

# **FEDERAL LAND BANK ASSOCIATION OF SOUTH ALABAMA, FLCA**

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## **2009 Quarterly Report 3rd Quarter**



**For the Quarter Ended September 30, 2009**



Part of the Farm Credit System

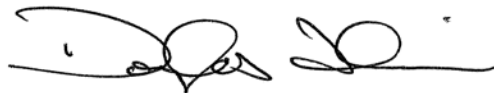
## REPORT OF MANAGEMENT

The financial statements of the Federal Land Bank Association of South Alabama, FLCA (Association) are prepared by management, who are responsible for the statements' integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The financial statements have been prepared in conformity with generally accepted accounting principles appropriate in the circumstances. Other financial information included in the quarterly report is consistent with that in the financial statements.

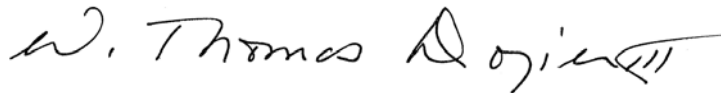
To meet its responsibility for reliable financial information, management depends on the Farm Credit Bank of Texas' (Bank) and the Association's accounting and internal control systems, which have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded and transactions are properly authorized and recorded. The systems have been designed to recognize that the cost of controls must be related to the benefits derived. The annual financial statements are audited by PricewaterhouseCoopers LLP, independent accountants, who conduct a review of internal controls solely for the purpose of establishing a basis for reliance thereon in determining the nature, extent and timing of audit tests applied in the audit of the financial statements in accordance with generally accepted auditing standards. The Association is also examined by the Farm Credit Administration.

The audit committee of the board of directors has oversight responsibility for the Association's system of internal controls and financial reporting. The audit committee consults regularly with management and meets periodically with the independent auditors and the internal auditor to review the scope and results of their work. The independent auditors and internal auditor have direct access to the audit committee.

The undersigned certify that, to the best of our knowledge and belief, the financial statements and other financial information included in this quarterly report reliably present the financial condition of the Federal Land Bank Association of South Alabama, FLCA and the results of its operations for the periods shown.



Douglas Thiessen  
President/Chief Executive Officer  
October 28, 2009



W. Thomas Dozier, III  
Chairman, Board of Directors  
October 28, 2009



M. Scott Sellers, CPA  
Sr.VP/Chief Financial Officer  
October 28, 2009



J.K. Love, CPA  
Chairman, Audit Committee  
October 28, 2009

## **FEDERAL LAND BANK ASSOCIATION OF SOUTH ALABAMA, FLCA MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following commentary reviews the financial performance of the Federal Land Bank Association of South Alabama, FLCA (Federal Land Credit Association), referred to as the Association, for the quarter and nine months ended September 30, 2009. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2008 Annual Report of the Association.

The Association is a member of the Farm Credit System (System), a nationwide network of cooperatively owned financial institutions established by and subject to the provisions of the Farm Credit Act of 1971, as amended, and the regulations of the Farm Credit Administration (FCA) promulgated thereunder.

The financial statements were prepared under the oversight of the Association's audit committee.

On September 21, 2009, the Association's stockholders approved the establishment of a Production Credit Association (PCA) and an Agricultural Credit Association (ACA) holding company. The PCA will operate as a wholly-owned subsidiary of the ACA and will allow the Association an opportunity to provide short-term lending. Equity ownership in the existing Federal Land Bank Association of South Alabama, FLCA will be transferred to the ACA. Concurrent with the change in corporate structure, the Association's name will change from Federal Land Bank Association of South Alabama, FLCA, to Alabama Ag Credit, FLCA. Likewise, the new ACA holding company will operate under the name Alabama Ag Credit, ACA, and the PCA will operate under the name Alabama Ag Credit, PCA. This change in corporate structure is pending final approval by FCA, and if approved will become effective on or after January 1, 2010.

### **Results of Operations:**

The Association had net income of \$2,468,011 and \$4,997,448 for the three and nine months ended September 30, 2009, as compared to net income of \$2,586,720 and \$8,400,509 for the same periods in 2008 reflecting a decrease of 4.6 and 40.5 percent, respectively. Net interest income was \$4,223,855 and \$12,422,595, respectively, for the three and nine months ended September 30, 2009, compared to \$3,959,171 and \$11,923,913 for the same periods in 2008. Interest income for the first nine months of 2009 decreased by \$2,391,618 or 8.7 percent from the same period of 2008, primarily due to declines in yields on earning assets, offset partially by an increase in average loan volume. Interest expense for the first nine months of 2009 decreased by \$2,890,300, or 18.4 percent, from the same periods of 2008 due to a decrease in interest rates offset partially by an increase in average debt volume. The provision for loan losses for the first nine months of 2009 increased by \$2,703,634 or 10,176.3 percent, over the same period of 2008, due mostly to specific reserves recorded for three large credits in 2009. All three credits were participation loans in the ethanol industry and are discussed further in the "Risk Exposure" section of Management's Discussion and Analysis below. Average loan volume for the third quarter of 2009 was \$625,333,975, compared to \$570,987,921 in the third quarter of 2008.

Noninterest income for the three and nine months ended September 30, 2009, decreased by \$67,200 and \$621,399, or 11.4 percent and 27.6 percent, respectively, over the same periods of 2009. This is due primarily to lower patronage income from Farm Credit Bank of Texas (the Bank) in the first nine months of 2009 as compared to the first nine months of 2008. This decrease in patronage is due almost entirely to the fact that in 2009, the Association began accruing less Direct Note patronage from the Bank on a monthly basis than in 2008. Accordingly, nine months of estimated Direct Note patronage, to be received at year end, have been accrued into income as of September 30, 2009, but at a lesser amount than in the prior year.

Noninterest expenses for the three and nine months ended September 30, 2009, increased by \$114,897 and \$487,075, or 5.9 percent and 8.5 percent, respectively, as compared to the same periods in 2008. The increase is due primarily to an increase in salaries and employee benefits costs and Farm Credit System Insurance Corporation (FCSIC) premium expense. The increase in salaries and employee benefits is primarily due to an increase in contributions to the defined benefit retirement plan, as well as the addition of three employees. For more

information on the defined benefit plan, refer to the 2008 Annual Report and Note 6, "Employee Benefit Plans," to the financial statements, included in this quarterly report. FCSIC premiums increased on the basis of the Association having higher loan volume in the first three quarters of 2009 than in the first three quarters of 2008.

The Association had charge-offs of \$240,743 and \$995,572 for the three and nine months ended September 30, 2009, and charge-offs of \$0 and \$35,004 for the same periods in 2008. The Association did not record any recoveries during these respective time periods. The Association's allowance for loan losses was 0.4 percent and 0.1 percent of total loans outstanding as of September 30, 2009, and 2008, respectively.

The Association's return on average assets for the nine months ended September 30, 2009, was 1.05 and 1.93 percent for the same period in 2008. The Association's return on average equity for the nine months ended September 30, 2009, was 6.49 and 11.50 percent for the same period in 2008.

### Loan Portfolio:

The Association makes and services loans, secured by a first lien on real estate, to farmers, ranchers, rural homeowners and certain farm-related businesses. The majority of the loans serviced by the Association contain provisions for variable interest rates and are long-term. Loans serviced by the Association offer several installment payment cycles, the timing of which usually coincides with the seasonal cash-flow capabilities of the borrower.

Total loans outstanding at September 30, 2009, stated at recorded investment (principle less funds held), were \$630,777,355 compared to \$593,982,063 at December 31, 2008, reflecting an increase of 6.2 percent. The major commodities within the Association's loan portfolio are timber, poultry, cattle, and field crops.

The following table reflects the credit quality of the Association's loan volume as of:

	<u>September 30, 2009</u>	<u>December 31, 2008</u>
Acceptable	94.9 %	96.2 %
Special Mention	1.7 %	1.9 %
Substandard	3.4 %	1.9 %
Total	<u>100.0 %</u>	<u>100.0 %</u>

### Risk Exposure:

High-risk assets include nonaccrual loans, loans that are past due 90 days or more and still accruing interest, formally restructured loans and other property owned. The following table illustrates the Association's components and trends of high-risk assets.

	<u>September 30, 2009</u>		<u>December 31, 2008</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Nonaccrual	\$ 8,513,472	85.2%	\$ 4,231,385	91.5%
90 days past due and still accruing interest	238,613	2.4%	129,691	2.8%
Formally restructured	-	0.0%	-	0.0%
Other property owned, net	<u>1,237,293</u>	<u>12.4%</u>	<u>262,784</u>	<u>5.7%</u>
Total	<u>\$ 9,989,378</u>	<u>100.0%</u>	<u>\$ 4,623,860</u>	<u>100.0%</u>

At September 30, 2009, loans that were considered impaired were \$8,752,085 compared to \$4,361,076 at December 31, 2008. This represents 1.4 percent and 0.7 percent of loan volume, respectively. Impaired loans consist of all high-risk assets except other property owned, net. The increase in impaired assets is primarily due to three large credits related to the ethanol industry, which has experienced significant financial stress as a result of high input costs, among other factors, and a small number of other loans adversely affected by the poor economic conditions over the past year.

The Association originated a loan to one borrower through the Capital Markets of the South (CMS) and participated the loan to 13 other Farm Credit associations, with the Association serving as the lead lender. The original funded balance of the loan was \$68,500,000, and the Association retained 5.56 percent of the loan. In 2007, the loan was deemed to be nonaccrual due to its significant under collateralized position and a credit default. Accordingly, the Association began pursuing collection efforts, including liquidating part of the loan's collateral, which was applied to the outstanding balance for all participants. In addition, by the end of 2007 the Association, along with the four other CMS member associations, repurchased, on a pro-rata basis, the portions of the loan held by all other non-CMS participants. As part of loan repurchase transactions noted above, the Association received a general release from the non-CMS participants for claims related to the loan, and agreed to indemnify the non-CMS participants from any liability arising from legal proceedings related to the loan.

In 2008 collection efforts continued, resulting in legal judgments against the borrowers, allowing the Association to foreclose on portions of the real estate collateral, with sales proceeds being applied against the outstanding balance of the loan. The Association is still in process of foreclosing on the remaining portions of the real estate collateral. In addition, the borrowers have surrendered various other real and personal properties, all of which is to be liquidated and applied against the loan balance. All sales of remaining real estate collateral and other properties are expected to be completed by the first quarter of 2010.

During 2007, charge-offs of \$30,245,000 were recognized; the Association's portion of the 2007 charge-offs was \$4,812,212. No further charge-offs or allowance reserves were required to be recognized in 2008 or year to date in 2009. As of September 30, 2009, the Association's portion of the loan's remaining book balance was \$352,334. For more information on impaired loans and the allowance for loan losses, see Note 2 to the financial statements, "Allowance for Loan Losses," included in this quarterly report.

#### **Liquidity and Funding Sources:**

The Association secures the majority of its lendable funds from the Farm Credit Bank of Texas (The Bank), which obtains its funds through the issuance of Systemwide obligations. The following schedule summarizes the Association's borrowings.

	<b>September 30, 2009</b>	<b>December 31, 2008</b>
Note payable to the Bank	\$ <b>539,985,535</b>	\$ 506,309,605
Accrued interest on note payable	<b>1,408,457</b>	1,687,429
Total	<b>\$ 541,393,992</b>	<b>\$ 507,997,034</b>

#### **Capital Resources:**

The Association's capital position increased by \$1,589,457 at September 30, 2009, compared to December 31, 2008. The Association's debt as a ratio to members' equity was 5.23:1 as of September 30, 2009, compared to 4.99:1 as of December 31, 2008.

In February 2009, the board declared a \$3,500,000 cash patronage to be paid to stockholders from the Association's 2008 Earnings. The patronage distribution was completed in April 2009.

Under regulations governing minimum permanent capital adequacy and other capitalization issues, the Association is required to maintain a minimum adjusted permanent capital of seven percent of risk-adjusted assets as defined by the FCA. The Association's permanent capital ratio at September 30, 2009, was 15.1 percent, which is in compliance with the FCA's minimum permanent capital standard. The Association's core surplus ratio and total surplus ratio at September 30, 2009, were 14.5 and 14.5 percent, respectively, which is in compliance with the FCA's minimum surplus standard.

## **Legal Proceedings:**

In relation to the loan described in the "Risk Exposure" section of Management's Discussion and Analysis, above, the Association is now involved in two lawsuits as of the date of this report. One of these is the suit brought by the Association to foreclose the lien of its mortgage in Muhlenberg County, Kentucky. In February 2009, the Association received approval to foreclose the lien of its mortgage on the remaining real estate collateral located in Muhlenberg County, Kentucky and intends to foreclose such lien as soon as possible. However, prior to conducting the foreclosure, the Association is investigating the value of coal reserves on the property in order to properly understand the overall value of the property. A limited test drilling plan has been completed and the Association expects the results of a formal assessment of value, prepared by an outside consultant, to be provided shortly. The remaining action is a suit brought by the Association in the US Federal District Court in Texas, seeking recovery of a payment in the amount of \$100,000 made by the borrower to attorneys for criminal defense services.

The previous action brought by the Association against the parties responsible for defrauding it has been resolved at the trial court level. As was previously reported, on March 19, 2009, the court rendered judgment in favor of the Association against all parties, jointly and severally, on all counts for \$41,549,236 in actual damages. On April 23, 2009, the Court trebled the judgment to \$124,647,710. Two defendants are pursuing an appeal of this judgment. The Association is continuing to pursue the assets of all liable parties in satisfaction of the judgment.

The Association has been and will remain vigorous in pursuit of collection of the loan balances outstanding and other potential sources of recovery.

## **Relationship with the Farm Credit Bank of Texas:**

The Association's financial condition may be impacted by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect the stockholders' investment in the Association. The Management's Discussion and Analysis and Notes to Financial Statements contained in the December 31, 2008, Annual Report of Federal Land Bank Association of South Alabama, FLCA more fully describe the Association's relationship with the Bank.

The Tenth Farm Credit District's (District) annual and quarterly stockholder reports are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, The Ag Agency, P.O. Box 202590, Austin, Texas 78720, or by calling (512) 483-9260. Copies of the District's quarterly and annual stockholder reports also can be requested by e-mail at [fcdb@farmcreditbank.com](mailto:fcdb@farmcreditbank.com). The District makes its annual and quarterly stockholder reports available on its web site at [www.farmcreditbank.com](http://www.farmcreditbank.com).

The Association's annual and quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Federal Land Bank Association of South Alabama, FLCA, P.O. Box 241687, Montgomery, Alabama, 36124-1687, or by calling (334) 270-8687. Copies of the reports can also be requested by e-mailing [awolf@farmcreditbank.com](mailto:awolf@farmcreditbank.com). The Association's quarterly stockholder reports are available on its website at [www.alabamalandloan.com](http://www.alabamalandloan.com) approximately 40 days after each quarter end, and the annual stockholder report is available on its website 75 days after the fiscal year end. Copies of the annual stockholder report can also be requested 90 days after fiscal year end.

**FEDERAL LAND BANK ASSOCIATION OF SOUTH ALABAMA, FLCA**

**BALANCE SHEET**

	<b>September 30, 2009 (unaudited)</b>	<b>December 31, 2008</b>
	<hr/>	<hr/>
<b><u>ASSETS</u></b>		
Cash	\$ 237,765	\$ 2,115,315
Loans	630,777,355	593,982,063
Less: allowance for loan losses	2,694,348	959,718
Net loans	<hr/> 628,083,007	<hr/> 593,022,345
Accrued interest receivable	8,474,896	8,069,442
Investment in and receivable from the Bank:		
Capital stock	9,567,900	9,567,900
Accrued patronage receivable	382,500	365,891
Other	226,486	-
Other property owned, net	1,237,293	262,784
Premises and equipment	1,873,955	1,794,341
Other assets	504,560	205,034
Total assets	<hr/> <b>\$ 650,588,362</b> <hr/>	<hr/> <b>\$ 615,403,052</b> <hr/>
 <b><u>LIABILITIES</u></b>		
Note payable to the Bank	\$ 539,985,535	\$ 506,309,605
Accrued interest payable	1,408,457	1,687,429
Drafts outstanding	2,147,723	1,172,178
Other liabilities	2,645,290	3,421,940
Total liabilities	<hr/> <b>546,187,005</b> <hr/>	<hr/> <b>512,591,152</b> <hr/>
 <b><u>MEMBERS' EQUITY</u></b>		
Capital stock and participation certificates	3,615,455	3,494,180
Unallocated retained earnings	100,631,115	99,133,667
Accumulated other comprehensive income (loss)	154,787	184,053
Total members' equity	<hr/> <b>104,401,357</b> <hr/>	<hr/> <b>102,811,900</b> <hr/>
Total liabilities and members' equity	<hr/> <b>\$ 650,588,362</b> <hr/>	<hr/> <b>\$ 615,403,052</b> <hr/>

**FEDERAL LAND BANK ASSOCIATION OF SOUTH ALABAMA, FLCA**

**STATEMENT OF INCOME**

(unaudited)

	Quarter Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2009	2008	2009	2008
<b><u>INTEREST INCOME</u></b>				
Loans	\$ 8,479,216	\$ 9,036,998	\$ 25,246,427	\$ 27,638,045
<b><u>INTEREST EXPENSE</u></b>				
Note payable to the Bank	4,255,361	5,077,827	12,823,832	15,714,132
Net interest income	4,223,855	3,959,171	12,422,595	11,923,913
<b><u>PROVISION FOR LOSSES</u></b>				
Provision for loan losses	184,249	49,449	2,730,202	26,568
Provision for (reversal of) acquired property losses	58,496	(8,000)	102,110	12,475
Net interest income after provision for loan losses	3,981,110	3,917,722	9,590,283	11,884,870
<b><u>NONINTEREST INCOME</u></b>				
Patronage income from the Bank	202,081	322,614	612,433	1,213,674
Loan fees	318,132	266,758	969,034	977,234
Financially related services income	2,157	1,603	4,824	4,137
Gain (loss) on sale of premises and equipment, net	1,905	500	(3,988)	2,772
Other noninterest income	-	-	47,369	53,254
Total noninterest income	524,275	591,475	1,629,672	2,251,071
<b><u>NONINTEREST EXPENSES</u></b>				
Salaries and employee benefits	1,269,618	1,188,730	3,844,562	3,346,395
Directors' expense	30,977	57,982	180,514	184,799
Purchased services	266,018	305,247	1,172,686	1,670,840
Travel	73,999	116,623	211,092	281,456
Occupancy and equipment	77,825	73,925	234,449	197,164
Communications	24,418	21,036	75,183	68,417
Advertising	49,399	49,783	95,880	125,139
Public and member relations	33,149	32,529	103,841	99,296
Supervisory and exam expense	52,251	55,569	163,388	164,339
Insurance fund premiums	245,769	168,076	790,877	631,164
Other noninterest expense	26,120	25,548	72,660	73,052
Loss on other property owned, net	36,983	25,790	29,891	25,790
CMS expense reimbursement	(149,152)	(198,361)	(752,516)	(1,132,419)
Total noninterest expenses	2,037,374	1,922,477	6,222,507	5,735,432
Net income	\$ 2,468,011	\$ 2,586,720	\$ 4,997,448	\$ 8,400,509

**FEDERAL LAND BANK ASSOCIATION OF SOUTH ALABAMA, FLCA**

**STATEMENT OF CHANGES IN MEMBERS' EQUITY**

(unaudited)

	<b>Capital Stock/ Participation Certificates</b>	<b>Unallocated Retained Earnings</b>	<b>Accumulated Other Comprehensive Income (Loss)</b>	<b>Total Members' Equity</b>
Balance at December 31, 2007	\$ 3,326,230	\$ 91,538,558	\$ 282,547	\$ 95,147,335
Adjustment to beginning balance due to FAS No. 158 accounting change	-	(18,492)	-	(18,492)
Balance at January 1, 2008	3,326,230	91,520,066	282,547	95,128,843
Comprehensive income				
Net income	-	8,400,509	-	8,400,509
Amortization of costs included in periodic retirement benefit costs	-	-	(29,284)	(29,284)
Total comprehensive income	-	8,400,509	(29,284)	8,371,225
Capital stock/participation certificates issued	469,835			469,835
Capital stock/participation certificates retired	(347,835)	-	-	(347,835)
Patronage refunds:				
Cash	-	(3,200,000)	-	(3,200,000)
Change in patronage declared and paid		294		294
<b>Balance at September 30, 2008</b>	<b>\$ 3,448,230</b>	<b>\$ 96,720,869</b>	<b>\$ 253,263</b>	<b>\$ 100,422,362</b>
Balance at December 31, 2008	\$ 3,494,180	\$ 99,133,667	\$ 184,053	\$ 102,811,900
Comprehensive income				
Net income	-	4,997,448	-	4,997,448
Amortization of costs included in periodic retirement benefit costs	-	-	(29,266)	(29,266)
Total comprehensive income	-	4,997,448	(29,266)	4,968,182
Capital stock/participation certificates issued	412,595			412,595
Capital stock/participation certificates retired	(291,320)	-	-	(291,320)
Patronage refunds:				-
Cash	-	(3,500,000)	-	(3,500,000)
<b>Balance at September 30, 2009</b>	<b>\$ 3,615,455</b>	<b>\$ 100,631,115</b>	<b>\$ 154,787</b>	<b>\$ 104,401,357</b>

**FEDERAL LAND BANK OF SOUTH ALABAMA, FLCA**  
**NOTES TO THE FINANCIAL STATEMENTS**  
(UNAUDITED)

**NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:**

The Federal Land Bank Association of South Alabama, FLCA (Federal Land Credit Association), referred to as the Association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves the counties of Autauga, Baldwin, Barbour, Bibb, Bullock, Butler, Chambers, Chilton, Choctaw, Clarke, Coffee, Conecuh, Coosa, Covington, Crenshaw, Dale, Dallas, Elmore, Escambia, Geneva, Greene, Hale, Henry, Houston, Lee, Lowndes, Macon, Marengo, Mobile, Monroe, Montgomery, Perry, Pickens, Pike, Russell, Sumter, Tallapoosa, Tuscaloosa, Washington and Wilcox in the state of Alabama. The Association is a lending institution of the Farm Credit System (the System), which was established by Acts of Congress to meet the needs of American agriculture.

A description of the Association's significant accounting policies and the financial condition and results of operations as of December 31, 2008, are contained in the 2008 Annual Report to the stockholders. These unaudited third quarter 2009 financial statements should be read in conjunction with the 2008 Annual Report to the stockholders.

On September 21, 2009, the Association's stockholders approved the establishment of a Production Credit Association (PCA) and an Agricultural Credit Association (ACA) holding company. The PCA will operate as a wholly-owned subsidiary of the ACA and will allow the Association an opportunity to provide short-term lending. Equity ownership in the existing Federal Land Bank Association of South Alabama, FLCA will be transferred to the ACA. Concurrent with the change in corporate structure, the Association's name will change from Federal Land Bank Association of South Alabama, FLCA, to Alabama Ag Credit, FLCA. Likewise, the new ACA holding company will operate under the name Alabama Ag Credit, ACA, and the PCA will operate under the name Alabama Ag Credit, PCA. This change in corporate structure is pending final approval by FCA, and if approved will become effective on or after January 1, 2010.

Effective January 1, 2009, the Association adopted accounting guidance for fair value measurements of nonfinancial assets and nonfinancial liabilities. The impact of adoption resulted in additional fair value disclosures but did not have an impact on our financial condition or results of operations.

In April 2009, the FASB issued guidance, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly". The guidance emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique and inputs used, the objective for fair value measurement is unchanged from what it would be if markets were operating at normal activity levels or transactions were orderly; that is, to determine the current exit price. It sets forth additional factors that should be considered to determine whether there has been a significant decrease in volume and level of activity when compared with normal market activity. The reporting entity shall evaluate the significance and relevance of the factors to determine whether, based on the weight of evidence, there has been a significant decrease in activity and volume. The guidance indicates that if an entity determines that either the volume or level of activity for an asset or liability has significantly decreased (from normal conditions for that asset or liability) or price quotations or observable inputs are not associated with orderly transactions, increased analysis and management judgment will be required to estimate fair value. It is further noted that a fair value measurement should include a risk adjustment to reflect the amount market participants would demand because of the risk (uncertainty) in the cash flows.

This guidance also requires a reporting entity to make additional disclosures in interim and annual periods. It is effective for interim periods ending after June 15, 2009, with early application permitted for periods ending after March 15, 2009. Revisions resulting from a change in valuation techniques or their application are accounted for as a change in accounting estimate. The Association adopted the guidance in second quarter 2009. The adoption did not have a material impact on the financial condition or results of operations of the Association.

In May 2009, the FASB issued guidance, "Subsequent Events," which sets forth general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. There are two types of subsequent events: the first type consists of events or transactions that provide additional evidence about conditions that existed at the balance sheet date (recognized subsequent events) and the second type consists of events that provide evidence about conditions that did not exist at the balance sheet date but arose after that date (nonrecognized subsequent events). Recognized subsequent events should be recognized in the financial statements since the conditions existed at the date of the balance sheet.

Nonrecognized subsequent events are not recognized in the financial statements since the conditions arose after the balance sheet date but before the financial statements are issued or are available to be issued. This guidance, which includes a required disclosure of the date through which an entity has evaluated subsequent events, was effective for interim or annual periods ending after June 15, 2009.

The accompanying 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, except for the inclusion of a statement of cash flows. Generally accepted accounting principles require a business enterprise that provides a set of financial statements reporting both financial position and results of operations to also provide a statement of cash flows for each period for which results of operations are provided. However, in regulations issued by FCA, associations have the option to exclude statements of cash flows in interim financial statements. Therefore, the Association has elected not to include a statement of cash flows in these financial statements.

The preparation of these financial statements requires the use of management's estimates. The results for the quarter ended September 30, 2009, are not necessarily indicative of the results to be expected for the year ended December 31, 2009. Certain amounts in the prior period's financial statements have been reclassified to conform to current financial statement presentation.

## NOTE 2 — ALLOWANCE FOR LOAN LOSSES:

The allowance for loan losses is maintained at a level considered adequate by management to provide for estimated losses inherent in the loan portfolio. The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition and prior loan loss experience. An analysis of the allowance for loan losses follows:

	<b>September 30, 2009</b>	September 30, 2008
Balance at beginning of quarter	\$ 2,750,842	\$ 494,679
Provision for loan losses	184,249	49,449
Charge-offs	(240,743)	-
Recoveries	-	-
Balance at end of quarter	<u>\$ 2,694,348</u>	<u>\$ 544,128</u>

The following table presents information concerning impaired loans:

	<b>September 30, 2009</b>	September 30, 2008
Impaired loans with related allowance	\$ 3,021,073	\$ 3,321,733
Impaired loans with no related allowance	5,731,012	1,116,504
Total impaired loans	<u>\$ 8,752,085</u>	<u>\$ 4,438,237</u>
Allowance on impaired loans	\$ 2,064,286	\$ 327,887
Average impaired loans	\$ 7,753,357	\$ 3,334,982
Interest income on impaired loans for the quarter	\$ 15,439	\$ 3,329

## NOTE 3 — CAPITAL:

The Association's board of directors has established a Capital Adequacy Plan (Plan) that includes the capital targets that are necessary to achieve the institution's capital adequacy goals as well as the minimum permanent capital standards. The Plan monitors projected dividends, equity retirements and other actions that may decrease the Association's permanent capital. In addition to factors that must be considered in meeting the minimum standards, the board of directors also monitors the following factors: capability of management; quality of operating policies, procedures, and internal controls; quality and quantity of earnings; asset quality and the adequacy of the allowance for losses to absorb inherent losses within the loan portfolio; sufficiency of liquid funds; needs of an institution's customer base; and any other risk-oriented activities, such as funding and interest rate risk, potential obligations under joint and several liability, contingent and off-balance-sheet liabilities or other conditions warranting additional capital. At least quarterly, management reviews the Association's goals and objectives with the board.

In February 2009, the board declared a \$3,500,000 cash patronage to be paid to stockholders from the Association's 2008 Earnings. The patronage distribution was completed in April 2009.

**NOTE 4 — CAPITAL MARKETS:**

Until the second quarter of 2007, the Association participated in the Capital Markets of the South (CMS), a joint venture created in 2003 for the purpose of expanding the participants' lending opportunities. The CMS group was comprised of the Association, the Federal Land Bank Association of North Alabama, FLCA, the Land Bank of North Mississippi, FLCA, Southern AgCredit, ACA (formerly Land Bank South, FLCA), and the Louisiana Federal Land Bank Association, FLCA. During the second quarter of 2007, the CMS members decided to discontinue the joint venture. The Association will continue to service the existing CMS loan portfolio, with revenue and expenses continuing to be shared accordingly as noted below, until such time as all of the loans are fully matured or paid off.

Pursuant to the terms of the alliance, each of the five CMS participating associations generally share equally in the costs of operating the venture. All CMS noninterest expenses are recorded gross on the Association's books and then reimbursed 80% by the other four associations. The total amount of reimbursements is included on the statement of income in the line item entitled "CMS expense reimbursements." The Association's pro-rata share of income from CMS operations are recorded in the statement of income in their respective line items.

**NOTE 5 — FAIR VALUE MEASUREMENTS:**

Authoritative guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 12 to the 2008 Annual Report to Stockholders for a more complete description.

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

	<b>Fair Value Measurement Using</b>			<b>Total Fair Value</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	
Assets:				
Loans *	\$ -	\$ -	\$ 2,996,962	\$ 2,996,962
Other property owned	-	-	1,352,303	1,352,303

\* Represents the fair value of certain loans that were evaluated for impairment under authoritative guidance, "Accounting by Creditors for Impairment of a Loan". The fair value was based upon the underlying collateral since these were collateral dependent loans for which real estate is the collateral.

**Valuation Techniques**

As more fully discussed in Note 12 to the 2008 Annual Report to Stockholders, authoritative guidance 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. The following represent a brief summary of the valuation techniques used for the Bank and its related Associations' assets and liabilities. For a more complete description, see Notes to the 2008 Annual Report.

*Loans*

For certain loans evaluated for impairment under authoritative guidance, the fair value is based upon the underlying collateral since the loans were collateral dependent loans for which real estate is the collateral. 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 real estate, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established.

### *Other Property Owned*

Other property owned is generally classified as Level 3. The fair value is based upon the collateral value. Costs to sell represent transaction costs and are not included as a component of the assets fair value.

### **NOTE 6 — EMPLOYEE BENEFIT PLANS:**

The following table summarizes the components of net periodic benefit costs for the nine months ended September 30, :

	Other Benefits	
	2009	2008
Service cost	\$ 36,468	\$ 32,304
Interest cost	58,803	52,458
Expected return on plan assets	-	-
Amortization of prior service costs	(29,267)	(29,742)
Amortizations of net (gain) loss	-	456
Net periodic benefit cost	<u>\$ 66,004</u>	<u>\$ 55,476</u>

In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 158 “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans” (SFAS 158), which required 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 SFAS 158 were adopted at December 31, 2007. SFAS 158 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, we used a September 30 measurement date for other postretirement benefit plans. The Standard provides two approaches for an employer to transition to a fiscal year end measurement date. The Association has applied the second approach, which allows for the use of the measurements determined for the prior year end.

Under this alternative, postretirement benefit expense measured for the three-month period October 1, 2007, to December 31, 2007, (determined using the September 2007 measurement date) was recorded as an adjustment to beginning 2008 retained earnings. As result, the Association decreased retained earnings by \$18,492 and increased the postretirement benefit liability by \$18,492.

The Association previously disclosed in its Annual Report to the stockholders for the year ended December 31, 2008, that it expected to contribute \$27,959 to its postretirement health and welfare benefits plan in 2009. As of September 30, 2009, \$16,189 of contributions have been made. The Association’s liability for the plan’s unfunded accumulated benefit obligation at September 30, 2009 was \$1,334,961 and is included in “Other liabilities” in the balance sheet.

### **NOTE 7 — SUBSEQUENT EVENTS:**

The Association has evaluated subsequent events through October 28, 2009, which is the date the financial statements were available to be issued, and determined that there are no subsequent events to report.