ArborOne, ACA

2006 Annual Report

Contents

Management

Jasper W. Shuler........ President and Chief Executive Officer
Kathy S. Heustess........ Chief Financial Officer
William H. Wise, Jr........ Chief Operating Officer
Richard H. Horn........ Chief Lending Officer

Board of Directors

James M. Ward........ Chairman
Harry B. DuRant........ Vice Chairman
DuPree Atkinson........ Director
W. Edwin Dargan, Jr........ Director
Dale W. Player........ Director
Jimmy Poston........ Director
Harold C. Stowe........ Director

Message from the President

Dear Stockholders and Friends of **Arbor***One*

As I present this report for 2006, I am pleased to say it was a year of successful financial performance for our Association, as well as a transition for us that will open doors and allow us to take advantage of new opportunities. First of all, it was another year of strong growth and strong earnings, which translates into another strong patronage performance distribution to stockholders. In December 2006, we revolved allocated surplus to our stockholders. In the spring of 2007, we will pay 25 percent of our interest earned, 40 percent in cash and 60 percent in allocated surplus from our 2006 earnings. The retained earnings help us capitalize the business for future growth. Additionally, the patronage refund meets the goal of the Board of Directors, effectively reducing interest rates on the average loan by 1.50 percent.

2006 will be remembered most of all as the ushering in of a new era for our Association as Pee Dee Farm Credit became **Arbor***One*, ACA on September 1. This name change is a testament to the phenomenal growth we have experienced. As we have grown, we saw the need to change to accommodate new markets across South Carolina, the Southeast and beyond. It is a pivotal moment in the history of our organization, providing us with the ability to expand our boundaries and serve more people throughout rural America. More importantly, it will allow us to better serve our customers and to meet the growing demand for rural real estate mortgages and land financing. Our name has changed, but our commitment to our existing customers has not. We will continue to provide the exceptional service you have come to expect from us with financing for agricultural and rural living as we have since 1917. As before, we will remain a cooperative owned by member-borrowers, and of course our customers will continue to receive patronage refunds. We hope that you will join with us in celebrating this name change and the opportunities it will bring to our Association.

In August, **Arbor***One* expanded its role within rural communities as we closed the first United States Department of Agriculture (USDA) guaranteed Investment in Rural America Bond. Our partnering with Morgan Keegan, the USDA and other Farm Credit Associations across the nation is another example of our opportunity to expand. In this collective venture we were able to make a new $16 million health care facility a reality for St. James, Minnesota and the surrounding community. Farmers rely upon their local towns and communities for services like health care. This was an opportunity to help the community of St. James provide that service.

Because of our growth, we have added new employees. I am delighted to say our reputation gives us the opportunity to attract the brightest and most talented people to our staff. I would like to welcome each of them to the Association and look forward to working with our exceptional staff for many years.

As always, I want to thank our Board of Directors for their dedication and leadership during the year, giving of their valuable time for meetings and planning sessions. The Board of Directors embraced the new governance regulations promulgated by our regulator, the Farm Credit Administration. These regulations ensure continued transparency into the way we operate our cooperative. The regulations spell out specific training and orientation requirements of new and existing board members. Additionally, the Board has appointed a financial expert, as required by the regulations. Mr. Harold Stowe, our appointed director, serves in this capacity. The Association's Audit Committee meets regularly, further supporting the governance regulations and both the Audit and Compensation Committees have adopted a charter under which they operate.

We extend a special thank you to Dale Player, who will be retiring from the Board after serving the Farm Credit System beginning in 1971 at the Central Production Credit Association. Mr. Player is the only remaining Board member from when I came to the Association in 1987. In addition to the **Arbor***One*, ACA Board, he also serves on the AgFirst Farm Credit Bank Board of Directors.

We also want to honor Doris Johnson who is retiring from **Arbor***One*, ACA after 30 years of service. Doris has worked in several locations in the Association, most recently in the Florence office.

Also, I want to recognize the service of Bill Wise who will be retiring as Chief Operating Officer in December 2007. Bill and I go back to our days at Clemson. I have worked closely with Bill since coming to Florence in 1987 and will truly miss his guidance, his ear and his insight into Association operations.

We continue to look for ways to manage our capital so that we may bring the most value to our shareholders. In November, we sold a pool of loans to AgFirst Farm Credit Bank. This allows us to receive earnings from loans sold, yet free capital for additional growth.

This year we will begin construction on a new building for our Florence operations, which will house both our lending offices and corporate offices of the Association. We hope to be in by late 2007 or early 2008.

I would like to thank our employees for their hard work, as they continue to meet their goal of providing excellent customer service. They contribute to our success everyday. Also, I would like to thank our customers for choosing us. Your continued support is greatly appreciated.

"Choose to Be Extraordinary" is the theme for **Arbor***One* in 2007. We have developed a Business Plan after having spent significant time looking at opportunities for us to return the most value to our stockholders and employees. Planning and preparing for the future is the reason **Arbor***One* will continue to remain a strong and productive institution you can trust to meet your financial needs. Look for our new marketing campaign emphasizing the value members receive for doing business with **Arbor***One*. We are proud to serve you. I wish each of you a happy and healthy 2007.

Jasper W. Shuler
President and Chief Executive Officer

February 28, 2007

Report of Management

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

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

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

The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that the 2006 Annual Report has been prepared 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.

The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

James M. Ward
Chairman of the Board

Jasper W. Shuler
Chief Executive Officer

Kathy S. Heustess
Chief Financial Officer

February 28, 2007

Consolidated Five - Year Summary of Selected Financial Data

(UNAUDITED)

(dollars in thousands)	2006	2005	December 31, 2004	2003	2002
Balance Sheet Data					
Cash	$ 2	$ —	$ 7	$ 2	$ 1,190
Investment securities, held to maturity	10,107	12,538	12,553	—	—
Loans	297,393	287,374	245,040	230,091	240,891
Less: allowance for loan losses	243	1,011	1,000	5,446	5,320
Net loans	297,150	286,363	244,040	224,645	235,571
Investment in other Farm Credit institutions	11,609	4,080	3,645	3,774	4,212
Other property owned	—	49	—	—	—
Other assets	141,498	83,651	8,746	5,278	5,537
Total assets	$ 460,366	$ 386,681	$ 268,991	$ 233,699	$ 246,510
Notes payable to AgFirst Farm Credit Bank*	$ 402,799	$ 334,915	$ 222,656	$ 193,623	$ 207,571
Accrued interest payable and other liabilities with maturities of less than one year	11,788	10,100	7,221	9,429	9,017
Total liabilities	414,587	345,015	229,877	203,052	216,588
Protected borrower stock	453	522	584	701	818
Capital stock and participation certificates	1,151	1,171	1,172	1,155	1,188
Retained earnings					
Allocated	26,826	23,977	22,225	16,653	15,735
Unallocated	17,349	15,996	15,133	14,618	14,865
Accumulated other comprehensive income (loss)	—	—	—	(2,480)	(2,684)
Total members' equity	45,779	41,666	39,114	30,647	29,922
Total liabilities and members' equity	$ 460,366	$ 386,681	$ 268,991	$ 233,699	$ 246,510
Statement of Income Data					
Net interest income	$ 8,670	$ 7,741	$ 6,437	$ 6,470	$ 6,516
Provision for (reversal of allowance for) loan losses	(723)	—	(4,413)	—	1,150
Noninterest income (expense), net	(921)	(1,345)	(1,199)	(1,711)	(1,130)
Net income	$ 8,472	$ 6,396	$ 9,651	$ 4,759	$ 4,236
Key Financial Ratios					
Rate of return on average:					
Total assets	1.86%	2.08%	3.82%	1.95%	1.72%
Total members' equity	18.50%	15.13%	28.72%	14.63%	12.54%
Net interest income as a percentage of average earning assets	1.97%	2.62%	2.59%	2.71%	2.71%
Net chargeoffs (recoveries) to average loans	0.01%	(0.004)%	0.01%	(0.05)%	0.53%
Total members' equity to total assets	9.94%	10.78%	14.54%	13.11%	12.14%
Debt to members' equity (:1)	9.06	8.28	5.88	6.63	7.24
Allowance for loan losses to loans	0.08%	0.35%	0.41%	2.37%	2.21%
Permanent capital ratio	13.29%	14.59%	15.66%	16.01%	13.53%
Total surplus ratio	12.89%	14.15%	15.11%	15.38%	12.49%
Core surplus ratio	8.70%	11.94%	11.50%	11.80%	10.06%
Net Income Distribution					
Estimated patronage refunds:					
Cash	$ 2,320	$ 1,821	$ 1,590	$ 1,997	$ 1,590
Qualified allocated retained earnings	794	—	1,174	2,075	1,741
Nonqualified allocated retained earnings	2,686	2,640	1,212	921	643
Nonqualified retained earnings	1,751	819	5,026	—	—

* *General financing agreement is renewable on three-year cycles. The next renewal date is December 31, 2009.*

Management's Discussion & Analysis of Financial Condition & Results of Operations

(dollars in thousands, except as noted)

GENERAL OVERVIEW

On May 1, 2006, the Board of Directors of the Association unanimously approved a resolution to change the name of Pee Dee Farm Credit, ACA to **Arbor***One*, ACA through charter amendment. On July 6, 2006, the Farm Credit Administration gave its approval for the name change. Effective September 1, 2006, through charter amendment, Pee Dee Farm Credit, ACA changed its name to **Arbor***One*, ACA.

The following commentary summarizes the financial condition and results of operations of **Arbor***One*, ACA, (Association) for the year ended December 31, 2006 with comparisons to the years ended December 31, 2005 and December 31, 2004. This information should be read in conjunction with the Consolidated Financial Statements, Notes to the Consolidated Financial Statements and other sections in this Annual Report. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors. For a list of the Audit Committee members, refer to the "Report of the Audit Committee" reflected in this Annual Report. Information in any part of this Annual Report may be incorporated by reference in answer or partial answer to any other item of the Annual Report.

The Association is an institution of the Farm Credit System (System), which was created by Congress in 1916 and has served agricultural producers for 90 years. The System's mission is to maintain and improve the income and well-being of American farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses. The System is the largest agricultural lending organization in the United States. The System is regulated by the Farm Credit Administration, (FCA), which is an independent safety and soundness regulator.

The Association is a cooperative, which is owned by the members (also referred to throughout this Annual Report as stockholders or shareholders) served. The territory of the Association extends across a diverse agricultural region of 12 counties located in northeastern South Carolina. Refer to Note 1, "Organization and Operations," of the Notes to the Consolidated Financial Statements for counties in the Association's territory. The Association provides credit to farmers, ranchers, rural residents, and agribusinesses. Our success begins with our extensive agricultural experience and knowledge of the market.

The Association obtains funding from AgFirst Farm Credit Bank (AgFirst or Bank). The Association is materially affected and shareholder investment in the Association could be affected by the financial condition and results of operations of the Bank. Copies of the Bank's Annual and Quarterly Reports are on the AgFirst website, ***www.agfirst.com,*** or may be obtained at no charge by calling 1-800-845-1745, extension 316, or writing Wanda Martin, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202.

Copies of the Association's Annual and Quarterly reports are also on the Association's website, ***www.arboroneaca.com***, or may be obtained upon request free of charge by calling 1-800-741-7332, extension 14 or writing Joan Boice, Corporate Secretary, **Arbor***One*, ACA, P.O. Box 13209, Florence, SC 29504. The Association prepares a quarterly report within 45 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Association.

CRITICAL ACCOUNTING POLICIES

The financial statements are reported in conformity with accounting principles generally accepted in the United States of America. Our significant accounting policies are critical to the understanding of our results of operations and financial position because some accounting policies require us to make complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. We consider these policies critical because management must make judgments about matters that are inherently uncertain. For a complete discussion of significant accounting policies, see Note 2, "Summary of Significant Accounting Policies," of the Notes to the Consolidated Financial Statements. The following is a summary of certain critical policies.

- *Allowance for loan losses* — The allowance for loan losses is management's best estimate of the amount of probable losses existing in and inherent in our loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs. The allowance for loan losses is determined based on a periodic evaluation of the loan portfolio, which generally considers relevant historical charge-off experience adjusted for relevant factors. These factors include types of loans, credit quality, specific industry conditions, general economic and political conditions, and changes in the character, composition, and performance of the portfolio, among other factors.

  Significant individual loans are evaluated based on the borrower's overall financial condition, resources, and payment record, the prospects for support from any financially responsible guarantor, and, if appropriate, the estimated net realizable value of any collateral. The allowance for loan losses attributable to these loans is established by a process that estimates the probable loss inherent in the loans, taking into account various historical and projected factors, internal risk ratings, regulatory oversight, and geographic, industry and other factors.

  Changes in the factors considered by management in the evaluation of losses in the loan portfolios could result in a change in the allowance for loan losses and could have a direct impact on the provision for loan losses and the results of operations.

- *Valuation methodologies* — Management applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets for which an observable liquid market exists, such as most investment securities. Management utilizes significant estimates and assumptions to value items for which an observable liquid market does not exist. Examples of these items include impaired loans, pension and other postretirement benefit obligations, and certain other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing and liquidation values. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on the Association's results of operations. For additional information, refer to the Recently Issued Accounting Pronouncements disclosed in this Annual Report.

- *Pensions* — The Bank and its related Associations participate in defined benefit retirement plans. These plans are noncontributory and benefits are based on salary and years of service. In addition, the Bank and its related Associations also participate in defined contribution retirement savings plans. Pension expense for all plans is recorded as part of salaries and employee benefits. Pension expense is determined by actuarial valuations based on certain assumptions, including expected long-term rate of return on plan assets and discount rate. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that portfolio of assets. The discount rate is used to determine the present value of our future benefit obligations. We selected the discount rate by reference to Moody's Investors Service Aa long-term corporate bond index, actuarial analyses and industry norms. For additional information, refer to the Recently Issued Accounting Pronouncements disclosed in this Annual Report.

ECONOMIC CONDITIONS

During 2006, economic conditions in our region were average in both yield and price as applies to commodities. There has been some cooling of the real estate and housing market but sales remain strong and prices relatively high. There has been significant change in our market base over the past year, with the Association buying and selling loan participations as well as the Association's involvement in government guarantee programs. During 2006, the Association targeted certain segments of our business with hopes of increasing market share. Continued efforts are being made to expand services, increase public knowledge of our services and streamline our current delivery of products to enhance our existing portfolio.

MISSION-RELATED INVESTMENTS

During 2005, the FCA initiated an investment program to stimulate economic growth and development in rural areas. The FCA outlined a program to allow System institutions to hold such investments, subject to approval by the FCA on a case-by-case basis. FCA has approved the Rural America Bonds pilot and the Tobacco Buyout Program under the mission-related investments umbrella, as described below.

Rural America Bonds

In October 2005, the FCA authorized AgFirst and the Associations to make investments in Rural America Bonds under a three-year pilot period. Rural America Bonds may include debt obligations issued by public and private enterprises, corporations, cooperatives, other financing institutions, or rural lenders where the proceeds would be used to support agriculture, agribusiness, rural housing, or economic development, infrastructure, or community development and revitalization projects in rural areas. Examples include investments that fund value-added food and fiber processors and marketers, agribusinesses, commercial enterprises that create and maintain employment opportunities in rural areas, community services, such as schools, hospitals, and government facilities, and other activities that sustain or revitalize rural communities and their economies. The objective of this pilot program is to help meet the growing and diverse financing needs of agricultural enterprises, agribusinesses, and rural communities by providing a flexible flow of money to rural areas through bond financing. These bonds may be classified as Loans or Investments on the Consolidated Balance Sheets depending on the nature of the investment. As of December 31, 2006, the Association had $4,663 in Rural America Bonds, and they are classified as Loans on the Consolidated Balance Sheets. The Association is actively planning to evaluate more opportunities in the future.

Tobacco Buyout Program

On October 22, 2004, Congress enacted the "Fair and Equitable Tobacco Reform Act of 2004" (Tobacco Act) as part of the "American Jobs Creation Act of 2004." The Tobacco Act repealed the Federal tobacco price support and quota programs, provided for payments to tobacco "quota owners" and producers for the elimination of the quota and included an assessment mechanism for tobacco manufacturers and importers to pay for the buyout. Tobacco quota holders and producers will receive equal annual payments under a contract with the Secretary of Agriculture. The Tobacco Act also includes a provision that allows the quota holders and producers to assign to a "financial institution" the right to receive the contract payments (Successor-in-Interest Contracts (SIIC)) so that they may obtain a lump sum or other payment. On April 4, 2005, the United States Department of Agriculture (USDA) issued a Final Rule implementing the "Tobacco Transition Payment Program" (Tobacco Buyout).

The FCA recognized that the Tobacco Buyout has significant implications for some System institutions and the tobacco quota holders and producers they serve. The FCA determined that System institutions are "financial institutions" within the meaning of the Tobacco Act and are therefore eligible to participate in the Tobacco Buyout. The goal of this program is to provide quota holders and producers with the option to immediately receive Tobacco Buyout contract payments and reinvest them in future business opportunities.

On December 31, 2006, the Association held $128,053 of SIIC. The SIIC are classified as Other Investments on the Combined Balance Sheets. In addition, the Association had loans outstanding collateralized by assignments of contract payments in the amount of $11,996 that are included in Loans on the Consolidated Balance Sheets.

LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners, and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans through numerous product types.

The gross loan volume of the Association as of December 31, 2006, was $297,393, an increase of $10,019 or 3.49 percent as compared to $287,374 at December 31, 2005 and an increase of $52,353 or 21.37 percent as compared to $245,040 at December 31, 2004. Net loans outstanding (gross loans net of the allowance for loan losses) on December 31, 2006, were $297,150 as compared to $286,363 at December 31, 2005 and $244,040 at December 31, 2004. Net loans accounted for 64.55 percent of total assets on December 31, 2006 as compared to 74.06 percent of total assets at December 31, 2005 and 90.72 percent of total assets at December 31, 2004.

The diversification of the Association loan volume by type for each of the past three years is shown below. See Note 5, "Loans and Allowance for Loan Losses," of the Notes to the Consolidated Financial Statements for the loans outstanding amounts.

Loan Type	12/31/06	12/31/05	12/31/04
Real estate mortgage	31.21%	34.67%	40.80%
Production and intermediate term	55.10	53.18	50.46
Agribusiness:			
Loans to cooperatives	.39	.72	–
Processing and marketing	6.45	4.39	1.43
Farm-related business	2.92	3.33	3.10
Energy	.71	.29	–
Rural residential real estate	3.22	3.42	4.21
Total	100.00%	100.00%	100.00%

The following table presents the contractual maturity distribution of loans at December 31, 2006:

Loan Type	Due in 1 year or less	Due after 1 year through 5 years	Due after 5 years	Total
		(dollars in thousands)		
Real estate mortgage	$ 10,325	$ 39,785	$ 42,699	$ 92,809
Production and intermediate term	74,201	63,199	26,491	163,891
Agribusiness:				
Loans to cooperatives	135	142	875	1,152
Processing and marketing	15,649	3,525		19,174
Farm-related business	1,026	4,289	3,379	8,694
Energy	2,110	–	–	2,110
Rural residential real estate	178	1,202	8,183	9,563
Total	$ 103,624	$ 112,142	$ 81,627	$ 297,393

While we make loans and provide financially related services to qualified borrowers in the agricultural and rural sectors and to certain related entities, our loan portfolio is diversified. The following tables reflect the commodities financed and the geographic locations served.

The geographic distribution of the loans by state for the past three years is as follows:

State	12/31/06	12/31/05	12/31/04
South Carolina	59.1%	65.2%	64.1%
Florida	13.2	12.8	14.3
Georgia	12.0	10.5	8.7
Texas	4.9	3.5	1.3
North Carolina	5.2	3.4	1.4
Other	5.6	4.6	10.2
Total	100.0%	100.0%	100.0%

Commodity and industry categories are based upon the Standard Industrial Classification system published by the federal government. The system is used to assign commodity or industry categories based upon the largest agricultural commodity of the customer.

The major commodities in the Association loan portfolio are shown below. The predominant commodities are forestry, livestock, poultry, tobacco and row crops, which constitute over 75 percent of the entire portfolio.

	Percent of Portfolio		
Commodity Group	2006	2005	2004
Forestry	29%	27%	25%
Livestock	14	15	14
Poultry	12	12	15
Row Crops	11	9	19
Other	9	11	9
Tobacco	9	11	7
Cotton/Cotton Gins	6	7	1
Field/Grain	4	3	3
Nurseries/Greenhouses	3	2	4
Rural Home	3	3	3
Total	100%	100%	100%

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The Association's loan portfolio contains a concentration of larger loans, with the largest concentration in Forestry. Although a large percentage of the loan portfolio is concentrated in Forestry, many of these operations are diversified within their enterprise and/or with additional sources of income, including non-farm businesses and salaried income. Even though the concentration of large loans has increased over the past several years, the agricultural enterprise mix of these loans is diversified and similar to that of the overall portfolio. The risk in the portfolio associated with commodity concentration and large loans is reduced by the range of diversity of enterprises in the Association's territory.

The increase in gross loan volume for the twelve months ended December 31, 2006, is primarily attributed to the draw of seasonal loans and to participation loan activity. The Association continues to review and engage in participation opportunities, as well as customer opportunities within the territory.

For the past few years, the Association has experienced a shift in loan assets. The long-term volume trend has been downward while the short and intermediate-term loan volume trend is upward. The short-term portfolio, which is heavily influenced by operating-type loans, normally reaches a peak balance in August and rapidly declines in the fall months as commodities are marketed and proceeds are applied to repay operating loans. However, participation activity generally has been consistent all year.

During 2006 and 2005, the Association increased activity in the buying and selling of loan participations within and outside of the System. This provides a means for the Association to spread credit concentration risk and realize non-patronage sourced interest and fee income, which may strengthen their capital position.

Loan Participations	2006	2005	2004
		(dollars in thousands)	
Participations Purchased – FCS Institutions	$ 140,823	$ 96,086	$ 74,357
Participations Purchased – Non-FCS Institutions	53,407	53,489	9,343
Participations Sold	(164,386)	(107,727)	(46,298)
Total	$ 29,844	$ 41,848	$ 37,402

The Association sells qualified long-term mortgage loans into the secondary market. For the period ended December 31, 2006, the Association originated loans for resale totaling $2,595, which were sold into the secondary market. The Association also participates in the Farmer Mac Long Term Stand-By program. Farmer Mac was established by Congress to provide liquidity to agricultural lenders.

At December 31, 2006, the Association had loans amounting to $21,180 which were 100 percent guaranteed by Farmer Mac. The Association, in the past has purchased portions of loans that are guaranteed by the United States Department of Agriculture. These loans were held for the purposes of reducing interest rate risk and managing surplus short-term funds as allowable under FCA regulations. During 2006, the Association liquidated the balance of these loans (including the unamortized premium) leaving a balance of $0, compared to $3,901 at December 31, 2005 and $3,316 at December 31, 2004. The Association also had other federal guaranteed loans in the amount of $2,349 at December 31, 2006, compared to $2,500 at December 31, 2005 and $0 at December 31, 2004. In addition, the Association had $26,415, FSA guaranteed loans at December 31, 2006 year compared to $21,757 in 2005 and $19,604 in 2004.

INVESTMENT SECURITIES

At December 31, 2006, the Association had investment securities with an amortized cost of $10,107. The investments consist of mortgage-backed securities (MBS.) MBSs are collateralized by U.S. government or U.S. agency-guaranteed residential mortgages that have an AAA rating. It is the Association's objective that liquid, high-quality investments shall be utilized as an asset liability management strategy to manage and diversify its income sources.

RISK EXPOSURE

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

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

The credit risk management process begins with an analysis of the borrower's credit history, repayment capacity, and financial position. Repayment capacity focuses on the borrower's ability to repay the loan based upon cash flows from operations or other sources of income, including non-farm income. Real estate loans must be collateralized by first liens on the real estate (collateral). As required by FCA regulations, each institution that makes loans on a collateralized basis must have collateral evaluation policies and procedures. Real estate mortgage loans may be made only in amounts up to 85 percent of the original appraised value of the property taken as collateral or up to 97 percent of the appraised value if guaranteed by a state, federal, or other governmental agency. The actual loan to appraised value when loans are made is generally lower than the statutory maximum percentage. Appraisals are required for loans of more than $250,000. In addition, each loan is assigned a credit risk weighting based upon the underwriting standards. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses, and risks in a particular relationship.

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

	12/31/06	12/31/05	12/31/04
	(dollars in thousands)		
High-risk Assets			
Nonaccrual loans	$ 1,891	$ 263	$ 469
Restructured loans	–	–	–
Accruing loans 90 days past due	86	–	1
Total high-risk loans	1,977	263	470
Other property owned	–	49	–
Total high-risk assets	$ 1,977	$ 312	$ 470
Ratios			
Nonaccrual loans to total loans	0.64%	0.09%	0.18%
High-risk assets to total assets	0.43%	0.08%	0.17%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or future interest accruals, under the contractual terms of the loan. In substance, nonaccrual loans reflect loans where the accrual of interest has been suspended. Nonaccrual loans increased $1,628, or 619.01 percent in 2006. This increase was primarily the result of one participation account being transferred into nonaccrual. A specific reserve has been set up for this account. Of the $1,891 in nonaccrual volume at December 31, 2006, $206 or 10.89 percent, compared to 15.21 percent and 61.20 percent at December 31, 2005 and 2004, respectively, was current as to scheduled principal and interest payments, but did not meet all regulatory requirements to be transferred into accrual status.

Loan restructuring is available to financially distressed borrowers. Restructuring of loans occurs when the Association grants a concession to a borrower based on either a court order or good faith in a borrower's ability to return to financial viability. The concessions can be in the form of a modification of terms or rates, a compromise of amounts owed, or deed in lieu of foreclosure. Other receipts of assets and/or equity to pay the loan in full or in part are also considered restructured loans. The type of alternative financing structure chosen is based on minimizing the loss incurred by both the Association and the borrower.

Credit Quality

We review the credit quality of the loan portfolio on an ongoing basis as part of our risk management practices. Each loan is classified according to the Uniform Classification System, which is used by all Farm Credit System institutions. Below are the classification definitions.

- Acceptable – Assets are expected to be fully collectible and represent the highest quality.
- Other Assets Especially Mentioned (OAEM) – Assets are currently collectible but exhibit some potential weakness.
- Substandard – Assets exhibit some serious weakness in repayment capacity, equity, and/or collateral pledged on the loan.
- Doubtful – Assets exhibit similar weaknesses to substandard assets. However, doubtful assets have additional weaknesses in existing facts, conditions and values that make collection in full highly questionable.
- Loss – Assets are considered uncollectible.

The following table presents selected statistics related to the credit quality of loans including accrued interest at December 31.

Credit Quality	2006	2005	2004
Acceptable & OAEM	99.25%	99.29%	99.38%
Substandard	.75	.71	.62
Doubtful	–	–	–
Loss	–	–	–
Total	100.00%	100.00%	100.00%

Allowance for Loan Losses

During 2004, the Association completed its study to further refine the allowance for loan losses methodology, taking into account guidance issued by FCA, as well as the Securities and Exchange Commission (SEC) and Federal Financial Institutions Examination Council. As a result of this study and resulting refinements in methodology, during the fourth quarter of 2004, the Association recorded a reversal of the allowance for loan losses of $4,413.

Previously, the Association's allowance for loan losses methodology had been based upon criteria developed in the late 1980s and reflected the credit losses experienced in the mid-to-late 1980s, which was a period of unusually adverse economic conditions in American agriculture. Given the long cyclical nature of the agricultural economy, loss factors utilized to determine the allowance for loan losses subsequent to 1989 continued to reflect, to some extent, the loss history of the mid-to-late 1980s, which resulted in conservative estimates of the allowance for loan losses. The Association's allowance for loan losses methodology utilized throughout the period was in accordance with generally accepted accounting principles and was consistently applied.

While conservative in estimating the allowance for loan losses, the methodology used resulted in annual provisions for loan losses over the periods that reflected changes in credit quality and loss experience. Accordingly, the reserves provided in the mid-to-late 1980s had, in effect, remained part of the allowance for loan losses. The Association's allowance for loan loss methodology has consistently adhered to proper accounting policies, under the regulatory supervision of the FCA in its role as a "safety and soundness" regulator. It was the FCA's view that the allowance for loan losses should include, among others, an assessment of probable losses, historical loss experience and economic conditions.

In April 2004, the FCA issued an Informational Memorandum to System institutions regarding the criteria and methodologies that would be used in evaluating the adequacy of a System institution's allowance for loan losses. The FCA endorsed the direction provided by other bank regulators and the SEC and indicated that the conceptual framework addressed in their guidelines would be included as part of their examination process.

The refinement in methodology resulted in a calculated allowance for loan losses that was significantly less than the previously recorded balance due to revised loss factors that are more indicative of actual loss experience in recent years and current borrower analysis. The factors considered in determining the revised level of allowance for loan losses are generally based on recent historical charge-off experience adjusted for relevant environmental factors. The Association considers the following when adjusting the historical charge-off experience:

- changes in credit risk classifications,
- changes in collateral values,
- changes in risk concentrations,
- changes in weather related conditions and
- changes in economic conditions.

While the reversal had a significant impact on 2004 results of operations and the previously recorded allowance for loan losses, the refinement in methodology is not expected to have a significant impact on comparative results of operations in future periods. Additionally, the refinement in methodology did not have a significant impact on the level of risk bearing capacity of the Association, generally referred to as "risk funds" (capital plus the allowance for loan losses), which totaled $46,022 at December 31, 2006 (15.48 percent of Association loans), as compared with $42,677 at December 31, 2005 (14.85 percent of Association loans) and $40,114 at December 31, 2004 (16.37 percent of Association loans).

The allowance for loan losses at each period end is considered by Association management to be adequate to absorb probable losses existing in and inherent to its loan portfolio. The allowance for loan losses was $243 at December 31, 2006, as compared with $1,011 and $1,000 at December 31, 2005 and 2004, respectively.

Net loan charge-offs (recoveries) of $45, ($11) and $33 were recorded in 2006, 2005 and 2004, respectively. Net loan charge-offs as a percentage of average loans remained at low levels of 0.01 percent, (0.004) percent, and 0.01 percent for 2006, 2005 and 2004, respectively. The net loan charge-offs in 2006 were primarily the result of several small accounts being written off in excess of recoveries on several small accounts.

The following table presents the activity in the allowance for loan losses for the most recent three years:

Allowance for Loan Losses Activity:	2006	2005	2004
	(dollars in thousands)		
Balance at beginning of year	$ 1,011	$ 1,000	$ 5,446
Charge-offs:			
Real estate mortgage	$ –	$ –	$ (8)
Production and intermediate term	(109)	(5)	(28)
Total charge-offs	(109)	(5)	(36)
Recoveries:			
Production and intermediate term	$ 64	$ 11	$ 3
Rural residential real estate	–	5	–
Total recoveries	64	16	3
Net (charge-offs) recoveries	(45)	11	(33)
Provision for (reversal of allowance for) loan losses	$ (723)	$ –	$ –
Nonrecurring allowance for loan losses reversal*	–	–	(4,413)
Balance at end of year	$ 243	$ 1,011	$ 1,000
Ratio of net charge-offs during the period to average loans outstanding during the period	(.01%)	.004%	(.01%)

* *Represents the amount of allowance reversal due to the refinement in methodology.*

The allowance for loan losses by loan type for the most recent three years is as follows:

Allowance for Loan Losses by Type	December 31, 2006	2005	2004
	(dollars in thousands)		
Real estate mortgage	$ 160	$ 263	$ 263
Production and intermediate term	79	648	642
Agribusiness	3	39	39
Communication	1	3	3
Rural residential real estate	–	58	53
Total loans	$ 243	$ 1,011	$ 1,000

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

Allowance for Loan Losses as a Percentage of:	December 31, 2006	2005	2004
Total loans	.08%	.35%	.40%
Nonperforming loans	12.29%	375.84%	200.00%
Nonaccrual loans	12.85%	384.41%	213.22%

The financial positions of our borrowers have generally strengthened during the past decade as farmers' net cash income has been at a favorable level due, in part, to direct federal government payments and steady increases in land values over the period. With borrowers' strengthened financial positions and the continued emphasis on sound underwriting standards, the credit quality of our loan portfolio has remained healthy. Please refer to Note 5, "Loans and Allowance for Loan Losses," in the Notes to the Consolidated Financial Statements, for further information concerning the allowance for loan losses.

EMPLOYEE RETIREMENT PLANS

For the years ended December 31, 2006, 2005 and 2004, the Association contributed $0, $522 and $2,292, respectively, to the District-wide defined benefit retirement plan. The funding brought the retirement plan's assets to an amount exceeding the accumulated benefit obligation as of the Plan's measurement date, eliminating the minimum pension liability and the charge to accumulated other comprehensive income. For additional information, see Note 2 I., "Employee Benefit Plans," and refer to the Recently Issued Accounting Pronouncements disclosed in the Notes to the Consolidated Financial Statements.

RESULTS OF OPERATIONS

Net income for the year ended December 31, 2006, totaled $8,472, an increase of $2,076 or 32.46 percent, as compared to $6,396 for the same period of 2005 and a decrease of $1,179 or 12.22 percent, as compared to $9,651 for the same period of 2004. Interest income for the year ended December 31, 2006, was $32,143, an increase of $12,533 or 63.91 percent as compared to $19,610 for the same period of 2005. Interest income increased by $5,743 for the period ended December 31, 2005, compared to December 31, 2004. Major components of the change in net income for the past two years are outlined in the following table.

Change in Net Income:	2006-2005	2005-2004
	(dollars in thousands)	
Net income (prior year)	$ 6,396	$ 9,651
Increase (decrease) in net income due to:		
Interest income	12,533	5,743
Interest expense	(11,604)	(4,439)
Net interest income	929	1,304
Provision for loan losses	723	(4,413)
Noninterest income	1,383	847
Noninterest expense	(976)	(1,039)
Provision for income taxes	17	46
Total changes in income	2,076	(3,255)
Net income	$ 8,472	$ 6,396

Net Interest Income

Net interest income increased by $929 or 12.00 percent in 2006 and increased by $1,304, or 20.26 percent, compared to 2005 and 2004, respectively. In comparing 2006 and 2005, an increase in volume accounted for $2,899 of the increase while interest rate increases accounted for the offsetting decrease of $1,877. When comparing 2005 and 2004, the primary reason for the increase was the rising interest rate environment, along with increased growth in loan volume. Interest income on nonaccrual loans for 2006 totaled $109, a decrease of $93, compared to $202 for 2005 and an increase of $82 in 2005 compared to $120 for 2004. The Association's net interest income as a percentage of average earning assets was 1.97 percent on December 31, 2006, compared to 2.62 percent on December 31, 2005 and 2.59 percent on December 31, 2004. Interest Income from SIIC of $7,097 and $343 was offset by Interest Expense of $7,077 and $356 in 2006 and 2005 respectively. While the Net Interest Income (Loss) generated from the SIIC was $20 and ($13) for 2006 and 2005, respectively, the patronage paid to the Association from AgFirst based on the average Direct Note (Notes Payable to AgFirst) as a result of the SIIC was $887 and $46 for 2006 and 2005, respectively, while not requiring any capital allocation. The sources of change in net interest income are summarized, as follows:

Change in Net Interest Income:

	Volume*	Rate	Nonaccrual Income	Total
	(dollars in thousands)			
12/31/06 - 12/31/05				
Interest income	$ 9,482	$ 3,144	$ (93)	$12,533
Interest expense	6,583	5,021	–	11,604
Change in net interest income	$ 2,899	$ (1,877)	$ (93)	$ 929
12/31/05 - 12/31/04				
Interest income	$ 2,594	$ 3,067	$ 82	$ 5,743
Interest expense	1,579	2,860	–	4,439
Change in net interest income	$ 1,015	$ 207	$ 82	$ 1,304

* *Volume variances can be the result of increased/decreased loan volume or from changes in the percentage composition of assets and liabilities between periods.*

Please refer to the Consolidated Five-Year Summary of Selected Financial Data in this Annual Report to review key financial ratios pertaining to earnings and net interest income.

Noninterest Income

Noninterest income for each of the three years ended December 31 are shown in the following table:

Noninterest Income	For the Year Ended December 31, 2006	2005	2004	Percentage Increase/(Decrease) 2006/2005	2005/2004
	(dollars in thousands)				
Loan fees	$ 1,617	$ 1,099	$ 1,055	47%	4%
Fees for financially related services	514	444	397	16	12
Patronage refund from other Farm Credit Institutions	4,199	3,063	2,649	37	16
Gains (losses) on other property owned, net	1	(2)	–	150	–
Gains (losses) from sale of premises & equipment, net	23	311	130	(93)	139
Other noninterest income	388	444	281	(13)	58
Total noninterest income	$ 6,742	$ 5,359	$ 4,512	26%	19%

Regarding patronage refunds received from other Farm Credit Institutions, the Association received $3,364 in a patronage refund and $564 in a special distribution from the Bank for the year ended December 31, 2006, compared to $2,022 and $837 for 2005, and $1,658 and $799 for 2004.

Noninterest Expense

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

Noninterest Expense	For the Year Ended December 31, 2006	2005	2004	Percentage Increase/(Decrease) 2006/2005	2005/2004
	(dollars in thousands)				
Salaries and employee benefits	$ 4,929	$ 4,657	$ 3,933	6%	18%
Occupancy and equipment expense	381	381	326	–	17
Insurance Fund premium	433	130	111	233	17
Other operating expense	1,946	1,545	1,304	26	18
Total noninterest expense	$ 7,689	$ 6,713	$ 5,674	15%	18%

Noninterest expense increased $976 or 14.54 percent for December 31, 2006, as compared to the same period of 2005 and December 31, 2005 increased $1,039 or 18.31 percent compared to the same period in 2004. Salaries and employee benefits account for $272 or 27.87 percent of the increase in operating expenses, which is due to increased salaries from hiring additional employees. Insurance Fund premiums increased $303 or 31.05 percent of the increased operating expenses. This is due to higher premiums along with increased loan volume.

The Association recorded a benefit for income taxes of $26 for the year ended December 31, 2006, as compared to a benefit of $9 for 2005 and a provision of $37 for 2004.

Key Results of Operations Comparisons

Key results of operations comparisons for each of the twelve months ended December 31 are shown in the following table:

Key Results of Operations Comparisons	For the 12 Months Ended 12/31/06	For the 12 Months Ended 12/31/05	For the 12 Months Ended 12/31/04
Return on Average Assets	1.86%	2.08%	3.82%
Return on Average Members' Equity	18.50%	15.13%	28.72%
Net Interest Income as a Percentage of Average Earning Assets	1.97%	2.62%	2.59%
Net Charge-offs (Recoveries) to Average Loans	0.01%	(0.004)%	0.01%

A key factor in the growth of net income for future years will be continued improvement in net interest and noninterest income. Our goal is to generate earnings sufficient to fund operations, adequately capitalize the Association, and achieve an adequate rate of return for our members. To meet this goal, the agricultural economy must continue the improvement shown in recent years and the Association must meet certain objectives. These objectives are to attract and maintain high quality loan volume priced at competitive rates and to manage credit risk in our entire portfolio, while efficiently meeting the credit needs of our members.

LIQUIDITY AND FUNDING SOURCES

Liquidity

Liquidity management is the process whereby funds are made available to meet all financial commitments including the extension of credit, payment of operating expenses and payment of debt obligations. The Association receives access to funds through its borrowing relationship with the Bank and from income generated by operations. The Association's participation in the Farmer Mac, investments, and other secondary market programs provides additional liquidity. Sufficient liquid funds have been available to meet all financial obligations.

Funding Sources

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement (GFA). The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association, creating notes payable to the Bank. The notes payable are segmented into variable rate and fixed rate components. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association.

Total notes payable to the Bank at December 31, 2006, was $402,799 as compared to $334,915 at December 31, 2005 and $222,656 at December 31, 2004. The increase of 20.27 percent compared to December 31, 2005 and the increase of 80.91 percent compared to December 31, 2004, is attributable to rising interest rates, increased loan volume, and the funding of SIIC, along with security investments. The average volume of outstanding notes payable to the Bank was $403,681 and $259,658 for the years ended December 31, 2006 and 2005, respectively. Refer to Note 9, "Notes Payable to AgFirst Farm Credit Bank," of the Notes to the Consolidated Financial Statements, for additional information concerning the Association's debt.

The Association has a line of credit totaling $78 with another financing institution in support of letters of credit. **Arbor***One* participates these letters of credit with other associations and its net exposure is $6.

Funds Management

The Bank and the Association manage assets and liabilities to provide a broad range of loan products and funding options, which are designed to allow the Association to be competitive in all interest rate environments. The primary objective of the asset/liability management process is to provide stable and rising earnings, while maintaining adequate capital levels by managing exposure to credit and interest rate risks.

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers fixed, adjustable and variable rate loan products that are marginally priced according to financial market rates. Variable rate loans may be indexed to either the Prime Rate or the 90-day London Interbank Offered Rate (LIBOR). Adjustable rate mortgages are indexed to U.S. Treasury Rates. Fixed rate loans are priced based on the current cost of System debt of similar terms to maturity.

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

CAPITAL RESOURCES

Total members' equity at December 31, 2006, increased 9.87 percent to $45,779 from the December 31, 2005, total of $41,666 and increased 17.04 percent from the December 31, 2004 total of $39,114. The increase was primarily attributed to net income partially offset by cash patronage, the revolvement of allocated retained earnings, and the reduction of capital stock and participation certificates.

Total capital stock and participation certificates were $1,604 on December 31, 2006, compared to $1,693 on December 31, 2005 and $1,756 on December 31, 2004. The decrease was attributed to the retirement of protected stock and participation certificates on loans liquidated in the normal course of business, retirement of excess stock through revolvement and new loans being capitalized at low regulatory rates.

The Association Board of Directors establishes, adopts, and maintains a formal written capital adequacy plan. There were no material changes to the capital plan for 2006 that would affect minimum stock purchases or would have an effect on the Association's ability to retire stock and distribute earnings.

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

	2006	2005	2004	Regulatory Minimum
Permanent Capital	13.29%	14.59%	15.66%	7.00%
Total Surplus	12.89%	14.15%	15.11%	7.00%
Core Surplus	8.70%	11.94%	11.50%	3.50%

At December 31, 2006, the Association's permanent capital ratio, (average at-risk capital divided by average risk adjusted assets), calculated in accordance with FCA regulations, exceeded the regulatory minimum of 7.00 percent. In addition to these regulatory requirements, the Association has established a permanent capital ratio goal in excess of the 7.00 percent FCA minimum requirement. As of December 31, 2006, the Association has met the goal. The decrease in the Association's permanent capital, total surplus, and core surplus for December 31, 2006 and December 31, 2005 was attributed to the association's growth in loan volume.

See Note 10, "Members' Equity," of the Notes to the Consolidated Financial Statements, for further information concerning capital resources.

PATRONAGE PROGRAM

Prior to the beginning of any fiscal year, the Association's Board of Directors, by adoption of a resolution, may establish a Patronage Allocation Program to distribute its available consolidated net earnings. This resolution provides for the application of net earnings in the manner described in the Association's Bylaws. This includes the setting aside of funds to increase surplus to meet minimum capital adequacy standards established by FCA Regulations, to increase surplus to meet Association capital adequacy standards to a level necessary to support competitive pricing at targeted earnings levels, and for reasonable reserves for necessary purposes of the Association. After excluding net earnings attributable to (a) the portion of loans participated to another institution, and (b) participation loans purchased, remaining consolidated net earnings are eligible for allocation to borrowers. Refer to Note 10, "Members' Equity," of the Notes to the Consolidated Financial Statements, for more information concerning the patronage distributions. The Association declared patronage distributions of $7,551 in 2006, $5,280 in 2005, and $9,002 in 2004.

YOUNG, BEGINNING AND SMALL (YBS) FARMERS AND RANCHERS PROGRAM

The Association's mission is to provide financial services to agriculture and the rural community, which includes providing credit to young*, beginning** and small*** farmers. Because of the unique needs of these individuals, and their importance to the future growth of the Association, the Association has established annual marketing goals to increase our market share of loans to YBS farmers. Specific marketing plans have been developed to target these groups, and resources have been designated to help ensure YBS borrowers have access to a stable source of credit.

The following table outlines the loan volume and number of YBS loans in the loan portfolio for the Association.

	As of December 31, 2006	
	Number of Loans	Amount of Loans
Young	229	$ 30,133
Beginning	282	65,969
Small	625	79,527

Note: For purposes of the above table, a loan could be classified in more than one category, depending upon the characteristics of the underlying borrower.

The 2002 USDA (2002 is the latest USDA Ag census data available; next census will be available in 2008.) Ag census data has been used as a benchmark to measure penetration of the Association's marketing efforts. The census data indicated that within the Association's chartered territory (counties) there were 5,346 reported farmers of which by definition 229 or 4.3 percent were Young, 1,540 or 28.8 percent were Beginning, and 4,920 or 92.0 percent were Small. Comparatively, as of December 31, 2006, the demographics of the Association's agricultural portfolio, of which by definition 229 or 100 percent were Young, 282 or 18.31 percent were Beginning and 625 or 12.70 percent were Small.

The Association is committed to the future success of young, beginning and small farmers.

* Young farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who are age 35 or younger as of the date the loan is originally made.

** Beginning farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who have 10 years or less farming or ranching experience as of the date the loan is originally made.

*** Small farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who normally generate less than $250 in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

The following strategies and outreach programs have been conducted which allowed the Association to meet its objectives and goals with young, beginning, and small farmers.

- Support of 4-H, FFA, and Young Farmer organizations through activities, sponsorships and donations.
- Sponsor seminars on farm transition planning and financial management.
- Sponsor and participant in the Young Couples Co-Op Conference
- Sponsor/participant in Jr. Beef Roundup, South Carolina Rodeo Association, and other events

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Accounting for Uncertainty in Income Taxes

In June 2006, the Financial Accounting Standards Board (FASB) released Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48). This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. Adoption of FIN 48 is not expected to have a material impact on the Association's Consolidated Balance Sheet or Consolidated Statement of Income.

Accounting for Defined Benefit Pension and Other Postretirement Plans

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (FAS 158). FAS 158 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 through comprehensive income changes in that funded status in the year in which the changes occur. FAS 158 also provides guidance relating to the discount rate, which may require the Bank and related associations to adjust their basis for selecting the discount rate for their pension and non-pension postretirement benefit plans. The Bank and related associations will be required to implement FAS 158 for the year ended December 31, 2007. In addition, FAS 158 requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the Bank and associations use 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 FAS 158.

FORWARD LOOKING INFORMATION

Certain information included in this discussion constitutes forward-looking statements and information that are based upon management's belief as well as certain assumptions made by and information currently available to management. When used in this discussion, the words "anticipate," "project," "expect," "believe," and similar expressions are intended to identify forward-looking statements. Although management of the Association believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations and projections will prove to have been correct. Such forward-looking statements are subject to certain risks, uncertainties and assumptions. Should one or more of these risks materialize, or should such underlying assumptions prove to be incorrect, actual results may vary materially from those anticipated, projected, or expected. Among key factors that may have a direct bearing on the Association's operating results are fluctuations in the economy, the relative strengths and weaknesses in the agricultural credit sectors and in the real estate market, the actions taken by the Federal Reserve for the purpose of managing the economy, and the continued growth of the agricultural market consistent with recent historical experience.

Disclosure Required by Farm Credit Administration Regulations

Description of Business

Descriptions of the territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations are incorporated herein by reference to Note 1 to the consolidated financial statements, "Organization and Operations," included in this annual report to shareholders.

The description of significant developments that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, and concentrations of assets, if any, is incorporated in "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in this annual report to shareholders.

Description of Property

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

Location	Description	Form of Ownership
2229 South Irby Street Florence	Administrative/ Branch	Owned
900-C Main Street Conway	Branch	Leased *

* *Leased through March, 2007 at $1700 per month.*

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 15 to the consolidated financial statements, "Commitments and Contingencies," included in this annual report to shareholders.

Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 10 to the consolidated financial statements, "Members' Equity," included in this annual report to shareholders.

Description of Liabilities

The description of liabilities, contingent liabilities and intrasystem financial assistance rights and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 9, 13 and 15 to the consolidated financial statements included in this annual report to shareholders.

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

"Management's Discussion and Analysis of Financial Condition and Results of Operations," which appears in this annual report to shareholders and is to be disclosed in this section, is incorporated herein by reference.

Senior Officers

The following represents certain information regarding the senior officers of the Association:

Senior Officer	Position
Jasper W. Shuler	*President and Chief Executive Officer*, has been with the Farm Credit System since January, 1974
Kathy S. Heustess	*Chief Financial Officer,* has been with the Farm Credit System since July, 1989 and serves on the boards of the Darlington Country Club and the Darlington YMCA Advisory Board.
William H. Wise, Jr.	*Chief Operating Officer,* has been with the Farm Credit System since December, 1975.
Richard H. Horn	*Chief Lending Officer,* has been with the Farm Credit System since August, 1981.

The total amount of compensation earned by the CEO and the highest paid officers as a group during the years ended December 31, 2006, 2005 and 2004, is as follows:

Name of Individual or Number in Group	Year	Annual Salary	Annual Bonus	Deferred Comp.	Perq./-Other	Total
Jasper W. Shuler	2006	$222,068	$150,515	–	$ 5,548	$ 378,131
Jasper W. Shuler	2005	$194,305	$136,731	–	–	$ 331,036
Jasper W. Shuler	2004	$187,432	$ 58,000	–	–	$ 245,432
5	2006	$571,131	$366,667	–	$12,145	$ 949,944
7	2005	$786,269	$556,955	–	–	$1,343,224
7	2004	$752,653	$260,056	–	–	$1,012,709

In addition to a base salary, all employees, with the exception of the chief executive officer, are eligible for additional compensation under incentive plans. In addition to the general plan, specified employees are eligible for individual or group incentive plans. The chief executive officer is eligible for a bonus at the sole discretion of the board. The executive management is eligible for a long-term incentive plan.

Executive management, excluding the chief executive officer, is eligible for an incentive plan based on overall company results. The long-term plan is based on long-range financial results achieved over a three-year period. The general incentive plan is designed to reward excellent performance while increasing the Association's financial position and shareholder wealth. The individual and group incentive plans are specifically for account officers, credit officers, participations credit support/accounting staff (capital markets) and farm-related business coordinator to reward them when goals in their incentive plans are exceeded.

The goals of the account officers' plan include generation of fee and farm related services income in excess of salaries with an on/off switch based on Association credit quality and customer satisfaction. The goal of the credit officer plan is to generate fee income from loans in excess of salary with on/off switches based on credit administration, credit quality, and customer satisfaction. The AgScore Credit Administrator is eligible for incentive in a plan which promotes the use of AgScore, an automated loan scoring system. The goal of the capital markets plan is to generate fee income in excess of salaries with on/off switches based on credit quality, credit administration and customer satisfaction. The goal of the farm related services coordinator's plan is to increase related services income over previous year's income. The general plan is paid based on a percentage of net income in excess of budgeted net income. The key factors for payment of the general plan include credit quality, and customer satisfaction survey results. The criteria for payment of all incentive plans include: employees must be employed as of the fiscal year end, new employees with less than a full year of employment will receive a pro rata share based on the number of months employed during the calendar year, designated beneficiaries of employees who die prior to year end will receive a pro rata share of the incentive, the plan will be paid based on percentage of salary, and will be paid from the Association's core earnings. The employees must have satisfactory performance and not have been on probation during the year. The payment of the incentive available to all employees is determined on a percentage basis. The executive plan is paid based on the Association's ability to generate a 30% patronage. If that criteria is met, executive management is additionally eligible for 6 percent of net income in excess of budgeted income. The long-term executive plan has five categories and pays up to twenty-five percent if all categories are met. Bonuses are shown in the year earned, which may be different than the year of payment. The marketing manager plan was deleted from previous year.

Disclosure of information on the total compensation paid during 2006 to any senior officer, or to any other individual included in the total, is available to shareholders upon request.

Directors

Directors and senior officers are reimbursed on an actual cost basis for all expenses incurred in the performance of official duties. Such expenses may include transportation, lodging, meals, tips, tolls, parking of cars, laundry, registration fees, and other expenses associated with travel on official business. A copy of the policy is available to shareholders of the Association upon request.

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was $26,933 for 2006, $27,652 for 2005, and $33,509 for 2004.

Subject to approval by the board, the Association allows directors a monthly honoraria of $500 and the chairman $625 as well as a per diem of the same amounts for attendance at committee meetings or special assignments. Total compensation paid to directors, as a group was $70,500.

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

James M. Ward, Chairman, has been a self-employed farmer for the past five years. During 2006, he served 5 days at Association board meetings and 20 days in other official activities and was paid $15,250. His three-year term of office began March 2004.

Harry B. DuRant, Vice Chairman, has been a self-employed farmer for the past five years. He serves on the Phillip Morris Quality Control Committee. During 2006, he served 5 days at Association board meetings and 20 days in other official activities and was paid $12,500. His three-year term of office began March 2006.

DuPree Atkinson has been a self-employed farmer for the past five years. He serves on the SC Department of Agriculture Tobacco Board as chairman and the SC Farm Bureau Board. During 2006, he served 5 days at Association board meetings and 13 days in other official activities and was paid $9,000. His three-year term of office began March 2005.

W. Edwin Dargan, Jr. has been a self-employed farmer for the past five years. He serves on the board of Darlington County Bank. During 2006, he served 5 days at Association board meetings and 11 days in other official activities and was paid $8,000. His three-year term of office began March 2005.

Dale W. Player has been a self-employed farmer for the past five years. He serves on the boards of AgFirst Farm Credit Bank, SC Cotton Board, Carolina Cotton Growers Association, and the National Cotton Council. During 2006, he served 5 days at Association board meetings and 19 days in other official activities and was paid $8,250. His three-year term of office began March 2004.

Jimmy Poston has been a self-employed farmer for the past five years. He serves on the boards of Florence County Soil and Water Conservation District, Florence County Farm Service Agency County Committee, and serves as the President of the SC Tobacco Growers Association. During 2006, he served 5 days at Association board meetings and 13 days in other official activities and was paid $9,000. His three-year term of office began March 2006.

Harold C. Stowe is acting Dean of Wall College of Business at Coastal Carolina University in Conway, SC. He is retired as President of Canal Holdings, LLC and serves on the boards of Ruddick Corporation and SCANA Corporation. He has been in Executive Management at Canal Holdings, LLC and its predecessors for the past five years. During 2006, he served 5 days at Association board meetings and 8 days in other official activities and was paid $6,500. His three-year term of office began April 2004.

Transactions with Senior Officers and Directors

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 14 to the consolidated financial statements, "Related Party Transactions," included in this annual report to shareholders.

Involvement in Certain Legal Proceedings

There were no matters which came to the attention of management or the board of directors regarding involvement of current directors or senior officers in specified legal proceedings which should be disclosed in this section.

Relationship with Independent Public Accountants

There were no material disagreements with our independent public accountants on any matter of accounting principles or financial statement disclosure during this period.

Consolidated Financial Statements

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated February 28, 2007 and the report of management, which appear in this annual report to shareholders are incorporated herein by reference.

Copies of the Association's quarterly reports are available upon request free of charge by calling 1-800-741-7332, or writing Joan Boice, Corporate Secretary, ArborOne, ACA, P.O. Box 13209, Florence, SC 29504, or accessing the website, ***www.arboroneaca.com***. The Association prepares a quarterly report within 45 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

Borrower Information Regulations

Since 1972, Farm Credit Administration (FCA) regulations have required that borrower information be held in strict confidence by Farm Credit System (FCS) institutions, their directors, officers and employees. These regulations provide Farm Credit institutions clear guidelines for protecting their borrowers' nonpublic personal information.

On November 10, 1999, the FCA Board adopted a policy that requires FCS institutions to formally inform new borrowers at loan closing of the FCA regulations on releasing borrower information and to address this information in the annual report to shareholders. The implementation of these measures ensures that new and existing borrowers are aware of the privacy protections afforded them through FCA regulations and Farm Credit System institution efforts.

Shareholder Investment

Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of the District annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 316, or writing Wanda Martin, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst's website at ***www.agfirst.com***.

Report of the Audit Committee

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

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

PricewaterhouseCoopers LLP (PwC), the Association's independent auditor for 2006, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 61 *(Communication with Audit Committees)*. PwC has provided to the Committee the written disclosures and the letter required by Independence Standards Board Standard No. 1 *(Independence Discussions with Audit Committees)*, and the Committee has discussed with PwC that firm's independence.

The Committee has also concluded that PwC's provision of non-audit services, if any, to the Association is compatible with PwC's independence.

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Association's Annual Report for 2006. The foregoing report is provided by the following independent directors, who constitute the Committee:

Harold C. Stowe
Chairman of the Audit Committee

Members of Audit Committee

W. Edwin Dargan
DuPree Atkinson

Report of Independent Auditors

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
10 Tenth Street, Suite 1400
Atlanta, GA 30309
Telephone (678) 419 1000

Report of Independent Auditors

To the Board of Directors and Members
of **Arbor***One*, ACA

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of changes in members' equity and of cash flows present fairly, in all material respects, the financial position of **Arbor***One*, ACA (the Association) and its subsidiaries at December 31, 2006, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

February 28, 2007

Consolidated Balance Sheets

(dollars in thousands)	December 31, 2006	December 31, 2005	December 31, 2004
Assets			
Cash	$ 2	$ —	$ 7
Investment securities, held to maturity	10,107	12,538	12,553
Loans	297,393	287,374	245,040
Less: allowance for loan losses	243	1,011	1,000
Net loans	297,150	286,363	244,040
Other investments, held to maturity	128,053	73,189	—
Accrued interest receivable	5,670	3,687	2,438
Investment in other Farm Credit institutions	11,609	4,080	3,645
Premises and equipment, net	518	444	610
Other property owned	—	49	—
Prepaid retirement expense	2,689	3,082	2,946
Due from AgFirst Farm Credit Bank	3,933	2,859	2,436
Other assets	635	390	316
Total assets	$ 460,366	$ 386,681	$ 268,991
Liabilities			
Notes payable to AgFirst Farm Credit Bank	$ 402,799	$ 334,915	$ 222,656
Accrued interest payable	2,037	1,383	723
Patronage refund payable	2,496	1,975	1,675
Other liabilities	7,255	6,742	4,823
Total liabilities	414,587	345,015	229,877
Commitments and contingencies			
Members' Equity			
Protected borrower stock	453	522	584
Capital stock and participation certificates	1,151	1,171	1,172
Retained earnings			
Allocated	26,826	23,977	22,225
Unallocated	17,349	15,996	15,133
Total members' equity	45,779	41,666	39,114
Total liabilities and members' equity	$ 460,366	$ 386,681	$ 268,991

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

Consolidated Statements of Income

(dollars in thousands)	For the year ended December 31, 2006	2005	2004
Interest Income			
Loans	$ 24,295	$ 18,462	$ 13,682
Investment securities	751	805	185
Other	7,097	343	—
Total interest income	32,143	19,610	13,867
Interest Expense			
Notes payable to AgFirst Farm Credit Bank	23,473	11,869	7,430
Net interest income	8,670	7,741	6,437
Provision for (reversal of allowance for) loan losses	(723)	—	(4,413)
Net interest income after provision for (reversal of allowance for) loan losses	9,393	7,741	10,850
Noninterest Income			
Loan fees	1,617	1,099	1,055
Fees for financially related services	514	444	397
Patronage refund from other Farm Credit institutions	4,199	3,063	2,649
Gains (losses) on other property owned, net	1	(2)	—
Gains (losses) on sales of premises and equipment, net	23	311	130
Other noninterest income	388	444	281
Total noninterest income	6,742	5,359	4,512
Noninterest Expense			
Salaries and employee benefits	4,929	4,657	3,933
Occupancy and equipment	381	381	326
Insurance Fund premiums	433	130	111
Other operating expenses	1,946	1,545	1,304
Total noninterest expense	7,689	6,713	5,674
Income before income taxes	8,446	6,387	9,688
Provision (benefit) for income taxes	(26)	(9)	37
Net income	$ 8,472	$ 6,396	$ 9,651

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

Consolidated Statements of Changes in Members' Equity

(dollars in thousands)	Protected Borrower Stock	Capital Stock and Participation Certificates	Retained Earnings Allocated	Retained Earnings Unallocated	Accumulated Other Comprehensive Income	Total Members' Equity
Balance at December 31, 2003	$ 701	$ 1,155	$ 16,653	$ 14,618	$ (2,480)	$ 30,647
Comprehensive income						
Net income				9,651		9,651
Minimum pension liability adjustment					2,480	2,480
Total comprehensive income						12,131
Protected borrower stock retired	(117)					(117)
Capital stock/participation certificates issued		92				92
Capital stock/participation certificates retired		(75)				(75)
Patronage distribution						
Cash				(1,590)		(1,590)
Qualified allocated retained earnings			1,174	(1,174)		—
Nonqualified allocated retained earnings			1,212	(1,212)		—
Nonqualified retained earnings			5,026	(5,026)		—
Retained earnings retired			(1,924)			(1,924)
Distribution adjustment			84	(134)		(50)
Balance at December 31, 2004	584	1,172	22,225	15,133	—	39,114
Net income				6,396		6,396
Protected borrower stock retired	(62)					(62)
Capital stock/participation certificates issued		179				179
Capital stock/participation certificates retired		(180)				(180)
Patronage distribution						
Cash				(1,821)		(1,821)
Nonqualified allocated retained earnings			2,640	(2,640)		—
Nonqualified retained earnings			819	(819)		—
Retained earnings retired			(1,942)			(1,942)
Distribution adjustment			235	(253)		(18)
Balance at December 31, 2005	522	1,171	23,977	15,996	—	41,666
Net income				8,472		8,472
Protected borrower stock retired	(69)					(69)
Capital stock/participation certificates issued		110				110
Capital stock/participation certificates retired		(130)				(130)
Patronage distribution						
Cash				(2,320)		(2,320)
Qualified allocated retained earnings			794	(794)		—
Nonqualified allocated retained earnings			2,686	(2,686)		—
Nonqualified retained earnings			1,751	(1,751)		—
Retained earnings retired			(1,948)			(1,948)
Distribution adjustment			(434)	432		(2)
Balance at December 31, 2006	$ 453	$ 1,151	$ 26,826	$ 17,349	$ —	$ 45,779

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

Consolidated Statements of Cash Flows

(dollars in thousands)	For the year ended December 31, 2006	2005	2004
Cash flows from operating activities:			
Net income	$ 8,472	$ 6,396	$ 9,651
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	129	182	183
Amortization of discount on other investments	(7,097)	—	—
Provision for (reversal of allowance for) loan losses	(723)	—	(4,413)
(Gains) losses from sales of premises and equipment, net	(23)	(311)	(130)
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	(1,983)	(1,249)	(133)
(Increase) decrease in prepaid retirement expense	393	(136)	(2,946)
(Increase) decrease in due from AgFirst Farm Credit Bank	(1,074)	(423)	(596)
(Increase) decrease in other assets	(245)	(74)	2,623
Increase (decrease) in accrued interest payable	654	660	168
Increase (decrease) in minimum pension liability	—	—	(1,380)
Increase (decrease) in other liabilities	513	1,919	(503)
Total adjustments	(9,456)	568	(7,127)
Net cash provided by (used in) operating activities	(984)	6,964	2,524
Cash flows from investing activities:			
Purchases of investment securities, held to maturity	—	(3,569)	—
Proceeds from maturities of or principal payments received on investment securities, held to maturity	2,431	3,584	—
Net (increase) decrease in loans	(10,064)	(42,372)	(27,535)
(Increase) decrease in investment in other Farm Credit institutions	(7,529)	(435)	129
Purchases of other investments	(63,998)	(73,189)	—
Proceeds from payments received on other investments	16,231	—	—
Purchases of premises and equipment	(224)	(112)	(165)
Proceeds from sales of premises and equipment, net	44	407	176
Proceeds from sales of other property owned	49	—	—
Net cash provided by (used in) investing activities	(63,060)	(115,686)	(27,395)
Cash flows from financing activities:			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	67,884	112,259	29,033
Protected borrower stock retired	(69)	(62)	(117)
Capital stock and participation certificates issued	110	179	92
Capital stock and participation certificates retired	(130)	(180)	(75)
Patronage refunds paid	(1,801)	(1,539)	(2,133)
Retained earnings retired	(1,948)	(1,942)	(1,924)
Net cash provided by (used in) financing activities	64,046	108,715	24,876
Net increase (decrease) in cash	2	(7)	5
Cash, beginning of period	—	7	2
Cash, end of period	$ 2	$ —	$ 7
Supplemental schedule of non-cash activities:			
Loans transferred to other property owned	$ —	$ 49	$ —
Cash dividends or patronage distributions declared or payable	2,320	1,821	1,590
Decrease (increase) in accumulated other comprehensive income related to minimum pension liability	—	—	2,480
Supplemental information:			
Interest paid	$ 22,819	$ 11,209	$ 7,262
Taxes paid, net	9	56	54

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

Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

Note 1 — Organization and Operations

A. **Organization:** ArborOne, ACA (Association) is a member-owned cooperative which provides credit and credit-related services to or for the benefit of eligible borrowers/shareholders for qualified purposes in the following states and counties:

Alaska *– Anchorage*
Arizona *– Coconino*
Arkansas *– Arkansas*
California *– Alameda, Calaveras, Los Angeles, Sacramento*
Colorado *– Weld*
Delaware *– New Castle*
Florida *– Alachua, Charlotte, Dade, Desoto, Duval, Hendry, Hernando, Highlands, Hillsborough, Holmes, Lee, Madison, Miami-Dade, Nassau, Polk, Sarasota*
Georgia *– Baldwin, Banks, Bullock, Calhoun, Decatur, Effingham, Evans, Fulton, Glynn, Macon, Sumter*
Kansas *– Allen*
Kentucky *– Knox*
Louisiana *– Allen*
Maine *– Franklin*
Maryland *– Frederick, Garrett*
Minnesota *– Watonwan*
Mississippi *– Hinds*
New Jersey *– Burlington*
New York *– Chautauqua, Genesee, Monroe*
North Carolina *– Alamance, Catawba, Columbus, Forsyth, Franklin, Guilford, Iredell, Mecklenburg, Pitt, Richmond, Union*
Pennsylvania *– Wayne*
South Carolina *– Abbeville, Allendale, Anderson, Berkley, Calhoun, Charleston, Chesterfield, Clarendon, Colleton, Darlington, Dillon, Florence, Georgetown, Greenwood, Horry, Kershaw, Lancaster, Lee, Lexington, Marion, Marlboro, Pickens, Richland, Spartanburg, Sumter, Williamsburg, York*
Texas *– Anderson, Austin, Bexar, Nueces, Walker*
Virginia *– Isle of Wight, Northumberland*
Washington *– Cowlitz*
West Virginia *– Hampshire*
Wisconsin *– Florence, Sauk*

The Association is a lending institution of the Farm Credit System (System), a nationwide system of cooperatively owned banks and associations, which was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (Farm Credit Act). The most recent significant amendment to the Farm Credit Act was the Agricultural Credit Act of 1987. At December 31, 2006, the System was comprised of four Farm Credit Banks, one Agricultural Credit Bank and ninety-six Associations.

AgFirst Farm Credit Bank (Bank) and its related Associations are collectively referred to as the "District." The Bank provides funding to all Associations within the District and is responsible for supervising certain activities of the Association, as well as the other Associations operating within the District. The District consists of the Bank and twenty-three Agricultural Credit Associations (ACAs), all of which have reorganized as ACA parent-companies, which have two wholly owned subsidiaries, a Federal Land Credit Association (FLCA) and a Production Credit Association (PCA). FLCAs are tax-exempt while ACAs and PCAs are taxable.

ACA parent-companies provide financing and related services through its FLCA and PCA subsidiaries. The PCA is dormant. The FLCA makes collateralized long-term agricultural real estate and rural home mortgage loans. The ACA makes short- and intermediate-term loans for agricultural production or operating purposes.

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

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (Insured debt), (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary uses by the Insurance Corporation to provide assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank is required to pay premiums, which may be passed on to the Association, into the Insurance Fund, based on its annual average loan principal outstanding until the monies in the Insurance Fund reach the "secure base amount." The secure base amount is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (Systemwide debt obligations) or such other percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums, but it still must ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

B. **Operations:** The Farm Credit Act sets forth the types of authorized lending activity, persons eligible to borrow, and financial services which can be offered by the Association. The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related businesses.

The Association may sell to any System borrowing member, on an optional basis, credit or term life insurance appropriate to protect the loan commitment in the event of death of the debtor(s). The sale of other insurance necessary to protect a member's farm or aquatic unit is permitted, but limited to hail and multi-peril crop insurance, and insurance necessary to protect the facilities and equipment of aquatic borrowers.

The AgFirst Annual Report to Shareholders, the AgFirst District Annual Report to Shareholders, and the AgFirst District's quarterly reports are available on its web site, *www.agfirst.com*. Upon request, shareholders of the Association will be provided with copies of these reports at no charge by calling 1-800-845-1745, Ext. 316. The Association's financial condition may be impacted by factors that affect the Bank. The Bank's Annual Report discusses the material aspects of the District's financial condition, changes in financial condition, and results of operations. In addition, the District's Annual Report identifies favorable and unfavorable trends, significant events, uncertainties and the impact of activities of the Insurance Corporation.

The lending and financial services offered by the Bank are described in Note 1 of the AgFirst Annual Report to Shareholders.

Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the Association conform with accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results may differ from these estimates.

The consolidated financial statements include the accounts of the FLCA and the PCA. All significant inter-company transactions have been eliminated in consolidation.

A. **Cash:** Cash, as included in the statements of cash flows, represents cash on hand and on deposit at banks.

B. **Investment Securities:** The Association, as permitted under the FCA regulations, holds investments to manage and diversify its income sources. The Association's investments are classified as held to maturity and accordingly have been reported at amortized cost. Premiums and discounts are amortized or accreted ratably over the term of the respective security. In addition, the Association may also hold additional investments in accordance with mission-related investment programs, approved by the FCA.

The Association reviews all investments that are in a loss position in order to determine whether the unrealized loss, which is considered an impairment, is temporary or permanent. In the event of permanent impairment, the cost basis of the investment would be written down to its fair value, and the realized loss would be included in current earnings.

C. **Loans and Allowance for Loan Losses:** Long-term real estate mortgage loans generally have original maturities ranging from 5 to 30 years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less. Loans are carried at their principal amount outstanding less unearned income. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding.

Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days (unless adequately collateralized and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in the prior year).

When loans are in nonaccrual status, the interest portion of payments received in cash is recognized as interest income if collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it. Otherwise, loan payments are applied against the recorded investment in the loan. Nonaccrual loans may be returned to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected and the loan is not classified "doubtful" or "loss."

Loans are charged-off, wholly or partially, as appropriate, at the time they are determined to be uncollectible.

In cases where a borrower experiences financial difficulties and the Association makes certain monetary concessions to the borrower through modifications to the contractual terms of the loan, the loan is classified as a restructured loan. If the borrower's ability to meet the revised payment schedule is uncertain, the loan is classified as a nonaccrual loan.

The allowance for loan losses is a valuation account used to reasonably estimate loan and lease losses existing as of the financial statement date. Determining the appropriate allowance for loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss.

The 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. It is based on estimates, appraisals and evaluations of loans which, by their nature, contain elements of uncertainty and imprecision. The possibility exists that changes in the economy and its impact on borrower repayment capacity will cause these estimates, appraisals and evaluations to change.

The level of allowance for loan losses is generally based on recent charge-off experience adjusted for relevant environmental factors. The Association considers the following factors when adjusting the historical charge-offs experience:

- Changes in credit risk classifications,
- Changes in collateral values,
- Changes in risk concentrations,
- Changes in weather related conditions, and
- Changes in economic conditions.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms of the loan. Impaired loans include nonaccrual loans, restructured loans, and loans past due 90 days or more and still accruing interest. A loan is considered contractually past due when any principal repayment or interest payment required by the loan instrument is not received on or before the due date. A loan shall remain contractually past due until it is formally restructured or until the entire amount past due, including principal, accrued interest, and penalty interest incurred as the result of past due status, is collected or otherwise discharged in full.

A specific allowance may be established for impaired loans under Statement of Financial Accounting Standards No. 114. Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent. See Note 3 for a discussion on the refinement of the allowance for loan losses methodology.

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs.

D. **Other Investments:** Other investments include Tobacco Buyout Successor-in-Interest Contracts (SIIC), which qualify as Mission Related Investments under FCA regulations. Under the SIIC, the tobacco quota holders and producers may sell their rights to receive SIIC contract payments to a third party. The successor purchases the entire contract and all related rights and obligations associated with the contract. These investments in SIIC are purchased at a discount. Contract payments are made by the United States Department of Agriculture (USDA) in equal annual payments. Interest income is recognized from the accretion of discounts using the effective interest method.

E. **Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** The Association is required to maintain ownership in the Bank in the form of Class B and Class C stock. Accounting for this investment is on the cost plus allocated equities basis. Patronage refunds from the Bank are accrued as earned. The receivable for such patronage refunds is classified as Due from AgFirst Farm Credit Bank.

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

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

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

I. **Employee Benefit Plans:** Substantially all employees of the Association may participate in the retirement plan (Plan) of the AgFirst District, which is a defined benefit plan. The District utilizes the "Projected Unit Credit" actuarial method for financial reporting purposes and for funding purposes. As a result of the funded status at the Plan's measurement date (September 30) of the underlying Plan, the Association may record a minimum liability, an intangible asset relating to unrecognized prior service cost and other comprehensive income (loss). The adjustment to other comprehensive income (loss) would be net of deferred taxes, if significant. For participants hired before January 1, 2003, benefits are determined based on a final average pay formula. For those participants hired on or after January 1, 2003, benefits are determined using a cash balance formula.

Substantially all employees of the Association may also be eligible to participate in the District's thrift plan (Thrift Plan), which qualifies as a 401(k) plan as defined by the Internal Revenue Code. For employees hired on or prior to December 31, 2002, the Association contributes $.50 for each $1.00 of the maximum employee contribution of 6 percent of total compensation. For employees hired on or after January 1, 2003, the Association contributes $1.00 for each $1.00 of the maximum employee contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service. Thrift Plan costs are expensed as funded.

Effective January 1, 2006 the Districtwide 401(k) Plan known as the AgFirst Farm Credit Employee Thrift Plan merged with the Farm Credit Bank of Texas Thrift Plus Plan. The new plan is known as the AgFirst/FCBT 401(k) Employee Benefit Plan.

The Association may provide certain health care and life insurance benefits to eligible retired employees. Substantially all employees may become eligible for these benefits if they reach early retirement age while working for the Association.

J. **Income Taxes:** The Association is generally subject to Federal and certain other income taxes. As previously described, the ACA holding company has two wholly-owned subsidiaries, a PCA and a FLCA. The FLCA subsidiary is exempt from federal and state income taxes as provided in the Farm Credit Act. The ACA holding company and the PCA subsidiary are subject to federal, state and certain other income taxes.

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

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

The Association records a valuation allowance at the balance sheet dates against that portion of the Association's deferred tax assets that, based on management's best estimates of future events and circumstances, more likely than not (a likelihood of more than 50 percent) will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of our expected patronage program, which reduces taxable earnings.

K. **Patronage Refund from AgFirst and Other Financial Institutions:** The Association records patronage refunds from the Bank and certain District Associations on an accrual basis.

L. **Recently Issued Accounting Pronouncements:** In June 2006, the Financial Accounting Standards Board (FASB) released Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. Adoption of FIN 48 is not expected to have a material impact on the Association's Consolidated Balance Sheet or Consolidated Statement of Income.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (FAS 158). FAS 158 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 through comprehensive income changes in that funded status in the year in which the changes occur. The Bank and its related Associations will be required to implement FAS 158 for the year ended December 31, 2007. In addition, FAS 158 requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the Bank and its related Associations use 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 Bank and its related Associations are currently evaluating the impact of implementing FAS 158.

Note 3 — Refinement of the Allowance for Loan Losses Methodology

During 2004, the Association conducted a study to further refine its allowance for loan losses methodology taking into account recently issued guidance by FCA, as well as the Securities and Exchange Commission (SEC) and Federal Financial Institutions Examination Council guidelines.

Previously, the Association's allowance for loan losses methodology had been based upon criteria developed in the late 1980s and reflected the credit losses experienced in the mid-to-late 1980s, which was a period of unusually adverse economic conditions in American agriculture. Given the long cyclical nature of the agricultural economy, loss factors utilized to determine the allowance for loan losses subsequent to 1989 continued to reflect, to some extent, the loss history of the mid-to-late 1980s, which resulted in conservative estimates of the allowance for loan losses. The Association's allowance for loan losses methodology utilized throughout the period was in accordance with generally accepted accounting principles and was consistently applied.

While conservative in estimating the allowance for loan losses, the methodology used resulted in annual provisions for loan losses over the periods that reflected changes in credit quality and loss experience. Accordingly, the reserves provided in the mid-to-late 1980s have, in effect, remained part of the allowance for loan losses. The Association's allowance for loan losses methodology has consistently adhered to proper accounting policies, under the regulatory supervision of FCA in its role as a "safety and soundness" regulator. It was FCA's view that the allowance for loan losses should include among others, an assessment of probable losses, historical loss experience and economic conditions.

In April 2004, FCA issued an "Informational Memorandum" to System institutions regarding the criteria and methodologies that would be used in evaluating the adequacy of a System institution's allowance for loan losses. FCA endorsed the direction provided by other bank regulators and the SEC and indicated the conceptual framework addressed in their guidance would be included as part of their examination process.

During the fourth quarter of 2004, the Association completed its study and refined its methodology to be in compliance with the guidance discussed in the previous paragraph. The refinement in methodology resulted in a calculated allowance for loan losses that was significantly less than the previously recorded balance due to revised loss factors that are more indicative of actual loss experience in recent years and current borrower analysis.

While the $4,413 reversal had a significant impact on 2004 results of operations and the previously recorded allowance for loan losses, the refinement in methodology did not have a significant impact on 2006 comparative results of operations and is not expected to have a significant impact in future periods. Additionally, the refinement in methodology did not have a significant impact on the level of the risk bearing capacity of the Association, generally referred to as "risk funds" (capital plus the allowance for loan losses), which totaled $46,022 at December 31, 2006 (15.48 percent of Association loans), as compared with $42,677 at December 31, 2005 (14.85 percent of Association loans), and $40,114 at December 31, 2004 (16.37 percent of Association loans).

Note 4 — Investment Securities

A summary of the amortized cost and fair value of investment securities held to maturity at December 31, 2006, 2005 and 2004 follows:

	December 31, 2006				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Govt. Agency MBS	$ 7,847	$ 84	$ –	$ 7,931	8.73%
Commercial MBS	2,260	–	(65)	2,195	4.89
Total investment securities	$10,107	$ 84	$ (65)	$10,126	7.83%

	December 31, 2005				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Govt. Agency MBS	$ 9,776	$ –	$ (23)	$ 9,753	7.60%
Commercial MBS	2,762	6	–	2,768	4.86
Total investment securities	$12,538	$ 6	$ (23)	$12,521	6.99%

	December 31, 2004				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Govt. Agency MBS	$12,553	$ 263	$ –	$12,816	5.79%
Total investment securities	$12,553	$ 263	$ –	$12,816	5.79%

The Association's investments consist primarily of mortgage-backed securities (MBSs) and asset backed securities (ABSs). MBSs are collateralized by U.S. government or US agency guaranteed residential mortgages and have a AAA credit rating. ABSs are also rated AAA due to the senior/subordinate structure and/or a credit wrap by a bond insurer. All unrealized losses referenced above are related to changes in interest rates and are not credit related.

The following table shows the fair value and gross unrealized losses for investments in a loss position aggregated by investment category and the length of time the securities have been in a continuous unrealized loss position at December 31, 2006. The continuous loss position is based on the date the impairment occurred. The unrealized losses on these investments resulted from interest rate volatility and are not credit related. The Association expects to recover substantially all of our cost in these investments. Substantially all of these investments were in U. S. government securities and we expect that these securities would not be settled at a price less than their amortized cost. Because the decline in market value was caused by interest rate increases and not credit quality, and because the Association has the ability and intent to hold these investments to maturity, the Association has not recognized any other-than-temporary impairment in connection with these investments.

	Less than 12 Months		Greater than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities	$ –	$ –	$ 2,260	$ 65
Other asset-backed securities	–	–	–	–
Total	$ –	$ –	$ 2,260	$ 65

A summary of the expected maturity, amortized cost and estimated fair value of investment securities at December 31, 2006, follows:

	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	$ –	$ –	–%
After one year through five years	855	829	4.75
After five years through ten years	1,405	1,366	4.97
After ten years	7,847	7,931	8.73
Total	$ 10,107	$ 10,126	7.83%

Expected maturities for collateralized mortgage obligations will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Note 5 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31, 2006	2005	2004
Real estate mortgage	$ 92,809	$ 99,643	$ 99,977
Production and intermediate term	163,890	152,844	123,642
Agribusiness:			
Loans to cooperatives	1,153	2,067	–
Processing and marketing	19,174	12,603	3,510
Farm related business	8,693	9,560	7,600
Energy	2,110	834	–
Rural residential real estate	9,564	9,823	10,311
Total loans	$ 297,393	$ 287,374	$ 245,040

The Association's concentration of credit risk in various agricultural commodities is shown in the following table. While the amounts represent the Association's maximum potential credit risk as it relates to recorded loan principal, a substantial portion of the Association's lending activities is collateralized and the Association's exposure to credit loss associated with lending activities is reduced accordingly. An estimate of the Association's credit risk exposure is considered in the determination of the allowance for loan losses.

Total loans at December 31, 2006, 2005 and 2004 consisted of the following commodity types:

	December 31,		
Commodity Type	**2006**	**2005**	**2004**
Forestry	29%	27%	25%
Livestock	14	15	14
Poultry	12	12	15
Row Crops	11	9	19
Other	9	11	9
Tobacco	9	11	7
Cotton/Cotton Gins	6	7	1
Field/Grain	4	3	3
Nurseries/Greenhouses	3	2	4
Rural Home	3	3	3
Total	100%	100%	100%

The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but typically includes farmland and income-producing property, such as crops and livestock, as well as receivables. Long-term real estate loans are collateralized by the first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (97 percent if guaranteed by a government agency) of the property's appraised value. However, a decline in a property's market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the Association in the collateral, may result in the loan to value ratios in excess of the regulatory maximum.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms.

The following table presents information relating to impaired loans.

	December 31,		
	2006	**2005**	**2004**
Nonaccrual loans:			
Current as to principal and interest	$ 206	$ 40	$ 287
Past due	1,685	223	182
Total nonaccrual loans	1,891	263	469
Impaired accrual loans:			
Restructured accrual loans	–	–	–
Accrual loans 90 days or more past due	86	–	1
Total impaired accrual loans	86	–	1
Total impaired loans	$1,977	$ 263	$ 470

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2006.

Interest income is recognized and cash payments are applied on nonaccrual impaired loans as described in Note 2. The following table presents interest income recognized on impaired loans.

	Year Ended December 31,		
	2006	**2005**	**2004**
Interest income recognized on nonaccrual loans	$ 109	$ 202	$ 120
Interest income on impaired accrual loans	3	6	4
Interest income recognized on impaired loans	$ 112	$ 208	$ 124

The following table presents information concerning impaired loans as of December 31,

	2006	**2005**	**2004**
Impaired loans with related allowance	$ 1,214	$ –	$ 204
Impaired loans with no related allowance	763	263	266
Total impaired loans	$ 1,977	$ 263	$ 470
Allowance on impaired loans	$ 200	$ –	$ 3

The following table summarizes impaired loan information for the year ended December 31,

	2006	**2005**	**2004**
Average impaired loans	$ 582	$ 359	$ 720

The following table summarizes interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans:

	Year Ended December 31,		
	2006	**2005**	**2004**
Interest income which would have been recognized under the original loan terms	$ 179	$ 249	$ 205
Less: interest income recognized	109	202	120
Foregone interest income	$ 70	$ 47	$ 85

The changes in the allowance for loan losses are as follows:

	Year Ended December 31,		
	2006	**2005**	**2004**
Balance at beginning of year	$ 1,011	$ 1,000	$ 5,446
Charge-offs:			
Real estate mortgage	$ –	$ –	$ (8)
Production and intermediate term	(109)	(5)	(28)
Total charge-offs	(109)	(5)	(36)
Recoveries:			
Production and intermediate term	$ 64	$ 11	$ 3
Rural residential real estate	–	5	–
Total recoveries	64	16	3
Net (charge-offs) recoveries	(45)	11	(33)
Provision for (reversal of allowance for) loan losses	$ (723)	$ –	$ –
Nonrecurring allowance for loan losses reversal	-	–	(4,413)
	(723)	–	(4,413)
Balance at end of year	$ 243	$ 1,011	$ 1,000
Ratio of net charge-offs during the period to average loans outstanding during the period	(0.010%)	0.004%	(0.01%)

As previously discussed in Note 3, the nonrecurring allowance for loan losses reversal resulted from the refinement of the Association's allowance for loan losses methodology.

In addition, the following is a breakdown of the allowance for loan losses for the end of the last three fiscal years:

	December 31, 2006		December 31, 2005	
	Amount	%	Amount	%
Real estate mortgage	$ 160	65.8%	$ 263	26.0%
Production and intermediate term	79	32.5	648	64.0
Agribusiness	3	1.5	39	4.0
Communication	1	0.2	3	0.3
Rural residential real estate	–	–	58	5.7
Total	$ 243	100.0%	$ 1,011	100.0%

	December 31, 2004	
	Amount	%
Real estate mortgage	$ 263	26.3%
Production and intermediate term	642	64.2
Agribusiness	39	3.9
Communication	3	0.3
Rural residential real estate	53	5.3
Total	$ 1,000	100.0%

To mitigate the risk of loan losses, the Association may enter into long-term standby "commitment to purchase" agreements with the Federal Agricultural Mortgage Corporation (Farmer Mac). The agreements, which are effectively credit guarantees that will remain in place until the loans are paid in full, give the Association the right to sell the loans identified in the agreements to Farmer Mac in the event of default (typically four months past due), subject to certain conditions. The Association not only uses these agreements as a credit risk tool, but also as a tool to manage capital not associated with credit issues. The balance of loans under long-term standby commitments was $21,180 , $33,995 and $29,604 at December 31, 2006, 2005 and 2004, respectively. Fees paid to Farmer Mac for such commitments totaled $143, $145 and $158 for the years ended December 31, 2006, 2005 and 2004, respectively. These amounts are classified as noninterest expense.

Note 6 — Other Investments

On October 22, 2004, Congress enacted the "Fair and Equitable Tobacco Reform Act of 2004" (Tobacco Act) as part of the "American Jobs Creation Act of 2004." The Tobacco Act repealed the Federal tobacco price support and quota programs, provides for payments to tobacco "quota owners" and producers for the elimination of the quota, and provides an assessment mechanism for tobacco manufacturers and importers to pay for the buyout. Tobacco quota holders and producers will receive 10 equal annual payments under a contract with the Secretary of Agriculture. The Tobacco Act also includes a provision that allows the quota holders and producers to assign to a "financial institution" the right to receive the contract payments so that they may obtain a lump sum or other payment. On April 4, 2005, the USDA issued a Final Rule implementing the "Tobacco Transition Payment Program" (Tobacco Buyout).

The FCA determined that System institutions are "financial institutions" within the meaning of the Tobacco Act and are, therefore, eligible to participate in the Tobacco Buyout. The FCA recognized that the Tobacco Buyout has significant implications for some System institutions and the tobacco quota holders and producers they serve. The FCA's goal is to provide System institution borrowers with the option to immediately receive Tobacco Buyout contract payments and reinvest them in future business opportunities.

For the years ended December 31, 2006 and 2005, the Association held Tobacco Buyout SIIC of $128,053 and $73,189, respectively, net of discount.

Note 7 — Investment in AgFirst Farm Credit Bank

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

Note 8 — Premises and Equipment

Premises and equipment consisted of the following:

	December 31, 2006	2005	2004
Land	$ 63	$ 63	$ 99
Buildings and improvements	599	598	741
Furniture and equipment	742	753	767
	1,404	1,414	1,607
Less: accumulated depreciation	886	970	997
Total	$ 518	$ 444	$ 610

Note 9 — Notes Payable to AgFirst Farm Credit Bank

The Association's indebtedness to the Bank represents borrowings by the Association to fund its loan portfolio. This indebtedness is collateralized by a pledge of substantially all of the Association's assets and the terms of the revolving lines of credit are governed by a general financing agreement. Interest rates on both variable and fixed rate notes payable are generally established loan-by-loan based on the Bank's marginal cost of funds, capital position, operating costs and return objectives. The interest rate is periodically adjusted by the Bank based upon agreement between the Bank and Association. The weighted average interest rates on the variable rate notes were 6.25 percent for LIBOR-based loans, 6.47 percent for Prime-based loans, and the weighted average remaining maturities were 3.6 years and 6.6 years, respectively, at December 31, 2006. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) notes payable which are match funded by the Bank was 5.73 percent and the weighted average remaining maturity was 5.4 years at December 31, 2006. The weighted average interest rate on all interest-bearing notes payable was 6.03 percent and the weighted average remaining maturity was 5.4 years at December 31, 2006.

Variable rate and fixed rate notes payable represent approximately 29.03 percent and 70.97 percent, respectively, of total notes payable at December 31, 2006.

Under the Farm Credit Act, the Association is obligated to borrow only from the Bank, unless the Bank approves borrowing from other funding sources. The Bank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2006, the Association's notes payable were within the specified limitations.

The Association has a line of credit totaling $78 with another financing institution in support of letters of credit. ArborOne participates these letters of credit with other associations and its net exposure is $6.

Note 10 — Members' Equity

A description of the Association's capitalization requirements, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below.

A. **Protected Borrower Equity**

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

B. **Capital Stock and Participation Certificates**

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

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

C. **Regulatory Capitalization Requirements and Restrictions**

FCA's capital adequacy regulations require the Association to achieve permanent capital of seven percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the seven percent capital requirement can initiate certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Association's financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless prescribed capital standards are met. FCA regulations also require that additional minimum standards for capital be achieved. These standards require all System institutions to achieve and maintain ratios as defined by FCA regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of seven percent and of core surplus as a percentage of risk-adjusted assets of three and one-half percent. The Association's permanent capital, total surplus and core surplus ratios at December 31, 2006 were 13.29 percent, 12.89 percent and 8.70 percent, respectively.

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

D. **Description of Equities**

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

The Association had the following shares outstanding at December 31, 2006:

		Shares Outstanding	
Class	**Protected**	**Number**	**Aggregate Par Value**
A Common/Nonvoting	Yes	38,024	$ 190
B Common/Nonvoting	Yes	45,844	229
C Common/Voting	No	211,373	1,057
B Participation Certificates/Nonvoting	Yes	6,846	34
C Participation Certificates/Nonvoting	No	18,753	94
Total Capital Stock and Participation Certificates		320,840	$ 1,604

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

Retained Earnings

The Association maintains an unallocated retained earnings account and an allocated retained earnings account. The minimum aggregate amount of these two accounts is determined by the Board. At the end of any fiscal year, if the retained earnings accounts otherwise would be less than the minimum amount determined by the Board as necessary to maintain adequate capital reserves to meet the commitments of the Association, the Association shall apply earnings for the year to the unallocated retained earnings account in such amounts as may be determined necessary by the Board. Unallocated retained earnings are maintained for each borrower to permit liquidation on a patronage basis.

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

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

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

At December 31, 2006, allocated members' equity consisted of $11,952 of qualified surplus, $7,507 of nonqualified allocated surplus, and $7,368 of nonqualified retained surplus.

Patronage Distributions

Prior to the beginning of any fiscal year, the Board, by adoption of a resolution, may obligate the Association to distribute to borrowers on a patronage basis all or any portion of available net earnings for such fiscal year or for that and subsequent fiscal years. Patronage distributions are based on the proportion of the borrower's interest to the amount of interest earned by the Association on its total loans unless another proportionate patronage basis is approved by the Board.

If the Association meets its capital adequacy standards after making the patronage distributions, the patronage distributions may be in cash, authorized stock of the Association, allocations of earnings retained in an allocated members' equity account, or any one or more of such forms of distribution. Patronage distributions of the Association's earnings may be paid on either a qualified or nonqualified basis, or a combination of both, as determined by the Board. A minimum of 20 percent of the total qualified patronage distribution to any borrower for any fiscal year shall always be paid in cash.

Dividends

The Association may declare noncumulative dividends on its capital stock and participation certificates provided the dividend rate does not exceed 20 percent of the par value of the respective capital stock and participation certificates. Such dividends may be paid solely on Classes A or D Preferred Stock, or on all classes of stock and participation certificates.

The rate of dividends paid on Class A Preferred Stock for any fiscal year may not be less than the rate of dividends paid on Classes A, B and C Common Stock or participation certificates for such year. The rate of dividends on Classes A, B and C Common Stock and participation certificates shall be at the same rate per share.

Dividends may not be declared if, after recording the liability, the Association would not meet its capital adequacy standards. No dividends were declared by the Association for any of the periods included in these consolidated financial statements.

Transfer

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

Impairment

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

1. Class C Common Stock and Class C Participation Certificates
2. Classes A and B Common Stock and Class B Participation Certificates
3. Classes A and D Preferred Stock

Liquidation

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities should be distributed to the holders of the outstanding stock and participation certificates in the following order:

1. Holders of Classes A and D Preferred Stock
2. Holders of Classes A and B Common Stock and Class B Participation Certificates
3. Holders of Class C Common Stock and Class C Participation Certificates

4. Holders of allocated surplus evidenced by qualified written notices of allocation, in the order of year of issuance and pro rata by year of issuance, until the total amount of such allocated surplus has been distributed
5. Holders of allocated surplus evidenced by nonqualified written notices of allocation, in the order of year of issuance and pro rata by year of issuance, until the total amount of such allocated surplus has been distributed
6. Any remaining assets of the Association after such distributions shall be distributed to past and present Patrons on a patronage basis, to the extent practicable.

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

The Association reports other comprehensive income (loss) in its Consolidated Statements of Changes in Members' Equity. During 2004, the District Associations funded the pension plans sufficiently to eliminate the pension-related component of other comprehensive income (loss) at December 31, 2004. See Note 12 for further information.

Note 11 — Income Taxes

The provision (benefit) for income taxes follows:

	Year Ended December 31, 2006	2005	2004
Current:			
Federal	$ (4)	$ (4)	$ 23
State	1	(1)	6
	(3)	(5)	29
Deferred:			
Federal	(23)	(3)	7
State	–	(1)	1
	(23)	(4)	8
Total provision (benefit) for income taxes	$ (26)	$ (9)	$ 37

The provision (benefit) for income tax differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as follows:

	December 31, 2006	2005	2004
Federal tax at statutory rate	$ 2,872	$ 2,171	$ 3,294
State tax, net	1	(1)	5
Patronage distributions	(1,059)	(503)	(855)
Tax-exempt FLCA earnings	(1,700)	(1,666)	(1,852)
Reversal of allowance for loan losses	–	–	(454)
Change in valuation allowance	20	53	–
Other	(160)	(63)	(101)
Provision (benefit) for income taxes	$ (26)	$ (9)	$ 37

Deferred tax assets and liabilities result from the following at:

	December 31, 2006	2005	2004
Deferred income tax assets:			
Allowance for loan losses	$ 12	$ 176	$ –
Annual leave	–	174	2
Nonaccrual loan interest	61	43	–
Postretirement benefits other than pensions	–	1,116	22
Depreciation	–	–	2
Gross deferred tax assets	73	1,509	26
Less: valuation allowance	(73)	(53)	–
Gross deferred tax assets, net of valuation allowance	–	1,456	26
Deferred income tax liabilities:			
Future Bank equity redemption	–	–	(42)
Pensions	–	(1,456)	(11)
Depreciation	–	(23)	–
Gross deferred tax liability	–	(1,479)	(53)
Net deferred tax asset (liability)	$ –	$ (23)	$ (27)

At December 31, 2006, deferred income taxes have not been provided by the Association on approximately $0.5 million of patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

The Association recorded a valuation allowance of $33 and $53 during 2006, and 2005, respectively. The Association will continue to evaluate the realizability of these deferred tax assets and adjust the valuation allowance accordingly.

Note 12 — Employee Benefit Plans

The employees of the Association may participate in a Districtwide defined benefit retirement plan. This plan is noncontributory and covers substantially all Association employees. Benefits are based on salary and years of service. The assets, liabilities and costs of the plan are not segregated by participating entities but are allocated among the participating entities. Pension costs are allocated by multiplying the District's net pension expense times the Association's salary expense as a percentage of the District's salary expense.

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

The Association participates in a Districtwide Thrift Plan. For employees hired on or prior to December 31, 2002, the Association will contribute $.50 for each $1.00 of the maximum employee contribution of 6 percent of total compensation. For employees hired on or after January 1, 2003, the Association will contribute $1.00 for each $1.00 of the maximum employee contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service.

The District sponsors a plan providing certain benefits (primarily health care) to its retirees. Certain Association charges related to this plan are an allocation of District charges based on the Association's proportional share of the plan liability.

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Act) was signed into law. This act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. In May 2004, the FASB issued FASB Staff Position (FSP) 106-2, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" (the Act). This Staff Position provides guidance on the accounting for the effects of the Act for employers that sponsor postretirement health care plans that provide prescription drug benefits. The District sponsored plan adopted FSP 106-2 effective July 1, 2004 (measured as of March 31, 2004). The benefit obligation valuation as of December 31, 2004 reflects the impact of the Medicare Act.

In determining the benefit obligation as of December 31, 2004, the expected per capita claims cost were estimated to be reduced by 12 percent beginning in 2006, for Medicare-eligible participants receiving actuarially equivalent drug benefits, due to a government reimbursement of a portion of prescription drug benefits. The District reduced its accumulated postretirement benefit obligation (APBO) for the subsidy related to benefits attributed to past service. The effect of the subsidy on the measurement of net periodic postretirement cost for 2005 was a reduction of 2005 expense. The effect included lower amortization of actuarial losses, lower service costs and lower interest costs on the APBO.

The Retiree and Disabled Medical Plan was amended effective January 1, 2006 to change the medical and prescription drug coverage for Medicare-eligible retirees and/or eligible spouses 65 years and older. Beginning in 2006, the AgFirst/FCBT Retiree and Disabled Medical Plan will provide medical and prescription drug coverage to Medicare-eligible retirees and/or eligible spouses 65 years and older through fully-insured AARP endorsed Medicare Supplement policies and subsidized basic Medicare D coverage through a selected Prescription Drug Plan. Dental coverage was not changed. Certain other retirees who are grandfathered under insured arrangements were not impacted by the change. The benefit obligation valuation as of December 31, 2005 reflects the impact of this plan amendment.

In determining the benefit obligation as of December 31, 2005, there was no impact due to government reimbursement of prescription drug benefits. After the plan amendment, the plan no longer provides prescription drug benefits directly for retirees and/or eligible spouses 65 years and older. Instead, the District subsidizes the cost of coverage obtained under the Medicare D program through the selected Prescription Drug Provider.

For further information on postretirement costs, see "Postretirement Benefits" section in the Notes to the AgFirst Farm Credit District Consolidated Financial Statements.

The following is a table of retirement and postretirement benefits expenses:

	2006	2005	2004
Pension	$ 393	$ 386	$ 447
Thrift/deferred compensation	117	86	70
Other postretirement benefits	280	477	574
Total	$ 790	$ 949	$1,091

For the years ended December 31, 2006, 2005 and 2004, the Association had contributed $0, $522 and $2,292, respectively, to the Districtwide defined benefit retirement plan, which was sufficient to meet its accumulated benefit obligation. For 2004, the contributions eliminated the minimum pension liability and the pension-related charge to accumulated other comprehensive income (OCI) in members' equity. As a result of the fundings and the reclassification of the OCI, the Association ended 2006, 2005 and 2004 with $2,689, $3,082 and $2,946, respectively, in Prepaid retirement expense in Other assets on the Consolidated Balance Sheets.

Note 13 — Intra-System Financial Assistance

The Farm Credit Act provided for capital assistance to System institutions experiencing severe financial stress through the issuance, prior to October 1, 1992, by the Financial Assistance Corporation of U.S. Treasury-guaranteed 15-year bonds, of which $1.261 billion in principal amount was originally issued. The last remaining Financial Assistance Corporation bonds matured and were repaid on June 10, 2005.

Pursuant to the Farm Credit Act, the U.S. Treasury paid $440 million, on behalf of the System, in interest costs on $844 million of the Financial Assistance Corporation bonds issued for purposes other than funding Capital Preservation Agreement accruals. The Banks had irrevocably set aside funds, including interest earned, that totaled the $440 million needed to repay the interest advanced by the U.S. Treasury. On June 10, 2005, the Banks repaid the U.S. Treasury the interest advanced. The Farm Credit Act provided that the Financial Assistance Corporation would continue in existence no longer than two years following the maturity of the debt in June 2005. The Financial Assistance Corporation was dissolved effective as of December 31, 2006.

Note 14 — Related Party Transactions

In the ordinary course of business, the Association enters into loan transactions with officers and directors of the Association, their immediate families and other organizations with which such persons may be associated. Such loans are subject to special approval requirements contained in the FCA regulations and are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

Total loans to such persons at December 31, 2006 amounted to $1,719. During 2006, $1,381 of new loans were made and repayments totaled $1,544. In the opinion of management, none of these loans outstanding at December 31, 2006 involved more than a normal risk of collectibility.

Note 15 — Commitments and Contingencies

The Association has various commitments outstanding and contingent liabilities.

The Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers and to manage their exposure to interest-rate risk. These financial instruments include commitments to extend credit and/or commercial letters of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2006, $63,702 of commitments to extend credit were outstanding. No commercial letters of credit were outstanding.

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the consolidated balance sheets until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. Outstanding standby letters of credit have expiration dates ranging from January 2, 2007 to December 31, 2011. The maximum potential amount of future payments the Association is required to make under the guarantees is $3,822.

During 2006, the Association agreed to become one of several investors in a USDA-approved Rural Business Investment Company (RBIC) whose mission is to promote economic development and job creation in rural areas. The total commitment to purchase equities was $250 of which $13 have been purchased as of December 31, 2006 and are included in Other Assets in the Consolidated Balance Sheets. At December 31, 2006, there is a remaining outstanding commitment of $237 to make additional equity purchases.

Note 16 — Disclosures About Fair Value of Financial Instruments

The following table presents the carrying amounts and fair values of the Association's financial instruments at December 31, 2006, 2005 and 2004. The fair value of a financial instrument is generally defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

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

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

	December 31, 2006		December 31, 2005	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash	$ 2	$ 2	$ –	$ –
Loans	$ 297,393	$ 304,861	$ 287,374	$ 288,068
Allowance for loan losses	243	–	1,011	–
Loans, net	$ 297,150	$ 304,861	$ 286,363	$ 288,068
Investment securities	$ 10,107	$ 10,126	$ 12,538	$ 12,521
Tobacco Buyout SIIC	$ 128,053	$ 125,500	$ 73,189	$ 72,275
Financial liabilities:				
Notes payable to AgFirst Farm Credit Bank	$ 402,799	$ 396,126	$ 334,915	$ 333,666

	December 31, 2004	
	Carrying Amount	Estimated Fair Value
Financial assets:		
Cash	$ 7	$ 7
Loans	$ 245,040	$ 246,829
Allowance for loan losses	1,000	–
Loans, net	$ 244,040	$ 246,829
Investment securities	$ 12,553	$ 12,816
Tobacco Buyout SIIC	$ –	$ –
Financial liabilities:		
Notes payable to AgFirst Farm Credit Bank	$ 222,656	$ 222,470

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 stocks are not traded. As described in Note 7, 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 4.16 percent of the issued stock of the Bank as of December 31, 2006 net of any reciprocal investment. As of that date, the Bank's assets totaled $24.4 billion and shareholders' equity totaled $1,181 million. The Bank's earnings were $190 million during 2006.

   In addition, the Association has an investment of $892 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 and Standby Letters of 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.

Note 17 — Quarterly Financial Information (Unaudited)

Quarterly results of operations for the years ended December 31, 2006, 2005 and 2004 follow:

	2006				
	First	**Second**	**Third**	**Fourth**	**Total**
Net interest income	$ 2,026	$ 2,193	$ 2,355	$ 2,096	$ 8,670
Provision for (reversal of allowance for) loan losses	(211)	–	–	(512)	(723)
Noninterest income (expense), net	(296)	(45)	55	(635)	(921)
Net income	$ 1,941	$ 2,148	$ 2,410	$ 1,973	$ 8,472

	2005				
	First	**Second**	**Third**	**Fourth**	**Total**
Net interest income	$ 1,843	$ 1,902	$ 2,017	$ 1,979	$ 7,741
Provision for (reversal of allowance for) loan losses	–	–	–	–	–
Noninterest income (expense), net	(363)	(91)	(234)	(657)	(1,345)
Net income	$ 1,480	$ 1,811	$ 1,783	$ 1,322	$ 6,396

	2004				
	First	**Second**	**Third**	**Fourth**	**Total**
Net interest income	$ 1,490	$ 1,654	$ 1,529	$ 1,764	$ 6,437
Provision for (reversal of allowance for) loan losses	–	–	–	(4,413)	(4,413)
Noninterest income (expense), net	(533)	(333)	(325)	(8)	(1,199)
Net income	$ 957	$ 1,321	$ 1,204	$ 6,169	$ 9,651