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**ArborOne, ACA**

**FIRST QUARTER 2010**

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**CERTIFICATION**

The undersigned certify that we have reviewed the March 31, 2010 quarterly report of **ArborOne, ACA**, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.



Jasper W. Shuler  
Chief Executive Officer



Tammy G. Smith  
Chief Financial Officer



James M. Ward  
Chairman of the Board

May 7, 2010

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**ArborOne, ACA**

# **Report on Internal Control Over Financial Reporting**

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

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

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of March 31, 2010. In making the assessment, management used the framework in *Internal Control — Integrated Framework*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association concluded that as of March 31, 2010, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of March 31, 2010.



Jasper W. Shuler  
Chief Executive Officer



Tammy G. Smith  
Chief Financial Officer

May 7, 2010

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

*(dollars in thousands)*

The following commentary reviews the financial condition and results of operations of **ArborOne, ACA**, (Association) for the period ended March 31, 2010. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2009 Annual Report of the Association. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

## LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans. The Association's loan portfolio is diversified over a range of agricultural commodities in our region, including tobacco, poultry, swine and forestry. Farm size varies and many of the borrowers in the region have diversified farming operations. These factors, along with the numerous opportunities for non-farm income in the area, somewhat impact the level of dependency on a given commodity. Approximately twenty-nine percent of the portfolio has significant outside income to diversify dependence on agriculture, consisting of lifestyle loans and loans to less than full-time farmers with retirement income, salaried income and non-agricultural business income. Further, approximately seventeen percent of the assets carry federal guarantees as a risk management tool.

The gross loan volume of the Association as of March 31, 2010, was \$265,510, a decrease of \$3,845 as compared to \$269,355 at December 31, 2009. Net loans outstanding at March 31, 2010, were \$264,338 as compared to \$268,185 at December 31, 2009. During the three months ended March 31, 2010, the Association's sold participations to **AgFirst Farm Credit Bank** (the Bank) decreased by \$11,404. As of March 31, 2010, the Association had \$96,730 of such participations outstanding. The Association has investment securities that are classified as available for sale in the amount of \$1,096 at March 31, 2010 compared to \$21,103 at December 31, 2009. The Association entered into commitments to acquire Successor-in-Interest Contracts (SIIC), beginning in the fourth quarter of 2005. As of March 31, 2010, the Association had \$81,128 in other investments for SIIC, compared to \$101,922 at December 31,

2009. Net loans and investments accounted for 93.68 percent of total assets at March 31, 2010, as compared to 93.12 percent of total assets at December 31, 2009.

Net loans and investments decreased by \$44,307 during the reporting period. The decrease in loan volume is primarily due to a decrease in gross loan volume, and was partially offset by a decrease in participations sold loan volume. The Association has tightened its lending policies as well as strengthened its capital position.

Investment securities available for sale decreased by \$20,007 and investments held to maturity increased by \$341. The decrease in investment securities available for sale was due to the sale of twelve investment securities which include four Agency mortgage-backed securities (MBAs), two Non-Agency MBAs and six asset backed securities (ABSs) in the amount of \$18,866 with a net realized loss of \$85. Normal principal pay downs during the quarter totaled \$1,308. The remaining two Non-Agency investment securities had an unrealized loss of \$392 as of March 31, 2010 which is an improvement of \$281 as compared to December 31, 2009. The investments held to maturity increased due to the funding of one Rural America Bond. The other investments for SIIC decreased by \$20,794, which was due to the annual payments on the contracts and partially offset by purchasing additional contracts in the amount of \$653. The Association continues to review and engage in investments in Rural America and participation opportunities, while serving customers within the territory.

There is an inherent risk in the extension of any type of credit. However, portfolio credit quality continues to be maintained at an acceptable level, and credit administration remains satisfactory. Nonaccrual loans increased from \$12,414 at December 31, 2009, to \$13,006 at March 31, 2010. This was due to one large participation account that was moved to nonaccrual status, partially offset by one participation loan that was reinstated to accruing status.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on credit quality, current conditions, and expected future conditions. The allowance for loan losses at March 31, 2010, was \$1,172, compared to \$1,170 at December 31, 2009. There were recoveries of \$532 for the three months ended March 31, 2010 of which \$515 was attributed to one participation loan. The charge-offs for

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the period ended March 31, 2010 were \$22 of which one was a participation loan and four were core agricultural loans. Reversals were made to the allowance during the first quarter in the amount of \$508. The allowance for loan losses for the period ending March 31, 2010, is considered by management to be adequate to cover any future possible losses.

## RESULTS OF OPERATIONS

### *For the three months ended March 31, 2010*

Net income for the three months ended March 31, 2010, totaled \$2,424, as compared to \$798 for the same period in 2009. Net interest income increased \$315, for the three months ended March 31, 2010, as compared to the same period in 2009. Interest expense decreased by \$430.

Interest income on accruing loans decreased by \$549 for the three months ended March 31, 2010 compared to \$3,939 for the three months ended March 31, 2009. Nonaccrual income was \$130 for the three months ended March 31, 2010, as compared to \$4 for the same period in 2009. Interest income on investment securities was \$649 compared to \$144 for the same period in 2009. Interest income on other investments (SIIC) was \$1,062 for the three months ended March 31, 2010, and \$1,259 for the same period in 2009. Interest expense decreased \$430 for the three months ended March 31, 2010, as compared to the comparable period of 2009. The interest expense decrease was a result of decreased loan and investment volume as well as a decrease in rates. The Association recorded a reversal of allowance for loan losses of \$508 for the quarter compared to the provision of \$667 for the comparable period of 2009.

Noninterest income for the three months ended March 31, 2010, totaled \$2,257 as compared to \$2,109 for the same period of 2009, an increase of \$148. The increase is primarily the result of insurance premium refunds. During the first quarter of 2010, the Association recorded \$380 of insurance premium refunds from the Farm Credit System Insurance Corporation (FCSIC), which insures the System's debt obligations. These payments are nonrecurring and resulted from the assets of the Farm Credit Insurance Fund exceeding the secure base as defined by the Farm Credit Act. Patronage income for loans sold to the Bank was higher as of March 31, 2010 compared to March 31, 2009 attributed mainly to \$102 in insurance premium refunds from FCSIC. Noninterest expense for the three months ended March 31, 2010, increased \$18 compared to the same period of 2009. Increases in salaries and employee benefits and other operating expenses were primarily offset by decreases in occupancy and equipment

and insurance fund premiums. The Association did not record a provision for income taxes for the three months ended March 31, 2010 compared to \$6 for the three months ended March 31, 2009.

## FUNDING SOURCES

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The funds are advanced by the Bank to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at March 31, 2010, was \$337,487 as compared to \$388,123 at December 31, 2009. The decrease during the period is primarily attributable to decreased loan and investment volume.

In September 2008, the Association issued \$7,500 of fixed rate unsecured subordinated debt due in 2018, generating proceeds that were primarily used to increase the permanent capital of the Association pursuant to the Farm Credit Administration regulations, and for general corporate purposes. The debt is payable to another association in the Farm Credit System (System). It is subordinate to all other categories of creditors, including any claims of the Bank and general creditors, and is senior to all classes of shareholders. The subordinated debt is not considered System debt, and thus is not guaranteed by the System and not insured by the Farm Credit System Insurance Corporation.

## CAPITAL RESOURCES

Total members' equity at March 31, 2010, increased to \$56,657 from the December 31, 2009, total of \$53,937. The increase is primarily attributable to the increase in retained earnings in excess of the reduction of protected stock and revolved equities, along with a decrease in other comprehensive losses.

Total capital stock and participation certificates were \$1,440 on March 31, 2010, compared to \$1,470 on December 31, 2009. This decrease is attributed to the retirement of protected stock and participation certificates on loans liquidated in the normal course of business and the annual retirement of B stock.

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The Association reports other comprehensive income (loss) (OCI) in its Consolidated Statements of Changes in Members' Equity. The Association has an unrealized OCI loss of \$93 as of March 31, 2010, as compared to \$110 in 2009 for FAS 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." The Association also has an unrealized OCI loss of \$392 as of March 31, 2010 as compared to \$673 as of March 31, 2009 on investments available for sale.

Farm Credit Administration (FCA) regulations require all Farm Credit institutions to maintain minimum permanent capital, total surplus and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus and core surplus as defined in FCA regulations, by a risk-adjusted asset base. As of March 31, 2010, the Association's total surplus ratio and core surplus ratio were 17.46 percent and 14.63 percent, respectively, and the permanent capital ratio was 17.92 percent. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

#### **Recently Issued Accounting Pronouncements**

Please refer to Note 1, "Organization, Significant Accounting Policies, and Recently Issued Accounting Pronouncements", in the Notes to the Financial Statements, and the 2009 Annual Report to Shareholders for recently issued accounting pronouncements.

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**NOTE:** Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst's Annual and Quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Stephen Gilbert, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, [www.agfirst.com](http://www.agfirst.com). Copies of the Association's Annual and Quarterly reports are also available upon request free of charge by calling 1-800-741-7332, writing Casey Sherman, Corporate Secretary, ArborOne, ACA, P.O. Box 3699, Florence, SC 29502, or accessing the website, [www.arborone.com](http://www.arborone.com). The Association prepares a quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

# ArborOne, ACA

## Consolidated Balance Sheets

| <i>(dollars in thousands)</i>   | March 31,<br>2010<br><i>(unaudited)</i> | December 31,<br>2009<br><i>(audited)</i> |
|---|---|--|
| <b>Assets</b>   |   |  |
| Cash  | \$ 105                                  | \$ 56                                    |
| Investment securities:  |   |  |
| Available for sale (amortized cost of \$1,488<br>and \$21,777 respectively) | 1,096                                   | 21,103                                   |
| Held to maturity (fair value of \$34,112<br>and \$29,929 respectively)      | 36,460                                  | 36,119                                   |
| Total investment securities   | 37,556                                  | 57,222                                   |
| Loans   | 265,510                                 | 269,355                                  |
| Less: allowance for loan losses   | 1,172                                   | 1,170                                    |
| Net loans   | 264,338                                 | 268,185                                  |
| Other investments   | 81,128                                  | 101,922                                  |
| Accrued interest receivable   | 2,966                                   | 3,153                                    |
| Investment in other Farm Credit institutions                                | 15,463                                  | 16,348                                   |
| Premises and equipment, net   | 731                                     | 765                                      |
| Other property owned  | 680                                     | 765                                      |
| Due from AgFirst Farm Credit Bank   | 1,610                                   | 5,975                                    |
| Other assets  | 4,288                                   | 4,516                                    |
| Total assets  | \$ 408,865                              | \$ 458,907                               |
| <b>Liabilities</b>  |   |  |
| Notes payable to AgFirst Farm Credit Bank                                   | \$ 337,487                              | \$ 388,123                               |
| Subordinated debt payable to other Farm Credit<br>institutions (Note 5)     | 7,500                                   | 7,500                                    |
| Accrued interest payable  | 1,190                                   | 1,326                                    |
| Patronage refund payable  | 269                                     | 1,484                                    |
| Other liabilities   | 5,762                                   | 6,537                                    |
| Total liabilities   | 352,208                                 | 404,970                                  |
| Commitments and contingencies   |   |  |
| <b>Members' Equity</b>  |   |  |
| Protected borrower equity   | 292                                     | 324                                      |
| Capital stock and participation certificates                                | 1,148                                   | 1,146                                    |
| Retained earnings   |   |  |
| Allocated   | 32,343                                  | 32,406                                   |
| Unallocated   | 23,358                                  | 20,844                                   |
| Accumulated other comprehensive income (loss)                               | (484)                                   | (783)                                    |
| Total members' equity   | 56,657                                  | 53,937                                   |
| Total liabilities and members' equity                                       | \$ 408,865                              | \$ 458,907                               |

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

# ArborOne, ACA

## Consolidated Statements of Income

(unaudited)

For the three months  
ended March 31,

| <i>(dollars in thousands)</i>   | 2010     | 2009   |
|---|----------|--------|
| <b>Interest Income</b>  |          |        |
| Investment securities   | \$ 649   | \$ 144 |
| Loans   | 3,520    | 3,944  |
| Other   | 1,062    | 1,258  |
| Total interest income   | 5,231    | 5,346  |
| <b>Interest Expense</b>   |          |        |
| Notes payable to AgFirst Farm Credit Bank                                       | 3,392    | 3,822  |
| Subordinated debt payable to other Farm Credit institutions (Note 4)            | 169      | 169    |
| Total interest expense  | 3,561    | 3,991  |
| Net interest income   | 1,670    | 1,355  |
| Provision for (reversal of allowance for) loan losses                           | (508)    | 667    |
| Net interest income after provision for (reversal of allowance for) loan losses | 2,178    | 688    |
| <b>Noninterest Income</b>   |          |        |
| Loan fees   | 344      | 486    |
| Fees for financially related services   | 16       | 56     |
| Equity in earnings of other Farm Credit institutions                            | 1,623    | 1,477  |
| Gains (losses) on other property owned, net                                     | (85)     | —      |
| Gains (losses) on sale of rural home loans, net                                 | —        | 1      |
| Gains (losses) on sales of investment securities, net                           | (85)     | —      |
| Insurance Fund refund   | 380      | —      |
| Other noninterest income  | 64       | 89     |
| Total noninterest income  | 2,257    | 2,109  |
| <b>Noninterest Expense</b>  |          |        |
| Salaries and employee benefits  | 1,323    | 1,261  |
| Occupancy and equipment   | 238      | 253    |
| Insurance Fund premium  | 54       | 99     |
| Other operating expenses  | 396      | 380    |
| Total noninterest expense   | 2,011    | 1,993  |
| Income before income taxes  | 2,424    | 804    |
| Provision (benefit) for income taxes  | —        | 6      |
| Net income  | \$ 2,424 | \$ 798 |

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

**ArborOne, ACA**  
**Consolidated Statements of Changes in**  
**Members' Equity**

*(unaudited)*

|   | Protected<br>Borrower<br>Capital | Capital<br>Stock and<br>Participation<br>Certificates | Retained Earnings |             | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Total<br>Members'<br>Equity |
|---|----------------------------------|---|-------------------|-------------|--|-----------------------------|
|   |                                  |   | Allocated         | Unallocated |  |                             |
| <i>(dollars in thousands)</i>   |                                  |   |                   |             |  |                             |
| Balance at December 31, 2008  | \$ 371                           | \$ 1,205  | \$ 30,751         | \$ 20,738   | \$ (1,976)   | \$ 51,089                   |
| Comprehensive income  |                                  |   |                   |             |  |                             |
| Net income  |                                  |   |                   | 798         |  | 798                         |
| Unrealized gains (losses) on investments available<br>for sale, net of reclassification adjustments |                                  |   |                   |             | 10   | 10                          |
| Employee benefit plans adjustments  |                                  |   |                   |             | 23   | 23                          |
| Total comprehensive income  |                                  |   |                   |             |  | 831                         |
| Protected borrower equity retired   | (31)                             |   |                   |             |  | (31)                        |
| Capital stock/participation<br>certificates issued/(retired), net                                   |                                  | (18)  |                   |             |  | (18)                        |
| Patronage distribution adjustment   |                                  |   | 368               | (647)       |  | (279)                       |
| Balance at March 31, 2009   | \$ 340                           | \$ 1,187  | \$ 31,119         | \$ 20,889   | \$ (1,943)   | \$ 51,592                   |
| Balance at December 31, 2009  | \$ 324                           | \$ 1,146  | \$ 32,406         | \$ 20,844   | \$ (783)   | \$ 53,937                   |
| Comprehensive income  |                                  |   |                   |             |  |                             |
| Net income  |                                  |   |                   | 2,424       |  | 2,424                       |
| Unrealized gains (losses) on investments available<br>for sale:                                     |                                  |   |                   |             |  |                             |
| Other-than-temporarily impaired (Note 2)  |                                  |   |                   |             | 12   |                             |
| Temporarily impaired (Note 2)   |                                  |   |                   |             | 269  |                             |
| Total unrealized gains (losses) on investments available<br>for sale                                |                                  |   |                   |             |  | 281                         |
| Employee benefit plans adjustments  |                                  |   |                   |             | 18   | 18                          |
| Total comprehensive income  |                                  |   |                   |             |  | 2,723                       |
| Protected borrower equity retired   | (32)                             |   |                   |             |  | (32)                        |
| Capital stock/participation<br>certificates issued/(retired), net                                   |                                  | 2   |                   |             |  | 2                           |
| Patronage distribution adjustment   |                                  |   | (63)              | 90          |  | 27                          |
| Balance at March 31, 2010   | \$ 292                           | \$ 1,148  | \$ 32,343         | \$ 23,358   | \$ (484)   | \$ 56,657                   |

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

# Notes to the Consolidated Financial Statements

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

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

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

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

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

The Association maintains an allowance for loan losses in accordance with GAAP. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of March 31, 2010 the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

In addition to the recently issued accounting pronouncements discussed in the 2009 Annual Report to Shareholders, in June 2009, the Financial Accounting Standards Board (FASB) issued guidance "Accounting for Transfers of Financial Assets," which amended previous guidance by improving the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets.

This guidance was effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application was prohibited. This guidance must be applied to transfers occurring on or after the effective date. Additionally, on and after the effective date, the concept of a qualifying special purpose entity is no longer relevant for accounting purposes. Therefore, formerly qualifying special-purpose entities (as defined under previous accounting guidance) should be evaluated for consolidation by reporting entities on and after the effective date in accordance with the applicable consolidation guidance. If the evaluation on the effective date results in consolidation, the reporting entity should apply the transition guidance that requires consolidation. The Association evaluated the impact of adoption on its loan participation agreements to ensure that participations would meet the requirements for sales treatment. The impact of adoption on January 1, 2010 was immaterial to the Association's financial condition and results of operations.

In June 2009, the FASB also issued guidance, to improve financial reporting for those enterprises involved with variable interest entities, which amends previous guidance by requiring an enterprise to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity.

Additionally, an enterprise is required to assess whether it has an implicit financial responsibility to ensure that a variable interest entity operates as designed when determining whether it has the power to direct the activities of the variable interest entity that most significantly impact the entity's economic performance.

This guidance was effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application was prohibited. The Association does not have any variable interest or controlling interest in a variable entity. Therefore, there was no impact of adoption of the guidance for the Association.

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

a greater level of disaggregated information and more detailed disclosures of valuation techniques and inputs to fair value measurement. The new disclosures and clarification of existing disclosures were effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the rollforward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this guidance had no impact on the Association's financial condition and results of operations but resulted in additional disclosures (see Note 6).

## NOTE 2 – INVESTMENT SECURITIES

A summary of the amortized cost and fair value of investment securities held as available-for-sale at March 31, 2010 and December 31, 2009 follows:

|                         | March 31, 2010    |                        |                         |            |       |
|-------------------------|-------------------|------------------------|-------------------------|------------|-------|
|                         | Amortized Cost    | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Yield |
| Commercial MBS          | \$ 1,488          | \$ –                   | \$ (392)                | \$ 1,096   | 7.49% |
|                         | December 31, 2009 |                        |                         |            |       |
|                         | Amortized Cost    | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Yield |
| Commercial MBS          | \$ 10,354         | \$ –                   | \$ (540)                | \$ 9,814   | 1.34% |
| Asset-backed Securities | 11,423            | –                      | (134)                   | 11,289     | 1.19  |
| Total                   | \$ 21,777         | \$ –                   | \$ (674)                | \$21,103   | 1.26% |

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

|                             | March 31, 2010    |                        |                         |            |       |
|-----------------------------|-------------------|------------------------|-------------------------|------------|-------|
|                             | Amortized Cost    | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Yield |
| Mission Related Investments | \$36,460          | \$ –                   | \$ (2,348)              | \$34,112   | 6.42% |
|                             | December 31, 2009 |                        |                         |            |       |
|                             | Amortized Cost    | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Yield |
| Mission Related Investments | \$36,119          | \$ –                   | \$ (6,190)              | \$29,929   | 6.43% |

A summary of the expected maturity, amortized cost and estimated fair value of investment securities at March 31, 2010 follows:

### Available-for-Sale:

|                                    | Amortized Cost | Fair Value | Weighted Average Yield |
|------------------------------------|----------------|------------|------------------------|
| In one year or less                | \$ –           | \$ –       | –%                     |
| After one year through five years  | –              | –          | –                      |
| After five years through ten years | –              | –          | –                      |
| After ten years                    | 1,488          | 1,096      | 7.49                   |
| Total                              | \$ 1,488       | \$ 1,096   | 7.49%                  |

### Held-to-Maturity:

|                                    | Amortized Cost | Fair Value | Weighted Average Yield |
|------------------------------------|----------------|------------|------------------------|
| In one year or less                | \$ –           | \$ –       | –%                     |
| After one year through five years  | –              | –          | –                      |
| After five years through ten years | 981            | 997        | 7.75                   |
| After ten years                    | 34,479         | 33,115     | 6.37                   |
| Total                              | \$ 36,460      | \$ 34,112  | 6.42%                  |

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.

During March 2010, the Association sold six mortgage-backed securities (MBSs) and six asset backed securities (ABSs) in the amount of \$18,866 with a realized loss of \$85. The Association's investments as of March 31, 2010 consist of two Non-Agency MBSs, one of which has an AAA credit rating.

MBSs are held for maintaining a liquidity reserve, managing short-term surplus funds and managing interest rate risk. These securities must meet the applicable Farm Credit Administration (FCA) regulatory guidelines, which require these securities to be high quality, senior class, and rated AAA at the time of purchase. To achieve the ratings, these securities have a guarantee of timely payment of principal and interest or credit enhancement achieved through over collateralization and the priority of payments of senior classes over junior classes. The FCA considers an MBS investment ineligible if it falls below the AAA credit rating criteria and requires System institutions to divest of such an investment unless approval is granted by the FCA to continue to hold. For the one investment security in the Association's portfolio at March 31, 2010 rated below AAA (total fair value of \$682 and amortized cost of \$973), the Association has received approval, with conditions, from the FCA to hold the security until maturity. The only other investment security held by the Association at March 31, 2010 is considered eligible under FCA regulatory guidelines.

Mission related investments consist of private placement securities purchased under the Rural America Bond Program approved by the FCA.

An investment is considered impaired if its fair value is less than its cost. A continuous unrealized loss position for an investment is based on the date the impairment was first identified. The following table shows the fair value and gross unrealized losses for investments that have been in a continuous unrealized loss position aggregated by investment category at March 31, 2010:

|                             | Less than<br>12 Months |                      | Greater than<br>12 Months |                      |
|-----------------------------|------------------------|----------------------|---------------------------|----------------------|
|                             | Fair<br>Value          | Unrealized<br>Losses | Fair<br>Value             | Unrealized<br>Losses |
| Mission related investments | \$ 31,411              | \$ (1,867)           | \$ 2,701                  | \$ (481)             |
| Commercial MBS              | -                      | -                    | 1,096                     | (392)                |
| Total                       | \$ 31,411              | \$ (1,867)           | \$ 3,797                  | \$ (873)             |

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

Based on the results of all analyses, the Association has not recognized any other-than-temporary impairment during 2010 as the unrealized losses resulted from non-credit related factors. The Association has the ability and intent to hold all these temporarily impaired investments until a recovery of unrealized losses occurs, which may be at maturity, and at this time expects to collect the full principal amount and interest due on these securities, especially after considering credit enhancements. The Association does not intend to sell these investments and it is not more likely than not that the Association would be required to sell these investments before recovering its costs. All securities continue to perform.

The following schedule details the activity related to cumulative credit losses on investments recognized in earnings as of March 31, 2010. The Association initially recognized other-than-temporary impairment and related credit loss during the fourth quarter of 2009. Credit loss is defined as the shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis.

|   | For the three months<br>ended March 31, 2010 |     |
|---|--|-----|
| <b>Beginning balance at January 1, 2010</b>   | \$   | 286 |
| Additions for the amount related to credit loss for which other-than-temporary impairment was not previously recognized |  | -   |
| Additions for the amount related to credit loss for which other-than-temporary impairment was previously recognized     |  | -   |
| <b>Ending balance at March 31, 2010</b>   | \$   | 286 |

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

An analysis of the allowance for loan losses follows:

|   | For the three months<br>ended March 31, |          |
|---|---|----------|
|   | 2010                                    | 2009     |
| Balance at beginning of period          | \$ 1,170                                | \$ 1,911 |
| Provision for (reversal of) loan losses | (508)                                   | 667      |
| Charge-offs                             | (22)                                    | (1,677)  |
| Recoveries                              | 532                                     | 3        |
| Balance at end of period                | \$ 1,172                                | \$ 904   |

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

|  | 2010   | 2009   |
|--|--------|--------|
| Impaired loans with related allowance    | \$ -   | \$ -   |
| Impaired loans with no related allowance | 16,585 | 10,603 |
| Total impaired loans                     | 16,585 | 10,603 |
| Allowance on impaired loans              | \$ -   | \$ -   |

The following table summarizes impaired loan information for the three months ended March 31,

|  | 2010      | 2009     |
|--|-----------|----------|
| Average impaired loans                       | \$ 16,293 | \$ 8,026 |
| Interest income recognized on impaired loans | 131       | 6        |

#### NOTE 4 – EMPLOYEE BENEFIT PLANS

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

|                               | For the three months ended March 31, |               |
|-------------------------------|--------------------------------------|---------------|
|                               | 2010                                 | 2009          |
| Pension                       | \$ 326                               | \$ 292        |
| 401(k)                        | 31                                   | 28            |
| Other postretirement benefits | 47                                   | 60            |
| Total                         | <u>\$ 404</u>                        | <u>\$ 380</u> |

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

|                               | Actual YTD Through 3/31/10 | Projected Contributions For Remainder of 2010 | Projected Total Contributions 2010 |
|-------------------------------|----------------------------|---|------------------------------------|
| Pension                       | \$ –                       | \$ 1,028                                      | \$ 1,028                           |
| Other postretirement benefits | 53                         | 87  | 140                                |
| Total                         | <u>\$ 53</u>               | <u>\$ 1,115</u>                               | <u>\$ 1,168</u>                    |

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

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

#### NOTE 5 – SUBORDINATED DEBT

In September 2008, the Association issued \$7,500 of fixed rate unsecured subordinated debt due in 2018, generating proceeds that were primarily used to increase the permanent capital of the Association pursuant to the Farm Credit Administration regulations, and for general corporate purposes. The debt is payable to another association in the AgFirst District. It is subordinate to all other categories of creditors, including any claims of the Bank and general creditors, and is senior to all classes of shareholders. The subordinated debt is not considered Farm Credit System (System) debt, and thus is not guaranteed by the System and not insured by the Farm Credit System Insurance Corporation.

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

#### NOTE 6 – FAIR VALUE MEASUREMENT

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

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

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

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

### Level 1

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets. The Association's Level 1 assets at March 31, 2010 consist of assets held in trust funds related to deferred compensation and supplemental retirement plans. The trust funds include investments in securities that are actively traded and have quoted net asset value prices that are directly observable in the marketplace.

### Level 2

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability. The Association has Level 2 assets and no Level 2 liabilities measured at fair value on a recurring basis. Level 2 assets include available-for-sale investment securities that are traded in active, non-exchange markets. These securities are Non-Agency mortgage-backed securities, which have unadjusted values from third-party or internal pricing models. The fair value of the Association's available-for-sale investment securities is determined from third-party valuation services that estimate current market prices. Inputs and assumptions related to third-party market valuation services are typically observable in the marketplace. Such services incorporate prepayment assumptions and underlying mortgage-backed collateral information to generate cash flows that are discounted using appropriate benchmark interest rate curves and volatilities. Third-party valuations also incorporate information regarding broker/dealer quotes, available trade information, historical cash flows, credit ratings, and other market information. Such valuations represent an estimated exit price, or price to be received by a seller in active markets to sell the investment securities to a willing participant.

### Level 3

Level 3 inputs to the valuation methodology are unobservable and supported by little or no market activity. Valuation is determined using pricing models, discounted cash flow methodologies, or similar techniques, and could include significant management judgment or estimation. Level 3 assets and liabilities also could include instruments whose price has been adjusted based on dealer quoted pricing that is different than the third-party valuation or internal model pricing.

Level 3 assets include impaired loans which represent the fair value of certain loans that were evaluated for impairment under FASB guidance. The fair value was based upon the underlying collateral since these were collateral-dependent loans. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established.

Other property owned is classified as a Level 3 asset at March 31, 2010. The fair value for other property owned is based upon the collateral value. Costs to sell represent transaction costs and are not included as a component of the fair value of other property owned. Level 3 liabilities at March 31, 2010 include standby letters of credit whose market value is internally calculated based on information that is not observable either directly or indirectly in the marketplace.

### Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following tables present the assets and liabilities that are measured at fair value on a recurring basis at March 31, 2010 and December 31, 2009 for each of the fair value hierarchy levels:

|                                 | March 31, 2010 |          |         | Total      |
|---------------------------------|----------------|----------|---------|------------|
|                                 | Level 1        | Level 2  | Level 3 | Fair Value |
| <b>Assets:</b>                  |                |          |         |            |
| Investments available-for-sale: |                |          |         |            |
| Commercial MBS securities       | \$ -           | \$ 1,096 | \$ -    | \$ 1,096   |
| Total                           | -              | 1,096    | -       | 1,096      |
| Assets held in trust funds      | 4              | -        | -       | 4          |
| Total Assets                    | \$ 4           | \$ 1,096 | \$ -    | \$ 1,100   |
| <b>Liabilities:</b>             |                |          |         |            |
| Standby letters of credit       | \$ -           | \$ -     | \$ 43   | \$ 43      |
| Total Liabilities               | \$ -           | \$ -     | \$ 43   | \$ 43      |

|                                    | December 31, 2009 |            |            | Total<br>Fair<br>Value |
|------------------------------------|-------------------|------------|------------|------------------------|
|                                    | Level<br>1        | Level<br>2 | Level<br>3 |                        |
| <b>Assets:</b>                     |                   |            |            |                        |
| Investments<br>available-for-sale: |                   |            |            |                        |
| Commercial                         | \$ -              | \$ 9,814   | \$ -       | \$ 9,814               |
| MBS                                |                   |            |            |                        |
| Asset-backed<br>securities         | -                 | 11,289     | -          | 11,289                 |
| Total                              | -                 | 21,103     | -          | 21,103                 |
| Assets held in<br>trust funds      | 4                 | -          | -          | 4                      |
| Total Assets                       | \$ 4              | \$ 21,103  | \$ -       | \$ 21,107              |
| <b>Liabilities:</b>                |                   |            |            |                        |
| Standby letters<br>of credit       | \$ -              | \$ -       | \$ 50      | \$ 50                  |
| Total Liabilities                  | \$ -              | \$ -       | \$ 50      | \$ 50                  |

The following tables present the changes in Level 3 assets and liabilities measured at fair value on a recurring basis for the three months ended March 31, 2010 and 2009. The Association had no transfers of assets or liabilities into or out of Level 1 or Level 2 during the first three months of 2010 and 2009.

|   | Standby<br>Letters<br>Of Credit |
|---|---------------------------------|
| Balance at January 1, 2010                              | \$ 50                           |
| <b>Total gains or (losses)<br/>realized/unrealized:</b> |                                 |
| Included in earnings                                    | -                               |
| Included in other<br>comprehensive loss                 | -                               |
| Purchases, sales, issuances<br>and settlements, net     | (7)                             |
| Transfers in and/or out of level 3                      | -                               |
| Balance at March 31, 2010                               | \$ 43                           |

|   | Standby<br>Letters<br>Of Credit |
|---|---------------------------------|
| Balance at January 1, 2009                              | \$ 22                           |
| <b>Total gains or (losses)<br/>realized/unrealized:</b> |                                 |
| Included in earnings                                    | -                               |
| Included in other<br>comprehensive loss                 | -                               |
| Purchases, sales, issuances<br>and settlements, net     | 12                              |
| Transfers in and/or out of level 3                      | -                               |
| Balance at March 31, 2009                               | \$ 34                           |

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

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

|                            | March 31, 2010 |            |            |                        | YTD<br>Total<br>Gains<br>(Losses) |
|----------------------------|----------------|------------|------------|------------------------|-----------------------------------|
|                            | Level<br>1     | Level<br>2 | Level<br>3 | Total<br>Fair<br>Value |                                   |
| <b>Assets:</b>             |                |            |            |                        |                                   |
| Impaired<br>loans          | \$ -           | \$ -       | \$ -       | \$ -                   | \$ 510                            |
| Other<br>property<br>owned | \$ -           | \$ -       | \$ 686     | \$ 686                 | \$ (85)                           |

|                            | December 31, 2009 |            |            |                        | YTD<br>Total<br>Gains<br>(Losses) |
|----------------------------|-------------------|------------|------------|------------------------|-----------------------------------|
|                            | Level<br>1        | Level<br>2 | Level<br>3 | Total<br>Fair<br>Value |                                   |
| <b>Assets:</b>             |                   |            |            |                        |                                   |
| Impaired<br>loans          | \$ -              | \$ -       | \$ -       | \$ -                   | \$ (1,909)                        |
| Other<br>property<br>owned | \$ -              | \$ -       | \$ 765     | \$ 765                 | \$ (41)                           |

### NOTE 7 — DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the carrying amounts and fair values of the Association's financial instruments at March 31, 2010 and December 31, 2009.

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

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

|  | March 31, 2010  |                      | December 31, 2009 |                      |
|--|-----------------|----------------------|-------------------|----------------------|
|  | Carrying Amount | Estimated Fair Value | Carrying Amount   | Estimated Fair Value |
| <b>Financial assets:</b>                                   |                 |                      |                   |                      |
| Cash   | \$ 105          | \$ 105               | \$ 56             | \$ 56                |
| Loans, net of allowance                                    | \$ 264,338      | \$ 268,835           | \$ 268,185        | \$ 272,266           |
| Investment securities                                      | \$ 37,556       | \$ 35,208            | \$ 57,222         | \$ 51,032            |
| Tobacco Buyout SIIC  | \$ 81,128       | \$ 87,387            | \$ 101,922        | \$ 108,223           |
| Assets held in trust funds                                 | \$ 4            | \$ 4                 | \$ 4              | \$ 4                 |
| <b>Financial liabilities:</b>                              |                 |                      |                   |                      |
| Notes payable to AgFirst Farm Credit Bank                  | \$ 337,487      | \$ 353,477           | \$ 388,123        | \$ 410,258           |
| Subordinate debt payable to other Farm Credit institutions | \$ 7,500        | \$ 8,145             | \$ 7,500          | \$ 7,963             |

A description of the methods and assumptions used to estimate the fair value of each class of the Association's financial instruments for which it is practicable to estimate that value follows:

- A. **Cash:** The carrying value is primarily a reasonable estimate of fair value.
- B. **Loans:** Because no active market exists for the Association's loans, fair value is estimated by discounting the expected future cash flows using the Association's current interest rates at which similar loans would be made to borrowers with similar credit risk. Discount rates are based on the Bank's loan rates as well as management estimates.

For purposes of determining fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics based upon repricing and credit risk. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

Fair value of loans in a nonaccrual status is estimated to be the carrying amount of the loan less specific reserves.

The carrying value of accrued interest approximates its fair value.

- C. **Investment Securities:** For MBSs, fair value is primarily based upon prices obtained from a third party valuation service. See Note 6 for additional information. For mission related investments, fair value is determined by discounting the expected future cash flows using appropriate interest rates for similar assets.

- D. **Tobacco Buyout SIIC:** Fair value is determined by discounting the expected future cash flows using current interest rates for similar assets.

- E. **Assets Held in Trust Funds:** See Note 6 for discussion of estimation of fair value for this instrument.

- F. **Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** Estimating the fair value of the Association's investment in the Bank and Other Farm Credit Institutions is not practicable because the stock is not traded. The net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying Consolidated Balance Sheets. The Association owns 3.87 percent of the issued stock of the Bank as of March 31, 2010 net of any reciprocal investment. As of that date, the Bank's assets totaled \$30.1 billion and shareholders' equity totaled \$1.7 billion. The Bank's earnings were \$117 million during the first three months of 2010.

In addition, the Association has an investment of \$756 related to other Farm Credit institutions.

- G. **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.
- H. **Subordinate Debt Payable to Other Farm Credit Institutions:** Fair value is determined by discounting the expected future cash flows using appropriate interest rates for similar liabilities.
- I. **Commitments to Extend Credit:** The estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics and since the related credit risk is not significant.

## NOTE 8 – SUBSEQUENT EVENTS

The Association has evaluated subsequent events and has determined there are none requiring disclosure through May 7, 2010, which is the date the financial statements were issued.