

# **SECOND QUARTER 2009**

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## **CERTIFICATION**

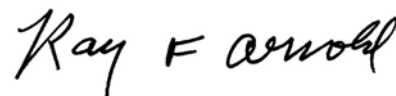
The undersigned certify that we have reviewed the June 30, 2009 quarterly report of Chattanooga Agricultural Credit Association, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.



Gary D. Keith  
Chief Executive Officer



Sue J. Maiser  
Chief Financial Officer



Ray F. Arnold  
Chairman of the Board

July 24, 2009

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*Chattanooga Agricultural Credit Association*

# 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, 2009. 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, 2009, 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, 2009



Gary D. Keith  
Chief Executive Officer



Sue J. Maiser  
Chief Financial Officer

July 24, 2009

# 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 Chattanooga Agricultural Credit Association (the Association) for the period ended June 30, 2009. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2008 Annual Report of the Association. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

## **SIGNIFICANT EVENTS**

The Association's credit quality began to deteriorate in early 2009 due to the impact of a poultry integrator in the Association's territory filing Chapter 11 bankruptcy; this bankruptcy had a residual effect on Association grower borrowers due primarily to counterparty risk associated with the integrator. Also over the past year the Association recognized problems with the ethanol industry as a whole and responded accordingly.

At this time, the Association has received some servicing requests from growers with Association loans as a result of this financial strain on the integrator. At June 30, 2009, Association loans to growers with this integrator consisted of 112 loans representing \$18,027 in volume of which \$5,660 have government guarantees and \$6,668 were sold to into the Capitalized Participation Pool (CPP) with the Bank. Also at June 30, 2009, the Association held four ethanol participation loans with a total exposure of \$3,509. The Association will continue to monitor developments within these specific sectors of its loan portfolio and properly adjust loan values and any allowance for loan losses to appropriate levels as deemed needed.

## **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 including poultry, dairy, livestock and produce. 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, somewhat reduces the level of dependency on any single commodity.

The gross loan volume of the Association as of June 30, 2009, was \$150,723, an increase of \$4,660 as compared to \$146,063 at December 31, 2008. Net loans outstanding at June 30, 2009, were \$149,248, an increase of \$4,429 as compared to \$144,819 at December 31, 2008. Net loans accounted for 91.44 percent of total assets at June 30, 2009, as compared to 91.08 percent of total assets at December 31, 2008. The increase in gross and net loan volume during the reporting period is partly attributable to a decrease in loans sold.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality has deteriorated over the past year, with loans classified under the Farm Credit Administration's Uniform Loan Classification System as "acceptable" or "other assets especially mentioned" at 92.62 percent of total loans and accrued interest as compared to 97.05 percent at December 31, 2008.

Nonaccrual loans increased from \$2,124 at December 31, 2008, to \$2,615 at June 30, 2009. This increase is primarily the result of twenty-one accounts transferred to nonaccrual status, offset by payments received, transfers to other property owned and charge-offs recorded in the normal course of business.

Other property owned (OPO) consists primarily of assets once held as loan collateral that were acquired through foreclosure or deeded to the Association in satisfaction of secured loans. Traditionally, OPO is primarily in the form of real estate. However, it can also include equipment and equity interests in companies or partnerships. The Association's ownership interest in an ethanol plant is primarily in the form of a limited liability company (LLC) equity. The Association's OPO totaled \$1,369 at June 30, 2009 due to three nonaccrual loans that were transferred into OPO including one ethanol plant.

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 Association increases the allowance by providing a provision for loan losses in the income statement. Loan losses are recorded against and serve to decrease the allowance when management determines that any portion of a loan is uncollectible. Any subsequent recoveries are added to the allowance. Management's evaluations consider factors which include among many things, loan loss experience, portfolio quality, loan portfolio composition, current agricultural production conditions and general economic conditions.

The allowance for loan losses at June 30, 2009, was \$1,475 compared to \$1,244 at December 31, 2008 which reflects an increase of \$231 and was considered by management to be adequate to cover probable losses.

## **RESULTS OF OPERATIONS**

### ***For the three months ended June 30, 2009***

Net income for the three months ended June 30, 2009, totaled \$(486), as compared to \$798 for the same period in 2008. The decrease of \$1,284 is the result of a decrease in net interest income of \$118 and a decrease in noninterest income of \$429, along with an increase in provision for loan losses of \$668 and an increase in noninterest expenses of \$70, offset by a decrease in provision for income taxes of \$1. The provision for loan losses increase is primarily due to the current economic conditions being experienced.

Net interest income decreased by \$118 for the three months ended June 30, 2009, as compared to the same period in 2008. The change in net interest income is the result of lower interest rates on loan volume and on lendable equity and the Association's participation in the CPP Program with the Bank. Under the CPP Program district associations can offer to sell to the Bank an undivided participation interest in loans originated by the Association. The Association is required to purchase stock in the Bank equal to eight percent of the total amount of loans sold. Income from the sale of loans into the CPP Program is recognized as patronage from the bank and shown as equity in earnings of other Farm Credit institutions. Participation in the program enhances the Association's capital ratios.

Noninterest income for the three months ended June 30, 2009, totaled \$293, as compared to \$722 for the same period of 2008, a decrease of \$429. The decrease is primarily the result of a decrease in equity earnings from other Farm Credit institutions offset by increases in loan fees, fees for financially related services, gains on sale of rural home loans and other noninterest income. The decrease in equity earnings from other Farm Credit institutions was primarily the result of additional provision for loan losses on loans sold into the CPP Program that are associated with the poultry integrator discussed above.

Noninterest expense for the three months ended June 30, 2009, increased \$70 compared to the same period of 2008. The primary reasons for the increase in noninterest expense were increases in salaries and employee benefits, insurance fund premiums and other operating expenses, offset by a decrease in occupancy and equipment.

### ***For the six months ended June 30, 2009***

Net income for the six months ended June 30, 2009, totaled \$21, as compared to \$1,743 for the same period in 2008. The decrease of \$1,722 is the result of a decrease in net interest income of \$333 and a decrease in noninterest income of \$246,

along with an increase in provision for loan losses of \$936 and an increase in noninterest expenses of \$207. The provision for loan losses increase is primarily due to the current economic conditions being experienced.

Net interest income decreased \$333 for the six months ended June 30, 2009, as compared to the same period in 2008. The change in net interest income is the result of lower interest rates on increased loan volume and on lendable equity and the Association's participation in the CPP Program.

Noninterest income for the six months ended June 30, 2009, totaled \$1,140, as compared to \$1,386 for the same period of 2008, a decrease of \$246. The decrease is primarily the result of a decrease in equity earnings from other Farm Credit institutions offset by increases in loan fees, fees for financially related services and gains on sale of rural home loans. The decrease in equity earnings from other Farm Credit institutions was primarily the result of additional provision for loan losses on loans sold into the CPP Program that are associated with the poultry integrator discussed above.

Noninterest expense for the six months ended June 30, 2009, increased \$207 compared to the same period of 2008. The primary reasons for the increase in noninterest expense were increases in salaries and employee benefits, occupancy and equipment, insurance fund premium and other operating expenses.

## **FUNDING SOURCES**

The principal source of funds for the Association is the borrowing relationship established with AgFirst Farm Credit Bank (the Bank) through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances funds to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating fund 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, 2009, was \$132,848 as compared to \$128,447 at December 31, 2008.

## **CAPITAL RESOURCES**

Total members' equity at June 30, 2009, increased to \$24,684 from the December 31, 2008 total of \$24,657. The increase is attributed to an increase in member owned stock and the retention of earnings.

Total capital stock and participation certificates were \$3,053 on June 30, 2009, compared to \$3,032 on December 31, 2008. The increase is attributed to an increase in loan volume. The initial borrower investment, through either purchase or

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transfer, must be in an amount equal to the lesser of two percent of the total loan amount or \$2.

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, 2009, the Association's total surplus ratio and core surplus ratio were 11.86 percent and 8.19 percent, respectively, and the permanent capital ratio was 13.86 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 materially 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. 378, 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 423-624-2169 ext. 18 or writing Sue J. Maiser, Chief Financial Officer, Chattanooga, ACA, P.O. Box 5220, Chattanooga, TN 37406, or accessing the website, [www.chattanoogaagcredit.com](http://www.chattanoogaagcredit.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.

# Chattanooga Agricultural Credit Association

## Consolidated Balance Sheets

<i>(dollars in thousands)</i>	<b>June 30, 2009</b> <i>(unaudited)</i>	<b>December 31, 2008</b> <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 1,079	\$ 338
Loans	150,723	146,063
Less: allowance for loan losses	1,475	1,244
Net loans	149,248	144,819
Other investments	87	104
Accrued interest receivable	1,484	1,552
Investment in other Farm Credit institutions	8,117	8,582
Premises and equipment, net	825	849
Other property owned	1,369	—
Due from AgFirst Farm Credit Bank	—	2,589
Other assets	1,015	165
Total assets	<u>\$ 163,224</u>	<u>\$ 158,998</u>
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 132,848	\$ 128,447
Subordinated debt payable to other Farm Credit institutions (Note 4)	2,500	2,500
Accrued interest payable	475	546
Patronage refund payable	72	801
Other liabilities	2,645	2,047
Total liabilities	<u>138,540</u>	<u>134,341</u>
Commitments and contingencies		
<b>Members' Equity</b>		
Capital stock and participation certificates	3,053	3,032
Retained earnings		
Allocated	10,362	10,215
Unallocated	11,269	11,410
Total members' equity	<u>24,684</u>	<u>24,657</u>
Total liabilities and members' equity	<u>\$ 163,224</u>	<u>\$ 158,998</u>

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

# Chattanooga Agricultural Credit Association

## Consolidated Statements of Operations

*(unaudited)*

<i>(dollars in thousands)</i>	<b>For the three months ended June 30,</b>		<b>For the six months ended June 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
<b>Interest Income</b>				
Loans	\$ 2,305	\$ 2,671	\$ 4,597	\$ 5,491
Other	1	1	2	3
Total interest income	2,306	2,672	4,599	5,494
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	1,403	1,707	2,871	3,543
Subordinated debt payable to other Farm Credit institutions (Note 4)	56	—	112	2
Total interest expense	1,459	1,707	2,983	3,545
Net interest income	847	965	1,616	1,949
Provision for (reversal of allowance for) loan losses	776	108	1,044	108
Net interest income after provision for (reversal of allowance for) loan losses	71	857	572	1,841
<b>Noninterest Income</b>				
Loan fees	113	100	211	192
Fees for financially related services	9	2	10	4
Equity in earnings of other Farm Credit institutions	165	620	895	1,169
Gains (losses) on other property owned, net	(3)	—	(3)	—
Gains (losses) on sale of rural home loans, net	7	—	9	2
Other noninterest income	2	—	18	19
Total noninterest income	293	722	1,140	1,386
<b>Noninterest Expense</b>				
Salaries and employee benefits	582	530	1,160	976
Occupancy and equipment	40	41	83	78
Insurance Fund premium	60	52	117	103
Other operating expenses	168	157	330	326
Total noninterest expense	850	780	1,690	1,483
Income before income taxes	(486)	799	22	1,744
Provision (benefit) for income taxes	—	1	1	1
Net income	\$ (486)	\$ 798	\$ 21	\$ 1,743

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

Chattanooga Agricultural Credit Association  
**Consolidated Statements of Changes in  
Members' Equity**

*(unaudited)*

<i>(dollars in thousands)</i>	<b>Capital Stock and Participation Certificates</b>	<b>Retained Earnings</b>		<b>Total Members' Equity</b>
		<b>Allocated</b>	<b>Unallocated</b>	
Balance at December 31, 2007	\$ 2,973	\$ 9,440	\$ 10,796	\$ 23,209
Net income			1,743	1,743
Capital stock/participation certificates issued/(retired), net	110			110
Patronage distribution adjustment		(76)	99	23
Balance at June 30, 2008	\$ 3,083	\$ 9,364	\$ 12,638	\$ 25,085
Balance at December 31, 2008	\$ 3,032	\$ 10,215	\$ 11,410	\$ 24,657
Net income			21	21
Capital stock/participation certificates issued/(retired), net	21			21
Patronage distribution adjustment		147	(162)	(15)
Balance at June 30, 2009	\$ 3,053	\$ 10,362	\$ 11,269	\$ 24,684

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

*Chattanooga Agricultural Credit Association*

## 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 Chattanooga Agricultural Credit Association (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, 2008, are contained in the 2008 Annual Report to Shareholders. These unaudited second quarter 2009 consolidated financial statements should be read in conjunction with the 2008 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, 2009, are not necessarily indicative of the results to be expected for the year ending December 31, 2009.

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, 2009, 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 2008 Annual Report to Shareholders, effective January 1, 2009, the Association adopted Financial Accounting Standards Board (FASB) Statement of Position (FSP) No. 157-2, "Effective Date of FASB Statement No. 157." This FSP delayed the effective date of Statement No. 157 for nonfinancial assets and nonfinancial liabilities until fiscal years beginning after November 15, 2008. The impact of adoption requires additional fair value disclosures (see Note 5), primarily regarding other property owned, but does not have an impact on the Association's financial condition or results of operations.

In April 2009, the FASB issued FSP No. 107-1 and Accounting Principles Board (APB) No. 28-1, "Interim Disclosures about Fair Value of Financial Instruments." This FSP requires disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. The FSP is effective for interim periods ending after June 15, 2009 (see Note 6).

In May 2009, the FASB issued SFAS No. 165, "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. 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 Standard, which includes a required disclosure of the date through which an entity has evaluated subsequent events, is effective for interim or annual periods ending after June 15, 2009 (see Note 7).

**NOTE 2 – ALLOWANCE FOR LOAN LOSSES AND IMPAIRED LOANS**

An analysis of the allowance for loan losses follows:

	<b>For the six months ended June 30,</b>	
	<b>2009</b>	<b>2008</b>
Balance at beginning of period	\$ 1,244	\$ 650
Provision for (reversal of) loan losses	1,044	108
Charge-offs	(814)	(1)
Recoveries	1	–
Balance at end of period	<u>\$ 1,475</u>	<u>\$ 757</u>

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

	<b>2009</b>	<b>2008</b>
Impaired loans with related allowance	\$ 341	\$ 12
Impaired loans with no related allowance	2,397	100
Total impaired loans	<u>\$ 2,738</u>	<u>\$ 112</u>
Allowance on impaired loans	<u>\$ 152</u>	<u>\$ 12</u>

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

	<b>2009</b>	<b>2008</b>
Average impaired loans	\$ 3,186	\$ 164
Interest income recognized on impaired loans	24	6

### NOTE 3 – 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>	
	<b>2009</b>	<b>2008</b>
Pension	\$ 169	\$ 43
401(k)	37	38
Other postretirement benefits	45	37
Total	<u>\$ 251</u>	<u>\$ 118</u>

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

	<b>Actual YTD Through 6/30/09</b>	<b>Projected Contributions For Remainder of 2009</b>	<b>Projected Total Contributions 2009</b>
Pension	\$ -	\$ 368	\$ 368
Other postretirement benefits	13	25	38
Total	<u>\$ 13</u>	<u>\$ 393</u>	<u>\$ 406</u>

As of June 30, 2009, no contributions have been made to the pension plan for 2009. Actuarial calculations as of the last plan measurement date (December 31, 2008) projected contributions of \$1,018 to the pension plan for 2009. However, a new funding policy adopted during 2009 by the plan's Sponsor Committee resulted in a revised \$368 projected total contribution for 2009 as shown in the table above. Market conditions could impact discount rates and return on plan assets which could make additional contributions necessary before the next plan measurement date of December 31, 2009.

Further details regarding employee benefit plans are contained in the 2008 Annual Report to Shareholders.

### NOTE 4 – SUBORDINATED DEBT

In September 2008, the Association issued \$2,500 of fixed rate unsecured subordinated debt due in 2018, generating proceeds that were primarily used to increase the permanent capital of the Association pursuant to the Farm Credit Administration regulations, and for general corporate purposes. The debt is payable to another association in the Farm Credit System (System). It is subordinate to all other categories of creditors, including any claims of the Bank and

general creditors, and is senior to all classes of shareholders. The subordinated debt is not considered System debt, and thus is not guaranteed by the System and not insured by the Farm Credit System Insurance Corporation.

The subordinated debt bears interest at an annual fixed rate of 9 percent, payable on the fifteenth day of each month, beginning on October 15, 2008. Interest will be deferred if, as of the fifth business day prior to an interest payment date of the debt, any applicable minimum regulatory capital ratios are not satisfied. A deferral period may not last for more than five consecutive years or beyond the maturity date of the subordinated debt. During such a period, the Association may not declare or pay any dividends or patronage refunds, among other certain restrictions, until interest payments are resumed and all deferred interest has been paid. The subordinated debt may be redeemed, at the Association's option, on October 15, 2013, or upon the occurrence of certain defined regulatory events, at a redemption price of 100 percent of the principal amount, plus any accrued but unpaid interest to the date of redemption, provided the Association has made payment in full of all amount then due in respect of its senior indebtedness.

### NOTE 5 – FAIR VALUE MEASUREMENT

Effective January 1, 2008, the Association adopted Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (SFAS No. 157). This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements for certain assets and liabilities measured at fair value on a recurring and non-recurring basis. These assets and liabilities primarily consist of standby letters of credit, impaired loans and other property owned.

SFAS No. 157 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.

SFAS No. 157 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 has no Level 1 assets or liabilities at June 30, 2009.

### 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, 2009.

### 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, 2009 include impaired loans which represent the fair value of certain loans that were evaluated for impairment under SFAS No. 114. 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, 2009. The fair value for other property owned is based upon the collateral less estimated costs to sell. Level 3 liabilities at June 30, 2009 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, 2009 for each of the fair value hierarchy levels:

June 30, 2009				
	Level 1	Level 2	Level 3	Total Fair Value
<b>Liabilities:</b>				
Standby letters of credit	\$ -	\$ -	\$ 12	\$ 12
Total Liabilities	\$ -	\$ -	\$ 12	\$ 12

The following table presents the changes in Level 3 assets and liabilities measured at fair value on a recurring basis:

	Standby Letters Of Credit
Balance at January 1, 2009	\$ 12
<b>Total gains or (losses) realized/unrealized:</b>	
Included in earnings	-
Included in other comprehensive loss	-
Purchases, sales, issuances and settlements, net	-
Transfers in and/or out of level 3	-
Balance at June 30, 2009	\$ 12

### 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, 2009 for each of the fair value hierarchy values are summarized below:

June 30, 2009					
	Level 1	Level 2	Level 3	Total Fair Value	YTD Total Gains (Losses)
<b>Assets:</b>					
Impaired loans	\$ -	\$ -	\$ 189	\$ 189	\$ (389)
Other property owned	\$ -	\$ -	\$ 1,368	\$ 1,368	\$ (1)

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

The following table presents the carrying amounts and fair values of the Association's financial instruments at June 30, 2009.

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

	<b>June 30, 2009</b>	
	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>
<b>Financial assets:</b>		
Cash	\$ 1,079	\$ 1,079
Loans, net of allowance	\$ 149,248	\$ 152,769
Tobacco Buyout SIIC	\$ 87	\$ 92
<b>Financial liabilities:</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 132,848	\$ 137,320
Subordinate debt payable to other Farm Credit institutions	\$ 2,500	\$ 2,652

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 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. As the discount rates are based on the Bank's loan rates, as well as management estimates, management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale.

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 less specific reserves.

The carrying value of accrued interest approximates its fair value.

- C. **Investment Securities:** Fair value is based upon quoted broker price.

- D. **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 1.84 percent of the issued stock of the Bank as of June 30, 2009 net of any reciprocal investment. As of that date, the Bank's assets totaled \$30.0 billion and shareholders' equity totaled \$1.5 billion. The Bank's earnings were \$116 million during the first six months of 2009.

In addition, the Association has an investment of \$17 related to other Farm Credit institutions.

- E. **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.
- F. **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.
- G. **Tobacco Buyout SIIC:** Fair value is determined by discounting the expected future cash flows using current interest rates for similar assets.
- H. **Subordinate Debt Payable to Other Farm Credit Institutions:** Fair value is determined by discounting the expected future cash flows using appropriate interest rates for similar liabilities.

#### NOTE 7 – SUBSEQUENT EVENTS

The Association has evaluated subsequent events through July 24, 2009, which is the date the financial statements were available to be issued.