

# ALABAMA AG CREDIT, ACA

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## 2011 Quarterly Report 1st Quarter



**For the Quarter Ended March 31, 2011**



## REPORT OF MANAGEMENT

The consolidated financial statements of Alabama Ag Credit, ACA (Association) are prepared by management, who are responsible for the statements' integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America appropriate in the circumstances. Other financial information included in the quarterly report is consistent with that in the consolidated financial statements.

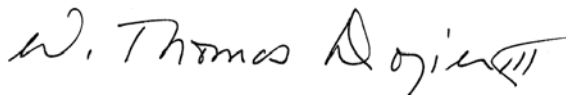
To meet its responsibility for reliable financial information, management depends on the Farm Credit Bank of Texas' (Bank) and the Association's accounting and internal control systems, which have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded and transactions are properly authorized and recorded. The systems have been designed to recognize that the cost of controls must be related to the benefits derived. The annual financial statements are audited by PricewaterhouseCoopers LLP, independent accountants, who conduct a review of internal controls solely for the purpose of establishing a basis for reliance thereon in determining the nature, extent and timing of audit tests applied in the audit of the financial statements in accordance with auditing standards generally accepted in the United States of America. The Association is also examined by the Farm Credit Administration.

The audit committee of the board of directors has oversight responsibility for the Association's system of internal controls and financial reporting. The audit committee consults regularly with management and meets periodically with the independent auditors and the internal auditor to review the scope and results of their work. The independent auditors and internal auditor have direct access to the audit committee.

The undersigned certify that, to the best of our knowledge and belief, the consolidated financial statements and other financial information included in this quarterly report reliably present the financial condition of Alabama Ag Credit, ACA and the results of its operations for the periods shown.



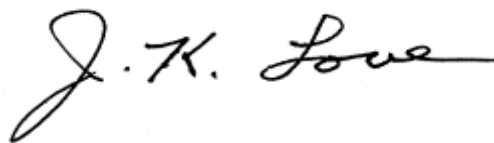
Douglas Thiessen, President/Chief Executive Officer  
May 4, 2011



W. Thomas Dozier, III, Chairman, Board of Directors  
May 4, 2011



M. Scott Sellers, CPA, Sr. VP/Chief Financial Officer  
May 4, 2011



J.K. Love, CPA, Chairman, Audit Committee  
May 4, 2011

## **ALABAMA AG CREDIT, ACA MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following commentary reviews the financial performance of the Alabama Ag Credit, ACA (Agricultural Credit Association), referred to as the Association, for the quarter ended March 31, 2011. These comments should be read in conjunction with the accompanying consolidated financial statements and the December 31, 2010 Annual Report of the Association.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The consolidated financial statements were prepared under the oversight of the Association's audit committee.

### **Results of Operations:**

The Association had net income of \$2,708,589 for the three months ended March 31, 2011, as compared to net income of \$3,324,944 for the same period in 2010 reflecting a decrease of 18.5 percent. Net interest income was \$4,977,337 for the three months ended March 31, 2011, compared to \$4,504,439 for the same period in 2010. Interest income for the first three months of 2011 decreased by \$39,912 or 0.5 percent from the first three months of 2010, primarily due to a decrease in yields on earning assets, offset by an increase in average loan volume. Interest expense for the first three months of 2011 decreased by \$512,810, or 12.5 percent, from the same period of 2010 due to a decrease in interest rates, offset partially by an increase in average debt volume.

Noninterest income for the three months ended March 31, 2011 decreased by \$278,923, or 47.8 percent, over the same period of 2010. The decrease is due primarily to the implementation of ASC310 which calls for the deferral of net loan origination fees whereby the fees are amortized over the life of the loan using the effective-interest method. The deferral of net loan origination fees was not implemented until the fourth quarter of 2010, therefore no deferrals had been recognized in the three months ended March 31, 2010.

Noninterest expenses for the three months ended March 31, 2011 increased by \$349,865, or 21.1 percent, as compared to the same period in 2010. The increase is due primarily to losses on acquired property that were recorded in the first three months of 2011 due to decreases in the value of the underlying collateral as compared to gains that were recorded on the sales of acquired properties in the first three months of 2010. Salary and employee benefits costs also increased for the first three months of 2011 compared to the first three months of 2010. The primary reason for the increase in these costs is from hiring two new employees and an increase in actuarially-determined, required contributions to the defined benefit (DB) retirement plan. For more information on the DB plan, refer to the 2010 Annual Report and Note 7, "Employee Benefit Plans," to the consolidated financial statements in this quarterly report. The increase in salary and employee benefits costs was offset partially due to the implementation of ASC310 in relation to the capitalization and deferral of net loan origination fees. For the first three months of 2011 advertising costs decreased compared to the first three months of 2010. This decrease in advertising is due to the Association spending additional dollars in the first quarter of 2010 to publicize the Association's name change and expanded lending opportunities in connection with converting from a Federal Land Credit Association (FLCA) to an ACA at the beginning of 2010.

The Association's provision for loan loss was \$568,400 for the quarter ending March 31, 2011 as compared to \$107,935 for the same period in 2010. The increase is due primarily to the Association updating the loan loss percentages used in the allowance for loan loss process in addition to an increased number of substandard and impaired loans in the first three months of 2011 compared to the first three months of 2010. The updated loan loss percentages reflect more recent and higher loss experience that the loss factors used in the first quarter of 2010. The Association recorded no recoveries and \$255,234 in charge-offs for the quarter ending March 31, 2011, and \$74,803 in recoveries and \$79,861 in charge-offs for the same period in 2010. The Association's allowance for loan losses was 0.6 percent and 0.5 percent of total loans outstanding as of March 31, 2011, and 2010, respectively.

The Association's return on average assets for the three months ended March 31, 2011, was 1.63 percent compared to 2.00 percent for the same period in 2010. The Association's return on average equity for the three months ended March 31, 2011, was 9.51 percent, compared to 12.49 percent for the same period in 2010.

### **Loan Portfolio:**

The Association makes and services loans to farmers, ranchers, rural homeowners and certain farm-related businesses. The Association's loan volume consists of long-term farm mortgage loans, production and intermediate-term loans, and farm-related

business loans. These loans are available to eligible borrowers with competitive prime- and LIBOR-based, fixed and adjustable interest rates and loan maturities ranging up to 40 years. Loans serviced by the Association offer several installment payment cycles, the timing of which usually coincides with seasonal cash-flow capabilities of the borrower.

Total loans outstanding at March 31, 2011, stated at recorded investment (principal less funds held), were \$658,136,273 compared to \$654,208,651 at December 31, 2010, reflecting an increase of 0.6 percent. The major commodities within the Association's loan portfolio are timber, poultry, cattle and field crops.

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

	<u>March 31, 2011</u>	<u>December 31, 2010</u>
Acceptable	94.3 %	95.2 %
Special Mention	1.1 %	1.3 %
Substandard	4.6 %	3.5 %
Total	<u>100.0 %</u>	<u>100.0 %</u>

### Risk Exposure:

High-risk assets include nonaccrual loans, loans that are past due 90 days or more and still accruing interest, formally restructured loans and other property owned. The following table illustrates the Association's components and trends of high-risk assets.

	<u>March 31, 2011</u>		<u>December 31, 2010</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Nonaccrual	\$ 18,486,134	81.9%	\$ 11,310,269	76.1%
90 days past due and still accruing interest	71,526	0.3%	207,892	1.4%
Formally restructured	185,199	0.8%	183,696	1.2%
Other property owned, net	3,838,245	17.0%	3,167,851	21.3%
Total	<u>\$ 22,581,104</u>	<u>100.0%</u>	<u>\$ 14,869,708</u>	<u>100.0%</u>

At March 31, 2011 loans that were considered impaired were \$18,742,859, compared to \$11,701,857 at December 31, 2010. This represents 2.8 percent and 1.8 percent of loan volume, respectively. Impaired loans consist of all high-risk assets except other property owned, net. Total nonaccrual loans as of March 31, 2011 increased compared to December 31, 2010 as economic deterioration resulted in several more loans being classified as nonaccrual, due to management's belief that the Association will not receive all principal and interest according to the original terms of the loans. However, almost 95% of the increase is attributable to only three borrowers with large credits.

### Liquidity and Funding Sources:

The Association secures the majority of its lendable funds from the Farm Credit Bank of Texas (the Bank), which obtains its funds through the issuance of System-wide obligations. The following schedule summarizes the Association's borrowings.

	<u>March 31, 2011</u>	<u>December 31, 2010</u>
Note payable to the bank	\$ 557,417,269	\$ 550,975,385
Accrued interest on note payable	1,247,832	1,265,927
Total	<u>\$ 558,665,101</u>	<u>\$ 552,241,312</u>

### Capital Resources:

The Association's capital position increased by \$2,736,670 at March 31, 2011, compared to December 31, 2010. The Association's debt as a ratio to members' equity was 4.84:1 as of March 31, 2011, compared to 4.94:1 as of December 31, 2010.

In December 2010, the board declared a \$5,100,000 cash patronage to be paid to stockholders from the Association's 2010 earnings. The patronage distribution was completed in March 2011.

Under regulations governing minimum permanent capital adequacy and other capitalization issues, the Association is required to maintain a minimum adjusted permanent capital of seven percent of risk-adjusted assets as defined by the FCA. The

Association's permanent capital ratio at March 31, 2011, was 16.1 percent, which is in compliance with the FCA's minimum permanent capital standard. The Association's core surplus ratio and total surplus ratio at March 31, 2011, were 15.5 and 15.5 percent, respectively, which is in compliance with the FCA's minimum surplus standards.

#### **Significant Recent Accounting Pronouncements:**

In January 2011, the Financial Accounting Standards Board (FASB) issued guidance entitled, "Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings." This guidance temporarily delays the effective date of the disclosures about troubled debt restructurings required by the guidance previously issued on "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses." The effective date of the new disclosures about troubled debt restructurings and guidance for determining what constitutes a troubled debt restructuring will be coordinated and is anticipated to be effective for periods ending after June 15, 2011.

In July 2010, the FASB issued guidance on "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Loan Losses," which is intended to provide additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of the allowance for credit losses. Existing disclosures are amended to include additional disclosures of financing receivables on a disaggregated basis (by portfolio segment and class of financing receivable) including among others, a rollforward schedule of the allowance for credit losses from the beginning of the reporting period to the end of the period on a portfolio segment basis, with the ending balance further disaggregated on the basis of the method of impairment (individually or collectively evaluated). The guidance also calls for new disclosures including but not limited to credit quality indicators at the end of the reporting period by class of financing receivables, the aging of past due financing receivables by class, the nature and extent of financing receivables modified as troubled debt restructurings by class and the effect on the allowance for credit losses. For nonpublic entities, the disclosures are effective for annual reporting periods ending on or after December 15, 2011. The adoption of this Standard will not have an impact on the Association's financial condition or results of operations, but will result in additional disclosures for annual reporting periods ending after December 15, 2011.

In January 2010, the FASB issued guidance on "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 robust 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 were effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this Standard did not impact the Association's financial condition and results of operations but resulted in additional disclosures.

#### **Relationship with the Farm Credit Bank of Texas:**

The Association's financial condition may be impacted by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect the stockholder's investment in the Association. The Management's Discussion and Analysis and Notes to Consolidated Financial Statements contained in the December 31, 2010 Annual Report of Alabama Ag Credit, ACA more fully describe the Association's relationship with the Bank.

The Tenth Farm Credit District's (District) annual and quarterly stockholder reports are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, The Ag Agency, P.O. Box 202590, Austin, Texas 78720, or by calling (512) 483-9260. Copies of the District's quarterly and annual stockholder reports also can be requested by e-mail at [fcdb@farmcreditbank.com](mailto:fcdb@farmcreditbank.com). The District makes its annual and quarterly stockholder reports available on its web site at [www.farmcreditbank.com](http://www.farmcreditbank.com).

The Association's annual and quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Alabama Ag Credit, ACA, P.O. Box 241687, Montgomery, Alabama, 36124-1687, or by calling (334) 270-8687. Copies of the reports can also be requested by e-mailing [andra.wolf@AlabamaAgCredit.com](mailto:andra.wolf@AlabamaAgCredit.com). The Association's quarterly stockholder reports are available on its web site at [www.AlabamaAgCredit.com](http://www.AlabamaAgCredit.com) approximately 40 days after each quarter end, and the annual stockholder report is available on its web site 75 days after the fiscal year end. Copies of the annual stockholder report can also be requested 90 days after fiscal year end.

**ALABAMA AG CREDIT, ACA**

**CONSOLIDATED BALANCE SHEET**

	<b>March 31, 2011 (unaudited)</b>	<b>December 31, 2010</b>
<b><u>ASSETS</u></b>		
Cash	\$ 10,519	\$ 10,550
Loans	658,136,273	654,208,651
Less: allowance for loan losses	3,910,621	3,597,455
Net loans	<u>654,225,652</u>	<u>650,611,196</u>
Accrued interest receivable	6,611,974	6,751,262
Investment in and receivable from the Bank:		
Capital stock	11,050,455	11,050,455
Accrued patronage receivable	137,745	264,972
Other	523,790	582,689
Other property owned, net	3,838,245	3,167,851
Premises and equipment	2,638,398	2,627,020
Other assets	958,837	240,084
Total assets	<u><u>\$ 679,995,615</u></u>	<u><u>\$ 675,306,079</u></u>
<b><u>LIABILITIES</u></b>		
Note payable to the Bank	\$ 557,417,269	\$ 550,975,385
Accrued interest payable	1,247,832	1,265,927
Drafts outstanding	1,320,109	1,227,576
Patronage distributions payable	21,373	5,102,148
Other liabilities	3,630,373	3,113,054
Total liabilities	<u>563,636,956</u>	<u>561,684,090</u>
<b><u>MEMBERS' EQUITY</u></b>		
Capital stock and participation certificates	3,910,510	3,875,435
Unallocated retained earnings	112,519,029	109,810,440
Accumulated other comprehensive loss	(70,880)	(63,886)
Total members' equity	<u>116,358,659</u>	<u>113,621,989</u>
Total liabilities and members' equity	<u><u>\$ 679,995,615</u></u>	<u><u>\$ 675,306,079</u></u>

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

**ALABAMA AG CREDIT, ACA**

**CONSOLIDATED STATEMENT OF INCOME**

(unaudited)

	<b>Quarter Ended</b>	
	<b>March 31,</b>	
	<b>2011</b>	<b>2010</b>
<b><u>INTEREST INCOME</u></b>		
Loans	\$ 8,571,281	\$ 8,611,193
<b><u>INTEREST EXPENSE</u></b>		
Note payable to the Bank	3,593,944	4,106,754
Net interest income	<u>4,977,337</u>	<u>4,504,439</u>
<b><u>PROVISION FOR LOSSES</u></b>		
Provision for loan losses	568,400	107,935
Net income after provision for losses	<u>4,408,937</u>	<u>4,396,504</u>
<b><u>NONINTEREST INCOME</u></b>		
Patronage income from the Bank	208,845	213,551
Loan fees	49,421	339,645
Financially related services income	1,062	1,272
Gain on sale of premises and equipment, net	14,669	1,063
Other noninterest income	30,459	27,848
Total noninterest income	<u>304,456</u>	<u>583,379</u>
<b><u>NONINTEREST EXPENSES</u></b>		
Salaries and employee benefits	1,315,632	1,274,003
Directors' expense	76,315	80,868
Purchased services	157,979	249,234
Travel	73,268	45,479
Occupancy and equipment	83,377	83,022
Communications	25,825	31,430
Advertising	39,368	74,520
Public and member relations	46,647	44,598
Supervisory and exam expense	59,025	52,251
Insurance Fund premiums	154,495	182,575
Other noninterest expense	32,416	28,796
Loss (gain) on other property owned, net	25,920	(325,618)
CMS expense reimbursements	(85,463)	(166,219)
Total noninterest expenses	<u>2,004,804</u>	<u>1,654,939</u>
Net income	<u>\$ 2,708,589</u>	<u>\$ 3,324,944</u>

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

ALABAMA AG CREDIT, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

(unaudited)

	<u>Capital Stock/ Participation Certificates</u>	<u>Unallocated Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Members' Equity</u>
Balance at December 31, 2009	\$ 3,661,325	\$ 101,029,380	\$ 120,854	\$ 104,811,559
Comprehensive income				
Net income	-	3,324,944	-	3,324,944
Change in postretirement benefit plans	-	-	(9,756)	(9,756)
Total comprehensive income	-	3,324,944	(9,756)	3,315,188
Capital stock/participation certificates issued	153,370	-	-	153,370
Capital stock/participation certificated retired	(86,415)	-	-	(86,415)
Balance at March 31, 2010	<u>\$ 3,728,280</u>	<u>\$ 104,354,324</u>	<u>\$ 111,098</u>	<u>\$ 108,193,702</u>
Balance at December 31, 2010	\$ 3,875,435	\$ 109,810,440	\$ (63,886)	\$ 113,621,989
Comprehensive income				
Net income	-	2,708,589	-	2,708,589
Change in postretirement benefit plans	-	-	(6,994)	(6,994)
Total comprehensive income	-	2,708,589	(6,994)	2,701,595
Capital stock/participation certificates issued	117,225	-	-	117,225
Capital stock/participation certificates retired	(82,150)	-	-	(82,150)
<b>Balance at March 31, 2011</b>	<u><b>\$ 3,910,510</b></u>	<u><b>\$ 112,519,029</b></u>	<u><b>\$ (70,880)</b></u>	<u><b>\$ 116,358,659</b></u>

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

**ALABAMA AG CREDIT, ACA**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

**NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:**

Alabama Ag Credit, ACA (Agricultural Credit Association), referred to as the Association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves the counties of Autauga, Baldwin, Barbour, Bibb, Bullock, Butler, Chambers, Chilton, Choctaw, Clarke, Coffee, Conecuh, Coosa, Covington, Crenshaw, Dale, Dallas, Elmore, Escambia, Geneva, Greene, Hale, Henry, Houston, Lee, Lowndes, Macon, Marengo, Mobile, Monroe, Montgomery, Perry, Pickens, Pike, Russell, Sumter, Tallapoosa, Tuscaloosa, Washington and Wilcox in the state of Alabama. The Association is a lending institution of the Farm Credit System (the System), which was established by Acts of Congress to meet the needs of American agriculture.

A description of the Association's significant accounting policies and the financial condition and results of operations as of December 31, 2010 are contained in the 2010 Annual Report to the stockholders. These unaudited first quarter 2011 consolidated financial statements should be read in conjunction with the 2010 Annual Report to the stockholders.

In January 2011, the Financial Accounting Standards Board (FASB) issued guidance entitled, "Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings." This guidance temporarily delays the effective date of the disclosures about troubled debt restructurings required by the guidance previously issued on "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses." The effective date of the new disclosures about troubled debt restructurings and guidance for determining what constitutes a troubled debt restructuring will be coordinated and is anticipated to be effective for periods ending after June 15, 2011.

In July 2010, the FASB issued guidance on "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Loan Losses," which is intended to provide additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of the allowance for credit losses. Existing disclosures are amended to include additional disclosures of financing receivables on a disaggregated basis (by portfolio segment and class of financing receivable) including among others, a rollforward schedule of the allowance for credit losses from the beginning of the reporting period to the end of the period on a portfolio segment basis, with the ending balance further disaggregated on the basis of the method of impairment (individually or collectively evaluated). The guidance also calls for new disclosures including but not limited to credit quality indicators at the end of the reporting period by class of financing receivables, the aging of past due financing receivables by class, the nature and extent of financing receivables modified as troubled debt restructurings by class and the effect on the allowance for credit losses. For nonpublic entities, the disclosures are effective for annual reporting periods ending on or after December 15, 2011. The adoption of this Standard will not have an impact on the Association's financial condition or results of operations, but will result in additional disclosures for annual reporting periods ending after December 15, 2011.

In January 2010, the FASB issued guidance on "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 robust 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 were effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this Standard did not impact the Association's financial condition and results of operations but resulted in additional disclosures.

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, except for the inclusion of a statement of cash flows. Generally accepted accounting principles require a business enterprise that provides a set of financial statements reporting both financial position and results of operations to also provide a statement of cash flows for each period for which results of operations are provided. In regulations issued by FCA, associations have the option to exclude statements of cash flows in interim financial statements. Therefore, the Association has elected not to include a statement of cash flows in these consolidated financial statements.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The preparation of these consolidated financial statements requires the use of management's estimates. The results for the quarter ended March 31, 2011, are not necessarily indicative of the results to be expected for the year ended December 31, 2011. Certain amounts in the prior period's financial statements have been reclassified to conform to current financial statement presentation.

**NOTE 2 — LOANS AND ALLOWANCE FOR LOAN LOSSES:**

A summary of loans follows:

<u>Loan Type</u>	<u>March 31, 2011</u>	<u>December 31, 2010</u>
Real estate mortgage	\$ 640,206,123	\$ 637,733,800
Production and intermediate term	2,826,074	908,015
Agribusiness:		
Loans to cooperatives	1,424,000	512,000
Processing and marketing	4,231,968	5,519,684
Farm-related business	79,770	81,803
Rural residential real estate	9,368,338	9,453,349
Total	<u>\$ 658,136,273</u>	<u>\$ 654,208,651</u>

The allowance for loan losses is maintained at a level considered adequate by management to provide for estimated losses inherent in the loan portfolio. The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition and prior loan loss experience. An analysis of the allowance for loan losses follows:

	<u>March 31, 2011</u>	<u>March 31, 2010</u>
Balance at beginning of quarter	\$ 3,597,455	\$ 3,437,322
Provision for loan losses	568,400	107,935
Charge-offs	(255,234)	(79,861)
Recoveries	-	74,803
Balance at end of quarter	<u>\$ 3,910,621</u>	<u>\$ 3,540,199</u>

The following table presents information concerning impaired loans:

	<u>March 31, 2011</u>	<u>March 31, 2010</u>
Impaired loans with related allowance	\$ 7,571,557	\$ 6,562,241
Impaired loans with no related allowance	11,171,302	5,547,729
Total impaired loans	<u>\$ 18,742,859</u>	<u>\$ 12,109,970</u>
Allowance on impaired loans	\$ 901,831	\$ 1,751,438
Average impaired loans	\$ 10,899,914	\$ 10,106,553
Interest income on impaired loans for the quarter	\$ 43,654	\$ 24,348

### **NOTE 3 — CAPITAL:**

The Association's board of directors has established a Capital Adequacy Plan (Plan) that includes the capital targets that are necessary to achieve the institution's capital adequacy goals as well as the minimum permanent capital standards. The Plan monitors projected dividends, equity retirements and other actions that may decrease the Association's permanent capital. In addition to factors that must be considered in meeting the minimum standards, the board of directors also monitors the following factors: capability of management; quality of operating policies, procedures, and internal controls; quality and quantity of earnings; asset quality and the adequacy of the allowance for losses to absorb potential loss within the loan portfolio; sufficiency of liquid funds; needs of an institution's customer base; and any other risk-oriented activities, such as funding and interest rate risk, potential obligations under joint and several liability, contingent and off-balance-sheet liabilities or other conditions warranting additional capital. At least quarterly, management reviews the Association's goals and objectives with the board.

In December 2010, the board declared a \$5,100,000 cash patronage to be paid to stockholders from the Association's 2010 earnings. The patronage distribution was completed in March 2011.

### **NOTE 4 — CAPITAL MARKETS:**

Until the second quarter of 2007, the Association participated in the Capital Markets of the South (CMS), a joint venture created in 2003 for the purpose of expanding the participants' lending opportunities. The CMS group was comprised of the Association, Alabama Farm Credit, ACA, Mississippi Land Bank, ACA, Southern AgCredit, ACA, and the Louisiana Land Bank, ACA. During the second quarter of 2007, the CMS members decided to discontinue the joint venture. The Association will continue to service the existing CMS loan portfolio, with revenue and expenses continuing to be shared accordingly as noted below, until such time as all of the loans are fully matured or paid off.

Pursuant to the terms of the alliance, each of the five CMS participating associations generally share equally in the costs of operating the venture. All CMS noninterest expenses are recorded gross on the Association's books and then reimbursed 80 percent by the other four associations. The total amount of reimbursements is included on the statement of income in the line item entitled "CMS expense reimbursements." The Association's pro-rata share of income from CMS operations are recorded in the statement of income in their respective line items.

### **NOTE 5 — INCOME TAXES:**

Alabama Ag Credit, ACA and its PCA subsidiary, Alabama Ag Credit, PCA, (Associations) are subject to federal and certain other income taxes. The Associations are eligible to operate as cooperatives that qualify for tax treatment under Subchapter T of the Internal Revenue Code. Under specified conditions, the Associations can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage refunds. During 2011, the Association is participating in a patronage program. Deferred taxes are recorded at the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution and will therefore impact future tax payments. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (more than 50 percent probability), based on management's estimate, that they will not be realized. The Association has recorded a full valuation allowance against its deferred tax asset as of March 31, 2011, based on management's estimate that it is more likely than not that the deferred tax asset will not be realized. For the three months ended March 31, 2011, the Association had no taxable income.

The FLCA subsidiary, Alabama Ag Credit, FLCA, is exempt from federal and other income taxes as provided in the Farm Credit Act of 1971.

## NOTE 6 — FAIR VALUE MEASUREMENTS:

FASB guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 12 to the 2010 Annual Report to Stockholders for a more complete description.

Assets and liabilities measured at fair value on a non-recurring basis for each of the fair value hierarchy values are summarized below:

<u>March 31, 2011</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Loans *	\$ -	\$ -	\$ 9,167,974	\$ 9,167,974
Other property owned	-	-	4,450,642	4,450,642
<u>December 31, 2010</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Loans *	\$ -	\$ -	\$ 6,953,843	\$ 6,953,843
Other property owned	-	-	3,612,044	3,612,044

\*Represents the fair value of certain loans that were evaluated for impairment under authoritative guidance, "Accounting by Creditors for Impairment of a Loan." The fair value was based upon the underlying collateral since these were collateral dependent loans for which real estate is the collateral.

### Valuation Techniques

As more fully discussed in Note 12 to the 2010 Annual Report to Stockholders, authoritative guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following represent a brief summary of the valuation techniques used for the Bank and its related Associations' assets and liabilities. For a more complete description, see Notes to the 2010 Annual Report to Stockholders.

#### *Loans*

For certain loans evaluated for impairment under authoritative guidance, the fair value is based upon the underlying collateral since the loans were collateral dependent loans for which real estate is the collateral. 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 real estate, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established.

#### *Other Property Owned*

Other property owned is generally classified as Level 3. The fair value is based upon the collateral value, which is generally determined using appraisals or other indications based on comparable sales of similar properties. Costs to sell represent transaction costs and are not included as a component of the assets fair value.

By contrast, however, other property owned, net is reported in the accompanying balance sheet at the lower of the related loan's carrying amount (at acquisition) or the collateral's fair value less estimated costs to sell. As of March 31, 2011, other property owned, net is reported at \$3,838,245 in the balance sheet.

**NOTE 7 — EMPLOYEE BENEFIT PLANS:**

The following table summarizes the components of net periodic benefit costs of non-pension other postretirement employee benefits for the three months ended March 31:

	Other Benefits	
	2011	2010
Service cost	\$ 13,436	\$ 11,639
Interest cost	23,144	20,770
Expected return on plan assets	-	-
Amortization of prior service costs	(9,462)	(9,756)
Amortizations of net (gain) loss	2,468	-
Net periodic benefit cost	<u>\$ 29,586</u>	<u>\$ 22,653</u>

The Association previously disclosed in its financial statements for the year ended December 31, 2010, that it expected to contribute \$25,694 to its defined pension plan in 2011. As of March 31, 2011, \$6,793 of contributions have been made. The Association's liability for the plan's unfunded accumulated obligation at March 31, 2011 was \$1,664,238 and is included in "Other Liabilities" in the balance sheet.

**NOTE 8 — COMMITMENTS AND CONTINGENT LIABILITIES:**

The Association is involved in various legal proceedings in the normal course of business. In the opinion of management, there are no legal proceedings at this time that are likely to materially affect the Association.

**NOTE 9 — SUBSEQUENT EVENTS:**

The Association has evaluated subsequent events through May 4, 2011, which is the date the financial statements were available to be issued, and determined that there are no subsequent events to report.