

# ALABAMA AG CREDIT, ACA

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## 2010 Quarterly Report 2nd Quarter



**For the Quarter Ended June 30, 2010**

 Part of the Farm Credit System

## 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 financial statements have been prepared in conformity with generally accepted accounting principles appropriate in the circumstances. Other financial information included in the quarterly report is consistent with that in the 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 generally accepted auditing standards. 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  
July 27, 2010



W. Thomas Dozier, III, Chairman, Board of Directors  
July 27, 2010



M. Scott Sellers, CPA, Sr. VP/Chief Financial Officer  
July 27, 2010



J.K. Love, CPA, Chairman, Audit Committee  
July 27, 2010

## **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 and six months ended June 30, 2010. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2009 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.

### **Significant Events:**

On September 21, 2009, the Association's stockholders approved the establishment of a Production Credit Association (PCA) and an Agricultural Credit Association (ACA) holding company. The PCA operates as a wholly-owned subsidiary of the ACA and allows the Association an opportunity to provide short-term and intermediate-term lending. Equity ownership in the existing Federal Land Bank Association of South Alabama, FLCA was transferred to the ACA. Concurrent with the change in corporate structure, the Association's name changed from Federal Land Bank Association of South Alabama, FLCA, to Alabama Ag Credit, FLCA. Likewise, the new ACA holding company operates under the name Alabama Ag Credit, ACA, and the PCA operates under the name Alabama Ag Credit, PCA. This change in corporate structure was approved by the Farm Credit Administration (FCA), and became effective on January 4, 2010.

### **Results of Operations:**

The Association had net income of \$2,987,756 and \$6,312,700 for the three and six months ended June 30, 2010, as compared to net income of \$866,283 and \$2,529,437 for the same periods in 2009 reflecting an increase of 244.9 and 149.6 percent, respectively. Net interest income was \$4,552,007 and \$9,056,445, respectively, for the three and six months ended June 30, 2010, compared to \$4,108,502 and \$8,198,741 for the same periods in 2009. Interest income for the first six months of 2010 increased by \$478,715 or 2.9 percent from the same period of 2009, primarily due to increases in yields on earning assets and an increase in average loan volume. Interest expense for the first six months of 2010 decreased by \$378,989, or 4.4 percent, from the same period of 2009 due to a decrease in interest rates offset by an increase in average debt volume. Average loan volume for the second quarter of 2010 was \$650,290,935, compared to \$610,887,207 in the second quarter of 2009.

Noninterest income for the three and six months ended June 30, 2010 increased by \$534,116 and \$852,651, or 102.3 percent and 76.6 percent, respectively, over the same periods of 2009. This is due primarily to a couple of factors. During the second quarter the Association received a refund of \$558,365 from the Farm Credit Insurance Corporation (FCSIC) on prior years' premiums; no such refunds were received in 2009. Second, during the first six months of 2010 the Association recognized gains on the sale of acquired properties of \$327,523 as compared to \$7,092 the first six months of 2009.

Noninterest expenses for the three and six months ended June 30, 2010, decreased by \$251,128 and \$385,513, or 12.1 percent and 9.2 percent, respectively, as compared to the same periods of 2009. The decrease is due primarily to a decrease in salaries and employee benefits costs and Insurance Fund premium expense. The decrease in salaries and employee benefits is primarily due to a decrease in actuarially-determined, required contributions to the defined benefit (DB) retirement plan, as well as the retirement of one employee. For more information on the DB plan, refer to the 2009 Annual Report and Note 7, "Employee Benefit Plans," to the financial statements included in this quarterly report. Insurance Fund premiums decreased due to the fact that the FCSIC board decreased the insurance premium assessment rate for Farm Credit System banks. The premium rate was 20 basis points on adjusted insured debt for all of 2009; however the FCSIC board decreased the premium rate to 5 basis points for 2010.

The Association's provision for loan loss was \$778,173 and \$886,107 for the quarter and six months ended June 30, 2010 as compared to \$1,711,226 and \$2,545,953 for the same periods in 2009. In the second quarter of 2009, the Association recognized provisions on two large participation loans in the ethanol industry, accounting for most of the year-to-date provision expense. In the second quarter of 2010, the Association recognized provision expense on a higher number of loans, but the loans and the related loss exposures are much smaller by comparison to the prior year. In addition, the Association realized recoveries of \$600,096, as further detailed below and in Note 2, "Allowance For Loan Losses," to the financial statements included in this quarterly report.

The Association recognized charge-offs of \$1,305,449 and \$1,385,310 for the three and six months ended June 30, 2010, and charge-offs of \$32,801 and \$754,830 for the same periods in 2009. The Association recorded recoveries of \$525,293 and \$600,096 for the three and six months ended June 30, 2010 as compared to no recoveries being recorded for the same time periods in 2009.

The Association's return on average assets for the six months ended June 30, 2010, was 1.89 percent compared to 0.81 percent for the same period in 2009. The Association's return on average equity for the six months ended June 30, 2010, was 11.65 percent, compared to 4.94 percent for the same period in 2009.

### 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 variable, fixed, adjustable and prime-based 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 June 30, 2010, stated at recorded investment (principle less funds held), were \$650,909,758 compared to \$637,803,081 at December 31, 2009, reflecting an increase of 2.1 percent. The major commodities within the Association's loan portfolio are timber, cattle, poultry, and field crops.

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

	<u>June 30, 2010</u>	<u>December 31, 2009</u>
Acceptable	94.6 %	94.5 %
Special Mention	1.4 %	1.8 %
Substandard	4.0 %	3.7 %
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>June 30, 2010</u>		<u>December 31, 2009</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Nonaccrual	\$ 13,114,518	90.4%	\$ 9,943,379	77.8%
90 days past due and still accruing interest	-	0.0%	120,087	0.9%
Formally restructured	180,690	1.2%	-	0.0%
Other property owned, net	1,216,841	8.4%	2,724,225	21.3%
Total	<u>\$ 14,512,049</u>	<u>100.0%</u>	<u>\$ 12,787,691</u>	<u>100.0%</u>

At June 30, 2010 loans that were considered impaired were \$13,295,208 compared to \$10,063,466 at December 31, 2009. This represents 2.0 percent and 1.6 percent of loan volume, respectively. Impaired loans consist of all high-risk assets except other property owned, net. Total nonaccrual loans as of June 30, 2010 increased compared to December 31, 2009 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 90% of the increase is attributable to only four borrowers with large credits.

Other property owned, net decreased from December 31, 2009 as the Association sold several properties during the first six months, three of which accounted for approximately 84% of the year end balance. Several properties remain as of June 30, 2010, however the average size and value of the properties is much smaller in comparison to the properties owned at December 31, 2009.

### Liquidity and Funding Sources:

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

	June 30, 2010	December 31, 2009
Note payable to the Bank	\$ 554,780,160	\$ 545,536,104
Accrued interest on note payable	1,361,347	1,394,506
Total	<u>\$ 556,141,507</u>	<u>\$ 546,930,610</u>

### Capital Resources:

The Association's capital position increased by \$6,400,744 at June 30, 2010, compared to December 31, 2009. The Association's debt as a ratio to members' equity was 5.03:1 as of June 30, 2010, compared to 5.29:1 as of December 31, 2009.

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 June 30, 2010, was 15.4 percent, which is in compliance with the FCA's minimum permanent capital standard. The Association's core surplus ratio and total surplus ratio at June 30, 2010, were 14.9 and 14.9 percent, respectively, which is in compliance with the FCA's minimum surplus standards.

### Significant Recent Accounting Pronouncements:

In 2009, the Financial Accounting Standards Board (FASB) issued guidance on several issues, including fair value measurements and accounting for transfers of financial assets. This guidance is discussed in detail in Note 1, "Organization and Significant Accounting Policies," to the financial statements included in this quarterly report.

### 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 Financial Statements contained in the December 31, 2009 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 [fcf@farmcreditbank.com](mailto:fcf@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 website at [www.AlabamaAgCredit.com](http://www.AlabamaAgCredit.com) approximately 40 days after each quarter end, and the annual stockholder report is available on its website 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>June 30, 2010 (unaudited)</b>	<b>December 31, 2009</b>
<b><u>ASSETS</u></b>		
Cash	\$ 10,276	\$ 16,683
Loans	650,909,758	637,803,081
Less: allowance for loan losses	3,538,216	3,437,322
Net loans	647,371,542	634,365,759
Accrued interest receivable	7,920,805	7,738,470
Investment in and receivable from the Bank:		
Capital stock	10,512,930	10,512,930
Accrued patronage receivable	273,000	335,034
Other	349,838	873,568
Other property owned, net	1,216,841	2,724,225
Premises and equipment	2,499,916	2,026,448
Other assets	612,096	249,851
Total assets	\$ 670,767,244	\$ 658,842,968
<b><u>LIABILITIES</u></b>		
Note payable to the Bank	\$ 554,780,160	\$ 545,536,104
Accrued interest payable	1,361,347	1,394,506
Drafts outstanding	1,191,099	908,418
Patronage distributions payable	2,148	3,000,059
Other liabilities	2,220,187	3,192,322
Total liabilities	559,554,941	554,031,409
<b><u>MEMBERS' EQUITY</u></b>		
Capital stock and participation certificates	3,768,880	3,661,325
Unallocated retained earnings	107,342,080	101,029,380
Accumulated other comprehensive income	101,343	120,854
Total members' equity	111,212,303	104,811,559
Total liabilities and members' equity	\$ 670,767,244	\$ 658,842,968

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

ALABAMA AG CREDIT, ACA

CONSOLIDATED STATEMENT OF INCOME  
(unaudited)

	Quarter Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
<b><u>INTEREST INCOME</u></b>				
Loans	\$ 8,634,735	\$ 8,394,426	\$ 17,245,927	\$ 16,767,212
<b><u>INTEREST EXPENSE</u></b>				
Note payable to the Bank	4,082,728	4,285,924	8,189,482	8,568,471
Net interest income	4,552,007	4,108,502	9,056,445	8,198,741
<b><u>PROVISION FOR LOSSES</u></b>				
Provision for loan losses	778,173	1,711,226	886,107	2,545,953
Provision for acquired property losses	16,065	(24,264)	16,065	43,614
Net income after provision for losses	3,757,769	2,421,540	8,154,273	5,609,174
<b><u>NONINTEREST INCOME</u></b>				
Patronage income from the Bank	212,648	204,378	426,200	410,352
Loan fees	229,985	302,959	569,630	650,902
Financially related services income	891	960	2,163	2,667
Gain on other property owned, net	1,905	7,159	327,523	7,092
Gain (Loss) on sale of premises and equipment, net	20,943	6,571	22,005	(5,893)
Other noninterest income	589,771	-	617,619	47,369
Total noninterest income	1,056,143	522,027	1,965,140	1,112,489
<b><u>NONINTEREST EXPENSES</u></b>				
Salaries and employee benefits	1,221,900	1,273,088	2,495,903	2,574,944
Directors' expense	54,304	56,996	135,172	149,537
Purchased services	269,815	368,199	519,048	906,669
Travel	88,638	80,513	134,118	137,093
Occupancy and equipment	76,298	78,609	159,321	156,623
Communications	22,171	24,573	53,601	50,766
Advertising	84,338	28,293	158,857	46,481
Public and member relations	36,572	34,104	81,170	70,692
Supervisory and exam expense	52,250	55,568	104,501	111,137
Insurance Fund premiums	34,469	263,249	217,044	545,109
Other noninterest expense	35,518	30,923	64,314	46,540
CMS expense reimbursements	(150,117)	(216,831)	(316,336)	(603,365)
Total noninterest expenses	1,826,156	2,077,284	3,806,713	4,192,226
Net income	\$ 2,987,756	\$ 866,283	\$ 6,312,700	\$ 2,529,437

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, 2008	\$ 3,494,180	\$ 99,133,667	\$ 184,053	\$ 102,811,900
Comprehensive income				
Net income	-	2,529,437	-	2,529,437
Change in postretirement benefit plans	-	-	(19,511)	(19,511)
Total comprehensive income	-	2,529,437	(19,511)	2,509,926
Capital stock/participation certificates issued	253,980	-	-	253,980
Capital stock/participation certificates retired	(197,655)	-	-	(197,655)
Patronage refunds:				
Cash	-	(3,500,000)	-	(3,500,000)
Balance at June 30, 2009	<u>\$ 3,550,505</u>	<u>\$ 98,163,104</u>	<u>\$ 164,542</u>	<u>\$ 101,878,151</u>
Balance at December 31, 2009	\$ 3,661,325	\$ 101,029,380	\$ 120,854	\$ 104,811,559
Comprehensive income				
Net income	-	6,312,700	-	6,312,700
Change in postretirement benefit plans	-	-	(19,511)	(19,511)
Total comprehensive income	-	6,312,700	(19,511)	6,293,189
Capital stock/participation certificates issued	279,800	-	-	279,800
Capital stock/participation certificates retired	(172,245)	-	-	(172,245)
<b>Balance at June 30, 2010</b>	<b><u>\$ 3,768,880</u></b>	<b><u>\$ 107,342,080</u></b>	<b><u>\$ 101,343</u></b>	<b><u>\$ 111,212,303</u></b>

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, 2009 are contained in the 2009 Annual Report to the stockholders. These unaudited second quarter 2010 consolidated financial statements should be read in conjunction with the 2009 Annual Report to the stockholders.

Effective January 1, 2010, the Farm Credit Bank of Texas (Bank) and related associations adopted Financial Accounting Standards Board (FASB) guidance on "Fair Value Measurements and Disclosures," which is to improve disclosures about fair value measurements by increasing transparency in financial reporting. The guidance will provide for a greater level of disaggregated information and more robust disclosures of valuation techniques and inputs to fair value measurements. The adoption of this guidance had no impact on the Association's financial condition and results of operations.

In June 2009, the FASB issued guidance on "Accounting for Transfers of Financial Assets," which amends 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 is 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 is prohibited. This Statement 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 standards) 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 provided in the pronouncement that requires consolidation. The Association reviewed its loan participation agreements to ensure that participations would meet the requirements for sales treatment and there are no special-purpose entities that would require consolidation. 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 is 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 is prohibited. The Association does not have any variable interest or controlling interest in a variable entity, thus there is no impact of adoption of the guidance.

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. However, 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 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 six months ended June 30, 2010 are not necessarily indicative of the results to be expected for the year ended December 31, 2010. Certain amounts in the prior period's financial statements have been reclassified to conform to current financial statement presentation.

## NOTE 2 — ALLOWANCE FOR LOAN LOSSES:

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:

	<b>June 30, 2010</b>	June 30, 2009
Balance at beginning of quarter	\$ 3,540,199	\$ 1,072,417
Provision for loan losses	778,173	1,711,226
Charge-offs	(1,305,449)	(32,801)
Recoveries	525,293	-
Balance at end of quarter	<u>\$ 3,538,216</u>	<u>\$ 2,750,842</u>

The following table presents information concerning impaired loans:

	<b>June 30, 2010</b>	June 30, 2009
Impaired loans with related allowance	\$ 4,149,162	\$ 5,859,420
Impaired loans with no related allowance	9,146,046	3,546,967
Total impaired loans	<u>\$ 13,295,208</u>	<u>\$ 9,406,387</u>
Allowance on impaired loans	\$ 1,653,240	\$ 2,133,201
Average impaired loans	\$ 12,737,724	\$ 5,959,492
Interest income on impaired loans for the quarter	\$ 17,658	\$ 8,625

## 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 losses 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 2009, the board declared a \$3,000,000 cash patronage to be paid to stockholders from the Association's 2009 earnings. The patronage distribution was completed in March 2010.

#### 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 2010, 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 (over 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 June 30, 2010, based on management's estimate that it is more likely than not that the deferred tax asset will not be realized. For the six months ended June 30, 2010, 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:

Authoritative 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 11 to the 2009 Annual Report to Stockholders for a more complete description.

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

<u>June 30, 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 *	\$ -	\$ -	\$ 6,535,943	\$ 6,535,943
Other property owned	-	-	1,404,721	1,404,721
<u>December 31, 2009</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 *	\$ -	\$ -	\$ 4,693,542	\$ 4,693,542
Other property owned	-	-	2,819,516	2,819,516

\* 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 11 to the 2009 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 2009 Annual Report.

### *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. 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 June 30, 2010, other property owned, net is reported at \$1,216,841 in the balance sheet.

## **NOTE 7 — EMPLOYEE BENEFIT PLANS:**

The following table summarizes the components of net periodic benefit costs for the six months ended June 30, :

	Other Benefits	
	2010	2009
Service cost	\$ 23,278	\$ 24,312
Interest cost	41,540	39,202
Expected return on plan assets	-	-
Amortization of prior service costs	(19,511)	(19,511)
Amortizations of net (gain) loss	-	-
Net periodic benefit cost	\$ 45,307	\$ 44,003

The Association previously disclosed in its Annual Report to the stockholders for the year ended December 31, 2009, that it expected to contribute \$23,920 to its postretirement health and welfare benefits plan in 2010. As of June 30, 2010, \$13,984 of contributions have been made. The Association's liability for the plan's unfunded accumulated benefit obligation at June 30, 2010 was \$1,436,062 and is included in "Other liabilities" in the balance sheet.

## **NOTE 8 — COMMITMENTS AND CONTINGENCIES:**

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 July 27, 2010, which is the date the financial statements were available to be issued, and determined that there are no subsequent events to report.