

SECOND QUARTER 2010

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CERTIFICATION

The undersigned certify that we have reviewed the June 30, 2010 quarterly report of First South Farm Credit, 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.



Thomas A. Parker
Chairman of the Board



Stephen L. Rochelle
Chief Executive Officer



Bryan Applewhite
Chief Financial Officer

August 6, 2010

First South Farm Credit, 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 June 30, 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 June 30, 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 June 30, 2010.



Stephen L. Rochelle
Chief Executive Officer



Bryan Applewhite
Chief Financial Officer

August 6, 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 *First South Farm Credit, ACA* (Association) for the period ended June 30, 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 mortgage loans. The Association's loan portfolio is diversified over a range of agricultural commodities including poultry, cotton, livestock and forestry. Farm size varies and many of the borrowers in the region have diversified farming operations. This factor, along with the numerous opportunities for non-farm income in the area, somewhat reduces the level of dependency on any single commodity.

Comparison of June 30, 2010 to December 31, 2009

The gross loan volume of the Association as of June 30, 2010, was \$1,221,856, an increase of \$68,421, as compared to \$1,153,435 at December 31, 2009. Net loans outstanding at June 30, 2010, were \$1,212,937 as compared to \$1,146,100 at December 31, 2009. Net loans accounted for 90.69 percent of total assets at June 30, 2010, as compared to 89.40 percent of total assets at December 31, 2009. The increase in loan volume is primarily attributable to seasonal lending within the portfolio.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level and credit administration remains satisfactory. Nonaccrual loans increased to \$12,921 at June 30, 2010 from \$11,464 at December 31, 2009, an increase of \$1,457.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions. The allowance for loan losses at June 30, 2010, was \$8,919 compared to \$7,335 at December 31, 2009,

and was considered by management to be adequate to cover possible losses.

Comparison of June 30, 2010 to June 30, 2009

As stated previously, as of June 30, 2010, gross loan volume of the Association was \$1,221,856 and net loans outstanding were \$1,212,937. This represents an increase of \$13,728 in gross loan volume as compared to \$1,208,128 at June 30, 2009, and represents an increase of \$12,032 in net loans outstanding as compared to \$1,200,905 at June 30, 2009. Net loans increased as a percentage of total assets slightly to the aforementioned 90.69 percent of total assets at June 30, 2010, from 90.78 percent of total assets at June 30, 2009. The increase in loan volume is primarily attributable to normal loan growth of the Association.

Nonaccrual loans decreased from \$24,551 at June 30, 2009, to \$12,921 at June 30, 2010, a decrease of \$11,630. This decrease is primarily the result of two relatively large loans being transferred to accruing status.

The allowance for loan losses at June 30, 2010, was \$8,919 compared to \$7,223 at June 30, 2009, an increase of \$1,696.

RESULTS OF OPERATIONS

For the three months ended June 30, 2010

Net income for the three months ended June 30, 2010, totaled \$5,296, as compared to \$1,921 for the same period in 2009. The increase in net income relates to improved net interest margins, increased Bank patronage and an overall reduction in Insurance Fund costs. Net interest income increased \$1,223 for the three months ended June 30, 2010, as compared to the same period in 2009. The increase in net interest income was primarily the result of increased margins along with relatively modest growth in loan volume.

Noninterest income for the three months ended June 30, 2010 totaled \$5,575, as compared to \$4,804 for the same period of 2009, an increase of \$771. The increase is primarily the result of increased equity in earnings of other Farm Credit institutions of \$695 and increased gains in other property owned of \$268, partially offset by a decrease in loan fees of \$76 and a decrease in financially related services of \$77.

Noninterest expense for the three months ended June 30, 2010 decreased \$334 compared to the same period of 2009. The primary reason for the decrease in noninterest expense was a decrease in the Insurance Fund premium of \$455.

The Association recorded a provision for loan loss of \$2,270 for the three months ended June 30, 2010, compared to \$3,317 for the same period in 2009. The Association recorded a provision for income taxes of \$87 for the three months ended June 30, 2010, which was directly in line with the same period of 2009.

For the six months ended June 30, 2010

Net income for the six months ended June 30, 2010, totaled \$10,471, as compared to \$5,278 for the same period in 2009. As stated previously, this increase in net income relates to improved net interest margins, increased Bank patronage and an overall reduction in Insurance Fund costs. Net interest income for the second quarter has increased \$3,155 or 23.17 percent, as compared to the same period in 2009. The increase in net interest income was primarily the result of increased margins along with modest growth within the portfolio.

Noninterest income for the six months ended June 30, 2010, totaled \$11,980, as compared to \$9,938 for the same period of 2009, an increase of \$2,042. The increase is primarily the result of an increase in equity in earnings of other Farm Credit institutions of \$709, an insurance refund premium of \$1,211, and increased gains in other property owned of \$320, partially offset by a decrease in loan fees of \$38, a decrease in financial related services of \$77 and a decrease in other non interest income of \$83. The increase in equity in earnings of other Farm Credit Institutions is primarily the result of the increase in loan participations sold to the Bank compared to the same period in 2009.

Noninterest expense for the six months ended June 30, 2010, decreased \$438 compared to the same period of 2009. The primary reason for the decrease in noninterest expense was a decrease in Insurance Fund premiums of \$640, partially offset by an increase in the other operating expenses of \$58 and an increase in salaries and employee benefits of \$134.

The Association recorded a provision for loan losses of \$5,210 for the six months ended June 30, 2010, compared to a provision of \$4,783 for the same period in 2009.

INSURANCE FUND REFUND

During the first quarter of 2010, the Association recorded \$1,211 of insurance premium refunds from the Farm Credit System Insurance Corporation (FCSIC), which insures the System's debt obligations. The amount is reflected in Noninterest Income on the Consolidated Statements of Income. These payments are nonrecurring and resulted from the assets of the Farm Credit Insurance Fund exceeding the secure base amount as defined by the Farm Credit Act.

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 Bank advances funds to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating 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 June 30, 2010 was \$1,061,522 as compared to \$1,007,408 at December 31, 2009, an increase of \$54,114, and was \$1,064,411 at June 30, 2009, a decrease of \$2,889 as compared to June 30, 2010. The increase in notes payable from December 31, 2009 to June 30, 2010 is related to the routine recording of earnings of the Association.

CAPITAL RESOURCES

Total members' equity at June 30, 2010, June 30, 2009 and December 31, 2009 was \$241,760, \$222,279 and \$235,032, respectively. The increase from June 30, 2009 to June 30, 2010 is primarily attributable to a decrease in accumulated other comprehensive loss of \$3,419, and a net increase in allocated and unallocated retained earnings of \$15,306. The increase of \$6,728 in total members' equity from December 31, 2009 to June 30, 2010 is mainly attributable to a net increase in allocated and unallocated retained earnings of \$5,580 and a decrease in accumulated other comprehensive loss of \$653. Total capital stock and participation certificates were \$65,708, \$64,951 and \$65,212 at June 30, 2010, June 30, 2009 and December 31, 2009, respectively.

Farm Credit Administration (FCA) regulations require all Farm Credit institutions to maintain minimum permanent capital, total surplus and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus and core surplus as defined in FCA regulations, by a risk-adjusted asset base. As of June 30, 2010, the Association's total surplus ratio and core surplus ratio were 12.53 percent and 11.48 percent, respectively, and the permanent capital ratio was 13.80 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.

STOCKHOLDER INVESTMENT

Stockholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst Farm Credit Bank's Quarterly and Annual Reports are on the AgFirst website, www.agfirst.com, or may be obtained at no charge by calling 1-800-845-1745, extension 2378, or writing Stephen Gilbert, 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.firstsouthland.com, or may be obtained upon request free of charge by calling 1-800-955-1722 or writing Bryan Applewhite, First South Farm Credit, ACA, 574 Highland Colony Parkway, Suite 100, Ridgeland, MS 39157. 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.

First South Farm Credit, ACA

Consolidated Balance Sheets

| <i>(dollars in thousands)</i> | June 30, | | December 31, |
|---|---------------------|---------------------|---------------------|
| | 2010 | 2009 | 2009 |
| | <i>(unaudited)</i> | <i>(unaudited)</i> | <i>(audited)</i> |
| Assets | | | |
| Cash | \$ 1,170 | \$ 877 | \$ 9,906 |
| Loans | 1,221,856 | 1,208,128 | 1,153,435 |
| Less: allowance for loan losses | 8,919 | 7,223 | 7,335 |
| Net loans | 1,212,937 | 1,200,905 | 1,146,100 |
| Accrued interest receivable | 11,410 | 11,725 | 11,631 |
| Investment in other Farm Credit institutions | 90,061 | 89,810 | 87,429 |
| Premises and equipment, net | 6,486 | 6,522 | 6,585 |
| Other property owned | 5,496 | 3,445 | 661 |
| Due from AgFirst Farm Credit Bank | 8,162 | 8,195 | 16,455 |
| Other assets | 1,753 | 1,447 | 3,292 |
| Total assets | <u>\$ 1,337,475</u> | <u>\$ 1,322,926</u> | <u>\$ 1,282,059</u> |
| Liabilities | | | |
| Notes payable to AgFirst Farm Credit Bank | \$ 1,061,522 | \$ 1,064,411 | \$ 1,007,408 |
| Accrued interest payable | 2,475 | 2,612 | 2,548 |
| Patronage refund payable | 5 | 4 | 4,467 |
| Other liabilities | 31,713 | 33,620 | 32,604 |
| Total liabilities | <u>1,095,715</u> | <u>1,100,647</u> | <u>1,047,027</u> |
| Commitments and contingencies | | | |
| Members' Equity | | | |
| Protected borrower equity | 91 | 92 | 92 |
| Capital stock and participation certificates | 65,708 | 64,951 | 65,212 |
| Retained earnings | | | |
| Allocated | 98,061 | 89,175 | 102,957 |
| Unallocated | 97,265 | 90,845 | 86,789 |
| Accumulated other comprehensive income (loss) | (19,365) | (22,784) | (20,018) |
| Total members' equity | <u>241,760</u> | <u>222,279</u> | <u>235,032</u> |
| Total liabilities and members' equity | <u>\$ 1,337,475</u> | <u>\$ 1,322,926</u> | <u>\$ 1,282,059</u> |

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

First South Farm Credit, ACA

Consolidated Statements of Income

(unaudited)

| <i>(dollars in thousands)</i> | For the three months ended June 30, | | For the six months ended June 30, | |
|--|--|-------------|--|-------------|
| | 2010 | 2009 | 2010 | 2009 |
| Interest Income | | | | |
| Loans | \$ 16,007 | \$ 15,237 | \$ 31,399 | \$ 29,490 |
| Interest Expense | | | | |
| Notes payable to AgFirst Farm Credit Bank | 7,444 | 7,897 | 14,626 | 15,872 |
| Net interest income | 8,563 | 7,340 | 16,773 | 13,618 |
| Provision for (reversal of allowance for) loan losses | 2,270 | 3,317 | 5,210 | 4,783 |
| Net interest income after provision for (reversal of allowance for) loan losses | 6,293 | 4,023 | 11,563 | 8,835 |
| Noninterest Income | | | | |
| Loan fees | 641 | 717 | 1,691 | 1,729 |
| Fees for financially related services | 31 | 108 | 31 | 108 |
| Equity in earnings of other Farm Credit institutions | 4,868 | 4,173 | 8,878 | 8,169 |
| Gains (losses) on other property owned, net | 18 | (250) | 71 | (249) |
| Insurance Fund refund | — | — | 1,211 | — |
| Other noninterest income | 17 | 56 | 98 | 181 |
| Total noninterest income | 5,575 | 4,804 | 11,980 | 9,938 |
| Noninterest Expense | | | | |
| Salaries and employee benefits | 4,654 | 4,606 | 9,248 | 9,114 |
| Occupancy and equipment | 313 | 285 | 613 | 603 |
| Insurance Fund premium | 9 | 464 | 235 | 875 |
| Other operating expenses | 1,509 | 1,464 | 2,878 | 2,820 |
| Total noninterest expense | 6,485 | 6,819 | 12,974 | 13,412 |
| Income before income taxes | 5,383 | 2,008 | 10,569 | 5,361 |
| Provision (benefit) for income taxes | 87 | 87 | 98 | 83 |
| Net income | \$ 5,296 | \$ 1,921 | \$ 10,471 | \$ 5,278 |

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

First South Farm Credit, ACA
**Consolidated Statements of Changes in
Members' Equity**

(unaudited)

(dollars in thousands)

| | Protected Borrower Capital | Capital Stock and Participation Certificates | Retained Earnings | | Accumulated Other Comprehensive Income | Total Members' Equity |
|---|----------------------------------|---|-------------------|-------------|---|-----------------------------|
| | | | Allocated | Unallocated | | |
| Balance at December 31, 2008 | \$ 97 | \$ 64,590 | \$ 93,412 | \$ 85,259 | \$ (23,630) | \$ 219,728 |
| Net income | | | | 5,278 | | 5,278 |
| Employee benefit plans adjustments | | | | | 846 | 846 |
| Total comprehensive income | | | | | | 6,124 |
| Protected borrower equity retired | (5) | | | | | (5) |
| Capital stock/participation certificates issued/(retired), net | | 361 | | | | 361 |
| Retained earnings retired | | | (4,061) | | | (4,061) |
| Patronage distribution adjustment | | | (176) | 308 | | 132 |
| Balance at June 30, 2009 | \$ 92 | \$ 64,951 | \$ 89,175 | \$ 90,845 | \$ (22,784) | \$ 222,279 |
| Balance at December 31, 2009 | \$ 92 | \$ 65,212 | \$ 102,957 | \$ 86,789 | \$ (20,018) | \$ 235,032 |
| Net income | | | | 10,471 | | 10,471 |
| Employee benefit plans adjustments | | | | | 653 | 653 |
| Total comprehensive income | | | | | | 11,124 |
| Protected borrower equity retired | (1) | | | | | (1) |
| Capital stock/participation certificates issued/(retired), net | | 496 | | | | 496 |
| Retained earnings retired | | | (4,791) | | | (4,791) |
| Patronage distribution adjustment | | | (105) | 5 | | (100) |
| Balance at June 30, 2010 | \$ 91 | \$ 65,708 | \$ 98,061 | \$ 97,265 | \$ (19,365) | \$ 241,760 |

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

First South Farm Credit, ACA

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 First South Farm Credit, 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 second 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 six months ended June 30, 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 June 30, 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 detail 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 4).

NOTE 2 – ALLOWANCE FOR LOAN LOSSES AND IMPAIRED LOANS

An analysis of the allowance for loan losses follows:

| | For the six months ended June 30, | |
|---|-----------------------------------|-----------------|
| | 2010 | 2009 |
| Balance at beginning of period | \$ 7,335 | \$ 7,941 |
| Provision for (reversal of) loan losses | 5,210 | 4,783 |
| Charge-offs | (3,723) | (5,504) |
| Recoveries | 97 | 3 |
| Balance at end of period | <u>\$ 8,919</u> | <u>\$ 7,223</u> |

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

| | 2010 | 2009 |
|--|-----------------|-----------------|
| Impaired loans with related allowance | \$ 9,298 | \$13,436 |
| Impaired loans with no related allowance | 3,934 | 11,461 |
| Total impaired loans | <u>13,232</u> | <u>24,897</u> |
| Allowance on impaired loans | <u>\$ 3,211</u> | <u>\$ 2,208</u> |

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

| | 2010 | 2009 |
|--|-----------|-----------|
| Average impaired loans | \$ 12,882 | \$ 27,486 |
| Interest income recognized on impaired loans | 78 | 67 |

NOTE 3 – EMPLOYEE BENEFIT PLANS

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

| | For the six months ended June 30, | |
|-------------------------------|-----------------------------------|----------------|
| | 2010 | 2009 |
| Pension | \$ 1,447 | \$1,792 |
| 401(k) | 164 | 143 |
| Other postretirement benefits | 451 | 327 |
| Total | <u>\$ 2,062</u> | <u>\$2,262</u> |

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

| | Actual YTD Through 6/30/10 | Projected Contributions For Remainder of 2010 | Projected Total Contributions 2010 |
|-------------------------------|----------------------------|---|------------------------------------|
| Pension | \$ - | \$ 893 | \$ 893 |
| Other postretirement benefits | 208 | 465 | 673 |
| Total | <u>\$ 208</u> | <u>\$1,358</u> | <u>\$1,566</u> |

Contributions in the above table include allocated estimates of funding for a multi-employer plan 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 4 – 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 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 has no Level 1 assets or liabilities measured at fair value on a recurring basis at June 30, 2010.

Level 2

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability. The Association has no Level 2 assets or liabilities measured at fair value on a recurring basis at June 30, 2010.

Level 3

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

Level 3 assets at June 30, 2010 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 June 30, 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 June 30, 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 table presents the assets and liabilities that are measured at fair value on a recurring basis at June 30, 2010 and December 31, 2009 for each of the fair value hierarchy levels:

| | June 30, 2010 | | | Total Fair Value |
|---------------------------|---------------|---------|---------|------------------|
| | Level 1 | Level 2 | Level 3 | |
| Liabilities: | | | | |
| Standby letters of credit | \$ - | \$ - | \$ 610 | \$ 610 |
| Total Liabilities | \$ - | \$ - | \$ 610 | \$ 610 |
| December 31, 2009 | | | | |
| | Level 1 | Level 2 | Level 3 | Total Fair Value |
| Liabilities: | | | | |
| Standby letters of credit | \$ - | \$ - | \$ 586 | \$ 586 |
| Total Liabilities | \$ - | \$ - | \$ 586 | \$ 586 |

The following tables present the changes in Level 3 assets and liabilities measured at fair value on a recurring basis for the six months ended June 30, 2010 and 2009. The Association had no transfers of assets or liabilities into or out of Level 1 or Level 2 during the first six months of 2010 and 2009.

| | Standby Letters Of Credit |
|---|--|
| Balance at January 1, 2010 | \$ 586 |
| Total gains or (losses) realized/unrealized: | |
| Included in earnings | - |
| Included in other comprehensive loss | - |
| Purchases, sales, issuances and settlements, net | 21 |
| Transfers in and/or out of level 3 | - |
| Balance at June 30, 2010 | <u>\$ 610</u> |

| | Standby Letters Of Credit |
|---|--|
| Balance at January 1, 2009 | \$ 454 |
| Total gains or (losses) realized/unrealized: | |
| Included in earnings | - |
| Included in other comprehensive loss | - |
| Purchases, sales, issuances and settlements, net | (19) |
| Transfers in and/or out of level 3 | - |
| Balance at June 30, 2009 | <u>\$ 435</u> |

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

Assets and liabilities measured at fair value on a non-recurring basis at June 30, 2010 and December 31, 2009 for each of the fair value hierarchy values are summarized below:

| June 30, 2010 | | | | | |
|----------------------------|------------|------------|------------|------------------------|-----------------------------------|
| | Level 1 | Level 2 | Level 3 | Fair Value | YTD Total Gains (Losses) |
| Assets: | | | | | |
| Impaired loans | \$ - | \$ - | \$ (5,982) | \$ (5,982) | \$ 6,079 |
| Other property owned | \$ - | \$ - | \$ 4,937 | \$ 4,937 | \$ 20 |
| December 31, 2009 | | | | | |
| | Level 1 | Level 2 | Level 3 | Total Fair Value | YTD Total Gains (Losses) |
| Assets: | | | | | |
| Impaired loans | \$ - | \$ - | \$ 5,155 | \$ 5,155 | \$ (3,963) |
| Other property owned | \$ - | \$ - | \$ 756 | \$ 756 | \$ 16 |

NOTE 5 — DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

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

| | June 30, 2010 | | December 31, 2009 | |
|--|--------------------|-------------------------|--------------------|-------------------------|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Financial assets: | | | | |
| Cash | \$ 1,170 | \$ 1,170 | \$ 9,906 | \$ 9,906 |
| Loans, net of allowance | \$1,212,937 | \$ 1,236,152 | \$ 1,146,100 | \$ 1,178,934 |
| Financial liabilities: | | | | |
| Notes payable to AgFirst Farm Credit Bank | \$1,061,522 | \$ 1,001,666 | \$ 1,007,408 | \$ 1,020,697 |

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 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 10.36 percent of the issued stock of the Bank as of June 30, 2010 net of any reciprocal investment. As of that date, the Bank's assets totaled \$30.7 billion and shareholders' equity totaled \$1.9 billion. The Bank's earnings were \$206.7 million during the first six months of 2010.

In addition, the Association has an investment of \$34 related to other Farm Credit institutions.

- D. **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.
- E. **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 6 – SUBSEQUENT EVENTS

The Association has evaluated subsequent events and has determined there are none requiring disclosure through August 6, 2010, which is the date the financial statements were issued.