



Texas AgFinance

2008 ANNUAL REPORT

December 31, 2008



Part of the Farm Credit System

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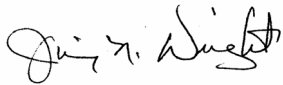
REPORT OF MANAGEMENT

The consolidated financial statements of Texas AgFinance, Farm Credit Services (Association) are prepared by management, who are responsible for the statements' integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America appropriate in the circumstances. Other financial information included in the annual report is consistent with that in the consolidated financial statements.

To meet its responsibility for reliable financial information, management depends on the Farm Credit Bank of Texas' and the Association's accounting and internal control systems, which have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded and transactions are properly authorized and recorded. The systems have been designed to recognize that the cost of controls must be related to the benefits derived. The consolidated financial statements are audited by PricewaterhouseCoopers LLP, independent accountants, who conduct a review of internal controls solely for the purpose of establishing a basis for reliance thereon in determining the nature, extent and timing of audit tests applied in the audit of the consolidated financial statements in accordance with auditing standards generally accepted in the United States of America. The Association is also examined by the Farm Credit Administration.

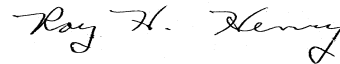
The board of directors has overall responsibility for the Association's systems of internal control and financial reporting. The board consults regularly with management and reviews the results of the audits and examinations referred to previously.

The undersigned certify that this annual report has been reviewed and 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 or belief.



Jimmy N. Wright, Chief Executive Officer

March 9, 2009



Ray H. Henry, Chairman, Board of Directors

March 9, 2009



Keith A. Ibrom, Chief Financial Officer

March 9, 2009

REPORT OF AUDIT COMMITTEE

The Audit Committee (Committee) is composed of the board of directors of Texas AgFinance, Farm Credit Services (Association). In 2008, twelve Committee meetings were held. The Committee oversees the scope 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 Committee's approved responsibilities are described more fully in the Audit Committee Charter, which is available on request or on the Association's web site. The Committee approved the appointment of PricewaterhouseCoopers LLP for 2008.

Management is responsible for the Association's internal controls and the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. The consolidated financial statements are prepared under the oversight of the Committee. PricewaterhouseCoopers LLP is responsible for performing an independent audit of the Association's consolidated financial statements in accordance with auditing standards generally accepted in the United States of America and to issue a report thereon. The Committee's responsibilities include monitoring and overseeing the processes.

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

The Committee discussed with PricewaterhouseCoopers LLP its independence from the Association. The Committee also reviewed the non-audit services provided by PricewaterhouseCoopers LLP and concluded that these services were not incompatible with maintaining the independent accountant's independence. The Committee has discussed with management and PricewaterhouseCoopers LLP such other matters and received such assurances from them as the Committee deemed appropriate.

Based on the foregoing review and discussions and relying thereon, the Committee recommended that the board of directors include the audited consolidated financial statements in the Association's Annual Report to Stockholders for the year ended December 31, 2008.

Audit Committee Members

Joe Little, Chairman, Audit Committee
John Prukop, Vice Chairman, Audit Committee
Kelvin Barry, Audit Committee
David Henneke, Audit Committee
Ray H. Henry, Audit Committee
Ralph Hesse, Audit Committee
Jesse W. Howell, Audit Committee
Joe W. Ruple, Audit Committee

March 9, 2009

TEXAS AGFINANCE, FARM CREDIT SERVICES

FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA
(unaudited)
(dollars in thousands)

	December 31,				
	2008	2007	2006	2005	2004
<u>Balance Sheet Data</u>					
<u>Assets</u>					
Cash	\$ 113	\$ 57	\$ 2,315	\$ 1,032	\$ 469
Loans	418,135	397,794	334,169	249,127	200,482
Less: allowance for loan losses	1,000	195	154	169	246
Net loans	417,135	397,599	334,015	248,958	200,236
Investment in and receivable from the Bank	7,803	6,962	5,180	4,051	3,142
Other assets	5,240	6,064	5,505	4,162	2,950
Total assets	<u>\$ 430,291</u>	<u>\$ 410,682</u>	<u>\$ 347,015</u>	<u>\$ 258,203</u>	<u>\$ 206,797</u>
<u>Liabilities</u>					
Obligations with maturities of one year or less	\$ 4,206	\$ 4,527	\$ 5,437	\$ 2,759	\$ 2,643
Obligations with maturities greater than one year	386,325	370,215	310,362	226,403	178,351
Total liabilities	<u>390,531</u>	<u>374,742</u>	<u>315,799</u>	<u>229,162</u>	<u>180,994</u>
<u>Members' Equity</u>					
Capital stock and participation certificates	1,511	1,633	1,636	3,080	3,227
Allocated retained earnings	7,708	7,148	6,828	4,396	4,828
Unallocated retained earnings	29,978	26,547	22,752	21,565	17,748
Accumulated other comprehensive income	563	612	-	-	-
Total members' equity	<u>39,760</u>	<u>35,940</u>	<u>31,216</u>	<u>29,041</u>	<u>25,803</u>
Total liabilities and members' equity	<u>\$ 430,291</u>	<u>\$ 410,682</u>	<u>\$ 347,015</u>	<u>\$ 258,203</u>	<u>\$ 206,797</u>
<u>Year Ended December 31,</u>					
<u>Statement of Income Data</u>					
Net interest income	\$ 10,371	\$ 10,235	\$ 8,407	\$ 7,429	\$ 6,165
(Provision for loan losses) or loan loss reversal	(805)	(40)	16	80	2,502
Income from the Bank	1,623	1,534	1,119	796	413
Other noninterest income	1,638	1,557	2,123	1,401	1,233
Noninterest expense	(7,207)	(6,847)	(5,847)	(4,897)	(5,696)
Benefit from income taxes	(123)	(117)	(131)	(92)	130
Net income	<u>\$ 5,497</u>	<u>\$ 6,322</u>	<u>\$ 5,687</u>	<u>\$ 4,717</u>	<u>\$ 4,747</u>
<u>Key Financial Ratios for the Year</u>					
Return on average assets	1.3%	1.7%	2.0%	2.0%	2.6%
Return on average members' equity	15.3%	18.4%	18.7%	17.1%	22.0%
Net interest income as a percentage of average earning assets	2.5%	2.8%	3.0%	3.3%	4.8%
Net charge-offs as a percentage of average loans	0.0%	0.0%	0.0%	0.0%	0.0%

TEXAS AGFINANCE, FARM CREDIT SERVICES

FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA
(unaudited)
(dollars in thousands)

	December 31,				
	2008	2007	2006	2005	2004
<u>Key Financial Ratios at Year End</u>					
Members' equity as a percentage of total assets	9.2%	8.8%	9.0%	11.2%	12.5%
Debt as a percentage of members' equity	982.2%	1042.7%	1011.7%	789.1%	701.4%
Allowance for loan losses as a percentage of loans	0.2%	0.0%	0.0%	0.1%	0.1%
Permanent capital ratio	11.8%	13.3%	10.9%	12.9%	14.3%
Core surplus ratio	10.6%	12.0%	10.3%	11.4%	11.6%
Total surplus ratio	11.3%	12.6%	10.3%	11.4%	12.2%
<u>Net Income Distribution</u>					
Patronage refunds:					
Cash	\$ 1,500	\$ 1,350	\$ 270	\$ 243	\$ 229
Allocated retained earnings	1	707	718	1,062	523

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following commentary explains management's assessment of the principal aspects of the consolidated financial condition and results of operations of Texas AgFinance, Farm Credit Services, including its wholly-owned subsidiaries, Texas AgFinance, PCA and Texas AgFinance, FLCA (Association) for the years ended December 31, 2008, 2007 and 2006, and should be read in conjunction with the accompanying consolidated financial statements. The accompanying financial statements were prepared under the oversight of the Association's Audit Committee.

Forward-Looking Information:

This annual information statement contains 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 of these terms are intended to identify the forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other 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;
- economic fluctuations in the agricultural, rural utility, international and farm-related business sectors;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry; and
- actions taken by the Federal Reserve System in implementing monetary policy.

Significant Events:

In December 2008, the Association received a direct loan patronage of \$1,144,998 from the Bank, representing 30 basis points on the average daily balance of the Association's direct loan with the Bank. During 2008, the Association received \$268,939 in interest credit patronage payments from the Bank, based on the Association's stock investment in the Bank. Also, the Association received a capital markets patronage of \$208,663 from the Bank, representing 65 basis points on the year's average daily balance of participations in capital markets loans with patronage commitments.

Nonaccrual loans increased significantly during 2008. The Association has not recorded any specific allowance for loan loss. Based on analysis performed by the Bank and the Association, the Association concluded the entire balance of nonaccrual loans is well securitized by either a prioritized security interest in real estate with an appraised value well in excess of the principal loan balances less selling expenses, or an agency guarantee. The specific loan balances and analysis supporting this conclusion is discussed further in Note 3 to the consolidated financial statements, "Loans and Allowance for Loan Losses," included in this annual report.

For over 74 years, the Association has continued to provide its members with quality financial services. The board of directors and management remain committed to maintaining the financial integrity of the Association while offering competitive loan products that meet the financial needs of agricultural producers.

Loan Portfolio:

The Association makes and services loans to farmers, ranchers, rural homeowners and certain farm-related businesses. The Association's loan volume consists of long-term farm mortgage loans, production and intermediate-term loans, and farm-related business loans. These loan products are available to eligible borrowers with competitive variable, fixed, adjustable and prime-based interest rates. Loan maturities range from one to 40 years, with annual operating loans comprising the majority of the commercial loans and 20- to 30-year maturities comprising the majority of the mortgage loans. Loans serviced by the Association offer several installment payment cycles, the timing of which usually coincides with the seasonal cash-flow capabilities of the borrower.

The composition of the Association’s loan portfolio, including principal less funds held of \$418,135,309, \$397,793,943 and \$334,169,483 as of December 31, 2008, 2007 and 2006, respectively, is described more fully in detailed tables in Note 3 – “Loans and Allowance for Loan Losses.”

At December 31, 2008, the Association held loans totaling \$1,000,000 extended under the Rural America Bond Program approved by the Farm Credit Administration (FCA). The program is designed to meet the growing and changing needs of agricultural enterprises, agribusinesses and rural communities by providing investment in rural areas.

Purchase and Sales of Loans:

During 2008, 2007 and 2006, the Association was participating in loans with lenders. As of December 31, 2008, 2007 and 2006, these participations totaled \$59,855,916, \$51,655,250 and \$39,882,208, or 14.3 percent, 13.0 percent and 11.9 percent of loans, respectively. Included in these amounts are participations purchased from entities outside the District of \$17,360,802, \$19,018,355 and \$14,342,117, or 4.2 percent, 4.8 percent and 4.3 percent of loans, respectively. The Association has also sold participations of \$87,079,192 as of December 31, 2008.

Risk Exposure:

High-risk assets include nonaccrual loans, loans which are past due 90 days or more and still accruing interest, formally restructured loans and other property owned, net. The following table illustrates the Association’s components and trends of high-risk assets serviced for the prior three years as of December 31:

	2008		2007		2006	
	Amount	%	Amount	%	Amount	%
Nonaccrual	\$ 4,554,894	98.5%	\$ 4	0.0%	\$ 354	100.0%
90 days past due and still accruing interest	70,841	1.5%	84,200	100.0%	-	0.0%
Total	\$ 4,625,735	100.0%	\$ 84,204	100.0%	\$ 354	100.0%

At December 31, 2008, 2007 and 2006, loans that were considered impaired were \$4,625,735, \$84,204 and \$354, representing 1.1 percent, 0.1 percent and 0.0 percent of loan volume, respectively. Impaired loans consist of all high-risk assets except other property owned, net. The majority balance of high-risk loans, \$4,525,072, is comprised of three participation loans the Association purchased from other Farm Credit System institutions. The remaining balance of high-risk loans, \$100,663, relates to two loans originated by the Association.

Except for the relationship between installment due date and seasonal cash-flow capabilities of the borrower, the Association is not affected by any seasonal characteristics. The factors affecting the operations of the Association are the same factors that would affect any agricultural real estate lender.

Allowance for Loan Losses:

The following table provides relevant information regarding the allowance for loan losses as of, or for the year ended, December 31:

	2008	2007	2006
Allowance for loan losses	\$ 1,000,000	\$ 194,665	\$ 153,887
Allowance for loan losses to total loans	0.2%	0.0%	0.0%
Allowance for loan losses to nonaccrual loans	22.0%	4,866,625.0%	43,470.9%
Allowance for loan losses to impaired loans	21.6%	231.2%	43,470.9%
Net charge-offs to average loans	0.0%	0.0%	0.0%

The allowance for loan losses is maintained based upon estimates that consider the general financial strength of the agricultural economy, loan portfolio composition, credit administration and the portfolio’s prior loan loss experience. Based upon ongoing risk assessment and the allowance for loan losses procedures outlined above, the allowance for loan losses of \$1,000,000, \$194,665 and \$153,887 at December 31, 2008, 2007 and 2006, respectively, is considered adequate by management to compensate for inherent losses in the loan portfolio at such dates. Based on analysis performed by the Bank and the Association, the Association concluded the entire balance of nonaccrual loans is well securitized by either a prioritized security interest in real estate with an appraised value well in excess of the principal loan balances less selling expenses, or an agency guarantee.

Results of Operations:

The Association's net income for the year ended December 31, 2008, was \$5,496,869 as compared to \$6,322,265 for the year ended December 31, 2007, reflecting a decrease of \$825,396, or 13.1 percent, the result of increasing the Association's general reserve for loan losses. The Association's net income for the year ended December 31, 2006 was \$5,686,873. Net income increased \$635,392, or 11.2 percent, in 2007 versus 2006.

Net interest income for 2008, 2007 and 2006 was \$10,371,314, \$10,235,308 and \$8,406,936, reflecting increases of \$136,006, or 1.3 percent, for 2008 versus 2007 and \$1,828,372, or 21.8 percent, for 2007 versus 2006. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets and cost of debt. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following tables:

	2008		2007		2006	
	Average Balance	Interest	Average Balance	Interest	Average Balance	Interest
Loans	\$ 410,230,533	\$ 27,559,055	\$ 367,748,546	\$ 29,636,396	\$ 281,381,921	\$ 22,472,554
Interest-bearing liabilities	381,711,566	17,187,741	341,733,342	19,401,088	257,494,299	14,065,618
Impact of capital	<u>\$ 28,518,967</u>		<u>\$ 26,015,204</u>		<u>\$ 23,887,622</u>	
Net interest income		<u>\$ 10,371,314</u>		<u>\$ 10,235,308</u>		<u>\$ 8,406,936</u>
	Average Yield		Average Yield		Average Yield	
Yield on loans	6.72%		8.06%		7.99%	
Cost of interest-bearing liabilities	4.50%		5.68%		5.46%	
Interest rate spread	2.22%		2.39%		2.54%	

	2008 vs. 2007			2007 vs. 2006		
	Increase (decrease) due to			Increase (decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
Interest income	\$ 3,412,961	\$ (5,490,302)	\$ (2,077,341)	\$ 6,897,671	\$ 266,171	\$ 7,163,842
Interest expense	2,268,564	(4,481,911)	(2,213,347)	4,593,387	742,083	5,335,470
Net interest income	<u>\$ 1,144,397</u>	<u>\$ (1,008,391)</u>	<u>\$ 136,006</u>	<u>\$ 2,304,284</u>	<u>\$ (475,912)</u>	<u>\$ 1,828,372</u>

Interest income decreased by \$2,077,341, or 7.0 percent, compared to 2007, primarily due to a decrease in average interest rates. Interest expense for 2008 decreased by \$2,213,347, or 11.4 percent, compared to 2007 due to a decrease in the Association's weighted average cost of funds. The interest rate spread decreased by 17 basis points to 2.22 percent in 2008 from 2.39 percent in 2007, primarily because most of the Association's loan growth is in its FLCA loan portfolio for longer-term real estate loans, which competitively have lesser spreads than the Association's shorter-term operating loans. The interest rate spread decreased by 15 basis points to 2.39 percent in 2007 from 2.54 percent in 2006, primarily due to the same migration to a larger FLCA portfolio as discussed above.

The Association uses a pricing model to determine interest rates. The model takes into account the benchmark spreads established by the Asset and Liability Committee (ALCO) plus a number of other factors that will affect the loan's profitability. This includes credit risk, loan amount, fee income, cost of doing business, competition and other potential income or expense. ALCO can modify benchmark spreads as needed. The vast majority of loans have spreads fixed for a specific time period based on the loan product chosen by the borrower. ALCO can adjust the spreads on existing loans once the spread-lock period has expired, although this is not common practice.

Noninterest income for 2008 increased by \$165,188, or 5.3 percent, compared to 2007, due primarily to an increase in crop insurance commissions and an increase in fee income associated with large participation loans purchased from the Bank. Noninterest income for 2007 decreased by \$151,566, or 4.7 percent, compared to 2006, due primarily to a reduction in crop insurance commissions related to changes in crop planted and reduced origination fees on large loans the Association closed in 2006.

Operating expenses consist primarily of salaries, employee benefits and purchased services. Expenses for purchased services may include administrative services, marketing, information systems, accounting and loan processing, among others. Total operating and

noninterest expenses were \$7,202,077, \$6,846,926 and \$5,846,994 for the years ended December 31, 2008, 2007 and 2006, respectively. The increase in expenses for 2008 was due to several factors. The Association's employee benefit costs increased due to additional funding to the Association's pension fund, which lost value due to decreasing returns in the financial markets. This increase in expense was slightly offset by a decrease in salary expense due to a decrease in bonuses paid in 2008 versus 2007. The Association's Farm Credit System Insurance Corporation premium, which is based on each Association's loan volume, increased substantially due to an increase in loans and an increase in the premium rate. Fees paid in exchange for loan guarantees to the Federal Agricultural Mortgage Corporation (Farmer Mac) and the Bank, which are classified as other noninterest expense, increased in 2008 due to the Association increasing its participation in both guarantee programs. The guarantees help support the Association's capital ratios and also reduce overall credit risk. Public and member relations expense increased in 2008 due to the Association increasing its sponsorship of several agricultural programs within its territory. Expenses for 2007 increased mostly in salaries and benefits related to new and existing staff, increases in Farmer Mac guarantee fees and an increase in the Farm Credit System Insurance Corporation premium.

The Association's management decided to increase its general allowance reserve in response to the recent volatility in the credit markets and the downturn in the economy. A bad debt provision of \$805,335 was recorded during 2008, bringing the allowance for loan loss reserve to \$1,000,000 as of December 31, 2008. Management believes this reserve is adequate to cover all inherent losses in the Association's loan portfolio as of December 31, 2008.

For the year ended December 31, 2008, the Association's return on average assets (ROA) was 1.3 percent, as compared to 1.7 percent and 2.0 percent for the years ended December 31, 2007 and 2006, respectively. For the year ended December 31, 2008, the Association's return on average members' equity (ROE) was 14.1 percent, as compared to 18.4 percent and 18.7 percent for the years ended December 31, 2007 and 2006, respectively. A large percentage of the decrease in ROA and ROE is attributed to the large bad debt provision.

Because the Association depends on the Bank for funding, any significant positive or negative factors affecting the operations of the Bank would have a similar effect on the operations of the Association.

Liquidity and Funding Sources:

The interest rate risk inherent in the Association's loan portfolio is substantially mitigated through the funding relationship with the Bank. The Bank manages interest rate risk through its direct loan pricing and asset/liability management process.

The primary source of liquidity and funding for the Association is a direct loan from the Bank. The outstanding balance of \$384,991,152, \$368,581,278 and \$308,929,654 as of December 31, 2008, 2007 and 2006, respectively, is recorded as a liability on the Association's balance sheet. The note carried a weighted average interest rate of 4.02 percent, 5.67 percent and 5.45 percent at December 31, 2008, 2007 and 2006, respectively. The indebtedness is collateralized by a pledge of substantially all of the Association's assets to the Bank and is governed by a financing agreement. The increase in note payable to the Bank and related accrued interest payable since December 31, 2007, is due to an increase in loans. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were \$32,396,421, \$28,221,026 and \$23,498,033 at December 31, 2008, 2007 and 2006, respectively. The maximum amount the Association may borrow from the Bank as of December 31, 2008, was \$420,104,723 as defined by the general financing agreement.

The liquidity policy of the Association is to manage cash balances to maximize debt reduction, and to increase accrual loan volume. This policy will continue to be pursued during 2009. As borrower payments are received, they are applied to the Association's note payable to the Bank.

The Association will continue to fund its operations through direct borrowings from the Bank, capital surplus from prior years and borrower stock. It is management's opinion that funds available to the Association are sufficient to fund its operations for the coming year.

Capital Resources:

The Association's capital position remains strong, with total members' equity of \$39,759,884, \$35,940,554 and \$31,216,157 at December 31, 2008, 2007 and 2006, respectively. Under regulations governing minimum permanent capital adequacy and other capitalization issues, the Association is required to maintain a minimum adjusted permanent capital of 7.0 percent of risk-adjusted assets as defined by the FCA. The permanent capital ratio measures available at-risk capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the institution's financial capacity to absorb potential losses beyond that provided in the allowance for loss accounts. The Association's permanent capital ratio at December 31, 2008, 2007 and 2006 was 11.8 percent, 13.3 percent and 10.9 percent, respectively. The core surplus ratio measures available core surplus capital relative to

risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the quality of capital that exists to maintain stable earnings and financial strength. The Association's core surplus ratio at December 31, 2008, 2007 and 2006 was 10.6 percent, 12.0 percent and 10.3 percent, respectively, which is in compliance with the FCA's minimum ratio requirement of 3.5 percent. The total surplus ratio measures available surplus capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the reserves existing to protect borrowers' investment in the Association. The Association's total surplus ratio at December 31, 2008, 2007 and 2006 was 11.3 percent, 12.6 percent and 10.3 percent, respectively, which is in compliance with the FCA's minimum ratio requirement of 7.0 percent.

The Association monitors its capital on a continuous daily basis. The tremendous loan growth experienced by the Association has put a strain on its capital ratios. Management evaluated a number of alternatives to help boost the Association's capital ratios and concluded that the Farmer Mac guarantee loan program was most beneficial. The Farmer Mac program guarantees payments in the form of standby commitments to purchase loans that exceed 90 days past due. Farmer Mac charges a nominal fee for the guarantee. The Association is only required to capitalize 20 percent of the net loan volume guaranteed by Farmer Mac. In addition to the Farmer Mac program, the Bank offers a similar guarantee program to the District associations for short- to intermediate-term loans that otherwise would not qualify for the Farmer Mac program. Associations are only required to capitalize 20 percent of these loans for capital reporting. The Association participated in both programs during the year 2008.

An alternative to the Farmer Mac and Bank guarantee programs is for the Association to participate loans with other lenders. This helps increase the Association's capital ratios by reducing the amount of loan volume needed to be capitalized. The downside is that the Association loses the net interest income associated with the participated loan volume. The Association can participate the loan volume contingent to a servicing fee, which helps offset the loss in net interest income. The Association views this alternative as less favorable compared to the guarantee programs because of the greater loss of net earnings.

In December 2007, the Association's board of directors resolved to pay an ACA patronage to members based on the ACA's final 2008 net earnings. It is the Association's practice to accrue the estimated qualified patronage, which will be paid in following fiscal year after financial results are finalized, by establishing the cash portion as a liability on the Association's consolidated balance sheet and recording the remainder as allocated retained earnings. The Association has established a liability on its consolidated balance sheet as of December 31, 2008 of \$1,509,211. The Association paid patronage distributions of \$1,500,887, \$2,056,774 and \$987,524, of which \$0, \$680,574 and \$715,795 were from allocated equities, in the years 2008, 2007 and 2006, respectively. See Note 6 to the consolidated financial statements, "Members' Equity," included in this annual report, for further information.

Relationship With the Bank:

The Association's statutory obligation to borrow only from the Bank is discussed in Note 5 to the consolidated financial statements, "Note Payable to the Bank," included in this annual report.

The Bank's ability to access capital of the Association is discussed in Note 2 to the consolidated financial statements, "Summary of Significant Accounting Policies," included in this annual report, within the section "Capital Stock Investment in the Bank."

The Bank's role in mitigating the Association's exposure to interest rate risk is described in the section "Liquidity and Funding Sources" of Management's Discussion and Analysis and in Note 5 to the consolidated financial statements, "Note Payable to the Bank," included in this annual report.

The Bank provides computer systems to support the critical operations of all District associations. In addition, each association has operating systems and facility-based systems that are not supported by the Bank. As disclosed in Note 9 to the consolidated financial statements, "Related Party Transactions," included in this annual report, the Bank provides many services that the Association can utilize, such as administrative, marketing, information systems, and accounting services. Additionally, the Bank allocates District expenses to the associations, such as the Farm Credit System Insurance Corporation insurance premiums.

Summary:

Over the past 74 years, regardless of the state of the agricultural economy, your Association's board of directors and management, as well as the board of directors and management of the Bank, have been committed to offering their borrowers a ready source of financing at a competitive price. Your continued support will be critical to the success of this Association.

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Stockholders
of Texas AgFinance, Farm Credit Services

In our opinion, the accompanying consolidated balance sheet and related consolidated statements of income, changes in members' equity and cash flows present fairly, in all material respects, the financial position of Texas AgFinance, Farm Credit Services and subsidiaries (Association) at December 31, 2008, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These consolidated financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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

Austin, Texas
March 9, 2009

TEXAS AGFINANCE, FARM CREDIT SERVICES

CONSOLIDATED BALANCE SHEET

	December 31,		
	2008	2007	2006
<u>Assets</u>			
Cash	\$ 113,268	\$ 56,821	\$ 2,315,101
Loans	418,135,309	397,793,943	334,169,483
Less: allowance for loan losses	1,000,000	194,665	153,887
Net loans	<u>417,135,309</u>	<u>397,599,278</u>	<u>334,015,596</u>
Accrued interest receivable	3,928,790	5,100,610	4,447,993
Investment in and receivable from the Bank:			
Capital stock	7,594,110	6,734,125	5,004,215
Other	209,356	227,398	175,508
Deferred taxes, net	57,015	62,974	67,062
Premises and equipment	1,157,563	867,069	833,527
Other assets	95,195	34,149	155,901
Total assets	<u>\$ 430,290,606</u>	<u>\$ 410,682,424</u>	<u>\$ 347,014,903</u>
<u>Liabilities</u>			
Note payable to the Bank	\$ 384,991,152	\$ 368,581,278	\$ 308,929,654
Advance conditional payments	751,317	996,678	1,744,283
Accrued interest payable	1,399,652	1,691,606	1,515,614
Patronage distributions payable	1,509,211	1,522,192	1,387,611
Other liabilities	1,879,390	1,950,116	2,221,584
Total liabilities	<u>390,530,722</u>	<u>374,741,870</u>	<u>315,798,746</u>
<u>Members' Equity</u>			
Capital stock and participation certificates	1,511,400	1,632,965	1,635,865
Allocated retained earnings	7,707,562	7,148,304	6,828,092
Unallocated retained earnings	29,978,245	26,547,479	22,752,200
Accumulated other comprehensive income	562,677	611,806	-
Total members' equity	<u>39,759,884</u>	<u>35,940,554</u>	<u>31,216,157</u>
Total liabilities and members' equity	<u>\$ 430,290,606</u>	<u>\$ 410,682,424</u>	<u>\$ 347,014,903</u>

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

TEXAS AGFINANCE, FARM CREDIT SERVICES

CONSOLIDATED STATEMENT OF INCOME

	Year Ended December 31,		
	2008	2007	2006
<u>Interest Income</u>			
Loans	\$ 27,559,055	\$ 29,636,396	\$ 22,472,554
<u>Interest Expense</u>			
Note payable to the Bank	17,181,207	19,391,671	14,040,646
Advance conditional payments	6,534	9,417	24,972
Total interest expense	<u>17,187,741</u>	<u>19,401,088</u>	<u>14,065,618</u>
Net interest income	<u>10,371,314</u>	<u>10,235,308</u>	<u>8,406,936</u>
<u>Provision for Losses</u>			
Provision for loan losses or (loan loss reversal)	<u>805,335</u>	<u>40,288</u>	<u>(15,965)</u>
Net interest income after provision for loan losses	<u>9,565,979</u>	<u>10,195,020</u>	<u>8,422,901</u>
<u>Noninterest Income</u>			
Patronage income from the Bank	1,622,600	1,533,947	1,118,603
Loan fees	837,361	909,501	1,230,510
Financially related services income	665,899	415,096	568,186
Gain on sale of premises and equipment, net	-	3,722	28,354
Other noninterest income	134,925	228,632	296,811
Total noninterest income	<u>3,260,785</u>	<u>3,090,898</u>	<u>3,242,464</u>
<u>Noninterest Expenses</u>			
Salaries and employee benefits	4,045,941	3,977,472	3,498,078
Directors' expense	173,183	142,689	131,751
Purchased services	407,416	449,851	424,902
Travel	182,700	168,806	177,223
Occupancy and equipment	223,378	237,782	247,684
Communications	158,248	136,869	110,760
Advertising	72,355	74,418	79,331
Public and member relations	232,307	142,863	143,876
Supervisory and exam expense	101,336	94,429	85,896
Loss on sale of premises and equipment, net	4,699	-	-
Insurance Fund premiums	606,554	560,316	412,056
Other noninterest expense	998,659	861,431	535,437
Total noninterest expenses	<u>7,206,776</u>	<u>6,846,926</u>	<u>5,846,994</u>
Income before income taxes	<u>5,619,988</u>	<u>6,438,992</u>	<u>5,818,371</u>
Provision for income taxes	<u>123,119</u>	<u>116,727</u>	<u>131,498</u>
Net income	<u>\$ 5,496,869</u>	<u>\$ 6,322,265</u>	<u>\$ 5,686,873</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

	Capital Stock/ Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
		Allocated	Unallocated		
Balance at December 31, 2005	\$ 3,080,460	\$ 4,395,616	\$ 21,565,327	\$ -	\$ 29,041,403
Net income	-	-	5,686,873	-	5,686,873
Capital stock/participation certificates issued	542,750	-	-	-	542,750
Capital stock/participation certificates and allocated retained earnings retired	(1,987,345)	-	-	-	(1,987,345)
Patronage refunds:					
Cash	-	(717,524)	(1,350,000)	-	(2,067,524)
Capital stock/participation certificates and allocated retained earnings	-	3,150,000	(3,150,000)	-	-
Balance at December 31, 2006	1,635,865	6,828,092	22,752,200	-	31,216,157
Net income	-	-	6,322,265	-	6,322,265
Adjustment to initially apply FAS No. 158	-	-	-	611,806	611,806
Capital stock/participation certificates issued	365,485	-	-	-	365,485
Capital stock/participation certificates and allocated retained earnings retired	(368,385)	-	-	-	(368,385)
Patronage refunds:					
Cash	-	(706,774)	(1,500,000)	-	(2,206,774)
Capital stock/participation certificates and allocated retained earnings	-	1,026,986	(1,026,986)	-	-
Balance at December 31, 2007	1,632,965	7,148,304	26,547,479	611,806	35,940,554
Adjustment to beginning balance due to SFAS No. 158 accounting change	-	-	(5,958)	-	(5,958)
Balance at January 1, 2008	1,632,965	7,148,304	26,541,521	611,806	35,934,596
Comprehensive income					
Net income	-	-	5,496,869	-	5,496,869
Change in pension and postretirement benefit plans	-	-	-	(49,129)	(49,129)
Total comprehensive income	-	-	5,496,869	(49,129)	5,447,740
Capital stock/participation certificates issued	247,375	-	-	-	247,375
Capital stock/participation certificates and allocated retained earnings retired	(368,940)	-	-	-	(368,940)
Patronage refunds:					
Cash	-	(742)	(1,500,145)	-	(1,500,887)
Capital stock/participation certificates and allocated retained earnings	-	560,000	(560,000)	-	-
Balance at December 31, 2008	\$ 1,511,400	\$ 7,707,562	\$ 29,978,245	\$ 562,677	\$ 39,759,884

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

TEXAS AGFINANCE, FARM CREDIT SERVICES

CONSOLIDATED STATEMENT OF CASH FLOWS

	Year Ended December 31,		
	2008	2007	2006
Cash flows from operating activities:			
Net income	\$ 5,496,869	\$ 6,322,265	\$ 5,686,873
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses or (loan loss reversal)	805,335	40,288	(15,965)
Depreciation	122,416	119,323	99,014
Loss (gain) on sale of premises and equipment, net	4,699	(3,722)	(28,354)
Decrease (increase) in accrued interest receivable	1,171,820	(652,617)	(1,412,597)
Decrease (increase) in other receivable from the Bank	18,042	(51,890)	(101,918)
Decrease in deferred tax assets	5,959	4,088	38,842
(Increase) decrease in other assets	(61,046)	121,752	(14,120)
(Decrease) increase in accrued interest payable	(291,954)	175,992	642,740
(Decrease) increase in other liabilities	(125,813)	340,338	255,250
Net cash provided by operating activities	<u>7,146,327</u>	<u>6,415,817</u>	<u>5,149,765</u>
Cash flows from investing activities:			
Increase in loans, net	(20,341,366)	(63,624,460)	(85,042,739)
Cash recoveries of loans previously charged off	-	490	1,440
Purchase of investment in the Bank	(859,985)	(1,729,910)	(1,026,930)
Purchases of premises and equipment	(436,609)	(175,716)	(113,698)
Proceeds from sales of premises and equipment	19,000	26,573	88,246
Net cash used in investing activities	<u>(21,618,960)</u>	<u>(65,503,023)</u>	<u>(86,093,681)</u>

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

TEXAS AGFINANCE, FARM CREDIT SERVICES

CONSOLIDATED STATEMENT OF CASH FLOWS

	Year Ended December 31,		
	2008	2007	2006
Cash flows from financing activities:			
Net draws on note payable to the Bank	16,409,874	59,651,624	83,355,902
(Decrease) increase in advance conditional payments	(245,361)	(747,605)	1,265,722
Issuance of capital stock and participation certificates	290,170	365,485	542,750
Retirement of capital stock and participation certificates	(411,735)	(368,385)	(1,987,345)
Patronage distributions paid	(1,513,868)	(2,072,193)	(949,913)
Net cash provided by financing activities	14,529,080	56,828,926	82,227,116
Net increase (decrease) in cash	56,447	(2,258,280)	1,283,200
Cash at the beginning of the year	56,821	2,315,101	1,031,901
Cash at the end of the year	\$ 113,268	\$ 56,821	\$ 2,315,101
 Supplemental schedule of noncash investing and financing activities:			
Loans charged off	\$ -	\$ -	\$ 692
Dividends declared			
Patronage distributions declared	1,500,000	1,500,000	1,350,000
 Supplemental cash information:			
Cash paid during the year for:			
Interest	\$ 17,479,695	\$ 19,190,238	\$ 13,442,878
Income taxes	119,000	119,000	119,000

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

TEXAS AGFINANCE, FARM CREDIT SERVICES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 — ORGANIZATION AND OPERATIONS:

- A. Organization: Texas AgFinance, Farm Credit Services, including its wholly-owned subsidiaries, Texas AgFinance, PCA and Texas AgFinance, FLCA (collectively called “the Association”), is a member-owned cooperative which provides credit and credit-related services to, or for the benefit of, eligible borrowers/stockholders for qualified agricultural purposes in the counties of Aransas, Atascosa, Austin, Bandera, Bee, Bexar, Brooks, DeWitt, Dimmit, 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, Washington, Wilson 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 (System), a nationwide system of cooperatively owned banks and associations that was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (Act). The most recent significant amendment to the Act was the Agricultural Credit Act of 1987 (1987 Act). At December 31, 2008, the System consisted of four Farm Credit Banks and their affiliated associations, one Agricultural Credit Bank and its affiliated associations, the Federal Farm Credit Banks Funding Corporation (Funding Corporation) and various service and other organizations.

The Farm Credit Bank of Texas (Bank) and its related associations are collectively referred to as the “District.” The Bank provides funding to all associations within the District and is responsible for supervising certain activities of the District associations. At December 31, 2008, the District consisted of the Bank, 6 FLCAs and 13 ACA parent companies, which have two wholly-owned subsidiaries, an FLCA and a PCA, operating in or servicing the states of Alabama, Louisiana, Mississippi, New Mexico and Texas.

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

The Act established the Farm Credit System Insurance Corporation (FCSIC) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations, (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for the discretionary uses by the FCSIC of providing assistance to certain troubled System institutions and to cover the operating expenses of the FCSIC. Each System bank has been required to pay premiums, which may be passed on to the associations into the Insurance Fund, based on its annual average loan principal outstanding, until the monies in the Insurance Fund reach the “secure base amount,” which is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (Systemwide debt obligations) or other such percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the FCSIC is required to reduce premiums, but it still must ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount. In June 2008, with the passage of the Food, Conservation, and Energy Act of 2008 (Farm Bill), the basis for assessing premiums was changed, beginning with the second half of 2008, to reflect each Bank’s pro rata share of outstanding insured debt. The Farm Bill imposes premiums of 20 basis points on adjusted insured debt obligations, with the Insurance Corporation Board having the ability to reduce the amount, and a risk surcharge of 10 basis points on nonaccrual loans and other-than-temporarily impaired investments.

FCA regulations require borrower information to be held in strict confidence by Farm Credit institutions, their directors, officers and employees. Directors and employees of the Farm Credit institutions are prohibited, except under specified circumstances, from disclosing nonpublic personal information about members.

- B. Operations: The Act sets forth the types of authorized lending activity, persons eligible to borrow, and financial services that can be offered by the Association. The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents and farm-related businesses. The Association makes and services short- and intermediate-term loans for agricultural production or operating purposes, and secured long-term real estate mortgage loans, with funding from the Bank.

The Association also serves as an intermediary in offering credit life insurance and multi-peril crop insurance, and providing additional services to borrowers such as financial management services and an investment bond program.

The Association's financial condition may be affected by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect stockholders' investment in the Association. Upon request, stockholders of the Association will be provided with the Tenth Farm Credit District's Annual Report to Stockholders, which includes the combined financial statements of the Bank and all of the District associations. The District's annual report discusses the material aspects of the financial condition, changes in financial condition, and results of operations for the Bank and the District. In addition, the District's annual report identifies favorable and unfavorable trends, significant events, uncertainties and the impact of activities of the Insurance Fund.

The lending and financial services offered by the Bank are described in Note 1 of the District's annual report to stockholders.

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The accounting and reporting policies of the Association conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results could differ from those estimates. Certain amounts in prior years' consolidated financial statements have been reclassified to conform to current financial statement presentation. The consolidated financial statements include the accounts of Texas AgFinance, PCA and Texas AgFinance, FLCA. All significant intercompany transactions have been eliminated in consolidation.

- A. Cash and Cash Equivalents: Cash and cash equivalents, as included in the statement of cash flows, represent cash on hand and on deposit at local banks.
- B. Loans and Allowance for Loan Losses: Long-term real estate mortgage loans generally have original maturities ranging from five to 40 years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less.

Loans are carried at their principal amount outstanding adjusted for charge-offs and deferred loan fees or costs.

Statement of Financial Accounting Standards (SFAS) No. 91, "Accounting for Nonrefundable Fees and Costs Associated With Originating and Acquiring Loans and Initial Direct Costs of Leases," (SFAS No. 91) requires loan origination fees and direct loan origination costs, if material, to be capitalized and the net fee or cost to be amortized over the life of the related loan as an adjustment to yield. SFAS No. 91 has not been implemented because the effects were not material to the financial position or results of operations for any year presented.

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

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

Payments received on nonaccrual loans are generally applied to the recorded investment in the loan asset. If collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it, the interest portion of payments is recognized as current interest income. Nonaccrual loans may be transferred to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected, and the loan is not classified as "doubtful" or "loss." If previously unrecognized interest income exists upon transfer of a nonaccrual loan to accrual status, interest income will be recognized as cash payments are received.

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

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

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable 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. It is based on estimates, appraisals and evaluations of loans which, by their nature, contain elements of uncertainty and imprecision. The possibility exists that changes in the economy and its impact on borrower repayment capacity will cause these estimates, appraisals and evaluations to change.

- C. **Capital Stock Investment in the Bank:** The Association's investment in the Bank is in the form of Class A voting capital stock and allocated retained earnings. This investment is adjusted periodically based on the Association's proportional utilization of the Bank compared to other District associations. The Bank requires a minimum stock investment of 2 percent of the Association's average borrowing from the Bank. This investment is carried at cost plus allocated equities in the accompanying consolidated balance sheet.

If needed to meet regulatory capital adequacy requirements, the board of directors of the Bank may increase the percentage of stock held by an Association from 2 percent of the average outstanding balance of borrowings from the Bank to a maximum of 5 percent of the average outstanding balance of borrowings from the Bank.

- D. **Other Property Owned, Net:** Other property owned, net, consisting of real and personal property acquired through a collection action, is recorded at fair value less estimated selling costs upon acquisition. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income and expenses from operations and carrying value adjustments are included in gains (losses) on other property owned, net.
- E. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. Depreciation is provided on the straight-line method using estimated useful lives of the assets. Gains and losses on dispositions are reflected in current operations. Maintenance and repairs are charged to operating expense, and improvements are capitalized.
- F. **Advance Conditional Payments:** The Association is authorized under the Act to accept advance payments from borrowers. To the extent that the borrower's access to such funds is restricted, the advance conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as liabilities in the accompanying consolidated balance sheet. Advance conditional payments are not insured. Interest is generally paid by the Association on such accounts at rates established by the board of directors.
- G. **Employee Benefit Plans:** Employees of the Association participate in either the defined benefit retirement plan (DB Plan) or the defined contribution plan (DC Plan) and are eligible to participate in the Farm Credit Benefits Alliance 401(k) Plan. The DB Plan is closed to new participants. Participants generally include employees hired prior to January 1, 1996. The DB Plan is noncontributory and provides benefits based on salary and years of service. The "Projected Unit Credit" actuarial method is used for financial reporting and funding purposes for the DB Plan.

Participants in the DC Plan generally include employees who elected to transfer from the DB Plan prior to January 1, 1996, and employees hired on or after January 1, 1996. Participants in the DC Plan direct the placement of their employers' contributions, 5.0 percent of salaries for the year ended December 31, 2008, made on their behalf into various investment alternatives.

The structure of the District's DB and DC plans are characterized as multi-employer, since neither the assets, liabilities nor costs of any plan are segregated or separately accounted for by the associations. No portion of any surplus assets is available to the associations, nor are the associations required to pay for plan liabilities upon withdrawal from the plans. As a result, the associations recognize as pension cost the required contribution to the plans for the year. Contributions due and unpaid are recognized as a liability. The Association recognized pension costs for the DC Plan of \$100,264, \$113,135 and \$75,631 for the years ended December 31, 2008, 2007 and 2006, respectively. For the DB Plan, the Association recognized pension costs of \$585,882, \$173,938 and \$226,147 for the years ended December 31, 2008, 2007 and 2006, respectively. Based on estimates provided by the District's actuarial agent, the Association made a special contribution to the DB Plan in 2008 to increase the fund's value to meet its future estimated liability.

The Association also participates in the Farm Credit Benefits Alliance 401(k) Plan which requires the Associations to match 100 percent of employee contributions up to 3.0 percent of base salary and to match 50 percent of employee contributions for

the next 2.0 percent of employee contributions, up to a maximum employer contribution of 4.0 percent of base salary. Association 401(k) plan costs are expensed as incurred. The Association's contributions to the 401(k) plan were \$97,097, \$107,785 and \$81,060 for the years ended December 31, 2008, 2007 and 2006, respectively.

In addition to pension benefits, the Association provides certain health care and life insurance benefits to qualifying retired employees (other postretirement benefits). These benefits are not characterized as multi-employer and, consequently, the liability for these benefits is included in other liabilities.

- H. **Income Taxes:** The ACA holding company conducts its business activities through two wholly-owned subsidiaries. Long-term mortgage lending activities are operated through the wholly owned FLCA subsidiary which is exempt from federal and state income tax. Short- and intermediate-term lending activities are operated through the wholly-owned PCA subsidiary. Operating expenses are allocated to each subsidiary based on estimated relative service. All significant transactions between the subsidiaries and the parent company have been eliminated in consolidation. The ACA, along with the PCA subsidiary, is subject to income tax. The Association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the Association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated retained earnings. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage refunds. Deferred taxes are provided on the Association's taxable income on the basis of a proportionate share of the tax effect of temporary differences not allocated in patronage form. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (over 50 percent probability), based on management's estimate, that they will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of our expected patronage program, which reduces taxable earnings.

Deferred income taxes have not been provided by the Association on patronage stock distributions from the Bank prior to January 1, 1993, the adoption date of SFAS No. 109, "Accounting for Income Taxes." Management's intent is (1) to permanently invest these and other undistributed earnings in the Bank, thereby indefinitely postponing their conversion to cash, or (2) to pass through any distribution related to pre-1993 earnings to Association borrowers through qualified patronage allocations.

The Association has not provided deferred income taxes on amounts allocated to the Association which relate to the Bank's post-1992 earnings to the extent that such earnings will be passed through to Association borrowers through qualified patronage allocations. Additionally, deferred income taxes have not been provided on the Bank's post-1992 unallocated earnings. The Bank currently has no plans to distribute unallocated Bank earnings and does not contemplate circumstances that, if distributions were made, would result in taxes being paid at the Association level.

- I. **Patronage Refunds From the Farm Credit Bank of Texas:** The Association records patronage refunds from the Bank upon receipt of the patronage.
- J. **Fair Value Measurement:** Effective January 1, 2008, the System 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 describes three levels of inputs that may be used to measure fair value:

Level 1 — Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 asset and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury, other U.S. Government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 — Observable inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly or indirectly. Level 2 inputs include the following: (a) quoted prices for similar assets or liabilities in active markets; (b) quoted prices for identical or similar assets or liabilities in markets that are not active so that they are traded less frequently than exchange-traded instruments, the prices are not current or principal market information is not released publicly; (c) inputs other than quoted prices that are observable such as interest rates and yield curves, prepayment speeds, credit risks and default rates; and (d) inputs derived principally from or corroborated by observable market data by correlation or other means. This category generally includes certain U.S. Government and agency mortgage-backed debt securities, corporate debt securities, and derivative contracts.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities are considered Level 3. These unobservable inputs reflect the reporting entity's own assumptions about assumptions that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include

financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain private equity investments, retained residual interests in securitizations, asset-backed securities, and highly structured or long-term derivative contracts.

The Association has no fair value disclosures to report in accordance with SFAS No. 157.

- K. **Recently Issued Accounting Pronouncements:** In March 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 161, “Disclosures about Derivative Instruments and Hedging Activities,” (SFAS No. 161) which amends and expands the disclosure requirements for derivative instruments and for hedging activities previously required by SFAS No. 133. It states that an entity with derivative instruments shall disclose information to enable users of the financial statements to understand: (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under this Statement and related interpretations, and (c) how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This Statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Association does not expect adoption of SFAS No. 161 to have any impact on its financial statement disclosures.

NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES:

A summary of loans as of December 31 follows:

Loan Type	2008		2007		2006	
	Amount	%	Amount	%	Amount	%
Agriculture	\$ 210,979,948	50.5%	\$ 209,152,791	52.6%	\$ 221,144,024	66.2%
Farm-related	207,155,361	49.5%	188,641,152	47.4%	113,025,459	33.8%
Total	\$ 418,135,309	100.0%	\$ 397,793,943	100.0%	\$ 334,169,483	100.0%

At December 31, 2008, the Association held loans totaling \$1,000,000 extended under the Rural America Bond Program approved by the FCA. The program is designed to meet the growing and changing needs of agricultural enterprises, agribusinesses and rural communities by providing investment in rural areas.

Geographic Distribution:

County	2008	2007	2006
Atascosa	4.9%	5.5%	6.4%
Nueces	4.3%	4.3%	5.3%
Washington	4.2%	4.4%	4.1%
Zavala	4.1%	4.6%	3.6%
McMullen	3.8%	3.9%	5.0%
Uvalde	3.6%	3.4%	3.1%
San Patricio	2.9%	3.6%	4.0%
Austin	2.6%	2.1%	2.1%
Bandera	2.6%	2.8%	2.9%
Hidalgo	2.5%	2.9%	3.5%
Waller	2.5%	2.9%	3.1%
La Salle	2.4%	2.1%	2.5%
Gonzales	2.3%	2.5%	2.0%
Wilson	2.2%	1.1%	1.0%
Webb	2.1%	1.0%	0.9%
Medina	2.1%	1.9%	0.9%
Kendall	2.0%	2.2%	1.7%
Frio	2.0%	1.6%	1.6%
Jim Wells	1.9%	2.4%	2.1%
Maverick	1.6%	1.9%	2.1%
Edwards	1.5%	1.2%	0.9%
Potter	1.3%	1.8%	2.2%
DeWitt	1.3%	1.5%	1.2%
Guadalupe	1.2%	1.1%	1.4%
Kinney	1.1%	0.2%	0.2%
Harris	1.0%	1.1%	1.8%
Other	28.4%	29.5%	27.8%
Other States	7.6%	6.5%	6.6%
	100.0%	100.0%	100.0%

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

Operation/Commodity	2008		2007		2006	
	Amount	%	Amount	%	Amount	%
Real Estate	180,164,604	43.1%	171,515,191	43.1%	161,282,010	48.3%
Livestock	146,052,345	34.9%	154,965,471	39.0%	101,237,996	30.3%
Crops	57,529,292	13.8%	51,775,595	13.0%	41,902,151	12.5%
Farm-related	27,019,383	6.5%	17,125,961	4.3%	15,406,234	4.6%
Poultry	2,565,769	0.6%	2,049,188	0.5%	1,134,131	0.3%
Other	4,803,916	1.1%	362,537	0.1%	13,206,961	4.0%
Total	\$ 418,135,309	100.0%	\$ 397,793,943	100.0%	\$ 334,169,483	100.0%

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

The Association has obtained loan guarantees in the form of standby commitments to purchase qualifying loans from the Federal Agricultural Mortgage Corporation through an arrangement with the Bank. At December 31, 2008, 2007 and 2006, loans totaling \$178,732,071, \$183,916,110 and \$101,401,883, respectively, were guaranteed by these commitments. Fees paid for these guarantees totaled \$769,889, \$702,895 and \$334,147 in 2008, 2007 and 2006, respectively, and are reflected in “other noninterest expense.”

Asset Quality:

The following table reflects the credit quality of the Association’s loan volume as of December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Acceptable	98.9%	99.5%	99.9%
Special mention	0.0%	0.4%	0.8%
Substandard	1.1%	0.1%	0.0%
Doubtful	0.0%	0.0%	0.0%
Loss	0.0%	0.0%	0.0%
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.7%</u>

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms. The following presents information relating to impaired loans as of December 31:

	<u>2008</u>		<u>2007</u>		<u>2006</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Nonaccrual loans						
Current as to principal and interest	\$ 2,681,979	58.0%	\$ -	0.0%	\$ 350	98.9%
Past due	1,872,915	40.5%	4	0.0%	4	1.1%
Total nonaccrual loans	<u>4,554,894</u>	<u>98.5%</u>	<u>4</u>	<u>0.0%</u>	<u>354</u>	<u>100.0%</u>
Accrual loans						
90 days or more past due	70,841	1.5%	89,646	100.0%	-	0.0%
Formally restructured	-	0.0%	-	0.0%	-	0.0%
Total impaired accrual loans	<u>70,841</u>	<u>1.5%</u>	<u>89,646</u>	<u>100.0%</u>	<u>-</u>	<u>0.0%</u>
Total impaired loans	<u>\$ 4,625,735</u>	<u>100.0%</u>	<u>\$ 89,650</u>	<u>100.0%</u>	<u>\$ 354</u>	<u>100.0%</u>

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2008.

Interest income is recognized and cash payments are applied on nonaccrual impaired loans as described in Note 2, “Summary of Significant Accounting Policies.” The following table presents interest income recognized on impaired loans.

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Interest income recognized on nonaccrual loans	\$ 119,011	\$ 39,782	\$ 640
Interest income recognized on impaired accrual loans	11,039	5,651	-
Interest income recognized on impaired loans	<u>\$ 130,050</u>	<u>\$ 45,433</u>	<u>\$ 640</u>

A summary of the allowance for loan losses as of December 31 follows:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Beginning balance	\$ 194,665	\$ 153,887	\$ 169,104
Provision for loan losses	805,335	40,288	(15,965)
Loans charged off	-	-	(692)
Recoveries	-	490	1,440
Allowance for loan losses	<u>\$ 1,000,000</u>	<u>\$ 194,665</u>	<u>\$ 153,887</u>

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

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Impaired loans with related allowance	\$ -	\$ -	\$ -
Impaired loans with no related allowance	4,625,735	89,650	354
Total impaired loans	\$ 4,625,735	\$ 89,650	\$ 354
Allowance on impaired loans	\$ -	\$ -	\$ -

The majority balance of impaired loans is comprised of three participation loans the Association purchased from other Farm Credit System institutions. The largest loan, with a balance of \$1,846,233, was purchased from another District association and is well securitized by a prioritized security interest in real estate with an appraised value well in excess of the principal loan balance less selling expenses. Two other loans with a combined outstanding principal balance of \$2,678,839 were purchased from and serviced by the Bank. Based on the Bank's analysis and confirmed by the Association, these two loans are well capitalized by cash on hand and securitized collateral. The final two loans are loans that were originated by the Association. The larger of the two loans with a balance of \$70,732 is guaranteed by a Farm Service Agency (FSA) guarantee which will pay the principal balance in full once all covenants are complete. The final loan of \$29,818 is well secured by equipment with a fair market value in excess of its principal balance.

The following table summarizes impaired loan information for the years ended December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Average impaired loans	\$ 1,779,727	\$ 77,261	\$ 242

Interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans at December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Interest income which would have been recognized under the original terms	\$ 553,621	\$ 302,780	\$ 640
Less: interest income recognized	(130,050)	(45,433)	(640)
Foregone interest income	\$ 423,571	\$ 257,347	\$ -

NOTE 4 — PREMISES AND EQUIPMENT:

Premises and equipment consisted of the following at December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Land and improvements	\$ 335,078	\$ 137,315	\$ 137,315
Building and improvements	1,111,655	1,111,656	1,111,655
Furniture and equipment	321,844	327,928	310,221
Computer equipment and software	223,177	252,558	220,888
Automobiles	382,453	258,241	163,031
	2,374,207	2,087,698	1,943,110
Accumulated depreciation	(1,216,644)	(1,220,629)	(1,109,583)
Total	\$ 1,157,563	\$ 867,069	\$ 833,527

The Association leases office space in San Antonio and Flatonia. It closed its Cotulla office in May 2008 and did not renew the lease. The Flatonia lease is for 12-month periods with options to renew an additional 12 months at the lease expiration date. The San Antonio lease expires September 2011. Lease expense was \$53,182, \$63,196 and \$46,360 for 2008, 2007 and 2006, respectively. Minimum annual lease payments for the next five years are as follows:

<u>Year</u>	<u>Operating</u>
2009	\$ 51,404
2010	50,075
2011	38,303
Thereafter	<u>-</u>
Total	<u>\$ 139,782</u>

NOTE 5 –NOTE PAYABLE TO THE BANK:

The interest rate risk inherent in the Association’s loan portfolio is substantially mitigated through the funding relationship with the Bank. The Bank manages interest rate risk through its direct loan pricing and asset/liability management process. The Association’s indebtedness to the Bank represents borrowings by the Association to fund the majority of its loan portfolio. The indebtedness is collateralized by a pledge of substantially all of the Association’s assets, and is governed by a general financing agreement. The interest rate on the direct loan is based upon the Bank’s cost of funding the loans the Association has outstanding to its borrowers.

The total amount and the weighted average interest rate of the Association’s direct loan from the Bank at December 31, 2008, 2007 and 2006, was \$384,991,152 at 4.50 percent, \$368,581,278 at 5.67 percent and \$308,929,654 at 5.45 percent, respectively.

Under the Act, the Association is obligated to borrow only from the Bank unless the Bank approves borrowing from other funding sources. The Bank and FCA regulations have established limitations on the Association’s ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2008, 2007 and 2006, the Association’s note payable was within the specified limitations. The maximum amount the Association may borrow from the Bank as of December 31, 2008, was \$420,104,723, as defined by the general financing agreement.

In addition to borrowing limits, the financing agreement establishes certain covenants including limits on leases, investments, other debt, and dividend and patronage distributions; minimum standards for return on assets and for liquidity; and provisions for conducting business, maintaining records, reporting financial information, and establishing policies and procedures. Remedies specified in the financing agreement associated with the covenants include additional reporting requirements, development of action plans, increases in interest rates on indebtedness, reduction of lending limits or repayment of indebtedness. As of and for the years ended December 31, 2008, 2007 and 2006, the Association was not subject to remedies associated with the covenants in the financing agreement.

NOTE 6 — MEMBERS’ EQUITY:

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

In accordance with the Act and Association’s capitalization bylaws, each borrower is required to invest in the Association as a condition of borrowing. Borrowers are required to purchase investment in Class B capital stock (in the case of agricultural loans to producers) or participation certificates (in the purchase of rural home loans and farm-related business loans) equal to 2.0 percent of the principal amount of the loan balance for both PCA and FLCA members with a maximum of \$1,000. The borrower usually acquires the Class B capital stock or participation certificates by adding the aggregate par value to the disbursement on the related loan obligation. The capital stock or participation certificates are subject to a first lien by the Association. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding capital stock or participation certificates.

If needed to meet regulatory capital adequacy requirements, the board of directors of the Association may increase the percentage of stock requirement for each borrower.

Each owner or joint owners of Class B capital stock are entitled to a single vote. Class A and Class P capital stock, Class C preferred stock and participation certificates provide no voting rights to their owners. Borrowers who wish to retain their investment in the Association after liquidating their loan balance may convert their Class B capital stock holdings to Class A capital stock. At December 31, 2008, 2007 and 2006, the Association had \$8,835, \$7,935 and \$9,205, respectively, of Class A stock.

The Association is authorized to have outstanding Class A, B, and P common stock, Class C and D preferred stock and participation certificates in such amounts as may be necessary to conduct its business. Each share of stock and unit of participation certificates has a par or face value of \$5. All transfers, exchanges, conversion and retirements of stock are recorded at book value not to exceed par. In 2000, Texas AgFinance, Farm Credit Services retired all shares of its Class D preferred stock.

All borrower stock is at risk. Any losses which result in any impairment of the Association's capital stock shall be borne ratably, first by each share or unit of all classes of common stock and participation certificates, and then by each share of Class C preferred stock. Impaired stock and participation certificates shall be restored in the reverse sequence until each share of stock and unit of participation certificates has a book value equal to the par or face value, respectively. In the event of the liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities shall be distributed to the holders of stock and participation certificates in the following order of priority:

First, to the holders pro rata of Class C preferred stock then outstanding until an amount equal to the aggregate par value of such stock has been distributed to such holder;

Second, to the holders of common stock and participation certificates, pro rata in proportion to the number of shares of units of stock or participation certificates then outstanding until an amount equal to the aggregate par value or unit value of all shares of such stock and participation certificates issued and outstanding has been distributed to such holders;

Third, to the holders of allocated surplus evidenced by Qualified Written Notices of Allocation, on the basis of the oldest allocations first, until the total amount of such allocated surplus has been distributed;

Fourth, to the holders of allocated surplus evidenced by Nonqualified Written Notices of Allocation, on the basis of the oldest allocations first, until the total amount of such allocated surplus has been distributed;

Fifth, any remaining assets of the Association after such distribution shall be distributed to members, both past and present, in proportion to which the aggregate patronage of each such member bears to the total patronage of all such parties insofar as practicable, unless otherwise provided by law.

Dividends and patronage distributions may be paid on the capital stock and participation certificates of the Association, as the board of directors may determine by resolution subject to capitalization requirements as defined by the FCA. Amounts not distributed are retained as unallocated retained earnings. The following dividends and patronage distributions were declared and paid in 2008, 2007 and 2006, respectively:

<u>Date Accrued</u>	<u>Date Declared</u>	<u>Date Paid</u>	<u>Accrued Patronage</u>	<u>Cash Paid</u>	<u>Retained Earnings Allocated</u>	<u>Adjustment when Paid</u>
December 2008			\$ 5,000,000		\$ 3,500,000	
December 2007	March 2008	April 2008	\$ 5,000,000	\$ 1,500,887	\$ 3,500,000	\$ 887
December 2006	March 2007	April 2007	\$ 4,500,000	\$ 1,376,200	\$ 3,150,000	\$ 26,200
December 2005	March 2006	April 2006	\$ 900,000	\$ 271,729	\$ 630,000	\$ 1,729

The Association's bylaws require that any distribution of retained earnings allocated as patronage must be from the oldest retained earnings allocated that are held by the Association. The following retained earnings allocated were declared and paid by the Association in 2007 and 2006, respectively. There was no payment of retained earnings allocated in 2008:

<u>Date Declared</u>	<u>Date Paid</u>	<u>Year Retained</u>	<u>Amount Retained</u>	<u>Amount Paid</u>	<u>Balance Retained</u>
November 2007	December 2007	2001	\$ 680,574	\$ 680,574	\$ -
September 2006	October 2006	2000	\$ 715,795	\$ 715,795	\$ -

The FCA's capital adequacy regulations require the Association to achieve permanent capital and total surplus of at least 7.0 percent and core surplus of at least 3.5 percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the ratio requirements can initiate certain mandatory and possibly additional discretionary actions by the FCA that, if undertaken, could have

a direct material effect on the Association's financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to stockholders unless prescribed capital standards are met. The Association's permanent capital ratio, core surplus ratio and total surplus ratio at December 31, 2008, were 11.8 percent, 10.6 percent and 11.3 percent, respectively.

The Farm Credit Administration regulations (Regulations) require that the Association's board of directors determine the amount of total capital, core surplus, total surplus, and unallocated surplus needed to assure the institution's continued financial viability and to provide for growth necessary to meet the needs of the borrowers. The Regulations require that the board establish and maintain a formal written capital adequacy plan as part of the financial plan. The plan must include the capital targets that are necessary to achieve the Association's capital adequacy goals as well as the minimum permanent capital and surplus standards. The plan shall address any projected dividends, patronage distribution, equity retirements, or other action that may decrease the Association's capital or the components there of for which minimum amounts are required. There are numerous other factors that have a direct effect on the organization's capital needs. Such factors include interest rate risk, System assessments, lending limit regulations, off-balance sheet risks, and participation loan purchases. Management, in its view, has sufficiently addressed these issues and has a formal contingency plan should the Association's capital level warrant intervention.

An FCA regulation empowers the FCA to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. The Association has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

At December 31, the Association had the following shares of Class A capital stock, Class B stock and participation certificates outstanding at a par value of \$5 per share:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Class A stock	1,767	1,587	1,841
Class B stock	298,610	321,601	314,627
Participation certificates	1,903	3,405	10,705
Total	<u>302,280</u>	<u>326,593</u>	<u>327,173</u>

NOTE 7 — INCOME TAXES:

The provision for income taxes follows for the years ended December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Current:			
Federal	\$ 117,160	\$ 104,044	\$ 102,000
Deferred:			
Federal	5,959	12,683	29,498
Total provision for income taxes	<u>\$ 123,119</u>	<u>\$ 116,727</u>	<u>\$ 131,498</u>

The provision for income tax differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as follows for the years ended December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Federal tax at statutory rate	\$ 1,868,935	\$ 2,189,257	\$ 1,978,246
Effect of nontaxable FLCA subsidiary	(251,775)	(385,213)	(346,246)
Patronage distributions	(1,500,000)	(1,700,000)	(1,530,000)
Other	5,959	12,683	29,498
Provision for income taxes	<u>\$ 123,119</u>	<u>\$ 116,727</u>	<u>\$ 131,498</u>

Deferred tax assets and liabilities in accordance with SFAS No. 109, "Accounting for Income Taxes," are comprised of the following at December 31:

	2008	2007	2006
Allowance for loan losses	\$ 73,917	\$ 45,372	\$ 33,565
Postretirement benefits, other	211,158	269,497	301,744
Gross deferred tax assets	<u>285,075</u>	<u>314,869</u>	<u>335,309</u>
Deferred tax asset valuation allowance	<u>(228,060)</u>	<u>(251,895)</u>	<u>(268,247)</u>
Net deferred tax asset	<u>\$ 57,015</u>	<u>\$ 62,974</u>	<u>\$ 67,062</u>

The calculation of tax assets and liabilities involves various management estimates and assumptions as to the future taxable earnings including the following at December 31, 2008: Nonpatronage income is expected to be 25 percent of total taxable income (before patronage) and patronage income retained is expected to be 70 percent of total patronage income on a tax basis. The expected future tax rates are based upon enacted tax laws.

The ACA is required to maintain an investment in the Bank of 2 percent of the average direct note. This investment can be held by both the PCA and FLCA. A deferred tax liability is established for the PCA for any excess investment in the Bank over that allocated to the 2 percent investment requirement. Upon formation of the ACA, additional amounts of previously excess investment held by the PCA were included in the calculation of the 2 percent requirement of the ACA. The PCA did not hold any excess investment as of December 31, 2008, 2007 or 2006, respectively.

The Association reduced its valuation allowances by \$23,835 and \$16,352 during 2008 and 2007, respectively. The Association changed to the valuation method of accounting for deferred tax assets in 2006. The Association will continue to evaluate the realizability of the deferred tax assets and adjust the valuation allowance accordingly.

NOTE 8 — EMPLOYEE BENEFIT PLANS:

Employee Retirement Plans: Employees of the Association participate in either the defined benefit retirement plan (DB Plan) or the defined contributions plan (DC Plan) and are eligible to participate in the Farm Credit Benefits Alliance 401(k) Plan. These plans are described more fully in section G of Note 2, "Summary of Significant Accounting Policies."

Other Postretirement Benefits: In addition to pension benefits, the Association provides certain health care and life insurance benefits to qualifying retired employees (other postretirement benefits). These benefits are not characterized as multi-employer and, consequently, the liability for these benefits is included in other liabilities.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)," 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 No. 158 were adopted at December 31, 2007. SFAS No. 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, the System 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. The System has 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 a result, the Association decreased retained earnings \$5,958 and increased the pension and other postretirement benefit liabilities by \$5,958.

The following table reflects the benefit obligation, cost and actuarial assumptions for the Association's other postretirement benefits:

**10th Farm Credit District
Retiree Welfare Benefit Plans**

Disclosure Information Under FASB Statement 132

	2008	2007	2006
Change in accumulated postretirement benefit obligation			
Accumulated postretirement benefit obligation, beginning of year	\$ 1,013,418	\$ 1,119,360	\$ 1,172,437
Service cost	32,413	31,350	39,953
Interest cost	80,855	66,005	60,708
Plan participants' contributions	3,141	2,400	4,020
Plan amendments	-	-	(9,598)
Actuarial gain	(34,347)	(169,773)	(113,573)
Benefits paid	<u>(48,110)</u>	<u>(35,924)</u>	<u>(34,587)</u>
Accumulated postretirement benefit obligation, end of year	\$ 1,047,370	\$ 1,013,418	\$ 1,119,360
Change in plan assets			
Plan assets at fair value, beginning of year	\$ -	\$ -	\$ -
Company contributions	44,969	33,524	30,567
Plan participants' contributions	3,141	2,400	4,020
Benefits paid	<u>(48,110)</u>	<u>(35,924)</u>	<u>(34,587)</u>
Plan assets at fair value, end of year	\$ -	\$ -	\$ -
Funded status of the plan	\$ (1,047,370)	\$ (1,013,418)	\$ (1,119,360)
Contributions between measurement date and fiscal year-end	<u>-</u>	<u>7,021</u>	<u>(506,370)</u>
Net postretirement liability at end of year	\$ (1,047,370)	\$ (1,006,397)	\$ (1,625,730)
Amounts recognized in statement of financial position			
Current liabilities	\$ (42,069)	\$ 36,557	\$ -
Noncurrent liabilities	<u>(1,005,301)</u>	<u>(1,042,954)</u>	<u>(1,625,730)</u>
Total	\$ (1,047,370)	\$ (1,006,397)	\$ (1,625,730)
Amounts recognized in accumulated other comprehensive income			
Net actuarial gain	\$ (96,682)	\$ (60,542)	\$ -
Prior service credit	<u>(465,995)</u>	<u>(551,264)</u>	<u>-</u>
Total	\$ (562,677)	\$ (611,806)	\$ -
Additional information			
Increase in minimum liability included in other comprehensive income	\$ 49,129	\$ -	\$ -
Weighted-average assumptions used to determine obligations at year-end			
Measurement date	12/31/2008	9/30/2007	9/30/2006
Discount rate	6.30%	6.50%	6.00%
Health care cost trend rate assumed for next year (pre-/post-65) - medical	8.5%/6.5%	8.5%/6.5%	9.0%/6.75%
Health care cost trend rate assumed for next year - Rx	12.00%	12.00%	13.00%
Ultimate health care cost trend rate	5.00%	4.75%	4.75%
Year that the rate reaches the ultimate trend rate	2015	2016	2016

Total cost	2008	2007	2006
Service cost	\$ 25,930	\$ 31,350	\$ 39,953
Interest cost	64,684	66,005	60,708
Amortization of:			
Unrecognized prior service cost	(68,217)	(73,654)	(73,337)
Unrecognized net loss	1,436	1,577	6,359
Net postretirement benefit cost	23,833	25,278	33,683
Adjustment to retained earnings for 2008 due to change in measurement date	\$ 5,958	\$ -	\$ -
Other changes in plan assets and projected benefit obligation recognized in other comprehensive income			
Net actuarial gain	\$ (34,347)	\$ -	\$ -
Amortization of net actuarials gain	(1,795)	-	-
Amortization of prior service cost	85,271	-	-
Total recognized in other comprehensive income	\$ 49,129	\$ -	\$ -
AOCI amounts expected to be amortized into expense in 2009			
Unrecognized prior service cost	\$ (67,316)	\$ -	\$ -
Weighted-average assumptions used to determine benefit cost			
Measurement date	9/30/2007	9/30/2006	9/30/2005
Discount rate	6.50%	6.00%	5.25%
Health care cost trend rate assumed for next year (pre-/post-65) - medical	9.0%/6.75%	9.0%/6.75%	9.5%/7.0%
Health care cost trend rate assumed for next year - Rx	13.00%	13.00%	13.50%
Ultimate health care cost trend rate	4.75%	4.75%	4.75%
Year that the rate reaches the ultimate trend rate	2016	2016	2016
Expected future cash flows			
Expected benefit payments (net of employee contributions)			
Fiscal 2009	\$ 42,069		
Fiscal 2010	49,635		
Fiscal 2011	58,992		
Fiscal 2012	53,308		
Fiscal 2013	63,336		
Fiscal 2014–2018	359,079		
Expected contributions			
Fiscal 2009	\$ 42,069		

NOTE 9 — RELATED PARTY TRANSACTIONS:

Directors of the Association, except for any director-elected directors, are required to be borrowers/stockholders of the Association. Also, in the ordinary course of business, the Association may enter into loan origination or servicing transactions with its officers, relatives of officers and directors or with organizations with which such persons are associated. Such loans are subject to special approval requirements contained in FCA regulations and are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

Total loans to such persons for the Association amounted to \$13,533,880, \$15,531,750 and \$14,075,829 at December 31, 2008, 2007 and 2006, respectively. During 2008, \$33,795,111 of new loans were made and repayments totaled \$34,790,805. In the opinion of management, no such loans outstanding at December 31, 2008, 2007 and 2006 involved more than a normal risk of collectability.

Expenses included in purchased services may include purchased services such as administrative services, marketing, information systems, accounting services and allocations of expenses incurred by the Bank passed through to the associations such as FCSIC expenses. The Bank charges the individual associations directly for these services based on each association's proportionate usage. These expenses totaled \$407,416, \$449,851 and \$424,902 in 2008, 2007 and 2006, respectively.

The Association received patronage payments from the Bank totaling \$1,622,600, \$1,533,947 and \$1,118,603 during 2008, 2007 and 2006, respectively.

NOTE 10 — COMMITMENTS AND CONTINGENCIES:

In addition to those commitments and contingencies discussed in Note 2, "Summary of Significant Accounting Policies," the Association is involved in various legal proceedings in the ordinary course of business. In the opinion of legal counsel and management, there are no legal proceedings at this time that are likely to materially affect the Association.

The Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers in the form of commitments to extend credit and commercial letters of credit. These financial instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2008, \$109,221,440 of commitments to extend credit were outstanding.

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

NOTE 11 — DISCLOSURE ABOUT THE FAIR VALUE OF FINANCIAL INSTRUMENTS:

The following table presents the carrying amounts and estimated fair values of the Association's financial instruments at December 31, 2008, 2007 and 2006. Quoted market prices are generally not available for certain System financial instruments, as described below. Accordingly, fair values are based on judgments regarding anticipated cash flows, future expected loss experience, discount rates, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The estimated fair values of the Association's financial instruments as of December 31 follow:

	2008		2007		2006	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets						
Cash	\$ 113,268	\$ 113,268	\$ 56,821	\$ 56,821	\$ 2,315,101	\$ 2,315,101
Loans, net	417,135,309	432,949,231	397,599,278	398,227,485	334,015,596	328,076,799
Financial liabilities						
Note payable to the Bank	384,991,152	399,586,464	368,581,278	369,163,636	308,929,654	303,436,885

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

A. Cash:

The carrying value is a reasonable estimate of fair value.

B. Loans:

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

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

Fair value of loans in nonaccrual status that are current as to principal and interest is estimated as described above, with appropriately higher discount rates to reflect the uncertainty of continued cash flows. For noncurrent nonaccrual loans, it is assumed that collection will result only from the disposition of the underlying collateral. Fair value of these loans is estimated to equal the aggregate 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. Where the net realizable value of the collateral exceeds the legal obligation for a particular loan, the legal obligation is generally used in place of net realizable value.

The carrying value of accrued interest approximates its fair value.

C. Investment in the Bank:

Estimating the fair value of the Association's investment in the Bank is not practicable because the stock is not traded. As described in Note 2, "Summary of Significant Accounting Policies," the investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying consolidated balance sheet. The Association owns 3.3 percent of the equity of the Bank as of December 31, 2008. As of that date, the Bank's assets totaled \$14.8 billion and members' equity totaled \$744.5 million. The Bank's earnings were \$76.7 million during 2008.

D. Note Payable to the Bank:

The note payable to the Bank is not regularly traded; thus, quoted market prices are not available. Fair value of this instrument is discounted based on the Association's and Bank's loan rates as well as on management estimates. For the purposes of this estimate it is assumed that the cash flow on the note is equal to the principal payments on the Association's loan receivables plus accrued interest on the note payable. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures. Management has no basis to determine whether the fair values would be indicative of the value negotiated in an actual sale.

E. Commitments to extend credit:

The Association does not normally assess fees on its commitments to extend credit; hence, there is no fair value to be assigned to these commitments until they are funded.

NOTE 12 – QUARTERLY FINANCIAL INFORMATION (UNAUDITED):

Quarterly results of operations for the years ended December 31 (in thousands) follow:

	2008				
	First	Second	Third	Fourth	Total
Net interest income	\$ 2,603	\$ 2,560	\$ 2,734	\$ 2,474	\$ 10,371
Reversal of (provision for) loan losses	32	(49)	(4)	(784)	(805)
Noninterest expense, net	(1,048)	(972)	(615)	(1,434)	(4,069)
Net income	\$ 1,587	\$ 1,539	\$ 2,115	\$ 256	\$ 5,497

	2007				
	First	Second	Third	Fourth	Total
Net interest income	\$ 2,340	\$ 2,573	\$ 2,705	\$ 2,617	\$ 10,235
Reversal of (provision for) loan losses	(6)	(33)	(14)	13	(40)
Noninterest expense, net	(898)	(789)	(418)	(1,768)	(3,873)
Net income	\$ 1,436	\$ 1,751	\$ 2,273	\$ 862	\$ 6,322

	2006				
	First	Second	Third	Fourth	Total
Net interest income	\$ 1,982	\$ 2,052	\$ 2,161	\$ 2,212	\$ 8,407
Reversal of (provision for) loan losses	26	(1)	4	(13)	16
Noninterest expense, net	(933)	(792)	(495)	(516)	(2,736)
Net income	\$ 1,075	\$ 1,259	\$ 1,670	\$ 1,683	\$ 5,687

DISCLOSURE INFORMATION AND INDEX

Disclosures Required by Farm Credit Administration Regulations

DESCRIPTION OF BUSINESS

The description of the territory served, the persons eligible to borrow, the types of lending activities engaged in and the financial services offered, and related Farm Credit organizations required to be disclosed in this section is incorporated herein by reference from Note 1 to the consolidated financial statements, "Organization and Operations," included in this annual report.

The descriptions of significant developments that had or could have a material impact on earnings or interest rates to borrowers and acquisitions or dispositions of material assets, if any, required to be disclosed in this section are incorporated herein by reference from "Management's Discussion and Analysis of Financial Condition and Results of Operations," included in this annual report.

DESCRIPTION OF PROPERTY

The Texas AgFinance, Farm Credit Services (Association) serves its 38-county territory through its main administrative and lending office at 545 South Highway 77, Robstown, Texas 78380. Additionally, there are six branch lending offices and one loan processing office located throughout the territory. The Association owns the office buildings in Bandera, Brenham, Pleasanton, Robstown and Uvalde, free of debt. The Association leases the lending office building in San Antonio and the loan processing building in Flatonia. In 2008, the Association closed its lending office in Cotulla by not renewing the 12-month lease. The Association services the Cotulla loans through the Pleasanton lending office. The Association signed a lease agreement in October 2008 on an office building in Flatonia which will be used to process loans.

LEGAL PROCEEDINGS

In the ordinary course of business, the Association is involved in various legal proceedings. In the opinion of legal counsel and management, there are no legal proceedings at this time that are likely to materially affect the consolidated financial statements of the Association.

DESCRIPTION OF CAPITAL STRUCTURE

The information required to be disclosed in this section is incorporated herein by reference from Note 6 to the consolidated financial statements, "Members' Equity," included in this annual report.

DESCRIPTION OF LIABILITIES

The description of contingent liabilities required to be disclosed in this section is incorporated herein by reference from Notes 2 and 10 to the consolidated financial statements, "Summary of Significant Accounting Policies" and "Commitments and Contingencies," respectively, included in this annual report.

RELATIONSHIP WITH THE FARM CREDIT BANK OF TEXAS

The Association's financial condition may be impacted by factors that affect the Farm Credit Bank of Texas (Bank), as discussed in Note 1 to the consolidated financial statements, "Organization and Operations," included in this annual report. The financial condition and results of operations of the Bank may materially affect the stockholders' investment in the Association.

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 78720-2590 or calling (512) 483-9204. Copies of the District's annual and quarterly stockholder reports can also be requested by e-mailing fcf@farmcreditbank.com. The District's annual and quarterly stockholder reports are also available on its web site at www.farmcreditbank.com.

The Association's quarterly stockholder reports are also available free of charge, upon request. These reports will be available approximately 40 days after quarter end and 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 or are available on the Association's web site www.texasagfinance.com. The Association's annual stockholder report is available on its web site 75 days after the fiscal year end. Copies of the Association's annual stockholder report can also be requested 90 days after the fiscal year end.

SELECTED FINANCIAL DATA

The selected financial data for the five years ended December 31, 2008, required to be disclosed, is incorporated herein by reference to the “Five-Year Summary of Selected Combined Financial Data” included in this annual report to stockholders.

MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

“Management’s Discussion and Analysis,” which precedes the combined financial statements in this annual report, is incorporated herein by reference.

DIRECTORS AND SENIOR OFFICERS

The Association’s member-elected and director-elected board of directors and senior officers are as follows:

<u>NAME</u>	<u>POSITION</u>	<u>ELECTED/ EMPLOYED</u>	<u>TERM EXPIRES</u>
Ray H. Henry	Chairman	1992	2009
David Henneke	Vice Chairman	2005	2011
Jesse W. Howell	Director	1982	2009
Joe Little	Director	1989	2009
Joe W. Ruple	Director	2002	2011
John Prukop	Director	1990	2011
Kelvin Barry	Director	2000	2009
Ralph Hesse	Director	1995	2010
Jimmy N. Wright	President/CEO	1979	-
Mark A. Miller	Sr. VP/Chief Credit Officer	1989	-
Keith A. Ibrom	VP/Chief Financial Officer	1999	-
John Parker	VP/Information Technology	2003	-
Charles Holtkamp	VP/Branch Manager	1991	-
John O’Brien, IV	VP/Branch Manager	2000	-
Walt Franklin	VP/Branch Manager	1990	-
Y. N. Strait	VP/Branch Manager	1989	-
Lane Pepper	Asst. VP/Branch Manager	2004	-
Roger Parker	Asst. VP/Relationship Manager	2004	-

A brief statement of the business and employment background of each director and senior officer is provided for informational purposes.

RAY H. HENRY, chairman, age 72, was elected to the board of directors in 1992. He is a partner in the Henry Brothers farming and ranching operation located in Uvalde County. Mr. Henry has a bachelor of science degree in agriculture from Texas A&I University. He was formerly on the board of directors of Uvalde PCA. Mr. Henry serves as chairman of the Uvalde County Farmer’s Co-op. He maintains an acceptable class loan with Texas AgFinance.

DAVID HENNEKE, vice chairman, age 57, is Texas AgFinance’s director-appointed director. He is an independent investment advisor providing investment and brokerage services from his office in Alice. Mr. Henneke is a 1974 graduate of Texas A&I University with a bachelor of business administration degree in business and has more than 20 years of banking experience. He maintains no loans with Texas AgFinance.

JESSE W. HOWELL, age 63, lives in Jim Wells County where he has a cattle feedlot operation. He was appointed by the Federal Intermediate Credit Bank of Texas to the board of directors in 1982. Mr. Howell serves on the board of directors of South Texas Property Rights Association. He own an interest in and serves on the board of directors of South Texas Mix. Mr. Howell has been a member of the Association since 1963 and was elected to serve as a board member in 1983. He maintains acceptable class loans with Texas AgFinance.

JOE LITTLE, age 64, lives in Zavala County and has owned a ranching business in Zavala and Dimmit counties for the past 25 years. He is an attorney and a certified public accountant. Mr. Little was elected by stockholders in 1989. He maintains acceptable class loans with Texas AgFinance.

JOE W. RUPLE, age 51, lives in Atascosa County where he owns Ruple Farms, Inc., a farming and ranching operation. He is involved in numerous real estate development and ranch brokerage operations. Mr. Ruple has interests in Ruple Properties, Inc., 3W Investments LLC and Trophy Oaks, LLC. He is active in Resource Diversification Group and Operation H2O. He has been a member since 1993 and was elected by stockholders in 2002. He maintains acceptable class loans with Texas AgFinance.

JOHN PRUKOP, age 55, lives in Jim Wells County and has been farming since 1974 in Jim Wells, Kleberg and Nueces counties. Mr. Prukop has a bachelor of science degree from Texas A&I University in agricultural economics. Mr. Prukop serves as chairman of the Kleberg-Kennedy Soil and Water Conservation District. He serves on the board of directors of South Texas Property Rights Association. He was elected by stockholders in 1990. He maintains acceptable class loans with Texas AgFinance.

KELVIN BARRY, age 51, lives in Waller County where he farms corn and milo, runs a cow-calf and stocker business, and owns feedyard cattle. Mr. Barry has been a PCA member since 1991 and was elected by stockholders to serve as a board member in 2000. Prior to his election as board member, Mr. Barry served on the Association’s Nominating Committee. He maintains acceptable class loans with Texas AgFinance.

RALPH HESSE, age 62, lives in Uvalde County and is president and manager of Chaparral Feeders, Inc., a custom cattle-feeding operation. Mr. Hesse also owns and manages a row crop farm in Uvalde County. He serves as vice chairman of the Winter Garden Co-op Gin. Mr. Hesse has been a member of the Association since 1975 and was elected to serve as a board member in 1995. He maintains acceptable class loans with Texas AgFinance.

JIMMY N. WRIGHT, age 58, president/CEO, has been with Texas AgFinance for 30 years. He started with the organization in 1979 as an assistant vice president/loan officer and manager of a branch office with prior Farm Credit and commercial bank experience. Mr. Wright later became vice president in 1981 and chief credit officer in 1984. The board of directors appointed Mr. Wright as president of Texas AgFinance in August 1986.

MARK A. MILLER, age 44, chief credit officer, has been with Texas AgFinance since March 1989. Prior to that time, he was employed with Texas A&M University as a research assistant. Mr. Miller is a graduate of the Texas Agricultural Lifetime Leadership (TALL) program.

KEITH A. IBROM, age 43, chief financial officer, started with Texas AgFinance in July 1999. Formerly, he worked for the Farm Credit Bank of Texas where he served as manager of accounting. Prior to that time, he held various managerial and staff positions in the manufacturing and healthcare industries. Mr. Ibrom is a certified public accountant.

JOHN PARKER, age 41, vice president – information technology, has been with Texas AgFinance since May 2003. John was previously employed with the Texas Agriculture Extension Service for 12 years following graduation from Texas A&M University in 1990.

CHARLES HOLTKAMP, age 53, vice president and branch manager of the Brenham branch office, has been with Texas AgFinance since 1991. He has over 20 years in the Farm Credit System with prior experience at Farmers and Ranchers PCA. Prior to this, Mr. Holtkamp worked as a livestock buyer for a commercial cattle company.

JOHN O’BRIEN, IV, age 32, vice president and branch manager of the Robstown branch office, has been with Texas AgFinance since July 2000. Formerly, he was employed by the Bank of America in their commercial lending department as a bank officer.

WALT FRANKLIN, age 52, vice president and branch manager of the Pleasanton office, has been with Texas AgFinance since 1991. Prior experience includes working for a commercial lender and another Farm Credit institution.

Y. N. STRAIT, age 59, vice president and branch manager of the Uvalde branch office, has been with Texas AgFinance since February 1989. Before joining Texas AgFinance, Mr. Strait worked for a commercial bank and had prior Farm Credit System experience as a loan officer for Winter Garden, PCA.

LANE PEPPER, age 29, vice president and branch manager of the San Antonio and Bandera branch offices, has been with Texas AgFinance since April of 2004. Prior to joining Texas AgFinance, Mr. Pepper was a loan officer for a commercial bank.

ROGER W. PARKER, age 29, assistant vice president and relationship manager of the San Antonio office. He has been with Texas AgFinance since February of 2004 and was the manager of the San Antonio branch office until 2007. Prior to this time, he was a loan officer with First Ag Credit. He has over seven years of experience in the Farm Credit System.

COMPENSATION OF DIRECTORS AND SENIOR OFFICERS

Directors were compensated for their service to the Association in the form of an honorarium at the rate of \$500 per day for director meetings and committee meetings, and they were reimbursed for certain expenses incurred while representing the Association in an official capacity. Mileage for attending official meetings during 2008 was paid at the IRS-approved rate. A copy of the travel policy is available to stockholders of the Association upon request.

<u>Name</u>	<u>Number of Days Served, Board Meetings</u>	<u>Number of Days Served, Special Meetings</u>	<u>2008 Compensation</u>
Ray H. Henry	22.5	10.7	\$ 16,595
David Henneke	9.5	14.6	12,040
Kelvin Barry	21.5	14.1	17,795
Jesse W. Howell	15.5	12.8	14,175
Joe Little	20.5	12.0	16,240
John Prukop	15.0	8.4	11,675
Joe W. Ruple	12.7	7.7	10,200
Ralph Hesse	21.2	11.8	16,500
			<u>\$ 115,220</u>

The aggregate compensation paid to directors in 2008, 2007 and 2006 was \$115,220, \$93,250 and \$85,650, respectively. The aggregate amount of reimbursement for travel, subsistence and other related expenses paid to directors and on their behalf was \$57,963, \$49,439 and \$46,101 in 2008, 2007 and 2006, respectively.

<u>Name of Individual or Group</u>	<u>Year</u>	<u>Salary</u>	<u>Bonus</u>	<u>Total</u>	
Jimmy N. Wright, CEO	2008	\$ 200,000	\$ 54,671	\$ 254,671	
	2007	170,000	95,607	265,607	
	2006	160,000	85,898	245,898	
Number of all Senior Officers (excludes CEO)	9	2008	\$ 836,728	\$ 251,457	\$ 1,088,185
	9	2007	804,131	460,553	1,264,684
	9	2006	750,550	351,645	1,102,195

Disclosure of information on the total compensation paid and the arrangements of the compensation plans during the last fiscal year to any senior officer or to any other officer included in the aggregate are available and will be disclosed to shareholders of the institution upon request.

Total compensation paid to all officers of the Association, including bonuses, was \$1,342,856, \$1,530,291 and \$1,348,093 in 2008, 2007 and 2006, respectively. Bonuses paid to such officers for 2008, 2007 and 2006 were \$306,128, \$556,160 and \$437,543, respectively.

Employees assigned Association vehicles are given the option to drive a company-owned vehicle or receive a compatible auto allowance to purchase a personal vehicle. Employees opting for the auto allowance are liable for all payroll taxes. The auto allowance is exempt from 401(k) matching and is not included in any incentive calculations. Employees who drive company-owned vehicles reimburse the Association for personal miles at a board-established rate. Employees who use their personal automobile for business purposes were reimbursed during 2008 at the IRS-approved rate.

TRANSACTIONS WITH DIRECTORS AND SENIOR OFFICERS

The Association's policies on loans to and transactions with its officers and directors, required to be disclosed in this section, are incorporated herein by reference from Note 9 to the consolidated financial statements, "Related Party Transactions," included in this annual report.

DIRECTORS' AND SENIOR OFFICERS' INVOLVEMENT IN CERTAIN LEGAL PROCEEDINGS

The Association has no senior officers or directors with any involvement in certain legal proceedings as described in FCA §620.5(k).

RELATIONSHIP WITH INDEPENDENT AUDITOR

No change in auditors has taken place since the last annual report to stockholders and no disagreements with auditors has occurred that the Association is required to report to the Farm Credit Administration under part 621 of the FCA regulations governing this disclosure. Fees paid during the reporting period for audit services to the independent auditors, PricewaterhouseCoopers, LLP, were \$30,250. No other services were rendered by the independent auditors during the reporting period.

FINANCIAL STATEMENTS

The financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 9, 2009, and the report of management in this annual report to stockholders, are incorporated herein by reference.

CREDIT AND SERVICES TO YOUNG, BEGINNING AND SMALL FARMERS AND RANCHERS, AND PRODUCERS OR HARVESTERS OF AQUATIC PRODUCTS

The Association has established a policy related to providing credit and services to young, beginning and small (YBS) farmers and ranchers. "Young" farmers and ranchers are defined as producers under the age of 35. "Beginning" farmers and ranchers are producers that have been on the farm or ranch for less than 10 years. A producer is considered a "Small" farmer and rancher if their gross agricultural sales are less than \$250,000.

The Association created a YBS mission statement to help guide its efforts. The mission statement is as follows:

"Texas AgFinance will promote the interests of young, beginning and small farmers, ranchers and producers of aquatic products by providing credit to creditworthy producers through individualized loan programs and services. The financing of YBS producers is not intended to exceed the Association's risk-bearing ability nor create undue risk to the overall loan portfolio."

The Association is committed to cooperating with all farm credit institutions, state and federal agencies, such as the United States Department of Agriculture and Small Business Administration, commercial lending institutions, and all other guarantors or cosigners to benefit young, beginning and small producers. It has committed staff and financial resources to the development and execution of its YBS program.

Each year the Association establishes objectives related to its YBS program. The objectives are approved by the board of directors and are included in the Association's strategic plan. The following table summarizes the Association's 2008 objectives compared to actual results.

<u>YBS Program</u>	<u>2008 Objective</u>	<u>2008 Result</u>
New young farmer and rancher loan volume	\$ 15,000,000	\$ 46,757,000
New beginning farmer and rancher loan volume	\$ 100,000,000	\$ 132,719,000
New small farmer and rancher loan volume	\$ 90,000,000	\$ 122,641,000

Based on the USDA-NASS 2002 Census, the latest data available, the Association had YBS demographics as follows:

<u>YBS Program</u>	<u>Territory</u>	<u>Association</u>
New young farmer and rancher	4.7%	10.2%
New beginning farmer and rancher	32.3%	4.7%
New small farmer and rancher	98.0%	2.2%

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