
FARM CREDIT OF SOUTH FLORIDA, ACA

2006 ANNUAL REPORT

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Management

| | |
|---------------------------|-----------------------------------|
| Don Rice..... | President/Chief Executive Officer |
| C. Robert Pendleton | Chief Lending Officer |
| Linda Rusciano | Chief Financial Officer |
| Esther Morales | Chief Credit Officer |

Board of Directors

| | |
|----------------------------|---------------|
| John D. Martin, Jr. | Chairman |
| Jack C. Coker | Vice Chairman |
| Richard T. Alger | Director |
| William E. Bowman, Jr..... | Director |
| Robert J. Callaway | Director |
| Sherwood J. Johnson..... | Director |
| Louis E. Larson, Jr. | Director |
| Charles F. Martin | Director |
| Robert G. Sexton..... | Director |

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Message from the President

As we wrap up 2006, I am again very pleased to report that your association's earnings again grew to record levels, that credit quality and loan performance remained at very high levels and that both total assets and capital grew significantly. The association also continued to operate as one of the most efficient and profitable organizations in the Farm Credit System.

While most of our producers experienced adequate cash flows in 2006, we believe the year was fundamentally different than a normal production year. Cash flows were supplemented by unique and sometimes extraordinary sources of income. Although the territory had no hurricanes or significant weather events during our reporting period, many of our farmer members were still receiving material levels of crop insurance and other disaster assistance from the 2005 and 2004 storms. Moreover, the USDA and State of Florida's program to eradicate Asian Citrus Canker was abandoned in early 2006 with significant final payments being made in early 2006 for trees lost in prior years.

However, the most significant change in agricultural cash flows resulted from the dramatic changes in the market for rural property. In recent years the market for farm land has been directly tied to Southeast Florida's white hot housing market. Farmland prices grew exponentially each year between 2000 and 2005 as thousands of new homes were started. The last half of 2006 saw a sharp increase in unsold house inventory, a sharp decline in home starts, and falling home prices. This housing market decline has contributed to a material decline in land sales and a leveling or decline in the overall market. Our lending activity has also shown large numbers of sales contracts that did not close.

We believe 2007 will see farm cash flows, previously driven by land sales, replaced by cash flows from actual farm production. Most of the farm products grown in South Florida still show fundamentally sound returns for efficient producers. As the land market has slowed, we have seen renewed interest by farmers wishing to expand or make capital improvements in their existing operations. We also remain optimistic that the cooling of the land market will result in a "soft landing" with no additional declines in values as investors exit the farm land market.

The strong earnings of 2006 combined with the sound capital position of the association, will again allow us to distribute over \$5 million in cash patronage to our members as well as revolve \$3 million in allocated surplus from 1999. We attribute our success in 2006 to you, our members, as you continued to utilize the services of our cooperative. We are pleased that we can return that success to you in the form of patronage refunds.

On behalf of our entire Farm Credit team, we want to thank you for your patronage of the cooperative and for the opportunity to serve you. We take no greater pride than knowing, that as a cooperative, every customer we serve is the owner of the bank.



Don Rice
President

February 28, 2007

Report of Management

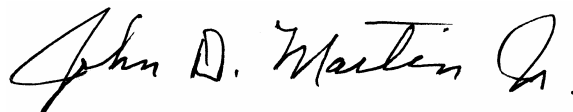
The accompanying consolidated financial statements and related financial information appearing throughout this annual report have been prepared by management of Farm Credit of South Florida, ACA (Association) in accordance with generally accepted accounting principles appropriate in the circumstances. Amounts which must be based on estimates represent the best estimates and judgments of management. Management is responsible for the integrity, objectivity, consistency, and fair presentation of the consolidated financial statements and financial information contained in this report.

Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all financial statements, and that the assets of the Association are safeguarded. The design and implementation of all systems of internal control are based on judgments required to evaluate the costs of controls in relation to the expected benefits and to determine the appropriate balance between these costs and benefits. The Association maintains an internal audit program to monitor compliance with the systems of internal accounting control. Audits of the accounting records, accounting systems and internal controls are performed and internal audit reports, including appropriate recommendations for improvement, are submitted to the Board of Directors.

The consolidated financial statements have been examined by independent public auditors, whose report appears elsewhere in this annual report. The Association is also subject to examination by the Farm Credit Administration.

The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that the 2006 Annual Report 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 our knowledge and belief.

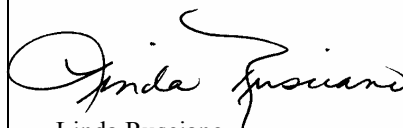
The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.



John D. Martin, Jr.
Chairman of the Board



Don Rice
Chief Executive Officer



Linda Rusciano
Chief Financial Officer

February 28, 2007

Consolidated Five - Year Summary of Selected Financial Data

(UNAUDITED)

| <i>(dollars in thousands)</i> | 2006 | 2005 | December 31, 2004 | 2003 | 2002 |
|---|------------|------------|----------------------|------------|------------|
| Balance Sheet Data | | | | | |
| Cash | \$ 667 | \$ 904 | \$ 1,090 | \$ 472 | \$ 945 |
| Loans | 514,258 | 467,557 | 480,183 | 461,887 | 417,911 |
| Less: allowance for loan losses | 5,198 | 5,106 | 5,100 | 14,881 | 14,895 |
| Net loans | 509,060 | 462,451 | 475,083 | 447,006 | 403,016 |
| Investment in other Farm Credit institutions | 6,773 | 5,411 | 5,642 | 4,823 | 4,811 |
| Other property owned | — | — | — | — | 85 |
| Other assets | 18,914 | 13,264 | 11,769 | 7,590 | 6,425 |
| Total assets | \$ 535,414 | \$ 482,030 | \$ 493,584 | \$ 459,891 | \$ 415,282 |
| Notes payable to AgFirst Farm Credit Bank* | \$ 420,609 | \$ 372,272 | \$ 399,589 | \$ 382,450 | \$ 343,688 |
| Accrued interest payable and other liabilities with maturities of less than one year | 23,378 | 23,852 | 17,638 | 20,120 | 19,078 |
| Total liabilities | 443,987 | 396,124 | 417,227 | 402,570 | 362,766 |
| Protected borrower stock | 2,739 | 2,898 | 3,135 | 3,347 | 3,755 |
| Capital stock and participation certificates | 777 | 808 | 810 | 769 | 697 |
| Retained earnings | | | | | |
| Allocated | 21,752 | 22,550 | 21,277 | 20,471 | 21,637 |
| Unallocated | 66,159 | 59,650 | 51,135 | 34,902 | 28,804 |
| Accumulated other comprehensive income (loss) | — | — | — | (2,168) | (2,377) |
| Total members' equity | 91,427 | 85,906 | 76,357 | 57,321 | 52,516 |
| Total liabilities and members' equity | \$ 535,414 | \$ 482,030 | \$ 493,584 | \$ 459,891 | \$ 415,282 |
| Statement of Income Data | | | | | |
| Net interest income | \$ 16,702 | \$ 14,898 | \$ 12,768 | \$ 11,740 | \$ 8,917 |
| Provision for (reversal of allowance for) loan losses | — | — | (9,823) | — | 1,250 |
| Noninterest income (expense), net | (489) | 2,052 | 861 | 276 | (422) |
| Net income | \$ 16,213 | \$ 16,950 | \$ 23,452 | \$ 12,016 | \$ 7,245 |
| Key Financial Ratios | | | | | |
| Rate of return on average: | | | | | |
| Total assets | 3.20% | 3.56% | 5.02% | 2.80% | 2.27% |
| Total members' equity | 17.97% | 20.98% | 38.29% | 21.69% | 14.02% |
| Net interest income as a percentage of | | | | | |
| average earning assets | 3.41% | 3.20% | 2.72% | 2.72% | 2.63% |
| Net chargeoffs (recoveries) to average loans | (0.019)% | (0.001)% | (0.01)% | 0.003% | 0.001% |
| Total members' equity to total assets | 17.08% | 17.82% | 15.47% | 12.46% | 12.65% |
| Debt to members' equity (:1) | 4.86 | 4.61 | 5.46 | 7.02 | 6.91 |
| Allowance for loan losses to loans | 1.01% | 1.09% | 1.06% | 3.22% | 3.56% |
| Permanent capital ratio | 16.31% | 16.76% | 12.76% | 12.99% | 13.54% |
| Total surplus ratio | 16.18% | 16.58% | 12.58% | 12.81% | 13.40% |
| Core surplus ratio | 14.94% | 14.44% | 10.86% | 10.87% | 10.90% |
| Net Income Distribution | | | | | |
| Estimated patronage refunds: | | | | | |
| Cash | \$ 5,147 | \$ 4,007 | \$ 3,502 | \$ 2,868 | \$ 2,349 |
| Nonqualified retained earnings | 4,383 | 4,173 | 3,692 | 2,939 | — |

* General financing agreement is renewable on three-year cycles. The next renewal date is December 31, 2007.

Management's Discussion & Analysis of Financial Condition & Results of Operations

(dollars in thousands, except as noted)

GENERAL OVERVIEW

The following commentary summarizes the financial condition and results of operations of Farm Credit of South Florida, ACA, (Association) for the year ended December 31, 2006 with comparisons to the years ended December 31, 2005 and December 31, 2004. This information should be read in conjunction with the Consolidated Financial Statements, Notes to the Consolidated Financial Statements and other sections in this Annual Report. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors. For a list of the Audit Committee members, refer to the "Report of the Audit Committee" reflected in this Annual Report. Information in any part of this Annual Report may be incorporated by reference in answer or partial answer to any other item of the Annual Report.

The Association is an institution of the Farm Credit System (System), which was created by Congress in 1916 and has served agricultural producers for almost 90 years. The System's mission is to maintain and improve the income and well-being of American farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses. The System is the largest agricultural lending organization in the United States. The System is regulated by the Farm Credit Administration, (FCA), which is an independent safety and soundness regulator.

The Association is a cooperative, which is owned by the members (also referred to throughout this Annual Report as stockholders or shareholders) served. The territory of the Association extends across a diverse agricultural region in southeast Florida. Refer to Note 1, "Organization and Operations," of the Notes to the Consolidated Financial Statements for counties in the Association's territory. The Association provides credit to farmers, ranchers, rural residents, and agribusinesses. Our success begins with our extensive agricultural experience and knowledge of the market combined with our cooperative business model.

The Association obtains funding from AgFirst Farm Credit Bank (AgFirst or Bank). The Association is materially affected and shareholder investment in the Association could be affected by the financial condition and results of operations of the Bank. Copies of the Bank's Annual and Quarterly Reports are on the AgFirst website, www.agfirst.com, or may be obtained at no charge by calling 1-800-845-1745, extension 316, or writing Wanda Martin, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202.

Copies of the Association's Annual and Quarterly reports are also on the Association's website, www.farmcreditsfl.com, or may be obtained upon request free of charge by calling 1-800-432-4156, extension 240, or writing Linda Rusciano, Farm Credit of South Florida, ACA, P. O. Box 213069, Royal Palm Beach, FL 33421. The Association prepares a quarterly report within 45 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Association.

CRITICAL ACCOUNTING POLICIES

The financial statements are reported in conformity with accounting principles generally accepted in the United States of America. Our significant accounting policies are critical to the understanding of our results of operations and financial position because some accounting policies require us to make complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. We consider these policies critical because management must make judgments about matters that are inherently uncertain. For a complete discussion of significant accounting policies, see Note 2, "Summary of Significant Accounting Policies," of the Notes to the Consolidated Financial Statements. The following is a summary of certain critical policies.

- *Allowance for loan losses* — The allowance for loan losses is management's best estimate of the amount of probable losses existing in and inherent in our loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs. The allowance for loan losses is determined based on a periodic evaluation of the loan portfolio, which generally considers relevant historical charge-off experience adjusted for relevant factors. These factors include types of loans, credit quality, specific industry conditions, general economic and political conditions, and changes in the character, composition, and performance of the portfolio, among other factors.

Significant individual loans are evaluated based on the borrower's overall financial condition, resources, and payment record, the prospects for support from any financially responsible guarantor, and, if appropriate, the estimated net realizable value of any collateral. The allowance for loan losses attributable to these loans is established by a process that estimates the probable loss inherent in the loans, taking into account various historical and projected factors, internal risk ratings, regulatory oversight, and geographic, industry and other factors.

Changes in the factors considered by management in the evaluation of losses in the loan portfolios could result in a change in the allowance for loan losses and could have a direct impact on the provision for loan losses and the results of operations.

- *Valuation methodologies* — Management applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets for which an observable liquid market exists, such as most investment securities. Management utilizes significant estimates and assumptions to value items for which an observable liquid market does not exist. Examples of these items include impaired loans, pension and other postretirement benefit obligations, and certain other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing and liquidation values. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on the Association's results of operations. For additional information, refer to the Recently Issued Accounting Pronouncements disclosed in this Annual Report.
- *Pensions* — The Bank and its related Associations participate in defined benefit retirement plans. These plans are noncontributory and benefits are based on salary and years of service. In addition, the Bank and its related Associations also participate in defined contribution retirement savings plans. Pension expense for all plans is recorded as part of salaries and employee benefits. Pension expense is determined by actuarial valuations based on certain assumptions, including expected long-term rate of return on plan assets and discount rate. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that portfolio of assets. The discount rate is used to determine the present value of our future benefit obligations. We selected the discount rate by reference to Moody's Investors Service AA long-term corporate bond index, actuarial analyses and industry norms. For additional information, refer to the Recently Issued Accounting Pronouncements disclosed in this Annual Report.

ECONOMIC CONDITIONS

The economy of the area served by the association remained stable throughout most of 2006. Recovery continued from the four devastating hurricanes that struck the Association's territory in 2004 and 2005. The very robust, perhaps overheated, housing market slowed dramatically during the year with inventory of unsold houses increasing and new construction starts sharply decreasing. Overhang of inventory has resulting downward pressure on new and existing home prices. Although housing had driven the economy for the past several years, its slowing has yet to show any significant downward pressure on the overall economy. Commercial construction and public infrastructure projects appear to have

replaced much of the economic activity void that might have been created by the slowing of residential construction. Although short term interest rates have increased sharply, fixed rate loans used to fund capital investment have remained relatively low. Much of the net farm income over the past few years has been from capital gains on the sale of land for development purposes. With the slowing in the housing market, farmers who remain in farming will be forced to generate sufficient profits from actual agricultural production.

The agricultural economy remained stable although cash flows from crop sales were dramatically reduced due to the hurricane losses of 2004 and 2005. Overall farm income was supplemented with crop and casualty insurance proceeds and other direct government disaster payments. Many of these payments were actually received by farmers in 2006 supplementing farm incomes during this non-disaster year. Should residual storm damage from the 2005 storms impact crop production 2006 – 2007 growing cycle, farm incomes may be materially reduced in 2007 when the disaster payments are no longer available. Also, many farmers were forced to make material capital investments to replace uninsured or underinsured structures. These sometimes large capital expenditures have leveraged many farmers' financial position and will reduce future net income as these assets are depreciated and interest costs increase on debt associated with the replacement expenses.

In addition to storm damage, the citrus industry is facing devastating losses of production due to diseases. Canker, citrus greening and other diseases have resulted in the loss of thousands of acres of groves over the past few years. Prices for citrus products are currently high due to the reduced crop but the long-term prospects of keeping sufficient acres in production to operate the industry efficiently are bleak. The industry should be able to continue to produce at some level, however, the industry's infrastructure capacity will greatly exceed production. Not only will the industry be forced to adopt new practices to produce crops threatened by these diseases, it will also face dramatic changes in the way it harvests, processes and markets the crops. Many packing houses, processors, and others who provide services to the industry will be forced out of business due to the decreased volume of fruit.

While the performance of the economy and the association's portfolio remained strong at the end of 2006, some decline is anticipated in both during 2007. The management team and Board have taken steps to adjust the Association's loan underwriting and servicing practices, business processes, and even its capital and allowance for loan loss reserves to better position our ability to deal with additional performance stress in the loan portfolio that may result in 2007.

MISSION-RELATED INVESTMENTS

During 2005, the FCA initiated an investment program to stimulate economic growth and development in rural areas. The FCA outlined a program to allow System institutions to hold such investments, subject to approval by the FCA on a case-by-case basis.

Rural America Bonds

In October 2005, the FCA authorized AgFirst and the Associations to make investments in Rural America Bonds under a three-year pilot period. Rural America Bonds may include debt obligations issued by public and private enterprises, corporations, cooperatives, other financing institutions, or rural lenders where the proceeds would be used to support agriculture, agribusiness, rural housing, or economic development, infrastructure, or community development and revitalization projects in rural areas. Examples include investments that fund value-added food and fiber processors and marketers, agribusinesses, commercial enterprises that create and maintain employment opportunities in rural areas, community services, such as schools, hospitals, and government facilities, and other activities that sustain or revitalize rural communities and their economies. The objective of this pilot program is to help meet the growing and diverse financing needs of agricultural enterprises, agribusinesses, and rural communities by providing a flexible flow of money to rural areas through bond financing. These bonds may be classified as Loans or Investments on the Consolidated Balance Sheets depending on the nature of the investment. As of December 31, 2006, the Association had no investment in Rural America Bonds. The Association is actively seeking opportunities in the Rural America Bond Program; however, very limited opportunities exist within the Association's largely urban territory.

LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners, and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans through numerous product types.

The gross loan volume of the Association as of December 31, 2006, was \$514,258, an increase of \$46,701 or 9.99 percent as compared to \$467,557 at December 31, 2005 and an increase of \$34,075 or 7.10 percent as compared to \$480,183 at December 31, 2004. Net loans outstanding (gross loans net of the allowance for loan losses) on December 31, 2006, were \$509,060 as compared to \$462,451 at December 31, 2005 and \$475,083 at December 31, 2004. Net loans accounted for 95.08 percent of total assets on December 31, 2006 as compared to 95.94 percent of total assets at December 31, 2005 and 96.25 percent of total assets at December 31, 2004.

The diversification of the Association loan volume by type for each of the past three years is shown below. See Note 4, "Loans and Allowance for Loan Losses," of the Notes to the Consolidated Financial Statements for the loans outstanding amounts.

| Loan Type | 12/31/06 | 12/31/05 | 12/31/04 |
|----------------------------------|----------|----------|----------|
| Real estate mortgage | 75.69% | 82.43% | 80.53% |
| Production and intermediate term | 12.40 | 13.06 | 12.98 |
| Agribusiness: | | | |
| Processing and marketing | 8.90 | 2.30 | 3.53 |
| Farm-related business | 1.73 | 1.94 | 2.02 |
| Communication | 1.25 | .21 | .84 |
| Rural residential real estate | .03 | .06 | .10 |
| Total | 100.00% | 100.00% | 100.00% |

The following table presents the contractual maturity distribution of loans at December 31, 2006:

| Loan Type | Due in 1 year or less | Due after 1 year through 5 years | Due after 5 years | Total |
|----------------------------------|-------------------------------|----------------------------------|-------------------|------------|
| | <i>(dollars in thousands)</i> | | | |
| Real estate mortgage | \$ 37,351 | \$ 296,830 | \$ 55,073 | \$ 389,254 |
| Production and intermediate term | 35,650 | 21,070 | 7,029 | 63,749 |
| Agribusiness: | | | | |
| Processing and marketing | 23,699 | 15,116 | 6,976 | 45,791 |
| Farm-related business | 936 | 6,732 | 1,221 | 8,889 |
| Communication | 6,244 | - | 158 | 6,402 |
| Rural residential real estate | 11 | 118 | 44 | 173 |
| Total | \$ 103,891 | \$ 339,866 | \$ 70,501 | \$ 514,258 |

While we make loans and provide financially related services to qualified borrowers in the agricultural and rural sectors and to certain related entities, our loan portfolio is diversified. The following tables reflect the commodities financed.

Commodity and industry categories are based upon the Standard Industrial Classification system published by the federal government. The system is used to assign commodity or industry categories based upon the largest agricultural commodity of the customer.

The major commodities in the Association loan portfolio are shown below. The predominant commodities are horticulture, livestock, equine, and sugar cane, which constitute over 49 percent of the entire portfolio.

| Commodity Group | Percent of Portfolio | | |
|--------------------------|----------------------|------|------|
| | 2006 | 2005 | 2004 |
| Nursery/Greenhouse | 29% | 27% | 27% |
| Other | 17 | 16 | 10 |
| Participations Purchased | 16 | 12 | 16 |
| Livestock | 8 | 8 | 8 |
| Equine | 6 | 8 | 7 |
| Sugar Cane | 6 | 4 | 7 |
| Citrus Fruits | 5 | 9 | 10 |
| Vegetables | 5 | 9 | 7 |
| Dairy | 4 | 4 | 4 |
| Fruit | 4 | 3 | 4 |
| Total | 100% | 100% | 100% |

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The Association enjoys a diverse commodity portfolio with no significant single concentration in any one commodity. While the Nursery/Greenhouse group represents 29% of the portfolio, it should be noted this group is a consolidation of many different horticultural items ranging from interior foliage (houseplants) to large trees. Growing, marketing and consumption practices vary widely within this overall commodity group. Even though the concentration of large loans has increased over the past several years, the agricultural enterprise mix of these loans is diversified and similar to that of the overall portfolio.

The increase in gross loan volume for the twelve months ended December 31, 2006, is primarily attributed to capital improvements and farm expansion by existing borrowers and increased activity in participations purchased with other Farm Credit institutions. Fluctuations in volume can also be influenced by usage of borrower SmartCash accounts, a

voluntary additional conditional payment fund, which are offset against the related loans outstanding in the portfolio. SmartCash balances at December 31, 2006 were \$8,314, compared to \$8,082 at December 31, 2005 and \$6,264 at December 31, 2004. Additional SmartCash funds, held in Other Liabilities against commitment balances, totaled \$8,354 as of December 31, 2006 as compared to \$11,925 and \$7,068, at 2005 and 2004, respectively.

For the past few years, the Association has experienced a shift in loan assets. The short and intermediate-term volume trend has been downward while the long-term loan volume trend is upward. The short-term portfolio, which is heavily influenced by operating-type loans, normally reaches a peak balance in December and rapidly declines in the spring months as commodities are marketed and proceeds are applied to repay operating loans.

During 2006, the Association increased activity in the buying and selling of loan participations within and outside of the System. This provides a means for the Association to spread credit concentration risk and realize non-patronage sourced interest and fee income, which may strengthen our capital position.

| Loan Participations | 2006 | 2005 | 2004 |
|--------------------------|-------------------------------|------------|-----------|
| | <i>(dollars in thousands)</i> | | |
| Participations Purchased | | | |
| – FCS Institutions | \$ 85,903 | \$ 58,352 | \$ 37,761 |
| Participations Purchased | | | |
| – Non-FCS Institutions | 19,330 | 25,254 | 41,535 |
| Participations Sold | (90,693) | (93,464) | (51,852) |
| Total | \$ 14,540 | \$ (9,858) | \$ 27,444 |

The Association sells qualified long-term mortgage loans into the secondary market. For the period ended December 31, 2006, the Association originated loans for resale totaling \$2,327, which were sold into the secondary market. The Association additionally purchased portions of loans that are guaranteed by the United States Department of Agriculture. These loans are held for the purposes of reducing interest rate risk and managing surplus short-term funds as allowable under FCA regulations. At December 31, 2006, the balance of these loans (including the unamortized premium) was \$18,152, compared to \$23,798 at December 31, 2005 and \$41,535 at December 31, 2004.

In March, 2006, the Association purchased 22,000 sq. ft. or approximately 70% of an existing office building on Southern Boulevard in Royal Palm Beach. This site was chosen to provide a more centralized location in proximity with the agricultural community of Palm Beach County. The office space was renovated during the year and the administrative office and Lake Worth branch moved their operations to the new location in December. Currently, the Association will occupy about half of the available space allowing for future growth and expansion while currently leasing the remaining space to offset the cost of occupancy. The Lake Worth office site is currently under contract for sale and is scheduled to close in 2007.

RISK EXPOSURE

Credit risk arises from the potential inability of an obligor to meet its repayment obligation. As part of the process to evaluate the success of a loan, the Association continues to review the credit quality of the loan portfolio on an ongoing basis. With the approval of the Association Board of Directors, the Association establishes underwriting standards and lending policies that provide direction to loan officers. Underwriting standards include, among other things, an evaluation of:

- Character – borrower integrity and credit history
- Capacity – repayment capacity of the borrower based on cash flows from operations or other sources of income
- Collateral – protection for the lender in the event of default and a potential secondary source of repayment
- Capital – ability of the operation to survive unanticipated risks
- Conditions – intended use of the loan funds

The credit risk management process begins with an analysis of the borrower’s credit history, repayment capacity, and financial position. Repayment capacity focuses on the borrower’s ability to repay the loan based upon cash flows from operations or other sources of income, including non-farm income. Real estate loans must be collateralized by first liens on the real estate (collateral). As required by FCA regulations, each institution that makes loans on a collateralized basis must have collateral evaluation policies and procedures. Real estate mortgage loans may be made only in amounts up to 85 percent of the original appraised value of the property taken as collateral or up to 97 percent of the appraised value if guaranteed by a state, federal, or other governmental agency. The actual loan to appraised value when loans are made is generally lower than the statutory maximum percentage. Collateral evaluations or appraisals are required for loans of more than \$250,000. In addition, each loan is assigned a credit risk weighting based upon the underwriting standards. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses, and risks in a particular relationship.

The Association’s loan portfolio is divided into performing and high-risk categories. A Special Assets Management Department is responsible for servicing loans classified as high-risk. The high-risk assets, including accrued interest, are detailed below:

| | 12/31/06 | 12/31/05 | 12/31/04 |
|----------------------------------|-------------------------------|----------|----------|
| | <i>(dollars in thousands)</i> | | |
| High-risk Assets | | | |
| Nonaccrual loans | \$ 138 | \$ – | \$ – |
| Restructured loans | – | – | – |
| Accruing loans 90 days past due | 267 | – | 101 |
| Total high-risk loans | 405 | – | 101 |
| Other property owned | – | – | – |
| Total high-risk assets | \$ 405 | \$ – | \$ 101 |
| Ratios | | | |
| Nonaccrual loans to total loans | 0.03% | – | – |
| High-risk assets to total assets | 0.08% | – | 0.02% |

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or future interest accruals, under the contractual terms of the loan. In substance, nonaccrual loans reflect loans where the accrual of

interest has been suspended. Nonaccrual loans increased \$138, or 100.00 percent in 2006. This increase resulted from one borrower being more than 90 days delinquent and collection was considered doubtful. Of the \$138 in nonaccrual volume at December 31, 2006, \$59 or 42.75%, was current as to scheduled principal and interest payments, but did not meet all regulatory requirements to be transferred into accrual status.

Loan restructuring is available to financially distressed borrowers. Restructuring of loans occurs when the Association grants a concession to a borrower based on either a court order or good faith in a borrower's ability to return to financial viability. The concessions can be in the form of a modification of terms or rates, a compromise of amounts owed, or deed in lieu of foreclosure. Other receipts of assets and/or equity to pay the loan in full or in part are also considered restructured loans. The type of alternative financing structure chosen is based on minimizing the loss incurred by both the Association and the borrower.

Credit Quality

We review the credit quality of the loan portfolio on an ongoing basis as part of our risk management practices. Each loan is classified according to the Uniform Classification System, which is used by all Farm Credit System institutions. Below are the classification definitions.

- Acceptable – Assets are expected to be fully collectible and represent the highest quality.
- Other Assets Especially Mentioned (OAEM) – Assets are currently collectible but exhibit some potential weakness.
- Substandard – Assets exhibit some serious weakness in repayment capacity, equity, and/or collateral pledged on the loan.
- Doubtful – Assets exhibit similar weaknesses to substandard assets. However, doubtful assets have additional weaknesses in existing facts, conditions and values that make collection in full highly questionable.
- Loss – Assets are considered uncollectible.

The following table presents selected statistics related to the credit quality of loans including accrued interest at December 31.

| Credit Quality | 2006 | 2005 | 2004 |
|-------------------|---------|---------|---------|
| Acceptable & OAEM | 98.21% | 99.73% | 97.77% |
| Substandard | 1.79 | .27 | 2.23 |
| Doubtful | – | – | – |
| Loss | – | – | – |
| Total | 100.00% | 100.00% | 100.00% |

Allowance for Loan Losses

During 2004, the Association completed its study to further refine the allowance for loan losses methodology, taking into account guidance issued by FCA, as well as the Securities and Exchange Commission (SEC) and Federal Financial Institutions Examination Council. As a result of this study and resulting refinements in methodology, during the fourth quarter of 2004, the Association recorded a reversal of the allowance for loan losses of \$9,823.

Previously, the Association's allowance for loan losses methodology had been based upon criteria developed in the late 1980s and reflected the credit losses experienced in the mid-to-late 1980s, which was a period of unusually adverse economic conditions in American agriculture. Given the long cyclical nature of the agricultural economy, loss factors utilized to determine the allowance for loan losses subsequent to 1989 continued to reflect, to some extent, the loss history of the mid-to-late 1980s, which resulted in conservative estimates of the allowance for loan losses. The Association's allowance for loan losses methodology utilized throughout the period was in accordance with generally accepted accounting principles and was consistently applied.

While conservative in estimating the allowance for loan losses, the methodology used resulted in annual provisions for loan losses over the periods that reflected changes in credit quality and loss experience. Accordingly, the reserves provided in the mid-to-late 1980s had, in effect, remained part of the allowance for loan losses. The Association's allowance for loan loss methodology has consistently adhered to proper accounting policies, under the regulatory supervision of the FCA in its role as a "safety and soundness" regulator. It was the FCA's view that the allowance for loan losses should include, among others, an assessment of probable losses, historical loss experience and economic conditions.

In April 2004, the FCA issued an Informational Memorandum to System institutions regarding the criteria and methodologies that would be used in evaluating the adequacy of a System institution's allowance for loan losses. The FCA endorsed the direction provided by other bank regulators and the SEC and indicated that the conceptual framework addressed in their guidelines would be included as part of their examination process.

The refinement in methodology resulted in a calculated allowance for loan losses that was significantly less than the previously recorded balance due to revised loss factors that are more indicative of actual loss experience in recent years and current borrower analysis. The factors considered in determining the revised level of allowance for loan losses are generally based on recent historical charge-off experience adjusted for relevant environmental factors. The Association considers the following when adjusting the historical charge-off experience:

- changes in credit risk classifications,
- changes in collateral values,
- changes in risk concentrations,
- changes in weather related conditions and
- changes in economic conditions.

While the reversal had a significant impact on 2004 results of operations and the previously recorded allowance for loan losses, the refinement in methodology is not expected to have a significant impact on comparative results of operations in future periods. Additionally, the refinement in methodology did not have a significant impact on the level of risk bearing capacity of the Association, generally referred to as "risk funds" (capital plus the allowance for loan losses), which totaled \$96,625 at December 31, 2006 (18.79 percent of Association loans), as compared with \$91,012 at December 31, 2005 (19.47 percent of Association loans) and \$81,457 at December 31, 2004 (16.96 percent of Association loans).

The allowance for loan losses at each period end is considered by Association management to be adequate to absorb probable losses existing in and inherent to its loan portfolio. The allowance for loan losses was \$5,198 at December 31, 2006, as compared with \$5,106 and \$5,100 at December 31, 2005 and 2004, respectively.

Net loan recoveries of \$92, \$6 and \$42 were recorded in 2006, 2005 and 2004, respectively. Net loan recoveries as a percentage of average loans remained at low levels of 0.019 percent, 0.001 percent, and 0.01 percent for 2006, 2005 and 2004, respectively. The net loan recoveries were primarily associated with the recovery of one loan previously charged off in satisfaction of a deficiency judgment.

The following table presents the activity in the allowance for loan losses for the most recent three years:

| Allowance for Loan Losses Activity | 2006 | 2005 | 2004 |
|--|-------------------------------|-------------|-------------|
| | <i>(dollars in thousands)</i> | | |
| Balance at beginning of year | \$ 5,106 | \$ 5,100 | \$ 14,881 |
| Charge-offs: | | | |
| Real estate mortgage | \$ (2) | \$ - | \$ - |
| Production and intermediate term | - | - | (1) |
| Total charge-offs | (2) | - | (1) |
| Recoveries: | | | |
| Production and intermediate term | \$ 94 | \$ 6 | \$ 43 |
| Total recoveries | 94 | 6 | 43 |
| Net (charge-offs) recoveries | 92 | 6 | 42 |
| Provision for (reversal of allowance for) loan losses | \$ - | \$ - | \$ - |
| Nonrecurring allowance for loan losses reversal* | - | - | (9,823) |
| Balance at end of year | \$ 5,198 | \$ 5,106 | \$ 5,100 |
| Ratio of net recoveries during the period to average loans outstanding during the period | 0.019% | 0.001% | 0.01% |

* Represents the amount of allowance reversal due to the refinement in methodology.

The allowance for loan losses by loan type for the most recent three years is as follows:

| Allowance for Loan Losses by Type | December 31, | | |
|--|-------------------------------|-------------|-------------|
| | 2006 | 2005 | 2004 |
| | <i>(dollars in thousands)</i> | | |
| Real estate mortgage | \$ 3,597 | \$ 3,599 | \$ 3,600 |
| Production and intermediate term | 1,400 | 1,305 | 1,300 |
| Agribusiness | 136 | 137 | 135 |
| Communication | 59 | 59 | 59 |
| Rural residential real estate | 6 | 6 | 6 |
| Total loans | \$ 5,198 | \$ 5,106 | \$ 5,100 |

The allowance for loan losses as a percentage of loans outstanding and as a percentage of certain other credit quality indicators is shown below:

| Allowance for Loan Losses as a Percentage of: | December 31, | | |
|--|---------------------|-------------|-------------|
| | 2006 | 2005 | 2004 |
| Total loans | 1.01% | 1.09% | 1.06% |
| Nonperforming loans | 1283.5% | -% | 5049.5% |
| Nonaccrual loans | 3766.7% | -% | -% |

The financial positions of our borrowers have generally strengthened during the past decade as farmers' net cash income has been favorable, however, the hurricanes of 2004 and 2005 significantly reduced farm incomes from actual product sales. Crop insurance and government assistance helped support farm income in those years. Damage from these storms is expected to reduce income in years well into the future. The Association continues to place continued emphasis on sound underwriting standards and the credit quality of our loan portfolio has remained healthy. Please refer to Note 4, "Loans and Allowance for Loan Losses," in the Notes to the Consolidated Financial Statements, for further information concerning the allowance for loan losses.

EMPLOYEE RETIREMENT PLANS

For the years ended December 31, 2006, 2005 and 2004 the Association contributed \$0, \$591 and \$2,400, respectively, to the District-wide defined benefit retirement plan. The funding brought the retirement plan's assets to an amount exceeding the accumulated benefit obligation as of the Plan's measurement date, eliminating the minimum pension liability and the charge to accumulated other comprehensive income. For additional information, see Note 10, "Employee Benefit Plans," and refer to the Recently Issued Accounting Pronouncements disclosed in the Notes to the Consolidated Financial Statements.

RESULTS OF OPERATIONS

Net income for the year ended December 31, 2006, totaled \$16,213, a decrease of \$737 or 4.35 percent, as compared to \$16,950 for the same period of 2005 and a decrease of \$7,239 or 30.87 percent, as compared to \$23,452 for the same period of 2004. The decrease in income from both 2005 and 2004 is a result of non-recurring income adjustments in both prior years. In 2005, the Association received a benefit for income tax of \$1,323 resulting from two taxable events. First, the Association revolved non-qualified allocated equities where the association paid the tax in the year declared, then received a refund upon revolvment, and secondly, the reversal of a provision for income tax in conjunction with the IRS settlement in 2001. In 2004, the Association recognized income of \$9,823 from the reversal of a portion of the allowance for loan losses as explained in the Allowance for Loan Losses section discussed above.

Interest income for the year ended December 31, 2006, was \$39,305, an increase of \$7,046 or 21.84 percent as compared to \$32,259 for the same period of 2005. Interest income increased by \$5,577 for the period ended December 31, 2005, compared to December 31, 2004. Major components of the change in net income for the past two years are outlined in the following table.

| Change in Net Income: | 2006-2005 | 2005-2004 |
|--|-------------------------------|------------------|
| | <i>(dollars in thousands)</i> | |
| Net income (prior year) | \$ 16,950 | \$ 23,452 |
| Increase (decrease) in net income due to: | | |
| Interest income | 7,046 | 5,578 |
| Interest expense | (5,242) | (3,448) |
| Net interest income | 1,804 | 2,130 |
| Provision for loan losses | - | (9,823) |
| Noninterest income | (690) | 300 |
| Noninterest expense | (521) | (463) |
| Provision for income taxes | (1,330) | 1,354 |
| Total changes in income | (737) | (6,502) |
| Net income | \$ 16,213 | \$ 16,950 |

Net Interest Income

Net interest income increased by \$1,804 or 12.11 percent in 2006 and increased by \$3,934, or 30.81 percent, compared to 2005 and 2004, respectively. The primary reason for the increase during the last two years is a result of increases in the variable interest rate environment coupled with the growth in loan volume.

There was no interest income from nonaccrual loans during 2006 and 2005, in 2004, \$29 was recognized. The Association's net interest income as a percentage of average earning assets was 3.41 percent on December 31, 2006, compared to 3.20 percent on December 31, 2005 and 2.72 percent on December 31, 2004. The sources of change in net interest income are summarized, as follows:

Change in Net Interest Income:

| | Volume* | Rate | Nonaccrual Income | | Total |
|-------------------------------|----------|----------|-------------------|------|----------|
| | | | | | |
| <i>(dollars in thousands)</i> | | | | | |
| 12/31/06 - 12/31/05 | | | | | |
| Interest income | \$ 1,726 | \$ 5,320 | \$ - | \$ - | \$ 7,046 |
| Interest expense | 856 | 4,386 | - | - | 5,242 |
| Change in net interest income | \$ 870 | \$ 934 | \$ - | \$ - | \$ 1,804 |
| 12/31/05 - 12/31/04 | | | | | |
| Interest income | \$ (228) | \$ 5,835 | \$ (29) | \$ - | \$ 5,578 |
| Interest expense | (398) | 3,846 | - | - | (3,448) |
| Change in net interest income | \$ 170 | \$ 1,989 | \$ (29) | \$ - | \$ 2,130 |

* Volume variances can be the result of increased/decreased loan volume or from changes in the percentage composition of assets and liabilities between periods.

Please refer to the Consolidated Five-Year Summary of Selected Financial Data in this Annual Report to review key financial ratios pertaining to earnings and net interest income.

Noninterest Income

Noninterest income for each of the three years ended December 31 are shown in the following table:

| Noninterest Income | For the Year Ended | | | Percentage Increase/(Decrease) | |
|--|--------------------|----------|----------|--------------------------------|--------|
| | December 31, | | | 2006/ | 2005/ |
| | 2006 | 2005 | 2004 | 2005 | 2004 |
| <i>(dollars in thousands)</i> | | | | | |
| Loan fees | \$ 1,999 | \$ 1,877 | \$ 1,742 | 6.50% | 7.75% |
| Fees for financially related services | 419 | 625 | 619 | (32.96) | 0.97 |
| Patronage refund from other Farm Credit Institutions | 3,866 | 4,348 | 4,541 | (11.09) | (4.25) |
| Gains (losses) on sale of other property owned, net | 27 | 27 | 27 | - | - |
| Other noninterest income | 124 | 248 | (104) | (50.00) | 338.46 |
| Total noninterest income | \$ 6,435 | \$ 7,125 | \$ 6,825 | (9.68)% | 4.40% |

Regarding patronage refunds received from other Farm Credit Institutions, the Association received \$3,265 in a patronage refund and \$601 in a special distribution from the Bank for the year ended December 31, 2006, compared to \$2,946 and \$1,338 for 2005, and \$3,094 and \$1,439 for 2004. Additionally, a reduction of \$206 in fees for financially related services is the result of the USDA changing crop insurance sale dates for citrus trees and citrus fruit. This change resulted in a shorten coverage period reducing the premiums and related commissions for the 2006 season.

Noninterest Expense

Noninterest expense for each of the three years ended December 31 is shown in the following table:

| Noninterest Expense | For the Year Ended | | | Percentage Increase/(Decrease) | |
|---------------------------------|--------------------|----------|----------|--------------------------------|--------|
| | December 31, | | | 2006/ | 2005/ |
| | 2006 | 2005 | 2004 | 2005 | 2004 |
| <i>(dollars in thousands)</i> | | | | | |
| Salaries and employee benefits | \$ 4,419 | \$ 4,463 | \$ 4,183 | (0.99)% | 6.69% |
| Occupancy and equipment expense | 608 | 370 | 378 | 64.32 | (2.12) |
| Insurance Fund premium | 681 | 207 | 212 | 228.99 | (2.36) |
| Other operating expense | 1,209 | 1,356 | 1,160 | (10.84) | 16.90 |
| Total noninterest expense | \$ 6,917 | \$ 6,396 | \$ 5,933 | 8.15% | 7.80% |

Noninterest expense increased \$521 or 8.15 percent for December 31, 2006, as compared to the same period of 2005 and increased \$984 or 16.59 percent compared to December 31, 2004. The increase in 2006 is attributed to an increase in the Farm Credit Insurance Fund premium of \$474. Another factor influencing the increase was \$238 in additional occupancy and equipment expenses incurred in the purchase of a new building for the administrative office.

The Association recorded a provision for income taxes of \$7 for the year ended December 31, 2006, as compared to a benefit of \$1,323 for 2005 and a provision of \$31 for 2004. The benefit recorded in 2005 was a result of the reversal of a provision for income tax booked in 2001. This provision was in connection with the tax refund received from the IRS settlement resolving the taxability of prior years' earnings from the long-term lending activities. The statute of limitations expired on this refund and the provision was reversed. An additional benefit was realized in conjunction with the revivment of non-qualified allocated equities where the association paid the tax at the time the equities were declared and received a refund upon revivment.

Key Results of Operations Comparisons

Key results of operations comparisons for each of the twelve months ended December 31 are shown in the following table:

| Key Results of Operations Comparisons | For the | For the | For the |
|---|--------------------------|--------------------------|--------------------------|
| | 12 Months Ended 12/31/06 | 12 Months Ended 12/31/05 | 12 Months Ended 12/31/04 |
| Return on average assets | 3.20% | 3.56% | 5.02% |
| Return on average members' equity | 17.97% | 20.98% | 38.29% |
| Net interest income as a percentage of average earning assets | 3.41% | 3.20% | 2.72% |
| Net chargeoffs (recoveries) to average loans | (.019)% | (.001)% | (.01)% |

A key factor in the growth of net income for future years will be continued improvement in net interest and noninterest income. Our goal is to generate earnings sufficient to fund operations, adequately capitalize the Association, and achieve an adequate rate of return for our members. To meet this goal, the agricultural and the general economy must continue the improvement shown in recent years and the Association must meet certain objectives. These objectives are to attract and maintain high quality loan volume priced at competitive rates and to manage credit risk in our entire portfolio, while

efficiently meeting the credit needs of our members and providing adequate returns on members' investments in the cooperative.

LIQUIDITY AND FUNDING SOURCES

Liquidity

Liquidity management is the process whereby funds are made available to meet all financial commitments including the extension of credit, payment of operating expenses and payment of debt obligations. The Association receives access to funds through its borrowing relationship with the Bank and from income generated by operations. The Association's participation in other secondary market programs provides additional liquidity. Sufficient liquid funds have been available to meet all financial obligations.

Funding Sources

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement (GFA). The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association, creating notes payable to the Bank. The notes payable are segmented into variable rate and fixed rate components. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association.

Total notes payable to the Bank at December 31, 2006, was \$420,609 as compared to \$372,272 at December 31, 2005 and \$399,589 at December 31, 2004. The increase of 12.98 percent compared to December 31, 2005 and the increase of 5.26 percent compared to December 31, 2004, is attributable to increases in loans outstanding between the respective periods. The average volume of outstanding notes payable to the Bank was \$395,160 and \$376,606 for the years ended December 31, 2006 and 2005, respectively. Refer to Note 7, "Notes Payable to AgFirst Farm Credit Bank," of the Notes to the Consolidated Financial Statements, for additional information concerning the Association's debt.

The Association had no lines of credit from third party financial institutions as of December 31, 2006.

Funds Management

The Bank and the Association manage assets and liabilities to provide a broad range of loan products and funding options, which are designed to allow the Association to be competitive in all interest rate environments. The primary objective of the asset/liability management process is to provide stable and rising earnings, while maintaining adequate capital levels by managing exposure to credit and interest rate risks.

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers fixed, adjustable and variable rate loan products that are marginally priced according to financial market rates. Variable rate loans may be indexed to either the Prime Rate or the 90-day London Interbank Offered Rate (LIBOR). Adjustable rate mortgages are indexed to U.S. Treasury Rates. Fixed rate loans are priced based on the current cost of System debt of similar terms to maturity.

The majority of the interest rate risk in the Association's Consolidated Balance Sheets is transferred to the Bank through the notes payable structure. The Bank, in turn, actively utilizes funds management techniques to identify, quantify and control risk associated with the loan portfolio.

CAPITAL RESOURCES

Total members' equity at December 31, 2006, increased 6.43 percent to \$91,427 from the December 31, 2005 total of \$85,906 and increased 19.74 percent from the December 31, 2004 total of \$76,357. The increase was primarily attributed to continued growth in net income offset by distribution of cash patronage and revolvment of allocated surplus.

Total capital stock and participation certificates were \$3,516 on December 31, 2006, compared to \$3,706 on December 31, 2005 and \$3,945 on December 31, 2004. The decrease was attributed to the retirement of protected stock and participation certificates on loans liquidated in the normal course of business, retirement of excess stock through revolvment and new loans being capitalized at lower regulatory levels.

The Association Board of Directors establishes, adopts, and maintains a formal written capital adequacy plan. There were no material changes to the capital plan for 2006 that would affect minimum stock purchases or would have an effect on the Association's ability to retire stock and distribute earnings.

The Association's capital ratios as of December 31 and the FCA minimum requirements follow:

| | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>Regulatory Minimum</u> |
|-------------------|-------------|-------------|-------------|---------------------------|
| Permanent Capital | 16.31% | 16.76 % | 12.76 % | 7.00% |
| Total Surplus | 16.18% | 16.58 % | 12.58 % | 7.00% |
| Core Surplus | 14.94% | 14.44 % | 10.86 % | 3.50% |

At December 31, 2006, the Association's permanent capital ratio, (average at-risk capital divided by average risk adjusted assets), calculated in accordance with FCA regulations, exceeded the regulatory minimum of 7.00 percent. In addition to these regulatory requirements, the Association has established a permanent capital ratio goal in excess of the 7.00 percent FCA minimum requirement. As of December 31, 2006, the Association has met the goal.

See Note 8, "Members' Equity," of the Notes to the Consolidated Financial Statements, for further information concerning capital resources.

PATRONAGE PROGRAM

Prior to the beginning of any fiscal year, the Association’s Board of Directors, by adoption of a resolution, may establish a Patronage Allocation Program to distribute its available consolidated net earnings. This resolution provides for the application of net earnings in the manner described in the Association’s Bylaws. This includes the setting aside of funds to increase surplus to meet minimum capital adequacy standards established by FCA Regulations, to increase surplus to meet Association capital adequacy standards to a level necessary to support competitive pricing at targeted earnings levels, and for reasonable reserves for necessary purposes of the Association. After excluding net earnings attributable to (a) the portion of loans participated to another institution, and (b) participation loans purchased, remaining consolidated net earnings are eligible for allocation to borrowers. Refer to Note 8, “Members’ Equity,” of the Notes to the Consolidated Financial Statements, for more information concerning the patronage distributions. The Association declared patronage distributions of \$9,530 in 2006, \$8,180 in 2005, and \$7,194 in 2004.

YOUNG, BEGINNING AND SMALL (YBS) FARMERS AND RANCHERS PROGRAM

The enabling legislation for the Farm Credit System establishes the Association’s mission is to provide financial services to agriculture and the rural community, which includes providing credit to young*, beginning** and small*** farmers. The Association has further expanded this mission to include minority**** farmers. Because of the unique needs of these individuals, and their importance to the future growth of the Association, the Association has established annual marketing goals to increase our market share of loans to YBS&M farmers. Specific marketing plans have been developed to target these groups, and resources have been designated to help ensure YBS borrowers have access to a stable source of credit.

The following table outlines the loan volume and number of YBS loans in the loan portfolio for the Association. (Formal data is not collected on minority borrowers.)

| | As of December 31, 2006 | |
|-----------|-------------------------|-----------------|
| | Number of Loans | Amount of Loans |
| Young | 170 | \$ 65,769 |
| Beginning | 464 | 198,607 |
| Small | 430 | 131,974 |

Note: For purposes of the above table, a loan could be classified in more than one category, depending upon the characteristics of the underlying borrower.’

The most recent USDA Ag census data has been used as a benchmark to measure penetration of the Association’s marketing efforts. The census data indicated that within the Association’s chartered territory (counties) there were 5,879 reported farmers of which by definition 256 or 4.4 percent were Young, 2,095 or 35.6 percent were Beginning, and 5,144 or 87.50 percent were Small. Comparatively, as of December 31, 2006, the demographics of the Association’s agricultural portfolio contained 661 farmers, of which by definition 123 or 18.61 percent were Young, 309 or 46.75 percent were Beginning and 313 or 47.35 percent were Small.

In addition to the association’s overall marketing plan, the association has developed and implemented a specific YBS&M plan to better identify and serve this unique and important segment of Agriculture in South Florida.

The YBS&M plan contains several components including staffing, identification, education, development, and direct financial support. Staffing represents the foundation of the program. The association recognizes that to serve this community, its staff must understand the culture and needs of each group. The association has focused on diversity in its employment practices for several years because we believe strongly that our staff should reflect the diversity of the community we serve. The association currently has Credit, Lending and Operational staff fully capable of conducting business in four languages. The association also has specialized programs and specially trained staff to serve the YBS&M community. Specific quantitative and qualitative goals have been set for the association and specific staff members insure their focus on the program as well as measure our performance in reaching these segments of our market.

Identification and outreach are also critical components of the program. The association constantly monitors any public record databases, organizational membership roles, etc. available that could assist in identification of YBS&M potential customers. In addition, staff members are active in community, trade and cultural organizations felt to have membership that might include YBS&M farmers. Outreach also includes maintaining relationships with other agricultural trade organizations and agencies such as the Federal, State and county agricultural agencies to insure they understand our programs and would refer YBS&M farmers with financial or credit needs to Farm Credit. The association has also worked closely with these agencies in providing training and development opportunities for YBS&M farmers. The association aggressively attempts to partner with these agencies in joint programs. The association is a “Preferred Lender” in USDA guaranteed lending programs.

A final component of the program is in the area of Youth development programs. The association actively supports those organizations such as FFA, 4-H, NAYFE, and other youth based programs that are training and developing the farmers and ranchers of the future.

The Association is committed to the future success of young, beginning and small farmers.

- * *Young farmers* are defined as those farmers, ranchers, producers or harvesters of aquatic products who are age 35 or younger as of the date the loan is originally made.
- ** *Beginning farmers* are defined as those farmers, ranchers, producers or harvesters of aquatic products who have 10 years or less farming or ranching experience as of the date the loan is originally made.
- *** *Small farmers* are defined as those farmers, ranchers, producers or harvesters of aquatic products who normally generate less than \$250 in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Accounting for Uncertainty in Income Taxes

In June 2006, the Financial Accounting Standards Board (FASB) released Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48). This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. Adoption of FIN 48 is not expected to have a material impact on the Association's Consolidated Balance Sheet or Consolidated Statement of Income.

Accounting for Defined Benefit Pension and Other Postretirement Plans

On September 29, 2006, the FASB issued Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (FAS 158). FAS 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize through comprehensive income changes in that funded status in the year in which the changes occur. FAS 158 also provides guidance relating to the discount rate, which may require the Bank and its related associations to adjust its basis for selecting the discount rate for its pension and non-pension postretirement benefit plans. The Bank and its related associations will be required to implement FAS 158 for the year ended December 31, 2007. In addition, FAS 158 requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the Bank and its related associations use a measurement date of September 30th. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. The Bank and its related associations are currently evaluating the impact of implementing FAS 158

FORWARD LOOKING INFORMATION

Certain information included in this discussion constitutes forward-looking statements and information that are based upon management's belief as well as certain assumptions made by and information currently available to management. When used in this discussion, the words "anticipate," "project," "expect," "believe," and similar expressions are intended to identify forward-looking statements. Although management of the Association believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations and projections will prove to have been correct. Such forward-looking statements are subject to certain risks, uncertainties and assumptions. Should one or more of these risks materialize, or should such underlying assumptions prove to be incorrect, actual results may vary materially from those anticipated, projected, or expected. Among key factors that may have a direct bearing on the Association's operating results are fluctuations in the general economy, the relative strengths and weaknesses in the economics of agricultural products grown in the Association's

territory, the real estate market, the actions taken by the Federal Reserve for the purpose of managing the economy, changes in government policy and regulations impacting producers in the Association's service area, significant weather events and other natural disasters, and the continued growth of the agricultural market consistent with recent historical experience.

Disclosure Required by Farm Credit Administration Regulations

Description of Business

Descriptions of the territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations are incorporated herein by reference to Note 1 to the consolidated financial statements, "Organization and Operations," included in this annual report to shareholders.

The description of significant developments that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, and concentrations of assets, if any, is incorporated in "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in this annual report to shareholders.

Description of Property

The following table sets forth certain information regarding the properties of the reporting entity, all of which are located in Florida:

| <u>Location</u> | <u>Description</u> | <u>Form of Ownership</u> |
|--|---------------------------|--------------------------|
| 11903 Southern Blvd. Suite 200 Royal Palm Beach | Administrative/ Branch | Owned |
| 7150 20th Street Vero Beach | Branch | Leased |
| 403 NW 6th Street Okeechobee | Branch | Owned |
| 24700 SW 177th Avenue Homestead | Branch | Owned |

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 13 to the consolidated financial statements, "Commitments and Contingencies," included in this annual report to shareholders.

Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 8 to the consolidated financial statements, "Members' Equity," included in this annual report to shareholders.

Description of Liabilities

The description of liabilities, contingent liabilities and intrasystem financial assistance rights and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 7, 11 and 13 to the consolidated financial statements included in this annual report to shareholders.

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

"Management's Discussion and Analysis of Financial Condition and Results of Operations," which appears in this annual report to shareholders and is to be disclosed in this section, is incorporated herein by reference.

Senior Officers

The following represents certain information regarding the senior officers of the Association:

| <u>Senior Officer</u> | <u>Position</u> |
|-----------------------|--|
| Don Rice | <i>President/Chief Executive Officer</i> since November 1995 |
| C. Robert Pendleton | <i>Executive Vice President & Chief Lending Officer</i> since July 2000 previously Sr. Vice President |
| Linda Rusciano | <i>Executive Vice President & Chief Financial Officer</i> since July 2000 previously Sr. Vice President |
| Esther Morales | <i>Sr. Vice President & Chief Credit Officer</i> since July 2000 |

The business experience for the past five years for senior officers is with the Farm Credit System.

The total amount of compensation (in whole dollars) earned by the CEO and six most highly paid officers (including the CEO) as a group during the years ended December 31, 2006, 2005 and 2004, is as follows:

| <u>Aggregate Number of Officers</u> | <u>Year</u> | <u>Annual</u> | | | | <u>Other</u> | <u>Total</u> |
|-------------------------------------|-------------|---------------|--------------|------------------------------|---|--------------|--------------|
| | | <u>Salary</u> | <u>Bonus</u> | <u>Deferred/-Perquisites</u> | | | |
| 6 | 2006 | \$824,932 | \$239,972 | \$183,790 | - | \$1,248,694 | |
| 6 | 2005 | \$764,237 | \$217,990 | \$175,093 | - | \$1,157,320 | |
| 6 | 2004 | \$698,527 | \$194,251 | \$173,963 | - | \$1,066,741 | |

In addition to a base salary, all employees earn additional compensation under an incentive plan. The Association incentive plan is designed to motivate employees to exceed the business plan goals during the fiscal year. These goals typically include return on assets, credit quality, credit administration, loan volume, nonaccrual loan volume, permanent capital and other key ratios. The goals incorporated in the current plan include return on assets, return on equity, credit quality, credit administration, high-risk loans, nonaccrual loan volume and operating efficiencies. Payment of the incentive is in the first quarter 2007. Bonuses are shown in the year earned, which may be different than the year of payment.

The Association's 2007 Annual Meeting Information Statement (AMIS) contains additional information regarding the compensation earned by the CEO. The AMIS is available for public inspection at the reporting association office. Disclosure of information on the total compensation paid during 2006 to any senior officer, or to any other individual included in the total, is available to shareholders upon request.

Directors

Directors and senior officers are reimbursed on an actual cost basis for all expenses incurred in the performance of official duties. Such expenses may include transportation, lodging, meals, tips, tolls, parking of cars, laundry, registration fees, and other expenses associated with travel on official business. A copy of the policy is available to shareholders of the Association upon request.

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was \$26,247 for 2006, \$26,237 for 2005, and \$25,186 for 2004.

Subject to approval by the board, the Association may allow directors honoraria of \$600 for attendance at board meetings and \$300 for attendance at committee meetings or special assignments. Total compensation paid to directors as a group was \$119,700.

The following represents certain information regarding the directors of the Association and their principal occupation and employment for the past five years:

John D. Martin, Jr., Chairman, is a retired vegetable farmer and nurseryman in Palm Beach County and is currently a citrus grower in St. Lucie County. He currently serves on the board of Martin Properties of Palm Beach County, Inc. Mr. Martin served 9 days at Association board meetings and 14 days in other official activities and was paid \$13,600. His term of office is 2006 – 2009.

Jack C. Coker, Vice Chairman, is a beef cattle rancher and real estate developer in Okeechobee County. He currently serves on the boards of B and J Investments, Inc., J & M Investments, Inc. and Coker Cattle Corporation. Mr. Coker served 11 days at Association board meetings and 23 days in other official activities and was paid \$14,200. His term of office is 2005 – 2008.

Richard T. Alger is a vegetable grower and nurseryman in Dade County. He serves on the boards of directors of First National Bank of Homestead, Baptist Hospital Foundation and the Homestead Housing Authority. Mr. Alger served 11 days at Association board meetings and 23 days in other official activities and was paid \$13,900. He was elected to the Association board in 2005 for a three-year term.

William E. Bowman, Jr. is a cattle rancher with his farming operations based in Okeechobee and eastern Palm Beach Counties. He currently serves on the boards of directors of Florida State Fair, the South Florida Fair, Bowman & Sons, Inc., McArthur Dairy, Triple Ranch, Inc., Taylor Creek Ranch, Inc., Dairy Feeds, Inc. and the Law Enforcement Assistance Foundation. Mr. Bowman served 10 days at Association board meetings and 13 days in other official activities and was paid \$11,200. Mr. Bowman was elected to the Association board in 2004 for a three-year term.

Robert J. Callaway serves as an Outside Director for the Association. He is a co-founder of Callaway and Price, Inc., a real estate appraisal and consulting firm. Mr. Callaway serves on the boards of the West Palm Beach Fishing Club & Foundation and Law Enforcement Assistance Foundation, a fund raising organization. He served 10 days at Association board meetings and 17 days in other official activities and was paid \$13,900. Mr. Callaway was appointed to the Association board in 2005 for a three-year term.

Sherwood J. Johnson is a citrus grower in the Indian River area. He currently serves as a director on the boards of Delta Farms Water Control District, University of Florida Share Council, Treasure Coast Agriculture Research Foundation, Treasure Coast Research and Education Park, a research center, and HESCO, a packinghouse supply cooperative. He served 10 days at Association board meetings and 23 days in other official activities and was paid \$15,100. Mr. Johnson's term of office is 2006 – 2009.

Louis E. Larson, Jr. is a dairy farmer in Okeechobee County. He serves on the boards of directors of Larson Dairy, Inc., SunTrust of Mid-Florida, Dairy Feeds, Inc., Okeechobee Cattleman's Association and Southeast Milk, Inc. During 2004, Mr. Larson served 9 days at Association board meetings and 24 days in other official activities and was paid \$13,900. He was elected in 2004 for a three-year term.

Charles F. Martin is a nurseryman in Dade County. He serves as secretary/treasurer of Harold B. Martin, Inc. Mr. Martin served 9 days at Association board meetings and 16 days in other official activities and was paid \$12,700. Mr. Martin's term of office is 2004 – 2007.

Robert G. Sexton is a citrus grower in Indian River County. He is president of Oslo Citrus Growers Association and currently serves on the boards of directors of AgFirst Farm Credit Bank, Oslo Citrus Growers Association, McArthur Farms, Orchid Island Juice Company and Sexton Holdings. Mr. Sexton attended 9 Association board meetings and 15 days in other official activities and was paid \$11,200. He was elected to a three-year term in 2005.

Transactions with Senior Officers and Directors

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 12 to the consolidated financial statements, "Related Party Transactions," included in this annual report to shareholders.

Involvement in Certain Legal Proceedings

There were no matters which came to the attention of management or the board of directors regarding involvement of current directors or senior officers in specified legal proceedings which should be disclosed in this section.

Relationship with Independent Public Accountants

There were no material disagreements with our independent public accountants on any matter of accounting principles or financial statement disclosure during this period.

Consolidated Financial Statements

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated February 28, 2007 and the report of management, which appear in this annual report to shareholders are incorporated herein by reference.

Copies of the Association's quarterly reports are available upon request free of charge by calling 1-800-432-4156 or writing Linda Rusciano, Farm Credit of South Florida, ACA, P. O. Box 213069, Royal Palm Beach, FL 33421 or accessing the website, www.farmcreditsfl.com. The Association prepares a quarterly report within 45 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

Borrower Information Regulations

Since 1972, Farm Credit Administration (FCA) regulations have required that borrower information be held in strict confidence by Farm Credit System (FCS) institutions, their directors, officers and employees. These regulations provide Farm Credit institutions clear guidelines for protecting their borrowers' nonpublic personal information.

On November 10, 1999, the FCA Board adopted a policy that requires FCS institutions to formally inform new borrowers at loan closing of the FCA regulations on releasing borrower information and to address this information in the annual report to shareholders. The implementation of these measures ensures that new and existing borrowers are aware of the privacy protections afforded them through FCA regulations and Farm Credit System institution efforts.

Report of the Audit Committee

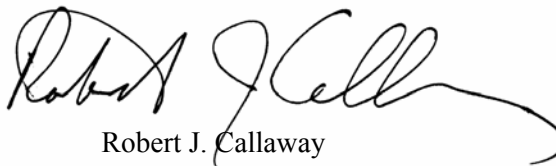
The Audit Committee of the Board of Directors (Committee) is comprised of the directors named below. None of the directors who serve on the Committee is an employee of Farm Credit of South Florida, ACA (Association) and in the opinion of the Board of Directors, each is free of any relationship with the Association or management that would interfere with the director's independent judgment on the Committee.

The Committee has adopted a written charter that has been approved by the Board of Directors. The Committee has reviewed and discussed the Association's audited financial statements with management, which has primary responsibility for the financial statements.

PricewaterhouseCoopers LLP (PwC), the Association's independent auditor for 2006, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 61 (*Communication With Audit Committees*). PwC has provided to the Committee the written disclosures and the letter required by Independence Standards Board Standard No. 1 (*Independence Discussions with Audit Committees*), and the Committee has discussed with PwC that firm's independence.

The Committee has also concluded that PwC's provision of non-audit services, if any, to the Association is compatible with PwC's independence.

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Association's Annual Report for 2006. The foregoing report is provided by the following independent directors, who constitute the Committee:



Robert J. Callaway
Chairman of the Audit Committee

Members of Audit Committee

Robert J. Callaway
Richard T. Alger
Sherwood J. Johnson
Louis E. Larson, Jr.

Report of Independent Auditors



PricewaterhouseCoopers LLP
10 Tenth Street, Suite 1400
Atlanta, GA 30309
Telephone (678) 419 1000

Report of Independent Auditors

To the Board of Directors and Members
of Farm Credit of South Florida, ACA

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of changes in members' equity and of cash flows present fairly, in all material respects, the financial position of Farm Credit of South Florida, ACA (the Association) and its subsidiaries at December 31, 2006, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

February 28, 2007

Consolidated Balance Sheets

| <i>(dollars in thousands)</i> | December 31, 2006 | December 31, 2005 | December 31, 2004 |
|--|------------------------------|------------------------------|------------------------------|
| Assets | | | |
| Cash | \$ 667 | \$ 904 | \$ 1,090 |
| Loans | 514,258 | 467,557 | 480,183 |
| Less: allowance for loan losses | 5,198 | 5,106 | 5,100 |
| Net loans | 509,060 | 462,451 | 475,083 |
| Accrued interest receivable | 3,572 | 3,378 | 2,646 |
| Investment in other Farm Credit institutions | 6,773 | 5,411 | 5,642 |
| Premises and equipment, net | 6,777 | 1,196 | 1,289 |
| Prepaid retirement expense | 2,619 | 3,035 | 2,881 |
| Due from AgFirst Farm Credit Bank | 3,782 | 4,285 | 4,533 |
| Other assets | 2,164 | 1,370 | 420 |
| Total assets | <u>\$ 535,414</u> | <u>\$ 482,030</u> | <u>\$ 493,584</u> |
| Liabilities | | | |
| Notes payable to AgFirst Farm Credit Bank | \$ 420,609 | \$ 372,272 | \$ 399,589 |
| Accrued interest payable | 2,071 | 1,567 | 1,316 |
| Patronage refund payable | 5,307 | 4,159 | 3,541 |
| Other liabilities | 16,000 | 18,126 | 12,781 |
| Total liabilities | <u>443,987</u> | <u>396,124</u> | <u>417,227</u> |
| Commitments and contingencies | | | |
| Members' Equity | | | |
| Protected borrower stock | 2,739 | 2,898 | 3,135 |
| Capital stock and participation certificates | 777 | 808 | 810 |
| Retained earnings | | | |
| Allocated | 21,752 | 22,550 | 21,277 |
| Unallocated | 66,159 | 59,650 | 51,135 |
| Total members' equity | <u>91,427</u> | <u>85,906</u> | <u>76,357</u> |
| Total liabilities and members' equity | <u>\$ 535,414</u> | <u>\$ 482,030</u> | <u>\$ 493,584</u> |

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

Consolidated Statements of Income

| <i>(dollars in thousands)</i> | For the year ended December 31, | | |
|--|---------------------------------|-----------|-----------|
| | 2006 | 2005 | 2004 |
| Interest Income | | | |
| Loans | \$ 39,305 | \$ 32,259 | \$ 26,682 |
| Interest Expense | | | |
| Notes payable to AgFirst Farm Credit Bank | 22,603 | 17,361 | 13,914 |
| Net interest income | 16,702 | 14,898 | 12,768 |
| Provision for (reversal of allowance for) loan losses | — | — | (9,823) |
| Net interest income after provision for (reversal of allowance for) loan losses | 16,702 | 14,898 | 22,591 |
| Noninterest Income | | | |
| Loan fees | 1,999 | 1,877 | 1,742 |
| Fees for financially related services | 419 | 625 | 619 |
| Patronage refund from other Farm Credit institutions | 3,866 | 4,348 | 4,541 |
| Gains (losses) on other property owned, net | 27 | 27 | 27 |
| Other noninterest income | 124 | 248 | (104) |
| Total noninterest income | 6,435 | 7,125 | 6,825 |
| Noninterest Expense | | | |
| Salaries and employee benefits | 4,419 | 4,463 | 4,183 |
| Occupancy and equipment | 608 | 370 | 378 |
| Insurance Fund premiums | 681 | 207 | 212 |
| Other operating expenses | 1,209 | 1,356 | 1,160 |
| Total noninterest expense | 6,917 | 6,396 | 5,933 |
| Income before income taxes | 16,220 | 15,627 | 23,483 |
| Provision (benefit) for income taxes | 7 | (1,323) | 31 |
| Net income | \$ 16,213 | \$ 16,950 | \$ 23,452 |

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

Consolidated Statements of Changes in Members' Equity

| <i>(dollars in thousands)</i> | Protected Borrower Stock | Capital Stock and Participation Certificates | Retained Earnings | | Accumulated Other Comprehensive Income | Total Members' Equity |
|--|--------------------------------|---|-------------------|-------------|---|-----------------------------|
| | | | Allocated | Unallocated | | |
| Balance at December 31, 2003 | \$ 3,347 | \$ 769 | \$ 20,471 | \$ 34,902 | \$ (2,168) | \$ 57,321 |
| Comprehensive income | | | | | | |
| Net income | | | | 23,452 | | 23,452 |
| Minimum pension liability adjustment | | | | | 2,168 | 2,168 |
| Total comprehensive income | | | | | | 25,620 |
| Protected borrower stock retired | (212) | | | | | (212) |
| Capital stock/participation certificates issued | | 122 | | | | 122 |
| Capital stock/participation certificates retired | | (81) | | | | (81) |
| Patronage distribution | | | | | | |
| Cash | | | | (3,502) | | (3,502) |
| Nonqualified retained earnings | | | 3,692 | (3,692) | | — |
| Retained earnings retired | | | (2,872) | | | (2,872) |
| Distribution adjustment | | | (14) | (25) | | (39) |
| Balance at December 31, 2004 | 3,135 | 810 | 21,277 | 51,135 | — | 76,357 |
| Net income | | | | 16,950 | | 16,950 |
| Protected borrower stock retired | (237) | | | | | (237) |
| Capital stock/participation certificates issued | | 108 | | | | 108 |
| Capital stock/participation certificates retired | | (110) | | | | (110) |
| Patronage distribution | | | | | | |
| Cash | | | | (4,007) | | (4,007) |
| Nonqualified retained earnings | | | 4,173 | (4,173) | | — |
| Retained earnings retired | | | (3,001) | | | (3,001) |
| Distribution adjustment | | | 101 | (255) | | (154) |
| Balance at December 31, 2005 | 2,898 | 808 | 22,550 | 59,650 | — | 85,906 |
| Net income | | | | 16,213 | | 16,213 |
| Protected borrower stock retired | (159) | | | | | (159) |
| Capital stock/participation certificates issued | | 95 | | | | 95 |
| Capital stock/participation certificates retired | | (126) | | | | (126) |
| Patronage distribution | | | | | | |
| Cash | | | | (5,147) | | (5,147) |
| Nonqualified retained earnings | | | 4,383 | (4,383) | | — |
| Retained earnings retired | | | (5,292) | | | (5,292) |
| Distribution adjustment | | | 111 | (174) | | (63) |
| Balance at December 31, 2006 | \$ 2,739 | \$ 777 | \$ 21,752 | \$ 66,159 | \$ — | \$ 91,427 |

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

Consolidated Statements of Cash Flows

| <i>(dollars in thousands)</i> | For the year ended December 31, | | |
|--|--|-------------|-------------|
| | 2006 | 2005 | 2004 |
| Cash flows from operating activities: | | | |
| Net income | \$ 16,213 | \$ 16,950 | \$ 23,452 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | |
| Depreciation on premises and equipment | 288 | 204 | 227 |
| Provision for (reversal of allowance for) loan losses | — | — | (9,823) |
| (Gains) losses on other property owned, net | (27) | (27) | (27) |
| Changes in operating assets and liabilities: | | | |
| (Increase) decrease in accrued interest receivable | (194) | (732) | 417 |
| (Increase) decrease in prepaid retirement expense | 416 | (154) | (2,881) |
| (Increase) decrease in due from AgFirst Farm Credit Bank | 503 | 248 | (1,557) |
| (Increase) decrease in other assets | (794) | (950) | 1,961 |
| Increase (decrease) in accrued interest payable | 504 | 251 | 231 |
| Increase (decrease) in minimum pension liability | — | — | (1,236) |
| Increase (decrease) in other liabilities | (2,126) | 5,372 | (2,109) |
| Total adjustments | (1,430) | 4,212 | (14,797) |
| Net cash provided by (used in) operating activities | 14,783 | 21,162 | 8,655 |
| Cash flows from investing activities: | | | |
| Net (increase) decrease in loans | (46,609) | 12,632 | (18,254) |
| (Increase) decrease in investment in other Farm Credit institutions | (1,362) | 231 | (819) |
| Purchases of premises and equipment | (5,869) | (111) | (178) |
| Proceeds from sales of other property owned | 27 | — | — |
| Net cash provided by (used in) investing activities | (53,813) | 12,752 | (19,251) |
| Cash flows from financing activities: | | | |
| Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net | 48,337 | (27,317) | 17,139 |
| Protected borrower stock retired | (159) | (237) | (212) |
| Capital stock and participation certificates issued | 95 | 108 | 122 |
| Capital stock and participation certificates retired | (126) | (110) | (81) |
| Patronage refunds paid | (4,062) | (3,543) | (2,882) |
| Retained earnings retired | (5,292) | (3,001) | (2,872) |
| Net cash provided by (used in) financing activities | 38,793 | (34,100) | 11,214 |
| Net increase (decrease) in cash | (237) | (186) | 618 |
| Cash, beginning of period | 904 | 1,090 | 472 |
| Cash, end of period | \$ 667 | \$ 904 | \$ 1,090 |
| Supplemental schedule of non-cash activities: | | | |
| Cash dividends or patronage distributions declared or payable | \$ 5,147 | \$ 4,007 | \$ 3,502 |
| Decrease (increase) in accumulated other comprehensive income related to minimum pension liability | — | — | 2,168 |
| Supplemental information: | | | |
| Interest paid | \$ 22,099 | \$ 17,110 | \$ 13,683 |
| Taxes paid, net | (5) | — | (14) |

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

Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

Note 1 — Organization and Operations

A. **Organization:** Farm Credit of South Florida, ACA (the Association) is a member-owned cooperative which provides credit and credit-related services to or for the benefit of eligible borrowers/shareholders for qualified purposes in the counties of Broward, Dade, Indian River, Martin, Monroe, Okeechobee, Palm Beach, and St. Lucie in the state of Florida.

The Association is a lending institution of the Farm Credit System (System), a nationwide system of cooperatively owned banks and associations, which was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (Farm Credit Act). The most recent significant amendment to the Farm Credit Act was the Agricultural Credit Act of 1987. At December 31, 2006, the System was comprised of four Farm Credit Banks, one Agricultural Credit Bank and ninety-six Associations.

AgFirst Farm Credit Bank (Bank) and its related Associations are collectively referred to as the "District." The Bank provides funding to all associations within the District and is responsible for supervising certain activities of the Association, as well as the other Associations operating within the District. The District consists of the Bank and twenty-three Agricultural Credit Associations (ACAs), all of which have reorganized as ACA parent-companies, which have two wholly owned subsidiaries, a Federal Land Credit Association (FLCA) and a Production Credit Association (PCA). FLCAs are tax-exempt while ACAs and PCAs are taxable.

The ACA parent company holds a charter for the two wholly-owned subsidiaries. The FLCA makes secured collateralized long-term agricultural real estate and rural home mortgage loans. The PCA is authorized to make short- and intermediate-term loans for agricultural production or operating purposes; however, the Association is operating its short- and intermediate-term lending activities through the ACA instead of the PCA.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System banks and associations. The FCA examines the activities of the associations and certain actions by the associations are subject to the prior approval of the FCA and the supervising Bank.

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (Insured debt), (2) to ensure the retirement of

protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary uses by the Insurance Corporation to provide assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank is required to pay premiums, which may be passed on to the Association, into the Insurance Fund, based on its annual average loan principal outstanding until the monies in the Insurance Fund reach the "secure base amount." The secure base amount is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (Systemwide debt obligations) or such other percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums, but it still must ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

B. **Operations:** The Farm Credit Act sets forth the types of authorized lending activity, persons eligible to borrow, and financial services which can be offered by the Association. The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related businesses.

The Association may sell to any System borrowing member, on an optional basis, credit or term life insurance appropriate to protect the loan commitment in the event of death of the debtor(s). The sale of other insurance necessary to protect a member's farm or aquatic unit is permitted, but limited to hail and multi-peril crop insurance, and insurance necessary to protect the facilities and equipment of aquatic borrowers.

The AgFirst Annual Report to Shareholders, the AgFirst District Annual Report to Shareholders, and the AgFirst District's quarterly reports are available on its web site, www.agfirst.com. Upon request, shareholders of the Association will be provided with copies of these reports at no charge by calling 1-800-845-1745, Ext. 316. The Association's financial condition may be impacted by factors that affect the Bank. The Bank's Annual Report discusses the material aspects of the District's financial condition, changes in financial condition, and results of operations. In addition, the District's Annual Report identifies favorable and unfavorable trends, significant events, uncertainties and the impact of activities of the Insurance Corporation.

The lending and financial services offered by the Bank are described in Note 1 of the AgFirst Annual Report to Shareholders.

Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the Association conform with accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results may differ from these estimates.

Certain amounts in prior years' financial statements have been reclassified to conform to current consolidated financial statement presentation. Such reclassifications had no effect on net income or total members' equity of prior years. The consolidated financial statements include the accounts of the FLCA and the PCA. All significant inter-company transactions have been eliminated in consolidation.

A. **Cash:** Cash, as included in the statements of cash flows, represents cash on hand and on deposit at banks.

B. **Loans and Allowance for Loan Losses:** Long-term real estate mortgage loans generally have original maturities ranging from 5 to 30 years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less. Loans are carried at their principal amount outstanding less unearned income. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding.

Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days (unless adequately collateralized and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in the prior year).

When loans are in nonaccrual status, the interest portion of payments received in cash is recognized as interest income if collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it. Otherwise, loan payments are applied against the recorded investment in the loan. Nonaccrual loans may be returned to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected and the loan is not classified "doubtful" or "loss."

Loans are charged-off, wholly or partially, as appropriate, at the time they are determined to be uncollectible.

In cases where a borrower experiences financial difficulties and the Association makes certain monetary concessions to the borrower through modifications to the contractual terms of the loan, the loan is classified as a restructured loan. If the borrower's ability to meet the revised payment schedule is uncertain, the loan is classified as a nonaccrual loan.

The allowance for loan losses is a valuation account used to reasonably estimate loan and lease losses existing as of the financial statement date. Determining the appropriate allowance for loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss.

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. It is based on estimates, appraisals and evaluations of loans which, by their nature, contain elements of uncertainty and imprecision. The possibility exists that changes in the economy and its impact on borrower repayment capacity will cause these estimates, appraisals and evaluations to change.

The level of allowance for loan losses is generally based on recent charge-off experience adjusted for relevant environmental factors. The Association considers the following factors when adjusting the historical charge-offs experience:

- Changes in credit risk classifications,
- Changes in collateral values,
- Changes in risk concentrations,
- Changes in weather related conditions, and
- Changes in economic conditions.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms of the loan. Impaired loans include nonaccrual loans, restructured loans, and loans past due 90 days or more and still accruing interest. A loan is considered contractually past due when any principal repayment or interest payment required by the loan instrument is not received on or before the due date. A loan shall remain contractually past due until it is formally restructured or until the entire amount past due, including principal, accrued interest, and penalty interest incurred as the result of past due status, is collected or otherwise discharged in full.

A specific allowance may be established for impaired loans under Statement of Financial Accounting Standards No. 114. Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent. See Note 3 for a discussion on the refinement of the allowance for loan losses methodology.

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs.

C. **Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** The Association is required to maintain ownership in the Bank in the form of Class B and Class C stock. Accounting for this investment is on the cost plus allocated equities basis. Patronage refunds from the Bank are accrued as earned. The receivable for such patronage refunds is classified as due from AgFirst Farm Credit Bank.

- D. **Other Property Owned:** Other property owned, consisting of real and personal property acquired through a collection action, is recorded upon acquisition at fair value less estimated selling costs. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income and expenses from operations and carrying value adjustments are included in gains (losses) on other property owned, net.
- E. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Gains and losses on dispositions are reflected in current operations. Maintenance and repairs are charged to operating expense and improvements are capitalized.
- F. **Advanced Conditional Payments:** The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, the advanced conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as interest-bearing liabilities in the accompanying consolidated balance sheets. Advanced conditional payments are not insured. Interest is generally paid by the Association on such accounts.
- G. **Employee Benefit Plans:** Substantially all employees of the Association may participate in the retirement plan (Plan) of the AgFirst District, which is a defined benefit plan. The District utilizes the "Projected Unit Credit" actuarial method for financial reporting purposes and for funding purposes. As a result of the funded status at the Plan's measurement date (September 30) of the underlying Plan, the Association may record a minimum liability, an intangible asset relating to unrecognized prior service cost and other comprehensive income (loss). The adjustment to other comprehensive income (loss) would be net of deferred taxes, if significant. For participants hired before January 1, 2003, benefits are determined based on a final average pay formula. For those participants hired on or after January 1, 2003, benefits are determined using a cash balance formula.

Substantially all employees of the Association may also be eligible to participate in the District's thrift plan (Thrift Plan), which qualifies as a 401(k) plan as defined by the Internal Revenue Code. For employees hired on or prior to December 31, 2002, the Association contributes \$.50 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. For employees hired on or after January 1, 2003, the Association contributes \$1.00 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service. Thrift Plan costs are expensed as funded.

Effective January 1, 2006 the Districtwide 401(k) Plan known as the AgFirst Farm Credit Employee Thrift Plan merged with the Farm Credit Bank of Texas Thrift Plus Plan. The new plan is known as the AgFirst/FCBT 401(k) Employee Benefit Plan.

The Association may provide certain health care and life insurance benefits to eligible retired employees. Substantially all employees may become eligible for these benefits if they reach early retirement age while working for the Association.

- H. **Income Taxes:** The Association is generally subject to Federal and certain other income taxes. As previously described, the ACA holding company has two wholly-owned subsidiaries, a PCA and a FLCA. The FLCA subsidiary is exempt from federal and state income taxes as provided in the Farm Credit Act. The ACA holding company and the PCA subsidiary are subject to federal, state and certain other income taxes.

The Association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the Association 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 taxable earnings that will not be distributed as qualified patronage refunds. The Association distributes patronage on the basis of book income.

The Association accounts for income taxes under the asset and liability method, recognizing deferred tax assets and liabilities for the expected future tax consequences of the temporary differences between the carrying amounts and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled.

The Association records a valuation allowance at the balance sheet dates against that portion of the Association's deferred tax assets that, based on management's best estimates of future events and circumstances, more likely than not (a likelihood of more than 50 percent) will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of our expected patronage program, which reduces taxable earnings.

- I. **Patronage Refund from AgFirst and Other Financial Institutions:** The Association records patronage refunds from the Bank and certain District Associations on an accrual basis.
- J. **Recently Issued Accounting Pronouncements:** In June 2006, the Financial Accounting Standards Board (FASB) released Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. Adoption of FIN 48 is not expected to have a material impact on the Association's Consolidated Balance Sheet or Consolidated Statement of Income.

On September 30, 2006, the FASB issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (FAS 158). FAS 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize through comprehensive income changes in that funded status in the year in which the changes occur. The Bank and its related Associations will be required to implement FAS 158 for the year ended December 31, 2007. In addition, FAS 158 requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the Bank and its related Associations use a measurement date of September 30th. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. The Bank and its related Associations are currently evaluating the impact of implementing FAS 158.

Note 3 — Refinement of the Allowance for Loan Losses Methodology

During 2004, the Association conducted a study to further refine its allowance for loan losses methodology taking into account recently issued guidance by FCA, as well as the Securities and Exchange Commission (SEC) and Federal Financial Institutions Examination Council guidelines.

Previously, the Association's allowance for loan losses methodology had been based upon criteria developed in the late 1980s and reflected the credit losses experienced in the mid-to-late 1980s, which was a period of unusually adverse economic conditions in American agriculture. Given the long cyclical nature of the agricultural economy, loss factors utilized to determine the allowance for loan losses subsequent to 1989 continued to reflect, to some extent, the loss history of the mid-to-late 1980s, which resulted in conservative estimates of the allowance for loan losses. The Association's allowance for loan losses methodology utilized throughout the period was in accordance with generally accepted accounting principles and was consistently applied.

While conservative in estimating the allowance for loan losses, the methodology used resulted in annual provisions for loan losses over the periods that reflected changes in credit quality and loss experience. Accordingly, the reserves provided in the mid-to-late 1980s have, in effect, remained part of the allowance for loan losses. The Association's allowance for loan losses methodology has consistently adhered to proper accounting policies, under the regulatory supervision of FCA in its role as a "safety and soundness" regulator. It was FCA's view that the allowance for loan losses should include among others, an assessment of probable losses, historical loss experience and economic conditions.

In April 2004, FCA issued an "Informational Memorandum" to System institutions regarding the criteria and methodologies that would be used in evaluating the adequacy of a System institution's allowance for loan losses. FCA endorsed the direction provided by other bank regulators and the SEC and indicated the conceptual framework addressed in their guidance would be included as part of their examination process.

During the fourth quarter of 2004, the Association completed its study and refined its methodology to be in compliance with the guidance discussed in the previous paragraph. The refinement in methodology resulted in a calculated allowance for loan losses that was significantly less than the previously recorded balance due to revised loss factors that are more indicative of actual loss experience in recent years and current borrower analysis.

While the \$9,823 reversal had a significant impact on 2004 results of operations and the previously recorded allowance for loan losses, the refinement in methodology did not have a significant impact on 2006 comparative results of operations and is not expected to have a significant impact in future periods. Additionally, the refinement in methodology did not have a significant impact on the level of the risk bearing capacity of the Association, generally referred to as "risk funds" (capital plus the allowance for loan losses), which totaled \$96,625 at December 31, 2006 (18.79 percent of Association loans), as compared with \$91,012 at December 31, 2005 (19.47 percent of Association loans), and \$81,457 at December 31, 2004 (16.96 percent of Association loans).

Note 4 — Loans and Allowance for Loan Losses

A summary of loans follows:

| | December 31, | | |
|----------------------------------|-------------------|-------------------|-------------------|
| | 2006 | 2005 | 2004 |
| Real estate mortgage | \$ 389,254 | \$ 385,420 | \$ 386,668 |
| Production and intermediate term | 63,749 | 61,070 | 62,346 |
| Agribusiness: | | | |
| Processing and marketing | 45,791 | 10,772 | 16,954 |
| Farm related business | 8,890 | 9,063 | 9,711 |
| Communication | 6,401 | 960 | 4,028 |
| Rural residential real estate | 173 | 272 | 476 |
| Total loans | \$ 514,258 | \$ 467,557 | \$ 480,183 |

The Association's concentration of credit risk in various agricultural commodities is shown in the following table. While the amounts represent the Association's maximum potential credit risk as it relates to recorded loan principal, a substantial portion of the Association's lending activities is collateralized and the Association's exposure to credit loss associated with lending activities is reduced accordingly. An estimate of the Association's credit risk exposure is considered in the determination of the allowance for loan losses.

Total loans at December 31, 2006, 2005 and 2004 consisted of the following commodity types:

| Commodity Type | December 31, | | |
|--------------------------|--------------|-------------|-------------|
| | 2006 | 2005 | 2004 |
| Nursery/Greenhouse | 29% | 27% | 27% |
| Other | 17 | 16 | 10 |
| Participations Purchased | 16 | 12 | 16 |
| Livestock | 8 | 8 | 8 |
| Equine | 6 | 8 | 7 |
| Sugar Cane | 6 | 4 | 7 |
| Citrus Fruits | 5 | 9 | 10 |
| Vegetables | 5 | 9 | 7 |
| Dairy | 4 | 4 | 4 |
| Fruit | 4 | 3 | 4 |
| Total | 100% | 100% | 100% |

The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but typically includes farmland and income-producing property, such as crops and livestock, as well as receivables. Long-term real estate loans are collateralized by the first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (97 percent if guaranteed by a government agency) of the property's appraised value. However, a decline in a property's market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the Association in the collateral, may result in the loan to value ratios in excess of the regulatory maximum.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms.

The following table presents information relating to impaired loans.

| | December 31, | | |
|--|-----------------|-------------|---------------|
| | 2006 | 2005 | 2004 |
| Nonaccrual loans: | | | |
| Current as to principal and interest | \$ 59 | \$ - | \$ - |
| Past due | 79 | - | - |
| Total nonaccrual loans | 138 | - | - |
| Impaired accrual loans: | | | |
| Restructured accrual loans | - | - | - |
| Current as to principal and interest | 4,286 | - | - |
| Accrual loans 90 days or more past due | 267 | - | 101 |
| Total impaired accrual loans | 4,553 | - | 101 |
| Total impaired loans | <u>\$ 4,691</u> | <u>\$ -</u> | <u>\$ 101</u> |

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2006.

Interest income is recognized and cash payments are applied on nonaccrual impaired loans as described in Note 2. The following table presents interest income recognized on impaired loans.

| | Year Ended December 31, | | |
|--|-------------------------|-------------|--------------|
| | 2006 | 2005 | 2004 |
| Interest income recognized on nonaccrual loans | \$ - | \$ - | \$ 29 |
| Interest income on impaired accrual loans | 352 | 1 | 23 |
| Interest income recognized on impaired loans | <u>\$ 352</u> | <u>\$ 1</u> | <u>\$ 52</u> |

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

| | 2006 | 2005 | 2004 |
|--|---------------------------------------|-------------|---------------|
| | Impaired loans with related allowance | \$ 4,286 | \$ - |
| Impaired loans with no related allowance | 405 | - | 101 |
| Total impaired loans | <u>\$ 4,691</u> | <u>\$ -</u> | <u>\$ 101</u> |
| Allowance on impaired loans | <u>\$ 2,134</u> | <u>\$ -</u> | <u>\$ -</u> |

The following table summarizes impaired loan information for the year ended December 31,

| | 2006 | 2005 | 2004 |
|------------------------|---------------|-------------|---------------|
| Average impaired loans | <u>\$ 496</u> | <u>\$ 7</u> | <u>\$ 445</u> |

The following table summarizes interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans:

| | Year Ended December 31, | | |
|--|-------------------------|-------------|-------------|
| | 2006 | 2005 | 2004 |
| Interest income which would have been recognized under the original loan terms | \$ 10 | \$ - | \$ 29 |
| Less: interest income recognized | - | - | 29 |
| Foregone interest income | <u>\$ 10</u> | <u>\$ -</u> | <u>\$ -</u> |

The changes in the allowance for loan losses are as follows:

| | Year Ended December 31, | | |
|--|-------------------------|-----------------|-----------------|
| | 2006 | 2005 | 2004 |
| Balance at beginning of year | \$ 5,106 | \$ 5,100 | \$ 14,881 |
| Charge-offs: | | | |
| Real estate mortgage | \$ (2) | \$ - | \$ - |
| Production and intermediate term | - | - | (1) |
| Total charge-offs | <u>(2)</u> | <u>-</u> | <u>(1)</u> |
| Recoveries: | | | |
| Production and intermediate term | \$ 94 | \$ 6 | \$ 43 |
| Total recoveries | 94 | 6 | 43 |
| Net (charge-offs) recoveries | 92 | 6 | 42 |
| Provision for (reversal of allowance for) loan losses | \$ - | \$ - | \$ - |
| Nonrecurring provision for loan losses reversal | - | - | (9,823) |
| | <u>-</u> | <u>-</u> | <u>(9,823)</u> |
| Balance at end of year | <u>\$ 5,198</u> | <u>\$ 5,106</u> | <u>\$ 5,100</u> |
| Ratio of net recoveries during the period to average loans outstanding during the period | <u>0.019%</u> | <u>0.001%</u> | <u>0.01%</u> |

As previously discussed in Note 3, the nonrecurring allowance for loan losses reversal resulted from the refinement of the Association's allowance for loan losses methodology.

In addition, the following is a breakdown of the allowance for loan losses for the end of the last three fiscal years:

| | December 31, 2006 | | December 31, 2005 | |
|----------------------------------|-------------------|-------------|-------------------|-------------|
| | Amount | % | Amount | % |
| Real estate mortgage | \$ 3,597 | 69% | \$ 3,599 | 70% |
| Production and intermediate term | 1,400 | 27 | 1,305 | 26 |
| Agribusiness | 136 | 3 | 137 | 3 |
| Communication | 59 | 1 | 59 | 1 |
| Rural residential real estate | 6 | - | 6 | - |
| Total | <u>\$ 5,198</u> | <u>100%</u> | <u>\$ 5,106</u> | <u>100%</u> |
| | December 31, 2004 | | | |
| | Amount | % | | |
| Real estate mortgage | \$ 3,600 | 70% | | |
| Production and intermediate term | 1,300 | 26 | | |
| Agribusiness | 135 | 3 | | |
| Communication | 59 | 1 | | |
| Rural residential real estate | 6 | - | | |
| Total | <u>\$ 5,100</u> | <u>100%</u> | | |

Note 5 — Investment in AgFirst Farm Credit Bank

The Association is required to maintain ownership in the Bank of Class B and Class C stock as determined by the Bank. The Bank may require additional capital contributions to maintain its capital requirements.

Note 6 — Premises and Equipment

Premises and equipment consisted of the following:

| | December 31, | | |
|--------------------------------|-----------------|-----------------|-----------------|
| | 2006 | 2005 | 2004 |
| Land | \$ 439 | \$ 439 | \$ 439 |
| Buildings and improvements | 6,810 | 1,238 | 1,237 |
| Furniture and equipment | 1,395 | 1,380 | 1,331 |
| | <u>8,644</u> | <u>3,057</u> | <u>3,007</u> |
| Less: accumulated depreciation | <u>1,867</u> | <u>1,861</u> | <u>1,718</u> |
| Total | <u>\$ 6,777</u> | <u>\$ 1,196</u> | <u>\$ 1,289</u> |

Note 7 — Notes Payable to AgFirst Farm Credit Bank

The Association's indebtedness to the Bank represents borrowings by the Association to fund its loan portfolio. This indebtedness is collateralized by a pledge of substantially all of the Association's assets and the terms of the revolving lines of credit are governed by a general financing agreement. Interest rates on both variable and fixed rate notes payable are generally established loan-by-loan based on the Bank's marginal cost of funds, capital position, operating costs and return objectives. The interest rate is periodically adjusted by the Bank based upon agreement between the Bank and Association. The weighted average interest rates on the variable rate notes were 6.25 percent for LIBOR-based loans, 6.47 percent for Prime-based loans, and the weighted average remaining maturities were 2.5 years and 3.3 years, respectively, at December 31, 2006. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) notes payable which are match funded by the Bank was 5.91 percent and the weighted average remaining maturity was 3.7 years at December 31, 2006. The weighted average interest rate on all interest-bearing notes payable was 6.09 percent and the weighted average remaining maturity was 3.4 years at December 31, 2006.

Variable rate and fixed rate notes payable represent approximately 23.76 percent and 76.24 percent, respectively, of total notes payable at December 31, 2006.

Under the Farm Credit Act, the Association is obligated to borrow only from the Bank, unless the Bank approves borrowing from other funding sources. The Bank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2006, the Association's notes payable were within the specified limitations.

Note 8 — Members' Equity

A description of the Association's capitalization requirements, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below.

A. Protected Borrower Equity

Protection of certain borrower equity is provided under the Farm Credit Act, which requires the Association, when retiring protected borrower equity, to retire such equity at par or stated value regardless of its book value. Protected borrower equity includes capital stock, participation certificates and allocated equities that were outstanding as of January 6, 1988, or were issued or allocated prior to October 6, 1988. If an Association is unable to retire protected borrower equity at par value or stated value, amounts required to retire this equity would be obtained from the Insurance Fund.

B. Capital Stock and Participation Certificates

In accordance with the Farm Credit Act and the Association's capitalization bylaws, each borrower is required to invest in Class C stock for agricultural loans, or participation certificates in the case of rural home and farm related business loans, as a condition of borrowing. The initial borrower investment, through either purchase or transfer, must be in an amount equal to the lessor of two percent of the loan amount or \$1,000. The Board of Directors may increase the amount of investment if necessary to meet the Association's capital needs. Loans designated for sale or sold into the Secondary Market on or after April 16, 1996 will have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation.

The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, but usually does not make a cash investment. The aggregate par value is generally added to the principal amount of the related loan obligation. The Association retains a first lien on the stock or participation certificates owned by borrowers. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding stock or participation certificates.

C. Regulatory Capitalization Requirements and Restrictions

FCA's capital adequacy regulations require the Association to achieve permanent capital of seven percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the seven percent capital requirement can initiate certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Association's financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless prescribed capital standards are met. FCA regulations also require that additional minimum standards for capital be achieved. These standards require all System institutions to achieve and maintain ratios as defined by FCA regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of seven percent and core surplus as a percentage of risk-adjusted assets of three and one-half percent. The Association's permanent capital, total surplus and core surplus ratios at December 31, 2006 were 16.31 percent, 16.18 percent and 14.94 percent, respectively.

An FCA regulation empowers it to direct a transfer of funds or equities by one or more System institutions to another

System institution under specified circumstances. The Association has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

D. Description of Equities

The Association is authorized to issue or have outstanding Classes A and D Preferred Stock, Classes A, B, and C Common Stock, Classes B and C Participation Certificates and such other classes of equity as may be provided for in amendments to the bylaws in such amounts as may be necessary to conduct the Association’s business. All stock and participation certificates have a par or face value of five dollars (\$5.00) per share.

The Association had the following shares outstanding at December 31, 2006:

| Class | Protected | Shares Outstanding | |
|--|-----------|--------------------|---------------------|
| | | Number | Aggregate Par Value |
| A Common/Nonvoting | Yes | 84,867 | \$ 424 |
| B Common/Nonvoting | Yes | 446,314 | 2,232 |
| C Common/Voting | No | 150,904 | 755 |
| B Participation Certificates/Nonvoting | Yes | 16,600 | 83 |
| C Participation Certificates/Nonvoting | No | 4,414 | 22 |
| Total Capital Stock and Participation Certificates | | 703,099 | \$ 3,516 |

Protected common stock and participation certificates are retired at par or face value in the normal course of business. At-risk common stock and participation certificates are retired at the sole discretion of the Board at book value not to exceed par or face amounts, provided the minimum capital adequacy standards established by the Board are met.

Retained Earnings

The Association maintains an unallocated retained earnings account and an allocated retained earnings account. The Board determines the minimum aggregate amount of these two accounts. At the end of any fiscal year, if the retained earnings accounts otherwise would be less than the minimum amount determined by the Board as necessary to maintain adequate capital reserves to meet the commitments of the Association, the Association shall apply earnings for the year to the unallocated retained earnings account in such amounts as may be determined necessary by the Board. Unallocated retained earnings are maintained for each borrower to permit liquidation on a patronage basis.

The Association maintains an allocated retained earnings account consisting of earnings held and allocated to borrowers on a patronage basis. In the event of a net loss for any fiscal year, such allocated retained earnings account will be subject to full impairment in the order specified in the bylaws beginning with the most recent allocation.

The Association has a first lien and security interest on all retained earnings account allocations owned by any borrowers, and all distributions thereof, as additional collateral for their indebtedness to the Association. When the debt of a borrower is in default or is in the process of final liquidation by payment or otherwise, the Association, upon approval of the Board, may order any and all retained

earnings account allocations owned by such borrower to be applied on the indebtedness.

Allocated equities shall be retired solely at the discretion of the Board; provided, however, that minimum capital standards established by the FCA and the Board are met. All nonqualified distributions are tax deductible only when redeemed.

At December 31, 2006, allocated members’ equity consisted of \$6,372 of qualified surplus and \$15,380 of nonqualified retained surplus.

Patronage Distributions

Prior to the beginning of any fiscal year, the Board, by adoption of a resolution, may obligate the Association to distribute to borrowers on a patronage basis all or any portion of available net earnings for such fiscal year or for that and subsequent fiscal years. Patronage distributions are based on the proportion of the borrower’s interest to the amount of interest earned by the Association on its total loans unless another proportionate patronage basis is approved by the Board.

If the Association meets its capital adequacy standards after making the patronage distributions, the patronage distributions may be in cash, authorized stock of the Association, allocations of earnings retained in an allocated members’ equity account, or any one or more of such forms of distribution. Patronage distributions of the Association’s earnings may be paid on either a qualified or nonqualified basis, or a combination of both, as determined by the Board. A minimum of 20 percent of the total qualified patronage distribution to any borrower for any fiscal year shall always be paid in cash.

Dividends

The Association may declare noncumulative dividends on its capital stock and participation certificates provided the dividend rate does not exceed 20 percent of the par value of the respective capital stock and participation certificates. Such dividends may be paid solely on Classes A and D Preferred Stock, or on all classes of stock and participation certificates.

The rate of dividends paid on Class A Preferred Stock for any fiscal year may not be less than the rate of dividends paid on Classes A, B or C Common Stock or participation certificates for such year. The rate of dividends on Classes A, B, or C Common Stock and participation certificates shall be at the same rate per share.

Dividends may not be declared if, after recording the liability, the Association would not meet its capital adequacy standards. No dividends were declared by the Association for any of the periods included in these financial statements.

Transfer

Classes A and D Preferred, Classes A, B and C Common Stocks, and Classes B and C Participation Certificates may be transferred to persons or entities eligible to purchase or hold such equities.

Impairment

Any net losses recorded by the Association shall first be applied against unallocated members' equity. To the extent that such losses would exceed unallocated members' equity, such losses would be applied consistent with the Association's bylaws and distributed pro rata to each share and/or unit outstanding in the class, in the following order:

- a) **First**, Assistance Preferred Stock issued and outstanding;
- b) **Second**, allocated surplus, in its entirety, with application to most recent allocation first and then in reverse order until all allocated surplus has been exhausted;
- c) **Third**, Class C Common Stock and Class C Participation Certificates issued and outstanding, pro rata until such stock is fully impaired;
- d) **Fourth**, Class A Common and Class B Common Stock and Class B Participation Certificates issued and outstanding, pro rata until such stock is fully impaired; and
- e) **Fifth**, Class A Preferred and Class D Preferred Stock issued and outstanding, if any.

Distribution on Liquidation

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities, shall be distributed in the following order of priority:

- a) **First**, to the holders of Class D Preferred Stock until an amount equal to the aggregate par value of all shares of said stock then issued and outstanding has been distributed to such holders,
- b) **Second**, to the holders of Class A Common Stock, Class B Common Stock, Class C Common Stock and Participation Certificates, pro rata in proportion to the number of shares or units of each such class of stock or participation certificates then issued and outstanding, until an amount equal to the aggregate par value or face amount of all such shares or units has been distributed to such holders;
- c) **Third**, to the holders of allocated surplus evidenced by qualified written notices of allocation, in the order of the year of issuance, until the total amount of such account has been distributed;
- d) **Fourth**, to the holders of allocated surplus evidenced by nonqualified written notices of allocation, in the order of the year of issuance, until the total amount of such account has been distributed;
- e) **Fifth**, all unallocated surplus accrued or issued after April 22, 1995, shall be distributed to present and former Patrons from said date through the date of liquidation on a patronage basis to the extent practicable; and
- f) **Sixth**, any remaining assets of the Association after such distribution shall be distributed ratably to the holders of all classes of Common Stock and Participation

Certificates in proportion to the number or shares or units of such class of Common Stock or participation certificates held by such holders.

All distributions to the holders of any class of stock and/or participation certificate holders shall be made in proportion to the number of shares or units of such classes of stock or participation certificates held by such holders. All distributions to holders of allocated surplus shall be pro-rata by year of issuance.

E. Other Comprehensive Income (Loss)

The Association reports other comprehensive income (loss) in its Consolidated Statements of Changes in Members' Equity. During 2004, the District Associations funded the pension plans sufficiently to eliminate the pension-related charge to other comprehensive income (loss) at December 31, 2004. See Note 10 for further information.

Note 9 — Income Taxes

The provision (benefit) for income taxes follows:

| | Year Ended December 31, | | |
|--|--------------------------------|------------------|--------------|
| | 2006 | 2005 | 2004 |
| Current: | | | |
| Federal | \$ 7 | \$(1,323) | \$ 29 |
| State | — | — | 2 |
| | <u>7</u> | <u>(1,323)</u> | <u>31</u> |
| Deferred: | — | — | — |
| Total provision (benefit) for income taxes | <u>\$ 7</u> | <u>\$(1,323)</u> | <u>\$ 31</u> |

During 2005, the Association reversed a provision for income tax in the amount of \$623, which represented a contingent liability established in 2001, in the event the IRS had determined the refund(s) to be taxable. As of September 2005, the statute of limitations expired on the refunds and the Association was able to reverse the \$623 provision. Additionally, the Association recorded a benefit of \$712 for a refund the Association received upon revocation of non-qualified allocated equities. The tax was paid at the time the equities were declared.

The provision (benefit) for income tax differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as follows:

| | December 31, | | |
|--|---------------------|------------------|--------------|
| | 2006 | 2005 | 2004 |
| Federal tax at statutory rate | \$ 5,515 | \$ 5,314 | \$ 7,984 |
| State tax, net | — | — | 1 |
| Bank equity redemption | — | 90 | — |
| Patronage distributions | (1,750) | (146) | (1,191) |
| Nonqualified written notices | — | (712) | — |
| Tax-exempt FLCA earnings | (3,784) | (5,399) | (4,639) |
| Long-term lending related refunds | — | (623) | — |
| Change in deferred tax asset valuation allowance | 16 | (46) | (1,907) |
| Other | 10 | 199 | (217) |
| Provision (benefit) for income taxes | <u>\$ 7</u> | <u>\$(1,323)</u> | <u>\$ 31</u> |

Deferred tax assets and liabilities result from the following at:

| | December 31, | | |
|---|--------------|--------|---------|
| | 2006 | 2005 | 2004 |
| Deferred income tax assets: | | | |
| Allowance for loan losses | \$ 527 | \$ 491 | \$ 514 |
| Net operating loss – carryforward | 382 | 408 | 281 |
| Nonaccrual loan interest | 2 | – | – |
| Nonqualified patronage distributions | – | – | 827 |
| Gross deferred tax assets | 911 | 899 | 1,622 |
| Less: valuation allowance | (688) | (672) | (1,545) |
| Gross deferred tax assets, net of valuation allowance | 223 | 227 | 77 |
| Deferred income tax liabilities: | | | |
| Bank patronage | (223) | (225) | (244) |
| State income tax | – | – | 167 |
| Other | – | (2) | – |
| Gross deferred tax liability | (223) | (227) | (77) |
| Net deferred tax asset (liability) | \$ – | \$ – | \$ – |

At December 31, 2006, deferred income taxes have not been provided by the Association on approximately \$1.1 million of patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

The Association recorded a valuation allowance of \$688, \$672 and \$1,545 during 2006, 2005 and 2004, respectively. The Association will continue to evaluate the realizability of the deferred tax assets and adjust the valuation allowance accordingly.

Note 10 — Employee Benefit Plans

The employees of the Association may participate in a Districtwide defined benefit retirement plan. This plan is noncontributory and covers substantially all Association employees. Benefits are based on salary and years of service. The assets, liabilities and costs of the plan are not segregated by participating entities but are allocated among the participating entities. Pension costs are allocated by multiplying the District’s net pension expense times the Association’s salary expense as a percentage of the District’s salary expense.

In addition, deferred compensation options are provided to certain key employees under a supplemental deferred compensation plan. Assets have been allocated and separately invested for this plan but these assets are not isolated from the general creditors of the Association.

The Association participates in a Districtwide Thrift Plan. For employees hired on or prior to December 31, 2002, the Association will contribute \$.50 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. For employees hired on or after January 1, 2003, the Association will contribute \$1.00 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service.

The District sponsors a plan providing certain benefits (primarily health care) to its retirees. Certain Association charges related to this plan are an allocation of District charges based on the Association’s proportional share of the plan liability.

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Act) was signed into law. This act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. In May 2004, the FASB issued FASB Staff Position (FSP) 106-2, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003” (the Act). This Staff Position provides guidance on the accounting for the effects of the Act for employers that sponsor postretirement health care plans that provide prescription drug benefits. The District sponsored plan adopted FSP 106-2 effective July 1, 2004 (measured as of March 31, 2004). The benefit obligation valuation as of December 31, 2004 reflects the impact of the Medicare Act.

In determining the benefit obligation as of December 31, 2004, the expected per capita claims cost were estimated to be reduced by 12 percent beginning in 2006, for Medicare-eligible participants receiving actuarially equivalent drug benefits, due to a government reimbursement of a portion of prescription drug benefits. The District reduced its accumulated postretirement benefit obligation (APBO) for the subsidy related to benefits attributed to past service. The effect of the subsidy on the measurement of net periodic postretirement cost for 2005 was a reduction of 2005 expense. The effect included lower amortization of actuarial losses, lower service costs and lower interest costs on the APBO.

The Retiree and Disabled Medical Plan was amended effective January 1, 2006 to change the medical and prescription drug coverage for Medicare-eligible retirees and/or eligible spouses 65 years and older. Beginning in 2006, the AgFirst/FCBT Retiree and Disabled Medical Plan will provide medical and prescription drug coverage to Medicare-eligible retirees and/or eligible spouses 65 years and older through fully-insured AARP endorsed Medicare Supplement policies and subsidized basic Medicare D coverage through a selected Prescription Drug Plan. Dental coverage was not changed. Certain other retirees who are grandfathered under insured arrangements were not impacted by the change. The benefit obligation valuation as of December 31, 2005 reflects the impact of this plan amendment.

In determining the benefit obligation as of December 31, 2005, there was no impact due to government reimbursement of prescription drug benefits. After the plan amendment, the plan no longer provides prescription drug benefits directly for retirees and/or eligible spouses 65 years and older. Instead, the District subsidizes the cost of coverage obtained under the Medicare D program through the selected Prescription Drug Provider.

For further information on postretirement costs, see “Postretirement Benefits” section in the Notes to the AgFirst Farm Credit District Consolidated Financial Statements.

The following is a table of retirement and postretirement benefits expenses (credits):

| | <u>2006</u> | <u>2005</u> | <u>2004</u> |
|-------------------------------|---------------|---------------|---------------|
| Pension | \$ 416 | \$ 436 | \$ 451 |
| Thrift/deferred compensation | 99 | 80 | 74 |
| Other postretirement benefits | 117 | 194 | 233 |
| Total | <u>\$ 632</u> | <u>\$ 710</u> | <u>\$ 758</u> |

For the years ended December 31, 2006, 2005 and 2004, the Association had contributed \$0, \$591 and \$2,400, respectively, to the Districtwide defined benefit retirement plan, which was sufficient to meet its accumulated benefit obligation. For 2004, the contributions eliminated the minimum pension liability and the pension-related charge to accumulated other comprehensive income (OCI) in shareholders' equity. As a result of the fundings and the reclassification of the OCI, the Association ended 2006, 2005 and 2004 with \$2,619, \$3,035 and \$2,881, respectively, in Prepaid retirement expense on the Consolidated Balance Sheets.

Note 11 — Intra-System Financial Assistance

The Farm Credit Act provided for capital assistance to System institutions experiencing severe financial stress through the issuance, prior to October 1, 1992, by the Financial Assistance Corporation of U.S. Treasury-guaranteed 15-year bonds, of which \$1.261 billion in principal amount was originally issued. The last remaining Financial Assistance Corporation bonds matured and were repaid on June 10, 2005.

Pursuant to the Farm Credit Act, the U.S. Treasury paid \$440 million, on behalf of the System, in interest costs on \$844 million of the Financial Assistance Corporation bonds issued for purposes other than funding Capital Preservation Agreement accruals. The Banks had irrevocably set aside funds, including interest earned, that totaled the \$440 million needed to repay the interest advanced by the U.S. Treasury. On June 10, 2005, the Banks repaid the U.S. Treasury the interest advanced. The Farm Credit Act provided that the Financial Assistance Corporation would continue in existence no longer than two years following the maturity of the debt in June 2005. The Financial Assistance Corporation was dissolved effective as of December 31, 2006.

Note 12 — Related Party Transactions

In the ordinary course of business, the Association enters into loan transactions with officers and directors of the Association, their immediate families and other organizations with which such persons may be associated. Such loans are subject to special approval requirements contained in the FCA regulations and are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

Total loans to such persons at December 31, 2006 amounted to \$10,715. During 2006, \$7,813 of new loans were made and repayments totaled \$10,686. In the opinion of management, none of these loans outstanding at December 31, 2006 involved more than a normal risk of collectibility.

Note 13 — Commitments and Contingencies

The Association has various commitments outstanding and contingent liabilities.

The Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers and to manage their exposure to interest-rate risk. These financial instruments include commitments to extend credit and/or commercial letters of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2006, \$147,677 of commitments to extend credit were outstanding. No commercial letters of credit were outstanding.

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the consolidated balance sheets until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. Outstanding standby letters of credit have expiration dates ranging from January 31, 2007 to May 19, 2011. The maximum potential amount of future payments the Association is required to make under the guarantees is \$10,092.

Note 14 — Disclosures About Fair Value of Financial Instruments

The following table presents the carrying amounts and fair values of the Association's financial instruments at December 31, 2006, 2005 and 2004. The fair value of a financial instrument is generally defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Quoted market prices are generally not available for certain System financial instruments, as described below. Accordingly fair values are based on judgments regarding anticipated cash flows, future expected loss experience, current economic conditions, risk characteristics of various financial instruments,

and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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

| | December 31, 2006 | | December 31, 2005 | |
|---------------------------|-------------------|----------------------|-------------------|----------------------|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Financial assets: | | | | |
| Cash | \$ 667 | \$ 667 | \$ 904 | \$ 904 |
| Loans | \$ 514,258 | \$ 521,783 | \$ 467,557 | \$ 469,407 |
| Allowance for loan losses | 5,198 | — | 5,106 | — |
| Loans, net | \$ 509,060 | \$ 521,783 | \$ 462,451 | \$ 469,407 |

| | December 31, 2006 | | December 31, 2005 | |
|---|-------------------|----------------------|-------------------|----------------------|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Financial liabilities: | | | | |
| Notes payable to AgFirst Farm Credit Bank | \$ 420,609 | \$ 422,532 | \$ 372,272 | \$ 371,073 |

| | December 31, 2004 | |
|---------------------------|-------------------|----------------------|
| | Carrying Amount | Estimated Fair Value |
| Financial assets: | | |
| Cash | \$ 1,090 | \$ 1,090 |
| Loans | \$ 480,183 | \$ 484,088 |
| Allowance for loan losses | 5,100 | — |
| Loans, net | \$ 475,083 | \$ 484,088 |

| | December 31, 2004 | |
|---|-------------------|----------------------|
| | Carrying Amount | Estimated Fair Value |
| Financial liabilities: | | |
| Notes payable to AgFirst Farm Credit Bank | \$ 399,589 | \$ 400,722 |

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

- A. **Cash:** The carrying value is a reasonable estimate of fair value.
- B. **Loans:** Because no active market exists for the Association's loans, fair value is estimated by discounting the expected future cash flows using the Association's current interest rates at which similar loans would be made to borrowers with similar credit risk. As the discount rates are based on the Bank's loan rates, as well as management estimates, management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale.

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

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

The carrying value of accrued interest approximates its fair value.

- C. **Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** Estimating the fair value of the Association's investment in the Bank and Other Farm Credit Institutions is not practicable because the stocks are not traded. As described in Note 5, the net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying Consolidated Balance Sheets. The Association owns 2.60 percent of the issued stock of the Bank as of December 31, 2006. As of that date, the Bank's assets totaled \$24.4 billion and shareholders' equity totaled \$1,181 million. The Bank's earnings were \$190 million during 2006.

In addition, the Association has an investment of \$17 related to other Farm Credit institutions.

- D. **Notes Payable to AgFirst Farm Credit Bank:** The notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association's loan receivables plus accrued interest on the notes payable. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.
- E. **Commitments to Extend Credit and Standby Letters of Credit:** The estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics and since the related credit risk is not significant.

Note 15 — Quarterly Financial Information (Unaudited)

Quarterly results of operations for the years ended December 31, 2006, 2005 and 2004 follow:

| | 2006 | | | | |
|---|----------|----------|----------|----------|-----------|
| | First | Second | Third | Fourth | Total |
| Net interest income | \$ 4,086 | \$ 4,100 | \$ 4,236 | \$ 4,280 | \$ 16,702 |
| Provision for (reversal of allowance for) loan losses | — | — | — | — | — |
| Noninterest income (expense), net | 189 | (417) | (224) | (37) | (489) |
| Net income | \$ 4,275 | \$ 3,683 | \$ 4,012 | \$ 4,243 | \$ 16,213 |

| | 2005 | | | | |
|---|----------|----------|----------|----------|-----------|
| | First | Second | Third | Fourth | Total |
| Net interest income | \$ 3,564 | \$ 3,557 | \$ 3,811 | \$ 3,966 | \$ 14,898 |
| Provision for (reversal of allowance for) loan losses | — | — | — | — | — |
| Noninterest income (expense), net | (102) | (256) | (64) | 2,474 | 2,052 |
| Net income | \$ 3,462 | \$ 3,301 | \$ 3,747 | \$ 6,440 | \$ 16,950 |

| | 2004 | | | | |
|---|----------|----------|----------|-----------|-----------|
| | First | Second | Third | Fourth | Total |
| Net interest income | \$ 3,106 | \$ 3,061 | \$ 3,158 | \$ 3,443 | \$ 12,768 |
| Provision for (reversal of allowance for) loan losses | — | — | — | (9,823) | (9,823) |
| Noninterest income (expense), net | (163) | (105) | 256 | 873 | 861 |
| Net income | \$ 2,943 | \$ 2,956 | \$ 3,414 | \$ 14,139 | \$ 23,452 |