation
W. Jeffrey (Jeff) Simpson	10	10	Compensation
Harold J. Smith, Jr.	12	16	Compensation
Michael T. (Bo) Stone	12	21	Compensation, Governance
Terray F. Suggs, <i>Outside Director</i>	12	22	Audit, Compensation
Gene S. West	5	4	Audit
Alfred K. Wooten	11	13	Audit
Jimmy W. Frederick**	2	4	Audit

\* Includes board committee meetings and other board activities other than regular board meetings.

\*\* Denotes former director who voluntarily resigned from the board in 2010.

Directors 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 \$101,816 for 2010, \$112,347 for 2009 and \$113,521 for 2008.

# Disclosure Required by Farm Credit Administration Regulations (continued) dollars in thousands, except as noted

## 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
<b>Independent Auditor</b>	
PricewaterhouseCoopers LLP	
Audit services	\$ 55,319
Total	<u>\$ 55,319</u>

Audit services 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 Annual and Quarterly reports are available upon request free of charge by calling 1-800-368-5819, extension 3243 or writing Matthew J. Currin, Chief Financial Officer, Cape Fear Farm Credit, PO Box 2405, Fayetteville, NC, 28302 or by accessing the web site, [www.capefearfarmcredit.com](http://www.capefearfarmcredit.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. 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 by going to AgFirst's web site at [www.agfirst.com](http://www.agfirst.com). The Bank prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Bank prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Bank.

# REPORT OF THE AUDIT COMMITTEE

## Report of the Audit Committee

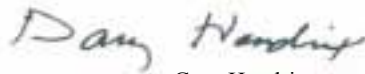
The Audit Committee of the Board of Directors (Committee) is comprised of the directors named below. None of the directors who serve on the Committee is an employee of Cape Fear Farm Credit (Association) and in the opinion of the Board of Directors, each is free of any relationship with the Association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

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

PricewaterhouseCoopers LLP (PwC), the Association's independent auditor for 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:



Gary Hendrix

Chairman of the Audit Committee

### **Members of Audit Committee**

Terray Suggs, Vice Chairman

James Harriss

Daniel Lewis

Gene West

Alfred Wooten

March 14, 2011

# Report of Independent Auditors



## Report of Independent Auditors

To the Board of Directors and Members  
of Cape Fear Farm Credit, ACA

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of changes in members' equity and of cash flows present fairly, in all material respects, the financial position of Cape Fear Farm Credit, ACA (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>	<b>December 31, 2010</b>	<b>December 31, 2009</b>	<b>December 31, 2008</b>
<b>Assets</b>			
Cash	\$ 4,416	\$ 3,972	\$ 1,819
Investment securities:			
Held to maturity (fair value of \$5,712, \$6,351 and \$0 respectively)	5,690	6,200	—
Loans	717,476	743,178	762,501
Less: allowance for loan losses	7,951	10,076	5,986
Net loans	709,525	733,102	756,515
Loans held for sale	393	—	—
Other investments	20,356	24,742	28,847
Accrued interest receivable	6,134	7,781	9,826
Investments in other Farm Credit institutions	11,630	12,288	11,682
Premises and equipment, net	2,931	3,148	3,453
Other property owned	5,626	828	313
Due from AgFirst Farm Credit Bank	6,641	7,074	6,482
Other assets	6,125	6,406	5,832
Total assets	<u>\$ 779,467</u>	<u>\$ 805,541</u>	<u>\$ 824,769</u>
<b>Liabilities</b>			
Notes payable to AgFirst Farm Credit Bank	\$ 636,329	\$ 678,235	\$ 695,160
Accrued interest payable	1,476	1,885	2,524
Patronage refund payable	7,464	5,023	11,400
Other liabilities	9,396	9,236	9,711
Total liabilities	<u>654,665</u>	<u>694,379</u>	<u>718,795</u>
Commitments and contingencies			
<b>Members' Equity</b>			
Protected borrower stock	50	56	73
Capital stock and participation certificates	2,634	2,645	2,634
Retained earnings			
Allocated	34,552	21,739	17,699
Unallocated	87,883	87,041	85,891
Accumulated other comprehensive income (loss)	(317)	(319)	(323)
Total members' equity	<u>124,802</u>	<u>111,162</u>	<u>105,974</u>
Total liabilities and members' equity	<u>\$ 779,467</u>	<u>\$ 805,541</u>	<u>\$ 824,769</u>

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
<b>Interest Income</b>			
Investment securities	\$ 317	\$ 122	\$ —
Loans	41,121	44,894	54,787
Other investments	1,137	1,418	1,645
Total interest income	42,575	46,434	56,432
<b>Interest Expense</b>			
Notes payable to AgFirst Farm Credit Bank	19,879	24,223	32,519
Net interest income	22,696	22,211	23,913
Provision for (reversal of allowance for) loan losses	(1,848)	6,203	2,287
Net interest income after provision for (reversal of allowance for) loan losses	24,544	16,008	21,626
<b>Noninterest Income</b>			
Loan fees	2,284	2,557	3,180
Fees for financially related services	86	129	204
Patronage refund from other Farm Credit institutions	7,154	7,347	6,495
Gains (losses) on other property owned, net	(1,953)	(10)	(48)
Gains (losses) on sales of rural home loans, net	77	—	—
Insurance Fund refund	788	—	—
Other noninterest income (expense)	144	135	(1)
Total noninterest income	8,580	10,158	9,830
<b>Noninterest Expense</b>			
Salaries and employee benefits	8,457	7,432	6,754
Occupancy and equipment	891	891	853
Insurance Fund premiums	321	1,270	1,071
Other operating expenses	2,203	2,045	2,447
Total noninterest expense	11,872	11,638	11,125
Income before income taxes	21,252	14,528	20,331
Provision for income taxes	199	250	19
Net income	\$ 21,053	\$ 14,278	\$ 20,312

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

# Consolidated Statements of Changes in Members' Equity

<i>(dollars in thousands)</i>	Protected Borrower Stock	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2007	\$ 124	\$ 2,542	\$ 16,631	\$ 83,542	\$ (337)	\$ 102,502
Comprehensive income						
Net income				20,312		20,312
Employee benefit plans adjustments (Note 12)				(9)	14	5
Total comprehensive income						20,317
Protected borrower stock retired	(51)					(51)
Capital stock/participation certificates issued/(retired), net		92				92
Patronage distribution						
Cash				(11,293)		(11,293)
Nonqualified retained earnings			6,333	(6,333)		—
Retained earnings retired			(5,651)			(5,651)
Patronage distribution adjustment			386	(328)		58
Balance at December 31, 2008	73	2,634	17,699	85,891	(323)	105,974
Comprehensive income						
Net income				14,278		14,278
Employee benefit plans adjustments (Note 12)					4	4
Total comprehensive income						14,282
Protected borrower stock retired	(17)					(17)
Capital stock/participation certificates issued/(retired), net		11				11
Patronage distribution						
Cash				(4,915)		(4,915)
Nonqualified retained earnings			8,286	(8,286)		—
Retained earnings retired			(4,234)			(4,234)
Patronage distribution adjustment			(12)	73		61
Balance at December 31, 2009	56	2,645	21,739	87,041	(319)	111,162
Comprehensive income						
Net income				21,053		21,053
Employee benefit plans adjustments (Note 12)					2	2
Total comprehensive income						21,055
Protected borrower stock retired	(6)					(6)
Capital stock/participation certificates issued/(retired), net		(11)				(11)
Patronage distribution						
Cash				(7,439)		(7,439)
Nonqualified retained earnings			12,926	(12,926)		—
Patronage distribution adjustment			(113)	154		41
Balance at December 31, 2010	\$ 50	\$ 2,634	\$ 34,552	\$ 87,883	\$ (317)	\$ 124,802

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
<b>Cash flows from operating activities:</b>			
Net income	\$ 21,053	\$ 14,278	\$ 20,312
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	451	505	498
Premium amortization (discount accretion) on other investments	(1,136)	(1,418)	(1,645)
Provision for (reversal of allowance for) loan losses	(1,848)	6,203	2,287
(Gains) losses on other property owned, net	1,953	10	48
Changes in operating assets and liabilities:			
(Increase) decrease in loans held for sale, net	(393)	—	—
(Increase) decrease in accrued interest receivable	1,647	2,045	2,231
(Increase) decrease in due from AgFirst Farm Credit Bank	433	(592)	317
(Increase) decrease in other assets	281	(574)	(524)
Increase (decrease) in accrued interest payable	(409)	(639)	(560)
Increase (decrease) in other liabilities	166	(471)	(1,283)
Total adjustments	1,145	5,069	1,369
Net cash provided by (used in) operating activities	22,198	19,347	21,681
<b>Cash flows from investing activities:</b>			
Purchases of investment securities, held to maturity	—	(6,200)	—
Proceeds from maturities of or principal payments received on investment securities, held to maturity	510	—	—
Net (increase) decrease in loans	18,650	16,422	(59,478)
(Increase) decrease in investment in other Farm Credit institutions	658	(606)	(1,423)
Purchases of other investments	—	—	(2,752)
Proceeds from payments received on other investments	5,522	5,523	4,980
Purchases of premises and equipment	(234)	(200)	(461)
Proceeds from sales of other property owned	20	263	93
Net cash provided by (used in) investing activities	25,126	15,202	(59,041)
<b>Cash flows from financing activities:</b>			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	(41,906)	(16,925)	54,101
Protected borrower stock retired	(6)	(17)	(51)
Capital stock and participation certificates issued/(retired), net	(11)	11	92
Patronage refunds and dividends paid	(4,957)	(11,231)	(11,414)
Retained earnings retired	—	(4,234)	(5,651)
Net cash provided by (used in) financing activities	(46,880)	(32,396)	37,077
Net increase (decrease) in cash	444	2,153	(283)
Cash, beginning of period	3,972	1,819	2,102
Cash, end of period	\$ 4,416	\$ 3,972	\$ 1,819
<b>Supplemental schedule of non-cash activities:</b>			
Loans transferred to other property owned	\$ 6,775	\$ 788	\$ 363
Cash dividends or patronage distributions declared or payable	7,439	4,915	11,293
Employee benefit plans adjustments (Note 12)	(2)	(4)	(5)
<b>Supplemental information:</b>			
Interest paid	20,288	24,862	33,079
Taxes (refunded) paid, net	392	229	50

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:** Cape Fear Farm Credit, ACA (Association) is a member-owned cooperative which provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified purposes in the counties of Bladen, Brunswick, Columbus, Cumberland, Duplin, Harnett, Hoke, New Hanover, Pender, Robeson, Sampson, and Scotland in the state of North Carolina.

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.

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

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

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (Insured

debt), (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary uses by the Insurance Corporation to provide assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank has been required to pay premiums, which may be passed on to the Association, into the Insurance Fund, based on its annual average 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 to 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.

# Notes to the Consolidated Financial Statements

(continued) dollars in thousands, except as noted

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

The Association reviews all investments that are in a loss position in order to determine whether the unrealized loss, which is considered an impairment, is temporary or other-than-temporary. In the event of other-than-temporary impairment, the 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. 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:** The Association is required to maintain ownership in the Bank in the form of Class B and Class C stock. Accounting for this investment is on the cost plus allocated equities basis. Patronage refunds from the Bank are accrued as earned. The receivable for such patronage refunds is classified as due from AgFirst Farm Credit Bank.

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

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

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

I. **Employee Benefit Plans:** Substantially all employees of the Association may participate in either the AgFirst Farm Credit Final Average Pay Retirement Plan or the AgFirst Farm Credit Cash Balance 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,

# Notes to the Consolidated Financial Statements

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which qualifies as a 401(k) plan as defined by the Internal Revenue Code. For employees hired on or prior to December 31, 2002, the Association contributes \$.50 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. For employees hired on or after January 1, 2003, the Association contributes \$1.00 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service. 401(k) plan costs are expensed as funded.

The Association may provide certain health care and life insurance benefits to eligible retired employees. Substantially all employees may become eligible for these benefits if they reach early retirement age while working for the Association. 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 and certain other income taxes. As previously described, the ACA holding company has two wholly-owned subsidiaries, a PCA and a FLCA. The FLCA subsidiary is exempt from federal and state income taxes as provided in the Farm Credit Act. The ACA holding company and the PCA subsidiary are subject to federal, state and certain other income taxes.

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

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

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:** The Association records patronage refunds from the Bank on an accrual basis.

- 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 and 2009 follows. The Association had no investment securities at December 31, 2008.

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

	December 31, 2009				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Mission-related investments	\$ 6,200	\$ 151	\$ —	\$ 6,351	5.39%

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

	December 31, 2010		
	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	5,690	5,712	5.06
Total	\$ 5,690	\$ 5,712	5.06%

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 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 in connection with its investment securities. The Association has the ability and intent to hold these investments until maturity and at this time expects to

# Notes to the Consolidated Financial Statements

(continued) dollars in thousands, except as noted

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 cost. All securities continue to perform and were in an unrealized gain position at December 31, 2010 and 2009.

## 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	\$ 254,585	\$ 253,452	\$ 241,148
Production and intermediate-term	404,299	414,779	437,369
Agribusiness:			
Loans to cooperatives	929	1,274	—
Processing and marketing	22,113	34,791	46,630
Farm-related business	14,756	18,537	21,916
Total agribusiness	37,798	54,602	68,546
Communication	3,358	3,317	3,350
Energy	10,988	8,460	—
Rural residential real estate	6,448	8,568	12,088
<b>Total Loans</b>	<b>\$ 717,476</b>	<b>\$ 743,178</b>	<b>\$ 762,501</b>

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 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	\$ 593	\$ 37,085	\$ —	\$ 1,429	\$ —	\$ 24,750	\$ 593	\$ 63,264
Production and intermediate term	15,087	101,861	—	—	6,064	—	21,151	101,861
Agribusiness								
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
<b>Total</b>	<b>\$ 40,342</b>	<b>\$ 195,176</b>	<b>\$ —</b>	<b>\$ 1,429</b>	<b>\$ 6,064</b>	<b>\$ 24,750</b>	<b>\$ 46,406</b>	<b>\$ 221,355</b>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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 21.25 percent of loans had maturities of one year or less:

<i>(dollars in thousands)</i>	<b>Due less than 1 year</b>	<b>Due 1 Through 5 years</b>	<b>Due after 5 years</b>	<b>Total</b>
Real estate mortgage	\$ 12,294	\$ 63,330	\$ 178,962	\$ 254,586
Production and intermediate term	104,181	112,634	187,484	404,299
Agribusiness				
Loans to cooperatives	487	-	442	929
Processing and marketing	16,787	3,428	1,898	22,113
Farm-related business	3,961	6,970	3,824	14,755
Total agribusiness	21,235	10,398	6,164	37,797
Communication	3,357	1	-	3,358
Energy	10,988	-	-	10,988
Rural residential real estate	416	601	5,431	6,448
Total Loans	<u>\$ 152,471</u>	<u>\$ 186,964</u>	<u>\$ 378,041</u>	<u>\$ 717,476</u>

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:

	<b>2010</b>	<b>2009</b>	<b>2008</b>		<b>2010</b>	<b>2009</b>	<b>2008</b>
<b>Real estate mortgage:</b>							
Acceptable	91.48%	93.35%	94.71%				
OAEM	3.45	2.39	3.83	<b>Total agribusiness</b>	81.16%	88.79%	90.84%
Substandard/doubtful/loss	5.07	4.26	1.46	Acceptable	8.67	3.38	3.75
	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>	OAEM	10.17	7.83	5.41
				Substandard/doubtful/loss	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>
<b>Production and intermediate-term:</b>							
Acceptable	86.58%	88.65%	91.20%	<b>Energy and water/waste disposal:</b>			
OAEM	7.81	3.88	6.59	Acceptable	13.25%	17.28%	100.00%
Substandard/doubtful/loss	5.61	7.47	2.21	OAEM	86.75	82.72	-
	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>	Substandard/doubtful/loss	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>
<b>Agribusiness:</b>				<b>Communication:</b>			
<b>Loans to cooperatives:</b>				Acceptable	100.00%	100.00%	100.00%
Acceptable	52.28%	100.00%	100.00%	OAEM	-	-	-
OAEM	47.72	-	-	Substandard/doubtful/loss	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>
Substandard/doubtful/loss	-	-	-				
	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>	<b>Rural residential real estate:</b>			
				Acceptable	89.14%	93.65%	95.64%
<b>Processing and marketing</b>				OAEM	2.26	1.04	1.58
Acceptable	70.02%	82.53%	86.79%	Substandard/doubtful/loss	8.60	5.31	2.78
OAEM	12.74	5.28	5.45		<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>
Substandard/doubtful/loss	17.24	12.19	7.76				
	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>	<b>Total Loans:</b>			
				Acceptable	87.01%	89.56%	92.38%
<b>Farm-related business</b>				OAEM	7.42	4.18	5.36
Acceptable	99.72%	99.77%	99.43%	Substandard/doubtful/loss	5.57	6.26	2.26
OAEM	0.10	0.03	0.14		<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>
Substandard/doubtful/loss	0.18	0.20	0.43				
	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>				

# Notes to the Consolidated Financial Statements

(continued) dollars in thousands, except as noted

The following table provides an age analysis of past due loans and related accrued interest 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	\$ 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	\$ 4,517	\$ 6,614	\$ 11,131	\$ 712,454	\$ 723,585	\$ -

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
<b>Nonaccrual loans:</b>			
Real estate mortgage	\$ 11,635	\$ 9,230	\$ 3,340
Production and intermediate-term Agribusiness	11,774	19,293	4,711
Processing and marketing	2,514	2,727	3,643
Farm-related business	27	38	51
Total agribusiness	2,541	2,765	3,694
Rural residential real estate	202	260	235
Total nonaccrual loans	\$ 26,152	\$ 31,548	\$ 11,980
<b>Accruing restructured loans:</b>			
Real estate mortgage	\$ 16	\$ 19	\$ 20
Total accruing restructured loans	\$ 16	\$ 19	\$ 20
Total nonperforming loans	\$ 26,168	\$ 31,567	\$ 12,000
Other property owned	5,626	828	313
Total nonperforming assets	\$ 31,794	\$ 32,395	\$ 12,313
Nonaccrual loans as a percentage of total loans	3.64%	4.25%	1.57%
Nonperforming assets as a percentage of total loans and other property owned	4.40%	4.35%	1.61%
Nonperforming assets as a percentage of capital	25.48%	29.14%	11.62%

There were no loans accruing and 90 days past due at December 31, 2010, 2009 and 2008.

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	\$ 18,623	\$ 14,663	\$ 10,118
Past due	7,529	16,885	1,862
Total impaired nonaccrual loans	<u>26,152</u>	<u>31,548</u>	<u>11,980</u>
Impaired accrual loans:			
Restructured	16	19	20
90 days or more past due	-	-	-
Total impaired accrual loans	<u>16</u>	<u>19</u>	<u>20</u>
Total impaired loans	<u>\$ 26,168</u>	<u>\$ 31,567</u>	<u>\$ 12,000</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
<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	<u>2,541</u>	<u>2,636</u>	<u>317</u>	<u>2,967</u>	<u>93</u>
Rural residential real estate	81	79	1	94	3
Total	<u>\$ 16,903</u>	<u>\$ 16,324</u>	<u>\$ 3,711</u>	<u>\$ 19,738</u>	<u>\$ 600</u>
<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	<u>-</u>	<u>1,301</u>	<u>-</u>	<u>-</u>	<u>(3)</u>
Rural residential real estate	121	152	-	142	4
Total	<u>\$ 9,265</u>	<u>\$ 12,680</u>	<u>\$ -</u>	<u>\$ 10,823</u>	<u>\$ 324</u>
<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	<u>2,541</u>	<u>3,937</u>	<u>317</u>	<u>2,967</u>	<u>90</u>
Rural residential real estate	202	231	1	236	7
Total	<u>\$ 26,168</u>	<u>\$ 29,004</u>	<u>\$ 3,711</u>	<u>\$ 30,561</u>	<u>\$ 924</u>

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

The Association had \$781 in 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	\$ 2,296	\$ 1,229	\$ 731
Less: interest income recognized	<u>880</u>	<u>429</u>	<u>566</u>
Foregone interest income	<u>\$ 1,416</u>	<u>\$ 800</u>	<u>\$ 165</u>

# Notes to the Consolidated Financial Statements

(continued) dollars in thousands, except as noted

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	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
<b>2010 allowance ending balance:</b>							
Individually evaluated for impairment	\$ 1,106	\$ 2,287	\$ 317	\$ —	\$ —	\$ 1	\$ 3,711
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
<b>2010 recorded investment ending balance:</b>							
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 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 the quota holder or producer 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.

At December 31, 2010, 2009, and 2008, the Association held Tobacco Buyout SIIC of \$20,356, \$24,742, and \$28,847, respectively, net of discount.

## Note 6 — Investment in AgFirst Farm Credit Bank

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

## Note 7 — Premises and Equipment

Premises and equipment consists of the following:

	December 31,		
	2010	2009	2008
Land	\$ 1,021	\$ 1,021	\$ 1,021
Buildings and improvements	3,505	3,504	3,402
Furniture and equipment	2,545	2,500	2,557
	<u>7,071</u>	<u>7,025</u>	<u>6,980</u>
Less: accumulated depreciation	4,140	3,877	3,527
Total	<u>\$ 2,931</u>	<u>\$ 3,148</u>	<u>\$ 3,453</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	\$ 16	\$ 10	\$ 8
Carrying value unrealized gains (losses)	(1,938)	1	(49)
Operating income (expense), net	<u>(31)</u>	<u>(21)</u>	<u>(7)</u>
Gains (losses) on other property owned, net	<u>\$(1,953)</u>	<u>\$ (10)</u>	<u>\$ (48)</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 1.58 percent for LIBOR-based loans, 1.95 percent for Prime-based loans, and the weighted average remaining maturities were 2.3 years and 5.8 years, respectively, at December 31, 2010. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) notes payable which are match funded by the Bank was 2.86 percent and the weighted average remaining maturity was 6.5 years at December 31, 2010. The weighted average interest rate on all interest-bearing notes payable was 2.55 percent and the weighted average remaining maturity was 5.6 years at December 31, 2010.

Variable rate and fixed rate notes payable represent approximately 12.16 percent and 87.84 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. Protected Borrower Stock

Protection of certain borrower stock is provided under the Farm Credit Act which requires the Association, when retiring protected borrower stock, to retire such stock at par or stated value regardless of its book value. Protected borrower stock includes capital stock and participation certificates which were outstanding as of January 6, 1988, or were issued or allocated prior to October 6, 1988. If an Association is unable to retire protected borrower stock at par value or stated value, amounts required to retire this equity would be obtained from the Insurance Fund.

### B. Capital Stock and Participation Certificates

In accordance with the Farm Credit Act and the Association's capitalization bylaws, each borrower is required to invest in Class C stock for agricultural loans, or participation certificates in the case of rural home and farm related business loans, as a condition of borrowing. The initial borrower investment, through either purchase or transfer, must be in an amount equal to 200 shares (\$1,000.00) or one (1) share for each \$250.00 (or fraction thereof) of the amount of the loan. The Board of Directors may increase the amount of investment if necessary to meet the Association's capital needs. Loans designated for sale or sold into the Secondary Market on or after April 16, 1996 will have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation.

The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, but usually does not make a cash investment. The aggregate par value is generally added to the principal amount of the related loan obligation. The Association retains a first lien on the stock or participation certificates owned by borrowers. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding stock or participation certificates.

### C. Regulatory Capitalization Requirements and Restrictions

The FCA's capital adequacy regulations require the Association to achieve permanent capital of 7.00 percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the 7.00 percent capital requirement can initiate certain mandatory and possibly additional discretionary actions by the FCA that, if

# Notes to the Consolidated Financial Statements

(continued) dollars in thousands, except as noted

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. The 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 15.94 percent, 15.60 percent and 15.60 percent, respectively.

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

## D. Description of Equities

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

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

Class	Protected	Shares Outstanding	
		Number	Aggregate Par Value
B Common/Nonvoting	Yes	9,200	\$ 46
C Common/Voting	No	511,600	2,558
B Participation Certificates/Nonvoting	Yes	800	4
C Participation Certificates/Nonvoting	No	15,200	76
Total Capital Stock and Participation Certificates		536,800	\$ 2,684

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

### Retained Earnings

The Association maintains an unallocated retained earnings account and an allocated retained earnings account. The minimum aggregate amount of these two accounts is determined by the Board. At the end of any fiscal year, if the retained earnings accounts otherwise would be less than the minimum amount determined by

the Board as necessary to maintain adequate capital reserves to meet the commitments of the Association, the Association shall apply earnings for the year to the unallocated retained earnings account in such amounts as may be determined necessary by the Board. Unallocated retained earnings are maintained for each borrower to permit liquidation on a patronage basis.

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

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

Allocated equities shall be retired solely at the discretion of the Board, provided that minimum capital standards established by the FCA and the Board are met. All nonqualified distributions are tax deductible only when redeemed.

At December 31, 2010, allocated members' equity consisted of \$34,552 of nonqualified retained surplus.

### 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 D Preferred Stock or on all classes of stock and participation certificates.

The rate of dividends paid on Class D Preferred Stock for any fiscal year may not be less than the rate of dividends paid on Classes A, B or C Common Stock or participation certificates for such year. The rate of dividends on Classes A, B and C Common Stock and participation certificates shall be at the same rate per share. Dividends may not be declared if, after recording the liability, the Association would not meet its capital adequacy standards. No dividends were declared by the Association for any of the periods included in these Consolidated Financial Statements.

### 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 on patronage loans 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.

#### Transfer

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

#### Impairment

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

- (a) **First**, allocated surplus evidenced by nonqualified written notices of allocation, in its entirety, with application to most recent allocation first and then in reverse order until all such allocated surplus has been exhausted;
- (b) **Second**, allocated surplus evidenced by qualified written notices of allocation, in its entirety, with application to most recent allocation first and then in reverse order until all such allocated surplus has been exhausted;
- (c) **Third**, Class A Common Stock, Class B Common Stock, Class C Common Stock and Class C Participation Certificates issued and outstanding, pro rata until such stock is fully impaired; and
- (d) **Fourth**, Class D Preferred Stock issued and outstanding, if any.

Impairments shall be considered as being applied pro rata to each share and/or unit outstanding in the class.

#### 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:

- (a) **First**, to the holders of Class D Preferred Stock until an amount equal to the aggregate par value of all shares of said stock then issued and outstanding has been distributed to such holders;
- (b) **Second**, to the holders of Class A Common, Class B Common, Class C Common, Class B Participation Certificates and Class C Participation Certificates, pro rata in proportion to the number of shares or units of each such class of stock or participation certificates then issued and outstanding, until an amount equal to the aggregate par value or face amount of all such shares or units has been distributed to such holders;
- (c) **Third**, to the holders of allocated surplus evidenced by qualified written notices of allocation, in the order of year of issuance and pro rata by year of issuance, until the total amount of such allocated surplus has been distributed;
- (d) **Fourth**, to the holders of allocated surplus evidenced by nonqualified written notices of allocation, in the order of year of issuance and pro rata by year of issuance, until the total amount of such allocated surplus has been distributed; and
- (e) **Fifth**, any remaining assets of the Association after such distributions shall be distributed to past and present Patrons on a patronage basis, to the extent practicable.

#### E. Other Comprehensive Income (Loss)

The Association reports other comprehensive income (loss) (OCI) in its Consolidated Statements of Changes in Members' Equity. The Association reported OCI of \$2, \$4, and \$14 in 2010, 2009, and 2008 due to FASB guidance on employers' accounting for defined benefit pension and other postretirement plans" (see Note 12 for further information).

#### Note 11 — Income Taxes

The provision (benefit) for income taxes follows:

	Year Ended December 31,		
	2010	2009	2008
Current:			
Federal	\$ 199	\$ 250	\$ 19
State	—	—	—
	<u>199</u>	<u>250</u>	<u>19</u>
Deferred:			
Federal	—	—	—
State	—	—	—
	<u>—</u>	<u>—</u>	<u>—</u>
Total provision (benefit) for income taxes	<u>\$ 199</u>	<u>\$ 250</u>	<u>\$ 19</u>

# Notes to the Consolidated Financial Statements

(continued) dollars in thousands, except as noted

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	\$ 7,226	\$ 4,939	\$ 6,913
State tax, net	-	-	-
Patronage distributions	(2,529)	(3,013)	(5,672)
Tax-exempt FLCA earnings	(3,974)	(2,304)	(1,492)
Change in valuation allowance	(541)	578	(1,028)
Adjustment to deferred-prior period	(63)	(23)	1,457
Other	80	73	(159)
Provision (benefit) for income taxes	<u>\$ 199</u>	<u>\$ 250</u>	<u>\$ 19</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	\$ 1,995	\$ 2,543	\$ 1,325
Net operating loss – carryforward	445	632	1,485
Nonaccrual loan interest	559	365	152
Gross deferred tax assets	<u>2,999</u>	<u>3,540</u>	<u>2,962</u>
Less: valuation allowance	<u>(2,999)</u>	<u>(3,540)</u>	<u>(2,962)</u>
Gross deferred tax assets, net of valuation allowance	<u>-</u>	<u>-</u>	<u>-</u>
Deferred income tax liabilities:			
Future Bank equity redemption	-	-	-
Loan fees	-	-	-
Gross deferred tax liability	<u>-</u>	<u>-</u>	<u>-</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 \$3.6 million of patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

The Association recorded a valuation allowance of \$2,999, \$3,540, and \$2,962 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 the Association 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 district sponsored benefit plans. These plans include a defined benefit final average pay retirement plan, a 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 final average pay retirement plan (the FAP Plan) or the defined benefit cash balance retirement plan (the CB Plan.) These two plans are noncontributory and include eligible District employees. For participants hired prior to January 1, 2003, benefits are provided under the FAP Plan and are based on eligible compensation and years of service. For participants hired on or after January 1, 2003, 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 District defined benefit plans, the Association funded \$1,698 for 2010, \$2,049 for 2009, and \$973 in 2008, through its note payable to the Bank. Plan expenses included in salaries and employee benefits were \$2,060 for 2010, \$1,815 for 2009, and \$350 for 2008.

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 \$326 for 2010, \$361 for 2009, and \$340 for 2008.

Under FASB guidance on employers' accounting for defined benefit pension and other postretirement plans, accounting for the Standard follows the plan sponsor, which is at the District entity level for the District wide benefit plans in which the Association participates. Therefore, there is no impact to the Association's financial statements due to this guidance for the defined benefit plans discussed above. Additional financial information for the District sponsored plans, including the impact of this guidance, may be found in Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' 2010 Annual Report.

In addition, supplemental retirement benefits are provided to certain key employees under a supplemental defined benefit executive plan. Assets have been allocated and separately invested for this plan but are not isolated from the general creditors of the Association.

The supplemental defined benefit executive plan is unfunded and had a projected benefit obligation of \$377 and a net under-funded status of \$377 at December 31, 2010. Net periodic pension cost for the period was \$37. The assumptions used to determine the projected benefit obligation included a discount rate of 5.65 percent.

FASB guidance requires the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. The balance sheet recognition provisions of this guidance were adopted at December 31, 2007 by the Association for the single employer supplemental nonqualified plan, resulting in no adjustment to accumulated other comprehensive income (AOCI).

FASB guidance also requires that employers measure the benefit obligation and plan assets as of the fiscal year end for fiscal years ending after December 15, 2008. In fiscal 2007 and earlier, a September 30 measurement date was used for pension and other postretirement benefit plans. This guidance provides two approaches for an employer to transition to a fiscal year end measurement date. The approach applied by the Association allows for the use of the measurements determined for the prior year end. Under this alternative, pension and other postretirement benefit expense measured for the three-month period October 1, 2007 to December 31, 2007 (determined using the September 30, 2007 measurement date) is reflected as an adjustment to beginning 2008 unallocated retained earnings. As a result, the Association decreased unallocated retained earnings by \$9.

FASB guidance further requires the determination of the fair value of plan assets and recognition of actuarial gains and losses, prior service costs or credits, and transition assets or obligations as a component of AOCI. These amounts are subsequently recognized as components of net periodic benefit costs over time. For 2010, 2009, and 2008, \$2, \$4, and \$14, respectively, has been recognized as a net credit to AOCI to reflect these elements.

The Association participates in a defined contribution Districtwide 401(k) plan, which qualifies as a 401(k) plan as defined by the Internal Revenue Code. For employees hired on or prior to December 31, 2002, the Association will contribute \$.50 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. For employees hired on or after January 1, 2003, the Association will contribute \$1.00 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service. Employer contributions to this plan were \$137, \$182, and \$172 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, amortized 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 \$29,839. During 2010, \$17,975 of new loans were made and

repayments totaled \$15,452. 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, \$92,397 of commitments to extend credit and no 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 \$4,311 of standby letters of credit, with expiration dates ranging from January 4, 2011 to June 21, 2013. The maximum potential amount of future payments the Association may be required to make under these existing guarantees is \$4,311.

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

# Notes to the Consolidated Financial Statements

(continued) dollars in thousands, except as noted

letters of credit had a fair value of \$61 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 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 December 31, 2010 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 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 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 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
<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

	December 31, 2009			
	Level 1	Level 2	Level 3	Total Fair Value
<b>Assets:</b>				
Assets held in trust funds	\$ 169	\$ —	\$ —	\$ 169
Total Assets	\$ 169	\$ —	\$ —	\$ 169
<b>Liabilities:</b>				
Standby letters of credit	\$ —	\$ —	\$ 97	\$ 97
Total Liabilities	\$ —	\$ —	\$ 97	\$ 97

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

	December 31, 2008			Total Fair Value
	Level 1	Level 2	Level 3	
<b>Assets:</b>				
Assets held in trust funds	\$ 154	\$ –	\$ –	\$ 154
<b>Total Assets</b>	<b>\$ 154</b>	<b>\$ –</b>	<b>\$ –</b>	<b>\$ 154</b>
<b>Liabilities:</b>				
Standby letters of credit	\$ –	\$ –	\$ 127	\$ 127
<b>Total Liabilities</b>	<b>\$ –</b>	<b>\$ –</b>	<b>\$ 127</b>	<b>\$ 127</b>

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	\$ 97
<b>Total gains or (losses) realized/unrealized:</b>	
Included in earnings	–
Included in other comprehensive loss	–
Purchases, sales, issuances and settlements, net	(36)
Transfers in and/or out of level 3	–
<b>Balance at December 31, 2010</b>	<b>\$ 61</b>

	Standby Letters Of Credit
Balance at January 1, 2009	\$ 127
<b>Total gains or (losses) realized/unrealized:</b>	
Included in earnings	–
Included in other comprehensive loss	–
Purchases, sales, issuances and settlements, net	(30)
Transfers in and/or out of level 3	–
<b>Balance at December 31, 2009</b>	<b>\$ 97</b>

	Standby Letters Of Credit
Balance at January 1, 2008	\$ 160
<b>Total gains or (losses) realized/unrealized:</b>	
Included in earnings	–
Included in other comprehensive loss	–
Purchases, sales, issuances and settlements, net	(33)
Transfers in and/or out of level 3	–
<b>Balance at December 31, 2008</b>	<b>\$ 127</b>

## 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 non financial instruments, such as other property owned, began in 2009.

	December 31, 2010			Total Fair Value	YTD Total Gains (Losses)
	Level 1	Level 2	Level 3		
<b>Assets:</b>					
Impaired loans	\$ –	\$ –	\$ 11,107	\$ 11,107	\$ 2,692
Other property owned	\$ –	\$ –	\$ 5,974	\$ 5,974	\$ (1,923)

	December 31, 2009			Total Fair Value	YTD Total Gains (Losses)
	Level 1	Level 2	Level 3		
<b>Assets:</b>					
Impaired loans	\$ –	\$ –	\$ 12,992	\$ 12,992	\$ (6,656)
Other property owned	\$ –	\$ –	\$ 637	\$ 637	\$ 12

	December 31, 2008			Total Fair Value	YTD Total Gains (Losses)
	Level 1	Level 2	Level 3		
<b>Assets:</b>					
Impaired loans	\$ –	\$ –	\$ 7,023	\$ 7,023	\$ (1,998)

# Notes to the Consolidated Financial Statements

(continued) dollars in thousands, except as noted

## 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.

	December 31, 2010		December 31, 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>				
Cash	\$ 4,416	\$ 4,416	\$ 3,972	\$ 3,972
Loans, net of allowance	\$ 715,635	\$ 720,654	\$ 740,855	\$ 756,627
Investment securities	\$ 5,714	\$ 5,712	\$ 6,228	\$ 6,351
Tobacco Buyout SIIC	\$ 20,356	\$ 21,354	\$ 24,742	\$ 26,552
Assets held in trust funds	\$ 157	\$ 157	\$ 169	\$ 169
<b>Financial liabilities:</b>				
Notes payable to AgFirst Farm Credit Bank	\$ 637,805	\$ 641,497	\$ 680,120	\$ 690,319

	December 31, 2008	
	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>		
Cash	\$ 1,819	\$ 1,819
Loans, net of allowance	\$ 766,341	\$ 788,285
Investment securities	\$ —	\$ —
Tobacco Buyout SIIC	\$ 28,847	\$ 30,501
Assets held in trust funds	\$ 154	\$ 154
<b>Financial liabilities:</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 697,684	\$ 716,276

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 in AgFirst Farm Credit Bank:** Estimating the fair value of the Association's investment in the Bank is not practicable because the stock is not traded. As described in Note 6, the net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying Consolidated Balance Sheets. The Association owns 3.20 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.
- D. **Notes Payable to AgFirst Farm Credit Bank:** The notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association's loan receivables plus accrued interest on the notes payable. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.
- E. **Commitments to Extend Credit:** 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 15 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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 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	\$ 5,349	\$ 5,381	\$ 5,756	\$ 6,210	\$ 22,696
Provision for (reversal of allowance for) loan losses	—	—	229	(2,077)	(1,848)
Noninterest income (expense), net	131	(145)	(1,139)	(2,338)	(3,491)
Net income (loss)	\$ 5,480	\$ 5,236	\$ 4,388	\$ 5,949	\$ 21,053

	2009				
	First	Second	Third	Fourth	Total
Net interest income	\$ 5,432	\$ 5,651	\$ 5,678	\$ 5,450	\$ 22,211
Provision for (reversal of allowance for) loan losses	1,007	445	2,565	2,186	6,203
Noninterest income (expense), net	(513)	(659)	(629)	71	(1,730)
Net income (loss)	\$ 3,912	\$ 4,547	\$ 2,484	\$ 3,335	\$ 14,278

	2008				
	First	Second	Third	Fourth	Total
Net interest income	\$ 5,951	\$ 5,942	\$ 6,201	\$ 5,819	\$ 23,913
Provision for (reversal of allowance for) loan losses	—	385	230	1,672	2,287
Noninterest income (expense), net	369	(701)	(512)	(470)	(1,314)
Net income (loss)	\$ 6,320	\$ 4,856	\$ 5,459	\$ 3,677	\$ 20,312

## Note 18 – Subsequent Events

The Association has evaluated subsequent events through March 14, 2011, which is the date the financial statements were issued, and has noted one significant event requiring disclosure. Subsequent to year end, management placed one of the Association's large loans into nonaccrual status. Management estimates that this action will result in the need for an additional \$2 to \$5 million reserve. However, final valuation of the collateral on this loan is pending. A more accurate estimate of possible loss will be available once the valuation has been completed.

# RELATIONSHIP LENDING AT ITS BEST



Kenansville member, Bret Brown (left) with Gerald Wilson, Kenansville branch relationship manager (right)





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