



AgHeritage® Farm Credit Services
2008 Annual Report

TABLE OF CONTENTS

AgHeritage Farm Credit Services, ACA

Message from the Chairperson of the Board and Chief Executive Officer	1
Consolidated Five-Year Summary of Selected Financial Data	2
Management's Discussion and Analysis	3
Report of Management	9
Report of Audit Committee	10
Report of Independent Auditors	11
Consolidated Financial Statements	12
Notes to Consolidated Financial Statements	16
Disclosure Information Required by Regulations	25

AgriBank, FCB's financial condition and results of operations materially affect members' investment in AgHeritage Farm Credit Services, ACA. To request a free copy of the combined AgriBank, FCB and Affiliated Associations' financial reports contact us at 119 East Third Street, Suite 200, Little Rock, Arkansas 72201, (800) 299-2290, or through the website at www.agheritagefcs.com or contact AgriBank, FCB at 375 Jackson Street, St. Paul, MN 55101-1810, (651) 282-8800, or via electronic mail to AGRIBANKMN@AGRIBANK.COM. The reports are also available through AgriBank, FCB's website at www.agribank.com.

To request a free copy of our annual or quarterly reports contact us as stated above. The annual report is available on our website 75 days after the end of the calendar year and members are provided a copy of such report 90 days after the end of the year. The quarterly reports are available 40 days after the end of each calendar quarter.

MESSAGE FROM THE CHAIRPERSON OF THE BOARD AND CHIEF EXECUTIVE OFFICER



Dear AgHeritage Farm Credit Services Customer-Owners,

We are pleased to report that AgHeritage Farm Credit Services, ACA had a record year. We achieved sound financial performance while fulfilling our mission. Total earning asset growth, measured as average daily balance, increased 10.35 percent over last year. That measure is 22.59 percent when we include a block of mortgage loans sold to AgriBank in May 2008.

Net earnings were in excess of \$11.5 million, which represents an increase of \$2.2 million over the previous year. The improved earnings were supported by strong growth in total earning assets as well as continued efforts on prudent expense management. Net interest margin improved while we provided competitive interest rates, and both the association and customer-owners benefited from declining interest rates.

AgHeritage FCS is proud to be your lending cooperative providing both customer and stockholder value to our members. We will remain focused on being a reliable and dependable source of credit and a leading price competitor focused on providing solutions to the financial needs of our customer-owners.

We are pleased to announce that we have continued the patronage program with \$2.5 million of 2008 earnings being paid to eligible customer-owners in late February 2009. This is part of the Board's commitment to our customer-owners in sharing the success of your cooperative. The \$2.5 million patronage represents approximately 21.5 percent of net earnings. This payout allows retention of a portion of earnings to provide for future growth and capital stability.

This annual report provides detailed documentation supporting the financial results of the association. We encourage you to review it carefully; and if you have questions, contact our corporate office or any branch location.

The U.S. and global economy experienced an unprecedented economic situation with the credit crisis in 2008. Agriculture also experienced record volatility. Despite the situation, your association was able to achieve record performance and remain a financially strong organization. AgHeritage FCS and the Farm Credit System are well capitalized and are in a strong financial position to meet the needs of our customer-owners.

We recognize that our successes are a result of hard work and dedication of our staff. We want to thank them for their many efforts. We also want to thank you, our customer-owners, for your loyalty and for allowing us to serve your credit and financial service needs.

Sincerely,



Michael D. Taylor
Chairperson of the Board
AgHeritage Farm Credit Services, ACA



Greg Cole
President and Chief Executive Officer
AgHeritage Farm Credit Services, ACA

February 27, 2009

CONSOLIDATED FIVE-YEAR SUMMARY OF SELECTED FINANCIAL DATA

AgHeritage Farm Credit Services, ACA

(Dollars in thousands)

	2008	2007	2006	2005	2004
Statement of Condition Data					
Loans	\$594,240	\$594,078	\$499,426	\$476,184	\$434,213
Allowance for loan losses	469	352	286	543	323
Net loans	593,771	593,726	499,140	475,641	433,890
Investment securities	19,652	21,098	--	--	--
Investment in AgriBank, FCB	22,519	13,397	11,652	11,652	11,652
Other assets	16,331	20,090	17,409	16,025	12,726
Total assets	\$652,273	\$648,311	\$528,201	\$503,318	\$458,268
Obligations with maturities of one year or less	\$532,712	\$538,016	\$425,241	\$405,981	\$368,127
Total liabilities	532,712	538,016	425,241	405,981	368,127
Protected members' equity	4	4	4	4	4
Capital stock and participation certificates	2,348	2,182	2,045	2,026	2,008
Unallocated surplus	117,209	108,109	100,911	95,307	88,129
Total members' equity	119,561	110,295	102,960	97,337	90,141
Total liabilities and members' equity	\$652,273	\$648,311	\$528,201	\$503,318	\$458,268
Statement of Income Data					
Net interest income	\$17,974	\$15,455	\$13,702	\$13,156	\$12,325
Provision for (reversal of) loan losses	159	8	(197)	220	(8,121)
Patronage and dividend income	2,905	1,676	1,429	1,346	1,147
Other expense, net	8,682	7,015	7,541	6,804	6,532
Provision for income taxes	441	671	183	300	1,235
Net income	\$11,597	\$9,437	\$7,604	\$7,178	\$13,826
Key Financial Ratios					
Return on average assets	1.7%	1.6%	1.4%	1.5%	3.1%
Return on average members' equity	10.1%	8.8%	7.6%	7.7%	17.3%
Net interest income as a percentage of average earning assets	2.9%	2.7%	2.7%	2.9%	2.8%
Member's equity as a percentage of assets	18.3%	17.0%	19.5%	19.3%	19.7%
Net chargeoffs as a percentage of average loans	--	--	--	--	--
Allowance for loan losses as a percentage of loans	0.1%	0.1%	0.1%	0.1%	0.1%
Permanent capital ratio	15.8%	15.7%	17.2%	17.2%	15.9%
Total surplus ratio	15.4%	15.4%	16.9%	16.8%	15.4%
Core surplus ratio	15.4%	15.4%	16.8%	16.4%	14.8%
Other					
Patronage distribution payable to members	\$2,500	\$2,250	\$2,000	\$ --	\$ --

The patronage distribution to members accrued for the year ended December 31, 2008 was distributed in cash during the first quarter of 2009. The patronage distributions accrued for the years ended December 31, 2007 and 2006, were distributed in cash during the first quarter of each subsequent year. For the years ended December 31, 2005 and 2004, no cash patronage distributions were either accrued or paid. No income was distributed to members in the form of dividends, stock or allocated surplus during the five years presented.

MANAGEMENT'S DISCUSSION AND ANALYSIS

AgHeritage Farm Credit Services, ACA

The following commentary reviews the consolidated financial position and consolidated results of operations of AgHeritage Farm Credit Services, ACA and its subsidiaries and provides additional specific information. The accompanying consolidated financial statements and notes also contain important information about our financial position and results of operations.

Forward-Looking Information

Certain sections of this Annual Report contain forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions that are difficult to predict. Words such as "anticipates", "believes", "could", "estimates", "may", "should", "will", or other variations on these terms are intended to identify such forward-looking statements. These statements are based on assumptions and analyses made in light of experience, historical trends, current conditions, and expected future developments. However, actual results and developments may differ materially from our expectations and predictions due to a number of risks and uncertainties; many of which are beyond our control. These risks and uncertainties include, but are not limited to:

- political, legal, regulatory, and economic conditions and developments in the United States and abroad,
- fluctuations in the agricultural and general economies,
- periodically occurring weather-related conditions and plant and animal disease that impact agricultural productivity and income and consumer demand,
- changes in United States government support of the agricultural industry, and
- bio-terrorism and other terrorism.

Loan Portfolio

Loan volume totaled \$594.2 million at December 31, 2008. The changes in loan volume for the last two years were as follows (in thousands):

Change in	2008 vs. 2007		2007 vs. 2006	
loan volume				
Accrual				
Mortgage	(\$74,843)	(18.2%)	\$49,105	13.5%
Commercial	62,492	34.5%	45,697	33.8%
Nonaccrual	12,513	1271.6%	<u>(150)</u>	(13.2%)
Total loans	<u>\$162</u>	0.0%	<u>\$94,652</u>	19.0%

During May 2008, we sold \$124.0 million of a participation interest in real estate loans to AgriBank, FCB (AgriBank). AgriBank has established a separate patronage pool for these assets. Any patronage declared on these pools is solely at the discretion of the AgriBank Board of Directors. AgriBank expects to pay patronage in an amount that approximates the net earnings of those loans. As required by our agreement with AgriBank, we purchased additional AgriBank common stock equal to 8% of the pool assets. The sale of these assets was designed to improve our regulatory capital measures and increase AgriBank's net collateral ratio.

The increase in the commercial loan portfolio since year end 2007 is due to increases in new intermediate term loans and new operating loan commitments.

Portfolio Distribution

We are chartered to operate in certain counties in Arkansas. Approximately 40.7% of our total loan portfolio was in Lonoke, Lawrence, Jackson, Monroe, and Arkansas counties at December 31, 2008.

Our portfolio is concentrated in rice, cotton, poultry and soybeans. Due to the high concentration of operating loans to producers of row crops, the commercial loan portfolio shows some seasonality. These loans are normally at their lowest levels during the winter months because of operating repayments following harvest. They then increase throughout the year as farmers borrow for operating and capital needs.

Financial Market Volatility

The Farm Credit System (the System) continues to fulfill its mission and be a reliable source of debt capital for the farmers, ranchers and other rural businesses that we serve. However, during the second half of 2008, negative economic developments in the global financial markets created a high level of volatility and uncertainty among global financial institutions in general. This volatility has restricted the System's ability to issue debt at preferred maturities and structures that have traditionally been used to fund our loan portfolios. However, the System has been able to issue debt with a broad range of maturities allowing the AgriBank District to continue to offer our complete array of products. Responses by the Federal Government, including explicit actions to protect the housing Government Sponsored Entities (GSEs) and to capitalize and guarantee the liabilities of commercial banks, have had an unintended consequence of increasing our funding cost and reducing our ability to issue debt at preferred maturities and structures. During December 2008 and into January 2009, the spreads to Treasuries have narrowed significantly from levels seen during the fourth quarter but still remain "wide" of housing GSE and government guaranteed bank debt. Due to the System's sound financial condition, we expect to continue to be able to issue debt securities as necessary to meet our funding needs. However, spreads relative to treasuries and swap rates and the relative cost of such debt securities is expected to remain at higher levels than our historical experience.

Agricultural and Economic Conditions

The Food, Conservation, and Energy Act of 2008 (FCEA/farm bill) was enacted into law in June 2008. FCEA includes significant federal financial support for wheat, feed grains, cotton, rice, oilseeds, and dairy, largely continuing the same total level of financial support to agriculture, while changing the distribution and methods of allocating such support. FCEA also contains new, expanded assistance to certain specialty crops, and added price support and trade protection for domestically produced sugar. FCEA continues the direct payment, loan rate, and countercyclical payments (CCP) programs from previous farm support legislation, but the levels of support provided by each program have changed. Also, FCEA provides a new income support program called Average Crop Revenue Election (ACRE).

Strong agricultural economic conditions in 2008 were the result of record high prices for agricultural commodities and the continued positive impact of government programs. The USDA reported \$86.8 billion in net farm income in 2007 representing a significant increase over the reported \$59.0 billion in net farm income in 2006, and 42% higher than the 10-year average net income of \$61.1 billion. Increases in income were due to higher agricultural commodity prices, partially offset by increases in agricultural production costs, including fuel, land, fertilizer and pesticides. Net farm income is forecast to be \$86.9 billion (down from \$96.6 billion previously forecasted) in 2008 but virtually unchanged from 2007. Net cash income, a more critical

statistic for lenders, is forecast to be \$90.7 billion in 2008, a \$3.3 billion (4%) increase over 2007 net cash income. Sales of 2007 crops in 2008 account for the larger increase in net cash income compared to the increase in net farm income.

Commodity prices remain higher relative to historical averages, however, the markets remain volatile. Gains in commodity prices have been partially offset by higher input costs. It is expected that cash flow margins in our row crop area will be stable from a year ago. We are seeing more stress in our poultry portfolio, with cutbacks by poultry integrator companies impacting some contract growers in our area. Land prices generally continue to increase at a moderate pace with a good amount of activity in the market.

Analysis of Risk

The following table summarizes risk assets (accruing volume includes accrued interest receivable) and delinquency information (in thousands):

As of December 31	2008	2007	2006
Loans:			
Accruing restructured	\$ --	\$ --	\$ --
Past due 90 days or more still accruing	1,009	--	262
Nonaccrual	13,497	984	1,134
Total risk loans	\$14,506	\$984	\$1,396
Other property owned	--	--	--
Total risk assets	\$14,506	\$984	\$1,396
Risk loans			
as a percentage of total loans	2.4%	0.2%	0.3%
Total delinquencies			
as a percentage of total loans	0.6%	0.3%	0.4%

Based on our analysis, loans 90 days or more past due and still accruing interest were adequately secured and in the process of collection.

The volume of nonaccrual loans remained at an acceptable level at December 31, 2008, and represented 2.2% of our total portfolio. At December 31, 2008, 97.8% of our nonaccrual loans were current.

The credit quality of our portfolio declined during 2008. Adversely classified assets increased from 2.7% of the portfolio at December 31, 2007, to 4.5% of the portfolio at December 31, 2008. Adversely classified assets are assets we have identified as showing some credit weakness outside our credit standards. We have considered portfolio credit quality in assessing the reasonableness of our allowance for loan losses.

In certain circumstances, we use various government guarantee programs to reduce the risk of loss. At December 31, 2008, \$37.9 million of our loans were, to some level, guaranteed under these government programs.

Analysis of the Allowance for Loan Losses

The allowance for loan losses is an estimate of losses on loans in our portfolio as of the financial statement date. We determine the appropriate level of allowance for loan losses based on the periodic evaluation of factors such as:

- loan loss history,
- portfolio quality, and
- current economic and environmental conditions.

Comparative allowance coverage of various loan categories follows:

As of December 31	2008	2007	2006
Allowance as a percentage of:			
Loans	0.1%	0.1%	0.1%
Nonaccrual loans	3.5%	35.8%	25.2%
Total risk loans	3.2%	35.8%	20.5%
Net chargeoffs as a percentage			
of average loans	--	--	--
Adverse assets to risk funds	27.8%	16.9%	16.9%

In our opinion, the allowance for loan losses was reasonable in relation to the probable losses in the loan portfolio at December 31, 2008. After a thorough review of the fair value of the collateral, management determined that only a minimal additional reserve was necessary.

Young, Beginning and Small Farmers and Ranchers

We have specific programs in place to serve the credit and related needs of young, beginning and small farmers and ranchers in our territory. The definitions of young, beginning and small farmers and ranchers follow:

- Young: A farmer, rancher, or producer or harvester of aquatic products who is age 35 or younger as of the loan transaction date.
- Beginning: A farmer, rancher, or producer or harvester of aquatic products who has 10 years or less farming or ranching experience as of the loan transaction date.
- Small: A farmer, rancher, or producer or harvester of aquatic products who normally generates less than \$250 thousand in annual gross sales of agricultural or aquatic products.

Demographics

We have compared counts of our customer level records of those borrowers fitting within the YBS parameters against the 2002 Ag Census data. The census stratifies at a county level the age, years on farm and gross receipts. It must be understood that some of the census categories are not ideal for comparative analysis of the YBS portfolio. The Small comparison is most similar as the census clearly quantifies the population of farms with sales less than \$250 thousand. The Young category is the next best comparison. The census does vary from YBS parameters by stratifying by age into a category of those less than 35 years of age while YBS parameters include those 35 years of age or less. Finally, the Beginning category is less comparable. The census does not quantify years of experience, but it does tabulate Years on Present Farm into a category of Less than 10 Years. This is not an exact comparison for the YBS category of Beginning, but will be utilized as the best comparison available. Finally, the two disparate populations pose another analysis challenge. The census measures the total population regardless of borrowing characteristics; while we operate within a sub-group of the census based on farmers who both finance their operation and finance with AgHeritage Farm Credit Services, ACA.

The following chart compares our YBS customers to the 2002 Ag Census:

Total Farms	Census < 10 yrs	AgHeritage Beginning	% of Census
13,539	4,178	476	11.0%
	Census <35 Yrs Old	AgHeritage Young	
	959	374	39.0%
	Census Sales <\$250k	AgHeritage Small	
	11,970	2,257	19.0%

Comparing the 2002 Ag Census to the 1997 Ag Census shows similar movement for YBS demographic categories. For Arkansas overall, Beginning and Small increased as a percentage of total farms by 5% and 7%, while Young decreased 29%. For our local service area, the changes for Beginning and Small were 7% for each with Young decreasing 23%.

Mission Statement

Management and the Board of Directors feel that it is strategically important to support and develop YBS programs. Our mission is to develop and implement programs to attract Young, Beginning and Small and next generation farmers and have at least proportional market share in these areas. Further, we coordinate with other FCS institutions, government agencies, and private credit sources to attract and support YBS farmers.

Quantitative Goals

We desire to maintain at least a proportional share of YBS customers based on demographic analysis. Therefore, we will seek to maintain our current number of Young loans and seek to increase Beginning and Small loans at a 1% annual rate. At a 1% annual increase over five years between censuses this would be a 5% increase, which is close to the most recent census increase.

During 2008, we experienced the below changes in the number and percentage of YBS loans over the prior year:

	Young	Beginning	Small
Increase/(decrease) by #	66	214	(45)
Increase/(decrease) as %	0.18%	2.47%	(3.30%)

Qualitative Goals

The following related services were offered to YBS farmers during 2008:

- crop insurance, both hail and multi-peril,
- life insurance,
- fee real estate appraisal services, and
- equipment and facility leasing.

We made use of federal loan guarantee programs in providing loans and leases to YBS farmers. We maintain a Preferred Lender Program designation with Farm Service Agency.

Outreach Programs

We encourage the use of Young and Beginning farmer programs such as those offered by the Farm Service Agency and the Cooperative Extension Service. We are an active sponsor of the Farm Safety Week in our local branch locations. We have also partnered with Farm Credit Services of Western Arkansas to sponsor Financial Management Seminars for cattle ranchers.

We continue to sponsor an annual scholarship program for college bound students with one recipient from each branch office.

We serve as a sponsor for the Arkansas Farm Bureau Young Farm Family program. This program annually recognizes and rewards Young Farm Families who take an active role in agriculture at the state and local levels. The program also offers educational opportunities during meetings including a weekend conference for the Young Farm Family participants.

We continue to sponsor and participate in the annual Arkansas State University Ag Business Conference. Each year this conference attracts a large number of attendees from across Arkansas and the midsouth. The conference includes experts in a variety of agriculture-related topics at the regional, national and global levels.

We sponsored and participated with presentations and employees attending the University of Arkansas – Division of Agriculture’s Women in Ag conference.

We are also an active supporter of the Arkansas Farm Family of the Year program. We have enjoyed having members each year who are honored at the local and state level by the Farm Family of the Year program as exemplary farmers, ranchers and producers. Implicit in the Farm Family of the Year is the next generation of farming. The honored families are typically multi-generational and include members who frequently fit within our YBS and Next Generation Farmer parameters.

We continued the AgHeritage Board’s significant multi-year pledge to the Arkansas 4-H Foundation Development campaign.

During 2008, we continued our Youth Loan Program for 4-H and FFA students who desire to borrow money for their crop and livestock projects.

Safety and Soundness of the Program

We will limit the amount of risk classified loans that meet the Next Generation Farmer and/or YBS qualifications. The amount of volume for either will not exceed 50% of the Association’s risk funds. This limit will be cumulative and should not be exceeded at any point.

The credit quality and monitoring guidelines ensure that credit offered to the YBS and Next Generation Farmer groups is provided in a safe and sound manner within our risk-bearing capacity. This credit quality is monitored on a quarterly basis.

Results of the Program

Young and Beginning Farmers and Ranchers – Number/Volume of Loans Outstanding December 31, 2008				
Category	Number Of Loans	Percent of Total	Volume Outstanding	Percent of Total
Total loans and commitments 1. outstanding at year end	4,967		784,175	
2. Young farmers and ranchers	907	18.26%	141,042	17.99%
3. Beginning farmers and ranchers	1,564	31.49%	283,750	36.18%

Small Farmers and Ranchers*- Number/Volume of Loans Outstanding by Loan Size				
Number/Volume Outstanding	\$0 - \$50,000	\$50,001 - \$100,000	\$100,001 - \$250,000	\$250,001 and greater
1. Total number of loans and commitments outstanding at year end (a)	2,319	848	914	886
2. Total number of loans to small farmers and ranchers	1,002	286	324	96
3. Number of loans to small farmers and ranchers as a % of total number of loans (line 2 / line 1 * 100 = 0.00%)	43.21%	33.73%	35.45%	10.84%
4. Total loan volume outstanding at year end (a)	\$46,458	\$62,194	\$147,624	\$527,899
5. Total loan volume to small farmers and ranchers	\$18,140	\$20,270	\$48,694	\$47,846
6. Loan volume to small farmers and ranchers as a % of total loan volume (line 5 / line 4 * 100 = 0.00%)	39.05%	32.59%	32.99%	9.06%

Additional Loan Information

Additional loan information is included in Notes 3, 12 and 13.

Investments and Other Earning Assets

In addition to loans, we hold investments which represent our share of investment securities made up of the guaranteed portion of loans guaranteed by the Small Business Administration. Investments totaled \$19.7 million at December 31, 2008 and \$21.1 million at December 31, 2007. We did not hold any investments prior to 2007.

Results of Operations

The following table illustrates profitability information (in thousands):

For the year ended December 31	2008	2007	2006
Net income	\$11,597	\$9,437	\$7,604
Return on average assets	1.7%	1.6%	1.4%
Return on average members' equity	10.1%	8.8%	7.6%

Changes in these ratios relate directly to:

- changes in income as discussed below,
- changes in assets discussed in the Loan Portfolio Section, and
- changes in members' equity discussed in the Capital Adequacy Section.

The following table summarizes the changes in components of net income (in thousands):

	2008 vs. 2007	2007 vs. 2006
Increase (decrease) in net income		
Net interest income	\$2,519	\$1,753
Provision for loan losses	(151)	(205)
Patronage income	1,229	247
Financially related services and miscellaneous income, net	(515)	842
Operating expenses	(1,152)	(316)
Provision for income taxes	230	(488)
Total change in net income	\$2,160	\$1,833

Net Interest Income

Net interest income was \$18.0 million for the year ended December 31, 2008. The following table quantifies changes in net interest income (in thousands):

	2008 vs. 2007	2007 vs. 2006
Changes in net interest income due to:		
Changes in volume	\$1,566	\$1,657
Changes in rates	1,134	26
Changes in nonaccrual income and other	(181)	70
Net change	\$2,519	\$1,753

Net interest income included income on nonaccrual loans that totaled \$72 thousand in 2008, \$107 thousand in 2007, and \$107 thousand in 2006. Nonaccrual income is recognized when:

- received in cash,
- collection of the recorded investment is fully expected, and
- prior chargeoffs have been recovered.

Net interest margin (net interest income divided by average earning assets) was 2.9% in 2008, 2.7% in 2007, and 2.7% in 2006.

Provision for Loan Losses

The variance in the provision for loan losses is related to our estimate of losses in our portfolio for the applicable years.

Patronage Income

We receive three different types of discretionary patronage from AgriBank. AgriBank's Board of Directors sets the level of patronage for each of the following:

- patronage on our note payable with AgriBank,
- patronage based on the net earnings of the pool of loans sold to AgriBank in May 2008, and
- equalization income based on our preferred stock investment in AgriBank.

We received patronage income based on the average balance of our note payable to AgriBank. AgriBank's Board of Directors sets the patronage rate. We recorded patronage income of \$1.5 million in 2008, \$1.6 million in 2007, and \$1.4 million in 2006. Changes in our note payable to AgriBank and patronage rate changes caused the variances in the patronage income

amounts. The patronage rates paid by AgriBank were 27 basis points in 2008, 34 basis points in 2007, and 32 basis points in 2006. We also received patronage income related to our sale of a participation interest in certain real estate loans to AgriBank, as described in the Loan Portfolio Section of this report. As part of that agreement, we received patronage income in an amount that approximates the net earnings of those loans. Net earnings represents the net interest income associated with these loans adjusted for certain fees/costs specific to the related loans as well as adjustments deemed appropriate by AgriBank related to the credit performance of the loans, as applicable. Similar to the patronage on our note payable described above, we also received 27 basis points on the estimated note payable of the asset pool loans. We recorded asset pool patronage income of \$1.4 million in 2008.

We received another component of patronage, referred to as equalization income, from AgriBank. The quarterly average balance of any excess stock investment in AgriBank is used to determine this amount. AgriBank's Board of Directors sets the equalization rate. The targeted rate equals the average cost of funds for all affiliated associations as a group. As of September 30, 2007, we no longer had any preferred stock investment in AgriBank. Equalization income totaled \$32 thousand for 2007 and \$71 thousand for 2006.

Financially Related Services and Miscellaneous Income, Net

The decline in financially related services and miscellaneous income, net is primarily due to the sale of all Farm Credit System Financial Assistance Corporation stock held by us in the prior year. See further discussion at Note 14.

We originated rural home loans for resale in the secondary market. We sold loans through the secondary market totaling \$4.9 million in 2008, \$8.7 million in 2007, and \$11.2 million in 2006. The fee income from this activity totaled \$71 thousand in 2008, \$179 thousand in 2007, and \$269 thousand in 2006.

Operating Expenses

The following presents a comparison of operating expenses by major category and the operating rate (operating expenses as a percentage of average earning assets) for the past three years (in thousands):

For the year ended December 31	2008	2007	2006
Salaries and benefits	\$5,569	\$4,646	\$4,432
Purchased and vendor services	805	808	753
Advertising and promotion	423	412	358
Communications	163	153	223
Occupancy and equipment	701	644	642
Examination	201	202	203
Farm Credit System insurance	889	766	728
Other	789	757	733
Total	\$9,540	\$8,388	\$8,072
Operating rate	1.5%	1.5%	1.6%

The operating expense increases were primarily related to employee salaries and benefits, which includes a one-time payment to a former senior officer, as well as Farm Credit System insurance expense which increased due to an increase in rates during 2008.

Provision for Income Taxes

We recorded tax expense of \$441 thousand for the year ended December 31, 2008, compared to \$671 thousand for 2007, and \$183 thousand for 2006. Patronage distributions to members reduced our tax liability in 2008, 2007, and 2006. See Note 9 for additional discussion.

Funding and Liquidity

We borrow from AgriBank under a note payable, in the form of a line of credit, as described in Note 7. During 2008, our average balance was \$539.9 million with an average interest rate of 3.9%. Our average balance during 2007 was \$483.4 million with an average interest rate of 5.1% and during 2006 our average balance was \$424.3 million with an average interest rate of 4.8%. Our other source of lendable funds is from unallocated surplus.

Our approach to sustaining sufficient liquidity to fund operations and meet current obligations is to maintain an adequate line of credit with AgriBank. At December 31, 2008, we had \$132.8 million available under our line of credit. We generally apply excess cash to this line of credit.

We offer variable, fixed, capped, indexed, adjustable interest rate loans, and lease programs to our borrowers. We determine interest margins charged on each lending program based on:

- cost of funds,
- market conditions, and
- the need to generate sufficient earnings.

The repricing attributes of our line of credit generally correspond to the repricing attributes of our loan portfolio which significantly reduces our market interest rate risk.

Capital Adequacy

Total members' equity increased \$9.3 million during 2008 due to net income for the period and an increase in capital stock and participation certificates outstanding, partially offset by patronage distribution accruals.

Members' equity position information is as follows (in thousands):

As of December 31	2008	2007	2006
Members' equity	\$119,561	\$110,295	\$102,960
Surplus as a percentage of members' equity	98.0%	98.0%	98.0%
Permanent capital ratio	15.8%	15.7%	17.2%
Total surplus ratio	15.4%	15.4%	16.9%
Core surplus ratio	15.4%	15.4%	16.8%

Our capital plan is designed to maintain an adequate amount of surplus and allowance for loan losses which represents our reserve for adversity prior to impairment of stock. We manage our capital to allow us to meet member needs and protect member interests, both now and in the future.

At December 31, 2008, our permanent capital, total surplus, and core surplus ratios significantly exceeded the regulatory minimum requirements. See Note 8 for further discussions of these regulatory ratios.

In addition to these regulatory requirements, we establish an optimum permanent capital target. This target allows us to maintain a capital base adequate for future growth and investment in new products and services. The target is subject to revision as circumstances change. As of December 31, 2008, our optimum permanent capital target was 14.0%.

The changes in our capital ratios reflect changes in capital and assets. Refer to the Loan Portfolio Section for further discussion of the changes in assets. Additional members' equity information is included in Note 8.

Initiatives

We are involved in a number of initiatives designed to improve our credit delivery, related services, and marketplace presence.

Trade Credit

We have entered into agreements with certain dealer networks to provide alternative service delivery channels to borrowers. These trade credit opportunities create more flexible and accessible financing options to borrowers through programs such as dealer point-of-purchase financing.

Farm Cash Management

We offer Farm Cash Management to our members. Farm Cash Management links members' revolving lines of credit with an AgriBank Investment Bond to optimize members' use of funds.

Relationship with AgriBank

Borrowings

We borrow from AgriBank to fund our lending operations in accordance with the Farm Credit Act of 1971, as amended. Approval from AgriBank is required for us to borrow elsewhere. A General Financing Agreement, as discussed in Note 7, governs this lending relationship. Cost of funds under the General Financing Agreement includes:

- a marginal cost of debt component,
- a cost of servicing component,
- a bank spread component, and
- a risk premium component, if applicable.

In the periods presented, we were not subject to the risk premium component. The marginal cost of debt approach simulates match funding the cost of underlying debt with substantially the same terms as the anticipated terms of our loans to borrowers. This methodology substantially protects us from interest rate risk.

Investment

We are required to invest in AgriBank capital stock as a condition of borrowing. This investment may be in the form of purchased stock or stock representing previously distributed AgriBank surplus. As of December 31, 2008, we were required to maintain a common stock investment equal to 2.5% of the average quarterly balance of our note payable to AgriBank. AgriBank's current bylaws allow AgriBank to increase the required investment to 4.0%. Effective in 2009, our required investment will include an additional 1% on growth that exceeds a targeted rate. In addition, as described in the Loan Portfolio Section of this report, in May 2008, we sold \$124.0 million of a participation interest in real estate loans to AgriBank. As part of this transaction, we are required to hold AgriBank common stock equal to 8% of the quarter-end balance of these loans. We met this requirement through the conversion of excess stock held and the purchase of additional stock.

At December 31, 2008, \$11.6 million of our investment in AgriBank consisted of stock representing distributed AgriBank surplus and \$10.9 million consisted of purchased investment. For the periods presented in this report, we have received no dividend income on this stock investment and we do not anticipate any in future years.

Patronage

We receive patronage income based on the annual average daily balance of our note payable to AgriBank, patronage income in an amount that approximates the net earnings of the asset pool loans, patronage income based on the estimated note payable of the asset pool loans, and equalization income based on the quarterly average daily balance of our excess stock investment in AgriBank. AgriBank's Board of Directors sets the patronage rates. As of September 30, 2007, we no longer had any preferred stock in AgriBank.

Purchased Services

We purchase various services from AgriBank including:

- certain information systems,
- certain financial services,
- certain accounting and reporting services, and
- selected retail product processing and support.

The total cost of services we purchased from AgriBank was \$478 thousand in 2008, \$429 thousand in 2007, and \$489 thousand in 2006.

Affect on Members' Investment

Due to the nature of our financial relationship with AgriBank, the financial condition and results of operations of AgriBank materially affect our members' investment. To request a free copy of the combined AgriBank, FCB and Affiliated Associations' financial reports contact us at 119 East Third Street, Suite 200, Little Rock, Arkansas 72201, (800) 299-2290, or through the website at www.agheritagefcs.com or contact AgriBank at 375 Jackson Street, St. Paul, MN 55101-1810, (651) 282-8800, or via electronic mail to AGRIBANKMN@agribank.com. The reports are also available through AgriBank's website at www.agribank.com.

To request a free copy of our annual or quarterly reports contact us as stated above. The annual report is available on our website 75 days after the end of the calendar year and members are provided a copy of such report 90 days after the end of the year. The quarterly reports are available 40 days after the end of each calendar quarter.

Relationship with Other Farm Credit Institutions

We have a relationship with CoBank, ACB which involves purchasing or selling participation interests in loans. As part of this relationship, at December 31, 2008, our required equity investment in CoBank, ACB was \$1 thousand. CoBank, ACB provides direct loan funds to associations in its chartered territory and also makes loans to cooperatives and other eligible borrowers.

We participate in the Insight Technology Unit with other AgriBank District associations to facilitate the development and maintenance of certain technology systems essential to providing credit to our borrowers. The Insight Technology Unit is governed by representatives of each participating association. The expenses are shared prorata based on the number of loans and leases of each participant.

REPORT OF MANAGEMENT

AgHeritage Farm Credit Services, ACA



We prepare the consolidated financial statements of AgHeritage Farm Credit Services, ACA and are responsible for their integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. The consolidated financial statements, in our opinion, fairly present the financial condition of AgHeritage Farm Credit Services, ACA. Other financial information included in the annual report is consistent with that in the consolidated financial statements.

To meet our responsibility for reliable financial information, we depend on accounting and internal control systems designed to provide reasonable but not absolute assurance that assets are safeguarded and transactions are properly authorized and recorded. Costs must be reasonable in relation to the benefits derived when designing accounting and internal control systems. Financial operations audits are performed to monitor compliance. PricewaterhouseCoopers LLP, our independent auditors, audit the consolidated financial statements. They also conduct a review of internal controls to the extent necessary to comply with generally accepted auditing standards in the United States of America. The Farm Credit Administration also performs examinations for safety and soundness as well as compliance with applicable laws and regulations.

The Board of Directors has overall responsibility for our system of internal control and financial reporting. The Board of Directors and its Audit Committee consults regularly with us and meets periodically with the independent auditors and other auditors to review the scope and results of their work. The independent auditors have direct access to the Board of Directors, which is composed solely of directors who are not officers or employees of AgHeritage Farm Credit Services, ACA.

The undersigned certify we have reviewed AgHeritage Farm Credit Services, ACA's annual report and it has been prepared in accordance with all applicable statutory or regulatory requirements and the information contained herein is true, accurate, and complete to the best of our knowledge and belief.



Michael D. Taylor
Chairperson of the Board
AgHeritage Farm Credit Services, ACA



Greg Cole
President and Chief Executive Officer
AgHeritage Farm Credit Services, ACA



Noel Morris
Senior Vice President, Chief Financial Officer
AgHeritage Farm Credit Services, ACA

February 27, 2009

REPORT OF AUDIT COMMITTEE

AgHeritage Farm Credit Services, ACA



The consolidated financial statements were prepared under the oversight of the Audit Committee. The Audit Committee is composed of a subset of the Board of Directors of AgHeritage Farm Credit Services, ACA. The Audit Committee oversees the scope of the Association's internal audit program, the approval and independence of PricewaterhouseCoopers LLP (PwC) as our independent auditors, the adequacy of the Association's system of internal controls and procedures, and the adequacy of management's action with respect to recommendations arising from those auditing activities. The Audit Committee's responsibilities are described more fully in the Internal Control Policy and the Audit Committee Charter.

Management is responsible for internal controls and the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. PwC is responsible for performing an independent audit of the consolidated financial statements in accordance with generally accepted auditing standards in the United States of America and to issue their report based on their audit. The Audit Committee's responsibilities include monitoring and overseeing these processes.

In this context, the Audit Committee reviewed and discussed the audited consolidated financial statements for the year ended December 31, 2008, with management. The Audit Committee also reviewed with PwC the matters required to be discussed by Statement on Auditing Standards No. 114, *The Auditor's Communication with Those Charged with Governance*, and both PwC and the internal auditors directly provided reports on significant matters to the Audit Committee.

The Audit Committee had discussions with and received written disclosures from PwC confirming its independence. The Audit Committee also reviewed the non-audit services provided by PwC, if any, and concluded these services were not incompatible with maintaining PwC's independence. The Audit Committee discussed with management and PwC such other matters and received such assurances from them as the Audit Committee deemed appropriate.

Based on the foregoing review and discussions, and relying thereon, the Audit Committee recommended that the Board of Directors include the audited consolidated financial statements in the Annual Report for the year ended December 31, 2008.



Russell Bonner
Chairperson of the Audit Committee
AgHeritage Farm Credit Services, ACA

Audit Committee members: Russell Bonner, Thomas M. "Ken" Shea, Jerry Burkett, and Terry L. Richardson

February 27, 2009

PricewaterhouseCoopers LLP
225 South Sixth Street
Suite 1400
Minneapolis MN 55402
Telephone (612) 596 6000
www.pwc.com

Report of Independent Auditors

To the Board of Directors and Members of
AgHeritage Farm Credit Services, ACA

In our opinion, the accompanying consolidated statement of condition 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 AgHeritage Farm Credit Services, ACA (the Association) and its subsidiaries at December 31, 2008, 2007 and 2006, and the results of their operations and their cash flows for the years then ended 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 27, 2009

CONSOLIDATED STATEMENT OF CONDITION

AgHeritage Farm Credit Services, ACA

(Dollars in thousands)

As of December 31	2008	2007	2006
ASSETS			
Loans	\$594,240	\$594,078	\$499,426
Allowance for loan losses	469	352	286
Net loans	593,771	593,726	499,140
Investment securities	19,652	21,098	--
Investment in AgriBank, FCB	22,519	13,397	11,652
Accrued interest receivable	11,466	15,801	13,029
Premises and equipment, net	2,270	2,356	2,494
Other assets	2,595	1,933	1,886
Total assets	\$652,273	\$648,311	\$528,201
LIABILITIES			
Note payable to AgriBank, FCB	\$522,804	\$526,295	\$415,342
Accrued interest payable	4,683	6,814	5,389
Patronage distribution payable	2,500	2,250	2,000
Net deferred income tax liability	437	399	479
Other liabilities	2,288	2,258	2,031
Total liabilities	532,712	538,016	425,241
MEMBERS' EQUITY			
Protected members' equity	4	4	4
Capital stock and participation certificates	2,348	2,182	2,045
Unallocated surplus	117,209	108,109	100,911
Total members' equity	119,561	110,295	102,960
Total liabilities and members' equity	\$652,273	\$648,311	\$528,201

Contingencies

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

CONSOLIDATED STATEMENT OF INCOME

AgHeritage Farm Credit Services, ACA

(Dollars in thousands)

Year ended December 31	2008	2007	2006
Interest income	\$38,888	\$40,144	\$34,001
Interest expense	20,914	24,689	20,299
Net interest income	17,974	15,455	13,702
Provision for (reversal of) loan losses	159	8	(197)
Net interest income after provision for loan losses	17,815	15,447	13,899
Other income			
Patronage income	2,905	1,676	1,429
Financially related services and miscellaneous income, net	858	1,373	531
Total other income	3,763	3,049	1,960
Operating expense			
Salaries and employee benefits	5,569	4,646	4,432
Other operating expense	3,971	3,742	3,640
Total operating expense	9,540	8,388	8,072
Income before income taxes	12,038	10,108	7,787
Provision for income taxes	441	671	183
Net income	\$11,597	\$9,437	\$7,604

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

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

AgHeritage Farm Credit Services, ACA

(Dollars in thousands)

	Protected Members' Equity	Capital Stock and Participation Certificates	Unallocated Surplus	Total Members' Equity
Balance at December 31, 2005	\$4	\$2,026	\$95,307	\$97,337
Net income			7,604	7,604
Unallocated surplus designated for patronage distributions			(2,000)	(2,000)
Capital stock/participation certificates issued		224		224
Capital stock/participation certificates retired		(205)		(205)
Balance at December 31, 2006	4	2,045	100,911	102,960
Net income			9,437	9,437
Unallocated surplus designated for patronage distributions			(2,239)	(2,239)
Capital stock/participation certificates issued		328		328
Capital stock/participation certificates retired		(191)		(191)
Balance at December 31, 2007	4	2,182	108,109	110,295
Net income			11,597	11,597
Unallocated surplus designated for patronage distributions			(2,497)	(2,497)
Capital stock/participation certificates issued		354		354
Capital stock/participation certificates retired		(188)		(188)
Balance at December 31, 2008	\$4	\$2,348	\$117,209	\$119,561

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

CONSOLIDATED STATEMENT OF CASH FLOWS

AgHeritage Farm Credit Services, ACA

(Dollars in thousands)

Year ended December 31	2008	2007	2006
Cash flows from operating activities			
Net income	\$11,597	\$9,437	\$7,604
Adjustments to reconcile net income to cash flows from operating activities:			
Depreciation on premises and equipment	277	313	315
Provision for (reversal of) loan losses	159	8	(197)
Decrease (increase) in accrued interest receivable	4,328	(2,785)	(1,742)
(Increase) decrease in other assets	(662)	(47)	295
(Decrease) increase in accrued interest payable	(2,131)	1,425	1,104
Increase in other liabilities	68	147	522
Loss on sale of other property owned	9	--	4
Gain on sale of Farm Credit System Financial Assistance Corporation stock	--	(707)	--
(Gain) loss on sale of premises and equipment	(6)	(37)	3
Total adjustments	2,042	(1,683)	304
Net cash provided by operating activities	13,639	7,754	7,908
Cash flows from investing activities			
Increase in loans, net	(245)	(94,356)	(23,456)
Decrease (increase) of investment securities, net	1,446	(21,095)	--
Increase in investment in AgriBank, net	(9,122)	(1,745)	--
Sales of other property owned, net	306	--	276
Sale of Farm Credit System Financial Assistance Corporation stock	--	707	--
Purchases of premises and equipment, net	(185)	(138)	(255)
Net cash used in investing activities	(7,800)	(116,630)	(23,435)
Cash flows from financing activities			
(Decrease) increase in note payable to AgriBank, FCB, net	(3,491)	110,953	15,634
Patronage distributions	(2,247)	(1,989)	--
Capital stock and participation certificates retired, net	(101)	(88)	(107)
Net cash (used in) provided by financing activities	(5,839)	108,876	15,527
Net change in cash	--	--	--
Cash at beginning of year	--	--	--
Cash at end of year	\$ --	\$ --	\$ --
Supplemental schedule of non-cash activities			
Stock financed by loan activities	\$329	\$305	\$200
Stock applied against loan principal	62	80	74
Interest transferred to loans	7	13	--
Loans transferred to other property owned	315	--	280
Patronage distributions payable to members	2,500	2,250	2,000
Supplemental information			
Interest paid	\$23,045	\$23,264	\$19,195
Taxes paid	580	764	259

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AgHeritage Farm Credit Services, ACA

NOTE 1: ORGANIZATION AND OPERATIONS

Farm Credit System and District

Farm Credit System Lending Institutions: The Farm Credit System is a nationwide system of cooperatively owned banks and associations established by Congress to meet the credit needs of American agriculture. At December 31, 2008, the Farm Credit System consisted of four Farm Credit Banks, one Agricultural Credit Bank, and ninety associations. AgriBank and its affiliated associations are collectively referred to as the District. At December 31, 2008, the District consisted of seventeen Agricultural Credit Associations that each have wholly-owned Federal Land Credit Association and Production Credit Association subsidiaries. Federal Land Credit Associations are authorized to originate long-term real estate mortgage loans. Production Credit Associations are authorized to originate short-term and intermediate-term loans. Agricultural Credit Associations are authorized to originate long-term real estate mortgage loans and short-term and intermediate-term loans either directly or through their subsidiaries. Associations are also authorized to provide lease financing options for agricultural purposes. AgriBank provides funding to all associations chartered within the District.

Associations are authorized to provide, either directly, or in participation with other lenders, credit and related services to eligible borrowers. Eligible borrowers may include farmers, ranchers, producers or harvesters of aquatic products, rural residents and farm-related service businesses. In addition, associations can participate with other lenders in loans to similar entities. Similar entities are parties that are not eligible for a loan from a Farm Credit System lending institution, but have operations that are functionally similar to the activities of eligible borrowers. Associations are also authorized to purchase and hold certain types of investments.

Farm Credit System Regulator: The Farm Credit Administration is authorized by Congress to regulate the Farm Credit System banks and associations. We are examined by the Farm Credit Administration and certain association actions are subject to the prior approval of the Farm Credit Administration and/or AgriBank.

Farm Credit Insurance Fund: The Farm Credit Act of 1971, as amended, established the Farm Credit System Insurance Corporation to administer the Farm Credit Insurance Fund. The Farm Credit Insurance Fund is used:

- to insure the timely payment of principal and interest on Farm Credit Systemwide debt obligations,
- to insure the retirement of protected borrower capital at par or stated value, and
- for other specified purposes.

At the discretion of the Farm Credit System Insurance Corporation, the Farm Credit Insurance Fund is also available to provide assistance to certain troubled Farm Credit System institutions and for the operating expenses of the Farm Credit System Insurance Corporation. Each Farm Credit System bank has been required to pay premiums into the Farm Credit Insurance Fund until the assets in the Farm Credit Insurance Fund equal 2% of Systemwide debt obligations. This percentage of aggregate obligations can be changed as the Farm Credit System Insurance Corporation, in its sole discretion, determines to be actuarially sound. Prior to July 1, 2008, the premiums were based on each bank's annual average loan principal outstanding. Insurance rates were 15 basis points on accrual loans and 25 basis points on nonaccrual loans through June 30, 2008. Effective July 1, the basis for assessing premiums was changed from loans to debt outstanding. Adjustments to debt outstanding are made for

nonaccrual loans and impaired investments which are assessed a surcharge and guaranteed loans which are deductions to the premium base. The premium rate on this base, originally 15 basis points, increased to 18 basis points effective October 1, 2008. AgriBank, in turn, assesses the associations premiums each year based on these same factors. Previously, AgriBank assessed the associations annual premiums based on the average principal outstanding of accrual and nonaccrual loans of the associations.

Association

AgHeritage Farm Credit Services, ACA and its subsidiaries, AgHeritage Farm Credit Services, FLCA and AgHeritage Farm Credit Services, PCA are lending institutions of the Farm Credit System. We are a member-owned cooperative providing credit and credit-related services to, or for the benefit of, eligible members for qualified agricultural purposes in the counties of Arkansas, Ashley, Bradley, Chicot, Cleburne, Cleveland, Desha, Drew, Fulton, Independence, Izard, Jackson, Jefferson, Lawrence, Lincoln, Lonoke, Monroe, Prairie, Pulaski, Randolph, Sharp, Stone, White and Woodruff in the state of Arkansas.

We borrow from AgriBank and provide financing and related services to our members. Our ACA holds all the stock of the FLCA and PCA subsidiaries. The FLCA makes secured long-term agricultural real estate and rural home mortgage loans and holds certain types of investments. The PCA makes short-term and intermediate-term loans and provides lease financing options for agricultural production or operating purposes.

We offer various risk management services, including credit life, term life, crop hail, and multi-peril crop insurance for borrowers and those eligible to borrow. We also offer fee appraisals.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Our accounting and reporting policies conform to accounting principles generally accepted in the United States of America and the prevailing practices within the financial services industry. Preparing financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The consolidated financial statements present the consolidated financial results of AgHeritage Farm Credit Services, ACA (the parent) and AgHeritage Farm Credit Services, FLCA and AgHeritage Farm Credit Services, PCA (the subsidiaries). All material intercompany transactions and balances have been eliminated in consolidation.

The following are our significant accounting policies:

Loans: Mortgage loan terms range from 5 to 40 years at origination. Almost all commercial loans are made for agricultural production or operating purposes with original loan terms of 10 years or less.

Loans are carried at their principal amount outstanding. Loan interest is accrued and credited to interest income based upon the daily principal amount outstanding. We currently account for loan origination fees in accordance with Statement of Financial Accounting Standards No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating*

or *Acquiring Loans and Initial Direct Costs of Leases*, which establishes the accounting for nonrefundable fees and costs associated with lending, commitment to lend, or purchasing a loan or group of loans. Material fees, net of related costs, are deferred and recognized over the life of the loan as an adjustment to the yield. Other loan fees are recorded as an offset to the related origination fees. The net amount of these fees and expenses is not material to the consolidated financial statements taken as a whole.

We place loans in nonaccrual status when:

- principal or interest is delinquent for 90 days or more (unless the loan is well secured and in the process of collection) or
- circumstances indicate that full collection is not expected.

When a loan is placed in nonaccrual status, we reverse accrued interest to the extent principal plus accrued interest before the transfer exceeds the net realizable value of the collateral. Any unpaid interest accrued in a prior year is capitalized to the recorded investment of the loan. Any cash received on nonaccrual loans is applied to reduce the recorded investment in the loan, except in those cases where the collection of the recorded investment is fully expected and the loan does not have any unrecovered prior chargeoffs. Nonaccrual loans may be returned to accrual status when:

- principal and interest are current,
- prior chargeoffs have been recovered,
- the ability of the borrower to fulfill the contractual repayment terms is fully expected, and
- the loan is not classified as doubtful or loss.

Investments: We are authorized to purchase and hold certain types of investments. As we have the positive intent and ability to hold these investments to maturity, they have been classified as held-to-maturity and are carried at cost.

Allowance for Loan Losses: The allowance for loan losses is an estimate of losses on loans in our portfolio as of the financial statement date. We determine the appropriate level of allowance for loan losses based on periodic evaluation of factors such as:

- loan loss history,
- portfolio quality, and
- current economic and environmental conditions.

Loans in our portfolio that are considered impaired are analyzed individually under Statement of Financial Accounting Standard No. 114, *Accounting by Creditors for Impairment of a Loan*, to establish a specific allowance for impaired loans. A loan is impaired when it is probable that all amounts due under the contractual terms of the loan agreement will not be collected. We measure impairment based on the net realizable value of the collateral. All risk loans are considered to be impaired loans. Risk loans include:

- nonaccrual loans,
- formally restructured loans, and
- loans that are 90 days or more past due and still accruing.

We record a specific allowance to reduce the carrying amount of the risk loan to the lower of book value or the net realizable value of collateral. When collection is unlikely, we charge the loan principal and prior year(s) accrued interest against the allowance for loan losses. Subsequent recoveries, if any, are added to the allowance for loan losses.

We apply Statement of Financial Accounting Standard No. 5, *Accounting for Contingencies*, to loans that are not individually assessed as impaired. An allowance is recorded for probable and estimable credit losses as of the financial statement date.

Changes in the allowance for loan losses consist of provision activity, recorded as "Provision for (reversal of) loan losses" on the Consolidated Statement of Income, and chargeoffs and recoveries.

Investment in AgriBank: Accounting for our investment in AgriBank is on a cost plus allocated equities basis. The investment in AgriBank is in the form of Class P common stock.

Premises and Equipment: The carrying amount of premises and equipment is at cost, less accumulated depreciation. Calculation of depreciation is generally on the straight-line method over the estimated useful lives of the assets. Gains or losses on disposition are included in current operating results. Maintenance and repairs are included in operating expense and improvements are capitalized.

Other Property Owned: We record other property owned, which consists of real and personal property acquired through foreclosure or deed in lieu of foreclosure, at the lower of the carrying amount or the fair value less estimated selling costs. Income and expense from operations and carrying value adjustments are included in "Financially related services and miscellaneous income, net" on the Consolidated Statement of Income.

Leases: We have finance leases. Under finance leases, unearned income from lease contracts represents the excess of gross lease receivables plus residual receivables over the cost of leased equipment. We amortize net unearned finance income to earnings on the interest method. The carrying amount of finance leases is included in "Loans" on the Consolidated Statement of Condition and represents lease rent receivables net of the unearned income plus the residual receivable.

Employee Benefit Plans: Our employees may be eligible to participate in the defined benefit retirement plan of the Seventh Farm Credit District. The plan is comprised of two benefit formulas. Effective October 1, 2001, all new benefits-eligible employees participate in the cash balance formula. Employees hired prior to October 1, 2001, were on the final average pay formula. These employees were given a one-time option to convert to the cash balance formula or to remain on a final average pay formula. The District plan utilizes the "Projected Unit Credit" actuarial method for financial reporting purposes and the "Entry Age Normal Cost" method for funding purposes. Effective January 1, 2007, the defined benefit retirement plan was closed to new employees. Employees hired after December 31, 2006, only participate in the defined contribution plan.

The defined contribution plan allows eligible employees to save for their retirement either pre-tax/post-tax or both with an employer match on a percentage of the employee's contributions. For employees hired after December 31, 2006, the defined contribution plan is the only retirement plan available, and we provide benefits under this plan in the form of a fixed percentage of salary contribution in addition to the employer match. Employer contributions are expensed when incurred.

We also provide certain health and life insurance benefits to eligible retired employees according to the terms of those benefit plans. The anticipated cost of these benefits is accrued during the employees' active service period.

Income Taxes: The ACA and PCA accrue federal and state income taxes. Deferred tax assets and liabilities are recognized for future tax consequences of temporary differences between the carrying amounts and tax basis of assets and liabilities. Deferred tax assets are recorded if the deferred tax asset is more likely than not to be realized. If the realization test cannot be met, the deferred tax asset is reduced by a valuation allowance. We have adopted Financial Accounting Standards Board Interpretation No. 48 – *Accounting for Uncertainty in Income Taxes*. Under the interpretation, the expected future tax consequences of uncertain income tax positions are accrued.

The FLCA is exempt from federal and other taxes to the extent provided in the Farm Credit Act of 1971, as amended.

Patronage Program: We accrue patronage distributions according to a prescribed formula approved by the Board of Directors. We pay the accrued patronage during the first quarter after each subsequent year.

Statement of Cash Flows: For purposes of reporting cash flow, cash includes cash on hand.

Fair Value Measurement: Fair Value Measurements: Effective January 1, 2008, we adopted SFAS No. 157, "Fair Value Measurements." This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. It also clarifies that the term fair value is intended to mean a market-based measure, not an entity-specific measure. It describes three levels of inputs that may be used to measure fair value.

Where quoted prices are available in an active market, investment securities would be classified as Level 1. If quoted prices are not available in an active market, the fair value of securities is estimated using pricing models that utilize observable inputs, quoted prices for similar securities received from pricing services or discounted cash flows. Generally, these securities would be classified as Level 2. Where there is limited activity or less transparency around inputs to the valuation, the securities are classified as Level 3. The fair value disclosures have been expanded in accordance with SFAS No. 157, as disclosed in Note 13.

NOTE 3: LOANS AND INVESTMENT SECURITIES

Loans consisted of the following (in thousands):

As of December 31, 2008	Amount	Percentage
Long-term agricultural mortgage	\$321,242	40.1%
Production	96,461	12.0%
Intermediate term	122,431	15.3%
Rural home	36,359	4.5%
Finance leases	46	0.0%
Participations purchased	78,572	9.8%
Processing and marketing	122,303	15.3%
Other	24,321	3.0%
Subtotal	801,735	100.0%
Participations sold	(207,495)	
Total loans	\$594,240	

As of December 31, 2007	Amount	Percentage
Long-term agricultural mortgage	\$295,748	49.8%
Production	69,284	11.7%
Intermediate term	90,324	15.2%
Rural home	27,063	4.5%
Finance leases	86	0.0%
Participations purchased	51,822	8.7%
Processing and marketing	31,011	5.2%
Other	29,092	4.9%
Subtotal	594,430	100.0%
Participations sold	(352)	
Total loans	\$594,078	

As of December 31, 2006	Amount	Percentage
Long-term agricultural mortgage	\$266,663	51.0%
Production	55,074	10.6%
Intermediate term	71,638	13.7%
Rural home	21,518	4.1%
Finance leases	277	0.1%
Participations purchased	35,427	6.8%
Processing and marketing	40,024	7.7%
Other	31,305	6.0%
Subtotal	521,926	100.0%
Participations sold	(22,500)	
Total loans	\$499,426	

Participations

We may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume, and comply with Farm Credit Administration Regulations or General Financing Agreement limitations. The following table presents information regarding participations purchased and/or sold (in thousands):

As of December 31, 2008	Participations	
	Purchased	Sold
Participations purchased from / sold to:		
AgriBank	\$ --	\$116,114
Other Farm Credit institutions	\$75,858	\$91,381
Non-Farm Credit institutions	2,714	--
Total participations purchased/sold	\$78,572	\$207,495

The participation volume is largely due to participations on loans to agribusinesses.

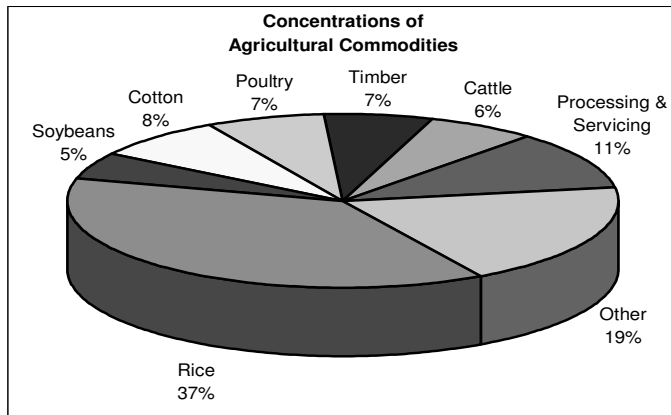
Included in the AgriBank activity above, we originally sold \$124.0 million of a participation interest in real estate loans to AgriBank and received \$1.4 million of asset pool patronage in 2008 related to this participation.

Portfolio Concentrations

We have concentrations with individual borrowers, within various agricultural commodities and within our chartered territory.

At December 31, 2008, volume plus commitments to our ten largest borrowers totaled an amount equal to 96.3% of members' equity.

Our agricultural commodity concentrations at December 31, 2008, were as follows:



The commodity concentrations have not changed materially from prior years.

We are chartered to operate in certain counties in Arkansas. Approximately 40.7% of our total loan portfolio was in Lonoke, Lawrence, Jackson, Monroe, and Arkansas counties at December 31, 2008.

While these concentrations represent our maximum potential credit risk as it relates to recorded loan principal, a substantial portion of our lending activities is collateralized. This reduces our exposure to credit loss associated with our lending activities. We consider credit risk exposure in establishing the allowance for loan losses.

Risk Loans

A loan is considered a risk loan if it is probable that we will be unable to collect all principal and interest according to the loan agreement. The following table presents risk loan (accruing volume includes accrued interest receivable) information (in thousands):

As of December 31	2008	2007	2006
Nonaccrual loans:			
Current as to principal and interest	\$13,202	\$355	\$386
Past due	295	629	748
Total nonaccrual loans	13,497	984	1,134
Accruing restructured loans	--	--	--
Loans past due 90 days or more still accruing	1,009	--	262
Total risk loans	\$14,506	\$984	\$1,396
Volume with specific reserves	\$930	\$67	\$164
Volume without specific reserves	13,576	917	1,232
Total risk loans	\$14,506	\$984	\$1,396
Total specific reserves	\$68	\$67	\$41
For the year ended December 31	2008	2007	2006
Income on accrual risk loans	\$18	\$30	\$11
Income on nonaccrual loans	72	107	107
Total income on risk loans	\$90	\$137	\$118
Average recorded investment	\$4,190	\$1,572	\$1,533

Most of the increase in nonaccrual loans from 2007 to 2008 was due to the addition of poultry and ethanol loans because of the downturn in those industries.

We did not have any material commitments to lend additional money to borrowers whose loans were at risk at December 31, 2008.

Loans 90 days or more past due and still accruing interest were adequately secured and in the process of collection.

Investment Securities

We purchased investment securities in the form of the guaranteed portion of loans guaranteed by various U.S. Government agencies. The following table presents the book value, unrealized gain/loss and fair value of the investment securities (in thousands).

As of December 31	2008	2007
Book value	\$ 19,652	\$ 21,098
Gross unrealized gains	23	-
Gross unrealized losses	(558)	(1,618)
Estimated fair value	<u>\$ 19,117</u>	<u>\$ 19,480</u>
Weighted Average Yield	3.7%	6.2%

Income is recorded in interest income and totaled \$700 thousand in 2008 and \$835 thousand in 2007.

NOTE 4: ALLOWANCE FOR LOAN LOSSES

A summary of the changes in the allowance for loan losses follows (in thousands):

For the year ended December 31	2008	2007	2006
Balance at beginning of year	\$352	\$286	\$543
Provision for (reversal of) loan losses	159	8	(197)
Loan recoveries	17	99	7
Loan chargeoffs	(59)	(41)	(67)
Balance at end of year	\$469	\$352	\$286

NOTE 5: INVESTMENT IN AGRIBANK

At December 31, 2008, we were required by AgriBank to maintain an investment equal to 2.5% of the quarter-end balance of our note payable to AgriBank. Effective in 2009, our required investment will include an additional 1% on growth that exceeds a targeted rate.

At December 31, 2008, we were required by AgriBank to maintain an investment equal to 8% of the quarter-end balance of the participation interest in real estate loans sold to AgriBank during 2008.

The following summarizes investment balances (in thousands):

	2008	2007	2006
As of December 31:			
Common stock	\$22,519	\$13,397	\$10,799
Preferred stock	--	--	853
Total investment	\$22,519	\$13,397	\$11,652

NOTE 6: PREMISES, EQUIPMENT AND ASSETS HELD FOR LEASE

Premises and equipment consisted of the following (in thousands):

As of December 31	2008	2007	2006
Land, buildings and improvements	\$2,436	\$2,389	\$2,387
Furniture and equipment	1,990	1,961	1,981
Subtotal	4,426	4,350	4,368
Less: accumulated depreciation	(2,156)	(1,994)	(1,874)
Total	\$2,270	\$2,356	\$2,494

NOTE 7: NOTE PAYABLE TO AGRIBANK

Our note payable to AgriBank represents borrowings, in the form of a line of credit, to fund our loan portfolio. The line of credit is governed by a General Financing Agreement and our assets serve as collateral. The total line of credit was \$660.0 million and the outstanding principal under the line of credit was \$522.8 million as of December 31, 2008. The interest rate is adjusted monthly and was 3.2% at December 31, 2008. During 2008, our average balance was \$539.9 million with an average interest rate of 3.9%. Our average balance during 2007 was \$483.4 million with an average interest rate of 5.1% and during 2006 our average balance was \$424.3 million with an average interest rate of 4.8%. The maturity date is May 31, 2009, for our note payable, at which time the note will be renegotiated.

The General Financing Agreement provides for limitations on our ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. We cannot exceed these limitations without approval from AgriBank. At December 31, 2008, and throughout the year, we were within the specified limitations and in compliance with all debt covenants.

NOTE 8: MEMBERS' EQUITY**Capitalization Requirements**

In accordance with the Farm Credit Act of 1971, as amended, each borrower is required to invest in us as a condition of obtaining a loan. As authorized by the Agricultural Credit Act of 1987 and our capital bylaws, the Board of Directors has adopted a capital plan that establishes a stock purchase requirement for obtaining a loan of 2% of the customer's total loan(s) or one thousand dollars, whichever is less. The purchase of one participation certificate is required of all customers to whom a lease is issued and of all non-stockholder customers who purchase financial services. The Board of Directors may increase the amount of required investment to the extent authorized in the capital bylaws. The borrower acquires ownership of the capital stock at the time the loan/lease is made, but usually does not make a cash investment. The aggregate par value of the stock is added to the principal amount of the related obligation. We retain a first lien on the stock or participation certificates owned by customers.

Protection Mechanisms

Under the Farm Credit Act of 1971, as amended, certain borrower equity is protected. We are required to retire protected borrower equity at par or stated value regardless of its book value. Protected borrower equity includes capital stock and participation certificates that were outstanding as of January 6, 1988, or were issued prior to October 6, 1988 as a requirement for obtaining a loan. If an association was unable to retire protected borrower equity at par value or stated value, the Farm Credit Insurance Fund would provide the amounts needed to retire this equity.

Regulatory Capitalization Requirements

Under capital adequacy regulations, we are required to maintain a permanent capital ratio of at least 7%, a total surplus ratio of at least 7%, and a core surplus ratio of at least 3.5%. The calculation of these ratios in accordance with Farm Credit Administration Regulations is discussed below:

- The permanent capital ratio is average at-risk capital divided by average risk-adjusted assets. At December 31, 2008, our ratio was 15.8%.
- The total surplus ratio is average unallocated surplus less any deductions made in the computation of permanent capital divided by average risk-adjusted assets. At December 31, 2008, our ratio was 15.4%.
- The core surplus ratio is average unallocated surplus less any deductions made in the computation of total surplus and less any preferred stock investment in AgriBank divided by average risk-adjusted assets. At December 31, 2008, our ratio was 15.4%.

We have an agreement with AgriBank which defines how our investment in AgriBank is allocated in calculating regulatory capital ratios. According to the agreement, we include in our ratios all preferred stock which is the amount of our investment in AgriBank that is in excess of the required amount. At December 31, 2008 and December 31, 2007, we no longer had any preferred stock. At December 31, 2006, we included 7.3% of our investment in AgriBank as capital. These changes did not have a material impact on our regulatory capital ratios.

Description of Equities

The following table presents information regarding classes and number of shares of stock and participation certificates outstanding as of December 31, 2008. All shares and participation certificates were \$5.00 par value.

As of December 31, 2008	Shares Outstanding
Class A common stock (protected)	734
Class C common stock (at-risk)	462,660
Participation certificates (at-risk)	6,940

Under our bylaws, we are also authorized to issue Class B and Class D common stock. This stock is at-risk and nonvoting with a \$5.00 par value per share. Currently, no stock of these classes has been issued.

Only holders of Class C stock have voting rights. Our bylaws do not prohibit us from paying dividends on any classes of stock. However, no dividends have been declared during the last three years.

Our bylaws generally permit stock and participation certificates to be retired at the discretion of the Board of Directors and in accordance with our capitalization plans, provided prescribed capital standards have been met. At December 31, 2008, we exceeded the prescribed standards. We do not anticipate any significant changes in capital that would affect the normal retirement of stock.

In the event of our liquidation or dissolution, according to our bylaws, any remaining assets after payment or retirement of all liabilities will be distributed in the following order of priority:

- first, to holders of common stock,
- second, any remaining assets of the Association after such distribution shall be distributed to present and former patrons on a patronage basis, to the extent practicable.

Any impairment of capital stock shall be treated as impairing all shares of common stock, pro rata to each share outstanding without preference to class of stock; however, protected stock will be retired at par value regardless of impairment.

All classes of stock are transferable to other customers who are eligible to hold such class as long as we meet the regulatory minimum capital requirements.

Patronage Distributions

We accrued patronage distributions of \$2.5 million at December 31, 2008, \$2.25 million at December 31, 2007, and \$2.0 million at December 31, 2006. The patronage distributions were made in cash during the first quarter of each subsequent year. The Board of Directors authorizes a distribution of earnings in excess of board-specified levels provided we meet all statutory and regulatory requirements.

The Farm Credit Administration Regulations prohibit patronage distributions to the extent they would reduce our permanent capital ratio below the minimum permanent capital adequacy standards. We do not foresee any events that would result in this prohibition in 2009.

NOTE 9: INCOME TAXES

Provision for (Reversal of) Income Taxes

Our provision for (reversal of) income taxes follows (in thousands):

For the year ended December 31	2008	2007	2006
Current:			
Federal	\$334	\$623	\$146
State	69	128	31
Total current	403	751	177
Deferred:			
Federal	31	(66)	5
State	7	(14)	1
Total deferred	38	(80)	6
Provision for income taxes	\$441	\$671	\$183
Effective tax rate	3.7%	6.6%	2.4%

The following table quantifies the differences between the provision for income taxes and income taxes at the statutory rates (in thousands):

For the year ended December 31	2008	2007	2006
Federal tax at statutory rate	\$4,094	\$3,436	\$2,648
State tax, net	51	77	20
Effect of non-taxable entity	(3,264)	(2,559)	(2,231)
Tax on income eliminated			
in consolidation	--	482	420
Patronage distributions	(439)	(765)	(680)
Other	(1)	--	6
Provision for income taxes	\$441	\$671	\$183

Deferred Income Taxes

Deferred tax assets and liabilities are composed of the following (in thousands):

As of December 31	2008	2007	2006
Allowance for loan losses	\$103	\$136	\$96
Postretirement benefits accrual	151	148	140
Leasing related	--	--	(10)
Accrued dividend not received	(70)	(99)	(75)
Accrued pension asset	(192)	(166)	(195)
AgriBank 2002 allocated stock	(243)	(243)	(243)
Depreciation	(80)	(83)	(86)
Other assets	19	35	20
Other liabilities	(125)	(127)	(126)
Net deferred tax liabilities	(\$437)	(\$399)	(\$479)
Gross deferred tax assets	\$273	\$319	\$256
Gross deferred tax liabilities	(\$710)	(\$718)	(\$735)

A valuation reserve for the deferred tax assets was not necessary at December 31, 2008, December 31, 2007, or December 31, 2006.

We have not provided deferred income taxes on approximately \$9.6 million of patronage allocations received from AgriBank prior to 1993. Such allocations, distributed in the form of stock, are subject to tax only upon conversion to cash. Our intent is to permanently maintain this investment in AgriBank. Additionally, we have not provided deferred income taxes on accumulated FLCA earnings of \$92.0 million as it is our intent to permanently maintain this equity in the FLCA or to distribute the earnings to members in a manner that results in no additional tax liability to us.

We adopted the provisions of the Financial Accounting Standards Board Interpretation No. 48 – *Accounting for Uncertainty in Income Taxes*, on January 1, 2008. At the time of adoption, as well as at December 31, 2008, we had no uncertain income tax positions to recognize.

NOTE 10: EMPLOYEE BENEFIT PLANS

Our employees may be eligible to participate in a District-wide multi-employer defined benefit retirement plan (the Plan). The Plan is noncontributory and covers eligible District employees. Benefits are based on salary and years of service. The assets, liabilities and costs of the plan are not segregated by participating entities. Costs are determined for each individual employer based on costs directly related to their current employees as well as an allocation of the remaining costs based proportionately on the estimated projected liability of the employer under the plan. We recognize our proportional share of expense and contribute a proportional share of funding. As a participant in the Plan, we contributed \$406 thousand for 2008 and \$175 thousand for 2007. We did not make a contribution in 2006. Plan expenses included in salaries and employee benefits expense in the Consolidated Statement of Income were \$272 thousand for 2008, \$329 thousand for 2007 and \$323 thousand for 2006. Additional financial information for the Plan may be found in the AgriBank, FCB and Affiliated Associations 2008 Annual Report.

The funded status of the plans will be recorded at the District level only. Please refer to the AgriBank, FCB and Affiliated Associations 2008 Annual Report for detailed disclosures under Statement of Financial Accounting Standard No. 158 – *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*.

In December 2007, the District adopted SFAS No. 158, which required the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. SFAS No. 158 also requires that employers measure the benefit obligation and plan assets as of fiscal year end in 2008. The Standard allows for the use of the measurements determined for the prior year-end.

Under this approach, pension and postretirement benefit income measured for the three-month period October 1, 2007 to December 31, 2007 (determined using the September 30, 2007 measurement date) was credited to beginning 2008 unallocated surplus. As a result, the District decreased unallocated surplus by \$5.0 million and increased the pension and other postretirement benefits liabilities by \$5.0 million.

Life Insurance and Retiree Medical Plans

District employers also provide certain health and life insurance benefits to eligible retired employees according to the terms of those benefit plans. The anticipated costs of these benefits are accrued during the period of the employee's active status. Postretirement benefits (primarily health care benefits and life insurance) included in salaries and employee benefits expense were \$74 thousand for 2008, \$92 thousand for 2007 and \$84 thousand for 2006. Additional financial information for this plan may be found in the AgriBank, FCB and Affiliated Associations 2008 Annual Report.

Retirement Savings Plan

We also participate in a retirement savings plan. For employees hired before January 1, 2007, employee contributions are matched dollar for dollar up to 2% and 50 cents on the dollar on the next 4% on both pre-tax and post-tax contributions. The maximum employer match is 4%. For employees hired after December 31, 2006, we contribute 3% of the employee's compensation and will match employee contributions dollar for dollar up to a maximum of 6% on both pre-tax and post-tax contributions. The maximum employer contribution is 9%. Employer contributions and recorded expense to this plan were \$148 thousand in 2008, \$147 thousand in 2007, and \$127 thousand in 2006.

NOTE 11: RELATED PARTY TRANSACTIONS

In the ordinary course of business, we may enter into loan transactions with our officers, directors, their immediate family members, and other organizations with which such persons may be associated. Such transactions are subject to special approval requirements contained in Farm Credit Administration Regulations and are made on the same terms, including interest rates, amortization schedules, and collateral, as those prevailing at the time for comparable transactions with other persons. In our opinion, none of these loans outstanding at December 31, 2008, involved more than a normal risk of collectability.

The following table represents information on loans and leases to related parties as determined at each year end (in thousands):

	2008	2007	2006
As of December 31:			
Total related party loans and leases	\$5,589	\$3,883	\$7,043
For the year ended December 31:			
Advances to related parties	\$9,064	\$6,168	\$7,795
Repayments by related parties	10,030	7,577	8,542

The composition of related parties can be different each year end due primarily to changes in the makeup of the Board of Directors. Advances and

repayments to related parties at the end of each year are included in the preceding chart.

We purchase various services from AgriBank including certain information systems, certain financial services, certain accounting and reporting services, and selected retail product processing and support services. The total cost of services we purchased from AgriBank was \$478 thousand in 2008, \$429 thousand in 2007, and \$489 thousand in 2006.

NOTE 12: CONTINGENCIES AND COMMITMENTS

In the normal course of business, we have various contingent liabilities and commitments outstanding which may not be reflected in the accompanying consolidated financial statements. We do not anticipate any material losses because of these contingencies or commitments.

From time to time, we may be named as a defendant in certain lawsuits or legal actions in the normal course of business. At the date of these consolidated financial statements, we were not aware of any such actions that would have a material impact on our financial condition. However, such actions could arise in the future.

We have commitments to extend credit and letters of credit to satisfy the financing needs of our borrowers. These financial instruments involve, to varying degrees, elements of credit risk not 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 loan contract. Standby letters of credit are agreements to pay a beneficiary if there is a default on a contractual arrangement. At December 31, 2008, we had commitments to extend credit and unexercised commitments related to standby letters of credit of \$186.7 million. Additionally, we had \$4.5 million of issued standby letters of credit as of December 31, 2008.

Commitments to extend credit and letters of credit generally have fixed expiration dates or other termination clauses and we may require payment of a fee. If commitments and letters of credit remain unfulfilled or have not expired, they may have credit risk not recognized in the financial statements. Many of the commitments to extend credit and letters of credit will expire without being fully drawn upon. Therefore, the total commitments do not necessarily represent future cash requirements. Certain letters of credit may have recourse provisions that would enable us to recover from third parties amounts paid under guarantees, thereby limiting our maximum potential exposure. The credit risk involved in issuing these financial instruments is essentially the same as that involved in extending loans to borrowers and we apply the same credit policies.

NOTE 13: FAIR VALUE OF FINANCIAL INSTRUMENTS

Quoted market prices are generally not available for our financial instruments. Accordingly, we base fair values on:

- judgments regarding future expected losses,
- current economic conditions,
- risk characteristics of various financial instruments,
- credit risk, and
- other factors.

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

Estimating the fair value of our investment in AgriBank is not practical because the stock is not traded. As discussed in Note 2 and Note 5, the investment is a requirement of borrowing from AgriBank.

A description of the methods and assumptions used to estimate the fair value of each class of our financial instruments, for which it is practical to estimate that value, follows:

Loans: The estimate of the fair value of loan assets is determined by discounting the expected future cash flows using current interest rates. Current interest rates are estimated based on similar loans made or loans repriced to borrowers with similar credit risk. This methodology is used because no active market exists for the vast majority of these loans. Since the discount rates are based upon internal pricing mechanisms and other estimates, we cannot determine whether the fair values presented would equal the exit price negotiated in an actual sale. Furthermore, certain statutory or regulatory factors not considered in the valuation, such as the unique statutory rights of Farm Credit System borrowers, could render our portfolio unmarketable outside the Farm Credit System.

We segregate the loan portfolio into pools of loans with homogenous characteristics for purposes of determining fair value of accruing loans. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

Fair value of nonaccrual loans, current as to principal and interest, are discounted with appropriately higher rates, reflecting the uncertainty of continued cash flows. We assume that for noncurrent nonaccrual loans, collection will result only from the sale of the underlying collateral. Fair value is estimated to equal the total net realizable value of the underlying collateral, discounted at an interest rate that appropriately reflects the uncertainty of the expected future cash flows over the average disposal period. We use the legal obligation if the net realizable value of the collateral exceeds the legal obligation for a particular loan.

SFAS No. 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 2 for further discussion.

Assets measured at fair value on a non-recurring basis at December 31, 2008 for each of the fair value hierarchy levels are summarized below:

	Fair Value Measurement Using			Total Fair Value	Total Losses
	Level 1	Level 2	Level 3		
Loans*	\$0	\$197	\$664	\$861	\$68

* Represents the fair value of certain loans that were evaluated for impairment under SFAS No. 114. The fair value was based upon the underlying real estate collateral. The fair value measurement process uses independent appraisals and other market-based information. As a result, these fair value measurements fall within Level 2 of the hierarchy. However, in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the real estate, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established.

Investment Securities: If an active market exists, the fair value is based on currently quoted market prices. For those securities for which an active market does not exist, we estimate the fair value of these investments by discounting the expected future cash flows using current interest rates.

Note Payable to AgriBank: Estimating the fair value of the note payable to AgriBank is determined by segregating the note into pricing pools according to the types and terms of the underlying loans funded. We discount the estimated cash flows from these pools using the current rate charged by AgriBank for additional borrowings with similar characteristics.

Commitments to extend credit and letters of credit: Estimating the fair value of commitments and letters of credit is determined by the inherent credit loss in such instruments.

The estimated fair value of our financial instruments is as follows (in thousands):

	Carrying Amount	Estimated Fair Value
As of December 31, 2008		
Financial assets:		
Loans, net	\$593,771	\$602,000
Investment securities	19,652	19,117
Financial liabilities:		
Note payable to AgriBank, FCB	\$522,804	\$531,969
Unrecognized financial instruments:		
Commitments to extend credit and letters of credit		(\$239)
As of December 31, 2007		
Financial assets:		
Loans, net	\$593,726	\$597,112
Investment securities	21,098	19,480
Financial liabilities:		
Note payable to AgriBank, FCB	\$526,295	\$529,723
Unrecognized financial instruments:		
Commitments to extend credit and letters of credit		(\$207)
As of December 31, 2006		
Financial assets:		
Loans, net	\$499,140	\$495,657
Financial liabilities:		
Note payable to AgriBank, FCB	\$415,342	\$413,137
Unrecognized financial instruments:		
Commitments to extend credit and letters of credit		(\$187)

NOTE 14: FARM CREDIT SYSTEM FINANCIAL ASSISTANCE CORPORATION STOCK SALE

In January 2007, we sold to AgriBank all Farm Credit System Financial Assistance Corporation stock held by us at 71% of the face value of that stock. Legislation in 1987 required us to purchase this stock to capitalize the Farm Credit System Financial Assistance Corporation. Due to the uncertainty regarding the realization of the asset, the stock had previously been written off and carried at zero book value. The sale resulted in a gain of \$707 thousand in the first quarter of 2007. The gain was recorded in "Financially related services and miscellaneous income, net" on the Consolidated Statement of Income. The Financial Assistance Corporation's charter was cancelled as of December 31, 2006.

NOTE 15: QUARTERLY FINANCIAL INFORMATION (Unaudited)

Quarterly consolidated results of operations for the years ended December 31, 2008, December 31, 2007 and December 31, 2006, follow (in thousands):

2008	First	Second	Third	Fourth	Total
Net interest income	\$4,446	\$4,635	\$4,605	\$4,288	\$17,974
Provision for (reversal of)					
loan losses	--	19	(110)	250	159
Patronage income	362	676	913	954	2,905
Other expense, net	2,673	1,926	2,112	1,971	8,682
Provision for					
income taxes	(34)	145	334	(4)	441
Net income	<u>\$2,169</u>	<u>\$3,221</u>	<u>\$3,182</u>	<u>\$3,025</u>	<u>\$11,597</u>
2007	First	Second	Third	Fourth	Total
Net interest income	\$3,540	\$3,795	\$4,110	\$4,010	\$15,455
Provision for (reversal of)					
loan losses	69	(58)	32	(35)	8
Patronage income	290	324	360	702	1,676
Other expense, net	1,217	1,849	1,850	2,099	7,015
Provision for					
income taxes	256	81	205	129	671
Net income	<u>\$2,288</u>	<u>\$2,247</u>	<u>\$2,383</u>	<u>\$2,519</u>	<u>\$9,437</u>
2006	First	Second	Third	Fourth	Total
Net interest income	\$3,228	\$3,404	\$3,695	\$3,375	\$13,702
(Reversal of) provision for					
loan losses	(60)	37	37	(211)	(197)
Patronage income	271	284	304	570	1,429
Other expense, net	1,838	1,848	1,826	2,029	7,541
Provision for					
income taxes	6	20	49	108	183
Net income	<u>\$1,715</u>	<u>\$1,783</u>	<u>\$2,087</u>	<u>\$2,019</u>	<u>\$7,604</u>

DISCLOSURE INFORMATION REQUIRED BY REGULATIONS

AgHeritage Farm Credit Services, ACA

(Unaudited)

DESCRIPTION OF BUSINESS

General information regarding the business is discussed in Note 1 of this annual report.

The description of significant business developments, if any, is discussed in the "Management's Discussion and Analysis" portion of this annual report.

DESCRIPTION OF PROPERTY

The following table sets forth certain information regarding our properties:

Location	Description	Usage
Little Rock, AR	Leased	Headquarters
Batesville, AR	Leased	Branch
Brinkley, AR	Owned	Branch
Dermott, AR	Owned	Branch
Lonoke, AR	Owned	Branch
Newport, AR	Owned	Branch
Pocahontas, AR	Owned	Branch
Searcy, AR	Owned	Branch
Star City, AR	Owned	Branch
Stuttgart, AR	Owned	Branch

LEGAL PROCEEDINGS

Information regarding legal proceedings is discussed in Note 12 of this annual report. We were not subject to any enforcement actions at December 31, 2008.

DESCRIPTION OF CAPITAL STRUCTURE

Information regarding our capital structure is discussed in Note 8 of this annual report.

DESCRIPTION OF LIABILITIES

Information regarding liabilities is discussed in Note 7 and Note 12 of this annual report.

SELECTED FINANCIAL DATA

The "Consolidated Five-Year Summary of Selected Financial Data" is presented at the beginning of this annual report.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Information regarding any material aspects of our financial condition, changes in financial condition, and results of operations are discussed in the "Management's Discussion and Analysis" portion of this annual report.

BOARD OF DIRECTORS

Information regarding directors who served as of December 31, 2008, including business experience in the last five years and any other business interest where a director serves on the board of directors or as a senior officer follows:

Michael Taylor – Chairperson of the Board, is a self-employed grain farmer. He also serves as Director and Secretary/Treasurer for the White County Farm Bureau Board, which is involved in insurance, in Searcy, Arkansas, as well as a manager at Wood Family Mineral Development, LLC, which is involved in natural gas. His term on the board expires in 2012.

Dwain Morris – Vice Chairperson of the Board, is a self-employed grain farmer. He serves on the board of Randolph County Farm Bureau in Pocahontas, Arkansas, which is involved in insurance. He also serves on the board of the Pocahontas Airport Commission, involved in maintaining and leasing airport land and activities. His term on the board expires in 2010.

Jerry Burkett is a self-employed grain farmer. He serves on the Advanced Environmental Recycling Technologies board, which is involved in recycling plastic and saw dust and extruding composite lumber for decking and homes. They are located in Springdale, Arkansas. He also serves on the Arkansas County Farm Bureau board, which is involved in insurance. His term on the board expires in 2009.

Ray C. "Chuck" Culver III - Outside Director, is Director of Development, Division of Agriculture at the University of Arkansas. He serves as Vice Chairman of the University of Arkansas Wesley Foundation, which is a United Methodist campus ministry. He also serves as membership chairman at Gideons International, which is a Christian witnessing and bible distribution organization. His term on the board expires in 2012.

J.O. "Neil" Daniels is a self-employed grain farmer. He serves on the board of Lonoke County Coop, which is engaged in the sale of feed, fertilizer, chemicals and farm supplies. He also serves on the Lonoke Dryer Council, involved in Riceland Foods grain and marketing. His term on the board expires in 2011.

Olan H. Mencer is a self-employed grain and livestock farmer. He serves as a Director on the Farmers Grain Terminal board which is involved in grain merchandising. His term on the board expires in 2012.

Thomas M. "Ken" Shea is President and General Manager of McKennon Implement Co. in McGehee, Arkansas. He serves on the Southeast Arkansas Levee Board, which is involved in levee flood control, administration and maintenance on the south bank of the Arkansas River and west bank of the Mississippi River. He also serves on the Desha County Drainage District #5 board, which is involved in drainage control for area farm land in the community of Dumas, Arkansas. His term on the board expires in 2009.

Terry L. Richardson - Outside Director, is Vice President - Administration and Secretary of Riceland Foods, Inc. He also serves on the advisory board of FM Global Insurance Company in Waltham, Massachusetts. His term on the board expires in 2010.

Russell Bonner is a self-employed grain and cotton farmer. He serves as a board member of the Monroe County Farm Bureau, which is involved in insurance. He also serves on the New People's Gin Company board, which is involved in cotton ginning. His term on the board expires in 2010.

Mike Burkett is a self-employed grain farmer. He serves as a board member of the Woodruff County Farm Bureau, which is involved in insurance, and is a County Committee Member of Woodruff Co. FSA, which oversees farm programs in the county. His term on the board expires in 2009.

Mike Ellis is a self-employed grain and livestock farmer. His term on the board expires in 2011.

Keith Watkins is a self-employed grain farmer and partner in Watkins Farms. He also serves as a director for Riceland Foods which is involved in grain marketing, as well as serving as a director for the White County Farm Bureau Board, which is involved in insurance. His term on the board expires in 2012.

Pursuant to our bylaws, directors are paid a reasonable amount for attendance at board meetings, committee meetings or other special assignments. Directors are also reimbursed for reasonable expenses incurred in connection with such meetings or assignments. The Board of Directors has adopted a rate of \$350 per day. Board members also receive a \$2,500 annual retainer fee, except for the Board Chairperson and Vice chairperson who receive a retainer fee of \$4,000 and \$3,250, respectively, for their additional duties as Board Chairperson and Vice Chairperson.

Information regarding compensation for each director who served during 2008 follows:

	Number of Days Served		Total Compensation Paid in 2008
	Board Meetings		
	Board Meetings	Other Official Activities	
Ray C. "Chuck" Culver	11.0	3.0	\$7,450
Olan H. Mencer	11.0	9.0	9,700
Dwain Morris	11.0	20.5	14,250
Ken Shea	10.0	6.5	8,325
J.O. "Neil" Daniels	10.0	5.0	7,900
Terry L. Richardson	10.0	5.5	8,075
Jimmy Devorak**	4.0	2.0	2,100
Michael Taylor	11.0	20.0	15,200
Jerry Burkett	10.0	8.0	9,300
Russell Bonner	11.0	9.0	9,550
Mike Burkett	11.0	5.0	8,250
Mike Ellis	10.0	7.5	8,625
Keith Watkins*	5.0	6.0	6,350
Total	125.0	107.0	\$115,075

* New director in 2008
**Retired director in 2008

Name of committee	Compensation paid for service on a board committee
Ray C. "Chuck" Culver	Member Relations \$400
Olan H. Mencer	Executive 800
Dwain Morris	Executive 800
	Member Relations 225
Ken Shea	Executive 700
	Audit 225
J.O. "Neil" Daniels	--
Terry L. Richardson	Audit 575
Jimmy Devorak**	--
Michael Taylor	Executive 800
	Finance 175
Jerry Burkett	Executive 450
	Audit 575
	Finance 175
Russell Bonner	Executive 100
	Audit 525
	Finance 175
Mike Burkett	--
Mike Ellis	Finance 175
Keith Watkins*	Finance 175
Total	\$7,050

* New director in 2008

**Retired director in 2008

SENIOR OFFICERS

The senior officers include:

Greg W. Cole, President and Chief Executive Officer
Noel Morris, Senior Vice President, Chief Financial Officer
Drue Ford, Senior Vice President, Chief Credit Officer
Sherry Williams, Senior Vice President, Human Resources
Nathan Wagner, Senior Vice President, Retail Delivery

Charles S. Conklin retired as Chief Executive Officer effective January 25, 2008.

All of the senior officers have been with our association for the past five years. Other business interests where a senior officer served as a director or senior officer include: Sherry Williams, Senior Vice President – Human Resources, is a member of the Leadership Greater Little Rock Board, which is involved in business and community growth as well as a member of the Arkansas Compensation Association Board, which is a professional organization devoted to providing information and leadership on compensation matters.

A summary of compensation earned by the most highly compensated individuals, and others included in the senior officers previously noted, during 2008 follows (in thousands):

Name of Individual	Year	Salary	Bonus	Deferred/ Perquisites	Other	Total
Greg Cole*	2008	\$152	\$85	\$2	\$ --	\$239
Charles Conklin**	2008	39	--	--	500	539
Charles Conklin**	2007	215	107	6	--	328
Charles Conklin**	2006	204	101	5	--	310
*Became CEO effective 4/23/08. Compensation shown is for the entire year of 2008.						
**Retired as CEO effective 1/25/08.						
Aggregate Number of Individuals (excluding CEO)						
Five	2008	\$561	\$255	\$11	\$ --	\$827
Five	2007	551	246	16	--	813
Five	2006	541	198	24	--	763

The amount included in "other" in the preceding table represents a one-time payment to a former senior officer.

Members may request information on the compensation paid during 2008 to the individuals listed in the preceding table.

Senior officer incentives are paid annually based on performance criteria established by the Board of Directors. The criteria include return on assets, loan volume, capital position, credit quality, personal objectives and performance ratings. We calculate the incentives after the end of the plan year (the plan year is the calendar year). We pay out the incentives within 90 days of year end.

TRANSACTIONS WITH SENIOR OFFICERS AND DIRECTORS

Information regarding related party transactions is discussed in Note 11 of this annual report.

TRAVEL, SUBSISTENCE AND OTHER RELATED EXPENSES

Directors and senior officers are reimbursed for reasonable travel, subsistence and other related expenses associated with business functions. A copy of our policy for reimbursing these costs is available by contacting us at 119 East Third Street, Suite 200, Little Rock, Arkansas 72201, (800) 299-2290, or through the website at www.agheritagefcs.com.

The total directors' travel, subsistence and other related expenses were \$64 thousand in 2008, \$63 thousand in 2007, and \$75 thousand in 2006.

INVOLVEMENT IN CERTAIN LEGAL PROCEEDINGS

No events occurred during the past five years that are material to evaluating the ability or integrity of any person who served as a director or senior officer on January 1, 2009 or at any time during 2008.

MEMBER PRIVACY

Farm Credit Administration Regulations protect members' nonpublic personal financial information. Our directors and employees are restricted from disclosing information about our association or our members not normally contained in published reports or press releases.

RELATIONSHIP WITH QUALIFIED PUBLIC ACCOUNTANT

There were no changes in independent auditors since the last annual report to members and we are in agreement with the opinion expressed by the independent auditors. The total fees paid during 2008 were \$22 thousand. The fees paid were for audit services.

FINANCIAL STATEMENTS

The "Report of Management", "Report of Audit Committee", "Report of Independent Auditors," "Consolidated Financial Statements", and "Notes to Consolidated Financial Statements" are presented prior to this portion of the annual report.

CREDIT AND SERVICES TO YOUNG, BEGINNING, AND SMALL FARMERS AND RANCHERS

Information regarding credit and services to young, beginning, and small farmers and ranchers and producers or harvesters of aquatic products is discussed in the "Management's Discussion and Analysis" portion of this annual report.

EQUAL EMPLOYMENT OPPORTUNITY

We are an equal opportunity employer. It is our policy to provide equal employment opportunity to all persons regardless of race, national origin, religion, age, sex, disability, marital status, veteran status, public assistance status, or any other condition or status covered by law. We comply with all state and local equal employment opportunity regulations. We conduct all personnel decisions and processes relating to our employees and job applicants in an environment free of discrimination and harassment.

AgHeritage Farm Credit Services, ACA

Funds Held Program

The Association offers a Funds Held Program ("Funds Held") that provides for customers to make advance payments on designated real estate and intermediate term loans. The following terms and conditions apply to all Funds Held unless the loan agreement, or related documents, between the Association and customer provide for other limitations.

Payment Application: Loan payments received by the Association before the loan has been billed will be placed into Funds Held upon request and applied against the next installment due. Loan payments received after the loan has been billed will be directly applied to the installment due on the loan and related charges, if any. Funds received in excess of the billed amount will be placed into Funds Held unless the customer has specified the funds to be applied as a special prepayment of principal.

When a loan installment becomes due, moneys in Funds Held for the loan will be automatically applied toward the installment on the due date. Any accrued interest on Funds Held will be applied first. If the balance in Funds Held does not fully satisfy the entire installment, the customer must pay the difference by the installment due date.

Account Maximum: The amount in Funds Held may not exceed 50% of the unpaid principal balance of the customer's loans. However, the amount in funds held may not exceed 10% of the loan's original commitment if the loan contains a prepayment penalty.

Interest Rate: Interest will accrue on Funds Held at a simple rate of interest that may be changed by the Association from time to time based upon the current interest rate environment. The interest rate may never exceed the interest rate charged on the related loan. Interest rates are currently reported on each customer's loan statement.

Withdrawals: Money in Funds Held may be withdrawn for the following items, depending on the customer's loan program:

- ◇ Customers may use funds for future installments, insurance or real estate taxes on collateral for the respective loan. In addition, customers may make up to three additional withdrawals per calendar month for other approved purposes in lieu of increasing the loan amount. These three withdrawals have a minimum size limit of the lesser of \$100 or the remaining balance in Funds Held.
- ◇ Customers required to assign income to their loan, such as poultry and dairy assignments, may withdraw amounts in excess of their next installment.

Association Options: In the event of default on any loan, or if Funds Held exceeds the maximum limit as established above, or if the Association discontinues the Funds Held program, the Association may apply funds in the account to the unpaid loan balance and other amounts due, and shall return any excess funds to the customer.

Uninsured Account: Funds Held is not a depository account and is not insured. In the event of Association liquidation, customers having balances in Funds Held shall be notified according to regulations.

Questions: Please direct any questions regarding Funds Held to AgHeritage Farm Credit Services, ACA.



PRESORTED
STANDARD
U.S. POSTAGE PAID
PERMIT NO. 2805
MINNEAPOLIS, MN

AgHeritage Farm Credit Services, ACA

119 East Third Street, Suite 200 • Little Rock, Arkansas 72201 • (800) 299-2290

Visit us at www.agheritagefcs.com