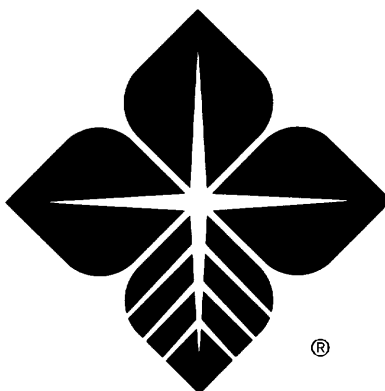


# **TEXAS AGFINANCE, FARM CREDIT SERVICES**

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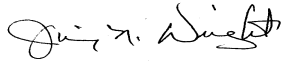
## **2008 Quarterly Report Second Quarter**



**For the Quarter Ended June 30, 2008**

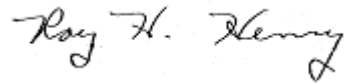
## REPORT OF MANAGEMENT

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



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Jimmy N. Wright  
CEO/President  
August 7, 2008



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Ray Henry  
Chairman, Board of Directors  
August 7, 2008



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Keith A. Ibrom  
Chief Financial Officer  
August 7, 2008

**TEXAS AGFINANCE, FARM CREDIT SERVICES  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following commentary reviews the financial performance of the Texas AgFinance, Farm Credit Services (Agricultural Credit Association), referred to as the Association, for the quarter and six months ended June 30, 2008. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2007 Annual Report of the Association.

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

**Loan Portfolio:**

Total loans outstanding at June 30, 2008, including nonaccrual loans and sales contracts, were \$415,013,326 compared to \$397,793,943 at December 31, 2007, reflecting an increase of 4.3 percent. Nonaccrual loans as a percentage of total loans outstanding were 0.5 percent at June 30, 2008, compared to 0.0 percent at December 31, 2007.

The Association recorded \$0 in recoveries and \$0 in charge-offs for the quarter ending June 30, 2008, and \$0 in recoveries and \$0 in charge-offs for the same period in 2007. The Association's allowance for loan losses was 0.1 percent and 0.0 percent of total loans outstanding as of June 30, 2008, and December 31, 2007, respectively.

The Association continues to experience strong demand for its loan products. Credit quality remains near all-time highs and nonperforming assets at historic lows.

**Risk Exposure:**

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

	June 30, 2008		December 31, 2007	
	Amount	%	Amount	%
Nonaccrual	\$ 1,879,055	100.0%	\$ -	0.0%
90 days past due and still accruing interest	-	0.0%	490,011	100.0%
Total	\$ 1,879,055	100.0%	\$ 490,011	100.0%

**Results of Operations:**

The Association had net income of \$1,539,192 and \$3,125,560 for the three and six months ended June 30, 2008, as compared to net income of \$1,750,547 and \$3,186,837 for the same periods in 2007 reflecting a decrease of 12.1 and 1.9 percent, respectively. Net interest income was \$2,559,792 and \$5,162,954, respectively, for the three and six months ended June 30, 2008, compared to \$2,572,630 and \$4,912,404 for the same periods in 2007. Interest income for the first six months of 2008 decreased by \$341,975 or 2.4 percent from the same periods of 2007, primarily due to declines in yields on earning assets. Interest expense for the first six months of 2008 decreased by \$592,525, or 6.3 percent, from the same periods of 2007 due to a decrease in average portfolio cost of funds. Average loan volume for the second quarter of 2008 was \$407,454,892, compared to \$365,613,638 in the second quarter of 2007. The average spread on the loan portfolio for the second quarter 2008 was 2.24 percent, compared to 2.44 percent in the second quarter of 2007.

The Association's return on average assets for the six months ended June 30, 2008, was 1.51 and 1.76 percent for the same period in 2007. The Association's return on average equity for the six months ended June 30, 2008, was 16.88 and 19.70 percent for the same period in 2007.

The Association's noninterest income increased \$153,000, or 12.3% for the six months ended June 30, 2008 compared to the same period in 2007 primarily due to an increase in Bank patronage and loan origination fee income. The Association's noninterest expense increased \$488,525, or 17.4%, for the six months ended June 30, 2008 compared to the same period in 2007 primarily due to an increase in personnel, an increase in the Association's captive insurance coverage, which is based on loan volume, and an increase in Farmer Mac and Bank guarantees, which is classified as other noninterest expense. The Association has approximately \$184,000,000 in net loans guaranteed from credit risk. The fees associated with the guarantees range from 35 to 80 basis points of the loan's outstanding balance.

### Liquidity and Funding Sources:

The Association secures the majority of its lendable funds from the Bank, which obtains its funds through the issuance of Systemwide obligations and with lendable equity. The following schedule summarizes the Association's borrowings.

	June 30, 2008	December 31, 2007
Note payable to the Bank	\$ 386,260,316	\$ 368,581,278
Accrued interest on note payable	1,368,791	1,691,606
Total	<u>\$ 387,629,107</u>	<u>\$ 370,272,884</u>

The Association applies all excess capital to pay-down the Association's note payable to the Bank. It draws funds from the note payable to fund new loans and operating expenditures. Therefore, the Association's note payable to the Bank has a direct correlation to the Association's loan volume and operating cash flows.

### Capital Resources:

The Association's capital position increased by \$3,033,705 at June 30, 2008, compared to December 31, 2007. The Association's debt as a percentage of members' equity was 10.02:1 as of June 30, 2008, compared to 10.43:1 as of December 31, 2007.

Under regulations governing minimum permanent capital adequacy and other capitalization issues, the Association is required to maintain a minimum adjusted permanent capital of seven percent of risk-adjusted assets as defined by the FCA. The Association's permanent capital ratio at June 30, 2008, was 10.8 percent, which is in compliance with the FCA's minimum permanent capital standard. The Association's core surplus ratio and total surplus ratio at June 30, 2008, were 9.6 and 10.2 percent, respectively, which is in compliance with the FCA's minimum surplus standard.

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

The Association's financial condition may be impacted by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect the stockholder's investment in the Association. The Management's Discussion and Analysis and Notes to Financial Statements contained in the December 31, 2007 Annual Report of Texas AgFinance, Farm Credit Services more fully describe the Association's relationship with the Bank.

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

The Association's quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Texas AgFinance, Farm Credit Services, P.O. Box 711, Robstown, Texas, 78380 or calling (361) 387-8563. Copies of the Association's quarterly stockholder reports can also be requested by e-mailing [kibrom@texasagfinance.com](mailto:kibrom@texasagfinance.com). The Association makes its annual and quarterly stockholder reports available on its Web site at [www.texasagfinance.com](http://www.texasagfinance.com).

**TEXAS AG FINANCE, FARM CREDIT SERVICES**

**CONSOLIDATED BALANCE SHEET**

	<b>June 30, 2008 (unaudited)</b>	<b>December 31, 2007</b>
<b>ASSETS</b>		
Cash	\$ 1,069,110	\$ 56,821
Loans	415,013,326	397,793,943
Less: allowance for loan losses	211,855	194,665
Net loans	414,801,471	397,599,278
Accrued interest receivable	5,049,989	5,100,610
Investment in and receivable from the Bank:		
Capital stock	6,734,125	6,734,125
Other	-	227,398
Deferred taxes, net	61,190	62,974
Other property owned, net	-	-
Premises and equipment	908,579	867,069
Other assets	1,007,883	34,149
Total assets	\$ 429,632,347	\$ 410,682,424
<b>LIABILITIES</b>		
Note payable to the Bank	\$ 386,260,316	\$ 368,581,278
Advance conditional payments	1,420,797	996,678
Accrued interest payable	1,368,791	1,691,606
Drafts outstanding	-	-
Patronage distributions payable	9,211	1,522,192
Deferred taxes, net	-	-
Other liabilities	1,598,973	1,950,116
Total liabilities	390,658,088	374,741,870
<b>MEMBERS' EQUITY</b>		
Capital stock and participation certificates	1,581,345	1,632,965
Allocated retained earnings	7,147,562	7,148,304
Unallocated retained earnings	29,666,936	26,547,479
Accumulated other comprehensive income (loss)	578,416	611,806
Total members' equity	38,974,259	35,940,554
Total liabilities and members' equity	\$ 429,632,347	\$ 410,682,424

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

**TEXAS AGFINANCE, FARM CREDIT SERVICES**

**CONSOLIDATED STATEMENT OF INCOME**

(unaudited)

	Quarter Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
<b><u>INTEREST INCOME</u></b>				
Loans	\$ 6,721,297	\$ 7,445,756	\$ 13,927,124	\$ 14,269,099
<b><u>INTEREST EXPENSE</u></b>				
Note payable to the Bank	4,158,858	4,872,163	8,759,903	9,353,288
Advance conditional payments	2,647	963	4,267	3,407
Total interest expense	<u>4,161,505</u>	<u>4,873,126</u>	<u>8,764,170</u>	<u>9,356,695</u>
Net interest income	2,559,792	2,572,630	5,162,954	4,912,404
<b><u>PROVISION FOR LOSSES</u></b>				
Provision (negative provision) for loan losses	48,749	33,043	17,190	38,808
Net interest income after provision for loan losses	<u>2,511,043</u>	<u>2,539,587</u>	<u>5,145,764</u>	<u>4,873,596</u>
<b><u>NONINTEREST INCOME</u></b>				
Patronage income from the Bank	375,454	336,064	763,584	671,871
Loan fees	182,678	188,772	421,761	439,712
Financially related services income	37,754	43,985	114,252	80,417
Gain (loss) on sale of premises and equipment, net	-	-	637	(2,436)
Other noninterest income	44,500	23,598	93,992	51,662
Total noninterest income	<u>640,386</u>	<u>592,419</u>	<u>1,394,226</u>	<u>1,241,226</u>
<b><u>NONINTEREST EXPENSES</u></b>				
Salaries and employee benefits	838,721	712,247	1,715,378	1,462,214
Directors' expense	60,021	44,029	105,392	84,485
Purchased services	17,985	37,294	44,717	105,523
Travel	53,755	48,733	84,355	78,975
Occupancy and equipment	115,567	120,892	230,101	242,961
Communications	36,317	35,786	76,522	64,687
Advertising	19,322	17,094	30,620	32,730
Public and member relations	68,093	31,589	130,639	74,434
Supervisory and exam expense	25,735	22,898	51,470	45,796
FCSIC insurance expense	150,543	132,579	297,205	268,226
Other noninterest expense	227,758	179,272	523,088	340,931
Total noninterest expenses	<u>1,613,817</u>	<u>1,382,413</u>	<u>3,289,487</u>	<u>2,800,962</u>
Income before income taxes	<u>1,537,612</u>	<u>1,749,593</u>	<u>3,250,503</u>	<u>3,313,860</u>
Provision for (benefit from) income taxes	(1,580)	(954)	124,943	127,023
Net income	<u>\$ 1,539,192</u>	<u>\$ 1,750,547</u>	<u>\$ 3,125,560</u>	<u>\$ 3,186,837</u>

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

TEXAS AGFINANCE, FARM CREDIT SERVICES

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

(unaudited)

	Capital Stock/ Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
		Allocated	Unallocated		
Balance at December 31, 2006	\$ 1,635,865	\$ 6,828,092	\$ 22,752,200	\$ -	\$ 31,216,157
Net income	-	-	3,186,838	-	3,186,838
Capital stock/participation certificates issued	203,420	-	-	-	203,420
Capital stock/participation certificates and allocated retained earnings retired	(201,915)	-	-	-	(201,915)
Patronage refunds:					
Capital stock/participation certificates and allocated retained earnings	-	(1,606)	2	-	(1,604)
Balance at June 30, 2007	<u>\$ 1,637,370</u>	<u>\$ 6,826,486</u>	<u>\$ 25,939,040</u>	<u>\$ -</u>	<u>\$ 34,402,896</u>
Balance at December 31, 2007	\$ 1,632,965	\$ 7,148,304	\$ 26,547,479	\$ 611,806	\$ 35,940,554
Comprehensive income					
Net income	-	-	3,125,560	-	3,125,560
Amortization of costs included in net periodic pension costs	-	-	-	(33,390)	(33,390)
Comprehensive income	-	-	3,125,560	(33,390)	3,092,170
Capital stock/participation certificates issued	186,255	-	-	-	186,255
Capital stock/participation certificates and allocated retained earnings retired	(237,875)	-	-	-	(237,875)
Patronage refunds:					
Cash	-	-	(7,061,155)	-	(7,061,155)
Capital stock/participation certificates and allocated retained earnings	-	(742)	7,055,052	-	7,054,310
Balance at June 30, 2008	<u>\$ 1,581,345</u>	<u>\$ 7,147,562</u>	<u>\$ 29,666,936</u>	<u>\$ 578,416</u>	<u>\$ 38,974,259</u>

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

**TEXAS AGFINANCE, FARM CREDIT SERVICES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

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

The Texas AgFinance, Farm Credit Services (Agricultural Credit Association), referred to as the Association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves the counties of Aransas, Atascosa, Austin, Bandera, Bee, Bexar, Brooks, DeWitt, Dimmitt, Edwards, Fayette, Frio, Goliad, Gonzales, Guadalupe, Jim Wells, Karnes, Kenedy, Kerr, Kinney, Kleberg, LaSalle, Lavaca, Live Oak, Maverick, McMullen, Medina, Nueces, Real, San Patricio, Uvalde, Val Verde, Waller, Wilson, Washington, and Zavala, parts of Refugio, and the lower half of Lee in the State of Texas. The Association is a lending institution of the Farm Credit System (the System), which was established by Acts of Congress to meet the needs of American agriculture.

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

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The preparation of these consolidated financial statements requires the use of management's estimates. The results for the quarter and the six months ended June 30, 2008, are not necessarily indicative of the results to be expected for the year ended December 31, 2008. Certain amounts in the prior period's financial statements have been reclassified to conform to current financial statement presentation.

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

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

	<b>June 30, 2008</b>	June 30, 2007
Balance at beginning of quarter	\$ 163,106	\$ 160,142
Provision for loan losses	48,749	33,043
Charge-offs	-	-
Recoveries	-	-
Balance at end of quarter	<u>\$ 211,855</u>	<u>\$ 193,185</u>

The following table presents information concerning impaired loans:

	<b>June 30, 2008</b>	June 30, 2007
Impaired loans with related allowance	\$ -	\$ -
Impaired loans with no related allowance	1,879,055	4
Total impaired loans	<u>\$ 1,879,055</u>	<u>\$ 4</u>
Allowance on impaired loans	\$ -	\$ -
Average impaired loans	\$ 1,956,648	\$ 4
Interest income on impaired loans for the quarter	\$ (49,928)	\$ 1,285

### NOTE 3 — CAPITAL:

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

### NOTE 4 — INCOME TAXES:

Texas AgFinance, Farm Credit Services and its subsidiary are subject to federal and certain other income taxes. The Associations are eligible to operate as cooperatives that qualify for tax treatment under Subchapter T of the Internal Revenue code. Under specified conditions, the Associations can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage refunds. During 2008, the Association did not participate in a patronage program. Deferred taxes are recorded at the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution and will therefore impact future tax payments. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (over 50 percent probability), based on management's estimate, that they will not be realized. For the six months ended June 30, 2008, and 2007 net income for tax purposes Association recorded federal income taxes of \$124,943 and \$127,023, respectively.

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

The Association is unaware of any material changes in uncertain tax positions or changes in classification of interest and/or penalties.

### NOTE 5 — EMPLOYEE BENEFIT PLANS:

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

	Other Benefits	
	2008	2007
Service cost	\$ 12,964	\$ 15,675
Interest cost	32,342	33,002
Amortization of prior service costs	(34,108)	(36,827)
Amortizations of net (gain) loss	718	788
Net periodic benefit cost	\$ 11,916	\$ 12,638

In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 158 "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (SFAS 158), which required the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. The balance sheet recognition provisions of SFAS 158 were adopted at December 31, 2007. SFAS 158 also requires that employers measure the benefit obligation and plan assets as of the fiscal year end for fiscal years ending after December 15, 2008. In fiscal 2007 and earlier, we used a September 30 measurement date for pension and other postretirement benefit plans. The Standard provides two approaches for an employer to transition to a fiscal year end measurement date. We have applied the second approach, which allows for the use of the measurements determined for the prior year end.

Under this alternative, pension and postretirement benefit income measured for the three-month period October 1, 2007 to December 31, 2007 (determined using the September 2007 measurement date) was recorded as an adjustment to beginning 2008 retained earnings. As result, the Association increased retained earnings \$611,806 and decreased the pension and postretirement benefit asset/liability by \$611,806.

The Association previously disclosed in its financial statements for the year ended December 31, 2007, that it expected to contribute \$36,557 to its pension plan in 2008. As of June 30, 2008, \$18,279 in contributions have been made. The Association presently does not anticipate contributing any additional funds, above its previous estimate, to its pension plan in 2008.