


# SECOND QUARTER 2010

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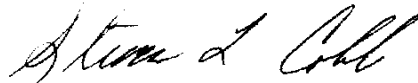
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## CERTIFICATION

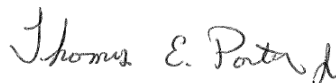
The undersigned certify that we have reviewed the June 30, 2010 quarterly report of Carolina Farm Credit, ACA, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.



Michael R. Morton  
Chief Executive Officer



Steven L. Cobb  
Chief Information and Technology Officer



Thomas E. Porter, Jr.  
Chairman of the Board

August 6, 2010

# Report on Internal Control Over Financial Reporting

The Association's principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association's Consolidated Financial Statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by, or under the supervision of the Association's principal executives and principal financial officers, or persons performing similar functions, and effected by its Board of Directors, management and other personnel. This process provides reasonable assurance regarding the reliability of financial reporting information and the preparation of the Consolidated Financial Statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

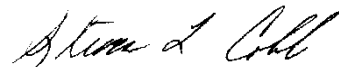
Internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Association's assets that could have a material effect on its Consolidated Financial Statements.

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of June 30, 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 June 30, 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 June 30, 2010.



Michael Morton  
Chief Executive Officer



Steven L. Cobb  
Chief Information and Technology Officer

August 6, 2010

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

*(dollars in thousands)*

The following commentary reviews the financial condition and results of operations of Carolina Farm Credit, ACA (Association) for the period ended June 30, 2010. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2009 Annual Report of the Association. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

## **LOAN PORTFOLIO**

The Association provides funds to farmers, rural homeowners and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans. The Association's loan portfolio is diversified over a range of agricultural commodities in our region, including part-time farm, poultry, and rural home loans. Farm size varies and many of the borrowers in the region have diversified farming operations. This factor, along with the numerous opportunities for non-farm income in the area, reduces the dependency on a single agricultural commodity.

The gross loan volume of the Association as of June 30, 2010, was \$1,164,067 a decrease of \$15,993 as compared to \$1,180,060 at December 31, 2009. Net loans outstanding at June 30, 2010, were \$1,155,529, as compared to \$1,170,783 at December 31, 2009. Net loans accounted for 88.88 percent of total assets at June 30, 2010, as compared to 87.94 percent of total assets at December 31, 2009. The decrease in loan volume during the reporting period is a result of principal payments and payoffs outpacing new loan volume.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level, however, and credit administration remains satisfactory.

Nonaccrual loans decreased from \$49,152 at December 31, 2009, to \$46,994 at June 30, 2010. This decrease is primarily the result of repayments and transfer to other property owned in excess of transferring loans into nonaccrual status.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions. The allowance for loan losses at June 30, 2010, was \$8,538 compared to \$9,277 at December 31, 2009, and was considered by management to be adequate to cover probable losses.

## **RESULTS OF OPERATIONS**

### ***For the three months ended June 30, 2010***

Net income for the three months ended June 30, 2010, totaled \$7,947, as compared to \$2,123 for the same period in 2009. Net interest income increased \$722 for the three months ended June 30, 2010, as compared to the same period in 2009.

At June 30, 2010, total interest income decreased \$448 compared to June 30, 2009. Nonaccrual income was \$351 for the three months ended June 30, 2010, as compared to \$100 for the same period in 2009. Interest expense decreased \$1,170 for the three months ended June 30, 2010, as compared to the comparable period of 2009.

The Association recorded a provision for loan losses of \$247 for the three months ended June 30, 2010 as compared to a provision of \$4,770 for the same period of 2009.

Noninterest income for the three months ended June 30, 2010, totaled \$5,633, as compared to \$4,829 for the same period of 2009, an increase of \$804. This rise in earnings is attributed to an increase of \$1,008 in equity in earnings of other Farm Credit institutions and \$140 in gains on sale of rural home loans when compared to the same period in 2009. These increases were offset by decreases of \$72 in loans fees, \$10 in fees for financially related services, \$218 in losses on other property owned, and \$44 in other noninterest income when compared for the same period of 2009.

Noninterest expense for the three months ended June 30, 2010, increased \$255 compared to the same period of 2009. This rise in noninterest expense is attributed to an increase of \$634 in salaries and employee benefits, \$66 in occupancy and equipment and \$31 in other operating

expenses when compared to the same period in 2009. These increases were offset by a decrease of \$476 in the insurance fund premium when compared for the same period of 2009.

The Association recorded a provision for income taxes of \$5 for the three months ended June 30, 2010 as compared to a provision of \$35 for the same period of 2009.

#### ***For the six months ended June 30, 2010***

Net income for the six months ended June 30, 2010, totaled \$16,781, as compared to \$6,912 for the same period in 2009. This increase of \$9,869, or 142.78 percent, is attributed to a significant decrease to the provision for loan loss and an increase in non-interest income.

At June 30, 2010, total interest income decreased \$3,112 compared to June 30, 2009. Nonaccrual income was \$874 for the six months ended June 30, 2010, as compared to \$152 for the same period in 2009. Interest expense decreased \$3,660 for the six months ended June 30, 2010, as compared to the same period in 2009. Both interest income and interest expense have decreased due to the lower interest rate environment, but also from the significant sales of loans to AgFirst during the first quarter of 2010.

The Association recorded a provision for loan losses of \$101 for the six months ended June 30, 2010 as compared to a provision of \$6,440 for the same period of 2009. The decrease provision for loan losses is related to the decrease in nonaccrual loans and loans charged down to fair value.

Noninterest income for the six months ended June 30, 2010, totaled \$12,394, as compared to \$9,421 for the same period of 2009, an increase of \$2,973. The rise in earnings is attributed to an increase of, \$1,764 in equity in earnings of other Farm Credit institutions and \$235 in the gains on sale of rural home loans, and \$1,480 in insurance fund refunds when compared to the same period in 2009. These increases were offset by a decrease of \$120 in loan fees, \$35 in fees for financially related services, \$232 in the gains on other property owned, and \$119 in other noninterest income when compared to the same period in 2009.

During the first quarter of 2010, the Association recorded \$1,480 of insurance premium refunds from the Farm Credit System Insurance Corporation (FCSIC), which insures the System's debt obligations. The amount is reflected in insurance fund refunds on the Consolidated Statements of Income. These payments are nonrecurring and resulted from the assets of the Farm Credit Insurance Fund exceeding the secure base amount as defined by the Farm Credit Act.

Noninterest expense for the six months ended June 30, 2010, increased \$9 compared to the same period of 2009. This rise in noninterest expense is attributed to an increase of \$617 in salaries and employee benefits, \$85 in occupancy and equipment, and \$48 in other operating expenses when compared to the same period in 2009. The increases were offset by a decrease of \$741 in the insurance fund premium when compared for the same period of 2009.

The Association recorded a provision for income taxes of \$16 for the six months ended June 30, 2010 as compared to a provision of \$34 for the same period of 2009.

#### **FUNDING SOURCES**

The principal source of funds for the Association is the borrowing relationship established with AgFirst through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The funds are advanced by the Bank to the Association in the form of notes payable. The notes payable is segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at June 30, 2010, was \$1,042,753 as compared to \$1,083,521 at December 31, 2009. The decrease during the period is primarily attributable to the decline in loan volume.

The Association has no lines of credit outstanding with third parties as of June 30, 2010.

#### **CAPITAL RESOURCES**

Total members' equity at June 30, 2010, increased to \$236,328 from the December 31, 2009, total of \$219,560. The change in capital is attributed to net earnings for the six months ending June 30, 2010.

Farm Credit administration (FCA) regulations require all Farm Credit institutions to maintain minimum permanent capital, total surplus and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus and core surplus as defined in FCA regulations, by a risk-adjusted asset base. As of June 30, 2010, the Association's total surplus ratio and core surplus ratio were 15.53 percent and 13.35 percent, respectively, and the permanent capital ratio was 16.19 percent. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

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**NOTE:** Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst's annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 2378, or writing Stephen Gilbert AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, [www.agfirst.com](http://www.agfirst.com). Copies of the Association's annual and quarterly reports are also available upon request free of charge by calling 1-800-521-9952, or writing Michael R. Morton, CEO, Carolina Farm Credit, ACA, P.O. Box 1827, Statesville NC 28687-1827, or accessing the website, [www.carolinafarmcredit.com](http://www.carolinafarmcredit.com). The Association prepares a quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

Carolina Farm Credit, ACA  
**Consolidated Balance Sheets**

<i>(dollars in thousands)</i>	<b>June 30, 2010</b> <i>(unaudited)</i>	<b>December 31, 2009</b> <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 1,276	\$ 2,678
Investment securities:		
Held to maturity (fair value of \$2,400 and \$2,125 respectively)	2,155	2,200
Loans	1,164,067	1,180,060
Less: allowance for loan losses	8,538	9,277
Net loans	1,155,529	1,170,783
Loans held for sale	2,999	—
Other investments	43,864	54,840
Accrued interest receivable	12,678	12,699
Investment in other Farm Credit institutions	37,605	38,166
Premises and equipment, net	16,433	16,582
Other property owned	6,454	2,604
Due from AgFirst Farm Credit Bank	7,920	13,743
Other assets	13,149	17,105
Total assets	\$ 1,300,062	\$ 1,331,400
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 1,042,753	\$ 1,083,521
Accrued interest payable	2,805	3,000
Patronage refund payable	443	5,081
Other liabilities	17,733	20,238
Total liabilities	1,063,734	1,111,840
Commitments and contingencies		
<b>Members' Equity</b>		
Protected borrower equity	127	187
Capital stock and participation certificates	7,770	7,713
Retained earnings		
Allocated	112,843	113,492
Unallocated	115,722	98,306
Accumulated other comprehensive income (loss)	(134)	(138)
Total members' equity	236,328	219,560
Total liabilities and members' equity	\$ 1,300,062	\$ 1,331,400

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

Carolina Farm Credit, ACA

# Consolidated Statements of Income

*(unaudited)*

<i>(dollars in thousands)</i>	For the three months ended June 30,		For the six months ended June 30,	
	2010	2009	2010	2009
<b>Interest Income</b>				
Investment securities	\$ 34	\$ —	\$ 68	\$ —
Loans	17,105	17,442	34,201	37,107
Other	571	716	1,158	1,432
Total interest income	17,710	18,158	35,427	38,539
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	8,512	9,682	17,107	20,767
Net interest income	9,198	8,476	18,320	17,772
Provision for (reversal of allowance for) loan losses	247	4,770	101	6,440
Net interest income after provision for (reversal of allowance for) loan losses	8,951	3,706	18,219	11,332
<b>Noninterest Income</b>				
Loan fees	686	758	1,449	1,569
Fees for financially related services	104	114	237	272
Equity in earnings of other Farm Credit institutions	4,797	3,789	8,800	7,036
Gains (losses) on other property owned, net	(331)	(113)	(380)	(148)
Gains (losses) on sale of rural home loans, net	305	165	622	387
Insurance Fund refund	—	—	1,480	—
Other noninterest income	72	116	186	305
Total noninterest income	5,633	4,829	12,394	9,421
<b>Noninterest Expense</b>				
Salaries and employee benefits	4,710	4,076	9,751	9,134
Occupancy and equipment	684	618	1,362	1,277
Insurance Fund premium	14	490	250	991
Other operating expenses	1,224	1,193	2,453	2,405
Total noninterest expense	6,632	6,377	13,816	13,807
Income before income taxes	7,952	2,158	16,797	6,946
Provision (benefit) for income taxes	5	35	16	34
Net income	\$ 7,947	\$ 2,123	\$ 16,781	\$ 6,912

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

Carolina Farm Credit, ACA

# Consolidated Statements of Changes in Members' Equity

*(unaudited)*

*(dollars in thousands)*

	Protected Borrower Capital	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2008	\$ 234	\$ 7,734	\$ 104,671	\$ 99,384	\$ (129)	\$ 211,894
Net income				6,912		6,912
Protected borrower equity retired	(41)					(41)
Capital stock/participation certificates issued/(retired), net		(45)				(45)
Patronage distribution adjustment			10	(305)		(295)
<b>Balance at June 30, 2009</b>	<b>\$ 193</b>	<b>\$ 7,689</b>	<b>\$ 104,681</b>	<b>\$ 105,991</b>	<b>\$ (129)</b>	<b>\$ 218,425</b>
Balance at December 31, 2009	\$ 187	\$ 7,713	\$ 113,492	\$ 98,306	\$ (138)	\$ 219,560
Net income				16,781		16,781
Employee benefit plans adjustments					4	4
Total comprehensive income						16,785
Protected borrower equity retired	(60)					(60)
Capital stock/participation certificates issued/(retired), net		57				57
Patronage distribution adjustment			(649)	635		(14)
<b>Balance at June 30, 2010</b>	<b>\$ 127</b>	<b>\$ 7,770</b>	<b>\$ 112,843</b>	<b>\$ 115,722</b>	<b>\$ (134)</b>	<b>\$ 236,328</b>

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

# Notes to the Consolidated Financial Statements

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

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

The accompanying financial statements include the accounts of Carolina Farm Credit, ACA (the Association). A description of the organization and operations of the Association, the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2009, are contained in the 2009 Annual Report to Shareholders. These unaudited second quarter 2010 consolidated financial statements should be read in conjunction with the 2009 Annual Report to Shareholders.

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles (GAAP) and prevailing practices within the banking industry. The results for the six months ended June 30, 2010, are not necessarily indicative of the results to be expected for the year ending December 31, 2010.

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

The Association maintains an allowance for loan losses in accordance with GAAP. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of June 30, 2010, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

In addition to the recently issued accounting pronouncements discussed in the 2009 Annual Report to Shareholders, in June 2009, 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 as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application was prohibited. This guidance must be applied to transfers occurring on or after the effective date. Additionally, on and after the effective date, 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 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 as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application was prohibited. 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.

In January 2010, the FASB issued guidance "Fair Value Measurements and Disclosures," which is to improve disclosures about fair value measurement by increasing transparency in financial reporting. The changes will provide a greater level of disaggregated information and more detail

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 5).

## NOTE 2 – INVESTMENT SECURITIES

A summary of the amortized cost and fair value of investment securities held-to-maturity at June 30, 2010 and December 31, 2009 follows.

	June 30, 2010				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Mission related investments	\$ 2,155	\$ 245	\$ -	\$ 2,400	6.15%

	December 31, 2009				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Mission related investments	\$ 2,200	\$ 125	\$ -	\$ 2,325	6.15%

A summary of the expected maturity, amortized cost and estimated fair value of investment securities held-to-maturity at June 30, 2010 and December 31, 2009 follows:

	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	\$ 133	\$ 134	4.50 %
After one year through five years	-	-	-
After five years through ten years	-	-	-
After ten years	2,022	2,266	6.26
Total	\$ 2,155	\$ 2,400	6.15 %

	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	\$ 133	\$ 134	4.50 %
After one year through five years	-	-	-
After five years through ten years	-	-	-
After ten years	2,067	2,191	6.26
Total	\$ 2,200	\$ 2,325	6.15 %

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 June 30, 2010 and December 31, 2009.

The Association performs periodic credit reviews, including other-than-temporary impairment analyses, on its investment securities portfolio. The objective is to quantify any future possible loss of principal or interest due on each security identified for additional analysis. Factors considered in determining whether an impairment is other-than-temporary include among others as applicable: 1) the length of time and the extent to which the fair value is less than cost, 2) adverse conditions specifically related to the industry, 3) geographic area and the condition of the underlying collateral, 4) payment structure of the security, 5) ratings by rating agencies, 6) the credit worthiness of bond insurers, and 7) volatility of the fair value changes.

Based on the results of all analyses, the Association has not recognized any other-than-temporary impairment as the unrealized losses resulted primarily from non-credit related factors. The Association has the ability and intent to hold these investments until a recovery of unrealized losses occurs, which may be at maturity, and at this time expects to collect the full principal amount and interest due on these securities. The Association does not intend to sell these investments and it is not more likely than not that the Association would be required to sell these investments before recovering its costs. All securities continue to perform.

## NOTE 3 – ALLOWANCE FOR LOAN LOSSES AND IMPAIRED LOANS

An analysis of the allowance for loan losses follows:

	For the six months ended June 30,	
	2010	2009
Balance at beginning of period	\$ 9,277	\$ 10,257
Provision for (reversal of) loan losses	101	6,440
Charge-offs	(857)	(5,049)
Recoveries	17	24
Balance at end of period	\$ 8,538	\$ 11,672

The following table presents information concerning impaired loans as of June 30,

	<u>2010</u>	<u>2009</u>
Impaired loans with related allowance	\$ 25,243	\$ 26,755
Impaired loans with no related allowance	21,767	24,234
Total impaired loans	<u>47,010</u>	<u>50,989</u>
Allowance on impaired loans	<u>\$ 6,754</u>	<u>\$ 8,034</u>

The following table summarizes impaired loan information for the six months ended June 30,

	<u>2010</u>	<u>2009</u>
Average impaired loans	\$ 50,705	\$ 48,504
Interest income recognized on impaired loans	959	159

#### NOTE 4 – EMPLOYEE BENEFIT PLANS

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

	<b>For the six months ended June 30,</b>	
	<u>2010</u>	<u>2009</u>
Pension	\$ 2,558	\$ 2,438
401(k)	209	189
Other postretirement benefits	446	478
Total	<u>\$ 3,213</u>	<u>\$ 3,105</u>

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

	<b>Actual YTD Through 6/30/10</b>	<b>Projected Contributions For Remainder of 2010</b>	<b>Projected Total Contributions 2010</b>
Pension	\$ 18	\$ 4,321	\$ 4,339
Other postretirement benefits	322	343	665
Total	<u>\$ 340</u>	<u>\$ 4,664</u>	<u>\$ 5,004</u>

Contributions in the above table include allocated estimates of funding for multi-employer plans in which the Association participates. These amounts may change when a total funding amount and allocation is determined by the respective Plan's Sponsor Committee. Also, market conditions could impact discount rates and return on plan assets which could change contributions necessary before the next plan measurement date of December 31, 2010.

Further details regarding employee benefit plans are contained in the 2009 Annual Report to Shareholders.

#### NOTE 5 – FAIR VALUE MEASUREMENT

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

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

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

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

##### Level 1

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets. The Association's Level 1 assets at June 30, 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 June 30, 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 June 30, 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 June 30, 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 June 30, 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 table presents the assets and liabilities that are measured at fair value on a recurring basis at June 30, 2010 and December 31, 2009 for each of the fair value hierarchy levels:

June 30, 2010				
Level 1	Level 2	Level 3	Total Fair Value	
<b>Assets:</b>				
Assets held in trust funds	\$ 123	\$ -	\$ -	\$ 123
Total Assets	\$ 123	\$ -	\$ -	\$ 123
<b>Liabilities:</b>				
Standby letters of credit	\$ -	\$ -	\$ 259	\$ 259
Total Liabilities	\$ -	\$ -	\$ 259	\$ 259
December 31, 2009				
Level 1	Level 2	Level 3	Total Fair Value	
<b>Assets:</b>				
Assets held in trust funds	\$ 139	\$ -	\$ -	\$ 139
Total Assets	\$ 139	\$ -	\$ -	\$ 139
<b>Liabilities:</b>				
Standby letters of credit	\$ -	\$ -	\$ 201	\$ 201
Total Liabilities	\$ -	\$ -	\$ 201	\$ 201

The following tables present the changes in Level 3 assets and liabilities measured at fair value on a recurring basis for the six months ended June 30, 2010 and 2009. The Association had no transfers of assets or liabilities into or out of Level 1 or Level 2 during the six months of 2010 and 2009.

	<b>Standby Letters Of Credit</b>
Balance at January 1, 2010	\$ 201
<b>Total gains or (losses) realized/unrealized:</b>	
Included in earnings	-
Included in other comprehensive loss	-
Purchases, sales, issuances and settlements, net	58
Transfers in and/or out of level 3	-
Balance at June 30, 2010	<u>\$ 259</u>

	<b>Standby Letters Of Credit</b>
Balance at January 1, 2009	\$ 267
<b>Total gains or (losses) realized/unrealized:</b>	
Included in earnings	-
Included in other comprehensive loss	-
Purchases, sales, issuances and settlements, net	(28)
Transfers in and/or out of level 3	-
Balance at June 30, 2009	<u>\$ 239</u>

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

Assets and liabilities measured at fair value on a non-recurring basis at June 30, 2010 and December 31, 2009 for each of the fair value hierarchy values are summarized below:

	June 30, 2010				
	Level 1	Level 2	Level 3	Total Fair Value	YTD Total Gains (Losses)
<b>Assets:</b>					
Impaired loans	\$ -	\$ -	\$ 18,489	\$ 18,489	\$ (282)
Other property owned	\$ -	\$ -	\$ 5,115	\$ 5,115	\$ (224)

	December 31, 2009				
	Level 1	Level 2	Level 3	Total Fair Value	YTD Total Gains (Losses)
<b>Assets:</b>					
Impaired loans	\$ -	\$ -	\$ 17,277	\$ 17,277	\$ (8,183)
Other property owned	\$ -	\$ -	\$ 2,883	\$ 2,883	\$ (236)

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

The following table presents the carrying amounts and fair values of the Association's financial instruments at June 30, 2010 and December 31, 2009. The fair value of a financial instrument is generally defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

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

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

	June 30, 2010		December 31, 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>				
Cash	\$ 1,279	\$ 1,276	\$ 2,678	\$ 2,678
Loans, net of allowance	\$ 1,155,529	\$ 1,182,158	\$ 1,170,783	\$ 1,199,641
Investment securities	\$ 2,155	\$ 2,400	\$ 2,200	\$ 2,325
Tobacco Buyout SIIIC	\$ 43,864	\$ 47,484	\$ 58,840	\$ 58,333
Assets held in trust funds	\$ 123	\$ 123	\$ 139	\$ 139
<b>Financial liabilities:</b>				
Notes payable to AgFirst Farm Credit Bank	\$ 1,042,753	\$ 1,066,136	\$ 1,083,521	\$ 1,104,030

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.

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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 and Other Farm Credit Institutions:** Estimating the fair value of the Association's investment in the Bank and Other Farm Credit Institutions is not practicable because the stock is not traded. 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 9.76 percent of the issued stock of the Bank as of June 30, 2010 net of any reciprocal investment. As of that date, the Bank's assets totaled \$30.7 billion and shareholders' equity totaled \$1.9 billion. The Bank's earnings were \$206.7 million during the first six months of 2010.

In addition, the Association has an investment of \$473 related to other Farm Credit institutions.

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

- G. **Assets Held in Trust Funds:** See Note 5 for discussion of estimation of fair value for this instrument.

- H. **Investment Securities:** Fair value is determined by discounting the expected future cash flows using appropriate interest rates for similar assets.

#### **NOTE 7 – SUBSEQUENT EVENTS**

The Association has evaluated subsequent events and has determined there are none requiring disclosure through August 6, 2010, which is the date the financial statements were issued.