

# **AGTEXAS FARM CREDIT SERVICES**

---

**2009  
Quarterly Report  
Second Quarter**



**For the Quarter Ended June 30, 2009**

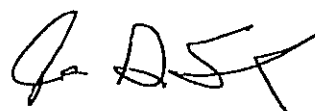
## REPORT OF MANAGEMENT

The undersigned certify that we have reviewed this report, that it has been prepared in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate and complete to the best of his or her knowledge and belief.



Mitchell Harris  
Chief Executive Officer

*July 24, 2009*



James Ray Schronk  
Chairman, Board of Directors

*July 24, 2009*



Jerry Spruill  
Chief Financial Officer

*July 24, 2009*

**AGTEXAS FARM CREDIT SERVICES  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following commentary reviews the financial performance of the AgTexas Farm Credit Services (Agricultural Credit Association), referred to as the Association, for the quarter and six months ended June 30, 2009. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2008 Annual Report of the Association.

The association is a member of the Farm Credit System (System), a nationwide network of cooperatively owned financial institutions established by and subject to the provisions of the Farm Credit Act of 1971, as amended, and the regulations of the Farm Credit Administration (FCA) promulgated thereunder.

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:**

The Association is experiencing an extreme slowing in the real estate sector of new loan applications or even inquiries due to the state of the economy. This is a significant change from the last few years and could reflect lower earnings for the year 2009 along with a decrease in average loan volume. As a result, the Association is experiencing a deleveraging with some increases in spreads due to the current market rate environment. The slowing of new loan originations is reflected in lower fee income with year to date reported of \$364,817, a decline in comparison with the amount reported for the same period in 2008 of \$959,886. The Association in 2009 has recognized a gain on the sale of \$27,801,768 of individual loan securities in the amount of \$278,968.

The Association has recognized some deterioration in credit quality with related provisions to the allowance in 2009 totaling \$432,977 compared with negative provisions during the same period in 2008 of \$83,315.

During the second quarter of 2009, the Association reduced the number of employees. The cost of this reduction, special severance packages, is reflected in the higher salary and employee benefits category for the quarter and year to date in comparison with prior years.

**Loan Portfolio:**

Total loans outstanding at June 30, 2009, including nonaccrual loans and sales contracts, were \$534,917,039 compared to \$554,038,897 at December 31, 2008, reflecting a decrease of 3.5 percent. Nonaccrual loans as a percentage of total loans outstanding were 1.6 percent at June 30, 2009, compared to 1.1 percent at December 31, 2008.

The Association recorded \$1,661 in recoveries and \$7,750 in charge-offs for the quarter ending June 30, 2009, and \$8,670 in recoveries and \$0 in charge-offs for the same period in 2008. The Association's allowance for loan losses was 0.2 percent and 0.2 percent of total loans outstanding as of June 30, 2009, and December 31, 2008, respectively.

**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, 2009</u>		<u>December 31, 2008</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Nonaccrual	\$ 8,683,354	66.2%	\$ 6,069,477	94.0%
90 days past due and still accruing interest	4,437,129	33.8%	385,922	6.0%
Formally restructured	-	0.0%	-	0.0%
Other property owned, net	-	0.0%	-	0.0%
Total	<u>\$ 13,120,483</u>	<u>100.0%</u>	<u>\$ 6,455,399</u>	<u>100.0%</u>

The increase in 90 days past due and still accruing interest, reflected in June 30, 2009 in the amount of \$4,437,129 consist of \$3,282,564 of the 100% U.S. agency guaranteed portfolio. All outstanding principal and interest is guaranteed on the current past due amounts. The unamortized related premiums on the past due securities is \$170,972.

## Results of Operations:

The Association had net income of \$725,055 and \$2,085,667 for the three and six months ended June 30, 2009, as compared to net income of \$1,285,120 and \$2,706,534 for the same periods in 2008 reflecting an decrease of 43.6 and 22.9 percent, respectively. Net interest income was \$3,024,333 and \$5,771,301, respectively, for the three and six months ended June 30, 2009, compared to \$2,809,962 and \$5,522,135 for the same periods in 2008. Interest income for the first six months of 2009 decreased by \$577,785 or 4.0 percent from the same periods of 2008 , primarily due to declines in yields on earning assets. Interest expense for the first six months of 2009 decreased by \$826,951, or 9.2 percent, from the same periods of 2008 due to a decrease in interest rates. Average loan volume for the second quarter of 2009 was \$517,532,777, compared to \$482,469,608 in the second quarter of 2008. The average spread on the loan portfolio for the second quarter 2009 was 2.03 percent, compared to 1.81 percent in the second quarter of 2008. The earnings from lendable equity represents 0.26% of a net interest margin (NIM) of 2.29% during the 2009 second quarter compared with 0.49% of a NIM of 2.30% for the same period in 2008.

The Association's return on average assets for the six months ended June 30, 2009, was 0.75 and 1.16 percent for the same period in 2008. The Association's return on average equity for the six months ended June 30, 2009, was 7.68 and 10.34 percent for the same period in 2008.

## 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 Systemwide obligations and with lendable equity. The following schedule summarizes the Association's borrowings.

	June 30, 2009	December 31, 2008
Note payable to the Bank	\$ 496,288,418	\$ 524,372,757
Accrued interest on note payable	1,284,340	1,810,157
Total	<u>\$ 497,572,758</u>	<u>\$ 526,182,914</u>

## Capital Resources:

The Association's capital position increased by \$1,968,738 at June 30, 2009, compared to December 31, 2008. The Association's debt as a percentage of members' equity was 9.18:1 as of June 30, 2009, compared to 9.99:1 as of December 31, 2008.

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, 2009, was 11.1 percent, which is in compliance with the FCA's minimum permanent capital standard. The Association's core surplus ratio and total surplus ratio at June 30, 2009, were 10.5 and 10.5 percent, respectively, which is in compliance with the FCA's minimum surplus standard.

## 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, 2008 Annual Report of AgTexas Farm Credit Services 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 quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to AgTexas Farm Credit Services, P.O. Box 53240, Lubbock, Texas 79453 or calling 806-687-4068. Copies of the Association's quarterly stockholder reports can also be requested by e-mailing [jspruill@agtexas.com](mailto:jspruill@agtexas.com).

**AGTEXAS FARM CREDIT SERVICES**

**CONSOLIDATED BALANCE SHEET**

	<b>June 30, 2009 (unaudited)</b>	<b>December 31, 2008</b>
<b><u>ASSETS</u></b>		
Cash	\$ 915,204	\$ 2,861,414
Investments	16,905,050	17,928,982
Loans	534,917,039	554,038,897
Less: allowance for loan losses	<u>1,288,310</u>	<u>950,003</u>
Net loans	533,628,729	553,088,894
Accrued interest receivable	6,842,771	9,393,528
Investment in and receivable from the Bank:		
Capital stock	9,120,035	9,120,035
Other	1,277,301	1,149,888
Premises and equipment	2,674,462	2,817,623
Other assets	<u>1,547,847</u>	<u>528,591</u>
Total assets	<u><u>\$ 572,911,399</u></u>	<u><u>\$ 596,888,955</u></u>
<b><u>LIABILITIES</u></b>		
Note payable to the Bank	\$ 496,288,418	\$ 524,372,757
Advance conditional payments	6,275,546	8,545,285
Accrued interest payable	1,289,364	1,810,158
Drafts outstanding	1,484,230	2,858,739
Patronage distributions payable	-	1,200,000
Other liabilities	<u>11,281,586</u>	<u>3,778,499</u>
Total liabilities	<u><u>516,619,144</u></u>	<u><u>542,565,438</u></u>
<b><u>MEMBERS' EQUITY</u></b>		
Capital stock and participation certificates	2,581,180	2,703,015
Allocated retained earnings	10,693,145	10,693,068
Unallocated retained earnings	42,675,765	40,595,928
Accumulated other comprehensive income (loss)	<u>342,165</u>	<u>331,506</u>
Total members' equity	<u>56,292,255</u>	<u>54,323,517</u>
Total liabilities and members' equity	<u><u>\$ 572,911,399</u></u>	<u><u>\$ 596,888,955</u></u>

**AGTEXAS FARM CREDIT SERVICES**

**CONSOLIDATED STATEMENT OF INCOME**  
(unaudited)

	Quarter Ended		Six Months Ended	
	June 30,		June 30,	
	2009	2008	2009	2008
<b><u>INTEREST INCOME</u></b>				
Loans	\$ 6,820,227	\$ 7,207,426	\$ 13,785,280	\$ 14,449,667
Investments	75,566	74,632	161,234	74,632
Total interest income	6,895,793	7,282,058	13,946,514	14,524,299
<b><u>INTEREST EXPENSE</u></b>				
Note payable to the Bank	3,865,468	4,443,357	8,159,325	8,925,572
Advance conditional payments	5,992	28,739	15,888	76,592
Total interest expense	3,871,460	4,472,096	8,175,213	9,002,164
Net interest income	3,024,333	2,809,962	5,771,301	5,522,135
<b><u>PROVISION FOR LOSSES</u></b>				
Provision (negative provision) for loan losses	400,000	26,815	432,977	(83,315)
Provision for acquired property losses	-	-	-	-
Net interest income after provision for loan losses	2,624,333	2,783,147	5,338,324	5,605,450
<b><u>NONINTEREST INCOME</u></b>				
Income from the bank:				
Patronage income	403,540	372,743	821,784	713,888
Loan fees	139,322	464,534	364,817	959,886
Financially related services income	319,568	309,186	614,106	601,519
Gain (loss) on other property owned, net	-	-	-	-
Gain (loss) on sale of loan securities	(11,584)	-	278,968	-
Gain (loss) on sale of premises and equipment, net	31,048	665	31,587	12,030
Other noninterest income	9,201	23,767	73,024	69,607
Total noninterest income	891,095	1,170,895	2,184,286	2,356,930
<b><u>NONINTEREST EXPENSES</u></b>				
Salaries and employee benefits	1,896,838	1,685,095	3,669,588	3,354,314
Directors' expense	45,638	37,470	99,748	76,418
Purchased services	107,407	156,175	207,021	274,770
Travel	63,849	107,502	138,732	195,247
Occupancy and equipment	243,361	236,827	472,894	507,598
Communications	50,020	37,999	89,895	76,796
Advertising	33,694	26,140	65,450	62,320
Public and member relations	49,283	67,616	110,525	147,456
Supervisory and exam expense	36,753	30,785	73,507	61,569
Insurance Fund premiums	170,955	137,711	351,366	275,779
Other noninterest expense	92,575	145,602	158,217	223,579
Total noninterest expenses	2,790,373	2,668,922	5,436,943	5,255,846
Income before income taxes	725,055	1,285,120	2,085,667	2,706,534
Provision for (benefit from) income taxes	-	-	-	-
Net income	\$ 725,055	\$ 1,285,120	\$ 2,085,667	\$ 2,706,534

AGTEXAS FARM CREDIT SERVICES

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY  
(unaudited)

	Capital Stock/ Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
		Allocated	Unallocated		
Balance at December 31, 2007	\$ 2,569,760	\$ 11,219,573	\$ 37,455,079	\$ 443,178	\$ 51,687,590
Adjustment to beginning balance due to FAS No. 158 accounting change	-	-	-	-	-
Balance at January 1, 2008	2,569,760	11,219,573	37,455,079	443,178	51,687,590
Comprehensive income					
Net income	-	-	2,706,534	-	2,706,534
Change in unrealized gains (losses) on investment securities	-	-	-	72,729	72,729
Amortization of costs included in periodic retirement benefit costs	-	-	(25,420)	(50,840)	(76,260)
Total comprehensive income	-	-	2,681,114	21,889	2,703,003
Capital stock/participation certificates issued	402,915	-	-	-	402,915
Capital stock/participation certificates and allocated retained earnings retired	(376,530)	-	-	-	(376,530)
Stock equalization	-	-	-	-	-
Dividends declared	-	-	-	-	-
Patronage refunds:					
Cash	-	-	(1,000,000)	-	(1,000,000)
Capital stock/participation certificates and allocated retained earnings	-	(1,306,326)	3,332	-	(1,302,994)
Balance at June 30, 2008	<u>\$ 2,596,145</u>	<u>\$ 9,913,247</u>	<u>\$ 39,139,525</u>	<u>\$ 465,067</u>	<u>\$ 52,113,984</u>
Balance at December 31, 2008	\$ 2,703,015	\$ 10,693,068	\$ 40,595,928	\$ 331,506	\$ 54,323,517
Comprehensive income					
Net income	-	-	2,085,667	-	2,085,667
Change in unrealized gains (losses) on investment securities	-	-	-	52,915	52,915
Amortization of costs included in periodic retirement benefit costs	-	-	-	(42,256)	(42,256)
Total comprehensive income	-	-	2,085,667	10,659	2,096,326
Capital stock/participation certificates issued	510,855	-	-	-	510,855
Capital stock/participation certificates and allocated retained earnings retired	(632,690)	-	-	-	(632,690)
Stock equalization	-	-	-	-	-
Dividends declared	-	-	-	-	-
Patronage refunds:					
Cash	-	-	-	-	-
Capital stock/participation certificates and allocated retained earnings	-	77	(5,830)	-	(5,753)
Balance at June 30, 2009	<u>\$ 2,581,180</u>	<u>\$ 10,693,145</u>	<u>\$ 42,675,765</u>	<u>\$ 342,165</u>	<u>\$ 56,292,255</u>

**AGTEXAS FARM CREDIT SERVICES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

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

The AgTexas Farm Credit Services (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 Brown, Cochran, Comanche, Crosby, Eastland, Ellis, Erath, Gaines, Garza, Hamilton, Hill, Hockley, Hood, Johnson, Lubbock, Lynn, Navarro, Parker, Somervell, Tarrant, Terry, Wise and Yoakum. 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.

Effective January 1, 2009, the Association adopted Financial Accounting Standards Board (FASB) Staff Position No. 157-2, "Effective Date of FASB Statement No. 157" (FSP 157-2). This FSP delayed the effective date of Statement of Financial Accounting Standard (SFAS) No. 157, "Fair Value Measurements" (SFAS 157) for nonfinancial assets and nonfinancial liabilities. The impact of adoption resulted in additional fair value disclosures but did not have an impact on our financial condition or results of operations.

In April 2009, the FASB issued FSP No. 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" (FSP 157-4). FSP 157-4 emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique and inputs used, the objective for fair value measurement is unchanged from what it would be if markets were operating at normal activity levels or transactions were orderly; that is, to determine the current exit price. It sets forth additional factors that should be considered to determine whether there has been a significant decrease in volume and level of activity when compared with normal market activity. The reporting entity shall evaluate the significance and relevance of the factors to determine whether, based on the weight of evidence, there has been a significant decrease in activity and volume. FSP 157-4 indicates that if an entity determines that either the volume or level of activity for an asset or liability has significantly decreased (from normal conditions for that asset or liability) or price quotations or observable inputs are not associated with orderly transactions, increased analysis and management judgment will be required to estimate fair value. It is further noted that a fair value measurement should include a risk adjustment to reflect the amount market participants would demand because of the risk (uncertainty) in the cash flows.

FSP 157-4 also requires a reporting entity to make additional disclosures in interim and annual periods. It is effective for interim periods ending after June 15, 2009, with early application permitted for periods ending after March 15, 2009. Revisions resulting from a change in valuation techniques or their application are accounted for as a change in accounting estimate. The Association adopted the FSP in second quarter 2009. The adoption did not have a material impact on the financial condition or results of operations of the Association.

In April 2009, the FASB issued FSP No. 115-2, "Recognition and Presentation of Other-Than-Temporary Impairments" (FSP 115-2), which amends the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt securities in the financial statements. It does not change existing recognition and measurement guidance related to other-than-temporary impairments of equity securities.

FSP 115-2 changes existing impairment guidance under FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities (FSP 115) by eliminating the "ability and intent to hold" provision. In addition, impairment is now considered to be other than temporary if an entity (i) intends to sell the security, (ii) more likely than not will be required to sell the security before recovering its cost, or (iii) does not expect to recover the security's entire amortized cost basis (even if the entity does not intend to sell). The "probability" standard relating to the collectability of cash flows is also eliminated, and impairment is now considered to be other-than-temporary if the present value of cash flows expected to be collected from the debt security is less than the amortized cost basis of the security (any such shortfall is referred to in FSP 115-2 as a "credit loss"). If an entity intends to sell an impaired debt security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the impairment is other-than-temporary and should be recognized currently in earnings in an amount equal to the entire difference between fair value and amortized cost. If a credit loss exists, but an entity does not intend to sell the impaired debt security and is not more likely than not to be required to sell before recovery, the impairment is other-than-temporary and should be separated into (i) the estimated amount relating to credit loss, and (ii) the amount relating to all other factors. Only the estimated credit loss amount is recognized currently in earnings, with the remainder of the loss amount recognized in other comprehensive income. For held-to-maturity securities, the portion of the other-than-temporary impairment not related to a credit loss will be recognized in a new category of other comprehensive income and amortized over the remaining life of the debt security as an increase in the security's carrying amount. Disclosure requirements for impaired debt and equity securities are expanded and will now be required quarterly, as well as annually.

FSP 115-2 is effective for interim and annual periods ending after June 15, 2009, with early application permitted for periods ending after March 15, 2009. For securities held at the beginning of the interim period of adoption for which an other-than-temporary impairment was previously recognized, if an entity does not intend to sell and it is more likely than not that it will be required to sell before recovery of its amortized cost basis, the entity shall recognize the cumulative effect of initially applying this FSP adjustment to the opening balance of retained earnings with a corresponding adjustment to accumulated other comprehensive income. The Association adopted the FSP in the second quarter of 2009 and did not recognize an adjustment to beginning retained earnings or accumulated other comprehensive income since no impairment losses were previously recognized.

In May 2009, the FASB issued SFAS No. 165, "Subsequent Events" (SFAS 165), which sets forth general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Recognized subsequent events should be recognized in the financial statements since the conditions existed at the date of the balance sheet. Nonrecognized subsequent events are not recognized in the financial statements since the conditions arose after the balance sheet date but before the financial statements are issued or are available to be issued. This Standard, which includes a required disclosure of the date through which an entity has evaluated subsequent events, is effective for interim or annual periods ending after June 15, 2009.

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 and the six months ended June 30, 2009, are not necessarily indicative of the results to be expected for the year ended December 31, 2009. Certain amounts in the prior period's financial statements have been reclassified to conform to current financial statement presentation.

## NOTE 2 — Investments:

### Available-for-Sale

A summary of the amortized cost and fair value of investment securities available-for-sale, excluding mission-related and other investments, at June 30, 2009 is as follows:

	Gross Unrealized	Gross Unrealized		Weighted	
<u>June 30, 2009</u>	Amortized Cost	Gains	Losses	Fair Value	Average Yield
U.S. agency securities	16,733,999	171,051	-	16,905,050	3.47%
<u>December 31, 2008</u>					
U.S. agency securities	17,810,845	118,137	-	17,928,982	3.30%

The Association evaluates investment securities for other-than-temporary impairment on a quarterly basis. Factors considered in determining whether an impairment is other-than-temporary include: 1) the length of time and the extent to which the fair value is less than cost, 2) whether or not we intend to sell the security, 3) whether it is more likely than not that we would be required to sell the security before recovering its costs, or, 4) whether we do expect to recover the security's entire amortized cost basis (even if we do not intend to sell). In addition, we qualitatively consider all available information when assessing whether impairment is other-than-temporary. Based on the results of these evaluations, if it is determined that the impairment is other-than-temporary, the carrying value of the security is written down to fair value, the credit-related portion is recognized through earnings and the non-credit related portion is recognized in other comprehensive income.

### NOTE 3 — 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:

	June 30, 2009	June 30, 2008
Balance at beginning of quarter	\$ 894,399	\$ 378,600
Provision for loan losses	400,000	26,815
Charge-offs	(7,750)	-
Recoveries	1,661	8,670
Balance at end of quarter	<u>\$ 1,288,310</u>	<u>\$ 414,085</u>

The following table presents information concerning impaired loans:

	June 30, 2009	June 30, 2008
Impaired loans with related allowance	\$ 4,545,132	\$ -
Impaired loans with no related allowance	8,575,351	540,246
Total impaired loans	<u>\$ 13,120,483</u>	<u>\$ 540,246</u>
Allowance on impaired loans	\$ 866,170	\$ 104,275
Average impaired loans	\$ 11,686,787	\$ 2,462,883
Interest income on impaired loans for the quarter	\$ 73,117	\$ 10,545

The increase in the impaired loans in comparison with the same prior period is a reflection of the economy. The impaired loan volume, as of June 30, 2009, includes \$6,300,554 of loans purchased from other Farm Credit Institutions with \$263,000 allowance, \$3,282,564 guaranteed investments that are 90 days past due and still accruing interest with \$0 allowance, and the remaining \$3,537,365 of impaired loans includes originations by AgTexas with \$603,170 of allowance.

### NOTE 4 — 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 and lease portfolios; 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.

### NOTE 5 — INCOME TAXES:

AgTexas Farm Credit Services and its subsidiary 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. 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. For the six months ended June 30, 2009, and 2008 net income for tax purposes was \$0 due to the Association's patronage program and related cooperative deduction.

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

**NOTE 6 — FAIR VALUE MEASUREMENTS:**

SFAS No. 157 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 2 to the 2008 Annual Report to Stockholders for a more complete description.

Assets and liabilities measured at fair value on a recurring basis at June 30, 2009 are summarized below:

	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Investments available-for-sale	\$ -	\$ 16,905,050	\$ -	\$ 16,905,050
Total assets	-	16,905,050	-	16,905,050

**Valuation Techniques**

As more fully discussed in Note 2, paragraph K to the 2008 Annual Report to Stockholders, SFAS No. 157 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. For a more complete description, see Notes to the 2008 Annual Report.

*Investment Securities*

Where quoted prices are available in an active market, available-for-sale securities are classified as Level 1. If quoted prices are not available in an active market, the fair value of securities is estimated using quoted prices for similar securities received from pricing services, pricing models that utilize observable inputs or discounted cash flows. Generally, these securities are classified as Level 2. This would include certain mortgage-backed securities and in AgTexas all investments are 100% guaranteed U.S. government agency securities. Where there is limited activity or less transparency around inputs to the valuation, the securities are classified as Level 3. Securities classified within Level 3 include asset-backed securities and certain mortgage-backed securities, including those issued by Farmer Mac.

**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	
	2009	2008
Service cost	\$ 18,356	\$ 16,672
Interest cost	36,298	33,363
Expected return on plan assets	-	-
Amortization of prior service costs	(25,486)	(25,821)
Amortizations of net (gain) loss	6,860	401
Net periodic benefit cost	\$ 36,028	\$ 24,615

The Association previously disclosed in its financial statements for the year ended December 31, 2008, that it expected to contribute \$1,680,933 to its defined pension plan in 2009. As of June 30, 2009, \$1,680,933 of contributions have been made. The total contribution will be amortized monthly during 2009. During the second quarter, the Association recognized \$420,233 of benefit expense due to the amortization with a year to date expense recognized of \$840,466. The Association presently does not anticipate contributing additional funds to its defined pension plan in 2009.