

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

**2007
Quarterly Report
Third Quarter**



For the Quarter Ended September 30, 2007



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.

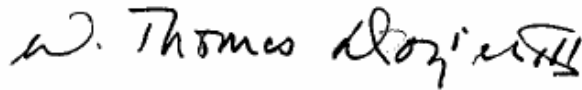
To meet its responsibility for reliable financial information, management depends on the Farm Credit Bank of Texas' (Bank) and the Association's accounting and internal control systems, which have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded and transactions 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.



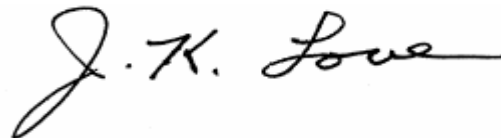
Douglas Thiessen, Chief Executive Officer
November 1, 2007



W. Thomas Dozier, III, Chairman, Board of Directors
November 1, 2007



M. Scott Sellers, CPA, Chief Financial Officer
November 1, 2007



J.K. Love, CPA, Chairman, Audit Committee
November 1, 2007

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 the nine months ended September 30, 2007. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2006 Annual Report of the Association.

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

Results of Operations:

The Association had net income of \$2,179,961 and \$5,844,124 for the three and nine months ended September 30, 2007, as compared to net income of \$2,859,342 and \$7,419,860 for the same periods in 2006 reflecting a decrease of 23.8 and 21.2 percent, respectively. Net interest income was \$4,025,904 and \$11,861,565, respectively, for the three and nine months ended September 30, 2007, compared to \$3,756,417 and \$10,957,148 for the same periods in 2006. Interest income increased by \$3,391,789 or 12.9 percent, from the first nine months of 2007, primarily due to a slight increase in yields on earning assets and an increase in average loan volume. Interest expense for the first nine months of 2007 increased by \$2,487,372, or 16.2 percent, from the same periods of 2006 due to an increase in interest rates and an increase in average debt volume. The provision for loan losses for the first nine months of 2007 increased by \$1,797,036, or 199.2 percent, over the same period of 2006, due to specific reserves recorded for two large credits, the larger of which is explained further in the "Loan Portfolio" section of Management's Discussion and Analysis, below. Average loan volume for the third quarter of 2007 was \$525,171,148, compared to \$480,506,734 in the third quarter of 2006.

Noninterest income for the three months ended September 30, 2007 increased by \$17,006, or 3.9 percent, over the same period of 2006. This increase was due primarily to increases in loan fees and patronage income in the third quarter of 2007 compared to the third quarter of 2006. Total loan volume closed in the third quarter of 2007 was lower than the third quarter of 2006, and there was also less CMS activity in the third quarter of 2007 versus 2006. However, for the third quarter time frame, loan fees were slightly higher in 2007 versus 2006 due to the fact that there were more loans closed, in number, and the average loan origination fee was higher, resulting in higher overall loan fees. There was less CMS activity as a result of the CMS member associations deciding to discontinue the joint venture during the second quarter of 2007, as explained further in Note 4 to the financial statements included in this quarterly report. The Association received higher patronage income from Farm Credit Bank of Texas (the Bank) in the third quarter of 2007 as compared to the third quarter of 2006. The patronage income was higher due to a higher investment in the Bank thus far in 2007 as compared to 2006.

Noninterest income for the nine months ended September 30, 2007 increased by \$8,249, or 0.6 percent, over the same period of 2006. This overall slight increase is due primarily to increased patronage income from the Bank, consistent with the explanation above, however this increase was offset somewhat by decreased loan fees (YTD). The decrease in loan fees is a result of competitive pressures driving down the average loan origination fees, as well as less CMS activity as mentioned above.

Noninterest expenses for the three months ended September 30, 2007 increased by \$289,769, or 21.8 percent, as compared to the same period in 2006. Noninterest expenses for the nine months ended September 30, 2007 increased by \$691,366, or 17.4 percent, as compared to the same period in 2006. The increase for both time frames is due primarily to increases in each of the following categories: salaries and employee benefits costs,

directors' expense, purchased services expense, and Farm Credit System Insurance Corporation (FCSIC) premium expense. These expense increases were offset partially by an increase in CMS expense reimbursements. The increase in salaries and employee benefits is primarily due to the normal annual increase in compensation rates from the prior year for all employees, plus the unusual circumstance of overlapping cost from hiring the Association's new CEO in January 2007 and still having the retiring CEO on the payroll until his official retirement date of June 1, 2007. Directors' expense increased as a result of having one additional outside director, appointed in early 2007, and more director-related activities in the third quarter and YTD in 2007 than the same measurement periods in 2006. Purchased services increased primarily due to legal and consulting fees incurred in connection with protecting the Association's interests in credit-related matters with borrowers with large credits from the Association, as noted below in the "Loan Portfolio" section of the Management's Discussion and Analysis. FCSIC premiums increased on the basis of the Association having higher loan volume in the third quarter and YTD in 2007 than the same measurement periods in 2006. CMS expense reimbursements increased because the majority of the legal and consulting fees incurred as mentioned above were related to a CMS loan.

The Association recorded no recoveries and \$1,789,757 in charge-offs for the quarter ending September 30, 2007, and no recoveries or charge-offs for the same period in 2006. The Association's allowance for loan losses was 0.1 percent and 0.1 percent of total loans outstanding as of September 30, 2007, and 2006, respectively.

The Association's return on average assets for the nine months ended September 30, 2007, was 1.47 and 2.03 percent for the same period in 2006. The Association's return on average equity for the nine months ended September 30, 2007, was 8.53 and 11.95 percent for the same period in 2006.

Loan Portfolio:

The Association's loan portfolio at September 30, 2007 consisted of 3,849 loans that totaled \$536,712,081. The total loan volume, stated as recorded investment plus accrued interest, increased \$28.1 million (5.5 percent) since December 31, 2006, primarily due to the continued demand for real estate and continued marketing and service efforts.

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

	<u>September 30, 2007</u>	<u>December 31, 2006</u>
Acceptable	99.4 %	97.6 %
Special Mention	0.3 %	1.7 %
Substandard	0.3 %	0.7 %
Total	<u>100.0 %</u>	<u>100.0 %</u>

The major commodity concentrations within the Association's loan volume are timber, cattle, poultry, and field crops.

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.

	September 30, 2007		December 31, 2006	
	Amount	%	Amount	%
Nonaccrual	\$ 1,448,971	94.0%	\$ 595,219	100.0%
90 days past due and still accruing interest	-	0.0%	-	0.0%
Formally restructured	-	0.0%	-	0.0%
Other property owned, net	92,075	6.0%	-	0.0%
Total	\$ 1,541,046	100.0%	\$ 595,219	100.0%

Nonaccrual loans as a percentage of total loans outstanding were 0.3 percent at September 30, 2007, compared to 0.1 percent at December 31, 2006. Nonaccrual loans increased compared to December 31, 2006 because a large loan was placed in nonaccrual status; said loan is described in the paragraph below. This same loan was previously classified as Special Mention at December 31, 2006.

The Association originated a loan to one borrower through 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 \$68.5 million, and the Association retained 5.56% of the loan. During the second quarter of 2007, the loan was deemed to be nonaccrual due to its significant undercollateralized position and a credit default. The Association is currently pursuing collection efforts, and in the third quarter liquidated part of the loan's collateral, which was applied to the outstanding balance for all participants. In addition, in the third quarter the Association, along with the four other CMS member associations, began repurchasing, on a pro-rata basis, the portions of the loan held by the other non-CMS participants. This repurchase was completed for one non-District participant prior to September 30, 2007. As of September 30, 2007, charge-offs of \$30.245 million have been recognized, and specific reserves of \$1.46 million remain on the books related to this loan. The Association's portion of charge-offs and specific reserves was \$2.329 million and \$120 thousand, respectively. As of September 30, 2007, the Association's portion of the loan's remaining book balance is \$878 thousand.

During October 2007, the repurchase transaction was completed for all of the other participants except for one, and negotiations are currently ongoing to complete the buy-back for the lone remaining non-CMS participant. The repurchase transaction for the remaining participant is expected to be completed during the fourth quarter of 2007. As a result of the October 2007 loan repurchase transaction, the Association recognized additional provision for loan losses of \$2.395 million. As of the date of this report, the Association's portion of the loan's remaining book balance is \$1.946 million. For more information on impaired loans and the allowance for loan losses, see Note 2 to the financial statements included in this quarterly report.

Liquidity and Funding Sources:

The Association secures the majority of its lendable funds from the Bank, which obtains its funds through the issuance of Systemwide obligations and with lendable equity. The following schedule summarizes the Association's borrowings.

	September 30, 2007	December 31, 2006
Note payable to the Bank	\$ 446,598,417	\$ 423,598,301
Accrued interest on note payable	2,084,080	1,925,238
Total	<u>\$ 448,682,497</u>	<u>\$ 425,523,539</u>

Capital Resources:

The Association's capital position increased by \$3,013,691 at September 30, 2007, compared to December 31, 2006. The Association's debt as a ratio to members' equity was 4.84:1 as of September 30, 2007, compared to 4.74:1 as of December 31, 2006.

In January 2007, the Association's board of directors declared a cash patronage of \$3,000,000 of the Association's 2006 earnings to be paid to the stockholders. The patronage distribution was completed in the second quarter of 2007. See Note 3 to the financial statements included in this quarterly report and Note 6 to the financial statements included in the 2006 Annual Report for further discussion.

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, 2007, was 16.1 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, 2007, were 15.4 and 15.4 percent, respectively, which is in compliance with the FCA's minimum surplus standard.

Legal Proceedings:

In relation to the loan described in "Loan Portfolio" section of Management's Discussion and Analysis, above, the Association is involved in three lawsuits as of the date of this report. The overall character of the lawsuits is of collection of the principal and interest from the borrower and control of the loan's collateral. Two of the lawsuits were filed in the borrower's domicile state of Texas and involved enjoining the borrower from denying access to collateral, as well as civil complaints by the Association against the borrower and other related individuals as well as third parties for damages incurred as a consequence of alleged wrongful acts by the respective parties. The third lawsuit was filed in the state of Kentucky, where the primary real estate collateral is located, for the purpose of gaining access to and foreclosing the lien of its mortgages on the real estate and commencing an action for collection of the debt. The Kentucky state court has appointed a Receiver to protect the Association's collateral and preserve the status quo pending resolution of the suit. The borrower and other related individuals have responded by filing a counter-claim against the Association, alleging various claims, including breach of contract.

These legal proceedings have the potential to be very lengthy and the outcome is unknown at this time. However, the Association has been and will remain vigorous in pursuit of collection of the loan balances outstanding and in defense of the borrower's counter-claims against the Association. The Association's legal counsel believes that the Association's claims are supported by facts and have a reasonable chance of success, and at the same time believe that the borrower's claims are without merit and the Association will be successful in its defense against such claims.

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 stockholder's investment in the Association. The Management's Discussion and Analysis and Notes to Financial Statements contained in the December 31, 2006 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 fcf@farmcreditbank.com. The District makes its annual and quarterly stockholder reports available on its web site at 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. The Association makes its annual and quarterly stockholder reports available on its Web site at www.alabamalandloan.com.

FEDERAL LAND BANK ASSOCIATION OF SOUTH ALABAMA, FLCA

BALANCE SHEET

	September 30, 2007 (unaudited)	December 31, 2006
	<hr/>	<hr/>
<u>ASSETS</u>		
Cash	\$ 270,945	\$ 1,699,487
Loans	526,764,686	500,257,260
Less: allowance for loan losses	339,961	455,588
Net loans	<hr/> 526,424,725	<hr/> 499,801,672
Accrued interest receivable	9,947,395	8,344,502
Investment in and receivable from the Bank:		
Capital stock	8,047,100	8,047,100
Accrued patronage receivable	-	267,470
Other property owned, net	92,075	-
Premises and equipment	1,660,326	1,710,844
Other assets	280,265	185,478
Total assets	<hr/> \$ 546,722,831 <hr/>	<hr/> \$ 520,056,553 <hr/>
 <u>LIABILITIES</u>		
Note payable to the Bank	\$ 446,598,417	\$ 423,598,301
Accrued interest payable	2,084,080	1,925,238
Drafts outstanding	2,246,009	1,311,196
Other liabilities	2,241,698	2,682,882
Total liabilities	<hr/> 453,170,204 <hr/>	<hr/> 429,517,617 <hr/>
 <u>MEMBERS' EQUITY</u>		
Capital stock and participation certificates	3,305,290	3,150,865
Unallocated retained earnings	90,247,337	87,388,071
Total members' equity	<hr/> 93,552,627 <hr/>	<hr/> 90,538,936 <hr/>
Total liabilities and members' equity	<hr/> \$ 546,722,831 <hr/>	<hr/> \$ 520,056,553 <hr/>

The accompanying notes are an integral part of these financial statements

FEDERAL LAND BANK ASSOCIATION OF SOUTH ALABAMA, FLCA

STATEMENT OF INCOME

(unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	2006	2007	2006
<u>INTEREST INCOME</u>				
Loans	\$ 10,156,170	\$ 9,259,967	\$ 29,686,646	\$ 26,294,857
<u>INTEREST EXPENSE</u>				
Note payable to the Bank	6,130,266	5,503,550	17,825,081	15,337,709
Net interest income	4,025,904	3,756,417	11,861,565	10,957,148
<u>PROVISION FOR LOSSES</u>				
Provision for loan losses	678,797	2,692	2,699,331	902,295
Net interest income after provision for loan losses	3,347,107	3,753,725	9,162,234	10,054,853
<u>NONINTEREST INCOME</u>				
Patronage income from the Bank	110,828	97,672	329,582	277,645
Loan fees	334,546	320,503	961,568	994,193
Financially related services income	1,991	1,972	4,732	4,938
Loss on other property owned, net	(1,925)	-	(1,925)	-
Gain (loss) on sale of premises and equipment, net	3,811	14,416	(2,183)	19,081
Other noninterest income	5,000	2,682	49,878	37,546
Total noninterest income	454,251	437,245	1,341,652	1,333,403
<u>NONINTEREST EXPENSES</u>				
Salaries and employee benefits	797,654	769,201	2,639,999	2,360,134
Directors' expense	28,092	24,552	152,280	123,821
Purchased services	524,612	133,130	916,694	424,670
Travel	88,999	69,636	218,948	185,655
Occupancy and equipment	64,342	63,812	179,448	169,805
Communications	22,196	16,092	61,512	48,797
Advertising	56,812	46,397	96,480	100,118
Public and member relations	23,302	13,602	78,745	73,123
Supervisory and exam expense	54,386	46,655	147,695	134,625
FCSIC insurance expense	213,007	206,434	630,581	560,313
Other noninterest expense	49,316	23,578	104,894	73,194
CMS expense reimbursements	(301,321)	(81,461)	(567,514)	(285,859)
Total noninterest expenses	1,621,397	1,331,628	4,659,762	3,968,396
Net income	\$ 2,179,961	\$ 2,859,342	\$ 5,844,124	\$ 7,419,860

The accompanying notes are an integral part of these financial statements

FEDERAL LAND BANK ASSOCIATION OF SOUTH ALABAMA, FLCA

STATEMENT OF CHANGES IN MEMBERS' EQUITY

(unaudited)

	Capital Stock/ Participation Certificates	Unallocated Retained Earnings	Total Members' Equity
Balance at December 31, 2005	\$ 2,888,490	\$ 77,298,045	\$ 80,186,535
Net income	-	7,419,860	7,419,860
Capital stock/participation certificates issued	462,920	-	462,920
Capital stock/participation certificates retired	(263,430)	-	(263,430)
Patronage refunds:			
Cash	-	(1,200,000)	(1,200,000)
Balance at September 30, 2006	<u>\$ 3,087,980</u>	<u>\$ 83,517,905</u>	<u>\$ 86,605,885</u>
Balance at December 31, 2006	\$ 3,150,865	\$ 87,388,071	\$ 90,538,936
Net income	-	5,844,124	5,844,124
Capital stock/participation certificates issued	516,845	-	516,845
Capital stock/participation certificates retired	(362,420)	-	(362,420)
Patronage refunds:			
Cash	-	(3,000,000)	(3,000,000)
Change in patronage declared and paid		15,143	15,143
Balance at September 30, 2007	<u>\$ 3,305,290</u>	<u>\$ 90,247,338</u>	<u>\$ 93,552,628</u>

The accompanying notes are an integral part of these financial statements

FEDERAL LAND BANK ASSOCIATION 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, 2006 are contained in the 2006 Annual Report to the stockholders. These unaudited third quarter 2007 financial statements should be read in conjunction with the 2006 Annual Report to the stockholders.

On September 30, 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 158 – Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans. The Standard requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in that funded status in the year in which the changes occur through comprehensive income. The Standard is effective for employers with publicly traded securities for the fiscal year ending after December 15, 2006 and for employers without publicly traded securities for the fiscal year ending after June 15, 2007. The Association will be required to implement the Standard for the year ended December 31, 2007. In addition, this Standard requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the Association uses a measurement date of September 30th. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. The Association is currently evaluating the impact of implementing this Standard. It is anticipated that the implementation of this Standard will have no impact on the income statement and, based on the current funded status of the defined benefit plans, it is not expected to have a material or significant impact on the balance sheet.

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. 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 and the nine months ended September 30, 2007, are not necessarily indicative of the results to be

expected for the year ended December 31, 2007. 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:

	September 30, 2007	September 30, 2006
Balance at beginning of quarter	\$ 1,450,921	\$ 335,588
Provision for loan losses	678,797	2,692
Charge-offs	(1,789,757)	-
Recoveries	-	-
Balance at end of quarter	<u>\$ 339,961</u>	<u>\$ 338,280</u>

The following table presents information concerning impaired loans:

	September 30, 2007	September 30, 2006
Impaired loans with related allowance	\$ 1,152,479	\$ 343,355
Impaired loans with no related allowance	296,492	253,695
Total impaired loans	<u>\$ 1,448,971</u>	<u>\$ 597,050</u>
Allowance on impaired loans	\$ 171,590	\$ 122,187
Average impaired loans	\$ 2,568,983	\$ 611,186
Interest income on impaired loans for the quarter	\$ 1,609	-

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 losses inherent 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 January 2007, the board declared a \$3,000,000 cash patronage to be paid to stockholders from the Association's 2006 earnings. The patronage distribution to the stockholders was completed in the second quarter of 2007.

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, 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.

As of September 30, 2007 and 2006, the Association had CMS-related loan volume outstanding of \$26,322,330 and \$31,142,854, respectively. In addition, the Association had remaining commitments on CMS loans to lend an additional \$18,392,715 as of September 30, 2007.

NOTE 5 — EMPLOYEE BENEFIT PLANS:

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

	Other Benefits	
	2007	2006
Service cost	\$ 33,726	\$ 39,063
Interest cost	47,091	40,494
Expected return on plan assets	-	-
Amortization of prior service costs	(32,625)	(31,779)
Amortizations of net (gain) loss	591	3,582
Net periodic benefit cost	<u>\$ 48,783</u>	<u>\$ 51,360</u>

The Association previously disclosed in its Annual Report to the stockholders for the year ended December 31, 2006, that it expected to contribute \$13,119 to its post-retirement health and welfare benefits plan in 2007. As of September 30, 2007, \$8,623 of contributions have been made. The Association's liability for the plan's unfunded accumulated benefit obligation at September 30, 2007 was \$1,353,951 and is included in "Other liabilities" in the balance sheet.

NOTE 6 — SUBSEQUENT EVENT

The Association originated a loan to one borrower through 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 \$68.5 million, and the Association retained 5.56% of the loan. During the second quarter of 2007, the loan was deemed to be nonaccrual due to its significant undercollateralized position and a credit default. During the third quarter of 2007, the Association and the four other CMS associations began repurchasing, on a pro-rata basis, portions of the loan from the other participants. In October 2007, the CMS associations completed the loan repurchase from all participants but one. These transactions resulted in an additional provision for loan loss of \$2,395,949. As of the date of this report, negotiations are under way with the lone remaining non-CMS participant for the repurchase of their portion of the loan. This buy-back is expected to be completed during the fourth quarter of 2007. As a result of these repurchase transactions, the Association owns 18.2% of the loan as of the date of this report.

NOTE 7 — CONTINGENCIES

As of September 30, 2007, the Association was party to three lawsuits related to the loan noted in note 6 above. The overall character of the lawsuits is of collection of the principal and interest from the borrower and control of the loan's collateral. Two of the lawsuits were filed in the borrower's domicile state of Texas and involved enjoining the borrower from denying access to collateral, as well as civil complaints by the Association against the borrower and other related individuals as well as third parties for damages incurred as a consequence of alleged wrongful acts by the respective parties. The third lawsuit was filed in the state of Kentucky, where the primary real estate collateral is located, for the purpose of gaining access to and foreclosing the lien of its mortgages on the real estate and commencing an action for collection of the debt. The Kentucky state court has appointed a Receiver to protect the Association's collateral and preserve the status quo pending resolution of the suit. The borrower and other related individuals have responded by filing a counter-claim against the Association, alleging various claims, including breach of contract. These legal proceedings have the potential to be very lengthy and the outcome is unknown at this time.